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Is Tax Increment Financing a Fiscal Bane or Boon?

Phuong Nguyen-Hoang

Background

Among urban planners, tax increment financing (TIF) is a popular economic development financing tool. The financing process begins when a municipality establishes the boundaries and duration of a TIF district. Next, the district's total property value in the year before TIF establishment, or base value, is used to determine property tax levy that will go to taxing jurisdictions, such as schools, cities and counties, during TIF duration. The increment, or additional property levy above the base value, is diverted to TIF development projects. Once the district is dissolved, the increment becomes available to affected jurisdictions.

Critics claim that during its life, TIF is a fiscal bane for overlapping jurisdictions because it may affect both the base value and increment that would have been available for these jurisdictions. First, the base value available during the TIF duration should stay unchanged, or remain a frozen base value (FBV). However, mandated base-calculating methods can lead to annually varying base values that are smaller than the FBV. Second, a TIF project should meet a "but for" condition, which stipulates that private development cannot be realized without TIF funding. In many cases, the TIF establishment fails to meet the "but for" condition, implying that development would have occurred absent TIF and private developers benefit from TIF increments that should have been available for overlapping jurisdictions.

Critics and proponents agree that a successful TIF with increment provides a larger tax base for affected jurisdictions after TIF termination. Proponents also assert that overlapping jurisdictions lose nothing during TIF duration because the FBV would have stayed the same or decreased absent TIF. This scenario suggests that overlapping jurisdictions suffer no losses when the "but for" condition is met. Another key benefit of TIF to affected jurisdictions is returned excess increment (REI). Although a TIF authority can access a TIF district's entire increment above the FBV, in any year of TIF duration the authority can legally tap only the increment needed to pay TIF-related debts, releasing excess increment (EI) to affected jurisdictions.

Although REI is mandated or allowed in 29 states, there has been little research on it. This study seeks to fill this gap by determining whether TIF during its life is a fiscal bane or boon for affected jurisdictions, especially school districts, when REI is taken into account. The study focuses on school districts because the potential TIF impact on school districts is high: they cannot activate or (usually) opt out of a TIF process but are likely to contribute the most taxes to TIF funds, and noncongruent school district and municipality boundaries may mean that TIF projects are partially financed by nonresidents.

This study focuses on TIF impact in Iowa, where TIF is prevalent and statewide regulations may bring both losses and gains to affected jurisdictions. As of 2015, Iowa contained 2,485 active TIF districts, which encompassed 85% of school districts. Key TIF regulations in Iowa include: no formal test of the "but for" condition; allowed but not mandated return of EI; and Iowa Code section 403.20 (or §403.20), which can lower a TIF district's base value (even to zero) and decrease revenue for overlapping jurisdictions during the TIF life. In addition, jurisdictions can access the entire increment for debt service levy, as can school districts for physical plant and equipment (PPEL) and instructional support programs (ISP) levies.

Study Methods

To estimate statewide fiscal effects of TIF under Iowa's current legal framework, this study uses 18 years of Iowa TIF district-level data (from FY2000 to FY2017) to simulate how TIF may affect overlapping jurisdictions in different scenarios, including those in which the "but for" condition is not met. A series of simulations are used to calculate mean total statewide property levy gains and losses and determine whether or not TIF can be a fiscal boon by providing more property levy for overlapping jurisdictions than they would receive without TIF.

Primary Question of Interest

Is tax increment financing fiscally helpful or harmful for affected jurisdictions, particularly school districts, when returned excess increment is taken into account?

Results

The simulated outcomes demonstrate that TIF is highly likely to produce benefits for the general funds of overlapping jurisdictions, including school districts, even when simulation assumptions include that all economic development-only and no-designation TIF districts fail to meet the "but for" conditions and that 70–80% of these districts follow scenarios that would lead to the largest property value loss for school districts.

Even under TIF simulation scenarios in which school districts would likely incur general-fund losses, gains for debt service, PPEL and ISP levies were nearly three times larger than losses, which would allow schools to divert revenue they would have spent on debt, PPEL and ISP to general funds.

Key Finding

During its life, tax increment financing tends to produce REI-induced benefits for affected jurisdictions, including school districts, even when development might have occurred without it.

Conclusions

TIF is likely a fiscal boon for Iowa. This finding has several implications. Although economic development-only TIF districts (many of which fail the "but for" test) greatly outnumbered slum and blight development TIF districts in the data set, on average slum and blight development generated 1.5 times as much annual incremental value and resulted in higher excess increment returns. The data bears out critics' proposition that TIF is best used to address urban blight.

In Iowa, TIF benefits to affected jurisdictions would be greater if REI was mandated. Benefits were also curtailed by §403.20; in states without similar regulations, TIF revenue may be higher. In states where school districts are barred from or allowed to opt out of TIF contributions, benefits for school districts' general funds could be larger than those estimated for Iowa.

Especially for states without mandated or allowed REI, Iowa's protection of debt service and school PPEL and ISP levies from TIF diversion is a good practice, because its benefits can reduce or reverse potential harmful fiscal effects of TIF.

See the full article in Journal of Planning Education and Research here.

Distribution of TIF districts over the sample period

AY	Total # of active TIF districts	Percent of TIF districts with zero annual base value (%)	Percent of TIF districts that returned their entire increments (%)	Percent of TIF districts that partially returned their increments (%)
1998	1,379	7.2	9.2	25.7
1999	1,467	10.0	11.0	30.9
2000	1,552	8.6	13.3	23.8
2001	1,637	14.7	13.4	24.9
2002	1,736	11.7	13.2	23.0
2003	1,753	17.1	10.4	28.0
2004	1,806	15.1	12.5	27.2
2005	1,898	20.5	14.1	27.6
2006	1,967	18.5	14.6	26.3
2007	2,052	22.5	18.4	28.5
2008	2,070	21.0	18.5	28.5
2009	2,125	23.4	21.2	27.8
2010	2,238	22.4	20.6	27.6
2011	2,270	25.0	20.8	29.8
2012	2,292	23.8	21.4	28.7
2013	2,356	44.9	22.5	26.9
2014	2,438	47.0	22.8	26.4
2015	2,485	46.6	23.3	27.4

Notes: This table does not include "inactive" TIF districts. Inactive districts are listed in TIF reports but do not have key information on assessed/taxable value, base value or base year. "AY" stands for assessment year.

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