Elements of an Effective Tax Increment Financing Policy for North Carolina Local Governments

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Executive Summary

In 2004, North Carolina voters approved an amendment to the state constitution that allowed the use of tax increment financing (TIF) to increase property values in areas that are blighted, depressed or underdeveloped. As North Carolina communities decide whether or not to use TIF, it is important that those decisions be made on a sound basis. This paper identifies elements that are important in developing a tax increment financing policy for a North Carolina county or municipality and provides examples of how those elements are incorporated into actual TIF policies.

Introduction and Purpose
Tax increment financing (TIF) is a method of advancing community or economic development in a municipality or county that would not otherwise occur without the assistance of a government entity (sometimes referred to as "but for" in development).[1] After designating an area as a TIF district, a municipality or county issues debt or otherwise finances public infrastructure and other development projects with the goal of attracting private investment and increasing property values in the district. The additional property tax revenues (and sometimes other revenue sources) are used to secure and repay debts the municipality or county incurs from the development project. TIF provides local governments a tool to fund redevelopment or community improvement projects, without requiring a ballot referendum or raising the general property tax rate. In 2004, North Carolina voters approved an amendment to the state constitution that allows the use of TIF to increase property values in areas that are blighted, depressed or underdeveloped.[2]

As North Carolina communities decide whether or not to use TIF, it is important that those decisions be made on a sound basis. The Government Finance Officers Association of the United States and Canada recommends that local governments interested in using TIF first develop a policy. These policies should be based on state TIF statutes, but also provide flexibility to the local government.[3] "Guidelines are important, but policies that are too rigid will turn away viable projects," says Laura Radcliff, Director of the Public Finance Department for Wachovia Securities.[4] Tom Warshauer, Economic Development Manager for Charlotte, North Carolina, states, "It's very helpful to have a framework for staff to operate within. That way they know how to respond to proposals quickly, especially when to say 'no'. It avoids wasting time.[5]" Having a policy to guide the creation of a tax increment financing district also will help a community make choices that have the best chance of success. To date, three North Carolina TIF projects have been approved by the Local Government Commission: one in Roanoke Rapids, one in Kannapolis, and one in Woodfin (along with involvement from Buncombe County). Of the municipalities and counties in those three projects, only Buncombe County had a TIF policy in place beforehand.[6] This capstone identifies elements that are important and should be considered when developing a tax increment financing policy for a North Carolina county or municipality and provides examples of how those elements were incorporated into actual TIF policies adopted by municipalities or counties in other states.

Research Design
Six important elements for developing a tax increment financing policy were found to be important after reviewing existing TIF literature and recommended practices, as well as consulting local government leaders and TIF experts.[7] Existing TIF policies from Aaa bond rated municipalities and counties in the Southeast and in the Midwest also were gathered and reviewed for examples of how those communities incorporate the six elements into their own TIF policies.[8]

Six Important Elements for Effective TIF Policies
North Carolina local governments wishing to develop a TIF policy should incorporate the following elements into such a policy:

- Steps for the municipality or county to follow in order to meet state law
- Policy objectives
- How much risk a municipality or county is willing to assume
- A process for analyzing the expected costs and benefits and alternative methods of financing
- Public support for TIF and how a project may impact citizens
- Evaluation criteria and methods for determining how well TIF meets community goals

Each of these elements is discussed along with examples of how the element has been incorporated into actual TIF policies.

Outline Steps to Meet State Law
The most important element for a local government to consider in a TIF policy is conforming to state laws on tax increment financing usage. North Carolina was the 49th state to approve tax increment financing as

a way to finance public infrastructure and development projects. Because of this, North Carolina was able to benefit from other states' experiences with TIF and incorporate "best practices" to prevent problems in implementing and using the tool. As written, the North Carolina legislation provides a conservative framework for tax increment financing that is designed to limit the risk local governments may face when creating a TIF district.[9]

To use TIF in North Carolina, a municipality or county must define a district that, when combined with other TIF projects, is less than five percent of the total land area of the municipality or county. A county district must be made up of land that is one of the following: blighted, deteriorating or undeveloped; appropriate for rehabilitation or conservation activities; or appropriate for economic development.[10] Municipalities may designate areas that meet one of these criteria as TIF districts, or the municipality's planning commission may designate areas that meet the criteria for a redevelopment district as defined in G.S. 160A-503.[11]

After defining a TIF district, the North Carolina statute requires that the local government create a development financing plan which describes the boundaries of the district; the proposed public and private development of the district and the cost of the public development; the sources of funds to pay for the public development and the amount of funding to be taken from each source; the base valuation of the district; the projected incremental increase in valuation of property within the district after the project is completed; how the proposed development will benefit district residents and business owners by way of jobs, affordable housing or services; and any action which will be undertaken if the proposed development negatively impacts residents or business owners.[12] The development financing plan also must include an estimate of how long the TIF district will exist for the purposes of repaying bonds, and a statement that the initial users of new manufacturing facilities in the district will be required to pay an average wage that is either above the average manufacturing wage paid in the county or is not less than 10 percent above the state average weekly manufacturing wage, unless an exemption is approved by the secretary of commerce.[13]

Plans that involve new manufacturing facilities must be submitted to the Department of Environment and Natural Resources for review. Municipalities also must notify counties of development financing plans prior to adoption, and counties have 28 days to disapprove the plan. Municipalities and counties also must hold a public hearing prior to adoption of the plan.[14] Before implementation of the plan, the Local Government Commission (LGC) must approve the project. The Commission must make the following findings when reviewing and approving development plans:

- The local government uses sound debt management practices.
- Proposed projects are feasible.
- TIF is necessary to secure significant new project development for a district.
- The private development forecast in the development financing plan would not likely occur without the public investment in the project.
- Incremental tax revenues from the district, along with any other revenues pledged by the municipality or county, will be sufficient to pay the proposed TIF debt.
- The proposed TIF debt can be marketed at reasonable interest cost to the unit.[15]

After the district is established and the LGC approves financing for the project, the municipality or county must work with the tax assessor to establish the base valuation of the district. The base valuation is frozen for the lifetime of the district and incremental revenues beyond the base valuation are used to repay TIF bonds. To account for proceeds from taxes levied on the incremental valuation of the district, a local government must set up a revenue increment fund. Money in this fund may be used to finance capital expenditures in the district, to meet principal and interest requirements on TIF debt, to repay monies spent on debt service on TIF debt instruments, and to establish and maintain debt service reserves.[16] If there is any money remaining in the revenue increment fund after fulfilling these purposes at the end of each year, these funds may or must be transferred to the municipality or county's general fund.[17]

Establish policy objectives
It is important for municipalities and counties to determine why tax increment financing will benefit the community and in what scenarios TIF may be of more use than other financing alternatives.[18] A best practices study for tax increment financing found that the most successful projects are those that conform to the municipality or county's master plan for development. These projects contribute to the public good by improving the community. If a local government creates a TIF district for a project that does not fit the master plan, political criticism should be expected.[19]

In addition to conforming to the county's revitalization plan, officials in Arlington County, Virginia, give preference to TIF projects that fall within geographical areas where public infrastructure investment would most likely stimulate private investment. The county manager may specify what geographical areas are of higher priority.[20]

The city of Minneapolis only uses TIF if it helps the city accomplish one of the following seven identified development objectives:

- Expand the Minneapolis economy to create more living-wage jobs, with an emphasis on providing job opportunities for the unemployed and underemployed.
- Attract and expand new and existing services, developments and employers in order to position Minneapolis and the region to compete in the economy of the 21st century.
- Increase the city's property tax base and maintain its diversity. Clean contaminated land to provide sites for uses that achieve city redevelopment objectives.
- Provide an array of housing choices that meet the needs of current residents and attract new residents to the city, with an emphasis on providing affordable housing.
- Eliminate blighting influences throughout the city.
- Support neighborhood retail services, commercial corridors and employment hubs.
- Support redevelopment efforts that enhance and preserve unique urban features and amenities, including downtown, the riverfront and historic structures.[21]

These objectives were created by city staff and approved by the city council. Preference is not given to one objective over another; proposed TIF projects must simply meet one or more of the objectives.[22]

Decide How Much Risk to Assume
To protect a municipality or county's financial interests, the GFOA recommends that local governments decide how much risk they are willing to assume in TIF projects. As part of the TIF development agreement, the private developer and the local government should clearly document each party's responsibilities for risk sharing.[23] Laura Radcliff of Wachovia Securities states that it is important for communities to ask of a private developer how much they are willing to risk in a proposed TIF project. The answer has implications for the success of the project.[24] In addition to municipalities and counties analyzing risk in TIF, North Carolina created a detailed LGC approval process for projects and financial plans to assess and limit risk to a local government.

To minimize risk, Buncombe County, North Carolina, allows other revenue besides the incremental tax to be pledged towards the TIF project as a form of security, as long as those revenues do not come from Buncombe County's taxing power. Buncombe County also does not allow the use of revenues from special taxing districts, such as fire districts, to be used towards security for the TIF project. In addition to using other revenue sources, the county may enter into a contract with property owners in the district that defines a minimum valuation of the property, regardless of whether any improvements are made to the property. Using these techniques helps to ensure that a TIF district in Buncombe County will generate enough revenues to repay debt on the project.[25]

In Cobb County, Georgia, private developers must include with their TIF[26] project proposal evidence that the developer has the financial capability to both complete and operate the project, which is another way to limit risk. Developers in Cobb County must also demonstrate that they have explored other financing methods, and that they will contribute equity of at least fifteen percent of the total cost of the project.[27] When reviewing TIF project proposals, officials in Anne Arundel County, Maryland, look for projects where the outstanding debt is no more than the underlying land value prior to development.[28] To ensure that private developers will complete their portion of a development project, the city of Cincinnati requires proof of private financing or a completion guarantee surety bond before the city will commit to the project.[29]

Establish Process for Analyzing "But For," Expected Costs and Benefits, and Alternative Methods
Economic analyses of a proposed TIF project are crucial to its success or failure. Researcher Craig L. Johnson studied TIF projects nationwide and found a common thread between most of those that were unsuccessful: "In…instances where incremental revenue growth has dangerously underperformed expectations, it is mostly because of poor project planning.[30]" The GFOA recommends that local governments conduct a feasibility study on proposed TIF projects that include an evaluation of whether redevelopment could take place within an acceptable timeframe, and if the development would occur without economic assistance from the local government. Local governments also should determine the economic benefit to the local economy of a TIF project; the fiscal impacts to overlapping tax entities, such as school districts; and the economic cost of TIF district incentives.[31]

The experience of the city of Rock Hill, South Carolina, with TIF illustrates the necessity of strong analysis work before creating a TIF district. The city's first tax increment district was created in 1988 to build a business park. The city expected utility revenues, as well as tax revenues, to increase due to the new development and those two revenue streams were pledged to repay debt issued to fund the public improvements. Unfortunately, the originally projected tax revenues from the business park did not materialize. In 1988, tax revenue was expected to exceed $3.2 million by 2003, but actual revenues by that time were just above $700,000. Because the actual tax revenue was not enough to pay off the debt from the TIF district, additional revenues from the utility fund were used per the original 1988 pledge. Rock Hill plans to repay the utility fund for this “bail out.[32]” Rock Hill created two other TIF districts, one in 1991 and one in 1993. The actual revenues from these districts have been lower than projected, but the city expects to pay off the debt from each of these projects without assistance from other revenue streams.[33]

Because of the negative public perception of TIF, thirteen years passed before Rock Hill created another TIF district. In 2006, the city created a fourth TIF district, but only after extensive analysis and preparation. The city is more conservative regarding TIF and needs evidence from private developers on why public money needs to be invested at all. Rock Hill is determined to never let the financial outcome of that first TIF district happen again. “The groundwork must be laid, appropriate research and conservative analysis must be done,” stated David Vehaun, management services administrator for Rock Hill.[34]

The TIF policy for Wake County, North Carolina, requires an independent third party consultant to calculate how much the property in the district would be worth without additional public investment. The policy also lists information the developer is expected to provide before the analysis can take place.[35] Matt Roylance of the Wake County Budget and Management Services department stated, "We want to ask ourselves two important questions: First, should we be doing the project [at all], and second, how do we pay for it? TIF is only one method of financing a project.[36]" As part of its general guidelines for using TIF, Minneapolis states that alternative methods of financing redevelopment projects such as “pay as you go” financing and reimbursing public redevelopment costs with tax increment revenues, are preferable to TIF bonds and are to be analyzed and used if appropriate. Developers in Minneapolis also bear the onus of demonstrating why public investment is necessary for the success of the project.[37]

Consider Public Support and Impacts On Citizens
Public support for TIF is important to the successful use of the financing tool. TIF should not be used for projects that have previously been voted down in bond referendum, because it may reduce citizen

confidence in the local government and politicize the financing method.[38] Before creating a TIF district, the GFOA recommends that local governments obtain public input for any project proposals.[39]

The city of Minneapolis requires that financial analyses on impacts to the city's general tax base be reported to the city council in a way that can be easily understood by the general public prior to approval of the proposed project.[40] Making sure the public can understand the financial aspects of TIF could encourage citizen support of the method.

Before Wake County commissioners choose to participate in a proposed TIF project, developers may be required to submit a description of how they will ameliorate any negative impacts of a TIF project on residents or owners within the proposed district.[41] A contingency plan for addressing adverse effects of a project may lessen public opposition and contribute to the overall success of a TIF district.

Evaluate How Well TIF is Meeting Goals

The GFOA recommends that local governments periodically review TIF districts to determine if projects are achieving the desired results intended by the municipality or county. In the review, local governments should compare actual performance as compared with projected performance. Suggested performance measures are actual versus projected tax base, jobs created, and the potential impact of shifting economic development from non-TIF areas to TIF areas.[42] Researcher Thomas Luce also recommends that local governments evaluate whether a TIF project produced the most bang for the municipality or county's buck. If a project generates many very low paying or temporary jobs, for example, this may not have been the best use of available resources.[43] Evaluation of past TIF projects will help local government leaders when deciding whether or not to approve future TIF development plans and also can help other jurisdictions that have not used TIF decide if the financing method is appropriate for their community.

None of the Aaa bond rated municipalities or counties in this study built into their policies methods for evaluating the success of TIF projects in meeting community objectives and goals. The city of Minneapolis, however, states in their TIF policy that staff will review TIF revenues annually as part of the city's annual budget process and report findings to the city council. Districts earning higher revenues than expected may be ended earlier and property tax revenues from those districts can be used in other needed areas.[44]

Summary and Conclusion

Though not required by law, effective TIF policies enhance a municipality's or county's ability to use the financing method successfully. When crafting a policy, communities should make sure that their TIF policies and practices conform to state law on tax increment financing. In addition, TIF policies should include the community's objectives for using TIF and set boundaries for how much risk that the municipality or county will assume in a TIF project. Communities also should outline how they will determine "but for" and the expected costs and benefits, as well as a process for analyzing alternative methods of financing. Finally, effective TIF policies should contain methods for evaluating how well the tool is meeting community goals and consider how TIF impacts the public.

Without a policy in place, it will be more difficult for local officials to make fair and equitable decisions when considering possible TIF projects. Having a policy may also reduce the number of proposals a municipality or county receives if developers know beforehand what types of projects the local government will not approve. Good TIF policies requiring detailed fiscal and administrative planning will help prevent the creation of unsuccessful TIF projects and improve the odds of creating successful projects.

Endnotes

[1] "But for" is the condition where private development that is forecast in the tax increment financing plan would not likely happen without the accompanying public projects described in the TIF plan. As described in N.C.G.S. § 159-105, when reviewing proposed TIF projects the Local Government Commission will look for "whether the projects to be financed from the proceeds of the project development financing debt instrument issue are necessary to secure significant new project development for a development financing district." TIF researchers describe the condition as "Development would not take place *'but for'* the public expenditure or subsidy." [Richard Dye and David Merriman, "Tax Increment Financing: A Tool for Economic Development," *Land Lines*, January 2006 18:1]

[2] TIF is referred to as "Project Development Financing" in the North Carolina General Statutes.

[3] Government Finance Officers Association, "Recommended Practice: Tax Increment Financing as a Fiscal Tool (2006) (DEBT and CEDCP)," (February 2006), 1.

[4] Laura Radcliff, "Tax Increment Financing Seminar," North Carolina Economic Developers Association (Raleigh, NC), October 19, 2007.

[5] Tom Warshauer, Interview, February 1, 2008.

[6] The TIF project in Roanoke Rapids has recently run into management difficulties that are not related to the debt arrangement. At this point, it is unclear if a TIF policy would have prevented any of these difficulties from occurring.

[7] These include representatives from Wake County, NC; Charlotte, NC; Rock Hill, SC; Minneapolis, MN; and Wachovia Securities.

[8] Buncombe County, North Carolina, does not have a Aaa rating, but their TIF policy was reviewed as part of this study to provide another example of how policies may be structured for North Carolina municipalities and counties.

[9] UNC Charlotte Center for Real Estate and the UNC Charlotte Urban Institute, "Applying Tax Increment Financing in the Charlotte-Mecklenburg Region," (Charlotte, NC: UNC Charlotte, May 2006) iii-iv.

[10] Local Government Commission, "Amendment One: Project Development Financing," (Raleigh, NC: North Carolina Department of the State Treasurer, Sept. 2005, Revised March 2007) 1-2.

[11] William C. Rivenbark, Shea Riggsbee Denning, and Kara A. Millonzi, "2007 Legislation Expands Scope of Project Development Financing in North Carolina," Local Finance Bulletin 36 (November 2007), 5.

[12] "Amendment One," 2.

[13] Rivenbark, Denning, and Millonzi, "2007 Legislation Expands Scope of Project Development Financing in North Carolina," 6.

[14] "Amendment One," 2.

[15] "Amendment One," 2-3.

[16] "Amendment One," 3.

[17] "Amendment One," 3.

[18] Radcliff, "Tax Increment Financing Seminar."

[19] Gary Sullivan, Steve Johnson, and Dennis Soden, Tax Increment Financing (TIF) Best Practices Study, (El Paso: University of Texas at El Paso, Sept. 2002) 16-17.

[20] Arlington County, "Tax Increment Public Infrastructure Fund Policy." (Arlington County, VA: December 2002), 4.

[21] City of Minneapolis, "Minneapolis Tax Increment Policy," (Minneapolis, MN: April 2005).

[22] Pamela McKenna, City of Minneapolis Department of Finance, Interview, February 21, 2008.

[23] "Recommended Practice," 1-2.

[24] Radcliff, "Tax Increment Financing Seminar."

[25] "Buncombe County Project Development Financing Policy," http://www.buncombecounty.org/governing/commissioners/ArchivedAgenda/20070403/web_PDF/Taxincrementfinancingpolicy.pdf (April 3, 2007, Accessed February 21, 2008).

[26] TIF is referred to as "Tax Allocation District Financing" in Georgia.

[27] Cobb County Office Economic Development, "Tax Allocation District Financing Policy and Guidelines," (Cobb County, GA: April 2003, Revised June 2007) 5.

[28] John Hammond, E-mail to author, July 11, 2007.

[29] "City of Cincinnati TIF Policy," (Cincinnati, OH: August 1, 2007) 4.

[30] Craig L. Johnson "Fiscal Policies Limiting Debt," in Craig L. Johnson and Joyce Y. Man, ed., Tax Increment Financing and Economic Development: Uses, Structures, and Impacts, (Albany, NY: State University of New York Press, 2001) 71-85.

[31] "Recommended Practice," 1-2.
[32] David Vehaun, Interview, July 19, 2007.
[33] Vehaun.
[34] Vehaun.
[35] "Wake County Project Development Financing Policy," http://www.wakegov.com/agendas/2007/april16/19/01policy.htm (April 16, 2007, Accessed July 2, 2007).
[36] Matt Roylance, Interview, February 14, 2008.
[37] "Minneapolis Tax Increment Policy."
[38] Sullivan, Johnson, and Soden, 16-17.
[39] "Recommended Practice," 2.
[40] "Minneapolis Tax Increment Policy."
[41] "Wake County Project Development Financing Policy."
[42] "Recommended Practice," 2.
[43] Thomas Luce, Reclaiming the Intent: Tax Increment Finance in the Kansas City and St. Louise Metropolitan Areas, (Brookings Institution: April 2003), 4
[44] "Minneapolis Tax Increment Policy."