

GILMORE & BELL

A PROFESSIONAL CORPORATION
ATTORNEYS AT LAW

ONE METROPOLITAN SQUARE
211 NORTH BROADWAY, SUITE 2350
ST. LOUIS, MISSOURI 63102-2733

314-436-1000
FAX: 314-436-1166
WWW.GILMOREBELL.COM

KANSAS CITY, MISSOURI
WICHITA, KANSAS
LINCOLN, NEBRASKA

September 2008

TAX INCREMENT FINANCING IN MISSOURI

CONTENTS

- I. GENERAL
 - II. MISSOURI STATUTORY PROVISIONS
 - III. FEDERAL TAX ANALYSIS
 - IV. MARKETABILITY OF BONDS
 - V. TAXABLE FINANCING ALTERNATIVES
-

TAX INCREMENT FINANCING IN MISSOURI

I. GENERAL

Tax increment financing (sometimes referred to as "TIF") is a statutory procedure available to municipalities in a number of states to encourage the redevelopment of "blighted" areas, as defined in the various state statutes. Typically, a TIF statute authorizes the governing body of a municipality to adopt a redevelopment plan providing for the redevelopment of a designated area and to use tax increment financing to fund the costs of redevelopment projects in the designated area. Tax increment financing involves the issuance of bonds or other obligations which are secured by a pledge of payments, in lieu of taxes, attributable to the increase in assessed valuation of taxable real property within the designated area resulting from redevelopment improvements.

The Missouri TIF law authorizes cities and counties to adopt a redevelopment plan that provides for the redevelopment of a designated area, and to use TIF to fund a portion of the project costs.

The theory of tax increment financing is that, by encouraging redevelopment projects, the value of real property in a redevelopment area should increase. When a TIF plan is adopted, the assessed value of real property in the redevelopment area is frozen for tax purposes at the current base level prior to construction of improvements. The owner of the property continues to pay property taxes at this base level. As the property is improved, the assessed value of real property in the redevelopment area increases above the base level. By applying the tax rate of all taxing districts having taxing power within the redevelopment area to the increase in assessed valuation of the improved property over the base level, a "tax increment" is produced. The tax increments, referred to as "payments in lieu of taxes," are paid by the owner of the property in the same manner as regular property taxes. The payments in lieu of taxes are transferred by the collecting agency to the treasurer of the municipality and deposited in a special allocation fund. In addition, the county and city transfer 50% of all incremental sales and utility tax revenues to the treasurer of the municipality for deposit into the special allocation fund. All or a portion of the moneys in the fund are used to pay directly for redevelopment project costs or to retire bonds or other obligations issued to pay such costs.

The net effect of tax increment financing is to permit a developer to use a portion of property taxes that otherwise would be paid on the completed project to repay all or a portion of the development costs, thereby reducing the net annual debt service on the completed project (and thus increasing the rate of return on the project). In this manner, future tax increases are not abated, but rather are used to fund costs of the project.

TIF statutes typically require the municipality to make two key determinations prior to approving a TIF project. The first is the "blight" test: the redevelopment area must be classified as a "blighted" area as defined in the applicable state statute; and second, the project must satisfy the "but-for" test: but for the adoption of the redevelopment plan, the redevelopment area would not reasonably be anticipated to be developed.

The remainder of this Memorandum (1) outlines the Missouri statutory provisions relating to tax increment financing; (2) analyzes the types of projects that may be financed with tax-exempt bonds under the Internal Revenue Code of 1986, as amended (the "Code"); (3) discusses the marketability of bonds or other obligations issued to finance TIF projects; and (4) discusses taxable financing alternatives.

II. MISSOURI STATUTORY PROVISIONS

A. The TIF Act.

The Real Property Tax Increment Allocation Redevelopment Act, codified in Sections 99.800 to 99.865 of the Revised Statutes of Missouri (the "TIF Act"), was enacted by the Missouri General Assembly in 1982 and has been amended several times.

The TIF Act authorizes a municipality (defined in the TIF Act to mean a city, village, incorporated town or county) to provide long-term financing for redevelopment projects in designated redevelopment areas through the issuance of bonds or other obligations. Such bonds or obligations may be payable from incremental payments in lieu of real estate taxes and 50% of the increase in certain other tax revenues generated by economic activities within the redevelopment area (including most sales taxes and earnings taxes). The TIF bonds or other obligations may be issued directly by a municipality or by a tax increment financing commission on behalf of a municipality.

The TIF Act permits municipalities to undertake different redevelopment projects within a redevelopment area pursuant to the same redevelopment plan. If a redevelopment plan has multiple redevelopment projects, the municipality may designate different "redevelopment projects" and adopt tax increment financing at different times for each redevelopment project. This structure enables municipalities and developers to phase in projects and to derive additional benefits from the payments in lieu of taxes created by the redevelopment projects.

Before a municipality may implement tax increment financing, (1) the municipality must create a TIF commission as provided in the TIF Act, (2) a redevelopment plan, including a description of the redevelopment area and the redevelopment projects therein, must be prepared, (3) the TIF commission must hold a public hearing and make a recommendation to the municipality pertaining to the redevelopment plan, the redevelopment projects and the designation of the redevelopment area, and (4) the municipality must adopt an ordinance approving the redevelopment plan, the redevelopment projects and the designation of the redevelopment area as discussed below. If a TIF commission makes a recommendation in opposition to a proposed redevelopment plan, redevelopment project, or designation of a redevelopment area, or amendments thereto, the governing body of the municipality may only approve such plan, project, designation or amendment upon a two-thirds majority vote. Once the ordinance is adopted, tax increment financing may be implemented for one or more redevelopment projects within a redevelopment area. Because of various notice and hearing requirements, it will take at least 90 days (and more commonly 120 days or longer) to establish a TIF commission and adopt a TIF plan.

B. Entities Authorized To Utilize Tax Increment Financing.

The TIF Act provides that any "municipality" may exercise the statutory powers granted by the TIF Act. The TIF Act defines "municipality" to be "a city, village, or incorporated town or any county of this state" established on or before December 23, 1996. Mo. Rev. Stat. §99.805(7). If a county is exercising such powers, references in this Memorandum to "ordinance" shall mean "resolution". The TIF Act provides that a county which desires to implement a TIF project within the boundaries of a city within the county must first obtain the permission of the governing body of the city. Mo. Rev. Stat. §99.815.

In addition to the general powers granted in connection with TIF financing, a municipality must create a TIF commission by ordinance of its governing body. The composition of the TIF Commission depends on (1) whether a city or a county is undertaking the redevelopment project, and (2) the location of the city or county undertaking the redevelopment project, as described in the following chart:

Number of members appointed by:	Entity Creating TIF Commission				
	City (outside St. Louis, St. Charles and Jefferson Counties)	City (inside St. Louis, St. Charles or Jefferson Counties)	County (other than St. Louis County)	St. Louis County	St. Louis City
City(ies)	6	3*	6	3*	6
School districts	2	2	2	2	2
County	2	6	0	6	0
Other taxing districts	1	1	1	1	1
Total members	11	12	9	12	9

* These members are appointed by cities that have TIF districts in the county.

The TIF commission conducts the public hearings required under the TIF Act, and makes recommendations to the governing body of the municipality concerning the adoption of redevelopment plans or redevelopment projects and the designation of redevelopment areas. The redevelopment plans, redevelopment projects and the designation of the redevelopment area must receive final approval of the governing body of the municipality. The TIF commission, if authorized by the municipality, may issue bonds and other obligations to finance redevelopment projects. The members of the TIF commission appointed by the county, school districts and other taxing districts serve, at the option of the City-appointed members, for a fixed term or until the TIF commission makes its recommendation to the governing body regarding the approval of the redevelopment plan and redevelopment project.

C. Designation of Redevelopment Area.

The “redevelopment area” must contain property which may be classified as a “blighted area”, a “conservation area” or an “economic development area” (described below), or any combination thereof. The entire redevelopment area need not meet the criteria of one of these three categories, but must include only “those parcels of real property and improvements thereon directly and substantially benefitted by the proposed redevelopment project improvements.” Mo. Rev. Stat. §99.820.1(1) (emphasis added). Thus, as discussed in *Part IV: Marketability of Bonds*, a larger redevelopment area that includes property that is increasing in value can enhance the feasibility of a TIF project, provided the larger area, on the whole, is a blighted, conservation or economic development area and is “substantially benefitted” by the redevelopment project.

Section 99.805 of the TIF Act defines a blighted area, a conservation area and an economic development area as follows:

“Blighted area” is defined as

an area which, by reason of the predominance of defective or inadequate street layout, unsanitary or unsafe conditions, deterioration of site improvements, improper subdivision or obsolete platting, or the existence of conditions which endanger life or property by fire and other causes, or any combination of such factors, retards the provision of housing accommodations or constitutes an economic or social liability or a menace to the public health, safety, morals, or welfare in its present condition and use.

“Conservation area” is defined as

any improved area within the boundaries of a redevelopment area located within the territorial limits of a municipality in which fifty percent or more of the structures in the area have an age of thirty-five years or more. Such an area is not yet a blighted area but is detrimental to the public health, safety, morals, or welfare and may become a blighted area because of any one or more of the following factors: dilapidation; obsolescence; deterioration; illegal use of individual structures; presence of structures below minimum code standards; abandonment; excessive vacancies; overcrowding of structures and community facilities; lack of ventilation, light or sanitary facilities; inadequate utilities; excessive land coverage; deleterious land use or layout; depreciation of physical maintenance; and lack of community planning.

“Economic development area” is defined as

any area or portion of an area located within the territorial limits of a municipality, which does not meet the requirements of [a blighted area or a conservation area], and in which the governing body of the municipality finds that redevelopment will not be solely used for development of commercial businesses which unfairly compete in the local economy and is in the public interest because it will: (1) discourage commerce, industry or manufacturing from moving their operations to another state; or (2) result in increased employment in the municipality; or (3) result in preservation or enhancement of the tax base of the municipality.

The redevelopment project must meet at least three of the factors under the definition of “conservation area” to qualify as a conservation area.

In 2006, the General Assembly amended Missouri’s condemnation laws, which also had an effect on tax increment financing projects. First, farmland that is declared blighted cannot be acquired by eminent domain. Second, blight must be evaluated on a parcel-by-parcel basis, if any property in the redevelopment area will be acquired through (or under the threat of) condemnation.

An amendment to the TIF Act in 2007 prohibits new tax increment financing projects in any “greenfield area” within St. Louis, St. Charles, Jefferson and Franklin Counties. A “greenfield area” is defined as “any vacant, unimproved, or agricultural property that is located wholly outside the incorporated limits of a city, town, or village, or that is substantially surrounded by contiguous properties with agricultural zoning classifications or uses unless said property was annexed into the incorporated limits of a city, town, or village ten years prior to the adoption of the ordinance approving the redevelopment plan for such greenfield area.”

Other legislation in 2007 prohibits new tax increment financing projects in "Hunting Heritage Protection Areas." Such areas consist of all land within the 100 year flood plain of the Missouri and Mississippi rivers, as designated by FEMA, but excluding (1) areas with a population of at least 50,000 persons and designated as an "urbanized area" by the United States Secretary of Commerce, (2) any land ever used, operated or owned by an entity regulated by the Federal Energy Regulatory Commission, (3) any land used for the operation of a physical port of commerce, (4) any land within Kansas City or St. Louis City, and (5) any land located within one half mile of any interstate highway. There are also several exceptions to the general prohibition against new tax increment financing projects including (1) the ability to expand existing tax increment financing projects located within a Hunting Heritage Protection Area, subject to certain limitations, (2) redevelopment projects for the purposes of flood and drainage protection, and (3) redevelopment projects for the purposes of constructing or operating renewable fuel facilities.

Although the TIF Act provides for redevelopment projects in an "economic development area," certain questions remain regarding the constitutionality of TIF financing in such an area that may require a court case to resolve. It is unclear whether there are any instances under which a redevelopment project may be undertaken in an economic development area.

D. Costs That May Be Financed.

The TIF Act provides for the use of tax increment financing to pay all reasonable or necessary costs incurred or incidental to a redevelopment project. Such costs include but are not limited to the following:

1. Costs of studies, surveys and plans;
2. Professional service costs, such as financial advisory fees, bond counsel fees and planning expenses, subject to certain limitations as provided in the TIF Act;
3. Land acquisition and demolition costs;
4. Costs of rehabilitating and repairing existing buildings;
5. Initial costs for an economic development area;
6. Costs of constructing public works or improvements, such as street lighting, street repairs or parking;
7. Financing costs, such as capitalized interest, underwriting expenses and bond printing;
8. A taxing district's capital costs resulting from the redevelopment project, to the extent the municipality by written agreement accepts and approves such costs;
9. Relocation costs; and
10. Payments in lieu of taxes.

A question that is sometimes raised under the TIF Act is whether tax increment financing may be used to pay for new construction of private industrial or commercial facilities, particularly new buildings, within the redevelopment area. Although new construction (other than of public works) is not specifically enumerated in the TIF Act as a redevelopment project cost, a reading of the TIF Act as a whole supports the conclusion that the General Assembly intended that construction of new buildings and structures in a blighted area or a conservation area be a permissible redevelopment project cost under the TIF Act to the extent required to cure the blight.

In 1996, the General Assembly enacted legislation that enables an emergency service district, upon showing that the district has incurred direct costs of providing emergency services to a redevelopment area that are directly attributable to the operation of a redevelopment project, to be reimbursed from TIF revenues for such costs. The emergency service district must show that the increased tax revenues it receives from the redevelopment project will be insufficient to fund such direct costs. The amount of the

reimbursement shall not be less than 25 percent nor more than 100 percent of the tax increment attributable to the emergency service district. Amendments to the legislation in 2002 to increase the reimbursement level and to revise the process for obtaining reimbursements were found by the Cole County Circuit Court to be improperly enacted.

E. Preparation of Redevelopment Plan.

Before proceeding with a redevelopment project, the municipality must approve a redevelopment plan which designates the redevelopment area, describes the redevelopment project and sets forth a comprehensive program for redevelopment. Section 99.810 of the TIF Act requires the following information to be included in the redevelopment plan:

1. Estimated redevelopment project costs;
2. The anticipated sources of funds to pay the costs;
3. Evidence of commitments to finance the project costs;
4. The anticipated type and term of the sources of funds to pay costs;
5. The most recent equalized assessed valuation of the property within the redevelopment area which is to be subjected to payments in lieu of taxes and economic activity taxes;
6. An estimate of the equalized assessed valuation after redevelopment; and
7. The general use of the land in the redevelopment area.

Additional information not required by statute may be included in the plan, such as the total acreage in the redevelopment area and the total payments in lieu of taxes and economic activity taxes estimated to be generated over the period the plan is in effect.

F. Public Hearing Regarding Redevelopment Plan.

Prior to the designation of a redevelopment area and approval of the redevelopment plan and redevelopment project by the municipality or any recommendation to the municipality by the TIF commission, the TIF commission must hold a public hearing on the redevelopment plan and redevelopment project and the proposed redevelopment area. Mo. Rev. Stat. §99.825. Notice of the hearing must be given as follows:

- 1. To all taxing districts within the redevelopment area and to the department of economic development:**

Notice by certified mail must be given at least 45 days prior to the public hearing to all taxing districts which have taxable property included in the proposed redevelopment area or redevelopment project, and to the director of the Missouri department of economic development. The notice must include an invitation to each taxing district to submit comments to the TIF commission concerning the subject matter of the hearing prior to the date of the hearing.

- 2. To persons within the area who pay property taxes:**

Notice must be mailed at least 10 days prior to the public hearing to the person or persons in whose name the general taxes for the last preceding year were paid on any parcel of land lying within the redevelopment area or the redevelopment project which is to be subjected to the payments in lieu of taxes and economic activity taxes. If taxes were not paid for the last preceding year, the notice shall be sent to the persons listed as owners of such property for the preceding three years.

3. To the general public:

Notice must be given at least twice in a newspaper of general circulation within the proposed redevelopment area. The first publication must be not more than 30 days before the date of the hearing; the second publication must be not more than 10 days before the hearing.

4. Information required in all notices:

- a. Time and place of public hearing;
- b. The general boundaries of the proposed redevelopment area or redevelopment project by street location, where possible;
- c. A statement that all interested persons shall be given an opportunity to be heard at the public hearing;
- d. A description of the proposed redevelopment plan or redevelopment project and a location and time where the entire plan or project proposal may be reviewed by any interested party; and
- e. Such other matters as the TIF commission may deem appropriate.

At the public hearing, any interested person or affected taxing district may file written objections to, or comments on, and may be heard orally with respect to, any issues embodied in the notice. The TIF commission shall hear and consider all protests, objections, comments and other evidence presented at the hearing. Mo. Rev. Stat. §99.825.

The hearing may be continued to another date without further notice other than a motion to be entered in the minutes that sets the date and time of the subsequent hearing. Prior to the conclusion of the hearing, changes may be made in the redevelopment plan, redevelopment project or redevelopment area, provided written notice of the changes is given to each affected taxing district at least seven days prior to the conclusion of the hearing. After the hearing but prior to the adoption of an ordinance approving a redevelopment plan or redevelopment projects or designating a redevelopment area, certain changes can be made to the redevelopment plan, redevelopment projects or redevelopment area without holding another public hearing, so long as (1) the changes do not enlarge the exterior boundaries of the redevelopment area and do not substantially affect the general land uses established in the redevelopment plan or substantially change the nature of the redevelopment projects, and (2) notice of such changes is given by publication and by mail to each affected taxing district at least 10 days prior to the adoption of the changes by ordinance. After the ordinance approving the redevelopment plan or redevelopment projects or designating the redevelopment area is adopted, no changes can be made which alter the boundaries of the redevelopment area, affect the general land uses established by the redevelopment plan or change the nature of the redevelopment projects unless another public hearing is held and notice thereof is given as provided above.

The TIF commission is required to vote on any proposed redevelopment plan, redevelopment area and redevelopment project within 30 days after the public hearing is held and to make recommendations in connection with the foregoing to the municipality within 90 days after the public hearing.

If the county-wide TIF commission required for municipalities in St. Louis, St. Charles, and Jefferson Counties fails to make a recommendation within 30 days of the public hearing, the plan, project, or designation at issue will be deemed to have been rejected by the TIF commission. Additionally, public hearings held by the county-wide TIF commission may not be continued for more than 30 days unless a

longer period is requested by the chief elected official of the municipality creating the commission and approved by a majority of the members of the county-wide TIF commission.

G. Adoption of Ordinances by Municipality.

1. Approval of Redevelopment Plan.

The redevelopment plan will become effective upon adoption of an ordinance by the municipality that approves the redevelopment plan and the redevelopment project and designates the redevelopment area. As discussed above, if the TIF Commission makes a recommendation in opposition to the redevelopment plan, the redevelopment project or the designation of the redevelopment area, the governing body of the municipality may only approve such plan, project or designation upon a two-thirds majority vote. The ordinance must be introduced at least 14 days but not more than 90 days after the public hearing described above. Mo. Rev. Stat. §99.820.

2. Required Findings.

The TIF Act does not specify in detail what information must be included in the ordinance approving the redevelopment plan. However, Section 99.810 states that no redevelopment plan may be adopted without findings that:

a. The redevelopment area on the whole is a blighted area, a conservation area or an economic development area, including a detailed description of the factors that qualify the redevelopment area.

b. The redevelopment area has not been subject to growth and development through investment by private enterprise and would not reasonably be anticipated to be developed without the adoption of tax increment financing (this is sometimes referred to as the “but-for” test, as discussed above, and must be supported by an affidavit of the developer submitted with the redevelopment plan).

c. The redevelopment plan conforms to the comprehensive plan for the development of the municipality as a whole.

d. The estimated dates, which shall not be more than 23 years from the adoption of the ordinance approving a redevelopment project within a redevelopment area, of completion of any redevelopment project and retirement of obligations incurred to finance redevelopment project costs have been stated.

e. A plan has been developed for relocation assistance for businesses and residences. The relocation plan must comply with the provisions of Sections 523.200 to 523.215 of the Revised Statutes of Missouri, as amended.

f. A cost-benefit analysis has been prepared showing the economic impact of the plan on each taxing district that is at least partially within the boundaries of the redevelopment area.

g. The redevelopment plan does not include the initial development or redevelopment of any gambling establishment.

3. Adoption of Tax Increment Financing.

At the same time a municipality approves a redevelopment project, the municipality may also adopt tax increment financing, either in the same ordinance or by a separate ordinance. Mo. Rev. Stat. §99.845. If there will be multiple redevelopment projects within the redevelopment area, the ordinance adopting tax increment financing for each redevelopment project should not be adopted until that particular redevelopment project is ready to proceed. However, no ordinance approving a redevelopment project may be adopted more than 10 years after the adoption of the ordinance approving the redevelopment plan under which the redevelopment area is organized. Mo. Rev. Stat. §99.810(3). The ordinance adopting tax increment financing shall provide that, after the total equalized assessed valuation of the real property in the area selected for the redevelopment project exceeds the total initial equalized assessed valuation of the real property in such area, the amount attributable to the excess over the initial equalized assessed valuation shall be paid into a "special allocation fund" as a payment in lieu of tax. Payments in lieu of taxes which are due and owing constitute a lien on the real estate from which they were derived, and may be foreclosed in the same manner as a special assessment lien.

In addition to the payments in lieu of real property taxes which are deposited into the special allocation fund, the TIF Act provides that municipalities shall deposit into the special allocation fund 50% of the total additional revenues from certain taxes imposed by any local taxing district which are generated by "economic activities" in the area of the redevelopment project while tax increment financing is in effect. The TIF Act specifically excludes from capture for tax increment financing sales taxes on sleeping rooms at hotels and motels, license fees, special assessments, personal property taxes, and certain taxes imposed in Jackson and St. Louis Counties.

The municipality may pledge all or any part of the funds deposited in the special allocation fund to the payment of the redevelopment project costs and obligations. The municipality may provide for distribution to the taxing districts of moneys in the special allocation fund not required for payment of redevelopment costs or obligations. All surplus payments in lieu of taxes shall be distributed annually to the taxing districts in the redevelopment area that impose ad valorem taxes on a basis that is proportional to the current collections of revenue that each taxing district receives from real property in the redevelopment area. All surplus economic activity taxes and other revenues shall be distributed to taxing districts on a basis that is proportional to the contribution that each taxing district made to the economic activity taxes or other revenues in the year prior to disbursement. Mo. Rev. Stat. §99.835.

H. Determination of Payment in Lieu of Taxes.

After the municipality passes an ordinance providing for tax increment financing, the municipality should send a copy of the ordinance to the county assessor so the county assessor can determine the total equalized assessed value of all taxable real property within the designated redevelopment project area prior to redevelopment. Thereafter, the total equalized assessed valuation of taxable real property in the redevelopment project area in excess of the initial equalized assessed valuation is computed by the county assessor for each year that tax increment financing is in effect. The payments in lieu of taxes are made by property owners in the redevelopment area on the increase in current equalized assessed valuation of each taxable parcel of real property over and above the initial equalized assessed valuation of each such parcel, and such payments are deposited into the special allocation fund.

I. Economic Activity Taxes.

The TIF Act requires that 50% of the increase in total revenues of incremental sales and utility taxes (referred to as “economic activity taxes”) are captured and deposited into the special allocation fund.

Under the TIF Act, economic activity taxes do not include taxes imposed on sales or charges for sleeping rooms paid by transient guests of hotels and motels, licenses, fees, special assessments and personal property taxes. Any economic development sales tax imposed pursuant to Section 67.1305 of the Revised Statutes of Missouri is not captured by tax increment financing unless recommended by the economic activity tax board and approved by the governing body imposing the tax. Any city or county which levies a children’s service sales tax pursuant to Section 67.1775 of the Revised Statutes of Missouri and approves a redevelopment plan or project after August 28, 2007 must reimburse the amount of the children’s services sales tax captured and deposited into the special allocation fund to the community children’s service fund established in conjunction with the imposition of the children’s services sales tax.

J. New State Revenues and MODESA.

Pursuant to the 1997 amendments to the TIF Act, up to 50% of any new state revenues generated within a redevelopment area after January 1, 1998 may, under certain circumstances, be rebated to the municipality for reimbursement of eligible redevelopment project costs. “New state revenues” means either (1) state sales taxes except those that are constitutionally dedicated, school district trust fund taxes, and sales and use taxes on motor vehicles, trailers, boats and outboard motors or (2) state income tax withholding. Mo. Rev. Stat. §99.845.

Blighted areas in enterprise zones, blighted areas in federal empowerment zones, or blighted areas in central business district or urban core areas may qualify for the rebate of new state revenues. The central business district or urban core area must contain one or more buildings at least 50 years old, suffer from generally declining population or property taxes, or be a certain historic hotel described in the TIF Act or a certain federally approved levee district.

Among the conditions precedent for the appropriation of new state revenues are: (1) approval by the Department of Economic Development and the Commissioner of Administration of an application for state rebate; (2) submission of an affidavit signed by the developer stating the project would not be developed “but for” the rebate; and (3) submission of a fiscal impact study upon the State of Missouri. In addition, for plans and projects adopted after December 23, 1997, the redevelopment plan must ensure that 100% of the payments in lieu of taxes and 50% of the economic activity taxes will be used for eligible redevelopment project costs, and will not be distributed to taxing districts as surplus funds.

In 2003 the Missouri General Assembly passed “MODESA,” the Missouri Downtown and Rural Economic Stimulus Act. MODESA is only mentioned and described briefly here, as it is a completely separate statutory scheme for tax increment financing. The key differences regarding the capture of new state revenues between MODESA and “traditional” tax increment financing statutes described above are: (1) MODESA can be used in more locations; (2) MODESA allows for the capture of both up to 50% of the new state sales taxes and up to 50% of the new state income tax generated by the project, whereas traditional tax increment financing only allows the capture of one of these state revenues; and (3) traditional tax increment financing requires annual state appropriation for each project and MODESA does not. Please contact Gilmore & Bell for more information about MODESA.

K. Issuance of Bonds or Other Obligations.

Either the municipality or the TIF commission may issue bonds or other obligations under the TIF Act which are payable from moneys in the special allocation fund or other funds specifically pledged. The TIF Act provides that voter approval of TIF bonds is not required. The bonds or other obligations must mature within 23 years, may bear any interest rate and may be sold at public or private sale as determined by the municipality or TIF commission. The bonds or other obligations are not a general obligation of the municipality and, accordingly, do not count toward the municipality's constitutional debt limitation.

L. Surplus Funds Remaining in Special Allocation Fund.

When redevelopment project costs have been paid and any related obligations retired, any surplus funds in the special allocation fund are to be paid to the taxing districts in the designated redevelopment project area, in the same proportion that distributions of real property taxes are made to the affected districts. Mo. Rev. Stat. §99.850. This formula, which is inconsistent with the formula for distributing surplus funds set forth in Section 99.835, favors taxing districts (such as school districts) that receive more revenues from property taxes than sales and other taxes that constitute "economic activity taxes."

M. Reporting/Hearing Requirements.

1. Annual Reports.

The governing body of the municipality must submit to the Missouri Department of Economic Development an annual report concerning the status of each redevelopment plan and project. The municipality must also publish in a newspaper of general circulation in the county a statement showing the payments in lieu of taxes received and expended in that year, the status of the redevelopment plan and projects, the amount of outstanding bonded indebtedness and any additional information the municipality deems necessary. Mo. Rev. Stat. §99.865.

2. Public Hearing Every Five Years.

Every five years, the governing body of the municipality must hold a public hearing to determine if the redevelopment project is making satisfactory progress under the proposed time schedule contained in the redevelopment plan. Notice of the public hearing must be given in a newspaper of general circulation in the redevelopment area once each week for four weeks immediately prior to the hearing. Mo. Rev. Stat. §99.865.

N. Disposition of Land; Selection of Developer.

The TIF Act states that no disposition of land or agreement relating to the development of property in a redevelopment area may be made without public disclosure of the terms of the disposition and all bids and proposals made in response to the municipality's request. Mo. Rev. Stat. §99.820.1(3). Pursuant to the 1997 amendments to the TIF Act, each municipality or TIF Commission must also establish written procedures relating to bids and proposals for implementation of redevelopment projects. Based on the 1997 amendments, we interpret the TIF Act to require municipalities to solicit proposals from developers to carry out each redevelopment plan and redevelopment project. The request for proposals must provide a reasonable opportunity for developers to submit alternative bids or proposals. Practice varies among municipalities as to whether the TIF commission recommends a developer to the municipality.

III. FEDERAL TAX ANALYSIS

TIF bonds or other obligations issued as part of a tax increment financing plan may be issued as either tax-exempt or taxable obligations. The interest on such obligations will be exempt from federal income taxation if the proceeds are used only for a governmental purpose or if the bonds meet certain other requirements of the Internal Revenue Code of 1986, as amended (the "Code").

A. Governmental Bonds.

When bond proceeds are used to finance traditional governmental facilities such as streets, roads and sewers, the interest on the bonds is excluded from gross income for purposes of federal income taxation under Section 103 of the Code. This generally will be true even when the bonds are paid from tax increment payments made by the owner/developer, provided the governmental facilities are available for use by members of the general public on an equal basis.

B. Private Activity Bonds.

If the bond proceeds are used to finance facilities used in the trade or business of a developer or other private entity, the bonds may be "private activity bonds" within the meaning of Section 141 of the Code and must meet certain other very restrictive provisions of the Code in order to be tax-exempt. Each project must be examined on a case-by-case basis to determine whether the bonds are classified as "private activity bonds. Generally, if the private activity bond is payable solely from tax increment revenues, the interest on the bonds will be tax-exempt. If the private activity bonds are also secured by other sources of payment (e.g. letter of credit, guaranty, etc.), the interest on the bonds will be generally taxable.

IV. MARKETABILITY OF BONDS

Difficulty in marketing TIF bonds usually will be the greatest obstacle to successful completion of tax increment financing projects in Missouri. In some states, the law provides for the issuance of TIF bonds that are also general obligations of the issuing municipality. Such bonds are payable from tax increments but are also backed by the full faith and credit of the municipality in the event the tax increment revenues are insufficient to pay the bonds. Consequently, such double barrel bonds carry the general credit rating of the municipality and generally are readily marketable. Under the Missouri TIF Act, tax increment allocation bonds are not general obligations but are backed solely by the tax increment and, therefore, the financial strength and credit of the developer. As a result, several factors will affect both the marketability and interest cost of TIF bonds.

The first consideration will be the anticipated assessed valuation of the completed redevelopment project, which in turn will determine the amount of tax increment revenues that will be generated by the project. Redevelopment projects should generate tax increments (including payments in lieu of taxes and economic activity taxes) in an amount comfortably in excess of debt coverage. Debt coverage refers to the amount of revenue available to pay the annual debt service on the bonds or other obligations issued to finance the redevelopment project. Most investment banking firms would consider tax increments of 125% to 200% of debt coverage to be adequate, depending on the creditworthiness of the developer. Therefore, if the annual debt service is \$100,000, tax increments plus other revenues available for debt service should exceed \$125,000.

The second factor affecting marketability will be the ability of a municipality to demonstrate that redevelopment is imminent, for if the project is not completed there will be no increase in assessed valuation and thus no tax increment. Prior to issuing bonds, the municipality should have firm construction commitments from the developer. In addition, the municipality may require good faith deposits and evidence that the developer has financing commitments for the project. In general, the municipality should take all possible steps to ensure that the private development will occur in a timely manner.

The last factor affecting marketability, and probably the most important, is the creditworthiness of the developer. Potential bond purchasers should be informed of the developer's experience with similar projects, project management and the financial strength of the developer and other project users, if any.

Municipalities may improve the marketability of TIF bonds by using one or more of the following techniques:

1. *Credit Enhancement.* If the redevelopment project is being undertaken at the request of a private developer, the developer may be required to obtain a bank letter of credit as additional security for the bonds. The bonds then would carry the same rating as obligations of the bank issuing the letter of credit. This alternative would cause the bonds to be private activity bonds if the financed facilities are to be used for private business purposes but would not if the financed facilities are for public infrastructure improvements.

2. *Enlarge Redevelopment Area.* So long as the redevelopment area on the whole qualifies as a blighted, conservation or economic development area, the municipality can enlarge the redevelopment area to include not only the immediate vicinity of the proposed redevelopment, but also surrounding areas which will be substantially benefitted by the redevelopment. If the redevelopment area is large enough to encompass areas in which assessed value is increasing, additional tax increments can be generated. In addition, if the increments are sufficient to retire the bonds without major future developments, the speculative nature of the program is removed.

3. *Create a Seed Project.* The municipality can begin its redevelopment program with a "seed project." The municipality would postpone issuing its tax increment bonds until a redevelopment project is essentially completed. Hopefully, this new development will produce sufficient tax increments to retire the bonds without major future developments. Like an enlarged project area, seed projects can remove some of the speculative aspects of a redevelopment program.

4. *Appropriate General Revenues.* The municipality may agree to appropriate moneys, subject to annual appropriation from its general revenue funds, to pay debt service on TIF bonds until the tax increments produced by the redevelopment project reach a specified level of debt service coverage.

5. *Capitalized Interest and Debt Service Reserve Fund.* In order to address cash flow problems that may be experienced during the construction period and before the assessed valuation of the project increases, a portion of the proceeds of the TIF bonds issued to finance the project may be set aside and used to meet debt service on bonds during this start up period, and to fund a reserve that would be available thereafter for payment of debt service if cash flow is insufficient. Principal is not retired on the bonds until after the construction is completed. Under the TIF Act, capitalized interest may be funded for a period equal to the construction period plus 18 months. This technique should be carefully utilized since the issuance of the additional bonds will reduce debt coverage for the remaining life of the bond issue.

6. *General Obligation Bonds.* In lieu of issuing bonds under the TIF Act, a municipality might consider issuing general obligation bonds to fund project costs. The bonds must be authorized by an election and issued in the same manner as other general obligation bonds. Although tax increment revenues, to the extent available, would be the first funds used to pay the bonds, such bonds would be secured by the municipality's full faith and credit and, if necessary, would be payable from taxes levied by the municipality. The use of general obligation bonds in conjunction with a tax increment program can reduce interest costs, eliminate cash flow problems and simplify the financing program. However, the use of the municipality's general credit bonds to back a redevelopment project would involve significant policy considerations by the municipality's governing body.

7. *Neighborhood Improvement District Bonds.* A municipality might also consider issuing bonds to pay project costs under the Neighborhood Improvement District Act, Sections 67.453 through 67.475 of the Revised Statutes of Missouri, as amended. A neighborhood improvement district consists of property that is benefitted by public improvements within the district. The improvements are paid for through special assessments levied against the benefitted property. The Missouri Supreme Court has held that neighborhood improvement district bonds are backed by the full faith and credit – but not the unlimited taxing power – of the municipality. *Spradlin v. City of Fulton*, 924 S.W.2d 259 (Mo 1996) (en banc). If a neighborhood improvement district and a TIF district have the same boundaries, the municipality could issue neighborhood improvement district bonds to pay redevelopment costs identified in the TIF redevelopment plan. The incremental revenues under the TIF redevelopment plan could then be applied, instead of the special assessments, to repay the neighborhood improvement district bonds. The use of neighborhood improvement district bonds can result in lower interest costs than on tax increment financing bonds, since the City's full faith and credit is securing the neighborhood improvement district bonds.

V. TAXABLE FINANCING ALTERNATIVES

As discussed in *Part III: Federal Tax Analysis*, tax-exempt financing for redevelopment projects is sometimes limited. However, the primary incentive for using tax increment financing will be the economic benefit from property tax relief rather than federal income tax exemption. The benefits of tax increment financing may be utilized in connection with nearly any type of taxable financing alternative. Upon meeting the statutory requirements for qualification of a redevelopment project, the payments in lieu of taxes and economic activity taxes may be used to finance taxable bonds or obligations issued by the municipality or TIF commission or any financing obtained directly by the developer, including conventional loans or taxable bonds issued on behalf of the developer by any other bond issuing authority.

* * * *

Prepared by:

Mark D. Grimm
(314) 436-1000
mgrimm@gilmorebell.com