

Using Tax Increment Financing for Brownfields Redevelopment

by Evans Paull

Summary

Tax Increment Financing (TIF), once considered on the cutting edge of economic development incentives, now is a mainstream tool in most parts of the country. The connection between brownfields projects and TIF financing works in certain circumstances, but it could have more widespread application, even reaching some weak-market and upside-down sites, if brownfields financing vehicles were specifically designed to complement TIFs. Several states have taken the lead in structuring such programs, notably Michigan, Connecticut, and Wisconsin. Other states should consider state-facilitated TIF financing as an effective and efficient means to improve their brownfields programs and obtain cleanup-redevelopment results.

Growth of TIF Financing

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

In the 1980s, California boosted the TIF phenomena when Proposition 13 forced localities to make the most out of their existing revenue sources. 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 al-

most 2,000 total 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 now has completed six such agreements and three more are on the drawing boards (three of the nine total are brownfields projects). Massachusetts recently became the 49th state to adopt TIF enabling legislation.

While quantitative data are in short supply, brownfields projects also have benefited from this trend, as brownfields success stories from every region of the country cite TIF financing 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 a site's pre-development levels and then uses the expected post-development increases in taxes as a revenue stream to finance a bond or loan, which then pays for the upfront (infrastructure) costs. There are, however, numerous variations on the theme. At one end of the spectrum are cities and states that use TIF only for private development gap financing and the TIF district is small and well-defined, often coinciding with the project that will be financed. At the other end of the spectrum are communities that designate large areas of the city, or even the entire city, and then use the TIF revenue much like general obligation bonds in order to fund capital projects that can't be financed through operating funds.

While there are many exceptions, some discussed below, the usual TIF approach involves going to the private bond market to convert the incremental revenue stream into upfront cash for the project.

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. Cleanup expenditures are usually not eligible uses of TIF proceeds. This limitation sometimes has to do with statutory authority — many states restrict the use of TIF proceeds to public infrastructure. But even in states where this is not the case, cleanup of private property is interpreted as “private activity,” in which case the TIF bond becomes taxable, meaning the terms will be less favorable and the bond will be harder to sell.
2. TIF bonds, in many cases, can be sold only when the “vertical development” (the buildings, as opposed to site improvements) is 100 percent assured. This means that the funds may come into the project too late to assist with the upfront brownfields-related expenditures. This timing problem is particularly difficult for local governments that are acquiring and cleaning up

brownfields without a committed end user.

3. The tax increments often are less than they should be for brownfields sites because the base property tax value usually does not reflect the impact of the contamination on the property's value.

These are not insurmountable problems — many brownfields projects work with TIFs that only assist with the infrastructure and only provide funding when vertical development is ready to proceed. However, brownfields development could get a real boost if states designed their TIF authority and financing programs in order to facilitate the brownfields-TIF connection. A number of states have done exactly that.

The state that has been involved the longest and has the most tools in place for making the TIF-brownfields connection is Michigan.

Michigan Brownfield Redevelopment Authorities

TIF is the key element in Michigan's brownfield program. To encourage brownfield redevelopment, the Brownfield Redevelopment Financing Act (1996 PA 381, as amended) allows 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. Local Brownfields Redevelopment Authorities (BRAs, the entities that govern the TIF plans) also may establish a Local Site Remediation Revolving Fund from surplus captured taxes in order to cover cleanup and site preparation at other designated properties in the BRA's jurisdiction.

Michigan's TIF-Complementary Financing Programs.

Recognizing the mismatch between how the bond market works and how brownfields projects work, Michigan

created three alternative financing vehicles, including Brownfields Redevelopment Grants (BRG) and two loan programs — Brownfields Redevelopment Loans (BRL — for cleanup) and Revitalization Revolving Loans (RRL — for demolition and site preparation).

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The two loan programs are designed to work with TIFs, as they feature flexible repayment terms, such as no payments due for the first five years and 2-percent interest rates. These terms are an ideal match with front-loaded, long-lead-time brownfields projects. Notably, the RRL funds demolition and site preparation because Michigan recognized that brownfields projects often involve financing gaps that are due to a whole set of site conditions, not just cleanup.

The developer also may apply for a Single Business Tax (SBT) Brownfield Redevelopment Credit, which boosts the state's participation in a project. This credit can total 10 percent of any innocent party's development (not cleanup) costs, up to \$1 million.

With Michigan's BRG grant program, its two TIF-oriented loan programs, and the SBT tax credit, Michigan has an impressive arsenal to close financing gaps on brownfields projects. However, all but the SBT are now endangered as funding through

the Clean Michigan Initiative has been exhausted and renewal is uncertain.

Michigan — Results.

There are 261 BRAs in Michigan. The state's brownfields incentives have provided \$120.7 million for 296 projects statewide since program inception in 1998. Although there is no comprehensive accounting of impacts, a typical example might be the City of Grand Haven, which is using BRA TIF financing for three projects:

- *Grand Landing:* The project is a \$70-million residential/mixed use redevelopment of a former tannery. A \$2-million cleanup has been financed through a \$1-million state grant and a \$1-million state loan to be paid back through BRA TIF;
- *Challenge Shop:* This \$11-million redevelopment for industrial/commercial/office use includes \$3.9 million in remediation/site preparation that the developer will recoup through the BRA TIF.
- *City-owned property at Jackson Street and Beacon Boulevard:* Plans call for a mixed-use development, projected at \$50 million in new private investment. The city is utilizing BRA tax capture to finance \$10.4 million in site/infrastructure work.

Other State Programs that Work with TIFs

A number of other states have adopted measures that are designed to encourage the use of TIF mechanisms for brownfields. These include:

Wisconsin's Environmental Remediation Tax Incremental Financing

This program represents a new twist on previous Wisconsin TIF authority, which was already one of the more permissive. Wisconsin law allows TIF funds to flow back to the developer for a variety of allowable development costs (not limited to public in-

frastructure.) The application of TIF to brownfields sites (under either the new Environmental Remediation authority or under the previous TIF authority) involves three basic models:

- Locality advances cleanup/site preparation funds to the developer from a previously authorized general obligation (GO) bond issue and then reimburses itself from the tax increments;
- Locality takes the proposed project to the bond market, as a revenue bond, to raise the upfront funds for the project; advances the bond funds to the developer; and then reimburses itself from the tax increment;
- Developer finances the cleanup/site preparation from private sources, and the city agrees to devote the tax increment to re-pay part or all of the developer's investment.

Connecticut's Brownfields

Redevelopment Authority (CBRA)

CBRA offers financing for brownfields remediation through its parent organization, the Connecticut Development Authority (CDA). Grants up to \$10 million (derived from the TIF) are available to investors, developers, and business owners who undertake brownfields redevelopment projects. CDA has pre-existing bond funds that are used for this purpose. The grant proceeds can be used for any expense directly related to the remediation of the project, and the project can be located anywhere in Connecticut. Municipal authorities must agree with CBRA as to the allocation of incremental tax revenues. The allocation is the key factor in determining the amount of the grant.

A typical site might involve: an improvement that will generate \$100,000 in new annual taxes; an agreement by the city to devote 50 percent of the incremental taxes for 10 years to the TIF; the delivery by CBRA of \$500,000 (minus fees) to the developer for the

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cleanup costs. 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

This 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 can 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

This program permits 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.

Creative Solutions in Mississippi — Bringing State Tax Revenues to a Deal

Most TIF projects work with local property taxes as the revenue stream, but for some projects, that is not enough to cover a financing gap. Such was the case for a 540-acre former-chemical plant on the Mississippi River in Vicksburg, Mississippi. Under an agreement adopted under special legislation by the Mississippi state legislature, all state taxes (sales, income, and franchise taxes) will be rebated to the developer for ten years or 2½ times the cleanup costs, whichever is less. With this financing in place, Silvertip Properties (the developer) is proceeding with an \$8-million cleanup, which is paving the way for a planned resort and casino.

Using Federal Programs with TIF on Brownfields Sites

The two federal programs that have been successfully matched up with TIF financing on brownfields sites are HUD 108 and the Environmental Protection Agency's (EPA's) Brownfields Cleanup Revolving Loan Fund (BCRLF).

HUD 108

At least two cities — Baltimore and Chicago — have successfully carried out brownfields projects using HUD 108 with TIF repayment. Because the ultimate security for a HUD 108 loan is the city's Community Development Block Grant allocation, the Department of Housing and Urban Development (HUD) views a TIF deal with much more flexibility than the bond market. A HUD 108 loan can be interest-only for several years, an important advan-

tage for front-loaded brownfields deals (although not as good as Michigan's no-payments for five years). Most importantly, HUD can issue the loan coinciding with acquisition, rather than coinciding with vertical development, as would be the usual case with bond market TIF financing.

HUD 108 has been used extensively for TIF/brownfields projects in Chicago. In 1996, the city developed a strategy for addressing the increasing problem of abandoned industrial property by combining three tools: acquiring property through tax foreclosure and eminent domain; borrowing from HUD 108 (\$72 million total) to finance cleanup, site preparation, and infrastructure; and re-paying the loans through land sales and TIF proceeds.

Baltimore is using a \$13-million HUD 108 to finance the acquisition of 11 acres of land just south of M&T Bank Stadium on the Upper Middle Branch of the Patapsco River. The area will be redeveloped as "Gateway South," a green business park. TIF and land sale proceeds will repay the HUD 108 loan. Baltimore is currently entertaining two development proposals, each featuring about 800,000 square feet of new space and each projected to generate at least 1,500 jobs and \$100 million in new investment. Both developers are committed to meeting a LEED Silver standard for green buildings.

EPA — BCRLF

EPA's Brownfields Cleanup Revolving Loan Fund (BCRLF) is another flexible source of financing, although it can only be used for cleanup. A good example is that the City of Des Moines, Iowa structured a \$1 million BCRLF loan to finance the cleanup of the former Pittsburgh-Des Moines Steel site in the Riverpoint West redevelopment area. The developer's plans call for three industrial/flex buildings with about \$15 million in new improvement value. The city is dedicating 50 percent of the tax increment for 12 years

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to the cleanup. The loan is structured with no payments for three years, then, as the new buildings go on the tax rolls, payments are made from the tax increments generated in that year, with the developer responsible for any shortfall.

Conclusions — State-Supported TIF Financing

While the above federal resources are productive places to explore for TIF help, it is at the state level where most deals get done and where there is real promise for innovation. States that are looking to get more mileage from their brownfields programs would do well to consider financing mechanisms that work with TIFs. Comparing state-supported TIF financing to the more common state approach of doling out direct loans and grants for brownfields site assessments and cleanups, there are at least five advantages to the state-supported TIF approach:

- 1. More money into deals** — TIF financing, with a potential ability to capture taxes for as long as 30 years, can put more dollars into a deal than is typical of cash-strapped loan and grant programs. The result is that more sites and tougher sites are being redeveloped.
- 2. The perfect marriage of state and local commitment** — State funds can be viewed

as leveraging local funds, as well as private investment. The state's investment goes further — is more productive — under this arrangement.

- 3. Greater use of loans and guarantees/less use of grants** — State funds can be mostly (or even exclusively) loans and guarantees rather than grants. Once a loan program is capitalized it will revolve and self-generate.
- 4. Greater efficiency in use of limited funds** — The state-supported TIF framework has automatic controls because localities are going to scrutinize a deal that involves foregoing taxes for many years. Lacking the TIF element, state loan and grant programs may encourage inefficiencies because local advocates will try to maximize state investment.
- 5. More proactive action by local government** — The availability of state TIF-linked loan funds under favorable terms allows local governments to proactively acquire, cleanup, and redevelop mothballed and other difficult sites that have failed to attract private investment.

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