Chapter 5.
Tax Increment Financing
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WHAT IS TAX INCREMENT FINANCING?

Tax increment financing TIF is a common financial tool utilized by local governments to aid funding capacity for capital projects with new tax revenue via redevelopment of “blighted” areas usually associated with the center city. Also known as a “bootstrapping” economic development tool, which allows cities to “think big, but start small”, cities have adopted this type of development for it’s little to no requirements for money up front (Squire 2004). It is presently one of the few tools that local government can implement to directly involve themselves in private development and is done by way of general obligation bonds issued by the local government. The main theme behind the original TIF programs was threefold:

- To aid municipalities in preventing further blight within the city;
- To aid developers in development by shifting development cost off of the private entities and onto the municipalities; and
- To aid the public in improving the community without raising taxes.

Although TIFs can be used in a variety of ways, they are generally used to acquire property to be resold after a decrease in the price known as a “write down” price. This is done to lower the taxes of the purchased property. Once the property is sold at a lower price, an assessed value or “original assessed value” is determined. Any additional increases in the value of the property from this point on are designated as “captured assessed value” which could also be construed as an annual tax increment. This captured value is utilized when proposing the estimated cost of redevelopment and will be used to payoff the revenue bonds at the time of debt retirement.

Since the early 1970’s, TIFs have been commonly used by nearly every state in the Union. To date, 49 states in the Union have passed TIF legislation as well as the District of Columbia; Arizona is now the only state without any type of tax increment financing legislation.

SALES VS. PROPERTY

There are two types of TIFs: property tax TIF’s and sales tax TIF’s. Property tax TIF’s are the most widely used vs. sales tax for many reasons including:

- sales tax revenue is more volatile and therefore becomes a greater risk for a government and more expensive in the long run;
- sales tax revenue can collect money throughout an entire area while TIF property tax revenue outlines a specific TIF district; and
- sales TIF districts require large retailers to make them work successfully and because of this, the TIF money often becomes more of a subsidy to private development.

Property tax TIF’s allow local governments to freeze property taxes at a “pre development” level in a designated TIF district where redevelopment is proposed to occur. This freeze allows any new stream of tax revenue, generally called increments, directly related to the improvements in
the TIF district to be utilized by the government for capital improvement programs throughout the
district including roads, sewer, water, and other forms of infrastructure.

**TIF Regulations**

Originally, TIF funds could be used only for redevelopment within the center city and specifically
for planning/engineering consultants, fees associated with conceptual designs and feasibility
reports, and limited private subsidies. Now the regulations and requirements of TIF districts have
expanded their use not only to redevelopment of “blighted” areas but also to properties deemed
to be underutilized, which may or may not be in the inner city areas. These areas are usually
vacant but have some attribute, which would make them appealing to development usually in the
form of transportation or visibility. The use of TIF moneys has expanded as well so that cities can
use the monies in other ways including purchasing of property, demolition of existing dilapidated
buildings, environmental cleanup, job training, along with additional incentive subsidies to private
developers. With this expansion; however, comes misappropriation of TIF funds, especially when
utilizing the money for private subsidies. Three of the most common abuses of TIF allocated funds
are:

- the TIF is managed so that it never expires and the increment is never released to other
tax districts;
- the government allots portions of the incremental revenue to all tax districts and the
  “excess increment” that is not utilized is still incorporated into the supposed frozen base
tax, which skews the tax levy rate of the other jurisdictions; and
- a “gestation period” is created in which no bonds are issued and no increment collected.
  This activity is used when the government believes development will occur regardless and
  they stake claim to future development increment without using the TIF fund, which are
  held until after the gestation period

Due to this abuse, 17 states as well as the District of Columbia now require governments to use
the “but for” clause to determine the needs of a TIF district (Lawrence 1995).

The “but for” clause simply states that the area would never increase tax revenue or develop
further than its existing state “but for” public funding or subsidies. However, this assessment is
hard to prove because of the difficulties associated with long range planning projections. Cities
are also now required to identify the characteristics of the “blighted” area to prove hardship.
These characteristics are general in nature for all states: vacant or dilapidated buildings, decrease
in population, brownfields or environmentally challenged land, little to no property tax revenue,
falling infrastructure, high poverty levels and/or underutilized properties located near vital
transportation systems. This chapter will address the arguments both for and against TIF funding.

In 1952, California state government passed the first legislation to allow TIF districts. In the
1970’s and 1980’s, federal policy redistributed funding from local and state governments to other
areas requiring local governments to fend for themselves. This decrease in funding enticed state
governments to pass the required legislation to allow TIF districting for local governments.

**The TIF Process**

At the State level, TIF funding was positive in that it created a uniform procedure process for all
municipalities requesting local level funding rights; one problem with this however, is if at any
time the requirements were to change, the process required for at the State level could be slow
and tedious causing a missed opportunity for development at the local level. Once the legislation
is in place, county governments set up applicable tax relief for the population within the tax districts, which gave them administrative rights, but omitted them from the approval process of the TIF and the amount allotted for the TIF projects. The local governments then proceeded to identify district areas by way of a TIF establishment process. This process may vary somewhat from state to state but the underlying guidelines remain the same; identify the TIF district via the “blighted” characteristics addressed in this chapter, compile a conceptual redevelopment plan, economic feasibility study and redevelopment agreement, propose distribution of funding, and estimate increment revenue. The typical timeline for a TIF project ranges from 20-30 years and generally proceeds as follows:

- Due diligence begins. Feasibility study and designation of TIF district to be submitted to local government. Begin talks with possible developers.
- Public hearing. Required public notice beforehand.
- Local government creates an ordinance/resolution approving the TIF district area, redevelopment concept plan, and budget/financing plan.
- Redevelopment agreement between local government and developer are approved and signed. Government issues bonds.
- Construction begins. Construction is completed. Incremental revenue allocated and bonds are retired.
- TIF district becomes inactive.

**Benefits of Tax Increment Financing**

Proponents of TIF funding identified by the Bureau of Governmental Research argue that:

- local governments receive otherwise unfeasible benefits from the funding;
- the funding allows for self-financing without burden on the public;
- there is limited general obligation for the local government;
- TIFs have public appeal due to no tax increase;
- there is flexible control of money and investment;
- it allows for sharing of redevelopment costs.

First, most local governments who utilize TIF funding do not have the money for capital improvements up front and therefore, would otherwise not be able to make those capital improvements. This type of funding allows these governments to revitalize and improve areas without payment up front. Secondly, since the TIF funding is provided initially, and paid off via new increment taxes, there is no loss of existing tax revenue and no burden on the public. Third, the limited obligation for municipalities adds to the appeal of TIFs. According to the Bureau of Governmental Research, “TIF indebtedness does not constitute a general obligation” which means that “the local government is not liable if the anticipated revenue stream does not materialize” (p.11). Therefore, a municipality’s debt limit is not negatively impacted. Fourth, TIF’s have great public appeal from both residents and governments because of it’s requirements- no tax increases, a positive for residents and no voter approval required, a positive for governments.
Fifth, the money associated with TIF funding has such general guidelines for usage that governments enjoy much flexibility on how it is distributed. Finally, in the past, redevelopment for governments would be a 100% burden on the local government and the taxpayers. With a TIF under the Pay-As-You-Go funding, the developer, who is submitting the proposal to redevelop, must share the burden of cost.

CASE STUDIES

State of Indiana

One case study concerning Indiana cities and the multiple TIF districts was analyzed by Man and Rosentraub in 1998. In this study, the authors utilized empirical data to determine that the TIF districts were in fact, beneficial to the overall tax base for the cities. The study specifically reviews the effects on property value growth before and after the implementation of the TIF districts. First implemented in 1975, TIF districts legislation in Indiana was not utilized by cities until the mid-1980. Man and Rosentraub included 151 cities in Indiana with a population of at least 2,500 in 1980. Of the 151 cities, 23 have TIF districts in 1980 and 38 have TIF districts in 1990 (Man 1998). The study estimated that there was an 11% increase in property values inside the TIF districts, which began growing two years after the TIFs implementation (Man 1998). Their conclusion was that TIF’s were an important funding tool that increases property values as well as a spillover effect in the entire community’s real estate market. However positive for property values, the study did not determine if the tax revenue was sufficient to meet the cost associated with the development and who paid for it in the end.

Southaven Towne Center, Southaven, MS

A study of the Southaven Towne Center retail development also shows signs of positive feedback. Southaven, Mississippi and Desoto County as a whole, has had explosive growth due to flight from Memphis with an average growth of 7% per year (Census 2000). Until recently, residents as far south as Grenada, Mississippi and would drive to do their shopping in Memphis, therefore no sales tax revenue or commercial property tax revenue went to Mississippi or it’s municipalities. A TIF in the amount of $9.2 million was proposed for 120+ acres of property, which was to be utilized for commercial development only (Wilson 2006). It was designated as an underutilized parcel of land because of it’s close proximity to Interstate 55, the largest interstate system in Mississippi. Consultants also identified a wetlands area on the property, which allowed the City to utilize the “but for” clause in that the property would not be developed otherwise due to the cost of wetland removal process. The TIF funds allowed the City to improve the water and sewer systems to increased capacity, widen several surrounding roads to accommodate increased traffic, improve traffic signals and file proper paperwork with the Department of Environmental Quality for relocating wetlands (Gouras 2006). Seven years after the TIF conceptual design and redevelopment agreements were approved; a 900,000+ sq. ft. lifestyle center was constructed and opened in October 2005, including three large retail stores. The actual constructed development was extremely close to the proposed concept plan and the generated tax revenue as of March 2006 is near to perfect. In conjunction with this TIF development, areas outside of the district, recently vacant, are now developing as power centers associated with the lifestyle center. However, it is hard to determine if these abutting properties would have remained vacant or would they have failed the “but for” clause.

NEGATIVE IMPACT OF TAX INCREMENT FINANCING

Critiques of TIF funding cite many negative aspects, including:
• increased operating costs that are not accounted for;
• negative impact on businesses outside of the TIF districts;
• decreased revenue due to failing businesses outside of TIF districts;
• relocation of “blighted” areas;
• unwarranted regional competition for development;
• overestimated development revenue with over compensation to private developers; and
• an overlapping of tax districts, which allows distortion in the distribution of tax monies (bgr.org).

This first major dilemma addressed above involves increased and possibly unforeseen operating costs. When a district is redeveloped, which may include retail, residential or industrial property the additional police, fire protection and ambulatory services automatically increase. If the TIF budget did not include the cost of additional services, the monies associated with the increase are then taken from other government aid areas such as schools. The second concern is targeted toward the negative impact that the redevelopment may have on businesses outside of the TIF district. Research in several TIF districts has shown a decrease in sales for businesses without the additional funding sources of a TIF. In conjunction, the third concern deals with the loss of revenue to the government from the failing businesses. If the revenue lost outside the district outweighs the revenue gained inside the TIF district, then the development puts further financial strain on the government as a whole. A forth concern addresses the relocation of “blighted” areas, due to gentrification of the neighborhoods. When redevelopment occurs in a “blighted” area, populations within the area can be forced out due to property value increase, rent increase and commercialization of once residential properties. These people, already poverty stricken, simply find somewhere else to go that may otherwise, may not have been a location designated as low income or poverty stricken. The TIF is said to have simply moved the poor elsewhere. Another major concern is the competition between local governments for development. This competition not only abuses the TIF funding in that it is used mostly as an incentive tool to lure developers to a specific location, but it also kills the regional economy since local governments in the region are fighting each other for development. Since long range project planning involves so much guess work and good faith agreement, overestimating a project’s success becomes a big concern of critics. Developers want the local government to provide as much incentive as possible and therefore may exaggerate the revenue that a future development would produce.

Unfortunately for the government, if the developer is proven wrong in the estimation phase, the money is already gone and there is little to no recourse action to take. Finally, the most argued point against TIF funding is the overlapping tax district argument. All local governments have other taxing bodies associated with these areas, which may include- water districts, school districts, library districts, sewer districts, etc. When a local government establishes a TIF district and uses the increments to pay off capital improvements, other taxing bodies that are influenced by the increased population accrue none of the additional money until such time that the TIF districts time period is over, which is usually 23-30 years. Therefore, it becomes an unwarranted and unaccounted for avoidance of benefits that would have otherwise been accrued by the other taxing districts, which would have increased over that time without the TIF. Utilizing the “but for” clause as described in this paper could possibly eliminate this type of negative impact for other taxing districts in an area. Figure 1 shows the overlapping of such districts and where the TIF funding that is being allotted.

**Figure 1.** Overlapping of tax districts in TIF’s
CASE STUDIES

St. Thomas District, New Orleans, LA

The St. Thomas District in New Orleans was an important case study which detailed one specific location where public housing was to be torn down and replaced with mixed income housing, low income housing, retirement and assisted living housing, luxury condos and a Wal-Mart Super Center. Shown below in Figure 2 is the actual TIF district boundaries proposed for the St. Thomas TIF.

The TIF funding was to be used primarily to finance a 1,238 unit apartment complex for low and medium income levels located next to a proposed 217,000 square foot Wal-Mart Super Center. Sale tax revenue of 2.5% from Wal-Mart was to be used to pay for the mixed residential development estimated at $20 million (bgr.org). Local residents of the area protested against the development and concerns of gentrification and displacement of existing residents were viewed by the authorities as valid but the New Orleans government went ahead with the plan as proposed. This project very quickly
created a negative impact. First, it was obvious that the TIF money was used solely as an incentive with no regard to improvements to surrounding area. Wal-Mart, along with the associated developers was given the majority of the funding as a subsidy for locating in this area. Secondly, the city identified a lack of low income housing; however, this proposal removed more low income housing and proposed developing market value housing with the increment. Third, the city overly anticipated the pay off debt of the bonds, which distorted the estimated interest rate. Due to comparison of governments like New Orleans and their interest rates, the city’s estimated interest rate had exceeded the rate for bonds by local governments and caused a major inflation distortion of the money. Finally, with the TIF being entirely sales tax funded, the city’s general fund lost the existing sales tax revenue from the existing businesses within the areas, something that was not accounted for in the TIF plan. In the end, the St. Thomas TIF lost millions of dollars for the City of New Orleans and made a negative impact on the residents of the area causing displacement, resettlement of “blighted” areas, decrease in low income housing and loss of historic character. St. Thomas is one of the most famous cases for opponents of TIF districts; however, it should be noted that the TIF was based on sales tax revenue not on property tax revenue. It should also be noted that studies of this areas have been halted due to Hurricane Katrina’s direct effect on the area and the damage to the Wal-Mart Super Center, which has yet to be reopened.

**Maxwell Street, Chicago, IL**

The Windy City first enacted TIF districts in 1984 and as of 1998 they have attracted $1.8 billion in private investment (Dye 2006). However positive the tax revenue return may be, Chicago residents feel that the negative impact is more human in nature. Eli Lehrer in 1998 wrote an article on the impact of TIF redevelopment in older neighborhoods and their residents and merchants in Chicago specifically Maxwell Street. In the 1930-40’s Maxwell Street was a merchant’s goldmine, even after the government moved the Maxwell Market two years ago, the street still held strong. With the new TIF district encompassing all of Maxwell Street and the University of Illinois-Chicago, the historical character of the area is gone. A proposed $450 million mixed use development catering to the college population will cause the removal of nearly all historical buildings ranging from the 1800’s to early 1900’s with the exception of one historical police station building (Dye 2006). Although there are no residents to speak of, a wind shield
survey in 1996 compared with one in 1998 shows a building vacancy increase of almost 20% even though construction was not set to begin for another 12 months (Lehrer1998).

As of 2002, Chicago has 129 TIF districts encompassing 30% of its entire land and allocates $400 million in TIF funds. Due to grassroots efforts in the City the

![How Chicago Spent TIF Funds in 2002](image)

**Figure 3.** Neighborhood Capital Budget Group; [www.ncbg.org/tifs](http://www.ncbg.org/tifs)

council now sees that a certain amounts of TIF money go directly benefit the existing residents of the district’s communities per the funding pie chart shown in figure 3.

Some cities still remain leery of TIF districting and funding such as San Antonio, Texas. Currently, the San Antonio Spurs reside in the ATT center arena. There has been a joint proposal between the City of San Antonio and the Spurs to construct a new arena- Longhorn Arena (Andrews). To make this development happen, the City and the team have proposed TIF funding; however, they have not sold City Council on the concept. To date, all discussions concerning funding for a new arena via a TIF project have ceased and the Spurs remain in their existing arena. Cities such as Pittsburgh, Pennsylvania are now rethinking their view of TIF funding. The proposed Market Place at Fifth and Forbes was proposed to be funded from a TIF and was approved by council; but the decision was reversed by council until further studies could be reviewed and possible changes to the city’s regulations of TIF’s could be addressed.

**SUMMARY: ALTERNATIVE PLANS?**

Due to discrepancies with the allocation of TIF funds, many alternative funding plans identified by the Neighborhood Capital Budget Group are being utilized by cities. Special service areas allow a particular group of taxpayers to control the funds for the development while allowing local government to increase their taxes in return. This type of development is mainly for commercial and industrial developments. Another alternative, which is similar to TIF districts are Redevelopment areas; however, they do not utilize taxing provisions, instead they grant
municipalities land acquisition powers and creates areas eligible for grants and low interest loans. Empowerment zones are federal programs that create incentive packages for developments including tax exempt bonds, tax deductions/freezes on property and wage credits in return for locating in specific areas. Enterprise Zones a local and state incentive programs which draw developers/businesses into areas that would otherwise be less appealing in return for tax exemptions/reductions including real estate, property, sales, utility, etc. Local governments as well as developers can always misuse funding for municipal projects, some funding types such as TIF’s need to be more specific with the requirements and the allocation of the funds to minimize the discrepancies, especially during the concept plan phase where the “sky is the limit” scenario is used to gain access to the funds when in reality it is not a feasible or realistic development. Without consequences for the exaggerations or the “misguidance” of the conceptual plan, developers as well as governments have no reason to incorporate any further due diligence into the planning stage of a proposed TIF district.

TIF’s if used correctly and planned by knowledgeable consultants after proper due diligence periods, could be beneficial in aiding cities and municipalities which have limited funding in receiving the necessary money for capital improvements. It is important for local governments to be realistic about the increment return and to not be star struck by wealthy developers. However, as this chapter has shown, cities along with developers, have more often than none, abused the system and quite possibly without fully understanding the consequences of their actions.

REFERENCES:


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