[Washington University Law Review](https://openscholarship.wustl.edu/law_lawreview)

Volume 77 | Issue 3

January 1999

In a TIF: Why Missouri Needs Tax Increment Financing Reform

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IN A TIF: WHY MISSOURI NEEDS TAX INCREMENT FINANCING REFORM

I. INTRODUCTION

In St. Louis County, Missouri, shopping malls, private commercial real estate developers, and section 99.800 of the Missouri Municipal Housing Code are starting to add up to trouble. Missouri passed its Real Property Tax Increment Allocation Redevelopment Act[1] ("the statute") in 1982.[2] Its creators intended tax increment financing (TIF) as a tool to allow communities to redevelop "blighted" areas by financing that redevelopment through increased property tax revenues generated by the redeveloped land.[3] Recently, however, some have criticized the statute, voicing concern that projects financed under it run contrary to its original intent.[4]

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1. MO. REV. STAT. §§ 99.800 - .865 (1994 and Supp. 1998).

2. *See* Christina G. Dudley, *Tax Increment Financing for Redevelopment in Missouri: Beauty and the Beast,* 54 UMKC L. REV. 77, 79 (1985).

3. *See* Marc Jolin et al., *Tax-Increment Financing: Urban Renewal of the 1990s*, 32 CLEARINGHOUSE REV. 81 (1998); *see generally*, John E. Anderson, *Tax Increment Financing: Municipal Adoption and Growth*, 43 NAT'L TAX J. 155 (1990); John F. Cook, *The Battle Against Blight*, 43 MARQ. L. REV. 444 (1959); David A. Hegg, *Tax-Increment Financing of Urban Renewal—Redevelopment Incentive Without Federal Assistance*, 2 REAL EST. L.J. 575 (1973); Jack R. Huddleston, *A Comparison of State Tax Increment Financing Laws*, 55 ST. GOV'T. 29 (1982); Eugene B. Jacobs & Jack G. Levine, *Redevelopment: Making Misused and Disused Land Available and Usable*, 8 HASTINGS L.J. 241 (1956-1957); Gerald M. Trimble, *Tax Increment Financing for Redevelopment: California Experience is Good,* 31 J. HOUSING 458 (1974); Thomas J. Burnside, Comment, *Tax Increment Financing: "Rational Basis" or "Revenue Shell Game"?,* 22 URBAN L. ANN. 283 (1981); Dan McMahan, Note, *Municipal Corporations: The Constitutionality of Oklahoma's Central Business District Redevelopment Act,* 35 OKLA. L. REV. 821 (1982); Randall V. Reece & M. Duane Coyle, Note, *Urban Redevelopment: Utilization of Tax Increment Financing,* 19 WASHBURN L.J. 536 (1980); John H. Herman, Recent Development, *Municipal Blight Declarations,* 23 URBAN L. ANN. 423 (1982).

Although this Note will provide more analysis in subsequent parts, the following explains in brief the usual purpose and function of a tax increment financing project. A municipality issues tax-exempt bonds in order to raise revenue to finance private redevelopment in a blighted area. At the beginning of the project, the municipality freezes the property tax assessment of the site and then uses the incremental revenue from the increased property taxes on the site to retire the bonds. Once the municipality repays the bonds, the property tax base is unfrozen and all future tax revenues go to the local taxing authorities. The key to a successful TIF project is an increase in the assessed value of the property so that the bonds may be retired and the property will generate greater revenue for the municipality than it does in its current form. *See generally*, DANIEL R. MANDELKER ET AL., STATE AND LOCAL GOVERNMENT IN A FEDERAL SYSTEM, 290-302 (4th ed. 1996); *see also infra* Part II.A.

4. *See, e.g.,* Anne Kessen Lowell, *So West County Mall is Blighted Property?,* ST. LOUIS POST DISPATCH, July 29, 1998, at B7 ("[Three recently proposed TIF sites] are not blighted and do not qualify, under the spirit of the TIF law, for taxpayer-financed assistance. Proponents are quick to point out that these sites *legally* fit the definition of blight under [the] Missouri statute but their argument only highlights

Two controversial projects in St. Louis County provide good examples of the debate over the appropriate uses of TIF. The first project involves a proposed retail development that would require a zoning change from residential to commercial[5] in one of St. Louis' more than ninety municipalities.[6] The real estate developers asked the city of Olivette for $40 million in tax increment financing, almost a third of the total estimated cost of the development. These companies proposed to then use this money to purchase homes in the area for two-and-a-half times their fair market value.[7] In this neighborhood, which appears merely middle-class to the casual observer, the homes are neither dilapidated nor vacant.[8]

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a poorly written statute.") (emphasis added); *see also* Virginia Young, *Missouri House Panel Targets Tax Incentives for Businesses, Seeks Compromise on TIFs,* ST. LOUIS POST DISPATCH, Sept. 18, 1998, at B3 ("The tax-increment financing program . . . was intended to rebuild blighted areas, but it has been used to build . . . shopping malls. [S]uch projects generate no new tax revenue—they just shift retail sales from one community to another.").

Importantly, the discussion in this Note is meant to be illustrative of the many current controversies involving TIF statutes around the country. Controversy is not necessarily limited to those states with statutes substantially similar to Missouri's. State TIF statutes all have generally the same objective—the redevelopment of blighted areas. Battles over the use or abuse of TIF statutes can therefore be seen in a variety of contexts other than those discussed with reference to Missouri in this Note. Therefore, the discussion and proposal in this Note is broadly applicable to other state contexts. *See, e.g.,* John Gibeaut, *The Money Chase,* A.B.A. J., Mar. 1999, at 58 (discussing controversies and litigation involving TIF districts in Texas, Illinois, and Kansas, as well as Missouri); Mike Patty, *Counties Oppose Rail Line on U.S. 36, Commissioners Object to Tax Financing to Pay for Commuter Project*, DENV. ROCKY MTN. NEWS, Mar. 17, 1999, at 30A (noting objections of various municipalities to proposal to use TIF to build a commuter rail line from Boulder to Denver when "[i]t is debatable if an increase in property value would even happen . . . and if it did whether it would be enough to repay the debt"); Daniel B. Wood, *Rebuilding America's Blighted Cities, But at What Cost?,* CHRISTIAN SCI. MONITOR, Mar. 10, 1999, at 3 (discussing controversy surrounding a plan to build a $750 million film studio in North Hollywood and noting the lack of concern over testing the effectiveness of developments built using TIF); Tim Pareti, *Funding Plan Sought for Downtown Renovation; TIF District Extension Worries School Board,* CHI. TRIB., Mar. 12, 1999, at 5C (discussing opposition of local school board to extension of TIF district for additional 12 years).

5. *See* Sterling Levy, *Commercial Change in Comprehensive Plan Gains Backing,* ST. LOUIS POST DISPATCH, Sept. 14, 1998 (West Post), at 1.

6. *See* Young, *supra* note 4.

7. *See id.* Although the Missouri statute provides for the condemnation and taking of private land under eminent domain, the city is not invoking the doctrine in this case. This seems, however, only to have caused the developers proposing the project to increase the amount of requested TIF money in order to afford the buyouts. *See* Lowell, *supra* note 4 ("The Olivette development team says it needs TIF due to the significant extraordinary cost in developing an urban project of this magnitude. What they mean is, it's expensive to purchase existing owner-occupied single-family homes at above market value and knock them down."). Developers later decided that if 75% of homeowners in the area would agree to sell, they would acquire the remaining 25% through condemnation. *See* Linda M. Billingsly, *Developers Cut Price They Will Pay for Homes in Olivette,* ST. LOUIS POST DISPATCH, Oct. 12, 1999 (Metro), at B1.

8. The Olivette City Council has since decided to put approval of the project to a vote of Olivette residents because the project became so politically charged. The City Council first delayed its project-approval vote, then declared the project dead. *See* Dan Mihalopoulos, *Olivette Leaders Say Mall Project*

This proposed commercial development is controversial because some argue that using the TIF statute to change a thriving residential neighborhood into a bustling commercial one violates the spirit, if not the letter, of the TIF law.[9] Further, the development itself would almost certainly not bring any new retailers to the area.[10] The proposed development is, in fact, just minutes away from a new, substantially similar development.[11]

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is Dead, ST. LOUIS POST DISPATCH, Aug. 11, 1999, at A1; Dan Mihalopoulos, *Olivette Postpones Vote on Development,* ST. LOUIS POST DISPATCH, July 28, 1999, at B1. Two weeks later, the project was back, and the City Council voted both to approve the project and to put final approval of the project to a referendum vote of Olivette residents in February, 2000. *See* Dan Mihalopoulos, *City Council Will Take up Proposal Tonight, But No Final Vote is Expected,* ST. LOUIS POST DISPATCH, Aug. 24, 1999, at B1; Dan Mihalopoulos, *Olivette will Hold Referendum on Shopping Center Proposal,* ST. LOUIS POST DISPATCH, Sept., 8, 1999, at B1.

Since the City Council's meeting on September 7, the project's developers have lowered their buyout offers to homeowners in the TIF district, and Olivette residents, both for and against the project, have become increasingly disgruntled. Some have even gone so far as to file recall petitions for three City Council members and Olivette's Mayor. *See* Linda M. Billingsly, *Olivette Moves Forward on Bill that Might Spark Recall,* ST. LOUIS POST DISPATCH, Nov. 15, 1999 (West Post), at 1 (noting that "Olivette City Council members must approve legislation that places their own recalls from office on the ballot Feb. 8," the same day Olivette residents vote on the proposed project); Linda M. Billingsly, *Wrangling Over Development Continues to Engulf Olivette,* ST. LOUIS POST DISPATCH, Nov. 11, 1999 (West Post), at 1 (reporting that developers have decreased their offers to residents from $175,000 to $160,000). Until the vote in February, the city, residents in favor of the project, and residents against the project are all using their best lobbying efforts to persuade those that remain undecided. *See* Linda M. Billingsly, *Olivette Officials Hope PR Firm will Help Them Get Out the Word on Mall Project,* ST. LOUIS POST DISPATCH, Oct. 18, 1999 (West Post), at 1 (noting that Olivette hired a public relations firm through mid-February to "disseminate information" about the project).

9. *See generally* Todd A. Rogers, *A Dubious Development: Tax Increment Financing and Economically Motivated Condemnation,* 17 REV. LITIG. 145, 171-72 (1998) ("A . . . stronger objection to TIF is that it benefits an already privileged class—private developers—at the public's expense. The most basic concern is that TIF statutes are being used as a tool of the private developer in areas absent of blight.").

10. *See* Lowell, *supra* note 4.

11. *See In a TIF Tizzy*, ST. LOUIS POST DISPATCH, Aug. 10, 1998, at B6. The proposed Olivette development, named Olivette Town Center, would include a Wal-Mart, a Sam's Club, and another large home store, in addition to numerous smaller retailers. The similar development, less than a year old and located only two miles away on Interstate 170, includes a Target, one of Wal-Mart's primary competitors, in addition to numerous other, smaller retailers. Further, both a Wal-Mart and a Sam's Club are located within a fifteen-minute drive of the proposed Olivette development. *See* Lowell, *supra* note 4.

The developers involved in the Olivette development are not asking the city to use its eminent domain powers to force buyouts of the homes in the area. This tactic *has* been used in the proposed West County Mall expansion plan, however. *See infra* notes 13-14 and accompanying text. Because the Olivette developers are *not* seeking the use of eminent domain, they are forced to offer more to homeowners who are reluctant to sell. This has increased the amount of TIF money the developers are seeking from the city to help offset their costs. *See* Levy, *supra* note 5.

In fact, the "crazy-quilt" pattern of more than ninety municipalities in St. Louis county has no doubt fostered balkanization among these geographically proximate and demographically similar areas. Because each municipality is separately governed, each is free to compete with the others, to the detriment of all, for any and all commercial development. This competition, in turn, creates an incentive for private developers to pit one municipality against the other in order to gain the most beneficial tax treatment, at

A second controversial TIF project in St. Louis County involves a large regional shopping mall, the owners of which are seeking TIF money to expand. The owners of a second, competing, regional mall sued to enjoin the project, arguing the area does not qualify as blighted under the TIF statute.[12] The plaintiffs maintain that public money should not be used to help the mall expand, simply to enhance its competitiveness within the local and regional shopping mall market.[13]

The heated debate surrounding these two developments serves to highlight some of the flaws in the Missouri TIF statute that allow the law to be used for projects adverse to its true redevelopment origins.[14] In general, the broadly-

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the cost of hindering economic development for the region as a whole. *See* Young, *supra* note 4.

Even though the municipalities in St. Louis county are governed independently, municipal planning from a regional perspective makes economic sense for the region's taxpayers. From a TIF perspective, such regional consideration would "evaluate whether a TIF-financed development in one area actually increases overall tax revenue or merely transfers revenue from one jurisdiction to another as shoppers transfer their spending dollars from existing stores to new ones." Lowell, *supra* note 4. A more narrow definition of blight under the Missouri TIF statute would ensure that economic planning would take place on a more regional scale and that only the neediest sites, falling under the spirit of the TIF law, would acquire financing to foster redevelopment.

12. On September 28, 1999, a St. Louis County Circuit Judge ruled that the city of Des Peres did not break the law when it declared part of Des Peres blighted. Thus, mall owners may move forward with the mall renovation, and the plaintiffs in the action are left to appeal the judge's decision to the Missouri Court of Appeals. *See* William C. Lhotka, *Judge Oks West County Center Subsidy,* ST. LOUIS POST DISPATCH, Sept. 29, 1999, at A1. The judge based his holding on the grounds that he had no discretion to determine whether the project area was actually blighted, but could only review the city's determination for bad faith or fraud. *See Move Mall Wars to Legislature,* ST. LOUIS POST DISPATCH, Oct. 3, 1999, at B2. Apparently, however, the judge criticized the city's decision to declare the area blighted, noting the irony of a blight declaration in one of the wealthiest areas of St. Louis County. *See id.* The plaintiffs have appealed the decision to the Missouri Court of Appeals, and construction on the expansion is scheduled to begin in February, 2000. *See* Linda M. Billingsly, *Firm, Des Peres Residents File Appeal of TIF-Financing for West County Center*, ST. LOUIS POST DISPATCH, Nov. 18, 1999 (West Post), at 1.

13. *See In a TIF Tizzy, supra* note 11. Some critics of proposed TIF sites in St. Louis have noted that, in order to be financially viable, developments of the type currently proposed would need to pull traffic away from nearby existing competitors, rather than bringing new retailers or retail categories to the area. *See* Kathleen Hill, *Use of Tax Financing for Development Draws Fire,* ST. LOUIS POST DISPATCH, Sept. 14, 1998 (West Post), at 5.

Another relevant criticism with regard to this particular project, considering the multitude of municipalities competing for private development, is that some wealthier municipalities could use TIF to lure development from poorer areas. *See* Steve Birmingham, *2 Firms Jockey for Project, Pledge Low Tax Financing,* ST. LOUIS POST DISPATCH, Sept. 14, 1998 (West Post), at 1.

The implication of this is that the new development does not create new, high paying jobs, but just shifts low-paying retail jobs from other sites in the area, since, in general, large retail developments do not create consumer demand, they merely redistribute it. *See* Hill, *supra.* Many of these "part-time, low-wage, low-benefit" jobs will not even raise a person's income above the income level required to remove the person from eligibility for food stamps, Medicaid, or earned income tax credits. Because of this, in addition to merely shifting jobs, any new jobs that might be created are only a further drain on taxpayers. *See When Tax Help Goes to Those Not in Need,* ST. LOUIS POST DISPATCH, Aug. 16, 1998, at B3.

14. *See* Rogers, *supra* note 9, at 161 ("TIF statutes trace their origins to the urban redevelopment

worded statute allows many projects to technically fall under the statute's definition of "blight," when in fact the economic health of these areas is sufficient to garner adequate private investment.

This, in turn, encourages the abuse discussed above. Municipalities have an incentive to offer large TIF packages to private developers to entice them to build within the particular municipality. While this brings additional revenue to the municipality, it is contrary to the intent of the TIF statute as a tool of last resort. Such distortion leads to the "redevelopment" of areas neither intuitively nor rationally considered "blighted."[15]

The effects of the incentives discussed above could hold dire consequences for the economic health of the region, as well as the individual municipalities which may overburden themselves with debt and not realize increased revenues of the magnitude anticipated. This further highlights another inadequacy of the Missouri TIF statute that may not be evident from the above discussion: its

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and slum clearance statutes of the 1930s and 1940s."); *see also* MO. REV. STAT. § 353.020 (1994).

15. Even more egregious abuses of TIF statutes have been noted in other states. In Illinois, for example, Chicago's South Loop neighborhood was redeveloped under the state's TIF statute, which is substantially similar to the Missouri statute. *See* 65 ILL. COMP. STAT. 5/11-74.4-1 (West 1997). South Loop was home to old warehouses, office buildings, a substantial amount of affordable housing, and the city's largest homeless shelter. *See* Jolin, *supra* note 3, at 91.

After Chicago declared the area a TIF district, the demographics of the area quickly shifted, and homes worth more than $300,000 became the primary landmarks in the area. *See id.* This influx of money into the area drove out a number of the older, low-income residents as well as the homeless shelter. *See id.* Therefore, while the TIF district had the effect of redeveloping the neighborhood, it did so at the expense of the area's long-term residents, who reaped none of the benefits of the inflow of money.

Critics of this project maintain that, although the neighborhood may have needed public assistance, TIF projects should not be used to displace poor residents in favor of wealthy ones. *See id.* Even if allowing TIF for the area was a good use of money, the benefits of the project were misallocated, and those whom the TIF statute was designed to help were forced to leave. *See id.* This again shows distortion of the underlying intent of TIF statutes.

Illinois' TIF statute has also been the subject of more serious litigation than seen in Missouri. One Chicago suburb attempted to use TIF to drive out its Hispanic population by declaring the two largely Hispanic neighborhoods in the suburb blighted under the TIF statute. This declaration made the neighborhoods subject to condemnation and those residents subject to relocation. *See id.*

Although residents successfully challenged this TIF district in federal court, the fact that municipal officials in Chicago even conceived of using the statute for discrimination points to its obvious flaws. *See* Hispanics United v. Village of Addison, 958 F. Supp. 1320 (N.D. Ill. 1997). Listed by the village as "blight" conditions, as required under the Illinois TIF statute, were: "dust on windowsills, missing toilet paper roll holders, small cracks in linoleum floors, paint spots on woodwork or baseboards, stained porcelain bathroom fixtures, and unwashed dishes in kitchen sinks." Hispanics United v. Village of Addison, No. 94C-6074 (N.D. Ill. Dec. 23, 1994) (complaint para. 45, 58(e), 73(e)). Residents challenged the declaration under the Fair Housing Act, 42 U.S.C. §§ 3601 et seq. (1994). *See* Jolin, *supra* note 3, at 91-92.

Such abuses of the TIF statute in Illinois led to a number of proposed reforms during the 1997-98 session of the Illinois Legislature. *See* H.R. 525-90, 90th Leg., 1st Reg. Sess. (Ill. 1997); *see also infra* note 51 and accompanying text.

exemption from state constitutional limits on municipal debt. This means that voter approval is not required for a TIF project,[16] and that municipalities have no incentive to weigh the costs and benefits of a TIF project against other possible expenditures when preparing annual budgets.

These criticisms raise the question of whether any conceivable benefits from the TIF statute could possibly outweigh the potentially disastrous costs. Tax increment financing is an urban redevelopment tool that has been utilized for nearly fifty years by local governments as part of a trend toward partnerships between local governments and private developers.[17] Properly used, as its origins and history dictate,[18] TIF can be a powerful tool for revitalization of declining urban areas[19] and is important in the wake of declining federal financial assistance for urban renewal projects.[20]

Since TIF statutes gained wide acceptance during the late 1970s and early 1980s, however, many states have recognized that TIF statutes hold enormous potential for abuse and have begun to reform them.[21] This Note argues that Missouri, instead of recognizing the potential for abuse inherent in its TIF statute, has instead allowed its TIF statute to be abused. Using examples of TIF abuse to highlight the flaws in the TIF statute, this Note calls for statutory reform to prevent such abuses in the future.[22]

Part II of this Note first reviews the history and policy behind TIF statutes in general. It then focuses on the Missouri TIF statute, explaining how the law functions, how the Tax Reform Act of 1986 affects TIF projects, and how the

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16. *See* MO. REV. STAT. § 99.810 (1994); *see also infra* Part II.B. The statute requires a redevelopment plan with a general description of the program, a finding of blight and a public hearing, but no vote other than that of the redevelopment commission. *See* MO. REV. STAT. § 99.820.1(1) (1994).

17. *See* Daniel R. Mandelker, *Public Entrepreneurship: A Legal Primer*, 15 REAL EST. L.J. 3 (1986).

18. *See infra* Part II.A.

19. *See* Jonathan M. Davidson, *Tax Increment Financing as a Tool for Community Redevelopment,* 56 U. DET. J. URB. L. 405 (1979).

20. *See* Mandelker, *supra* note 17, at 15.

21. Minnesota is one example. In 1979, before Missouri even implemented a TIF statute, Minnesota recognized the *potential* for abuse and revised its statute. *See id.* at 18; s*ee also* MINN. STAT. §§ 469.174-469.179 (1994); Note, *The 1979 Minnesota Tax increment Financing Act*, 7 WM. MITCHELL L. REV. 627 (1981). The revisions to the Minnesota statute required all private developers in TIF districts to comply with specified disclosure, planning, and reporting requirements. Further, the revised statute shifts to the developer more of the risk resulting from an incomplete project. *See* Mandelker, *supra* note 17, at 17.

22. Others agree with the idea of urgent need for TIF reform. In addition to the numerous newspaper articles cited above and public outcry over the current use of the Missouri TIF statute, both Republican and Democratic legislators introduced TIF reform proposals in the Missouri Legislature during the 1997-98 session. *See* H.B. 131, 89th Leg., 1st Reg. Sess. (Mo. 1997), H.B. 589, 89th Leg., 1st Reg. Sess. (Mo. 1997). For the text of one of these bills, see *infra* note 51.

TIF statute, as presently constituted, creates potential for abuse. By focusing on the implementation problems of the Missouri TIF statute, Part III of this Note considers caselaw from states holding TIF projects subject to constitutional debt limitations and states holding the opposite. Finally, Part IV proposes two revisions to the Missouri TIF statute: imposing a stricter definition of "blight" and subjecting TIF debt to the municipal debt limit imposed by the state constitution. As part of the proposed revisions, this Note encourages broad reform of all TIF statutes subject to abuses similar to those found in Missouri.

II. HISTORY OF TAX INCREMENT FINANCING AS A TOOL FOR URBAN REDEVELOPMENT

California was the first state to implement tax increment financing in 1952.[23] The idea was conceived when Los Angeles had trouble gaining enough votes to raise the local share required to match federal urban renewal funds.[24] Since then, forty-three other states[25] have enacted TIF legislation and have increasingly used TIF as the primary financing tool for local redevelopment.[26]

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23. *See* Dudley, *supra* note 2, at 77; *see also* CAL. HEALTH & SAFETY CODE §§ 33670-33676 (West 1994 & Supp. 1999).

24. *See* 42 U.S.C. § 1453(a)(2)(B) (1994). Cities with a population over 50,000 were required to finance a third of the redevelopment project costs to match a grant of funds covering two-thirds of the local project costs. *See* Davidson, *supra* note 19, at 406 n.5.

25. *See, e.g.*, ARIZ. REV. STAT. § 36-1488.01 (1994); FLA. STAT. ch. 163.335 (1994); 65 ILL. COMP. STAT. 5/11-74.4-1 (West 1994); IND. CODE § 36-7-14-27 (1994); MINN. STAT. §§ 469.174-469.179 (1994); NEB. REV. STAT. § 18-2102 (1994); OHIO REV. CODE ANN. § 725.01-725.11 (Anderson 1994); WIS. STAT. § 66.46 (1994).

Although California passed its TIF statute in 1952, the majority of states, including Missouri, waited almost thirty years to follow suit. "This fact tends to support the idea that economic growth may precede TIF adoption, because the national economy as a whole expanded during the 1980s." Fred Allen Forgey, *Tax Increment Financing: Equity, Effectiveness, and Efficiency*, 32 ICMA MUN. YEARBOOK 25 (1993).

Two states enacted TIF statutes between 1951 and 1960, four states between 1961-70, 11 states between 1971-75, 20 states between 1976-80, and the remainder after 1980. *See* Huddleston, *supra* note 3, at 33 n.1.

Moreover, almost every state has wrestled with challenges to its statute's constitutionality. *See, e.g.*, City of Tucson v. Corbin, 623 P.2d 1239 (Ariz. Ct. App. 1980); Denver Urb. Renewal Auth. v. Byrne, 618 P.2d 1374 (Colo. 1980); State v. Miami Beach Redev. Agency, 392 So.2d 875 (Fla. 1980); People *ex rel*. Canton v. Crouch, 403 N.E.2d 242 (Ill. 1980); South Bend Pub. Transp. Corp. v. City of South Bend, 428 N.E.2d 217 (Ind. 1981); Richards v. City of Muscatine, 237 N.W.2d 48 (Iowa 1975); State *ex rel*. Schneider v. City of Topeka, 605 P.2d 556 (Kan. 1980); Miller v. Covington Dev. Auth., 539 S.W.2d 1 (Ky. 1976); City of Minneapolis v. Wurtele, 291 N.W.2d 386 (Minn. 1980); R.E. Short Co. v. City of Minneapolis, 269 N.W.2d 331 (Minn. 1978); City of Sparks v. Best, 605 P.2d 638 (Nev. 1980); Meierhenry v. City of Huron, 354 N.W.2d 171 (S.D. 1984); Metro. Dev. & Hous. Agency v. Leech, 591 S.W.2d 427 (Tenn. 1979); Salt Lake County v. Murray City Redev., 598 P.2d 1339 (Utah 1979); Tribe v. Salt Lake City Corp., 540 P.2d 499 (Utah 1975); Sigma Tau Gamma Fraternity House Corp. v. City of Menomonie, 288 N.W.2d 85 (Wis. 1980).

26. *See* Huddleston, *supra* note 3, at 29.

Thus, as federal funding for public urban renewal projects has declined, TIF has become the primary replacement for such programs.[27]

The California constitution required, as do most state constitutions, enabling legislation to authorize the TIF law.[28] Subsequent challenges to the law's constitutionality were unsuccessful,[29] although California courts have invalidated particular attempted uses of TIF.[30] Only later, after the suspension of federal community development grants,[31] did local governments take control of redevelopment financing[32] and begin to utilize TIF to finance entire projects.[33]

A. Mechanics of a TIF Project

The idea behind TIF is simple and elegant, and most states follow a standard procedure under their TIF statutes.[34] Once a TIF statute is enacted, a municipality declares a redevelopment district and prepares a redevelopment plan for the district that includes construction of, for example, an office complex or other commercial, industrial or residential development.[35] The report must also declare boundaries for the proposed project area, the cost of land acquisition, and the cost of the improvements.[36] These expenditures on basic land development serve to make the project more attractive to private developers.[37]

A municipality usually issues bonds,[38] generally tax-exempt for TIF

27. *See id.*

28. *See* Mandelker, *supra* note 17, at 15.

29. *See, e.g., In re* Bunker Hill Urban Renewal Project, 389 P.2d 539 (Cal. 1964) (holding, *inter alia*, that clearance and redevelopment of blighted areas are public uses and that redevelopment statute is not unconstitutional); Redevelopment Agency v. Malaki, 216 Cal. App. 2d 480 (Cal. Dist. Ct. App. 1963) (same).

30. *See, e.g.,* Regus v. City of Baldwin Park, 70 Cal. App. 3d 968 (Cal. Ct. App. 1977) (holding that no evidence in the record supported conclusion that the project area, consisting of two noncontiguous sites located more than a mile apart, was a blighted area and hence eligible for redevelopment, that project area was required to be blighted when considered as a whole, and that to include both sites only for purposes of raising enough money for the entire project was impermissible); Sweetwater Valley Civic Ass'n v. National City, 555 P.2d 1099 (Cal. 1976) (holding that proposed redevelopment site was not blighted even though it did have drainage and soil problems).

31. *See* Davidson, *supra* note 19, at 406 n.7. These funds, which authorized assistance to local governments, were impounded for eighteen months prior to the enactment of the Housing and Community Development Act in August, 1974. *See id.*

32. *See id.* at 406.

33. *See id.*

34. For a list of selected state statutes, see *supra* note 25.

35. *See* Davidson, *supra* note 19, at 407.

36. *See* Reece & Coyle, *supra* note 3, at 538.

37. *See* Dudley, *supra* note 2, at 78.

38. This is not always the case. In some states, a special fund is created directly and no bonds are

projects,[39] to pay the costs of the project, whether those costs are merely for land clearance or are to prepare for the private developer.[40] Of principal importance, the report must demonstrate that the proposed project area meets certain statutory criteria for a finding of "blight"[41] under the TIF statute.[42] Further, most statutes require a finding that "private initiatives are unlikely to alleviate these conditions without substantial public assistance."[43]

Typically, statutes require the municipality to hold public hearings to allow comment on the proposed project.[44] Following the public hearing, the redevelopment commission votes on whether to approve the project.[45]

Once the TIF project is approved, property tax assessments in the project area are "frozen," and existing recipients of that property tax money are guaranteed to receive all taxes levied on these assessments for the duration of the project.[46] This simply means that those entities (usually schools) that received the property tax money before the project will continue to receive the same amount of money for the duration of the project. The property owner pays all taxes due on the property based on its actual value,[47] however, and all revenues from any increases in tax assessments that occur because of the

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issued. The end result is the same: the incremental property tax revenues are used to repay the debt from the project whether incurred through bonds or otherwise. *See* Davidson, *supra* note 19, at 408.

39. See *infra* Part II.B.4 for a discussion of the implications for TIF of the Tax Reform Act of 1986.

40. *See* MANDELKER ET AL., *supra* note 3, at 290.

41. In order for a city or municipality to take private property by eminent domain, the city must have a valid public purpose. *See* U.S. CONST. amend. V; *see also* Dudley, *supra* note 2, at 88. The use of TIF does not affect the public purpose of the project—it must be an acceptable public purpose under the state constitution. *See* Mandelker, *supra* note 17, at 15. Generally, courts find that the redevelopment of a blighted area in itself is a proper public purpose. *See id.* at 16. If the TIF statute is not limited to blighted areas, however, then the economic development objectives of the project must be for some other proper public use. *See id.* In this vein, Professor Mandelker notes that detailed legislative findings supporting the public purpose of particular economic development legislation, including TIF legislation, are essential, as courts give "considerable attention" to such findings when considering the constitutionality of the legislation. *Id.* at 20.

42. *See* Reece & Coyle, *supra* note 3; *see also infra* Part II.B.1 for a discussion of what qualifies as "blight" in Missouri.

43. *See* Davidson, *supra* note 19, at 409. The establishment of a TIF district by the municipality reflects two assumptions underlying the use of TIF for redevelopment. First, the community has concluded that "property values in the area would remain static or decline without public intervention," and second, "increases in land values and assessments in the project area are *caused by* the redevelopment authority's own promotion of economic activity in the district." *Id.* at 409-10. These assumptions are of significant importance in the projects discussed in Part I. It is not clear that this "but for" assumption of the need for redevelopment is met in either case.

44. *See* Reece & Coyle, *supra* note 3, at 538; *see also* MO. REV. STAT. § 99.830.1 (1994); *infra* note 61.

45. *See* Reece & Coyle, *supra* note 3, at 538.

46. *See* MANDELKER ET AL., *supra* note 3, at 290.

47. *See* Dudley, *supra* note 2, at 77.

redevelopment ("tax increments") are used to repay the bonds issued to fund the project.[48] When all of the municipality's costs have been paid, or the bonds are retired, the TIF district's tax assessments are unfrozen and all taxing districts receive increased revenues from the redeveloped land.[49]

B. TIF In Missouri

1. Required Findings

Missouri's Real Property Tax Increment Allocation Redevelopment Act[50] is a typical TIF statute. The statute defines "blighted area" as:

> An area which, by reason of the predominance of defective or inadequate street layout, unsanitary or unsafe conditions, deterioration of site improvements, improper subdivision or obsolete platting, the existence of conditions which endanger life or property by fire and other causes, or any combination of such factors, retards the provision of housing accommodations or constitutes an economic or social liability or a menace to the public health, safety, morals, or welfare in its present condition and use.[51]

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48. *See id.* For an example of the calculation of a "tax increment," and how the funds are allocated between the project and the existing tax recipients, see Forgey, *supra* note 25, at 32.

49. *See* Dudley, *supra* note 2, at 77. Thus, the success, and indeed, justification, of TIF as a redevelopment tool depends on the assumptions discussed *supra* at note 43. On its face, and in the short time of a single tax year, the diversion of the increments from the increased property taxes apparently subsidizes the project area. If these assumptions are met, however; that is, if the area truly is blighted and would not have received the development and the increased property value *but for* the redevelopment, then the increment is due solely to the redevelopment, and the tax funds represent money that would not have been available otherwise. Therefore, in the long-term, under these assumptions, the affected taxing districts and citizens of the municipality gain from the increased value brought by the redevelopment. *See* Davidson, *supra* note 19, at 411.

50. MO. REV. STAT. § 99.800-.865 (1994 and Supp. 1998).

51. MO. REV. STAT. § 99.805.1 (1994). Representative Levin introduced a bill in the Missouri Legislature in 1998 that would further require that "[p]roof of whether an area is a blighted area shall be shown by clear and convincing evidence." H.B. 1486, 89th Leg., 2nd Reg. Sess. (Mo. 1997). The proposal, however, contains no criteria as to the establishment of "clear and convincing" evidence. *See id.*

Representative Rizzo, on the other hand, introduced a bill with a more comprehensive revision of "blighted area." In addition to the above definition, Representative Rizzo would require satisfaction of either (a) or (b) below:

> a. The area has the following characteristics:
>
> > (a) It is one of pervasive poverty, unemployment and general distress;
> >
> > (b) At least sixty-five percent of the residents living in the area have incomes below eighty percent of the median income of all residents within the state of Missouri according to the last decennial census or other appropriate source as approved by the director; and

The statute requires a finding, under the redevelopment plan adopted by the municipality, that the redevelopment area as a whole is blighted,[52] a conservation area,[53] or an economic development area.[54] Further, the

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> (c) The level of unemployment of persons . . . within the area exceeds one and one-half times the average rate of unemployment of the state of Missouri over the previous twelve months, or the percentage of area residents employed on a full-time basis is less than fifty percent of the statewide percentage of residents employed on a full-time basis; or
>
> b. The area is characterized by the following physical or economic conditions;
>
> (a) Buildings in the area are unsafe or unhealthy for persons to live or work in. This may be caused by such factors as serious building code violations, dilapidation and deterioration, defective design, or faulty or inadequate utilities; or
>
> (b) Depreciated or stagnant property values or impaired investments; or
>
> (c) There are abnormally high business vacancies, abnormally low lease rates, high turnover rates, abandoned buildings or excessive vacant lots; or
>
> (d) A high crime rate that constitutes a serious threat to the public safety and welfare; or
>
> (e) Vacant land that is without one or more industrial, commercial or residential buildings or is, prior to being designated as part of a redevelopment area, subject to chronic flooding which adversely affects real property in the area.

H.B. 131, 89th Leg., 1st Reg. Sess. (Mo. 1997). The Missouri Legislature, however, did not pass any of these intiatives.

52. *See supra* note 51 and accompanying text.

53. *See* MO. REV. STAT. § 99.805.2 (1994). A "conservation area" is an area within the boundaries of the redevelopment area in which fifty percent or more of the structures in the area have an age of thirty-five years or more, although such an area is not yet a blighted area. In addition to building age, the area must be detrimental to the public health, safety, morals, or welfare and be likely to become a blighted area

> . . . because of any one or more of the following factors: dilapidation; obsolescence; deterioration; illegal use of individual structures; presence of structures below minimum code standards; abandonment; excessive vacancies; overcrowding of structures and community facilities; lack of ventilation, light or sanitary facilities; inadequate utilities; excessive land coverage; deleterious land use or layout, depreciation of physical maintenance; and lack of community planning.

Id. § 99.805.2. The statute notes that the area must meet at least three of the above factors in order to be a conservation area. *See id.* The statute is arguably ambiguous, however, as to what finding would be necessary to declare a conservation area. The first sentence of section three seems to stand on its own; a building must only be thirty-five years old in order to be declared a conservation area. Logically, however, it would seem as though the other factors would also need to be present in order for a true need for redevelopment to arise. *See id.*

The text, in requiring three of the factors to be present, seems to assume that those factors will be present in any area in which fifty percent of the buildings are over thirty-five years old. On the other hand, many cities have older, well-maintained neighborhoods that add to the value of the land, not detract from it. Therefore, it would seem to be necessary that the factors tending toward blight would also be present. *See id.*

54. *See* MO. REV. STAT. § 99.805.5(a)-(c) (1994). An economic development area does not meet the requirements for a blighted area or a conservation area, but requires a finding by the municipality that redevelopment will not be solely used for development of commercial businesses that unfairly compete in the local economy. Further, the economic development area must be in the public interest because it either discourages "commerce, industry or manufacturing" from leaving the state, results in increased employment in the municipality, or results in "preservation or enhancement" of the tax base of the municipality. *Id.*

TIF may only be used in an economic development area to fund highways, roads, streets, bridges, sewers, traffic control systems and devices, water distribution and supply systems, and curbing and sidewalks. TIF may not be used within an economic development area to fund buildings. *See id.*

redevelopment commission must find that, in addition to being a blighted area, a conservation area, or an economic development area, the area "has not been subject to growth and development through investment by private enterprise and would not reasonably be anticipated to be developed without the adoption of tax increment financing."[55] These findings must include a detailed description of the factors that qualify the land for redevelopment under the statute.[56]

The redevelopment project must be completed and the bonds retired within twenty-three years after the adoption of the ordinance approving the project.[57] In addition, the redevelopment plan must include a cost-benefit analysis of the economic impact of the plan on the taxing districts involved, as well as a statement as to the economic effect of building or not building it.[58]

The plan must give a general description of the program, the estimated cost of redevelopment, the sources of funds to pay for the project, the terms of those sources, the most recent assessed value of the property, the use of the land upon completion of the project, and its estimated value upon completion of the project.[59]

2. *Public Disclosure*

The TIF commission must hold a public hearing prior to the adoption of a redevelopment plan or project,[60] and notice of the hearing must be given by

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§ 99.825.2.

55. MO. REV. STAT. § 99.810.1 (1994). This is the "but for" assumption noted by Davidson. *See supra* note 43 and accompanying text.

56. *See* MO. REV. STAT. § 99.810 (1994). Under section 99.810.2, the redevelopment plan must conform to the comprehensive plan for the development of the municipality as a whole. *See id.* § 99.810.2. The ambiguity of the TIF statute again takes its toll here, however. Olivette recently changed its comprehensive plan to allow commercial development and to change the zoning of the area so that a proposed redevelopment area would fall under the technical requirements of the statute. *See* Levy, *supra* note 4. It is not argued that a municipality should *never* change its comprehensive plan, but instead that the logical order would be to change the plan because it was in the best interest of the community and then to decide on a redevelopment initiative. In the case of Olivette, the private developer approached the municipality with a proposal for a new retail development, and this prompted the city to change its comprehensive plan to include just this sort of commercial development.

57. *See* MO. REV. STAT. § 99.810.3 (1994). In addition, the ordinance approving the redevelopment plan must be approved within ten years of the adoption of the redevelopment project, and no property may be taken by eminent domain later than five years from the adoption of the ordinance approving the project. *See id.*

58. *See* MO. REV. STAT. § 99.810.5 (1994 & Supp. 1998). Notably, however, the statute does not require a comparative analysis of alternative projects.

59. *See id.* § 99.810.

60. *See* MO. REV. STAT. § 99.825.1 (1994).

publication and mailing.[61] At the public hearing, any interested party may file written objections to or comments on the proposed plan or may comment orally.[62]

After the public hearing, changes can be made to the redevelopment plan without further hearing, provided those changes do not enlarge the boundaries of the redevelopment area, affect the general proposed land use, or materially change the nature of the project. Further, each taxing district must receive written notice of the proposed change and the proposed change must be published.[63]

3. *Repayment of Bonds*

When the value of a redeveloped parcel of property exceeds its initial assessed, "frozen" value, the municipality allocates the portion of the tax revenue attributable to the initial value of the property to the appropriate taxing districts, in the amount they would have received had the project not been undertaken.[64]

The incremental increase in revenues from the property, "payment in lieu of taxes" ("PILOTS"), is paid to the municipal treasurer who deposits the payments in a "Special Allocation Fund." The purpose of the Special Allocation Fund is to repay the debt incurred during the redevelopment project.[65] In addition, fifty percent of the incremental revenue from taxes generated by economic activities, "economic activity taxes" ("EAT"), within the redevelopment area, as measured against the economic activity taxes from the previous year, may be allocated to the Special Allocation Fund and used to retire bonds.[66]

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61. *See id.* § 99.830.1. Notice by publication must be given at least twice, with the first publication not more than thirty days, and the second publication not more than ten days prior to the hearing. Notice must be published in a "newspaper of general circulation in the area of the proposed redevelopment." *Id.* Notices must be sent by certified mail to all persons who paid general property taxes on each parcel of property located within the redevelopment area. *See id.* The notices issued must include the following: the time and place of the public hearing, the boundaries of the proposed project, a statement that all interested parties may attend the public hearing and be heard, and a description of the proposed project and a location where the entire proposal may be viewed. *See id.* § 99.830.2(1)-(4).

62. *See* MO. REV. STAT. § 99.825.1 (1994).

63. *See id.* § 99.825.1.

64. *See* MO. REV. STAT. § 99.845.1(1) (1994 & Supp. 1998).

65. *See id.* § 99.845.1(2).

66. *See id.* § 99.845.3. This excludes personal property taxes, taxes imposed on sales or charges for hotel guests, taxes imposed on public transportation. *See id.* These revenues are paid into a "separate segregated account within the special allocation fund." *Id.*

A municipality may secure tax increment bonds with the money in the Special Allocation Fund and may retire those obligations with that revenue.[67] The bonds bear interest as determined by the municipality,[68] and the bonds may mature at any time up to twenty-three years from the date of issuance.[69]

Although Missouri's TIF statute is closely modeled after the Illinois statute, Missouri's statute does not authorize municipalities to issue debt secured by the full faith and credit of the city or the state.[70] The Illinois statute contains such a provision.[71]

The Missouri statute allows revenue bonds to be issued, secured by the revenue of the redevelopment project, and for a mortgage on all or part of the project.[72] Finally, the Missouri statute contains the important disclaimer:

> Neither the municipality, its duly authorized commission, the commissioners or the officers of a municipality nor any person executing any obligation shall be personally liable for such obligation by reason of the issuance thereof. The obligations issued pursuant to sections 99.800 to 99.865 shall not be a general obligation of the municipality, county, state of Missouri, or any political subdivision thereof, nor in any event shall such obligation be payable out of any funds or properties other than those specifically pledged as security therefor. *The obligations shall not constitute indebtedness within the meaning of any constitutional, statutory or charter debt limitation or restriction*.[73]

4. Tax Reform Act of 1986

Prior to 1986, municipalities generally financed redevelopment projects through tax-exempt bonds.[74] The tax-exempt status of municipal bonds has

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67. *See* MO. REV. STAT. § 99.835.1 (1994).

68. *See id.* § 99.835.3; *see also infra* Part II.B.4, discussing the implications of the Tax Reform Act of 1986 on the tax-exempt status of tax increment bonds and the importance of tax-exempt status for interest on the bonds.

69. *See* MO. REV. STAT. § 99.835.3 (1994).

70. *See* Dudley, *supra* note 2, at 82.

71. *See* 65 ILL. COMP. STAT. 5/11-74.4-1 (West 1993).

72. *See* MO. REV. STAT. § 99.835.2 (1994); *see also* Dudley, *supra* note 2, at 82.

73. MO. REV. STAT. § 99.835.5 (1994) (emphasis added); *see also supra* notes 70-71 and accompanying text; *infra* Part III.

74. *See* Catherine Michel, *Brother, Can You Spare a Dime: Tax Increment Financing in Indiana*, 71 IND. L.J. 457, 461 (1996). Municipal bonds typically fall into two categories: general obligation bonds, which are secured by the full faith, credit, and taxing power of the government, and revenue or special fund bonds, which are secured by the revenues or receipts of a project or a special fund. Revenue bonds are not backed by the full faith and credit of the government. TIF bonds fall into this second

been an important contributor to the growth of municipal borrowing.[75] Interest on these municipal bonds had always been tax-exempt.[76] The Tax Reform Act of 1986 (the Act),[77] however, placed limitations on tax-exempt municipal bonds, making it more difficult to qualify the interest on those bonds as tax-exempt.[78] In turn, this affected the interest rates that municipalities had to offer in order to make their bonds attractive to investors.[79]

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category. *See* MANDELKER ET AL., *supra* note 3, at 353. Further, investors who buy revenue bonds typically demand a higher rate of return since those bonds are riskier. *See id.*

75. *See* MANDELKER ET AL., *supra* note 3, at 353. Those who buy bonds issued by state or local governments do not have to pay income tax on the interest generated by those bonds. *See id; see also* McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819); Marbury v. Madison, 5 U.S. (1 Cranch) 137 (1803); I.R.C. § 103 (1994).

Typically, the largest holders of these bonds are commercial banks and insurance companies. The income tax exemption benefits wealthy investors, however. For example, on a taxable $100,000 investment with a ten percent rate of return, that is, $10,000 per year, a bond-holder in the twenty-eight percent tax bracket would normally incur $2,800 of tax liability. On a tax-exempt bond, however, the full $10,000 is realized. *See* MANDELKER ET AL., *supra* note 3, at 353. Thus, a rational, profit-maximizing bond-holder would be willing to accept a lower interest rate on that bond, which saves the local government money.

This differential between the lower rate of interest paid on a tax-exempt municipal bond and the higher rate of interest on a taxable bond is known as a "putative" tax. *See* WILLIAM A. KLEIN & JOSEPH BANKMAN, FEDERAL INCOME TAXATION 263 (11th ed. 1997). A bond holder would be just as satisfied with a 7.8% return on the tax-exempt bond as he or she would on the 10% non-tax-exempt bond. This, in turn, increases the attractiveness to municipalities of issuing debt, the municipalities issue more debt, and investors spend more money buying municipal bonds. This results, however, in a loss of revenue for the federal government (in the form of the putative tax), thus prompting tax reform. *See id.* at 264. The Treasury estimated the loss of federal revenue at $3.2 billion in 1981 and $4.2 billion in 1982 as a result of private activity tax-exempt bonds outstanding in those years. *See* MANDELKER ET AL., *supra* note 3, at 377 (citing Conference Committee on the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA)). It is important to note, however, that this putative tax, or flow of money from the federal government to state governments, only raises equity concerns when purchasers of tax-exempt bonds have marginal tax rates higher than the spread between the tax-exempt and the taxable rate. When this occurs, investors can save money by investing in tax-exempt bonds and paying the putative tax rather than the actual one. *See* KLEIN & BLANKMAN, *supra*, at 264.

76. *See* Michael A. Livingston, *Reform or Revolution? Tax-Exempt Bonds, The Legislative Process, and the Meaning of Tax Reform*, 22 U.C. DAVIS L. REV. 1165, 1170 (1989) (noting that "[i]nterest on state and local obligations has been tax-exempt since the original income tax was enacted in 1913."). The distinction between bonds that were tax-exempt and those that were taxable arose from abuses in private business borrowing. During the Depression, companies borrowed from the government merely to avoid paying the higher interest that resulted when the bonds were not tax-exempt, and therefore, the municipality issuing the bonds was merely a funnel for the money and was being used to finance only private development. *See id.*

77. Pub. L. No. 99-514, 100 Stat. 2085 (1986).

78. *See* Michel, *supra* note 74.

79. *See* David E. Cardwell & Harold R. Bucholtz, *Tax-Exempt Redevelopment Financing in Florida*, 20 STETSON L. REV. 667, 681 (1991). If investors had to pay income tax on the interest they received from the bonds, they would require a higher rate of return on the bonds to cover the opportunity cost of not pursuing other investments. This, in turn, would raise the cost of the project to the city. If the interest is not tax-exempt, the municipality could pay as much as one or two percent more on the bonds. Over a twenty-year period, this could result in as much as $2,000,000 more in interest on a $10,000,000

Tax increment bonds, called qualified redevelopment bonds under the Act, are tax-exempt private activity bonds,[80] and are therefore subject to the volume

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debt. *See id.* at 680-81.

80. Prior to the Tax Reform Act, almost all government bonds fell into two categories: industrial development bonds ("IDBs") and non-industrial development bonds ("non-IDBs"). *See* Cardwell & Bucholtz, *supra* note 79, at 681. Non-IDBs financed projects that benefited the general public, and IDBs financed projects that benefited only a few private parties. Non-IDBs were tax-exempt, while IDBs were not. *See id.*

Whether a particular bond is either an IBD or a non-IBD turned on the administration of two tests: the "trade or business" test, which focused on the type of entity that was to use the funds, and the "security interest" test, which focused on the method of bond repayment or how their repayment was secured. *See* Livingston, *supra* note 76, at 1174.

A bond fulfilled the trade or business test if it was "issued as part of an issue all or a major portion of the proceeds of which [were] to be used directly or indirectly in any trade or business carried on by any person who [was] not an exempt person." Cardwell & Bucholtz, *supra* note 79, at 681. Any bond "passing" this test was an IDB. *See id; see also* Livingston, *supra* note 76, at 1174.

A bond fulfilled the "security interest" test if the payment of the principal or interest was, in whole or major part:

> (i) secured by any interest in property used or to be used in a trade or business or in payments in respect of such property, or
>
> (ii) to be derived from payments in respect of property, or borrowed money, used or to be used in a trade or business.

I.R.C. § 103(b)(2)(B) (1994)*; see also* MANDELKER ET AL., *supra* note 3 (discussing the security interest test).

Congress first adopted these two tests in 1968. These tests have since had a significant impact on the structure of new tax legislation in two ways. *See* Livingston, *supra* note 76, at 1174. First, this legislation used a "double negative" structure, in that state and local bonds were presumptively tax-exempt unless they met one of the two above tests. Second, the legislation created exceptions for certain projects that, while meeting either the business test or the security interest text, could nonetheless be financed using tax-exempt non-IDB bonds. *See id.* at 1175-76.

In 1986, with the passage of the Tax Reform Act, the designations of the bond categories changed. Bonds still fall into one of two categories: "private activity bonds" or "non-private activity bonds." *See* Cardwell & Bucholtz, *supra* note 79, at 681. The former "trade or business" test is now the "private business use" test, and the "security interest test" is now the "private security or payment test". *See id.* at 682; *see also* I.R.C. § 141(b)(1), (2) (1994); MANDELKER ET AL., *supra* note 3, at 380. Almost all of the new provisions in 1986 made it harder to use tax-exempt financing, particularly for private activities. *See* Livingston, *supra* note 76, at 1206. The Act reduced allowable private activity bonds to a maximum of the greater of fifty dollars per capita or $150 million for an entire state. This limitation applies to all types of private activity bonds. *See id.* This includes tax increment bonds, which are classified as qualified redevelopment bonds. Tax increment bonds were previously exempt from any limits. *See id.*

In addition, more bonds now fall into the category of "private activity" bonds. *See id.* at 1207. This is the case because under the old law, up to 25% of the amount of the bond issue was eligible for private use before the bond was technically a private activity bond. *See id.* After the Tax Reform Act of 1986, a bond is a private activity bond if, under the "use" test, any private business will use more than ten percent of the proceeds of the project. *See id.; see also* I.R.C. § 141(b)(6)(A). "Use" does not include use as a member of the general public. *See* Livingston, *supra* note 76, at 1207.

Under the "security interest" test, if more than ten percent of the principal or interest on the bonds is repaid from, or secured by, a private business or private money, then the bond is a private activity bond. *See id.* In addition, under the act, either "direct or indirect" repayment satisfies the security interest test. *See id.* Therefore, ". . . private activity bonds include bonds that are economically, even if not legally, repaid by a private business." *Id.* The net effect of the Act, then, in addition to lowering the volume limit limitation.[81] Further, under the Act, TIF bonds must apply ninety-five percent of their proceeds to redevelop a blighted area and must be secured by "incremental or general tax revenues of the issuing governmental unit."[82]

TIF bonds must be issued under state enabling legislation and with a redevelopment plan approved by the municipality.[83] The redevelopment plan must define a blighted area based on "state statutory criteria which take into account all relevant factors and contain affirmative findings of a substantial presence of these factors."[84] No more than twenty percent of the assessed value of all real property in the municipality may be declared blighted. Further, any particular blighted area must be at least "100 compact and contiguous acres" or between ten and one hundred compact acres with no more than twenty-five percent of the bond-financed land provided by any one person or related persons.[85]

III. ANALYSIS

The adoption of TIF statutes has raised a number of issues, including equal protection for taxpayers and affected districts,[86] improper delegation of

on private activity bonds, was to make it ". . . significantly more difficult to avoid these limits." *Id.*

81. *See* MANDELKER ET AL., *supra* note 3, at 301.

82. *Id.*

83. *See id.*

84. *See id.* (internal quotations omitted).

85. *See id.* For a general discussion of whether these requirements represent an appropriate response on the part of the federal government to a loss of revenue or an "inappropriate federal intrusion into local and state prerogatives," see *id.* at Chapter 8.

86. Commentators have challenged TIF statutes on the basis that they unfairly benefit developers and those within the redevelopment area to the detriment of those outside the redevelopment area. *See* Davidson, *supra* note 19, at 431. Courts, however, generally consider the overriding public purpose of removal of blight as outweighing any slight advantage to those within the redevelopment area. *See, e.g.,* Richards v. City of Muscatine, 237 N.W.2d 48, 59-60 (Iowa 1975); Short v. City of Minneapolis, 269 N.W.2d 331, 338-40 (Minn. 1978); Tribe v. Salt Lake City Corp., 530 P.2d 499, 503-04 (Utah 1975).

Furthermore, proponents argue, residents outside of the redevelopment area are not deprived of tax revenues because only the incremental increase in property value is used to retire the debts of the redevelopment project. *See* Davidson, *supra* note 19, at 432. This again implicates the underlying assumption that the increase in value of the land would not appear *but for* the redevelopment.

Assuming the project has a rational basis, and because the redevelopment project is considered to benefit the community *as a whole,* a TIF project can overcome constitutional objections of unfair treatment of those outside of the project area. *See* Davidson, *supra* note 19, at 432. A court generally will not second-guess the judgment of a municipal government without a showing of significant procedural defect or arbitrary and capricious conduct. *See* Berman v. Parker, 348 U.S. 26 (1954).

Missouri courts generally follow this Supreme Court guidance and hold that the clearing of blight in itself is a public use and the selling of land to a private interest is irrelevant. *See* Dudley, *supra* note 2, at 96; *see also* Dalton v. Land Clearance for Redev. of Kansas City, 270 S.W.2d 44 (Mo. 1954). Courts generally accept a legislative declaration of public purpose as conclusive unless such finding was arbitrary authority to the redevelopment commission,[87] constitutional debt limitation exceptions, finding of public purpose, and overly broad blight definitions. The next section addresses TIF debt with respect to state constitutional debt limitations.

A. Constitutional Debt Limitations

State and local governments face an inherent conflict when they act under a TIF statute between the goal of eradicating blight and the goal of allowing the public to voice its opinion on the projects and, therefore, the debts that the municipality undertakes.[88] Tax increment financing allows a municipality to act without accountability to voters.[89] Moreover, when a legislature gives municipal governments little guidance on projects, and when these projects do not garner much public attention, the potential for abuse and corruption increases.[90]

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or induced by fraud, collusion, or bad faith, as shown by clear evidence. *See Dalton,* 270 S.W.2d at 52.

It is also important to note that if the TIF statute does not require a finding of blight; that is, an economic development area may receive TIF funds, the court must be able to find that the economic development purpose fulfills a valid public purpose. *See* Mandelker, *supra* note 17, at 16; *see also* Meierhenry v. City of Huron, 354 N.W.2d 171 (S.D. 1984). Professor Mandelker further notes that detailed legislative findings on the public purpose of an economic development project will improve the chance that a court will hold favorably as to the public purpose of a project, as courts generally grant deference to such findings. *See* Mandelker, *supra* note 17, at 20.

87. In the TIF context, some have argued that by permitting a redevelopment authority to issue bonds and incur debt, the legislature is improperly delegating its taxing authority. *See* Joseph F. Luther, *Tax Increment Financing: Municipalities Avoiding Voter Accountability,* 1987 DET. C.L. REV. 89, 115.

For example, Kentucky declared its TIF statute unconstitutional on these grounds. *See* Miller v. Covington Dev. Auth., 539 S.W.2d 1 (Ky. 1976). The court held that the statute granted too much authority to redevelopment authorities. *See id.* at 5.

Other courts, including those in Missouri, have rejected this argument in deciding that the redevelopment agency's power is delegated directly by the state legislature. *See In re* Bunker Hill Urban Renewal Project, 389 P.2d 538 (Cal. 1964). Because the agency's power is derived from the state, the collection of TIF revenue becomes a state concern. Therefore, TIF is not bound by home rule limitations, which would implicate some rights for the affected taxing districts during the approval and allocation of TIF projects. *See* Davidson, *supra* note 19, at 436-37.

Utah courts have found that the eradication of blight is a state concern and therefore the establishment of a redevelopment agency with quasi-municipal state corporation is constitutional. *See Tribe,* 540 P.2d at 502-03. The dissent in *Tribe*, however, highlighted the possible dangers in "creatively" defining the nature of a redevelopment authority in order to grant it discretion in TIF matters. The dissent expressed concern that the uncontrolled discretion on the part of the redevelopment agency, combined with a vague definition of "blight" and inadequate criteria and oversight in the establishment of TIF districts, could lead to abuses of discretion on the part of the redevelopment agency, or at the least, a lack of concern for all economic impacts of large TIF projects. *Id.* at 507-15; *see also* Davidson, *supra* note 19, at 437.

88. *See* Luther, *supra* note 87, at 116.

89. *See id.* Luther notes that "[s]erious fundamental problems arise, however, when all the branches of government decide that the public is best served by not having a voice in municipal activities. Elimination of voter accountability is the inherent defect in tax increment financing." *Id.*

90. *See id.*

Local governments may take advantage of voters' lack of power and continue to abuse their discretion, until, after a series of such abuses, voters take notice of the abuse. This may be when it is too late, however, because projects have already been built that voters might not have approved. Voters might have chosen to keep their homes rather than selling to make way for another big-box development that lends no unique aspect to the city.[91]

All states have limits on municipal debt in either constitutional or statutory form.[92] Further, nearly all states have provisions requiring approval by referendum for general obligation long-term municipal debt.[93] Therefore, unless the municipality can circumvent the debt limitation[94] by convincing a court that the debt falls outside the limitation, a debt will violate one of these two restrictions unless either the amount of the restriction, combined with all other municipal debt obligations, does not exceed the local limit, or voter approval to exceed the limit has been obtained.[95]

When a municipality issues bonds that it will repay with incremental tax revenue, the credit of the municipality is implicated through its pledge to repay the bonds at a specified rate of interest after a certain length of time.[96] Therefore, even in states such as Missouri, where the TIF statute specifies that the TIF debt incurred is not considered a debt of the city, courts may hold

91. *See supra* Part I. Again, this argument is not that there are *no* benefits to TIF, just that the statute, as currently written, allows for abuses that violate the spirit of the law.

92. *See* MANDELKER ET AL., *supra* note 3, at 386.

93. *See id.*

94. One of the most common methods of avoiding constitutional debt limitations, and the one implicated in TIF issues, is the Special Fund Doctrine. Under this principle, debt that is retired from revenues other than general tax revenues, e.g., general project revenues, is not subject to municipal debt limitations. These debts are not considered under debt limit provisions because they are not considered to commit the full faith and credit of the municipality. For example, some municipal debt is financed through a special assessment on real property. Even though bonds may be issued to pay the short-term costs of the project, the bonds are retired solely through revenues from the special assessment on the property involved. *See* MANDELKER ET AL., *supra* note 3, at 402. This applies to projects financed through the use of TIF, because the increments generated through the increased property taxes are funneled into a "special fund" used to retire the bonds. *See supra* Part II.

The difference with TIF, however, is that no matter how the funds are channeled, they are still tax revenue, and are not generated through any sort of special assessment. *See Richards,* 237 N.W.2d at 57. The court noted that if the bonds were repayable from the general revenue of the city, the constitutional debt limit would be implicated. The simple fact that the TIF statute carved out just a portion of the city's revenues and limited the city's liability to those revenues is irrelevant. "If the result were otherwise, a city could divide its general revenues into several special funds, each with a bond issue restricted to recourse against its own fund—and thus commit large portions of the city's revenues without regard to [the constitutional debt limitation which] . . . could thus be virtually nullified." *Id.* at 64.

95. *See* MANDELKER ET AL., *supra* note 3, at 387.

96. *See* Davidson, *supra* note 19, at 438.

otherwise.[97] The crux of the issue centers around whether the commitment of a municipality's taxing power implicates the credit of the city, which would require TIF to remain under constitutional debt limitations.[98] Whether the implication of the municipality's taxing power is formal or informal, the concern has always been a municipality's ability to repay its obligations out of speculative future revenues.[99]

1. *Missouri Constitutional Debt Limitation Provision*

Missouri is no exception to the general rule. Under the Missouri Constitution,[100] voter approval is required if a municipality wants to use tax revenues to retire debt it incurs in excess of its income and revenue for the year.[101] If the debt is not repaid by tax revenue, it is not a municipal debt.[102] Tax increment bonds, repaid from the property tax increment generated by a redevelopment project, are repaid through taxation. If a court accepts, as Missouri courts have, that the redevelopment agency is *not* an independent agency, but rather an arm of the state or municipality, then this finding, coupled with the expenditure of property tax revenue for the retirement of the bonds, would seem to implicate the Missouri constitutional debt limitation.

Because the purpose of a constitutional debt limit is to keep a municipal government from financially overextending itself, and because TIF statutes provide few other restrictions, such as voter accountability, on municipal government, state constitutional debt limitations should be implicated.

2. *States that Hold TIF Bonds Subject to Debt Limitations*

State courts are divided on the issue of whether debt incurred through the TIF instrument is truly a debt of the city. Iowa,[103] Arizona,[104] South Dakota,[105]

97. *See id.* Further, it remains unclear exactly what would happen in the case of a municipality defaulting or repaying late on the bonds it issues for a TIF redevelopment. *See id.*

98. *See id.* at 438-39.

99. *See id.* at 439.

100. MO. CONST. art. VI, § 26(a).

101. *See* State *ex rel.* Mitchell v. City of Sikeston, 555 S.W.2d 281 (Mo. 1977). In this case, the proposed payment did not violate constitutional debt restrictions, because the municipality in question was not using tax revenue to retire the debt. *See id.*

102. *See id.* Included in the constitutional limitation, therefore, is debt that is repaid either directly or indirectly "by resort to taxation." *Id.* at 292.

103. *See* Richards v. City of Muscatine, 237 N.W.2d 48 (Iowa 1975). The constitutional provision at issue prohibited a municipality from carrying debt amounting to more than five percent of the value of the taxable property within the municipality. *See* IOWA CONST., art. XI, sec. 3; *see also Richards*, 237

Kentucky,[106] and Wisconsin[107] have all held debt generated from a TIF project to be subject to constitutional debt limits.

a. Iowa

In *Richards v. Muscatine*,[108] the Iowa Supreme Court held that urban renewal bonds did create an indebtedness by the city within the scope of the

N.W.2d 48 at 63. The proposed project would have placed the city $100,000 over its debt limit, if the TIF bonds were considered a "debt" under the constitution. *See id.* at 63-64.

104. *See* City of Tucson v. Corbin, 623 P.2d 1239 (Ariz. 1980). The Arizona constitution requires that bonds issued by a municipality must be approved by property owners. *See* ARIZ. CONST. art. 7, sec. 13. The state TIF statute provided that bonds issued by a municipality were not "a general obligation or general debt of the municipality," and the bonds were not subject to state municipal debt restrictions. *Corbin*, 623 P.2d at 1241; *see also* ARIZ. REV. STAT. § 36-1481B (1993).

The court considered and rejected arguments that the TIF statute provided that the bonds were not general obligations of the city, and that the bonds were retired from a special fund. *See Corbin*, 623 P.2d at 1243. The court stated: "we must look to the transaction for what it is, and not what it is called." *Id.* at 1243. Therefore, the court held, merely funneling tax revenue through a special fund "does not remove these bonds from the category of obligations which must be approved by the voters under [the Arizona] constitution." *Id.* at 1243. The court quoted at length from a Washington Supreme Court opinion in *Washington State Finance Committee v. Martin*, 384 P.2d 833 (Wash. 1963). The court in that case held:

> . . . the true test of [the special fund] . . . is not what comes out of the fund, but what goes into it . . . if the state undertakes or agrees to provide any part of the fund from any general tax, be it excise or ad valorem, then securities issued upon the credit of the fund are likewise issued upon the credit of the state and are in truth debts of the state.

Id. at 842. Therefore, the Arizona court held the voters of the given district must have a vote on the proposed redevelopment plan. *See Corbin*, 623 P.2d at 1245. The court further noted that California amended its state constitution to exempt TIF from its municipal debt limit. Therefore, the voters in California had a vote as to how their cities shouldered debt. *See id.* at 1245.

105. *See* Meierhenry v. City of Huron, 354 N.W.2d 171 (S.D. 1984). The Supreme Court of South Dakota has also held that tax increment bonds issued pursuant to the South Dakota TIF statute are debts within the meaning of the South Dakota constitution. *See id.* at 178; *see also* S.D. CODIFIED LAWS § 11-9-36 (Michie 1994). The statute stated that "[e]ach bond or note shall contain such recitals as are necessary to show that it is only so payable and that it does not constitute a general indebtedness of the municipality or a charge against its general taxing power." *Id.*

The court agreed with the Supreme Court of Arizona and held that the court must look not to the legislature's classification of the bonds, but their true nature. *See Meierhenry*, 354 N.W.2d at 178; *Corbin*, 623 P.2d 1239; *see also supra* note 104; Mettet v. City of Yankton, 25 N.W.2d 460 (S.D. 1946) (holding when only source of payment of bonds was revenue from operation of a bridge, constitutional debt limitation not implicated); Gross v. City of Bowdle, 182 N.W. 629 (S.D. 1921) (holding bonds paid only by funds to be collected from special assessment and not by any general taxes were not an indebtedness within the meaning of the state constitution).

The court, relying on *City of Tucson v. Corbin*, 623 P.2d 1239 (Ariz. 1981), *Richards*, 237 N.W.2d 48 (Iowa 1975), and *Miller v. Covington Development Authority*, 539 S.W.2d 1 (Ky. 1976), held that the indebtedness created through the TIF statute created a debt obligation under the state constitution and was therefore subject to the constitutional debt limitation. *See Meierhenry*, 354 N.W.2d at 179.

106. *See* Miller v. Covington Dev. Auth., 539 S.W.2d 1 (Ky. 1976).

107. *See* City of Hartford v. Kirley, 493 N.W.2d 45 (Wis. 1992).

108. 237 N.W.2d at 65-66.

state constitutional provision.[109] The court observed that the purpose of a constitutional provision limiting the ability of a municipality to incur debt is to "prevent the general taxes of a political subdivision from becoming overburdened by obligations."[110] The court stressed that the reality of the situation was that the "credit" of a city lies in its power to assess general taxes, and that when it pledges part of that power, it *does* pledge its credit and incur an obligation.[111] The court held that only that part of the proposed project which would keep the city's debt within the constitutional limit was permissible.[112]

b. Kentucky

The Kentucky Supreme Court held the Kentucky TIF statute unconstitutional in *Miller v. Covington Development Authority*.[113] The court observed that the mayor appointed members of the redevelopment commission and stressed the important notion that a legislative body should not divest itself of its legislative power. The court held that one reason the Kentucky TIF legislation was unconstitutional was that "[i]t authorize[d] the agency to exercise choices that the people are entitled to have exercised by their elected representatives."[114] The court then held that the incremental *ad valorem* tax revenues, which were to be used to retire the bonds, could not be placed in the category of "special funds."[115] Since the "ad valorem tax is the one tax that is mandatory" under the Kentucky constitution, the court found that tax to be "the ultimate resource of its fiscal integrity."[116] Therefore, any project that uses

109. *Id.*

110. *Id.* at 64.

111. *See id.*; *see also* City of Ottumwa v. City Water Supply Co., 119 F. 315 (8th Cir. 1902); City of Redondo Beach v. Taxpayers, Property Owners, Citizens and Electors of the City of Redondo Beach, 352 P.2d 170 (Cal. 1960) (holding that sales, use, and license taxes were general tax revenues, that those revenues were used to retire bonds, and that bonds were a debt under California constitutional debt limitation clause); Brunk v. City of Des Moines, 291 N.W. 395 (Iowa 1940) (holding bonds payable from fund created by levy of special tax constitute indebtedness under the constitution); Windsor v. City of Des Moines, 81 N.W. 487 (Iowa 1900) (holding that special tax to be levied in the future to pay expenses for electric plant constitutes debt).

112. *See Richards*, 237 N.W.2d at 66. This disallowed just $100,000 of the $800,000 proposed project. *See id.* at 64.

113. 539 S.W.2d 1 (Ky. 1976).

114. *Id.* at 4. The court said: "[i]f there is one essential characteristic inherent in legislative power, it is that such power must be exercised by an elected representative or representatives of the people, and not by a person, persons or agency created or designated by those representatives." *Id.* The court therefore recognized the fundamental flaw of TIF legislation in general: lack of voter accountability.

115. *See id.* at 5.

116. *Id.*

property tax revenue is a debt under the Kentucky constitution.[117]

3. *States Holding TIF Debt Not Subject to Debt Limitations*

In contrast to the states discussed above, several states, including Indiana,[118] Colorado,[119] Florida,[120] Utah,[121] and Missouri, maintain that TIF debt is not subject to municipal debt limitations.[122] These courts typically base their decisions on the formalistic notion that the debt obligation is repaid from a "special fund," and not through tax revenue.[123] This special fund garners its revenue from the TIF project financed by the bonds.[124] The inherent contradiction in this, of course, is that all of the money paid into the "special fund" is generated through the additional *property tax* generated from the redeveloped property.[125]

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117. *See id.*

118. *See* South Bend Pub. Transp. Corp. v. City of South Bend, 428 N.E.2d 217 (Ind. 1981); *see also* IND. CODE § 36-7-14-25. The court held that TIF bonds were not subject to constitutional debt limitations. *See* IND. CONST. art. 13, sec. 1. The Indiana court based its holding on two findings. The court first deferred to the Indiana legislature's power to create special taxing districts, as distinct entities from municipal corporations. Indiana's constitutional debt limitation does not apply to special taxing districts, and so did not apply in the case at bar. *See South Bend Pub. Transp. Corp.*, 428 N.E.2d at 220. Second, the appellants argued that since the TIF bonds ultimately pledged the general taxing power of the municipality, they constitute debt. The court disagreed, noting:

> The Redevelopment Commission can only apply incremental tax revenues which are attributable to increases in the assessed value of taxable property in the Allocation Area to the repayment of the bonds. If the value of property does not increase, the bonds will not be repaid. Therefore, the original taxing power of the municipality will not be changed.

Id. at 221.

119. *See* Denver Urb. Renewal Auth. v. Byrne, 618 P.2d 1374 (Colo. 1980); *see also* COLO. REV. STAT. § 31-25-107(9) (West 1990 & Supp. 1998); COLO. CONST. art. XI, sec. 6 (West 1990). The court based its holding on the fact that:

> The tax allocation structure has been carefully drafted so that there is a direct relationship between the increased valuation of property within the project area, and thus, increased ad valorem tax revenues, and the project financed by the bond issue. Denver has not lost the benefit of any ad valorem tax revenues which would otherwise have been available for its general revenue purposes had the plan never been adopted.

618 P.2d at 1382.

120. *See* Florida v. Miami Beach Redev. Agency, 392 So. 2d 875 (Fla. 1980); *see also* FLA. CONST. art. VII, sec. 12 (West 1995); FLA. STAT. ch. 163.387 (1994).

121. *See* Tribe v. Salt Lake City Corp., 540 P.2d 499 (Utah 1975); *see also* UTAH CONST. art. 14, sec. 3, 4 (Michie 1998); UTAH CODE ANN. § 17a-2-1260 et seq. (1994).

122. *See* Tax Increment Fin. Comm'n v. J.E. Dunn Constr. Co., 781 S.W.2d 70 (Mo. 1989); *see also* MO. CONST. art. VI, sec. 27(b); MO. REV. STAT. § 99.805 (1994).

123. This principle is known as the Special Fund Doctrine. *See* MANDELKER ET AL., *supra* note 3, at 402-04.

124. *See South Bend Pub. Tansp. Corp.*, 428 N.E.2d at 220-21; *J.E. Dunn Constr. Co.*, 781 S.W.2d at 77.

125. *See* Michel, *supra* note 74, at 464-65.

The Missouri Supreme Court explained its reasoning on this issue in *Tax Increment Financing Commission of Kansas City v. J.E. Dunn Construction Co., Inc.*[126] in 1989. Relying on its earlier interpretation of article VI, section 26(a) of the Missouri Constitution in *Mitchell v. City of Sikeston*,[127] the court held that, because PILOTS[128] are "special assessments" paid into a "special fund" by the redevelopment district, PILOTS are not taxes.[129] The court further noted that the essential character of PILOTS is not changed, even though they are "measured" by the assessed value of the redeveloped property.[130] Therefore, under *Mitchell*, because PILOTS are not taxes, TIF debt is not subject to municipal debt limitations, nor is it subject to voter approval.[131]

4. *Critique*

States holding that debt from TIF projects is not subject to state constitutional debt limitations do so largely through a semantical manipulation of the TIF statute. Even statutes, such as Missouri's,[132] that expressly state that TIF debt is not subject to constitutional debt limitations ignore the underlying reality of TIF projects.

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126. 781 S.W.2d 70 (Mo. 1989).

127. 555 S.W.2d 281 (Mo. 1977). At issue in this case was whether bonds issued by Sikeston to build a plant to supply electricity, which were to be retired through revenues generated by selling the electricity to neighboring municipalities, were subject to the constitutional debt limitation. *See id.* at 283. The court held that this obligation was not an indebtedness of the municipality under article VI of the state constitution. *See id.* at 292.

The standard in determining what constitutes indebtedness under the constitution is as follows: "It has been held repeatedly in this state that the constitutional limitation imposed by . . . the Missouri Constitution on the indebtedness a political corporation may incur, contemplates a debt which must be paid *directly or indirectly* by resort to taxation." *Id.* (citations omitted) (emphasis added); *see also* Wunderlich v. St. Louis, 511 S.W.2d 753, 756 (Mo. 1974). The *Mitchell* court further noted:

> It is likewise well established that the 'special fund doctrine' prevails in Missouri, and that an indebtedness of a city or other like political corporation payable only out of income derived from the property purchased is not a debt within the meaning of the above provision of the Constitution. . . . But if the special fund pledged to the payment of the debt must be replenished by taxation, the contrary is true. . . . The proscription against municipal indebtedness without voter approval is only applicable in a situation where the municipality proposes to expend tax revenues.

Mitchell, 555 S.W.2d at 292. In this case, because the bonds were to be repaid solely from the revenues of the electrical plant, the taxing power of the municipality was not obligated. *See id.*

128. *See supra* Part II.

129. *J.E. Dunn*, 781 S.W.2d at 77.

130. *Id*. In addition to relying on the arguments presented in *Mitchell,* 555 S.W.2d 281, the court argued that, since PILOTS are not "initially available for deposit into the general fund of the taxing districts," they cannot be taxes. *J.E. Dunn Constr. Co.,* 781 S.W.2d at 77.

131. *J.E. Dunn Constr. Co.,* 781 S.W.2d at 77.

132. *See supra* note 73 and accompanying text.

As the Wisconsin Supreme Court noted in *Hartford v. Kirley*,[133] the court should look past the legislature's "recital that TIF bonds do not constitute a debt within the meaning of the constitution [and] examine the substance of the obligations to ascertain their effect . . . ."[134] A legislative statement about the character of the bonds should not control a court's determination.[135]

Upon determination that a legislative declaration is not controlling, a court should next consider the underlying purpose of a constitutional debt limitation as reflective of a desire to ensure that municipalities not overburden themselves with debt they cannot pay.[136] Courts which uphold a legislative determination that TIF bonds are not subject to constitutional debt limitations essentially ignore this broader purpose behind the constitutional provision.

A court that holds TIF debt not subject to constitutional debt limitations further ignores the underlying reality of such a limitation when, as the Supreme Court of Missouri has done, it allows the diversion of property tax revenue into a special fund and declares that all money from that fund is therefore not "revenue from taxes."[137] As the Iowa Supreme Court noted in *Richards v. City of Muscatine*,[138] the character of revenue does not change simply because a law carves out a portion of a city's general revenue and limits the liability of the city with respect to those revenues. As the court noted, "[i]f the result were otherwise, a city could divide its general revenues into several special funds, each with a bond issue restricted to recourse against its own fund—and thus commit large portions of the city's revenues without regard to [constitutional debt limits]."[139] Therefore, when a court respects a legislatively-created fiction which only diverts tax revenue, it circumvents the state constitution in an impermissible way. Moreover, by allowing circumvention of the constitutional debt limitation in this way, courts open the door to further abuses by municipalities through the creation of other "special funds." Therefore, courts should respect the underlying reality of TIF funds as diversions of property tax revenue and hold TIF debt subject to state constitutional debt limitations.

IV. PROPOSAL

133. 493 N.W.2d 45 (Wis. 1992).
134. *Id.* at 50.
135. *See id.* at 51.
136. *See id.*
137. *See* Tax Increment Fin. Comm'n of Kansas City v. J.E. Dunn Constr. Co., 781 S.W.2d 70, 77 (Mo. 1989).
138. 237 N.W.2d 48 (Iowa 1975).
139. *Id.* at 64.

As this Note has discussed, Missouri's TIF statute, through its vague definition of blight and its lack of voter accountability, creates inter-municipality competition and does not benefit areas that are truly in need of redevelopment. Therefore, this Note proposes two revisions to the Missouri TIF statute: a more restrictive definition of blight, and the application of constitutional debt limitations to TIF bonds. This will allow TIF to remain a useful and productive redevelopment tool, but will help eliminate the current abusive "cart before the horse" practices angering Missouri voters.

A. Definition of Blight

Missouri's current statutory definition of "blight" is too broad to provide any significant restriction on the discretion of private developers and municipalities in choosing redevelopment sites. The Missouri Legislature should amend the TIF statute to require a more definitive "but for" finding with respect to blight conditions on a particular parcel of land. For example, the legislature could revise sections 99.805 and 99.810[140] to read as follows:

> § 99.805. Definitions
>
> As used in sections 99.800 to 99.865, unless the context clearly requires otherwise, the following terms shall mean:
>
> (1) "Blighted area," an area that satisfies either (a) or (b) below:
>
> (a) Buildings in the area are:
>
> 1. Unsanitary, unsafe for living or working;
>
> 2. Substantially vacant; or
>
> 3. Subject to a crime rate significantly higher than other surrounding neighborhoods.
>
> (b) The area in general is characterized by:
>
> 1. Pervasive poverty, unemployment, and general distress, as evidenced by
>
> a. At least seventy-five percent of the residents living in the area have incomes below eighty percent of the median income of all residents within the state of Missouri; and,
>
> b. The level of unemployment of persons within the area exceeds one and one-half times the average rate of unemployment for the state of Missouri over the previous twelve months.
>
> 2. A cost benefit analysis, performed by an independent

140. For the current text of these two sections, see *supra* notes 51-55 and accompanying text.

> contractor, that enumerates the effect of the project on tax revenues if the project is built both with the proposed tax increment financing and without the tax increment financing, with a required showing of substantial and certain long-term economic feasibility and benefit to the affected taxing districts in order for approval of the proposed plan.[141]

These revisions would help ensure that proposed projects in areas that would be likely to receive private investment would not qualify for tax increment financing under the statute, and would thus help fulfill the underlying rationale of the TIF statute in three ways. First, the revised statute would preserve to a greater extent the normal market equilibrium by using TIF as a tool of last resort. By allowing public assistance only after a determination that the area is unlikely to receive private investment moneys in the foreseeable future and that such investment is necessary to prevent the area from becoming a drain on the property tax base of the area, the proposed revision would help stem the flow of private investment from one bidding municipality to the next.

Second, by determining that property values will certainly decline in the foreseeable future without public assistance, the proposed revision will curb the public financing of projects that will merely cause property values to increase more, or at a higher rate.[142]

Third, by requiring an explicit finding that the increase in property values will be due to public intervention in the form of the redevelopment project, the proposed revision further ensures that the diversion of revenue to retire TIF bonds is justified. If the redevelopment is not the sole stimulus for the increased property values, however, the TIF project is not justified. Therefore, implementation of a statutory revision similar to the one proposed herein would help curb abuses of the TIF statute and would help stimulate private development in those areas that are truly "blighted" under the language and spirit of the TIF statute.

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141. Substantial portions of this text are borrowed from Representative Rizzo's 1997 proposed changes to Missouri's TIF statute. *See* H.B. 131, 89th Leg., 1st Reg. Sess. (Mo. 1997); *see also supra* notes 22, 51 and accompanying text.

142. As discussed above, the impetus behind TIF is not necessarily to ensure that *all* property is put to its *single, best use.* Instead, TIF should be a tool of last resort used only when property values have declined to such a degree that but for the TIF, private developers would not utilize the land. This is an assumption of primary importance when one considers how TIF operates, because, unless the property value will decline or at least remain constant, freezing the property assessment will result in lost property tax revenue to the taxing district. *See supra* note 56 and accompanying text.

B. Debt Limitation

Although the TIF statute specifies,[143] and the Missouri Supreme Court has held,[144] that revenue from TIF bonds is not a general obligation of the municipality and therefore not subject to either municipal debt limitations or voter approval, the Missouri Legislature should amend the TIF statute to require that TIF bonds are subject to the constitutional debt limitation.[145] Doing so would require voter approval of any TIF project that would put a municipality in the position of having its debt exceed its revenue for the year.[146] This would provide two checks on unfettered TIF spending. First, municipalities would be forced to weigh projects against each other in order to maximize their limited resources. Second, for any debt that exceeded five percent of the value of the taxable property within the municipality,[147] voter approval would be required. This requirement would allow voters a more active role in municipal governance and a greater choice in the development of their own community. This requirement would also provide the ultimate oversight for the dangerous combination of profit-maximizing private developers and overeager municipal authorities.

V. CONCLUSION

This Note explains and highlights both the potential benefits and detriments of a typical TIF statute. The problems found in Missouri are typical of similarly drafted TIF statutes, although some states have experienced problems of a more serious nature. The reforms suggested are by no means the only cure for the afflicted TIF statute, but through such changes, the TIF statute would become a more effective tool to redevelop and revitalize blighted urban areas and would thus benefit those most in need of aid.

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143. *See* MO. REV. STAT. § 99.835 (1994); *see also supra* note 73 and accompanying text.

144. *See* Tax Increment Fin. Comm'n of Kansas City v. J.E. Dunn Constr. Co., 781 S.W.2d 70 (Mo. 1989); *see also* notes 126-31 and accompanying text.

145. For example, the amendment could take the form of simply replacing the wording "[t]he obligations shall not constitute indebtedness within the meaning of any constitutional, statutory or charter debt limitation or restriction," *see* MO. REV. STAT. § 99.835.5 (1994), with a statement making clear the intention to subject TIF debt to state constitutional debt limitations.

146. *See supra* note 100 and accompanying text.

147. *See* Mo. Const. art. VI, sec. 26(b); *see also supra* notes 101-03 and accompanying text.