ILLINOIS MUNICIPAL

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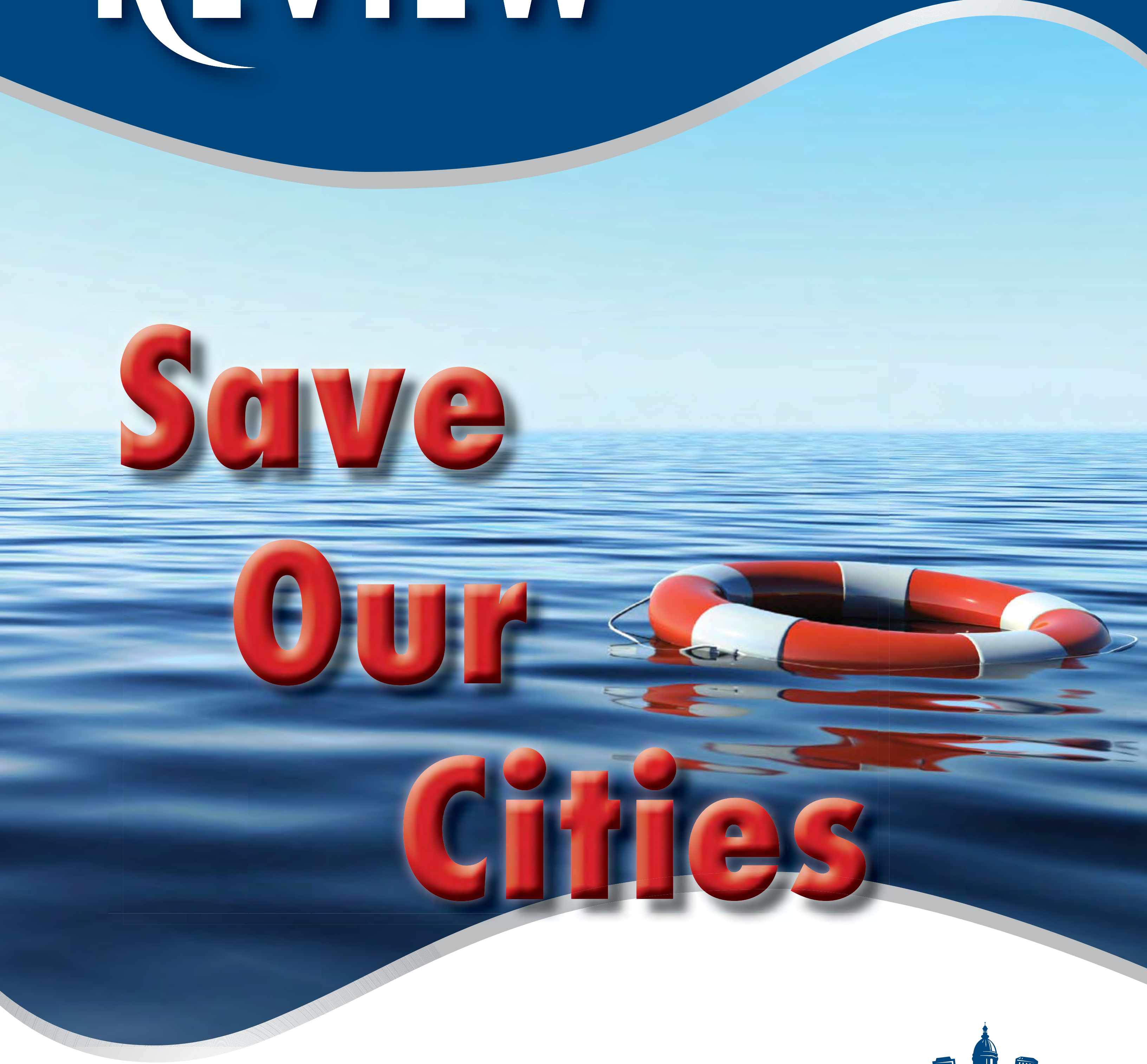

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ILLINOIS MUNICIPAL LEAGUE

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Strengthening Economic Development During the Post-Recession Environment

BY NICHOLAS GREIFER

The goal of this article is to assess the actions municipal leaders should consider in the new economic environment emerging out of the Great Recession of 2008-2009. Although the economy has stabilized in the past 3 years, Illinois cities and villages face a number of headwinds as they seek to jump-start their local economic recovery. In addition to the tough state and national economic climate, the real estate sector and sub-sectors such as retail are under severe pressure. To complicate matters, state legislation would limit municipal authority to establish redevelopment programs by imposing new limits and curtailing local control. Given the new realities, mayors and city managers will need to develop new strategies and tactics to promote economic development at the local level.

THE POST-RECESSION ENVIRONMENT AND THE NEW NORMAL

What is the general environment for Illinois cities and villages, and the prospects for economic development in 2012? Because the Illinois economy is highly correlated with the national economy, state economic growth (GDP) is likely to move in tandem with the national in the near future. In terms of employment levels Illinois job creation is likely to post modest gains as well, but not recover and return to the pre-recession high water mark immediately.

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For municipal officials responsible for economic development, a similar mixed picture emerges. Retail sales, a key priority for municipal development officials, have started to rebound (measured in terms of metrics such as same-store sales for national retailers). However, because retail represents only one sector of the real estate market, municipal economic development officials will need to monitor the various other sectors and sub-sectors affecting local economies, especially those sectors showing resiliency. Areas showing strength in the nascent economic recovery include multi-family rental housing, health care offices, senior housing and specific sub-sectors within retail (e.g., certain restaurant categories, specialty grocers, etc.).

The bottom line: the strategies to promote economic development in the 1990s and 2000s are not necessarily going to be the same ones during the next 10 years. Municipalities face a changed state and national economic and real estate environment, with a more complex set of options for pursuing viable projects within the real estate sector. Although local governments will continue to look to private sector developers to determine the most viable redevelopment projects and their implementation, localities will need to exercise even greater due diligence in evaluating the merits of private developers' projects – and in signing on for (and potentially subsidizing) redevelopment projects that offer acceptable risks to localities.

THE FUTURE OF TIF DISTRICTS; TIF ALTERNATIVES

Going forward, one of the challenges will be to re-examine familiar tools available to municipalities and weigh their relative utility in the new economic environment. Although Illinois communities' pre-dominant tool for economic development has been tax increment financing for the past twenty-five years, the current legislative climate may have shifted and may not be favorable toward municipal-led TIF District authority. It is possible that significant limitations will be imposed upon Illinois municipalities in the near future – e.g., proposals to limit the usage of TIFs, adding cost to the process of TIF District formation, veto power to Joint Review Board members, etc.

Given the current climate, municipal leaders may find it beneficial to "step back" and explicitly consider alternate approaches to promote economic development. Even if a municipality ultimately selects TIF as the tool to be used on a given project it may be healthy to have internal discussions about TIF alternatives. For example, it may be prudent to go through a checklist of options prior to committing to the establishment of a TIF district. Accordingly, some of the leading alternatives to TIF are presented on the following pages.

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BUSINESS DISTRICTS

One alternative gaining favor is the formation of Business Districts. Like a TIF District, a Business District requires a formal qualification report with explicit criteria needing to be met and documented (if an additional sales or hotel tax is to be imposed). Other similarities to TIF include: designation of a target area or zone, flexibility in reimbursement for a variety of development costs (e.g., public infrastructure and certain developer-incurred costs such as site preparation/environmental remediation), and a 23-year implementation period. However, two key differences include (a) limitation to commercial or hotel or retail uses (generally a Business District is not applicable to industrial or residential uses) and (b) the revenue source is derived from an add-on sales tax (up to 1.00% add-on tax, in .25% increments) that goes into a segregated fund – rather than property tax revenue resulting from incremental growth in property tax valuations (EAV) within a TIF District. A similar add-on hotel tax can be applied to hotel projects.

TARGETING OF IN-KIND BENEFITS TO A SPECIFIC AREA

Some municipalities have chosen to focus city services (planning, marketing, utility improvements and/or transportation enhancements) on specific areas within a community. The rationale is that an area experiencing obsolescence is suffering from certain deficits such as: lack of coordinated city land use planning, lack of knowledge among private investors due to insufficient outreach/ marketing, and lack of public investments in infrastructure. For example, many communities have conducted “corridor” planning studies, as well as ongoing outreach to commercial brokers or local business groups or the broader development community. Additionally, transportation and infrastructure planning is often layered on top of such efforts and helps target scarce federal, state, and local transportation programs into certain corridors or neighborhoods of a community.

COUNTY PROGRAMS

Certain counties have economic development programs that can be operated in tandem with municipal programs. Cook County, for example, has specific classifications connected to specific land uses (e.g., the Cook County Class 6b program provides a lower assessed valuation for certain types of projects involving industrial expansion, new construction, rehabilitation, or occupancy of previously vacated industrial/ warehouse space). Additionally, certain counties under Illinois law have quasi-TIF programs that may be used in unincorporated areas or in some instances in overlapping municipalities.

OTHER PROGRAMS

Other alternatives to TIF formation include special services areas (SSAs), special assessment districts, and tax abatement programs. Refer to the table below for additional information.

OVERLAYING MULTIPLE TOOLS

The economic development tools cited above are not mutually exclusive. It may be advantageous to use multiple tools, e.g., tools (such as Business Districts or special service districts overlaying TIF Districts) that may provide revenue in the short-run but that can be phased out or abated as incremental revenue is realized over the long-run. Such layering may also be advantageous in terms of reaching a consensus with external stakeholders such as school districts that may otherwise oppose projects implemented solely via TIF financing.

WHAT ACTIONS CAN BE TAKEN NOW TO PREPARE FOR REDEVELOPMENT EFFORTS?

In addition to the financing tools listed above, some Illinois municipal leaders are taking certain actions to “set the table” for redevelopment. For example, some municipalities have been aggressive in assembling parcels in anticipation for future development while taking advantage of the down cycle in the real estate market. As always, municipalities face a trade-off between project control (as land owner) versus the risk associated with ownership – risks including the timing of land acquisitions and the potential need to write-down the value of properties to spur development. Three other types of preparatory actions for redevelopment observed in recent years include the following:

Incentive Tool	Form of Incentive	Time Limit	Dollar Limit	Permissible Land Use	Complexity of Eligibility Process
TIF	Varied – In-kind subsidy (infrastructure), direct payment per RDA*, land write-down	23 years	None	Commercial, industrial, residential	Medium to high
BUSINESS DISTRICTS	Same as TIF	23 years**	None	Commercial, industrial	Medium
TAX ABATEMENTS	Annual tax reduction	12 years	$4 million per project	Commercial	Medium
SPECIAL ASSESSMENT	Infrastructure / public improvements	30 years	None	Any land use	Medium
SSA	Infrastructure / public improvements	30 years	None	Any land use	Low to medium

*Redevelopment agreements
**The Business District Development and Redevelopment Law, as amended, includes a termination date tied to the retirement of Business District obligations.

MARKET STUDIES

Certain communities have undertaken market studies, viewing them as an important part of a municipality's economic development toolkit. Before underwriting the costs of such a study, it is important to define (a) what constitutes a true "market study," (b) the methodology employed, and (c) the outcome desired from a study. For example, some retail market studies often seek to determine if the community or an area within it is underserved – lacking, for example, a category of national retailer (e.g., a gap between the "supply" of consumer electronic stores for a community and the "demand" within a trade area for consumer electronics). The consultant performing the market study may use a methodology that involves determining the location of the targeted category of retailer relative to competing retailers (e.g., a geographic analysis mapping the distribution of competing stores with concentric circles around the existing stores' trade area). It may lead to the conclusion that a community is underserved, has a locational gap with no competing stores in the targeted trade area and would thus be a viable candidate for landing the targeted store.

There are three main caveats regarding such studies. First, it may provide a result that the client municipality wants to hear ("our community needs an upscale grocer and the market study shows that such retailers currently do not serve the municipality"). Secondly, the methodology may be unsound or incomplete. For example, market viability for a given community may be determined by other factors than simple geographic proximity. Third, the analysis may not be "actionable" or specific enough to target certain retailers and may be overly reliant on general data sources such as census data.

In contrast, higher quality market studies will often focus on a narrow real estate sub-sector, one that the firm conducting the study has deep experience in. For example, the firm may specialize in a sector such as hotel development and the study will provide in-depth analysis of feasible prospects for types of hotel chains as candidates to locate in the community, potential revenues for the prospective hotel operator, and a comparison to industry benchmarks adjusted for the region or sub-region that the community is in. Such studies may also address the ability of the developer to access private capital for the project.

OPPORTUNITIES FOR REGIONAL COOPERATION

Just as municipalities have formed intergovernmental agreements (IGAs) in order to consolidate services, a handful of municipalities are using IGAs to promote economic development, assist retailers located across multiple jurisdictions, and ultimately strengthen their collective tax bases.

For example, the village of Oak Park, town of Cicero, and city of Berwyn recently received a national award for a project to improve a key arterial road covering the three communities. The strategy involved sharing costs for the planning and construction of a large project to improve Roosevelt Road, the scope of which entailed utility upgrades, roadway resurfacing, streetscaping, sidewalk improvements, high quality light fixtures, etc.... Aside from improving the experience for motorists and pedestrians, it will make the area more appealing as a destination for shoppers and ultimately increase the property and sales tax base. The public investments coincided with a number of private investments whereby new restaurants and national retailers have located to the area shortly after the roadway improvement program began. One of the key insights was that the project would have a greater impact – in terms of shifting perceptions from a "tired" shopping area to a revitalized, more attractive retail district – through larger scale, collective action involving the participation of multiple jurisdictions.

ECONOMIC DEVELOPMENT POLICIES

As discussed below, municipalities may want to consider specific TIF policies or general economic development policies to shape how they invest scarce public dollars in economic development.

ECONOMIC DEVELOPMENT/TIF POLICIES – A BRIDGE BETWEEN STRATEGY AND ACTION

Economic development policies or TIF policies are an important bridge between the high-level strategic plans/land use plans guiding economic development and the detailed transactions involved in redevelopment agreements. On the one hand, strategic plans, comprehensive plans, corridor studies and other visioning exercises may be useful in laying out a future for a previously blighted or underutilized area as well as defining a specific area or neighborhood for redevelopment. At the opposite end of the spectrum, redevelopment agreements specify the terms of a transaction between the municipality and developer that will (hopefully) improve a neighborhood or target area.

Economic development/TIF policies are a useful intermediate step taking a municipality from broad, visionary plans to specific, executed transactions. Moreover, such policies can help protect a municipality in terms of structuring mutually beneficial agreements with developers. The Government Finance Officers Association (GFOA) recommends that municipalities adopt such policies as practical measures to

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Exhibit B
GFOA Best Practice (Excerpt)

DEVELOPING AN ECONOMIC DEVELOPMENT INCENTIVE POLICY

Recommendation. The Government Finance Officers Association (GFOA) recommends jurisdictions using or considering the use of economic development incentives create a policy on the appropriate parameters for use of such incentives and that the finance officer play an active role in the creation of the policy.

Evaluation Process. A clearly defined evaluation process should be outlined in an economic development policy for the purposes of consistency and transparency. Evaluation activities and factors typically include:

a. How a proposal measures up to established economic development criteria;

b. A cost/benefit analysis;

c. An evaluation of tax base impact, both in terms of increases in taxable value and, where a TIF is proposed, the impact on all overlapping taxing jurisdictions;

d. Analysis of the impact of a project on existing businesses;

e. A determination of whether the project would have proceeded if the incentive is not provided.

Performance Standards. An economic development policy should require that specific performance standards be established for each project receiving incentives. Not only will these performance standards help a jurisdiction gauge the effectiveness of its overall economic development program, but may also be used to recover promised financial benefits, through clawbacks or linkage agreements, of recipients failing to fulfill their commitments.

Source: www.gfoa.org

protect the public interest. GFOA recommends that such policies identify (a) specific goals and objectives for TIF and other economic development incentives, (b) the type of incentives/tools to be used and limits on their usage, (c) an evaluation process for staff, (d) performance standards, and (e) monitoring. (See Exhibit B which provides an excerpt on the performance standards.)

Recently, not long after forming its first TIF District the village of Brookfield chose to establish a TIF policy to help manage future redevelopment projects and have a consistent, equitable basis for assessing subsidy requests. Essentially, it viewed village investments as a scarce resource to be selectively employed. The process was straightforward, with village staff, elected officials and the village's consultant setting basic goals and reviewing existing TIF policies, including those outside Illinois (at the time, and still true today, very few Illinois municipalities had a TIF policy in effect) and the GFOA guidelines listed above.

The resulting policy established by the village sets a sound framework for future redevelopment projects. In addition to goals, it establishes a process and basic performance measures it will track, prior to release of funds. Some of the key elements of the policy are as follows:

GENERAL GUIDELINES FOR REDEVELOPMENT PROJECTS

- TIF Act compliance review
- Economic evaluation/risk assessment of all projects
- Establishment of pay-as-you-go and infrastructure-based incentives as preference over bond-financed projects

PROCESS FOR ECONOMIC EVALUATION/ RISK ASSESSMENT

- Analysis prior to board action
- Staff review of documentation (e.g., "proformas") required for the assessment
- Evidence of developer's ability to complete projects in the past

PERFORMANCE MEASURES TO BE USED

- Projected revenues to village
- Leverage ratio (private investment dollars per public dollar invested)
- Financial "gap"/Internal Rate of Return analysis
- Developer equity as a percentage of overall project cost

One of the challenges for the village of Brookfield was determining the level of specificity for the policy, seeking a balance between a rigorous developer review process and maintenance of flexibility. Thus, it did not attempt to set before-the-fact benchmarks (for example, the policy did not specify an Internal Rate of 10-15% for a project with municipal participation, or developer equity at 20% of overall project cost). The policy preserves flexibility for staff to determine specific targets, in consultation with village elected officials.

Illinois municipal leaders are taking a number of actions to reinvigorate their local business development programs.

CONCLUSION

As the economy slowly emerges from the crater of the Great Recession, Illinois municipal leaders are taking a number of actions to reinvigorate their local business development programs. Some of the suggestions offered in this article involve re-assessing familiar tools such as tax increment financing and examining alternative tools such as Business Districts either as a replacement for or supplement to TIF. Newer tools such as economic development/TIF policies (to date, rarely used in Illinois), regional projects involving multiple governments, and market studies would also assist municipalities in laying the foundation for new economic development projects in the coming years.

Nicholas Greifer is a Vice President with Kane, McKenna and Associates, Inc.