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Scorecard

By Ralph J. Basile, Brian Dowling, and Tory Salomon

FINANCING ECONOMIC DEVELOPMENT

This article examines five economic development financing tools from a practitioner's standpoint. We detail the pros and cons associated with using each tool and assign a simple grade (from A to C+) for each to capture our experiences with applying these tools to further economic development objectives at the local government level. The five tools are tax abatements, brownfields funding, CDBG funding, Tax Increment Financing (TIF), and New Markets Tax Credits (NMTC).

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A myriad of economic development financing tools are available to local and state government officials and practitioners. This article addresses the effectiveness of five of these financing tools used to stimulate economic development ventures nationwide: tax abatements, brownfields funding, CDBG funding, Tax Increment Financing (TIF), and New Markets Tax Credits (NMTC). For each financing tool, we:

- Describe the tool or program,
- Identify how extensively the tool is used,
- List pros and cons associated with using the tool, and
- Provide a "scorecard" grade and the reasons why.

A caution: this article is not intended to offer an extensive dissertation about each financing tool. Rather, our observations intend to capture our experiences as economic development consultants, plus some limited additional research. Naturally, others through their own more extensive research or varied experiences may arrive at a different "grade" on their scorecard. At a minimum, we hope our results spur dialogue within the economic development community about which tools work best and under which circumstances.

Why did we focus on these five tools? We examined these particular tools based on our assumption that using some tools offers significant advantages over others in terms of flexibility and positive impacts. We wanted to examine a mix of financing tools, some of which are used more frequently than others by economic development practitioners. Other financing mechanisms not examined in this article, such as land writedowns, utility rate concessions, housing tax credits, loan guarantees, and outright incentive grants, were deemed narrower in focus and applicability and, hence, were not addressed in this article.

Our rationale for assigning the grade chosen included such considerations as:

- How broadly and flexibly can the tool be applied,
- How effective has the tool been in causing economic development,
- How important is the tool considered by private entities seeking its application to their projects,
- How successful have practitioners been in directing these funds specifically to economic development endeavors, and
- How equitable is it to use the tool, given the challenging fiscal conditions faced today by those who govern.

The use of New Markets Tax Credits in the reuse of the Arcade Hotel in Bridgeport, CT helped shape the community's redevelopment.

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This article examines five economic development financing tools from a practitioner's standpoint. We detail the pros and cons associated with using each tool and assign a simple grade (from A to C+) for each to capture our experiences with applying these tools to further economic development objectives at the local government level. The five tools are tax abatements, brownfields funding, CDBG funding, Tax Increment Financing (TIF), and New Markets Tax Credits (NMTC).

TAX ABATEMENTS

Program Description:

Tax abatements can be defined as either the forgiving of taxes by government or their deferral to a later predetermined date. The amount of abatement is typically determined as a percentage of tax payable or as a dollar amount of the tax attributable to the particular parcel receiving the abatement. The length of abatements can vary, though most state laws set a limit of 10 or 12 years as the maximum time taxes can be forgiven or deferred.

The Pier Village and Beachfront North projects built in Long Branch, NJ utilized tax abatements to spur oceanfront redevelopment.

The theories behind tax abatement programs are that businesses are incentivized to locate in jurisdictions with local property tax rates that are lower than the average national rate, or property tax reduction is the level of subsidy needed to make private project financing viable. A jurisdiction that has a lower tax rate than others should see a rise in business and economic activity and a rise in land prices. Depending on the local labor force's mobility, an increase in employment, a rise in wages, or a combination of both would also result. In theory, these economic benefits to a jurisdiction could outweigh the costs of offering tax abatements to businesses.

Jurisdictions offer tax abatements for these reasons:

- Businesses generate a "consumer surplus" to citizens in the jurisdiction where they are located. They offer benefits greater than what the jurisdiction pays in the form of locally provided business services and/or possible local environmental degradation.
- The increased capital investment, educated workforce, and increased productivity brought by some firms to a locality generate a greater exchange of ideas and/or a bigger pool of labor to draw from for existing local firms.
- Most local incentives are intended to be temporary. By locating in a jurisdiction, a business commits immobile and taxable capital to a place for longer than the period of the incentive. The incentive thus becomes an up-front payment for a stream of guaranteed future tax payments.
- It is in the best interest of the jurisdiction trying to capture the greatest business property tax revenue to charge different tax prices to different types of firms. A jurisdiction could charge a higher tax price to firms that really want to be there, while revenue maximization requires a lower tax price (through abatement) to firms that have other location options.

How Extensively Used:

Tax abatements have become a common, almost standard tool for jurisdictions to attract businesses to their area. There has been a noticeable increase in property tax abatements allowed within the United States, from 30 percent of the states allowing them in 1964 to 70 percent in 2004. As of 2007, all but seven states offered some form of tax abatement program.

Driven by the profit motive of lower property taxes, businesses searching for a new location or existing firms that convey a reasonable threat of mobility will lobby politicians representing high property tax jurisdictions for tax relief as a condition for entry or remaining. Local representatives of these high business tax jurisdictions in a state then ask their state's lawmakers for the ability to offer property tax abatements.

Once the previously higher tax jurisdiction offers abatement, another jurisdiction in the state faces the same pressure to also offer abatement. This series of events is the likely reason for the observed increase of tax abatement programs across the county.

Pros:

- Both surveys of business leaders and some empirical evidence show that taxes affect business location decisions.
- Abatements finance local job creation and thus are potentially cost effective.
- Abatements foster competitiveness and dissuade governments from imposing too high a business property tax burden.
- Abatements offer local officials the ability to be "action oriented" in their approach to economic development and allow local politicians to send out a positive signal on the locality's "pro-business climate."
- Stand-alone property tax abatement programs allow a local jurisdiction to neutralize a state and local tax system over which they otherwise have little influence.

Cons:

- Property taxes are a relatively small portion of overall costs faced by businesses making location decisions.
- Some empirical studies have shown abatements to be cost ineffective.
- The selective use of abatements raises questions of equity, as jurisdictions often favor corporations over smaller or local businesses.

- Abatements pull public dollars away from infrastructure, health, and education improvements.
- The proliferation of jurisdictions offering tax abatements turns the decision of where a business will locate into a "game" not of where a business will best operate but of where the business can receive the most "free handouts."
- The ability to offer abatements creates a zero-sum game where on the micro scale cities, in their competition with one another, drive deals so far down that the only real beneficiaries are the companies. Additionally, for state governments, one locality's gain likely comes at the expense of another locality-within-the-state's loss.

Score and Why:

B-

Tax abatements are a well established tool for area economic development. Though their effectiveness is not always as strong as anticipated, they show that a jurisdiction is pro-business and at least actively trying to attract businesses. The success of offering tax abatements depends on the level of government from which abatements are offered, how abatements are structured, and the expected response from other jurisdictions vying for the same economic development activity. However, as long as one jurisdiction offers them, others will follow suit in an attempt to remain competitive.

The Dayton TechTown project is situated on the Miami River in downtown Dayton on the former GM truck plant site. State, federal, and private (GM) cleanup funding was acquired and used to remediate the site for technology office uses.

Brownfields subsidies typically are designed to influence where and how development occurs on a specific property. Financial assistance from public agencies is offered in the form of direct and indirect financing incentives. Direct financing tools include loans or grants, and indirect financing assistance includes tax abatements or credits, loan guarantees, and loss reserves.

BROWNFIELDS FUNDING

Program Description:

Brownfield sites are defined in the 2002 federal brownfields law as "real property, the expansion, redevelopment, or reuse of which may be complicated by the presence or potential presence of a hazardous substance, pollutant, or contaminant." Financing brownfields cleanup continues to be a barrier to their reuse. The three most commonly cited impediments to brownfields redevelopment are the lack of cleanup funds, concerns over environmental liabilities, and the need for environmental assessments. In a 2003 U.S. Conference of Mayors study, more than 40 percent of respondents indicated that market conditions were also one of the five most important impediments that cities encounter in redeveloping brownfields.

All states offer some form of brownfields cleanup financing assistance to compensate for the costly and complicated task of redeveloping a brownfields site. Brownfields subsidies typically are designed to influence where and how development occurs on a specific property. Financial assistance from public agencies is offered in the form of direct and indirect financing incentives. Direct financing tools include loans or grants, and indirect financing assistance includes tax abatements or credits, loan guarantees, and loss reserves.

The primary goals of brownfields redevelopment incentives are to:

- Offer incentives to property owners to help level the economic playing field between brownfields and greenfields,
- Bring a greater level of certainty to the cleanup and redevelopment process,
- Establish finality for cleanups, with liability relief and no further action mechanisms, and
- Ensure that the long-term management of contaminated land protects human health and the environment.

How Extensively Used:

Federal, state, and local programs continue to be at the forefront of brownfields cleanup and redevelopment, as both the public and private markets recognize the opportunities of response programs in ensuring protective and sustainable cleanups. Numerous groups representing a wide range of interests – developers, engineers, lo-

Redevelopment of brownfields sites in the Mid-Town Corridor of Cleveland, OH will help bring jobs back to communities.

cal appointed and elected officials, lenders, regulators, and the environmental community – continue to support brownfields redevelopment, and interest in brownfields continues to grow. The increasing number of properties entering into state programs further exemplifies states' growing role in brownfields cleanup. Several states recently passed legislative changes to establish new programs, while other states adopted new regulations to enhance their programs and encourage cleanups.

Pros:

- Federal and state promotion of brownfields has yielded numerous success stories of underutilized contaminated properties that now house a variety of economic activities.
- Brownfields redevelopment can increase a city's tax base, neighborhood revitalization, and job creation.
- Financial support reduces development costs, increasing the expected rate of return on a private investment to counter the uncertain liabilities that often occur in redeveloping contaminated properties.
- Brownfields redevelopment improves environmental quality through cleanup of contamination while reducing the demand for undeveloped land. According to a 2001 George Washington University report, every acre of reclaimed brownfields saves 4.5 acres of greenspace such as park and recreation areas.

Cons:

- Little has been documented about how economically distressed populations (those who often have the fewest tools to make brownfields redevelopment work) capture the benefits of brownfields regeneration within their communities.
- Some federal, state, and local brownfields programs de-emphasize the "brown" and focus on the economic development priorities.
- The remediation strategy of choice at many brownfields sites – to leave contamination in place but limit the public's exposure to it through capping, fences, and institutional controls – could unfairly or unwisely transfer risk to future generations.
- It is not completely clear which kind of public sector assistance for brownfields redevelopment is most beneficial to the private sector.

Score and Why:

B+

The uncertain liabilities in redeveloping brownfield sites and the significant costs (compared to clean parcels) associated with investigating, remediating, and redeveloping such sites make public assistance in brownfields welcome and sometimes essential.

CDBG FUNDING

Program Description:

The federal Community Development Block Grant (CDBG) program distributes funds to local jurisdictions and states based on a standard formula, but as long as the funds principally benefit low- and moderate-income people, local players are given almost all program decision-making responsibilities. CDBG was developed with the idea that local governments and community development nonprofits are better situated to determine community development needs than a more centralized oversight body. The program's broad objective of creating "viable communities through decent housing, suitable living environments and expanded economic opportunities for low- and moderate-income people" has meant that funding touches many lives through a number of avenues: employment training and literacy programs, youth and senior services, upgrades to public infrastructure like water and sewer systems, commercial corridor enhancements, homebuyer assistance, and home safety and energy efficiency improvements.

Commercial revitalization projects, including Greenville Commons in Greenville, SC, use CDBG grants as a funding opportunity.

How Extensively Used:

Created in 1974, the CDBG program, one of the longest continuously running programs at the U.S. Department of Housing and Urban Development (HUD), is one of the federal government's largest community development and neighborhood revitalization programs. Despite the debate regarding the best use and distribution of funds, bipartisan support for CDBG in Congress and strong support at the local government level are encouraging signs that the program will continue to direct investment into low- and moderate-income communities.

Pros:

- A survey by the Urban Institute of 17 CDBG recipient cities found that all surveyed cities saw that their CDBG investments were linked to improvements in neighborhood quality (based on median loan amounts and number of businesses).
- The broad range of uses allowed under the program means that local allocation strategies can be crafted in ways that are responsive to local conditions.

- The use of CDBG funds for many programs, even on a small scale, is a more politically appealing approach than funding fewer programs on a larger scale.

Cons:

- The flexibility of the CDBG program can make it susceptible to mismanagement.
- The current allocation formula, which includes the program's core variables (such as poverty, age of housing stock, overcrowding, and population), has not been updated since 1978.
- The program is generally targeted to low- and moderate-income communities often in a "scatter-shot" approach. More careful programmatic targeting could generate more effective leveraging of resources but may conflict with benefiting low- and moderate-income areas.
- The variability of program uses creates difficulty in establishing uniform performance standards and in assessing program impacts.
- Documenting eligibility can be time consuming.

Score and Why:

C+

CDBG funding, when used in combination with other community development programs such as HUD's HOME program and Low Income Housing Tax Credits, can be successful in incentivizing development in low- and moderate-income communities. More leveraging of program funds to benefit targeted groups may yield a higher score. The lower grade reflects the fact that the funding is used for a broad range of community development programs which are not always related to economic or real estate development.

TAX INCREMENT FINANCING (TIF)

Program Description:

Tax Increment Financing (TIF) is a tool that uses expected future tax revenue to pay for a variety of development costs related to a real estate project. The basic TIF process begins with the demarcation of a geographic area that is designated as a TIF district. This area can vary in size from a large district encompassing many acres and parcels to a single parcel. Next, there is the determination of the existing tax value assessment of the land and improvements within the TIF district; this is the base level. Finally, the future or incremental tax value assessment that will result from the planned real estate development project is forecast. The increased assessed value above the base level will generate incremental, or new, tax revenue.

Under the TIF mechanism, all or a portion of the new tax revenue provides a cash flow to support debt. That debt is used to finance a portion of the development costs associated with the real estate project that is driving the increase in assessed value. The types of costs that can be paid for with TIF vary by state but are generally focused on infrastructure, public space, demolition costs, land costs, parking, and environmental remediation.

Reasons TIF Is Used:

- Allows policy makers to encourage investment in urban/brownfield locations.
- Provides public financing assistance for projects with challenges that present significant obstacles to development. These challenges can include the existence of blight (e.g., dilapidation, obsolescence, and deterioration), environmental issues, or reuse of a specialized asset (e.g., military base). The theory is that without a way to reduce costs posed by the challenges, the projects would not attract private investment and, therefore, would not move forward.
- Ensures that the infrastructure costs related to new development are borne by the drivers of those costs rather than the existing area residents and businesses.

The use of tax increment financing was instrumental in developing the Park Place project in Annapolis, MD.

How Extensively Used:

Legislation enabling TIF goes back as far as 1940 (Tennessee) and now exists in every state except Arizona. Midwestern states and California are among the most active users of the TIF mechanism. Some key variations among states include the types of eligible tax revenues (property, sales, PILOTs, other), the duration (years) of the TIF district, and types of costs that can be financed with TIF.

Pros:

- Targeted mechanism providing solution to projects with significant development challenges.
- Potential to achieve public support as it allows for public investment without impacting existing tax rates.
- Widely used, understood, and accepted by public finance and real estate development communities.
- Can have a successful TIF district without issuing bonds.
- Can be used to fund public improvements when traditional financing is not available.

Cons:

- May require negotiations and agreements with other taxing authorities (school districts, county, etc.).
- Susceptible to misuse when applied to projects where need is not adequately proven (e.g., liberal interpretation of blight definition).
- Due to the administration/issuance costs related to the formation of a TIF district and issuance of TIF bonds, TIF financing is more effective for large projects.
- Depending on the structure of a TIF bond, it could impact a municipality's credit rating and ability to issue additional debt.

Score and Why:

A

As evidenced by its widespread and longstanding use as an economic development tool, TIF is an effective and flexible mechanism. The structure enables policy makers to direct investment into areas that have a need, while leveraging private investment for large projects that are likely to have a significant positive impact on the surrounding areas. Furthermore, because the public investment is financed through future tax revenue, TIF is seen as an equitable tool that does not impact the existing tax base.

NEW MARKETS TAX CREDITS (NMTC) PROGRAM

Program Description:

The New Markets Tax Credits (NMTC) program is a community development lending tool designed to stimulate the flow of investment to underserved communities by creating new jobs and accelerating economic revitalization. The program can supply needed capital for real estate and other economic development projects by providing federal tax credits to investors when a qualifying investment is made. (Unlike a tax deduction, a federal tax credit allows $1 reduction in federal tax liability for every $1 in secured tax credits.) The simple process flow chart depicts how the NMTC program works.

Community Development Financial Institutions Fund (CDFI Fund): Part of the U.S. Treasury Department, the CDFI Fund is responsible for certifying CDEs (see below) and allocating tax credits through a competitive application process. In 2009, the fund awarded $4 billion in tax credits to 100 CDEs. The total available allocation is set annually by the federal government.

Community Development Entities (CDEs): NMTC provides a credit against federal income taxes for investors that make Qualified Equity Investments into Community Development Entities (CDEs). The CDFI Fund certifies CDEs on an ongoing basis and annually awards NMTC allocations to select CDEs through a competitive application process. To qualify as a CDE, the entities must meet the following criteria:

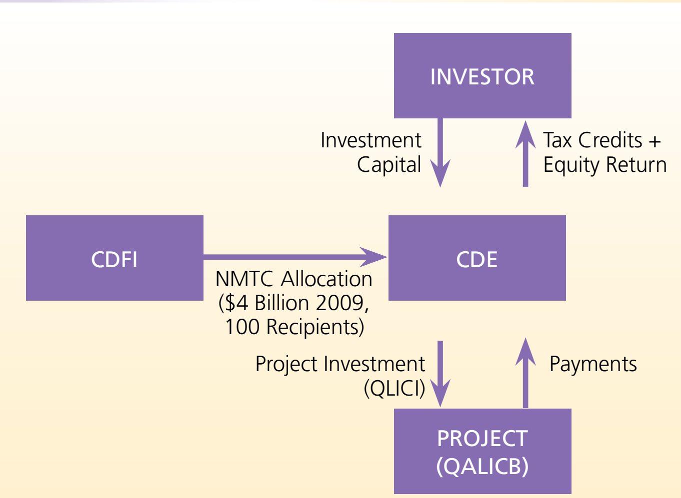
a) Have a primary mission of serving or providing investment capital for low-income communities or low-income persons (at least 60 percent of activities are focused on low- income communities or people);
b) Maintain accountability to residents of low-income communities through their representation on any governing board or advisory board to the entity; and
c) Be private and for-profit, though their parent entities can be public or non-profit.

Once awarded a NMTC allocation, the CDEs are generally responsible for identifying and screening projects, underwriting and deal structuring, project monitoring and asset management, and investor reporting.

Investors: Tax payers who make a qualified equity investment and in return receive a 39 percent cumulative tax reduction, along with project equity and associated financial returns. The credits are designed to be used over seven years, allowing for a 5 percent tax reduction in the first three years and a 6 percent reduction in each of the remaining four years. The credits are used as incentives to help attract private sector investors who, in exchange, provide the CDEs with capital that is used to finance projects designed to revitalize low-income communities.

The developer of the UMB BioPark received a New Markets Tax Credit allocation for use in this project, because the site chosen in West Baltimore is in a low income and impoverished neighborhood. The 39 percent tax credit over seven years went to offset the infrastructure and other development costs.

NEW MARKETS TAX CREDITS PROGRAM – SIMPLE PROCESS FLOW CHART



Project Investment: Investments are termed Qualified Low-Income Community Investments (QLICI). Project types can include, among other things, investments in businesses and real estate projects in low-income communities. To be eligible, a project must be located in census tracts where the median family income does not exceed 80 percent of AMI (area median income).

The CDE invests in one or more QLICI, which usually translates into a debt or equity investment in a Qualified Active Low-Income Community Business (QALICB).

Development activities include loans, equity or capital investments; purchase of certain loans made by other CDEs; and financial counseling and related services to businesses. NMTC funds cannot be used in projects which are already subsidized by other federal tax subsidies, with certain exceptions.

Real estate projects considered under this program include:

- Multi-tenant office buildings;
- Grocery and/or credit-tenant-anchored shopping centers;
- Owner-occupied properties;
- Retail distribution centers;
- Business/office parks;
- Single-site manufacturing facilities;
- Mixed-use developments (retail/office); and
- Charter schools, community centers, childcare centers, and other community facilities.

Housing and Mixed-use: NMTC may not be used to develop affordable housing. In certain circumstances, NMTC may be used to finance mixed-use projects, where less than 80 percent of the gross rental income comes from dwelling units. In cases such as this, the Low Income Housing Investment Tax Credits and NMTC may not be used to subsidize the same square foot. In the case of mixed-use developments, the subsidization may be split between uses, allowing NMTC financing for parts of the project.

Ineligible Activities:

- Residential rental properties – buildings which derive 80 percent or more of their gross rental income from dwelling units; and
- Liquor stores, golf courses, and tanning salons.

Reasons Used:

- Provide financing solution to fill "funding gap" that can prevent investment in low-income communities.
- Provide mechanism to leverage federal investment with other sources of private and public capital.

How Extensively Used:

- NMTC program was established by Congress in 2000. Through the first seven rounds of the program, $26 billion in tax credits have been allocated to 495 CDEs.
- Types of CDEs include banks, community development organizations, government entities, and real estate companies.

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- NMTC can be used for a wide range of real estate projects (retail, office space, educational and community facilities, child care centers, and community health centers) and business financing.
- NMTC has been used to finance rural and urban projects throughout the United States.

Pros:

- Federal tax credits provide significant financial incentive to investors.
- Flexible – allows creative deal structuring involving investors, lenders, and project owners.

Cons:

- Limited availability, requires project sponsor to either partner with or become a certified CDE.
- Only available for projects located in areas that qualify as low-income census tracts.
- Tax allocations are awarded on a competitive basis (in 2009, the CDFI Fund received 249 applications and selected 100 for allocation awards, a 40 percent selection rate).
- Due to fixed compliance and monitoring costs, NMTC is more effective for large projects.

Score and Why:

B-

The NMTC program can bring an additional source of capital to a project that would otherwise not be feasible. The structure of the program also allows for flexibility and creative mixes of various types of financing. However, given the certification requirements, eligibility criteria, monitoring and compliance costs, and competitive award format, NMTC may not be available for many redevelopment projects.

CONCLUSION

We concluded that some tools (such as tax increment financing and brownfields funding) offer significant advantages over others in terms of flexibility and positive impacts, not only in terms of the desired project but also on surrounding areas. Use of other tools (such as CDBG funding and tax abatements) is viewed as more challenging due to competing local interests which count on these funds for other community development programs or the negative perception tied to offering some businesses "a deal" over others. Finally, while potentially valuable tools, some programs (such as CDBG and NMTC) present obstacles regarding certification, eligibility, compliance costs, and others that may hinder interest in their use.

In closing, our "scorecard" for financing economic development is shown below.

We concluded that some tools (such as tax increment financing and brownfields funding) offer significant advantages over others in terms of flexibility and positive impacts, not only in terms of the desired project but also on surrounding areas.

Financing Tool	Brief Description	Grade
Tax abatements	Reduction or deferment of tax obligations	B-
Brownfields funding	Direct (e.g. grant) and indirect (e.g. loan guarantees) financing assistance for project costs related to environmental remediation	B+
CDBG funding	Federal grant program administered by local governments for community development activities to benefit low- and moderate-income people	C+
Tax Increment Financing (TIF)	Financing tool that leverages future projected tax revenue to pay for upfront development costs (e.g. infrastructure)	A
New Markets Tax Credits (NMTC)	Federal program that awards federal tax credits to designated development entities for projects located in underserved communities	B-

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