What is Tax Increment Financing (and Why Should Anyone Care)?

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Abstract

Data from State reports and City Council journals indicate that Omaha has been increasingly reliant on Tax Increment Financing (TIF) to provide incentives for economic growth. State guidelines for TIF plans seem to be followed haphazardly at best. TIF projects have done little to benefit the most poverty-stricken districts. As profit-making entities have become aware of the availability of Tax Increment Financing, more of them have crowded onto the City agenda and used it to build in high-growth areas. Oversight of the TIF plan approval process, especially as to the need for public subsidy, seems to be lacking.

Keywords: Tax Increment Financing, accountability, oversight, private vs. public

Tax Increment Financing is "[a] method of financing redevelopment projects which allows the property taxes produced from the incremental value of the improved property to be used to pay a portion of the development costs." (City of Omaha, 2011, p. 8).[1,2] For projects that the City has deemed worthwhile, it is a way to reduce the cost to developers by forgoing tax revenue from the project for a period of time.

Citizens of Omaha should care because each approved TIF plan is a decision by the City about what to do with public monies. It is a decision on whether a given project is worthwhile and just how worthwhile it is; that is, it is a way to put a monetary value on how much of the City's resources should be put into making that project happen.

How Does Tax Increment Financing Work?

First, the TIF project must be in an area declared blighted (Nebraska Revised Statutes, 2010a). Nebraska State Statute defines the criteria for blight (Nebraska Revised Statutes, 2010b):

> Blighted area shall mean an area within a city or village (1) which by reason of the presence of a substantial number of deteriorated or deteriorating structures, defective or inadequate street layout, faulty lot layout in relation to size, adequacy, accessibility or usefulness, unsanitary or unsafe conditions, deterioration of site or other improvements, diversity of ownership, tax or special assessment delinquency exceeding the fair value of the land, defective or unusual conditions of title, improper subdivision or obsolete platting, or conditions which endanger life or property by fire and other causes or any combination of such factors substantially impairs or arrests the sound growth of the community, retards the provision of housing accommodations, or constitutes an economic or social liability and is detrimental to the public health, safety, morals, or welfare in its present condition and use and (2) in which there is at least one of the following conditions: (a) Unemployment in the designated area is at least one hundred twenty percent of the state or national average; (b) the average age of the residential or commercial units in the area is at least forty years; (c) more than half of the plotted and subdivided property in the area is unimproved land that has been within the city or village for forty years and has remained unimproved during that time; (d) the per capita income of the area is lower than the average per capita income of the municipality in which the area is designated; or (e) the area has had either stable or decreasing population based on the last two decennial censuses.

Because of this requirement, large swaths of North and South Omaha and smaller parcels

1 A more in-depth discussion of Tax Increment Financing is found on the Nebraska State government website: http://www.revenue.ne.gov/PAD/research/Tif_Reports.html , the 2009 Tax Increment Financing Report PDF, pp. 3-4. See also: http://www.neded.org/content/view/100/232/

2 This method of financing (TIF) is authorized by Nebraska Revised Statutes §§18-2101 to §§18-2154, known collectively as Community Development Law.

elsewhere have been declared blighted. The TIF map shows areas declared blighted as of March 16, 2010 (City of Omaha, 2010b). However, an excellent paper by Briffault (2010) notes that nationwide the designation of “blight” is recognized as a mere formality to the point that “sixteen states no longer require a finding of blight as a precondition for TIF.” (p. 71)

Second, based on the developer's plans, the city estimates how much the value of the property will increase over a 15 year period (the usual life of a TIF plan) because of the project . The estimated tax for the 15 year period is next calculated just on the estimated increased valuation; the result is the amount loaned by the developer to the City. The City pays back the loan over the period of the TIF plan using taxes paid by the developer on the increased property valuation.

In keeping with the purposes of the TIF redevelopment plan, although the TIF monies are referred to as a “loan to the City”, no money is actually transferred from the developer to the City; the developer simply uses those funds (which they generally borrow from a bank) to pay for project infrastructure improvements (sewer, sidewalks, utilities, etc.). They then are reimbursed for these expenditures by having the increased taxes that they pay the City during the period of the TIF returned to them.

For example: suppose a developer wants to put a condominium where there is currently an abandoned warehouse. Let's say that the current owner of the property pays $1,500.00 per year in property taxes. For 15 years, the developer will continue to pay the same amount in property taxes that the previous owner had paid ($1,500.00) and these taxes continue to go to the City, the school district, etc. The developer will also pay taxes on the increased valuation (say the increased valuation comes to $1,000,000.00 and the yearly tax on the increased valuation is $20,000.00). The total tax the developer pays to the City is now $21,500 (including the base tax of $1,500.00) but the City turns around and gives $20,000.00 back to the developer. The developer generally uses this money from the City to pay off the costs of the loan to put in improved sewer hookups, sidewalks, electrical conduit, etc.

So for 10 to 15 years (whatever it takes for the loan to be paid off) the taxes on the increased valuation are turned back to the developer rather than going into the City or the public schools, mass transit, the Natural Resources District, etc.

The Pros and Cons of Tax Increment Financing

Supporters of Tax Increment Financing generally make the following arguments:

1. TIF plans produce economic growth in blighted areas where it is needed.
2. TIF plans provide incentives to go ahead with projects that contribute to economic growth that would not otherwise happen.

3. TIF plans are essentially cost-free, since the same amount of tax that had been generated by the undeveloped property continues to go to local government.
4. The City benefits further by the fact that, after the fifteen-year tax break, the increased taxes go to the local governments.
5. If the City did not provide these tax breaks to business, some other city would; economic growth would be siphoned off to other jurisdictions.

Opponents of Tax Increment Financing generally make the following arguments:

1. The criteria for "blighted areas" are sufficiently malleable that just about any area can be and has been given that designation.
2. Although North and South Omaha (notable for high concentrations of both poverty and minorities) anchor the "blighted areas", most of the actual investment has gone into Downtown Omaha and has benefited persons of means. This is true whether referring to the new condos and townhouses or to entertainment complexes that the average family wage earner can only rarely afford. Poverty downtown has not so much been alleviated as relocated and replaced by gentrification. North and South Omaha remain relatively untouched. See the TIF map for the locations of TIF projects present and past (City of Omaha, 2010b).
3. TIF plans can subsidize projects that would have happened anyhow.
4. Since an unknown number of the TIF projects would have happened anyhow, what the TIF designation does is shift costs in those cases from the developer to the rest of the City. For fifteen years, the other property taxpayers in the City pay for the increased police and fire protection, Emergency Medical Services, mass transit, schools and other public services that the TIF project uses but is not paying for[3].
5. The City ends up paying for infrastructure improvements that otherwise the developer would have paid for. Developers who do not have the incentive of a TIF plan do have to pay the costs of these infrastructure improvements. This seems to give developers who receive TIF funds an unfair competitive advantage.
6. Some projects, such as retail strip malls, really don't have much more than a fifteen-year life expectancy. In this case, local governments would receive little, if any, benefit from the TIF plan.
7. TIFs tend to encourage the "bidding war" and "race to the bottom" mentality of municipalities as businesses play one off against the other to see who will give the biggest incentives.
8. Developers begin to develop a sense of entitlement and expect to rely on government handouts rather than taking risks on their own.

3 Condos, apartments and office buildings require fire department services, for example. What had been a two-alarm fire when the building was a warehouse could be a five-alarm fire when it is turned into apartments.

Why Tax Increment Financing?

The question addressed in this paper is whether the City is adequately addressing whether these expenditures are for public, rather than private, benefit. It would seem that, if the City as a whole benefits, then the project is worthwhile. If the primary beneficiary is the developer, it is unclear why the City should subsidize it. This also raises controversial questions about the tension between private enterprise and the public good.

For instance, Briffault (2010) reports “a longstanding concern about the potential for public support of private activity to both bankrupt the public sector and to invite private sector actors to corrupt government decisionmakers in pursuit of public support.” (p. 10)

Many will argue that any economic development benefits the City as a whole. Although Briffault (2010) goes on to state that “that government programs that promote economic development are now generally treated as serving a public purpose.” (p. 10), the paper also makes the point that there is no conclusive agreement as to whether TIF projects actually create new economic development or simply shift it around from one part of the city to another. (Briffault, 2010, pp 82-83)

TIF supporters will counter that there may still be value in shifting certain kinds of economic development to economically depressed areas. For instance, Aldi's grocery was given a TIF authorization as incentive to put up a store at the intersection of 30th and Sorensen Parkway (City of Omaha, 2008a). Prior to this, zip code 68111 had no major chain grocery store nor were other grocery chains banging on the City's door to build one there, so this might be considered a use of City funds to subsidize a private company for public benefit.

Given the current City budget travails, one may still ask if a given TIF plan is the best use of City money. For instance, if the project involved in the TIF plan would be built even without Tax Increment Financing, why should the City put its money there? This consideration originally led to state legislation requiring such proposals to demonstrate that, if it were not for the use of the Tax Increment Financing, the project could not be built (known as the *but-for* clause).

However, today only about half the states have such a requirement; and for those that do, usually a simple assertion that the project would not proceed without the TIF suffices (Briffault, 2010). Such a requirement does exist in Nebraska law (Nebraska Revised Statutes, 2010c). Of the 37 TIFs approved in 2008 and 2009, 30 lacked any statement or justification that the project could not proceed without TIF designation (Dunn, 2011a).

Of the seven projects that did provide such justification, at least two seem questionable:

- Gahm's Block (City of Omaha, 2009a) for instance - the "But-For" statement shows that the project would make less profit without a TIF, but would still be profitable.
- 2566 Leavenworth, LLC (City of Omaha, 2009b): The "But-For" statement shows that the project would be modestly profitable within 3 years without a TIF, but would be greatly profitable within 1 year with a TIF.

The question here becomes "how much profitability is the City willing to subsidize?" Given that profit is the amount that the developer pockets after all expenses have been paid, should the City be subsidizing projects beyond the break-even point?

TIFs in Omaha

According to the TIF map (City of Omaha, 2010b), although North Omaha is included in the blighted area there are comparatively few TIF plans in that area. There are some industrial TIF plans by the Airport on the outskirts of the North Omaha area.

Nebraska State Statute (Nebraska State Statutes, 2010d) requires that cities report to the Nebraska Property Tax Administrator annually on each redevelopment plan approved that uses Tax Increment Financing.

Discrepancies

According to the Nebraska Department of Revenue 2009 Tax Increment Financing Report (State of Nebraska, 2010), there were 176 TIF plans active in Omaha that year. That same document shows six TIF plans initiated in 2008; of these six plans recorded by the State, one was recorded as canceled and one was noted as “no project plan received from the city”. Ten are shown as initiated in 2009[4].

A review of the minutes of the City Council (called journals) for those years shows 22 TIF plans approved in 2008 and 14 approved in 2009 (Dunn, 2011a).

A representative of the City Planning Department stated that one reason for the smaller numbers in the State report has to do with the fact that the cutoff date for preparing the report is

4 Another way to view this information is to review the City Tax Levy spreadsheet "ctl_project_name_project_date.pdf " which summarizes the information in the State report by year along with a number of interesting variables (Dunn, 2011b).

August 1 of each year and since the time periods are not the same, the numbers will vary. However, a review of the City Council minutes show that 10 TIF plans were approved in 2008 prior to August 1, not 6, and one would expect the number to be even higher if it is supposed to include TIF plans approved in 2007 after August 1, 2007 (our review of City Council Journals currently only includes the years 2008 and 2009).

A review of the City Council minutes for 2009 shows that 9 TIF plans were approved prior to August 1 of that year. However, adding these together with the 12 TIFs approved on or after August 1, 2008 would yield 21 TIF plans approved, not the 10 listed with the State Tax Administrator.

But the biggest reason for the discrepancy perhaps has to do with the fact that the City does not certify a TIF plan to the State until it formally enters the tax stream as a TIF. The County Assessor's office says that the numbers reported to them (which are then reported to the State) depend on the City declaring a "notice to divide". The City divides the property valuation in two, one part of which is the base value and the other is the excess value. The base value is the tax valuation of the property prior to any improvements being done; the excess value is the valuation of the improvements[5].

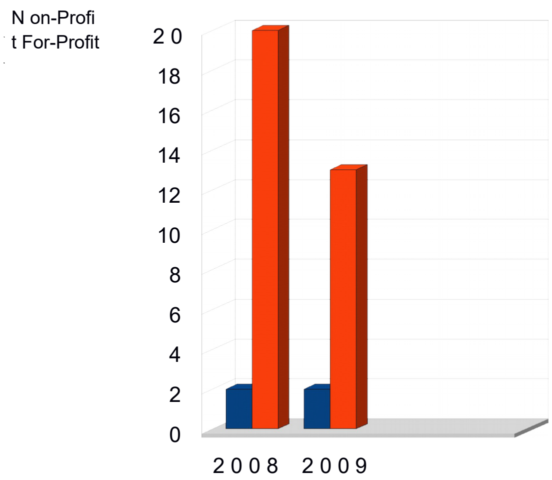
This process is not done until the project is fully ready. The City then sends a "notice to divide" to the County Assessor. This is official confirmation of a TIF plan. The projects that reach this stage are the ones reported to the State. Some TIF authorizations, for whatever reason, never reach this stage; the developer may have canceled their plans, financing may have fallen through, etc.

Tax Revenue Forgone

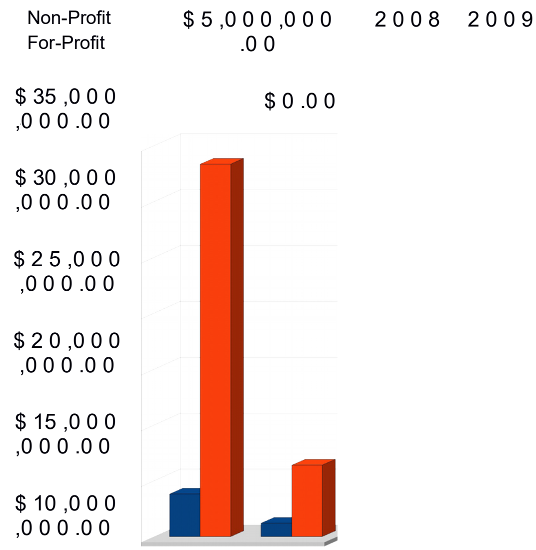
Even after the "notice to divide", there may still be no incremental tax on the property. Of the six TIF plans reported to the State as initiated in 2008, only three had improvements made on them warranting increased (incremental) taxes by 2009 (State of Nebraska, 2010).

If all of the TIF plans approved by the City in 2008 were successful, we would expect taxes forgone to be $37,121,678.50, of which $33,308,678.50 were allocated to 20 profit-making ventures. Similarly, tax expenditures in the amount of $7,587,831.00 were approved by the City in 2009, of which $6,387,831.00 were allocated to 13 profit-making ventures. Total anticipated City income forgone in these two years combined was $44,709,509.50 of which $39,696,509.50 went to profit-making ventures (Dunn, 2011a).

5 This can be seen clearly in the State TIF report for 2009: http://www.revenue.ne.gov/PAD/research/TIF_Reports/TIF_REPORT_2009.pdf



Comparative Number of TIF Plans Approved



Comparative Cost of TIF Plans Approved

This paper will focus on the tax expenditures going to profit-making ventures since most non-profits are of clear public benefit (low-income housing, homeless shelters, etc.).

On the one hand, while almost $40 million in anticipated tax expenditures designated in two years might seem like a large amount, it must be taken into account that the typical lifetime of a TIF plan is 15 years. This means that over the next 15 years only about $2.6 million annually would be lost to the City by the TIFs approved in 2008 and 2009.

From this vantage point it is easy to second-guess the City and wonder why, when the real estate market was already in significant decline, 20 TIF plans for profit-making ventures were approved in 2008 and 13 in 2009.

On the other hand, TIF plans must be approved by the Planning Department before reaching the stage of approval by the City Council. Further research is needed to track the approval rate and the conditions affecting it at the Planning Department level, which is where TIF plans begin.

Finally, from the City Tax Levy spreadsheet (Dunn, 2011b), we find that a total of $27,166,340.35 in tax expenditures from TIF plans were actually processed by the City in 2009. Of this amount, $24,849,043.90 went to profit-making ventures. Cumulatively, over the past 15 years, $135,707,194.38 has been spent in tax expenditures from TIF plans, of which $125,511,515.52 went to profit-making entities[6].

6 Profit-making vs non-profit designation was determined by making an educated guess based on the description provided in the City Council minutes or in the State TIF report.

The percentage of non-profits benefiting from TIF plans has been decreasing. 16 non-profits (or more than half of the 29 total in the sixteen-year span covered by the above report were initiated from 1994 through 1999 (or six years); the rest (13) were approved during the remaining ten years (2000 through 2009). This compares to 48 TIF plans approved from 1994 through 1999, or 27% of the 176 total. The conclusion here is that the use of TIF plans for profit-making entities became a much higher priority in the 00's.

Questionable TIF Decisions

It is not the purpose of this paper to review each TIF plan approved by the City Council in 2008 and 2009. In general, little opposition has surfaced to TIF plans before the Planning Board or the City Council.

Granted, both the Planning Board and City Council meet on weekdays in the early afternoon making it difficult for working people to attend. However, neighborhood associations located within a mile of the TIF project must be notified at least 10 days prior to the City Council public hearing (Nebraska Revised Statutes, 2010e) and two notices must be published in “a legal newspaper of general circulation in the community” (para. 1), so one may assume that, if there were serious opposition to a given TIF proposal, it would probably surface.

It probably is worth noting, however, that at least two TIF plans in this study do draw scrutiny (Dunn, 2011a). The Blue Cross Headquarters project (Quadtech LLC) received $12,000,200.00 in TIF funds, the largest amount authorized by far in the two-year period, and Aksarben Village (Zone 5 LLC) received $1,857,000.00. Blue Cross is a successful business venture; other than possibly avoiding having the headquarters locate outside of Omaha (which raises the issue of whip-sawing municipalities for tax breaks), it is hard to imagine why the project would need a TIF plan to proceed. Aksarben Village is a private venture located about 67th and Center. With the extensive development nearby associated with the University, it is unclear why anyone would think that this development needed to be subsidized by the City.

A third TIF plan, that of 2566 Leavenworth LLC, is actually one of the better prepared TIF plans submitted. As mentioned above, the TIF plan also shows that the project would be modestly profitable without the TIF plan and impressively profitable with one. The plan also states that the lending institution, American National Bank, listed as a condition of the loan that TIF money be included in the overall financing (City of Omaha, 2009b). This is a singular requirement and does not show up in any other recent TIF plan; which leads one to question the origins of this requirement.

Conclusions

Nebraska State Statute 18-2113 requires that every TIF plan shall be subject to a cost-benefit analysis. The relevant section of the statute reads:

> "The authority shall conduct a cost-benefit analysis for each redevelopment project whose redevelopment plan includes the use of funds authorized by section 18-2147. In conducting the cost-benefit analysis, the authority shall use a cost-benefit model developed for use by local projects. Any cost-benefit model used by the authority shall consider and analyze the following factors:
>
> (a) Tax shifts resulting from the approval of the use of funds pursuant to section 18-2147;
>
> (b) Public infrastructure and community public service needs impacts and local tax impacts arising from the approval of the redevelopment project;
>
> (c) Impacts on employers and employees of firms locating or expanding within the boundaries of the area of the redevelopment project;
>
> (d) Impacts on other employers and employees within the city or village and the immediate area that are located outside of the boundaries of the area of the redevelopment project; and
>
> (e) Any other impacts determined by the authority to be relevant to the consideration of costs and benefits arising from the redevelopment project."

Cost-benefit analyses in the TIF plans in this study are either non-existent or simply boiler-plate language. This would seem to be a matter for the Planning Department Staff and Board since they are the ones who, in conjunction with the developers, draw up and give initial approval to the TIF plan. The analyses that came the closest to meeting the full State requirements were prepared separately by developers. Final responsibility, however, rests with the City Council which has the duty to reject any plan that does not contain an adequate cost-benefit analysis.

Recommendations

We recommend that the Planning Department staff and Board, and the City Council, ensure that each TIF plan contain a thorough, easily understood cost-benefit analysis as prescribed by State Statute.

To provide maximum opportunity for citizen input, we recommend that the Planning

Department and the City Council hold their meetings in the evening when the majority of citizens can attend.

In this time of economic constriction, we encourage the Planning Department and the City Council to closely scrutinize each proposed TIF plan to assure that it really does provide for public, as opposed to primarily private, benefit.

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