Tax Increment Financing (TIF) In New Mexico:
How It Works, Problems Identified and Lessons Learned

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How TIF Works
Tax Increment Financing (TIF) is an economic development tool available to local governments and developers in 49 states and the District of Columbia. TIF was originally created by California in the 1950s as a way to encourage reinvestment in older, blighted areas that were seen as too risky or costly for private investors to improve. Since then, its use has expanded and there are now thousands of Tax Increment Development Districts (TIDDs) across the country. New Mexico has a uniquely generous arrangement allowing for capture of state Gross Receipts Tax (GRT) revenue in addition to city and county GRT and property tax.

First, a district, the TIDD, is defined for (re)development. Second, a baseline property and gross receipts tax is established within the district, known as the TIF's base GRT and base property tax. In a previously developed area, there usually is some preexisting tax base; in greenfields, or previously undeveloped areas, there usually is none. Third, the TIDD district negotiates a deal with the taxing agencies (City Council, County Commission, and/or Board of Finance/New Mexico Legislature) to receive up to 75% of the incremental increase in tax revenue resulting from the improvement within the district for up to 25 years.

When and if the property in the district increases in value and sales revenues rise, these increases above the base are called the district's GRT increment and property tax increment. This money is used by the TIF district to pay the developer for the costs of infrastructure, land acquisition, demolition, utilities and planning and other improvements within the district. Tax exempt revenue bonds are issued by the TIF district to finance the infrastructure. At the date the TIDD is terminated, the incremental taxes revert back to the taxing entities and they receive all the taxes paid from that point forward.

The Downsides of TIDDs
<u>Financial Concerns</u>

- **Massive diversions of state Gross Receipts Tax could cripple the General Fund**. State GRT revenue accounts for fully one-third of the General Fund, which provides money for basic services across the state, like schools, teachers and health care. SunCal and Mesa del Sol alone will have claim on over $1.1 billion dollars of state GRT for the next 25 years in just the first phases of their development. These developer deals are the biggest in the country, both in terms of land area and money. Other developers are also getting on the bandwagon, compounding the problem.

- **TIDDs shift private sector risk to the public sector.** New development has inherent risk: Will the houses sell? Will they sell at a good price? Will it attract good jobs? How long will the jobs last? Normally, a developer and their financing partners bear this risk. With TIDDs, this risk is shifted to the public sector through state issue bonds. If the TIDD doesn't deliver on its promises and the tax increment generated in the TIDD is insufficient to repay the bonds, the bond defaults. Although government is not technically responsible, TIF bond defaults could spill over and adversely impact the community or state's credit rating.

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- **Failure to meet "But For" standard results in revenues captured, not created**. Government investments only pay off if new economic development is created that would not have been created "but for" the TIDD. In the case of greenfield fringe development, the state is subsidizing low-risk development that would likely have occurred anyway. In this case, the added tax revenue is being captured, not leveraged or created, and state and local government lose taxes that could have gone to other uses.

- **Estimates of out of state job performance and business recruitment are unrealistic.** The applicants' usual cost-benefit study assumes all jobs and income generated by TIDDs are new, and did not exist previously in the state. In reality, this is unlikely. When businesses from within the city and the state relocate to the TIDD, a business that was paying all of its taxes for community and state use is now paying only a fraction of its taxes to the government; our tax base is further eroded. For example, SunCal's own documents indicated that 90% of the expected demand for industrial space will come from *within* the greater Albuquerque region.

- **Inflation erodes the tax base**. Since the TIDD's tax baseline is not adjusted for inflation, the value of this base will be eroded each year by inflation.

- **TIF raise taxes outside of the TIDD**. Although greenfield TIDDs will be adding thousands of new homes to Albuquerque, the larger community may only have as little as 25% of taxes to provide all the necessary public services to these citizens, like highways, street maintenance, police and fire protection and schools. Forced with the need to provide these services, yet lacking the money to do so, local governments are likely to cut service and/or raise taxes to cover the gap.

- **TIDDs tie up funding for 25 years**. There are no limitations on the number and size of TIDDs or total tax funds that can be used, and once the bonds are issued the funding cannot be reallocated.

- **TIDDs are often layered with other economic development incentives.** The state already provides incentives for economic development in the form of tax credits, job training funds and more. In the case of Mesa del Sol, the state has offered a $130 million incentive to a solar firm for 1,500 jobs and $47 million for an investment firm for 1,200 jobs. Combined with the $500 million TIDD deal, the state's money is quickly swallowed up.

- **TIDD bonds will have a higher interest rate than general obligation bonds.** Because TIDD bonds will be issued to finance the district's infrastructure before the community has been fully developed, they present considerable risk for an investor and will bear interest rates higher than general obligation bonds pledging the full faith and credit of government. Higher financing costs will be borne by taxpayers.

<u>Process Concerns</u>

- **At the state, city and county level, there is no common methodology or process for reviewing TIDD applications**. The lack of an overall policy to guide the use of TIF means that TIF is not necessarily being used either in a responsible fiscal manner nor to achieve the best outcomes for the state's scarce resources.

- **TIFs skirt accountability, transparency and public oversight.** TIF uses future general fund revenues to support the repayment of property tax and GRT-backed debt, without voter approval and without violating debt limitations. TIF does not appear in city, county or state budgets, so it is largely invisible to the public.

- **TIF districts are not subject to the state, city or county procurement code.** Who will get billions of dollars worth of public business without a sealed, competitive bid process or public scrutiny? How will the public know that it's getting good work at a fair price? In reality, the public has limited assurances that its tax dollars are being used for the public good rather than simply lining the pockets of private developers.

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- **No reporting or auditing requirements exist to measure or enforce the success of TIDDs.** No reporting, auditing or statutory performance requirements exist that require TIDDs to deliver on their promises and there are no penalty or clawback provisions that exist for local governments to enforce such expectations.

- **The state lacks ongoing oversight of its GRT.** Once the TIDD is approved, and having no member on TIDD boards, the state loses all control over a large revenue stream for up to 25 years, and it is spent without any oversight by either the executive or legislative branches.

- **TIDDs may lack consistency with community plans and may make coordination among city, regional and state governments more challenging.** Once a TIDD is established, few statutory restraints are placed upon its operation, which are governed by the TIDD board. It remains to be seen how local governments will govern with possibly dozens of TIDDs within their borders.

Equity Concerns

- **New homes by the thousands will only exacerbate the lending crisis.** With thousands of homes sitting empty across the state, building thousands more in massive masterplanned communities will only further compromise vitality and investment in existing neighborhoods. Because the areas where these new homes will be built are subsidized by public dollars, costs may be artificially low, creating further inequity among existing homeowners.

- **TIF uses the public's tax dollars to create private profit.** TIDDs use future tax increments to pay developers for the costs of private infrastructure development, like roads, sewer and water lines. Without a TIDD, these costs would be born by private developers.

- **GRT funds should benefit the whole state, not just one area.** The Department of Finance and Administration's chief economist has raised concerns about using state GRT revenues in TIDDs: "In effect, [a TIDD] is a capital outlay project that will only benefit residents of the project area and the near surrounding areas, but will be funded by all the taxpayers of New Mexico through lower levels of state services."

- **TIDDs don't pay their fair share to help the larger community.** First, while other citizens pay property and sales taxes to help pay for government operations, services and capital for maintenance and rehabilitation of infrastructure needed by the entire city, TIDD taxpayers will pay first and foremost for TIDD infrastructure with little left over for the expansion of city or county services into the TIDD or for meeting basic needs outside of the TIDD.

- **TIDDs create a competitive disadvantage for small businesses.** TIDDs create an artificial marketplace that favors large corporations and big box retailers, who generate larger amounts of GRT.

- **TIDDs suck money, jobs, homebuyers and economic vitality out of the existing community.** Rather than spurring development, Greg LeRoy of Good Jobs First argues, TIFs "move some economic development from one part of a city to another." In this way, TIDDs can create a spatial mismatch between unemployed workers in the city core and job growth at the fringe. Sprawl also drains the tax base from the inner city and inner-ring suburbs, forcing those areas to raise tax rates and cut back on public services. Schools, healthcare, public safety, libraries, parks and other public services all suffer, and that in turn makes the neighborhoods less attractive for employers. Furthermore, unless significant affordable housing and public transportation is offered, urban and low-income workers may not be able to benefit from the new jobs created in TIDDs on the fringe of the city.

Environmental Concerns

- **Although originally developed to promote urban infill development, TIDDs have been being used to subsidize "greenfield" development.** Subsidizing fringe development and drawing jobs and vitality from the existing community contributes to global warming. New Mexico already ranks 6th in the nation for per person vehicle miles traveled. As a result, transportation emissions are the second largest source of carbon dioxide pollution in New Mexico, and the fastest growing source of new emissions. Unfortunately, New Mexico's TIF law incentivizes sprawl development, which makes this problem worse. Although some TIDD proposals incorporate mixed use and transit-oriented development components, reducing transportation and land use greenhouse gas emissions means changing not just *how* we develop, but *where*. A "smart location" outperforms even the greenest sprawl house with hybrid cars.

- **Subsidizing sprawl contributes to loss of open space.** From the wide open prairie grasslands of the eastern plains to the deserts of our southern borderlands, high peaks of our Northern mountain ranges and endless solitude of our vast expanses of national forests, New Mexico has a rugged beauty that is unparalleled. Yet as more and more people discover the state's treasures and all that life here has to offer, the natural environment that defines New Mexico has become increasingly threatened. According to the U.S. Department of Agriculture's National Resources Inventory (NRI), between 1982 to 1997, when population in the contiguous United States grew by about 15 percent, developed land increased by 25 million acres, or 34 percent. Most of this growth is taking place at the edge of developed areas, which can include forestland, meadows, pasture, and rangeland. Because New Mexico's TIF law attracts large masterplanned communities and incentivizes greenfield development, our open space will be increasingly threatened.

- **Inefficient land use patterns and growth on the fringe negatively impact public health.** Ozone levels are higher in sprawling areas. Traffic fatalities rise as people spend more time in their vehicles. Sprawl also means less people walk and bike to work, school and shops and has been linked to increased rates of obesity and hypertension.

- **Increased impervious land cover contributes to declining water quality.** Development that uses land efficiently and protects undisturbed natural lands allows a community to grow and still protect its water resources. Higher density development results in less runoff and impervious cover and affects less of the total watershed than low density development.

Lessons Learned

- **Chicago, Illinois**: In 1970 Illinois had only one TIF district; by 2007, the state had 874. A report conducted by the Cook County Commission found that many of Chicago's TIFs failed to grow any more than similar areas where TIF has not been used. And, because of a failure to account for inflation, local governments in Cook County have lost nearly $700 million simply to inflation, the report concluded. They also identified a lack of transparency in budget reporting, noting that if TIF had been included in the city's 2005 budget, it would have ranked as Chicago's fourth largest budget category. Additionally, comparing TIFs to comparable non-TIF districts, they found that 40% of Chicago's tax increment from 1997 to 2005 has been captured, not created, by TIF. As a result, they found that Chicagoans paid nearly 3% more in taxes than they would have had to if incremental property value had been *created*, not captured by the TIF. Illinois' use of state taxes offers an additionally cautionary tale for New Mexico. Within a year of expanding TIDD to state funds, the sheer number of new requests threatened to drain the state treasury. An emergency repeal was enacted, and pre-existing TIFs were scaled back.

- **Denver, Colorado**: A study by the Front Range Economic Strategy Center found that only 2 of 15 projects in the city of Denver were exceeding revenue projections and that, on average, projects were performing at only 62% of original projections.

- **Kansas City, Missouri**: A study conducted by Dr. Michael Kelsay at the University of Missouri-Kansas City found that on average, TIFs produced only 23% of projected revenues, and were rarely focused in areas in the most need of redevelopment. An audit by city government noted that 50% of TIF districts that issued bonds were not generating enough revenue to cover the bond payments.

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