Department of Planning &
Community & Economic Development

TIF Policy Discussion & Background

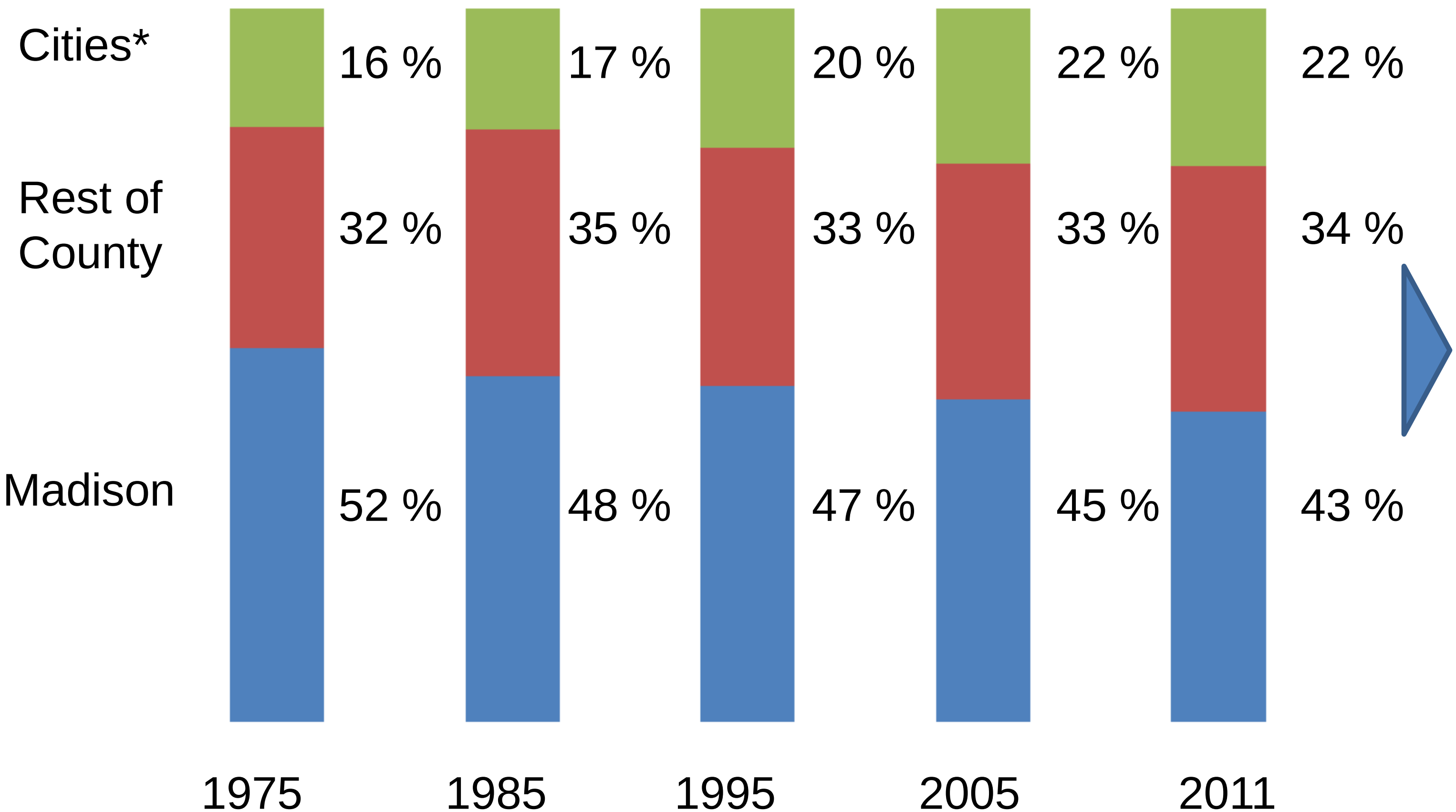
Economic Development Committee

September 19, 2012

Madison has lost “market share” within Dane County

Percent of Equalized Value within Dane County – all real estate classes

ALL PROPERTY CLASSES



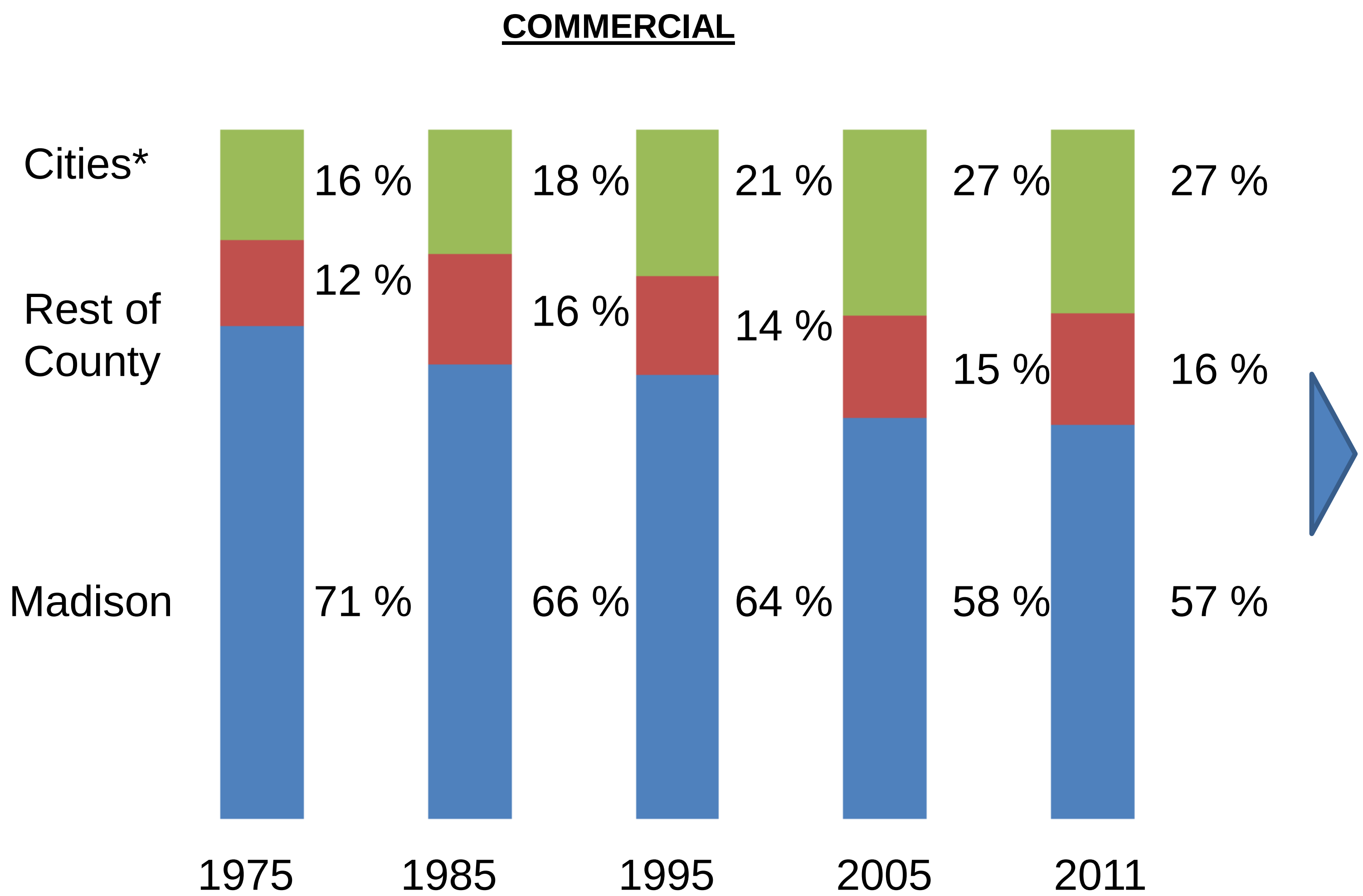
Maintaining a 52% share of value would have added **$39 million** to the 2012 budget – or cut taxes on average home by **$448**

* Fitchburg, Middleton, Monona, Stoughton, Sun Prairie, Verona – excludes Edgerton

Sources: Department of Revenue, 2012 Madison Budget, analysis

Steeper decline in commercial class

Percent of Equalized Value within Dane County – Commercial Property



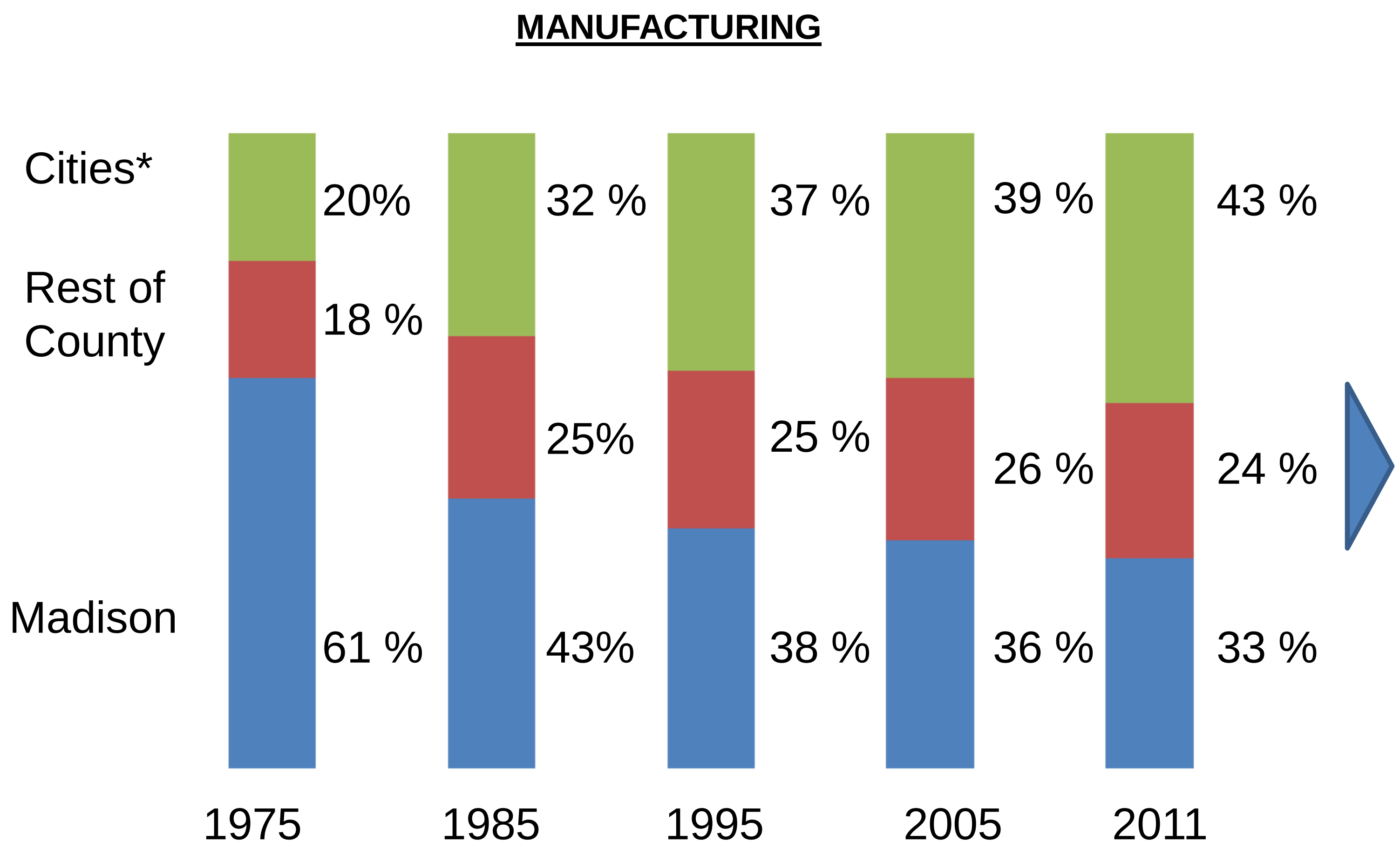
Madison continues to enjoy a strong employment base with over 50% of the commercial class

* Fitchburg, Middleton, Monona, Stoughton, Sun Prairie, Verona – excludes Edgerton

Sources: Department of Revenue, analysis

Even greater decline in manufacturing class

Percent of Equalized Value within Dane County – Manufacturing Property



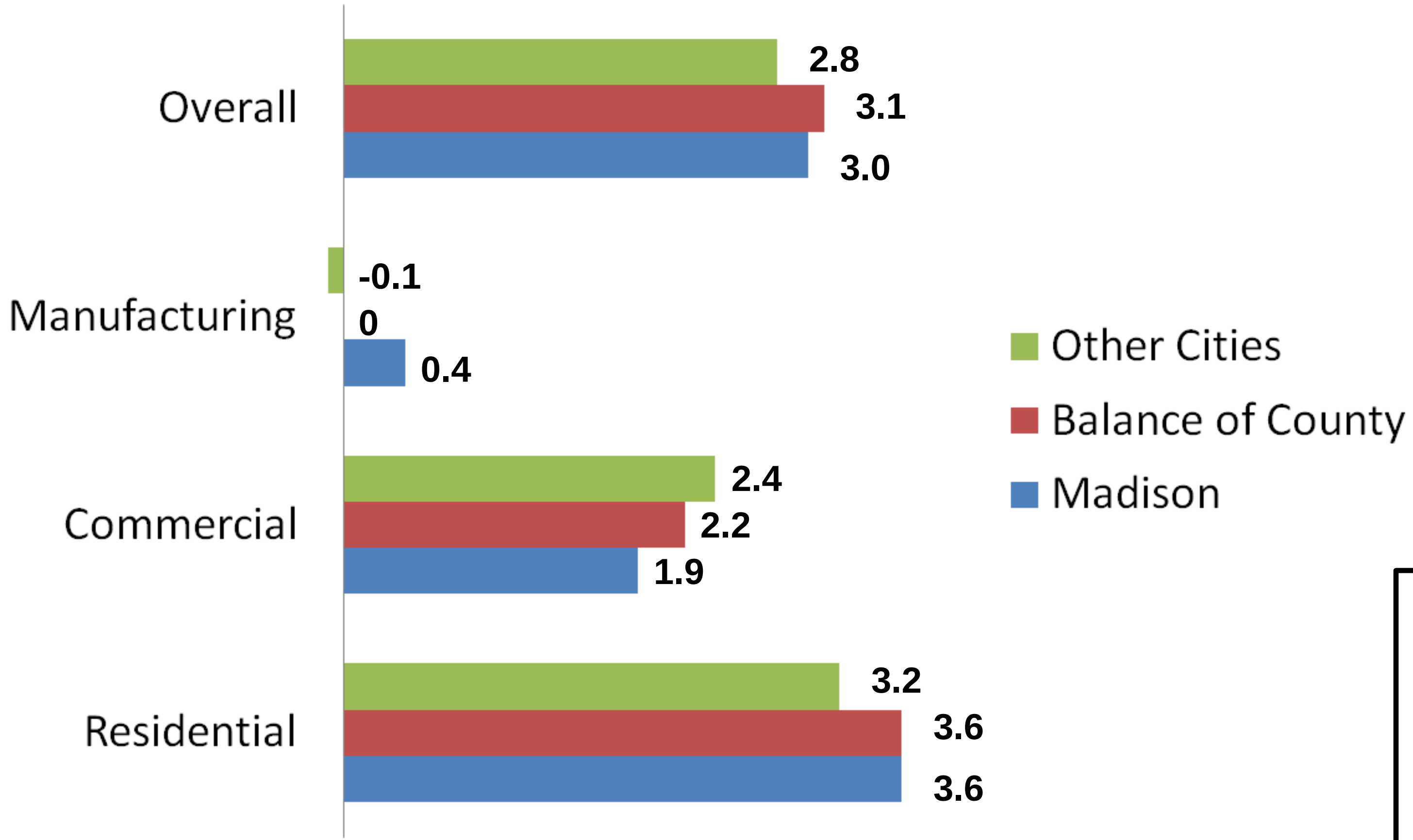
Madison has taken steps to increase land available for industrial and employment uses

* Fitchburg, Middleton, Monona, Stoughton, Sun Prairie, Verona – excludes Edgerton

Sources: Department of Revenue, analysis

Market share decline is not caused by appreciation

Percent Economic Change/Appreciation of Equalized Value (CAGR 1998-2010)

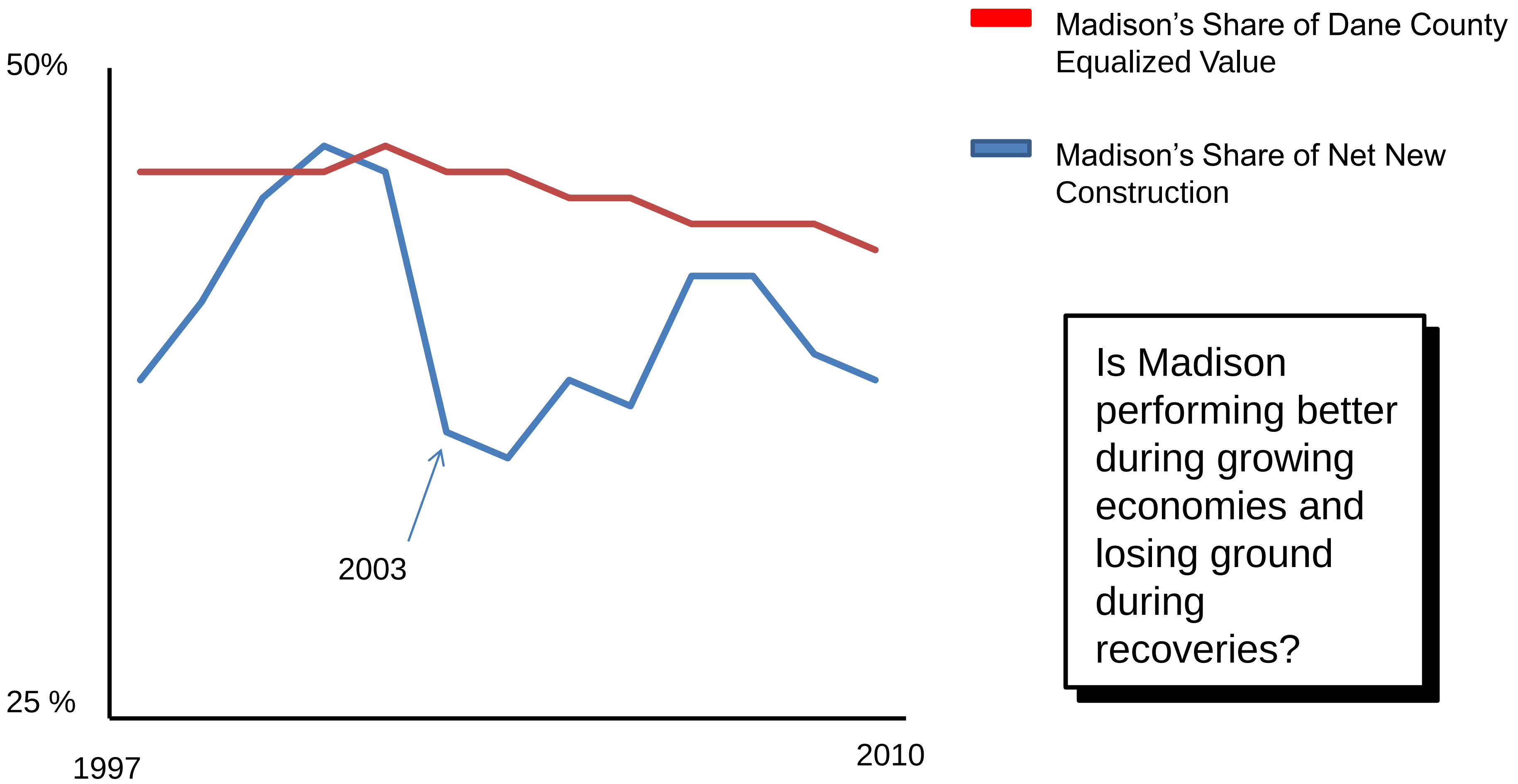


Differences in appreciation do not account for lost share of property value

Sources: Department of Revenue, analysis

Net new construction gap driving loss of share

Madison's share of Dane County equalized value vs. Madison's share of Net New Construction



Is Madison performing better during growing economies and losing ground during recoveries?

Sources: Department of Revenue, analysis

Gap due to differences in “Net New Construction”

Index of Cumulative Growth of Net New Construction – All Property Types (1997-2010)

Sources: Department of Revenue, analysis

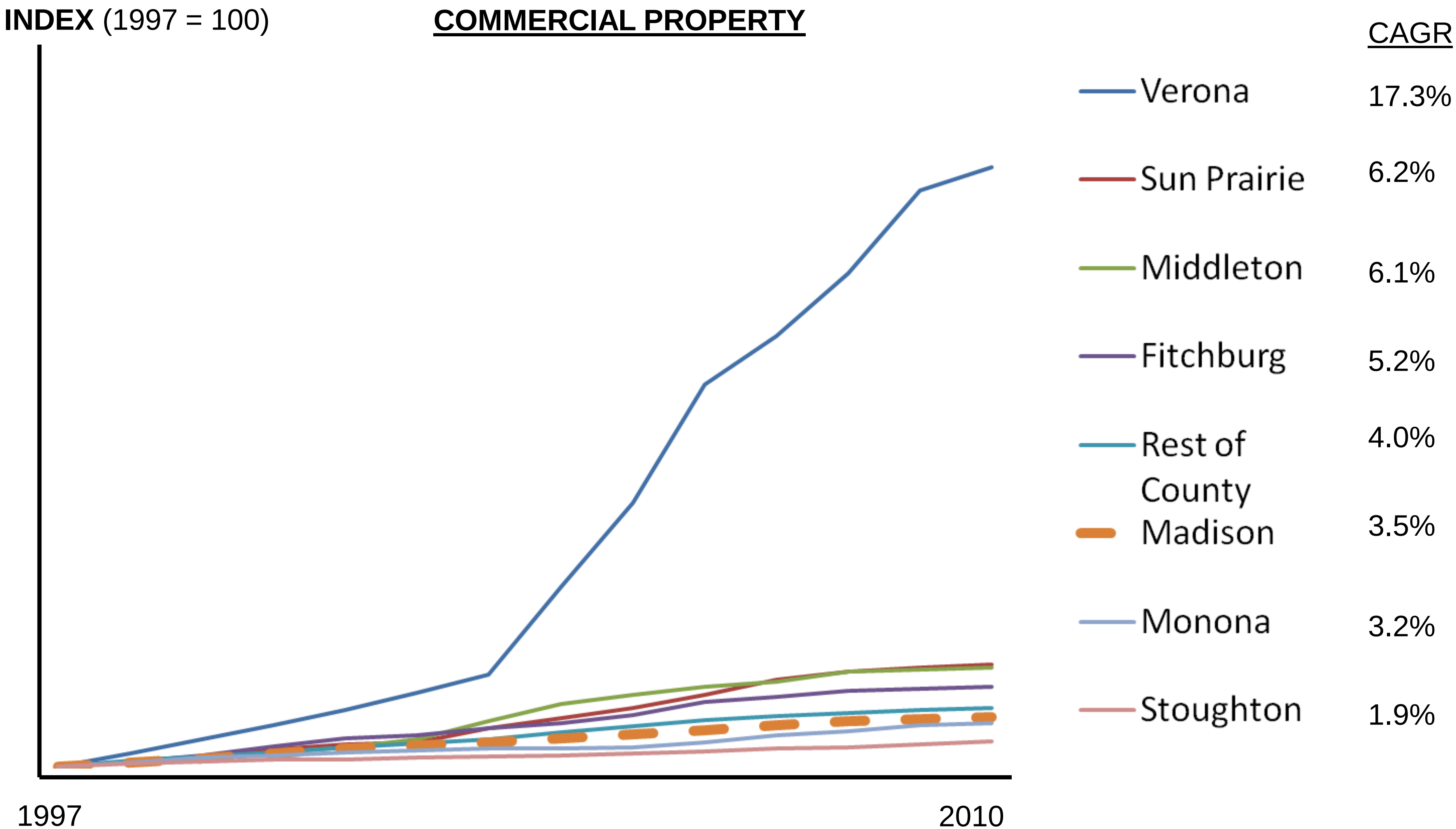
Net New Construction gap exists across classes

Index of Cumulative Growth of Net New Construction – Residential Construction (1997-2010)

Sources: Department of Revenue, analysis

Epic Systems distorts the commercial picture

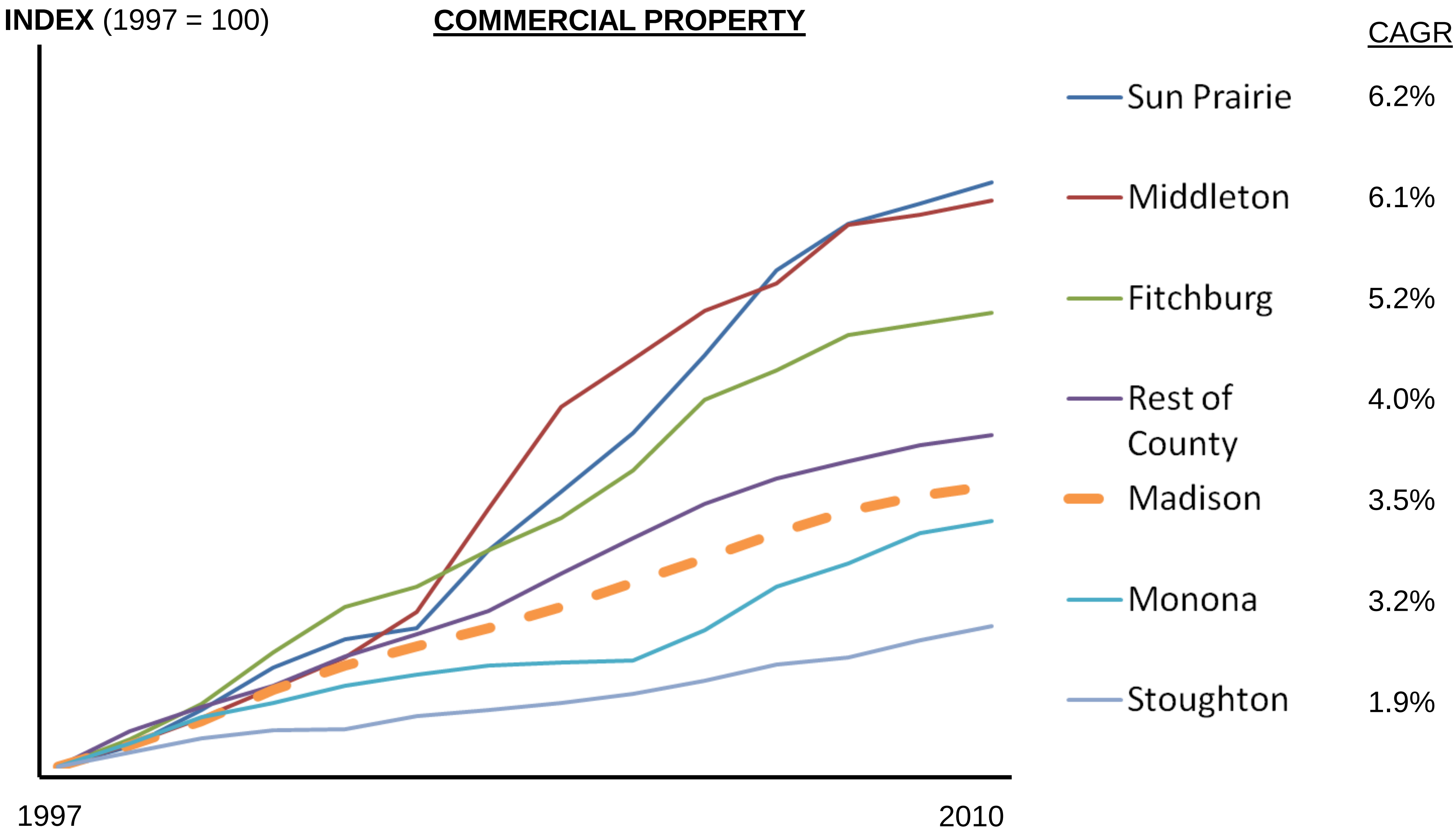
Index of Cumulative Growth of Net New Construction – Commercial Construction (1997-2010)



Sources: Department of Revenue, analysis

Commercial construction without Verona

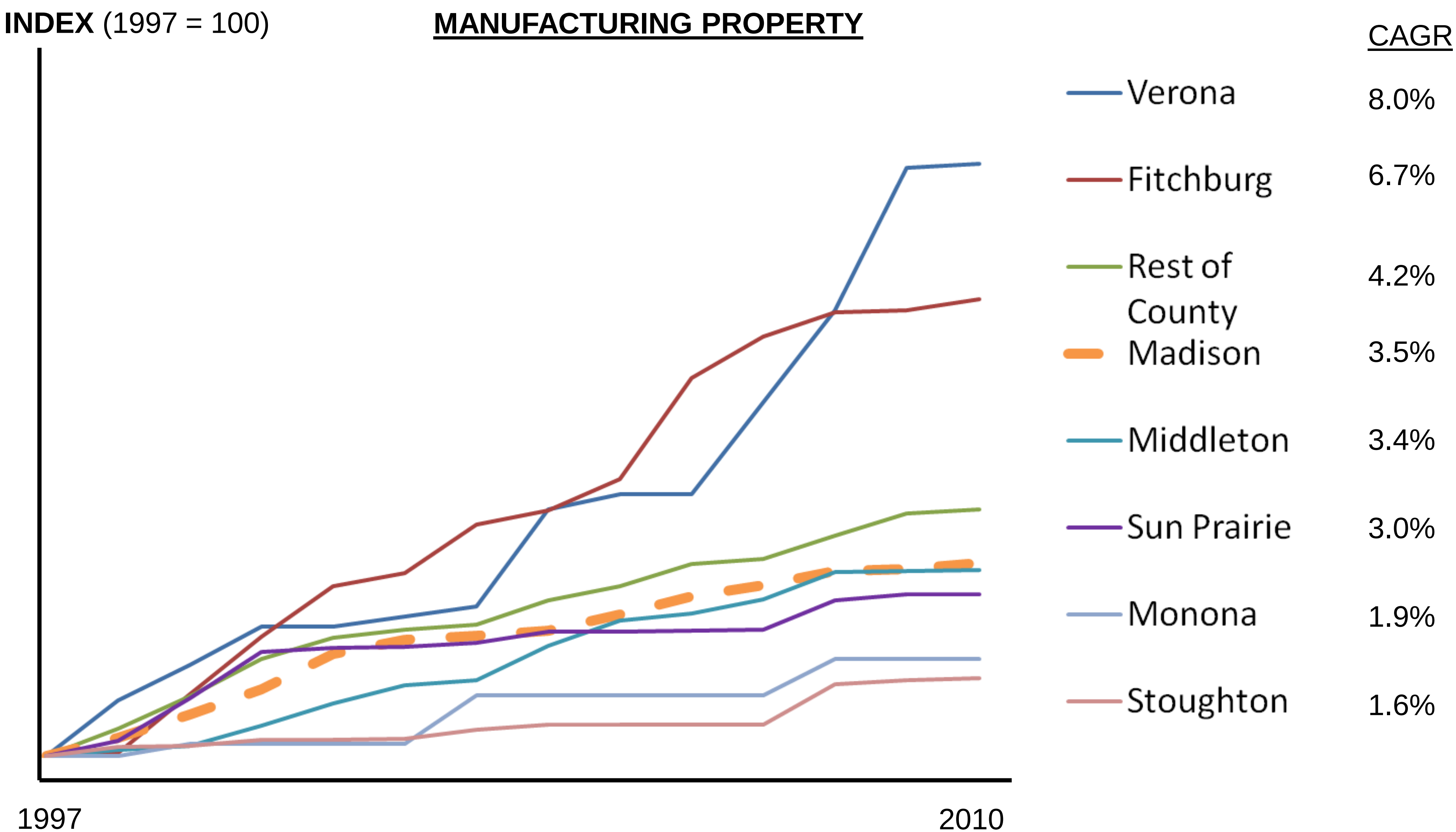
Index of Cumulative Growth of Net New Construction – Commercial Construction (1997-2010)



Sources: Department of Revenue, analysis

Pattern in manufacturing is slightly different

Index of Cumulative Growth of Net New Construction – Manufacturing Construction (1997-2010)



Sources: Department of Revenue, analysis

Madison requires more projects to grow at same rate

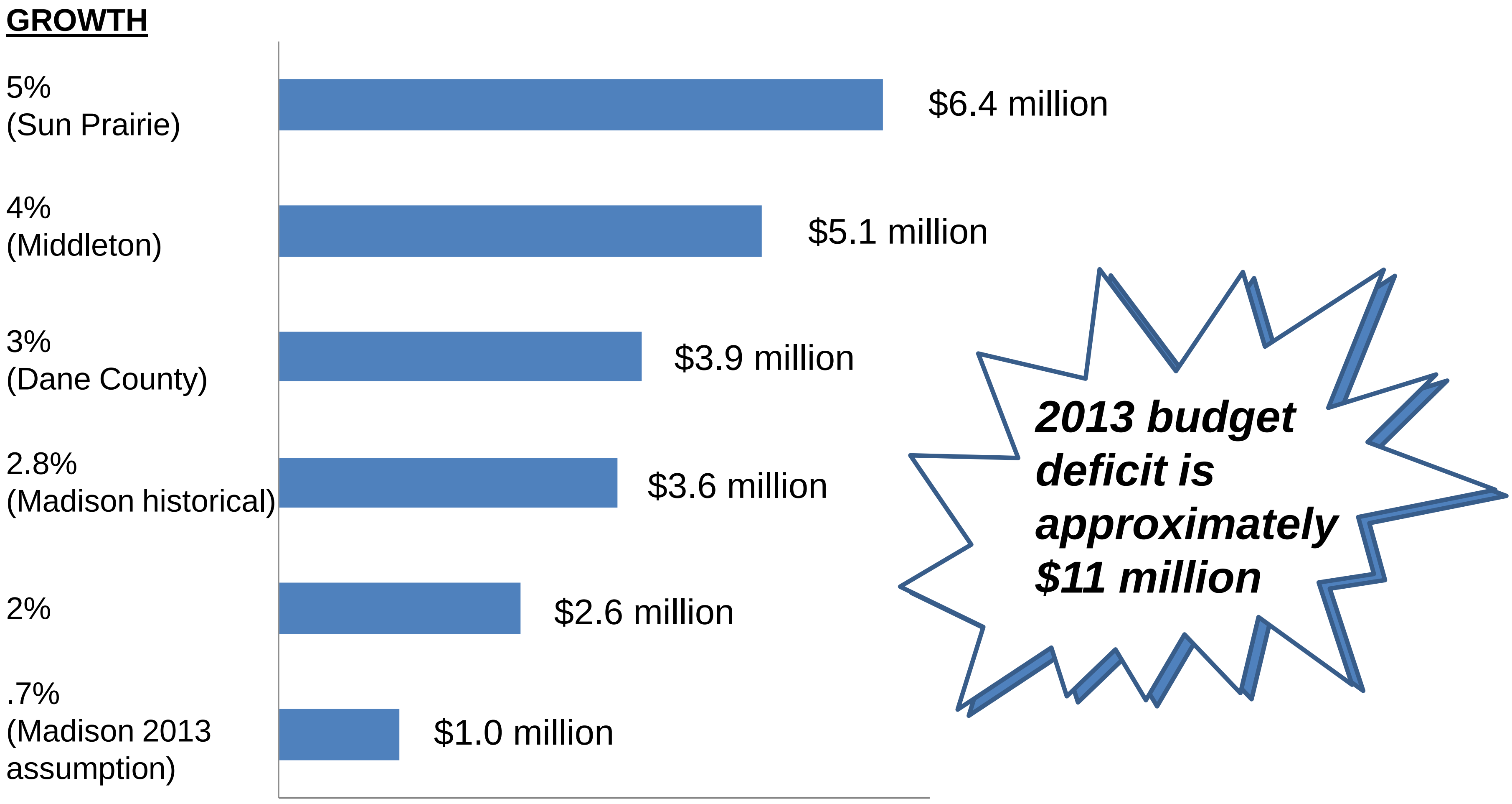
Impact of representative projects (Improvement value only) on Net New Construction rate

TARGET

2012 Eq. Value		Hilldale - $8 million	Hilton - $15 million
$ 918 million	**Stoughton**	0.87%	1.63%
$ 1,078 million	**Monona**	0.74%	1.39%
$ 1,580 million	**Verona**	0.51%	0.95%
$ 2,354 million	**Sun Prairie**	0.34%	0.64%
$ 2,447 million	**Fitchburg**	0.33%	0.61%
$ 2,712 million	**Middleton**	0.30%	0.55%
$ 21,697 million	**Madison**	0.04%	0.07%

In era of strict levy limits, net new construction is vital

Hypothetical implications for Madison achieving various competitor’s construction rates on 2013 budget*



* Assumes $128.4 million base levy; 2013 budget deficit less net new construction

Value of higher construction rates compounds

Hypothetical implications of achieving various growth rates over time

Net New Construction Benchmark	2013 year revenue implication*	2017 revenue implication**
5.0 %	$ 6.4 million	$ 35.5 million
4.0 %	$ 5.1 million	$ 27.8 million
3.0 %	$ 3.9 million	$ 20.4 million
2.8 %	$ 3.6 million	$ 19.0 million
2.0 %	$ 2.6 million	$ 13.4 million
1.0 %	$ 1.3 million	$ 6.5 million
0.7 %	$ 1.0 million	$ 4.8 million

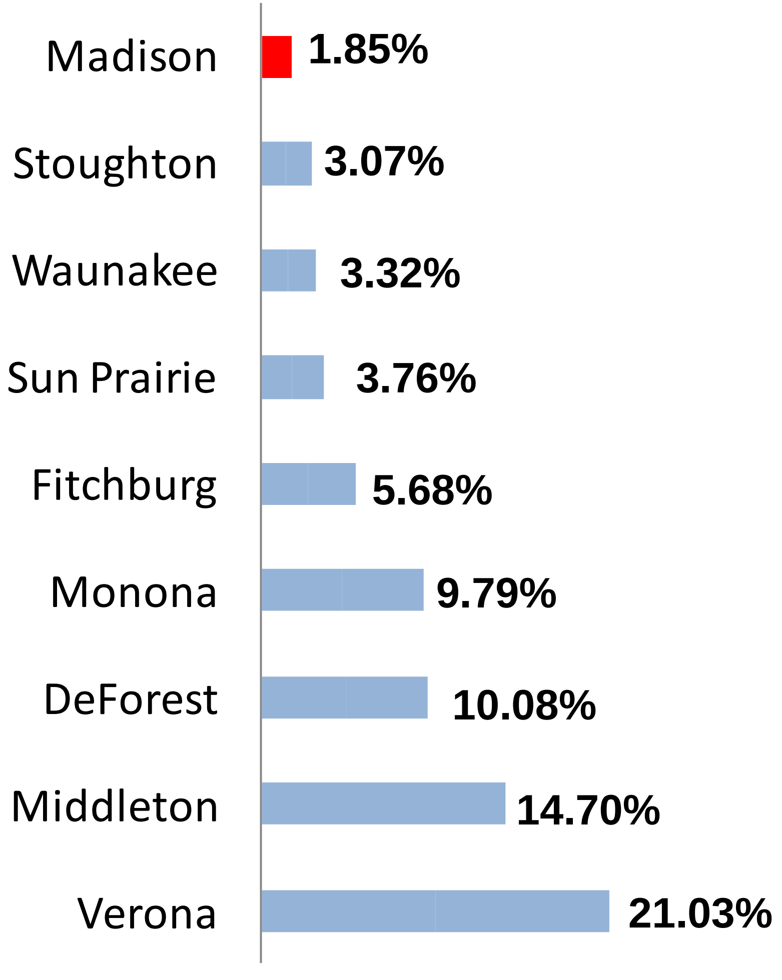
* Assumes $128.4 million base levy; 2013 budget deficit less net new construction

** Assumes $128.4 million base levy; 5 years of net new construction at specified rate; does not account for other changes to levy

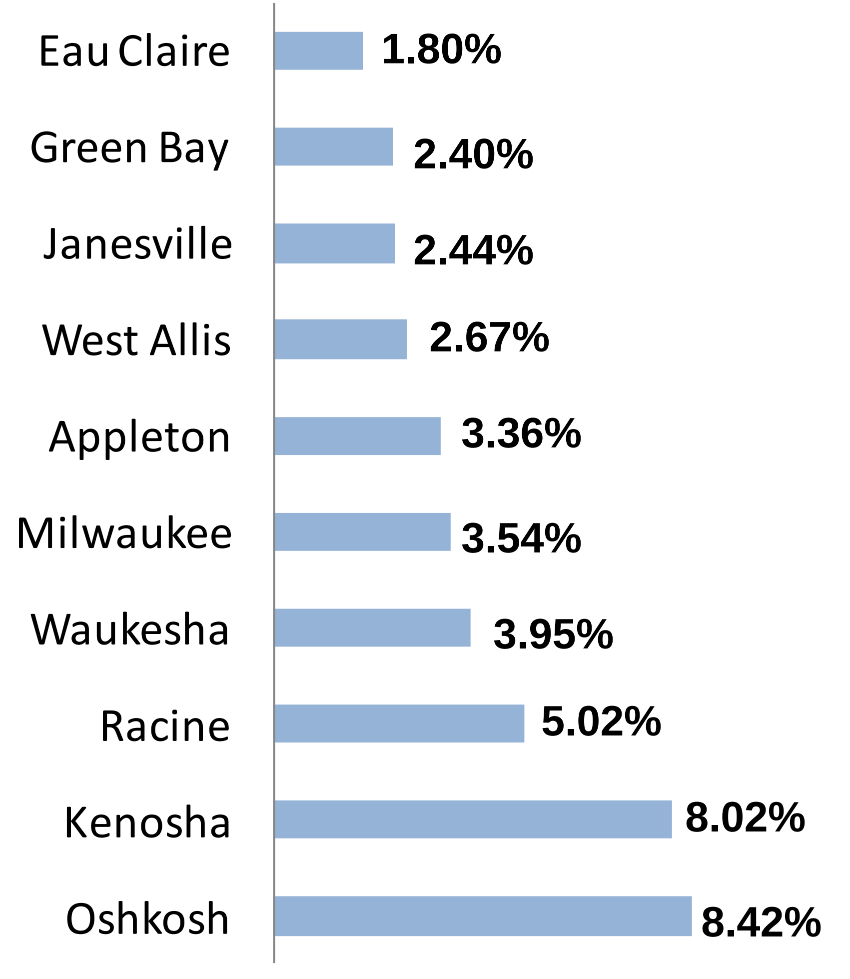
Madison has less property in TIDs than most cities

Percentage of Equalized Value in TIDs - 2012

LARGEST DANE COUNTY CITIES/VILLAGES



TEN LARGEST CITIES IN WISCONSIN*

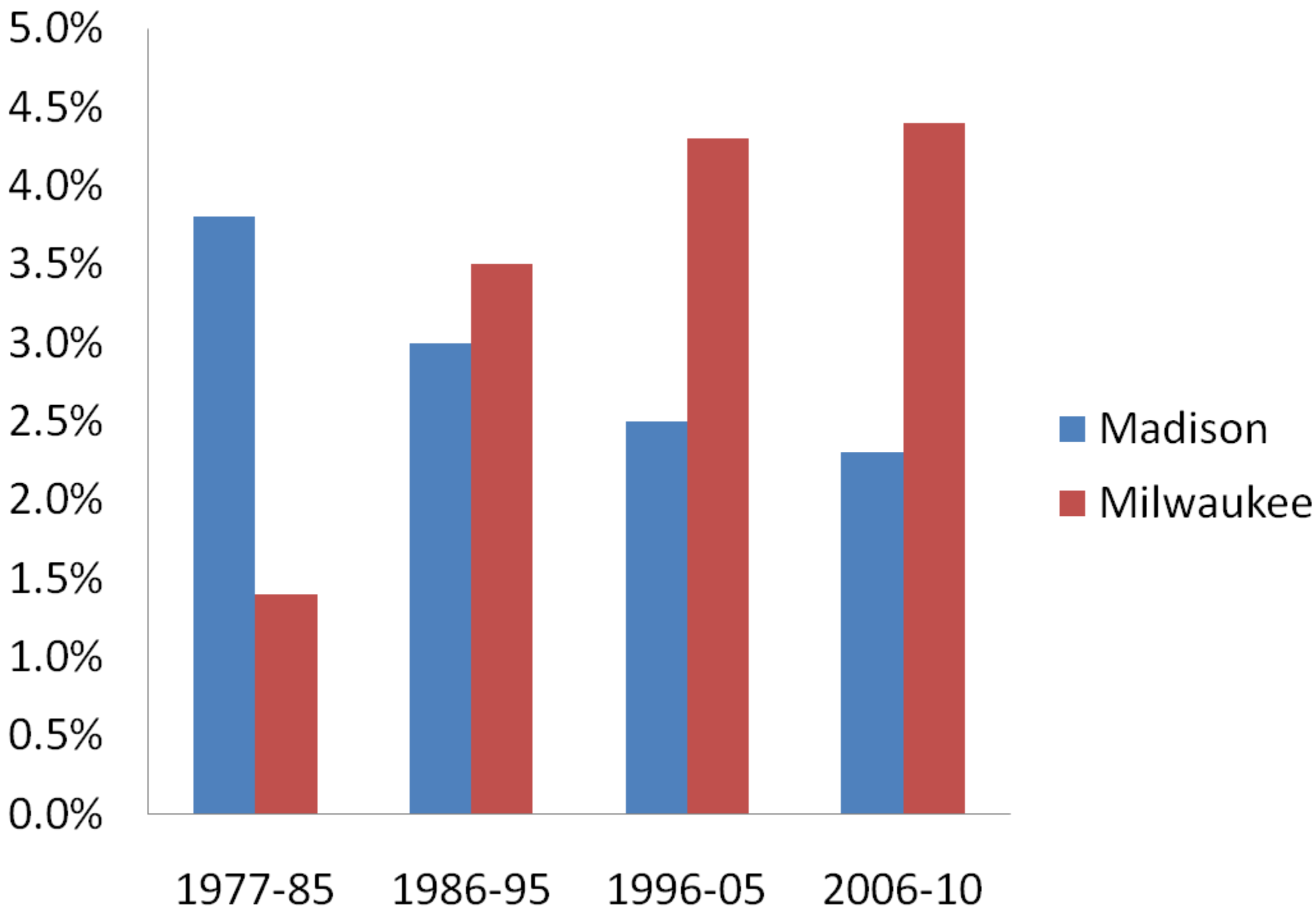


* Top eleven largest cities excluding Madison

Sources: Department of Revenue, analysis

Madison's relative use of TIF has declined

Share of Cumulative Wisconsin TIDs Created (1977-2010)



	1977-85	1986-95	1996-05	2006-10
Cumulative TIDs created	**369**	**833**	**1428**	**1739**
Madison TIDs	**14**	**25**	**36**	**40**

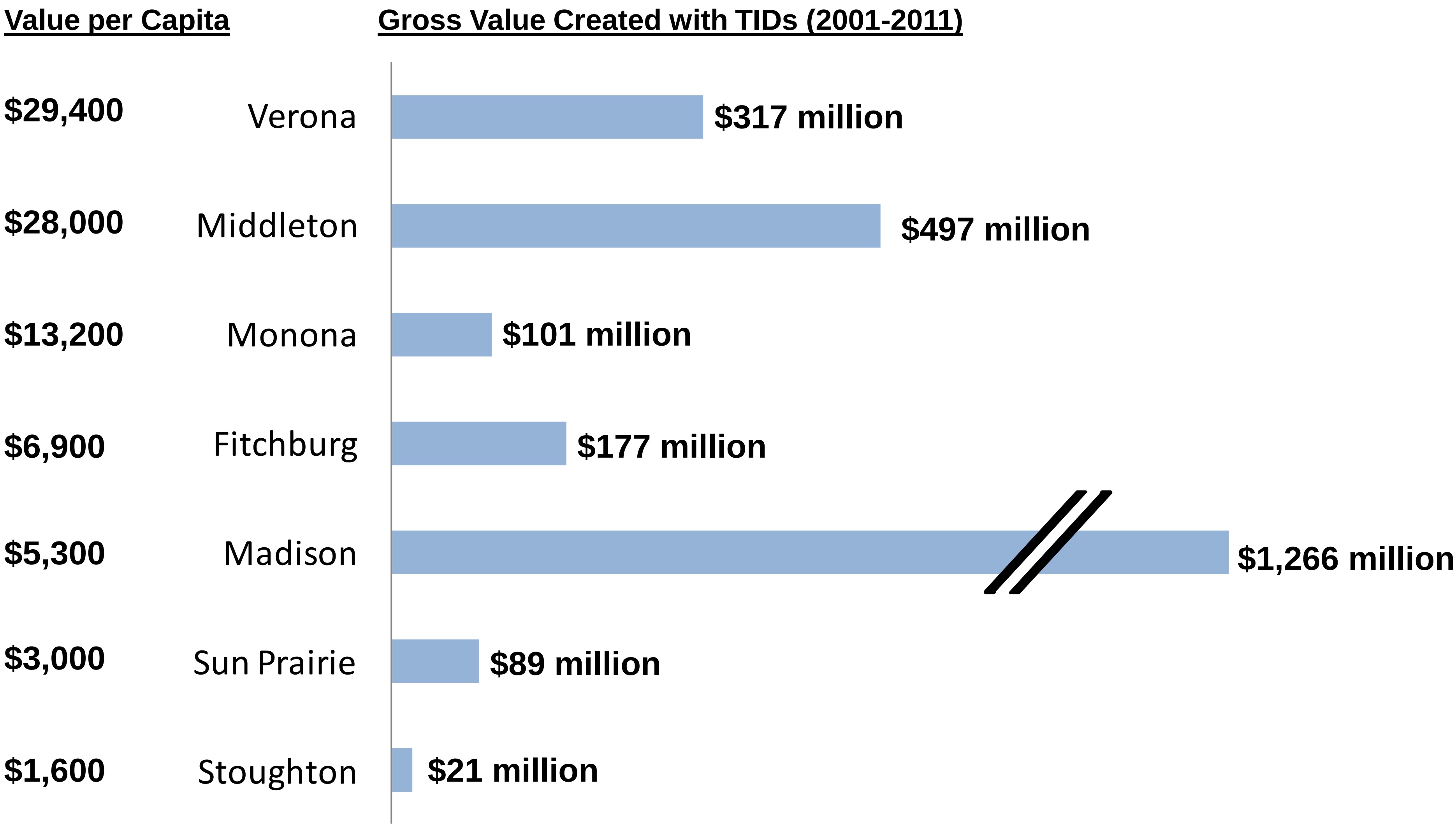
Madison was an early adopter of TIF but has seen its share of statewide TIDs decline

Some difference may be explained by size of TIDs (e.g., Milwaukee may have more single-purpose TIDs)

Sources: Department of Revenue, City of Madison, City of Milwaukee, Wisconsin Blue Book

Madison has created more value than neighbors…

Tax Base Growth in and after TIDs (2001-2011) relative to 2001 base



Sources: Department of Revenue, Census Bureau, analysis

...But less value relative to Madison’s base

Tax Base Growth in and after TIDs (2001-2011) relative to 2001 base

Returned to Rolls

0%

38%

2%

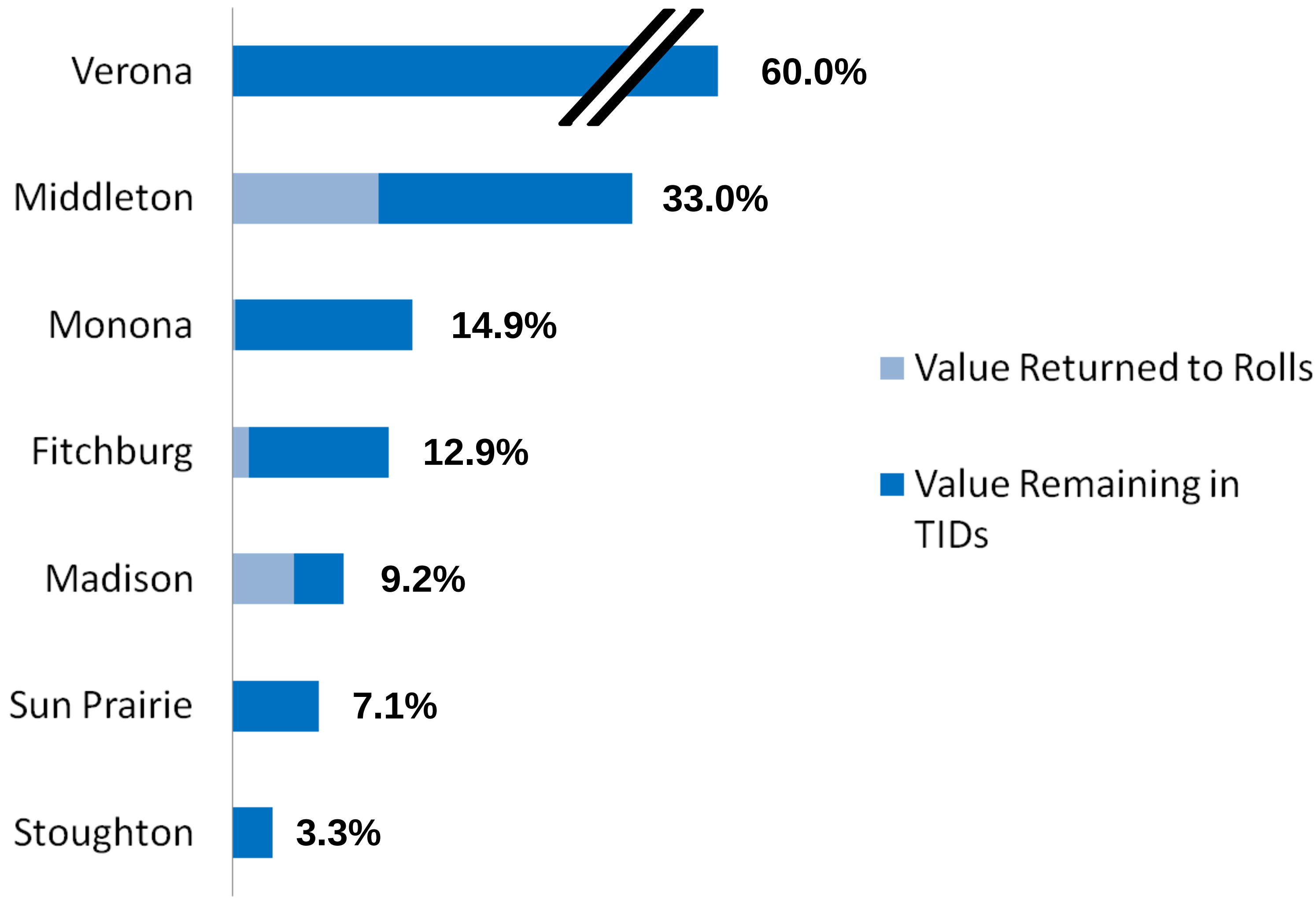
10%

59%

0%

0%

Value Created from TIDs relative to base (2001-2011)



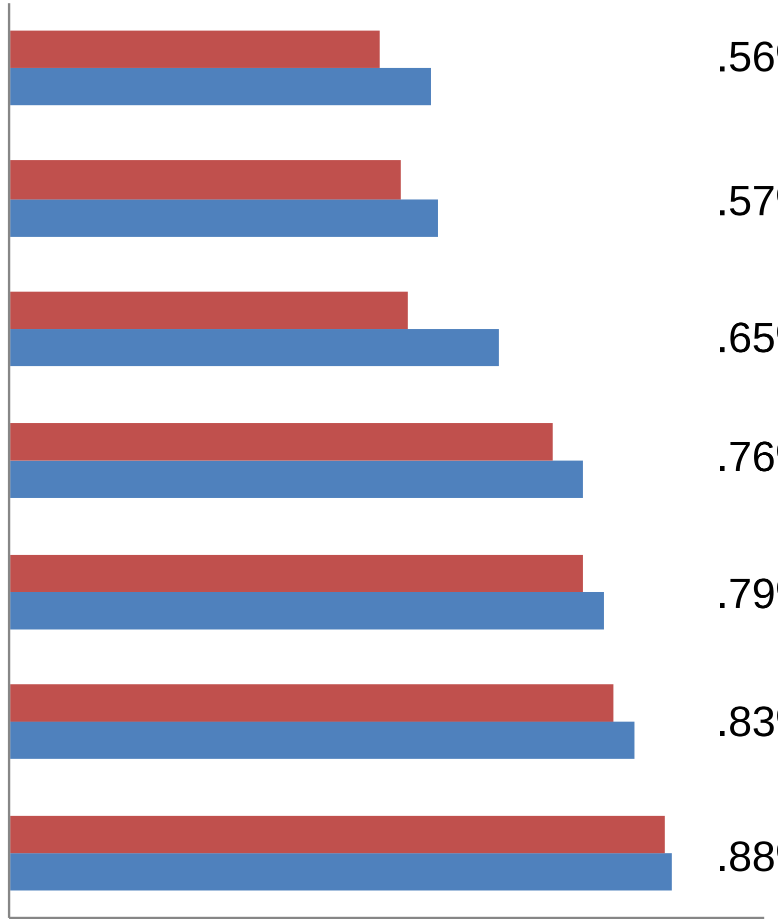
Sources: Department of Revenue, analysis

Remaining value locked in TIDs is significant

Hypothetical implication if all TIDs were closed immediately

Community	2011 Mill Rate	Tax Cut	Additional Spending*
Middleton	.56%	13 %	$2.2 M
Monona	.57%	9 %	$0.6 M
Verona	.65%	18 %	$2.2 M
Fitchburg	.76%	5 %	$1.1 M
Stoughton	.79%	3 %	$0.2 M
Sun Prairie	.83%	3 %	$0.7 M
Madison	.88%	2 %	$3.5 M

Change in Mill Rate if TIDs closed



2011 Mill Rate

Mill Rate if TIDs Closed

* Theoretical - levy limit could preclude capturing the value through spending

Current TIF Policy has been successful

- Approximately $1.486 billion of value created
- Investments of ~$100 million (approximately 14:1 leverage)
- TIF has built substantial infrastructure
- No failed or distressed districts
- Average TID closes in 12-13 years

Policy was developed following condo experience

TIF Loans ($500,000+) since 2000

Project	Type	Year
Bedford Court	Residential	2000
Capitol Point	Condo	2000
Madison Mark	Residential	2003
Tobacco Warehouses	Residential	2003
Gorman & Company	Residential	2004
Monroe Commons	Mixed-Use/Condo	2005
University Square	Mixed-Use/Residential*	2005
Block 51 (Capitol West)	Mixed-Use/Condo	2006
Arbor Gate	Commercial	2007
Revival Ridge	Acquisition	2007
Village on Park	Acquisition	2008
Burr Oaks	Acquisition	2010
Constellation	Mixed-Use/Residential	2012
Wingra Clinic	Commercial	2012
University Crossing	Commercial/Residential	2012

Current TIF Policy created and adopted

* TIF funded commercial (non-residential) component of project

Opportunity to update policy

- Features logical for condo market (e.g., equity participation) may make less sense for commercial/employment-oriented development

- Economic pressure to be more competitive within Dane County

- Strong track record creates platform to be more aggressive while controlling risk

- Opportunity to address strategic situations, especially with regard to employers

Potential TIF Policy and Process Issues to Consider

1. Generator Requirement
2. 50% Rule
3. Equity Participation
4. Personal Guarantees
5. “Competitive Factors” Policy
6. Simultaneous Land-use Approvals
7. Greenfield TIDs
8. User-friendly editing
9. Underwriting & Legal Issues
    - Assessable costs
    - Application fee
10. Role of TIF Team
11. Potential Opportunities
    - Affordable Housing
    - Small Cap TIF
    - Retail Development Grants

Generator requirement can cause an issue

Waiting until a generator is 100% ready to go can increase risk for either city and/or developer

Current Solutions

- Conversion to Loan (increases developer risk)
- City bears risk (increases city risk)

Potential change: Create criteria for strategic creation

Create/amend TIDs when a generator is locked in

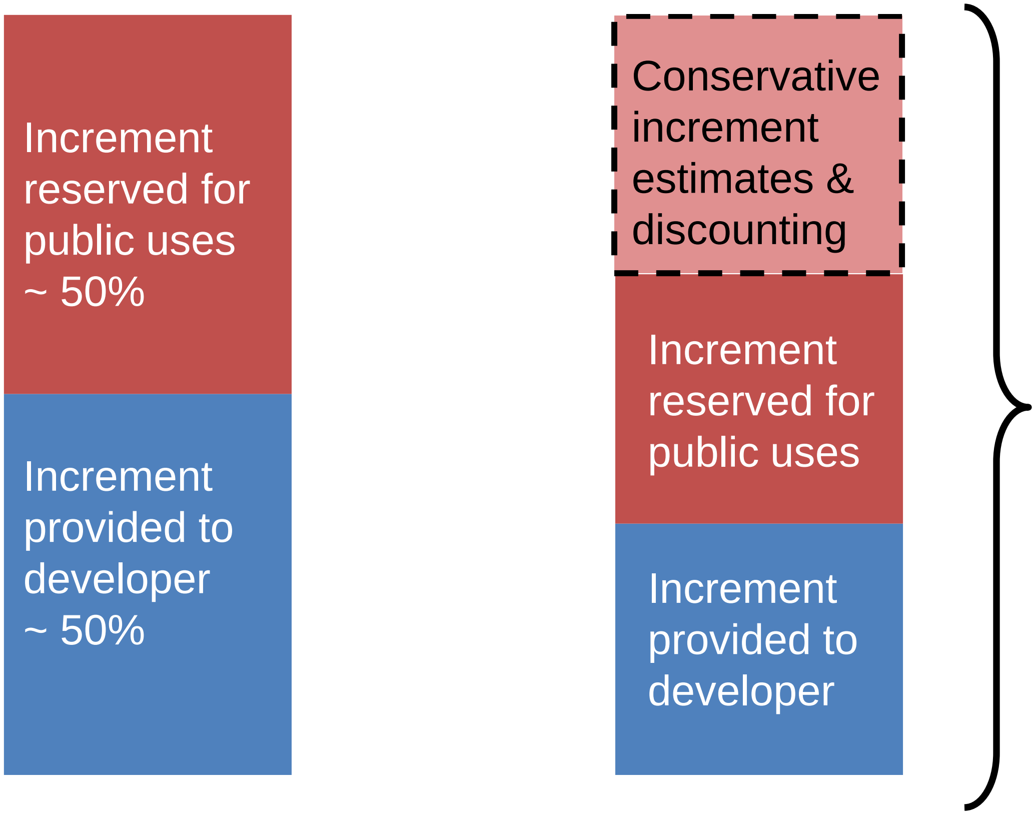
– or –

Create/amend TIDs when:

- City owns land and is actively seeking to (re)develop it
- Potential development has strategic importance to city and timing favors immediate creation/amendment (e.g., Royster Clark)
- City *commits to minimizing* infrastructure/non-increment generating expenditures until a generator commences construction

City should also ensure proposed TID maps are circulated to EDD, Planning, Finance, Alder, and Engineering prior to approval by the Joint Review Board

Issue 2: The 50% Rule is misleading



Perception of rule

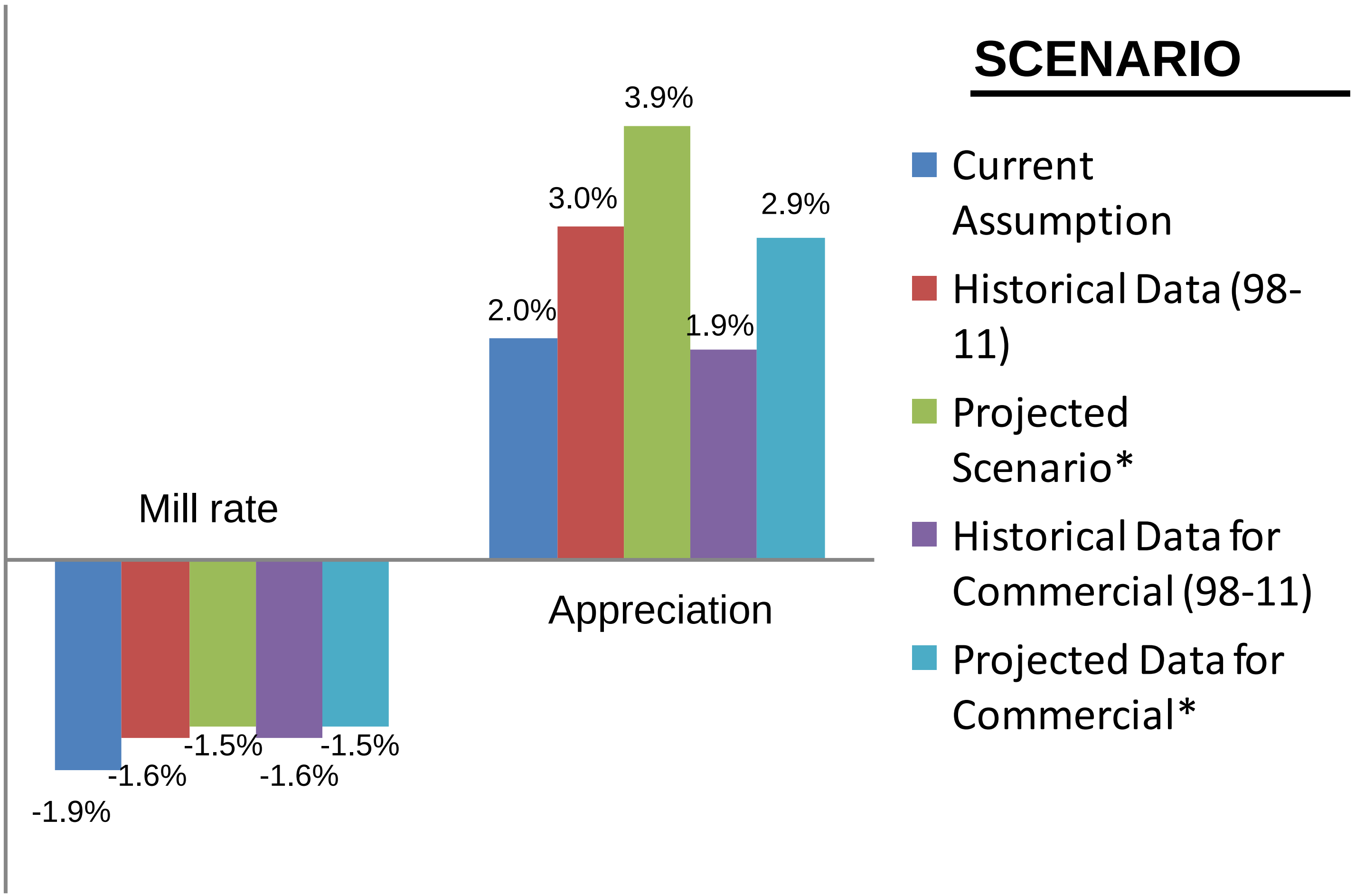
Reality of rule

The city is conservative and employs two safety mechanisms:

1. Estimating and discounting increment

2. Providing 50% of the estimate

City assumptions underestimate actual increment

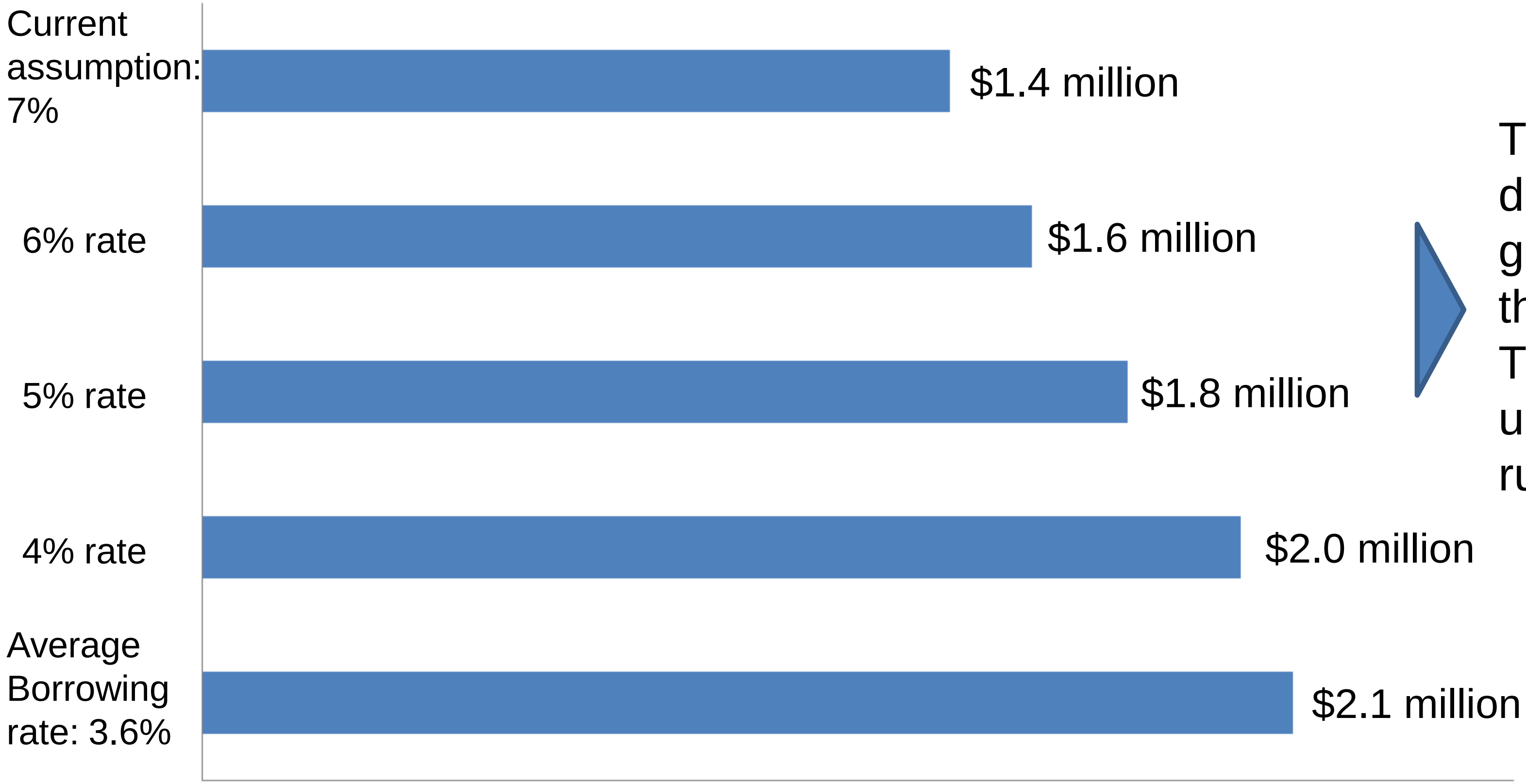


City's assumptions tend to underestimate TIF increment, though they are close for commercial property

* Projected scenario assumes real estate slump once every 27 years; Historical mill rate decline 98-09 = 3%

Available increment sensitive to discount rate

TIF Increment available for $10 million project at 50% of discounted increment

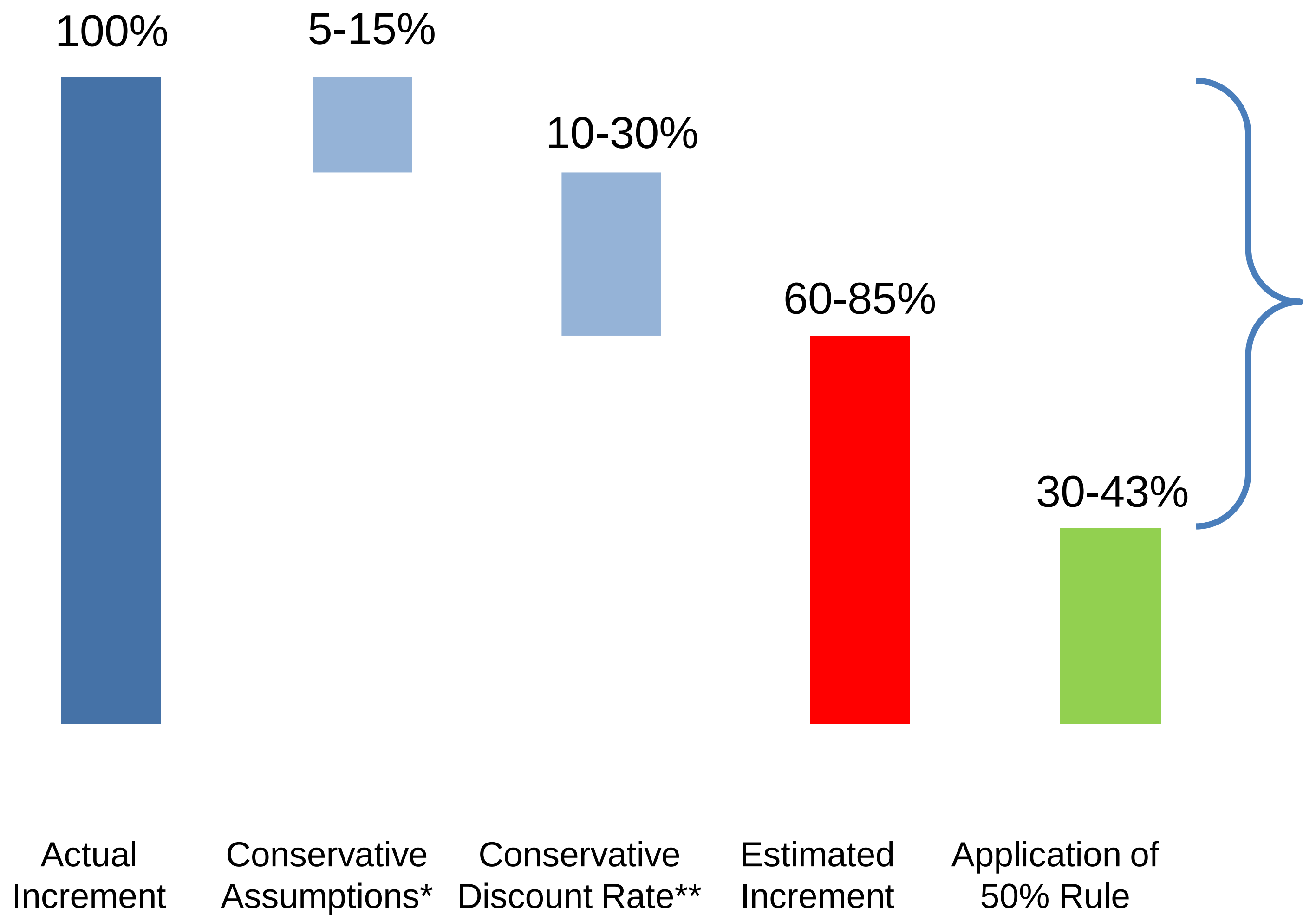


The choice of discount rate greatly affects the amount of TIF available under the 50% rule

Note: The average cost of the city to borrow at taxable rates for TIF projects over the previous 6 years is 3.59%

Our actual “cushion” is greater than 50%

Percentage of Increment on hypothetical $10 million project



Actual excess available for infrastructure and cushion is between 57% and 70%

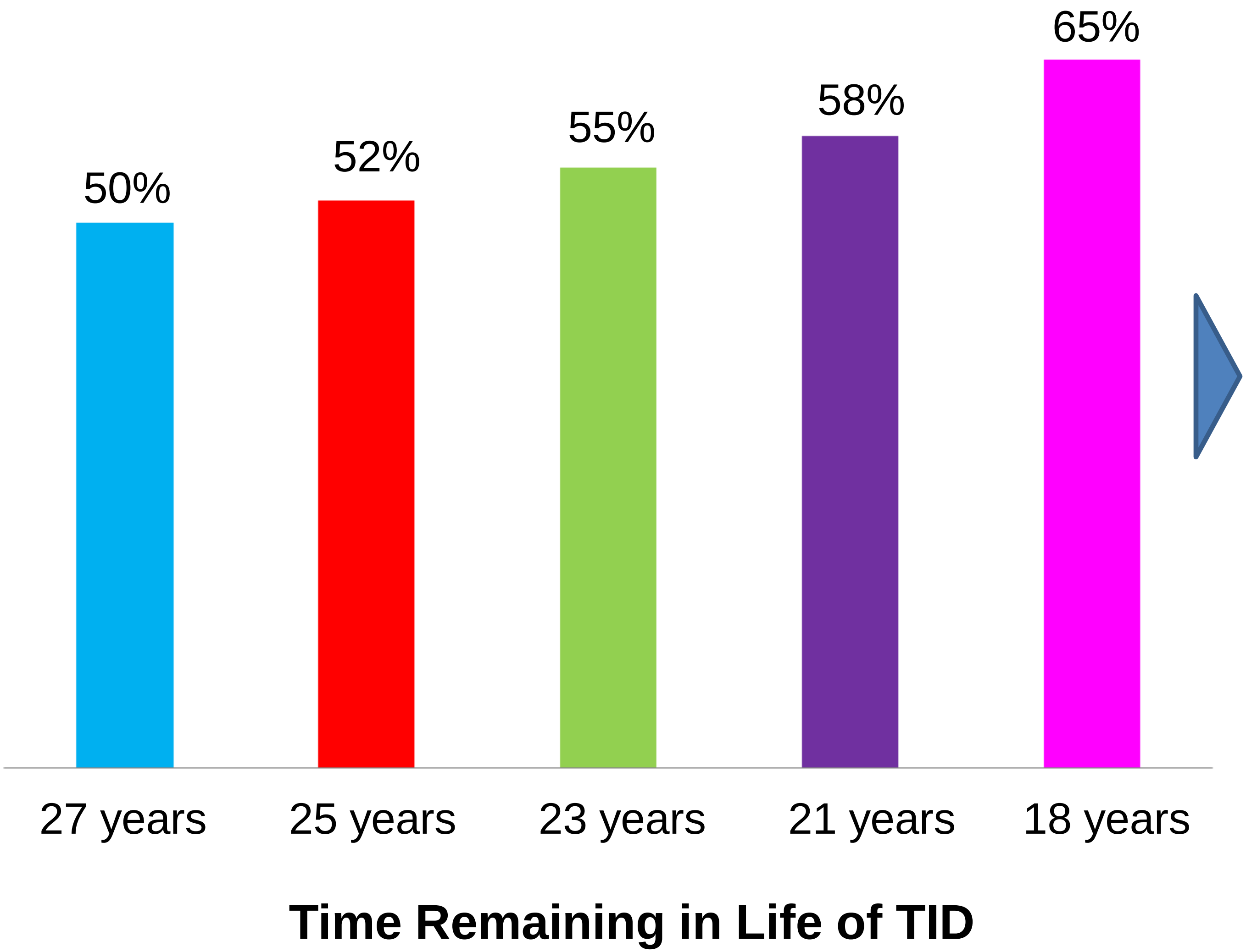
* Assumptions consider mill rates and appreciation for all classes and commercial only

** Sensitivity tested between 3.59% and 7%

Sources: City of Madison data; Department of Revenue; analysis

Lifespan of TIDs also creates issues for the 50% rule

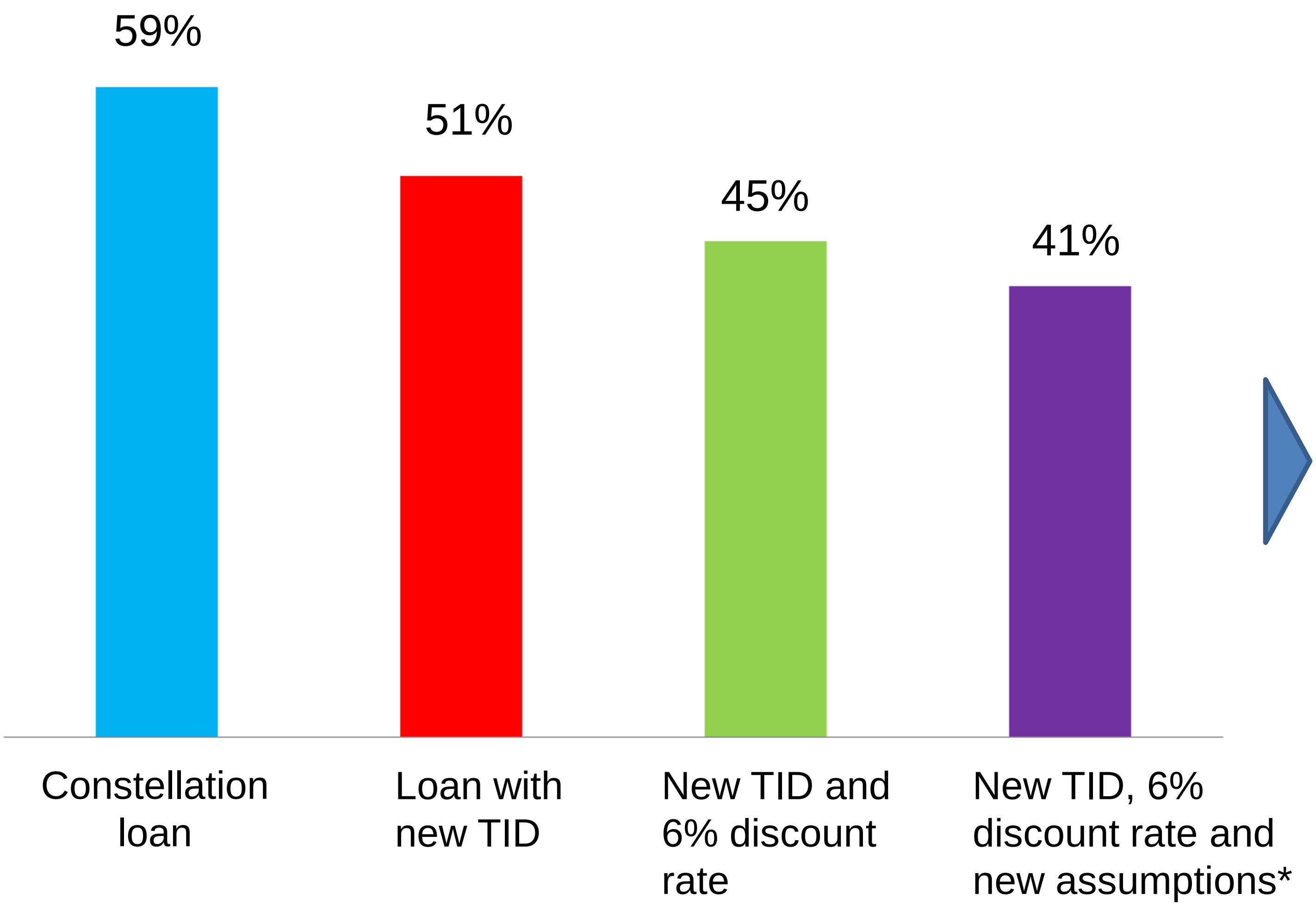
Percent of Increment Consumed for Identical Loan in TIDs with varying lifespans



A loan conforming to the 50% rule in a new TID would use 65% of the increment in a TID that is nine years old

Example: Constellation Capitol East District Project

Percent of Increment Consumed for Constellation Loan under varying assumptions



The $3.4 million TIF loan to the Constellation (Gebhardt) would nearly conform to the 50% rule if the TID had been new.

* Assumes mill rate declines at 1.6% versus 1.9%, commercial appreciation at 2.8% versus 2%

Possible Reforms to the 50% Rule

Option 1:
Analyze Margin for Error

Description
Instead of reporting the % of increment, staff would report the "margin for error" using 10-15 year rolling averages (of mill rates, appreciation, and borrowing rate)

Rationale
Policymakers would have a tool to assess likely risk rather than an arbitrary "rule of thumb"

Option 2:
Use Years of Payback (Middleton approach)

Description
Instead of reporting the %, staff would report the number of years until a project pays for itself. Could establish guidelines for various project types

Rationale
Policymakers would have a tool to assess risk and to compare projects independent of the life of the TID

Option 3:
Maintain % analysis with criteria for deviations

Description
Continue reporting the % of projected increment but establish guidelines that account for (location, strategic importance, lifespan of TID, extraordinary design/public benefits, etc.)

Rationale
A more nuanced version to articulate guidelines where deviations from the 50% rule are acceptable

Option 4:
Cashflow analysis for all/major projects

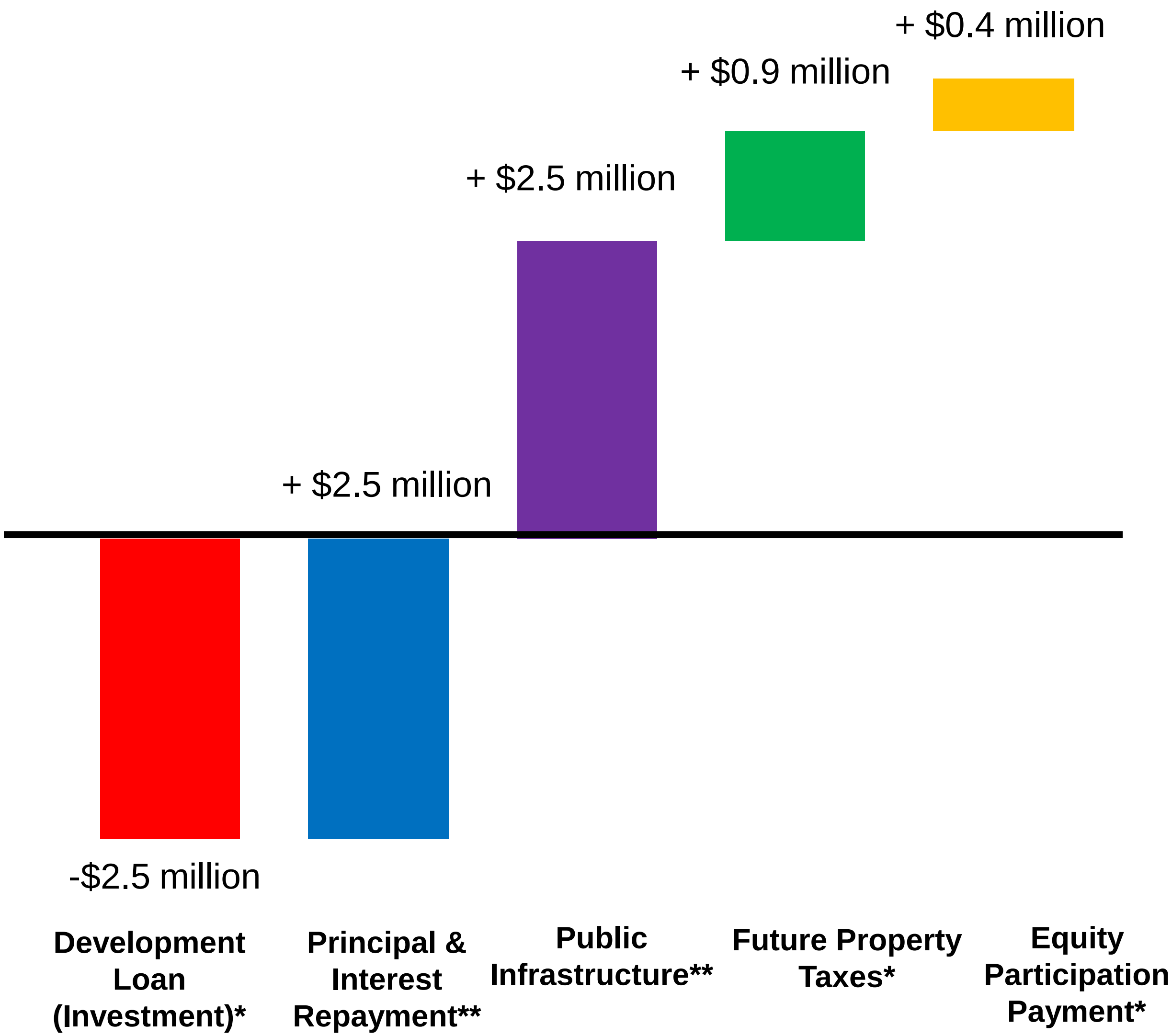
Description
Model TID cashflows based on projected increment and estimated interest rates (in lieu of discount rates)

Rationale
Allows more accurate estimates of when TIDs would actually cover debt and be able to close

NOTE: Careful scrutiny should be given to awards that exceed 100% and do not meet the self-supporting policy

Equity participation the least important component

Hypothetical return from $20 million project



Equity participation payments are the least important part of the city's return but one of the biggest sticking points in closing deals

* Calculated on standard city assumptions at 50% of increment using a 7% discount rate with 100 year time horizon

** Paid through property taxes, not direct payment; assumes actual interest rate in lieu of using 7% discount rate

Possible Reforms to Equity Participation

Option 1:
Eliminate Equity Participation

Description
Stop requiring equity participation payments

Rationale
• City's investment recouped through other means
• City not sharing downside risk due to developer guarantees
• Makes Madison more attractive place to seek deals
• Option preferred by staff

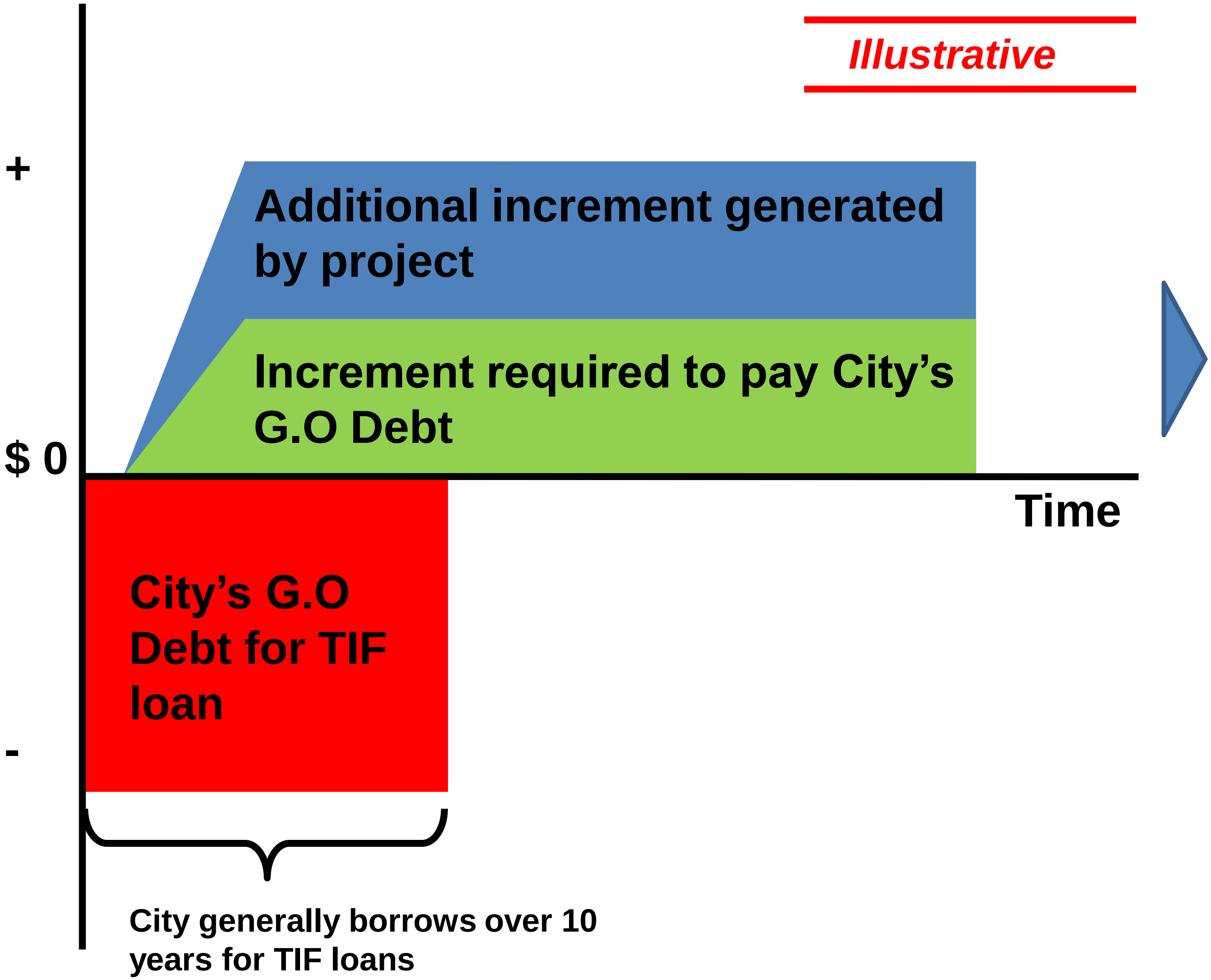
Option 2:
Modify to encourage long-term investing

Description
• Keep equity participation in place for 10 years (or length of TIF loan)
• Captures equity payments from condos and other similar projects

Rationale
• Encourages long-term investing
• City would share in any windfall profits from early sale
• Development community generally accepting of this concept

Consider affirming or modifying personal guarantee

Illustrative example of issue



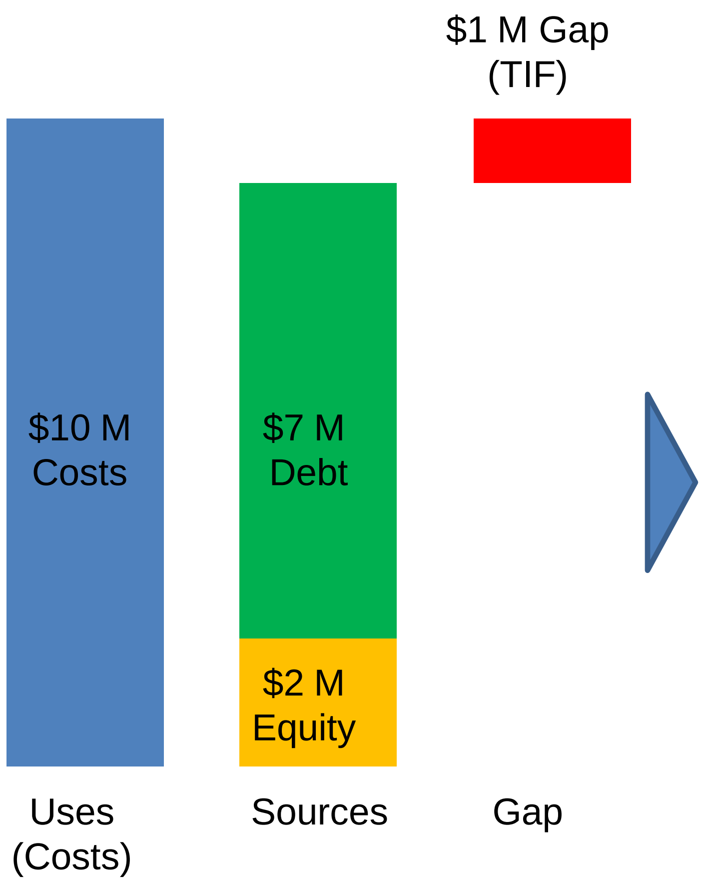
Developers generally accept requirement to guarantee the increment (green) necessary to recoup the City's investment (red)

Current TIF Policy also requires developers to guarantee the additional increment (blue) intended for infrastructure or other public purposes

City's Method Doesn't Always Translate for Companies

Schematic of City's Underwriting Method

City's Underwriting Method



Comments

- Analysis of gap useful in demonstrating that "but for" TIF, the project would not occur
- Gap financing method especially relevant to developer real estate projects
- Gap analysis is less useful in situations where employers are making location or investment decisions
- Companies allocate capital based on expected returns
- Sometimes a subsidy is required to make Madison projects more attractive than other projects ("but for" the subsidy, the project may happen elsewhere)
- Other communities use TIF as an incentive
- City needs to develop policy to address situations where "competitive factors" are at play*

* See City Attorney Opinion, "Legal Limitations on Tax Incremental Financing (TIF)" dated August 5, 2009

Simultaneous Land-use approval can be problematic

Current Policy

TIF Policy requires simultaneous approval of TIF loan and land-use by Common Council

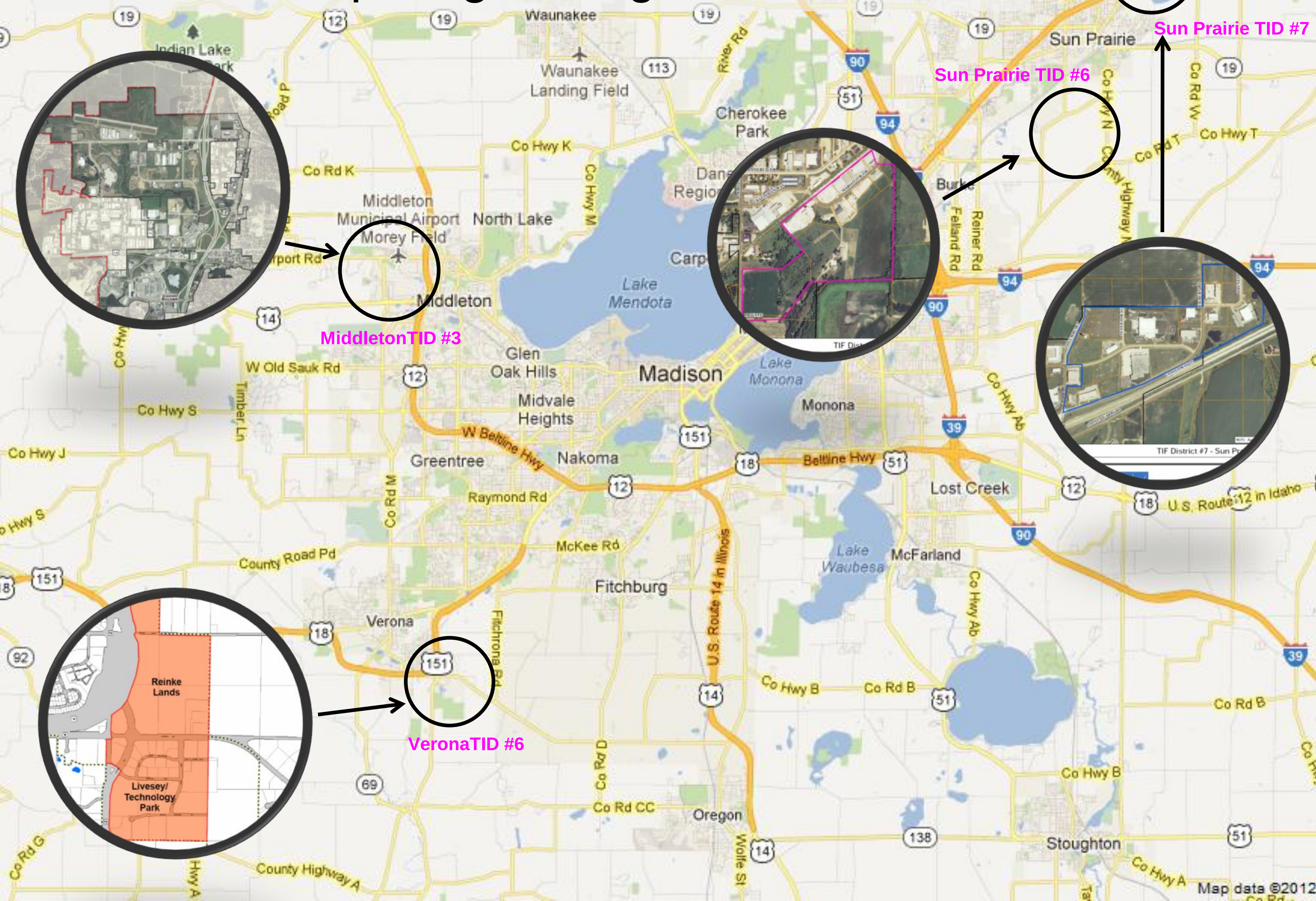
Issues

- Does not naturally occur
- Results in delay
- Land-use decisions (esp. design decisions) can impact TIF amount
- TIF often can't be locked in until design is finalized

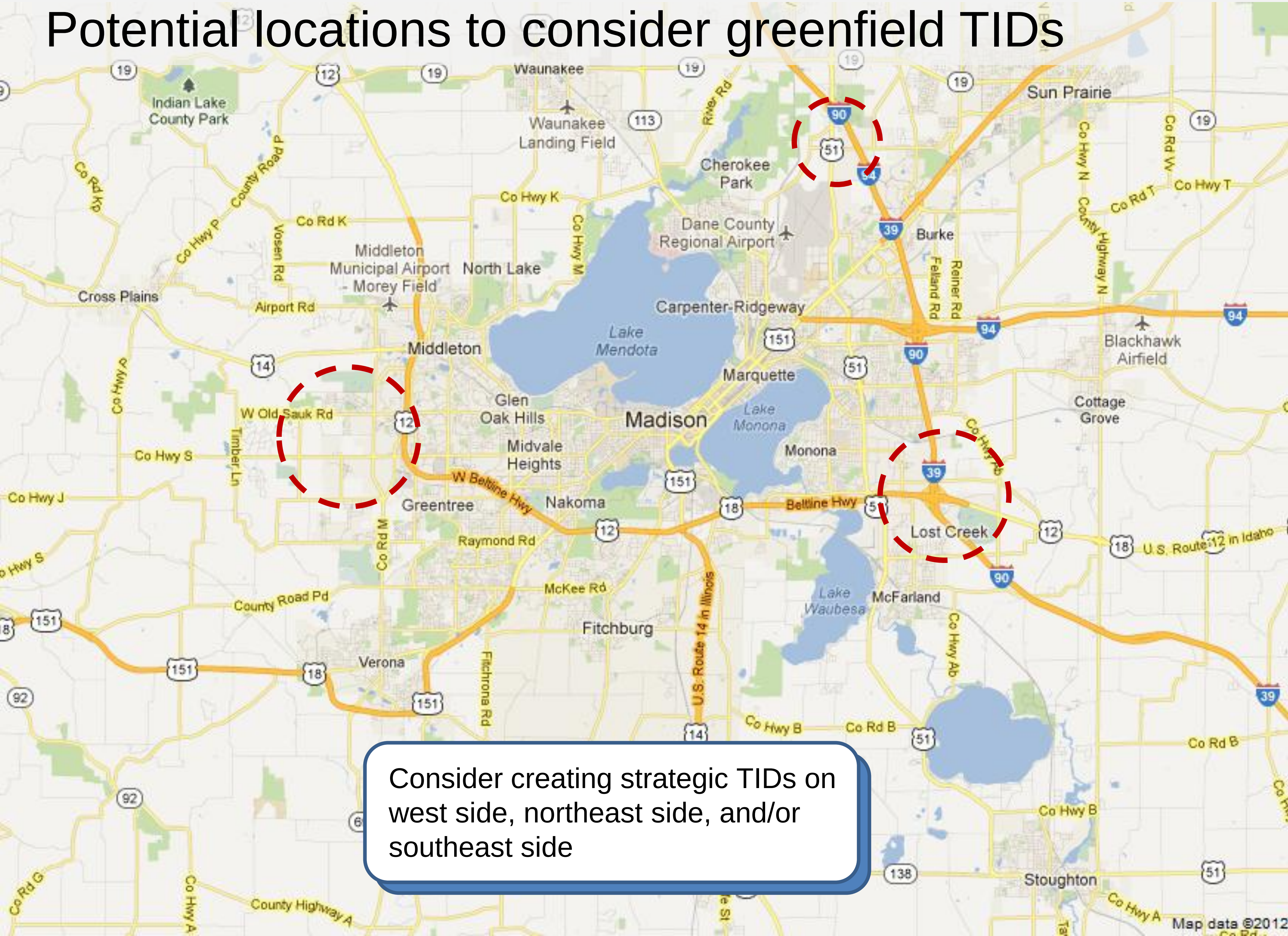
Potential Policy

- Allow decoupling of decisions
- Encourage TIF staff and UDC/Plan Commission staff to coordinate on issues that interact (esp. design/cost)
- Consider creating a mechanism to assess trade-offs between cost and design

Madison competing with "greenfield" TIDs



Potential locations to consider greenfield TIDs



Consider creating strategic TIDs on west side, northeast side, and/or southeast side

Consider striking unnecessary language

Consider shortening TIF Policy to be as user-friendly as possible by eliminating unnecessary language. Consider creating a separate document to articulate the vision, goals and values Madison has for TIF

Example of policy language that could be trimmed

~~**SECTION 1: TIF GOALS, OBJECTIVES AND STRATEGIES**~~

~~**Goal 1: Support Economic Development**~~

~~TIF Objectives:~~

~~(1) **Job Creation in High Need Areas.** Job creation in "high need" areas located within blighted area TIDs that demonstrate a **significant and substantial** combination of the following economic factors:~~

- ~~i. Deteriorating or obsolete building stock~~
- ~~ii. Stagnation or decline in property values~~
- ~~iii. Commercial and/or industrial vacancy~~
- ~~iv. Concentration of unemployment within an existing or proposed TID boundary that exceeds the national average unemployment rate~~

~~(2) **Job Creation Through New Business Development.** New business development in high need areas or industrial TIDs to create living wage jobs.~~

~~(3) **Job Creation Through Attraction, Retention, Expansion of Existing Business.** Attraction,retention or expansion of existing business in high need areas or industrial TIDs that create and retain jobs with a preference for businesses that are located near existing housing or planned housing developments.~~

~~(4) **Mixed Use or Industrial Projects Linked to Workforce Housing** . Whenever feasible, consider projects within mixed-use TIDs that combine the creation of living wage jobs with the provision of workforce housing. In order to be considered, a developer must demonstrate a direct connection between the jobs created and the housing being developed.~~

~~**Strategies to Support Economic Development:**~~

~~(1) Improve the public infrastructure.~~

~~(2) Support development of industrial sites and business parks to attract new industries and provide suitable locations for expansion and relocation of existing industries.~~

~~(3) Upon demonstrating that "but for" TIF a project could not otherwise be built, provide financial assistance to new and existing businesses whose projects create living wage jobs~~

~~(4) Focus such financial assistance to businesses that create such jobs in the following categories or clusters:~~

- ~~(a) Manufacturing~~
- ~~(b) Medical/Biotechnological~~
- ~~(c) Agricultural/Biotechnological~~
- ~~(d) Information Systems, Software Technology, Communications~~
- ~~(e) Financial and Insurance~~

Consider exploring assessment policy in TIDs

TIF was designed, in part, to make investments in infrastructure that would assist development

<u>DOR TIF Manual:</u>

"The standard is called the "but for" test…For example, new development may not happen in a certain area because there are not enough **streets, sidewalks, sewer lines or other pieces of physical infrastructure**. After using TIF to provide these improvements, the development becomes desirable and will proceed." (emphasis added)

Chapter 66 requires municipalities to deduct special assessments when calculating eligible project costs. In other words, TIF law prohibits double-dipping for costs that are assessed. It does not prohibit using TIF to fund costs that are assessable.

<u>Wis. Stats. 66.1105</u>

"Project costs" mean any expenditures …which are listed in a project plan as costs of public works or improvements…plus any incidental costs, diminished by any income, **special assessments**, or other revenues,

Consider working with City Attorney, Engineering and Public Works to determine whether modifications to assessment policy could make TIF more useful while treating property owners fairly

Consider change to application fee process

Current Process

1. Developer submits application
2. Developer pays application fee
3. TIF underwriting conducted
4. TIF loan considered/ approved
5. Fee refunded if necessary

Proposed Process

1. Developer submits application
2. TIF underwriting conducted
3. TIF loan considered/approved
4. Developer pays loan origination fee

- Current fee often refunded in practice if loan is not approved
- Creates a barrier to collaboration
- If an incentive is desired to discourage high TIF requests, fee can be based on TIF request not amount approved

Investigate Pay-as-you-go TIF

Pay-as-you go TIF is common for other municipalities.

Under Pay-as-you-go:
- Instead of the city issuing G.O. debt, the developer finances the entire project
- The City authorizes the developer to utilize some or all of the increment generated to retire their debt

The benefits are:
- Avoiding additional borrowing
- Perception that risk is transferred to the developer (they are on the hook for creating the increment)

Madison has not traditionally used it due to:

- Our ability to borrow at more attractive interest rates
- Enjoying plenty of room under borrowing limits
- Belief that city would remain morally obligated for debt, thus eliminating chief benefit of pay-as-you go (risk reduction)

Madison should research the use of pay-as-you-go by other communities, especially Verona's approach of paying out increment

Clarify role of TIF team

EDD staff meets with developers and completes preliminary underwriting

↓

TIF team convenes to assess project and develop negotiating strategy/parameters and make recommendation to Mayor

↓

EDD staff negotiate deal terms with consultation of Mayor and TIF team

TIF Team: DPCED, EDD, Finance, City Atty., Treasurer, Mayor’s Office

TIF team should establish strategy prior to negotiations

TIF team should reconvene to review revised deal if terms vary from strategy previously agreed to and to agree on recommended exceptions to policy

Potential opportunities in revised TIF Policy

Affordable Housing

- TIF is not currently effective in supporting affordable housing
- Policy could clarify role for TIF in supporting affordable housing by:
  - Treating investment in affordable housing like infrastructure
  - Investing only after a generator is secured
  - Investing in projects that will bring outside investment, especially WHEDA credits or New Market Tax Credits

Small Cap TIF

- Madison has experimented with Small Cap TIF but has not seen extensive usage
- Policy could consider modifications including:
  - Streamlining approvals
  - Making incentive more generous
  - Allowing developers/investors to rehab homes for single-family sale

Retail Development Grants

- Madison could consider making grants to non-food/beverage retailers in future targeted TIDs (e.g., State Street, Williamson Street, etc.) for:
  - Remodeling/Permanent Tenant Improvements
  - Façade grants
  - Attractive signage

Priority Issues

1. Guidance related to 50% Rule

2. Potential modifications to Equity Participation

3. Establish policy for working to attract employers ("competitive factors")

4. Review format, length, and clarity of policy

5. Clarify affordable housing policy (re: WHEDA tax credits)

Summary: Potential Ingredients of new TIF Policy

Potential Policy Changes

- Strategic creation of TIDs in some cases
- Modification of the 50% rule
- Modification of equity participation
- Affirmation or modification of guarantee
- Modification of simultaneous land-use approval
- Review and edit excess language

Potential Process Changes

- Consider interaction with assessment policy
- Consider crafting policy to address situations where employers are involved and "competitive factors" must be considered
- Modify fee payment schedule
- Clarify role of TIF team

Potential New Efforts

- Consider creating greenfield TIDs
- Clarifying role of TIF in affordable housing policy
- Small Cap TIF modifications
- Retail grants in some TIDs