

Tax Increment Financing (TIF) 101
Prepared for February 2005 General Membership Meeting
By Progressive Dane Economic Development Task Force

Want to get involved with our Task Force? Contact co-chairs Vicky Selkove (ysselkove@aol.com, 772-6046) or Brian Larson (results@careersmith.com) or come to our monthly meetings (4th Tuesday of the month, 6:30 p.m. at the Social Justice Center).

WHAT IS A TIF?

Tax Increment Financing, or TIF, is a special financial tool that can generate money for economic development in a specific geographic district. They are also called TIDs.

TIFs were created so that local municipal governments could issue bonds to finance infrastructure improvements, undertake land assembly, and provide incentives to lure private investment to blighted urban neighborhoods.

WHAT TYPES OF AREAS CAN BECOME TIF DISTRICTS?

To become a TIF district, an area has to have certain characteristics AND has to reasonably be shown that the area would not be developed without TIF.

1. State law allows municipalities to create a TIF if the area is “blighted.” (There are also industrial, conservation and mixed use TIFs). Blight is the most commonly used TIF.

So How Does the City Determine If An Area Is Blighted?

A City generally hires a private consultant to perform a survey of the area. The consultant does a visual survey of the area to determine the condition of buildings and the amount of vacant land, researches the number of building permits that have been issued for the neighborhood in recent years, and checks to see whether the value of properties within the proposed TIF has grown or shrunk. There is rarely any public participation in the process. **In general, physical, economic and social conditions contribute to a determination of blight.** A finding of blight does not trigger condemnation, building code enforcement or penalties for property owners.

2. The “But For” Test

The idea behind creating a TIF district is that the area is so blighted that little or no new development or growth would take place in the area without the use of the TIF. This is sometimes called the "but for" test - **no growth would happen *but for* the TIF.**

HOW DOES A TIF ACTUALLY WORK?

TIFs work by capturing all new property tax revenues from a specific area and re-investing them in that same area.

That means that once a TIF district is established, the local taxing bodies, such as Madison Metropolitan School District, the City of Madison and Dane County get no new revenue from the TIF.

A TIF generates money through increased Equalized Assessed Values (EAV) of the total property within the district. The EAV is the Assessor's way of assigning similar taxes to similar structures and spreading the property tax burden equally. Properties in TIF areas have lower EAVs than similar properties outside the TIF areas because of the physical and economic problems of the TIF.

When a TIF district is created, the City looks at the value of all of the property in the proposed TIF district. *This is the base rate.* Once an area is designated a TIF district, the total EAVs are calculated and become the base. As properties are improved within the TIF district, the EAV or values of the properties increase. The difference between the base EAV and the new EAV, after the development has occurred, *is the increment.* These "new" revenues – the "increments" – arise when new development takes place in the TIF district, or if the value of existing properties rises, resulting in higher property values.

HERE'S AN EXAMPLE OF HOW A TIF WORKS:

A TIF district is designated and the total EAV is \$100,000. **This is the base.** After a few years of development and improvements, the total EAV is \$150,000. The property taxes paid on the **increment** of \$50,000 is reinvested into the TIF; the property taxes paid on the base of \$100,000 is collected by the varying taxing bodies (city, county, state) just like it normally would have been. The taxing bodies get no new revenue from the TIF – their share of the property taxes is frozen at the base level that it was at just before the TIF was created. **The taxes on all of the new property value in the TIF are reinvested within the TIF district.**

Property tax revenues to these local taxing bodies stay frozen at the base level of \$100,000 for the length of the TIF, which can last up to 27 years. Ideally, after the TIF project is complete and the 27 years are over, the newly developed land increases the tax base and creates more revenues for all of the taxing bodies in that area.

HOW DOES TIF MONEY GET SPENT?

The increments generated by a TIF district can be used for:

- infrastructure and other public improvements (including improvements to streets and streetscapes, storm water upgrades, bike and pedestrian access, and parkland) or
- direct subsidies of private residential, commercial, or industrial development.

These priorities are laid out in a “redevelopment plan” approved by a joint committee of the taxing entities, the Board of Estimates and the City Council that outlines the priorities for the area and an estimated budget. **The major limitation on TIF funds is that they can’t be used for the “bricks and mortar” costs of construction (except for affordable housing).** TIF money can be used for:

- Planning expenses, such as studies and surveys, legal and consulting fees, accounting, and engineering.
- Acquiring land and preparing it for redevelopment, including the costs of environmental cleanup and building demolition. Especially in older areas, making a site ready for a developer reduces costs & eliminates a major barrier to redevelopment.
- Financing and interest subsidies for the loans a developer takes out to pay for a project.

HOW HAVE TIFs BEEN USED IN MADISON?

According to Joe Gromacki of Madison’s Planning Dept., Madison tends to be fairly conservative in approving new TIF districts. The average lifespan of a Madison TIF is 12 years. 32 districts have been created since 1977, 12 are currently active. Over this period \$30 million in TIF borrowing has resulted in \$450 million in new development, a spectacular return on taxpayer’s “investment”.

The City has established TIF objectives: enhance downtown redevelopment, underwrite the costs of underground parking, improve aesthetics, and attract and retain business. The expectation is that \$3 million in new increment is the minimum threshold to create a TIF district. **Several years ago, the City added a 10% set aside for affordable housing.** Recently a Council committee has been: reviewing “priorities” for what gets TIF funding, studying the controversial “equity kicker”, and investigating a “pay as you go” model of funding. In 2005, the Mayor budgeted \$41million in General Obligation Bond borrowing for TIF funding.

Interestingly, **TIF could be used to help small, locally-owned businesses** (instead of larger-scale development projects), but are rarely used that way, likely due to lack of education on the part of small business owners or entrepreneurs about the possibility of getting TIF and lack of information about how to navigate city processes to apply for TIF.

WHAT ARE THE POTENTIAL NEGATIVE IMPACTS OF TIFs?

- **The “But For” test is not strongly enforced.** State law does not provide a good set of criteria for determining whether or not development would take place without the TIF. Still, in neighborhoods where an unwanted TIF is on the drawing board, it can be helpful to cite evidence of development that is already taking place without the aid of public subsidies, or show how property taxes in the area are already on the rise.
- **Many TIF districts get created in areas that are not really “blighted.”** There are not very specific rules about which areas can be considered for a TIF. There is a lot of room for consultants and cities to manipulate the boundaries of a TIF to make sure it qualifies even if the area would never meet a common sense definition of “blight.”
- Unlike other city programs, TIFs **don’t come with cash up-front.** Dollars generally aren’t available for several years until the TIF begins to generate its own tax revenue from rising property values, or a bond is issued to “front-fund” the TIF.
- **TIF may lead to gentrification and accompanying displacement,** use of eminent domain, rapid transformation of a community’s historic character, and the attraction of “replacement” populations, while long-time stakeholders may have to move on to less desirable, but more affordable neighborhoods.
- **TIFs can end up costing the municipality.** If the proposed development really should have failed the “but for” test (if the development would’ve happened even without TIF) then the municipality is forfeiting the taxes it could’ve received from the new projects.

WHAT COULD BE DONE TO IMPROVE TIF POLICY LOCALLY?

- Increase **public participation** in the process when TIF districts are being considered by making the process far more transparent & understandable.
- Set up specific, clear measurements for what **constitutes blight.**
- Consider making developers **sign risk-sharing agreements** where they would pay back the subsidy if the projects don’t actually increase value by a set amount.
- Set-aside some of the increment for **small business development,** with a particular emphasis on aiding women and minority business owners and conduct **education & outreach to small businesses,** so they understand that TIF can be used for smaller-scale projects, not just large developers.
- Require the City to make its **own annual priority plan and budget for TIF** so that usage of TIF is City driven, not developer driven. This would require the City to set priorities each year for projects and geographic areas and then have developers step forward, seeking TIF funds for projects that the City already has identified as needed or areas already prioritized for assistance.
- **Require more from developers who receive TIF** – the City could create “Community Benefits Agreements” with these developers requiring them to provide jobs at living wages, hiring of local residents and/or minorities, community impact reports, environmental or traffic impact reports, etc.
- Create a clearer & more **effective system of accountability & monitoring** of TIF projects after the initial approval process.