Betting on the Future to Finance the Present

BY CHARLES GERENA

While other sports teams demand that taxpayers fund new stadiums, the Richmond Braves have offered to build their own ballpark as part of a $330 million development. The catch is the minor-league baseball club wants to use tax increment financing (TIF) to cover the stadium's $80 million cost. Cities and counties throughout the Fifth District use this mechanism, but TIF isn't the free lunch that its supporters portray it to be.

California pioneered TIF in 1952 and a few states followed. The mechanism became more widely used in the 1970s and '80s. West Virginia and North Carolina were among the last states to embrace TIF, with voters approving this approach in 2002 and 2004, respectively.

Here's how it works. Municipalities issue debt to pay for public improvements. The debt is repaid using just the revenue generated by increases in property values, retail sales, or other taxable activities within a designated area that benefits from the improvements. Typically, a separate development authority issues the debt in the form of tax-exempt bonds.

TIF's main selling point is that localities can encourage private investment in economically distressed or blighted areas without dipping into their budgets directly. They also avoid issuing general obligation bonds, which requires public approval. (Charlotte voters, for example, soundly rejected a bond issue to pay for a new basketball arena and minor-league ballpark in 2001.) Such bonds also count against a locality's debt limits.

Studies have shown that TIF can have positive effects on property values of designated areas, but that growth may come at the expense of other places. "When you build a TIF [project], it drains development out of the rest of the city," says economist David Merriman of Loyola University Chicago, who co-authored a 1999 paper on how TIF has affected growth patterns in the greater Chicago area.

Of course, redistributing wealth to blighted communities may be the goal of TIF users. Several states, for instance, have a "but-for" test that requires TIF to be used for public improvements in a location only if private development wouldn't have take place there. But proving such a thing is often difficult to do, says Merriman and others.

This highlights an important risk. Bond investors must be assured that they will receive their payments, or few TIF-backed projects will go forward. Since repayment of TIF bonds depends on development occurring where it supposedly would not have happened, this uncertainty could scare off investors. South Carolina had this problem until municipalities were allowed to offer water and sewer revenues as a backup source of debt payments.

A locality also can promise to appropriate general funds if incremental revenue from a TIF-designated area falls short. "It's not a binding obligation," but a good faith provision, says John Petersen of George Mason University's School of Public Policy. Still, a locality is unlikely to let a TIF bond default because doing so could hurt its credit rating.

This arrangement exists in Richmond, where streetscape work on Broad Street and the construction of downtown parking garages are being funded with TIF. If the taxing district yields a lower amount of parking fees and other revenue than what is necessary to cover the bond payments, the city has promised to pay up to $3 million of the shortfall.

To minimize these risks and make TIF more attractive to investors, local officials may ask for a letter of credit from the developer or keep the proceeds of a TIF in escrow until a project meets certain milestones. More commonly, they wait until economic growth is already occurring in an area before approving the use of TIF, or they recapture revenues from a broadly drawn taxing district that includes nearby businesses.

These latter tactics contradict the idea that TIF should support development that wouldn't have occurred otherwise. In West Virginia, TIF has been used mostly in areas where the population is growing, not in counties that have been losing residents and lacking economic development.

Even when new development occurs as planned, TIF often still represents an opportunity cost to taxpayers. The incremental increases in tax revenue that would have gone to a variety of general purposes instead go toward repaying debt for 20 years or more. Further, that revenue is unavailable to fund services needed by new businesses or residents.

Despite these costs and risks, communities may still be willing to leverage tomorrow's tax revenues in order to influence the pace and nature of development today. "The community can go to the developer and say, 'We can provide a lot of your basic financing at a cheaper rate ... but here's the kind of project we want,'" says Petersen. For developers, that's a difficult offer to refuse. **RF**

TIF Projects In Action

District of Columbia: Mandarin Oriental Hotel, Gallery Place (mixed-use development)
Maryland: Toys-R-Us distribution center in Frederick County; Park Place in Annapolis (mixed-use)
South Carolina: Sewer and road improvements in Hilton Head; Manchester Village in Rock Hill (mixed-use)
Virginia: MacArthur Center in Norfolk (regional mall); Town Center of Virginia Beach (mixed-use)
West Virginia: Extension of sewer lines in growing residential areas in Raleigh County; Square at Falling Run in Morgantown (mixed-use)