

Tax Increment Financing:  
A Case Study of Pierre, South Dakota

**A Professional Paper**

In Partial Fulfillment of the Master of Public Policy Degree Requirements  
The Hubert H. Humphrey Institute of Public Affairs  
The University of Minnesota

Gabriel D. Vogt  
May 12, 2009

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Dr. Jay Kiedrowski  
Signature of Paper Supervisor,  
certifying successful completion of oral presentation

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Date of oral presentation

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Dr. Jay Kiedrowski  
Signature of Paper Supervisor,  
certifying successful completion of professional paper

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Date

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Dr. Carissa Schively Slotterback  
Signature of Second Committee Member,  
certifying successful completion of professional paper

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Date

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## Introduction

Tax increment financing (TIF) is a popular economic development tool by which local governments use incremental property tax revenue to fund the public costs of economic revitalization and growth. For many years, municipalities have been looking for innovative ways to fund economic development projects. A wide array of policies, programs, and strategies has been designed to provide financial assistance, directly or indirectly, to businesses to promote economic development in a community. This paper focuses on one such economic development strategy – tax increment financing (TIF).

Tax increment financing has become increasingly popular throughout the United States over the last 25 years. Even though almost every state in the country has TIF authorizing legislation, some municipalities are just starting to utilize tax increment financing. The vast majority of academic research has been done on large municipalities and states that have used TIF for many years. However, the TIF literature lacks research on smaller rural communities that have started to use TIF districts to attract economic development projects to their communities. This paper will analyze the current academic literature about tax increment financing and use that information to examine a first-time TIF district in a small municipality.

Tax increment financing is a very attractive tool for municipalities and counties because of the lack of direct tax increases to finance economic development projects within their communities. This paper will explore the financial decision-making process the City of Pierre, South Dakota, went through to establish a tax increment financing district. This paper develops a better understanding of a city's rationale for using tax increment financing.

## Literature Review

### TIF Mechanics

The explanation used to educate elected officials about tax increment financing is usually simplistic. Financial consultants come to the elected officials and state that tax increment financing is basically incremental property tax revenue that is generated by new construction in a designated “blighted” area. This new property tax revenue is deposited in a special fund and used to pay for public improvements within the designated area. Unfortunately, this explanation does not do justice to the complexity of TIF. The financial decision for municipalities seems simple and risk-free. The following will give a detailed evaluation about the mechanics of tax increment financing.

Tax increment financing projects are used in areas defined as being “blighted.” The blighted areas in a city are deemed unable to attract economic development. TIF districts are used to correct market failure. Without government intervention and use of a TIF district, these areas would continue to see economic decline and no new economic development. The area within the TIF district would continue to see flat or falling property tax revenues for all of the taxing authorities in the area.

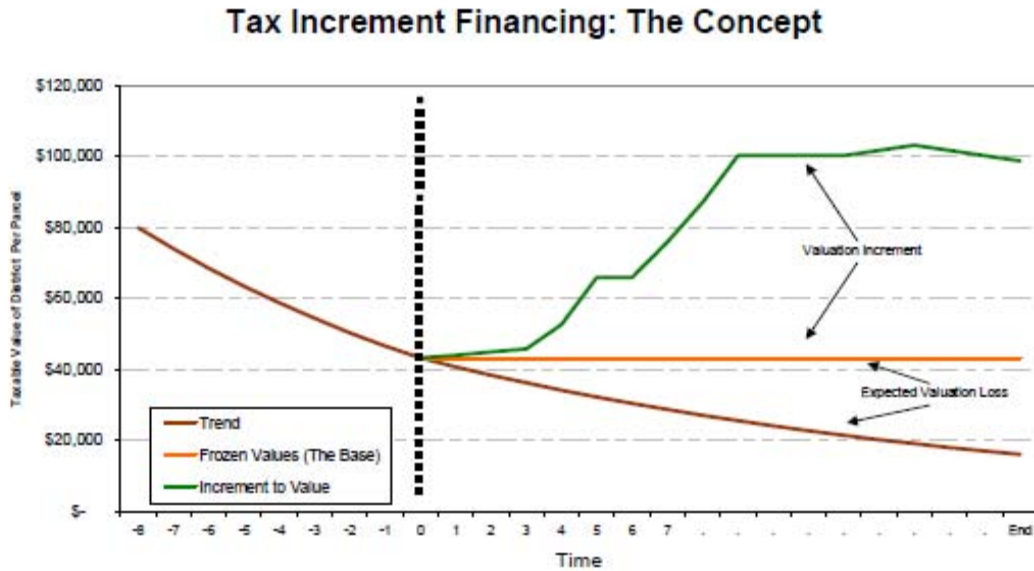
Once an area has been determined to be “blighted,” the city creates a tax increment financing district. On the day that the TIF district is approved, the property tax value of that district is frozen. All of the taxing jurisdictions that have property tax authority continue to receive the same amount of property tax dollars from the area. The other taxing authorities are usually the county, school districts, and special taxing districts. By freezing the taxable value of properties in the area, the taxing jurisdictions do not lose funds. However, the taxable authorities do lose the gains in property tax

revenue once redevelopment occurs. These taxing authorities will gain only the property tax benefits of redevelopment once the public costs for redevelopment have been repaid.

Before redevelopment can occur, the development authority can issue tax increment debt to finance the public infrastructure improvements. The tax increment debt is secured by the incremental tax revenues derived from property taxes levied within the TIF district. The alternative is to pay for the improvements once the new property taxes come into the district. The incremental tax revenue does not represent a new tax. Rather, the property tax revenue is a reallocation of a portion of the city's general property tax revenues. Tax increment debt is popular because in most states the financial obligations of the TIF district are not subject to municipal debt limits or public referendum requirements. "TIF is a way for general governmental units to provide off-balance sheet capital asset financing" (Johnson 71).

At this point in the TIF process, the city prepares the area for redevelopment. The area may need new public infrastructure – roads, sewer, and water. The TIF district may need to have old buildings condemned and demolished. Once the government has attended to the entire public infrastructure needs, it can redevelop the area. As the TIF district develops, the incremental value of new property taxes that the taxing authorities would have collected is retained by the governmental unit that undertook the TIF district to pay off the costs of readying the TIF district for redevelopment. According to Johnson's (2001) research, 65 percent of TIF bond issues have a term-to-maturity greater than 20 years (75). At the conclusion of repayment, all of the increment is released to all taxing jurisdictions. All taxing jurisdictions receive all of the new taxable wealth. The idea of tax increment financing is that after taking the initial risk, all of the taxing

jurisdictions are better off than they would have been if no action had been taken to create a TIF district.



(Swenson and Eathington 2)

The above graph is a representation of the tax increment financing concept. The horizontal axis is the time period. The vertical axis shows the taxable value (\$) of district per parcel of land. The red line (downward sloping line) on the graph is the taxable value of the land throughout the time period. As the graph shows, the land is experiencing a decline in its value. Without government intervention, the property tax value of the land would continue to fall, and all taxing authorities within the district would see declining property tax revenues. At time zero, when the TIF district is established, the tax base values are frozen for all taxing authorities – represented by the horizontal orange line. The green line represents the valuation increment. The increment grows slowly because of the time required to prepare the district for redevelopment. Also, as the site becomes more developed, it attracts more industry, commercial, and residential investments. When

the tax increment bonds are paid off, represented by the end point on the time scale, the entire increment is released to all taxing authorities. The graph clearly shows that the tax increment financing district benefits all taxing authorities in the long-run. In this example, without the TIF district, the taxing authorities would have lost \$80,000 (\$100,000 minus \$20,000) per parcel of land in the district.

The TIF process sounds good in theory. Unproductive land that is losing property tax value is declared a TIF district. While the city or county assumes the risk, every other taxing authority is held without risk or loss of funds. The city is acting in the collective best interest of all the taxing authorities. Because the city declares a TIF district, new growth in the area is started, and this governmental action enhances the public as well as private interests.

### Why Adopt a TIF District?

#### *Unemployment and Economic Decline*

In order to reduce unemployment and poverty, states and cities have chosen to use different types of tax and financial incentives to stimulate job creation (Man, Urban Studies 1151). Tax increment financing has become one of the most popular alternatives selected by local officials. One of the primary goals of TIF programs is to create jobs and increase the demand for labor by encouraging new businesses to locate in a targeted “blighted” area. Many elected officials believe that without government intervention in these “blighted” areas, developers and investors are more willing to choose outlying areas of the city for development. The investors are attracted to outlying cities because the land is usually cheaper and because infrastructure is often in better shape. TIF districts make

the inner-city “blighted” areas more attractive to developers because the government improves the infrastructure through TIF-generated funds.

Empirical analysis has shown that local governments use tax increment financing to help reverse a city’s increasing unemployment rate and economic decline. In Man’s (1999) research of the TIF adoption decision for Indiana cities, the author concluded that cities with higher per capita incomes are less inclined to adopt TIF than cities with lower incomes. Man’s research suggests that financially strained and economically distressed cities are more likely to use TIF as an economic development tool (1165). TIF districts are popular choices for communities struggling to attract new businesses to their communities.

### *Fiscal Stress*

Another reason cities may choose to adopt tax increment financing is the increasing strains on the budgets of cities. During the 1980s the federal government reduced federal aid to state and local governments. During the same time period, state and local tax dollars were increasingly committed to medical assistance, public safety, and other operating expenses (1151). The fiscal stress led cities to reduce or cut resources that were marked for capital improvements. With the lack of federal funds coming to states and with increased operating costs, cities have had to search for alternative means to fund infrastructure improvements.

In Man’s (1999) research of TIF districts in Indiana, the author found that cities with declining per capita state aid are more likely to adopt TIF, while cities experiencing increases in state aid are less likely to create a TIF district. Also, Man found that if a city recently increased property taxes, the probability of adopting a TIF is increased. Man’s



study suggested that fiscal stresses played a significant role in the municipal adoption decision (1165).

California is one state that has used tax increment financing because of fiscal stress. Many cities in California had to deal with natural disasters such as earthquakes, droughts, and forest fires. These disasters led to a decline in sales and property tax revenues and a short-term increase in public expenditures. Research by Chapman (2001) concludes that local fiscal stress as experienced in California influences the degree of TIF development that occurs (131). As city budgets around the country continue to be stressed by decreases in state aid and falling property tax revenues, the trend is that more cities will likely experiment with using tax increment financing for economic development projects.

#### *Political Attractiveness of TIF*

The main reason that tax increment financing is politically popular is because it is claimed to be a self-financing instrument that pays for the development projects from increased tax revenues that the project generates rather than from new taxes or tax increases (Man, "Determinants of the Municipal Decision" 93). Because the land is determined to be "blighted," the development on the land should produce larger tax revenues from that area than would have been produced if no development has occurred. The deferred benefit from increased property taxes seems reasonable to pay for the development costs (Klemanski 24).

Most TIF districts require a tax increment bond to finance the development costs of the project. Politicians like TIF bonds because most state laws do not require voter approval of the debt obligations through a referendum. Also, since general obligation

debt does not have to back the bonds, in most states the TIF bonds do not count against constitutional or statutory debt limits of the city. Without requiring voter approval and having no debt limit, TIF is very appealing for public officials who face a difficult task of generating funds for economic development (Man, “Determinants of the Municipal Decision” 93).

Some tax incentive programs for new businesses get a bad reputation with the public. Taxpayers do not like government handing out “corporate welfare” to new or expanding businesses (94). TIF is politically attractive because it is self-financing. No new taxes are raised to pay for economic development, and the government does not have to pay a direct subsidy to businesses. The TIF mechanism allows cities to recover the expenditures they make for development activities. With tax increment financing, politicians do not have to raise taxes, worry about their debt limit, or get voter approval.

### *Inter-Jurisdictional Competition*

Local governments often are in competition to locate new businesses in their community. In order to attract the businesses, local governments may adopt incentive programs to remain competitive in the selection process. Communities fear that without an extensive local incentive program, their communities would be at a distinct disadvantage. TIF programs become an essential addition to the incentive packages that local communities offer new businesses. Some communities believe that a solid incentive package that includes a TIF district has a significant effect on a firm’s decision to relocate to a community (94).

Man’s (1999) research showed that communities feel that they must provide TIF districts in their financial incentive package in order to remain competitive in the

selection process of a firm's relocation decision. Man's study showed that a city's probability of adopting TIF is increased if its neighboring cities have implemented a TIF district (1165). According to McHone (1987) research, a state's development incentive policies are influenced by the recent adoption of similar incentives in neighboring states. The research suggests that TIF districts are more likely if a city is willing to win a bidding war by copying incentive packages from cities that have been successful in attracting new businesses (95).

### *Reorientation of Local Development Policies*

During the 1980s, the federal government cut state and local government aid (Man, "Fiscal Pressure" 1151). As a result, cities had to change their urban renewal policies from rehabilitation of residential areas to strengthening commercial and industrial tax bases. Clarke and Gaile's (1992) research indicates that local governments in the 1980s shifted their public policy away from conventional economic development to a market-based approach (198). TIF emerged as a development tool that was well suited for the current economic climate. Cities using TIF districts were able to target specific development activities in areas that had distressed commercial and industrial businesses.

### *Expected Gains*

The increased use of tax increment financing as an economic development tool may be driven by the fact that local officials believe that economic incentives have significant influence on business location and expansion decisions. The perception that TIF has significant economic impact has been reinforced by studies of the impact of state and local tax policy on economic performance. Research done by Duffy-Deno and Eberts

(1991) found a positive relationship between public infrastructure investment and economic performance (340). These studies reinforce economic development officials' belief that reducing business costs by using TIF and offering tax incentives, financial subsidies, and new infrastructure will attract more business to the area.

Man's (1999) research confirmed that expected gains from the adoption of TIF districts influenced the municipal adoption decision. Man's research found a statistically significant positive effect of the expected growth resulting from the use of TIF on the probability of a city's adoption of TIF (Man, Urban Studies 1159). These findings support the argument that city officials implement TIF programs with the expectation that property tax values will increase with public investment.

### Perceived Benefits of TIF

#### *Public-Private Partnership*

Many developers and proponents of economic development have believed that state and local governments have been a hindrance to private business through bureaucratic delays such as complicated government forms and a long approval process (Man, "Introduction" 2). Proponents of TIF programs believe that such programs have made significant contributions to the beneficial restructuring of government and private relationships. Many believe that if government and private business work together, they can work to solve the problem of deteriorating areas within a city (2).

An example of an effective public-partnership occurred in Chesterfield, Missouri. In 1993, a flood destroyed Chesterfield Valley – a district the city envisioned as a potential area for economic growth. To recover from the flood, the city and private business used TIF as an effective tool to restore the development viability of the valley to

its pre-flood level. The TIF district debt was retired 10 years ahead of schedule. Several factors attribute to the TIF district's success, according to Staenberg and Herring (2008): 1) finding a well-financed developer/partner, 2) committing to spend all TIF proceeds on public infrastructure improvements, and 3) securing support from all taxing jurisdictions before establishing the TIF district (22). By creating and maintaining a successful public-private partnership, the city of Chesterfield was able to create economic development in a distressed area.

#### *A Tool for Correcting Market Failure*

When the private market is unable to achieve economic efficiency on its own, it is referred to as market failure (Man, "Introduction" 2). Tax increment financing has become a valuable tool that local government uses to correct private market failures. In theory, when market failure occurs, relying on private investment in a "blighted" area would leave other areas within the same city with an undersupply of capital. Instead, the government intervenes by offering tax incentives or other investments that otherwise would not have occurred. TIF districts may generate significant capital investment to certain types of projects that are economically feasible but would not have been funded without TIF (3).

#### *An Effective Economic Development Tool*

Tax increment financing programs are seen as an effective tool to locate business in a targeted area, resulting in increased economic activities, more jobs, lower unemployment, higher wages, greater property values, more tax revenue, and revitalization of blighted areas (3). In addition, some believe that TIF districts even create

economic growth outside of the development area. They theorize that the new businesses within a TIF district will have workers who will live outside of the targeted business area. This new population will generate increases in local income taxes, sales taxes, and motor vehicle excise taxes (3).

Man and Rosentraub (1998) investigated whether TIF programs raise property tax revenue in a community beyond the level that would have been expected, had the TIF district not been enacted. Their research concluded that Indiana TIF programs have increased the median housing value by 11.4 percent in the TIF-adopting cities relative to what it would have been without the TIF program (523). Their research demonstrated that the adoption of a TIF program does stimulate property value growth.

Individual cities around the country have shown anecdotal evidence that TIF programs are an effective economic development tool. For example, Greenville, South Carolina, established one of the first TIF districts in the area for revitalization of their historic downtown. Greenville's downtown has boomed while neighboring cities' downtowns remain dormant (Boyanoski 22). Because of local examples and extensive academic research, many local officials believe that tax increment financing districts are an effective economic development tool for local communities.

### *A Flexible Tool*

One of the main reasons tax increment financing is a popular tool is that it can be used in many different circumstances. Because most state TIF laws are not restrictive, TIF can be applied to any area meeting broad statutory standards (Paetsch & Dahlstrom 16). A city can use TIF almost any time it perceives an economic development opportunity – if it meets the broad definition of “blight.” The city may use the money

raised through the tax increment for a wide-range of purposes – capital costs, financing costs, professional services, and organizational costs. Development officials like to use TIF with other economic development programs simultaneously. Many cities use TIF funds as a part of a tax and financial incentive package used to attract and retain businesses (Protexter, 2008). The flexibility of TIF allows local governments to be creative with their economic development policies.

### Criticism of TIF

#### *Ineffective Economic Development Tool*

One fundamental criticism of tax increment financing is that most economic development programs are ineffective and inefficient (Man, “Introduction” 4). Many researchers believe that state and local governments’ financial incentives usually account for only a small portion of a firm’s production costs, so TIF programs are unlikely to affect business location or expansion decisions (Cummings, 1988). Surveys of business firms often show state and local taxes rank low as a location determinant. Executives claim that state and local taxes played little role in their firms’ location decisions when choosing between states (Man, “Introduction” 5).

Research by Dye and Merriman (1999) does not find a statistically positive effect of TIF adoption on annualized growth rate of property values from cities in the Chicago Metropolitan area (Man, “Effects of TIF” 105). Dye and Merriman’s research was controversial because most of the research of past TIF districts showed positive economic growth of a city because of TIF districts. In order to test their results, Dye and Merriman (2003) undertook another study to verify their first study’s results. The second study found similar results. The study concluded that policy makers should pay careful

attention to land use when considering TIF. Their research showed evidence that non-TIF areas of a municipality that use TIF grow no more rapidly and perhaps more slowly than similar municipalities that do not use TIF (29). In other words, Dye and Merriman believe that property value may grow in the TIF district at the expense of the rest of the city.

### *A Zero-Sum Game*

Tax increment financing has also been criticized as being a zero-sum game. When a state or city wins by convincing a firm to locate within its boundaries, other states or cities lose. Therefore, states and cities may compete for a finite number of jobs throughout the country or region. Zero-sum games are particularly likely to occur when a company decides to locate in a particular region. Cities within that region are more likely to compete for the business by offering extensive incentive programs to the firm. Since cities are likely to match or give even more extensive incentive programs, the marginal economic effect for a city may decline or even disappear. The bidding war between communities may allow companies looking to expand or relocate to expect communities to offer extensive incentive packages and thus reduce the economic gains for a community (Man, "Introduction" 5).

### *A Budget-Manipulating Instrument Used by Municipalities and Counties*

Critics argue that TIF is nothing more than a budget-manipulating instrument adopted by growing cities to capture property tax revenues that otherwise would have gone to the school district or other taxing authority (Anderson 157). The city that enacts a TIF district receives the funds from the increased property tax revenues to pay off the



development costs. However, not all of the taxing authorities are content with delaying the increased property tax revenues.

Usually the largest critics of TIF programs are the local school districts that lose the increased property tax revenues of the economic development. The school districts will have to pay more to finance their increased local service costs generated by the development of the TIF district. Even though the school district will get increased property tax revenues once the TIF bonds have been paid off, it usually take fifteen or more years for that to occur. Some states have enacted legislation to combat the loss of property tax revenue by school districts by giving additional state aid to the school districts affected by TIF districts (Lehnen & Johnson 142). This legislation remedies the school district's budget problems but places more fiscal demand on state budgets.

### *Complexity and Costliness*

Many critics argue that tax increment financing programs are too complicated and costly. Johnson and Kriz (2001) identify five stages in the TIF process: “1) initiation, 2) formulation, 3) adoption, 4) implementation, and 5) evaluation and termination” (32). These stages require considerable time and expertise above and beyond the city administration's normal duties. A typical TIF district requires an eligibility report, inspection of the project site, real estate valuation data, and a financial feasibility analysis. All of these stages require considerable expertise. Many city governments lack the in-house experience or expertise to effectively conduct the required steps for a TIF program. TIF opponents believe that the process is too complicated for a city to handle, so the cost of the outside experts increases the redevelopment costs of the TIF project.

### *Lack of Voters' Participation*

In some states, the decision to adopt tax increment financing districts is made without the citizens' voting or the participation of the other taxing authorities with overlapping jurisdictions. Also, since most TIF developments are funded through issuing TIF debt, the taxpayer could be exposed to considerable risk. Most TIF bonds are not counted against the debt limit of a city or county. Therefore, cities and counties can accumulate considerable TIF debt if they enact multiple TIF districts. If the increment of the TIF district were unable to pay the TIF debt, the taxpayers of the entire city could be exposed to higher property tax rates to pay bond holders. Critics believe that lack of voter participation allows cities to aggressively push TIF districts for redevelopment without concern for TIF bond default (Klemanski 26).

### *Abused Use of TIF*

“Some opponents of tax increment financing charge that some cities abuse TIF by designating large areas as TIF districts for the purpose of capturing tax increments not directly related to the public infrastructure improvements financed through TIF” (Man, “Introduction” 5). These critics argue that since the statutes that authorize TIF districts are sometimes vague, cities will use the increment for purposes unrelated to redevelopment projects. Many TIF projects are designed to maximize the potential property tax increment rather than to eliminate blight (Reingold 223).

The main goal of TIF is to direct private investment to an area that is considered “blighted.” However, critics of TIF argue that some TIF districts are created in areas that would have been developed regardless of the incentive of the TIF district. Parts of a city

that are near areas that are ripe for gentrification are sometimes targeted to speed up the process of gentrification.

There have even been a few legal cases where local authorities were charged with misusing TIF districts to solidify patterns of residential segregation within their city. In 1997, the village of Addison, Illinois, located twenty miles west of downtown Chicago, agreed to an out-of-court settlement for undertaking a TIF project that violated the Fair Housing Act of 1968 (Reingold 224). The city of Addison established two TIF districts in areas that needed retail space. However, the two TIF districts were gerrymandered to include only apartment complexes in which the majority of the residents were Hispanic. The selected housing districts were condemned and demolished while similar apartment complexes near the same development area that housed white residents were left untouched. Even though the Addison, IL, case appears to be an isolated incident, it is possible that other cases of TIF being abused to alter patterns of residential segregation have escaped public attention and legal scrutiny.

### Summary of Literature Review

Tax increment financing is a policy tool that allows a municipality or county to designate an area for economic improvement and then earmark any future property tax growth to pay for the economic development expenditures. The research suggests that if all of the future growth of property taxes with the TIF district is clearly and fully caused by the TIF-funded improvements, then TIF is a simple device where projects pay for themselves. However, TIF is controversial because studies conflict on the effectiveness of TIF. If some future growth in property taxes would occur without the TIF

expenditures, the use of tax increment financing can result in inefficient government expenditure choices.

Over the last several decades, the number of municipalities and counties adopting tax increment financing as an economic development tool has increased. The rise of the importance of TIF can be attributed to the decline in federal and state funding of other local economic development incentives. Municipalities find the self-financing mechanism of TIF politically and economically attractive. However, many cities do not fully understand the criticisms of TIF districts. If any increment to the property tax base would occur independently of the TIF project, then TIF raises a variety of incentive and equity concerns.

Deciding to undertake tax increment financing must be made with caution. The academic research compiled on TIF districts has shown mixed results. Some researchers find positive economic effects for the entire city, while other studies show only a shift in economic development within the city. As TIF districts continue to become more popular around the country, more extensive research will become available about the effectiveness of tax increment financing for economic development.

## TIF in Reality

### *Pierre, South Dakota*

Pierre is a small community of 14,000 people in central South Dakota. As the capital of the state, Pierre's top employer is the State of South Dakota. Over 2,300 public sector jobs are located in Pierre because of state government (PEDCO, 2008). The vast majority of Pierre's population is employed through some governmental entity. Good jobs from the private sector are scarce in Pierre. The top two private employers in the city of Pierre are St. Mary's Hospital and Wal-Mart, creating 450 and 350 jobs respectively (PEDCO, 2008). Pierre's population rises and falls with changes to state government's workforce. The city of Pierre is dependent on South Dakota state government for its survival.

The lack of private sector jobs in the community has caused city leaders to make economic development a top priority. In order to remain competitive and attract new businesses to the area, city leaders and the Pierre Economic Development Corporation (PEDCO) decided to experiment with alternative economic development options. One of those economic development tools city leaders have experimented with is tax increment financing.

Tax increment financing is a new concept for Pierre's elected officials. Previous city leaders had created three TIF districts, but project plans were never approved by the city commission. Therefore, those TIF districts were abolished. In the past two years, Pierre has increased its economic development initiatives and is moving forward with two new TIF districts. In 2008, Pierre approved TIF districts Numbers Four and Five. TIF district Number Four used TIF funds to clean up the site of an abandoned gas station and turn it into a multi-business facility (City of Pierre, "Resolution No. 2353" 2007). TIF

Number Five was part of an economic development package to entice a software-company, Eagle Creek Software Services, to locate a satellite office in Pierre (City of Pierre, “Resolution No. 2381” 2008). Both of these economic development projects were aimed at boosting private sector employment opportunities to the Pierre area.

This section of the paper will describe the development of a tax increment financing district, TIF District Number Five, the Eagle Creek Software Services Project in Pierre, South Dakota, from its inception to completion. Through interviews with stakeholders and documents obtained regarding the Eagle Creek TIF, this section of the paper lays out the process that elected officials used when deciding to use tax increment financing for economic development.

### *Eagle Creek Software Services*

Eagle Creek Software Services, a national organization headquartered in Minnetonka, Minnesota, specializes in implementing and integrating Oracle customer relationship management (CRM) software for Fortune 2000 clients. Eagle Creek is a consultant for a wide variety of industries, including financial services, health care, manufacturing, transportation, telecommunications, and consumer goods (Eagle Creek, 2008).

Eagle Creek has been a rapidly growing company since 1999 (Eagle Creek, 2008). It opened a satellite office in Valley City, North Dakota, in 2004, which brought 100 jobs to the area (Smithwick, 2005). By 2008, the company was looking to expand again. After considering numerous sites around the country, Eagle Creek decided to open a location in Pierre, South Dakota. This expansion is a big boost to Pierre’s economy. Eagle Creek promised to bring 200 private sector jobs to the area, making Eagle Creek

the third largest private employer in Pierre (PEDCO, 2008). Local and state economic development officials estimated the total local economic impact of Eagle Creek Software to be more than \$131 million over the next five years for the city of Pierre (Callahan, 2008).

Eagle Creek was a perfect fit for the city of Pierre. Pierre was looking for companies that would bring white collar jobs to the community (Gill, 2008). Since Pierre is a highly educated city with over 25% of adults with college degrees, Pierre wanted companies that fit the community's profile ([PEDCO](#), 2008). Pierre's elected officials believed that Eagle Creek would be welcomed by the community and has worked hard to make the company feel comfortable with its expansion. If Eagle Creek continues to expand, Eagle Creek's President and CEO, Ken Behrendt, has indicated to Pierre's leaders that an additional 750 jobs could come to the Pierre area (Carbonneau, 2008). The Eagle Creek expansion is the type of economic development that the city of Pierre hoped for when it began increasing its economic development activities.

#### *Governor's Office of Economic Development*

The Governor's Office of Economic Development (GOED) is one division in the state agency Tourism and State Development. The GOED's main focus is to be a clearinghouse for potential business expansion into South Dakota. Basically, the office sells South Dakota to the business community around the country. The office highlights the business-friendly atmosphere of South Dakota as well as gives financial incentives to possible economic development projects. The GOED notes that South Dakota has been ranked number one in Entrepreneurial Friendliness by Small Business and Entrepreneurial Council (GOED, 2008). South Dakota was also ranked number two by

the Tax Foundation for State Business Tax Climate (GOED, 2008). These rankings are good selling points to bring new businesses to the state.

The GOED was the first governmental organization to hear about the possible Eagle Creek expansion into South Dakota when the company contacted the GOED for information about possible sites to expand their operations. The GOED asked Eagle Creek to provide information/guidelines about what the company was looking for from a community (Brusseau, 2008). From this information provided by Eagle Creek, the GOED compiled a list of communities that fit the profile of Eagle Creek's needs. Since each city in South Dakota submits demographic information to the GOED to be used for business recruitment, the GOED was able to give Eagle Creek a list of 25 communities in South Dakota that fit the Eagle Creek profile (Brusseau, 2008). Pierre was one of those communities.

After Eagle Creek received the information about the 25 communities in South Dakota, they narrowed down the list to ten communities that they wanted to explore further. At this point the GOED sent out a "request for information" (RFI) to the selected cities. The RFI for Eagle Creek came to the Pierre Economic Development Corporation. Since the RFI did not list the name of the potential business, the project name for Eagle Creek was "Hawk." On the original RFI, PEDCO was asked to provide requested information about local contacts, infrastructure, housing, and community information. The only information provided to PEDCO was the type of company, target employee profile, facility needs, project costs, and incentive needs (GOED, RFI – Project Hawk, 2007).

Eagle Creek reviewed the RFIs and continued to narrow down the list of potential expansion sites. Pierre continued to make the cut. GOED sent another RFI to PEDCO for



more information about the community. This additional RFI was more descriptive. Eagle Creek wanted to know more in-depth information about the community, so PEDCO provided information about housing, recreation, fact sheet about other business in the area, community's commitment to retaining the workforce, and community plans for the future (GOED, RFI, 2007). Eagle Creek was concerned about retaining the young professionals if they moved to Pierre and wanted to make sure that Pierre would be a quality place for hosting potential clients (GOED, RFI, 2008).

As Eagle Creek narrowed the list down even further, Pierre was one of three communities in the state that Eagle Creek executives visited (Brusseau, 2008). At this point in the process, the GOED left the deal making to the cities and the company, but it acts as a facilitator in the process and will help cities develop an incentive package and development agreement. The GOED has staff expertise on different financial packages and does not push cities to use TIF, but when a city asks for assistance, it will provide information and contacts for specialists in the area (Brusseau, 2008).

The Governor's Office of Economic Development is always looking for economic development opportunities. They cold call companies, use referrals, and travel to conventions and expos to find leads for South Dakota. In 2008, GOED had 320 new prospects that led to 100 RFIs (Brusseau, 2008). Eagle Creek Software Services was a success story for the office in 2008. They matched a company's needs – Eagle Creek – to the needs of a South Dakota community – Pierre.

#### *Pierre Economic Development Corporation (PEDCO)*

The Pierre Economic Development Corporation (PEDCO) is a public-private partnership that seeks to attract businesses to the Pierre area. First formed in 1980 as

Pierre Unlimited, the Pierre Economic Development Corporation has been involved in many aspects of Pierre's growth. The Ramkota RiverCentre (meeting facilities), Runnings Farm & Fleet Distribution Center, and the Airport Industrial Park are examples of PEDCO's determination to build a better Pierre (PEDCO, 2008). PEDCO stresses to companies considering expansion or relocation that they will find supportive government with no red tape and a workforce ethic offering the highest level of quality, reliability, and productivity. PEDCO also offers financing, wage and labor studies, facilities, training, and a cost comparison of doing business in Pierre (PEDCO, 2008). PEDCO seeks to make a business transition to Pierre as easy as possible.

PEDCO has a staff of one, the Executive Director, Jim Protexter. PEDCO is an arm-length extension of the city government, and 75% of PEDCO's operating dollars comes from the city of Pierre (Protexter, 2008). The other 25% of PEDCO's operating dollars comes from the fees of 150 business members. Another source of PEDCO's funds is the operation of the Airport Industrial Park in Pierre. It owns the building and leases the space to Pierre businesses. The Eagle Creek building was built by PEDCO and then leased to Eagle Creek.

Since PEDCO received 75% of its operating funds from the city government, the city administrator and city commissioners serve on PEDCO's Board of Directors. PEDCO and city government have had a positive relationship with economic development projects. The past two mayors and city commission as a whole have been willing partners in PEDCO development projects. If the city commission has needed information regarding economic development project, PEDCO has provided it. When the city was developing the incentive package for Eagle Creek, PEDCO was the entity that presented the information about tax increment financing to the city commission.

PEDCO stresses to potential businesses the unique business characteristics of Pierre and South Dakota. Some of these state characteristics include no corporate income tax, no personal income tax, no personal property tax, no business inventory tax, no inheritance tax, competitive workers' compensation rates, the lowest average unemployment insurance rates, and the fourth lowest overall crime rate state in the nation, and in addition, South Dakota is a right-to-work state. The following are some of the unique characteristics for the city of Pierre: average commute time of less than 10 minutes, Expansion Management Education Quotient Gold Medal school district, highest high school graduation rates in the nation, and over 25 percent of adults with college degrees. American City Business Journal, the nation's largest publisher of metropolitan business newspapers, says the Pierre area (Hughes County) ranks first in the state and 95th in the nation for quality of life (PEDCO, 2008).

PEDCO's economic development leads come from three sources – community members, direct mail, and the Governor's Office of Economic Development (Protexter, 2008). GOED gives PEDCO about four or five leads a year -- the Eagle Creek Project was one of those projects. PEDCO knew little about the company that was asking for more information; all they knew was that a software services company was looking to expand and that they had infrastructure concerns (Protexter, 2008).

After it made the first cut, Pierre received the second RFI to fill out and sent it back to the state. This RFI had more information about Eagle Creek and its needs. The executive director of PEDCO spent his time preparing for a site visit from Eagle Creek executives and preparing community tours with the Pierre's city administrators. During these site visits by the company, PEDCO learned that Pierre was one of seven finalists located throughout the country. The two other communities in South Dakota being

considered were Yankton and Dakota Dunes (Protexter, 2008). In order to remain competitive, PEDCO and the city of Pierre tried to put together the best financial package possible to attract Eagle Creek Software Services. Their proposal included the economic development tool, tax increment financing.

PEDCO knew that the city commission needed help in understanding tax increment financing and that it was vital to the project, so PEDCO hired Toby Morris of Northland Securities as a consultant. Through individual meetings with city commissioners and public hearings, the TIF project gained popularity. The City of Pierre Planning Commission held a public hearing on April 21, 2008, to consider tax increment financing district number five. On April 22, 2008, the city commission approved the boundaries and created tax increment district number five (City of Pierre, Resolution 2381, 2008). PEDCO and consultant Toby Morris worked through the summer to develop the Project Plan for the TIF District Number Five. This project plan for TIF Number Five was approved by the city of Pierre on January 6, 2009 (City of Pierre, TIF #5 project plan, 2009).

PEDCO hopes that the city of Pierre will continue to be supportive of economic development. If the right opportunity comes again, PEDCO plans to partner with the city of Pierre or Hughes County in establishing future tax increment financing districts and hopes that the Eagle Creek Project will be a great example of an effective public-private partnership in economic development.

### *City of Pierre*

Pierre has a combination of the commission and manager-council types of city government, which consists of four elected city commissioners and an elected mayor, all

elected in city-wide elections. The mayor chairs the commission meetings but has no more power than each of the commissioners. The city commission hires a city administrator to carry out the day-to-day operations of the city, but he or she has the added responsibility of ensuring that policy and procedures adopted by the city commission are effectively carried out. The city administrator serves at the discretion of the city commission (City of Pierre, 2009).

The current city commission is composed of elected officials with varying degrees of experience with city government. The new mayor, Laurie Gill, was a former three-term city commissioner. Elected as Pierre's Mayor in June 2008, Mayor Gill has put economic development at the top of her agenda for the city. Commissioner Larry Weiss is a retired engineer who worked for the state and has been a commissioner for ten years. The other three commissioners were recently elected to the city commission. All five members of the Pierre City Commission are dedicated to economic development (Gill, 2008). One of the other commissioners, Steve Harding, is actually employed in the Governor's Office of Economic Development (City of Pierre, 2008).

The first time the city commission heard about the Eagle Creek Project was through PEDCO. Pierre had already made Eagle Creek's first cut through evaluating the GOED's RFI procedures. PEDCO came to the city commission to help prepare the city for the tours of Pierre by Eagle Creek executives. With PEDCO and the City of Pierre as partners, they realized they needed to have a point person in the city government who could focus on a possible Eagle Creek transition. The City of Pierre hired Scott Carbonneau for a newly created position – Community Development Coordinator. In this position, Carbonneau works to integrate companies into the community. He takes prospective companies and employees on tours of the city and works with other

stakeholders in the community to fix problems that would occur with new companies locating in Pierre (Carbonneau, 2008).

Since Eagle Creek's main concern about expanding to a new location was housing and the social characteristics associated with employee recruiting and retention efforts, Carbonneau focused his attention on meeting possible housing needs. He created a website to help potential employees find appropriate housing. He also conducted a community survey to find areas of need to help the community grow. After all of the marketing efforts of Pierre by PEDCO and the members of the city government, Eagle Creek chose Pierre for its expansion.

After Eagle Creek chose Pierre as the site for its expansion, PEDCO came to the city commission to discuss the use of tax increment financing. The members of the commission were excited at the opportunity to have a new business in the city and were looking to help in any way that they could. However, the city commission did not have a lot of experience with TIF and were uncomfortable with moving too quickly. The mayor was also concerned that public perception would be that the city government was giving away public funds to attract a company to the area (Gill, 2008). The city commission held a public hearing at which PEDCO and consultants educated the commissioners and the public on TIF. The city knew that the process had to be done quickly in order to meet the needs of Eagle Creek. The city of Pierre passed TIF district number five Eagle Creek project only a month after the project was presented to them (Gill, 2008).

After going through two tax increment financing projects within the last year, the city has gained institutional knowledge that they believe will give them an advantage in recruiting new businesses to the area. Mayor Gill believed that the Eagle Creek TIF was a

great learning process and hopes to use TIF and other alternative economic development tools for future business developments (Gill, 2008).

### TIF Pros and Cons with Stakeholders

The first section of the paper outlined the perceived benefits and criticisms of tax increment financing by looking at academic studies and papers. This section of the paper lays out the views about tax increment financing from two of the key stakeholders in the Eagle Creek TIF. The information presented came from personal interviews of two of the key stakeholders of the Eagle Creek TIF District – Jim Protexter (Executive Director, PEDCO) and Laurie Gill (Mayor, City of Pierre).

#### *Jim Protexter, Executive Director, PEDCO*

Mr. Protexter believes tax increment financing is an effective tool for municipalities and counties when trying to spur economic development. When businesses are looking to relocate or expand to an area, the company often looks at the business climate of the area. With TIF districts being developed in a community, a company may believe that the city government is willing to work with private business. The public-private partnership is essential for a positive business climate (Protexter, 2008).

According to Mr. Protexter, TIF does correct market failure. In the case of the Eagle Creek TIF, the designated TIF district was an undeveloped, commercially zoned property located behind the Pierre Mall and close to new residential construction. The TIF district spurred the economic development. According to Mr. Protexter, the Eagle Creek project would not have happened without TIF (Protexter, 2008).

When asked about the TIF requirement for finding blight on a property, he indicated that the Eagle Creek Project met the statutory requirements (Protector, 2008). In South Dakota, 25% of the TIF district must be considered blighted. South Dakota's laws make the finding of blight simple:

An area which is predominately open and which because of obsolete platting, diversity of ownership, deterioration of structures or of site improvements, or otherwise, substantially impairs or arrests the sound growth of a municipality is "blight." (Ellingson, 2001)

Mr. Protector criticized neighboring City of Fort Pierre in its use of TIF for a new hotel located on the banks of the Missouri River. He believed that if a riverfront property is considered blighted, an open field (Eagle Creek site) near the airport certainly fits into the definition of "blight" as well (Protector, 2008).

In addition, Mr. Protector believes the city of Pierre would be less willing to engage in financing of economic development projects if the city had to use conventional city funds (Protector, 2008). With tax increment financing the city can support economic development as well as continue the same level of support to its citizens.

According to Mr. Protector, TIF is a very flexible tool. Many different project costs can be paid by TIF funds (Protector, 2008). According to South Dakota law, TIF funds may be spent on public works or improvements associated with the project. These include costs for site preparation, installation of utilities, and construction of streets, sidewalks, public parking, and landscaping. It also includes costs associated with architect and engineering fees, construction management expenses and insurance (Ellingson, 2001). This flexibility allows economic development projects to move forward without undue red-tape (Protector, 2008).



Mr. Protexter does not have a lot of criticism of tax increment financing. He believes that most of the common criticisms of TIF have been addressed by South Dakota law. One major criticism is that TIF districts can be abused. According to Mr. Protexter, South Dakota requires a blight study, which ensures that improper uses of TIF will be caught. Also, South Dakota law makes TIF debt count toward the TIF authorizing jurisdiction's debt limit (Morris, 2008). This greatly hampers communities from overusing TIF.

Mr. Protexter believes that the perceived lack of voter participation could affect future TIF projects. Mr. Protexter points out that the Eagle Creek TIF was discussed and explained in an open city commission meeting that was recorded for viewing on public television. In addition, citizens have a thirty-day window in which they can gather signatures to refer the TIF district plan for voters' approval (Protexor, 2008).

*Laurie Gill, Mayor, City of Pierre*

Mayor Gill knew little about tax increment financing when PEDCO came to the city commission to ask for TIF funds. Through education and the experiences of the TIF Districts Number Four and Number Five, the mayor has come to believe that tax increment financing is a good economic development tool for cities to use to attract new private businesses to the community (Gill, 2008).

Mayor Gill believes that the TIF process has made the bond between the city of Pierre and Eagle Creek Software Services stronger. Without positive governmental help, Eagle Creek could feel less a part of the community and could be less willing to stay or expand its Pierre operations. The mayor believes that if other private businesses can

justify a TIF, the city of Pierre must be willing to help because it wants the reputation of a strong supporter of the business community (Gill, 2008).

One of the positive aspects for TIF is that elected officials like the option of supporting private enterprise without taking away public funds. However, Mayor Gill pointed out that in South Dakota, TIF districts can be referred to public vote. She wanted to make sure that the process was transparent in order for the public to be fully aware and comfortable with the city's decision. The only concerns the public had regarding TIF District Number Five were the increases to the city's debt limit; some people thought the city was changing too quickly (Gill, 2008). There were no disagreement by Pierre's citizens at the public meeting, and the questions that were asked were answered satisfactorily by the commission (Gill, 2008).

One aspect that attracted Mayor Gill to tax increment financing was the self-financing aspect, which allowed the city to move quickly to support the Eagle Creek development. She was glad that the city did not have to search for federal funds to help with the development, allowing the city to move ahead quickly without going through bureaucratic red-tape (Gill, 2008).

There were only two criticisms of TIF that Mayor Gill discussed during the interview. One was the complexity and costliness of enacting a TIF district. Mayor Gill stated that the TIF process was complicated. However, plenty of TIF experts that helped the commission understand what legal obligations the city was entering into. Even though the TIF funds were used to pay for the consultants, the taxpayers indirectly paid for them through a larger TIF bond. Mayor Gill believes that in the future those costs will go down because of the institutional knowledge PEDCO and the city of Pierre gained through the TIF process (Gill, 2008).

The other criticism of tax increment financing addressed was the possibility of a zero-sum game with competing communities. Across the Missouri River is the small community of Fort Pierre, which has also been experimenting with TIF districts in the past few years. However, Mayor Gill does not believe that the two communities will compete for businesses looking to relocate to the Pierre-Fort Pierre community. Rather, she believes that the communities will work as partners. If one community uses a TIF to attract a business, both communities will benefit (Gill, 2008). Since all taxing jurisdictions are constrained by South Dakota's laws regarding TIF and city debt limits, she hopes to partner with Hughes County to take the lead in future TIF projects that would benefit the community. Mayor Gill believes that creating partnerships is more important for the community than competing with different jurisdictions (Gill, 2008).

*Tax Incremental District Number Five, City of Pierre – Project Plan*

According to South Dakota law, the city commission of Pierre must pass a tax incremental financing plan. In the TIF plan, the city must meet certain statutory requirements (City of Pierre, TIF Plan 2009). One of the first requirements is an economic feasibility study, which lays out the need for a TIF District. According to the feasibility study, “Without the city’s financial participation and support, TIF 5 could not be redeveloped and new facility be constructed as proposed” (15). The city has funded \$828,000 for project costs. The total cost of the redevelopment project is approximately \$4,200,000 (15). The amount of property tax value over the based assessed value will be approximately “\$999,884 in the first year, rising to approximately \$4,375,000 in the final year” (16). The study concludes that TIF 5 would be feasible to finance the requested TIF funds.

The next portion of the TIF plan includes the Blight Certificate Report for TIF Number Five. In this report, the TIF plan describes the statutory criteria met to have the land considered blighted in the TIF District. According to the TIF plan, TIF Number Five found the following conditions of blight: 1) predominance of defective or inadequate street layouts, 2) faulty lot layout in relation to size, adequacy, accessibility or usefulness, 3) unsanitary or unsafe conditions, 4) defective or unusual conditions of title, 5) the existence of conditions, which arrest the sound growth of a municipality or constitute an economic or social liability, and 6) open areas impairing growth defined as blighted (23). According to the blight study, TIF District Number Five meets the conditions of blight.

Another section of the TIF Plan is a fiscal impact statement. The fiscal impact statement is intended to provide a quick analysis of the impact to overlapping jurisdictions in the TIF district. According to the TIF plan, the cumulative impact of the TIF district on the local school district was \$147,656.25. The cumulative impact on Hughes County was \$161,578.13. The TIF plan does point out that the full school levy is 14.77 but realizes an impact of only 3.50 per \$1000 of valuation. The difference is made up by the State of South Dakota. If the numbers were analyzed using present value at 6%, the cumulative impact for schools would be \$93,396.59 for the school and \$102,202.56 for the county (14). These numbers are only projections. Inflation was not taken into account nor was the possibility of future construction on the site.

The final portion of the TIF plan contains the development agreement between PEDCO and the city of Pierre. This agreement lays out the Eagle Creek project in legal terms. According to the development agreement, the city will buy the TIF land for \$828,000 and will then sell the land to PEDCO for \$1. The cost of the project and all other improvement expenses will be paid through the use of the developer's own capital.

PEDCO may use the TIF district as collateral to secure loans for the financing of the project. This agreement holds the developer, PEDCO, liable if the TIF Revenue is insufficient to cover the debt service. The agreement was signed January 6, 2009 (39).

## Analysis

### *Effective Economic Development Tool?*

Academicians have argued about the effectiveness of tax increment financing in spurring economic development. A Man and Rosentraub (1998) study investigated whether TIF programs raised property revenue in a community beyond the level that would have been expected had the TIF district not been enacted. Their research found that TIF programs raised the median housing value relative to what it would have been without the TIF program (523). However, research by Dye and Merriman (1999) did not find a statistically positive effect of TIF programs on the annualized growth rate of property values in the Chicago Metropolitan area (Man, “Effects of TIF” 105). Therefore, the academic literature on TIF programs’ effectiveness is mixed.

The Eagle Creek TIF in Pierre has brought a new company to the community’s business environment. Approximately 200 new jobs will help stimulate the economy of the area, and city leaders believe that without tax increment financing, the new jobs would not have come to Pierre (Protexter, 2008). Even though there is not any empirical evidence to show that the city would not have been able to attract Eagle Creek without TIF, there have been no major employers coming to the city of Pierre prior to the use of tax increment financing. This is anecdotal evidence, but city leaders are adamant that TIF was vital to the final decision of Eagle Creek to locate to Pierre (Gill, 2008).

### *Fiscal Stress?*

Another reason cities may choose to adopt tax increment financing is the increasing strain on city budgets. Man’s (1999) research of TIF districts in Indiana

showed that cities with declining per capita state aid are more likely to adopt TIF, while cities experiencing increases in state aid are less likely to create a TIF district (Man, Urban Studies 1165). The Eagle Creek TIF does not seem to be the result of fiscal stress on a city budget. Rather, the city leaders believed that using general funds of the city budget to entice economic development would have been tough to sell to their constituents. TIF was a more politically attractive option. However, with the increasing strain on city and state's budgets with the economic decline across the country in 2008 and 2009, more TIF may be used because of fiscal stress. The tough economic situation may result in TIF being the only option for cities to use for economic development opportunities instead of being one option among many tools.

#### *Political Attractiveness?*

Tax increment financing has been used by city leaders across the country because of its political attractiveness. First, TIF seemingly pays for itself; taxpayers do not directly pay for the economic development project. Secondly, tax increment bonds do not usually affect the city's debt limit since they are often not general obligation bonds. Finally, TIF usually does not need voter approval. All of these facts give incentive to politicians to use tax increment financing for economic development projects.

One of the reasons that the city of Pierre did use TIF was the political expediency of the TIF process. PEDCO and city officials realized that they would need to hurry in order to get a plan in place to entice Eagle Creek to come to the city. Going through traditional bureaucratic red tape could have cost the city the new jobs from Eagle Creek.

The state of South Dakota has different TIF laws than many other states in the country. In South Dakota, TIF districts can be referred to public vote. Currently, no TIF

districts in South Dakota have been subject to voters' approval (Morris, 2008). Therefore, Mayor Gill did try to have a transparent TIF process to avoid any voter-initiated setbacks. To date, the public has shown little resistance to using tax increment financing to attract economic development projects to the area (Gill, 2008). Finally, South Dakota's TIF laws make the city count TIF debt toward their debt limit. This fact could greatly slow the growth of TIF districts in the city. Mayor Gill did mention that she hopes to partner with Fort Pierre – the small city across the river – and Hughes County in order to continue to offer TIF districts for economic development projects while avoiding problems with constitutional debt limits (Gill, 2008).

During the 2009 South Dakota legislative session, a bill was introduced that would have mandated that TIF districts be approved by all governing bodies that have jurisdiction over the TIF districts (LRC, 2009). This bill was introduced on behalf of county governments frustrated by the use of TIF districts by city governments. Proponents argued that the increase in TIF districts throughout their counties greatly constrained the counties' budgets. The bill was defeated primarily because economic development experts testified that this bill would slow or possibly kill future economic development activities throughout the state. Even though this bill did not make it past the committee phase, any changes to South Dakota's TIF law could either greatly increase or slow TIF's growth in the future.

#### *Public-Private Partnership?*

One perceived benefit of tax increment financing is the partnering of the public and private sector. In the past, many developers and proponents of economic development policies have felt that the governments have been a hindrance to private



business through red-tape and bureaucratic delays. Proponents of TIF believe that such programs have made significant contributions to the restructuring of government and private business relationships. There are many anecdotal cases where TIF created a beneficial partnering between private businesses and the government. In Chesterfield, Missouri, a flood destroyed an area that was considered a potential area for economic growth. To recover from the flood, the city and private business used TIF to effectively restore the viability of the area (Staenberg & Herring 22). Staenberg and Herring's (2008) research concluded that in order for a successful TIF, these factors contributed to its success: 1) finding a well-financed developer, 2) committing to spend all TIF proceeds on public infrastructure improvements, and 3) securing support from all taxing jurisdictions before establishing the TIF.

The Eagle Creek TIF could also be seen as an effective public-private partnership. PEDCO and the city of Pierre worked extremely hard to make the transition for Eagle Creek as seamless as possible. Mayor Gill believes that the TIF process has made the bond between the city of Pierre and Eagle Creek stronger and that without positive governmental support, Eagle Creek would feel less a part of the community and may not be willing to stay or expand their Pierre operations (Gill, 2008). This optimism may be naïveté from a community with little experience with tax increment financing. However, it seems that the actions of Pierre's city government have created a positive business environment in the community.

### *Flexible Economic Development Tool?*

One of the main reasons tax increment financing has become a popular tool for local development officials is that it can be used in many different circumstances. Its

flexible nature allows cities to use TIF any time it perceives an economic development opportunity. Also, according to South Dakota law, TIF funds can be spent on public works or improvements associated with the project. These include costs for site preparation, installation of utilities, and construction of streets, sidewalks, public parking and landscaping. TIF funds can also be used for costs associated with architect and engineering fees, construction management expenses and insurance (Ellingson, 2001). Many times TIF is used as part of a tax and financial incentive package to attract or retain a business in the community.

The Eagle Creek TIF utilized the flexible nature of the tax increment financing laws in order to pay for “real property assembly” on the Eagle Creek site (City of Pierre, “Project Plan” 2009). These “real property assembly” costs are not itemized in the project plan. From reading the project plan, one would assume that these estimated costs include acquiring the land, preparing it for development, and paying consultant expenses. However, nowhere in the project plan are these costs specifically listed. The flexibility of TIF allowed the Eagle Creek project to move forward without undue bureaucratic red-tape (Protexter, 2008).

### *Complexity and Costliness?*

One of the major criticisms of tax increment financing is that it is complex and costly. Johnson and Kriz (2001) identified five stages in the TIF process: “1) initiation, 2) formulation, 3) adoption, 4) implementation, and 5) evaluation and termination” (32). All of these stages require considerable time and expertise. A typical TIF district requires an eligibility report, inspection of the project site, real estate valuation data, and a financial feasibility analysis (33). Many city governments lack the in-house expertise to effectively

conduct the required steps of a TIF program. Since the process may be too complicated for a city to handle, outside experts are needed to complete the required tasks. Those costs are included in the TIF expenses. Thus, the total redevelopment costs for the TIF go up.

The City of Pierre did not have the expertise to effectively create, run, and evaluate a tax increment financing district. PEDCO has a staff of one, and the city of Pierre did not have any staff member with expertise about TIF. The city commission needed to hire a consultant to inform the commission about TIF. This consultant not only educated the commission but also wrote the project plan for the Eagle Creek TIF. Because of the increased use of consultants, the taxpayers had to pay indirectly for the lack of knowledge and expertise through a larger TIF bond. Mayor Gill acknowledged that the process was complicated and costly. However, Mayor Gill believes that in the future those costs will go down because of the institutional knowledge that PEDCO and the City of Pierre gained through two TIF processes (Gill, 2008).

### *Abused Use?*

There have been documented cases of TIF abuse. For example, in Addison, Illinois, local authorities were charged with misusing TIF districts to solidify patterns of residential segregation within their city. The City of Addison wanted to create new retail space within their city. The city officials gerrymandered two TIF districts to include only apartment complexes where the majority of the residents were Hispanic. The similar apartment complexes comprised of white residents were left untouched (Reingold, 224).

Most abuse of TIF districts is not as obvious. The definition of “blight” varies between states, allowing local development officials to develop land for which the

“blight” status could be seen as questionable. Since these types of projects follow the letter of the law, they are allowed to continue but as a result, create a bad public perception. Abuse and overuse of TIF could cause the public to turn against the continued use of TIF.

According to South Dakota law, 25 percent of the TIF district must fit the statutory requirements for being “blighted.” South Dakota law defines “blight” in a very broad manner: “an area which is predominately open and which because of obsolete platting...deterioration of structures or otherwise, substantially impairs or arrests the sound growth of a municipality is blight” (Ellingson, 2001). At first glance, the land for the Eagle Creek TIF does not seem blighted. The land is an open field on the edge of town. But according to the project plan, the land meets the definition of blight because of “inadequate street layout (none present), unsafe conditions (no existing infrastructure), and the existence of conditions that arrest the growth of the city (challenging topography)” (City of Pierre, “Project Plan” 2009). Some may find the broad analysis as stretching the truth. However, the author of this paper could not determine if the certificate of “blight” was evaluated by anyone other than the city commission.

Across the Missouri River from Pierre is the small town of Fort Pierre. Recently, Fort Pierre did their first tax increment financing district. The Fort Pierre TIF project was for the construction of a hotel located on riverfront property. PEDCO Executive Director Jim Protexter believes that the statutory definition of blight can be abused. However, Mr. Protexter believes that if a riverfront property is considered legally blighted, then an open field (Eagle Creek site) near the airport fits into the legal definition of being blighted. No resident of Pierre has complained over the Blight Certificate report for the Eagle Creek project.

### *Effective TIF Plan?*

According to South Dakota law, the city commission of Pierre must pass a tax increment financing plan. In the TIF plan, the city must complete certain statutory requirements: economic feasibility study, blight study, list of project costs, fiscal impact statement, and monetary obligations (City of Pierre, Project Plan 2009). All of these statutory requirements are in the TIF Number Five Project Plan. However, this author found the information contained in these statutorily required items lacked details. For example, the economic feasibility study is a four-page document with little in-depth analysis. The study restates what a TIF district is and the steps required in South Dakota to finalize the TIF plans. The last two paragraphs of this document explain that the property tax value will rise from \$999,884 in the first year to \$4,375,000 in the final year (16). The document concludes that TIF 5 would be feasible to finance \$828,000 (16). There is no rationale provided for why the amount of \$828,000 was chosen. Was this dollar amount the estimated costs of the project, or was this dollar amount the most the city leaders felt they could comfortably finance? Explanations to these questions could ease concerns raised over the amount of TIF dollars financed.

Schedule 1 of the project plan is a detail of the project costs (11). The entire “detail” of the project costs includes: “Real Property assembly cost of \$828,000 for All of Lot 1 of the Plat of lots 1-5, Eagle Hills Development to the City of Pierre, Hughes County, South Dakota, according to the recorded plat thereof” (11). This lack of detail of actual project costs increases the likelihood that taxpayers may grow weary of how tax increment funds are being spent. This description may meet statutory requirements, but this author believes that a much more detailed description of project costs should be

included in this project plan. Citizens might want to know how much of the TIF funds are going to consultants, construction fees, and/or land improvement.

The fiscal impact statement is a two-page document that shows the estimated impact on all entities levying taxes upon the property in the district. This document states that it “is not intended to rival the level of detail required by a detailed financial analysis” (13). The second page contains a chart estimating the impact to the school district and the county. This impact also has a present value analysis to show the actual value of the revenue stream. This author believes that a detailed financial analysis would be helpful to better understand the assumptions made by the project plan. A member of the school board and/or a member of the county commission would be interested to know how these assumptions are made since the impact is felt directly in their budgets. Also, the statewide taxpayer would be interested to know that in South Dakota, the state makes up the difference of the increment to the school districts. Therefore, taxpayers in cities that do not have TIF districts are indirectly paying for the school districts in other jurisdictions that do have a TIF project. Especially during years when state budgets are tight, a large number of TIF districts in the state could put an increased strain on state budgets to make up the difference in school districts’ budgets because of TIF.

Finally, the last portion of the project plan is the development agreement between the City of Pierre and PEDCO. This part of the document defines the project and is heavily laced with legal terms. According to the development agreement, the city will buy the TIF land for \$828,000. They will then sell the land to PEDCO for \$1. The cost of the project will be paid through all of the developer’s own capital (39). This author found the development agreement very confusing. The entire project plan lays out what the city can use TIF funds for, and then the development agreement said all of the money is being

used to buy the land. This may be the legal way a development plan is written, but this author believes that to the lay person the development agreement muddies the intentions of the city and PEDCO. At minimum, a section of the project plan should summarize the development agreement with PEDCO.

## Conclusion

The purpose of this paper was to better understand the theories behind tax increment financing and the process of using TIF in the real world. The author chose the City of Pierre, South Dakota, because of the author's knowledge of the city, the small population of the city, and the relative inexperience of the city officials in using TIF. This paper has given the author a better understanding of the importance of TIF for small municipalities looking to invest in economic development projects. In tough economic times and tight city budgets, tax increment financing definitely has an appropriate use and is a very attractive tool because of no increased taxes for citizens with the possibility of increased economic development.

Even though using tax increment financing sounds like an easy decision for government leaders, this paper has uncovered concerns about TIF in general and specifically with the Eagle Creek Plan. TIF's effectiveness as an economic development tool is still being debated by academicians. TIF is costly and complex and can be abused. Companies can demand that cities use TIF in order for them to locate or stay in a community. Also, since so few understand TIF, it is easily subject to misinformation or baseless concerns by the public.

Therefore, this author believes state legislators could take the following steps to strengthen tax increment financing laws:

- **Increase transparency with the TIF process by fully disclosing all agreements made between the TIF authorizing entity and companies benefiting from TIF.**



Pierre's TIF Number Five Project plan, which in South Dakota is a public document, has no information about the agreement made between PEDCO and Eagle Creek. Therefore, the public should be concerned about the city's risk if Eagle Creek abandons Pierre before the TIF debt is retired. Taxpayers should be made aware of the consequences of a failed TIF district and the possible liabilities from it.

- **Include in the Project Plan alternative scenarios that could occur during the TIF District's lifetime.**

This author believes that economic development officials sometimes create too rosy a picture about TIF to elected officials and make it sound as if TIF has no risk. The current economic climate has shown the first major decline in property values since the Great Depression. This fact may mean that some TIF Districts around the country will have a smaller increment than projected and that the TIF debt may not be able to be paid. By developing these alternative scenarios, city leaders and taxpayers will have more information available to better evaluate a TIF plan before it is enacted.

- **Make clear rules regarding eligibility requirements for a TIF District.**

In South Dakota, the finding of blight is not a large burden for economic development officials. Practically, any piece of property could be construed to meet the minimum requirements of blight. This fact could lead to abuse by municipalities. Also, the state law should be very specific about what kind of businesses can qualify for a TIF. For example, all communities need grocery stores, hotels, and restaurants. If there is a need, private investment should pay for it. The government should not approve a TIF district for a business that could have come to the city without government assistance.

All things considered, the Eagle Creek TIF was a good decision for the City of Pierre. It has brought new jobs, new faces, and less reliance on state government for

employment to a small community. In addition, city leaders are more aware of economic development options in order to grow the city in the future. There is a genuine excitement throughout the community about Eagle Creek's arrival in Pierre. But in order for future TIFs to occur, the city must realize that the public is skeptical of TIF and unaware of the details. City government should try to continue to educate the public and make the process as transparent as possible. Without continued public support, TIF will not continue and economic development could suffer.

Tax increment financing is still a relatively new economic development tool. Since TIF districts remain active for many years, it is uncertain if the long-term consequences of TIF have been adequately studied. In the future, this author would like to follow-up on the Eagle Creek TIF. Did the Eagle Creek TIF succeed? Do local governmental leaders still want to use TIF as an economic development tool? Did the city change the process of establishing TIF projects? By following up on these types of questions, the process of tax increment financing can be improved, and small municipalities can use TIF wisely for economic development.

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