

TIF 101: PROPER CREATION AND USE OF TAX INCREMENTAL DISTRICTS

League of Municipalities

October 15, 2010

Joe Gromacki, TIF Coordinator

Economic Development Division

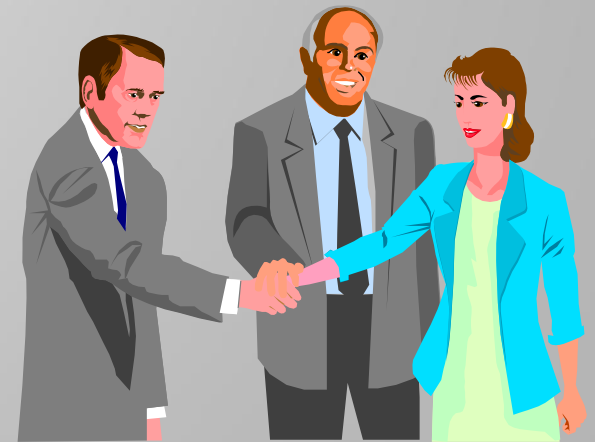
Department of Planning & Community & Economic Development

City of Madison, WI

Part 1: History

In the past:

- ❑ Cities paid for development costs but shared the tax benefits with other tax districts. This was not equitable.
- ❑ In the 1950's, the State of California developed Tax Increment Finance or "TIF".
- ❑ In 1975, the Wisconsin Legislature responded created its own the TIF Law.
- ❑ Through TIF, cities and other tax districts share both the costs and benefits of development.



Part 2: Foundations and Elements

TID Boundary—

- The city proposes a geographic boundary around a development or redevelopment area.
- The boundary must contain whole units of property.

Types of TIDs—

- Blighted Area-27-yr. Life, 50% blighted
- Industrial – 20 –yr. Life, 50% zoned and suitable for industrial
- Mixed Use –20-yr. Life, 50% zoned for mixed-use, no more than 35% newly-platted residential

Base Value & Tax Increment—

- Property value that exists prior to the creation of a TID.
- Other tax jurisdictions don't lose revenues they had prior to TIF
- Tax increment = Total levy on value growth above, flows to City

Cost Recovery—

- When costs are repaid, TID must close
- Value growth returned to other tax jurisdictions
- Residual tax increment distributed

Eligible & Ineligible Project Plan Costs per TIF Law

Eligible Costs

Public Improvements
Streetscape
Land Acquisition
Demolition
Remediation
Construction
TIF Administration Cost
Finance Cost

Ineligible Costs

Public Buildings
City Operating Costs
Assessable Costs

1. TID Boundary Drawn

2. TID Base Value Established: \$1,000,000

Tax Distribution:

City	\$6,000
County	10,000
School District	13,000
<u>Technical College</u>	<u>1,000</u>
Total Levy	\$30,000

3. TID Created – Partnership With Overlying Tax Jurisdictions

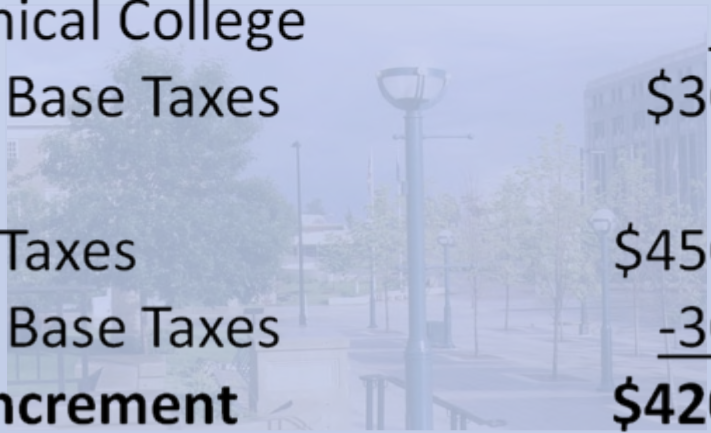
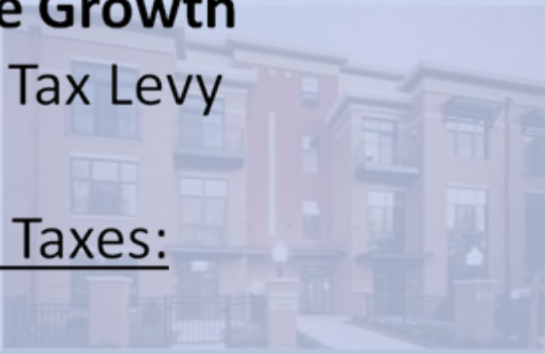


4. Development Occurs



5. Tax Increment Generated

Value Growth	\$15,000,000
New Tax Levy	\$450,000
<u>Base Taxes:</u>	
City	\$6,000
County	10,000
School District	13,000
Technical College	<u>1,000</u>
Total Base Taxes	\$30,000
New Taxes	\$450,000
Less: Base Taxes	<u>-30,000</u>
Tax Increment	\$420,000



Steps to Create a Tax Incremental District (TID)

- ▣ **Blight Determination:** A private consultant measures blighting conditions in the area.
- ▣ **TIF Project Plan:** Staff draws a boundary, forecasts growth and project costs.
- ▣ **Public Hearing:** The Plan Commission hears public comment. Common Council adopts.
- ▣ **Joint Review Board:** Overlying tax districts approve the TID.

TID Creation Process - Timeline

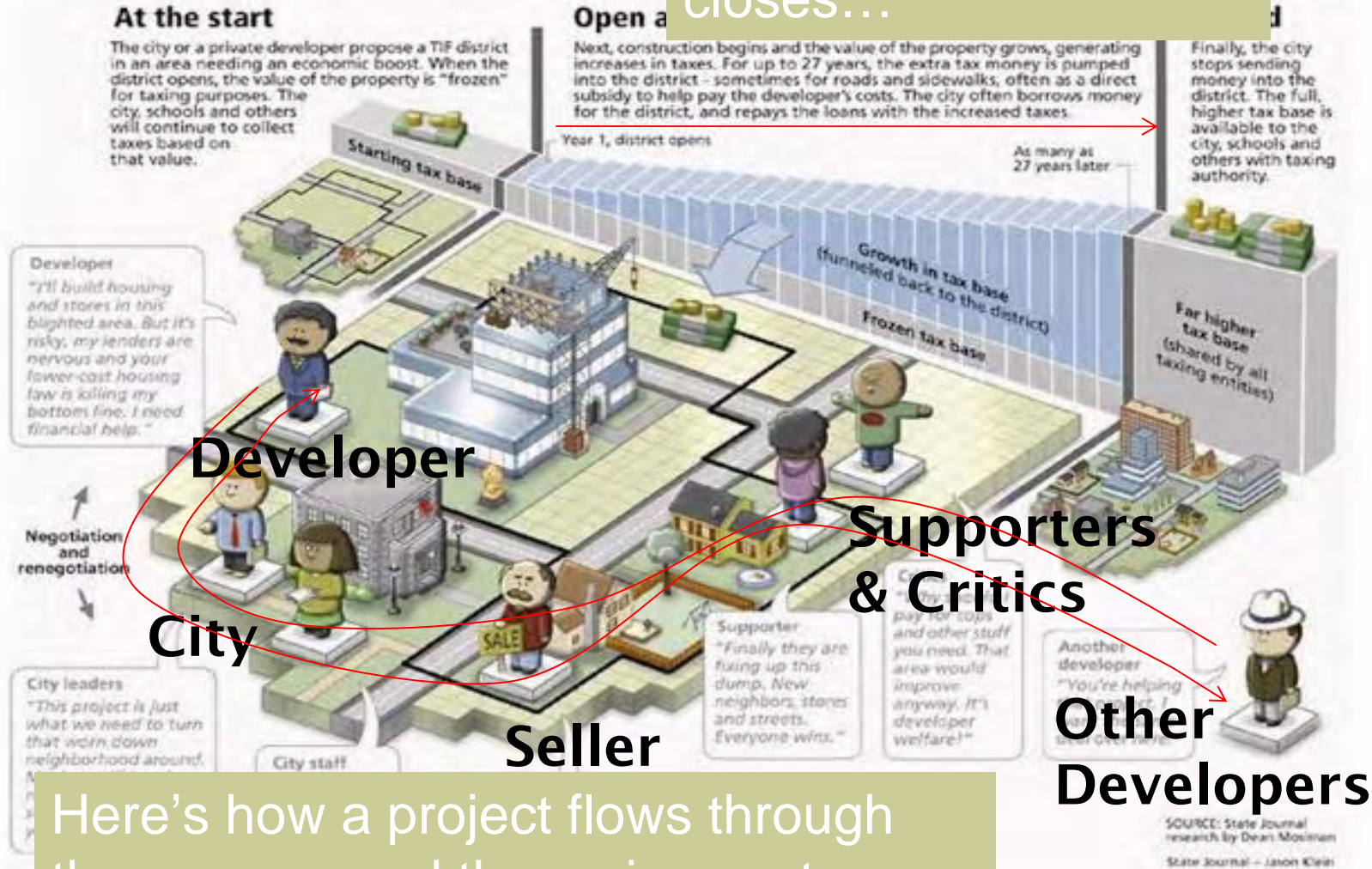


What is blight?

- ▣ There are three types of blight:
 - 1) Physical
 - Poor condition
 - Obsolete platting or poor land use
 - 2) Economic
 - Declining property value
 - High vacancies
 - 3) Social
 - Crime
 - Unemployment
- ▣ There are different degrees of blight...
 - Correctable (i.e. a broken window, cracking paint or graffiti)
 - Severe (i.e. cracked foundation wall or sagging roof)
- ▣ A blight determination does not trigger condemnation, cause a cloud on title, building code enforcement or penalties.

The TIF Process

Here's how the TID begins, grows and then closes...



Here's how a project flows through the process and the various actors that affect it.

Part 3: TID Management

TIF Objectives and Policies:

1. Set priorities for TIF
2. Establish rules for creation and amendment of TIDs
3. Create TIF Loan underwriting standards

Financial Decision Making

1. Importance of TIF Generator
2. How TIF Pays for Cost
3. Methods of Financing
 - Accrual & Borrowing
4. Cost Recovery and TID Closure
5. Gap Analysis

City of Madison TIF Policy

- TIF Process
 - Land Use and TIF decisions made simultaneously
- Key TIF Underwriting Policies:
 - TID creations or amendments must have at least \$3 MIL TIF “generator”
 - A project requiring a TID creation or amendment must meet the “but for” prior to TID being amended or created.
 - “But for” standard is determined through gap analysis
 - The “50% Rule” – a project is eligible for up to 50% of TIF it generates
 - Developer equity must equal or exceed TIF loaned to the project.

Does every project
get TIF assistance?



Not always. TIF Policy outlines its objectives, priorities and practices concerning the use of TIF.

Some projects are more desirable than others because they meet one or more of these TIF Policy objectives.

Importance of a TID Generator

- ▣ Near-term private development projects, called “TID generators” are essential to generate immediate tax increment that jump-starts a new TID.
- ▣ Madison TIF Policy requires that new TIDs have at least a \$3 million TID generator.
- ▣ Expenditures in the TID Project Plan are conservatively timed upon such generators.

How TIF Pays for Costs

Project Cost



The Two Methods of TIF Funding

Year	Estimated Increment	Accumulated Increment Method	Discounted Value of Dollar	Borrowed Funds Method
1	\$0	\$0	1.00	\$0
2	\$210,000	\$210,000	.95	\$199,500
3	\$420,000	\$630,000	.90	\$567,000
4	\$425,000	\$1,055,000	.85	\$896,750
5	\$430,000	\$1,485,000	.80	\$1,188,000

Increment may be spent as it is collected or accrues

Or..borrow funds based on the discounted value of tax increments collected over time.

Cost Recovery and TID Closure

1. Excess increment is deposited in a special debt service account.

Funds Borrowed	\$2,000,000	10 Years, 5% Interest					
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Balance Owed (P&I)	2,550,000	2,550,000	2,250,000	1,960,000	1,680,000	1,410,000	1,150,000
Tax Increment	-	420,000	430,000	440,000	550,000	650,000	750,000
Annual Principal Pmt	-	(200,000)	(200,000)	(200,000)	(200,000)	(200,000)	(200,000)
Annual Interest Pmt.	-	(100,000)	(90,000)	(80,000)	(70,000)	(60,000)	(50,000)
Total Payment	-	(300,000)	(290,000)	(280,000)	(270,000)	(260,000)	(250,000)
Excess Increment	-	120,000	140,000	160,000	280,000	390,000	500,000
Accrued Excess Increment	-	120,000	260,000	420,000	700,000	1,090,000	1,590,000
Accrued Excess Increment Yr. 7	1,590,000						
Balance Owed (P&I)	(1,150,000)						
Residual Tax Increment	440,000						

2. When enough excess increments accrue to make the remaining principal and interest payments, the TID closes.

3. A portion of the residual tax increment is distributed to each tax jurisdiction when the TID closes.

Positive Impact of TIF at Closure

So... in return for foregoing their portions of the levy on value growth, overlying tax jurisdictions benefit by increased tax revenues when a TID closes.

Base Value	\$1,000,000	
Incremental Value	<u>15,000,000</u>	
Total Value Upon TID Closure	\$16,000,000	
<u>Taxes:</u>		
City	96,000	\$ 90,000 increase (16x)
County	113,000	\$103,000 increase (10x)
School District	225,000	\$212,000 increase (17x)
Technical College	<u>16,000</u>	\$ 15,000 increase (16x)
Total Tax Levy	\$450,000	

Without TIF, the schools would receive their share of the levy with perhaps, modest growth.

But what if we wait? Don't our schools need those levy revenues right now?

TIF's objective is to increase that levy through significant value growth.

Finally, TIF is budget-neutral for schools, i.e. a reduction in value growth = increased by state aid.

Conversely, increased value at TID closure = reduced state aid.



Tax Levy Without TIF

	Year 1	Year 2	Year 3	Year 4
Property Value	\$1,000,000	\$1,020,000	\$1,040,000	\$1,060,000
Taxes Levied*	30,000	30,600	31,200	31,800
% Value Growth	2%	2%	2%	2%
*Constant mill rate	Here's the impact of a slower value growth without TIF			
<u>Taxes</u>				
City	\$6,000	\$6,120	\$6,240	\$6,360
County	10,000	10,200	10,400	10,600
Schools	13,000	13,260	13,520	13,780
Tech. College	<u>1,000</u>	<u>1,020</u>	<u>1,040</u>	<u>1,060</u>
Total Levy	\$30,000	\$30,600	\$31,200	\$31,800

In this case, the benefit of a \$450,000 future tax levy with TIF outweighs foregoing 2% value growth without TIF.

But how do we know that the \$15 million project wouldn't be built anyway?

By proving that a “but for” condition exists.
We do this through gap analysis.



Gap Analysis: Important Steps

Step 1: Estimate available TIF.

- ▣ Value estimate is important. Value drives the amount of tax increment.
- ▣ The City estimates increment generated by either a project or a TID in a document called a “TIF Run.”

Step 2: Analyze sources and uses (cost).

- ▣ Loans, Equity, lending ratios etc. Are they standard?
- ▣ Verify costs, ratios, industry standards for soft costs, fees

Step 3: Define the gap, present the “but for” finding.

- ▣ Gap exists when cost exceeds funding sources
- ▣ Gap is demonstrated by numbers, not a developer incentive
- ▣ No gap = no TIF. No questions.

Step 4: Audit the project at completion

- ▣ If actual numbers are different, developer repays difference
- ▣ Keep data for comparison

The "TIF Run"

TIF Increment Projection

TID # 28 - Block 51 Phase 1 - with \$43,090,000 of Incremental Development Today (22 Broom St Condos)

5/14/05

Note how the value is timed based on construction

YEAR	INCREMENT CALCULATION				AVAILABLE FOR ASSISTANCE	
	DISTRICT VALUE AS OF JAN 1	PROJECT VALUE ADDED	INCREMENTAL VALUE AS OF JAN 1	INCREMENT REVENUE	INCREMENT AFTER COVERAGE	PRESENT VALUE
2006	2,799,000	1,920,000				
2006	4,607,660	32,076,000	1,874,660	1,874,660		
2007	56,775,613	9,194,000	\$4,042,813	40,524		
2008	46,705,325		43,972,329	729,139		
2009	47,659,436		44,906,436	924,047		
2010	22,445,792,310	434,048,564	45,859,225	925,867		
2011	23,792,639,848	472,210,527	46,564,036	927,671		
2012	25,220,092,239	491,098,948	50,655,351	929,456		
2013	25,733,297,774	510,742,906	48,833,459	931,222		
2014	25,337,295,640	531,172,623	49,364,787	932,468		
2015	30,037,533,378	552,419,527	53,649,743	934,669		
2016	31,839,789,381	574,515,309	54,722,737	936,409	468,204	222,113
2017	33,750,172,501	597,198,961	55,817,192	938,162	469,051	206,264
2018	35,775,182,854	621,395,839	56,933,536	939,777	469,889	194,987
2019	37,921,693,626	646,252,713	58,072,207	941,436	470,718	182,593
2020	40,196,995,455	672,102,821	59,233,651	943,078	471,539	170,907
2021	42,608,815,183	698,985,934	60,418,324	944,704	472,352	160,002
2022	45,165,344,068	726,945,112	61,626,660	946,313	473,157	149,789
2023	47,875,264,739	756,024,268	62,859,224	947,907	473,954	140,226
2024	50,747,780,629	786,265,389	64,116,409	949,486	474,745	131,270
2025	53,792,647,461	817,715,848	65,398,737	951,049	475,525	122,885
2026	57,020,208,308	850,424,482	66,708,712	952,598	476,299	115,032
			<u>43,090,000</u>	<u>17,666,947</u>	<u>6,893,424</u>	<u>4,157,150</u>

Note how tax increment accrues

ASSUMPTIONS:

Annual Increase in Citywide Tax Base	6.00%
Annual Increase in Tax Levy	4.00%
Annual Increase in Assessment after construction	2.00%
Percent of Estimated Increment Available	50.00%
Assumed Interest Rate (Discount Rate)	7.00%
NPV Assumes Discounting to	2005

NPV= 8,314,301

4,157,150

Value and levy growth and interest assumptions

The amount that could be borrowed

The amount available to project per 50% Rule

Buildout Today

Excerpt from Gap Analysis

5/24/00

City of Madison
Gap Analysis for TIF Assistance

Joe's Copy

2

Capital Point Condominiums (Block 100) **FINAL**

COST	Proposed	
Land	\$ 2,533,000	
Hard Cost (Market Rate)	\$ 18,372,000	
Hard Cost (Affordable)	\$ 575,000	
Parking	\$ 1,925,000	
Soft Cost	\$ 3,963,000	
TOTAL COST	\$ 27,368,000	

Includes: \$850,000 developer fee.

Adjusted	
\$ 2,678,000	
\$ 18,122,000	
\$ 575,000	
\$ 1,925,000	
\$ 3,963,000	
\$ 27,263,000	

Includes:
\$1,883,000 - Parkside
795,000 - Buck's (\$145,000 over budget)
Cost is high. Must reduce by \$250,000.

EQUITY	Proposed	
Cash	\$ 2,258,000	
Land	\$ 342,000	
Prepays	\$ 500,000	
Developer Fee	\$ 400,000	
Other	\$ -	
TOTAL EQUITY	\$ 3,500,000	

City's

Adjusted	
\$ 2,258,000	
\$ 342,000	
\$ 500,000	
\$ -	
\$ -	
\$ 3,100,000	

Includes Contingencies:
\$250,000 - Holding Cost
\$150,000 - Affordable Renovation
\$350,000 - Misc. contingency
\$175,000 - Buck's Relocation

Staff does not include deferred developer fees as equity.

PROFIT	Proposed	
Investment Period (Years)	2.00	
Return on Equity %	13.24%	
	Proposed	Per Unit
TOTAL PROFIT	\$ 927,000	\$ 11,305

Adjusted	
2.00	
12.00%	

City profit allowance is 12% per year.

Adjusted	Per Unit
\$ 744,000	\$ 9,073

Staff adjusted return percentage to 12% per year over 2 yrs. (24%).

ADJUSTED GAP	Proposed	Per Unit
Net Sale Price	\$ 25,446,960	\$ 310,329
Less: Total Cost	\$ 27,368,000	\$ (333,756)
Initial Gap (w/o Profit)	\$ (1,921,040)	\$ (23,427)
Add: Adjusted Profit	\$ (927,000)	\$ (11,305)
		\$ (34,732)

Adjusted	Per Unit
25,437,610	\$ 310,215
27,263,000	\$ 332,476
(1,825,390)	\$ (22,261)
(744,000)	\$ (9,073)
(2,569,390)	\$ (31,334)

Adjusted gap is not a TIF commitment. See After TIF Pro Forma.

In this column, the project numbers are analyzed.

In this column, the City makes adjustments based on market data.

Capital Point Condominiums (Block 100) *FINAL*

AFTER TIF PRO FORMA

Project Sources & Uses	Adjusted	Per NSF	Includes housing and commercial units.	TIF/Unit		TIF shall not write-down sales prices.	Pro Forma - After TIF	
				TIF/Unit	Old TIF		Pro Forma - After TIF	
Net Sale Price/Unit	\$ 293,225	\$ 166.10		\$ -	\$ -	\$ 293,225		
Parking Sales/Stall	\$ 14,512		NSP for 96 stalls (6.5% broker fee).	\$ -	\$ -	\$ 14,512		
Land Cost/Unit	\$ 32,659	\$ 19.42		\$ 14,634	\$ 1,199,988	\$ 18,025	CEDU analysis determined \$18,000 as feasible market threshold for land costs.	
Hard Cost/Unit	\$ 228,012	\$ 131.45		\$ 10,214	\$ 837,548	\$ 217,796		
Soft Cost/Unit	\$ 48,329	\$ 28.75		\$ -	\$ -	\$ 48,329		
Parking Cost/Stall	\$ 20,052			\$ 5,540	\$ 454,280	\$ 14,512		
Avg. Profit (Loss)/Unit	\$ (21,316)			\$ 30,388	\$ 2,491,816	\$ 9,073	Profit After TIF	
			The profit (loss) per unit before TIF assistance is provided.			\$ 9,073	Target Profit/Unit	

SOURCES AND USES

Leverage (Sources)	Proposed
Loan(s)	\$21,020,000
Equity	\$3,500,000
TIF	\$2,748,000
Total Leverage	\$27,268,000

Adjusted
\$ 21,671,184
\$ 3,100,000
\$ 2,491,816
\$ 27,263,000

Leverage Ratios	Proposed
Loan to Value (LTV)%	82.63%
Loan as % of Cost	76.81%
Equity % of Cost	12.79%
TIF % of Cost	10.04%
Total % of Cost	99.63%

Adjusted
85.19%
79.49%
11.37%
9.14%
100.00%

Total Cost (Uses)	Proposed
	\$ 27,368,000

Adjusted
\$ 27,263,000

This section analyzes and adjusts profit

TIF Available @ 50%	\$ 2,729,540
Recommended TIF Assistance	\$ 2,492,000

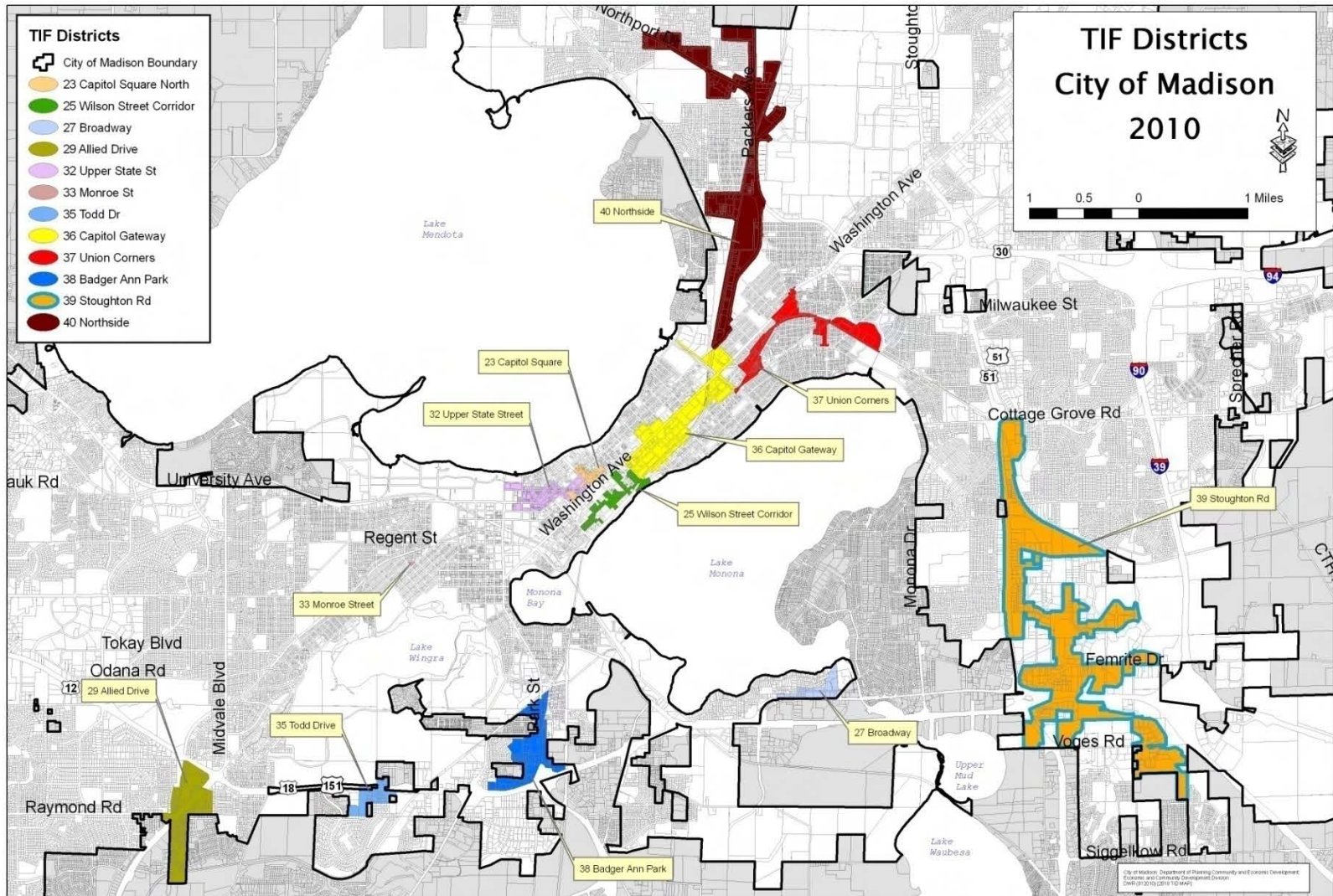
The gap finding is the result of all adjustments to sources, uses and profit

This section analyzes and adjusts sources and uses

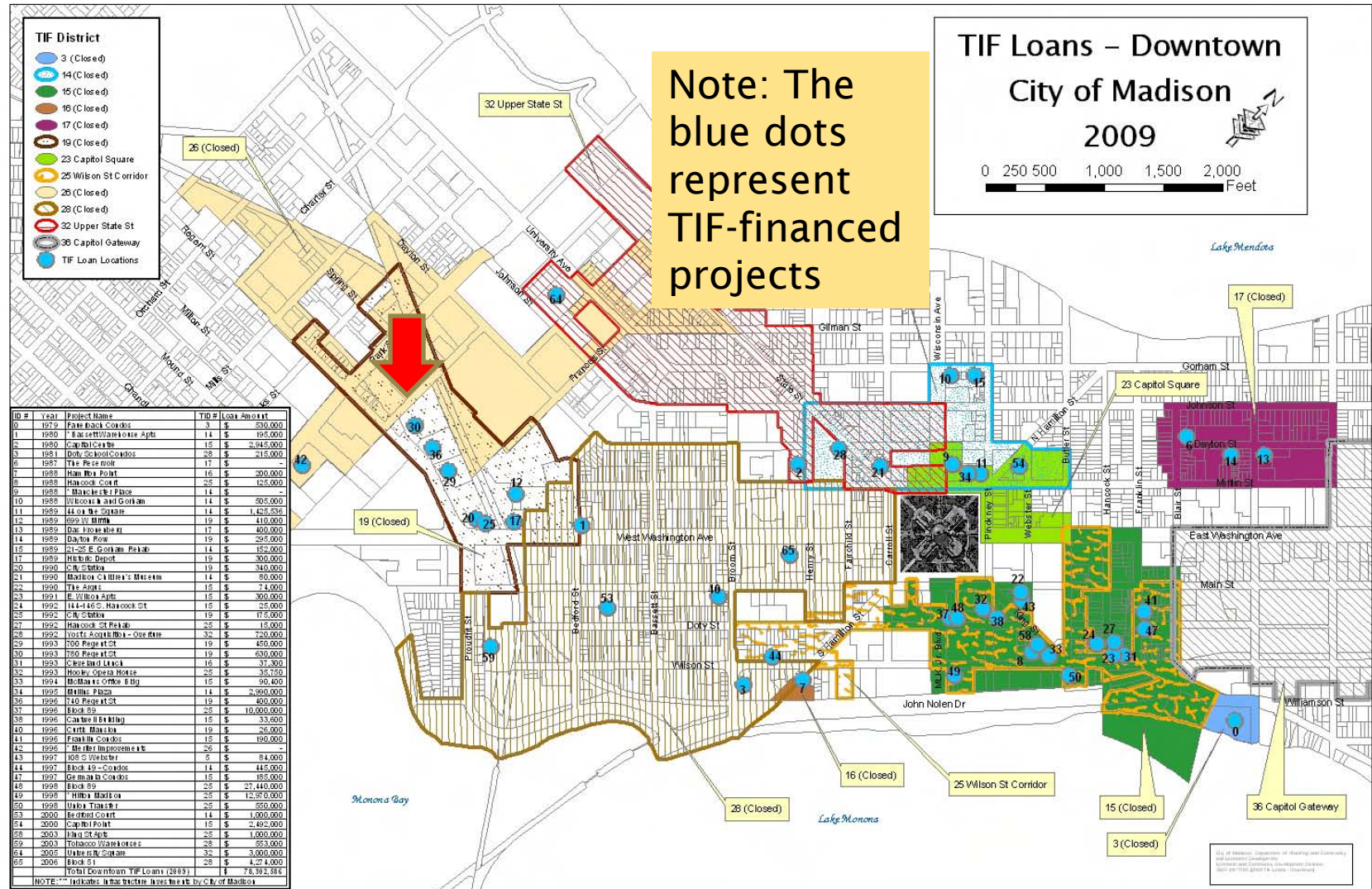
Part 4: Madison TIF Track Record

- 36 TIDs created since 1977.
- No failed TIDs—i.e. increment is repaying debt
- 12 active TIDs
- \$95 million of TIF invested in 68 projects
- \$1.3 billion of growth in all active TIDs.
- Average TID Life: 12 years
- Residual Increment Distributed By TID Closings: **\$21.3 million**
- Residual Increment Distributed to Schools By TID Closings: **\$9.7 million**

Active TIF Districts



Detail: Downtown TIFs



Questions

More questions contact:

Joe Gromacki

TIF Coordinator

City of Madison, WI

215 Dr. Martin Luther King Jr. Blvd

Madison 53701

(608) 267-8724

jgromacki@cityofmadison.com