

LEVERAGING PROPERTY TAX GROWTH: TAX INCREMENT FINANCING IN TENNESSEE

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I. INTRODUCTION

Local economic development officials face the daunting challenge of attracting new businesses and promoting worthy projects in challenging economic times, when every community in the country is prepared to vigorously compete for any new project. As local economic development officials in Tennessee strive to promote their communities, they try to utilize every possible tool in the economic development toolbox to make their location as attractive as possible. At the local level, however, the breadth of incentives in Tennessee is fairly limited, and the mythical toolbox is not very full.

However, one type of incentive that has become a tool frequently used by local governments in Tennessee to promote economic development is tax increment financing, which is commonly referred to as a “TIF.”¹ While tax increment financing is inherently a broad category, the term generally describes, as to Tennessee, the mechanism by which certain incremental local property tax

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¹ In this Article, the term “tax increment financing” or “TIF” is used to describe any transaction where incremental property tax revenues are used to support a specific project, whether or not an actual financing occurs. As is discussed herein, a property tax increment can, in some cases, be used to directly reimburse a third party for costs incurred in connection with a project, and no actual financing is undertaken. However, because the term “tax increment financing” is so commonly used in the economic development area, that term is used generically in this article to describe any tax increment transaction, whether or not a financing actually occurs.

revenues² that are created within a designated area are allocated to a tax increment agency to be used to assist in the payment of costs related to a specified project. The tax increment financing process essentially diverts local property taxes from the coffers of a taxing entity, such as a city or county, to provide support to a specific project.³

Because tax increment financing has not been used widely in Tennessee until recently, little has been written about the applicable laws in this area. The goal of this article is to provide an overview, from a legal perspective, of how tax increment financing is undertaken in Tennessee. It is not our goal to argue, from an economic development perspective, whether the use of tax increment financing is wise or wasteful, as that discussion is well beyond the scope of this article. Suffice it to say that use of tax increment financing to support a project frequently generates acute public interest and community discussion, and economic development officials will be well served to understand the legal underpinnings of the TIF process to be able to respond to the inevitable inquiries that arise relating to the utilization of a TIF. This article will hopefully help inform not only legal practitioners in this area, but also provide a resource to local government officials and developers that are considering a tax increment financing.

II. WHY USE TAX INCREMENT FINANCING?

A. *Tax Abatement Versus Tax Increment Financing*

While there are not many incentive tools at the local level in the economic development toolbox, the primary tool that has historically been used by local governments to incentivize the location of a business or the undertaking of a

² In Tennessee, the only property taxes that are imposed are local property taxes, as no property tax has been imposed at the state level. Property taxes in Tennessee can generally be imposed by cities, counties, and, in certain areas of the State, special school districts. The property taxes imposed by any of these entities can be subjected to tax increment financing.

³ Generally, state law in Tennessee does not authorize taxes other than property taxes to be utilized in connection with a tax increment financing transaction. For example, sales taxes, occupancy taxes, and other business taxes cannot be paired, in most cases, with property taxes as part of a tax increment financing in Tennessee. There are a few statutes that permit incremental sales taxes from certain types of projects to be used to pay debt service on debt incurred to finance those types of projects, but those statutes are generally limited to unique facilities such as stadiums and similar large public facilities.

desired project is tax abatement.⁴ Local industrial development boards created by cities and counties have broad authority to abate local property taxes in Tennessee. This economic development tool has been very effective in helping local governments in Tennessee attract economic development prospects and compete with other states in the economic development arena.

Tax abatement, however, has some inherent limitations that make it a less valuable economic development tool in certain situations. For example, to accomplish tax abatement in Tennessee, the property that is the subject of the tax abatement must be transferred to a local governmental entity, typically an industrial development board. Some economic development prospects find the transfer of the ownership of their property to be troubling, and such a transfer can sometimes make the financing of the project more challenging. While these concerns can usually be addressed satisfactorily with most prospects, tax increment financing does not require any transfers of property; so these issues as to property ownership never arise.

A second limitation of tax abatement as an incentive is that it is limited to the property taxes that would be realized from the particular property that is transferred to the local government entity. If an economic development project substantially increases the value of adjoining property, without any action by the adjoining property owner, a tax abatement transaction cannot capture the incremental property tax growth in property taxes from the adjoining property as part of an economic incentive transaction even though the property tax growth was the result of the project that is being incentivized.

From a public perception standpoint, tax abatement often has negative connotations as compared to tax increment financing. Tax increment financing results in the application of incremental property tax revenues to the payment of specific costs, often public improvements, related to the project being incentivized. This targeted application of taxes, which otherwise would not be realized except for the project being incentivized, is sometimes more palatable to a community than tax abatement, in which a private party receives a direct subsidy for an unspecified purpose.

⁴ See G. Mark Mamantov, *Abating Property Taxes in Tennessee: An Essential Tool in the Economic Development Toolbox*, 4 TRANSACTIONS: TENN. J. BUS. L. 89 (2003) (discussing the tax abatement process in Tennessee).

Most importantly, it is very difficult to monetize upfront the value of a tax abatement transaction.⁵ In many cases, a project needs the infusion of an upfront incentive, not the deferred benefit of tax abatement, in order to be successful. Because tax increment financing typically results in the upfront monetization of the property tax growth resulting from a particular project, tax increment financing can often fill the funding gap that many projects must close in order to be viable.

Tax abatement can be a more effective development tool under many circumstances. Because the economic benefit of tax abatement is not generally limited to incremental taxes created by a project, it can be a more valuable incentive to a prospect, particularly a prospect that does not need to monetize the incentive upfront. Generally, a tax abatement transaction is easier to document and requires fewer approvals than a tax increment financing. As a result, a tax abatement transaction can be less costly to implement than a tax increment financing. But in many cases, tax increment financing will be a viable alternative for a community to consider to incentivize a project for the reasons discussed above.

B. *The Basic Economics of a TIF*

The basic concept of tax increment financing is generally easy to comprehend, but it is helpful to illustrate the mechanics of a tax increment calculation in order to provide a deeper understanding of how a TIF functions. The following chart shows a hypothetical calculation of the property tax increment allocable to support a project for a ten-year period. This calculation is typical for a retail development project where a building for an anchor tenant is constructed and then additional adjacent retail space is developed along with outparcels, thereby increasing the available property taxes in the first several years of the calculation.

⁵ It is possible for an industrial development board to negotiate an annual payment in lieu of tax from an economic development prospect and to monetize upfront the value of those payments in lieu of taxes by borrowing against the revenue stream created by those payments. Such a transaction is often difficult to accomplish because of the possibility that the payments in lieu of taxes could terminate as a result of a default, but such transactions are feasible, particularly with a prospect with strong credit. Such a transaction is essentially an alternative method for accomplishing tax increment financing.

Year	Current (Base) Taxes	Forecasted Real Estate Taxes (City)	Forecasted Real Estate Taxes (County)	Forecasted Personal Property Taxes (City)	Forecasted Personal Property Taxes (County)	Less Amount Allocable to City and County Debt Service	Allocable Increment
2015	\$1,000.00	\$60,000.00	\$93,714.29	\$9,000.00	\$14,057.14	(\$35,354.29)	\$140,417.14
2016	\$1,000.00	\$100,000.00	\$156,190.48	\$13,000.00	\$20,304.76	(\$57,899.05)	\$230,596.19
2017	\$1,000.00	\$250,000.00	\$390,476.19	\$30,000.00	\$46,857.14	(\$143,466.67)	\$572,866.67
2018	\$1,000.00	\$265,000.00	\$413,904.76	\$27,723.00	\$43,300.69	(\$149,985.69)	\$598,942.76
2019	\$1,000.00	\$290,000.00	\$452,952.38	\$24,945.16	\$38,961.96	(\$161,371.90)	\$644,487.59
2020	\$1,000.00	\$375,000.00	\$585,714.29	\$24,728.13	\$38,622.99	(\$204,813.08)	\$818,252.33
2021	\$1,000.00	\$400,000.00	\$624,761.91	\$21,127.72	\$32,999.48	(\$215,777.82)	\$862,111.28
2022	\$1,000.00	\$400,000.00	\$624,761.91	\$16,543.00	\$25,838.59	(\$213,428.70)	\$852,714.80
2023	\$1,000.00	\$400,000.00	\$624,761.91	\$14,136.00	\$22,079.08	(\$212,195.40)	\$847,781.58
2024	\$1,000.00	\$400,000.00	\$624,761.91	\$12,964.12	\$20,248.72	(\$211,594.95)	\$845,379.80

The legal underpinning for each column in this chart will be developed more thoroughly throughout this article. At this point, we will focus on the economics of the transaction. In this hypothetical TIF example, the taxes on the areas subject to the tax increment financing prior to the approval of the financing, which are referred to as the base taxes, are only \$1,000. Such a minimal tax payment is fairly common for retail developments on property that was previously used for agricultural purposes. This hypothetical TIF calculation assumes that the property is located within both a city as well as a county,⁶ and therefore, the projected property tax revenues for each of the city and county are shown. These taxes increase in the first six years of the calculation on the assumption that the area subject to the tax increment financing will be developed in stages, as is described above. Columns for both real property taxes and personal property taxes are shown.⁷ A hypothetical amount of the incremental tax revenues that is dedicated to pay the city and the county’s debt service on

⁶ In Tennessee, unlike some states, all property will be located within and taxed by a county even if the property is also within the corporate limits of a city unless the county and the city have adopted a metropolitan form of government. Property may also be located in and subject to tax by an incorporated city. Some smaller cities in Tennessee do not impose a property tax, but many cities do impose property taxes.

⁷ As will be discussed herein, tax increment financing undertaken by industrial development boards can include the increment created by personal property taxes, while housing authorities are not clearly authorized to capture the increment created by personal property taxes.

their own indebtedness is subtracted from the otherwise available increment.⁸ The remainder, which is shown in the last column as the allocable increment, would be available to pay debt service on a tax increment debt obligation incurred to finance project costs relating to the area subject to the tax increment financing.

The developer of the project area subject to this hypothetical tax increment financing calculation will typically facilitate a borrowing against the income stream created by the allocable tax increment.⁹ While lending criteria vary widely among lenders that purchase tax increment financing obligations, most lenders will require a reasonable coverage of allocable incremental taxes to projected debt service payments as a condition of lending. A projected coverage ratio of 1.2 times the annual projected debt service on the tax increment obligation is a fairly common requirement among lenders. Taking into account this likely coverage requirement and interest expense, a developer will likely realize an upfront amount equal to only 60% to 80% of the total allocable tax increment over the tax increment period as an upfront contribution to project costs. In other words, the upfront amount realized from the tax increment is essentially a present value calculation of the projected allocable tax increment, and the higher the present value factor applied to such revenues (due to a high coverage requirement or high interest rate), the lower the amount realized upfront as a cash infusion into the targeted project.

III. THE STATUTORY STRUCTURE

A. *Overview of Relevant Statutes*

Generally, two types of local governmental instrumentalities are authorized in Tennessee to undertake tax increment financings.¹⁰ The first type

⁸ The requirement to subtract the city and county debt service component is discussed later in this article.

⁹ While it is not common, some communities, instead of the private developer of a project, will take the lead in trying to locate a lender for tax increment financing to support a project that is perceived to be particularly important to a community. However, in the large majority of transactions, the private developer of a project will initiate and arrange the tax increment financing.

¹⁰ The Community Redevelopment Act of 1998, 1998 Tenn. Pub. Acts 987, also authorizes entities known as community redevelopment agencies to undertake tax increment financing. By its terms, the Community Redevelopment Act only applies to Shelby County at this time, and therefore has very limited application and will not be discussed in detail herein. Mysteriously, the Community Redevelopment Act was not codified. In at least one city, being Johnson City, the tax increment financing powers of the local housing authority have been delegated to a redevelopment authority created by private act in addition to the local housing authority. 1985 Tenn. Private Acts 52.

of such instrumentality is a housing authority. Housing authorities are created under and governed by Chapter 20 of Title 13 of the Tennessee Code Annotated (the “Housing Authorities Law”). Generally, any city or county in Tennessee can create a housing authority, and most cities in Tennessee have created a housing authority in order to facilitate the development of low-income and/or elderly housing projects, many of which are subsidized by the federal government. While most cities have created housing authorities, few housing authorities have actively utilized their statutory powers to promote redevelopment in addition to housing. These redevelopment powers of housing authorities include the authority to undertake tax increment financing to promote the redevelopment of blighted areas.

Housing authorities have had the authority to utilize tax increment financing as part of their redevelopment activities since 1945. However, few housing authorities other than the housing authorities in Nashville and Knoxville have actively utilized this tool. Some communities wanting to utilize tax increment financing to help promote the redevelopment of blighted areas have found that their first hurdle is to convince their local housing authority to assist in achieving their goals.

The other type of local governmental instrumentality that has the authority to undertake tax increment financing is an industrial development corporation, which is more commonly known as an industrial development board or IDB. Any city or county in Tennessee may create an industrial development board under Chapter 53 of Title 7 of the Tennessee Code Annotated (the “IDB Act”), and most counties and many cities in Tennessee have created industrial development boards.¹¹

In 2004, the IDB Act was amended to add a provision that authorizes IDBs to utilize tax increment financing to promote economic development projects. Since the enactment of the provision, a number of IDBs across Tennessee have utilized this provision to assist in promoting industrial growth, retail development, and corporate relocations.

¹¹ An industrial development board created by a county can exercise its powers throughout that county, whether or not an industrial development board has been created by a city within that county. Whether an industrial development board created by a county or city can exercise its powers outside of the county or city that created the board is not expressly addressed in the IDB Act, but many industrial development boards have exercised their powers outside the jurisdiction in which they have been created when requested to do so in a jurisdiction that has not created an industrial development board.

In 2012, as the use of tax increment financing became more prevalent in Tennessee, the Tennessee General Assembly, with the encouragement of the Comptroller of the State, adopted legislation to harmonize and clarify some of the key provisions relating to tax increment financing by housing authorities and IDBs. This legislation was codified as Chapter 23 of Title 9 of the Tennessee Code Annotated and was designated the Uniformity in Tax Increment Financing Act of 2012 (the “Uniformity Act”).

While the TIF authorization process for housing authorities and IDBs is quite similar, particularly after the enactment of the Uniformity Act, there are material differences between the two types of entities as to tax increment financing. For example, the types of costs that can be financed and the term for allocating tax increment revenues can differ among the two entities. Therefore, an analysis of the respective statutes, taking into account the overlay of the Uniformity Act, is essential to understanding the tax increment financing process in Tennessee.

B. *The TIF Approval Process for a Housing Authority*

Housing authorities are generally authorized under the Housing Authorities Law to undertake “redevelopment projects” within their jurisdiction.¹² While the Housing Authorities Law is not explicit on this point, it is clear that the intent of the Housing Authorities Law is that a housing authority can only undertake a redevelopment project with respect to an area that is a “blighted area.” Section 13-20-201 of the Housing Authorities Law defines “blighted areas” as “areas, including slum areas, with buildings or improvements that, by reason of dilapidation, obsolescence, overcrowding, lack of ventilation, light and sanitary facilities, deleterious land use, or any combination of these or other factors, are detrimental to the safety, health, morals, or welfare of the community.”¹³

In furtherance of a redevelopment project, a housing authority is permitted to undertake a number of activities. These activities generally include:

- The acquisition of real property that is blighted or that is needed to reduce blight;¹⁴

¹² TENN. CODE ANN. § 13-20-202 (2012).

¹³ TENN. CODE ANN. § 13-20-201(a).

¹⁴ TENN. CODE ANN. § 13-20-202(a)(1)-(3); *see also* Knoxville’s Community Dev. Corp. v. County of Knox, No. 733, 1987 Tenn. App. LEXIS 3080, at *10 (Tenn. Ct. App. Nov. 19, 1987) (holding that a housing authority may acquire property by lease or in fee simple and holding further that such property acquired by the housing authority will still be entitled to the tax increment financing

- Clearing property for redevelopment;¹⁵
- Installation or relocation of streets, utilities and site improvements needed to prepare and development sites for redevelopment;¹⁶
- Installation or improvements of parks, public open spaces, public playgrounds, pedestrian ways and all parking structures, regardless of use;¹⁷ and
- Relocation, administrative, engineering and energy conservation expenses in connection with a redevelopment project.¹⁸

Before undertaking a redevelopment project, a housing authority must first prepare a redevelopment plan for the area in which the redevelopment project is located. A redevelopment plan is a document that outlines the proposed development or redevelopment of an area within the housing authority's boundaries. The plan must specifically describe the boundaries of the plan area and include detail regarding:

- The relationship of the plan to local objectives for land use, traffic, public transportation, public utilities, recreational and community facilities and other public improvements;¹⁹
- Land use and building requirements in the redevelopment area;²⁰ and

provisions under TENN. CODE ANN. § 13-20-205 if it is leased or sold to private developers pursuant to the development project).

¹⁵ TENN. CODE ANN. § 13-20-202(a)(4)(A).

¹⁶ TENN. CODE ANN. § 13-20-202(a)(4)(B).

¹⁷ TENN. CODE ANN. § 13-20-202(a)(4)(C). It is important to note that the statute explicitly states that parking structures may be undertaken as part of a redevelopment project, irrespective of the use, which indicates that parking that will be privately controlled is a permissible cost of a redevelopment project. This interpretation is consistent with the Uniformity Act, which treats private parking as public infrastructure. *See* TENN. CODE ANN. § 9-23-102(15) (2012).

¹⁸ TENN. CODE ANN. § 13-20-202(a)(4)(D). If a redevelopment plan is also designated as an urban renewal plan under the Housing Authorities Law, a housing authority may also use tax increment financing to finance urban renewal projects, which expand further the scope of activities that can be undertaken by a housing authority with tax increment financing. *See* TENN. CODE ANN. §§ 13-20-202(a)(8), 210.

¹⁹ TENN. CODE ANN. §§ 13-20-203(a)(1)(A), (b)(1)(A)(i). The Housing Authorities Law differentiates slightly in the process for adopting redevelopment plans for metropolitan governments of a certain size (presently only the Metropolitan Government of Nashville and Davidson County would fit in this category) and all other jurisdictions. Parties undertaking a tax increment financing in any such metropolitan government should note carefully such procedural differences.

²⁰ TENN. CODE ANN. § 13-20-203(a)(1)(B), (b)(1)(A)(ii).

- The relocation of any residents displaced by redevelopment projects.²¹

The adoption of a redevelopment plan for an area does not automatically authorize the use of tax increment financing in that area. The redevelopment plan must specifically authorize the use of tax increment financing in the redevelopment area. If the plan authorizes the use of tax increment financing, the plan must also include the following information:

- An estimate of redevelopment project costs;²²
- A description of the sources of revenues to be used to finance the costs of redevelopment projects, including the estimated tax increment;²³
- An estimate of the amount and final maturity of any TIF;²⁴ and
- An estimate of the impact of TIF on any affected taxing agency.²⁵

To become effective, a redevelopment plan must be approved by the governing body of each city in which any part of the redevelopment project is located.²⁶ If the redevelopment plan includes a tax increment financing provision that is applicable to county property taxes, the governing body of that county must also approve the plan.²⁷ Prior to the approval of the redevelopment plan, the governing body of the city or a designated agency (frequently the housing authority) must hold a public hearing to determine the necessity for the redevelopment plan.²⁸ Prior notice of the time, place, and purpose of the public hearing, along with details of how a map of the plan area and information relating to the tax increment financing required above can be viewed by the public, must be published in a local newspaper and mailed to owners or occupants within the boundaries of the proposed redevelopment plan.²⁹

Once a redevelopment plan with tax increment financing provisions has been adopted, incremental property tax revenues will be allocated to the housing authority as provided in the redevelopment plan. The housing authority may issue notes or other indebtedness to finance any redevelopment project and

²¹ TENN. CODE ANN. § 13-20-203(a)(1)(C), (b)(1)(A)(iii).

²² TENN. CODE ANN. § 13-20-205(b)(1)(A).

²³ TENN. CODE ANN. § 13-20-205(b)(1)(B).

²⁴ TENN. CODE ANN. § 13-20-205(b)(1)(C).

²⁵ TENN. CODE ANN. § 13-20-205(b)(1)(D).

²⁶ TENN. CODE ANN. §§ 13-20-203(a)(1), (b)(1)(A), 205(c)(1).

²⁷ Inferentially, if the redevelopment plan does not contemplate applying tax increment financing to taxes levied by the applicable county, approval by the governing body of the county is not required.

²⁸ TENN. CODE ANN. § 13-20-203(a)(3), (b)(3).

²⁹ TENN. CODE ANN. §§ 13-20-203(a)(3), (b)(3), 205(c)(2).

secure the payment of such indebtedness with specific revenues, including incremental tax revenues. No further approval or action is needed from the governing body of any city or county to undertake a tax increment financing.

C. *The TIF Approval Process for an IDB*

Section 7-53-312 of the IDB Act authorizes IDBs to undertake tax increment financing.³⁰ The process for authorizing tax increment financing under the IDB Act is very similar to the process under the Housing Authorities Law, which is not surprising given that the relevant provisions of the IDB Act were modeled after the Housing Authorities Law. However, the terminology used in the IDB Act is quite different, and there are some substantive differences between the two statutes.

Instead of using a redevelopment plan, an IDB can only implement tax increment financing by preparing an economic impact plan. The plan must specifically identify the area subject to the plan. That area must include an industrial park or a project, within the meaning of the IDB Act, that is owned by the IDB or to which the IDB is providing financial assistance. Generally, the use of tax increment financing can serve as the financial assistance provided by the IDB for the project.

A broad range of facilities and improvements qualify as a project within the meaning of the IDB Act. Because the IDB Act requires a liberal construction,³¹ most capital projects will qualify as a “project” within the meaning of the IDB Act and thus may be assisted with tax increment financing. Without limitation, the term “project” includes essentially any type of commercial enterprise,³² manufacturing facilities³³, office buildings,³⁴ amusement parks,³⁵

³⁰ Technically, TENN. CODE ANN. § 7-53-312 (2012) does not apply to counties that have a metropolitan form of government and have a population in excess of 500,000. Currently, only the Metropolitan Government of Nashville and Davidson County falls within this classification. TENN. CODE ANN. § 7-53-314 (2012) is essentially an identical statute that applies to counties that **do** have a metropolitan form of government and a population exceeding 500,000. The differences between TENN. CODE ANN. § 7-53-312 and TENN. CODE ANN. § 7-53-314 are inconsequential, as they are procedural in nature, and are therefore not discussed in this article. However, anyone undertaking a tax increment financing in the Metropolitan Government of Nashville and Davidson County should note any differences between the statutes.

³¹ TENN. CODE ANN. § 7-53-102(b) (2012).

³² TENN. CODE ANN. § 7-53-101(13)(A)(ii); *see also* Small World, Inc. v. Industrial Development Board, 553 S.W.2d 596, 601 (Tenn. Ct. App. 1976) (holding that a retail store is a permissible project under the IDB Act).

³³ TENN. CODE ANN. § 7-53-101(13)(A)(i).

multifamily housing facilities to be occupied by persons of low or moderate income,³⁶ and pollution control facilities,³⁷ including wastewater collection and treatment facilities.

The IDB Act specifies what information must be included in an economic impact plan. Particularly, in addition to identifying the area subject to the plan, the plan must identify the specific project to be located within the plan area.³⁸ The area that is subject to the plan may include, in addition to the project, any other properties that the IDB determines will be directly improved or benefited due to the undertaking of the project.³⁹ Furthermore, the plan must discuss the expected benefits to the municipality from the development of the area subject to the plan, including anticipated tax receipts and jobs created.⁴⁰ Finally, the plan must explain the mechanics of allocating the incremental property taxes from the plan area during the time specified in the plan.⁴¹

Prior to submitting the plan to any local government for approval, the IDB is required to hold a public hearing related to the plan.⁴² At least two weeks prior to the public hearing, the IDB must publish notice of the hearing in a local newspaper.⁴³ The notice must include the time, place, and purpose of the hearing and details of how a map of the plan area can be viewed by the public.⁴⁴

After the IDB holds a public hearing on the plan, the IDB must submit the plan to be approved by the governing body of the city or county that created the IDB.⁴⁵ Furthermore, the plan must be approved by any other taxing authority (such as a county if the IDB was created by a city) whose taxes are to be allocated to the IDB under the plan.⁴⁶ Thus, approval is required by each taxing authority if the taxes otherwise payable to such taxing authority are to be allocated to the IDB under the plan. On the other hand, approval is not required by a taxing

³⁴ TENN. CODE ANN. § 7-53-101(13)(A)(iv), (v).

³⁵ TENN. CODE ANN. § 7-53-101(13)(A)(ix).

³⁶ TENN. CODE ANN. § 7-53-101(13)(A)(x).

³⁷ TENN. CODE ANN. § 7-53-101(13)(C).

³⁸ TENN. CODE ANN. § 7-53-312(b)(2) (2012).

³⁹ TENN. CODE ANN. § 7-53-312(b).

⁴⁰ TENN. CODE ANN. § 7-53-312(b)(3).

⁴¹ TENN. CODE ANN. § 7-53-312(b)(4).

⁴² TENN. CODE ANN. § 7-53-312(g).

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ TENN. CODE ANN. § 7-53-312(a), (c), (f).

⁴⁶ TENN. CODE ANN. § 7-53-312(f).

authority if the taxes due to such taxing authority are not allocated to the IDB under the plan.

The IDB Act allows incremental tax revenues allocated to it under an economic impact plan to be applied to pay a wide variety of costs. Those costs include expenses of the IDB to promote economic development, the cost of any project within the meaning of the IDB Act, or debt service on debt incurred by the IDB to pay any costs of a project.⁴⁷ However, the ability of an IDB to pay such costs is somewhat limited by the Uniformity Act, as is described below. An IDB is specifically authorized to pledge incremental tax revenues allocated to it under an economic impact plan to the payment of debt incurred by the IDB to finance costs of any project.⁴⁸

D. *The Uniformity Act Overlay*

By enacting the Uniformity Act, the Tennessee General Assembly established more specific parameters for the different types of tax increment financing authorized under existing law.⁴⁹ The basic provisions for developing and submitting a redevelopment plan or economic impact plan were not changed. However, the new law (as its name suggests) sought to bring uniformity by specifying baseline allowable standards for most TIFs (such as term length and eligible costs) that do not require explicit approval by the applicable state officials. The Uniformity Act also added consistency by requiring central filing of TIF plans with the state, providing uniform calculation of the incremental tax calculation, and by creating the opportunity for local governments to cover administrative costs relating to TIFs.⁵⁰ Below is a summary of five of the key provisions of the Uniformity Act.

1. Mechanics of Base Tax Calculations and Allocations

Before the Uniformity Act, the Housing Authorities Law permitted housing authorities to determine the base amount of taxes allocated to local governments under a redevelopment plan based upon the assessment in place prior to the adoption of the plan and not upon the taxes imposed prior to the adoption of the plan.⁵¹ If the base assessment approach was used, the periodic

⁴⁷ TENN. CODE ANN. § 7-53-312(h).

⁴⁸ *Id.*

⁴⁹ TENN. CODE ANN. §§ 9-23-101-108 (2012).

⁵⁰ TENNESSEE COMPTROLLER OF THE TREASURY, ROADMAP TO TAX INCREMENT FINANCING (2012), available at http://www.comptroller.tn.gov/repository/NR/4_PageRoadmap.pdf.

⁵¹ TENN. CODE ANN. § 13-20-205 (2012).

reappraisal of properties that occurs every four years in Tennessee could result in an increment arising within a redevelopment area even if no improvements had been undertaken within the redevelopment area. This unexpected increment that was not the result of redevelopment was obviously problematic for municipalities. Under the Uniformity Act, the local taxing agencies will always get the base amount of taxes that were imposed on property subject to a redevelopment plan prior to the approval of the plan, and this risk of an unexpected increment arising was eliminated.⁵²

The Uniformity Act also clarified that the portion of the incremental taxes designated by each taxing agency to pay debt service on its debt obligations will not be allocated to a housing authority or IDB. This portion of the incremental taxes is referred to in the Uniformity Act as “dedicated taxes.”⁵³ This portion of the incremental taxes is usually simple to identify for counties, which are required to identify the portion of their property tax levy dedicated to the payment of debt service. For cities that are not required to specify the portion of their property taxes dedicated to debt service, the Uniformity Act permits cities to designate the applicable amount in an appropriate certificate.⁵⁴

The Uniformity Act also gave housing authorities and IDBs more flexibility in structuring tax increment financings. Specifically, the Uniformity Act authorizes a housing authority or IDB to calculate the allocable tax increment on a parcel-by-parcel basis or on an aggregate basis for an entire plan area.⁵⁵ The methodology selected for this purpose can result in materially different amounts in terms of available increment. Furthermore, plans may vary the timing of the commencement of the tax increment allocation among parcels or parcel groups to coincide with the different phases of the development construction and allow the development to maximize the benefit of the tax increment financing.⁵⁶ The Uniformity Act also clarifies that any penalties or interest relating to delinquent tax payments are pro rated among the respective amounts payable to the taxing entities and the applicable housing authority or IDB, unless the relevant plan provides otherwise.⁵⁷

Furthermore, the Uniformity Act specifically established that up to five percent (5%) of tax increment revenues may be set aside for administrative

⁵² TENN. CODE ANN. § 9-23-103(a)(1).

⁵³ *Id.*

⁵⁴ TENN. CODE ANN. § 9-23-103(g).

⁵⁵ TENN. CODE ANN. § 9-23-103(d).

⁵⁶ *Id.*

⁵⁷ TENN. CODE ANN. § 9-23-103(f).

expenses relating to the TIF incurred by the housing authority or IDB or any taxing agency.⁵⁸ The Uniformity Act also clarified that a redevelopment plan or economic impact plan can provide that less than the full amount of the otherwise allowable increment be allocated to the applicable housing authority or IDB.⁵⁹ This provision means that a city or county can provide that a certain percentage or amount of the increment that otherwise would be payable to a housing authority or IDB will be withheld by the city or county for general governmental purposes.⁶⁰

2. Time Limitations on Allocations

The Uniformity Act also implemented general maximum time periods in which tax increment revenues could be allocated as to any parcel covered by a plan. An IDB is generally limited to an allocation of 20 years under an economic impact plan as to any property, and a housing authority is generally limited to an allocation of 30 years under a redevelopment plan.⁶¹ However, a longer time period is available if the Comptroller and the Commissioner of Economic and Community Development determine in writing that a longer time period is in the best interest of the State (i.e., reasonably necessary for plan completion).⁶² Furthermore, if the written determination approving or denying the longer term is not rendered within 30 days from the request for such approval, the longer term is deemed approved.⁶³

3. Eligible Expenditures for an IDB TIF

The Uniformity Act also limited the types of costs that can be paid by an IDB with incremental tax revenues allocated to it under an economic impact plan without the approval of the Comptroller and the Commissioner of Economic and Community Development.⁶⁴ The language in the Uniformity Act on this issue is difficult to parse, but generally, the Uniformity Act allows “public infrastructure” to be financed with tax increment financing without receiving any State approvals.⁶⁵ Fortunately, “public infrastructure” is broadly defined to include

⁵⁸ TENN. CODE ANN. § 9-23-105.

⁵⁹ TENN. CODE ANN. § 9-23-103(b).

⁶⁰ *Id.*

⁶¹ TENN. CODE ANN. § 9-23-104.

⁶² TENN. CODE ANN. §§ 9-23-102(2)(B), 104.

⁶³ TENN. CODE ANN. § 9-23-104.

⁶⁴ TENN. CODE ANN. §§ 9-23-102(5)-(6), 108.

⁶⁵ TENN. CODE ANN. § 9-23-108.

“roads, streets, publicly-owned or privately-owned parking lots, facilities or garages, traffic signals, sidewalks or other public improvements that are available for public use, utility improvements and storm water and drainage improvements, whether or not located on public property or a publicly-dedicated easement, that are necessary or desirable, as determined by the [housing authority or IDB].”⁶⁶ If a proposed expenditure is not for “public infrastructure”, the expenditure generally can still be made with tax increment financing if it is for a capital expenditure on public property.⁶⁷ If the expenditure is on private property or is for general economic development purposes (and not a project expenditure), and is not for “public infrastructure,” the expenditure can only be made with the proceeds of tax increment financing if the Comptroller and the Commissioner of Economic and Community Development determine that such purposes are in “the best interest of the state” (which is defined as “the project would not have occurred but for the payment, expenditure or financing”).⁶⁸ Again, if the written determination approving or rejecting the proposed use is not rendered within 30 days, the use is deemed approved.⁶⁹

4. Central Reporting

The Uniformity Act also imposes uniform reporting requirements for all TIFs. After the TIF plan is approved, the housing authority or IDB must file with the Comptroller and each applicable tax assessor: (i) a description of all property within the TIF plan, (ii) a copy of the resolutions approving the TIF plan, and (iii) the base tax amounts for all property within the TIF plan.⁷⁰ Additionally, the TIF agency must annually file with the Comptroller a statement of all tax incremental revenues allocated to the TIF agency.⁷¹

5. Policies and Procedures

Even with the many helpful provisions in the Uniformity Act, there are many unanswered questions relating to the development of a tax increment financing program that are not addressed in any of the relevant statutes. Helpfully, the Uniformity Act provides that any taxing agency and housing authority or IDB may establish policies and procedures for allocating and calculating tax increment revenues and implementing TIFs as long as such

⁶⁶ TENN. CODE ANN. § 9-23-102(15).

⁶⁷ TENN. CODE ANN. § 9-23-108.

⁶⁸ TENN. CODE ANN. §§ 9-23-102(2)(A), 108.

⁶⁹ TENN. CODE ANN. § 9-23-108.

⁷⁰ TENN. CODE ANN. § 9-23-106 (2012).

⁷¹ *Id.*

policies and procedures comply with the Uniformity Act and the other TIF authorizing statutes.⁷²

E. The Pros and Cons of a Housing Authority TIF Versus an IDB TIF

After the enactment of the Uniformity Act, the substantive differences between a tax increment financing under the Housing Authorities Law and a tax increment financing under the IDB Act are fairly limited. However, some differences remain, and if a project is eligible for support from tax increment financing under either statute, the parties involved should consider which statute best fits their goals related to the financing of the project.

The statutes authorizing a housing authority to utilize tax increment financing are more favorable in a number respects. As mentioned above, the maximum allocation period for a tax increment financing is 30 years for a housing authority, in contrast to 20 years for an IDB, without receiving any approvals from State officials.⁷³ Also, the Uniformity Act does not require a housing authority to receive approval from any State official of any expense that otherwise would be eligible for financing under the Housing Authorities Law, whether or not that expense is with respect to private property. The Housing Authorities Law provides specific authority to housing authorities to assist a redevelopment project by reducing land acquisition costs, which can be financed with tax increment financing, to support a redevelopment project.⁷⁴ An IDB can only accomplish a reduction in land acquisition costs for a project with the appropriate approval of State officials.⁷⁵ Finally, most IDBs generally consist of volunteers and do not have any full-time staff to assist with projects. Most housing authorities have some full-time staff to assist with the implementation of redevelopment projects.

There are also potential advantages to utilizing an IDB for a tax increment transaction. The most obvious is that an IDB can undertake a transaction in an area that is not blighted. Secondly, a redevelopment plan generally gives the housing authority the power to condemn blighted properties within the plan area in connection with undertaking a redevelopment project.⁷⁶ An IDB does not have eminent domain powers, even if an economic impact plan is approved, and some property owners within a plan area may prefer not to be subject to the risk

⁷² TENN. CODE ANN. § 9-23-107.

⁷³ TENN. CODE ANN. § 9-23-104.

⁷⁴ TENN. CODE ANN. § 13-20-204(a) (2012).

⁷⁵ TENN. CODE ANN. § 9-23-108.

⁷⁶ See TENN. CODE ANN. § 13-20-212.

of condemnation. The potential uses of proceeds of tax increment financing by IDBs remains very broad with the approval of the appropriate State officials, and it may be necessary to utilize an IDB for a tax increment financing in order to finance certain eligible costs. Finally, an IDB does not technically need to borrow to implement a tax increment financing. Under the IDB Act, incremental tax revenues allocated to an IDB can be used to directly reimburse project costs without the necessity of a borrowing.⁷⁷ Under the Housing Authorities Law, all incremental tax revenues allocated to a housing authority must be deposited in a special fund to be used to pay debt service on debt incurred by the housing authority to pay the cost of a redevelopment project.⁷⁸ Finally, it is not clear whether personal property taxes can be included in the tax increment under the Housing Authorities Law, while it is clear that such taxes may be included under the IDB Act.

Each project and community is unique, and the best vehicle for utilizing tax increment financing will depend on the particular facts relating to the project in question. However, housing authorities have proven to be very effective conduits for implementing tax increment financing to support redevelopment projects in inner city areas, particularly if the project involves the write down of land acquisition costs to make a project viable. IDBs are typically better suited for implementing tax increment financing to support retail development in undeveloped areas and to provide incentives that support industrial recruitment and corporate relocations.

IV. Constitutional Issues

When a community first undertakes a tax increment financing, local officials will often need to educate themselves regarding the legal requirements relating to tax increment financing. One of the first questions that local officials frequently ask is whether tax increment financing is constitutional under Tennessee law. The seminal case upholding the constitutionality of tax increment financing is *Metropolitan Development & Housing Agency v. Leech*.⁷⁹ In *Leech*, the Tennessee Supreme Court considered a number of attacks on the constitutionality of tax increment financing based primarily on the following three clauses of Article II, Sections 28 and 29 of the Tennessee Constitution: (1) the equal taxation clause, (2) the public purpose clause, and (3) the lending of credit

⁷⁷ TENN. CODE ANN. § 7-53-312(h) (2012).

⁷⁸ TENN. CODE ANN. § 13-20-205(a)(2).

⁷⁹ *Metro. Dev. & Hous. Agcy. v. Leech*, 591 S.W.2d 427 (Tenn. 1979).

clause.⁸⁰ The Tennessee Supreme Court found that tax increment financing withstood scrutiny under each of those clauses.

A. Equal Taxation Clause

Article II, Section 28 provides that “all property, real, personal or mixed shall be subject to taxation” (subject to certain exceptions not applicable in tax increment financing).⁸¹ This section further provides that the ratio of assessment to value of similarly situated property “shall be equal and uniform throughout the State” and “[e]ach respective taxing authority shall apply the same tax rate to all property within its jurisdiction.”⁸² Furthermore, Article II, Section 29 provides that “all property shall be taxed according to its value....”⁸³ These constitutional provisions essentially require uniform taxation of similarly situated properties and prevent local governments from picking and choosing which properties to tax.

The petitioners in *Leech* argued that the Housing Authorities Law violated Sections 28 and 29 because it diverted taxes collected on the redevelopment property for specific expenditures related to the property rather than paying for general county and municipal services.⁸⁴ In other words, the redevelopment property contributed less, in proportion to its value, to the cost of such services than other similarly situated properties.⁸⁵ However, the Court rejected this argument and explained that the actual use of the tax revenue from each property does not have to be uniform.⁸⁶ Rather, Sections 28 and 29 require that “only the tax *burden* apply equally to all nonexempt property.”⁸⁷ Therefore, because the owner of a property in a TIF area must pay the same amount of taxes in proportion to the property’s value according to the same rate as similarly classified non-TIF property, tax increment financing does not violate the equal taxation clause of the Tennessee Constitution (regardless of the fact that the use of the tax revenue differs).

B. Public Purpose Clause

⁸⁰ *Id.*

⁸¹ *See* TENN. CONST. art. II, § 28.

⁸² *Id.*

⁸³ *See* TENN. CONST. art. II, § 29.

⁸⁴ *Leech*, 591 S.W.2d at 429.

⁸⁵ *Id.*

⁸⁶ *Id.*

⁸⁷ *Id.* (emphasis added) (citing *King v. Sullivan County*, 160 S.W. 847 (Tenn. 1913)).

The public purpose clause is derived from the following language in Article II, Section 29: “The General Assembly shall have power to authorize the several counties and incorporated towns in this State, to impose taxes for County and Corporation [i.e. municipal] purposes respectively, in such manner as shall be prescribed by law.”⁸⁸ This provision essentially requires taxes to be utilized for the governmental purposes of city and counties.

Based upon this provision, the petitioners in *Leech* contended that a county violates the public purpose clause when the county appropriates funds to a municipal entity in a tax increment financing arrangement because the municipal entity serves a municipal purpose and not a county purpose.⁸⁹ The court refused to construe the provision so narrowly and explained that the upgrading of blighted urban areas (which was the purpose of the TIF in *Leech*) “is not only a municipal purpose, but the proper concern of both the county in which the municipality lies and the state as a whole.”⁹⁰

C. Lending of Credit Clause

Article II, Section 29 provides that “the credit of no County, City or Town shall be given or loaned to or in aid of any person, company, association,

⁸⁸ TENN. CONST. art. II, § 29.

⁸⁹ *Leech*, 591 S.W.2d at 429.

⁹⁰ *Id.* While the constitutionality of the IDB Act relating to tax increment financing has not been tested in a published court case, the public purpose of the IDB Act is to promote economic development, and the Tennessee courts have consistently recognized that the promotion of economic development is a valid public purpose. See *Industrial Development Board of Sevier County v. First U.S. Corp.*, 407 S.W.2d 457, 460 (Tenn. 1966) (finding that the development of a planetarium and/or museum in Gatlinburg was to promote industry and develop trade to provide against low wages and unemployment and holding that “the purposes of the financing of the project should be held to be public in all respects”); *West v. Indus. Dev. Bd.*, 332 S.W.2d 201, 202 (Tenn. 1960) (holding that promoting industry and developing trade to provide against low wages and unemployment by the IDB’s issuance of a bond to construct a facility for the worldwide headquarters of a private company that the IDB would lease to the company is a public purpose); *McConnell v. Lebanon*, 314 S.W.2d 12, 20 (Tenn. 1958) (holding that the city’s issuance of a bond to construct a factory building that the city would lease to a private company for 25 years in order to provide against low wages and unemployment was a valid public purpose); and *Small World, Inc. v. Industrial Development Board*, 553 S.W.2d 596, 601 (Tenn. Ct. App. 1976) (holding that the IDB’s issuance of a bond to construct and equip a retail clothing store within a shopping center that the IDB would lease to a private company in order to provide jobs and service to the community was a valid public purpose). When tax increment financing is used to finance private property other than public infrastructure, a finding by the Comptroller and the Commissioner of Economic and Community Development that the financed costs are in the best interests of the state also helps buttress the conclusion that a public purpose is served by the financing.

or corporation, except upon an election to be first held”⁹¹ The petitioners in *Leech* argued that the statute implementing tax increment financing impermissibly authorized the lending of public credit to a corporation (the corporation was the housing authority in *Leech*).⁹² However the court made short order of the petitioner’s argument noting that “as the housing authority alone is liable on the bonds issued, there is no lending of the credit of either the municipality or the county.”⁹³ Thus, as long as just the housing authority or the IDB (and not the municipality or the county) is liable on the TIF bonds, a tax increment financing transaction does not violate the lending of credit clause.

V. POTENTIAL DRAFTING PITFALLS IN REDEVELOPMENT OR ECONOMIC IMPACT PLAN

When drafting an economic impact plan or redevelopment plan containing tax increment financing provisions, attorneys and consultants should be aware of a number of pitfalls that can dramatically affect the success of a tax increment financing transaction. The first of these pitfalls relates to the grouping of parcels for purposes of calculating available incremental tax revenues where multiple parcels of property are subject to a plan. Under the Uniformity Act, a plan may provide that the base and dedicated taxes will be calculated on either an aggregate basis or a parcel-by-parcel basis.⁹⁴ If an aggregate basis is selected, then the base taxes are established as the sum of the taxes on the group of parcels in the year before the plan is adopted. Under this method, when the incremental tax revenue is calculated, the collective base tax is subtracted from the sum of all taxes collected on the parcels subject to the plan. For example, if four parcels are subject to a plan and the base taxes with respect those parcels are \$200 (Parcel 1), \$100 (Parcel 2), \$100 (Parcel 3) and \$300 (Parcel 4), then, under the aggregate method, the base tax on the parcels is \$700. If after development, the taxes due with respect to the parcels is \$500 (Parcel 1), \$300 (Parcel 2), \$400 (Parcel 3) and \$500 (Parcel 4), then the collective base taxes, here \$700, is subtracted from the collective post-development taxes, here \$1,700, yielding \$1,000 of tax increment revenues.⁹⁵ If a parcel-by-parcel calculation method is elected, then a calculation

⁹¹ TENN. CONST. art. II, § 29.

⁹² *Leech*, 591 S.W.2d at 429.

⁹³ *Id.*; see also *Cleveland Surgery Ctr., L.P. v. Bradley County Mem’l Hosp.*, 30 S.W.3d 278, 279 (Tenn. 2000) (holding that Article II, Section 29 is to be construed literally to apply only to counties, cities, or towns and that it does not apply to quasi-governmental entities that do not have the power to levy taxes).

⁹⁴ TENN. CODE ANN. § 9-23-103(c) (2012).

⁹⁵ Please note that, for simplicity, these examples ignore the concept of dedicated taxes.

of tax increment revenues is applied to each parcel on an individual basis. Utilizing the same parcels discussed above, the tax increment revenues available for Parcel 1 would be \$300 (\$500 less \$200), for Parcel 2 would be \$200 (\$300 less \$100), for Parcel 3 would be \$300 (\$400 less \$100) and for Parcel 4 would be \$200 (\$500 less \$300). The total incremental revenues would again be \$1,000. However, suppose that the owner of Parcel 2 neglected to pay her taxes. Applying the same methods described above, under the aggregate calculation, the municipality would still receive the full amount of base taxes or \$700 and a reduced amount, only \$700, of tax increment revenues would be available to pay debt service on the tax increment financing transaction until the delinquent taxes were paid. Under the parcel-by-parcel calculation, the municipality would receive no base taxes with respect to Parcel 2 until paid and would therefore receive only \$600 in base taxes. The full amount of tax increment revenues would be available with respect to Parcels 1, 3 and 4, a total of \$800. Therefore, the aggregate calculation is more advantageous to municipalities because the municipality will be entitled to the full base taxes without regard to whether the taxes have been paid on every parcel. Moreover, from an administrative perspective, the aggregate calculation is less time consuming as there is a single calculation for each parcel grouping rather than a calculation for each parcel in each group. Of course, developers may favor a parcel-by-parcel calculation for the advantages with respect to delinquent tax payments.

Another potential pitfall is correctly timing the allocation of tax increment revenues. Under the Uniformity Act, an allocation of tax increment revenues cannot exceed 20 years in the case of an economic impact plan or 30 years in the case of a redevelopment plan as to any property.⁹⁶ Tax increment financing transactions are typically entered into for the purpose of financing certain eligible costs in connection with a new development. The plan authorizing the tax increment financing is often approved as part of a developer's diligence process when a project is still in the planning stages. The developer will then complete the planning process, close on construction financing (including the tax increment financing transaction) and begin construction of the project. For large projects, it is conceivable that five or more years might pass between approval of the plan and completion of construction. The parties may want the beginning of the period of an allocation of tax increment revenues to coincide with completion of construction and reassessment of a project, not with the approval of the plan. If the period of allocation of tax increment revenues begins too early, there will be no tax increment revenues yet available from the project. Therefore, attorneys

⁹⁶ TENN. CODE ANN. § 9-23-104.

and consultants should closely coordinate with developers to understand estimated construction completion dates and with local taxing agencies to determine estimated dates of reassessment based upon the estimated construction completion date. The plan may simply establish the maximum period of allocation of tax increment revenues (i.e., ten years, 20 years, etc.) as to any parcel in the plan area. The timing of the commencement of the allocation period can be established in the tax increment financing documents.

For larger projects involving multiple parcels of property and several phases of development, the timing of the allocation of tax increment revenues becomes even more important. Often, such developments will be constructed over a period of years with each phase achieving completion of construction and the resulting reassessment at a different time. If a single period of allocation of tax increment revenues is established on the date of the first reassessment after completion of construction of the first phase, the full benefit tax increment revenues will not be realized from later phases. Under the Uniformity Act, a plan may permit the allocation of tax increment revenues with respect to a parcel or group of parcels within a plan area to begin in different years.⁹⁷ This facilitates the staggering of allocation periods for a single project. If a tax increment financing transaction to be secured by a 20-year allocation of tax increment revenues is authorized for a multiple-phase project and the plan permits a staggered implementation of allocation periods, a separate tax increment financing note could be issued with respect to each phase and could be secured by a 20-year allocation of tax increment revenues generated by that phase of the project. The staggered implementation of allocation periods provides for the most efficient leveraging of the tax increment revenues in a multi-phase project.

Another issue that is important to address in a plan is the annual date on which tax increment revenues will be paid to the tax increment agency. Under the Uniformity Act, unless otherwise provided in a plan, tax increment revenues must be paid to the tax increment agency no later than March 31 of each year during the allocation period.⁹⁸ March 31 is not an arbitrary date. Under Tennessee law, the last day of February is the final day for payment of property taxes to counties without being considered delinquent.⁹⁹ This allocation date

⁹⁷ TENN. CODE ANN. § 9-23-103(d).

⁹⁸ TENN. CODE ANN. § 9-23-103(e).

⁹⁹ TENN. CODE ANN. § 67-5-2010. However, this section does not apply to counties that have a population in excess of 700,000. Currently, Shelby County is the only county meeting this criterion. Many cities also use February 28th as the delinquency date for property taxes. However, many cities use other payment dates for city property taxes. Attorneys or consultants drafting a

gives county trustees 30 days to calculate tax increment revenues due to housing authorities and IDBs. However, if a county has an active tax increment financing program, 30 days may be an inconveniently brief period in which to accurately calculate tax increment revenues and pay them to the housing authority or IDB. If a county has an active tax increment program or simply for the county's convenience, the date on which tax increment revenues must be paid to the housing authority or IDB can be set later than March 31 to allow ample time for the taxing agency to calculate the amount of tax increment revenues due to the housing authority or IDB. The alternative date should be designated in the plan.

Another issue that may arise with respect to payments from taxing agencies to housing authorities and IDBs is the payment of tax increment revenues realized from delinquent tax payments. Under the Uniformity Act, unless otherwise provided in a plan, tax increment revenues realized from delinquent tax payments are paid to the tax increment agency within 30 days of receipt by the taxing agency.¹⁰⁰ This poses a difficult situation for taxing agencies. Without modification in a plan, a taxing agency must monitor properties in a plan area year round if taxes are delinquent. In addition to staff time devoted to monitoring properties in a plan area with delinquent taxes, the taxing agency may also incur additional administrative fees associated with wiring funds. Therefore, attorneys and consultants should coordinate with their local taxing agency to include realistic payment dates for tax increment revenues realized from delinquent tax payments.

While there are certainly pitfalls to be aware of in drafting economic impact plans and redevelopment plans, a thorough understanding of the project benefitting from the proposed tax increment financing and coordination with the affected taxing agencies are instrumental in avoiding such pitfalls.

VI. STRUCTURING A TYPICAL TIF FINANCING

The documentation for tax increment financing transactions varies greatly depending on the unique nature of each transaction and the lender's and developer's requirements. However, certain types of documentation are utilized in most TIF transactions. In essentially all tax increment financing transactions used to incentivize the undertaking of a private development, a development agreement will be entered into between the housing authority or IDB and the

tax increment plan should confirm the applicable delinquency date for city taxes and provide for an appropriate allocation period as to city taxes that is comparable to the allocation period for county taxes.

¹⁰⁰ *Id.*

private developer. This development agreement will generally set forth the commitment of the private developer to undertake certain developments in accordance with plans to be approved by the housing authority or IDB and will set forth the maximum time that the developer will have to complete that commitment. The development agreement will also typically stipulate what eligible costs the housing authority or IDB is willing to pay with the proceeds of the tax increment financing and also set forth the maximum amount of the expenses. Finally, the development agreement will often provide that the private developer will agree to make up any shortfall in the tax increment revenues if such revenues are inadequate to make any required debt service payments on the tax increment debt. Any such payments by the developer are typically treated as additional loans to the housing authority or IDB that would only be paid once the tax increment financing with a third-party lender is paid in full.

Assuming that the tax increment financing involves an actual borrowing,¹⁰¹ the lender for the tax increment financing will typically enter into a loan agreement with the housing authority or IDB under which the lender will make the loan to the housing authority or the IDB. The loan will generally be non-recourse to any assets or revenues of the housing authority or the IDB other than the incremental tax revenues pledged to the payment of the loan. The loan will usually be evidenced by a tax increment note from the housing authority or IDB in favor of the lender. The loan agreement will also frequently contain any conditions precedent to disbursements of the loan proceeds, much like a construction loan. It will also contain the mechanics under which periodic transfers of incremental tax revenues are transferred to a designated account in order to pay debt service on the tax increment financing.

The loan agreement and the note will also likely set forth an assumed minimum amortization for the principal of the tax increment note in each year. Because future tax increment revenues generally cannot be precisely projected, the lender will often require that an assumed amount of principal be paid on the tax increment note in each year. If the tax increment revenues are inadequate to pay that principal amount, the lender will typically require the developer that benefits from the tax increment financing to make up any shortfall pursuant to the terms of the development agreement or a separate guaranty. The goal of the

¹⁰¹ As is discussed elsewhere in this article, a tax increment financing through a housing authority requires that a borrowing occur in order to allocate tax increment revenues. If an IDB is used to implement a tax increment financing, the IDB could just reimburse the private developer for eligible costs from tax increment revenues, with no borrowing by the IDB.

lender is to not allow the principal payments on the note to be too small to permit the full amortization of the note over the term of the note.

The last critical document is the security agreement pledging the tax increment revenues to the payment of loan. This document often takes the form of an assignment of tax increment revenues and is similar to an assignment of rents in a real estate transaction. The security interest granted through this assignment may be perfected by a financing statement if the issuer of the debt is an IDB. A financing statement should not be required to perfect a pledge by a housing authority because a housing authority is exempt from the perfection requirements of the Uniform Commercial Code.¹⁰²

In addition to developing the appropriate documents to reflect the tax increment financing transaction, the parties will want to determine whether the tax increment note is a tax-exempt obligation under federal tax laws. Because the note is issued by a local governmental entity, it is possible for the note to be tax-exempt provided certain federal tax requirements are met. A discussion of those federal tax requirements is well beyond the scope of this article, and many tax increment transactions cannot be issued as tax-exempt debt for various reasons. However, if a tax increment note can be issued as a tax-exempt obligation, the interest rate will be substantially lower than a comparable taxable obligation, so the parties should check with competent counsel in this area to determine whether federal tax requirements can be met to achieve tax-exempt status.

VII. ADMINISTERING A TAX INCREMENT FINANCING PROGRAM

Tax increment financing can be an effective economic development tool for municipalities in Tennessee. When deciding to implement a tax increment financing program to incentivize development in a county, it is a good idea for the county, any incorporated cities, and each housing authority and IDB in that county to implement a tax increment financing policy for that county. The policy should provide a guide for elected officials of taxing agencies, staff, and appointed members of housing authorities and IDBs and private parties. Ideally, such policies should acquaint the reader with the agencies involved in the tax increment financing process, the application process, the steps for approval of a tax increment financing transaction (i.e., public hearings, approval of governing bodies and drafting of economic impact plans or redevelopment plans, as applicable), any post-closing administrative obligations, and any fee obligations on the part of developers.

¹⁰² TENN. CODE ANN. § 9-22-104.

A short application for a tax increment financing incentive is advisable and may also be included in the policy or otherwise made available to interested private parties. Information requested in the application may vary, but would likely include contact information for the developer, parcel identification numbers for the property to be developed, and a description of the proposed development. Other information to be provided is dependent upon the tax increment agency's preferred evaluation criteria. Different tax increment agencies may document to different degrees of detail the criteria upon which an application for tax increment financing will be evaluated. For example, a tax increment agency focused only on economic development might evaluate applicants based upon a numerical formula reflecting the amount of capital investment and jobs created by an applicant. However, a tax increment agency focused on remediation of blight in a downtown area might focus on the feasibility of a project if tax increment financing is not implemented. Such a determination might include a review of the financial projections for the project. Whatever the factors for evaluating applications may be, they should be consistently applied to ensure a fair and transparent process.

A tax increment financing policy can also help with coordination among the several agencies affected by such transactions. The decision to enter into a tax increment financing transaction creates an obligation of the affected taxing agencies and the housing authority or IDB to work together to facilitate the transaction for a period as long as the maturity of the tax increment financing note or bonds. Each year, the available tax increment revenues must be calculated and transferred to the tax increment agency, which in turn ensures that the tax increment revenues are applied as a payment on the tax increment financing debt. Under the Uniformity Act, a tax increment agency must send written notice of the approval of a plan to all affected taxing agencies.¹⁰³ That notice must include the parcel identification numbers for the property subject to the plan.¹⁰⁴

While this required information sharing is certainly helpful, much more coordination is required to successfully administer a tax increment financing program involving a large number of transactions. First, the agency responsible for calculating available tax increment revenues must be identified. In some cases, the taxing agency takes on responsibility for tracking parcels subject to

¹⁰³ TENN. CODE ANN. § 9-23-106 (a). It should be noted that the Housing Authorities Law requires that the taxing agencies be notified prior to approval of the plan. TENN CODE ANN. § 13-20-205(c) (2012).

¹⁰⁴ *Id.*

plans and calculating available tax increment revenues each year. In other cases, the housing authority or IDB tracks the parcels subject to each plan, calculates the available tax increment revenues and then invoices the taxing agency. Second, the method of gathering the necessary information on parcels subject to a plan must be agreed upon. For some municipalities, the only available method is to obtain a receipt for taxes paid for each parcel subject to a plan and to calculate available tax increment revenues by hand. Other municipalities may purchase or develop software that assembles the necessary information on parcels so that calculations may be made quickly with minimal human error. This process can be further complicated where parcels have been aggregated or subdivided since the approval of a plan and the subsequent notice provided to the taxing agencies. A valuable addition to a tax increment financing policy and to the tax increment financing transaction documents is a requirement that developers provide notice of any aggregation or subdivision of parcels. Third, the tax increment agency must facilitate the transfer of available tax increment revenues. Depending on the number of tax increment financing transactions in which the tax increment agency is involved, this can be a very involved coordination of wiring and/or deposit instructions for a number of different lenders. Finally, the taxing agencies and the tax increment agency must repeat such calculations and transfers for tax increment revenues due with respect to delinquent tax payments.¹⁰⁵ The responsibility for these processes can be detailed in a tax increment financing policy agreed upon by the taxing agencies and the tax increment agency. Having clearly delineated processes and responsibilities creates a much more dependable and efficient payment process, which in turn reinforces a successful tax increment financing program. Success of a tax increment financing program is dependent upon the availability of willing lenders, and lenders will be reassured by a clear and organized payment process.

Another post-closing nuance unique to tax increment financing transactions is that both the Housing Authorities Law and the IDB Act provide that tax increment revenues must be deposited into an account in the name of the housing authority or industrial development corporation, as applicable.¹⁰⁶ If the tax increment financing transaction does not involve a private developer, this

¹⁰⁵ Please see Section V for a discussion of establishing payment dates in a plan. Note that TENN. CODE ANN. § 9-23-103(e) provides a plan may provide how tax increment revenues with respect to delinquent taxes will be paid or that a taxing agency and tax increment agency may agree otherwise. This language provides taxing agencies and a tax increment agency the opportunity to outline the desired procedure for payment of tax increment revenues with respect to delinquent taxes in a mutually agreed upon policy rather than in each plan.

¹⁰⁶ See TENN. CODE ANN. § 13-20-205(c); TENN. CODE ANN. § 7-53-312(c)(2) (2012).

requirement creates less of an administrative challenge. However, in tax increment financing transactions where the developer obtains the lender and guarantees the tax increment financing note, the lender may be more resistant to keeping an account open in the name of the tax increment agency. Typically, only one or two payments are made each year on a tax increment financing note. Therefore, the payment is wired to the account, and the lender will almost immediately debit the account to make the payment on the tax increment financing note. It is difficult for a lender to justify the administration and expense of keeping an account open for only two nearly simultaneous transactions per year. Therefore, it is important to communicate early and often with both developers and lenders the importance of maintaining such an account for the entire term of the tax increment financing note for the purpose of complying with applicable law.

As this section has shown, administration of tax increment financing transactions is likely to involve some amount of staff time on the part of both taxing agencies and tax increment agencies. In order to reduce the financial burden on such agencies, the Uniformity Act provides that a plan may provide that a total of up to five percent of tax increment revenues may be set aside for administrative expenses incurred by the tax increment agency and the taxing agency.¹⁰⁷ If a tax increment agency intends to implement such fees, it is advisable that the fee structure be mentioned in the tax increment financing policy so that developers and lenders are aware of the fee structure at the outset of the transaction. Tax increment agencies may want to correlate the percentage of the fee to the sizing of the transaction. Five percent of annual tax increment revenues for a \$500,000 tax increment financing transaction will be significantly less than five percent of annual tax increment revenues for a \$10,000,000 tax increment financing transaction. Tax increment agencies may consider a fee structure of the lesser of five percent of annual tax increment revenues or a sum certain. The ability to recover administrative costs is important as a large tax increment financing program can place a significant financial burden on both tax increment agencies and taxing agencies.

The implementation of a tax increment financing policy can be helpful in facilitating an efficient and successful relationship among the tax increment agency and the taxing agencies and can be an excellent resource for developers and lenders. Even if a tax increment agency decides against implementing a tax increment financing policy, it is important for a tax increment agency to

¹⁰⁷ TENN. CODE ANN. § 9-23-105 (2012).

coordinate with affected taxing agencies to ensure smooth implementation of its tax increment financing program.

VIII. TIF UTILIZATION IN PUBLIC PROJECTS

While most TIFs in Tennessee are used to provide incentives to complement private development projects, tax increment financing can also be used to promote unique projects that primarily provide direct public benefit and require public assistance to be viable and that are primarily orchestrated by public entities and not private parties. For example, a large municipality (“BigTown”) might determine that its newly constructed convention center requires a large adjacent hotel to accommodate anticipated conventioners and desires to use the financing tools available to it to attract a private operator of the hotel. However, private hotel operators might not be willing to undertake such a big project without the support from public revenue streams. BigTown’s city council and industrial development board or housing authority could approve an economic impact or redevelopment plan and provide tax increment financing to assist in the construction of the hotel. In this way, tax increment financing helps make possible what is essentially a public project operated by a private entity because the convention center would not succeed without the availability of the adjacent hotel rooms.

Another situation where tax increment financing can be used to support public infrastructure development with minimal private involvement is where a county and a city agree to collaborate in the redevelopment of a blighted area. In this case, BigTown and its housing authority can approve a redevelopment plan for the blighted area, with the goal of incentivizing redevelopment within the area. BigTown might determine that the best way to incentivize redevelopment in the area is to reconfigure certain streets, install sidewalks, and construct a greenway along the edge of the area. BigTown could issue its general obligation bonds (bonds payable by a city’s general city-wide property taxes and revenues) and use the proceeds to make a TIF loan to its housing authority to construct these projects. BigTown could simultaneously approach the county in which BigTown is located (“LargeCounty”) and ask that LargeCounty approve the redevelopment plan and allocate its incremental property tax collections in the blighted area (which it likely would not receive without BigTown’s investment in public infrastructure) to the repayment of BigTown’s bonds. In this way, LargeCounty uses tax increment financing to make a targeted investment and partner with BigTown to incentivize needed redevelopment.

IX. CONCLUSION

The expanding use of tax increment financing as a local economic incentive is an exciting development in the economic development community. Among other things, this economic development tool gives local governments in Tennessee the ability to finance public infrastructure necessitated by an economic development project with the incremental taxes created by that project without incurring additional general obligation debt. In this very competitive economic climate, the ability to provide a tax increment financing incentive may mean the difference between attracting a quality manufacturer, a major retailer or a corporate headquarters, and losing the project to another jurisdiction that is offering more lucrative incentives.

Tax increment financing is not, however, a panacea that will solve all economic development challenges. Tax increment financings are complex transactions with many legal considerations, including tax considerations for both the community and the economic development prospect.¹⁰⁸ The legal documents implementing the transaction can be quite intricate, with many issues to be negotiated. As a result, prospective purchasers of tax increment debt should consider requiring the delivery of a legal opinion upon closing any tax increment transaction as to the legality of the transaction and the tax status of any interest payable with respect to the tax increment financing. While tax increment financing transactions can be complex, they clearly are becoming a more important tool to communities across Tennessee in targeting and promoting specific economic development initiatives.

¹⁰⁸ A detailed examination of this topic is beyond the scope of this article, but it should be noted that the use of tax increment financing to pay the costs of private property may result in taxable income to the private party that benefits from the use of the tax increment financing. Economic development prospects should consult with their tax advisors to determine whether any income will be realized as a result of the application of tax increment financing to pay or reimburse project costs.