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MEMORANDUM

To: CMAP Board

From: CMAP staff

Date: September 4, 2013

Re: Examination of Local Economic Development Incentives in Northeastern Illinois

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Shortly after the approval of GO TO 2040 in October 2010, CMAP assembled a Regional Tax Policy Task Force, an advisory group consisting of representatives from local and state government, business, civic organizations, and academia. Throughout 2011, this group deliberated on a range of state and local tax policies affecting the economic competitiveness of northeastern Illinois. One issue of interest to the Task Force was the use of local tax incentives, specifically sales tax rebates, to spur the development of large, sales tax-generating establishments. In its final report, the Task Force recommended that CMAP analyze the impact of sales tax rebates on development decisions. In its discussion of this report, the CMAP Board directed staff to conduct a detailed study on the prevalence of these rebates as well as other local incentives, and also analyze the impact on local and regional economic development.

In August 2013, CMAP released a study examining the use of Tax Increment Financing districts, sales tax rebates, property tax abatements, and Cook County property tax incentive classes. The report's analysis of these incentive tools focuses on their prevalence, structure, associated community goals, types of firms receiving assistance, and the extent to which their use supports the goals of GO TO 2040, the regional comprehensive plan. The attached executive summary highlights key findings from this report.

ACTION REQUESTED: Discussion

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Executive Summary

Local incentives play a major role within the overall economic development landscape of northeastern Illinois. In recent years, more than 70 percent of the region's 284 municipalities have used at least one of four local economic development incentive tools: tax increment financing (TIF), sales tax rebates, property tax abatements, and Cook County property tax incentive classes. These incentives have been used to attract or retain a wide variety of commercial, industrial, and residential uses including retail, auto dealerships, corporate offices, manufacturing, warehousing, mixed-use, and affordable housing developments.

CMAP has examined the use of these incentive tools, focusing on their prevalence, structure, associated community goals, types of firms receiving assistance, and the extent to which their use supports the goals of GO TO 2040, the regional comprehensive plan. The following summarizes key findings from this report.

State tax policy drives the prevalence of local economic development incentives

The vast majority of the region's municipalities, 202 out of 284, have deployed at least one of the four primary incentive tools in recent years. State statute establishes the criteria and policies that allow local governments to use tax revenue to incentivize development. These include the criteria governing specific local incentives and the state tax policies that govern state sales tax revenue sharing and differential property assessment levels in Cook County.

For example, while establishment of a TIF district requires satisfying state-imposed blight and conservation area criteria, these districts persist throughout northeastern Illinois. A total of 157 municipalities currently have at least one district, and TIF accounts for more than 10 percent of the total property tax base in 24 municipalities. Overall, TIF expenditures totaled $2.6 billion between 2000 and 2010.

Sales tax rebates also remain common throughout the region. Since 1996, at least 137 communities have used this tool to attract or retain sales tax-generating developments like shopping centers, auto dealerships, supercenter/discount stores, and home improvement stores. The use of sales tax rebates will remain extremely common as long as the state tax system provides communities with a fiscal incentive to encourage the development of retail and other establishments that generate sales tax revenue. While this system allows municipalities to recoup the costs of supporting a retail development, sales tax revenues often exceed the costs of serving these developments. These fiscal benefits create intraregional competition among communities for sales tax-generating developments.

The widespread use of Cook County incentive classes reflects the unique nature of Cook County's property tax assessment classification system, a policy permitted under the state constitution. In 2011, 5.8 percent of estimated commercial or industrial market value across Cook County was designated with an incentive class. The prevalence suggests that the existing classification system, which shifts the property tax burden toward commercial and industrial properties, impedes economic development in many communities in Cook County.

Incentives often influence site selection for businesses making an intraregional move or for a national firm expanding its market

Local economic development incentives typically encourage development in a particular location rather than attract a business to the region as a whole. Incentives affect the site selection process by reducing the cost of initial site improvements or local taxes over the long term. This only influences where a development occurs in the region rather than whether it occurs at all. CMAP's case studies indicate that the vast majority of local incentive deals involve intraregional moves, the expansion of an existing business, or national firms expanding their market. Only rarely did local incentives lure a firm from another state or assist a new business. This aligns with the findings of various academic studies showing that tax differences are more effective at influencing site selection within, rather than across, metropolitan regions.

Local communities often provide incentives without knowledge of whether the development would have occurred anyway. Businesses are typically in an advantageous position to negotiate incentives with local governments—they may have several sites to choose from and may receive incentive offers from multiple communities in the region. This situation puts communities in the difficult position of competing against each other for economic development opportunities, many of which involve businesses or developers that intend to select a site in northeastern Illinois and are choosing from several specific sites in the region.

Communities often provide incentives to maximize tax revenue, but these investments may generate few spillover benefits to the larger regional economy

Based on available data, CMAP finds that many communities target incentives based upon future tax revenues rather than overall economic impact. For example, local governments have spent or committed significant amounts of sales tax rebates to firms that generate considerable sales tax revenue but are associated with low jobs multipliers and low wages. In examining 137 sales tax rebates, CMAP found rebates averaging $2.5 million for home improvement stores and $3.8 million for discount stores, despite the fact that one retail job supports just an estimated 0.3 to 0.9 other jobs in the regional economy and provides relatively low wages (an average of $21,903 per year).

On the other hand, some local governments do use incentive tools to attract firms that employ workers in high skilled jobs. Office or manufacturing developments typically provide lower local tax revenues but higher regional economic benefits. For instance, one manufacturing job supports between 1.7 and 4 jobs in other sectors and provides higher average wages ($41,373). The economic benefits of these developments are more likely to spill over into other industries and to support employment in a range of sectors including business services, retail, and human services.

The use of local economic development incentives varies in terms of aligning with the land use goals of GO TO 2040

GO TO 2040 prioritizes local government efforts to improve livability and encourages a future pattern of more compact, mixed-use development that focuses growth where infrastructure already exists. Communities often utilize local economic development incentives for goals that align with GO TO 2040, such as redeveloping an underutilized site, developing affordable housing, or meeting other reinvestment strategies. Specifically, redevelopment can require the consolidation of many small parcels under separate ownership, remediation of environmental contamination, rehabilitation of existing structures, or an upgrade of public infrastructure. In these cases, incentives can bridge the gap between market prices and high redevelopment costs, meeting both public goals and private investment needs.

On the other hand, communities also use local incentives to compete for new developments on undeveloped land, which typically does not entail extraordinary development costs. While GO TO 2040 acknowledges that some greenfield development will occur, the plan does not prioritize the associated expenditure of limited public resources toward these ends.

Proactive and collaborative planning does not always play a role in the use of local incentives

While a significant majority of the region's local comprehensive plans include a heavy or moderate focus on economic development, comparatively few of these plans discuss specific incentives. While the general goals of incentive agreements and comprehensive plans often coincide, it is unclear if incentives are being utilized to implement specific recommendations of a plan or if their use is more reactive. In general, aligning incentives with community plans builds on the analysis and public input that went into the plan, and ensures that public dollars follow long-term desired outcomes and land use patterns.

Including clawback provisions in incentive agreements can also help protect community's investments in development. Some local governments include a number of requirements in incentive agreements, such as requiring the business or firm to stay in the community for a certain number of years, hire community residents, generate a specific level of tax revenue, or maintain or modernize infrastructure.

Employing incentives to compete with other communities over development runs contrary to the type of collaborative planning efforts envisioned in GO TO 2040. These collaborative efforts can help communities to gain efficiencies, share information, and strategically invest scarce public funds. GO TO 2040 encourages the formation of inter-jurisdictional planning groups to develop cooperative approaches to community challenges like economic development. Moving forward, fostering a collaborative environment to facilitate economic development would better utilize public resources and would benefit the region as a whole.