Urban Revitalization and Tax Increment Financing in Chicago

This article describes how the City of Chicago used tax increment financing to lure business and development, while revitalizing the local economy.

By Lori Healey and John F. McCormick

Throughout the late 1800s and early 1900s, the Chicago Stockyards provided jobs for thousands of residents and fueled the local economy, earning the city the nickname "Hog Butcher to the World." But as traditional meatpacking and butchering industries declined rapidly in the late 20th century, the South Side's Stockyards closed production in 1980, leaving vast parcels of vacant and blighted land and buildings. At the time, few federal resources were available to rebuild the area's infrastructure; the soil was unstable, many roads were privately owned and unusable, and the land was divided into small lots. These factors made large-scale redevelopment for modern industries impossible.

Through a series of industrial and commercial tax increment financing (TIF) districts, the city has successfully brought this once-thriving industrial center back to life. TIFs provided the funding mechanism to clean up the stockyards and prepare land for redevelopment. The Stockyards Industrial Park is now home to modern industrial facilities for companies like Culinary Foods, Inc., Luster Products, and OSI Industries, while a new retail center has brought stores and services to a once-underserved area. In this age of dwindled state and federal funding, the Chicago Stockyards have become a national model for urban economic development.

Tax Increment Financing

Tax increment financing is a technique for financing a capital project from the stream of revenue generated by the project. It can be an important community development tool for attracting the development that will generate new taxes.

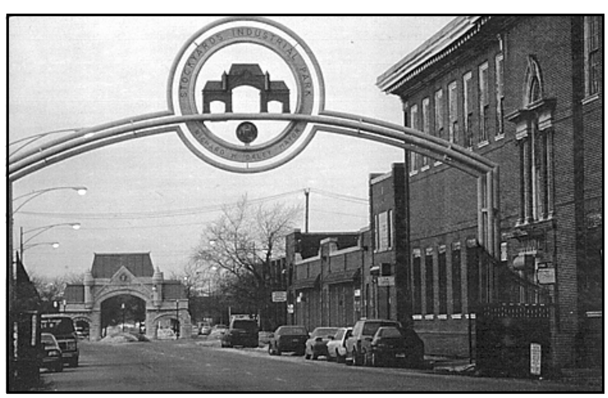
Federal economic development money available in 1997 was down 56 percent from its 1980 level, and what little funding is available usually is offered on a short-term annual basis, which makes it too unreliable to support multi-year revitalization and development programs. In response to these cutbacks, many areas began using TIF. Another advantage of using TIF over federal economic development money is that it allows for more project flexibility and local control.

TIF was first enacted in Illinois in 1977 after the drastic reduction of state and federal economic development funds. For an area to be eligible for TIF in Illinois, the structures in it must have some of the following problems:

- age;
- obsolescence;
- illegal use of individual structures that are below minimum code standards;
- excessive vacancies;
- overcrowding of facilities;
- lack of ventilation, light, and/or sanitary facilities;
- inadequate utilities;
- excessive land coverage;
- deleterious land use or layout;
- lack of physical maintenance;
- lack of community planning; or
- dilapidation or deterioration.

Even though the TIF law was established in 1977 in Illinois, Chicago approached the program cautiously and did not create its first TIF district until 1984. When Mayor Richard M. Daley took office in 1989, there were only 12 TIF districts in the city. Many of them were not well monitored, and as a result, had not been generating much in terms of private investment. Mayor Daley's administration embraced TIF as a tool for reaching Chicago's economic development goals. From 1990 to 1997, the city adopted 32 more TIF districts. By the end of 1999, there will be more than 75 TIFs in Chicago.

In terms of sheer scope and scale, Chicago's use of TIF to retain and attract industry is unprecedented in urban America. Through TIF, Chicago has become one of the strongest industrial markets in the country.



The Stockyards arch welcomes visitors to the Stockyards TIF district (photo courtesy of City of Chicago).

TIF in Chicago

The City of Chicago works with local aldermen, community groups, businesses, and developers to identify areas not living up to their potential. The city then examines the land to determine if it is eligible to become a TIF district. If it qualifies, the city creates a TIF redevelopment plan to revitalize the neighborhood and public hearings are held to provide input. Once the redevelopment plan is completed, the City Council

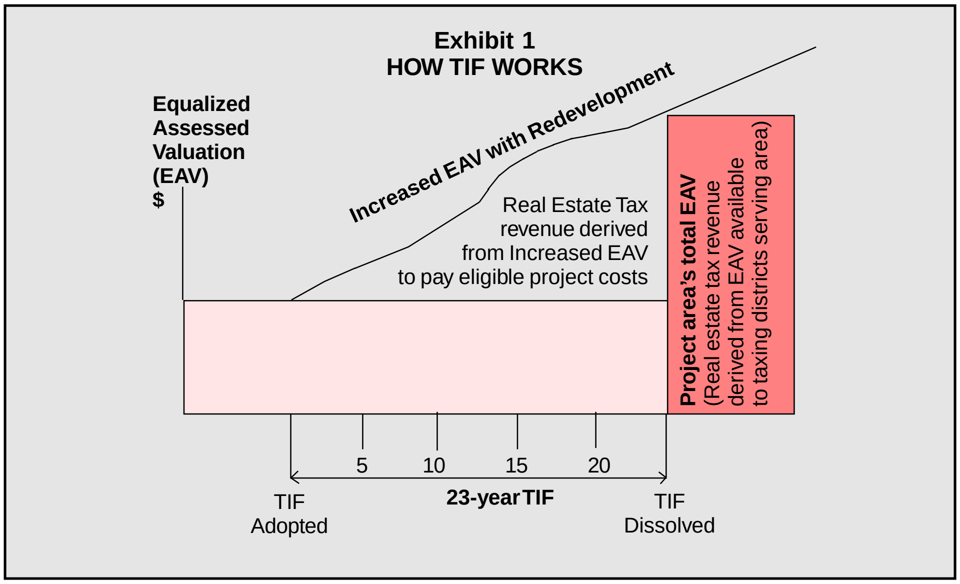


Exhibit 1
HOW TIF WORKS

formally votes on the creation of the TIF district.

When the City creates a TIF district, the amount of tax revenue the area currently generates is set as a baseline that will serve as the amount local governmental taxing bodies will receive from that area for the life of the TIF, which is 23 years. As vacant and dilapidated properties are developed, with TIF assistance, the value and tax revenue from those properties increases. The "increment" above the baseline is then captured and used solely for improvements and redevelopment activities in the TIF district. After the TIF expires, or when the city's investments are repaid, all property tax revenues are again shared by all of the local taxing bodies.

Financing

The City of Chicago initially made a policy decision not to issue general obligation bonds to directly fund projects in its TIF districts. Other than four TIF Bonds issued in 1987 for commercial shopping centers that were supported by real estate tax increment, city sales tax, and state sales tax (the State of Illinois discontinued the sales tax TIF program after one year), the city was limited to offering "pay-as-you-go" TIF funding on a yearly basis for individual projects.

Because individual companies and developers often need up-front funding to make their deal complete, other initiatives needed to be taken to keep Chicago competitive with other cities and states in attracting development.

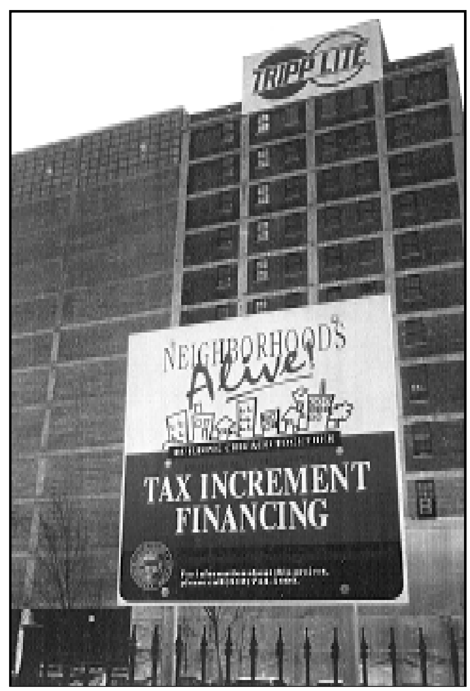
In 1992, the city allocated approximately $25 million from its larger, citywide general obligation bond issue for economic development funding. Funds from this allocation allowed the city to attract and retain large industrial companies like Culinary Foods, Luster Products, Eli's Cheesecake, National Wine Service, and Farley Candy. After completion of these projects––with their proven real estate tax increment numbers––TIF bonds were issued in the Stockyards, Reed-Dunning, and Sanitary and Ship Canal TIF districts. Proceeds from these bonds then were used to repay the funds originally allocated from the 1992 general obligation bond.

Two of Chicago's "mature" TIFs––the Near South and Central Loop TIFs––were deemed qualified for AAA-rated insurance through AMBAC. The Lincoln-Belmont-Ashland TIF was insured by ACA. The city will look to the municipal bond insurance companies in the future, realizing that the underwriters have higher requirements for the insurance (larger size, greater diversification, proven numbers, and overall higher increment coverage), rather than unenhanced TIF bonds.

The use of other forms of up-front funding, such as CD Float Loans and developer notes, provide time for projects to mature and become "bondable" (as they did in the North Side's Lincoln-Belmont-Ashland and Irving Cicero TIFs). Developer Revenue Notes place the project-completion risk upon the developer, his or her equity partners, and lenders. Here, developers enter into redevelopment agreements, complete the project, pay for eligible costs, and are then pledged incremental revenues occurring over time as a result of their project.

The developer, as holder of the securities and source of the incremental revenue stream, eliminates default risk. Costs of issuance expenses are minimal, and generally the need for a debt service reserve and capitalized interest are eliminated. Higher interest rates (equal to the developer's borrowing costs) are mitigated by the municipality's ability to call and refund these securities at any time in the future. This is especially valuable when the city wishes to issue a Tax Increment Bond for the entire district at a lower interest rate, refunding one or more high interest developer notes.

The city has been proactive in using TIF to assist financing low- and moderate-income housing revenue bonds. While Chicago's TIF funding has mainly been limited to the 30 percent interest rate write-down provided by the state TIF statutes, new legislation raised the level of assistance to 70 percent of interest rate costs, as well as 50 percent of construction costs, which could trigger even more financing in this area.



The "Neighborhoods Alive" sign designates a TIF district (photo courtesy of City of Chicago).

In the Near North Redevelopment Project, the most recent TIF financing of $55 million was issued on two series, had two letter of credit providers, and utilized a swap to provide an optimum interest rate. This TIF area covers Cabrini Green, once one of the poorest, most crime-infested public housing projects in the country. Tax increment to fund the TIF area is provided by a large commercial shopping center and market-rate condominiums, which were constructed in the area after the TIF was established. Project funds will be used for parks, infrastructure, new schools, and a new housing project, which will consist of a mixture of market-rate, low- and moderate-income housing, as well as replacement housing for the Cabrini residents currently in soon-to-be-demolished high-rise buildings.

TIF Programs

In order to bring some of the benefits of TIF to small businesses, homeowners, and small-scale downtown projects, the city has initiated three new lender-backed micro-TIF investment fund programs. These unique initiatives target housing and business programs in some of Chicago's most needy areas, as well as small improvements to the central business district.

The Small Business Improvement fund (SBIF) reimburses businesses and building owners for TIF-eligible investments that preserve building stock, improve neighborhood appearance or commercial value, and enable businesses to stay in the neighborhood, remain competitive, or expand. Businesses may be reimbursed for up to 50 percent of eligible costs with a maximum assistance of $50,000 per project. Businesses such as free standing fast food chains and branch banks are not eligible. Priority is given to businesses located at major intersections or major commercial corridors, projects resulting in the retention or creation of jobs, and historically significant buildings.

A pilot program in two South Side neighborhoods provides homeowners with TIF assistance for home repairs and improvements such as new roofs, entryways, windows, porches, exterior siding, and masonry work. Coordinated through the city's new TIF Neighborhood Investment Program (TIF-NIP), the program provides a maximum grant amount of $10,000 for single-family homes, $12,500 for two-flats, $15,000 for three-flats, $17,500 for four-flats, and a maximum of $50,000 for buildings with five or more units.

Two programs in the downtown "Loop" business district provide local businesses with financial assistance for projects that contribute to the area's growth as an entertainment, retail, and financial district.

The Central Loop Improvement Fund uses TIF proceeds to help property owners improve their buildings according to the standards outlined in the city's two downtown vision plans. The plans encourage building owners to install pedestrian-friendly improvements (such as new signs, awnings, facades, doors, and windows) as well as environmental remediation and upgrades to electrical and plumbing systems. The fund provides grants of up to $150,000 or 50 percent of eligible costs.

The Central Loop Loan Program, a companion to CLIF, provides low-interest loans of up to $50,000 to retail, commercial, and service-oriented businesses that are undertaking projects that benefit the city and employ Chicago residents, but do not qualify for TIF funds. Eligible projects include leasehold improvements and expenses involving inventory, working capital, equipment, and building rehabilitation. Loans last up to five years at 3 percent interest.

Special Considerations

Tax increment financing can be a controversial subject. Misinformation about TIF districts can lead to a fear of higher taxes and the perception that TIF will take money away from other entities, particularly school districts. But in fact, additional taxes created by redevelopment of blighted land goes to relieve the tax burden of other properties in the city. TIFs also work to create money for school districts and other taxing entities by developing a solid tax base that will help fund them for years to come. Local taxing bodies will realize a budget windfall after a TIF district expires. They will receive much higher revenues than they would have without the TIF-funded development. Simply put, TIF does not take a bigger piece of the taxation pie, rather, it creates a bigger pie.

While Chicago's Loop/downtown TIFs have been criticized by some as unnecessary, they have been incredibly productive for all of Chicago. Most of the downtown success stories in recent years are due to TIF: the creation and retention of thousands of jobs, providing the funds for the reconstruction of the State Street retail district, and the needed funding efforts to save and restore several historic theaters from demolition. Such projects have been integral to the revitalization of Chicago's downtown and have played an essential role in the formation of a new Theater District.

Results

By the end of 1998, Chicago's TIF program had created more than 9,800 jobs and retained more than 24,000. New housing units totaled more than 3,000.

Exhibit 2
CHICAGO CUMULATIVE TIF RESULTS 1984-1998

TIF Districts:	64 at end of 1998 (More than 75 by end of 1999)
PUBLIC/PRIVATE INVESTMENT	
Total public investment	$ 526,925,838
Total private investment	$ 2,821,990,004
Total investment	$ 3,348,915,842
Leverage ratio	$5.36/$1
EMPLOYMENT	
New jobs created	9,875
New jobs retained	24,108
Total jobs	33,983
RESIDENTIAL DEVELOPMENT	
New rental units	1,506
New owner-occupied units	1,415
New student housing beds	757
New youth hostel beds	250
Total housing units (excl. student housing/hostel)	2,921
COMMERCIAL DEVELOPMENT	
New office space	4.73 million square feet
Rehabilitated office space	1.08 million square feet
New retail space	2.36 million square feet
Rehabilitated retail space	198,400 square feet
New parking spaces	4,615
Rehabilitated theater seats	10,920
New movie theaters	2
INDUSTRIAL DEVELOPMENT	
New industrial space	3.98 million square feet
Rehabilitated industrial space	1.03 million square feet
Total industrial space	5.01 million square feet

New and rehabilitated office space topped 5.7 million square feet, and new and rehabilitated retail space was more than 2.5 million square feet. The city also had more than 1,300 TIF-encouraged new hotel rooms, two 10-screen movie theaters, a newly created Chicago Theater District with 11,000 seats in rehabilitated downtown theaters, 4,600 spaces in new parking facilities, and a new 250-bed youth hostel and college dormitory.

A statistic which may best illuminate the success of Chicago's TIF program is the calculation of private return leveraged from public investment. For every one dollar of public funds spent on TIF projects, the private sector has invested almost five and a half dollars. By the end of 1998, Chicago had invested a cumulative $526 million in TIF funds and benefited from $2.82 billion in private investment.

The City of Chicago has put in place an overall TIF program that not only serves its taxpayers well, but provides a model that other cities have looked to follow. This program has been successful by creating and following a policy that is aggressive and innovative in its utilization of TIF as an economic development tool, but conservative in its financing guidelines.

Many of Chicago's neighborhoods are coming alive with new development and growth. Modern industrial facilities are replacing abandoned factories, while new shopping centers are appearing in city neighborhoods that have not seen commercial or retail development in more than a generation. In most cases, these improvements would not be possible without TIF. Chicago's TIF program has become a key ingredient in rebuilding Chicago and awakening its neighborhoods. □

LORI HEALEY *is First Deputy Commissioner for the City of Chicago's Department of Planning and Development.* JOHN F. MCCORMICK *is TIF Financial Manager in the Chicago Department of Finance.*