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Tax Increment Financing Basics

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Agenda

- Introduction to Tax Increment Financing
  - Background
  - Laws
  - Procedures

- Best Practices
  - Pro-Forma Review
  - Look Back Provisions
  - Risk Mitigation

What is Tax Increment Financing?

- Economic development tool used in Wisconsin and many other states

- Allows cities to capture all ***property tax revenue*** from ***growth*** in defined area and use that revenue to benefit it.

- Key acronyms:
  - TIF = Tax Increment Financing (the tool)
  - TID = Tax Increment District (where the tool is used)

TIF in Wisconsin

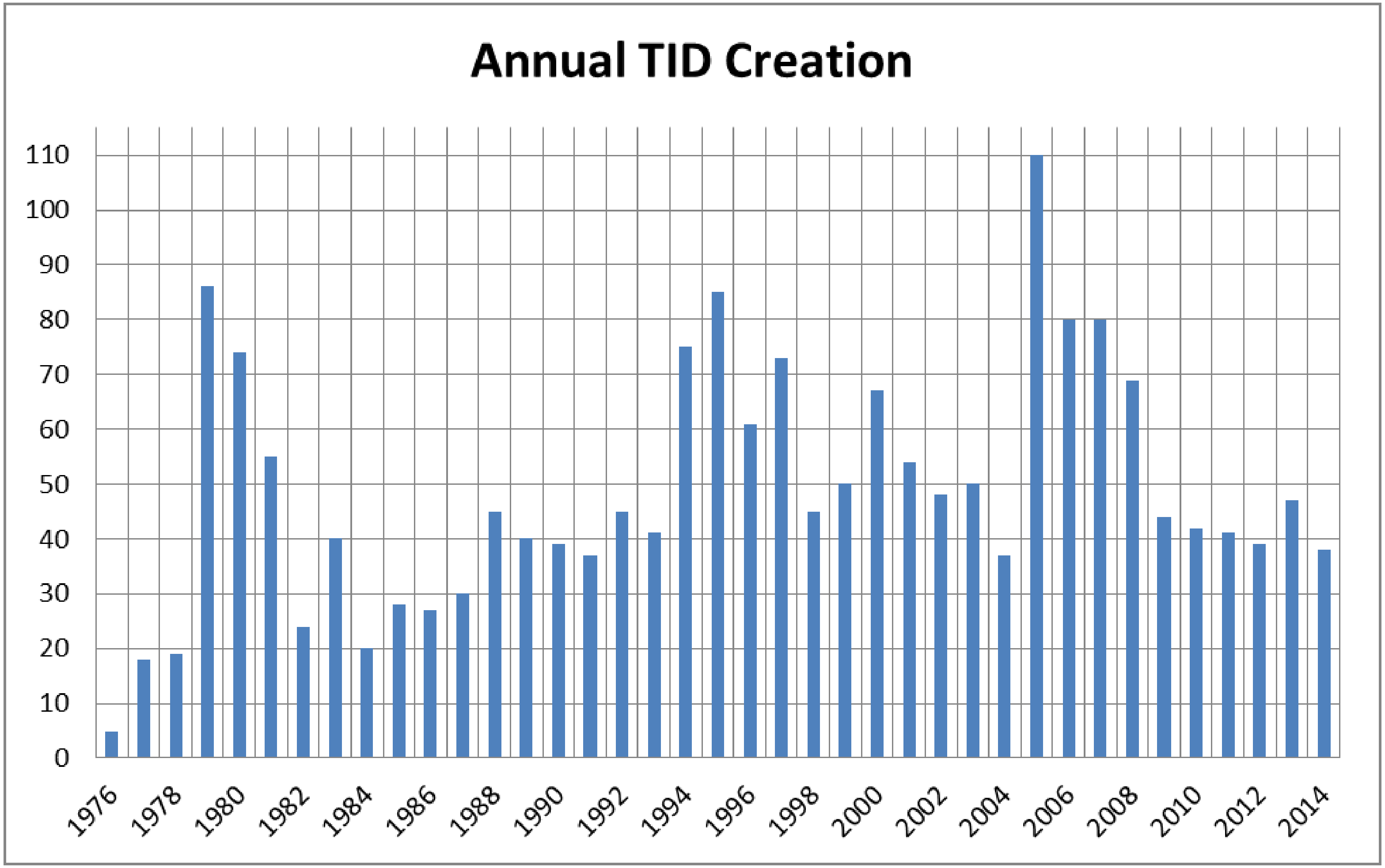
- Since 1976 has been THE most powerful economic development tool available to local government

- Intent:
  - Promote economic development
  - Address lack of incentives and financial resources
  - Promote cooperation between public and private sectors
  - Counteract economic downtown (mid 70's recession)

TID Utilization

- 1,908 districts have been created since 1976.
- 765 districts have been dissolved.
- 1,151 active TIDs currently in existence.
- 426 communities in Wisconsin have used TIF (out of 593 Cities and Villages)

Annual Creations through 2014



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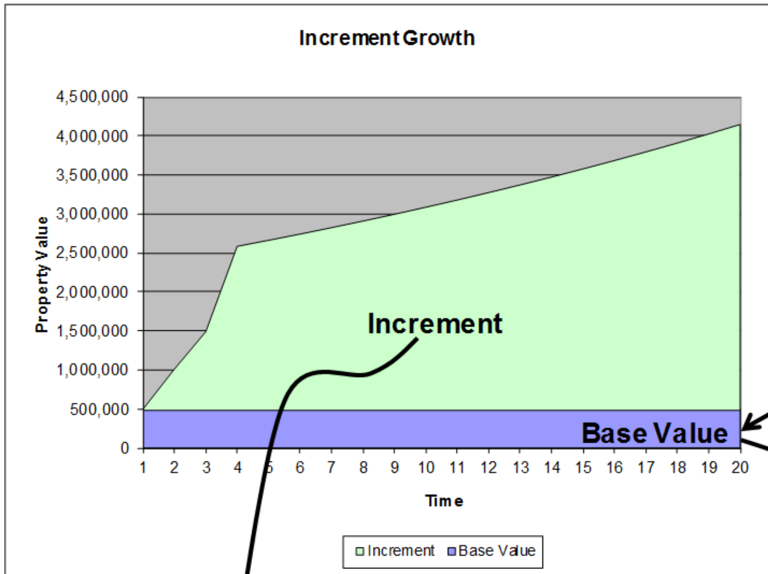
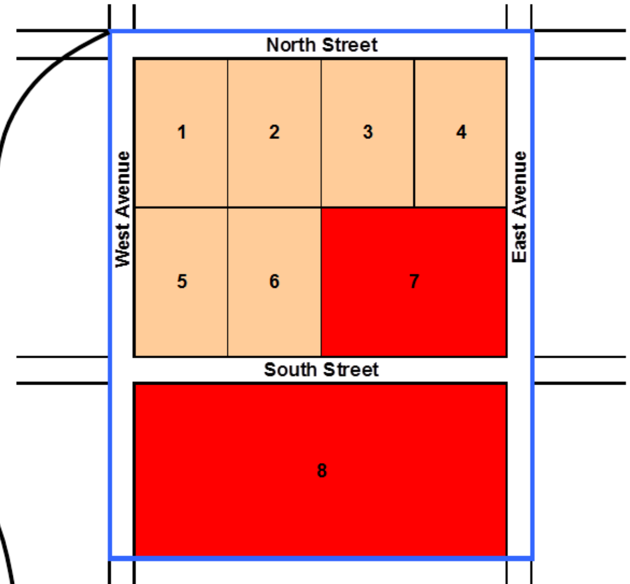
How does TIF work?





	Mill Rate
TID	20.00
Total	20.00

The TID receives taxes on the increment value at the combined rate of all taxing entities

	Mill Rate
Local	6.50
County	4.00
School	7.50
VTAE	2.00
Total	20.00

All taxing jursidictions continue to receive their share of the tax levy on the base value of the TID

TIF Since 2008

- A more conservative approach
  - More thorough vetting of developers
  - Better definition of risks
  - More conservative assumptions
  - Hedging against continued economic deprecation
  - More development project driven
  - Leveraging successful TIDs
  - Greater public investment where warranted

Eligible Project Costs

- Public works & improvements
- Financing costs
- Real property assembly costs (land write-down)
- Professional service costs
- Admin./Organization costs
- Contribution to Community Development Authority or Redevelopment Authority
- Relocation costs
- Organizational costs
- Pro-rated costs of utility infrastructure
- Cash grants (requires developer agreement)
- Environmental remediation
- Projects within ½ mile of district
- **All costs must directly relate to purpose of the TID**

Prohibited Project Costs

- Costs of constructing or expanding administrative, police, fire, community, recreational, library and school buildings
- Costs of constructing or expanding facilities if similar facilities are financed only with utility user fees
- General government expenses unrelated to the TIF district
- Costs associated with newly platted residential development (except in Mixed Use districts with "qualifying residential")

The “But For” Test

- Key underpinning of the TIF program is referred to as the “but for” test

- “But for” the use of TIF, the proposed development would not occur:
  - As proposed
  - Within the same time period
  - With the same level of value
    - Property
    - Jobs
    - Amenities

Best Practices – But For

- “But for” the use of TIF, the development expected in the TID would not occur as proposed
- More fundamentally, is it a good project?
  - What local needs or objectives are met?
  - Consistency with land use and other planning documents
  - Consideration of alternative uses
  - Will governing body and public support?
  - Is the assistance request in line with your risk tolerance?

Financing Projects

- Several options for financing projects with TIF:
  - Issue general obligation or revenue debt which is repaid by TIF revenues.
  - Advances from other funds, repaid from TIF revenues.
  - Developer agrees to up-front costs, repaid from TIF revenues

    (Sometimes referred to as Pay As You Go, PAYGO or Developer financed TID.)

- Each Option has its risks:
  - Municipality obligated in most cases to pay debt service even if TID revenue is not sufficient
  - Advances from other funds may never be repaid
  - Developer capital more expensive than municipality raised capital.

Capital Planning and Financial Monitoring

- Planning/monitoring: Effective ways to mitigate financing risk

- When used proactively and together these can:
  - Better match expenses and debt service to revenues
  - Ensures TID does not undertake projects it is unlikely to be able to pay for

- Cannot fully eliminate risks
  - Economic cycles
  - Changes in state law
  - Performance of businesses within TID

Best Practices – Proforma Review

- We have come a long way on the “But For Analysis”
  - Communities used to rely on:
    - Developer Representations
    - Historic or anecdotal knowledge.
    - Uncle Fred or the Mayor said it wouldn’t happen.
- Many communities are now asking for the numbers
- Is there a financing “gap” or not?
- Developers need to make a Profit
- But there are standards and ranges of return needed to attract capital to a deal
- Standards change with market conditions
- You need to have someone knowledgeable in your corner who can perform a good analysis

Best Practices – Proforma Review

- From Developer's perspective:
  - Developers don't like divulging their financials.
  - Numbers can be kept confidential (to a point) if provided to a private consultant to perform analysis
  - The more sophisticated the developer generally, the more willing to provide an "open book" if a competent review is conducted
  - Analysis can be provided to Council or Board in closed session as part of negotiation process

Best Practices – Proforma Review

- Four types of review:
  - Development comparison to industry standards
  - Profit Cash-on-cost on for-sale projects for housing & commercial
  - Cash-on-cash return on rental projects
  - Internal rate of return on rental projects

Best Practices – Proforma Review

- Do they Need TIF Participation?
- If so, how much is enough?
- Only an independent analysis running your own numbers will allow testing of “tolerance” of the deal to different levels of TID participation
- Begin by using developers numbers
- Tie out to their projections to verify the math
- Then do your own sensitivity by varying inputs

Best Practices – Proforma Review

- So now we have a BEST ESTIMATE of what the profitability will look like – BUT----
- We know no matter how much diligence is done up front, the actual experience will vary
- The best way to manage the ultimate TID participation amount is through a "LOOK BACK" clause in the development agreement
- A look back is simply a provision wherein the developer agrees to provide the ACTUAL sources / uses and cash flow numbers at project stability or upon sale

Best Practices – Proforma Review

- The Look Back identifies an agreed upon maximum level of profitability that the developer is entitled to AFTER WHICH the developer agrees to share the upside with the City up to the amount of TID participation
- Assume the stipulated uncapped IRR up front is 16%. The IRR is run upon sale or agreed date and shows a 17.5% return. Of the additional 1.5 % Developer gets 0.75% for a total of 16.75% and City gets 0.75% --- assuming a 50/50 split was agreed upon
- This helps assure a higher level of integrity to the process up front

Best Practices – Proforma Review

- When do you do a look back?
  - After project stability, upon sale or agreed upon date– typically 5-10 years– could go longer .
- Why would you do a look back?
  - Keeps developers honest.
  - Assures elected officials and citizens that TID is not unduly enriching the developer.
  - Good business—after all, it is supposed to be a “partnership”.
- Share in the “up side”
  - Developer is still incented to do better than projections
  - City will use funds to close TID sooner.

Best Practices – Planning the TID

- Build a cushion
  - Plan to recover all project cost obligations using no more than 70% - 80% of the maximum allowable TID life
  - Structure debt and other project cost obligations to require no more than 80% - 90% of annual projected cash flows (comparable to revenue bond underwriting standards of 1.25 – 1.10 coverage)
- Challenge assumptions
  - Don’t take the developer’s word on project value – do your diligence
  - Don’t use assumed economic appreciation, or other unreliable assumptions, to make a cash flow work

Best Practices – Planning the TID

- Mitigate risk
  - Where possible, provide development incentives on a “pay as you go” basis vs. capital up front
  - Provide protections for public investment in development agreement
  - Require committed projects prior to making expenditures, and phase expenditures
  - Ensure the developer has sufficient skin in the game
  - **Understand the worst case scenario and determine whether the community could manage through it**

Best Practices – Planning the TID

- Some options for developer agreements to protect against cash flow shortfalls
  - Valuation benchmarks tied to receipt of incentives
  - Value guarantees
  - Shortfall guarantee
  - Direct debt repayment guarantee
  - Deferred special assessments (a.k.a. “springing” specials)
- Depending on specific language, guarantees may cause financing to become taxable – consult your bond attorney

Best Practices – Planning the TID

- Some enforcement options for developer agreements
  - Irrevocable letter of credit
  - Performance bonds
  - Mortgage lien (on project or other property)
  - Assignment of securities or other collateral
  - Restrictions on assignment of developer agreement
  - Withholding of permits or other approvals
  - Personal guarantee

Summary and Conclusion

- TIF is STILL the most important tool available to help stimulate growth.
- This tool has a lot of features, options and potential risks to consider.
- Do your own due diligence and require good data from your developers and advisors to quantify those risks.
- Recognize that everything changes, including TIF law.
- Plan ahead to position yourself to take advantage of growth opportunities in your community.

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