Tax increment financing

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Deputy Prime Minister Nick Clegg announced on 20 September 2010 that the Coalition Government would allow local authorities to use tax increment financing (TIF) in order to finance infrastructure projects. TIF has been used in the United States for approximately forty years and has generally been seen as a success. Nonetheless, differences in the tax systems mean that there will be differences between TIF in the UK and TIF in the US. The Labour Government had previously announced that it would introduce accelerated development zones in order to enable the development of TIFs, and a number of organisations including the Core Cities Group and the British Property Federation have welcomed the move.

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1 Background

Speaking at the Liberal Democrat conference on 20 September 2010, Nick Clegg, Deputy Prime Minister, announced that the government would introduce tax increment financing (TIF). The press release accompanying the announcement says:

> These new borrowing powers, known as Tax Increment Financing (TIF), will allow Local Authorities to borrow against predicted growth in their locally raised business rates. They can use that borrowing to fund key infrastructure and other capital projects, which will support locally driven economic development and growth.
>
> TIF will operate within a carefully designed framework of rules, which the Government will work closely with Local Authorities to design. More information on how TIF will operate will be set out alongside the Spending Review.[1]

The Department for Communities and Local Government announced the timetable for implementation, most recently in the November update of the Department's structural reform plan:

> Develop and introduce proposals to implement local retention of business rates and Tax Increment Financing and any further changes agreed in the local government resource review, working with HM Treasury (end Apr 2012).[2]

TIF works by allowing local authorities to borrow money for infrastructure projects against the anticipated increase in business rates income expected as a result of the said infrastructure project. The Core Cities Group (CCG), which has been campaigning for TIFs for some time, has published a 'Rough Guide' to TIFs in conjunction with the British Property Federation. This notes:

> The UK TIF model is based on reinvesting a proportion of future business rates from an area back into infrastructure and related development. It applies where the sources of funding available for a scheme to deliver economic growth and renewal cannot cover the cost of infrastructure required by the scheme. Often this will be a regeneration project, and although UK TIF could be used more widely, it will not be suitable for all schemes. A lead agency – a local authority, private sector partner or some combination – raises money upfront to pay for infrastructure, on the basis that the increased business rate revenues generated by the scheme can be used to repay that initial investment. The upfront funding may be borrowed from public or private sources, or it may be provided by the developer from capital available to it.
>
> The Treasury may enjoy the wider fiscal benefits of the scheme – higher stamp duty revenues resulting from rising property values, higher income and corporate tax revenues due to more economic activity, and lower health, security and benefits costs as the community enjoys the social benefits of regeneration. The full increased revenue from business rates in the designated area will also be available to the Treasury after the funding cost for the infrastructure has been paid off. It's a neat solution where the risks can be clearly allocated to the lead agency or the private sector partner and controlled.[3]

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1. *More financial freedom for local authorities*, HM Treasury press release, 20 September 2010
2. *Department for Communities and Local Government Structural Reform Plan Monthly Implementation Update*, November 2010
3. *A Rough Guide to Tax Increment Financing*, by the Core Cities Group and the British Property Federation, 2010

The CCG has also published more detailed research on the concept in a report in 2008 in conjunction with Price WaterhouseCoopers. This said:

> TIF is a financing tool designed to forward fund key infrastructure improvements, and works by deploying the projected future tax gains of those improvements to finance the infrastructure itself. For example, when a public project such as a road, school, or hazardous waste cleanup is carried out, there is an increase in the value of surrounding real estate, and often new and additional investment in the area. This increased site value and investment creates more taxable property, which in turn increases potential tax revenues.
>
> These increased tax revenues are the 'tax increment'. Tax Increment Financing dedicates this increased revenue to finance debt issued to pay for the initial infrastructure development. Typically, TIF is designed to channel funding toward improvements in distressed or underdeveloped areas where development could not otherwise occur. In other words, TIF creates funding for public projects that may otherwise be unaffordable to localities.[4]

The report called for TIFs to be introduced in the UK, but in a modified form known as Accelerated Development Zones (ADZ), which would work within the following key principles:

> It is designed to allow cities to 'participate in the growth dividend' – or, in other words, allow local authorities to capture incremental value in the form of tax revenue generated from new development. In order to do this, cities require the power to retain long-term local tax revenues generated from development, such as business rates, allowing funds to be raised for investments through securitisation of those revenues... ADZs would be defined physical areas, consisting of either a single or multiple administrative areas linked by a common infrastructure requirement.
>
> Within ADZs, local authorities could retain new business rates that are supplementary to the existing revenues for the area, and securitise that income to raise funding for upfront infrastructure investment.
>
> Business rate growth would be captured and reinvested for a maximum of, for instance, 20 years or more or until finance raised to invest in upfront enabling infrastructure is repaid.[5]

The reason for using the ADZ model rather than directly lifting the TIF concept from the United States was because of differences in the tax regimes between the two countries,

According to the report, the benefits of introducing these measures include:

> ADZs would allow cities to 'participate in the growth dividend' (ie. allow local authorities to capture incremental value in the form of tax revenues generated from new development). In order to do this, cities require the power to retain, for a long-term period, local tax revenues.

The All Party Urban Development Group has also taken an interest in the introduction of ADZ style-TIFs in the UK. Its report, *Regeneration and recession: unlocking the money*, built on the Core Cities/PwC report and said that:

> The UK model would involve one or more local authorities having the freedom to retain business rates over and above the existing receipts of the area caused by new

[4] *Unlocking City Growth: Interim Findings on New Funding Mechanisms*, A report by the Core Cities Group and PricewaterhouseCoopers, 2008, pp26

[5] Ibid, pp5-6

> development. These rates would be securitised to pay for upfront infrastructure, with the debts repaid over a period of 20 plus years. According to PwC, the use of ADZs could generate a much larger source of revenue to support local infrastructure investment, and would help to fill the infrastructure funding gap left by other sources of finance.

The Labour Government had previously announced its intention to examine whether to introduce TIF in the pre-budget report of December 2009. The report said:

> 4.35 Local government and city regions...have a vital role in driving economic outcomes, including through delivering the investment in infrastructure and housing needed for growth…The Government is also interested in exploring, subject to the overall fiscal position, what further finance mechanisms, powers and flexibilities could support local authorities to drive growth and innovation most effectively.
>
> 4.36 In light of this, the Government will continue to examine the framework that would be needed to implement Tax Increment Financing and consider the primary legislation that would be needed if schemes were to be introduced.[6]

The Labour Government then announced in the March 2010 budget that:

> The Government will support investment in infrastructure in our cities and other centres of growth through an Accelerated Development Zone (ADZ) pilot programme. The pilot schemes will be introduced in locations across England in 2011-12. Combined authorities, as they are agreed, and selected local authorities, will receive capital grant funding to a total of £120 million to help support projects that deliver key infrastructure and commercial development to unlock growth. The Government will assess the impact of the investment on business rates growth within the defined ADZ area to further understand the case for introducing Tax Increment Financing.[7]

Following the election, the Coalition Government confirmed its commitment to the introduction of TIF both in Nick Clegg's statement and in the *Local growth: realising every place's potential*[8] white paper. The Paper also gave an indication of how the system could be developed:

> 3.39 We will introduce new borrowing powers to enable authorities to carry out Tax Increment Financing (TIF). This will require legislation. In determining the affordability of borrowing for capital purposes, local authorities take account of their current income streams and forecast future income. Currently, this does not factor in the full benefit of growth in local business rates income. TIF will enable them to borrow against future additional uplift within their business rates base. Councils can use that borrowing to fund key infrastructure and other capital projects, which will further support locally driven economic development and growth. They will need to manage the costs and risk of this borrowing alongside wider borrowing under the prudential code.
>
> 3.40 Depending on responses to the proposals outlined above, in particular the retention of locally raised business rates, we anticipate that TIF would, at least initially, be introduced through a bid-based process. Lessons from a set of initial projects will inform future use of the power. This will help minimise the risks to both local and central government associated with the introduction of TIF, with Government and local

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6 *Securing the recovery: growth and opportunity*, Pre-Budget Report, Cm 7747, HM Treasury, December 2009, p66

7 *Budget 2010, Securing the recovery: Economic and Fiscal Strategy Report and Financial Statement and Budget Report*, HC 451, 2009-10, HM Treasury, March 2010, p62

8 CM 7961, HM Government, October 2010

authorities working together to understand the risks involved and develop a shared approach to implementation.

2 Implementation

Several recent parliamentary questions have confirmed the Government's intention to introduce TIF:

> 13 December 2010
>
> **Alison Seabeck**: To ask the Secretary of State for Communities and Local Government whether he plans to pilot tax increment financing measures in 2011-12.
>
> **Robert Neill**: The Government have confirmed that they will legislate to introduce powers to allow tax increment financing and we will move as quickly as possible to do so. We are considering how to deliver tax increment financing in the context of our wider proposals on business rates retention. The Local Government Resource Review will look at both issues in the round and develop proposals by July 2011.[9]
>
> 14 December 2010
>
> **Mr Watts**: To ask the Secretary of State for Communities and Local Government who will conduct his Department's review of the local government grants system.
>
> **Robert Neill**: The local government resource review will consider proposals to introduce greater incentives for local authorities to promote economic growth by allowing them to retain locally raised business rates, and introduce new powers to enable local authorities to carry out tax increment financing. The review will be carried out by my Department.[10]
>
> 31 January 2011
>
> **Mr Sanders**: To ask the Secretary of State for Transport what discussions he has had with the Secretary of State for Communities and Local Government on the possibility of using tax increment financing to fund regional transport infrastructure projects. [35061]
>
> **Norman Baker**: This is a matter for the Treasury. The Local Government Resource Review is assessing the implications of using tax increment financing and developing options for taking it forward through legislation.[11]

A DCLG paper, *Regeneration to enable growth: What Government is doing in support of community-led regeneration*, said:

> To maximise the impact of incentives we are removing the barriers that thwart local ambition and limit agencies' room for manoeuvre. We will sweep away outdated planning rules imposed by Whitehall, and introduce powers to allow authorities to implement tax increment financing, thereby enabling them to fund key infrastructure and capital projects by borrowing against future income from business growth.[12]

The DCLG's *Structural Reform Plan Monthly Implementation Update, February 2011*, indicated that implementation was dependent on the local government resource review.[13]

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9 HC Deb 13 December 2010 c484w
10 HC Deb 14 December 2010 c679-80W
11 HC Deb 31 January 2011 c547W
12 DCLG, January 2011
13 See Library Standard Note SN/PC/6030, *The local government resource review*, July 2011

1.1(v)	Develop and introduce proposals to implement local retention of business rates and Tax Increment Financing and any further changes agreed in the local government resource review, working with HM Treasury (end Apr 2012)	Work ongoing

The DCLG published a consultation paper, *Local government resource review: proposals for business rates retention*, on 18 July 2011, which included information on the plans for TIF.. The *Plain English guide* to the proposals notes that TIF:

> will allow councils to pay for future infrastructure developments by allowing them to borrow against projected rate growth. Councils are not currently permitted to retain their rates so cannot borrow against them. Rate retention would remove this barrier. The consultation sets out two options. An open structure that lets councils invest and take on the risks alone or one with stronger Government controls that guarantees revenue and disregards the levy or reset processes.[14]

The consultation runs until 24 October 2011.

TIF has not been introduced in Wales although there have been calls from the Welsh Liberal Democrats to do so. In a debate on 15 June 2011 the Welsh Minister for Business, Enterprise, Technology and Science, Edwina Hart, commented "On tax increment finance, let me make it clear that any increase in local government's capacity for prudent long-term capital investment is to be welcomed, but we need to understand the detail."[15]

3 Issues and reaction

TIFs if successful can lead to increased regeneration and long term benefits. However, there are a number of issues that need to be considered when establishing TIFs. The Rough Guide to TIFs lists a number of Frequently Asked Questions, which include:

> *Isn't this just more borrowing?*...UK TIF is about identifying schemes which are low risk but would deliver important benefits in terms of jobs, economic growth and physical and social regeneration if they could be funded. It is not borrowing in the unsure hope that money will be found at a later date, but investment with clear returns to support it...
>
> *Won't schemes just displace existing business from nearby areas?* There may be some displacement in some schemes and this can be factored in to calculating the additional revenues, and what will be payable as a TIF. It's something to be thought about carefully in each scheme, but business needs opportunities to grow and thrive, and it's better it moves a short distance than leaves the area altogether because its needs can't be met. But schemes will need to show some new business growth and will only be allowed to access incremental business rates which are truly additional.
>
> *How can you be sure the rates are additional?* There will need to be a pragmatic agreement on an overall formula that is negotiated for schemes. This will not be an entirely scientific exercise, as modelling financial outcomes in alternative scenarios inevitably involves assumptions and some guesswork. However, it is not impossible to do and there are precedents that can help. The lead agency will be asked to take the risk on this, which in most cases will be relatively small.[16]

[14] DCLG, *Local Government Resource Review: Proposals for Business Rates Retention, A Plain English Guide*, July 2011
[15] National Assembly for Wales Record of proceedings 15 June 2011
[16] Ibid

Chris Murray of the CCG has been quoted in the *Local Government Chronicle* as saying "TIF should not be regarded as unusually risky and ministers should resist political pressure to impose restrictive limits on the scheme, such as a cap on the amount councils can borrow, which would only deaden its impact" and that the Treasury should put in place a "sensible process that works for everyone...It's cities and businesses taking on the risk – they assess that risk and borrow what they are certain can be paid back. This is not borrowing to prop up failure but borrowing for investment and is the same kind of borrowing.[17]

Boris Johnson, Mayor of London, is also in favour of the scheme.

> The GLA and London Councils would like to explore further with government the potential for tax increment financing to fund specific projects. This would enable boroughs to boost economic development by investing upfront in enabling infrastructure. The freedom and responsibility to generate and manage local revenue streams will provide a significant incentive to investment, leveraging private sector funding. TIF would be a timely and proportionate response to the impact of the recession. The pay back would be substantial. Introducing TIF would ensure that London can lead the way out of recession by generating and sharing in the "growth dividend". TIF is also an important practical response to the localism agenda.[18]

Nonetheless, there are perceived problems with TIFs that will need to be addressed with any system introduced into the UK. Tony Travers of the London School of Economics has been quoted in the *Guardian* as saying:

> It's difficult to capture the tax yield because in Britain at present all the tax yield goes to the Treasury, except for the Council Tax. There would have to be a way of the Treasury allowing the public authority to capture at least part of the tax yield.[19]

Writing in the *Evening Standard*, Business reporter Russell Lynch raised a number of doubts about the scheme:

> . What if the expected increment fails to emerge? Best-laid plans can come unstuck — witness National Express handing back the East Coast Main Line to the government after revenues collapsed in the downturn. But the council will still have to service the extra debt, at a time when the LGA forecasts that authorities may face a £20 billion funding gap by 2014-15.
>
> If central government does not stand behind TIF schemes with some kind of guarantee, then the debt financing could be pricey. According to ratings agency Standard & Poor's, the "common pitfalls" of TIF bonds include volatility in commercial real estate values during a downturn, particularly for warehouses and hotel properties, falling house prices and construction risk. Investors will want paying for that.
>
> Perversely, more prosperous areas may attract cheaper financing, because there is less of a risk that the benefits of development will fail to materialize — leaving poorer areas in dire need of investment paying through the nose for funding. The onus will also be on authorities to prove that proposals will produce genuinely "additional" tax revenues rather than just sucking it away from the surrounding area.
>
> Other obvious hurdles are the UK's planning system — hardly an aid to rapid infrastructure development in recent years — and a lengthy legislative process to

[17] "Boring but important: TIF, a primer", by Allistair Hayman, *Local Government Chronicle*, 21 September 2010

[18] *Investing for recovery: A new deal for London*, Greater London Authority, December 2009

[19] "Boris Johnson favours tax increment financing method. Eh?" By Dave Hill, *The Guardian website*, 30 November 2009

> ensure councils can retain the growth in business rates brought about by the scheme. TIF may not get off the ground for two years at least.[20]

An article in *Estates Review* notes:

> So, who pays? Councils will most likely take on the debt through prudential borrowing – at least initially. Most critically, though, is how to underwrite this type of funding. TIF poses a substantial risk should plans go awry, with repayments taking up to 25 years. However, as the All Party Urban Development Group (APUDG) argues, the cost of private financing may be prohibitively high if there is no central government guarantee.
>
> There is also an obvious difficulty in estimating the future tax increment, due to the complexity of the business rating system. But, says the BPF, this is by no means insurmountable: it may not be possible to forecast the increase perfectly, but we can look to American examples in reducing the margins of error and reach appropriate estimations.
>
> Another hitch is the displacement of taxes, whereby a new development pinches business from a neighbouring district. Chris Brown, chief executive of Igloo Regeneration, says: "The reason [some] TIFs have gone very badly wrong in the States is that property developers come along and say, 'My scheme is going to generate $100m', and not saying that it is just being sucked from elsewhere." The APUDG suggests the use of oversight via an appropriate government agency, and clear rules to help to contain taxes and stimulate a genuine uplift. The purpose of TIF is to stem blight and the criteria for granting TIF status should reflect that. Yet critics warn of the abuse of TIF in America, where rules have been bent to fuel competition and increase revenues. For instance, the BPF reports that an industrial park and Wal-Mart centre were built on farmland in Wisconsin, where 'blight' was defined by a single, uninhabited house in the district.[21]

4 TIF elsewhere

4.1 Scotland

Legislation was passed by the Scottish Parliament in December 2010 to approve the use of TIF for six projects. The Scottish Futures Trust has been asked by the Scottish Government tom lead on implementation of TIF, and their website notes:

> Any TIF proposals should be supported through the development of a Business Case by a local authority, which should detail the justification, including the financial and economic cases, for utilising TIF to deliver investment within the proposed area, the basis for the selection of the chosen enabling infrastructure and why it's believed this infrastructure will deliver the growth and additionality envisaged. The TIF Business Case also details how the project will be delivered and also how risk is allocated and managed.
>
> From a practical perspective, SFT has worked closely with City of Edinburgh Council ("CEC") and a number of local authorities to develop the TIF model for Scotland. In September 2010, the Cabinet Secretary for Finance and Sustainable Growth followed SFT's recommendation to approve in principle CEC's business case for a TIF project in the waterfront area of Edinburgh (further details are contained in the [News] section). Full approval was granted in March 2011. This represents the first establishment of TIF

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[20] "Yet more borrowing? Nick Clegg should be careful", by Russell Lynch, *Evening Standard*, 28 September 2010

[21] "Tax Increment Financing – a viable new funding stream?", *Estates Review*, 22 September 2009

in the UK, allowing Scotland to progress with this exciting model for funding regeneration ahead of the rest of the UK.

In December 2010 enabling legislation was passed for up to six TIF pilot projects to be developed across Scotland.[22] This includes the Edinburgh waterfront development as well as the two further pilot projects already identified: Ravenscraig (North Lanarkshire Council) and the Buchanan Quarter (Glasgow City Council). SFT is in dialogue with other Local Authorities to seek to bring forward further business cases to be considered as the remaining three pilots. It is estimated that the first three pilots will bring c.£250 million of public sector investment and further unlock more than £1.5bn of private sector investment.[23]

4.2 United States

TIF is widely used in the US to finance regeneration plans. In fact, Arizona is the only state that does not have a TIF law. A report prepared for Calgary City Council when it passed its own TIF Act gives more background:

> The 1949 Housing Act provided federal funds to cities for urban redevelopment in the post-war period. The Act offered funds to local public agencies to assemble, clear, and resell or lease land for predominantly residential uses to private developers or public housing agencies. In the early 1950s many State legislatures created housing authorities to act as urban renewal agencies, to manage these federal funds. The earliest urban renewal projects were often characterized as “slum clearance” and generated the most controversy because of the widespread displacement of residents and businesses and the demolition of heritage buildings.
>
> The Housing Act required a local match for federal urban renewal funds. In 1951, the State of California enacted implementing legislation so that TIF could be used as a local financing tool to match federal urban renewal funds. In the 1950s TIF was primarily used for purpose of financing the redevelopment of blighted communities. The use of TIF grew rapidly in the 1970s and 1980s when there was a fundamental shift in the way urban renewal was being planned and implemented. Instead of focusing on land clearance and housing renewal, plans expanded into a revitalization tool to improve both the built and social environment of decayed urban areas.
>
> The use of TIF has grown and changed since its inception in the 1950s. TIF has been used for a variety of purposes ranging from the earliest federal housing programs, to urban revitalization plans, to economic development. Today TIF is authorized as a financing method in 48[24] states. It is applied in a variety of ways and the application of generic TIF principles varies greatly across states.[25]

The report lists a number of requirements for the successful introduction of TIF in the US:

> The two determining qualifications for TIF are the presence of blight conditions and meeting the “but for” test that states redevelopment will not occur in a specified area without TIF.
>
> An initial study is required that documents blight, demonstrates that the “but for” requirement is met, and establishes TIF district boundaries.

[22] The *Non-Domestic Rating Contributions (Scotland) Amendment Regulations 2010*, SSI 2010/391
[23] http://www.scottishfuturestrust.org.uk/a.asp?a=104
[24] Now 49 states
[25] *The U.S. Experience with Tax Increment Financing (TIF): A Survey of Selected U.S. Cities*. Calgary City Council, March 2005, p2

> A redevelopment plan is prepared that includes major project activities and costs, plans for public acquisition of property, project completion dates, and a financial analysis.
>
> TIF may not be the sole source to support incurred debt. Other supplementary funding sources include the municipality's capital improvement program, federal and state grants, municipal land sales, and donations are utilized.
>
> TIF programs are lead by a municipality, or its redevelopment agency, but several overlapping taxing jurisdictions, such as a county or school district also participate in the program.
>
> Urban renewal projects that include TIF programs have legislated requirements for public involvement such as public notices and public hearings prior to adoption of TIF districts. Local development authorities also work with citizen advisory committees and organize public meetings, to provide information and receive feedback.

Chicago is one of the key users of TIFs, having 131 TIFs within the city limits. The Chicago Neighbourhood Capital Budget Group has noted:

> These "new" revenues – also called "increments" – arise if new development takes place in the TIF district, or if the value of existing properties rises, resulting in higher tax bills. These funds can be spent on public works projects or given as subsidies to encourage private development. But TIF also makes it much easier for the City to acquire private property and demolish buildings to make way for new construction. With consistent community participation, TIF can be a tool for implementing a community-based revitalization plan through encouraging affordable housing development, improving parks and schools, fixing basic infrastructure, putting vacant land to productive use, creating good-paying jobs, and meeting other local needs.
>
> Without strong and sustained public participation, however, TIFs can give the City power to change the basic character of a neighborhood against the wishes of those who live and work there, accelerate the pace of gentrification, and drive up property values to the point that existing residents and businesses can't afford to stay in the community. In short, TIF is a mixed bag, and its success or failure depends on how active the community is in their planning and implementation.[26]

There has been some criticism of TIFs in the US. For example, a study in *Land Lines Journal* noted:

> Policy makers should use TIF with caution. It is, after all, merely a way of financing economic development and does not change the opportunities for development or the skills of those doing the development planning. Moreover, policy makers should pay careful attention to land use when TIF is being considered. Our evidence shows that commercial TIF districts reduce commercial property value growth in the non-TIF part of the same municipality. This is not terribly surprising, given that much of commercial property is retailing and most retail trade needs to be located close to its customer base. That is, if you subsidize a store in one location there will be less demand to have a store in a nearby location.[27]

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[26] *What is a TIF*, Neighborhood Capital Budget Group, Chicago

[27] "Tax Increment Financing: A Tool for Local Economic Development", by Richard F. Dye and David F.Merriman, *Land Lines*: January 2006, Volume 18, Number 1