

LEGISLATIVE AUDIT DIVISION

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors:
Cindy Jorgenson
Joe Murray

MEMORANDUM

TO: Legislative Audit Committee Members

FROM: Alyssa Sorenson, Senior Performance Auditor

CC: Gene Walborn, Director, Department of Revenue
Shauna Helfert, Deputy Director, Department of Revenue
Gordy Conn, Property Assessment Division Administrator, Department of Revenue
Dan Whyte, Chief Legal Counsel, Department of Revenue

DATE: January 2020

RE: Performance Audit Follow-Up (19SP-17): Tax Increment Financing Administration and Impact (orig. 17P-03)

ATTACHMENTS: Original Performance Audit Summary

Introduction

The *Tax Increment and Financing Administration and Impact* (17P-03) report was issued to the Legislative Audit Committee in February 2018. The audit included six recommendations, five to the Department of Revenue (DOR) and one to the Montana Legislature. We followed up with DOR to assess implementation of the report recommendations. This memorandum summarizes the results of our work.

Overview

Tax increment financing (TIF) is an economic development tool used by local governments in defined development zones. DOR is responsible for administering portions of this tool to calculate and report property value in the TIF district. Our original performance audit found DOR needed to develop TIF-related policies and processes to ensure duties are consistently and accurately completed. We found need for improvements to the TIF approval process, the certification of district values, distribution of district revenues, and maintenance and communication of TIF-related information. We also found TIF statute needed clarification regarding district qualifications, statutory goals, state and local administration, monitoring, and evaluation. Our follow-up work found DOR implemented four recommendations and is implementing one more. The final recommendation to the Montana Legislature was not implemented; no TIF related bills passed in the 2019 Legislative Session.

Background

Since 1974, local governments in Montana have been able to create different types of economic development districts to fund projects using a statutory financing provision called tax increment financing (TIF). These districts are commonly referred to as TIF districts. The statutory goals for these districts are to combat blight or improve infrastructure in order to attract or retain value-adding industry. State law provides local governments flexibility in achieving their development goals using TIF. Prior to creating a TIF district, local governments must adopt an urban renewal or comprehensive development plan that

identifies blighted conditions and infrastructure deficiencies in the district. This plan establishes goals, objectives, and strategies on how these conditions will be addressed.

When a TIF district is established, the original property value of the district is calculated and set as the “base value” to continue to be taxed normally by local taxing jurisdictions. Ideally, as development projects are completed in the district, property value will rise above the base value. This additional property value, which is called the “increment value,” is taxed at the same rate as the base value, but the generated revenue (“tax increment”) is segregated to fund development projects in the TIF district. In cases where TIF revenue is not sufficient to pay for more costly improvements, debt can be issued against future TIF revenue to fund projects. Anticipated tax increment revenues can be used to secure a bond issued for up to 25 years. As of 2016, there were 55 active TIF districts in 24 local governments, which segregated approximately \$35.7 million in tax revenue to the districts in tax year 2016. Though TIF is primarily implemented at the local level, state government also plays a role in administering TIF districts. DOR is responsible for calculating the value of properties in these districts to determine how much taxable property value is available for development within the TIF districts. DOR also approves districts prior to providing property values and reports basic TIF information in its biennial report.

Audit Follow-Up Results

The following sections summarize the progress toward implementation of the report’s recommendations. During our follow-up, we interviewed staff in DOR’s Property Assessment Division (PAD) who work with tax increment financing. We reviewed the applications for new TIF districts submitted since the report was issued, new administrative rules relating to the creation of districts, DOR data for TIF districts, and DOR’s new TIF communication tools. We also conducted a survey of local government officials and TIF district managers to inquire on issues such as the ease of creating new TIF districts, the accuracy of TIF district values, and the effectiveness of DOR communication with stakeholders. The results of this survey were compared to the survey conducted during the original audit to note any changes in perception. We also reviewed TIF-related bills that were introduced in the 2019 Legislative Session were also reviewed to determine if any statutory changes were made.

RECOMMENDATION #1

We recommend the Department of Revenue:

- A. Update tax increment financing administrative rules to require local governments to submit documentation that demonstrates they met statutory requirements when creating TIF districts, and**
- B. Develop and implement policies and procedures to accurately communicate deadline requirements to local governments.**

Implementation Status – Implemented

- A. Our original audit found DOR was inconsistently obtaining and reviewing documentation of TIF district applications prior to setting their base and increment values. For example, we found rules required a list of district property be included in the application, but not all applications included these lists. DOR reported they did not enforce this rule because the local governments did not have the ability to provide this list of property and needed to ask DOR to compile the list in advance of the deadline of submitting their application. We also found documentation of the completion of public notice requirements were not required by rule and were inconsistently reviewed. Staff used administrative rules to identify what aspects of an application would be reviewed prior to approval. We recommended the rules be updated to improve the consistency of the approval process and ensure legal requirements were met prior to the district being approved and established in the state’s property appraisal and tax system.

DOR updated administrative rules relating to TIF by amending ARM 42-19-1401, 1403, 1404, 1407, and 1412. It also repealed ARM 42.19.1402, 1408, 1409, 1410, and 1411. The amendment of these rules included more specific information about what public notice documentation is required during approval process. These rules went into effect March 29, 2019. Follow-up work included a review of each TIF district application approved in the 2019 cycle. This review found all applications were consistently approved by PAD staff based on the updated rules.

- B. During our audit we found DOR did not communicate to local governments that it needed to know in advance if a community planned to submit a TIF district packet for approval. This caused delays in the valuation and set up of some districts. We recommended DOR clearly communicate deadline requirements for creation and approval of TIF districts. In response, PAD is sending annual fall memos to local government officials, TIF district managers, and other stakeholders with clear expectations and requirements for submission of information relating to the creation or modification of TIF districts. These memos were sent in both 2018 and 2019. They also created and launched a new TIF district-specific information page on DOR's website that includes information about the deadlines associated with TIF district creation and amendments.

RECOMMENDATION #2

We recommend the Department of Revenue improve certification of tax increment financing taxable values by:

- A. Developing and implementing a process to verify certified base and increment values for TIF districts before sending them to local taxing jurisdictions, and**
- B. Defining formal lines of communication between local governments and the department for questions relating to TIF district values.**

Implementation Status – *Being Implemented*

- A. Our audit found examples of issues with the accuracy of DOR's certification of base and increment values for TIF districts. Local governments reported these errors caused problems ranging from expensive recertification to unexpected interruption of district projects. We determined a lack of verification of TIF district values in the annual certification process and informal TIF-related responsibilities with DOR staff caused these issues. Since the audit was published, DOR has made steps to verify certified base and increment values. First, DOR consolidated data to a single master spreadsheet (from three spreadsheets prior). This spreadsheet can be used by regional PAD staff and management to verify accuracy when completing certification of values. PAD staff also said they improved their quality assurance reports used when TIF districts are created or amended to identify property in the district. They believe these improvements will help accurately identify all property in a TIF district. In addition, starting in 2020, staff plan to have certified value forms for areas with TIF districts to be double-checked by PAD staff in Helena.

Based on a survey of local government officials, while there are improvements in the timeliness and accuracy of certified value reporting from DOR, there continues to be some issues with valuation of TIF districts. One local government official reported all the TIF districts created in a certain year were retroactively adjusted due to an incorrect tax rate being entered into DOR's tax system. The local government official reported having to reimburse some taxpayers after-the-fact to account for the change. Others indicated they still experience issues with changes to new property value and centrally assessed property in TIF districts.

- B. The audit found when local government staff had questions or identified issues with TIF district increment and base values, it was difficult to identify the appropriate DOR staff to speak with. To address the need for formal lines of communication, DOR has improved communication of appropriate points of contact to local government staff. DOR consolidated TIF responsibilities from three business units to a single business unit – PAD. Contact information for the PAD staff working with TIF is now posted in the annual survey sent to local governments to collect updates on TIF district information and on the DOR’s website. The annual survey also requires local governments to update contact information for their designated manager of each TIF district.

RECOMMENDATION #3

We recommend the Department of Revenue guide and support county treasurers by developing an alternative method to calculate tax increment revenue according to district-wide increment and base values of tax increment financing districts.

Implementation Status – Implemented

During audit work we identified problems with the accuracy of the TIF increment allocation by counties, typically related to incorrect formulas used in their tax software. We determined DOR did not communicate the legally-required method for calculating the distribution of tax increment based on aggregate district increment rather than levy district or parcel-by-parcel increments. DOR has since developed a formula and guidance on how to set up districts to accurately calculate tax increment distribution. The formula appears accurate and considers some of the challenges local governments have in correctly allocating the tax distribution with their tax system modules. DOR commits to continuing to work with local governments and their tax billing software companies. In a survey of local government officials, only minor issues were reported with tax billing software relating to TIF. This is an improvement from the results of the original audit.

RECOMMENDATION #4

We recommend the Department of Revenue coordinate the collection, entry, and maintenance of tax increment financing district information by defining formal job duties and processes.

Implementation Status – Implemented

Our audit found DOR did not maintain accurate or timely TIF district information, including TIF district values, expiration dates, or application information. Information was inconsistently maintained and stored, conflicted between office records, and was often incomplete or outdated. We determined this was the result of a lack of coordination and formalization of job duties and processes relating to the collection, entry, and maintenance of TIF district information. DOR has since consolidated the duties related to the collection, entry, and maintenance of district information to PAD staff. This includes clarifying and streamlining responsibility for the review, approval, and storage of district applications.

RECOMMENDATION #5

We recommend the Department of Revenue:

- A. Further develop tax increment financing policies and procedures, and**
- B. Communicate these policies and procedures to stakeholders by providing, at a minimum:**
- A description of how TIF works,
 - A summary of legal requirements,
 - Answers to frequently asked questions,

- **Requirements to create or modify a TIF district, and**
- **Points of contact for assistance.**

Implementation Status – *Implemented*

We found DOR did not consistently communicate TIF expectations to local governments, which led to uncertainty and multiple lawsuits. We determined this was due to unclear policies and procedures as well as communication of these expectations to stakeholders. To address this, DOR completed the revision of the administrative rules, consolidated TIF responsibilities to PAD, and developed a TIF information page on its website. The webpage includes information on the specified minimum policies and procedures outlined in the recommendation. Few survey respondents were aware of the new webpage, but those that were found it to be helpful.

RECOMMENDATION #6

We Recommend the Montana Legislature:

- A. Define what criteria the Department of Revenue should review to approve qualified tax increment provisions as described in §7-15-4285, MCA, and**
- B. Clarify tax increment financing laws, including statutory goals, state and local administration, monitoring, and how TIF should be evaluated.**

Implementation Status – *Not Implemented*

We found there was a lack of statutory guidance regarding what constitutes a qualified TIF district. In addition, there was a lack of clarity on the state's goals, performance measurements, and reporting on TIF. We recommended the Montana Legislature pass legislation to clarify these areas. One bill addressing this recommendation, House Bill 462, was introduced in the 2019 Legislative Session. HB 462 would have required annual local reporting of tax increment districts, publication of these reports by DOR, and an impact analysis and public hearing if a new or amended district would result in a base taxable-value greater than 35 percent of the taxing jurisdiction's certified taxable value. The bill did not pass the legislature.