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## TAX INCREMENT FINANCING IN CLEVELAND

Prepared by:

Jason Kral (JD 2009), Alexander McElroy (JD 2010) and Matthew Rossman (Faculty)  
The Urban Development Lab  
Case Western Reserve University School of Law  
Cleveland, Ohio

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### INTRODUCTION AND TIF OVERVIEW:

Tax increment financing (TIF) is a mechanism utilized throughout the country to help finance real estate development by using potential future property tax revenues to fund a current development project. TIFs are used when the market does not support the viability of projects in areas needing rehabilitation.<sup>1</sup> In particular, TIF encourages developers to construct buildings and make private improvements, or pay for public improvements, in urban areas requiring rehabilitation.<sup>2</sup> This paper examines the principal mechanisms under Ohio law for creating TIF and how, in practice, TIF has been utilized in the City of Cleveland. Throughout this paper, reference is made to Appendix A which is attached to this paper and which identifies all of the TIF projects currently active in the City of Cleveland according to the Ohio Department of Development.<sup>3</sup>

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<sup>1</sup> Minnesota House of Representatives House Research, *How TIF Works: Basic Mechanics, Typical Uses* <http://www.house.leg.state.mn.us/hrd/issinfo/tifmech.htm> (last visited November 1, 2008).

<sup>2</sup> *Id.*

<sup>3</sup> State of Ohio Department of Development website, *See at* <http://www.development.ohio.gov/OTEISearch/TIF/selection.aspx?County=Cuyahoga> (last visited August 30, 2009).

The typical TIF project starts with a city agreeing to allocate future increases in tax revenue on a property on which a developer will complete a project (“TIF proceeds”) over a specified period of time to a fund that will offset the costs of that project.<sup>4</sup> Usually, a public or private entity (“loan issuer”) will then loan the developer money upfront for those costs based on the anticipated TIF proceeds.<sup>5</sup> The loan issuer usually funds the developer’s loan by issuing bonds.<sup>6</sup> The developer uses the loan to fund its construction costs and to pay for public improvements related to the project (such as streets, sidewalks, sewer and water, etc.).<sup>7</sup> Over time, as the value of the property on which the development is located appreciates, the developer pays an amount equivalent to what would be the increased amount of property taxes to the local taxing authority. These funds (or a portion of them) are then allocated to a city managed fund utilized to pay off the loan issuer and for other expenses related to the developer’s project contemplated in the TIF Agreement entered into between the city and the developer.

#### **TIF IN OHIO:**

Although the concept behind TIF is the same across the country, the mechanics of it vary from state to state. The conventional approaches for creating a TIF under Ohio law are provided for under Ohio Revised Code (“O.R.C.”) Sections 5709.40 and 5709.41 (the “TIF Statutes”). There are also more specialized mechanisms for TIF in “blighted” or “slum” areas which are part of an “urban renewal plan” (O.R.C. Chapter 725) or for projects carried out by a “community urban redevelopment corporation” (O.R.C. Chapter 1728). Because §5709.40 and 5709.41 are the most commonly used forms this paper focuses on them.

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<sup>4</sup> KENNETH W. BOND, TAX INCREMENT FINANCING – CAN YOU? SHOULD YOU? 2 (Squire, Sanders, & Dempsey, L.L.P.) (Sept. 15, 2004).

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> *How TIF Works: Basic Mechanics, supra* note 1, at *Purpose*.

Below is a brief overview of how the Ohio TIF Statutes operate generally speaking, followed by a discussion of the important distinctions between utilizing §5709.40(B), §5709.40(C) or §5709.41 as the basis for the TIF. Prior to the creation of a TIF project under any of the TIF Statutes, the city in which the property is located must declare, through legislation, that the improvements resulting from the developer's project will serve a public purpose.<sup>8</sup> The State of Ohio gives great latitude to cities to determine whether an improvement serves a public purpose. In the one case challenging this discretion, the Ohio Supreme Court found that once a township has determined that improvements serve a public purpose, the Ohio Tax Commissioner does not have the power to review whether the decision was correct.<sup>9</sup>

Once a municipality declares by ordinance that the improvements have a public purpose, then the value of the improvements (which, for tax purposes, means the increase in the property's value) can be declared exempt, in whole or in part, from real property taxation for a fixed number of years, not to exceed 30.<sup>10</sup> The O.R.C. requires notice to and receipt of permission from any affected school board for TIF projects exceeding ten years or 75% of the value of improvements.<sup>11</sup> In Ohio, public schools are funded primarily by property taxes and, therefore, any TIF arrangement has the potential to deprive the local schools of funding.<sup>12</sup> For this reason, the municipality must negotiate with the local school district on TIF arrangements that are long-term and/or constitute a large percentage of the tax associated with the improvements. This often leads to the school board receiving a portion of the resulting TIF proceeds.<sup>13</sup>

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<sup>8</sup> OHIO REV. CODE § 5709.40(B), § 5709.41(B).

<sup>9</sup> Princeton City Sch. Dist. Bd. of Educ. v. Zaino, 94 Ohio St. 3d 66, 75 (2002).

<sup>10</sup> OHIO REV. CODE § 5709.40(D)(1)-(2); § 5709.41(C)(1)-(2).

<sup>11</sup> OHIO REV. CODE § 5709.40(B); § 5709.40(C)(3); § 5709.41(C)(1)-(2).

<sup>12</sup> MEGHAN SULLIVAN, THE IMPACT OF TAX INCREMENT FINANCING REFORM ON SCHOOL DISTRICT FUNDING I (Ohio Department of Taxation, Tax Research Series Number 3) (Jan. 2009).

<sup>13</sup> See Appendix A: Tax Increment Financing Projects in Cleveland (attached to this paper).

In exempting the improvements from taxation, the municipality will almost always require the owner of the property on which the improvements are made to make annual service payments in lieu of taxes to the county treasurer. While the O.R.C. only provides that service payments in lieu of taxes “may” be required,<sup>14</sup> they almost always are required (and in an amount equivalent to the taxes that would have otherwise been due) to ensure that the diverted property taxes are used to further the purposes underlying the TIF and are not simply absorbed by the property owner.<sup>15</sup> Service payments in lieu of taxes are charged and collected in the same manner as property taxes.<sup>16</sup> The county treasurer will then distribute the service payments into a fund controlled by the municipality to be spent for the purposes specified in the municipal ordinance approving the TIF.<sup>17</sup> The city and the developer will also typically enter into a written contract specifying in greater detail how the service payments will be spent to support the developer’s project.

In Cleveland, in order to get any TIF project approved, the City Council will typically take the following steps: (i) declare improvements to the parcels of real property at issue to serve a public purpose, (ii) describe the improvements to be made on the parcels, (iii) exempt the improvements from property tax, (iv) require the owner of the improvements to make service payments in lieu of taxes, (v) establish a fund for the deposit of service payments in lieu of taxes and enter into a contract with the developer for management of these funds, and (vi) authorize a compensation agreement between the Cleveland Municipal School District and the owner of the

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<sup>14</sup> OHIO REV. CODE § 5709.42(A).

<sup>15</sup> See Appendix A, *supra* note 13.

<sup>16</sup> OHIO REV. CODE § 5709.42(A).

<sup>17</sup> OHIO REV. CODE § 5709.43. A municipality approving TIF under O.R.C. § 5709.40 “shall establish a municipal public improvement tax increment equivalent fund” (§ 5709.43(A)); a municipality approving TIF under O.R.C. § 5709.41 “may establish an urban redevelopment tax increment equivalent fund” (§ 5709.43(B)).

real property.<sup>18</sup> A City Council Member or the Mayor will then introduce an ordinance accomplishing the above, and that ordinance must be approved by a vote of City Council. The ordinance will take effect and be in force upon passage by the Council and approval by the Mayor.<sup>19</sup>

#### **DISTINGUISHING FEATURES OF OHIO TIF STATUTES:**

As noted above, the most conventional TIF arrangements pursuant to Ohio law are under: (i) O.R.C. § 5709.40 which allows for both individual TIF parcels (authorized by § 5709.40(B)) and Multi-Parcel Incentive District TIFs (authorized by § 5709.40(C)) that support public infrastructure improvements, and (ii) O.R.C. § 5709.41 which permits TIF for any improvements to property conveyed or leased by a municipal corporation engaged in "urban redevelopment."<sup>20</sup> Below is a description of the important features of each of these forms of TIF and some examples of how each has been utilized locally. See also Appendix A to this Paper which lists and details TIF projects currently in place in Cleveland.

##### *§ 5709.40(B) TIF Parcel:*

Under § 5709.40(B), a municipality may use TIF to fund public infrastructure improvements to a particular parcel of property that serve a public purpose. As noted earlier, municipalities have very broad discretion in what serves a public purpose as can be seen in the following examples from Cuyahoga County. A representative of the City of Cleveland Office of Economic Development said that projects that create jobs or help bring a needed improvement to a particular neighborhood, e.g., a grocery store to an area without one, could be viewed as

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<sup>18</sup> See, e.g., City of Cleveland, Ohio, Ordinance 1645-05 (Nov. 9, 2005); Cleveland, Ohio Ordinance 2006-06 (Nov. 29, 2006); Appendix A, containing additional ordinance numbers and publication information.

<sup>19</sup> Charter of City of Cleveland Ch. 5 § 33, 36 - 37 (June 30, 2009), See at <http://www.clevelandcitycouncil.org/Home/CodifiedOrdinances/tabid/66/Default.aspx>.

<sup>20</sup> OHIO REV. CODE § 5709.41(A)(2).

serving a public purpose.<sup>21</sup> The city of Strongsville approved TIF using § 5709.40(B) for a commercial retail development project by declaring property to be developed between two big box retail stores blighted and hazardous because it housed buildings with asbestos and was located on an underground storage tank.<sup>22</sup> The TIF was then used for land acquisition, demolition of buildings, and removal of environmental hazards.<sup>23</sup> In creating a Downtown Euclid TIF utilizing § 5709.40(B), the City of Euclid simply declared that the project constituted a public purpose without any explanation on the record as to why.<sup>24</sup> In that case, the TIF was used for: the acquisition and clearance of properties; the construction or reconstruction of public streets, sidewalks, streetscapes, and utilities; the construction or reconstruction of off street parking facilities and utility connections; landscaping; and environmental remediation.<sup>25</sup>

Despite the broad interpretation of “public purpose” in this context, a significant statutory limitation applies to the use of this form of TIF for residential projects. § 5709.40(B) provides that “Improvements with respect to a parcel that is used or to be used for residential purposes may be declared a public purpose under this division only if the parcel is located in a *blighted area of an impacted city (emphasis added)*.”<sup>26</sup> “Blighted area” means that seventy per cent of parcels in an area are blighted and what constitutes a blighted parcel is not left entirely to the judgment of the municipality but is statutorily defined.<sup>27</sup> Some examples of what constitutes a blighted parcel include: (a) A dilapidated, unsanitary, unsafe, or vermin infested structure designated unsafe for human habitation or use; (b) The property poses safety risks due to environmentally hazardous conditions, solid waste pollution, or contamination; and (c) Tax or

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<sup>21</sup> Interview with Jeff Shoykhet, Office of Economic Development, City of Cleveland (Oct. 10, 2008).

<sup>22</sup> City of Strongsville, Ohio, Ordinance 2007-245 (Dec. 17, 2007).

<sup>23</sup> *Id.*

<sup>24</sup> City of Euclid, Ohio, Ordinance 37-2008 (Feb. 19, 2008), *See at* [http://www.cityofeuclid.com/uploads/previous\\_site\\_pdf\\_library/37-2008.pdf](http://www.cityofeuclid.com/uploads/previous_site_pdf_library/37-2008.pdf).

<sup>25</sup> *Id.*

<sup>26</sup> OHIO REV. CODE § 5709.40(B).

<sup>27</sup> OHIO REV. CODE § 1.08.

special assessment delinquencies, exceeding the land's fair value, remain unpaid for thirty-five days after notice is given.<sup>28</sup>

For example, to qualify the residential component of the Flats East Bank Project under §5709.40(B), the developers demonstrated that the area was blighted (consistent with municipal and state definitions of this terminology) based on a survey done of the area and a public hearing before the City Planning Commission.<sup>29</sup> The Cleveland City Council heard oral reports and testimony determining that the area was blighted due to one or more of the following factors: “structural deficiencies, deterioration, dilapidation, obsolescence, nonconformities with the modern code requirements relating to building or fire protection, existing conditions therein endangering life and property by fire or other causes, or other conditions which are detrimental to the public health, safety, morals, and general welfare.”<sup>30</sup> Additionally, the developers prepared a Flats East Bank Community Development Plan that outlined steps associated with their proposed development that would result in elimination of the conditions of blight and deterioration and for the prevention of its recurrence.<sup>31</sup>

“Impacted city” means a municipal corporation that 1) has public housing and has been certified by the Ohio Department of Development to have a workable community improvement program, or 2) been declared a major disaster area, or is part of one, and has been extensively damaged or destroyed.<sup>32</sup> Accordingly, the use of TIF under §5709.40(B) for residential projects is substantially limited. It is worth noting, however, that the Ohio Department of Development has certified Cleveland as an impacted city.<sup>33</sup>

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<sup>28</sup> OHIO REV. CODE § 1.08(B).

<sup>29</sup> City of Cleveland, Ohio Ordinance 1644-05 (Oct. 26, 2005).

<sup>30</sup> *Id.*

<sup>31</sup> *Id.*

<sup>32</sup> OHIO REV. CODE § 1728.01.

<sup>33</sup> *See, e.g.,* City of Cleveland, Ohio Ordinance 1645-05, *supra* note 18; OHIO REV. CODE § 1728.01.

Proceeds generated by TIFs created under § 5709.40(B) may only be used for “public infrastructure improvements” that directly benefit the TIF property.<sup>34</sup> A public infrastructure improvement directly benefits a parcel of land only if a project places or will place additional demand on public infrastructure.<sup>35</sup> O.R.C. § 5709.40(A)(7) defines “public infrastructure improvement” as including but not limited to:

public roads and highways; water and sewer lines; environmental remediation; land acquisition, including acquisition in aid of industry, commerce, distribution, or research; demolition, including demolition on private property when determined to be necessary for economic development purposes; storm water and flood remediation projects, including such projects on private property when determined to be necessary for public health, safety, and welfare; the provision of gas, electric, and communications service facilities; and the enhancement of public waterways through improvements that allow for greater public access.

While very broad, the definition does suggest that the purely private components of a project (e.g. construction of a private commercial building) would not qualify for TIF funds under this section.

§ 5709.40(C) *Incentive District TIF:*

In certain circumstances, § 5709.40(C) of the O.R.C. authorizes the creation of TIF projects that are larger than one parcel via designation as an Incentive District.<sup>36</sup> An Incentive District TIF covers multiple parcels which sit in an area less than three hundred acres enclosed by a continuous boundary and that demonstrate one or more “characteristics of distress.” TIF proceeds are generated by all of the parcels located within the District. By statute, the following are “characteristics of distress”:

- a) [a]t least 51% of the residents of the district have incomes of less than 80% of the median income of the residents of the political subdivision in which the district is located in,

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<sup>34</sup> OHIO REV. CODE § 5709.40(B).

<sup>35</sup> STUART MECK & KENNETH PEARLMAN, OHIO PLANNING AND ZONING LAW § 15:30 (14th ed. 2009).

<sup>36</sup> OHIO REV. CODE § 5709.40(A)(5), (C).



- b) [t]he average rate of unemployment in the district during the most recent twelve-month period for which data is available is equal to at least 150% of the average rate of unemployment for this state for the same period,
- c) [a]t least 20% of the people residing in the district live at or below the poverty level,
- d) [t]he district is a blighted area,<sup>37</sup>
- e) [t]he district is in a situational distress area,
- f) the public infrastructure serving the district is inadequate to meet the development needs of the district, and
- g) the district is comprised entirely of unimproved land that is located in a distressed area.<sup>38</sup>

As the statute suggests, distress can be demonstrated in a number of ways. However, demonstrating distress can be politically sensitive in areas that are not obviously blighted or where labeling an area distressed will anger local residents. When the City of Lakewood established a TIF Incentive District, the authorizing ordinance contained a clause stating that the City Director of Planning and Development had determined that over 50% of area residents earned a median income that was less than 80% of the median income of other City of Lakewood residents.<sup>39</sup> Cities can also use O.R.C. § 5709.40(A)(5)(f) as a less controversial way to demonstrate distress by having the city engineer certify that the property is unfit for development due to lack of proper infrastructure as evidenced by a written plan that has been adopted by the City Council. The City of Parma Heights did exactly that when it passed an ordinance for a proposed TIF Incentive District. The authorizing ordinance stated that the City Engineer certified the existing infrastructure to be inadequate for the purposes of the proposed development, thus allowing the incentive district to be established without upsetting local residents.<sup>40</sup>

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<sup>37</sup> See text accompanying footnotes 27-28 for statutory definition of “blighted area”.

<sup>38</sup> OHIO REV. CODE § 5709.40(A)(5).

<sup>39</sup> City of Lakewood, Ohio, Ordinance 48-06

<sup>40</sup> City of Parma Heights, Ohio, Ordinance 2004-40

As with § 5709.40(B) individual TIF parcels, funds generated by a TIF Incentive District must be utilized for public infrastructure improvements that serve a public purpose.<sup>41</sup> One significant difference, however, is that Incentive Districts are not subject to the same limitations on residential projects. Funds generated by an Incentive District TIF may be used to finance housing renovations, in addition to “public infrastructure”, as long as other parcels within the District are used for industrial or commercial purposes that will require the public infrastructure improvements funded by the TIF.<sup>42</sup>

The Incentive District is also advantageous when compared to seeking separate, individual TIF approvals for a collection of properties located in close proximity. For instance, Incentive District TIF allow for more flexibility in spending the TIF funds than individual TIF Parcels. TIF Incentive Districts are allowed to combine the proceeds from the various properties within the District to fund one particular part of the project, even if the improvement does not directly benefit every parcel within the District.<sup>43</sup> An Incentive District TIF is ideal when a developer wants to develop multiple properties in a certain portion of a city, and wants to put large portions of the TIF funds into specific portions of the development. Additionally, Incentive District TIFs allow developers to use economies of scale and eliminate the administrative time and expense related to creating multiple individual TIF parcels.

There are, however, additional procedural burdens associated with an Incentive District. For example, when a city creates a TIF Incentive District it must secure county approval if the associated tax exemption will equal more than 75% of the anticipated tax increase or will last for

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<sup>41</sup> OHIO REV. CODE § 5709.40(C)(1).

<sup>42</sup> OHIO REV. CODE § 5709.40(C)(3)(b).

<sup>43</sup> State of Ohio Department of Development, *Tax Increment Financing Incentive Districts* (Including provisions enacted by amended substitute HB 66 enacted June 2005, and amended HB 530, enacted March 2006), See at <http://development.ohio.gov/cms/uploadedfiles/EDD/OTI/TIFIncentiveDistrictsSummary.pdf> (last visited August 30, 2009).

more than 10 years.<sup>44</sup> The city needs to hold a public hearing for all property owners within the District no less than 30 days prior to its adoption at which these owners could conceivably seek to dissuade the city from approving the TIF.<sup>45</sup> Also, based on recent amendments to § 5709.40, the portion of service payments arising from an Incentive District TIF that would otherwise, if paid as taxes, be paid to support certain health and social service tax levies in a county must go to the county rather than to the TIF fund.<sup>46</sup>

§ 5709.41 TIF:

The State of Ohio also allows for TIF to be approved for improvements made to property that has been conveyed or leased by a municipal corporation engaged in urban redevelopment. The fact that the city once owned it automatically qualifies the improvements to be declared a “public purpose” by the municipality.<sup>47</sup> Upon first glance, this statute seems to be fairly restrictive. However, because of Cleveland’s willingness to act as a “straw man” for development it supports, § 5709.41 TIFs have become a favorite tool of developers in Cleveland. The provision only requires that the city appear as an owner in the chain of title for the property,<sup>48</sup> it does not matter how long the city owned it. Therefore, if a developer transfers title ownership of the property to the City of Cleveland, and the City simply transfers it back to the developer the improvements are technically eligible for a § 5709.41 TIF. For example, in connection with the E. 4<sup>th</sup> Street District’s rehabilitation, the City of Cleveland passed an ordinance acquiring title to the property and then immediately re-conveyed it to the original developer.<sup>49</sup> City ordinances transferring the property for this project—the Lower Euclid

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<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

<sup>46</sup> OHIO REV. CODE § 5709.40(F)

<sup>47</sup> OHIO REV. CODE § 5709.41.

<sup>48</sup> *Id.*

<sup>49</sup> City of Cleveland, Ohio, Ordinance 2246-02 (Dec. 4, 2002).

Avenue Commercial and Residential District—explicitly stated that the rationale of this transfer was to qualify for O.R.C. § 5709.41 TIF.<sup>50</sup>

Another feature that makes an O.R.C. § 5709.41 TIF particularly attractive to developers is that it does not require that the service payments in lieu of taxes be used for public infrastructure improvements, nor does it require any characteristic of economic distress to be demonstrated. Like the § 5709.40(B) individual parcel TIF, however, if the development project is residential, improvements are only eligible for TIF if the parcel is located in a blighted area of an impacted city.<sup>51</sup> Beyond this, however, the only requirement on § 5709.41 TIF funds is that the city approving the TIF be engaged in “urban redevelopment”, which could encompass almost any project in the City of Cleveland.<sup>52</sup> Even when multiple properties are involved, local developers usually prefer using a separate § 5709.41 TIF for each individual property involved in a development rather than creating a § 5709.40 TIF Incentive District because of the flexibility in the use of the funds. Generally speaking, § 5709.41 is the most versatile form of TIF. Appendix A demonstrates the City of Cleveland’s strong preference for § 5709.41; eleven of the fourteen TIF projects currently active in Cleveland were approved under § 5709.41.

#### **ESTABLISHING A TIF IN CLEVELAND:**

Initially, a developer seeking to create a TIF in Cleveland under any of the TIF statutes should contact the City of Cleveland Economic Development Office.<sup>53</sup> Although Cuyahoga County also has some authority to create TIFs, it cannot do so within Cleveland’s borders because Cleveland is incorporated.<sup>54</sup>

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<sup>50</sup> *Id.*

<sup>51</sup> OHIO REV. CODE § 5709.41(B).

<sup>52</sup> OHIO REV. CODE § 5709.41(A)(2).

<sup>53</sup> Shoykhet, *supra* note 21.

<sup>54</sup> OHIO REV. CODE § 5709.78(A) (A County may only declare parcels of property located in the unincorporated territory of the county to serve a public purpose).

The developer should strongly consider creating and submitting a formal development plan to the City. A development plan will help the City gain a better understanding of the developer's planned development and use of TIF funds. It is a tool that can be used to consolidate all of the required information into one source, while at the same time marketing a developer's project to the city. For instance, a development plan is an ideal place to show that the tax history in the area has been declining, that the developer's improvements would increase the real estate value in the area, and that increased property value would benefit the area through increased real property tax revenue.

If the developer is successful in convincing the City that the project is worth approving for TIF, the developer and the City will need to determine: the market value of the proposed improvements,<sup>55</sup> the taxable value of the improvements,<sup>56</sup> the City's real property tax rate,<sup>57</sup> the public infrastructure costs associated with the project (if using §5709.40(B) or (C)), the value of the proposed exemptions (so that the exemptions will generate enough revenue to finance the improvements), and who must be notified (e.g. School Board, neighboring property owners, the county) under the applicable TIF Statute.<sup>58</sup> Then, City Council needs to enact legislation that: (a) designates the parcel(s) exempt from taxation, (b) declares that improvements made to private property within the area are serving a public purpose, (c) outlines the improvements to be made, and (d) specifies the tax increment equivalent funds to be created for those redirected monies.<sup>59</sup> Additionally, the City must enter a contract with the property owner/developer creating the

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<sup>55</sup> State of Ohio Department of Development, *Tax Increment Financing Suggested Implementation*, <http://development.ohio.gov/cms/uploadedfiles/EDD/OTI/TIFImplementation.pdf> (last visited August 30, 2009).

<sup>56</sup> *Id.*

<sup>57</sup> See, e.g., Cuyahoga County, Taxes By District, City of Cleveland, <http://treasurer.cuyahogacounty.us/PDF/taxesbydistrict/Cleveland.pdf> (last visited November 14, 2008) (The commercial and industrial tax rate for the City of Cleveland is 2.8 percent per year).

<sup>58</sup> *Tax Increment Financing Suggested Implementation*, *supra* note 55.

<sup>59</sup> *Id.*

obligation to remit service payments in lieu of taxes.<sup>60</sup> If bonds will be issued in anticipation of the TIF proceeds, the agreement will also typically include formal legal guarantees from the property owner that sufficient funds will be available to the City in order to retire any debt incurred based on the TIF proceeds.<sup>61</sup> Due to the specialized nature of TIFs, both the State of Ohio and the City of Cleveland recommend utilizing legal counsel before establishing a TIF. Cleveland specifically recommends Roetzel & Andress because of the City's experience working with the firm in the past on these issues.<sup>62</sup>

As the above discussion indicates, local government cooperation is paramount to establishing a TIF. The Cleveland City Council is the entity that in conjunction with the school district must be involved in deciding on all material provisions of the TIF (note: the school board's role is discussed further below). Furthermore, if a developer hopes for a § 5709.41 TIF, the City will need to agree to participate as a straw man in the conveyance of the property. Therefore, in order to get a TIF passed, a developer should enlist the help of a representative on City Council. After a TIF has been established, the developer and the City must maintain a close relationship and both parties have to adhere to various reporting requirements to the State of Ohio. This relationship will be ongoing throughout the life of the TIF.<sup>63</sup>

#### **PROCESSES FOR ACCUMULATING AND ACCESSING TIF FUNDS:**

##### *Service Payments in Lieu of Taxes:*

In Cleveland, in almost all cases, the City will require the owner of TIF property to make annual service payments in lieu of taxes attributable to the improved value of the property to the Cuyahoga County Treasurer on the same schedule and in the same amount as those real property

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<sup>60</sup> *Id.*

<sup>61</sup> *Id.*

<sup>62</sup> Shoykhet, *supra* note 21.

<sup>63</sup> *Tax Increment Financing Suggested Implementation*, *supra* note 55.

taxes (See Appendix A). Each payment is charged and collected as if the owner were paying real property taxes for the improved value of the parcel.<sup>64</sup> These payments constitute the TIF proceeds. The Cuyahoga County Treasurer then distributes the service payments to the City and, if applicable, the school district in which the property is located at the same time and in the same manner as real property taxes.<sup>65</sup>

*Funds:*

By statute, the City must maintain a municipal public improvement tax increment equivalent fund into which the County Treasurer will deposit the service payments received for any § 5709.40(B) TIF individual parcel or §5709.40(C) Incentive District TIF.<sup>66</sup> The City of Cleveland must establish at least one account in the municipal public improvement tax increment equivalent fund for each TIF parcel and one account for each Incentive District TIF. The money in an account is used to finance the public infrastructure improvements designated in the ordinance authorizing that particular TIF.<sup>67</sup> Although the statutory definition of “Public Infrastructure Improvements” lists only infrastructure construction and similar activities,<sup>68</sup> the funds have been used in certain instances for administrative costs attributable to the sale of bonds financing those public infrastructure costs.<sup>69</sup>

For service payments made in connection with § 5709.41 TIF, the City, by statute, maintains an urban redevelopment tax increment equivalent fund, into which the County Treasurer deposits these service payments.<sup>70</sup> Unlike with the § 5709.40 TIFs, these funds need not be used only for public infrastructure improvements; instead the funds may be used for any

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<sup>64</sup> OHIO REV. CODE § 5709.42(A).

<sup>65</sup> OHIO REV. CODE § 5709.42(B).

<sup>66</sup> OHIO REV. CODE § 5709.43(A).

<sup>67</sup> *Id.*

<sup>68</sup> OHIO REV. CODE § 5709.40(A)(7).

<sup>69</sup> See, for example, the “Residential and Commercial Development in Flats East Bank Community” improvements summary in Appendix A.

<sup>70</sup> OHIO REV. CODE § 5709.43(B).

purposes authorized in the ordinance establishing the fund (although presumably they would need to support some form of “urban redevelopment).”<sup>71</sup> As noted earlier, this makes § 5709.41 TIFs more versatile, because essentially the funds can be used for any purpose as long as the City Council is willing to adopt an ordinance allowing such purpose. For example, the ordinance authorizing the Lower Euclid Avenue Project specified that the improvement funds would be used in part to pay the principal and interest payments on bonds that were used to build the residential, office, retail, restaurant, and entertainment facilities, and the supporting facilities such as parking spaces.<sup>72</sup> Another example of an urban redevelopment tax increment equivalent fund is the one established for the Steelyard Commons Project, the ordinance for which specified that 70% of the fund would be used for acquisition of land and improvement of a trail and park, and the remaining 30% of the fund would be used for retail assistance programs and other commercial and industrial initiatives offsetting the impact of Steelyard Commons on adjacent neighborhood commercial districts.<sup>73</sup>

*School Districts:*

Generally speaking, under both § 5709.40 and § 5709.41, the school board of the jurisdiction in which the TIF parcel(s) are located must approve a TIF in which over 75% of the value of improvements are exempted from tax, or which lasts over 10 years.<sup>74</sup> In these cases, the school district typically requires that the TIF ordinance provide that it receive some percentage of the service payments generated by the TIF. A municipality’s property tax funds its public schools and TIF would divert funds otherwise available to the local school district if this arrangement were not made. Alternatively, developer and the school district may agree

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<sup>71</sup> *Id.*

<sup>72</sup> City of Cleveland, Ohio, Ordinance 2047-02 (Nov. 20, 2002).

<sup>73</sup> City of Cleveland, Ohio, Ordinance 1780-05 (Jan. 4, 2006).

<sup>74</sup> OHIO REV. CODE § 5709(B), § 5709.40(C)(3), and § 5709.41(C).



upfront that the developer will directly compensate the school district based on some percentage of the service payments. As a matter of policy (implemented during the Jackson mayoral administration), the City of Cleveland has not allowed any new TIFs to cut into the portion of property taxes that would be allocated to the school district even if the TIFs would not by statute require school board approval.<sup>75</sup>

In practice, the City of Cleveland has apportioned the School District's share of service payments in multiple ways. In the Steelyard Commons Project, the City put a provision in the TIF ordinance which required that a portion of the service payments collected equal to the amount that the Cleveland Municipal School District would have received had the TIF not been approved, be distributed to the CMSD.<sup>76</sup> 55.13% is the amount that goes to the school district from a non-TIF commercial parcel's property taxes.<sup>77</sup> Accordingly, in the Steelyard Commons Project, approximately 45% of the TIF proceeds are directed towards the TIF fund and approximately 55% goes to the school district.<sup>78</sup> In the Veterans Administration Project, the City put a provision in the ordinance which required that the City make annual payments to the School Board pursuant to a compensation agreement.<sup>79</sup> The School Board authorized this compensation agreement, which provided for annual payments to it of at least 30% of the TIF total service payments.<sup>80</sup> In other cases, the developer and the School Board will agree to a compensation agreement and the School Board will condition its approval of the TIF on this.

It is worth noting that for municipalities that levy their own income taxes, if a TIF project under § 5709.40 will generate annual payroll for new employees of at least \$1,000,000, the city

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<sup>75</sup> Shoykhet, *supra* note 21.

<sup>76</sup> Ordinance 1780-05, *supra* note 73.

<sup>77</sup> Taxes By District, *supra*, note 57.

<sup>78</sup> See Shoykhet, *supra* note 21.

<sup>79</sup> City of Cleveland, Ohio, Ordinance 2006-06 (Nov. 29, 2006).

<sup>80</sup> *Id.*

must enter into a revenue sharing agreement with the local school district for the income taxes.<sup>81</sup> If this doesn't occur within six months of the TIF legislation's passage, state law requires that the revenues generated by these new employees be split 50/50 between the city and the school district.<sup>82</sup>

### **LEVERAGING BONDS WITH TIF FUNDS:**

As noted at the outset of this paper, issuing bonds is one method a loan issuer can use to provide a developer with money upfront equivalent to the rise in anticipated property taxes attributable to the development or redevelopment of the TIF parcel(s) in future years.<sup>83</sup> Ohio allows cities to issue bonds on behalf of a TIF project so that developers can obtain the funds upfront.<sup>84</sup> The bonds are repaid using the developer's service payments (i.e. payments in lieu of taxes).<sup>85</sup> Alternatively, the municipality can agree that the developer will pay for the costs associated with the project and be reimbursed by the municipality over time with the TIF funds that are generated.<sup>86</sup> Typically when a developer pays the upfront costs, the municipality will sign a promissory note evidencing the municipality's obligation to reimburse the developer.<sup>87</sup> In the past, the City of Cleveland issued bonds but it no longer does because of high issuance costs and the potential liability associated with bond issuance.<sup>88</sup> Instead, the City allows developers to obtain bonds on their own and has worked with Baird Co. in Columbus, Ohio to do this.<sup>89</sup> A

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<sup>81</sup> *Tax Increment Financing Incentive Districts*, *supra* note 43.

<sup>82</sup> *Id.*

<sup>83</sup> *Tax Increment Financing- Can You? Should You?*, *supra* note 4.

<sup>84</sup> OHIO REV. CODE § 5709.40(H).

<sup>85</sup> *Tax Increment Financing- Can You? Should You?*, *supra*, note 4.

<sup>86</sup> *Id.*

<sup>87</sup> *Id.*

<sup>88</sup> Shoykhet, *supra* note 21.

<sup>89</sup> *Id.*

City of Cleveland representative stated that Baird uses a bond rate of 5.25 percent and allows bond repayment for between 20 and 30 years to finance projects.<sup>90</sup>

The Cleveland Cuyahoga County Port Authority is another place from which a local developer should consider obtaining bond financing. The Port allows developers to finance public infrastructure improvements such as “streets, roads, underground utilities, sidewalks, streetlights, landscaping and public parking garages.”<sup>91</sup> The Port of Cleveland has financed several TIF projects via bonds since 1993. It issued \$40,600,000 worth of bonds (out of a total \$128 million project cost) to help fund construction of a new shopping complex’s parking garage in University Heights.<sup>92</sup> The Port Authority issued \$8,850,000 in revenue bonds (out of a \$78 million Garfield Heights retail center) to finance public improvements, including roads and utilities, in connection with the center’s construction.<sup>93</sup>

#### **FINAL OBSERVATIONS:**

TIF is a financing tool that allows developers and municipalities to work together and make projects possible that wouldn’t have otherwise been feasible. Implementing TIF projects can increase a city’s overall tax revenue, tax base, and economic activity (jobs, sales tax, etc.) and improve areas that desperately need the help. Local examples of TIF projects are wide-ranging and include renovations of historic areas like Shaker Square and the Old Arcade, and the construction of new retail stores like Target (See Appendix A).

A TIF must be financially feasible in order to be undertaken. Because of the administrative and transactional costs associated with implementing TIF, the City of Cleveland

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<sup>90</sup> *Id.*

<sup>91</sup> Port of Cleveland, *Development Overview*, <http://www.portofcleveland.com/site.cfm/Development-Financing/Financing-Options.cfm> (last visited July 21, 2009).

<sup>92</sup> Press Release, Port of Cleveland, *Bond Financing Provided by the Cleveland-Cuyahoga County Port Authority 1993-Present* (last visited August 3, 2009) See

<http://www.portofcleveland.com/assets/attachments/file/Project%20Narrative%20-%20October%202008.pdf>.

<sup>93</sup> *Id.*, at 6.

recommends that a TIF project involve high dollar improvements in order to make use of TIF viable. Some costs involved in establishing a TIF are hiring bond counsel and planning and complying with TIF legislation. Currently, there are a few TIF projects being considered by the City of Cleveland, ranging in dollar values from \$16 to \$70 million. According to a representative of the City of Cleveland, \$16 million is at the low end of projects in which TIF is worthwhile from the City's perspective.<sup>94</sup> Because Cleveland analyzes TIF applications on a case-by-case basis, no standard guidelines, laws, or rules exist for what projects get approved. A prudent developer should develop a good rapport with the City of Cleveland and work closely with the City's economic development office if it would like to be seriously considered for a TIF proposal.

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<sup>94</sup> Shoykhet, *supra* note 21.

**APPENDIX A: TAX INCREMENT FINANCING PROJECTS IN CLEVELAND**

<b>Project</b>	<b>Ordinance</b>	<b>City Record Date</b>	<b>Statutory Basis (O.R.C.)</b>	<b>TIF Funds May Be Used To/For:</b>	<b>Compensation of School District</b>
410 Euclid – East 4 <sup>th</sup> and Euclid Ave	2212-05	7-19-06	5709.41	<ul style="list-style-type: none"> <li>Demolish interior walls and ceilings</li> <li>All construction cost associated with renovating the interior building</li> <li>Acquire and install machinery and equipment for operation of a café/restaurant and for a 16-lane bowling alley</li> <li>Purchase and install public art work including signage</li> <li>Construct sidewalk improvements and streetscape</li> <li>Exterior façade renovations</li> </ul>	Ordinance provides that payments will be made to the Cleveland Municipal School District equal to the amount of the taxes that would have been payable to it had the Improvements not been exempt from taxation.
Colonial Market Place, LLC	1010-98	9-2-1998	5709.41	<ul style="list-style-type: none"> <li>Invest \$29 million in the project within three (3) years</li> <li>Renovate and maintain the public open space of the arcades</li> <li>Pay principal and interest on revenue bonds issued by the City</li> </ul>	Ordinance provides that payments will be made to the Cleveland Municipal School District equal to the amount of the taxes that would have been payable to it had the Improvements not been exempt from taxation.
Downtown Euclid Avenue Revitalization Plan (Revitalization of the Old Arcade)	189-99	6-2-99	5709.41	<ul style="list-style-type: none"> <li>Invest \$45 million in the project within three (3) years</li> <li>Renovate and maintain the public open spaces and arcade</li> <li>Pay principal and interest on city revenue bonds or other government financing used to finance projects</li> <li>Pay costs attributable to sale of bonds</li> </ul>	Ordinance provides that payments will be made to the Cleveland Municipal School District equal to the amount of the taxes that would have been payable to it had the Improvements not been exempt from taxation.
Lee Harvard Neighborhood Shopping	2009-98	2-17-99	5709.41	<ul style="list-style-type: none"> <li>Construct new parking lot, landscaping, sidewalks, and walkways</li> <li>Renovate building adjacent to the Cleveland Public library and walkway in front of the Finast Building</li> <li>Construct a 52,000 sq. ft. two story building and three outlot buildings totaling nearly 20,000 sq. ft.</li> </ul>	Ordinance provides that payments will be made to the Cleveland Municipal School District equal to the amount that would have been payable to it had the Improvements not been exempt from taxation.

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Lower Euclid Avenue Commercial and Residential District	2247-02	11-20-02	5709.41	<ul style="list-style-type: none"> <li>Residential, office, retail or entertainment facilities</li> <li>Another use which supports the above facilities, including, without limitation, at least 250 parking spaces</li> </ul>	Ordinance provides that payments will be made to the Cleveland Municipal School District equal to the amount that would have been payable to it had the Improvements not been exempt from taxation.
Superior Avenue	867-2000	6-28-00	5709.40	<ul style="list-style-type: none"> <li>Public Improvements, including, but not limited to: sidewalks, curbs, landscaping, brick splash-strips, traffic signals and a traffic median</li> <li>Pay principal and interest on city revenue bonds to finance a portion of the costs of the public improvements</li> <li>Pay costs attributable to the sale of the bonds</li> </ul>	Ordinance provides that payments will be made to the Cleveland Municipal School District equal to the amount that would have been payable to it had the Improvements not been exempt from taxation.
Shaker Square Commercial District Area Urban Redevelopment Plan	2175-99	2-2-00	5709.41	<ul style="list-style-type: none"> <li>Install new landscaping, sidewalks, and expand curbs</li> <li>Renovate 136,000 sq. ft. of existing building space and construct 21,000 sq. ft. of building space</li> <li>Add 187 parking places</li> <li>Pay principal and interest on city revenue bonds or other government financing used to finance improvements</li> <li>Pay costs attributable to the sale of the bond</li> </ul>	Ordinance authorizes the City Director of Economic Development to enter into a compensation agreement with the Shaker Heights City School District; Ordinance also provides that payments will be made to the Cleveland Municipal School District equal to the amount that would have been payable to it had the Improvements not been exempt from taxation.
Steelyard Commons	1780-05	1-4-06	5709.41	<ul style="list-style-type: none"> <li>70% for acquisition of land and to make improvements to the Tow Path Trail and Canal Park</li> <li>30% for retail assistance programs and other commercial and industrial initiatives, including land acquisition, within the City. Primarily for projects that offset the impact of Steelyard Commons on adjacent neighborhood commercial districts, and use of these funds will be guided by a retail impact study</li> </ul>	Ordinance provides that payments will be made to the Cleveland Municipal School District equal to the amount of the taxes that would have been payable to it had the Improvements not been exempt from taxation.

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<b>Project</b>	<b>Ordinance</b>	<b>City Record Date</b>	<b>Statutory Basis (O.R.C.)</b>	<b>TIF Funds May be Used To/For:</b>	<b>Compensation of School District</b>
Target Corporation	1274-05	6-21-06	5709.41	<ul style="list-style-type: none"> <li>• Clear obsolete buildings</li> <li>• Update roadway and utility infrastructure</li> </ul>	Ordinance provides that the Cleveland Municipal School District receive a portion of the service payments equal to the amount of the taxes that would have been payable to it had the Improvements not been exempt from taxation.
Third Federal S&L Headquarters	159-98	7-1-98	5709.41	<ul style="list-style-type: none"> <li>• Remove and replace pavement, remove overhead wiring and replace with underground conduit, expand sidewalks, install trees and plants, and new ornamental and street lights on Broadway Avenue</li> </ul>	Ordinance provides that the Cleveland Municipal School District receive a portion of the service payments equal to the amount of the taxes that would have been payable to it had the Improvements not been exempt from taxation.
Tower City Center	1405-89	8-2-89	725	<ul style="list-style-type: none"> <li>• Construction of museum archives, library, hall of fame relating to the field of contemporary music including rock and roll</li> </ul>	Because percentage of improvements subject to TIF was only 75%, school board approval/compensation was not required.
Veterans Administration Urban Redevelopment Plan	2006-06	11-29-06	5709.41	<ul style="list-style-type: none"> <li>• Construct 122 bed domiciliary, 2,040 space multi-level parking garage, and an administrative office building</li> <li>• Public Infrastructure including, but not limited to: grading, draining, curbing, paving, (re)constructing public roads, storm and sanitary sewers, water mains, sidewalks, electrical lighting, underground utilities, traffic control devices, public benches, trash receptacles, and landscaping</li> <li>• Pay owners for capital improvements to the property</li> <li>• Construct, operate, and maintain public improvements and publicly owned-facilities</li> <li>• Pay principal and interest on Port Authority bonds; establish reserves for such payments</li> </ul>	City of Cleveland and Cleveland Municipal School District ("CMSD") entered into a compensation agreement pursuant to which the CMSD receives an annual payment equal to 30.32% of the total service payments each year.

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Flats East Bank Community (construction of a bulkhead and river walk along the Cuyahoga River from Front Avenue to Main Avenue)*	2088-06	12-20-06	5709.41	<ul style="list-style-type: none"> <li>• Cover construction project costs</li> <li>• Construct, operate, and maintain public improvements and publicly-owned facilities</li> <li>• Acquire land and prepare the site;</li> <li>• Pay principal and interest on city bonds</li> <li>• Subsidize State and federal grant sharing commitments</li> <li>• Subsidize community development construction or renovation loans</li> <li>• Fund activities that will eliminate blight and deterioration</li> <li>• Cover administrative costs</li> </ul>	The City entered into a Compensation Agreement with the Cleveland Municipal School District.
Residential and Commercial Development in Flats East Bank Community*	1645-05	10-26-05	5709.40	<ul style="list-style-type: none"> <li>• Construct, operate, and maintain public improvements and publicly-owned facilities</li> <li>• Pay principal and interest on city revenue bonds or other government financing used to finance improvements</li> <li>• Pay costs attributable to the sale of the bond</li> <li>• Reimburse the city for previous project expenses</li> </ul>	The City and the Cleveland Municipal School District entered into a Compensation Agreement.

\*These projects have not commenced.