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Getting the Most Out of Tax Increment Finance

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In the wake of an economic downturn, many cities are left with sites, projects, districts, or entire urban cores requiring redevelopment. A targeted tool, such as tax increment finance, can focus attention on a problematic area and catalyze development.

Tax increment finance (TIF) can be effective for addressing such problems, but this is not a given fact. The nation's newspapers are filled with stories about both successful and unsuccessful uses of TIF. Unfortunately, these articles rarely indicate (at least, not explicitly) what separates the good districts from the bad.

Much of the time, the separation between good and bad districts is caused by insufficient awareness or transparency. In other cases, the project needed additional support or planning on the financial side of the equation. The bottom line is that the successful operation of TIF requires attention to both project financing and best practices.

What is Tax Increment Finance?

TIF is a development finance tool that captures the future value of an improved property to pay for the current costs of those improvements. This mechanism can be used to finance a number of costs, typically pertaining to public infrastructure, land acquisition, demolition, utilities, planning, and more.

The TIF process helps to further clarify the financing model. First, the TIF district's geographic boundaries are established. Second, the initial value of all land within the district is assessed. Third, the current value of property (or other) tax revenue is established as a baseline and is frozen.

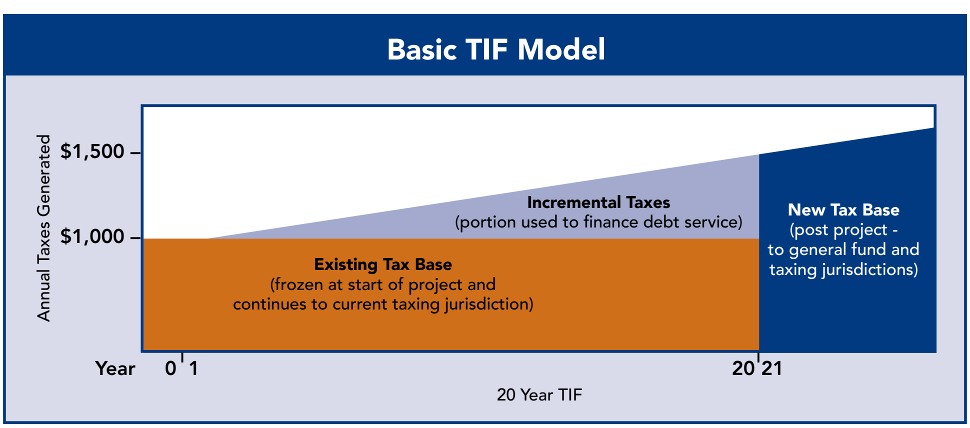
As development occurs and revenue from property taxes rise, this increase—or increment—above the baseline is used to pay debt service for the improvements made to the district. In this way, municipalities are able to build infrastructure and incentivize development without raising taxes.

The benefits of this model have made TIF a popular development finance tool, particularly for addressing blight and promoting district-oriented development. TIF is currently authorized in 49 states and the District of Columbia and is employed by cities of all sizes.

Best Practices in Tax Increment Finance

Best practices are important to the use of any development finance tool, but this may be particularly true for tax increment finance. Once property (or other) taxes have been frozen and any TIF bonds have been issued, revenue collected from the TIF district has the potential to become a sore point among community stakeholders, including area residents, school districts, and others. Following best practices in creating and operating the TIF district can help ensure that the community remains committed to the project.

The first area of TIF best practices to consider is related to public policy and statutes. For example, a TIF project should be clearly eligible according to the state's authorizing statute. In most cases, the project should not be viable



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"but for" any TIF assistance, in order to ensure appropriate use of tax revenue. The project should yield a positive net gain for the community.

The second area of TIF best practices is focused on the mechanics of the project. Identifying the experience and financial history of the developer is a crucial early step. The municipality and developer should determine up front when TIF funds will be needed and whether the project will require TIF bonds. In assessing the financial viability of the project, consideration should be given to whether the (re)development has a high likelihood of maintaining an enduring presence in the community.

The third—and often forgotten—area of TIF best practices is community support and buy-in. The municipality should make an effort to identify the project's broader stakeholders, which include neighborhood groups, business leaders, school districts, and elected officials. A plan for communicating the importance of the project, as well as information on how the project will be financed, should be developed and executed.

By following the best practices recommended by CDFA and working openly with community stakeholders, a TIF district or project will position itself for success.

Pairing TIF and Other Development Finance Tools

Unfortunately, a strict adherence to best practices does not always determine the financial viability of a project, and incremental finance alone may be insufficient or inappropriate for some or all of a project. This may be the case when some particular problem with the area—such as environmental damage or acute poverty—causes a project to have particularly high initial costs or long-term risk. In such a case, an additional development finance tool may be necessary to attract investors, complete a project, or lower the cost of the TIF bonds.

For example, consider a property that is considered blighted because of environmental damage caused by a previous owner. The high initial costs and risks of redeveloping this property may make TIF bonds less than ideal for at least the first phase of redevelopment. Brownfield finance programs may finance the site's cleanup costs to a sufficient level to make a later bond issuance on the property viable.

Brownfields programs, which are another form of targeted development finance tools, often pair well with TIF districts and projects. The U.S. Environmental Protection Agency offers several brownfields programs, including a tax incentive and assessment grants. State and local development agencies also frequently offer support for brownfields cleanup. Payment-in-lieu-of-taxes (PILOTs), tax abatements, and grants are common forms of financing.

CDFA's Tax Increment Finance Resources

CDFA is the national leader in supporting TIF. Further information on any of the financing programs or recommended practices discussed in the article can be found in CDFA's numerous TIF resources, including:

CDFA Reference Guides

Tax Increment Finance Best Practices Reference Guide
Advanced Tax Increment Finance Reference Guide

Tax Increment Finance Resource Center

TIF State-by-State Map & Report
Daily TIF Headlines

CDFA Training Institute

Intro Tax Increment Finance Course
Advanced Tax Increment Finance Course

CDFA Tax Increment Finance Coalition Webcast Series

Visit www.cdfa.net for more information.

Regardless of the financing type, brownfields programs help reduce the costs and risks of redeveloping properties blighted by environmental damage. Depending on the needs and wants of the community, the TIF district can be put in place before the cleanup or after. This decision will have a significant effect on the district's frozen value—and therefore on the district's potential to generate TIF revenues. In either case, issuing TIF bonds after the cleanup risks have been borne out will likely result in a more favorable financing structure.

Other examples of TIF projects that may require additional financing are districts that encompass low-income census tracks. These projects may be considered particularly risky, as a financial analysis could well indicate that businesses will be reluctant to invest in such areas. In these cases, an investment tool, such as New Markets Tax Credits, could be paired with TIF redevelopment to make low-income areas attractive to a number of stakeholders, including investors, businesses, developers, and non-profits.

New Markets Tax Credits (NMTC) are designed to incentivize investment in businesses located in low-income census tracts. Receiving financing for a qualified project also requires working with a Community Development Entity that has received a tax credits allocation. A TIF district covering a blighted area may well meet NMTC requirements.

The benefit of the NMTC program for a TIF district is that the tax credits can provide an additional source of equity for a project that costs more than TIF bonds alone can bear. TIF revenues can be put towards the relative public costs of infrastructure, while developer and tax credit equity can go into the bricks and mortar development to be located within the district. These two programs may work particularly well in states that strictly limit the use of TIF revenue to infrastructure costs alone.

Getting the Most out of TIF

The bottom line is that TIF, although complicated and occasionally challenging, has much to offer communities and businesses looking to redevelop sites neglected or otherwise blighted by the recession. Economic development finance agencies should utilize TIF as part of their development finance toolbox and promote the benefits of this tool to their constituents. By following best practices and creatively pairing district revenue with other financing tools, TIF can effectively provide targeted redevelopment. ■