Breaking Ground
COMMERCIAL REAL ESTATE TRENDS

TIF is not a Four Letter Word

A Brief Summary of how the program works

So much has been said about incentive programs in recent years that there is a tremendous amount of misinformation about specific programs, how they works and how they effect local tax bodies. This article is intended to provide a brief outline of one of the more prevalent and controversial programs. Tax Increment Financing or “TIF” for short is a method for municipalities to either finance public improvements for the betterment of the community or for use as an incentive to encourage developers to invest in markets.

Here is how it works; a specific geographic TIF District is set up by a municipality in which the incremental real estate taxes (those taxes above the base taxes imposed on the unimproved parcel), are not distributed to the individual taxing bodies, rather, they are distributed directly to the TIF Fund which can then use these incremental funds within their reasonable discretion. The taxing bodies don’t “lose” any of what they were getting, they just don’t receive the tax increment for a designated period of time (the Redevelopment Period). At the expiration of the TIF, the taxing bodies then receive the windfall of taxes that were directed to new development projects during the Redevelopment Period.

In cases where a private development is the direct beneficiary of a TIF incentive, a “Redevelopment Agreement” outlines the specific structure of the arrangement between the developer and the municipality. Typically a municipality may rebate a percentage of the incremental real estate tax to the developer for a period of years. If the taxes on the property were $100 before the development, and after the property is improved by the developer the taxes raise to $300, then $200 is the increment and is the basis for a TIF Agreement. Using these fictitious numbers as an example, a typical TIF arrangement with one local municipality would allow for the developer to receive an annual rebate of $140, or 70% of the increment for a period of 7 years. During the Redevelopment Period, the municipality and specific taxing bodies would still receive the base $100 tax. At the expiration of the Redevelopment Agreement, in year 8, the municipality and specific taxing bodies would receive the entire $300. Stringent legal guidelines require the developer to allocate the incentive directly into the subject project, and not just “line his pockets”, as some objectors have suggested. Certainly there are some abuses of the system. But by and large the system has been a tremendous growth impetus in many markets.

In theory, by giving up a little - for a period of time - of something they might not get anyway, a municipality and its taxing bodies will receive much more later. Unfortunately, there are some inherent problems with the programs. TIF’s were intended to provide the impetus for development in areas that are “blighted”. In practice however, it is common for the term blight to be used somewhat liberally for purposes of creating a TIF District. This has been caused by the competition between markets within a larger trade area. For instance, many Chicago Suburban areas have created TIF Districts that encompass some of the more elegant retail trade areas within the marketplace, certainly an arguable definition of blight.

What this means, however, is that markets that must compete for real estate development have to use every tool available to them in order to attract retail, commerce and industry. This has created a “necessary evil”’ in many cases. It may be best if all incentive programs were immediately sunsetted, but as long as more mature and thriving markets are using these powerful tools, each community must use everything they can in order to gain a competitive edge.

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