The Impact of Tax Increment Financing on School Finance

Public K-12 education in Colorado is financed through state and local sources. The school finance formula in state law establishes a statewide total funding level. The difference between this amount and the local share determines the state's school finance obligation. The local share is paid primarily from property taxes.

Exemptions, policy adjustments, or other factors that reduce or slow the growth of property taxes requires the state to increase its share of K-12 education funding. This issue brief discusses the impact of tax increment financing (TIF) on the state and local shares of K-12 education funding.

What is tax increment financing?

TIF is a tax incentive for redevelopment projects in Colorado. Under Colorado law, municipalities and counties can create urban renewal authorities (URA), downtown development authorities (DDA), and county revitalization authorities (CRA) that use TIFs for specific, time-limited projects.

TIF allows these districts to divert future gains (the increment) in sales or property taxes collected from a project to pay for upfront investments. Gains from the revitalization pay off debt balances or are reinvested in the area.

Statute outlines the specific purposes for each type of TIF district. Generally, URAs are utilized to improve "blighted" areas, DDAs are used to promote the vitality of central business districts, and CRAs are to promote revitalization and economic investment in unincorporated areas.

How are property taxes impacted by TIF?

The basic premise of TIF is that blight or other factors are impairing economic development in the district and surrounding areas. Diverting property taxes from school districts, counties, and special districts will fund redevelopment, increasing property values, spurring economic development, and boosting local revenue in both the near and long terms. By only diverting revenue from incremental value, TIF preserves the existing tax base.

In the near term, higher property values in surrounding areas will increase tax revenue. In the long term, when a TIF district expires, the revitalized property will increase property taxes further as diversions to the TIF district end.

However, TIF diversions may instead reduce or limit growth in property taxes. An important criterion in assessing whether a TIF district grows or impairs revenue depends on whether the project would have occurred without the incentive. If property values would have increased, if the project would have occurred without the TIF, or if projects merely relocate development, then TIF diversions reduce or limit revenues.

David Hansen
Legislative Council Staff · 200 E. Colfax Ave, Room 029 · Denver CO 80203

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How is school finance impacted by TIF?

The state is required to fund the difference between the local share of school finance and the amount of total school finance funding determined by state law.

If a TIF district diverts property taxes away from school districts for development that would have occurred anyway, the state will be required to backfill what the local share would have been absent the TIF incentive.

If a redevelopment project increases property taxes over time, it will thereby reduce the required amount of state funding.

The impact on property tax revenue depends on the degree these projects occur because of the TIF incentive.

TIF and TABOR

Article X, Section 20, of the Colorado Constitution (TABOR) imposes limits on the growth of property tax revenue for all school districts. For a district at its property tax revenue limit, additional assessed value from new development results in a lower mill levy. Currently, Steamboat Springs is the only district in this position.

The TIF revenue loss may also mean that the district's mill levy for school finance drops as a result of the assessed value increase, but not as much as it would have absent the TIF.

TIF and mill levy equalization

State law requires that school district total program mill levies be effectively increased by 1 mill annually, until the district levies a target number of mills. Mill levy equalization does not apply to Steamboat Springs, as its revenue is limited by TABOR.

Increasing mill levies increases the potential property tax impact of TIF on the local share, and the corresponding change in the state share. From FY 2019-20 to FY 2023-24, the value of property tax diversions associated with total program mill levies increased about 63 percent, compared with about 57 percent growth in TIF district assessed value.

How has the use of TIF diversions from school districts grown?

The number of school districts with TIF diversions has grown over time, from 34 school districts in FY 2010-11 to 49 districts in FY 2023-24. The value of TIF diversions for total program mill levies has grown from about $41.7 million to $150.1 million over the same time period, while the potential increase in state share has increased from about $37 million to about $148 million. The difference in these two values is an impact of the budget stabilization factor, a reduction to the state share that was enacted by the General Assembly during that time period.

With the proliferation of more TIF districts and other factors, TIF diversions of local share property taxes have increased faster than overall assessed values. Figure 1 presents the maximum estimated impact of TIF on the state share of school finance from FY 2019-20 to FY 2023-24. The impact of the budget stabilization factor was calculated by applying the factor to the reduction in local share from TIF. Figure 2 shows the value of diversions in school districts where TIFs were used in FY 2023-24. TIF diversions are mostly concentrated along the Front Range, with the largest one totaling about $47.1 million in Denver Public Schools in FY 2023-24.

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Figure 1
TIF Districts and Potential TIF Impact on the State Share of School Finance

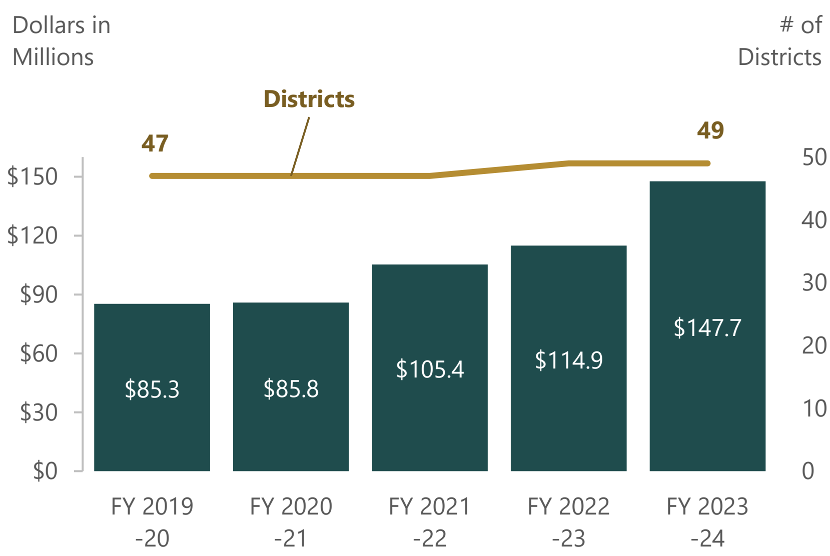

Figure 2
TIF Total Program Diversions by School District, FY 2023-24