

Key Considerations Regarding Tax Increment Financing for Developers (IL)

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A Practice Note providing an in-depth exploration of tax increment financing (TIF) in Illinois, a pivotal tool for economic development and community revitalization. TIF is authorized by the Illinois Tax Increment Allocation Redevelopment Act, empowering municipalities to fund infrastructure improvements by leveraging anticipated increases in property tax revenues. This Note examines the mechanics of TIF, highlighting its role in transforming blighted and underutilized areas into vibrant communities. It discusses the legal framework and practical considerations for developers, including the criteria for designating blighted and conservation areas, and the statutory requirements for public purpose and TIF district establishment. The document also addresses the conditions under which TIF funds can be used, emphasizing the necessity of proving that projects would not proceed without such incentives. Additionally, this Note offers a hypothetical example to illustrate TIF's financial dynamics, including the calculation of incremental tax revenues and reimbursement of eligible costs. By understanding these elements, stakeholders can effectively utilize TIF to stimulate private investment and achieve sustainable economic growth.

Tax increment financing (TIF) has become an increasingly important and widely used economic development tool in Illinois. It serves as a powerful incentive for private developers looking to invest in areas that might otherwise be considered too risky or unprofitable. Simultaneously, TIF offers municipalities a creative and effective way to fund infrastructure improvements and stimulate economic growth, particularly in blighted, underutilized, or otherwise underdeveloped communities. By leveraging the anticipated increase in property tax revenues generated by new development, TIF allows municipalities to finance public projects and incentives that make private investment viable.

This Practice Note discusses the mechanics of TIF in Illinois, which is authorized by the Illinois Tax Increment Allocation Redevelopment Act (TIF Act) (65 ILCS 5/11-74.4-1 to 5/11-74.4-12), exploring its benefits and the legal and practical considerations that are essential for developers to understand when using

this complex financing mechanism. This Note will also examine the factors driving TIF's popularity and its overall impact on community revitalization efforts.

Public Purpose Requirement

In Illinois, public funds may be used only for a public purpose (Ill. Const. 1970, art. VIII, § 1(a)). Economic development to eliminate or prevent commercial blight is a legitimate public purpose (*Kelo v. City of New London, Conn.*, 545 U.S. 469, 478 (2005); *People ex rel. City of Urbana v. Paley*, 68 Ill. 2d 62, 73 (1977)).

A redevelopment project is any public and private development project that furthers the objectives of a redevelopment plan (65 ILCS 5/11-74.4-3(o)). Before a redevelopment project can qualify for TIF reimbursement of redevelopment project costs (TIF Eligible Costs) (65 ILCS 5/11-74.4-3(q)), the municipality must have a comprehensive program (65 ILCS 5/11-74.4-3(n)) for development

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or redevelopment to reduce or eliminate the existing conditions that qualified the redevelopment project area (TIF District) (65 ILCS 5/11-74.4-3(p)) as a blighted area or a conservation area, or a combination of both (65 ILCS 5/11-74.4-3(n)).

Not all redevelopment costs qualify for reimbursement. Illinois is significantly more restrictive than many other states in that it 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)).

A TIF District has a statutory maximum duration of 23 years (65 ILCS 5/11-74.4-3.5(a)) but can be extended by the Illinois General Assembly for an additional 12 years (65 ILCS 5/11-74.4-3.5(c)).

Condition for Using TIF Funds

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 does not disqualify its use as a proper public purpose. (*Clayton v. Vill. of Oak Park*, 117 Ill. App. 3d 560, 567 (1983).)

Commercial Blight

TIF is a public funding mechanism designed to help municipalities overcome and prevent commercial blight (65 ILCS 5/11-74.4-2(b)). Commercial blight leads to commercial properties becoming a drain on public revenue by producing a smaller share of taxes and requiring excessive expenditures of public funds for crime prevention, public health and safety, fire and accident protection, and other public services.

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 (65 ILCS 5/11-74.4-2(b)). The use of TIF requires the blighted area to encompass at least 1.5 acres (65 ILCS 5/11-74.4-3(p)).

Areas of commercial blight are often situated in older and centrally located parts of a municipality and, once existing, spread unless they are eradicated. 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.

Definition of Blighted Areas for Improved Property

Improved blighted areas are described in the TIF Act as areas where a major portion of the industrial, commercial, and residential buildings and structures are detrimental to the public safety, health, and welfare of the occupants and the welfare of the urban community because of a combination of five or more of the following factors, each of which must be present, properly documented, and reasonably distributed throughout the improved part of the redevelopment project area:

- **Dilapidation.** This is a state of severe disrepair or neglect, confirmed by a building condition analysis, where critical structural components require major repairs or are so severely damaged that demolition is necessary.
- **Obsolescence.** This is the when a structure is no longer suitable for its original purpose due to disuse.
- **Deterioration.** For:
 - Buildings, this includes, but is not limited to, major defects in the secondary building components such as doors, windows, porches, gutters, downspouts, and fascia; and
 - Surface improvements, this includes evidence of deterioration in the condition of roadways, alleys, curbs, gutters, sidewalks, off-street parking, and surface storage areas including, but not limited to, surface cracking, crumbling, potholes, depressions, loose paving material, and weeds protruding through paved surfaces.
- **The presence of structures below minimum code standards.** This includes all structures that do not meet the standards of zoning, subdivision, building, fire, and other governmental codes that apply to the property (excluding housing and property maintenance codes).
- **The illegal use of individual structures.** This applies to structures that are being used in violation of applicable federal, State of Illinois, or local municipal laws or ordinances (but excluding those laws or ordinances that apply to the presence of structures that are below minimum code standards).

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- **Excessive vacancies.** This applies if there are buildings that are unoccupied or underutilized and that represent an adverse influence on the area because of the frequency, extent, or duration of the vacancies.
- **The lack of ventilation, light, or sanitary facilities.** This refers to areas with insufficient ventilation, lighting, or sanitation, characterized by poor air circulation, lack of natural light, or inadequate window size and placement, as well as an inability to remove airborne contaminants such as dust, odors, or smoke. Additionally, these areas may have inadequate or absent sanitary facilities, including inadequate garbage storage and disposal, bathroom facilities, hot water access, or functional kitchens. Furthermore, structural issues may hinder safe access to and from rooms and units within a building.
- **Inadequate utilities.** This occurs when underground and overhead utilities, such as storm sewers, storm drainage, sanitary sewers, waterlines, gas, telephone, and electrical services, are inadequate to support the redevelopment project area. Specifically, this includes utilities that are insufficient in capacity, deteriorated, outdated, or in disrepair, as well as those that are entirely lacking in the area.
- **Excessive land coverage and overcrowding of structures and community facilities.** This occurs when a property is overdeveloped, resulting in a crowded site with poorly situated or inadequately sized buildings and accessory facilities. This can include buildings that are not compatible with current health and safety standards due to their placement on parcels that are too small or irregularly shaped, or parcels that are overcrowded with multiple buildings. For a finding of excessive land coverage, these parcels must exhibit one or more of the following conditions:
 - insufficient provision for light and air within or around buildings;
 - increased threat of the spread of fire due to the close proximity of buildings;
 - lack of adequate or proper access to a public right-of way;
 - lack of reasonably required off-street parking; or
 - inadequate provisions for loading and service.
- **Deleterious land use or layout.** This involves the existence of incompatible land-use relationships, buildings occupied by inappropriate mixed-uses, or uses considered to be noxious, offensive, or unsuitable for the surrounding area.
- **Environmental remediation is needed.** For this requirement, the area must have incurred Illinois Environmental Protection Agency or U.S. Environmental Protection Agency remediation costs. Properties can also meet this requisite if an independent consultant, with an expertise in environmental remediation, has conducted a study that determines a need for the clean-up of hazardous waste, hazardous substances, or underground storage tanks required by federal or the State of Illinois law. The remediation costs must constitute a material impediment to the development or redevelopment of the project area.
- **Lack of community planning.** This occurs when the project area was developed before or without the benefit or guidance of a community plan or that the plan was not followed when the area was developed. It must be documented by:
 - evidence of adverse or incompatible land-use relationships;
 - inadequate street layout;
 - improper subdivision;
 - parcels of inadequate shape and size to meet contemporary development standards; or
 - other evidence that demonstrates an absence of effective community planning.
- **The total equalized assessed value of the proposed redevelopment project area has declined for three of the last five years prior to the year in which the redevelopment project area is designated.** This also applies if the total equalized assessed value of the redevelopment project area is increasing at an annual rate (comparative annual rate) that is less than:
 - the equalized assessed value for the balance of the municipality for three out of the last five calendar years for which information is available; or
 - the Consumer Price Index for All Urban Consumers published by the U.S. Department of Labor or successor agency for three of the last five calendar years prior to the year in which the redevelopment project area is designated.

(65 ILCS 5/11-74.4-3(a)(1).)

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Definition of Blighted Areas for Vacant Land

Vacant blighted areas under the TIF Act encompass spaces where the sound growth of the redevelopment project area is impaired by two or more of the following factors, each of which must be present, properly documented, and reasonably distributed throughout the vacant part of the redevelopment project area:

- Obsolete platting of the vacant land. This occurs when platting creates parcels that are too small, narrow, or irregularly shaped, making them difficult to develop according to modern standards. This also applies where the plat:
 - failed to create rights-of-ways for streets or alleys;
 - created inadequate right-of-way widths for streets, alleys, or other public rights-of-way; or
 - omitted easements for public utilities.
- Land assembly for development is impeded because ownership is divided among many vacant parcels.
- Tax and special assessment delinquencies exist or the property has been the subject of tax sales under the Property Tax Code (35 ILCS 200/1-1 to 200/32-17) within the last five years.
- Deterioration has occurred to structures or site improvements in neighboring areas that are adjacent to the vacant land.
- Environmental remediation is needed.
- The total equalized assessed value for the redevelopment project area is increasing at an annual rate less than the comparative annual rate (see Definition of Blighted Areas for Improved Property).

(65 ILCS 5/11-74.4-3(a)(2).)

Vacant property may also be designated as blighted if the sound growth of the redevelopment project area is impaired by one of the following factors, each of which must be present, properly documented, and reasonably distributed throughout the vacant part of the redevelopment project area:

- The area consists of one or more unused quarries, mines, or strip mine ponds.
- The land has unused rail yards, rail tracks, or railroad rights-of-way.
- Chronic flooding issues justify redevelopment when either the area itself experiences flooding damaging

property (which must be certified by a registered, professional engineer or the appropriate regulatory agency), or its surface water discharge contributes to flooding. However, this justification requires the redevelopment project to include facilities or improvements that actively contribute to flood alleviation.

- An unused or illegal dump site exists in the area, containing earth, stone, building debris, or similar waste from construction, demolition, excavation, or dredging.
- The area, which measured between 50 and 100 acres before November 1, 1999, is currently at least 75% vacant. The area must also:
 - meet at least one of the factors of blight listed for improved real estate (see Definition of Blighted Areas for Improved Property);
 - have been designated as a town or village center by ordinance or a comprehensive plan adopted prior to January 1, 1982; and
 - must not have been developed for that purpose.
- If the area qualified as a blighted, improved area immediately before becoming vacant, it qualifies, provided there has not been substantial private investment in the immediate vicinity.

(65 ILCS 5/11-74.4-3(a)(3).)

Conservation Areas

TIF can also be used to prevent commercial blight through the redevelopment of conservation areas. Conservation areas per the TIF Act are areas that:

- Do not yet constitute a blighted area but 50% or more of the structures in the location are 35 years or older.
- Risk becoming a blighted area through the presence of at least three factors that are detrimental to the public safety, health, morals, or welfare (risk factors). The risk factors are the same as those for improved property (see Definition of Blighted Areas for Improved Property; 65 ILCS 5/11-74.4-3(b).)

(65 ILCS 5/11-74.4-3(a)(3).)

Overview of How a TIF Works

TIF allocates only incremental taxes generated within the TIF District for use in reimbursing TIF Eligible Costs. This means that if the equalized assessed

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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 (Base EAV) will continue to support local taxing districts throughout the term of the TIF District. Only taxes generated from EAV exceeding the Base EAV can be allocated to reimburse the developer for TIF Eligible Costs.

Average property values in each Illinois county must be assessed at 33 1/3% of fair market value (FMV) (35 ILCS 200/17-25). 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 may assess property at different levels based on differing property types. For property classification codes in Cook County, Illinois, see the Cook County Assessor's [website](#).

In Cook County, there are numerous property classifications. At the low end residential and vacant properties are assessed at 10% of FMV. At the higher end, commercial and industrial properties are assessed at 25% of FMV. With much more residential property than commercial and industrial property in Cook County, the weighted average assessment of all Cook County property is roughly 11% of countywide FMV. The IDOR has assigned an equalization factor of just over three for Cook County, meaning that whatever the determined assessed value is for any property, the EAV will be roughly three times that amount.

Hypothetical Example

Assumption 1: The combined property tax rate in the county is 5.7% of EAV. Based on this 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 the FMV.

Assumption 3: The state equalization factor (multiplier) for Cook County is three resulting in commercial property in Cook County having an average EAV of 75% of FMV. In 2023, the Cook County equalization factor was 3.0163.

Assumption 4: The developer proposes to build a new project within the TIF District at a cost of \$20,000,000, with \$6,000,000 of these costs incurred for:

- The demolition of functionally obsolete buildings.
- The clearing of the land.
- The remediation of environmental contamination.
- The installation of new sidewalks and driveways.
- Upgrading or replacing existing utility systems.
- Resolving existing drainage and flooding issues.
- 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: On completion and stabilization, the FMV of the newly developed commercial property will be \$24,000,000, with a new total EAV of \$18,000,000 based on 75% of FMV (Total EVA). Applying a 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: The developer has sufficiently established to the municipality that it cannot proceed with the project unless it receives reimbursement for \$6,000,000 of the TIF Eligible Costs plus interest at 9% per annum (approximately \$8,000,000 through full repayment), for a total TIF payout to the 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.

The developer would have incurred most or all the TIF Eligible Costs early in the construction period. It is typical to reimburse the developer for the time value of money (interest) (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 the 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 (\$6,000,000 in TIF Eligible Costs + \$8,000,000 in interest) total payment amount from incremental taxes.

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Assumption 7: The first TIF payment will be 24 months after substantial completion of the project. Property taxes will be based on 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 in two installments.

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 = 14.89 years) once TIF payments commence, (which in this hypothetical is two years after substantial completion) resulting in full TIF reimbursement 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 \$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. This assumes that the taxes average \$1,100,000 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 and thereby reduce the overall interest payable for full TIF reimbursement.

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 (65 ILCS 5/11-74.4-8).

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