# Appendix 10

## White Paper: Tax Increment Financing

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One of the successful strategies for funding parking facility development noted in this parking strategic plan is Tax Increment Financing (TIF). While this concept is well known within economic development circles, not all parking and transportation professionals are familiar with the specifics of how TIF programs function. This whitepaper is intended to answer basic questions for those that are interested in better understanding this concept.

### Introduction

Tax Increment Financing is a tool with great flexibility that allows a municipality to address some of the problems of urban decline. With the reduction in federal and state funding, it provides one of the few mechanisms where a municipality can make a major effort to revitalize older parts of the community. When used properly, it can create an opportunity to focus on what the municipality thinks is important for the area in question and what steps need to be taken to turn an area around.

#### ***What Is Tax Increment Financing?***

Tax Increment Financing (TIF) is a redevelopment tool authorized by state statute to help revitalize certain areas by eliminating certain blighting conditions and instituting conservation measures in order to encourage private investment and to enhance the tax base. The "tax increment" is the difference between the amount of property taxes collected before and after the designation of a TIF District. TIF originated in California in 1954, and is currently in use in some form in 47 states. It is a concept designed for municipalities of all sizes.

#### ***How TIF Works***

In theory, tax increment financing works as follows:

- A geographic area is designated (the TIF district)
- A plan for specific improvements in the TIF district is developed
- Bonds are issued and the proceeds are used to pay for the planned improvements;
- The improvements encourage private development and thus raise property values above where they would have been without the improvement
- With higher values, property tax revenues rise, and
- Property tax revenue from increased assessments over and above the level before the TIF project began (the tax increment) is used to service the debt.

Although TIF differs from traditional methods of financing public investments, it is still a form of public debt and as such must be authorized by state legislation. In some states, private developers can also arrange their own financing, and the municipality uses the tax increment to reimburse the developers as the tax revenues are received.

The widespread adoption of TIF laws since 1970 reflects a combination of several factors. While the continued decline of urban areas — particularly of central cities — created a growing need for redevelopment in the 1970s and 1980s, federal assistance for urban renewal projects fell, and voter opposition to new taxes rose. Tax increment financing represented a politically viable tool for local government officials to publicly finance infrastructure and other economic development initiatives without drawing on existing revenues or proposing new taxes.

## *How Does "Blight" Factor into TIF Designation?*

One avenue to qualifying as a TIF District involves demonstrating that an area is in decline, or that it shows signs of "blight." The TIF law defines a "blighted" area as meeting at least 5 of 13 listed criteria, which include dilapidation, structures failing to meet minimum building codes, inadequate utilities, excessive vacancies, declining assessed values, and the necessity of environmental clean-up.

Please note that the TIF law does not require every parcel in the area must have blighting characteristics for the area to qualify either as a blighted or a conservation area. In fact, new construction can exist in the proposed area. Rather, the blighting factors must be present to a meaningful extent and be reasonably distributed throughout the area.

## *What is the "But For" Test?*

For a municipality to establish a TIF District, the municipality must determine that the TIF District, as a whole, would not develop without the assistance to be provided by TIF. This is what is known as the **"But For"** test and is one of the safeguards to prevent the abusive use of TIF. This test does not imply that any new proposed development occurring without TIF assistance would disqualify the District. Rather, you have to look throughout the District to see if the whole area would develop without the benefit of TIF, and not just one or two parcels.

## *How Does TIF Make Development Occur?*

The Municipality undertakes certain activities or agrees to pay certain private costs as incentives to make the TIF District attractive for private redevelopment. The costs connected with these actions by the municipality are paid for with the tax increment, caused by new private development. The types of activities include: construction of public improvements, acquisition of property, relocation costs, demolition of buildings, site preparation, creation of certain training programs, developing planning studies, the rehabilitation of existing structures, and occasionally the construction of facilities for other taxing bodies.

## *What Happens to Property Located Within a TIF District?*

Some properties will remain unchanged, while others will be purchased and redeveloped either by the Town or by private interests.

## *How Is the TIF Process Organized?*

The process of establishing a TIF District is very open. Well before the municipality adopts TIF, it must have a tentative plan which describes the proposed boundaries, why the area might qualify as a TIF District, what the municipality intends to do to eliminate problem areas and attract private investment, what the general land uses are proposed to be, what private and public projects are anticipated, what the estimated budget is and what the estimated life of the TIF District will be.

Citizens can take an active role by attending public hearings and meetings to voice their opinions on the TIF proposal. Notice of the availability of the plan and the date and time of a public hearing must be sent to all property owners within the proposed TIF District, as well as other interested parties. In addition, a Joint Review Board (JRB), composed of representatives from local taxing bodies, such as the school district, is organized to review the proposal. Prior to the adoption of the plan and the TIF District, the JRB votes and makes a recommendation to the municipality. Final approval of a TIF District is given by the City Council.

Finally, a detailed annual report of activities and the financial status of the TIF District must be filed with the State Comptroller and with members of the Board. This will indicate how successful the municipality is in utilizing TIF.

## *What Is the Life of a TIF District?*

The maximum life of a TIF District is 23 years. However, it can be shorter if the municipality determines that a shorter period is more appropriate. The municipality has the ability throughout the life of the TIF District to terminate the District at any time, subject to any contractual obligations that may exist.

## *Characteristics of TIF Laws*

TIF laws in most states provide TIF as a tool to eliminate "blight," subject to the constraint that a municipality can only engage in redevelopment, which "…cannot be accomplished by private enterprise alone…" The law stops short of saying how this private enterprise condition should be satisfied, however, and gives the municipality significant discretion in defining blight. Relatively few state laws provide quantitative criteria to be applied in identifying blight. Some state laws explicitly allow the use of TIF for economic development without a finding of blight.

In contrast to general obligation bonds, TIF bonds are not secured by the "faith and credit" of either the city or the state, and the TIF debt does not count against the municipality's constitutional debt limit. Like general obligation debt, however, interest on TIF debt may be tax exempt if it satisfies certain criteria set out in the federal Tax Reform Act of 1986.

## *What Are Some of the Popular Myths Concerning TIF?*

- <u>Some property owners would be receiving some kind of tax break.</u> This is not true. Property owners pay the same amount of property taxes they would have paid had the TIF District not existed.

- Property taxes for owners within the TIF District will increase. This is also not true. Their property taxes are the same as everyone else in the municipality. They will only increase if the value of their property increases.
- The school district will be deprived of revenues during the life of the TIF District. Again, this is not true. First, because of the way tax rates of the various taxing bodies are calculated when a TIF District is established, the school district as well as the county, the municipality and the other taxing bodies continue to receive the full amount of the taxes that they have levied during the life of the District. Secondly, the school aid formula at the state level has been adjusted so that during the life of the TIF District, the school district actually receives more school aid from the state than it would have, had the TIF District not been in place. Third, because the area would not have been developed without TIF, the school district could not take advantage of any increased equalized assessed value.

## *Typical TIF-Funded Projects*

TIF has been used to finance a wide array of projects, including public infrastructure, private development, and brownfield cleanup. Public works projects are typically small-scale.

Examples include land acquisition, installation of streetlights and water and sewer lines, roadway expansions, and construction of public parking garages. Large-scale projects have usually been joint ventures, most often with private partners. In joint ventures, the TIF financing is used only to finance the public contribution to the project. Examples of relatively large TIF-funded projects include the following:

- Chicago helped finance the expansion of the University of Illinois at Chicago ($50 million in 2000), renovation of several theaters ($18 million for the Cadillac Theater, for example), and streetscaping of Michigan Avenue in the Central Loop ($15 million in the late 1990s). Chicago is currently financing the construction of two schools (about $50 million per school).
- Fremont, California is contributing to the upgrade of four major interstate interchanges ($50 million for construction in 1999 through 2005) and is planning to finance the construction of a Bay Area Rapid Transit (BART) station ($75 million).
- Indianapolis helped finance the construction of the Circle Centre mall downtown ($187 million in 1995) and the United Airlines Maintenance Center ($244 million in 1991).
- Los Angeles helped finance the renovation of the Los Angeles Central Library ($135 million in the early 1990s) and expansion of the Los Angeles Convention Center ($126 million in 1986-1987).
- Minneapolis helped finance 900 Nicollet Mall, a downtown Target store and office complex ($62 million in 2001), and City Center, a downtown retail and hotel complex ($50 million in the mid-1980s). It also used TIF to acquire the Target Center, home of the Timberwolves basketball team ($72 million in 1994).
- San Jose financed the San Jose Arena ($140 million in 1993) and a convention center ($163 million in 1986), and it is currently financing its share of the total cost of a Joint City/University Library with San Jose State University ($73.4 million).
- Washington, D.C. used TIF to help finance the International Spy Museum ($6.9 million in 2001), the Mandarin Oriental Hotel Project ($46 million this year), and the Gallery Place Project, a downtown retail and entertainment complex ($73.6 million this year).

## *The Draw and Drawbacks of TIF*

For local policymakers, TIF has many attractive features. But it also has potential drawbacks that need consideration.

### The TIF Draw

There are several features that draw policymakers to using TIF financing. As noted previously, TIF debt typically does not count against a municipality's debt limit, nor is the municipality or state responsible for repayment from sources other than the tax increment for the TIF district. Perhaps equally as important, the local government essentially has full control once the state TIF law is in place. Plans are generally not subject to state approval.

Another factor explaining TIF's popularity is voter opposition to tax increases. Because property tax revenue from pre-TIF assessments flow from the TIF district to the municipality as before, it is possible to portray any additional property taxes paid by property owners in the TIF district as payment for benefits received from TIF improvements.

### Potential Drawbacks

While TIF has proven to be an effective and flexible financing method in a variety of settings, some municipalities have encountered problems with their TIF projects.

### Sufficient Revenue

Actual TIF revenues may fall short of the projections made when the TIF bonds were sold.
Unlike a municipality with a variety of revenue sources to draw upon for debt service obligations, a TIF district generally has only one source: incremental property taxes. A shortfall risks default or a bailout using other municipal revenues, undermining the reason for using TIF in the first place.

A revenue shortfall can occur for a variety of reasons. The projected level of development might not be reached - or might be reached with significant delay. Assessed property values for a TIF district might also decline, at least temporarily. The city of St. Petersburg, Florida ran into difficulties in its TIF districts because of recession, public acquisition of private property, and acquisition of private property by tax-exempt entities within the district, removing them from the TIF tax base as well.10 In their Bayboro Harbor TIF district (established in 1988), for example, the actual 1998 taxable property value for the district was $20.7 million—about 60 percent less than the projection made at the start of project, and about 25 percent less than its pre-TIF value of $28.1 million.

Tax increments may also drop or grow more slowly than expected due to policy decisions. California's Proposition 13 probably represents the most familiar example of an unexpected change in the property tax code. More recently, when the state of Minnesota took over education finance last year, the education portion of local property tax increments that previously had gone to TIF projects was redirected to the state. TIF districts suddenly lost about 37 percent of the total increment they had received before the change in policy.

Property tax abatements or exemptions, which are often used as incentives for developers, can also reduce tax revenues below projections if not anticipated correctly. A study of Michigan TIF districts found that taxable property values in some districts actually declined from their base values, despite positive growth in commercial property values. The reason was the concurrent granting of property tax abatements for properties in the districts.

Some project costs or changes in property values also are very difficult or impossible to anticipate. For example, the town of Greenburgh, New York accumulated legal bills and settlement costs when it was sued over the price it paid for a property in its TIF district. The city of East Grand Forks, Minnesota saw a drop in taxable property value in one of its TIF districts when a grain elevator burned down.

To reduce the risk of default, a municipality may designate a relatively large TIF district. Indianapolis did this when it used TIF to finance its downtown Circle Centre mall. Alternatively, a back-up revenue source can be built into the plan. St. Petersburg has used franchise taxes and parking revenue as its secondary revenue source, while East Grand

Forks used lease payments and general revenue to fill its gap. Of course, both of these policies redirect resources from other uses and stand at odds with the conceptual underpinnings of TIF.

The Redevelopment Agency of the City of San Jose, California uses a third strategy to reduce the risk of default—joint financing of TIF districts. Bonds are issued for all projects funded by the agency and tax increments from all TIF districts are used to service the debt. Their 2003-2007 Capital Improvement Plan includes 157 capital projects and programs in TIF districts all over the city with a total cost of $882 million.

Yet another strategy to reduce risk is a loan guarantee from a private developer. Hoffman Estates, a suburb of Chicago, required such a guarantee when it entered a TIF deal with Sears for relocation of its headquarters and development of a new office park in Hoffman Estates. When tax increments have fallen short of required payments, Sears has paid the difference.

In the event that tax increments do fall far short of projections, the initial debt might be refinanced or restructured. St. Petersburg has taken both measures in recent years, in addition to lining up secondary revenue sources.

## Cost Spillovers

Another potential problem with TIF is spillover of costs to taxpayers outside the TIF district.
Municipal service requirements - such as police, fire, sanitation, education, and transportation -will almost certainly rise as development occurs within a TIF district.

In turn, the regular property taxes paid to a municipality by property owners within the TIF district - which are based on pre-TIF assessments - could well fall short of the cost of services provided for the TIF district. When this happens, taxpayers outside the TIF district are faced with the tab. The larger the TIF district, the larger this impact will be on the surrounding area. One source of revenue to cover these additional costs could
be the additional sales and income tax revenue generated by the new development in the TIF district. Whether these additional revenues are sufficient will depend on the intensity of the development induced by the TIF-

financed improvements and whether other sales and income tax incentives are also available within the TIF district.

Some critics of TIF have questioned whether the amount of tax revenue generated by TIF improvements actually equals the tax increment revenue allocated to pay for the improvements. Using data for a sample of 38 TIF districts in California and 38 matched areas with similar characteristics, the most comprehensive analysis of this question found only four TIF districts where property values outgrew their matches by enough to justify the tax increment received by the TIF districts. A total of eight projects generated at least 80 percent of the revenue they received. Not surprising, the TIF districts with the most vacant land before the projects began showed the greatest tax increment growth. Overall, the study found that the 38 TIF districts collectively generated about half the tax revenue they received. This suggests that, on average, the TIF districts could have generated additional revenue equal to half the revenue generated with the TIF improvements even if the improvements had not been made, and that this revenue would have been available to pay for some portion of the additional services required by the TIF districts or other capital improvements.

### Benefit Spillovers

In direct contrast to concerns about cost spillovers are concerns about benefit spillovers. If a TIF improvement has regional benefits, many who benefit significantly from the improvement may make no contribution to cover the cost. For example, the taxpayers of Indianapolis are financing a mall and two sports arenas with TIF, while benefits are enjoyed by all in central Indiana.

### Fragmentation of the Tax Base

Some observers say that the use of TIF may ultimately lead to fragmentation of the tax base, under which thriving neighborhoods would retain all growth in their property tax collections for their own development, rather than contributing part of this growth to citywide investments and assistance for less prosperous neighborhoods. Concern about fragmentation has been expressed in Chicago, which now has over 100 TIF districts within its boundaries.

### Distribution of Development

Another potential problem is not specific to TIF but instead pertains to all geographically targeted economic development programs. It is possible that TIF projects may simply shift development around the city, rather than attracting new business to Charlotte from elsewhere in the region and beyond. This appears to be happening in Columbus, Ohio, where the city has sold more than $30 million in TIF bonds to finance infrastructure improvements for the new Arena District, a large office and retail development project that is centered on the new home of the Columbus Blue Jackets hockey team. Just a few miles downtown, office vacancy rates are above 20 percent and the City Center mall (which was built in the 1980s with city assistance) sits half empty. Similar criticism has been voiced in Dallas about the proposed Victory office-retail complex between the city’s new hockey arena and downtown. Opponents argue that downtown Dallas retailers will be hurt, and they point to other city priorities, including more than $1 billion in needed roadway repairs elsewhere in the city.

In a worst-case scenario, TIF could shift development from more to less productive locations. If this happens, tax revenue—property, sales, income, and others—could actually be reduced from its potential maximum. A study of municipalities surrounding Chicago found evidence consistent with this hypothesis. Their results suggest that total assessed property values in cities that used TIF grew more slowly than in cities that did not, after controlling for area characteristics.

### Potentially Expensive Debt

Also of concern may be the relative cost of TIF debt. Because TIF debt is not backed by the “faith and credit” of the city or state, investors could view it as more risky than general obligation debt and demand a higher interest rate. To reduce the potential risk of default to investors, policymakers might designate a relatively large TIF district or build in a back-up revenue source, but these tactics have opportunity costs, as noted above.

An additional issue that arises with large-scale TIF-financed projects is required payment of debt service before significant revenue gains are realized. For large projects in a city’s general capital plan, funds may be drawn from alternative sources. But in the absence of such other funding sources, the first several years of debt service must also be borrowed, adding to the total project cost.

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