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Missouri State Auditor

City of St. Louis

Tax Increment Financing

Report No. 2020-076

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CITIZENS SUMMARY

Findings in the audit of the City of St. Louis - Tax Increment Financing

Strategic Planning for Tax Increment Financing Incentives Needs Improvement	The City of St. Louis' strategic planning for tax increment financing (TIF) incentives is in need of improvement. While the city has documented policies related to TIF usage, the city's policy does not include specific program goals or strategic preferences, does not clearly define the evaluation process or criteria to be used in project selection, and does not include effective project cost limits or overall program cost controls. The city also does not maintain TIF data in a useful and transparent manner.
Cost Control and Project Financing Policies are Ineffective	Cost control policies in place for individual TIF projects have been ineffective in controlling costs. While these policies appear to provide specific project limits, in practice, they have been ineffective due to language in the policies allowing these requirements to be waived.
Project Evaluation Improvements Needed	The city policy does not define how the need for TIF incentives should be determined and documented. The city and the St. Louis Development Corporation (SLDC) were not able to provide documentation of all cost-benefit analyses requested, and projects were approved with flawed cost-benefit analyses, including overestimated revenue projections. While a new evaluation model has been put in place and improved these processes, additional improvement is needed. In addition, policies are needed to ensure allowable developer fees are reasonable and defined.
Developer Profits Not Monitored	The city has historically not compared actual developer profit to the projected profit by project. As a result, the city may be providing public incentives for private projects that did not need to be incentivized.
Fee Structure Creates the Appearance of a Conflict of Interest	The SLDC's fee structure creates the appearance of a conflict of interest for the agency. This agency evaluates project applications and makes recommendations related to incentive projects, and is also partially funded with fees generated from approved incentive projects. The amount of the fees received increases with the size of the award.
Governmental Accounting Standards Board Violation	The city did not include the amount of TIF project revenues redistributed for fiscal 2018 or 2017 in its Comprehensive Annual Financial Report as required by the Governmental Accounting Standards Board Statement No. 77.

In the areas audited, the overall performance of this entity was **Fair.***

***The rating(s) cover only audited areas and do not reflect an opinion on the overall operation of the entity. Within that context, the rating scale indicates the following:

Excellent: The audit results indicate this entity is very well managed. The report contains no findings. In addition, if applicable, prior recommendations have been implemented.

Good: The audit results indicate this entity is well managed. The report contains few findings, and the entity has indicated most or all recommendations have already been, or will be, implemented. In addition, if applicable, many of the prior recommendations have been implemented.

Fair: The audit results indicate this entity needs to improve operations in several areas. The report contains several findings, or one or more findings that require management's immediate attention, and/or the entity has indicated several recommendations will not be implemented. In addition, if applicable, several prior recommendations have not been implemented.

Poor: The audit results indicate this entity needs to significantly improve operations. The report contains numerous findings that require management's immediate attention, and/or the entity has indicated most recommendations will not be implemented. In addition, if applicable, most prior recommendations have not been implemented.

City of St. Louis - Tax Increment Financing
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NICOLE GALLOWAY, CPA
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To the Honorable Mayor
and
Executive Director, St. Louis Development Corporation
City of St. Louis, Missouri

We have audited certain operations of the City of St. Louis regarding the administration of tax increment financing in fulfillment of our duties under Section 29.200.3, RSMo. The State Auditor initiated audits of the City of St. Louis in response to a formal request from the Board of Aldermen. The city engaged KPMG LLP, Certified Public Accountants (CPAs), to audit the city's financial statements for the year ended June 30, 2018. To minimize duplication of effort, we reviewed the CPA firm's audit report. The scope of our audit included, but was not necessarily limited to, the year ended June 30, 2018. The objectives of our audit were to:

1. Evaluate the city's internal controls over significant management and financial functions related to tax increment financing.

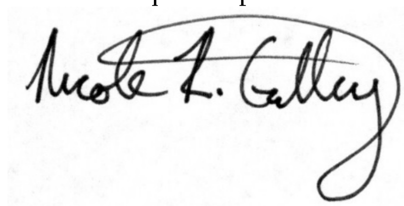
2. Evaluate the city's compliance with certain legal provisions related to tax increment financing.

3. Evaluate the economy and efficiency of certain management practices and procedures, including certain financial transactions related to tax increment financing.

We conducted our audit in accordance with the standards applicable to performance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform our audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides such a basis.

For the areas audited, we identified (1) deficiencies in internal controls, (2) noncompliance with Governmental Accounting Standards Board requirements, and (3) the need for improvement in management practices and procedures. The accompanying Management Advisory Report presents our findings arising from our audit of the administration of tax increment financing by the City of St. Louis.

Additional audits of various officials and departments of the City of St. Louis are still in process, and any additional findings and recommendations will be included in subsequent reports.



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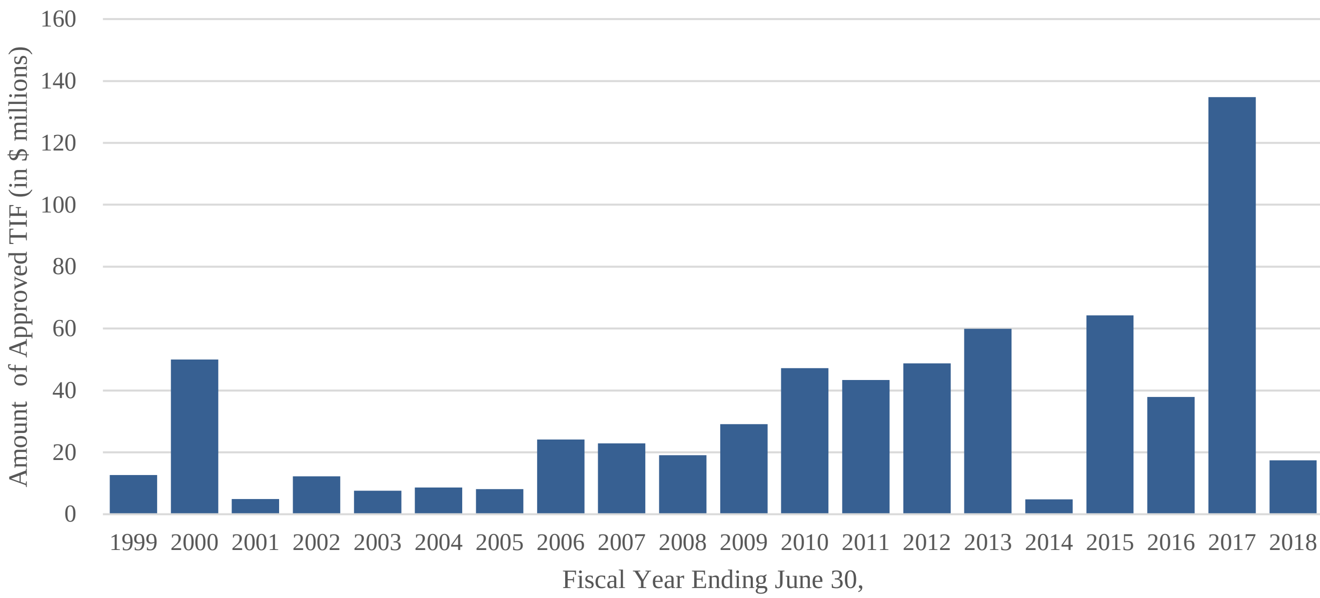
Background

The Real Property Tax Increment Allocation Redevelopment Act (Act) was established in 1982 under Section 99.800 to 99.865, RSMo. The Act permits the use of a portion of local property and economic activity taxes to assist funding the redevelopment of certain designated areas.[1] The City of St. Louis (city) uses tax increment financing (TIF) to help provide financing to encourage development of commercial, industrial, and residential sites; improvement of public infrastructure; and remediation of blighted properties. TIF incentives can be used to help develop or redevelop existing structures or new structures, such as buildings for retail establishments, and to help develop the public infrastructure supporting those developments such as construction of or improvements to streets, streetlights, public parking, and sidewalks.

Based on city and St. Louis Development Corporation (SLDC) records, there were 109 active TIF projects in the city as of June 30, 2018. Figure 1 shows the dollar amount in millions of the approved TIF by year from 1999 through 2018 for these 109 active projects. A total of approximately $657.8 million in TIF incentives was awarded for these 109 projects. Approximately $347.9 million in principal and interest has been paid, with approximately $515.5 million of unpaid TIF liabilities remaining as of June 30, 2018. TIF liabilities are generally only payable to the extent TIF revenues are generated, as described in the redevelopment plans and agreements associated with each TIF project.

[1] A redevelopment area is defined in Section 99.805(12), RSMo, as a blighted area, conservation area, or economic development area, an enterprise zone, or a combination thereof.

Figure 1: Dollar amount in millions of approved TIF for projects active as of June 30, 2018



Source: Prepared by the State Auditor's Office (SAO) using data from the city Comptroller's office.

St. Louis Development Corporation

The SLDC is a non-profit corporation with the mission of fostering economic development and growth in the city. The SLDC's Board of Directors is composed of the chairmen of the city's Industrial Development Authority, Land Clearance for Redevelopment Authority, Land Reutilization Authority, Local Development Company, Planned Industrial Expansion Authority, and Port Authority; the chairmen of the Board of Aldermen's Ways and Means and Housing, Urban Development, and Zoning Committees; and one person appointed by the Mayor of the city. The SLDC operates with its own Board of Directors and staffing. SLDC staff perform initial reviews and some monitoring activities,[2] and provide guidance to the city regarding economic incentives, including TIF.

TIF Award process

The process of receiving a TIF award is initiated by the property owner/developer submitting an application to the SLDC proposing a project to be completed in a redevelopment area. The SLDC, in cooperation with representatives of other city departments and officials, will determine if the project is eligible based on the Act[3] and the TIF Commission's Policy and

[2] City departments, including the offices of the Comptroller, Collector, and Assessor undertake certain TIF monitoring functions due to their respective offices' inherent responsibilities.
[3] Section 99.810.1, RSMo.

Application Procedure.[4] If the application is complete and the project is eligible, the application is submitted to the TIF Commission. The SLDC staff also provide a recommendation regarding the merits of the application.

The TIF Commission consists of nine appointed members,[5] consisting of the representatives of the city, the school district and other affected taxing districts. The TIF Commission reviews the projects and makes recommendations to the St. Louis Board of Aldermen (BoA). Following the TIF Commission review, an alderman may sponsor the necessary legislation to approve the TIF with the BoA. The President of the BoA typically assigns redevelopment plan bills to the Housing, Urban Development, and Zoning Committee. If approved by that committee, the ordinance will be considered by the BoA and needs a majority vote to pass.[6] If the TIF Commission recommends against the proposed project, the BoA can still approve the project with a two-thirds majority vote.[7] If the BoA approves the project, the BoA also considers legislation detailing the funding methods and description of the redevelopment area.[8] Once a project has been approved by the BoA, it is presented to the Mayor for signature or veto.

TIF Revenues

Once approved, the Assessor will determine the base assessed value (BAV) of all property within a redevelopment area.[9] The BAV within the redevelopment area is then frozen for the shorter of 23 years or until the approved project costs have been repaid. The property taxes generated from the assessed valuation (AV) above the BAV, or the incremental AV, are used to fund approved project costs. These incremental property tax revenues are referred to as Payments in Lieu of Taxes (PILOTs). Also, 50 percent of the total additional taxes generated by economic activity within the redevelopment area are used to fund approved project costs.[10] These incremental taxes are referred to as Economic Activity Taxes (EATs) and are primarily sales taxes and earnings/payroll taxes. Both the PILOTs and the EATs are deposited by the city into a special allocation fund. The special allocation fund is then used to pay approved project costs.

TIF Financing

Typically, a developer must advance all costs of a TIF project because TIF revenues will not be generated until a project is completed and operational. State law allows, and the city primarily uses, two different financing methods

[4] The TIF Commission adopted the original Policy and Application Procedure in 2001. It was revised in 2014.
[5] As defined in Section 99.820.2, RSMo.
[6] Section 99.825.1, RSMo.
[7] Section 99.825.2, RSMo.
[8] As defined in Section 99.810.1, RSMo.
[9] Section 99.855.1, RSMo.
[10] Goods and services exempt from being captured as Economic Activity Taxes (EATs) are outlined in Section 99.845.2, RSMo.

to reimburse developers for TIF-eligible costs of projects. One method is to issue special obligation notes to the developer, which are backed solely by the future PILOTs and EATs generated in the redevelopment area[11] and not by the city's general credit. These notes bear interest at the rate outlined in the ordinance approved by the BoA and are issued upon substantial completion of the project. The notes are endorsed only to the extent the developer proves, to the city's satisfaction, that it has incurred eligible reimbursable costs under the Act, the redevelopment plan, and the redevelopment agreement, up to the maximum amount of TIF assistance permitted by the redevelopment plan and the redevelopment agreement. When the project begins to generate revenues into the special allocation fund, the Comptroller uses the proceeds from the special allocation fund to begin to reimburse the developer for the certified project costs (i.e., to pay off the notes outstanding).When the notes mature, they are retired and no longer an obligation to the city, regardless of whether the notes have been paid off in their entirety.

Alternatively, the city may utilize the "pay-as-you-go" (PAYG) method. This financing method may be structured to have financing costs built into the amount to be reimbursed, or may be structured to reimburse the developer's actual interest paid on not-yet-reimbursed project costs. The reimbursement process to the developer/note holder is similar in both methods because the city reimburses the developer/note holder incrementally over a period of no more than 23 years. The method and terms of the reimbursement, including, if applicable, the issuance of the notes are set forth in the ordinances approving the redevelopment plan and the redevelopment agreement.

TIF Reporting

The city reports information regarding the status, amount of revenue, expenditures, debt obligations, BAV, and other information of each project/plan by November 15 annually to the Department of Revenue (DOR).[12] The information is published on the Missouri Accountability Portal and a summary is submitted to the State Auditor's Office (SAO).[13]

Scope and Methodology

The scope of our audit included, but was not limited to, the year ended June 30, 2018.

Our methodology included gathering information regarding projects through discussions with various city officials and the SLDC and reviewing information maintained by these entities. We reviewed the applications and analyses of the economic impact of the project, and performed site visits for

[11] Section 99.835, RSMo, allows obligations to be secured by the special allocation fund for redevelopment costs.
[12] Further outlined in Section 99.865.1, RSMo.
[13] The information received by the SAO is available at <https://app.auditor.mo.gov/TIF/SearchTIF.aspx>

a select number of projects. We discussed the oversight of these projects with city officials and SLDC officials. We also reviewed annual reporting information submitted by the city to the DOR regarding tax collections and compliance with reporting requirements.

To gain an understanding of the legal requirements governing TIF, we reviewed applicable state laws and city policies, including TIF application guidelines, the SLDC policy and procedures manual, and the city's Comprehensive Economic Development Strategy. We also interviewed individuals from the city and the SLDC.

We selected 13 redevelopment projects to review in more detail. The projects selected and the calendar year the establishing ordinances were passed are noted in the table below:

Projects reviewed

Redevelopment Project	Year Established
920 Olive/1000 Locust	2002
1111 Olive	2010
1225 Washington	2009
Chouteau/Compton Industrial Center	1998
Delmar East Loop	2006
Edison Brothers Warehouse	1999
Maryland Plaza South	2004
Northeast Hampton/I-44 Ackerman Toyota	2015
Paul Brown/Arcade Building	2002
Printer's Lofts - 1601-27 Locust Street	2003
Soulard Market Apartments - 1535 S. 8th Street	2003
Terra Cotta Annex and Garage	2003
Washington East Condominiums	2004

We analyzed these redevelopment projects using city-provided financial information, including the Comptroller's debt listing and amortization schedules; the Assessor's assessed valuation and ward listing for TIF projects; SLDC tracking information that included revenues, debt, developer fees, and payments by year; and annual reports submitted to the SAO each year that included revenues, payments, and assessed valuations. We reviewed all of the information we received for each TIF to ensure completeness and accuracy between the reports.

We also obtained applications, cost benefit analyses, and amortization schedules for the 13 projects above to analyze further. These analyses included reviewing financial ratios for each project for profitability and feasibility; reviewing a debt obligation analysis regarding outstanding debt, accrued interest, and the payment structures; reviewing the projected and current assessed valuations of each redevelopment area; evaluating developer fees for each project; reviewing the amount of TIF award compared to owner-provided finances per project; comparing projected and actual revenues generated; reviewing the debt coverage of the project; and identifying any additional incentives that existed within the same boundaries of each project.

Since the approval of the 13 projects listed above, the SLDC has implemented new policies and procedures regarding the review and evaluation of proposed TIF projects, including a "scorecard" methodology that attempts to measure the economic benefit of the proposed project relative to city and neighborhood-level tax revenue targets. These new policies and procedures have evolved over the course of our fieldwork and have been used by the city to evaluate a relatively small number of projects. We reviewed "scorecard" files for two projects approved for incentives as part of our fieldwork.

1. Strategic Planning for Tax Increment Financing Incentives Needs Improvement

The City of St. Louis's (city) strategic planning for tax increment financing (TIF) incentives is in need of improvement. While the city has documented policies related to TIF usage, the city's policy does not include specific program goals or strategic preferences, does not clearly define the evaluation process or criteria to be used in project selection, and does not include effective project cost limits or overall program cost controls. A TIF policy that includes these elements would provide clarity, consistency, and transparency to the city's use of TIF incentives.

1.1 No specific program goals or strategic preferences

The city's existing TIF policy does not contain any specific goals or measurable objectives. It contains mention of various strategic preferences, but there is no clear indication of how those preferences are implemented in the current process.

The current city TIF policy broadly communicates the TIF Commission's desire for "judicious use of TIF" toward projects that show a "substantial and significant public benefit" and broadly supports projects that create new jobs and retain existing jobs by:

> . . . eliminating blight, financing desirable public improvements, strengthening the employment and economic base, increasing property values, reducing poverty, creating economic stability, upgrading existing neighborhoods, facilitating economic self-sufficiency, and implementing the Strategic Land Use Plan and any other component of the City's Comprehensive Plan.

The city's TIF policy does not include any specific strategic outcome preferences and does not include any measureable objectives by which to evaluate the effectiveness of the program. For example, a more effective policy could require a certain percentage of incentives go towards affordable housing, or require that a certain percentage of incentive awards be used in certain parts of the city. The effectiveness of this hypothetical policy could be measured by tracking and reporting on the number of housing units, or on the change in assessed valuation in the targeted wards.

Rather than specific strategic preferences, the city policy makes generic references to certain preferences. For example, the policy states "priority will be given to projects that include downtown development, Brownfield development,[14] rehabilitation of historic structures, and projects with high employment."[15] Since the policy does not clearly define how projects will be evaluated, it is unclear how projects that fit those categories will be

[14] Generally defined as any former industrial or commercial site where future use is affected by real or perceived environmental contamination.
[15] The city updated sections of its TIF policy in October 2018 with Resolution 104. These updates did not address the preferences listed.

"preferred" and to what extent. SLDC staff have recently begun to evaluate TIF proposals with an internal evaluation tool that captures and documents the scoring of the projects. The development of this "scorecard" document is an improvement to the process, and is discussed further in MAR finding 3.1. However, more improvement is needed.

No strategic preferences regarding location of projects

The city has not established a clear strategic preference as it relates to development locations.

Out of the 28 wards in the city, 52 percent of the projects are located in the 4 wards with the largest AV.[16] These 4 wards account for 42 percent of the assessed value (AV) of the city. By contrast, 6 percent of projects are located in the 14 wards with the smallest AV. These 14 wards account for 21 percent of the AV of the city.[17] See Appendixes C and D for maps showing the dollar amount of TIF notes issued and total AV by ward; respectively. City officials stated certain wards that are primarily residential would have lower AV and generally would not be considered good candidates for TIF projects. However, establishing strategic preferences would aid the SLDC in how, and to what extent, a project's location should be considered during the project evaluation stage and would also provide clarity to the public.

Government Finance Officers Association (GFOA) guidance[18] recommends an entity "create a policy on the appropriate parameters for use of economic development incentives," and that such policy should be specific enough to establish clear boundaries. Specifically, GFOA recommends the policy contain clear goals and measurable objectives in order to create accountability. Such a policy would provide policymakers with information with which to make informed decisions about the program going forward. In addition, GFOA guidance recommends that the evaluation process be clearly defined, including how each proposal measures up to the criteria established by the entity. The criteria established should align with the entity's stated goals and objectives. According to GFOA guidance, a policy and process of this nature would provide consistency and transparency to the process.

1.2 No overall TIF program limits have been established

The city has not established any overall program usage limits. Such overall program limits have been put in place in other states and cities to provide overall cost controls to incentive programs. For example, the states of Oregon and Wisconsin require a local entity to limit the amount of AV within TIF

[16] Wards 6, 7, 17, and 28.

[17] This information is based on a listing of projects provided by the St. Louis Development Corporation and the assessed valuation of each ward provided the by St. Louis City Assessor's office.

[18] GFOA Best Practices *Establishing an Economic Development Incentive Policy*, is available at < https://www.gfoa.org/materials/establishing-an-economic-development-incentive-policy>, accessed January 24, 2020.

boundaries to a particular percentage of total AV. In addition, GFOA guidance states that an incentive policy should define the types of incentives the jurisdiction is permitted to use and any limitations on their use, such as maximum dollar amounts, time limits, and project types.

The establishment of an overall cost limit would likely result in the city ensuring the TIF projects approved provided the most benefit to the city. Such a limit would also require the city to more carefully vet each project before approving. In addition, with an overall program cost limit, once the city reached its overall program limit, no new TIF projects could be approved until an existing project was paid off. Such a limit would provide an incentive to structure TIF projects in such a way that TIF debts could be paid off in a more timely manner.

1.3 Data tracking and transparency

The city does not maintain TIF data in a useful and transparent manner. Currently, the SLDC maintains information on project applications, projections, and note amounts, the Comptroller maintains payment and note amortization data, and the Assessor maintains information regarding actual assessed valuation. This information is not compiled in a centralized source, reconciled to ensure accuracy, or presented in a format that would be accessible for policy makers or taxpayers.

State law requires the annual reporting of TIF data on a per project basis and the SLDC completes these reports as required. State law does not require the reporting of cumulative TIF data on a per-city basis. However, without complete and accessible data, informed strategic decisions and complete analyses are impossible, particularly for a program the size of the one maintained by the City of St. Louis. Accessible and transparent data would also help the Board of Aldermen and the public maintain some level of oversight of the TIF program.

Recommendations

The City of St. Louis:

1.1 Establish specific goals and measurable objectives for the TIF program, and identify specific strategic preferences of the TIF program and incorporate these preferences in the TIF policy and project evaluation process. Establishing such strategic preferences would include establishing appropriate performance measures to track the effectiveness of the policy.

1.2 Establish appropriate overall program cost limits of the TIF incentive program.

1.3 Establish procedures to ensure TIF incentive data is readily available to the Board and to the public.

Auditee's Response

The city provided a written response. See Appendix E.

Auditor's Comment

The city's response to MAR finding number 1 correctly states that state law does not require the establishment of a strategic plan regarding the use of TIF incentives. However, our report makes clear that adding specific targets and program usage limits to the existing strategic plan would provide clarity, consistency, and transparency to the city's use of TIF incentives, and is considered a best practice by the GFOA. Similarly, the tracking of cumulative TIF incentive data is not required by state law, but is necessary for the effective administration of a such a large TIF program. We encourage the city to continue its efforts to improve its data systems related to the TIF program in an effort make such information more readily available to the public.

2. Cost Control and Project Financing Policies Are Ineffective

Cost control policies in place for individual TIF projects have been ineffective in controlling costs. The city's current TIF policy includes a per-project incentive limit of 15 percent of total project costs, and further includes requirements that estimated project revenues be sufficient to cover at least 110 percent of the debt service payments (the amount required to cover principal and interest of the note). The policy further states a project that relies on EATs to cover debt service must show the project is expected to generate revenues of at least 125 percent of the projected debt service payments. These policies appear to provide specific project limits; however, in practice, neither policy has been effective due to language in the policies allowing these requirements to be waived.

2.1 Project cost limits are not defined, and are regularly exceeded

The city does not have defined project cost limitations that are followed. SLDC officials stated there are 4 factors that limit the amount of TIF awarded to each project:

(1) The revenues the project is expected to generate,

(2) The Internal Rate of Return (IRR) the developer will generate if the TIF is awarded,

(3) The developer's need for gap financing,

(4) City policy of the TIF incentives not to exceed 15 percent of total project costs.

The first 3 factors are not documented in a policy, but are instead general practices SLDC officials stated they follow. We identified significant flaws with the revenue projections (see Management Advisory Report (MAR) finding number 3.2) and with the IRR calculations (see MAR finding number 3.1). Additionally, the developer provides the projected revenues, IRR calculations, and the gap financing schedule but the city does not review the information with adequate scrutiny. These documents are submitted by the same entity that is trying to obtain TIF incentives.

The 15 percent limitation is included in the policy. However, the policy includes a provision that allows for the 15 percent cap to be waived, but no guidance is provided about the extent to which it can be waived, and no overall per-project cap is provided. For the 13 projects we reviewed in more detail (documented in the Scope and Methodology section), the 15 percent cap was exceeded 9 times. For these 9 projects, total development costs were $165 million, and a total of $35 million in incentives were approved, or an average of 21 percent. As a result, the city awarded $10.3 million in TIF awards over the stated 15 percent cap for these 9 projects alone.

GFOA guidance recommends incentive policies specify any limitations on their use, including maximum dollar amounts or limits on repayment time. Incentive caps on a per-project basis serve as a means to ensure cost controls are in place, provide some consistency in the implementation of the city's incentive policy, and help ensure a certain portion of the project is financed by the developer. Providing some flexibility to allow for additional incentives when certain conditions exist is reasonable, and is consistent with GFOA guidance, but in order to maintain consistency and transparency those exceptions need to be defined and consistent with stated policy objectives. Additional detail in the city's per-project incentive limit policy is needed to clarify to applicants, evaluators, and the public, what project limits apply to each project.

2.2 Policy on funding methods has not ensured project revenues are sufficient to cover debt service, has resulted in significant accrued interest, and has reduced transparency

City TIF policy regarding financing methods and requiring a minimum level of debt service coverage have been ineffective in ensuring project revenues are sufficient to cover financing costs. The city primarily uses interest bearing TIF notes to finance TIF projects. As a result, projects regularly accrue significant levels of interest, which can result in increased costs and reduce the likelihood TIF projects will be paid off in less than the statutory 23-year limit. The use of TIF notes also reduces the transparency of the amount that will ultimately be reimbursed on the project.

Per current policy, TIF assistance can be provided via (1) bonds or notes, (2) direct reimbursement to the applicant (pay-as-you-go, or PAYG), (3) pledging TIF revenue to private debt, or (4) a combination of all three. The city policy regarding TIF financing methods provides no specific guidance on which funding method is preferred, but states the "prevailing factor" in determining which method to use is "total costs." The city policy also states the financing method is at the city's discretion. According to city officials, no review has been performed to determine which financing method is in the best interest of the city.

TIF notes primarily used; debt coverage policy not effective

Our review of city TIF data shows 102 of the 109 active TIF projects as of June 30, 2018, and 12 of 12[19] projects selected for additional review, have been financed using interest-bearing TIF notes. Approximately $263 million in total has been paid on these notes. Approximately $200 million of that amount was used to pay interest and an additional $49.5 million in accrued interest was still due as of June 30, 2018. In the event a TIF project is financed using a note, city policy requires the project to cover 110 percent of projected debt service payments (125 percent if project involves EATs). However, the city policy also includes significant exceptions to this requirement. For example, the policy states one exception is "if the project involves redevelopment of existing structures, includes a significant jobs component[,] or involves the assembly and clearance of land upon which existing structures are located." As a result of allowing numerous exceptions, the vast majority of projects do not adhere to the debt service coverage requirements, resulting in significant levels of accrued interest.

TIF notes result in significant levels of accrued interest

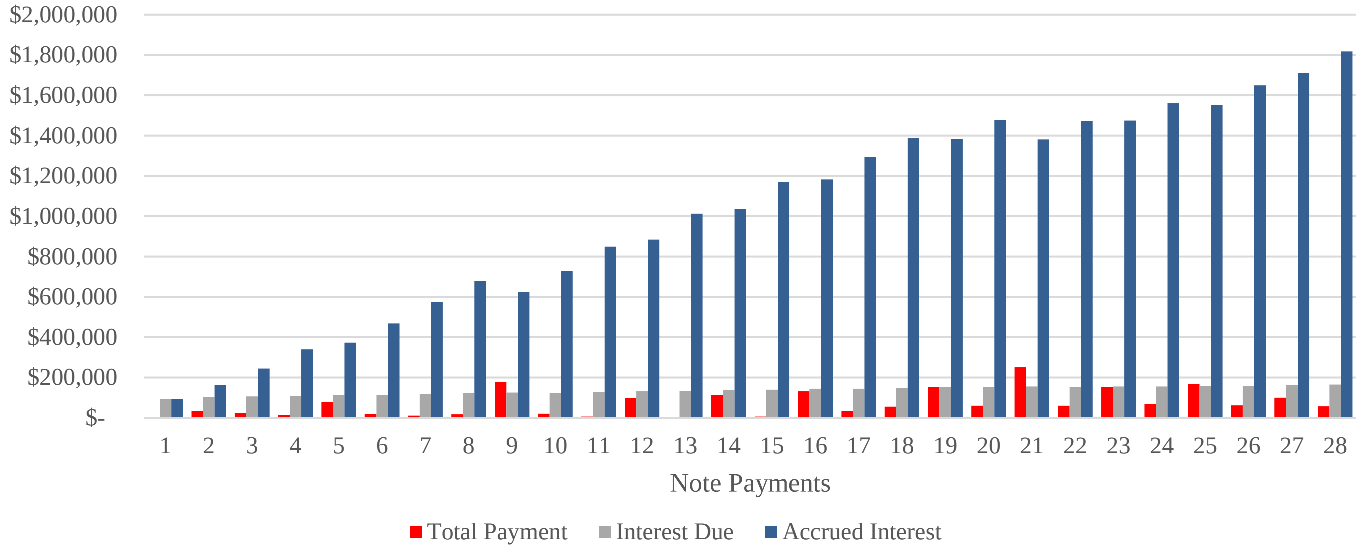
Our review of city information for the TIF notes issued for 12 of the 12[20] projects selected for additional review showed that the projects had significant levels of accrued interest. As of June 30, 2018, the city had issued approximately $50.2 million in TIF notes for these 12 projects, and paid $39.4 million toward these notes. However, the payments have not been sufficient to cover the interest liability due. An additional $10.4 million in accrued interest is due on them, and only $9.6 million of the $39.4 million paid has gone toward principal. In total, despite paying $39.4 million on these 12 notes, the city still owed approximately $51 million[21] on them as of June 30, 2018; more than the principal value of the notes.

Some TIF notes include compounding interest

In addition to issuing notes with interest, the city issued notes for 29 projects with compounding interest. For these notes, as unpaid interest accrues, even more interest is due on the following payment. This can result in a note for which revenues are insufficient to pay the current interest even after the project stabilizes and begins to generate revenue. Figure 2 shows the payments made, the interest due for the current period, and the total outstanding accrued interest for each semi-annual payment for the 920 Olive/1000 Locust TIF note:

[19] We were able to review 12 of the projects selected for additional review, instead of the 13 selected, because the city had not yet issued a note for the Northeast Hampton/I-44 Ackerman Toyota project by the end of our audit period.
[20] The city had not yet issued a note for the Northeast Hampton/I-44 Ackerman Toyota project by the end of our audit period.
[21] $40,649,453 in outstanding principal plus $10,358,221 in accrued interest.

Figure 2: 920 Olive/1000 Locust Semi-annual Note Payments



Source: Prepared by the SAO using note payment information provided by the city Comptroller's office.

Based on Figure 2, the city was able to pay the full current period interest due for only 4 of the 28 payments.[22] However, for these 4 payments, no principal was paid because accumulated interest was paid after current interest, as required by the city ordinance,[23] and nothing was left to apply to the principal. This $2,667,732 note was issued in September 2004. From the period of March 2005 through September 2018, $1,979,236 had been paid, $1,818,166 in accrued interest was still owed, and $0 of principal had been paid. In the application for the 920 Olive/1000 Locust TIF, the developer stated it is "not requesting the city to issue any bonds or notes." However, the city issued a note with compounding interest. It is unclear why notes with compounding interest were approved even when it was not requested by the developer in the application.

There is currently no policy regarding when it is appropriate to issue TIF notes, what interest rate is appropriate for these notes, or the type of interest allowed (compound or simple). For the 13 projects selected for additional review, 12[24] were financed with TIF notes (8 with compounding interest). The average interest rate on these 12 notes was 6.5 percent, with the highest

[22] The total payment exceeded the current period's interest due for payments 9, 19, 21, and 25.

[23] Ordinance #65749.

[24] We were able to review 12 of the projects selected for additional review, instead of the 13 selected, because the city had not yet issued a note for the Northeast Hampton/I-44 Ackerman Toyota project by the end of our audit period.

rate at 9 percent.[25] The interest rate is approved by the BoA. One project's financing had not been finalized at the time of our review, but a TIF note was subsequently issued. None of the projects selected involved the use of PAYG financing. According to city officials, only 2 of the 109 active projects as of June 30, 2018, have PAYG financing.[26]

Interest on notes can result in increased costs and reduces the likelihood projects will be paid off in less than 23 years

The accrued interest on projects with TIF notes can result in additional costs to the taxpayers, and reduces the likelihood projects will be paid off prior to the 23-year maximum.

State law limits the life of TIF districts to 23 years and the city is not liable for any unpaid principal and interest at the end of this 23-year period; however, due to the significant levels of accrued interest on TIF projects financed with notes, those projects are significantly more likely to last the full 23 years allowable by law. For example, the Paul Brown/Arcade Building project received a TIF note of $3,264,200 in 2006. As of December 1, 2018, the city has paid $3,285,570 on the note; however, the outstanding principal and interest balance was $3,073,960. Due to the significant accrued interest on this project, the note still had an outstanding principal balance of almost $3 million and the local taxing districts will likely not receive the increased revenues until the end of the TIF's statutory life in December 2025. See Appendixes A and B for additional information regarding the financing of the individual projects. If TIF liabilities were paid off in a more timely manner, the affected local taxing districts would receive the additional tax revenues from the project sooner.

Additional transparency needed

When a TIF note is approved, the amount of the award and the interest rate is known, but the total amount of interest that will accrue and be paid is unknown and is dependent on the amount of revenue generated by the project. As a result, there is significant uncertainty in the amount that will ultimately be reimbursed to the developer. The use of PAYG financing method could reduce the uncertainty of costs to taxpayers. PAYG TIFs may include an interest component, but can be structured such that verified interest expense may be paid as an eligible reimbursable cost that has been incurred by the developer,[27] or an interest component can be built into the TIF award.[28] In both of these PAYG structures, the total amount of interest to be paid could be defined and transparent. In the event interest is reimbursed to the

[25] Two of the three notes issued for the Chouteau/Compton Industrial Center were for 9%, while the third note was issued for 7%. As a result, we used a weighted average to calculate a single interest rate for Appendix A.
[26] The Lafayette Square and the Old Post Office projects are PAYG.
[27] This is the primary method used by another large municipality in the state to finance TIF projects.
[28] In this method, the TIF award would be larger than the amount of the TIF incentive necessary to complete the project. The final value is based on an implied interest factor.

developer, such reimbursement would be based on actual interest expenses of the developer and can be limited or budgeted to certain levels.

According to an SLDC official, issuing TIF notes is preferred by developers because they are more marketable than other financing types to banks and investors. Additionally, this official stated if TIF notes with interest are issued, the city could potentially refinance the notes into a tax exempt bond at a cheaper interest rate. However, based on city records, only 6 of the 109 notes have been refinanced into tax exempt bonds. Also, the official stated if PAYG is used, the city would have to award a larger amount of TIF to the developer due to the time value of money. While this is accurate, using PAYG would cap the amount of city money paid on the award, since interest cannot accrue, and this would result in more transparency to the public since the maximum amount to be reimbursed would be known.

The current funding method policy provides no specific guidance on the preferred funding method of TIF projects, although it appears to give preference to whatever method results in lower "total costs." Based on our review, the use of TIF notes is the predominate funding method currently used. However, the use of TIF notes is not clearly consistent with the "total costs" portion of the policy. A more specific funding method policy would clarify what funding method is preferred and would also include a more consistent debt coverage policy to ensure project revenues are sufficient to keep the project on schedule and, in the event TIF notes are used, keep any accrued interest to a minimum. An improved funding method policy would also ensure additional transparency regarding the potential cost of the TIF project being considered.

Conclusion

Transparency and clarity are needed in the city's TIF program. Under the current policies there are no defined project cost limits, and TIF projects are primarily financed with interest bearing TIF notes. These notes accrue significant interest and essentially ensure most projects will last the full 23-year statutory maximum before being completed. More specific and defined per-project limits and project funding method policies would provide clarity to the process, potentially reduce costs, allow the local taxing districts to receive the additional revenue sooner, and be in the best interest of taxing districts and taxpayers.

Recommendations

The City of St. Louis:

2.1 More strictly define the cost limitation policy, and ensure any necessary waivers from this policy are well defined and documented.

2.2 More strictly define the debt coverage policy to ensure projects approved have sufficient revenues to cover projected liabilities and consider not allowing this requirement to be waived. Also, consider updating the policy to define what funding method is preferred.

Auditee's Response

The city provided a written response. See Appendix E.

Auditor's Comment

The city's response to MAR finding number 2.1 incorrectly suggests that the report recommends rigid cost limits that provide no flexibility. Our report clearly states that providing some flexibility to allow for additional incentives when certain conditions exist is reasonable, but in order to maintain consistency and transparency those exceptions need to be defined and consistent with stated policy objectives. This finding is also consistent with GFOA best practices.

In the response to MAR finding number 2.2, the city correctly states the financing method used is allowed by law. The report does not suggest otherwise. The response also suggests the city's almost exclusive use of TIF notes is due to this method being preferred by private investors. While the preferences of investors must be considered, our report provides information regarding the need for additional transparency that would be in the best interests of taxpayers. As our report also documents, another large municipality in the state utilizes an alternate funding method that provides transparency to the public while also taking the needs of the investors into account.

3. Project Evaluation Improvements Needed

Project evaluation procedures are in need of improvement. The city policy does not define how the need for TIF incentives should be determined and documented. The city and SLDC were not able to provide documentation of all cost-benefit analyses requested for our test items, and projects were approved with flawed cost-benefit analyses, including overestimated revenue projections. While a new evaluation model has been put in place and improved these processes, additional improvement is needed. In addition, policies are needed to ensure allowable developer fees are reasonable and defined. We reviewed 13 projects with a total of $55,421,629 in TIF awards in greater detail.[29]

3.1 The policy does not define how the need for TIF should be evaluated and documented

A primary guideline of the city's TIF policy and state law[30] is that "each applicant must demonstrate that without the use of TIF, the project is not feasible and would not otherwise be completed." This is commonly referred to as the "but-for" test. While this process has been improved in recent years with the development of an evaluation model, the current policy contains no specific guidance on how this requirement is to be "demonstrated,"

[29] We used the amount of the TIF note issued by the city to determine the award. The city had not yet issued the note for the Northeast Hampton/I-44 project, so we used the amount the TIF award could be issued up to in Ordinance 71002 as the award amount.
[30] As required by Section 99.810.1(1), RSMo.

determined, or documented. As a result, it is not always clear how the amount of TIF incentives awarded was derived, or that the amount of incentives awarded was necessary for the project to go forward.

For example, for the 13 projects reviewed, 7 project files[31] had no analysis of the project's expected return in the files. For these 7 project files, the only documentation to satisfy the but-for test is a statement in the application that the incentives were necessary. SLDC officials stated these analyses were maintained by an employee in the former Mayor's office and the analyses were not retained when that individual left employment. We identified concerns with the analyses for the remaining 6 projects. The concerns we identified are:

- The developer of the 920 Olive/1000 Locust project provided the developer's IRR without TIF at 5.2 percent and with TIF at 10.8 percent. We noted the developer fee was not included in either IRR calculation. This error artificially lowers the developer IRR giving the appearance the developer is making less of a profit. Additionally, we could not determine how the IRRs were calculated because the detailed calculations were not available for review. When the error was discussed with SLDC officials, they were unsure why the omission occurred and were unable to tell us how the IRRs were calculated, stating the files explaining the calculations were not maintained.

- The developer of the Maryland Plaza South project provided the developer's IRR without TIF at 1.7 percent and with TIF at 3.5 percent. We noted the with-TIF IRR calculation incorrectly excluded projected PILOTs, and only included projected EATs. This error artificially lowered the developer's IRR, giving the appearance the developer was making less of a profit with public assistance. Additionally, we could not determine how the IRRs were calculated because the detailed calculations were not available for review. When we discussed the error with SLDC officials, they were unsure why the omission occurred and were unable to tell us how the IRRs were calculated, stating the files explaining the calculations were not maintained.

  The developer of the Printer's Lofts - 1601-27 Locust Street project provided the developer's IRR without TIF at negative 0.7 percent and with TIF at 8.2 percent. We could not determine how the IRRs were calculated because the data was not available for the financial calculation.

[31] 1111 Olive, 1225 Washington, Chouteau/Compton Industrial Center, Delmar East Loop, Edison Brothers Warehouse, Paul Brown/Arcade Building, and Washington East Condominiums.

SLDC personnel were unable to tell us how the IRRs were calculated, stating the files explaining the calculations were not maintained.

- The developer of the Terra Cotta Annex and Garage project provided the developer's IRR without TIF at negative 0.8 percent and with TIF at 8.4 percent. We could not determine how the IRRs were calculated because the data was not available for the financial calculations. SLDC personnel were unable to tell us how the IRRs were calculated, stating the files explaining the calculations were not maintained.

- The developer of the Soulard Market Apartments - 1535 S. 8th Street project provided the developer's IRR without TIF at 5.5 percent and with TIF at 8.6 percent. We could not determine how the IRRs were calculated because the data was not available for the financial calculation. SLDC personnel were unable to tell us how the IRR was calculated, stating the files explaining the calculation were not maintained.

- The developer of the Northeast Hampton/I-44 Ackerman Toyota project provided the developer's operating return on equity (ROE) without TIF at negative 3.6 percent and with TIF at 3.5 percent. We could not determine how the ROEs were calculated due to a lack of financial equity information. SLDC officials were unable to tell us how the ROEs were calculated, stating the files explaining the calculations were not maintained.

These examples show the need for more defined policies related to estimated and allowable returns on TIF projects. For two of these projects, the IRR without TIF exceeded 5 percent, while the with-TIF IRR for another project was 3.5 percent. Another project showed a with-TIF IRR of over 10 percent without including the developer fee, which would erroneously show a lower level of return. In addition, for the 6 projects with some form of return analysis in the file, the calculations were not consistent. Without clear policies on acceptable levels of return, or established policies on how a return is to be calculated, it is unclear how the city determined the appropriate level of TIF award (see concerns identified with project cost limitations in MAR finding number 2.1).

State law[32] requires the municipality to determine that it is not reasonably anticipated that the area would be developed without the adoption of tax increment financing. Requiring the same financial metrics to be used in all analyses to support the developers' need for TIF would allow city officials to compare the merits of each project against other projects to make a better informed decision on the use of public assistance. Defining how this

[32] Section 99.810.1(1), RSMo.

determination would be made and documented is necessary to ensure transparency to the public.

New evaluation model process developed

In 2016, the city began implementing a new evaluation model that incorporates an analysis of the developer's IRR, as well an evaluation of projected revenues. Based on our review of project evaluation documentation from the new model, there is a comparison of the range of acceptable market return, the with-TIF rate of return, and the without-TIF rate of return. According to SLDC documentation, no incentives will be approved if the without-TIF rate of return is already within the acceptable market return range, and incentives will only be awarded that keep a project's rate of return within the acceptable range. This model is relatively new and has been used to evaluate a relatively small number of projects. In addition, the model has continued to evolve past our audit scope, so testing and verification of the model was minimal. We reviewed project evaluations for two projects that were approved for incentives, including the "scorecard" generated by the new model. According to SLDC documents, developer fees and other tax incentives are now included in the determination of the IRR in the new model. Based on our limited review of the new model, it appears to be an improvement over past procedures as it relates to determining the need for incentives.

3.2 Flawed cost-benefit analyses have led to significant overstatements of projected revenues, additional oversight is needed

Improvement is needed in the oversight of cost-benefit analysis documents during the project application process. Our review identified flaws in the cost-benefit analyses for our test cases, including unreasonable AV assumptions that understated the no-build option, unreasonable AV assumptions that overstated the build option, and overly aggressive AV and EAT assumptions that overestimated project revenues. In addition, cost-benefit analysis information was not maintained for 4 test items. The cost-benefit analysis is an important aspect of project evaluation, and flawed analyses can result in decisions that are not in the best interest of taxpayers. Improvements are needed to help ensure the accuracy and transparency of these estimates.

Cost-benefit documentation not maintained and assumptions flawed

The city could not provide cost-benefit analyses for several of the projects we selected for additional review. Also, for some of the cost-benefit analyses provided, we identified errors in these analyses. State law[33] requires the municipality to consider a cost-benefit analysis showing the impact of the project on each taxing district that is at least partially in the boundaries of the redevelopment area. Typically, the developer provides a revenue forecast that shows the projected amount of PILOTs and EATs the developer anticipates the project will generate. The cost-benefit analyses also compare projected revenues for each taxing district based on whether the TIF project occurs or

[33] Section 99.810.1(5), RSMo.

does not occur. These two scenarios are typically referred to as "build" and "no-build" scenarios.

Cost-benefit analyses were either missing or relied on flawed or unsupported assumptions for 8 of the 13 projects (62 percent) we selected for additional review. These 8 projects were awarded $36.7 million of public incentives. We identified the following concerns:

- A cost benefit analysis was not in the project file for 4 of the approved projects.[34] SLDC officials stated these analyses were performed and evaluated, but could not provide the analyses for review, documentation the analyses were reviewed, or an explanation as to why the analyses and documentation of the review were not retained.

- The 1111 Olive and 1225 Washington cost-benefit analyses assumed the TIF debt would be paid off in 19 years, with a large increase in revenue to the taxing districts occurring in the 20th year due to the abolishment of the district. However, there is no data to support this assumption. This assumption causes the total revenues to the taxing districts in the analysis to be overstated.

- The Edison Brothers Warehouse cost-benefit analysis assumed no increase in AV for 11 years under the no-build scenario. However, AVs typically increase marginally, especially considering the project's proximity to downtown and the Enterprise Center. This assumption artificially increases the benefit to the taxing districts if the project is built.

- The Paul Brown/Arcade Building cost-benefit analysis assumed a small decrease in the AV over a 10-year period and then sharply decreased to $0 AV for year 11 under the no-build scenario. It is unclear how the AV of a property located in the ward with the highest AV in the city could abruptly drop to $0. This assumption understates the revenue the taxing districts would receive if the project was not built.

Cost-benefit revenue projections are overstated, additional oversight needed

The flawed assumptions used in cost-benefit projections have historically led to the city approving projects with significantly overstated revenue projections. As a result, many projects have accrued significant interest and taken longer to complete than expected, and the benefits to the taxing districts at completion of the project have been significantly lower than anticipated. Additional oversight of cost-benefit assumptions is needed to help ensure projects produce the benefits to the public they are approved to provide.

[34] Chouteau/Compton Industrial Center, Maryland Plaza South, Soulard Market Apartments - 1535 S. 8th Street, and Washington East Condominiums.

Based on the project application files and annual reports submitted by the SLDC, our analysis of 10 projects[35] selected for additional review were projected to generate approximately $59.2 million in revenues from the inception of the projects through December 31, 2017. However, these projects actually generated $35.9 million (61 percent of projected revenues) over the period of inception through June 30, 2018.[36]

Figure 4 below compares projected PILOTs and EATs from inception through June 30, 2018, to actual PILOTs and EATs in total from inception through December 31, 2017, for 10 projects selected for additional review.

Figure 4: Projected PILOTs and EATs vs Actual PILOTs and EATs

	Projected from inception through December 31, 2017	Actual from inception through June 30, 2018	Difference
PILOTs	$38,307,969	$27,284,826	$(11,023,143)
EATs	$20,885,587	$8,598,540	$(12,287,047)
Total	$59,193,556	$35,883,366	$(23,310,190)

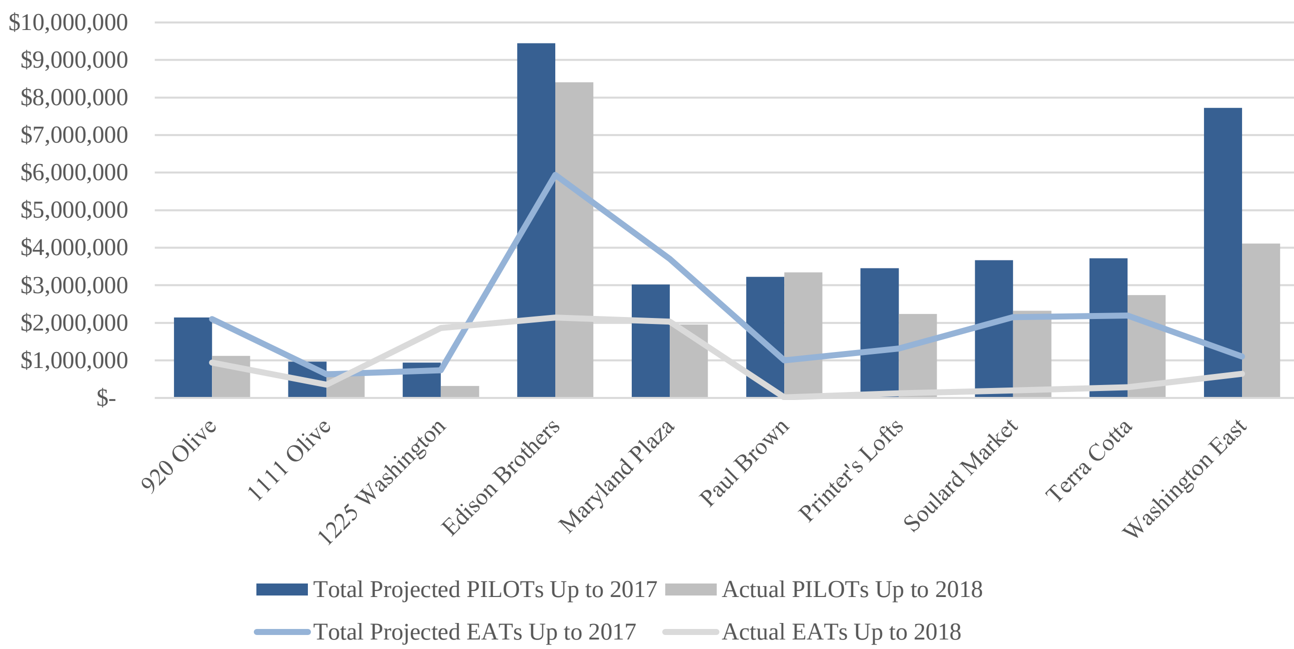
Figure 5 below compares projected PILOTs and EATs to actual PILOTs and EATs from the inception of the project through 2018 for the 10 projects analyzed. Our analysis of these 10 projects noted the following trends:

- Only 1 of the 10 projects generated enough EAT revenues to meet projections, and 1 of the 10 projects generated enough PILOT revenue to meet projections.
- On average, the 10 projects generated 41 percent of their projected EAT revenue, and 71 percent of their projected PILOT revenue.
- 6 of the 10 projects generated less than 50 percent of projected EAT revenue, and 3 of the 10 projects generated less than 10 percent of projected EAT revenue.

[35] We attempted to analyze all 13 projects chosen for review. However, Chouteau/Compton Industrial Center and Delmar East Loop TIF projects were missing information regarding the projected revenues and Northeast Hampton/I-44 Ackerman Toyota TIF project had not reported actual revenues due to the timing of project completion. Due to missing information, we were not able to analyze these projects in our review.

[36] The City maintains projected TIF revenues on a calendar year basis and actual TIF revenues on a fiscal year ending June 30 basis. Projected revenues were obtained from the project application files. Actual revenues were obtained from the annual reports submitted to the Department of Revenue. Because these amounts are not available on the same yearly basis, we conservatively used the projected amounts through December 31, 2017, and actual amounts through June 30, 2018, which gave the projects an additional 6 months more of actual revenues compared to corresponding the projected revenues.

Figure 5: Projected PILOTs and EATs from inception through December 31, 2017, compared to Actual PILOTs and EATs, from inception through June 30, 2018, by Project, for 10 Projects Tested



Source: Prepared by the SAO using information from the individual project applications for revenue projections (on a calendar year basis) and the annual reports submitted to the Department of Revenue pursuant to Section 99.865.1, RSMo, (on a fiscal year ended June 30 basis).

Aggregate information for each of the 10 projects is located in Appendix A and detailed information for each project is located in Appendix B.

The shortages in PILOT revenue projections are directly correlated to overestimated AV projections. Based on information provided by the St. Louis Assessor and information in the project application files, through 2018, 11 of the 13[37] projects selected for additional review projected the total AV of the project areas to be approximately $59.4 million. However, the actual AV for these 11 projects was approximately $39.1 million (66 percent of the projected AV).

City officials stated that a portion of these revenue shortages may be due to delays in construction/completion, and also were the result of the 2008 recession that was unforeseen. However, even if projected revenues for the

[37] The projected AV by year was not provided for the Chouteau/Compton Industrial Center. The only AV provided was the AV at substantial completion, which was planned for the year 2000. The projected AV in 2000 was $2,363,850 while the actual 2018 AV was $905,800. Additionally, substantial completion had not yet occurred for the Northeast Hampton/I-44 Ackerman Toyota project. As a result, it was not included as it would not be a genuine comparison to projected AV.

years in which there were no actual revenues are excluded, [38] actual revenues were still $19.5 million (39 percent) less than projected for the 10 projects[39] selected for additional review. In this analysis, projected revenues were $50.4 million while actual revenues were $30.9 million (61 percent of projected revenues).

Overestimated revenue projections result in accrued interest, longer TIF district life, and reduced public benefit from the project

Overestimated project revenues result in significant accrued interest on projects because the actual revenue stream is insufficient to pay TIF note debts. The importance of these issues is discussed in more detail in MAR finding number 2.2. In addition to these issues, overestimating project revenues also has the effect of overstating the positive impacts the project will have on the relevant taxing districts when the TIF district is eventually dissolved. For example, the actual AV for the 11 projects described above was $19.4 million less than what was projected for 2018. Based on the 2019 property tax levy that was projected when the project was approved, this AV shortage results in the St. Louis Public Schools receiving $969,235 less funding annually than the projects were projected to generate for these 11 projects alone.

Providing additional critical oversight to revenue projections, including a review of projected-to-actual AV increases generated by the project, could help the city make a better determination of whether the proposed project is in the best interest of the city.

3.3 Inconsistent and potentially excessive developer fees allowed

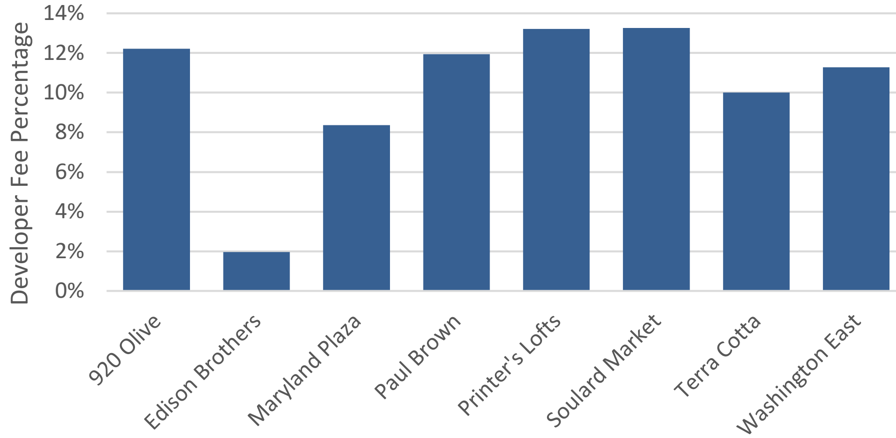
The city does not have an established policy regarding how much of a developer fee is allowed on TIF projects. As a result, developer fees are inconsistent from project to project, and in some cases, appear excessive. The developer fee is the fee charged by the developer to complete the project. The developer sets its own developer fee and documents the fee in the TIF application. According to the SLDC, the developer fee covers overhead costs of the developer (such as office rent and salaries) and the developer's profit. This developer fee is in addition to any profit earned on the project as an investor. We noted 5 of the projects[40] selected for further review did not disclose a developer fee in the application. We reviewed the developer fees from the applications of the remaining 8 projects. Figure 6 shows the developer fee as a percentage of the total project cost for the 8 projects.

[38] Since the data provided by the SLDC on the annual reports shows the 2007 actual revenues as cumulative from inception through 2007, we used 2008 as the first year in our calculation for the projects that had actual revenues prior to 2008.

[39] We attempted to analyze all 13 projects chosen for review. However, Chouteau/Compton Industrial Center and Delmar East Loop TIF projects were missing information regarding the projected revenues and Northeast Hampton/I-44 Ackerman Toyota TIF project did not report actual revenues due to the timing of project completion. Due to missing information, we were not able to analyze these projects in our review.

[40] 1111 Olive, 1225 Washington, Chouteau/Compton Industrial Center, Delmar East Loop, and Northeast Hampton/ I-44 Ackerman Toyota.

Figure 6: Developer fees as a percentage of the total project cost



Source: Prepared by the SAO using information from the individual project applications.

According to SLDC officials, part of the SLDC's review of the project is to determine if the developer fees are consistent with industry standards and with the portfolio of projects the SLDC has reviewed in the past. An SLDC official stated developer fees on large projects can typically range from 5 to 10 percent; however, 5 of the 8 projects in Figure 6 above exceeded the high end of this typical range.

Without guidelines on acceptable developer fees, the city and SLDC cannot ensure the fees are reasonable for the services the developers are providing.

Recommendations

The City of St. Louis:

3.1 Ensure the project evaluation model continues to develop and ensure the calculation of developer return is defined and consistently calculated, and the calculation is maintained.

3.2 Ensure the cost-benefit analysis required by state law is submitted for each project and retained, and perform a critical review of cost-benefit assumptions to improve the accuracy of project revenue projections used in the TIF decision-making process.

3.3 Establish a policy regarding acceptable levels of developer fees for TIF projects and ensure developer fees stay within allowable ranges.

Auditee's Response

The city provided a written response. See Appendix E.

Auditor's Comment

The city's response to MAR finding number 3.1 takes issue with the age of the projects in the audit sample. However, in order to evaluate the TIF program as a whole, and because the majority of TIF projects last the full 23 years allowed by law, such a sample was necessary. The response, as well as the audit report, discusses the existence and development of a new methodology for project evaluation. The audit report recommends the city continue to develop this model.

The city's response to MAR finding number 3.2 provides information regarding the difficulty in accurately projecting financial information over the 23-year life of a TIF project. The audit report acknowledges the difficulty of such an undertaking, but also provides information regarding the consistent and significant overestimating of project revenues for the projects reviewed, and recommends the cost-benefit projection process be improved. The response also suggests that the risk of overly optimistic financial projections are born by the developer and investor, and not the city. However, this ignores that if project revenues would have been more accurately projected, certain projects might not have been approved for incentives.

The city's response regarding MAR finding 3.3 argues that because the new evaluation methodology takes developer fees into account when evaluating the proposed return on investment, it is unnecessary to establish "subjective caps" on the amount of developer fees allowed. However, our report documents that prior to the development of the city's new evaluation model there was no process in place to ensure developer fees were reasonable. The city should continue to implement the new evaluation model to help ensure developer fees are reasonable and should establish allowable developer fee levels to provide additional transparency and clarity to the public.

4. Developer Profits Not Monitored

The city has historically not compared actual developer profit to the projected profit by project. As a result, the city may be providing public incentives for private projects that did not need to be incentivized.

As discussed in MAR finding number 2.1, a developer submits financial information showing the planned profit the developer anticipates generating by using the public monies for the project. No review is performed after the project is completed to ensure the actual profit generated is consistent with the developer's estimate during the application phase of the project. Additionally, a significant source of revenue for the developer occurs when the property is sold. A projected sales price was included in the application for several of the projects. However, no one in the city compares the projected sales price to the actual sales price to determine if the projected sales price in the application was understated. We were unable to compare the projected developer profit to actual developer profit because the city was unable to explain how the developer's profit was calculated in the application (see MAR finding number 3.1) and because the city did not document the actual sales price of the project when sold by the developer. SLDC officials could not explain why the actual IRR for the projects were not tracked for reasonableness when compared to the projected IRR.

The city added monitoring provisions to the TIF policy in October 2018 with the passage of Resolution 104. This policy revision requires developers to provide annual information on payrolls, income, cash flow, and tenant information, in part, to perform back-testing of the "but for" analysis. Because this policy change is relatively new and was passed outside of our scope, we did not perform testing on this requirement.

By implementing the requirements of Resolution 104, the city can monitor actual developer profits to ensure they are consistent with projected profits. This would provide additional assurance public monies were needed in order to complete the project and help with evaluating future projects.

Recommendation

The City of St. Louis ensure the requirements imposed by Resolution 104 are implemented and monitor the IRRs to ensure actual IRRs are similar to the projected IRRs.

Auditee's Response

The city provided a written response. See Appendix E.

Auditor's Comment

The city's response to MAR finding number 4 misrepresents the audit report's findings by suggesting the report is recommending the implementation of clawback provisions or an onerous monitoring process. However, the report simply recommends the city ensure the requirements imposed by Resolution 104 are implemented and that the city monitor project IRRs to ensure actual IRRs are similar to the projected IRRs. Doing so would help the city improve project projection processes going forward.

5. Fee Structure Creates the Appearance of a Conflict of Interest

The SLDC's fee structure creates the appearance of a conflict of interest for the agency. This agency evaluates project applications and makes recommendations related to incentive projects, and is also partially funded with fees generated from approved incentive projects. The amount of the fees received increases with the size of the award.

From November 2001 through October 2014, the SLDC fee structure was as follows:

- $5,000 application fee per project.
- 3/10 of a percent (0.3 percent) of the value of the TIF financing upon the adoption of the redevelopment plan per project.
- 2/10 of a percent (0.2 percent) annually of the outstanding TIF project financing for all projects.

In October 2014, the SLDC fee structure was changed to the following:

- $5,000 application fee per project.

- 1 7/10 of a percent (1.7 percent) of the maximum amount of the TIF notes allowed to be issued by the city pursuant to the redevelopment agreement.

Neither the city nor the SLDC was able to provide us a complete listing of the fees received by the SLDC or a breakdown of the fees paid to the SLDC by type. However, the city was able to provide information indicating the SLDC has received approximately $6 million in fees from TIF projects between 2003 and 2018.

The existing fee structure creates the appearance of a conflict of interest for the SLDC, and is not in the best interest of the city. While we saw no evidence to believe projects were approved for this reason, the fee structure provides the SLDC a financial incentive to support as many projects as possible, to promote larger incentive awards than necessary, and to recommend financing methods that do not benefit the public. For example, using overstated revenue projections to support an inflated TIF note amount, or recommending a waiver to the 15 percent cost limitation would result in higher fees to the SLDC than recommending a smaller TIF award. Prior to 2014, it was in SLDC's best interest to have TIF projects be financed using TIF notes because part of the fee was based on the outstanding balance of TIF notes. While the 2014 policy change removed the annual fee to the SLDC based on the amount of outstanding TIF project financing for new projects, this fee still applies to projects that were approved prior to the policy change.

Basing the compensation paid to the SLDC on actual costs needed to provide the service of evaluating projects, or requiring a flat fee per project evaluation would remove the conflict, and help provide the city with more assurance the advice given by the SLDC is in the best interest of the city.

Recommendation

The City of St. Louis evaluate and restructure the fees paid to the SLDC to remove the appearance that a conflict exists.

Auditee's Response

The city provided a written response. See Appendix E.

Auditor's Comment

The city's response to MAR finding number 5 misrepresents the audit report's finding. Our finding does not suggest that charging fees on TIF projects is inappropriate, rather it recommends the fee structure be reevaluated and restructured to remove the appearance of a conflict of interest.

6. Governmental Accounting Standards Board Violation

The city did not include the amount of TIF project revenues redistributed for fiscal years 2018 or 2017 in its Comprehensive Annual Financial Report (CAFR) as required by the Governmental Accounting Standards Board (GASB) Statement No. 77. According to the Comptroller, PILOTs totaled approximately $23.9 million and $20.9 million, respectively for fiscal years ended June 30, 2018, and June 30, 2017, and EATs totaled approximately $13.2 million and $13.5 million, respectively in those years.

GASB Statement No. 77 requires the city to disclose the "gross dollar amount tax abatements as well as other information pertaining to the tax abatements" in its notes to the financial statements. GASB Statement No. 77 defines a tax abatement as "a reduction in tax revenues that results from an agreement between one or more governments and an individual or entity in which (a) one or more governments promise to forgo tax revenues in which they are otherwise entitled and (b) the individual or entity promises to take a specific action after the agreement has been entered into that contributes to economic development or otherwise benefits the governments or the citizens of those governments." We contacted both the city's financial auditors and an official from the GASB and both agreed redistributed TIF project revenues are considered tax abatements under GASB Statement No. 77, and should be disclosed.

Recommendation

The City of St. Louis consult with its financial auditor to determine proper TIF reporting for the city's CAFR.

Auditee's Response

The city provided a written response. See Appendix E.

Auditor's Comment

As explained in the finding, the city's auditors, as well as an official from the GASB, confirmed that TIF incentives should be disclosed in the city's CAFR. The city's fiscal year 2019 CAFR subsequently included TIF data as part of its GASB 77 disclosure, as recommended.

Appendix A
City of St. Louis - Tax Increment Financing
Projects Selected for Additional Review, Summarized Information

District Name	Year Established	Ward Location	Projected Cost of Project	Amount of Note issued	Interest Rate	Debt Service Payments	Outstanding Balance as of December 31, 2018	Projected Revenues	Actual Revenues	2018 Projected Assessed Valuation	2018 Actual Assessed Valuation	Developer Fee
	(1)	(2)	(3) (11)	(1)	(1)	(1) (6)	(1)	(3)	(4)	(3)	(5)	(3)
920 Olive/1000 Locust	2002	7	$ 12,277,761	2,667,732	7.50%	1,979,236	4,485,898	4,623,534	2,059,868	2,500,902	1,014,270	1,500,000
1111 Olive	2010	7	11,750,583	2,396,000	8.02%	1,027,603	2,807,185	1,838,279	1,063,733	2,512,635	1,583,600	(7)
1225 Washington	2009	5	21,672,113	6,425,000	6.50%	2,128,551	6,949,099	1,929,218	2,187,350	2,566,734	1,201,140	(7)
Chouteau/Compton Industrial Center	1998	6	14,502,400	2,436,000	8.77%	3,033,628	4,371,322	(8)	3,558,939	(8)	905,800	(8)
Delmar East Loop	2006	28	10,500,000	3,000,000	6.36%	2,824,923	1,124,000	(9)	4,125,038	5,041,745	4,233,030	(7)
Edison Brothers Warehouse	1999	7	38,105,000	5,600,000	6.50%	8,527,381	0	16,398,345	10,547,081	8,607,215	7,494,710	750,000
Maryland Plaza South	2004	28	20,571,935	4,133,176	5.76%	3,874,318	3,405,000	7,391,894	3,993,928	4,172,624	2,820,800	1,719,401
Northeast Hampton/I-44 Ackerman Toyota	2015	10	17,925,125	(10)	(10)	(10)	(10)	887,926	(10)	3,088,200	408,400	(10)
Paul Brown/Arcade Building	2002	7	46,065,280	3,264,200	7.50%	3,285,570	3,073,960	4,613,668	3,361,846	4,044,051	4,205,910	5,500,000
Printer's Lofts - 1601-27 Locust Street	2003	5	26,502,500	4,410,000	6.00%	2,525,490	5,333,028	5,222,184	2,362,253	4,790,559	2,820,660	3,500,000
Soulard Market Apartments - 1535 S. 8th Street	2003	7	29,226,316	4,400,000	7.00%	2,314,846	7,331,961	6,340,619	2,522,788	4,427,406	2,967,000	3,875,000
Terra Cotta Annex and Garage	2003	5	24,398,026	3,520,000	7.50%	2,852,548	4,618,040	6,731,695	3,023,286	8,698,384	4,791,340	2,441,091
Washington East Condominiums	2004	7	60,280,874	7,997,521	5.50%	5,035,788	7,508,181	9,747,536	4,761,233	12,043,694	5,963,200	6,800,000
Totals			$ 333,777,913	50,249,629		39,409,882	51,007,674	65,724,898	43,567,343	62,494,149	40,409,860	26,085,492

(1) This information was provided by the Comptroller's office.

(2) This information was provided by the SLDC.

(3) This information was obtained from application files provided by the SLDC.

(4) This information was obtained from the annual reports prepared by the SLDC.

(5) This information was provided by the Assessor's office.

(6) Due to multiple notes being issued for the Chouteau/Compton Industrial Center, Maryland Plaza South, Printer's Lofts - 1601-27 Locust Street, and Washington East Condominiums projects, we used a weighted average calculation to represent a single interest rate.

(7) The developer fee was not disclosed in the application.

(8) The Chouteau/Compton Industrial Center application was not available for review. As a result, we were unable to obtain Projected Revenues, Projected Assessed Valuation, or the Developer Fee.

(9) The Delmar East Loop Project application did not include Projected Revenues.

(10) As of June 30, 2018, a note had not been issued for this project and actual revenues had not been reported because the project had not been completed.

(11) The Projected Cost of Project for the Delmar East Loop project was obtained from the Redevelopment Agreement because the application was not available.

Appendix B
City of St. Louis - Tax Increment Financing
Projects Selected for Additional Review, Detailed Information
920 Olive/1000 Locust

Year		(1) Projected PILOTs	(1) Projected EATs	(2) Actual PILOTs	(2) Actual EATs	(3) Principal Payments	(3) Interest Payments	(3) Outstanding Principal	(3) Outstanding Interest
2003	$	86,852	73,919	(4)	(4)	0	0	0	0
2004		121,929	103,542	(4)	(4)	0	0	2,667,732	0
2005		128,363	108,726	(4)	(4)	0	34,819	2,667,732	161,517
2006		128,363	114,169	(4)	(4)	0	37,708	2,667,732	339,102
2007		135,118	119,884	123,004	50,070	0	98,538	2,667,732	467,332
2008		135,118	125,885	0	41,648	0	28,311	2,667,732	678,140
2009		142,211	132,186	163,375	41,920	0	198,749	2,667,732	728,356
2010		142,211	138,802	83,938	37,457	0	103,816	2,667,732	883,782
2011		149,658	145,749	0	29,126	0	118,444	2,667,732	1,036,518
2012		149,658	153,044	151,337	34,357	0	136,668	2,667,732	1,182,661
2013		157,478	160,703	42,512	76,958	0	88,762	2,667,732	1,386,819
2014		157,478	168,744	108,613	111,146	0	214,220	2,667,732	1,476,616
2015		165,689	177,188	201,554	120,007	0	311,160	2,667,732	1,472,702
2016		165,689	186,055	91,690	133,262	0	223,176	2,667,732	1,560,102
2017		174,310	195,364	101,296	139,424	0	227,397	2,667,732	1,649,526
2018		174,310	205,139	49,711	127,463	0	157,468	2,667,732	1,818,166
Total	$	2,314,435	2,309,099	1,117,030	942,838	0	1,979,236		

(1) This information was obtained from the application files provided by the SLDC and is on a calendar year basis.
(2) This information was obtained from the annual reports prepared by the SLDC and is on a fiscal year ending June 30 basis.
(3) This information was obtained from the amortization schedule provided by the Comptroller's office.
(4) Actual revenues per year were only available for 2008 and after. Revenues in 2007 are shown as a cumulative amount from inception through 2007.

Appendix B
City of St. Louis - Tax Increment Financing
Projects Selected for Additional Review, Detailed Information
1111 Olive

Year		(1) Projected PILOTs	(1) Projected EATs	(2) Actual PILOTs	(2) Actual EATs	(3) Principal Payments	(3) Interest Payments	(3) Outstanding Principal	(3) Outstanding Interest
2010	$	0	37,211	0	0	0	0	0	0
2011		129,930	76,355	0	4,705	4,000	0	2,392,000	95,919
2012		129,930	79,927	82,144	22,272	0	112,236	2,392,000	175,521
2013		135,842	81,578	112,671	33,639	0	134,086	2,392,000	233,274
2014		135,842	84,317	114,029	40,306	0	162,695	2,392,000	262,418
2015		141,990	87,151	97,089	63,244	0	142,926	2,392,000	311,330
2016		141,990	90,082	97,151	60,704	0	134,785	2,392,000	368,383
2017		148,384	93,115	107,329	63,142	0	184,204	2,392,000	376,018
2018		148,384	96,251	104,073	61,235	0	152,671	2,392,000	415,185
Total	$	1,112,292	725,987	714,486	349,247	4,000	1,023,603		

(1) This information was obtained from the application files provided by the SLDC and is on a calendar year basis.
(2) This information was obtained from the annual reports prepared by the SLDC and is on a fiscal year ending June 30 basis.
(3) This information was obtained from the amortization schedule provided by the Comptroller's office.

Appendix B
City of St. Louis - Tax Increment Financing
Projects Selected for Additional Review, Detailed Information
1225 Washington

Year		(1) Projected PILOTs	(1) Projected EATs	(2) Actual PILOTs	(2) Actual EATs	(3) Principal Payments	(3) Interest Payments	(3) Outstanding Principal	(3) Outstanding Interest
2010	$	105,910	44,620	0	8	0	0	0	0
2011		110,731	90,511	0	1,590	0	0	0	0
2012		110,731	93,226	55,971	298,594	125,000	195,650	6,300,000	0
2013		116,382	96,023	58,235	368,561	0	365,709	6,300,000	43,791
2014		122,260	98,903	46,190	281,721	0	251,411	6,300,000	201,880
2015		122,260	101,870	46,175	208,583	0	206,742	6,300,000	404,638
2016		128,372	104,928	35,520	218,479	0	236,848	6,300,000	577,290
2017		128,372	108,074	41,346	212,793	0	394,556	6,300,000	592,234
2018		134,729	111,316	39,122	274,462	0	352,636	6,300,000	649,099
Total	$	1,079,747	849,471	322,559	1,864,791	125,000	2,003,551		

(1) This information was obtained from the application files provided by the SLDC and is on a calendar year basis.
(2) This information was obtained from the annual reports prepared by the SLDC and is on a fiscal year ending June 30 basis.
(3) This information was obtained from the amortization schedule provided by the Comptroller's office.

Appendix B
City of St. Louis - Tax Increment Financing
Projects Selected for Additional Review, Detailed Information
Chouteau/Compton Industrial Center

Year		(1) Projected PILOTs	(1) Projected EATs	(2) (4) Actual PILOTs	(2) (4) Actual EATs	(3) Principal Payments	(3) Interest Payments	(3) (5) Outstanding Principal	(3) Outstanding Interest
2007	$	(1)	(1)	395,336	122,051	0	0	2,120,000	1,025,066
2008		(1)	(1)	25,429	52,913	0	10,594	2,120,000	1,200,486
2009		(1)	(1)	25,368	59,297	0	81,733	2,436,000	1,430,722
2010		(1)	(1)	36,317	197,277	0	157,675	2,436,000	1,617,148
2011		(1)	(1)	37,811	163,020	0	204,744	2,436,000	1,773,144
2012		(1)	(1)	38,831	197,723	24,000	230,116	2,412,000	1,916,819
2013		(1)	(1)	40,402	226,481	29,000	257,079	2,383,000	2,044,049
2014		(1)	(1)	41,171	266,143	43,000	256,692	2,340,000	2,180,021
2015		(1)	(1)	7,892	316,505	52,000	323,396	2,288,000	2,255,524
2016		(1)	(1)	75,058	381,374	48,000	408,029	2,240,000	2,246,934
2017		(1)	(1)	45,360	369,374	65,000	362,608	2,175,000	2,281,195
2018		(1)	(1)	46,547	391,259	55,000	424,963	2,120,000	2,251,322
Total	$	(1)	(1)	815,522	2,743,417	316,000	2,717,628		

(1) Projected revenues were unavailable for analysis due to no application files available for us to review.
(2) This information was obtained from the annual reports prepared by the SLDC and is on a fiscal year ending June 30 basis.
(3) This information was obtained from the amortization schedule provided by the Comptroller's office.
(4) Actual revenues per year were only available for 2008 and after. Revenues in 2007 are shown as a cumulative amount from inception through 2007.
(5) Three notes were issued on this project. Two notes were issued on December 31, 2007, and one on February 27, 2009.

Appendix B
City of St. Louis - Tax Increment Financing
Projects Selected for Additional Review, Detailed Information
Delmar East Loop

Year		(1) Projected PILOTs	(1) Projected EATs	(2) Actual PILOTs	(2) Actual EATs	(3) Principal Payments	(3) Interest Payments	(3) (4) Outstanding Principal	(3) Outstanding Interest
2007	$	(1)	(1)	0	23,443	0	0	0	0
2008		(1)	(1)	19,812	131,001	0	0	0	0
2009		(1)	(1)	13,341	350,869	0	0	0	0
2010		(1)	(1)	8,851	140,617	0	0	0	0
2011		(1)	(1)	41,826	314,450	0	0	0	0
2012		(1)	(1)	59,183	594,224	6,000	50,350	2,994,000	0
2013		(1)	(1)	71,538	21,771	111,000	186,889	2,883,000	0
2014		(1)	(1)	61,689	258,604	162,000	179,384	2,721,000	0
2015		(1)	(1)	73,447	305,512	300,000	167,904	2,421,000	0
2016		(1)	(1)	149,132	406,042	340,000	146,248	2,081,000	0
2017		(1)	(1)	154,824	340,331	422,000	123,575	1,659,000	0
2018		(1)	(1)	212,950	371,581	535,000	94,573	1,124,000	0
Total	$	(1)	(1)	866,593	3,258,445	1,876,000	948,923		

(1) Projected revenues were unavailable for analysis because they were not included in the project application files.
(2) This information was obtained from the annual reports prepared by the SLDC and is on a fiscal year ending June 30 basis.
(3) This information was obtained from the amortization schedule provided by the Comptroller's office.
(4) This project was initially funded as a PAYG. A note was issued on July 26, 2012, to provide additional funding and the PAYG ceased.

Appendix B
City of St. Louis - Tax Increment Financing
Projects Selected for Additional Review, Detailed Information
Edison Brothers Warehouse

Year		(1) Projected PILOTs	(1) Projected EATs	(2) Actual PILOTs	(2) Actual EATs	(3) Principal Payments	(3) Interest Payments	(3) Outstanding Principal	(3) Outstanding Interest
2000	$	476,459	241,162	(4)	(4)	0	0	0	0
2001		486,703	254,468	(4)	(4)	0	0	0	0
2002		486,703	268,569	(4)	(4)	0	0	0	0
2003		497,153	279,992	(4)	(4)	0	0	0	0
2004		497,153	289,640	(4)	(4)	0	73,082	5,600,000	34,095
2005		507,811	298,368	(4)	(4)	374,000	338,916	5,226,000	48,132
2006		507,811	307,372	(4)	(4)	263,000	285,148	4,963,000	95,709
2007		518,682	316,663	2,970,734	833,278	307,000	326,891	4,656,000	84,564
2008		518,682	326,249	397,997	171,899	288,000	313,340	4,368,000	67,273
2009		529,771	336,139	446,928	146,159	290,000	288,310	4,078,000	55,665
2010		529,771	339,288	459,219	135,931	311,000	256,964	3,767,000	55,496
2011		541,082	349,606	478,111	121,694	337,000	221,631	3,430,000	68,832
2012		541,082	360,254	536,057	132,697	437,000	230,223	2,993,000	49,594
2013		552,618	371,241	560,332	126,524	474,000	226,068	2,519,000	4,273
2014		552,618	382,579	697,887	120,471	650,000	147,163	1,869,000	0
2015		564,386	394,278	181,181	129,401	174,000	115,477	1,695,000	353
2016		564,386	406,351	1,067,271	123,547	1,079,000	75,471	616,000	0
2017		576,389	418,810	335,484	72,401	616,000	28,698	(5)	0
2018		576,389	431,667	275,136	26,742	0	0	(5)	0
Total	$	10,025,649	6,372,696	8,406,337	2,140,744	5,600,000	2,927,381		

(1) This information was obtained from the application files provided by the SLDC and is on a calendar year basis.
(2) This information was obtained from the annual reports prepared by the SLDC and is on a fiscal year ending June 30 basis.
(3) This information was obtained from the amortization schedule provided by the Comptroller's office.
(4) Actual revenues per year were only available for 2008 and after. Revenues in 2007 are shown as a cumulative amount from inception through 2007.
(5) The note was paid off on December 27, 2017.

Appendix B
City of St. Louis - Tax Increment Financing
Projects Selected for Additional Review, Detailed Information
Maryland Plaza South

Year		(1) Projected PILOTs	(1) Projected EATs	(2) Actual PILOTs	(2) Actual EATs	(3) Principal Payments	(3) Interest Payments	(3) Outstanding Principal	(3) Outstanding Interest
2005	$	135,547	216,697	(4)	(4)	0	0	4,133,176	0
2006		185,875	226,232	(4)	(4)	0	0	4,133,176	187,122
2007		210,666	236,200	75,093	1,037	0	45,655	4,133,176	392,582
2008		216,984	246,622	84,018	36,101	0	129,001	4,133,176	524,463
2009		223,462	257,519	84,737	98,194	0	245,577	4,133,176	545,311
2010		230,107	268,914	249,778	142,005	0	336,311	4,133,176	473,698
2011		236,922	280,830	117,978	148,138	0	262,214	4,133,176	474,880
2012		243,911	293,291	173,988	154,600	0	303,012	4,133,176	433,415
2013		251,080	306,324	180,283	165,823	0	361,105	4,133,176	330,813
2014		258,432	319,955	182,308	191,671	0	337,429	4,133,176	246,276
2015		272,116	334,213	182,256	338,010	23,000	489,807	4,110,176	738
2016		272,116	349,127	199,993	300,527	286,000	229,245	3,824,176	0
2017		286,486	364,729	219,339	239,794	195,000	210,322	3,629,176	0
2018		286,486	381,051	209,345	218,912	224,176	196,462	3,405,000	0
Total	$	3,310,190	4,081,704	1,959,116	2,034,812	728,176	3,146,142		

(1) This information was obtained from the application files provided by the SLDC and is on a calendar year basis.
(2) This information was obtained from the annual reports prepared by the SLDC and is on a fiscal year ending June 30 basis.
(3) This information was obtained from the amortization schedule provided by the Comptroller's office.
(4) Actual revenues per year were only available for 2008 and after. Revenues in 2007 are shown as a cumulative amount from inception through 2007.

Appendix B
City of St. Louis - Tax Increment Financing
Projects Selected for Additional Review, Detailed Information
Northeast Hampton/I-44 Ackerman Toyota

Year		Projected PILOTs	Projected EATs	Actual PILOTs	Actual EATs	Principal Payments	Interest Payments	Outstanding Principal	Outstanding Interest
2015	$	0	1,211	(1)	(1)	(1)	(1)	(1)	(1)
2016		116,589	57,150	(1)	(1)	(1)	(1)	(1)	(1)
2017		233,178	121,880	(1)	(1)	(1)	(1)	(1)	(1)
2018		233,178	124,740	(1)	(1)	(1)	(1)	(1)	(1)
Total	$	582,945	304,981	(1)	(1)	(1)	(1)		

(1) As of June 30, 20 18, a note had not been issued for this project and actual revenue had not been reported because the project had not been completed.

Appendix B
City of St. Louis - Tax Increment Financing
Projects Selected for Additional Review, Detailed Information
Paul Brown/Arcade Building

Year		(1) Projected PILOTs	(1) Projected EATs	(2) Actual PILOTs	(2) Actual EATs	(3) Principal Payments	(3) Interest Payments	(3) Outstanding Principal	(3) Outstanding Interest
2003	$	0	3,500	(4)	(4)	0	0	0	0
2004		0	0	(4)	(4)	0	0	0	0
2005		111,200	36,994	(4)	(4)	0	0	0	0
2006		241,200	59,881	(4)	(4)	0	69,099	3,264,200	134,914
2007		247,700	62,324	234,738	0	0	159,239	3,264,200	220,490
2008		247,700	64,687	250,556	0	0	244,156	3,264,200	221,150
2009		254,300	67,173	249,958	3,710	0	247,268	3,264,200	218,696
2010		254,300	69,782	256,822	0	0	250,422	3,264,200	213,090
2011		261,200	72,414	0	0	0	260,987	3,264,200	196,917
2012		261,200	75,171	545,965	39	0	272,217	3,264,200	169,515
2013		265,400	78,053	289,850	3,011	0	286,461	3,264,200	127,869
2014		265,400	97,581	293,343	0	36,000	250,943	3,228,200	120,390
2015		269,600	101,364	293,250	0	45,000	241,850	3,183,200	118,968
2016		269,600	105,302	293,437	1,380	50,000	238,450	3,133,200	117,382
2017		274,000	109,295	324,177	7,223	90,000	235,135	3,043,200	113,863
2018		274,000	113,347	314,387	0	80,000	228,343	2,963,200	110,760
Total	$	3,496,800	1,116,868	3,346,483	15,363	301,000	2,984,570		

(1) This information was obtained from the application files provided by the SLDC and is on a calendar year basis.
(2) This information was obtained from the annual reports prepared by the SLDC and is on a fiscal year ending June 30 basis.
(3) This information was obtained from the amortization schedule provided by the Comptroller's office.
(4) Actual revenues per year were only available for 2008 and after. Revenues in 2007 are shown as a cumulative amount from inception through 2007.

Appendix B
City of St. Louis - Tax Increment Financing
Projects Selected for Additional Review, Detailed Information
Printer's Lofts - 1607-27 Locust Street

Year		(1) Projected PILOTs	(1) Projected EATs	(2) Actual PILOTs	(2) Actual EATs	(3) Principal Payments	(3) Interest Payments	(3) Outstanding Principal	(3) Outstanding Interest
2003	$	0	70,430	(4)	(4)	0	0	0	0
2004		93,375	101,200	(4)	(4)	0	0	0	0
2005		208,799	63,762	(4)	(4)	0	0	0	0
2006		208,799	67,135	(4)	(4)	0	72,030	4,410,000	0
2007		224,958	70,676	191,864	11,383	0	264,600	4,410,000	0
2008		224,958	74,395	147,803	8,863	0	264,600	4,410,000	0
2009		242,249	78,299	172,820	5,707	0	258,193	4,410,000	6,407
2010		242,249	82,399	176,497	4,028	0	164,477	4,410,000	106,722
2011		260,749	86,705	211,320	4,592	0	199,482	4,410,000	177,905
2012		260,749	91,225	184,728	10,035	0	179,596	4,410,000	272,324
2013		280,545	95,971	199,415	15,001	0	199,382	4,410,000	352,115
2014		280,545	100,954	179,246	16,173	0	174,012	4,410,000	462,895
2015		301,727	106,186	175,960	11,572	0	173,028	4,410,000	581,435
2016		301,727	111,680	177,750	12,099	0	169,674	4,410,000	710,649
2017		324,391	117,449	198,949	14,266	0	193,973	4,410,000	822,822
2018		324,391	123,507	219,277	12,905	0	212,443	4,410,000	923,028
Total	$	3,780,211	1,441,973	2,235,629	126,624	0	2,525,490		

(1) This information was obtained from the application files provided by the SLDC and is on a calendar year basis.
(2) This information was obtained from the annual reports prepared by the SLDC and is on a fiscal year ending June 30 basis.
(3) This information was obtained from the amortization schedule provided by the Comptroller's office.
(4) Actual revenues per year were only available for 2008 and after. Revenues in 2007 are shown as a cumulative amount from inception through 2007.

Appendix B
City of St. Louis - Tax Increment Financing
Projects Selected for Additional Review, Detailed Information
Soulard Market Apartments - 1535 S. 8th Street

Year		(1) Projected PILOTs	(1) Projected EATs	(2) Actual PILOTs	(2) Actual EATs	(3) Principal Payments	(3) Interest Payments	(3) (4) Outstanding Principal	(3) Outstanding Interest
2004	$	218,054	111,032	(5)	(5)	0	0	2,760,533	0
2005		229,431	116,445	(5)	(5)	0	0	2,760,533	176,619
2006		229,431	122,107	(5)	(5)	0	13,386	2,760,533	371,963
2007		241,377	128,029	96,968	1,420	0	72,964	4,400,000	588,090
2008		241,377	134,223	184,210	29,051	0	205,544	4,400,000	731,108
2009		253,921	140,703	180,591	32,270	0	186,982	4,400,000	903,481
2010		253,921	147,482	184,115	28,357	0	188,549	4,400,000	1,086,283
2011		267,091	154,575	191,930	18,235	0	194,800	4,400,000	1,276,172
2012		267,091	161,995	197,429	19,204	0	199,006	4,400,000	1,474,755
2013		280,920	169,759	206,204	16,826	0	202,918	4,400,000	1,683,345
2014		280,920	177,883	209,445	12,973	0	206,727	4,400,000	1,902,914
2015		295,441	186,384	209,391	14,727	0	203,242	4,400,000	2,141,616
2016		295,441	195,281	209,694	11,223	0	200,566	4,400,000	2,399,990
2017		310,687	204,593	231,067	3,115	0	215,674	4,400,000	2,661,097
2018		310,687	214,338	224,378	9,965	0	224,485	4,400,000	2,931,961
Total	$	3,975,790	2,364,829	2,325,422	197,366	0	2,314,846		

(1) This information was obtained from the application files provided by the SLDC and is on a calendar year basis.
(2) This information was obtained from the annual reports prepared by the SLDC and is on a fiscal year ending June 30 basis.
(3) This information was obtained from the amortization schedule provided by the Comptroller's office.
(4) The note was issued on October 7, 2004. The note was refinanced and additional monies borrowed on January 30, 2007.
(5) Actual revenues per year were only available for 2008 and after. Revenues in 2007 are shown as a cumulative amount from inception through 2007.

Appendix B
City of St. Louis - Tax Increment Financing
Projects Selected for Additional Review, Detailed Information
Terra Cotta Annex and Garage

Year	(1) Projected PILOTs	(1) Projected EATs	(2) Actual PILOTs	(2) Actual EATs	(3) Principal Payments	(3) Interest Payments	(3) Outstanding Principal	(3) Outstanding Interest
2003	$ 0	36,602	(4)	(4)	0	0	0	0
2004	18,006	93,291	(4)	(4)	0	0	0	0
2005	131,833	112,264	(4)	(4)	0	0	3,520,000	0
2006	144,075	122,726	(4)	(4)	15,000	81,543	3,505,000	109,294
2007	154,817	128,885	218,826	79,325	0	199,821	3,505,000	179,516
2008	154,817	135,351	175,375	34,558	0	171,289	3,505,000	283,741
2009	166,203	142,141	175,214	7,952	0	167,458	3,505,000	400,006
2010	166,203	149,271	168,546	4,759	0	163,821	3,505,000	528,776
2011	178,273	156,756	179,992	4,318	0	170,369	3,505,000	660,829
2012	178,273	164,616	155,054	5,145	0	149,189	3,505,000	825,119
2013	191,066	172,870	146,310	20,126	0	156,163	3,505,000	994,422
2014	524,890	181,535	265,403	24,764	0	274,797	3,505,000	1,053,632
2015	558,481	190,634	267,419	23,655	0	280,753	3,505,000	1,111,665
2016	558,481	200,188	315,452	26,944	0	324,939	3,505,000	1,127,754
2017	594,087	210,220	336,588	26,963	0	353,433	3,505,000	1,115,823
2018	594,087	220,753	338,121	22,477	0	343,973	3,505,000	1,113,040
Total	$ 4,313,592	2,418,103	2,742,300	280,986	15,000	2,837,548		

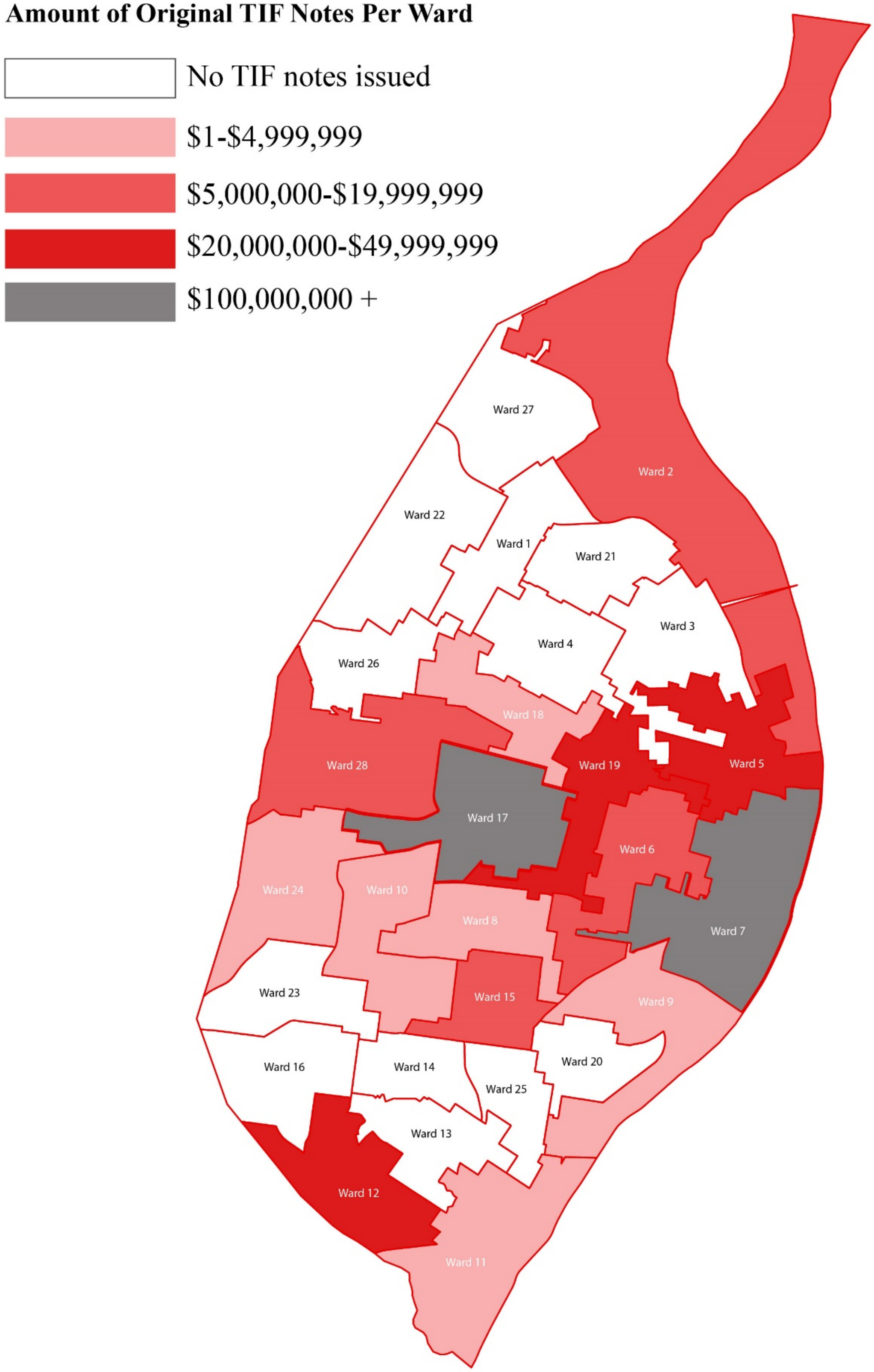
(1) This information was obtained from the application files provided by the SLDC and is on a calendar year basis.
(2) This information was obtained from the annual reports prepared by the SLDC and is on a fiscal year ending June 30 basis.
(3) This information was obtained from the amortization schedule provided by the Comptroller's office.
(4) Actual revenues per year were only available for 2008 and after. Revenues in 2007 are shown as a cumulative amount from inception through 2007.

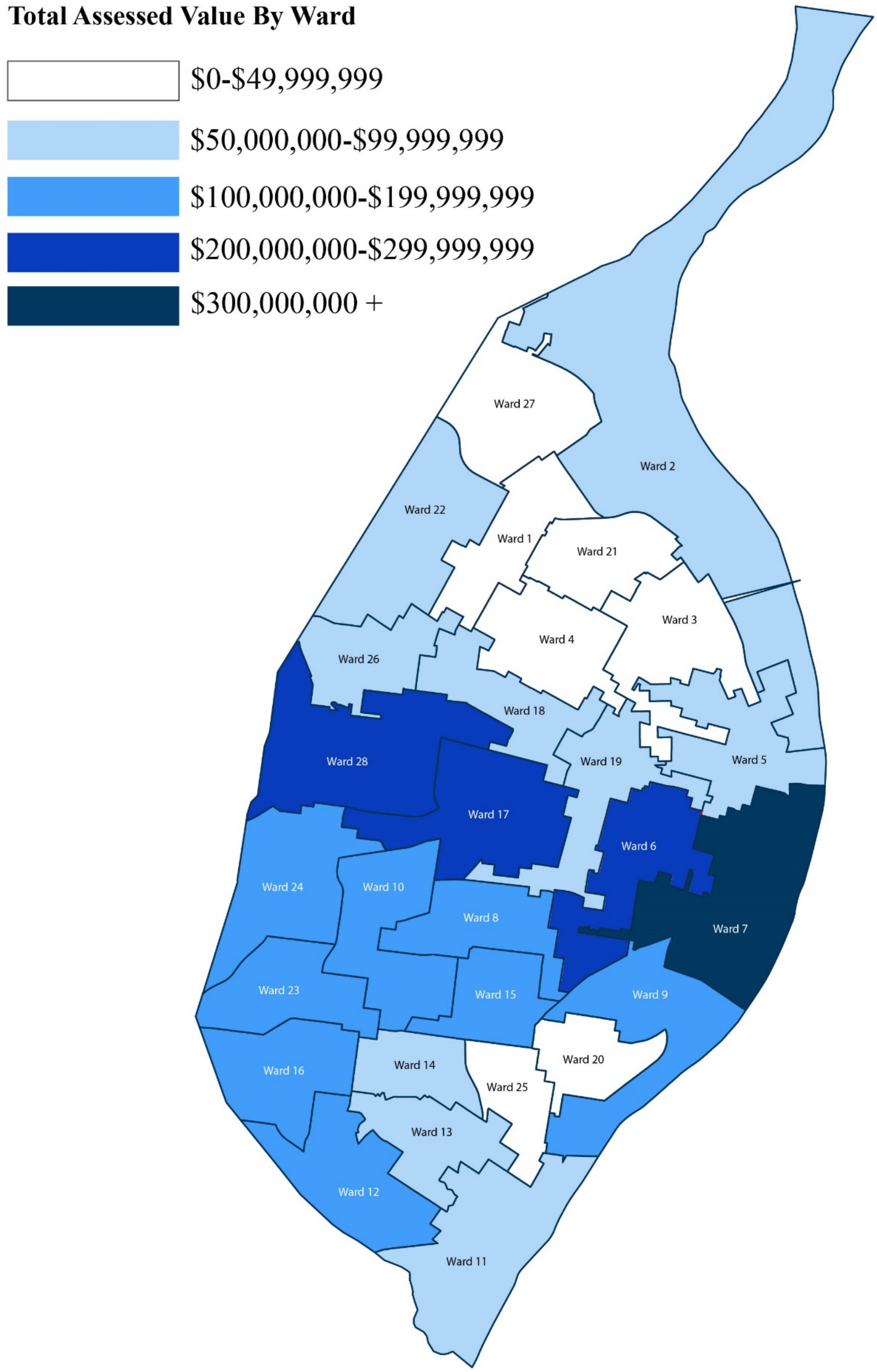
Appendix B
City of St. Louis - Tax Increment Financing
Projects Selected for Additional Review, Detailed Information
Washington East Condominiums

Year		(1) Projected PILOTs	(1) Projected EATs	(2) Actual PILOTs	(2) Actual EATs	(3) Principal Payments	(3) Interest Payments	(3) (4) Outstanding Principal	(3) Outstanding Interest
2005	$	107,393	48,282	(5)	(5)	0	0	0	0
2006		210,980	70,850	(5)	(5)	0	0	0	0
2007		568,239	73,639	99,613	16,224	0	104,323	5,480,000	0
2008		568,239	76,511	207,483	21,511	137,000	297,633	7,860,521	0
2009		610,654	79,469	270,745	46,568	0	354,103	7,860,521	44,379
2010		610,654	82,516	525,385	74,272	120,000	474,628	7,740,521	0
2011		656,039	85,654	13,896,797	120,218	45,000	404,030	7,695,521	20,461
2012		656,039	88,887	(13,138,840)	102,645	194,000	442,958	7,501,521	0
2013		704,601	92,216	372,988	62,062	42,000	411,429	7,459,521	0
2014		704,601	95,645	288,245	33,450	0	390,116	7,459,521	20,158
2015		756,563	99,178	426,821	35,110	0	421,147	7,459,521	11,760
2016		756,563	102,816	359,335	32,624	10,000	357,136	7,449,521	65,206
2017		812,161	106,563	388,972	54,453	40,000	364,714	7,409,521	112,465
2018		812,161	110,423	417,920	46,632	47,000	378,573	7,362,521	145,660
Total	$	8,534,887	1,212,649	4,115,464	645,769	635,000	4,400,788		

(1) This information was obtained from the application files provided by the SLDC and is on a calendar year basis.
(2) This information was obtained from the annual reports prepared by the SLDC and is on a fiscal year ending June 30 basis.
(3) This information was obtained from the amortization schedule provided by the Comptroller's office.
(4) Five notes were issued for this project. Two were issued on May 8, 2007, two on June 26, 2007, and one on December 29, 2008.
(5) Actual revenues per year were only available for 2008 and after. Revenues in 2007 are shown as a cumulative amount from inception through 2007.

Appendix C
City of St. Louis - Tax Increment Financing
Project Amount by Ward




Total Assessed Value By Ward
$0-$49,999,999
$50,000,000-$99,999,999
$100,000,000-$199,999,999
$200,000,000-$299,999,999
$300,000,000 +
Ward 27
Ward 2
Ward 22
Ward 1
Ward 21
Ward 3
Ward 4
Ward 26
Ward 18
Ward 28
Ward 19
Ward 5
Ward 17
Ward 6
Ward 24
Ward 10
Ward 8
Ward 7
Ward 23
Ward 15
Ward 9
Ward 14
Ward 20
Ward 16
Ward 25
Ward 13
Ward 12
Ward 11

LYDA KREWSON
MAYOR

OFFICE OF THE MAYOR
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September 16, 2020

Honorable Nicole Galloway, CPA
State Auditor's Office
P.O. Box 869
Jefferson City, Missouri 65102

Re: City of St. Louis Response to State Auditor's Findings Regarding Tax Increment Financing

Dear Auditor Galloway:

The City of St. Louis sincerely thanks you and your staff for the time invested in preparing your report relating to the consideration, approval and administration of tax increment financing (TIF) redevelopment projects, including correction of most of the factual errors contained in the initial draft audit that the City reviewed. The City's use of TIF has proven to be a very effective tool for redeveloping blighted property, leveraging private investment and creating jobs (based on an analysis of local earnings tax returns, we estimate over 35,000 jobs in the City are located within TIF redevelopment areas). The City, through its partnership with St. Louis Development Corporation (SLDC), expends considerable resources to evaluate and vet all applications for TIF assistance before they are considered by the City's TIF Commission and Board of Aldermen. Most of the projects reviewed by the State Auditor predate the City's current "Scorecard" evaluation methodology. The Scorecard evaluation methodology is a robust review process, which among other things, takes into account the developer's forecasted return and the tax revenues, net of TIF, that are projected to be available to the City and other taxing districts if a TIF project is successfully implemented.

The City has reviewed the State Auditor's findings and welcomes constructive criticism of its process. However, the City notes that several of the findings are policy proposals that are not required by state law or reflect a simple difference of opinion regarding best practices or policies. The City's responses to the State Auditor's findings are set forth below:

1. Strategic Planning for Tax Increment Financing Incentives Needs Improvement

1.1 No specific program goals or strategic preferences

Auditor Finding: **The City's existing TIF policy does not contain any specific goals or measurable objectives.**

City's Response: While no state law requires such a TIF policy, the City, nonetheless, has established policies for TIF projects that express goals and preferences while also allowing the City's TIF Commission and Board of Aldermen to consider the individual merits of a project. These policies are included in the application packet available on the SLDC website for prospective developers. The City's policies intentionally allow for some flexibility when reviewing projects because rigid policies hinder policymakers' abilities to consider differences in locations, uses and extraordinary redevelopment costs when evaluating projects.

Moreover, TIF is one of many economic development tools employed by the City and SLDC and should be evaluated as part of a larger economic development strategy. Depending on the nature of the project, tax abatement, tax credits or other incentive programs may be more appropriate. A draft of the St. Louis Equitable Economic Development Strategy Framework (the "Framework") was recently published for public comment and should be finalized soon. The Framework represents the City's future vision for the use and implementation of economic development incentives to achieve more equitable outcomes.

The City further believes that other economic development tools, including tax abatement, certain tax credit programs, CDBG grants and tax-exempt bond financing, are more useful for residential and lower density projects common throughout much of the City. In practice, TIF tends to be most useful for larger commercial and mixed-use projects that increase density and generate significant economic activity taxes. Most of these projects, by their very nature, are located in or adjacent to the City's central corridor and may not be appropriate or viable in lower density areas of the City. The Framework represents the City's commitment to redevelop all portions of the City's equitably. TIF, by itself, is not the sole means to implement that goal.

1.2 No overall TIF program limits have been established

Auditor Finding: The City has not established any overall program usage limits.

City's Response: Overall program usage limits are not required by state law nor would such limits be in the best interests of the City or its residents.

The City has approximately 25,000 vacant or abandoned properties in need of redevelopment. Many occupied properties within the City are dilapidated or deteriorating, and the City and its residents would benefit immensely from the redevelopment of these properties. Creating an artificial cap on amount of TIF projects that could otherwise be undertaken would needlessly cripple the City's ability to pursue worthwhile redevelopment opportunities.

Moreover, the City only approves TIF projects that are projected to be financially beneficial to the City and other taxing districts. In accordance with the Missouri TIF Act, the City's Board of Aldermen, as a precondition to approving a TIF project, makes a finding that the TIF redevelopment area "would not reasonably be anticipated to be developed without the adoption of tax increment financing" (Section 99.810.1(1), RSMo.). Before this finding is made, evidence is presented by the developer and analyzed by SLDC to verify that, without TIF, there will not be sufficient funds to undertake the proposed redevelopment project and the estimated return on investment will be too low for a developer to undertake the proposed project without TIF assistance. As part of SLDC's Scorecard methodology, SLDC staff analyzes the revenues that will be generated, net of TIF assistance, if the proposed project is built and the revenues that will be generated if the proposed project is not built. Given that (1) vacant, dilapidated and deteriorated properties generate relatively little tax revenue and (2) a substantial amount of tax revenue from redeveloped properties continues to flow to taxing districts even after application of TIF (including 50% of most economic activity taxes, 100% of certain sales taxes, 100% of personal property taxes and 100% of the commercial surtax), the logical conclusion is that incentivizing redevelopment of properties with TIF *that would otherwise not be redeveloped* is financially beneficial to the City and other taxing districts and should not be artificially limited.

The City's most important responsibility is ensuring the well-being of its residents. To meet this responsibility, the City must be able to use all available incentive tools to generate tax revenues and attract development and job growth. The State Auditor seems to be suggesting that the City ignore this responsibility and impose an artificial cap on worthwhile projects, rather than reviewing the potential benefits to the City and its residents of each project. Accordingly, the City strenuously disagrees with the Auditor's policy proposal.

1.3 Data tracking and transparency

Auditor Finding: **The City does not maintain TIF data in a useful and transparent manner.**

City's Response: The City maintains TIF data in a useful and transparent manner that meets or exceeds every requirement of state law. The City also continuously seeks to improve the ability of the public to access TIF-related information in an easy and transparent matter.

Review, approval and administration of TIF projects impacts many City departments and affiliated entities, including, without limitation, SLDC, the Board of Aldermen, the City Register's office, the Comptroller's office, the Assessor's office, and the Collector of Revenue's office. As a result, creating the centralized source for all TIF-related documentation suggested by the State Auditor is a difficult and expensive undertaking. The City is not aware of any other city or county in Missouri that maintains a centralized source for all TIF-related documentation.

While there would certainly be benefits to having a centralized source for all TIF-related documentation, the City believes its record keeping is adequate and is reasonably available to assist policymakers and the public in a useful and transparent manner (with it being understood that certain TIF-related documents may be closed records pursuant to the Sunshine Law or otherwise subject to state confidentiality laws and cannot be publicly released). The City complies with all reporting requirements set forth in the TIF Act and regularly responds to Sunshine Law requests from the media and interested citizens. SLDC and City departments were responsive to the State Auditor's requests for information. SLDC's analysts are able to access data from various City sources to study, among other things, the number of jobs attributable to TIF projects; SLDC is confident it can obtain all data required for future studies and analysis.

Over the last year, SLDC has also been working on systematic improvements to increase the ease in which the public can access TIF-related information online.

2. Cost Control and Project Financing Policies are Ineffective

2.1 Project cost limits are not defined, and are regularly exceeded

Auditor Finding: **The City does not have defined project cost limitations that are followed.**

City's Response: State law does not require defined project limitations, nor is the City in favor of limitations that do not allow flexibility.

The City has policy guidelines that allow flexibility. Each project must be evaluated on its own merit and in light of the particular challenges the specific project faces. The City's policy guidelines provide that TIF awards should not exceed 15% of total project costs, but allow exceptions so that worthy projects may receive the amount of TIF necessary for the project to move forward.

Rigid limitations hinder policymakers' abilities to take into account differences in locations, uses and extraordinary redevelopment costs when evaluating projects. Rejecting otherwise worthwhile project because of rigid project cost limitations may cause negative external effects. Many TIF projects involve the clearance or rehabilitation of dangerous and derelict buildings. If an otherwise worthwhile project were rejected because it slightly exceeded a rigid limitation, the City could be subjecting its residents to the danger caused by those buildings for years to come until another viable redevelopment proposal is identified. Moreover, the City, its residents and other taxing jurisdictions (including the State of Missouri) would lose the benefit of job growth, greater economic vitality and increased tax revenues that the otherwise worthwhile TIF project would generate.

The City also notes that project cost limitations are only one of many considerations that should be taken into account when evaluating a proposed TIF project. The City's Scorecard methodology provides a more advanced, transparent and thorough analysis and is rightly used by policymakers when evaluating projects.

2.2. Policy on funding methods has not ensured project revenues are sufficient to cover debt service, has resulted in significant accrued interest, and has reduced transparency

Auditor Finding: **The City's TIF policy regarding financing methods and requiring a minimum level of debt service coverage have been ineffective in ensuring project revenues are sufficient to cover financing costs.**

City's Response: The City's TIF financing methods are permitted by state law.

The vast majority of the City's TIF projects are structured as TIF notes, which are payable only from TIF revenues *to the extent those revenues are actually* *generated by the project and not from citywide general tax revenues*. The City believes the TIF note or bond structure has been used judiciously and is preferred by private investors, which the City's TIF program must attract to successfully implement TIF projects. The City further believes that the State's Auditor's premise that project revenues have been insufficient to cover financing costs is not necessarily relevant to how TIF projects are actually financed and how the investor and lender communities analyze TIF notes and TIF revenues as a source of revenue to undertake a project. The City's approach is also completely consistent with the statutory requirements of the TIF Act.

Other cities in Missouri have issued TIF notes at higher interest rates than the City. The City's TIF note ordinances set interest rates based on a formula that relies on a published municipal bond market yield curve, resulting in lower interest rates than TIF notes issued by many other municipalities. Additionally, the City is aware of other cities that have issued TIF notes to developers upon the developer's acquisition of property, allowing interest on TIF notes to accrue for months or even years before a project is complete and able to generate TIF revenues to pay debt service on the TIF note. In contrast, the City's disciplined policy has been to issue TIF notes only after a project has been completed, thereby avoiding significant unpaid interest accrual.

Financing of a redevelopment project is often a complex endeavor. The availability of the TIF incentive must be leveraged to attract private investment. Without private investment, the redevelopment project will not be completed and the City's residents will continue to suffer the negative consequences associated with blighted, dangerous and derelict properties. While the City uses certain debt service coverage ratios as a guideline to evaluate projects, those guidelines purposefully provide flexibility for worthwhile projects. Moreover, the State Auditor's concern over early estimates of debt service coverage ratios ignores the limited risk to the City of TIF notes that remain unpaid and shows little faith in market debt and equity participants to make their own valuations and leverage their own structural preferences.

TIF incentives, regardless of whether structured as a note, bond or pay-as-you-go, are *not* secured by citywide general tax revenues and will go unpaid unless the TIF project generates enough TIF revenues to satisfy the incentive. Accordingly, the developer or third-party investor in a TIF note or bond bears the investment risk – not the City or its taxpayers. While TIF provides a valuable incentive, it typically requires a developer to obtain a bridge loan until the project is completed and TIF revenues are available as debt service on a TIF note or payments under a pay-as-you-go arrangement. The bridge lender must undertake its own analysis regarding the collateral value of the TIF incentive. Lenders have expressed a preference for the TIF note structure because it is a marketable municipal security instrument that, subject to certain limitations, may be sold to other accredited investors from time to time.

The City agrees that a pay-as-you-go structure, in theory, could be used to provide a similar collateral value to a willing lender. As the State Auditor describes, an interest expense would need to be included in the initial gross amount of the TIF incentive so that it would have the same present value as a TIF note (which would have a lower principal value but would accrue interest over time). However, the State Auditor's analysis of potential benefits of the pay-as-you-go structure is fundamentally flawed. Assuming a lender were willing to accept a pay-as-you-go structure as collateral, if the pay-as-you-go structure represented a lower level of payment to the developer or lender than a TIF note, the lender would logically determine that the pay-as-you go structure has a lower collateral value than the TIF note. If the TIF note has a lower collateral value, then the developer may never obtain the necessary bridge financing to complete the project. If a lender determines that the pay-as-you-go structure and the TIF note have the same collateral value (and, accordingly, is willing to make the bridge loan in the amount needed to move the project forward), then the lender likely determined that a similar amount of TIF revenues would be available under either scenario. Moreover, the use of the TIF note structure, with interest that accrues over time, presents the opportunity for well-performing projects to pay off principal quickly and reduce interest accrual. However, an equivalent pay-as-you-go structure, with interest factored into the initial gross amount of the incentive, as described by the State Auditor, could actually be financially disadvantageous to the City because a fixed interest component would need to be paid from TIF revenues regardless of how quickly TIF revenues are generated. For projects that do not generate enough TIF revenues to repay the entire amount of the incentive, there is no difference in the amount of TIF revenues paid out under either the TIF note or pay-as-you-go structure (i.e., under both structures, all TIF revenues will be paid out until the expiration of the TIF).

3. Project Evaluation Improvements Needed

3.1 The policy does not define how the need for TIF should be evaluated and documented

Auditor Finding: **Project evaluation procedures are in need of improvement.**

City's Response: The State Auditor has largely ignored improvements to the City's project evaluation procedures. The City notes that the average age of the projects selected by the State Auditor for a more detailed review is approximately 15.5 years, including only two projects that were approved within the last 10 years. Accordingly, the Auditor's analysis largely predates the City's Scorecard methodology, which has been developed and implemented over the last four years.

The City's Scorecard methodology provides a level of analysis of proposed TIF projects that is unparalleled in Missouri and goes well beyond any state law requirements. The City and SLDC will continue to monitor best practices across the country for evaluation of TIF projects and look for ways in which the Scorecard methodology may be improved (the Scorecard methodology and presentation have already been improved several times since its first inception).

3.2 Flawed cost-benefit analyses have led to significant overstatements of projected revenues, additional oversight is needed

Auditor Finding: **Improvement is needed in the oversight of cost-benefit analysis documents during the project application process.**

City's Response: Cost-benefit analyses prepared for the City's TIF projects comply with the requirements of the TIF Act.

Accurately projecting tax revenues over a 23-year TIF period is made difficult by an almost infinite list of unpredictable variables. Over the course of the projects examined by the State Auditor, the country experienced the Great Recession of 2008 and a massive change in consumer preference toward online retail, among other events that have materially impacted or disrupted economic trends. Moreover, tenants anticipated to be part of projects at the onset may go bankrupt, close or relocate for reasons beyond the control of the developer or the City (and for reasons that may be impossible to predict years earlier). Projects are currently being affected by the COVID-19 pandemic and its related economic disruption, which is likely to have a substantial impact on future TIF revenues in a manner that could not have been anticipated less than a year ago.

Nonetheless, the City's intention is that each cost-benefit analysis is based on reasonable assumptions at the time it is prepared and provides a fair basis for the City's TIF Commission and Board of Aldermen to make the findings required by the TIF Act. Typically, planning consultants engaged by the developer prepare the cost-benefit analysis and submit it for a thorough review by SLDC staff and consultants, who review both the reasonableness of the assumptions and whether the document contains the information required by the TIF Act. Cost-benefit analyses often go through several drafts during this vetting before they are submitted to the City's TIF Commission.

The TIF incentive, whether structured as a TIF note, TIF bond or pay-as-you go, is only paid to the extent TIF revenues are actually generated. Accordingly, if the projections in the cost-benefit analysis prove to be overly optimistic, the developer and, if applicable, third-party investors in TIF notes or bonds, bear the investment risk – not the City's taxpayers.

3.3 Inconsistent and potentially excessive developer fees allowed

Auditor Finding: **The City does not have an established policy regarding how much of a developer fee is allowed on TIF projects. As a result, developer fees are inconsistent from project to project, and in some cases, appear excessive.**

City's Response: The City disputes this finding by the State Auditor. The developer fee is taken into account as part of the Scorecard methodology when projecting the developer's return on investment and a capped developer fee is imputed as part of the "clawback" mechanism described in the City's TIF redevelopment agreements, which can be used to reduce the amount of the TIF award upon completion of the project.

The City further notes that the magnitude of developer fees varies significantly from project to project. A developer fee for a very challenging project should be higher than a developer fee for a less challenging project. Imposing subjective caps on developer fees could hinder the ability to attract developers for more difficult redevelopment projects and for developers to attract the necessary equity investors and lenders needed to capitalize their projects. SLDC employs financial analysts that rely on current market and industry data when evaluating developer fees and is confident in its ability to assess whether a developer fee is appropriate for a specific project.

4. Developer profits not monitored

Auditor Finding: **The City has historically not compared actual developer profit to the projected profit by project. As a result, the City may be providing public incentive for private projects that did not need to be incentivized.**

City's Response: The TIF Act does not require that the City monitor developer profits. However, the City agrees that projects should not be over-incentivized. In furtherance of that goal, the City and SLDC have established a program that strenuously evaluates project proposals as part of the Scorecard methodology and the City includes clawback mechanisms in TIF redevelopment agreements. These clawback mechanisms create a process to review and, if triggered, reduce the amount of TIF assistance upon completion of a project if the original amount of TIF assistance approved is no longer appropriate.

The State Auditor's suggestion of more robust monitoring of developer profits throughout the life of a TIF project is both impractical and not required by state law. Moreover, it would impede the ability to actually implement TIF projects and use tax-exempt bond financing to reduce interest costs and pay off TIFs earlier.

TIF districts have a maximum life of 23 years. During this time, project ownership, tenants, economic conditions and market rates of return will vary significantly. These aspects make it impractical to track specific internal developer performance data for the life of a TIF and relatively meaningless to measure such performance against standards set at the beginning of a TIF project. For example, assume a $5 million TIF was approved in year 1 and that the project was completed and a TIF note issued to the developer in year 2. In years 3-5, the City's economy is mediocre and at the end of year 5, the developer sells the project for a small profit to a new buyer. In years 6-8, the City's economy worsens, the project loses its anchor tenant and the new buyer sells the project at a loss to another buyer at the end of year 8. In year 10, the City's economy improves and the then-current owner makes improvements to the project (not funded by TIF) and leases anchor space within the project to a stable tenant that produces substantial TIF revenues. Soon after, smaller tenants are paying higher rents to locate near the successful anchor tenant. The then-current owner soon realizes a substantial return on its investment in excess of what the original developer anticipated when the project was first proposed. In this example, obtaining rate of return data from the second and third project owners would be exceedingly difficult because they would likely view that data as confidential, were not involved in the creation of the TIF, and had purchased the project in market transactions years after the TIF had originally been approved (and thus have little incentive to voluntarily cooperate). Moreover, even if such data could be obtained, the second property owner's negative rate of return and the third property owner's high rate of return would not be relevant to the City's decision to initially approve the TIF or the level of TIF assistance needed to cause the project to be completed under Year 1 and Year 2 economic conditions.

TIFs are routinely used as "gap" financing when private debt and equity are not sufficient to fund the construction of a project. As discussed under Section 2 above, the developer must typically secure a bridge loan using the promise of TIF notes to be issued upon completion of the project as collateral. Projections of future TIF revenues are relevant to a bridge lender's determination of the collateralized value of the future TIF notes. Potential clawbacks that extend for many years beyond the completion of the project would negatively impact that collateral value, making it harder to secure bridge financing. TIF incentives subject to clawbacks throughout the life of the TIF would also likely make it impossible to refinance TIF notes with low interest tax-exempt bonds because prospective TIF bond purchasers would be unlikely to assume the risk that their investment could be cancelled if the developer over-performs expectations.

5. Fee Structure Creates Appearance of a Conflict of Interest

Auditor Finding: **SLDC's fee structure creates the appearance of a conflict of interest for the agency.**

City's Response: *Despite finding absolutely no evidence that any projects were supported or the amount of the TIF subsidy was increased because of SLDC's fee structure*, the State Auditor claims that the SLDC's fee structure creates an appearance of a conflict of interest.

The City and SLDC believe that charging fees for TIF projects is appropriate because of the significant administrative expenses incurred in reviewing and administering projects (which should be borne by the developer and the project, rather than funded with City-wide general tax revenues). Similar to SLDC's fee structure, several State of Missouri incentive programs base their administrative fees on the size of the incentive (see, for example, Section 620.809.7(2) and Section 620.1900.1, RSMo., which allows the Missouri Department of Economic Development to charge a fee equal to 2.5% of the value of certain state-issued tax credits). Kansas City and Springfield also charge similarly-structured fees in connection with their tax increment financing programs.

The City also notes that for very large TIF projects, such as the St. Louis Innovation District, the City has capped its fees to ensure that the amount of fees generated do not disproportionately exceed the costs of administering the incentive program.

6. Governmental Accounting Standards Board Violation

Auditor Finding: **The City did not include the amount of TIF project revenues redistributed for fiscal years 2018 or 2017 in its Comprehensive Annual Financial Reports as required by Governmental Accounting Standards Board (GASB) Statement No. 77.**

City's Response: The State Auditor overstates the GASB No. 77 requirement. Appendix B, Note B5 of GASB No. 77 provides:

> *Other respondents to the Exposure Draft requested that the Board consider including specific types of programs—such as tax increment*

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> *financings, payments in lieu of taxes, or as-of-right agreements—in the scope of the Statement. The Board believes that some of those transactions may meet the definition of a tax abatement and, therefore, should be disclosed according to this Statement. However, the determination of whether a transaction meets the definition of a tax abatement should be based on the substance of the transaction, rather than on its form or label. Consequently, this Statement's scope does not include or exclude any specifically titled transaction or program in order to avoid inappropriately including transactions that do not meet the definition of a tax abatement or excluding those that do. (emphasis added)*

Nonetheless, the City will review GASB No. 77 compliance with its auditors as it relates to the disclosure of TIF project revenues in its future Comprehensive Annual Financial Reports. It is possible that the City's auditors could determine that some, but not all of, the City's TIF projects are subject to GASB No. 77 disclosure.

Sincerely,

Linda M. Martinez
Deputy Mayor for Development