October 15, 2015

TO: Metropolitan Development Commission
FROM: Midtown Economic Council
RE: Proposed Amended North Midtown TIF Boundaries

EXECUTIVE SUMMARY

A 2013 policy decision by the Indiana Department of Local Government Finance is undermining the ability of the North Midtown Tax Increment Finance Allocation Area (Midtown TIF) to finance new development.

City of Indianapolis Department of Metropolitan Development in coordination with the Midtown Economic Council have analyzed the situation and examined multiple scenarios for addressing the issue.

DMD and MEC have agreed that the most effective way to reinforce and stabilize the economic development strategy for Midtown is to modify the Midtown TIF boundaries and remove some residential parcels.

A policy decision by the Indiana Department of Local Government Finance is undermining the ability of the North Midtown Tax Increment Finance (TIF) Allocation Area to finance new development.

TIF and assessed values

Per statute, the county assessor must annually review each allocation area (TIF District) and determine whether the net assessed value (AV) of the base has increased or decreased.

Only AV increases for new commercial development are allowed to accrue to the TIF. Assessed value increases in residential properties do **not** add to the increment but they do add to the base. Prior to 2013, residential parcel gains and losses were adjusted in the base and had no impact on the TIF increment.

As defined by statute, a process called TIF Neutralization distinguishes between market fluctuations that affect the base and new commercial construction. This helps to ensure that the TIF captures only increased commercial assessment due to new construction. It prevents the TIF from being affected by adjustments due to appreciation or depreciation caused by market conditions.

The problem

A Policy Analytics LLC memo to the City of Indianapolis dated 4/20/15 sums up the issue:

> Per IC 36-7-14-39 residential assessed value is included in the base (and cannot capture increment) for Economic Development Areas created after June 30, 1995 and Redevelopment Areas created after June 30, 1997. The North Midtown Allocation Area meets these conditions, and therefore cannot generate increment on residential parcels. Until the recent update to PVD [a software program used to calculate property taxes], the calculation of base and increment assessed value was only applied to non-residential parcels for TIF districts that meet this criteria.
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> On October 8, 2013, DLGF issued a memo stipulating a different interpretation of IC 36-7-14-39. Under this interpretation, any loss of base AV due to declining residential assessed value must be restored, to the extent possible, by increment AV from non-residential parcels within the TIF. This means that though residential parcels cannot generate incremental AV, the loss of AV on a residential parcel can "cut into" the overall increment captured by the TIF district. This allocation procedure is applied at the parcel level, so that decreases in residential AV are not offset by increases in residential AV for other parcels.

While TIFs have always been required to make up **net** losses (commercial and residential) in the base due to demolition of property or conversion of property from taxable to tax exempt use, TIFs have never been required to make up losses that were solely attributable to market fluctuations.

The new policy interpretation requires the TIF to make up ***any*** losses in individual residential AVs even if there is a net gain in residential AV in the district.

The DLGF policy ignores the statutory obligation to accommodate market fluctuations in base AV.

What does this mean for Midtown TIF?
Despite a $3.5 million net gain to the residential AV in 2015, the policy deducted $4.65 million from commercially generated AV to offset individual residential parcel losses. If allowed to continue over the 25-year life of the TIF this policy will render the TIF unable to fund qualified new projects and jeopardizes its ability to meet current obligations.

What causes the AV declines?
The main causes of decreased net AV in residential properties can include the following:

- **Property tax appeals.** When a property owner successfully appeals an assessment a gap is created by the difference between the old assessment and the new assessment. The base was established on the old assessment. Under current statute, the base would be adjusted to reflect that fluctuation. Under the new policy the TIF district must make up that difference.

- **Mortgage/Homestead/Veterans exemptions** on formerly vacant or rental properties that become owner-occupied properties. Rental properties pay higher taxes because they don’t qualify for these exemptions. If rental property sells and becomes owner-occupied, the owner may take advantage of these exemptions, thereby reducing the net AV of the property. Under current statute, the base would absorb these adjustments as a market fluctuation. Under DLGF policy, the TIF must pay for these exemptions. Owner-occupied homes are a sign of stability and an indicator that people are investing in the district, yet under the DLGF interpretation, economic development is penalized for encouraging homeownership within the TIF.

- **Assessed value trending** – According to state statute, standard growth due to market forces is a required factor in adjusting the base and the essence of TIF neutralization. Until now, it has been applied at the neighborhood level, so that if a property doesn’t keep pace with the neighborhood trend, it affects the net AV of the parcel. Under DLGF policy, this creates a shortfalls and the TIF is responsible for making up the shortfall even though it did not cause it.

- **Decline in gross AV** – An actual decline in the gross AV of a residential property caused by property condition, market fluctuations, vacancies, foreclosures, etc. Declines in residential AV were not caused by the TIF or by commercial developments. The TIF is new. It has generated only one year of increment. Only half a dozen projects have contributed to that increment in that time. Others are in process but have either not been assessed or not fully assessed.

Why were residential properties included in the TIF?
When the Midtown TIF was established, residential properties were invisible to TIF unless or until redeveloped as a commercial use. Midtown neighborhoods include a mix of dense residential areas in close proximity to commercial nodes along historic mass transit corridors and to former industrial sites. City planning staff agreed with neighborhood groups that these areas presented development opportunities and prevented commercial creep into the heart of single-family residential areas.

By law, TIFs cannot absorb residential AV increases into the increment. Prior to the DLGF's policy change, TIF did not receive benefit or penalty from fluctuations in residential net AV because those adjustments were made to the base. The new DLGF policy requires decreases in net residential AV for individual parcels to be made up by non-residential parcels. This stunts economic growth that has been planned in the district during the past decade.

How can this problem be solved?
The most expedient option to stabilize the Midtown TIF district and render it fully functional is to remove residential parcels from it. The City of Indianapolis Department of Metropolitan Development, with the support of the Midtown Economic Council, is proposing removal of nearly 900 residential parcels.

Why are some residential parcels targeted for removal from the TIF?
The goal is to fine-tune the TIF district to create very clearly defined commercial nodes. Residential properties (including condominiums) that were having a detrimental impact on the TIF increment were excluded. Removing these parcels from the TIF district will not affect the parcels' AV.

For purposes of assessment, rental apartments are considered commercial. Structures with more than 4 units under a common roof — even multi-family units — are considered commercial and remain on the TIF map. Privately owned condominiums are considered residential and so have been removed. Some special-use properties not likely to be developed in the near future are also proposed for removal. Additionally, properties with no short-term likelihood of significant commercial development potential were deleted.

Approximately 150 parcels that the assessor has listed as residential were retained but not all are actually residential. Some have incorrect assessments. Others are being used as commercial spaces with or without appropriate variances. Many are owned by LLCs, while some are owned by the City and some by individuals.

Why modify the TIF now?
Unlike the downtown TIF district, the Midtown TIF district has a limited lifespan. The fiscal impact of the DLGF policy change has caused the community and City staff to plan on an even shorter time frame. The next decade is the period when the TIF has the best potential to generate sufficient increment to fund future projects. If the negative impact of the DLGF policy is not mitigated by **December 31, 2015**, nearly $5 million in commercially generated AV will again be depleted from the TIF in compliance with the DLGF policy. Increment loss from the TIF will occur annually with each new assessment

and will compound as residential volatility continues. Stabilization of the TIF is crucial to prevent these future losses.

Are there any other options to solve the problem?
Three alternative options have been studied:

- The DLGF could reverse its policy.
  Efforts to achieve this goal have been unsuccessful.

- The Indiana General Assembly could provide a remedy.
  This could not begin until January 2016 and could take up to four years to make its way through the legislative process.

- The matter could be litigated in court.
  A legal proceeding would likely result in reversal of the DLGF policy, but the effort would be costly and could take as long if not longer than legislative action.

What will happen if the problem is not solved?
If the volatility of the residential housing market continues as it has in the past several years, the TIF district will lose increment faster than it creates it. There could even be a deficit in increment as early as 2017, which would prohibit the TIF from functioning in the way it was intended: to invest in commercial development projects and to service existing debt obligations.

Nearly $120 million worth of projects have already disappeared due to the TIF's inability to support eligible projects. TIF subsidy is necessary to overcome additional costs of developing in the area, such as brownfields, utility upgrades, flood plain requirements, acquisition cost, public infrastructure, and parking.

Current Pending Projects
Approximately $79 million worth of projects have indicated a need for TIF subsidy over the next 18 months. The TIF is currently unable to support these or any other projects with financial backing secured by the TIF due to inadequate funds, in part due to the DLGF policy change. The proposed modification of the TIF boundaries will not immediately improve the financial position of the TIF. Instead, it will stop future losses of commercially generated increment due to the DLGF policy change. The only way new projects can be financed in the near term is with "developer-backed bonds." Such bonds do not rely on the financial backing of the TIF district, but instead rely solely on the increment generated by the developer's own project. Developers are required to buy or back the bonds. Any shortfalls in increment generation needed to service bond debt are thus the responsibility of the developer, ***not*** the TIF. There is no risk to the TIF or the City with developer-backed project financing; however, not all developers are able to provide such backing.

While the boundary revision is crucial to prevent future losses and help to stabilize the TIF in the long-term, it will not directly benefit projects financed with developer-backed bonds. Even with the proposed boundary revision, revenue projections indicate the TIF will remain unable to offer direct financial backing of TIF-eligible projects until at least 2017.

Glossary

Base: The net assessed value (AV) of properties included in a Tax Increment Finance Allocation Area.

Increment: Amount of AV increase for commercial properties within a TIF district over and above the base, not attributable to general market conditions.

Gross Assessed Value: Property value as determined by the county assessor.

Net Assessed Value: The difference between gross AV and adjustments that affect tax liability.

PVD: Name of software program used by Marion County Assessor to administer property taxes.

TIF Neutralization: A way of maintaining the base and ensuring that TIF districts benefit only from increased AV directly attributable to activity within the TIF.