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Another Harsh Lesson about TIFs for Retail

In the late 1990s and early 2000s, tax increment financing (TIF) became an oft-used financing scheme for local governments to use on development projects they wished to pursue. This was viewed as a way to repurpose property by using the future value of incremental tax payments to pay off a redevelopment bond. However, we warned at that time in our *Policy Briefs* (*Volume 4, Number 3 and Volume 6, Number 48*) that a TIF should not be used to subsidize retail projects. Our logic was simple: retail is an industry with little or no multiplier effect. Furthermore retail tends to do nothing more than shift dollars from one part of the community to another as shoppers pursue the newest strip malls and outlets leaving older ones to struggle.

The way a TIF works is simple. Suppose for example the local government taxing bodies wish to develop a parcel of property that is currently generating $100,000 in tax revenues. It is believed that once developed and repurposed, it will then generate $200,000 in tax revenues—providing an increment of $100,000. An authority (usually a redevelopment authority) then issues a bond in the appropriate amount to fund needed infrastructure and other site improvements to proceed with the project. Once the project has been completed and tax revenues reach $200,000 the taxing body will still keep the original amount ($100,000) but can use the increment (the additional $100,000), or any part thereof, to pay off the TIF bond that was issued.

Taxing bodies regard this financing option as relatively "risk free". However, if the project fails to live up to its projections, someone has to pay for the bonds that were issued. One such backstop is the Pennsylvania Department of Community and Economic Development which administers the TIF Guarantee Program providing up to $5 million per project. Otherwise the bonds become the responsibility of the authority issuing them.

One decade ago, in September 2006, we wrote a *Policy Brief* (*Volume 6, Number 48*) that discussed the Pittsburgh Mills mall project and the $50 million TIF the developer had received as part of a financial assistance package. The mall had opened in 2005 and we noted in that *Brief* its impact was being felt as local businesses had closed blaming a loss of customers to the mall. But we also said the following: "But none of this is to suggest that Pittsburgh Mills is booming. It still deals with the same constraints facing the region in the way of sluggish population growth and the necessary redirection of limited disposable income. A planned go-cart track never materialized and its upscale bowling alley attraction has already announced it will close."

That quote proved to be quite prophetic as the mall and the entire development struggled to hold onto tenants. According to recent local news articles, the mall is currently only 58 percent occupied, which is down from 65 percent from just last fall. In 2012 it was reportedly occupied at 85 percent.

And of course the high vacancy rates have affected its market value. While the entire project was built for $350 million, the mall itself was built for $226 million. The mall had a market value reportedly at $190 million in 2006—more than half the value of the whole development. According to news articles, its value plummeted to $30.8 million in February 2016 and by the end of August that value sank even further to $11 million. In fact, the mortgage holder of the mall foreclosed last November.

So what does this mean for the TIF project?

Looking at the assessed values for the project, the pre-development value (2002) of the entire 340 acre area was $1.3 million and the property tax revenue collected by Allegheny County ($6,242), Frazer Township ($2,063) and Deer Lakes School District ($30,613) totaled $38,918. These values became the base revenues that each taxing body would continue to collect after the development through the TIF package. They also agreed to keep a portion of any increment to the property taxes at a rate of 25 percent (Allegheny County and Frazer Twp.) and 20 percent (Deer Lakes SD).

Records show that the assessed value of the parcels in the area after development reached $215.13 million. The mall's assessed value was $127.97 million. In 2006 the County's millage rate was 4.69 and thus they collected $1,008,943 in property taxes on the development. Frazer Township (1.55 mills) collected $333,446 while Deer Lakes School District (23 mills) collected $4,947,908. The total property tax collection from the three taxing bodies came in at $6,290,298. Less the base amount ($38,918), the incremental property tax revenues were $6,251,379. As mentioned above each taxing body elected to retain some of the increment ($1,316,980) which left $4,934,399 to be placed in the TIF fund to repay the bonds. According to the debt service schedule, payments that year (2006) were only $2,729,850. Adding administrative costs of $581,312 (comprised of an annual public safety payment to Frazer Township ($500,000) and other fees) raised the payment to over $3.31 million. So at that point the increment was more than enough to pay the annual debt service and administration costs.

In 2016, the development's assessed value had increased by 10.4 percent to $237.59 million. The mall's assessed value increased eight percent to $138.36 million. Although millage rates had changed, Allegheny County (4.73 mills) collected $1,123,804, Frazer Township (1.42 mills) collected $337,379, and Deer Lakes (21.953 mills) collected $5,215,831 for a total of $6,677,014—a 6.14 percent increase over the 2006 amount. Once again, removing the base ($38,918) and the percent of the increment each taxing body elected to retain ($1.4 million) left $5,237,833 for debt service ($4.9 million) and administration expenses on the TIF bond (roughly $5.4 million). As can be seen, the increment to the property taxes collected falls a bit short of what is required. However in years where there was an excess collection, it was placed into a TIF fund presumably to cover any years in which there was a shortfall.

But the important point here is the struggling mall and its' assessed value versus its market value, along with other establishments which have already closed, leaving vacant structures.

As mentioned above the reported market value of the mall is currently $11 million—well below its' assessed value of $138.4 million. What if the mall's owner appeals its property assessment? What if the assessed value drops to $50 million? The assessed value of the entire project falls from $237.59 to $149.23 million. Keep in mind that the free standing Sears store (2016 assessed value of $7.5 million) closed as has a Smokey Bones restaurant ($1.94 million). This would drop the assessed value of the project even further if the property owners appeal.

If we assume an assessed value of $149.23 million, the property taxes collected from the three combined taxing bodies would fall from $6,677,014 to $4,193,802—a decline of $2,483,212. Less the base revenue amount and the amount of the increment retained by the taxing bodies, the funds left for the debt service obligation plus administrative expenses would be $3,278,434. According to the debt service schedule, that amount alone is just more than $5 million for next year and is to rise gradually to $5,660,160 in the payoff year of 2023. According to the Redevelopment Authority of Allegheny County's financial audit, for period ending December 31, 2015, the amount outstanding on the TIF bonds is $33,155,000. With the mall being placed into foreclosure and other ancillary establishments closing, the ability to repay the TIF bonds comes into question. And even worse, the tax revenue of Frazier and Deer Lakes schools will take a major hit. Not Good.

This just calls into stark relief the problem with subsidizing retail ventures. The Lazarus debacle should not be forgotten either. For the first few years Pittsburgh Mills appeared to be a success. But vacancies became an issue early and plagued the mall over the last few years. Now the mall has been foreclosed and its market value has plummeted to just $11 million. If the assessments are lowered to reflect the market value of the mall, the ability to repay the TIF bonds will be in doubt. How this saga will play out remains to be seen. But is should serve as a warning to development officials seeking to go down this road again.

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