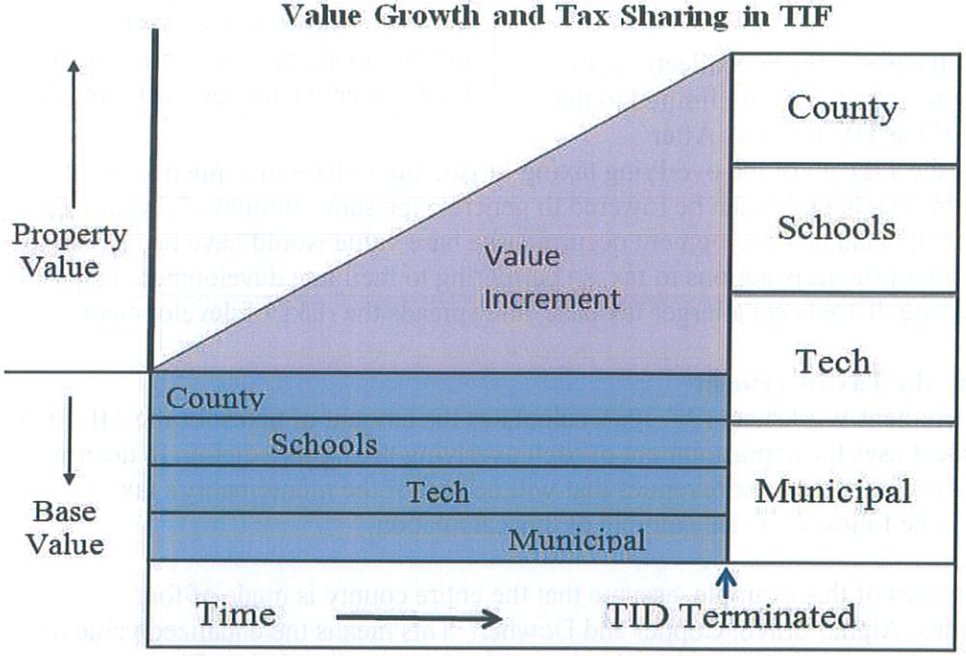
1.2 How does TIF work?

Tax Incremental Finance (TIF) generates tax revenue that can only be used to fund infrastructure investment and other eligible projects that will facilitate private development. Here's the explanation:

Sharing the Tax Base

Value Growth and Tax Sharing in TIF



When a Tax Incremental District (TID) is created, the current value of all the taxable property within the defined boundaries is established. This value is the "base value" of the TID (the base value in the graph is made up of the four **blue** stripes along the bottom). The taxes collected on this portion of the property value are shared by the overlying taxing jurisdictions, and once the TID is created this portion of the tax collections is allocated as it always has been. In this example the county, school, technical college and municipality split revenues on the base value. In areas with special taxing districts – like a sanitary district or lake rehabilitation district – this would appear in the graph as one more stripe along with the other four mentioned.

> **Please Note:** This discussion of how TIF works is dependent on the "but for" concept, explained fully in section 5.1.

Over the life of the TID, the county, school, technical college and municipality (and special district where applicable) all collect taxes from the property in the TID base. Meanwhile, new construction and investment increase the value of the property. All of the taxes collected on the growth in value of the property (or the "value increment") are turned over to the City as "tax increment" revenue. The City uses this revenue stream only to pay for the improvements that it made to the property in the TID that are in the approved project plan.

At the end of the maximum life period, or as soon as tax increments are collected in excess of total approved project costs, the TID must be terminated. The entire value of the property that was in the TID is returned to the tax rolls of the overlying taxing jurisdictions. In the graph this can be seen in the band along the right side – the wider segments represent that more property value is being subject to taxes.

Please Note: If the total tax increment revenue exceeds the total project costs, the surplus revenue must be returned to the overlying taxing jurisdictions in proportion to their respective tax levy without TIF.

While the TID exists, the tax collections for each overlying jurisdiction are limited to the base value of the TID parcels. After terminating the TID, all of the overlying taxing jurisdictions share in a much larger tax base. This means that rates can be lowered to generate the same amount of revenue for the jurisdiction. Had no development occurred, the base value would have been the only value for each of the jurisdictions to tax, so partnering to facilitate development helps all of the overlying districts get a larger tax base, and spreads the risks of development.

Calculating the Tax Increment

The Tax Increment Worksheet (PC 202), calculates the amount of taxes for the TIF fund. The worksheet uses the apportionment of each overlying taxing jurisdiction to determine the share of each district's tax revenues that will be part of the municipality's tax increment. The following is an example of this calculation.

For the purposes of this example, assume that the entire county is made of four municipalities: Alpha, Bravo, Copper and Downer. This means the equalized value of the county is the same as the combined value of the four municipalities. The county levy equals $1,500,000. Only Alpha has a TID. The values of the municipalities and the TID are as follows:

Municipality	TID IN Equalized Value
Alpha	*$400,000,000
Bravo	$70,000,000
Copper	$20,000,000
Downer	$10,000,000
Total (County)	*$500,000,000

Alpha TID #1

Base Value	$20,000,000
Current Value	$50,000,000
Increment Value	$30,000,000

*Includes Increment Value

The first step is to calculate what share of the county value each municipality comprises. This is done using "TID OUT" values of the municipalities and the county (these are the equalized values listed above minus any value increment they might include; for example Alpha's TID OUT value is $370,000,000). Dividing the municipal TID OUT value by the county TID OUT value equals the percent of the county's value that a municipality has (for Alpha, $370,000,000/$470,000,000 = 79%). This percentage is then multiplied by the total county levy to figure out how much of the total each municipality must collect. These are called the "Municipal Apportioned Tax or municipal apportioned levy from the county.

Next, the county apportionment rate on each municipality must be calculated. This is done by dividing the municipal apportioned tax by each municipality's TID OUT equalized value [for Alpha, (.79 * $1,500,000)/$370,000,000 = .0032, or 3.2 mills]. This mill rate is then multiplied by the TID IN equalized value of each municipality to get the total county taxes each municipality will collect (for Alpha, .0032 * $400,000,000 = 1,280,000). This value will include both the levy due to the county and the county's share of the tax increment that is due to Alpha. Alpha will collect the tax increment and retain that portion of the county levy in the TID #1 account.

NOTE: When a municipality has no TIDs, the TID OUT and TID IN values are the same for that municipality (as was the case for the other three municipalities), so the municipal apportioned levy is the same as the county taxes collected. If there are no TIDs in a county, the county mill rate is lower for everyone, meaning that every taxpayer in the county pays a higher rate when there are TIDs in order to generate the increment that must be paid to the municipality that operates the TID. This cost is shared by all taxpayers in the county because they will all share in the expanded tax base once the TID is closed.

A more complete version of this example calculation is available at the end of the publication titled "Tax Incremental Finance: An Intergovernmental/Private Partnership".