Missouri Municipal Finance Guide

Prepared by Gilmore & Bell, P.C.
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NOTICE: This Guide is intended as a reference work only. The original edition of this Guide was prepared in March 2012 by Gilmore & Bell attorneys, Toni Stegeman, Shannon Creighton and Meghan Wiedel. That edition was titled, "Missouri Municipal Finance: A Guide for City Clerks and Finance Officers." Gilmore & Bell attorneys have used their best efforts to compile and provide the most accurate information for the Guide; however, the materials are not intended or offered as legal advice. Please contact a Gilmore & Bell attorney to arrange for assistance for your city's specific needs. For contact information, visit the firm's website at www.GilmoreBell.com.

Reference to "RSMo" indicates the Revised Statutes of Missouri, as amended through the date of this Guide.

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ABOUT GILMORE & BELL

History and Background

Gilmore & Bell was established in 1979, and today is one of the leading public finance law firms in the United States. The firm specializes in public finance transactions, serving as bond counsel or underwriters' counsel in a wide variety of tax-exempt and taxable financings and providing tax and arbitrage rebate services in connection with tax-exempt financings. The firm also handles commercial and corporate finance transactions and securities law matters. As of March 1, 2012, Gilmore & Bell had 49 attorneys and four offices, located in Kansas City and St. Louis, Missouri, Wichita, Kansas and Lincoln, Nebraska. The firm's attorneys have varied and extensive experience in all aspects of public finance transactions, including planning, structuring and coordinating financings, drafting legal documents, appearing before public bodies and agencies, and consulting with issuers and investment bankers on a wide array of public law matters. All offices of the firm are listed in the municipal bond attorneys section of The Bond Buyer's Municipal Marketplace Directory (commonly known as the "Red Book"). A biographical summary for each of the firm's attorneys is included on the firm's website: www.gilmorebell.com.

National Bond Counsel Ranking

The firm has a national reputation in the field of tax-exempt bond financing and has one of the largest public finance practices in the country. In 2011, Gilmore & Bell acted as bond counsel on 430 long-term municipal issues aggregating $3.69 billion. According to published listings, in 2011 the firm ranked among bond counsel throughout the United States as follows:

National Bond Counsel Ranking[1]

	Missouri	Kansas	Nebraska	Nation
Gilmore & Bell				
Number of Issues:	1st	1st	2nd	1st
Dollar Volume:	1st	1st	3rd	19th

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(1) Source: Thomson Reuters.

Nationally-Ranked Public Finance Practice

Gilmore & Bell provides a full range of services in connection with tax-exempt and taxable financings for state and local governments and private for-profit and non-profit institutions, including bond counsel and underwriters' counsel services, representation of banks, credit and liquidity providers and other financial institutions, special tax services, and representation of municipalities on special matters. The firm's public finance practice is concentrated in Missouri, Kansas and Nebraska, but also extends to the regional and national level in certain areas such as health care, housing, municipal lease financings and underwriters' representation. The firm has served as bond counsel or underwriters' counsel in a wide variety of financings for numerous state and local government agencies and political subdivisions in Missouri, Kansas, Nebraska and a number of other states.

In the published listings for 2011, the firm's rankings among bond counsel throughout the United States for various types of long-term public finance issues are as follows:

Gilmore & Bell National Ranking[1]

Type of Issue	No. of Issues
General Purpose Bonds	1st
Long-Term Refunding Bonds	1st
Municipal Revenue Bonds	1st
Transportation Bonds	1st
General Obligation Bonds	3rd
Health Care Bonds	3rd
Higher Education Bonds	3rd
Nursing Home Bonds	3rd
Public Power Bonds	3rd
Water, Sewer & Gas Bonds	4th
Economic Development Bonds	5th
Education	7th

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(1) Source: Thomson Reuters.

The borrowers in these transactions include many types of public and private entities, including states, counties, cities, school districts and other governmental agencies and municipal issuers, private industrial corporations, hospitals, colleges and other private for-profit and non-profit institutions. These financings raise capital for many purposes, including general municipal improvements, schools and other public buildings, electric, water and sewer utilities, highways, streets and bridges, fire protection facilities, hospitals, nursing homes and retirement facilities, airports, parks and recreational facilities, colleges and universities, industrial, manufacturing and commercial projects, pollution control and solid waste and sewage disposal facilities, convention centers, sports facilities and single and multi-family housing projects. These financings involve new facilities, reimbursement of prior capital expenditures, refunding of outstanding tax-exempt debt and refinancing of outstanding taxable debt. They also involve various financing structures such as fixed interest rate bonds, multi-modal variable interest rate bonds with tender, purchase and remarketing features, auction rate bonds, current-interest and compound-interest bonds, pooled financings, master indenture financings, advance refundings, and various forms of credit-enhancement and liquidity supports including bond insurance, letters of credit, standby bond purchase agreements and lines of credit. These issues involve both competitively bid and negotiated sales, public offerings and private placements.

Bond Counsel Services

Gilmore & Bell provides the full range of bond counsel services to cities and other public entities, including the following:

1. *Legal Analysis and Structuring*. Provide advice to the city regarding the legal authority for the issuance of the bonds, various legal structures and other legal aspects of the financing.

2. *Preparation and Review of Legal Documents*. Prepare all proceedings and legal documents relating to the authorization and issuance of the bonds, including ordinances calling bond and levy elections, ordinances authorizing the issuance of the bonds, the trust indenture, the loan agreement and any related promissory notes, mortgages and other security agreements securing the bonds, the tax compliance agreement with respect to the bonds, bond forms, the notice of bond sale, and various other documents, certificates and opinions required to complete the financing, and review all documents prepared by underwriters' counsel and others in connection with the financing.

3. *Preparation of Disclosure Documents*. Prepare or assist in the preparation of the official statement or other disclosure document relating to the bonds. Advise the city on its disclosure responsibilities under securities laws. The current emphasis on disclosure in public finance transactions is consistent with the longstanding approach the firm has taken to the importance of disclosure.

4. *Ruling Requests and Regulatory Matters*. Prepare and handle required requests for rulings from the Internal Revenue Service or no-action letters from the Securities and Exchange Commission and handle such other matters before governmental regulatory bodies and agencies as may be required.

5. *Attendance at Meetings*. Attend such conferences and meetings as may be necessary in connection with the financing.

6. *Legal Opinions*. Render our approving legal opinion on the validity of the bonds, the federal and state income tax treatment of interest on the bonds and such incidental opinions as may be necessary.

7. *Bond Closing*. Coordinate and attend the closing of the transaction.

8. *Bond Transcripts*. Assemble bond transcripts covering the proceedings relating to the authorization and issuance of the bonds, and distribute copies of the transcript to the parties to the financing.

9. *Miscellaneous Services*. Provide consultation and advice on miscellaneous legal matters relating to the authorization, issuance, sale and delivery of the bonds and perform any additional standard bond counsel services that may be necessary to complete the financing.

Post-Issuance Compliance Services

Chapter 6 of this Guide summarizes the post-issuance compliance requirements that must be satisfied by cities relating to most bonds or other financing obligations. Gilmore & Bell's post-issuance compliance services are designed to help municipal issuers, other borrowers and trustees comply with the federal income tax laws and continuing disclosure requirements *after* the bonds are issued. The firm has performed arbitrage rebate computations since 1987 and regularly advises municipal issuers and borrowers on ways they can best comply with arbitrage investment restrictions, arbitrage rebate payment requirements, tax restrictions on the use of bond proceeds and bond-financed facilities, record keeping and retention rules, and other related federal income tax compliance issues. The firm also assists its municipal issuers and borrowers in responding to Internal Revenue Service tax examinations and other inquiries. In addition, the firm assists issuers and other borrowers in complying with federal and state laws regarding continuing disclosure of material information to the public markets. As a result of Gilmore & Bell's experience as bond counsel, tax counsel, and disclosure counsel, over twenty years' experience in preparing arbitrage rebate computations for hundreds of issuers, and its securities law expertise, the firm's tax and securities lawyers, assisted by a staff of financial analysts, can simplify the process of complying with ongoing tax and securities law requirements and, in some cases, minimize the municipal issuer's rebate liability.

Other Services

The firm also frequently serves as counsel to the underwriters of public finance transactions and has developed a separate national reputation for providing the full range of legal representation required by underwriters in such transactions.

In addition to its public finance practice, Gilmore & Bell has been increasingly involved in corporate finance and certain other commercial finance transactions.

Firm Philosophy

Gilmore & Bell is a service-oriented law firm that applies a philosophy of providing quality, cost-efficient and timely services to assist our clients in the completion of successful financings that meet the goals of the participants. Gilmore & Bell has the relevant experience, expertise and personnel to uniquely enable us to assist in the successful and expeditious completion of financings. All facets of our firm and its resources are designed and dedicated to provide effective, efficient and timely representation in financial transactions.

How to Contact Us

Please call any member of the firm with specific questions concerning the financing tools discussed in this Guide or other financing methods, or for additional information regarding the firm and its practice. There is no charge for Initial discussions about your city's financing needs and plans.

Following is the contact information for our two Missouri offices:

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CHAPTER 1

FINANCING GOVERNMENTAL PURPOSE PROJECTS [*]

As federal and state regulations become more complex and the financial resources needed to fund governmental operation become more scarce, the 21st Century brings a significant challenge to the municipal finance officer of Missouri. In order to "balance" the budget, the finance officer will need to utilize many funding sources. One of those sources is the ability to finance capital improvement projects. Used prudently, this financial management tool can allow a municipality to construct needed infrastructure improvements, while at the same time funding needed administrative, cultural and social programs from current revenues.

This presentation is intended as a summary of significant financing tools available to Missouri municipal finance officers. It is not intended to be exhaustive. Specific questions concerning the financing options discussed herein or other methods may be addressed to any member of the firm.

General Obligation Bonds

Missouri municipalities are authorized to issue general obligation bonds pursuant to Article VI, Section 26(b), (c), (d) and (e) of the Missouri Constitution and Sections 95.115 to 95.130, RSMo. General obligation bonds are secured by the full faith and credit, and taxing power of the municipality. This means that a court can compel the municipality to increase property taxes if needed to repay the bonds. The owner of a general obligation bond may look for repayment to all legally available sources of revenue that the municipality is entitled to receive.

What type of projects may be financed?

Municipalities may issue general obligation bonds for any municipal purpose authorized by charter or Missouri law.

What is the Source of Funds for Repayment?

General obligation bonds are secured by the full faith and credit, and taxing power of the municipality. This means that a court can compel the municipality to increase property taxes if needed to repay the bonds. The owner of a general obligation bond may look for repayment to all legally available sources of revenue that the municipality is entitled to receive.

[*] Prepared by **Toni I. Stegeman**, who is a shareholder in Gilmore & Bell's Kansas City office. Ms. Stegeman has practiced law as a municipal bond attorney since entering the law practice in 1994. She is licensed to practice law in Missouri and Illinois. She is a member of the National Association of Bond Lawyers (NABL), and serves regularly as a panelist at NABL's annual Bond Attorney Workshop. Ms. Stegeman is also a long-time member and former member of the board of directors of the Association for Governmental Leasing & Finance. She received her B.B.A. degree from West Texas State University in 1984 and her J.D. from the University of Houston in 1994. Ms. Stegeman devotes the majority of her practice to assisting governmental entities with financings for infrastructure, such as streets, storm water control, water and sewer systems, and for public facilities, equipment and vehicles.

Section 26(f) of the Missouri Constitution and Section 95.135 RSMo require that, before issuing general obligation bonds, a municipality must provide for the levy of an annual property tax that will be sufficient to pay the principal and interest on the bonds. To satisfy this requirement, the levy will be included in the ordinance authorizing the issuance of the bonds. The municipality may use other revenue sources (such as sales tax proceeds) to pay debt service on the bonds, in which case the property tax levy may be unnecessary and the municipality may choose not to collect the tax in a particular year.

What are the limitations on issuing general obligation bonds?

New Money Bonds. Article VI, Sections 26 of the Missouri Constitution governs the amount of general obligation bonds that may be issued by a city. The debt limit is tested at the time of the election to authorize the issuance of the bonds. Sections 26(b) and (c) permit a city to incur general obligation debt in an amount not to exceed 10 percent of the city's assessed valuation. Section 26(d) permits a city to incur general obligation debt for an additional 10 percent of the city's assessed valuation for the purpose of street and sewer improvements. Section 26(e) permits a city to incur general obligation debt for an additional 10 percent of the city's assessed valuation (so long as the total indebtedness does not exceed 20 percent) for the purpose of water, electric or light plant improvements. Section 108.170, RSMo, imposes limits on the interest rate and the sale price of the bonds, depending upon whether the sale is a negotiated sale or a competitive public sale.

Refunding Bonds. Article VI, Section 28 of the Missouri Constitution, and Section 108.140, RSMo, authorize the issuance by a municipality of general obligation bonds for the purpose of “refunding, extending, and unifying” all or any part of its validly issued general obligation bonds. The principal amount of the refunding bonds may not exceed the principal amount of the bonds being refunded, plus the accrued interest on those bonds to the date of the refunding bonds. The interest rate on the refunding bonds may not exceed the interest rate on the bonds being refunded – meaning that the refunding must result in debt service savings. The interest rate and sale price limits under Section 108.170, RSMo, apply equally to general obligation bonds issued to provide new money for project financing, or to refund bonds previously issued.

Final Maturity Limitation. In accordance with Section 26(f) of the Missouri Constitution and Section 95.135 RSMo, the final maturity of an issue of general obligation bonds must not be later than 20 years from the date of their issuance. Refunding bonds may extend the final maturity of the refunded bonds, as long as it does not exceed 20 years from the date of issuance of the refunding bonds. (Extending the maturity of the bonds through a refunding is generally limited by the requirement that the refunding must result in debt service savings. The longer the maturity, the more interest is paid.)

What are the voter-approval requirements?

Super-Majority Approval. Cities may only issue general obligation bonds after obtaining approval of four-sevenths or two-thirds (depending on the date the election is held) of the qualified voters of the municipality voting on the question. The below table shows the available election dates and the super-majority approval required for approving of general obligation bond questions on each date:

Election Date (1st Tuesday after the 1st Monday)	**Voter Approval Requirements for General Obligation Bonds**
February	2/3-majority in all years
April	4/7-majority in all years
June	2/3-majority in all years
August	4/7-majority in even-numbered years 2/3-majority in odd-numbered years
November	4/7-majority in even-numbered years 2/3-majority in odd-numbered years

The dates on which Section 115.123, RSMo, provides for bond elections to be held on days other than those shown above in special circumstances. Section 115.652, RSMo, allows for elections to be conducted by mail under certain conditions.

Form of Ballot Question. Section 95.150, RSMo, requires that the bond question be submitted in substantially the following form:

> Shall _________________ (name of city, town, or village) issue [general obligation] bonds in the amount of ________________ dollars for the purpose of _______________________________?

The prescribed form of the question in the statute does not include the bracketed words "general obligation," though this practice is recommended to clarify the nature of the bonds being voted upon. The bond question should not include any language stating that repayment of the bonds is intended to be made only from a particular funding source (like sales taxes), or that the property tax levy for repayment of the bonds is in any way limited.

Filing Notice of the Election with the Election Authority. Section 115.125, RSMo, requires that notice of the election be filed with the proper election authority (*i.e.,* county clerk(s) or elections board) not later than 5 p.m. on the 10th Tuesday prior to the election. The notice must include a certified copy of the ballot question and the legal notice required to be published by the election authority pursuant to Section 115.127, RSMo.

What is the procedure for issuing the bonds?

Upon conclusion of a successful election, the municipality can issue part or all of the bonds authorized by the election. The municipality will need an underwriter or other purchaser of the bonds.

Section 108.170, RSMo, imposes limits on the interest rate and the sale price of the bonds, depending upon whether the sale is a negotiated sale or a competitive public sale.

Upon the sale of the bonds, the governing body will approve an ordinance that includes all of the terms of the bonds (principal amount, interest rate, redemption provisions, paying agent, etc.). The municipality will be required to put into place a debt service levy sufficient to pay principal of and interest on the bonds.

Prior to the issuance of general obligation bonds, Section 108.240, RSMo, requires that the proceedings relating to the issuance of the bonds be presented to the state auditor for examination and issuance of a certificate that the proceedings comply with all conditions of Missouri law. Typically, the "closing" (when funds are available to the municipality) will occur within two weeks of the approval of the authorizing ordinance.

What are advantages and disadvantages of a general obligation bond-financing?

General obligation bonds are secured by the full faith, credit and taxing power of the municipality, which should result in the lowest possible interest rates for financing a capital project. This is the primary advantage to borrowing money by issuing general obligation bonds. Another advantage is generally lower costs of issuing general obligation bonds, when compared to most other methods of financing capital projects. This is because the legal structure for the issuance of general obligation bonds is less complex than for most other financing methods.

Disadvantages of issuing the general obligation bonds include a requirement for a super-majority approval of the voters. This is sometimes difficult to obtain, and can be a time-consuming process because of the limited election dates available. Elections may be held only on the dates specified in Missouri statutes. Issuing general obligation bonds will reduce the municipality's general obligation debt capacity by the principal amount of the bonds issued. This could impair the municipality's ability to issue general obligation bonds in the future.

What are the municipality's on-going administrative compliance responsibilities?

Depending on the nature of the bond issue, the municipality may have additional continuing disclosure and record keeping duties. For a more detailed summary of these requirements, see Chapter 6 of this Guide.

Revenue Bonds

What type of projects may be financed with revenue bonds?

Revenue bonds are issued to finance facilities that have a definable user or revenue base. Generally, specific statutory authority is required for the issuance of revenue bonds. Some commonly used sources of authority include Chapter 91, RSMo, for waterworks system revenue bonds; Chapter 250, RSMo, for combined waterworks and sewerage system revenue bonds; Section 71.360, RSMo, for parking facility revenue bonds; Section 94.577, RSMo, for capital improvement sales tax revenue bonds; and Section 94.700, RSMo, for transportation sales tax revenue bonds.

What is the Source of Funds for Repayment?

Revenue bonds are payable from and secured by the pledge of a specific source of funds from the facility or project that is financed.

What are the limitations on issuing revenue bonds?

New Money Bonds. Any limitation on the principal amount of revenue bonds issued is generally a contractually-imposed limit. The ordinance or trust indenture pursuant to which any outstanding revenue bonds were issued will likely include restrictions on the issuance of additional bonds that are payable from the same source of funds. This is typically referred to as an "additional bonds" test or covenant. Section 108.170, RSMo, imposes limits on the interest rate and the sale price of the bonds, depending upon whether the sale is a negotiated sale or a competitive public sale.

Refunding Bonds. Section 108.140(2), RSMo, authorizes the issuance by a municipality of revenue bonds for the purpose of refunding outstanding revenue bonds, so long as the refunding revenue bonds are payable from the same sources as were pledged to the payment of the bonds being refunded. There is no interest savings requirement, as there is for bonds issued to refund general obligation bonds. The interest rate and sale price limitations under Section 108.170, RSMo, also apply to refunding bonds.

Limit on Final Maturity. The maximum term for revenue bonds varies depending on the statutory authority. A common maximum term is 35 years. Sales tax revenue bonds, because they are considered "indebtedness", are limited to a maximum term of 20 years.

What are the voter approval requirements?

Generally, Simple Majority Approval (Except for Sales Tax Revenue Bonds). Nearly all revenue bonds, other than sales tax revenue bonds, require only simple majority voter approval for passage. (For available election dates, see the above discussion in this Guide relating to the voter approval requirements for general obligation bonds.)

Super-Majority Approval for Sales Tax Revenue Bonds. Sales tax revenue bonds constitute "indebtedness" under the Missouri Constitution. The Missouri Supreme Court has held that Article VI, Section 26 of the Missouri Constitution applies to all obligations payable from taxes. Consequently, sales tax revenue bonds constitute "indebtedness", and require the same super-majority voter approval as general obligation bonds. (For available election dates and the super-majority voter approval requirements, see the above discussion in this Guide relating to the voter approval requirements for general obligation bonds.)

Form of Ballot Question. The particular statute authorizing the issuance of the revenue bonds will generally prescribe the form of the ballot question.

Filing Notice of the Election with the Election Authority. The notice filing requirements are discussed above in this Guide, under the discussion on General Obligation Bonds.

What is the procedure for issuing the bonds?

Upon conclusion of a successful election, the municipality can issue part or all of the bonds authorized by the election. The municipality will need an underwriter or other purchaser of the bonds. Section 108.170, RSMo, imposes limits on the interest rate and the sale price of the bonds, depending upon whether the sale is a negotiated sale or a competitive public sale.

Upon the sale of the bonds, the governing body will approve an ordinance that includes all of the terms of the bonds (principal amount, interest rate, redemption provisions, paying agent, etc.). Typically, the “closing” (when funds are available to the municipality) will occur within two weeks of the approval of the authorizing ordinance.

What are advantages and disadvantages of a revenue bond-financing?

Advantages to issuing revenue bonds, rather than general obligation bonds, are the lower threshold required for voter approval, and the longer term allowed for repayment. Also, the interest rate for revenue bonds will usually be lower than for a lease purchase financing with a similar term. This is because the municipality is authorized to provide an enforceable pledge of revenues for repayment of the bonds, for the full term of the bonds. Lease purchase obligations are annually renewable obligations, and are rarely secured by an actual pledge of revenues. Note the distinction between the legal authority to “pledge” revenues to repay bonds, as opposed to the legal authority to “use” revenues to repay obligations. A pledge of revenues provides better security for an investor, thereby allowing the municipality to borrower at a lower interest rate.

A disadvantage to issuing revenue bonds is that they will usually have a higher interest rate than a municipality’s general obligation bonds with a similar term. The reason for this is that, unlike general obligation bonds, revenue bonds are not generally payable from ad valorem taxing authority.

What are the municipality’s on-going administrative and compliance responsibilities?

Bond Covenants. It is customary for purchasers of revenue bonds to require the municipality to agree to a “rate covenant” and other covenants intended to ensure that the revenue-producing system will actually generate sufficient revenues to pay all the operating and maintenance expenses, and the debt service payments for the revenue bonds that are payable from those revenues. This covenant will be contained in the authorizing ordinance, or in a trust indenture pursuant to which the bonds may be issued. It is important for the municipality to review the bond covenants annually to ensure continuing compliance. Failure to comply with a bond covenant may be considered a default.

Continuing Disclosure and Tax Compliance Requirements. Depending on the nature of the bond issue, the municipality may have additional continuing disclosure and record keeping duties. For a more detailed summary of these requirements, see Chapter 6 of this Guide.

Lease-Purchase Obligations

How is it structured and what is the legal authority?

Legal authority for a lease-purchase financing is found in statutes authorizing municipalities to lease property. Under a lease-purchase transaction, the municipality leases the equipment and/or real property to be acquired and constructed from a lessor, which may be an investor, a trustee bank, a leasing company, a nonprofit corporation or other entity. The municipality makes rental payments over a series of annually renewable one-year terms, and has the option to purchase the leased property at the end of the term. The municipality's obligation to make rental payments in any subsequent year is subject to appropriation of funds each year for that purpose by the municipality.

What is the Source of Funds for Repayment?

Because the lease-purchase agreement is not a voted obligation, the municipality will not have the ability to put into place a debt service levy or to legally pledge revenues to repay the bonds. Nonetheless, the municipality must be able to identify sufficient funds that will be available to make the rental payments. A common sources of funds is revenue generated from sales taxes that may legally be used for the purpose for which the lease-purchase proceeds will be spent. Remember the difference between a legally authorized "pledge" of revenues versus revenues that are legally available to be used to repay obligations. This is covered above under the discussion of sales tax revenue bonds. A municipality may choose to submit a sales tax to the voters, without asking the voters for authority to "pledge" the sales tax to repay bonds. In this case, only a simple majority voter-approval is required. Chapter 2 of this Guide includes a listing of sales taxes that municipalities are authorized to impose, upon receiving the required voter-approval.

Why isn't voter approval of the lease-purchase required?

Because the municipality is not obligated to make payments beyond any current year, lease-purchase obligations are not considered indebtedness of the municipality. The obligation is not, therefore, subject to constitutional restrictions on incurring indebtedness without voter approval. Though no voter approval is required for the municipality to enter into a lease-purchase obligation, the municipality may need to ask the voters to approve a source of funding that would be legally available for paying the lease-purchase obligation. See the discussion above under "*What is the source of funds for repayment?"*

What is the procedure for entering into a lease-purchase transaction?

Prior to the execution and delivery of a lease-purchase agreement, Sec. 432.070, RSMo, (applicable to all contracts entered into by the municipality), requires that the terms of the agreement be approved by the governing body of the municipality. When it is anticipated that an interest in a lease-purchase agreement will be sold to more than one investor, it is necessary to document that transaction in a manner that will allow the sale of portions of the municipality's obligation under the lease-purchase agreement. The two most common structures used to accomplish that objective are (1) lease participation certificates or certificates of participation evidencing a proportionate interest in the right to receive rentals under the lease-purchase agreement, and (2) lease revenue bonds payable solely from rentals received by the issuer of the bonds or the lessor under the lease-purchase agreement.

What are Certificates of Participation (COPs)?

Certificates of participation or lease participation certificates ("COPs") are merely certificates that represent a proportionate interest of the owner of each Certificate in the right of the lessor to receive rental payments made by the Lessee under the lease-purchase agreement. COPs are not obligations themselves, but merely evidence the obligations of the Lessee under the lease-purchase agreement. The lessor may be the vendor, a leasing company, an investment banking firm, a single purpose corporation or a bank or trust company. It is not necessary that the lessor be a nonprofit entity or have the ability to issue tax-exempt obligations. The Lessee and the lessor enter into a lease-purchase agreement pursuant to which the lessor leases the leased property to the Lessee, and the Lessee agrees to pay rent at specified times to the Issuer or its assigns. The lessor may assign its rights under the lease-purchase agreement and in the leased property to a trustee or an agent ("trustee bank") pursuant to an assignment agreement. The lessor and the trustee bank enter a trust indenture or an agency agreement pursuant to which the trustee bank, as assignee of the lessor, executes and delivers Certificates in the lease-purchase agreement to investors. Under an alternate structure, the trustee bank is the lessor and no assignment is required. In that structure, the trustee bank makes a declaration of trust pursuant to which it executes and delivers Certificates in the lease-purchase agreement to investors. In either case, the trustee bank has, either by assignment or directly, the interest of the lessor under the lease-purchase agreement. In any COPs or bond transaction involving real property, the trustee bank will generally have a leasehold interest in that real property, either by assignment or directly.

What are advantages and disadvantages of a lease-purchase financing?

Advantages to using a lease-purchase agreement as a capital financing tool include the lack of a voter-approval requirement, and the longer term allowed for repayment.

Disadvantages include generally higher interest rates for lease-purchase transactions than for revenue bonds or general obligation bonds with a similar term. This is because the municipality is authorized to provide an enforceable pledge of revenues for repayment of revenue bonds, for the full term of the bonds. Lease purchase obligations are annually renewable obligations, and are rarely secured by an actual pledge of revenues. A pledge of revenues provides better security for an investor, thereby allowing the municipality to borrower at a lower interest rate. Another disadvantage for lease-purchase transactions involving real property, is generally higher transaction fees than for general obligation or revenue bonds, due to the more complicated nature of the financing.

What are the municipality's on-going administrative and compliance responsibilities?

Lease Covenants. It is customary for a lease-purchase agreement to impose on the municipality duties to protect the leased property. These will include requirements to maintain property and liability insurance, and other requirements to maintain and repair the leased property. It is important for the municipality to review the lease covenants annually to ensure continuing compliance. Failure to comply with a lease covenant may be considered a default.

Continuing Disclosure and Tax Compliance Requirements. Depending on the structure of the lease-purchase transaction, the municipality may have additional continuing disclosure and record keeping duties. For a more detailed summary of these requirements, see Chapter 6 of this Guide.

Tax and Revenue Anticipation Notes

Missouri municipalities are authorized to issue notes maturing within one year from the date of issuance, in an amount not to exceed the estimated taxes and revenues for the current fiscal year that have not yet been collected. The proceeds of the notes may be used for capital improvements or for operating purposes, and the tax and revenue receipts are accumulated and used to pay off the notes at maturity. If it is intended that the interest payments on the note will be tax-exempt to the purchaser of the note, there are special tax law issues to be considered.

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CHAPTER 2

THE SALES TAX AS A FINANCING TOOL*

How to Use the Sales Tax as a Financing Tool

Missouri cities, counties and other political subdivisions have a continuing need for methods of financing capital improvements that are legal, practical and economically feasible. A sales tax can provide a workable financing alternative to issuing general obligation bonds. The sales tax is attractive as a financing tool because in most cases only a majority of voters needs to approve its imposition, as opposed to the four-sevenths or two-thirds vote necessary to authorize the issuance of general obligation bonds. A sales tax, once approved by the voters, can be used to finance particular projects in the following ways:

1. *Pay as you go.* As the sales tax is collected, it can be used immediately to fund capital improvement projects. This is the most straightforward method for utilizing sales tax revenue, but it is effective mainly for short-term, relatively low-cost projects such as street repairs.

2. *Tax anticipation notes.* At the beginning of the sales tax collection year, cities can issue tax anticipation notes in an amount not to exceed a percentage of the estimated taxes and revenues for the year yet uncollected. The proceeds of the notes are available for capital improvements and the sales tax receipts are accumulated and used to pay off the notes at maturity. Since such notes must mature within twelve months of their date of issuance or by the end of the fiscal period, this is necessarily a short-term financing method.

3. *Lease-purchase financing.* Using this financing method, a municipality can acquire certain equipment or facilities from a private entity (such as a bank, manufacturer or leasing company) pursuant to a lease-purchase agreement that is subject to annual appropriation by the municipality's governing body. The municipality's sales tax revenue provides a source of funds for making the lease payments. The municipality receives unencumbered title to the items being leased when the final lease payment is made. Lease-purchase financing is discussed in more detail in Chapter 1 of this Guide.

4. *Sales tax revenue bonds.* Certain cities may issue bonds directly to fund capital improvements and pledge sales tax revenues to repay the bonds. Before sales tax revenues can be pledged to the payment of bonds on a long-term basis, the bonds (other than refunding bonds) must be approved by the constitutionally required percentage of voters under Article VI, Section 26 of the Missouri Constitution (either four-sevenths or two-thirds, depending on the election date). Sales tax revenue bonds are also subject to the debt limitations of the Missouri Constitution. (For available election dates and the super-majority voter approval requirements, see the discussion in Chapter 1 of this Guide relating to the voter approval requirements for general obligation bonds.)

* Excerpts from a memorandum prepared and updated by various Gilmore & Bell attorneys.

The financing methods described above must be structured carefully in order to comply with constitutional and other legal requirements. For example, under federal tax law, interest on an obligation of a state or political subdivision will be exempt from federal income taxation only if certain requirements are satisfied. A municipality should seek legal advice before utilizing a particular method.

Sales Taxes Available to Municipalities

Upon receiving the required voter-approval, the following sales taxes are available to municipalities under current law:

Type of Sales Tax Authorized	**Statutory Authority (RSMo)**
Capital Improvements (Any municipality except those located in St. Louis County)	Section 94.577
Capital Improvements (Any municipality located in St. Louis County)	Section 94.890
Capital Improvements (Springfield)	Section 94.578
Community Center	Section 94.585
Community Services for Children (St. Louis City)	Section 67.1775
Convention and Tourism (Kansas City)	Section 92.325
Economic Development (Jefferson City)	Section 94.1010
Economic Development (Kirksville)	Section 94.1008
Economic Development, Local Option	Section 67.1305
Economic Development (Municipalities within many, but not all counties – see statute)	Section 67.1300
Economic Development, Local (St. Joseph, Springfield, Joplin and cities within the counties of Jasper and Butler)	Section 67.1303
Fire Protection	Section 321.242
General Purpose	Section 94.510
General Purpose (Any municipality in St. Louis County)	Section 94.850
Hotel and Motels (St. Louis City Regional Convention and Visitors Commission)	Section 67.619
Hotels and Motels – Transient Guest	Section 67.1000.1
Hotels and Motels – Transient Guest	Section 67.1003
Hotels and Motels – Transient Guest (Jefferson City)	Section 67.1000.4
Hotels and Motels – Transient Guest (Marshall)	Section 67.1015

Type of Sales Tax Authorized	Statutory Authority (RSMo)
Hotels, Motels, Bed and Breakfast Inns, Campgrounds and Docking Facilities Used by Transients for Sleeping – Transient Guest (Includes Arnold, Bethany, Bloomfield, Bonne Terre, Boonville, Caruthersville, Clarksville, Clinton, Cuba, Desloge, Festus, Grain Valley, Hollister, Leadington, Lebanon, Louisiana, New Madrid County and fourth class cities therein, Pacific, Park Hills, Parkville, Riverside, St. James, Sullivan, Union and Warrenton).	Section 67.1360
Hotels, Motels, Bed and Breakfast Inns, Campgrounds and Docking Facilities Used by Transients for Sleeping – Transient Guest (St. Joseph)	Section 67.1361
Hotels, Motels, Bed and Breakfast Inns, Campgrounds and Docking Facilities Used by Transients for Sleeping – Transient Guest (Independence)	Section 67.1366
Hotels and Motels – Transient Guest (Grandview)	Section 94.271
Hotels and Motels – Transient Guest (North Kansas City)	Section 94.832
Hotels and Motels – Transient Guest (Canton, La Grange and Edina)	Section 94.837
Hotels and Motels – Transient Guest (Lamar Heights)	Section 94.838
Hotels and Motels – Transient Guest (Salem)	Section 94.839
Hotels and Motels – Transient Guest (Raytown)	Section 94.840
Hotels and Motels – Transient Guest (Waynesville)	Section 94.1011
Mass Transit	Section 92.400
Medically Indigent (St. Louis City)	Section 94.1000
Museum and Tourism-Related Activities (Independence and Joplin)	Section 82.850
Museum, Local Option (Joplin)	Section 94.950
Parks and Storm Water Control, Local	Section 644.032
Police Department (Independence)	Section 82.875
Public Safety Department (Springfield)	Section 94.579
Public Safety (Blue Springs, Excelsior Springs, Harrisonville, Peculiar and St. Joseph)(See also Section 67.230)	Section 94.900
Public Safety (Gladstone, Grandview and Raytown)	Section 94.902
Public Safety Department (St. Louis City)	Section 92.500
St. Louis City Sales Tax on Sales of Hotels	Section 67.657
Storm Water Control and Local Parks	Section 644.032
Storm Water Control and Public Works Projects	Section 94.413
Theatre, Cultural Arts and Entertainment District	Section 67.2520
Tourism Community Enhancement District	Section 67.1959
Tourism (Weston)	Section 67.2030
Tourism (Branson)	Section 94.800
Tourism (Rolla)	Section 94.830
Tourism (Sweet Springs, Concordia and Marshall)	Section 94.834
Tourism and Infrastructure (Marston, Matthews and Steele)	Section 94.836

Type of Sales Tax Authorized	Statutory Authority (RSMo)
Tourism (Popular Bluff and Sikeston)	Section 94.870
Transportation	Section 94.700
Transportation (Kansas City and St. Louis City)	Section 94.600
Transportation (St. Louis City)	Section 94.660
Use Tax, Local	Section 144.757

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CHAPTER 3

ECONOMIC DEVELOPMENT 101*

Municipalities in Missouri and throughout the country are increasingly playing greater roles in economic development. These roles include developing economic development policies, approving certain incentives, participating in public-private partnerships, administering certain incentive programs and protecting taxpayer interests. This chapter is intended to provide a brief overview of these roles for municipal officials and summaries some of the economic development programs available in Missouri. Chapter 4 of this Guide includes more detailed summaries of some of the more popular economic development incentive tools.

Economic Development Policies

Many municipalities have found it desirable to adopt economic development policies to help guide their decision making process. These policies often contemplate (1) the types of incentives that will be considered, (2) the value of the incentives that will be considered, which is often expressed as a percentage of total project costs, and (3) desired outcomes, such as the creation of jobs or the remediation of blight. Municipalities also use economic development policies to communicate which uses of economic development incentives are not be acceptable in their communities.

Incentive Programs

Economic development incentive programs are often divided into the following categories:

Tax abatement: Project cashflows will improve when taxes are reduced or eliminated. Accordingly, projects that are not economically feasible because of low (or even negative) cashflows may become feasible if taxes are abated. Popular forms of real property tax abatement in Missouri include (1) the Urban Redevelopment Corporations Law (commonly known as “Chapter 353” abatement), which is available in blighted areas only and (2) industrial development bond transactions (commonly known as “Chapter 100” abatement), which does not require a blight finding. Construction materials and other personal property may also be rebated as part of a Chapter 100 transaction. A more detailed summary of these incentive programs is included in Chapter 4 of this Guide.

Tax addition: Missouri law allows for the creation of special taxing districts, known as Community Improvement Districts (CID), Transportation Development Districts (TDD) and Neighborhood Improvement Districts (NID). CIDs and TDDs have the ability to levy sales taxes, property taxes and

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special assessments within their boundaries. NIDs may levy special assessments. The revenues created from these additional taxes can then be used to finance the certain public improvements and services associated with a development. Recently, municipalities have also implemented the Local Option Economic Development Sales Tax on a municipality-wide basis to provide funding for eligible economic development projects. A more detailed summary of these incentive programs is included herein.

Tax credits: Many tax credit programs exist at the state and federal level. Tax credits offset tax liability and can be used to improve project cashflow or encourage investment. Some tax credits may be sold to raise money for a project. Municipalities generally do not control awards or administration of tax credits. However, municipalities should have an understanding of the types of various tax credit programs so that they can understand the true level of economic development incentives that a project hopes to utilize. Information on specific tax credit programs is available at http://www.ded.mo.gov/Programs.aspx.

Tax redistribution: The most popular type of tax redistribution is tax increment financing (TIF). When TIF is implemented, a TIF district "captures" a portion of the incremental tax revenue generated from a project. This "captured" revenue can then be used to pay eligible project costs. The Real Property Tax Increment Allocation Redevelopment Act, Sections 99.800 to 99.865, RSMo (the "TIF Act"), provides the statutory requirements for implementing TIF in Missouri. A more detailed summary of the TIF Act follows in Chapter 4 of this Guide. As an alternative to the process described in the TIF Act, municipalities may enter into tax rebate agreements with developers whereby incremental tax revenues from a project are directed to pay project costs. This is sometimes referred to as "Contract TIF". Unlike the incentives available under the TIF Act, which includes "capture" of most sales and property taxes, tax rebate agreements can only "capture" taxes that (1) are levied by the municipality itself (i.e., a tax rebate agreement entered into by a city would not apply to county sales taxes) and (2) are not imposed for limited purposes (i.e., revenues from a fire protection sales tax could not be used to pay project costs).

Grants/loans: Some municipalities have funded grant or loan programs to provide direct assistance to businesses and projects. The legality of such programs depends on several variables, including (1) the source of the funding, (2) the classification of the municipality, (3) statutory or charter authority and (4) the primary intent of the program. Recent examples of permissible programs include (a) establishing a program to provide grants for façade improvements as part of a downtown TIF plan and (b) creating a forgiveable loan program funded by revenues from a Local Option Economic Development Sales Tax (see Section 67.1305, RSMo.). Legal counsel should be heavily involved in the development of any type of grant or loan to program to ensure that such a program is within a local government's statutory, charter and constitutional powers.

Public-Private Partnerships

Awards of economic development incentives often involve entering into a public-private partnership. The terms of such partnership are generally detailed in a redevelopment agreement or other agreement between the municipality and a developer. It is important that such documents clearly describe the rights and responsibilities of the parties, including, but not limited to:

- What will be built and when?

- What incentives are available and how will they be paid?
- If the project is not completed, what happens?

Such agreements should be drafted by legal counsel in close consultation with municipal officials to insure that actions promised by the municipality are within the municipality's power and that terms of the agreement correspond to the "business deal" agreed to with the developer.

It is common practice for a municipality and developer to enter into a preliminary funding agreement prior to a municipality's consideration of incentives, whereby the developer will pay all or a portion of the municipality's costs incurred in consideration of the requested economic development program incentive(s) and the negotiation of a redevelopment agreement.

Administering Incentive Programs

Program Administration: Administrative responsibilities vary greatly depending on the type of economic development incentive program used. For example, under Missouri statute, municipalities with active TIF districts must, among other duties, file annual reports with the Missouri Department of Economic Development. If a city fails to file these reports, it will be prohibited from approving new TIF projects for 5 years. Municipalities may also be involved with the administration of a CID or TDD, which are separate political subdivisions and have their own budgets, boards of directors, etc. When planning to implement an economic development incentive program, it is important to identify (1) which party (municipality or developer) and personnel (City Clerk, Director of Planning/Community Development, etc.) will have what responsibilities and (2) where funding for administrative costs will come from (i.e., CID or TDD sales tax revenue, TIF revenue, developer payments, etc.). The following pages discuss specific administrative requirements for many of the economic development incentive programs discussed above.

Financing Administration: The use of CIDs, TDDs, NIDs and TIF often involve the issuance of bonds or notes and the verification of reimbursement requests from developers that advance fund eligible project costs. The process for verifying reimbursement requests should be detailed in the redevelopment agreement and/or other financing documents and will generally require a developer to provide copies of invoices or other proof of costs incurred to an identified municipal employee for verification prior to qualifying for reimbursement. When bonds or notes are issued, other administrative duties may also apply. For example, on a note issue, the municipality might elect to serve as its own paying agent rather then employee a trustee bank. If bonds are issued, a trustee bank will almost always be involved. Depending on the nature of the bond issue, the municipality may have additional continuing disclosure and record keeping duties. For a more detailed summary of these requirements, see Chapter 6 of this Guide. This continuing disclosure information required should be very similar to the information that a municipality provides in relation to its other type of bonds. Because the bonds are usually only secured by revenues created within a specific district (i.e., CID, TDD or TIF), the disclosure requirements may also include some information about the specific businesses within the district. Recently, the Internal Revenue Service has targeted bonds issued for economic development projects for closer scrutiny. Accordingly, it is important that you work with your bond counsel to identify the types of records that need to be maintained.

Protecting Taxpayer Interests

Protection of taxpayer (and taxing district) interests is a critical component to any consideration of economic development incentives. Good public policy requires municipalities to analyze the need for incentives and the risk to taxpayers and taxing districts. Local governments should be prepared to understand financial information provided by developers and have some ability (through internal staff and/or consultants) to determine if the financial information presented is reasonably realistic (i.e., construction budgets, sales projections, assessed value projections, etc.).

The TIF Act requires a municipality to make a finding that the project would not be feasible "but for" the TIF incentive. While such a finding is not legally required for other incentive programs, local governments may still want to rely on a similar justification before approving any tax abatement or tax redistribution incentives. Municipalities should also work closely with their legal counsel and financial advisors to ensure an incentive program remains in place for the least amount of time necessary to achieve the desired incentive value.

Tax abatement and tax redistribution incentive programs give municipalities the ability to affect the tax revenues of other taxing districts. While application of these incentive programs generally requires providing these affected taxing districts with an analysis of the impact of the proposed incentive program and an opportunity to participate in a public hearing, final approval is solely controlled by the municipality. Accordingly, municipalities should consider the impacts on other taxing districts and, if appropriate, explore measures to mitigate potential impacts.

* * *

CHAPTER 4

SUMMARIES OF POPULAR ECONOMIC DEVELOPMENT INCENTIVE PROGRAMS [*]

Property Tax Abatement Under Chapter 100, RSMo.

Cities, counties, towns and villages in Missouri are authorized, pursuant to Article VI, Section 27(b) of the Missouri Constitution and Sections 100.010 to 100.200, RSMo ("Chapter 100") to issue industrial development bonds ("IDBs") to finance projects for private corporations, partnerships and individuals. There are two primary reasons to issue IDBs under Chapter 100. First, if the bonds are tax-exempt, it may be possible to issue the bonds at lower interest rates than those obtained through conventional financing. Second, even if the bonds are not tax-exempt, ad valorem taxes on bond-financed property may be abated so long as the bonds are outstanding. *The description below focuses primarily on the issuance of taxable industrial development bonds issued for the purposes of the abatement of ad valorem taxes.*

What type of projects are allowed?

Chapter 100 permits any city, county, town or village ("Municipality") to issue bonds to finance the costs of warehouses, distribution facilities, research and development facilities, office industries, agricultural processing industries, services facilities which provide interstate commerce and industrial plants. Article VI, Section 27(b) of the Missouri Constitution also authorizes such bonds to be issued for other types of commercial facilities. In connection with such projects, the bond proceeds may be used to finance land, buildings, fixtures and machinery.

What are the advantages of Chapter 100?

From the Municipality's standpoint, IDB financing is a useful tool to induce responsible new industries to locate in the area, as well as encouraging companies already in the area to remain, by assisting them in improving their present facilities or in building new ones. The end result is often a combination of increased job opportunities, existing job retention and large-scale capital investment. Company's with large equipment investments may be particularly interested in an IDB financing because of the potential to abate both real and personal property taxes.

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How are taxes abated?

Property Tax - Under Article X, Section 6 of the Missouri Constitution and Section 137.100, RSMo, all property of any political subdivision is exempt from taxation. In a typical IDB transaction, the Municipality holds fee title to the project and leases the project to the company. The Municipality and the company may determine that partial tax abatement -- but not full tax abatement -- is desirable, in which case the company will need to agree to make "payments in lieu of taxes" to the city or county. The amount of payments in lieu of taxes is negotiable to any amount. The payments in lieu of taxes are payable by December 31 of each year, and are distributed to the applicable taxing districts in the same manner and in the same proportion as property taxes would otherwise be distributed under Missouri law.

Sales Tax - Under Section 144.054.3, RSMo, a company may apply to the Missouri Department of Economic Development to receive a sales tax exemption on all personal property purchased through an IDB transaction. The municipality may also furnish the company with a sales tax exemption certificate, so that materials used in constructing any real property improvements can be exempt from sales taxes.

How are projects approved?

Upon a determination by the Municipality to proceed with the financing, the Municipality normally adopts a resolution (referred to as a "resolution of intent" or "inducement resolution") stating the Municipality's willingness and intent to issue IDBs for the project. Thereafter, the Municipality must provide notice to each taxing district of the Municipality's intent to approve a "plan for industrial development" for the project. The plan must identify the primary terms of the proposed transaction, and must include a cost-benefit analysis that shows the impact of the proposed tax abatement on each taxing district. Finally, the Municipality adopts an ordinance approving the various bond documents and authorizing the issuance of the bonds.

What on-going administrative responsibilities will Municipalities have?

Municipalities that participate in an IDB financing will likely have to approve requisitions prepared by the company showing what real and personal property was purchased with bond proceeds and transferred to municipal ownership. County assessors will also have to determine which property is owned by the Municipality (and thus tax-exempt) and which is owned by the company (and thus taxable). Bond documents are generally drafted to require the company to provide detailed descriptions of property to the county assessor to make this task easier. At the end of the tax abatement period, municipalities will also need to transfer ownership of property by deed or bill of sale back to the company so that such property becomes taxable. The mechanism for such transfer should be included in the bond documents.

Property Tax Abatement Under Chapter 353, RSMo

Under Chapter 353, RSMo (Chapter 353), real property tax abatement is available within "blighted areas." An Urban Redevelopment Corporation is created under the general corporations laws of Missouri and, once created, it has the power to operate one or more redevelopment projects pursuant to a city-approved or county-approved (if St. Louis County or Jackson County) redevelopment plan.

What tax abatement is permitted?

Under this program, an eligible city or county may approve a redevelopment plan that provides for tax abatement for up to 25 years, thus encouraging the redevelopment of the blighted area. To be eligible for the abatement, the Urban Redevelopment Corporation must take title to the property to be redeveloped. During the first 10 years of tax abatement, (1) 100% of the incremental increase in real property taxes on the land are abated, (2) 100% of the real property taxes on all improvements are abated, and (3) the property owner continues to pay real property taxes on the land in the amount of such taxes in the year before the redevelopment corporation takes title.

During the next 15 years, between 50% and 100% of the incremental real property taxes on all land and all improvements are abated. Payments in lieu of taxes ("PILOTS") may be imposed on the Urban Redevelopment Corporation by contract with the city or county, as applicable, to achieve an effective tax abatement that is less than the abatement established by statute. PILOTS are paid on an annual basis to replace all or part of the real estate taxes that are abated. PILOTS will be allocated to each taxing district according to their proportionate share of ad valorem property taxes. The Urban Redevelopment Corporation may take title to lots, tracts or parcels of property within the redevelopment area in phases, in order to maximize the tax abatement during a phased redevelopment project.

How is a development plan approved?

The statute requires the governing body of the municipality to hold a public hearing regarding any proposed development plan. Prior to receipt of any development plan, municipalities should adopt an ordinance setting forth (1) procedures for giving notice (i.e., how many days, certified mail, etc.), (2) any application fees or other submission requirements and (3) any desired content requirements for development plans. Before the public hearing, the governing body must, in the manner prescribed by the ordinance, furnish to the political subdivisions whose boundaries include any portion of the property to be affected by tax abatement (1) notice of the scheduled public hearing and (2) a written statement of the impact on ad valorem taxes such tax abatement will have on the political subdivisions (a "tax impact statement"). The tax impact statement must include, at a minimum, an estimate of the amount of ad valorem tax revenues of each political subdivision that will be affected by the proposed tax abatement.

After the public hearing, the municipality may approve a development plan by ordinance. However, no tax abatement available under a development plan will be permitted until (1) the developer enters into a redevelopment agreement with the municipality describing the terms and conditions of the abatement and (2) title to the property at issue passes to an urban redevelopment corporation established under Chapter 353.

Who prepares a development plan?

Unless limited by local ordinance, there is no restriction on what entity may submit a development plan. Generally, developers form their own urban redevelopment corporations and prepare development plans. However, several cities in Missouri have formed their own urban redevelopment corporations to prepare development plans and pursue redevelopment opportunities.

What on-going administrative responsibilities will municipalities have?

If a municipality operates its own urban redevelopment corporation, it will need to make annual filings with the Secretary of State in the same manner as other Missouri corporations.

Community Improvement Districts (CID)

A community improvement district ("CID") may be created for the purpose of financing a wide range of public facilities, improvements or services. A CID is either a separate political subdivision with the power to impose a sales tax, a special assessment or a real property tax, or a nonprofit corporation with the power to impose special assessments.

What types of projects may be funded by a CID?

A CID may fund public facilities or improvements within its boundaries, including the following:

1. Pedestrian or shopping malls and plazas.
2. Parks, lawns, trees and any other landscape.
3. Convention centers, arenas, aquariums, aviaries and meeting facilities.
4. Sidewalks, streets, alleys, bridges, ramps tunnels, overpasses and underpasses, traffic signs and signals, utilities, drainage, water, storm and sewer systems and other site improvements.
5. Parking lots, garages or other facilities.
6. Lakes, dams and waterways.
7. Streetscape, lighting, benches or other seating furniture, trash receptacles, marquees, awnings, canopies, walls and barriers.
8. Telephone and information booths, bus stop and other shelters, rest rooms and kiosks.
9. Paintings, murals, display cases, sculptures and fountains.
10. Music, news and child-care facilities.
11. Any other useful, necessary or desired improvement.

A CID may also provide a variety of public services within its boundaries, including the following:

1. With the municipality's consent, prohibiting or restricting vehicular and pedestrian traffic and vendors on streets.

2. Operating or contracting for the provision of music, news, child-care or parking facilities, and buses, mini-buses or other modes of transportation.
3. Leasing space for sidewalk café tables and chairs.
4. Providing or contracting for the provision of security personnel, equipment or facilities for the protection of property and persons.
5. Providing or contracting for cleaning, maintenance and other services to public and private property.
6. Promoting tourism, recreational or cultural activities or special events.
7. Promoting business activity, development and retention.
8. Providing refuse collection and disposal services.
9. Contracting for or conducting economic, planning, marketing or other studies.

If the area within a CID has been found to be blighted by the governing body of the municipality, the CID has the additional power to demolish, renovate or rehabilitate any building or structure.

How is a CID created?

A CID is created by petitioning the municipality where the proposed district will be located. The CID petition must be signed by property owners that (1) collectively own at least 50% of the assessed value of the real property within the proposed district and (2) are more than 50% per capita of all owners of real property within the proposed district. Among other items, the petition must also identify the funding sources the CID may pursue and include a five-year plan that describes the purposes of the proposed district, the services it will provide, the improvements it will make and an estimate of the costs of the project. Once the petition is filed, the governing body of the municipality shall hold a public hearing and may approve the creation of the proposed district by ordinance.

After the CID has been created, it make seek voter approval for the funding sources identified in the CID petition. Property owners may vote in these elections if there are no registered voters residing in the CID.

A CID is governed by a board of directors. These directors may be appointed by the chief elected officer of the municipality (with the consent of the municipality's governing body) or elected by the qualified voters of the CID, as provided in the petition.

How does a CID finance a project?

A CID may finance the costs of a project through the imposition of (1) special assessments for those improvements that specifically benefit the properties within the district; (2) property taxes; or (3) a sales tax up to a maximum of 1% (however, CIDs created as nonprofit corporations may not levy property or sales taxes). A CID may finance the costs of a project through the imposition of fees, rents and charges for district property or services and seek out grants, gifts and donations.

A CID may issue bonds, notes and other obligations secured by its revenues and property. A CID may also appropriate its revenues to another entity, such as a municipality or industrial development authority that has issued obligations to fund the CID project.

What on-going administrative responsibilities will municipalities have?

CIDs, as legally separate entities, require significant administration – formulating budgets, procuring insurance, managing board meetings, etc. These duties may be handled by municipalities (if they agree to undertake such responsibilities), property owners within the CID, or a professional district administrator.

Transportation Development Districts (TDD)

A transportation development district ("TDD") is a separate political subdivision that may be created to fund, promote, plan, design, construct, improve, maintain and operate one or more transportation-related projects or to assist in such activity. A TDD may impose a sales tax, property tax, or special assessment. A TDD may also collect tolls or fees on a project.

What types of projects may be funded by a TDD?

A TDD can fund transportation-related improvements, including any bridge, street, road, highway, access road, interchange, intersection, signing, signalization, parking lot, bus stop, station, garage, terminal, hangar, shelter, rest area, dock, wharf, lake or river port, airport, railroad, light rail, or other mass transit and any similar or related improvement or infrastructure. However, before construction or funding of any project, a TDD is required to submit the proposed project, together with the proposed plans and specifications, to the Missouri Highways and Transportation Commission and/or the local transportation authority for their prior approval. A "local transportation authority" is a county, city, town, village, county highway commission, special road district, interstate compact agency, or any local public authority or political subdivision with jurisdiction over the proposed transportation project.

How is a TDD created?

A TDD may be created may be created by petition of (1) at least fifty registered voters within the proposed district or (2) if there are no registered voters within the district, the owners of all of the real property located within the proposed district. In addition, two or more local transportation authorities may adopt resolutions calling for the joint establishment of a district and then file a petition requesting the creation of a district. With certain limited exceptions, the property in the district must be contiguous. The petition is filed in the circuit court of the county that the proposed TDD is located in. The district may then be created upon judgment and order of the circuit court judge. Unless the petition was filed by property owners and there are no registered voters in the district, prior to ordering the creation of the TDD, the judge will call an election of the qualified voters within the proposed district. Voter approval is also required for implementation of any property tax, sales tax or special assessment.

How does a TDD finance a project?

Once created, a TDD can finance the costs of a project through the imposition of (1) special assessments for those improvements that specifically benefit the properties within the district; (2) a property tax in an amount not to exceed $0.10 per $100 of assessed valuation; (3) a sales tax up to a maximum of one percent; or (4) tolls and fees for use of the project. A TDD may also issue bonds, notes and other obligations and may secure its obligations by mortgage, pledge, assignment or deed of trust of any or all of the property and income of the district. A TDD may also appropriate its revenues to another entity that has issued obligations to fund the TDD project.

What on-going administrative responsibilities will municipalities have?

TDDs, as legally separate entities, require significant administration – formulating budgets, procuring insurance, managing board meetings, etc. These duties may be handled by municipalities (if they agree to undertake such responsibilities), property owners within the TDD, or a professional district administrator.

Neighborhood Improvement Districts (NID)

A neighborhood improvement district ("NID") is a special assessment district that may be created for the purpose of financing public facilities or improvements that confer a benefit upon property within the district.

What projects can be financed by a NID?

A NID may fund public facilities or improvements including the following:

1. Acquisition of property.
2. Improvement of streets, gutters, curbs, sidewalks, crosswalks, driveway entrances and structures, drainage works incidental thereto and service connections from sewer, water, gas and other utility mains, conduits or pipes.
3. Improvement of storm and sanitary sewer systems.
4. Improvement of streetlights and street lighting systems.
5. Improvement of waterworks systems.
6. Improvement of parks, playgrounds and recreational systems.
7. Landscaping streets or other public facilities.
8. Improvement of flood control works.
9. Improvement of pedestrian and vehicle bridges, overpasses and tunnels.
10. Improvement of retaining walls and area walls on public ways.
11. Improvement of property for off-street parking.
12. Acquisition and improvement of other public facilities or improvements.
13. Improvements for public safety.

How is a NID created?

A NID is created by either an election held or petition circulated within the proposed NID area. If created pursuant to an election, the NID must be approved by the percentage of voters within the proposed district voting thereon required for general obligation bonds (four-sevenths or two-thirds, depending on the date of the election). The voter-approval requirements for general obligation bonds are discussed under Chapter 1 of this Guide. Alternatively, a NID may be created by resolution or ordinance of the governing body of a municipality upon receipt of a petition signed by the owners of record of at least two-thirds by area of all real property located within the proposed district.

How is a NID project financed?

Special assessments are used to finance NID improvements. Once the NID has been created, plans and specifications for the project and a preliminary assessment roll will be prepared and the governing body of the municipality will hold a public hearing. Following the completion of the construction of the project, the final costs and assessments will be computed and notice mailed to taxpayers. Charges may be assessed equally per front foot, per square foot or pursuant to any other reasonable assessment plan; provided, the amount of the assessment correlates to the benefits accruing to the property by reason of the improvements.

The governing body of the municipality can issue temporary notes and permanent bonds to finance NID projects. NID bonds are a type of general obligation bonds. The bonds are payable as to both principal and interest from the assessments and, if not so paid, from current income and revenue and revenues and surplus funds of the municipality that formed the NID. If the municipality uses funds on hand to pay debt service, the issuer can reimburse itself from assessments at a later date. The maturity of the bonds is limited to 20 years.

What on-going administrative responsibilities will municipalities have?

When implementing a NID, a municipality's administrative responsibilities with respect to the NID largely end after a project has been completed and bonds are issued. However, if bonds are issued, the municipality will have on-going disclosure and record keeping responsibilities. These responsibilities would be generally the same as the disclosure and record keeping responsibilities that a municipality undertakes in association with any standard municipal bond issuance. See Chapter 6 of this Guide.

Local Option Economic Development Sales Tax

A Local Option Economic Development Sales Tax may be levied, subject to voter approval, at a rate of up to one-half of one percent (0.5%) by any city, town, village or county (collectively, a "municipality") pursuant to Section 67.1305, RSMo.

What can the sales tax revenues be used for?

The use of Local Option Economic Development Sales Tax revenue is subject to several restrictions:

- Sales tax revenue may not be used for any retail development project, except for the redevelopment of downtown areas or historic districts.

- At least twenty percent (20%) of the revenue must be used for projects directly related to long-term economic development preparation, including but not limited to the following:

    - Acquisition of land;

  - Installation of infrastructure for industrial or business parks;
  - Improvement of water and wastewater treatment capacity;
  - Extension of streets; and
  - Providing matching dollars for state or federal grants.

- Remaining revenue may be used for, but is not limited to, the following:

  - Marketing;
  - Providing grants and low-interest loans to companies for job training, equipment acquisition, site development and infrastructure;
  - Training programs to prepare workers for advanced technologies and high skill jobs;
  - Legal and accounting expenses directly associated with the economic development planning and preparation process; and
  - Developing value-added and export opportunities for Missouri agricultural products.

- Not more than twenty-five percent (25%) of revenue may be used annually for administrative purposes, including staff and facility costs.

- Sales tax revenue may be used outside of the boundaries of the municipality imposing the tax if:

  - The municipality imposing the tax or the state receives significant economic benefit from the economic development plan, economic development project or the designation of the economic development area; and

  - An agreement is entered between all municipalities participating in the economic development plan, economic development project or the designation of the economic development area detailing the authority and responsibilities of each municipality.

- When imposed in a tax increment financing (TIF) district, Local Option Economic Development Sales Tax revenue is not captured by TIF.

- When imposed in any special taxing district, including but not limited to TIF, Neighborhood Improvement Districts or Community Improvement Districts, Local Option Economic Development Sales Tax revenue may not be used for the purposes of the special taxing district unless recommended by the Economic Development Tax Board and approved by the governing body of the municipality levying the tax.

What on-going administrative responsibilities will municipalities have?

In conjunction with the Local Option Economic Development Sales Tax, municipalities must form an Economic Development Tax Board made up of appointees from the municipality, the county and the school district. The purposes of this Board are to (1) develop and consider economic development plans, economic development projects and designations of economic development areas, (2) hold public hearings, and (3) make recommendations to the governing body of the municipality concerning economic development plans, economic development projects and designations of economic development areas. However, the governing body of the municipality levying the Local Option Economic Development Sales Tax will make all final funding determinations.

The Economic Development Tax Board and the governing body of the municipality levying the Local Option Economic Development Sales Tax must make a public report at least annually on the use of the sales tax revenue and the progress of any economic development plan, economic development project or the designation of the economic development area.

Additionally, the Economic Development Tax Board must submit an annual report to the Joint Committee on Economic Development (a joint committee of the Missouri General Assembly) detailing the sales tax revenues and the status of the projects it has funded.

Tax Increment Financing (TIF)

Tax increment financing ("TIF") under the Real Property Tax Allocation Redevelopment Act, Sections 99.800 to 99.865, RSMo. (the "TIF Act"), is a mechanism to capture incremental tax revenues resulting from redevelopment and apply those revenues to pay redevelopment project costs.

What tax revenues does TIF affect?

The TIF Act allows for the capture of 100% of local incremental real property taxes and 50% of local incremental economic activity taxes (i.e., sales, utility and earnings taxes) generated within a redevelopment area. Incremental taxes are measured by comparing the current tax revenue to the revenues generated in the year prior to adoption of TIF. In some instances, incremental state tax revenues may also be available.

Personal property taxes, the commercial surcharge and certain sales taxes (including those levied on the sales of hotel and motel rooms) are not captured by TIF.

How is TIF adopted?

Prior to adoption of TIF, a municipality must:

1. Establish a TIF Commission as prescribed in the TIF Act;
2. Prepare a redevelopment plan and cost-benefit analysis describing the economic impact on the various taxing districts if the project is built and is not built; and
3. Have the TIF Commission hold a public hearing regarding the proposed redevelopment plan and project and make a recommendation to the governing body of the municipality.

After completion of the hearing and receipt of the TIF Commission's recommendation, the municipality may then make the findings required by the TIF Act, approve the redevelopment plan and project, designate the redevelopment area and adopt TIF. Municipalities will also need to enter into a redevelopment agreement with a developer prescribing the terms and conditions upon which TIF revenues will be applied to a redevelopment project.

The TIF Act requires the municipality to make several findings, including that the redevelopment area qualifies as a "blighted area," "conservation area" or "economic development area" (as those terms are described in the TIF Act) and that the project would not be feasible without TIF assistance.

What type of costs can TIF fund?

TIF revenues may be used to fund:

1. Costs of studies, surveys and plans;
2. Professional service costs, such as financial advisory fees, bond counsel fees and planning expenses, subject to certain limitations as provided in the TIF Act;
3. Land acquisition and demolition costs;
4. Costs of rehabilitating and repairing existing buildings;
5. Initial costs for an economic development area;
6. Costs of constructing public works or improvements, such as street lighting, street repairs or parking;
7. Financing costs, including bond issuance costs, capitalized interest and reasonable reserves;
8. Capital costs incurred by any taxing jurisdiction as a direct result of the project;
9. Relocation costs; and
10. Payments in lieu of taxes.

TIF revenues may also be used to pay debt service on bonds or other obligations used to finance such costs.

How long can TIF operate?

TIF can be in place for up to 23 years from the date of approval of any redevelopment project. Redevelopment projects must be approved within 10 years from approval of a redevelopment plan.

What on-going administrative responsibilities will municipalities have?

The governing body of the municipality must submit to the Missouri Department of Economic Development an annual report concerning the status of each redevelopment plan and project. If a municipality fails to provide an annual report to the Missouri Department of Economic Development, the municipality will be prohibited from implementing new TIF projects for at least five years.

The municipality must also publish in a newspaper of general circulation in the county a statement showing the payments in lieu of taxes received and expended in that year, the status of the redevelopment plan and projects, the amount of outstanding bonded indebtedness and any additional information the municipality deems necessary.

Every five years, the governing body of the municipality must hold a public hearing to determine if the redevelopment project is making satisfactory progress under the proposed time schedule contained in the redevelopment plan. Notice of the public hearing must be given in a newspaper of general circulation in the redevelopment area once each week for four weeks immediately prior to the hearing.

The municipality may also need to identify which of its tax receipts qualify as TIF revenues and provide any additional financial administration required by a redevelopment agreement. If TIF bonds are issued, the municipality will have on-going disclosure and record keeping responsibilities. These responsibilities will likely be somewhat greater than the disclosure and record keeping responsibilities that a municipality undertakes in association with a standard municipal bond issuance.

Sales Tax Rebate/Development Agreements

An alternative to TIF financing is for a municipality to enter into an agreement (commonly referred to as a "sales tax rebate agreement" or "development agreement") with a property owner, whereby the owner of a retail establishment agrees to fund the costs of certain public improvements and the municipality agrees to reimburse the owner for the cost of those improvements, with interest at an agreed-upon taxable interest rate, from the incremental sales taxes generated by the project. The owner generally agrees to be paid solely from those incremental sales taxes, and not from any other funds of the municipality.

What is the legal basis for these agreements?

Section 70.220, RSMo (the "Cooperation Law") authorizes any municipality or other political subdivision to contract with any other political subdivision, private person or firm for the "planning, development, construction, acquisition or operation of any public improvement or facility." The political subdivision may authorize the contract by ordinance or resolution.

How are these agreements generally structured?

Many retail developments require the installation of public improvements (such as roads, traffic signals and utilities) to accommodate the development. Under the typical agreement, the developer agrees to advance the costs of the public improvements. The political subdivision agrees to reimburse the developer for such costs, with interest, over a specified period of time. The agreement usually provides that only a portion of the incremental (*i.e.,* new) sales tax revenues generated from the development will be used to reimburse the cost of the public improvements. This results in immediate new revenue to the municipality, while also providing a source of repayment for the public improvements.

The Missouri Constitution generally requires voter approval if a political subdivision pledges tax revenue to the repayment of indebtedness that lasts for more than one year. Therefore, sales tax rebate agreements specifically provide that the political subdivision's obligation is from year-to-year only, and is subject to annual appropriation by the governing body.

What approvals are required?

Undertaking a sales tax rebate agreement is a fairly simple process, since the governing body is obligating only its funds – not the funds of any other political subdivision. No public hearing or consultation with other political subdivisions is required. Essentially, the governing body of the municipality is only required to approve the agreement by ordinance and make the applicable appropriations.

What on-going administrative responsibilities will municipalities have?

All on-going administrative responsibilities will be identified in the sales tax rebate agreement. At a minimum, these responsibilities will likely include financial record keeping regarding the payments made to the property owner.

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CHAPTER 5

SELECTED FEDERAL TAX ISSUES*

Tax-Exempt Issuer Does Not Always Mean Tax-Exempt Bonds

Contrary to what some may believe, just because the bonds or other obligations are issued by a "tax-exempt" entity (like a municipality), there is no certainty that the interest paid by the municipality will be tax-exempt income for the investor. There are many factors that contribute to the analysis of whether a particular issue of bonds or other obligations will be "tax-exempt", meaning that the interest paid to the investor or bond owner is excludable from gross income for purposes of federal income taxes.

Federal tax law governing tax-exempt bonds and other obligations is very complex. Purchasers of a municipality's tax-exempt bonds and other obligations offer lower interest rates than would be offered for a similar bond for which the interest income is fully taxable to the bond owner. There are a number of issues affecting the taxability of interest on a municipality's bonds or other obligations. The detailed requirements of the Internal Revenue Code and related regulations are beyond the scope of this Guide. Finance officers and other municipal officials should always consult with bond counsel before signing papers (especially IRS forms) that include representations about the tax-exempt nature of the financing. IRS forms often include a statement that the form is being signed under penalty of perjury.

Reimbursing Prior Expenditures

Sometimes a municipality will need to spend money on a project before the bonds or other financing obligations are issued, intending to reimburse such expenditures from bond proceeds. There are restrictions, and specific requirements to be followed, in order to preserve the option of using tax-exempt bond proceeds to reimburse prior expenditures. The municipality needs to consult with bond counsel before advancing money for project costs that are expected to be reimbursed from tax-exempt bonds or other financing obligations.

Bank-Qualified Bonds

What is a bank-qualified bond?

The term "bank-qualified" is a term that has been adapted by finance professionals and capital market participants to describe certain types of governmental obligations that may achieve more favorable federal tax treatment when owned by certain types of financial institutions. In fact, this term does not appear in the Internal Revenue Code of 1986, as amended, or the related regulations issued by

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* Includes excerpts from materials prepared by Gilmore & Bell's department of tax attorneys, who exclusively devote their time to advising clients and other attorneys in the firm of the ever-changing federal tax laws affecting tax-exempt obligations.

the U.S. Treasury Department (collectively referred to as the "Code"). The actual term is a "qualified tax-exempt obligation" as described in Section 265 of the Code.

What is the benefit of issuing bank-qualified bonds?

The benefit of being able to issue tax-exempt bonds or other obligations as “bank-qualified” is that the bonds will be a more attractive investment to the banks and financial institutions covered by Section 265 of the Code. The ability to market and sell the bonds to a wider group of potential investors should, in theory, result in lower interest rates for the bonds.

Why do banks care about bank-qualified status of the bonds?

Section 265(b) of the Code provides that no deduction is allowed to a financial institution for that portion of its interest expense which is allocable to tax-exempt interest. Section 265(b), which was added to the Code in 1986, expanded the prior law 20% disallowance set forth in previous sections of the Code. The disallowed interest deduction is determined on a pro rata basis based on the relative adjusted bases of the taxable and tax-exempt assets held by the financial institution. Section 265(b) applies generally to tax-exempt obligations acquired after August 7, 1986. To put this in perspective, a bank pays interest to its depositors. When the bank prepares its federal income tax return, it is allowed to deduct from gross income its ordinary and necessary business expenses, including such items as rent, salaries, utilities and interest paid to depositors. By deducting these amounts, the bank's taxable income is reduced, so it pays less income tax. But suppose a bank holds some municipal bonds in its portfolio, and these make up 25% of all the bank's assets (land, buildings, equipment, investment securities and loans). Unless the bonds are "qualified tax-exempt obligations" (described below), the bank must reduce its interest deduction by 25%, which will force it to pay more federal income tax. Because of this provision, most financial institutions are not willing to purchase municipal bonds unless the bonds are "bank qualified."

Section 265(b)(3) of the Code provides an exception to the general disallowance rule discussed above, in the case of any “qualified tax-exempt obligation,” defined as a bond, which (a) is not a private activity bond (other than a qualified 501(c)(3) bond and certain types of refunding bonds) and (b) is issued by an issuer which reasonably anticipates to issue, together with subordinate entities, not more than $10,000,000 of tax-exempt obligations (other than private activity bonds, as described in clause (a)) during the calendar year. Qualified tax-exempt obligations, which must be designated as such by the issuer of the bonds, are treated as acquired by the financial institution prior to August 8, 1986, and thus are not subject to the pro-rata loss of interest deduction discussed above, although they are subject to the 20% disallowance under Section 291(e)(10)(B) of the Code. Section 265(b)(3) was extensively amended in 1988 amendments to the Code in order to clarify its application, particularly to refunding bonds, composite issues and to the circumstances under which bonds of issuers must be aggregated in determining the $10 million limitation.

What is required to make the bonds bank-qualified?

Must be a Qualified Small Issuer and Make a Designation. Only "qualified small issuers" are permitted to designate their tax-exempt obligations as qualified tax-exempt obligations under Section 265(b) of the Code. Section 265(b)(3)(C) defines a qualified small issuer to mean, with respect to obligations issued during any calendar year, any issuer if the reasonably anticipated amount of tax-exempt obligations (other than obligations described below, which will be issued by such issuer during such calendar year does not exceed $10,000,000. Generally, an obligation is ***not*** taken into account in determining status as qualified small issuer if such obligation is:

(a) a private activity bond (other than a qualified 501(c)(3) bond, as defined in section Code Section 145); or

(b) an obligation issued to refund (other than to advance refund) any obligation to the extent the amount of the refunding obligation does not exceed the outstanding amount of the refunded obligation.

Limitations on Amount of Designation. In general, not more than $10,000,000 of obligations issued during any calendar year may be designated by such issuer as qualified tax-exempt obligations. Special rules apply for refundings. Issuing bonds as "bank-qualified" can be complicated.

Consult Bond Counsel. It is important to consult bond counsel to ensure that the bonds or other obligations can be designated as "bank-qualified", and that this designation will not adversely impact the tax status of any other bonds or obligations that have been, or will be issued by the municipality in the same calendar year.

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CHAPTER 6

POST-ISSUANCE COMPLIANCE REQUIREMENTS [*]

Establishing Post-Issuance Compliance

State and local governments (sometimes referred to as "issuers") spend a great deal of time, energy and money issuing tax-exempt debt. That effort is worthwhile because tax-exempt debt results in significant cost savings when compared to the alternative of borrowing in the taxable debt market. In addition to the time spent issuing tax-exempt debt, municipal issuers have responsibilities after the closing or "issue date" to comply with certain post-issuance compliance requirements, which include a range of federal tax, disclosure and bond document matters. Failure to attend to these responsibilities can have serious Federal tax or securities law consequences. For purposes of this chapter, the term "tax-exempt debt" includes tax-exempt bonds, notes and leases (and certificates of participation in leases). For simplicity, these various types of tax-exempt debt are referred to in this chapter as "bonds." In addition, municipal issuers should be aware that their post-issuance compliance responsibilities apply to certain taxable debt as well, including build America bonds, recovery zone economic development bonds and specific types of tax credit bonds.

In order to ensure that a City is maintaining adequate records to establish post-issuance compliance, the City must be prepared to answer the following five questions:

1. How does the City monitor the ongoing federal tax and securities law requirements related to its bonds?

   How to be prepared? Adopt and implement written compliance procedures applicable to all your bonds.

2. How does the City properly account for the expenditure of bond proceeds?

   How to be prepared? Complete a "final allocation" for each bond issue.

3. How does the City account for the use of bond-financed assets?

   How to be prepared? Complete an "annual compliance checklist" for each bond issue.

[*] Prepared by **Meghan Wiedel**, who is an attorney in the Kansas City office of Gilmore & Bell, P.C. Since entering the law practice in 2007, Ms. Wiedel has concentrated her practice in public finance and tax law. She is licensed to practice law in Missouri. Ms. Wiedel received her Bachelor of Science in Business Administration (Finance and Banking) from the University of Nebraska at Omaha in 2003, and her J.D. (*magna cum laude*) in Taxation from the University of Missouri-Kansas City in 2007. She also completed her LLM in Taxation from the University of Missouri-Kansas City in 2007. Ms. Wiedel is the direct supervisor of the firm's Compliance Services Group, which includes arbitrage rebate services and other federal tax compliance services, continuing disclosure services and economic development administrative services.

4. How does the City account for the investment of bond related funds?

   How to be prepared? Have arbitrage rebate calculation(s) completed for each bond issue.

5. Has the City made the required continuing disclosure filings?

   How to be prepared? File the City's "annual report" and any material event notices with the Municipal Securities Rulemaking Board.

It is imperative that the City have adequate records to establish post-issuance compliance in the event of an examination or audit of its bonds by the U.S. Internal Revenue Service ("IRS"). In addition, adequate records establishing post-issuance compliance will preserve the City's ability to refinance or refund its bonds in the future.

Written Compliance Procedures

What are the federal tax law requirements?

There is no provision in the Internal Revenue Code or the related Treasury Regulations (collectively referred to as the "Internal Revenue Code") that require an issuer to establish written procedures related to its outstanding bonds. For several years, however, IRS officials have expressed concern that state and local governments do not have adequate written procedures to ensure that ongoing federal tax requirements are met after the closing of a bond issue. If an issuer does not comply with its post-issuance compliance responsibilities, the IRS may determine that interest on the bonds is not tax-exempt, and the bond owners could incur a significant federal income tax liability.

The IRS recently published an article that clarifies its expectations on this topic and describes minimum post-issuance tax compliance standards for all issuers of tax-exempt bonds. The full article appears on the IRS website at: http://www.irs.gov/taxexemptbond/article/0,,id=243503,00.html. In the article, the IRS strongly suggests that issuers adopt a comprehensive set of tax compliance procedures that will govern all of the issuer's bonds, rather than attempting to follow the tax compliance procedures mandated by the federal tax certificate or other tax document relating to each specific bond issue.

In addition to this article, the IRS has revised Form 8038-G, the Informational Return for Tax-Exempt Governmental Obligations, which is required to be signed by the bond issuer and filed with the IRS for each bond issue. Form 8038-G now requires an issuer to "check the box" if it has written procedures to monitor its post-issuance compliance responsibilities. The IRS has also been asking questions about these written procedures in recent IRS examinations of bond issues. As a result, it is clear that the IRS expects issuers to have written procedures to ensure compliance with its post-issuance compliance responsibilities.

How does the City meet these federal tax law requirements?

The IRS article described above outlines key characteristics that should be included in a bond issuer's written tax compliance procedures:

- Due diligence review at regular intervals;
- Identifying the official or employee responsible for review;
- Training of the responsible official/employee;
- Retention of adequate records to substantiate compliance (e.g., records relating to expenditure of proceeds);
- Procedures reasonably expected to timely identify noncompliance; and
- Procedures ensuring that the issuer will take steps to timely correct any noncompliance.

Gilmore & Bell recommends that all issuers adopt and follow written procedures that cover each of the "key characteristics" described by the IRS in its article. Gilmore & Bell has developed several model tax compliance procedures that may be helpful for issuers that wish to draft and adopt a written tax compliance procedure. These examples may be viewed and downloaded from the firm's website at http://www.gilmorebell.com/services.shtml. While the City is welcome to use these forms in developing their own set of written procedures, keep in mind that a "model" document may not be appropriate for every issuer.

Accounting For The Expenditure Of Bond Proceeds

What are the federal tax law requirements?

Generally, bond proceeds are required to be spent in a timely fashion for expenditures that can be capitalized to a project. At the time the bonds are issued, an issuer must have a reasonable expectation that it will spend at least 85% of the bond proceeds within 3 years of the issue date of the bonds, and in most cases, the balance should be spent within a reasonable time thereafter. Issuer's that spend bond proceeds quickly may be able to take advantage of certain spending exceptions that reduce the issuer's arbitrage rebate liability. Issuers that are unable to meet these general guidelines or sufficiently explain the reasons for the delayed expenditure of bond proceeds may, however, jeopardize the tax-exempt status of the bonds.

In addition, the City is required to allocate bond proceeds (sale proceeds of the bonds plus any investment earnings on those sale proceeds) to project expenditures. An issuer may use any reasonable accounting method for allocating bond proceeds and other funds to project expenditures. In cases, where bond proceeds are held in a separate account, bond proceeds generally can be treated as allocated to expenditures at the time the bond proceeds are expended so long as the cost is a capital expenditure (for example, capital expenditures include hard costs to acquire, construct or improve land buildings and equipment). If bond proceeds are deposited into an account with other issuer funds or proceeds of another bond issue, then the issuer will need to (1) determine how the bond proceeds and other funds are allocated to expenditures (e.g, pro-rata, bond proceeds spent first, bond proceeds spent last, etc.) and (2) identify the property financed with the bond proceeds. The City must complete the allocation of bond proceeds to project expenditures (the "final allocation") within 18 months after the later of the date of the expenditure or date the project is placed in service, but not later than 5 years after the issue date of the bonds.

How does the City meet these federal tax law requirements?

In order to properly account for the expenditure of bond proceeds and identify the property financed by bonds, a final written allocation of bond proceeds should be completed for each bond issue. The City needs to designate the person responsible for accounting for the investment and allocation of bond proceeds and making the final written allocation. Separate accounts or subaccounts should be established to record expenditures for the costs of the project(s) financed in whole or in part with proceeds of a bond issue. As the project is being constructed, the City must maintain detailed accounting records of all expenditures for the project, which should include the following information: (1) identity of person or business paid, along with any narrative description of the purpose for the payment; (2) the date of payment; (3) the amount paid; and (4) invoice number or other identifying reference.

For a new money financing, the designated person should commence completing the final written allocation as of the earliest of (1) the requisition of all the bond proceeds from any segregated bond funded account, (2) the date the project has been substantially complete or (3) 4-1/2 years following the issue date of the bonds. For bonds issued to refinance or refund a prior bond issue, the City will likely work with bond counsel and include the final written allocation of the original obligations that financed the project in the tax document for the refunding bond issue.

Unless special circumstances apply, bond proceeds should be allocated to costs of the project in accordance with the City's accounting records. Each final written allocation should contain the following: (1) a reconciliation of the actual total sources (including the bond proceeds and other issuer funds, if applicable) to total uses for costs of the project; (2) the percentage of the cost of the project financed with proceeds of the bonds (sale proceeds plus any investment earnings on those sale proceeds); (3) the date the project was placed-in-service; and (4) the estimated economic useful life of the project. To complete the final written allocation, the City may be able to simply update the preliminary budget or cost allocation plan included in the tax document for the bond issue. An example of a final written allocation may be viewed and downloaded from the firm's website at http://www.gilmorebell.com/services.shtml.

Completing a final written allocation for all new money projects financed in whole or in part with bond proceeds is important for several reasons. First, it provides the City with the backup documentation necessary to verify that all bond proceeds have been spent in a timely manner and on "good costs" or capital expenditures in the event of an IRS audit. In addition, the final written allocation identifies the bond financed assets that require monitoring on an ongoing basis (See *Accounting for the Use of Bond Financed Assets* below). Finally, the City will likely be required to provide this information in the event it wishes to refinance or refund the bond issue in the future.

What records does the City need to maintain?

Each final written allocation completed for a bond issue, including the City's accounting records detailing project costs, should be maintained in the bond file for the applicable bond issue. These records must be retained by the City for the term of the bonds (including any refunding issues) plus three years.

Accounting For The Use Of Bond Financed Assets

What are the federal tax law requirements?

The Internal Revenue Code imposes limits on the City's ability to enter into agreements or other contractual arrangements with any person or entity (other than another state or local governmental entity) involving the use of bond financed property in the trade or business of that person or entity. This type of use of bond financed property is referred to as "private business use" or "bad use." Generally, no more than 10% of bond financed property may be used in a bad use. Oddly, the federal government is not treated as a governmental entity for this purposes, so use of the property by the federal government is treated as bad use.

Private business use of bond financed property may result from the following types of arrangements with an entity that is <u>not</u> a state or local government (or an agency of a state or local government):

1. the sale of bond financed property;

2. the lease of bond financed property;

3. entering into a contractual arrangement for the operation or management of bond financed property (for example, agreements for the operation of a parking garage, or a food service agreement related to the operation of a cafeteria);

4. the use of bond financed property to fulfill contractual obligations pursuant to a research agreement;

5. the use of bond financed property to fulfill an output contract; or

6. any other arrangement that grants special legal entitlements of bond financed property to an entity that is <u>not</u> a state or local government (or an agency of a state or local government).

How does the City meet these federal tax law requirements?

In the event of an IRS bond audit or in order to refinance a bond issue, the City will need to establish that it has not exceeded the private business use limits for that issue. The City should designate a person to complete an "annual compliance checklist" for each outstanding bond issue. The checklist will facilitate tracking, monitoring and documenting compliance with the federal tax requirements related to the use of bond financed property. An example of an annual compliance checklist may be viewed and downloaded from the firm's website at http://www.gilmorebell.com/services.shtml.

The person designated by the City should complete the annual compliance checklist each year following completion of the bond financed project and the final allocation of bond proceeds described above. Each annual compliance checklist should be designed and completed for the purpose of identifying potential noncompliance or bad use of the specific bond financed property. If potential noncompliance is discovered, the person completing the annual compliance checklist should contact bond counsel or other legal counsel to ensure that the agreement does not jeopardize the tax-exempt status of the bonds.

The annual compliance checklist can also be useful and serve as an additional reminder for the City to meet other post-issuance compliance responsibilities. For example, the City may wish to include in the checklist questions about arbitrage rebate computations and any required continuing disclosure filings. These other post-issuance compliance responsibilities are described further in this chapter.

What records does the City need to maintain?

All annual compliance checklists completed for a bond issue and any contract or arrangement entered into with a private user for the use of bond financed property in its trade or business should be maintained in the bond file for the applicable bond issue. These records must be retained by the City for the term of the bonds (including any refunding issues) plus three years.

Accounting For The Investment Of Bond Related Funds

What are the federal tax law requirements?

Unless the City meets certain exceptions in the Internal Revenue Code, the City is required to pay (or "rebate") to the United States a dollar amount representing the "excess" earnings on the investment of bond related funds. The excess earnings represent the difference between (1) what the City earned from the investment of bond related funds and (2) the amount the City would have earned had those same funds been invested at the average interest rate paid on the bonds (known as "bond yield"). Generally, the City's rebate liability must be calculated and paid at least every 5 years and upon the final maturity or redemption of the bonds. The bond related funds subject to the arbitrage rebate requirements are identified in the federal tax certificate or other tax document executed by the City at the time the bonds are issued. If the bond issue is exempt from rebate, the federal tax certificate or other tax document will often affirmatively state this as well.

How does the City meet these federal tax law requirements?

If the bonds are audited, the City will be required to prove either that the bond issue has no rebate liability or that the City has timely paid any rebate amounts to the IRS. The simplest way to establish that the City has complied with the arbitrage rebate requirements is to have an arbitrage rebate computation completed by a rebate analyst. At a minimum, the City should have an arbitrage rebate computation completed approximately 5 years after the bonds are issued and, depending on the bond issue, every 5 years thereafter and upon the final maturity or redemption of the bonds.

Many issuers find that having arbitrage rebate computations completed on an annual basis is beneficial. Annual calculations allow the issuer to identify any unanticipated accounting and record keeping problems before they become a major issue, when lost or missing records or statements are much easier to retrieve. Also, by periodically tracking the accrued rebate liability, issuers are in a position to make timely accounting elections, take other corrective action that may reduce the amount of the rebate liability, and budget and reserve funds in order to make a required payment to the IRS.

What records does the City need to maintain?

In order to have an arbitrage rebate computation completed, the City needs to maintain and provide to a rebate analyst investment records related to the applicable bond related funds. In cases where a bank, acting either as a trustee or as an escrow agent, holds the bond related funds, monthly trust reports will typically contain the necessary investment information.

The easiest way to account for the investment of bond related funds is to segregate the funds in a separate account and to invest and reinvest the funds in the account separately until they are spent. If the bond related funds are to be commingled with other funds (including other bond issues) the City must keep accurate accounting records for all investments in the commingled fund or account.

For bond related funds, the City's records should show the following information:

1. The amount, date and type of any investment that is purchased.
2. The amount and date of any interest payments received on the investments.
3. The amount and date of any payment received upon the sale or redemption of an investment.
4. A running balance of the total funds invested in the commingled fund or account.
5. A running balance of uninvested funds (if any) in the fund or account.
6. The date and amount of all deposits and withdrawals of cash from the commingled fund or account.

All records relating to the investment of bond proceeds, including any arbitrage rebate computation, must be retained by the City for the term of the bonds (including any refunding issues) plus three years.

Continuing Disclosure Filings

What are the securities law requirements?

Generally, in order to sell bonds through a public offering (usually through an investment banking firm), a City will be required to enter into a written agreement or undertaking to make certain financial information about the issuer publicly available for as long as any bonds remain outstanding.

The contractual obligation entered into by the City to make information available on an annual basis is referred to as "continuing disclosure." The written document that the City signs is usually called the Continuing Disclosure Undertaking, the Continuing Disclosure Instructions or the Continuing Disclosure Agreement. For this discussion, the document is referred to as the "Continuing Disclosure Undertaking".

Cities that have entered into a Continuing Disclosure Undertaking for outstanding bonds, are required to post continuing disclosure information required by the continuing disclosure undertaking on the Municipal Securities Rulemaking Board's ("MSRB") Electronic Municipal Market Access ("EMMA") website (www.emma.msrb.org). The exact type of information required to be updated annually and publicly disclosed through EMMA differs depending on the type of bond issue, but it generally consists of the City's audited financial statements and certain other specified operating data (the "annual report").

In addition, a City is required to provide notice to EMMA within 10 days after the occurrence of certain "material events" listed in the Continuing Disclosure Undertaking. The "material events" that are currently required to be included in Continuing Disclosure Undertakings are:

1. principal and interest payment delinquencies;
2. non-payment related defaults, if material;
3. unscheduled draws on debt service reserves reflecting financial difficulties;
4. unscheduled draws on credit enhancements reflecting financial difficulties;
5. substitution of credit or liquidity providers, or their failure to perform;
6. adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax status of the Bonds, or other material events affecting the tax status of the Bonds;
7. modifications to rights of bondholders, if material;
8. bond calls, if material, and tender offers;
9. defeasances;
10. release, substitution or sale of property securing repayment of the Bonds, if material;
11. rating changes;
12. bankruptcy, insolvency, receivership or similar event of the obligated person;
13. the consummation of a merger, consolidation, or acquisition involving the obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to

undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and

14. appointment of a successor or additional trustee or the change of name of the trustee, if material.

A City's repeated failure to make its continuing disclosure filings may limit the issuer's ability to access the municipal market.

How does the City meet these securities law requirements?

In order to meet its continuing disclosure requirements, the City should designate a person to review the Continuing Disclosure Undertaking for each outstanding bond issue to determine (1) the appropriate financial information and other operating data required to be disclosed and the timing requirements for making the annual filings, and (2) the "material events" that require prompt notice be filed with the MSRB through EMMA. The City's designated person should be responsible for ensuring that all continuing disclosure filings are made on a timely basis. The City may wish to obtain assistance with meeting its post-issuance compliance requirements related to its continuing disclosure filings from Gilmore & Bell, the City's auditor, the bond trustee or any other organization offering these type of services.

What records does the City need to maintain?

The City's annual filings and notices of certain material events filed by the City with the MSRB will be publicly available on EMMA and need not be separately maintained.

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