



TAX INCREMENT FINANCING (TIF)

National Association of Realtors

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Part One

TIF Primer

Executive Summary

Since the first TIF law passed in California in 1952, tax increment financing (TIF) has spread throughout the nation to become a useful, effective tool for local governments to finance capital projects in support of economic development. Though TIF laws are on the books in 48 states and the District of Columbia, the application of generic TIF principles varies greatly across states.

TIF was originally designed and justified as a local method of self-financing the redevelopment of blighted urban areas. TIF has successfully fulfilled its original intent by spurring the redevelopment of several blighted areas. Now, the use of TIF to raise project finance money has expanded into other areas. TIF bond proceeds commonly finance projects in non-blighted, as well as blighted areas, and for a variety of purposes associated with redevelopment, development, or related physical infrastructure improvements, such as elementary and secondary educational facilities, roads, bridges, parking facilities, recreational facilities, water and wastewater facilities, and electrical power plants.

TIF has financed a wide variety of successful commercial and industrial projects. In addition, TIF projects have been successful at building affordable housing, assisting in the revitalization of low-income and moderate-income neighborhoods, and tackling modern, technical redevelopment problems, like redeveloping contaminated sites such as brownfields.

TIF is also a fiscal tool used to overcome problems associated with local fiscal stress. TIF has been adopted by cities facing various forms of fiscal stress, including tax and expenditure limitations, infrastructure demands from population growth, and declines in intergovernmental aid. TIF has been used in communities with a wide range of socioeconomic characteristics, demonstrating its breadth as a development tool. In addition, there is empirical evidence that TIF programs in Michigan accelerated property

value growth, and TIF programs in Indiana raised property values and employment levels.

TIF has the revenue raising ability to finance projects by itself, but it is flexible enough to be used as a part of a larger package of financial incentives to retain and expand businesses or attract new business to the community. [TIF and alternative economic development techniques, particularly impact fees.]

Though TIF is most often thought of as a financing tool, it is also a land development and improvement tool. The TIF plan, usually referred to as a redevelopment plan, provides governments and community stakeholders with a forum and process to manage their redevelopment and growth for years to come. In the process, TIF provides a vehicle for local governments and the private sector to develop public-private partnerships to work on promoting economic development.

A Primer on TIF

Introduction

Though originally created for the limited purpose of financing the redevelopment of blighted communities, TIF has developed into an integral part of the revenue structure of many local governments across the nation. The rapid growth of TIF as an economic development technique of choice to finance land acquisition, site development, property rehabilitation, road improvements, water and sewer expansion, and building expansion, began in the early 1980's. Local government officials were faced with cuts in federal funds for economic development and infrastructure projects. At the same time voters began to protest property tax increases and, led by the passage of Proposition 13 in California, capped local property tax increases.

Local government officials turned to TIF as an annual source of local property tax revenue that they could use to finance economic development projects, and other physical infrastructure projects, without having to raise property tax rates. Moreover, with TIF they could leverage future general fund revenues to support the repayment of property-

tax backed debt, without having to go directly to voters for approval, and without violating debt limitations.

Ultimately, TIF became popular because it is both an effective financing tool *and* a land development tool. Its basic structure and processes fits well into the general structure of local government. The TIF template that has been exported to local jurisdictions around the nation; its generic framework easily adapts to different state environments and the circumstances of unique local jurisdictions.

TIF is used to pay for land and real estate improvements, capital projects, in specific geographic areas. TIF can be applied to most geographic areas, but is best suited to large tracts of land in need of significant redevelopment or land that is in the process of being developed. TIF can be used to fund new development or the rehabilitation of older communities.

TIF is considered a “self-financing” way to pay for economic development projects. Development projects are financed with tax revenues generated by the new development. Government officials do not have to impose a new tax, but rather simply reallocate new revenues from development to pay for development costs. Government officials can tap into their local property tax base for development, the primary source local government revenue throughout the nation, without imposing a new tax, or higher tax rate. Moreover, officials have broad discretion over the use of TIF funds, so they can use TIF funds to fund a variety of develop purposes and capital projects.

The TIF process can be initiated any time the community sees a development opportunity. TIF revenues may be used on a “pay-as-you-go” basis, with the annual stream of revenue often used to fund small projects. More often, TIF revenues are used to pay debt service costs over the life of the project, often a twenty-thirty year period. This is referred to as “pay-as-you-use” financing. TIF is effective at generating large amounts of capital for up-front capital investments.

TIF Debt

Officials use TIF to raise enough money, relatively quickly and inexpensively, to finance major, large-scale, multi-million dollar capital improvement projects. The proceeds from the sale of TIF bonds sold in the municipal securities market are used to

finance development project costs. This results in substantial benefits to developers. First, the cost of borrowing to developers is substantially cheaper if the government sells securities to finance development rather than the developer having to go to the bank or capital markets for financing. TIF bonds provide substantial interest cost savings to developers because most of them are tax-exempt. But even when the government sells taxable TIF bonds, developers still receive substantial cost savings because the interest costs are still lower, and the terms of repayment are much more generous to developers than they would be without government assistance, providing for longer repayment periods, government funded escrow accounts, and additional credit enhancement.

TIF debt is secured primarily by the incremental tax revenues derived from property taxes levied within the tax increment district. The incremental revenue does not represent a new tax, but rather a reallocation of a portion of the municipality's general property tax revenues. Municipalities issue tax increment debt, in part, to circumvent constitutional and statutory debt limitations and voter approval requirements on tax-supported debt. Unlike traditional general obligation (GO) bonds, tax increment bonds in most states are not subject to municipal debt limits or public referendum requirements. Therefore, local officials have much more discretion to sell TIF securities than they do general obligation securities, and it gives them more debt capacity to finance infrastructure improvements. Though, it should be noted that any future problems that arise with the governments TIF bonds will likely spill over to the general government, and could adversely impact credit quality throughout the government.

The TIF financing structure is designed to capture new tax revenues generated from increased property values expected to result from development. As a result, TIF districts must be located in areas capable of realizing a significant (and sufficient) increase in assessed property value in order to meet their debt service obligations in full and on time. If the tax base does not grow as projected, debt repayments may be put in jeopardy, as has happened in some TIF districts. In order to strengthen the likely repayment of TIF debt, and thereby reduce borrowing costs, TIF debt repayment is sometimes also supported, in a secondary position, by an additional pledge of the governments' general fund or special tax revenues. In addition, while the redevelopment authority receives the incremental revenues, it does not have control over setting the

property tax rate. This control remains wherever it was prior to establishment of the tax increment district (TID), usually the city or county.

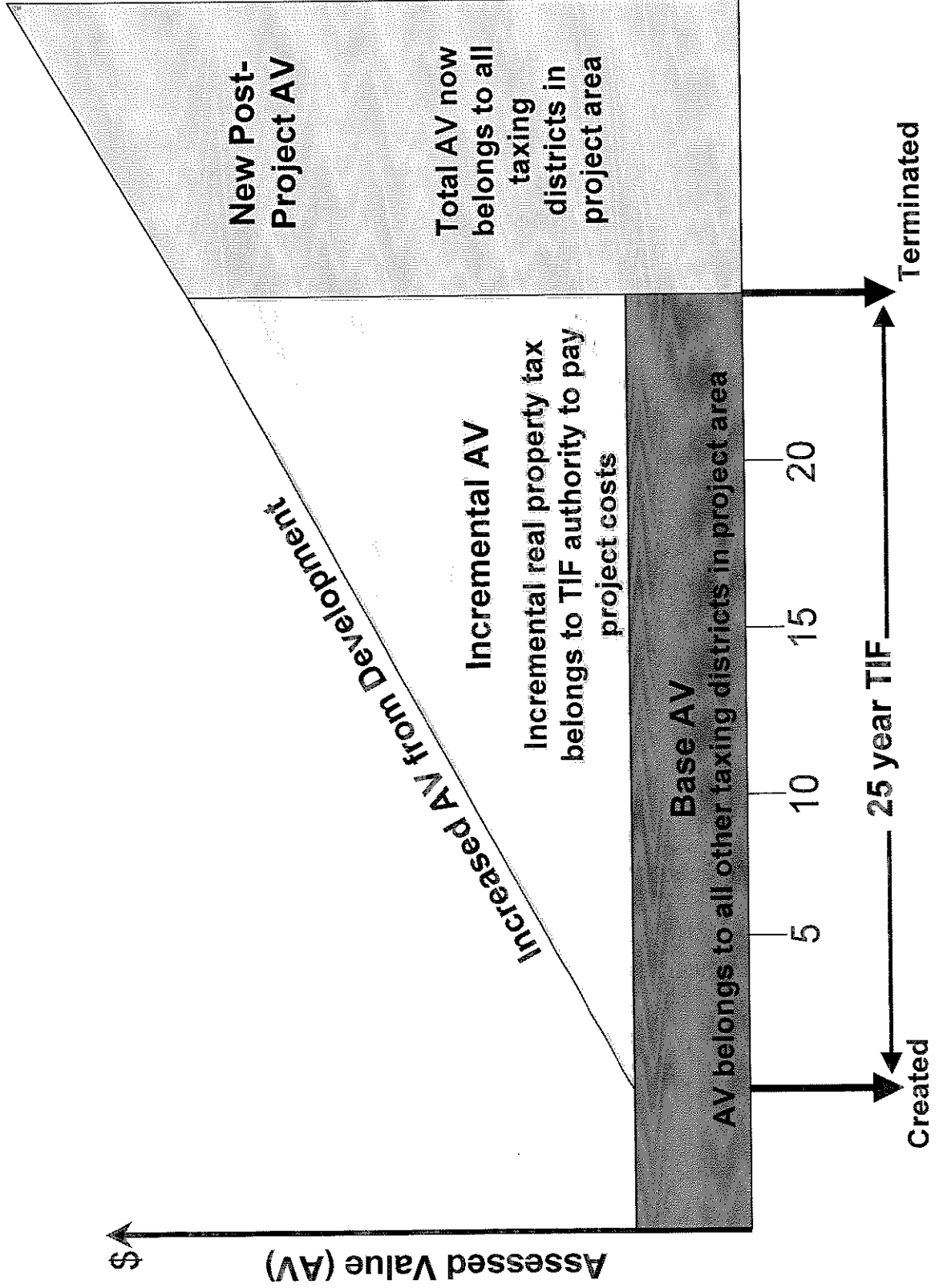
The Basic TIF Financing Structure

Tax increment financing policies are implemented through the creation of special tax increment districts (which are called allocation areas in California), which are distinct geographical areas. TIF districts (TIDs) commonly share boundaries with the enabling government, usually a city, or the TID may be a small part of a city, such as a section of the downtown area, or an industrial park between the city and residential suburbs. TIDs are usually governed by a redevelopment commission and operated by a redevelopment authority.

Redevelopment authorities or commissions are usually established and indirectly operated by local government officials to provide financial, organizational, and regulatory support for development activities. They are authorized to enter into contractual arrangements with private firms, and they sell TIF debt in the municipal securities market to generate funds for capital expenditures. Redevelopment authorities were used by general governments as a way to provide the community with off-balance sheet capital asset financing, but the new government-wide financial reporting requirements imposed by GASB Statement No. 34 should increase the transparency of transactions engaged in by redevelopment authorities that financially benefit, or harm, the sponsoring general government.

TIDs are special taxing districts set-up to generate revenue to pay for ongoing development costs. Once the TID is established a base year is determined. The base year is set at the beginning of the project, usually the year the TID is adopted. The assessed valuation of property in the TID is frozen at the base year. This area is labeled "Base AV" in Exhibit 1. The base year assessed value of property (Base AV) belongs to all the taxing districts in the TID. After the base year, all the assessed value in the TID - above the base value - belongs to the TID; this portion of the tax base is referred to as the incremental assessed value (Incremental AV). The other taxing units in the TID, the general government, library district and water district, for example, do not have a legal claim to the incremental assessed value, unless specifically dictated by law. But, they still have the base assessed value. At the date the TID is terminated, the incremental assessed

Exhibit 1. TIF Assessed Value (AV) Over Project Life



value reverts back to the other taxing units (New Post-Project AV). The TID is dissolved, and the tax base of the overlapping taxing units is made whole, at a higher assessed value level.

Exhibit 2 provides an example of the revenue flows from the base and incremental assessed values. The example is of a 5 year TIF project with assessed values increasing, simulating the expected property base growth from the implementation of the TIF development project. The overlapping jurisdictions consist of a sponsoring government (general government) and overlapping contributing governments (water and sewer district, a library district, and a school district). Each overlapping jurisdiction is a governmental taxing unit with associated tax rates. The sum of the individual tax rates is the governmental jurisdictions' total, or overall, tax rate (\$5.00). Once the TIF is adopted, this becomes the TIF tax rate as well.

In the second year after the base year is established, and the construction is complete and the facility is operational, the assessed value grows from \$500,000 to \$600,000, an increase of \$100,000. The \$100,000 assessed value is the incremental assessed value, and belongs to the TIF district. The \$500,000 is the base value, and remains with the sponsor and contributing jurisdictions. Since the incremental assessed value in Base Year + 2 is \$100,000, and the tax rate in the jurisdiction is \$5.00 per \$100 assessed value, the incremental revenue to the TIF district is \$5,000 ($\$100,000 * .05$), the incremental assessed value multiplied by the total tax rate of the TIF district. This is \$5,000 that the redevelopment authority can use to pay for development costs.

The incremental revenue in the TID grows from \$5,000 in the beginning to \$15,000 in the final year of the TIF (Base Year + 5), the termination year of the TID. Over the five years, the share of the revenues allocated to the TIF district from grows from 16.67 percent to 37.50 percent of the combined base plus incremental assessed value. At the end of the fifth year, the entire assessed value reverts back to the sponsor and contributing jurisdictions, and is \$300,000 higher than prior to the TIF project.

TIF in Practice

Practices used in the TIF process are most easily understood within a comprehensive development planning and financing process framework. The TIF

Exhibit 2. An Example of the Flow of Tax Incremental Revenue: Base Year, Assessed Value, and Incremental Revenue

	Assessed Values:	Base Year	Base Year +1	Base Year +2	Base Year +3	Base Year +4	Base Year +5	Post-TIF	
		\$500,000	\$500,000	\$600,000	\$650,000	\$700,000	\$800,000	\$800,000	
		Revenue							
	Tax Rate per \$100 AV								
<u>Jurisdiction</u>									
Sponsor	\$1.75	\$6,250	\$6,250	\$6,250	\$6,250	\$6,250	\$6,250	\$10,000	
Contributor									
Water and Sewer District	\$0.50	\$3,750	\$3,750	\$3,750	\$3,750	\$3,750	\$3,750	\$6,000	
Library District	\$0.25	\$4,250	\$4,250	\$4,250	\$4,250	\$4,250	\$4,250	\$6,800	
School District	\$2.50	\$9,500	\$9,500	\$9,500	\$9,500	\$9,500	\$9,500	\$15,200	
Total	\$5.00								
<u>Tax Revenues</u>									
Base Year (to contributors)		\$25,000	\$25,000	\$25,000	\$25,000	\$25,000	\$25,000	\$40,000	
Incremental Revenue (to TIF District)		\$0	\$0	\$7,500	\$10,000	\$10,000	\$15,000	\$0	
Total		\$25,000	\$25,000	\$30,000	\$32,500	\$35,000	\$40,000	\$40,000	
<u>Revenue Allocation</u>									
Share to sponsor and contributors		100.00%	100.00%	83.33%	76.92%	71.43%	62.50%	100.00%	
Share to TIF District		0.00%	0.00%	16.67%	23.08%	28.57%	37.50%	0.00%	

Exhibit 3.

The TIF Process

Create redevelopment plan

- ✓ Determine geographical boundaries
- ✓ Finding of blight or significant economic benefit
- ✓ Estimate project timeline and project costs
- ✓ Establish tax base, revenue increment, and debt financing polices
- ✓ Include special features
- ✓ Establish evaluation requirements and termination date

Determine project feasibility

- ✓ Need
- ✓ Economic benefits
- ✓ Financial feasibility
- ✓ Area eligibility
- ✓ Public-Private partnerships

FORMULATION

- Conduct public disclosure
 - ✓ Public hearings
 - ✓ Involve affected districts

Get political and legal approvals

- ✓ Draft new ordinances
- ✓ Draft public-private sector agreements

ADOPTION

Manage construction process

- ✓ Obtain land
- ✓ Prepare site
- ✓ Construction
- ✓ Post-construction management

Manage project finances

- ✓ Issue debt instruments
- ✓ Establish tax base and tax rates
- ✓ Authorize receipt and distribution of tax increments
- ✓ Generate tax increment to meet debt service payments

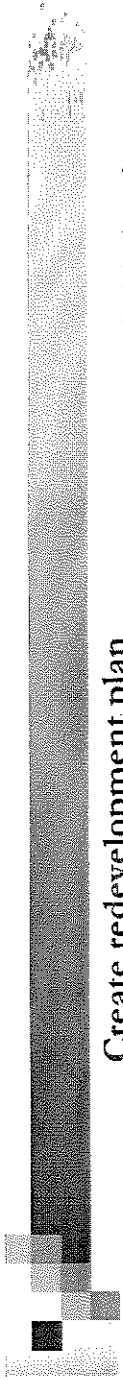
Dissolve tax increment district

- ✓ Evaluate project
- ✓ Total assessed value, base and incremental, now belong to overlapping governments

IMPLEMENTATION

EVALUATION & TERMINATION

INITIATION



development process progresses through five stages: 1. Initiation. 2. Formulation.. 3. Adoption. 4. Implementation. 5. Evaluation and Termination. Exhibit 3 provides an illustration of the process of a TIF project, highlighting some of the major items that must be handled along the way from project initiation to termination.

Initiating the Project

The first stage is initiation of the development process. A TIF project is usually initiated by the public sector, but also may be initiated by a private firm or non-profit agency interested in developing or redeveloping a geographic area. During this stage, the need to develop a specific project area is discussed by public sector and private sector decision-makers. They begin to take preliminary steps to address several development issues, including, the eligibility of the project area, the needs of the community, and financial feasibility and expected economic benefits from the project. In addition, a variety of public-private sector partnership scenarios may be probed to ascertain the level and breadth of interest.

If TIF legislation is not already on state and local statutes at this stage of the process, the basic enabling legal framework must be developed for general governments to set up tax increment districts, redevelopment authorities for day-t-to-day administration, along with an independent governing body. The enabling legislation should also spell out the formal process that taxpayers and affected local governments, such as school districts, can use to exert influence during the TIF approval process. A formal disclosure process involving public hearings that includes all local taxpayers and governing bodies that may be affected by the TIF project may be costly and delay the project somewhat, but it will likely increase public confidence in the project, increase local official accountability to community stakeholders, and increase the likelihood of project success and improved quality of life in the community in the long run.

Plan Formulation

Once the development process is initiated, the next step involves creating the redevelopment plan. This stage of the process brings together the two basic aspects of TIF, land development planning and project financing. The redevelopment plan serves

many purposes, but primarily it is a planning tool that sets forth the objectives, project timetable, and forms the written basis for communicating these matters to stakeholders, especially taxpayers, in the community. The plan is a statement of the objectives of the redevelopment project and should reflect the interests and existing plans of the community as a whole, which are commonly described in a community master plan.

TIF land planning begins with determining the geographical boundaries of the TIF district. Another way to think of this issue is: What property is going to be TIF'ed? The area of the TIF district may be larger than the actual area of new construction. For example, the actual construction project may be a four square block downtown area, while the TIF district may include the entire downtown "business" district, which might consist of 50 square blocks.

This is one area of controversy because some TIF districts encompass far more surrounding area than the TIF project itself. TIF districts should not be drawn merely to capture the assessed property values of surrounding areas. If surrounding areas do not receive an economic benefit from the TIF project, then they should not be included in the TIF district. On the other hand, if the benefits of the TIF project "spillover" to the surrounding community, as they will with most large public improvement projects, since they generate substantial social benefits, then the surrounding areas, and their overlapping governments should bear some of the cost of the project. The bottom line is that the properties included in the TIF, beyond the limited area of the actual construction project, may affect the success of the TIF project.

Another area of controversy at this stage of the process is the necessity of justifying TIF projects. The basic notion is that since TIF projects spend public funds, they should serve a public purpose. The initial theoretical justifications for TIF were that: 1) it would be used to finance redevelopment projects in *blighted* communities, and 2) these projects would not be financed without, or "*but for*," TIF.

TIF was not envisaged as a financing source for general government expenditures or projects in non-blighted areas. While at least 33 states have at one time required local officials to opine on the level of blight in the potential project area, the vacuousness of the definition of "blight" often makes it a meaningless exercise. An important dimension of a blight finding is whether it is a quantifiable, and therefore, measurable. A quantified

blight finding limits TIF to projects that those that can meet specific and measurable adoption criteria. Most states that require a finding of blight, do not require that it be quantified, and some courts have explicitly rejected the notion that a blight finding need be quantified, or even explained. In most states a non-quantified finding of blight, or a finding of economic benefits such as employment gains is required in order to begin the redevelopment process.

Related to the blighted finding is the “but for” test. The theoretical idea behind the “but for” test is that if the development would have occurred without the expenditure of public TIF funds, then a larger public purpose is not served, and therefore, TIF should not be used. However, determining whether development would have occurred is an extremely difficult matter. Many states require projects to cross some form of “but for” hurdle prior to project approval, but the tests are usually very low hurdles and not uniformly or rigorously applied. Most states have resorted to a simple finding by the authorizing governmental body that development would not occur without the assistance and public funds supplied by the government.

In the plan formulation stage, officials also begin to flesh out the actual details of the project or projects. Taxpayers should be provided with details on the scale and scope of the project, along with detailed estimates of project costs and a project timeline. Most states require an estimate of project costs in the redevelopment plan. If debt is going to be used to finance the project, then debt financing policies should also be put in place, especially the amount of debt authorized to be issued, the redevelopment authority ability to issue debt, and limitations on the amount of outstanding debt and maximum allowable debt service payments.

The redevelopment plan should also capture several other special features pertinent to overall TIF development policy, such as environmental protections, affordable housing requirements, quality of life neighborhood impact statements, and legal and practical guidance on negotiating and executing contracts with private firms.

Plan Adoption

The plan adoption stage of the TIF process involves public hearings and other vehicles for stakeholder participation prior to approval of a redevelopment plan or the

creation of TIF district. These mechanisms are designed to ensure that public projects involve public participation so that stakeholder input is infused into the decision making process. Most states require public hearings prior to plan approval or district creation. Fewer states require a hearing on the creation of the redevelopment plan and the TIF district.

In general, there is tremendous range over the required legal participatory mechanisms across the states. At one end of the spectrum, some states encourage input from all taxing districts affected by the TIF project. Some states go so far as to require approval from affected taxing districts. Other states do not provide affected taxing districts any formal process for influencing TIF project decisions, much less a veto over the redevelopment plan or the proposed TIF district. Clearly, there are tradeoffs in the level of participation afforded overlapping taxing districts.

At a minimum, enabling legislation should require local officials to design projects that proportionately spread costs and benefits across all affected jurisdictions. Affected taxing districts, school districts, for example, have a significant stake in any actions that affect the revenue flowing from their property tax base. Therefore, they should be able to help determine the redevelopment plan and characteristics of the TIF district. They should not, however, be given complete veto power. States with participatory mechanisms that give affected taxing districts some influence over the process, without giving them complete veto power, are enabling the districts to protect their self interest, without unduly constraining the whole jurisdiction. This balance should yield the best results in terms of promoting efficiency, effectiveness, and equity in the adoption process.

Once the redevelopment plan is adopted, enabling legislation is on local and state statutes, financing and administrative organizations have been established, and templates of public-private sector agreement are drawn, then work can commence on developing the project area.

Plan Implementation

The administration of the project area is guided by the parameters laid out in the enabling statutes. The implementation phase of the TIF project from the government

perspective involves providing general oversight of the construction process and managing the finances of the redevelopment authority and TIF district. TIF projects are usually large financial undertakings that impact local government finances for several years. By setting financing restrictions and carefully managing the flow of funds, local governments can develop financial plans under less uncertainty.

Almost all states allow the sale of TIF bonds to finance the costs of development. The impact on local government finance can be substantial if the bonds are considered obligations of the overlapping tax districts, since stringent limitations are often imposed by state constitution or statute on the amount of debt taxing authorities can issue or have outstanding. There are at least three different ways that states have chosen to deal with the relationship between TIF debt and local debt limitations. The least restrictive and most frequently used method is to allow TIF debt to be repaid from tax increments and to set forth explicitly in the enabling statute that it shall not be counted in calculating an overlapping taxing districts outstanding debt for the purposes of a debt limit. The next least restrictive way is to place separate restrictions on the amount of TIF debt that can be issued or outstanding. This is usually accomplished by setting the limits in the redevelopment plan. In either way mentioned above, an unintended result could be the transfer of power and future resources from overlapping taxing jurisdictions to the redevelopment authority.

Other states have chosen to simply omit comment on debt limits in the enabling statute. This approach leaves municipalities open to court challenges, especially regarding whether TIF debt should count against local debt limits. It has become increasingly clear in several decisions that the courts are finding against local governments that issue TIF debt that exceeds debt limits. Therefore, a states' decision to remain silent on this issue may ultimately be the most restrictive on TIF debt issuance.

Debt instruments are sold to generate proceeds to make capital expenditures. In the initial stage of the physical infrastructure improvement, land is purchased, cleared if necessary, and prepared for development. Often the assessed value in the project area will initially drop, which may adversely affect overlapping tax districts.

A policy choice may be made to reduce, or "write-down," the value of the land prior to setting the assessed base value to increase the eventual incremental revenue

flows. But since this may reduce the assessed property value of overlapping taxing districts, it should be accomplished in a way that holds overlapping taxing districts harmless or reimburses municipalities for financial losses.

In general, overlapping taxing districts that rely on property tax revenue to finance needed public expenditures should be protected from harm resulting from TIF projects. Often, TIF has been accused of siphoning off needed funds for school districts in particular. While this may have been the case in the early years of TIF, many states use methods to protect school district property tax bases. Some states mandate that school district property tax bases be fully excluded from TIF districts. Other states give schools the choice to participate in the incremental base, or opt out. Some states that give school districts a choice, give them the option of opting in for only a portion of their tax base. Though states use a variety of techniques to protect school districts in particular, and overlapping taxing districts in general, the most important point is that it can be done. TIF need not be synonymous with the raiding of overlapping government tax bases.

Another major set of financial management responsibilities involves the management of incremental revenue flows. The redevelopment authority is responsible for managing incremental funds. Ideally, the increase in the assessed value from development will generate just enough revenue to pay development costs, administer the project, and service the debt. But it is common for TIF projects to generate surplus revenues. The accumulation of “excess” revenues should be limited, and ultimately returned to taxing districts.

Evaluation and Termination

Finally, the last stage is the evaluation and termination of the TIF project. Once project construction is complete and the project has an operational history, it is important to formally evaluate the expected versus actual results. In addition, a public assessment of the redevelopment authority and TIF district every two or three years may be effective at holding redevelopment authorities accountable to stakeholders.

Another important aspect is the end date of the TIF. Because of a lack of oversight in some states, some TIF districts became “perpetual” governments. The life of a TIF district, or the time period for which increments can be collected, should be

expressly limited in statute. Maximum time limits are usually twenty-thirty years, provided that all debt has been repaid. As long as debt is outstanding, most TIF districts can exist and collect revenue.