



Government Finance Officers Association

## BEST PRACTICE

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# Creation, Implementation, and Evaluation of Tax Increment Financing

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### BACKGROUND:

Tax incremental financing (TIF) can be an important tool for local governments to attract economic development projects, create jobs, foster infrastructure investment, and/or redevelop blighted areas. TIF is a technique for funding a qualifying capital project, its related infrastructure, or maintenance of the project<sup>1</sup> from a stream of revenue generated within the geographic area defined as a TIF district. Depending on state and provincial regulations, primary governments with taxing powers can often use TIF, but redevelopment agencies may also be party to a TIF project. When a redevelopment agency uses TIF, the agency may share or redirect property or other taxes imposed by other taxing entities. TIF generally relies on incremental property taxes generated in a specific area, but it can also apply to other taxes, including sales taxes. Any organization considering the use of TIF should be aware of the risks involved. As demonstrated in previous economic downturns, TIF can significantly constrain an organizations ability to generate tax revenues, once a TIF is crafted, it can be very difficult to change the terms or cancel the agreement, especially if bonds have already been issued and the various interests in the flow of funds have been established. As a result, there is a need to focus on the long-term nature of TIF, and the long-term forecasts of the tax revenues that support it. The basic principles outlined herein are applicable to any type of TIF.

While TIF laws differ among states or provinces, most states have established laws and eligibility requirements to create or designate an area as a TIF district (e.g., blight, dilapidation or deterioration, age of structures). Once an area is legally designated as a TIF district, the base valuation amount of the property values is frozen.<sup>2</sup> Improvements to properties within the boundaries of the TIF district will then result in increases to this base of the increment which is captured through additional taxes and expended solely within the TIF district.<sup>3</sup> This increment can serve as a source of revenue to pay debt service, upfront development costs for additional improvements, or for individual projects on a pay-as-you-go basis. The maximum period of time a TIF may exist is determined by state law; legislation generally allows time for development efforts and a traditional 20-30 year financing period.

All TIF and TIF districts should be developed in a manner consistent with a governments TIF or economic development policies.<sup>4</sup> Specific components that organizations should include in a TIF policy include:

1. Objectives or strategic goals that the organization can satisfy by using TIF (e.g.: job creation, removal of blight, meeting infrastructure needs).
2. Eligible projects where TIF can be used.

3. Non-eligible projects or users where TIF may not be used.
4. Standards for creating a TIF district and/or evaluation criteria.
5. Processes for considering, reviewing, and implementing a potential TIF agreement.

#### RECOMMENDATION:

The Government Finance Officers Association (GFOA) recommends that local governments carefully evaluate whether TIF and TIF districts are the most appropriate and effective tool to assist the local government in its economic development plans. TIF can be a powerful economic development tool, but when tax revenues from the TIF increment is diverted to a TIF district, local governments will be affected by not receiving these revenues, which can constrain a government over the duration of the TIF. Additionally, the development project itself may contain risk, if the project fails to realize the projected results, it could subject the TIF (and the government) to significant financial pressures, particularly with respect to TIF debt service. When adopting a TIF policy, the governing body needs to identify when TIF districts are appropriate, taking into account risk, financial conditions, and the relationship of a project to the organizations overall plans, including maintenance and sustainability. The policy may be based solely on enabling statutes but should provide flexibility for the local governing body and be consistent with local preferences. The policy also should address the following steps to evaluate whether a TIF district should be created. These steps assume that the government has already compared TIF with other options, including other financing sources, and that the TIF aligns with community development goals and complies with the jurisdictions development policies and objectives. Recommended evaluation steps include the following:

- Identify the area for the TIF district designation to determine whether a proposed district meets the criteria under applicable state law and the priorities established by the governing body. TIF districts may vary in size, depending on the applicable state laws and local government objectives.
- Conduct feasibility studies, including an evaluation to determine whether development or redevelopment could take place within an acceptable timeframe, without economic assistance from the local government (e.g., but for the TIF assistance, the development would not be possible).
  - Include an evaluation of debt limitations.
  - Identify any taxpayer concentration, tax appeal history, and overlapping taxing jurisdictions contribution and commitment to pledged revenues.
  - Identify any laws that might cap assessed value growth or the effect of tax rates on the taxing entities credit ratings.
  - Evaluate the jurisdictions ability to meet the proposed TIF plan objectives and its ability to mitigate potential risks to local agencies, including the inability to repay debt in the event of revenue declines.
  - For property tax increments assessed value (AV) annual growth limits, for example, look at past and future AV growth trends and collection performance and delinquency rates.
  - For sales tax increments, look at historical sales tax collections, change in sales tax rates, pending re-authorizations of the sales tax, tax exemption status and any potential changes to it, and overall economic forecasts.
  - Subject assumptions and methods for all feasibility studies to sensitivity analysis and other modeling techniques (see the GFOA best practice, *Evaluating Data and Assumptions in Economic Development Proposals*).
  - If the government does not have the technical skills available on staff to conduct a feasibility study, then the use of a qualified consultant is appropriate and recommended. Additionally, an alternative analysis should be prepared to

evaluate pay-as-you-go financing and/or debt financing options that the TIF could support.

- Prepare a forecast of the costs and revenues applicable to the project.
- Analyze the long-term economic benefit to the local economy for the term of the TIF, the fiscal impacts to the affected jurisdictions and overlapping tax entities (e.g., school districts), and the economic cost of TIF incentives. Use various forms of analysis, including sensitivity analysis.
- Evaluate the risk to general government operations<sup>5</sup> when the TIF-related revenue is no longer available, including an evaluation of the total impact of all TIF districts on the tax base.
- Prepare a maintenance plan for the TIF districts projects, incorporating ongoing costs and future capital costs, and considering the revenue sources available to help cover those costs. If a third party or private-sector partner such as a developer is to maintain the TIF district, provide a maintenance plan that incorporates those components. Document any risk sharing between local government and the third party or private sector partner in a development agreement that clearly states each party's responsibilities. For example, the agreement should identify who is responsible for the following:
  - Project upkeep.
  - Who backs up project revenue if increments are not sufficient. (There are inherent risks any time the government's credit is used as a backup pledge.)
  - Ongoing maintenance responsibilities.
  - Maintaining designated reserves, if required.
  - Project reporting and monitoring.
  - Adherence with state and local laws.

If a government believes a TIF is warranted, based on a comprehensive evaluation, the following implementation steps are recommended, in addition to verifying compliance with state and local laws:

- Prepare a thorough development or redevelopment plan that includes the projects identified and an estimate of the incremental increase in real estate valuation the proposed projects will create. Governments may also consider hiring outside professionals to assist with this process. The development plan and agreement are critical, and should include the following:
  - Detailed performance measures.
  - Milestones for identified performance measures.
  - Steps for monitoring and evaluating the plan, enforcing the agreement (e.g., are target job creation numbers met?).
  - Steps to be taken if performance goals are not met, including descriptions of the consequences for either better or worse performance. (One option is to outline future benefits and burdens under all possible economic scenarios.)
  - Monitor bond covenants.
  - Determine which party is responsible for making any post-agreement filings.
- Thoroughly investigate any third-party or private-sector partners, and their ability to meet the obligations outlined in the development agreement. This includes due diligence in examining the developers financial and other resources, and its track record with similar projects.
- Obtain input from all parties involved in the project. In the case of multi-jurisdictional TIF districts, consider establishing an oversight board. Also obtain public input on the TIF and make adjustments accordingly, including public hearings if required or desired.

- Periodically review of TIF and TIF district to determine if the TIF is functioning as intended. This periodic review should include measures of actual performance, as compared to projected performance. Measurements could include items such as actual versus projected tax base, jobs created, and the potential impact of shifting economic development from non-TIF district to TIF district.
- Ensure that there is adequate understanding of governmental monitoring and reporting requirements. Also, identify who will be accountable for monitoring the TIF and preparing any necessary reports.

**Notes:**

<sup>1</sup> Governments need to ensure that they are eligible to enter into TIF, pursuant to state and local laws.

<sup>2</sup> Depending on state and local laws and regulations, the method of determining the base valuation of real estate tax revenue varies. Each jurisdiction should clearly define its methodology for determining the base prior to forming a TIF district.

<sup>3</sup> Generally, TIF applies to the capture of the frozen base real estate valuation, but similar methodology can be used with other taxes generated within the TIF district, such as sales tax revenue.

<sup>4</sup> See the GFOA best practice, Developing an Economic Development Policy(2008).

<sup>5</sup> General government operations include those core services performed by the local agency forming the TIF, such as public safety, sanitation, recreation, and library services.

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