I. Introduction

Local economic development tools are increasingly viewed by cities as necessary to attract business. In turn, the business community increasingly has come to expect incentives from local government(s). One of the current favorites among development-minded local officials and businesses is Tax Increment Financing (TIF). Pioneered in California (1952) and Minnesota (1960) the popularity of TIF has grown steadily to the point that forty-four states have embraced the concept. In its simplest form, TIF is restricted to property taxes. A development or redevelopment project increases the value of the property on which the project is located. The idea behind TIF is to use the increased property taxes associated with the increased value of property to finance project related infrastructure improvements. While the concept is easily grasped, implementing the financing mechanism is complex since the enabling legislation must address numerous technical and legal issues. State law must set the statutory criteria for project eligibility, and statutory limitations and restrictions on the newly formed TIF granting authorities. To further complicate the issue, some states, including Missouri, have expanded the TIF concept to taxes other than property taxes.

Although TIF programs differ from state to state, traditionally TIF has been employed to redevelop sites within the older central business districts of communities. These are the areas that have the greatest potential for growth in property value, since the existing value is low. Similar to the federal urban renewal programs of 40 years ago, states normally require that TIF projects be part of an area-wide redevelopment or development plan. Early on, states restricted TIF projects to “blighted” or “substandard” areas within the community. But over time, bending to local political pressures, the requirements for such a designation were watered down and lost any real meaning. The states of Iowa and Indiana, for example, dropped the “blighted” and “substandard” tests, and allow TIF to be used in “Economic Development Areas.” Under the expanded criteria literally any project qualifies for TIF, i.e., public improvement such as golf courses, and parks, and private projects such as housing, office buildings, hotels, and skywalks.

As noted, property tax revenue is the traditional method of funding TIF projects. Iowa, Indiana and Illinois are typical of the states that finance projects in this manner. Over time, however, the popularity of the TIF concept and the unbridled competition for business among the states induced several states to broadened the TIF concept to other community tax bases. Again, the states vary in their use of other tax bases, but sales tax, earnings tax, and business activity revenues are commonly allowed. The more aggressive states permit local communities to use all three of these tax sources.
II. Tax Increment Financing in Missouri

Like many of the states, Missouri restricts TIF projects to “blighted” or “conservation” areas within cities or counties. Approved projects must also be viewed as unlikely to occur without TIF assistance. Tax revenues generated by a project can be used to pay for project related infrastructure and capital improvement costs. The revenues must come from locally levied taxes, but the method of calculation and allocation is not uniform across tax sources. To view the entire statute, see http://www.moga.state.mo.us/STATUTES/C099.HTM, sections 99.800-99.865.

Property tax revenue is one of the sources of financing. Payments to the local taxing authorities are frozen at the pre-TIF or project level for twenty-three (23) years. An approved TIF Plan may, however, contain multiple projects, each project having a maximum life of no more than twenty-three years. Furthermore, projects may be phased in over a ten-year period, resulting in a maximum plan life of thirty-three years. The incremental tax revenues are placed in a “Special Allocation Fund” for disbursement to the developer, and the frozen portion is allocated among the taxing jurisdictions.

In addition to incremental property tax revenues, one-half of the incremental revenues generated by Economic Activity Taxes (EATS - mainly sales, earnings and utility taxes) may also be used to pay for infrastructure and capital improvement costs. This expansion of coverage has some interesting economic and political implications, and at least part of the reason for the expansion may be due to differing views by different political jurisdictions with regard to the benefits and costs of TIF. When property value is frozen, it is frozen not only for the city and/or county, but also for school districts, park districts and all other jurisdictions. While property tax may represent a relatively small portion of a city’s budget, it represents most of a school district’s budget. A recent study states that, for Missouri:

The use of sales taxes to help finance TIF districts is the direct result of actions by school districts. This is a result of their relatively greater reliance on property taxes as a source of revenue. In 1993, the average school levy was $3.13 compared to an average property tax rate of $0.78 for cities.

While it may have been politically expedient to expand the types of taxes which can be used to finance infrastructure and capital cost, this expansion complicates the economics of TIF substantially. Clearly the objective of the statute is to use incremental taxes, that is, taxes that would not have been collected but for the project. With property tax, it is fairly simple to determine what the incremental tax is, since property taxes are known and can be frozen. With economic activity taxes, the process of determining what is truly incremental is much more difficult.

As an example, consider a grocery store project which is granted TIF status, and can use incremental property tax and one-half of incremental sales tax to finance improvements. Assuming that no sales tax was being generated on the property prior to the project, then 50% of
all the sales tax generated by the grocery store is eligible for use to finance improvements. The economic question is how much of that sales tax is truly incremental. The new grocery store’s customers were buying groceries prior to the project, and probably generating sales tax for the jurisdiction. Thus much of what is being called incremental sales tax is really only a substitution of sales tax generated by a TIF grocery store for sales tax that was being generated by a non-TIF grocery store.

The example we have used (sales tax from a grocery store) is an extreme one, although there is at least one project which included a grocery store and for which 50% of sales tax is being used for financing of infrastructure and capital cost. This “substitution” effect will occur to some extent for most economic activity taxes. It is likely to be largest for sales tax on items readily available within the jurisdiction, and restaurant tax. It is likely to be less important for earnings tax or utility tax or sales tax on items which not available within the jurisdiction.

In the Missouri implementation of TIF, there is no process to evaluate such substitution. It is possible, therefore, for TIF to result in a reduction in tax revenue to the cities and/or counties which approve TIF projects.

Also to be considered is the fact that in the absence of TIF projects, resources may be used for other purposes which would generate tax revenue. While it is true that the enabling legislation for TIF in Missouri does provide for the use of the tool only for projects which would be “unlikely to occur” in the absence of TIF, this does not mean that the TIF incentive coaxes out resources which would otherwise not have been used.

III. TIF Projects in Kansas City

Prior to 1995, almost all of the use of TIF occurred in the Kansas City and St. Louis MSAs. Since 1995 there has been a marked increase in the number and value of projects requesting TIF eligibility. We have current information for Kansas City. This volume will be updated to include the rest of Missouri, as the data becomes available.

According to the Economic Development Corporation, twenty-four projects have been approved by the TIF Regional Commission and the appropriate City Councils in the Kansas City area. The approved projects include some 227 parcels of land which places Kansas City at the top of the state in terms of land parcels and number of approved projects.

Of the twenty-four projects, sixteen (16) are considered active, that is, under construction or completed. Six of the projects have yet to be started. Walnut Creek, the first Kansas City TIF project, was completed in 1990 and is no longer carried on the books since all TIF related costs have been reimbursed. The approved projects vary widely in terms of construction value and economic purpose. The Hickman Mills project is the largest with an estimated completion value of $655 million; the 10th & Troost project is the smallest at a little more than $1.1 million. In terms of usage or purpose, the projects’ breakdown are as follows:

- Projects with Commercial Space: 12
- Projects with Office Space: 13
- Projects with Housing units/Apts.: 6
When completed, the estimated value of the listed projects is $2.494 billion. Based on the current or pre-TIF assessed values for these properties, the projects are anticipated to add $813.7 million in taxable property. The later figure is nearly 14 times the original or pre-TIF values for these properties. From the project reports filed with the City, the projects are forecast to generate $871 million in earmarked TIF funds over their lifetimes. The latter figure is the sum of the projected annual tax revenues from property and economic activity taxes. The revenues are not discounted, and the forecasting methodology increases revenues at an annual rate of 2 percent.

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3 Hotel Taxes are excluded from the economic activity taxes which are eligible for TIF.

4 Bureau of Business Research, UMC. An Analysis of Selected Missouri Economic Development Tax Credits. June, 1995, p. 84.