TAX INCREMENT FINANCING (TIF)

A primary tool in economic development and redevelopment, tax increment financing, also known as TIF, is a legislatively authorized tool available to cities and special entities such as housing and redevelopment authorities. Used to finance real estate development costs, municipalities create TIF districts to encourage development and to pay for related public improvements and infrastructure needs such as streets, sidewalks, or sewer. The amount of TIF financing cities can access depends on their net tax capacity among other factors.

THE BASIC IDEA BEHIND TIF

The idea underlying TIF is relatively simple. New investments in housing, business, or industry result in rising market values and increased tax base within the district. At the creation of a TIF district, the county auditor determines the current tax capacity, establishing the district's original tax capacity. Increases above the original tax capacity are captured tax capacity. The auditor also establishes an original tax rate, which is the total property tax rate that applies in the district. The tax increment is determined by multiplying the original tax rate by the captured tax capacity:

"original tax rate" x "captured tax capacity" = "tax increment"

That amount roughly equals increased tax revenue due to development. The district will have a time limit, often as long as 15 or 20 years, and the tax increment will be realized annually over that period.

TIF got its start in the era of urban renewal, mostly to deal with blight, but over time its authorized uses have expanded. It is not uncommon today to use TIF for public infrastructure, general economic development, environmental clean-up, affordable housing construction, and neighborhood revitalization.

WHERE AND WHEN TIF IS LIKELY TO WORK

TIF depends on increasing tax values. When land is developed at low density or a low intensity of land use, the increase in property tax values generated by the TIF may be insufficient. For this reason, TIF is more effective when a greater land intensity or density is planned. Additionally, although TIF is often used for infrastructure and other public investments, certain tax exempt properties, such as government buildings or those occupied by non-profit organizations, will not contribute to the increased tax base no matter what the market value.


Figure 1- Redevelopment on Williams Hill, east of downtown St. Paul

Another limitation on using TIF is that project costs such as site work, pre-design, and construction require payment 'up front,' not over a period of 5, 10, or 20 years. This problem was traditionally remedied by the local municipality issuing bonds to provide the upfront capital the project developer needs. Tax reforms in 1986, however, made it more difficult to issue tax exempt bonds for TIF. An alternative approach, "pay-as-you-go," has become the typical model, where developers must pay development costs when due then wait for the increments to be realized. Cities with unused tax exempt bonding authority might still consider a traditional type of TIF financing; as an alternative, cities can provide their own resources to help cover the upfront costs (in essence, making an advance).

THE "BUT-FOR" TEST MUST BE MET

One important requirement of TIF law and finance is that it is dependent on a local finding that the subsidized development (the development receiving the TIF increment) would not have happened "but for" the use of TIF. This requirement has two purposes—first, to prevent the excessive use of TIF (avoiding unneeded public subsidy), and second, to protect overlapping taxing authorities from losing revenue, as TIF operates using increment derived from these other authorities (e.g. county, state, or school taxes).

Continue to next page

Interestingly, requirements for market value findings that must be made under the “but-for test” do not apply to qualified housing TIF districts created to provide low-income housing. For this purpose, the public benefit is clear as this type of investment is not likely to occur without subsidy. Furthermore, affordable housing, while often producing significantly increased tax base, will not generate the highest market value for the site. As such, it would not satisfy the “but-for” test, and thus receives an exemption.

CASE STUDIES

- Golden Valley Town Square is a 13-acre redevelopment project including affordable housing, office, and retail space. The City of Golden Valley used TIF financing for demolition and infrastructure improvements, and several funders including the Council, Hennepin County, and Minnesota Housing helped make the development’s rental units affordable.
- The City of Chaska utilized a Housing TIF district for owner-occupied housing in its Clover Ridge Neighborhood to contribute to its larger development including walkable streets, a neighborhood center, and gathering space for residents. The district includes a mix of housing styles and prices to support Chaska’s diverse workforce.


Figure 2- Clover Field Townhomes; Clover Ridge Development

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