

# Tax increment Financing in Iowa: Background, Research, and Recommendations

David Swenson

Associate Scientist

Department of Economics

Iowa State University

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## ***Brief Background on Tax Increment Finance Research***

I am a community economics researcher and educator in the College of Agriculture at ISU. I have served in that capacity since 1989. I am also an adjunct faculty member in the Community and Regional Planning program at ISU as well as in the School of Urban and Regional Planning at The University of Iowa.

I have looked at this issue as a policy researcher and as a regional economist consistently since 1985.

- Specifically studied and documented TIF and other city community development initiatives enabled by the Iowa Code while a staff member of the Institute of Public Affairs, The University of Iowa, 1985 to 1988.
- In the mid-1990s I testified before an interim legislative committee, along with Professor Tom Pogue of the University of Iowa, about what was thought at the time to be very rapid growth in TIF usage among Iowa cities. My concern then was that the TIF effort did not appear to demonstrate meaningful correlations with job growth and population growth.
- In 2003 I was asked to make presentations about TIF to both House and Senate committees based on my research report: "Do Tax Increment Finance Districts in Iowa Spur Regional Economic and Demographic Growth?"
- Another 2006 ISU study generated a quite a few opportunities for presentations and discussions in several venues statewide.

- Discussions and readings on TIF and other economic development tools are part of the curricula that I teach as an adjunct instructor in the graduate program in Community and Regional Planning at ISU.

## ***Government Involvement in the Economy Has Evolved Over the Past 25 Years***

Ours is a market society, and we broadly agree that market processes result in the most efficient allocation of goods and services across most categories.

Markets do fail, however. They do not provide an optimal amount of public goods, for example, which necessitates the provision of these services by governments, to list just a few:

- Public education
- Protection and court services
- Critical infrastructure
- Environmental and health regulation
- In short, activities that promote the health, safety, and welfare of the population

There are other types of market failures like pollution and monopolies, and governments address these concerns at varying levels at the federal, state, and local levels.

Prior to the mid 1980s, however, state and local government direct involvement in economic development was relatively well-circumscribed and financially limited. As will be demonstrated, it tended to be statutorily constrained to extra-ordinary circumstances like remediating urban blight and decay. During the 1980s, however, there were several occurrences that led to a broad re-evaluation of the role of government in economic development.

First, over the course of the 1980s, the flow of federal fund transfers to state and local governments dried up across many areas that helped to support infrastructure spending, roads, housing, health facilities, and many other critical community needs. Second, whole regions of the U.S. underwent prolonged periods of economics stress. Most hit were manufacturing areas and areas that experienced the farm debt crisis. Third, it became evident that there were regionally-specific structural issues with economies that required extra-ordinary policy attention. Rural areas, as was the case in Iowa, began to depopulate. Commercial activity in small towns waned in favor of regional trade centers. Jobs become more and more concentrated in regional trade centers, and rapidly, communities became much more aggressive in seeking or securing economic activity.

In summary, much of the U.S suffered from persistently high unemployment caused by structural economic problems (not just cyclical), which also can be considered a regionalized market failure necessitating certain types of government action. These were some of the major issues confronting Midwestern community and state leaders at that time:

- Farm debt crisis and rural household dislocation
- Large losses in traditional manufacturing capacity
- Absence of economic diversification
- Significant rural area outmigration and statewide depopulation – Iowa’s population declined by 4.3 percent during the 1980s.
- Concomitant shifting of trade and service capacity into regional trade centers and an erosion in the viability of small town commerce and small town social institutions

Like many states, Iowa responded by broadening state and local government authorities in the area of economic development. Among the changes, Iowa made it so that the blight and decay requirements on the designation of Tax Increment Finance districts were no longer the only justification for the use of public funds in this manner (much more explanation of TIF procedures will follow); they created a new activity called “economic development” TIFs; statutory changes elevated economic development to the level of “essential corporate purpose,” like police, fire, and other traditional essential public services; and separately, Iowa created the Iowa Department of Economic Development and greatly expanded the state’s authority to act in the name of economic development across a wide range of topics.

### ***The Majority of Iowa Cities Started Down the Economic Development Path Slowly***

In the mid 1980s to mid 1990s, cities were comparatively cautious about using their new economic development authority. They tended to limit assistance to traditional industrial base categories – firms that served regional or national markets, like :

- Manufacturing
- Power generation
- Corporate headquarters
- Wholesaling and distribution

Initially, they were much more inclined to use short-term tax abatements instead of TIF authority on projects, and they were usually quite stingy with public assistance. Competition between places was not as intense. Intensity initially revealed itself as communities bid for meat packing plants.

Eventually, though tax increment financing activity grew in scope and popularity, most especially during the next decade, which was a period of broad-based recovery for much of the state. During the 1990s the state recovered the population than it lost, it enjoyed a prolonged period of job growth, and resurgence in non-metropolitan manufacturing employment.

## ***Contrasting Tax Increment Finance Authority Before and After 1980s Changes***

Original tax increment authority is found in urban renewal efforts dating back to the late 50s. These statutes were designed to address unarguable systematic market, social, and political failures in cities – usually in central city slums and in run-down business or industrial districts.

TIF contained a “bootstrap” approach to development – it was primarily self-financed (a graph of TIF in practice follows shortly). The process allowed for and was justified by the accumulation of both economic and social benefits.

Implicitly, there was a “but – for” presumption when TIF was used to remedy blight or to redevelop abandoned historical districts. As in “but-for our efforts, the deterioration would have continued, and but-for our efforts here, this development would not have occurred.”

This is the definition found in the Iowa code (Chapter 403.2(1) Code of Iowa) regarding the pre-conditions for blight and the determination of an urban renewal area. There had to be a public finding of a situation that would:

*... constitute a serious and growing menace, injurious to the public health, safety, morals and welfare of the residents of the state; that the existence of such areas ... constitutes an economic and social liability imposing onerous municipal burdens which decrease the tax base and reduce tax revenues, [and] substantially impairs or arrests the sound growth of municipalities ....*

Changes to the Iowa Code in the mid-1980s made that grave determination unnecessary, and TIF has become increasingly popular over the past 25 years. While there currently is quite a bit of TIF of the original form still in Iowa (downtown Des Moines has been that type since 1978), the vast majority of TIF activity now is for economic development purposes, not the remediation of blight.

Along the way, as well, there has been a shift in the qualifying uses of this authority from traditional industrial recruitment and the re-establishment of basic commerce and housing rehabilitation in significantly blighted areas to broad commercial and housing development (especially the past decade).

## ***The Subsidization of Private Development is Now Widely Viewed as Inefficient, Imprecise, and Inevitable***

Along with the liberalization of the use of TIF authority, tremendous increases in competition for capital development among the states and cities have led states and local governments to use more types and greater amounts of inducements to support growth.

Whereas pre-1985, the use of public funds to support private development was extremely limited and used very selectively, it has now evolved that for any city or state to be to be competitive, there must be a substantial “standing offer” of incentives on the table or business will look elsewhere.

Evolving TIF policy and practice over the years cannot be viewed in abstraction from all economic development policies at the state and local level. More to the point, as is the case with all government spending, government has an obligation to be efficient, effective, and fair in its decision making processes and in the allocation of public resources.

If one holds the view that the public sector should minimize its subsidization of private development of all forms, one is very hard pressed to know, given the current system, what levels of spending were necessary to secure which amounts of economic growth that are currently associated with TIF projects. There is a very large amount of research indicating that a majority if not a super-majority of public underwriting of private development flows to firms that would have built regardless of the availability of local assistance.

As the economic development process is informationally asymmetric, that is, the firm has all of the knowledge and the awarding governments only know what the firm tells them, one must assume that all governments, state and local, frequently make inefficient decisions regarding public subsidy of development, and that public resources are therefore not used for the best purposes.

The question is how inefficient are those decisions and at what costs to society at large. According to Fisher and Bruner, 2003, “If TIFs are too easy to use, and appear to be cheap to the cities and counties that use them, there is a high likelihood that they will be overused at considerable expense to taxpayers.”

This is precisely the situation addressed currently in the General Assembly.

### ***How Traditional TIF Works***

The figure below describes a traditional TIF scenario involving a blighted area. It illustrates a market failure where there is a persistent devaluation of area properties over time as represented by the downward sloping line. The dotted line indicates the expected trend for this declining territory.

In recognition of the situation, the City goes through the urban renewal determination process and declares an intention to utilize tax increment financing to restore the blighted area. At that point the base is frozen, and that is all that is available for property taxation to the general funds of all jurisdictions that have taxing authority in that region.

Next, the community borrows money to begin restoring the area and making it desirable for investment and rehabilitation. That yields an increment in property tax values. Now, if the city

were only allowed to recover its incremental tax gains, it would likely under-invest in urban renewal, but because it can recover all of the incremental tax revenues from all of the other governments, it can invest more in rehabilitation and renewal. Over time, once all borrowed indebtedness has been paid off, then the increments are to be released to back to the general funds.

This is important, however: the only justification for diverting the other governments’ revenues is that the city is dealing with a clear and unarguable market failure which, had there not been a city intervention, would have worsened the tax base for all jurisdictions. The principle of fairness dictates that the city should recover its investment costs in righting this failure and that all beneficiaries from the process should contribute to the recovery.

With regard to economic development TIFs, where there is not a clear market failure, there is no justification for the city to divert other governments’ property tax revenues. Nonetheless, in Iowa, cities, and increasingly counties, are allowed to sequester other governments’ revenues for long periods of time in the name of economic development.

### Tax Increment Financing: Blighted Area

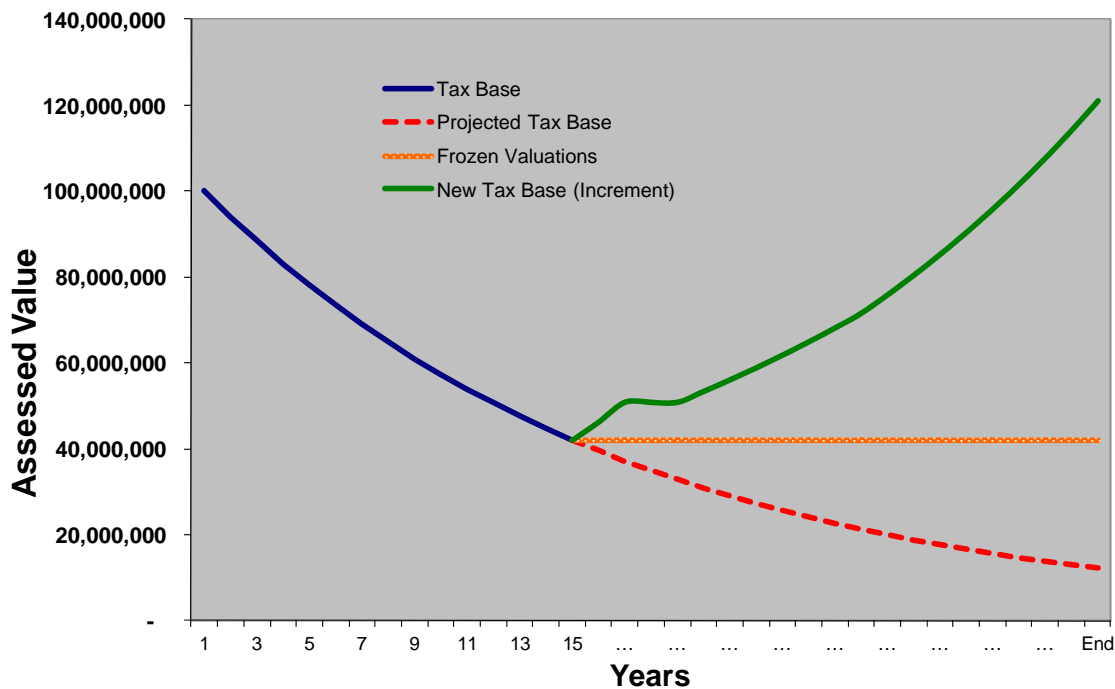


Figure 1

It may be argued by economic development TIF cities that cities and counties in-fact enjoy increased property tax revenues in the future “but-for” the city’s economic development

efforts. That may or may not be true, but it is irrelevant. The tax principles of accountability and of fairness deem that the school districts and the counties must have a say in the use of their tax base. As the TIF process is a unilateral decision, it violates these core principles.

### ***Modern Rationale For TIF***

Eliminating blight is still important, and there is ongoing work in many of areas on these original TIF designations.

Imperfect markets – for many states and cities, there has been an attempt to diversify and “manufacture” desirable growth, however, the ability of communities to manufacture growth is very limited.

Competitive bidding – inter-state and inter-community competition for jobs makes it hard to not offer all alternatives, and communities will argue that the use of TIF incentives allows them the most flexibility in responding to development opportunities

Leveraging – cities argue that economic development now requires an aggressive partnership between state and local government actors and that TIF funding allows for the leveraging of state resources

Cost shifting – given local and state funding responsibilities, TIF can shift costs to the state or to the federal government. In Iowa this is well demonstrated by the graph below. As the school foundation formula is determined by the taxable value that is available to fund students in a district multiplied times the \$5.40 levy, the state of Iowa in effect pays the \$5.40 level on the increment. The chart below demonstrates the cost shifting of TIF use in Iowa. In 1992, the state incurred \$5.2 million in additional school state aid from TIFs. In 2012 that amount had grown to \$46.8 million.

### Tax Increment Financing Impact on State School Aid

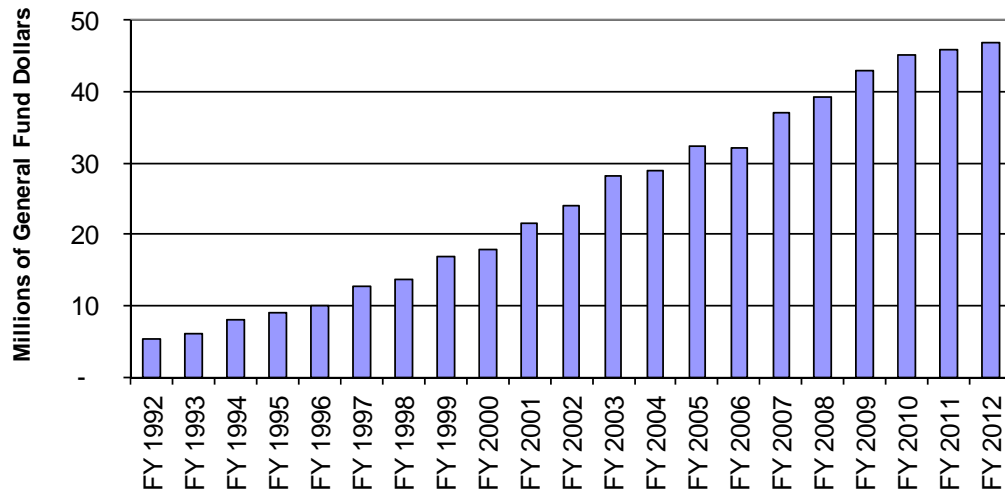


Figure 2

There is also cost shifting to immobile assets in the community. As new development property taxes are sequestered for debt retirement or other purposes, remaining property tax owners, commercial as well as residential, may find tax rates increasing to cover the cost of area general government services. This is especially true if the TIFs are in fact fueling both job and population growth that puts pressure on a wide array of local government services.

### ***Summary of Our Research in '02 and in '06 on TIF in Iowa***

The '02 study looked at TIF in practice in Iowa in the manner that a social scientist would. Information was aggregated to the county level to get at several meaningful indicators of growth:

Hypothesis: TIF usage positively correlates with ...

- assessed residential valuation,
- taxable commercial and industrial valuation,
- jobs,
- population,
- earnings, and
- retail trade shares

Our interest was whether the correlations were strong. That is, were there meaningful variances in social and economic indicators that were correlated with the aggregate level of TIF effort in a region?



The findings were, regarding evidence of TIF efficacy along the variable studied, disappointing:

- There were no meaningful correlations of TIF activity and area-wide job growth. In short, there was no equation that X level of TIF activity resulted in Y level of job gain at the county level. Remember, this was during the 1990s when the state posted robust job gains.
- That study did not find evidence TIF effort was meaningfully correlated with population growth at the county level.
- The research documented a minor correlation with TIF effort and manufacturing job growth ( $r=.25$ ), which is what TIF authority was primarily used for at the time, but it also found the next highest correlation with TIF effort and non-TIF property taxes per capita ( $r= .22$ ). As TIF effort increased, so too did taxes in non-benefitted areas. But, again, the correlation was minor.

Given the proliferation of TIF use and the general unresponsiveness of the variables to levels of TIF activity, we concluded that

*“... the law now has become a de facto entitlement for new industry and housing development in much of the state with little to no evidence of overall public benefit or meaningful discussion of the mean costs of the practice.”*

We revisited TIF in '06 with an eye towards identifying where TIF growth was accumulating most. These are some of the major findings:

- More than a quarter of 1997 to 2006 real statewide property valuation growth had been diverted to TIF activity. There was a very high level of accumulation of valuation in TIF districts that was not available to local government general fund spending.
- The gains were disproportionately concentrated in growth centers. Iowa's metro counties accounted for 74 percent of all TIF growth (and half of all TIF growth was concentrated in just 11 cities).
- There was evidence of significant and non-beneficial inter-community competition leading us to conclude that most of the commercial (retail and service sector) growth that was benefitted by TIF activities would have occurred nonetheless as the forces of urbanization occurring at the time significantly trump the ability of local governments to influence the rate or pace of economic growth.

Beyond Iowa's metropolitan areas, the parts of Iowa that struggle to stabilize their economies and their population bases, we found:

- Between 1997 and 2006, 88 percent of all property tax valuation growth in medium sized Iowa cities (those 10,000 to 49,999) was in TIF increments, and 53 percent of the property tax valuation growth in all other TIF-using cities was in TIF increments.

- But, as was the case in the '02 research, on net, the large areas had declines in their population shares (-8 percent), and the remaining nonmetro cities, despite their aggressive use of TIF, failed to improve their shares of population.
- Widespread beneficial TIF-related social spillovers (population and job gain differences explained by TIF effort) again were not evident.

### ***The Distribution and Extent of TIF Effort, 1991 to 2012***

The accompanying maps represent the cities that were using TIF authority in 1991, 2006, and 2012. The first three depict the exact same differentiation: Dots represent cities with TIFs, and dark color dots represent cities in which 20 percent or more of their tax base is in TIF.

Figure 3 gives the Fiscal 1991 distribution. Readers will see that there are concentrations around metropolitan areas and along the interstate highways. At that time there were only two communities in which the valuation in TIF exceeded 20 percent of the regional tax base.

Figure 4 clearly shows the proliferation in TIF usage among the cities. Of the 375 cities utilizing TIF increments that year, city value in TIF exceeded 20 percent of the cities' tax bases in 85 communities. Those high effort communities were clustered in NW Iowa, SE Iowa near Pottawattamie County, in central Iowa, especially to the north and west of Polk County, and in eastern and northeastern Iowa, especially surrounding the Iowa City, Cedar Rapids, and Waterloo metropolitan areas. It is important to note that our '06 research found that non-metropolitan areas averaged from 53 percent to 88 percent of all tax value growth in TIF regions, yet those areas had, on average, population declines or no gains.

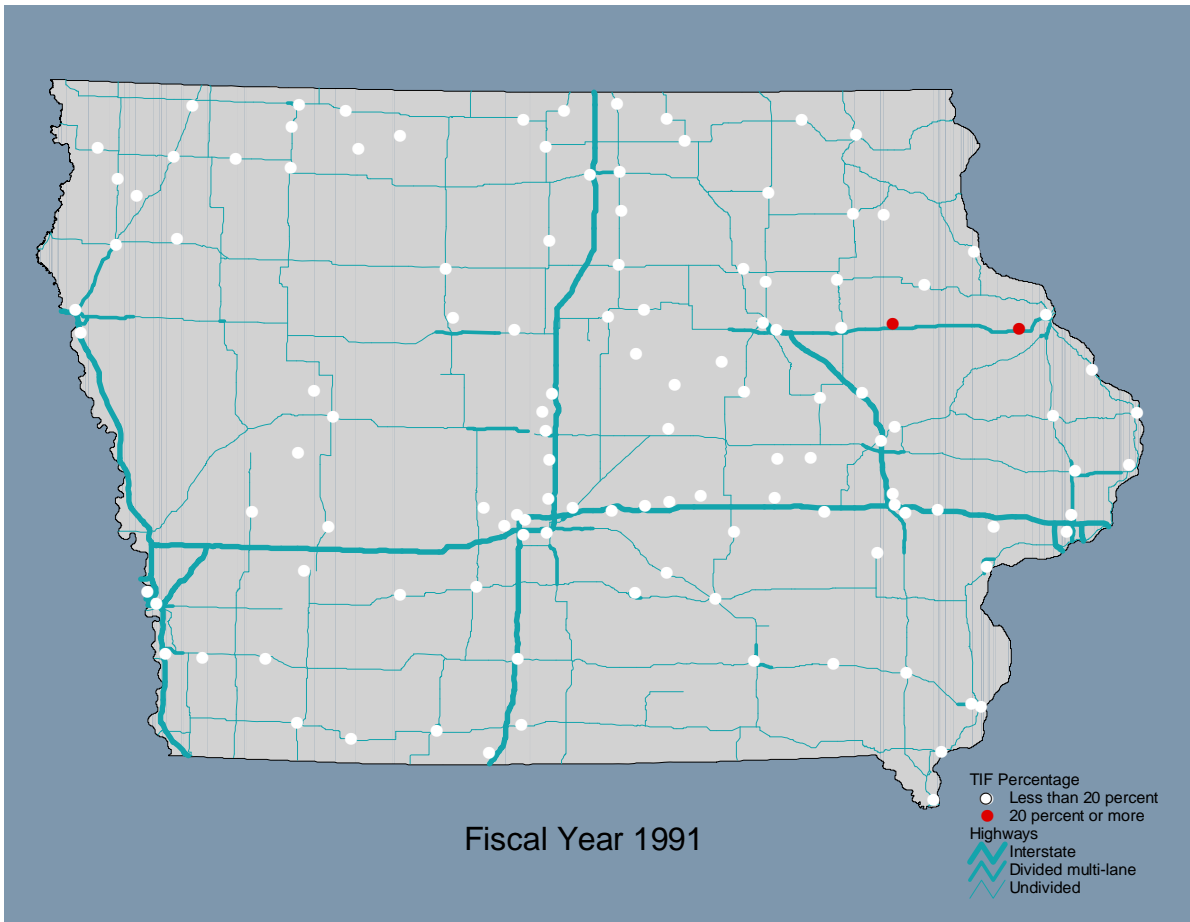


Figure 3

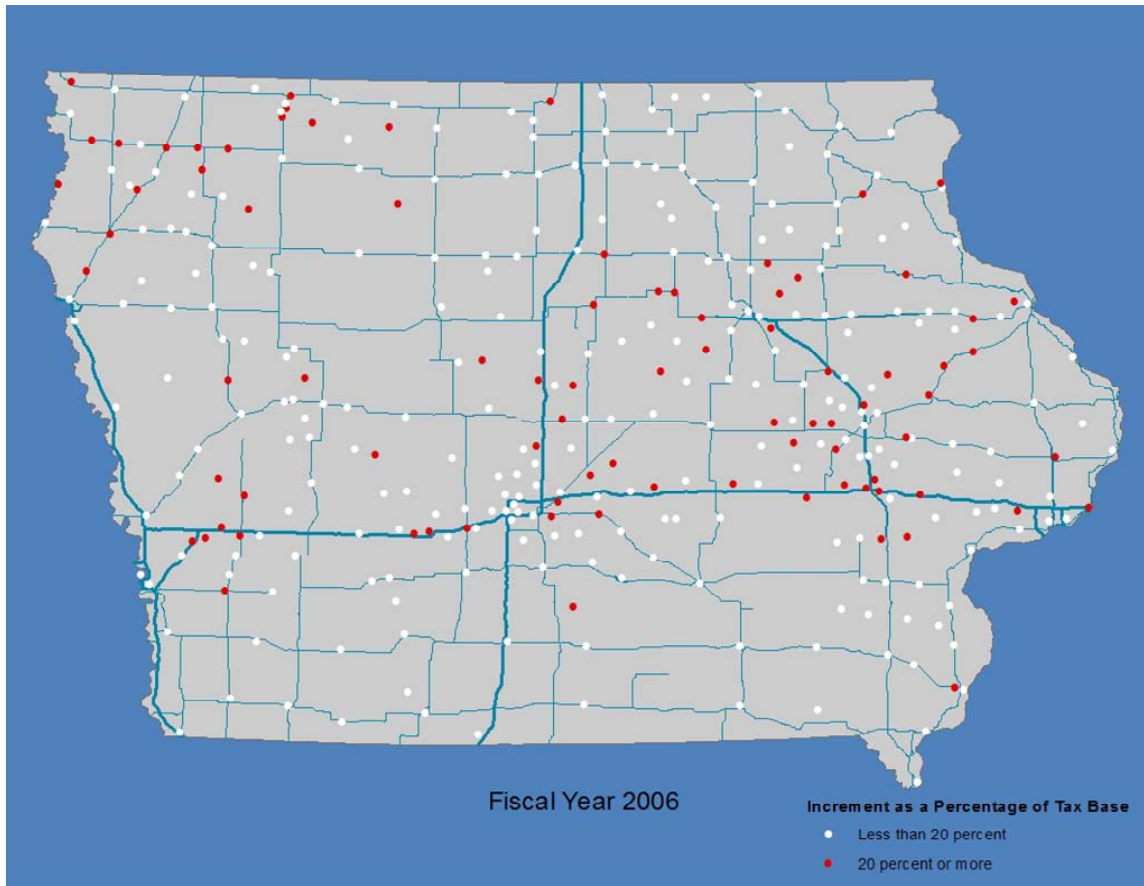


Figure 4

Figure 5 shows the same data for Fiscal 2012, the current fiscal year. The number of higher-effort cities, those with 20 percent or more of their taxable valuation in TIF, was essentially the same as the previous map, but the distribution is different. The communities appear to be more tightly clustered around the metropolitan areas.

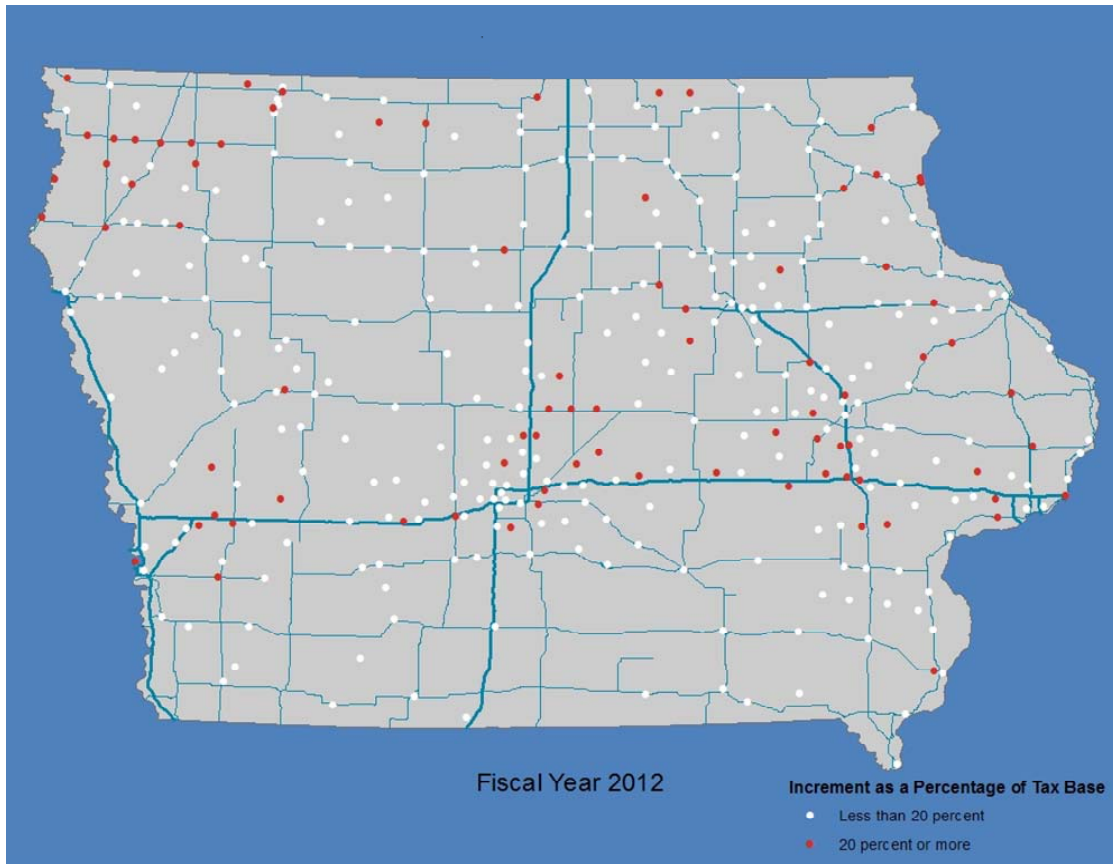


Figure 5

But looking just the TIF increment only tells part of the picture, we have recently learned. Many communities have designated very large fractions of their communities as TIF areas.

Figure 6 shows the distribution of TIF cities as displayed in the previous graph, but it measures the combination of frozen base and TIF increment that are in TIF areas as fractions of the entire city tax base. The total amount of community property valuation is less than a third in 187 of the TIF cities. However, it more than a third of the tax base in 169 of the TIF communities, and of that group, 42 have more than two-thirds of their tax base in TIF districts.

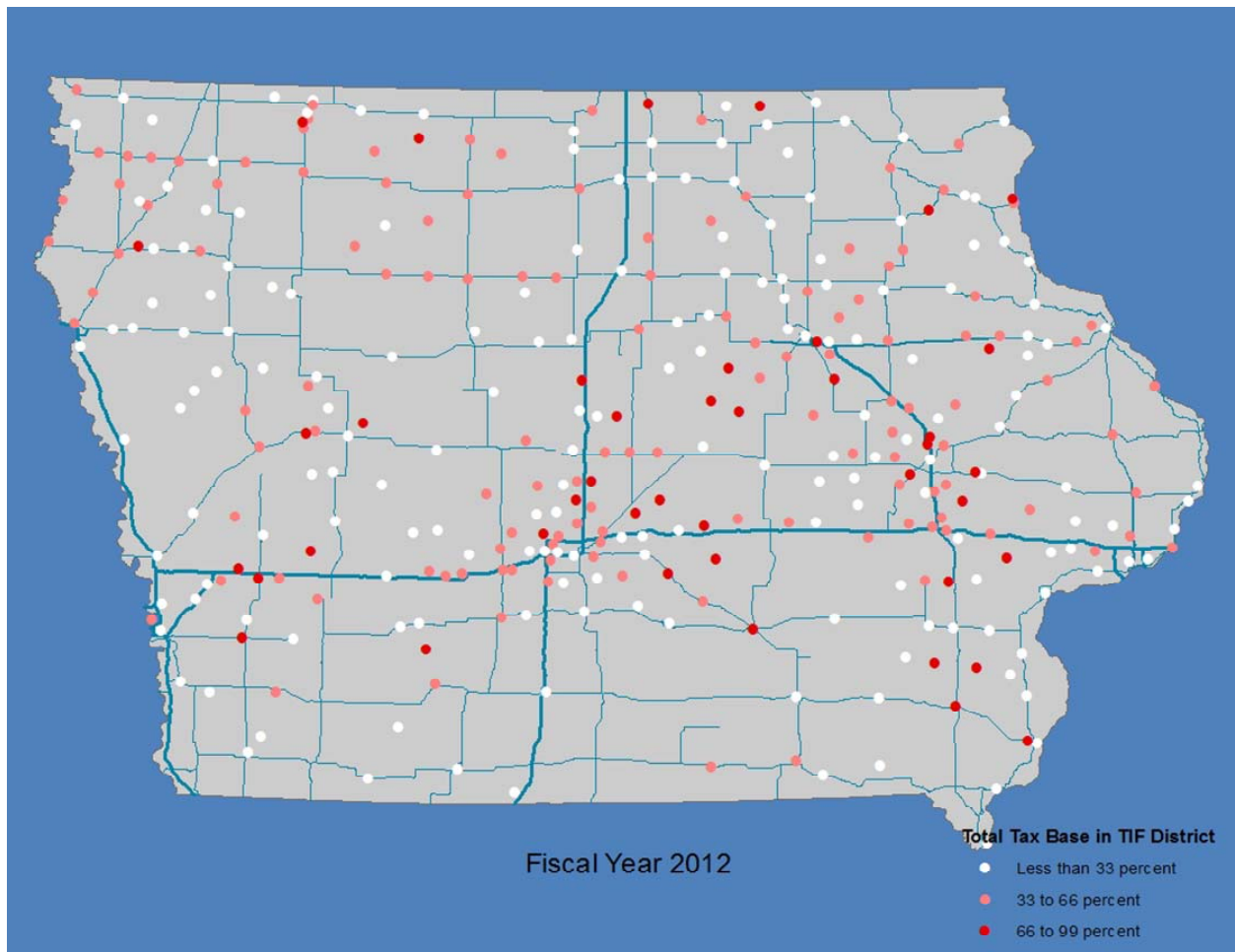


Figure 6

### ***My Primary Conclusions***

TIFs are very easy to use for economic development purposes, and they are very lucrative to either the city or the industry that is benefitted by them as two-thirds of the dollar value of the TIF increment property tax value is non-city revenues (i.e., school districts and county government). There are strong incentives to hoard that advantage, use TIF revenues for purposes that were not originally part of an economic development project, and to roll-over a TIF district.

Notwithstanding minor increases in reporting over the past eight years or so, TIFs have limited local or statewide oversight and accountability. Iowa lawmakers do not have a good sense of how TIF activities are actually carried out. They rely heavily on first-hand testimonials as compared with standard accounting and categorization of TIF uses and TIF outcomes. For example, there has been a growing tendency to simply rebate portions or all of an industry's property taxes using TIF authority. That rebate is treated as a "debt" within the meaning of TIF

authority. It could be a repayment for infrastructure additions or a simple rebate. In all, as a consequence, TIF debt that develops infrastructure and TIF debt that pays tax rebates are mingled leading to confusion as to the amount and character of debt associated with TIF activity in Iowa.

In response to criticisms of TIF usage, cities argue that TIF authority is the most potent and flexible mechanism they have for economic development. That, however, is misleading. As economic development is an essential corporate purpose, cities can issue general obligation bonds at any time to underwrite support for economic development. Additionally, there are other tools available to city governments to include existing tax rebate authority if needed to assist business growth.

It is unarguable that the rapid growth of city TIFs over the past decade has placed a burden on state K-12 funding as the city-generated actions constrain the available tax base for calculating the foundation formula, thereby necessitating higher state appropriations into those high TIF districts. It has been incorrectly asserted and broadly assumed that the state makes up the bulk of the loss. That is not true, the state makes up the loss associated with the foundation levy – the \$5.40 – it does nothing to make up the loss in the rest of the school levy affected by the TIF district.

This has different implications for growing versus declining districts. In growing districts it affects their abilities to keep up with genuine demand. In declining areas, this further financially impedes already struggling districts.

And counties are emerging as questionable utilizers of their TIF powers.

- Like the cities, many aggressively used TIF to boost housing development during the housing bubble.
- During the brief ethanol boom, there was aggressive use of TIF authority to underwrite lucrative incentives to ethanol plants that had to locate in Iowa because this was where the corn was. This was pure inter-jurisdictional competition that did not serve the public's interests.
- Now we have wind-energy TIFs popping up to underwrite secondary road development and other economic development activities at the rural level. From a distance this appears to be nothing short of a cynical tax base grab done solely because it is possible.

## ***Recommendations for Reform***

### **Sunshine:**

- For economic development TIFs, secure the agreement of school districts and county governments for both the duration and the value of their tax increments that can be diverted.
- Require cities and counties to prepare and publish an annual comprehensive audit of all uses of TIF funds to include status updates of all existing or pending TIF contracts and obligations.
- Require the state of Iowa to prepare a comprehensive annual TIF activities report as part of its economic development reporting requirements.

### **Clear and Compelling Need:**

- Require a clear statement of the public purposes to be achieved in the TIF district and exercise that authority only within a contiguous, compact, and publicly determined urban development area.
- Require proof that the aided development would not have occurred in the area or region “but-for” the assistance of the local government.
  - The burden of proof for this must be on the developer
  - This would be much like state government requires, including signed and notarized certifications.
- Require an Iowa Finance Authority determination of unmet regional housing need for all housing-related TIFs.

### **Oversight**

- Limit the area of a city or the fraction of its total tax base that can be contained within a TIF district.
- Clearly enumerate allowable uses of TIF funding to prevent diversion of TIF revenues into subsidizing city or county general fund obligations.
- Allow TIFs to be used solely for actual debt, either short or longer term bonding, not tax rebate obligations to businesses.
- Most importantly: establish and enforce reasonable sunset periods for urban renewal and for economic development TIFs. Limit the ability of TIFs to be rolled-over or extended after initial indebtedness has been satisfied.



After all, if tax base relief is a primary concern of this General Assembly and the Governor, eliminating distortions in the tax base must be a priority. The current TIF system has seriously distorted the property tax system in that a continuously growing fraction of the base is no longer available for general fund uses.

The sooner increments are released back to the various taxing districts the better it is for the economy, communities, all local governments, and ultimately all taxpayers.

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