TAX INCREMENT FINANCING

A Valuable Development Tool – Illinois

By: R. Kymn Harp

Tax Increment Financing (TIF) is a development tool often misunderstood by real estate developers and the public at large. TIF is authorized in every state (except Arizona) and the District of Columbia. TIF is authorized in Illinois by the Tax Increment Allocation Redevelopment Act.[i]

WHY TIF?

TIF is a public funding mechanism designed to help municipalities overcome and prevent commercial blight.[ii] Commercial blight leads to commercial properties becoming a drain on public revenue by producing a smaller share of taxes,[iii] and requiring excessive and disproportionate expenditures of public funds for crime prevention, public health and safety, fire and accident protection, and other public services.[iv] The eradication and prevention of commercial blight and the construction of redevelopment projects financed by private capital with financial assistance from governmental bodies is a public use essential to the public interest.[v]

Areas of commercial blight are often situated in older and centrally located areas of town and, once existing, spread unless eradicated.[vi] Though intended primarily as a tool for municipalities to eliminate and prevent blight within its territorial boundaries, TIF can benefit real estate developers and investors as well by bridging the financial gap to make otherwise marginal projects feasible for development.

COMMERCIAL BLIGHT

Blighted areas are described as "*areas where a major portion of the commercial buildings and structures are detrimental to the health, safety and welfare of the occupants and the welfare of the urban community because of age, dilapidation, overcrowding or faulty arrangement, or lack of ventilation, light, sanitation facilities, adequate utilities or access to transportation, commercial marketing centers or to adequate labor supplies.*"[vii] Use of TIF may be available if a blighted area encompasses at least 1½ acres.[viii]

TIF can be also be used to prevent commercial blight through redevelopment of "conservation areas" - which are areas that do not yet constitute a blighted area but in which 50% or more of the structures have an age of 35 years or more and risk becoming a blighted area through the presence of 3 or more (out of 13) listed factors detrimental to the public safety, health, morals or welfare.[ix]

PUBLIC PURPOSE

Public funds may be used only for a public purpose.[x] Economic development to eliminate or prevent commercial blight is a legitimate public purpose.[xi]

Before a redevelopment project[xii] can qualify for TIF reimbursement of redevelopment project costs[xiii] ("TIF Eligible Costs") the municipality must have a comprehensive program ("Redevelopment Plan")[xiv] for development or redevelopment to reduce or eliminate the existing conditions that qualified the redevelopment project area[xv] ("TIF District") as a blighted area or a conservation area, or a combination of both.[xvi] TIF Districts have a statutory maximum duration of 23 years[xvii] but can be extended by the General Assembly for an additional 12 years[xviii].

THE “*BUT FOR*” TEST

A condition to using TIF funds for commercial development is that “*but for*” the TIF incentive the development project will not proceed. If the project will proceed in all events, no public purpose is served by allocating public funds. The fact that the TIF incentive will also benefit private interests will not disqualify its use as a proper public purpose.[xix]

HOW TIF WORKS – A (VERY) SIMPLE OVERVIEW

TIF (Tax Increment Financing) allocates only *incremental* taxes generated within the TIF District for use in reimbursing TIF Eligible Costs. This means that if the equalized assessed valuation (“EAV”) of all property within a TIF District on the date the TIF District is established totals, for example, $1,500,000, property taxes derived from that EAV (the “Base EAV”) will continue to support local taxing districts throughout the term of the TIF District. Only taxes generated from EAV in excess of the Base EAV can be allocated to reimburse the developer for TIF Eligible Costs.

Hypothetical Example:

- *Assumption #1*: The combined property tax rate in the county is 5.7% of EAV.

  Based on that assumption, the Base EAV ($1,500,000) multiplied by the assumed tax rate will generate $85,500 per year in property taxes.

- *Assumption #2*: The TIF District is in Cook County, Illinois. Commercial property located in Cook County is assessed at 25% of fair market value (FMV).[xx]

- *Assumption #3*: The state equalization factor (multiplier) for Cook County is three (3)[xxi]; resulting in commercial property in Cook County having an average EAV of 75% of FMV.[xxii]

- *Assumption #4*: Developer proposes to build a new project within the TIF District at a cost of $20,000,000, with $6,000,000 of those costs incurred for demolition of functionally obsolete buildings, clearing the land, remediation of environmental contamination, installation of new sidewalks and drives, upgrading or replacing existing utility systems, resolving existing drainage and flooding issues, and adding a public gathering area as requested by the municipality. The project can be completed and stabilized within 36 months from the date the TIF District is established, leaving a remaining term of 20 years.

- *Assumption #5*: Upon completion and stabilization the fair market value of the newly developed commercial property will be $24,000,000, implying a new EAV of $18,000,000 (“Total EAV”) based on 75% of FMV.

  Applying the Assumption #1 property tax rate of 5.7% to the Total EAV would generate total estimated annual real estate taxes of $1,026,000.

Because TIF allocates only taxes from the *incremental* increase in EAV to pay TIF Eligible Costs, the annual TIF increment would be $940,500 ($1,026,000 on Total EAV *minus* $85,500 on Base EAV) – with the tax revenue from the Base EAV still reserved for the combined local taxing districts.

- *Assumption #6*: Developer has established to the satisfaction of the municipality that it cannot proceed with the project unless it receives reimbursement for $6,000,000 of the TIF Eligible Costs plus interest[xxiii] at 9% per annum (approximately $8,000,000 through full repayment), for a total TIF payout to developer over the life of the TIF District aggregating $14,000,000, with 100% of the incremental taxes applied to the TIF payout until full reimbursement.

- *Assumption #7*: The first TIF payment will be 24 months after substantial completion of the project.[xxiv]

- *Assumption #8*: If redevelopment does not occur, the commercial blight will continue, limiting property taxes to those generated by the Base EAV.

If everything goes as planned, the developer will receive the full TIF reimbursement in approximately 15 years ($14,000,000/$940,500 per year = 14.88 years) once TIF payments commence, which in this hypothetical is 17 years after substantial completion and 20 years after the TIF District was established. After full reimbursement or expiration of the TIF District all real estate taxes generated by the property will inure to the combined taxing districts encompassing the TIF District.

If the TIF District were to rapidly increase in value generating an average of, say, $1,100,000 per year in taxes on the incremental EAV during the remaining 20-year life of the TIF District, the TIF Eligible Costs could be fully reimbursed in approximately 13 years after substantial completion.[xxv]

If real estate taxes on incremental EAV were to, instead, average only $640,000 per year, the developer would recover only $12,800,000 over the 20 year post-completion period without further recourse against public funds because the sole source of payment of the TIF reimbursement obligation is the incremental increase in property taxes during the life of the TIF District.[xxvi]

CONCLUSION

Elimination of commercial blight within Illinois communities is in the public interest. Tax Increment Financing is a valuable tool to eradicate and prevent commercial blight.

---

[i] 65 ILCS 5/11-74.4-1 *et seq.*

[ii] 65 ILCS 5/11-74.4-2(b)

[iii] 65 ILCS 5/11-74.2-1(c)

[iv] 65 ILCS 5/11-74.2-1(d)

[v] 65 ILCS 5/11-74.2-1(f)

[vi] 65 ILCS 5/11-74.2-1(b)

[vii] 65 ILCS 5/11-74.2-1(a); the indices of which are detailed in 65 ILCS 5/11-74.4-3(a).

[viii] 65 ILCS 5/11-74.4-3(p)

[ix] 65 ILCS 5/11-74.4-3(b)

[x] Illinois Constitution, Article VIII § 1(a)

[xi] *Kelo v. City of New London, Connecticut* 545 U.S. 469 (2005); *People ex rel. City of Urbana v. Paley*, 368 N.E. 2d 915, 920-21 (Ill. 1977).

[xii] 65 ILCS 5/11-74.4-3(o)

[xiii] 65 ILCS 5/11-74.4-3(q). Not all redevelopment costs qualify for reimbursement. In fact, Illinois is significantly more restrictive than many other states, including the nearby states of Indiana and Wisconsin, in that, generally, Illinois does not permit reimbursement for the cost of construction of any new privately-owned buildings while other states do. 65 ILCS 5/11-74.4-3(q)(12).

[xiv] 65 ILCS 5/11-74.4-3(n)

[xv] 65 ILCS 5/11-74.4-3(p)

[xvi] 65 ILCS 5/11-74.4-3(n)

[xvii] 65 ILCS 5/11-74.4-3.5(a)

[xviii] 65 ILCS 5/11-74.4-3.5(c)

[xix] *Clayton v. Village of Oak Park*; 453 N. E. 2d 937, 943 (Illinois 1st Dist. 1983).

[xx] Property Classification Codes https://www.cookcountyassessor.com/classifications-real-property

[xxi] In 2023 the Cook County equalization factor was 3.0163

[xxii] 35 ILCS 200/17-25 requires average property values in each Illinois county to be assessed at 33 1/3% of Fair Market Value (FMV). To provide uniformity between counties, the Illinois Department of Revenue (IDOR) is required to calculate an equalization factor for each county. Unlike all other Illinois counties, Cook County is permitted to assess property at different levels based on differing property types (Property Class). In Cook County, there are numerous Property Classes. At the low end are residential and vacant properties assessed at 10% of FMV; and at the higher end, commercial and industrial properties assessed at 25% of FMV. With much more residential property than commercial/industrial property in Cook County, the weighted average assessment of all Cook County property is roughly 11% of countywide FMV. IDOR has assigned an equalization factor of just over three (3) for Cook County, meaning that whatever the determined assessed value is for any property, the equalized assessed value (EAV) will be roughly three (3) times that amount.

[xxiii] The developer would have incurred most or all the TIF Eligible Costs early in the construction period. It is typical to reimburse Developer for the time value of money (interest) as permitted at 65 ILCS 5/11-74.4-3(q)(6). Interest at 9% per annum accrues during the 24 to 36 month construction period on the $6,000,000 in TIF Eligible Costs as incurred (estimated. $1,000,000) and another estimated $1,000,000 in interest between substantial completion of the project and the first bi-annual payment from TIF proceeds 24 months after substantial completion, and then an estimated $6,000,000 in interest paid during the reimbursement period = $14,000,000 total payment amount from incremental taxes.

[xxiv] Property taxes will be based upon the completed project, which in the hypothetical is assumed to occur 36 months after creation of the TIF District. Illinois taxes are assessed one year in arrears – and Cook County taxes are payable to two installments.

[xxv] Assumes the taxes average the higher amount throughout the first 13 years, which may not be likely, but any material increase in taxes over the projected $$940,400 per year will shorten the payment period.

[xxvi] 65 ILCS 5/11-74.4-8