CITY INTELLIGENCE

Tax Increment Financing (TIF)

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1 Introduction

This paper sets out the background to the Tax Increment Financing (TIF) model, and describes some case studies in which TIFs have been used, both here in the UK, and in the US.

TIFs are an important potential source of revenue generation for the public sector, enabling development projects, such as housing regeneration programmes and transport infrastructure, to go ahead, and TIFs have previously been used by the Greater London Authority (GLA) in the Battersea and Nine Elms development, and the Royal Docks.

2 Background

Tax increment financing began life in California in 1952 as a tool to enable local governments to fund economic development. It provided an alternative to issuing bonds, which had hitherto been the main source of funding for development, and which required voter approval. It is now in widespread use in urban renewal, particularly in the United States.

TIF works on the theory that development today can be funded by increased tax revenues in the future; the development increases local property values and therefore tax revenue. This future, additional, tax revenue is ring-fenced to pay back the initial costs of the development.

TIF was specifically intended to provide funding for improvements in areas which are run down, in decline or where development would not have otherwise happened.

In the US, state legislation gives local governments the authority to designate TIF districts, which normally last for 20 to 25 years, or enough time to pay back the bond or loan taken out to pay for the upfront costs of the project. Often, bonds may only be floated based on a percentage of the assumed increase in tax revenue, rather than the entire amount. Successful TIFs are then able to contribute some of their expected revenues to other public projects. Some tax increases are capped so they don't exceed what would have occurred without the project.

3 Potential TIF applications

Across the US, TIF has been used to fund a variety of schemes, including:

- Public infrastructure programmes
- Land acquisition
- Planning costs
- Sewer expansion and repair
- Storm drainage
- Street lighting
- Street building
- Landscaping
- Parks improvements
- Environmental remediation

Because the financing model depends on future revenues, TIFs are often deployed in underdeveloped areas that show the promise of future increased property values which can repay the initial cost (*Anderson, 1990*).

As a result, TIFs have been established to finance projects which include not only urban development projects but also, among other examples, a supermarket on farmland and a golf course in a suburb (*Lefcoe, 2011 and Weber, R & Godderis, L. 2007*). A 1999 study found that 45% of Wisconsin's 661 TIFs were used to develop open space, primarily farmland (*Youngman 2011*). As Youngman (2011: p4) points out: "these areas may not be blighted or underserved by private developers, but they may offer dramatic increases in assessed value simply by being reclassified as commercial or industrial."

4 How it Works

A TIF begins with the designation of a geographic zone or district. For the duration of the scheme, a "base value" of property taxes is paid to the relevant authorities. Revenues resulting from increases in property value above the base value, the "increment", are paid to the local authority, or an economic development authority operating on its behalf. While not common, TIF districts may capture other revenue streams, such as sales tax, payments in lieu of taxes (PILOTs) or fees (CDFA 2015) (Fisher, Leite, Moe 2020).

Funding for the upfront costs of the development still needs to be raised and this can be done in a number of ways. Local authorities may create a non-profit development agency with the power to issue bonds. Bonds are 'sold' to investors, and the money raised can then be used to pay for the capital programme. The

income from the bonds is 'borrowed' from the investor for a given period of time (the term) and with a set interest rate. Interest is then paid to the investor for the duration of the term until the investment has been fully paid off.

Or local authorities can create a "pay as you go" process using current tax revenues from the TIF district to pay for new public improvements or reimburse developers' up-front costs. Less frequently, developers use conventional loans to fund infrastructure investments, which are later repaid by the TIF increment (Fisher, Leite, Moe 2020). Or local authorities may simply borrow against their predicted income.

TIF can also draw on subsidies from local authorities designed to lower developers' investment costs (Merriman 2018). In Massachusetts, TIF revenue is disbursed in the form of tax abatements, where developers pay discounted property taxes for a particular period (U.S. PIRG Education Fund 2011). In other states, such as Illinois or Michigan, land rental or sale at below fair-market value subsidize TIF projects (Merriman 2018).

5 TIFs in the UK

Historically in the UK, local authorities have been able to raise money for development projects by trading local authority bonds issued on the stock market. These arrangements became less common in the 1980s as local authority credit became more tightly controlled and funding more centralised (Pinsent Masons 2011).

In 2010, the Chancellor, in his four-year spending review, introduced TIFs and announced the reintroduction of Enterprise Zones, within which TIFs would operate. This would enable local authorities to fund development in Enterprise Zones through the generation of the increased local business rates that the projects would stimulate. The TIFs would have a lifespan of 25 years.

Normally, locally generated business rate income is collected by local authorities on behalf of the Treasury, which then reallocates this money to individual authorities. In a TIF arrangement, the local authority can assign this anticipated money to a specific local project that requires significant investment (Pinsent Masons 2011) or to a number of projects in the designated enterprise or TIF zone.

A local authority TIF may be involved in two specific areas of activity:

- 'Downstream' activities: this means the local authority designates a specific 'TIF Zone' and pays for the projects being created. Here, the risks that must be considered are those associated with the completion of the development;
- 'Upstream' activities: here the local authority will raise and repay finance for the developers to borrow from. Here, the risks that must be considered are those associated with cash flow from future business rates (Pinsent Masons 2011)

6 Case Studies

6.1 The Vauxhall, Nine Elms and Battersea Opportunity Area

The Greater London Authority (GLA) sought to redevelop the area around Vauxhall / Nine Elms / Battersea area, the key to which was the extension of the Northern Line. The cost of the extension was estimated to be £1.5bn. so the GLA proposed the creation of an Enterprise Zone, and retaining incremental business rates to fund the scheme.

The Chancellor's 2011 Autumn Statement confirmed the Government's support for the Northern Line Extension (NLE), and stated that they would consider creating a new Enterprise Zone at Battersea, subject

to a commitment from a developer to develop the Power Station site and make agreed Section 106 contributions.

Then, in the 2012 Autumn Statement, the Government confirmed that borrowing of up to £1bn from the Public Works Loan Board would be available to the GLA, along with a supporting guarantee to be provided under the UK Guarantee Scheme.

Borrowing for the Northern Line Extension (NLE) would be serviced by:

- Incremental business rates retained by the GLA in the new Enterprise Zone (EZ), for a duration of at least 25 years, with the possibility of a five-year extension if this was deemed necessary to pay off any remaining debt.
- Contributions from local developers, collected by the two boroughs under s106 and the Community Infrastructure Levy (CIL).

Any surplus income could be used to fund other economic priorities. And should the income over an extended 30-year period not enable full repayment of NLE debt, the GLA Group would be responsible for meeting any further repayment, up to the point at which the UK guarantee can be exercised. HM Treasury agreed that each borough would be statutorily required to pass 100% of the business rate uplift to the GLA. The GLA would pass back 30% of the uplift to the boroughs.

6.2 The Royal Docks

The Royal Docks Enterprise Zone (EZ) was designated by the government in 2012 and became operational in 2013. Its aim was to support local development and economic growth. The EZ structure was set up to enable additional business rates income, collected in the EZ, to be retained and recycled for a 25-year period, and for the London Economic Action Partnership (LEAP) to use those funds to support further development and economic activity in the EZ.

The Royal Docks Delivery Team worked with AECOM, Cushman & Wakefield, and Futurecity on the preparation of a five-year detailed Delivery Plan to help accelerate economic and housing growth. The Delivery Plan proposed an integrated package of transport infrastructure, connectivity, economic development, placemaking, estate management and creative programming projects. It set out a proposed investment of £314.3m, consisting of £255.3m capital and £59m revenue, for the five-year delivery period from 2018/19 to 2022/23 to transform the Royal Docks and accelerate the delivery of commercial space within the EZ.

The business rates retained within the EZ from the commercial space are expected to fund expenditure, but will not be generated quickly enough to fund the Delivery Plan. GLA will therefore forward fund through borrowing, which will be repaid from the business rates generated over the life of the EZ. The funding strategy is underpinned by business rates modelling, carried out by Cushman & Wakefield (C&W), who also prepared a Business Rates Income Growth Report.

In the case of a downturn in income, projects within the initial approval can be deferred or reduced.

When the Royal Docks EZ Delivery Plan was endorsed in 2018, a commitment was made to return to the LEAP Board after the first two years of delivery to reflect on early delivery progress, explore key areas of delivery achievement and weakness, and draw lessons to inform the evolution and adaptation of delivery approaches over the remainder of the Delivery Plan period.

A review of the Delivery Plan took place in 2020 and the Plan has subsequently been updated and extended from five to 10 years, until 2028. It remains compliant with the original Delivery Plan endorsement, but also

now responds to the London recovery missions and Newham recovery pillars and is informed by stakeholder and community consultation that was undertaken in 2019.

The review found that good progress was made during the first two years of delivery. This included building delivery capacity, refining delivery focus, and building local trust and partnerships to set the foundation for effective long-term delivery.

Key outputs for the first two years include:

- 120,000m2 of public realm improved
- approximately 330 trees planted (or planting underway)
- 30 pieces of street furniture installed, and provision of two bike hire stations
- five underused sites refurbished for public activities, two disused sites receiving enabling works to unlock development, and one disused building refurbished and bought back into use
- 130 additional rateable commercial properties in the EZ since 2018
- 1,735 residential homes under construction and 691 completed
- 250 cultural events supported and delivered across the Royal Docks
- over 135,000 event attendees and visitors, of whom 45 per cent were first time visitors and 90 per cent said they would recommend the area to friends and family
- 163 community engagement activities, including 1,738 people engaged via Join the Docks in 2019
- 121,000 unique web visitors, 17 per cent audience growth and 36 per cent audience engagement across social media
- 3,400 media articles about the Royal Docks with an audience reach of 1.6 billion and 97 per cent of articles positive or neutral
- 1,451 housing completions and a further 1,483 are under construction on GLA owned land

COVID-19 and Brexit have resulted in risks to the pace of delivery and of income shortfalls in the short to medium term.

The following actions are being undertaken to monitor and mitigate these risks:

- An annual review of EZ business rate income forecasts
- A pause or delay of large capital expenditure commitments if repayment risks increase
- Annual updated assessments of business rates income to be carried out to track, monitor and analyse income and expenditure projections
- A proposed comprehensive review at the five-year stage in autumn 2023
- Close tracking and performance monitoring of developer delivery

6.3 Glasgow's TIF Scheme for the Buchanan Quarter

2012

In 2012 Glasgow City Council approves a scheme for the Buchanan Quarter which includes public infrastructure and public realm works:

- A new entrance atrium to the Royal Concert Hall
- Pedestrianisation works
- Strengthening of Cathedral Street Bridge
- £10m contribution towards the redevelopment of the Royal Concert Hall to accommodate Royal Scottish National Orchestra, as well as internal refurbishment

- Pedestrian linkages between the proposed new car park at North Hanover Street, Queen Street Station, the Buchanan Galleries development and Cathedral Street
- Improvements to Concert Square, George Square and Cathedral Street
- Additional public realm works in the TIF area, subject to budget availability

The scheme also includes private sector development:

- 392,177sq.ft expansion of the Buchanan Galleries, including a new cinema
- A new 1,500 space car park at Queen Street Station on a site owned by Network Rail, with associated retail units encompassing 35,045 sq.ft. This would replace the existing 2,000 space Buchanan Galleries car park
- The provision of a new retail development of 50,000 sq.ft at the southern end of the existing Buchanan Galleries site
- A refurbished Buchanan Galleries on the existing footprint.

The £80m TIF scheme is expected to leverage £310m in private investment and create 1,500 new jobs. Glasgow City Council is required to have in place an action plan to maximise benefits for other areas in the city not included in the project.

2015

In 2015 developers halt the extension of Buchanan Galleries and the replacement of the steps of the Royal Concert Hall, blaming the risks associated with parallel improvements to Queen Street station. Glasgow City Council cancels enabling work for the extension on North Hanover Street next to George Square and Queen Street station. Developers believe both schemes cannot be delivered at the same time.

The mall had been scheduled to open for Christmas 2017 and at least one business had already had to relocate because its building was subject to a compulsory purchase order.

Critics of the scheme say they believe the mall will threaten jobs and sales elsewhere in the city centre and that there is no business case for the TIF, which supposed a worst-case scenario of retail sales growth averaging at more than two per cent a year for two and a half decades.

2017

Glasgow City Council approve a series of measures designed to allow the completion of the southern extension of Buchanan Galleries to occur earlier than would otherwise have happened.

Following the halting of the scheme in 2015, the developer and Transport Scotland carried out reviews of the scheme and set forth some options to take it forward, including varying the lease terms for the developer from 100 years to 175 years.

2019

Glasgow City Council revive the TIF. This involves the developer progressing a reduced Buchanan Galleries project, which would see the existing car park remain and the site formerly held for the car park potentially developed as office space.

The revised TIF business case focuses on the proposed office development, with the overall TIF approval of £80m reduced to correlate with the non-domestic rate (NDR) revenue to be generated from the North Hanover Street office development.

6.4 The Cortex Redevelopment Plan, Missouri

In 2016 St. Louis, Missouri had over one hundred TIF projects in place, with around $2b of public tax dollars redirected to developers via TIF schemes. A 2011 survey found that approximately 80% of the projects were retail-orientated, with most of the remainder residential.

In Missouri, a TIF district freezes property taxes within the district and then requires property owners to make payments in lieu of taxes (PILOTS) to a special fund. The state also allows for up to half of local income and sales tax revenue generated by new economic activity to be captured and placed in the fund which is then used to reimburse the developer or to clear debt from bonds used to finance the development up front.

In 2012, Missouri approved the Cortex Redevelopment Plan, a large mixed-use development with new offices, research facilities, retail, healthcare, recreational open space, and a new public-transit station, most of which was built on vacant land.

The scheme is due for completion in 2024 at an estimated cost of $2bn, including $158.2m TIF funds. In its first phase, Cortex leveraged around $10m in TIF funds to attract $155m of investment. Around 955 technology and management jobs were created in the area.

The second phase is expected to generate $186m for the district, along with 1,400 additional permanent jobs. Over the course of 25 years, Cortex is expected to produce an estimated 2,400 jobs. In 2016 Cortex already saw 4,100 people working for 260 companies, in activities such as new hotels, apartment complexes and retail centres (*Crittenden, G, 2020*).

In 2019 an impact report found that Cortex was a powerful, and growing, economic engine for the region, with 5,780 employees currently working in the Cortex Innovation Community, and the economic activity of the development generating $2.1 bn in economic output impacts for the St. Louis region in 2018. Cortex is also expanding the regional tax base, with reported state and local tax revenues of $69.6m, and $185.4m in federal taxes (primarily payroll taxes) in 2018. Over the 30-year life of the TIF, it is projected that over $775 in revenues will be generated (*TEConomy Partners LLC, 2019*).

Ashley Fahey and Gloria Lloyd of the St. Louis Business Journal ranked St. Louise as 'a top office, retail performer coming out of Covid.' They reported that:

"The St. Louis area economy is recovering faster than peers according to a report released by commercial real estate advisory firm Newmark Group Inc., which ranked St. Louis in the top 5 in key economic indicators coming out of the pandemic."

7 Potential Problems / Pitfalls

In the case of the Vauxhall / Nine Elms / Battersea development, the main area of contention was the reliance on one tax stream, which resulted in the need to ensure sufficient commercial property was built to generate enough business rates. Access to other revenue streams, for example VAT on construction or stamp duty, that would have raised sufficient funding and would have enabled the GLA to run the scheme over a shorter period of time, would have spread risk and, arguably, would have reduced the risk of skewing development towards commercial and very high density. However, the use of other revenue streams was not permitted.

There are other risks. TIF arrangements hinge on anticipated cash flow in the form of business rates that will have been ringfenced for the project, so there must be certainty that the development will be both

completed and occupied (Pinsent Masons 2011) – there are very few levers over developers to deliver to a pre-set schedule.

Issues around project risk must be covered in a Funding Agreement between the local authority and developer or project sponsor. These risks include occupancy rates, uninsurable risks, changes in the law and changes in business rates (Pinsent Masons 2011).

Other areas of concern, mainly arising in the US where TIFs have been in existence for nearly 70 years, include:

- The development may result in rising property values and gentrification
- Saying an area is blighted or in decline can lead to property being condemned
- TIF arrangements can lead to favouritism for politically connected property developers
- If the TIF is poorly written, increased property values may have generated additional funds anyway, which would have paid for other public services rather than being channelled back into the TIF. Funding is therefore taken out of the public purse
- If TIF zones are too large they may capture revenue from areas that would have appreciated in value regardless of the TIF
- Projects can overlook the fact that incremental rises in property values may require an increase in the provision of public services, which then need to be funded from somewhere
- TIFs result in money leaving taxpayers hands to be spend on projects that aren't always transparent. There is a risk of displacement i.e. subsidies through the TIF could encourage developments in an area which would otherwise have happened elsewhere. Ideally a TIF should encourage a development which would not have happened anywhere else, not just would not have happened in the TIF zone.

8 Conclusion

TIFs are an important policy and funding tool. They are not without risks; income may be lower than forecast, or the pace of development may be slower than anticipated or held up by unforeseen circumstances. If the TIF is poorly written and defined, development may negatively impact neighbouring areas. Reliance on one tax stream can result in development being focussed too heavily on, for example, commercial property.

Net economic gain is brought about in increasing land values, and so the additional tax take could be targeted here. Taxing business rates achieves this, even if it presents additional risks described above. But while there is an argument around diversification for other taxes, these would be less well targeted on the underlying economic issue.

However, if well written and the TIF zone is well defined, this finance mechanism offers an important funding tool, and can result in economic gain, significant job creation and the economic and social regeneration of difficult-to-develop neighbourhoods.

9 Glossary

Section 106 Agreement

Also referred to as Planning Gain. Developers applying for planning permission can be asked to contribute financially, and in other ways such as providing green space or play facilities, to the infrastructure needed to support the new development, and to mitigate any negative impacts arising from it. In this way local authorities can secure additional public benefits from developers.

Community Infrastructure Levy (CIL)

In addition to negotiations which take place under Section 106, the CIL can be levied by local authorities on new development in their area. The CIL is a planning charge for landowners and developers and, while there are exceptions to where the levy can be applied, most new development which creates net additional floor space of 100 square metres or more, or creates a new dwelling, is potentially liable.

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