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TIF Creep Means Growing Costs, Less Accountability

By Pam Thomas

Tax increment financing (TIF) is a common method for financing economic development that uses increased tax revenues after property is redeveloped to help pay for the costs of development. Kentucky started using TIF as a means to finance projects in 2000, with a menu of incentives that are much more generous than those offered in other states. Since 2000, the legislature has amended Kentucky's TIF laws numerous times to relax standards, decrease accountability and make benefits more generous.

This continuing "creep" of the TIF program is concerning because the fiscal impact is growing quickly and there is little evidence the incentives actually result in increased economic activity that justifies the diversion of tax dollars from important funding priorities like education, public safety and other public goods we all benefit from.

A Brief History of TIF

TIF was first used many years ago in California as a way to encourage the development of blighted or abandoned property with significant and costly infrastructure needs, primarily in urban areas. The claim behind TIF is that by helping local governments and developers pay for the public infrastructure improvements associated with a project, a barrier that would otherwise prevent the development of the property is removed, and the entire community benefits from the improvements. Today, local governments in every state except Arizona use TIF in some form.

The most common use of TIF provides all or a portion of the additional property taxes generated by the increase in the value of the property because of the development to the developer for several years after the project is completed. The "increment" is the difference between old revenues (property taxes paid within the footprint of the property before the development) and new revenues (property taxes paid within the footprint of the property when the development is complete). The developer uses these payments to help satisfy debt issued to pay for the project. During this period, the local government continues to receive the portion of the property taxes attributable to the original assessed value of the property. In most states, TIF is a development tool used exclusively by local governments, and the only taxes that can be pledged are property taxes, or in some cases, sales taxes.

The most popular argument made in support of TIF is that it doesn't cost governments anything because the incremental revenues aren't available unless the project is completed as planned. This argument is at least plausible when the only taxes pledged are property taxes, because the increase in property value is direct, related and easily measurable. However, when TIF allows taxes to be pledged that are not as directly tied to the property — such as income, sales and occupational taxes — as is the case in Kentucky, this argument falls apart. Further, for it to be a valid argument that TIF arrangements are cost-free to governments, it must be true that the development would not occur "but for" the infusion of public tax revenues – and this is very difficult to prove.

Kentucky TIF - More Generous Than Most

The use of TIF became prominent in Kentucky beginning in 2000, with the enactment of two bills – one that authorized pilot projects in Jefferson County that included the possible pledge of both local and state

tax revenues, and one that authorized the use of TIF by local governments.[1] These new TIF laws went beyond those available in most other states by allowing:

- The pledge of local taxes besides property taxes including local occupational taxes;
- The pledge of state sales, individual income and corporate income taxes; and
- The "footprint" of the TIF district – the physical area from which tax increments are received – to be larger than the area encompassed by the land actually being redeveloped.[2]

The pledge of taxes beyond property taxes is problematic because there is no requirement those revenues come from new economic activity that occurs as a direct result of the development. The result is that existing tax revenues being received by the state and by local governments — in other words revenue that was not generated by the development – can easily be diverted to the developer. Here is how that happens:

> An existing business with its current employees relocates from outside the TIF footprint to inside the TIF footprint after the development is completed. Under Kentucky's TIF laws, the income and occupational taxes paid by that business and the employees of that business are counted as "new revenues" for purposes of the TIF. Although the revenues are not "new revenues" from the standpoint of the Commonwealth, they are "new revenues" for purposes of the development. This situation constitutes a direct diversion of existing revenues to the project developer that would otherwise be deposited in the General Fund or be available to support a local government. There is no new economic activity, and no new job creation. Instead, there is a real and measurable loss of revenues for the Commonwealth and the local government. There is also an empty building outside the TIF footprint vacated by the company that relocated.

This same situation occurs when a business currently collecting sales tax on behalf of the Commonwealth moves from outside the footprint to inside the footprint. No new activity and no new revenues result but tax dollars are diverted and another vacant building is left outside the TIF footprint.

Inadequate Accountability

For a TIF project in Kentucky to move forward with state participation, the Office of State Budget Director (OSBD) and the Finance and Administration Cabinet must find that the project has a net positive impact on the Commonwealth.[3] At first blush, this may seem like an effective way to ensure that approved projects do not result in less revenue for the Commonwealth. However, at the time this determination is made, information is often not available relating to the specific businesses that will be located within the footprint, or how many of those businesses are simply relocations that result in no real new revenue for the Commonwealth. This initial determination is never revisited or corrected when the project is complete to reflect what actually happens. Thus, this "safeguard" really isn't much of a safeguard at all. Instead, there is a very large loophole through which existing state and local tax revenues can easily be diverted.

Expansions and Exceptions Further Broaden Reach

Kentucky's TIF statutes have been amended eight times since 2002 and in almost all cases, the amendments broadened the scope of the program, expanded the list of expenses that can be recovered by developers, or deleted required findings that local governments must officially make to justify the use of TIF and reporting requirements. Most of these amendments were made to accommodate individual projects that could not meet the requirements to qualify initially, or that were having trouble meeting the requirements to begin receiving increments after approval. These amendments all moved Kentucky further from the norm for TIF, and raise concerns that there is no end in sight to the continuing "creep" and corresponding increasing cost that has plagued this program since its inception.

Lots of Revenue, Little Transparency

Since 2002, 24 TIF projects have been approved for state participation, with four additional projects currently in the preliminary approval stage.[4] The total incentive amount that could be claimed from the pledge of state sales, income and property taxes over the next several years is $3.1 billion. [5] Currently, 10 projects have progressed to the point that tax increments are being received. The most current tax expenditure report produced by the Kentucky Office of State Budget Director estimates that the TIF program will reduce state revenues by $22.3 million in 2018[6].

While aggregate data show the large fiscal impact of TIF on the state of Kentucky, there is no way to know how much each project receives in incremental revenue payments each year as this information is not required by law to be made public. The amount of tax dollars diverted through the TIF program will only grow larger as projects currently receiving increments ramp up to full capacity, more approved projects qualify to begin receiving increments and KEDFA approves additional projects.

There is also uncertainty about the cost of TIF at the local level. Kentucky allows cities and counties to establish local only TIF development areas and to pledge local property and occupational license taxes generated within the development area to support it. Local governments can also impose special assessments against anyone working in the TIF development area whose job was created because of the development. Those assessments can provide additional revenue to satisfy debt incurred for the development. Unfortunately, there are no requirements for centralized reporting for local TIFs, so there is no way to know without examining records in each city and county in the Commonwealth how prevalent the use of local only TIF is, the nature of the projects supported and how much has been pledged.

New Government Accounting Standard Board (GASB) rules that require local governments to disclose the aggregate revenue lost to economic development tax-based subsidies, including TIF, will help.[7] Because of these new rules, there will be additional information available from local governments on economic development incentives, with major tax abatement programs reported separately. However reporting on specific projects will not be required.

Conclusion and Recommendations

In the few short years after its creation, Kentucky's already overly generous TIF program has been expanded, its safeguards have been reduced and its original purposes have been forgotten. The resulting diversion of public resources to developers should reexamined, and the program reformed. The Commonwealth and local governments must weigh the value and cost-effectiveness of the program against other public investments, and like other tax incentive programs be willing to end such programs based on such an evaluation. At a minimum, we should pursue the following policy changes:

- Kentucky should amend its laws to more closely resemble TIF programs available in other states that limit the revenues pledged to property taxes, and that limit the use of TIF for blighted, abandoned or brownfield property.
- If Kentucky's program is not limited to property taxes, the legislature should amend Kentucky's statutes to exclude taxes paid by existing businesses and their employees relocating from outside the TIF footprint to inside the footprint from new revenues in calculating the increment due the developer.
- The Cabinet for Economic Development should be required to report the amount of incremental revenues received by each project on an annual basis.
- Policymakers should require centralized reporting of detailed information about each TIF project approved by local governments so that the public can easily access this information.

[1] 2000 Acts, Ch. 326, http://www.lrc.ky.gov/statrev/tables/00rs/actsmas.pdf, codified as KRS 65.490 to 65.499. 2000 Acts, Ch. 358, http://www.lrc.ky.gov/statrev/tables/00rs/actsmas.pdf, codified as KRS 65.680 to 65.699.

[2] Allowing the footprint from which revenues are derived to be larger than the actual development area receiving TIF can work for or against a project, depending on the circumstances. Current state law does not allow the footprint to be larger than the actual development for projects in which the state participates, however the law relating to local only TIF still allows the footprint to be larger. Either way, if the footprint extends beyond the actual development, it is difficult to make a case that the development had any impact on revenues of surrounding businesses.

[3] Note that this requirement applies to projects approved after January 1, 2008. There were five projects approved by the TIF Commission over a three month period at the end of 2007 for which most of the findings and the requirements were waived, including the independent consultant report and net positive impact determination, even though the statutes in effect at that time also included all of these requirements.

[4] "Tax Increment Financing Projects with State Participation", Kentucky Cabinet for Economic Development available at https://thinkkentucky.com/kyedc/pdfs/TIFProjects.pdf. Retrieved June 12, 2017. Three projects that received approval have since been listed as inactive, leaving 25 active or in process projects.

[5] Project periods range from twenty years to over forty years and this number reflects the total amount that could be claimed by all approved projects over the life of those projects.

[6] "Tax Expenditure Analysis Fiscal Years 2016-2018", Kentucky Office of State Budget Director available at http://osbd.ky.gov/Publications/Documents/Special%20Reports/Tax%20Expenditure%20Analysis%20Fiscal%20Years%202016-2018.pdf. Retrieved June 12, 2017.

[7] "Summary of Statement No. 77 Tax Abatement Disclosures", Governmental Accounting Standards Board available at http://www.gasb.org/cs/ContentServer?c=Pronouncement_C&pagename=GASB/Pronouncement_C/GASBSummaryPage&cid=1176166392168. Retrieved June 12, 2017.