# Making Tax Incentives Work

## Lessons from Boston, Massachusetts

The use of tax incentives to encourage economic growth has increased over the last several decades. Given this escalation, it is important for policy makers to employ techniques that promote growth while avoiding practices that needlessly erode the tax base. Tax incentive policies must balance the desire to stimulate job growth and economic activity with the need for fiscal integrity and performance.

Elected officials understand that a vibrant economy produces jobs, raises incomes, and expands the tax base. In an economic system based on competition, incentive programs provide tangible evidence of a political leader's commitment to attracting businesses and providing economic opportunity to their communities. Many tax incentives, however, are not effective. Academic studies of the economic impact of tax incentive mechanisms conclude that many are either unnecessary or wasteful, often subsidizing businesses for activities they may have undertaken anyway.[1]

Boston's tax incentive policies and tactics attempt to strike the right balance, supporting expansion of the City's tax base, appreciation in property values, and job and income growth in recent years. Property tax revenue is critical to Boston's overall fiscal health, generating nearly 70 percent of revenue; growth of the property tax base is essential for covering escalating municipal costs and funding new initiatives. While Boston's economy grew by 5.3 percent from 2013 to 2014—significantly more than the U.S. or Massachusetts growth rates of 2.4 percent and 2.5 percent, respectively[2]—the City has demonstrated the ability to generate this economic growth while maintaining strong fiscal performance, achieving a AAA bond rating while meeting the public service demands of a growing population and workforce. Tax incentive policies are just one element of many contributing to Boston's favorable economic performance.

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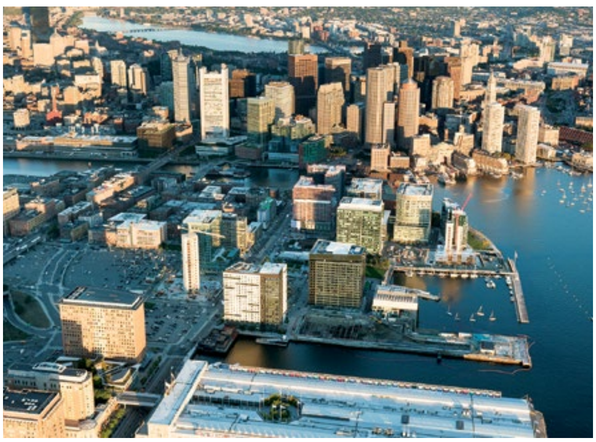

**Fan Pier Boston, Before and After**

The City of Boston used tax incentives to stimulate development and expand the tax base in Fan Pier, in Boston's Seaport District, shown here in 1987 before redevelopment and in 2014 after the project was complete. *Credit: Steve Dunwell*

## Recommendations

The following core practices, drawn from the experience of Boston, Massachusetts, provide lessons from an incentive program that has proven able to maximize economic impact while minimizing the risks of unnecessary subsidies.

### ESTABLISH CLEAR GUIDELINES

Communities with clear policies for the use of incentives are less likely to use them when they are not necessary. A community with set guidelines is also unlikely to overextend in the heat of a competition to attract a company or advance a development. The most important factors to consider are the state of the local economy and the community's fiscal condition and tax structure. For example, a community may be more inclined to offer tax incentives when economic conditions are soft, or when real estate development is slow.

Boston's tax incentive policy is driven by its reliance on property tax revenues. New development is expected to proceed without incentives and pay full taxes. Incentives are exceptional, considered only when they are necessary to advance economic development priorities where the market does not support full taxes. Reasons for offering an incentive may include:

- assisting a project with unique economic or construction challenges,
- attracting a key industry or company that will yield many more jobs, or
- stimulating economic development in a strategic location.

Incentives should play only a supporting role in an economic development program. Expedited permitting, infrastructure assistance, and other efforts to highlight Boston's comparative advantages are also important to drive economic development.

### ESTIMATE THE FULL TAX BILL FOR ALL PROJECTS

It's important to determine the full taxes that a project would pay without assistance before offering a tax incentive. A firm or developer often requests a tax incentive without knowing the level of taxes without assistance. Determining the full tax level may allow a community to demonstrate that its level of taxation is competitive or that a project is feasible without an incentive. This exercise also demystifies the assessment process, making the tax amount a more certain, predictable cost.

The full tax amount also provides a benchmark for determining the cost of any incentive. When the cost of a potential incentive is known, a community is more likely to stay within its incentive policies and not overextend. A clear cost benchmark also provides transparency, as the value of any incentive offer is established.

### REQUIRE COMPANIES AND DEVELOPERS TO PROVIDE DETAILED FINANCIAL DISCLOSURES

In order to make informed decisions on whether to offer or to appropriately size an incentive, policy makers must receive detailed financial information from a proponent considering a facility. A pro forma—including information on the cost of the project, projected revenue and expenses, and the expected return—is necessary to analyze the impact of any incentive. A good rule of thumb is that developers should share information similar in detail to what they would provide a bank or investor considering the project.

It's often difficult to obtain information that businesses may consider confidential and proprietary. To address these concerns, many jurisdictions can collect financial information by using statutory authority that will treat the filing as a confidential tax return. Some might argue that the collection of financial information in this manner runs counter to the need for transparency when providing incentives. While the concern is valid, a community needs to balance the need for detailed financial information with transparency considerations.

Detailed financial information ensures that if an incentive is offered, it is structured to provide only the level of assistance required to make a project feasible.

### REQUIRE THAT INCENTIVES RESULT IN AN ECONOMIC RETURN FOR THE COMMUNITY

Incentive programs should lead to measurable economic outcomes. Firms most often commit to adding and maintaining a level of new jobs in return for an incentive. Reporting and auditing provisions are critical to ensuring communities can effectively monitor these benefits.

Incentive agreements may contain provisions for "clawbacks" that allow the community to recoup all or a portion of the incentive if a project performs below promised levels. While clawback provisions are worthwhile, they can sometimes be difficult to implement and enforce.

An alternative model makes the annual incentive amount contingent upon performance benchmarks. For example, a community may offer a tax incentive of $10 million over 10 years to a firm committed to bringing 1,000 new jobs to a new facility. Instead of simply structuring the incentive as a $1 million annual tax credit, the community and firm can agree to a schedule. If the firm meets or exceeds its employment commitment in each year, it receives the full $10 million. However, if during the term the company reduces its employment, the incentive is also reduced to an agreed-upon level. This method matches the value of the incentive with the performance of the firm annually, avoiding the potential angst of a clawback mechanism.

### CONSIDER PROVIDING PUBLIC INFRASTRUCTURE SUPPORT INSTEAD OF A TAX SUBSIDY

Public infrastructure is often necessary to support new development. Tight municipal budgets have forced many jurisdictions to shift the responsibility of financing and building infrastructure onto developers. In a classic case of the dog chasing its tail, developers often seek tax incentives to help offset the costs of building the infrastructure. Providing infrastructure support may have several advantages over tax incentives:

- Infrastructure costs tend to be more known—both in terms of direct costs and debt service requirements—while the costs of tax incentives are often less tangible and may vary considerably over the life of the incentive as economic conditions change.
- Infrastructure investments may benefit several development projects or firms, while tax incentives tend to help a single entity.
- Providing infrastructure puts government back into a more traditional, familiar role of providing streets, sewers, and other public amenities.
- New infrastructure will continue to benefit the city even if the subsidized business relocates or goes out of business.

### ENSURE THAT GOVERNMENTS COOPERATE ON REGIONAL ECONOMIC ISSUES

Neighboring communities should work together on economic development issues to benefit the entire region. Using tax incentives to lure companies across borders simply erodes local tax bases and does not generate regional economic benefits. For example, Boston has joined with neighboring communities Braintree, Cambridge, Chelsea, Quincy, and Somerville to create the Greater Boston Regional Economic Compact. Members meet several times per year to develop strategies to promote growth in the region.

Local communities must also coordinate with state government. Since the economic benefit of new development accrues to the entire region, local government should leverage state resources to support strategic development opportunities. For example, new office and retail development in Boston often generates significantly more state income and sales taxes than local property tax revenue. When state and local governments equitably share the costs of development incentives, it enables development opportunities while preserving the local tax base.

A coordinated effort between state and municipal government provides greater leverage and a more accurate accounting of benefits, to ensure the public sector does not collectively overextend. Intergovernmental collaboration also creates a favorable impression on businesses considering a major investment in the region. Officials at GE said the cooperative relationship between city and state leaders influenced the company's decision to relocate its headquarters to Boston.[3]

## Reviving Fan Pier Boston

The Fan Pier project illustrates how Boston used incentives to stimulate development and expand the tax base to ignite growth in the city's Seaport District.

The Fan Pier—15 acres of vacant land and surface parking lots on prime, waterfront real estate in the heart of the Seaport—was underutilized for decades. In 2010, Boston partnered with the property's owner and state government to use a new infrastructure incentive program called I Cubed, to provide $37.8 million for infrastructure required by the development.[4] Under I Cubed, the state uses new income and sales tax revenues from increased employment and business activity at a new development to pay the infrastructure debt service. If the new revenues are insufficient to pay the infrastructure debt, the developer is assessed an amount to cover the shortfall.

The potential lead tenant for Fan Pier was Vertex Pharmaceuticals, an expanding biotech company that was considering relocation out of state. Vertex committed to transferring 1,700 employees to the site in two buildings containing 1.1 million square feet of office and research lab space. The state offered Vertex $10 million in tax credits from a program established to encourage the growth of the biotech industry. In addition, Boston provided a $12 million property tax incentive to Vertex. The combined value of these incentives made Vertex's occupancy costs at the site more competitive with options in other states, and the company relocated to the Fan Pier.[5]

Vertex's commitment provided the critical mass necessary to get the office and lab space and the required infrastructure built at the site. Today, the Fan Pier is the Seaport's signature mixed-use development. Additional development at the site has resulted in thousands of new jobs, residents, and businesses, and catalyzed the surge of development occurring in the broader Seaport district today. $1.5 billion of new development is under construction, and $850 million is scheduled to break ground soon.[6] Notably, this additional development has occurred without incentives.

In the Keynesian tradition of priming the pump, sometimes extra effort is required to make the first domino fall. The high-quality, mixed-use development—with an art museum, public parks, and a marina—established Fan Pier as a destination. Vertex's move brought 1,700 employees to the area and demonstrated the district's potential as a location for companies in the innovation economy. At the very least, the incentives accelerated the pace of development for the area. In this context, the City's $12 million investment in an incentive appears prudent. The Vertex parcel itself is projected to yield $55 million over the seven-year term of the tax agreement. The development wave noted above also spurred a fourfold increase in annual property taxes from the Seaport District, from $30 million in 2008 to $127 million in 2017. This amount will grow significantly as properties currently under construction reach completion. State government will also see substantial increases in revenues from the new economic activity in the area.

Would the Seaport have developed without the infrastructure investment and tax incentives? It's impossible to know for sure, but the longstanding lack of progress in the area certainly left Boston's policy makers with legitimate concern. Perhaps the better question is this: given the site's potential, would it have been wise to do nothing and risk delaying or even preventing this wave of development?

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1 Daphne A. Kenyon, Adam H. Langley, and Bethany P. Paquin, *Rethinking Property Tax Incentives for Business* (Lincoln Institute of Land Policy, 2012), 2.

2 *Boston Economy 2016*, Boston Planning and Development Agency, www.bostonplans.org/research-maps/research/research-publications (July 29, 2016).

3 Shirley Leung, "An Alliance of Leaders Helped Lure GE to Boston" (*The Boston Globe*, January 16, 2016).

4 The project was authorized for $50 million in I cubed funds, but only $37.8 million was utilized.

5 In 2014 Vertex experienced a short-term setback resulting in a 25 percent workforce reduction. This led to the company returning $4.9 million in life science tax credits to the state and a $3 million reduction in the City tax incentive that was in proportion to the job cuts. Vertex's employment levels have since recovered and continue to grow.

6 Tim Logan and David L. Ryan, "A Waterfront That's Rapidly Transforming" (*The Boston Globe*, January 31, 2017).