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Business Districts Use TIFs to Help with Financing

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Tax Increment Financing (TIF), sales tax financing, and special service areas have all been used to fund public/private partnerships for qualifying real estate development projects. Recent amendments to the Illinois Business District Development and Redevelopment Act (65 ILCS 74.3 et seq) make Business Districts another viable financing tool for developers and an alternative to TIF. As property acquisition and development costs escalate, implementation of a Business District may be the means to achieve the necessary hurdle rate for a development otherwise on the margins of financial viability.

Business District financing is a tool that can enhance TIF revenues or be used instead of other public financing mechanisms, with many less restrictions. A short analysis of other public/private financing mechanisms illustrates advantages of Business District financing under the right circumstances.

TIF Pros

- Captures future real estate tax increment
- Provides bonding authority for funds to pay project costs
- Can be used in conjunction with sales tax financing, Special Service Area financing, and Business District financing

TIF Cons

- Requires a very specific "blight" finding
- Requires a lengthy process involving public hearings, forming a joint review board, and notifying property owners
- Requires the political will of the community and school districts

Yet another public financing vehicle, Special Service Area (SSA) financing, allows the levy of an additional real estate tax on property in a designated area that may be used to pay for public improvements in that area. However, SSA Financing is generally unpopular with commercial users because it financially means a direct increase in property taxes.

Special Service Areas Pros

- SSA tax is an additional real estate tax which is bondable
- Funds are used for improvements in the Area
- SSAs can be created and the SSA tax imposed in a short time frame

Special Service Areas Cons

- Higher property taxes
- Consent of a majority of affected property owners and requires the vote of affected property owners

Sales Tax Financing Pros

- Timeframe is short: no public hearings or land owner consent needed
- Revenue is from existing sales tax, no new tax is imposed
- Generally, very little restriction on the use of the funds
- Minimum statutory requirements must be met

Sales Tax Financing Cons

- No bonding authority, so pay-as-you-go is the only option
- No authority to impose an additional tax

The Business District Act gives municipalities, whether home rule or not, the authority to impose a tax of up to one percent on retail sales in a Business District and to issue bonds supported by the new sales tax to pay for project costs. Previously, a municipality could use a portion of the local share of State sales tax to fund development projects but only pay-as-you-go financing was available – there is no bonding authority.

Financing under the Business District Act has another advantage: it gives municipalities the authority to pledge a portion of the one percent local share of the State sales tax collected within the Business District to support bonds. Without the Business District authority, municipalities could only pledge local sales tax on the pay-as-you-go basis.

Formation of a Business District does not require the consent of the property owners within the district and the sales tax that is levied is paid by those who purchase goods and services in the District. To form a Business District and levy a sales tax in the District, the Act requires that a municipality prepare a plan, hold public hearings, and make a blight finding. However, it must be stressed that a single factor, such as inadequate street layout or obsolete platting, would qualify.

The Act does not define Business District project costs in the same detail as contained in the TIF statute, but refers to the payment of project costs set forth in the Business District Plan adopted by the municipality. Generally, costs reimbursable under the TIF Act would be reimbursable Business District costs if they benefit the district and are contemplated by the plan.

Business District Act Pros

- Provides bonding authority for funds to pay project costs
- Allows an additional sales tax to be imposed
- Allows the local share of sales tax to be pledged and bonded
- Can be used in conjunction with sales tax financing, TIF and SSA financing
- The District can be formed in a short time frame and does not require land owner consent
- Greater latitude in defining eligible costs

Business District Act Cons

- Commercial users might disfavor a higher sales tax
- Requires a "blight" finding, although much more lenient than TIF requirements
- Involves public hearings

Let's say a developer wants to build a 500,000-square-foot shopping center but needs $20 million in a public-private partnership to cover certain on- and off-site project costs and the developer needs immediately available financing rather than pay-as-you-go financing. The site is vacant land that does not otherwise qualify under the TIF statute as blighted. The municipality is willing to pledge a portion of the one percent local share of State sales taxes that would be generated by the new center, but as a non-home rule community it doesn't have the authority to issue bonds based on those sales taxes, nor would the taxes alone be sufficient to generate the net bond proceeds the developer needs when coverage factors are taken into account. If it's found that, for example, there is obsolete platting, or inadequate street layout, a Business District can be formed giving the municipality the authority to impose up to a one percent Business District tax on sales at the new center and the authority to issue Business District bonds to pay for Business District costs. Also, under the authority of the Business District Act, the municipality pledges a portion of the one percent local share of the State sales tax generated by the new center and issues sales tax bonds to pay for project costs. If total sales from the new center are $150 million per year, and the Business District tax is one percent, and the municipality pledges 50 percent of its one percent local share of the State sales tax, then approximately $2.25 million per year will be available to support the $20 million in bonds.

With the recent amendments, the Business District Act has become an important tool for developers in structuring public/private partnerships. Alone or in conjunction with TIF, sales tax financing, and Special Service Areas, Business Districts can be formed to provide developer financing for public/private partnerships that just might make the difference for a successful project.

Deborah A. Faktor, a partner with the Chicago-based law firm Polsky & Associates, Ltd., represents developers and corporations nationwide in public/private financings, including tax increment financing, sales tax financing, and economic development bonds. She provides counsel on the acquisition and sale of commercial and industrial properties, the structuring of public/private partnerships, and the documentation of those transactions. Her corporate work has included acquisitions, mergers, leveraged buy-outs, and a variety of financings such as senior, mezzanine and subordinated debt, debt/equity conversions, preferred stock, and warrants.