POLICY BRIEF

March 15, 2012
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Tax Increment Financing in Polk County

By Peter S. Fisher and Michael Lipsman

As Tax Increment Financing (TIF) faces new scrutiny this year by taxpayers, local officials and state legislators, it is important to understand how the TIF law has been used by different jurisdictions across the state. There is wide variation in TIF practice. Some cities use the program quite judiciously to aid development projects in targeted areas, and then release the incremental taxes, or most of them, to the schools, the county, and to other taxing authorities when the project has been paid off. Other cities have included most or nearly all of the city in a TIF area and continue to divert all TIF revenues long after the original project costs have been recovered. This divergence in practice is illustrated well in Polk County, as it was in an earlier study of Johnson County.[1]

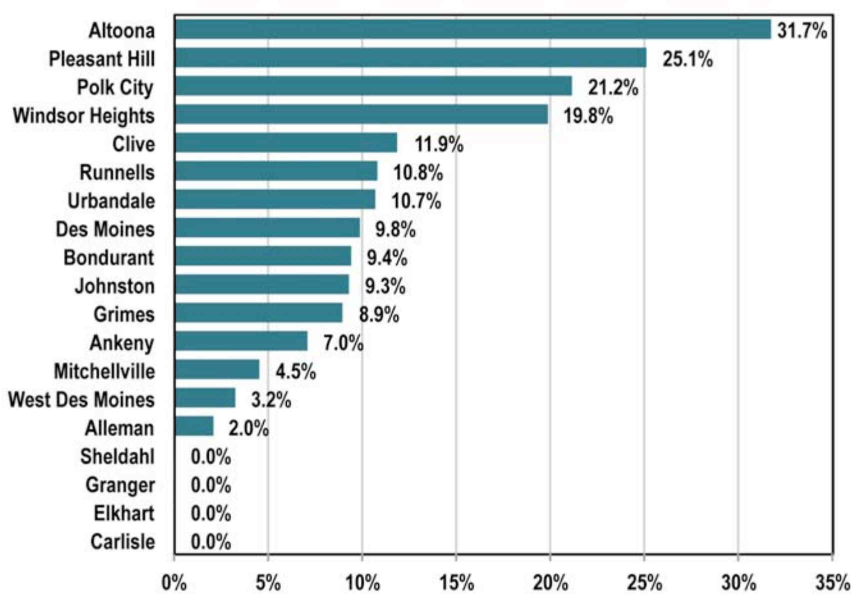
How does TIF work?

Under Iowa law, cities may designate “urban renewal areas” and then divert future increases in taxes within that area to the city’s TIF fund. A city may claim part of this expanded tax base exclusively for a designated TIF project. Tax revenues that would normally flow to all local governments — for regular school, county and city services — are diverted to help pay for their share of the additional costs associated with development. To make up for the lost revenue, counties and school districts must raise their own property tax rates.

TIF thus shifts costs to county and school taxpayers outside the city — and to state taxpayers, through state aid to local schools. Combined with loose stipulations on use of TIF, this creates strong incentives for cities to overuse and abuse TIF.

This report is an overview of how TIF has been used by cities in Polk County, and its effect on school and countywide tax rates. We focus in particular on the Southeast Polk school district, the district in the county that is by far the most impacted by the use of TIF.

Figure 1. Almost 1 in 3 Altoona Tax Base Dollars Locked in TIF District
Percent of Tax Base in a TIF Increment



Adjusted increment as a percent of total taxable value, for January 2011 valuations. Source: Polk County Auditor.

TIF Use in Polk County

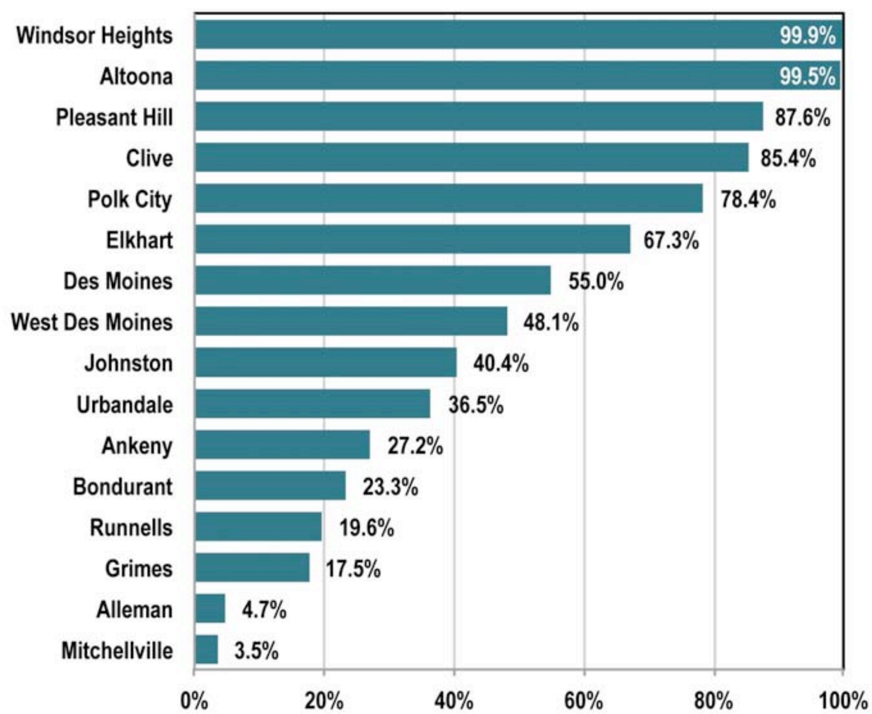
The TIF practices of some cities in Polk County demonstrate the need for TIF reform to ensure that the program is focused on its core purposes of redeveloping blighted areas and promoting economic development. As shown in Figure 1, significant shares of the property tax base of cities in Polk County are locked in a TIF district. As we will see, this has an impact on all jurisdictions that derive tax revenue and provide services to residents in those communities. In addition, the experience of Polk County shows that sensible reforms would not constrain the constructive and judicious use of TIF where it serves its original purpose. Without reform, however, we can assume that increasing numbers of cities will come to see TIF as a long-term mechanism for financing normal city infrastructure spending at the expense of taxpayers in other cities and rural areas. Besides the advantages of this tax shifting, which come about through higher county and school tax rates, TIF offers cities a way to circumvent referendum requirements for bond issues and to exceed the constitutional limitation on debt through the use of "annual appropriation" TIF bonds. The Polk County experience also illustrates dramatically the need to limit TIF areas to a single school district.

Figure 1 shows the percent of 2011 taxable valuation that was within a TIF increment, for each city in Polk County, with revenues from that increment being diverted to the city TIF fund. Altoona has the largest share of its taxable value in a TIF increment, followed by Pleasant Hill, Polk City and Windsor Heights. Four cities (three of which are located only partially in Polk County) have no TIF valuation in Polk County.

Cities also vary in whether TIF revenue is released to the county, school district, and other taxing authorities once the initial project costs have been paid. Figure 2 shows the percent of available TIF revenue (what the city could divert to its TIF fund if it claimed the entire increment in the TIF area) that is actually claimed by the city historically. These percentages are based on actual practice since each city's first TIF area went into effect and are therefore averages over that historical period. In the middle of the pack are Des Moines and West Des Moines, where about half of available TIF revenue is claimed each year. At the high end are Windsor Heights and Altoona, which claim virtually all available TIF revenue every year, while Pleasant Hill, Clive and Polk City have all claimed over three-fourths.

Figure 2. Some Cities Claim Almost All Available TIF Revenue

Percent of Available Incremental Revenue Claimed by the City



Adjusted increment as a percent of full increment for January 2011 taxable values; Source: historical data from Polk County Auditor.

It would be expected that a larger share of the available TIF revenue would be claimed in the early years of a TIF area, and that the share would decline or drop to zero as the project costs are paid for. Thus some of the cities might show a high percentage in the table because they have only recently established a TIF area. However, of the cities shown in Figure 2, all but Elkhart first established TIF areas at least 15 years ago. Windsor Heights has been diverting TIF revenue since 1990, Altoona since 1991. In these cities even the oldest TIFs continue to divert all or most of the available revenue.

The Effect of TIF on School and Countywide Property Tax Rates

In the current fiscal year, $18.8 million in taxes is being diverted by TIFs throughout Polk County from county government, the county assessor, Broadlawns Hospital, and the Des Moines Area Community

College. All of these entities impose countywide property tax levies, so all are affected by the 9.3 percent of county taxable value that is within a TIF increment. Table 1 shows the effect of the TIF diversions on the countywide tax levies. Since the tax base available to these entities is lower because of TIF, a higher tax rate on the remaining taxed area must be imposed to generate the same amount of revenue.

There is also a levy everywhere in the county for Des Moines Area Rapid Transit (DART). This levy ranges from 15 cents to 58 cents per thousand, and the effect of TIF is to raise this rate everywhere by about 10 percent, but the increase would vary, of course, in dollar terms.

Table 1. Maximum Potential Effect of All Polk County TIFs on Countywide Tax Levies, FY2012

Jurisdiction		TIF Rate Effect
Polk County	$	0.58
County Assessor		0.02
Broadlawns Hospital		0.27
Area XI Community College		0.06
Total Countywide rate effect	**$**	**0.93**

Source: Authors' calculations based on FY2012 non-debt levies by jurisdiction and total county adjusted TIF increment valuation.

Table 1 shows the maximum effect of TIF, assuming no TIF-inspired increase in the tax base. This also represents a maximum in the sense that TIF could cause other local governments to reduce services instead of increase tax rates. The actual effect of TIF financing per se is likely to be close to this number because (1) any use of TIF for normal city infrastructure purposes or tax-exempt facilities does not even purport to be the cause of an increase in the tax base; (2) where TIF is used to provide incentives for development that would increase the base, the city could have provided similar incentives in another fashion (such as normal general obligation (GO) debt or city assumption of land costs) that would have relied only on city tax revenues, had TIF not existed; (3) in many instances where TIF is used to incentivize development, the incentives were not actually necessary; and (4) in many instances where TIF was necessary, it was used to induce development that could not be supported by the market, which results in the new project cannibalizing sales from existing properties in the region, which drives down their taxable values.

Overall, TIF use has driven up countywide tax levies by as much as 93 cents per thousand dollars of taxable value. This represents almost a 10 percent increase in the overall tax rate for these four entities or about $200 on a business assessed at $200,000.[2]

In the case of school districts, the effects are more clear cut. Under state law, school districts are constrained to spend a certain amount per pupil ($5,883 in FY2012). They must impose a base levy of $5.40 per thousand dollars of taxable value, and the state aid formula then makes up the difference between what the district can raise with this property tax levy and 87.5 percent of the allowed per pupil spending ($5,148 in FY2012). For the remaining 12.5 percent, the district is on its own, and must levy whatever additional rate is needed to generate the remaining $735 in allowed per pupil spending. Because TIF lowers a school district's tax base, it lowers the revenue obtained from the foundation levy of $5.40 and this automatically produces an increase in state aid: See Figure 3. TIF also forces up the additional levy rate (as well as the management levy) — with a lower base, a higher tax rate is needed to generate the remaining 12.5 percent of costs.

Figure 3. TIF Increases State School Aid as Diverted Property Value Limits Revenue from Uniform $5.40 School Levy

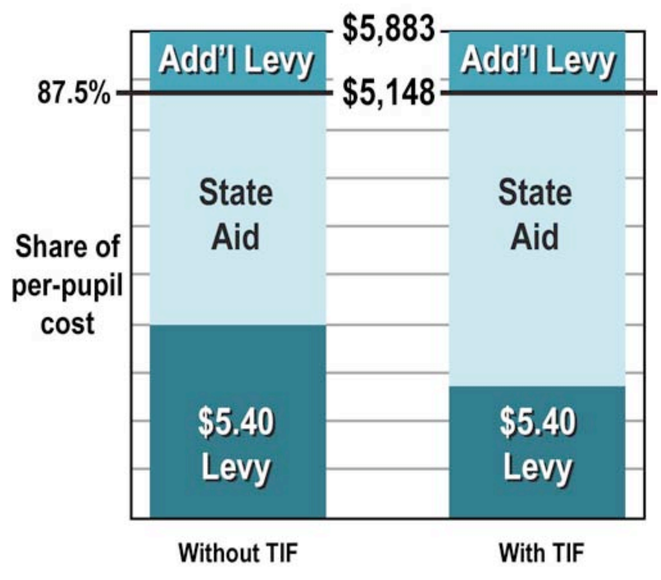


Table 2 shows the effect of TIF on school property tax levies. Southeast Polk is by far the district most affected. TIF diverts $1,014 per pupil in property taxes, forcing the school tax rate up by $2.86 per thousand. The effect of TIF is to increase the school levy by 15 percent, making it the highest school tax levy in the county.

Table 2. TIF Diverts Polk County School Taxes by Hundreds of Dollars Per Pupil in Most Districts, FY2012

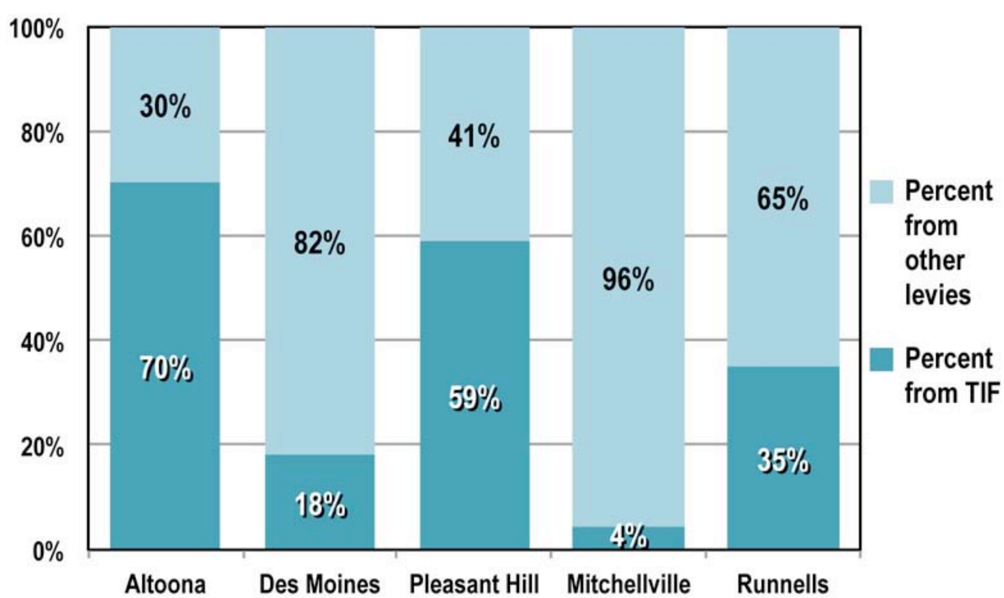
District	TIF Valuation	Total School Levy Rate	Additional & Management Levy Rate	Impact of TIF on Levy Rate	Percent Increase in Levy Rate	Diverted Taxes per Pupil
Southeast Polk	339,747,330	21.66	7.07	2.86	15.2%	1,014
Bondurant-Farrar	41,642,020	19.83	5.44	1.51	8.2%	479
Des Moines	637,913,680	18.35	7.73	1.06	6.1%	358
North Polk	32,757,140	19.85	5.98	0.96	5.1%	366
Johnston	133,946,540	17.35	4.57	0.65	3.9%	318
Ankeny	162,080,600	21.07	5.05	0.75	3.7%	310
Dallas Center-Grimes	55,327,592	16.54	4.70	0.55	3.5%	348
Urbandale	73,741,000	17.64	4.48	0.51	3.0%	292
West Des Moines	258,276,420	13.85	3.62	0.40	3.0%	350
Woodward-Granger	3,264,331	19.75	5.99	0.16	0.8%	63
Saydel	3,925,000	13.98	3.15	0.04	0.3%	37
Carlisle	711,700	20.65	6.78	0.03	0.1%	6

Note: The table omits school districts primarily in adjoining counties that have only a handful of students in Polk County (Ballard, Collins-Maxwell, Madrid, and PCM).
Source: Iowa Association of School Boards, Excel spreadsheets: "FY 2012 Impact of Tax Increment Financing (TIF) Districts on State General Fund and School Additional Levy Property Tax Rates", and "FY12 IASB Property Tax Rates."

The Effects of TIF on the Southeast Polk School District

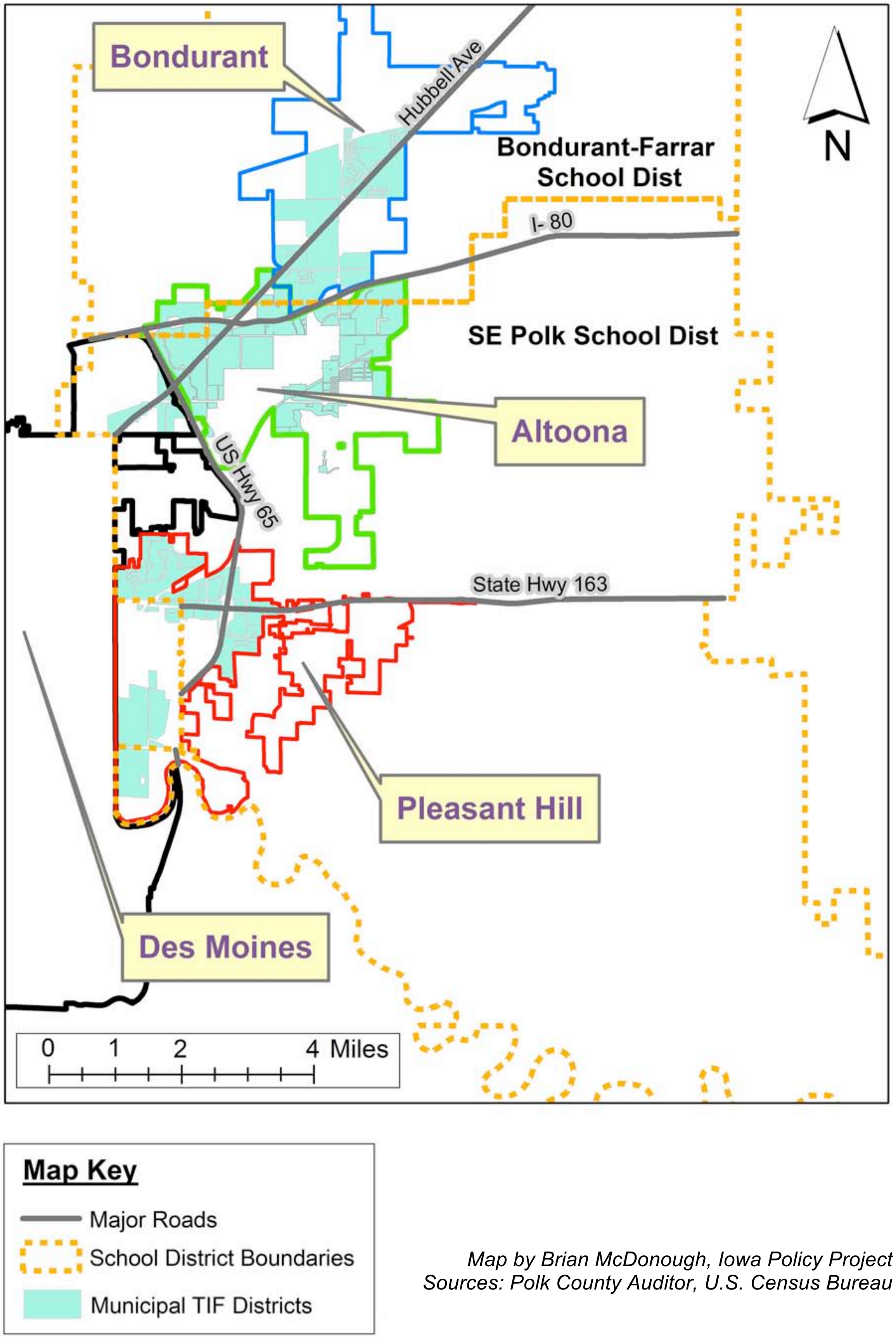
Southeast Polk School District experiences the largest impact from TIF because it includes the two Polk County cities that have used TIF most aggressively: Altoona and Pleasant Hill. As we saw above, these cities have more of their tax base in a TIF increment than any other, and they historically have claimed most or all of the available increment. In both cities, TIF property tax revenues now provide more revenue to the city than all other levies combined (see Figure 4). Of all property taxes flowing to the city, TIF revenues account for 70 percent in Altoona, 59 percent in Pleasant Hill. This compares with just 18 percent for Des Moines.

Figure 4. Share of Property Taxes from TIF vs. Gen. Fund & Other Levies



For FY2012. Source: City Budget Forms, available on the Iowa Department of Management web site http://www.dom.state.ia.us/local/city/budget_search/index.html

Figure 5. Municipal TIF Districts in Southeast Polk & Bondurant-Farrar School Districts



Map by Brian McDonough, Iowa Policy Project
Sources: Polk County Auditor, U.S. Census Bureau

Altoona in particular has been aggressive in the use of TIF, using TIF revenues to finance nearly all city capital projects financed with debt. Of the total debt service payments that the city is responsible for in FY2012, 95 percent is covered by TIF revenue, only 5 percent by the debt service levy or other sources. TIF revenue has been used to provide property tax rebates and incentives to the tune of $1.6 million in the current fiscal year, but the bulk of TIF revenue ($8.2 million) goes to retire bonds. Those bonds have financed the Bass Pro Shops store and associated land and infrastructure totaling about $56 million; they have also paid for a new library, a sports complex, improvements to the recreation center, and a variety of road improvements, some associated with an economic development area, some not. Much of the debt is for facilities that will never be on the tax rolls and that most cities would finance with non-TIF debt.

As of the end of last fiscal year (June 30, 2011) Altoona had used up 82 percent of its general obligation debt capacity. Total general obligation and TIF debt, plus developer rebate agreements subject to the debt limit, totaled $43.7 million, compared to a constitutional debt limit (5% of total assessed valuation) of $53.2 million.[3] To avoid exceeding the debt limit, the city issued the $56 million in TIF bonds for the Bass Pro store in 2008 as "Annual Appropriation Urban Renewal Tax Increment Revenue Bonds." With annual appropriation debt the city is allowed to count only the current year's debt service towards the constitutional debt limit. If they had issued the bonds as normal TIF bonds, they would have had over $100 million in TIF and GO debt, exceeding their debt limit by $47 million.

While legal, such annual appropriation debt creates the fiction that the city is not obligated to any debt payments beyond the current year; while technically this is true, everyone knows that the city cannot default on those debt payments without jeopardizing its ability to issue bonds in the future, and that it does treat them as an obligation just as much as GO debt – if it did not, the bonds would not have been saleable. It is difficult to view annual appropriation debt as anything other than a legal gimmick to circumvent the constitutional debt limit.

Both the Bass Pro Shops debt and the use of TIF for financing facilities such as libraries and soccer fields are inconsistent with the basic principle of TIF. The rationale for TIF is that the city will use the TIF revenue diverted from other jurisdictions temporarily to recover the city's cost of development projects that will increase the tax base of those jurisdictions. Under this rationale, when the city's costs are recovered, the revenue diversion no longer is justified and those revenues should be released to the school district, the county, and other entities.

What Altoona and many other cities have done is to use TIF to finance projects that will never add tax base to the school district. This happens in two instances: (1) when the city continues the revenue diversion after an economic development project has been paid for and uses the revenue to build public facilities that are tax exempt, and (2) when the city uses TIF revenues from within the SE Polk district to subsidize private development that will eventually provide tax revenues, but is located not in SE Polk but in the Bondurant-Farrar school district. SE Polk taxpayers are thereby required to pay higher taxes for over three decades in order to eventually create additional tax base and lower school taxes for the residents of the Bondurant-Farrar school district. The Bass Pro Shops bond issue is for 35 years, with the final payment ($15 million) not due until 2043.

This result is possible because the state TIF statute places no limitations on the scope of a TIF district or on the ability of a city to combine existing districts. Altoona was able to consolidate all 16 of its TIF areas into one large TIF area, which enables them to use the incremental revenue from one area to pay for development projects in another area when those projects could not pay for themselves. This is most problematic when most of the TIF revenue currently is coming from the Southeast Polk school district TIF areas, but a large share of it is being spent in one small TIF area in the Bondurant-Farrar school district — the TIF created for Bass Pro Shops. The Bass Pro Shops bond issue accounts for over a quarter of all the TIF debt that Altoona is paying off, yet it is being retired from city-wide TIF revenue. Since 87 percent of the Altoona TIF increment value is located in the Southeast Polk district, the bulk of the cost of the Bass Pro Shops project is paid for in higher school taxes on residents of Southeast Polk (as well as by taxpayers countywide through higher county levies). Those residents will never benefit from the tax base accounted for by Bass Pro Shops, if in fact such base is still there to be taxed in 2043.

The various TIF projects in Altoona within the Southeast Polk District diverted $4.2 million in revenue from the school district in FY2012, representing 68 percent of the TIF revenues diverted from the district that year (see Table 3). The Altoona TIFs are responsible for an increase in the school tax rate of $1.94 per thousand, spreading the cost of Altoona's TIF projects across all taxpayers in the Southeast Polk District. Altoona accounts for 50.6 percent of the total property valuation; but this means that nearly half the valuation is elsewhere, which in turn means that nearly half of the $4.2 million tax cost of Altoona's TIF projects is paid by taxpayers outside the city of Altoona.

Table 3. TIFs Cause $2.86 Levy Increase in the Southeast Polk School District

	Altoona	Pleasant Hill	Other	Total
Total Taxable Value Within School District				
TIF Area: Base	123,231,512	58,545,456	40,235,708	222,012,676
TIF Area: Increment	230,898,360	106,388,730	2,460,240	339,747,330
Outside TIF Area	358,950,691	99,431,677	389,010,928	847,393,296
Total	713,080,563	264,365,863	431,706,876	1,409,153,302
Tax Revenues				
TIF Area: Non- Diverted	6,172,647	3,162,775	1,923,121	11,258,543
TIF Area: Diverted	8,598,380	4,116,876	97,557	12,812,813
Outside TIF Area	14,970,361	4,379,802	15,759,223	35,109,386
Total	29,741,388	11,659,453	17,779,901	59,180,742
City TIF Revenues: Taxes Diverted From				
County & County Assessor	1,492,220	687,555	15,900	2,195,675
Southeast Polk Schools	4,193,715	1,932,296	44,684	6,170,695
City	2,020,885	1,094,740	27,607	3,143,232
Other*	891,561	402,285	9,172	1,303,018
Total	8,598,380	4,116,876	97,363	12,812,619
Percent of total for Southeast Polk				
Total Taxable Value	50.6%	18.8%	30.6%	100.0%
TIF revenues diverted	68.0%	31.3%	0.7%	100.0%
Increase in school tax rate, $ per thousand, due to city TIF	**1.94**	**0.90**	**0.02**	**2.86**

**Broadlawns Hospital, Des Moines Area Community College, and Des Moines Area Transit.*
For FY 2012. Source: Taxable value by TIF area, from Polk County Auditor. Tax rates from Iowa Department of Management .

Pleasant Hill accounts for another $1.9 million in school taxes diverted in FY2012 from Southeast Polk to city TIF projects. This raises the school tax rate another 90 cents per thousand. Pleasant Hill, however, accounts for only 18.8 percent of the district tax base, so the vast majority of the $1.9 million in Pleasant Hill TIF costs are shifted to taxpayers outside the city of Pleasant Hill, including Altoona and the smaller cities and rural areas.

Tax shifting is an integral part of TIF; it is unavoidable when cities are allowed to divert taxes from overlying entities — school districts, community colleges, transit authorities, the county — which are then forced to raise taxes to make up for the lost revenue from the increment. Residents of those broader jurisdictions — inside and outside the city — thus pay higher taxes. And when TIF is working as it should, this is justifiable. The diverted taxes are paying for the city's cost of development projects that otherwise would not have existed, and that development will add tax base that each of those overlying entities will benefit from down the road.

What we see in too many instances, however, is the continued diversion of revenue long after the project has been paid for, so that the other entities are denied a benefit from the increased tax base that they should eventually receive. At that point TIF becomes a cash cow for the city — a mechanism to shift a city's ongoing costs to taxpayers outside the city. We are also seeing, in the case of Altoona, that the TIF diversion can be unjustified from the start, because the district losing revenue will never benefit from the increased tax base.

Conclusions and Policy Recommendations

The effect of TIF on the Southeast Polk School District illustrates clearly the need to prevent TIF areas from becoming cash cows for the purpose of financing city infrastructure at the expense of taxpayers living outside the city. This could be accomplished by requiring:

- that TIF projects be subjected to a "but for" test to demonstrate the likelihood that the project could not proceed without TIF incentives or subsidies
- that TIF projects produce an increase in taxable value
- that TIF areas be narrowly confined to the area that will directly benefit from TIF-financed improvements
- that TIF revenues be used only to retire original TIF project debt, and
- that the TIF diversion end once that project debt has been retired.

These requirements would effectively make all TIFs into project-based TIFs, which is what many TIFs are currently, including very successful ones and including all tax rebate TIFs. The restrictions would not in any way interfere with the legitimate use of TIF to stimulate development that adds to the tax base. They would in fact ensure that TIF be used *only* for such purposes. Nor would they interfere with a long-term redevelopment effort that requires multiple investments. If a second project is undertaken within the same TIF area, the base valuation for determining the increment for that project would be the taxable value as of the year preceding the issuance of debt for that second project, and so on. This is already how rebate TIFs work.

The Altoona experience also illustrates clearly the need to prohibit creation of TIF areas that span more than one school district. Consideration should also be given to other forms of limitation on TIF areas, in terms of the percent of taxable value or geographic area that can be included, and a requirement that all TIF debt — including so-called annual appropriation debt — be included in calculating those limits. To avoid grandfathering in a vast number of TIFs that have already become cash cows, existing TIF areas should be subject to a sunset, regardless of the law under which they were created, so that all cities, including those that have abused the system the most, will at some point have to begin playing under the new rules.

[1] Peter S. Fisher, *Tax Increment Financing: A Case Study of Johnson County*, Iowa Fiscal Partnership, November 21, 2011. http://www.iowafiscal.org/2012docs/111121-TIF-JC.pdf.

[2] It is, of course, possible that TIF has to some extent produced a reduction in services rather than an increase in the tax rate. To put it another way, if these entities could fully tax the increment the result would no doubt be some reduction in the tax rate and some increase in services provided.

[3] *City of Altoona, Independent Auditor's Reports, June 30, 2011*, p. 12.

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