A Resource Guide to Tax Increment Financing (TIF)

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What Is TIF?

Tax Increment Financing (TIF) is a program that allocates future increases in property taxes from a designated area, or TIF district, to pay for improvements within that area. In Illinois, the TIF district can remain in place for up to 23 years after its creation. The district can be extended for another 12 years, but an extension requires an act of the state legislature. Other states' laws regarding TIF vary, but the key principles are similar across the country.

How It Works

Normally, property is taxed by several different governmental jurisdictions: the municipality (City or Village), School District, County, Park District, Water Reclamation District, etc. The taxes levied are allocated to each district in accordance with its tax rate. (In this document, we refer to the municipality as the City, but it also applies to Villages).

Under TIF, the property taxes resulting from increased value due to new development, rehabilitation or improvement, property appreciation, equalization, or rate changes are all allocated to the City. Other jurisdictions continue to receive the property taxes generated by the base value of properties in the district.

All properties in the district are assessed in the same manner as all other properties and taxed at the same rate. TIF is not an increase in taxes. It is only a re-allocation of how they are used. Increases in property taxes experienced by property owners are due to reassessment and rate increases, not TIF.

Rationale

The rationale for TIF is that only the City has the responsibility and authority to support redevelopment and, more broadly, economic development. All taxing bodies benefit in the long run from the City's activities. It is, therefore, appropriate to utilize "their taxes" to help pay for costs necessary to bring about redevelopment from which the entire City will benefit. Since only the City can incur those costs, it is fair to re-allocate those tax dollars for the use of the City for a redevelopment project.

TIF District Designation

TIF Law Eligibility

Illinois law provides for three different potential types of eligibility analyses that could result in an area being deemed eligible for designation as a TIF district:

1) Improved land
2) Vacant Land
3) Industrial Park Conservation Area and Jobs Recovery Act Eligibilities

1. IMPROVED LAND

If an area is improved, it can qualify for TIF eligibility in one of two ways:

1) **Conservation Area.** In this finding, over 50 percent of buildings within the area must be 35 years old or older, AND three (3) or more eligibility factors from the list below must be found to be present to a meaningful extent and reasonably distributed through the area:

    a. Dilapidation
    b. Obsolescence
    c. Deterioration
    d. Presence of structures below minimum code standards
    e. Illegal use of structures
    f. Excessive vacancy
    g. Lack of ventilation, light or sanitary facilities
    h. Inadequate utilities
    i. Excessive land coverage and overcrowding of structures and community facilities
    j. Deleterious land use or layout
    k. Environmental clean-up
    l. Lack of community planning
    m. Lack of growth in EAV

2) **Blighted Area.** In this finding, five (5) or more of the eligibility factors listed above must be found to be present to a meaningful extent and reasonably distributed throughout the area.

2. VACANT LAND

There are two ways to qualify vacant land for TIF eligibility: the two-factor test or one-factor test.

1) **Two-Factor Test.** One way is to find that at least two (2) of the following six (6) factors are present to a meaningful extent and reasonably distributed throughout the study area:

    a. Obsolete platting
    b. Diversity of ownership
    c. Tax and special assessment delinquencies
    d. Deterioration of structures or site improvements in areas adjacent to vacant land
    e. Environmental issues
    f. Lack of growth in EAV

2) **One-Factor Test.** Vacant land may also qualify if the area meets one of the following criteria:

    a. Contains unused quarries, strip mines, or strip mine ponds
    b. Contains unused rail yards, rail tracks, or railroad rights-of-way
    c. Is subject to chronic flooding that adversely impacts real property or discharges water

that contributes to flooding within the watershed (In order to consider this factor, the redevelopment project must provide for facility improvements that will contribute to the alleviation of all or part of the flooding)

d. Contains unused or illegal dumping sites
e. Was designated as a town center prior to January 1, 1982, is between 50 and 100 acres in size, and is 75 percent vacant land
f. Qualified as blighted prior to becoming vacant

3. INDUSTRIAL PARK CONSERVATION AREA AND JOBS RECOVERY ACT ELIGIBILITIES

These two approaches are much less frequently utilized and are used only to designate industrial park TIF districts. They rely on findings regarding unemployment and inadequate infrastructure levels, vacant buildings, or environmentally contaminated sites.

These types of TIF districts only allow for industrial development and thus are rather limiting from a future land use perspective.

District Designation Required Findings and Tests

In addition to meeting the eligibility standards outlined above, in order to create a TIF district, the following tests must also be passed:

1) **Lack of Growth & Development through Investment by Private Enterprise**. This is a backward-looking finding that the area has not been subject to prior growth via private investment.

2) **"But for" TIF**, the study area "would not reasonably be anticipated to be developed."

3) **Contiguity**. A finding must be made that only those contiguous parcels of real property that are expected to benefit substantially from the TIF district are included in the district boundary.

4) **Conformance to the Plans of the Municipality**. The future land use plan for a TIF district must conform to the comprehensive plan or other land use plans or regulations for a City. TIF plans are not permitted to be used to make new land use policy.

5) **Housing Impact Study**. If the redevelopment plan would result in the displacement of residents from 10 or more inhabited residential units, or if the redevelopment project area contains 75 or more inhabited residential units, and no municipal certification that displacement will not occur is made, then a housing impact study is required.

Providing TIF Assistance to a Project

TIF funding can be used to assist both public and private projects.

Public Project Review Considerations

The review considerations for supporting a public project, such as a park, streetscape or other public capital project, are relatively simple.

1) Are there sufficient TIF funds available or projected to be available to pay for the project?
2) Does the proposed project support the goals and objective of the TIF plan?

Private Project Review Considerations

For projects that are driven by private sector developers or business owners, providing public TIF funding should be considered an extraordinary intervention in the largely privately-driven real estate market. Accordingly, such interventions are worthy of a good deal of scrutiny, and any agreement to financially support a private project must be structured carefully to provide the City with reasonable protections and assurances regarding outcomes. We recommend that projects requesting City TIF assistance be reviewed in the following ways:

1) **Project Feasibility Review –** Before getting too far into detailed financial and legal work, some level of market and/or other higher-level feasibility testing may be warranted. Assuming the project passes this initial test, further research and analyses may be desired.

2) **Public Benefit –** This analysis is crucial because an inability to get private financing does not necessarily mean a project warrants TIF funding. The core question here is: "What is the benefit that the City is receiving that warrants an extraordinary intervention?" Public benefits can include bringing a contaminated site back into productive use, employment growth, and tax base growth, among others.

3) **Eligible/Extraordinary Costs –** State law only allows for certain types of costs to be paid for with TIF funds. A close inspection of the project budget is required to ensure that the City is reimbursing for legally allowed costs.

4) **Gap Analysis –** Assuming a project is providing sufficient public benefits to potentially warrant TIF funding, a detailed review of the project's financials is recommended. Examinations of projected revenues, costs, absorption pace, financing plan and other key elements of the project are necessary to determine whether the project needs TIF money to achieve a market-level return for the developer. By subjecting the project's financial projections to close scrutiny, the City also demonstrates to taxpayers and other taxing bodies that they are careful stewards of these funds and seek to use TIF only when the project legitimately requires assistance.

5) **TIF Revenue Projections –** In addition to validating the need for assistance, a City should also assess whether there will be sufficient revenues to provide the required assistance. Revenue projections based on market-validated comparable assessments and absorption levels provide a sense of the scale of potential assistance.

6) **Balancing Risk and Structuring Deals –** Once the level of assistance has been negotiated based on the work conducted above, the form, timing and terms of that assistance must be negotiated. For example, in this process, cities often introduce "go dark" provisions; if a project stops operating within a certain period of time, the TIF payments can be stopped and prior payments can be recaptured.

Bond Feasibility Study

If, in the course of reviewing the project's pro forma, it is determined that TIF bonds are required by the developer and/or desirable for the City, additional research regarding revenue projections will be required. Refined TIF revenue projections along with substantial supporting documentation must be prepared to make the bonds saleable both legally and from a market perspective.

Compliance and Reporting Considerations

TIF payments must be made as reimbursements for costs already incurred. Documentation of costs incurred and paid must be submitted and approved before releasing TIF funds. In addition, state law requires cities to prepare regular reports on TIF districts to help ensure that adequate public scrutiny is given to these funds.

Project Compliance

It is common practice for a City to review the documentation regarding TIF-eligible costs prior to making a payment. Documentation of project costs often includes:

1) Lien waivers for lienable costs such as hard construction costs
2) Copies of invoices and canceled checks for non-lienable costs (soft costs)
3) Transfer tax documents for land purchases
4) Interest cost statements from lenders

Some cities require a total investment amount as a part of their agreement(s) with developers. That figure can often be verified by reviewing an Owner's Sworn Statement in concert with other documents.

A close review of these documents ensures that a City is only reimbursing for costs that were incurred at the right time, in the right location, and used for legally allowable purposes. Again, close scrutiny of these issues can help show the care with which a City is utilizing TIF funds.

State Reporting Compliance

In addition to reviewing project costs to be sure that TIF funds are being spent legally, Illinois state law requires that cities generate reports to explain the activities occurring within a TIF district to other taxing bodies and the public. There are two major types of reports that must be generated:

1) **Annual Reports** – These reports are generated within a template provided by the State Office of the Comptroller. They provide a summary-level reporting of revenues and expenses for the most recent year and cumulatively since the creation of the TIF district. These reports must be completed prior to the annual Joint Review Board Meeting, also required by state law.

2) **10-Year Status Reports** – Illinois law also requires cities to provide a status report after a TIF district has been in place for 10 years. State law provides general guidance in terms of report content. However, these reports are much more narrative in nature and can vary from one TIF district to another. For an example of a 10-Year Status Report completed for the City of Chicago, please visit: http://bit.ly/K7309A.

Conclusions

Tax Increment Financing (TIF) is a powerful tool that allows municipalities to make targeted investments to help spur economic development. The right combination of experience and expertise is essential to ensure that TIF districts are created and managed in accordance with applicable state statutes and maximize the public benefits of investing property tax dollars in public and private projects. In addition, following best practices in eligibility analysis and reporting can help ensure that public funds are well-managed and increase public confidence in municipalities' TIF programs. Enabling legislation requires a variety of findings when establishing a district, defines eligible costs that can be funded with TIF money, and requires ongoing reporting and compliance to help ensure transparency and accountability to taxpayers and other taxing bodies.

A well-managed TIF program can help certain communities spur development and/or redevelopment while being sensitive to legal and public policy concerns of other local stakeholders.

NOTE: This document is only a brief summary of the requirements and conditions for Tax Increment Financing. The full text, including recent reforms, of the Illinois Tax Increment Allocation Redevelopment Act, 65 ILCS 5/11-74.4-1, can be found online at:

http://bit.ly/1ghRAuP
http://bit.ly/K74f8B

The full text of the Industrial Jobs Recovery Law can be found online at:

http://bit.ly/1dgCDek

For more information on Tax Increment Financing and/or TIF consulting services, please contact *SB Friedman Development Advisors* at (312) 424-4250 or info@sbfriedman.com, or visit: www.sbfriedman.com.