DORSEY

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TAX INCREMENT FINANCING

In 1974, the Montana legislature authorized cities with urban renewal plans and districts to use tax increment financing for urban renewal projects, created and approved in accordance with Title 7, Chapter 15, Part 42. In 1989, it authorized the use of tax increment funding for industrial districts pursuant to Section 7-15-4297, and then in 1999, authorized it for uses in the aerospace transportation and technology districts.

To date in Montana, tax increment financing has been successfully used in urban renewal districts and industrial districts, both through the issuance of bonds for projects and on a pay as you go basis.

What is Tax Increment? In simple terms, tax increment is the increase in the amount of taxes generated within a tax increment district over what was collected in the base year, the year that the district was first created. The increment is derived primarily from the increase in the taxable valuation of the property in the district and is calculated annually given the number of the mills being levied by all taxing jurisdictions making levies against property in the district, except for the 6 mill levy imposed by the university system.

Impact of District. By creating a tax increment district, the governing body that creates it is authorized to segregate and capture the tax increment to be used for eligible projects in the districts. It can be an advantageous business development tool that benefits both the governmental body and business entity that the City is trying to induce to locate in its jurisdiction. Tax increment financing allows the taxes that the business would pay normally to be used to pay costs of infrastructure related to the project, such as water, sewer, roads, and parking, or to write down the cost of land by financing demolition or site work. The creation of a district does not deprive other taxing jurisdictions of any existing tax revenues, but rather precludes, for the time being, the other taxing jurisdictions from benefiting directly from the growth in the tax base.

Duration of Tax Increment Districts. As a general rule, a tax increment financing provision will terminate at the end of 15 years from the date of its creation or upon the final maturity or payment of any tax increment bonds payable from the increment derived from the district. Bonds can be issued for a term of up to 25 years, and thus it is possible to have a tax increment district extending 40 years.

Bonds. Tax increment bonds are a form of revenue bond, and are special and limited obligations of the issuer. They are not general obligations, even though they, too, are payable from property tax. Tax increment bonds are secured and payable solely from the tax increment revenues generated in the district or by a project. Because there is no ongoing pledge of the issuer with respect to the amount of tax increment collected in a district, it is necessary that additional security be provided in order for the bonds to be sold. This may include a debt service reserve account, guaranty agreement, development agreement, or payment in lieu of tax agreement. These Bonds:

- can only be issued if districts or plans have been created and approved in strict compliance with the statutes.
- must be issued for eligible projects that the issuer has approved as an urban renewal, industrial, or aerospace project in accordance with the acts.
- may be payable from the entire revenue of the district, as is most often the case in an established urban renewal district, or may be payable from a specific project in the district. In some cases a district may only include one project.

- present different risks than other municipal bonds and for that reason are often more difficult to sell. Some of the risks are: change in rate of taxation of classes of property subject to the property tax, elimination or reduction of the property tax, damage and destruction of buildings.
- must have coverage requirements, development agreements, deficiency tax payments, payment in lieu of tax agreements, perhaps secured by letter of credits, to minimize risks or make bonds marketable.
- depending on the use of the project being financed and the form of additional security, if any, the bonds may not be tax exempt.

Use of Increment. If Bonds have been issued, the bond holders will have a first lien on the annual revenues. The Bond resolution will usually provide that excess revenue in each year can be used for operations of the program or other projects, or remitted to the other taxing entities.

At the termination of tax increment financing, unspent tax increment in the tax increment fund must be remitted to the other taxing jurisdictions.

Projection of Increment. To determine whether a tax increment bond is viable, the projected annual tax burden of the project must be calculated to determine what amount of debt the increment could support each year over the proposed term of the bonds. To do this, take the developer's projected capital costs of each component of the project; determine the rate of taxation, if any, on the various classes of property constituting the project; then calculate the taxable value of the project by applying the applicable tax rate to the market value of the different classes of property in the project; and then multiply by the number of mills currently being levied by the taxing jurisdictions in the district, exclusive of the 6 mill levy;

From that, you can calculate the maximum principal amount of the bonds that could be issued over a period of time at an assumed rate of interest. Then, it can be determined how much of the proceeds of the bonds would be available for hard project costs, cost of issuance, reserve, and other costs. Various policy and security issues will figure in the allocation of bond proceeds.

In the case of the developer or a single project tax increment bond, you will almost always need a development agreement, wherein the developer commits to build the project at x cost, by a certain date and install x amount of personal property; and that to the extent that the size of the bond issue is calculated based on a specific amount of annual property tax revenues, the developer agreement to pay that amount of tax.