



Auditor of State Bulletin

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TO: County Auditors and Treasurers
City Auditors, Finance Directors, and Treasurers
School District Treasurers
Educational Service Center Treasurers
Township Fiscal Officers
Village Fiscal Officers
Independent Public Accountants

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SUBJECT: Tax Increment Financing (TIF) & TIF Service Payments

Summary: There has been an increasing use of tax-increment financing among Ohio governments. This bulletin describes:

- How a typical TIF operates under Ohio law;
- Funds Ohio law may require to account for TIF service payments and TIF activity; and
- Acceptable accounting and financial reporting for cash, budgetary, and GAAP bases.

This bulletin provides general accounting guidance and common examples. While this Bulletin describes common Ohio Revised Code TIF requirements, it is not a substitute for reading a TIF's specific contractual requirements, and the TIF requirements in Ohio Revised Code Chapter 5709. Some TIF agreements may impose additional requirements this Bulletin does not address. Regardless, governments using or contemplating TIF should consult with legal experts to help assure they comply with TIF legal requirements.

Municipalities, townships and counties (TIF governments) can use TIF to finance public infrastructure or certain other assets or services benefitting a TIF district.

- TIF "locks in" real property at its unimproved value for up to thirty years in a defined TIF district.
 - The county continues to assess property taxes on the unimproved value during this period.
- In lieu of additional property taxes on improved values, a TIF government may charge *service payments*, typically from developers owning parcels within the district, computed on the improvements.

- If a TIF government charges service payments, the Ohio Revised Code requires charging, collecting, and distributing service payments in the same amount and manner as if they were property taxes.
- The TIF government must use service payments to finance public infrastructure costs (e.g. roads, water and sewer lines servicing the TIF district) or to pay for other assets or services a TIF agreement defines.
 - The TIF government may issue debt, payable from future service payments.
- A TIF arrangement may also require a TIF government to allocate some service payments to school districts and other governments, to help offset property taxes these governments would have received had the improvements not been exempted.
 - The remainder of this bulletin refers to these amounts as *compensation* paid to school districts and other governments.

Summary of Ohio Rev. Code sections referenced in this Bulletin

(This is not a comprehensive list of ORC TIF requirements)

Requirement	Municipality	Township	County
Declare parcels in an area to be a TIF district, exempt from taxes on improvements.	5709.40(C) 5709.41(C)	5709.73(C)	5709.78(B)
Assess service payments.	5709.42	5709.74	5709.79
Negotiate compensation with school districts or other governments.	5709.40(D), (E) 5709.41(C)	5709.73(D), (E)	5709.78(C), (D)
Establish a <i>tax-equivalent fund</i> to receipt service payments. Generally use the service payments for infrastructure, <u>certain</u> debt service and compensation payments.	5709.43	5709.75	5709.80
Service payment liens attach similarly to real property liens.	5709.91	5709.91	5709.91

Summary of a typical TIF Process

The following elaborates on the brief description above. Because TIF arrangements can differ, not all of the following steps will apply to every TIF.

- A property owner (i.e. developer) requests a government to add infrastructure to serve unimproved property parcels in a defined TIF district.
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- If the TIF government agrees with the developer, and plans to exempt more than 75% of the estimated improvements to parcel value, or if the tax abatement will apply for more than 10 years, the TIF government must obtain approval from affected school districts and certain other governments on *compensation* terms. For example, a school district may agree to accept a portion of the service payments as compensation for the likely loss of future property tax increases.

- Because these arrangements are commonly referred to as “holding harmless” the school districts or other governments from the effect of lost property tax increases, these governments are sometimes referred to as *hold-harmless governments*.
- The TIF government passes legislation exempting property in the TIF district from taxes on the developer’s improvements for up to 30 years.
- The TIF government and developer enter into a service agreement regarding infrastructure or other assets or services the TIF government will provide.
- The TIF government may pass legislation authorizing debt to pay for infrastructure additions.
 - Sometimes the debt is a general obligation issued under Ohio Rev. Code Chapter 133. Other times, service payments collateralize the debt.
- The TIF government uses service payments or debt proceeds to construct infrastructure so the developer can improve the property.
- The TIF government and developer may enter into a trust agreement whereby a trustee receives service payments from the county, pays debt service and hold-harmless governments’ compensation and other defined costs.
- As development occurs, the county assesses service payments on the improvements in the same manner and amount as if the improvements were taxed.
- Under Ohio Revised Code Chapter 5709, developers remit service payments to the county treasurer, who distributes the service payments to the TIF government, to hold-harmless governments, and / or to a trustee (described later) when property taxes are normally distributed.
 - For some TIF, the county remits all service payments collected to the TIF government. In this case, the TIF government must remit compensation per agreement with hold-harmless governments. (When this arrangement exists, it affects the *fund requirements* described later in this Bulletin.)
- The TIF government or trustee pays debt service from service payments.
- TIF governments have certain filing requirements with the Ohio Department of Development. A description of these requirements is beyond this Bulletin’s scope. TIF governments should discuss these requirements with legal counsel.

Service Agreement

The service agreement usually identifies the improvements to be made, the developer's obligation for service payments, the use of service payments, and other pertinent information.

Noncompliance with the service agreement may be an event of default materially affecting the determination of financial statement amounts (or disclosures). Therefore, auditors should consider service agreement requirements when designing compliance tests.

Trust Agreement

A TIF government may contract with a bank or other entity to serve as trustee, whereby the county pays service payments to the trustee. The trustee pays for all costs associated with the project including construction, debt principal and interest, arbitrage, etc.

The trust agreement normally specifies the funds required (such as a sinking fund, bond (i.e. capital project) fund, reserve fund, etc.), the permitted investments the trustee may acquire, terms for principal and interest payments, early redemption provisions, application of moneys and other responsibilities.

If a trust agreement requires one or more funds to account for service payments, we would deem these funds to be *TIF tax-equivalent funds* (discussed below), and therefore not subject to the AOS' consent to establish them.

Auditors should consider whether noncompliance with trust agreements materially affects the determination of financial statement amounts (or disclosures) when designing compliance tests.

Accounting Guidance

Fund Requirements and Classification

Because statutes mandate the funds this section describes, the requirement in Ohio Rev. Code § 5705.12 to obtain the Auditor of State's permission to establish them does not apply.

Tax-Equivalent Fund

As described in the table above, Ohio Rev. Code Chapter 5709 requires TIF governments to establish a tax-equivalent fund by resolution or ordinance, to account for service payment receipts and their disbursement, usually for infrastructure costs or debt service.

The tax-equivalent fund may require classification as *special revenue*, *debt service*, or *capital project*, depending on its predominant activity, and whether TIF debt (if any) is a general obligation vs. collateralized by service payments.

1. If service payments primarily pay debt service, classify it as a *debt service fund*.¹

¹ RC 5709.40(H), .75(B) & .81(B) permit paying debt service from the tax-equivalent fund when service payments collateralize the debt.

- a. This is appropriate regardless of whether the debt is collateralized by service payments or is a general obligation.²
 - b. In other words, in this circumstance, using one fund satisfies the tax-equivalent fund requirements of Chapter 5709, and the bond retirement fund requirements of Sections 5705.09(C).
 - c. However, if this fund also accounts for compensation payments (per 4 below), the TIF government may also need another debt service fund in addition to the tax-equivalent *debt service fund*.
2. GASB staff advised us to classify the tax-equivalent fund as a *special revenue fund*, if service payments pay for debt service and infrastructure improvements.
 3. If a TIF government does not issue debt, and spends tax-equivalent fund service payments primarily for infrastructure or other TIF assets, classify the tax-equivalent fund as a *capital projects fund*.
 4. We are aware of circumstances where a county distributes service payments *plus compensation payments* to the TIF government as part of property tax distributions. The TIF government must then pay the compensation to the school districts or other governments. If this occurs, the TIF government should receipt and disburse compensation payments in the tax-equivalent fund. The TIF government should classify the fund as *debt service*, *special revenue*, or *capital projects*, depending on the predominant use of the service payments as described in 1 – 3 above.

Requirement for a Separate Debt Service Fund

If TIF debt is a *general obligation*, the TIF government must pay debt service from a bond retirement fund (RC 5705.09(C)).

1. The Tax-Equivalent Fund satisfies this requirement if it uses service payments primarily to pay debt service (as described in No. 1 in the preceding Section).
2. However, if:
 - a. TIF debt is a general obligation and
 - b. The TIF government receives service payments for more than just debt service (such as 2 and 4 above):
 - i. We believe RC 5705.09(C) implies debt service payments should not be commingled in the same fund with compensation and / or infrastructure payments. Therefore:
 - ii. The tax-equivalent fund should transfer required debt service amounts to a debt service fund established under RC 5705.09(C).³

² Governments often issue debt collateralized with its full faith and credit (i.e. general obligation debt) *without* levying additional property taxes. A general obligation pledge authorizes a government to levy additional property taxes if other revenue is insufficient to pay the debt. This Bulletin assumes service payments are sufficient to retire the debt without an additional levy.

³ ~~Appendix A to Ohio Compliance Supplement Chapter 1, *Transfers to Debt Service Funds*~~, explains why the Auditor of State believes these transfers are not subject to the all the transfer

Transfer guidance now included in Appendix A-1 in the Ohio Compliance Supplement Implementation Guide.

3. Conversely, if the TIF debt is secured only by service payments:
 - a. The TIF government can pay the debt directly from the tax equivalent *special revenue* or tax equivalent *debt service* fund.⁴
 - b. And the requirement above to transfer to a separate debt service fund does not apply.

Requirements for a Capital Project (Bond) Fund

If a TIF government issues debt to finance infrastructure or other TIF assets, Ohio Rev. Code Section 5705.09(E) requires the TIF government to establish a separate fund to account for the debt proceeds and their disbursement. TIF governments should classify this as a *capital projects fund*.

Cash and Investments

Cash-basis and GAAP-basis TIF governments should report amounts trustees hold as assets in their statements, classified as *cash with trustee* (or *cash with fiscal agent*).

If a TIF government remits service payments to its trustee, this is equivalent to moving cash from one bank account to another. TIF governments should not record these remittances as disbursements. Instead, the TIF government should report disbursements when the trustee pays cash on the government's behalf.

Accounting for Cash-Basis Governments' Service Payments

Governments using a cash accounting basis should record all receipts (e.g. service and compensation payments), disbursements (e.g. infrastructure construction costs, debt service, compensation payments, etc.), and *other financing sources* (debt proceeds) related to TIF when received or paid in cash.

GAAP Accounting for Service Payments

Ohio law requires counties to distribute service payments at the same time and in the same manner as real property tax payments. Therefore, GAAP governments receiving service payments (or hold-harmless governments receiving compensation) should accrue it using the guidance below, adopted directly from the *property tax* guidance in Auditor of State Bulletin 2001-004:

Asset (i.e. Receivable) Recognition

An asset is recognized for *imposed nonexchange transactions*⁵ in the period when an enforceable legal claim to the asset arises. . . [For service or compensation payments,] an

requirements of Ohio Rev. Code Chapter 5705. That is, these transfers *fulfill*, rather than *violate* restrictions on using the service payments.

⁴ Remember the tax-equivalent fund is a *special revenue fund* if it is paying for both debt service and infrastructure.

⁵ Property taxes and service and compensation payments are *imposed nonexchange transactions*. The guidance in Bulletin 2001-004 derives from GASB Cod. N 50, which describes how to account for imposed nonexchange transactions.

Deferred inflow or unearned revenue.

enforceable legal claim exists at June 30 for schools, and at December 31 for cities and counties for the [service or compensation payments] identified below. These amounts would be reported as receivables [and deferred revenue] at year-end:

- Schools - at June 30, [2009], the August, [2009] and February, [2010] compensation payments due] . . .
- Cities and counties - at December 31, [2009], the February, [2010] and August, [2010] service or compensation payments due] . . .

Revenue Recognition

The following [service or compensation payments] have been levied, and would be reported as revenue, for the fiscal year ending June 30, [2009] for schools and for the calendar year ending December 31, [2009] for cities and counties, [on both the modified and full-accrual bases]:

- Schools – the [compensation payments] which are scheduled by statute to occur within the fiscal year and which by statute are available for appropriation (August, [2008] and February [2009] compensation payments), plus any advance against the August, [2009] compensation payments] available from the county auditor on June 30, [2009].
- Cities and counties - the [service or compensation payments] which are scheduled by statute to occur within the calendar year (February, [2009] and August, [2009] service or compensation payments] . . .).

Delinquent [service or compensation payments] from prior years would also be included as a receivable and revenue to the extent they are considered collectible.

Governments that have not previously recorded receivables and deferred revenue for the next year’s service (or compensation) payments should do so commencing with their next GAAP compilation. However, they need not describe this change as a *restatement*, because there is no effect on net assets or fund balances.

TIF Governments’ Accounting for Compensation Payments

TIF governments should not accrue compensation payments owed to other governments based on the calendar dates above, because:

- A TIF government has no obligation to collect or remit these payments if the county is doing so, and
- A TIF government has no obligation to compensate a hold-harmless government for delinquent service payments.

As explained in the *Fund Types* section above, we are aware of instances where a county remits all service and compensation payments to a TIF government, and the TIF government *is* responsible for remitting cash (compensation) to hold-harmless governments.

Now termed "deferred inflow" or "unearned revenue."

- In these instances, the TIF government should not accrue receivables (or deferred revenue) for hold-harmless amounts based on the calendar dates described above.
- Instead, the TIF government should debit cash and credit a liability to a hold harmless government *when it receives cash* for compensation payments it must pass on to a hold harmless government. Though a TIF government is acting in an agency capacity for these payments, the TIF government should account for these payments in its tax-equivalent fund, and classify this fund using the *Fund Types* guidance in this Bulletin.

Revenue Classification When Following GAAP or an *Other Comprehensive Basis of Accounting*

Statements of Activity prepared using GAAP or an OCBOA (See Auditor of State Bulletin 2005-002) should classify service or compensation revenue as *general revenue*.⁶

GAAP Restatements for Service Payments

We are aware that during 2009, some GAAP governments accrued a long-term receivable for the sum of future service or compensation payments. This section applies only to these governments.

Because of the approximate equivalence of developers' service payments to the cost of infrastructure or other assets or services provided to a TIF district, service payments do have characteristics of an *exchange* transaction, which suggests accruing a long-term receivable as a TIF government constructs infrastructure, computed as the discounted sum of future service payments

However, we discussed this with the GASB's staff, who concluded service and compensation payments are *imposed nonexchange transactions* (i.e. are essentially similar to the property taxes they replace).

Therefore, preparers who accrued long-term service or compensation payments receivable should restate the opening balances of next year's statements to remove this asset.

Because service payments do have similarities to exchange transactions, we do not believe auditors must deem restatements arising from adopting this Bulletin's accounting guidance to indicate inadequate judgment representing control deficiencies.

However, audit opinions should include an explanatory paragraph referring to notes summarizing the changes, *if material*, because this represents a misapplication of GAAP, per AU 420.12.

Notes to the financial statements should disclose the nature and justification for the change and disclose the restated fund balances / net assets.

Income Tax Sharing for GAAP Governments

Under Ohio Revised Code Section 5709.82, TIF governments may pay a portion of their income taxes collected within the TIF district to school districts.

⁶ Guidance derived from GASB *Comprehensive Implementation Guide* questions 7.34.8, 7.35.5 and 7.35.8.

- TIF governments should not change their current policies for recognizing income tax receivables and revenue.
- However, these TIF governments should report income taxes due to the school district as an intergovernmental expense / expenditure and liability to the school in full-accrual statements (e.g. entity wide statements) as the related income is earned.⁷
 - For example, if a TIF government estimates that 5% of total income taxes receivable are payable to a school district, then the TIF government should record an intergovernmental expenditure / expense for amounts payable to the school district, and should credit a payable equal to 5% of its year-end receivable.
- If a TIF government did not previously report the expense / expenditure / liability the preceding bullet describes, **and** if the amount is significant to expenditure / expenses, or fund balance / net assets, TIF governments should restate opening fund balance / net assets for amounts that should have been accrued as of the prior year end.
 - If the amount is not material, do not restate opening balances. Instead, record the change as part of the intergovernmental expense.
- School districts should record an intergovernmental receivable and revenue on both full and modified-accrual statements equal to the intergovernmental payable the TIF government reports.
 - This may require contacting the TIF government for information about this entry, based on the TIF government's best estimate of amounts owed but unpaid as of June 30.
 - Alternatively, the school district might reasonably estimate this receivable based on prior payments, etc.
 - If a district did not previously report this asset, **and** if it is material to beginning or end of year fund balance / net assets or revenue, districts should restate opening fund balances / net assets.
 - If the amount is not material, do *not* restate opening balances. Instead, record the change as part of intergovernmental revenue.

Accounting for Other School TIF Arrangements

We are aware that some school districts have dealt directly with developers. Some of these agreements, for example, exempt improvements from the school's property tax increases in exchange for assets a developer provides. Examples include exchanging vacant land for future school district expansion or promising future development services. We recommend school districts entering into these agreements adopt legislation to clarify the terms and conditions of these arrangements.

These agreements may not be subject to Ohio Rev. Code Section 5709. Some of these agreements may constitute *exchange transactions*, and the accounting described herein would

⁷ Governmental fund (modified-accrual) statements should also follow this guidance, *except* they should record deferred ~~revenue~~ instead of revenue for any receivable amounts not due within the available period.

Now termed "deferred inflow" or "unearned revenue."

not apply. Governments normally recognize exchange transactions when the exchange occurs. However, because of the variety of arrangements, accounting for these transactions requires a case-by-case analysis, and are beyond the scope of this Bulletin.⁸

TIF Debt

GAAP governments should report TIF debt in the appropriate liability caption in its full accrual *statement of net assets*.

- This debt would not normally be a liability in governmental fund statements until due.
- When paying debt service, full accrual GAAP financial statements debit debt service principal payments to reduce the debt liability, and record a *capital and related financing activity* cash flow.

Cash-basis governments should briefly disclose the general nature of their participation in a TIF:

- Include TIF debt in its debt amortization schedule.
- Describe whether the debt is a general obligation, or secured with service payments.
- The approximate amount of service payments to be received in future years to pay this debt.
 - Stating “Future TIF service payments are due from property owners in the same years and for approximately the same amounts as debt service payments,” would satisfy this requirement, assuming it is true.

GAAP governments should of course, follow GAAP debt-related display and disclosure requirements. This would include (but certainly is not limited to) the *pledged revenue* disclosure requirement in Codification 2300.122, if service payments collateralize TIF debt.

Budgetary Guidance

Governments must follow all budgetary laws related to TIF activity including the following:

- Governments should include all TIF receipts and disbursements in its Tax Budget (Ohio Revised Code 5705.29)
- Governments should certify service and compensation payments, debt proceeds, and interest earnings in the Certificate of Estimated Resources (Ohio Revised Code 5705.34 to .36)
- Governments should appropriate intergovernmental payments (compensation payments and any income taxes owed to school districts), debt service payments (principal, interest, and fiscal charges), and capital outlay when paid by the TIF government, *or when paid by a trustee*. (Ohio Revised Code 5705.38 to .41)

Questions

⁸ Auditor of State financial auditors should discuss accounting for these agreements with the GAAP convertor and with their A&A consultant.

If you have any questions regarding the information presented in this Bulletin, please contact Local Government Services at the Auditor of State's Office at (800) 282-0370.

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