Planning and Finance

Tax Increment Financing Revisited

Patrick L. Dugan, Everett, Washington

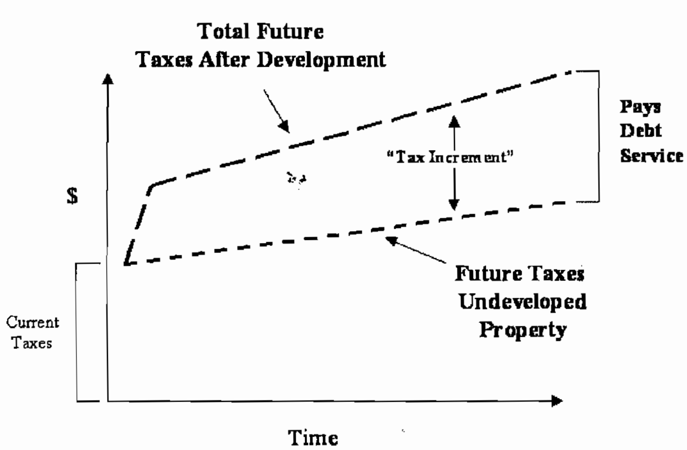
Introduction

When it comes to public finance, planners seem particularly fascinated with tax increment financing (TIF).[1] Although I have written before on this subject over the 12 years I have been contributing to *The Western Planner*, it is the one topic that is requested by my readers more than any other. Since I have not examined this topic in the last couple of years, it may be appropriate to revisit it.

How it Works

The TIF concept is straightforward. New development will generate additional revenue through future taxes on that development, even without any increase in tax rates or applying any new taxes. TIF merely captures the additional revenue from new development to finance the new facilities needed to make new development possible. The appeal of

Tax Increment Financing



TIFs is that they provide a means of financing infrastructure needed by new development without instituting any new or increased taxes.

The above graph illustrates how this works. The value of vacant or underdeveloped land generates a given amount of taxes. As this property appreciates in value over time, it will generate more tax revenue. However, if the property is developed or redeveloped, its value increases much more. This increase in value generates additional tax revenue over and above the revenue that would be generated by the vacant or underutilized land alone. This difference is the "tax increment." The tax increment can then be used to finance capital facilities.

Pat Dugan

With appropriate state authorizing statutes, a local government implements the TIF concept by forming a "tax increment finance district." Within this district, the additional tax revenue (usually property tax revenue) is captured from new development and diverted from the usual purpose to finance the facilities in the district needed to support that development. In most cases, TIFs not only capture the incremental tax revenues of the city forming the district, but also the incremental revenues from the district of other taxing jurisdictions, such as schools and county government as well.

History

Use of TIFs began in California in the early 1950s and has spread to at least 48 states having legislation on the books authorizing the use of TIFs.[2] However, this is misleading since some states, such as Washington, and at least West Virginia, may have enacted the authority for tax increment financing; however, courts have found such TIFs to be unconstitutional (or have other legal difficulties); rendering the laws ineffective and not used. California makes perhaps the most use of the authority with approximately 500 districts operating. Other states make minimal use of this tool (reportedly Hawaii, Mississippi, and New Jersey).

Although each state enacts its own TIF requirements, procedures for implementing a TIF are similar. Initially, TIFs were limited to targeting redevelopment of blighted areas. However, TIF programs in many states have expanded to finance projects in non-distressed areas. This expansion appears to be due to increased competition among localities to attract new investment. Some states, such as California, have required that a portion of the increment finance affordable housing.[3]

In most states, the concept applies only to property taxes, although a few states allow TIFs to capture the increase in sales taxes in the same manner as property taxes. Recent legislation in Washington State (known as LIFT-Local Infrastructure Financing Tool) has focused on applying the TIF to state sales taxes on a limited scale. (This very complex set of laws limits the authority to only some jurisdictions and strictly controls the potential diversion of state sales tax revenues. As one contemplates the law's complexity, one wonders whether it is different than the state developing a grant program for the same purposes and whether such grant program would be simpler for the state and local governments to implement).

Continued on Page 5 . . .

Planning and Finance Continued from Page 2 . . .

Issues

While TIFs can be a powerful means of financing capital facilities, there is no free lunch. Tax Increment Financing raises significant issues that should be considered by anyone using it as a financing tool. These issues include the following.

- Since TIFs usually involve borrowing money to finance facilities, there is risk involved. A local government must be careful not to initiate this process on speculative developments, since if the anticipated development does not occur, or occurs at a level less than planned, the jurisdiction may need to divert money from other uses to pay off the debt.

- A major difficulty with TIF is that it diverts that revenue from other purposes (some would say it robs Peter to pay Paul). By locking up future revenues for debt service on capital facilities, these revenues will not be available to support ongoing services such as schools, police and fire protection, even though the new development will add demand for these services.

- Businesses often see TIFs as a subsidy of competing businesses. If tax revenue from new development is used to finance facilities, competing businesses may believe that their tax bill will need to be higher to make up for the money that would have gone to paying for on-going services. In response to this criticism, some states prohibit applying it to retail commercial development, reserving TIFs for industrial development or similar uses that would pose less potential competition with local businesses.

- In California, many local governments that have used the authority extensively are now finding it difficult to keep up with service demands since much of their revenue potential is committed to TIFS.

Conclusion

Tax increment financing is a powerful financing tool that most local governments have in their arsenals to promote desired development or redevelopment. However, it can have adverse financial implications if it is too extensively and readily applied. By diverting future revenues for capital projects, it makes those revenues unavailable to respond to future operational needs. It should only be used sparingly, and only in those situations where the desired development is both guaranteed and where it would not otherwise occur without use of tax increment financing.

[1] TIFs may be known by different names in different states.

[2] Perhaps the most comprehensive review of Tax Increment Financing systems throughout the country is *Tax Increment Financing and Economic Development*, by Craig Lawrence Johnson, Joyce Y. Man, SUNY Press, 2001, and much of the information presented here is derived from that source. It is unclear what states do not have TIF authority.

[3] This requirement seems particularly ironic since the most TIFs would divert school revenue generated by such housing to finance infrastructure rather than supporting schools.

Pat Dugan has been both a city planning director and a city finance director. During the last 30 years, he has held various financial and planning positions in cities, counties, and regional agencies in three states. He has shared his views on public finance and planning with planners through these regular articles in The Western Planner *since 1995. He is now a private consultant in Everett, Washington, and can be reached at* <dugan.consulting@verizon.net>.

President's Column Continued from Page 1 . . .

arrangements occurred within the historic train depot across the plaza from the hotel.

Other people deserve my deep gratitude, as well. Thanks to WP Journal Editor and conference photographer **Debbie Ehlers**, who is "The Glue" that keeps us all functioning throughout the year! Thanks also to **Brian Frampton**, my PAW colleague on the WPR Editorial Board and Editor of the PAW Newsletter (printed regularly within *The Western Planner*), who participated on a conference panel. Way to Go, Brian! You're gonna make a heckuva PAW representative replacement on the WPR Board when I decide to move on.

Thank you, fellow WPR Board members and everyone on the Editorial Board for all you do to keep the organizational ball rolling! Mostly, it's a thankless job. Someone has to do it—you!

For me, the ultimate in total enjoyment is being able to share my time with my family. Once again, my brother from San Diego joined me. In addition to having him support us during our auction efforts, Duane accompanied me on another "Once-In-a-Lifetime" 3,662-mile trip throughout the southwest to the various national parks, monuments, and canyon lands. Thanks, **Duane,** for adding value to my life by sharing it on this planet with me! And, my **kids and granddaughter** joined me throughout my travels to and from this conference, making it even better!

Seriously, plan to be with us next year in Spearfish and have lots of fun! Here's a long-distance hint: be prepared for a most excellent event in **Vancouver, Washington**, when the **Planning Association of Washington (PAW)** co-hosts the **2010 Western Planner Conference.** We plan to share the spotlight with our neighbors to the south who are new to the WPR network. Plan to meet up and help us send a proper welcome to Oregon from the entire *Western Planner* family!

Again, thank you, all! I really like my new buffalo pin.