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TAX INCREMENT FINANCING: PROS, CONS, AND EXAMPLES

Can TIF Strategies be the Key to Your Next Commercial Real Estate Project?

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Savvy financing instruments are available to developers of real property to fund the redevelopment of old commercial properties to combat urban blight. This article explains how Tax Increment Financing works, with examples of success stories and cautionary tales, TIF benefits, and some TIF drawbacks.

TIF Overview & Background

Tax Increment Financing (TIF) is a popular mechanism in the United States today. It's goal is to allow developers and local governments to collaborate in the redevelopment of old or abandoned properties into renewed, vibrant neighborhoods and other kinds of projects.

Some of the best contemporary mixed-use developments (where people "live, work and play") were once rundown or underused areas revitalized using TIF schemes — places that might otherwise have contributed to urban blight for many years. Given US EPA estimates of more than 450,000 brownfield sites in the country, TIF could be of value in many redevelopment projects.

A Valuable Redevelopment Option

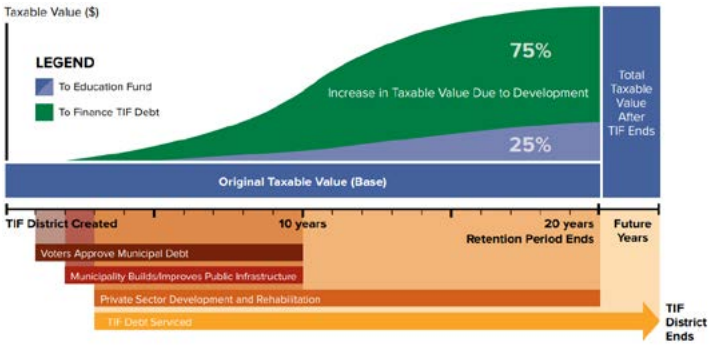
The TIF concept is quite easy to understand and is a useful financing mechanism in certain circumstances. However, TIF is controversial for a variety of reasons, including poor or inappropriate implementation of the strategy, and the challenge of gentrification. Success stories exist, yet community activists have organized against abuses of this mechanism. TIF schemes could be valuable in redeveloping older properties, but it's crucial to avoid the common shortcomings.

TIF Financing Basics

Let's begin by describing how a TIF arrangement typically works.

A developer or a local government (or both) study an area that could benefit from redevelopment. This could be a former garment district (for instance) with decrepit red brick factories, or an unappealing industrial shoreline or port land that's crying out for redevelopment. TIF districts are often determined inside "opportunity zones" identified by local or regional governments, though not always. TIF can even be used to replace aging public transit infrastructure. *(See sidebar on Transit TIFs on last page.)*

A TIF district emerges when the authorities first figure out the "base taxes" the area generates in its current condition, then extrapolate the base over a period of time (typically around 20 years). State and local authorities continue to receive these "base taxes" throughout the life of the project, and beyond. *(See diagram.)*



The authorities then estimate the *increased tax revenue* that will flow from the district once improvements are made. This increased tax revenue *increment* is made available up front to developers to help finance or jump start the improvements. Projects are preferred that wouldn't occur "but for" the TIF financing (which gives us the "but for" provision in many TIF contracts).

Typically, bonds are issued to reflect the increased revenue, with the money given to the developer to complete their project. Over the next 20 years, "incremental" higher tax income from rising assessments is used to pay off the bonds. When the term of the TIF ends and the bonds are repaid, all future tax revenue

The Cortex REDEVELOPMENT

In the State of Missouri, a TIF district freezes the property taxes within the district and then requires property owners to make Payments in Lieu of Taxes (PILOTS) to a special fund. The state also allows for up to half of local income and sales tax revenue generated by new economic activity to be captured and placed in the special-allocation fund.

This money is used to reimburse the developer or to retire debt from bonds used to finance development. (We see already here that TIFs have different permutations.)

Back in 2016 St. Louis had over a hundred TIF projects in place, establishing the city as one of the most active TIF areas in the United States. Around $2 billion of public tax dollars were redirected to area developers via TIF schemes. A 2011 survey discovered that about 80 percent of the projects were retail-oriented developments, with most of the remainder residential.

Large Mixed-Use Undertaking

The Cortex Redevelopment Plan was approved in 2012 and is an excellent example of a large mixed-use undertaking. The TIF district included new offices, research facilities, retail outlets, a healthcare facility, recreational open space, and a new public-transit station. All of this was built on mostly vacant land (the result of economic decline and people moving away).

Up to 2,400 New Jobs

The scheme is due for completion in 2024 at an estimated cost of upwards of $2 billion, including $158.2 million in TIF funds. In its first phase, Cortex leveraged around $10 million in TIF funds to attract and deploy $155 million of investment. Around 955 technology and management jobs were created in the area. The second phase is expected to generate $186 million for the district, along with 1,400 additional well-paying, permanent jobs. Over the course of 25 years, Cortex is expected to produce an estimated 2,400 jobs. In 2016 Cortex already saw 4,100 people working for 260 companies, amid burgeoning activity such as new hotels, apartment complexes and retail centers.

flows to the municipality and state. The strategy is a bit like buying a house: by financing the purchase with a mortgage, buyers enjoy living in the house while paying it off over time.

Know the Pros and Cons

TIFs are responsible for some of the enticing new neighborhoods popping up across North America in place of old industrial sites, often surrounded by chain-link fencing or with some contamination present. Sometimes projects are as specific as a single building. Let's look at some of the "pros" of TIFs, then list some of the "cons."

TIF PROS:

- TIFs stimulate redevelopment of blighted areas years before such activity might occur naturally (if ever).
- TIF projects can restore older buildings with historical value.
- TIFs can support an infrastructure expansion strategy.
- TIFs promote partnerships between government and the private sector that might not occur otherwise, and create future increased revenues for government.
- They attract construction where it might not otherwise occur, and can inspire a higher quality of project than ones where no funds are available.
- TIFs may revitalize urban centers, public transit, and cultural attractions such as art galleries and theatres. For instance, redevelopment of the Hammer Theatre — owned by the City of San Jose and operated by San Jose State University — was funded in large part by the San Jose Redevelopment Agency.
- TIFs raise the value of the tax base, granting local and regional governments larger budgets (once the TIF is retired, i.e., when the bonds are repaid).

TIF CONS:

- TIFs may set different urban areas and different levels of government in competition with one another over funding. Cities can obtain revenues that would otherwise have flowed to overlying government levels or school districts.
- It can be difficult to assess precisely how much an incremental gain in tax revenues relates to the TIF project.
- TIF financing sometimes lacks transparency, which can generate public suspicion that the TIF district program is undesirable or not being operated legitimately or even legally.

- TIFs are sometimes used like slush funds by politicians to achieve conflicted or questionable legacy projects in violation of the TIF agreement. (Egregious examples abound in the City of Chicago that is revising how it implements TIFs. Other examples include expensive sports stadiums and entertainment complexes.)
- TIFs may upgrade a neighborhood to such an extent it's unaffordable to the original residents, who are subsequently displaced.
- TIFs may be implemented to finance projects that would have been built anyway, violating the aforementioned "but for" principle.
- TIFs are not always successful, sometimes failing to attract anticipated development and private investment. They may simply underperform.

TIF Success Stories

An example of a successful TIF project is the Cortex Redevelopment Plan (also known as the Innovation District Redevelopment Area) — one of the largest TIF-supported undertakings in St. Louis, Missouri. This example is adapted from Improving Tax Increment Financing (TIF) — a recommended and quite comprehensive "policy focus report" written by David Merriman on behalf of the Lincoln Institute of Land Policy based in Cambridge, Massachusetts.

The Cortex Redevelopment Plan illustrates the use of tax-increment financing in the context of a large city facing economic and competitiveness challenges. Cortex has paired with two major universities in the area — Washington University in St. Louis and University of Missouri — as well as private, nonprofit, and government organizations. (See sidebar on previous pages.)

Chicago Navy Pier CONTROVERSY

Navy Pier is one of Chicago's biggest tourist draws. The site is home to souvenir shops, a large Ferris wheel, and the Chicago Children's Museum. Set along picturesque Lake Michigan, Navy Pier is far away from the many TIF districts that, taken together, represent a quarter of all properties in the city.

TIF spending rules vary, but what they all have in common is the money isn't allowed to be spent on projects outside designated districts or even adjacent ones. As has been reported in media stories, Navy Pier doesn't qualify for TIF funding, yet money was directed to the attraction anyway.

Redirected Funds?

Under former Mayor Rahm Emanuel, the city allocated more than $1.6 billion in TIF funding for various projects. Of this, $55 million was allocated to acquire land and construct the McCormick Place hotel (formally called the Marriott Marquis Chicago). This was one of the largest contributions granted in Emanuel's term involving a private partner.

Disturbingly, the $55 million was never intended to be used for the hotel; instead, the funds were redirected by hotel project administrators into the coffers of Navy Pier Inc. (NPI).

Chicago's system provides insight into the nuts and bolts of how TIFs work, at least in Cook County (where the city is located). Property taxes are based on a taxing district's "levy request" and the Equalized Assessed Value (EAV) of the parcels in the district: together these generate the tax rates that appear on a property tax bill.

When a TIF is formed, the EAV for the TIF district is frozen for the life of the TIF. (This is typically 23 years in Cook County). Tax revenue collected above the frozen value goes into the TIF fund. Since 1986, more than $5 billion has been collected by Chicago from TIF districts.

Secret Budgets?

Problematic issues include "porting" — which occurs when funds are transferred to an adjoining TIF, in another neighborhood. In Chicago, the concern among community activists has been that the term "urban blight" is used too loosely, and the enormous TIF diaspora represents parallel budgets (i.e., political piggybanks, secret budgets).

This is why the Navy Pier project's utilization of TIF money was so disturbing. It signified everything people found troubling.

In the final analysis, the transfer of TIF funds to Navy Pier was papered over when the McCormick Place hotel opened along with the neighboring 10,387-seat Wintrust Arena (constructed for DePaul University basketball games). In July 2013, just two months after Mayor Emanuel unveiled Elevate Chicago, MPEA CEO Reilly emailed other MPEA officials and NPI executives that the $55 million TIF award for the hotel "will enable MPEA to grant $55M to NPI for its reconstruction project."

Other examples of success include the Case apartment building — an infill development in Dallas — that, along with the renovated Murray Street Coffee Shop, has attracted more residents to the Deep Ellum TIF District in Dallas, Texas. And there's the 2009 Jefferson County TIFID Plan, which proposed the Sunlight Business Park in Montana.

TIF can be used for infrastructure projects such as large transportation corridors. *(See boxed item on last page.)*

Organized OPPOSITION

Anyone interested in TIF should learn the thinking and strategies of possible opponents. Developers and consultants could benefit from watching this segment from The Real News in which TIF instruments are described in unflattering terms as The Neoliberal Scam: Public Money for Private Playgrounds.

The segment delves into the $106 million TIF tax break in the form of upfront bonds for the Harbor Point development in Baltimore, Maryland, which translates into $235 million in forgone tax money for the community, and $1.2 billion in the case of Port Covington (another Baltimore development). In one scene a volleyball court that's supposedly part of a public beach is only available to patrons of the beachfront restaurant. Such gentrification excludes less affluent members of the public.

Misuse of the TIF strategy and gentrification has led some activists and communities to pursue another approach, often called Community Land Trusts (or similar names). In those arrangements, funds are provided to acquire the underlying land of a neighborhood and place it in a trust structure, which helps mitigate against land speculation and sudden increases in rents and house prices. *(We'll explore Community Land Trusts further in a future article.)*

…and Cautionary Tales

Not all TIF districts in St. Louis have been as successful as Cortex. A 2018 summary on the city's website lists approximately 180 TIF districts. Many are still active, so it's difficult to determine their success; roughly 20 of the TIF districts were terminated before completion, and approximately 16 ultimately failed to get approval after potential developers filed applications with the redevelopment agency.

In Kansas City, Missouri, eight times as many TIF deals were approved in affluent areas such as Country Club Plaza than in poorer areas like East Kansas City (which has poverty rates above 30 per cent).

According to the website *Governing*, "TIF is controversial because it's become a financing source, and in some cases a slush fund, for some municipalities to speculate on private redevelopment projects… it's also been used for the controversial practice of performing eminent domain for private uses, such as when Detroit demolished a neighborhood for a GM plant."

Slush Funds for Developers?

Perhaps the best example of problematic application of TIF comes from Chicago; since 1979 more than 500 TIF districts have been created in Chicago's Cook County, but politicians have often failed to implement them with transparency.

UIC Professor Rachel Webber says, "For years officials haven't been able to follow the money trails."

Tom Tresser on *Chicago Tonight* said TIF stands for "taking it from schools" and alleges they're secretive slush funds for developers. TIFs, he argues, hoard money in wealthy communities and starve the poor ones.

An example of egregious abuse of the TIF strategy is what happened at Chicago's Navy Pier. According to a *City Lab* article, to renovate the lakeside attraction Mayor Rahm Emanuel used $55 million in TIF dollars — ostensibly meant for fighting blight — and passed it through another project in order to disguise use of the funds to construct a tourist attraction. *(See sidebar on previous page.)*

Reforms on the Horizon?

Chicago Deputy Mayor of Economic Development Samir Mayekar stated that the city is bringing "sweeping reforms to the TIF system, in order to bring more transparency, accountability and equity to the system in terms of how public dollars are administered."

A Special Case: TRANSIT TIFs

How Transit TIFs Work

Transit TIFs are intended to provide funding for public transit projects and differ from traditional TIFs in several ways: they may run for 35 years rather than the typical 23 years, "blight" need not be demonstrated, and TIF revenues are distributed in part to the other taxing districts that intersect the TIF. The RPM1 Transit funds are intended to repay $622 million in transportation infrastructure loans which were set up as matching funds for state and federal grants.

The Atlanta BeltLine Project - In 2004, the Atlanta BeltLine TAD was approved by the city council with the support of the mayor. In 2006, Invest Atlanta, formerly the Atlanta Development Authority, formed the Atlanta BeltLine Inc., and a $60 million capital campaign was launched to support the project. By 2008, the capital campaign was 50 percent complete, and more than $60 million dollars of bonds were sold to investors with backing of TIF revenues. Over the next several years, the BeltLine project increasingly emphasized environmental responsibility, equitable development, and affordable housing. Construction proceeded on several transportation, recreation, and housing projects.

It seems the city is taking the need for reform seriously, and provides an online TIF portal that allows greater transparency for all stakeholders.

Conclusions & Recommendation

Tax increment financing is an important and widely used tool to promote economic development, especially in areas facing blight and other significant economic challenges. TIF performs best when the public and private sectors work together to stimulate economic development. TIF can be a useful tool to create commitments that engender trust among the various parties involved and lead to successful implementation of development plans.

Unfortunately, the design of TIF in some states makes it vulnerable to exploitation by cities, which can obtain revenues that would have otherwise gone to overlying governments, especially school districts.

TIF has been used very unevenly across states, with extensive use in Midwestern states, for example. Critics say TIF has been used disproportionately in areas that were already moderately prosperous, and should be used more to benefit depressed areas.

Transparency and monitoring are very uneven at the municipal and state level. Studies suggest TIF often fails to deliver economic growth beyond what might have occurred anyway, or may simply relocate economic activity. TIF can diminish or reallocate school revenues and increase budget volatility, especially in economically unstable periods. Anyone planning to utilize TIF needs to study such strategies carefully and implement best practices, and avoid the well documented pitfalls.