Giving Away the Store to Get a Store

Tax increment financing is no bargain for taxpayers.

Daniel McGraw | January 2006

If you're imagining an attraction that will draw 4.5 million out-of-town visitors a year, the first thing that jumps to mind probably isn't a store that sells guns and fishing rods and those brown jackets President Bush wears to clear brush at his ranch in Crawford, Texas. Yet last year Cabela's, a Nebraska-based hunting and fishing mega-store chain with annual sales of $1.7 billion, persuaded the politicians of Fort Worth that bringing the chain to an affluent and growing area north of the city was worth $30 million to $40 million in tax breaks. They were told that the store, the centerpiece of a new retail area, would draw more tourists than the Alamo in San Antonio or the annual State Fair of Texas in Dallas, both of which attract 2.5 million visitors a year.

The decision was made easier by the financing plan that Fort Worth will use to accommodate Cabela's. The site of the Fort Worth Cabela's has been designated a tax increment financing (TIF) district, which means taxes on the property will be frozen for 20 to 30 years.

Largely because it promises something for nothing--an economic stimulus in exchange for tax revenue that otherwise would not materialize--this tool is becoming increasingly popular across the country. Originally used to help revive blighted or depressed areas, TIFs now appear in affluent neighborhoods, subsidizing high-end housing developments, big-box retailers, and shopping malls. And since most cities are using TIFs, businesses such as Cabela's can play them off against each other to boost the handouts they receive simply to operate profit-making enterprises.

A Crummy Way to Treat Taxpaying Citizens

TIFs have been around for more than 50 years, but only recently have they assumed such importance. At a time when local governments' efforts to foster development, from direct subsidies to the use of eminent domain to seize property for private development, are already out of control, TIFs only add to the problem: Although politicians portray TIFs as a great way to boost the local economy, there are hidden costs they don't want taxpayers to know about. Cities generally assume they are not really giving anything up because the forgone tax revenue would not have been available in the absence of the development generated by the TIF. That assumption is often wrong.

"There is always this expectation with TIFs that the economic growth is a way to create jobs and grow the economy, but then push the costs across the public spectrum," says Greg LeRoy, author of *The Great American Jobs Scam: Corporate Tax Dodging and the Myth of Job Creation*. "But what is missing here is that the cost of developing private business has some public costs. Road and sewers and schools are public costs that come from growth." Unless spending is cut--and if a TIF really does generate economic growth, spending is likely to rise, as the local population grows--the burden of paying for these services will be shifted to other taxpayers. Adding insult to injury, those taxpayers may include small businesses facing competition from well-connected chains that enjoy TIF-related tax breaks. In effect, a TIF subsidizes big businesses at the expense of less politically influential competitors and ordinary citizens.

"The original concept of TIFs was to help blighted areas come out of the doldrums and get some economic development they wouldn't [otherwise] have a chance of getting," says former Fort Worth City Councilman Clyde Picht, who voted against the Cabela's TIF. "Everyone probably gets a big laugh out of their claim that they will draw more tourists than the Alamo. But what is worse, and not talked about too much, is the shift of taxes being paid from wealthy corporations to small businesses and regular people.

"If you own a mom-and-pop store that sells fishing rods and hunting gear in Fort Worth, you're still paying all your taxes, and the city is giving tax breaks to Cabela's that could put you out of business," Picht explains. "The rest of us pay taxes for normal services like public safety, building inspections, and street maintenance, and those services come out of the general fund. And as the cost of services goes up, and the money from the general fund is given to these businesses through a TIF, the tax burden gets shifted to the regular slobs who don't have the same political clout. It's a crummy way to treat your taxpaying, law-abiding citizens."

Almost every state has a TIF law, and the details vary from jurisdiction to jurisdiction. But most TIFs share the same general characteristics. After a local government has designated a TIF district, property taxes (and sometimes sales taxes) from the area are divided into two streams. The first tax stream is based on the original assessed value of the property before any redevelopment; the city, county, school district, or other taxing body still gets that money. The second stream is the additional tax money generated after development takes place and the property values are higher. Typically that revenue is used to pay off municipal bonds that raise money for infrastructure improvements in the TIF district, for land acquisition through eminent domain, or for direct payments to a private developer for site preparation and construction. The length of time the taxes are diverted to pay for the bonds can be anywhere from seven to 30 years.

Local governments sell the TIF concept to the public by claiming they are using funds that would not have been generated without the TIF district. If the land was valued at $10 million before TIF-associated development and is worth $50 million afterward, the argument goes, the $40 million increase in tax value can be used to retire the bonds. Local governments also like to point out that the TIF district may increase nearby economic activity, which will be taxed at full value.

So, in the case of Cabela's in Fort Worth, the TIF district was created to build roads and sewers and water systems, to move streams and a lake to make the property habitable, and to help defray construction costs for the company. Cabela's likes this deal because the money comes upfront, without any interest. Their taxes are frozen, and the bonds are paid off by what would have gone into city coffers. In effect, the city is trading future tax income for a present benefit.

But even if the dedicated tax money from a TIF district suffices to pay off the bonds, that doesn't mean the arrangement is cost-free. "TIFs are being pushed out there right now based upon the 'but for' test," says Greg LeRoy. "What cities are saying is that no development would take place but for the TIF....The average public official says this is free money, because it wouldn't happen otherwise. But when you see how it plays out, the whole premise of TIFs begins to crumble." Rather than spurring development, LeRoy argues, TIFs "move some economic development from one part of a city to another."

Development Would Have Occurred Anyway

Local officials usually do not consider how much growth might occur without a TIF. In 2002 the Neighborhood Capital Budget Group (NCBG), a coalition of 200 Chicago organizations that studies local public investment, looked at 36 of the city's TIF districts and found that property values were rising in all of them during the five years before they were designated as TIFs. The NCBG projected that the city of Chicago would capture $1.6 billion in second-stream property tax revenue--used to pay off the bonds that subsidized private businesses--over the 23-year life spans of these TIF districts. But it also found that $1.3 billion of that revenue would have been raised anyway, assuming the areas continued growing at their pre-TIF rates.

The experience in Chicago is important. The city invested $1.6 billion in TIFs, even though $1.3 billion in economic development would have occurred anyway. So the bottom line is that the city invested $1.6 billion for $300 million in revenue growth.

The upshot is that TIFs are diverting tax money that otherwise would have been used for government services. The NCBG study found, for instance, that the 36 TIF districts would cost Chicago public schools $632 million (based on development that would have occurred anyway) in property tax revenue, because the property tax rates are frozen for schools as well. This doesn't merely mean that the schools get more money. If the economic growth occurs with TIFs, that attracts people to the area and thereby raises enrollments. In that case, the cost of teaching the new students will be borne by property owners outside the TIF districts.

Such concerns have had little impact so far, in part because almost no one has examined how TIFs succeed or fail over the long term. Local politicians are touting TIFs as a way to promote development, promising no new taxes, and then setting them up without looking at potential side effects. It's hard to discern exactly how many TIFs operate in this country, since not every state requires their registration. But the number has expanded exponentially, especially over the past decade. Illinois, which had one TIF district in 1970, now has 874 (including one in the town of Wilmington, population 129). A moderate-sized city like Janesville, Wisconsin--a town of 60,000 about an hour from Madison--has accumulated 26 TIFs. Delaware and Arizona are the only states without TIF laws, and most observers expect they will get on board soon.

First used in California in the 1950s, TIFs were supposed to be another tool, like tax abatement and enterprise zones, that could be used to promote urban renewal. But cities found they were not very effective at drawing development into depressed areas. "They had this tool, but didn't know what the tool was good for," says Art Lyons, an analyst for the Chicago-based Center for Economic Policy Analysis, an economic think tank that works with community groups. The cities realized, Lyons theorizes, that if they wanted to use TIFs more, they had to get out of depressed neighborhoods and into areas with higher property values, which generate more tax revenue to pay off development bonds.

The Entire Western World Could Be Blighted

Until the 1990s, most states reserved TIFs for areas that could be described as "blighted," based on criteria set forth by statute. But as with eminent domain, the definition of blight for TIF purposes has been dramatically expanded. In 1999, for example, Baraboo, Wisconsin, created a TIF for an industrial park and a Wal-Mart supercenter that were built on farmland; the blight label was based on a single house in the district that was uninhabited. In recent years 16 states have relaxed their TIF criteria to cover affluent areas, "conservation areas" where blight might occur someday, or "economic development areas," loosely defined as commercial or industrial properties.

The result is that a TIF can be put almost anywhere these days. Based on current criteria, says Jake Haulk, director of the Pittsburgh-based Allegheny Institute for Public Policy, you could "declare the entire Western world blighted."

In the late 1990s, Pittsburgh decided to declare a commercial section of its downtown blighted so it could create a TIF district for the Lazarus Department Store. The construction of the new store and a nearby parking garage cost the city more than $70 million. But the property taxes on the new store were lower than expected, as the downtown area surrounding Lazarus never took off the way the city thought it would. Sales tax receipts were also unexpectedly low. Lazarus decided to close the store last year, and the property is still on the block. Because other businesses were included in the TIF, it is impossible to predict whether the city will be on the hook for the entire $70 million. But given that the Lazarus store was the centerpiece of the development, it is safe to say this TIF is not working very well, and Pittsburgh's taxpayers may have to pick up the tab.

If businesses like Lazarus cannot reliably predict their own success, urban planners can hardly be expected to do a better job. Typically, big corporations come to small cities towing consultants who trot out rosy numbers, and the politicians see a future that may not materialize in five or 10 years. "The big buzzwords are economic development," says Chris Slowik, organizational director for the South Cooperative Organization for Public Education (SCOPE), which represents about 45 school districts in the southern suburbs of Chicago, each of which includes at least one TIF. "The local governments see a vacant space and see something they like that some company might bring in. But no one thinks about what the costs might be....They are giving away the store to get a store." Big-box retail chains such as Target and Wal-Mart seem to be the most frequent beneficiaries of TIFs. (Neither company would comment for this story, and local politicians generally shied away as well.)

Given the competition between cities eager to attract new businesses, TIFs are not likely to disappear anytime soon. "Has it gone overboard?" asks University of North Texas economist Terry Clower. "Sure....But the problem is that if a city doesn't offer some tax incentives, the company will just move down the road." According to Clower, "In a utopian world, there would be no government handouts, and every business would pay the same tax rate. But if a city stands up and says they aren't doing [TIFs] anymore, they will lose out."

Instead, it's the competitors of TIF-favored businesses that lose out. Academy Sports & Outdoors, which employs 6,500 people, has about 80 sporting goods stores in eight Southern states, including a store in Fort Worth. When the Fort Worth City Council was considering the TIF for Cabela's, Academy Sports Chairman David Gochman spoke out against the tax incentives, realizing that his company is a big business, but not big enough. "This is not a nonprofit, not a library, not a school," he said. "They are a for-profit business, a competitor of ours, along with Oshman's and Wal-Mart and others."

TIFs Have Become the Standard Handout

Al Dalton, owner of Texas Outdoors, a 10,000-square-foot hunting and fishing shop in Fort Worth, echoed the sentiment that the city was favoring one business over another. "We don't have the buying power, and we don't have the advertising dollars," Dalton said. "It doesn't make any difference even if we've got the best price in town if nobody knows about it. The deep pockets, in every way, [make] a lot of difference."

And that may be the key to understanding how TIFs are now applied: The companies with the deep pockets are able to fill them with subsidies.

The Cabela's location in Fort Worth does not fit any of the blight criteria people had in mind when TIFs were first created. The 225,000-square-foot store, with its waterfalls, multitude of stuffed animals, and wild game cafôUsits on prime property just off Interstate 35. It is a few miles down the road from the Texas Motor Speedway (which has its own TIF), and the 200,000 NASCAR and IRL fans who attend races there three times a year--not to mention the fans who come to the speedway's concerts and other special events--might want to shop at Cabela's.

The area around Cabela's is affluent and has been growing for years. A half-dozen shopping centers nearby were on the drawing board well before the TIF was considered. Within a five-mile radius of the hunting/fishing megastore, 10,000 new homes have been built since 2000. That same area is expected to grow by 20,000 people in the next two years.

But the argument against the "but for" assumption is not being heard. In 2004 a state judge threw out a lawsuit against the Cabela's TIF by a Fort Worth citizens' group that claimed blight was never proven, and that the city was misusing TIFs in a prosperous area that needed no tax breaks for future development. The blight designation came from a pond and stream on the property. It was an odd designation, given that the property is in a prime development area and ponds and streams are not what one would classify as blighted.

The press releases and newspaper articles about the new Cabela's emphasize that the store is going to draw more people to Texas than visit the Alamo (the studies were done by Cabela's). The press release never mentions that a Bass Pro Shop store, part of a chain almost identical to Cabela's, is just 10 miles down the road. While Cabela's was negotiating its TIF with Fort Worth, it was also negotiating a TIF with the city of Buda, 120 miles away, outside of Austin. Cabela's got about $20 million from Buda, and the same tourist claims are being made there. If each Texas store is going to draw 4.5 million tourists, as the chain claims, that means 9 million people will be coming to Texas every year just to visit the two Cabela's stores.

"The notion that a hunting store would draw all these tourists is ridiculous," says Greg LeRoy. "But what is even more ridiculous is cities thinking that tax breaks are the primary reason businesses relocate or expand in certain areas. There are so many other factors at play--transportation costs, good employment available, housing costs and quality of life for executives--that the tax breaks like TIFs aren't very high up on their priority list. But these corporations are asking for them--and getting them--because everyone is giving them out. TIFs have become the standard handout, and the businesses have learned how to play one city off the other. Businesses would be stupid for not asking for them every time."

If TIFs continue to multiply at the present rate, we may see the day when every new 7-Eleven and McDonald's has its own TIF. That prospect may seem farfetched, but it wasn't too long ago that cities wouldn't even have considered giving up tens of millions of dollars in exchange for yet another store selling guns and fishing rods.?