

# TIF 101: ADVICE FOR MUNICIPALITIES CONSIDERING THE FIRST USE OF TAX INCREMENT FINANCING

Part 3 in a 3-part series: The TIF Contract and Financing Alternatives

By David Bushek and Rich Wood

*This is the third article in a three-part series. Part 1 (issue May 2009) addressed questions regarding the preparation of a TIF plan and the appropriate use of TIF. Part 2 (issue June 2009) discussed the process for approval of a TIF plan. Part 3 is an overview of the effective use of a TIF contract and financing alternatives to implement a TIF plan.*

Cities and counties that are considering the use of tax increment financing (TIF) for the first time, or that may have previously used TIF on a limited basis, frequently have several questions about the TIF contract and financing alternatives to implement a TIF plan. This article is designed to address the most common questions that arise regarding the TIF contract and financing alternatives that are available to a city or county (collectively referenced as "municipalities") under the Real Property Tax Increment Redevelopment Act, Sections 99.800 to 99.865 (TIF Act). Additional specific issues may arise during the drafting and negotiation of a TIF plan and the selection of a financing plan, and the municipality should consult with legal counsel in these cases.

## THE TIF CONTRACT

### What is the TIF contract?

In the most basic sense, a TIF contract is an agreement between a municipality and a developer that establishes the rights, duties, and obligations of the parties regarding the implementation of a TIF plan. It is most commonly a two-party agreement, involving the municipality and the developer that has been selected by the municipality to implement a TIF plan or a TIF proj-

ect. If a TIF plan has multiple project areas that will be constructed by different developers, then the municipality would commonly enter into a separate contract with each developer to govern the implementation of each project area within the larger TIF redevelopment area.

### Is the TIF contract necessary?

Yes. While the TIF plan is the municipality's legislative declaration to provide TIF revenues for a project, the TIF contract is the key document that controls the expenditure of TIF revenues for the project. If a TIF plan is the heart of public financing for a project, then TIF revenue is the blood and the TIF contract makes the heart beat and regulates the flow of public funding. Carrying this analogy further, the TIF contract can also establish the arrangements under which the other organs of the public funding, as may be applicable to a project, will work in concert with the TIF plan. For example, if the project will also use a transportation development district (TDD) to impose a sales tax for road improvements, then the terms and conditions under which the parties will create and operate the TDD in conjunction with the TIF plan can be established in the TIF contract.

After a TIF plan is approved, a developer may proceed as if the assistance authorized in the TIF plan is an entitlement of the project. It is important to remember, however, that providing TIF assistance is a legislative and discretionary decision, and the adoption of a TIF plan does not establish all of the conditions under which TIF assistance is provided as the project is constructed and operated. In this regard, the TIF contract may be considered equally

as important, or possibly even more important, than the TIF plan.

### How is a TIF contract prepared and approved?

The initial draft of the contract is typically prepared by the municipality, and negotiated between the developer and municipality. Missouri law governing TIF contracts is generally the same law that governs any municipal contract. The municipality must comply with the municipal statute of frauds (Section 432.070, RSMo) for all contracts, including a TIF contract, as well as all other laws that are generally applicable to municipal contracts. The process of negotiating the contract is typically a back-and-forth discussion until both parties reach agreement on a contract that they are willing to execute.

A municipality takes official action through its legislative body, but the initial negotiations for a TIF contract are frequently handled by the municipal staff and its special legal counsel. For this reason, it is important for the developer to remember that statements by staff in negotiations are not binding on the municipality, and all terms and conditions of a draft contract are ultimately subject to approval by the governing body before the municipality can become bound by the TIF contract. Most municipalities approve a contract by action of the governing body, although the TIF Act also grants authority to a TIF commission to approve and authorize the execution of a TIF contract.

### When should the TIF contract be negotiated and approved?

The terms of the TIF contract typically start to take shape as the TIF plan is being considered by the municipality. An issue that is raised, discussed, and

resolved in front of the TIF commission or governing body can be reduced to a specific TIF contract provision that governs that particular aspect of the project. So, even though the parties may not be expressly negotiating the TIF contract in the early stages of the process when the TIF plan is being considered, the parties may nevertheless be discussing and reaching conclusions on key issues that will become TIF contract provisions.

In those situations where a developer has proposed a TIF plan to a municipality, some municipalities defer the TIF contract drafting and negotiations until after the TIF plan is approved, following a policy that resources should not be expended on the TIF contract until after the municipality and developer know that the TIF plan has been approved. Other municipalities take a completely different approach, where the governing body wants to see the final or near-final TIF contract at the same time that it considers final approval of the TIF plan, following a policy that the TIF plan should not be approved until the elected officials are comfortable with the specific terms and conditions under which the TIF plan will be implemented.

Each approach has advantages and drawbacks, and either approach can be used by a municipality. The best advice when considering a developer-proposed TIF plan is to clearly communicate which approach will be used, so that all private parties involved with the project (the developer and its lenders, tenants, and consultants) will know what to expect regarding the timing for TIF contract approval and execution. This will allow all parties involved to establish more accurate project schedules and proper budgets.

### What is the authority to enter into a TIF contract?

Section 99.820.1(2), RSMo provides municipalities with broad authority to make and enter into contracts which are "necessary or incidental to the implementation and furtherance" of its TIF plan or project. This authority covers the TIF contract itself, along with any of the more specific agreements that may spawn from the TIF contract to implement the project. The authority for other contracts that are needed in connection with implementing a TIF plan may be found in other legislation, such as the authority granted to all Missouri political subdivisions in Section 70.220, RSMo to cooperate with any other political subdivision or private party for the development and construction of any public improvements or facility.

### What does the TIF contract contain?

The TIF contract will typically contain provisions related to the following general topics:

- The developer's obligation to construct the project;
- The construction schedule, including any phasing;
- The municipality's obligation to pay for TIF-eligible project costs;
- The terms and conditions under which the municipality will issue debt, if applicable, to finance TIF-eligible project costs;
- Any particular land-use or tenant restrictions in the project;
- Any desired restrictions on ownership of the TIF property, control of the TIF project, and ownership and management of the developer during the life of the TIF plan;

- The developer's obligation to insure the project during construction and operation; and

- Various provisions that protect the municipality, such as indemnification by the developer for claims or damages suffered by the municipality as a result of the developer's actions in connection with constructing or operating the project.

Many other issues can be dealt with in the TIF contract, depending upon the circumstances of the project and the needs of the municipality.

### What does a TIF contract not cover?

There can be many other types of contracts that are involved with implementation of a TIF project, but which are executed after the TIF contract is executed. The TIF contract may reference and establish the general subject matter of these separate contracts, but the specific terms and conditions of the other agreements may not be covered in detail in the TIF contract. For example, if another public funding source is involved with a project, such as a TDD or a CID, the municipality and funding district will commonly enter into a separate cooperative agreement governing the use of that separate funding source. If bonds are issued by the municipality to finance a TIF project, there will be several other agreements executed by the municipality that govern the issuance of the bonds and the use of the bond proceeds.

Public regulatory mechanisms that govern certain aspects of the project may not be covered in detail in the TIF contract. For example, if a municipality adopts a specifically-tailored "planned development" zoning ordinance that governs the zoning, subdivision and

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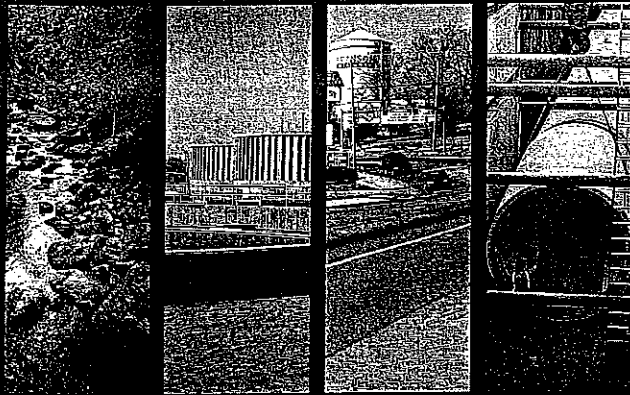
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land uses of the project, the TIF contract may reference the zoning ordinance generally but not contain the specific regulations that are established by the zoning ordinance.

There may be other specific contracts that are executed after the TIF contract that govern particular aspects of the project that require more detailed contractual provisions. For example, if a developer is managing the construction of a large number of public improvements that will be built in connection with the TIF project, the municipality and developer may execute a separate "public improvements development agreement" that establishes the more specific rights, duties, and obligations of the developer to design, construct, and insure completion of the public improvements and the manner in which the municipality will reimburse the developer for such work from TIF revenues and possibly other public funding sources. A developer or related entity may also be requested to execute a contract that guarantees the completion of the project or other matters related to construction, since many of the development entities are single asset limited liability companies.

**Should a municipality engage legal counsel to negotiate the TIF contract?**

The same special legal counsel that assists the municipality with ap-

proval of the TIF plan would typically draft the TIF contract and assist the municipality with negotiating the TIF contract. While there are many forms of TIF contracts that have been used in the past, it is strongly recommended that an attorney who has experience with TIF contracts be involved in the process of drafting and negotiating the TIF contract, to protect the municipality's interests. A developer may be represented by legal counsel who is intimately familiar with the TIF process, but that law firm represents the developer at all times and has a fiduciary duty to achieve the best possible result for their client the developer. In the event that a lawsuit is filed against the municipality by the developer, a disgruntled taxing district, or an unhappy adjacent property owner that challenges the TIF plan or the TIF contract, the best defense is often having an experienced attorney involved for the municipality throughout the TIF process before the lawsuit is filed.

#### TIF FINANCING ALTERNATIVES

**What are the basic TIF financing alternatives available to the municipality?**

The two most common methods of implementing TIF financing are the issuance of bonds or using the "pay as you go" method of reimbursement. When TIF bonds are issued, most of the

proceeds generated from the issuance of bonds are deposited in a "project fund" that is a specific account managed by a trustee for the municipality. Payments are made from the project fund to the developer for certified TIF-reimbursable project costs. The bonds are then repaid over time as the project generates TIF revenues. When bonds are issued for a TIF project, the developer is typically reimbursed for all or a large portion of the TIF-reimbursable project costs early in the process. Multiple series of bonds can be issued, however; which provide for reimbursement in stages as bonds are issued.

Under the "pay as you go" reimbursement method, as it is commonly called, bonds are not issued. Instead, the developer is reimbursed for TIF-reimbursable project costs as TIF revenues are collected from the project over time. This reimbursement method commonly includes an interest calculation for reimbursable project costs that have been certified by the municipality and are due to the developer. For example, a developer may request and the municipality may certify \$3 million worth of TIF-reimbursable project costs for a particular project. If the TIF project generated \$400,000 in TIF revenues during the first year, a certain portion of these annual TIF revenues would reimburse the developer for certified project costs and another portion would reimburse the developer for carrying costs on the developer's funds initially used to pay for the projects for which reimbursement is being provided since typically the developer would have a loan that funded such costs.

**What are more sophisticated financing options and when should they be used?**

The nature of the project and the specific needs of the municipality may require some form of extra security for the debt that is issued by the municipality, and a wide range of creative options are available. The developer may be required to post a letter of credit that burns off after a specific period of time or after a certain development threshold has been satisfied, such as a designated amount of leased area of the project. The developer may provide a deed of trust for certain land within the project, as a form of security against an underperforming development. Special assessments may be imposed on the

project property through a TDD, CID, or neighborhood improvement district (NID) that serve to supplement any shortfalls in TIF revenues generated by the project. Each of these options should be carefully planned within the framework of the TIF plan, and a tax attorney should be consulted to determine what affect, if any, each option may have on any tax-exempt bonds that are issued by the municipality for the project.

**Does the municipality have to issue TIF bonds after a TIF plan is approved?**

This question is actually two questions rolled into one, but the answer to both is the same: (1) No, the municipality is not required to issue bonds of any type for a TIF project; and (2) No, if bonds are issued for a TIF project, they do not necessarily have to be TIF bonds, but can be other types of debt instruments. The issuance of bonds for a project is authorized by Section 99.835, RSMo, but the decision to issue bonds, even after a TIF plan has been approved, is always a legislative decision that carries the full legislative

discretion of the municipal governing body (or TIF commission).

If a municipality has decided that bonds should be issued for a project, the bonds do not necessarily need to be issued under the authority of the TIF Act, and the municipality itself does not necessarily need to be the issuer. A municipality might use its industrial development authority to issue bonds that would be repaid from several different sources of funds including TIF revenue. This option may provide added flexibility to blend the support of multiple funding sources for a single bond issuance for a particular project.

**What is a TIF "note"?**

The issuance of TIF notes is a method for a municipality to document its obligation to the developer to repay certified TIF reimbursable project costs. TIF notes are issued by a municipality to the developer in the amount of certified reimbursable project costs. Once a municipality makes a decision to issue TIF notes, the municipality is deemed to have:

- issued notes for the amount of

certified reimbursable project costs;

- deposited the funds necessary for payment of the project costs in a project fund;

- reimbursed the developer in full for the certified costs from the amounts on deposit in the project fund; and

- the developer is deemed to have advanced the funds necessary to purchase the notes.

TIF notes generally provide for payment of interest on funds due to the developer. The notes may also provide for abatement of interest for failure to comply with certain provisions of the TIF contract. Once bonds are issued, TIF notes are subordinated to repayment of the bonds and bond proceeds may be used to reimburse the developer for project costs that were secured by the notes, thereby satisfying the municipality's obligations under the TIF notes.

**What are the requirements for bonds to be issued?**

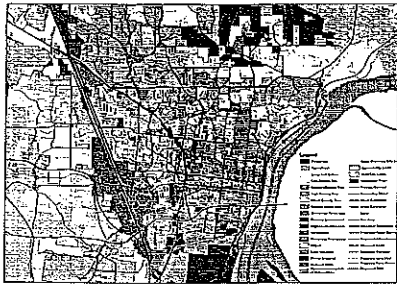
The TIF contract can pre-define the conditions that must be satisfied

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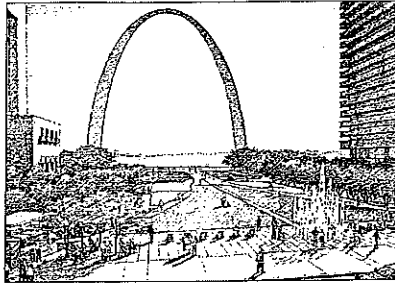
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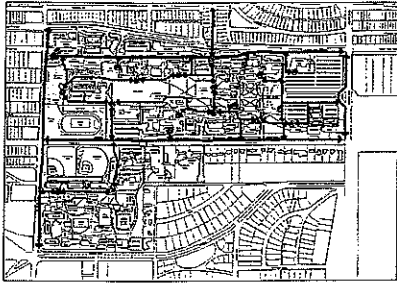
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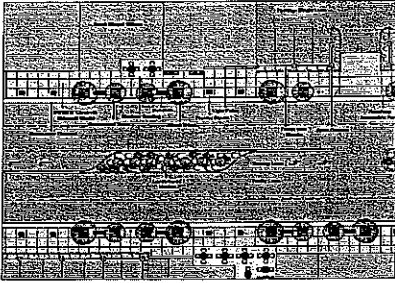
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in order to issue bonds. Some of the common conditions are:

- The developer having obtained leases or other binding occupancy commitments that would allow the underwriter and/or the municipality's financial consultant to determine that the projected TIF revenues from the business will cover debt service on the bonds, plus coverage.
- Proof that the developer has obtained a private loan sufficient, when combined with the developer's equity to be contributed to the project, to fund construction and completion of the private portion of the project.
- Proof that the developer has entered into a construction contract and commenced pouring foundations for the private improvements.
- The developer having received all necessary government approvals for the project.
- The underwriter and/or the city's financial consultant having determined that the bonds can be sold on terms acceptable to the municipality.

**If a developer requests that the municipality "back the bonds," what does this mean?**

This means that the municipality would back the bonds with a general annual appropriation pledge. This type pledge enhances the marketability of the bonds that results in a lower interest rate. In the event project revenues are not sufficient to pay debt service on the bonds in any particular year, the municipality may appropriate sufficient funds to pay the amount of the shortfall. There are a number of factors that could create a revenue shortfall that results in the municipality paying a portion of the debt service, including casualties to revenue producing businesses in the TIF area, revenue projections that do not materialize or do not assume other unanticipated events and circumstances that may occur after bond issuance and unanticipated changes in market conditions.

## 2009 CHANGES TO THE TIF ACT

Section 99.865 of the TIF Act requires municipalities to annually

"prepare a report concerning the status of each redevelopment plan and redevelopment project" and submit the report to the Missouri Department of Economic Development. House Bill 191, passed during the last legislative session, revised the TIF Act to prohibit the municipality from implementing new TIF projects for at least five years if the annual report is not filed.

This new provision should only apply prospectively to future TIF projects. Current TIF projects (including the capture of applicable TIF revenues) should not be affected.

A municipality may submit its annual report at any time during the year. The reporting period can be for any 12-month period ending any time prior to September 30 of the reporting year. A standard annual report will only cover a 12-month period. However, if a municipality has not previously filed annual reports, it is recommended that by August 28, 2009, the municipality either (1) prepare a report for each year that a report was not previously filed or (2) prepare a single report that covers all prior years for which reports were not filed.

The five-year penalty period should begin January 1 of the year following a municipality's failure to comply. It is not clear who will determine whether the penalty remains in effect for more than five years.

The TIF Act also imposes two other ongoing responsibilities for municipalities with existing TIF projects: (1) annually reporting information about any business that relocates to the TIF area to the Missouri Department of Economic Development by the last day of February; and (2) holding a public hearing every five years after approving a redevelopment plan to determine if the TIF project is making satisfactory progress. While the penalty for not filing the annual reports under Section 99.865.7 of the TIF Act does not currently apply to these two ongoing responsibilities, municipalities should complete these actions to ensure full compliance with the TIF Act. □

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