

Tax Increment Financing: Property Tax Diversion or Property Tax Surcharge?

by Jacob Butcher, CAC legal intern



It is impossible to escape the impression that something has gone gravely wrong with the way that Illinois municipalities have employed the economic stimulus tool known as Tax Increment Financing, or TIF.

Last week, for example, the Chicago Tribune ran an editorial entitled “TIFs were abused. Time for a new approach to city investment.” Both Inspector General Joe Ferguson and former Cook County Clerk David Orr have urged TIF reform.

But what, exactly, is the problem? The standard criticism is that TIF diverts money from public schools and other government services to line the pocketbooks of developers. Call this the diversion thesis.

The diversion thesis receives support from a cursory glance at Chicago’s fiscal situation. At the beginning of 2018, the City of Chicago had over \$1.4 billion sitting in its TIF accounts, and just earlier this year approved a \$1 billion subsidy for Sterling Bay’s Lincoln Yards project. Meanwhile, the city is undergoing a pension crisis and numerous Chicago public schools are underfunded (50 were closed in 2013).

The diversion thesis has a kernel of truth to it, and it is correct in contending that TIF, as currently administered, is a scheme of regressive redistribution. But it mistakes the kernel of truth for the whole truth and misdiagnoses the primary mechanism by which TIF’s regressive redistribution is

effectuated. But to understand why, we must delve into some of the mechanics of how TIF interacts with property taxes and government funding.



A Refresher on How Property Taxes Fund Local Governments

First, it is important to understand how local taxing bodies receive their property tax-based revenue.

To simplify, I'll use the Chicago Board of Education as my example, and I'll further imagine that the CBOE is the only taxing body in the city. To meet its budget, the CBOE first determines how much money it needs for the upcoming fiscal year. It then requests this dollar amount, which is called the levy. The City's property tax rate is determined by figuring out what rate must be imposed in order to reach the levy.

The formula looks like this:

$$[\text{the city's total property value}] \times [\text{the property tax rate}] = [\text{the levy}].$$

There are two crucial takeaways from this:

First, the CBOE gets the levy it requests regardless of whether TIFs exist. TIFs thus don't "divert" money from the CBOE in any straightforward fashion. (This doesn't, however, show that the diversion thesis is completely wrong. Some taxing bodies may attenuate their levies because of the existence of TIFs, and otherwise might have requested higher levies to receive more tax dollars in the absence of TIFs.)

Second, if we hold the levy amount constant, *a lower total taxable property value results in a higher property tax rate.*

If it's not clear why that is so, have another look at the formula:

$$[\text{the city's total property value}] \times [\text{the property tax rate}] = [\text{the levy}].$$

As one of the values on the left side of the equation decreases, the other value on the left side must increase to make up for it.

This second takeaway—the inverse relation between taxable property value and property tax rates—is the key to understanding how TIFs actually redistribute wealth. But to see why, we need a brief primer on what a TIF does.



A Refresher on How TIFs Operate

When an area is declared a TIF, the *taxable property value of the area is frozen*; during the lifetime of the TIF (23-35 years), the area’s taxable property value remains fixed at the value it had when the TIF was created.

This value is called the “base value,” and any increase in the property’s value during the TIF’s lifetime is called “incremental value.”

The incremental value of a TIF district is not taxable property value. This means that when the government is calculating what property tax rate it will impose to meet the levy, it performs this calculation using the city’s base value rather than its total value (**total value = base value + incremental value**).

By shielding incremental value from factoring into the tax rate calculation, TIFs reduce the city’s taxable property value. And remember: *a lower taxable property value results in a higher property tax rate*. TIFs thus increase property tax rates city-wide by reducing the amount of taxable property value.

(It’s also worth noting that people who live in TIFs pay their property tax rate not only on the base value of their property, but also on its incremental value. To the extent that TIFs do generate incremental value, this means that TIF-district-dwellers experience a double-whammy: both the

increased tax rate that the whole city feels, *plus* an increased property value on which they pay that increased rate.



TIFs Act as a Surcharge on Property Taxes

It's thus best to think of TIF mainly as, in the words of the Chicago Reader's Ben Joravsky, a *surcharge* on your property taxes. The primary effect of TIFs is not to cause money that would otherwise go to the general treasury to instead go into TIF accounts. Instead, their primary effect is that money that would otherwise remain in your bank account instead goes into TIF accounts. How much more? It's impossible to say for sure, but here's one figure to consider: nearly a third of all property tax revenue goes into TIF accounts.

The counterargument to the surcharge thesis is that the incremental value would not exist but for the TIFs, and so it wouldn't be taxable value in a world without TIFs because it wouldn't exist at all. But it defies credulity to claim that, for example, the City of Chicago only or even mainly uses TIFs to invest in areas that otherwise would not attract developers: Chicago's most lucrative TIFs—those receiving the greatest incremental tax revenues—are located in affluent downtown business and North Side districts. Economic analysis indicates that these areas would have developed without the aid of TIF.

A recent example: In April of this year, Chicago's City Council passed an ordinance creating the Lincoln Yards TIF, which is nestled amidst some of the most affluent neighborhoods in Chicago.

Why a Surcharge Is a Form of Regressive Redistribution

Why is the function of TIFs as a property tax surcharge a form of regressive redistribution? To see why, consider who the surcharge benefits and who it burdens.

Who is burdened? In the first instance, TIF burdens property owners who experience increased property taxes. Illinois residents pay the second-highest property taxes in the country, and Chicago-

area property taxpayers are in the 93rd percentile of the nation's largest counties. TIF also burdens renters, who indirectly pay those increased taxes in the form of higher rents.

Who is benefited? TIF benefits developers like Sterling Bay (the developer behind the Lincoln Yards project) when TIF money is used to subsidize their development projects as a means of luring them to the municipality.

Defenders of TIF are quick to point out that significant sums of TIF revenues are also used for public services and infrastructure, like public schools and transit. This defense does some work against the diversion thesis by noting that some of the funds diverted from local taxing bodies into TIF accounts ends up getting funneled back into those same taxing bodies.

But this argument misses a key point: most TIF revenue is spent in comparatively prosperous parts of the city rather than in the south- and west-side neighborhoods that genuinely need the investment. This inequality in TIF-revenue expenditure is built into TIF's legal framework: TIF money must be spent within the boundaries of the TIF district area in which it was raised (or in the case of contiguous TIFs, an adjacent one), and the TIF districts with the most incremental revenue to spend are in prosperous downtown and North Side districts. TIFs thus trap tax revenue in relatively wealthy parts of the city, where arguably redevelopment would have occurred in the absence of the creation of a TIF district.



TIF: a tool that exacerbates inequity rather than curing blight

A white paper by Chicagoland Researchers and Advocates for Transformative Education found that “[s]chools receiving TIF funds are strongly concentrated in the north half of Chicago ... Meanwhile, the southern half of the city ... is left behind. This is especially pertinent for Latino communities that are significantly underrepresented in the allocation of TIF revenues for school construction projects.” The same report noted that only 1% of CPS schools are selective enrollment schools, yet they receive 25%



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of TIF funds used for schools. “Meanwhile, local neighborhood attendance area schools ... compose 69% of the CPS school system but only receive 48% of TIF revenues.

Tax increment financing, as presently administered by Illinois municipalities, is a sophisticated scheme of regressive wealth redistribution, benefiting entities with access to ample financial resources at the expense of everyone else. Although Chicago has been a focus of this critique, the mechanism of regressive redistribution is applicable in any municipality that uses TIF to develop so-called blighted areas. Change will only come when a critical mass of Illinoisans demands it. But to be effective advocates for change, we must understand how TIF works: TIF redistributes wealth from households to developers primarily by functioning as a tax surcharge rather than a tax diversion.