

Tax Increment Financing: History, Basics, Issues, and Evolution

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As municipal governments seek to maintain an urban center, many tools and incentives are used. One of these is tax increment financing. This development tool has the potential to provide tax-base neutral funding for areas in blight, potentially blighted, or with the potential to be economically and socially active. As municipal government officials, business leaders, and active citizens engage in civic discussion regarding economic development tools, it is important to understand the history, terminology, pitfalls, and current legislative trends. This paper provides an overview of the institutional history, basic functioning, debates, and current evolution of tax increment financing.

INTRODUCTION

As the urban centers of the United States continue to face social and economic stress, development practitioners have used a variety of tools to combat the pressures of decline as well as to promote quality of life. Many of these tools are supply-side, that is, an approach which seeks to decrease startup and relocation costs for new or existing firms. As local government officials, business and civic leaders, explore methods to promote urban social and economic development, it is important to understand current tools of economic development practitioners. One example and the focus of this paper is tax increment financing (TIF).

Historically, in the United States, TIF gained widespread use during the early 1970's. In general, TIF by design appears to be a sound method to produce new business environments, economic opportunity, as well as increasing the aesthetic quality of an urban community. Although, just as any public policy, it is not always perfect in application. There are cases where TIF has effectively raised property values, helped to revitalize economic activity, and does end up being tax-base neutral. At the same time, there are countless examples where TIF did not perform, resulted in a zero-sum outcome, or used in inappropriate economic areas (where incentives were not needed to attract business activity).

To help inform the many stakeholders impacted by TIF and to encourage informed civic discussion, this paper will begin with an overview of TIF, providing a general framework and context for its use. Next will be a historical-institutional overview of TIF; this section argues that the roots of TIF began much earlier than its widespread use in the 1970's and the historical evolution presented reveals much about the current design of TIF. Following this section will be a discussion of current issues regarding TIF. Lastly, legislative trends will be reviewed, particularly the monumental changes in the U.S. state of California's economic development policy, revealing the evolving characteristics and recognized power and abuse of this development tool.

OVERVIEW OF TAX INCREMENT FINANCING

In general, TIF is a municipal government tool used for developing brownfields or redeveloping urban areas which are determined to be suffering from economic and/or social blight. Particularly, with the designation of a TIF zone—where designation depends upon the municipality and state—property tax rates remain constant for a specified number of years (CDFA). Tax beneficiaries, such as schools, fire and police, and other public services, will continue to receive tax allotments for operational purposes, although these payments will be a fixed value for the life of the TIF project. During this time, redevelopment or new development proceeds are expected to lead to an increase in property values. This upward increment in property values—realized as increased tax payments to the municipality—channel into a special revenue fund where the proceeds are then used to pay the cost of construction (including finance). After the project completion or the TIF zone expires, property tax rates are unfrozen, the special account closes, and tax-receiving institutions resume funding based on the current, potentially higher, property tax rates in the area. Thus, TIF is believed to be a method which funds new or revitalizing development at no cost to tax receiving public entities or contributes to the municipal debt.

Proponents of TIF argue that this type of development creates a public-private relationship, where the public floats the cost of construction and where the private developer constructs and reestablishes tax generating business activity after completion. In some cases, municipalities also issue bonds. The bond payoff comes from an expected increase in tax revenue resulting from the TIF project. Hence, supporters of TIF argue that these bonds do not add public debt or compromise credit ratings and existing tax revenues.

The latter financial structure is known as *Payment in Lieu of Taxes (PILOTs)*. Similarly, although not used by all states, *Economic Activity Taxes (EATs)*, may be collected to pay back finance costs. EATs apply when the city or developer argues that the expected economic activity in the TIF zone will increase due to the new or redevelopment. Thus incremental sales tax, profits, or utility earnings will be captured and also used to pay construction costs (Kelsay, 2007).

Whereas a brownfield has a clear and accepted definition of a vacant or polluted, industrial or commercial parcel, blight is a legal term which varies by locality. Generally, blight is the perception that a commercial or neighborhood area is suffering from either or both stagnating property values and economic activity. Given this situation, from the municipal governments' point of view, these areas are a net loss regarding tax revenue, that is, public service costs for the area are greater than the inflow of tax dollars. Thus, TIF can be used to reinvigorate the taxable base of the area without negatively affecting other taxable entities in the locality. Such an outcome is known as the “but for” clause associated with most TIF projects; it is no cost to the city or constituency as the area would have gone undeveloped *but for* a TIF project.

Described above is TIF in its most general understanding. For a more informed assessment of TIF, the institutional evolution of urban redevelopment policy is needed. Much of the content of current debate and as well of the design of TIF stems from the historical use and misuse of government-sponsored urban development; with issues such as blight, the “but for” clause, eminent domain, and political motivations taking precedence.

HISTORICAL CONTEXT

The widespread use of TIF began in the mid-1970's although the first use of TIF occurred in California in 1952 to receive matching federal funds for urban renewal (Byrne, 2005).¹ This fact reveals that TIF as a tool for urban redevelopment has a richer past, stemming from a time when the federal government was a more active player in urban communities. Indeed, as this section argues, the foundations for the use of TIF began during the Great Depression in the context of urban housing.

The Great Depression contributed immensely to the issue of adequate and affordable housing. Even before 1929, housing conditions and standards of living for much of the U.S. population were inadequate. Planned cities and development projects had yet to occur substantially, and much of the

nation was living in what would be considered in the present day as sub-standard to deplorable conditions. As Jewel Bellush points out, “in 1929 eighteen million families, roughly 50 percent of all families were living at minimum subsistence income....Much of the nation’s housing was described as obsolete; many units lacked an interior water supply, were without toilets, and a third still had only wood or coal burning stoves” (Bellush and Hausknecht, 1967, p.4)

The market crash of that same year only perpetuated these rough conditions. A wave of mortgage defaults heavily contributed to massive eviction and a flight away from home ownership towards rental living. This situation further depressed national private investment and helped to legitimize a wave of government social programs aimed at inducing the renewal of national income and aggregate demand. For example, programs such as the Public Works Administration (PWA) were created to facilitate economic activity.

One of the major assignments of the PWA aimed at the demolition of substandard housing and the creation of large-scale housing projects. Classified under the PWA as the Housing Division, their authorized duties permitted such activities as to:

1. lend money to any limited-dividend corporation financing slum clearance projects, or engaged in construction or rehabilitation of low-rent housing; 2) make grants and loans to public bodies for the same purposes; 3) buy, condemn, sell, or lease property in developing new projects itself (Bellush and Hausknecht, 1967, p.6).

The implication of this government program is paramount for the eventual development of TIF. These actions represented the first occasion that the United States government had ever permitted the widespread use of eminent domain on US citizens as well as provide mass-subsidization for private investment. To justify such use of power—the seizure and redistribution of private property— legislative rhetoric was used to argue constitutionality. Specifically, this occasion appears to be the beginning² of the long-term use of the concept of urban blight, as well as the notion of a government-sponsored private investment which serves the public purpose (Weber & O’Neill-Kohl, 2013; Byrne, 2017, p.82).

During this time, blight was argued as a type of social disease, causing both economic and social destruction. This view of blight as a sort of random virus and that which contributes to social and moral decay implicitly implied that no single person, household, or business could solve or cure such a problem. Indeed, blight was an issue of urban agglomeration and varied from place to place. Truly, blight had no definitive characteristics (Greer, 1966, p.21). As described by the 1960 Urban Renewal Administration:

Blight does not stand still. It has a way of spreading from house to house, from block to block, from neighborhood to neighborhood. Caught early enough, blight can be arrested and the downward trend reversed. On the other hand, once an area has reached an advanced state of deterioration, nothing short of the major surgery of clearance and redevelopment will suffice. (Greer, 1966, p.24)

As urban blight was thought to endanger health, safety, and morals, and cannot be solved by any particular individual, it became constitutionally permissible to condemn, redistribute, and redevelop blighted urban areas. Hence, once an area was determined—either by a government authority or developer—blighted, public funds could be allotted to fund either private or public investment. With the attack on urban slums and blight, public programs were created to aid in improving housing conditions, the creation of employment, and more importantly, a revitalization of private business investment.

As the early urban redevelopment policies of the depression era ended, and the urban renewal policies of the 1950’s and 60’s blossomed, the intention of these previously mentioned programs began to shift. Rather than be strictly a means to alleviate urban poverty, slums, and failing neighborhood conditions, amendments were made to include general economic blight as well. For example,

In the 1949 Act particular emphasis was placed on the role of private enterprise; it was encouraged to provide as large a part of the total housing need as possible. Communities could be assisted in slum clearance programs only after they demonstrated that their needs are not being met through reliance solely upon private enterprise”(Bellush, 1967, p.13).

Furthermore, the percentage of total funds allotted to non-housing project renewal in a matter of seven years increased from 10 percent to 30.

Social policy was evolving from what was seemingly concerned with assisting the poor and needy to a more entrepreneurial focus towards the subsidization of private enterprise and local government tax base. With the advent of civil unrest and social uprising in the late 1960's, this reality became a source of social conflict. Neighborhood organizations and urban leadership started to push for an active role in the urban revitalization process. Indeed, “City governments were forced to seek new means of achieving economic conversion that could accommodate increasing political and racial polarization” (Kantor, 1988, p.262). Unfortunately, these gains would be short-lived for the era of public funding for urban redevelopment ended in the 1970's. In the wake, a New Federalism emerged, one largely influenced by a changing political spectrum away from Keynesianism. This political shift and change in the urban economic life—away from an industrial base towards service sector employment—would create financial and economic pressures for urban municipalities. As Paul Kantor argues, urban economic development in America also faced major change. He states:

Since the 1970s...central city political economies have precipitated substantial changes in developmental programs. The major change has been a shift away from massive downtown redevelopment in favor of more varied and specialized urban entrepreneurial programs that serve to continue the process of economic conversion. (Kantor, 1988, p. 263)

Given this, cities would face multiple pressures of declining federal aid, tax base, and urban core population. These pressures would contribute greatly to the true dilapidation and blighting of urban cores. Moreover, the previous period of Federalism was deemed inefficient and a burden on the American taxpayers.³ To this extent, urban social programs were not secure.

These changes meant that a city government would need to find new—and importantly—private methods for development and revitalization. It was now becoming a widespread contention that a strong business climate, and hence a deregulated private sector would solve urban economic depression as well as social ills. Furthermore, it was thought that Federal programs were simply getting in the way of private initiative (Harvey, 2011). In the wake of such social and economic changes came a number of new development approaches.

THE RISE OF TIF

With the decline in federal funds, urban industrial concentration, and the rapid movement of population to suburban areas, cities faced a declining general fund tax base. Commercial and retail districts became abandoned and physically deteriorated. It seemed as if urban renewal had come full circle; the city core again faced a “slum” existence. As well, and as was suggested, the rise of a political climate which favored private enterprise as the sole creator of wealth and employment, created an environment in which municipal governments could only utilize limited government public policy (Harvey, 2011). Given such a change, TIF constituted a consensus mechanism to fulfill the public purpose while maintaining political and ideological commitments.

Indeed, in the early advancement of TIF—as a basis for public policy reminiscent of urban renewal—the rhetoric still engaged the community as a beneficiary. TIF would provide a timely, ultimately cost-free, and win-win method for urban revitalization (Weber, 2013). As Davidson suggests, “This overall

process [was believed to provide] local governments with a flexible funding source for redevelopment activity that avoids much of the red-tape and delay associated with grant programs” (Davidson, p.408). As was mentioned, one of the reasons for the fall of the Federal Urban Renewal Program was the political and social movement away from governmental involvement in private markets. The question emerged as to how local governments could justify local government intervention in private enterprise? This issue of government involvement, as well as the design, implementation, and outcomes, comprise much of the long-standing debates surrounding TIF.

ISSUES WITH TIF

Since the early use of TIF, controversy arose regarding constitutionality and realized benefits; this is no less the case today. To this extent, the following section will consider the issues related to the use and assertion of: urban blight; the “but for” clause; economic development areas; eminent domain; and a non-democratic and politically motivated process. Conclusively, TIF by its very design and language creates much of the content of debate surrounding its use. As it is the purpose of this paper to help create an informed discussion, across a wide range of stakeholders, the following will be paramount.

Blighted Again

It is a principal use of TIF to aid in the issue of urban blight. As was discussed, the concept of blight established precedent for government intervention to resolve urban social and economic policy. Historically, blight as a justification for state and municipal involvement had to some extent a specific context and understanding. Originally, blight had its use concerning housing conditions; for example, dilapidated structures which could result in a loss of human health or safety. Indeed, urban dwellings which could be characterized as shacks or of slum conditions were deemed hazardous to the general population and unfit for a community. It was with the transition to the urban renewal movement where policymakers could designate blight for commercial buildings and general economic activity (Fainstein et al., 1987). This form of blight as a conditional term for public policy is where much of its definable characteristics becomes subjective. Even today, the term has remained the primary means to describe the decline of a geographic area, economic activity, or set of structures. As an example, Missouri, one of the nation’s more aggressive TIF users currently define blight as including generally any aspect that endangers human life but as well: inadequate streets, morals, welfare, or menace (Luce, 2003). Succinctly put, a blighted area “is a district which is not what it should be” (Gordon, 2004, p.306). This description reveals that almost anything can be in blight. Indeed, “Blight can [in this definition even] include such things as a home not having to full bathrooms or three full bedrooms” (Lefcoe, 2008, p.15).

Beyond Missouri, this type of language is common among the 48 states which utilize blight as a conditional use for TIF. For example, California, until recently in 2012, had a similar definition, although they went further to divide types of blight:

To establish a viable redevelopment project under California law, the redevelopment agency need cite only one physical and one economic blighting condition. For instance, a criterion from the physical list points to dilapidated structures in such bad shape as to be unsafe or unhealthy. Economic blight includes such factors as a high business vacancy rate, an excess of liquor stores or adult oriented businesses, or stagnant property values. (Lefcoe, 2008, p.20)

While seemingly more specific, California had simply added a direct initiative for commercial and retail development; a common trend in TIF statute. Unfortunately, with such vague characteristics comes a chance for abuse. A few examples make the point abundantly clear. In 1985 the wealthy community of Coronado near San Diego was declared to be entirely blighted; they then used this designation to apply for school funding from the state. Secondly, in a suburb in St. Louis, Missouri, “local officials declared a thriving shopping mall “blighted” in 1997 because, it “was too small and had too few anchor stores” and

more specifically, because it didn't have a Nordstrom's. (Gordon, 2004, p.306-307). Recently, in Kansas City, Missouri, the Intercontinental Hotel chain sought approval to be blighted as they had not had any restorations in the last nine years; with this designation they sought a local 1% tax to help cover the cost of construction. Given this application, the general manager of a nearby Marriott hotel stated, "Should the InterContinental be successful in this application, we would also like to apply" (Rodriguez, 2016).

Blight defined so broadly involves an inherent conflict of interest concerning public and private benefit; that is, it is often difficult to pinpoint who the beneficiary will be with the designation of blight. This problem has not gone unnoticed, much debate regarding the use of blight as a justification for government involvement has led to a demand for legislative change to qualify blight (Gold, 2011; Farwell, 2005; Gordon, 2004). The "but for" clause is an example of a way to supplement and justifies the characterization of urban blight, hence, urban redevelopment.

The "But For" Clause

A "but for" clause is a typical amendment to TIF statutes. The concept is simplistic, yet has immense implications regarding the overarching and abusive use of TIF. A "but for" clause is the notion that a declining area would not have developed "but for" public assistance; essentially correcting a market coordination failure. The failure suggests that private enterprise sees no prospects for a sufficient return on investment. As Weber and O'Neill-Kohl (2013) states, "This difficult-to-demonstrate but easy-to-argue test harkens back to the notion that every area is a potential slum" (p.197). Although appearing as a control mechanism for the abuse of TIF, in practice, "the "but for" tests let private developers define blight by letting them define the likelihood of natural economic growth in a given area" (Gordon, 2004, p.324).

Arguably, blight and "but for" can qualify the use of TIF in areas that may not be in decline. Furthermore, given the asserted intent of TIF—a cost-free development tool—TIF zones could be established in areas where an expected return (increase in property values) is more likely. "For these reasons, redevelopment authorities avoid genuinely blighted urban areas and devote their attention to those in which private developers are already poised to invest" (Gordon, 2004, p.325). In short, "but for" continues the trend started in the 1950's, a movement towards the direct subsidy of the interests of private enterprise (Logan, 2007).

Economic Development Areas

Following this movement away from any mention of support for truly "blighted" areas, and toward a generally utilized business enterprise subsidy, TIF has pushed beyond the limits of its original design. For example, "conservation" as well as economic development areas (EDA) are sometimes added to the use of TIF. These designations assume that an area either may be expected to succumb to blight or is simply an area in which there is a private initiative for future business investment. As Gordon points out, the issue with such designation is that "even the relative prosperity of an area can be used as an argument for its redevelopment—on the assumption that such prosperity cannot last" (Gordon, 2004, p.324).

Some states have even gone as far as to eliminate the condition of blight and "but for" qualification. These states, use the catch-all designation of economic development when designating TIF zones. For example, as Missouri allows, "localities [can] designate TIF districts in areas that fit into at least one of three designations: blight, conservation, and economic development" (Luce, 2003, p.6).

With the evolution of TIF statutes and allowable use tending toward economic development, retail and commercial development projects have become pervasive. Although this might favor one locality regarding serviceability of consumer goods or decreasing transportation costs to obtain such goods, this type of construction can have the effect of simply moving dollars from one location to another. Indeed, this is a direct example of Reilly's law of retail gravitation⁴. Consequently, "[t]he larger the geographic scope of your point of view, the more likely it is that TIF will be viewed as simply another tool in the zero-sum competition for tax base that goes on in every part of the country" (Luce, 2003, p.2). This argument does mean to imply that retail creation is a purely unconstructive use of TIF. Rather, it is the use of TIF for retail and commercial expansion in highly developed and prominent areas that undermine

the original intent of the policy tool and contributes to further urban economic and social segregation. For the community as a whole, retail development in highly developed areas does not aid in the creation of stable or well-paying jobs.

In consequence of such construction, it might cause a decline (or blight) in other local markets, as customers leave their old shopping areas for the new (Dye and Merriam, 2000). Such a possible outcome should make community stakeholders question TIF as a cure for blight and as well spur discussion of what is meant by economic development. At a minimum, thorough investigation of potential gains and losses of using TIF should be undertaken.

From a practical level, the use of TIF for retail and commercial development raises another outstanding issue: what are the true reasons for business relocation or new construction? Even within the discipline of urban economics, there is not conclusive evidence that firms will choose their location based upon municipal tax abatements or reduced infrastructure costs. To this extent, another concern in the use of TIF becomes, does TIF attract new business? As Kelsay notes, there exists evidence that economic incentives such as TIF may not be a key component of new private investment. He found: “quality of life issues such as availability of trainable labor, access to transportation, availability of skilled labor, and quality of the elementary and high-school systems were deemed far more important in location decisions than economic development tools” (Kelsay, 2007, p.13).

These findings suggest that firms are more interested agglomeration economies or economies of locality⁵ than infrastructure and overhead municipal tax and regulation costs. With these results, in addition to the fact that TIF applies for reasons other than the purpose of eliminating blight, TIF might not even be a needed tool for economic development (Kerth, 2011). Furthermore, given the vague nature of blight and economic distress, TIF zones are haphazardly appointed in areas that are already growing (McGraw, 2006; Chamberlin, 2006). Similarly, Man (1999) found that municipalities sometimes create TIF zones to appear competitive with neighbor cities who utilized economic incentives rather than for specific projects (pg.1152). This latter situation becomes problematic given the diversion of tax dollars to local city functions such as fire, police, and education. Not using TIF would alleviate urban taxpayers the potential risk of projects that do not meet projected gains as well as provide local education and safety services adequate finance *which would have been provided “but for” TIF.*

Eminent Domain

A more controversial issue regarding TIF has been in cases where eminent domain has been used. As TIF is used to aid in the reduction of blight—argued the public purpose—states and municipalities have invoked the Fifth Amendment to the Constitution. This has caused much controversy regarding what constitutes the public purpose—areas where all people have utilization access or a broader definition including the reduction of moral, social, and economic distress but also to further the improvement of non-blighted areas. Further controversy regards the potential benefit of private parties as the public purpose is pursued. How then could eminent domain be justifiable? The answer again seems to be of historical precedent.

As was shown previously, the use of eminent domain—for example in urban renewal—has had much time to be defended in the public sphere. Generally, “[a]s long as the local decision was not “clearly arbitrary or unreasonable,” judges refuse to second-guess the many ways local officials might determine that an area could “no longer meet the economic and social needs of modern city life” (Gordon, 2004, p.323). Indeed, it is thought to be up to the local government to determine what public use is and with concern for the public purpose. Hence, “It is not difficult to understand why TIF statutes, created in the wake of judicial opinions which dramatically stretched the meaning of public use, seek to implement eminent domain as a means to achieve economic development” (Rogers, 1998, p.161).

In 2005 these issues were brought to the Supreme Court in the case of *Kelo vs. The City of New London*. The courts ruled that the broader-based definition as public purpose prevail and is to be decided by state and local governments. As well, it was decided that it is unavoidable that private parties might benefit from government actions to promote public purpose (*Kelo v. City of New London*, 2005). This is why other economic development tools—such as enterprise zones, community improvement districts, or

special tax collection districts—utilize eminent domain for economic development; it has not been politically viable or would require major justification to qualify economic development as a public purpose. Many states after the court decision added legal language to restrict the use of eminent domain, responding to the public outcry from the decision. Although, as Byrne (2017) reports, “While 41 states passed laws purporting to restrict the use of eminent domain in the two years following *Kelo*, only 20 states effectively restricted the use of eminent domain for economic development purposes”(p.83).

Conclusively, if increased property values become public purpose, and the project is for public use, municipal governments are constitutionally permissible to use eminent domain in the case of TIF economic development projects.

Non-participatory and Politically Motivated Process

A further issue regarding TIF is how TIF zones are appointed and by whom. In general, a TIF commission is appointed by a municipal government. By design, the commission is a separate unit of the local government financed through the TIF project rather than general revenue funds. This finance structure is necessary if TIF is assumed to be cost-free; yet, in consequence, does not guarantee public transparency or liability of the TIF commission. While it is the elected officials who appoint the TIF commission, the public at large does not have the power of vote or veto.

In addition to municipal citizens not having voting power as to who appoints TIF zones, they ultimately do not have the power to choose where TIF zones occur or an ability to stop them. At most, citizens are alerted through public notice about TIF zones or projects and as well can express their concerns at a TIF commission sponsored hearing. Wilson (2014) found that in St. Louis, Missouri, “the very same people who are affected by the TIF often have little say in the plan, despite the requirement of the public hearing” (p.87). At the same time, in many states, local government is not required to hold public discussion or hearings. Even in the case where the public TIF commission hearing finds issue with the TIF, there are cases where the local government can easily overturn decision (Ibid, p.87). At best, these TIF commission sessions allow citizens to vent their frustrations, and in cases of obvious abuse, create public concern. In short, the use of TIF, while touting social and economic development allows a municipality and business community to potentially act without accountability to voters and the public purpose. For transparency, public involvement, and proper use of TIF, stakeholders should be aware of this issue and at a minimum understand potential consequences.

Does TIF Work?

As a final issue, those parties involved or impacted by TIF need to be aware of the evidence regarding its success. Most research points to mixed results and ends with a suggestion of caution regarding its use. Success can be categorized in three ways 1) property value appreciation 2) generation of employment 3) reduction in blight.

As many scholars who have studied the use of TIF realize, TIF is typically more successful in areas where property values have not bottomed out. As Gordon argues,

Because TIFs use future tax revenues to finance redevelopment, they are actually ill-suited to conventional residential urban renewal, which usually involves significant up-front costs for land acquisition and clearance...TIFs depend upon dramatic increases in property values, and as a result, are geared more toward new commercial investment--often in well-heeled suburban neighborhoods. Therefore, while TIFs generally require a finding of "blight" they often turn that notion on its head. (Gordon, 2004, p.319)

Indeed, for TIF to be truly successful, there must be a dramatic improvement in property values. Given this, TIF is used most frequently where returns can be guaranteed, making its use simply a developer subsidy. George Lefcoe (2011) states bluntly, “The problem is that TIF is an ineffectual tool for assisting most seriously blighted areas. Few "truly distressed areas marked by a high poverty and/or unemployment rate” offer untapped profitable private development" (Lefcoe, 2011, p.443-444). In general, this fact has

limited TIF use in low-income areas or what the public might consider truly blighted. For example, Kelsay (2007) discovered in Kansas City, Missouri: “An examination of poverty status according to the 2000 Census by Council District shows that Council District 2 which has 41.4% of all TIF plans has the lowest poverty rate in all City Council Districts at 5.0%” (Kelsay, 2007, p.7). Additionally, District 2 was also found to have lower rates of unemployment, higher levels of educational attainment, higher medium income, and was the least racially diverse. These statistics are historical fact and were argued to not be a result of TIF or other economic development incentives.

More recent research has found that TIF success—regarding property value appreciation—might be dependent upon the type of development; for example industrial, retail, or residential. This implies that TIF may not be acceptable in all cases. Additionally, TIF has been found to have varying success dependent upon the use of other economic development incentives (Byrne, 2010). Beyond the appreciation of property value comes the more important goal of job creation and the reduction of blight.

In a 2013 study of TIF in Chicago—specifically regarding job creation—that on average, little to no influence on job creation could be found in TIF projects (Lester, 2013). Testing the “but for” clause in Chicago resulted in little to no confidence that development would not have occurred without TIF development incentives. “Overall, TIF failed to produce the promise of jobs, business development or real estate activity at the neighborhood level beyond what would have occurred without TIF” (Lester, 2013, p.671). Additionally, Lester (2017) conducted the same analysis in Missouri—in the cities of Kansas City and St. Louis—and concluded the same results. Interestingly, they found more support for changes in employment stemming from macroeconomic effects than economic development tools such as TIF (Lester & El-Khattabi, 2017, p.18).

While there are specific cases and projects where TIF has worked, given the potential for massive redistribution of public funds, stakeholders should be aware of the mixed outcomes of TIF outside their city. As most economists understand, there is never a pure one to one correlation between economic variables. Given this, TIF may need to evolve to meet the obvious concerns that have been established over the last 60 years.

In what seems to be a full circle reality, California, the earliest implementer of TIF has recently (2012) abolished the predominant mechanism—redevelopment areas (RDAs)—that utilize this source of development finance. In its place, they have sought new ways to fund development that does not put public funds in as much potential risk or diversion.

RECENT DEVELOPMENTS IN TIF—THE CASE OF CALIFORNIA

The Path to Elimination

California, being one of the first states to implement TIF is also the first state to broadly limit its abuse. This action began as the state battled budgetary issues in part due to its unique tax collection/distribution schema. Essentially, per the 1978 passage of Prop 13, local governments are not responsible or have the authority to control local property tax rates. Effectively, this put the state in charge of the allocation of tax funds to counties, local governments, schools, and special districts. Coupled with an earlier court decision⁶ which dictated the allocation of school funds on the grounds of equal education for all—thereby reducing the local government's power to raise property taxes to fund public schools—the state took on an enormous role concerning local government finance. Of particular interest is the fact that if economic development programs—for example, RDA/TIF—diverted funds away from property tax collection, the state would be required to backfill the resources needed to meet the school districts constitutionally mandated finance. In turn, this effectively transferred tax dollars away from local governments to the state to be distributed to California schools (Lefcoe, 2012).

This transfer of power put a strain on local governments and economic development. In 2010, local governments and economic development agencies pushed for Proposition 22 and won. This blocked the state from further acquiring tax revenue from other areas such as hotel taxes, utility taxes, sales tax, and parcel taxes. It was argued that these funds should be of exclusive use to local government functions, including redevelopment agencies.

Even with this protection from the state, critics of RDA's utilizing TIF remained. Citing extravagant projects, school officials and the public at large began to question the power of economic developers and their stated intention of public welfare creation as teachers and other public employees became unemployed due to state budget cuts (Lefcoe, 2012, p.775). On the other side, RDAs wanted to stop 'raids' on local government tax revenue, including TIF dollars. Eventually, California Redevelopment Assn. v. Matosantos went to court. The final decision did not favor economic development. In February of 2012, all 400-plus California redevelopment agencies dissolved. This monumental decision is the first of its kind in the long history of economic development in the United States.

The Aftermath and the Evolution of TIF in California

With the dissolve of RDA's in CA, TIF has become a much more focused and transparent economic development tool. In place of RDA's a number of new economic development programs have been established allowing local governments to use a form of TIF, although with very strict rules surrounding their geographic location. The state realized the benefit of TIF but needed to address the issue of funding for primary and community college school districts as well as education administration. Furthermore, state officials also had a concern for transparency in economic development. In 2014, Senate Bill 628 authorized the use of Enhanced Infrastructure Financing Districts (EIFDs). Following this legislation, in 2015, Assembly Bill 2, allowed for the creation of Community Revitalization and Investment Authorities (CRIAs). Both of these programs seek to allow TIF to be used to fund economic development.

Enhanced Infrastructure Financing Districts

The logic of EIFDs is simple—use tax increment financing where the benefits are clear and predictable while not causing a shortfall in public education. While there is a broad designation of acceptable EFID projects, there is a push toward public use development as well as environmental cleanup, transit, and sustainability. At the same time, EIFD's can be used for private industry, and the designation of blight is not mandatory.

The process of forming an EIFD is similar to previous redevelopment programs although more public oversight and specific project components must be included. First, a plan is submitted to either the county board of supervisors or city council to adopt a resolution to start the process. This first hurdle helps to eliminate unworthy projects that might be inconsistent with the local general plan. If accepted, a Public Financing Authority (PFA) is constructed for the EFID. Members include all tax impacted parties as well as public representatives. An Infrastructure Financing Plan (IFP) is produced. An IFP is more like a business plan. This is a large difference between EIFD projects and previous redevelopment schemes. Lastly, a public hearing is held. While no public vote is needed to create an EIFD, if there are other participating agencies, they must all have their own hearing regarding the IFP.

Some requirements in EIFD projects limit the potential for abuse. For example, EIFDs cannot use eminent domain; there must be public representation in EFID governance; the EFID is a separate legal entity; projects must be consistent with the local general plan, and any bonds issued are not a liability of any component of local government. If significant bonds are needed to fund the project, there must be a 55% of voter approval. To promote stakeholder transparency, EIFD proposals must include "the proposed location, timing, and cost of the facilities, development and financial assistance. The code also requires that all facilities, development and financial assistance that are being provided in the area of the district be described" (CALED, 2017, p.9).

In short, this new approach to economic development—while including the use of TIF—requires the demonstration to a wide audience of stakeholders that the EIFD has an actual source of funding as well as a solid strategy and business plan. While no project is guaranteed, EIFD legislation seeks to increase project transparency, reduce public financial risk, and create projects that benefit a local community, county, region, and state.

Community Revitalization and Investment Authorities

Often referred to as “redevelopment 2.0” community revitalization and investment authorities (CRIAs) provide another alternative to the previous era of RDAs. Similar to EIFD, CRIA was constructed to allow the use of TIF although with much more oversight and transparency. Furthermore, while blight is not a condition for the formation of a CRIA, strict requirements regarding depressed socioeconomic characteristics must be met. Also, CRIAs must find either deteriorated infrastructure or dilapidated economic centers, provide revitalization of a former military base, or be used to assist in a state-designated disadvantaged community. To aid in transparency CRIAs are required to review and report their plan annually as well as every ten years.

The adoption process of a CRIA first involves the creation of a separate political entity governed by a board of directors. Upon establishment, the CRIA leadership constructs a revitalization plan. After construction, the CRIA members must involve direct and indirect stakeholders before plan adoption. A CRIA plan undergoes three separate public hearings known as a protest process. This gives stakeholders a chance to raise concerns with the CRIA plan. By the third hearing if more than half of property owners and the local public disagree the plan is abolished. If less than half but more than one quarter disagree a public election occurs. If there is majority dissent, the plan is terminated, and the CRIA is restricted from producing a new plan for at least one year. It is hoped that this process which includes broad public oversight will help to provide public discourse and oversight of the local tax base.

If a revitalization plan is approved the powers of the CRIA are wide-reaching, ranging from the construction of low-income housing, brownfield cleanup, direct assistance to business, and infrastructure retrofitting. On the finance side, CRIAs can utilize TIF, borrow from local and state governments, issue bonds, acquire and transfer property, and seek to qualify for state funds to aid disadvantaged communities. Additionally, unlike EIFDs, CRIAs can use eminent domain although with strict timing and purpose requirements—for example, a “subject property may not be condemned for a continuation of its present use” (CALED, 2017, p.16).

The strict requirements of CRIA along with issues of financing have initially limited their use. Recently, Hoem (2018), found that only one CRIA has been formed stating “All other municipalities that have considered CRIAs have either come to an impasse or decided to use other economic development tools to accomplish their goals” (Hoem, 2018, p.35). Arguably, this may be a sign that the actions taken to limit the abuse of TIF based economic development have been successful.

CONCLUSION

Through the examination of the history, issues, and evolution of TIF, it is clear that the power of this economic development tool is both recognized and needed. Indeed, as municipalities continue to exist in an age of dependency—from both new and existing business as well as population growth—tools such as TIF may be needed to achieve economic viability. At the same time, tools such as TIF, with such a seemingly simplistic functioning, are ripe for abuse. Hence, it is of utmost importance that all stakeholders have a clear understanding of the historical and contemporary issues surrounding this approach to economic development.

The case of California presents a new and hopeful era of the use of TIF. CRIAs and EIFDs seek to eliminate many ways that TIF was abused. They create a much more inclusive and transparent process so that the public has a stronger voice in the use of local tax dollars. The oversight process for approved CRIA and EIFD areas helps resolve the potential secrecy and corruption that was once such a pervasive issue in the era of RDAs. At the same time, the development and use of these new tools must be part of a comprehensive economic development plan and not be the sole source of financing.

Lessons from the U.S. case of TIF has considerations for other countries that face similar urban issues. As TIF, in general, has the potential to work almost universally—that is development causes an increase in taxable property value—the use of this type of tool has obvious applicability. Even with such universality, it must be understood that TIF does not have an absolute rate of return and is highly

dependent upon both local and macroeconomic market conditions. As such, clear policies and public and private oversight must be included for TIF to be effective.

ENDNOTES

1. Urban Renewal was a set of federal and state urban redevelopment policies formally beginning in the 1950's. These policies sought to reinvigorate American cities, first with adequate housing, then increasingly to aid in the maintenance and construction of a viable business environment. These policies were increasingly scrutinized on the grounds of racism, wasteful federal spending, and effectiveness. Urban Renewal formally ended in the early to mid-1970's.
2. A concept which had prior use to describe the moral, social, and economic distress encountered in urban areas; for example, during the English industrial revolution.
3. Indeed, as Milton Friedman argues in his piece *What is Killing the City*, a piece in his 1972 *An Economist's Protest*, 'Government spending is the problem, not the solution. We do not need new government programs. We need to abolish the old programs and let people spend their own money in accordance with their own values. The city would then get better—and better and better' (Friedman, 1972, p.227).
4. This is less of a law than an empirical tendency. The notion is that markets in a geographic area have a finite number of customers. In general, new development in this area would simply attract customers from old development to new, hence there is no net gain of economic activity; rather there is a pull away from one market center to another.
5. These are the benefits to a firm that accrue from a lively, culturally diverse, pedestrian friendly, aesthetically pleasing community environment. These reasons alone have more to do with the firm location decision than business development subsidies.
6. See: *Serrano v. Priest*, 5 Cal.3d 584 (1971) (*Serrano I*); *Serrano v. Priest*, 18 Cal.3d 728 (1976) (*Serrano II*); and *Serrano v. Priest*, 20 Cal.3d 25 (1977) (*Serrano III*).

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