

**Performance Audit  
Estimating Tax Dollars Owed  
to the TIF Commission**

March 2005

**City Auditor's Office  
City of Kansas City, Missouri**

March 15, 2005

Honorable Mayor and Members of the City Council:

This audit examines barriers to defining and redirecting tax revenue to the TIF Commission. Stakeholders agreed that current processes are inefficient and identified a number of barriers to defining and processing economic activity and real property tax payments to the TIF Commission.

Stakeholder obligations are not enforced. Businesses have not provided all of the economic activity tax information that the city needs to define and transfer tax dollars to the TIF Commission. Developers want the TIF Commission to process their reimbursement requests but have not notified businesses about their reporting obligations. The city has not enforced reporting requirements, the TIF Commission has not provided timely base year information, and developers informally agree to exclude EATs for some locations. We recommend that the city support a limit on EATs payment liability by establishing the maximum time that developers and businesses located in TIF areas have to submit documentation supporting economic activity tax liability.

Fragmented communications and differing interpretations of what is required by state law have also resulted in delays. Some counties are excluding use taxes and some utility sales taxes from their economic activity tax payments. And while the city appears to have overpaid some economic activity taxes and paid other economic activity taxes earlier than needed, Clay County did not retain enough sales tax revenue to meet its TIF obligations. We recommend that the city identify and recapture EATs overpayments made to the TIF Commission and work with the counties to clarify which taxes should be included in EATs transfers.

Defining the economic activity tax base and increment is complex and inexact. Missouri is one of only a few states that use economic activity taxes for tax increment financing. Although the documentation required to process economic activity tax payments to the TIF Commission gives the illusion of precision, economic activity taxes can only be estimated. We recommend that the city and counties develop a less burdensome method of estimating economic activity taxes for existing TIF projects and use only the real estate based payments in lieu of taxes increment to finance future TIF projects.

County employees have had difficulty establishing the base year real property values for some TIF projects because some property descriptions are inaccurate. We recommend that county assessment staff review and approve legal descriptions and parcel values submitted by developers before the TIF Commission and City Council approve TIF plans, projects, and amendments.

The city does not have an economic development incentive policy, despite the growing use of incentives and abatements. We recommend that the City Council adopt an economic development incentive policy to serve as the basis for consistent decision-making, guide staff actions, enhance understanding among stakeholders, and strengthen the role of elected officials.

We sent the draft report to the President and Chief Executive Officer of the Economic Development Corporation, the City Manager, the acting Director of Finance, and Clay, Jackson, and Platte county staff members on October 25, 2004, and revisions on December 9, 2004. A draft report was also sent to the City Attorney on December 9, 2004. Written responses are appended. We appreciate the courtesy and cooperation of city, TIF Commission, and Clay, Jackson, and Platte county staffs during the audit. The team for this audit was Julia Talauliker and Nancy Hunt.

Mark Funkhouser  
City Auditor

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# Estimating Tax Dollars Owed to the TIF Commission

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# Introduction

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## Objectives

We conducted this performance audit of the city process used to define and redirect tax dollars to the Tax Increment Financing (TIF) Commission under the authority of Article II, Section 13 of the city charter, which establishes the Office of the City Auditor and describes the City Auditor's primary duties.

A performance audit systematically examines evidence to independently assess the performance and management of a program against objective criteria. Performance audits provide information to improve program operations and facilitate decision-making.<sup>1</sup>

This audit is a part of an ongoing review of the TIF process.<sup>2</sup> We began this audit in response to concerns raised by the TIF Commission's commercial auditor and staff. The TIF Commission's commercial auditor cited the Commission's lack of a system to account for the tax increment financing receivables due from the city and counties as a material weakness.<sup>3</sup> In addition, TIF Commission staff did not believe that they were receiving TIF revenues timely.

We designed the audit to answer the following questions:

- What are the barriers to identifying and transferring tax dollars made available to fund TIF development?
- Can any of these barriers be reduced? And if so, how?

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<sup>1</sup> Comptroller General of the United States, *Government Auditing Standards* (Washington, DC: U.S. Government Printing Office 2003), p. 21.

<sup>2</sup> *Performance Audit: Tax Increment Financing*, Office of the City Auditor, Kansas City, Missouri, September 1998; *Performance Audit: Review of the 1999 TIF Annual Report*, Office of the City Auditor, Kansas City, Missouri, August 2000; *Performance Audit: Controls Over TIF Expenditures*, Office of the City Auditor, Kansas City, Missouri, September 2003.

<sup>3</sup> Tax Increment Financing Commission of Kansas City, Missouri, Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*, Cochran, Head & Co., P.C., for the years ending April 30, 2002 and April 30, 2003. A material weakness is a significant deficiency in which the design or operation of specific internal controls does not ensure that errors or irregularities material to the financial statements will be detected promptly by employees in the normal course of their work.

## **Scope and Methodology**

This audit focuses on the city Finance Department and county processes for defining and redirecting tax revenue to the TIF Commission. We followed generally accepted government auditing standards in conducting the audit. Our methods included:

- Interviewing the staff in the city Finance Department’s Treasury and Revenue divisions and City Planning and Development Department; the TIF Commission;<sup>4</sup> Clay, Jackson, and Platte counties; and the chairman of the TIF Commission<sup>5</sup>.
- Reviewing information in the city’s financial system and documentation provided by Treasury and other sources.
- Reviewing applicable state statutes, TIF policies and procedures, city procedures, and TIF project records.
- Reviewing studies and literature on TIF.

We omitted no privileged or confidential information from this report.

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## **Background**

The city uses tax increment financing (TIF) as an incentive to encourage real estate development and redevelopment. TIF is intended to reduce or eliminate adverse conditions in an area and to enhance the tax base. TIF is authorized by state statute, created by the city, and administered through the TIF Commission.

Tax increment financing is based on the premise that if an area of the city is improved, it will generate additional tax revenues. The additional tax revenues can then be used to reimburse developers for approved project costs, creating an incentive to developers, or to pay off bond debt incurred to finance the development. Each TIF plan identifies the taxes that will be used to pay for TIF development expenses.

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<sup>4</sup> The Economic Development Corporation is an umbrella organization that provides staff support for the TIF Commission and other statutory agencies.

<sup>5</sup> Appendix A provides a list of stakeholders we interviewed.

### **Real Property Generates PILOTs**

When a developer constructs a TIF project the value of the real property increases. The additional property taxes that are due on the increased value of the property are abated. The value of the abated taxes is the "increment." The owner of the property pays property tax on the original value of the real property, and also pays the amount of the increment. Payment of the increment is called a "payment in lieu of taxes" (PILOT) instead of property tax. The city and affected county identify the increment amount paid by the property owner. The county transfers PILOTs to the city, and in turn, the city transfers the county's and city's increments to the TIF Commission to reimburse the developer for a portion of the project's costs, to pay bond obligations, and to pay for the cost of administering the TIF program. (See Appendix B for a flow chart of the PILOTs process.)

### **Economic Activities Generate EATs**

Missouri law authorizes the use of local economic activity tax (EAT) increments for tax increment financing. The city collects EATs from sales, earnings, profits, utility, use, and convention and tourism taxes. Counties collect EATs from sales taxes and potentially from use taxes. In most TIF plans, fifty percent of the EATs increment from the TIF area is available to pay project costs. Both the city and the affected county in which the project is located redirect tax dollars to the TIF Commission. County EATs are not transferred through the city, but flow directly to the TIF Commission.

**Businesses report economic activity tax information using one of two methods.** For the city and counties to process payments to the TIF Commission, businesses within a TIF area must provide confidential tax information. Businesses are assigned to use either a "conventional" or "beta" reporting method.

Under the conventional method, businesses provide copies of their own completed tax returns and other supplemental information for the TIF business location. With the beta method, businesses located within a TIF area submit a one-page form that provides identifying information such as business name, address, federal and state tax identification numbers, and state sales tax site code. For both methods, businesses must provide copies of their utility bills in order to identify eligible utility taxes. Businesses are supposed to submit information used to estimate economic activity taxes twice a year for up to 23 years. (See Appendix C for flow charts depicting the conventional and beta processes.)

**History of the Beta Process**

The beta method was established to simplify reporting responsibilities for the developer. In 2000, Health Midwest was unable to obtain tax information from tenants in the Southtown TIF area. The developer reasoned that since the city already received tax payments and returns, that information should be sufficient to identify the economic activity tax increment. The City Manager directed the Finance Department to change its EATs process. The city evaluated alternative methodologies and presented the beta method to the TIF Commission. The beta method was initially used for Southtown, and has expanded to other plan areas. Beta is now used for 29 TIF plans.

**TIF Revenues Are Growing**

The amount of redirected tax revenues that are transferred to the TIF Commission more than tripled between 2000 and 2004. The city transferred more than \$34 million in county PILOTs and city PILOTs and EATs to the TIF Commission in fiscal year 2004. (See Exhibit 1.)

Exhibit 1. Percentage of TIF Revenues That Flow Through the City by Source

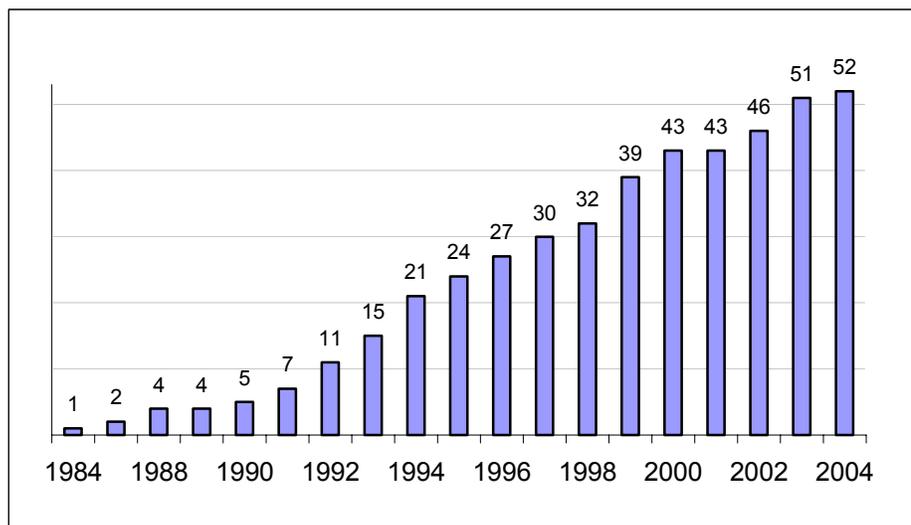
Source	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
PILOTs-City	1.2%	9.6%	8.1%	11.7%	9.2%
PILOTs-County	53.9%	54.6%	36.0%	46.9%	47.1%
EATs-City	44.4%	34.9%	55.6%	41.3%	43.6%
Interest on Investment	0.5%	0.8%	0.3%	0.1%	0.1%
<b>Total Transferred</b>	<b>\$11,060,179</b>	<b>\$15,968,673</b>	<b>\$22,655,306</b>	<b>\$30,218,159</b>	<b>\$34,112,555</b>

Source: AFN.

**Number of TIF Plans Is Increasing**

The number of approved TIF plans has steadily grown since the approval of the first TIF plan in 1984. Over the course of twenty years, the City Council has approved 52 plans. (See Exhibit 2.) Of these plans, two have been terminated, four are inactive, and two have been absorbed into other plans. (See Appendix D for maps of plan locations.)

Exhibit 2. Number of Approved TIF Plans by Year



Source: Finance Department.

**TIF plans are concentrated in two council districts.** The second council district contains almost half of the approved plans and the fourth council district contains almost a third of the approved plans. The fifth, sixth, and third districts each contain only 6 to 8 percent of approved plans. (See Exhibit 3.)

Exhibit 3. Approved TIF Plans by Council District<sup>6</sup>

Council District	Number of Plans	Percentage
1	9	17%
2	24	46%
3	4	8%
4	15	29%
5	3	6%
6	3	6%

Sources: Finance and Information Technology departments.

<sup>6</sup> Five approved TIF plans include property located in more than one council district.

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## Findings and Recommendations

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### Summary

The city and counties face barriers to identifying and transferring EATs and PILOTs to the TIF Commission. Although in theory the use of EATs and PILOTs to finance real estate development sounds straightforward, the application has proved difficult, inexact, and burdensome. To improve the TIF process, we make a number of recommendations.

First, we recommend that the city no longer approve EATs funding for future TIF projects, but instead use PILOTs exclusively because:

- PILOTs are relatively easy to compute and pay, because by definition they are tied to a specific parcel and based on public information, unlike EATs.
- EAT financing tends to attract retail intensive projects with few high paying jobs and is most attractive for undeveloped parcels.
- Retail projects are far more likely to take sales away from existing business via the substitution effect than are manufacturing and wholesaling projects.
- PILOTs are a more stable source of revenue to service long-term debt.
- Most states use PILOTs and only a few states have authorized and used EATs that are not sales tax based.

Second, we recommend that the city and counties develop an alternative method of estimating EATs for existing TIF plans because:

- The current methodology for estimating EATs requires that businesses supply confidential tax and utility information.
- Although all businesses located in TIF areas bear the burden of reporting information twice a year for up to 23 years, businesses are not providing all of the required information.
- Critical information is not provided to the city and counties because the TIF Commission has not enforced its EATs policy,

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the city has not enforced its reporting requirements, and developers have not notified businesses about reporting requirements.

Third, we recommend that until the current method of calculating EATs is changed, the city implement the following changes:

- The Finance Department should calculate the EATs payment by comparing the total EATs increment to the total EATs base before redirecting tax dollars to the TIF Commission.
- The city should support state legislation to establish the maximum time that developers and businesses located in TIF areas have to submit documentation supporting EAT liability.
- The Director of Finance should ensure that agreements with developers to exclude EATs activity for businesses or locations are established in writing.
- The City Attorney and county and TIF Commission legal advisors should attempt to clarify which taxes should be included in EATs payments to ensure that taxing jurisdictions contribute their appropriate share of development expenses.

Fourth, we recommend that the TIF Commission require legal descriptions be drafted by qualified professionals using bearings and distances and that county assessment staff review and approve legal descriptions and parcel values prior to their inclusion in plans, projects, and amendments because:

- Property descriptions contained in some TIF plans are inaccurate.
- Base year parcel values must be established before the PILOT increment can be calculated.
- Base year parcel values can be difficult to identify after the fact.

Fifth, we recommend that the city adopt an economic development incentive policy because:

- The city has not established the conditions under which to provide incentives although the city provides tens of millions of dollars in developer abatements and economic development incentives annually.
- Oversight and decision making over incentives is fragmented, potentially inconsistent, and lacks transparency.

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## **Economic Activity Tax Methodology and Use Should Be Re-Evaluated**

Defining the economic activity tax (EAT) base and increment for TIF projects is complex and inexact. The current EAT methodology is dependent on the cooperation of businesses located in TIF areas; however, businesses haven't provided all of the necessary information.

Unfulfilled obligations have contributed to delays in transferring economic activity taxes to the TIF Commission. The Commission has not enforced its EATs policy, the city has not enforced reporting requirements, developers have not consistently complied with business notification requirements, and Clay County did not retain enough EATs to meet its TIF obligation. Delays in establishing the base year value, fragmented communications, and differing perspectives have delayed the transfer of economic activity taxes to the TIF Commission. In some instances, however, the city appears to have overpaid EATs, paid EATs earlier than necessary, and paid on taxes that the counties exclude.

The current economic activity tax methodology gives the illusion of precision, but produces only an estimated base and increment value. While most states have adopted some type of tax increment financing incentive, few states use EATs and only four states have authorized the use of EATs that are not sales or use tax based. Rather than using detailed documentation to produce an estimate, we recommend that the City Council discontinue using economic activity taxes to finance new TIF development and develop a less burdensome method of estimating EATs for existing projects.

### **EAT Estimates Depend on Business Supplied Documentation**

Businesses located within a TIF area must supply information semi-annually for up to 23 years in order for the city to estimate economic activity tax increments. The city uses information supplied by businesses to define and estimate the economic activity taxes attributable to specific locations. The city uses identifying information to pull sales tax payments from the state sales tax CDs and from convention and tourism tax returns. For some other types of taxes, city staff review business-supplied information to allocate economic activity taxes that are not attributable to a single location.

A business's tax return information is insufficient to estimate the economic activity taxes generated in a TIF project area when a business has multiple locations. For example, if a business has more than one location within the city, its profits tax return doesn't show the percentage of profits originating for the location within the TIF area. Similarly, earnings tax returns that a

business files for its employees do not show the portion earned from the location within the TIF area when the business has more than one Kansas City location or employees work at other locations.

To calculate the earnings tax and profits tax increments under the current methodologies, businesses need to provide the percentage of employees located within a TIF area. City staff verify the reasonableness of the percentage, then allocate reported earnings and profits taxes to the TIF area. To calculate utility sales tax and license and franchise fee information, businesses need to provide copies of their utility bills. City staff can then enter figures from utility bills into spreadsheets, apply appropriate formulas, and calculate the portion of the city’s taxes that should be included in the EAT estimate. Other factors can also complicate the city’s EAT estimates. (See Exhibit 4.)

Exhibit 4. Factors That Complicate EATs Estimates for TIF

Tax Type	Filing Method	Factors that Complicate EAT Estimates
Earnings	Business entity or individual files a return with the city	<ul style="list-style-type: none"> <li>▪ Employer may have multiple locations</li> <li>▪ Employees may work at multiple locations</li> <li>▪ Employees may file for tax refunds<sup>7</sup></li> </ul>
Profits	Business entity files a return with the city	<ul style="list-style-type: none"> <li>▪ Business may have multiple locations</li> </ul>
Utility License and Franchise Fees	Utility company files a return with the city	<ul style="list-style-type: none"> <li>▪ Utility company collects the fees from individual consumers but the return reflects only aggregate figures</li> <li>▪ Consumers must supply copies of individual utility bills</li> </ul>
Sales	Business entity files a return with the state by location	<ul style="list-style-type: none"> <li>▪ Business may incorrectly report multiple location activity under a single sales tax location number<sup>8</sup></li> <li>▪ Business address may not be correct<sup>8</sup></li> <li>▪ Business may not be identified</li> </ul>
Sales-Utility	Utility company files a return with the state	<ul style="list-style-type: none"> <li>▪ Utility company collects sales tax from individual consumers but the return reflects only aggregate figures</li> <li>▪ Consumers must supply copies of individual utility bills</li> </ul>
Use	Business entity files a return with the state	<ul style="list-style-type: none"> <li>▪ Business may have multiple locations</li> <li>▪ Business may file for use tax refund</li> </ul>
Convention and Tourism <sup>9</sup>	Business entity files a return with the city	<ul style="list-style-type: none"> <li>▪ State law excludes taxes paid on sleeping rooms.</li> </ul>

<sup>7</sup> For the first half of 2002, the city’s Revenue Division identified about \$221,300 in earnings tax refunds requested by individuals working for businesses located in TIF areas.

<sup>8</sup> *Special Report Sales Tax Study*, City Auditor’s Office, Kansas City, Missouri, February 2001, p. 12.

<sup>9</sup> The city’s convention and tourism tax is levied on sleeping rooms and restaurants. However, RSMO 99.845 specifically excludes the taxes paid on sleeping rooms from inclusion in the calculation of the TIF increment.

### Businesses Are Not Providing EATs Documentation

Businesses within TIF areas have not submitted all required documentation needed to estimate the EATs increments. For 2003, 684 active businesses located in TIF areas should have submitted EATs documentation and information to the city. Of these, 544 businesses should have submitted the beta form and 140 businesses should have submitted copies of their tax returns and other supporting documentation.

Only 56 percent of the businesses that should have submitted conventional EATs documentation to the city for 2003 provided all of the needed information. About one third of businesses that should have submitted conventional EATs documentation for 2003, have not submitted any EATs documentation for 2003 as of January 2005. (See Exhibit 5.)

Exhibit 5. Businesses Fulfilling EATs Reporting Requirements – Conventional Reporting Method

Businesses Submitting:	2000		2001		2002		2003	
	No.	%	No.	%	No.	%	No.	%
No Documentation	50	32	51	31	48	34	46	33
Incomplete Documentation	14	9	15	9	18	13	15	11
Complete Documentation	94	59	100	60	77	54	79	56
Total Number of Businesses	158		166		143		140	

Source: Finance TIF records as of January 2005.

Only about 60 percent of active businesses filing under the beta method provided all of the required documentation for 2003. While more businesses are submitting all or part of the required documentation, incomplete information affects the EATs estimates for almost 40 percent of businesses using the beta method. (See Exhibit 6.)

Exhibit 6. Businesses Fulfilling EATs Reporting Requirements – Beta Reporting Method

Businesses Submitting:	2000		2001		2002		2003	
	No.	%	No.	%	No.	%	No.	%
Federal Identifying Information	267	88	423	87	434	87	483	89
State Identifying Information	303	100	481	99	494	99	539	99
Percentage of Employees	105	35	243	50	303	61	340	63
Complete Documentation	102	34	232	48	293	59	333	61
Number of Businesses	304		486		499		544	

Source: Finance TIF records as of January 2005.

### Incomplete documentation can delay and complicate EATs transfers.

The city's Professional Services Agreement with the TIF Commission calls for the city to process EAT documentation within 30 days of receipt. Some transfers take a long time, however, because businesses haven't submitted necessary documentation. In fiscal year 2003, the city processed EATS for every year back to 1996. (See Exhibit 7.) When businesses do not provide complete documentation, the city's EAT transfers are delayed, the TIF

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Commission cannot pay developer reimbursements, and interest could be accruing on unpaid reimbursements.

Exhibit 7. FY 2003 City EAT Transfers by Tax Year

<u>Tax Year</u>	<u>City EATs Transferred to the TIF Commission</u>
1996	\$ 1,237
1997	2,701
1998	36,385
1999	(26,704) <sup>10</sup>
2000	258,783
2001	2,715,977
2002	8,818,630
<u>Total<sup>11</sup></u>	<u>\$11,807,009</u>

Source: Finance wire transfer enclosure statements.

Although the TIF Commission's Economic Activity Taxes Policy requires annual and semi-annual submissions of EATs documentation, the state does not impose a time frame within which business must submit EATs documentation for processing. Substantial delays in submissions could present difficulties. The statute of limitations for the city's economic activity taxes is 3 or 5 years depending on the tax type. The city destroys tax returns 5 years past the filing deadline. Under the current EATs methodology, if a business submits documentation after the return information has been destroyed, staff could have difficulty verifying that the taxes were paid. The City Council should include in the city's state legislative priorities and seek county support for a limit on EATs payment liability by establishing the maximum time that developers and businesses located in TIF areas have to submit documentation supporting economic activity tax liability.

**Lack of documentation delayed the transfer of \$5.2 million to the TIF Commission.** Economic activity tax dollars paid to the city by businesses within TIF areas but not yet transferred to the TIF Commission are a liability to the city. Based on Treasury's method for estimating EATs liability, the city's TIF liability at the end of April 2004 was \$10.4 million.<sup>12</sup> This amount included estimates of TIF revenues that were collected between 1996 and

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<sup>10</sup> The credit value is the result of correcting a duplicate transfer for the 11<sup>th</sup> Street Corridor Plan.

<sup>11</sup> We used information from the Finance Department's wire transfer enclosure statements to develop this exhibit. We were unable, however, to match these totals to the amounts recorded in AFN, the city's electronic accounting system.

<sup>12</sup> In December 2002, at the request of the City's Finance Director, to assist the TIF Commission's auditor in completing the Commission's financial audit for the year ending April 2002, we examined the city's estimated TIF liability. We completed work steps designed by the TIF Commission's auditor, because the Commission's auditor did not have access to confidential taxpayer information to verify the information. We found that Treasury's method for calculating EATs liability was very rough and likely understated the liability, especially for earnings tax. We recommended that Treasury improve its method of estimating the city's EATs liability. Treasury's new method of estimating EATs liability is reasonable. Treasury now includes a liability estimate for every business identified by searching the business list provided by the Missouri Department of Revenue, the city's revenue system, and the phone book.

2004 but could not be transferred to the TIF Commission. About half of the estimated liability, or \$5.2 million, could not be transferred because businesses had not supplied documentation. Most of the remaining estimated liability reflected timing issues related to year-end reporting and processing. (See Exhibit 8.)

Exhibit 8. City's Estimated EATs Liability<sup>13</sup>

Tax Year	4/30/02	4/30/03	4/30/04
1996	\$ 69,531	\$ 68,294	\$ (85,975) <sup>14</sup>
1997	210,915	208,168	344,569
1998	575,729	539,784	881,428
1999	532,987	918,348	457,630
2000	1,191,678	936,660	670,211
2001	3,315,328	918,031	467,336
2002	3,987,697	2,293,081	898,925
2003	N/A	3,987,307	1,600,040
2004	N/A	N/A	5,177,200
Total Liability	\$9,883,866	\$9,869,672	\$10,411,364

Source: Finance Department.

### Stakeholders Not Meeting Obligations Contribute to Delays

Developers, the TIF Commission, and the city have not taken steps that could provide more timely information from businesses. The TIF Commission has established an EATs policy<sup>15</sup> to facilitate the reporting of information needed to estimate the EAT increment used to reimburse developers for TIF project expenses. The policy outlines the responsibilities of the Commission, developer, project area businesses, property owners and the city; however, these obligations have not been fulfilled. The city adopted an ordinance in 2001 requiring businesses to provide economic activity tax information, but the ordinance has not been used to prosecute businesses that fail to provide economic activity tax information. In addition, Clay County did not set aside sufficient economic activity taxes to meet its obligations.

<sup>13</sup> The EATs liability estimate does not include utility taxes. The omission, however, does not significantly impact the liability estimate because utility taxes account for a small portion of total TIF revenue. The estimate also does not reflect all earning tax refunds.

<sup>14</sup> City staff undertook a review of the Southtown TIF plan liability in 2004. This review identified additional businesses located within the plan area and increased the base year value used to calculate previously transferred EAT increments. When a base year value goes up, there is a corresponding decrease in the increment. Based on the higher base year value, city staff found that the city had transferred too much money to the TIF Commission for the Southtown TIF plan for the 1996 tax year. As a result, the city's estimated 1996 liability figure showed an overpayment or negative liability. The base year EATs values for the 12<sup>th</sup> & Wyandotte, Civic Mall, and Grand Boulevard plans were also increased.

<sup>15</sup> See Appendix E for the TIF Commission's *Economic Activity Taxes Policy*, January 14, 2004 (Revised July 14, 2004).

**Developers have not notified businesses about reporting obligations.**

The TIF Commission's EATs policy requires that the developer inform businesses located in a TIF plan area about reporting requirements.<sup>16</sup> For leased property, the developer/owner is also obligated to report annually on the entities located within the project area in order to facilitate identification of EATs used to reimburse developer and plan expenses. The TIF Commission has not enforced these obligations. As a result, businesses locating in a TIF area may not know about the semi-annual reporting requirements. In addition, the city and counties may not know which businesses are located in TIF areas or the dates of operation.

**The TIF Commission and developers do not always provide sufficient base year information.** The EATs base year value is the amount of economic activity taxes paid by each business located in the project area in the year immediately preceding the City Council's approval of the TIF project. The TIF Commission, assisted by the developer, is responsible for obtaining EATs tax information from businesses located within the TIF area. According to the TIF Commission's EATs policy, the Commission is to provide the Finance Department with a list of all businesses operating in the project area during the base year along with the businesses' federal identification number, state MITS number and location code, and copies of all base year utility bills.

The city cannot estimate or transfer the EATs increment until the base is established. The base year EATs values for the Parvin Road and Uptown TIF projects were each delayed for years because information was not provided. Other potential transfers continue to be delayed because base year values have not been established. In some circumstances, when a developer has difficulty identifying businesses or gathering base year information from individual businesses, rather than delaying the transfer of EATs indefinitely, the developer will agree to estimate EATs base year values from information available from other sources or exclude some tax types and properties or portions of properties.

**Unwritten EATs exclusions present difficulties.** Developers and Treasury staff have agreed to exclude some businesses or locations from plans, but these agreements are not in writing. As a result, it is not clear that there is a common understanding of the exclusions. For example, staff are not certain whether floors or businesses on those floors were excluded in a building in the Grand Boulevard plan. In addition, as a new building is planned for Southtown Project I to replace a previously excluded location, the issue of base year values resurfaces, years after the project began. The

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<sup>16</sup> A developer, who sells, assigns, leases or subleases property within a project, must include in contracts and require for inclusion in any subsequent contracts, a requirement for the submission of EATs documentation. In addition, a memorandum of the agreement is also to be filed as part of the property record for all property within the TIF district in order to put subsequent takers on notice.

Director of Finance should ensure that agreements with developers to exclude EATs for businesses or locations are established in writing.

**The city has not yet enforced the reporting requirement.** City code section 50-11 provides an enforcement mechanism for non-reporting businesses located in TIF areas. Business owners and tenants may be given a 30-day written notice to provide their Missouri sales tax number and location code and their federal identification number. Businesses must also report the number of employees working in the TIF area and the percentage of each employee's work performed within the TIF area, and provide copies of utility bills. If this information is not provided, businesses may be prosecuted. If convicted of a violation, a fine of not less than \$100 nor more than \$500 per day may be imposed.

While it has been available since August 2001, no business has been prosecuted under this code section. The TIF Commission has updated its EATs policy to include information on this enforcement mechanism, notified some non-reporting businesses of the code requirements, and passed a resolution requesting that the city take legal action to enforce the reporting requirements. Commission staff is currently working with the city's Law Department and Treasury staffs on enforcement activities. The effectiveness of Municipal Court prosecutions, however, could be hampered by the need to actually identify an individual as a defendant and get that individual physically into a courtroom so that the prosecution can occur.

**Clay County did not set aside enough economic activity tax revenue to meet its obligation.** Although the county, working with the city and TIF Commission staffs, has now established an estimated EAT liability, sufficient cash is not available to transfer to the Commission.

Clay County shifted the responsibility for EATs payments from the County Clerk to the Assistant County Administrator in 2001. The Administrator, however, did not have access to the county's copy of the state sales tax CDs that the city and counties use to identify most of the sales tax portion of EATs.

For 2001, Clay County received a qualified opinion from its commercial auditors because the auditors could not obtain sufficient evidence to support the county's estimated TIF liability of about \$1.6 million. For 2004, Clay County budgeted EATs revenues of approximately \$3.2 million, but only budgeted EATs expenses of \$1.3 million. The reasoning behind this gap in revenues and expenses is not clear.

Clay County used EATs revenues to finance other county activities. In 2004, the Clay County Commission transferred \$493,000 from the county's TIF

### *Estimating Tax Dollars Owed to the TIF Commission*

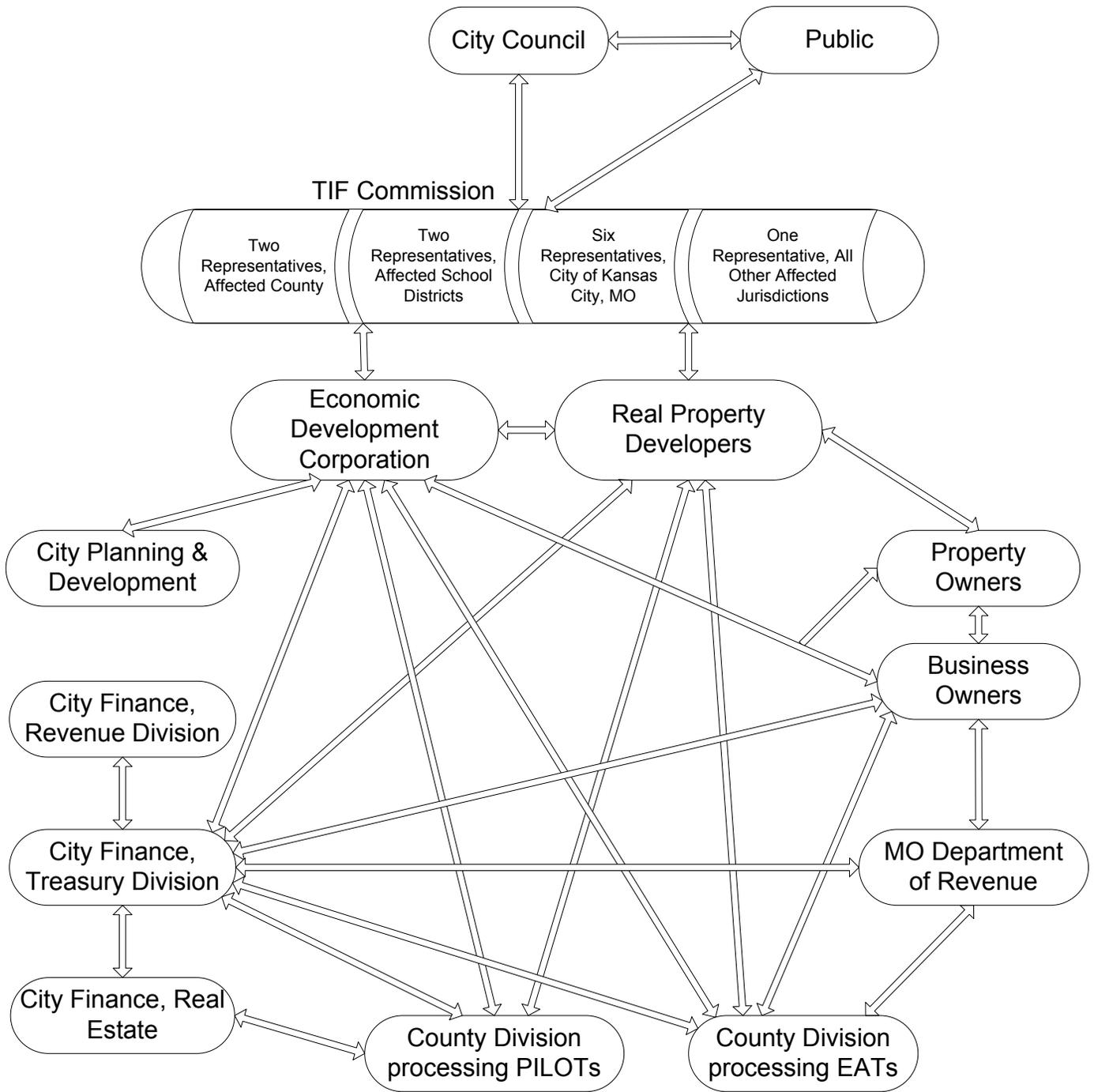
budget to the Parks Department to partially fund improvements at a county golf course until bond proceeds were available. When the county bonds were subsequently issued, the previous transferred moneys were returned to the TIF account.

In 2004, the county's elected auditor, working with the city and TIF Commission reconciled the county's EATs liability with the city's liability estimates and the EATs payments that had been made to the TIF Commission. Clay County has developed a schedule to pay off its EATs liability. Clay County made its first payment of almost \$223,000 and is scheduled to pay off the remaining \$891,000 on or before June 30, 2005.

### **Stakeholder Communications Have Been Fragmented**

Stakeholders agree that their information needs are not well understood and have not been met. Constraints on communications have resulted in a lack of understanding, distrust, and inefficient administration. Information sharing among TIF stakeholders is inconsistent and sometimes restricted by law. Exhibit 9 provides a visual representation of the complexity of the process of identifying and transferring PILOTs and EATs to the TIF Commission. Multiple communication channels are used to transfer information, documents, and revenues. (See Exhibit 9.)

Exhibit 9. TIF Process – Identifying and Transferring Redirected Tax Dollars



-  Identifies an entity involved in the process
-  Represents the necessary communication between the entities

**Stakeholders protect the interests of the organization they represent.**

Stakeholders do not share a common perspective or goal with regards to TIF. The city and county staffs serve the interests of their taxing jurisdiction by safeguarding tax revenues, avoiding misallocation of funds, and protecting the confidentiality of tax information. The TIF Commission and its staff are interested in the timely transfer of TIF tax revenues in order to reimburse developer and Commission expenses.

Mistrust among stakeholders has been common. Fragmented communications, a lack of common goals, and incomplete information have contributed to administrative difficulties. All stakeholders do not understand the entire TIF process or how activities fit into the whole. Some stakeholders see only a portion of the information used to administer TIF. Various taxing jurisdictions are represented on the TIF Commission, however, the make up of the TIF Commission favors the city. And, political pressures can influence TIF processes.

**Stakeholder communications are improving.** City, TIF Commission, and the counties' staff believe their communications with one another have improved within the past 18 months. The city and TIF Commission staffs have begun sharing and comparing lists of business tenants and beta projects. In August 2004, the TIF Commission arranged a half-day seminar for TIF stakeholders. This was the first meeting that staff could recall that included invitations to staff members from the city, TIF Commission, and all counties. Also in August, the city and Clay County entered into an intergovernmental agreement that allows the city to share more detailed EATs information with the county that in turn should allow the county to define and estimate EATs using city developed detail.

**Stakeholders Interpret State Statute Differently**

The state TIF statute is broad and leaves room for interpretation. Stakeholder organizations can interpret the statute differently, resulting in disagreements and potential inequities. For example, the city and TIF Commission have different opinions on when TIF liability occurs. TIF Commission staff argues that the city's liability occurs when tax revenues are collected and the funds should be immediately deposited into a restrictive fund. The city believes that the liability occurs only after the base is established and the increment identified.

**Stakeholders do not agree on which taxes can or should be included in the EAT increment.** Clay County is not including use tax in their EATs calculations, questioning whether state statutes require its inclusion. Platte County does not include sales taxes from utility bills in its EATs transfers because the utility companies' sales tax payments do not contain details

that permit the county to trace the payment back to the individual customer's bill to verify that the customer actually paid the tax. Stakeholders interpret the statute differently and when questions do arise, it is uncertain who can provide the definitive answer without litigation. The City Attorney and county and TIF Commission legal advisors should attempt to clarify which taxes should be included in EATs payments.

**The city may be supporting more than its share of TIF expenses.**

Because both the city and county contribute money for the same projects, when the city pays its EAT increment from a tax type that the county is excluding from its transfers, the city could end up paying an unexpectedly greater proportion of project costs. The TIF Commission staff have been working with utility companies to develop methods of providing the city and counties with utility based EATs payment information.

**The city has accelerated its EATs payments.** The city uses partial year bases to calculate the EATs increment for most plans. The city calculates and transfers its EATs increment based on 3, 6, and 12-month bases. When EATs are calculated on less than a 12-month base, the city could be transferring EATs to the TIF Commission earlier than necessary and before the city captures the entire base.

**The city has overpaid EATs for some projects.** The city's method of calculating the economic activity tax increment has resulted in the overpayment of EATs to the TIF Commission. The city has calculated each base and increment of EATs by individual tax. When a project contained a tax component that experienced a decline or negative increment value for a period, city staff eliminated the negative value from the increment calculation rather than including the negative value in the calculation of the total increment payment. A review of 2003 TIF records as of July 2004, found that eliminating the negative increment values resulted in a potential over payment to the TIF Commission of approximately \$800,000. The Director of Finance should direct staff to calculate the EATs payment by comparing the total EATs increment to the total EATs base, not transfer EATs until the entire EATs base for the project is captured, calculate the EATs overpayments for all years, and determine the best method to recapture the overpayments.

**The city and counties didn't exclude a state processing fee from the increment.** The city and counties rely on the state's sales tax CD to calculate EATs. The city recently discovered that the sales tax figures pulled from the CD were not adjusted to reflect the one percent processing fee charged by the state for collecting and distributing sales tax revenues. The city and counties over paid the TIF Commission. The city is taking credits for the overpayments against current reimbursements and the counties are determining how best to recapture prior overpayments.

### **Stakeholders Should Consider Alternative Ways to Estimate EATs**

The processes involved in estimating economic activity tax increments are inexact and burdensome to the city, counties, businesses within TIF areas, and the developers. The economic activity increment, calculated based on detailed documentation, can produce only an estimate of the new taxes received resulting from real economic growth. The City Council should no longer approve economic activity tax financing for new TIF projects and stakeholders should develop a simplified method of estimating the economic activity tax increment for existing projects.

**Detailed documentation and processing give the illusion of precision, but EATs is only an estimate.** Business owners, developers, and city, counties, and TIF Commission staffs must devote time to providing or processing information to develop EATs estimates. Confidential tax information, utility bills, and lists of businesses are required, but not consistently provided. Developers exclude some businesses and locations and Treasury staff can only estimate some base year taxes. The current framework generates estimates based on detailed information, not the actual increase in economic activity generated by the real estate development.

**Sales substitution is not fully accounted for with current EATs methodology.** The current framework, while permitting an adjustment to the base year in certain circumstances,<sup>17</sup> does not fully take into account the substitution effect or shifting of sales from competing businesses and locations.

The substitution effect is the movement or transfer of sales from other locations to TIF business locations. For example, when a consumer needs a bottle of aspirin and the purchase is made at a business located in a TIF area, the sales tax generated is included in calculating the increment for the TIF area. The purchase, however, does not necessarily reflect new economic activity. The consumer needed and purchased only a single bottle of aspirin. The sale to fulfill the consumer's need would have occurred at another location if the business located in the TIF district did not exist. To develop a true EATs base and increment, a method for separating new activity from a mere change in the location of the activity needs to be developed.

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<sup>17</sup> For projects and plans approved after December 23, 1997, the base year value can be adjusted for retail establishments relocating within one year from one facility to another within the same county when the municipal governing body finds that the relocation is a direct beneficiary of tax increment financing. The EATs generated by the retail establishment shall equal the total additional revenues from EATs over the EATs in the calendar year prior to its relocation to the TIF area. RSMo 99.805(4).

**Few states fund TIF development with EATs.** Missouri is one of the few states to use economic activity taxes for tax increment financing. Although almost all states have some type of TIF development incentive, most states use PILOTs as the sole funding source.

In 2001, only eight states<sup>18</sup> and the District of Columbia authorized the funding of TIF developments with EATs. Missouri is one of only four states that have authorized funding of TIF projects with economic activity taxes other than sales or use tax.

**PILOTs are better suited than EATs as development incentives.** The base and increment for PILOTs are tied to specific locations and relatively easy to identify. The base and increment change in economic activity are not always clearly linked to investment in a geographic area and are difficult to estimate.

The current methods of defining the EAT base and increment do not capture the true increment induced by the development in the TIF area. The use of EATs creates an incentive for developers to implement sales-tax intensive projects like shopping centers that are more likely to take sales from other nearby locations than generate new sales. Retail development is likely to occur without subsidies, is most attractive for undeveloped parcels, not blighted urban areas, and creates few high-wage jobs with strong career tracks. And, the inherent fluctuations in EATs are not a good foundation for long-term debt service.<sup>19</sup> The City Council should no longer approve EATs funding for future TIF projects, but instead use PILOTs exclusively.

**The use of EATs financing should be re-examined.** Delays in transferring the EAT increments have generated distrust among stakeholders. The city, county, and TIF Commission staffs spend a lot of time gathering or processing documentation used to estimate EATs; however, businesses within TIF areas are not submitting required documentation. Rather than relying on a process that uses prosecution as an incentive for reporting, the TIF Commission and the City Council should eliminate the use of economic activity taxes to finance future TIF projects.

Doing away with EATs does not relieve the administrative burden of existing projects that could be active for the next 23 years. Therefore, the

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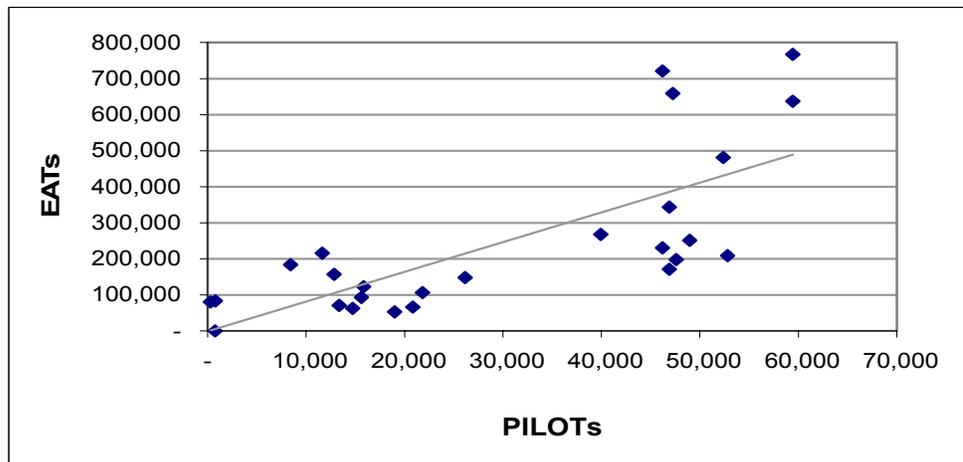
<sup>18</sup> Colorado, Illinois, Indiana, Kansas, Louisiana, Maine, Missouri, and Wyoming.

<sup>19</sup> Craig L. Johnson and Joyce Man, *Tax Increment Financing and Economic Development, Uses, Structures, and Impact* (Albany: State University of New York Press, 2001) and Thomas Luce, "Reclaiming the Intent: Tax Increment Finance in the Kansas City and St. Louis Metropolitan Areas," Ameregis, Inc., April 2003, prepared for The Brookings Institution Center on Urban and Metropolitan Policy.

city should also consider a less administratively complex way of estimating EATs.

**A method of estimating EATs that does not rely on confidential business records should be developed.** Since TIF is a real property development incentive, tying the moneys used to reimburse development costs more closely to the actual growth in the real estate value is reasonable. We analyzed EATs and PILOTs data for five TIF projects. The data reflected actual payments plus liability projections from 1996 through 2003. We found that higher values of EATs are associated with higher values of PILOTs. The variation in PILOTs explains about 74 percent of the variation in EATs for the data examined.<sup>20</sup> (See Exhibit 10.)

Exhibit 10. Scatter Diagram Measuring Relationship Between EATs and PILOTs<sup>21</sup>



Source: Finance Department.

An approach that develops EATs estimates based on real property values would be less paper intensive, take less time, cost less to administer, and be more transparent. Potential advantages include:

- No need to calculate an EATs base
- No need to collect information from businesses for 23 years
- No need to keep track of active businesses within TIF areas
- No need to allocate earnings and profits taxes
- No need to include reporting requirements in contracts
- No need to verify employees' work locations

<sup>20</sup> Correlation analysis assesses the strength of the relationship between variables, in this example, the variables are PILOTs and EATs. The correlation coefficient can vary from -1.0 to +1.0. If the two variables were perfectly linearly related, plotting PILOTs against EATs would produce a straight line and a correlation coefficient of 1. Variables that have no linear relationship will have a correlation coefficient of zero. The correlation coefficient of PILOTs and EATs for the five TIF projects was .74.

<sup>21</sup> The scatter diagram is a graph on which plotted points represent an observed pair of values of the dependent variable (EATs) and independent variable (PILOTs).

- No need to track tax refunds by location
- No need to prosecute businesses to obtain confidential information
- Allows the TIF Commission and developers to verify EATs
- More timely payment of EATs to the TIF Commission

**Missouri uses estimates for some state TIF appropriations.** Provisions of the state's tax increment financing statute permits the State of Missouri to redirect up to fifty percent of the new state revenue generated in some TIF areas.<sup>22</sup> Either the estimated incremental increase in the general revenue portion of the state sales tax revenues or the estimated state income tax withheld by employers on behalf of new employees in the TIF area can be appropriated. The application that a municipality completes to receive state revenues under this statute requires that the methodologies used to determine the base year and increment be described. The state's appropriation is a portion of the estimated incremental increase in the state's sales or income tax, suggesting a recognition on the part of the state that EATs activities are only estimates and that various methodologies may be employed to derive the increment. The statute also sets a limit on the aggregate annual appropriation that may be made.

The Director of Finance and appropriate county staff should devise and recommend to their elected bodies a method of estimating EATs for existing TIF plans that does not rely on confidential business records. A method should be developed to estimate EATs based on real property values for the project area. The method could estimate EAT revenues for a project based on a relationship between the real property values within TIF project area, real property values for the jurisdiction, and economic activity taxes collected by the jurisdiction. Tying project EATs to the jurisdictions' EATs would also take into account at least a portion of the substitution effect for sales tax revenue. If it is determined that a streamlined estimating methodology is not possible under the current statute, the city should seek to revise the state statute.

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## **Timely Identification and Valuation of Real Property Parcels Needed**

County employees have experienced difficulties in establishing the base year real property values for some TIF projects. The property descriptions contained in some plans and plan amendments are inaccurate. County assessment staff may not receive notification of TIF projects in time to capture parcel values before they are eliminated from some county's electronic records. As a result, the PILOT base year value and the identification and transfer of PILOTs can be delayed, contributing to a lack of trust among stakeholders.

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<sup>22</sup> RSMo 99.845.

### **TIF Property Descriptions Are Not Always Accurate**

Both Clay County and Jackson County officials<sup>23</sup> report that they have had problems identifying TIF area boundaries and parcels. The boundaries described in TIF plan documentation do not always form enclosed areas. Because PILOTs and EATs are based on the identification of property and businesses located within a TIF area, it is essential that the boundaries be accurate.

TIF is a real estate development incentive. An accurate legal description of the plan area is crucial for identifying PILOTs. Although a property description is included in the initial plan document, they are not always included in plan amendments.

**Professionals should draft TIF legal description.** Qualified personnel do not always draft the legal descriptions defining the boundaries of TIF areas. Only licensed land surveyors may do work that affects real property rights. Although TIF Commission staff report that developers are now supplying property descriptions drafted by outside professionals, the TIF Commission staff has sometimes written and edited property descriptions that are included in TIF plans and amendments.

**Legal descriptions using bearings and distances could help identify land located in TIF areas.** Plan property boundaries can be written using different types of descriptions. The person drafting the description may use identifying features that are on one map but may not be located at the same location or at all on the maps used by the city or county. Descriptions written by professionals using bearings and distances could permit mapping professionals at the city and county to more precisely identify and draw the boundaries of TIF areas on the maps used by those entities.

The TIF Commission should require that legal descriptions be drafted by qualified professionals using bearings and distance descriptions.

### **Timeliness of Valuation of Real Property Parcels Could Be Improved**

The county assessor must establish the initial or base value of parcels contained in a TIF area before PILOTs can be identified and transferred to reimburse TIF development expenses. The base year value can be difficult to establish after the fact. State law also requires that TIF plans contain the most recent equalized assessed valuation of property within the redevelopment area. In order to develop this information, the developer

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<sup>23</sup> PILOTs are not currently used to finance Kansas City, Missouri, TIF projects in Platte County.

would need to identify and obtain the assessed value of all of the parcels contained within the plan area. Because the county assessor must also identify parcels and develop the initial assessed value of the TIF area as soon as it is approved by the City Council, the process could be improved by involving the county assessor earlier.

**Base year values are needed before PILOTs are estimated.** PILOTs are the estimated revenues generated from taxes levied on the increase in assessed value of real property parcels contained in a TIF project over the initial value of the same parcels. Until the county assessors have identified the parcels in the TIF area and have established a base year or initial valuation of those parcels, the increment to be used to reimburse development expenses cannot be estimated or paid.

**Base year values are difficult to identify after-the-fact.** County assessors are required to immediately determine and certify the most recent total assessed value of all taxable real property in a TIF project area when the city approves a TIF project.<sup>24</sup> County assessment staff report, however, that they are not always notified when a TIF plan is in the works or a project is activated.

Clay County does not maintain prior year property values in an accessible electronic format. Real property values are reviewed and adjusted every two years or when changes in use or activity occur, or at the owner's request. Clay County assessment officials told us that once the property values are updated, they have difficulty reconstructing the base year information.

**Developers should work with assessors before TIF plans are approved.** A cooperative effort between the developer and assessment staff could decrease the duplication of effort and insure that TIF legal descriptions are complete and accurate and that all real property parcels are identified. The identification and correction of discrepancies earlier in the process could insure that the assessor is able to establish the base year for PILOTs in a timely manner improving the taxing jurisdictions' ability to identify and transfer PILOTs.

The TIF Commission should require that county assessment staff review and approve the legal descriptions and parcel values submitted by developers in plans, projects, and amendments.

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<sup>24</sup> RSMo 99.855.1.

## **The City Needs an Economic Development Incentive Policy**

The city does not have an economic development incentive policy. The City Council has not established the conditions under which to provide incentives. With the city providing tens of millions of dollars in developer abatements and economic development incentives annually, it is important that elected officials establish an economic development incentive policy. Such a policy could serve as the basis for consistent decision-making, guide staff, enhance understanding among stakeholders, and strengthen the role of elected officials.

### **Earlier Efforts to Create a Policy Failed**

In both the 2000 and 2002 adopted budgets, the former City Manager called for the City Council to develop a public policy to manage the financial challenge presented by the growth in TIF. In June 2001, the Chairman of the Finance and Audit Committee introduced Resolution 010924 to establish city policy for the use of tax increment financing for economic development. The committee held the policy resolution until it was removed from the agenda in July 2003.

Also in 2003, the City Planning and Development Department led an effort to create an economic development incentive policy. The draft policy was referred to the city's Planning, Zoning and Economic Development Committee on February 13, 2003. The draft was not approved; however, on March 27, 2003, the City Council did adopt committee substitute for resolution 030191, which stated the Council's intention to establish an economic development incentive policy using the un-adopted third draft of the policy as the basis of ongoing discussions. No policy has been forthcoming.

### **Development Incentive Policy Would Provide Direction**

The City Council has not established a policy defining the conditions under which incentives will be provided. Currently, economic development decision-making and oversight are fragmented. The adoption of a policy could serve as the basis for consistent decision-making, guide staff actions, and enhance understanding among stakeholders. In addition, the role of elected officials could be strengthened from one of ministerial approval of individual projects to one of establishing the goals that would direct future activities and criteria against which projects could be evaluated.

The Government Finance Officers Association (GFOA) recommends four components that should be included in a public policy for economic development incentives:

- Specific goals and criteria that define the economic benefit both the government and the entities receiving the incentives expect to gain.
- The conditions under which the incentives are to be granted.
- The actions to be taken should actual benefits differ from planned benefits.
- The economic benefits to the government and the costs of the incentive should be measured and compared against the goals and criteria that have been previously established.

We have previously reported that a tax increment financing policy could produce additional benefits.<sup>25</sup> These benefits could include establishing the City Council's primary role as policy maker; increasing public confidence in the integrity of the TIF process; and clarifying the city's development expectations. We also recommended that the City Council consider including provisions that would limit the city's overall financial risk and recognize the costs of administration.

To establish a clear vision and improve the transparency and consistency of decision-making, the City Manager should submit an economic development incentive policy for City Council consideration.

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<sup>25</sup> Memoranda from City Auditor Mark Funkhouser to Councilman Evert Asjes, Chair, and members of the Finance and Audit Committee, September 24, 2002 and January 27, 2003.

## **Recommendations**

1. The City Council should no longer approve EATs funding for future TIF projects, but instead exclusively use PILOTs.
2. The Director of Finance and appropriate county staff should devise and recommend to their elected bodies a method of estimating EATs for existing TIF plans that does not rely on confidential business records. If it is determined that a streamlined estimating methodology is not possible under the current statute, the city should seek to revise the state statute and re-examine the current beta estimating methodologies.
3. The Director of Finance should direct that city staff calculate the EATs payment by comparing the total EATs increment to the total EATs base, not transfer EATs until the entire EATs base for the project is captured, determine the amount of EATs overpayment for prior years, and recapture identified overpayments.
4. The City Council should include in the city's state legislative priorities and seek county support for a limit on EATs payment liability by establishing the maximum time that developers and businesses located in TIF areas have to submit documentation supporting economic activity tax liability.
5. The Director of Finance should ensure that agreements with developers to exclude EATs activity for businesses or locations are established in writing.
6. The City Attorney and county and TIF Commission legal advisors should attempt to clarify which taxes should be included in EATs payments.
7. The TIF Commission should require that legal descriptions be drafted by qualified professionals using bearings and distance descriptions and that county assessment staff's review and approval of legal descriptions and parcel values be contained in plans and amendments submitted by developers.
8. The City Manager should submit an economic development incentive policy for City Council consideration.

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## **Appendix A**

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### **Stakeholders Interviewed by the City Auditor's Office**

*Estimating Tax Dollars Owed to the TIF Commission*

**City Finance Department**

Kevin Riper, Former Director of Finance  
Wanda Gunter, Acting Director of Finance  
Randall Landes, City Treasurer  
Dan Bagunu, Manager of Financial Analysis Unit, Treasury  
Joe Pehlman, TIF Manager, Treasury  
Jamie Landes, Financial Analyst, Treasury  
Kellee Wood, Financial Analyst, Treasury  
Jordan Griffin, Acting Commissioner of Revenue  
Mark Rhuems, Municipal Revenue Agent II, Revenue

**City Planning and Development**

Robert Hurst, Chief of Citywide Planning

**Clay County**

Pamela Mason, County Clerk  
Vic Hurlbert, County Auditor  
Sheila Snell Ernzen, County Treasurer  
Cathy Rinehart, County Assessor  
Alexa Barton, Assistant County Administrator/Director of Purchasing  
Debbie Ehling, Cartographer

**Jackson County**

Gloria Ortiz Fisher, Director of Finance  
Robert Burnett, Deputy Director of Assessments  
Habib Ahmed, Audit and Procedures Analyst

**Platte County**

Bonnie Brown, County Treasurer

**TIF Commission**

Peter Yelorda, Chair

**The Economic Development Corporation**

Laura Whitener, TIF Development Officer  
Andi Udris, President and Chief Executive Officer  
Gary Sage, Executive Vice-President, Business Retention and Attraction  
Gloria J. Morris, Finance and Administrative Officer  
Debbie Carter, Controller  
Cathleen Flournoy, Financial Coordinator, TIF Commission  
Drew Kloeppe, Manager of Finance & Records, TIF Commission

**Other**

David L. Cochran, Cochran, Head & Co., P.C.  
Joyce Y. Man, Associate Professor of Public Finance and Policy, Indiana  
University

*Estimating Tax Dollars Owed to the TIF Commission*

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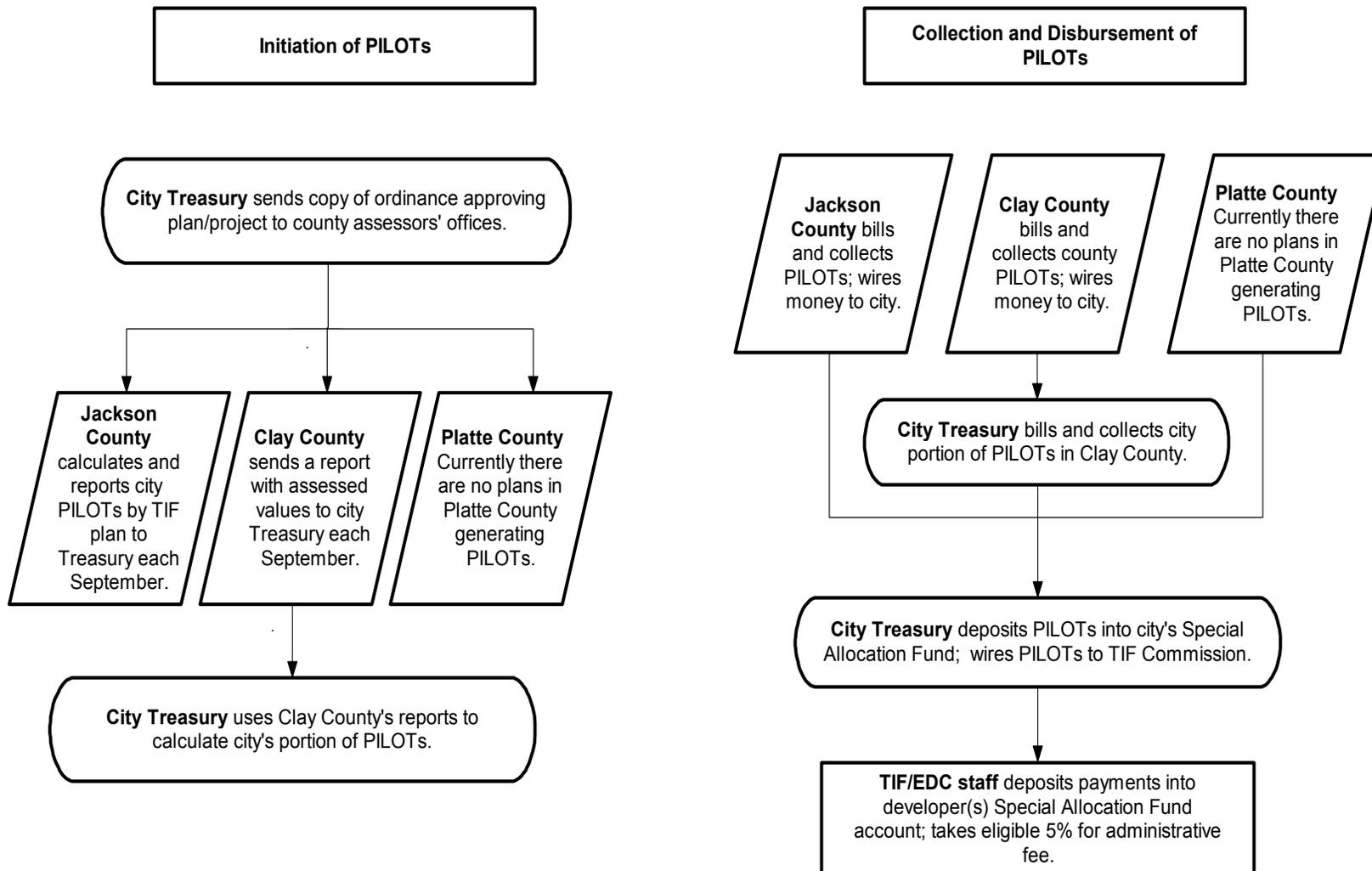
## **Appendix B**

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### **Process to Transfer Payments in Lieu of Taxes (PILOTs)**

*Estimating Tax Dollars Owed to the TIF Commission*

**Payments in Lieu of Taxes (PILOTs)**



*Estimating Tax Dollars Owed to the TIF Commission*

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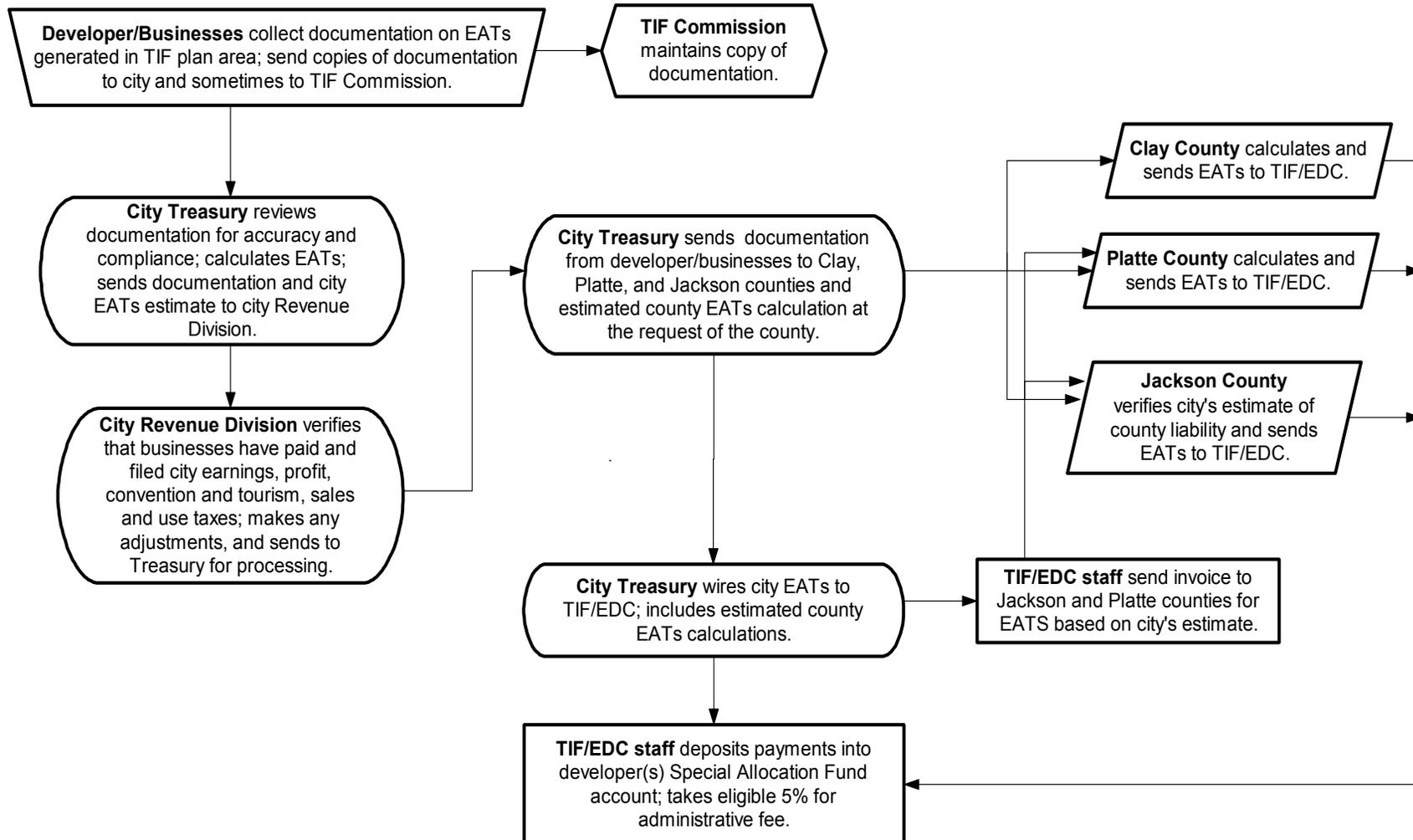
## **Appendix C**

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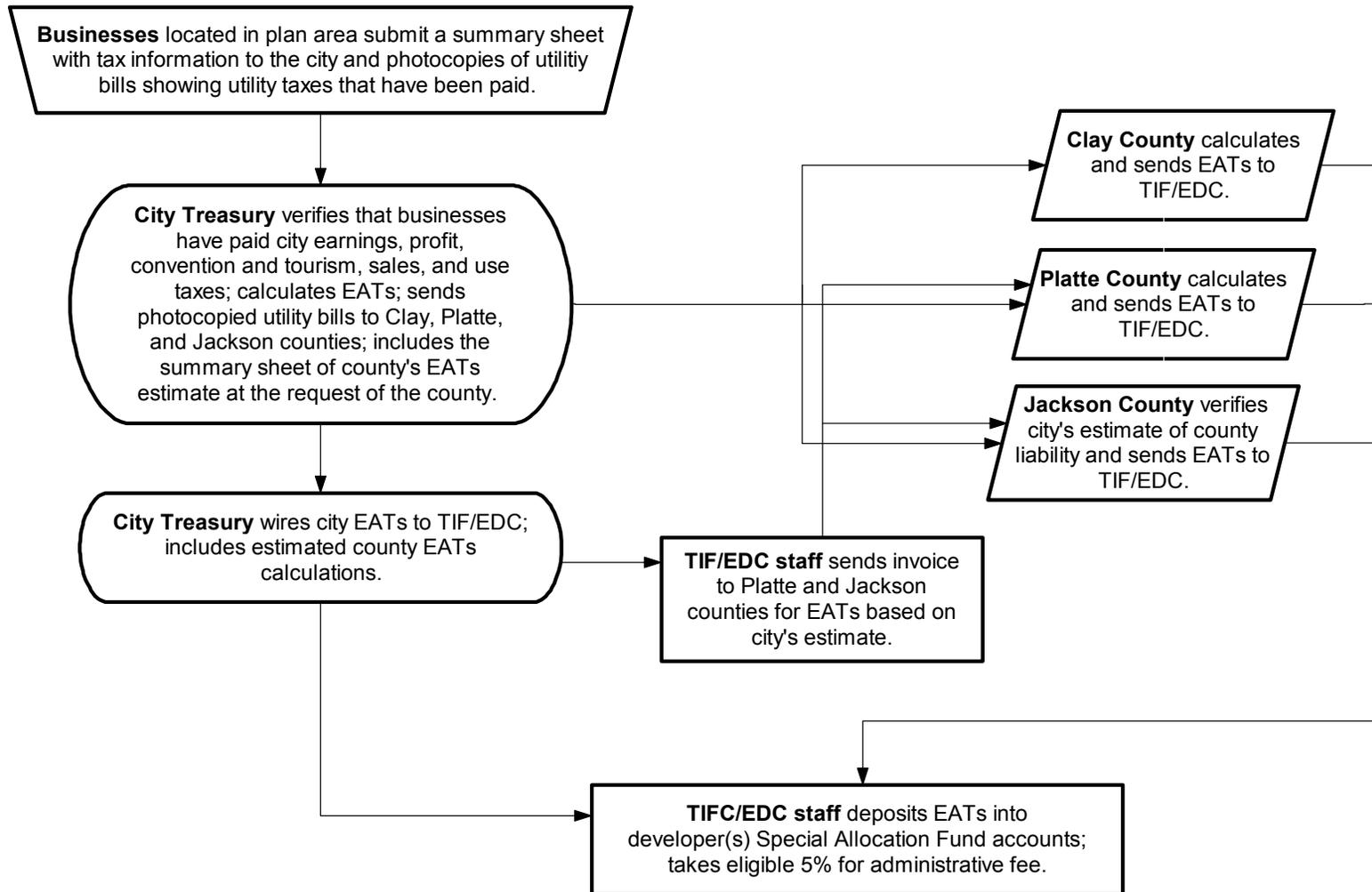
### **Processes to Transfer Economic Activity Taxes (EATs)**

*Estimating Tax Dollars Owed to the TIF Commission*

### Steps for Conventional EATs Collection and Disbursement Process



### Steps in EATs "Beta" Process



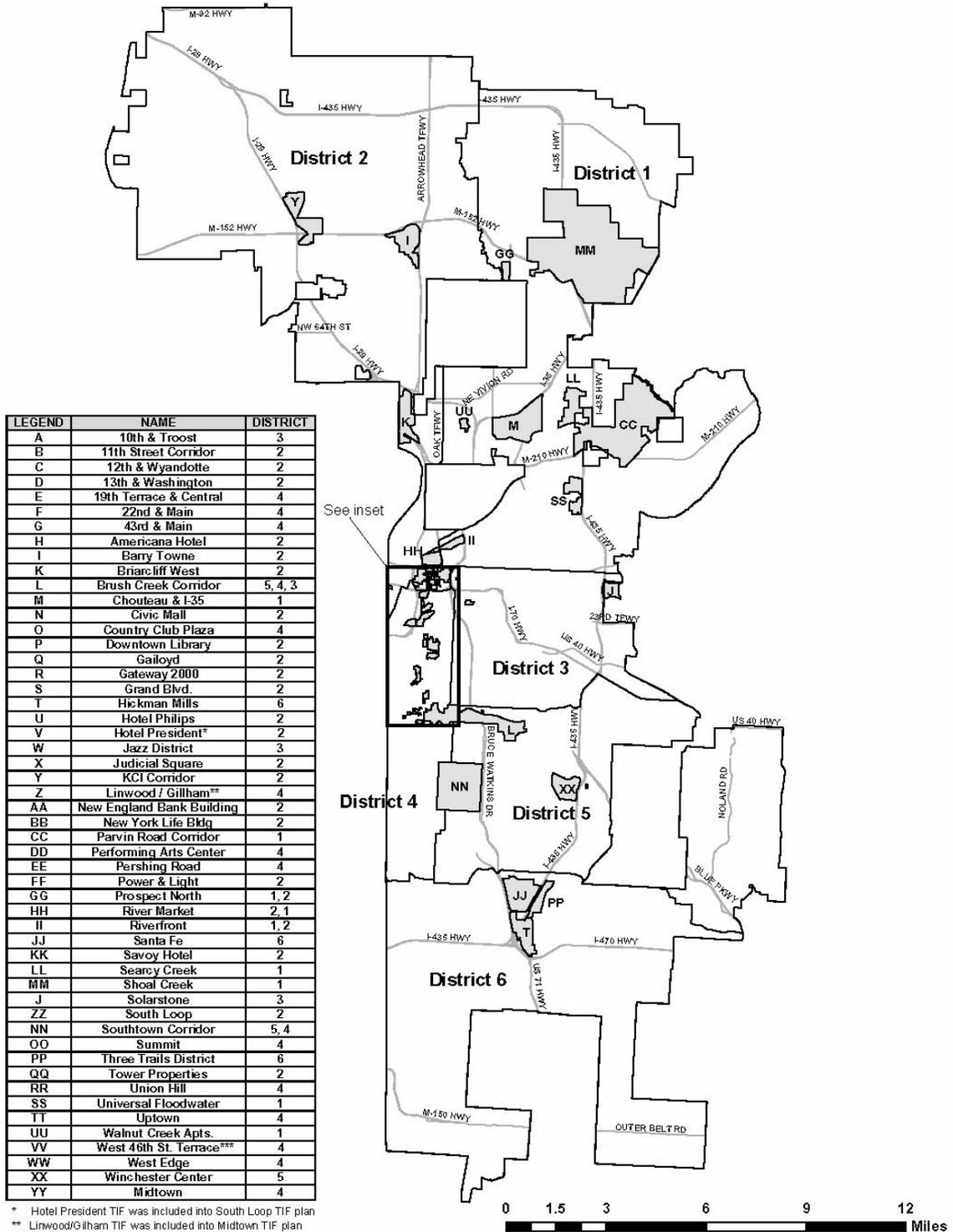
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## **Appendix D**

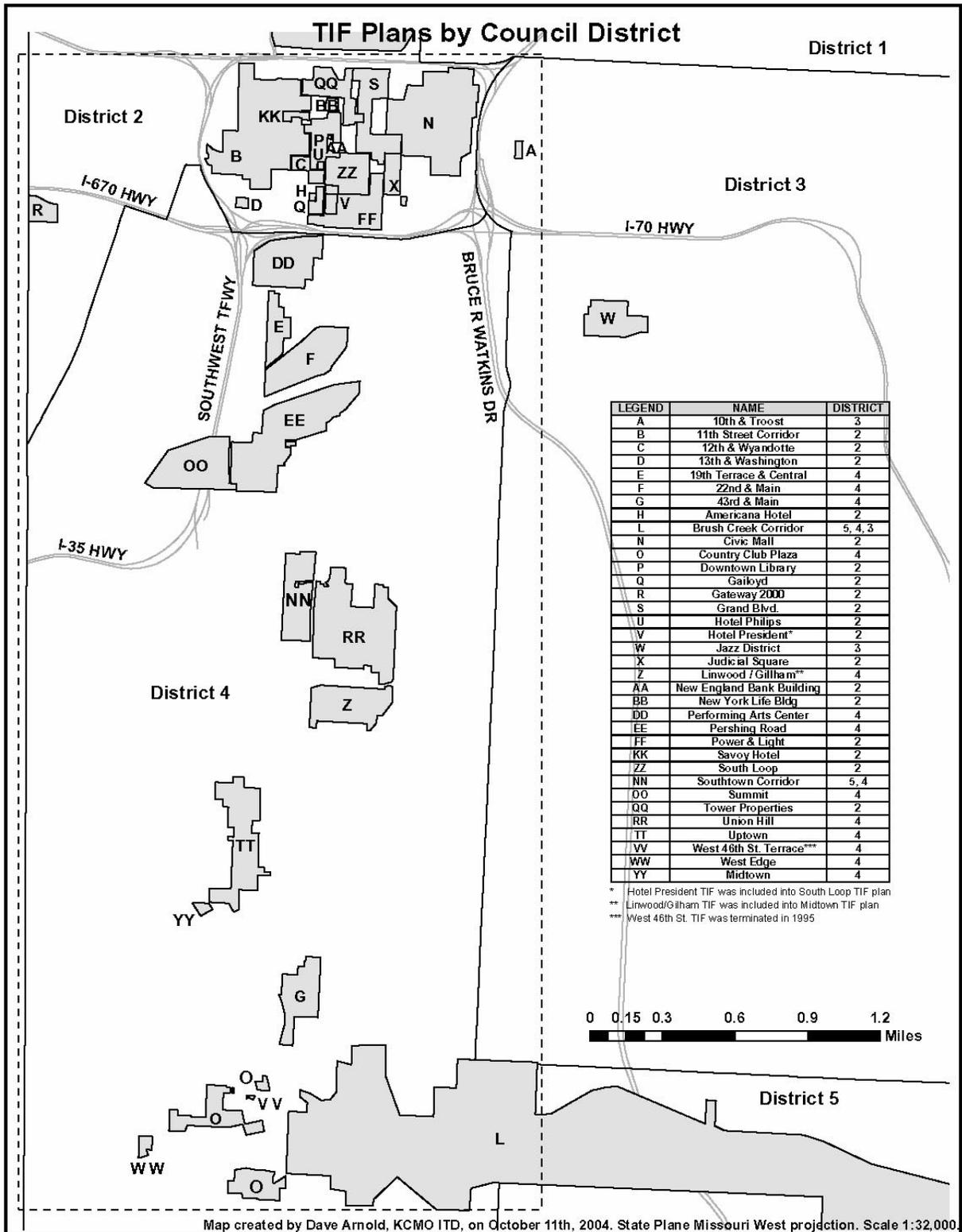
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### **Maps of Approved TIF Plans**

### TIF Plans by Council District



Please note that this map is an enlargement of the inset on the previous page.



*Estimating Tax Dollars Owed to the TIF Commission*

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## **Appendix E**

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### **TIF Commission's Economic Activity Taxes Policy**

*Estimating Tax Dollars Owed to the TIF Commission*

**Policy Name:** Economic Activity Taxes  
**Date Approved:** January 14, 2004 (Revised 7-14-04)  
**Resolution Number:** 1-1-04 (Revised by Resolution No. 7-3-04)

## **I. Policy**

In accordance with the Real Property Tax Increment Allocation Redevelopment Act, Missouri Revised Statutes, Section 99.845.3, fifty percent of the incremental taxes resulting from economic activities within the redevelopment area shall be made available for the special allocation fund. To quote the statute:

“(F)or redevelopment plans and projects adopted or redevelopment projects approved by ordinance after August 31, 1991, fifty percent of the total additional revenue from taxes which are imposed by the municipality or other taxing districts, and which are generated by economic 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, but excluding personal property taxes, taxes imposed on sales or charges for sleeping rooms paid by transient guests of hotels and motels, taxes levied pursuant to Section 70.500, RSMo. or effective January 1, 1998, taxes levied for the purpose of public transportation pursuant to Section 94.660, RSMo., licenses, fees or special assessments, other than payments in lieu of taxes, 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.”

## **II. Purpose of this Document**

- A. To define those Economic Activity Taxes (EATs) which may be allocated to the Special Allocation Fund (SAF).
- B. To set forth the procedures for the documentation, collection and deposition of EATs into the SAF.

## **III. Premises**

- A. The TIF Commission’s only resources for reimbursing eligible project costs are the PILOTs and EATs paid by property owners and businesses located in the Redevelopment Project Area(s).

- B. For TIF revenues to be deposited into the SAF and then used to reimburse a developer or finance the debt service on bonds, evidence must be supplied showing payment and amount of PILOTs and EATs or in the event a TIF plan is within a revised EATs processing TIF area, evidence of requested tax identification numbers as specified below.
- C. The Developer, property owners, project area businesses, TIF Commission and City will need to cooperate in the process of collecting and documenting TIF revenues on a timely basis in order to ensure successful reimbursement of eligible project costs.
- D. The Developer, property owners and project area businesses, will need to cooperate by providing documentation of taxes paid and utility bills on a timely basis in order to ensure successful reimbursement of eligible project costs.

**IV. Objectives**

- A. To document and disperse the EATs available to reimburse project costs in a timely and efficient manner.
- B. To encourage development of documentation capabilities and procedures at the City which will increasingly facilitate the improvement of documentation and disbursement of EATs.
- C. To encourage further development of capabilities and procedures with respect to the annual TIF appropriations by the TIF Commission on behalf of the City of Kansas City, MO.

**V. Types of Economic Activity Taxes and Availability to the SAF**

- A. EATs Available to the Special Allocation Fund
  - 1. Sales Taxes: These taxes are paid monthly to the State by businesses earning income from sales. The State in turn disperses sales tax revenues to the affected city and/or county. There is a three-month delay between the time the sales taxes are paid to the State and the time the city and/or county receives the sales tax revenue. The reimbursable tax rates, which may be modified from time to time, are as follows:

(a) City	1.9625%	(includes firefighters and police tax)
(b) Jackson County	.75%	
(c) Clay County	.875%	
(d) Platte County	1.00%	
  - 2. Earnings Taxes: Earnings taxes on individual wages are usually withheld by businesses on wages of employees working within Kansas City,

Missouri. The business usually files a tax return and pays earnings taxes quarterly to the City. The tax rate is 1%.

3. Net Profits Taxes: Businesses file a tax return and pay taxes annually to the City, with taxes being due 105 days after the end of the business' fiscal year (e.g., if the fiscal year and calendar year are the same, taxes are due April 15<sup>th</sup> of each year). The tax rate is 1%.
4. Food and Beverage (Convention & Tourism Tax): Food and Beverage Taxes are paid on a quarterly basis by the business to the City of Kansas City. The tax rate is 1.75%.
5. Utility Taxes: Utility Companies figure in utility taxes as a part of the utility bill. The utility companies ultimately pay these taxes. The amount of the taxes can be ascertained from the utility bills.
 

(a) Gas	10% Com'l & Ind'l; 9% Res'l
(b) Electric	10% Com'l & Ind'l; 9% Res'l
(c) Telephone	10% Com'l & Ind'l; 9% Res'l
(d) Steam	3%
(e) Cable Television	3%

**B. EATs Not Available to the Special Allocation Fund**

1. Personal Property Tax
2. Taxes Levied for the Purpose of Public Transportation, Pursuant to Section 94.660 RSMo.
3. Taxes Levied Pursuant to Section 70.500 RSMo.
4. Licenses
5. Fees
6. Special Assessments
7. State Sales Taxes
8. Taxes Imposed on Sales of Charges for Hotel and Motel Rooms

**VI. Verification of the Base**

Section 99.845 of the Missouri Tax Increment Financing legislation specifies that the base for determining eligible EATs revenue is that calendar year prior to the adoption of the redevelopment project by ordinance. At the time of designation of a redevelopment project by the City Council, the TIF Commission shall exert best faith efforts to provide to the City Finance Department a copy of the:

Legal description of the project area;

A list of all businesses operating in the project area during the base year along with the business's Federal Identification Number, MITS Number and Location Code; and

The utility bills for the base year for all businesses operating within the project area.

The TIF Commission will look to the Developer to assist in the provision of said information.

## **VII. Procedures for Documentation and Collection of Economic Activity Taxes**

### **A. Construction Activity**

#### **1. Developer & TIF Commission Directed Construction Activities**

- (a) **Sales Taxes:** Unless the sales tax on construction materials was generated and paid within the TIF area, the tax is not a reimbursable item. In the event the sales tax was generated and paid within the TIF area, documentation consisting of the invoices of actual taxes paid must be sent to the TIF Commission on a semi-annual basis. The TIF Commission will then submit all documentation to the City Finance Department.
- (b) **Earnings Taxes:** The Developer and TIF Commission shall include in all contracts and subcontracts, and require as a condition in all subcontracts, that all contractors and subcontractors shall submit to the Developer or the TIF Commission documentation of the amount of earnings taxes withheld or paid which are attributable to the project site. This documentation will consist of copies of all earnings tax returns filed during the construction period and a cover sheet stating the total amount of earnings taxes directly attributable to the project site. All submissions shall be done on a semi-annual basis. The TIF Commission will then submit all documentation to the City Finance Department.
- (c) **Net Profits Taxes:** The Developer and TIF Commission shall include in all contracts and subcontracts, and require as a condition in all subcontracts, that all contractors and subcontractors shall submit to the Developer or the TIF Commission documentation of the amount of net profits taxes paid which are attributable to the project site. This documentation will consist of copies of net profits tax returns filed during the construction period and a cover sheet stating the total amount of earnings taxes directly attributable to the project site. Submissions shall be done on an annual basis. The TIF Commission will then submit all documentation to the City Finance Department.
- (d) **Food and Beverage Taxes:** Not applicable during construction.

- (e) **Utility Taxes:** The Developer shall provide to the TIF Commission on a semi-annual basis, copies of all utility bills and a cover sheet showing the total amount paid to each utility over the six month period for the project. The TIF Commission will then submit all documentation to the City Finance Department.
  - 2. **Construction Activity by Parties other than TIF Commission or Developer.** If a party other than the TIF Commission or Developer are involved with development activities within the project area, they shall also be required to provide documentation and follow the same procedures as those set forth for the Developer and the TIF Commission. Examples of parties other than the Commission or Developer may include, but are not limited to, the City's Central Relocation Authority and City's Public Works Department.
- B. **Completed Development**
- 1. **Single Owner/User**

- (a) **Sales Taxes:** The user/owner shall submit to the TIF Commission on a semi-annual basis documentation of the amount of sales taxes which are attributable to the Redevelopment Project. Typically, this documentation will consist of copies of all sales tax returns and a cover sheet stating the total amount of sales taxes paid over the reporting period. The TIF Commission will then submit all documentation to the City Finance Department.

In the event a business is located within a TIF plan area, such business is required to submit annually an appropriate form provided by the TIF Commission, which requests the business' MITS number as well as the business' location code. The appropriate form will assist the City's Finance Department in determining the reimbursable increment. The TIF Commission will then submit the documentation to the City Finance Department.

(See Exhibit 1 attached hereto)

- (b) **Earnings Taxes:** The user/owner shall submit to the TIF Commission on a semi-annual basis documentation of the amount of earnings taxes withheld or paid which are attributable to the Redevelopment Project. This documentation will consist of copies of all earnings tax returns (including Corporate Profits Taxes) and a cover sheet stating the amount of earnings taxes directly attributable to the project site over the reporting period. The TIF

Commission will then submit all documentation to the City Finance Department.

In the event a business is located within a TIF plan area, such business is required to submit annually an appropriate form provided by the TIF Commission, which requests the business' Federal Identification number as well as the percentage of earnings tax generated by the business within the TIF plan area. The appropriate form will assist the City's Finance Department in determining the reimbursable increment. The TIF Commission will then submit the documentation to the City Finance Department.

- (c) Net Profits Taxes: The user/owner shall submit to the TIF Commission on an annual basis documentation of the amount of net profits taxes paid which are attributable to the Redevelopment Project. This documentation will consist of copies of the net profits tax returns and a cover sheet stating the amount of earnings taxes directly attributable to the project site over the reporting period. The TIF Commission will then submit all documentation to the City Finance Department.

In the event a business is located within a TIF plan area, such business is required to submit annually an appropriate form provided by the TIF Commission, which requests the business' Federal Identification number as well as the percentage of net profits tax generated by the business within the TIF plan area. The appropriate form will assist the City's Finance Department in determining the reimbursable increment. The TIF Commission will then submit the documentation to the City Finance Department.

- (d) Food and Beverage Taxes: The user/owner shall submit to the TIF Commission on a semi-annual basis documentation of the amount of food and beverage taxes which are attributable to the Redevelopment Project. This documentation will consist of copies of all food and beverage tax returns and a cover sheet stating the total amount of food and beverage taxes paid over the reporting period. The TIF Commission will then submit all documentation to the City Finance Department.

In the event a business is located within a TIF plan area, such business is required to submit annually an appropriate form provided by the TIF Commission, which requests the business' Federal Identification number as well as the percentage of food & beverage tax generated by the business within the TIF plan area.

The appropriate form will assist the City's Finance Department in determining the reimbursable increment. The TIF Commission will then submit the documentation to the City Finance Department.

- (e) Utility Taxes: The Developer/owner shall provide to the TIF Commission on a semi-annual basis copies of all utility bills and a cover sheet showing the total amount paid to each utility over the six month period. The TIF Commission will then submit all documentation to the City Finance Department.

In the event a business is located within a TIF plan area; such business is required to submit semi-annually copies of all utility bills. The TIF Commission will then submit the documentation to the City Finance Department.

## 2. Multiple Users/Multiple Ownership

- (a) Sales Taxes: The Developer/owner shall include as a part of all assignments, sales and lease agreements entered into during the life of the redevelopment project, and require for inclusion in any subsequent assignments, sales, leases and subleases, the provision that all users of the project site shall submit to the TIF Commission documentation of the amount of sales taxes paid at that site. Typically, this documentation will consist of copies of all sales tax returns filed and a cover sheet stating the total amount of sales taxes paid during the reporting period. The TIF Commission will then submit all documentation to the City Finance Department.

In the event businesses located within a TIF plan area are subject to this Policy, such businesses are required to submit annually an appropriate form provided by the TIF Commission which requests the businesses' MITS number as well as the businesses' location code. The appropriate form will assist the City's Finance Department in determining the reimbursable increment. The TIF Commission will then submit the documentation to the City Finance Department.

- (b) Earnings Taxes: The Developer/owner shall include as a part of all assignments, sales and lease agreements entered into during the life of the redevelopment project, and require for inclusion in any subsequent assignments, sales, leases and subleases, the provision that all users of the project site shall submit to the TIF Commission documentation of the amount of earnings taxes withheld or paid at that site. This documentation will consist of copies of all earnings tax returns filed and a cover sheet stating the total amount of

earnings taxes paid for that site during the reporting period. The TIF Commission will then submit all documentation to the City Finance Department.

In the event the businesses located within a TIF plan area are subject to this Policy, such businesses are required to submit annually an appropriate form provided by the TIF Commission, which requests the businesses' Federal Identification number as well as the percentage of earnings tax generated by the businesses within the TIF plan area. The appropriate form will assist the City's Finance Department in determining the reimbursable increment. The TIF Commission will then submit the documentation to the City Finance Department.

- (c) **Net Profits Taxes:** The user/owner shall submit to the TIF Commission on an annual basis documentation of the amount of net profits taxes paid which are attributable to the Redevelopment Project. This documentation will consist of copies of the net profits tax returns and a cover sheet stating the amount of earnings taxes directly attributable to the project site over the reporting period. The TIF Commission will then submit all documentation to the City Finance Department.

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- (d) **Food and Beverage Taxes:** The Developer/owner shall include as a part of all assignments, sales and lease agreements entered into during the life of the redevelopment project, and require for inclusion in any subsequent assignments, sales, leases and subleases, the provision that all users of the project site shall submit to the TIF Commission documentation of the amount of food and beverage taxes paid at that site. This documentation will consist of copies of all food and beverage tax returns filed and a cover sheet stating the total amount of food and beverage taxes paid during the reporting period. The TIF Commission will then submit all documentation to the City Finance Department.

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- (e) **Utility Taxes:** The Developer/owner shall include as a part of all assignments, sales and lease agreements entered into during the life of the redevelopment project, and require for inclusion in any subsequent assignments, sales, leases and subleases, the provision that all users of the project site shall submit to the TIF Commission documentation of the amount of utility taxes paid at that site. This documentation will consist of copies of all utility bills paid and a cover sheet stating the total amount of utility taxes paid during the reporting period. The TIF Commission will then submit all documentation to the City Finance Department.

In the event the businesses located within a TIF plan area are subject to this Policy, such businesses are required to submit semi-annually copies of all utility bills. The TIF Commission will then submit the documentation to the City Finance Department.

3. The conditions set forth herein shall be made a part of the property record. This will be accomplished by filing for record a memorandum of agreement with respect to the developer's agreement which will become a part of the real estate records pertaining to all the property within the TIF district and will serve to put any subsequent taker of such property, either lessee or purchaser, of the existence of the developer's contract and of its provisions. In addition, at the time of any sale or lease, the Commission shall be apprised of said sale or lease of property during the life of the Redevelopment Plan.

#### **VIII. Schedule for Reporting and Verification of EATs**

All documentation, which is required to be submitted pursuant to this Policy (the "EATs Documentation"), shall be submitted semi-annually to the TIF Commission. The EATs Documentation shall be submitted by July 31 for the period from January 1 through June 30 and by January 31 for the period from July 1 through December 31. Within thirty (30) days of the TIF Commission's receipt of the Documentation, the TIF Commission will forward the same to the City's Finance Department. The City Finance Department will deposit all required funds into the Special Allocation Account.

(See Exhibit 2 attached hereto.)

**IX. Procedure for Tenants and Property Owners Who Fail to Submit EATs Documentation**

- A. In the event a tenant or property owner within a Redevelopment Project Area fails to submit EATs Documentation to the TIF Commission within the time periods set forth in Section VIII, then the TIF Commission, in accordance with Ordinance No. 010710, shall notify such tenant or property owner, in writing, that the TIF Commission has not received such EATs Documentation.
- B. In the event the TIF Commission does not receive the EATs Documentation from any tenant or property owner within thirty (30) days after the TIF Commission has notified such tenant or property owner in accordance with Section IX.A., the TIF Commission will notify, in writing, the City Attorney's Office of the City of Kansas City, Missouri, of such tenant's or property owner's violation of Ordinance No. 010710.

**X. Monitoring of Future Lease of Property**

The Developer/owner of the property shall provide to the TIF Commission on an annual basis a certified list of businesses within the Redevelopment Project Area. The certified list shall list the name of the business, the address, the business identification number, and the date of occupancy if such has occurred within the last year.

The TIF Commission and City staffs will work together to monitor and check the certified list provided by the Developer/owner. The TIF Commission will work with the City regarding the modification of the City Finance Department's computer system in order to facilitate the ongoing monitoring of business and Economic Activity Taxes.

**XI. Declaration of Surplus Funds and Termination of Plan**

The Real Property Tax Increment Allocation Redevelopment Act, Missouri Revised Statutes, Section 99.850 provides for the declaration of surplus funds and termination of the special allocation fund in the event all redevelopment project costs have been paid. The following is the language from Section 99.850 regarding declaration of surplus and termination of the special allocation fund.

- 1. When such redevelopment project costs, including, but not limited to, all municipal obligations financing redevelopment project costs incurred under sections 99.800 to 99.865 have been paid, all surplus funds then remaining in the special allocation fund shall be paid by the municipal treasurer to the county collector who shall immediately thereafter pay such funds to the taxing districts in the area selected for a redevelopment project in the same manner and proportion as the most recent distribution by the collector to the affected districts of real property taxes from real property in the area selected for a redevelopment project.

2. Upon the payment of all redevelopment project costs, retirement of obligations and the distribution of any excess moneys pursuant to section 99.845 and this section, the municipality shall adopt an ordinance dissolving the special allocation fund for the redevelopment area and terminating the designation of the redevelopment area as a redevelopment area. Thereafter, the rates of the taxing districts shall be extended and taxes levied, collected, and distributed in the manner applicable in the absence of the adoption of tax increment financing.”

## **XII. Confidentiality**

All documentation will be held confidential by the TIF Commission to the extent allowed by law. Documentation of Economic Activity Taxes received by the TIF Commission will be treated as follows:

1. If studies and documents are presented to the TIF Commission for this purpose marked “Confidential,” they will be so treated by the Commission and staff;
2. Confidential studies and documents shall be shared with staff members and TIF Commission only on a “need-to-know” basis;
3. The information shall be kept in a special confidential file separate from the Commission’s public records;
4. Staff members violating the confidentiality of any such material will be disciplined.

## **XIII. Modeling**

Staff shall work with City staff to enhance existing TIF models and to develop a model to provide more accurate means of projecting and documenting EATs generated by the Tax Increment Financing plans and projects approved by the TIF Commission. The purpose of this model is to ensure that the TIF Commission shall have available to it the most accurate revenue projections and be able to most effectively document, budget and collect the EATs being generated by approved TIF projects.

*Estimating Tax Dollars Owed to the TIF Commission*

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## **Appendix F**

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### **City Manager's Response**

*Estimating Tax Dollars Owed to the TIF Commission*



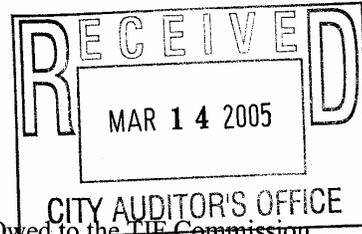
## Interdepartmental Communication

DATE: December 28, 2004

TO: Mark Funkhouser, City Auditor

FROM: Wayne A. Cauthen, City Manager

SUBJECT: Response to Report on Estimating Tax Dollars Owed to the TIF Commission



The recently completed draft audit conducted by your department has revealed a number of issues that must be addressed to increase the efficacy of the city's efforts to accurately calculate dollars owed the city and developers for TIF projects. My observations of overall TIF business and programs carried on in the City of Kansas City generally resonate with the auditor's findings, and has raised a few concerns in my mind including how baseline data is acquired and verified so that it is fair and accurate; how collections are undertaken and enforced; and finally the high number of TIF districts and projects that exist in the City.

I agree with the recommendations addressing the city's efforts, and submit to you the following:

**Recommendation 2:** The Director of Finance and appropriate county staff should devise and recommend to their elected bodies a method of estimating EATs for existing TIF plans that does not rely on confidential business records. If it is determined that a streamlined estimating methodology is not possible under the current statute, the city should seek to revise the state statute and re-examine the current beta estimating methodologies.

**Response: Agree in part.** The Finance Department agrees that the current methods (e.g., conventional and "beta") of estimating and redirecting EATs are complex and potentially inexact. There are two barriers that prohibit the Department from immediately adopting a simpler, formula-based methodology for calculating EATs: (1) a clear legal opinion supporting the proposed new methodology, and (2) technological limitations of the city's current tax collection systems. Along with the technological limitations, there are confidentiality issues. Though significant, these barriers are not prohibitive to the city's ability to eventually adopt this recommendation.

Should the City Attorney render a favorable legal opinion about the proposed simpler methodology, the department must also consider ancillary issues that address the current disposition and intended use of TIF revenues, as committed by contractual obligations and agreements. To improve the transparency of the process, the department is investigating how other cities with IRS agreements are able to calculate disbursements of EATs while eliminating the confidentiality issues. This research may enable the city to eventually implement and practice a similar method to the suggested method of estimating EATs. Assuming the research is favorable, the department will make efforts to include the changes in the city's new automate revenue collection system

Additionally, if the City Council agrees with the City Auditor's assertion that changes in state law are necessary to improve the EATs estimation process, the department will prepare a series of recommendations for inclusion in the city's state legislative priorities agenda. Finally, the department has engaged the City Manager and City Attorney, and will continue to coordinate as the city assesses the most appropriate way of moving forward with this recommendation.

**Recommendation 3:** The Director of Finance should direct that city staff calculate the EATs payment by comparing the total EATs increment to the total EATs base, not transfer EATs until the entire EATs base for the project is captured, determine the amount of EATs overpayment, and capture identified overpayments.

**Response: Agree.** The department agrees with this recommendation, and recognizes it to be a necessary, but challenging one for the city to adopt. Chief among those challenges are again, two major barriers that are not prohibitive. They are: (1) a fundamental shift in the way the city calculates tax-type decrements and integrates them into the aggregate EATs increments; and (2) a substantial change in the information gathering habits, and reporting relationships between the city and the Economic Development Corporation. The first of these barriers is a reversible one that can be addressed by replacing the limited information gathering and remittance systems, and internally reengineering how the city calculates aggregate EATs increments.

The second of these barriers will be far more challenging. The information gathering and reporting habits of the TIF Commission, and Economic Development Corporation are not activities that are under the purview of the department but that significantly impact the outcome of the department's findings. Thus, for the city to complete information databases in instances where the city has partial or missing information for EATs base, it requires increased collaboration between all affected parties including: The EDC, the TIF Commission, area developers, area businesses, and the city. The EATs policy adopted by the TIF Commission is supportive of this type of effort for verification of base-year taxes. Once the verification is complete, the city will have the ability to objectively compare EATs base to EATs increment and accurately calculate any discrepancies owed the city or developers. Those discrepancies will be remedied after consultation with the City Manager's Office and the City Attorney.

**Recommendation 5:** The Director of Finance should ensure that agreements with developers to exclude EATs activity for businesses or locations are established in writing.

**Response: Agree.** The department will attempt to document instances where TIF plans or projects do not adhere to the strict written language of state statute regarding EATs base and increment calculations. Again, we will seek the City Attorney's advice regarding the most appropriate manner in which to address this recommendation.

**Recommendation 8:** The City Manager should submit an economic development incentive policy for City Council consideration.

**Response: Agree.** Due to the decentralized nature of the city's economic development activities, an integrated incentive policy is one that is much-needed. The City Manager's Office is dedicated to leading the efforts to devise such a policy. The development of this policy requires close coordination with the Economic Development Corporation, the City Manager's Office, and various city departments including: City Planning and Development, Finance, and the City Attorney.

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**Appendix G**

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**City Attorney's Response**

*Estimating Tax Dollars Owed to the TIF Commission*

CITY OF FOUNTAINS  
HEART OF THE NATION



KANSAS CITY  
MISSOURI

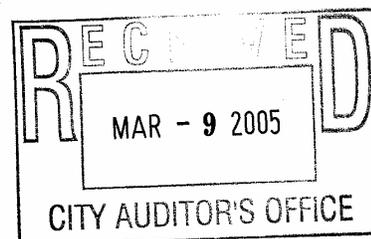
Office of the City Attorney

28th Floor, City Hall  
414 East 12th Street  
Kansas City, Missouri 64106

(816) 513-3142  
Fax: (816) 513-3133

March 9, 2005

Mark Funkhouser  
City Auditor  
City of Kansas City, Missouri



**Re:** March 2005 Audit Entitled "Performance Audit Estimating Tax Dollars Owed to the TIF Commission"

Dear Mark:

This letter acknowledges that I have had the opportunity to review drafts of this audit and provide you comments regarding those drafts. I provided you comments regarding portions of the first draft. I had no further comments after reviewing the second draft.

Recommendation No. 6 is directed, in part, to the City Attorney's Office. I agree with that recommendation.

Cordially,



Galen Beaufort  
City Attorney

GB:maw

*Estimating Tax Dollars Owed to the TIF Commission*

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## **Appendix H**

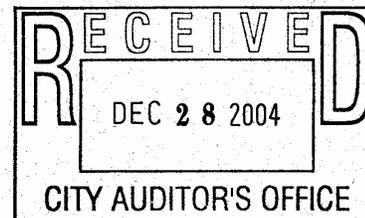
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### **Economic Development Corporation's Response**

*Estimating Tax Dollars Owed to the TIF Commission*



December 28, 2004



Mark Funkhouser, City Auditor  
 21<sup>st</sup> Floor, City Hall  
 414 East 12<sup>th</sup> Street  
 Kansas City, Missouri 64106

Dear Dr. Funkhouser:

I am in receipt of the second draft of the *Performance Audit Estimating Tax Dollars Owed to the TIF Commission*. While we met last week in person, your letter dated December 9, 2004, asked that we submit a final written response addressing any issues of significance.

The section of the audit titled *Objectives* states that this audit was begun "in response to concerns raised by the TIF Commission's commercial auditor and staff." The comment goes on to state, "The TIF Commission's commercial auditor cited the Commission's lack of a system to account for the tax increment financing receivables due from the city and counties as a material weakness." There are several very important points to remember regarding these statements:

- **The TIF Commission and its staff does not have the ability to correct the material weakness cited in the audit due to issues of taxpayer confidentiality.** This finding can only be resolved through changes in the City Finance Department's and Revenue Division's systems and procedures.
- **The TIF Commission, its staff, and our commercial auditors requested your assistance in resolving this finding on two occasions.** We first approached your department during the commercial audit of the financials for the fiscal year 2002. We again asked for your assistance during the performance audit of Tax Increment Financing dated September 30, 2003.
- The magnitude of this issue is not small. You state, "**Based on Treasury's method for estimating EATs liability, the city's TIF liability at the end of April, 2004 was \$10.4 million.**" In other words, the city has collected this amount of money, placed it in the city's general operating fund, and has failed to pass it through to the TIF Commission for subsequent disbursement. This is the same issue on which Clay County has received considerable negative press. The only major difference is that the exact amount of the liability owed from Clay County has been determined. The number from the City is still only an estimate.
- You state only in a small footnote of this audit, "We found that Treasury's method for calculating EATs liability was very rough and likely understated the liability, especially for earnings tax."

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**ECONOMIC DEVELOPMENT CORPORATION OF KANSAS CITY, MISSOURI**

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To be very frank, I was quite disappointed to find that your audit did not aid in resolution of the original problem. Instead, upon review of the initial draft, your attention seems to be focused upon programmatic issues dealing with the TIF process rather than enforcing the current State law as written. Our attorneys have already expressed concern that your original recommendations were not legal according to state statute. I have enclosed a copy of our initial response as well as a copy of the letter from Bryan Cave L.L.P. Our response prompted you to revise your recommendations, and to include a statement saying the city should seek to revise the state statute. There are now eight recommendations in the audit, which I would like to address, point by point.

**Audit Recommendation #1:**

The City Council should no longer approve EATs funding for future TIF projects, but instead exclusively use PILOTs.

**DISAGREE:** *Economic Development Policy adopted by City Council should not be driven by the tools of economic development but by the goals and objectives that the elected body wishes to achieve. Tax Increment Financing is the most powerful tool in the Kansas City economic development toolbox for recruiting and maintaining businesses in the city. During the history of the program in Kansas City over 23,000 new jobs have been created and over 22,000 have been retained. The elimination of EATs would fatally erode our ability to act on future job retention, creation and economic development growth projects.*

*To put this into perspective historically; there would have only been five projects that would have come to fruition due to the plans being based upon PILOTs only. The plans are Walnut Creek, Searcy Creek, River Market, Civic Mall, and a portion of Briarcliff. As a further example, the entire Shoal Creek TIF plan would not even exist as this plan only uses EATs with all PILOTs being surplused back to the taxing jurisdictions. **Even more dramatic, there wouldn't be a KC Live South Loop project** taking place due to the reliance on EATs within the entertainment district.*

*This recommendation would also put a particularly unfair burden on the School Taxing districts since they forgo the largest amount of property taxes when PILOTs are used. The State specifically included EATs so that local communities also share the tax redirection burden when making decisions to use the TIF tool.*

**Audit Recommendation #2:**

The Director of Finance and appropriate county staff should devise and recommend to their elected bodies, a method of estimating EATs for existing TIF plans that does not rely on confidential business records. If it is determined that a streamlined estimating methodology is not possible under the current statute, the city should seek to revise the state statute and re-examine the current beta estimating methodologies.

**DISAGREE:** *We have continually suggested that an information technology driven solution is the best answer. The finance department has been using a bureaucratic system whereby in order for a developer to receive reimbursement they have to submit numerous and cumbersome private documents. An enhanced or updated automated data processing system, currently being issued for an RFP by the Finance Department should allow identification of a new business or employee within a TIF district immediately as the tax is paid. Rather than attempting to change the state statute, a simple city ordinance requiring site specific reporting for earning and profits tax would resolve the issue. Food and Beverage taxes and Real Estate Property taxes, already collected by the city, require this level of information.*

**Audit Recommendation #3:**

The Director of Finance should direct that city staff calculate the EATs payment by comparing the total EATs increment to the total EATs base, not transfer EATs until the entire EATs base for the project is captured, determine the amount of EATs overpayment, and capture identified overpayments.

**AGREE:** *We are in agreement that any overpayment of EATs should be identified and captured.*

**DISAGREE:** *We disagree that no EATs should be forwarded until the full base for the project is captured. Currently as a request for reimbursement is submitted every six months, one-half of the base is applied to that reimbursement with the second half coming out of the next filing. This is a logical approach that provides funds evenly throughout the fiscal year and we see no practical reason to discontinue this practice.*

**Audit Recommendation #4:**

The City Council should include in the city's state legislative priorities and seek county support for a statute of limitations on EATs payment liability by establishing the maximum time that developers and business located in TIF areas have to submit documentation supporting economic activity tax liability.

**DISAGREE:** *The state statute under section 99.845.3 RSMo states that the monies shall be allocated to, and paid by the local political subdivision collection 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.*

*The cumbersome, antiquated, and bureaucratic system is what has caused there to be old taxes that haven't been transferred. The taxes were paid to the city. The transfer to the TIFC merely hasn't taken place. We should not create a loophole where tax payments are being delayed, as in the case of Clay County, and then legal payment obligations not be enforced. Your audit states that the city has certain record retention policies and taxes being paid couldn't be verified after these records are destroyed. A record retention policy shouldn't be confused with or interchanged with payment of taxes. If a business doesn't pay their taxes for five years, they certainly aren't forgiven. An enhanced tax collection system would resolve this issue.*

**Audit Recommendation #5:**

The Director of Finance should ensure that agreements with developers to exclude EATs activity for businesses or locations are in writing.

**AGREE:** *The TIF Commission agrees with this recommendation and would be happy to work with the finance department to accomplish this.*

**Audit Recommendation #6:**

The City Attorney and county and TIF Commission legal advisors should clarify which taxes should be included in EATs payments.

**AGREE:** *The TIF Commission agrees with this recommendation and would be happy to work with the City Attorney's office to accomplish this.*

**DISAGREE:** *County officials should be consulted but the final decision should be made by the City.*

**Audit Recommendation #7:**

The TIF Commission should require that legal descriptions be drafted by qualified professionals using bearings and distance descriptions and that county assessment staff's review and approval of legal descriptions and parcel values be contained in plans and amendments submitted by developers.

**AGREE:** *As a matter of policy and practice for nearly a year, the TIF Commission does require legal descriptions to be drafted by qualified professionals and have submitted such information to county assessment staff for their review of legal descriptions and parcel values prior to their inclusion in plans, projects, and amendments.*

**DISAGREE:** *We do not agree that these descriptions need to be **approved** by the county staff. Prior approval by the county staff would be impractical in that the county does not have veto or delaying power over the TIF Commission or the City.*

**Audit Recommendation #8:**

The City Manager should submit an economic development incentive policy for City Council consideration.

**DISAGREE:** *The audit states that the city does not have an economic development incentive policy. We would suggest to you that the city does indeed have a policy. It is called FOCUS.*

*Additionally, it should be noted that the TIF Commission has spent a considerable amount of time over the past year to update their policies. The policy and procedures manual is available on the EDC's website for review.*

*While the TIF Commission has previously established numerous policies, we would agree that this is not something done across the board for all economic development programs such as 353, IDA and PIEA. We would certainly agree that each agency should have a written and adhered to set of policies.*

The EDC appreciates the efforts that you and your staff have put forth. The overall operation of the TIF Commission has improved considerably over the past year as a direct result of your efforts. I also feel it would be unfair of the TIF Commission to be critical of your efforts unless a workable solution was then presented.

Currently the Automated Revenue System (ARS) tracks tax information by the Federal Identification Number (FIN) for each business. Under each FIN, there are several City account numbers for tax types including profits, earning, food/beverage, hotel/motel, business license tax, etc. For restaurants with multiple locations, there are several food/beverage and business license tax accounts that are site specific. However, there is only one earnings and profit account for the entire amount, regardless of the number of locations an employer has.

There are two aspects that would improve this process. By adding site specific accounts for earnings, amounts that are attributed to a TIF Plan would be easier to identify. The second would be to modify the current food/beverage form to allow businesses to fill out one form for multiple locations, saving the businesses filing time. This enhanced beta system should be rolled out to all business within TIF areas. The conventional method of developers submitting the cumbersome box of information would be then totally obsolete.

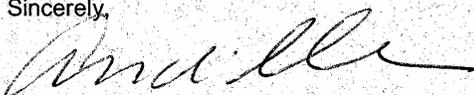
It is our understanding that the Revenue Division has stated it would be too costly to modify the system to allow site specific accounts for earnings. We would question exactly how much this cost would be. The TIF Commission has in the past made offers to help finance a new system.

We further understand that this past summer there was a position advertised for an Analyst III position (Manager of the Administration Section of the Revenue Division). The job responsibilities included replacing the current revenue system (ARS). We would ask if this job has been filled as of yet. Additionally, as this new person would begin their review of the current system, the needs of the TIF Commission should be a factor in the evaluation.

This solution might possibly only be an interim solution. There are revenue collection programs utilized in other localities that should be investigated. Such a system is utilized in Cleveland and Cincinnati, Ohio. I have discussed this with Wanda Gunter, Acting Director of Finance and have given her the name of a contact person. **The point is: let's begin the dialog of solving the problem with a practical solution rather than merely doing away with the program.** Again, TIF is the best tool in the economic development toolbox of Kansas City. We have made significant strides in the administration of the TIF program over the past year and I believe the City Council supports the direction we have taken. I am certain we can all arrive at a better solution than those that you have proposed.

While the staff of the TIF Commission appreciates the opportunity to respond to this audit, I need to express a concern of the TIF Commissioners. At our recent meeting you directed that we were to not give a copy of this audit to the TIF Commissioners before it was publicly released. Chairman Yelorda asked that we be given additional time to respond until the audit could be discussed with all the Commissions. This time was not granted by your office. Therefore, I believe that Mr. Yelorda and the members of the Commission will have a direct and public response to present after the audit is released.

Sincerely,



Andi Udris  
President & CEO  
Economic Development Corporation  
of Kansas City, Missouri



November 15, 2004

Mark Funkhouser, City Auditor  
21<sup>st</sup> Floor, City Hall  
414 East 12<sup>th</sup> Street  
Kansas City, Missouri 64106

Dear Dr. Funkhouser:

I am in receipt of the draft Performance Audit Estimating Tax Dollars Owed to the TIF Commission dated November, 2004. I have spent considerable time reviewing the recommendations set forth in the document.

On behalf of the Tax Increment Financing Commission and the Economic Development Corporation of Kansas City, Missouri, I would extend our appreciation for the recommendations presented in this audit. The TIF Commission and the staff of the EDC continue to strive for improvement so that Kansas City's TIF Program is not only locally, but nationally recognized for excellence. Knowing that excellence in Kansas City's TIF Program is also your motivation, thank you for the opportunity to respond specifically to the audit's Findings and Recommendations. Your cover letter asks that we specifically address recommendation four and to address any other issues we feel are significant.

Over the course of the past year we have made remarkable progress in addressing issues presented in a prior audit by your office. We will be presenting an ARTS report to the Budget and Audit Committee on November 30, 2004 that details this progress. **In fact, your Recommendation #4 was resolved nearly a year ago.** As a matter of policy and practice, we do require legal descriptions be drafted by qualified professionals using bearing and distance descriptions and that county assessment staff review legal descriptions and parcel values prior to their inclusion in plans, projects, and amendments.

Additionally, the audit conducted by the firm of Cochran, Head & Co., P.C. for the year ended April 30, 2004, has removed the "material weakness" clause from the management letter in light of these improvements. In the TIF management letter dated April 30, 2004, under Recording & Reconciliation of Tax Increment Financing Activity, the auditors "commend the Commission for reorganizing the TIF staff responsibilities and assigning personnel to perform site visits of TIF districts to determine if all businesses within the district are being reported and providing the necessary information".

Another area of concern to the TIF Commission that was presented in your audit is:

Recommendation #1: The Director of Finance and appropriate county staff should devise and recommend to their elected bodies a method of estimating EATs for existing TIF plans that does not rely on confidential business records.

■ ■ ■  
ECONOMIC DEVELOPMENT CORPORATION OF KANSAS CITY, MISSOURI

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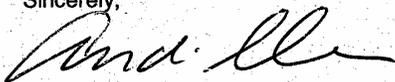
I asked our legal counsel to take a look at your suggestions to see if this is legally permissible under the TIF Statute. A copy of their response is attached for your review. The TIF Commission believes that they have raised some very valid points with regard to not just the legality of the proposal but,

- The effect on taxing jurisdictions such as the school districts
- Breach of existing contracts
- Debt Service on Bonds

I would close by saying that I do believe there are reforms and improvements that need to be made to our present system. As I have stated many times before and have demonstrated in our response to the previous audit, **the solution needs to be technology driven**. Instead of eliminating one of the most fundamental development tools Kansas City has to offer, let's instead direct our efforts and resources into building a modern computerized finance system capable of not only enhancing the income tax collection process but identifying the needed information to process the EATs collections. To that end, I would dedicate my own personal efforts and that of the TIF staff to making that a reality.

It is my understanding that the audit is scheduled to be presented before the City Council's Budget and Audit Committee on Monday, November 22, 2004. I will be in attendance, along with our legal counsel to discuss any questions you might have with our response. Again, Mark, thank you for your recommendations.

Sincerely,



Andi Udris  
President & CEO  
Economic Development Corporation of  
Kansas City, Missouri



November 10, 2004

Ms. Gloria Morris  
Tax Increment Financing Commission  
10 Petticoat Lane, Suite 250  
Kansas City, Missouri 64106

Re: TIF Commission Performance Audit Response

Dear Gloria:

Upon our review of the Performance Audit Estimating Tax Dollars Owed to the TIF Commission (the "Performance Audit"), which was conducted by the City Auditor's Office of the City of Kansas City, Missouri (the "City") in November, 2004, we have serious concerns as to whether the recommendation of the Auditor's Office to estimate economic activity activities tax revenue ("EATS") generated within Redevelopment Areas for the purpose of reimbursing Redevelopment Costs is (i) legally permissible under the Sections 99.800 to 99.865 RSMo (the "TIF Statute"), existing redevelopment agreements and other bond related documents entered into by the Commission and (ii) financially advantageous to the TIF Commission, the City and affected taxing jurisdictions. Prior to delivering an opinion as to such concerns, we would like to thoroughly review the TIF Statute, all existing redevelopment agreements, Missouri case law and all agreements entered into by the Commission in connection with the issuance bonds for the purpose of financing Redevelopment Costs. However, in the interest of time, in this letter, I will summarize our understanding of the Auditor's Office's recommendation to estimate EATs and our concerns related thereto.

It is our understanding that the Auditor's Office recommends that the City's Director of Finance and appropriate county staff recommend to their elected bodies a method of estimating EATS for existing TIF Plans that does not rely on confidential business records. Specifically, the new method would "estimate EATS revenues for a project based on a relationship between the real property values within a TIF Project area, real property values for the jurisdiction and EATs collected by the jurisdiction."

**Bryan Cave LLP**

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Our concerns with respect to the above recommendation are as follows:

First, in the event the EATs, as estimated for a TIF Project in the manner set forth in the Auditor's Office recommendation, is less than the actual EATs generated by that TIF Project:

- (i) such excess amount that is not used to pay Redevelopment Costs, shall be deemed surplus funds and shall be required, by the TIF Statute, to be paid by the City Treasurer to the appropriate county collector for distribution to the affected taxing jurisdictions in the manner provided by Section 99.820(12) RSMo;
- (ii) the term of such TIF Project will be extended unnecessarily, thereby (1) delaying the time in which the Redevelopment Area will be returned to the tax roles and (2) precluding the affected taxing jurisdictions from realizing the actual tax benefit for which they may have considered when the TIF Project was approved;
- (iii) the Commission may be in breach of existing Redevelopment Agreements that require the Commission to reimburse a Developer for certain Redevelopment Costs from the actual amount of EATs generated within a specific TIF Project; and
- (iv) to the extent the Commission or the City have entered into Financing Agreements or other bond related documents that require them to pledge and transfer all EATs generated within a Redevelopment Project to a trustee for the payment of debt service on Bonds issued to finance Redevelopment Costs, the Commission or City (1) may be in breach of such agreements and (2) in the alternative, if the City secures such debt service payments with the City's General Fund, the City's General Fund becomes exposed unnecessarily.

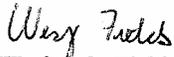
Secondly, in the event the EATs, as estimated for a TIF Project in the manner set forth in the Auditor's Office recommendation, is more than the actual EATs generated by that TIF Project, the City would be overpaying the amount of EATs required to reimburse Redevelopment Costs and thereby inappropriately utilizing funds within its General Fund.

Bryan Cave LLP

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In the event you would like Bryan Cave to provide the TIF Commission with an opinion regarding the concerns mentioned above, please notify me and we will begin our review of the TIF Statute, Missouri case law, all existing Redevelopment Agreements and all bond related documents entered into by the Commission in connection with the financing of Redevelopment Costs.

Kind regards,

  
Wesley O. Fields

cc: Andi Udris  
Peter Yelorda