

Executive Summary

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The Right Tool for the Job? An analysis of Tax Increment Financing

Overview

Tax Increment Financing (TIF) is an economic development tool that uses the expected growth (or increment) in property tax revenues from a designated geographic area of a municipality to finance bonds used to pay for goods and services calculated to spur growth in the TIF district. The analysis performed for this study found TIF does not tend to produce a net increase in economic activity; favors large businesses over small businesses; often excludes local businesses and residents from the planning process; and operates in a manner that contradicts conventional notions of justice and fairness. We recommend seeking alternatives to TIF and reforms to TIF that make the process more democratic and the distribution of benefits more fair to residents of TIF districts.

1. Tax increment financing (TIF) is seldom evaluated from a community perspective.

Tax Increment Financing (TIF) is an economic development tool that uses the expected growth (or *increment*) in property tax revenues from a designated geographic area of a municipality to finance bonds used to pay for goods and services calculated to spur growth in the TIF district. It is widely heralded as “one of the last remaining fiscal devices for repairing areas of the city afflicted by urban decay.” But TIF is also a controversial tool.

Evaluations of TIF typically focus only on the number of new jobs thought to be created in the TIF district and how much property values rose. Such evaluations overlook what happens to community residents and to areas surrounding the TIF district. Were community residents given an opportunity to apply for the new jobs? Were these jobs genuinely new, or were they simply shifted into the district from surrounding areas? Did the jobs pay as well as the jobs that may have been displaced?

Our work provides the basis for public understanding and discussion of TIF from a community standpoint. We studied five TIF districts in Chicago and the neighborhoods surrounding them to show how a community-centered analysis might be performed. The case studies included both qualitative data on neighborhood-wide changes and interviews with individuals and organizations affected by the TIF district. We also performed a policy analysis, examining TIF law to see what types of development TIF would best be able to facilitate, and what types it can perform only with great difficulty.

2. TIF has only a limited impact on economic development.

The five case studies found TIF increased land values. However, the case studies also found:

TIF did not consistently increase the number of businesses: Two of the three commercially oriented TIF districts and their surrounding areas experienced a net loss in businesses. The third had a net increase, but at a rate slower than the city average. The two residentially oriented TIF districts and their surrounding areas saw net increases in number of businesses above the city average.

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TIF tended to increase residential property sales: Three of the five TIF districts and their surrounding areas saw dramatic increases in the number of residential sales, well above the citywide rate. Two reported small decreases.

TIF's impact on housing prices was mixed: In some instances, median housing prices increased faster than the citywide median, in other cases slower. In the two residential TIF districts, the sale prices of the TIF-subsidized housing were considerably higher than the citywide median.

3. TIF takes power away from long-time community residents and small businesses and puts it in the hands of a much smaller group of political and economic interests often located outside the community.

The legal rules for establishing TIF districts are so flexible and almost capricious that they give government officials and developers arbitrary authority over long-time community residents, an arrangement that poses a significant risk to the freedoms of the latter. The "but for" clause is a legal fiction with little basis in economic reality. Elected officials are free to create TIFs almost at will.

TIF legislation and regulations provide few opportunities for access and input by the public, and often invite public participation only after major decisions have been made. This means the voices, interests, and ideas of the largest part of the community are missing from the planning process. Economic development plans produced without this input cannot be as successful as those created spontaneously by markets or democratically through a truly open political process.

TIF, by making it easier to use the power of eminent domain to condemn and take properties that stand in the way of someone's vision of development, poses a threat to the owners of homes and commercial buildings. This power lifts a small group of elected and unelected officials and developers above the usual checks, balances, and limitations that discipline other agents in both the public and private sectors.

4. TIF creates winners and losers.

Although its advocates say the revenue from TIF is “free,” we recognize there is no such thing as a free lunch. TIF simply shifts the cost of lunch to someone other than the eater. Among the winners created by TIF are property owners and business owners who help design and implement the TIF plan. Often these are individuals and companies based outside the community, and increasingly they are national corporations. The losers are small business owners, landowners who face condemnation, and low-income renters who are forced to leave the community to find affordable housing.

Interviews conducted for the Chicago-area case studies show how TIF puts political and economic power in the hands of some interest groups. In general, the larger and older a group was, the better it felt about its participation in TIF planning. Smaller groups, or those on the political outside, usually felt dissatisfied with the participatory process. Many existing local business owners also felt shut out of the process. Smaller organizations and businesses that could not access the process thought the distribution of benefits was less fair.

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5. TIF violates conventional notions of justice and fairness.

Communities consist of people as well as places. Their residents are united by interests as well as geography, though often those interests do not exactly coincide. To celebrate community is not to justify all opposition to change or to romanticize old neighborhoods, but to recognize that *current* residents and business owners have the right to participate in decisions that affect their communities. They’ve earned that right. Decision-making procedures must be designed to give them meaningful participation.

TIF threatens communities when it prevents people from being able to participate in collective decision-making at the community level and to be recognized for their contributions. It damages communities when it compels people to sell their property and leave the neighborhood, breaking the many invisible bonds that make neighborhoods safe and life worth living. And it undermines communities when it moves authority outside the neighborhood, giving it to people whose interests are different from those of the people affected by their decisions.

Two definitions of justice that win widespread support are equal treatment under the Rule of Law, and justice as fairness. The three historical tests of just laws are that they be negative, general, and unchanging. The case studies found TIF failed to meet all three tests. The case studies also show TIFs fail the test of justice as fairness because those who propose and implement them would seldom choose to change places with the small business owners who face subsidized competition, low-income renters who are forced to leave the community, or property owners whose buildings are condemned to make way for a more-favored developer.

6. Four recommendations for policymakers.

We offer four recommendations to communities seeking to spur economic growth:

1. **Consider alternative strategies before choosing TIF.** Tax increment financing has not proven effective at generating jobs or new businesses. It has an ambiguous effect on housing markets, but usually harms low-income renters and homeowners. Methods of encouraging economic development that are more compatible with the goals of stable and healthy communities and justice, and that allow community members to peacefully pursue their own visions of their community's future, ought to be pursued first.

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2. **Provide better information to the public about the effects of TIF.** Until now, there has been little data collected and reported to the public about the impact of TIF in Chicago. This project has shown that such analysis is possible and enlightening. Additional analysis would be a simpler task for government bodies who have more resources at their disposal than the groups in this project.

3. **Make TIF decision-making procedures more inclusive and fair.** Much of the damage done by TIF occurs because public access is limited and comes too late in the process to affect key decisions. Decisions involving TIF should be made openly and transparently. Municipalities receive considerable powers through TIF, so special review procedures are justified to ensure these powers are used well.
4. **Distribute the benefits of TIF more fairly.** The fact that TIF creates winners and losers, rather than being a "win-win" process, is a major problem that can be addressed only partially by reforms. In some cases, "distributing the benefits of TIF more fairly" may mean not using TIF at all. In cases where TIF is used, the potential for abuse or unfairness in a TIF district could be minimized if companies that benefit from redevelopment agreements were required to hire locally and pay wages and benefits sufficient to allow community residents to stay in their community, if they so choose. Local business owners in the community should have a right to participate in plans that might adversely affect them by raising rents or subsidizing new competitors.

Based on *The Right Tool for the Job? An Analysis of Tax Increment Financing*, a report by the Developing Neighborhood Alternatives project. Copies of the 60-page report and a 59-page Appendix presenting case studies of five Chicago-area TIF districts are available for \$20 each. To order, contact The Heartland Institute at 312/377-4000, the Center for Economic Policy Analysis at 312/786-1825, the Jewish Council on Urban Affairs at 312/663-0960, or the Statewide Housing Action Coalition at 312/939-6074.

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