

Tax Increment Financing

March 1996

Program Evaluation Division
Office of the Legislative Auditor
State of Minnesota

Program Evaluation Division

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STATE OF MINNESOTA

OFFICE OF THE LEGISLATIVE AUDITOR

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JAMES R. NOBLES, LEGISLATIVE AUDITOR

March 8, 1996

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Since the late 1980s, the Legislature has enacted several important reforms to tax increment financing (TIF), the development tool that enables cities and certain other jurisdictions to capture the additional taxes which are generated by a development project to finance up-front site preparation or acquisition costs. The purpose of most of the reforms was to limit the use of TIF to certain kinds of development projects and to eliminate perceived abuse of the financing tool.

Our evaluation found that legislative restrictions have addressed most of the perceived abuses of TIF, which we documented in our earlier evaluation of TIF, published in 1986. Most TIF districts created since 1990 appear to meet the guidelines established by the Legislature. In addition, legislative reforms have apparently reduced the use of TIF by cities. While the amount of captured tax capacity grew by an average of 24 percent per year between 1984 and 1989, it slowed to just 2 percent per year between 1990 and 1995.

But some issues continue to demand legislative attention. For example, instead of retiring old TIF districts that have completed their original development goals, some cities have amended their TIF plans to use tax increment revenues to pay for general government activities. We also offer several suggestions to the State Auditor's Office for focusing its new responsibilities for monitoring the implementation of TIF.

This report was researched and written by Susan Von Mosch (project manager) and David Chein, and cost approximately \$60,000. Our research team also produced an additional document, entitled "*Description of Selected Tax Increment Financing Districts*," (96-06a). We appreciate the assistance of local government officials in 46 cities and counties, the Department of Revenue, and the State Auditor's Office.

Sincerely,

Handwritten signature of James Nobles in black ink.

James Nobles
Legislative Auditor

Handwritten signature of Roger Brooks in black ink.

Roger Brooks
Deputy Legislative Auditor

Table of Contents

	<u>Page</u>
EXECUTIVE SUMMARY	ix
INTRODUCTION	1
1. BACKGROUND	3
How Tax Increment Financing Works	
TIF Users and Public Purposes	
Types of Tax Increment Districts and Activities	
Financing Options	
Legislative Restrictions on the Use of TIF	
Reduced Restrictions on the Use of TIF	
Oversight	
The Costs of TIF	
2. TRENDS	29
Changes in the Use of Tax Increment Financing	
Location of Tax Increment Financing Activity	
Analysis of TIF by Date of District Creation	
Types of Tax Increment Financing Districts	
Summary	
3. ANALYSIS OF RECENT USES OF TAX INCREMENT FINANCING	45
Analysis of Sample Cities and Counties	
Have Restrictions Limited the Ability of Cities to Use TIF?	
Metropolitan Council Policies	
Summary	
4. RECOMMENDATIONS	83
Enforcement Suggestions	
Options for Legislative Consideration	
APPENDIX A: Sample Cities and Counties	89
APPENDIX B: TIFs in Sample Cities that Received DTED Economic Recovery Funds	91

	<u>Page</u>
APPENDIX C: Decertified Tax Increment Districts from Sample Cities	93
GLOSSARY	97
AGENCY RESPONSE	101
RECENT PROGRAM EVALUATIONS	Back Cover

List of Tables and Figures

	<u>Page</u>
	xii
Table 1.1	22
Table 2.1	30
Table 2.2	32
Table 2.3	34
Table 2.4	36
Table 2.5	37
Table 2.6	38
Table 2.7	39
Table 2.8	39
Table 2.9	40
Table 2.10	42
Table 2.11	42
Table 3.1	46
Table 3.2	48
Table 3.3	57
	xi
Figure 1.1	4
Figure 1.2	8
Figure 1.3	9
Figure 1.4	10
Figure 1.5	11
Figure 1.6	24
Figure 2.1	31
Figure 2.2	33

		<u>Page</u>
Figure 2.3	Percent of Total County Tax Capacity Captured in Tax Increment Districts, 1995	35
Figure 3.1	Public and Site Improvements Financed with Tax Increments from Pre-1990 Districts in Sample Cities	60
Figure 3.2	Public and Site Improvements Financed with Tax Increments from Post-1990 Districts in Sample Cities	62
Figure 3.3	Interpretations of the "But For" Test	72

Tax Increment Financing

EXECUTIVE SUMMARY

Tax increment financing (TIF) is a tool used by cities and other development authorities to finance certain types of development costs. The public purposes of TIF are the redevelopment of blighted areas, construction of low- and moderate-income housing, provision of employment opportunities, and improvement of the tax base.

Tax increment financing enables a city to use the additional property taxes generated by a new development to pay for certain development expenses. With TIF, a city "captures" the additional property taxes generated by the development that would have gone to other taxing jurisdictions and uses the "tax increments" to finance the development costs.

TIF requires different taxing jurisdictions to share in the costs of financing local development. The state finances more TIF costs than other taxing jurisdictions because it compensates school districts for most of their tax revenue losses through increases in state education aids. The House Research Department has estimated that total state costs were \$100 million in 1994, assuming that the development would have occurred elsewhere in Minnesota without TIF.

Cities used TIF extensively in the late 1970s and 1980s. However, perceived misuse of TIF prompted the Legislature to place restrictions on the program in 1988, 1989, 1990, and 1995. Conflicting opinions about whether current laws are too restrictive or too permissive prompted our study. Our evaluation addressed the following questions:

- **How has the use of tax increment financing changed over time? Are there geographic variations in the use of tax increment financing in Minnesota?**
- **How have cities and other development authorities used tax increment financing in recent years?**
- **Have legislative restrictions, particularly those enacted in 1990, been effective in correcting the misuses of tax increment financing? Are further restrictions or other legislative approaches needed?**

Cities are the primary users of TIF, but the state and county governments share in its costs.

To conduct our study, we visited 43 cities and 3 counties and interviewed local officials. Prior to our site visits, we reviewed TIF plans and bonded indebtedness reports filed with the Minnesota Department of Revenue and the TIF annual disclosure statements and financial reports filed with the Office of the State Auditor. We also analyzed data reported by county auditors to the Revenue Department in the Abstract of Tax Lists and Tax Increment Financing Supplement.

BACKGROUND

The Minnesota Tax Increment Financing Act of 1979 permits cities and other development authorities to establish tax increment districts for: (1) redevelopment, (2) renewal and renovation, (3) soil conditions, (4) housing projects, (5) economic development, (6) mined underground space, and (7) hazardous substance clean-up. Districts established prior to August 1, 1979, when the TIF Act took effect, are referred to as "pre-1979 districts."

The TIF Act placed significant restrictions on the use of tax increment financing. For example, it limited the duration of districts, the geographic areas that may be designated for certain districts, and the type and amount of tax increment spending. The act also required cities to develop TIF plans and make annual financial reports on their districts.

Between 1988 and 1990, the Legislature enacted many additional restrictions. For example, the Legislature: limited the ability of cities to capture tax increments from development not stimulated by TIF; adopted stricter blight requirements for redevelopment districts; required larger portions of increments generated by redevelopment districts to be spent on blighted properties; restricted the use of economic development districts to manufacturing and related activities; and limited the ability of cities to "pool" increments from multiple districts. The Legislature also reduced state aid paid to local governments that created districts after April 30, 1990, referred to as "post-1990 districts," but amendments in 1995 reduced the impact of these aid reductions.

RECENT USES OF TAX INCREMENT FINANCING

Overall, we found that:

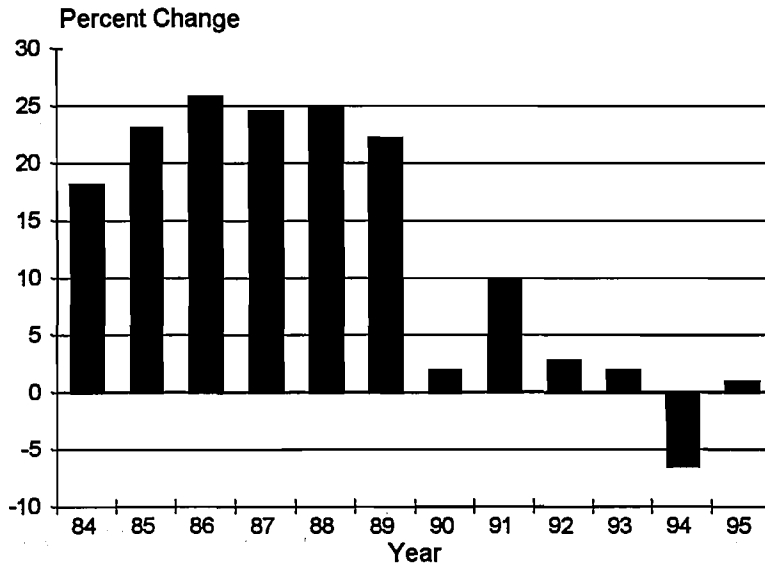
- **Legislative restrictions on the use of tax increment financing have addressed many of the previously identified problems with TIF and helped slow the growth of TIF activity.**

Captured tax capacity increased by an average of 24 percent per year between 1984 and 1989, but increased by only 1.9 percent per year between 1990 and 1995. The number of districts with captured tax capacity grew by 25 percent annu-

ally between 1986 and 1989, compared with only 3.4 percent between 1991 and 1995. In 1995, Minnesota had 1,436 tax increment districts in 363 cities and towns. The districts had \$203.3 million in captured tax capacity, or 8 percent of these local governments' total tax capacity.

Captured tax capacity increased by an average of only 2 percent per year in the 1990s.

Percent Annual Change in Total Captured Value, 1984-95



Source: Program Evaluation Division analysis of Minnesota Department of Revenue data.

All of Minnesota's large cities, 90 percent of medium-sized cities, and about one-fourth of small cities had at least one tax increment district in 1995. Districts in large cities were larger and captured more tax capacity, on average, than those in smaller cities. We also found that:

- **Pre-1979 districts were larger and captured more tax capacity, on average, than districts created later, and post-1990 districts were smaller, on average, than older districts.**

Although the 110 pre-1979 districts represented only 8 percent of all TIF districts, they accounted for 30 percent (\$61 million) of the total 1995 captured tax capacity. In contrast, the 346 post-1990 districts represented 24 percent of all districts but accounted for only 5 percent of the captured tax capacity. In part, this is because many post-1990 districts are just starting to generate tax increments; over half were certified in 1992 and 1993. However, post-1990 districts were also smaller than older districts. The average number of parcels per district declined from 146 for pre-1979 districts to 25 for August 1979-April 1990 districts and 8 for post-1990 districts.

Since late 1990, for the most part Minnesota cities have used tax increment financing productively to induce the redevelopment of blighted areas, to encourage the

Captured Tax Capacity and District Size by Time of Creation

Time of District's Creation	Number of Districts	Average Number of Parcels per District	Captured 1995 Tax Capacity	Percent of Statewide 1995 Captured Tax Capacity	Average Captured Tax Capacity Per District
Pre-1979	110	146	\$61.1 million	30%	\$555,007
August 1979 - April 1990					
August 1979 - December 1985	336	40	68.5 million	34	\$203,863
January 1986 - December 1988	339	19	43.0 million	21	126,971
January 1989 - April 1990	<u>305</u>	<u>14</u>	<u>21.4 million</u>	<u>11</u>	<u>70,062</u>
Sub Total	980	25	\$132.9 million	65%	\$135,622
Post-1990	346	8	\$9.3 million	5%	\$26,967
All Districts	1,436	30	\$203.3 million	100%	\$141,568

Source: Program Evaluation Division analysis of Department of Revenue's 1995 TIF Supplement data base.

construction of low- and moderate-income housing, and to assist with expansion of manufacturing businesses. Based on our review of 172 post-1990 tax increment districts in our sample cities and counties, we found that:

- **About two-fifths of the post-1990 tax increment districts in our sample were created to assist new or existing manufacturing businesses, while office developments, retail facilities, and housing projects each accounted for one-fifth of the districts.**

Most recent retail projects were in areas needing redevelopment.

As a result of 1990 restrictions on economic development districts, retail and office projects have occurred, for the most part, in areas that needed redevelopment, rather than on vacant land. Some cities used TIF to facilitate the development of retail stores and office buildings on bare ground that had poor soils. However, legislative amendments in 1995 required that increments from soils condition districts be spent only for pollution clean-up, so tax increments from these districts can no longer be used to finance extensive excavation, soil compacting, grading, and filling.

Legislation tightening the "blight" criteria for redevelopment districts and requiring that large portions of increments to be spent on blighted properties have reduced the tendency of cities to create very large redevelopment districts or to use redevelopment districts for purposes other than rehabilitating blighted parts of a city. We found that:

- **Most post-1990 redevelopment districts were smaller than pre-1990 districts, were contiguous, and were focused on individual projects.**

Plans for post-1990 redevelopment districts usually include assistance with demolition and renovation of existing structures and site preparation for new facilities.

It is difficult to quantify the extent to which cities have not pursued development projects because of possible state aid reductions, although some city officials told us that the potential aid changes have caused them to reduce the number of tax increment districts they otherwise would have certified. So far the state aid reductions have had a relatively small fiscal impact because they only applied to districts certified after April 30, 1990, and most districts qualified for a five-year grace period. State aid payments will be reduced by a total of \$1.6 million in 1996, affecting 64 cities, 2 counties, and 1 town.

Because most of the legislative restrictions on TIF have not applied to existing districts, we also found that:

- **Legislative restrictions on the use of TIF have not addressed the use of tax increments from districts established between 1979 and April 30, 1990.**

Some cities have created large "project areas," or areas in which increments from TIF districts may be spent. Sometimes these project areas encompass entire cities or large portions of them. The TIF law allows cities to "pool," or combine, tax increments from multiple districts within a project area, and to spend tax increments anywhere within the project area. We found that:

- **Of the 45 cities and counties that we visited with more than one TIF district, two-thirds have pooled tax increment revenues between districts or have project area configurations that would permit pooling.**
- **Many cities and development authorities have amended tax increment plans for their pre-1990 districts in order to spend tax increment dollars for general public improvements and community projects.**

Many cities use tax increments from pre-1990 districts as a general purpose funding source.

As a rule, cities do not terminate districts before their expiration dates and frequently use tax increments as a general purpose funding source. We found cities spending tax increments on park improvements (ice arenas, playground equipment, land acquisition), community centers, freeway interchanges, bridges, water towers, and wastewater treatment plants. Some cities have used tax increments from pre-1990 districts to capitalize economic development funds and business loan programs and to establish reserve accounts for various purposes. If TIF districts were retired after serving their original purpose - rather than being continued to finance activities that many cities pay for with their own tax dollars - then counties and other taxing jurisdictions would be able to reduce their tax rates and state aid to school districts could be lowered without affecting educational programs.

In contrast, we found no cities pooling increments from post-1990 districts at this time. Legislative limits on the pooling and spending of tax increments from post-1990 districts limit the degree to which increments from these districts can be used to fund general public improvements. However, since most post-1990 districts are less than five years old and are not yet generating large amounts of tax

increment revenues, it is still too early to evaluate the impact of these restrictions on post-1990 districts.

While we did not conduct a financial audit, we reviewed the financial status of over 400 TIF districts in our sample cities. We found that:

- **The vast majority of tax increment districts are financially stable and generate sufficient tax increment revenues to pay for project costs. Only a few cities have needed to levy general taxes to make up for revenue shortfalls.**

Some cities have used pooled increments from two or more districts to support districts that were not able to generate enough increments to pay project costs. Other non-performing districts involved "pay-as-you-go financing," where developers provide the up-front financing and bear the risk of non-performing projects.

Although the extent of pay-as-you-go financing is difficult to estimate, we think this type of financial arrangement has increased. Among the 172 post-1990 districts we examined, over half used pay-as-you-go arrangements, one-quarter used internal loans from other city funds, and less than one-fifth issued bonds to finance the project costs. One concern we have is that some cities using pay-as-you-go financing have not specified project activities and expenditures in their TIF plans, making it difficult to ensure that developers are spending TIF funds for activities allowed by state laws.

COMPLIANCE ISSUES

The purpose of this study was to gain insight into how cities are currently using TIF, not to comprehensively audit cities' finances or their compliance with state law. However, we found that:

- **The quality of annual financial reports for tax increment districts is mixed.**

While nearly all cities and development authorities filed annual disclosure statements and financial reports, some did not file reports for all districts. For instance, some cities only filed reports for districts with captured value. Several cities filed one combined statement for all pooled districts, making it impossible to analyze revenues and spending for individual districts. In addition, some cities filed incomplete statements. Finally, nine of the cities we visited filed unaudited annual financial statements.

According to the TIF Act, before a city creates a TIF district it must find that the proposed development or redevelopment would not occur within the reasonable foreseeable future "but for" the use of tax increment financing. While the TIF Act requires cities to "set forth in writing the reasons and supporting factors" behind the "but for" finding, we found that:

Legislative restrictions have been reasonable, but have made TIF more difficult to use.

- Some cities were unable to provide documentation or analysis on how their TIF districts met the "but for" requirements.

State law also requires cities and development authorities to file TIF plans with the Department of Revenue. Five of the cities we visited had not filed any TIF plans with the Department of Revenue and nearly half filed some but not all plans. Some cities submitted plans using "boilerplate" language, which did not identify specific development objectives or activities, making it difficult to determine how they are using TIF.

Finally, cities with housing districts are required to monitor the incomes of residents to ensure that the project is fulfilling its commitment to provide housing for low- and moderate-income people. We found that some cities do not appear to have any monitoring procedures in place or do not appear to be enforcing the income requirements.

RECOMMENDATIONS

In our view, the changes made to the TIF law in recent years have been reasonable, even though they have made TIF more difficult to use. However, we believe that more comprehensive monitoring and oversight will be needed to ensure that the new laws are properly enforced. As a result of 1995 legislation, the Office of the State Auditor has assumed new enforcement responsibilities for the TIF Act this year, and we offer several suggestions for implementing those responsibilities. We also suggest policy options the Legislature may wish to consider for dealing with pre-1990 tax increment districts.

Enforcement Suggestions

We think the Office of the State Auditor should focus its monitoring efforts on those areas we have identified as problems with tax increment financing. In particular, we suggest that:

- The State Auditor should monitor compliance of cities and development authorities with state laws governing: (1) the pooling and spending restrictions for post-1990 districts as they mature, (2) the types of TIF spending in all districts (especially those using pay-as-you-go financing), (3) restrictions on economic development districts, (4) the "but for" requirement, and (5) the "blight" requirements for redevelopment districts.

Also, as noted in our report, the quality of TIF plans, annual disclosure statements, financial reports, and debt reports has been mixed. We are particularly concerned about financial reporting for pay-as-you-go arrangements, which do not rely on bonded debt. We suggest that:

Oversight is needed to ensure that TIF laws are properly enforced.

- **The State Auditor should work with cities and development authorities to ensure that all tax increment financing users are aware of and comply with the reporting requirements contained in state law.**

The consolidation of the TIF reporting requirements under the State Auditor's Office, which is also responsible for financial and compliance auditing, should result in higher quality financial data.

Options for Legislative Consideration

We think that the continued use of tax increment revenues from pre-1990 districts to finance general public improvements and community projects is an issue requiring legislative attention. Under normal circumstances, cities would finance these projects with their own funds, special assessments, or other sources of funding, such as user fees. Although some types of public improvements may contribute to development activity, most improvements have little direct impact on tax base or employment growth. Tax increment financing is being used to provide a state and county subsidy for functions that most cities finance from other sources.

Therefore, we recommend that:

- **The Legislature should consider placing additional restrictions on the use of tax increment revenues for general public improvements and community projects. Restrictions should apply to all districts certified between August 1, 1979 and April 30, 1990.**

These districts account for the majority of 1995 captured tax capacity, and some of them could last for up to 19 more years.

Restrictions on using tax increment revenues to finance general public improvements could be structured in a number of ways. One option would be to prohibit the use of tax increments from pre-1990 districts for specific purposes, such as park improvements and recreation facilities, community centers, civic centers, ice arenas, wastewater treatment plants, water towers, freeway interchanges, or bridges.

A second option would be to prohibit any future amendments to existing TIF plans that authorize increased tax increment spending for general public improvements and community projects. If the Legislature pursues this alternative, it should consider making this change retroactive to, say, January 1, 1996, to prevent cities and development authorities from approving amendments before a future effective date.

A third option would be to address those cases involving cities that have already adopted amendments to TIF plans for pre-1990 districts. The Legislature could allow the use of tax increments for new projects for which cities have issued bonds or entered into other legally binding commitments by a specified future date. After the specified date, any projects remaining in the city's amended TIF budget could not be financed with tax increments. This option could be structured similar

Restrictions on using TIF for general public improvements could be structured in several different ways.

to the five-year spending restriction that is in the law for post-1990 districts. Most tax increments collected from a post-1990 district must be spent on activities for which bonds have been issued or binding legal commitments have been made within five years after the district's approval. To prevent cities from continuing to approve amendments for increased spending, this option could be combined with the option that prohibits future amendments to increase TIF spending for general public improvements.

Finally, the Legislature could require that future tax increments from all pre-1990 districts be used to pay outstanding bonds or contractual obligations entered into by some date in the near future. This could be similar to limitations already approved by the Legislature for pre-1979 districts. In 1988, the Legislature required that all tax increments collected from pre-1979 districts after April 1, 2001 be used to retire bonds that were issued before April 1, 1990. By law, cities must decertify pre-1979 districts as soon as those bonds are retired. The Legislature could require that all tax increments received after April 1, 2001 (or some other date) from tax increment districts created between 1979 and 1990 be used to retire bonds issued by April 1, 1996 (or some other date). This option is more restrictive than the prior option because it could limit the ability of some cities to complete initial projects identified in approved TIF plans. For instance, it is possible that weak market conditions or failures on the part of a developer have prevented some cities from issuing bonds for projects in the original TIF plan.

Under existing law, the Revenue Department is charged with enforcement of the income requirements for housing districts, but it is not currently enforcing this provision because of limited resources within the Department. When the Legislature transferred TIF enforcement responsibilities to the State Auditor's Office in 1995, enforcement of the income requirements remained with the Revenue Department. We recommend that:

- **The Legislature should consider whether the Revenue Department or the State Auditor's Office should be responsible for enforcing the housing district income requirements.**

The Legislature could retain the enforcement responsibilities with the Revenue Department and provide funding for that function or it could transfer the function to the State Auditor's Office and consolidate it with other TIF enforcement responsibilities. Alternatively, the State Auditor's Office could monitor compliance with the income requirements as it conducts its other TIF audit and compliance responsibilities and refer any violations to the Revenue Department for enforcement.

The Legislature may want to clarify its intentions related to the use of TIF for government-leased buildings. The TIF Act limits the use of TIF for buildings that are government-owned and used primarily to conduct government business. Some cities have used tax increments to support development projects which lease space to government agencies. On the one hand, developers do not always know who their tenants will be, and they cannot refuse to lease to government agencies. On the other hand, it is hard to argue that office space for government agencies would not develop in the absence of TIF.

Finally, the Legislature may want to require that cities with economic development districts or projects providing TIF assistance to manufacturing, office, or retail developments report on wages paid as part of the TIF annual disclosure statement. The Legislature may also want to require that the Minnesota Department of Trade and Economic Development analyze the wage data and report to the Legislature.

Introduction

Legislators have questioned whether current TIF laws are too restrictive or too permissive.

Tax increment financing (TIF) is a tool used by cities and other development authorities to finance certain types of development costs. Among the purposes of TIF are the redevelopment of blighted areas, the construction of housing for low- and moderate-income individuals and families, and the stimulation of economic activity in local communities.

Tax increment financing enables a city to use the additional property taxes generated by a new development to pay for certain development expenses. These expenses may include items such as the costs of land acquisition and "write-down," demolition, site preparation, and construction of public infrastructure.¹ Bonds are often used to finance the up-front costs, and the principal and interest payments on the bonds are paid for by future tax increments.

The property owner of the newly developed or redeveloped property continues to pay the full property taxes. However, under TIF, the city or development authority "captures" the additional taxes generated by increases in the property's value and can use the "tax increments" to pay the costs of development and public improvements. Without TIF, the increased taxes from a new development would be shared by other taxing jurisdictions, primarily the county and school district.

In Minnesota, tax increment financing became an increasingly popular development tool in the late 1970s and early 1980s. But legislators and others questioned whether TIF was being used appropriately. In 1986, the Legislative Auditor's Office issued a report that detailed how TIF had been both productively used and misused throughout the state and recommended changes to the TIF statutes.² Partially in response to the recommendations in that report, the Legislature passed laws that tightened the use of TIF in 1988, 1989, 1990, and 1995.

There are conflicting opinions about whether current laws are too restrictive or too permissive, but there is little comprehensive information available on how tax increment financing is being used. Thus, in June 1995, the Legislative Audit Commission directed us to study the use of tax increment financing in Minnesota, focusing particularly on changes since the recent reforms. In our evaluation, we addressed the following questions:

¹ A "write-down" is when a local government sells land to a developer for a price below the purchase price paid by the government.

² Office of the Legislative Auditor, *Tax Increment Financing* (St. Paul, January 1986).

- **How has the use of tax increment financing changed over time in Minnesota? Are there geographic variations in the use of tax increment financing?**
- **How have cities and other development authorities used tax increment financing in recent years?**
- **Have legislative restrictions, particularly those enacted in 1990, been effective in correcting the misuses of tax increment financing? Are further restrictions or other legislative approaches needed?**
- **Have legislative restrictions made it too difficult for cities and other development authorities to pursue worthwhile development projects?**
- **Has the use of tax increment financing been consistent with the Metropolitan Council's policies for urban development in the Twin Cities metropolitan area?**

To answer these questions, we visited 43 cities and 3 counties and interviewed local officials about individual TIF projects. In preparation for our site visits, we reviewed the tax increment financing plans and bonded indebtedness reports filed by TIF users with the Minnesota Department of Revenue and the annual disclosure statements and financial reports filed with the State Auditor's Office. We analyzed data reported by county auditors to the Revenue Department in the Abstract of Tax Lists and the Tax Increment Financing Supplement. In addition, we reviewed Minnesota laws and literature relevant to the use of tax increment financing, and we interviewed policy makers, representatives of local government associations, and others with an interest in tax increment financing.

Our report is organized in four chapters. Chapter 1 provides an overview of tax increment financing and summarizes recent changes to the laws governing TIF. Chapter 2 describes trends in the use of tax increment financing. Chapter 3 presents the results of our research on how cities and other development authorities have used tax increment financing in recent years. Chapter 4 presents recommendations for addressing some of the continuing problems with the use of tax increment financing. Appendix A contains a list of the cities and counties we visited. A separate document, *Description of Selected Tax Increment Financing Districts*, describes the tax increment districts established within those cities and counties.

Background

CHAPTER 1

Minnesota was one of the first states to pass laws authorizing the use of tax increment financing (TIF), and the first district was created in 1968 in Robbinsdale. Since then, TIF has become one of Minnesota's most used tools to encourage redevelopment and new development. This chapter provides an introduction to tax increment financing and discusses legislative changes that have either restricted and expanded its use. We asked:

- How does tax increment financing work?
- What government authorities can use TIF, and for what public purposes?
- To what extent have legislative changes restricted or permitted more flexible use of TIF?
- Who pays the costs of TIF?

Our analysis is based on a review of Minnesota laws and current literature on tax increment financing.¹

HOW TAX INCREMENT FINANCING WORKS

TIF is used by cities to finance certain development costs.

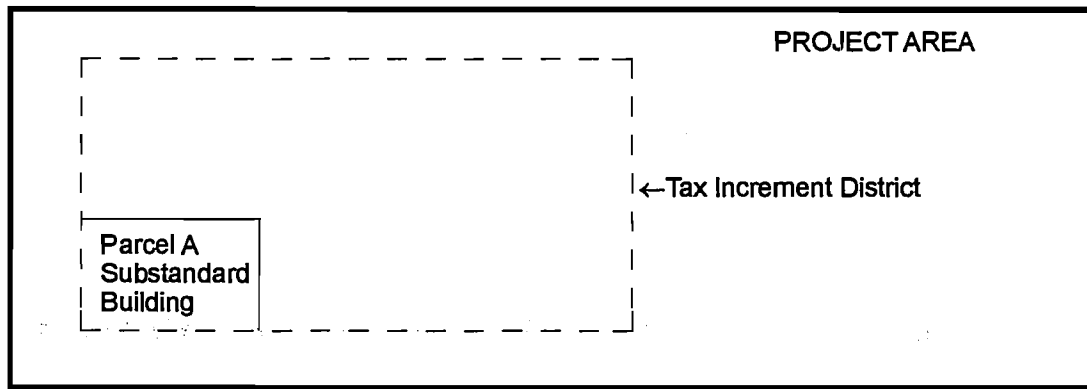
Tax increment financing (TIF) enables a city to use the additional property taxes that a proposed development would generate to finance development costs and public improvements. When a TIF district is created, the net tax capacity of the properties in the district is certified as the district's "original tax capacity." The property taxes that are paid on the property value above the original tax capacity are "captured" by the city, rather than being paid to all the taxing jurisdictions (county, school district, and special taxing districts, in addition to the city). These additional property taxes are referred to as "tax increments" and are used to pay development costs. Usually, the city issues general obligation bonds to finance the

¹ Our background discussion on tax increment financing borrows from Office of the Legislative Auditor, *Tax Increment Financing* (St. Paul, January 1986), and Minnesota House Research Department, *Tax Increment Financing Project: An Introduction, Working Paper #1* (St. Paul, February 1990).

up-front development costs.² The principal and interest on the bonds are repaid with the tax increments generated by the new development.

Tax increment financing can be further explained through the example in Figure 1.1, which illustrates the redevelopment of a site containing a substandard structure.³ The example assumes that a city would like to redevelop a site (Parcel A) containing a vacant, substandard commercial building and that a developer is considering building an office/warehouse building. Construction of the building on Parcel A will require demolition of the existing building and installation of new public utilities (sewer and water). The cost of acquiring the property, demolishing the building, and putting in utilities is \$1,000,000. Since the developer can

Figure 1.1: Example of Tax Increment Financing



- = Project Area Boundaries
- - - - = Tax Increment Financing District Boundaries

CALCULATION OF THE TAX INCREMENT

	Original Tax Capacity	Post- Development Tax Capacity	Captured Tax Capacity
Parcel A	\$200,000	\$800,000	\$600,000
Rest of Tax Increment District	<u>2,000,000</u>	<u>2,000,000</u>	<u>0</u>
District Total	\$2,200,000	\$2,800,000	\$600,000

Captured tax capacity = \$600,000 (post-development tax capacity *minus* original tax capacity)

Tax rate = 110.0 percent

Tax increment = \$660,000 (captured tax capacity X tax rate)

² There are actually a number of financing options available. These options are discussed later in this chapter.

³ This is an oversimplified example that is intended to illustrate how TIF works. It is not intended to represent the typical tax increment project or the complexities involved with actual use of the financing mechanism or Minnesota's property tax system.

TIF does not change the total amount of property taxes paid.

acquire a comparable site in a neighboring city for \$200,000, the developer is not inclined to build on Parcel A unless the city can reduce the costs of developing Parcel A to a comparable level.

To induce the developer to build on the site, the city designates a "project area" and creates a "tax increment financing district" that includes the development site, as illustrated in Figure 1.1. A project area is the geographic area in which tax increments may be spent. A tax increment district consists of the specific parcels located within a project area from which increments are collected. In our example, the district consists of Parcel A and surrounding property that is also occupied by substandard buildings. The city agrees to pay the costs (\$1,000,000) to acquire the site, demolish the substandard building, put in utilities, and sell the site to the developer for \$200,000.

Tax increment financing and the sale of tax increment bonds enable the city to finance the up-front development costs. The city might issue bonds totaling \$1,250,000 to pay for the project expenditures of \$1,000,000, plus "capitalized interest" and administrative expenses of \$250,000. Capitalized interest is the interest that the city must pay to bondholders during the first several years following issuance of the bonds. It is necessary to build capitalized interest into the bond issuance because tax increments will not be available to the city for payment of bond principal and interest until the construction is complete and the development is on the property tax rolls.

The principal and interest on the \$1,250,000 of bonds is repaid from two sources: (1) tax increments collected from the district and (2) proceeds from land sales, if any (\$200,000 in this example). The tax increments are calculated by applying the tax rate to the additional tax capacity generated by the development. In this example, we assume the district's original tax capacity was \$2,200,000 (including \$200,000 for Parcel A and \$2,000,000 from the remainder of the district). After the redevelopment of Parcel A, the city assesses the parcel and assigns it a current tax capacity \$800,000, while the remainder of the district continues to have a tax capacity of \$2,000,000. The total tax capacity of the district is \$2,800,000. Tax increment financing allows the city to capture the taxes on the difference between the current and the original tax capacity for the district. The difference, or captured tax capacity, is \$600,000 in this case. The captured taxes, or tax increments, are \$660,000 per year (110.0 percent tax rate times \$600,000). The amount of tax increments captured could increase or decrease each year, depending on changes in the tax capacity of property in the TIF district.

TIF determines which taxing jurisdiction receives property tax revenues.

Tax increment financing does not change the amount of property taxes a developer pays. In the above example, the developer of Parcel A pays taxes of \$880,000 (110.0 percent tax rate times a tax capacity of \$800,000), the same amount the developer would pay if the project had been constructed without tax increment financing. However, tax increment financing determines which taxing jurisdictions will receive the property tax revenues. If this development occurred without tax increment financing, the entire \$880,000 would be distributed to the city, county, school district, and other taxing jurisdictions, according to their tax rates. With tax increment financing, only \$220,000 (110.0 percent tax rate times the original tax

capacity of \$200,000 on Parcel A) is divided among the various taxing jurisdictions in this manner. The remaining \$660,000 in taxes on Parcel A is distributed to the city to pay the development costs of the tax increment district. As a result, the county, school district, and other taxing jurisdictions provide part of the funding for city development projects using tax increment financing. And, as we discuss later in this chapter, the state pays for a portion of TIF by making larger aid payments to school districts than would be made in its absence.

While TIF does not change the amount of property taxes that developers pay, it may lower the developers' cost of doing business. For example, cities sometimes provide developers with virtually "free" land in an effort to induce development at a particular site; this is called a land "write-down." In our example, if the city had sold the cleared land in Parcel A to the developer for \$1 instead of \$200,000, then the developer would have received a subsidy of \$199,999 over what was required to make the project occur. That is, it would cost the developer \$199,999 less to undertake the project on Parcel A than in the neighboring city, where land acquisition and preparation costs were \$200,000. As we discuss in Chapter 3, some cities in our sample have provided land to developers for \$1.

TIF USERS AND PUBLIC PURPOSES

Tax increment financing is used by more than 350 Minnesota cities or towns, as approved by their city or town councils, housing and redevelopment authorities (HRAs), economic development authorities (EDAs), or port authorities. In addition, there are 16 Minnesota counties that currently use tax increment financing through their county HRAs or rural development financing authorities.

The use of tax increment financing requires the use of two statutes. First, the Minnesota Tax Increment Financing Act of 1979 (*Minn. Stat.* §§469.174-469.179) governs the establishment of tax increment districts and their plans. This complex act has been amended frequently since 1979, and a tax increment district is usually governed by the laws that were in effect in the year that it was created.

Besides the TIF Act, a city or development authority establishing a district must use a second statute to create the project area in which the tax increment district is located and specify the public purpose served by the project. The second statute authorizes local authorities to use tax increment financing to redevelop blighted areas, provide housing for low- and moderate-income individuals and families, increase employment opportunities, and increase the tax base. Any of the following acts may apply:

- The Minnesota Housing and Redevelopment Authority Act (*Minn. Stat.* §§469.001-469.047).
- The Municipal Development District Act (*Minn. Stat.* §§469.124-469.134).

Cities are the primary users of TIF.

- The Port Authorities Act (*Minn. Stat.* §§469.048-469.089).
- The Municipal Industrial Development Act (*Minn. Stat.* §§469.152-469.165).
- The Rural Development Finance Authority Act (*Minn. Stat.* §§469.142-469.150).
- The Economic Development Authority Act (*Minn. Stat.* §§469.090-469.108).

Almost one-half of Minnesota's captured tax capacity in 1995 is from municipal development and industrial development districts, followed by HRAs with 30 percent.⁴ For the purposes of tax increment financing, these statutes define what entities can use TIF. They also govern the types of expenditures that can be made using tax increments. While the TIF Act of 1979 lists some purposes for which tax increments *cannot* be used, these six statutes define the purposes for which tax increment *can* be used. Generally, tax increments are used for site acquisition and preparation costs. However, the statutes authorize the use of tax increments for a variety of purposes, such as those shown in Figure 1.2.

TYPES OF TAX INCREMENT DISTRICTS AND ACTIVITIES

The Minnesota Tax Increment Financing Act permits the establishment of seven different types of tax increment districts: (1) redevelopment, (2) renewal and renovation, (3) soils condition, (4) housing, (5) economic development, (6) mined underground space, and (7) hazardous substance subdistricts.⁵ In addition, legislation limits the geographic areas that may be designated for some types of districts, the duration of tax increment districts, and the development costs that may be financed with tax increment revenues. Each type of tax increment district, along with the limitations that apply to it, is described below. Figure 1.3 summarizes the duration limits, or the length of time that increments may be collected, for each type of district.

⁴ Minnesota Department of Revenue, Property Tax Division, TIF Supplement for taxes payable in 1995.

⁵ The TIF Act and other statutes also provide for the establishment of qualified housing districts, qualified manufacturing districts, and qualified hazardous substance subdistricts in relation to the state aid offset provision. That provision and these district types are discussed later in this chapter.

Figure 1.2: Authorized Uses of Tax Increment Financing

- Acquire "blighted" properties or "marginal" lands, or any property as part of a development plan to eliminate or prevent the development of "blight." (*Minn. Stat. §§469.002, Subd. 13 and 14(1); 469.059, Subd. 2*)
- Demolish and remove "blighted" or other structures. (*Minn. Stat. §§469.002, Subd 14 (5)(ii); 469.059, Subd. 15; 469.2*)
- Install, construct, or reconstruct streets, utilities, and other site improvements. (*Minn. Stat. §§469.002, Subd. 14 (2); 469.059, Subd. 15; 469.090, Subd. 5(4)*)
- Provide relocation benefits to the occupants of acquired properties. (*Minn. Stat. §469.012, Subd. 1(9)(25); 469.090, Subd. 5(5); 469.133*)
- Sale, lease or other disposition of acquired properties at or below market value (i.e., "land write-downs"). (*Minn. Stat. §§469.029; 469.059, Subd. 12; 469.101, Subd. 10*)
- Construct, reconstruct, or repair new or existing buildings to provide housing for low- and moderate-income families and individuals (*Minn. Stat. §§469.002, Subd. 13, 15; 469.012, Subd. 1(6)(7)*)
- Planning, engineering, legal and other services, including allocated administrative expenses of the authority (*Minn. Stat. §469.090, Subd. 5 (6)(7)*)
- Restore acquired properties of historic or architectural value. (*Minn. Stat. §469.002, Subd. 14(5)(vi)*)
- Interest rate reduction payments for low- and moderate-income rental housing developments. (*Minn. Stat. §§469.012, Subd. 7 to 9; 469.176, Subd. 4f*)
- Down payment assistance loan and grant programs to encourage owner occupancy of single family residences (*Minn. Stat. §469.012, Subd. 13*)
- Acquire and construct public parking lots and ramps, and pedestrian systems including skyways (*Minn. Stat. §469.126, Subd. 2*)
- Acquire, construct, improve, and equip agricultural processing projects, including forestry and timber products (*Minn. Stat. §469.142-143*)
- Capital investment loan for rail line rehabilitation made to rail users (*Minn. Stat. §469.142(8)*)

Source: Minnesota House Research Department, *Tax Increment Financing Project: An Introduction, Working Paper #1* (St. Paul, Revised February 1990), 18-19. Updated by Office of the Legislative Auditor.

Figure 1.3: Duration Limits of Tax Increment Districts

<u>District Type</u>	<u>Duration Limit¹</u>
Redevelopment	25 years or 20 years if the authority identifies a minimum market value before increments are captured provided it is no more than four years after the date of original certification.
Renewal and Renovation	15 years.
Soils Condition	12 years from creation.
Housing	25 years or 20 years if the authority identifies a minimum market value before increments are captured provided it is no more than four years after the date of original certification.
Housing: Interest Reduction Program	12 years.
Economic Development	8 years from receipt of the first increment or 10 years from creation, whichever is less, for districts certified on or before May 31, 1993. 9 years from receipt of the first increment or 11 years from creation, whichever is less, for districts certified after May 31, 1993.
Mined Underground Space	25 years.
Hazardous Substance Subdistrict	25 years, or 20 years if the authority identifies a minimum market value before increments are captured provided it is no more than four years after the date of original certification or the period necessary to recover clean-up costs, whichever is less.
Pre-1979 Districts	30 years through August 1, 2009. However, after April 1, 2001 increments may only be used to pay the debt service on bonds issued before April 1, 1990.

¹*Minn. Stat. §469.176, subd. 1b, 1c, 1e.* The duration limits are measured from the receipt of the first increment, unless noted otherwise.

Redevelopment Districts

The purpose of a redevelopment district is to remove blighted buildings or improve marginal land to induce redevelopment. Tax increment financing can be used to assist with the private redevelopment of areas containing substandard structures, including acquiring property and reselling (or giving) it to private developers and installing public improvements. Redevelopment districts are limited to "blighted" areas. The criteria in state law for determining blighted conditions have changed several times since 1979. To qualify as a redevelopment district, all properties in the district must meet one of the two blight criteria shown in Figure 1.4.

Legislation has tightened the definition of "blight" conditions.

Figure 1.4: Blight Criteria For Redevelopment Tax Increment Districts

To qualify as a redevelopment tax increment district, one of the following conditions, reasonably distributed throughout the district, must apply:

- (1) parcels consisting of 70 percent of the area of the district are occupied by buildings, streets, utilities, or other improvements and more than 50 percent of the buildings, not including outbuildings, are structurally substandard to a degree requiring substantial renovation or clearance;¹ or
- (2) the property consists of vacant, unused, underused, inappropriately used, or infrequently used rail yards, rail storage facilities, or excessive or vacated railroad rights-of-way.

For districts consisting of two or more noncontiguous areas, each area must qualify as a redevelopment district under this definition to be included in the district, and the entire area of the district must satisfy the definition.

Source: *Minn. Stat.* §469.174, subd. 10.

¹"Structurally substandard" means containing defects in structural elements or a combination of deficiencies in essential utilities and facilities, light and ventilation, fire protection including adequate egress, layout and condition of interior partitions, or similar factors, which defects or deficiencies are of sufficient total significance to justify substantial renovation or clearance.

A building is not structurally substandard if it is in compliance with the building code applicable to new buildings or could be modified to satisfy the building code at a cost of less than 15 percent of the cost of constructing a new structure of the same square footage and type on the site.

A redevelopment district can collect tax increments for up to 25 years after the receipt of the first tax increment. Alternately, it can collect increments up to 20 years if the authority chooses to delay its initial receipt of tax increments (1) until a minimum market value is reached, or (2) for up to four years. At least 90 percent of the tax increments collected must be spent to eliminate the blight conditions that justified creation of the redevelopment district. The qualifying expenditures include acquiring sites containing substandard buildings, demolition of structures, clearing land, and installing sewer, water, roads, sidewalks, and parking facilities.

Renewal and Renovation Districts

Legislation passed in 1990 authorized creation of renewal and renovation districts, with a 15-year duration. To qualify as a renewal and renovation district, the properties in the district must meet the blight criteria shown in Figure 1.5. These criteria previously had been part of the statutory criteria for redevelopment districts. State law requires that at least 90 percent of the tax increments collected be spent to correct the blight conditions which were used to justify the creation of these districts.

Figure 1.5: Blight Criteria For Renewal and Renovation Districts

To qualify as a renewal and renovation district, the following conditions, reasonably distributed throughout the geographic area of the district, must apply:

(1)(i) parcels consisting of 70 percent of the area of the district are occupied by buildings, streets, utilities, or other improvements; (ii) 20 percent of the buildings are structurally substandard; and (iii) 30 percent of the other buildings require substantial renovation or clearance to remove existing conditions such as: inadequate street layout, incompatible uses or land uses relationships, overcrowding of buildings on the land, excessive dwelling unit density, obsolete buildings not suitable for improvement or conversion, or other identified hazards to the health, safety, and general well-being of the community.

The definition of structurally substandard and other provisions of redevelopment districts apply to renewal and renovation districts.

Source: *Minn. Stat.* §469.174, subd. 10a.

Soils Condition Districts

Soils condition districts have been limited to pollution clean-up.

In 1988, the Legislature authorized creation of soils condition districts with a duration of 12 years.⁶ To qualify as a soils condition district before June 30, 1995, the following conditions were required to exist:

- (1) unusual terrain, the presence of hazardous substances, pollution, or contaminants, or soil deficiencies for 80 percent of the acreage in the district, requiring substantial filling, grading, removal or remedial action, or other physical preparation for use; and
- (2) the estimated cost of the physical preparation exceeds the fair market value of the land before completion of the preparation.⁷

⁶ Before 1988, cities could use unusual terrain and unstable soil conditions as justification for creating redevelopment districts.

⁷ *Minn. Stat.* §469.174, Subd 19. Prior to 1993, the soils condition district criteria required that at least 70 percent of the area be vacant and hazardous wastes were not a criterion.

Tax increment revenues could only be used to pay the costs of correcting soils and terrain difficulties (filling, grading, and compacting soil) and the added costs of public improvements resulting from soils or terrain difficulties.

The 1995 Legislature eliminated the unusual terrain and soil deficiency criteria. After June 30, 1995, hazardous substances, pollution, or contaminants requiring removal or remedial action must be present for land to qualify as a soils condition district.⁸ Tax increment revenues from this type of district must be spent on pollution and contamination clean-up.

In addition, if bedrock soil conditions are present in 80 percent or more of the acreage of the district, legislation allowed tax increments from economic development districts to be used to pay for site preparation and public improvements.⁹

Housing Districts

The purpose of a housing district is to encourage the development of housing for low- and moderate-income individuals and families. Tax increments may be used to finance land purchase and site preparation, install public improvements, and provide interest rate subsidies. Projects can be used for either rental or owner-occupied housing. Interest rate reduction programs are limited to rental housing and cannot exceed 12 years. Housing districts need not be established on blighted property. To qualify as a housing district, a minimum of 80 percent of the fair market value of improvements must be for low- and moderate-income housing. Up to 20 percent of the fair market value of improvements may be for commercial uses or uses other than low- and moderate-income housing.

To maintain qualification as a housing district, residents' incomes must be within ranges prescribed by law. For owner-occupied housing, 95 percent of the units must be purchased initially by persons with incomes that are less than or equal to the income requirements for qualified mortgage revenue bonds under federal law. For rental projects, 50 percent of the units must be occupied by individuals with incomes of 80 percent or less of the area median income. The rental requirements apply for the life of the district. If the income requirements are violated, a district's duration is reduced to that of an economic development district.¹⁰

Economic Development Districts

An economic development district is one that does not meet the requirements of any other type of district but is found by the city or development authority to be in the public interest because it will: discourage commerce, industry or manufactur-

⁸ *Minn. Laws* (1995), Ch. 264, Art. 5, Sec. 13 and 23. The estimated cost of the proposed removal and remediation action must exceed the fair market value of the land before completion of the site preparation.

⁹ *Minn. Laws* (1995), Ch. 264, Art. 5, Sec. 24. The estimated site preparation cost must exceed the fair market value of the land before completion of the preparation, and revenues from tax increments can be used only for additional costs of preparing the site or installing public improvements because of unstable soils and the bedrock soils conditions.

¹⁰ *Minn. Stat.* §469.1761.

TIF is used to encourage affordable housing.

Economic development districts have been restricted to manufacturing and related activities.

ing from moving their operations to another state or city, increase employment in the state, or preserve and enhance the tax base of the state.¹¹

An economic development district can be established in any location. For economic development districts created after April 30, 1990, at least 85 percent of the buildings and facilities (based on square footage) must be used for: manufacturing; warehousing, storage and distribution of personal property (excluding retail sales); research and development related to the prior activities; telemarketing; tourism facilities; or space necessary for and related to these activities.¹² In 1995, the Legislature allowed tax increments from economic development districts to be used to pay for site preparation and public improvements if bedrock soils conditions are present in 80 percent or more of the districts' acreage and other conditions are met (as discussed above).

Mined Underground Space Districts

Legislation authorizing mined underground space districts was enacted in 1985. Tax increment revenues may only be used to pay the cost of excavating, supporting, and providing public access to mined underground space for private development, such as commercial or industrial use, or for public improvements.

Hazardous Substance Subdistricts

A hazardous substance subdistrict is an area within a tax increment district that consists of parcels containing pollution or contamination.¹³ Before an area is designated as a subdistrict, the development authority must have entered into an agreement and have a response action plan approved by the Pollution Control Agency that provides for clean-up of the hazardous substances. Tax increments must be used to finance removal of pollution, pollution testing, and demolition required by the response action, purchase of environmental insurance, and related administrative and legal costs.

In 1995, the Legislature authorized the extension of a tax increment district's duration to recover clean-up costs if each of the following conditions are met: (1) pollution is discovered after the district was created, and (2) the clean-up is paid for with city funds other than tax increments. The duration extension is limited to 10 years or the time needed to recover the clean-up costs. This provision was effective on June 2, 1995 and applies to all tax increment districts certified after December 31, 1988.¹⁴

¹¹ *Minn. Stat.* §469.174, Subd. 12.

¹² Tourism facility is specifically defined in statute. See Glossary.

¹³ Parcels contiguous to those containing the pollution may also be included, if they are necessary to provide a developable site. *Minn. Stat.* §469.175, Subd. 7.

¹⁴ *Minn. Laws* (1995), Ch. 264, Art. 5, Sec. 22.

Pre-1979 Districts

Prior to August 1, 1979 (when the Minnesota Tax Increment Financing Act took effect), cities and other local authorities were able to establish tax increment districts through the statutory provisions found in the development authority statutes or through special legislation. Districts certified prior to August 1, 1979 constitute a unique type of district, referred to as "pre-1979 districts." Although pre-1979 districts generally are not subject to the TIF Act, they are restricted to a maximum duration of 30 years from the effective date of the 1979 TIF Act, or August 1, 2009. The 1988 Legislature required that increments collected in pre-1979 districts after April 1, 2001 may only be used to retire debt issued before April 1, 1990. Once the debt is retired, the district must be decertified.

FINANCING OPTIONS

Cities can finance the up-front development costs related to tax increment financing projects in a variety of ways, including general obligation bonds of the city or the development authority, revenue bonds, internal city financing, and pay-as-you-go arrangements.

TIF projects are financed with bonds, internal city funds, or developer funds.

Most TIF costs are incurred at the beginning of a project, typically to acquire land, demolish buildings, and install public improvements. Traditionally, these costs have been financed by issuing bonds which are repaid from the increased property taxes resulting from the development. Three types of bonds are used to finance TIF project costs. The first type, general obligation (GO) bonds, are backed by the full faith and credit of the city. If tax increments are insufficient to meet debt service payments, the city must levy a tax or find other sources of revenue to pay the bond obligations. The second type are GO bonds backed by the full faith and credit of the development authority. Because the authority has only limited taxing authority, these bonds are less secure than city GO bonds. The third type are revenue bonds, backed by the revenues generated from the project (such as tax increments, proceeds from land sales, or lease revenues). Revenue bonds are used primarily to refinance GO bonds after the development has occurred and the flow of tax increments is relatively secure.

Cities may also use their own funds to support the preliminary costs of development. The mechanics of this type of internal financing can work in a number of ways. Cities may "borrow" money from their general funds, economic development funds, municipal utility funds, or federal grant funds. Then, cities use tax increments generated from development projects to repay the "loans" from these funds. Cities may also use "pooled" tax increments from a successful district to support the start-up costs in a new district in the same project area, to create a development fund, or to transfer money to various city improvement projects related to tax increment districts.

Another alternative to bond financing is a pay-as-you-go arrangement between the city and the developer. With pay-as-you-go financing, cities provide less up-front

public financial assistance. Instead, developers obtain their own project financing and pay for development costs. The city uses tax increments to reimburse the developer for those development costs. Normally, these arrangements are formalized in a developer agreement. Pay-as-you-go financing arrangements can be structured in a variety of ways. Cities may reimburse the developer with tax increments annually over a specified time period, which may be as long as the life of the district and may include up to 100 percent of the increments generated. Cities may also use revenue notes or bank loans. Under this type of financing arrangement, the developer bears the risk if increments are insufficient to repay the costs incurred.

LEGISLATIVE RESTRICTIONS ON THE USE OF TIF

In addition to the limitations discussed above, the Minnesota Tax Increment Financing Act places a number of restrictions on tax increment financing. These provisions impose requirements for planning, disclosure and reporting, limit the uses of tax increment financing, and reduce state aid for cities that use TIF. Although the Legislature has added many restrictions to the act over the past decade, some restrictions in the law have been relaxed in recent years.

In 1986, the Office of the Legislative Auditor issued a report detailing ways in which TIF had been used and misused. Some of the findings from that report included: (1) cities were capturing taxes from development that was already occurring without TIF assistance, as well as from general inflation in property values and increases in tax rates; (2) cities were pooling tax increments among districts and establishing large project areas which enabled cities to spend increments instead of decertifying districts; (3) tax increments generated within redevelopment districts were not being used to correct the blight conditions that permitted the district to be established; and (4) the blight criteria were not specific enough to target TIF assistance to areas needing it the most. Many of the legislative restrictions enacted in 1988, 1989 and 1990 were in response to the concerns and recommendations of that report.¹⁵

Planning, Disclosure, and Reporting Requirements

Prior to establishing a tax increment district, the city or development authority must prepare and approve a tax increment financing plan. The plan must describe: project objectives, the development program and activities, the type of development expected to occur and when it is likely to occur, development contracts entered into, estimated costs and revenues, and the impact TIF will have on taxing jurisdictions in which the district is located. The city or authority must provide an opportunity for the affected county and school district boards to comment on the

¹⁵ Office of the Legislative Auditor, *Tax Increment Financing* (St. Paul, January 1986).

A city must find that development would not occur "but for" TIF assistance.

plan and it must hold a public hearing. If the development authority is not a city, the TIF plan must be approved by the governing body of the city.¹⁶

Before approving a tax increment financing plan, the city or authority must make a number of findings supported by written statements of reasons and supporting facts. The most important finding is that the proposed development, in the city's opinion, would not be reasonably expected to occur solely through private investment within the reasonably foreseeable future. In short, the city must find that "but for" the use of tax increment financing the development would not happen.¹⁷

In 1995, a condition was added to the "but for" test, which requires the city to find that the use of TIF will increase the taxable market value of the site over that which would occur without TIF. In applying this new condition, the city must deduct the present value of the tax increment subsidies from the projected market value of the TIF development.¹⁸ The "but for" test is considered by many to be a critical requirement to help restrict the use of TIF to those situations in which it is necessary and desirable. In Chapter 3, we will discuss the impact of the "but for" test on decisions to use TIF.

The city or development authority is also required to meet certain reporting requirements. Prior to January 1, 1996, state law placed the following reporting requirements on local governments:

- After adoption, a tax increment financing plan containing the elements specified in statute must be filed with the Minnesota Department of Revenue.
- For *all* tax increment districts, an annual disclosure statement on the status of the district must be made to the county board, county auditor, school board(s), and Revenue Department, and, if the development authority is not the same as the city, the affected city.¹⁹
- For *all* tax increment districts, an annual financial report must be made to the county board, county auditor, school board(s), Office of the State Auditor, and, if the development authority is not the same as the city, the affected city.²⁰
- For each municipality and *all* tax increment districts, an annual report on bonded indebtedness must be submitted to the Minnesota Department of Revenue.

¹⁶ *Minn. Stat.* §469.175, Subd. 1 - 4.

¹⁷ *Minn. Stat.* §469.174, Subd. 3.

¹⁸ *Minn. Laws* (1995), Ch. 264, Art. 5, Sec. 18.

¹⁹ *Minn. Stat.* §469.175, Subd. 5.

²⁰ *Minn. Stat.* §469.175, Subd. 6 (d) allows the annual financial reporting to the Office of the State Auditor to be made in lieu of the annual disclosure required by subdivision 5.

The 1995 Legislature restructured these reporting requirements. Beginning January 1, 1996, the annual disclosure, financial and bonded indebtedness reports must be submitted to the Office of the State Auditor by July 1 of each year. The State Auditor's Office may combine the three reports so that cities and development authorities only have to make one report each year.²¹ Amendments in 1995 also made publication of the annual disclosure statement mandatory.

Limitations on the Use of TIF

The TIF Act imposes limits on tax increment districts established after August 1, 1979. These limits are of several types: (1) limits on the type and amount of tax increment spending; (2) limits on the ability of cities to capture tax increments from development not stimulated by TIF; (3) limits on increases in increments caused by tax rate increases; (4) limits to prevent cities and authorities from taking excessive risks; (5) reductions in state aid to local governments using TIF; and (6) other recently enacted limits.

Limits on the Type and Amount of TIF Spending

The 1979 Act imposed several general restrictions on how tax increments can be spent. These restrictions are in addition to the statutory spending limits for increments generated from particular types of TIF districts, noted in our earlier discussions regarding development authorities and tax increment districts.

- Beginning in 1982, tax increments cannot be used to finance construction, renovation, operation, or maintenance of a municipally-owned building used primarily and regularly for conducting the business of a city. In 1988, legislation extended this restriction to county, school district, or other local government, or the state or federal government buildings. (Parking ramps, parks, and facilities used for social, recreational, or conference purposes and not primarily for conducting city business are exempted from this restriction.)²²
- Administrative expenses cannot exceed 10 percent of a district's total tax increment expenditures or the total tax increment expenditures authorized by the TIF plan, whichever is less.²³
- If a district's increments exceed projections and the district generates more tax increments than are necessary to pay the costs authorized by the tax increment financing plan, then these "excess" tax increments must be used to repay outstanding bonds, placed in an escrow account dedicated to payment of existing bonds, or returned to all the affected taxing districts in proportion to their tax rates.²⁴

²¹ *Minn. Laws* (1995), Ch. 264, Art. 5, Sec. 19 to 21, and 34.

²² *Minn. Stat.* §469.176, Subd 4g.

²³ *Minn. Stat.* §469.176, Subd. 3 and §469.174, Subd. 14. Administrative expenses are defined in the Glossary.

²⁴ *Minn. Stat.* §469.176, Subd. 2.

The latter restriction appears to establish a clear policy that excess increments should be used to retire a district early or at least diminish the tax impact on other taxing jurisdictions. However, this restriction may not be as effective as it appears because cities may adopt an ambitious tax increment financing plan that includes a long list of possible projects and expenditures. Cities may also amend the tax increment financing plan and increase the size of the district, amount of tax increment spending, or amount of bonded indebtedness, although the law places some restrictions on the ability to amend plans and increase spending.²⁵

In 1982, the Legislature amended the TIF Act to permit the "pooling" of tax increments. Pooling allows increments to be spent anywhere within the project area, either inside or outside of the tax increment district boundaries. The following 1990 amendments to the TIF Act restricted the pooling and spending of tax increments for districts certified after April 30, 1990, or "post-1990" districts.

Amendments in 1990 further restricted TIF spending.

- The Legislature required that 75 percent of the tax increment revenues be spent on activities within the district from which the increments were generated; no more than 25 percent of the tax increments may be pooled and spent on activities outside the district. These pooling restrictions were tightened further in 1995 when the Legislature required that no more than 20 percent of tax increment revenues may be pooled. This change applied to districts (other than redevelopment districts) certified after June 30, 1995.²⁶
- The use of tax increments from post-1990 districts is limited to activities for which binding legal commitments have been made within five years after approval of the district. Increments must be used (1) to pay bonds issued within the five-year period, (2) to reimburse costs paid during the five-year period, or (3) to pay binding contracts with a third party entered into during the five-year period. Tax increment revenues received after the five-year period must be used to pay these obligations and decertify the district. These restrictions do not apply to the 25/20 percent of the tax increments which may be pooled and spent outside the district.²⁷

In addition to these limitations on TIF spending, the Legislature authorized counties to recover certain costs of administering the property tax system that results from TIF and costs of increased public services to serve development.

- The law authorizes counties to recover the actual cost of administering the TIF law from tax increment revenues.²⁸

²⁵ The geographic area of a district can not be enlarged after five years following certification of the original tax capacity. The area of pre-1979 districts can not be enlarged after August 1, 1984. Modifications to a tax increment financing plan that enlarge the geographic area, or increase tax increment spending or bonded indebtedness must follow the same approval procedures required for the original plan. *Minn. Stat.* §469.175, Subd. 4.

²⁶ *Minn. Stat.* §469.1763, Subd. 2. *Minn. Laws* (1995), Ch. 264, Art. 5, Sec. 26.

²⁷ *Minn. Stat.* §469.1763, Subd. 3.

²⁸ *Minn. Stat.* §469.176, Subd. 4h(a).

- If the use of TIF increases traffic on county roads requiring road improvements, then the county may require a TIF district to pay the cost of those improvements.²⁹

Limits on Ability to Capture Tax Increments from Non-TIF Development

The Legislature has limited the ability of cities to capture tax increments from development not stimulated by tax increment financing. Without such limitations, cities could capture increments without investing in local development projects. These limitations, which do not apply to pre-1979 districts, include the following:

- Tax increments cannot be captured on the value of improvements for which building permits were issued less than 18 months prior to creation of the district.³⁰
- Tax increments cannot be collected on any parcel in a tax increment district if within four years after creation of the district (1) that parcel has not been developed, or (2) the city has not acquired the parcel or made improvements on or adjacent to the parcel. This provision is called the "four year knock-down provision." Increments can begin to be collected from the knocked-down parcel if improvements are made on it.³¹
- Similarly, tax increments cannot be paid if the city or authority has not issued bonds, acquired property, or constructed public improvements in the district within three years after creation of the district. This provision is referred to as the "three year knock-out rule."³²
- To prevent general inflation in property values from being captured in economic development districts, the original tax capacity is adjusted by the inflation rate on property values in the district before the district was established. This is called the "economic adjustment factor."³³

Limits on Increases in Increments Caused by Rising Tax Rates

When tax rates increase the amount of tax increment revenues will also increase. However, tax increment financing plan budgets were usually based on the tax rate in effect when the district was established. As a result, a tax rate increase would provide unanticipated tax increment revenues that could be used to finance other projects. In 1988, the Legislature enacted the following provision to address con-

²⁹ *Minn. Stat.* §469.175, Subd. 1a. Originally, the county authority to require payment of road costs applied only to soils conditions districts certified after May 1, 1988, but 1990 legislation expanded the county's authority to all districts certified after April 30, 1990.

³⁰ *Minn. Stat.* §469.177, Subd. 4 enacted in 1988.

³¹ *Minn. Stat.* §469.176, Subd. 6.

³² *Minn. Stat.* §469.176, Subd. 1a. County auditors are responsible for enforcing both the three and four year "knock-down" provisions.

³³ *Minn. Stat.* §469.177, Subd. 1 enacted in 1988.

cerns that TIF districts were collecting increased tax increment revenues because of rising tax rates.

For districts created on or after May 1, 1988, the current tax rate is certified at the same time the original tax capacity is certified. This *original local tax rate* or the actual tax rate, whichever is lower, is used to calculate the amount of increment. If the tax rate applicable to the district increases, the taxes that result from this rate increase are paid to the taxing jurisdictions, not the development authority. These "excess taxes" are distributed to the taxing jurisdictions in proportion to the respective increases in their tax rates.³⁴

Statewide, a total of \$12.2 million in excess taxes from 581 tax increment districts were distributed to affected taxing jurisdictions in 1995. Districts in the Twin Cities metropolitan area generated over two-thirds of the excess taxes. School districts received approximately 53 percent of the excess taxes, while counties received 30 percent, and cities got 17 percent.³⁵

Limits to Prevent Excessive Risk Taking

The TIF Act contains limitations intended to prevent cities and authorities from taking excessive risks. These limits arose from concerns that cities would use tax increment financing to acquire property or make investments in site improvements and public infrastructure without firm development projects for the site. If development failed to occur, general tax dollars would need to be used to finance the costs of these improvements. To prevent speculative risk taking, the TIF Act restricts the amount of land which may be acquired with the proceeds of tax increment bonds to no more than 25 percent of the land in redevelopment districts and 10 percent in economic development and housing districts. This restriction does not apply to land for which the city or authority has entered into a development agreement.³⁶

Reductions in State Aid to Local Governments Using TIF

The 1990 Legislature imposed further restrictions on the use of tax increment financing when it reduced state aid payments to cities to partially offset the increased state school aid payments that can result from the use of TIF. This is also called the state aid offset. The departments of Revenue and Education implement this provision by calculating the amount of additional education aid that will be paid in the next year because tax increment captured value is excluded from the measure of local tax base under the education aid formulas. All or part of this amount is subtracted from the Local Government Aid (LGA) and the Homestead and Agricultural Credit Aid (HACA) that is paid to cities with TIF districts.

**In 1990,
legislation
reduced state
aid to cities
using TIF.**

³⁴ *Minn. Stat.* §469.177, Subd. 1a and 9. Distributions to school districts in excess of \$25,000 trigger a recalculation of their state aid payments. *Minn. Stat.* §124.214, Subd 3.

³⁵ Minnesota Department of Revenue, Property Tax Division, Tax Increment Financing Supplement for Taxes Payable in 1995.

³⁶ *Minn. Stat.* §469.176, Subd. 5.

The state aid reduction applies to all districts certified after April 30, 1990, however, the amount of the aid reduction depends on the type of district and the number of years after certification, as discussed below. The full state aid offset applied immediately to economic development and soils condition districts. Redevelopment, renovation and renewal, housing, and hazardous substance districts were given a five-year grace period before the offset was applied. In addition, the offset is phased-in in equal annual amounts over 16 years for redevelopment, housing, and hazardous substance districts and over 8 years for renovation and renewal districts. In 1995, the Legislature applied the state aid reduction to any district that is authorized with a longer duration than allowed by general law or that has its duration extended by a special law.³⁷ For these districts, the aid reduction is applied in the first year in which tax increments are collected beyond the standard duration limits, and phase-in rules do not apply.

State aid reductions have had a relatively small impact.

In 1993, the Legislature created a "qualified housing district" for residential rental projects in which the only properties receiving TIF assistance meet all of the requirements for federal low-income housing programs.³⁸ Qualified housing districts certified after August 1, 1993 are exempt from the state aid offset.

Since the state aid offset applies only to new districts and since most districts qualify for a five-year grace period, the offset has had a relatively small impact. Table 1.1 shows that 105 tax increment districts generated an aid deduction. A total of \$1,555,842 in 1996 LGA/HACA aid will be reduced from 64 cities, 2 counties, and 1 town.³⁹ Fifteen metropolitan area local governments account for \$703,357, or 45 percent, of the total aid reductions, with Maple Grove accounting for the largest aid reduction (\$197,819), followed by Brooklyn Park (\$149,529). Amendments enacted in 1995 to reduce the impact of the state aid offset are discussed below.

Other Limits

In 1995, legislation prohibited cities from including property in a TIF district if the property had been enrolled in the Green Acres, Open Space, and Metropolitan Agricultural Preserves deferred assessment programs within the previous five calendar years. The prohibition does not apply outside the seven-county metropolitan

³⁷ *Minn. Laws* (1995), Ch. 264, Art. 5, Sec. 8. As an alternative, the city may elect to have the captured tax capacity added to the school's tax base for state aid purposes. These districts cannot be exempted by making local contributions which were permitted in 1995.

³⁸ After 1990, the Legislature created several types of districts and exempted them from the state aid reductions. The Legislature created a "qualified hazardous substance subdistrict" in 1991 that was exempt from the state aid offset if the city paid at least 18 percent of the costs to remove pollution out of its own funds. In 1995, the Legislature replaced the 18 percent provision with a local contribution of 7.5 percent of tax increments. In 1991, the Legislature allowed cities located wholly outside the seven-county metropolitan area, with a population of less than 10,000, to create a "qualified manufacturing district" as a type of economic development with a 6 year phase-in of the state aid offset. The non-metropolitan requirement was eliminated in 1993 and the entire provision was repealed in 1995.

³⁹ Minnesota Department of Revenue, Property Tax Division, "Tax Increment Aid Reductions," November 27, 1995.

Table 1.1: Tax Increment Aid Reductions, 1992-96

Aid Year ^a	TIF Districts ^b	Affected Taxing Districts			Captured Tax Capacity ^c	Aid Reductions		
		Counties	Cities	Towns		LGA	HACA	Total
1992	1	--	1	--	\$ 1,262	\$ 447	\$ 0	\$ 447
1993	6	1	5	--	129,951	37,785	895	38,680
1994	28	1	23	1	563,961	237,395	5,514	242,909
1995	61	1	43	1	1,851,050	677,276	65,982	743,258
1996	105	2	64	1	3,500,552	1,417,290	138,552	1,555,842

Source: Minnesota Department of Revenue, Property Tax Division, November 27, 1995.

^aFigures shown are for the year aid is paid to local governments. For example, aid reductions in 1996 are based on tax increment data for taxes payable in 1995.

^bNumber of tax increment districts generating an aid reduction.

^cCaptured tax capacity subject to the aid reduction provisions.

area if 85 percent of the square footage of the proposed buildings is used for manufacturing facilities.⁴⁰

Also in 1995, the Legislature required cities that wish to seek statutory duration extensions for individual TIF districts to obtain prior approval from affected counties and school districts. This provision also applied to six of the seven cities that were granted duration extensions in 1995.⁴¹

REDUCED RESTRICTIONS ON THE USE OF TIF

In general, Minnesota's Tax Increment Financing Act of 1979 and subsequent amendments have placed restrictions on the use of tax increment financing, but some amendments have relaxed restrictions on the use of TIF. The most significant relaxation of TIF restrictions occurred in 1982 when the relationship between tax increment districts, project areas, and spending of tax increments was changed. In 1995, the Legislature amended the TIF Act to minimize the impact of the state aid offset enacted in 1990.

Pooling

Prior to the TIF Act of 1979, tax increment districts were required to be coterminous with development project areas. As a result, if a city designated a large downtown business district as a redevelopment project area and used TIF for the

⁴⁰ *Minn. Laws* (1995), Ch. 264, Art. 5, Sec. 25. The amendment also repealed the 20-year prohibition against including these types of properties in an economic development district.

⁴¹ *Minn. Laws* (1995), Ch. 264, Art. 5, Sec. 35 - 38, 40, 41, 43.

project, the entire downtown business district was also placed in a tax increment district. To reduce the amount of commercial property being placed in TIF districts, the 1979 Legislature permitted cities and development authorities to establish tax increment districts that were smaller in size than their associated project areas. The 1979 Act also allowed noncontiguous and multiple tax increment districts within a single project area. Initially, the tax increments generated by a district could only be spent within that district. The city would have to expand the district to spend tax increments outside the district. Figure 1.6 illustrates the relationship between tax increment districts and project areas before and after enactment of the 1979 law.

Some restrictions in law have been relaxed.

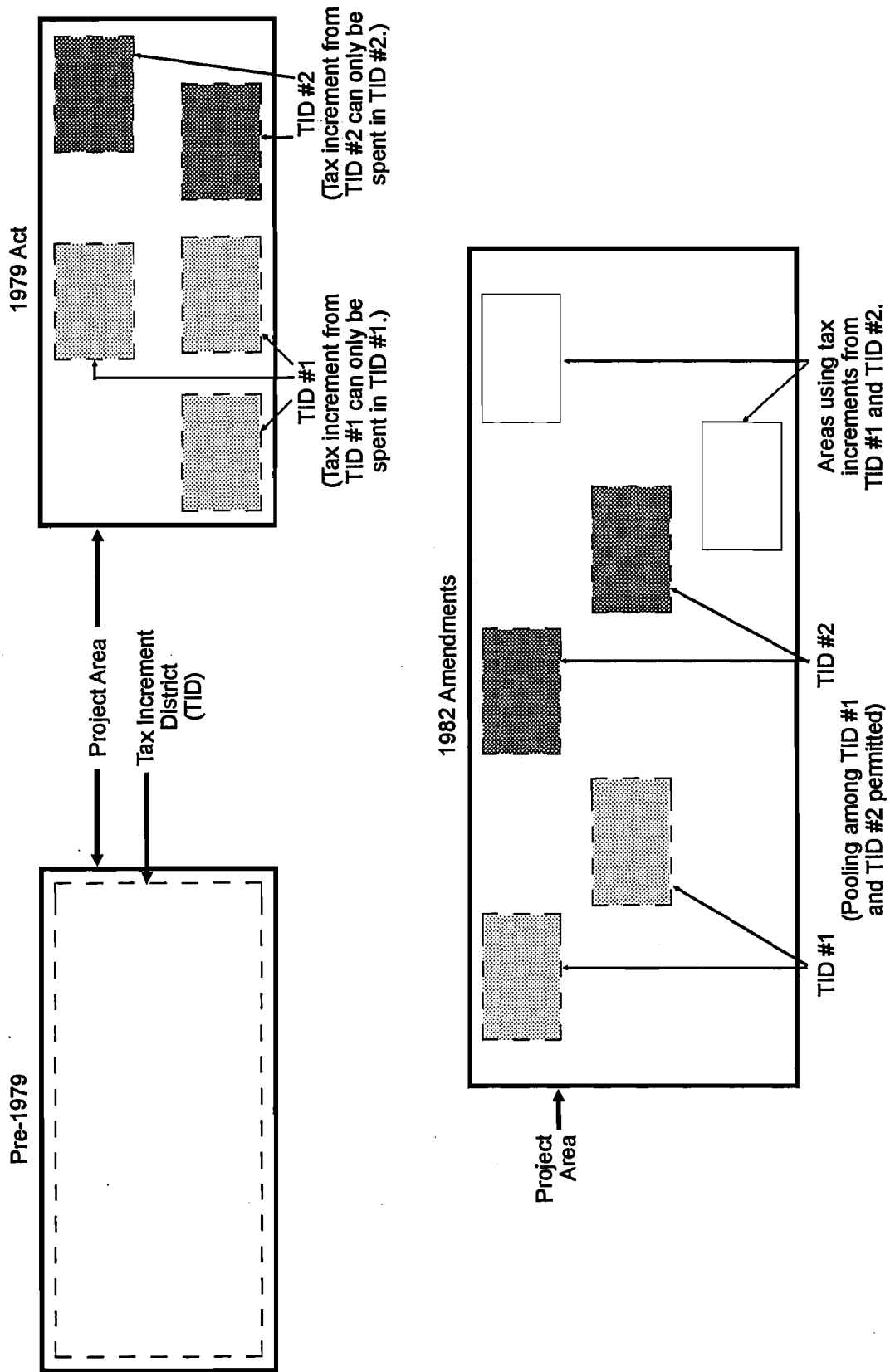
In 1982, amendments to the TIF Act permitted cities to "pool" tax increments. "Pooling" allows cities to spend tax increments collected from a tax increment district anywhere within the associated project area even though the development activity is located outside the district. Tax increments from one district in a project area could be used to support development activity in other districts in the same project area, including other types of districts, or in portions of the project area in which no district exists. Figure 1.6 illustrates how the 1982 amendments further relaxed the restrictions on tax increment spending.

Since the adoption of these amendments, cities and development authorities have used a variety of methods to pool increments, including large project areas and bonds backed by tax increments from a number of districts. Since a project area might encompass an entire city, pooling might allow a city to spend tax increments from a district anywhere else within the city. The ability of cities to establish large project areas, create noncontiguous tax increment districts, pool tax increments among districts, and spend increments anywhere within the project area raises a number of important issues related to TIF use. In Chapter 3, we discuss these issues and review how cities have used pooled tax increments.

Local Contributions For Exemption From the State Aid Reduction

Another example of reduced restrictions occurred in 1995, when the Legislature restructured the state aid reduction for new TIF districts. This law exempts TIF districts from the state aid reduction if the city creating the district chooses to make a qualifying local contribution out of unrestricted government funds. The contribution is 10 percent of the tax increment for a housing, renewal and renovation, or economic development district and 7.5 percent of the tax increment for a redevelopment, mined underground space, soils condition district, or a hazardous substance subdistrict. The maximum contribution by a city is limited to 2 percent of its property tax base. The contribution must be used to pay project costs and may not be made either directly or indirectly from tax increments or developer payments. State grants or other payments for the project may be used for up to one-half of the local contribution. These provisions apply to new TIF districts and additions to existing TIF districts for which certification was requested after June 30, 1994, and to all hazardous substance subdistricts regardless of when certified.

Figure 1.6: Changes in the Configuration of Tax Increment Districts and Project Areas



For districts certified before July 1, 1995, the governing body must choose the local contribution option no later than December 31, 1995.⁴²

There have been other changes to the state aid reduction provisions of the law. Soils condition districts, which the 1995 Legislature limited to contamination and pollution clean-up purposes, were also switched to the 16-year phase-in for the state aid reduction. In addition, any TIF district is exempt from reductions in state aid if all of the following requirements are met: the district is established to construct or expand an agricultural processing facility; the project creates at least five permanent, full-time jobs and is located outside the seven-county metropolitan area; the total amount of tax increment for the district does not exceed \$1.5 million; and the county board approves the TIF plan.

OVERSIGHT

State oversight of TIF has been minimal.

Until recently, state oversight of TIF was mainly intended to ensure that local governments submitted reports required by law. The agency designated to accept those reports has changed from the State Planning Agency to the Department of Trade and Economic Development to the Department of Revenue, and, most recently, to the Office of the State Auditor. For the most part, the TIF plans and annual disclosure and financial reports were reviewed only when special TIF studies were conducted.

In 1985, the Office of the State Auditor was directed to establish a uniform system of accounting and financial reporting for all tax increment districts. The result was the Schedule of Sources and Uses of Public Funds, which cities typically file with their annual city financial reports. In 1989, the Legislature required development authorities to file a TIF bonded indebtedness report with the Department of Revenue.

The Legislature assigned TIF enforcement authority to the Department of Revenue in 1990. The State Auditor retained responsibility for conducting financial and compliance audits of TIF districts, forwarding any evidence of violations to the Revenue Department. However, neither agency received funds to carry out these duties.⁴³

- In 1995, the Legislature transferred TIF enforcement responsibilities from the Revenue Department to the Office of the State Auditor.

Without prior notice, the State Auditor may examine and audit the use of TIF for all districts on a random basis to determine compliance with the laws. These enforcement responsibilities became effective on January 1, 1996 and will be financed with a one-tenth of 1 percent administrative fee collected from *all* tax increments distributed to a city or development authority.

⁴² *Minn. Laws* (1995), Ch. 264, Art. 5, Sec. 4-6.

⁴³ County auditors are also responsible for enforcing some provisions of the TIF statute, such as the four-year "knock down" provisions (*Minn. Stat.* §469.176, Subd. 6).

If the State Auditor discovers violations of the TIF Act, it must submit the information on the violations to the county attorney who may bring action to enforce the TIF laws. The State Auditor must also send a non-compliance report to the municipality that approved the TIF district. The municipality must respond in writing within 60 days. The State Auditor must summarize the responses from the cities and send its summary along with copies of the cities responses to the chairs to relevant legislative committees. In addition, legislation streamlined the reporting process by requiring that the annual disclosure statement, financial report, and bonded indebtedness report for each TIF district be submitted to the State Auditor.⁴⁴

THE COSTS OF TIF

One of the unique features of tax increment financing is that it requires different governmental jurisdictions to share in the costs of financing development projects. In the Twin Cities metropolitan area the combined effect of the fiscal disparities law and TIF could also impact other commercial/industrial properties.

When cities and development authorities decide to use tax increment financing to support development projects, they are "capturing" the increased property tax revenues that would have gone to other taxing jurisdictions if the development had occurred without TIF. Three levels of government have a financial stake in tax increment financing: the state (which compensates school districts for most of their tax revenue losses), the city, and the county.

The state indirectly pays for a significant portion of the costs of tax increment financing because the use of TIF increases state spending on school aid. The state provides a large share of revenues to local school districts through education aid. The calculation of education aid payments is directly affected by the amount of tax capacity or local property wealth in a school district. As the property tax base increases, the amount of state aid drops. The tax capacity captured in TIF districts is not included as part of local property wealth in the formulas used to calculate state education aid. So, to the extent that TIF captures increases in property value that otherwise would have been subject to property taxes, it results in higher payments of state aid.

The Minnesota House of Representatives Research Department has made the most reliable estimate of these costs.⁴⁵ According to House Research,

- **State education aid would have dropped by \$100.8 million in 1994 if tax increment values were included in the education aid formulas.**

⁴⁴ *Minn. Laws* (1995), Ch. 264, Art. 5, Sec. 19-21, 33, 34.

⁴⁵ Minnesota House Research Department, *Estimates of State Aid Impact of Tax Increment Financing, 1994 Update*. The original report contains a detailed discussion of the issues and methodology used to estimate the state costs related to TIF. See Minnesota House Research Department, *Tax Increment Financing Project: An Estimate of the State Costs of Tax Increment Financing, Working Paper #3* (St. Paul, 1986).

The state and county governments share in the costs of development projects using TIF.

This cost estimate was calculated by including TIF captured tax capacity values in local tax bases and then recomputing state aids. This method assumes that the total state property tax base would have been higher by the full amount of captured value in the absence of TIF. Some people believe that this runs counter to the assumption that "but for" the use of TIF the development and increased property values would not have occurred. House Research acknowledges this point and indicates that, to the extent that TIF stimulates a net increase in Minnesota's taxable property values, "estimates should be regarded as an upper bound estimate of the impact of TIF on state aid payments."⁴⁶

As noted above, the 1990 Legislature reduced state aid payments to cities to partially offset the increased state school aid payments resulting from the use of TIF. Because the state aid reduction only applies to tax increment districts created after April 30, 1990 and had a five-year phase in for most districts, it has had a small fiscal impact on state aid payments (\$1.56 million in 1996).

The net costs to other taxing jurisdictions are harder to estimate than the impacts on the state. Although city governments lose property tax revenues through the use of TIF, tax increments reimburse the city for staff and other expenses related to managing TIF projects. Cities also benefit when they continue to collect tax increments from districts after the development projects identified in the original TIF plan are completed and bonds are repaid. As discussed later in this report, cities tend not to decertify districts but use tax increment revenues to finance a wide range of public improvement projects. In this manner, cities and other development authorities are able to use property tax revenues from other taxing jurisdictions to pay for city projects.

Counties may be adversely affected by the use of TIF, depending on whether the development would have occurred elsewhere in the county without TIF assistance. For example, a city might use TIF to ensure that a project will develop on a particular site instead of at a competing site within the city. Or, a city might use TIF to encourage development to occur within its boundaries, rather than in an adjacent city. However, a county may prefer not to subsidize development that would occur within its boundaries without TIF assistance. From the county's perspective (or the state's), TIF expenditures might not result in a net job creation or tax base increase. In other words, there are instances where the county or state may contribute financially to TIF projects but receive little net benefit in return.

TIF may not result in a net benefit to the state.

Local use of TIF may sometimes induce higher levels of county spending for services—for example, for county highways to serve TIF developments, or for the county's cost of administering TIF districts through the property tax system. However, the Legislature has amended state law in recent years to allow counties to recoup some of these expenses.⁴⁷

⁴⁶ House Research, *Estimates of State Aid Impacts*, 4. The House Research reports also discuss at length the possible factors that may cause the estimates to overstate or understate the impact of TIF on state aid payments. In general, we think the House Research estimates are reasonable. Most TIF districts involve investments that would have occurred elsewhere in Minnesota without TIF, even if they would not have occurred in a particular location but for the TIF subsidies.

⁴⁷ *Minn. Stat.* §469.175, Subd. 1a and §469.176, Subd. 4h(a).

Another issue related to TIF which affects only the seven-county Twin Cities metropolitan area is fiscal disparities, a tax-base sharing mechanism.⁴⁸ Under fiscal disparities, cities contribute 40 percent of the increase in commercial and industrial tax capacity value since 1971 to an area-wide pool. The pool is allocated to metropolitan taxing jurisdictions according to a formula based on population and fiscal capacity, thus lessening the revenue-raising disparities among taxing jurisdictions.

Increases in commercial and industrial tax capacity in tax increment districts are generally counted when contributions to the fiscal disparities area-wide pool are calculated. However, a city or development authority may choose one of two options for making the contribution. The contribution to the pool can be made directly from the tax increment revenues generated by the district or the contribution can be made by commercial/industrial property located elsewhere in the city but outside the district.

If a city or development authority chooses to make the contribution to the fiscal disparities pool from the tax increment revenues of a district, this will reduce the increments available to pay for the costs of public improvements or development. This choice will not financially affect other commercial/industrial properties in the city. We estimate that about 15 percent of the tax increment districts contributing to the fiscal disparities pool do so from tax increments generated by the district. However, if a city or development authority chooses to make the fiscal disparities contribution from other commercial/industrial property located in the city but not in the district, this could increase the tax rate for other commercial/industrial properties in the city.

⁴⁸ *Minn. Stat. Chap. 473F.*

Trends

CHAPTER 2

In this chapter, we describe Minnesota's tax increment financing (TIF) districts and examine trends in their size and scope. Specifically, we ask:

- How has the use of tax increment financing changed over time?
- What impact have changes to the TIF law had on TIF activity?
- Which cities and counties use TIF the most? Are there geographic variations in the use of tax increment financing in Minnesota?

To answer these questions, we relied primarily on data reported by county auditors to the Minnesota Department of Revenue in: (1) the Abstract of Tax Lists for Taxes Payable in 1995, which aggregates TIF data by city and county using only tax increment districts with captured tax capacity, and (2) the Tax Increment Financing Supplement to the Abstract of Tax Lists for Taxes Payable in 1995, which provides detailed information on each tax increment district, including districts without any captured tax capacity. For some districts we found discrepancies between data reported in the TIF Supplement and information in the tax increment financing plans or city council resolutions. We corrected the discrepancies for our sample cities but could not do this for all TIF districts in other jurisdictions.

Growth in TIF activity has slowed in the 1990s.

In general, we found that after rising dramatically in the 1980s, the growth in tax increment financing activity has increased at a slower pace in the 1990s. TIF districts in the Twin Cities metropolitan area, districts in larger cities, and districts created before passage of the Tax Increment Financing Act in 1979 are larger and capture more tax capacity than non-metro districts, districts in smaller cities, and districts created since 1979. TIF districts created after April 1990 are smaller and capture less value, on average, than districts created in the 1980s.

CHANGES IN THE USE OF TAX INCREMENT FINANCING

The use of tax increment financing grew dramatically in the 1980s, but has remained stable since the Legislature enacted changes to the tax increment financing

statute in 1990. Based on our analysis of tax increment financing data, we found that:

- **Changes in the number of tax increment financing districts and the amount of statewide tax capacity captured in tax increment districts continued a six-year trend of moderate increases in 1995.**

Table 2.1 shows the changes in captured tax capacity between 1974 and 1995. The amount of the state's tax capacity captured in tax increment districts in 1995 totaled \$203.3 million, for a 1 percent increase over 1994. This followed a year which saw the state's first decline in captured value since TIF was implemented. Captured tax capacity increased by an average of 1.9 percent per year between 1990 and 1995, compared with a 24 percent average annual increase between 1984 and 1989, as shown in Figure 2.1.¹

Table 2.1: Historical Statewide Use of TIF, 1974-95

Captured tax capacity increased by an average of only 2 percent per year in the 1990s.

Year ^a	Cities and Towns	Captured Value ^b	Percent Captured ^c	Tax Increment
1974	4	\$ 3,634,483	0.2%	\$ 437,085
1975	10	20,036,557	0.8	2,689,574
1976	21	26,220,175	0.8	3,181,516
1977	29	32,127,149	0.8	3,939,863
1978	42	43,380,473	0.9	5,306,640
1979	57	62,286,066	1.1	7,418,288
1980	81	102,280,206	1.4	11,305,114
1981	99	223,310,857	2.4	22,489,390
1982	122	332,367,840	3.0	35,141,374
1983	127	437,194,546	3.4	46,425,859
1984	159	516,587,125	3.6	58,154,901
1985	181	635,897,231	4.0	70,761,120
1986	224	800,406,816	4.5	92,355,076
1987	248	996,907,289	5.1	117,465,743
1988	262	1,246,503,585	5.8	154,372,728
1989	283	182,846,710 ^b	7.8	183,983,207
1990	309	186,491,610	8.6	192,295,363
1991	329	204,893,672	9.0	230,125,125
1992	331	210,850,640	8.5	255,788,716
1993	335	215,122,620	8.8	278,915,518
1994	347	201,339,456	8.3	268,517,539
1995	357	203,291,153	8.0	276,845,444

Source: Minnesota Department of Revenue, Property Tax Division.

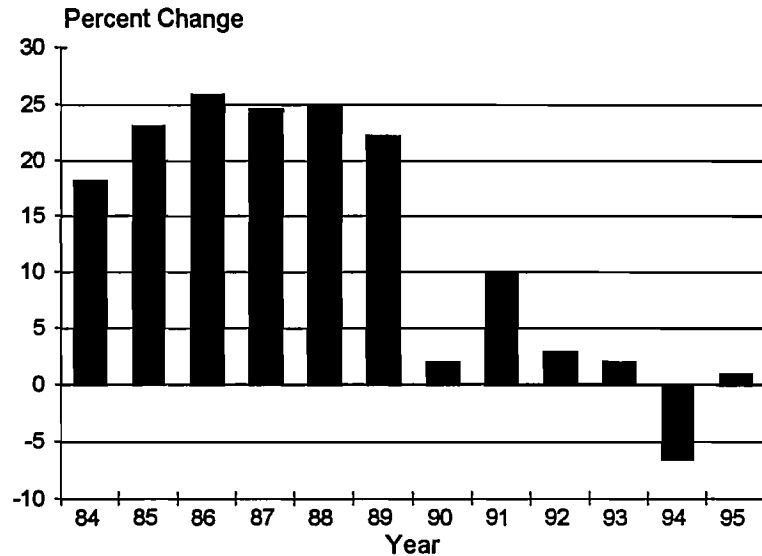
^aYear in which taxes are payable.

^bCaptured value is: assessed values for 1974 to 1988 and tax capacity value for 1989 and thereafter. Captured value is the value after reduction of any captured value shared with the local taxing districts and after contributions to the fiscal disparity pool in the seven-county metropolitan area.

^cPercentages represent the portion of total assessed/tax capacity value that is captured in cities with tax increment districts.

¹ Other factors contributing to this trend include changes in market values and property classification rates for commercial and industrial properties.

Figure 2.1: Percent Annual Change in Total Captured Value, 1984-95



Source: Program Evaluation Division analysis of Minnesota Department of Revenue data.

The number of TIF districts increased an average of 3 percent per year between 1991 and 1995.

In 1995, 357 cities and towns had tax increment districts that captured 8 percent of these local governments' total tax capacity, a slight decline in captured value from 1994 when 347 cities had TIF districts that captured 8.3 percent of their total tax capacity, and a full percentage point below the peak of 9.0 percent in 1991.²

Table 2.2 shows the number of cities and towns with TIF districts and the number of districts with captured value between 1986 and 1995. A total of 1,338 tax increment districts captured tax capacity in 1995, an increase of 5.1 percent over 1,273 districts in 1994.³ The average annual increase in the number of districts capturing tax increments was 3.4 percent between 1991 and 1995, compared with an average annual increase of 25 percent between 1986 and 1989.

LOCATION OF TAX INCREMENT FINANCING ACTIVITY

Different pictures result when counties are ranked by the amount of tax capacity captured in tax increment districts compared with the percent of total tax capacity

² Tax increment districts captured 6.2 percent of the total state tax capacity in 1995, including cities and towns with no TIF districts.

³ It is difficult to estimate the number of tax increment districts in Minnesota. The Abstract of Tax Lists data base includes only districts with captured value for taxes payable in 1995. The TIF Supplement contains 1,436 TIF districts certified by county auditors by July 1, 1994 for taxes payable in 1995. Some of these districts did not capture any tax capacity. In addition, we found 50 new districts in the 46 sample cities and counties we visited that were not yet included in the TIF Supplement.

Table 2.2: Number of Tax Increment Financing Districts, 1986-95

<u>Year</u>	<u>Number of Cities and Towns with Districts</u>	<u>Number of Districts</u>
1986	224	500
1987	248	645
1988	262	813
1989	283	981
1990	309	NA
1991	329	1,169
1992	331	1,182
1993	335	1,221
1994	347	1,273
1995	357	1,338

Note: Number of cities and towns with districts includes cities and towns with all or a portion of at least one tax increment financing district within their boundaries. Number of districts includes districts with captured value.

NA = Not available.

Source: Minnesota Department of Revenue, Property Tax Division, Abstract of Tax Lists.

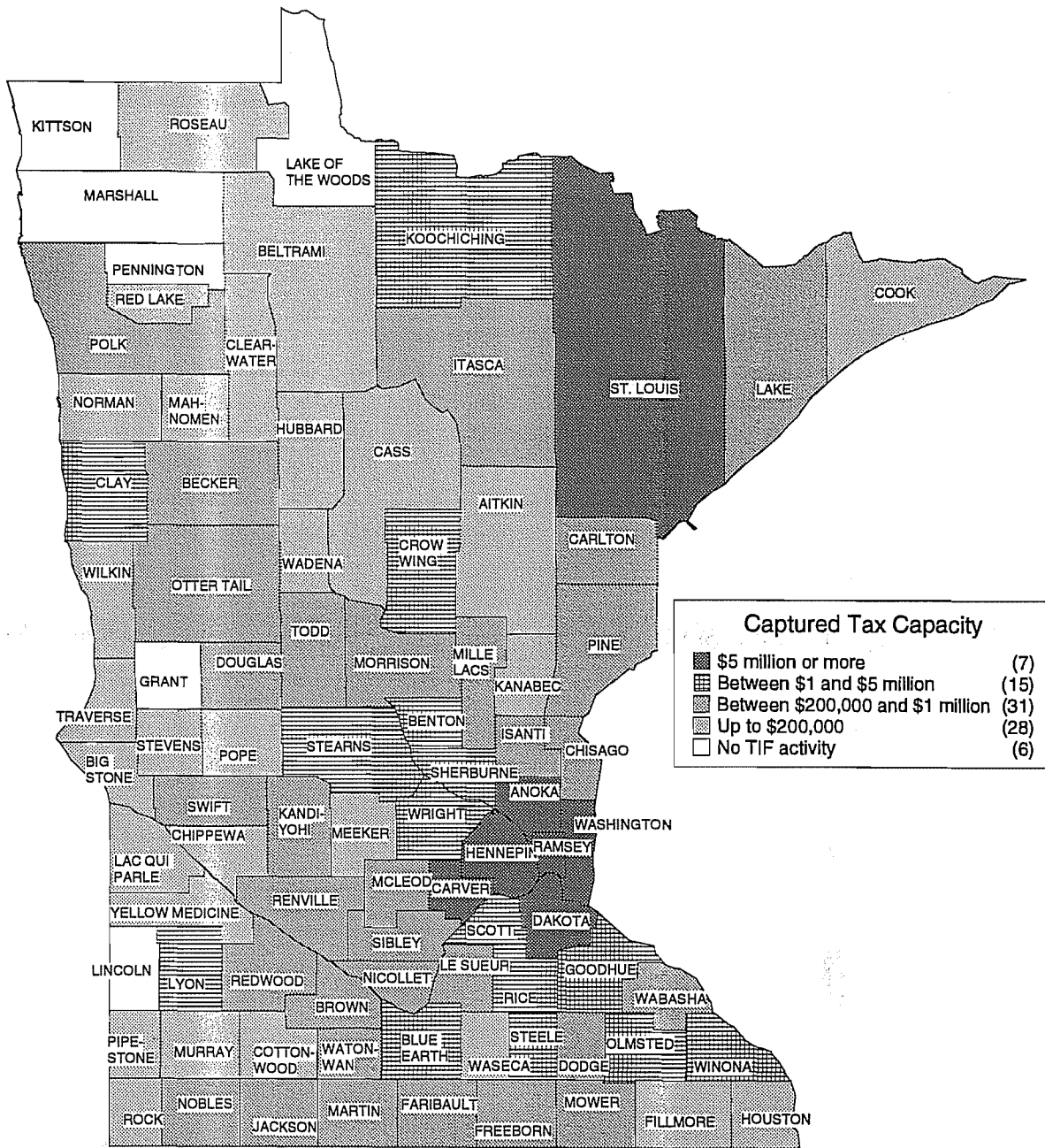
captured. Figure 2.2 shows the distribution of the amount of captured tax capacity among Minnesota's 87 counties.⁴ Counties in the Twin Cities metropolitan area and counties with large cities have more captured tax capacity than smaller counties. In fact, the top 10 counties in total captured tax capacity include the seven Twin Cities counties and St. Louis, Stearns, and Olmsted counties. Several factors account for this, but the main reason is that these counties also account for the largest share of property tax wealth in Minnesota. Other factors, including the larger size of districts in these counties and the higher number of pre-1979 districts in the Twin Cities metropolitan area and larger cities, will be discussed later.

As shown in Table 2.3, 49 cities had tax increment districts with over \$1 million in captured tax capacity in 1995 and 21 cities had over \$2 million in captured tax capacity. Thirty-seven of the 49 cities in Table 2.3 are in the seven-county Twin Cities metropolitan area.

Figure 2.3 presents a distribution of counties by the percent of their total tax capacity that was captured by TIF districts in 1995. From this perspective, there is no clear geographical pattern. This is because one or two large projects in a rural county with relatively low property values may account for a high percentage of the total tax capacity value. Koochiching County, for example, ranked first in this category, with 36 percent of the county's 1995 tax capacity in captured TIF districts. Carver, Benton, and Jackson counties each had over 20 percent of their total tax capacities captured in TIF districts. Hennepin County had by far the largest amount of captured value (\$90 million) but this constituted only 8.7 percent of the county's 1995 total tax capacity.

⁴ Six counties, Grant, Kittson, Lake of the Woods, Lincoln, Marshall, and Pennington, did not have any tax increment financing activity within their boundaries in 1995.

Figure 2.2: Tax Capacity Captured in Tax Increment Districts, 1995



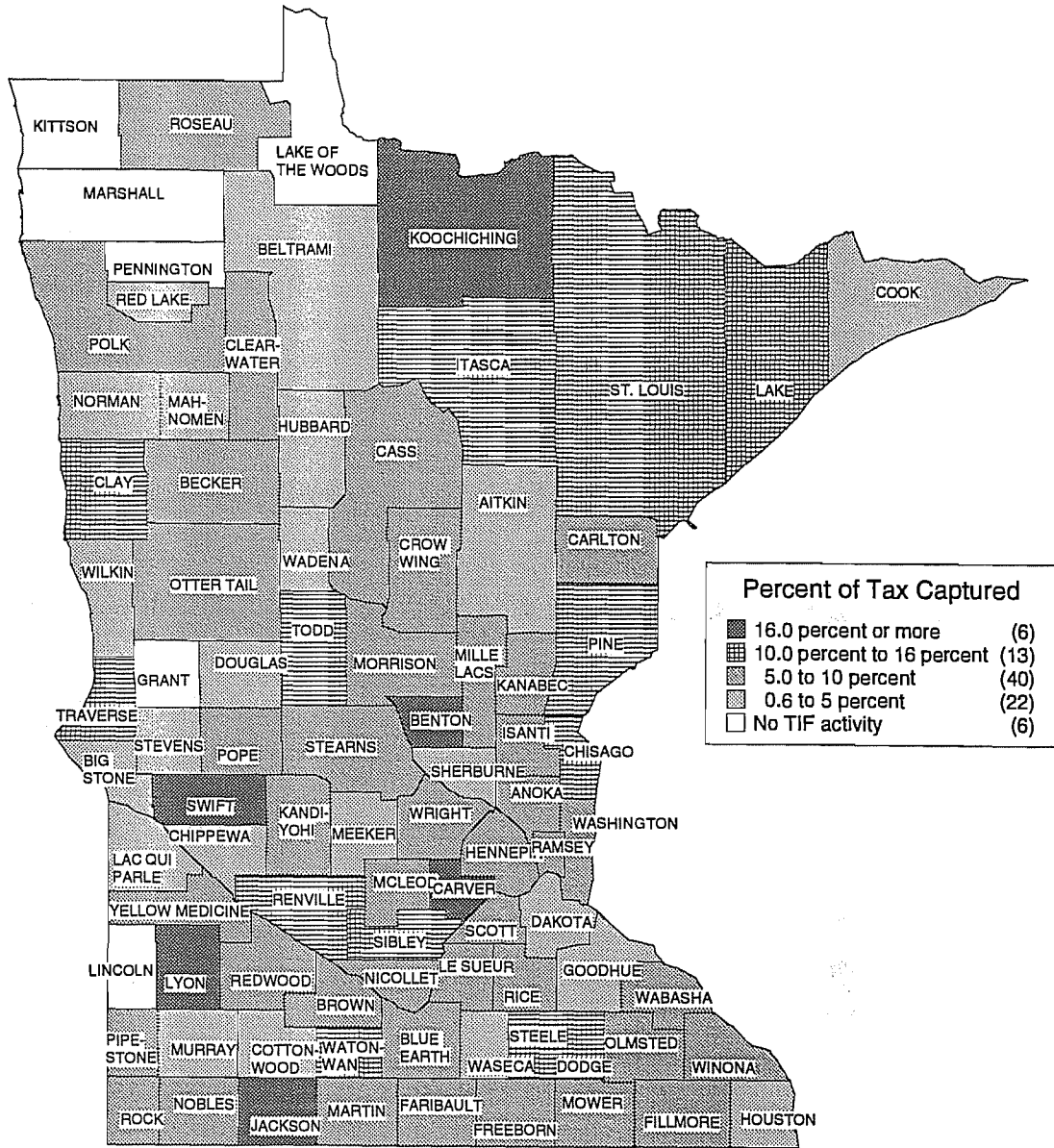
Source: Minnesota Department of Revenue, Property Tax Division, Abstract of Tax Lists.

Table 2.3: Cities with Over \$1 Million in Captured Tax Capacity, 1995

<u>City</u>	<u>Captured Tax Capacity</u>	<u>Percent of Total Tax Capacity</u>
Minneapolis	\$40,424,769	12.8%
Bloomington	14,858,999	11.6
St. Paul	10,388,009	6.6
Duluth	6,425,663	16.2
Edina	5,162,771	6.1
Roseville	4,793,226	11.2
Plymouth	4,673,782	6.5
Chanhassen	4,340,074	25.4
Chaska	4,160,480	33.9
Brooklyn Park	3,986,377	11.0
St. Louis Park	2,929,643	6.5
Rochester	2,892,573	5.1
Golden Valley	2,892,193	9.9
Coon Rapids	2,821,211	8.6
St. Cloud	2,747,850	8.7
Fridley	2,642,692	9.6
Maple Grove	2,232,946	6.8
Blaine	2,232,727	9.1
Richfield	2,219,234	10.8
International Falls	2,032,433	36.4
Apple Valley	2,022,099	7.7
New Brighton	1,784,355	11.0
Shakopee	1,730,528	11.7
Burnsville	1,693,005	2.9
Mounds View	1,564,191	22.1
Mankato	1,530,820	7.9
Woodbury	1,495,910	6.0
South St. Paul	1,424,892	14.6
White Bear Lake	1,368,798	9.2
Vadnais Heights	1,355,779	13.3
New Hope	1,294,802	7.8
Lakeville	1,288,809	5.8
Marshall	1,280,943	16.8
Robbinsdale	1,223,301	16.8
Buffalo	1,198,997	27.1
Moorhead	1,190,549	9.5
Becker	1,181,727	3.8
Stillwater	1,177,177	10.8
Brooklyn Center	1,165,933	5.0
Mendota Heights	1,164,792	8.2
Owatonna	1,138,550	10.4
Ramsey	1,100,506	14.0
Waite Park	1,080,945	22.1
Maplewood	1,043,576	3.0
Savage	1,039,536	11.4
Columbia Heights	1,034,134	11.3
Hopkins	1,021,176	6.6
Sauk Rapids	1,007,314	25.1
Oakdale	1,001,348	8.6

Source: Program Evaluation Division analysis of Department of Revenue, Abstract of Tax Lists data base.

Figure 2.3: Percent of Total County Tax Capacity Captured in Tax Increment Districts, 1995



Source: Minnesota Department of Revenue, Property Tax Division, Abstract of Tax Lists.

Table 2.4 lists the 24 cities and towns that had over 20 percent of their total tax capacity captured in TIF districts in 1995. Irondale Township in Crow Wing County heads the list, followed by Dundas (Rice County) and International Falls (Koochiching County). Chaska, Chanhassen, Rogers, Mounds View, and Young America are the only metropolitan area cities with more than 20 percent of their total tax capacity captured by tax increment districts. In 1995, 107 Minnesota cities and towns had over 10 percent of their tax base captured in TIF districts; 76 were non-metropolitan cities and towns and 31 were metropolitan area cities and towns.

Table 2.4: Cities and Towns that Captured Over 20 Percent of Their Total Tax Capacity, 1995

In 1995, 107 cities had over 10 percent of their tax base captured in TIF districts.

<u>City or Town</u>	<u>Captured Tax Capacity</u>	<u>Percent of Total Tax Capacity</u>
Irondale Township	\$498,804	58.3%
Dundas	128,618	38.4
International Falls	2,032,433	36.4
Chaska	4,160,480	33.9
Young America	232,732	32.3
Des Moines Township	218,721	27.9
Buffalo	1,198,997	27.1
Gaylord	193,940	26.9
Annandale	266,774	26.4
Chanhassen	4,340,074	25.4
Sauk Rapids	1,007,314	25.1
Rush City	163,860	23.8
Dilworth	217,580	23.7
Rogers	492,672	23.6
Maynard	18,348	22.8
Mounds View	1,564,191	22.1
Waite Park	1,080,945	22.1
Dodge Center	192,172	22.0
Welcome	44,187	21.2
LaPrairie	56,261	21.0
Avon	120,646	20.9
Chisago City	243,583	20.3
Benson	146,713	20.2
Hinckley	238,261	20.2

Source: Program Evaluation Division analysis of Department of Revenue, Abstracts of Tax Lists data base.

Analysis of TIF Activity by City Size

We reviewed the amount of tax increment financing activity in cities of different sizes and found that:

- TIF districts in larger cities contained more parcels and captured more tax capacity in 1995 than districts in smaller cities and towns.

We divided cities and towns into three categories based on 1994 population estimates from the State Demographer's Office. We defined large cities as those with a population of over 20,000, medium-sized cities and towns as those with between 2,500 and 20,000 people, and small cities and towns as those with a population of less than 2,500.⁵ We then used the Minnesota Department of Revenue's TIF Supplement to determine the number of districts, their parcel size, and the amount of captured tax capacity for each district for taxes payable in 1995.⁶

In 1995, 346 cities and 15 towns had tax increment districts. All 40 of Minnesota's larger cities and 90 percent of medium-sized cities had at least one TIF district. About one-fourth of the cities with populations less than 2,500 had at least one tax increment district.

Table 2.5 shows the number of districts and captured tax capacity by city size. Although large cities contained 26 percent of the TIF districts, those districts accounted for over two-thirds of the total captured tax capacity in 1995. Medium-sized cities and towns contained 47 percent of the TIF districts but accounted for only 27 percent of the captured tax capacity, and small cities and towns contained 27 percent of the districts but accounted for only 5 percent of the captured value. Districts in large cities contained about four and one-half times more captured value, on average, than districts in medium-sized cities and towns (\$364,699 versus \$81,762), and districts in medium-sized cities and towns captured about three times more captured value per district than districts in small cities and towns (\$81,762 versus \$26,872).

Table 2.5: Captured Tax Capacity by City Size, 1995

<u>City Size</u> ¹	<u>Number of Districts</u>	<u>Percent of State's Districts</u>	<u>Captured 1995 Tax Capacity</u>	<u>Percent of Statewide 1995 Captured Tax Capacity</u>	<u>Average Captured Tax Capacity Per District</u>
Large (n = 40)	379	26%	\$138.2 million	68%	\$364,699
Medium (n = 138)	668	47	54.6 million	27	81,762
Small (n = 185)	389	27	10.5 million	5	26,872
All cities and towns with districts (n = 363)	1,436	100%	\$203.3 million	100%	\$141,568

Source: Program Evaluation Division analysis of Department of Revenue's 1995 TIF Supplement data base.

¹Large cities are those with over 20,000 people in 1994. Medium cities are those with between 2,500 and 20,000 people and includes two towns. Small cities are those with a population of less than 2,500 and includes 13 towns.

⁵ There were no towns with over 20,000 people. White Bear and St. Cloud Townships were the only two medium-sized towns with TIF districts in 1995.

⁶ The TIF Supplement contains 1,436 districts, including 98 TIF districts (7 percent) with no captured value in 1995. Most of these districts were recently created and the proposed development had not been completed or assessed yet. There were also some older districts where the hoped for development did not occur. We included all 1,436 districts in our analysis.

Table 2.6 shows the average number of districts per city and the average number of parcels per district.⁷ We found that large cities had, on average, about twice as many districts as medium-sized cities and towns. Medium-sized cities and towns had over twice as many districts per city as small cities and towns with TIF districts. There were an average of 60 parcels per district in large cities, compared with 22 in medium-sized cities and 13 parcels per district in small cities.

Table 2.6: Number and Size of Districts by City Size, 1995

<u>City Size¹</u>	<u>Average Number of Districts Per City</u>	<u>Average Number of Parcels Per District</u>
Large (n = 40)	9.5	60
Medium (n = 138)	4.8	22
Small (n = 185)	2.1	13
All cities and towns with districts (n = 363)	4.0	30

Source: Program Evaluation Division analysis of Department of Revenue's 1995 TIF Supplement data base.

¹Large cities are those with over 20,000 people in 1994. Medium cities are those with between 2,500 and 20,000 people and includes two towns. Small cities are those with a population of less than 2,500 and includes 13 towns.

Metro Versus Non-Metro Districts

We also examined the distribution of tax increment districts between the seven-county Twins Cities metropolitan area and outstate Minnesota. We found that:

- Cities in the seven-county metropolitan area had more and larger tax increment districts that captured more tax capacity, on average, than non-metropolitan cities with tax increment districts.

Table 2.7 shows that although the Twin Cities metropolitan area contained 37 percent of all TIF districts, those districts accounted for over three-fourths of the total 1995 captured tax capacity. The average TIF district in the Twin Cities metro area captured over five times as much tax capacity as the average non-metro district (\$287,207 versus \$54,572).

Table 2.8 shows that metro area cities had an average of 5.8 TIF districts per city compared with 3.3 districts per non-metro city. TIF districts in the metropolitan area were also larger, containing 50 parcels on average compared with 18 parcels for non-metro districts.

Metro area districts had over three-fourths of the total captured tax capacity.

⁷ The number of parcels is only an approximation of district size because parcel size can vary among districts.

Table 2.7: Captured Tax Capacity for Metro and Non-Metro Cities, 1995

<u>City Location</u>	<u>Number of Districts</u>	<u>Percent of State's Districts</u>	<u>Captured 1995 Tax Capacity</u>	<u>Percent of Statewide 1995 Captured Tax Capacity</u>	<u>Average Captured Tax Capacity Per District</u>
Twin Cities Metro Area (n= 93)	537	37%	\$154.2 million	76%	\$287,207
Non-Metro (n = 270)	899	63	49.1 million	24	54,572
Total	1,436	100%	\$203.3 million	100%	\$141,568

Source: Program Evaluation Division analysis of Department of Revenue's 1995 TIF Supplement data base.

Table 2.8: Number and Size of Districts for Metro and Non-Metro Cities, 1995

<u>City Location</u>	<u>Average Number of Districts Per City</u>	<u>Average Number of Parcels Per District</u>
Twin Cities Metro Area (n = 93)	5.8	50
Non-Metro (n = 270)	3.3	18
All cities and towns with Tax Increment Finance districts	4.0	30

Source: Program Evaluation Division analysis of Department of Revenue's 1995 TIF Supplement data base.

ANALYSIS OF TIF BY DATE OF DISTRICT CREATION

We divided districts into three time periods: pre-August 1979, August 1979 through April 1990, and post-April 1990. We found that:

- **Districts created before August 1979 were larger and captured more tax capacity than districts created later, and districts created after April 1990 were smaller and captured less tax capacity than districts created in the 1970s and 1980s.**

As noted in Chapter 1, TIF districts created before the Tax Increment Financing Act became effective on August 1, 1979 were given a 30-year duration until 2009 and were not required to file a financing plan, designate a district type, or abide by many of the other subsequent requirements of the act. These districts are commonly referred to as "pre-1979" districts. In 1990, the Legislature passed significant changes to the tax increment laws, including state aid reductions, restrictions on pooling, and more restrictive district definitions. Those changes became effective

tive for districts certified after April 30, 1990.⁸ These districts are referred to as "post-1990" districts.

Table 2.9 shows the parcel size and captured 1995 tax capacity by time period. In this table, we further divided the August 1979 to April 1990 period into three sub-periods to examine trends during the 1980s.⁹ We found that:

- On average, pre-1979 districts captured the most tax capacity, \$555,007 per district; districts created between August 1979 and April 1990 captured an average of \$135,622; the average post-1990 district captured \$26,967.
- Although pre-1979 districts represented only 8 percent of all active TIF districts, they accounted for 30 percent (\$61 million) of the total 1995 captured tax capacity. In contrast, post-1990 districts represented 24 percent of all districts but accounted for only 5 percent of the captured tax capacity.
- The average number of parcels per district declined from 146 for the pre-1979 districts to 25 for the August 1979-April 1990 districts and 8 for the post-1990 districts.

Table 2.9: Captured Tax Capacity and District Size by Time of Creation

Time of District's Creation	Number of Districts	Average Number of Parcels per District	Captured 1995 Tax Capacity	Percent of Statewide 1995 Captured Tax Capacity	Average Captured Tax Capacity Per District
Pre-1979	110	146	\$61.1 million	30%	\$555,007
August 1979 - April 1990					
August 1979 - December 1985	336	40	68.5 million	34	\$203,863
January 1986 - December 1988	339	19	43.0 million	21	126,971
January 1989 - April 1990	<u>305</u>	<u>14</u>	<u>21.4 million</u>	<u>11</u>	<u>70,062</u>
Sub Total	980	25	\$132.9 million	65%	\$135,622
Post-1990	346	8	\$9.3 million	5%	\$26,967
All Districts	1,436	30	\$203.3 million	100%	\$141,568

Source: Program Evaluation Division analysis of Department of Revenue's 1995 TIF Supplement data base.

Over half of the existing 346 post-1990 districts were certified in 1992 and 1993, so it is likely that some of the post-1990 districts were not yet fully developed and will capture more tax capacity in the future. We found that the average tax capacity of 167 districts created between May 1990 and December 1992 (that have had

⁸ Specifically, the 1990 law applies to all districts for which the city or development authority's request to the county auditor for certification was made after April 30, 1990.

⁹ We grouped these sub-periods based on captured values and parcel sizes for districts created during each year between August 1979 and April 1990.

more time to complete proposed development projects) was \$34,941, above the amount for all post-90 districts but still well below the average captured tax capacity of pre-1990 districts.

We also found that districts created during the early 1980s captured more tax capacity than those created in the late 1980s. For example, districts created between August 1979 and December 1985 captured an average of \$203,863 in 1995 tax capacity compared with districts created between January 1986 and December 1988, which captured an average of \$126,971 per district. Districts created between January 1989 and April 1990 captured an average of \$70,062.

We believe that refinements to the tax increment financing law during the 1980s (including definitions of districts, blight requirements, and changes in the way captured tax capacity is calculated) may have resulted in smaller districts that capture less tax capacity even before the more encompassing 1990 changes.

**Post-1990
districts were
smaller than
districts
created earlier.**

Table 2.10 shows the distribution of metropolitan and non-metropolitan districts by district type and time period.¹⁰ A higher percentage of metro area districts were created before August 1979 (11 percent versus 6 percent for non-metro districts) and a slightly higher percentage of non-metro districts were created after April 1990 (26 percent of the non-metro versus 20 percent of the metro districts). Over two-thirds of all active districts (68 percent) were created between August 1979 and April 1990.¹¹

TYPES OF TAX INCREMENT FINANCING DISTRICTS

Table 2.11 shows the average parcel size and captured 1995 tax capacity for different types of TIF districts. We found that:

- **Redevelopment and economic development districts are the most common type of district, together accounting for 79 percent of all districts.**
- **Post-1990 economic development districts have remained about the same size as pre-1990 districts (eight parcels per district), but the other types of post-1990 districts are considerably smaller than their pre-1990 counterparts.**

10 We found that county auditors reported the incorrect district type in the TIF Supplement for 37 of the 479 TIF districts in our sample cities (7.7 percent). We corrected those errors but we do not know if there were similar errors for the cities we did not visit.

11 Thirteen of the pre-1979 districts were in cities with less than 2,500 population (accounting for 3 percent of all small city tax increment districts), 52 were in cities with between 2,500 and 20,000 population (8 percent of medium-sized city tax increment districts) and 45 were in cities over 20,000 population (12 percent of large city tax increment districts). Post-1990 districts made up 17 percent of the large city districts, 24 percent of the medium-sized city districts, and 32 percent of the small city districts.

Table 2.10: Types of Tax Increment Financing Districts in Metro and Non-Metro Cities by Time of Creation

Type and Year of District	Metro Districts		Non-Metro Districts	
	Number	Percent	Number	Percent
Pre-1979	58	11%	52	6%
August 1979 - April 1990				
Redevelopment	200	37%	295	33%
Housing	49	10	69	8
Economic Development	116	22	246	27
Soils Condition	5	1	0	0
Sub Total	370	69%	610	68%
Post-1990				
Redevelopment	42	8%	93	10%
Housing	21	4	28	3
Economic Development	36	7	108	12
Soils Condition	8	2	5	1
Renewal and Renovation	2	0	3	0
Sub Total	109	20%	237	26%
Total	537	100%	899	100%

Source: Program Evaluation Division analysis of Department of Revenue's 1995 TIF Supplement data base.

Table 2.11: Captured Tax Capacity and District Size by Type of District and Time of Creation

Type of District	Number of Districts	Percent of State's Districts	Average Number of Parcels Per District	Average Captured 1995 Tax Capacity Per District
Pre-1979	110	8%	146	\$555,007
August 1979 - April 1990				
Redevelopment	495	34%	30	\$183,511
Housing	118	8	53	100,026
Economic Development	362	25	8	81,875
Soils Condition	5	0	19	125,988
Post-1990				
Redevelopment	135	9%	9	\$14,607
Housing	49	3	7	20,968
Economic Development	144	10	8	37,075
Soils Condition	13	1	5	72,564
Renewal and Renovation	5	0	3	9,772
All Districts	1,436	100%	30	\$141,568

Source: Program Evaluation Division analysis of Department of Revenue's 1995 TIF Supplement data base.

- **The average captured tax capacity for post-1990 districts was less than the average captured tax capacity for pre-1990 districts for all types of districts. The difference was greatest for redevelopment districts, which declined from \$183,511 for pre-1990 districts to \$14,607 for post-1990 districts.**

SUMMARY

There were 1,436 TIF districts in 363 Minnesota cities and towns in 1995; 1,338 of those districts (in 357 cities and towns) captured some tax capacity. Tax increment districts captured a total of \$203.3 million of 1995 tax capacity, an increase of 1 percent over the prior year. Larger cities and cities in the Twin Cities metropolitan area had districts with more parcels and more captured tax capacity than smaller and non-metropolitan area cities. On average, TIF districts created before the 1979 Tax Increment Financing Act were larger and captured a larger share of 1995 tax capacity than districts created after 1979. Post-1990 districts were smaller and captured less tax capacity than districts created in the 1970s and 1980s. These findings suggest that changes in the tax increment financing law in the 1980s and in 1990 have resulted in fewer large multi-purpose districts that generate large tax increments. In Chapter 3, we discuss the recent use of TIF in our sample cities and counties.

Analysis of Recent Uses of Tax Increment Financing

CHAPTER 3

The Legislature made significant changes to the tax increment financing law in the late 1980s and in 1990. Legislative debate about further changes in 1995 once again elevated interest in the use of TIF, but statewide information on specific city uses of tax increment financing was not readily available. As a result, we visited cities and counties to evaluate their use of TIF.

We asked the following questions:

- **How have cities and other development authorities been using tax increment financing in recent years? What are the current trends in financing for TIF projects?**
- **To what extent have legislative restrictions limited the ability of cities and other development authorities to pursue development projects?**

To obtain detailed information on the use of tax increment financing in Minnesota, we selected a non-random sample of 43 cities and 3 counties currently using TIF. In our sample, we included cities with a large number of post-1990 TIF districts, cities with large amounts of total captured tax capacity and with a variety of tax increment districts, and a combination of large and small cities from various parts of the state.¹ Finally, we included active users of TIF before 1990 who have not certified any new districts since 1990.

This evaluation looked at how a sample of cities are using TIF.

For each of the cities and counties in our sample, we reviewed the TIF plans and 1994 annual disclosure, financial, and bonded indebtedness reports. After this review, we traveled to the cities and counties to discuss the districts with local officials, including city or county administrators, finance directors, and community or economic development directors.² As time permitted, we visited tax increment sites. Following the site visits, we verified district information by telephone and we asked city officials to review summaries of their districts for accuracy.

¹ We relied on data reported by county auditors to the Department of Revenue in the TIF Supplement to develop the sample. As discussed in Chapter 2, the TIF Supplement contained some errors in identifying the type of district which affected our sample selection. For example, we selected some cities thinking that they had post-1990 economic development districts. When we examined the TIF plans, however, we found that some of these districts were actually redevelopment districts.

² We conducted telephone interviews with city officials from East Grand Forks, International Falls, and North Branch.

The cities and counties visited for this study represent about 13 percent of the local jurisdictions using tax increment financing. The TIF districts in the sample captured \$122 million in tax capacity in 1995, representing 60 percent of the total captured tax capacity in Minnesota for 1995. Table 3.1 shows the captured tax capacity of cities and development authorities we visited; Table 3.2 shows the types of districts for each city and development authority visited. Appendix A lists the cities and counties we visited. A separate document, *Description of Selected Tax Increment Financing Districts*, contains a summary of over 400 tax increment districts in those cities and counties.

Table 3.1: Captured Tax Capacity in Cities Visited, 1995

	Number of Districts	Total City Tax Capacity	Total Captured Tax Capacity	Percent of City Tax Capacity That Is Captured
METRO AREA				
Bloomington	13	\$127,643,351	\$14,858,999	11.6%
Brooklyn Park	11	36,359,513	3,986,377	11.0
Burnsville	4	58,738,039	1,693,005	2.9
Chaska	8	12,268,049	4,160,480	33.9
Dakota County ¹	9	—	1,505,929	—
Eagan	3	59,299,204	593,573	1.0
Edina	6	84,055,819	5,162,771	6.1
Farmington	11	3,683,003	283,950	7.7
Fridley	10	27,545,541	2,642,692	9.6
Hopkins	13	15,510,773	1,021,176	6.6
Maple Grove	7	33,008,438	2,232,946	6.8
Minneapolis	52	317,158,321	40,424,769	12.8
Oakdale	13	11,662,563	1,001,348	8.6
Plymouth	16	71,428,665	4,673,782	6.5
Richfield	7	20,495,008	2,219,234	10.8
Roseville	15	42,803,926	4,793,226	11.2
St. Paul	9	158,302,112	10,388,009	6.6
Shakopee	6	14,785,689	1,730,528	11.7
Vadnais Heights	24	10,230,240	1,355,779	13.3
White Bear Lake	25	14,959,687	1,368,798	9.2
Woodbury	7	24,938,450	1,495,910	6.0
METRO AREA TOTALS	269	\$1,144,876,391²	\$106,087,352²	9.3%²
NON METRO AREAS				
Albert Lea	11	\$7,399,062	\$441,595	6.0%
Alexandria	11	5,904,696	171,362	2.9
Becker	2	31,385,629	1,181,727	3.8
Branch	1	1,478,799	242,266	16.4
Buffalo	7	4,419,120	1,198,997	27.1
Cloquet	3	6,428,161	547,014	8.5
Crow Wing County ³	2	855,196	498,804	58.3
Detroit Lakes	14	4,605,903	353,762	7.7
Dodge Center	9	871,800	192,172	22.0
Dundas	2	335,170	128,618	38.4
East Grand Forks	6	3,359,545	126,191	3.8
Elk River	9	9,895,736	571,376	5.8
Fairmont	16	4,601,327	209,462	4.6
Glencoe	10	2,141,810	330,385	15.4

Table 3.1: Captured Tax Capacity in Cities Visited, 1995, continued

	Number of Districts	Total City Tax Capacity	Total Captured Tax Capacity	Percent of City Tax Capacity That Is Captured
NON METRO AREAS, cont.				
Hibbing	6	5,833,873	158,654	2.7
International Falls	3	5,585,707	2,032,433	36.4
Little Falls	13	2,924,227	342,214	11.7
Mankato	21	19,306,756	1,530,820	7.9
Marshall	11	7,640,413	1,280,943	16.8
Morrison County ⁴	3	--	21,894	--
Nisswa	8	2,540,285	96,515	3.8
Red Wing	8	32,214,609	919,222	2.9
Renville	7	321,307	12,345	3.8
St. Cloud	17	31,683,297	2,747,850	8.7
Winona	10	11,372,494	640,574	5.6
NON METRO TOTALS	210	\$203,104,922 ⁵	\$15,955,301 ⁵	7.9% ⁵
STATEWIDE TOTALS	479	\$1,347,981,313	\$122,042,653	9.1%

Source: Office of the Legislative Auditor determined the number of districts. The tax capacity data are from the Minnesota Department of Revenue Abstract of Tax Lists.

¹The Dakota County Housing and Redevelopment Authority (HRA) has tax increment districts in ten communities.

²Metropolitan area totals exclude Dakota County HRA tax increment activity.

³Both of Crow Wing County HRA's tax increment districts are in Irondale Township. Tax capacity data includes Irondale Township only.

⁴The Morrison County Rural Development Finance Authority (RDFA) has tax increment districts in two townships and one city.

⁵Non-metropolitan area totals exclude Morrison County RDFA tax increment activity.

ANALYSIS OF SAMPLE CITIES AND COUNTIES

In this section we examine how cities and development authorities have been using tax increment financing in recent years. In particular, the section looks at the types of activities and projects in districts certified after April 30, 1990, compares the nature of tax increment spending between pre-1990 and post-1990 districts, examines trends in pooling and financing, and reviews the financial status of districts.

Supported Activities and Projects

Cities and development authorities have created 346 tax increment districts since enactment of the 1990 legislative amendments. To determine how cities and counties are using TIF, we reviewed the 172 post-1990 districts in the cities and counties we visited. In this section, we discuss the types of development activities

Table 3.2: Types of Tax Increment Districts in Cities Visited

City	Pre-1979	Pre-1990 TIF Activity				Post-1990 TIF Activity				Total
		Redevelopment	Economic Development	Housing	Soils Condition	Redevelopment	Economic Development	Housing	Soils Condition	
Bloomington	1	6	2	3	0	1	0	0	0	13
Brooklyn Park	0	1	4	0	1	4	0	1	1	11
Burnsville	0	2	1	0	0	0	0	1	0	4
Chaska	0	1	3	1	2	1	0	0	0	8
Dakota County	0	1	0	4	0	0	4	0	0	9
Eagan	0	0	1	1	0	1	0	0	0	3
Edina	2	2	2	0	0	0	0	0	0	6
Farmington	1	0	1	0	1	7	0	1	1	11
Fridley	1	5	1	0	3	0	0	0	0	10
Hopkins	6	4	0	0	1	1	1	0	0	13
Maple Grove	0	1	2	1	0	3	0	0	0	7
Minneapolis	24 ^a	15	1	5	5	0	1	1	1	52
Oakdale	0	3	4	0	0	1	3	1	1	13
Plymouth	0	0	13	0	1	1	0	1	1	16
Richfield	1	1	1	0	4	0	0	0	0	7
Roseville	0	10 ^b	1	1	2	0	0	1	1	15
St. Paul	1	8 ^c	0	0	0	0	0	0	0	9
Shakopee	2	2	2	0	0	0	0	0	0	6
Vadnais Heights	0	8	8	0	3	4	1	0	0	24
White Bear Lake	0	5	5	3	2	3	0	6	0	25
Woodbury	0	1	5	1	0	0	0	0	0	7
METRO TOTALS	39	76	57	20	25	27	10	13	269	

Table 3.2: Types of Tax Increment Districts in Cities Visited, continued

City	Pre-1979	Pre-1990 TIF Activity				Post-1990 TIF Activity				Total
		Redevelopment	Economic Development	Housing	Soils Condition	Redevelopment	Economic Development	Housing	Soils Condition	
Albert Lea	0	2	4	1	0	0	0	0	0	11
Alexandria	0	2	3	0	0	0	1	0	0	11
Becker	0	1	0	0	0	0	1	0	0	2
Branch	0	0	0	0	0	0	0	1	1	1
Buffalo	1	0	4	0	0	0	1	0	1	7
Cloquet	0	0	1	0	0	0	2	0	0	3
Crow Wing County	0	0	1	0	0	0	0	1	0	2
Detroit Lakes	0	5	3	0	0	4	4	0	0	14
Dodge Center	0	2	0	1	0	3	3	2	0	9
Dundas	0	2	0	0	0	0	0	0	0	2
East Grand Forks	0	2	1	0	0	3	0	0	0	6
Elk River	0	2	2	1	0	1	2	1	0	9
Fairmont	0	7	1	0	0	6	2	0	0	16
Glencoe	1	2	1	2	0	2 ^d	1	1	0	10
Hibbing	0	2	0	0	0	3	0	1	0	6
International Falls	0	1	1	0	0	1	0	0	0	3
Little Falls	1	1	5	0	0	2	4	1	0	13
Mankato	2	4	6	2 ^e	0	3	4	0	0	21
Marshall	0	7	1	2	0	0	0	0	1	11
Morrison County	0	0	0	0	0	1	2	0	0	3
Nisswa	0	2	1	0	0	2	2	1	0	8
Red Wing	2	0	0	0	0	3	3	0	0	8
Renville	0	0	0	0	0	3	4	0	0	7
St. Cloud	1	5	2	1	0	1	7	0	0	17
Winona	1	8	1	0	0	0	0	0	0	10
NON-METRO TOTALS	8	57	38	10	0	38	47	9	3	210
STATEWIDE TOTALS	47	133	95	30	2	63	74	19	16	479

Source: Office of the Legislative Auditor.

^aTwo pre-1979 districts have hazardous substance subdistricts that were certified in 1994.

^bOne district has a hazardous substance subdistrict.

^cOne district qualifies as both a redevelopment and housing district and one district has a hazardous substance subdistrict.

^dOne of these districts is a renovation and renewal district.

^eOne of these districts is certified as both a housing and a redevelopment district.

supported by TIF -- manufacturing, retail, office, and housing.³ We were not able to categorize every district, and some districts served more than one purpose. Of those districts we could categorize, we found that:

- **About two-fifths of the post-1990 districts were created to assist new or existing manufacturing businesses, while office developments, retail facilities, and housing projects each accounted for one-fifth of the districts.**

Manufacturing

About two-fifths of the post-1990 TIF districts created by cities and counties in our sample assisted manufacturing companies with land acquisition, site preparation, or other public improvements. Most of these districts were economic development districts (76 percent), but some cities used soils condition and redevelopment districts, if the district qualified, to assist manufacturing companies.

Most TIF-assisted manufacturing companies were local businesses that wanted to expand.

We estimate that the majority (about three-fourths) of the manufacturing companies receiving TIF assistance were local businesses that wanted to expand. City officials told us that these businesses had outgrown their existing location and were considering options for expanding, including relocating to other Minnesota cities or to other states. Some city officials told us about companies in their cities that received offers of financial assistance to move to Wisconsin, Iowa, and other states. We have not attempted to verify those claims. However, a recent article claimed that at least 31 industrial parks have been constructed in three Wisconsin border counties (Polk, St. Croix, and Pierce) in the last 30 years. The manufacturing tax bases of those counties' have increased by 28 to 43 percent between 1994 and 1995.⁴ City officials felt that unless their cities provided assistance, companies would leave and the cities would lose both jobs and tax base. Cities created the following TIF districts to assist existing manufacturing companies:

- *Bloomington (Seagate)*: The city created this economic development district to facilitate the expansion of Seagate Technologies, an international manufacturer of disk drives, in the city. Tax increments will assist with public improvements (including storm and sanitary sewers and a water main), parking lot improvements, landscaping, and soil corrections. The expansion will create 150 administrative jobs and 350 production jobs.
- *Elk River (Tescom)*: A local manufacturer of regulators, valves, and control devices was looking at expansion options. Elk River created an economic development district in 1993, provided a land write-down on a

³ Manufacturing includes printing companies, computer software, agricultural/value added processing, and food production. Offices include banks, medical buildings, and other professional office buildings, along with wholesale distribution and mail order processors and distributors. Retail includes hotels and motels, and service and repair centers.

⁴ Cassano, Dennis, "Officials in Wisconsin, Minnesota See Need to Coordinate Development," *Star Tribune*, November 12, 1995, p. D1. One city official showed us a letter to a local company from a St. Croix County developer, highlighting Wisconsin's lower tax rates and workers compensation costs and inviting the company to relocate there.

vacant site adjacent to the company's existing facility in the industrial park, and assisted with site preparation and soil testing.

- *Glencoe (Seneca)*: Seneca Corporation, owner and operator of an old Green Giant facility in Glencoe with 165 full-time jobs and nearly 2,000 seasonal jobs, threatened to build a new cold storage facility in another city. Glencoe created an economic development district in 1994 to assist with site preparation, utility extensions, and construction of footings, foundations, and a parking lot.
- *Nisswa (D & H Docks)*: A local manufacturer of boat docks constructed a new manufacturing facility in this 1993 economic development district. The city used TIF to reimburse the developer for land acquisition and site improvements.
- *St. Cloud (Woodcraft)*: A wooden cabinet door company was considering moving to Kentucky. The city created an economic development district in 1991 to assist the company with land acquisition for expansion of its manufacturing facility. The city amended the tax increment financing plan in 1994 to provide TIF assistance for site preparation (including tree removal, excavation, landscaping, and paving) for another expansion.

While city officials are primarily concerned with retaining existing businesses, about one-fourth of manufacturing companies receiving TIF assistance were new companies or were new to the city. City officials told us that many companies shop around to try to get the best deal. As a result, cities use TIF to compete with one another for new businesses. Cities with industrial parks sometimes offer free land and public improvements, such as utilities and street extensions. Cities created the following TIF districts to help companies establish new manufacturing facilities:

**Cities also use
TIF to compete
with one
another for
businesses.**

- *Little Falls (Monarch Plastics)*: This 1995 economic development district in the city's industrial park assisted a new company with construction of a facility for reprocessing plastic waste into usable products. The city assisted with land acquisition, site improvements, and parking.
- *Becker (Liberty Paper)*: The company wanted to construct a cardboard recycling facility near a power plant in order to use steam in its production process. It had explored sites in Wisconsin and Mankato. Becker created an economic development district in 1993 to acquire property, purchase recycling equipment, extend utilities, improve streets, install sidewalks, construct a railroad spur and crossings, and construct a new city water tower to provide water pressure for fire fighting requirements. Mankato also established a TIF district for this facility, but its plans fell through when the company decided to accept Becker's offer.
- *Renville (Egg Production Facility)*: A joint venture of three regionally owned farmer cooperatives asked the city for assistance with construction

of 16 laying barns, one processing building to wash, pack, and prepare egg products for shipment, and a conveyor. Renville created two economic development districts (in 1994 and 1995) to provide a land write-down, extend utilities to the site, and provide site improvements, including grading, foundation work, and parking.

The following examples illustrate how cities have used TIF to attract companies from other Minnesota cities:

- *Buffalo (Whirltronics)*: A manufacturer of lawn mower blades previously located in Brooklyn Park was looking at a number of Minnesota communities for an expansion site. Buffalo created an economic development district in 1991 in its industrial park and constructed a manufacturing facility that it leases to Whirltronics.
- *Detroit Lakes (D. L. Printing)*: D.L. Printing, a subsidiary of the Fargo Forum, wanted to expand from its existing site in Hawley. Detroit Lakes created an economic development district in 1992 to assist with site acquisition and improvements for a new printing plant for the regional newspaper. City officials think that the company would have located in Fargo without TIF assistance.
- *Farmington (Minnesota Pipe)*: This 1994 economic development district helped a Lakeville pipe distributor relocate to Farmington's industrial park. The city sold the company a lot in the industrial park for \$1 and assisted with site preparation.
- *Red Wing (Advertising Unlimited)*: A manufacturer of executive gifts was previously located in Maplewood. Red Wing's Port Authority created an economic development district in 1992, provided a land write-down, assisted with site improvements, and abated street assessments and utility connection fees for construction of a new manufacturing facility. The company recently acquired a Connecticut company and plans to consolidate operations in Red Wing in 1996.

In the following example, a city used TIF to attract a Canadian company:

- *Red Wing (Industrial Hardwood Products)*: A Canadian manufacturer of wood flooring for truck trailers was considering locations in Minnesota, Wisconsin and Iowa. The Port Authority established a redevelopment district in 1992 on the site of a vacant industrial building, acquired the site, made substantial improvements to the building, and rented part of the building to Industrial Hardwood Products.

Office Buildings

About one-fifth of the TIF districts created since April 1990 assisted office developments, ranging from large office and warehouse facilities to small professional office buildings. These projects were located primarily in economic development

and redevelopment districts, but several were in soils condition districts.⁵ The following TIF districts were created to assist office buildings:

- *Brooklyn Park (CSM)*: The city established this economic development district in 1993 to help develop the Boone Avenue Business Center, a 168,000 square foot multi-tenant office, showroom, and warehouse facility. Tax increment financing assisted the developer with land acquisition costs.
- *Fairmont (S.R.S. Partnership)*: The city created a redevelopment district in 1994 to demolish an old school house and some abandoned homes. A developer constructed a professional office building on the site.
- *Oakdale (Oakdale Crossing Business Park)*: This 1993 economic development district consists of 82 acres of vacant land near I-694 and I-494. A developer will construct an office/warehouse park in four phases. Tax increments will reimburse the developer for land acquisition and installation of streets and utilities. The park's first tenant, Spartan Promotional Group, Inc., constructed a 25,000 square foot office/warehouse complex.
- *Plymouth (P.O.S.)*: The city created this soils condition district in 1994 to assist a computer software peripherals and training company with construction of an office building. TIF will assist with soil correction costs including removal of topsoil and installation of a storm sewer and drain tiling system.
- *Red Wing (Durkee Atwood)*: Previously, the district contained an old factory in substandard condition. The property owner gave the site to the Port Authority. The city created a redevelopment district in 1992 and used TIF to remove asbestos and demolish the building. A developer bought the site for \$25,000 and constructed an office building.

Housing

About one-fifth of the TIF districts created since April 1990 have been for housing. About half of these districts were housing districts providing low- and moderate-income housing and the remainder were redevelopment and soils condition districts for market-rate housing. TIF assistance for projects in housing districts often includes financial assistance for land acquisition and site improvements. Several jurisdictions in our sample used TIF to provide interest rate reduction loan programs to make housing units affordable. In some housing districts, development authorities used TIF in combination with other forms of financing such as Minnesota Housing Finance Agency resources, including housing tax credits. However, city officials also told us that federal housing finance assistance had declined considerably. In their opinion, housing developments usually do not pro-

⁵ The Legislature restricted the use of economic development districts in 1990. At least 85 percent of the buildings and facilities (based on square footage) must be used for manufacturing, warehousing, and other related activities. We found that TIF supported many office/warehouse developments in post-1990 economic development districts, but we did not determine if warehouse space was at least 85 percent of the total project.

vide sufficient financial incentives to attract many developers, so TIF is necessary to make projects economically feasible. We also found some low-density housing districts that required the use of pooled tax increments from other districts to meet financial obligations.

The following are examples of TIF-assisted housing projects in post-1990 districts:

TIF supported both affordable and market-rate housing projects.

- *Dakota County HRA (Apple Valley Family Housing)*: The HRA created this housing district in 1991 to provide assistance to two projects. Tax increments provide an interest rate reduction loan to a 39-unit multi-family rental housing project. A 50-unit senior rental housing facility, which the HRA constructed, owns, and operates, received TIF assistance for land acquisition, public improvements, and soil tests and surveys.
- *Roseville (College Properties)*: This 1993 redevelopment district contained a run-down hotel and bar. The city used TIF to provide a land write-down for a multi-use housing project, including a 57-unit motel, 90 assisted-living units, and 140 independent-living units for seniors. A future project includes a 36-bed residential facility for Alzheimer's patients.
- *Richfield (Richfield Rediscovered Housing Program)*: This program includes four redevelopment districts created in 1991 and 1993 in which the city purchases substandard single-family homes at their appraised value, demolishes them, and sells the parcels to developers for construction of market-rate homes. The city has identified 70 houses to participate in the program. City officials hope that the replacement of blighted homes will encourage new families to move into the city and existing homeowners to maintain their properties.
- *Farmington (Soils Condition District)*: A developer approached the city for assistance to construct up to 426 single-family homes and 132 multi-family townhome units. The city created this 173-acre district in 1994 to finance soil correction of lowlands. Plans include adding three feet of soil to raise the ground level, upgrading city water and sewer lines, and constructing a waterway to control flooding and provide drainage.

Retail

For the most part, 1990 statutory restrictions have limited economic development districts to assisting manufacturing and related activities, as defined in the TIF Act. However, cities have continued to use redevelopment districts and soils condition districts to assist retail developments. Retail developments accounted for about one-fifth of the post-1990 TIF projects in our sample.

City officials told us that they often use TIF to redevelop blighted buildings in their commercial districts. Many small city officials told us that TIF is crucial to maintaining the vitality of their downtowns, and that, without it, businesses would build on vacant lots or other locations where it is less costly to build. In the fol-

lowing examples, cities created retail-related redevelopment districts to renovate existing buildings or replace vacant or blighted buildings with new ones:

- *Alexandria (Woodsmen Distributing)*: The city created this redevelopment district in 1995 to demolish a substandard house, five cabins, and two garages (some of the structures were fire-damaged), allowing for construction of a retail store and service center for a local distributor of all terrain vehicles. The city will provide TIF assistance for land acquisition, demolition, site preparation, and public improvements.
- *Chaska (FMG)*: This 1991 redevelopment district contained a fire-damaged cosmetic and soap outlet store. The city used TIF to acquire the property, demolish the building, and prepare the site for construction of a retail music store.
- *Farmington (City Center)*: The city created this redevelopment district in 1991 to develop abandoned railroad property and clean up an old city dump. The city used TIF to acquire the railroad property, prepare sites, improve streets, purchase and demolish an existing manufacturing facility, and construct a parking lot for the Farmington City Center, a complex of shops including a grocery store, medical office, and other retail shops.
- *Minneapolis (Ninth Street and Hennepin Avenue)*: This 1995 redevelopment district consists of three parcels. The Minneapolis Community Development Agency acquired the old Hirschfelds building, made interior and exterior improvements, and leased it to Hey City Stage, a theater production company. The city plans to acquire two additional buildings and renovate them for development of a restaurant.
- *St. Cloud (Lincoln/Target)*: This 1993 redevelopment district previously contained a printing company that moved to the industrial park, an abandoned city maintenance garage, and abandoned railroad property. The city used TIF to pay for site acquisition, demolition, and clean up of contaminated soils. It leased the site to Target, which helped pay for soil clean-up and constructed a retail store.

Some cities have used soils condition districts to provide TIF assistance to large retail developments, as the following examples show:

- *Branch (Tanger Factory Outlet Center)*: This 1992 soils condition district consists of 20 acres of vacant land. The city created the district to assist with development of a 140,000 square foot retail outlet center. The city used TIF to finance water system, drainage and street improvements, and soil correction costs.
- *Brooklyn Park (Wal-Mart)*: The city created this district in 1992 to assist with construction of a 116,000 square foot Wal-Mart store. Topsoil was removed to provide a stable foundation for construction.

**Most recent
retail projects
were in areas
needing
redevelopment.**

**Some cities
relied on soil
conditions to
justify
TIF-assisted
retail projects.**

- *Buffalo (Target)*: An undeveloped 16-acre site had unstable soils. The city created this district in 1992 to reimburse a developer for soil correction costs. An 86,500 square foot retail facility has been constructed on the site.

Soils Condition Districts

Cities have used soils condition districts to assist all types of development activities including manufacturing, offices, retail, and housing projects. White Bear Lake accounted for 6 of the 17 post-1990 soils condition districts in our sample cities. According to city officials, White Bear Lake has soft and unstable soils in many parts of the city. As a result, White Bear Lake has removed or replaced topsoil to provide a secure foundation for construction. Other cities have cited similar conditions to justify creation of soils condition districts. In 1995, the Legislature restricted the use of soils condition districts to contamination and pollution clean-up, so conditions such as unusual terrain and unstable soils will no longer qualify for creation of soils condition districts. However, if bedrock conditions are present and other conditions are met, tax increments from economic development districts can be used to pay for site preparation and public improvements.⁶

Project Area and District Configurations

Before enactment of the TIF Act of 1979, most cities' tax increment districts were coterminous with their project areas. As a result, many pre-1979 tax increment districts were very large and captured sizable amounts of tax capacity.⁷ The TIF Act permitted cities to establish tax increment districts that were smaller than the project areas of which they were a part.

Our sample included a number of pre-1979 districts that contain most or all of a city's central business district.⁸ These include: St. Paul with 1,062 parcels; Buffalo with 492 parcels; Hopkins with 299 parcels in its 6 North Sector districts; Red Wing with 168 parcels in 2 downtown districts; Mankato, 102 parcels; Farmington, 71 parcels; Glencoe, 61 parcels; and St. Cloud, 46 parcels.

Other large pre-1979 districts include Edina's Southeast district (2,013 parcels which consists primarily of condominium and townhouse developments), Richfield's Lyndale/Hub/Nicollet district (806 parcels), and Minneapolis' pre-1979 districts (which range up to 1,424 parcels).

The TIF Act of 1979 included provisions designed to contain the size of TIF districts, such as blight criteria, the "knock-down provision," and the opportunity to

⁶ *Minn. Laws* (1995) Ch. 264, Art. 5, Sections 13 and 24.

⁷ Data presented in Chapter 2 confirm that existing pre-1979 districts contain more parcels and capture a greater share of tax capacity than TIF districts certified after August 1, 1979.

⁸ The number of parcels listed is the current number of parcels in the district as reported by county auditors to the Department of Revenue for taxes payable in 1995. The number of parcels is an imperfect indicator of district size because there is no uniform parcel size. A parcel may be one city lot, a city block, or large tracts of undeveloped land. It may also be individual units in a townhome or condominium development.

create project areas and tax increment districts of different sizes (described in Chapter 1). Our analysis of districts certified after 1979 found that some cities have created small districts, containing only the area directly benefited by the project. However, we also found that some cities continued to create large tax increment districts during the 1980s. Table 3.3 lists the largest districts created between 1979 and April 30, 1990 in the cities we visited.

Table 3.3: Large Tax Increment Districts Established Between 1979 and 1990 in Sample Cities and Counties

<u>City</u>	<u>District</u>	<u>Parcels</u>
St. Paul	New Housing/Blighted Lands TID	722
	Neighborhood Business Development TID	598
	Energy Park TID	246
	River Front TID	201
Dakota County	Multiple Cities TID 2	684
	North Robert Street and Smith Avenue TID	135
St. Cloud	SCSU TID	670
Maple Grove	Eagle Ridge Apartments HRA TID	448
Burnsville	Billy Goat Sienna TID	305
	Development District Number One	290
Chaska	Flood Control TID	213
Brooklyn Park	85th Avenue Improvements TID	122
Winona	River Front TID	117
Roseville	Villa Park TID	116

Source: Minnesota Department of Revenue, Property Tax Division, TIF Supplement.

In Chapter 2, we noted that the parcel size of tax increment districts has declined from an average of 146 parcels for pre-1979 districts to 8 parcels for post-1990 districts. Still, some cities created post-1990 districts containing a large number of parcels: Inver Grove Heights (economic development district with 367 parcels); Ramsey (economic development district with 260 parcels); Mahtomedi (redevelopment district with 118 parcels); Mille Lacs County (redevelopment district with 107 parcels); Itasca County (redevelopment district with 103 parcels); and Albany (redevelopment district with 103 parcels).

We also examined the size of cities' project areas. While the tax increment district contains the properties from which revenues will be collected, the project area consists of those properties on which tax increments can be spent. The TIF Act places some limitations on expanding the size of a TIF district, but there are no restrictions on increasing the size of project areas. In our sample, we found that:

- **Some cities have very large project areas that encompass entire cities or large portions of them.**

For example, 9 of 46 jurisdictions in our sample had project areas that are the same as the city or county boundaries. These jurisdictions are Crow Wing County and the cities of Becker, Burnsville, Elk River, Hibbing, Little Falls, Nisswa, and Roseville. Some cities have recently expanded their project areas. For example, Burnsville amended its project area in February 1995, making it the same as the city limits. Similarly, Crow Wing County expanded its project area to be coterminous with the county boundaries in 1995.

Many cities have created large project areas to pool tax increments.

Other cities have very large project areas that include most, if not all, land within the city limits. For example, Albert Lea's project area contains nearly two-thirds of the city. Shakopee's project area includes most of the developed area within the city. Most of the developed portion of International Falls is also in a project area. In addition, several cities use one project area that contains all tax increment districts. When a city certifies a new district, the project area is expanded to include that district and the TIF plans for all prior districts are amended to reflect the new expanded project area. The following cities structured their districts and project areas in this manner: Brooklyn Park, Marshall, Fairmont, Plymouth, Vadnais Heights, and White Bear Lake.

Many cities and development authorities have created large project areas to pool tax increments between two or more districts or to spend tax increments outside the boundaries of the district. We found that:

- **Of the cities and counties in our sample with more than one tax increment district, two-thirds have pooled tax increment revenues between districts or have project area configurations that will permit pooling.**

For example, Vadnais Heights has pooled the tax increments from several districts to finance construction of a water tower and bridge over an interstate highway and related road improvements. Glencoe uses pooled tax increments from one of its successful districts to support an industrial park development that has not been self-supporting. While Burnsville does not pool increments among its pre-1990 districts, in 1995 it combined three project areas into one that was coterminous with the city boundaries. The city also authorized \$25 million in increased tax increment spending for future commercial and industrial projects located throughout the city. Roseville pools all of its pre-1990 tax increment districts, and has used tax increments to finance an outdoor ice oval, an indoor ice arena, and other public projects.

We did not see evidence of pooling with post-1990 districts, primarily because over half of the existing post-1990 districts were certified in 1992 and 1993, following a slowdown in activity after the 1990 legislative restrictions became effective. Many post-1990 districts are just starting to generate tax increment revenues needed to finance projects in the original TIF plan. In addition, legislative restrictions on pooling and spending of tax increments from post-1990 districts were

It is too early to evaluate 1990 legislative restrictions on TIF spending.

intended to limit pooling from these districts.⁹ However, it is still too early to determine the full impact of these restrictions on post-1990 districts.

Expenditure Trends

We gathered information on tax increment expenditures from TIF plans filed with the Minnesota Department of Revenue. These plans are supposed to contain a list of development activities along with estimates of project costs. We also reviewed 1994 annual financial reports that contain amounts budgeted and actually spent on: acquisition of land and buildings, site improvements and preparation costs, installation of public utilities and other public improvements, and administrative costs.¹⁰ Because these categories are broad, a more detailed analysis is not possible. A separate document, *Description of Selected Tax Increment Financing Districts*, provides a description of tax increment projects, including expenditures when available, for the TIF districts in the cities and counties we visited.

General Trends

Based on analysis of information from the cities and counties in our sample, we found:

- **The majority of both pre- and post-1990 districts use tax increments to provide land write-downs to developers.**
- **Public improvements financed with tax increments from post-1990 districts focused more on individual projects than pre-1990 districts.**

We compared tax increment expenditures for "pre-1990" districts (or districts for which certification was requested on or before April 30, 1990, including pre-1979 districts) and post-1990 districts (or districts certified after April 30, 1990). Cities used tax increments to provide land write-downs in over half of the pre-1990 districts. In addition, cities and development authorities used tax increments to finance a wide variety of public and site improvements. Figures 3.1 and 3.2 summarize the types of improvements financed with TIF from both pre-1990 and post-1990 districts in the cities we visited.

Figure 3.1 shows that many cities used tax increments from pre-1990 districts to extend city services to newly developing parts of cities, extend public utilities to development sites, improve existing local streets and roads, construct parking lots or ramps, make general downtown improvements, improve drainage and ponding, and correct poor soil conditions. The use of tax increments to finance major

⁹ For TIF districts certified after April 30, 1990 and before June 30, 1995, no more than 25 percent of the tax increments may be pooled. For districts certified after June 30, 1995, no more than 20 percent of the tax increments generated may be pooled. However, redevelopment districts remain at 25 percent. In addition, tax increments from districts certified after April 30, 1990 must be spent on activities for which bonds have been issued or binding legal commitments have been made within five years after the district's approval. Tax increments received after the five-year period must be used to pay these obligations and decertify the district.

¹⁰ Issues related to TIF reporting are discussed later in this chapter.

Figure 3.1: Public and Site Improvements Financed with Tax Increments from Pre-1990 Districts in Sample Cities

Extension of roads, sewers to large, new developing areas:

Albert Lea	Burnsville	Chaska	Farmington
Hibbing	Little Falls	Mankato	Maple Grove
Marshall	St. Cloud	Shakopee	Winona
Woodbury			

Improvement of existing local streets and roads (including curb and gutter):

Albert Lea	Bloomington	Brooklyn Park	Buffalo
Chaska	Cloquet	Eagan	Edina
Elk River	Fairmont	Fridley	Glencoe
Hopkins	International Falls	Little Falls	Maple Grove
Marshall	Plymouth	Richfield	Roseville
St. Cloud	St. Paul	Shakopee	Vadnais Heights
White Bear Lake			

Construction of major new highway improvements (including freeway interchanges, bridges, ring roads):

Bloomington	Brooklyn Park	Edina	Plymouth
Roseville	Shakopee	Vadnais Heights	Winona
Woodbury			

General downtown improvements (such as sidewalks, lighting, street furniture):

Buffalo	Chaska	Dodge Center	Farmington
Glencoe	Hibbing	Hopkins	Red Wing
Shakopee	Vadnais Heights	White Bear Lake	Winona

Extension of utilities to site (storm or sanitary sewer, water):

Albert Lea	Becker	Bloomington	Buffalo
Burnsville	Cloquet	Crow Wing County	Detroit Lakes
Dundas	Eagan	Elk River	Fridley
Glencoe	Hibbing	Little Falls	Mankato
Maple Grove	Marshall	Nisswa	Oakdale
Richfield	Roseville	St. Cloud	St. Paul
Shakopee	Vadnais Heights	Winona	Woodbury

Skyways:

Minneapolis	St. Cloud	St. Paul
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Public parks/recreation:

Buffalo	Burnsville	Chaska	Edina
Elk River	Mankato	Maple Grove	Marshall
Nisswa	Roseville	St. Cloud	St. Paul
Vadnais Heights	Winona		

Government-owned or leased buildings:

Dodge Center (airport)
Hibbing
Roseville (post office)
St. Paul (civic center, Minnesota Department of Revenue Building)

Construction of lift station, water wells, water towers:

Buffalo	Chaska	Crow Wing County	Dodge Center
Elk River	International Falls	Little Falls	Shakopee
Vadnais Heights	Winona		

Wastewater treatment plants, pre-treatment plants:

Albert Lea	Detroit Lakes	Dodge Center	Marshall
Shakopee (planned)			

Figure 3.1: Public and Site Improvements Financed with Tax Increments from Pre-1990 Districts in Sample Cities, continued

Drainage and ponding:

Albert Lea	Bloomington	Buffalo	Chaska
Edina	Fairmont	Fridley	Little Falls
Mankato	Maple Grove	Marshall	Oakdale
Roseville	St. Cloud	St. Paul	Shakopee
Vadnais Heights	White Bear Lake	Woodbury	

Soil corrections (including grading and excavation):

Albert Lea	Brooklyn Park	Burnsville	Cloquet
Detroit Lakes	Dundas	Fairmont	Fridley
Glencoe	Hopkins	Mankato	Maple Grove
Marshall	Red Wing	Richfield	Roseville
St. Cloud	St. Paul	Shakopee	Vadnais Heights
White Bear Lake	Winona		

Burying utilities/power lines:

Little Falls	Shakopee
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Parking ramps and lots:

Albert Lea	Bloomington	Buffalo	Burnsville
Detroit Lakes	Dodge Center	Edina	Elk River
Farmington	Fridley	Hibbing	Hopkins
Little Falls	Mankato	Nisswa	Red Wing
Richfield	Roseville	St. Cloud	St. Paul
White Bear Lake	Winona		

Landscaping:

Buffalo	Burnsville	Elk River	Mankato
Maple Grove	Nisswa	St. Cloud	St. Paul

Foundations and footings:

Cloquet	Little Falls	Nisswa
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Source: Office of the Legislative Auditor.

public improvement projects is discussed later in this section. In addition to the public and site improvement expenditures shown in Figure 3.1, at least seven cities in our sample used tax increments to capitalize economic development funds or business loan programs,¹¹ six cities and one county used tax increments to provide interest rate reduction programs for housing projects,¹² and two cities used tax increments to fund reserve accounts for various purposes.¹³

Among cities in our sample with post-1990 districts, the use of TIF to provide land write-downs continued to predominate; cities provided land write-downs in 62 percent of these districts. However, Figure 3.2 shows that public and site improvements funded with tax increments from post-1990 districts have focused on specific projects, at least so far. Most cities used increments to finance soil correc-

¹¹ Buffalo, Fridley, Hopkins, Marshall, Red Wing, White Bear Lake, and Woodbury. Crow Wing County adopted a 1994 amendment authorizing development of a business loan program, but the program is not yet operational.

¹² Dakota County and the cities of Eagan, Edina, Mankato, Marshall, St. Paul, and White Bear Lake.

¹³ Minneapolis and Roseville.

Figure 3.2: Public and Site Improvements Financed with Tax Increments from Post-1990 Districts in Sample Cities

Extension of roads, sewers to large, new developing areas:

Maple Grove Oakdale

Improvement of existing local streets and roads (including curb and gutter):

Eagan Farmington Fridley White Bear Lake

Construction of major new highway improvements (including freeway interchanges, bridges, ring roads):

None

General downtown improvements (such as sidewalks, lighting, street furniture, etc.):

Farmington Red Wing

Extension of utilities to site (storm or sanitary sewer, water):

Albert Lea	Alexandria	Becker	Bloomington
Branch	Cloquet	Dodge Center	Elk River
Farmington	Fridley	Glencoe	Little Falls
Maple Grove	Morrison County	Nisswa	Oakdale
Red Wing	Renville	St. Cloud	

Skyways:

None

Public parks/recreation:

None

Government-owned or leased buildings:

Hibbing (Family Resource Center)

Construction of lift station, water wells, water towers:

Becker (water tower)
East Grand Forks (water treatment plant)

Wastewater treatment plants, pre-treatment plants:

Crow Wing County (septic tanks)

Drainage and ponding:

Dodge Center	Farmington	Fridley	Hopkins
Marshall	Oakdale	Plymouth	Vadnais Heights

Soil corrections (including grading and excavation):

Albert Lea	Alexandria	Bloomington	Branch
Buffalo	Burnsville	Cloquet	Dakota County
Dodge Center	Elk River	Farmington	Little Falls
Marshall	Minneapolis	Oakdale	Plymouth
Red Wing	Renville	Roseville	St. Cloud
Vadnais Heights	White Bear Lake		

Burying utilities/power lines:

None

Parking ramps and lots:

Albert Lea	Bloomington	Farmington	Glencoe
Hibbing	Little Falls	Morrison County	Nisswa
Renville			

Figure 3.2: Public and Site Improvements Financed with Tax Increments from Post-1990 Districts in Sample Cities, continued

Landscaping:

Bloomington
Nisswa
White Bear Lake

Elk River
Renville

Farmington
St. Cloud

Morrison County
Vadnais Heights

Foundations and footings:

Cloquet
Renville

Dodge Center

Glencoe

Little Falls

Source: Office of the Legislative Auditor.

tions (including grading, excavation, and removing contaminated soils), utility extensions, drainage and ponding improvements, parking ramp and lot construction, and landscaping. Only two cities in our sample used tax increments to extend city services to large, newly developing parts of cities, and no cities used post-1990 increments to construct major new highway improvements or for public parks and recreation projects.

The TIF Act limits the use of TIF for government buildings. Tax increments may not be used to finance buildings used primarily to conduct municipal, county, school district, state, or federal government business. Some cities in our sample have used tax increments to support development projects that lease space to government agencies. These projects include:

TIF has financed development projects that lease space to government agencies.

- *Roseville.* In 1989 the city used tax increments to help renovate a building which the developer then leased to the U.S. Postal Service for a post office. The State Lottery Office leases space in a building (that also houses a computer company) that received TIF assistance.
- *St. Paul (Riverfront):* Between 1988 and 1990, the city used tax increments to acquire and demolish old buildings on the Amhoist manufacturing plant site and extend a street to assist with construction of a privately-owned office building that is currently leased to the Minnesota Department of Revenue.
- *St. Paul (Neighborhood Business Development):* As part of assisting with the construction of a multi-tenant office building, the city used tax increments to help demolish an old bakery building and construct a parking lot. The Attorney General's Office and the Office of the State Auditor currently occupy leased space in this building.
- *Hibbing (Family Resource Center):* The city used tax increments from a 1991 redevelopment district to renovate a building, which it owns and

leases to a variety of other government agencies, including the school district and county.¹⁴

In some situations, the original intended use of a building receiving TIF support may not involve leasing space to a government agency. For instance, a developer could construct or renovate a building with TIF assistance without knowing who the building's future tenants will be. Or, a developer could receive TIF assistance to help construct a building that is intended to be leased to a government agency.

Public Improvements and Community Projects

We examined the extent to which cities in our sample use tax increments to finance general public improvements that normally could be financed from sources other than tax increment financing. Examples include park and recreation improvements, community centers, bridges, road improvements and streetscaping, water towers, and wastewater treatment plants.

Some legislators expressed concern about cities using tax increments for public improvements and community projects that are not related to the original TIF plan or to the TIF objectives of building the tax base, producing jobs, eliminating blight, and providing affordable housing. Instead of repaying bonds and decertifying districts, cities use tax increment revenues to finance public improvement projects that primarily benefit the cities. Normally, cities would finance these public improvements with increased tax levies, special assessments, bond issues, and user fees. By using tax increments, cities do not have to ask the taxpayers directly for the money (through a bond referendum or increased taxes) or justify why the improvements are needed. In effect, the state, counties, school districts, and other taxing jurisdictions are subsidizing city improvements.

City officials, on the other hand, consider TIF one of the few remaining financing tools for public improvements, especially given the reduced availability of federal funds for projects such as wastewater treatment plants and highway improvements. Officials told us that the public improvement projects funded with tax increments are necessary to stimulate economic development. They also pointed out that, when feasible, they have funded public improvements using a variety of sources, including TIF. For example, Marshall used tax increments from three TIF districts to finance about two-fifths of its wastewater treatment plant. Increased user fees and assessments financed the remainder of the plant. In another case, city officials said that a financial analysis revealed that special assessments alone would not be sufficient to finance construction of a freeway interchange, so tax increment financing provided an additional source of revenue.

Based on our analysis of cities in our sample, we found that:

- **Many cities and development authorities have amended existing pre-1990 tax increment plans in order to spend tax increments for**

¹⁴ City officials told us that the original intent of the TIF district was to renovate the building for use by a private company. When that proposal fell through, it converted the building to its current use as a Family Resource Center.

general public improvements and community projects that were not part of the original tax increment plan. So far, such projects are not evident in post-1990 districts.

Our evaluation found that cities are not using tax increments from post-1990 districts to finance public improvements beyond those contained in the original TIF plan. As noted earlier, many post-1990 districts are just starting to generate the tax increments needed to finance projects in the original TIF plan. Nevertheless, under current law, no more than 20 or 25 percent of the tax increments from post-1990 districts may be pooled. In addition, the use of tax increments from post-1990 districts is limited to activities for which bonds have been issued or other binding legal commitments have been made within five years after approval of the district.

Amendments to TIF plans authorizing increased tax increment spending to finance public improvement projects occurred primarily in pre-1990 districts. For example:

Many cities have used tax increments from pre-1990 districts to finance general public improvements.

- *Cloquet.* Tax increments from an economic development district (scheduled to be decertified in 1996) will partially finance the resurfacing of Cloquet Avenue and replacement of curbs, sidewalks, storm and sanitary sewers, and water mains.
- *Shakopee.* Projects funded with pooled tax increments have included: downtown street and streetscape improvements, a highway bypass, a highway bridge and junction, and storm drainage improvements. In August 1995, the city approved a plan for additional tax increment spending for construction of a community center, park improvements, the city's contribution to the Chaska sanitary sewer interceptor, and downtown alley reconstruction.
- *Mankato and St. Cloud.* Both cities used TIF to help construct civic centers.
- *Maple Grove.* The city modified the Wedgewood Commerce Center redevelopment district plan in 1992 and 1995 to authorize increased tax increment spending for a combination of development and public improvement projects. The public improvements included road improvements, development of a freeway interchange at I-94 and Weaver Lake Road, and pedestrian trail and bridge improvements, including a freeway overpass.
- *Buffalo.* Tax increments from the city's pre-1979 downtown district have or will be used to reroute a county highway, expand the park system along Buffalo Lake and construct a rest area, improve drainage and storm sewers, install a looped water main, construct a bike and pedestrian path, improve downtown streetscaping, and develop a pedestrian-oriented marina.

- *Elk River.* The city has used increments from its water tower economic development districts to acquire eight acres of land to expand a city park, 160 acres to establish Woodland Trails Park, and 5.5 acres of railroad corridor for additions to the city trail system.
- *Roseville.* The city has used pooled increments to finance construction of an outdoor ice oval, an indoor ice arena, a gymnasium for an elementary school, a bridge over County Road B2, and traffic improvements at County Road B and Fairview Avenue. The city also used tax increments to contribute to siting and parking improvements for a Ramsey County library.
- *International Falls.* Plan amendments in 1992 authorized the city to use tax increments from the Boise Cascade economic development district to pay for a water tower, looped water main, settling basin, water main replacement, highway improvements, and other public improvements.
- *Marshall.* In 1992, the city authorized the use of tax increments from three districts to repay bonds for expansion of the city's wastewater treatment plant. Increments from the Minnesota Corn Processors, Schwan's, and Heartland Foods redevelopment districts financed approximately two-fifths of the total plant expansion costs.
- *Glencoe.* In 1993, the city used pooled tax increments from its pre-1979 downtown district and three other districts to finance reconstruction of all downtown streets (including street resurfacing and replacement of curbs and gutters, storm and sanitary sewers, and water mains).

Some cities also create tax increment districts to provide public services or increase the existing capacity of public services, with the expectation that this will stimulate development. Some people argue that these projects represent examples of how tax increment financing is intended to be used -- to provide funding for public improvements that are necessary to stimulate development, create jobs, and increase the tax base. Others argue that cities should finance these projects through methods other than TIF. Most of these projects were in pre-1990 districts, as the following examples illustrate:

- *Elk River.* In the early 1980s, the city identified a severe deficiency in the storage capacity of its existing water system which limited the city's future development. In 1985 and 1986, the city created two economic development districts to finance construction of a water tower and related water system improvements. These public improvements enabled extensive commercial and residential development to occur within the TIF districts.
- *Dundas.* The city does not have a central sewer system. It created a TIF redevelopment district in 1989 to assist with development of a Kmart store and it planned to use tax increments not pledged to debt service to finance construction of a central sanitary sewer system. This has not occurred

because the city of Northfield has agreed to allow Dundas to hook in to its central sewer system.

- *Plymouth.* All of Plymouth's 13 pre-1990 districts were created to finance construction of major roads and freeway interchanges. City officials told us that the lack of adequate freeway access hampered the city's economic development.
- *Woodbury.* A 1986 traffic study determined that the city needed two freeway interchanges and local road improvements. The city created three TIF districts in April 1990 to help finance construction of one freeway interchange and other road improvements. In 1994, Woodbury issued bonds for the interchange project, which was completed in the fall of 1995.

We also found a few examples of public improvement projects in post-1990 districts, although the public improvements in these examples were intended to benefit particular development projects:

- *Becker.* In 1993, the city used TIF to finance construction of a new city water tower and a number of public improvements related to construction of a cardboard recycling facility.
- *East Grand Forks.* The city used tax increments from a 1991 redevelopment district to partially finance improvements to the city's water treatment plant and water distribution system. These improvements facilitated expansion of an American Crystal Sugar plant.

Cities may be tempted to identify additional "needs" that require the contribution of TIF funding.

The use of large project areas, pooling, and the ability to amend TIF plans to increase spending enables cities to use tax increments to finance public improvements and community projects that were not part of the original TIF plan. Rather than returning tax increment districts to the tax rolls once the bonds are retired, cities may be tempted to identify additional "needs" that require the contribution of TIF funding. In this manner, tax increment financing may become a convenient financing mechanism that allows cities to "borrow" development revenues from other taxing jurisdictions.

Financial Status of Tax Increment Districts

While we did not conduct a financial audit, we reviewed the financial status of over 400 TIF districts in our sample cities. We found that:

- **The majority of districts are financially stable and generate sufficient tax increment revenues to pay for project costs. Only a few cities have needed to levy general taxes to make up for revenue shortfalls.**

If a city or development authority issues general obligation tax increment financing bonds and a district does not generate the necessary tax increments, then the city has several options. It can rely on general property tax revenues to support

the district or it can use pooled increments from other successful tax increment districts to make debt service payments. We found several cities relying on general tax levies to support unsuccessful districts.

- *Bloomington (Oxboro TID O-1)*: Market conditions did not support the city's redevelopment plans for this district. In 1994, the city levied \$484,000 in general property taxes to support the project. Bond refunding and debt restructuring in 1995 will reduce the tax levy needed to support the district to \$250,000 per year. The city also transferred \$116,275 in pooled tax increments from its Nativity of Mary pre-1979 district to Oxboro O-1 in 1995.
- *Hibbing (Chopsticks)*: The city created this economic development district to facilitate construction of a chopsticks factory which subsequently closed. The city levies between \$120,000 and \$126,000 a year to cover debt service on bonds that were issued for development of an industrial park. The district was decertified on December 21, 1992.¹⁵
- *East Grant Forks (Burlington Northern Triangle TIDs)*: The city created two districts to redevelop rail yards and industrial property. The area has not been renovated and a grain elevator on the property burned down in 1993, reducing the district's tax capacity. The city uses about \$24,000 from a combination of lease payments and general city funds to make debt service payments.

Some cities use pooled increments from successful districts to support districts that are not able to generate enough increments to pay project costs. Examples include:

- *Glencoe (Industrial Park)*: The city created a redevelopment district in 1987 to develop an industrial park. A \$1.2 million TIF bond financed land acquisition, public improvements, and site preparation. The district has not been self-supporting; the city used tax increments from a 1983 housing district to make debt service payments. City officials told us that only three lots remain undeveloped in the industrial park and the district should be self-supporting by the end of 1995.
- *White Bear Lake (Highway 61 West and Depot TIDs)*: The city created these downtown redevelopment districts in April 1990 to remove blighted structures and provide infrastructure improvements for new residential and commercial development. TIF bonds of \$3.8 million financed demolition and relocation costs, street and sewer improvements, and other costs. The hoped for development has not yet occurred; the districts have not generated any tax increments. The city is using pooled tax increments from other TIF districts to make debt service payments.

¹⁵ This district was recertified as part of a redevelopment district in 1993 for development of an industrial park.

Finally, our sample included a number of non-performing districts using pay-as-you-go financing arrangements which require the developer to pay for development costs up-front. This type of financing arrangement can reduce a city's risk. If the project does not develop as scheduled, then the developer usually ends up absorbing the loss. Examples of districts with pay-as-you-go financing that did not develop as planned include:

"Pay-as-you-go" financing requires a developer to pay site acquisition or preparation costs up front.

- *Buffalo (Polka Dot Recycling)*: The city created this economic development district to support construction of a recycling business. After some delay, the developer constructed a 12,600 square foot industrial building and then went bankrupt. The city has not made any payments for this project.
- *Mankato (National Poly Products TID 6b)*: The city budgeted \$500,000 in tax increments to reimburse the developer for construction of a 70,000 square foot industrial facility in this redevelopment district. The company decided to build in another Mankato location. The city is soliciting other proposals for the site.
- *Nisswa (Nisswa Lakes Plaza)*: Originally, the city envisioned development of a major retail mall in this redevelopment district with up to \$3.2 million in tax increment revenues used to reimburse the developer for public and site improvements. So far only a motel has been developed on the site. The city will use \$304,000 in tax increments to reimburse the motel developer for public utility and improvement costs.

Financing Trends

Cities have a number of options available to them for financing the up-front development costs for tax increment financing projects, including: general obligation bonds of a city or development authority, revenue bonds, internal financing (such as borrowing from other city accounts), and pay-as-you-go arrangements. (See discussion in Chapter 1.)

We attempted to analyze financing trends for tax increment districts using (1) the annual financial reports filed with the Office of the State Auditor for the year ended December 31, 1994, and (2) the TIF district bonded indebtedness report filed by cities with the Department of Revenue for outstanding debt on December 31, 1994. These sources collect different types of debt information related to tax increment districts. The annual financial reports provide audited financial information on TIF bonded indebtedness. The debt reports are self-reported by cities and provide information on bonded indebtedness and outstanding principal on loans from authority funds, development agreements used in pay-as-you-go financing arrangements, and other binding financial agreements. Unfortunately, we found that:

- **The self-reported TIF debt information is not always consistent with the audited TIF bonded indebtedness data.**

**The use of
"pay-as-you-go"
and internal
city financing
of TIF projects
has increased.**

The Office of the State Auditor reported that cities had \$1.36 billion in outstanding TIF bonded indebtedness at the end of 1994. Cities with populations over 2,500 accounted for 95 percent of the total TIF debt; general obligation TIF bonds accounted for 72 percent of the total debt. However, cities reported a total of \$956.2 million in TIF bonded indebtedness to the Revenue Department, which was 30 percent less than the audited figures from the State Auditor's Office.

The true extent of pay-as-you-go and internal financing is difficult to measure. The city bonded indebtedness report to the Revenue Department is the only central source of information on the use of internal financing and developer agreements, but we lack confidence in that data because it is not always consistent with audited data for bonded indebtedness. Nevertheless, that report indicated that cities had \$74.6 million in outstanding principal on loans from authority funds or revenue notes at the end of 1994, plus \$119 million in outstanding principal from development agreements and \$88.3 million in outstanding principal from other binding financial obligations.

If information from our sample cities is an accurate reflection of overall trends, we conclude that the use of pay-as-you-go and internal financing has increased. Among the 172 post-1990 districts in our sample, over half used pay-as-you-go financing arrangements, one-quarter used various forms of internal financing, and less than one-fifth issued bonds to finance the preliminary project costs. We also found that amendments to TIF plans for pre-1990 districts provided for pay-as-you-go financing to fund increased spending or additional projects.

When the 1995 Legislature gave the Office of the State Auditor responsibility for enforcing TIF laws, it also consolidated the TIF financial reporting requirements in the State Auditor's Office. We think the bonded debt report should continue to summarize information on internal and pay-as-you-go financing obligations. We are hopeful that these changes will result in more reliable financial data for TIF activity in the future.

Pay-as-you-go financing can reduce a city's costs of issuing bonds and a city's risk if a project does not get implemented. Depending on how pay-as-you-go financing is structured, developers may assume most of the risk for failed projects. However, while some cities specifically identify developer costs eligible for reimbursement and require documentation of those costs (land write-down, utility extensions, etc.), others obtain little documentation of actual expenditures. In the latter cases, it may be difficult to ensure that developers are using TIF funds for activities allowed by state law.

A number of projects receiving tax increment support also received Economic Recovery Funds from the Minnesota Department of Trade and Economic Development (DTED). Appendix B lists the 32 tax increment districts in 22 of the cities and towns we visited that also received DTED Economic Recovery Funds. In addition, some development authorities also operate revolving loan funds and industrial revenue bond programs and use these programs to provide additional financial support to projects located in TIF districts.

We found that very few cities routinely collect information on the number of jobs created or wages and salaries paid by businesses and industries receiving TIF support. Therefore, we are unable to make any conclusions or projections about the number or types of jobs created or the wage levels paid related to these projects. An objective analysis of TIF's employment impacts would be difficult to conduct because of this scarcity of job information.

Decertified Districts

County auditors decertify a tax increment financing district when the district reaches the end of its statutory duration limit. City officials may also notify the county auditor that they want to decertify a district prior to its mandated expiration. There is no central source of information on decertified districts. We asked cities and counties in our sample about decertified tax increment districts. Appendix C contains a list of 72 tax increment districts that city officials told us they have decertified or planned to decertify at the end of 1995 or in the near future. We found that:

- Generally, cities do not decertify tax increment districts before their expiration dates.

Over two-thirds of the decertified tax increment districts were economic development districts at the end of their duration limits or unsuccessful districts. Using the Revenue Department's TIF Supplement database, we estimate that approximately 192 economic development districts, or 38 percent of all existing economic development districts, should be decertified in the next three years.¹⁶

The "But For" Test

The Tax Increment Financing Act requires that before a city establishes a TIF district, the governing body must find that, "the proposed development or redevelopment, in the opinion of the municipality, would not reasonably be expected to occur solely through private investment within the reasonably foreseeable future..."¹⁷ This requirement, known as the "but for" test, is intended to restrict the use of TIF. However, its usefulness depends on how cities apply the "but for" test. We reviewed TIF plans in our sample cities and interviewed city officials to see how they determine that a development meets the "but for" test. We found that:

- Cities interpret the "but for" requirement in a variety of ways.

¹⁶ These numbers are based on the assumption that the duration of economic development districts will be 10 years from the date certified. The estimates are approximate because of reporting problems with district type information in the TIF Supplement.

¹⁷ *Minn. Stat.* §469.175, Subd. 3 (2). In 1995, the Legislature added another condition for the "but for" test. The new condition requires the city to find that the use of TIF will increase the market value of the site over that which would occur without TIF. In applying the new condition, the city must deduct the present value of the TIF subsidies from the projected market value of the TIF development. Qualified housing districts are exempt from the new "but for" test. (*Minn. Laws* (1995), Ch. 264, Art. 5, Sec. 18.)

Figure 3.3 shows cities' interpretations of the "but for" requirement. Cities frequently use the high cost of a proposed development to justify public assistance. Some cities analyze project costs and expected financial returns and determine that financial assistance is required for a developer to earn a reasonable profit on his investment. If a proposed project requires demolition of existing buildings or other site improvements and the developer could construct a similar facility on vacant land in another city, then city officials may determine that the request for assistance is justified based on the higher project costs.

Figure 3.3: Interpretations of the "But For" Test

- | | |
|-------------------------------|---|
| 1. Cost | A city cites unusual circumstances, such as the need to remove blighted structures or the need to treat contaminated soils, making the project too expensive without public assistance. |
| 2. Location | A city recognizes that the proposed development would occur without assistance, but it uses TIF to make sure the development occurs in this city and not another, and at a location consistent with the city's development goals. |
| 3. Timing | A city concedes that development could occur without assistance, but it concludes that development will occur sooner if the city provides assistance. |
| 4. Scope and Quality | A development might occur without public assistance, but it will be bigger or better with assistance. |
| 5. Ultimatums | An existing company wishes to expand and threatens to go elsewhere if it does not receive assistance. |
| 6. Public Improvements | A city makes public improvements, such as developing an industrial park, improving the appearance of downtown, or improving roads to make the city more attractive to new businesses. |

It is difficult for a development project not to meet the "but for" test.

Sometimes, cities use TIF to ensure that a facility's location is consistent with city development goals. Many cities are interested in redeveloping blighted parts of the city and maintaining the viability of their central business districts. They may use TIF to assist a retail development downtown when the developer might be willing to locate at another city location without TIF. Fairmont, for example, established five tax increment districts to help local banks renovate existing downtown buildings rather than building new facilities on the outskirts of town.

In some cases, city officials told us that development might have occurred without TIF assistance, but the TIF support made the development occur sooner. In other cases, a development was going to occur, but cities provided assistance to ensure that the developer constructed a larger or better quality facility. For example, Brooklyn Park officials said they provided assistance to the developer of the Boone Avenue Business Center (TID 13) because the city did not want a cheap looking structure in a prestigious business area.

Companies sometimes request financial assistance as an incentive to locate in a particular city, and that city's officials assume that if they do not offer TIF assistance, another city will. The same is true when an existing facility wishes to expand and seeks assistance. In these cases, city officials feel that if they do not provide assistance, the company will expand someplace else. Frequently, it is difficult for city officials to judge whether a company truly intends to move. City officials, however, are often unwilling to risk the loss of tax base and jobs on the chance that a company might be bluffing.

Several cities in our sample established TIF districts to fund public improvements to facilitate development. The most common example is extending sewer and water utilities (and sometimes streets) to new industrial parks. Other cities created TIF districts to construct highway interchanges, widen or extend roads, and install traffic signals. Cities have concluded that these public improvements meet the "but for" test because development would not be feasible without them.

Given the variety of interpretations available, it is difficult to imagine a development that would not meet the "but for" test in some sense. Ultimately, however, the "but for" analysis evaluates the merits of a proposed development from the city's perspective, not the county's or state's perspective. If the "but for" analysis for a proposed development were conducted from the county or state perspective, the outcomes would likely be different. From the state's perspective, using TIF to subsidize a manufacturing company that could relocate in any number of Minnesota cities is much less likely to result in a net increase in jobs than using state resources to attract a manufacturing company that competes in national or international markets.

"But for" analyses are based on cities' perspectives, not the state's.

The tax increment financing law requires that the city or development authority "set forth in writing the reasons and supporting facts" for the "but for" finding. Some cities in our sample require developers to submit financial statements documenting proposed project costs and expected financial returns. One financial consultant we interviewed said that he compares a developer's figures with industry construction costs and area rental rates to determine if the developer requires financial assistance to earn a reasonable return on his investment. This type of analysis is based on projected figures of developers and judgments of city officials. For recent soils condition districts, some cities provided cost estimates from engineering consultants to document projected soil correction costs.

Some city officials had copies of letters from companies or financial institutions that said the project would not be feasible without TIF, although some of the letters were written after the city established the TIF district. In some cases, the TIF plan or the city council resolution establishing the district contained a statement of finding for the "but for" requirement, but we found that:

- **Some cities were unable to provide documentation or analysis supporting their finding that a TIF district met the "but for" requirement.**

Rather, they relied on their first-hand knowledge of the project to assure us that it would not have proceeded without TIF.

Blight Criteria for Redevelopment Districts

The criteria in state law for determining blighted conditions have changed several times since 1979. Under current law, in order to create a redevelopment district, a city must find that parcels containing 70 percent of the area of the district must be occupied by buildings, streets, utilities, or other improvements and that more than 50 percent of the buildings must be structurally substandard to a degree requiring substantial renovation or clearance.¹⁸ For districts certified after October 3, 1989, at least 90 percent of tax increments collected must be spent to eliminate the blight conditions that justified creation of the redevelopment district.

We reviewed the recent redevelopment districts in our sample cities to see how they met those requirements and asked cities officials to provide us with the supporting evidence that their recent redevelopment districts met the statutory requirements. We found that:

- **Statutory changes to the "blight" requirements have reduced the tendency of cities to create very large redevelopment districts or to use redevelopment districts for purposes other than rehabilitating blighted parts of a city.**

The TIF Act allows cities to create noncontiguous TIF districts. During the 1980s, several cities created districts that included aging parts of the city along with undeveloped areas intended for retail or industrial development. Examples include: Chaska's Flood Control district (1985), which includes the city's downtown, the river front area, and undeveloped land in the northern part of the city earmarked for industrial development; Dodge Center's Airport district (1983), which includes the airport, a manufacturing firm that was planning to expand, and some businesses containing old buildings; and Vadnais Heights' SEH/Super America district (1989), a scattered site district consisting of parcels with old houses on one side of the freeway and undeveloped land on the other.

Legislative restrictions have made it difficult to create large, scattered-site redevelopment districts.

Several statutory changes have made it difficult for cities to create large, scattered-site redevelopment districts like those illustrated above. The 1989 Legislature required parcels containing 70 percent of the area, rather than 70 percent of the parcels, to be occupied. It also added a requirement that, for noncontiguous districts, *all parts* of the district (plus the district as a whole) must separately meet the law's blight requirements. Thus, the Chaska example cited above, which was able to meet the 70 percent occupancy requirement by combining a few large undeveloped parcels with many smaller inner city parcels, would not qualify as a redevelopment district under the current definition. Other scattered site districts cited above would qualify only if each of the sites met the blight criteria contained in law. As a result:

¹⁸ In 1990, the Legislature added a definition of structurally substandard to the TIF statute and created renewal and renovation districts. (See Figures 1.4 and 1.5.) According to the TIF Supplement, there were only five renewal and renovation districts created between 1990 and 1995.

- **Most post-1990 redevelopment districts were smaller than pre-90 districts, were contiguous, and were focused on individual projects.**

Project plans for post-1990 redevelopment districts usually include assistance with demolition or renovation of existing structures and site preparation for new facilities. Nevertheless, it is still possible to create unusually shaped districts. For instance, Glencoe created its Nordic Track district in 1992. The district consists of seven parcels and a stretch of Highway 22 right-of-way. Six parcels contain an empty 165,000 square foot industrial building located outside the city limits that was not served by public utilities. Another parcel contains a single-family house located in the city. The city annexed the industrial site and extended water and sewer to it.

Between 1982 and 1988, cities were permitted to establish redevelopment districts on bare land if 80 percent of the acreage contained unusual terrain or soil deficiencies that required substantial filling, grading, or other physical preparation. Using this criterion, cities created large redevelopment districts to correct excessive or unstable soil, poor drainage, and steep grading. For example, Fridley created its North Area district in 1982 to facilitate industrial and commercial development; Marshall's Minnesota Corn Processors 1982 district consisted of a 90-acre site that had contained a sewage lagoon; and Burnsville created two large districts in 1984 and 1987 to facilitate a mix of housing, office/warehouse, and industrial park developments. In 1988, the Legislature removed poor soils as a criterion for redevelopment districts and created a 12-year soils condition district in its place. In recent years, the Legislature has also tightened the criteria for soils condition districts.

We asked some cities with post-1990 redevelopment districts to provide us with copies of the documentation used to analyze the blight criteria. Some cities provided copies of inspection reports from building inspectors or engineers that found deficiencies such as cracked foundations, leaking roofs, or electricity code violations. Some cities had photographs of blighted conditions or fire-damaged buildings. Some cities' documentation consisted of a statement that city staff had determined that the structures were substandard or in disrepair.

Reporting Requirements and Other Issues

Our study of tax increment financing was a program evaluation, not a compliance audit. Our purpose for visiting cities was to gain insight into how they were currently using tax increment financing, not to comprehensively audit cities' TIF finances or their compliance with state law. We only found a few specific situations that did not appear to meet the intent of the Minnesota TIF Act, but we discovered several compliance-related issues.¹⁹

State law requires cities and development authorities to file TIF plans with the state. Over the years the agency required to receive TIF plans changed from State

¹⁹ For instance, the city of Buffalo expanded the area of its pre-1979 district twice in the early 1990s. City officials told us that the expansions were made to correct mistakes between the map and the legal description in the original documentation.

Planning to the Department of Energy and Economic Development/Trade and Economic Development to the Department of Revenue, where it currently rests. We collected plans for our sample cities from both DTED and the Revenue Department. For cities with post-1990 districts, we found that:

- **Five cities had not filed any TIF plans with the Revenue Department, nearly half had filed some but not all TIF plans, and about 40 percent had filed all TIF plans.**

In addition, some cities submitted plans using "boilerplate" language which did not identify specific development objectives or activities, making it difficult to determine how some cities are using TIF.

TIF laws require cities and development authorities to make annual financial and disclosure reports for *all* tax increment districts to the Office of the State Auditor. State law specifies the content for each of these reports. The State Auditor's Office developed the annual financial reporting form, called the Schedule of Sources and Uses of Public Funds. According to the State Auditor's Office, 21 of the over 340 Minnesota cities with TIF districts in 1994 did not file an annual financial report for their TIF districts. We also found that:

- **The quality of annual financial reports for tax increment districts is mixed.**

While nearly all cities and development authorities file annual financial reports with the Office of the State Auditor, some cities had not included reports for all of their districts. For instance, some cities only filed a report for districts with captured value. Several cities filed one combined statement for all pooled districts, making it impossible to analyze revenues and spending for individual districts.²⁰ Many cities filed incomplete statements. For instance, few cities provided information on the nature of land write-downs given, as statutes require. Finally, nine of the sample cities filed unaudited annual TIF financial reports.

Another possible compliance issue is the monitoring of low- and moderate-income requirements for housing districts. Cities have a variety of methods for monitoring income requirements. If the project received state or federal funding, in addition to tax increment support, then state or federal housing or financial agencies may conduct the monitoring. Some city HRAs, which are frequently the TIF development authorities, are responsible for monitoring. One city in our sample contracts with the county HRA for monitoring services. Some cities require the building owner to submit annual reports on occupancy and income to the city. However, we also found that some cities do not appear to have any monitoring procedures in place or do not appear to be enforcing the monitoring requirements for housing districts.

During our city visits and interviews with county officials, we asked about implementation of "knock-down provisions" of state law. These provisions limit the ability of a city to collect increments from a district or parcels in a district if the

Some cities may not be enforcing housing district income requirements.

²⁰ One city's annual financial statement was based on bonds issued not TIF districts.

city has not, within a specified time limit, issued bonds or constructed public improvements, or if the parcel has not been developed. (See the discussion of the "knock-down provisions" in Chapter 1.) City officials told us they allow parcels to be knocked down and then bring those parcels back into the district, with updated tax capacity values, when the city is ready to make public improvements or when a development project is ready to move forward. Some cities told us they have made public improvements to prevent a district from being decertified or parcels from being knocked down. However, a few city officials also told us that they were not sure if county auditors are implementing the knock-down provisions.

HAVE RESTRICTIONS LIMITED THE ABILITY OF CITIES TO USE TIF?

Legislative restrictions have limited the use of economic development districts.

We think that the legislative restrictions passed in the late 1980s and in 1990 have restricted certain types of development activity. For the most part, 1990 restrictions on the activities in economic development districts have restricted their use to assisting manufacturing and related activities, as defined in statute. In our sample, only five post-1990 economic development districts involved "retail" activity: two districts involved retail development in cities with fewer than 5,000 people and qualified for the 5,000 square foot exception, one supported development of a motel that qualified as a tourism facility, and two assisted electrical service contractors.²¹ No post-1990 economic development districts contained office buildings without warehouse facilities.

Restrictions on the blight requirements for redevelopment districts have reduced the tendency of cities to create very large redevelopment districts or to use redevelopment districts for purposes other than rehabilitating blighted parts of the city. Our review of post-1990 redevelopment districts found that these districts were smaller than pre-1990 districts, were contiguous, and were focused on individual projects.

Some cities in our sample used soils condition districts to assist retail stores, manufacturing and office developments, and housing projects. In 1995, the Legislature restricted the use of soils condition districts to contamination and pollution clean-up. While tax increments from economic development districts will be able to correct for sites with bedrock soil conditions, this change means tax increments cannot be used for land needing extensive grading, excavation, filling, and soil compacting. If the new soils condition district criteria had been in effect earlier, most districts in our sample would not have qualified as soils condition districts.

It is difficult to quantify the extent to which cities have not pursued development projects because of possible state aid reductions. Based on interviews with city officials, one impact of the state aid reductions has been to reduce the number of tax increment financing projects that cities have decided to pursue. Some city offi-

²¹ Between 1990 and 1995, cities with a population of less than 5,000 could use economic development districts for up to 5,000 square feet of commercial or retail space.

cials told us that their city councils or development boards have rejected projects because they were not willing to lose any of their state aid. Officials from cities with pre-1990 districts but without any post-1990 districts told us that they were not certifying any additional TIF districts because of the state aid reductions. However, some city officials told us that their city councils took a long-term perspective and were willing to take state aid reductions in return for bringing jobs to the community or increasing the tax base.

Some cities have not created new TIF districts because of the state aid reductions.

In 1995, the Legislature provided cities with an alternative to the state aid reduction. The amendment allows cities to make an annual local contribution to the tax increment district instead of having state aid payments reduced. Cities are still in the process of evaluating the impact of the local contribution. Only a few cities in our sample have used the local contribution option for their recently certified districts. Consequently, it is too early to assess how the local contribution alternative will affect cities' decisions to create new tax increment districts.

Some people suggested to us that cities and other development authorities were creating redevelopment districts instead of economic development districts and were shortening the duration of districts to avoid state aid reductions. We found that, when possible, cities create redevelopment districts. However, only one city in our sample created an odd shaped post-1990 redevelopment district for a project that could have been an economic development district (Glencoe and its Nordic Track district). City officials told us they created a redevelopment district because they needed additional years of increment collection (25 instead of 8) to provide enough revenues to make debt service payments. Regarding early decertification of districts, we found relatively few instances where cities planned to decertify redevelopment districts before their statutory time period expired.

City officials and development consultants expressed concerns about restrictions related to housing districts. First, current legislation limits interest rate reduction (IRR) programs for rental housing projects to a duration of 12 years. However, many low- and moderate-income housing projects receive financing from a combination of sources, including federal low-income housing tax credits which have a term of 15 years. This inconsistency between the IRR program and tax credits means that cities and development authorities need to find other sources of funding for the last three years of an IRR program.

Second, 1993 legislation created a "qualified housing district," for residential rental projects in which all the properties receiving TIF assistance must meet the requirements for federal low-income housing tax credits, regardless of whether the project actually receives a tax credit. Qualified housing districts created after August 1, 1993 are exempt from the state aid reduction. City officials and development consultants expressed an interest in applying the qualified housing district designation to housing districts that meet the criteria but were certified between May 1, 1990 (the effective date of the state aid reduction) and August 1, 1993 and that are currently subject to state aid reductions. However, cities calculated the state aid reduction into the cash flow analysis for housing districts certified prior to August 1, 1993. To change that requirement retroactively could provide those districts with additional, unanticipated tax increment revenues.

METROPOLITAN COUNCIL POLICIES

The Metropolitan Council coordinates regional development through decisions on regional systems, such as wastewater treatment, transportation, and parks in the seven-county Twin Cities metropolitan area. The Council's *Regional Blueprint* outlines policies needed for the short- and long-term health of the region. We examined the *Blueprint* to determine how its policies compare with how cities are using tax increment financing.

The *Blueprint* contains several policies that are related to local development and the investment of public dollars. The Council supports "local economic development initiatives that retain and foster the growth of local businesses, bring new businesses to the region, add to the tax base and generate new jobs for the region as a whole."²² The *Blueprint* also states, however, that public resources should be targeted to areas of the region needing redevelopment rather than to undeveloped areas.

The Council will lead a(n)... effort to carry out redevelopment strategies focused on revitalization of distressed areas of the region, especially commercial/industrial revitalization and efforts to strengthen neighborhood vitality. The Council will support the targeting of public and private financial resources for redevelopment and reinvestment.²³

The policy emphasizes focusing public dollars in the region's distressed areas. It promotes the continued use of TIF to reduce the cost difference between suburban development on vacant land and urban redevelopment of blighted property. The Metropolitan Council has been trying to maximize the use of existing public infrastructure before encouraging development of new infrastructure.

**Some
TIF-supported
projects may
not be
consistent with
Metropolitan
Council
policies.**

Consistent with the Metropolitan Council policies, the cities of Minneapolis and St. Paul and other inner-ring metropolitan suburbs have used TIF to finance redevelopment projects. But TIF has been used by other cities to subsidize new development in some of the fastest growing, most desirable locations within the metropolitan area. For example, suburban cities have used TIF to support commercial/industrial developments along I-694, near the junction of I-694 and Highway 36, along I-94, and near of I-94 and I-494 in the western suburbs.

Some second- and third-tier suburban cities have used TIF to increase the capacity of the metropolitan area's public infrastructure. Examples of TIF-supported public improvements include sewer interceptors, water towers and systems, freeway interchanges, bridges, ring roads, and highway bypasses. Even if cases such as these resulted in increasing jobs and tax base for the region as a whole, the use of public subsidies to support such project may not have been consistent with the Metropolitan Council's regional development goals.

²² Metropolitan Council, *Regional Blueprint* (St. Paul, September 1994), 18.

²³ *Regional Blueprint*, 23.

As discussed earlier, legislative changes have made it more difficult for suburban cities to use TIF on vacant land. For example, the Legislature reduced the ability of cities to create large redevelopment districts by adopting stricter blight requirements and eliminating poor soils as justification for a redevelopment district.²⁴ In addition, legislation restricted economic development districts to manufacturing, warehousing, and related activities. As a result of these restrictions, retail and office projects have occurred, for the most part, in areas that needed redevelopment, rather than on vacant land.

While legislative changes have restricted the use of TIF in suburban cities, it is also possible that some of these restrictions may have limited the ability of the central and inner-ring metropolitan cities to use TIF to eliminate blight and foster redevelopment. For example, the city of St. Paul has not created any new tax increment districts since early 1990. City officials told us that they have been unwilling to lose local government aid from the state, so they have preferred to concentrate on redevelopment projects within districts that were certified prior to 1990.

SUMMARY

Cities and development authorities have certified 346 tax increment financing districts since April 30, 1990, when legislative amendments on economic development districts, state aid reductions, pooling, and spending restricted the use of TIF. We reviewed 172 post-1990 districts certified in our 46 sample cities and counties. There is less evidence from recently-created tax increment districts of some of the more questionable uses of TIF found in an earlier 1986 evaluation. We found that about two-fifths of the post-1990 districts were created to assist new or existing manufacturing businesses, while office developments, retail facilities, and housing projects each accounted for one-fifth of the districts.

For the most part, 1990 statutory restrictions have limited economic development districts to assisting manufacturing and related activities. While some cities in our sample used soils condition districts to assist with construction of retail stores and office buildings on bare ground, the Legislature addressed this issue in 1995 when it restricted the use of soils condition districts to contamination and pollution clean-up.

Legislative restrictions on the "blight" requirements for redevelopment districts have reduced the tendency of cities to create very large redevelopment districts or to use redevelopment districts for purposes other than rehabilitating blighted parts of the city. Most post-1990 redevelopment districts were smaller than pre-1990 districts, were contiguous, and were focused on individual projects.

²⁴ The 1989 Legislature required that, for noncontiguous districts, all parts of the district (plus the district as a whole) must separately meet the law's blight requirements. It also required that 90 percent of the tax increments be used to correct the blight conditions used to justify creation of the district. In 1988, the Legislature removed poor soils as a criterion for redevelopment districts and created a 12-year soils condition district. Legislative amendments in 1995 limited the use of increments from soils condition districts to pollution clean-up, so tax increments from these districts can no longer be used to finance extensive excavation, soil compacting, grading, and filling.

We also found that some cities have created large project areas, encompassing either the entire city or large portions of it, in order to pool of tax increments between two or more districts or to spend tax increments outside the boundaries of the tax increment district. Of the cities and counties in our sample with more than one TIF district, two-thirds have pooled tax increment revenues among districts or have project area configurations that will permit pooling. We found no cities pooling increments from post-1990 districts. However, many post-1990 districts are just starting to generate the tax increments; over half of these districts were certified in 1992 and 1993. Thus, it is still too early to evaluate the 1990 legislative restrictions on pooling and spending placed on post-1990 districts.

Many cities and development authorities have amended existing pre-1990 tax increment plans to authorize increased spending of tax increments on general public improvements and community projects. The use of tax increments to finance public improvements and community projects is not evident in post-1990 districts at this time.

In 1990, the Legislature authorized reductions in state aid to local governments that created new TIF districts. It is difficult to quantify the extent to which cities have not pursued development projects because of possible state aid reductions, although some city officials told us that potential state aid changes have caused them to reduce the number of tax increment projects that they otherwise would have created.

Recommendations

CHAPTER 4

In our view, the changes made to the TIF law in recent years have been reasonable, even though they have made TIF more difficult to use. However, we believe that more comprehensive monitoring and oversight will be needed to ensure that the new laws are properly enforced. As a result of 1995 legislation, the Office of the State Auditor has assumed new enforcement responsibilities for the TIF Act this year.

This chapter addresses the following questions:

- **How should the Office of the State Auditor focus its new responsibility for enforcing the provisions of the Minnesota Tax Increment Financing Act?**
- **Are further legislative restrictions or other legislative approaches needed to correct misuses of tax increment financing?**

ENFORCEMENT SUGGESTIONS

While this report is a program evaluation and not a compliance audit, we found some tax increment financing compliance issues that should be monitored by the Office of the State Auditor in coming years. For example:

- In 1990, the Legislature limited pooling and enacted a five-year spending restriction for districts certified after April 30, 1990, and we did not find evidence of pooling in districts created after that date. However, many post-1990 districts are just starting to generate tax increments; over half were certified in 1992 and 1993. Because these districts have not reached the point where increments are being generated, it is too early to judge the full effects of the 1990 restrictions. We believe that the pooling and spending restrictions for post-1990 districts should be carefully monitored.
- With pay-as-you-go financing, developers provide their own up-front financing and the city uses tax increments to reimburse the developer for initial development costs. While the extent of this type of financing is difficult to estimate with existing information sources, we think the use of pay-as-you-go financing has increased. Unfortunately, we observed that

some cities using pay-as-you-go financing have not adequately specified project activities and expenditures in the TIF plan, making it difficult to determine whether developers are spending TIF funds for activities allowed by state laws.

- The Legislature restricted the use of economic development districts in 1990. At least 85 percent of the buildings and facilities (based on square footage) must be used for manufacturing, warehousing, and other related activities. We found that TIF supported many office/warehouse developments in post-1990 economic development districts, but warehouse space should be monitored to ensure that it constitutes of at least 85 percent of the total project.
- While cities are required to "set forth in writing the reasons and supporting factors" behind the "but for" finding, some cities were unable to provide us with documentation or analysis on how their TIF districts met the "but for" requirements. A legislative change in 1995 required that cities demonstrate that a proposed development would have a greater tax base value (after subtracting the public assistance to the project) than the development that would occur without the TIF assistance. The intent of this amendment was to tighten the "but for" test for creating a new tax increment district.
- Some cities were unable to provide us with supporting evidence that recent redevelopment districts met the blight criteria contained in the TIF Act.

More oversight and monitoring are needed to ensure that TIF laws are properly enforced.

Therefore, we suggest that:

- **The State Auditor should monitor compliance of cities and development authorities with state laws governing: (1) the pooling and spending restrictions for post-1990 districts as they mature; (2) the types of TIF spending in all districts (especially those using pay-as-you-go financing), (3) restrictions on economic development districts, (4) the "but for" requirement, and (5) the "blight" requirements for redevelopment districts.**

The quality of city and development authorities' annual disclosure statements, financial reports, and debt reports has been mixed (as discussed in Chapter 3). Some cities have not provided required reports, or have provided information that is incomplete. We are particularly concerned about financial reporting for pay-as-you-go arrangements, which do not rely on bonded debt. Previously, the Revenue Department collected data on pay-as-you-go financing as part of its bonded indebtedness report. We urge the State Auditor to continue collecting financial information on revenue notes, developer agreements, and other binding financial obligations related to pay-as-you-go financial arrangements.

We suggest that:

- **The State Auditor should work with cities and development authorities to ensure that all tax increment financing users are aware**

of and comply with the TIF reporting requirements contained in state law.

The consolidation of the TIF reporting requirements under the State Auditor's Office, which is also responsible for financial and compliance auditing, should result in higher quality financial data.

OPTIONS FOR LEGISLATIVE CONSIDERATION

In this evaluation, we found less evidence from recently-created tax increment districts of some of the more questionable uses of TIF found in an earlier 1986 evaluation. However, we think there are some issues that the Legislature should consider, as discussed below.

Using Tax Increments to Finance General Public Improvements

The use of tax increments to finance general public improvements requires legislative attention.

Some cities have created large project areas in which increments from TIF districts can be spent. Sometimes these project areas encompass entire cities or large parts of them. Some cities are also pooling tax increments from multiple districts and spending tax increments anywhere within the project area. We also found that many cities have amended tax increment plans for their pre-1990 districts in order to spend tax increment revenues for general public improvements and community projects. Examples from cities we visited include: park improvements (ice arenas, playground equipment, land acquisition), community centers, freeway interchanges, bridges, water towers, and wastewater treatment plants.

As a rule, cities do not terminate districts before their expiration dates and frequently use tax increments as a general purpose funding source. Under normal circumstances, most cities use their own funds to finance these activities. Although some types of public improvements may contribute to development activity, most improvements have little direct impact on the tax base or employment growth. If TIF districts were retired after serving their original purpose, then counties and other taxing jurisdictions would be able to reduce their tax rates, and state aid to school districts could be lowered without affecting educational programs. Instead, tax increment financing is being used to provide a state and county subsidy for functions that most cities finance from other sources.

We think that the continued use of tax increment revenues from pre-1990 districts to finance general public improvements and community projects is an issue requiring legislative attention. Therefore, we recommend that:

- **The Legislature should consider placing additional restrictions on the use of tax increment revenues for general public improvements and**

community projects. Restrictions should apply to all districts certified between August 1, 1979 and April 30, 1990.

These districts account for the majority of 1995 captured tax capacity, and some of them could last for up to 19 more years.

Restrictions on using tax increment revenues to finance general public improvements and community projects could be structured in a number of ways. One option would be to prohibit the use of tax increments from pre-1990 districts for specific purposes, such as park improvements and recreation facilities, community centers, ice arenas, wastewater treatment plants, water towers, freeway interchanges, or bridges. This restriction also could be applied to post-1990 districts.

A second option would be to prohibit any future amendments to existing TIF plans that authorize increased tax increment spending for general public improvements and community projects. If the Legislature pursues this alternative, it should consider making this change effective at some retroactive date, say, January 1, 1996, to prevent cities and development authorities from approving amendments before a future effective date. For example, many cities created districts in April 1990 to avoid restrictions in the 1990 TIF legislation that was effective for districts created after April 1990.

Restrictions on using TIF for general public improvements could be structured in a variety of ways.

A third option would be to address those cases involving cities that have already adopted amendments to TIF plans for pre-1990 districts. The Legislature could allow the use of tax increments for new projects for which cities have issued bonds or entered into other legally binding commitments by a specified future date. After the specified date, any projects remaining in the city's amended TIF budget could not be financed with tax increments. This option could be structured similar to the five-year spending restriction that is in the law for post-1990 districts. Most tax increments collected from a post-1990 district must be spent on activities for which bonds have been issued or binding legal commitments have been made within five years after the district's approval. To prevent cities from continuing to approve amendments for increased spending, this option could be combined with the option that prohibits future amendments to increase TIF spending for general public improvements.

Finally, the Legislature could require that future tax increments from all pre-1990 districts be used to retire outstanding bonds or contractual obligations entered into by some date in the near future. This option could be similar to limitations already approved by the Legislature for pre-1979 districts. In 1988, the Legislature required that all tax increments collected from pre-1979 districts after April 1, 2001 be spent to retire bonds that were issued before April 1, 1990. By law, cities must decertify pre-1979 districts as soon as those bonds are retired. The Legislature could require that all tax increments received after April 1, 2001 (or some other date) from tax increment districts created between 1979 and 1990 be used to retire bonds issued by April 1, 1996 (or some other date). This option is more restrictive than the prior option because it could limit the ability of some cities to complete initial projects identified in approved TIF plans. For instance, it is possi-

ble that weak market conditions or failures on the part of a developer have prevented some cities from issuing bonds for projects in the original TIF plan.

Enforcement of Housing District Income Requirements

Cities with housing districts are required to monitor the incomes of residents to ensure that the projects are fulfilling their commitment to provide housing for low- and moderate-income people. Under existing law, the Revenue Department is charged with enforcement of the income requirements for housing districts, but it is not currently enforcing this provision because of limited resources within the Department. When the Legislature transferred TIF enforcement responsibilities to the State Auditor's Office in 1995, enforcement of the income requirements remained with the Revenue Department. We recommend that:

- **The Legislature should consider whether the Revenue Department or the State Auditor's Office should be responsible for enforcing the housing district income requirements.**

The Legislature could retain the enforcement responsibilities in the Revenue Department, which has access to individual income information, and provide funding to ensure that an enforcement effort is established. It could transfer the function to the State Auditor's Office and consolidate it with other TIF enforcement responsibilities. Finally, the State Auditor's Office could monitor compliance with the housing district income requirements as it conducts its other TIF audit and compliance responsibilities and refer any apparent violations or questionable situations to the Revenue Department for enforcement.

TIF for Buildings Leased to Government Agencies

The TIF Act limits the use of TIF for buildings that are government-owned. Cities cannot use tax increments to finance buildings used primarily to conduct municipal, county, school district, state, or federal business. But some cities we visited have used tax increments to support development projects which **lease** space to government agencies.

On the one hand, TIF financing for government-leased buildings may be justified by the fact that developers do not always know who their tenants will be, and they cannot refuse to lease to government agencies. On the other hand, it is hard to argue that office space for government agencies would not develop in the absence of TIF. The Legislature may want to clarify its intentions related to the use of TIF for government-leased buildings.

Salary Information

One public purpose of tax increment financing is to provide employment opportunities. But we found that very few cities routinely collect information on the number of jobs created or salaries paid by businesses and industries receiving TIF support, making an objective analysis of TIF's employment impacts difficult. If the Legislature wants information on the wage levels of TIF-assisted projects, it may want to require that cities with economic development districts or with projects providing TIF assistance to manufacturing, office, and retail developments report on wages paid as part of the TIF annual disclosure statement. The Legislature may also want to require that the Minnesota Department of Trade and Economic Development analyze the data on wages paid and report to the Legislature.

Sample Cities and Counties

APPENDIX A

This appendix lists the sample cities and counties visited as part of this evaluation.¹ A separate document, *Description of Selected Tax Increment Financing Districts*, contains brief descriptions of over 400 Minnesota tax increment districts in these cities and counties. Copies of this document are available from the Office of the State Auditor at 612/296-4708 (Fax: 612/296-4712).

Twin Cities

Metropolitan Area

Bloomington²
Brooklyn Park
Burnsville
Chaska
Dakota County
Eagan
Edina
Farmington
Fridley
Hopkins
Maple Grove
Minneapolis³
Oakdale
Plymouth
Richfield
Roseville
St. Paul
Shakopee
Vadnais Heights
White Bear Lake
Woodbury

Non-Metropolitan Area

Albert Lea
Alexandria
Becker
Branch
Buffalo
Cloquet
Crow Wing County
Detroit Lakes
Dodge Center
Dundas
East Grand Forks
Elk River
Fairmont
Glencoe
Hibbing
International Falls
Little Falls
Mankato
Marshall
Morrison County
Nisswa
Red Wing
Renville
St. Cloud
Winona

¹We conducted telephone interviews with city officials from East Grand Forks, International Falls, and North Branch.

²The evaluation focused on districts in the Airport South Project Area, pooled districts, and most recently created districts.

³The evaluation focused on post-1990 districts.

TIFs in Sample Cities that Received DTED Economic Recovery Funds

APPENDIX B

This appendix summarizes the tax increment districts in the cities we visited that received Minnesota Department of Trade and Economic Development Economic Recovery Funds.

	<u>District Name</u>	<u>District Type</u>	<u>Year Certified</u>
METROPOLITAN CITIES			
Bloomington	Seagate ¹	Economic development	1995
Brooklyn Park	Damark # 15	Economic development	1994
Chaska	Flood Control #4 ²	Redevelopment	1985
	Kallestad #5	Economic development	1989
	Nordic Track #10	Redevelopment	1993
Fridley	McGlynn Bakery	Redevelopment	1992
White Bear Lake	Smarte Carte #18	Soils condition	1993
Woodbury	Rivertown Trading #9	Economic development	April 1990
NON-METRO CITIES			
Albert Lea	Farmstead #2-1	Economic development	1984
	Bridgeport #5-5 ³	Economic development	1994
Alexandria	APV Douglas #7	Economic development	1991
Branch	Tanger Development	Soils condition	1992
Buffalo	Von Ruden Mfg. #5	Economic development	1989
Crow Wing County/ Irondale Twp.	MacMillan Bloedel #1	Economic development	1989
East Grand Forks	American Crystal Sugar	Redevelopment	1991
Elk River	All Tool #5 ⁴	Economic development	1988
	Tescom #9	Economic development	1993

	<u>District Name</u>	<u>District Type</u>	<u>Year Certified</u>
NON-METRO CITIES, continued			
Hibbing	Kahler Park Hotel	Redevelopment	1992
International Falls	International Bitrite ⁵	Redevelopment	1986
Little Falls	United Mailing #1-1	Economic development	1985
	Industrial Park #1-5 ⁶	Economic development	1989
	Designer Wood #1-7	Economic development	1992
Mankato	Winland Electronics #19-2	Economic development	1994
Marshall	Heartland Foods #1-10 ⁷	Redevelopment	1989
Morrison County	Morey Fish-Motley #1-2	Redevelopment	1993
Red Wing	Hygenic Service Systems #3-1	Economic development	1994
St. Cloud	Fingerhut # 24 ⁸	Economic development	1988
	Woodcraft # 32	Economic development	1991
	Webway # 53	Economic development	1994
	FSI # 54	Economic development	1994
Winona	Winona Knitting Mills	Redevelopment	1983

¹Anticipated recipient of Economic Recovery Funds (ERF) in 1996.

²Mammoth Industries received an ERF.

³Tecmetal Group Inc., a company in the industrial park, received an ERF.

⁴In addition to an ERG, All Tool Manufacturing also received other DTED funding.

⁵This project did not receive an ERF but received other DTED funding.

⁶Northern Cap Manufacturing received an ERF.

⁷In addition to an ERF, Heartland Foods also received other DTED funding.

⁸ERFs were for the 1994 Fingerhut expansion.

Decertified Tax Increment Districts from Sample Cities

APPENDIX C

This appendix summarizes the tax increment districts that either have been decertified or that city officials told us would be decertified at the end of 1995 or in the near future.

	<u>District Name</u>	<u>District Type</u>	<u>Year Certified</u>	<u>Year Decertified</u>
METROPOLITAN CITIES				
Bloomington	Opus #1-B	Economic development	1984	1994
	Bor-Son #1-D	Economic development	1984	1994
	Muir #1-E	Economic development	1985	1995
	VTC #1-F	Economic development	1985	1995
	Homart #4	Economic development	1985	1995
	Hilton #1-H	Economic development	1986	1996
Brooklyn Park	Boone Ave # 1	Economic development	1980	1989
	Boone Ave # 2	Economic development	1982	1992
	Creekside Edinburgh	Economic development	1988	1995
	Wal-Mart # 10	Soils condition	1992	1996
Burnsville	Golden Triangle	Economic development	April 1990	1992
	Apothecary Products	Economic development	April 1990	1992
Chaska	American Crystal Sugar	Redevelopment	1983	1994
Eagan	Sperry # 2	Economic development	1985	1995
Edina	44th and France	Economic development	April 1990	1991
	Valley View/Wooddale	Economic development	April 1990	1991
Fridley	Johnson/Skywood #4	Economic development	1984	1994
	Paschke #5	Economic development	1984	1994
	Shorewood Inn	Economic development	1986	1996
Minneapolis	Centre Village	Economic development	1981	1991
	Radisson	Economic development	1984	1994
	Broadway/I-35W	Economic development	1980	1991
	2900 Dean Blvd.	Pre-1979 (housing)	1978	1985
	Kasota-Elm Street	Pre-1979 (industrial)	1973	1985
	53rd & Lyndale	Pre-1979 (housing)	1976	1991
	Spring Street	Pre-1979 (industrial)	1975	1981
	Mississippi Courts	Pre-1979 (housing)	1978	1984
	Bureau of Engraving	Pre-1979 (industrial)	1979	1993

	<u>District Name</u>	<u>District Type</u>	<u>Year Certified</u>	<u>Year Decertified</u>
METROPOLITAN CITIES, continued				
Oakdale	Zycad #1	Economic development	1986	1995
Plymouth	District #1	Economic development	1984	1993
	District #1-2	Economic development	1985	1993
	District #2	Economic development	1985	1993
	District #1-2A	Economic development	1986	1994
	District #1-3	Economic development	1986	1995
	District #3-1	Economic development	1986	1995
Roseville	Sheland/Rice	Economic development	1987	1995
St. Paul	Park Nursery # 81	Pre-1979	1977	1990
	Hammond Bldg # 28	Economic development	1982	1991
	Waldorf # 55	Economic development	1985	1995
Shakopee	Race Track #4	Economic development	1984	1994
	Family Chow Mein #5	Redevelopment	1984	1986
Vadnais Heights	IC System #1-9	Economic development	1988	1992
	Hoffman Corners #1-2	Economic development	1985	1995
	Ridgeview Partners #1-4	Economic development	1985	1995
White Bear Lake	Banning & 5th	Economic development	1983	1993
	Roberts Development #15	Economic development	1992	1996
Woodbury	Pondview I #1-3 ¹	Economic Development	1988	1994
NON-METRO CITIES				
Albert Lea:	Red Owl	Pre-1979	1970s	1992
	Northridge Mall #1-1	Economic development	1984	1995
Alexandria:	Randy Fisher #5	Economic development	1988	1989
Buffalo	Furniture Gallery #3	Economic development	1989	1990
Cloquet	Potlatch #2	Economic development	1986	1996
Detroit Lakes	D & S #6-1	Economic development	1984	1990
	UPS #7-1	Economic development	1987	1995
East Grand Forks	Industrial Park #1	Economic development	1984	1994
Elk River	Water Tower #1	Economic development	1985	1994
	Water Tower #3	Economic development	1986	1995
	Guardian Angels #2	Housing	1985	1995
Fairmont	National Grain # 5	Redevelopment	1989	1995
Glencoe	District #7	Economic development	April 1990	1991
Hibbing	Chopsticks	Economic development	1984	1992
Little Falls	United Mailing	Economic development	1985	1995

	<u>District Name</u>	<u>District Type</u>	<u>Year Certified</u>	<u>Year Decertified</u>
NON-METRO CITIES, continued				
Mankato	Chesley	Economic development	1981	1991
	Inn Towne #5	Economic development	1983	1993
	Union Square #7	Economic development	1984	1994
	Tow Distributing #8	Economic development	1984	1994
	South Broad #9	Economic development	1985	1994
	Old Town #10	Economic development	1985	1996
	Eagle Apts. #11	Redevelopment	1985	1995
	Hiniker Pond #16	Economic development	1989	1994
	MSU #20	Economic development	April 1990	1991
St. Cloud	LFR #6	Pre-1979	1974	1991
	West CBD	Pre-1979	1978	1991

¹Decertified because the economic adjustment factor reduced the tax increment collected to zero.

Glossary

Administrative expenses: All expenditures of a development authority other than the amount paid for the purchase of land or paid to contractors or others providing materials and services, including architectural and engineering services, directly connected with the physical development of real property in the district. They include expenses for bond counsel, fiscal consultants, and planning or economic development consultants fees. Administrative expenses cannot exceed 10 percent of a district's total tax increment expenditures or the total tax increment expenditures authorized by the TIF plan, whichever is less. The limit is 5 percent for districts created between August 1, 1979 and June 30, 1982. (*Minn. Stat.* §469.174, Subd. 14; *Minn. Stat.* §469.176, Subd. 3.)

"Blight:" A general term used to denote conditions such as dilapidated, deteriorating, or substandard structures. Tax increment redevelopment and renewal and renovation districts are designed to induce redevelopment of blighted areas.

"But for" test: A statutory requirement that a municipality, in approving creation of a tax increment district, must find that the "proposed development or redevelopment, in the opinion of the municipality, would not reasonably be expected to occur solely through private investment within the reasonably foreseeable future." The municipality must also find that the use of TIF will increase the market value of the site over that which would occur without tax increment financing. (*Minn. Stat.* §469.175, Subd. 3(2).)

Captured tax capacity: The current tax capacity of the parcels in the TIF district after development activities have been completed minus the original tax capacity. The captured tax capacity is multiplied by the tax rate to determine the amount of the tax increment. (*Minn. Stat.* §469.174, Subd. 4.)

Development authority: Special purpose government entities authorized to exercise a variety of development powers, including the use of tax increment financing powers. Authorities include cities (exercising powers under the municipal development or industrial development acts), housing and redevelopment authorities, port authorities, economic development authorities, and rural development finance authorities. (*Minn. Stat.* §469.174, Subd. 2.)

Excess increments: Tax increments that exceed the amount needed to pay the costs authorized under the tax increment financing plan. Increments are not excess increments if the TIF plan has been amended or modified to permit addi-

tional spending. The law requires that excess increments be used to prepay outstanding bonds or deposited in an escrow account for bond payments or returned to the city, county, and school district(s) in proportion to their local tax rates. (*Minn. Stat.* §469.176, Subd. 2)

Excess taxes: Taxes resulting from an increase in the tax rate imposed on property in a TIF district. The amount of excess taxes equals the actual tax rate minus the original tax rate, multiplied by the captured tax capacity. If the tax rate applicable to the district increases, the taxes that result from this tax rate increase are paid to other taxing jurisdictions. Excess taxes are distributed to other taxing jurisdictions in proportion to the respective increases in their tax rates. If a school district receives excess taxes, its state aid can be recalculated. Rules on excess taxes apply only to TIF districts created on or after May 1, 1988. (*Minn. Stat.* §469.177, Subd. 1a and 9.)

Four-year knock-down rule: Tax increments cannot be collected on any parcel in a TIF district if within four years after its certification the parcel has not been developed or the city has not acquired the parcel or made improvements on or adjacent to the parcel. The parcel can be restored if development activity subsequently occurs. (*Minn. Stat.* §469.176, Subd. 6.)

Internal financing: A method of financing tax increment projects where a city uses its own funds to support the start-up costs for a new TIF district or to fund city improvement projects in a tax increment district. The city may borrow money from its general fund, economic development fund, municipal utility fund or federal grant funds, or it may use "pooled" tax increments from another district. The city then repays itself with tax increments generated from the new development.

Interest rate reduction program: A project that uses tax increment revenues to subsidize a developer's interest payments on a private loan to finance low- and moderate-income housing developments. Interest rate reduction programs are limited to a duration of 12 years and may not be used to assist owner-occupied single-family dwellings. (*Minn. Stat.* §469.176, Subd. 4f.)

Land write-down: A transaction where a development authority acquires property and transfers it to a private developer at less than the authority's acquisition cost.

Municipality: A general purpose government required to approve creation of a tax increment district, issuance of bonds, and other major decisions made by the development authority. In most cases, the municipality is the city in which the TIF district is located. For districts outside of a city, the municipality is the county.

Original tax capacity: The tax capacity of the property within a TIF district at the time the district is created. The original tax capacity may be changed due to changes in the tax-exempt status of property, changes in the property classification rates of parcels in the district, and additions or deletions of parcels. For economic development districts, the original tax capacity is also adjusted by the

inflation rate on property values in the area before the district was established. (*Minn. Stat.* §§469.174, Subd. 7; 469.177, Subd. 1(f).)

Original tax rate: The sum of all the tax rates imposed by all taxing jurisdictions (city, county, and school district) at the time a TIF district is created. The original tax rate is certified when the district is created and is the tax rate for the life of the district. This rate is multiplied by the captured tax capacity to determine the amount of the tax increment. This rule applies only to TIF districts created on or after May 1, 1988. (*Minn. Stat.* §469.177, Subd. 1a.)

Pay-as-you-go financing: A method of financing tax increment projects where a developer obtains the project financing and pays for the up-front development costs. The development authority uses the tax increments generated from the development to reimburse the developer for those development costs (plus interest). Usually, these arrangements are formalized in a developer agreement. With pay-as-you-go financing, the developer bears the risk if tax increment revenues are insufficient to cover project costs.

Pooling: Allows tax increments collected from a TIF district to be spent on activities outside the district. The activities must be within the project area, but may or may not be located in another TIF district. Pooling was first permitted under the TIF Act for TIF districts created after 1982. For districts created after April 30, 1990, not more than 25 percent of tax increment revenues may be spent outside the TIF district. For districts created after June 30, 1995, not more than 20 percent of tax increment revenues may be pooled, although the limit for redevelopment districts remains at 25 percent. (*Minn. Stat.* §469.1763, Subd. 2.)

Project area: The geographic area in which tax increment revenues may be spent. These revenues must be collected from TIF districts located within the project area. Project areas are designated by development authorities under applicable development laws.

Structurally substandard: A building containing defects in structural elements or a combination of deficiencies in essential utilities and facilities, light and ventilation, fire protection, or similar factors, which are of sufficient total significance to justify substantial renovation or clearance. A building is *not* structurally substandard if it is in compliance with the building code applicable to new buildings or could be modified to satisfy the building code at a cost of less than 15 percent of the cost of constructing a new structure. (*Minn. Stat.* §469.174, Subd. 10(b).)

Tax increments: Tax increment revenues are the increased property taxes paid by properties in the TIF district. Mathematically, tax increments are determined by multiplying the captured tax capacity by the current tax rate for districts created before May 1, 1988, or by the original tax rate for districts created on or after May 1, 1988.

Tax increment financing act: The 1979 Act, and subsequent amendments, that governs the establishment of tax increment districts and the collection of tax increments. (*Minn. Stat.* §§469.174-469.179.)

Tax increment district: A district consists of the geographic area from which tax increments are collected. The development authority defines the area in the tax increment financing plan. A district may be a contiguous or non-contiguous area within a project area. (*Minn. Stat.* §469.174, Subd. 9.)

Tax increment financing plan: A plan that must describe the project supported by tax increment financing, project objectives, development program and activities to be undertaken, type and duration of district being created, parcels included in the district, the estimated costs and revenues, impact on other taxing jurisdictions, and other details of the proposal. The plan must be approved by the city after a public hearing and it may be amended at any time. However, a public hearing must be held before significant changes are approved, such as increasing the size of the district or increasing spending or bonded indebtedness. The size of the district cannot be increased five or more years after the district was created. (*Minn. Stat.* §469.175, Subd. 1, 4)

Tax increment financing general obligation bonds: Either a city or a development authority may issue general obligation bonds to finance the projects for which the tax increment district was created. Municipal general obligation bonds are backed by the full faith and credit of the city. If tax increments are not sufficient to repay the bonds, the city must use general property taxes or other city funds to repay the bonds. Authority general obligation bonds are backed by the full faith and credit of the development authority (such as the housing redevelopment authority), but not the city. Because the authority has only limited taxing authority, these bonds are less secure than city general obligation bonds. (*Minn. Stat.* §469.178.)

Tax increment revenue bonds: These bonds are backed by revenues generated from a development project, such as tax increments, proceeds from land sales, or lease revenues. (*Minn. Stat.* §469.178.)

Three-year knock-out rule: Tax increments cannot be paid if the development authority has not issued bonds, acquired property within the district, or constructed public improvements in the district within three years after creation of the district. Failure to satisfy this rule results in decertification of the district. (*Minn. Stat.* §469.176, Subd. 1a.)

Tourism facility: Property that is acquired, constructed, or rehabilitated for use as a convention and meeting facility, amusement park, recreation facility, cultural facility, marina, park, hotel, motel, or lodging facility that is intended to serve primarily individuals from outside the county. To qualify, the property must be located outside of the seven-county metropolitan area, in a city with less than 20,000 people, and in a county where the median income is no more than 85 percent of the state median income and tourism-related earnings are at least 15 percent of the total earnings in the county. (*Minn. Stat.* §469.174, Subd. 22.)



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March 1, 1996

Mr. Roger Brooks
Deputy Legislative Auditor
Office of the Legislative Auditor
Centennial Office Building
St. Paul, MN 55155

Dear Mr. Brooks:

Thank you for the opportunity to respond to the Legislative Auditor's *Tax Increment Financing Report*. As noted in your report, additional enforcement authority in this area was given to the Office of the State Auditor in the 1995 legislative session, effective January of 1996. Your analysis and evaluation will be useful as we continue to shape our Tax Increment Financing Department and begin our new enforcement responsibilities.

The Office of the State Auditor is not in a position to comment either on the validity of the analysis or the accuracy of the conclusions contained in the report. Given the length of the report and the limited review time provided, we offer the following general comments.

In Chapter 4 of the report it is noted that under current law the Revenue Department is charged with enforcement of income requirements for housing districts. When the 1995 legislature transferred tax increment financing enforcement responsibilities to the Office of the State Auditor, the enforcement of housing district income requirements was left with the Revenue Department. We felt at that time, and still feel, the Revenue Department is the appropriate state entity to enforce the requirements contained in this section. Minnesota Statute §469.1761 requires that housing projects comply with income requirements for qualified mortgage bond projects and qualified residential rental projects as defined by the Internal Revenue Code. The Revenue Department is the appropriate entity to be working with individual or family income requirements created and defined by provisions of the Internal Revenue Code. In addition to its expertise with these income requirements and Revenue Code compliance, the Revenue Department has the ability to issue a Commissioner's order of noncompliance upon determining that a violation has occurred. This order must be appealed to the tax court. It is this special ability to impose a consequence for noncompliance in housing projects which makes



OFFICE OF THE STATE AUDITOR

Mr. Roger Brooks

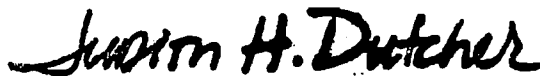
March 1, 1996

Page 2

the Revenue Department the appropriate oversight entity. The only enforcement procedure available to the Office of the State Auditor is referring violations to the applicable county attorney who, in their discretion, may pursue the matter in district court. For these reasons, I recommend that the enforcement responsibilities for housing district income requirements remain with the Revenue Department.

Although your evaluation was not a compliance audit, Chapter 4 of the report contains suggestions regarding specific compliance areas which should be monitored in coming years. The Office of the State Auditor would like to thank the Legislative Audit staff for its well written report. The members of our Tax Increment Financing Department will review the suggestions contained in the report and will consider the Legislative Auditor's suggestions.

Sincerely,



Judith H. Dutcher
State Auditor

JHD/smk

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