Massachusetts Institute of Technology

Tax Increment Finance Districts
Business Improvement Districts
Opportunity Zones

11.438 Economic Development Planning

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Tax Increment Financing

- Goes by a number of names – District Increment Financing, Community Redevelopment Areas, others
- Emerged as federal funding for urban redevelopment declined in 70s+
- Often some overlap with Urban Renewal Districts – but not always
- Urban Renewal Districts provide for streamlined eminent domain powers and other state powers

Tax Increment Financing

- Generally only municipalities can use it
- All of the states have adopted some form at some time (AZ repealed in 1999)
- Essentially clips off the increase in property taxes in an area and designates them to improvements in that area
- Why not just use property tax to pay for those improvements?

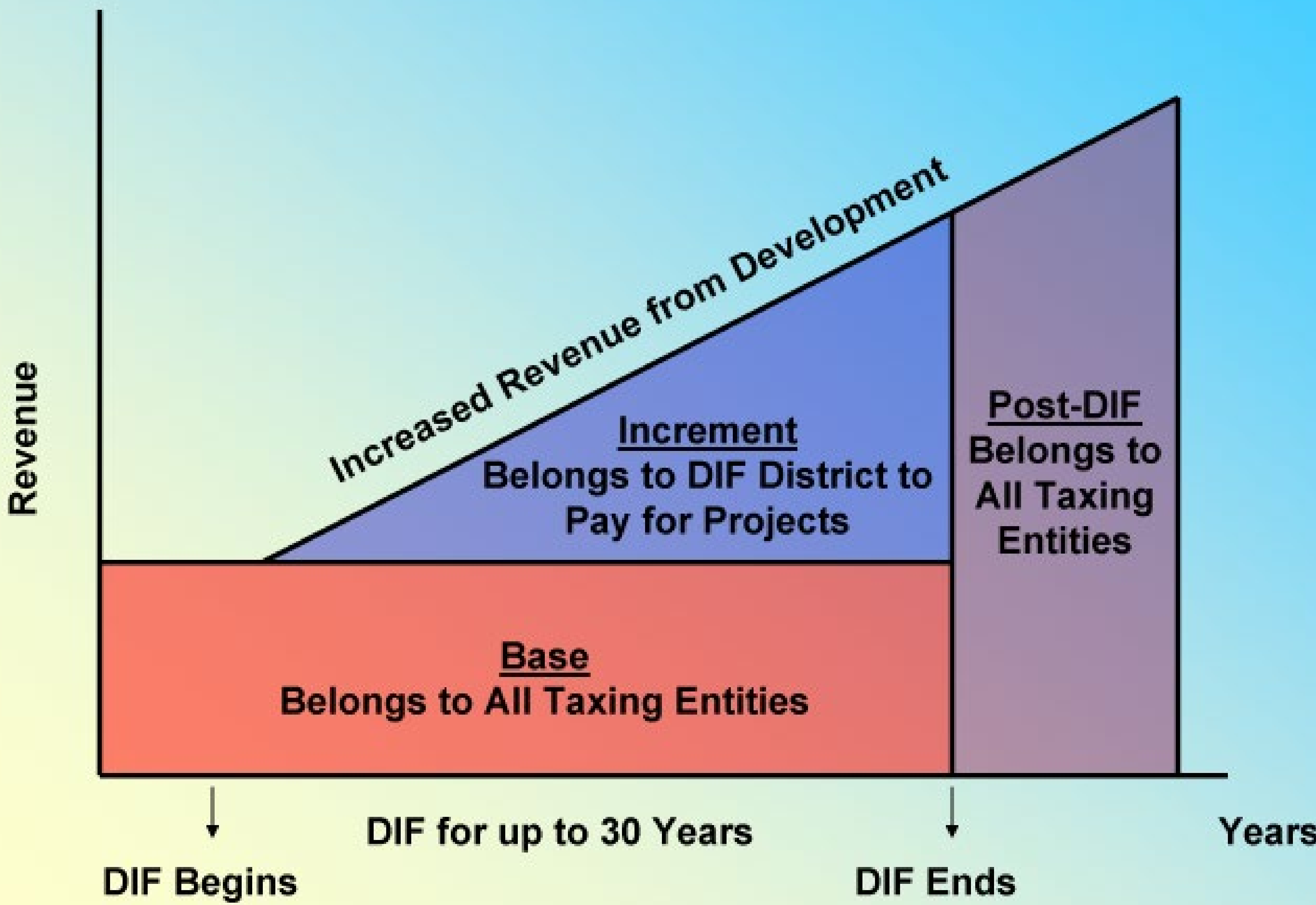
TIF Benefits

- Dedicated revenue stream that can be borrowed against
- Shows commitment to the district
- Acknowledges local impact of some improvements by rededicating taxes to district
- May result in higher tax increment in the district (often assumed)
- Good planning?

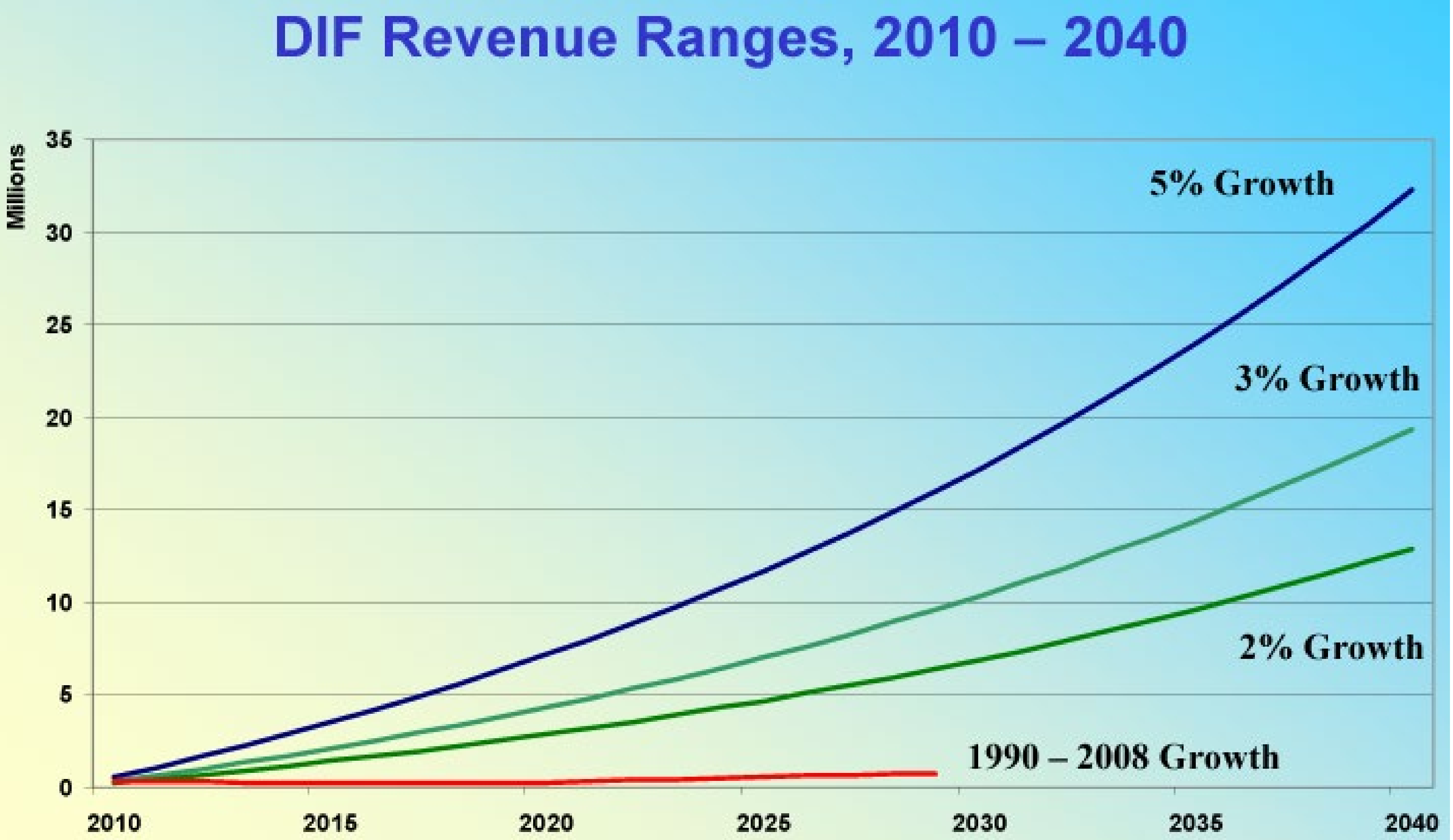
TIF Drawbacks

- May cause rest of municipality to have lower level of services
- May cause non-infrastructure portions of budget to have lower funding levels
- Can cause intergovernmental transfers by allowing TIF district to appropriate funds that would otherwise go to other taxing districts

How does DIF work?



Revenue Forecast



How is a TIF district created?

- Requires legislative vote (City Council) and often state approval of plan
- Developer may initiate
- City may initiate based on strong vision or plan, or desire to build something big
- District boundaries may be regulated by state law.
- Many states have a “but for” requirement, hard to prove

What is the Tax Increment?

- ✓ Development increment
- ✓ Inflationary increment
- ✓ “Natural” increment

- Generally can take all three types, but may not always do so.
- Can be calculated using parcel or aggregate method

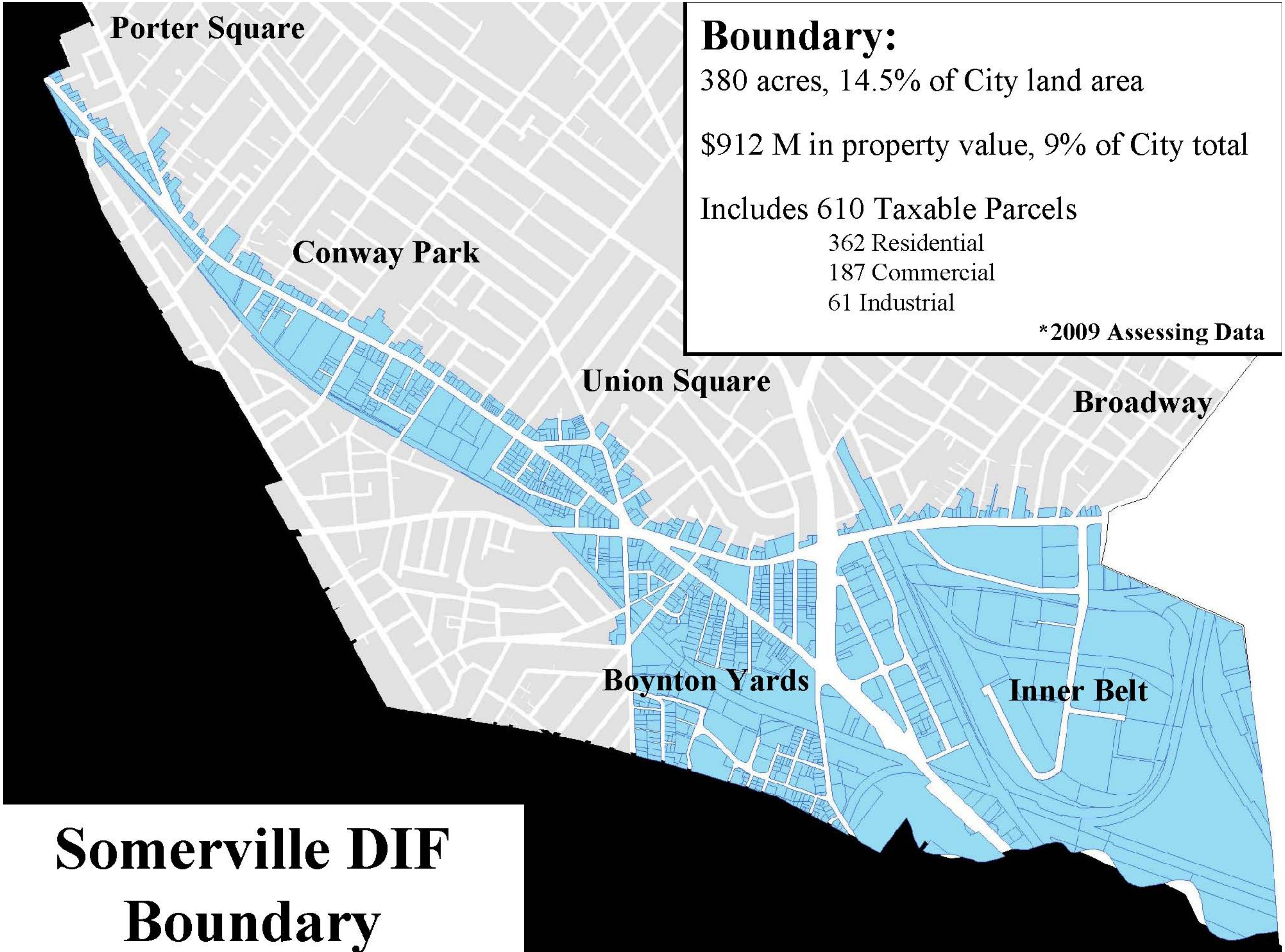
What Happens to other Taxers?

- Often get the short end here.
- School districts, mosquito districts, park districts, transit districts, anyone else relying on property taxes
- Argument is tied back to the “but for” and is really based on increment #1

How Are they Spent?

- Based on capital needs assessment
- Based on risk
- Based on politics
- Based on public benefits
- Other methods or a combination
- Used for “pay as you go” projects or for financing- sometimes for “Tax Anticipation Notes” which are somewhere inbetween

Somerville DIF Boundary



Boundary:

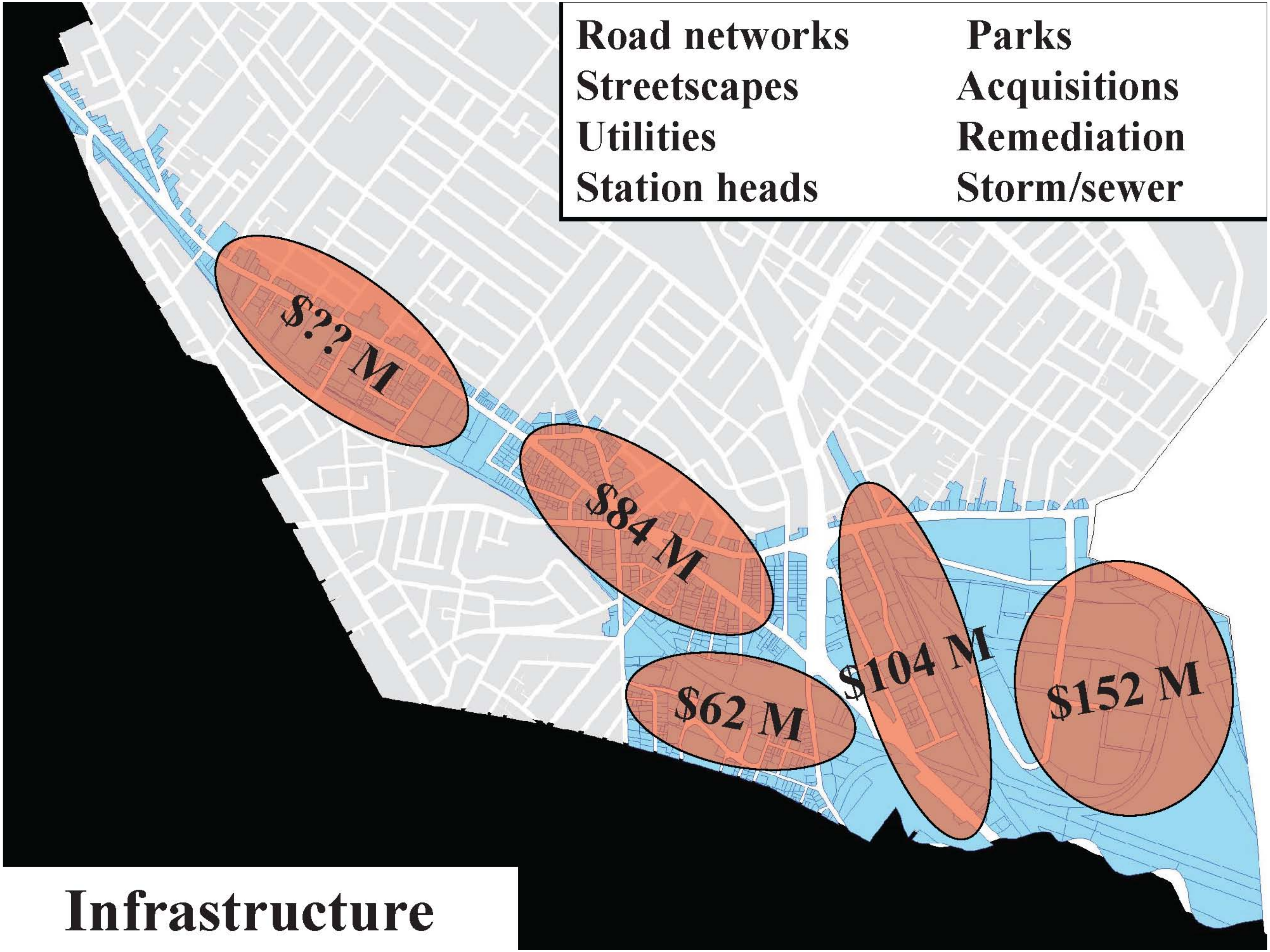
380 acres, 14.5% of City land area

$912 M in property value, 9% of City total

Includes 610 Taxable Parcels

362 Residential
187 Commercial
61 Industrial

***2009 Assessing Data**



Infrastructure

Somerville DIF Budget - (Program start 1/1/2011)

Fiscal Year	2011	2012	2013	2014	2015	2016	2017
Projected DIF Growth Rate	1.25%	2.5%	4.0%	4.0%	5.0%	5.0%	5.0%
Gross Increment	$ 166,919	$ 540,593	$ 1,162,769	$ 1,822,822	$ 2,694,370	$ 3,628,120	$ 4,628,174
General Fund Set Aside %	0%	0%	0%	0%	0%	0%	0%
General Fund Set Aside Amount	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Residual Increment	$ 166,919	$ 540,593	$ 1,162,769	$ 1,822,822	$ 2,694,370	$ 3,628,120	$ 4,628,174
Net Increment	**$ 167,000**	**$ 541,000**	**$ 1,163,000**	**$ 1,823,000**	**$ 2,694,000**	**$ 3,628,000**	**$ 4,628,000**

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OPERATING BUDGET	2011	2012	2013	2014	2015
Administrative & Programmatic Expenditures					
Personnel	$ -	$ 55,000	$ 55,000	$ 55,000	$ 55,000
Fringe Benefits	$ -	$ 17,000	$ 17,000	$ 17,000	$ 17,000
Office Supplies, Postage, IT	$ -	$ 5,000	$ 5,000	$ 5,000	$ 5,000
Subtotal Operational	**$ -**	**$ 77,000**	**$ 77,000**	**$ 77,000**	**$ 77,000**
Programatic Expenditures					
Business Best Practices	$ -	$ 10,000	$ 10,000	$ 10,000	$ 10,000
Storefront, Historic, Tenant Programs	$ -	$ 50,000	$ 50,000	$ 100,000	$ 150,000
Beautification, Programing, and Marketing	$ -	$ 20,000	$ 20,000	$ 20,000	$ 43,000
Subtotal Programatic	**$ -**	**$ 80,000**	**$ 80,000**	**$ 130,000**	**$ 203,000**
Engineering Design & Consulting Expenditures					
USQ Transportation Plan 25% to 100%	$ 167,000	$ 329,000	$ 365,000	$ -	$ -
Boynton Yards Transportation Plan 25% to 100%	$ -	$ 55,000	$ 276,000	$ 539,000	$ 387,000
Design of USQ Parking Structure(s)	$ -	$ -	$ -	$ 200,000	$ 300,000
Somerville Ave Central Parking Study and Design	$ -	$ -	$ -	$ -	$ 63,000
Bond Counsel Consulting	$ -	$ -	$ 104,000	$ -	$ -
IBelt/Bbottom Trans Plan Pt. 1 (to 25%)	$ -	$ -	$ -	$ -	$ -
IBelt/Bbottom Trans Plan Pt. 2 (25% to 100%)	$ -	$ -	$ -	$ -	$ -
Design of Open Space and Shared Use Paths	$ -	$ -	$ -	$ -	$ -
Subtotal Consulting	**$ 167,000**	**$ 384,000**	**$ 745,000**	**$ 739,000**	**$ 750,000**
Debt Service					
Total Bond Level	$ -	$ -	$ 2,750,000	$ 9,300,000	$ 17,800,000
Principle Balance			$ 2,750,000	$ 9,162,500	$ 17,197,500
Principle Payment			$ 137,500	$ 465,000	$ 890,000
Cumulative Principle Payments			$ -	$ 137,500	$ 602,500
Interest Payment			$ 123,750	$ 412,313	$ 773,888
Total Payment			$ 261,250	$ 877,313	$ 1,683,888
Subtotal Bond Costs	**$ -**	**$ -**	**$ 261,000**	**$ 877,000**	**$ 1,664,000**
Total Operating Costs	$ 167,000	$ 541,000	$ 1,163,000	$ 1,823,000	$ 2,694,000
Increment Funding	$ 167,000	$ 541,000	$ 1,163,000	$ 1,823,000	$ 2,694,000
Operating Budget Balance (surplus/deficit)	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**

CAPITAL BUDGET	2011	2012	2013	2014	2015
Capital Expenditures					
Net Bond Proceeds	$ -	$ -	$ (2,750,000)	$ (6,550,000)	$ (8,500,000)
Project Expenditures					
Webster Avenue Streetscape & Utilities	$ -	$ -	$ 2,750,000	$ 2,750,000	$ -
Prospect Street Streetscape & Utilities	$ -	$ -	$ -	$ 3,800,000	$ -
Somerville Avenue Streetscape & Utilities	$ -	$ -	$ -	$ -	$ -
Washington Street Streetscape & Utilities	$ -	$ -	$ -	$ -	$ 3,500,000
USQ Parking Structure(s) (land acq and const)	$ -	$ -	$ -	$ -	$ 5,000,000
Union Square Plaza Improvements	$ -	$ -	$ -	$ -	$ -
Park/path renovation or construction	$ -	$ -	$ -	$ -	$ -
Land Acquisition	$ -	$ -	$ -	$ -	$ -
Subtotal Capital	**$ -**	**$ -**	**$ (2,750,000)**	**$ (6,550,000)**	**$ (8,500,000)**
Total Capital Costs	$ -	$ -	$ (2,777,778)	$ (6,616,162)	$ (8,585,859)
Capital Budget Balance (surplus/deficit)	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**
Total Budget	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**

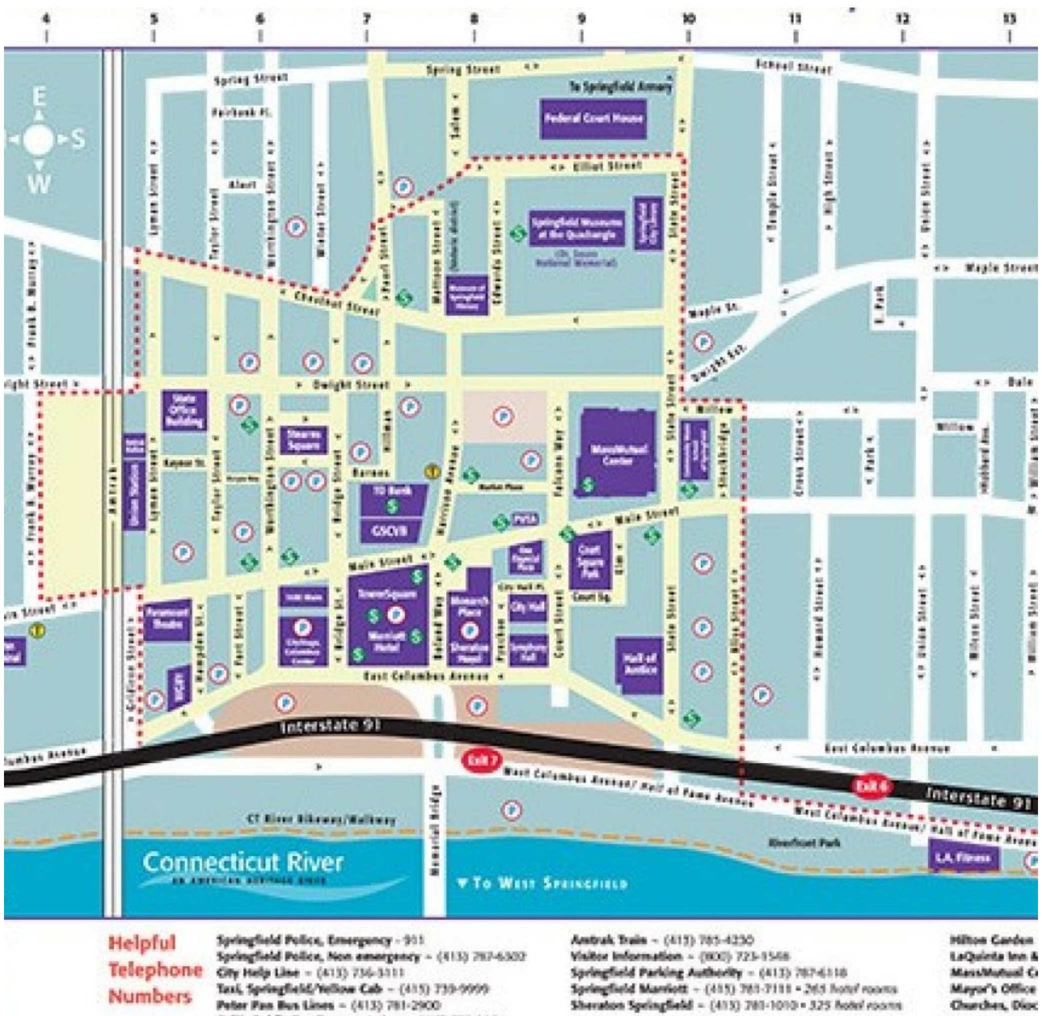
Business Improvement Districts

- Like a TIF, captures increased property tax revenue
- Unlike a TIF, this increase is not new to additional growth but a higher mill rate
- Additional revenue used to provide additional services- public works, public safety, programming and publicity.

Business Improvement Districts

- Provide welcoming services and extra security for public spaces and private businesses.
- Advocate and lobby on behalf of downtown businesses.
- Generate financing for capital improvements
- Commission research and marketing services, collect and analyze economic and demographic data, and promote businesses in the area.
- Embark on integrated planning efforts.
- Allow BID businesses to experiment with innovative practices *(credit: Project for Public Spaces)*

Springfield (MA) BID



- Founded 1998 "TO PROMOTE THE DEVELOPMENT OF BUSINESS AND ECONOMIC ACTIVITY WITHIN THE BUSINESS IMPROVEMENT DISTRICT IN SPRINGFIELD, MASSACHUSETTS"
- 2018 revenue: $1.296 million
- 2018 expenditures: $1.117 m.
- BID fees (increased tax rate) generated $982,491
- Staff of 4

Springfield BID Programs

- **Marketing and Public Relations**
- **The Springfield Central Cultural District**
- **“Clean and Safe” program**
- **Architectural Lighting Program**
- **Pedestrian and Bicycle-friendly Improvements**
- **Marketing Efforts and Unique Events**

Criticisms of BID’s

- Privatizing of public services
- Crime spillover and diversion to other areas
- Operational democracy
- Accountability

Opportunity Zones

The Opportunity Zones tax incentive was established by Congress in the 2017 Tax Cut and Jobs Act as an innovative approach to spur long-term private sector investments in low-income urban and rural communities nationwide. This economic development initiative is based on the bipartisan **Investing in Opportunities Act**.

What are Opportunity Zones?

Opportunity Zone: A low-income census tract **(LIC)**, as determined within New Markets Tax Credits legislation, is designated as an Opportunity Zone **(OZ)** by the governor of the of the state or territory in which it is located. Designations will stay in place for 10 years.

Up to 25% of LICs in a U.S. state or territory may be designated as OZs.

States or territories in which there are fewer than 100 LICs may designate up to 25 LICs as OZs.

Up to 5% of census tracts contiguous to LICs may be designated as OZs, if the median family income of the census tract does not exceed 125% of the median family income of the LIC to which the tract is contiguous.

Designated Opportunity Zones

All states and territories have officially designated their Opportunity Zones, as of June 14, 2018.

8,762

census tracts designated

24 million

current jobs in designated tracts

1.6 million

businesses in designated tracts

Rural census tracts	1,858
Average poverty rate	31%
Average unemployment rate	14.4%
Average family income in OZ census tracts relative to area median income (AMI)	60%

Opportunity Fund Roles

Investor Capital → **Opportunity Fund** → **Eligible Investments**

DIRECT:

- High net worth individuals
- Corporations

INDIRECT:

- Broker-dealers
- Wealth advisors
- Community foundations
- CDFIs

DIRECT MANAGEMENT:

- Investors + CPAs

INDIRECT MANAGEMENT:

- Private equity firms
- CDFIs
- Fund management companies

EXAMPLES:

- Commercial real estate
- Multi-family housing
- Single family housing
- Operating businesses
- Equipment leasing

Investor **Incentives**

U. S. investors currently **hold $2.3 trillion in unrealized capital gains**, representing a significant untapped resource for economic development. Opportunity Funds will allow these investors throughout the country to pool and deploy their resources as Opportunity Zone investments.

>

OPPORTUNITY ZONE INVESTMENTS PROVIDE AN IMMEDIATE BENEFIT

to investors of deferring payment of the capital gains tax that would be paid in 2018 until 2026. Further incentives are linked to the duration of an investor's commitment to Opportunity Fund investments.

THE OZ TAX INCENTIVE WILL ALLOW

a modest reduction in capital gains taxes in exchange for holding Opportunity Fund investments for five to seven years.

IF INVESTMENTS ARE HELD 10+ YEARS,

gains accrued on the Opportunity Fund investment during that 10-year period will not be taxed, further incentivizing patient capital.

Timeline for Opportunity Zone Investments

	Investment Year 2018	Year 5 2023	Year 7 2025	Year 8 2026	Year 10 2028
Tax on Capital Gain Invested	Gain realized and invested in Opportunity Fund **within 180 days***	10% reduction of capital gains tax	15% reduction of capital gains tax	All taxes due on 12/31/26. Investor pays tax on 85% of original gain	
Tax on Opportunity Fund Investment		Any gain realized on Opportunity Fund investment is fully taxable if liquidated	Any gain realized on Opportunity Fund investment is fully taxable if liquidated	Any gain realized on Opportunity Fund investment is fully taxable if liquidated	Any gain realized on Opportunity Fund investment **is tax free****

*** Tax is deferred until the earlier of investment liquidation (return of capital) or 12/31/26**

**** Any appreciation on Opportunity Fund investment is tax free if held > 10 years**

Ex. 10 Year Investment: **Fully Taxable vs. Opportunity Zone Fund**

Assumptions:

- 10% annual investment appreciation
- 24% capital gains tax (federal only)

Fully Taxed Investment	
Capital Gain	$100,000
- Tax payable (24%)	$24,000
Total Capital to Invest	$76,000
Sales Price after 10 years	$197,000
- Tax on Appreciation (24%)	$29,070
After Tax Funds Available	$168,054

Opportunity Zone Investment	
Capital Gain	$100,000
- Tax payable	$0
Total Capital to Invest	$100,000
Sales Price after 10 years	$259,374
- Tax on Appreciation	$0
Deferred Capital Gain Tax (24%) paid in 2026	$20,480
After Tax Funds Available	$238,974

Opportunity Funds

Opportunity Fund: An investment vehicle organized as a corporation or partnership for the purpose of investing in Opportunity Zone property.

Opportunity Funds will be self-certified per IRS guidelines. They must be organized for the purpose of investing in Opportunity Zones

Opportunity Funds are required to invest 90% or more of their capital as EQUITY in Opportunity Zone property

Opportunity Zone property includes stock, partnership interest, or business property in an Opportunity Zone

Eligible **Investments**

Only equity investments are eligible for the Opportunity Zone tax incentive.

Business investments

can include investments in new stock issuance for corporations and ownership interests in partnerships and LLCs.

2 Investments in real estate

must include an ownership interest of new construction or assets that will be **"substantially improved"** within 30 months of acquisition by the Opportunity Fund.

3 New equipment and other assets

are also eligible investments.

Economic Development Examples

1. **Business infrastructure real estate funds:**
   - *Industrial*
   - *Retail*
   - *Mixed use*
   - *TOD*

2. **Venture capital funds:**
   - *Seed stage investments*
   - *Series A investments*

3. **Operating business private equity:**
   - *Equity recapitalizations*
   - *Growth capital investments*

4. **Enhancement for other federal tax credit transactions:**
   - *NMTCs*
   - *Historic Tax Credits*

Affordable Housing Examples

1 Pairing with LIHTC or the HTC

- Effective for providing housing for families at or under 60% AMI
- Issues: Do institutional investors have capital gains that they want to use to invest in the LIHTC?

2 Focus on Workforce Housing

- Providing Housing for families at 80 – 100% AMI
- Anticipate a 10 year investment
- No ongoing compliance regulations unless required through local funding or zoning
- Ability to attract High Net Worth Individuals or Corporations as investors

Strengths

Local	Flexible	New Investor Class	Potential	Straightforward
Designations are made by states and localities, rather than Federal agencies, ensuring more local buy in and coordination.	The flexibility of the investment tool can support investments in any type of asset class.	The incentive has the ability to attract high net worth individual investors to community development finance.	The incentive could attract hundreds of billions of private sector capital into low-income communities (compared with about \$10 - \$12 billion annually under LIHTC and \$3.5 billion annually under NMTC).	The tool is relatively straightforward from an investment and compliance standpoint, in comparison to LIHTC and NMTC.

Potential Concerns

Lack of Oversight

Lack of oversight from government entities could lead to program abuses.

Lack of Impact Incentives

Incentives focus on back-end returns, rather than investments that will result in community impacts.

Gentrification and Displacement

The tool might aid in the gentrification and displacement of residents and businesses in Opportunity Zone communities.

Future of Other Tax Incentives

The new incentive might be used as an excuse to diminish or eliminate other community development tax incentives, such as the NMTC program.

Key Points

Investors

- Tax incentive is most valuable for 10 year investments in appreciating assets
- Six months to invest after realizing a capital gain
- Another six months to deploy 90% of capital in Zones
- Capital is required to be an equity investment – loans from investors are not eligible for the tax incentive

Funds

- All capital must flow through an Opportunity Fund to be eligible for the tax incentive
- Funds are self-certified via an IRS tax form
- Fund must be established for the purpose of investing in Opportunity Zones
- 90% of fund assets must be invested in Zones to maximize the tax incentive

Eligible Investments

- Must be equity investments
- Real estate investments must include substantial rehabilitation – doubling basis within 30 months
- "Sin businesses" are not eligible
- Other requirements include property use in "active conduct of business" and limits on assets held in cash