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The Application and Role of Tax Increment Financing (TIF) in Community Redevelopment and Intergovernmental Relations

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Executive Summary

Overview

Over the last 60 years, the use of Tax Increment Financing (TIF) has become an increasingly used tool for addressing specific community needs. The vast majority of community redevelopment projects across the United States utilize TIF as funding for infrastructure improvements. Community needs and redevelopment projects vary widely by location and context, but the manner in which TIF is applied is largely standard across the 49 states that have enabled TIF legislation. State implementation of TIF legislation has allowed municipalities to create Redevelopment Agencies (RDAs) to tap into a revenue source (property taxes) and redirect funds to address needs within defined project areas. While the use of TIF is almost exclusively a local and state-local method of community redevelopment, its use is largely due to federal government decisions in the 1940s and the 1970s. Through this evolution (state enabling of TIF and subsequent creation of RDAs), new pathways for intergovernmental relations and communications have formed. Understanding how TIF is applied, and evaluating past present use of TIF, is vital for future community redevelopment project successes.

Information Sources

Numerous quantitative and qualitative assessments of the usage of TIF exist. Journal research and findings guided much of this report. In general, journals that focus on public administration and urban policy often provided rich statistical analysis and results of TIF enabled areas. Outside academia, knowledge and publication of TIF terminology, history, usage, and ensuing results, in the larger scheme of community redevelopment and health, widely varies and is often conflicting. While journal data was a useful guide for this report, TIF project area selection and site-specific attributes make generalizing to other regions less valuable. On the other hand, sources that attempt to evaluate and explore TIF usage in a holistic or ecological model would have been extremely useful, but are short in supply. Few sources were found that provided a balanced statistical analysis, detailed local vs. national trends, comprehensive site-specific variable recognition, and/or thorough examination of benefits (quantifiable and otherwise).

Findings

- The shifts of federal government funding methods and priorities, beginning in the 1970s, has caused state and local governments to find own-source funding options for community redevelopment projects.
- The application and role of TIF in community redevelopment projects would not be possible without many intergovernmental relationships, mostly centered at the local-local and state-local levels.
- The application of TIF, and evaluation throughout its lifecycle, is necessary within each project area, but methods of evaluation may not be usefully adapted to other regions due to local and national economic conditions, method of application, degree of community involvement, and many other factors.

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The Application and Role of Tax Increment Financing (TIF) in Community Redevelopment and Intergovernmental Relations

Quick examination of a TIF related community redevelopment project area map can easily reveal clearly defined project area boundaries, but to the pedestrian or commuter, community redevelopment areas are not as identifiable. When walking or driving through a neighborhood it is virtually impossible to know when one is entering or exiting a redevelopment area.

While the effects of community redevelopment may be more evident when widespread services are added or large-scale public infrastructure improvements are made, few have the time or resources to understand how and why such changes to the urban environment occur. Furthermore, the historical background and current funding mechanisms to support such transformations are often a mystery to those not involved in community redevelopment issues.

Proponents of community redevelopment frequently promote its ability to created jobs, increase affordable housing stock, make communities safer, and improve the overall quality of life within focused project areas. Supporters assert that the increasingly used method of TIF, essentially the diversion and reinvestment of property tax increases to fund specific projects within redevelopment areas, is justified, as community redevelopment provides benefits both within and outside (spillover) project area boundaries.

For critics, community redevelopment, especially TIF related, is judged as an unfair offset to private development costs, and therefore a misappropriation of a portion of local property taxes. Other criticisms assert that redevelopment projects are usually unnecessarily expensive, too community specific, and exclusionary.

This report explains, in a lifecycle perspective (birth, growth, maturity, and retirement), the fundamentals of tax increment financing, including key terms, basic enabling steps, and general usage of TIF for community redevelopment purposes. Brief analysis of historical federal activities and funding, as they relate to TIF, are included throughout the report. Additionally, intergovernmental relationships, including examples specific to Los Angeles involving TIF usage, are identified.

Information Sources

Approximately half of the research obtained for this report originated from journal articles and similar studies. Most of the cited quantitative evaluations of TIF were extracted from journal articles and research from different regions of the United States. Books, websites, and two interviews with the Community Redevelopment Agency of Los Angeles, Assistant Project Manager Caroline Sim, provided the general framework of TIF usage (including TIF application within the City of Los Angeles) for this report. Many public policy related websites were explored and provided further insight to potential success factors for the usage of TIF usage, as well as identifying common difficulties learned by past TIF funded projects.

Findings

Birth of TIF Legislation.

The origins of the usage of TIF stretch back, in some cases, several hundred years in Asia, South America, Europe, and Africa. Outside the United States, TIF is commonly referred to as "betterment levies" and "value capture", but while the terminology may be different, TIF usage in the past is largely similar to methods used today.

Day (2005) found recorded examples of betterment levies in the United Kingdom that can be traced back to the Middle Ages. Early examples of such levies included the taxing of beneficiaries in 1662 of street widening in London, and again to beneficiaries of re-building after the Great Fire in 1667 (Day, 2005). In Latin America, TIF similar projects date back to the early 1900s. Colombia use of TIF, termed "Contribution de Valorizacion (CV)" (Brown-Luthango, 2005) was initially introduced at national level, mainly because "political and economic challenges which Colombia faced at the time made it difficult for the country to compete with other Latin American countries for external funding" (Brown-Luthango, 2005, p. 15).

Origination of TIF within the United States is often attributed to the tax reallocation financing methods devised by California, the first state enable TIF legislation in 1952. By 2009, 49 states have authorized the use of TIF (Arizona being the only current standout). Figure 1 summarizes state adoption of TIF enabled legislation, grouped by decade.

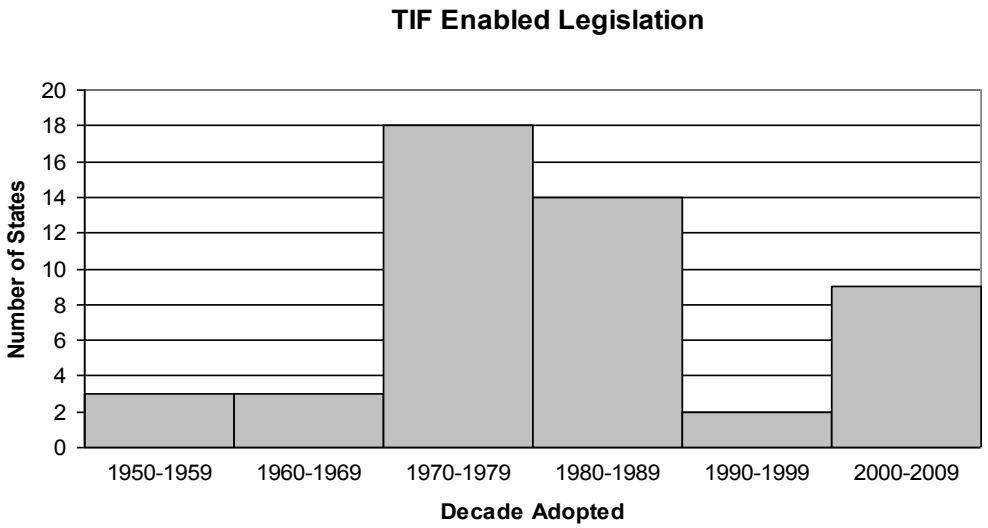

Figure 1. State adoption of TIF legislation by decade
Note. Data adapted from "*2008 TIF State-By-State Report,*" by Council of Development Finance Agencies (2008).

Growth of State use of TIF

The first half of the twentieth century is commonly understood as a period of increased centralization of the U.S. federal government, utilizing a progressive tax structure. However, the second half of the twentieth century is generally described as a period of progressive tax structure decay, "starting in the 1960s and 1970s and accelerating later on" (Stephens & Wikstrom, 2007, p. viii). This decay, is perhaps best exemplified by the decrease in personal income tax rate on the highest earning 1% of individual income tax payers (as a percentage of adjusted gross income) from 60.1% in 1950 to 27.4% in tax year 2000 (Stephens & Wikstrom, 2007, p. 82).

These decreases in potential federal funds available to local communities mirrored other general trends of decreased federal funding to local governments. In 1981, the Ronald Reagan signing of the Omnibus Reconciliation Act further reduced funding to state and local governments by 25%, and between 1952 and 2001, state use of "own source revenue" almost quadrupled (Stephens & Wikstrom, 2007, p. 78). In 1960, the federal government financed 47.3% of physical capital in the nation; by 2005 that percentage had declined to 14.3% (Scheppach & Shafroth, 2008). The sole federal financial burden of social security (1935) and Medicare (1965) are two factors that are claimed to have led to federal funding decreases to states and local governments.

The effects of these decreases in federal funding can be seen in Figure 1, as 32 states, under enormous pressure from local governments, grappled with new ways to channel funds to local governments, and enabled TIF from 1970-1989.

The shift from federal funding dependency, a disadvantage from the perspective of states, also led to positive changes on the state level. States focused internally on capacity building, developed internal funding sources, made revisions of their constitutions (including city charter structures), increased communication between states, and explored adoption and diffusion of policy across state lines. This period of "modernization of state government" began in the 1950s

with the establishment of the Little Hoover Commissions but it took time for states to become the "new keystones" in the federal system (Stephens & Wikstrom, 2007, p. 160). The new keystones enriched the nature of intergovernmental relations (federal-state) of the time, in both formal and informal ways, as state leadership became more professional and accountable.

These eventual increases in state capacity trickled down to local governments, and largely led to increases in urban-service local government "Special Districts" (Figure 2). Arefi (2003) explained that this increased capacity has shifted state attention from solely addressing community needs, to extending capacity building and empowerment to communities based on their assets (Arefi, 2003).

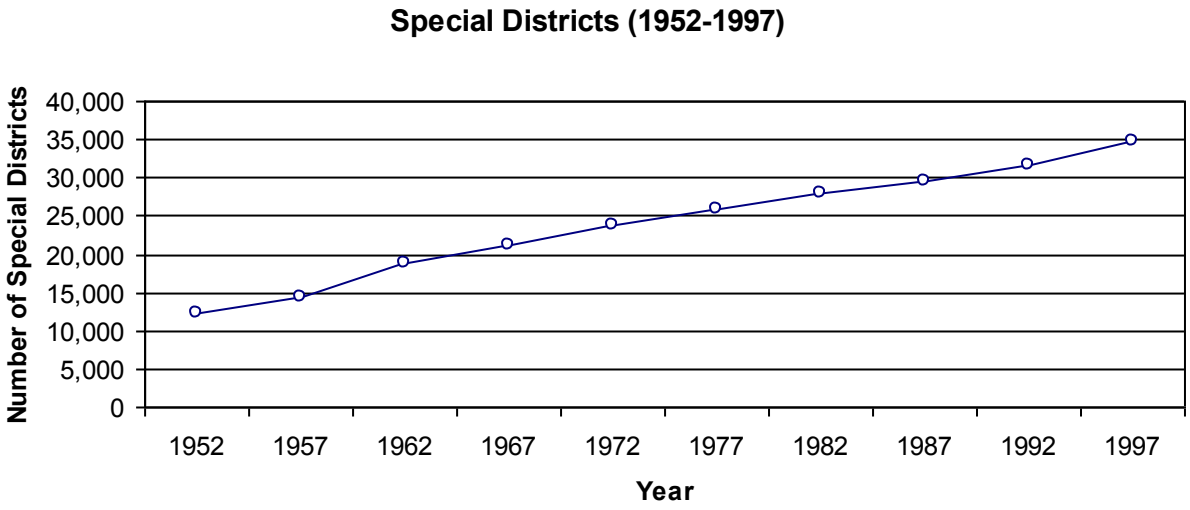

Figure 2. Number of local government special districts (urban-service) from 1952-1997. *Note*. Data adapted from "Multilevel governance and metropolitan regionalism in the USA," by C. Mitchell-Weaver, D. Miller, and R. Deal, 2000, *Urban Studies, 37*(5-6), p. 855.

With both easily identifiable needs for infrastructure improvements and the new capacity to responsibly handle community redevelopment, state TIF legislation proliferated. Each state identified its own local needs, and incorporated its own specific wording for the purpose of TIF usage in its legislation (although the terms "blight", "underdevelopment", and "redevelopment"

are commonly defined TIF usage requirements in all TIF legislation). Innate in the TIF model is its ability to address the specific needs of each state, community, and redevelopment area.

The general concept for TIF usage, across all TIF enabled states, is to improve areas that are substandard (based on criteria and definitions included in state legislation) and that are in the public interest. For example, TIF usage in California is directed by California Community Redevelopment Law (contained in the State Health and Safety Code) Section 33071 and states:

> "The Legislature further finds and declares that a fundamental purpose of redevelopment is to expand the supply of low- and moderate-income housing, to expand employment opportunities for jobless, underemployed, and low-income persons, and to provide an environment for the social, economic, and psychological growth and well-being of all citizens" (California Department of Housing and Community Development, 2009).

After TIF is enabled by state legislation, typically a consultant is hired by a city to perform a feasibility study and a redevelopment plan to (a) determine if a specific, requested area of redevelopment is appropriate, and (b) check for compliance with state law. If the feasibility study meets city desires and state compliance, the redevelopment "General Plan" and budget is then modified based on city and citizen input. Commonly a City Council vote for approval ensues, followed by a request for state approval, to initiate the formal creation of the redevelopment project area. If approved, a "Redevelopment Agency" (RDA) is then charged to enact the plan.

In California, if a new redevelopment area falls within the geographic coverage area of an established RDA, the existing RDA must approve the project area prior to City Council approval; if approved, it becomes absorbed into the established RDA. For example, new project areas within the City of Los Angeles become a project of the City of Los Angeles, Community Redevelopment Agency (CRA/LA).

Other primary steps of enacting TIF community redevelopment include the creation of an oversight commission, formation of specialized committees (including citizen committees),

implementation of "conflict of interest" safeguards, and establishment of other necessary organizational infrastructure (all typically required and directed by the state TIF legislation). Vining and Boardman (2008) stated that the creation and separation of these responsibilities is vital to the success of the ensuing projects because "although it may be inevitable that the administering agency turns into a political poodle, it needs to be flanked by junkyard dogs" (p. 157). TIF enabled community redevelopment projects are continually reviewed by local, city, county, and state officials to ensure compliance with state law.

The next major step is the "freezing" of the tax base to determine increment collection and subsequent reallocation. To determine the tax base, the local County assesses the property value of all the properties contained in the redevelopment project area and the updated property tax amount collected from the included properties becomes the "base year" tax collection level. The base year level sets the maximum level of tax the County can collect for its own uses on the included properties for the life of the project area. Any increases in property tax collected, based on increases in property value, is still collected by the County, but later redirected to the city or directly to the RDA, depending on state policy. Table 1 describes tax collection and distribution in a hypothetical TIF enabled project.

Table 1

Example of TIF Revenue Generation

Year	Action	Property Value	Tax Collected	Tax for County Uses	Tax for Project Area Uses
Base Year	Assessed Property Value	$20,000,000	$2,000,000	$2,000,000	$0
Year One	Reassessed Property Value	$25,000,000	$2,500,000	$2,000,000	$500,000
Year Two	Reassessed Property Value	$30,000,000	$3,000,000	$2,000,000	$1,000,000

Note. Hypothetical property tax rate = 10%.

Generally, TIF or revenue bonds (or a combination thereof) are made available to finance initial projects (a "leading by debt" model). Scheppach (2008) elucidated "the bonds, whose interest is exempt from federal individual income taxes, are secured either by a state's full faith and credit of its taxing authority or, if it is a revenue rather than a general obligation bond, by a secured pledge of tax revenue, fees, or tolls to meet the interest payments to the bondholders and repay the principal at maturity (p. 46)". In general, the TIF model spares the taxpayer of today from having to fully pay for benefits that will be provided over time.

It is vital to the project area that the property value does indeed increase over the life and the project. Failure for property value increases will lead to financial strain as other general revenue streams will need to meet the debt service of bond money that has already been spent. This highlights the importance for well-designed public-private partnerships and clearly defined long-term plans for project areas. Vining and Boardman (2008) described eight major rules for governmental engagement in public-private partnerships, mostly centered around choosing responsible partners and reducing financial risk.

Stephens and Wikstrom (2007) define intergovernmental relations (IGR) as "the activities and interaction that enable a federal system to function or not function" (p. 1). While the creation and growth period of TIF may not have explicit federal-local intergovernmental relationships, it would be very impractical for a non-federal system, with the attributes of the United States, to administer, oversee, and direct TIF usage. TIF usage revolves around the improvement of specific project areas, sometimes just a couple square miles in size. The procedural and organizational freedom of municipalities and states, afforded by the U.S. and state constitutions, are some of the reasons why TIF is an available tool.

Additionally, vertical intergovernmental relations, during the growth period, include approval of local RDA plans by city and state officials, county support to local and city when new

areas are assessed, and the continual evaluation and revision of state redevelopment laws as input from local and city politicians reach the state level government. State approval for expansion of TIF to new project areas, and federal priority shifts to states (in terms of redevelopment) are also examples of vertical IGR during this period.

Survival and Maturation of TIF

Internal survival and maturation of TIF relies heavily on responsible checks and balances systems and oversight mechanisms. In a case study of TIF usage in Virginia Beach, Virginia, it was noted, "The nation is facing an infrastructure funding crisis, and there is a need to apply innovative and creative solutions to infrastructure" (Leavitt, Morris, & Lombard, 2008). In the study, they concluded that "When TIFs are structured carefully and the public interest is protected through careful attention to the details of the agreement, a TIF can allow public goals to be met by incorporating both public and private investment capabilities" (Leavitt et al., 2008).

As Leavitt noted, externally, survival and maturation of TIF usage tends to focus on flexibility and partnerships. Scheppach (2008) explained "today, companies partner on some products and compete on others, this new mix of cooperation and competition creates a very flexible economy" (p. 43). Success and survival of TIF districts involves cooperation and communicative partnership regimes. Freyss (2004) stated that partnership regimes are exemplified when groups recognize each other's power, and conclude that it is more productive to work together than to constantly challenge each other.

For example, TIF related partnership regimes can join strong housing policy advocates (including politicians) with private developers, it can glue local government to state government for cooperation on large projects, and sometimes can involve joint ventures between groups that

could have never been imagined. The power of financing, especially in capital investments, involves sacrifice.

Partnerships relating to TIF can also result in policy change. The non-profit advocacy organization LAANE (Los Angeles Alliance for a New Economy) was influential in the revision of CRA/LA policy that now requires all CRA/LA funded projects to pay the City of Los Angeles minimum living wage to employees (including all subcontractors). The LAANE partnership was described as such:

> "LAANE has succeeded in getting a commitment from the developer of a billion-dollar Hollywood redevelopment project currently underway. In exchange for city subsidies totaling close to $100 million, project developer TrizecHahn has agreed to a deal whereby it will not only provide a living wage for employees in its own hotel and theatre complex but will ensure that businesses leasing space in its project do likewise (Gladstone & Fainstein, 2001, p. 34).

Feedback from community members, non-profits, politicians, and other stakeholders is also critical during adulthood use of TIF. For example, due to many complicated factors, affordable housing stock within California is often described as critically low. The Los Angeles based non-profit group Livable Places (now defunct) paraphrased a 2004 finding from the Southern California Association of Governments (SCAG) that estimated about half of new housing need for the City of Los Angeles is for households earning below 80% of median income (Livableplaces.org, 2004).

To address that concern, RDAs within California have prioritized assistance to affordable housing projects. California Community Redevelopment Law (section 3334.2) mandates that RDAs "act to retain and expand the affordable housing stock" within project areas, and requires that "a minimum of 20% of revenues accruing to a redevelopment agency be set aside for the purpose of maintaining and expanding the supply of housing for low- and moderate-income households" (California Department of Housing and Community Development, 2009).

Caroline Sim, a Senior Project Manager of the City of Los Angeles, Community Redevelopment Agency, further elaborated on the lack of affordable housing options for Los Angelinos, and explained that the CRA/LA has voluntarily increased the minimum allocation of TIF funding to affordable housing projects to 25% (personal communication, October 15, 2009). Sim further explained that in some fiscal years, 40-50% of CRA/LA investment occurred, depending on the project area, available opportunities, local real estate climate, and other project area conditions. According to Sim, the CRA/LA works diligently with each affordable housing investment opportunity to try to maximize the benefits to the corresponding project area. She explained that the CCRL is a very good guide to community redevelopment statewide, but the feedback from communities and the flexibility of TIF allows the local RDAs to fine-tune their spending to address each regional need.

The survival and maturation aspects of TIF related to IGR are mainly centered on partnerships. Local RDAs collaborate with state and county entities on large development projects. State of California Representatives often meet with their local CRA/LA to discuss improvements within their districts. Additionally, state representatives assist with non-TIF funding opportunities that can be utilized in TIF project areas – such as large Prop. 84 bond monies that are allocated to create new parks projects across the state. Federal-local linkages also exist, but less frequently.

Fiscally, intergovernmental relationships are key to the survival of TIF. As mentioned, the Counties serve as accountants and bankers, but perhaps more importantly is the role of the state. For example, the RDA's within California have been seen as a short-term budgetary fix for California's budget issues. In fiscal year 2008-09, the State attempted to take $350 million of CRA funds to help balance the state budget. A lawsuit followed, and found that the state take was

unconstitutional. In fiscal year 2009-10, the state has announced plans to take $2.05 billion from California RDAs, which has also triggered a lawsuit.

The most active IGR linkages during this period of TIF are horizontal collaborations between the sub-levels of a municipality. The CRA/LA works with nearly every non-support department within the City of Los Angeles. These can perhaps be described as ***intra***governmental relationships. The Mayor's office has significant interest in the success of TIF funded project areas. Additionally, any department within the City of Los Angeles that has landholdings has likely worked with the CRA/LA on land transfers, acquisitions, and joint construction projects.

Furthermore, with the increased capacity that has both supported TIF, and is a result of TIF, intragovernmental partnerships between states have increased during this phase. TIF districts look outside their own municipalities for future directions, as well as courting partnerships from large, private sector companies in attempts to bring them into their own project areas. Currently the CRA/LA is negotiating with a large manufacturer of train cars (based outside of California) for relocation to a downtown "clean tech" project area.

Retirement of TIF and Learning from its use

Retirement of TIF involves repayment of bonds, completion of land transfers and contract agreements, and other project specific issues. Retirement of project areas are inevitable since project areas have established lifespans (typically 20-30 years) but information and data regarding project area retirement is scarce, due to the relative age of most project areas. The oldest project area within the CRA/LA, for example, is the Bunker Hill Urban Renewal Project Area, which was established in 1959. Its retirement date has been extended several times, and is now slated for completion in 2012. A post-retirement study has not yet been done. The project area was extended due to help deter the decades long decay of downtown Los Angeles. With the intense

urban renewal that has occurred within the downtown area over the last 10 years, it will be interesting to the decisions made locally, citywide, and by the state as to its necessity. Retirement offers TIF users the opportunity to evaluate, and share knowledge of the results of efforts, not just within project areas, but also within RDAs, within cities, and even within states. Analysis, however, must be prefaced by acknowledging that TIF usage and results are highly site specific, and evaluation methods must be expanded for ensure cross-TIF policy can be applied to other project areas. Intergovernmental relations also plays a role in the retirement aspect of TIF, similarly as in the survival and maturation phase, as local municipalities look to other TIF project areas to seek methods of improvement and for future investors.

A study of Houston TIF Reinvestment Zones (Ewoh, 2007), for example, concluded that of 22 districts, only one was financially unsuccessful. Ewoh explained that the unsuccessful "Eastside" zone was due to its small monocrop tax base, with only three taxpayers were located in the district, and all three were oil industry related that suffered from a slumping economy. Ewoh further explained that the three oil companies successfully pressured the County Appraisal District to reduce their tax liability. All three reasons for the failure of this project area (small tax base, monocrop of interest, and taxpayer self-disinterest in the project area) are well-understood TIF pitfalls to avoid.

Along these lines, a study of the effect of TIF on industrial property values in Chicago reported that project areas, largely comprised of industrial properties, actually showed a decline in property value (Weber, Bhatta, & Merriman, 2003). The authors concluded, as with Ewoh, that mixed-use zones likely have a better chance for succeeding. The authors also concluded that their measurements were of property value only, and not of other benefits (such as job creation, wages, etc.). Carroll (2008) indicated that local real estate trends and overall potential growth of projects areas before TIF adoption has a significant effect on project area success.

Dye and Merriman (2006) performed two studies that included data from all 247 TIF districts in Illinois. They mainly concluded that TIF project areas cause the decline of property values in non-TIF areas, and that, overall, TIF project areas did not cause predictable increased growth even within project areas (Dye & Merriman, 2006).

Byrne (2006), in a similar study of factors that influence TIF success within Illinois, concluded that pre-existing conditions of sites within project areas, size of parcels, size of project areas, and population density all affect TIF success. He used the same dataset that Dye and Merriman had used on a study in 2000, and noted that his findings were different from those of Dye and Merriman, mostly due to site-specific attributes (Byrne, 2006).

Conclusions

The focus of this report did not include specific possibilities for TIF evaluation revision. However, several sources made mention to a need to expand, and if possible, standardize studies of TIF to incorporate a “development-in-context evaluation” (DICE) or “Participatory-Normative” methods. Both evaluation methods incorporate participants as partners, and tend to add value systems to the evaluation methods. Since TIF usage depends greatly on community attributes, incorporating these evaluation methods (such as DICE) can complement quantitative research and give a wider perspective on the results of TIF usage.

Perhaps the best instrument for localities to decide if the use of TIF is appropriate it to use the "but-for" method. For example, in Madison, Wisconsin, TIF can only be used if the proposed development would not occur "but for" city assistance (Center for Housing Policy, 2009).

TIF critics, however, may always claim that TIF enables government to divert tax revenue to subsidize projects that are not vital to the public interest. In 2006, the CRA/LA approved $25 million of improvements on a pending deal between the Los Angeles Coliseum and the National

Football League (Saskal, 2006). This potential project did not happen, but what if it did? Does the increased travel and tourism related funds that accompany a project like this justify the diversion of tax dollars from other potentially more vital uses?

TIF usage exists because of lack. TIF was created due the federal government lacking the capability to address inner-city decay, and probably more accurate, the federal government lacked the funds to do so. Or perhaps community redevelopment, from the federal government's perspective, lacked the priority to be included in the federal agenda. In short, TIF evolved on the backs of states, which, at the time, also lacked the capability to handle TIF, but as the capacity of the states, grew since the 1950s, so has the use of TIF. The concept of "lack" is a prominent theme of TIF; its usage is seen by some, as a confession of lack of attention to certain geographical areas and neighborhoods. In some senses, it can be viewed as a stopgap measure to address specific community problems, but in a wider sense, it encompasses elements of social, environmental, and economic justice (or lack thereof).

Intergovernmental relations, in respect to the usage of TIF, are vital to redevelopment efforts. Within Los Angeles, there is no other agency that is capable of performing the volume work the CRA/LA handles. However, as the State of California seeks to to balance its budget by usurping CRA/LA funds, what agency will advocate and redevelop decaying communities, such as Pico Union, large portions of South Los Angeles, and other older parts of Los Angeles? A kaleidoscope of opinions, answers, and potential solutions exist. Maybe a good starting point could be a shared understanding of public administration – I would suggest the work of Gaus (1947) as the model:

> "public administration should be understood from the ground up; from the elements of place – soils, climate, location, for example – to the people who live there – their numbers and ages and knowledge, and the ways of physical and social technology by which from the place and in relationships with one another, they get their living" (p. 81).

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