

Refocusing Wisconsin's TIF System On Urban Redevelopment

Three Reforms

Executive Summary

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About COWS

The Center on Wisconsin Strategy (COWS) is a research and policy center dedicated to improving economic performance and living standards in Wisconsin and beyond. Based at the University of Wisconsin-Madison, COWS promotes "high-road" strategies that support living wages, environmental sustainability, strong communities, and public accountability.



Refocusing Wisconsin's TIF System On Urban Redevelopment: Three Reforms

Wisconsin's tax incremental financing (TIF) was originally intended to provide crucial assistance for urban redevelopment projects. Today, however, it has grown into a program with responsibility for promoting all kinds of economic development across the state. This unchecked growth is not without side effects, as the current program may actually discourage urban redevelopment and increase the opportunities for misuse of the program. This paper proposes a solution to these problems through three reforms that create a stronger tax incremental district (TID) classification system, remove TIF-based incentives for developing open land, and add incentives for stricter joint review board examination of TIF project plans.

Background

TIF is an important economic development tool for Wisconsin, allowing a municipality to promote growth in a specific district, or TID, by borrowing on the district's future growth in taxable property value. In Wisconsin, TIDs may be created for three types of projects: blight or environmental remediation, industrial development, and (as of October 1, 2004) mixed-use development. These projects are financed in the following way: first, local assessors and the Wisconsin Department of Revenue (DOR) determine a year-one base value for all property within the TID. As the city invests money in the district—upgrading roads, adding sewer service, providing incentives to developers, rehabilitating old buildings, or remedying brownfields—the taxes on all property value growth above this base value are used to pay off the costs of those improvements. Taxes are always collected on the full property value of the TID, but only the amount generated from the base value are sent to local governments; all remaining tax revenue pays back TID debts until all project costs are repaid.

In many ways, TIF allows local governments to get something for nothing. In exchange for agreeing to stagnant tax revenues from a specified district over 10–20 years, local governments can use TIF to generate new value to be added back to property tax rolls upon full repayment of project debts. However, this reading of TIF glosses over the fact that new development increases demand for city, county, and school district services—demand not accompanied by increases in tax revenue to provide these services. For instance, a new subdivision will send more kids to school, require additional snow and trash removal, and need more road maintenance. When a local government district contains a number of TIDs, city, county, and school districts must either cut services or raise taxes. For areas of high property value growth, it often makes more sense not to use TIF. If some development is likely to occur, the overall benefits of accruing some tax revenue sooner but not paying for site improvements may outweigh investments of public money that result in a large development that will not provide additional tax revenue for 20 years.

What's Wrong with TIF Today: Sprawl and Misuse

Upon signing the bill authorizing TIF in 1975, then-Governor Patrick Lucey characterized the program as “an additional means of redeveloping areas primarily urban in character.”¹ The history of TIF in Wisconsin, however, shows a program continually widening its focus and losing its ability to foster urban redevelopment. As restrictions on TIF use have loosened, though, TIF has become a vital economic development tool in Wisconsin, funding all kinds of economic development projects that are likely never to be undertaken without it. TIF’s scope in Wisconsin stretches across the entire state, with 757 active TIDs in 69 out of 72 Wisconsin counties that comprise 4.24 percent of Wisconsin’s total property value.²

TIF underwent a major overhaul during the 2003–04 legislative session that amended TIF statutes to loosen the rules for which projects are eligible for TIF funding, authorizing TIF funding for “mixed-use” developments for the first time.³ Past changes to TIF law had already greatly expanded the program’s scope, and Wisconsin’s TIF system promises to grow even larger under these most recent reforms.

While TIF’s expansion has provided municipalities with another tool to improve their regional economies, and the state’s as a whole, it also has altered the incentives for municipalities and developers to undertake urban redevelopment projects. By treating all projects equally, TIF has cut urban areas’ ability to use TIF as an effective development incentive in addressing blight and decayed infrastructure. Urban redevelopment projects are treated no differently than retail developments, and, just as blighted areas receive little attention under traditional market incentives, they continue to be ignored under TIF. Consequently, TIF is used less to fund redevelopment and more to fund the development of open land. In fact, one study estimated that 30,000 acres of open land have been developed with assistance from TIF.⁴

TIF’s unchecked growth affects Wisconsin in other ways as well. The more the program grows, the greater the potential for abuse. Currently, joint review boards, composed of representatives from all affected taxing jurisdictions and the public, must find that the development would not have occurred without the use of TIF. However, the members on these joint review boards do not realize their interest in gathering good information about the kind of development targeted by the project, and its true need for public subsidy. We know that taxpayers lose out if TIF is approved for projects that would occur without it, yet all too often TIF projects are rubberstamped as a “something for nothing” tradeoff. Lands included in industrial and mixed-use TIDs carry a far higher potential for misuse, since these parcels have no significant barriers to development. As more TIDs are created under these two classifications, Wisconsin’s TIF program will likely be marred by greater abuse and increased handouts of taxpayer money to corporations and developers.

¹ 1000 Friends of Wisconsin, *Wisconsin’s Tax Incremental Finance Law: Lending a Hand to Blighted Areas or Turning Cornfields into Parking Lots?* Madison: (October 1999).

² Wisconsin Department of Revenue. Figures as of May 2004.

³ 2003 Wisconsin Act 126.

⁴ 1000 Friends of Wisconsin, *Wisconsin’s Tax Incremental Finance Law*.

Three Reforms for a Better TIF System

In its current form, Wisconsin's TIF system fails its residents. Urban areas remain perpetually underutilized, businesses locate further away from residents needing to access new jobs, and taxpayers pick up the tab for development that would have occurred naturally. Taken together, the following three reforms envision a better TIF program for Wisconsin: one that institutes a clearer TID classification system, refocuses TIF on addressing blight, and provides new incentives for joint review boards to prevent TIF abuse.

1. Institute a Better Classification System

The first step toward refocusing Wisconsin's TIF system on urban redevelopment is to separate redevelopment projects from those promoting industrial or mixed-use development. For the first twenty eight years that TIF existed in Wisconsin, municipalities could create TIDs without identifying their specific purpose; merely stating that the district fell under one of the state's three TID classifications. Reforms passed in 2003 require, for the first time, that municipalities specifically state under which of the three TID classifications a project was approved. This alone is not enough.

The State of Wisconsin should provide guidance to joint review boards on what constitutes an eligible project in each of the three classifications. Prior to the addition of the mixed-use category, the industrial classification acted as a catchall category without a strict definition. Now that there is a new, even wider catchall category of mixed-use development, Wisconsin should take the opportunity to refocus industrial development TIDs on aiding our struggling manufacturing sector. The result is three very distinct categories: blighted TIDs focused on urban redevelopment projects, industrial TIDs focused on growing Wisconsin's manufacturing sector, and mixed-use TIDs that foster commercial, retail, and residential growth not occurring in blighted areas.

2. Remove Rewards for Developing Open Land

Under Wisconsin's current TIF system, the manner in which TID base values are determined allows development of open land to be paid off more quickly than other projects. The root of this problem resides in land valuation guidelines designed to help farmers. In Wisconsin, agricultural land is assessed not at its market value but rather at its crop growth potential, so that farmers with favorably located land are not driven out of business by increasing property tax bills. However, when agricultural land specifically targeted for development is included in a TID, the base value is still determined on the land's potential farming value, rather than its potential value as developed land.

To level the playing field between new development and redevelopment projects, all previously undeveloped land should be revalued to reflect its future usage. The recalculated value, based on development and municipality-specific average land values, should be included in the TID's final base value.⁵ Under this reform, base values of comparatively sized TIDs in urban and exurban areas will come closer together. Redevelopment projects will pay themselves off at a rate closer to that of new development projects, in part restoring TIF's focus on redeveloping urban areas.

3. Add Incentives for Joint Review Boards to Enforce Restrictions on TIF Use

Wisconsin safeguards against TIF abuse by requiring project plans to be approved by a local joint review board. Board members are supposed to base their vote on whether the project is truly in need of public assistance and whether its benefits outweigh the costs of providing unfunded services to the development while it pays itself off. These determinations are difficult to make, and joint review board members are often ill-informed about the real costs of using TIF. Reform of the joint review board process is necessary to add incentives for better information gathering and stricter scrutiny of TID project plans.

First, base values should be tied to the rate of property value growth for the municipality creating the TID. Base values will increase each year according to the municipality-specific level of property value growth. This is distinct from the previous reform, which proposed revaluing open land at a municipality's average *land* value. This third reform will adjust TIDs' base values each year at the rate reflecting average *property* value growth in the community, a rate that includes both land appreciation and construction of new buildings. Under this system, base values for TIDs in fast-growing communities will increase more each year than in depressed communities, making it more difficult for TIDs in areas of great growth to pay themselves off. Faced with longer payback periods caused by high levels of existing property value growth, joint review boards will pay closer attention to whether the proposed project is truly in need of public financing.

Second, the annual adjustments in base value should be tied to a TID's classification. Blighted land contains significant impediments to development and, without public subsidy, is likely not to appreciate. Thus, base values for these TIDs should remain constant throughout payback. Industrial TIDs contain land suitable for development, although there is no guarantee the development will actually yield good-paying manufacturing jobs without targeted public funding. Base values for industrial TIDs should be indexed to manufacturing property value growth, establishing a minimum level for publicly funded growth in a struggling sector. Finally, because mixed-use TIDs are comprised of an unpredictable mix of developments, base values for these TIDs should be tied to the growth of property value in all classes.

⁵ Base values are currently calculated according to strict assessor standards and cannot actually be adjusted up or down. When we refer to base value adjustments we actually intend to adjust the threshold at which tax revenues divert from feeding local governments' general-purpose revenues to repaying TID project debts.

In practice, base values for mixed-use TIDs will typically increase more than those for industrial TIDs, and both will increase more than blighted TIDs' constant base values. This means that, all other things being equal, a TID classified as blighted will pay itself off more quickly than one classified as industrial, and both will pay back more quickly than mixed-use TIDs. Sponsoring municipalities, then, will aim to have every TID classified as blighted to get the most favorable payback prospects. In contrast, other taxing jurisdictions, which must struggle with providing services to the new development, will want to see the increased tax revenue flows from annual raises to the base value. Faced with different levels of taxable value for each TID classification, more emphasis will be placed on assigning TID classifications truly appropriate to the development targeted. Under this system, only genuinely blighted areas will receive the greatest assistance.

Results of these Reforms

Enacting the three reforms detailed above will make for a TIF system in Wisconsin that provides better benefits to the state. Municipalities and developers will undertake more projects that provide stronger benefits to our citizens, such as urban reclamation and job-creating manufacturing projects, with authorization from a strengthened joint review board process.

Fewer TIF-based Incentives for Developing Open Land

When searching for development locations, businesses often require large plots of land. This puts urban areas at an immediate disadvantage to new development areas, as blighted infrastructure must be cleared for development to occur. TIF, which was envisioned as a solution to this problem, actually exacerbates the problem by allowing future industrial and mixed-use developments to be valued at artificially low agricultural use-value standards.

The reforms here assert the following: open land targeted for development should be included in the base value at its average market value and not at its crop-growth potential. The effect of this change is to level the playing field between open land development and redevelopment projects: paydown on project debts will not occur merely from rezoning the land, and municipalities will think twice about creating TIDs that include hundreds of acres of agricultural land since each acre included will raise TID payback standards.

Decline in Use of TIF in Cases Where Development Would Have Otherwise Occurred

TIF is statutorily limited to projects that local joint review boards determine would not have occurred without public subsidy. In practice, this determination is typically a formality, receiving little attention. Local joint review boards will pay more attention to this determination under the proposed reforms because annual base value adjustments will be tied to the municipality's property value growth. Fast-growing communities will see the land's potential growth reflected in annual base value increases that limit the ability to pay off project costs. In short, fast-growing communities that are less likely to need TIF will now have less capacity to use it.

For More Information

For more information on the reforms presented here, or a full copy of the report *Refocusing Wisconsin's TIF System On Urban Redevelopment: Three Reforms*, contact:

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Added Incentives for Development of Blighted Areas and Manufacturing-Sector Jobs

The property values of land within TIDs classified as blighted, environmental rehabilitation, or industrial are likely to increase at a slower rate than mixed-use TID land. Indexing base values to this difference in potential growth tips incentives back toward blighted, rehabilitation, and industrial development since they will pay off more quickly than mixed-use projects. TIF thus will become a more useful tool for financing economic development projects that help build a healthy economy in Wisconsin by removing blight, remedying environmental concerns, and adding new manufacturing jobs.

Increased Funds Reallocated to Local Governments During TID Payback

As of May 2004, Wisconsin has 757 active TIDs. In each of these districts the tax revenue to local governments is locked in for a period of up to 20 years, irrespective of the land's natural appreciation and rising demand for services from the new growth within the TID. Receiving only a set level of tax revenue for the land in a single TID may not significantly strain local governments' budgets. However, as more and more TIDs are created—at a rate of 62.3 new districts per year—many county and school district budgets may include over 50 TIDs.⁶ Combined with shrinking state revenue sharing and looming property tax freezes, local governments are facing difficult financial situations further worsened by TIF's unchecked growth.

Municipality and development-specific adjustments to base values will provide local governments with an annually increasing flow of income. Coupled with the revaluation of all open land included in TIDs, local governments will be better equipped to hold the line on property taxes and preserve vital government services.

⁶ Rate calculated between 1998 and 2003. Wisconsin Department of Commerce, *1999-2000 Report on Tax Incremental Financing* (Madison: May 2002).

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