The Evolving Use of TIF

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When a property is improved, its value rises and the taxes generated at the site increase. The difference between the taxes generated before and after the investment in the property is called the tax increment. Tax Increment Financing (TIF) uses the annual increment to finance a portion of the costs the improvements made.

Today, TIF is one of the primary tools local governments have to increase investment in economic development or urban revitalization. In recent years, the use of TIF has increased significantly, in large part because of the federal government's decreasing role in the programmatic and monetary support of urban development. However, while the rise in use of TIF is inversely related to federal investment in our cities, the rules and regulations governing its use are made at the state level and it is implemented primarily at the local level. A good understanding of TIF, therefore, requires a review of its evolution and implementation in varying states and localities.

A Brief History of TIF Legislation

TIF was initiated in California in 1952 as a way of providing matching funds for federal urban renewal programs. It was slow to be adopted by other states, however, and by 1970 only Minnesota, Nevada, Ohio, Oregon, Washington, and Wyoming had passed TIF legislation. During the 1970s, as federal dollars for urban renewal declined precipitously, cities began to look for alternative ways of funding redevelopment projects and TIF was seen as an attractive option. This increased interest intensified during the 1980s and 1990s as the federal role was essentially eliminated.

TIF's popularity was also heightened during the 1980s-90s by the tide of voter opposition to new taxes that swept across the country. TIF provided a way of supporting redevelopment projects without increasing taxes, without requiring a popular vote, and, usually, without impacting a city's debt limit or financial stability.

Today, with the exception of Arizona, every state and the District of Columbia has legislation allowing local governments to utilize some form of TIF. Although widespread, the parameters of the legislation and the implementation procedures vary widely as does its frequency of use. For instance, in California, where it originated, and in a number of Midwestern states such as Minnesota, Wisconsin, and Illinois the use of TIF is commonplace. By contrast, it is rarely used in New York.

Authority

In most cases, the authority to use TIF is delegated to municipal governments by state-enabling legislation. However, nearly half of the states have also conveyed that authority to certain classes of county governments and even special purpose governmental entities such as the Connecticut Development Authority and local housing authorities in Tennessee.

Range of Taxes Used

Usually, real estate taxes are the sole source of TIF revenues. However, since real estate taxes are often the primary source of funds for education, and school taxes are a dominant share of County property taxes, there is pressure to lessen the impacts on school funding. California, Florida, Illinois, New York, and Wisconsin now exempt taxes that would otherwise go to school districts. Kentucky allows school districts to elect to withdraw their source of TIF revenues and Ohio makes provision for payments in lieu of taxes if the TIF is not approved by local school district.

In some cases, TIF that relies solely on a real estate tax does not yield enough revenue to justify use of TIF in the first place. In light of this, and, given the increasing pressure against diverting real estate taxes from school districts, a growing number of states are supplementing TIF revenues with sales taxes. The volatility of sales taxes and the potential for competition for sales taxes by municipalities within a region, however, have caused concern as well. In fact, both California and Illinois have disallowed or phased out the use of sales taxes for TIF. In addition to real estate and sales, other taxes such as hotel, entertainment, utility, and employment taxes, and other local option taxes are also used by a smaller group of states.

Uses and Justifications

The types of projects for which TIF can be used vary widely among the states. While use of TIF to support the construction of project related public infrastructure and facilities is unusual, it is advantageous to pay at least part of the cost of property acquisition. In addition, over two-thirds of the states allow it to be used to finance a portion of the cost of new buildings. Use of TIF in support of the development of commercial or industrial projects is standard, and three-fourths of the states permit it for residential projects. In fact, in California, Indiana, and Texas, TIF legislation is targeted toward the construction of low and moderate priced housing. Other states, such as Oregon and Tennessee, target recreation uses and Florida specifically allows TIF to support coastal and tourist revitalization while Michigan's legislation allows it to support educational projects.

Vermont has some of the most lenient legislative requirements for authorizing TIF. The legislation permits any projects that encourage development, create jobs, or increase tax revenues. Perhaps the broadest authorized purposes are permitted by Connecticut, Kentucky, Delaware, and North Carolina where the legislation includes general "economic development," and New Jersey which simply calls for the "promotion of redevelopment."

Nearly half of the states with TIF legislation require a finding that "but for" the use of TIF the project would not be feasible. In effect, TIF is to be used only to support development that would otherwise not take place.

Blight, Eminent Domain, and TIF

Traditionally, the purpose of TIF has been to eliminate or cure blight. Although more than three-fourths of the states require a finding of blight before TIF can be utilized, (*see map on page 4*), the requirements for determining the presence of blight vary considerably from state to state. An increasing number of states have moved away from a finding of blight as as a prerequisite for TIF eligibility and are using "economic development" (as noted above) as an authorized purpose.

In association with a finding of blight and the utilization of a TIF mechanism, two-thirds of the states (s*ee map on page 2*) currently allow the use of eminent domain to support a TIF redevelopment project. This association, in large measure, along with the increased use of "economic development" as a justification for TIF, has become highly controversial and has led to legal challenges such as the *Kelo v. New London* case recently decided by the U. S. Supreme Court. With the clarifications provided by *Kelo,* however, the controversy surrounding blight, eminent domain, and economic development is moot from a strictly legal point of view. ((*see article on Eminent Domain, page 1*)

Debt Financing-Length of Term

The length of financing, or how long tax revenues can be diverted away from the regular taxing recipients, is highly variable from state to state. In roughly one-fifth of the states, it is established as part of the ordinance or plan approving a TIF project without state imposed limits. Where a specific time limit is established legislatively, it can vary from as little as five years (New Mexico) to up to 40 years (Florida). In most states, TIFs can last from 20 to 30 years.

Voter Approval

Few states require any form of public vote to approve TIF. The exceptions include Georgia, which requires local voter approval, and Utah, which requires a public referendum when three-fourths of the property owners in a proposed TIF district object.

TIF is a simple theme with infinite variations. Forty-nine states with TIF enabling legislation and thousands of cities and counties all with different tax structures, development objectives, and levels of commitment to public participation in economic development and revitalization, make for a complex picture overall. Add to this a strong sense of competition between these jurisdictions in their quest for jobs and private investment. The result is an environment where, despite criticism and discontent with certain of its aspects, TIF will remain the primary means and the tool of choice for local governments when they deem it necessary to partner with private interests to invest in the future development of their communities.