



Recommended Practices: Effective Tax Increment Finance Program Management

EXECUTIVE SUMMARY

The Council of Development Finance Agencies (CDFA) has developed these recommended practices to serve as a set of guiding principles when developing or implementing a Tax Increment Finance (TIF) program. TIF has played an increasingly important role in financing economic development and redevelopment projects over the last several decades, and management of a TIF program requires responsible application. This publication has been researched, reviewed and approved by a committee of development finance professionals and the CDFA Board of Directors. This document addresses TIF, highlights some of the common procedural elements that development finance professionals face and provides guidance on strategies for maximizing TIF project success.

INTRODUCTION

Today, 49 states and the District of Columbia have TIF enabling legislation. While California, Illinois and Ohio have used TIF for many years, other states like North Carolina, Delaware and New Jersey have recently adopted TIF.

State and local governments have steadily increased their use of TIF since the 1970s as a result of decreased federal funding for redevelopment-related activities. In addition, spending reductions, amplified restrictions on tax-exempt bonds and a major shift of urban policy to local governments have forced many local governments to identify creative solutions, such as TIF, to address redevelopment.

TIF allows local governments to invest in infrastructure and other improvements and pay for them by capturing the increase in property tax revenues and, in some states, other types of incremental taxes. The increase in taxes generated by the enhancements, also known as increment, is used to pay the public debt incurred while making these improvements. TIF can work in communities of all sizes and can be used to finance a variety of costs and improvements pertaining to public infrastructure, land acquisition, demolition, utilities, planning costs and other improvements.

TIF is generally used to address blight and deterioration, promote neighborhood stability and inspire district-oriented economic development or redevelopment. While each state's TIF statute is different, common policy goals and objectives exist. Some states require that a "but for" test be met before

a TIF deal can be approved. It requires that "but for" the TIF assistance, growth or development at the proposed level would not occur. Often TIF is used to advance economic development priorities, such as targeted investment and redevelopment, developing industry niches and opening new markets for non-existent services, recycling infrastructure and cleaning up brownfields and creating or retaining jobs and supporting industrial development.

COMMON PROCESSES & RECOMMENDATIONS

Local governments face a variety of procedural hurdles when developing and implementing a successful TIF program. When local governments decide to use TIF, it should be done judiciously and with complete due diligence. The following outlines some basic principles to ensure that a TIF program is successful. These procedural elements can be grouped into the following categories:

- I. Due Diligence
- II. Transparency
- III. Accountability

I. Due Diligence

The due diligence process is one of the most important elements in the use of TIF and should be considered throughout the decision and financing process. Some local governments fail to conduct a thorough financial and legal analysis and find difficulties in project completion as a result of these actions. However, with a solid process for vetting and evaluating TIF projects, the local government can minimize conflict and increase community participation in project fulfillment.

Recommendation

Local governments should implement a transparent and thorough due diligence process. This includes closely examining the financial risk the local government will bear as well as the legal requirements of the state enabling legislation. Depending on state statute, there are a variety of risks that a local government might face including investment restrictions, tax revenue expectations, shortfall and debt service limitations and project completion schedules. Engaging quality bond counsel and financial experts throughout the process can mitigate these risks. In addition, fully understanding the TIF laws before applying the tool will



help mitigate legal issues from developing further into the process. While TIF can finance a variety of improvements, it does have limitations that should be understood.

Local governments should also fully vet the partners involved in the proposed project. Developer performance and their capacity to complete and fulfill the promised project should be examined closely. Ensuring that the developer has a seasoned team and the appropriate financing and capitalization to complete the project is critical. This includes a review of the developer and other stakeholder's financial capacity and project history. TIF may be used to fund pre-development infrastructure and area improvements, however, it is recommended that actual distribution of TIF funds be made only as vertical development progresses and taxable value is created. The municipality administering the TIF should make every effort to vet the financing plan for the ultimate development. While this can be difficult to determine with certainty in the early developmental stages, appropriate due diligence of the development partners' financial and construction capabilities can prevent unnecessary delays and the potential to have a partially completed project. High quality developers will demonstrate without doubt their capacity to complete the project within the project guidelines and within the provisions of the TIF agreement.

Policies, Procedures & Guidelines

Many local governments continue to use incentives, abatements and other public financing tools without employing policies, procedures and guidelines. This often causes conflict between stakeholders and the general community when tools are seen as overused or abused.

Recommendation

Careful consideration by local government leaders is required to prevent TIF from supporting a project that might be outside the scope of the community's long-term vision and/or subject it to unintended financial strain. Local governments should have a well-thought out master plan, and it should be referenced when determining if the project's anticipated outcome meets the goals and objectives of the local government's economic development priorities. If the project meets those specifications, then a financial package should be considered.

Local governments should develop a set of policies, procedures and guidelines that set forth a plan of action when using TIF. These documents determine when it is appropriate to use TIF and set a certain level of expectation for all parties involved in the transaction. Policies, procedures and guidelines should detail the step-by-step process that the

local government will use to determine if TIF should be awarded as well as outline the documentation required for making this determination.

Common elements of these documents include:

- Description and objectives of the TIF program
- Project requirements and eligibility for TIF assistance
- Evaluation criteria and requirements, including economic analysis or "but for" test, if required
- Financial considerations and/or determinates of the level of community participation
- Application process, procedures and timeline
- Reporting requirements
- Required forms
- Contact information

When developing these policies, procedures and guidelines, local governments should allow flexibility for projects that might occur in the future or that do not immediately fit within the plan. In addition, provisions should be included for creative solutions to non-conforming development concepts.

Local governments need to use these policies, procedures and guidelines as a means to evaluate TIF use to ensure that the tool is used appropriately. To help make this determination, local governments should consider elements such as the project's potential job creation, future tax income and the project's ability to encourage additional development outside of the TIF district.

II. Transparency

Transparency plays a major role in the use of TIF, and successful programs employ a deliberate approach to ensuring an open and communicative process. Employing a transparent process will lead to a greater understanding of the state TIF law, increased capacity to serve the needs of development projects and stronger stakeholder engagement during project development. Transparency is also good policy, as it leads to a more open form of government where stakeholders, citizens and business interests can all be part of the community's future development. There are several areas of transparency that should be addressed to ensure TIF program capitalization.

Transparency also includes an adherence to public meeting rules and the provision of open records throughout the process. The local government and all stakeholders should be an active part of the process and all decisions should be made during open public meetings.

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Advisory Team

TIF is a difficult and complex financing mechanism that requires considerable understanding. Many communities rely on their local economic development professionals, city staff and other sources for managing their TIF program. While many local governments are able to serve in this capacity, others fall short in the implementation process.

Recommendation

To strengthen a TIF project's likelihood for success, it is imperative to hire and retain a competent and experienced advisory team. This team should include financial advisors, legal professionals; bankers who understand TIF and consultants who will help safeguard the local government's investment. A qualified advisory team will help drive a more transparent process by ensuring adherence to legal requirements and open meeting requests.

Community Education and Engagement Process

In most states, the TIF process requires local governments to hold open and public discussions. However, the diversion of tax dollars to aid private development can be controversial and often creates a policy discussion regarding the proper role government plays in encouraging private development.

Recommendation

In order for a local government to use TIF to its fullest potential, it is essential to educate the community. TIF is a powerful tool, and the process must be conducted in an open and thoughtful fashion. Local governments that successfully engage TIF understand its capabilities and the necessary process, identify and engage community stakeholders early, build consensus throughout the community, and leverage communication tools to their advantage. There are a number of areas that local governments should consider as part of the education and engagement process.

- **Building Consensus** – While redevelopment can be exciting, it also triggers an emotional response from the community, particularly for developments that create transformational changes. Communities that have been the most successful in building support for a proposed project have engaged key stakeholders early in the process, marketed the proposed development and managed media coverage. Building support for the project demonstrates a commitment to community involvement, and it is essential to compromise and find creative solutions.

- **Identifying Stakeholders** – Because of the inherent complexities of TIF, misconceptions about the tool may occur. It is important to identify and involve all parties who may be impacted, influenced or otherwise affected by the proposed project including civic leaders, elected officials, neighborhood groups, business leaders, civic groups, religious community leaders and local residents. Involving these community stakeholders early in the process will help to address many of the initial concerns.
- **Media** – When TIF is being considered for a project, media attention generally follows. While this can create additional awareness of the project and excitement, it can also generate misinformation about TIF. For local governments to successfully navigate through the sea of media attention, one person should serve as the contact for all inquiries to help deliver a consistent, clear, correct and factual message about TIF and why it is being used in a particular situation.
- **Communications and Marketing** – Developing a marketing and communications strategy is important to the TIF project's success. With the advancement of technology, it is easier to make more information available to the community. Web sites and e-mail updates are an easy and cost-effective manner to communicate with a large audience. In addition, monthly or quarterly newsletters can be useful tools to inform stakeholders of the project's development. Local governments may want to consider hosting annual or semi-annual meetings to bring stakeholders together to update them on the project.

III. Accountability

The implementation of TIF ultimately rests with the powers of local government. This power yields an accountability factor that cannot be ignored or set aside for the sake of priorities, headlines or an eagerness to complete projects. Local governments that have followed the recommended practices for due diligence and transparency steps will find it easier to comply with accountability requirements.

Accountability starts with the decision makers and includes the project managers and advisory team. Throughout the TIF process, each participant is accountable to the public and leadership in the local government and must provide accurate, informative and timely information. Decisions by elected leaders to support projects should be based on

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financial analysis, identifiable community needs and the potential project impact. Without these elements as the foundation of the decision making process, the use of TIF can become burdensome and counterproductive. There are a variety of accountability aspects to consider when implementing a TIF program.

- Determining Appropriate TIF Contributions – Determining the appropriate amount of public resources to contribute to a TIF project can be a controversial decision making process. Local governments that have followed the due diligence and transparency steps, however, will find this process less cumbersome and more efficient. TIF contributions ultimately rest with the decision makers at the local level and vary from project to project. Each state statute is slightly different, and local governments should establish a project involvement level within their policies, procedures and guidelines documentation. This will serve as a clear statement to those requesting TIF assistance about how much the local government can be financially supportive of a project.

Local governments should also consider employing an open financial model that can help to determine TIF contributions. It is recommended, however, that the level of TIF funding ultimately approved to catalyze a private development should not exceed the maximum funding the project's projected tax increment is expected to generate. Several local governments, such as Madison and Milwaukee, Wisconsin, use financial models for calculating TIF involvement. While these models have not been adopted universally, the use of them has increased nationwide. Open financial models also provide a viewable and easily referenced source for explaining to the public and other stakeholders the local government's direct involvement in a project. Outcomes can be shared online and in reports and can be available for media and other interested parties upon request. They also aide in the decision making process for elected officials and other authorities when negotiating a project deal.

- Site-Specific vs. District-Wide TIF – Local governments must determine how large of an area to TIF. TIF is generally implemented either in a site-specific or district-wide fashion. Developments that approach TIF using the site-specific model involve a single project or piece of land, often making these

projects less complex. District-wide TIF projects involve multiple users and potentially several property owners, which results in these types of transaction having a more transformational impact but being more complicated. A district-wide approach is traditionally applied to large areas of land or entire neighborhoods that are targeted for economic development or redevelopment and can encompass a mix of land uses. There are pros and cons for both of these approaches that should be weighed carefully before determining which approach is a best fit for the community. Employing both approaches is a suitable alternative for local governments new to the TIF process. Large TIF districts may also require more than one series of bond issuance or other financing to meet economic development objectives.

- Gap Financing – While considering whether a project should receive TIF assistance, local government leaders should evaluate feasibility studies and all relevant financial documents. TIF is intended to provide gap financing to bridge the amount of investment received through more traditional lending sources and what is needed to complete the project. It is recommended that the local government hire an independent financial consultant and/or banker experienced in this area to conduct a review. This is an added step to ensure that public financing is necessary and offered at the appropriate level. It is also an added safeguard for examining the project's anticipated level of success.
- Negotiating the Deal – Negotiating the TIF deal should be part of the established TIF process. TIF is a business transaction between a local government and project stakeholders, and when a developer seeks TIF assistance, the local government should use the opportunity to negotiate the financing package. Local governments should use their TIF application to outline the financing that is available and how it will be calculated.

Examples

Hugo, Minnesota uses a weighted system based on the number of projected new jobs, type of development, sources of project financing, among other criteria, to determine the level of TIF assistance that might be available for the project. The city of Madison, Wisconsin conducts a gap analysis to determine the amount of financing

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available for a specific project. This is a four-step process with steps one through three being negotiable.

1. Estimate available TIF
2. Analyze sources and use of pledged financing
3. Demonstrate the need for TIF assistance (“but for” test)
4. Audit the project upon completion and keep data for comparison

In the end, a local government is able to examine the anticipated project value and compare it to the estimated developer's cost, minus the sources of capital to determine the appropriate level of TIF needed. A well thought out program that allows for flexibility in the event that certain projected events (i.e. job creation, number of residential units developed) do not materialize, can be valuable and will allow communities to nimbly deal with changing economic environments.

- Developer vs. Local Government Driven TIF Approach – Developers often initiate redevelopment by approaching the local government to seek public assistance. Local governments that are developer-driven should establish in their policies, procedures and guidelines the expectations of these types of projects. Adherence to these measures will prevent errors in the open meetings requirement and potential legal roadblocks. The alternative to this approach is a local government-driven TIF policy. Many local governments employ this strategy by identifying properties or districts that are within their master redevelopment plan and then market these sites to developers and partners to drive investment decisions. The local government-driven approach should also be directed by a sound adherence to policies, procedures and guidelines and follow the previously outlined due diligence and transparency recommendations.

CONCLUSION

TIF plays an important role in the economic development toolbox. Successfully used for many decades, TIF has transformed and rejuvenated blighted areas across the country. This important tool should be used judiciously and carefully to protect the public's interest and promote the economic development and redevelopment of areas that might otherwise not receive investment. Local government officials can use CDFA's Recommended Practices as a way to protect public investment and achieve maximum results.

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