

Fixing TIF: Common-Sense Solutions for 2012

Many options are being considered for reforms of Tax Increment Financing in Iowa. The following policy recommendations are drawn primarily from a November 2011 report by Peter Fisher for the Iowa Fiscal Partnership, *Tax-Increment Financing: A Case Study of Johnson County*. The full report is available on the IFP website, www.iowafiscal.org

TIF as used in Iowa no longer bears much resemblance to the original model that a city would undertake a redevelopment project in a declining area, creating an incentive for investment that would create new tax base, providing revenues to recover costs and ultimately benefit all local public service providers: cities, schools and counties. 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.

How Should TIF be Reformed?

1. *Convert all TIFs to project TIFs.*

This would be the single most important reform that lawmakers could approve this year, to assure that 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.

2. *Subsidy TIFs must pay for themselves.*

TIF revenues are often used to subsidize a private development project either by rebating taxes for a period of years or by paying a share of the upfront development costs. With a rebate, the subsidy is automatically limited to the taxes that the project itself will generate. The same limitation should apply to other forms of subsidy — the city's share of upfront costs must be recoverable from the incremental taxes on that project. In either case, the TIF diversion should end when the rebate period ends or the costs are recovered. This could serve as a substitute for the first recommendation, which may be more difficult to implement for non-subsidy TIFs such as city infrastructure investment.

3. *Prohibit or severely limit the inclusion of residential property in a TIF area.*

Strong limits could permit such uses as the creation of low- and moderate-income housing. There is no justification to include residential property in a TIF district unless it is to subsidize or improve that housing or neighborhood. Residential property should not be simply a tax base to be tapped to finance projects unrelated to that housing.

4. *Prohibit or severely limit the inclusion of retail areas in a TIF district.*

In general, retail TIFs should be discouraged, though exceptions can be justified for redevelopment projects and true blighted area TIFs. Not only is it unlikely that a public subsidy, including one provided through TIF, will be essential to the location-driven success of retail activity, but the incentive to use TIF

can be destructive. Cities are encouraged by 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 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.

5. *Limit the portion of a city's tax base that could be included in a TIF area.*

6. *Require that all TIF debt count toward the constitutional debt limit.*

General obligation debt is limited to 5 percent of the city's taxable value, and the courts have declared that TIF debt is GO debt. However, cities have circumvented this limit by the creation of "annual appropriation debt" for many TIF project. This loophole should be plugged.

7. *Impose size and contiguity limits.*

Because TIF is justified as a means of enhancing a school district's tax base for the day the TIF expires, a single TIF area should not include property from more than one school district. Coralville's TIF for the Iowa River Landing project, which is in the Iowa City school district, also draws from the tax base of the Clear Creek Amana (CCA) school district, which has 49 percent of its tax base under TIF. CCA is denied property taxes that are going largely to create development in the Iowa City school district.

8. *Put teeth in the anti-piracy provision of the Iowa Code.*

As it stands, this provision¹ is ineffectual, because a business that expands in the process of moving 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.

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.

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."

¹ 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."