Kansas Tax Increment Financing (TIF)
And
Sales Tax and Revenue (STAR)

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Springsted provides high quality, independent financial and management advisory services to public and non-profit organizations, and works with them in the long-term process of building their communities on a fiscally sound and well-managed basis.

1 Introduction

In its most common form, Tax Increment Financing (TIF) uses the increased property taxes generated by real estate development within a tax increment financing district to pay for certain eligible costs associated with the development. The value that is "captured" (that is, the increase in property value over the value in the year the TIF district was established) generates property tax increment. The incremental taxes are used to subsidize eligible project costs such as land acquisition, demolition, public and site improvements, and related consulting and administrative costs. The value of the property prior to development (the base or "non-captured" portion) continues to generate property taxes which are distributed to all appropriate taxing jurisdictions.

In Kansas, TIF districts may also capture city sales taxes and city franchise fees generated within a TIF district. This variation is less commonly used than property tax increment, but may provide a significant funding resource with which to supplement "regular" property TIF.

Justification for the use of tax increment financing solely with the "But For" test. A simple way to express this test is to ask whether the development or redevelopment would occur "but for" a tax increment subsidy. Critics of TIF often claim that the development would have occurred anyway, and that local officials are not rigorously applying this test. They argue that city overuse of TIF comes at the expense of the tax base of the county, school district, and other taxing jurisdictions. Supporters of TIF counter that while there have been limited abuses, this financing tool has helped to reshape and revitalize many communities. They argue that, in addition to assisting core development and redevelopment, residual growth outside of the established TIF districts provides a direct benefit to all taxing jurisdictions.

The purpose of this document is to outline the basic concepts and mechanics of tax increment financing within Kansas' statutory guidelines and parameters. This report outlines the standard TIF participants, mechanics, documents, and process, a discussion of benefits and costs, and policy questions associated with the use of TIF. It is intended to be read as a thorough but limited introduction to a somewhat complicated subject. The complete Tax Increment Financing Act can be found in Kansas Statutes Annotated, Sections 12-1770 to 12-1780d.

Springsted Incorporated has a proven track record in working with communities in the use of tax increment financing as an economic development and redevelopment tool. Please contact us if you need further information or would like to discuss in more detail the concepts contained in this report.

2 Participants

PARTICIPANTS	
City	Landowner/Developer
Elected Officials	Landowner or Developer
Advisory Commissions	Attorney
City Staff	
Fiscal Consultant: Springsted	
Bond Counsel	

OTHER GOVERNMENTAL JURISDICTIONS	
TIF District	Project
County	Federal Government
School District	State Government
Other Taxing Jurisdictions	County Government
	Other Municipalities Bordering Project Area

3 The Mechanics

Redevelopment TIF District and Redevelopment Project Area

A. Financial difference between the two

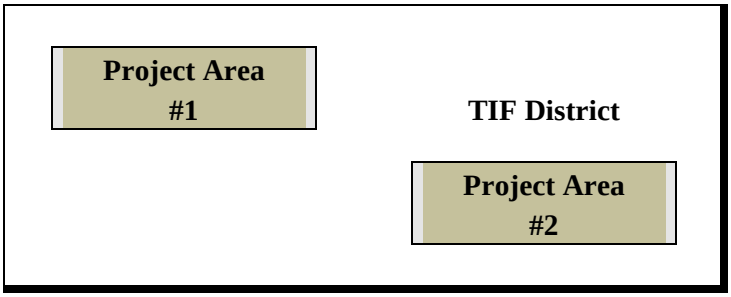
- Redevelopment TIF District - Area from which TIF funds are generated
- Redevelopment Project Area - Area in which TIF funds can be spent

B. Geographical difference between the two

- TIF District and Project Area can be the same, or

TIF District
=
Project Area

- TIF District can be larger than the Project Area



Redevelopment District

Eligible redevelopment districts are blighted areas, conservation areas, enterprise zones (see restriction below), a major tourism area, or buildings designated as historical theaters. The establishment or modification of a redevelopment district must be approved prior to establishment of a redevelopment project.

A. "Blighted Area" means an area where a majority of the following factors exist, inhibiting sound development and growth:

- Deteriorated structures
- Defective street layouts
- Unsanitary or unsafe conditions
- Deterioration of site improvement
- Diversity of ownership
- Tax or special assessment delinquency
- Defective or unusual conditions of title
- Improper subdivision
- Conditions endangering life or property by fire and other causes
- Economic obsolescence
- Has been identified as being environmentally contaminated and requires investigation, remediation, or similar action,
- A majority of the property is within a 100-year floodplain; or
- Has previously been found by resolution to be a slum or blighted area.

B. "Conservation Area" means an area comprising 15% or less of a city's land area, in which at least 50% of the structures are 35 years old or older. The area is not yet blighted but is at risk due to a combination of at least two of the following factors:

- Deteriorating and/or obsolete structures
- Illegal use of individual structures
- Structures below minimum code standards
- Building abandonment or excessive vacancies
- Overcrowding of structures
- Inadequate utilities and infrastructure

C. Enterprise zones designated prior to July 1, 1992 (KSA 12-17,110, prior to its repeal).

D. "Major tourism area" refers specifically to the Kansas City auto race track complex, with no less than $100,000,000 of capital improvements.

E. "Historic theater" means a theater constructed prior to 1940 which is operated by a nonprofit corporation and is eligible to be on the Kansas Register of Historic Places or is a member of the Kansas Historic Theatre Association.

Note: During the establishment process for redevelopment districts, the county or school district may veto the inclusion of any privately owned parcel subject to ad valorem taxes. Springsted recommends that cities seeking to establish new districts discuss their goals and rationales with the applicable county and school district early in the process, to minimize inter-jurisdictional veto threats.

Examples of TIF Eligible Project Costs

- Property acquisition (condemnation through eminent domain requires 2/3 vote of governing body)
- Site preparation including utility relocation
- Relocation assistance
- Sanitary and storm sewers and lift stations, drainage conduits, channels and levees, and river walk facilities
- Underground utilities: gas, electric, water
- Street light fixtures, connection and facilities
- Parking facilities
- Sidewalks and pedestrian ways
- Drives and driveway approaches located within public right-of-way
- Plazas, arcades, landscaping, fountains, benches, similar amenities
- Street grading, paving, graveling, macadamizing, curbing, guttering and surfacing
- All necessary related expenses to redevelop and finance the redevelopment project

Ineligible: Building construction or other improvements owned by or leased to a developer

Property Tax Increment

A. Prior to forming the TIF district

- Appraised Value (Market Value) of properties in the proposed TIF district is translated into "Assessed Value" through statutory classifications

Appraised Value → **Assessed Value**

- "Assessed Value" times "Total Mill Rate" equals property taxes

Assessed Value **X Total Mill Rate** **= Property Taxes**

-City
-County
-School District
-Other

B. When a TIF district is established

- The existing assessed value is given the term "Base Year Assessed Value" (BYAV).
- Property taxes generated by the BYAV of the TIF district continue to go to each individual taxing jurisdiction.

C. New development occurs within the TIF district

- New market value is added to the existing appraised value.

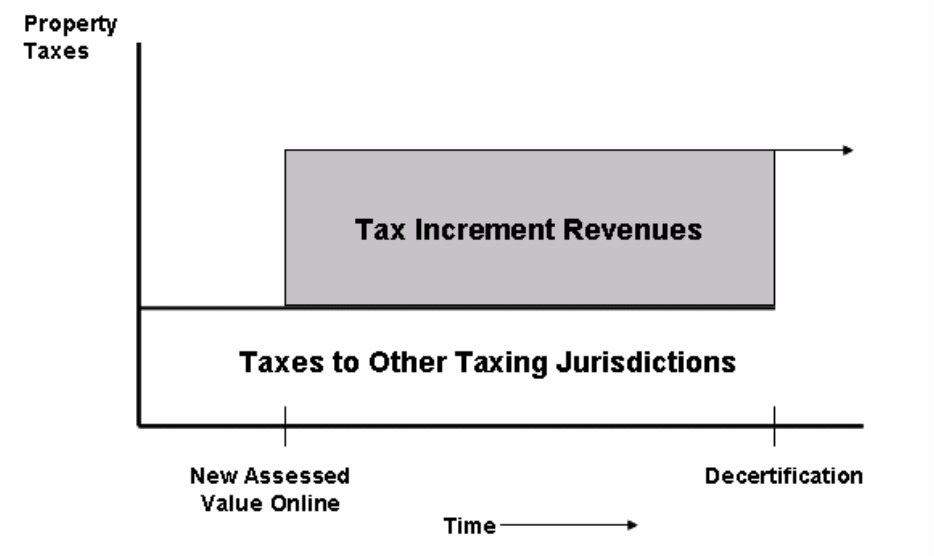
Total Appraised Value	Total Net Assessed Value				Total Property Taxes
Increase in Appraised Value	Increase in Assessed Value	X	TIF-Eligible Mill Rate	=	Tax Increment Revenue
Base Year Appraised Value	Base Year Assessed Value	X	Total Mill Rate	=	Taxes to Other Taxing Jurisdiction

- TIF-Eligible Mill Rate excludes 1.5 mill state levy and 20 mill general education levy that is part of school district levy.
- Although rarely done, cities may choose to exclude portions of the remaining TIF-eligible mill rate; for example, a portion of the county or school district rate.

D. Tax increment revenue is generated by the increase in Assessed Value.

- Term of collection

  - Tax increment may be collected and spent for eligible project costs for 20 years from the date of approval of the project plan. Projects must be established no more than 20 years after creation of the district.
  - Multiple projects may be established within a TIF district.
  - Most tax increment bonds have a maximum term of 20 years.



Sales Tax Increment

A. A portion or all of the revenue received by a city from sales taxes either city-wide or from taxpayers doing business within the city's redevelopment district and occupied by a redevelopment project may be captured.

B. Pledged sales taxes may be used for payment of special obligation bonds or full faith and credit tax increment bonds.

Franchise Tax Increment

A. A portion or all increased revenue received by the city from franchise fees collected from utilities and other businesses using public right-of-way within the redevelopment district.

B. Franchise tax increment may be used for payment of special obligation bonds or full faith and credit tax increment bonds

Sales Tax and Revenue (STAR) Bonds - Major Tourism Areas, Historic Theaters, Special Bond Projects, Major Motorsports Complex

- Class of districts eligible to receive revenue received from any transient guest tax and state, county and city sales and use taxes which are collected from taxpayers doing business within that portion of the city's redevelopment district. All STAR bond projects are subject to the review and approval of the Kansas Secretary of Commerce. Included in this class are:
  - Special Bond Projects -
    - Projects of regional significance with at least $50 million in capital investment and $50 million in projected gross annual sales revenue; OR
    - A project located outside of a metropolitan statistical area approved by the Secretary of Commerce after a determination that the district is located within an eligible area and the project would be of regional or statewide importance.
  - Historic Theaters – A district containing a theater constructed prior to 1940 which was constructed for the purpose of staging motion pictures, vaudeville shows or operas. The theater must be operated by a nonprofit corporation and have been designated by the state historic preservation officer as eligible to be on the Kansas Register of Historic Places or is a member of the Kansas Historic Theatre Association.
  - Major Tourism Areas – By definition, the Kansas Speedway and Village West development in Kansas City.

- Major Motorsports Complex – By definition, the Heartland Park racetrack in Topeka.

Unique attributes of these redevelopment districts include:

- An extensive feasibility study and marketing study are required. In addition to concluding that the project is economically feasible, the study must show that:
  - The project promotes, stimulates and develops the general and economic welfare of the state.
  - The project does not relocate a business from one part of the state to another.
  - There will not be a substantial negative impact upon businesses in the project market area or that the project will cause default on special obligation bonds issues for another special bond project.

- Special bond projects financed with STAR bonds use 100% of local sales taxes collected in the district, not just state sales, except for amounts committed by prior election of the voters or pledged toward repayment of previously issued bonds.

- The maximum maturity of STAR bonds is 20 years and the developer must commence work within 2 years of adoption of the project plan.

- Special bond projects cannot include gambling establishments.

- Bond proceeds cannot be used to finance personal property.

- Compensation for eminent domain for special bond projects is 125% of assessed valuation.

- The city must submit a report describing the status of the project to the Secretary of Commerce by October 1 of each year.

- Cities may create special bond projects within the corporate boundaries of the city, partially outside of the boundaries of the city, or wholly outside the city. Projects wholly outside the city require approval by the board of county commissioners.

- Cities owning buildings or structures constructed within major tourism, historic theater or special bond projects may engage a private entity to manage the building or structure.

- The state will not pay the debt service on STAR bonds in the event of a default by the city.

- Statutory provisions establishing special bond projects sunset July 1, 2007.

Financing of Project Costs

Bond Financing

- In some cases, a city will find it necessary to fund project costs prior to development occurring. In such circumstances, a city

may issue special obligation or general obligation tax increment bonds to finance project costs. Special obligation bonds are repaid from tax increment income, revenues derived from redevelopment activities, or private sources. General obligation bonds pledge the full faith and credit of the city in addition to project revenues.

- General obligation bonds are subject to reverse referendum protest petition. If within 60 days following date of public hearing a protest petition is signed by 3% of qualified voters, bonds may not be issued until majority of voters approve the issuance at an election. The failure of voters to approve general obligation bonds does not prevent city from issuing special obligation bonds.
- City receives tax increment revenues over a period of years and uses them to pay debt service on the bonds.
- Tax increment bonds may be repaid with:
  - Tax increment revenues
  - Other pledged revenues
  - G.O. bonds: City-wide property tax levy
- Financial limits on the city's ability to fund project costs are dictated by the amount and duration of the tax increment revenues available.

Pay-As-You-Go Financing

- In some cases the developer will pay all costs upfront and be reimbursed for eligible project costs over a period of time. This approach is generally referred to as "pay-as-you-go" financing.
  - Reimbursements are made from tax increment revenues.
  - If development does not occur or does not reach the levels forecasted, increment is lower and fewer funds are available for reimbursement.
  - This approach is preferable in that it significantly reduces city liability and risk but it may not be feasible in projects with substantial extraordinary costs or a developer with limited resources.

Taxable Versus Tax-Exempt Financing

Interest earned on TIF bonds is taxable if project meets both of the following federally imposed tests -

A. ***"Private Business Use Test"*** - Are more than 10% of the expenditures made for a private purpose?

- Types of expenditures for improvements available to every resident: streets, sewer, water
- Types of expenditures benefiting private parties, such as landowners/developers: land acquisition, soil corrections, site preparation

B. ***"Private Security Interest Test"*** - Are more than 10% of the payments of taxes and/or debt service guaranteed by the landowner/developer?

- A contract or guarantee requiring the landowner/developer to make tax payments and/or fund debt service shortfalls trigger the private security interest test.

- Minimum assessment agreements trigger the private security interest test.

4 The Documents

Redevelopment District Plan

- This document establishes overall guidelines for the district boundaries and the type and level of improvements to be constructed or acquired.
- This document does not establish the redevelopment project area but does identify the proposed project area(s) and the anticipated buildings, facilities, and improvements to be developed.

Redevelopment Project Plan or Project Plan

- This document establishes the boundaries of the project area, the expenditures and financing limitations.
- The project plan must include:
  - Summary of feasibility study (see below).
  - Description and map of project area.
  - Relocation assistance plan (if applicable).
  - Description of buildings and facilities proposed to be constructed or improved.
  - Other information deemed necessary to advise public.
  - Reference to the district plan.

Financial Feasibility Study

- Analysis which demonstrates that:
  - Economic benefits of the project exceed the costs.
  - Tax increment and other available revenues exceed the project costs.

Development Agreement

A. This document is a contract between the city and the developer stipulating the obligations of each party. The Development Agreement usually requires the developer to:

- Construct a development within a certain time frame with a specified minimum size and market value.
- Provide guarantees ensuring the timely completion of the development, and may require prompt payment of property taxes and debt service shortfalls
- The Development Agreement may require the city to construct public improvements and/or purchase land associated with the new development according to an agreed upon schedule using the expected tax increment revenue.

B. Financial terms of the project are detailed. Often these terms will dictate whether bonds are tax-exempt or taxable.

C. Many cities currently require a Development Agreement on all new developments.

5 Process for Establishment

In order to establish a redevelopment district and project area, two specific processes must be followed. These processes may occur concurrently.

- City may establish a Redevelopment (TIF) District by:
  - Passing a resolution of intent calling for a public hearing on the District Plan within 30 to 70 days. The resolution details the boundaries of the district and describes, in general terms, the plan for redevelopment of the area.
  - Publishing notice of the public hearing in the official city newspaper and sending notices to the county, school district and individuals or businesses owning property within the proposed district.
  - Holding public hearing at which:
    - City staff presents the proposed plan;
    - Comments are received from the general public.
  - After the public hearing, passing an ordinance which details the findings and establishes the Redevelopment District (simple majority vote required).
  - The applicable county or school district may veto creation of the District within 30 days after the public hearing.
- City may establish a Project Area by:
  - Passing a resolution of intent and providing notice of the public hearing exactly as required for the District Plan. If it is the city's intention to issue general obligation tax increment bonds, the resolution must state so.
  - Preparing a Project Plan, which must include:
    - Summary of feasibility study
    - Reference to the District Plan
    - Map of proposed project area
    - Relocation assistance plan (if applicable)
    - Details of new development
  - A Planning Commission finding that the Project Plan is consistent with the comprehensive general plan for city development.
  - Holding a public hearing on the Project Plan.
  - After public hearing, adopting the Project Plan by ordinance through (at least) a 2/3 majority of the city governing body.

6 Benefits and Costs

City's Perspective

A. Benefits

- Method for addressing areas not likely to be improved due to blight, contamination, or flooding. Since blight may include economic obsolescence, TIF is a good tool to promote redevelopment of a city core over greenfield development.
- Allows city to realize new development that would not occur without the use of TIF (the "But For" test). May also promote development that might not occur until some time in the future (e.g. higher density, shopping and entertainment venues).
- City may realize broader economic gains of new development in terms of employment, tax base enhancement and secondary spin-off effects.
- City may facilitate development of needed public infrastructure by coordinating a TIF project with more general improvements.
- City may have better control over the nature, design and/or aesthetic qualities of the development.
- City may be able to fund administrative and/or community development costs with revenue from the TIF district.

B. Costs

- City may assume the risk that property taxes might not be paid and/or changes in property tax laws might cause tax increments to fall short of scheduled debt service payments. City may pledge to use other funds or general property tax levies to pay debt service. (Note: Public risk may be mitigated through developer guarantees, other security provisions in development agreements.)
- City and other taxing jurisdictions (county, school district, etc.) must wait until TIF district is terminated until the new development becomes part of the general tax base.
- Policy Questions: Does the city wish to participate in private development? A project may not come to fruition even after significant time, effort and money has been expended.

Landowner(s) Perspective

A. Benefits

- Development can proceed because TIF provides a funding source for public improvements where no other viable funding source exists.

- Without TIF, the developer absorbs the full costs of:
  - Special assessments for public improvements, and/or
  - Hard costs of land acquisition and site preparation.
- With TIF, these costs are funded in whole or in part by increment revenues and the developer pays only its property taxes, which are the same whether TIF exists or not.
- Engages the city as a partner in the development, creating a vested interest in the project's success.

B. Costs

- TIF consideration and establishment approvals may increase the time and expense of development
- Developer may be required to provide financial guarantees securing taxes and/or debt service on TIF bonds (if applicable).
- Greater city monitoring of scope, quality and timing of new development.

7 Policy Questions

"But For" Test: Would Development Occur Without TIF Assistance?

- The statutory required feasibility study must show that project benefits will exceed project costs and that there will be sufficient income to pay expenditures, including debt. Springsted recommends that cities also evaluate:
  - Project feasibility;
  - The developer's financial and managerial capacity to perform; and
  - The appropriate level of public funding. Under a needs based analysis, the developer's business plan is analyzed to determine the level of assistance necessary to make the project feasible and return a reasonable profit to the developer given the relative risk of the undertaking.
- Critics of TIF state that most developments would occur anyway and the city is simply giving funds to a private party. The city should consider whether the same or similar project would occur without TIF or whether a less desirable development would take its place.
- Counties and school districts are particularly interested in this question because they will not realize any of the TIF district's enhancement to their general tax base until after the district is terminated.

TIF District and Project Area

As noted earlier, a TIF district can be the same size as one project area, or be sized to encompass several project areas. Questions to consider when establishing the TIF district and project area(s) are;

- Does the city intend to use TIF funds beyond the parcels from which most TIF revenue will be generated?
- Does the city envision numerous project areas created over time within a single TIF district?
- Does the city have other improvement projects in adjoining areas for which funding can be augmented with TIF?
- Does the proposed district meet statutory requirements?

Level of Assistance

A. How much funding does the city wish to commit to the project?
- Demonstration by private parties of need for level of TIF assistance requested.

B. Mandatory imposed limitations
- Statutory duration of the TIF district and project area.

C. Discretionary imposed limitations
- Term of TIF district may be shorter than maximum permitted
- Percentage of property tax, sales tax and/or franchise tax increment allocated to project may be less than 100%
- Nature of expenditures
  - Do they lead to taxability and higher interest rates, therefore yielding lower net bond proceeds?
- Pace of development
  - How soon will development occur? Does this affect how much TIF the city wishes to allocate?

City Security Guarantees

A. TIF bonds may be sold as special or general obligation bonds. General obligation TIF bonds require that, if increment revenue is not sufficient to pay debt service at any time over the life of the bonds, then the city is ultimately required to levy city-wide property taxes to repay the bonds.

B. How can this occur?
- New development is constructed over a longer time frame and/or to a lesser market value than was represented to the city at the time of approval;
- Property owners don't pay their taxes on time;
- Property owners pay their taxes on time, but tax rates are reduced or assessed valuations fall. Therefore, actual property tax payments are less than the scheduled debt service.

C. How does the city protect itself?
- Minimum assessment agreement stipulating the market value of new development and schedule of completion.
- Withholding bond proceeds or delaying construction of public improvement until all or a portion of new development is completed.
- Liquidity guarantees (letters of credit) provided by the developer ensuring timely payment of property taxes or adequate funds for required debt service.

- Pay-as-you-go: No debt is issued. The developer finances its own improvements and is reimbursed over time by the city from the actual collection of increment revenue.
- Sale of the bonds to the developer, developer's bank or other party affiliated with the developer.
- Once a district is created, indices (such as assessed valuation or sales tax proceeds) should be monitored on a regular basis to assure the project is performing as anticipated. Frequent review will allow proactive measures to be taken should problems arise.
- The appropriate combination of security measures will depend on the level of risk the city perceives itself to be exposed to.

City Administrative Costs

The establishment of a TIF district and the negotiation of a thorough development agreement requires substantial time commitments by city staff and its consultants. A large portion of that time is expended prior to the signing of the development agreement and before actual construction of the new development. Furthermore, additional city staff time is needed to monitor and report on the performance of the TIF district over its life. Cities are permitted to reimburse themselves for administrative costs.

The city should consider two relevant policy questions:

- Does the city wish to receive a guarantee of its costs from the developer for the period from inception of the TIF process until signing of the Development Agreement? Upfront escrow funds or other guarantees protect the city in the event that the project terminates during the negotiation phase.
- What is the appropriate level of administrative cost reimbursement?