



STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

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Statement of Position Small Cities' Expanded TIF Powers

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This Statement of Position is not legal advice and is subject to revision.

Recognizing the unique needs of small cities, the 1997 Legislature amended the Tax Increment Financing (TIF) Act to give small cities the ability to use economic development TIF districts to assist commercial facilities that otherwise could not be assisted.¹

A “small city” is defined in the TIF Act.² For districts with a request for certification made after June 30, 1997, through July 1, 2023, a small city is any home rule charter or statutory city that has a population of 5,000 or less and is located ten miles or more from a home rule charter or statutory city, located in Minnesota, with a population of 10,000 or more. For districts with a request for certification made after July 1, 2023, the ten mile distance parameter is reduced to five miles.³ The distance between the two cities is measured by drawing a straight line from the nearest boundaries of the two cities. Driving distance is not relevant.

A city’s qualification status is determined based on the year in which the request for certification was made and continues for the duration of the district, regardless of whether the city later meets or ceases to meet the population and distance requirements.⁴

Expanded Use of Tax Increment

The TIF Act generally limits the use of economic development districts to assist buildings and facilities used for:

- manufacturing;
- warehousing, storage, and distribution (excluding retail);
- research and development;
- telemarketing;
- tourism facilities; and
- qualifying workforce housing.⁵

¹ See Minn. Stat. § 469.176, subd. 4c(b). The TIF Act can be found at Minn. Stat. §§ 469.174 to 469.1794, inclusive, as amended.

² Minn. Stat. § 469.174, subd. 27.

³ See 2023 Minn. Laws, ch. 64, art. 8, sec. 1, for the change in the distance parameter and its effective date. The effective date for the original definition is found in 1997 Minn. Laws, ch. 231, art. 10, sec. 25 referencing the addition of the definition in sec. 4.

⁴ Minn. Stat. § 469.176, subd. 4c(c).

⁵ Minn. Stat. § 469.176, subd. 4c(a).

Generally, this limitation prevents economic development TIF districts from using their tax increment to assist other commercial and retail facilities (for example, grocery stores and fast food franchises). Small cities were given an exception to this limitation and are permitted to use tax increment from an economic development district to provide assistance in any form for a commercial facility.

Requirements and Limitations

Although the small city exception expands the use of increment from economic development districts to assist a broad range of commercial facilities, this expanded authority is subject to some requirements and limitations.

- *Necessity.* The assistance being provided through tax increment must be necessary to develop the facility.
- *Location and Size of the Commercial Facility.* The commercial facility receiving the assistance must be located within the municipal jurisdiction of the small city and the facility cannot exceed 15,000 square feet.
- *Separate Ownership of Facilities.* More than one commercial facility meeting the above requirements may receive assistance through tax increment, provided that they are separately owned. The Office of the State Auditor (OSA) does not consider facilities owned by related parties to be “separately owned” (e.g. different companies with the same parent company).
- *Increment Usage Limitation.* Tax increment may be spent only to assist the commercial facility directly and, except for administrative costs, must be spent on activities within the district. No pooling, or expenditures on activities outside the district (other than administrative costs), may occur.

These limitations relate only to the use of increment for commercial facilities under the small city exception. In addition, small cities may use increment for the standard economic development purposes permitted by the TIF Act, such as manufacturing, and warehousing.

TIF Plan and Modification Requirements

The OSA recommends a development authority expressly state in its TIF plan, when applicable, that the small city exception is being used to assist a commercial facility.⁶ If an original TIF plan does not contain this designation and the authority subsequently decides to make use of the small city exception, such a change is not considered a change to the type of TIF district that would require a new plan (i.e. a new district) to be created.⁷ However, the authority may be required to modify the existing TIF plan following the notice, discussion, public hearing, and findings requirements, as is required for other significant TIF plan modifications.

For example, the formal modification process is required if the small city exception to allow increment to pay for commercial facility costs results in an increase in the estimate of the costs of the project, including administrative expenses, that will be paid or financed with tax increment from the district. For the circumstances requiring the formal modification process, see Minn. Stat. § 469.175, subd. 4(b).

The modification to the plan should include, at a minimum: identification of the small city designation, a description of the commercial facility being assisted, updated cost estimates, and recognition that all tax

⁶ The OSA recommends this because each TIF plan must include a description of a district’s objectives and/or proposed development activities. See Minn. Stat. § 469.175, subd. 1(a)(1)(3)(4).

⁷ See Minn. Stat. § 469.175, subd. 4(c).

increments generated from the district may be used only for in-district costs for direct assistance necessary to develop the commercial facility and for administrative expenses.

If a district is designated as a small city economic development district but the development authority subsequently decides that the district's tax increment will not be used for commercial facilities, the authority may use the district in a manner consistent with the regular limitations of the TIF Act. However, a TIF plan modification would be appropriate to ensure that all revenues are ultimately used in accordance with the TIF plan.⁸

⁸ See Minn. Stat. § 469.176, subd. 4.