

TAX INCREMENTAL FINANCING – TOOL OR TOKEN?

Since 1985, Vermont municipalities have had available to them a tool for economic development that has swept the country as a major vehicle to eliminate urban blight, encourage private investment and enhance the local tax base. Yet, despite being on the books for 18 years, only three examples of tax incremental financing have ever been actually implemented; two others are now in the works.

Californians invented tax incremental financing (TIF) in 1954. Since then, a total of 47 states have enacted enabling legislation allowing municipalities and special districts to use this system. In the state of Illinois alone, more than 700 TIF districts now exist, 60% of them created in the 1990s and 91 in 1999 alone.¹ Chicago has been creating TIFs at the rate of one a month for the past four years.² A Google search returns pages and pages of Web sites of cities and states extolling the vehicle's availability to potential economic partners.

Tax incremental financing uses the additional property taxes to be paid by new development to pay bonds, loans or other forms of debt that a municipality issues or secures to construct public "improvements located wholly or partly within the district which will encourage development, provide for employment opportunities, improve and broaden the tax base, or enhance the general economy of the municipality, the region, or the state."³ Town listers would fix the value and determine the property tax revenues of an existing parcel or parcels of land to set the "original taxable value." The "tax increment" is the added appraisal value and resulting taxes generated by the economic development project constructed on the parcel.

Take, for example, a hypothetical downtown block having been recently devastated by a fire. On the April 1 following, the listers fix the original taxable value of the now vacant lot at \$100,000. A developer proposes to build a shopping and housing complex on the site that will result in a total new value of \$3,000,000, if the town commits to upgrading the streets, undergrounding the utilities and adding a small parking facility for a total cost of \$500,000.

If the town were to use a TIF to finance the public improvements, it would request that the voters approve a bond for the \$500,000 and complete the public improvements. The developer would construct and pay for the complex. The following April, the new appraisal of the complex property is \$3,000,000. Assume the municipal tax rate is a nice round \$1.00. The tax generated on that rate on the original taxable value of the lot, or \$1,000, will continue to be deposited in the town's general fund. That \$1 tax rate on the tax increment of \$2,900,000 or \$29,000, is used to pay off an annual portion of the bond that is due. The revenue generated by the tax increment continues to be committed to paying off the bond until it is retired, at which time the \$1 tax rate (or whatever the existing rate is at that time) against the entire value of the developed lot now and forever more is deposited in the general fund to pay for all municipal services. The bonds used to finance the public improvements can either be "revenue bonds" (pledging only the revenues to be derived from the tax increment on the new development) or "general obligation bonds" (pledging the full faith and credit of the municipality and all taxable property therein). There are pluses and minuses of using either form, which will vary depending on the project and the municipality. Other options are available to municipalities for securing the funding needed for the public improvements, such as state revolving loan programs for sewer and water projects and federal Housing and Urban Development Department Section 108 loans that are then repaid from the tax increment proceeds.

To date, only Burlington, Milton and, more recently, Winooski have pursued the idea of tax increment financing. After preparing a project related to its waterfront more than a decade ago (that, due to a charter provision unique to Burlington, required a two-thirds vote for approving the issuance of bonds), Burlington voters refused to approve a bond to pay for the project by just a few votes. Since that first failed attempt, Burlington has successfully funded two TIFs and it is now working on a third. In each case, the key to success included the revenues for the public improvements coming from federal Section 108 loans rather than local tax-supported bonding.

Milton's TIF is related partially to the Husky plant and to an industrial plant, and was created to provide upgrades to a sewer plant and lines and local roads. So far, the only purpose for which TIF funds have been pledged is for paying off a state sewer revolving loan. The Winooski TIF is just part of a huge urban redevelopment project involving \$40 million of public improvements that is close to commencing with many funding pieces that all need to fit together.

Of the total, \$20 million is to come from TIF revenues and, once again, Section 108 federal loans are the source for the original funds and no local bonding is expected.

One of the problems of making TIFs work in Vermont is that so little of the actual property tax dollar goes to municipal services. Almost 75% of the average local tax bill is deposited in the school bank accounts. This means that there is little revenue stream from the new private development left to divert to retire the public improvements debt. Act 60 complicates this, with the state laying claim to the school property taxes as a state resource. The law prohibits the use of TIFs committing any of the growth in education taxes resulting from new development to be used for the bond repayment without approval from the Vermont Economic Progress Council (VEPC). That is handicapped by only allowing \$300,000 of state education property taxes per year to be used for such purposes statewide, and that the repayments are limited to a ten year period – much too short for funding any meaningful projects with local bond revenues. VEPC can only approve committing state education property taxes for a project if there is clearly a long-term gain in the Education Fund from the new growth created by the TIF. To date only one of the Burlington and the Milton TIFs has been approved by VEPC to dedicate a portion of the new education tax revenues for TIF project repayments. The Legislature has granted an exception to VEPC rules for the Winooski project, allowing it to use education tax revenues more freely than for any other projects.

Another technical problem with Vermont's enabling legislation (24 V.S.A. §§ 1891-1899) is that the bonds issued can be used only for public improvements "located wholly or partly within the district." This means that if a sewer system needs a major main rebuilt to serve the district but is physically located outside of it, the project is ineligible for such funding.

Lastly, eligible TIF improvements do not currently include preserving open space in the district. Preserving urban open space is becoming a very valuable component to retaining the vitality of our downtowns, and allowing TIF proceeds for such acquisitions would help.

Though widely used nationally and widely accepted as being an effective tool to help localities redevelop downtowns and other areas that may otherwise continue to deteriorate, TIFs have begun to come under fire from some. A recent study of five TIFs in the Chicago area found that they had only limited impact on economic development.⁴ The study found that land values in the districts had increased, but that the number of businesses did not consistently increase, there was no net increase in jobs, residential property sales increased, and the impact on housing prices was mixed.

States and local governments have been using economic development incentives since 1791 when the State of New Jersey granted a tax exemption to a manufacturing company owned by Alexander Hamilton.⁵ Vermont has used property tax stabilization agreements at the local level as well as the proceeds from state and federal community development and downtown development grant programs. TIF districts are only one of the weapons in the arsenal of Vermont communities trying to attract and retain economic activity, and they are finally beginning to prove themselves valuable.

- Steve Jeffrey, VLCT Executive Director

¹ *The Right Tool for the Right Job? An Analysis of Tax Incremental Financing*, by the Developing Neighborhood Alternatives Project for the Center for Economic Policy Analysis, page 5.

² *ibid.*

³ Vermont Statutes Annotated, 24 V.S.A. § 1892.

⁴ Developing Neighborhood Alternatives Project, page 2.

⁵ *Development Strategies Review*, Vol. 13, Number 1, page 1.