OLR RESEARCH REPORT

March 4, 2011 2011-R-0105

TAX INCREMENT FINANCING

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You asked us to explain how Maine's tax increment financing law differs from Connecticut's.

SUMMARY

Connecticut and Maine allow municipalities to use tax increment financing (TIF) to fund economic development projects. TIF uses the new or incremental tax revenue a completed project generates to repay the costs incurred to fund it. Both states allow this revenue to cover the cost of bonds sold to acquire, clear, and improve land for development. But Maine also allows the revenue to cover ongoing economic development programs, including revolving loan funds, and the costs private developers incurred to construct or expand a facility or make other improvements.

Connecticut and Maine allow municipalities to use TIFs to develop areas or individual parcels. Connecticut allows TIF under different laws enabling municipalities to participate in federal and state-funded redevelopment, urban renewal, and municipal development programs. Maine established TIF as a separate program allowing municipalities to use incremental tax revenue to fund a wide range of projects and activities.

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Both states require municipalities to prepare detailed area development plans. Both allow them to use TIF in blighted areas or those suitable for commercial and industrial uses. But Connecticut imposes no similar criteria on where municipalities can use TIFs to fund information technology projects, although it limits this authority to 31 state-designated distressed municipalities and targeted investment communities. Connecticut and Maine specify how municipalities must calculate the incremental tax revenue generated in the designated areas.

TIF

As Table 1 shows, TIF is a financing technique municipalities use to repay bonds or other debt incurred to finance a development project. The technique taps the increased tax revenue (i.e., the increment) the project generates to repay the debt. Tapping the tax increment for this purpose allows municipalities to finance projects without raising new taxes or diverting funds needed to pay for other expenses. But municipalities may have to do both if the project fails to generate enough incremental revenue to cover the debt.

There are several ways to use TIF financing.

- Municipalities often use it to repay bonds issued to finance large-scale development projects in designated areas.

- Some use it to fund small-scale infrastructure projects without issuing bonds. In these cases, a municipality sets aside the incremental tax revenue the designated area generates until it has enough money to fund the projects (i.e., pay-as-you-go).

Some municipalities use TIFs to help a private developer construct, expand, or rehabilitate facilities. In these cases, the developer secures private financing and enters into a contract with the municipality specifying the costs it will cover with incremental revenue. The municipality returns some or all of that revenue to the developer after project is completed.

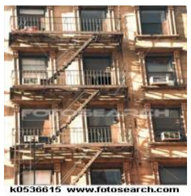
Table 1: Tax Increment Financing (TIF)

What is TIF?

Tax increment financing is a technique municipalities use to fund economic development in designated areas. It rests on the assumption that economic development increases property tax revenue by boosting property values in the designated area. TIF uses that additional revenue—the increment—to fund the economic development.

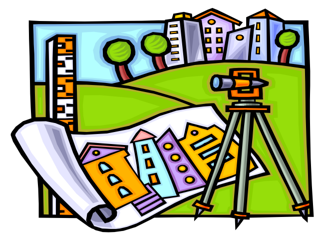
How does TIF work?

2010: Municipality designates an area for economic development and determines its current property values and tax payments



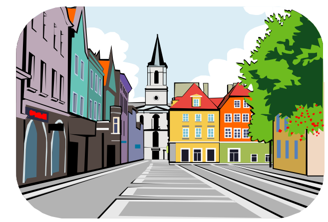
- Area's total assessed value: $20 million
- Area's total taxes based on 30 mill: $600,000

2011: Economic development occurs in the area



Total assessed value of improvements: $20 million

2012: The municipality dedicates the increase in property taxes generated by economic development to finance it.



Area's total assessed value after improvements: $40 million.
Area's total taxes based on 30 mills: $1.2 million Total 2012 Taxes: $1.2 million
-Total 2010 Taxes: $0.6 million
Total Incremental Tax Revenue: $0.6 m
The municipality uses the $600,000 to finance the economic development.

How does the TIF revenue fund economic development?

The answer depends on the scope of the economic development and how the municipality intends to fund it. TIF financing can take at least three forms:

Pay As You Go

The municipality designates a development area and dedicates the annual increase in property tax revenue from that area to fund relatively small public improvements there.

- This method works in areas where property values and, consequently, tax revenues are going up.
- It also allows the municipality to finance improvements without issuing bonds and incurring debt.
- But it could take time to build up the funds needed to fund major improvements

Bond Financing

The municipality adopts a plan to redevelop a designated area; issues tax-exempt bonds; uses the proceeds to acquire, clear, improve and assemble land parcels; and repays the bonds with the incremental property tax revenue the redeveloped area generates.

- Tax-exempt bonds bear a lower interest rate than other forms of financing.
- But the municipality's ability to repay the bonds depends on whether improvements generate enough incremental tax revenue to repay the bonds on schedule.

Credit Enhancements

A developer proposes to construct a new facility or rehabilitate an existing one with private dollars. The municipality designates the property a development area and agrees channel some or all of the incremental revenue back to the private developer to repay specified development costs. This approach:

- is "performance-based," meaning that the developer receives the revenue only if he or she completes the work;
- saves the municipality the expense of issuing bonds; and
- eliminates the risk that the improvements may not generate enough revenue to repay the bonds

Table 1: Tax Increment Financing (TIF)

CONNECTICUT AND MAINE MUNICIPAL TIF PROGRAMS

Connecticut

Bond-Funded TIFs. Under Connecticut law, municipalities can use TIF to repay bonds issued to finance physical projects in areas designated for redevelopment (CGS §§ 8-124 to 8-139), urban renewal (CGS §§ 8-140 to 8-145), or municipal development (CGS §§ 8-186 to 8-200b). State-designated distressed municipalities and targeted investment communities can also use bond-funded TIF to finance information technology projects; all municipalities can use it to clean up and redevelop contaminated property anywhere in a municipality (CGS § 32-23zz).

Designating Development Areas. As explained above, the law allows municipalities to use TIFs under four scenarios, three of which require them to designate development areas and adopt plans to develop them. Redevelopment and urban renewal areas must be blighted; municipal development areas must be suitable for commercial and industrial uses. The law imposes no size limits on the areas.

Eligible Activities. The law allows municipalities to use the TIF-backed bond to acquire, assemble, and improve property and relocate the people and businesses they displace because of these activities. They can also use the proceeds in urban renewal areas to rehabilitate deteriorated property; they can also use them to clean up contaminated property or help finance information technology projects.

Calculating the Increment. The law specifies how municipalities must calculate the incremental property tax revenue, but not the mill rate (or the bond repayment terms and conditions). A municipality calculates the incremental tax revenue first by determining the amount of revenue the unimproved property would have generated based on the current mill rate. It subtracts this amount from the amount of taxes the improved property generates based on that same rate. The method assumes that the completed development will increase tax revenue.

The municipality must deposit the incremental revenue in a special fund, which they must first use to make annual principal and interest payments. If the tax revenue exceeds the required debt payment, the municipality can use the difference to buy back the bonds and reimburse the party guaranteeing their payment (CGS § 8-134a for redevelopment and urban renewal projects, CGS § 8-192a for industrial or business development projects, and CGS § 32-23zz for brownfield remediation and information technology projects).

Maine

TIF Methods. Maine gives municipalities more options for using incremental revenue (MRS 30-A §§ 5221 to 5235.) Like Connecticut, Maine allows them to use TIFs to repay bonds sold to finance large-scale development projects. But it also allows them to use the incremental revenue to fund ongoing economic development programs and projects. It also allows them to return some or all of that revenue to private developers who improve property in a designated area (i.e., credit enhancements).

Eligible Activities. Municipalities in Maine and Connecticut can use TIFs to fund a wide range of physical development activities, including acquiring, clearing, improving and managing property. Maine's municipalities can also use TIFs to capitalize revolving loan funds and fund other economic development activities.

Eligible Areas. Both states impose criteria for designating areas, but Maine's are narrower. Maine's municipalities can designate an area for TIF-funded economic development if at least 25% of the area:

1. is blighted;

2. needs rehabilitation, redevelopment, or conservation; or

3. is suitable for industrial or commercial development.

The designated area cannot exceed 2% of a municipality's total acreage, and the total value of the area's taxable property cannot exceed 5% of the total value of the municipality's taxable property.

As stated above, Connecticut's municipalities can designate areas for redevelopment, urban renewal, or municipal development and use TIF to fund projects there. Redevelopment and urban renewal areas must be blighted; municipal development project areas need not. The areas do not have to conform to any size limits.

Both states specify procedures for designating areas that include public hearings and legislative body approvals. Maine's Department of Economic and Community Development (DECD) must review the designation and the TIF-funded proposal. Connecticut's DECD must review only those municipal development plans that will be implemented with state dollars.

Calculating the TIF. Maine's method for calculating incremental tax revenue is different than Connecticut's. Maine requires municipalities to determine the assessed value of the district's taxable property when they designate the district, thus setting a baseline for calculating the subsequent annual increases in assessed value. The municipality's legislative body must specify the share of incremental tax revenue the municipality will capture to fund economic development or a formula for calculating that share.

The municipality must allocate the specified share of the incremental revenue to a fund dedicated toward financing the economic development. The fund must consist of two accounts, depending on how the municipality financed the economic development. If the municipality issued bonds, it must create a sinking fund account pledged toward repaying them. If it provided a credit enhancement, it must create a project cost account pledged toward paying specified project costs.

As explained above, Connecticut municipalities determine the increment based on the difference in the tax revenues generated before and after redevelopment. They must allocate the increment to a special fund (unspecified) or to the Connecticut Development Authority, if it issued the bond on the municipality's behalf.

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