Tax increment financing

Overview

Tax increment financing (TIF) originated as a vehicle for issuing bonds to fund the redevelopment of blighted areas which are designated as TIF districts.

A jurisdiction starts by creating a TIF district with well-defined boundaries, and then issues bonds to pay for public infrastructure improvements and other amenities to stimulate private development within the district. The bonds are backed by the anticipated TIF revenue, and repaid with incremental tax receipts as private development activity increases. Alternatively, some jurisdictions use their own funds to pay for improvements, and then capture some or all of the increase in property tax receipts over the duration of the TIF district as reimbursement.

A number of cities, towns and counties now include development or preservation of affordable housing as part of the public infrastructure to be supported by a TIF district and require that a share of TIF revenue be used for these purposes. In addition, while not yet a well-established use of TIF, Texas has established a TIF-like structure that can be used in gentrifying areas, with the intention of capturing incremental tax revenue to build or preserve increasingly scarce affordable housing units. This strategy may be
well-suited to neighborhoods around proposed transit stations and other gentrifying areas when the public investment is likely to lead to property value increases.

Tax increment financing is most likely to be a useful tool in cities that can identify specific neighborhoods that meet state and local standards (e.g., for blight or other threshold requirements) and are likely to experience rising property values that could be tapped to create or preserve affordable housing. This section describes some of the key decisions for local jurisdictions considering use of tax increment financing to support affordable housing.

**Approach**

TIF districts are an important source of funding for affordable housing in some cities, towns and counties. However, they can be controversial because some or all of the increased tax revenue in the district is diverted to a special TIF fund and is not available for the same activities that other property tax revenue is used for, such as public schools, police and public safety, and recreational facilities. The assignment of school tax revenue to a TIF can be a particularly challenging flashpoint, as opponents may argue the funds are needed to meet the needs for teachers and school infrastructure to accommodate a growing population.

One way to address these concerns is to focus a TIF on a district where increases in tax revenue would be unlikely without the increased public investment resulting from the TIF. In such cases, the TIF district is generating new revenue, not diverting revenue that would have occurred even in its absence. An alternative approach may be to limit the use of TIF revenue to specified activities, and require that any excess revenue be returned to the school district (or other tax district). Cities can also negotiate for the TIF district to include only the incremental tax revenue from specific revenue sources and not others. This helps ensure that other needs can be met, including and especially any new needs related to the TIF itself (for example, new schools associated with an influx of children resulting from the TIF activity).

There are several ways to use TIF to support affordable housing. In many cases, cities authorize a wide range of uses for TIF revenue and do not require a minimum percentage of the revenue to be used for affordable housing. While the revenue from these TIF districts are sometimes used for affordable housing, this approach is less reliable in generating funding for affordable housing than TIFs that specify, when they initially create the TIF district, that a minimum percentage of TIF revenue must be
used for affordable housing-related activities. Under this approach, as investment in economic development or infrastructure improvements leads to growth in the tax base, a portion of the incremental proceeds is put into a special fund and used to ensure the continued availability of affordable housing. It is important to establish this allocation early in the process – ideally when the TIF district is authorized – to ensure the appropriate amount of funds will be reserved for the designated affordable housing purpose.

Cities, towns and counties can also tie affordability requirements to the number of housing units developed in a TIF district, for example, requiring at least 15 or 20 percent of the units be affordable to people at a certain income level. This approach is consistent with the approach in many cities that requires residential developers who benefit from certain public benefits, such as a zoning change or variance or public financing, to set aside a share of units for lower-income households. Going a step farther, some states allow the creation of affordable housing TIF districts established solely to support the creation and financing of new affordable housing. For example, the Affordable Housing Tax Increment Financing (AHTIF) Program in Maine can be used to cover the capital and operating costs of affordable housing and public infrastructure improvements inside the AHTIF district, as well as supportive services for residents of the affordable housing and recreational and childcare facilities.[1]

One challenge with using a traditional TIF structure in a high-cost city is that state authorizing legislation typically requires the area in which the district is located to be “blighted.” This helps increase the chances that the TIF revenue is coming from increases in property taxes that would have been unlikely without the investment. However, the concept of capturing incremental tax revenue could hold appeal in high-cost cities as well, if focused on areas that are gentrifying or in danger of gentrifying. In these situations, property values are set to rise on their own, without a public investment funded by TIF revenue, and affordability is likely to decline. If a TIF or TIF-like district could be created, some or all of the increased property taxes associated with the influx of higher-income households could be used to provide affordable housing, helping to preserve and expand affordable housing in that neighborhood.

If the jurisdiction lacks the legal authority to create a TIF district in a non-blighted area, it may be possible to create a TIF-like vehicle to capture some or all of the incremental property tax increases in gentrifying neighborhoods. Texas’s Homestead Preservation District (HPD) program is a primary example of this approach. Texas has authorized certain municipalities to create HPD districts, within which the city can provide bond financing, density bonuses, and other incentives to preserve and create new affordable housing, including creation of a TIF-like district dedicated solely to development and
preservation of affordable housing. Eligibility for designation as an HPD is limited to areas that have an overall poverty rate that is at least twice the poverty rate of the municipality; creation of the district is intended to protect existing residents from displacement as property values rise. When applied in gentrifying areas, this approach allows a significant amount of revenue to be rapidly generated and used to address a concentrated problem.

Coverage
Typically, the state legislation that authorizes creation of TIF districts also specifies coverage guidelines. For example, states may require that TIFs meet a minimum or maximum size threshold, or contain certain development types (e.g., commercial, industrial, etc.). States may also limit the percentage of land area within a municipality that can be designated as a TIF district. In some cases, TIF district boundaries are permitted to be non-contiguous, allowing parcels to be covered by the same TIF if they meet specified criteria. The maximum duration of the TIF—generally between 20 and 30 years—is also generally established at the state level.

Eligibility
Whether TIF districts are designed to promote investment in affordable housing or for another purpose, they are generally subject to two fundamental eligibility requirements. First, as mentioned above, designation of TIF districts is traditionally limited to “blighted” areas. Blighted areas are corridors, neighborhoods, or blocks that meet specific criteria for disinvestment and decline, such as an excessive number of code violations, inadequate utilities, extensive vacancies and/or dilapidated or deteriorated buildings and infrastructure.

Second, proposed TIF districts need to pass the “but for” test, meaning that economic growth would not take place “but for” the public investment associated with establishment of the TIF district. Where these conditions are not met, TIFs may be viewed as diverting tax revenue that would otherwise be used for other important public investments, such as schools or transportation infrastructure.

Once these criteria have been established, typically at the state level, cities, towns, and counties need to determine the duration of the TIF district (e.g., 15 or 20 years), the share of TIF revenues to be set aside for affordable housing during this period, and the specific activities that will be supported. Depending on state regulations and local priorities, TIF revenue can be used for a wide range of purposes – from homeownership or rental assistance to gap financing for new construction, acquisition and rehabilitation, and/or preservation of affordable housing. Cities, towns, and counties may consider allowing many types of assistance, recognizing that housing
needs will shift over time as the area experiences growth and increases in property values. By definition, TIF supports development in areas where property values are expected to increase, so affordability restrictions should be established for the longest feasible time period.

Cities, towns, and counties will also need to specify where TIF proceeds can be spent on affordable housing activities. Some cities, towns, and counties require TIF proceeds to be spent within the TIF district in which they are generated, while others allow their use in any TIF district within the jurisdiction. Other cities, towns, and counties don’t place any restrictions on the location of eligible projects, and may even deposit TIF proceeds in a housing trust fund to be allocated according to trust fund guidelines.

**Examples**

- Through the Multi-Family TIF Purchase-Rehab Program, the City of Chicago allocates TIF revenues to support the redevelopment of vacant and foreclosed apartment buildings within specified TIF districts as affordable housing. Private developers are eligible to receive grant funding of up to 50 percent of the total project cost, and eligibility is limited to the purchase and rehabilitation of buildings with six or more units where “substantial rehabilitation” is required. (To reach the six-unit threshold, developers may group together smaller buildings in a two-block radius.) The redeveloped units must remain affordable to households earning up to 50 percent of the area median income for a period of at least 15 years. The city partners with Community Investment Corp, a private lender, to manage the program. For more details, click here.

- The State of Minnesota authorizes cities and counties to create housing TIF districts in which incremental tax revenue may only be used to finance housing projects for low- and moderate-income individuals. Eligible activities include acquisition, construction, or rehabilitation of affordable housing, as well as professional costs and public improvements directly related to the affordable housing developments. Incremental tax revenue can be collected for 25 years after the receipt of the first increment, although collection may be postponed for the first four years to avoid using the duration limit when only a small amount of tax increment is likely to be generated. For more details, see here.

- In Texas, cities can create Tax Increment Reinvestment Zones (TIRZ) that do not need to meet any minimum criteria for blight. Eliminating the blight requirement opens up new possibilities for the application of tax increment financing, including in gentrifying areas where the incremental tax revenue can be used to help preserve affordable housing. Texas’ approach differs from other states in other ways as well. Each taxing unit within a TIRZ may negotiate the portion of the tax increment that
will be dedicated to public improvements – an approach that allows more flexibility but may also make the TIRZ more complex to administer and possibly limit its revenue potential. In addition, private property owners can petition for the creation of a TIRZ when they own at least 50 percent of the appraised property value within the proposed TIRZ. To support affordable housing in large cities, privately-initiated TIRZ zones are required to allocate at least one-third of the area to housing, and one-third of tax revenues to low-income housing. For more details, click here.

Related resources

Implementation

- An Elected Official’s Guide to Tax Increment Financing, Government Finance Officers Association (2005) – This booklet is structured as a series of questions that address major considerations in establishing a TIF district – including the type of projects they support, how they are financed and monitored, and considerations related to TIF-related bonds, such as the ideal debt coverage ratio and criteria used by rating agencies to evaluate TIF bonds.

- Tax-Increment Financing: The Need for Increased Transparency and Accountability in Local Economic Development Subsidies, U.S. PIRG Education Fund (Fall 2011) – While not specific to the application of TIF in support of affordable housing, this report lays out some of the major critiques of tax increment financing and offers suggestions for how to promote better stewardship of public funds.

- Tax Increment Financing: Tweaking TIF for the 21st Century, Urban Land Institute (June 2014) – This article provides a practical overview of how to structure a TIF program, including examples from Chicago, Atlanta, and California.

2. Texas Local Government Code, Title 12, Subtitle A, Chapter 373A. Homestead Preservation Districts and Reinvestment Zones. As of November 2017, expansion of the program has stalled in Austin due to a provision in the existing legislation that limits the size of the city in which Homestead Preservation Districts can be created. Since the legislation passed in 2005, Austin has grown and passed that threshold, and efforts to amend the legislation and raise the cap have been unsuccessful.

See also:
Demolition taxes and condominium conversion fees
State tax credits for affordable housing
Linkage fees/affordable housing impact fees