

Tax Increment Financing: A Tool for Rebuilding New York

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Introduction

Tax increment financing is widely used to stimulate redevelopment and finance public improvements. There are, for example, hundreds of tax increment financing districts in California, Illinois, and Florida. However, New York has made relatively little use of the process. What is tax increment financing and how could it be of use in New York?

Tax increment financing is, simply stated, a way of pledging some of the increased taxes that result when property is redeveloped to pay the costs of associated public investment. For example, if redevelopment will generate \$10 million in additional taxes each year, that \$10 million could be pledged for say 25 years to re-pay a \$90 million bond. That \$90 million would now be available for public improvements such as subway construction that are necessary to the redevelopment.

Using taxes generated by redevelopment to pay for itself is one of the least painful ways of financing public improvements. It is relatively painless to taxpayers because their taxes don't have to be raised. It is relatively painless to elected officials because they don't have to vote for higher taxes. The increment merely results from the normal application of existing tax rates to a tax base that is being made to grow through private investment. Critics will argue that the redevelopment project needs the increased tax revenue for police, fire and other city services. But it can be argued right back that the need for such services rarely increases as a result of improvement to an already developed area and is covered by the pre-redevelopment taxes that are untouched by tax increment financing..

How tax increment could be of use in New York

Tax increment financing can give New York another tool for meeting public infrastructure needs associated with its rebuilding after September 11th. Tax increment financing could, for example, supplement the limited capital resources of city, state and public transportation agencies to rebuild destroyed subways and even build them better. For this purpose, tax increment financing could be made operative in Lower Manhattan and perhaps in parts of the Midtown area as well. In fact, tax increment financing has been mentioned recently as a potential funding source for rapid transit in both the New York New Visions Report for Lower Manhattan and in the New York City Planning Department's Far West Midtown report. Tax increment financing also has potential uses supporting redevelopment in the outer boroughs. Chicago, similarly, has made extensive use of tax increment financing at the neighborhood level.

Examples of the use of tax increment financing

Tax increment financing originated in California in 1952 and by 1970 had spread to several, mainly western, states. Beginning in the 1970's its use spread more rapidly and today tax financing is allowed in 48 states (North Carolina and Delaware being the only exceptions). Initially, it was used primarily as a tool for attracting investors to revitalize lagging downtown areas. More recently it has also been used to support affordable housing, neighborhood revitalization and redevelopment of obsolete industrial areas.

Responding to local interest in using tax increment financing to construct rapid transit in New York, several examples of similar use elsewhere have been identified. Tax increment financing has been used to support subway construction in Chicago, where three public transportation projects in the downtown Loop have been funded with tax increment revenue:

- The Randolph/Washington Station received \$13,500,000 in tax increment funds.
- The Dearborn Subway-Lake/Wells received \$1,200,000 in tax increment funds.
- Miscellaneous Central Loop transit projects received \$24,000,000 in tax increment funds.

In Portland, Oregon, tax increment financing has been used for two transit improvement projects.

- A little over \$7.5 million in tax increment funds was used to support that portion of the alignment the Central City Streetcar that passes through the South Park Blocks tax increment district.
- The Interstate Avenue Light Rail was supported by the City of Portland's issuance of \$30 million in General Fund notes which the Portland Development Commission must re_pay when the Interstate tax increment district has the financial capacity to issue long term bonds. These funds also served as part of the local match for the overall project.

Current potential use in New York

In New York, current interest in tax increment financing is focused on its potential to finance Lower Manhattan transit facilities destroyed on September 11th, and to finance midtown transit improvements such as extension of the Number 7 Subway line, each of which offers its own set of issues. To understand those issues it is first necessary to understand that the principal features of the tax increment financing process are (1) an official determination of necessity, (2) a redevelopment plan, and (3) the sale of bonds.

In Lower Manhattan, a finding of blight could be based on the size and impact of the destroyed area which clearly fit the legal definition of 'buildings and structures which are deteriorated or unfit or unsafe.' In the Far West Midtown area, unless the law were to be changed, a well-documented blight study of the 59 block area would be needed to meet the standard of a predominance of deteriorated, unfit, unsafe, or economically unproductive buildings. The declaration of blight and the studies that justify it may seem to be pro forma, but actually are likely to be critically re-examined at later stages in the process and should be taken very seriously.

Both redevelopment areas would need a redevelopment plan. New York law requires the redevelopment plan to address land use, open space, neighborhood impact, economic feasibility and other issues. Economic feasibility is critical to the successful implementation of tax increment financing and should be carefully analyzed in the plan. It is also important to note that the redevelopment plan establishes a framework for determining which capital investments may be financed with tax increment funds. Therefore, the plan should address rapid transit improvements if that is an intended use of tax increment funds. Opportunities for plan review and public hearings are required prior to adoption, but adequate public participation throughout the redevelopment process is needed. Inadequacies with regard to public participation can cause a project to stall later on.

If basic hurdles are surmounted, such as the finding of blight and the completion of a redevelopment plan with adequate public support, it appears that either the Lower Manhattan or the Far West Midtown redevelopment could make use of tax increment financing. Specifically, the local interest in using tax increment for subway construction is allowable since New York law allows tax increment bonds for public improvements integral to the redevelopment plan and rapid transit meets the definition of a public improvement.

Practical difficulties and solutions for tax increment financing in New York

Various practical difficulties can arise in the implementation of tax increment financing. Local planners have mentioned the length of time it takes for development to be completed and move onto the tax rolls. Another is the location of public improvements, that is, whether they are in the project area or not.

However, tax increment financing can be made to work in a variety of circumstances, as the following sample of techniques demonstrates. For example, if tax revenues were expected to be delayed for an especially long time (as might be the case where the 2012 Olympics are part of the project), one could suggest ways to substitute other revenue in the early years.

Handling delays in revenue flow

- Expand the district to include areas having more immediate tax growth potential. However, there are limits on such expansion since the requirements of state law must still be met.
- Pledge alternative revenue streams, such as parking or utility revenues, to fund the early years. This technique is commonly used to enhance tax increment bonds by serving as a financial back-up.
- Borrow funds from another unit of government. This technique was used, for example, to fund Portland's Interstate Avenue Light Rail.
- Use sales or income tax increment financing. This is more difficult because it would require new legislation in New York. Several states including California, Illinois, Missouri and Colorado permit sales tax increment financing and Maine allows income tax based increment financing. Depending on the type of development, sales tax increment financing can produce significant revenues. However, sales taxes are subject to greater fluctuation than property taxes which can reduce the security of bonds.
- Explore creative ways of accelerating federal contributions to public infrastructure. A case could be made that this is particularly appropriate as a response to the attacks of September 11th.

Tax increment financing is generally designed so that funds are expended only within its defined redevelopment district. When an extended public improvement is contemplated, as might be the case with a subway line, it may be desirable to allow expenditures along the entire line.

Allowing for extended improvements

- Clarify legal intent of state legislation.
- Fund portions of the improvement that are within the district. Portland did this with its Central City Streetcar project which financed the portion of the alignment that passes through the district.
- Expand the district. This should be done very early in the process when boundaries are being considered. However, an expanded district may not be possible if it does not meet the criteria found in state legislation.
- Amend state legislation to allow district defined by different criteria. A relevant example for transportation improvements is Florida which allows a redevelopment district to be defined solely by inadequacy of transportation facilities. A district based on transportation needs might follow the alignment of a proposed subway.

- Amend state legislation to allow expenditures outside of the district. Obviously such improvements would still have to be necessary to the redevelopment plan.

This exploration of practical difficulties and possible solutions demonstrates that with knowledge and creativity, tax increment financing can be adapted to circumstances likely to be found in New York.

Conclusion

We have briefly defined tax increment financing, identified how tax increment financing could be of use in New York, showed that it is used for similar purposes elsewhere, confirmed that there are reasonable opportunities for its use in New York, and demonstrated that practical difficulties could be overcome.

It is important to place tax increment financing in perspective as one tool, but not the sole answer to the cost of providing public infrastructure. For rapid transit construction, traditional funding including federal sources, is almost certainly more important. In any case, the public infrastructure that tax increment revenues will support is limited by the actual increase in taxes generated and by factors in the bond market such as the level of security demanded by bond buyers and the prevailing interest rate.

However, even when put into perspective, the sheer size and cost of redevelopment projects in New York, possibly tens of millions of square feet and billions of dollars, can produce amounts of tax increment revenue that cannot be ignored, possibly hundreds of millions of dollars when bonded. The need for such tax increment funding is especially apparent when one considers the relative absence of subway construction in New York over the past 60 years. Tax increment financing is a way of making a commitment to meeting that need in the future.

Sources

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Far West Midtown - A Framework for Development, New York City Department of Planning, 2002, www.nyc.gov/html/dcp/html/fwmt.html, recommends the use of tax increment financing to help finance redevelopment of 59 blocks on the west side of midtown Manhattan that would be transformed with up to 30 to 40 million square feet of new offices, hotels, housing, and expanded exhibition and sports facilities, as well as new and improved open space.

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