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November 19, 2007

The Hon. Arnold Fielkow
Chair, Special Projects and Economic Development Committee
New Orleans City Council
1300 Perdido St., Room 2W40
New Orleans, LA 70112

Re: Task Force Report on Tax Increment Financing

Dear Councilmember Fielkow:

The Bureau of Governmental Research appreciates the opportunity to comment on the task force report on tax increment financing (TIF) presented by Dr. Blakely to the City Council's Special Development Projects and Economic Development Committee on October 9, 2007 (Task Force Report). We commend the City for taking this first step toward establishing an effective, impartial economic development policy.

We begin with some general observations on the use of TIFs and then proceed with issues in the order presented by the Task Force Report.

General Observations

TIFs Are Not Free Money

TIFs provide cash-strapped municipalities with a means of making investment in infrastructure and economic development projects. Much of their popularity stems from the self-financing nature of the mechanism. In theory, payments for the improvements come solely from incremental tax revenues that would not exist without the TIF investment.

The premise that TIFs are self-financing is open to question, however, for a number of reasons. It is difficult to assess whether redevelopment in an area would occur without the TIF. It is even more difficult to assess the extent to which gains in a TIF district are offset by stagnation, decline or reduced growth in other areas and businesses. Furthermore, when TIF district boundaries are drawn too expansively, they capture tax increments not attributable to the TIF investment. And TIF districts can increase a local government's operating costs without providing commensurate funds to the local government. The end result in that case is a transfer of the additional costs to residents outside the TIF district.

For these reasons, TIFs should not be viewed as free money. Rather, they represent an off-balance sheet investment of public funds and an allocation of public resources to specific parts of the city. As such, they should be evaluated with the stringency befitting an outlay of public funds. The objective should be to minimize the City's TIF investment while maximizing the return to the public. In addition, where TIFs are used to subsidize private development, they should allow no more than a reasonable rate of return to the developer.

Property vs. Sales Tax TIFs

As the Task Force Report observes, New Orleans is authorized to use TIFs based on either property or sales taxes. As it also observes, TIF based on property tax is not a practical tool because most of the tax revenue in the City is dedicated to specific purposes and unavailable for capture by the TIF district.

This leaves sales tax TIFs, which suffer from serious problems. They represent an outgrowth of the original TIF concept and are not allowed in approximately two-thirds of the states. (By contrast, only one state does not allow property tax TIF.) Sales tax TIFs are far more likely than property tax TIFs to cannibalize the existing tax base by capturing revenues unrelated to the TIF investment and by shifting sales from another part of the city to the TIF district. When used to directly subsidize retail development, they provide the recipient business with an unfair advantage over competitors. The quest for TIF sources can lead to unnecessary subsidies for big retailers. TIF debt financing tends to be more expensive than that based on property taxes, since the revenue source is more volatile.

The bottom line: Not all types of TIF are created equal. In the past, we have recommended that the City abandon the use of TIF based on sales and hotel taxes. If the City is determined to use sales tax TIFs, we recommend that the City mitigate the risk of adverse impacts on other businesses and the City’s finances by:

- Restricting the use of sales tax TIFs: (i) to financing improvements to public infrastructure and other public property to which the general public has access (e.g., streets, parks, promenades); or (ii) to the cost of environmental remediation that cannot be financed through other means. With the exception of environmental remediation, the funds should never be used to directly subsidize a retail enterprise.

- Using sales tax TIF only if the State is also willing to match the sales tax contributed by the local government.

- Setting a percentage cap on the amount of a tax increment that can be captured by a TIF district. For example, the policies might provide that a sales tax TIF cannot capture more than 80% of the sales tax increment generated in the district. The other 20% would go to the City’s General Fund.

We strongly recommend against using sales tax TIF to subsidize development directly. If the City decides to do so, however, it should set the percentage cap at a significantly lower level. For example, the policies might provide that no more than one-third of the increment in a sales tax

TIF district may be applied toward a development's costs; the other two-thirds would revert to the City's General Fund.

Comments on Task Force Recommendations

The following is a discussion of the Task Force's recommendations that tracks the Task Force Report on a section-by-section basis.

(1) TIF Procedures in the City of New Orleans

We concur in the recommendation that the City establish a uniform system for evaluating and approving TIF districts. We also support the recommendation that the City publish all TIF-related forms, guidelines and supporting documents on-line. We recommend that the City publish the procedures as well.

We note that the Task Force Report provides no information on important aspects of the process, such as who is conducting the review and making the decision on the TIF applications. While the report mentions an oversight committee, it is unclear whether that committee's role is limited to monitoring of projects that have already been approved.

(2) Geographic Considerations During Recovery and Rebuilding

This section addresses two issues: the use of TIF proceeds and the geographic areas in which TIF can be used.

Use of TIF Proceeds. The Task Force Report recommends that at least 50% of TIF proceeds should target infrastructure repair and improvement. The City's policy should clearly spell out permissible uses for the remaining 50% of TIF proceeds. In the case of property tax TIF, we suggest restricting its use to prep work needed to make the urban landscape more attractive for investment, such as streets, sewer and water systems, demolition, site preparation, property assembly and environmental clean-up. In the case of sales tax TIF, we recommend restricting its use to infrastructure and other public improvements accessible to the public or to environmental remediation costs that cannot be financed by other means.

Geographic Areas. The Task Force recommends that the City limit TIFs to the following geographic areas: areas included in medical districts, areas designated for riverfront development or redevelopment, existing commercial corridors, and Recovery Management Target Zones defined as "Rebuild" and "Redevelop."

It is difficult to comment on the choice of areas without more information as to why they were chosen, what they would include, and how the City would deploy proceeds from TIFs. The policies and procedures should include clear definitions of the areas and illustrative maps.

In their current, unrefined state, the area recommendations appear to be overly broad. Take for example, the Riverfront. This area presumably refers to the four-mile stretch that has been the focus of recent efforts by the Port of New Orleans, the New Orleans Building Corp. and the City

Planning Commission. Some of this area is not appropriate for a TIF, since it consists in part of prime real estate and healthy, developed areas. If the intent is to derive tax increments from new development to pay for public space along the riverfront, the policy should clearly specify that.

To take another example, commercial corridors is also too broad a geographic designation, since it also picks up thriving areas.

We recommend further restricting eligible geographic areas to:

- Blighted areas.

- Areas of the city that can become self-sustaining and are not exposed to a high risk of catastrophic flooding, based on objective criteria.

(3) Streamlined and Consolidated Process

The Task Force Report recommends that the City designate the Division of Economic Development as the single point of entry for TIF applications. It also recommends that the Division of Economic Development standardize the application and review process. We support a single point of entry and standardized forms and procedures, but note that there is insufficient detail at this time to provide useful comment.

(4) Clarification of Expectations

Here and in an earlier section entitled "Action Steps," the Task Force sets forth a list of eligibility requirements for TIFs. We agree in concept that there should be geographic restrictions, a "but for" test, minimum cost-benefit ratios, and minimum job creation and developer equity requirements. That said, these requirements should function as minimums for consideration of a TIF and not provide automatic authorization for projects that meet those requirements.

We offer the following comments on the specific requirements:

"But For" Test. We strongly support the Task Force recommendation for a "but for" test. We note that there are different concepts of that test. Some interpret it as meaning that a specific project would not proceed without the investment. Others define it as meaning that appropriate development would not occur in a targeted distressed area within a reasonable time frame without the TIF. The latter is the more widely used, and more appropriate, concept. The City's policy should specify this. The importance of the test as a threshold requirement cannot be overstated.

Cost-Benefit Ratio. The Task Force recommends a cost-benefit ratio of at least 1:3. We believe that this should be a minimum threshold for consideration of a TIF, rather than a determinative factor. The cost-benefit ratio should apply to both economic impacts (costs and benefits to the Orleans Parish economy) and fiscal impacts (costs and benefits to Orleans Parish governments' revenue).

The policies and procedures should include standards for economic impact studies, addressing what items would be included as benefits and costs, the appropriate time horizon, and what documentation would be necessary to evidence the numbers.

Job Creation. The Task Force recommends that 20% of jobs created be quality jobs offering a living wage. We support the concept of a requirement for job creation, but believe the standards set forth in the recommendations fall short of what is needed.

First, the expectations are vague. The policies and procedures should define what is meant by a “quality” job. Is it one that is high paying, one that requires a certain level of education or skill, or one in management? The policies should also define a living wage and provide specifics as to full- versus part-time work, benefits, etc.

Second, the Task Force should clearly articulate its goals with respect to job creation. Is the City trying to create highly paid jobs for skilled workers, jobs that will raise the living standards of the unskilled work force, or any type of jobs, including those paying minimum wage? The criteria in the Task Force Report suggest that the goals are very low, since 80% of the jobs can be of the latter type. Are minimum wage jobs worth a public investment? We submit not and suggest that the City aim higher.

Third, the recommendation does not call for a minimum number of new jobs nor does it tie the amount of tax diversion to the number of jobs created. One quality job paying a living wage would be sufficient to meet the articulated standard. We strongly recommend setting minimum standards and tying the amount of subsidy to the number, types and quality of jobs created.

Private Investment. The Task Force Report requires that the owner/investor have at least 25% equity in the project beyond the contribution of land. We agree with the concept of requiring significant private equity. The public investment should supplement the owner’s investment to help offset adverse conditions in the urban environment, rather than replace such investment. We do not understand why land would be excluded from the calculation of owner/investor equity.

We do not know how the Task Force arrived at the 25% figure. We suggest amending the recommendation to require that the owner/investor maintain equity in the greater of (i) that amount or (ii) the amount that would typically be required by lenders to finance a similar project in a healthy environment. We also recommend clarifying what type of investment counts as equity. For example, would tax credit equity be considered owner/investor equity?

We would add a separate requirement for a high ratio of private to public investment. Too often, developers accumulate multiple subsidies from the public. The result is that the private funding is insignificant compared to the public equity.

Project Feasibility. We support the requirement for a demonstration that the project is feasible.

Affordable Housing/Public Good. It is important to bear in mind that a TIF policy is an economic development policy and that any housing development should be evaluated in that light. A TIF investment related to housing should be based solely on demonstrated economic and fiscal benefits. The introduction of other goals will confuse the function of a TIF policy and lead to distortions in decision-making.

The concept of "public good" is too vague and should be eliminated. If it is intended to refer to infrastructure improvements, the standard should be recast in those terms.

(5) Enhanced Public Participation

We support the recommendation to create more opportunities for public comment. Such opportunities should be provided early in the process before critical decisions have been made.

All meetings relating to TIFs, including those of the oversight and other deliberative committees, should be conducted in accordance with both the letter and the spirit of the open meetings law. Practices that undermine transparency, such as one-on-one briefings and behind-closed-door negotiations among the administration, councilmembers and potential developers, should be avoided.

All documentation relating to TIF proposals and deliberations should be available to the public and posted online. By using public dollars to finance a project, a developer has accepted the public as an investor.

(6) Oversight, Monitoring and Accountability

The Task Force recommends that the Mayor's Office establish an oversight committee to evaluate the progress and compliance of projects using TIF support. We consider monitoring of compliance an indispensable function of a good economic development policy; however, the wording of the Task Force's recommendation creates some confusion.

It is unclear whether the monitoring committee is the same as the committee that reviews applications. This would be a conflict of interest. We suggest using the Office of Inspector General (if adequately staffed) for monitoring. The same principle should apply to hired advisors: those whom the City retains to evaluate and create TIFs should not be eligible to monitor projects that win approval.

To protect the interest of the City's residents and taxpayers, the City should obtain advisors or staff with the sophisticated financial, legal and managerial expertise needed to evaluate, establish and monitor such districts effectively.

We note that accountability requires a well-crafted legal agreement between the developer and the City. The agreement should spell out the expected performance and require owners of TIF projects to provide the City with the information necessary to compare the projected benefits with actual benefits on an annual basis. TIF investments should be structured to allow the City to recapture all or a portion of the public subsidy to the extent practicable through mechanisms such as long-term ground leases, subordinated loans and revenue participation.

To allow the public to judge the performance of TIFs, the City Council should provide an annual report on TIF districts, including the amount of public funds dedicated to TIF and the performance of the various districts.

Additional Recommendations

Clearly Defining the City's Goals

While the Task Force Report identifies certain requirements for TIFs, the document leaves the reader in the dark as to what the City hopes to accomplish through them. The problem stems in part from the City's lack of a comprehensive economic development plan with clear goals and priorities. It is difficult to formulate policies for using economic development tools without knowing what the goals and priorities are. In the absence of such a comprehensive economic development plan, the TIF policy itself must articulate the goals and priorities and tie the use of the subsidy to them.

Clearly Defining Terms

Many of the concepts presented in the Task Force Recommendations are vague and require further definition. Vague terms create uncertainty and open the door to inconsistent treatment, undermining the concept of a uniform system for evaluating and approving TIF districts. We urge the City to incorporate specific definitions in its policies and procedures.

Distinguishing Between Project-Based and Area-Based Districts

There are two different types of TIFs: development-specific and area-based with multiple owners. These require some differences in policies and procedures. Among other things, in the case of development-specific TIF, the City should clearly identify the types of industries that the City contemplates subsidizing. We suggest that the City prioritize subsidies for industries that could serve as a catalyst for significant economic growth or help to diversify the economy.

Consolidating Governance

To the extent possible, the City should consolidate the administration of TIF districts in one body. Transparency and accountability would particularly suffer were the City to create a number of pay-as-you-go, area-based TIFs with multiple governing boards.

Limiting Revenue Diversion

Factors such as the duration of the TIF and the percentage of incremental taxes subject to reinvestment in the district should be pegged to projected costs and benefits, in accordance with predetermined standards.

In no case should the duration of a TIF district exceed the shorter of 20 years or the term of the bonds.

If the tax revenues in a TIF district exceed projections, the excess should either be used to prepay TIF debt or returned to the City's General Fund.

To encourage prioritization and careful targeting of projects, the City should establish a cap, based on a dollar amount or a percentage of the City's General Fund, on the amount of taxes that can be diverted to TIF districts citywide. In addition, the policy should set a percentage cap on the amount of a tax increment that can be captured by an individual TIF district.

Finally, sales TIF should be used only if the State is also willing to match the sales tax contributed by the local government.

Conflicts of Interest

The TIF policies and procedures should include the highest ethical standards and strong conflict of interest rules for all individuals and entities involved in the decision-making process or the oversight of TIFs.

Comments on Scoring

We note that developing a scoring system is premature until a guiding policy has been completed.

From the information provided, it is difficult both to understand the reason for the scoring system and to envision its practical application. Typically, a scoring system is used to evaluate competing proposals. Is it here meant to apply to an RFP process for redevelopment of individual sites? Or would it apply to the evaluation of proposals for multiple sites across the city? Or is it intended to help the City evaluate projects that have already met minimum requirements for approval?

Regardless of its use, the proposed scoring system is seriously inadequate. It doesn't address criteria recommended in the Task Force Report, much less those that a completed policy should include. In addition, it provides no information on how points will be awarded. As a result, the system is too subjective and provides little in the way of guidance.

Comments on Application

It is difficult to evaluate the City's draft TIF application in the absence of a guiding policy. Producing an application at this stage is, in fact, premature. However, we offer the following suggestions for improving the draft application:

- The application form should attach the City's TIF policy. On a cover sheet, the application should clearly state that the applicant must follow the policy.

- The application fee(s) should be determined and disclosed.

- The review and approval process for the application should be reiterated.

- The following additional information and documents should be required as part of the application:
  - Statement of public purpose. Why should the City participate in the development?
  - Plans and elevations with a narrative description of the project, including the location, size, phases and proposed land uses.
  - A list of any permits and other governmental approvals required for the development of the property. Description of any required waivers.
  - Information to show that the proposed TIF will be consistent with City ordinances and the City's master land use plan.
  - Description of the development entity, with documents evidencing (i) ownership structure, providing all owners' names, addresses and percentage ownership of the entity; (ii) incorporation or organization status of the entity per the Louisiana Secretary of State; and (iii) the entity's most recent audited financial statements.
  - Description of the principal developer's experience in real estate development, listing past projects and appropriate references.
  - Evidence of site control, such as ownership, purchase option or contract, or long-term lease.
  - Environmental study of the site, and if necessary, a site remediation plan.
  - Letter of commitment or other evidence of the availability of financing.
  - Detailed, third-party market study demonstrating the market demand for the proposed project.
  - If public infrastructure improvements are requested, a detailed, third-party estimate of the infrastructure needs and costs and a traffic impact study to support any requested road/street improvements.
  - "Gap analysis," a detailed financial analysis based on the market study, development budget, pro forma, and infrastructure needs that determines the financing gap the developer proposes to fill with TIF.
  - Written explanation as to why financing is unavailable to fill the gap.
  - Declarations on whether the developer will pursue or expects to receive any other public assistance.
  - A written TIF proposal, detailing structure (e.g., annual rebate of infrastructure costs or revenue bonds supported by TIF), duration, anticipated annual increments diverted to the TIF district, and any anticipated surplus tax revenues to the City's General Fund.

- If bond financing is contemplated, additional information on projected form and terms of the bonds.

- A cost-benefit analysis that takes into account both the economic and fiscal impacts.

In closing, we would like to emphasize that TIFs based on sales taxes are fraught with pitfalls. They are far more problematic than standard, property tax TIFs. We have taken a position against them in New Orleans. If the City intends to use sales tax TIF, however, it should do so with extreme caution and employ aggressive safeguards to protect the public.

Once again, we thank you for the opportunity to comment as the City moves forward with this important endeavor. We look forward to reading the more comprehensive economic development policies and procedures that the report anticipates.

Sincerely yours,

Janet R. Howard
President

cc: Dr. Edward J. Blakely