

Approved: January 17, 1996
Date

MINUTES OF THE SENATE COMMITTEE ON COMMERCE.

The meeting was called to order by Vice Chairperson Pat Ranson at 8:00 a.m. on January 12, 1996, in Room 123-S of the Capitol.

Members present: Senators Downey, Feleciano, Gooch, Harris, Hensley, Jordon, Petty, Ranson, Reynolds, Steffes and Vidricksen.

Committee staff present: Lynne Holt, Legislative Research Department
Bob Nugent, Revisor of Statutes
Betty Bomar, Committee Secretary

Conferees appearing before the committee:
Joe L. Norton, Gilmore & Bell, Attorneys at Law
Randy Speaker, Kansas Director of Housing
Chris McKenzie, Executive Director, League of Kansas Municipalities

Others attending: See attached list

Upon motion by Senator Gooch, seconded by Senator Jordon, the Minutes of the January 11, 1996 meeting were unanimously approved.

SB 328 - Concerning Cities; relating to tax increment financing

Joe L. Norton, Gilmore & Bell, Attorneys at Law, completed his testimony about SB 328. Mr. Norton stated tax increment financing is a statutory procedure available to cities in the state to encourage the redevelopment of certain designated areas. The theory is by encouraging redevelopment projects the value of real property in a redevelopment district will increase. The net effect of TIF is to permit the city and a developer to use a portion of the property taxes that otherwise would be paid on a completed redevelopment project to repay all or a portion of the redevelopments costs of the city, thereby reducing or eliminating debt service requirements on that portion of the project associated with the tax increment. Mr. Norton informed the Committee of the present type of bonds available: Special Obligation Bonds, Full Faith and Credit Bonds and Industrial Revenue Bonds. These types of bonds are not available for the construction of buildings or structures to be owned by any developer.

SB 328 primarily redefines "blighted area" to encompass areas of open land within the corporate boundary of a city, for predominantly residential uses. SB 328 does not affect or modify other provisions of the TIF Act. It only amends the Act to enlarge the definition to include open land, located on the boundary of a city to allow a developer to utilize TIF for infrastructure in a development, after approval by the City, the County, and the local Board of Education. Attachment 1

Randy Speaker, Director of Housing, Kansas Department of Commerce & Housing, informed the Committee that changes which facilitate a greater use of TIF without threatening the tax base of communities is appropriate. Financing real estate development is complex, and TIF adds to the complexity because not only must it be responsive to fluctuations in the capital markets which fund the bonds, but TIF is also dependent upon future neighborhood values and the community's ability to increase its taxable base. The Department's concerns are: the loss of tax revenues and increased migration to the suburbs.

Mr. Speaker recommended (1) any changes in the law are simple and do not add to the complexity of the process. (2) expand TIF to include "conservation areas" which may not meet the current definition but are at risk of becoming blighted; (3) expand TIF to include "greenfield areas"; (4) allow increased revenue received by a city which is collected from other sources within the redevelopment district to be pledged for the TIF project; (5) extend the period for tax increment collection from 15 to 20 years; (6) permit a taxing authority to pledge less than 100% of the property tax increment if other revenues are available and pledged by the authority; (7) address the problem of outward migration by a formula that applies to a percentage of land area

CONTINUATION SHEET

MINUTES OF THE SENATE COMMITTEE ON COMMERCE, Room 123-S Statehouse, at 8:00 a.m. on January 12, 1996.

for conservation areas and greenfield areas for communities over a certain population.

The Department of Commerce and Housing is a conceptual supporter of SB 328; however, it is imperative the law be written in such a way to allow flexibility and simplicity so that communities can address their particular housing needs appropriately and lay the groundwork for successful real estate development.

Attachment 2

Chris McKenzie, Executive Director, League of Kansas Municipalities, advised the Committee the elected officials of each city have the freedom today to make the judgment that SB 328 would provide through the TIF law. It is not necessary to use TIF financing to subsidize housing costs. There is a concern also of decreasing the tax base while increasing a need for services. The League, at a policy meeting held on January 11th, opposed SB 328. Attachment 3

The next meeting is scheduled for January 16, 1996.

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SENATE BILL NO. 328

KANSAS SENATE COMMITTEE ON COMMERCE

SENATOR ALICIA L. SALISBURY, CHAIRMAN

JANUARY 9, 1996

PRESENTATION MATERIALS SUBMITTED

BY

JOE L. NORTON

JLNTIFMEMO

*Senate Commerce Committee
January 12, 1996*

Attachment 1 thru 1-11

Senate Bill No. 328 (the "Bill") was introduced by the Senate Committee on Commerce in the 1995 Session of the Legislature. The Bill proposes to amend K.S.A. 12-1771, which is a part of the Kansas act relating to redevelopment of central business district areas, commonly referred to as the "Tax Increment Financing Act" (the "Act").

The Act permits Kansas cities to assist in the development and redevelopment of central business district areas of cities, blighted areas located within cities, enterprise zones located within cities and environmentally contaminated areas located in cities and the county in which such city is located. The Act authorizes cities to issue tax increment special obligation and full faith and credit bonds to finance certain redevelopment projects in redevelopment districts created under the Act. Eminent domain powers are granted to cities in conjunction with such projects.

Attached hereto is a **Memorandum** prepared by our law firm summarizing the Act, procedures necessary to implement a tax increment project and associated federal tax law matters relating to bonds issued by cities to finance redevelopment projects.

Due to a number of factors, including limitations of the kinds of projects that can be financed by the Act and federal tax law considerations, the utilization of the Act to finance redevelopment projects has been limited.

The Act defines "Blighted Area" [Page 1, lines 27 to 43] to mean areas which: (1) because of a presence of a majority of certain factors, substantially impairs or arrests the sound development and growth of the municipality or constitutes an economic or social liability or is a menace to the public health safety and welfare; (2) has been identified by any federal or state environmental agency as being environmentally contaminated; and (3) was previously found to be slum and blighted under the "urban renewal law." The Bill [Page 2, lines 2 to 5] creates a fourth category of "blighted area" consisting of an area *composed of open land that, because of its location within the corporate boundary of a city, it is necessary for sound community growth through platting or replatting, and planning and development for predominantly residential uses.* The Bill [Page 2, lines 14 and 15] clarifies that powers conferred by the Act may be exercised in such designated residential development areas.

The Bill, if adopted in its present form, would allow the governing body of a city to determine if a sufficient need exists in its community for economic development purposes to create a redevelopment district to stimulate residential housing.

It is important to note that the Bill does not affect or modify other provisions of the Act. These provisions prescribe the method and manner of creating Districts and implementing a Plan. These procedures include provisions requiring public hearings, preparation of a comprehensive feasibility study which provides the benefits and costs associated with Projects and determines that income will be sufficient to pay for Project costs, that only land acquisition and infrastructure improvements may be financed (**costs of residential housing may not be financed with tax increment financing**), and that affected counties and school districts may veto such projects if their governing body determines that the proposed redevelopment district will have an adverse effect on such county or school district.

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MEMORANDUM

January 1996

TAX INCREMENT FINANCING IN KANSAS

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- III. PROCEDURES FOR IMPLEMENTING A TAX INCREMENT FINANCING PROJECT
- IV. FEDERAL TAX CONSIDERATIONS

TAX INCREMENT FINANCING IN KANSAS

I. GENERAL

Tax increment financing is a statutory procedure available to cities in the State of Kansas to encourage the redevelopment of certain designated areas. Cities may coordinate with non-governmental developers to undertake redevelopment projects in central business districts and other areas that meet statutory criteria. Such projects may include acquisition of a site or sites and existing structures thereon, razing such structures, undertaking infrastructure improvements adjacent thereto and related public parking areas. Financing is available from the proceeds of bonds to be issued by the city. Such bonds are primarily secured by the incremental increase in property valuation within the redevelopment district as a result of the rehabilitation, but may, under certain circumstances, also be general obligations of the city. The city may sell or lease property acquired for redevelopment purposes to developers, but may not finance with bonds construction of or improvements to buildings or structures to be owned by developers.

The theory of tax increment financing is by encouraging redevelopment projects the value of real property in a redevelopment district will increase. When a redevelopment plan is adopted, the assessed valuation of real property in the redevelopment district is frozen for tax purposes at the current base level prior to construction of redevelopment improvements. As property is improved, the assessed value in the redevelopment district increases above the base level. This "increment" produced is captured and utilized to pay the costs associated with the redevelopment, including debt service on bonds issued by the city to finance the redevelopment projects. The net effect of tax increment financing is to permit the city and a developer to use a portion of the property taxes that otherwise would be paid on a completed redevelopment project to repay all or a portion of the redevelopment costs of the city, thereby reducing or eliminating debt service requirements on that portion of the project associated with the tax increment. Future tax increases associated with redevelopment are **not** abated, but rather are used to fund costs associated with redevelopment.

The remainder of this memorandum outlines Kansas statutory provisions relating to tax increment financing, provides a summary of procedures necessary to implement a tax increment project and analyzes federal tax laws affecting bonds issued by cities to finance tax increment projects. Additional questions relating to this subject may be addressed to Joe L. Norton or Philip C. Lacey of our Wichita office or David W. Queen or Gary D. Anderson of our Kansas City office.

II. KANSAS STATUTORY PROVISIONS

General. K.S.A. 12-1770 *et seq.* (the "Act") authorizes cities to create redevelopment districts, acquire certain property and to issue special obligation bonds and/or full faith and credit tax increment bonds for the financing of redevelopment projects. Any city proposing to undertake one or more redevelopment projects (the "Project") must create a redevelopment district (the "District") by adoption of an ordinance. The District must be located in central business district areas of cities, blighted areas located within cities, environmentally contaminated areas located within and without cities and enterprise zones established prior to July 1, 1992 located within cities. No privately owned property shall be acquired and redeveloped under the provisions of the Act if the board of county commissioners or the board of education levying

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taxes on property proposed to be included in the District determines that the proposed District will have an adverse effect on such county or school district. The city must also prepare a redevelopment plan (the "Plan") in consultation with the planning commission of the city. The Plan must contain, among other items, a summary of the comprehensive feasibility study showing the benefits derived from the Project will exceed the costs and that the income therefrom will be sufficient to pay for the Project, a description of the buildings and facilities proposed to be constructed or improved and a relocation assistance plan for property owners within the District. The city is required to conduct a public hearing on the adoption of the Plan. At the conclusion of such public hearing, the governing body of the city may approve the Plan, by ordinance adopted by two-thirds vote. Once the redevelopment plan has been adopted in accordance with the specific provisions of the Act, the city may purchase or otherwise acquire real property. Eminent domain proceedings may be pursued upon two-thirds vote of the governing body of the city. Any property acquired by the city under the Act may be sold or leased to any person, firm or corporation, as the developer, in accordance with the Plan. The redevelopment plan may be undertaken in separate stages. Any Project shall be completed within fifteen years from the establishment of the District; provided that environmentally related Projects must be completed within twenty years from the date of a consent decree agreement with environmental regulators.

Blighted Areas. For the purposes of the Act, the term "blighted area" means an area which: (1) because of the presence of a majority of the following factors, substantially impairs or arrests the sound development and growth of the city or constitutes an economic or social liability or is a menace to the public health, safety, morals or welfare in its present condition and use: (a) a substantial number of deteriorated deteriorating structures; (b) predominance of defective or inadequate street layout; (c) unsanitary or unsafe conditions; (d) deterioration of site improvements; (3) diversity of ownership; (fa) tax or special assessment delinquency exceeding the fair value of the land; (g) defective or unusual conditions of title; (h) improper subdivision or obsolete platting or land uses; (i) the existence of conditions which endanger life or property by fire and other causes; or (j) conditions which create economic obsolescence; or (2) has been identified by any state or federal environmental agency as being environmentally contaminated to an extent that requires a remedial investigation, feasibility study and remediation or other similar state or federal action; or (3) previously was found by resolution of the governing body to be a slum or a blighted area under K.S.A. 17-4742 *et seq.*, ("Urban Renewal Law") and amendments thereto.

Tax Increment Captured. In any Plan the primary revenue source for repayment of debt is the tax increment generated from the redevelopment of the Project within the District. The Act provides that such increment is that portion of *ad valorem* taxes collected on real property (land and improvements thereon) within the District that is in excess of the amount produced from such property attributable to the assessed valuation of such property prior to the date the District was established. *Ad valorem* taxes collected on assessed valuation in existence on the date of establishment of the District will continue to be distributed to all taxing districts in the same manner as all other property taxes. The additional tax increment shall be captured, placed in a special fund and applied only for the purposes of paying the costs of the Project, including repayment of any authorized indebtedness associated with the Project. When such bonds and the interest thereon shall have been paid, the increment shall be apportioned to all taxing jurisdictions as before the creation of the District; provided however, if the Project has not been completed, the increment shall continue to be captured for the special fund until the Project is completed, not to exceed fifteen years after establishment of the District.

The incremental increase in valuation shall not be utilized in determining the bonded debt limit of the affected taxing jurisdictions or for any purpose other than raising funds for the District. The county

appraiser shall certify the increment to the county clerk on or before July 1 of each year. *The raising or lowering of tax levies by the affected taxing district (city, county and school district) or state law changes (e.g., school district funding formula and classification amendments) have an impact on the increment captured in each year.*

Bond Authority. Cities may use proceeds of special obligation bonds or full faith and credit tax increment bonds to finance the undertaking of any Project. The city may also issue industrial revenue bonds to benefit a developer located with the District. The maximum maturity of any such special obligation bonds or full faith and credit tax increment bonds shall be twenty (20) years. The Act specifies several different permissible uses of proceeds, including:

1. Acquisition of property within the Project area.
2. Payment of relocation assistance.
3. Site Preparation.
4. Sanitary and storm sewers and lift stations.
5. Drainage conduits, channels and levees.
6. Street grading, paving, graveling, macadamizing, curbing, guttering and surfacing.
7. Street lighting fixtures, connection and facilities.
8. Underground gas, water, heating and electrical services and connections located within the public right-of-way.
9. Sidewalks and pedestrian underpasses or overpasses.
10. Drives and driveway approaches located within public right-of-way.
11. Water mains and extensions.
12. Plazas and arcades.
13. Parking facilities.
14. Landscaping and plantings; fountains, shelters, benches, sculptures, lighting, decorations and similar amenities.
15. All related expenses to redevelop and finance the Project.

None of the proceeds from the sale of such bonds, however, shall be used for the construction of buildings or other structures to be owned by any developer.

Special Obligation Bonds. A city may issue special obligation bonds to finance those permissible expenses of a Project. Such bonds shall be payable, both as to principal and interest: (1) from property tax increments allocated to, and paid into a special fund of the city; (2) from revenues of the city derives from or held in connection with the undertaking and carrying out of any Project; (3) from any private sources, contributions or other financial assistance from the state or federal government; *or* (4) by any combination of these methods.

Special obligation bonds are not general obligations of the city, nor in any event shall they give rise to a charge against its general credit or taxing powers or be payable out of any funds or properties other than nay of those set forth above. These bonds shall be exempt from all state taxes except inheritance taxes and do not count toward the city's bonded debt limitations.

Full Faith and Credit Bonds. Cities may also issue full faith and credit tax increment bonds to finance a Project. These bonds are payable, both as to principal and interest: (1) from the revenue sources identified for special obligation bonds; and (2) from a pledge of the city's full faith and credit to use its *ad valorem* taxing authority for repayment thereof in the event all other authorized sources of

revenue are not sufficient. Prior to the issuance of these bonds, a feasibility study is required showing that the benefits derived from the Project will exceed the cost and that the income therefrom will be sufficient to pay the costs of the Project. The resolution establishing the public hearing on the Plan shall state the city's intent to issue full faith and credit tax increment bonds. The city may issue such bonds unless a protest petition signed by not less than three percent (3%) of the qualified voters of the city is filed with the city clerk within sixty (60) days following the date of such public hearing.

Full faith and credit tax increment bonds are general obligations of the city and shall be exempt from all state taxes except inheritance taxes. The amount of full faith and credit tax increment bonds issued and outstanding which exceed three percent (3%) of the assessed valuation of the city shall be within the bonded debt limit of the city.

Industrial Revenue Bonds. The city may issue industrial revenue bonds pursuant to K.S.A. 12-1740 et seq. to benefit a developer within the redevelopment district. All state law benefits associated with such bonds shall be available, **except that no ad valorem tax abatement shall be available.**

Relocation Assistance Plan

The city shall adopt a relocation assistance plan prior to undertaking the Project. Such assistance plan shall provide for relocation payments to persons and businesses who move from real property or must move personal property as a result of the Project. No persons or families residing in the redevelopment district shall be displaced unless there is a suitable housing unit available and ready for occupancy. The city shall also be responsible for damages to retailers by reason of liquidation of inventories necessitated by relocation.

III. PROCEDURES FOR IMPLEMENTING A TAX INCREMENT FINANCING PROJECT

Pursuant to the Act, the city must establish District and prepare a Plan in consultation with the planning commission of the city which outlines the proposed Project. The specific Project area must be declared a "blighted area" within the meaning of the Act, have been designated as an enterprise zone prior to July 1, 1992, or be in an environmentally contaminated area. The city must make a finding that the redevelopment of the area is necessary to promote the general and economic welfare of the city. The Act provides separate procedures for establishing a District and approving a Plan. These procedures may be combined. A summary of the procedural steps necessary to establish the District and approve the Plan are as follows:

1. City adopts resolution stating that is considering creation of a District. Notice of public hearing is disseminated to affected county, school district and property owners and published in official city newspaper. At conclusion of public hearing, city adopts resolution finding that a certain area within the city meets the requirements of a "blighted area," is in an enterprise zone established prior to July 1, 1992 or meets the requirements of an environmentally contaminated area. Thereafter, the city passes an ordinance creating the District.
2. No privately owned property may be acquired or redeveloped under the Act, if the board of county commissioners or the board of education levying taxes on such property determines by resolution adopted within 30 days following the conclusion of the public

hearing for the establishment of the redevelopment district, that the proposed redevelopment district will have an adverse effect on the county or the school district.

3. City formulates the Plan in conjunction with the planning commission. The city must also prepare a comprehensive feasibility study on the benefits and costs of the Project and the expected income derived therefrom. The planning commission must determine that the Plan is consistent with the comprehensive general plan for the development of the city. The Plan shall contain the following: (a) summary of feasibility study; (b) identification of District and Project area; (c) map of redevelopment area; (d) the relocation assistance plan; (e) detailed description of the buildings and facilities to be constructed or improved; and (f) other relevant information. Copy of Plan is forwarded to county and school board.
4. City adopts resolution calling public hearing, which fixes the date, time and location of the hearing and provides for giving notice of such public hearing. The date of the public hearing shall be not less than thirty (30) or more than seventy (70) days after adoption of the resolution calling the public hearing. The resolution shall describe the Plan, the boundaries of the District (including a map thereof), the method of financing the same (*i.e.*, special obligation bonds or full faith and credit bonds) and other relevant matters. A copy of such resolution shall be delivered to the county and school board associated with the District and mailed (certified) within ten (10) days to each owner and occupant of property within the District. The resolution shall also be published one time in the official city newspaper not less than one (1) week or more than two (2) weeks preceding the date of public hearing.
5. Upon conclusion of the public hearing and upon making the appropriate findings, the city may adopt the Plan by ordinance passed by not less than two-thirds vote of the governing body.
6. City issues full faith and credit bonds or special obligation bonds to finance the Project. No full faith and credit tax increment bonds may be issued until the sixty day protest period expires after the date of public hearing.
7. City may proceed to acquire property within the District by purchase or eminent domain (2/3 vote of city governing body required) and implement the Plan.

IV. FEDERAL TAX CONSIDERATIONS

General. Special obligation bonds or full faith and credit bonds may be issued either as "tax-exempt" or taxable obligations. The interest on such obligations will be excluded from federal income taxation if the proceeds are used only for a governmental purpose or if the bonds meet certain other requirements established in the Internal Revenue Code of 1986, as amended (the "Code").

Governmental Purpose Bonds. The interest on Bonds, the proceeds of which are used to finance traditional governmental facilities such as streets, water lines and sewers, is excluded from gross income for purposes of federal income taxation under *Section 103* of the Code. This generally will be true even when the bonds are paid from tax increment payments made by the owner/developer, provided the

governmental facilities are available for use by members of the general public on an equal basis. However, if bond proceeds are used to finance facilities used in the trade or business of a developer or other non-governmental entity, the bonds may be "private activity bonds" within the meaning of *Section 141* of the Code and must meet certain other very restrictive provisions of the Code for the interest to be excluded from federal income taxation.

Private Activity Bond Tests. A bond is a "private activity bond" (as said term is defined in *Section 141* of the Code) if it meets either the "private business tests" or the "private loan financing test." The private business test consists of (a) the "private business use test" and (b) the "private security or payments test."

The "private business use test" is met if more than 10% of the proceeds of an issue are used, directly or indirectly, in the trade or business of any person other than a governmental unit. Use on the same basis as the general public is disregarded. Thus, if bond proceeds are used for essential governmental functions, it does not matter that a single developer owns the land, provided that the developer is proceeding to develop and sell the land to members of the general public for residential or commercial use.

The "private security or payments test" is met if payment of the principal of or the interest on more than 10% of the proceeds of an issue is (under the terms of such an issue or any underlying arrangement) directly or indirectly: (a) are secured by an interest in (i) property used or to be used for a private business use, or (ii) payments in respect of such property; or (b) to be derived from payments (whether or not to the issuer), in respect of property or borrowed money, used or to be used for private business use.

With respect to the private security interest or payment test, relevant provisions of the Joint Committee on Taxation "Blue Book" provide:

1. Ad valorem taxes, or tax increments derived therefrom solely from the developer's property, are classified as "revenues from generally applicable taxes," and therefore are not treated as payments for purposes of the private security interest or private payment test.
2. However, even if bonds are nominally secured by incremental property tax revenues, the bonds will meet this test if a nongovernmental person has (i) entered into a special agreement with the city that the redevelopment site will be considered to have an assessed value for local property tax purposes of not less than a prescribed amount, until such time as the bonds are repaid, or (ii) agreed to be personally liable to pay the difference between the amount of real property taxes levied against the site and the amount of debt service on the bonds, or (iii) agreed to finance the cost of credit enhancement for the bonds.
3. Payments made by a lessee of bond-financed property to a redevelopment agency or similar agency are considered, even though the city is the issuer of the bonds and does not receive payments from the redevelopment agency.
4. Where bonds are used to acquire land that is to be sold to private persons for redevelopment, amounts paid by those persons for the land are payments for purposes of

the private security interest or private payment test, even though incremental property tax revenues are the stated security for the bonds.

The "private loan financing test" is met if the proceeds of an issue are to be used directly or indirectly to make or finance loans to persons other than a governmental unit if the loan exceeds the lesser of: (a) Five percent (5%) of such proceeds, or (b) \$5,000,000. "Private business use" means use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit. Any activity carried on by a person other than a natural person shall be treated as a trade or business.

Qualified Redevelopment Bonds. Even if tax increment bonds are "private activity bonds", the Code allows for exclusion of interest in certain circumstances. *Section 144(c)* of the Code defines "qualified redevelopment bonds" as "any bond issued as part of any issue 95% or more of the net proceeds of which are to be used for one or more redevelopment purposes in any designated blighted area." Qualified redevelopment bonds must be part of an issue wherein (1) 95% or more of the net proceeds are to be used for redevelopment purposes in a locally designated blighted area, and (2) the payment of principal and interest on which is primarily secured either (a) by taxes of general applicability imposed by a general purpose governmental unit, or (b) by a pledge of incremental property tax revenues, which must be reserved exclusively for debt service on the issue and other similar issues, to the extent necessary to cover such debt service.

Qualified redevelopment bond proceeds may be used only for the following purposes:

1. The acquisition, by a governmental unit having the power of eminent domain, of real property in the redevelopment area;
2. The clearing and preparation for redevelopment of land in the area that was acquired by the governmental unit;
3. The rehabilitation of real property located in the area that was acquired by the governmental unit; and
4. Relocation of occupants of the real property.

New construction may not be financed with bond proceeds.

Other Federal tax requirements in connection with qualified redevelopment bonds include:

1. *Assessed value limitation:* The assessed valuation of all blighted areas within the jurisdiction may not exceed 20% of the assessed value of all real property.
2. *Acreage limitation:* The blighted area must be "compact and contiguous." Also, the blighted area must equal or exceed 100 acres but it can be as small as 10 acres, if not more than 25% of the "financed area" is to be provided to one person.
3. *No additional charges:* Owners or users of land in the redevelopment area cannot be subject to charges not imposed on comparable property outside the project area.

Included in these specifications are the requirements that the interest in any real property located in the District and transferred to a person other than a governmental unit, be transferred for fair market value. The term "blighted area" is defined more strictly in the Code than under the Act.

Summary. If the bonds fail either private activity test, they may be issued as governmental purpose bonds. The business use test will be failed if no property is used in the trade or business of a non-governmental entity. In essence, the city will be its own developer of the Project. It may hire contractors, etc., but the property financed may not be transferred or leased to a private developer. The portions of the Project consisting of traditional infrastructure improvements usually fail the business use test. The security interest test may be failed if the developer pays no or nominal (less than ten percent [10%] of the principal amount of the bond issue) consideration for property transferred to it by the city. Additionally, if the only funds that support the bonds are taxes of general application (e.g., ad valorem or sales taxes) as opposed to special assessments, lease payments or other developer guarantees or credit support, the security interest test may not be met. The Act authorizes bonds to be issued regardless of whether the interest thereon is "taxable" or "tax-exempt." If bonds are "taxable," federal securities laws may place additional restrictions on the marketability of such bonds.

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TESTIMONY TO THE SENATE COMMERCE COMMITTEE
PROPOSED SENATE BILL 328 (EXPANSION OF TAX INCREMENT FINANCING)

Presented By: Randy Speaker, Director of Housing
Kansas Department of Commerce & Housing
January 12, 1996

Madam Chairperson and members of the Committee, it is my pleasure to appear before you today to reflect upon how expansion of the current Tax Increment Financing (TIF) legislation may affect housing opportunities in Kansas.

At the Division of Housing, we are committed to providing housing opportunities to all Kansans through the development of resources, partnerships and technical assistance. The current TIF legislation falls short of being considered one such resource which can be used easily by communities throughout the state. However, with careful planning, and responsive changes to the current statutes, it could be an effective tool for local communities as they strive to maximize their efforts to promote and enhance economic development. Changes which facilitate more widespread use of TIF without threatening the tax base of communities are appropriate and timely, given the increasing recognition of the linkage between housing and economic development. Furthermore, with the trend of comprehensive development through the use of our Consolidated Plan process, TIF will be increasingly important as commercial and housing developments will have more of an opportunity to be developed in tandem, thus leveraging historical funding sources.

As you know, there have also been discussions regarding TIF in the Special Committee on Assessment and Taxation. I would like to present to you some items for consideration which will reflect upon those hearings as well as the testimony you heard earlier this week during your own hearings.

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Attachment 2 thru 2-5

COMPLEXITY - Financing real estate development is difficult and complex in its own right. TIF adds to the complexity because not only must it be responsive to fluctuations in the capital markets which fund the bonds; but TIF is also dependent upon future neighborhood values and the community's ability to increase its taxable base. The neighborhood valuation portion of the equation has additional complexity built-in, since no two communities or neighborhoods have equal determinants of value. With this complexity comes a basic misconception: **Some view TIF as though it requires the local taxing authority to give up all current and future tax revenues. This is not true. The local taxing authority is simply pledging future tax revenues which it would not have if it were not for the increased value of the tax base which is created by the new development. Furthermore, this pledging of additional future revenues has a time limit. After this time limit the taxing authority then receives the full tax revenue at the higher rate. During the stipulated time period of the pledge, the local taxing authorities continue to receive the same tax revenues they would have received if the development never existed.**

CAVEAT - The assumption that larger cities may suffer increased migration to the suburbs when incentives are offered equally throughout a community is correct. Some feel that the valuation differences in land prices will provide their own disincentive to prevent this trend because the higher land prices in the suburbs will limit the potential incremental spread on valuation, which will then reduce the amount of tax revenue which is available to retire the bonds. While this may have a limited impact on a few cases, it will not serve as a general deterrent to this trend.

To assist you in making your analysis and resulting decisions, I would like to offer the following recommendations, observations and suggestions:

RECOMMENDATION #1 - Keep whatever changes are finally proposed simple, so as to not add to the complexity. Because of the individualistic nature of neighborhoods and communities, changes should be directed toward keeping as much flexibility and decision making authority as possible with the local communities. Too many limitations will hinder the use of TIF as a tool for local communities.

RECOMMENDATION #2 - Expand TIF to include "conservation areas" which may not meet the current definition but are "at risk" of becoming blighted. A definition of "at risk" should be based upon the ability of the feasibility study to identify the likelihood that a majority of the determinant currently identified in the statute will occur within a certain number of years. For instance, declining property trends should be identifiable over a 3 to 5 year period. This is better than identifying 35-year-old structures as the test because there are many neighborhoods which have 35-year-old structures which are not blighted.

RECOMMENDATION #3 - Expand TIF in include "greenfield areas" so that infill lots in urban communities and underdeveloped areas in rural communities can be included.

RECOMMENDATION #4 - Allow increased revenue received by a city which is collected from other sources within the redevelopment district to be pledged for the TIF project.

RECOMMENDATION #5 - Extend the period for tax increment collection from 15 to 20 years.

RECOMMENDATION #6 - Permit a taxing authority to pledge less than 100% of the property tax increment if other revenues are available and pledged by the authority.

RECOMMENDATION #7 - To address the problem of outward migration in larger cities, apply the 15% land area limitation on "conservation area" and "greenfield area" usage to all communities over 45,000 population. However, because this is less likely in smaller communities, the 15% limitation should not be applied there, since it may present a roadblock to the overall feasibility of a TIF project due to a lack of economies of scale.

RECOMMENDATION # 8 - Allow housing infrastructure to be an eligible use under TIF. If there is a desire to limit the price range of eligible persons, a limitation of 115% on median income could be applied without hindering the use of most other homeownership subsidy programs.

OBSERVATION #1 - Limiting the use of eminent domain to "non-conservation areas" may prohibit the use of TIF in circumstances where it could be a useful tool.

OBSERVATION #2 - If the school finance formula is attached to TIF, it should be done only as long as other sources of revenue are eligible for pledging by the taxing authorities. Remember, the taxing authority will not be giving up any of its current taxes. Also, the impact on the school system may be rather modest, especially in smaller communities.

In conclusion, we are a conceptual supporter of any tool which can be created or expanded to assist local communities in addressing their housing needs without creating a negative impact on the local tax base. It is imperative that we not make some of the same mistakes the federal government has made in the past of creating laws with the "one-size-fits-all" mentality. Simplicity and flexibility which will allow the local communities to address their particular housing needs appropriately will lay the groundwork for successful real estate development.

CASE SCENARIOS

<u>COUNTY</u>	<u>115% OF MEDIAN INCOME</u> (4 -person family)	<u>MAXIMUM PURCHASE</u>
Johnson	\$ 51,290	\$139,000
Shawnee	49,220	129,000
Sedgwick	48,760	127,000
Finney	41,630	93,000
Bourbon	36,110	67,200
Russell	34,960	61,800

CONDITIONS OF PURCHASE

Other monthly debt = \$500

Loan/Value = 90%

Interest Rate = 7.5%

Loan Term = 30 years

Taxes = \$125/month

Insurance = \$35/month



**League
of Kansas
Municipalities**

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TO: Senate Commerce Committee
FROM: Chris McKenzie, Executive Director *cm*
DATE: January 12, 1996
RE: Tax Increment Financing Proposals--SB 405 and SB 328

Thank you for the opportunity to appear today to discuss the League's views with regard to modifications to the Kansas tax increment financing (TIF) laws. The League participated this interim in the discussions concerning the use of TIF in conservation districts and possibly for housing and industrial projects. At the Committee's suggestion, the League met with Senator Feliciano, Randy Speaker of the Department of Commerce and Housing and other parties with an interest in the possible use of TIF for housing projects on the fringe of cities. In that meeting we explored both the feasibility of using TIF for housing and whether it should be available for middle and higher income housing.

We appreciated the opportunity to be part of those discussions. Yesterday I also had the chance to discuss this issue in depth with the membership of the League's Legislative and Finance and Taxation Policy Committees. Those Committees, sitting in joint session, voted overwhelmingly to recommend support for SB 405 and to oppose SB 328.

SB 405

Our reasons for supporting SB 405 are grounded in a belief that it is better to address the need to redevelop property before blight sets in rather than later. Furthermore, SB 405 addresses the need to allow cities to use franchise fees and sales tax revenues to finance principal and interest payments on TIF bonds as opposed to the property tax increment alone. Finally, SB 405 allows a city to adopt a redevelopment plan providing for less than 100% of the increment of additional property tax revenue to be pledged to the project. If sales tax, franchise fee and other revenues can be used in some cases, the balance of the increment can continue to go to the county, state and other taxing districts.

Quite frankly, our only concern about SB 405 (other than some minor drafting matters in paragraph (b) on page 2) is paragraph (c)(3) on page 9 of the bill. This new language prospectively removes the 35 mill school levy from the future increment of tax revenue to finance the project. In a community with an aggregate mill levy of 100 mills, this reduces the revenue stream by 35%--a substantial reduction. On the other hand, with the other changes in the bill TIF will be able to be used in conservation districts (to prevent blighting conditions from developing) and a wider range of revenues could be dedicated to the project. We do understand the rationale of the Special Committee in including this new provision, but I want the Committee to understand the fact that this will make TIF financing less feasible in some communities.

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SB 328

One of the more intense discussions at yesterday's League policy committee meetings centered on the issue of using TIF financing for housing projects. As was pointed out in that debate, for decades cities have been empowered to finance residential subdivision improvements through the use of special assessment bonds. Using this approach, the city issues tax exempt general obligation bonds to finance streets, sewer lines, sidewalks, etc. Each lot is then assessed its proportionate share of the cost of the total project, and that expense is repaid in annual installments.

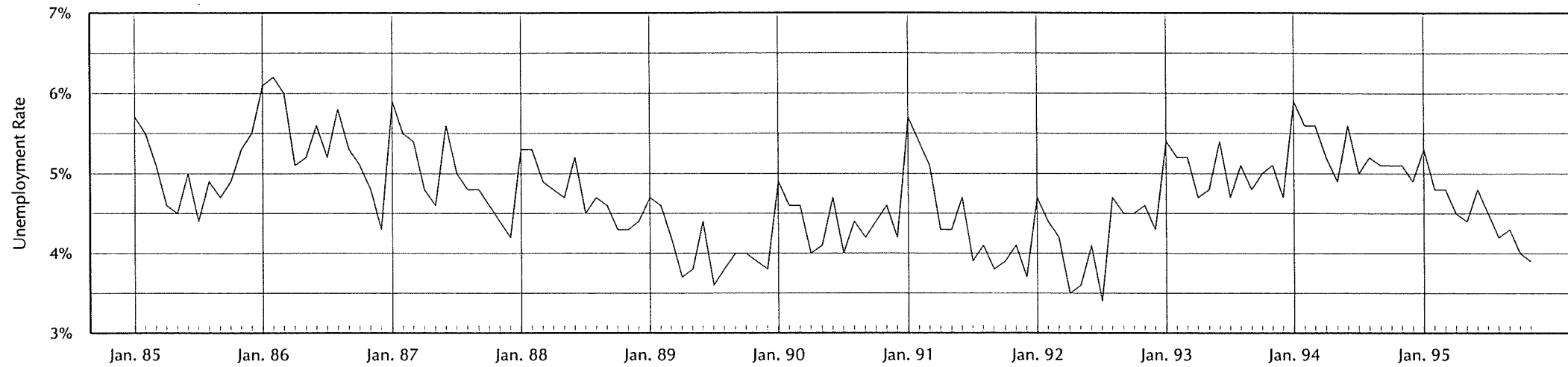
Under **current law** (K.S.A. 12-6a07), a city governing body may use its general funds or issue general obligation bonds to finance up to 95% of the cost of residential subdivision improvements (i.e., streets, sewers, etc.). The fact of the matter is that this rarely happens because of the belief in most communities that the general taxpayers should not subsidize residential subdivisions. While that choice can be argued with by the advocates of this bill, the fact is that the elected officials of each city have the freedom today to make the judgement that SB 328 would provide through the TIF law. It is not necessary to use TIF financing to subsidize housing costs.

There is another good reason not to broaden the TIF law at this time to allow widespread use of this tool for housing. The only use of TIF for housing in Kansas to date has been in Kansas City, Kansas in a blighted district. While Kansas City, Kansas is not necessarily representative of all communities in this respect, this project demonstrated one of the most profound challenges of using TIF for housing. When the property is only assessed at 11.5% of market value, it will generate an increment of revenue after improvement that is the equivalent of 46% of the increment generated by a commercial project of comparable market value which is assessed at 25% of its market value. As a result, in such cases additional public subsidies will likely be necessary in a TIF district for housing. In other words, in certain instances it is likely a housing based TIF project will not generate sufficient property tax increment in future years to pay its own way. Furthermore, if the Committee feels the 35 mill portion of the incremental increase in values should no longer be used to finance the TIF projects, the feasibility of housing TIF projects is even more in doubt.

It may be entirely appropriate for TIF to be used in a mixed-use project such as a planned unit development or as a way to leverage further private investment in the redevelopment of a blighted area. Current law would already allow such projects if they were located in blighted districts or enterprise zones. If the Committee recommends the addition of "conservation areas", TIF could be used to finance housing projects in such areas as well.

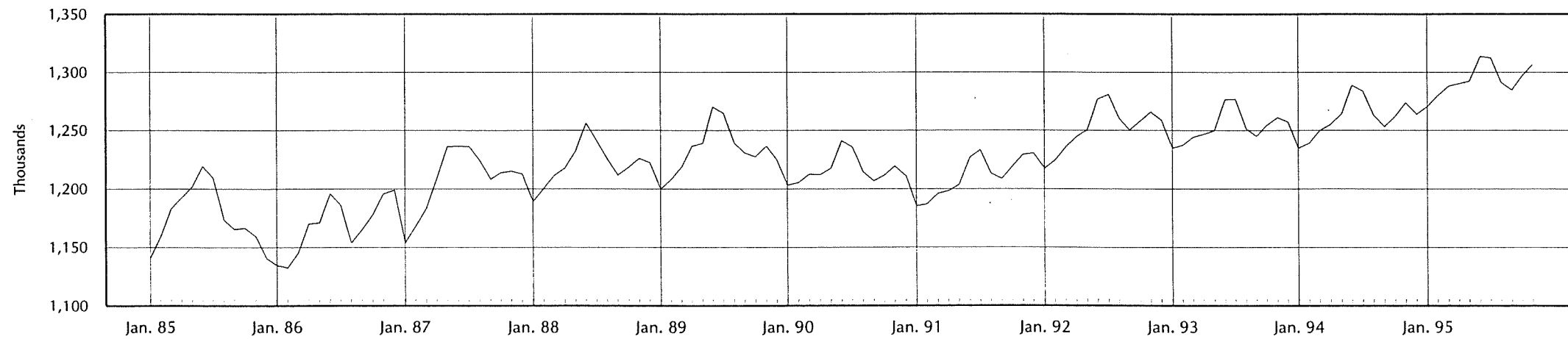
RECOMMENDATION: The League respectfully recommends approval of SB 405 and opposition to SB 328.

Kansas Monthly Unemployment Rates 1985 to Present



Source: KDHR Labor Market Information Services

Kansas Monthly Employment 1985 to Present



Source: KDHR Labor Market Information Services