

TAX INCREMENT FINANCING IN IOWA

by Phuong Nguyen-Hoang

Tax increment financing (TIF) is a popular urban renewal and economic development tool. First implemented in California in 1952, TIF has since spread to all states but Arizona. Although originally intended to address urban blight, TIF is frequently used by rural local governments, especially in Midwestern states. In Iowa, 431 rural cities—45.5% of all incorporated cities in Iowa—used TIF between fiscal years 2001 and 2017.

Under TIF, local governments (municipalities or counties) fund development projects within a designated district through property taxes generated from that district over a multiyear period. In effect, this means that a certain amount of property tax revenue (the increment generated above an established base value) is diverted from affected entities, including school districts. Within-district property values are a key determinant of education aid in 42 states (including Iowa), and school districts also use property tax base to set property tax rates for residents. Critics of TIF suggest that the during-TIF reduction of property tax revenue can have an overall harmful effect on school districts. This brief summarizes three studies by the Public Policy Center's Phuong Nguyen-Hoang that examine TIF's effects on school districts, including the first examinations of effects on rural school finance and on education expenditures.

TIF IN IOWA

Though TIF laws vary state by state, Iowa's TIF framework resembles those of many other states. Key elements of Iowa's TIF laws include:

- **No opt-out option for local jurisdictions.** Any school districts in a designated TIF district must participate in the process, which entails ceding property tax revenue that might otherwise go directly to the school district.
- **No “but-for” condition or blight-finding required.** In order to safeguard local property values, some states require the demonstration that a TIF project is necessary for improving property values before a TIF district can be established. In Iowa, this “but-for” condition is not required.
- **Available property tax revenue varies annually.** Upon TIF initiation, the TIF district's total property value is established (the original base value, OBV). In most states, OBV is fixed and the associated property tax revenue is available for school districts to tap annually throughout the TIF duration. However, in Iowa, school districts instead access an annually assessed base value (ABV) that can dip below the OBV and even reach zero, leaving a school district with no revenue from the TIF district. Annual instances of $ABV < OBV$ can occur frequently.
- **Return of excess increments.** As TIF-financed development projects occur, the annually assessed value (AV) of properties increases, leading to incremental value above the OBV (I), which goes to pay developers for TIF projects. When the district is permanently dissolved, incremental value becomes available to school districts and other affected entities. In addition, Iowa allows surplus incremental value (value that a TIF authority does not need for payment of TIF debts in a year) to be returned to school districts. This return of excess increments (REI) can mean that school districts are more likely to have funds on hand.
- **Protected debt service levy.** Affected jurisdictions, such as school districts, can access the full TIF increment for debt purposes. In addition, school districts may access the entire increment to pay for physical plant and equipment levy (PPEL) and instructional support programs (ISP).

DATA AND STUDY METHODS

Using 10–18 years of TIF district-level data in Iowa, these studies examine TIF's overall effects on the property tax revenues, property tax base, rates, and education expenditures of school districts, including on rural school districts in specific. Study strategies include a reduced-form constant-elasticity expenditure model, a simulation-based estimation approach, and a differences-in-differences (DID) estimation approach complemented by an event-study design.

RESULTS

The 2014 study finds a statistically significant but small negative effect of TIF on education expenditures. The two later studies, however, find that overall, TIF is most likely a fiscal boon for school districts. Slum and blight development TIF districts (those that would meet a “but-for” condition) tend to generate more incremental value for school districts, resulting in higher REI, than economic development-only TIF districts. When schools incur general-fund losses, the gains for debt service, PPEL, and ISP levies are large enough for school districts to redirect revenue to cover general-fund losses.

For rural school districts, TIF has mostly positive effects on property tax base and mixed effects on property tax rates. TIF-induced increases in tax base come mainly from residential property and slightly from commercial property. Also, the positive effects on property tax base come from TIF districts’ voluntary release of excess increments. Without released excess increments, TIF would have had negative effects on school districts’ property tax base, potentially as a result of failed but-for tests.

POLICY RECOMMENDATIONS

The potential for negative effects on school districts, such as in education spending and property tax base, justify policy measures to ensure school districts benefit from TIF. Below are four policy measures supported by the studies’ findings:

- **Preserve access to increment for debt service, PPEL, and ISP levies.** In Iowa, school districts retain access to the entire increment for debt service, PPEL, and ISP levies, which protects school districts’ capital tax base and reverses potentially harmful effects of TIF. Other states might consider a similar safeguard.
- **Mandate return of excess increments.** The return of excess increments is voluntary in Iowa, but it largely drives TIF’s benefits to school districts, particularly rural school districts. To increase benefits for school districts, Iowa could legally mandate the return of excess increments, as in some other states.
- **Preserve annual base values.** To counteract TIF’s potential harm to school districts’ property tax base, Iowa could amend TIF law to preserve ABV (i.e., ABV = OBV), as in some other states.
- **Mandate a but-for test.** Also to counteract harmful effects on property tax base, Iowa could institute a but-for test—ideally, one more stringent than the broad tests required by many states—as a prerequisite for TIF approval.

FEATURED RESEARCH

Nguyen-Hoang, P. (2014). Tax increment financing and education expenditures: The case of Iowa. *Education Finance and Policy*, 9(4), 515–540. https://doi.org/10.1162/EDFP_a_00145

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