

QUICKNOTES

Tax Increment Financing

Tax increment financing (TIF) has been described as a redevelopment “credit card” that enables cash-strapped local governments to buy new projects today and pay them off tomorrow. TIF allows municipalities, counties, or designated development agencies to borrow against anticipated growth in property tax revenue to cover the cost of the public improvements needed to help generate that growth.

TIF was long restricted to inner cities, but through the 1980s and 1990s it became the chief economic development tool for suburbs, counties, and rural areas. Today, 49 states and the District of Columbia allow some form of TIF, though implementation standards vary widely. It is used sparingly in New York and Arizona, for example, whereas California has nearly 400 operating redevelopment agencies using it. Midwestern states have been especially enthusiastic in implementing TIF, and the City of Chicago alone has more than 158 TIF districts that cover 30 percent of its land, with another dozen or so awaiting approval.

HOW TIF WORKS

First introduced in the 1950s, TIF is a tool used by cities and other development authorities to finance certain types of development costs. The public purposes of TIF are the redevelopment of blighted areas, construction of low- and moderate-income housing, the creation of employment opportunities, and an improved tax base. With TIF, a city “captures” the additional property taxes generated by the development that would otherwise have gone to other taxing jurisdictions or to general revenue-raising for the city, and uses the “tax increments” to finance public improvement costs such as improvements to streets, signalization, transit, parks, sewer and water facilities, and bicycle and pedestrian amenities.

TIF was reborn in the 1980s as dwindling federal grants for urban redevelopment, reduced tax breaks on municipal bonds, and state-imposed property tax caps pressed local governments to find new ways to finance public development. States passed new TIF enabling laws or amended old ones to allow its use on a wider variety of properties or for a wider array of uses.

Requirements vary, but usually a municipality or county board must find that 50 percent or more of the real property in a proposed TIF district is blighted, in need of rehabilitation or conservation, or suitable and zoned for industrial use. Any new investment proposed for that district must enhance the value of all property in the district, and the economic growth potential of the district must be enough to cover anticipated TIF costs. In addition, government entities (usually with the advice of a consultant who specializes in such analysis) must find that the development to be financed would not have occurred without TIF help.

When a TIF district—also known as a revenue allocation district (RAD), tax allocation district (TAD), tax increment district (TID), or tax increment reinvestment zone (TIRZ)—is set up, officials calculate the value of property within it. Local taxing bodies continue to receive property taxes based on that initial base value; the additional tax revenues collected on the increase in equalized assessed value (EAV) generated by development—the tax increment—is collected by the TIF agency and used to pay off the costs of improving the district.

Once established, TIF projects are typically overseen by a local government department or quasi-public authority set up to administer the program. The state (usually acting through its revenue office) makes sure that the district complies with state laws.

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CONTROVERSIES AND CURES

TIF has proven to be as controversial as it is popular, and even the most ardent critics concede that TIF is a useful revenue tool when used carefully. But some projects are not well suited for TIF; for example, studies strongly suggest that increased retail sales in TIF project areas usually come at the expense of sales in other parts of the region. So it is increasingly important for local governments to assess the needs of the community and the benefits and drawbacks of using TIF as a redevelopment tool.

TIF is sometimes not used for projects that will be most beneficial to a community but for those where it is likely to generate the most new revenue. Awarding TIF to projects in such areas may fail the “but for” test—the clause in most TIF statutes that demands that TIF be used only if the anticipated growth in property value at the affected site would not happen “but for” the availability of TIF capital.

Low-density development such as housing in urban areas seldom pays for itself and often adds to the cost burdens of schools and parks even as it diverts property tax revenue from those districts. Business attraction and retention incentives also offer dubious benefits, since they go to companies that don’t always stay put, rather than into land, which does. Critics also have complained that TIF subsidizes sprawl and accelerates gentrification. Further, there is a risk that routine infrastructure investment will be made according to the ability of an area to generate sufficient increment to pay for them, rather than being prioritized through normal budgetary, planning, and capital programming mechanisms.

The most problematic aspect of TIF is the one that is built into the program. TIF diversions short-change government agencies such as schools, parks, and libraries of their share of property tax revenues for as long as a generation, since most TIF districts are designed to last long enough to pay off the bonds that are typically used to finance improvements. Governments can make TIF a more efficient redevelopment tool by encouraging more transparency in the process, allowing school tax exemptions or negotiated agreements with TIF-granting agencies to protect local school revenues from diversion, and implementing clauses requiring developers to pay back all or part of the subsidy if they fail to meet their hiring targets or other obligations under the deal.

THE FUTURE OF TIF

TIF has proven successful in many instances. Indeed, in some situations—such as eliminating a site-specific impediment that is keeping an otherwise profitable site from achieving its highest and best use—it can be an essential tool.

Every state in which TIF has been widely used has seen efforts to make TIF more transparent by imposing more rigorous qualifying standards and oversight. Civic groups and other interested parties have routinely advocated for improving TIF requirements and for implementing reforms to protect other local government units and municipalities. The American Planning Association and its Chapters support several proposed state and local reforms, including:

- placing reasonable limits on the amount of tax increment that can be accrued by a redevelopment project area over a specified period of time;
- setting reasonable performance standards to ensure that redevelopment funds are used within a certain period of time and in the manner intended by the redevelopment plan;
- providing adequate opportunities for other government entities to receive the accrued taxes once a redevelopment project is completed or its statutory time period has expired; and
- providing sufficient guarantees and protections in the event that the private parties who receive tax benefits withdraw from participation.

Even without changing basic TIF statutes, this tool can be used in a fiscally responsible manner. TIF can advance a community’s economic, housing, and blight-eradication goals without unduly diminishing the capability of other taxing entities that serve important public needs. □

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MCA Housing Partners



A TIF project completed in March 2008, the Gateway I Family Apartments offer 42 affordable units.

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