PROGRAM EVALUATION

State Supplemental Tax Increment Financing Program
Program Evaluation

State Supplemental Tax Increment Financing Program

Prepared for the Committee on Legislative Research
by the Oversight Division

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Committee on Legislative Research
Oversight Subcommittee

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THE COMMITTEE ON LEGISLATIVE RESEARCH is a permanent joint committee of the Missouri General Assembly comprised of the chairman of the Senate Appropriations Committee and nine other members of the Senate and the chairman of the House Budget Committee and nine other members of the House of Representatives. The Senate members are appointed by the President Pro Temp of the Senate and the House members are appointed by the Speaker of the House of Representatives. No more than six members from the House and six members from the Senate may be of the same political party.

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The Joint Committee on Legislative Research adopted a resolution in May 2007, directing the Oversight Division to perform a program evaluation of the State Supplemental Tax Increment Financing Program to determine and evaluate program performance in accordance with program objectives, responsibilities, and duties as set forth by statute or regulation.

The report includes Oversight’s comments on internal controls, compliance with legal requirements, management practices, program performance and related areas. We hope this information is helpful and can be used in a constructive manner for the betterment of the state program to which it relates. You may request a copy of the report from the Oversight Division by calling 751-4143.

Respectfully,

Representative Scott Muschany
Chairman
EXECUTIVE SUMMARY

The State Supplemental Tax Increment Financing Program is one of many administered by the Department of Economic Development (DED). The intent of the program is to facilitate redevelopment in blighted areas by providing essential public infrastructure. Municipalities may apply to receive up to one half of the increase in either state general revenue sales tax or state income tax that is generated within approved redevelopment areas.

Since its inception in 1997, DED has repaid roughly $7.9 million of state tax increment back to municipalities under this program. These funds can be used for various things related to the redevelopment project, including land acquisition, land preparation, construction of public works or public improvements, rehabilitation, reconstruction or repair of existing buildings, professional services, and/or financing costs.

DED calculates the amount of increment earned by a project by comparing the sales tax or income tax paid to the Department of Revenue (DOR) to that of the base year for the project. Oversight noted several types of errors that occurred in computing the increment and recommended DED develop and utilize a procedural checklist for all future calculations and payments.

Oversight noted that the base amount of sales tax for one of the State TIF projects is zero, which in turn means that all of the sales tax revenue generated within the redevelopment area is then considered new (and subject to the increment calculation). The municipality appears to have been able to manufacture the zero basis for the project by extending the effective date of the project's approval and closing all business activity in the area prior to the base year calculation. Oversight recommends possible changes to the statutes that would prohibit this from occurring in the future.

A requirement of the application process is for developers to submit an affidavit that they would not develop the project if not for the financial assistance from the supplemental tax increment financing program. A similar determination is required by the Kansas City Economic Development Corporation (EDC) for all projects wanting to utilize local TIF in Kansas City; however, the EDC requires the applicant to pay for an independent consultant to submit evidence satisfying the "but for" test. Oversight recommends DED consider adding this third-party requirement in the application process for the State Supplemental Tax Increment Financing program.

Oversight notes in one instance, that DED changed the base amount on a specific project roughly nine years after the base year. Originally, the base for this redevelopment project was the amount of general revenue sales taxes collected by a grocery store in 1994. In 1997, the General Assembly passed House Bill 491 which reduced the sales tax rate on food by three percent (General Revenue portion), thereby making it more difficult to earn increment. In 2003, DED adjusted the base for the State TIF project to what it would have been if the 1997 repeal of general revenue sales tax on food had occurred prior to the base year. Oversight is uncertain if DED had the authority to reduce the basis for this State TIF project and assumes such recalculation of base year amounts conflict with the base year determination as outlined in
statutes. If DED intends to adjust base year amounts to other than what is stated in statute, DED should suggest legislation to amend the statute in order to provide for such recalculations.

Oversight also noted the lack of several important items from DED’s project files. Oversight recommends DED develop and utilize a checklist for the master file for each project to ensure that all important documents (such as executed municipal ordinances, annual reports for the underlying TIF projects, and verification of bond issuances) be obtained by DED and kept in the file.

Oversight wishes to thank the Missouri Department of Economic Development for their cooperation and assistance during the evaluation.

Mickey Wilson, CPA
Director
Chapter 1 - Introduction

Purpose

The Joint Committee on Legislative Research directed the Oversight Division to conduct a program evaluation of the State Supplemental Tax Increment Financing Program. The purpose of the evaluation was to determine the effectiveness of the program as administered by the Department of Economic Development (DED). The scope of the evaluation concentrated on the period of July 1, 2003 through June 30, 2006. The methodology used by the Oversight Division included review of DED reports and transactions, visits to a sample of projects utilizing the program, and interviews conducted with DED staff as well as municipalities.

Background

The Department of Economic Development (DED) administers the State Supplemental Tax Increment Financing Program (State TIF) which was established in 1997. The stated purpose of the program is to facilitate redevelopment in blighted areas by providing essential public infrastructure.

The program provides financing for redevelopment projects when local tax increment financing leaves a gap. Municipalities may apply to the state to receive up to one-half of the state's increase in general revenue sales tax income from a project area or up to one-half of the state's increase in state income tax revenue from net new jobs within a project area. State TIF may be awarded for a period of up to 15 years (a longer period may be requested, but cannot exceed 23 years). To be eligible for State TIF, the underlying local TIF must also dedicate at least 50% of the amount of new local sales tax (or earnings tax in St. Louis and Kansas City) revenue and 100% of the amount of the new real property tax revenue created by the project each year for which State TIF is sought. The program is limited each year to the amount appropriated by the General Assembly. The annual limit for the program was increased from $15 million to $32 million in 2005.

To be eligible for State TIF, the redevelopment project must meet each of the following criteria:
- The redevelopment project area must be blighted;
- The redevelopment project area must be located in a state enterprise zone, a federal empowerment zone, an urban core area, or a central business district;
- The area must contain at least one building that is 50 years of age or older; and
- The redevelopment project area, over the past 20 years, must have experienced a generally declining population or generally declining property taxes.

At the beginning of Fiscal Year 2008, there were four projects that were actively receiving payments from the state through this program, and roughly eight other projects that are in
various stages of redevelopment that have not yet received State TIF funding. One project has received its total allotment of state funding and is considered ‘complete.’ Of these thirteen (4+8+1) projects, seven are in the Kansas City area, three are in the St. Louis area, one is in Springfield, one is in Branson and one is in Excelsior Springs.

Generally, the program is initiated when a municipality applies with a Part 1 application to DED for funding assistance for a project. DED reviews the Part I application for statutory eligibility. The project is required to gain a line item placeholder, by name, within DED’s budget. After the legislative action takes place and the bill is signed and in effect, DED offers a decision regarding approval or denial of a project. DED makes a recommendation to the Office of Administration Commissioner for execution of the Certificate of Approval. DED and the municipality will determine the annual and total increment for which the project is eligible based upon the anticipated eligible expenses and projected state tax increment. Periodically, the municipality will request payment from DED of the increment that the project has generated. DED will then request information from the Department of Revenue (DOR) to calculate the amount of general revenue sales tax (or withholding tax) that has been paid to the state within this time frame by all businesses within the redevelopment plan. This is then compared to the base year amount and up to one-half of the increase (increment) of net new revenues are paid to back the city. The city then uses these State TIF payments to either retire bonds that have been issued to fund this project, or to reimburse the developer for eligible costs already incurred (known as ‘pay-as-you-go’).

Eligible redevelopment project costs include:
- studies, surveys, plans and specifications;
- land acquisition, land preparation;
- rehabilitation, reconstruction or repair or remodeling of existing buildings and fixtures;
- construction of public works or public improvements;
- professional services such as architectural, engineering, legal, financial and planning; and
- financing costs such as expenses of issuance of bonds.

Through calendar year 2006, the Department of Economic Development has returned roughly $7.9 million of state tax increment back to the municipalities under this program. The aggregate amount of State TIF that has been agreed to by DED and the municipalities under this program for all years totals $427.8 million through CY 2030, with the largest single calendar year total being $25.7 million in 2022.

The legislative authority for the program is contained in Sections 99.845.4-14 and 99.805, RSMo. Missouri’s Tax Increment Financing Law was first enacted in 1982 as the “Real Property Tax Increment Allocation Redevelopment Act” and was designed as a tool for redeveloping certain dilapidated, neglected, undeveloped, or economically vulnerable areas. The state supplement to the program was established through Senate Bill 1 from the Second Extraordinary Session in 1997. Senate Bill 343 in 2005 then increased the annual limit of State TIF payments from $15 million to $32 million.
Chapter 2- Comments

Comment 1:

Oversight recommends the Department of Economic Development (DED) develop an internal checklist to follow when issuing State tax increment payments. Oversight reviewed all of the payments that have been issued by DED for this program, and found several errors that might have been avoided if a checklist were utilized. Examples of redundant errors included:

- State TIF increment payments are calculated by comparing the state general revenue sales tax collections (or state income tax revenue) for businesses within a redevelopment project to that of the base year. If twelve months of current year income are compared to twelve months of base year income, the comparison should be relatively easy. Sometimes however, municipalities request payments for time periods that are not full years, which requires DED to reduce the base year amount of sales tax appropriately. Oversight found instances where this did not happen correctly. For example, a city requested a payment for a six month period, however, when DED calculated the payment, they failed to reduce the base amount by half so that an accurate calculation of increment could be made. Other examples include increment requests for three or four months in which DED did not reduce the base year sales tax amount correctly. Oversight recommends DED only allow increment payment requests for full years, half years or on a monthly basis (not allow increments of 2 months, 4 months, etc.) and ensure the base year is adjusted accordingly.

- Often, municipalities request State TIF payments for calendar years soon after the year is complete. If DED requests sales tax information for companies within a project area too soon in January, some of the December returns may not be posted to the Department of Revenue’s system yet. DED would then need to request the information again at a later date to capture the missing data; however, in some cases DED has not done so. For example, a request for one redevelopment project was sent to the Department of Revenue by DED on January 25, 2006 for the 2005 calendar year. The tax return for one of the companies within the project had not been posted to DOR’s system yet, so the sales taxes collected and remitted to the state for that business appeared to be $0 for the month. This subsequently lowered the payment made to the city by roughly $56,600. This amount could have been made up the following year by adding the December 2005 sales tax collections in with calendar 2006, however it was not. Oversight recommends part of the checklist specify a date after which information may be requested from the Department of Revenue, so that DOR is given sufficient time to post returns to their system.

- To avoid data entry errors, DED should compare totals with the Department of Revenue. DED usually inputs monthly tax collection amounts supplied by DOR into a worksheet to calculate the amount of increment earned within the redevelopment project. Oversight found a case in which a monthly sales tax collection total for a business was input into the DED worksheet as "$771" instead of the actual $7,719. This reduced the payment to the city by $3,475. The error could have been caught if DED had compared the sum of all monthly totals to the annual total provided by DOR.

- Oversight recommends DED, the municipality and the developer all agree on a base year
amount of General Revenue tax collections to use in all future tax increment financing calculations. While reviewing the TIF payments made by DED, Oversight found instances where the base year tax amount changed (and in some cases, more than once). Therefore, Oversight recommends DED keep in its State TIF folders a detailed explanation of the base year calculation, and if the need to change this amount arises, a detailed calculation showing the new amount.

Comment 2:

Under the program, up to one-half of the additional amount of state General Revenue generated by redevelopment projects is returned by the State to help retire the bonds associated with a project or to repay the builder for certain approved expenditures. This 'additional' amount of state tax (or increment) is calculated by comparing tax collections in a current year to a base year. Section 99.845.3, RSMo, describes the base year as the calendar year prior to the adoption of the redevelopment project by ordinance. Generally, the tax collections from all businesses operating within a redevelopment area before a project is approved by city ordinance will constitute the base year and will be used in all future tax increment calculations.

In the case of one particular project, the base year tax collections per the Department of Revenue was zero. Therefore, one half of all General Revenue sales tax collections through 2028 will be available to retire the debt issued for this project. This is the only project in the program for which the base year tax collection total is zero.

This particular city passed a Resolution in June 2001 supporting the concept of the project, including the general financing plan based upon the issuance of state or municipal revenue bonds secured by tax increment financing revenues. In January 2003, the city then adopted an ordinance approving the TIF Plan as well as the redevelopment area, the developer and authorized other actions with respect to the redevelopment plan. Then in March 2005, the city adopted an amended redevelopment plan. Finally, in May 2005, the city passed an ordinance approving Project J within the redevelopment plan; however, the effective date of the ordinance was set out as December 29, 2006. Therefore, with an effective date of December 29, 2006 (last business day in 2006), the base year for this project was considered to be 2005.

The city was able to acquire the property in the redevelopment area and cease all business activity within the project so that the base year sales tax collection total would be zero. Within the city's application for inclusion into this program, the amount of state sales tax paid by the businesses within the area in 2001 was stated to be approximately $1,600,000. Assuming that this represents total state sales tax (4.225%), the General Revenue portion of the state sales tax (3%) would total over $1.1 million per year. This potentially could have been used as the base year sales tax instead of $0 as is currently used, resulting in annual savings of $570,000 for the state.

Oversight assumes this may not be the intent of the original legislation and suggest changes to the Revised Statutes be made so that municipalities are not able to manufacture a zero basis for their redevelopment projects. Possibilities include changing the description of a base year to the
average annual tax collections of the five years prior to passage of the city ordinance, using the highest annual tax collections of the ten years prior to passage of the city ordinance, or possibly determining the base year on passage of the redevelopment plan instead of the passage of the redevelopment project.

**Comment 3:**

Section 99.845.13, RSMo, allows the Department of Economic Development and the Department of Revenue to recover a portion of the salaries and other expenses incurred during the ongoing administrative functions associated with the redevelopment projects. To date, no costs have been recovered by utilizing this section in statutes. Oversight recommends DED work with DOR to develop a cost allocation plan to recoup expenses from the State TIF projects that are currently receiving increment payments.

**Comment 4:**

Section 99.845.10(1)(e), RSMo, requires DED to collect, as part of the application process, an affidavit signed by the developer attesting that the project would not reasonably be anticipated to be developed without the adoption of the State tax increment financing (the ‘but-for’ test). Oversight was able to find such an signed affidavit for each of the projects currently included in the program; however, Oversight assumes it might be more beneficial to get such an assessment from an independent third party. The Economic Development Corporation (EDC) of Kansas City reviews all applications for local TIF projects within Kansas City before making recommendations to the TIF Commission and then the City Council. As part of the application process, the EDC requires potential developers to submit evidence of the requirements of Blight, Conservation Area or Economic Development Area, and “But For” in an independent study by consultants engaged by the TIF Commission at the expense of the developer. Oversight assumes an independent study by consultants would lend more credibility to the critical determination that the project would not be complete if not but for the financial assistance of the State in the form of State TIF payments.

**Comment 5:**

As stated earlier, the base is the total General Revenue sales or income taxes collected within the redevelopment area during the year prior to the ordinance adoption by the municipality. Future general revenue sales tax (or income tax) collections are then compared to this base to arrive at an increment, up to half of which is then paid to the municipality. In one instance, the base year (1994) sales tax was calculated using the sales tax collections at a grocery store that existed in the redevelopment area prior to the TIF project approval. In 1997, the General Assembly passed HB 491 which reduced the state sales tax rate on food by three percent (General Revenue portion). This in effect lowered the sales tax collections going forward for this grocery store, which reduced the amount of increment the project would generate.

In 2003, DED adjusted the base amount for this project to what it would have been if the repeal
of sales tax on food items had occurred prior to 1994. Through a DED calculation, the base for this redevelopment plan was lowered by over $225,000. This could result in higher increment payments of roughly $112,600 annually for the life of this project. Since DED has agreed to pay increment on this project through calendar year 2023, this could increase the total contribution by the state by $2.1 million (19 additional years x $112,600).

Oversight is uncertain if DED had the authority to reduce the basis for this State TIF project. Oversight assumes such recalculations of base year amounts conflict with base year determination as outline in statute. If DED intends to adjust base year amounts to other than what is stated in statute, DED should suggest legislation to amend the statute in order to provide for such recalculation.

Comment 6:

During the program evaluation, Oversight reviewed correspondence between the Department of Economic Development and a city regarding an approved State TIF project that has not progressed to the DED's satisfaction. DED wrote a letter attempting to terminate the State TIF approval for the project; however, there seemed to be a disagreement as to whether or not DED has the authority to do so.

Oversight recommends DED consider adding language to future Certificate of Approval agreements with municipalities clearly stating conditions that may result in termination of the State TIF agreement. Oversight also recommends DED determine if additional language should be added to the Revised Statutes to allow such a termination. Per conversations with DED, the potential to withdraw approval of State TIF payments for a project may result in additional project costs to be incurred by the municipalities since bond investors may require a higher interest rate to compensate for the added risk. However, Oversight feels there may be instances where a change in circumstances may cause the State to not want to be tied to a project for the remainder of the term of the agreement.

Comment 7:

During the program evaluation, Oversight reviewed the files for all of the projects that have been approved by DED and the Office of Administration. During this review, Oversight had difficulty locating various items, including copies of executed municipal ordinances, annual reports of the underlying TIF projects, verification of bond issuance (if applicable), determination of the base amount of taxes, and properly executed Certificates of Approval. Oversight recommends that a documentation checklist be developed for the master file of each project and that the file be organized in the order of the checklist. This list could then be modified slightly and utilized for Missouri Downtown Economic Stimulus Act (MODESA) projects which have a similar long list of documentation to provide with the application.
Comment 8:

Section 99.865.1, RSMo, states "Each year the governing body of the municipality, or its designee, shall prepare a report concerning the statute of each redevelopment plan and redevelopment project, and shall submit a copy of such report to the director of the department of economic development."

All files were reviewed to determine whether the required annual reports had been received. Copies of the annual report for TIF projects were located for some, but not all projects. Oversight recommends that annual reports for State TIF projects, as required by statute, be obtained for each project going forward.
APPENDIX I
APPENDIX II
Oversight Division
Committee on Legislative Research
Program Evaluation
State Supplemental Tax Increment Financing Program

Missouri Department of Economic Development Responses to Report

November 26, 2007

• Chapter 2 - Comment 1

Response:
The payments made to State TIF projects are made in a manner to accommodate the municipalities' bond payment cycle. Currently, only 4 projects are achieving pay outs. Branson is on a monthly cycle, Midtown is on a 6 month cycle. The Convention Center and Riverside are on 12 month cycles. (Note: There have been a couple of minor deviations from a strict one, six or twelve month payment period, usually caused by the city's asking us to pick up a couple of extra months' tax amounts from an individual new business that opened just shortly before a payment request was made and was not included in that request.)

The errors made in payments to Midtown and the St. Louis Convention Center were caught by the DED, and corrected immediately by the DED.

With respect to the baseline year calculation the changes are marked on the electronic spreadsheet. The DED will copy those to the file. The DED does not believe that the base year amount needs to be a mutual agreement between the municipality, the developer and the DED. Rather, any adjustments to the baseline year have been based on additional information discovered and made for accuracy purposes.

• Chapter 2 - Comment 3

Response:
Any reduction of the payment made to the municipality for its project will cause a gap in the project budget.

• Chapter 2 - Comment 5

The acceptance of the new baseline amount was a legal determination by Department General Counsel in 2003.

• Chapter 2 - Comment 6

Response:
Although early TIF agreements failed to include such language, all agreements made since 2005 have contained satisfactory language regarding the state's participation. All TIF agreements include the notification that the participation is subject to annual appropriation. If a TIF project is not generating revenue, then there is no cost to the state.
• Chapter 2 - Comment 7

Response:
The DED will create a file checklist.

• Chapter 2 - Comment 8

The DED sends annual notifications, in writing, to all known local TIF projects (including the ones receiving State TIF). The annual report is compiled by the DED and provided to the legislature in February of every year. The statute provides no penalty for not reporting.