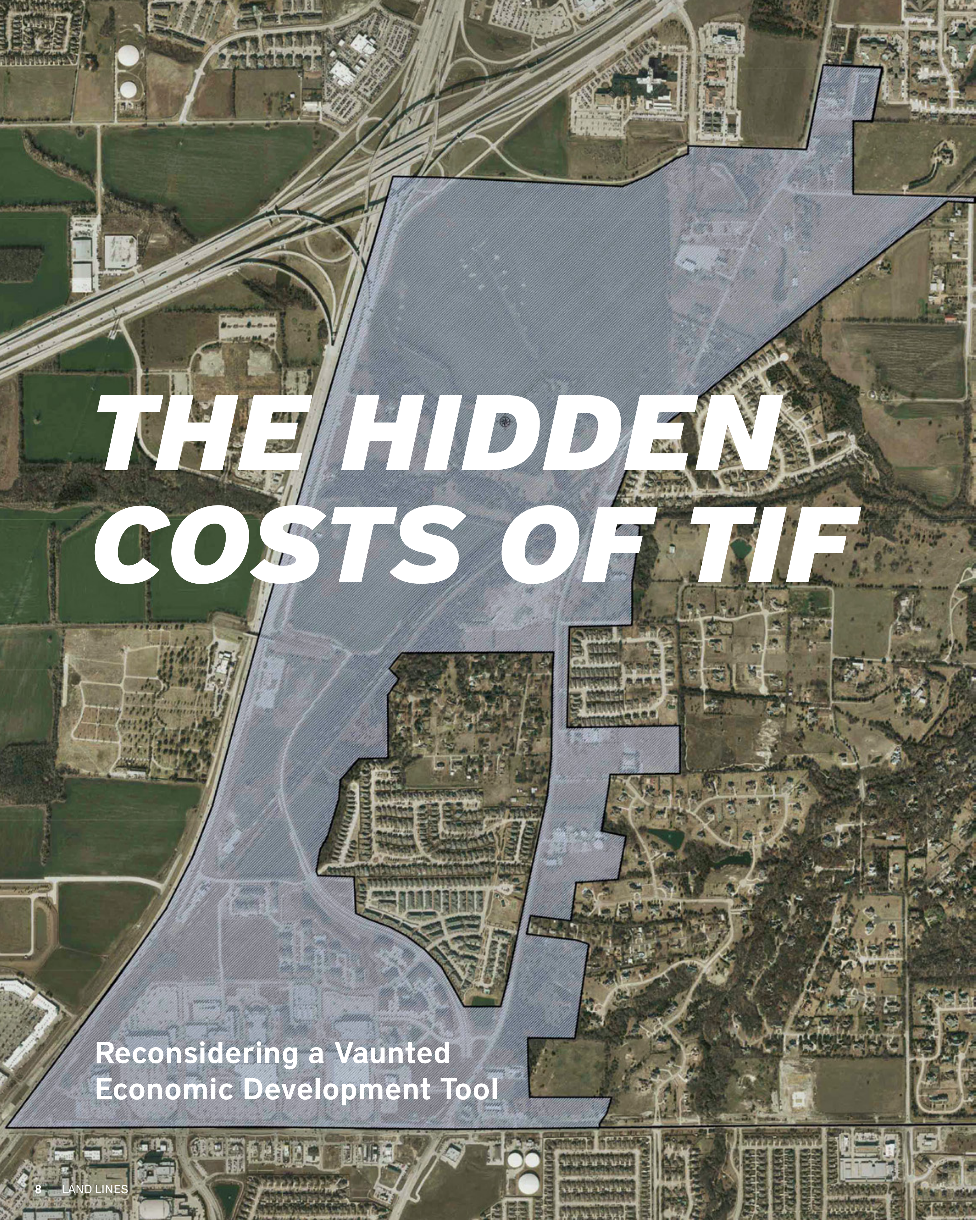


THE HIDDEN COSTS OF TIF

Reconsidering a Vaunted Economic Development Tool

By Anthony Flint

MOLLY METZGER DIDN'T PLAN TO BECOME AN EXPERT on tax increment financing (TIF), much less lead a citizens' group focused on the issue. But when racial strife in her native St. Louis was brought into stark relief by the high-profile shooting of Michael Brown in nearby Ferguson, she felt compelled to take action.

An expert on inequities in housing and economic development, Metzger was increasingly bothered by the fact that land use policies that had long been touted for their ability to jump-start development and create economic opportunity in underserved neighborhoods were doing neither. The closer she looked, the more she saw that TIF—which front-loads future property tax revenue to speed up selected projects—seemed to benefit neighborhoods that were already gentrifying and siphoned off funds that should have gone to public schools.

"Most people don't want to spend their free time learning about such a wonky topic," says Metzger, a professor at the Brown School of Social Work at Washington University in St. Louis. "But the question we are asking now is whether we should pump the brakes. If we continue to incentivize everything, it's not benefitting the whole city, and it's not building the tax base. It's like a lot of political issues—a tiny fraction benefits." Metzger helped found a group, called Team TIF, which serves as a watchdog over the way the city uses this public-finance mechanism. So far, the group has held public meetings and produced informational materials to raise public awareness.

Team TIF is one example of the scrutiny that TIF is undergoing lately. Municipal leaders say TIF is one of the most important tools they have to regenerate urban areas, particularly in postindustrial legacy cities. And they have embraced it since it took hold in the 1950s: The United States now has at least 10,000 TIF districts across 49 states (Merriman et al. 2018). But critics say TIF has become little more than a subsidy for the private sector, diverting revenue away from schools and other important services, and contend that many TIF programs are woefully lacking in transparency.

The problems are serious enough that several grassroots efforts have derailed proposed TIF districts in recent years, through either the ballot box or the courts. Tax increment financing runs the risk of functioning more like property tax incentives for business—another flawed practice that often fails to deliver on promises but remains in widespread use.

Planners and policy makers, however, aren't giving up on TIF. Instead, they are redesigning and reimagining it, adding provisions to ensure that equity is a consideration, and building in options that allow school districts to maintain access to revenue. Some jurisdictions have experimented with community improvement districts (CIDs) as a kind of hybrid or alternative framework that corrals both sales tax and property tax revenues for a given development project.

With participation from the private sector, cities are also bundling TIF with other financing instruments, such as credit enhancement agreements or stabilization funds—so much so that a traditional, stand-alone TIF has become known as an increasingly rare "naked" TIF.

A TIF district in Fairview, Texas. Credit: Courtesy of Town of Fairview.

"TIF can be viewed as something that will save and transform neighborhoods—or something that will gentrify neighborhoods and push people out."

HOW TIF WORKS

Tax increment financing began in California, where authorities created it to help redevelop urban areas. From there, it rapidly spread across the country. The Midwest took particular interest, with a flurry of TIF activity in Wisconsin, Minnesota, and Illinois through the 1970s and 1980s.

Missouri enacted TIF legislation in 1982, a full three decades after the tool was created, but wasted no time putting it into action: Today, there are 468 TIF districts in 116 municipalities in the state, including 210 in St. Louis County and the City of St. Louis—sequestering roughly $2.2 billion in tax revenue (Rittner et al. 2015). Elsewhere, the rush to use the tool has been dramatic (see Figure 1). Over the last decade, for example, the number of TIF districts in Iowa grew from 949 to 3,340 (Collins et al. 2018).

So how does TIF work? Typically, a municipal government, enabled by state legislation, partners with the private sector to designate an area as a TIF district, and calculates the amount of property tax revenue that the project will generate for the next 10 to 20 years or more. This projected revenue typically includes taxes on the project itself, as well as expected tax increases on other properties in the district as assessed values rise because of the TIF. That money is essentially sequestered to support the project's current financial needs and make it possible. The tax revenue can be used to fund public infrastructure, compensate private developers for their investments, or provide collateral for bonds.

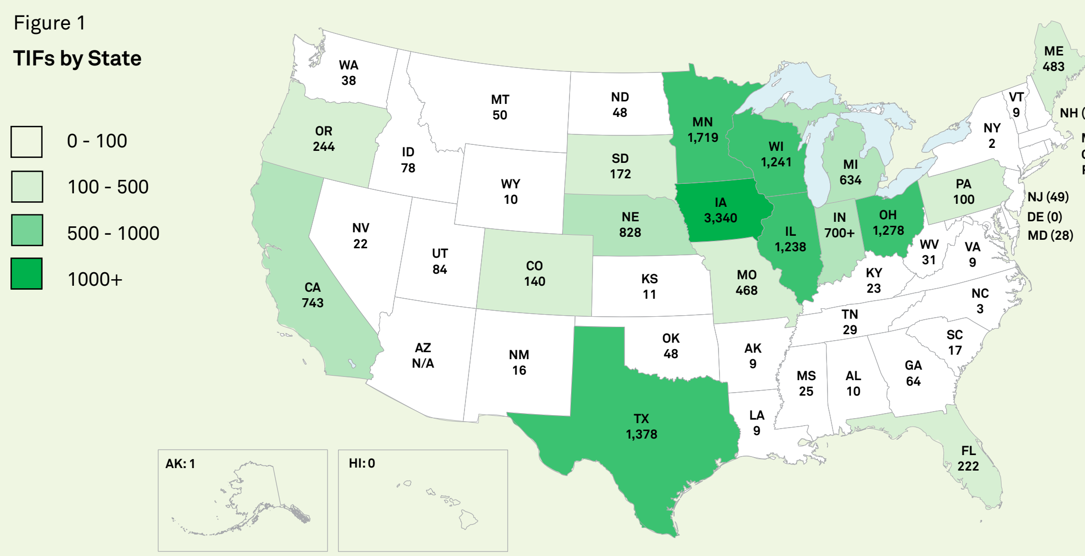
State enabling legislation spells out what TIF is supposed to be for—economic development, environmental remediation, or housing, to name just a few purposes. Most TIF use is designed to address urban blight. Some TIF districts pertain just to one parcel or development site, while others are much larger. (Critics say artificially large districts designed to boost projected revenues are just one of TIF's many pitfalls.)

Although TIF is deployed extensively, it is poorly understood except by public-finance insiders. It is also subject to a wide variation in design and interpretation.

"I've always been amazed at the way TIF inflames passions while not being fully understood," said David Merriman, professor at the University of Illinois at Chicago, who spent two years scouring the nation to produce the Lincoln Institute report *Improving Tax Increment Financing (TIF) for Economic Development* (Merriman 2018).

Figure 1

TIFs by State



Note: This map relies on data from *Improving Tax Increment Financing (TIF) for Economic Development*, Lincoln Institute of Land Policy. https://www.lincolninst.edu/publications/policy-focus-reports/improving-tax-increment-financing-tif-economic-development.

A new Lincoln Institute report identifies the Cortex Innovation District, a bioscience and technology hub that is one of the largest TIF-related undertakings in the St. Louis area, as a place where the public-finance mechanism worked relatively well. Credit: Cortex Innovation Community.

The report reviews the use of tax increment financing by a range of communities and recommends policies to improve TIF use. "It can be viewed as something that will save and transform neighborhoods—or something that will gentrify neighborhoods and push people out."

Researching TIF from coast to coast, Merriman found plenty of instances where the mechanism worked well, such as the Cortex Innovation District in St. Louis, a hub of bioscience and technology, which was built primarily on land left vacant by abandoned manufacturing enterprises from a previous era. In other cases, the use of the instrument led to major divisions. The fight over tax increment financing associated with Atlanta's Beltline was supercharged by concern about gentrification, issues of racial and income equity, and the diversion of tax revenue from schools.

Like tax incentives for business location, TIF can trigger bidding wars between jurisdictions competing for development. Free-market and libertarian groups have joined progressives in opposing TIF because it empowers governments to pick winners and losers.

The biggest problem associated with TIF over the last two decades is the lack of transparency, Merriman concluded. Embraced with zeal by former Chicago Mayor Richard M. Daley, tax increment financing mushroomed in Chicago to the point that $660 million—nearly a third of all property taxes in the city—was earmarked for TIF districts, effectively shielding the money from standard oversight by elected officials. Local journalists showed how the mechanism effectively became a kind of slush fund for favored projects. Mayor Rahm Emanuel commissioned a task force that recommended reforms, but change may be slow to come given that dozens of TIF districts in the city are not even halfway through their duration.

Merriman found that a relatively simple set of steps would foster transparency and benefit virtually every use of TIF in Chicago and beyond. In *Improving Tax Increment Financing (TIF) for Economic Development*, Merriman recommends that states carefully track and monitor TIF use. Model programs can be found in Wisconsin and Illinois, where state agencies track and report on total property tax revenues going to TIF districts, local governments are required to report detailed information related to revenues and their tax base, and nearly everything is published in online databases. All local governments would be well advised to provide extensive, easily accessible information about TIF use, revenues, and expenditures, he says. And researchers can do their part by studying and documenting the different outcomes of TIF in a wide variety of areas. To date, academic studies of TIF show mixed results but do not clearly explain the causes of this variation, according to the report.

States should allow counties, school districts, and other overlying local governments to opt out of TIF, the report says. They should also confront the phenomenon known as "but for"—a loose interpretation of proof that a proposed TIF development would not occur "but for" the establishment of a TIF district.

The "but for" clause may have outlived its already limited usefulness. "It's hard to demonstrate conclusively [that a development would not have occurred 'but for' the TIF], so nothing ever gets shot down. There should be a better hurdle for bad projects," said Merriman. "It would be better to have something more concrete—to talk about a project filling 10 percent of the gap, for example."

AN EVOLVING TOOL

In many respects, change is already underway. TIF is rapidly evolving, as policy makers take notice of the problems.

California, arguably where it all began, is once again a leader in reimagining the financing of urban redevelopment and associated infrastructure. Cities and towns in the Golden State once relied heavily on TIF, which was administrated through hundreds of quasi-public redevelopment authorities and ushered in more than $50 billion over the years for infrastructure and other development costs. In 2012, Governor Jerry Brown discontinued the practice due to concerns about growing debt.

But like a pruned branch growing back, a new mechanism evolved in 2015 for cities, counties, and special districts in California: the Enhanced Infrastructure Finance District, which allows the issuance of TIF bonds under specific circumstances, with thresholds built in for voter approval. The money can be used for public works, transportation, parks, libraries, and water and sewer facilities—with an emphasis on sustainable community goals under California's landmark climate legislation.

Research suggests that TIF often displaces economic activity that would have happened anyway in economically vibrant areas. In Kansas City, Missouri, eight times as many TIF deals were approved in low-poverty areas such as Country Club Plaza (left) than in areas like East Kansas City (right), with poverty rates above 30 percent. Credit: Eric Bowers.

TAX INCREMENT FINANCING VERSUS LAND VALUE CAPTURE

It may seem like the public-finance equivalent of angels on a pin, but there is a difference between tax increment financing and land value capture. The two policies have been conflated of late, adding to some misapprehension about how urban redevelopment is funded.

In a TIF district, development is financed by calculating the property tax revenue the project will generate over a defined time period—for example, 20 years in the future. That money is effectively plowed into making the development happen in the first place, in a kind of front-loading process. This anticipated future revenue is calculated by projecting what land and property owners would pay, under whatever local property tax system is in place, based on assessed value.

Land value capture, on the other hand, allows communities to recover and reinvest land value increases that result from public investment and government actions, such as a new subway line or a rezoning. The increases, also known as the land value increment, are measured to reflect the impact of those public actions, whether infrastructure or a new park or an expanded building envelope. The revenues from that calculation can be used for a range of improvements for more equitable urban development, such as affordable housing and infrastructure.

It is true that a well-functioning property tax system will reflect increases in land value, including those driven by public investments. But property tax revenue typically goes into a general fund, rather than toward the infrastructure that is triggering the increase in value. There are also limits and restrictions on increases in the property tax in many jurisdictions. Further, value capture purists argue that the increases in value attributed to public investment belong to the public; a portion is simply being recovered.

As David Merriman writes in the Lincoln Institute report *Improving Tax Increment Financing (TIF) for Economic Development*, the public captures no more of the value created by public investments in a TIF district than it would without the TIF district. In fact, he says, "if some TIF revenues are used to subsidize private activity, as is the usual case, TIF is more properly a device that 'transfers' value to, rather than 'captures' value from, the private sector."

Land value capture instruments include betterment contributions, special assessments, charges for building rights, exactions, and impact or linkage fees, to name a few. On the surface, TIF districts seem similar, in part because of the targeted and self-contained character of the mechanism. In the future, tax increment financing and land value capture might possibly be combined, through an extra surcharge or other special assessment. But for now, largely because the approaches are based on different underlying concepts, they are not equivalent. —AEF

Crowds in Chicago celebrate the opening of the Bloomingdale Trail and Park, which was partially funded through TIF. Credit: Charles Carper/Flickr CC BY 2.0.

Residents of Stillwater, Oklahoma, gathered signatures this summer in an effort to bring their community's proposed TIF district to a public vote. Credit: Michelle Charles/ Stillwater News Press.

Enhanced Infrastructure Finance Districts are also prioritized for "the acquisition, construction, or rehabilitation of housing for persons of low and moderate income." Proposed projects thus far are in a larger catchment area than a typical TIF district, theoretically enabling more components of a given urban neighborhood to benefit.

Recent activities in state legislatures across the country, as well as a handful of court rulings, have resulted in extensive TIF reforms. Since 2017, nine states have passed substantive legislation to change TIF, according to the Lincoln Institute database *Significant Features of the Property Tax*. The adjustments focus on three areas identified in Merriman's report: protecting school funding, calibrating the "but for" and blight provisions, and requiring transparency.

North Dakota, Colorado, Montana, and Kansas all amended their statutes to exempt school districts from TIF. Minnesota expanded TIF eligibility to cover workforce housing, and Wisconsin created special zones for electronics and information technology manufacturing where TIF can be used. In the courts, some projects have been derailed by legal challenges, but the judiciary has thus far generally backed the practice. This year, the Wisconsin Supreme Court upheld the use of TIF revenue to provide cash grants to developers for project costs (Collins et al. 2018).

TIF is also increasingly being bundled with other supporting finance mechanisms, such as credit enhancement agreements, up-front special assessment levies, or reserve or contingency funds to help buttress and safeguard deals, minimizing risk to the public sector.

"There's a lot of pressure on municipalities, and they're getting smarter about the tools in their toolbox," said Emily Metzler, senior vice president of MuniCap, a Columbia, Maryland–based firm that specializes in tax increment and special assessment financing. "We've seen an uptick in TIF use, but [also] greater understanding about how to best use TIF in the capital stack."

In structuring many bundled deals, the aim is to require the private-sector developer or landowner to put cash in a kind of escrow account until the TIF revenues provide enough coverage. Layering in a special assessment, credit enhancement, or stabilization fund helps minimize the risk period at the outset and further leverages the incremental revenues, Metzler said. This kind of bundling has become so common that "we refer to TIF alone as a naked TIF," she said.

It's not surprising that tax increment financing would become contentious in so many cases, Metzler said. "We're asking to take incremental revenues that otherwise would go into the general fund. Any time you do that, it's a public process. That process has become significantly more important. It used to be, you would go to a couple of council hearings and it would be done in four months. Now it is a full branding of the project, with a lot of public outreach, to make sure the public is behind you, and it takes at least a year."

Not all modifications are greeted with equal enthusiasm. In some communities, the change can't come fast enough. Some are skeptical that the bundling approach is merely adding on to a baseline of already generous incentives, and alternatives such as community improvement districts haven't fared particularly well.

The state auditor in Missouri, Nicole Galloway, recently issued a report critical of community improvement districts as an alternative to TIF, citing one instance where the only beneficiary of redirected sales tax revenue was a Starbucks. With 80 percent of CID boards controlled by developers, "spending decisions are made by the owners and developers who stand to gain the most from the districts' tax collections," she said.

Despite amendments to enabling legislation, the "but for" and blight provisions remain stubbornly fungible in many cases. These tests and thresholds can be easily manipulated, as both eager politicians and developers engage in the marketing of project proposals. Few guidelines compel consideration of income inequality and demographic factors or otherwise ensure that tax increment financing happens in the areas that truly need a boost—rather than in neighborhoods that have already turned the corner.

Some well-intentioned changes have produced unintended consequences. After Illinois rewrote the rules to allow school districts to opt out of TIF districts and become eligible for state aid, the mayor of Naperville, Illinois, just outside of Chicago, brazenly suggested making the entire city a TIF district to collect additional revenue to cover school funding.

Throughout, TIF has proven too great a temptation for elected officials focused on economic development. Lawmakers in Kentucky responded to one troubled TIF district by authorizing the extension of its duration from 23 to 45 years. In the closing days of the legislative session in Rhode Island this year, state leaders approved tax increment financing for the seaside towns of Middletown and Newport; the deal for the latter included a hotel and retail space for this popular tourist destination. They also unhesitatingly passed a stadium financing package that included TIF to try to keep the minor league Red Sox team in Pawtucket. This summer, the team agreed to relocate to Worcester, Massachusetts—which provided an even bigger bundle of incentives including a TIF district for the downtown where a new stadium is envisioned.

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END IT OR MEND IT?

Cities may well be at a crossroads on TIF—namely, whether to end it or mend it.

Joan Youngman, director of the Department of Valuation and Taxation and a senior fellow at the Lincoln Institute, said there are clear steps cities and states can take now to improve the performance of TIF. As tempting as it might be to stick with something familiar, those seeking more equitable development might consider skipping TIF and developing alternative tools for financing infrastructure, affordable housing, and economic development.

Merriman agrees, but added: "Economic development is viewed as the most important thing a city can do. It's not a giveaway. You pay the same taxes you would pay without the TIF. And it requires a tangible, up-front plan. At the same time, we have to keep a careful watch on it and understand the way it can be abused."

Dr. Molly Metzger of Washington University in St. Louis delivers a presentation on TIF inequities. Credit: Ethical Society of St. Louis.

The good news is, flaws in TIF policy are prompting innovation and creativity. Portland, Maine—an increasingly hot-market city—has been modifying TIF to achieve more targeted urban planning goals. As explained by planning director Jeff Levine, new state enabling legislation paves the way for cities to use a general TIF for credit enhancement or public infrastructure anywhere within their boundaries, up to 5 percent of the urban area, but there is no limit if the activity is within a defined downtown. Transit Oriented Development TIF can be used to fund transit operations in the area and can be combined with other TIF types. And an Affordable Housing TIF can be used to help fund any housing on a parcel or series of parcels as long as at least a third of the housing in the area is affordable at 120 percent of area median income, with deed restrictions.

In Portland, TIF is tailored to meet broader policy goals and frequently combined with other tools, such as historic or housing tax credits. The overall result is a more intentional framework for regeneration and development rather than the ad-hoc approach used elsewhere, often fueled by a sense of desperation.

The way cities approach redevelopment "has a lot to do with the self-esteem of the city," said Metzger. And it's not just St. Louis she's thinking about. A more coordinated plan that focuses on income inequality and affordable housing would help anywhere, she said—as long as governments invite the citizenry to participate.

"We have spelled out an agenda for transparency and racial equity, and we have the data and mapping to back it up," she said.

"We're trying to keep shining the light."

Anthony Flint is a senior fellow at the Lincoln Institute of Land Policy.

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