

MIDCONTINENT PERSPECTIVES

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Creating A Climate For Development – Tax Increment Financing, Chapter 353, And Community Attitudes

I want to thank Dr. Kimball for the opportunity to share with you some thoughts about a subject that has been in the news lately. I may as well tell you, to begin with, that I have a certain bias in that since I got out of public office in 1979 and have been practicing law, I principally represent developers. It's a job that I like because developers are people who take risks and make things happen. And if they do their job correctly they can change the face of the city for the better for all of us. I think they are the epitome of Adam Smith's capitalist in that seeking their own fortunes they tend to improve the quality of life for the rest of us, if they do their job correctly.

Every major city in the midcontinent region now has an economic development arm that is used to attract development to its area. The way we go about attracting development is really very simple. We go out and solicit it, and we create a climate for it to come to our city. The solicitation part is easy. We simply let people know we're on the map and that we want their business.

Creating the climate for development is a more complex issue. In the first place, the boosters who want development to come to their area don't control all the factors that may be involved in development. They can't create mountains and beaches, for example. We don't have those in the midcontinent region, but what we do have, of course, is location. Location is a very important factor as far as attracting development is concerned. Just on the one issue of shipping costs, the midcontinent region, which is located in the heart of the United States, has a 15 percent advantage over the East Coast and a 25 percent advantage over the West Coast. That's no small number when you consider that shipping costs have increased at double the rate of inflation in the last ten years – some 200 percent.

In the second place, the factors that go into making up the climate for development are many. Because they are really too numerous for me to attempt to catalog here, I've decided to focus today on a couple of them. One would be the overall attitude of a community about development and the other would be the statutory development tools that are available.

It may be that in any given city the general public and even government do not share the view of the civic leaders who would like to see more development. In some cities, in fact, the planners are seen as public enemy number one by those who would like to see more development. In this respect the planners get a lot more blame – or credit, however you want to

phrase it – than they deserve. The popular misconception is that planners at city hall draw circles on maps and say that this kind of development will occur in this location, and then the developers rush to city hall to get their building permits, adding, “Why didn’t I think of that?” Nothing could really be further from the truth. The fact is that no major kind of development occurs unless some developer sees the opportunity for a gain in the form of a demand for his product and is willing to take the risk involved. If the developers are foolish enough to ignore the laws of supply and demand, the lenders will probably bring it to their attention.

I think that in spite of the fact that development is largely demand-driven there have to be controls on development. There’s no question about that, and I’m speaking all the way from land use controls – what you can build in a location, that is embodied in the concept of zoning – to design review criteria, which dictate what kind of a building can be built, what style, and in some communities even what color. Kansas City is representative of most large cities in the midcontinent region in that it has a large amount of design review already built into its zoning ordinances. Without controls a few developers might be able to destroy the residential ambience of a neighborhood and create numerous other problems and build rather garish buildings in the bargain.

Design review is a concept that is becoming more and more prevalent in the thinking of city planners. It’s one that is coming to our city, I think, in a very short time.

The fear that you constantly hear expressed about design review is, “Would you want a building that is designed by a committee of city bureaucrats?” I think that probably on the whole design review would be good. The one thing that most of us have embraced is the notion of consistency, and I think that what design review would bring above all is consistency in a neighborhood style of architecture in a certain geographic area. The fear that I have is that while design review may prevent some awful buildings from being built, it may also prevent some brilliant buildings from being built. On the whole, we have to be for it and just pray that it doesn’t run the next Frank Lloyd Wright or Howard Roark out of Kansas City.

The public’s attitude about development, I have found in my short time on this earth, is also influenced by market forces. In times of high unemployment and high interest rates, you find that the public is more receptive to development than in times when you have a crane on every corner and when development is easy to get. One thing that results in every development is the idea of change. Something is always going to be changed when economic development of any kind comes to a city. Generally change means inconvenience, or worse, for someone. Most people would rather deal with things they know they don’t like than put up with the uncertainty of things that they might not like. And that’s why you often see a great deal of resistance to development. But the fact is that with no pain there is no gain. Development is like anything else good in life. There’s a price that has to be paid if you want new development. There’s a price that has to be paid if you want a city to grow. Those changes usually involve a change in the landscape or a change in traffic patterns and the like. I was speaking with a consultant the other day from New York and he said, “Gosh, you people don’t have any traffic problems at all. I could have a picnic lunch in the middle of the intersections that you call congested.” It is true that in the Midwest if we have to wait longer than ten seconds to make a left turn, we feel we’ve been horribly inconvenienced.

Also, this is a time of high technology solutions to almost every problem, which has exacerbated this feeling on the part of all of us that we want to have cheesecake with no calories

and to have an increase in the tax base without any traffic problems. If we really think about it, though, we would not want to return to the days of wide open spaces and no penicillin. Attitudes are a very subjective matter.

I would like to turn now to the second factor that goes into making up the climate for development. Something that is very much in black and white in the statute books and that we can sink our teeth into is the legislative incentives to encourage development to come to a certain area. I've chosen Missouri because I know the most about it. It is typical of states in the midcontinent region in this regard. And if you look at the tools that you have available to you in Missouri, you will find that they are the urban redevelopment corporation law, commonly known as "353" because that's the chapter of the Missouri statute in which it's found; the land clearance for redevelopment authority law; the industrial development bond law, planned industrial expansion; and, most recently, the tax increment financing law.

Industrial development bonds, as everybody knows, are now in a lot of trouble in Washington. If Representative Rostenkowski has his way, after the first of the year they will not be able to be used in private development. It's true that industrial development bonds have been abused. They've been used to build everything from golf courses to massage parlors, and I think Congress is getting fed up with that kind of thing. The major problem with industrial development bonds, though, began when they were authorized at the federal level. The original purpose of these bonds was to encourage redevelopment or to help economically depressed areas attract industry to their part of the country. What nobody noticed was that there were no geographical restrictions on these bonds. Instead of economically depressed areas using the bonds to attract development to their area, economically well off areas were using the bonds to attract industry from their less-well-off neighbors. You can't blame them for that because as long as the financing tool is available they're going to use it.

If there is a solution to this problem, it's got to be a global solution at the federal level. I think that if industrial development bonds are going to survive at all, regardless of whether you like them or don't like them, they are going to have to be restricted to geographical areas where there's some economic distress. This would be an easy thing to do; we have many of these kinds of tests in the federal law now. Missouri in a magnanimous display of altruism decided that it would not legalize the use of this kind of bond until 1977, while Kansas had been using it since the early fifties. And that meant that over the long haul, these bonds have not provided a competitive edge for Missouri. Rather, we have just played catch-up with our neighbors.

The next economic incentive I'd like to talk about and the one that's in the news most these days is the Missouri 353 urban redevelopment corporation law. First of all, some facts about this law. It was passed in 1945 by the Missouri Legislature and has not really been used much until recently. There have only been about 45 projects approved here in Kansas City, Missouri, since the law was passed. That's an average of about one a year. The way the statute works is this. The City Council can declare an area to be blighted. The definition of blight is a short one, and I'd like to read it to you. Blighted areas are those parts of the city within which the legislative authority of such city "determines that by reason of age, obsolescence, inadequate or outmoded design or physical deterioration, have become economic and social liabilities, and that such conditions are conducive to ill health, transmission of disease, crime or inability to pay reasonable taxes."

This law gives two things to any private redevelopment corporation. A city or a county can confer upon that corporation the power of eminent domain and also the power of tax abatement from real property taxes. The rationale is that by doing this the city or county will lure developers into areas in which the developers would not otherwise undertake projects. The controversial portion of this statute is found, first of all, in the abatement provisions – the abatement of real property taxes – and, secondly, in the blight provision. The abatement, by the way, is a temporary abatement for a 25-year period and a partial abatement – it's never total. Taxes on the existing property are not abated. Most cities, I think, have enacted ordinances that require developers to pay a greater amount of tax than the statute requires them to pay. This is called a payment in lieu of tax. But the taxing entities, it is said, lose tax revenue by virtue of 353 redevelopments. That is true if you believe that the development would be built anyway. If you do not believe that, then the taxing entity such as the school district, the county, and the city benefit from the redevelopment project.

The big issue in most 353 projects – and it seems that almost all of them are somewhat controversial – is whether blight is present. I don't think most people focus in on what the statute says about blight. Most people have an idea in their mind about what blight is and it's a very subjective thing at bottom. Blight, you could say, is probably the flip side of beauty. It's somewhat in the eye of the beholder. One thing that's certain is that people who live in the areas that are being redeveloped never agree that their area is blighted.

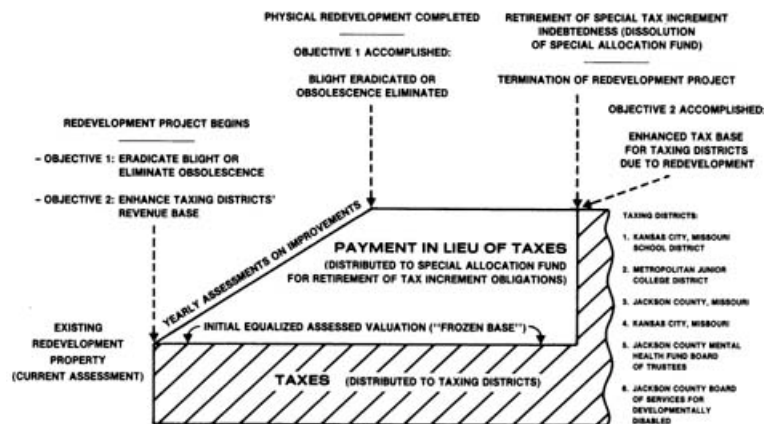
I told you a minute ago that there have been about 45 plans approved by the City of Kansas City, Missouri. The Supreme Court of Missouri in the late seventies handed down some decisions on what the definition of blight really means. And I think probably those decisions more than anything else are the reasons for the increase in the use of the statute over the last six or seven years. One of the things the Supreme Court has said is that a blighted area need not be a slum area. Another important thing that it has said about blight is that in a blighted area not each and every structure need be blighted. You can have some perfectly sound structure in an overall area that is blighted.

As the 353 urban redevelopment corporation law comes more and more under fire and under public scrutiny, the developers, "developees," and city councils will be looking for an alternative to it. One that they have turned their attention to is the tax increment financing law. Missouri passed such a statute in 1982. It has not been used because bond attorneys will not give an opinion on that statute until there are some state Supreme Court decisions that say that it is free from constitutional challenge. Tax increment financing is a concept that has been around a long time in other states. About 33 other states currently allow it. After Proposition 13 was passed in 1979, the state of California began using tax increment financing in earnest. And in fact I think you would find out there today that in most situations local governments are issuing only tax increment financing bonds, because under Proposition 13 – which, you may recall, is the Jarvis amendment – the debt limit on these cities was so low that they were up against the maximum for many years to come when the proposition passed.

The way tax increment financing works is this. A city may declare an area to be either a blighted area or a conservation district. The definition of blight is identical to that found in the land clearance for redevelopment authority law. The definition of a conservation district is a district in which over 50 percent of the structures are 35 years old or older and there are influences which if left unchecked would lead to blight, but the area itself is not blighted. Once the city council declares an area to be one of these two things, then the tax increment financing

commission sends out a request for further proposals from developers and selects a developer. Bonds are then issued, and the bond proceeds are used to acquire and clear land and perhaps relocate utilities, widen streets, and the like. The bonds themselves are paid off by the tax increment (called a payment in lieu of taxes) that is generated off the new construction that is built in the development.

Now I'd like to show you a chart that explains the tax increment financing law. The cross-hatched line at the bottom represents current taxes that would be paid in a certain area of redevelopment. At the beginning of a project there are two goals as far as the statute is concerned: (1) to eradicate blight or eliminate obsolescence, and (2) to enhance the taxing districts' revenue base. The white area labeled payment in lieu of taxes represents the payments that are made in lieu of taxes by the developer once the project is built. They are measured exactly like taxes and are what anyone else in Missouri would probably call taxes. As you can see, as the project comes on stream and is completed, these payments in lieu of taxes increase up to the point where the project is built. The goal of eliminating the blight or obsolescence is achieved at that point. These payments in lieu of taxes continue to be collected for the life of the bonds that have been issued and are then used to retire the bonds. At that point all of the taxes that are collected on the project are turned over to the local taxing districts.



There has been one decision by the Supreme Court of Missouri with respect to tax increment financing bonds. This decision was handed down in March of this year and really amounted to something like a private letter ruling from the Internal Revenue Service finding that the statute is constitutional but leaving the door open for further questions. I believe that in Missouri there will be further challenges to this statute. I think that the Supreme Court decision will cause some further challenges to this statute. Hopefully this issue of the constitutionality of the statute will be resolved in the very near future.

There are two features about tax increment financing that are of interest to you today, I believe. First is the payment in lieu of tax provision that I mentioned. As long as the Hancock tax-lid amendment exists in the state of Missouri, this kind of relabeling is going to occur not only in this statute but in a number of others.

The other feature that should be of interest to you is how this law differs from the Missouri 353 urban redevelopment corporation law. Both have the same purpose, but in the case of tax increment financing there is the ability to issue bonds at the beginning of the project. This is much more desirable to developers because it allows them to finance a portion of the project

up front, as opposed to the tax abatement that is granted under the 353 law. I think it's probably a lot more palatable to the general public, too, because when you use the tax revenues in tax increment financing they must be put back into the project and stay there. Another important difference is the notion of a conservation district, which does not exist under the Missouri 353 law. This would allow redevelopment of areas that are not yet blighted. I think the intention of the Legislature there is why wait until you have an area that is blighted in order to induce someone to come in and redevelop it. The third important difference is that the power of condemnation under the tax increment financing statute is exercised by the city, whereas in the case of the urban redevelopment corporation law this power is simply conferred upon the private redeveloper.

So to summarize, 353 and tax increment financing, unlike industrial development bonds, have the virtue of being required to be used in blighted or blight-prone areas. There's a great debate going on at this time about the use of any kind of redevelopment tool, especially urban redevelopment corporations. I believe the radical view is that all the development that occurs using these kinds of incentives would occur anyway whether you had the benefit of the law or not. That's a question that I can't answer and I don't think anyone knows and I don't think anyone will ever know. Local governments think that with this incentive they may have a chance to redevelop areas in their cities that they want to redevelop and without it they probably will not be able to. They're sort of like the guy who fell off the cliff and was hanging on to a branch. Praying for the first time in his life, he said, "If you'll get me out of this, I'll never go mountain climbing again." And a voice up there said, "Trust me. Let go of the branch." And the climber said after he thought a minute, "Is there anybody else up there?"

QUESTIONS AND ANSWERS

QUESTION: Does tax increment financing include the power of condemnation or eminent domain?

ANSWER: Yes, it does. The city rather than a private individual exercises that power and it's always had that power. The tax increment financing law simply allows the city to use it in that situation.

QUESTION: Is it true that only Missouri and Ohio have what's known as an urban redevelopment corporation law?

ANSWER: In the exact form as you find it in Missouri, that's probably true. But other states have similar laws that call for the redevelopment of blighted areas.

QUESTION: How many states have tax increment financing?

ANSWER: From the last count that I made, 33 states use tax increment financing. By the way, Missouri is surrounded by those states – Arkansas, Kansas, Iowa, Nebraska, Illinois. Miller Nichols, who is better informed than I, also says that all the states around Missouri have it. Thank you, Miller.

QUESTION: In the next case that goes to the Missouri Supreme Court on tax increment financing, will the issue of blight be tested?

ANSWER: I don't know because I don't know who the plaintiff is going to be, but I think that, more likely, they're going to focus their attention on the concept of a conservation district. I

say that because in Missouri, and in practically every other state in the region, the notion of blight has been pretty well defined by the state Supreme Court and has been pretty well accepted as a reason for the redevelopment of certain areas. A recent decision of the U.S. Supreme Court which upheld a law passed by the Legislature of Hawaii would lend an awful lot of substance to the argument that local governments can make these decisions for themselves, and the Court does not look behind legislative determinations. That law in Hawaii, by the way, was one that was far more pernicious in most people's minds than what we're talking about here. It's a law that allowed the state to take away property owned by a certain family. If the ownership of land is congregated too heavily in one family, the state could break up that combination of land and sell it to people who are interested in buying it.

QUESTION: What is the status of the case law on the definition of blight as far as the land clearance for redevelopment authority law or the urban redevelopment corporation law is concerned?

ANSWER: In Missouri there has been abundant case law, culminating with some decisions in the late seventies that basically stated that blight is what the city council says it is, and the courts will not look behind a legislative determination made by a city council in that regard.

QUESTION: What is the nature of the payments on these bonds that you described in the tax increment financing law?

ANSWER: They are not, first of all, general obligation bonds. Only the property in the redevelopment area is taxed, so to speak, to pay off these bonds. If they are anything like what you know, they are like special assessments to pay off streets and sewers and I would say almost identical to those although specifically they're like a square peg. They don't fit into any of the round holes that you're familiar with in Missouri law. And they are not an industrial development bond because the bonds are backed solely by a tax lien on the real estate. They're not backed by revenues. In fact, if the developer guaranteed these bonds, I suppose they would become an industrial development bond for federal purposes and then you'd have big problems.

QUESTION: Do you think the definition of blight is fair?

ANSWER: I think the definition of blight itself is fair, yes. The definition of blight is capable of being misused like anything else, but the Legislature has enacted a definition that it is comfortable with and I'm certainly comfortable with it.

QUESTION: What can you use these payments in lieu of taxes for under the Missouri tax increment financing law?

ANSWER: The revenues generated from payments in lieu of taxes have to be used only for those items that are on-site improvements and soft costs for this particular development. They're usually going to be used to pay off bonds that were issued to finance those kinds of things. The Missouri law is very liberal. It permits an allowable project cost to be practically anything.

QUESTION: Why do we use the term payments in lieu of taxes? Is it just because of the Hancock amendment?

ANSWER: Yes. They're measured exactly by every other indicia of taxes. They're measured by the levy and by the assessment ratios that are currently in use by the cities and counties.

QUESTION: Under tax increment financing, who owns the land during the period of abatement?

ANSWER: The developer. The city will either acquire the land if it is necessary and sell it to the developer or, in some cases if the developer owns all of it except for one parcel, convey the land to the developer at a cost that the city thinks will get the job done as far as inducing the developer to develop the project.

QUESTION: Where will the next tax increment financing project by the Kansas City TIF authority be located?

ANSWER: I suspect that it's going to be east of Troost, south of Eleventh Street, in an area that is currently owned mostly by the Kansas City Corporation for Industrial Development.

QUESTION: In a tax increment financing project what happens to the taxes paid on the buildings that may be torn down to make room for the new development?

ANSWER: The cross-hatched line on the chart represents those taxes on current land and improvements. It's called the frozen tax base because it gets frozen when the project is approved. The property itself, not the developer, is responsible for continuation of payment of those taxes. Even though the buildings may be torn down in the redevelopment area, those taxes still get paid.

QUESTION: Which would be more important to developers: (a) the power of eminent domain, which allows them to assemble parcels of land into one developable size, or (b) the tax benefits which, in the case of 353, are straight abatement or, in the case of tax increment financing, use of the proceeds to pay off the bonds?

ANSWER: I think that the power of eminent domain is more important to most developers, for the purpose not only of being able to assemble the ground, but also, sometimes more importantly, of being able to condemn restrictive covenants and easements that may exist with respect to the property.

QUESTION: What will happen to the state Legislature in Missouri with respect to its tax increment financing statute and its 353 redevelopment corporation law?

ANSWER: There will be some attempts, first of all, to amend the 353 redevelopment corporation law and I don't know what the nature of those attempts will be. There have been bills in the Legislature before to amend the law. One amendment that might find some favor would be to include a representative of school districts or any other taxing entity affected by a project on the city redevelopment coordinating committee that votes on whether to recommend approval of these projects. On tax increment financing, I know there's going to be legislation to clean up the language in Missouri's law because I drafted it.

QUESTION: If developers are paying payments in lieu of taxes on redevelopment projects, why is there controversy over these projects?

ANSWER: Even though payments in lieu of taxes are being made, there is still tax abatement, which is a very great benefit to the developer. I think some projects would be opposed simply for the zoning involved.

QUESTION: What is the current practice in Kansas City as far as tax payment is concerned under the 353 law?

ANSWER: The state law provisions on abatement provide that there is almost total abatement for the first 10 years. The developers pay taxes only on the existing real estate minus the buildings, and then for a subsequent 15-year period of the abatement they pay 50 percent of normal taxes. That practice has changed and Kansas City, Missouri, has enacted ordinances which allow it to impose payments in lieu of taxes, so that actually at a very bare minimum anywhere in the city the developers pay the existing taxes not only on the land but also on the buildings that have been torn down – similar to what you see in the tax increment financing statute.

QUESTION: What does the state law allow with respect to cities negotiating with developers to shorten the period of tax abatement?

ANSWER: Under the state law, of course, it's a straight 25-year abatement. But that doesn't prevent cities from doing what Kansas City has done – exacting payments in lieu of taxes, which, if the amounts are large enough, has the effect of terminating the abatement at an earlier point of time.

QUESTION: How does the city as a whole benefit from a tax increment financing project given that the taxes are plowed back into the project?

ANSWER: At the point of time when the bonds are paid off, then all the taxes flow to the taxing entities. One of the overall stated goals is to increase the tax base for the community at large. Secondly, through the elimination of blight.

QUESTION: Doesn't the developer get a windfall if the estimated taxes are less than actual? If they're more than actual, does that extend the life of the bonds?

ANSWER: No, it can't be longer than 20 years. In fact, the law provides that if by virtue of inflation, reassessments, or levy increases the payments in lieu of taxes expand to a size beyond that estimated at the outset, then the bonds will be paid off earlier.

QUESTION: When you said that there is a frozen tax base under the Missouri tax increment financing statute, is that base frozen at the valuation or is it frozen in terms of a dollar amount?

ANSWER: I believe it is frozen as far as the valuation is concerned and levy fluctuations may affect the dollar amount.

MICHAEL T. WHITE. His education, public sector employment, and professional law practice provide Mike White with a unique overview of city government and the incentives it uses to encourage development.

After graduating from the University of Missouri-Kansas City with a B.A. degree in Psychology in 1962 and the J.D. degree in 1966, and working in private practice, Mike served in the Jackson County, Missouri, Legislature from 1972 to 1974. As County Executive of Jackson County for the next four years, he supervised an annual expenditure of \$35 million. Since 1979 he has been a partner in the law firm of Polsinelli, White & Vardeman, where he specializes in regulatory agency law.

Mike's civic and corporate involvements have been extensive: a director of several banks, county government advisory and special task force committees, teaching, United Way, a number of charities, and, last but not least, a 30-year involvement as a professional musician, working with some of the legendary figures in the national jazz community.



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MIDCONTINENT PERSPECTIVES was a lecture series sponsored by the [Midwest Research Institute](#) as a public service to the midcontinent region. Its purpose was to present new viewpoints on economic, political, social, and scientific issues that affect the Midwest and the nation.

Midcontinent Perspectives was financed by the Kimball Fund, named for Charles N. Kimball, President of MRI from 1950 to 1975, Chairman of its Board of Trustees from 1975 to 1979, and President Emeritus until his death in 1994. Initiated in 1970, the Fund has been supported by annual contributions from individuals, corporations, and foundations. Today it is the primary source of endowment income for MRI. It provides "front-end" money to start high-quality projects that might generate future research contracts of importance. It also funds public-interest projects focusing on civic or regional matters of interest.

Initiated in 1974 and continuing until 1994, the sessions of the Midcontinent Perspectives were arranged and convened by Dr. Kimball at four- to six-week intervals. Attendance was by invitation, and the audience consisted of leaders in the Kansas City metropolitan area. The lectures, in monograph form, were later distributed to several thousand individuals and institutions throughout the country who were interested in MRI and in the topics addressed.

The [Western Historical Manuscript Collection-Kansas City](#), in cooperation with MRI, has reissued the Midcontinent Perspectives Lectures in electronic format in order to make the valuable information which they contain newly accessible and to honor the creator of the series, Dr. Charles N. Kimball.