EXECUTIVE SUMMARY

Tax Increment Financing: A Case Study of Johnson County

By Peter S. Fisher

Tax Increment Financing, or TIF, is poorly understood, yet hotly debated. Cities tout it as an important tool to promote local economic development, yet often its principal effect is to shift taxes from business to residential taxpayers, or from one city's taxpayers to residents of neighboring towns and rural areas. In other cases, TIF has been used to entice businesses to move from one city to another with no economic benefit to the region. Some cities use it very selectively, while other cities have placed most of the city in a TIF area, or are well on their way to doing so.

TIF is a financing mechanism whereby cities establish an "urban renewal area" (URA) and are then allowed to divert taxes on the increased value in the URA (the tax increment) from school districts and counties to the city's TIF fund. These diverted taxes are spent on development projects within the URA. These diversions, in fact, can be direct payments back to those who do the development within the URA, in effect rebating the developer's property taxes. This report illuminates how TIF has changed from a tool for redeveloping blighted areas to a means of subsidizing development projects of all kinds, often with little or no public benefit, and a device for shifting the costs of city infrastructure to taxpayers in rural areas and neighboring cities. The report focuses on the experience with TIF in Johnson County.

Key Findings

- Countywide, $759 million worth of taxable property, representing nearly 15 percent of the county urban tax base, is now part of a city TIF increment.
- Four cities now have over a third of their tax base in a TIF increment: Coralville (39.7 percent), Oxford (50.7 percent), Shueyville (55.4 percent) and Tiffin (56.7 percent).
- The City of Coralville accounts for 68.4 percent of the TIF valuation in the county, followed by North Liberty with 14.6 percent. Iowa City, with 56 percent of the total urban value in the county, accounts for only 3.3 percent of the TIF value.
- The City of Coralville's Merged Highway 6/Coral Ridge Mall Urban Renewal Area (the Mall/6 URA) is by far the largest in the county (54 percent of the county total TIF valuation) generating $12.8 million in property taxes diverted to the city's TIF fund this year: $5 million comes from the Clear Creek Amana (CCA) and Iowa City Community school districts, $2.7 million from Johnson County, and $4.7 million from the city's own general fund
- Of the $5 million in school property taxes diverted because of the Mall/6 URA, 44 percent is offset by increased state funds through the school aid formula. The remaining 56 percent is recovered through higher school property taxes. The Iowa City district levy is higher by $0.56 per $1,000 of taxable value because of the Mall/6 TIF, while the CCA levy is $2.83 higher.
- Through higher school and county tax rates, Iowa City residents and businesses are effectively being taxed by Coralville to build facilities that compete with Iowa City's hotels and to lure Iowa City businesses, such as Von Maur, to Coralville. The average single-family residence in Iowa City pays an extra $80 per year because of the Mall/6 TIF. A small business with $300,000 in taxable property pays an extra $254 per year.

- Clear Creek Amana school district residents forgo most property taxes from the Mall area, and these tax dollars are being used to redevelop the Iowa River Landing, entirely within the Iowa City Community School District. The average homeowner in CCA pays an extra $319 per year in property taxes because of the Mall/6 URA.
- In five cities, TIF revenue now exceeds regular property tax revenue. TIF revenue accounts for 83.8 percent of Shueyille's property taxes, 78.0 percent of Tiffin's, 75.4 percent of Oxford's, and 59 percent of Swisher's and Coralville's.
- TIF revenue diverted from the county and school district forces higher property taxes on county and district taxpayers residing outside the city, and higher state taxes through the higher school aid payments. Among the eight heavy TIF-using cities in Johnson County, Shueyville leads the pack with 62 percent of its property taxes exported to non-city taxpayers, followed by Tiffin at 49 percent, Oxford at 48 percent, Swisher at 42 percent and Coralville and Lone Tree at 31 percent.
- Five small towns (Swisher, Shueyville, Oxford, Tiffin and Lone Tree) are using TIF revenues primarily or exclusively to retire debt for water, sewer and street projects that otherwise could be retired entirely from a city debt service levy or from water charges.
- All of the growth in the number of school children in the county over the past 10 years has been in the eight communities that have placed much of their new tax base off limits to the school districts through the heavy use of TIF.
- The average residence in Johnson County, with a market value of $200,000 and a taxable value of about $94,000, pays an extra $373 a year because of all TIFs in the county if it is located in a rural portion of Clear Creek Amana. A small business with $250,000 in taxable real property would pay an extra $991, and an average 1,000-acre farm would pay an additional $2,489. In the rural part of the Iowa City school district, the corresponding effects of TIF are an extra $140 for the average residence, $371 for the small business, and $1,038 for the farm.

Conclusions

TIF promotes local government spending by lowering its perceived cost. When 50 percent of TIF revenues are exported, the effect is a half-price sale on public projects and TIF incentives. In the process, spending priorities are skewed in favor of incentives, buildings, and infrastructure, and away from services such as mental health, recreation, police protection, library acquisitions, and others.

TIF has been allowed to degenerate to the point that many cities view a TIF area as a perpetual cash cow to finance a wide range of city operations that have nothing to do with economic development. It is used to build hotels that lose money and compete with unsubsidized hotels in the same area, to entice retail stores to relocate from neighboring communities, and simply to get other people to pay for a community center or street improvements.

Without serious reform, we can look forward to a future in which increasing numbers of cities TIF all or most of their city for the primary purpose of shifting taxes to non-residents, and more and more cities join the incentive wars in retaliation for the piracy of retail and other businesses by their neighbors. The end result will be a local property tax system that is increasingly unfair, and an erosion of revenues that threatens the ability of cities and counties to finance important public services, many of which are part of the foundation for future economic growth. Ironically, this result will have been arrived at in the name of promoting "economic development."

***Peter Fisher** is research director of the nonpartisan Iowa Policy Project, part of the Iowa Fiscal Partnership (IFP). IFP is a joint public policy research and analysis initiative of IPP in Iowa City and another nonpartisan, nonprofit organization, the Child & Family Policy Center in Des Moines. Reports from IFP are at www.iowafiscal.org.*

Iowa Fiscal Partnership

Tax Increment Financing: A Case Study of Johnson County

By Peter S. Fisher

Tax Increment Financing, or TIF, is poorly understood, yet hotly debated. Cities tout it as an important tool to promote local economic development, yet often its principal effect is to shift taxes from business to residential taxpayers, or from one city's taxpayers to residents of neighboring towns and rural areas. In other cases, TIF has been used to entice businesses to move from one city to another with no economic benefit to the region. Some cities use it very selectively, while other cities have placed most of the city in a TIF area, or are well on their way to doing so.

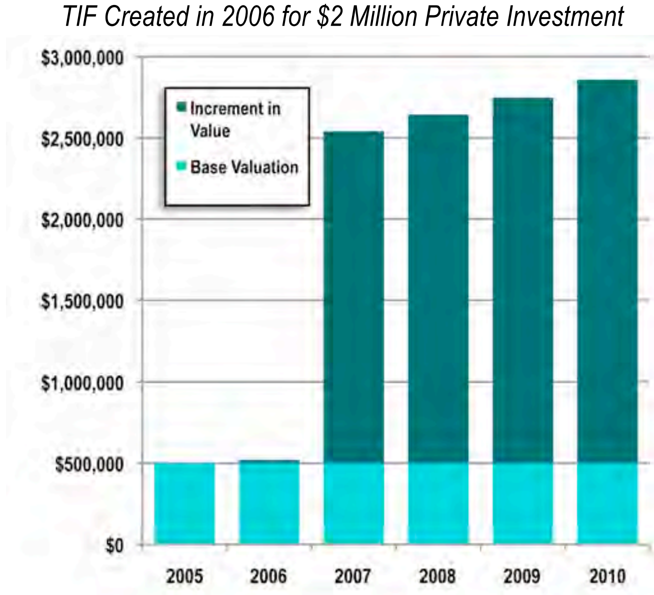
This report illuminates how TIF has changed from a tool for redeveloping blighted areas to a means of subsidizing development projects of all kinds, often with little or no public benefit, and a device for shifting the costs of city infrastructure to taxpayers in rural areas and neighboring cities. The report focuses on the experience with TIF in Johnson County.

How Does TIF Work?

Under Iowa's TIF law, cities are allowed to designate portions of the city as "urban renewal areas" and then to divert future increases in taxes within that area to the city's TIF fund.[1] This is an extraordinary power, for it allows the city to claim part of the tax base from new development exclusively for a designated TIF project as the city sees fit. Tax revenues are diverted that would normally flow to all local governments to help pay for their share of the additional costs associated with development: to the school district to help pay for public schooling, to the county for health and social services, and to the city general fund for police and fire protection, streets, parks and recreation, libraries, and a host of other services. To make up for the lost revenue, counties and school districts must raise their own property tax rates. TIF thus provides a mechanism to shift costs to county and school taxpayers outside the city — and to state taxpayers, through state aid to local schools. This feature, combined with the looseness of Iowa's TIF law, creates strong incentives for cities to overuse and abuse TIF.

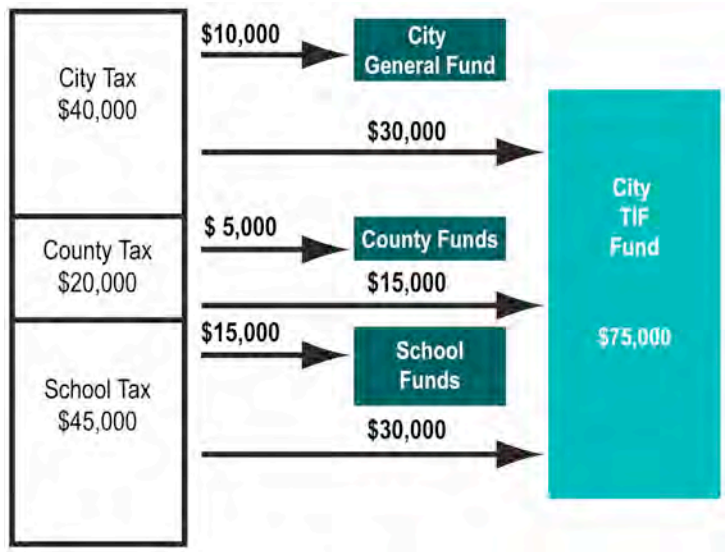
Figure 1. How a TIF Increment is Established and Grows

TIF Created in 2006 for $2 Million Private Investment



When an Urban Renewal Area (URA) is first established, the assessed value in the URA as of the preceding January becomes the base value. All increases in value after that represent the increment in value, as illustrated in Figure 1 for a hypothetical TIF created in 2006 for a $2 million private project.[2] In future years, total taxes on properties in the URA are the same as they would be outside the URA, but where those taxes flow is altered dramatically. The schools and the county collect their full tax rate only on the base value, and get to collect only debt levies (to pay off bonds) on the increment. All other taxes on the increment flow to the city's TIF fund, as illustrated in Figure 2. The flows in Figure 2 are based on typical FY2012 Johnson County tax levies on the 2010 valuation shown in Figure 1, ignoring the much smaller tax flows to Kirkwood and other jurisdictions for simplicity.

Figure 2. How TIF Diverts Property Taxes to a City TIF Fund



It is important to understand that TIF is not synonymous with economic development incentives. TIF is merely a financing mechanism. Cities can and do promote economic redevelopment and job creation in a variety of ways; cities can build facilities to accommodate private projects, they can provide tax abatements for both residential and non-residential property, and they can issue bonds to finance infrastructure, all without TIF. But TIF has become the mechanism of choice to *finance* economic development incentives in part because TIF creates the illusion that such incentives are costless, and in part because TIF in actuality shifts costs to other taxpayers. Furthermore, much (perhaps the majority) of TIF revenue is not used to incentivize development at all, but rather to finance routine city infrastructure spending that otherwise could be financed with city bonds, retired entirely by city taxpayers, or charged to developers.

It is often asserted that TIF is costless to taxpayers because the increment in revenue would never have happened without TIF. The taxes that are diverted are taxes that would not have existed but for TIF, so goes the argument, so no taxpayer is the worse off. This is the TIF illusion. It might be true that the development project would not have occurred without some city investment; most projects of any scale require city investments in streets, sidewalks, water and sewer extensions and the like. And it is probably the case that some private investment projects would not have happened without tax rebates or other incentives (though this surely occurs much less often than public officials commonly believe). But none of that requires TIF — which, remember, is just a way of financing such things, an alternative to city bonds or ordinary tax abatements. Thus it is rarely true that TIF is costless to non-city taxpayers; it is the financing mechanism of choice for many cities precisely because it does spread costs to others.

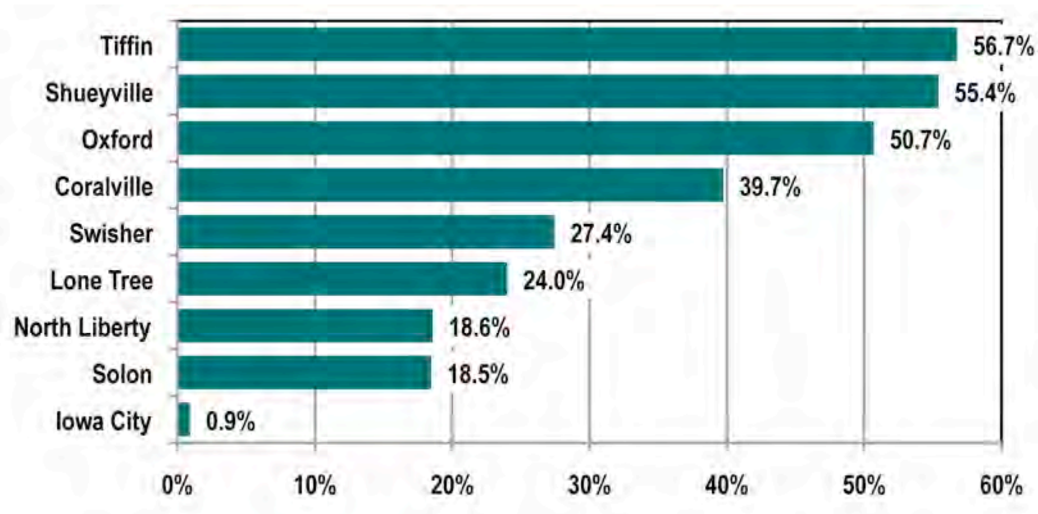
Some might counter-argue that without TIF the city wouldn't have chosen to finance the project at all, depriving the schools and the county of future tax base. Would the City of Coralville have forgone the opportunity to have the Coral Ridge Mall if the city investment in roads and other improvements had to come from city bonds instead of TIF revenues? Of course not. The Mall would have generated sufficient new property taxes to repay such bonds in a short period of time, and it was a very viable project needing no incentives. Would a city provide incentives to a private project that can't obtain private financing and is not viable without city subsidy, if the city couldn't use TIF? Perhaps it would, but if not, that would be for the best. In such cases, the financial market has determined that the project is not viable, and taxpayers would be saved from paying for a losing deal.

Perhaps most importantly, much TIF revenue is used not to incentivize development in the first place, but simply as a cheap way to finance city infrastructure such as streets and community centers

How is TIF Used in Johnson County?

Practices with regard to the use of TIF vary widely among cities and towns in Johnson County. The largest users are Tiffin, Oxford, Shueyville and Coralville, all of which have about 40 percent of the city tax base or more within a TIF increment. (The increment, remember, is the portion of the taxable value in the URA that represents the increase in value since the base year.)

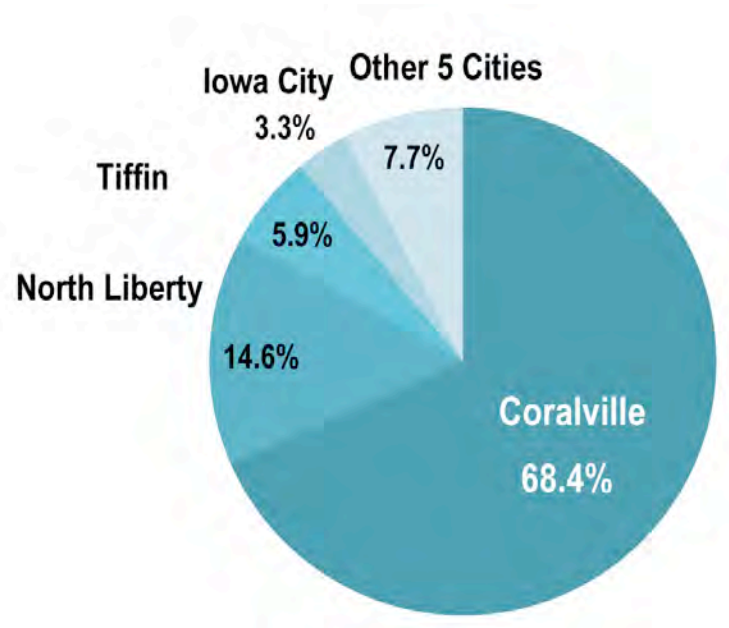
Figure 3. Three Cities in Johnson County Have Over Half of City Tax Base within a TIF Increment , FY2012



Countywide, there is $759 million worth of taxable property that is within a TIF increment in FY2012, representing nearly 15 percent of the urban property tax base in the county. Although Iowa City contains 56 percent of the total urban property value in the county, it accounts for only 3.3 percent of the TIF valuation. Both North Liberty and Tiffin, much smaller cities, have more value under TIF than Iowa City. On the other hand, Coralville, with 26 percent of the county's urban property value, accounts for over two-thirds of the TIF value in the county.

Figure 4. Over Two-Thirds of Johnson County TIF Value is in Coralville

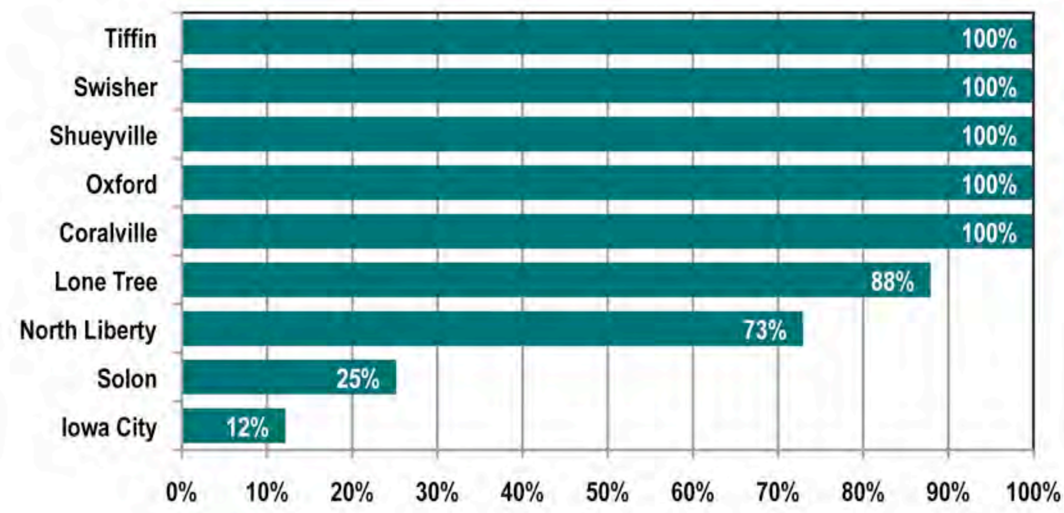
Percent of Johnson County TIF Increment Valuation by City, FY2012



When a city establishes an urban renewal area, all of the future increase in taxes from that area (except for debt service and the school PPEL taxes) are available for diversion to the city TIF fund.[3] But a city does not necessarily claim all of the taxes that it could. For example, once the Iowa City TIF for Plaza Towers had repaid the city costs of that project, the city allowed all potential TIF revenue to flow instead to the county and the school district, just as it would if there had been no TIF. The increments referred to in Figures 3 and 4 reflect the increments actually drawn on by the city, not the total available increment.

The graph below shows, for each city, the percentage of the available incremental revenue from the TIF areas that is being diverted by the city. The figures range from a low of 12 percent in Iowa City, to a high of 100 percent in Coralville, Oxford, Shuevyille, Swisher and Tiffin. Coralville, for example, has continued to divert all available incremental revenues from the Coral Ridge Mall long after the original city expenses associated with the Mall were recovered; the Mall TIF now finances projects in the Iowa River Landing area.

Figure 5. The Drive to Keep Diverting TIF Revenue in Johnson County
Percent of Available TIF Revenue Diverted, FY2012



How Does TIF Shift Taxes?

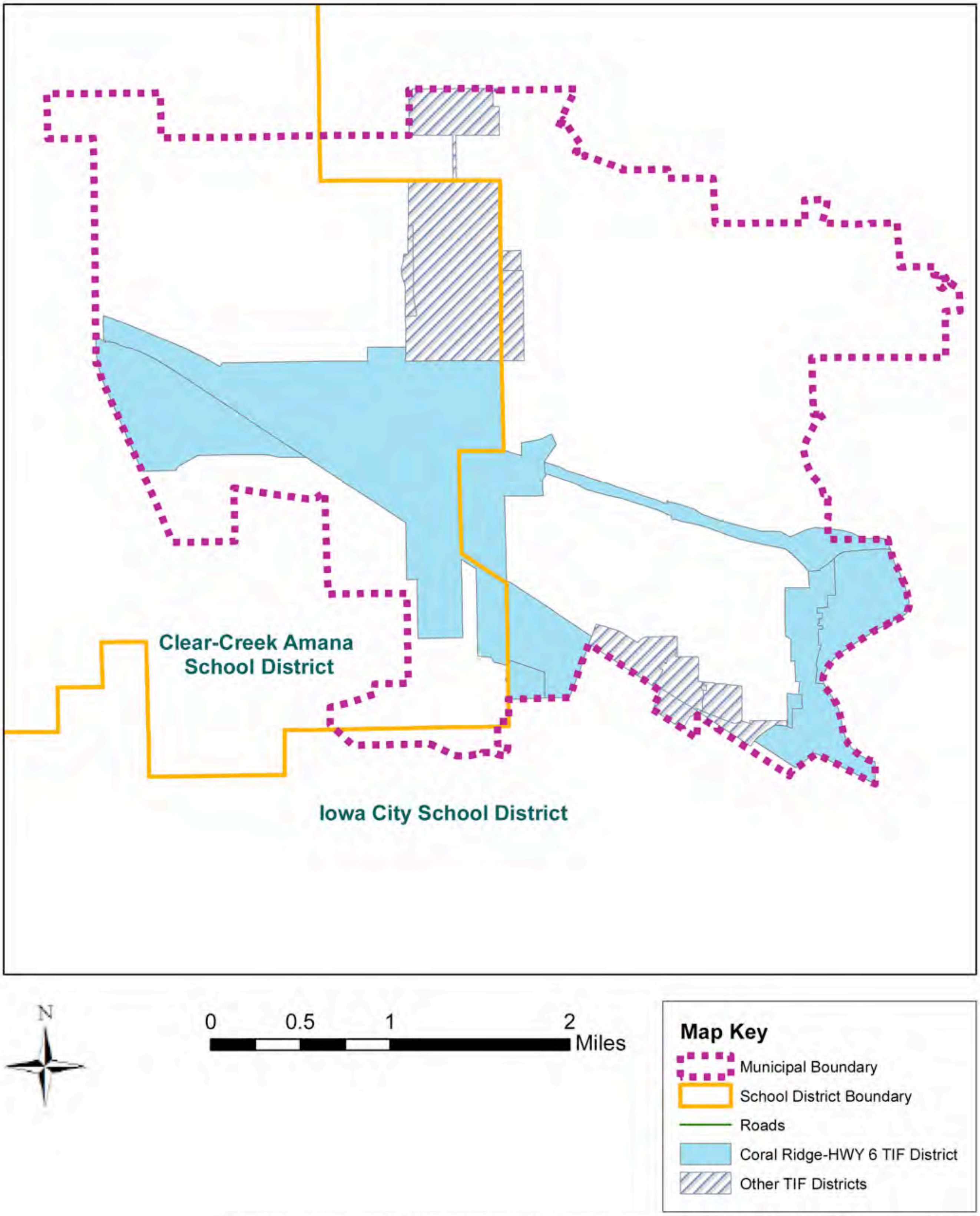
The tax shifting effects of TIF are best illustrated by examining in more detail what is by far the largest TIF district in the county, in terms of both land area and property value: the City of Coralville's Merged Highway 6 / Coral Ridge Mall Urban Renewal Area, which we call the Mall/6 URA for short. This area extends from the eastern city limits with Iowa City at the Iowa River, to the western city limits with Tiffin at I-380 (see Figure 6, next page). The expanded URA resulted from the joining of the older Highway 6 URA (now the site of the Marriott hotel and the Iowa River Landing project) with the Coral Ridge Mall URA in 2002 by including the I-80 right-of-way between the two districts.[4] The combined URA includes $411 million in TIF valuation, 54 percent of all the TIF valuation in the county. The combination allowed the city to use the enormous TIF revenue from the Mall ($10.5 million in FY2012) to finance projects in the Iowa River Landing area.

Of the $19.7 million in property taxes collected within the Mall/6 URA this fiscal year, more than $12.8 million (the increment) are diverted to the City of Coralville TIF fund. Table 1 shows where these diverted taxes come from — that is, where they would otherwise have gone, were it not for TIF. Almost two-fifths comes from the two school districts represented in the URA: Clear Creek Amana, and Iowa City. Note that 36 percent comes from the City of Coralville's own general fund. Thus $4.7 million that could otherwise fund police, fire, roads and other city functions is diverted to the TIF fund for spending on economic development projects. Of course, to the extent that some of this economic development spending is for streets and other infrastructure within the URA that would have come out of the city's general fund, this is not a loss to city taxpayers.

Table 1. Property Taxes Diverted to Coralville TIF Fund by the Mall/6 URA

	Property Taxes Diverted	Percent of Total
From Johnson County	$2,674,268	21%
From School Districts	4,988,624	39%
From Kirkwood Community College	327,808	3%
From Other Governments*	188,661	1%
Total from Other Governments	$8,179,361	64%
From City of Coralville General Fund	4,681,329	36%
Total TIF taxes diverted	$12,860,690	100%

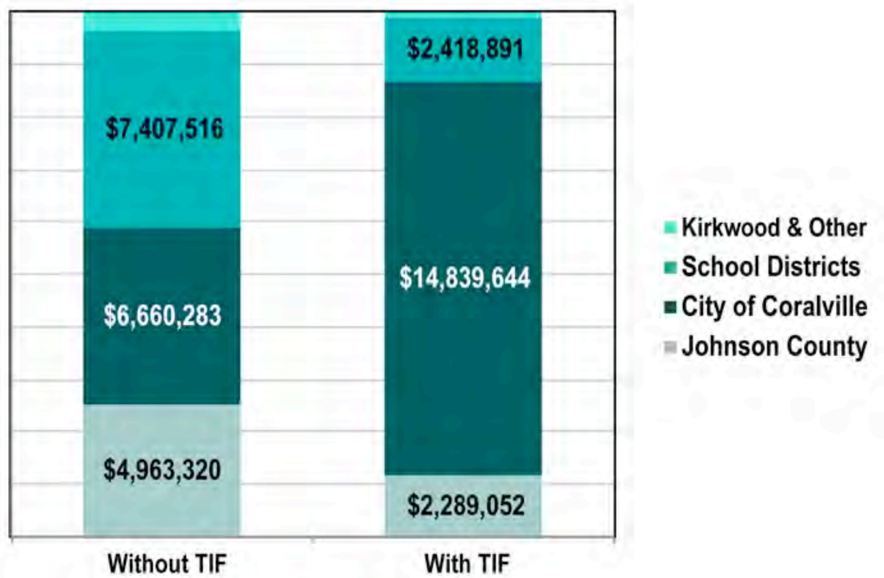
Figure 6. Coralville's Mall/Highway 6 Urban Renewal Area is Largest TIF District in Johnson County



Data sources: Iowa GIS Repository (www.iowagisdata.org) and Johnson Co. Planning & Zoning

Figure 7 shows how the property taxes collected within the Mall/6 URA would be distributed if there were no TIF diversion, and how they are in actuality distributed.[5] The City's share of total taxes collected (taxes going to the city general fund, the TIF fund, and other city funds) rises from 34 percent to 75 percent.

Figure 7. Property Taxes from the Mall/6 URA With and Without TIF



The Mall/6 URA diverts $4.99 million in property taxes from schools this fiscal year, nearly evenly divided between the two school districts: Clear Creek Amana and Iowa City Community. The existence of TIF does not directly affect how much either school district spends, however. The Iowa school financing formula dictates allowable per pupil spending each year for every school district. Furthermore, through the aid formula, the lower tax base per pupil resulting from the use of TIF produces greater state aid. However, this higher state aid offsets only about 44 percent of the lost revenue in these two districts; in order to maintain allowable spending, the districts must raise their tax rates. Table 2 shows that the Iowa City district rate must be $0.56 higher because of the Mall/6 TIF, while CCA must levy an additional $2.83.

The Mall/6 URA also diverts $2.67 million in property taxes from the county. Unlike schools, however, the effects are not so straightforward. If all of the property now part of a TIF increment were fully available to Johnson County, it would enable the county to finance exactly the same level of services it does now with a lower tax rate. However, the larger tax base would also allow some increase in services. Table 2 shows that the county tax rate is $0.45 higher because of the Mall/6 TIF; however, this is the maximum effect on the rate. Some of the TIF diversion may have reduced county services instead. Thus the dollar impacts of TIF on the average property owner in the county can be interpreted as services forgone or higher taxes, or some combination of the two. The Mall/6 TIF also reduces the tax base available to Kirkwood Community College, Agricultural Extension, and the County Assessor.

Table 2. Coralville Mall/6 URA Affects School and County Tax Rates, FY2012

	School District	
	Iowa City	Clear Creek Amana
Increase in levy rate ($ per thousand)		
School district tax	0.33505	2.83494
County tax	0.45124	0.45124
Other countywide taxes*	0.06106	0.10950
Total	0.84735	3.39567
Additional Property Taxes on an average ($200,000) home	$80	$319

*Kirkwood Community College, Ag Extension, and (outside Iowa City only) the County Assessor

Note: Figures for Iowa City Community School District are for property located within the City of Iowa City; the tax rate and average taxes would be slightly higher for residents of the school district outside the city because of the higher county assessor levy.

The overall effect of the Mall/6 URA is a tax rate that is $1.07 higher in Iowa City, $3.40 higher in the CCA school district. For an average home worth about $200,000 on the market, this translates into an annual cost of $80 in Iowa City, $319 in CCA. Residents of Iowa City are paying that much extra per year for

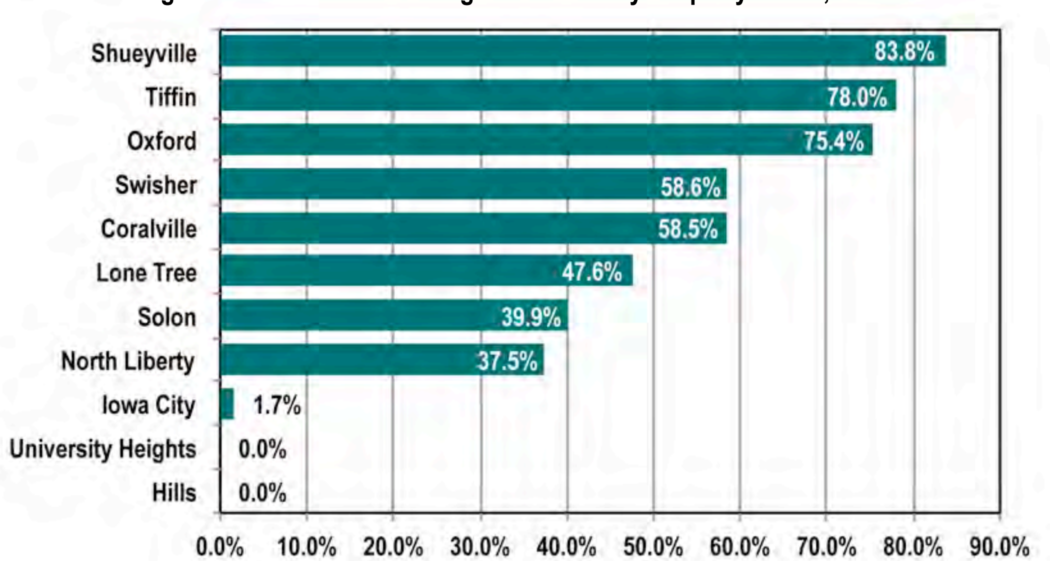
Coralville to develop the Iowa River Landing, including spending about $18 million to lure Von Maur to Iowa River Landing (IRL). Also included in the $80 are the payments on Coralville's debt for the Marriott Hotel. Iowa City residents and businesses are therefore being taxed by Coralville to build facilities that compete with Iowa City's hotels and to lure Iowa City businesses to Coralville.

Clear Creek Amana district residents are paying much more for the Mall/6 URA because the Coral Ridge Mall area properties within CCA represent a very large share of the district's tax base. Those residents are now foregoing taxes from the mall, which no doubt has stimulated growth to the west of Coralville within CCA and added to school population, and these tax dollars are being used to redevelop IRL, which is entirely within the Iowa City Community School District. It is important to remember that tax base enhancement is the rationale for allowing a city to divert a school district's property taxes. Yet any development in the IRL that ends up generating significant tax revenue in the future will provide no benefit whatever to CCA.

What are the Overall Effects of TIF in Johnson County?

Revenues flowing into city TIF funds have become a very large share of the total property taxes received by many cities in the county. In fact, in five cities TIF revenue now exceeds regular property tax revenue flowing into the city's general fund, employee benefits fund, and debt service fund combined. TIF revenue accounts for 83.8 percent of Shueyille's property taxes, 78.0 percent of Tiffin's, and 75.4 percent of Oxford's (Figure 8).

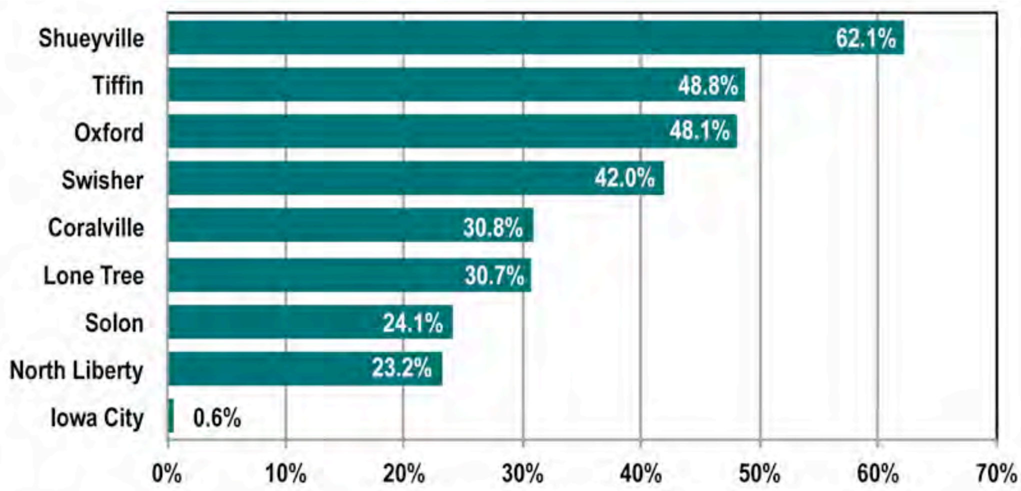
Figure 8. TIF Revenue is Large Share of City Property Taxes, FY2012



The ultimate tax shift produced by TIF is from city to non-city taxpayers. Some of the TIF revenue, of course, is diverted from the city's own general fund to the TIF fund. Furthermore, city residents themselves are paying a portion of the higher county and school taxes required because of the city's own TIF. But the remainder of the diverted TIF revenue is paid by county and school district property taxpayers residing outside the city, and by state taxpayers through the higher school aid payments, which offset about 44 percent of diverted school taxes.[6] Figure 9 shows how much of a city's TIF revenue comes from taxpayers residing outside of the city, including state taxpayers. Among the eight heavy TIF users, between 23 percent and 62 percent of their property taxes are exported to non-city taxpayers. Residents of Shueyville and Swisher, in fact, are able to export some of their taxes to residents of Linn County through higher College Community School District property tax rates.

Smaller towns are actually in a better position to export taxes because the town's tax base is a very small share of the county or district tax base; thus the effect of higher school and county tax rates is felt primarily elsewhere in the county or district. Iowa City, on the other hand, has much less ability to export taxes because city taxpayers will pay the lion's share of any higher county or school taxes. This is perhaps why small towns have put such a large share of the town in a TIF area. (The appendix to this report contains maps of all the TIF areas in the county.)

Figure 9. Percent of all City Property Taxes Paid by Taxpayers Outside the City, FY2012



Swisher, Shueyville and Oxford show no refunds, rebates or other TIF incentives in their FY2012 budgets. For Shueyville, 100 percent of TIF revenue is used to retire debt, and that debt was issued for a new community center/city hall and for a major street project. In Swisher, the TIF revenue has been used to retire sewer improvement bonds, though recently much of it has simply been allowed to accumulate in the TIF fund. Oxford has used TIF revenue primarily to pay for water and sewer projects. Lone Tree in FY12 spent $4,851 on incentives, but $136,947 on general obligation debt service, for city infrastructure. These small towns, in other words, are diverting TIF revenues to the city's debt service fund to retire debt for water, sewer and street projects that otherwise would be retired entirely from a city debt service levy or from water charges. In this fashion, they are able to shift infrastructure costs from city to rural taxpayers. Sheuyvillle, for example, has used TIF to get rural Johnson and Linn County taxpayers to pay for the majority of their recent projects — we saw above that 62 percent of Shueyville's TIF revenue comes from non-city properties, including Linn County residents of College Community School District.

Some smaller towns have created TIFs that capture nearly all of the new residential growth that occurs. Since growth in Oxford, Swisher, Solon, Lone Tree and Tiffin is largely residential, it brings with it increases in population and school children. Yet the tax base that accompanies those children is largely unavailable to the school districts that must educate them, the exception being the school debt levies. Instead, that revenue growth is captured by the cities themselves to pay for infrastructure and other city projects.

The six small towns that rely heavily on TIF, plus the larger cities of Coralville and North Liberty (the other heavy TIF users), together accounted for more than 100 percent of the growth in school-age children in Johnson County from 2000-10. The total population age 5 to 17 increased by 1,959 in the county, but by 2,534 in these eight communities that have come to rely heavily on TIF, while the number of children in that age range declined by 575 in the remaining four cities (Iowa City, Hills, University Heights, West Branch) and in rural Johnson County. The bottom line is that all of the growth in school children in the county over the past 10 years has been in the communities that have placed much of their new tax base off limits to the school districts.

What is the Effect on the Average Home or Farm?

What is the total effect of all TIFs in Johnson County on the property tax bills of typical residential or farm properties? The largest effects are for properties within the Clear Creek Amana or Iowa City Community school districts, which include 87 percent of the taxable valuation in the county. The effects can best be estimated for properties in the rural portions of the CCA or Iowa City districts, and are shown in Table 3 below. The average home in the county has a market value of around $200,000, which translates into a taxable value of $94,000 after applying the 2010 rollback and the homestead exemption.[7] We also consider a property with a taxable value of $250,000, which could either be a high-end residence (market value approaching $500,000) or a small business owning $250,000 in commercial real estate.[8] Finally, we consider the effect on a farm of 1,000 acres, including a farm home valued at $107,000. The tax impacts range from $140 per year for an average home in the rural portion of the Iowa City district, to $2,489 for a large farm in CCA.

Table 3. Potential Property Tax/Public Service Cost of All Johnson County TIFs, FY2012

		Property Located in:		
	Taxable Value	Clear Creek Amana School District — Rural Johnson County	Iowa City School District — Rural Johnson County	Iowa City School District — Inside Iowa City
Average home	$ 94,000	$ 373	$ 140	$ 132
High-end home or small business	250,000	991	371	352
Farm of 1,000 acres with farm home	822,000	2,489	1,038	

The impacts are best interpreted as a combination of higher taxes and lower public services. In the case of school districts, we know that the effect is to raise rates. (In CCA, 75 percent of the effect is through school taxes; in Iowa City, it is only 35 percent.) Most of the remaining effect is through higher county property taxes. For example, of the $140 for the average home in the rural portion of the Iowa City district, $74 represents either higher county taxes, or $74 worth of county services forgone, or some combination of both. (In the absence of TIF, the higher tax base would enable the County Board of Supervisors to lower taxes, to finance improved county services, or both.)

The effects on property taxes for properties within a city relying heavily on TIF are difficult to estimate. We provide estimates only for Iowa City, because the city's own TIF revenue accounts for only 1.7 percent of city property tax revenue.[9] For the remaining cities, where TIF revenues are a third or more of total property taxes, TIF could either raise or lower the taxes on city properties. This is because the city's own TIFs divert taxes from the general fund, which could produce higher general fund tax rates if the TIF taxes are used for incentives. But if TIF revenues merely substitute for city general taxes in financing city infrastructure, then the net effect of TIF is to substantially *lower* the city tax rate. Consider Shueyville, where 62 percent of the property taxes come from taxpayers outside the city. Thus the effect of TIF on Shueyville taxpayers is to drastically lower the city tax rate, or to finance a much higher level of city services. For cities such as North Liberty and Coralville, the gain to taxpayers from the city's use of TIF to finance routine city projects is counterbalanced by the increased school and county taxes due to their own and their neighbors' use of TIF, making the net effect difficult to sort out.

It should be emphasized that these tax impacts represent the *potential* effect of TIF. They are based on the assumption that in the absence of TIF, cities would have found other ways of financing projects financed by TIF, or that TIF incentives had no effect on development. Thus TIF, as a financing mechanism, has not been the cause of tax base growth. These are reasonable assumptions, though they are very much at odds with the claims of TIF proponents. First of all, only a portion of TIF revenue is spent on development incentives to begin with. The remainder finances city infrastructure, for the most part. Constructing infrastructure to accommodate growth is what cities do; in the absence of the TIF mechanism, the costs are paid from city property taxes, often the debt service levy to retire bonds that were issued to pay for the new roads or other improvements. Without the tax shifting benefits of TIF, cities would still perform these traditional city functions, financed in the traditional fashion.

Second, much of the TIF incentives are provided to residential and retail development. These are activities driven by the local market. Incentives are generally unnecessary because these activities cannot be anywhere else if they are to serve the local market. Where they do affect location, it would be better if they did not, because they only shift retail activity around within the market area, or induce development that the market cannot support. It is certainly possible to provide sufficiently generous incentives to make a commercial project viable that otherwise cannot be supported by the local market, but this merely allows the subsidized project to compete unfairly with existing businesses, drawing their customers away and creating vacancies. Vacancies, in turn, reduce rental income to property owners, which will translate into reduced assessments, offsetting the gain in value from the subsidized project.

Consider that largest example of retail TIF in the county. The Mall/6 URA in Coralville, by far the largest TIF area in the county, derives most of its revenue from the Coral Ridge Mall and peripheral retail development. The City is on record saying that no rebates or other incentives were provided to General Growth, owners of the Mall,[10] and the peripheral properties were developed because of the magnet effect of the Mall. If no incentives were needed or provided, it can hardly be claimed that the TIF is the cause of the Mall being there.

Putting residential property in a TIF area is generally not done to provide incentives for developers to build single-family homes, because this is hardly necessary. Instead, it is done to siphon property taxes from the new development and shift tax costs to nonresidents. At the same time, it pulls taxes away from the school district that must educate the children in those homes. It is hard to see any justification for allowing TIF for such purposes.

Incentives granted to manufacturing or other "footloose" export activities may bring tax base to the region that otherwise would locate elsewhere. Still, research has shown that taxes have no effect on the location decision even of industrial activity in the majority of instances, because taxes are such a small share of the total costs of doing business.[11] Furthermore, only 4.6 percent of the valuation within a TIF increment in the county is industrial property (Table 4). Most is residential (21 percent) or commercial (74 percent). Of the commercial, probably over half is retail; the Mall/6 URA makes up nearly half of all the commercial TIF value in the county. A significant share of the TIF valuation in Iowa City, North Liberty, and in the 12th Street TIF in Coralville is also retail, though the exact amount is difficult to ascertain.

Table 4. Most of TIF Increment is in Commercial, Residential Property
Composition of Property within TIF Increments, 2010 Taxable Values

	Residential	Commercial	Industrial
Coralville	5.4%	90.6%	3.9%
Iowa City	16.3%	75.9%	7.8%
Lone Tree	86.7%	12.6%	0.0%
North Liberty	26.5%	67.2%	6.2%
Oxford	68.6%	30.8%	0.0%
Shueyville	98.7%	1.1%	0.0%
Solon	72.0%	26.4%	1.4%
Swisher	85.9%	13.8%	0.0%
Tiffin	71.2%	28.6%	0.0%
Total County	21.0%	74.3%	4.6%

How Should TIF be Reformed?

Tax Increment Financing is sometimes described as Iowa's largest economic development program. In FY2009, over $250 million in property taxes was diverted to TIF funds, an amount well in excess of the annual cost of all of the state's business tax credits in recent years.[12] The state's share of TIF — through higher school aid payments, costing the state $46.8 million this fiscal year — is larger than many business credits.[13] But there is one problem with this argument: it is not clear that the majority of TIF spending can really be characterized as economic development at all.

TIF was originally conceived as a kind of bootstraps financing method, where a city could undertake a redevelopment project in a declining area, in the hopes of catalyzing private development and reversing a decline in property values. The increased tax base in the area would, it was hoped, generate enough revenue to allow the city to recover its costs; to encourage cities to undertake risky projects in low income and blighted areas, the city was allowed to scoop off the additional school and county taxes as well until its investment was repaid. Then the school and the county would benefit from the increased tax base.

TIF as used in Iowa no longer bears much resemblance to this model. It has been allowed to degenerate to the point that many cities view a TIF area as a perpetual cash cow to finance a wide range of city operations, from lawn mowing and street repairs to hiring lobbyists and consultants. In most cases it has nothing to do with revitalizing low income or declining neighborhoods. It is used to build hotels that lose money and compete with unsubsidized hotels in the same area, to entice retail stores to relocate from neighboring communities, and simply to get other people to pay for a community center or street improvements. Created as a tool to lure private investment to revitalize blighted areas, it is being used instead to put shopping malls and single-family homes on farmland.

A strong case can be made to prohibit or severely limit the inclusion of residential and retail activity in a TIF area, with the possible exception of such uses that are incorporated into a larger commercial project, or for the creation of low- and moderate-income housing. Businesses that serve the demands of local markets for housing or for goods and services are driven by local market conditions. If demand is sufficient, firms will build more stores or houses to meet that demand, and financial institutions will provide the financing. In most cases in Johnson County, residential property is not included within a TIF area for the purpose of subsidizing that housing, but simply to capture the incremental taxes to finance projects unrelated to that housing. The capture of these incremental taxes is made even more problematic by the effect of the residential rollback, which can result in the base valuation in a TIF area being driven to zero.[14]

Allowing retail activity to be part of a TIF area and to receive TIF incentives provides a strong incentive for cities to use TIF not to augment regional economic activity but simply to entice a retail business from one location to another within the same market area. This provides no benefit to the region, and in fact may operate to its detriment, creating vacancies in shopping areas that make it more difficult to lease the remaining space. In the long run, such a beggar-thy-neighbor use of TIF invites retaliation and can produce a downward spiral in commercial property tax revenues for all local governments, jeopardizing public services or necessitating increased taxes on remaining properties.

There should be no perpetual TIFs, even for blighted areas, and a 20-year time limit is much longer than needed to recover project costs in most cases. A number of other reforms would limit the overuse and abuse of TIF. But the most important single reform would be to convert all TIFs to project TIFs, where the TIF diversion ends as soon as the initial project is paid for. The TIF area could remain, with new projects financed in the same area, but the base year for the new project would be re-established when the new project is undertaken. A project-based TIF (which is the way it was originally intended to be used, and is still the way it is used by some cities) would also make it more feasible to eliminate the anti-democratic provision in TIF law that exempts TIF from public referendum requirements that otherwise would apply. As a result of this provision, a library bond issue must be approved by a majority of the voters, a school bond issue must be approved by a 60 percent supermajority, but a hotel financed as a TIF project need not be put to a vote at all.[15]

Serious consideration should be given to other limitations as well. There should surely be a limit to the portion of a city's tax base that could be included within a TIF area, and a limit to TIF debt as a share of total taxable value. While the latter limit was thought to exist because the courts had declared TIF debt to be general obligation debt, and GO debt is limited to 5 percent of the city's taxable value, this has been circumvented by the creation of "annual appropriation debt," which appears not to be debt at all and does not count against the GO debt limit. The law should be changed to prevent such a subterfuge. The City of Coralville has used such annual appropriation debt heavily; though its total GO and TIF debt is over twice the $93 million GO debt limit that total includes $130 million in annual appropriation TIF debt, and of that amount only the portion due this year counts against the debt limit.[16]

There should be serious consideration of size and contiguity limits. When TIF is justified as a means of enhancing a school district's tax base in the long run (when the TIF expires), it is absurd to allow a single TIF area to encompass more than one school district. The Mall/6 URA, which would violate any sensible contiguity rule, creates the spectacle whereby Clear Creek Amana, with 49 percent of its tax base under TIF, is denied property taxes that are going largely to create development in the Iowa City school district.

Most obviously, the anti-piracy provision in the Iowa Code needs to be given some teeth.[17] As it stands, it is ineffectual, because a business that expands in the process of moving (and it is safe to bet that this would include the vast majority of business moves) is not classified as a relocation. There should be no exemption for expansions, period. A move is a move, and cities have plenty of other tools to resort to in such a case; they need not have TIF as well.

It needs to be recognized that TIF is a strong driver of increased local government spending, and no doubt skews priorities in the process. TIF financing effectively lowers the price to a city of projects, and when you substantially lower the price of something you tend to buy more of it; it's called the law of demand. When 50 percent of the cost of a city hall or a fire station, for example, will be shifted to taxpayers outside the city, then what we have is a half-price sale on public projects, and we can expect more and fancier city halls and fire stations as a result. We can also expect incentive deals that far exceed what is reasonable and necessary. In the process, spending is skewed in favor of TIF development projects and less revenue flows into city and county general funds where it supports services like mental health, housing assistance, library acquisitions, recreation services, police protection — everything that doesn't involve new buildings or infrastructure.

Without serious reform, we can look forward to a future in which increasing numbers of cities TIF all or most of their city for the primary purpose of shifting taxes to nonresidents, and more and more cities join the incentive wars in retaliation for the piracy of retail and other businesses by their neighbors. The end result will be a local property tax system that is increasingly unfair, and an erosion of revenues that threatens the ability of cities and counties to finance important public services, many of which are part of the foundation for future economic growth. Ironically, this result will have been arrived at in the name of promoting "economic development."

---

[1] Technically, the city creates a "TIF area" after establishing an Urban Renewal Area; the TIF area could be smaller than the URA, but usually is identical with it. We use the term "URA" to be synonymous with "TIF area" in part because most of the TIF areas in Johnson County are named URAs.

[2] Figure 1 assumes that the TIF was established in 2006, so that the base value is the total valuation in the TIF area as of January 2005, or $500,000. A $2 million commercial project is completed during 2006 and goes on the tax roles as of January 2007. A small increment exists for 2006 because of inflation in the value of the base value property. We assume annual inflation of 4 percent.

[3] The debt service levies of the city, the county, the school district, and the community college district are exempt from the TIF diversion because they are legally obligated in their entirety for the repayment of debt. In addition, the school district's physical plant and equipment (PPEL) levy is not subject to TIF diversion.

[4] The Highway 6 URA was established in 1992 (and later expanded) as a blighted area TIF, and that portion of the combined URA remains a blighted area TIF with no expiration date. The Coral Ridge Mall URA was created in 1997 (and expanded in 2005) as an economic development TIF, which means that it expires at the end of 20 years. Thus the Coral Ridge Mall portion of the combined URA will cease to exist in 2018, whereas the remainder will continue on. The city will therefore no longer receive what is now a $10.5 million revenue flow into the TIF fund, representing 65 percent of the city's total TIF revenue in FY2012.

[5] Figure 7 assumes that the total property tax rate in the TIF area is the same with or without TIF. In actuality, the rate could be a little higher or a little lower. TIF forces school tax rates up, and will either force county tax rates up as well, or force a reduction in services. At the same time, to the extent that the city uses TIF revenue to substitute for general fund revenue, the city's own tax rate could be lower with TIF. The net effect could be total property taxes collected that are higher or lower with TIF than without.

[6] Included are higher Kirkwood and other countywide taxes. We do not include the share of increased state taxes paid by residents of the city because any one city's share of the state total would be very tiny. The 44 percent of diverted school taxes offset by state aid is the average for Johnson County's five main school districts: Clear Creek Amana, Iowa City, College, Lone Tree, and Solon. Small portions of six other districts extend into Johnson County but are unaffected by Johnson County TIFs.
[7] The average market value of a single-family residence in Johnson County (not including Iowa City) was about $200,000; the average value of a single-family residence in Iowa City (excluding condos) was also about $200,000. The homestead credit, funded at 63 percent for FY2010, has the effect on the homeowner of exempting the first $3,056 in taxable value.
[8] According to the abstract of assessment for Johnson County for January 2009, the average 100 percent value of a farm dwelling was $107,000, and the average "actual value" of farmland was $1,115 per acre. Since property is reassessed in odd-numbered years, these figures would have been virtually the same in January 2010. This translates into a taxable value of $52,659 for the home and $770 per acre for the land, after rollbacks. We assume the farm benefits from the family farm and ag land tax credits, which in effect rebate a portion of the general school taxes on farm land above the $5.40 levy. These credits are pro-rated; for FY2012 the two credits combined offset 27.2 percent of the general tax rate above $5.40, which in effect means that the farm pays 72.8 percent of the increase in the "additional levy" due to TIF, and all of the increase in the management levy.
[9] The tax effects are slightly smaller in Iowa City than in the rural portions of the Iowa City school district because Iowa City residents do not pay a higher county assessor levy due to TIF; the city has its own assessor.
[10] See Commentary by City Administrator Kelly Hayworth provided on Eye on Coralville, May 23, 2011, "Tax Increment Financing: Perception and Reality," http://blip.tv/coralvision/eocville-tif-5201252 .
[11] See Peter Fisher, *Corporate Taxes and State Economic Growth*, Iowa Policy Project, February 2011, at http://www.iowapolicyproject.org/2011docs/110209-IFP-corptaxes.pdf
[12] See Iowa state auditor's presentation on TIF at http://auditor.iowa.gov/tech_updates/TecTIFUpdate2008.pdf and the Dept. of Revenue's *Contingent Liabilities Report*, October 2011, Table 9, for data on tax credits, at http://www.iowa.gov/tax/taxlaw/1011RECReport.pdf .
[13] See Iowa Association of School Boards, Excel spreadsheet on impact of TIF for 2012, at http://www.ia-sb.org/Finance.aspx?id=4980
[14] This feature of TIF law is explained in detail in the above cited presentation of the State Auditor.
[15] Tax Increment Financing is part of the urban renewal statute, Chapter 403 of the Iowa Code. Chapter 403.9(2) declares that "Bonds issued under the provisions of this chapter are declared to be issued for an essential public and governmental purpose." While a simple majority vote in a referendum is required for "general corporate purpose" debt (which would include parks and libraries, among other things), for "essential public purpose" debt a referendum is not required at all.
[16] Emily Schettler, "Cities' debt varies across county." *Iowa City Press-Citizen*, Nov 3, 2011.
[17] Iowa Code section 15A.1(2) states (underlining added): "2. Before public funds are used for grants, loans, tax incentives, or other financial assistance to private persons or on behalf of private persons for economic development, the governing body of the state, city, county, or other public body dispensing those funds or the governing body's designee, shall determine that a public purpose will reasonably be accomplished by the dispensing or use of those funds. In determining whether the funds should be dispensed, the governing body or designee of the governing body shall consider any or all of the following factors:
….
a. Businesses that add diversity to or generate new opportunities for the Iowa economy should be favored over those that do not.
b. Development policies in the dispensing of the funds should attract, retain, or expand businesses that produce exports or import substitutes or which generate tourism-related activities.
c. Development policies in the dispensing or use of the funds should be targeted toward businesses that generate public gains and benefits, which gains and benefits are warranted in comparison to the amount of the funds dispensed.
d. Development policies in dispensing the funds should not be used to attract a business presently located within the state to relocate to another portion of the state unless the business is considering in good faith to relocate outside the state or unless the relocation is related to an expansion which will generate significant new job creation. Jobs created as a result of other jobs in similar Iowa businesses being displaced shall not be considered direct jobs for the purpose of dispensing funds."