Chapter 311: Tax Increment Financing

The Issue

Tax increment financing (TIF) allows local governments to use future tax revenues to pay for projects within a geographic area. Every state and the District of Columbia has enabled legislation for TIF, with the exceptions of Arizona. California was the first to enable TIF, but discontinued use of the tool in the face of repeated lawsuits. Most states justify TIF on the theory that it helps redevelop blighted areas that would not otherwise see private investment, and thereby increases total economic growth in the city.

Here's how TIF works: A city or county draws a boundary around an area that meets the criteria for redevelopment and forms a TIF district. At the moment a TIF district is created, the sales or property taxes generated in that district are frozen as the baseline level of revenue that will continue to fund local government services over the life of the district. But any increase in revenue over the baseline level—referred to as the "tax increment"—due to new development or increased property values in the TIF district are captured by the redevelopment entity. Consequently, local governments can sell bonds secured by the incremental tax revenue to finance development projects in the district.

In Texas, a TIF district is called a Tax Increment Reinvestment Zone (TIRZ), and the creation and use of TIRZs are outlined in Chapter 311 of the Tax Code. Three features distinguish Texas' TIRZ legislation from the TIF legislation of other states.

First, in most states only cities or other governmental entities can designate a TIF district. In addition to allowing cities and counties to create TIRZs, Texas allows owners of properties making up at least 50 percent of the appraised property value in the proposed district to petition to create a TIRZ, subject to city council approval.

Second, Texas addresses concerns that TIF districts simply capture revenue from overlying taxing entities (school districts, special purpose districts, counties) and redirect them toward city infrastructure projects, all while the overlying districts have no say in how funds are spent. After a TIRZ Board is formed to manage and operate the TIRZ, it must invite overlying taxing districts to share their tax increments for the proposed redevelopment projects. Importantly, these other taxing entities can opt out just by choosing to do nothing. If they wish to participate, they negotiate a contract over what portion of the tax increment they want to share with the TIRZ Board. Further, each participating taxing entity is entitled to name at least one TIRZ Board member.

Finally, Texas' statutory criteria for creating TIRZs are expansive, pushing beyond the narrower finding of blight required in other states. The primary limitation provided in Section 311.005 of the Tax Code is that the area's present condition must substantially impair the city's growth, retard the provision of housing, or constitute an economic or social liability to the public health, safety, morals, or welfare. This limitation has been interpreted broadly, so that tax increment money has been used in middle-income areas and to upgrade areas around downtown that already show signs of gentrifying.

The Arguments

TIF supporters assert that the projects are "self-financing," as the redevelopment projects within the district are allegedly what create the higher property values that pay for the projects. However, the truth of this claim is difficult to establish. In a normal market, property values would fall low enough that eventually people would begin to buy and invest for redevelopment without a public subsidy. It's unclear to what extent TIF is responsible for redevelopment, and to what extent it captures redevelopment that would have occurred anyway. Further, some studies suggest that TIF is a zero-sum game, meaning that TIF does not increase the total amount of development in a region, but instead transfers development from one part of the region to another. One study of Chicago's use of TIF districts indicates that they are actually negative sum—in other words, the city grew slower than it otherwise would have grown because of the TIF.

The use of TIF to fund public projects invites many questions and ideas for reform, but perhaps the most basic involves transparency. Right now, TIRZs, as well as many other types of special districts, are not required to make publicly available online financial information about their operations. This includes how much TIRZs are collecting, what they are spending those funds on, and the purpose for those expenditures. It's important that, at the least, state lawmakers take action in the next legislative session to require greater government transparency of these entities, so the public can more accurately determine what their value is.

Recommendations

- Require TIRZs to publish their financial information, meeting agendas, and agenda minutes on entity websites that are accessible to all.
- Require a finding of blight before the creation of a new TIRZ. Tax increment financing should be a last resort to finance redevelopment in areas that private investors would otherwise not enter, not a way for cities to finance development in already well-to-do areas. ✩

Resources

"ABC's of TIF" by Robert R. Eversberg and Paul R. Goebel, Real Estate Center Texas A&M University, Tierra Grande, July 2005 (accessed Sept. 9, 2016).

"Does Tax Increment Financing (TIF) Generate Economic Development?" by Adam Millsap, *Neighborhood Effects*, Mercatus Center at George Mason University, June 20, 2016 (accessed Sept. 9, 2016).

"Crony Capitalism and Social Engineering: The Case against Tax-Increment Financing" by Randal O'Toole, Cato Institute, May 18, 2011 (accessed Sept. 9, 2016).

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