



Inter-Departmental Communication

DATE: September 24, 2002

TO: Evert Asjes, Chair, and Members of the Finance and Audit Committee

FROM: Mark Funkhouser, City Auditor

SUBJECT: Need for a policy to control and direct Tax Increment Financing

Resolution 010924, introduced in June 2001, would establish city policy for the use of tax increment financing for economic development. On July 10, 2002, the Finance and Audit Committee received a memorandum from Laura Whitener, Director and Chief Operating Officer of the Tax Increment Financing Commission, which responds to the specific items contained in Resolution 010924. (A copy of Ms. Whitener's memorandum is attached.)

The purpose of this memorandum is to comment on Ms. Whitener's response. Taken as a whole, her comments seem to disparage the idea that the city should have a policy that limits in any way the use of tax increment financing (TIF). Throughout her memorandum, she argues that because the City Council has the final authority to approve or disapprove TIF plans and projects, there is no need for a policy that limits the use of TIF.

Although Ms. Whitener believes that individual TIF plans and projects should be considered by the City Council on a case-by-case basis, the city needs a policy to control and direct the use of TIF in order to:

- Limit the overall financial risk to the city;
- Assure public confidence in the integrity of the TIF process;
- Recognize the costs of the TIF program and its administration;
- Emphasize the fact that the City Council's role is to develop the city's policy and the TIF Commission's role is to implement that policy;
- Focus TIF as a tool to achieve clear, specific, measurable public goals; and
- Make developers understand what the City Council expects when TIF plans and projects come to it for final approval.

Limit the financial risk to the city. Resolution 010924 proposes that the Council establish a limit on the amount of total assessed valuation subject to TIF. Ms. Whitener's memorandum points out that the state law does not limit TIF in relation to assessed value

and asks what the policy would accomplish. The policy would limit the risk to the city by limiting the city's exposure.

The city's risk with regard to TIF is a function of two elements: the probability of an error and the city's potential financial exposure. The possible errors are that the "but for" test could be applied incorrectly, the amount of tax subsidy required to make the project feasible could be over-stated, or substitution could occur wherein some or all of the sales tax revenue generated was not in fact new revenue but was generated by sales that were previously occurring at existing businesses. The exposure is the amount of revenue redirected to the developers under TIF agreements or the amount of real estate designated as subject to TIF.

Ms. Whitener's memorandum assumes that the probability of an error is zero and therefore it is not necessary to limit exposure. The fact is, people make mistakes. It is illogical to assume that a group of people making a certain series of decisions have, for several years, always been right and will continue to always be right for the foreseeable future.

Assure public confidence in the integrity of the process. The absence of a formally adopted policy for the use of TIF erodes public confidence in the integrity of the process. It can seem as if the public bodies involved, including the TIF Commission and the City Council, are simply responding to project-specific pressure. To the public, as well as to knowledgeable insiders, it can appear that the critical element required for plan approval is not how well the proposed TIF advances agreed upon public goals while limiting the risk to the city, but instead how well connected the developer's attorneys are. With a clear and specific policy, stakeholders can compare what has been suggested by a developer to the criteria embodied in the policy and make a reasonable judgment about whether the proposal complies and should be approved. The chances of political manipulation are greatly reduced when decision-makers have formal criteria for making their decisions.

Recognize the costs of the TIF program and its administration. Resolution 010924 calls for funding the TIF Commission through the general fund rather than through a percentage of TIF revenues, as is presently the case. As Ms. Whitener's memorandum correctly points out, this proposal is inconsistent with the existing agreements between the Economic Development Corporation and the TIF Commission. However, the agreements, which are adopted annually by the parties involved, can be changed. The present situation provides a built-in conflict of interest wherein the body that approves the plans and projects gets a portion of the revenue from approved plans and projects. Worse, the present situation basically keeps the cost of the administration of the program "off the books." Hidden costs are much more difficult to control. Funding the administrative costs of TIF out of the city's general fund through the annual budget and appropriation process would improve the integrity and the management of the program by clearly identifying the costs of the program, bringing the program under the scrutiny of the City Council and other stakeholders, and making the program subject to the same budgetary and financial controls as other programs that compete for city funding.

Emphasize the city’s role as body establishing policy. Ms. Whitener’s memorandum states “Councilman Asjes and other members of the Finance and Audit Committee have specifically requested the TIF Commission establish policies for the use of tax increment financing.” That assertion is incorrect. Chairman Asjes asked for the Commission to comment on Resolution 010924, which, if adopted, would establish city policy with regard to TIF. Establishing policy is the City Council’s role and not that of the TIF Commission.

Ms. Whitener’s memorandum points out repeatedly that the City Council has ultimate approval authority for TIF projects and can review the projects and plans on a case-by-case basis. However, as long as the Council deals with these decisions on a case-by-case basis it is reacting to developer driven proposals, often after the deal has been largely put together and under significant time pressure. Adopting a TIF policy would increase the power of the Council to control TIF by forcing projects to conform to prospective requirements enacted by the Council. A formally adopted city policy would also give the Council a means for holding the TIF Commission and its staff accountable for appropriately reviewing and approving developer proposals that conform to city policy—as opposed to the current situation, which forces the Council to grapple with individual projects only on a case-by-case basis, without an overall policy framework.

Focus TIF as a tool to achieve clear, specific, measurable public goals. The need for improvements to public infrastructure is widely recognized in Kansas City. Improvements to infrastructure, including reducing the city’s large backlog of deferred capital maintenance, has been a high priority of the City Council through the last several budget cycles. In that context, Resolution 010924 proposes that the use of TIF be limited to public infrastructure.

Ms. Whitener’s memorandum states, “It is ultimately up to the City Council to determine whether TIF should be used solely for infrastructure. It is recommended that the city continue to look at projects on an individual basis and to judge those projects in light of public benefit and furtherance of public objectives. By limiting the use of TIF strictly to infrastructure, the city may be forswearing a valuable tool that may help in forwarding other public objectives.” Focusing TIF on a clear and specific public goal, such as improving public infrastructure, will provide more accountability for its use, improve the prospects for meaningful cost-benefit analyses, and improve the potential impact of the program by concentrating benefits on one aspect of the city’s diverse needs. Such a goal is more likely to be achieved if it is communicated clearly to stakeholders in advance.

Make developers understand what the City Council expects. Resolution 010924, if adopted, would provide a formal, written record of the City Council’s expectations with regard to TIF. In the long run, this is clearly less costly for developers and for citizens than having developers spend the money to prepare and present and having the government spend the money to review and then reject individual proposals.

If you would like to discuss these issues further, either individually or as a committee, please let me know.

Attachment

cc: Mayor Kay Barnes
Robert Collins, City Manager
Laura Whitener, Director and Chief Operating Officer, TIF Commission



TAX INCREMENT FINANCING COMMISSION OF KANSAS CITY, MISSOURI

July 10, 2002

Councilman Evert Asjes, Chairman,
and Members of the City Council
Finance and Audit Committee
City Hall – 24th Floor
414 E. 12th Street
Kansas City, Missouri 64106

Re: Resolution NO. 010924

Dear Councilman Asjes and Committee Members:

Members of the City Council have requested preparation of economic development policies. Councilman Asjes and other members of the Finance and Audit Committee have specifically requested the TIF Commission establish policies for the use of tax increment financing. To that affect, Resolution No. 010924 was introduced to City Council in early 2001 containing eleven factors proposed for inclusion in and for purpose of constituting the City'92s policy for the use of tax increment financing. Resolution No. 010924 has been held off the docket at the Finance and Audit Committee awaiting a response from the TIF Commission. The TIF Commission approved a series of policies at its March 2002 meeting in response to the request for policies and forwarded those policies to the Finance and Audit Committee on June 19, 2002 for its review and approval.

On June 19, 2002, the City Finance and Audit Committee expressed concern that the eleven specific factors had not been specifically addressed in Resolution No. 010924. This letter is intended to the address those factors contained in the resolution, which are not directly detailed in the TIF Commission's policies. At it's July 10, 2002 meeting the TIF Commission directed staff to respond to the specific policies. The response to each factor is as follows:

- 1. Maximum assessed valuation for use of TIF – The total assessed valuation of parcels for which tax increment financing has been approved will not exceed a percentage of the total assessed valuation of the City, which percentage will be determined by the Council.**

Response: Missouri TIF Statue is silent regarding limitation on the designation of TIF in relation to assessed value. The question comes down to what would this policy accomplish. As the basis of the tax increment financing program is strictly about the

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creation of new tax revenues, putting limits on TIF eligibility based on the assessed value would only serve to limit the further creation of new tax revenues for the City. It is unclear how this limitation on assessed value will help the City and whether this policy is relevant.

The TIF Commission has not addressed this in the policies as approved by the Commission in March 2002. The Commission believes that the "but for" test and the "pay-as-you-go" nature of the majority of TIF plans and projects protects the City from any negative impact. The "but for" analysis is intended to insure that the projects would not occur without the use of TIF assistance, and therefore there would be no deferral of property tax revenues or economic activity taxes which otherwise would occur and flow to the City's general fund. The "pay-as-you-go" nature insures that the City is not at risk of providing any assistance unless more than an equal amount of new value is created and PILOTS and EATS are paid to the affected taxing district. It is believed that these two conditions (i.e., but for, pay-as-you-go) do not reduce the existing assessed value and that the resulting TIF plans and projects have actually enhanced the existing assessed value within the designated areas and the surrounding areas. Ultimately, it is up to the City Council to determine whether the plan and/or project should be approved.

2. Use of TIF limited to public infrastructure. Tax increment financing may be used to reimburse costs directly related to the construction of public infrastructure, such as streets, sidewalks, bridges, sewers, and storm water drainage facilities.

Response: Section 99.800 RSMo provides for a broad range of reimbursable costs in addition to just infrastructure. The statute reads that eligible reimbursable costs "include the sum total of all reasonable or necessary costs incurred or estimated to be incurred, and any such costs incidental to a redevelopment plan or redevelopment project, as applicable." The intent of the statute is to use TIF to eliminate blighting conditions and to pursue economic development efforts. In order to guarantee that TIF is used for a public purpose, the statute requires that the City find that the proposed plan and projects are consistent with the City's comprehensive plan. The statute provides that the City is the sole and ultimate arbiter as to whether or not to approve a specific plan or projects while granting the City broad discretion regarding eligible reimbursable costs..

In practice a significant majority of the approved TIF plans and projects have been for the purpose of providing public infrastructure. More than 70% of the TIF reimbursements go for costs associated with public infrastructure, such as streets, sidewalks, bridges, sewers, and storm water drainage facilities and another 24% go to constructing parking. The remaining TIF has gone for rehabilitation of and construction of convention center related hotel rooms to support Bartle Hall, housing related activities and a few other city sanctioned uses.

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To date TIF has been a valuable resource in implementing City identified priorities set forth in FOCUS, other relevant planning documents and City resolutions. In addition to public infrastructure, TIF has been used to assist in: the construction of downtown

parking garages consistent with the goals set forth for the parking commission; provision of downtown convention center hotel rooms consistent with City Council Resolution No. 941748 providing for additional city incremental revenue ("Super TIF"); and provision of housing as set forth in Resolution No. 990405 and in Ordinance No. 010814 most recently providing for the Midtown Housing program.

It is ultimately up to the City Council to determine whether TIF should be used solely for infrastructure. It is recommended that the City continue to look at projects on an individual basis and to judge those projects in light of the public benefit and furtherance of public objectives. By limiting the use of TIF strictly to infrastructure, the City may be forswearing a valuable tool that may help in forwarding other public objectives. The City can never be sure what the next project will be and whether TIF will be the tool that will insure the City can successfully implement its objectives. For example, if an opportunity to assist in development of a life sciences development project should present itself, but the City has determined that TIF shall only be used to construct infrastructure improvements, such a policy might jeopardize the City's ability to successfully implement its objective to make Kansas City a leader in the life sciences.

3. TIF Commission funded through the general fund. Tax increment financing revenues generated by new tax increment financing plans will not be used to pay the costs of operating the Tax Increment Financing Commission or administering the tax increment financing program. Tax Increment Financing Commission costs, except those attributable to existing plans, will be annually appropriated through the City's 92 budget process.

Response: This proposal is inconsistent with both the existing agreements among the City Council, the Economic Development Corporation and affiliated agencies. Under the current and previous contracts between the City and the Economic Development Corporation and affiliated agencies, including the Tax Increment Financing Commission, the Contract states:

WHEREAS, it is the intent of this Council to maintain EDC as a viable and efficient economic development, business retention, and development planning agency of the City for the current fiscal year ending April 30, 2003, and to the extent possible for the EDC and the Statutory Agencies to become financially self sustaining entities, and that the Statutory Agencies involved will work cooperatively with the City on all projects represented by the City;"

This proposed policy would reduce the viable and efficient operation of the EDC and the Statutory Agency known as the TIF Commission, hampering the entities ability to become financially self-sustaining entities. Last fiscal year and this fiscal year the City Council has reduced the EDC budget by at least \$350,000. In addition to the TIF revenues being used to support the operation of the TIF, TIF supports the EDC through annual payments. These payments reimburse documented costs fronted by the EDC to keep the TIF Commission operational during the early years when there were insufficient TIF revenues to pay for TIF expenses. Those early expenses made it possible for the TIF Commission to: respond to litigation which established the validity of TIF (e.g., the Dunn Case); lobby the State in order maintain a viable TIF program; and maintain the day to day operations of the program. The TIF continues to repay the EDC for past documented expenses and to reimburse for current overhead costs associated with housing the TIF Commission and staff. Without the ability to use the TIF program to support the TIF program and in turn the EDC, the City would need to find additional funding just to maintain both the TIF program and the EDC.

4. Use of PILOTS. The City will devote 100 percent of the increment in property taxes to payments in lieu of taxes.

Response: This is dictated in State Statute. Section 99.845 RSMo requires the use of 100% of the PILOTS.

5. Prohibition on use of EATS. The City will not approve tax increment financing plans which call for allocation of incremental economic activity taxes for payment of redevelopment costs for tax increment financing plans.

Response: This is contrary to State Statute. Section 99.845.3 RSMo requires that "fifty percent of the total additional revenue from taxes, penalties and interest which are imposed by the municipality or other taxing districts, and which are generate by economic activity activities within the area of the redevelopment project over the amount of such taxes generated by economic activities within the area of the redevelopment project in the calendar year prior to the adoption of the redevelopment project by ordinance, while tax increment financing remains in effect...shall be allocated to, and paid by the local political subdivision collecting officer to the treasurer or other designated financial officer of the municipality, who shall deposit such funds in a separate segregated account within the special allocation fund".

6. Appropriation for shortfall in PILOTS. If tax increment financing is used to support debt and there is a shortfall in payments in lieu of taxes below that estimated by the Tax Increment Financing Commission and developer, the City will appropriate general fund revenues to make up for the short fall.

Response: This is consistent with current practice and contractual obligations of the City. The decision to obligate the City to support debt is determined solely by the City Council and is provided for in agreements entered into by the City Council. Such obligations are limited currently to six TIF projects (Americana Hotel, Muehlebach Hotel, Midtown, Uptown). In the majority of TIFS there is no City backed debt as the TIF projects are in the form of pay-as-you-go projects or through TIF issued bonds, with all the risk of shortfall lies with the redeveloper.

7. Annual budgets/reports required. For each tax increment financing plan the developer will be required to provide annual budgets, conforming to the City's 92 fiscal year, showing anticipated expenditures and source of revenue, and will include comparisons of actual budgeted expenditures for all prior years.

Response: This procedure is already in practice and is required by the City. In regards to the redevelopment budget and sources and uses, the redeveloper is required to submit a budget for estimated project costs and sources of funds at the time of approval of the plan and/or project. The budget and sources of funds are reviewed and recommended by the TIF Commission to the City Council for their ultimate approval. Typically the City Council's Planning, Zoning and Economic Development Committee receives the Plan, including the budget and sources and uses, as well as the recommendation by the TIF Commission and makes the final recommendation to the City Council. The budget and sources typically do not change once the plan has been approved and, if they change significantly, the redeveloper is obligated under the redevelopment agreement to return to the Commission.

Annual reports and budgets are already required under the City budgeting process. The TIF Commission works with the City Budgeting staff on an annual basis to provide annual budgets and to update the five-year budget forecast. These are brought to the Finance and Audit Committee of the City Council annually as a part of the annual budget process. This process provides for comparisons of actual to budgeted expenditures for all prior years. In addition, the TIF Commission has incorporated as part of its State required annual report, a graphic representation of comparisons of actual and budgeted expenditures for prior years. This annual report is sent to the City Council for its review each Fall.

8. Required commencement of construction. All development agreements will require construction of public infrastructure in an approved tax increment financing project to begin within three years of City Council approval of the plan or project, unless otherwise extended for up to an additional three years.

Response: This proposal is consistent with the desire by the TIF Commission to insure timely commencement of public infrastructure, though scheduling of construction of public infrastructure to date has been considered on a case-by-case basis in context of the specific TIF plan. In most cases construction of public infrastructure has started within three years, though this may not be feasible in all cases if the only source of TIF revenues is dependent upon market driven, TIF generating redevelopment. The TIF Commission has relied upon the approved TIF plan, contractual agreements, annual reports, on-site visits, cooperative efforts with City staff, and, in some cases, advice from TIF Commission created committees (some with City Council representation), to determine and monitor timeliness of construction of public infrastructure. Still the TIF Commission will further consider proposed policies for including in all future redevelopment agreements the requirement to begin construction of public infrastructure in a timely manner.

9. Extension of project completion dates. A project completion date may be extended for up to an additional three years when the developer establishes the existence of unforeseen and unanticipated conditions that reasonably prevented the commencement or completion of actual construction during the initial approved period.

Response: This proposal is consistent with the desire by the TIF Commission to insure timely commencement and completion of public infrastructure, though scheduling of construction of public infrastructure to date has been considered on a case-by-case basis in context of the specific TIF plan. In some cases where the TIF is strictly for construction of public infrastructure (e.g., Walnut Creek, Shoal Creek, Searcy Creek, KCI Corridor, Universal Floodwater TIFS) there may not be a scheduled completion date (other than that required under State Statute) as the plan provides that public infrastructure will be completed when funds become available and to the extent funds become available. In order to make sure that public infrastructure is completed in a timely manner, the TIF Commission has relied upon the approved TIF plan, contractual agreements, annual reports, on-site visits, cooperative efforts with City staff, and, in some cases, advice from TIF Commission created committees (some with City Council representation) to determine and monitor timeliness of construction of public infrastructure. Still the TIF Commission will further consider proposed policies to further insure timely completion of public infrastructure.

10. Limitation on reimbursement. All development agreements will require that if actual construction of public infrastructure has not commenced by the completion date, including the completion date as extended. The development agreements will expire and payments in lieu of taxes will not be available to reimburse costs related

to public infrastructure. No completion date will extend beyond six years from the initial approval of the project.

Response: The TIF Commission also wishes to insure timely completion of all public infrastructure, but sometimes six years is not enough time to accomplish the goals of constructing public infrastructure. In some cases where the TIF is strictly for construction of public infrastructure, the plans (e.g., Shoal Creek, KCI Corridor) have been structured so that there will be phased construction of infrastructure over the life of the plan, with construction occurring when TIF revenues become available and to the extent that funds become available. In the case of some of the existing TIF Plans the City would lose its opportunity to construct desired road improvements because the improvements had not been completed within 6 years (e.g., Shoal Creek, Walnut Creek, Universal, Santa Fe). There also may not be any more TIF Plans for public infrastructure along the lines of Shoal Creek, Santa Fe or KCI, as the six year limitation may appear too daunting a risk to individual redeveloper and they become unwilling to take the initiative to construct City roads and wait for reimbursement. Therefore it is recommended that each public infrastructure TIF plan be viewed on a case-by-case basis in order to increase the likelihood that the public infrastructure will be completed.

11. Individual projects. The City may impose additional requirements on a project-by-project basis to insure responsible use of the tax increment financing.


Response: This is already being done as each plan and project are individually analyzed and heard by both the TIF Commission and the City Council. The TIF Commission analyzes each plan and project on an individual basis and may impose additional requirements as a part of its recommendation to the City Council. The City Council as the ultimate decision maker can, and has, imposed additional requirements to TIF Plans, which requirements are incorporated in the TIF redevelopment agreement or other applicable agreements between the City and the redeveloper.

Related to this factor the TIF Commission did approve one new policy for review and approval by the Finance and Audit Committee. This new proposal provides that all TIF plans and projects also be provided to the relevant City staffs prior to review by the TIF Commission in order to insure additional input and comment to the City Council. In addition, the TIF Commission and the City Planning and Development Department have agreed that all projects be submitted to the City Planning and Development Department for review of land use, design and other planning issues prior to review by the TIF Commission. This new policy and new protocol will enable the TIF Commission and

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City Council to determine if there is need for any additional requirements on a project-by project basis.

Sincerely,

A handwritten signature in cursive script that reads "Laura Whitener".

Laura Whitener
Director and Chief Operating Officer