TIFs increasingly fuel city projects

By Melody Simmons and Joan Jacobson, *The Daily Record*, January 31, 2011

What is a TIF? The acronym stands for Tax Increment Financing, a little-understood form of public investment in urban redevelopment now favored by the city of Baltimore.

When City Hall approves a TIF to help finance a new development, bonds are sold to investors. The bonds are to be repaid not with city general funds but with future property taxes from the new development.

This financing mechanism decreases the upfront development costs, but it also decreases the amount of property taxes that flows into city coffers from the new development until the bonds are paid off.

Historically, Baltimore has enticed developers with a variety of tax breaks such as PILOTs (Payments In Lieu Of Taxes) or multimillion-dollar loans as second mortgages that often did not need to be repaid.

But in the current economy, city economic development officials like TIFs because they function like a blank check and can keep development moving even in the depths of recession.

A TIF is often seen as "a kind of free money," says Joan Youngman, a senior fellow and TIF expert at the Lincoln Institute of Land Policy in Cambridge, Mass.

"This is why they're often seen as the only game in town and the only feasible and palatable [option] when a tax increase is not popular," she explained.

Serious commitment

From the standpoint of the private investor, a TIF is viewed as a signal that the city has made a serious commitment to a project, said Steve Kraus, chief of the city's Bureau of Treasury Management.

Since May 2003, Baltimore has sold bonds for seven TIFs, Kraus said, totaling $116.1 million. Those TIFs were used for HarborView, Clipper Mill, Mondawmin Mall and Locust Point, among others.

"These projects would not have moved forward without the TIF and they needed more money than a PILOT," Kraus said.

No bonds have been issued yet for three additional TIF districts created by the City Council.

One of those districts is in Harbor Point, on the slice of land between Harbor East and Fells Point where developer and bakery magnate John S. Paterakis hopes to get $150 million in TIF bonds for new construction, according to members of the TIF task force.

Another is at Westport, where developer Patrick Turner envisions a 4.8 million-square-foot mixed-use development on 50 acres along the Patapsco River. It would include office, retail, housing and hotel space and cost $1.5 billion. Turner is expected to seek $160 million in TIF bonds, according to members of the TIF task force.

After the City Council voted to establish the Harbor East TIF district in November, Councilman Carl Stokes formed a task force to review TIF and PILOT financing in light of the city's budget woes.

At a task force meeting last Tuesday, Kraus said bond rating agencies consider TIF bonds the same as general obligation bonds in calculating a city's debt load.

Joseph T. "Jody" Landers III, a member of the task force who is executive vice president of the Greater Baltimore Board of Realtors and a former city councilman, cautioned that TIFs divert tax revenues from the city's general fund because the TIF bonds are repaid, often for decades, before full tax revenues are realized from a development.

"Clearly you're committing tax revenue to a specific project – it is money that doesn't go into the general fund," Landers said, agreeing that the impact on the city's borrowing capacity is also affected by TIF because rating agencies look at combined debt.

The New East Baltimore

The largest TIF issued by the city so far is for The New East Baltimore.

The bonds sold in 2008 and 2009 total $78 million, or more than one-third of the project's public funding to date.

A debt service schedule obtained by The Daily Record from the city's Bureau of Treasury Management shows that $199 million in property taxes will be diverted to repay holders of the TIF bonds over the next 29 years.

That schedule assumes there will be enough development on the property to generate the taxes to repay the investors. But today The New East Baltimore TIF tax district is largely vacant land.

According to city documents outlining the TIF, the property owner — East Baltimore Development Inc. — would be liable for the debt if there is not sufficient property tax revenue to repay it. If the property owner defaulted, the land would revert to the city like any tax delinquent property. But in that case, the bond holders would not get paid.

Youngman, the TIF expert at the Lincoln Institute of Land Policy, said she is unaware of a municipality anywhere in the country that hasn't collected enough property taxes to repay TIF investors. The institute is currently sponsoring research to see if declining property values in Wisconsin are adversely affecting repayment of TIF bonds.

One of the investors of the Baltimore TIF bonds was the locally-based national philanthropy, the Annie E. Casey Foundation, which pumped in $27 million in 2009 when the economy slumped and it became difficult to find traditional investors.

Douglas W. Nelson, Casey's recently retired CEO who is now chairman of EBDI's board, said he realized the risks inherent in getting loan repayments in difficult economic times.

"Of course, if there is no tax increment, the city can't pay us back, and so if we don't have homes … and other enterprises, we'll be in trouble," said Nelson.

"I don't expect the city to default on these bonds," he added, "but I recognize that this is a debt that requires a patient lender because of the time it will take to create the resources to repay the city."

In the meantime, city officials say they are confident there will be enough of a cushion in a reserve fund set aside to aid such repayments to cover expenses in the early years of the bond repayments.

Repayments of the New East Baltimore TIF began in 2008 with interest-only amounts of about $2 million a year. This year payments will be $3.8 million. By the year 2038 annual payments will be $9 million.

"We're going to get what's owed us and the bond holders will get paid," said Kraus, who praised the Casey Foundation for purchasing the bonds when conventional investors would not.

The city is not liable to repay the bond holders, said Kraus, and if the bonds don't get repaid, it will not affect the city's bond rating. He also noted that no TIF debt in Baltimore has ever gone unpaid.

Extra precautions

With that in mind, EBDI and the city are taking extra precautions they hope will keep Baltimore's TIF debt repayment record intact.

At the behest of city financial advisors, two recent additions to The New East Baltimore development plan — a $60 million graduate student housing tower owned by the Johns Hopkins University and a $175 million state Department of Health and Mental Hygiene lab — will be required to make unusual payments in lieu of taxes to make sure each tax-exempt building contributes to the TIF repayments.

“We need to hold fast” to the responsibility to bond investors, said Christopher Shea, EBDI’s CEO. “In order to welcome a tax-exempt building to the project,” he said, TIF repayments still must be made.

Hopkins will be responsible for a $400,000 annual payment in lieu of taxes, said Cynthia Swisher, EBDI’s chief financial officer. The annual amount of the state lab’s payment in lieu of taxes has yet to be determined.

‘We don’t even understand this’

TIF financing dates to 1952 in California. It became a popular way to finance development projects in the 1980s and 1990s as federal and state funding grew scarce, according to research conducted for the Lincoln Institute of Land Policy, an independent nonprofit organization that studies urban development and land taxation. Today, Wisconsin has more than 1,300 TIF districts, according to the Lincoln Institute

Recent articles in the *Chicago Reader* showed that Chicago has 159 areas where property taxes are redirected to repay TIF investors and finance new development. The *Reader* skeptically called Chicago’s TIF program the “shadow budget” because the city attempted to keep confidential the financial plans for half a billion dollars gleaned from TIF districts.

The newspaper also reported last year that Chicago’s TIF districts will run deficits in the next few years from declining property taxes.

Local governments tend to like TIFs because they typically don’t need voter approval like other bond issues, says Youngman, the Lincoln Institute TIF expert.

When asked if he thinks the average citizen understands the TIF financing mechanism and its implications for the government issuing the bonds, Baltimore City Councilman Carl Stokes said no.

“We don’t even understand this,” Stokes said, referring to his council colleagues.

Youngman cited a lawsuit filed in Florida by a man trying to stop a road project. In 2007 the Florida Supreme Court ruled that voters must approve TIFs, then reversed itself a year later after complaints from local governments, Youngman said.

In its reversal, according to the publication State Tax Today, the court wrote that demanding voter approval would “cause serious disruption to the governmental authorities.”

Baltimore City Councilman William H. Cole IV says TIFs are an essential development tool for the city.

Cole says he monitors Baltimore's TIF projects as chair of the council's Community Development Subcommittee and as a member of the Taxation, Finance and Economic Development Committee.

Without TIF bonds, says Cole, a project like The New East Baltimore might never get off the ground.

"We can't settle for the status quo," he said.