

Tax Increment Financing - A Bluffer's Guide

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In May 2009, the British Property Federation ("BPF") published its "Regeneration Manifesto" which outlined 5 key recommendations in relation to regenerating our towns and cities. One of these recommendations calls for the creation of tax increment financing ("TIF") districts in the UK.

TIF is already widely used in the US and, in the UK, retail giants Tesco and John Lewis, the Home and Communities Agency and Birmingham, Liverpool, Manchester and Newcastle City Councils have all backed BPFs plans to support regeneration through the downturn. The Chancellor has already hinted in the Budget that the government would explore TIF and most recently it has been reported in the property press that:

- Transport for London and the Treasury are considering TIF as a means of funding the extension of the Northern Line to Battersea Power Station;
- LandSec is considering promoting TIF for its £3bn project which proposes 10,000 homes and 9m sq ft of offices, shops and leisure facilities in Ebbsfleet;
- Grosvenor and Hammerson are in talks to pilot a TIF-like model of funding to deliver stalled regeneration schemes – Grosvenor at its flagship £625m regeneration of Crawley town centre and Hammerson at its £650m retail quarter in Sheffield.

What is TIF?

TIF is a tool to use future gains in taxes to finance current improvements. It works on the basis that the provision of new or improved infrastructure leads to new development and an increase in the value of the surrounding property. This increase in property value yields increased property tax revenues. The anticipated increase in taxation (the "tax increment") is captured in a bond and sold to fund infrastructure.

Higher property tax revenues flow from 4 main sources:

- expected normal uplift in tax from house price increases;
- growth in number of households paying property tax, as new houses built;

- additional appreciation in housing value that infrastructure investment usually delivers; and
- additional business rates.

How TIF works?

There must be enabling legislation in place to set out the local government powers and the criteria for TIF. This is in place in the US and the basic steps for a TIF scheme in the US (as set out by BPF), are as follows:

■ Need to stem blight

Initiator of the scheme makes the case for a need to stem blight in a deprived area. Initiator of scheme sets out redevelopment plans and estimates the impact of the project on property values and tax revenues.

■ Detailed study to show satisfaction of the "but for test"

A detailed study is undertaken to demonstrate if the area meets the criteria for TIF laid out in the enabling legislation – principally that it satisfies the "but for" test that, but for the TIF status, development would not be possible.

■ Creation of redevelopment agency

A creation of redevelopment agency is created to prepare a development plan for the area. The TIF is established when this and the TIF scheme are adopted.

■ Marketing

TIF markets the area to potential developers. Revenue is generated by selling bonds and incurring debt on anticipated revenues or by a pay-as-you go arrangement where revenues are spent on receipts without incurring debt.

■ Tax divided and paid into special fund

Property taxes in a TIF area are divided into 2 streams – original taxes and additional money generated by development. Revenues from additional monies are deposited into a special fund used to pay for public improvements in the TIF area. Once the redevelopment cost is met and the debt re-paid, "ring-fencing" of taxes is removed and additional tax may be spent elsewhere.

Advantages

- Local authorities can raise money to fund large-scale infrastructure and regeneration without central government funding that may have conditions attached.
- Public improvements can be created without increasing the burden of property taxes on existing taxpayers. It also provides an incentive for local authorities to work with developers.
- Government will enjoy higher tax revenues when bonds are repaid and the additional taxes can be spent elsewhere.
- Developers have some of their infrastructure needs paid for.
- Private investors have a tax exempt bond that generates tax free returns.
- Property owners in the district may see their property values rise after development occurs.

Disadvantages

- Timescales – it can take up to 20-25 years to repay the debt issued to pay for the project.
- The risk that the expected revenues from property taxes do not materialise within the anticipated timescales and there is insufficient money to pay bondholders.
- Dependent on strong economic conditions to provide the market for homes and development.
- Setting-up and administering the TIFs will increase local bureaucracy. Any local authority role in selecting developments to qualify for TIF status could shift the onus in decisions regarding public funding of new development back on to the local authority and could leave the local authority open to criticism.
- Unless there are sufficient controls, residents in non-TIF districts may lose out and in deprived areas more blight could result.
- The tax bases of local authorities are currently narrow and the Treasury would have to have devolve greater financial powers to local authorities. The fundamental changes required in local authority revenue control and rating may be a step too far.

Conclusion - TIF in the UK

TIF is an effective tool with proven track record. In the US it has generated billions of dollars of investment and led to increased jobs, affordable accommodation and better public services.

New legislation would be required in the UK; getting this right is essential and the legislation must guard against abuse. This would need to be put in place now so that we can benefit when the market picks up. The question is whether there is a sufficient appetite for this type of debt funding at this current stage of the economic cycle?

Contacts

If you require further information, please contact:



David Gidney

Partner

Tel: +44(0)117 902 2750

david.gidney@burges-salmon.com



Richard Walford

Partner

Tel: +44(0)117 939 2295

richard.walford@burges-salmon.com



Nicola Klinkenberg

Solicitor

Tel: +44(0)117 902 7790

nicola.klinkenberg@burges-salmon.com

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