

Development Trends: Tax Increment Financing for Brownfields Redevelopment - The State Role

*First of a 2-part series
Evans Paull*

Tax Increment Financing (TIF) has emerged as a dominant tool to close financing gaps on desirable economic and community development projects. With federal funding for economic and community development in decline and other state and local funding options limited, localities have increasingly turned to TIF as the only financing incentive that is both of sufficient size and within their control.

TIF use is now widespread, not only in major cities, but also in small towns – a recent survey in Minnesota found over 400 communities operating almost 2,000 TIF districts. The city of Baltimore, typical of many eastern urban centers, had never undertaken a TIF project before the year 2000, but the city has now completed six TIF agreements and three more are on the drawing boards. Massachusetts recently became the 49th state to adopt TIF enabling legislation.

While quantitative data is in short supply, the evidence indicates that brownfields projects have also benefited from this trend, with brownfields success stories from every region of the country citing TIF as a key element.

How TIFs Work. The basic principle behind TIF financing is that, in order to pay for upfront costs (usually infrastructure) the locality freezes the taxes at the pre-development levels and then uses the incremental increases in taxes as a revenue stream to finance a bond or loan, which is then used to pay for the upfront costs.

The Brownfields–TIF Mismatch. Financing a brownfields TIF project through the private bond market can be difficult. Investors want to minimize risk and uncertainty – two things that characterize every brownfields project. The brownfields–TIF mismatch might be further described as follows:

1. TIF bonds, in many cases, can only be sold when the vertical development is 100 percent assured. This means that the funds may come into the project too late to assist with the upfront brownfields-related expenditures.
2. Cleanup expenditures are not usually eligible uses of TIF proceeds. Many states restrict the use of TIF proceeds to public infrastructure.
3. The tax increments are often less than they should be because the base property tax value usually does not reflect the impact of the contamination on the value of the property.

State Programs that Work with TIFs. A number of states have adopted measures that are designed to encourage the use of TIF mechanisms for brownfields by offering either alternatives to bond market financing or guarantees and other forms of credit enhancement. These include:

- **Michigan Brownfield Redevelopment Authorities (BRA)** allow local units of government to establish a TIF district and capture the property tax increments to provide reimbursement for the costs of the eligible cleanup and site preparation activities. The BRA also may establish a Local Site Remediation Revolving Fund from surplus captured taxes to cover eligible expenses on other designated properties in the BRA's jurisdiction. Complimenting the BRA authority, Michigan created three financing vehicles, which include grants and loans that will be paid back through the TIF. Flexible repayment terms, such as no payments due for the first five years and 2 percent interest rates, are an ideal match with front-loaded, long-lead time brownfields projects. The property owner also may apply for a Single Business Tax (SBT) Brownfield Redevelopment Credit. This credit can total 10 percent of any innocent party's development (not cleanup) costs, up to \$1 million. Local governments have created 261 BRAs in Michigan.
- **Wisconsin's Environmental Remediation Tax Incremental Financing** allows the use of TIF funds for a variety of allowable cleanup and site preparation costs (not limited to public infrastructure). There are several models, with either the developer or the city advancing funds and then being paid back through TIF revenues.
- **Connecticut's Brownfields Redevelopment Authority (CBRA)** offers cleanup grants up to \$10 million based on reimbursement to CBRA from a TIF. Eligible entities include investors, developers, and business owners who undertake brownfields redevelopment projects. CBRA has pre-existing bond funds that are used for this purpose. Municipal authorities must agree with CBRA as to the allocation of incremental tax revenues. CBRA accepts the risk that the project will not perform, effectively shifting risk away from both the community and from the developer.
- **Pennsylvania's Tax Increment Financing Guarantee Program** is designed to assist local TIFs that qualify under a strict definition of blight removal. The state's guarantee, up to \$5 million per project, can serve as an important credit enhancement that may make the difference between a feasible and an infeasible project. TIF proceeds may be used for infrastructure and environmental remediation costs. The state gives priority to brownfields sites as one of several program criteria. The program is funded to provide \$100 million total in guarantees.
- **Minnesota's Hazardous Substance Subdistricts** permit the frozen tax value -- or "base" value -- in a subdistrict to be reduced or "written-down" by the cost of cleanup, thus increasing the increment. This increased increment creates an interesting option for sites where development may be years off. A tax increment can be generated without any vertical development -- the increment is the difference between the adjusted base (adjusted for cleanup costs) and the previous base.

Michigan's program is the most aggressive from the above list because of three advantages: sufficient funding through the Clean Michigan Initiative; clearly favorable alternatives to bond market financing; and the ability to address site preparation (as well as cleanup).

Other states that are reevaluating their brownfields financing programs would do well to consider state-facilitated TIF financing as an attractive alternative or addition to the standard brownfields loan and grant programs. By assisting localities with TIF financing, the state can make its limited dollars go further, assist more sites, and, especially, address the tougher sites that require higher resource commitments.

Several federal programs also work with TIF financing – these will be the subject of this column in the next issue.

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“State and Local Brownfields Innovations” is a new regular feature of Brownfields News. Evans Paull is Senior Policy Analyst for Northeast Midwest Institute. Evans has 10 years experience in brownfields development – prior to joining Northeast Midwest Institute, Evans directed the Brownfields Initiative for the City of Baltimore for 10 years. He can be reached at epaull@nemw.org