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Testimony before the Indiana Legislative Interim Study Committee on Fiscal Policy

Subject: Tax Increment Financing

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Background

Tax Increment Financing (TIF) is an economic development tool, which has been deployed since at least the late 1960's. The original purpose of Tax Increment Financing was to stimulate urban development in locations where outmigration and decay had significantly reduced population and the tax base.

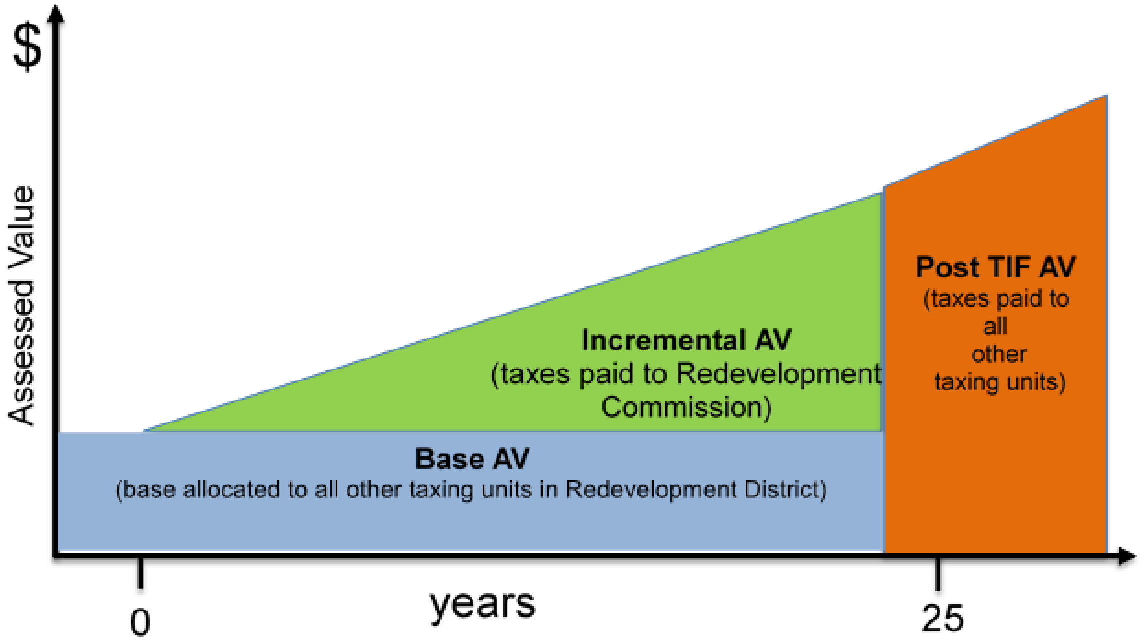
Since its first inception, TIF has been widely adopted, and at its peak used in 49 out of 50 states. However, the past several years have seen the publication of a large and varied body of research on TIF's effect on economic development, tax revenue, tax rates and the quality of public services. Likewise, the use of TIF in recent years has been significant, and anecdotal examples of misuse are now common. Over the past few years, two states have ended TIF, and several other states, including Indiana, have seen legislative efforts to modify or restrict its use. Anecdotal evidence suggests that some TIF districts are successful to the point of returning property tax dollars to overlapping government units, while other TIF districts are under financial stress because incremental growth has not met expectations.

We believe Indiana should preserve Tax Increment Financing, but with two broad types of reform. This testimony outlines our reasoning.

TIF Basics

The fundamental explanation for Tax Increment Financing is simple, elegant, attractive and largely a fiction. Briefly, a TIF district is created, new investment is made, and the taxes collected on the incremental growth are allocated towards activities that cause economic development. See Figure 1 for this depiction.

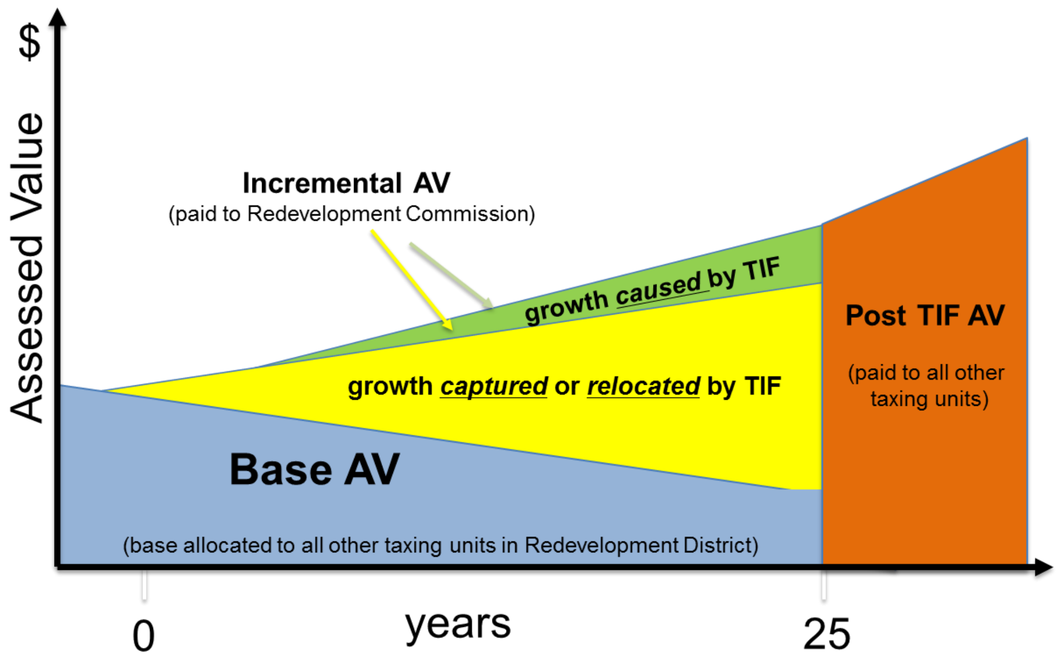
Figure 1: TIF as its proponents wish it to be . . .
(*all affects 'but for', and inside the Redevelopment District, no effect outside the Redevelopment District)*



As this graphic depicts, the hypothetical TIF may be a boon to communities, allowing both economic activity and new tax revenues to accrue to a region without cost. In this picture, Tax Increment Financing is, in the parlance of economics, a free lunch for a municipality. If this was the case, we would not now be discussing this issue before this study committee.

Several features of TIF mandate that this hypothetical condition will not hold. It should be clear that for a TIF to operate as illustrated in Graphic 1, no new investment in the TIF area could have occurred anywhere else. For property tax revenue purposes, anywhere else within the county is the geography of interest. If this new investment would have occurred anywhere in the county without the TIF, it has an effect on other taxpayers. Moreover, even if the new investment would not have occurred anywhere else, if it impacts any other firm in the county it would have a property tax revenue impact on taxing units and/or taxpayers within the county. Thus, a TIF 'captures' growth which would have occurred anyway. This has an impact within the TIF district. These are illustrated in Figure 2.

Figure 2: TIF as it may actually be . . .
(impacts inside the Redevelopment District)



The effect of 'growth capture' has both visible and invisible effects. It is obvious that if the economic activity were to occur without the TIF, then tax revenues are lost to other units, tax rates rise for taxpayers within the county, or some combination of these two impacts occur. This obviously has a negative impact on the county economy. The invisible effect is the result of underlying business dynamics.

In the most recent year for which the Department of Labor has data, business churn (the birth and death of firms) accounted for 23.4 percent of businesses and 6.2 million jobs.[1] So, firm births or deaths are ubiquitous and impact nearly one in four firms each year. Any tax instrument which captures firm births risks eroding the business assessed value of a taxing unit simply due to business churn. This is surely occurring in Indiana, given the large share of developable land currently within a redevelopment commission. The size of this we discuss in the next section.

The other invisible effect of TIF is its impact on businesses outside the TIF area. In many instances, new development is supported by TIF in industries which rely on local demand for goods or services (such as retail, grocery stores, and entertainment venues). In these instances, the use of TIF as a development subsidy may lead to the closure of competing stores, and a subsequent loss of tax revenue (both personal income and property taxes). We point to the Muncie Redevelopment Commission decision to

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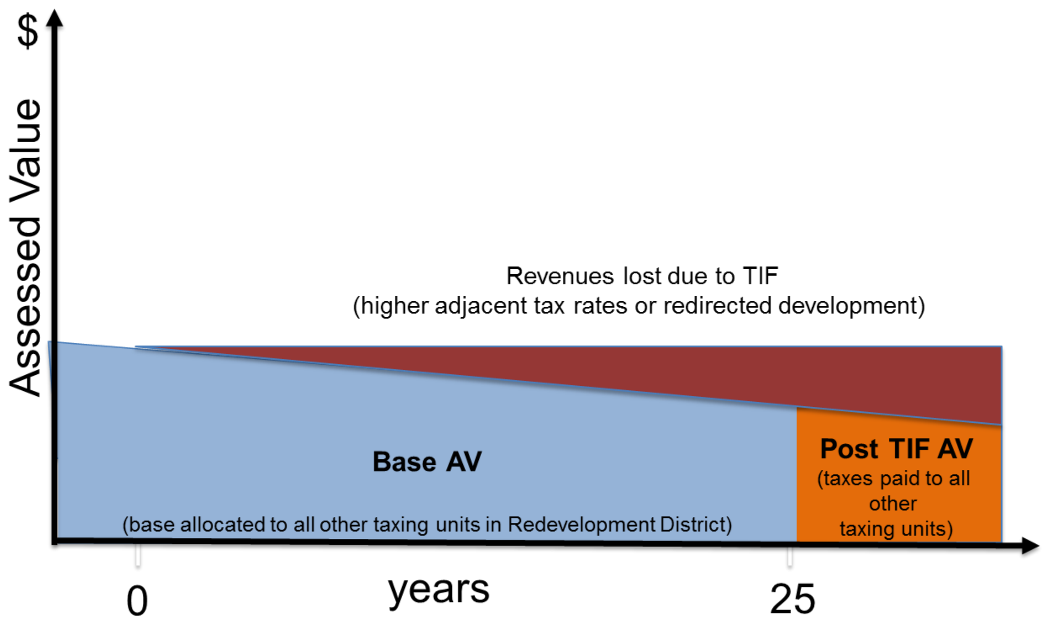
[1] See BLS Economic News Release, Table 8. Private Sector establishment births and deaths, seasonally adjusted. https://www.bls.gov/news.release/cewbd.t08.htm

subsidize with TIF a large sporting goods store. This led directly to the closure of two other sporting goods stores in the city. There are examples of this throughout Indiana. Evidently TIF use does not impact the demand for sporting goods.

In many instances, TIF has been deployed in the relocation of retail facilities. One result has been the proliferation of Big Box retail facilities, which are typically accompanied by the creation of a 'dark box' stores in other locations. It is likely that most Indiana communities facing 'dark box' assessment impact are in that position because of TIF. The impacts of TIF outside the redevelopment district appear in Figure 3.

Figure 3: TIF as it may actually be . . .
(impacts outside the Redevelopment District)



Research on TIF

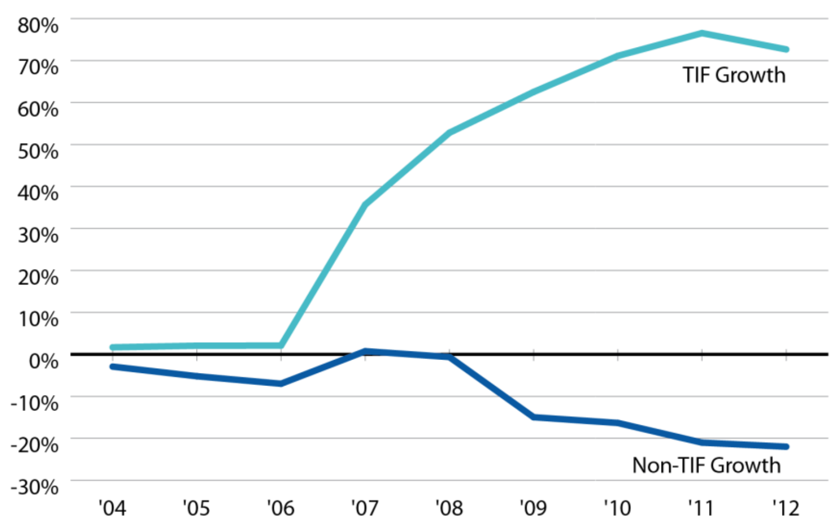
Over the past several years a significant amount of research and opinion about the efficacy of Indiana TIFs was published. Our studies on the issue have received ample press, and we will not detail findings. It is more important to understand what research questions do, and do not inform the issue, and what studies that ask the right questions conclude.

TIF districts have impacts beyond the property which lies within the Redevelopment (or TIF) District. The impacts of TIF, for good or ill, likely take more than a year or two to manifest themselves. This necessarily implies that short-term studies or those which do not examine the spillover effects of TIF adoption cannot speak to the policy issues of TIF.

Second, studies which do not assess both the fiscal and economic development effects miss the most critical policy issues. The various recent Indiana-focused TIF studies have found small positive or small negative economic and fiscal effects depending on the years examined and statistical methods used. We emphasis that the finding of each of these studies indicate that the impacts of TIF districts are *small*. None of these studies suggest that, in aggregate, TIF districts have large impacts on economic development outcomes. This has led us to conclude, as have other researchers, that TIF is really a local government budget management tool, devoid of broad, net economic development effects.

The strongest evidence of TIF as a budget management tool can be derived by examining one indicator. If TIF can be justified in a 'but for' case, meaning that the development would not otherwise occur without the use of TIF, then net growth in assessed value across counties should be perfectly correlated with the assessed value growth of TIF areas. In other words, if the 'but for' rule is actually followed, then every piece of new property in a TIF area would not otherwise have been placed in that county. In this case, assessed value growth in non TIF areas and TIF AV growth would be highly correlated. They are not, as the following figure clearly suggests.

Figure 4, Cumulative Assessed Value Growth in TIF and NonTIF Areas



Since the growth in TIF does not satisfy the 'but for' condition in an actual sense, there are likely other effects, including lost revenue to schools and other local governments and/or higher taxes on residents and businesses. Because this is necessarily true, we offer the following policy recommendations.

Policy Recommendations

In our opinion, the greatest danger to TIF is its frequent misuse and overuse. Still it remains among the few flexible local government budget management tools available to local government in Indiana. Thus, to protect it, reform is needed. We offer three reforms to loosen unnecessary restrictions, and three reforms to tighten oversight of TIF. These reforms are meant to provide both flexibilility and accountability.

Flexibility

- The ‘but for’ rule is meaningless. The only current metric for ‘but for’ justification is a vote by the Redevelopment Commission. Its use is meaningless and should be eliminated.

- Currently, TIF expenditures must be justified as relating to economic development. This too has no meaning, as such items as police body cameras have been purchased with TIF funds. Redevelopment commissions should be permitted to spend TIF monies without restrictions that bind other unelected government bodies.

- Current TIF districts may only collect taxes on incremental assessed value of commercial or industrial property. While this may be useful it ignores the potential greatest need in many communities, which is residential development. TIF should be expanded to include residential development—both new residential development and redevelopment of older neighborhoods.

The following recommendations address the management and flexibility of TIF oversight.

Oversight

- The practice of super abatements must be restricted. An increasing number of TIF deals structure the tax payments through ‘bonds’ which are purchased by the taxpayer. This simply recycles tax payments from the company, to itself in the form of a 25-year ‘super abatement.’ This suborns legislative intent of the current tax abatement legislation and undermines public confidence in TIF use.

- Lack of transparency of TIF adoption and expenditures remains significant. Taxpayers have no effective recourse to ascertain TIF expenditures and they are not aggregated by type in a location in which research or policy interest groups can effectively monitor. The TIF viewer on the “Indiana Gateway for Government Units” website offers no budgetary information, or historical information on TIF, and does not provide the year in which the TIF was created. This should be immediately updated to a database format which clearly displays revenue and spending items by redevelopment commissions across the state.

- Most importantly, the overuse of TIF removes revenue from elected bodies across 86 of Indiana’s 92 counties. An effective local government system demands a structure that prevents one taxing entity from capturing incremental assessed value growth from another. Thus, our most critical recommendation is that the capture of incremental value from any elected body be subject to a vote by that body. For example, if a city formed a TIF, the TIF would automatically receive the incremental assessed value growth which would, under normal taxing conditions flow to that municipality. Thus, it would require the redevelopment commission to secure votes from at least the county, school corporation and township to secure the full share of incremental revenue from the adoption of a TIF. This is a common process throughout the United States and would give distressed units the option of not giving up their portion of incremental AV growth. It would also require more transparent and detailed justification of projects by redevelopment commissions.

Of these recommendations, the final one in both areas is the most critical for successful resolution of a growing problem in Indiana: the overuse and misuse of Tax Increment Financing. The goals of these policy recommendations are to insure the continued availability of Tax Increment Financing, by reforming their use. We believe the current use of TIF misses its greatest and most important use, in the development and redevelopment of residential property. Further, we believe the current structure of TIF violates one of the most sacred elements of state and local governance by allowing an unelected body to capture tax revenues from local governments with elected bodies.