

***Tax
Increment
Financing
in New Orleans***

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Tax Increment Financing in New Orleans

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The Bureau of Governmental Research is a private, nonprofit, independent research organization dedicated to informed public policy making and the effective use of public resources for the improvement of government in the Greater New Orleans metropolitan area.

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EXECUTIVE SUMMARY

Recently, the City of New Orleans has turned its attention to a widely used local economic development tool: tax increment financing (TIF). Last fall the City Council approved the City's first sales TIF district in connection with the redevelopment of the former St. Thomas housing project. Another financing plan with TIF-like characteristics utilizing the hotel occupancy tax is under consideration in connection with the proposed conversion of a portion of the World Trade Center into a hotel. A bill to create a TIF district for the Lake Forest Plaza Shopping Center site was recently introduced into the State Legislature. Another to create a TIF district for a large portion of eastern New Orleans has been filed. In May, City Council will consider a TIF-like arrangement for a Lowe's Home Improvement Warehouse. Recognizing the importance of the issue, City Council has begun to develop policies and procedures to govern the use of TIF.

What is TIF?

TIF is a financing mechanism that enables a local government to capture new tax revenues generated in a designated area and reinvest them in that area to fund improvements. The local government freezes the tax base in the TIF district at the pre-development level for a period of years.¹ Taxing bodies continue to receive the taxes on the pre-development base, but the incremental taxes are applied to infrastructure and other improvements designed to spur private sector development. In theory, the TIF district finances its own revitalization and eventually generates larger tax revenue for the community as a whole.

A Brief Critique

TIF provides cash-strapped municipalities – of which New Orleans surely is one – with a means of making investment in infrastructure and economic development projects under severe financial and political constraints. TIF has tremendous political appeal in that it can be implemented without raising taxes and, in many cases, without obtaining voter approval. It has a certain conceptual beauty in that the investment is, in theory, self-financing and the development supporting it would not have occurred otherwise.

Under closer scrutiny, the underlying premise that a TIF is self-financing is open to question. Because of the difficulty of making long-range projections, it is difficult to assess whether development in an area would have occurred without TIF. It is even more difficult to determine whether, and to what extent, gains in a TIF district are offset by stagnation, decline, or reduced growth in other areas and businesses. To the extent that other areas and businesses are negatively impacted, the existing revenue base of the local government is reduced. In addition, successful TIF districts can increase a local government's operating costs without providing additional operating funds to the local government. The end result in that case is a transfer of the additional operating costs to residents outside the TIF district.

Given the many unknowns surrounding the performance of TIF districts, and the types of dislocations that can occur, it is exceedingly dangerous to view TIF as free money. Rather, TIF should be considered an allocation of future resources and assessed with a stringency befitting

other long-term investments of future revenue. The investment should be made only if it is effective, efficient, equitable, and in furtherance of a defined public policy.

For reasons discussed below, property TIF, the most widely used form of TIF, is preferable to sales TIF. Unfortunately, because of the nature of the local tax structure, property TIF is less practical in New Orleans than in other jurisdictions. In Louisiana, property TIF can only capture taxing bodies' ad valorem millage that is not dedicated to a special purpose. In 2001, undedicated millage for the City of New Orleans was 14.91 mills out of 169.29 total mills collected in New Orleans. Thus, for every \$1 million of incremental assessed value (or \$6.6 million of fair market value), only \$14,910 out of \$169,290 in total property taxes paid would be available for a TIF district. If the general millages of the Orleans Parish School Board and Orleans Levee Board are subject to capture (a matter which is unclear), an additional \$15,500 would be available for TIF. The homestead exemption and the exemptions enjoyed by nonprofits, government, and some industries further diminish the potential of property TIF use by reducing the tax base.

The tax structure, combined with requirements for voter approval of bonds backed by property tax increments (but not for bonds backed by sales tax increments), skews the use of TIF toward sales TIF. This is unfortunate, because sales TIF suffers from more serious problems than does property TIF:

- ◆ Sales tax revenues are more volatile than property tax revenues, a fact that makes sales TIF debt financing riskier and more expensive.

- ◆ Sales TIF districts are more likely than property TIF districts to capture revenues unrelated to TIF investment, thus reducing current tax revenues available to the jurisdiction.
- ◆ Because sales TIF districts need large, creditworthy retailers or shopping centers to generate significant tax increments, the quest for a TIF source can lead to land use distortions, unnecessary subsidies for big retailers, and a distortion of a local government's investment priorities.
- ◆ Subsidizing a retail operation with TIF revenues gives it an unfair advantage over its competitors.
- ◆ Unless contractually constrained, the retailer can enjoy the TIF subsidy and deprive the local government of projected benefits by departing when the TIF period ends.

There are other factors that suggest that TIF might not provide the most effective solution to blight or economic development issues. Regardless of the type of TIF, because the repayment obligation is limited to a specific funding source, TIF debt is more expensive than general obligation debt. Whether the premium paid to limit the obligation is worthwhile will depend on the particular circumstances. In some cases, such as the St. Thomas TIF, it is clear that the City could save millions of dollars in tax revenue by issuing lower-interest general obligation bonds. The capacity to issue such debt exists under the City's debt limit, which is 35% of gross assessed value, or \$816.8 million as

of Dec. 31, 2002. Debt outstanding as of late February was \$473.4 million, or 58% of capacity.

As in the use of other economic development incentives, the effective, efficient, and equitable use of TIF depends on the wisdom, financial sophistication, and integrity of those involved in the process. To the extent that decisions are based on sophisticated analysis, made with an unwavering focus on the public good, and implemented through skillful negotiation, the chances of successfully using TIF increase. To the extent that decisions are driven by relationships, political deals, and other agendas, or that the government lacks the high level of expertise needed to analyze and implement complicated transactions, TIF is likely to be an expensive mistake that results in an unnecessary transfer of wealth to private entities.

The potential problems associated with TIF are more than theoretical. New Orleans' two TIF districts – one approved for the St. Thomas redevelopment and another under consideration for the proposed World Trade Center hotel – provide case studies of the problems. A summary of the problems associated with these TIF districts can be found on pages 21 to 23 of this report. More detailed information is available in the appendices.

The trend with respect to TIF is disturbing. In just the past month, City Council has received a proposal for a TIF-like arrangement for a Lowe's, a bill has been introduced to create a TIF district for Lake Forest Plaza shopping mall, and another bill has been filed to create one for eastern New Orleans. Collectively and individually, they raise serious concerns, including the specter

of businesses routinely turning to the City for subsidies and the prospect of freezing the tax base for a huge swath of the City.

As noted above, the effective use of property TIF in New Orleans is severely limited by the prior dedication of most of the tax revenues. Ironically, the widespread use of sales TIF would create a similar limitation on government's future flexibility by converting unrestricted tax revenues into dedicated taxes. In addition, the proliferation of long-term dedications will contribute to the balkanization of government within the City, even as the community focuses increasingly on regionalism.

Given the potential expenses, risks, and abuses associated with TIF, the City should use TIF cautiously and only in tightly circumscribed conditions. BGR believes that the City should abandon completely the use of TIF and TIF-like arrangements based on sales and hotel occupancy taxes and restrict the use of TIF based on property taxes to public infrastructure and pre-development improvements in blighted areas.

Strict parameters for the use of TIF should be established at the state level through revision of TIF statutes and at the local level through the adoption of stringent policies and procedures. Specific recommendations for changes in legislation and the establishment of City policies and procedures for the use of TIF are set forth below.

RECOMMENDATIONS

State Legislation

- ◆ State law should impose severe limitations on TIF based on sales and hotel occupancy taxes, limiting their use to “main street” programs designed to revitalize commercial centers of smaller municipalities. The use of sales TIF for large-volume, major retail stores and shopping malls should be prohibited.
- ◆ The state should eliminate TIF legislation designed to accommodate specific projects. It should establish a cohesive set of general laws to replace the multitude of statutes on the books.
- ◆ State law should limit the use of TIF to blighted areas and require local governments to make a finding that an area is blighted. The statutes should define the specific characteristics of blighted property and define a blighted area in quantitative terms.
- ◆ State law should include a meaningful “but for” test conditioning the use of TIF on a finding that TIF is necessary for appropriate, future redevelopment (as opposed to a specific project) to occur in a designated area.
- ◆ State law should limit TIF expenditures to prep work needed to make the urban landscape more attractive for investment. Eligible costs should include expenditures for public improvements, such as streets and sewer and water systems, demolition, site preparation, property assembly, and

environmental clean-up. TIF should not be used to provide funding for privately owned projects and assets.

- ◆ State law should limit the duration of TIF districts.

City Policies and Procedures

BGR recommends that the City implement the following recommendations regardless of whether state law is changed.

Master Planning

- ◆ Before allowing additional TIF districts, the City should develop and adopt a city-wide economic development plan. Any TIF district should conform with, and promote the objectives of, the economic development plan.
- ◆ As part of the economic development plan, the City should develop a city-wide master plan for TIF. It should designate areas of the City that are eligible for TIF and establish detailed criteria and priorities for authorizing TIF districts within them. The plan should be based on an in-depth expert analysis of the City and should be prepared and adopted after city-wide public hearings.
- ◆ The TIF master plan and all TIF developments should conform with the master plan for the City.
- ◆ To encourage prioritization and careful targeting of projects, the City should establish a cap, based on a dollar amount or a percentage of the City’s General Fund, on the

amount of taxes that can be diverted from the General Fund to TIF districts.

Criteria for TIF

- ◆ In view of the problems associated with their use, the City should abandon the use of TIF based on sales taxes or hotel occupancy taxes.
- ◆ The City should identify, and designate as eligible for TIF, blighted or brownfield areas that offer the greatest potential for development, assuming an appropriate amount of public funding. Blight should be defined in meaningful, quantitative terms to reduce the risk of the unnecessary use of TIF.
- ◆ To limit the use of TIF to areas in which development would not otherwise occur, the City should condition the use of TIF on a finding that TIF is necessary for appropriate, future redevelopment (as opposed to a specific project) to occur in the designated area.
- ◆ The City should establish stringent, minimum standards for considering TIF districts. These should include, among other things, requirements for significant equity investment by the developer/owner, high ratios of private to public investment, and a finding that projected net benefits to the City exceed projected costs by a significant margin (e.g., 200 to 300%). The criteria should be viewed as minimum eligibility requirements, rather than as authorization for any transaction that satisfies them.

Review Process

- ◆ The City should require detailed supporting documentation that will enable it to determine whether a proposed TIF district is necessary, viable, and rewarding. Basic documentation would include cost-benefit analyses and financial feasibility studies prepared for the City by independent consultants. In the case of public-private partnerships, the City should gather additional detail through the developer's/owner's financial statements, detailed projections (including cash flow and revenues and expenses), rate of return and profitability analyses, and, where appropriate, independent market studies.
- ◆ The analysis of a proposed TIF district should include a comparison of the cost of tax increment financing against alternative financing methods, including the issuance of general obligation bonds.
- ◆ The City should establish a uniform system for evaluating and approving TIF districts.
- ◆ The evaluation should include careful scrutiny and evaluation of cost-benefit and other analyses. Factors such as the duration of the TIF and the percentage of incremental taxes subject to reinvestment in the district should be pegged to the projected costs and benefits, in accordance with predetermined standards.
- ◆ To protect the interest of the City's residents and taxpayers, the City should obtain advisors or staff with the sophisticated financial, legal,

and managerial expertise needed to evaluate, implement, and monitor such districts effectively.

Requirements to Ensure Objectivity and Accountability

- ◆ Developers and owners of TIF projects should be required to provide the City with the information necessary to compare projected benefits with actual benefits on an ongoing basis.
- ◆ The City's TIF policy should include provisions to reduce the life of the TIF if the developer fails to meet projections, provided that obligations under TIF bonds are not impaired.
- ◆ TIFs for projects should include arrangements that allow the public to recoup, to the extent possible, its investment from the developer/owner if the projected public benefits do not materialize.

Minimizing Investment and Maximizing Return

- ◆ The City's TIF policy should require a significant equity investment by the developer/owner comparable to the investment that would be required by a private lender.
- ◆ TIF investments should be structured to allow the City to recapture all or a portion of the public subsidy to the extent practicable, through mechanisms such as long-term ground leases, subordinated loans, and revenue participations.
- ◆ The life span of a TIF district should be restricted to a reasonable period. In no case should the

duration of a TIF district and its bonds exceed the shorter of 20 years or the expected life of the project supporting the TIF.

- ◆ TIF funds should be redirected to the City's General Fund after the TIF period expires or when they are otherwise not required for the TIF district generating them. Cross-subsidization of other TIF districts should not be permitted.

Transparency

- ◆ All meetings relating to TIFs should be conducted in accordance with both the letter and the spirit of the open meetings law. Practices that undermine transparency, such as one-on-one briefings and behind-closed-door negotiations between councilmembers and potential developers/owners, should be avoided.
- ◆ All documentation relating to TIFs should be available to the public.
- ◆ City Council should provide the public on an annual basis with a report on TIF districts, including the amount of public funds dedicated to TIF and the performance of the various districts.

I. INTRODUCTION

Recently, the City of New Orleans has turned its attention to a widely used local economic development tool: tax increment financing (TIF). Last fall the City Council approved the City's first TIF district in connection with the redevelopment of the former St. Thomas housing project. Another district with TIF-like characteristics has been proposed in connection with the conversion of a portion of the World Trade Center into a hotel. A bill to create a TIF district for the Lake Forest Plaza Shopping Center site was recently introduced into the State Legislature. Another to create a TIF district for a large portion of eastern New Orleans has been filed. In May, City Council will consider a TIF-like arrangement for a Lowe's Home Improvement Warehouse. Anticipating additional TIF proposals, the City Council has begun to develop policies and procedures to govern the use of TIF in the future.

As local governments have struggled to deal with increased blight and diminished resources, TIF has increased in popularity. However, whether it is effective and efficient has been the subject of growing debate. Proponents of the mechanism maintain that TIF creates more jobs, greater property values, more tax revenues, and revitalized blighted areas. Critics dispute the effectiveness of TIF as an economic development tool and raise questions about the cost and equity of the financing mechanism.

In this report, BGR:

- ◆ provides an overview of the use of TIF around the United States,
- ◆ reviews the perceived benefits of TIF, as well as the pitfalls and potential abuses associated with the mechanism,
- ◆ describes Louisiana law,
- ◆ reviews the TIF approved for the former St. Thomas site and the TIF proposed for the World Trade Center, and
- ◆ makes recommendations concerning state law and the future use of TIF in New Orleans.

II. WHAT IS TIF?

TIF is a financing mechanism that enables a local government to capture future incremental tax revenues in a designated area and reinvest them in that area to fund public improvements. Basically, the local government freezes the tax base in the TIF district at the pre-development level for a period of years.² Taxing bodies continue to receive the taxes on the pre-development base, but the incremental taxes are applied to infrastructure and other improvements designed to spur private sector development. In theory, the TIF district finances its own renewal and eventually generates greater tax revenue for the community as a whole.

The establishment of a TIF involves a number of decisions, including:

- ◆ the designation of the geographic area for the TIF district,
- ◆ the development of a plan for improvements in the district,
- ◆ the designation of the tax increment to finance the improvements,

- ◆ in some cases, the establishment of a TIF authority, and
- ◆ the designation of the financing mechanism.

These are discussed more fully below.

III. TIF IN THE UNITED STATES

A. Overview

In 1952, California became the first state to authorize TIF, allowing redevelopment agencies to use TIF to provide a local match for federal funding of urban renewal projects.³ The mechanism enabled cities to force other tax recipient bodies in the improved area to contribute to the cost of urban renewal. Prior to that time, the cities alone bore the cost of the local match, while all tax recipient bodies benefited from the increased tax base.

Nationwide, TIF did not gain widespread popularity until the 1970s. In that decade, the federal government began reducing the amount of funds available for urban renewal. States and cities, seeking to fill the gap with tax increases, met with opposition.⁴ In addition, the imposition of tax and expenditure limits on local governments, such as California's Proposition 13, severely restricted the ability of local governments to raise property taxes and issue debt. The trends of federal spending cuts and voter opposition to new taxes continued in the 1980s and 1990s, leading many states to adopt TIF legislation to facilitate infrastructure and economic development.⁵

Today, 47 states and the District of Columbia authorize the creation of new TIF districts. The most active users of the financing mechanism include California and several Midwestern states. About three-fourths of California cities have now established redevelopment agencies, the authorities that can use TIF.⁶ As of the late 1990s, Minnesota had established more than 1,700 TIF districts; Wisconsin, more than 800; Illinois, more than 400.⁷ The use varies widely among cities. Chicago has more than 120 TIF districts; New York City has none.

B. Variations on a Theme

TIF statutes vary widely as to the criteria for designating a TIF district, permissible uses, the types of taxes used, the maximum term for a district, and the required procedures.

1. Designating a TIF District

Use of TIF begins with the establishment of a TIF district, the geographic area in which incremental taxes will be captured and applied to improvements. TIF districts can be drawn tightly around one development project or broadly around an entire neighborhood. Two of the more common requirements – a finding of blight and satisfaction of the “but for” test – are discussed below.

Blight. Reflecting the genesis of TIF as a tool for urban revitalization, 18 states condition the use of TIF on a finding of blight. In 15 of the 18 states, blight is defined in qualitative terms by reference to characteristics such as the presence of abandoned buildings and excessive vacancies. The other three states quantify blight. For example, Alabama requires at least 50% of the buildings

in a redevelopment district to fit the statutory criteria for blight.⁸ Louisiana does not require a finding of blight.

Over the years, the blight requirement has often been loosely interpreted, leading to the use of TIF in suburbs and other areas that are not blighted. Several states that require a blight finding, including California and Illinois, have sought to strengthen the connection between TIF investment and urban redevelopment by enacting stricter standards.

“But For” Test. Seventeen states and the District of Columbia require local governments to determine that development would not occur “but for” the TIF. The test is formulated differently in the various statutes.

Twelve of the 17 states require a finding that TIF is necessary for any redevelopment to occur. Illinois, for example, prohibits approval of a TIF redevelopment plan unless the “municipality finds that the redevelopment project area on the whole has not been subject to growth and development through investment by private enterprise and would not reasonably be anticipated to be developed without the adoption of the redevelopment plan.”⁹

The other five states and the District of Columbia focus on whether the specific development would occur. Nebraska, for example, requires the local government to find that “the redevelopment project in the plan would not be economically feasible without the use of tax increment financing.”¹⁰

Louisiana does not impose a “but for” test.

2. Permitted Uses

The purposes for which TIF revenues can be expended vary from state to state. All 47 TIF states authorize the use of TIF funds for public works and infrastructure and a variety of site preparation and pre-development activities. Some of the more common activities include property assembly, demolition, clearing and grading of land, and administrative expenses.

Only five states restrict the use of TIF funds to infrastructure, site preparation, and pre-development activities. The other 42 states have added building renovations as eligible uses.

Of the 42 states, 33 also allow new building construction for a variety of purposes. These include 15 states in which private use or ownership is explicitly allowed by the statutes.

Many states allow a wide range of developments in a TIF district. These may include affordable housing, manufacturing plants, hotels, sports stadiums, downtown improvement, and historic renovations. Some states impose requirements to address particular issues of concern. California and Texas, for example, set aside portions of TIF revenue for the construction or rehabilitation of affordable housing in the TIF district.

Louisiana allows a broad array of development projects in a TIF district.

3. The Designated Tax Increment

Property tax is the dominant source of revenue for TIF. Forty-seven states and the District of Columbia authorize TIF based on property taxes.

BGR found that 13 states and the District of Columbia currently authorize the creation of new TIF districts based on sales taxes. Some of these states permit the use of sales TIF for broad purposes similar to those for which property TIF can be used. Others restrict sales TIF to a more limited universe of projects. For example, Wyoming and the District of Columbia limit the use of sales TIF to downtown districts; Kansas allows sales TIF only for historic theaters, auto racetracks, and multi-sport athletic complexes.

California withdrew the authority to create sales TIF districts in 1993 out of concern that automobile dealerships, large-volume retailers, and other sales tax generators were receiving unnecessary subsidies, and that the sales tax potential of projects was driving land use and TIF decisions.¹¹ Illinois is phasing out the use of sales TIF, which was based in that state on state sales taxes.¹²

A few states allow TIF for employment, hotel occupancy, and various entertainment taxes. Maine, for example, allows the reimbursement of a certain percentage of state employment withholding taxes to be captured by a TIF district.

Louisiana allows TIF for property, sales, and, in certain cases, hotel occupancy taxes.

4. Limits on the Duration of TIF Districts

At least 25 states with TIF statutes impose limits on the duration of the TIF. With few exceptions, the time limits range from 20 to 30 years. Louisiana statutes do not limit the term to a specific number of years.

5. Required Documentation

State statutes vary as to the type of documentation required for TIF. Although most require formal redevelopment plans, the contents of the plan vary from state to state. Plans may include the following:

- ◆ Purpose and objectives of the TIF
- ◆ Official finding of blight in the proposed area
- ◆ The TIF district's boundaries
- ◆ Proposed land use
- ◆ Proposed development activities and project timetables
- ◆ Sources and uses of public and private financing for these costs
- ◆ Terms of TIF bonds
- ◆ Economic impact or cost-benefit analysis
- ◆ Estimate of tax impacts on local governments
- ◆ Other public costs
- ◆ Timeframe for paying off the TIF

In conjunction with the redevelopment plan, some states require local governments to prepare special studies. Examples include economic and financial feasibility studies and neighborhood and environmental impact analyses. While such studies can provide useful information, they are also imprecise and subject to manipulation. Accordingly, they must be used cautiously.

Some of Louisiana's TIF statutes indirectly incorporate a requirement for an economic development plan. Others, such as the sales TIF statute for New Orleans, do not. The state does not require any studies.

6. Financing Options

TIF improvements can be made and financed through a number of options. One option is for the local government to issue debt to finance an up-front investment. A second option is for the local government to make and pay for improvements on a cash basis as incremental tax revenue is collected. This is commonly referred to as “pay-as-you-go” financing. The third is for a developer to fund projects up-front and receive reimbursements as TIF proceeds are received.

Louisiana’s property and sales TIF statutes applicable to New Orleans at large allow the local government to issue revenue bonds. They are silent as to pay-as-you-go financing and reimbursement of the developer.

IV. WHY DO LOCAL GOVERNMENTS USE TIF?

Proponents of TIF cite the following benefits, some of which apply to other economic development tools.

Expected Benefits. As the above history indicates, TIF provides cash-strapped local governments with a means of making infrastructure and other capital improvements. It enables local governments to undertake revitalization and economic development projects that, given political realities, would not be feasible otherwise. If the projects are carefully conceived and executed, the community enjoys multiple benefits: increased employment, improved environment, additional private investment, increased tax revenues, and civic pride.

TIF is perceived as a good mechanism for encouraging and leveraging public-private partnerships to address issues of unemployment, poverty, and blight. By funding public infrastructure improvements and demolition, site preparation, property assembly, and environmental clean-up costs, local governments make the urban landscape more attractive for private investment. In a successful TIF district, the initial public-private investment attracts additional private investment, multiplying the benefits of the initial investment.

Self-Financing Investment. Much of the popularity of TIF stems from the self-financing nature of the mechanism. In a pure TIF, the local government’s repayment obligation is limited to the incremental taxes generated in the TIF district. In theory, these incremental revenues have been generated by the TIF investment. Thus, the public suffers no loss of revenues; it pays for the development out of funds that it would not have otherwise received.

Limited Obligation. The limited nature of the obligation also contributes to TIF’s appeal. Because TIF indebtedness does not constitute a general obligation, the local government is not liable if the anticipated revenue stream does not materialize. In addition, TIF bonds generally do not count against the municipality’s debt limit.¹³

Political Appeal. TIF has tremendous political appeal for a variety of reasons. Most importantly, it allows local governments to make the desired investment without raising tax rates or cutting current expenditures. In most states, the investment can be made and supporting debt issued without voter approval.¹⁴

Flexibility. TIF also provides local governments with significant flexibility and control over the investment of future tax revenue. In addition, TIF avoids the bureaucracy associated with intergovernmental revenue transfers.¹⁵ TIF's local focus can lead to swifter government action to assist private development than would otherwise be possible.¹⁶

Equitable Sharing of Development Costs. Prior to the development of TIF, the municipality or county was the only local tax recipient body to bear the cost of redevelopment. Other taxing bodies that would ultimately benefit from the increased tax base made no contribution. TIF legislation in many states distributes costs more fairly by forcing overlapping tax recipient bodies to share in the TIF investment.

V. CRITICISMS OF TIF

As the use of TIF has proliferated, the mechanism has come under attack for being ineffective, inefficient, and inequitable. Critics claim that TIF has harmful side effects that negate or reduce benefits. These include the following:

Increased Costs Transferred to Others. TIF can impose significant financial burdens on local government by increasing operating costs (such as fire and police protection) without providing offsetting resources. The problem is particularly acute in states that provide for the capture of the tax increment that would otherwise have gone to overlapping tax bodies, such as school systems.

In addition to increasing the costs of government, TIF can transfer financial burdens from certain groups of residents to others. When taxes generated within a TIF district are retained for physical improvements, taxpayers outside the district pick up the tab for any increased government services in the redevelopment area. Those outside the district also cover the TIF district's pro rata share of the local government's overhead and other general operating costs.

Negative Impact on Other Businesses. TIF can also confer benefits on certain businesses at the expense of others. For example, a successful TIF-supported retail development will draw business away from retail businesses located outside the TIF district. A TIF for a hotel can provide the owner with a competitive pricing edge and draw guests away from non-subsidized hotels. The advantages provided by the public subsidy raise serious equity issues that must be carefully evaluated.

Reduced Operating Revenues. In addition, to the extent that a business in a TIF district attracts sales from businesses outside the district but inside the local jurisdiction, the existing revenue base of the local government is reduced. The general fund is deprived not only of the incremental revenues in the TIF district, but also of the tax revenues that it would have received from adversely affected businesses.

Negative Impact on Other Areas. As an unintended consequence, TIF districts can have a negative impact on unsubsidized areas by drawing investment and revenues away from them. This is particularly true where there is limited demand for a good or service.

To the extent that development in the TIF district is offset by stagnation or decline elsewhere in the taxing jurisdiction, the local government is engaged in a zero-sum game.

Intra-Regional Competition. On the regional level, TIF is sometimes used as a weapon in bidding wars for business development. The use of TIF by local governments to lure businesses from a neighbor leads to a zero-sum game for the region and state: one community wins, one loses, but there is no net gain.¹⁷

Some states have enacted laws to address the piracy issue, particularly with respect to retail stores:

- ◆ California prohibits any form of financial assistance to an automobile dealership or large volume retailer relocating from one community to another in the same market area, unless the two communities enter into a sales tax-sharing arrangement.¹⁸
- ◆ Illinois prohibits the use of TIF to subsidize a retailer relocating within a 10-mile radius, unless the closed store is inadequate, obsolete, or no longer in a viable retail location.¹⁹
- ◆ Maine's employment TIF program requires a finding that the TIF development will cause no substantial harm to existing Maine businesses.²⁰ In addition, a participating retail business must demonstrate that it receives 50% or more of its revenue from out-of-state sales or that increases in its sales will not include sales shifted from other Maine businesses.²¹

Expensive Funding. TIF bonds can be an expensive funding source. Because they are project-based or otherwise payable from restricted sources, such bonds can command a far higher interest rate than general obligation bonds. This is the downside of limiting the obligation to repayment from a specified source, rather than pledging the full faith and credit of the government.

Unwarranted Private Subsidy. When TIF is used to fund public infrastructure improvements, such as streets and sewer and water systems, and to pay for demolition, site preparation, property assembly, and environmental clean-up costs, it represents a public investment in the prep work needed to make the urban landscape more attractive for investment. TIF becomes more problematic when it is used to provide capital for privately owned projects and assets. In that case it acts as a circuitous tax abatement, redirecting public money to a developer/owner.

TIF is supposed to create conditions that encourage economically viable development. It is not intended to compensate for financial weaknesses in a developer/owner or inadequacies in the financial structure of a transaction (e.g., inadequate equity investment). Nor is it intended to offset the lack of demand for a service or a product.

Loss of Benefits. The benefits of TIF can be lost if the project is improperly structured. For example, as a spin-off effect, TIF is supposed to create other sources of revenue for a city. When TIF is used in tandem with other incentives that abate or divert other types of taxes, the community loses the additional benefit of revenue streams that the TIF

development would otherwise generate (e.g., when incremental property and sales tax revenues are both diverted).

Fragmentation of the Tax Base.

Allowing too many TIF districts can lead to a fragmented tax base in which the districts and neighborhoods experiencing growth lock up the incremental tax revenue they create.²²

Complex Analysis and Oversight. TIF is a complicated financing mechanism. To work effectively and efficiently, it requires a significant, long-term commitment of municipal resources and a high level of professional expertise for evaluation, implementation, and administration.²³ Such expertise runs the gamut from finance and accounting to real estate development. In addition, successful evaluation depends on the accuracy and rigor of the underlying markets, cost-benefit, and other impact studies.

Some of the criticisms leveled at TIF can be mitigated or avoided through cautious, appropriate use of the TIF mechanism.

VI. SPECIAL ISSUES WITH SALES TIF

Sales TIF districts can under some circumstances provide far larger tax revenue streams than property TIF districts would. This is true in areas with low assessments, large amounts of exempt property, or limitations on the types of property taxes that can be accessed for TIF. In those circumstances, sales TIF may be more feasible than property TIF.

There are, however, concerns with sales TIF that are not present (or are less pronounced) in the case of property TIF. These concerns include the following:

Land Use Distortions. Because the amount of revenue generated by a sales TIF district depends on sales volume, the mechanism favors the inclusion of high-volume retailer establishments, such as malls, big box stores and car dealerships, in the TIF district. The need for large retailers to support the TIF can lead to distorted land use decisions, with the decision being driven more by a perceived need for a subsidy of a given size than by sensible planning. Concern over distorted land use was one of the factors that led California to repeal authorization for sales TIF.²⁴

Subsidies for Big Retailers. The quest for large revenue sources can result in unnecessary subsidies for big retailers. This is both ineffective and inequitable, since it results in both a waste of public dollars and provides businesses with a subsidized competitive advantage. This was another factor that led California to terminate sales TIF authorization.²⁵

Capturing Non-incremental and Unrelated Revenues. Instead of creating new revenues, sales TIF districts merely shift business from other entities in the region, or even worse for the local jurisdiction, from other businesses within its boundaries. Losses suffered by those businesses actually result in a loss of current tax revenues available to the local jurisdiction.

Factors other than the TIF district improvements (e.g., an upturn in general economic conditions or changes in personal spending habits) may be fueling the increase in taxes. In that

case, the local jurisdiction is diverting from the general fund revenues that are not attributable to the TIF investment.

Less than Optimal Value. Because sales TIF districts require a significant generator of sales taxes, they are more likely to be used for retail development than for other uses, such as manufacturing and high-tech exports, that generally have a greater economic impact.²⁶ This can result in a commitment of community resources to an economic development strategy that is less than optimal. The risk is particularly pronounced in the case of local governments that turn to sales TIF because of structural weaknesses in their property tax base.

Unstable Revenues. A sales tax base is inherently less stable than a property tax base.²⁷ Sales TIFs are more susceptible to revenue fluctuations caused by local economic declines, competition from stores outside the district, and general changes in shopping patterns. This makes it riskier and more expensive to finance debt issues based on TIF.

Loss of Benefits. Unless contractually constrained, the retailer can enjoy the TIF benefits and deprive the local government of projected benefits by departing when the TIF period ends.

VII. LOUISIANA TIF STATUTES RELATING TO NEW ORLEANS

Louisiana statutes contain a confusing array of provisions on the use of tax increment financing. The statutes consist of provisions that apply generally to local governments and provisions on the same subject that apply only to certain

size local governments. The result is a crazy patchwork of provisions that can be understood and reconciled only if one performs a demographic analysis of the municipalities and parishes in Louisiana.

The TIF statutes applicable to New Orleans are set forth in the state's Cooperative Economic Development Law. That law addresses the use of TIF by both economic development corporations and by local governmental subdivisions.

Under the general statutes applicable to New Orleans, the City can establish TIF districts and issue revenue bonds payable from or secured by property or sales tax increments. TIF bonds based on property taxes must be approved by the voters; voter approval is not required for bonds based on sales taxes. The different voting requirements, along with legal constraints on the capture of property tax revenue, skew the use of TIF toward sales taxes.

There are also two special interest TIF statutes directed at special areas in the City: Algiers, through a special provision in a TIF law that applies to local governments with less than 200,000 people; and the World Trade Center property, as a special taxing district. Two other special interest TIF statutes have been proposed for the Lake Forest Plaza shopping mall in eastern New Orleans and for the large area of New Orleans east of the Industrial Canal.

A. Property TIF

La. R.S. 33:9032 authorizes local governmental subdivisions to issue revenue bonds payable solely from incremental property taxes collected in an economic

development area. The tax increments can be used to finance or refinance an economic development project or to pay for the costs of an economic development project. The costs of an economic development project are broadly defined in La. R.S. 33:9035 to embrace “all reasonable or necessary costs incurred incidental to or in furtherance of an economic development project ..., providing that any such costs are reasonably related or attributable to an approved economic development plan.”

The tax increment consists of the incremental ad valorem tax revenues collected for any or all taxing authorities from property in an economic development area; however, it does not include tax revenues previously dedicated for a special purpose.

The bonds require voter approval. The limitation of tax revenues to undedicated ones and the requirement for voter approval are significant differences from the TIF statutes of most states. As is discussed more fully below, these restrictions seriously restrict the usefulness of property TIF in New Orleans.

La. R.S. 33:9032, which is only half a page long, lacks the type of detail that is normally found in statutes authorizing bond issues. The statute does not contain any direction concerning the designation of an economic development area or the process for dedicating of tax increments. The establishment of an economic development area is circuitously addressed through other provisions in the state’s Cooperative Economic Development Law. Specifically, La. R.S. 33:9034 gives local governments the powers, rights, duties, and obligations of an economic development corporation. The powers include

the power to establish an economic development area, subject to approval of the chief executive officer or governing authority of a local government. La. R.S. 33:9034 contains no provision specifying the process for dedicating incremental tax revenues to a TIF district.

B. Sales TIF

The use of sales TIF by New Orleans is governed by La. R.S. 33:9033.3. The statute is much more detailed than the corresponding property TIF statute.

La. R.S. 33:9033.3 applies to municipalities with a population between 190,000 and 215,000 or with a population in excess of 400,000, and to parishes with a population between 400,000 and 475,000 as of the latest decennial census (the “Designated Municipalities”). Currently, the populations of Shreveport, New Orleans, Jefferson Parish, and East Baton Rouge Parish fall within those ranges.

The statute authorizes the Designated Municipalities to issue revenue bonds that are either payable from revenues generated by economic development projects with a pledge of sales tax increments for any shortfall, or payable solely from incremental sales tax revenues generated in an economic development area. The municipality is also authorized to pledge the revenues from any millage levied for economic development or any other funds available for economic development. Incremental sales tax revenues are restricted to those of the local government and do not include tax revenues dedicated for a special purpose.

Sales TIF bonds can be used to finance or refinance all or any part of an economic development project. “Economic development project” is broadly defined to embrace “any and all projects suitable to any industry determined by the municipality or, as appropriate, the issuers of revenue bonds, to create economic development.”

The total amount of principal and interest falling due in any calendar year cannot exceed 75% of the amount of the pledged sales tax increment that the municipality estimates will be received in the first full calendar year after the economic development project has been completed. The statute does not specify how the remaining increment can be used.

The sales TIF statute requires a municipality that proposes to issue sales TIF bonds to designate the boundaries of the TIF district and the portion of local sales taxes to be used for the tax increments. No voter approval is required for the issuance of the bonds.

Neither property nor sales TIF bonds are subject to any statutory debt limitations or restrictions. There is no statutory limit on the duration of a TIF district.

C. Issuance of TIF Bonds by Economic Development Corporations

As noted above, bonds secured by tax increments can be issued by economic development corporations with the consent of the affected governmental entities. Interestingly, the law does not state whether the consent of voters is required for economic development corporations to issue revenue bonds secured by property TIF.

D. Special Provision for Algiers

Legislation passed in 2002 provides special property and sales TIF authority for all municipalities and parishes with 200,000 people or less. The new law, La. R.S. 33:9038.1-9038.9 (the “Small Jurisdiction Statute”), also applies to Algiers. It is unclear exactly how the statute relates to the property and sales TIF statutes that apply to New Orleans at large.

The Small Jurisdiction Statute allows the City, or with the City’s consent, an industrial development board or public trust with jurisdiction in Algiers to issue revenue bonds payable from or secured by incremental property, sales, or hotel occupancy tax revenues. The City establishes the district from which the increments are to be pledged and deducted.

Property TIF may capture all incremental property taxes, if this does not result in a violation of dedications or other limitations and if all affected tax recipient bodies consent to the capture of the incremental property taxes. Revenue bonds secured by property taxes must also be approved in a special election for qualified electors within the proposed boundaries of the TIF district. If there are no electors, as in the case of vacant or purely commercial land, no election is required.

In contrast to TIF districts established in larger jurisdictions, the small government TIF districts may capture all incremental state and local sales and hotel occupancy taxes in the district, if the appropriate tax recipient bodies consent. State sales tax increments

cannot exceed the pledged local increment. No voter approval is required for the issuance of the bonds.

The annual debt service for both property and sales TIF bonds is limited to a percentage of tax increments. At the end of the life of a TIF, any unspent increments set aside for debt service reserves must be deposited in a trust fund to “promote other economic development opportunities.” In addition, incremental revenues can be deposited in a special trust fund to loan, grant, donate, or pledge for other economic development projects.

The districts can levy up to five mills of property tax, up to 2% of sales taxes, and up to 2% of hotel occupancy taxes, or any combination, on property within the district. The statute does not mandate specific uses for these taxes. As is the case of property taxes, a special election for qualified electors is required.

The Small Jurisdiction Statute is more disturbing than the statutes generally applicable to New Orleans in several respects. First, it eliminates the requirement for city-wide voter approval of property TIF bonds: the only vote required is for voters in the district who would benefit from the redirection of tax increases. Second, it allows the capture of state sales taxes. Third, it gives local governments the option of placing tax increments in a trust fund for other economic development projects.

E. World Trade Center Taxing District

La. R.S. 33:9038.21, enacted in 2002, created a special taxing district for the World Trade Center at the foot of Canal

Street. The taxing district includes the 33-story World Trade Center building, a parking garage, and adjacent land.

The legislation’s stated purpose is to facilitate cooperative economic development among the City, the World Trade Center of New Orleans Inc. (WTCNO), and a developer, WTC Development Ltd., to renovate, restore, and develop the World Trade Center property and to implement a lease between WTCNO and WTC Development Ltd.

The World Trade Center taxing district is authorized to levy and collect its own hotel occupancy tax in lieu of the hotel occupancy tax in Orleans Parish at a rate that is at least equivalent (currently 13%). The taxes can be used to pay revenue bonds issued by the district or any other financing of the property, including loans or mortgages, bonds, or certificates of indebtedness.

The tax can be levied through an ordinance adopted by the district’s three-member board of commissioners, composed of the City Council president, the president of New Orleans Building Corp., and the managing director of administration of WTCNO. Approval by the affected hotel tax recipients is not required for the capture.

The district will dissolve one year after the earlier of the repayment of revenue bonds issued by the district or the termination of a lease between WTCNO and WTC Development Ltd.

The statute prohibits the hotel from advertising below-market room rates; it does not specify how the market rate is to be determined.

F. Lake Forest Plaza TIF Proposal

During the spring session, the State Legislature will consider a bill (S.B. 808) to create a TIF district for the Lake Forest Plaza Shopping Center in eastern New Orleans. The purpose of the district is broadly stated as “renovation, restoration, and development within the district.” The purpose would be accomplished through cooperative economic development among the district, the City, and the owners of businesses and property within the district. The district’s governing board would consist of the president of City Council, and the state senator and state representative whose legislative districts include the proposed TIF district.

The bill would authorize the district to levy and collect its own hotel occupancy tax at a rate at least equal to the hotel occupancy tax rate in Orleans Parish. It is in lieu of any hotel tax other than a tax on a per-head or per-person basis. The tax may be levied without the approval of the hotel tax recipient bodies. The district may pledge the tax collections to pay revenue bonds that it issues. It may also pledge the collections to “any purpose” set forth in the legislation. Such financing may include loans, mortgages, bonds, or certificates of indebtedness. The bill includes a prohibition on advertising below-market room rates.

The bill also grants the Lake Forest Plaza district the TIF powers granted small municipalities and parishes under the Small Jurisdiction Statute. As noted previously, that statute allows capture of any incremental property or sales

taxes generated by development in the district, as long as the capture is legal and the tax recipient bodies consent.

The Small Jurisdiction Statute would also allow the district to levy and collect up to five mills of property tax, 2% of sales tax, and 2% of hotel occupancy tax. TIF bonds backed by property tax increments and additional tax levies require approval of qualified electors in the TIF district, if any live there.

S.B. 808 also contains a cryptic provision defining a “general sales tax increment” as a portion of the general sales tax increment determined and collected by the Lake Forest Plaza District in lieu of other such taxes levied by other taxing authorities. The import of the provision is unclear, since neither the term “general sales tax increment” nor the term “general sales tax” is used elsewhere in the bill. However, the provision opens the door to a possible capture of non-incremental sales taxes.

G. New Orleans East TIF Proposal

A bill to create a special taxing district for all of eastern New Orleans (H.B. 1737) has been pre-filed, but not formally introduced, for this spring’s legislative session. The bill would create the New Orleans East Tax Increment Financing District, bounded by the Industrial Canal, Lake Pontchartrain, and the Orleans Parish line.

The purpose of the district is “to provide for the orderly planning, development, acquisition, construction, and effectuation of the services, improvements, and facilities to be furnished by the district.”

The district would be governed by a board of commissioners consisting of members appointed by state legislators for eastern New Orleans, City Councilmembers from districts D and E, and the Mayor, and five members appointed by the other members from a list provided by the appointing parties.

The bill authorizes the district to create economic development areas and to issue revenue bonds for economic development projects. The bonds would be guaranteed by or payable from sales tax increments collected in an economic development area designated by the district. It is unclear which tax increments are covered, since the bill excludes dedicated revenues and sales taxes collected by the state or any political subdivision other than the district. The bill does not give the district authority to levy any taxes.

The sales TIF provisions appear to be based on the language of the TIF statute for New Orleans, R.S. 33:9033.3. The major difference is that the district, and not the City, has the power to designate the sales tax increment and issue bonds.

The bill would authorized the district to use property tax increment financing as provided elsewhere in Cooperative Economic Development Law. This could substantially impact future city property tax revenue, because eastern New Orleans encompasses 65% of the city's land.²⁸

Eligible projects that may be undertaken in the district are the same as those allowed in R.S. 33:9033.3.

VIII. TIF USE IN LOUISIANA

A. Sales TIF in Other Cities

The use of TIF outside New Orleans has been limited to a handful of sales TIF districts established to subsidize construction of retail development or build infrastructure for retail. Two cities, Ruston and Monroe, established sales TIF districts capturing both state and local sales tax increments.

Monroe has issued several series of bonds for roads and infrastructure for two retail areas, with large, national retailers, such as Wal-Mart, Home Depot, Lowe's, and Target. Most recently, it issued \$9.25 million of bonds with a maturity of 19 years and an interest rate of 5.49%.

In 2001, Ruston issued \$2 million of bonds to fund engineering studies for road construction to service a retail area with a Wal-Mart, auto dealerships, and other stores. Ruston expects to repay the bonds out of incremental state sales taxes, without using local sales taxes, an option no longer available. It plans to issue additional bonds to design and build the roads.

Lake Charles created a TIF district in 1996 for Prien Lake Mall. The city, school board, and law enforcement district agreed to reimburse the mall developer for expansion costs in an amount not to exceed \$8,000,000.

Shreveport created a 92.4-acre downtown entertainment TIF district in 1999 and spent \$1 million of general funds on streetscape improvements. The first \$1 million collected by the TIF district,

which captures incremental revenues from the city's 2.5% sales tax, will reimburse the city for those improvements.

B. TIF in New Orleans

Only two TIFs in New Orleans have significant history and information available for analysis: a TIF for the St. Thomas redevelopment, which was approved by City Council last fall, and the proposed TIF for a hotel in the World Trade Center, which continues to be negotiated by the City. BGR takes no position with respect to the merits of either development.

1. St. Thomas

The St. Thomas TIF district includes the former St. Thomas public housing site and an adjacent parcel of land on which a Wal-Mart Super Center will be constructed. The district was formed to assist with the financing of a HOPE VI redevelopment project for St. Thomas. The district will capture future City sales tax revenues (2.5%) from the Wal-Mart Super Center. The incremental taxes from Wal-Mart will not be diverted to Wal-Mart, but will be used instead to repay \$20 million of debt incurred to finance the construction of two mixed-income rental portions of the former St. Thomas site, known as CS1 and CS2. Further discussion of the St. Thomas TIF is presented in Appendix A to this report.

The St. Thomas TIF raises the following concerns:

Private Subsidy. The St. Thomas TIF is part of a package of substantial subsidies to a private developer. For the construction of CS1, one of the mixed-income rental portions of the project,

the cost to the public (including interest and other costs) will equate on a per-low-income-unit basis to almost \$348,000 (excluding infrastructure) and \$420,000 (including infrastructure).

Low-Priority Use of Funds. The revenues from the TIF district are being used to finance market-rate housing – a troubling application of public funds in a city that suffers from a lack of decent low-income housing.

Expensive Financing. The cost of the TIF bonds is extraordinarily high. The City has authorized the issuance of bonds with an anticipated interest rate of 8 to 8.5%. Although for technical reasons the stated maturity is 45 years, the City anticipates retiring the bonds in a maximum 13.5 years. The interest rate exceeds the rate for bonds issued by local governments with ratings comparable to New Orleans (currently around 4.5%) by a significant margin. The interest differential between \$20 million in bonds, payable over 13.5 years and bearing interest at 8.5% and bonds bearing interest at 4.5% would be \$7.1 million (or \$5.8 million discounted at 3% for inflation).

If the bonds remain outstanding for the stated maturity, which the City does not anticipate, the interest payments alone could total \$67 million. Under that worst-case scenario, the citizens of New Orleans would divert \$87 million from the general fund to pay for \$20 million in debt.

Reduced Sales Tax Revenue. The St. Thomas TIF district will result in a loss of sales tax revenues currently flowing to the City's General Fund. As a result of the loss of tax revenues from other businesses, the City estimates a sales

tax loss in the range of \$402,000 to \$554,000 a year for the life of the bonds. This loss in sales tax revenue is in addition to the total annual debt service paid by the TIF district over 13.5 years, which could average approximately \$2.5 million per year. The addition of \$2.5 million to the City's General Fund could translate into hiring 75 new police officers.

Multiple Subsidies. In addition to the sales TIF, the City is foregoing most of the future property taxes from the mixed-income rental housing, and is redirecting to CS1 the property taxes from Wal-Mart for 20 years. In general, jurisdictions using TIF anticipate increases in other tax streams to help justify a TIF district.

Historic Restoration Incorporated (HRI), the developer of the project, claims that the TIF is justified by significant net benefits, which according to a cost-benefit analysis prepared by MetroSource LLC for the Industrial Development Board of New Orleans, would equal approximately \$110 million for the City over a period of 50 years. HRI projects increased sales tax revenues of \$125 million (on a net present value basis, using a 2% inflation factor) for the City, Orleans Parish School Board, and the Regional Transit Authority over 25 years.

2. World Trade Center

In 2002, the State Legislature created a special taxing district for a proposed hotel development in the first 18 floors of the World Trade Center building at the foot of Canal Street. The taxing district differs from a traditional TIF district in that it will levy and collect a site-specific hotel occupancy tax in lieu of

the hotel occupancy tax levied in Orleans Parish. The rate will be equal to that of the replaced tax, currently 13%. Based on the hotel developer's revenue projections, the district has the potential to capture approximately \$48 million of taxes in the first decade of the hotel's operation.

The tax can be used to pay revenue bonds issued by the district or any other financing of the property. According to current reports, the district plans to issue \$40 million in revenue bonds, with a maturity not to exceed 30 years and an expected interest rate of 8.5 to 9.5%. In addition, TIF bondholders would receive an additional distribution equal to 50% of net income from the hotel. Further discussion of the World Trade Center hotel project and TIF is presented in Appendix B of this report.

The World Trade Center TIF suffers from the following problems:

Inadequate Private Equity. The public is being asked to compensate for inadequate equity investment in a project. The City claims the developer's equity contribution is \$1.5 million; the developer claims \$5.2 million. Neither amount is adequate for a \$140 million hotel project. Currently, lenders are willing to loan 50% to 60% of a hotel project's cost, expecting developers to piece together the remainder in equity and subordinated debt. There is a funding gap for which the developers are seeking public funding. In essence, the City and other tax recipient bodies are putting up the equity, while the return on their investment is going to the TIF bondholders and the developer.

Inadequate Return on Investment.

Under the lease executed before the TIF was introduced, the City would receive 50% of net revenues from the World Trade Center property. The World Trade Center of New Orleans Inc. (WTCNO), the nonprofit organization that leases the property from the City and will sublease a portion to the developer to build the hotel, currently expects the City's 50% share to equal \$861,000 to \$1.9 million per year for the first decade of hotel operation.

The addition of the TIF dramatically reduces the value of the World Trade Center lease to the City and the community. The hotel tax capture is projected to cost the City between \$462,000 and \$635,000 per year for the first decade of hotel operation, leaving the City with a net amount of \$399,000 to \$1.3 million per year. Collectively, the City and other hotel tax recipients would forego an estimated average of \$4.8 million per year in hotel occupancy taxes.

Negative Impact on Critical Services and Economic Engines.

The district would divert revenues from other projects and entities that provide important services or contribute significantly to economic development in the City and the region. These include the Orleans Parish School Board, the Ernest N. Morial Convention Center, the Regional Transit Authority, the Louisiana Stadium & Exposition District, the New Orleans Tourism Marketing Corp., and the New Orleans Metropolitan Convention & Visitors Bureau. To the extent that these entities lose future revenues, the City as a whole suffers.

High Cost of Debt. The cost of the TIF bonds is extraordinarily high. The anticipated rate of 8.5 to 9.5% exceeds the

rate that the City could expect to pay for general obligation bonds (currently around 4.5%) by a significant margin. The difference in total interest expense, based on similar amortizations over the stated maturity of the bonds, could be \$48.2 million (or \$31.6 million discounted at 3% for inflation). It should be noted that the City's share of foregone taxes for these payments would equal only 11.5% of the total.

Reduced Tax Base. As a result of the loss of hotel-motel taxes from other hotels, the City and other hotel tax recipients would lose revenues that currently flow to them. The City has estimated the tax loss at \$2.8 million in the first year, but the developer disputes this amount, arguing that other market factors will reduce lost tax revenues to a negligible amount.

Unfair Competitive Advantage.

Opponents maintain that the district would provide the hotel developer with an unfair competitive advantage, allowing it to reduce room rates by transferring a significant cost to the public. Proponents respond that their room rates will track those of other large, competing hotels downtown and that the TIF investment is necessary to make the city-owned World Trade Center usable in any form of commerce. Although the TIF legislation prohibits the hotel from advertising below market-rate rooms, preventing the hotel from offering reduced room rates would be difficult, if not impossible.

IX. FUTURE TIF USE IN NEW ORLEANS

As noted at the outset of the report, TIF is one of a number of economic development tools available to local governments. It provides cash-strapped municipalities – of which New Orleans surely is one – with a means of making investment in infrastructure and economic development projects under severe financial and political constraints. TIF has tremendous political appeal in that it can be implemented without raising taxes and, in many cases, without obtaining voter approval. It has a certain conceptual beauty in that the investment is, in theory, self-financing and the development supporting it would not have occurred otherwise.

Under closer scrutiny, the underlying premise that a TIF is self-financing is open to question. Because of the difficulty of making long-range projections, it is difficult to assess whether development in an area would have occurred without TIF. It is even more difficult to determine whether, and to what extent, gains in a TIF district are offset by stagnation, decline, or reduced growth in other areas and businesses. To the extent that other areas and businesses are negatively impacted, the existing revenue base of the local government is reduced. In addition, successful TIF districts can increase a local government's operating costs without providing additional operating funds to the local government. The end result in that case is a transfer of the additional operating costs to residents outside the TIF district.

Given the many unknowns surrounding the performance of TIF districts, and the identifiable types of dislocations that can occur, it is exceedingly dangerous to view TIF as free money. Rather, TIF should be considered an allocation of future resources and assessed with a stringency befitting other long-term investments of future revenue. The investment should be made only if it is effective, efficient, equitable, and in furtherance of a defined public policy.

For reasons discussed in Section VI, property TIF, the most widely used form of TIF, is preferable to sales TIF. Unfortunately, because of the nature of the local tax structure, property TIF is less practical in New Orleans than in other jurisdictions. In Louisiana, property TIF can only capture taxing bodies' ad valorem millage that is not previously dedicated to a special purpose. In 2001, this millage for the City of New Orleans was 14.91 mills out of 169.29 total mills collected in New Orleans. Thus, for every \$1 million of incremental assessed value (or \$6.6 million of fair market value), only \$14,910 out of \$169,290 in total property taxes paid would be available for a TIF district. It is unclear whether the general millage of the Orleans Parish School Board and Orleans Levee Board would be collectible for the TIF. If they were, it would increase the capture by \$15,500 per \$1 million of incremental assessed value. The homestead exemption and the exemptions enjoyed by nonprofits, government, and industry further diminish the potential of property TIF use by reducing the tax base.

The tax structure, combined with requirements for voter approval of bonds backed by property tax increments (but not for bonds backed by sales tax incre-

ments), skews the use of TIF toward sales TIF. The latter suffers from more serious problems than does the property TIF:

- ◆ Sales tax revenues are more volatile than property tax revenues, a fact that makes sales TIF debt financing riskier and more expensive.
- ◆ Sales TIF districts are more likely than property TIF districts to capture revenues unrelated to the TIF investment, thus reducing current tax revenues available to the jurisdiction.
- ◆ Because sales TIF districts need large, creditworthy retailers or shopping centers to generate significant tax increments, the quest for a TIF source can lead to land use distortions and unnecessary subsidies for big retailers.
- ◆ Subsidizing a retail operation with TIF revenues gives it an unfair advantage over its competitors.
- ◆ Unless contractually constrained, the retailer can enjoy the TIF subsidy and deprive the local government of projected benefits by departing when the TIF period ends.

Furthermore, a reliance on sales TIF may distort the City's investment priorities by directing public dollars into investments that do not offer the greatest return. Retail development may receive tax dollars that could have been directed to alternative developments with a greater potential for impact on the economy, such as businesses that export goods to out-of-town customers. It would be unfortunate if funds were

directed to less promising developments because they produce large streams of sales taxes and do not require voter approval.

There are other factors that suggest that a TIF might not provide the most effective solution to blight or economic development issues. Regardless of the type of TIF, because of the limited nature of the obligation, TIF debt is more expensive than general obligation bonds. Whether the premium paid to limit the obligation is worthwhile will depend on the particular circumstances. In some cases, such as the St. Thomas redevelopment, it is clear that the City could save millions of dollars in tax revenue by issuing lower-interest general obligation bonds and targeting key areas for infrastructure investment. The capacity to issue such debt exists under the City's debt limit, which is 35% of gross assessed value, or \$816.8 million as of Dec. 31, 2002. Debt outstanding as of late February was \$473.4 million, or 58% of capacity.

As in the use of other economic development incentives, the effective, efficient, and equitable use of TIF depends on the wisdom, sophistication, and integrity of those involved in the process. To the extent that decisions are based on sophisticated analysis, made with an unwavering focus on the public good, and implemented through skillful negotiation, the chances of successfully using TIF increase. To the extent that decisions are driven by relationships, political deals, and other agendas, or that the government lacks the high level of expertise needed to analyze and implement complicated transactions, TIF is likely to be an expensive mistake that results in an unnecessary transfer of wealth to private entities.

The potential problems associated with TIF are more than theoretical. The St. Thomas TIF and the TIF under consideration for the World Trade Center provide case studies of the problems associated with TIF.

The trend with respect to TIF is disturbing. In just the past month, City Council has received a proposal for a TIF-like financing for a Lowe's, a bill has been introduced to create a TIF district for Lake Forest Plaza shopping mall, and another bill has been filed to create one for eastern New Orleans. Collectively and individually, they raise serious concerns, including the specter of businesses routinely turning to the City for subsidies and the prospect of freezing the tax base for a huge swath of the City.

As noted above, the effective use of property TIF in New Orleans is precluded as a practical matter by the prior dedication of most of the tax revenues. Ironically, the widespread use of sales TIF would create a similar limitation on government's future flexibility by converting unrestricted tax revenues into dedicated taxes. In addition, the proliferation of long-term dedications will contribute to the balkanization of government within the City, even as the community focuses increasingly on regionalism.

Given the potential expenses, risks, and abuses associated with TIF, the City should use TIF cautiously and only in tightly circumscribed conditions. BGR believes that the City should abandon completely the use of TIF and TIF-like arrangements based on sales and hotel occupancy taxes and restrict the use of

TIF based on property taxes to public infrastructure and pre-development improvements in blighted areas.

Strict parameters for the use of TIF should be established at the state level through revision of TIF statutes and at the local level through the adoption of stringent policies and procedures. Specific recommendations for changes in legislation and the establishment of City policies and procedures for the use of TIF are set forth below.

X. RECOMMENDATIONS

State Legislation

- ◆ State law should impose severe limitations on TIF based on sales and hotel occupancy taxes, limiting their use to “main street” programs designed to revitalize commercial centers of smaller municipalities. The use of sales TIF for large-volume, major retail stores and shopping malls should be prohibited.
- ◆ The state should eliminate TIF legislation designed to accommodate specific projects. It should establish a cohesive set of general laws to replace the multitude of statutes on the books.
- ◆ State law should limit the use of TIF to blighted areas and require local governments to make a finding that an area is blighted. The statutes should define the specific characteristics of blighted property and define a blighted area in quantitative terms.
- ◆ State law should include a meaningful “but for” test conditioning the use of TIF on a finding that TIF is necessary for appropriate, future redevelopment (as opposed to a specific project) to occur in a designated area.
- ◆ State law should limit TIF expenditures to prep work needed to make the urban landscape more attractive for investment. Eligible costs should include expenditures for public improvements, such as streets and sewer and water systems, demolition, site preparation, property assembly, and

environmental clean-up. TIF should not be used to provide funding for privately owned projects and assets.

- ◆ State law should limit the duration of TIF districts.

City Policies and Procedures

BGR recommends that the City implement the following recommendations regardless of whether state law is changed.

Master Planning

- ◆ Before allowing additional TIF districts, the City should develop and adopt a city-wide economic development plan. Any TIF district should conform with, and promote the objectives of, the economic development plan.
- ◆ As part of the economic development plan, the City should develop a city-wide master plan for TIF. It should designate areas of the City that are eligible for TIF and establish detailed criteria and priorities for authorizing TIF districts within them. The plan should be based on an in-depth expert analysis of the City and should be prepared and adopted after city-wide public hearings.
- ◆ The TIF master plan and all TIF developments should conform with the master plan for the City.
- ◆ To encourage prioritization and careful targeting of projects, the City should establish a cap, based on a dollar amount or a percentage of the City’s General Fund, on the

amount of taxes that can be diverted from the General Fund to TIF districts.

Criteria for TIF

- ◆ In view of the problems associated with their use, the City should abandon the use of TIF based on sales taxes or hotel occupancy taxes.
- ◆ The City should identify, and designate as eligible for TIF, blighted or brownfield areas that offer the greatest potential for development, assuming an appropriate amount of public funding. Blight should be defined in meaningful, quantitative terms to reduce the risk of the unnecessary use of TIF.
- ◆ To limit the use of TIF to areas in which development would not otherwise occur, the City should condition the use of TIF on a finding that TIF is necessary for appropriate, future redevelopment (as opposed to a specific project) to occur in the designated area.
- ◆ The City should establish stringent, minimum standards for considering TIF districts. These should include, among other things, requirements for significant equity investment by the developer/owner, high ratios of private to public investment, and a finding that projected net benefits to the City exceed projected costs by a significant margin (e.g., 200 to 300%). The criteria should be viewed as minimum eligibility requirements, rather than as authorization for any transaction that satisfies them.

Review Process

- ◆ The City should require detailed supporting documentation that will enable it to determine whether a proposed TIF district is necessary, viable, and rewarding. Basic documentation would include cost-benefit analyses and financial feasibility studies prepared for the City by independent consultants. In the case of public-private partnerships, the City should gather additional detail through the developer's/owner's financial statements, detailed projections (including cash flow and revenues and expenses), rate of return and profitability analyses, and, where appropriate, independent market studies.
- ◆ The analysis of a proposed TIF district should include a comparison of the cost of tax increment financing against alternative financing methods, including the issuance of general obligation bonds.
- ◆ The City should establish a uniform system for evaluating and approving TIF districts.
- ◆ The evaluation should include careful scrutiny and evaluation of cost-benefit and other analyses. Factors such as the duration of the TIF and the percentage of incremental taxes subject to reinvestment in the district should be pegged to the projected costs and benefits, in accordance with predetermined standards.
- ◆ To protect the interest of the City's residents and taxpayers, the City should obtain advisors or staff with the sophisticated financial, legal,

and managerial expertise needed to evaluate, implement, and monitor such districts effectively.

Requirements to Ensure Objectivity and Accountability

- ◆ Developers and owners of TIF projects should be required to provide the City with the information necessary to compare projected benefits with actual benefits on an ongoing basis.
- ◆ The City's TIF policy should include provisions to reduce the life of the TIF if the developer fails to meet projections, provided that obligations under TIF bonds are not impaired.
- ◆ TIFs for projects should include arrangements that allow the public to recoup, to the extent possible, its investment from the developer/owner if the projected public benefits do not materialize.

Minimizing Investment and Maximizing Return

- ◆ The City's TIF policy should require a significant equity investment by the developer/owner comparable to the investment that would be required by a private lender.
- ◆ TIF investments should be structured to allow the City to recapture all or a portion of the public subsidy to the extent practicable, through mechanisms such as long-term ground leases, subordinated loans, and revenue participations.
- ◆ The life span of a TIF district should be restricted to a reasonable period. In no case should the

duration of a TIF district and its bonds exceed the shorter of 20 years or the expected life of the project supporting the TIF.

- ◆ TIF funds should be redirected to the General Fund after the TIF period expires or when they are otherwise not required for the TIF district generating them. Cross-subsidization of other TIF districts should not be permitted.

Transparency

- ◆ All meetings relating to TIFs should be conducted in accordance with both the letter and the spirit of the open meetings law. Practices that undermine transparency, such as one-on-one briefings and behind-closed-door negotiations between councilmembers and potential developers/owners, should be avoided.
- ◆ All documentation relating to TIFs should be available to the public.
- ◆ City Council should provide the public on an annual basis with a report on TIF districts, including the amount of public funds dedicated to TIF and the performance of the various districts.

APPENDIX A

ST. THOMAS TIF

In this Appendix, BGR presents a brief description of the St. Thomas redevelopment and the proposed TIF. It takes no position with respect to the merits of the redevelopment plan, or the social and environmental disputes that it has spawned.

Last year City Council approved the creation of the City's only sales TIF district. The district, which includes the former St. Thomas public housing site and an adjacent parcel of land owned by Riverview Retail Development Company LLC (Riverview Retail), will assist with the financing for the redevelopment of the former St. Thomas site as a HOPE VI project. Riverview Retail is owned in part by Historic Restoration Incorporated (HRI), the HOPE VI private developer.

The City Council also authorized the capture and dedication of future City sales tax revenues (2.5 cents) from a Wal-Mart Super Center to be built on the adjacent parcel. The incremental taxes from Wal-Mart will be used to repay \$20 million of debt incurred to finance the construction of two mixed-income rental housing portions of the former St. Thomas site, known as CS1 and CS2. Based on information from HRI, up to \$10.5 million of the \$20 million bond issue will be used for expenses related to CS1. The remainder of the proceeds will be devoted to expenses related to CS2, the second phase of rental housing.

A. Background

The redevelopment of the St. Thomas site has a long and contentious history. After several years of discussion, a HOPE VI application to redevelop the St. Thomas site was submitted in 1996 to the U.S. Department of Housing & Urban Development (HUD) by the Housing Authority of New Orleans (HANO). HOPE VI is a federal grant program that enables public housing authorities to partner with private developers to replace severely distressed public housing with new housing at a lower density.

In 1997, HUD awarded HANO a \$25 million HOPE VI grant to implement the planned redevelopment. HANO awarded the development contract to Creative Choice Homes Inc. In 1998, HUD declared the development contract null and void and instructed HANO to reopen the process for selecting a developer. The contract was awarded to HRI. The current development plan calls for the construction of 1,088 on-site housing units, 150 low-income, off-site housing units at scattered sites, and a Wal-Mart on a site adjacent to the St. Thomas site.

Under HRI's approved redevelopment plan, the former St. Thomas site will be divided into seven components, with different ownership and financing structures. They include: two mixed-income rental developments (CS1 and CS2), for-sale homes (with an affordable housing component), a residence for low-income elderly persons, an upscale continuing care retirement community, luxury condominiums, and a group of renovated historic buildings. Of the 1,088 on-

site units planned for the St. Thomas site, a total of 304 will be affordable or low-income housing units.

Publicly available information concerning most phases of the development is very sketchy. Detailed information is available only for the early phases, including the predevelopment, CS1, and the Wal-Mart. Important terms, such as the ownership and proposed financing, have been described in only general terms for the remainder of the project. It is clear, however, that the improvements on the former St. Thomas site will be privately owned. The land will be either privately owned or leased by HANO to private entities for 99 years at nominal rates.

The total cost of development, including the Wal-Mart, is estimated at approximately \$320 million. Public funding makes up more than \$90 million of this amount, with at least \$50 million coming from federal sources, including HOPE VI demolition and revitalization grants, a HUD Section 202 elderly housing grant, HANO contributions, and an undetermined amount of low income housing tax credits; \$8 million from state capital outlay funds; and \$32.6 million from the City of New Orleans. The latter includes city infrastructure bond proceeds, TIF and PILOT bond proceeds, and HOME Investment Partnership funds controlled by the City.

HOPE VI developers operate under a series of federally imposed constraints. The HOPE VI money is restricted to funding construction of public housing units, site preparation, project administration, and resident relocation. Housing may consist of 100% public housing units or a mix of public housing and

other low-income and market-rate units. HUD guidelines require that the project use HOPE VI and other HUD public housing grants to produce at a minimum the number of public housing units that could be built without other public or private financing. All units, regardless of financing, must be comparable in size, location, external appearance, and distribution on the site.

The St. Thomas TIF district was introduced into the redevelopment plans after HRI had been selected as the developer. Unfortunately, it suffers from many of the potential problems identified earlier in this report. Some of the more serious deficiencies of the TIF district and the process by which it was approved are discussed below.

B. TIF Analysis

HRI claims that the St. Thomas site cannot be redeveloped without the TIF. Relying on a report prepared by MetroSource LLC, it claims benefits to the City totaling \$110 million over a 50-year period. HRI projects increased sales tax revenues of \$125 million (on a net present value basis, using a 2% inflation factor) for the City, Orleans Parish School Board, and the Regional Transit Authority over 25 years.

An analysis of the MetroSource study is beyond the scope of this report. It should be noted, however, that the MetroSource report purports to project benefits over a 50-year period and does not take into account all of the public costs of the project.

Subsidy to a Private Entity. As noted above, TIF bond proceeds are to be used for costs associated with CS1 and CS2, the mixed-income rental components of

the St. Thomas redevelopment. CS1, the first phase of the development, consists of 296 units, of which 122 are designated for low-income renters.

The estimated cost of construction of CS1, exclusive of infrastructure, is \$44.8 million. Of this amount, \$31.3 million (70%) is provided from public funds. The estimated cost of construction of CS1, inclusive of infrastructure, is \$53.5 million. Of that amount \$40 million (75%) is provided from public funds. (All infrastructure and other predevelopment costs for the entire St. Thomas project are being paid exclusively from public funds.)

The funds provided up-front for construction costs represent only a portion of the total cost to the public. When interest and other costs are taken into account, the cost to the public exceeds \$51 million. This equates on a per-low-income-unit basis to almost \$348,000 (excluding infrastructure) or \$420,000 (including infrastructure). When the cost to the public is allocated to all units in CS1, it equates to almost \$144,000 per unit (excluding infrastructure) and \$173,000 per unit (including infrastructure).

The public contributions to CS1 come from a number of programs and sources, including federal, state and city grants and the diversion of future sales and property taxes from the City's General Fund. The amounts and sources of the public contributions and

other public costs are set forth below. An annotated schedule is set forth as Appendix A-1.

COST TO THE PUBLIC OF CS1	
(All figures in millions of dollars)	
HOPE VI Loan	\$12.4
TIF Payments	14.9
Wal-Mart PILOT (to support tax-exempt bonds)	5.4
4% Low Income Housing Tax Credits	6.0
Interest income (on HOPE VI escrow)	0.1
HOPE VI, HANO, state and local funds for CS1 infrastructure	8.7
CS1 share of lost sales tax revenue from Wal-Mart competitors	3.7
TOTAL COST TO THE PUBLIC	\$51.2

The above estimate is extremely conservative in two respects. First, as is discussed more fully below, the cost of the TIF could exceed the number used above by tens of millions of dollars. Second, it does not include the value of additional subsidies for which BGR is unable to make reasonable estimates. These subsidies include interest savings from tax-exempt bonds, the value of reduced taxes for CS1, and the value of the land on which CS1 is being built. Under the terms of the agreement for payments in lieu of taxes (PILOT) for CS1, the low-income units will be taxed at \$1 a unit, and the market-rate units at \$100 a unit. HANO is making the CS1 land available at a nominal annual rent of \$1 per unit for 99 years.

Available financial information for CS2, the other phase of the redevelopment using TIF funds, is less detailed. It is

clear, however, that CS2 will include multiple subsidies, including public funding for infrastructure and site preparation, HOPE VI funds, low income housing tax credits, TIF funds, reduced property taxes, and nominal land rent.

Poor Use of Public Funds. As the above numbers indicate, and HRI has stated, the TIF revenues will be used to finance market-rate housing. The application of TIF funds for this purpose is very troubling in a City that suffers from a lack of decent affordable housing for low-income residents and from a shortage of operating funds for basic services. It becomes almost inexplicable when one considers that, as a result of the diversion of most of the property taxes to operating costs, the market-rate housing will not even contribute significantly to the tax base.

Two reasons have been offered to justify a TIF for market-rate housing. The first is that market-rate units must be offered at below-market rent in order to induce middle-income residents to live next door to low-income ones. Leaving aside the fact that “market rate” is in that case a misnomer, it should be noted that the market-rate properties are already receiving other subsidies (e.g., reduced property taxes and the nominal land rent to HANO) that reduce operating costs. TIF enables the owners to further reduce operating costs by transferring to the public the carrying cost for a large portion of the debt for CS1.

The other reason offered in defense of the subsidy is that the market-rate housing must support the operating costs of the low-income housing on an ongoing basis. While the revenue from the low-income housing would be less

than that from the market-rate units, the carrying costs for such housing would also be lower. The construction of the low-income housing in CS1 is paid for entirely with public funds, all infrastructure costs are paid with public funds, and only nominal property taxes and land rent are payable on the low-income units.

High Cost of TIF Debt. City Council has authorized the issuance of \$20 million of TIF bonds with a maximum maturity of 50 years and an interest rate not to exceed 8.6%. Although for technical reasons the stated maturity is 45 years, the City expects to reduce the maturity through prepayments to 13.5 years. The City anticipates an interest rate of 8% to 8.5%.

Several aspects of the proposed bond issue are exceedingly disturbing. First, the anticipated interest rate for the TIF bonds (8 to 8.5%) significantly exceeds the rate for bonds issued by local governments with ratings comparable to New Orleans. That rate currently hovers around 4.5% for 30-year issues. While BGR recognizes that the high rate results from the limited repayment obligation, the fact remains that the money is very expensive. The magnitude of the cost can be illustrated by comparing the total interest expense for a \$20 million bond, payable in equal, semi-annual installments over a 13.5-year period and bearing interest at a rate of 8.5%, against interest expense for a similar bond bearing interest at a rate of 4.5%. The difference in total interest expense would be \$7.1 million (or \$5.8 million discounted at 3% for inflation).

Second, the cost of the TIF bonds could be far higher than the public has been led to believe. Because state law cur-

rently limits annual debt service for sales TIF bonds to 75% of the sales taxes received in the first full year of operation (estimated at \$1.7 million for debt service), the bonds will have a stated maturity of 45 years. The City, based on Wal-Mart's sales projections, expects to reduce the maturity dramatically by applying 80% of TIF revenues above \$1.7 million to prepayment of the bonds. However, if the funds for prepayment fail to materialize, the interest payments alone could total \$67 million. Under that scenario, the citizens of New Orleans would divert \$87 million from the General Fund to pay for \$20 million of debt.

With the application of excess TIF revenues, the total annual debt service paid by the TIF district over 13.5 years could average approximately \$2.5 million per year. This foregone revenue to the City's General Fund constitutes an opportunity cost for the City. The addition of \$2.5 million to the General Fund, for example, could translate into 75 new police officers.

Diversion of Multiple Revenue Streams. The financing for the St. Thomas development illustrates how the layering of subsidies can reduce the public's return on a TIF investment. As noted above, to support the HOPE VI project, the City is foregoing sales taxes from the Wal-Mart to support the TIF bonds. Unfortunately, other tax streams generated by the St. Thomas redevelopment are also being used to support the development.

As noted above, the property taxes on CS1 and CS2 have been drastically reduced through a PILOT. In addition, Wal-Mart's property taxes have been set at \$300,000 to \$450,000 over a 20-year

period and except for \$25,000 a year, will be diverted from the general fund to finance \$3.6 million in bonds for CS1. While these bonds are outstanding, the City will receive only \$25,000 in annual PILOT payments.

Reduced Sales Taxes. The St. Thomas TIF district illustrates a major downside of using TIF in conjunction with retail development: the loss of tax revenues from other businesses. The study prepared for City Council indicates that Wal-Mart will capture a portion of its sales from other businesses in New Orleans and that this will cause sales tax revenues attributable to those sales to drop by an estimated \$402,000 to \$554,000 a year until the bonds are repaid.²⁹

Inadequate Information. City Council and the public's efforts to understand the massive and complex St. Thomas redevelopment were hampered by a lack of key financial information. The City never received information as basic as the developer's financial statements. In addition, at the time that the City gave final approval to the TIF bonds, current budget information was available only for the infrastructure, Wal-Mart, and first phase of rental housing. The only available cost-benefit analysis, which had been prepared for the Industrial Development Board in 2001, was inaccurate because of alterations in the projections for housing and the retail development. Much of the data on the later phases of the redevelopment was not publicly updated after January 2002.

Constrained Review. The concept of TIF for the redevelopment of St. Thomas was first introduced into the HOPE VI redevelopment plans by HRI in 2000.

City Council introduced the legislation to establish the TIF District in January 2001, but it did not hire a consultant, Lambert Advisory, to conduct an analysis of CS1 and the need for TIF until early 2002. It approved the district and dedicated the sales tax revenues in April 2002, shortly after it received the consultant's analysis, reserving the right to negotiate and making the dedication contingent on its final approval of certain documents. Negotiations continued until November 2002, when the TIF district was made effective.

Lambert Advisory's report was conducted nearly five years after the HOPE VI Grant had been awarded and more than two years after HANO and HRI had entered into a redevelopment agreement. As the City's consultant noted, major decisions had been made and infrastructure was being installed. As a result, an option that could have been explored if the review had occurred earlier — redesigning the project — was deemed foreclosed. The inquiry dealt with what could be done under the existing circumstances, as is reflected in the consultant's conclusion that TIF was "the only immediately available option."³⁰

Distortions to Land Use. The need for a large sales tax generator to generate TIF revenues clearly affected the City's planning and zoning decisions. The need to produce a certain amount of tax revenues was one of the arguments put forth to justify the construction of a 200,000-square-foot store and to eliminate the restrictions recommended by the City Planning Commission.

Appendix A-1

COST TO THE PUBLIC OF CS1 ¹ (All figures in millions of dollars)	
HOPE VI Loan ²	\$12.4
TIF Payments ³	14.9
Wal-Mart PILOT (to support tax-exempt bonds) ⁴	5.4
4% Low Income Housing Tax Credits ⁵	6.0
Interest income (on HOPE VI escrow) ⁶	0.1
HOPE VI, HANO, state and local funds for CS1 infrastructure ⁷	8.7
CS1 share of lost sales tax revenue from Wal-Mart competitors ⁸	3.7
TOTAL COST TO THE PUBLIC	\$51.2

1. Figures, unless described otherwise below, are from "Preliminary Financing Terms and Conditions for CS1," dated October 22, 2002, and submitted to the State Bond Commission. That document details the sources and uses of funding available for CS1 as of the time of City Council and State Bond Commission approvals last fall.

The table does not include public contributions for which BGR is unable to make reasonable estimates, such as interest savings on tax-exempt bonds, the value of reduced property taxes, and the value of CS1 land.

2. According to the terms of the Development Agreement between HANO and HRI, as amended, HANO will loan HRI \$12.4 million based on the HOPE VI grant. The loan is the functional equivalent of a grant. Interest, which is payable at a rate of 1% per annum, will be reinvested by HANO in the project to supplement the allowable expense level (i.e., the maximum operating cost allowed for HUD subsidy of public housing units). Principal is payable at the end of 40 years.

If the HOPE VI loan is analyzed as a loan, the public contribution would exceed the \$12.4 million included in the table. The contribution would include the difference between the interest paid to HANO and market-rate interest. Assuming a 6% differential, the value of the interest differential would be \$17.1 million (discounted using a 3% inflation rate.) That number would be offset by \$3.8 million (the amount in current dollars of the future principal repayment), for a net contribution of \$13.3 million.

3. Estimate from HRI's financial advisor.

4. A payment in lieu of taxes (PILOT) for Wal-Mart has been approved by the Industrial Development Board. The City will receive annually \$25,000 of the PILOT to distribute to taxing bodies. The remainder of Wal-Mart's PILOT, beginning at \$275,000 a year and gradually increasing to \$425,000 a year over 20 years, will be used to pay off about \$3.6 million in tax-exempt bonds approved for CS1.

The total cost of the Wal-Mart PILOT reflects BGR's calculation of the amount of the PILOT required to retire the debt.

The revenue stream is discounted for inflation at an assumed annual rate of 3%.

5. Low Income Housing Tax Credits could be considered either public or private money. For St. Thomas, the credits will be sold by HRI to private investors, generating the \$6 million equity contribution to the project. However, these investors will ultimately use the tax credits against their federal income tax payments. Because of this, BGR has treated the credits as a public contribution.

6. Estimate from HRI's financial advisor.

7. Infrastructure costs for the project total \$19.4 million, according to Preliminary Financing Terms. The portion of infrastructure cost for CS1 was calculated based on its estimated 45% share of total street frontage (the percentage estimated by City Council's consultant. All infrastructure costs were publicly funded.

8. BGR calculated lost sales tax revenue by taking Lambert Advisory's estimated maximum of \$554,000 per year over 12 years and discounting the total by 3% for annual inflation. This amounted to \$5.5 million. The share applicable to CS1 was determined by multiplying the total by 67%, or the ratio of 122 CS1 low-income units to the total of 182 low-income units in CS1 and CS2.

APPENDIX B

WORLD TRADE CENTER TIF

According to current reports, WTC Development Ltd., the developer chosen for the World Trade Center hotel, wants the World Trade Center taxing district to apply the revenues from its hotel occupancy tax to repay \$40 million in revenue bonds with a maturity not to exceed 30 years, and an expected interest rate of 8.5 to 9.5%. In addition, the bondholders will receive an additional distribution equal to 50% of net income from the hotel.

A. Background

In 1963, the City through the New Orleans International Trade Building Corporation, entered into a lease for the World Trade Center to the World Trade Center of New Orleans Inc. (WTCNO), a nonprofit organization that promotes international trade and economic development. The lease was for a term of 56 years, ending in 2019, at a price of \$1 a year. WTCNO agreed to operate and manage the center and to pay off revenue bonds issued to finance the construction of the building. The bonds have been repaid.

Through the 1970s and early 1980s, the building thrived amid a bustling New Orleans economy. But the growth did not last; the mid-1980s collapse of the oil industry and reductions in local operations of shipping companies hurt occupancy at the World Trade Center. In 1994 WTCNO proposed converting a portion of the building into a hotel to

solve the building's occupancy problems. To do this, it needed a lease extension.

In 1998, with City and WTCNO lease negotiations ongoing, WTCNO through a public bid process selected WTC Development Ltd. as the hotel developer. WTC Development Ltd. is 50% owned by WTC Investment LLC, a partnership of local investors George Kleinpeter, Jr., Larry Sisung, Jr., and William Hindman, Jr. Thirty-eight percent is owned by Pelican Investment Holdings LLC, a group of 10 local minority investors, and 12% by Pelican Venture Holdings LLC, a group of three women.*

WTC Development Ltd.'s bid contemplated a total project cost of \$70 million for 635 rooms, half of the current cost estimate of \$140 million. WTC Development Ltd. was to contribute \$500,000 in equity to the hotel project. Another \$20 million in equity was to come from the parent company of the prospective hotel operator, Crowne Plaza. The balance of the financing was to be private debt. No public funding was mentioned.

In 2001, New Orleans International Trade Building Corp. transferred the World Trade Center and the related lease to New Orleans Building Corp. (NOBC). In that year, City Council approved a new lease of the World Trade Center land, building, and parking garage to WTCNO for 99 years. It also approved a sublease of the first 18 floors of the building, the 31st floor, and other property to WTC Development Ltd. for 99 years. While both 99-year leases were executed in 2001, they do not go

* According to a memorandum from the hotel developer to NOBC, the members of Pelican Investment Holdings are Bobby Major Jr., Douglas M. Evans, Ronald Guidry, Darren Mire, George V. Rainey, Dale M. Valdery, Gilbert C. Jackson, Mitchell Dasher II, Virgil Robinson, and Marshall Truehill. The members of Pelican Venture Holdings are Angela Barthe, Alana Villavaso, and Susan Campbell.

into effect until the opening of the hotel. Until the effective date, only a few obligations apply, such as an annual payment of \$50,000 a year from WTCNO to NOBC until hotel construction begins.

In the primary lease, WTCNO agrees to pay NOBC rent equal to 50% of the net revenues from the garage, hotel, and office space. The net revenues (gross revenues minus the buildings' operating expenses) are adjusted for certain credits and subject to a minimum of \$50,000 a year, inflation adjusted. WTCNO projects City revenues ranging from \$861,000 to \$1.9 million a year for the first decade of the lease.

The lease also requires WTCNO to invest up to \$1 million of its 50% share of net revenues in trade development programs for New Orleans residents and businesses. The programs are financed with the first \$1 million of net revenues above an adjustable baseline amount, which starts at \$1,075,309. The programs are operated by WTCNO but approved by NOBC.

The City and NOBC have agreed to reimburse half of WTCNO's pre-lease expenses incurred preparing for the hotel, regardless of whether the hotel is built. As of April 2003, WTCNO had spent about \$1.6 million.

In the sublease between WTCNO and WTC Development Ltd., the developer agrees to convert the first 18 floors of the World Trade Center into a hotel and to reimburse WTCNO for pre-hotel development expenditures not covered by the City. WTCNO has spent \$3.6 million so far in pre-hotel development expenditures, which include a new sprinkler system, fire alarms, roof repairs, new boilers, and removal of

the outside elevator. The developers are not obligated to reimburse WTCNO for these expenditures if the hotel is not built.

The hotel's rent to WTCNO is calculated as follows:

Year	Rent
1	\$250,000
2	\$500,000
3	\$750,000
4	3% of gross revenue for third year
5	3.5% of average gross revenue for third and fourth years
6-7	3.5% of average gross revenue for preceding three years
8-99	4% of average gross revenue for preceding three years

Note: Table compiled by BGR from information in the hotel sublease

Gross revenues consist of hotel room rentals, hotel-related parking and valet charges, and revenue from entertainment or restaurant operations. In addition, the developer will pay a percentage of rents received from any sub-tenants.

According to WTCNO projections reviewed by City Council in 2001, beginning in the fourth year, the lease payments to WTCNO should amount to at least \$1.5 million a year. The rent payments are projected to rise to \$2.5 million by the 10th year of hotel operation.

In 2001, prospective operator Crowne Plaza ceased to be a participant in the World Trade Center deal. In the spring of 2002, the developer with the support of WTCNO and NOBC approached the

State Legislature to create the special taxing district to provide public financing. No public money had been contemplated in the original bid.

Since the creation of the legislation, developers have signed a letter of intent with Westin Hotels & Resorts to operate the hotel. Recently, the Nagin administration, which inherited the World Trade Center lease, initiated negotiations to change the terms of the City's deal.

B. Analysis

Proponents of the World Trade Center TIF argue that hotel projects of this magnitude cannot be done in the current economic environment without substantial government subsidies. They also claim that the TIF will enable the City to increase its rental revenues from the building (currently \$1 a year) and receive increased sales and other local taxes, additional jobs and investment from construction and operation of the hotel, and other benefits. The revenue from the hotel project would also bolster a prominent trade organization. They also argue that the World Trade Center building is functionally obsolete and cannot be effectively utilized without a \$28 million investment in outside stairwells and other improvements to bring it up to code.

The project raises a number of grave concerns for the public:

Inadequate Private Equity. The hotel is woefully undercapitalized. According to NOBC, the developer has contributed only \$1.5 million in equity for a \$140 million project. According to the developer, the equity contribution is \$5.2 million. Either amount is inadequate for a hotel project of this size. Currently,

lenders are willing to loan 50% to 60% of a hotel project's cost, expecting developers to piece together the remainder in equity and subordinate debt. There is a funding gap for which the developers are seeking public funding. In essence, the City and other tax recipient bodies are putting up the equity, while the return on their investment is going to TIF bondholders and the developer.

Inadequate Return on Investment.

Under the lease executed before the TIF was introduced, the City would receive 50% of net revenues from the World Trade Center property. WTCNO currently expects the City's 50% share to equal \$861,000 to \$1.9 million per year for the first decade of hotel operation.

The addition of the TIF dramatically reduces the value of the World Trade Center lease to the City and the community. As a result of the TIF, the City's anticipated lease revenues would be offset by the City's share of the hotel occupancy taxes diverted to the hotel project. These taxes are estimated to range from \$462,000 to \$635,000 per year for the first decade of hotel operation, leaving the City with a net amount of \$399,000 to \$1.3 million per year. In essence, the City's increased investment reduces the return to the City.

To support the hotel, the City and the other hotel tax recipients would collectively forego an estimated average of \$4.8 million per year in hotel occupancy taxes. During the first decade of the project, the direct public investment in the project is expected to exceed the rental income in each year.

Negative Impact on Critical Services and Economic Development Engines.

The TIF would divert revenues from

other projects and entities that provide important services or contribute significantly to economic development in the City and the region. These include the Orleans Parish School Board, the Ernest N. Morial Convention Center, the Regional Transit Authority, the Louisiana Stadium & Exposition District, the New Orleans Tourism & Marketing Corporation, and the New Orleans Metropolitan Convention & Visitors Bureau. To the extent that these entities lose future revenues, the City as a whole suffers.

Over the first 10 years of hotel operations, local tax recipients would forego approximately \$48 million in hotel occupancy taxes. The breakdown of the foregone taxes by recipient appears at the bottom of this page.

WTCNO argues that its mission to promote international trade and economic development is just as deserving of state assistance as the work of the hotel tax recipients. While WTCNO's membership and operations would expand indirectly through new rental revenue from the

hotel development, this expansion does not directly justify the use of such a large public subsidy.

High Cost of Debt. The developer wants the World Trade Center taxing district to issue \$40 million of bonds with a maturity not to exceed 30 years and an interest rate of 8.5 to 9.5%. The proposed interest rate is roughly double the current rate of 4.5% for general obligation bonds. Interest payments on \$40 million in bonds amortized in equal, semi-annual installments over 30 years at an interest rate of 9.5% would total approximately \$81.5 million. The same bonds amortized at the current 4.5% rate for general obligation bonds would require interest payments of approximately \$33.3 million. The difference in total interest expense would be \$48.2 million (or \$31.6 million discounted at 3% for inflation). It should be noted that the City's share of foregone taxes for these payments would equal only 11.5% of the total.

Reduced Tax Base. NOBC estimates that 70% of the World Trade Center hotel's expected sales would be taken

Hotel Tax Recipient	Rate	10-year tax capture
State General Fund:		
Convention & Visitors Bureau	1.0%	\$ 3,728,000
Convention Center IV, Hornets, Saints	1.0%	\$ 3,728,000
Convention Center	3.0%	\$ 11,184,000
Orleans Schools	1.5%	\$ 5,592,000
City	1.5%	\$ 5,592,000
RTA:		
Canal Streetcar	0.6%	\$ 2,237,000
Convention Center Phase IV	0.2%	\$ 746,000
N.O. Tourism Marketing Corp.	0.2%	\$ 746,000
Louisiana Stadium & Exposition District	4.0%	\$ 14,912,000
Total 10-year Tax Capture	13.0%	\$ 48,465,000

Source: BGR calculations, based on numbers provided by NOBC

from other hotels. With \$4 million in hotel taxes expected to be captured in the first year of hotel operations, this would result in a loss of resources currently received by hotel tax recipient bodies equal to \$2.8 million.

The developer disputes NOBC's estimate. The developer claims that while 60% of expected sales at the hotel cannot be directly attributed to new demand created by the World Trade Center hotel, this 60% figure would be reduced to a negligible amount by new convention business, aggressive marketing by competing hotels, and attraction of visitors who would normally stay in suburban markets during major events, such as Mardi Gras or Jazz Fest.

Loss of Benefits. The TIF is not the only public subsidy for the development. In addition, through a proposed restoration tax abatement, the developers would not pay ad valorem taxes on the hotel for a period of 10 years.

Unfair Competitive Advantage.

Opponents maintain that the district would provide the hotel developer with an unfair competitive advantage, allowing it to reduce room rates by transferring a significant cost to the public. Proponents respond that their room rates will track those of other large, competing hotels downtown and that the TIF investment is necessary to make the city-owned World Trade Center usable for any form of commerce. Although the TIF legislation prohibits the hotel from advertising below market-rate rooms, preventing the hotel from offering reduced room rates would be difficult, if not impossible.

ENDNOTES

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IN THIS REPORT...

Recently, a widely used local economic development tool – tax increment financing or TIF — has captured the attention of New Orleans’ city government. A TIF district has been approved for the St. Thomas redevelopment and another is under consideration for the proposed World Trade Center hotel.

TIF, as it is commonly known, is a financing mechanism that enables a local government to capture new tax revenues generated in a specific area for reinvestment in that area. In theory, the investment is self-financing and the development supporting it would not have occurred otherwise.

Carefully conceived and executed, TIF can produce significant benefits— such as increased employment, improved environment, and increased tax revenues— that would not have otherwise occurred. However, TIF, particularly based on sales tax revenues, can also produce serious distortions and inequities. Misused, it is likely to be an expensive mistake that results in an unnecessary transfer of wealth to private entities.

Unfortunately, the trend with respect to TIF is disturbing. In just the past month, City Council has received a proposal for a TIF-like financing for a Lowe’s, a bill has been introduced to create a TIF district for Lake Forest Plaza Shopping Center, and another bill has been filed to create one for a large portion of eastern New Orleans. Collectively and individually, they raise serious concerns, including the specter of businesses routinely turning to the City for subsidies, the prospect of a frozen tax base for a huge swath of the City, and a balkanized tax structure.

Now is the time for the City to take stock of the risks associated with TIF and to develop a comprehensive program to ensure that TIF is used effectively, efficiently, and equitably. BGR hopes that City Council, which is currently developing procedures, will carefully consider the contents of this report.