TIF Basics

This document provides a primer on the use of tax increment financing (TIF) for Minnesota cities. It is intended to provide a basic understanding of the concepts related to the use of TIF.

Original Tax Capacity

The tax capacity (taxable) value of the parcels within a tax increment financing district at the time the district is created. Also known as the "base" value. While this amount is typically frozen over the life of the TIF district, certain factors may change the Original Tax Capacity. These factors include, but are not limited to, changes in the classification of the property.

Captured Tax Capacity

The difference between the current tax capacity of parcels within the TIF district and the Original Tax Capacity. This value is captured by the City and serves as the basis for producing tax increment.

Original Tax Rate

The total property tax rate for all jurisdictions (with taxing authority over property in the District) at the time the TIF District is created.

Tax Increment

Property tax revenues created by Captured Tax Capacity multiplied by the lesser of the current tax rate or the Original Tax Rate.

Ehlers & Associates, Inc. 3060 Centre Pointe Drive, Roseville, Minnesota 55113 651.697.8500

PROJECTS AND DISTRICTS

Projects

Tax increment financing is used in conjunction with underlying development and redevelopment powers. Tax increments must be spent within particular geographic areas created under the development statutes. The basic planning area is often referred to as a "Project Area," "Development District" or "Redevelopment Project" which also has other names according to the authorizing statute of the authority under which it was created. Typically, the following types of authorities can administer tax increment districts:

City Council:	Development District Act
City or County HRA:	HRA Act
***EDA*:**	EDA Act
Port Authorities or County EDA:	Special Legislation

All Projects require a general development or redevelopment plan, approved after a public hearing held by the City Council. The boundaries tend to be large areas within which the authority intends to promote development or redevelopment.

TIF Districts

TIF Districts are the specific parcels within a Project area from which tax increment will be captured. Following is a description of the general types of TIF districts:

Redevelopment Districts

Qualifications: "Redevelopment district" means a type of tax increment financing district consisting of a project, or portions of a project, within which the authority finds by resolution that one or more of the following conditions, reasonably distributed throughout the district, exists:

1. Parcels consisting of 70 percent of the area of the district are occupied by buildings, streets, utilities, paved or gravel parking lots or other similar structures and more than 50 percent of the buildings, not including outbuildings, are structurally substandard to a degree requiring substantial renovation or clearance;

2. The property consists of vacant, unused, underused, inappropriately used, or infrequently used railyards, rail storage facilities, or excessive or vacated railroad rights-of-way;

3. Tank facilities, or property whose immediately previous use was for tank facilities, as defined in M.S. Section 115c.02, subdivision 15, if the tank facilities:
   (i) have or had a capacity of more than 1,000,000 gallons;
   (ii) are located adjacent to rail facilities; and
   (iii) have been removed or are unused, underused, inappropriately used, or infrequently used; or

4. A qualified disaster area, as defined in M.S. Section 469.174, subdivision 10b.

Term and restrictions: Redevelopment districts may collect increment for twenty-five years after the date of receipt of the first increment. May designate commencement in the year when the market value reaches an agreed-upon minimum (no more than four years after date of certification), in which case the district duration is 20 years after such commencement date.

At least 90% of the increment must be used to finance the cost of correcting conditions that allow designation of redevelopment districts.

Renewal and Renovation Districts

Qualifications: The same parcel and area requirements apply as for a redevelopment district, but only 20% of the buildings need be structurally substandard; another 30% of the buildings must require renovation or clearance to remove conditions such as inadequate street layout, incompatible land uses, or obsolete buildings not suitable for improvement or conversion to other uses (that is, a lesser standard of blight).

Term, Restrictions.: May collect increment for fifteen years after the date of receipt of the first increment. At least 90% of the increment must be used to finance the cost of correcting conditions that allow designation of renewal and renovation districts.

Housing Districts

Qualifications: Must be a facility intended for occupancy in part by persons or families of low and moderate income. Up to 20% of the fair market value of the improvements may be for uses other than low and moderate income housing.

Term and Restrictions: May collect increment for twenty five years after the date of receipt of the first increment, subject to the same exception as for redevelopment districts. To maintain qualification as a housing district, residents' income must be limited. The rental income requirements apply for the life of the district. If the income requirements are violated, the district duration is reduced to that of an economic development district.

Economic Development Districts

Qualifications: The municipality must find that the district will (1) discourage business from moving to another state or municipality; (2) increase employment in the state; or (3) preserve and enhance the tax base of the state.

Term and Restrictions: May collect increment for eight years after the date of receipt of the first increment.

Increment may not be used to assist developments if more than 15% of the buildings and facilities (on a square footage basis) are used for a purpose other than:

(a) manufacturing;

(b) warehousing, storage and distribution of tangible personal property (excluding retail sales);

(c) research and development related to the aforementioned activities;

(d) telemarketing if that activity is the exclusive use of the property;

(e) "tourism facilities;"

(f) qualified border retail facilities; or

(g) space necessary for and related to the above.

Tourism Facility Economic Development Districts: The term "tourism facility" was substantially restricted for districts created after May 31, 1993. Now, such a facility means property that: (1) is located in a county where the median income is no more than 85 percent of the state median income; (2)is located in a county in development region 2, 3, 4, or 5, as defined in section 462.385; (3) is not located in a city with a population in excess of 20,000; (4) is acquired, constructed, or rehabilitated for use as a convention and meeting facility that is privately owned, marina, hotel, motel, lodging facility, or nonhomestead dwelling unit that in each case is intended to serve primarily individuals from outside the county.

Tourism counties include Aitkin, Becker, Beltrami, Carlton, Cass, Clay, Clearwater, Cook, Crow Wing, Douglas, Grant, Hubbard, Itasca, Koochiching, Lake, Lake of the Woods, Mahnomen, Morrison, Otter Tail, Pope, St. Louis, Stevens, Todd, Traverse, Wadena, and Wilkin.

Bedrock Soils Economic Development Districts: The 1995 legislature added language that allows revenue derived from tax increment from an economic development district to be used for site preparation and public improvements for any type of development if bedrock soils are present in 80 percent or more of the acreage of the district, the estimated costs of physical preparation of the site exceeds the fair market value of the land before completion of the preparation, and revenue derived from tax increments are expended only for the additional costs of preparing the site and installing public improvements because of unstable soils and the bedrock soils condition. The 1995 legislature also removed a previous exception that allowed use of tax increment to finance up to 5,000 square feet of commercial or retail facilities in cities of 5,000 people or less.

Small Cities Economic Development Districts: The 1997 legislature added language that permits revenues derived from tax increment from an economic development district to assist small city commercial facilities up to 15,000 square feet, within certain guidelines. The facilities must be separately owned and the city must have a population of 5,000 or less and must be located more than 10 miles from a city with a population of 10,000 or more.

Soils Condition Districts

Qualifications:

1. The presence of hazardous substances, pollution, or contaminants requires removal or remedial action for use;

2. The estimated cost of the proposed removal and remedial action exceeds the fair market value of the land before completion of the preparation.

The requirements of clause (b) need not be satisfied if each parcel either satisfied the requirements of that clause, or the estimated costs of the proposed removal or remedial action exceeds $2.00 per square foot for the area of the parcel.

Term and Restrictions: May collect increment for 12 years after the date of approval of the TIF Plan; increment may be spent only to: acquire parcels on which removal or remediation will occur; pay the cost of removal or remedial action, and pay allocated administrative expenses, including the cost of preparation of the development action response plan.

Soils districts could be created before June 30, 1995 based on unusual terrain and soils conditions. The 1995 amendments essentially changed a soils condition district to a hazardous waste district.

Hazardous Substance Subdistricts

Qualifications: Consists of parcels within a TIF District of any kind that are "designated hazardous substance sites" or are contiguous parcels that the authority expects to be developed together with the hazardous substance site.

"Designated hazardous substance sites" are parcels for which there is a state-approved "development action response plan," and the authority has entered into an agreement providing for removal actions or otherwise certified that it will finance such removal.

Term and restrictions: May collect increment from the subdistrict for up to twenty-five years after the date of receipt of the first subdistrict increment (which is, generally, the tax attributable to the "base value" of the parcel). This period overrides

any shorter duration for the underlying TIF District, except that during the extended period, the increment may be used only to pay the cost of hazardous waste removal and related administrative costs, and the "base value" increment is no longer collected.

Hazardous Waste Extension

The 1995 legislature added an alternative to hazardous substance subdistricts. An authority, with approval of the municipality, may extend the duration of any TIF district if:

1. contamination is discovered after the district was established;

2. the authority elects not to create a hazardous substance subdistrict; and

3. the municipality pays for the cost of removal or remediation out of general revenues and not from tax increments.

If those tests are met, the district may be extended for the lesser of (1) 10 years after the district would otherwise have terminated; or (2) the number of additional years necessary to collect increment equal to the clean up costs paid by the municipality from non-tax increment funds. Cleanup costs are restricted to actual costs of removal and remediation, including testing and engineering but excluding financing or interest costs. Cleanup costs are also reduced by any reimbursements or amounts recovered from private parties or other responsible parties.

This provision is available for any TIF district filed for certification after December 31, 1988.

Pre-1979 Districts

TIF districts created prior to August 1, 1979 are not generally subject to the TIF Act, except when the proposed development extends beyond the "scope of activity" in the project plan after May 1, 1988. After April 1, 2001, increment from a pre-1979 district may be used only to pay bonds that were outstanding as of April 1, 1990, but in no event may increment be collected after August 1, 2009.

TIF Special Taxing Districts

The 1998 Legislature authorized cities to establish special taxing districts within TIF districts and levy special taxes to make up deficits caused by the 1997 and 1998 reductions in the property tax class rates. This authority is limited to TIF districts for which the request for certification was made before June 2, 1997 (the enactment date of the 1997 class rate reductions). Only property that is subject to either an assessment agreement or a development agreement is subject to the tax.

In order to qualify, the city must have a TIF district deficit caused by the 1997 and 1998 reductions in the class rates and used any available increments from other TIF districts within the city. In order to establish a TIF special taxing district, the city must adopt an ordinance after holding a public hearing on the question. A notice of hearing, containing specific information, is also required. A copy of the ordinance must be sent to the commissioner of revenue.

HOW TO SET UP A TAX INCREMENT DISTRICT

TIF Plan

The use of increment must be spelled out in a TIF Plan approved by the City Council (or county board for a county HRA) after public hearing, with 30-day notice to the County and School District including the proposed plan and estimated fiscal implications, a published hearing notice with maps between 10 to 30 days from the hearing date, and review by the planning commission. The TIF Plan must include a statement of objectives, list of property to be acquired, a list of proposed development activities, identification of property to be included in the district, and a list of supporting studies and reports. In addition, the plan must include estimates of the costs associated with the project, sources of revenue, amount of bonded indebtedness, most recent net tax capacity of property within the district, estimate of captured net tax capacity upon completion, duration of the district and impact on other taxing jurisdictions. When approving the TIF Plan, the Council or Board must find (among other things) that the proposed development would not reasonably be expected to occur solely through private investment in the reasonably foreseeable future (the "but for" finding).

TIF Plans may be modified using the same process as for approval of the initial plan. Generally, modifications that do not increase expenditures or debt or call for new land acquisition may be approved simply by resolution. Modifications will not trigger application of current statutes unless the boundary of the TIF district is expanded.

County Commissioner Notice

For housing and redevelopment districts, the county commissioner who represents the area of the TIF district must be notified at least 30 days before the date of publication of the public hearing notice.

The "But For" Test

Under a 1995 legislative change, the municipality must find that the increased market value of the site that could reasonably be expected to occur without the use of tax increment financing (a hypothetical figure) would be less than the increase in the market value of the proposed development after subtracting the present value of the projected tax increments for the maximum duration of the district permitted by the TIF Plan (this requirement does not apply to qualified housing districts).

Example: If the development is estimated to add $500,000 in value, and the present value of the maximum stream of increment at an assumed discount rate is $300,000, the municipality must find that no other development would add more than $200,000 in market value at this site.

HOW INCREMENT MAY BE USED

Eligible Uses

In addition to the specific limitations for each type of TIF District, tax increment may be spent only for specified purposes permitted in the underlying development statutes. Such purposes generally include:

- land acquisition;
- site improvements;
- public and on-site utilities;
- demolition;
- relocation; and,
- administration.

If the authority owns a Project, increment may be used to finance essentially any aspect of the Project. Because the development statutes are often ambiguous, whether a particular activity is TIF-eligible may depend on the facts in each case.

Administrative Expense

Administrative expenditures are limited to 10% of the expenditures authorized in the TIF Plan, or 10% of actual increment expenditures, whichever is less. They are defined to mean all expenditures of the authority other than land acquisition and relocation costs and costs "directly connected with the physical development of the real property in the district."

The County auditor may assess each TIF district for the county's costs of administrating the district, and the fee may be paid from tax increment.

General Government Use

Increment may not be used to finance buildings that are used "primarily and regularly for conducting the business" of any unit of government, except for parking structures, a commons area used as a public park, or a facility used for social, recreational or conference purposes.

If a TIF-financed social, recreational or conference facility is operated by an entity other than the authority, the authority's governing body must approve operating policies for the facility. This would apply, for example, when an HRA finances a city community center.

Guaranty Fund

An authority may establish a guaranty fund to indemnity a person for liability for remediation costs under state or federal environmental law. The maximum term of the indemnity is 25 years, and the maximum amount is one-half of the remediation costs. The authority may deposit tax increments in the fund, and the municipality may also appropriate money for deposit in the fund.

OTHER CONSIDERATIONS

Geographic Restrictions

Pooling Limits. For districts created after June 30, 1995, no more than 20 percent of the increment (25 percent in the case of redevelopment districts) may be spent outside the boundaries of the TIF District. However, increment from housing TIF districts may be spent to finance "housing projects" located anywhere in the broader Project area. Administrative costs are considered spent outside the district. Increment from districts created before May 1, 1990 may be spent anywhere within the Project boundaries, which permits "pooling" of increment from more than one district.

Time Restrictions (other than duration)

3-year rule. Within three years after the date of certification, one of three things must happen for the district to remain alive: bonds are issued to aid the Project (excluding industrial revenue bonds); the authority acquires property within the TIF District; or the authority causes public improvements to be constructed within the TIF District.

4-year knock down rule. Increment will not be collected from a particular parcel unless, within four years after the date of certification, demolition, rehabilitation or renovation of property or other site improvements has taken place by either the authority or the owner in accordance with the TIF Plan. Construction or major construction of an adjacent street qualifies as an improvement to a parcel, but utility improvements do not. If the parcel is "knocked-down" and later improved, it is re-instated in the TIF District but at the market value at the time of the reinstatement.

5-year rule. For increment to be considered a spent expenditure within the TIF District, one of the following must occur within five years after certification of the district: (1) increment is paid to a "third party" for a TIF-eligible "activity"; (2) bonds, the proceeds of which are used to finance an activity, are sold to a third party and proceeds are reasonably expected to be spent within the five-year period (with certain limited exceptions); (3) binding contracts are entered with a third party for performance of an activity, and increment is spent under the contract; (4) costs are incurred by a "party" and revenues are spent to reimburse a party; or (5) expenditures are made for housing purposes.

The term "third party" excludes the party receiving TIF assistance and the "municipality or the development authority or other person substantially under the control of the municipality." Therefore, clause (4) permits the typical "pay as you go" reimbursement where the initial costs are incurred by the developer with the 5-year period. See Section III.B.

Note: The 5-year rule applies only to districts requested for certification after April 30, 1990.

Parcels Excluded from TIF Districts (the "Green Acre Exclusion").

For districts filed for certification after June 30, 1995, parcels in the seven-county metropolitan area may not be included in a TIF district if they qualified for special tax treatment under green acre, open space, or agricultural preserves provisions in any of the five calendar years before the request for certification. Outside the metropolitan area, such parcels may be included in a TIF district if at least 85 percent of the planned facilities (on a square footage basis) are used in manufacturing.

Legislation in 1996 changes this rule and makes it uniform statewide for districts filed for certification on or after August 1, 1996. Now, any parcel receiving special tax treatment mentioned above in the five years before the request for certification may be included in a TIF district anywhere if:

(1) At least 85 percent of the planned facilities (on a square footage basis) are for manufacturing or distribution facilities (distribution facilities were added by the 1998 Minnesota Legislature); or

(2) The district is a "qualified housing district."

Legislation in 1998 now requires that both manufacturing and distribution TIF projects on green acre parcels to pay 160 percent of the federal minimum wage to at least 90 percent of the employees.

TYPES OF FINANCING

Bonds

Bonds secured by tax increments are issued when there is a need for initial capital to finance public or private improvements. Typically, the bonds are general obligation bonds backed by the full faith and credit of the municipality. As long as at least 20% of the debt service on the bonds is reasonably expected to be paid with tax increments, the bonds may be issued without election.

Pay As You Go

An alternative to bond financing is a "pay as you go" arrangement with the developer. The developer pays for various TIF-eligible costs initially, and the authority promises to reimburse the developer from tax increment over time as it is generated. The developer (rather than an unrelated bondholder) bears the risk that the increments will be insufficient to repay the costs incurred.

This arrangement may be structured as a revenue note or bond issued to the developer, with an interest component to compensate the developer for costs of financing the improvements up front.

LOCAL GOVERNMENT AID PENALTY/LOCAL CONTRIBUTION

The 2001 Legislature eliminated the provisions for a reduction in state tax increment financing aid (RISTIFA) or the alternative qualifying local contribution.

STATUTE OF LIMITATIONS

The 2003 Legislature imposed a limitation on legal actions challenging findings made as part of the adoption of a tax increment financing plan. An action must be filed by the later of (1) 180 days after approval; or (2) 90 days from the request for certification.