



Using Tax Increment Financing in Tennessee

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Background and History of TIFs

Initially Tax Increment Financing (TIF) was pioneered in the State of California in 1952 as a way to find local matching funds for federal dollars available under the Federal government's urban renewal program. The creation of a TIF district allowed the use of property taxes from new development to pay for rehabilitation of blighted areas. As federal funding for redevelopment began to evaporate in the late 1970's and early 1980's more and more states began to find new uses of Tax Increment Financing. Enabling legislation in several states expanded the use of TIF to include economic development, training, recreation, and other areas.

Tennessee's statutes initially allowed new property taxes created within TIF districts by new development to be used to support blighted and deteriorated areas. These statutes were then expanded to allow the use of TIF districts for industrial development, recreation, convention centers and tourism. With this expansion the State authorized the use of sales tax revenues for TIF projects for convention centers and tourism, establishing a base sales tax level and dedicating the increment or increase in sales tax revenues to retire debt issued to finance the facilities.¹ A sports authority may also use ticket sales, concessions, and other income for debt retirement, even though these revenue streams are not technically referred to as TIF revenues.²

What Types of Projects are Appropriate for a TIF?

There are a number of creative projects that may be supported by TIFs, and to a large extent the answer depends on the most appropriate solution to a problem in an area or district. The easiest answer lies in the fundamental philosophy for creating and using TIFs. There are always exceptions, but generally a TIF district funds public improvements within the public right of way to help attract new development (or redevelopment) and to generate new revenues that in turn are captured to pay for the improvements. A property tax TIF should encourage or support private development that will generate new or higher property taxes. A sales tax TIF, on the other hand, should attract or support private retail development to help generate higher sales taxes.

If the goal is to redevelop a district, then a streetscaping project may be appropriate – by dressing up an area the district attracts higher commercial or residential development that will generate taxes that are captured to pay for the improvements. Street improvements may attract or support a hotel, retail district or other new development or redevelopment, as will parking facilities (leased or publicly owned), utilities, undergrounding of overhead

¹ Rose Naccarato, Tax Increment Financing Opportunities and Concerns (TACIR Research Brief, March 2007)

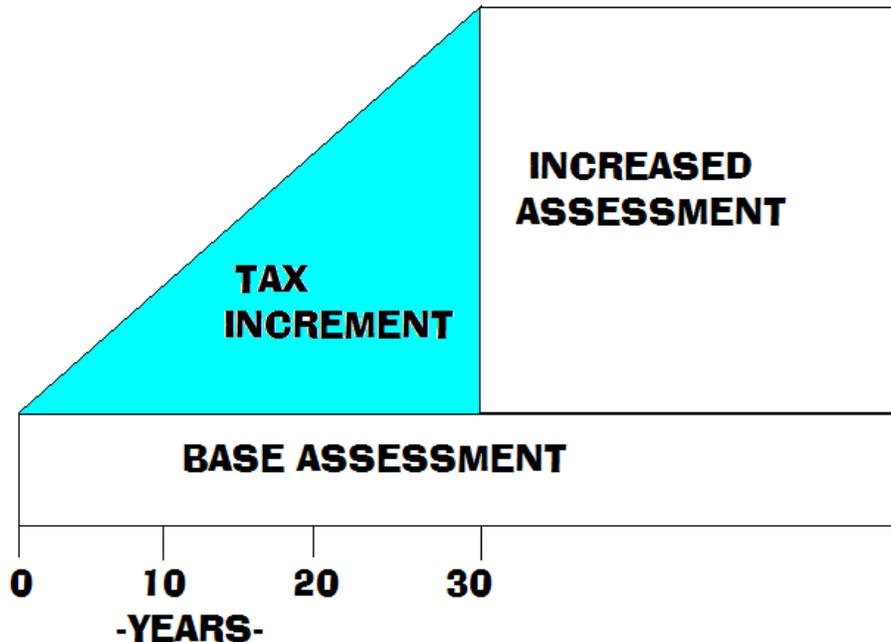
² Ibid

utilities, stormwater improvements, and a large number of other improvements in the public right of way. In an office or industrial park TIF, revenues can pay for planning and development of the park, parking, utility extensions, landscaping and speculative buildings.

How TIF Works

Every taxable property, with or without improvements, has an assessed value. That assessed value is the basis for determining the property taxes on the property. For the purposes of this example let's say that the property has an assessed value of \$40,000 and the city tax rate that is applied to all city property is \$2 per \$100 in value. The city tax on this property would therefore be \$800. In this instance the property owner decides to improve the property, and based on the value of these improvements the assessed value increases to \$400,000. Using the same tax rate, the increased tax amount would now be \$8,000. The additional tax revenues created with these improvements amount to \$7,200. Under the TIF concept this increased tax amount, or increment, is set aside in a special account to be used to pay debt service and other expenses in improving property, and we say that TIF revenues are paying for the project cost.

The illustration below can be used to show how the use of TIF can benefit a city and county. In a very real sense this is a truly transparent issue for the local government, as the revenues that accrue to the city or county do not decrease or change with the creation of a TIF district. The city and county continue to receive taxes based on the property's base assessment or value throughout the project repayment period. The development agency (housing authority or industrial board) captures or receives the extra increment in revenues and applies these new revenues to pay for the debt incurred to develop the improvements, or other project expenses. In a very real sense the revenues generated from the improvements pay for the improvements that make the project possible, and through the use of a TIF district the extra taxes generated by growth pay for the expenses that were required to make that growth possible. At the end of 30 years, or the bond repayment period, both the city and county receive higher taxes generated from the properties within the TIF, with the expectation of a higher value than may have been otherwise available without the TIF project. .



It is important to note that upon improvement of the property, in the above example, there will be two streams of property tax revenue. The first stream is referred to as base revenue from the base assessment. The base assessment is the assessment immediately preceding adoption of the resolution setting up the TIF. The base assessment, or value, in this example would be \$40,000. Property taxes from the base assessment would continue to be collected by the city and/or county and would not be affected by TIF. The second stream of revenue, which we will call the increment, would be placed in a special account and used to pay the development costs of the project. The effect of this process will be the new taxes generated from the improvements, without an increase in the tax rate, is used to fund development, and the city and/or county starts to receive the higher revenues only after the bonds are retired. At that time all future property tax revenue goes to the taxing jurisdictions.

When should Tax Increment Financing be used?

- When a particular development or redevelopment is important to the community, and
- It meets the But-For test – private development or redevelopment would not happen but for the public investment and the encouragement of the Redevelopment Agency.

What are the Advantages of the Use of TIFs?

- No grant applications to compete for federal and/or state funds;

- Additional revenues are available to encourage rehabilitation and improvement of residential, commercial, recreation, and industrial properties without having to increase the property tax rate;
- An increase to the tax base for a city and county;
- Use of TIF revenue is not subject to referendum;
- Ease of selling bonds, because they are backed by the full faith and credit of the city government;
- Bonds are easy to sell, because they are tax free;
- A TIF can be used as an automatic development fund;
- TIF can provide large amounts of capital for up-front capital investment; and
- Despite all of the arguments, pro and con, TIF works in the smallest to largest cities. In Chicago there are as many as 130 TIF projects going at any given time. It works without directions, restrictions, and endless regulations, competitive applications and limited funding from Washington or the state.

There Are Pitfalls and Obvious Disadvantages with the Use of TIF:

- There is an element of public risk – if revenues do not develop as projected, local taxpayers are still required to retire the debt. Cities can find themselves in a situation where a project does not generate the level of incremental revenues that were originally projected, with the result being that cities borrowed money for bond issues, and the TIF District fails to produce sufficient property tax revenues to pay the bonded indebtedness. In these cases when general fund revenues have to be used to supplement the TIF District revenues, city budgets may face shortfalls in paying for other services.
- TIFs and TIF condemnations can be controversial. Unless the local government restricts the use of condemnation, property acquisition in TIF developments may require condemnation of property in order to gain public ownership of the property. In some cases, this process can become controversial, especially if the property is then turned over to private developers as part of a larger development project.³ If a TIF is used where unnecessary to develop property, tax revenue for schools and other purposes may be frozen at the current level, and a TIF based on property tax revenues will not work where property taxes are very low or non-existent,

³ Rose Naccarato, Tax Increment Financing, Opportunities and Concerns; TACIR March 2007

Every TIF Process Should Address the Problems and Controversies Before the TIF is Established – the 5 Major Rules:

1. Clearly define the projects to be financed, with a scope of the project and maximum funding amount. If the projects need more funding or to be expanded, the public parties involved in the project need to be appraised and have an opportunity for approval or comment.
2. Clearly define and adopt a map of the properties to be covered under the TIF,
3. Clearly define the length of time before the TIF expires, and keep the time as short as possible.
4. Develop a process for changes to the above – do the public agencies involved have veto over changes, or just comment? Answering this process issue up front can resolve or allay many of the concerns.
5. Require a development agreement of the private developer, and decide if the private sponsors or contractors should provide performance bonds or insurance to limit the public risk – there is a cost as this will be built into the project, but the public risks can be high in the initial stages of the project.

Ideally, the developer is committed with a development agreement or contract requiring that he undertake certain objectives and commit to spend a fixed amount of money. There are still risks. What if, for example, the project burns as soon as it is constructed, or if the developer goes bankrupt when only the pilings are set? Is the community willing to live with an eyesore funded with public dollars? Insurance or performance bonds may mitigate such losses, but the key is to have this spelled out in the development agreement, and to have the ability for the public agency to take control over the project or select another developer and move to completion. All projects have such risks, and there is as much of a chance for a TIF project to fail as there is a chance for it to succeed.

Using TIF to Redevelop Blighted Areas and Support Economic Development in Tennessee.

1. **Redevelopment**. Tennessee Code Annotated **13-20-201** et. seq.; defines blighted areas, assigns **the public housing authority** with the power to develop blighted areas, and specifies the requirements of a redevelopment plan. Housing Authorities have significant latitude under the state statutes to utilize Tax Increment Financing. Authorities in Tennessee can acquire property for redevelopment when:
 - Those areas have been deemed blighted areas
 - In order to remove, prevent or reduce blight, blighting factors, or the causes of blight;

- If the condition of the title, diverse ownership, layout or other conditions exist such that acquiring the property presents the only path to redevelopment;
- The Authority can then sell or lease the land acquired for redevelopment, and
- Authorize TIF.

Procedural steps for using TIF for re-development include:

- The Authority must prepare an Redevelopment Plan;
- The plan area must include an estimate of the cost of the redevelopment;
- The plan must include an estimate of the impact of the tax increment provisions upon all taxing agencies in the redevelopment area;
- A public hearing is required; and
- The plan must be approved by both city and county to capture both increments.

Requirements of the redevelopment plan include:

- Indicate the plan's relationship to definite local objectives as to appropriate land uses and improved traffic, public transportation, public utilities, recreational and community facilities and other improvements.
- Indicate proposed land uses and building requirements in the area;
- Indicate method of temporary relocation of persons living in the area.
- Identify the sources of revenue to finance the costs of the project, including the estimated tax increment;
- Include an estimate of the amount and the final maturity of bonded, or other indebtedness, to be incurred;
- Include an estimate of the impact of the tax increment financing provision upon all taxing agencies in which the redevelopment project is to be located;
- Make available the foregoing information to the public not less than five (5) days prior to the date set for the public hearing required by law;
- No redevelopment plan adding a tax increment financing provision shall be effective unless and until it has been approved by the governing body of the city and the governing body of the county affected, following a public hearing as provided in TCA 13-30-203.

- Notice of the hearing must be published once a week for three (3) consecutive weeks immediately preceding the public hearing. The hearing is conducted by the governing body (or agency empowered by law so to act) to determine the necessity for the adoption of the plan.

MTAS recommends that cities employ competent planning consultants and legal counsel to assist with implementing any TIF District. Legal assistance will be required in reviewing the redevelopment plan, structuring the legal documents between the city and the developer, preparing bond documents, and enacting a resolution authorizing TIF.

2. Industrial Development.

Procedural steps for using TIF for industrial development include:

- The Industrial Development Board must prepare an Economic Impact Plan;
- The plan area must include a project with which the IDB will assist;
- The plan may include other affected areas;
- A public hearing is required; and
- The plan must be approved by both city and county to capture both increments.⁴

Support and engagement of both the city and county is critically important to the success of a TIF-funded project, and cities should attempt to get county support as soon as a potential project is conceived. To be successful a TIF requires the participation of the City and the County. Both ultimately benefit from the higher taxes and positive aspects of new development and without the involvement of both the revenues for the TIF district are lower and are no different from a direct appropriation or expense of the city or county.

Economic Impact Plan:

TCA 7-53-312 provides State requirements for an economic impact plan. The plan must identify the area included in the plan (must be in the city) and must also include an industrial park. It must also address other properties that will be directly improved or benefited. The plan shall:

- Identify boundaries of the area subject to the plan;
- Identify the industrial park;
- Discuss expected benefits from development of the area, including anticipated tax receipts and jobs created;

⁴ IDB Report: Frequently Asked Questions (rev. 2007); Tennessee State Board of Equalization, Tennessee Comptroller of the Treasury

- Provide that property taxes imposed, including personal property, will be distributed for the period of time specified in the plan.
- Upon approval of the city of an economic impact plan, all property taxes shall be allocated in accordance with TIF.
- Financing is limited to 30 years;
- The city may approve the economic impact plan by resolution, without respect to any private act charter requirement that might require otherwise. The county must approve a similar resolution for county taxes to be diverted.
- Before the resolution is adopted, a public hearing is required, with two (2) week notice, prior to the hearing, including the time, place, purpose, and notice of how a map of the area may be obtained.
- TIF proceeds may be used for: (1) promoting economic development; (2) paying the cost of projects; and (3) debt service.
- The City Recorder shall transmit to the tax assessor a copy of the description of the property subject to the economic impact plan and a copy of the resolution authorizing that plan.

What if a County does not approve of a Redevelopment Plan or an Economic Impact Plan?

A county may opt out of the use of County funds for a TIF district by disapproving either plan, and if the County does so only municipal taxes may be used for the TIF.

Sales Tax TIF's in Tennessee:

- Municipal Sports Authorities
- Tourist Development Zones

Municipal Sports Authorities:

TCA 67-6-103 allows for certain sales tax benefits for those municipalities that have built sports stadiums/facilities for a major league sports team or a minor league baseball team that is affiliated with a major league team and is a Class AA level or higher team.⁵

Tourism Development Zones:

Under **TCA 7-88-106**, the State allows cities with an approved “tourist development zone” that has built a tourism-related facility, to receive new sales tax revenues from within that zone. A city is allowed to receive benefits from only one (1) tourist development zone.

⁵ Rose Naccarato, Tax Increment Financing, Opportunities and Concerns; TACIR March 2007

Alternatives to using TIF in Tennessee:

- **PILOT funds – (Payments in Lieu of Taxes)** The property of governmental entities is not subject to taxation, and many communities have negotiated a payment in lieu of taxes as a means to recover revenues for services otherwise funded by property taxes. The property is not on the tax rolls because it belongs to an exempt entity, even if it is being leased to and used by a private company or individual. Private lessees of public property may be required or agree to make a PILOT, or even to pay actual taxes, for some or all of the years of the lease. The amounts and terms of these payments are negotiated by the parties.⁶
- **Direct Appropriation –** affordability is always an issue, but in most instances a city or county may also elect to fund or appropriate public dollars to support development and redevelopment. Restrictions on the use of public funding do apply, however, particularly with the transfer of public funds to improvements on private property,

⁶ Property Tax Abatements and Payments in Lieu of Taxes: Impact on Public Education; Ed Young, TACIR February 2004

Case Studies of TIF Districts in Tennessee

1. Jackson, Tennessee

Jackson created a tax increment financing district to allow the Redevelopment Agency to purchase and rehabilitate property now owned by Lambuth University. The property includes 33 residential units and is valued at more than \$1.2 million. Many of the units are deteriorating and contributing to the general decline of property values in the area. The goal with the creation of the TIF is to allow the Redevelopment Agency to rehabilitate these units and to both improve the area and to generate higher property taxes with the conversion of these to single-family home ownership.

The biggest challenge facing the Agency will be repaying contributions received from the City of Jackson in the amount of \$1.3 million dollars, but based on projections repayment from TIF revenues should be adequate. Other challenges facing the Agency will be the volatility of the economy, fluctuating property values, the downturn in residential sales, and increasing blight within the area.

2. Hendersonville, Tennessee

Hendersonville is a fast growing area noted for a high quality of life. City planners and elected officials have been concerned with how they might better manage the ongoing and future growth of the county. One technique they've drawn on recently as a part of their smart growth management plan is tax increment financing.

The city has used tax increment financing to fund a major development project related to the streets of Indian Lake. Two roadway projects and associated utility improvements underway in Hendersonville are being funded through the creation of a TIF with the developer of Indian Lake Village. This project includes the development of Saundersville Road and Wessington Road. Saundersville Road is to be extended and realigned from Indian Lake Boulevard to the current location of Saundersville Road near the interchange with State Route 386. A Wessington Road connector (including a bridge over Drakes Creek) will be extended west from Indian Lake Boulevard to Wessington Road near Whitten Elementary School.

The City sold bonds backed by the tax increment district revenues to help fund the Project. The Development District consists of approximately 40 acres located within the City limits near the intersection of Indian Lake Boulevard and Vietnam Veterans Parkway. Based on the pre-issue appraisal report, the appraised "as is" value of the property is \$26,000,000. The projected values upon completion of the development phase have been projected to be 187,000,000.

Bibliography

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