INSTITUTE BRIEF

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Tax Increment Financing: What are the Costs?

By Jonathan J. Miltimore

Tax increment financing (TIF) is a mechanism that was introduced during the 1950s to help cities redevelop blighted and economically distressed urban areas by granting cities, for an impermanent period of time, sole authority over the increased value in property tax (the increment) in a given area.

The rationale for TIF was that cities were reluctant to finance costly municipal improvements and projects that might revitalize depressed areas because the city would find it difficult to recoup the costs of its investment. While cities were pouring dollars into the revitalization projects, the increased property tax revenue was divided between the respective collecting jurisdictions (counties, school districts, etc.). Because cities were reluctant to invest in these depressed areas, infrastructure languished, further forestalling private capital investment and leaving these areas in a state of municipal impoverishment and dysfunction.

TIF intended to solve this problem by allowing cities to freeze property taxes at the current level — usually referred to as the base — and granting them sole access to the increment. That is, all increases in property tax value could be collected by the city to retire the bonds it issued to pay for improvements intended to attract investment. School districts and counties would continue to collect property tax revenues, but only at the base level. The formula seemed simple enough: Cities would invest in public infrastructure, private investment would follow, and once the investment bonds were retired, all jurisdictions would once again collect property taxes at the new increased level.

Yet problems exist with TIF under current Iowa law. First, the vast majority of TIF projects no longer serve their original purpose. Originally, the statute plainly and exclusively applied to areas that "constitute a serious and growing menace, injurious to the public health, safety, morals and welfare of the residents of the state."[1] However, as pointed out in a recent Iowa State study authored by David Swenson and Liesl Eathington, economic depression is no longer a prerequisite to creating a TIF zone: "Changes to state law…in 1985 made economic development a general purpose activity and effectively eliminated the…grave language requiring a find of blight."[2]

Iowa is not unique in this regard; nearly all states use TIF overwhelmingly for purposes of economic development. However, Iowa has one of the most indulgent TIF statutes in the United States. As Swenson and Eathington point out, in Iowa "there are virtually no effective state or local oversight mechanisms of TIF usage by cities, counties, and other authorities."[3] TIF users do not have to negotiate increment revenue sharing. There is no overseeing body to determine if a TIF district is serving a real purpose (bringing in private capital investment) and not simply cornering property tax revenue that was already coming into a district. There is no clearly defined limitation on the duration of a TIF or a mechanism to prohibit "rollovers" — a device used to keep a district a TIF zone long after the original project has been completed and the debt has been repaid.

The creation process for TIF districts is also questionable. Decisions are made by city councils, absent referendum, or negotiation among taxing entities. Citizens can petition for a referendum, but have only ten days to do so.[4] Since TIF can be used to circumvent Iowa's limit on tax abatements, theoretically vast amounts of public funds could pass directly to private entities with little or no public knowledge or input.

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The potential problems with TIF are palpable. In 2006 Iowans paid $3.3 billion in property taxes — over one-third of all taxes paid.[5] In short, Iowa is a property-wealthy state, heavily dependant on property taxes. There are few legal obstacles that would prevent a corrupt city from diverting public funds to a private company in a quid pro quo.

To further complicate matters, there has been a virtual explosion of TIF districts over the last two decades. In 1991 there were 746 TIF zones in Iowa. By 1997 this figure had risen to 1,014, and by 2006 there were a total of 2,058 TIF districts or projects.[6] According to Swenson and Eathington, TIF ordinance cities now command approximately "92 percent of all urban taxable valuation across the state."[7] Although there is no evidence of rampant TIF abuse in Iowa, it is probable that at least some of these projects do not serve a valid public interest.

Recent studies have concluded that there is minimal or no net gain from TIF. A collaborative study[8] conducted by The Heartland Institute, the Center for Economic Policy Analysis, the Jewish Council on Urban Affairs, and the Statewide Housing Action Coalition found that TIF projects were costly, ineffective, and unfair to local residents and small business owners who were stuck with the brunt of the property tax increase and benefited little from the projects. Data presented by Swenson and Eathington suggests that the average cost of a TIF created job in Iowa is over $3,000; the authors conclude, "the costs of TIF activities in the state appear to be very high."[9]

There are several TIF reforms to consider. Limit the duration of TIFs to 15 years and prohibit "rollovers." Extend the period of time in which citizens can petition for a referendum on the project to 30 or 60 days. Close the loophole that allows TIF to be used as an unlimited tax abatement. Restrict the use of TIF for projects that will not enhance property tax revenues, such as nonprofit corporations and public services that are exempt from paying property taxes. Establish disclosure rules and limits on TIF funds designated for private entities.

Tax increment financing is a valuable tool cities can use to revitalize and develop infrastructure and attract needed capital investment. It should not be the goal of Legislators to abolish TIF, but to establish sensible guidelines to ensure that TIF is used fairly and judiciously in Iowa.

(Endnotes)

1 Chapter 403.2 (1) Code of Iowa.
2 David Swenson and Liesl Eathington, "Do Tax Increment Finance Districts Spur Regional Economic and Demographic Growth?" Iowa Sate University, 2002, p. 3.
3 David Swenson and Liesl Eathington, "Tax Increment Financing Growth in Iowa," Iowa Sate University, 2006, p. 1.
4 Peter S. Fisher and Charles Bruner, "Tax Increment Financing in Iowa: What Should Be Done?" Policy Report, The Iowa Policy Project and Child & Family Policy Center, April 2003, p. 5.
5. Table 1: State and Local Government Finances by Level of Government and by State: 2004-05, United States Census Bureau, Governments Division, <http://www.census.gov/govs/estimate/0516iasl_1.html> (June 4, 2006).
6 Swenson and Eathington, "TIF Growth," p. 1.
7 Swenson and Eathington, "Do TIF Districts Spur ," p. 8.
8 "The Right Tool for the Job? Analysis of Tax Increment Financing," Developing Neighborhood Alternatives: A Collaboration Among Center for Economic Policy Analysis, The Heartland Institute, Jewish Council on Urban Affairs, & Statewide Housing Action Coalition, Executive Summary, March 2003.
9 Swenson and Eathington, "Do TIF Districts Spur ," p. 10.

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