Tax Increment Financing: Process and Planning Issues

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Abstract

Tax Increment Financing (TIF) is a technique for harnessing future revenues to pay for current expenditures that local governments use for financing (re)development activities. TIF has provided countless dollars to enable the municipal planning function at a time when other sources of funds have dried up. In the following primer, we provide an overview of the mechanism and describe its workings in a typical municipal context. We pay particular attention to the planning decisions that arise during the designation and implementation stages, and provide a hypothetical example to illustrate the mechanics of TIF use. We then evaluate the decision to use TIF for different kinds of development projects by looking at case studies of TIF in varying built environments and fiscal contexts across the United States and reviewing the existing scholarly literature. Finally, we identify reform efforts to address the concerns raised about TIF's implications for the fair and effective use of public monies.

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Tax Increment Financing: Process and Planning Issues

Introduction

Tax Increment Financing (TIF) is a technique that local governments use for financing (re)development activities. A local government designates an area for improvement, demonstrating that the area meets the eligibility requirements set out in the state's enabling legislation, and drafts a redevelopment plan of improvements it expects to see take place within the designated boundaries of the TIF district. The local government often subsidizes developers to make these improvements. As property values in the area rise and taxes increase, the local government uses the future growth in property tax revenues to pay off the initial and ongoing economic development expenditures.

TIF is essentially a tool for harnessing future revenues to pay for current expenditures. It is a reallocation of property tax revenues from a city's general fund to a smaller, more local jurisdiction – a TIF district. It is often misrepresented as a new tax or tax abatement, but property owners within the district only pay their "normal" tax burden – no more, no less. However, some of these same owners are often receiving a portion of their property taxes (and the revenues of others) back in the form of firm-specific subsidies for development, and, it can be argued, all property owners within the district may benefit from the TIF-financed infrastructure improvements.

This development incentive has been in existence for more than 50 years, but it has experienced a large surge of interest in the last 15 years or so. Although commonplace on the West Coast and upper Midwest, TIF is now used in 49 states and the District of Columbia. In the state of California, 78 percent of all local governments had a redevelopment agency in 2003, hosting a total of 386 active TIF districts.[1] In 2005, Illinois was home to 550 TIF districts, 130 in Chicago alone. Between 1991 and 2001, TIF revenue accounted for 38% of Minneapolis' revenues for economic development.

TIF has financed countless urban, suburban, and rural development projects across the country. Milwaukee used TIF, for example, to revitalize a declining downtown shopping center and to integrate development there with surrounding neighborhoods. Newark used TIF to convert a historic downtown structure into luxury residences. Fort Worth used TIF to finance the infrastructure improvements needed to lure big-box retailer, Cabela's. TIF has financed industrial expansions in rural Leominster, Massachusetts and New Ulm, Minnesota. It was even used to finance the International Spy Museum in Washington, DC!

Some of TIF's popularity can be attributed to factors external to a municipality's political and financial regime. A precipitous decline in federal funds for economic development, state-imposed restrictions on debt and property tax growth, and low interest rates have all

[1] TIF districts are called Community Redevelopment Agencies or CRAs in California. They are called District Improvement Financing programs or DIFs in Massachusetts.

been cited as reasons for the increase in TIF use. Moreover, TIF is part of a growing trend in municipal finance toward thinking about infrastructure and public improvements as having primarily localized impacts. If property taxes are generated in a specific location, the logic goes, they should also stay and be used in that same area, instead of being channeled to other parts of the municipality. Indeed, if TIF really causes property values in the district to increase, it may be considered "self-financing" and may obviate the need for unpopular tax rate hikes.

However, as we explain in the following pages, part of TIF's popularity is also due to its innate attractiveness as a local economic development tool. It offers local officials flexibility and autonomy in planning and decision-making and removes contested revenue allocation decisions from the frisson of every-day budgetary politics. With TIF, a municipality's redevelopment department or authority creates its own cache of earmarked funds; it does not have to compete with other government agencies at budget time. This form of off-budget (re)development financing has its advocates and detractors.

TIF has provided countless dollars to enable the municipal planning function at a time when other sources of funds have dried up. As such, the relationship between planning and this quirky form of financing needs to be better understood. What are the advantages and disadvantages of municipal dependence on TIF? When is it appropriate for planners to rely on TIF, and when might other governance and financing arrangements be better suited? How does TIF influence the critical land use, infrastructure, and public assistance decisions that planners make?

In the following paper, we provide an overview of the mechanism and describe its workings in a typical municipal context. We pay particular attention to the planning decisions that arise during the designation and implementation stages, and provide a hypothetical example to illustrate the mechanics of TIF use. We then evaluate the decision to use TIF for different kinds of development projects. Here we provide case studies of TIF in varying built environments and fiscal contexts across the United States. We review the scholarly literature on TIF's impact and effectiveness. Finally, we identify reform efforts that state and local governments have implemented to address the concerns raised about TIF's implications for the fair and effective use of public monies.

Planning for TIF

Legal authority

States set the legal context in which local governments tax, borrow, and spend. As wards of the state, municipalities depend on enabling legislation to provide them with powers to control and manage their economic and fiscal well-being. TIF is no exception. The power to use this financing mechanism must be expressly allowed by the authorizing state government. In the absence of such legislation, TIF may not be adopted by local governments. By 2005, 50 states and the District of Columbia had passed such legislation (although Arizona repealed theirs in 1999).

In most states, only municipalities are legally empowered to selectively reduce the tax bills paid by business and other property owners (e.g., by reducing the assessment rate) or to channel new growth to separate project funds. As such, they are the only legal entity empowered to designate TIF districts. For example, the Illinois Tax Increment Allocation Financing Act (Municipal Code, Chapter 24) was adopted in 1977, allowing municipalities alone to establish TIF districts. In some states, including Florida, Georgia, Minnesota and Missouri, enabling legislation has granted redevelopment authorities or state economic development commissions the power to designate such districts (see our case studies of Fort Ord in California and Michigan's SmartZone program). These authorities may have a municipally appointed or elected board, may possess the power of eminent domain, and may be authorized to levy their own taxes.

Despite the variation, common features of state enabling legislation include elements of the designation process (including any required notices and public hearings) and a listing of what public and private expenditures may be lawfully financed by TIF. Legislation must conform to state constitutions, which require that taxing districts spend public money for public purposes (Schoettle, 2003). What constitutes a *bona fide* public purpose is rarely spelled out in detail in the legislation, and municipalities continue to run afoul of the law when TIF provides what some may perceive as intentional, as opposed to incidental, private benefit.

Initiation

How does a municipality decide when to use TIF? In many cases, the process is initiated from outside the walls of City Hall. Developers, property owners, and private businesses propose the designation of a TIF district to assist them with redevelopment plans and projects on a specific site. These private interests may have identified a vacant parcel, deteriorated building, or underutilized area that, if developed, would yield needed property tax revenues. Municipalities often prefer to initiate TIF districts based on a developer's solicitation of funding because it reflects the developer's willingness and interest in investing in the area.

In other cases, the public sector may initiate a TIF designation on its own, without any external pressure to do so. Municipalities rarely adhere to formal policies for when TIF should be used, preferring a modicum of choice and flexibility in this matter. In the following section, we discuss several case studies that give insight into when the redevelopment objectives and TIF are best matched.

A municipality may decide to initiate the TIF process in an area without developer pressure when it:

- sees an opportunity to aggressively market a weak or very high-risk market. The municipality may wish to develop an important site (e.g., a highly visible location on a main arterial) or peripheral area that has not yet received much private developer interest.

- wants to pursue a mega-project. A municipality may wish to truly transform the fabric of a particular community and the scale of the proposed redevelopment is too large to attract any one developer. This may be the case with a military base conversion or a downtown entertainment district plan.

- identifies or anticipates specific site impediments that may discourage developers**.** Specific risk factors, such as potential environmental contamination, demolition, or historic restoration requirements, can deter development interest away from a site that is otherwise fundamentally feasible because such impediments will lead to high interest rates and/or high equity requirements.

- wants to have more control over development activities in a heated market. TIF can enable municipalities to write down the cost of land in expensive markets so that publicly or socially desired land uses (institutional uses, commercial uses, affordable housing) may appear more viable.

As we will explain, municipalities should consider alternatives to TIF with smaller-scale projects that cannot promise to generate spikes in property tax revenues or when potential developers do not require assistance with the up-front costs of land development.

Designation process

Once a municipality has decided to go forth with the TIF designation process, state enabling legislation may set out requirements for the physical boundaries of the proposed redevelopment project area. In Illinois, the project area must be at least one and one-half acres in size, must be contiguous, and must contain only properties that will be "substantially benefited" by the proposed TIF plan.

A review of the shape and size of TIF districts in any state would reveal that boundaries are often highly irregular and areas covered are quite varied. Parcels that have already reached what may be considered the pinnacle of their property value growth, residential areas, and institutional buildings (that pay no property taxes) are often excluded from TIF

districts. Political gerrymandering may also have an impact on the ultimate form of the district as council members demand that boundaries be drawn to reflect their respective interests.

Most states require that the project area meet both a "blight" and a "but for" requirement. Blight may be construed in many different ways, although most definitions harken back to the heyday of urban renewal in the 1960s and 1970s in defining this condition as one that threatens public safety, health, morals, or welfare. A blighted area is typically one where the built environment is older, deteriorated, depreciated, excessively vacant or abandoned, overcrowded, or sparsely developed compared to the rest of the municipality. For example, the TIF statute in Illinois requires that structures in a targeted area must meaningfully meet five of the following factors to be considered blighted:

> age; dilapidation; obsolescence; deterioration; illegal use of individual structures; presence of structures below minimum code standards; excessive vacancies; overcrowding of structures and community facilities; lack of ventilation, light or sanitary facilities; inadequate utilities; or excessive land coverage; deleterious land use or layout; depreciation or lack of physical maintenance; lack of community planning, are detrimental to the public safety, health, morals or welfare, or if vacant, the sound growth of the area is impaired by, (1) a combination of 2 or more of the following factors: obsolete platting of the vacant land; diversity of ownership of such land; tax and special assessment delinquencies on such land; deterioration of structures or site improvements in neighboring areas to the vacant land, or (2) the area immediately prior to becoming vacant qualified as a blighted improved area (65 ILCS 5/11-74.4-3(a)).

Property values may be declining or not increasing as fast as the municipal average. Some states allow for the blight requirement to be bypassed when other conditions are present. For example, industrial areas with a labor surplus or military bases that have been decommissioned may not need to be blighted in order to be designated as a TIF district.

The municipality must also attest to the fact that the area would not develop in the absence of incremental revenues derived from the creation of a TIF district. In other words, "but for" the TIF assistance developers would not invest in the area. Even more so than the blight requirement, this is a question that is difficult to answer definitively. However, municipalities can provide evidence that would satisfy this requirement, the origin of which stems from the public purpose doctrine. In particular, municipalities can determine:

- whether a prospective developer has adequate financial resources to fund the entire project;

- how long the key properties in the proposed redevelopment area have been abandoned or vacant;

- whether and what kinds of efforts have been previously attempted to improve the area;

- whether the key properties are marketable, and if they have been on the market, for how long and with what results;

- the assessed value of key properties relative to comparable properties.

Evidence to support the blight and but for determinations may be required in an "eligibility study" that is drafted either by municipal planners or by outside consultants retained by the municipality.

Once the municipality is confident that a proposed area meets the state's guidelines for eligibility, it must convene a team to engage in planning for the area. The team may be comprised of representatives from the lead government agency, real estate consultants, community based organizations, and financiers. This group may be tasked with the responsibility to prepare a redevelopment plan in accordance with the state legislation. The plan must be reviewed at public hearings.

Public hearings are typically required by the enabling legislation as are the guidelines for public notices. Notices are published in newspapers circulated in and around the affected area, and mailings must often be sent to property owners within the proposed redevelopment area. A state economic development agency or comptroller may also require notification. At the public hearing the boundaries of the district and the redevelopment plan are discussed, as are any financing options. Representatives from the developer, planning consultants, and local community along with city planners are often present. Affected parties are given an opportunity to express their opinions, and a transcript of the statements is recorded. These parties are not typically granted any legal powers to veto the proposed TIF district or modify the plan. But some states do provide more power to the community: for example, Georgia legislation requires voter approval for all new TIF districts.

Once hearings have adjourned and interested parties have submitted comments, the legislative body of the city must pass an ordinance that would approve the plan, designate the area as an official redevelopment district, and adopt TIF. The ordinance adopting TIF may also establish a separate tax allocation fund which is set up to receive the incremental property taxes from the district. In many cases, owners of property determined to be "blighted" must be notified. If there is significant and organized opposition to the TIF district boundaries or to the proposed plan, individual city council members may withhold their support or condition their support on specific changes to the proposal. Figure 1 identifies specific parties that often have an interest in opposing TIF districts and what planners can do to diffuse this opposition.

Figure 1: Potential opposition to TIF designation

Existing businesses within the proposed TIF district	
Arguments	**Strategies**
Because TIF involves allocating property tax dollars to particular development projects, municipalities open themselves up to accusations of bias and favoritism. Existing businesses in the proposed district fear that they will be overlooked as municipalities seek to attract larger businesses from outside the area. This is particularly true in the case of TIF districts where the predominant land use is retail. TIF has been used to lure national retailers and big-box format stores that, in some instances, have cannibalized the sales of local businesses.	Planners need to make efforts to understand the local market for products sold within the proposed district to determine how any newcomers may influence it. They may also want to propose a funding program especially for existing businesses so that not all of the new increment generated in the district goes toward improvements where the primary beneficiaries have few or no local roots (see case study of Chicago's Small Business Improvement Fund).
Existing homeowners within and outside the proposed TIF district	
Arguments	**Strategies**
Fear of rapid residential appreciation and displacement has prompted popular protest against the use of TIF across the country. Because TIF depends on increased property values to create the financing for economic development, existing residents within the district have reason to believe that their property values will rise more than they would without the use of this mechanism. Moreover new development within the district may drive up prices of homes in areas surrounding the district.	Planners can take steps to moderate the pace of appreciation for long-time home owners in neighborhoods where TIF is used. They can draw district boundaries so that few residential parcels are included. They may suggest various "circuit breakers" to protected targeted groups (the elderly) from steep property tax increases. They can provide a pool of funds from the TIF increment that is available to homeowners for building investments.
Overlapping taxing jurisdictions	
Arguments	**Strategies**
Property tax revenues generated within the district are unavailable to overlapping jurisdictions for the lifespan of the district. School districts and other jurisdictions across the country have sued or have threatened to sue municipalities over TIF, claiming they are being denied access to revenues that are rightfully theirs. These jurisdictions have gone from friendly requests for alternative redevelopment schemes, to hard-sell negotiation for a portion of the increment, to legal action.	Planners can alert all taxing districts about their interests in pursuing a TIF district and work with these entities to negotiate a deal preemptively that rewards the other jurisdictions for their participation in the TIF over time. We discuss other relevant reform efforts at the end of this paper.

The mechanics of TIF

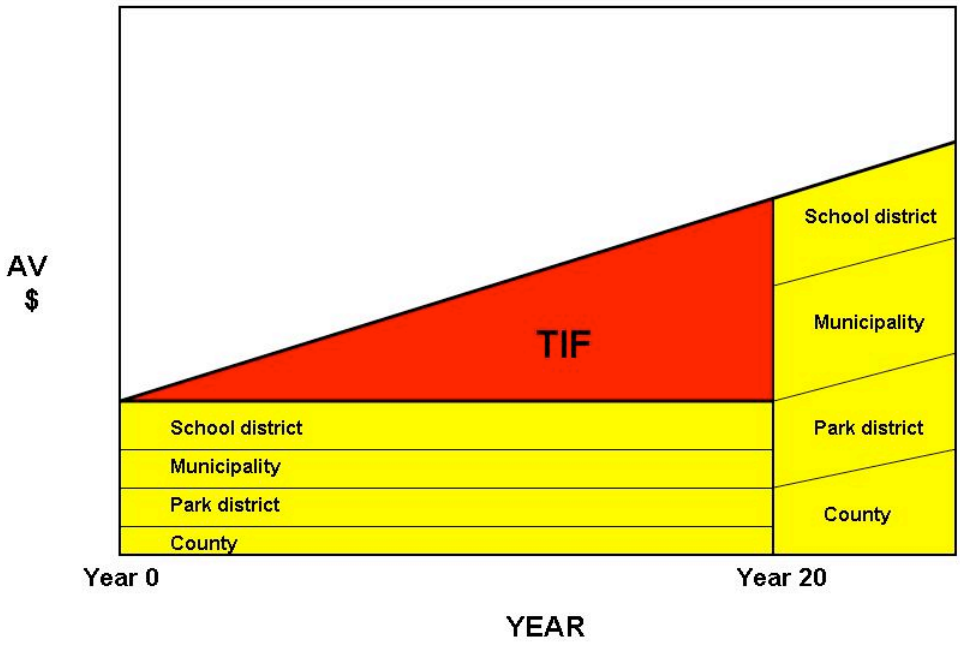
Once an area is designated as a TIF district, the initial assessed property valuation in the district is held constant for a period specified in the individual state's enabling legislation. The cumulative value of all parcels within the district at the moment of designation is known as the "base value" or "initial assessed value" and must be certified by the agency in charge of property assessment and valuation. In most states the base value does not increase during the lifespan of the TIF. In some states, such as Minnesota, the base may increase with the rate of inflation. The base value is the amount that will form the baseline for the TIF and will be used to measure incremental property taxes as redevelopment occurs.

In theory, after the designation of the TIF district, private development should be attracted to the district. Developers may be attracted because the municipality has used its powers of site clearance, relocation, utility installation, and street repair to improve the district. They may be attracted because the municipality pays for land assembly and sale, thereby reducing the developer's own equity investment and lowering mortgage payments. They may be attracted because the municipality offers subsidized financing, which lowers the project's financial risk and makes it more financially viable. They may be attracted because of the inherent desirability of the location. The "but for" requirement is intended to guard against this last scenario as it is the TIF-funded public incentives that are supposed to be the draw. If a developer would have been attracted to the site without assistance, it is less clear that the "but for" requirement has been met.

As public improvements are made and private investment is attracted to the area, the assessed value of property and its taxes are expected to rise. Indeed, when TIF designation is tied to a particular development project, properties in the district often experience a strong, initial surge of demand due to the specific growth "shock," and property values may spike in the first few years of the TIF district's life.

The difference between the base value and new assessed value in the district is the "value increment." This value, when taxed by all participating local governments produces the "tax increment". Instead of channeling the tax increment to the city's general fund and to other taxing bodies with jurisdiction over the area, these funds are channeled to the TIF authority and used to finance any debt the authority accumulated when making improvements (see Figure 2). Without TIF, each overlapping jurisdiction would levy its individual tax rate on the assessed value available in its district, and the municipality would be but one of several that receives revenues. With TIF, any increase in the assessed property values of the district over the lifespan of the TIF district will go into a separate fund and will pay for TIF activities, while taxes on the base value of the properties will remain the same and will continue to be paid to the local taxing bodies.

Figure 2: The allocation of assessed value (AV) in a TIF District



In reality, there are actually three separate kinds of value increment, which together collectively are the basis for the new property tax revenue that municipalities are able to access for development expenditures. These include the:

- development increment – the new value created by the new construction and the spillover effects of the new construction.

- inflationary increment – the increase in value that is attributed to the rate of increase in the general price level of all goods and services, including real estate.

- "natural" increment – the new value that is created by public and private development that would have been attracted to the location without TIF inducements and improvements. This is value attributed to development that would not have met the "but for" requirement.

In most states, the municipality or redevelopment agency governing the TIF district has access to all three kinds of value increments, even that which it did not directly create through this form of public intervention. Moreover, in some states, municipalities can access revenues other than property taxes that are generated within the district. In Missouri, for example, sales and use taxes are directed to the TIF fund, in addition to incremental property tax revenues.

The lifespan of TIF districts varies across states. In some states, a maximum life is set, and municipalities may choose to terminate the districts at any time beforehand. For example, in Massachusetts the time limit is 20 years, in West Virginia it is 30 years, and in Florida it is 40 years. This is the time period in which the state would expect the redevelopment plans of the municipality to be implemented and financed. Typically, the term of any bonds floated to front fund projects within the district is tied to the designated lifespan.

Other states, such as Texas and Georgia, do not specify a time limit but wait until the initiating jurisdiction votes to terminate the district, typically when all redevelopment costs have been paid. Even in states without legal limits, TIF districts tend to last for 20-25 years. This is because most TIF projects require a "gestation period" of approximately this amount of time to generate net benefits for local governments (Huddleston 1982).

Calculating property tax increments

There are actually two different methods for calculating tax increments, the aggregate method and the parcel method (Davis 1989). Knowledge of both methods will help planners to more accurately anticipate the fiscal performance of a TIF district.

The parcel method. When using the parcel method, as the name suggests, increment is calculated on the basis of individual parcels. The difference between the base EAV and the current EAV of each parcel is considered value increment, but the base is considered a moving target and may change if a new parcel is created.

What happens when a parcel is subdivided or is merged with other parcels, which are both common practices in property redevelopment? In the parcel method, these practices result in the creation of a new parcel, and consequently, a new base EAV. If a new *base* EAV is established, no increment can be collected from that parcel until the parcel has increased in value above the new base. Consider this example: two parcels within a TIF district are assembled and developed into a luxury condominium complex. Both of the assembled parcels were vacant lots with low base EAVs. But because the two vacant lots were combined into one new parcel, a new base EAV is calculated (likely higher than the original value of the lots) and the anticipated increment is significantly lower than expected.

In the parcel method, the base value is a moving target and can decline if the value of a parcel depreciates. Every year the base EAV of the parcel is calculated by determining whichever is lower, the initial EAV when the TIF was designated or the current EAV. The base may drop below the initial EAV when a building is demolished (a popular use of TIF funds). Any subsequent development on this site will create more increment if the new base value is lower than it was before the improvements were demolished.

The Aggregate Method

Under the aggregate method, the base EAV is still calculated on the basis of individual parcels, but these figures are aggregated into a total base EAV for the entire district. The amount of base EAV then remains unchanged unless the boundaries of the TIF district are altered. Consequently, the creation of new parcels within the existing boundaries has a negligible effect when using the aggregate method. Moreover, when the aggregate method is used, changes in the EAV of one parcel can offset changes in another.

The following case, derived from Davis (1989), will clarify the difference between the two methods. Assume that Figure 3 represents activity in a TIF district consisting of only two parcels of land. In the first year after the TIF district's designation, Parcel A contains a small building, and Parcel B is a vacant lot. The initial base EAV for the entire district is $50,000. In year 2, the Parcel A building is demolished and replaced with a parking lot (EAV $1,000). A shopping center was developed on Parcel B (EAV $99,000).

Figure 3: Calculating property tax increments

	Parcel A	Parcel B	Total EAV
Year 1 EAV	$49,000	$1,000	$50,000
Year 2 EAV	$1,000	$99,000	$100,000

	Parcel Method	Aggregate Method
Base EAV	$2,000	$50,000
Current EAV	$100,000	$100,000
Value increment	$98,000	$50,000
Tax increment @ 5 %	$4,900	$2,500

Adapted from Davis, 1989

Using the Parcel Method

Neither parcel was subdivided nor were the two parcels combined. However, under the parcel method, the base EAV for the district is calculated by summing the current EAV or the initial EAV, *whichever is lower*, for each parcel. Thus, the total base EAV for the district would be $2,000. The current EAV is calculated by summing the current EAV of each parcel. Using the parcel method, the district would generate $98,000 in value increment. Because the base EAV is a moving target and has decreased in this case, the municipality stands to gain more increment.

Using the Aggregate Method

The boundaries of the TIF district did not change in this example, so the base EAV of $50,000 remains unchanged in Year 2. Parcel A's $48,000 decrease in EAV is offset by a $98,000 increase in the EAV of Parcel B. In this particular case, the value increment generated ($50,000) is lower using the aggregate method as is the tax increment ($2,500).

In either case, the consolidated tax rate of participating local governments (assuming a hypothetical 5 percent) is applied to the value increments to produce the annual tax increments, as shown in Figure 3.

The role of overlapping jurisdictions

Taxes on any increment go into a separate fund to pay for TIF activities, while taxes on the base value of the properties remain the same for the designated lifespan of the TIF. In other words, overlapping taxing jurisdictions can only apply their share of the consolidated tax rate to the equalized assessed value that existed before the TIF was designated (unless, as in Minnesota, legislation allows them to tap the inflationary increment).

Overlapping jurisdictions may be county governments, school districts, library districts, or other special purpose districts with jurisdiction over property in the TIF. In certain parts of the city of Chicago, for example, up to fifteen overlapping districts are affected by TIF, including the Chicago Board of Education, the Chicago Park District, Community College District, Mosquito Abatement District, Chicago Transit Authority, Urban Transportation District, Forest Preserve District, The Metropolitan Sanitary District of Greater Chicago, the Cook County Health and Hospital Governing Commission, and Cook County. These taxing bodies must wait until the end of the life of the TIF district to levy taxes on the growth in the tax base.

In many states each municipality is required to form some sort of an oversight or review board for the TIF district, consisting of representatives of each of the affected jurisdictions. In some states, these boards lack any kind of veto power over the TIF designation or activities within the district. Moreover, in many states, these boards do not meet as regularly as required.

In many states the participation of these other taxing jurisdictions is mandatory; i.e., individual taxing jurisdictions cannot avoid contributing their share of future tax increments to development activities within the district. Indeed, TIF appears to be most popular in places with large numbers of overlapping taxing bodies. This is because, in such places, a greater proportion of tax base is claimed by non-municipal entities, and, therefore, municipalities have a strong incentive to "recapture" them through tools like TIF.

Why is one local taxing body able to unilaterally make decisions that have the potential to affect the tax bases of other taxing bodies? This "common pool" situation – where multiple jurisdictions share the same property tax base and try to extract the funding they need from the base without repelling current and potential residents and businesses – is associated with the kind of fiscal fragmentation commonly found within the United States. Some view the foregone revenues of the non-municipal taxing bodies as partial repayment for what the municipality will spend on improvements and subsidies for new private development. If the overlapping jurisdictions did not contribute up-front, the logic goes, these entities would be able to benefit from the TIF-induced development as

free riders. Therefore, one rationale for TIF use is that beneficiaries should pay for some of the benefits they accrue.

Moreover, if the use of TIF is indeed responsible for the new growth (e.g., in the case where financial incentives and land assembly played a decisive role in attracting new commercial or industrial development to the district), then the tax revenues generated by this development are not necessarily being "diverted" away from these jurisdictions. They would not have existed in the first place. In areas where property tax revenues were declining or growing slowly, TIF may eventually provide a financial advantage for these jurisdictions by increasing the size of the tax base. They will receive a "windfall" of new growth when the district expires. Therefore if new development is solely attributable to TIF, the immediate impact of TIF on school districts is null – except for the cost of providing any net new services associated with the new development that are not TIF-eligible expenses (e.g., educating new school children whose households have been drawn to the area because of development within the TIF district).

Conversely, if the entire increase in property value would have occurred without the use of the mechanism, TIF "captures" the total value of the incremental property increase (which would have increased the base for the overlapping jurisdictions). If TIF has no effect on the value of property within the district and property values increase, either because of normal inflationary pressures or the innate attractiveness of a particular location, then it becomes a device for diverting taxes from overlapping taxing bodies. Huddleston (1986) refers to the potential fiscal transfer from other jurisdictions as the "effective" TIF subsidy, and it increases as the property tax extension of the municipality declines relative to that of the overlapping jurisdictions. In other words, the larger the share of the tax base that a school district claims, the greater incentive the municipality has to capture this share and use it to pay off its own development project costs.

Overlapping jurisdictions fear that TIF may capture areas rich in property with high-growth potential, leaving them with parcels whose values are stagnating or, at least, not increasing as fast. Moreover TIF makes it difficult for such jurisdictions to effectively manage their finances as the decision to create a TIF may take away revenues previously anticipated. This is particularly true when municipalities rely on the parcel method of increment calculation because the base EAV is allowed to fluctuate and can actually decline.

Non-municipal taxing bodies have responded by initiating law suits against municipalities to prevent them from designating TIF districts. In the early 1980s, Los Angeles County sued every one of the localities within its borders that proposed a TIF district (Arana 1986). The County did not believe it was able to access its rightful share of the increment and yet was required to provide additional services within the district due to the TIF-assisted developments. School districts across the country have sued municipalities on similar grounds. They have also demanded inter-governmental agreements (IGAs) that compensate them for a portion of the revenues "captured" by the TIF district. We discuss IGAs in more depth in the final section of this report.

Other jurisdictions choose not to sue even thought they too argue that TIF causes fiscal strain on limited resources by increasing service demands without adequately compensating them for such burdens. Such jurisdictions may choose to raise tax rates to pay for the "loss" of a portion of their tax base and/or increased demand for expenditures. If this is the case, TIF may not negatively affect the overlapping jurisdictions as much as it shifts the burden of financing local services to the property owners in the municipality. In other words, taxpayers pay more for local services when overlapping jurisdictions share their tax base with a TIF district than they would in the absence of such a district.

District-level planning activities

The successful designation of a TIF district will result in holding the assessed value of the district's real property at the level it was in the tax year the district was designated, and then channeling any incremental property taxes produced by increases in assessed value into a special fund. These monies can only be used to pay for redevelopment project costs in the service area, including debt service on TIF bonds, which are intended to be part of the overall TIF redevelopment plan.

TIF redevelopment plans vary across municipalities. In general, the initial TIF redevelopment plan provides planners with loose guidelines for financing specific development and infrastructure projects. In some municipalities, they are formalities. In Illinois, for example, some plans are vague and open-ended "wish lists" of projects that they would like to see funded with increment. In Wisconsin, on the other hand, project expenditures must be specifically identified, and municipalities must define how much can be recovered by tax increments. In other locales, these plans include strategies to meet redevelopment goals, specific site plans, detailed financial analysis, and fiscal impact assessments for the overlapping jurisdictions. Most state enabling legislation requires that TIF plans conform to any comprehensive plans in place for the municipality and should include land uses that have been previously approved by the planning commission. Many municipalities, particularly smaller ones, lack comprehensive plans. In such cases, TIF plans may be required to conform to any existing zoning codes and regulations.

While municipalities retain the power to designate TIF districts, local redevelopment authorities (often public-private entities) and economic development commissions may retain some power to plan for them. In other cases, it is a municipal agency that is primarily responsible for district planning activities. Professional planners, employed as paid consultants, are often hired to draft redevelopment plans. Representatives from the affected communities can advise these plans by serving on the boards of directors of redevelopment authorities or by participating in community planning processes.

TIF legislation provides municipalities with powers to implement the TIF plan within the agreed-to boundaries. These powers may include the ability to: acquire property through purchase, donation, lease or eminent domain and to dispose of such property; demolish or remove existing buildings or structures; renovate or construct any building, public facility, or structure; install, repair, construct or relocate streets, utilities, and site

improvements; collect fees, rents and charges for the use of property; and incur eligible redevelopment project costs. Some of these are powers municipalities already enjoyed before the TIF designation and can be used in areas beyond the TIF boundaries. Such powers may be strengthened by the passage of a TIF ordinance.

States can delimit the eligible costs that the TIF increment can subsidize. These typically include the cost of land acquisition and conveyance, demolition, parcel assembly, land preparation, historic rehabilitation and other façade improvements. Land development and infrastructure are perhaps TIF's most popular uses, although TIF funds may be used for other public goods such as workforce development and training. Most TIF legislation also allows municipalities to offer subsidized, below-market rate financing to private developers from the increment. In Chicago, for example, it is common for TIF to pay for 30 percent of construction period interest costs. TIF funds can often be used to cover the cost of planning studies, surveys, and redevelopment plans, often undertaken by real estate consultants. Most states require that estimated project costs be included in redevelopment plans.

In most states, the increment is not portable. In other words, revenues generated within one district must be used in that very district. In some states, TIF districts within the same municipality may cross-subsidize each other. In Illinois, revenue may be used to finance a project in an adjacent TIF district, and in Minnesota, TIF districts within the same municipality may share increment — but only if this will help to eliminate a deficit.

The plan is implemented through individual redevelopment agreements, which are contracts that govern individual allocations of increment. Redevelopment agreements are critical documents as they formalize details of the individual deal and protect the interests of the municipality and the recipient developer. They provide assurances that development will proceed in a way envisioned by the plan (or at least by the planners, even if not codified into the plan) and describe the different parties' respective obligations. They detail the security provided to guarantee completion of a specific project and, if reflective of a planning process, should protect the municipality and developer from accusations that funds are being improperly used and potentially violating the public benefit provision inherent in economic development legislation. The agreement assures the developer that its project is supported by the municipality with a commitment of funds. Such agreements are often tightly structured – with a development schedule, specific commitment of funds that are allocated at each milestone, and description of terms to ensure the project's timely completion – and may require the developer to adhere to existing regulations (whether for obtaining a license or permit or hiring union or a mandated number of minority-owned contractors).

Redevelopment agreements also specify what municipalities ask for in return for their largesse with the increment. These provisions may include performance requirements beyond the development itself, clawbacks that require the developer to pay back some of the subsidy received if the performance requirements are not met, and other arrangements that may further public interests (e.g., profit-sharing with a government agency). When TIF is used to finance market-rate housing development, for example, the City of

Chicago requires that at least 20 percent of the units built be affordable to households making 80 to 120 percent of the area median income. Similarly, California law requires that redevelopment commissions use at least 20 percent of the tax increment funds collected to increase, improve, and preserve the supply of affordable housing. Because the developer leased publicly owned property, The Los Angeles Community Redevelopment Agency negotiated a participatory lease with the California Plaza project on Bunker Hill in the early 1980s and received 15 percent of all net profits (Arana 1986).

Increment allocation decisions

How does the municipality decide to whom and how much it should allocate portions of the total TIF increment? Such decisions comprise the most crucial part of planning within the TIF district and yet are typically the least regulated and formalized aspect of the entire process. Municipalities retain a tremendous amount of autonomy and flexibility in the increment allocation decision, which is perhaps the reason why local governments love TIF while others – citizens and other taxing jurisdictions – are often suspicious.

There are two broad methods of increment allocation: we call them the "technical" and "political" methods. The technical method of increment allocation relies on two age-old principles in public finance: one is the notion of capital budgeting; and the other is the benefit principle, the notion that the beneficiary (of public services) pays. The notion behind this decision model is simple – if a private developer furthers the principles of the redevelopment plan, they become eligible for a subsidy that amounts to no more than the present value of the future increment their project will produce until the termination of the TIF district (see Figure 4). In other words, the discounted value of expected future increments would represent the upper limit of assistance available to the developer. The rate at which property values may increase on an annual basis is a judgment call, determined by previous rates of growth, the scale of the project, and the rate of inflation. If the municipality planned to go to the bond market for the front funding, it would subtract the cost of debt service and other fees from the stream of increments to get a better estimate of the upper limit of its assistance.

Figure 4: The technical method for calculating TIF allocations to individual developers

$$PV = \sum \frac{(AV_n - AV_b) * TR_n}{(1+r)^n}$$

where,

AV_n = assessed value of the individual property in year n (year following both the designation of the TIF district and construction of the proposed project)

AV_b = assessed value of the individual property in the base year (i.e., the year TIF was designated)

TR_n = consolidated property tax rate in year n

r = public sector discount rate

Just how much lower than this upper limit the private subsidy is depends on several factors: the total development cost of the project, the degree to which the municipality was counting on the project to spur ancillary development, and judgments about the degree to which the subsidy was really necessary for the project to go forward. In general, municipalities apply informal rules of thumb about the percent of the developer's total development cost that they would be willing to finance. In Chicago, for example, this amounts to approximately 8 to 10 percent of developer-specific total development costs (not including infrastructure that would benefit a wider public) (Meck and Friedman 2005). If the public sector included infrastructure and site assembly costs, the public share may rise to 20 to 30 percent of a more inclusive notion of public and private development costs. In all cases, the developer is expected to risk a portion of their private equity in order to assure the municipality they have a strong commitment to the project's completion and successful performance.

The more common alternative to the technical method of increment allocation – if it can even be called a *bona fide* "method" – is guided more by the political context of the proposal than the increment that can be attributed to the individual development project. It is simply reactive municipal deal-making where all the financial details of the deal are open to negotiations and depend heavily on the political cachet of the parties involved. The political method is more popular for several reasons. First, new development often has positive and localized spillover benefits. Individual developers will claim responsibility for all such spillover effects and will seek some compensation for them, in the form of additional subsidy. In Chicago, for example, the district's alderman decides whether the developer is entitled to just the increment that their proposed project will create or the entirety (or a portion) of the increment generated by the whole TIF district. How much of the positive externalities the new development actually causes is not investigated *post facto*. It is the perceived reliability, reputation, and connections of the developer that are at stake.

Second, municipal agencies prefer flexibility in choosing which projects should receive funding. Unlike many federal and state funded categorical programs, TIF can be used for most kinds of projects that demonstrate financial feasibility and promise increases in property value. In general, the only significant restrictions imposed by state statutes are those directing TIF to certain redevelopment areas, defining "blight," and limiting the project term (Paetsch and Dahlstrom 1990).

Even within this loose, "anything-goes" method, projects may be selected and funded according to the following criteria:

- Market conditions. Municipalities tend to give away more assistance when market conditions are weak and capture benefits of rising land values when conditions are strong.

- Project risk. Very high-risk propositions, e.g., an untested market or product, will require public assistance beyond the usual benchmarks.

- Political connectedness**.** If a developer enjoys the support of a city council member with jurisdiction over the TIF district (perhaps because they have made contributions to their reelection campaign), they increase their chances of being awarded TIF increment.

- Private financing "gap". If the developer can convince the municipality that its equity participants will not be able to meet their investment and tax objectives without public assistance, the municipality may be more obliged to provide relief from selected development costs.

- Perceived public benefits. Municipal officials want to structure the deal so that the locality maximizes public benefits (job creation/retention, affordable housing, retail development in underserved areas, beautification, civic identity and pride).

While the political method is the one most preferred by government agencies, it comes with several risks. First, the developer and the municipal planning agency lack any guidelines for what constitutes a fair or efficient disbursement of public tax revenues. The municipality opens itself to suspicions of favoritism and arbitrary behavior. Second, uncertainty about the amount of the allocation combined with an involved and cumbersome application process will discourage all but the most confident and connected of developers from applying for funds. One developer in Chicago estimated that it can take anywhere between one and four years to negotiate the terms of a single redevelopment agreement. Because it relies so heavily on entrenched networks of relationships, this method creates barriers to entry for new developers hoping to break into the local real estate market.

Financing

TIF increments are essentially committed *before* they are generated. In other words, although developers and the public sector require the funds immediately, it is the future stream of expected increments that are assigned to subsidize projects. How do the development parties overcome the temporal inconsistencies in cash flows, especially given the risk that the expected tax revenues will not materialize?

As most projects require an infusion of public capital early on in the life of the TIF, municipalities draw on three "front-funding" methods for TIF projects. These are:

- **Pay-as-you-go**
- **Bond financing**
- **Short-term tax anticipation notes**

Pay-as-you-go

The first method of front-funding projects within a TIF district requires the developer to absorb some of the risk. This method, known often as "pay-as-you-go", forces the developer to pay for their own development expenses. The municipality reimburses the developer as the incremental taxes are generated by all of the parcels within the TIF district. Because developers require larger initial sums of money than the increments trickling in, they often turn to a conventional lender to fill the initial financing gaps. The lender will expect a written commitment from the municipality stating that TIF increments will be used to make principal and interest payments.

Bond Financing

The second method requires the TIF-sponsoring municipality to float bonds to pay for the expenditures within the district. The municipality pays off the bond with property tax increment. In other words, future TIF increments are pledged as security for current borrowing.

The majority of TIF bonds are revenue bonds, i.e., they do not require the sponsoring government to commit its full faith and credit to repaying the bond. They are secured by a dedicated stream of revenue generated by the new development and not by general tax revenues. Revenue bonds are sold through negotiated sales to experienced investors and allow municipalities to circumvent constitutional and statutory debt limitations as well as voter referenda. Some TIF bonds, however, may carry a general obligation or general fund pledge and are tax-exempt, allowing investors to earn a slightly higher than normal return. Other TIF bonds may be secured with pledges of sales tax revenues or other taxes levied and collected on any or all property in the municipality. For many years TIF debt comprised a small, unrated, and obscure segment of the bond market, but as the mechanism's popularity has grown, so too has the amount of bonded debt (Johnson 1999) and the degree to which municipalities can get away with no security other than incremental property taxes. Once a municipality develops a track record of development that generates incremental tax revenues, it can secure insurance, higher ratings, and, ultimately, cheaper debt (Weber 2003).

The amount of the debt issuance is determined by several factors: the anticipated cost of implementing the TIF plan; the term of debt service; agreements about the amount of private capital a developer will contribute; whether the bonds are tax-exempt (and therefore what the interest rate will be); the rate of projected increase in assessed value; and the cost of any potential litigation should there be challenges to the TIF or individual projects within the district (Curtner and Eiseman 1994). Perhaps the most crucial factors in determining whether a municipality will go to the bond market to front-fund a TIF project and how much it will seek to issue are the risks associated with the bonds and their underlying pledges. In bonding the increments, the public sector is taking on much of the risk that these revenues will not materialize.

Tax Anticipation Notes

Instead of committing to long-term, low-interest bond issuances, municipalities may issue short-term, higher-interest debt securities in anticipation of future property tax increments – the third method for front-funding TIF projects. Such products are referred to as Tax Anticipation Notes, and they are used by state and municipal governments to provide immediate funding for capital expenditures. A municipality may provide such notes to the developer, who is then responsible for "monetizing" or selling them to the highest bidder (often through a third-party intermediary). Banks and institutional investors often purchase the notes, taking on the project completion risk and the risk that the tax increments will not materialize in return for promises to be paid back with interest. Proceeds from the sale pay for the developer's TIF-eligible expenses.

The structure of each type of financing instrument can become very complicated to negotiate. Because of conflicting time horizons and risk preferences, the generation of multiple revenue streams, and the idiosyncratic nature of each deal, transaction costs tend to be high. As such, financial consultants are often brought into the project team (at great expense – although their fees are often considered to be eligible TIF expenses) to help municipalities navigate through the world of high finance.

How does a municipality decide which of the three financing options to select? The decision boils down to three primary factors: scale, risk, and timing.

> Scale. Most municipalities are reluctant to use their bonding authority to issue bonds for smaller (approximately under $3 million) projects. This is because the amount of deficit financing needed for small projects—for a new roof or small parking lot for an existing business—is not likely to clear the minimum threshold for new issues or justify the high transaction costs (e.g. bond counsel).
>
> Risk. The greater the perceived risk, the more likely a municipality will seek to migrate that to the developer through a pay-as-you-go scheme or shorter term debt obligations. There are several sources of risk in a TIF deal. In general, property taxes are considered a very risky income stream, less reliable than user fees because they are vulnerable to political gridlock and in-fighting. And individual TIF districts have no independent power to levy and collect property taxes. Even

municipalities are but one of the many taxing jurisdictions that determine the tax rate. If overlapping taxing bodies decide to lower their tax rates, the rate of increment generation may be affected. Moreover, property tax extensions are variable and may be influenced by everything from construction material shortages to economic recession. TIF projects are also considered risky because they often hinge on a commitment from an anchor tenant, who could unexpectedly pull out of the deal. The potential political risks inherent in a TIF deal may also cause municipalities to shy away from bonds. For example, a lawsuit filed on behalf by the tenants of Cabrini Green public housing complex in Chicago stalled an already complicated bond sale intended to raise money to redevelop that site into mixed-income housing.

Timing

If a TIF district is relatively young and no increment has accrued within the increment allocation account, the timing may not be right for a pay-as-you-go TIF (which assumes that some increment is available to reimburse the developer). Especially in a large city with thousands of parcels, it will take several years for the assessor to recognize the new value creation in the district. As such, a municipality may turn to some sort of a debt instrument when it foresees multiple qualified TIF projects and needs to overcome the short-term lack of available cash. On the other hand, the risks involved in a new TIF – the fact that the area does not yet have a good "track record" for development – may make the municipality less willing to put its bond rating behind a speculative project.

Despite the bull market, however, several TIF bonds defaulted in the 1990s, and for every actual default, there were a hundred close calls. Municipalities need to ensure that bonding TIF increments does not jeopardize their fiscal health. Indeed, concerns about interest rates increasing place a pall on the exuberant municipal borrowing of the last decade.

Administration

The management of TIF districts varies across the country. State legislation requires municipalities to designate a manager to keep track and release funds from the TIF accounts. In many states, this is a government agency such as the municipal comptroller (e.g., Chicago and St. Louis) or finance department who controls the cash flow. These agencies do not typically possess the independent discretion to allocate TIF increments to specific projects. They receive authorization to release funds from the agencies responsible for planning and development. In areas where redevelopment authorities are authorized to designate TIF districts, such authorities may manage the TIF accounts in addition to making the allocation decision (e.g., Atlanta). It is common for TIF accounts to earn interest while waiting to be spent and also to be temporarily "borrowed" for other uses when municipal operating budgets are tight. These accounts may temporarily relieve a municipality's operating and capital budgets of some maintenance and capital improvement projects although, in theory, increment investment in the TIF district should supplement instead of substitute for other public expenditures there.

Amending a project area after adoption of TIF ordinance (for example, substantially changing land uses or increasing the term of the TIF plan) is not something that is done casually. Adding or eliminating property from the district may have important implications for the EAV and therefore the increment available to repay bond obligations. As such, the municipality will have to notify the municipal attorney and may have to follow the original set of designation procedures, including a formal public hearing process.

In many states, municipalities are able to extend the lives of their TIF districts if they are able to win state or local approval. In special circumstances, extensions are possible in Minnesota for up to 6 years. More than 35 Illinois municipalities have successfully requested that the state General Assembly add another 12 years to their districts in order to complete their redevelopment plans. In Wisconsin, cities can obtain three year extensions by getting approval of affected local governments.

Hypothetical example: Springdale, Illinois

The following example of a hypothetical TIF district in Illinois is intended to illustrate how TIF works in practice and to tie the disparate pieces of information provided in this section together.

Setting: Springdale, Illinois. Population: 150,000.

Enabling legislation: The Illinois Tax Increment Allocation Financing Act of 1977 (Municipal Code, Chapter 24) provides the legal authority to municipalities to create TIF districts and support them for a period of 23 years. Real estate taxes are the sole source of TIF revenues. It is not possible for overlapping taxing districts to opt out of participating in the TIF district.

Initiation: In 1982, Baumann LLC, a residential developer active in the metropolitan region, approached Springdale's Department of Planning with a proposition to convert a factory complex one mile west of the central business district into residential lofts and townhouses.

City officials were supportive of the idea for several reasons:

- the project would be a catalyst for new residential and office development on the fringe of downtown, an area that had not experienced much development activity and therefore, officials believed, met the "but for" criteria;
- the facility was currently vacant (which, along with several other attributes, helped the area to meet the "blight" criteria), underutilized and benefiting from a tax status that allowed industrial users to pay half their assessment rate for periods of 10 years, with the option to renew;
- Baumann had earned a reputation as a reliable developer of highly marketable products; and
- the demand for urban industrial real estate was lagging behind demand for other forms of space as the economic base became more service oriented.

Springdale hired an experienced TIF consultant to draft the eligibility study, redevelopment plan, and to assist with the passage of a municipal ordinance designating the district.

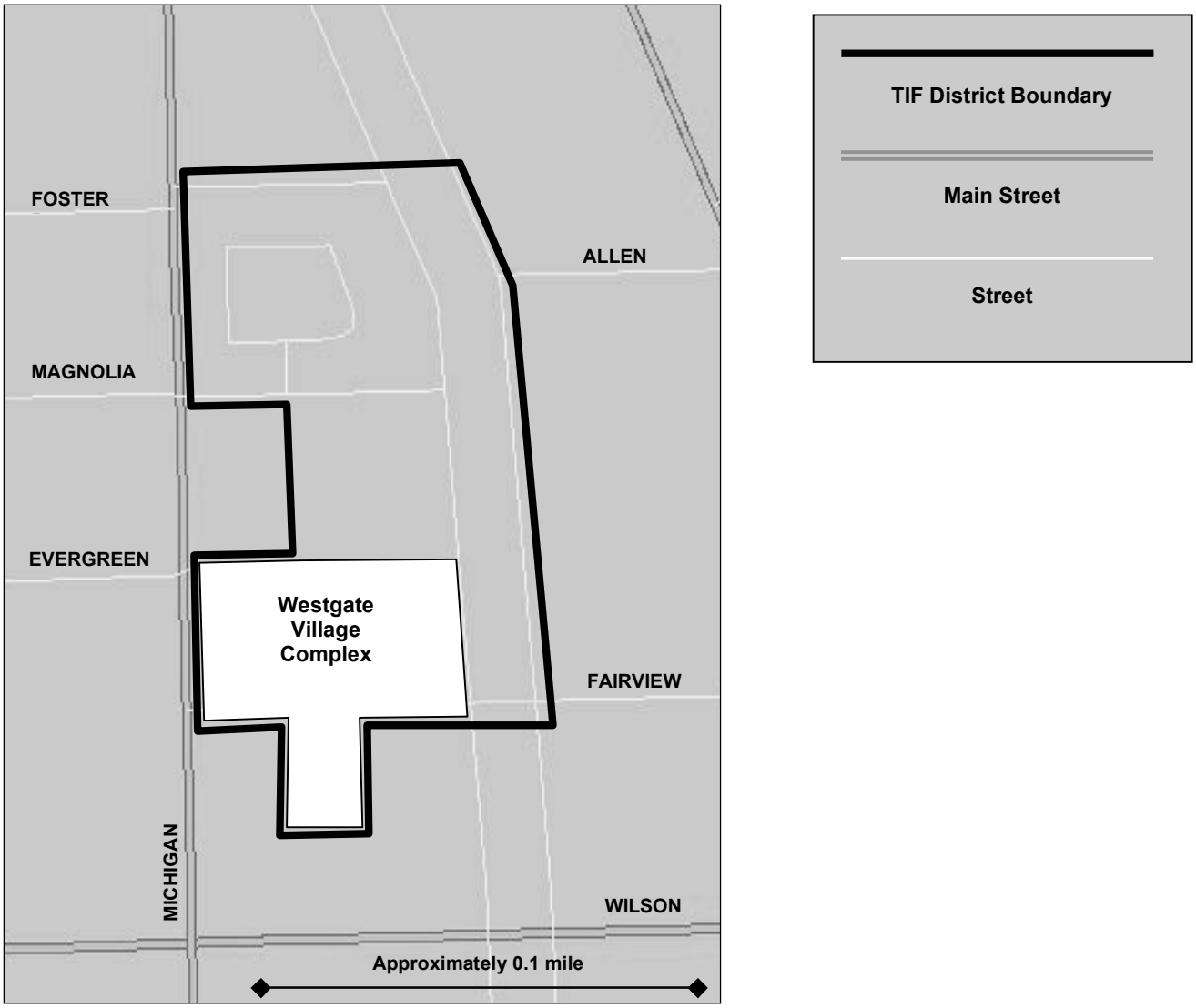
The original boundaries of the TIF district included a stable residential area of well-maintained bungalows and long-term homeowners. At the requisite public hearings, the local neighborhood organization raised concerns about rapid property value hikes and higher tax bills. In response, the TIF consultant redrew the boundaries to reduce the size of the district so that the final proposal contained approximately 9 acres (see Figure 5).

Supported by the local councilman, the ordinance creating the Westgate Tax Increment Financing District was passed in June of 1983.

Relationship with overlapping jurisdictions: The local school district, Springdale #75 (which is responsible for all K-12 education in the municipality), raised concerns that new residents of the area would increase service demands on the schools. The district estimated that every two-bedroom and three-bedroom unit built would increase the student population by 0.50 and 0.75 pupils, respectively, and that education costs would roughly average out to $6,000 per pupil for the twenty year period. In response, a) the developer decreased the number of two- and three-bedroom units in the project (from 100 to 50 units out of a total of 150) and b) the municipality agreed to sign an inter-governmental agreement (IGA) with the school district to compensate the district at $187,500 annually (31.25 pupils at $6,000) once the project was completed and fully occupied. Other taxing jurisdictions, less dependent on local property taxes, agreed to the TIF without demanding IGAs.

Increment allocation: Springdale entered into a redevelopment agreement with Baumann in December of 1983. Based on the agreement, Baumann would purchase the majority of parcels within the TIF district and convert them into 100 loft condominiums, 50 townhouses, a parking structure, and 20,000 square feet of retail space.

Figure 5: Map of the Westgate Tax Increment Financing District



The project, known as Westgate Village, received a zoning variance and $5 million of the project's $18 million development costs. This amount did not include additional infrastructure investments made by the City to prepare the land for development (e.g., utility hookups, road paving, street reconfiguration, traffic signals). The $5 million subsidy appeared reasonable to the City although it was more than the present value of incremental property taxes that the individual project would create over its 23-year lifespan (see Figure 6).

Figure 6: Present value of future tax increments from Westgate Village

Property taxes generated as industrial facility, 1983	$35,000
Property taxes that would be generated upon project completion, 1985	$400,000
Property tax increment, 1985	$365,000
Commitment to School District #75, 1985	$187,500
Present value of net tax increments over 23 years (1983-2006)*	$3,659,805

** assuming 3 % average annual growth rate and 5 % public sector discount rate. There is no increment recorded for 1983 and 1984 – before the project was completed and occupied.*

Although $3,659,805 could have reflected the maximum Springdale would be willing to provide to assist the developer with this project, the project was the first of its size in the area and was considered high-profile. Given Springdale's strong interest in seeing the project completed, the City agreed to commit almost 30 percent of Baumann's development costs.

For a period of about eight years, the Westgate Village project did not attract new development to the area – although existing properties appeared to receive a boost in value based on the increase in residential sales transactions in the district. However, in the early- to mid-1990s, a neighborhood-oriented strip mall, several small-scale apartment rehabs, and a new school were built within the TIF district. By this time, the TIF account had sufficient cash for Springdale to provide assistance to these projects (see Figure 7).

Value increments were calculated on an aggregate basis, whereby the base equalized assessed value (EAV) remains unchanged for the duration of the TIF's lifespan. Tax rates varied throughout the 23-year period as individual districts raised or lowered their individual portions of the consolidated rates according to their budgets and available property value. As the tax increments were created, they were used to pay down bonds, make additional infrastructure improvements, and cover eligible costs of private development in the district. It should be noted that Figure 7 is not a prospective spreadsheet, drafted in expectation of new development but a mock-up of actual increments generated *post-facto*.

Figure 7: Tax increments generated over the Westgate TIF District's 23-year lifespan

Year	1	2	3	4	5
Total EAV of parcels within TIF district	$45,060,000	$46,411,800	$51,411,800	$53,211,213	$55,073,605
Base EAV	$45,000,000	$45,000,000	$45,000,000	$45,000,000	$45,000,000
Incremental EAV	$60,000	$1,411,800	$6,411,800	$8,211,213	$10,073,605
Consolidated property tax rate	8%	9%	8%	7%	8%
TIF increment	$4,800	$127,062	$512,944	$533,729	$805,888
Compensation to School District # 75	$0	$0	$187,500	$187,500	$187,500
Net TIF increment	$4,800	$127,062	$325,444	$346,229	$618,388
Cumulative TIF increment	$4,800	$131,862	$457,306	$803,535	$1,421,923

Year	6	7	8	9	10
Total EAV of parcels within TIF district	$57,001,182	$58,996,223	$61,061,091	$63,198,229	$66,042,149
Base EAV	$45,000,000	$45,000,000	$45,000,000	$45,000,000	$45,000,000
Incremental EAV	$12,001,182	$13,996,223	$16,061,091	$18,198,229	$21,042,149
Consolidated property tax rate	8%	8%	8%	8%	7%
TIF increment	$960,095	$1,119,698	$1,284,887	$1,455,858	$1,472,950
Compensation to School District # 75	$187,500	$187,500	$187,500	$187,500	$187,500
Net TIF increment	$772,595	$932,198	$1,097,387	$1,268,358	$1,285,450
Cumulative TIF increment	$2,194,518	$3,126,716	$4,224,103	$5,492,461	$6,777,912

Year	11	12	13	14	15
Total EAV of parcels within TIF district	$69,014,046	$72,119,678	$74,283,268	$76,511,766	$78,807,119
Base EAV	$45,000,000	$45,000,000	$45,000,000	$45,000,000	$45,000,000
Incremental EAV	$24,014,046	$27,119,678	$29,283,268	$31,511,766	$33,807,119
Consolidated property tax rate	7%	7%	7%	7%	8%
TIF increment	$1,680,983	$1,898,377	$2,049,829	$2,205,824	$2,704,570
Compensation to School District # 75	$187,500	$187,500	$187,500	$187,500	$187,500
Net TIF increment	$1,493,483	$1,710,877	$1,862,329	$2,018,324	$2,517,070
Cumulative TIF increment	$8,271,395	$9,982,272	$11,844,601	$13,862,925	$16,379,994

Year	16	17	18	19	20
Total EAV of parcels within TIF district	$81,171,333	$84,418,186	$87,794,914	$91,306,710	$94,958,979
Base EAV	$45,000,000	$45,000,000	$45,000,000	$45,000,000	$45,000,000
Incremental EAV	$36,171,333	$39,418,186	$42,794,914	$46,306,710	$49,958,979
Consolidated property tax rate	8%	6%	6%	6%	5%
TIF increment	$2,893,707	$2,365,091	$2,567,695	$2,778,403	$2,497,949
Compensation to School District # 75	$187,500	$187,500	$187,500	$187,500	$187,500
Net TIF increment	$2,706,207	$2,177,591	$2,380,195	$2,590,903	$2,310,449
Cumulative TIF increment	$19,086,201	$21,263,792	$23,643,987	$26,234,890	$28,545,339

Year	21	22	23
Total EAV of parcels within TIF district	$98,757,338	$103,695,205	$108,879,965
Base EAV	$45,000,000	$45,000,000	$45,000,000
Incremental EAV	$53,757,338	$58,695,205	$63,879,965
Consolidated property tax rate	5%	5%	8%
TIF increment	$2,687,867	$2,934,760	$5,110,397
Compensation to School District # 75	$187,500	$187,500	$187,500
Net TIF increment	$2,500,367	$2,747,260	$4,922,897
Cumulative TIF increment	$31,045,705	$33,792,966	$38,715,863

Financing: Springdale floated a $10 million Tax Increment Bond to help front-fund the project. The increment for the entire district was pledged as security for the bond. Because bond counsel was able to demonstrate that the project fulfilled a public purpose, thereby allowing the City to classify that bond interest as tax-exempt, and because Springdale enjoyed a high bond rating, the City was able to secure a lower interest rate than the developer would have received if it had pursued conventional debt financing. Proceeds from these bonds were used to pay for a portion of the public infrastructure expenditures to prepare the land and service the new development. They were also used to reimburse the developer for approximately 30 percent of their total development costs ($5 million).

The City provided this assistance with the understanding that a) 50 percent of construction costs would be paid to minority or women-owned contractors; b) the developer would retain the original facades of the industrial buildings; and c) the developer would adopt design elements to help the project to fit in with its surroundings (e.g., masonry exteriors).

Because of the surplus accumulated in the TIF account by the early 1990s, the City was able to assist subsequent spin-off developments on a pay-as-you-go basis. In such cases, individual developers paid land preparation and construction expenses themselves and then billed the city of Springdale for those expenses that were considered TIF-eligible (up to an agreed-upon limit).

Termination: The Westgate TIF district was terminated in 2006, by which time it had cumulatively generated a total of $38.7 million in tax incremental revenue over its 23-year lifespan (not taking inflation into account).

When the TIF expired, the overlapping jurisdictions (including the City) were able to apply their individual tax rates to almost $64 million in new property *value*. For the school district, whose individual tax rate was 5 percent in 2006, this translated into an additional $3.2 million in property tax *revenues* for the 2007 school year.

When Is TIF used? Case studies

Although TIF appears to be ubiquitous across the fiscal landscape of the United States, it is possible to detect some patterns in its usage. While states such as New York and Arizona have used TIF sparingly if at all, others, particularly those in the Midwest and West Coast, have relied on TIF for years as their primary financing source for local redevelopment. States that use TIF tend to be those with highly fragmented fiscal structures and greater absolute numbers of taxing jurisdictions. In Maine, Illinois, and Indiana fiscal pressures were found to be the most significant predictor of TIF adoption (LaPlante 2001; Man 1999; Dye and Merriman 2000). Those municipalities that adopted TIF were also those with higher than average local tax rates, high and increasing tax burdens on local residents, and fewer elderly residents. Other studies have found that TIF-adopting municipalities tend to be those with a greater share of non-residential land uses and larger populations than non-adopters (Anderson 1990). TIF also appears popular in states that have passed property tax extension limitations – because new development created in the TIF district is not subject to the cap and, some argue, TIF allows municipalities to keep their property tax rates low (partly by shifting the need to raise taxes to other jurisdictions).

Within adopting municipalities, are TIF districts designated in areas that are truly "blighted"? Anecdotal evidence of TIF districts in areas with high incomes, commercial density, and tony reputations suggest otherwise. Indeed, stories of TIF abuse abound, such as when TIF is used to build golf-courses and luxury car dealerships in wealthy suburbs. However, Byrne (2002), Reingold (2001), and Gibson (2003) – all examining the case of Chicago – have found statistical evidence that local officials are, on average, adhering to the blight requirement. They compare the characteristics of Chicago's TIF districts with the city as a whole. Byrne found that TIF districts were less populated, poorer, and comprised of more minority residents and vacancies compared to averages for the city. Reingold (2001) found fewer differences between TIF-hosting communities and those without TIF districts. He determined that communities with TIF had a smaller share of owner-occupied housing but higher median home values. Gibson (2003) found that areas where TIF has been designated are, on average, economically distressed but not the most severely disadvantaged locations within the city.

The following five case studies confirm and challenge the results of these scholarly studies. Some are clearly in blighted areas, while others are better characterized as tough redevelopment projects given the number of jurisdictions involved, the new markets to be constructed, and the scale of the projects planned. In this sense they may not be your "average" TIF project, but they are illustrative of the opportunities and challenges associated with TIF-funded development projects. After each case study of TIF usage, we tease out lessons learned from that particular case to provide guidance in deciding which potential development projects are well matched with TIF and which might be better off with alternative financing and governance structures.

Atlantic Station
Atlanta, Georgia

Brownfield redevelopment in the central city

In the late 1990s, a former industrial site occupied prime land in midtown Atlanta. Though the site had been on the market for approximately 25 years, its asking price falling steadily, developers had continued to balk. The land was highly contaminated after years of industrial use, and it lacked sufficient infrastructure to support commercial or residential development. However, a perseverant development team, encouraged by the site's locational advantages, saw the potential to turn the area into a dynamic, mixed-use "city within a city," to be named "Atlantic Station". Though the project initially faced many obstacles at the local, state, and federal levels, it was modified several times and slowly progressed, finally celebrating its grand opening in the fall of 2005. The creation of Atlanta's second-only TIF district was instrumental in the development of Atlantic Station.

Once the home of the Atlantic Steel Industries plant and the Tri Chem Corporation (a fertilizer manufacturer), the 138-acre site was officially classified as a brownfield (i.e., the Environmental Protection Agency (EPA) recognized redevelopment would be hampered by the site's soil contamination). Brownfields are generally considered to meet the blight requirement for tax increment financing districts, but Georgia's version—the tax allocation district (TAD)—had been used sparingly since its legislative authorization in 1985. Under Georgia's Redevelopment Powers law, jurisdictions intending to designate a TAD must first secure approval from the State, and then again from their local voters. At the local level, a designated redevelopment agency—in this case, the Atlanta Development Authority (ADA)—handles much of the process oversight.

The developer, Jacoby Development, Inc., worked in partnership with AIG Global Real Estate Investment Corp. and the ADA to negotiate the terms of the Atlantic Station TAD. While Atlantic Station would be Atlanta's second TAD overall, it was the city's first project-driven case and also the first to request backing from the sale of municipal bonds. History had shown that developers viewed the site as too costly to remediate. In addition to extensive environmental work, redevelopment of the site would require zoning changes and major transportation infrastructure improvements, and potential developers were unwilling to assume the risks of such a massive project. Jacoby's plan, which called for thousands of new residences at different income levels and over 1 million square feet of retail and recreation areas, had the potential to bring tremendous property tax revenues to the city in the long run.

The Atlantic Station TAD was reviewed and approved by multiple participating jurisdictions, including the Atlanta City Council, the Fulton County Commission

and the Atlanta School Board. The final terms agreed upon for the 25-year TAD included several notable provisions. The city agreed to fund (through federal highway grants) a bridge that would connect Atlantic Station to midtown Atlanta; Jacoby would cover the cost of street extension to meet the bridge development. Since control of the new infrastructure would ultimately revert back to the city, it was willing to issue bonds to cover the costs up front. The city was to reimburse Jacoby for environmental remediation and infrastructure development costs, also using the net proceeds of its tax allocation bonds. The bonds were secured with property tax revenues generated by the Atlantic Station development. Because the development process was projected to take years, Jacoby agreed to make up the difference between tax revenues and debt service payments at the onset of the project while tax revenues remained relatively low.

Jacoby and its development partners had deep pockets, but it is likely that Atlantic Station would not have been built without funds provided by the city's TAD bonds. Jacoby intended to contract with other developers on individual components of the site, but major retail and commercial partners pulled out along the way, leaving Jacoby with more responsibility than they originally expected. The original plan called for a total of $120 million to be reimbursed by the city from the TAD bonds. The first payout, in 2001, was for $76 million. A second appropriation in 2004 brought the total reimbursement to approximately $170 million.

The project had long-term environmental implications. The overall site was designed with "smart growth" principles in mind. Close proximity of residences and businesses and access to public transit promoted walkability. The EPA granted the Downtown Connector bridge special "XL" (Excellence in Leadership) status, allowing construction to proceed in spite of a ban on new road development due to the city's deficient clean air performance. Reasoning that this type of development could more easily have located on suburban greenfields at a greater cost to the environment (such as greater loss of trees and increased air pollution), the EPA was encouraged by Atlantic Station's infill commitment.

Using TAD to support brownfield redevelopment bought the city two desirable outcomes for one price: environmental cleanup and economic development. The continued success of Atlantic Station, one of the nation's largest brownfield redevelopment projects to date, is evidence of this fact. It is home to the area's first LEED-certified building, a 500,000-sqaure-foot office building certified "silver" by the United States Green Building Council's Core and Shell rating system. Though the TAD bond commitment increased over time, so did the expected returns. A site that once contributed $300,000 annually in property taxes was anticipated to generate approximately $8 million in 2005, the year of the development's official opening, and as much as $25 million a year by 2010. The overall value of the project was estimated at $2 billion, though increasing land values continue to augment that amount.

Key lessons

This case study confirms what observers of TIF have noted for a long time: the design of TIF works well with high-density projects that promise quick and substantial spikes in tax increment (Arana 1986; Weber 2003). TIF is a useful tool in instances where land uses are up-zoned; i.e. when property moves from less-intensive usage to more-intensive usage. Such a move is likely to produce an immediate increase in taxable value. The renovation of an existing structure or the addition of new infrastructure alone may not create as large of a jump in property values as converting an abandoned brownfield site into thousands of units of new housing and commercial space, as it was in the case of Atlantic Station. If the increments generated are sufficient to pay for the wish list of redevelopment projects in the district, the TIF district may be retired early, and incremental property taxes can revert back to the overlapping jurisdictions.

The absence of prior development interest in a site with excellent locational attributes signals the presence of a site-specific development impediment. In the case of Atlantic Station, it was the extent of the cleanup costs that was putting off developers. TIF is an appropriate incentive to use in such cases: when a site is fundamentally attractive except for the presence of some specific flaw in the built environment that can be remedied through an investment of public dollars. Reducing the up-front costs of development (primarily those costs related to land development) can make an immediate and substantial impact on a developer's bottom line. In this sense, TIF can be more attractive to the developer (and also more costly to the local government) than conventional abatements that reduce a developer's tax burden over time.

The public benefits case for TIF can also be made more strongly in cases like Atlantic Station. The project has furthered several, laudable public goals: environmental remediation, affordable housing, and economic development were all incorporated into the redevelopment plan.

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Fort Ord
Monterey Bay Peninsula, California

Military base redevelopment across multiple jurisdictions

Established in 1917, the Fort Ord Army Base occupied approximately 28,000 acres of land on California's Monterey Bay Peninsula, where it served as a training ground for Army troops through the early 1990s. Following a 1990 designation as a federal Superfund site by the Environmental Protection Agency, the base was recommended for closure as part of the 1991 Base Realignment and Closure (BRAC) process. The base officially closed in 1994. Since 1988, nearly 100 military bases have been closed as part of the BRAC process, with almost one-third of that total in the state of California.

Projections of the economic impacts of these closures generally paint a grim picture, and the loss of jobs and large, abandoned parcels of land are clearly of concern to affected communities. Planners in such communities have proposed new, mixed-use communities that include residential villages, commercial centers, recreational facilities and improved transportation networks. Military base conversion projects are challenging, lengthy, and expensive endeavors, but California has led the way in using TIF to support these efforts -- to the point where it is used for virtually all such projects.

The Army intended to retain small portions of the Fort Ord property (approximately 5% of the total area), but it was expected that ownership of the remaining parcels would be transferred back to five neighboring jurisdictions; the cities of Marina, Seaside, Del Rey Oaks, Monterey, as well as Monterey County. In anticipation of the base closure, the Fort Ord Reuse Group was established in 1992 to bring representatives from effected jurisdictions together in planning for the redevelopment of the site. This effort evolved into the Fort Ord Reuse Authority (FORA), authorized by the California Senate in 1994, whose Fort Ord Base Reuse Plan was adopted in 1997. The plan sought to transform the former base into a mix of residential development (including affordable housing), hotels, commercial and office use, educational facilities, and recreation/green space. Fort Ord's plans were hailed as a national model for base redevelopment by Former Secretary of Defense William Perry.

Base redevelopment is challenging because of the disposition of public land and the transfer of property rights, which all can be held up by environmental problems associated with the base's former military uses. In Fort Ord, an additional complication has been the bureaucratic process, as over 67 federal and local agencies were authorized to comment on the plans and their interests were often in conflict. Nonetheless, planning and negotiations continued under the assumption that the property transfers would eventually go through. Before a bargaining solution was achieved, FORA preemptively and successfully applied

for TIF designation. The special state legislation authorizing FORA also gave it the TIF powers usually limited to cities and counties, such as the ability to issue debt, create TIF districts**,** and receive a share of the tax increment.

According to the Monterey County Office of Economic Development, without TIF, "there is no other way to make [base redevelopment] really economical." This is especially true in the case of Fort Ord because of its tremendous scale. The size of the site is comparable to the land area of the entire city and county of San Francisco. In addition, because the military had not built to the same standards as civilian developments, most structures needed to be removed or significantly rehabilitated, and the infrastructure needed major updating as well. Some of the buildings on the base are on the National Registry of Historic Places, which further complicates (and increases the cost of) their rehabilitation.

Parts of the Fort Ord site have been transferred or are in the process of being transferred to one of several jurisdictions, including the cities and county previously mentioned, the Federal Bureau of Land Management, and also to FORA itself. As the oversight entity, FORA is receiving most of the land, which it will then transfer to the municipalities in accordance with their specific reuse plans. Some parcels, such as those with schools or transit stations, have been transferred directly to their oversight agencies such as school districts or transit authorities.

Though FORA is overseeing the Fort Ord redevelopment, each individual jurisdiction is responsible for creating its own plan for its portion of the site. The individual plans must be consistent with several overarching documents, including the Fort Ord Reuse Plan, as well as county, regional, and environmental plans for the area. FORA is managing the aspects of the Fort Ord plan that cross jurisdictions, such as the transportation improvements. FORA also developed a Capital Improvements Plan, which includes the adoption of an impact fee to be assessed on all residential development on the Fort Ord site. This fee is expected to generate $50 million for the authority, half of which will be used to fund the transportation improvements. FORA's operating and capital expenses will also be backstopped by its share of the TIF increment.

The largest share of the Fort Ord site falls within the boundaries of unincorporated Monterey County. Its signature project, approved by the county in late 2005 and submitted to FORA for approval in early 2006, is known as the East Garrison Project and is being developed by a consortium of private developers. Plans call for the development of over 1,000 units of housing, a civic/commercial town center, recreation opportunities, public facilities, and a unique "arts habitat." The county anticipates using TIF to finance three aspects of this overall project: housing, including affordable units per California redevelopment law requirements; public facilities; and historic preservation/renovation. Currently in the works are plans to construct just under 200 apartments for very-low- and low-income tenants, using $48,000 per unit

from TIF bond proceeds, $5.5 million to construct new public facilities including a fire station and possibly a library and/or sheriff substation, and $5 million to renovate 23 historic buildings and transform them into a live/work community for artists. About $20 million of the total development costs (estimated at $153 million, excluding land) will come from TIF increments. Land payments from the developer to the county are estimated to reach $50 million by 2011, based on an initial payment of $1.5 million and subsequent profit-sharing payments. The developers project sales totaling $221 million on the market-rate parcels.

Three of the four municipalities receiving Fort Ord land also have projects in various stages of development. FORA is working with all of the jurisdictions receiving Fort Ord land to facilitate the use of TIF in their respective redevelopment projects. Marina has two large projects in progress, Marina Heights (1050 residential units, one-third priced below-market) and University Village (a mixed-use development containing an additional 1200 residential units, a luxury hotel, retail and office space). Seaside is developing a resort complex with a total of 500 hotel rooms and timeshare units, the Main Gate shopping center, and some below-market rate housing. The municipality has already completed 380 units of market-rate housing at Seaside Highlands. Del Rey Oaks is currently planning a 400 room resort hotel with a golf course, office park and residential development.

Key lessons

TIF is an appropriate funding source (one of many) for projects that fundamentally transform the fabric of a community. Base conversion projects, where a tremendous amount of new land becomes available to the public sector and private market, must be handled in an appropriately cautious manner. Governance mechanisms must be in place to bring together the interests of a panoply of different stakeholders, each of whom may have very different priorities for the future development. The Fort Ord case demonstrates the importance of a central authority, beholden to none of the individual interests, who has its own overarching plan and the authority to manage both the TIF increments and land disposition process.

In the case of most base conversions, the properties would have had to increase in value because they switched hands from public (i.e., tax exempt) to private ownership. In Fort Ord, they did so in a relatively high-end real estate market with a shortage of developable land. Thus it is not clear that TIF was necessary to jump-start development. However the demolition and infrastructure improvements necessary to prepare the land for future development and the massive size of the project point to the advantages of using TIF.

Two common complaints about TIF are less relevant in this case because of some innovative policies and practices. First, higher end, owner-occupied housing brings in more property tax increment compared to affordable rental units, and

many observers have accused TIF of biasing developers and municipalities toward this segment of the market. However, California's affordable housing set-aside requirement helps to ensure large-scale TIF projects will benefit a broader market. Second, overlapping jurisdictions that provide needed services to new residential developments must wait until the end of the TIF's life to tax the new increment, which may potentially place service pressures on them without adequate compensation. As such, many are opposed to using TIF for the purpose of subsidizing residential land uses. In response to such accusations, FORA's decision to apply impact fees on new residential development will pay for some of the necessary public services.

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Kalamazoo SmartZone
Kalamazoo, Michigan

Using TIF for high-tech industry clusters

Fear of a state-wide "brain drain" prompted former Michigan Governor John Engler to enact several high-tech initiatives in the late 1990s, including a new application of TIF called the SmartZone program. The program has continued, thanks in part to Governor Jennifer Granholm's commitment to retaining the state's labor force.

Before the implementation of the SmartZone program, the use of TIF in Michigan was restricted to public facilities and infrastructure improvements. The bodies authorized to use TIF, Local Development Financing Authorities (LDFAs) and Downtown Development Authorities (DDAs), were limited in their capacity to engage in private business attraction efforts. Under the original TIF legislation, taxes levied by the State, K-12 school districts, and intermediate school districts were excluded from capture by TIF, and so the authorities had modest amounts of funding to invest.

In 2000, the State of Michigan's enabling legislation was amended to expand TIF privileges to increase business development activities, such as business incubation and support for high-tech research. In an effort to foster public-private partnerships in high-tech fields, included in these amendments was the creation of a special type of business development area, the SmartZone. A key feature of SmartZones is their ability to capture tax increment revenue from a broader scope of properties than what was previously allowed. Business incubators, publicly-owned research and development facilities, and land acquisition for high-tech activities now qualify as eligible TIF uses. SmartZones were also given the power to capture a portion (up to 50 percent) of revenues from State, K-12 and Intermediate School District operating levies to fund public facilities in the SmartZone, subject to approval of the State Treasurer.

The legislation also extended new powers to the Michigan Economic Development Corporation (MEDC), which was to play an active role in the creation of SmartZones. The MEDC was granted permission to establish a specified number of SmartZones during a window of time that expired at the close of 2002. While municipalities were previously limited to the creation of a singular LDFA, under the new legislation, multi-jurisdictional governance of the SmartZones was permitted. Municipalities within the same county were permitted, through agreement with the MEDC to jointly establish an LDFA to govern a SmartZone. Allocation decisions are made by each SmartZone's LDFA.

Kalamazoo was selected to receive one of the state's 11 SmartZone designations in April of 2001. The application was jointly submitted on behalf of Western

Michigan University (WMU), the city of Kalamazoo, and the nonprofit economic development corporation Southwest Michigan First. The SmartZone area was designated as a "certified technology park," allowing for the maximum ability to capture and use TIF. Aggressive use of TIF on the project was justified, in part, by the fact that the attraction of private industry to previously tax-exempt state-owned land (the WMU campus) would generate a substantial property tax spike. This increment, supplemented by portions of state, K-12 and Intermediate School District taxes, would be reinvested in public improvements.

At the time of the SmartZone designation, construction had already begun on the 137-acre WMU Business Technology Research (BTR) Park, which was to become the anchor of the Kalamazoo SmartZone. The BTR Park announced its early roster of high-tech tenants and educational facilities throughout 2001, which included WMU's College of Engineering and Applied Sciences. Within five years, the Park had attracted 24 private enterprises to its location. Some businesses relocated their entire operations to the park completely, some maintained headquarters elsewhere and opened new branch plants in Kalamazoo, and others were new start-ups. The Southwest Michigan Innovation Center (SMIC), a business accelerator and incubator also moved into the BTR Park. It continues to provide office, work and laboratory space, specialized equipment, and support services to BTR Park businesses, 15 of which are housed within the facility.

A challenge to the use of TIF in the Kalamazoo SmartZone came in 2004, when, in the interest of accelerating the rate of growth for startup businesses, the incubator sought and was granted tax-exempt status. The SMIC tax exemption decreased the SmartZone's projected 2005 TIF revenue by approximately 25 percent. The tax abatement approval was eased by its inclusion of a clawback provision, which stated that businesses graduating from the incubator give preference to Kalamazoo when selecting new sites, and those that leave the city may be required to repay the abated taxes. In response to the tax abatement, the LDFA budget reduced the SMIC's allocation of the tax increment by approximately 50 percent. $350,000 in TIF revenue is projected for 2006, bringing the cumulative tax increment to over $1.4 million. Cumulative TIF revenue is projected to exceed $6 million by 2015. These monies are budgeted to reimburse street, water and sewer infrastructure improvements, reimburse a portion of WMU's investment, and cover some operating costs for the BTR Park, SMIC, and the City.

Kalamazoo is touted as a leading technology enclave in the State of Michigan, and TIF is playing a role in recent statewide and local efforts to retain and attract high-tech industries and develop research clusters. Kalamazoo's partnership with public institutions and private enterprise has used TIF to cultivate a reputation for excellence in engineering, life sciences, and information technology.

Key Lessons

The case of the Kalamazoo SmartZone illustrates one of the primary challenges of TIF-sponsored development: the fact that new and existing property owners must pay their normal tax burden in order for the TIF to generate enough increment to make a difference. To be attracted to the TIF, some property owners may want their property taxes abated, especially if they are small or a start-up business. Moreover, there is often a need for public institutions in the TIF district (from police stations to, as in this case, department space for universities), whose facilities will generate no new property taxes. Properties that have had their taxes abated or exempted will not contribute much to the TIF increment and can even be viewed as at cross-purposes with the effective functioning of this mechanism.

On the other hand, as the case of Fort Ord also made clear, TIF generates sufficient increment in cases where publicly owned property is converted to private ownership. In the case of Kalamazoo, state-owned university land and improvements are being sold to private owners, and the transfer of property inflates the tax rolls, all of which can be considered increment. Indeed, TIF provides an incentive for the public sector to privatize its real estate holdings, and each local government should weigh carefully the advantages and disadvantages of such a transaction. While the new property taxes may provide a needed short-term fix for a difficult financing deal, the public sector may relinquish control over key aspects of the deal if it sells its assets without examining other options.

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The Small Business Investment Fund
Chicago, Illinois

Targeting funds for small business

Most municipalities across the country exhibit a bias toward large-scale development projects when using TIF. In an effort to counteract this pattern, the City of Chicago piloted the Small Business Investment Fund (SBIF) program in 1999.

SBIF works in conjunction with TIF, earmarking increment funds generated by an existing TIF district specifically for small business investment. Only some TIF districts in Chicago are designated as SBIFs, and the decisions are made by the City's Department of Planning and Development (DPD). Its Development Support Services Division periodically reviews the progress of existing TIF districts to assess their potential for supporting a SBIF designation. DPD looks at the current activity and demand in each TIF district, as well future commitments of the increment. Communities occasionally advocate for SBIF designation on their own behalf, often through their aldermen. In cases where the demand for small business investment is extraordinary but no increment funds are available, the City will grudgingly issue a Tax Anticipation Note to jump-start the SBIF.

The City offers small businesses located in participating TIF districts reimbursement for up to 75% of qualified rehabilitation, remodeling and/or renovation expenses, for a maximum of $50,000. Reimbursement comes in the form of grants that do not have to be repaid. To qualify as a small business, industrial businesses must have less than 40 employees and commercial businesses are allowed maximum annual sales revenues of $1.5 million. Certain types of businesses, including (but not limited to) fast food or other national chain outlets, branch banks, currency exchanges, pawn shops, adult bookstores, liquor stores or bars, are ineligible for assistance.

While the program has been successful at channeling TIF increments to small businesses, the program's requirement that costs be covered by owners up front still presents a challenge to small businesses, particularly new startups. In most cases, these businesses must seek out additional funding from local banks or micro-lenders. Upon approval of SBIF projects, the City issues a letter to the applicant stating the expected amount of reimbursement, which can help to assure lenders of repayment. In some cases, direct payment of the SBIF reimbursement to the lender can also be arranged. Local economic development organizations are often especially helpful in assisting businesses with capital acquisition and the SBIF application process.

There were twenty-five SBIF districts in Chicago in 2006. The SBIF designation is theoretically valid for the life of the TIF district; however, it expires once all of

its funding has been exhausted, and most SBIFs are exhausted within 4 years. In some cases, a TIF district is actually supporting its second or third SBIF after spending down its previous allocation. As an alternative, DPD is considering authorizing a large pool of funding for future SBIFs but releasing only portions of it at a time.

A total of 127 grants have been issued by SBIFs to date, with an additional 139 pending at this time. Program outcomes vary by community. In the high-poverty North Lawndale neighborhood, businesses are generally using the SBIF grants for infrastructure improvements. Because the businesses are so dispersed and the improvements are mainly to building interiors, it is difficult to detect the impact of the program. However, in the Albany Park neighborhood, businesses are using SBIF grants for façade renovations and signage improvements. By adhering to historic and consistent design guidelines, these businesses have used the SBIF program to create an identifiable business district and the SBIF impact is more apparent.

Key lessons

Small businesses do not typically benefit directly from TIF, even though its use may enhance the overall local business climate. Instead most small businesses view TIF as an indirect and direct threat because municipalities prefer to work with a few large-scale projects rather than many small-scale deals to minimize transaction costs associated with the redevelopment agreements. The structure of TIF also dictates that construction on vacant land returns the largest increases in tax revenue, and many cities are using TIF to facilitate land assembly in order to attract large developers. New developers prefer national chains (i.e., "credit tenants") to small businesses as potential commercial tenants. Inclusion in a TIF district will generally increase the property taxes of a small business, but may not necessarily increase its revenues.

Targeted small business programs like the SBIF in Chicago can help to ensure that the benefits of TIF do not go exclusively to large-scale developments and national retailers. Such programs allow increments to be pooled into a fund to finance smaller deals that would likely fall below the threshold levels needed to justify the municipality's significant administrative costs associated with the allocation decision. Administration of such a program can be contracted out to a third-party intermediary so that this burden does not fall to the municipality. The SBIF helped small businesses to reclaim a small portion of their increased property taxes and use them to improve their facilities. In doing so, it enhanced the legitimacy of TIF by more widely distributing its benefits.

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East Tampa
Tampa, Florida

Revitalization of a disinvested community

East Tampa, Florida is experiencing a rebirth. An area once noted for crime, drugs, and physical deterioration is now receiving support from local governments, who aim to restore safety and economic stability to the community. Opportunities for public participation in the redevelopment process have energized community members, who are eager to reclaim and grow their neighborhood. TIF has played a critical role in this process.

In the 1950s and 60s, this area boasted an active business district and a close-knit social networks. As the civil rights movement gained momentum in the United States, African American residents of East Tampa became more mobile, with more choices about where they lived, worked and shopped. Many chose to relocate from East Tampa. In the 1980s, the community was disrupted by the introduction of crack cocaine, which many associated with increased outbreaks of violent crime.

In 2003, the City of Tampa elected Mayor Pam Iorio, whose campaign had promised a commitment to equality for all Tampa citizens, regardless of economic status. Iorio laid out five strategic principles upon which her administration would be founded, one of which was to pursue "economic development in our most challenged areas." Almost immediately after taking office, Iorio made known her commitment to East Tampa: she announced plans to create an East Tampa Development Division within the city's Urban Development Department, and she spoke in favor of a proposed East Tampa Community Redevelopment Area (CRA) designation. The East Tampa CRA would allow for the use of TIF in revitalization efforts.

In many cities, TIF districts are initiated by developers to support the construction of specific projects. In the case of East Tampa, Mayor Iorio and supporters advocated for the CRA without knowing exactly what types of improvement projects would materialize. The CRA was viewed as a necessary tool to complement other ongoing community change initiatives, most importantly the Tampa Housing Authority's HOPE VI revitalization project. Approval of the 1997 HOPE VI application signified a commitment of $32.5 from the federal government to redevelop two contiguous public housing projects in East Tampa. However, this money was only available for residential development, and a blighted commercial corridor sat adjacent to the HOPE VI site.

Iorio also planned to increase the police presence and, therefore, the safety of the neighborhood, aiming to reduce the stigma that kept potential business owners away from East Tampa. However, erasing the fear of crime and redeveloping

public housing are not overnight activities, and they alone were not likely to completely reverse the community's decline. Public officials, planners, and community members recognized the need for commercial development, and a potential CRA was suggested early on (during the 1997 HOPE VI application process) as a means to facilitate this type of development. Given that land values were increasing on a citywide basis, the CRA designation would ensure that the area's growing tax revenues would remain in—and be used for improvements to—the community.

The CRA and its associated 30-year TIF were established in June of 2004. Property values increased by 43 percent in the first two years, generating a first-year tax increment of $1.1 million. The city worked with a grassroots community organization, the East Tampa Community Revitalization Partnership (ETCRP), to budget for the TIF account. About one-tenth of the budget was reserved for East Tampa Development Division staffing and administrative costs, with the balance split between contractual services and capital improvements. Though the creation of the CRA had required an accompanying 30-year plan for the area, this plan was broad in nature and dealt with more long-term strategies. Thus, the CRA and the ETCRP elected to subcontract consultants using TIF revenues to develop a 5-year action plan with more specific directions for the area. Other activities such as housing rehabilitation grants, beautification/street enhancement, and investment in public facilities (including a new police station) all received funds from the first year's increment.

In its second year, the tax increment budget was set at $2.8 million. Some of this was budgeted to cover travel for ETCRP members attending seminars and conferences related to East Tampa redevelopment. The budget also included money for environmental infrastructure, including brownfield redevelopment and a retention pond study. In both years, the city supplemented TIF funds with contributions from its Capital Improvement Budget and Community Planning and Development Action Plan.

At the close of 2005, East Tampa residents, business owners, and other development stakeholders held a series of visioning sessions to develop a wish list of potential projects to utilize future TIF revenues. A wide range of projects were discussed, including micro-lending programs, development and expansion of regional commercial centers in the area (including big-box retailers), parks, and a movie theater or arts district. 2006's increment is expected to reach $5 million.

Use of TIF in Florida has not gone uncontested. The state shields school revenues from TIF capture, protecting CRAs from objections often raised by school districts in other states. In Florida, however, tensions have arisen between counties and cities with regard to CRAs. Some cities believe that they do not need the county's approval to designate a CRA. This issue is being discussed on a statewide basis. Recognizing the need to work together on CRAs, the City of Tampa drafted and approved an inter-governmental agreement with Hillsborough

County in 2003. Specific provisions include limiting the duration of CRAs in Tampa to 30 years, and allowing the County to retain 20 percent of the increment collected in years 11 to 30 of a CRA. This agreement has successfully mitigated potential opposition to the East Tampa CRA.

Key lessons:

It may be too early to tell if TIF was the right tool for this struggling community. It remains to be seen whether these public efforts have sufficiently removed barriers to private investment so that the market will follow suit. TIF may be more effective in areas where the "blight" is site-specific and contained. In neighborhoods that are more systemically poor and disinvested, TIF needs to be spent on general infrastructure needs and institutional assets before the private market will consider such places as feasible locations.

Despite the risk that the private market will lag behind, this case demonstrates the importance of having an earmarked source of funds that can bring people together, initiate a broader community planning process, and jumpstart an urban revitalization effort. Rising property values in the area helped to create a modest amount of increment that had to be spent locally. Increment allocation has been guided by both comprehensive and site-specific action plans, resulting in both long-term strategies, some short-term victories for the area, and more politically empowered community. The fact that the East Tampa TIF was not opposed by residents concerned about its impact on school finance is testament to the importance of state legislation that protects education revenues from potential TIF capture.

East Tampa has used TIF to complement other ongoing community development strategies, namely HOPE VI funds for public housing transformation. TIF is "filling in the gaps" of this federal program by providing a funding source for the commercial leg of a program that had previously only included the renovation of housing units.

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Summary

TIF has become a general-purpose economic development tool. However TIF use is not appropriate in every context, even if an area or land use meets the guidelines specified in state enabling legislation. TIF is more likely to provide the right amount of incentive (not too much or too little) and meet the "but for" test when it is used to eliminate a site-specific impediment that is keeping an otherwise profitable site from achieving its highest and best use. For example, Atlantic Station required expensive environmental remediation, and Ford Ord needed to consolidate and integrate a massive amount of vacant and deteriorated property into the regional real estate market.

In the case of the Kalamazoo SmartZone, the need for TIF is less obvious. A combination of general obligation bonds (or even better, a state appropriation) for an incubator and property tax abatements for high-tech start-ups might have served to jumpstart the project, although it is difficult to be certain in retrospect. Moreover, in the case of Kalamazoo, other economic development incentives, such as property tax abatements, "competed" with TIF and worked at cross purposes. In general, TIF does not work well with other property tax-based development incentives and area improvement programs, such as Business Improvement Districts (BIDs). Abatements reduce the expected increment, and BIDs (whereby individual property owners in a small geography agree to levy an additional tax upon themselves to pay for shared area improvements) may exacerbate what is likely to be a growing tax burden for property owners in the TIF district.

In some instances, municipalities have extended the use of TIF to include more community-based programming and small business assistance (e.g., Chicago's SBIF program and East Tampa). Without strong leadership, pressure from constituents, and the presence of supportive financial institutions, however, such programs would not exist as they are not a "natural" fit with the mechanism of TIF. Neither promises substantial spikes in increment and, in the case of East Tampa, doubts still loom about whether the private market will be attracted to the district despite the new public improvements. However in both cases, TIF is an important signal that the municipality is committed to small businesses or to a particular impoverished community. As such, the "best" in "highest and best use" may have broader social welfare connotations.

The reader will note that we did *not* include cases of TIF financing for: conventional format big-box construction (which may substitute for existing retail consumption and employment, pay poverty wages, and have deleterious effects on existing commercial centers); low-density development in urban areas (which creates less increment per square foot than more intensive uses); business attraction and retention incentives with no land development component (which create fewer positive local spillovers and latch on to the business instead of the space); routine public sector capital projects (which should be decided on through normal budgetary policies and not because an area can generate sufficient increment); and extravagant, private-access amenities such as golf courses (which undermine the notion of public goods). We do not include such projects because they are considered less optimal uses for TIF.

TIF projects may turn sour even if they originally meet the profile of what constitutes a good project. Such is the case when TIF districts experience unexpected financial difficulties, a condition that points to the inherently speculative nature of all TIF projects and not just those that were poorly conceived from the onset. Expenditures may exceed revenues, and bonding may not help municipalities to overcome the inherent lumpiness of payouts. Municipalities may find themselves in such positions when they overestimate property value growth, developer interest, or revenues from land sales, when cash flows are highly irregular, and when underlying economic conditions unexpectedly change for the worse.

Take the case of the city of Arvada, Colorado, a northwest suburb of Denver.[2] In 1981 it created an urban renewal authority by voter referendum in order to revitalize 443 acres within the city's center. Included in this area was a historic downtown district, which the city hoped to preserve, as well as other areas where the city hoped to expand the presence of larger national chains. While the population of Arvada grew steadily throughout the 1980s and rapidly during 1990s, the population increases were not accompanied by the economic growth the city had originally anticipated.

In 1985, the Arvada Urban Renewal Authority (AURA) issued $48 million of construction and serial term bonds in hopes of revitalizing the city's historic district. The authority intended to purchase commercial land, develop infrastructure there, and resell it to developers. However, a lack of interest from retailers caused a shortfall of tax revenues. The bonds were refinanced in 1987, at which time two developers were committed to the area. One of the developers subsequently pulled out, and the city's bond rating was downgraded.

The AURA continued to use accrued increment to fund projects such as streetscaping, façade improvements, land assembly, infrastructure improvements, marketing, economic development research and a historic district association, as well as to repay the city government for its seed money used to establish the authority. But it was spending more than it was bringing in. In 1994, the authority was collecting approximately $4 million in annual property and sales tax incremental revenues but when debt service payments increased to more than $4 million, the authority feared it would come up short. An additional $4 million was expected from land sales then tied up in contracts, but $1.5 million of that would be needed to cover infrastructure expenditures that the authority

[2] This case study was derived from the following sources: Keith Dubay. 1994. "Arvada, Colo., Agency to Swallow a Bitter Pill and Sell Some Land to Forestall Bond Default." *The Bond Buyer*, May 26, 308 (29410): 1(2); Angel Hernandez. 1995. "Arvada Renewal Agency Averts Bond Default." *Rocky Mountain News*. February 15; Angel Hernandez. 1994. "Retail Center on Fast Track in Arvada." *Rocky Mountain News*. November 9; David Hitchcock. 1995. "CreaTIFity Helps Cities Find Development Dollars." *American City & County*, May, 110 (6); Christine Pagan. 1997. "Yields Draw Buyers to Issue by Arvada, Colo., Agency." *The Bond Buyer*, Feb 3, 319 (30075): 6(1).

had already made. A sales tax increase had been approved by voters, but was being challenged in the courts at that time.

Distrust on behalf of voters led them to veto a proposal to restructure the bonds, though ironically, bond analysts suggested restructuring the bonds would have inspired more confidence in the area. The AURA, under new leadership, was forced to focus on increasing revenues from land sales within the TIF district. Fortunately, economic conditions—the real estate market in particular—began to improve by the mid-1990s, and retailers began expressing renewed interest in the area. A bond default was narrowly avoided and eventually, a 1997 issuance of $45.9 million refunded the 1987 bonds.

The city of Battle Creek, Michigan experienced a similarly close call when its main employer, the Kellogg Company, began to close its facilities.[3] Battle Creek created the first of its three TIF authorities, in 1979 to improve an area of concentrated disinvestment in this already declining industrial city. While many local manufacturers were choosing to relocate or close their doors entirely in the late 1970s and early 80s, Kellogg's wielded its political influence and catalyzed a merger between the city and neighboring Battle Creek Township. In return, Kellogg's pledged to remain in the city and build a new world headquarters downtown. The city had hoped that Kellogg's commitment would spur additional private investment downtown and planned to use tax increments to improve infrastructure, signage and streetscaping or other maintenance efforts. But years later, Battle Creek was faced with the downside of the company's monopoly in the local economy.

Citing declining earnings and outdated equipment, Kellogg's closed its South Plant in November 1999. In addition to precipitating the loss of 700 jobs, the closure looked as if it would jeopardize the fiscal health of the TIF and cause a bond default. The city's bond rating declined. In 1997, the city had issued $60 million in revenue bonds to refinance an original 1994 issue. Another $7 million worth of bonds backed by both district revenues and general obligation of the city were also outstanding. At that time, Kellogg's production facilities comprised 53 percent of the TIF authority's tax base, but the South Plant was only part of the entire operation. Nonetheless, the Battle Creek Downtown Development Authority expected the plant closure to decrease the district's incremental revenues (then totaling $8 million) by 25 percent (i.e., over $2 million).

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[3] Ruby L. Bailey. 1999. "Kellogg Offered Tax Breaks to Keep Battle Creek, Mich., Plant Humming." *Detroit Free Press*. July 25; Richard L. Brandt. 1984. "Letter From Battle Creek." *Business Week*. February 28; Business Wire. 2000. "Fitch IBCA Dwngr Battle Creek Downtown Develop Auth TIF Rev Bonds." May 31; Elizabeth Carvlin. 2004. "Battle Creek, Mich., Finishes Sale to Help Lure Kellogg's Keebler." *The Bond Buyer*, September 13, 349 (31967):7; Steven Greenhouse. 1985. "Where Breakfast Food is Still King." *The New York Times*. April 28; Andrew Ward. 1999. "Midwest Bond Watch: Battle Creek Affirmed." *The Bond Buyer*, August 11, 329 (30702): 28; Andrew Ward. 1999. "Possible Kellogg Plant Closure Imperils Michigan TIF Bonds." *The Bond Buyer*, June 29, 328 (30672): 1.

Despite the expected losses, the city offered Kellogg's a $56 million incentive package to keep the plant open. However, the subsidy was unable to sway the company's new administration. To complicate matters, the city had created a renaissance zone that overlapped with the TIF district boundaries. As a result, the planned 2002 expansion of another company in the TIF district (Kraft General Foods), part of which fell within both special zones, was projected to actually decrease district revenues by an additional $300,000 because of property tax abatements.

Bond analysts began to predict that Battle Creek would be unable to cover the outstanding debt service. The debt-coverage ratio was projected to decline from 1.6 in 1999 to 1.1 in 2002. Some warned of a worst case scenario whereby the city would have to tap approximately 6 percent of its general fund to make its payments.

In 2004, the city successfully issued $55 million of taxable, variable-rate bonds to refinance the 1997 bonds. A portion of these funds were used to construct an incentive package to relocate Keebler (a recently-acquired division of Kellogg) to the TIF district and renaissance zone. This restructuring allowed the authority to make lower debt service payments, freeing up more of the annual increment to offset the loss from tax abatements. The city was also able to secure access to school property tax revenues, thanks to a successful appeal to the state, and relied on a relatively large reserve account to help overcome the shock to its tax base.

Empirical research on the impact of TIF

Municipal officials and developers are quick to argue that TIF has been critical to revitalization efforts in the areas where they govern and operate. As the above case studies make clear, TIF districts across the country have experienced a tremendous amount of new construction. Shopping centers, hotels, office buildings, and mixed-use residential complexes have all been built with the help of TIF-financed improvements. Those who use TIF are confident that the "but for" criteria are being met and that such development would not take place in the absence of this mechanism. As evidence of TIF's success, studies commissioned or conducted by municipalities simply add up the increases in property value since a TIF district was initiated and either state or imply that TIF "caused" that positive change.

However, as is the case with the evaluation of economic development incentives in general, there is divergence between the opinions of practitioners using TIF and more formal evaluations of this mechanism that use appropriate statistical methods of analysis (Wolman 1988). Scholarly analysis of TIF has tested the relationship between the incentive and standard economic development outcome measures (e.g., change in property values and jobs). Moreover other studies have investigated the hidden costs of the municipal use of TIF, namely the potential for harm to the overlapping jurisdictions who share their tax bases with TIF districts. The evidence has been mixed at best. Different contexts and methodologies have led to the contradictory conclusions discussed in this section.

Impact on property values and jobs

Scholars have scrutinized the impact of TIF on property values because in order for TIF to be considered self-financing, the increases in property values within the district are attributable to TIF, i.e., they would not have occurred "but for" the incentive. If property value increases within a district are solely due to the municipality's public assistance, TIF may be a no-cost proposition because additional revenues generated by the new development would not have existed otherwise. If the incentives succeed in making an area more attractive for new investment, demand for property there will continue to increase and the price of land inside the district will likely be bid up.

If, on the other hand, TIF has no independent effect on the value of property within the district and property taxes would have increased without its use, then this mechanism is not really creating new value and cannot be called a "no-cost" financing method. When TIF is used in areas that need no stimulus, it becomes a device for capturing revenues in areas rich in appreciating property and redistributing them away from the overlapping taxing jurisdictions that would otherwise have been able to tax any increase in value subsequent to TIF designation. In other words, much of the tax revenue foregone by freezing the value of properties in TIF districts would have been paid to county governments or to the school, library, or other special districts with jurisdiction over property in the TIF.

Man and Rosentraub (1998) found evidence that, after an initial period of two years, TIF had a positive effect on the median value of owner-occupied housing of municipalities in Indiana. Comparing TIF-adopting and non-adopting municipalities, they show how this economic development program was responsible for increasing the median owner-occupied housing value in their sample by 11.4 percent between 1980 and 1990. Man (2002) also finds statistically significant positive relationships between TIF and employment growth across 53 Indiana municipalities, growth that should also have a positive impact on housing values.

In contrast, Dye and Merriman (2000) found TIF adoption had a negative impact on growth in municipal-wide property values in the Chicago region. They hypothesize that TIF may induce an inefficient geographic allocation of investment; i.e., TIF may subsidize growth in the TIF district at the expense of growth in the non-TIF portion of the same municipality. Dye and Merriman (2003) extend their results to cover municipalities throughout the state of Illinois and also run separate analyses for industrial, commercial, and other types of TIF districts. They find evidence that while commercial activity within TIF districts substitutes for other commercial activity within the same municipality, industrial activity within TIF districts does not appear to have relocated from elsewhere in the municipality. In other words, industrial TIF districts may be more likely to induce net new growth in a municipality relative to commercial land uses.

Regardless of whether the aggregate (i.e., municipality-wide) net impact is negative or positive, the local effects of TIF may be significant. Viewed from the vantage point of one individual municipality, the seemingly contradictory results of Man and Rosentraub (1998) and Dye and Merriman (2000) may, in fact, be more consistent. Both studies leave open the possibility that the TIF designation could increase residential property values *within* TIF districts in the same jurisdiction (even if accompanied by a decrease in value in non-TIF areas located further from these targeted areas).

Indeed, Dye and Merriman (2004) and Byrne (2002) find that the TIF increment grew at a faster rate than property in the rest of the TIF-hosting municipality. In contrast, Weber, Bhatta and Merriman (2003) find that, for industrial parcels in Chicago, location within a TIF introduces a value penalty: industrial land and buildings within TIF districts sold for prices below that which similar properties sold for outside of TIF districts. Such contradictory findings at the micro-geography of urban neighborhoods raise the issue of whether TIF should be judged by how well it improves the blighted project area alone or its impact on the entire municipality.

It should be noted that these studies use statistical techniques to control for "endogeneity", i.e., the possibility that the decision to create a TIF district at a particular site might be made based on whether property values are rising or declining. They account for the bias that may occur because changes in property values cause TIF districts to be designated as opposed to TIF districts causing change in property values.

Impact on overlapping jurisdictions

Other studies have examined how overlapping jurisdictions have been affected by the use of TIF, in particular whether there is support for the charge that TIF "captures" tax revenues from such entities. Weber (2003) found that school districts sharing their base with increment-rich TIF districts in Cook County, Illinois, experienced slower local revenue growth than school districts without TIF districts. However, some of the loss was made up for by the state equalization formula that provided a greater amount of state aid to those school districts with TIFs. Huddleston (1982) found that in a sample of Wisconsin municipalities, TIF produced revenues in excess of public costs for both the municipalities and overlapping districts, but that the net revenue growth only occurred over a lengthy period of time. Stinson (1992) found that few TIF districts in a sample of municipalities in southern Minnesota were able to generate enough gains in property tax revenue to compensate for the amount that they captured from other jurisdictions.

TIF has the potential to increase spending needs and reduce revenue growth for overlapping jurisdictions. This is particularly true if the TIF-financed development brings with it new school children to be educated, new housing units to be serviced by sewer systems, or other increased expenditure demands. If this is the case, overlapping jurisdictions may need to increase their individual tax rates. This burden would fall on existing property owners, although it could be a limited amount of time before the TIF starts generating spillover effects and windfalls for these entities when the districts expire.

Lehnen and Johnson (2001) assert that school districts must increase their tax rates to maintain revenue diverted by TIF, but they do not test this hypothesis statistically. Huddleston (1986) established that some overlapping jurisdictions in a small sample of Wisconsin municipalities had to apply higher property tax rates than they would have in the absence of TIF. Lawrence and Stephenson (1995) found that in a Des Moines, Iowa TIF district, overlapping and surrounding jurisdictions initially subsidized TIF redevelopment projects. After a certain point in time, however, TIF contributed to a lowering of property tax rates throughout the metropolitan area because of an expansion of the tax base. Weber (2003) did not find evidence that TIF caused school districts to have to raise their tax rates – but this may be due to the constraint placed on such districts by state tax expenditure limits (i.e., "tax caps").

In sum, research on the effects of TIF has raised more questions than it has answered. The varying results may be due to the different state fiscal structures and local development contexts analyzed. This is testament again to TIF's flexibility: its usage and constraints on that usage vary tremendously by locale.

Reform efforts

TIF enabling legislation may be amended and local practices can be modified if the political will exists. Indeed, many states and municipalities have made efforts to improve the effectiveness of TIF and to assuage the fears of overlapping taxing jurisdictions and local residents who suspect that TIF has a deleterious influence on their revenues and tax burdens.

Optional participation of overlapping jurisdictions

Several states have enacted policy measures that give school districts the choice of participating in a TIF district. South Carolina and Kansas amended their original legislation to allow school districts the freedom to choose whether to participate in TIF districts (i.e., "opt-out provisions"). In Texas, school boards can elect to contribute anywhere from 0-100 percent of their share of property tax revenue to the TIF.

Florida, Alaska, Maryland and South Dakota shield the school district's "portion" of property tax base from the TIF district (as well as from property tax abatements) (National Education Association 2003). Florida, for example, stipulates that local jurisdictions can only use county and city taxes to fund projects within the district.

In Georgia, where school districts are highly dependent on local property tax revenues, overlapping taxing jurisdictions must consent to participate in a Tax Allocation District (TAD) (Bourdeaux and Matthews 2004). Their participation may be of less concern to municipalities in Georgia because the law allows for the municipal capture of revenues other than property taxes, such as local sales taxes, hotel-motel taxes, and business license receipts, which are generated by the new development within the district. Georgia state law allows overlapping jurisdictions to condition their consent on certain provisions – for example, allowing a portion of their potential increment to revert to the TAD pool and limiting the size and term length of bonds. School districts have conditioned their consent on the municipality's commitment to use their portion of the increment for activities directly related to educational facilities and programming – in keeping with the state's constitution that requires that school tax funds be used only for "educational purposes". School districts have required that their portion of the tax increment be used for school construction, maintenance expenses, and job training programs.

If overlapping jurisdictions can opt out, the total increments available to municipalities and redevelopment authorities will not be as great. In Minnesota, municipalities saw the revenue from TIF districts decrease when the state became responsible for school financing and effectively appropriated the portion of the schools' revenues that would otherwise have reverted to the TIF pool (Minneapolis Star Tribune 2003). Some affected municipalities threatened that they would need to raise general tax rates to ensure bond repayments.

Size and land use restrictions within the TIF district

To prevent municipalities from overextending this financing mechanism, 22 states currently limit the land area and value of the tax base that can be tied up in a TIF district. For example, Georgia limits the aggregate amount of property value that can be covered by a district to 10 percent of the municipality's base. In Maine, this figure is lowered to 5 percent of the total property value of a municipality. In other states, it is not uncommon for TIF districts to cover more than 5 percent of a municipality's total tax base. Chicago, in an extreme case, had 16 percent of city's property tax base tied up in TIF districts in 2002 (Neighborhood Capital Budget Group 2002).

Some states also restrict development within TIF districts to commercial and industrial development in order to diminish the service expenditures associated with residential uses, primarily the cost of education. Illinois has taken steps to reimburse school districts for increased services demanded as a result of residential development within the TIF district. For TIF districts designated on or after November 1, 1999 (or amended to increase the number of TIF-assisted housing units), the amount reimbursed is supposed to equal the attendance increase resulting from TIF -assisted or -necessitated housing multiplied by the most recently available per capita tuition cost (less any increase in general state aid). In accepting the reimbursement, the school district waives the right to legally challenge the designation of the district.

Inter-governmental agreements

Some overlapping jurisdictions are able to sign inter-governmental agreements (IGAs) with municipalities that allow them to share in the new property tax wealth available in TIF districts. Individual jurisdictions and municipalities are free to negotiate their own deal structures within the context of the state enabling legislation. The decentralized and idiosyncratic nature of these various IGAs appeals to those who think individual jurisdictions will negotiate the most appropriate arrangements and that interference by higher levels of government would lead to sub-optimal results.

School districts are the most frequent beneficiary of these agreements. They may negotiate agreements whereby they receive a fixed percentage of the TIF increment or other fees generated within the district. In an innovative case, the inter-governmental agreement signed by the Village of Oak Park, Illinois and its overlapping school districts specifies that individual properties be "released" from the TIF district each year as they are developed. These properties revert back to the school districts' base and can be taxed at their respective rates.

These different types of agreements may neutralize some of the impact of TIF on the property tax revenues of overlapping districts. They do not, however, make them "whole", i.e., the rebated portion of the TIF is not equal to the jurisdiction's tax rate applied to the incremental EAV within the TIF district.

In Illinois, as in many states, the funds rebated in the inter-jurisdictional agreements are not considered part of the available property tax collections for the purposes of calculating state school aid. This means some school districts could be doubly compensated—by both the state and the TIF—for revenues potentially lost to TIF

Strengthening the "but for"

To prevent TIF from being used to capture revenues in places where property values were rising without any public assistance, Minnesota requires municipalities to make real investments in the district before any increment can be attributed to the TIF. If building permits were not issued in the 18 months before the assessment, if parcels were not redeveloped within 4 years of the district designation, or if the municipality never issued bonds or acquired property, then it cannot lay claim to the full amount of the increment. In this way, the legislation requires municipalities to demonstrate responsibility for creating the value that is appropriated for economic development.

In Minnesota and California, the base assessed value (to which school districts have access for the entirety of the life of the TIF district) also includes an inflationary increase based on annual changes in the consumer price index. In this way, overlapping jurisdictions are able to capture increases in property value that are caused by general economic conditions and not necessarily the TIF-funded project. They can then cover some of the costs whose rates of increase often exceed that of inflation (e.g., healthcare).

Allocation of surplus revenues

Enabling legislation in states such as Illinois and Michigan stipulate that "surplus" revenues within the TIF district be distributed to all local taxing jurisdictions on a pro rata basis. Any funds that remain within the tax reallocation fund after developers have been compensated for TIF-eligible expenses and after bond obligations have been repaid may be considered surplus and are intended to be distributed annually to the county tax collector who will then redistribute them to the taxing jurisdictions. This provision is intended to prevent local governments from amassing a large pool of uncommitted funds at the expense of the day-to-day operations of the participating jurisdictions.

In actuality, municipalities find ways to circumvent this requirement. If they place surplus funds in an infrastructure fund, municipalities are often able to retain them indefinitely and use them as projects arise. Although the law may allow TIF districts to share a portion of their revenue with taxing authorities participating in the TIF plan, it appears as if few do this in the absence of an inter-governmental agreement.

If states were to request, obtain, and compile information on surplus funds, municipalities would be more compelled to distribute the excess revenues. This oversight may provide an added incentive for municipalities to adhere to their original redevelopment plans and to seek to accomplish their stated redevelopment goals within the time period currently allotted by the state enabling legislation.

Conclusion

In a period of scarce federal and state funds for development, TIF has come to be regarded as a kind of municipal horn of plenty. In municipalities across the country, TIF has raised the expectations of every revenue-hungry developer, social service program, and government agency seeking to shift the financial burden of capital and operating expenses. The competition for these scarce funds has increased the pressure to create additional TIF districts rather than improve existing ones.

Care must be taken to calibrate the redevelopment needs of the municipality with the benefits (and costs) that a mechanism like TIF has to offer so that TIF does not become yet another incentive in the border wars for private investment. This paper can help the informed practitioner be more selective about the projects and project areas that are appropriate for TIF. We have provided information about how TIF functions in both hypothetical and real settings, drawing out lessons about inter-jurisdictional governance, deal financing, and the implementation of plans using this powerful tool. If TIF is not used more discriminately, its increasing popularity may only lead to more fiscal fragmentation, give-aways to the private sector, and spatial inequities in public resource allocation.

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