

POLICY REPORT

Executive Summary

The Iowa Policy Project

Child & Family Policy Center

April 2003

Tax Increment Financing in Iowa: What Should Be Done?

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Much attention has been given recently to problems with Tax Increment Financing in Iowa. The Farm Bureau has called for an end to TIFs, while the League of Cities has proposed some modest reforms. Some assert that TIFs are ineffective, and others claim they are an essential tool for economic development. Meanwhile, the valuation under TIFs has increased more than five-fold in the last decade, and the state will spend \$28 million in fiscal 2003 in additional state aid to school districts caused by the TIF value lost to those districts. This is expected to increase substantially each year.

In all of this debate, some fundamental questions about TIFs have yet to be raised, and a number of specific problems with current TIF law have not been addressed. In this report we pose those questions and note some of the specific problems. We then suggest some changes in TIF law.

The Idea of Tax Increment Financing

TIF was originally conceived as a method for “bootstraps” financing of public investment. It evolved out of the urban renewal laws of the 1950s and 1960s and so was focused on the redevelopment of “blighted” urban areas. The belief was that such areas would be unlikely to be rejuvenated on their own without an infusion of public capital. The core idea of TIF is that it would help the city to undertake potentially risky investment in blighted areas by allowing it to capture all new property taxes from the increased property tax base to pay off the investment. The city and other overlying jurisdictions – schools, counties, community colleges, special districts – would benefit in the long run by the additions to the tax base that would not have occurred but for the city-directed investment. But first, the city would be allowed to recover its costs. This simple and straightforward argument appeals both to fairness and to efficiency. All jurisdictions pass up immediate tax revenue, but everyone benefits in the end.

Do TIFs Work?

We know very little about how effective the original, blighted area TIFs have been in achieving urban revitalization objectives in Iowa in a way that genuinely benefits area residents. While TIFs have been employed widely in Iowa both in blighted areas and for other purposes, little actual detailed analysis has been conducted to determine if they actually stimulated investments that would not have occurred otherwise, or produced gains for the residents with the most at stake in seeing blighted areas improved.

Specific Problems With Iowa’s Current TIF Law

The use of TIFs has expanded well beyond its original purposes because of the looseness of the law. As one result, new TIF projects often are instituted well after the private investment has occurred. In such instances it would be more accurate to say that the private investment caused the city to use TIFs to capture the revenue, rather than that the TIF caused the private investment, yet this is allowed under the current law definition of the “base year.” It also allows expansion of a TIF district, so that tax revenues properly connected to and drawn for one project are then used for another, unrelated project, which

violates the original justification for the diversion of funds. The law also allows a TIF district to include parts of two or more school districts, which means revenues from one district may be used in another. It also allows use of TIF for projects that will not generate new tax base (not-for-profit, or government use), and lets cities avoid limits on tax abatements and requirements for a referendum on general purpose debt.

TIF Reforms

If TIF is to be maintained in Iowa, reforms should start with a moratorium on TIFs and issuance of TIF debt, and all existing districts should expire as of the date the current debt is retired. Existing TIF districts should have to be reconstituted under the new law in order to finance any further projects. TIF should (1) be required to serve a public purpose; (2) be limited in its use; and (3) be structured and approved in a manner to assure accountability. Here are some suggested reforms:

Ensuring that TIFs Serve a Public Purpose

- Tax increment financing should be used only if: (a) the investment serves a public purpose, (b) a legitimate finding of blight can be made, and (c) subsequent private redevelopment would not reasonably be expected to happen “but for” the public investment.
- There should be a showing of how a TIF in a blighted area will benefit the residents of that area. Any TIF project that will displace residents should be put to a referendum.
- The base period valuation for purposes of calculating the increment available to retire TIF bonds should be the valuation as of the January 1 nearest to the issuance of TIF debt, to guard against application of TIF to a project started without incentives.

Limiting TIFs to Prevent Overuse

- TIF districts should be compact, and property to be included within a district should be contiguous and within the same tax administration district (only one school district, for example).
- A percentage limit of a city’s total area or valuation for TIF use should be set by law.
- All TIF areas should expire in 15 years.
- TIF should not be used to finance tax abatements.
- Base valuation should increase each year by the general rate of inflation in the value of properties within the TIF area, by class of property. This ensures that the increment covers only new construction or rehabilitation.

Enhancing Accountability and Democratic Process

- TIF projects should be financed only with actual indebtedness, and that indebtedness should be considered a general obligation of the city, subject to constitutional debt limits.
- All TIF debt should fall under the same voter approval requirements as other general obligation debt; i.e., if it is not for an “essential corporate purpose,” there should be a referendum.

Limiting Use of Economic Development TIFs

- Economic development TIFs should require approval by the other jurisdictions involved.
- Economic development TIFs should include wage and benefit standards for any firm assisted.
- Economic development TIFs should not be allowed for a firm relocating from elsewhere in Iowa.
- Economic development TIFs should not be allowed for retail uses. In the absence of neighborhood blight, there is rarely a case that can be made for public subsidy of retail development.

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The full report is available to the public, free of charge, at www.iowapolicyproject.org.