Developing Public Recreation and Park Facilities with Tax Increment Financing

Sheila J. Backman
John L. Crompton

ABSTRACT: A majority of states have passed enabling legislation permitting tax increment financing to be used, but it remains unknown to many park and recreation administrators. This financing mechanism and the situations in which it can be appropriately used are described. Examples are provided of how it has been used to develop park and recreation facilities, and potential abuses of the mechanism are discussed.

KEYWORDS: Tax increment financing, parks and recreation.

THE AUTHORS: Sheila Backman is a doctoral candidate at Texas A&M University. She was previously Director of the Center of Leisure Studies at Acadia University in Nova Scotia.

John Crompton is a professor of Recreation and Parks at Texas A&M University.

Tax increment financing (TIF) has recently received an increased amount of attention from local and state governments, but the mechanism is not new. It was first introduced in 1952 in California where it was termed tax allocation financing. Tax increment financing is now used by government entities in 37 states (Mitchell 1977). During the period 1952–1975, 17 states enacted the necessary legislation. However, the use of TIF grew most rapidly from 1976–1980, since an additional twenty states authorized its use during this period.

Although state enabling legislation has to be passed before TIF can be used, it is essentially a local development finance tool. It acknowledges that urban blight or decay exists in cities, and recognizes that this often results in an uneven city tax base. As blight occurs, the tax base in that part of the city goes down, but the cost of providing necessary city services to such areas often increases. Taxpayers in economically healthy areas of a jurisdiction are required to make up this resulting shortfall in revenues by paying higher property taxes. Recognizing the adverse impact of blighted areas on the tax base, many local governments have turned to TIF as a tool that may assist in arresting urban decay.

What is Tax Increment Financing?

The process for using TIF is initiated by a local jurisdiction preparing and adopting a redevelopment plan for a specified area. This plan serves as a management tool as well as the legal guide for implementing the redevelop-
opment. Any amendment to it must be adopted by ordinance by the governing body of the local jurisdiction. After determining that the plan is economically feasible, the local government proceeds by creating a new, or designating an existing, separate entity, which is given the authority to operate a special redevelopment district.

The TIF enabling laws passed by states typically authorize local units of government to recover costs from tax increment funds that are established to receive property taxes generated by redevelopment projects. A variety of methods are available for financing public improvements in this district. Revenue bonds, general obligation bonds, the general fund, and pay-as-you-go financing can be used, provided the tax increments realized in the zone from year to year are used to repay the debt. Huddleston (1982) notes that many states also have authorized such mechanisms as industrial revenue bonds, special assessments, and municipal improvement bonds to be used as financing mechanisms in these districts.

In addition to this set of relatively traditional approaches, tax increment bonds may also be issued in redevelopment districts to provide a source of funding for public improvements. Tax increment bonds differ from general obligation bonds in that the increment bonds are secured only by the projected increases in revenues from the development and not by the full faith and credit of the city. Their repayment is contingent upon increases in the taxable value of the property in the district. These bonds are usually exempted from consideration in assessments of a city’s taxing power, general credit and debt limits. However, tax increment bonds require evidence of financial viability before they can be sold in the bond market.

The distinctive feature of TIF districts is that they rely on property taxes that are created directly by the revitalization projects in the district to pay for the redevelopment costs incurred by the public entity. The tax base of the property in the designated area is frozen at its current level before redevelopment. This freezing is agreed to by all entities that have taxing authority—for example, the city, county and school districts. (It is important to note that it is only the tax base that is frozen, not the tax rate.) Since rejuvenation of the district is likely to increase the value of their assets, landowners and residents have every reason to support the district’s establishment. Other jurisdictions, such as the school districts, city, and county, do not lose revenue by agreeing to a freeze of assessed valuation of property, because without rejuvenation this assessed value would decrease over time. In the short term, the rejuvenation activity makes it less likely that these jurisdictions will lose any of their tax base. In the long term, they are likely to gain substantially, because in most states the bonds must be repaid within 30 years. Once the bonds have been retired, increments flowing into the special fund are phased out, the special district is dissolved, and all property taxes go to the local taxing jurisdictions. As project redevelopment occurs, property values are likely to increase because of the improvements created by the capital invested.
While there are variations in state laws, all include a provision that enables each of the taxing jurisdictions to continue to receive from the frozen tax base that share of the taxes they had collected in the past. (See Figure 1A). Each taxing jurisdiction first applies its tax rate to the frozen value, then to the new property value. The difference between the two is the tax revenue increment available that year for repaying capital indebtedness attributed to the project. (See Figure 1B). These incremental dollars go to the special district which issued the bonds. As assessed valuation in the district increases above the frozen tax base level, greater increments are available for retiring the redevelopment district’s indebtedness.

Because a TIF redevelopment district must generate its own funding to repay bond debts, the projected tax increment cash flows are of crucial importance. Mitchell (1977) points out that it is advantageous to have substantial early development that will result in larger tax increments being available. For this reason, it is common practice before issuing TIF bonds to sign a contract with a developer guaranteeing commitment to a major project that will upgrade the district. Such a commitment accelerates the progress of the project, resolves cash flow problems, decreases the period for which the tax base will be frozen, and provides assurance to prospective investors in TIF bonds that their investment will yield the anticipated return.

Investors’ decisions to buy TIF bonds will be heavily influenced by the strength of any written agreement between the redevelopment agency and participating developers. If detailed agreements that specify the types of improvements to be made, their value, and a development timetable do not exist, the agency has less of a chance of selling the bonds. Agencies must be careful to ensure that the tax increment will materialize; otherwise, they will default on the bonds. While the city is not legally responsible for any losses to bond investors, such losses are likely to make it more difficult to sell similar bonds in the future. In order to make the bonds more attractive to investors, some jurisdictions have reduced the risk of purchasing them by making provisions to levy special assessments on property in the district area if the expected incremental increase in the tax base does not materialize. These provisions are at the option of the jurisdiction, and vary depending on state enabling legislation.

Redevelopment not only brings increased revenues from property taxes, but also from sales taxes and business licenses. Because these latter sources are not part of the tax increment, the benefits are received directly by local government to fund other public services.

Typically after a special district has been designated, any necessary relocation of people or property is negotiated, and contracts are signed by the district for demolition, clearance work, the removal of old infrastructure, and the installation of new public improvements and amenities.

Annual disclosure reports between each TIF district and a city are required in most states. The city’s governing body must submit to the chief
executive officer of each taxing unit involved in the TIF district an annual report documenting the current status of the redevelopment effort.

Using Tax Increment Financing for Developing Park and Recreation Facilities

Tax increment financing has not been widely used for funding park and recreation facilities. There appears to be relatively little awareness of this mechanism among park and recreation administrators. Most recent concern in the field has been focused upon finding ways to meet operational costs.
rather than capital costs. However, in some jurisdictions, sources of funds for capital development are becoming as much of a concern as those for operational costs. With tax increment financing, taxpayers in a district finance the costs of recreation and park facilities through increases in their property taxes. TIF Bonds serviced by the tax increments can be used to finance these facilities. This method is perceived by some to be more equitable, and often easier for elected officials to support, than asking all the citizens of the city to finance redevelopment in a specific district.

The City of Minneapolis has made extensive use of TIF through the Minneapolis Community Development Agency. To date, 20 TIF districts have been created. The Loring Park District is a 43-acre, nine-block site. It is a residential neighborhood convenient to the central business district. Over a period of eight to ten years, approximately 2,000 new rental and condominium apartments and townhouses have been developed in the district. The Loring Greenway, completed in 1980, and an extension of the Nicollet Mall completed in 1981 provide a pedestrian walkway connecting downtown Minneapolis with the Loring Park District (Minneapolis Community Development Agency 1984).

Prior to bonds being issued in 1973, assessed value of the Loring Park District was $6,572,748, while the 1983/1984 assessed value was $43,964,449. A public investment of $37 million has been projected to generate $200 million in private investment. The district returns nearly $5 million in real estate taxes annually, whereas before 1973 it returned less than $900,000 a year. Located in the district is a $44 million hotel/merchandise mart complex, which consists of a 540-room Hyatt Regency Hotel, a five-level merchandise mart, and an athletic club (Minneapolis Community Development Agency 1984). This development contributes to Minneapolis’ effort to attract convention trade.

The Nicollet Lake District was established in 1975 and consists of an eight-block area. This zone was intended to recreate a healthy commercial center. Developments that have taken place since the zone was created include the Minneapolis Institute of the Arts Complex.

Bonds for the City Center District were issued in 1977. The current assessed valuation rate is $53,311,000 up from $9,214,147 in 1977. This district is located in downtown Minneapolis and was created to redevelop commercial properties, expand retail and office space, and to strengthen Hennepin Avenue as a regional entertainment center (Minneapolis Community Development Agency 1984).

The Hubert H. Humphrey Metrodome is located in the Industry Square Redevelopment Tax Increment District. This zone is sited on the eastern edge of downtown and encompasses 223 acres. The Minneapolis Parks Board is also involved with the planning of the Mills District Planning Area of Industry Square, which is adjacent to the Mississippi River (Minneapolis Community Development Agency 1984).
In the City of Portland, Oregon, TIF has been used as seed money to finance the downtown business area and its adjacent waterfront (U. S. Department of the Interior 1979). In contrast to Minneapolis, where TIF districts have primarily been small areas, Portland’s use of TIF has focused on the development of a large area. The Portland Downtown Development Commission is the city’s designated urban renewal and development agency. It is responsible for implementing the downtown waterfront urban renewal plans, which involve 300 acres on the West bank of the Willamette River and include a 35-acre, 1 1/2-mile-long linear park.

Prior to 1972, when the city council adopted the Downtown Plan, Portland had already begun revitalization of an area near the waterfront through the traditional urban renewal approach. Included was a civic auditorium, pedestrian mall, new office and housing development, and a noted fountain designated by Lawrence Halprin. The success of these projects and the subsequent tax revenues that were generated created a positive atmosphere for more extensive redevelopment and encouraged the city to develop proposals for the nearby Willamette waterfront. Two plans, the Downtown Waterfront Urban Renewal Plan and the Waterfront Park Plan, were adopted by the City Council in 1974. In 1976 the Waterfront Urban Renewal District sold $10 million worth of tax increment bonds and another $15 million in 1978. Funds generated from the sale of these two bond issues were used to finance the first two phases of the Waterfront Park, which involved preservation and improvements in two abutting historic districts.

When the districts were established in 1974, their assessed valuation was $100 million, but by 1984 the assessed valuation had increased to $400 million. Waterfront Park has a mile-long esplanade on the riverfront that is currently being further extended with plazas, extensive open grassed areas, pension and condominium projects under construction, a recently completed public boat marina, and a large center available for restaurants, retail activities, entertainment, special events, and dance performances.

In addition to its waterfront project, Portland also used $1 million of TIF as seed money to develop the $8 million Pioneer Square. This is a central public square with fountains, seats and a pleasant environment whose upkeep is now the responsibility of the parks department.

The City of Corpus Christi, Texas, designated the Bayfront Area of the City as a TIF zone. The project plan developed for the zone envisages 70 specific public improvement projects being undertaken in the zone during the 20-year period 1983–2002. Their cost in 1983 dollars is estimated at $90 million. Of this amount, $15.8 million is designated for marina and shoreline improvements, $2.9 million for park renovation, $2.3 million for landscaping, and $10 million for a new 12,000-seat arena.

The project plan included an assessment of how much of the $90 million could be raised from tax increment funds. In 1982 the zone generated almost $3 million in property taxes. The amount produced from the tax increment base (the “frozen base”) will continue to be allocated and paid over to the
taxing units levying taxes in the zone area, based on their respective tax rate shares. Before the area was designated, contractual agreements were negotiated with each of the other taxing entities enabling them, in some instances, to share part of the tax increments.

Since it is impossible to predict what development will take place beyond what is already committed or considered firm, the project plan offered two separate levels of likely tax increment production: low range and moderate range.

The low-range projection was based only on the value of private developments that were either definitely committed or under construction. It is estimated that $13 million in tax increments would be accumulated over the 20-year period from these new developments. However, the maximum yield per year of $750,000 would not be available until 1987. (It would then remain at this level for the remainder of the 20-year period.) This reflects the usual "front end" lag affecting most tax increment projects, because the increments do not begin to show up until the tax producing developments are on the ground and fully taxable. Among the $13 million of public improvements that could be financed based on this projection, the plan included $6.125 million for marina and shoreline improvements, and $2 million for parks.

The moderate range projection included projects that, while not yet committed, were considered to be highly probable. This estimate anticipated that $30 million, in addition to the $13 million projected on the low-range assessment, would accrue in tax increments over the 20-year period. The maximum yield of $2.5 million would first emerge in the sixth year. Among the improvements this additional money would fund were $6.45 million for the marina and shoreline, $10 million for the 12,000-seat arena, $500,000 for park renovation, and $300,000 for landscaping.

The project plan suggests that both the low- and moderate-range projections may prove conservative given the growth potential of Corpus Christi. It points out that initial development success usually serves to enhance the overall development climate, thus producing a "spin-off" or multiplier effect. This has been experienced in many cities utilizing the tax increment financing tool.

An important part of the Corpus Christi strategy is to finance improvements from the cash flow generated by tax increments rather than from tax increment bonds. Utilizing this approach, substantial earnings will be used by eliminating the high funding costs.

Once the annual increment yields are built up, the City is in the position to maintain a steady level of capital improvement investments within the tax increment zone. There is the added flexibility at this point to utilize tax increment bond financing should the need arise. Bonds issued at this time would be easily marketed and could be placed at comparatively favorable rates, because the increment base will already have been established. The City maintains the flexibility to issue revenue bonds based on future tax incremental payments, should future review of the project plan and its prior-
payments, should future review of the project plan and its priorities indicate the necessity of shortening time plans for installation of improvements.

**Some Potential Abuses of Tax Increment Financing**

In his 1981 study, Hudderston identified three major abuses in the use of TIF. First, there was often an overcommitment of land. Of the TIF districts in Wisconsin that he reviewed, 40% indicated that at least 25% of their development land was vacant. He found that many Wisconsin cities devoted over 20% of their land area to TIF districts. The inclusion of such a large proportion of the tax base in a TIF district often resulted in increased city taxes because TIF monies cannot be assigned to operational budgets and only taxes derived from the frozen tax base in the TIF district are available for operational purposes.

A second abuse identified by Hudderston was the considerable license taken by some cities in defining TIF districts. They linked declining areas with growth areas, often tenuously by using a connecting road between a blighted and a growing area. This reduces the financial risk of the TIF district by enabling it to capture tax increments that may not be attributed to public investment in the blighted areas financed by TIF.

Similarly, some cities created redevelopment districts in situations where development would have occurred without the use of TIF. They tended to focus on the amount of revenue that could be generated if the district were created, rather than on the original intent of the enabling legislation, which was to encourage redevelopment of blighted areas. Such liberal use of TIF districts may lead to accusations by developers outside such districts that their competitors in the districts receive the unfair advantage of benefiting from an injection of public funds.

The potential for abuse increases when voter approval to establish a TIF district is not required by a state’s enabling legislation. Since officials of the TIF district are appointed and not elected, citizens may feel they have little control over decisions to use TIF or to invest in these districts.

**Concluding Comments**

In the past, many cities have relied upon federal and state programs as major supplementary sources of capital funds, but such intergovernmental transfers are generally declining. Local agencies must now initiate innovative mechanisms for funding capital as well as operational costs. Initially, the use of TIF was limited in many jurisdictions to providing local matching funds for federal or state grants, but in recent years as these funds have declined it has been adopted as a primary method of financing for local development.

The use of TIF affords local government units the opportunity to work with the private sector to encourage development and facilitate a public/private partnership using the strengths of both so that all will benefit. The public sector can assist the private sector in developing urban areas by securing lower cost financing through TIF bonds, providing costly infrastructure prior to
development, or by providing public amenities such as parks and recreation facilities that will enhance the attractiveness of a blighted area for private developers.

The local political climate will strongly influence a decision to use TIF. Traditionally, cities have borne the costs of development alone while other taxing jurisdictions have shared in the benefits. Complaints often arise from counties, school districts, and other taxing agencies that do not at first comprehend how they will benefit from a TIF district, and perceive it as a threat to their revenue base. For example, school districts may complain that the cost of providing services increases as redevelopment occurs, and because of the frozen tax base they are unable to respond to the increased service demands. However, the school district does have the power to raise the tax rate in order to increase revenue. In addition, some states have addressed this problem by writing enabling legislation that permits the return of partial revenues from the tax increment to school districts, instead of it all going into the TIF fund.

TIF provides a source of funds that can be used to inject amenities such as recreation and park facilities into deteriorating urban areas. The infusion of such investment is intended to stop the deterioration, attract private investment into the area, and revitalize the district so that it once again becomes a vibrant part of the city. The important ingredient is that the physical environment is upgraded by these infused amenities or attractions in such a way that people are again attracted to the area. TIF is a tool that has generally not been considered by parks and recreation administrators, but it appears to have considerable potential as a mechanism for upgrading park and recreation facilities in deteriorating urban areas.

References


