

*An
Elected
Official's
Guide to*

TAX INCREMENT FINANCING

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Government Finance Officers Association

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Foreword

Each year state and local governments invest in economic development strategies to promote growth in their local economies. These strategies focus on job creation, increased economic activity, and ultimately a broader economic base that can support needed government services. While these are enduring goals, over the past two decades the preeminent tool for achieving economic goals has been tax increment financing (TIF). TIF is widely used by municipalities across the United States, permissible in forty-nine states.

As TIF use has grown, so too has the need for information on creating and managing TIF districts. *An Elected Official's Guide to Tax Increment Financing* is intended to provide clear, concise answers to commonly asked questions about TIFs. The guide is designed to provide elected officials with basic information on the concepts and mechanics of TIFs as well as to describe successful financial management practices that have been used to implement TIF projects.

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INTRODUCTION

Local economic development is a big business. Municipalities collectively spend billions of dollars for subsidies to encourage existing businesses to stay or new businesses to move in. They employ myriad techniques to accomplish this: building or replacing municipal infrastructure, reducing regulatory burdens, and providing tax incentives.

The Government Finance Officers Association (GFOA) has a long-standing interest in promoting sound financial management when pursuing municipal economic development. In 1990, GFOA issued a recommended practice concerning the use of economic development incentives (reproduced on page 58). A key element of the recommendation was the practice of establishing criteria to measure progress toward goals, and identifying remedial steps when goals are not being met.

This publication was written to familiarize elected officials with one of the most popular tools for local economic development, tax increment financing (TIF). Although much has been written about the pluses and minuses of using this financing method, less has been written about the practical steps that can be taken to prudently use and manage TIFs. The objective of this book is to lay out the steps for using TIF as well as identify and describe important financial management concepts integral to TIFs. A secondary goal is to help elected officials become conversant in TIF techniques, so as to better oversee the staff that administer TIF districts on a day-to-day basis.

The guide is organized into four sections. Section I introduces the fundamental concepts behind tax increment financing and the historical rea-

sons for its growing use among city and county governments. Section II provides background on the mechanics and process of establishing and operating a TIF district. Section III discusses the impacts associated with tax increment financing, both positive and negative. Section IV discusses specific financing techniques used to fund TIF projects, including pay-as-you-go and bond issuance. Following the previously mentioned GFOA recommended practice, an appendix presents profiles of TIF districts in operation and a resource list.

Section I

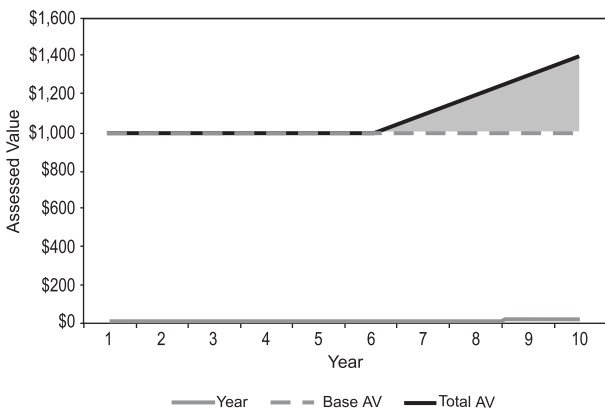
FUNDAMENTALS

What is tax increment financing?

Tax increment financing is a financial tool widely used by local governments to promote economic development and redevelopment. The TIF process splits tax revenue generated from properties within the TIF district into two components:

- *Base revenues* – This is the amount available before the TIF district is established; base revenues are shared among a mix of local governments that have the power to assess property taxes: schools, cities, counties, and special districts.
- *Incremental revenues* – These new revenues in excess of the base revenues are generated by development projects. Represented by the triangular area in Exhibit 1, these dollars are allocated to the government that sponsors the TIF project. Although some states permit counties to use tax increment financing, in most cases the sponsoring government is a municipality.

Exhibit 1 • Assessed Value of Prototypical TIF District



By giving exclusive use of incremental revenues to the sponsoring government, the successful tax increment financing process generates a revenue stream to underwrite projects within the TIF district and to provide development subsidies to encourage growth.

Why do governments use tax increment financing?

Governments employ tax increment financing to promote economic development and redevelopment. By capturing future incremental revenue, the sponsoring government is able to undertake economic development activities or provide subsidies that otherwise might not be possible.

Historically, tax increment financing has been viewed as a way to combat blight or deterioration within city districts or neighborhoods. As its use spread to more states, however, tax increment financing became recognized as a flexible, all-purpose financing tool for economic development. Today, it helps local governments achieve a variety of economic development goals, including job creation, growth in property values, and protection of the local tax base. Suburban municipalities even use tax increment financing today to spur development in “greenfields.”

A survey by the International City/County Management Association¹ (ICMA) finds that local government managers cite the most common goals for a TIF project to be, in order: (1) attraction of new business, (2) downtown redevelopment, and (3) retention or expansion of existing businesses. Other goals mentioned far less frequently were: neighborhood commercial development, small business development, office development, service sector growth, and minority business development. Perhaps surprisingly, alleviating blight was *not* cited as an explicit goal in establishing a TIF district.

¹Fred Allen Forgey, “Tax Increment Financing: Equity, Effectiveness and Efficiency,” in *The Municipal Year Book 1993* (Washington, D.C.: International City/County Management Association, 1993), pp. 25-33.

What are the different types of TIF districts?

Tax exempt financings have become so diverse that it is impossible to identify a typical example. Not only do TIF districts have varying economic development objectives (as discussed on the preceding page), but they also can be differentiated by financing type, land use, and even sponsoring government.

- *Financing type.* Property taxes are the most common financing source for TIF and are discussed in this publication. Some governments have also established TIF districts using sales or utility taxes as the source of incremental revenues.
- *Land use.* Tax increment financing can be employed for virtually any land use. As an economic development tool, commercial and industrial land uses have been common, but some jurisdictions have established residential TIF districts as well. In addition, many downtown redevelopment TIF projects result in mixed-use property, combining residential and commercial (office and retail) land uses.
- *Sponsoring government.* Many states give statutory authority to either counties or municipalities to establish a TIF district (further discussed on p. 8).

In addition, TIFs vary by the type of subsidies employed (discussed on page 9).

Where is tax increment financing used?

Tax increment financing is used in nearly every state. In fact, most mid-sized and large municipalities have one or more TIF districts in operation.² Currently, forty-nine states allow city and/or county governments to establish TIF districts.³ Only Delaware does not permit county or municipal governments to use tax increment financing.

In some states, tax increment financing has become a routinely used economic development tool. Indeed, in Wisconsin and California the incremental assessed value exceeds base assessed value statewide at the time of this writing.

²Craig L. Johnson and Joyce Y. Man, eds., *Tax Increment Financing and Economic Development: Uses, Structures and Impacts* (Albany, New York: State University of New York Press, 2001), p. 18.

³*Ibid*, p. 31.

Can local governments other than municipalities establish TIF districts?

In most states, the government sponsoring a TIF district – that is, establishing it directly or indirectly through a subsidiary redevelopment agency – is a municipality. A significant number of state statutes, however, also permit a county government to establish a TIF district. In fact, in Hawaii and West Virginia, *only* counties have authority to establish TIF districts.

Single-purpose governments such as schools and water treatment authorities do not have authority to engage in tax exempt financing.

Exhibit 2 • Types of Governments Sponsoring TIF Districts

Government Authorized to Initiate a TIF District	Number of States
Municipality only	25
Both county and municipality	21
County only	2
No state authorization	1

Note: In Kentucky, municipal authority is delegated to a redevelopment agency.

Source: Craig L. Johnson and Joyce Y. Man, eds., *Tax Increment Financing and Economic Development: Uses, Structures and Impacts* (Albany, New York: State University of New York Press, 2001), pp. 33-34.

What type of projects is tax increment financing used for?

Governments often use TIF resources to prepare land for development or redevelopment. In addition, governments may use TIF revenues to underwrite certain public structures, such as parking garages. If permissible under state statute, the construction of municipal facilities can be financed using TIF revenues.

An ICMA survey⁴ finds that site preparation is the most common use of TIF funds. Site preparation encompasses land acquisition, land condemnation, demolition of old structures, and environmental remediation. Other common uses of TIF funds are for infrastructure: sidewalk replacement, curb and gutter installation, and related planning and engineering. In general, governments using tax increment financing tend to provide in-kind subsidies for economic development rather than tax subsidies to targeted businesses. Many of these in-kind subsidies promote a public purpose, and can qualify for tax-exempt financing.

⁴Fred Allen Forgey, "Tax Increment Financing: Equity, Effectiveness and Efficiency," in *The Municipal Year Book 1993* (Washington, D.C.: International City/County Management Association, 1993), pp. 25-33.

Why has the use of tax increment financing become more widespread?

As noted, nearly every state has given local governments authority to establish TIF districts, either by passing referenda or by enacting enabling legislation. Equally important, the growing use of tax increment financing as an economic development tool has coincided with the reduction in federal funding for municipal economic development over the past twenty years. (The Community Development Block Grant program, for example, has declined significantly over the past twenty-five years when dollars are adjusted for inflation.)

Other factors may have influenced cities to pursue tax increment financing. For example, many localities have attempted to diversify their tax base to become less reliant on the property tax. As a way to generate sales tax revenues, tax increment financing offers a flexible revenue diversification option. Additionally, with growing experience and success in local TIF projects there has developed a cottage industry of advisers – TIF planning consultants, attorneys, and financial advisers for bond issuance – able to assist government officials with implementation of their TIF plans.

How does tax increment financing differ from other economic development financing tools?

Three attributes differentiate tax increment financing from other financing tools:

- *Self-financing*—Tax increment financing offers a way to dedicate a specific revenue source to pay for economic development subsidies. The incremental revenue expected to occur after businesses move into a TIF district provides the resources needed to carry out TIF projects, thus alleviating the need to establish a separate tax levy or increase tax rates upon residents outside the TIF district.
- *Local control*—Tax increment financing project initiation and management is carried out at the local level. TIF projects are not dependent upon federal or state funding.
- *Flexibility in project activities*—Partly because it is not subject to many federal or state requirements, tax increment financing can be used for a broad array of activities, such as land assembly, demolition, or environmental remediation and other in-kind subsidies. Tax increment financing can also be used to subsidize a developer directly through land donations, for example. Moreover, TIF subsidies can be layered upon non-TIF subsidies offered by the municipality or state government.

Section II

TIF MECHANICS

What is the general process for establishing a TIF district?

State law generally determines the process for establishing and operating a TIF. Enabling legislation enacted by state legislatures usually specifies detailed activities or checklists that localities must comply with. In most states, this includes a finding of need for a TIF, demarcation of the TIF boundaries, and creation of a TIF management team or organization. The following bullet points outline the sequence of steps for establishing a TIF district.

- Phase 1: Determine project feasibility
- Phase 2: Create redevelopment plan
- Phase 3: Adopt
- Phase 4: Implement
- Phase 5: Evaluate and terminate

Phase 1, determination of feasibility, is a pre-planning stage that serves as a prerequisite for the more formal and costly planning needed in phase 2. A feasibility study encompasses an assessment of “need” as judged by local policymakers and external stakeholders, as well as an assessment of economic benefits.

In phase 2, a formal plan must be developed. This entails:

- Determining the legal boundaries of the TIF district;
- Finding that the TIF district would support a state-mandated public policy goal, such as amelioration of blight or promotion of economic development;

-
- Estimating project timeline and costs;
 - Establishing the base assessed value and base revenue; and
 - Projecting incremental assessed value and incremental revenue.

In addition to a finding of blight, some states may require an additional finding that blight remediation or economic development will not occur *but for* the establishment of a TIF. That is, economic growth will not occur in the absence of TIF-related subsidies.

Phase 3 occurs when the government formally adopts the plan and establishes a TIF district. In some jurisdictions, this may necessitate two separate ordinances and may require action spread out over several weeks to allow for community input. The government may be required to provide a disclosure to overlapping districts affected by the TIF district (although this is often done earlier to get preliminary buy-in from other governments) and to the public, followed by public hearings. During this phase, the government also develops public-private sector agreements delineating obligations of the two parties.

In phase 4, a government implements its plan. In many communities, this is the government's undertaking of site preparation activities that were described on page 9 as well as private-sector construction of commercial, industrial, residential, or mixed-use buildings. Project financing also takes place in the fourth phase: establishment of the tax base and tax rates, issuance of debt, and generation of the tax increment necessary to retire debt.

In phase 5, a government monitors the performance of the TIF district and reports financial results to internal management and, if applicable, to state oversight bodies. Ultimately, the government would dissolve the district and evaluate its performance. At this point, the total assessed value (base and incremental) would be available to all units of government.

What criteria are used to establish a TIF district?

Most states require localities to meet specific criteria before a TIF district can go into operation. Historically, many states have required an area to be blighted, as measured in either qualitative or quantitative terms. For example, the State of Illinois stipulates that an area is blighted if it meets a minimum of five of thirteen qualitative factors.⁵

- Dilapidation,
- Deterioration,
- Obsolescence,
- Illegal use of individual structures,
- Structures below minimum building code standards,
- Excessive land coverage and overcrowding of structures and community facilities,
- Lack of ventilation, light, or sanitary facilities,
- Inadequate utilities,
- Excessive building “footprint” (structure too big relative to property),
- Deleterious land use or layout that is considered noxious,
- Environmental clean-up needed,

⁵A separate set of criteria is applied to the establishment of TIFs in vacant land, conservation districts, and industrial parks.

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- Declining assessed value, and
 - Lack of community planning.

Overall, 33 states require a finding of blight to establish a TIF. Only seven states, however, require a quantitative finding that measures the degree of blighted conditions.⁶

⁶Craig L. Johnson and Joyce Y. Man, eds., *Tax Increment Financing and Economic Development: Uses, Structures and Impacts* (Albany, New York: State University of New York Press, 2001), p. 38.

What is the “but for” requirement, and how is it defined?

Seventeen states require governments to establish that economic development would not occur within a designated area, *but for* the establishment of the TIF district. Stated another way, if the government does not provide subsidies to the district, then economic activity will remain stagnant and hoped-for outcomes (such as increasing assessed value) will not occur. Before the State of Wisconsin can adopt a TIF plan, for example, an intergovernmental review board must consider whether development would occur with or without TIF subsidies. Minnesota state law assigns the decision to the municipalities themselves. They must establish a two-part finding that a) no development would occur solely through private investment and b) the increased market value of the properties within the TIF district would be greater than without the it.

Local government leaders should not view the *but for* test as a state-imposed hurdle to overcome. Rather, it should be treated as an important safeguard for protecting local resources, since it theoretically prevents the misuse of public subsidies for unproductive purposes. Further, a diligent effort to limit subsidies to businesses that would locate in a jurisdiction without governmental support would reduce a point of friction with schools and other localities that could potentially be affected by a TIF.

It is difficult to determine with certainty that a TIF solution is truly needed, as it requires (a) predicting the future, (b) determining what a targeted business or businesses will do, and (c) developing a detailed TIF project plan. The TIF project plan may be the document that identifies, in detail, if TIF subsidies are needed or

not, but ironically it may not be fully developed until *after* the TIF is approved. The *but for* finding is usually made earlier, and does not involve detailed project planning.

How long are TIF districts in operation?

The life span for a TIF district can be statutorily determined and/or set by the term of the bonds issued to support the TIF projects and activities. Often, TIF districts function for more than twenty years. A lengthy financing period reflects the useful life of the projects and the time required for economic payback.

Some municipalities operating successful TIF districts have been able to terminate them ahead of schedule. Clearly, this benefits other government units that can then begin to share in the incremental revenues associated with a TIF district. In other cases, municipalities have elected to simply share surplus revenues annually rather than terminate the TIF altogether.

Who comprises the TIF management team?

Because tax increment financing is a high profile activity, the TIF management team usually involves the government's senior executives or their delegates. A city or county manager, finance director, and economic development director or coordinator generally oversee and administer the district. The economic development director also monitors daily TIF performance and ensures compliance with government-developer agreements.

Governments often rely on external advisors to establish, monitor, and report on TIF performance. Governments issuing TIF bonds rely on the standard set of advisors for a bond issue – financial advisor, underwriter, bond counsel, and credit rating agency. Additionally, governments rely on specialized TIF consultants to provide detailed oversight of a developer's economic development plans. This consultant can play an important role in securing compliance with state statutes by: a) establishing that TIF blight criteria are met; b) performing a due diligence review of developer proforma financial projections; and c) ongoing reporting.

Some of the services or deliverables provided by a TIF consultant include:

- *TIF plan* – identifying major characteristics of a planned TIF, including the plan budget, developer projects, land use, and years TIF is in effect;
- *Eligibility report* – establishing a finding that statutory blight criteria, *but for* criteria, or other criteria are met;

-
- *Feasibility report* – assessing the feasibility of the developer plans, including a due diligence review of proformas; and
 - *Annual TIF reporting requirements mandated by statute* – indicating financial results and other metrics.

How large should a TIF district be?

Most states allow localities leeway in how loose or tight the boundaries of a TIF district can be. As a result, governments sponsoring a TIF district must analyze where the district boundaries will be set. The arguments for a district with a broad geographic area are:

- It increases the likelihood that the area targeted for redevelopment will experience economic growth;
- It allows the municipality or county sponsoring the TIF district to capture more incremental revenues compared to a smaller TIF district; and
- If debt financing is used, it may result in a reduction in perceived credit risk and a corresponding increase in the bond rating.

On the other hand, an excessively broad TIF district may not be viewed as equitable. Schools and other government units may believe broad boundaries would lead to an inequitable distribution of tax revenues. The larger the geographic footprint of the TIF district, the larger the amount of revenue captured by the municipality at the expense of other government units.

In addition, there may be efficiency concerns – that is, the sponsoring government may not need to capture revenues that would otherwise be shared with other taxing districts. Moreover, a government issuing general obligation debt may not need to expand the boundaries to ensure a high credit rating, if it already has an upper-tier rating on recent bond issues.

How is stakeholder participation incorporated into the TIF process?

Stakeholder participation benefits governments by building consensus for tax increment financing projects and reducing the likelihood of potential litigation. In some instances, schools and other government units have sued the governments sponsoring TIF districts because they disputed the finding of blight and the contention that development would not occur *but for* the establishment of the TIF district.

In many states, TIF participation is accomplished through two means. First, the normal municipal ordinance process or a specific ordinance process is used, requiring advance disclosures to the public of TIF plans, financing arrangements, and proposed geographic boundaries. This may also involve public hearings before enactment of ordinances to gauge public sentiment. Second, the government sponsoring the TIF may have to involve other governments in TIF planning as well as ongoing oversight. For example, a joint review board can be charged with monitoring TIF performance, and the composition of the board would include schools, other governments, and/or citizens.

The City of Portland, Oregon, has a well-developed process of stakeholder participation. Every household in the city receives a mailing describing the proposed TIF district (referred to in Portland as an urban renewal area). The mailing provides photographs and drawings describing the boundaries of the area, answers to frequently asked questions, and other information to help citizens participate in subsequent public hearings. Additionally, each of the urban renewal areas has a citizens committee that provides monthly feedback to municipal managers.

Section III

EVALUATING TIFS

What are the general advantages of tax increment financing?

Tax increment financing offers a number of advantages to localities. First and foremost, in many jurisdictions the technique has been used to finance successful economic development projects. This is not to say that they always are successful; there is substantial risk in selecting and implementing TIF projects. Many additional benefits flow from the economic development benefit, such as increases in local revenues that diversify and strengthen the tax base.

Additionally, tax increment financing is a flexible tool: the decision to establish a TIF district is made at the local level with no approvals usually required by federal and/or state governments. Although some states impose a rigorous process to establish a TIF district, it is usually the local government itself that takes the steps necessary to complete the process. In contrast, federal and state grant programs (such as enterprise zones) usually require a grant application and approval process that considerably lengthens the time needed to execute a development project. Moreover, such programs may be competitive, since state and federal grants, tax credits, and subsidies usually have resource limits. This flexibility in using tax increment financing allows many more municipal and county governments an increased opportunity to establish TIF districts.

Another aspect of flexibility is that tax increment financing can be combined with other economic development subsidies. For example, some major economic development projects trigger state involvement (e.g., for a major distribution or manufacturing facility). In such situations, local TIF subsidies can be layered upon state sub-

sidies and even other local subsidies like tax abatements.

A third feature that makes tax increment financing attractive is that it does not require a direct increase in property tax rates. The incremental revenues that are derived from a TIF project are obtained by applying the same tax rate as in the rest of the municipality to new businesses that enter the TIF district. Governments, TIF consultants, and credit rating agencies as part of their due diligence will forecast TIF revenues using the same tax rate or possibly even a declining tax rate if state limits on local property taxes mandate such rate reductions. As a result, taxpayers outside the TIF districts will not see a direct increase in their property tax rates in order to finance TIF projects.⁷ Some TIF proponents view TIF projects as self-financing for this reason.

⁷Indeed, this advantage can become a disadvantage, since the unit of government sponsoring the TIF lacks the ability to increase tax rates in the TIF if it is not as robust as projected.

What are the disadvantages of tax increment financing?

Tax increment financing has several drawbacks, some of which are related to the perceived advantages. First, poorly designed or poorly implemented TIF plans may not always be financially successful, and there is a substantial risk that they will fail. A clear measure of risk is that investors will demand a risk premium when buying TIF revenue bonds that are supported only by incremental revenues. Governments often are unable to obtain a credit rating on such bonds.

Second, even financially successful TIF projects may not be successful in an economic sense. Governments providing TIF project subsidies to businesses located in a growth corridor experiencing natural economic expansion may be wasting dollars if the businesses would have located and prospered in that area anyway – with or without subsidies. Such TIFs fail the *but for* test.

In this regard, TIF economic development subsidies share the same drawbacks as other local economic development incentives. Critics also highlight these potential drawbacks of economic development incentives and tax increment financing:

- They may be ineffective, since economic development incentives do not generally sway business location decisions, which are driven primarily by market factors (such as the need to be close to consumers or close to a skilled labor force);
- They are inefficient, because TIF subsidies:
 - Create a zero-sum game in which businesses, especially retailers, locate in one

jurisdiction providing a subsidy at the expense of a neighboring one refusing to forego a subsidy;

- Interfere with the free market forces that theoretically bring about a more efficient allocation of capital and better location decisions.

Third, any TIF district failing the *but for* test results in an opportunity cost to other governments. Schools and other units of governments sharing the same tax base with the TIF-sponsoring governments will not share incremental revenues (unless provisions require the TIF sponsor to revenue-share) until the TIF district is dissolved many years later. Further, excessively large TIF districts may allow the TIF sponsor to capture incremental revenues that would otherwise be shared with the overlapping governments.

The loss of actual or potential revenues raises a fourth issue. Schools and similarly situated governments that lose revenues captured by the TIF sponsor may have to respond by increasing the tax rate to compensate for a stagnant tax base. Thus, although there may be no direct increase in tax rates, there may be an indirect tax rate increase later.

Why is tax increment financing controversial?

The very growth in the use of tax increment financing has caused an attendant concern about its appropriateness as a public policy tool. As long as TIF was a niche tool used in few states, it had minimal impact and raised few policy concerns. With the rise of TIF districts nationwide, critics have identified several issues that make them controversial. Some of the major controversies include:

- Whether TIF districts are an effective tool for economic development;
- Whether their use creates inequities among local governments, with the capture of incremental revenue often being contested by schools;
- Whether tax increment financing creates inequities among property owners within a TIF district, since certain land uses are often favored over other land uses (e.g., potentially eliminating residential housing to build commercial properties); and
- Whether TIF districts create an uneven playing field between businesses that lie within and outside its borders.

Elected officials considering the establishment of TIF districts need to anticipate these controversies and be prepared to address them by consulting with affected parties early in the planning process.

How are TIF projects assessed and monitored?

Many governments use measures to monitor the implementation of a TIF district and its ultimate impact upon a community. Like measures of other government programs, they can be categorized as measures of:

Inputs or resources used – This reflects budgetary resources provided to initiate and operate a TIF district, and includes in-kind subsidies (see page 9 on the types of TIF subsidies), financial subsidies, hard costs for construction, and soft costs for TIF planning and regulatory compliance;

Outputs or workload – This measures the level of goods or services provided by the government and its economic development partners, such as commercial office space created by TIF; often these are embedded in a government-developer agreement that requires a developer to meet certain performance measures before the release of government funds (see page 56);

Efficiency – This measures outputs against inputs or resources used, such as dollar per square foot of commercial office space; such measures allow for comparisons over time or against other governments operating TIF districts or against market benchmarks (e.g., cost of office space without subsidies);

Effectiveness – This measures the effect of a TIF project against its goal, such as blight reduction; it also can measure TIF service quality as perceived by customers.

Additionally, some governments and other parties involved in TIF projects may use risk measures to ensure that TIF projects are successful.

The following exhibit lists examples of measures used to monitor economic development objectives.

Exhibit 3 • TIF Measures

Measure	Examples
Input	Public investment (\$) Private investment (\$) Acres of land assembled for TIF Environmental remediation costs Bond proceeds
Output/Workload	Jobs created or retained Number of streetscaping fixtures installed Commercial space created (square feet) Hotel units Acres of land remediated Parking garage spaces
Efficiency	Leverage ratio (private investment / public investment) Cost per square foot of commercial space Cost per parking garage space Public subsidies per job created/retained Surplus TIF dollars as a percent of annual incremental revenues
Effectiveness	Assessed value (AV) within TIF versus AV in rest of city Assessed value within TIF before and after TIF creation Municipal sales taxes before and after TIF creation
Risk	Debt coverage ratio Credit ratings of anchor tenants Tenant diversification (e.g., percent of total TIF AV attributable to top ten tenants)

How effective is tax increment financing as an economic development tool?

Over time, tax increment financing has been used to achieve an increasing number of public policy goals. From its original use to combat blight, TIF has evolved into an all-purpose economic development tool employed as much in prosperous communities as in disadvantaged ones, and toward a variety of ends (the creation of California residential housing, for example).

As a tool purely for economic development, however, there is conflicting evidence about effectiveness. TIF impacts cannot easily be evaluated because the projects that they help finance vary significantly from state to state and jurisdiction to jurisdiction. TIF districts that promote mixed-use, downtown redevelopment represent a very different approach to economic development compared to districts creating, for example, light industrial development on previously vacant land on the suburban periphery. In this sense, tax increment financing is not really one tool but an umbrella for many different tools using the same financing technique.

Despite these caveats, some researchers have attempted to assess a variety of TIF strategies to determine if they collectively have increased economic activity above and beyond the rate of economic growth in the rest of the jurisdiction. For example, one small-scale study⁸ compared the rate of growth in property values (a measure of economic development used for the study) within five Chicago TIF districts against values outside the TIF boundaries (within Chicago), finding

⁸Assessing the Impact of Tax Increment Financing in Northeastern Illinois, The Civic Federation, March 1997.

that values had grown faster within all districts. A second study reached a similar conclusion for suburban Chicago. As indicated in Exhibit 4 below, the municipalities used a variety of economic development approaches, such as creation of shopping malls, industrial development, and other land uses.

Exhibit 4 • Evaluation of Chicago-area TIFs

TIF	Type	Size of District (in acres)	Growth in AV within TIF (percent)	Growth in AV outside TIF (percent)
City of Chicago				
1	Shopping mall/commercial strip	6	11	5
2	Industrial/commercial strip with distributor	3	34	5
3	Mixed development	75	14	2
4	Central business district redevelopment, mixed use	25	16	6
5	Mixed development/industrial	127	11	1
Suburban Chicago				
6	Mixed development	23	7	6
7	Mixed development	17	41	6
8	Central business district	18	23	6
9	Industrial	153	33	6
10	Central business district	123	24	5

Note: AV=assessed value. AV growth reflects annual averages from base year to 1995. Each TIF has different base years.

Source: Civic Federation

Note that these studies use comparative growth in assessed value as a proxy for effectiveness. While it is clear that in these cases assessed values grew faster within the TIF districts than outside them – in several cases substantially faster – the findings cannot be extrapolated to other jurisdictions. A broader study attempted to measure the impact in 79 Illinois municipalities. Contrary to Exhibit 4, it found that in nearly one-third of the municipalities, assessed values within the TIFs grew more *slowly* than outside the districts.

Moreover, it remains unclear what the valuations would have been within the districts if no subsidies had been provided all. It is possible that they would have been the same with or without TIF-based subsidies. To answer the *but for* question, it is necessary to go beyond simple comparisons of assessed valuations to use statistical techniques such as multiple regression analysis. Using multiple regression, the study of 79 Illinois municipalities found no statistically significant effect of tax increment financing upon assessed values. Although there may have been successful TIF districts in a few jurisdictions, the aggregate results show no positive impact.

Section IV

FINANCING TIF DISTRICTS

How are TIF expenditures financed?

Municipalities can use one or more of the following options to finance TIF projects:

- Pay-as-you-go financing;
- Developer financing;
- Municipal financing;
 - Revenue bonds
 - General obligation bonds and
- Municipal financing with developer participation.

Pay-as-you-go financing involves expenditures that are undertaken as incremental revenue is realized. Although pay-as-you-go financing avoids the costs and risk associated with debt financing, it does not allow for major, up-front investments often needed to make a TIF effort successful – such as land assembly, municipal infrastructure, or parking garages.

Developer financing is a means for a municipality to shift the risk of debt financing to a developer. Under this method, the developer incurs the risk of issuing debt and related issuance costs. A government then reimburses the developer for TIF-eligible costs as it obtains incremental revenues. Alternatively, the municipality may negotiate a loan from the developer, although such loans tend to cost more than municipal-issued debt.

Because of the limitations associated with the other financing methods, governments often will issue bonds to finance TIFs. While the municipality incurs long-term obligations that limit its financial flexibility to issue debt for other non-TIF projects,⁹ this option allows the government to undertake costly, non-routine projects often needed early in the lifecycle of a TIF.

Another alternative is for the municipality to issue the bonds while the developer simultaneously pledges to purchase all or a significant portion of them. This guarantees a market and can keep interest and issuance costs low, while demonstrating the developer's faith in the project. For example, one city issued bonds that were purchased by the developer and were taxable while the developer held them (during the initial stages of the TIF site redevelopment). In such a situation, once the TIF district begins to produce a reliable revenue stream, the city remarkets the bonds to new investors on a tax-exempt basis. This method mitigates the city's risk, particularly in the early phases of the TIF district, while providing an opportunity for low-interest financing in the long term.

⁹This is especially true for GO bonds, as opposed to revenue bonds. Issuing more GO debt will reduce the government's capacity to issue future GO debt for other municipal projects.

What is a feasibility analysis and proforma?

A financial feasibility analysis represents a critical step in moving from general to specific planning of a TIF. The analysis results in a year-by-year projection of the government's costs and revenues for all projects in the district. Although it would obviously show incremental property tax revenues, the analysis should incorporate other revenue sources that may increase after the TIF is operational, such as sales taxes, hotel/motel taxes, entertainment taxes, and parking fees (if a municipal parking garage is built). The feasibility analysis is important not only for determining projected TIF costs and benefits, but also because it helps the city determine the level of developer subsidies needed to make the TIF work.

To estimate overall annual revenues for a feasibility analysis, the government needs to perform a bottom-up analysis of individual properties (parcels) in a TIF district and their respective contribution toward revenue growth. Exhibit 5 describes the property and sales tax contributions toward TIF revenues, once they are operational.

In addition to determining the revenue impact of individual TIF properties, governments need to determine project timing. This requires estimating (a) the pace of construction, (b) market "absorption," and (c) the lag time from when properties reach the market to when they are assessed and taxes collected.

Exhibit 5 • Simplified TIF Feasibility Analysis

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Property Tax Increment	\$0	\$500,000	\$1,000,000	\$1,200,000	\$1,400,000	\$1,600,000	\$1,800,000
Sales Tax	\$0	\$50,000	\$100,000	\$102,000	\$104,040	\$106,121	\$108,243
Hotel Tax	\$0	\$100,000	\$200,000	\$206,000	\$212,180	\$218,545	\$225,102
Subtotal –Revenues	\$0	\$650,000	\$1,300,000	\$1,508,000	\$1,716,220	\$1,924,666	\$2,133,345
Soft Project Costs (external)	\$100,000	\$100,000	\$25,000	\$25,000	\$25,000	\$25,000	\$25,000
Internal Staffing	\$50,000	\$50,000	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000
Total Debt Service	\$0	\$0	\$0	\$2,000,000	\$2,000,000	\$2,000,000	\$2,000,000
Subtotal –Project Costs	\$150,000	\$150,000	\$35,000	\$2,035,000	\$2,035,000	\$2,035,000	\$2,035,000
Net revenues	-\$150,000	\$500,000	\$1,265,000	-\$527,000	-\$318,780	-\$110,334	\$98,345

The proforma is a developer document that shows its expectations of the project’s financial performance (see Exhibit 6). When the TIF has only one developer and only one project, the proforma feeds directly into the government’s feasibility analysis. When there are multiple

developers with multiple proformas, the government must combine the data into one document.

Developers expecting to receive public subsidies should be willing to divulge information in the proforma. Although the developer bears the burden of preparing the proforma, government officials should remember that the developer has a stake in the outcome and cannot be expected to be completely impartial. The government must perform its own due diligence on the developer's numbers, comparing them to market benchmarks and to previous actuals from similar projects undertaken by the developer.

**Exhibit 6 • Feasibility Analysis Component –
Operational TIF Projects**

Parcel	Project Description	Square Feet/ Units	Average Market Value	Square Feet Generating Sales Tax	Average Sales Square Feet/ Units
Parcel 1	Residential	150 units	\$300,000 per unit	0	0
Parcel 2	Book store	20,000 sq.ft.	\$100	20,000	\$300
Parcel 3	Grocer	11,000 sq.ft.	\$100	11,000	\$600

What factors determine whether a TIF revenue projection is accurate?

There are at least three critical factors that enable governments to generate accurate revenue estimates from TIF projects:

Market values. TIF properties often have a benchmark value or range familiar to experienced economic development officials or TIF consultants. As indicated in Exhibit 6, certain formulas or benchmarks are used, such as dollar per residential unit, or sales tax per square foot. A precise estimate requires knowledge of specific residential or commercial market niches, as well as reasonable estimates of value for each niche.¹⁰ This specialized knowledge is important: a TIF consultant familiar with the market values for entertainment-based TIF projects may not have know the market values for hotel projects, for example.

Absorption rates. Commercial or residential space created in a TIF district is not immediately built or absorbed by the marketplace. In some cases, TIF properties are phased in over several years. A sound revenue estimate takes into account construction schedules, regulatory approvals (such as building permits), tenant lease-up rates, and other factors that determine when units hit the market.

Familiarity with the assessment process. Often, the government sponsoring a TIF district is not the entity that assesses the taxes. Officials of the sponsoring government need to become knowl-

¹⁰ Significant deviations from historical, industry, or market benchmarked metrics should be carefully investigated by the issuing government and validated or explained by the developer.

edgeable about assessment practices since the timing of expected revenues is directly affected by it. They must be able to accurately determine the lag time from when a TIF property is valued by the market (that is, when a transaction occurs, such as sales or lease of commercial space to tenants) to when it is valued by the government. In states where the assessment is not conducted annually, there is a significant lag time between market valuation and assessment valuation. TIF consultants can be engaged to help with this analysis.

Many larger governments have a revenue forecasting division. While a revenue forecasting staff may be useful (e.g., in terms of understanding administrative provisions of taxes), the revenue estimation techniques they use may not readily apply to TIF district revenue forecasts. (For example, the revenue forecasting staff may use top-down revenue estimation models or econometric techniques that are applied to historical revenues for the entire jurisdiction. Revenue forecasting for a TIF requires a bottom-up approach where the revenue estimate is developed parcel by parcel, relying on knowledge of industry trends.)

What happens to TIF surplus funds?

Successful tax increment financing projects generate annual revenues that exceed yearly costs, so that over time a surplus can accrue to the government. True surpluses need to account for obligations that may not necessarily trigger an immediate disbursement of funds, but are nonetheless potential claims on TIF resources. For example, the government may have bond covenants establishing that it will maintain a debt coverage ratio of, for example, 1.5 (annual revenue inflows are 1.5 times debt service outflows). Tax objections represent another potential claim on resources.

Governments have at least two options when deciding how to allocate surplus funds. First, the government can continue to build annual surpluses that grow over time. This option gives the government the potential to call or retire bonds before the scheduled maturity date. Overlapping units of government are then able to share in the incremental taxes after the TIF is dissolved.

Second, it can disburse surplus funds to other government units, either on an ad-hoc or formal basis. Formal revenue sharing with local governments may be mandated by state law or can be negotiated when the TIF is formed. Although these formalized arrangements may also benefit overlapping taxing districts, they represent a claim on TIF resources and increase risk to bondholders (if bonds are issued) and could potentially raise the government's borrowing cost. This option is likely to extend the TIF district's life span.

What types of TIF-related bonds do governments issue?

Tax increment or tax allocation bonds represent debt financing for TIF-related projects. Although sometimes defined as bonds solely supported by incremental revenues, here it is defined more broadly to include bonds supported by:

- Incremental revenues (revenue bonds);
- The full faith and credit of the issuer (general obligation bonds); or
- A mix of the two.

Governments may support TIF bonds not only with incremental property tax revenues (which are often formally pledged) but also with sales tax and other revenues that are projected to increase during the life of the project. TIF-related bonds can be issued either by the city or county government that sponsors the TIF, or in some states by a redevelopment agency (typically a subsidiary of the government) empowered to issue bonds.

There is a tradeoff between the risk of the financing instrument and the interest rate. A government can absorb the risk of a bond issuance by issuing general obligation (GO) bonds, extending its full taxing powers to support the bond issue, and thereby reducing the risk to bondholders. While this results in a lower interest rate, governments in fact are taking on the risk that the TIF project will be financially viable. If it fails, government taxpayers are still responsible for retiring the bonds and would have to draw upon general fund revenues.

TIF revenue bonds are not backed with a full pledge of the sponsoring government. Although they lower the government's exposure to project-failure risk, they shift the risk to investors underwriting the bond. As a result, such bonds typically command a higher interest rate. These costs can be mitigated in cases where the developer pledges to purchase the bonds.

Some finance officers observe that TIF revenue bonds, while not resulting in a formal pledge of full faith and credit, may create a moral obligation in the event a TIF project fails. In this scenario, a TIF project that does not produce sufficient revenue to retire a revenue bond would create a moral obligation to use general fund resources to make timely payments on a revenue bond.

Exhibit 7 • Comparison of TIF Bonds

Type of TIF Bond	Risk to Government Issuer	Risk to bondholder	Interest Rate
GO	Greater	Lesser	Lower
Revenue	Lesser	Greater	Higher

How are TIF bond proceeds invested?

Governments can invest TIF bond proceeds using either a segregated account (such as a trust arrangement) or in a pooled account. Some governments pool or commingle bond proceeds with other surplus funds – funds not needed for immediate operating needs or immediate disbursement – that a government invests for operating purposes. The City of Portland, Oregon, for example, pools bond proceeds on behalf of the Portland Development Commission with other city dollars not required for immediate use or disbursement. The city is able to obtain economies of scale in investment and reduced transaction costs by commingling funds, while providing separate investment accounting for TIF funds.

Like other investments, bond proceeds are governed by state statutes and local investment policies that establish a number of controls over the invested assets.¹¹ For example, investment policies will typically impose the following requirements to manage investment risk:

- Diversification requirements (e.g., a limit on the number of securities purchased by one issuer);
- Credit quality requirements; and
- Limits on maturities.

Government investment officials ensure that the portfolio has sufficient liquidity to meet scheduled disbursements, such as payments for debt service, payroll, or vendor services. This requires

¹¹ Investment options may also be restricted by provisions in a bond ordinance and/or indenture.

the government to develop a detailed cash flow forecast before implementing an investment strategy, and then executing a strategy that generates needed liquidity. Investment techniques such as bond laddering or disbursement matching are examples of strategies that can provide desired liquidity.

Although bond proceeds can be pooled with other surplus funds, the investment of the proceeds is differentiated by two important factors. First, bond proceeds may have a different, possibly longer investment horizon. Since the government issuing TIF bonds may have a debt repayment schedule that extends over twenty years or more, bond proceeds can be invested much further out on the yield curve if desired. Second, the regulatory framework is different: government investment officials need to comply with federal arbitrage regulations and bond agreements or covenants that determine the parameters of the investment program.

What criteria do rating agencies use to evaluate tax increment bonds?

Rating agencies generally rate bonds upon four sets of broad criteria. These criteria are especially relevant to general obligation bonds issued for a TIF district, but they generally apply to other TIF-related bonds as well.

1. *Quality of administration* – These qualitative factors take into account the soundness of a government’s general and financial management, such as establishment of rigorous annual and capital budgeting, adherence to investment policies, maintenance of effective employee relations, and other practices.
2. *Debt indicators* – These include debt capacity and using indices for existing and projected debt levels (e.g., direct debt, debt per capita etc.).
3. *Financial performance* – This factor assesses the government’s budgetary performance, examining trends in revenues, expenditures, reserves, and fund balance as well as other measures.
4. *Economic base* – This factor considers the strength of the private sector supporting government-sector services. Measures include income, population, annual building permits, employment levels, and major taxpayers. Although the government does not have direct control over the economic base of its area, economic development efforts can serve to strengthen it.

When evaluating the creditworthiness of TIF-related bonds that are supported only by in-

cremental revenues (non-GO bonds), rating agencies consider additional risk factors. These factors include:

- *Tax base concentration* – A tax increment district often depends upon just a handful of large taxpaying businesses, such as a shopping mall’s primary or anchor tenants; creditworthiness is enhanced by a greater number and more diverse variety of taxpayers.
- *Market competition* – Certain firms, such as retail businesses, may be subject to intense competitive pressure, or may face unexpected competition mid-way through the life of the TIF project. When this happens, the firm’s revenues are eroded, which in turn depresses incremental property taxes and, if applicable, sales taxes.
- *Revenue or rate limitations* – With most TIFs, the government or redevelopment agency operating the TIF district cannot increase the tax rate to compensate for an erosion in the tax base. Any change in state law governing property tax revenue (e.g., limiting increases in assessed value) makes it difficult for governments to realize projected incremental revenues.

As mentioned, debt indicators are a rating criterion generally applicable to any bond issue, but these may be given somewhat greater weighting for TIF bonds supported only by incremental revenues.

What risks do bondholders face in buying TIF bonds?

Like any bonds, TIF bonds present three risks to investors: market risk, credit risk, and event risk. Both general obligation (GO) and non-GO TIF bonds pose these risks, but credit risk is of particular concern with the latter. All three types of risk are reviewed below:

Market risk – Market or interest rate risk is the risk that a bond will drop in value when prevailing interest rates rise; there is little that an investor can do to manage this risk other than to shorten the duration of his or her municipal bond portfolio; likewise, there is little that a government issuing bonds can do to help investors, except to issue variable rate bonds.

Credit risk – Credit risk is the possibility of the issuer not making payments to bondholders, in full and on time; investors can manage risk by purchasing highly rated bonds and diversifying their bond portfolio; governments can help investors by either pledging full faith and credit and/or obtaining municipal bond insurance.

Event risk – Although rating agencies assess the credit risk that is measurable and can be projected forward over several years, some risks cannot be measured or predicted based on available data. For example, natural disasters, fraud, or malfeasance – such as that committed by Orange County, California, officials in 1994 – are inherently unpredictable.

Bondholders are compensated for the risks that they take when purchasing the bonds, and the riskier the bonds, the greater the compensation. The compensation is reflected in the interest rate spread between the TIF bond issue and a low-risk security such as a Treasury bond.

What can governments do to obtain a better credit rating?

Bonds supported only by incremental tax revenues are often viewed as poor credit risk, and are not likely to be rated investment grade. As a result, governments often will not seek a credit rating and the bonds will necessarily be sold at a higher interest rate.

A government that desires a rating, however, can take several steps to improve its credit rating (apart from pledging full faith and credit). First, it can establish a higher debt coverage ratio, which is the ratio of annual tax increment divided by annual debt service.

Second, it can expand the TIF boundaries to increase the number of taxpayers and reduce the tax base concentration. Standard & Poor's observes that a larger district, generally exceeding 150 acres, is typically more creditworthy.

There are practical limits to expanding TIF boundaries. From a public policy standpoint, the practice could violate the *but for* objective, since expanding the TIF would allow the government to tap incremental revenues from additional properties that are growing without any subsidies. It could also engender opposition from school districts and other overlapping governments that would lose incremental revenues from these areas.

Is there an ideal debt coverage ratio for bonds supported by incremental revenues?

There is no hard and fast rule for what the debt coverage ratio should be. One rating agency, Fitch Ratings, uses two tests to determine if a non-general obligation TIF bond will be investment grade:

- Net incremental revenues to the government issuing the bond must be at least 100 percent of the level of debt service in the year preceding debt issuance; and
- Net incremental revenues in the following year must be at least 110 percent of debt service.

Net incremental revenues are revenues available for debt service, after deducting revenues that are shared with other governments (e.g. in California, a percentage of incremental revenues is earmarked for low-income housing and in many states municipalities form a revenue sharing agreement with schools). Debt coverage ratios may need to be adjusted upward if the TIF presents unique risks, such as excessive tax base concentration.

Governments can act to increase debt coverage ratios. At the front end it can be achieved through careful selection of TIF developments, and rejection of developer proposals that will not engender sufficient revenues to achieve a high debt ratio. At the same time, the government can size the bond issue so that it results in a level of annual debt service that produces a target debt coverage ratio.

In addition, governments can wait to issue long-term debt until incremental revenue is actually collected and disbursed to the government sponsoring the TIF district. At that point, the incremental revenues would no longer be considered speculative and the government would be able to demonstrate the TIF district's financial strength.

What documents do rating agencies need to evaluate tax increment bonds?

Rating agencies need a variety of documents not only to determine ratings at the time of bond issuance, but also to judge whether ratings should be upgraded or downgraded in the future. TIF-sponsoring governments have many of these documents on hand, since they are needed to perform their own due diligence:

TIF documentation

- City council resolutions or ordinances establishing the TIF district, enacting the TIF plan, and approving TIF bond issuance;
- Agreement or agreements between the governments and developer(s);
- Intergovernmental agreements, such as for revenue sharing;
- Tax collection agreements;
- Market studies and or project feasibility studies; and
- Sample tenant leases (e.g., between the developer and anchor tenants).

Bond documentation

- Trust indenture/resolution;
- Loan/lease agreements;
- Official statements;
- Surety or revenue insurance;

-
- Debt service cash flows; and
 - Information about the bond insurer.

In addition, for tax increment bonds issued after a TIF project is producing revenue – that is, a mature TIF – rating agencies may request annual financial audits or reports issued to state oversight bodies, if applicable.

Will insurance companies provide credit enhancement for tax increment bonds?

Municipal bond insurance companies provide credit enhancement for only certain types of TIF bonds. They are likely to insure TIF general obligation bonds that are backed by a government pledge of full faith and credit. In addition, they may insure TIF bonds that are backed only by the pledge of incremental revenues. In the latter case, however, it may be necessary for the government to first obtain an investment grade credit rating (BBB or better, for example). Should the government be unable to obtain an investment grade rating, or should the bond be unrated, a bond insurance company likely will decline to provide credit enhancement.¹²

It can be beneficial to obtain credit enhancement for a TIF bond issue. Generally, the application of credit enhancement to the government's bond issue raises the rating to a top tier, such as AAA. This results in a significant reduction in the yield necessary to attract investors. This yield reduction (measured in basis points) translates into a reduction in annual payments of principal and interest, which would have to be compared against the premium paid to the bond insurance company. According to one large municipal bond insurer, governments generally break even on bond insurance premiums around the mid-point of the bond repayment period (e.g., in year 10 of a twenty-year bond issue).

¹²TIF projects that have a proven revenue stream are more likely to obtain a credit rating.

What are the benefits of a financial policy governing tax increment financing?

Most local governments have policies that determine how they invest assets for cash management or pension objectives, yet few have policies that govern how tax dollars are invested for economic development or tax increment financing. This is true despite the fact that government economic development subsidies represent undiversified, risky investments costing millions of dollars each year in outlays or foregone taxes.

Although not widely used, TIF policies offer a number of benefits to governments:

- Like any financial policy, they strengthen the government internal control environment.
- They establish a level playing field for all developer proposals. Many times a TIF district is not initiated by a municipality, but rather by a developer requesting public assistance. Established policies help the government deal consistently with all developers.
- They help ensure that public subsidies are not squandered on high-risk, low-return investments by guaranteeing that newer staff have guidelines on historical practice, and that the pertinent data collection and analyses are carried out.
- They help coordinate TIF planning with other planning processes, such as the annual budget cycle.
- They offer a bridge between city strategic plans and objectives and the activities needed to realize them.

The City of Minneapolis, Minnesota, has established a detailed TIF financial policy that provides many of the benefits mentioned above. It sets policy goals and objectives and identifies key decision makers responsible for TIF project evaluation. Moreover, the policy spells out techniques for evaluating TIF projects that go beyond state statutes to provide detailed guidance to economic development staff. It also contains general guidelines that establish pay-as-you-go financing as a preferred financing tool over debt financing.

The policy also details economic and risk analysis criteria to protect the city's financial interests. It contains economic criteria for project selection that build on the basic blight and *but for* criteria in state law. For instance, the policy requires that the city compare the ratio of public to private investment against other city public-private partnerships to determine if it is reasonable. It also mandates that staff carry out quantitative cost/benefit analysis as a standard practice.

How does a government protect its financial position vis-à-vis a developer?

Depending on the type and scale of a TIF project, a government may seek the services of a developer that will manage a TIF project. To a great extent, the success or failure of a TIF project hinges on the government's ability to prudently select a qualified developer and then properly structure the relationship. Central to structuring the relationship is a sound municipal-developer agreement that protects the government's financial position during all project phases.

A qualified developer will have the requisite experience for the type of TIF project envisioned by the government. For example, a developer experienced in downtown redevelopment would not necessarily be a good fit for a government seeking to build new construction on previously vacant land on the suburban periphery. According to a bond underwriting firm experienced in tax increment financing, a developer should have verifiable experience in:

- Managing construction of projects similar in size, scope, and use to the one anticipated by the government, having successfully met project milestones;
- Lease-up and tenant retention of projects similar to the government's; and
- Post-construction management and site maintenance.

Additionally, the government should verify that the developer and/or its subsidiary corporation assigned to the government's TIF project has the

financial capacity to meet its financial commitments.

A government needs to exercise due diligence in crafting a municipal-developer agreement. Important provisions include, but are not limited to, the following:

- Putting construction and permanent financing in place before the expenditure of any government moneys or the conveyance of land;
- Obtaining long-term leases from important tenants, such as anchor tenants;
- Obtaining an as-built appraisal of the property, using a government-selected appraiser;
- Disclosure of the amounts and sources of all of the developer's project funds;
- Agreeing on a schedule for releasing public funds, so that the ratio of disbursed public/private funds is kept constant through construction phases;¹³ and
- Monitoring compliance with performance measures in the agreement (such as construction of a certain amount or percentage of residential units or commercial office space by a specific date) and imposing penalties for non-compliance.

¹³For additional information on structuring the developer relationship, refer to Thomas Gavin, *Tax Increment Financing: A Primer for City Policymakers*, a white paper published by Robert W. Baird Incorporated; and Kurt Froehlich, "Practical Considerations in Negotiating and Drafting Development and Redevelopment Agreements," *The Urban Lawyer*, (Fall 1994): 73.

GFOA RECOMMENDED PRACTICE

Economic Development Incentives (1990)

Background. Economic development incentives are tools used by state and local governments to retain or attract jobs and/or tax base. There are expenditures and/or opportunity costs as well as potential or actual benefits associated with these incentives. These costs and benefits often do not clearly appear in a budget or financial statement, and if they do, the overall impact of these incentive costs and benefits often take place over many years.

Recommendation. The Government Finance Officers Association (GFOA) recommends that any jurisdiction's economic development incentives have specific goals and criteria that serve to define the economic benefit both the government and the entities receiving the incentives expect to gain from the incentives, the conditions under which the incentives are to be granted, and the actions to be taken should the actual benefits differ from the planned benefits.

For any specific economic development incentive, it is recommended that the economic benefit to the government, as well as the cost of the incentive, be measured and compared against the goals and criteria that have been previously established.

APPENDIX

Profiles of TIF Districts

Jurisdiction: City of Portland, Oregon

Goal:

The district (referred to as an urban renewal area) is adjacent to the southern edge of the downtown, containing vacant parcels or tracts that had been underutilized. The goal for this TIF project was to redevelop the area into a mixed-use, central city neighborhood, with both commercial and residential land uses.

Types of subsidies:

Land assembly (land acquisition, land condemnation, relocation subsidies for existing businesses). Additionally, the city undertook several infrastructure improvements, including street-scaping, roadway construction, enhancement to municipal parks, extension of the streetcar system, and construction of an aerial tramway (a gondola connecting a major university employer's facilities).

Revenue sources:

Subsidies were financed using property taxes, city system development charges (for transportation/parks improvements), and federal grants (streetcar).

Performance measures:

Achievement of city policy goals (e.g., output measures for job creation, number housing units and/or affordable housing units) and dollars of private development (return on public investment).

Contact:

Portland Development Commission

Jurisdiction: City of Evanston, Illinois

Goal:

Prior to redevelopment, the district contained underutilized parcels (e.g., surface parking) located on the western edge of the downtown business district. The goal for this multi-stage TIF project was to a) create a joint venture research park between a leading Big Ten university and the city and b) develop other parcels for parking garage, commercial (hotel, restaurant, entertainment, office), and residential land uses. The district is situated near a regional commuter train line and light-rail train line that reaches the central city (Chicago).

Types of subsidies:

Land assembly (land acquisition, land condemnation, relocation subsidies for existing businesses), construction of parking garage, operating subsidy for parking (discount for hotel guests and moviegoers), and hotel property tax rebate (on a portion of the property taxes based on a formula of taxation per square foot).

Revenue sources:

In addition to property tax increment, revenues supporting TIF costs include sales taxes, hotel taxes, amusement taxes (from newly constructed movie theater), and parking revenues.

Performance measures:

For the comprehensive annual financial report and a state-mandated annual report, the city tracks incremental revenues and expenditures (inputs) on an annual and cumulative basis since the formation of the TIF. Additionally, it tracks progress on TIF projects using measures such as leverage ratios (dollars of private investment divided by public investment dollars), annual EAV growth, and occupancy rates on office space and sales of condominium units, expressed as a percent of total available space.

Contact:

City of Evanston Planning Division

Jurisdiction: City of Milwaukee, Wisconsin

Goal:

Redevelop a strategic and visible center of business and entertainment in the heart of the city's downtown. Construction of a 940-space public parking structure would in turn make possible the construction of a mixed-use private development (high-end residential condominiums, 220,000 square feet of leased office space, and another 24,000 square feet of ground floor retail space). The public parking structure, owned by the city, accommodates condominium tenants, employees, retail customers, as well as the public.

Types of subsidies:

In-kind subsidy of parking garage construction

Revenue sources:

Property tax and parking garage receipts

Performance measures:

Performance measures were devised to answer two questions. First, is the proposed project likely to be successful? To address this, the city estimated the internal rate of return to the city as well as the net present value over at least twenty to twenty-five years (beyond the expected life of the district). Second, is the proposed subsidy necessary to make the project happen? This involved assessing the expected private investor returns to confirm that strictly private financing of the proposed public parking structure was not financially feasible.

This requires forecasting a cash-on-cash return to the developer along with the proceeds from the ultimate sale of the private development ten to twenty years after construction.

Contact:

Redevelopment Authority of the City of Milwaukee (RACM)

Jurisdiction: Village of Deerfield, Illinois

Goal:

The TIF district was located on both sides of a planned regional arterial road that was subsequently built. The district had consisted of vacant parcels, underutilized parcels, and non-polluted industrial uses. The goal was to redevelop the area into mixed-uses, including of-
fice-research and retail, which would be compatible with neighboring residential land uses.

Types of subsidies:

Primarily infrastructure improvements—modernization of the village-owned sewerage treatment plant; construction of a new collector roadway (traffic levels between a regional arterial road and a residential street) with a grade crossing of rail lines; extension of water and sewer mains; and reclamation of a non-hazardous waste landfill. The latter resulted in the construction of a combined village/park district public works facility and adjacent park. In addition, TIF revenues contributed to the construction of a new senior center with additional private resources.

Revenue sources:

Property tax. Projects were financed with bond proceeds serviced by the TIF property tax increment and subsequent additional incremental property taxes.

Performance measures:

Increase in assessed valuations. (Base property valuation of \$14 million in 1982 has grown to over \$173 million in 2003 tax year. Over \$107 million in surplus revenue has been returned to the local taxing districts and district was terminated early.)

Contact:

Village of Deerfield, Finance Department

Resources

The International Economic Development Council

Association representing state and local officials and private-sector consultants involved in economic development.

<http://www.iedconline.org/>

The Illinois Tax Increment Association

State association representing private-sector advisors and local governments using TIF as an economic development tool.

www.illinois-tif.com/

Civic Federation

Non-partisan government research organization performing assessment of metropolitan Chicago government programs, including an impact analysis of city and suburban TIFs.

http://civicfed.org/articles/civicfed_134.pdf

National Association of Realtors

Report commissioned for national association representing real estate brokers.

<http://www.realtor.org/SG3.nsf/Pages/TIFReport?OpenDocument>

City of Minneapolis, Minnesota

Financial policy governing use of TIF subsidies.

http://www.ci.minneapolis.mn.us/cped/tax_increment_policy.asp