STATE OF MINNESOTA

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Statement of Position
TIF Bond Financing of Project Costs

Tax increment financing (TIF) uses the increase in property taxes (tax increment) that results from new development to pay for at least part of that same development. Because development must occur before TIF revenues can be collected, debt is commonly incurred. Project costs, therefore, are generally paid with debt obligations, placing debt obligations and how these obligations are secured at the center of the law and practice of tax increment financing. Bonds are broadly defined in the TIF Act and are the primary methods of financing project costs within a TIF district.[1]

Tax Increment Bonds

Any bond to which payment for tax increment is pledged is a tax increment bond. A tax increment bond issued in connection with "any project for which tax increment financing has been undertaken" must be one of the types of bonds expressly authorized by section 469.178 of the TIF Act.[2] The types of bonds expressly authorized by section 469.178 are:

- municipality general obligation bonds;
- authority general obligation bonds;
- authority revenue bonds (including pay-as-you-go, or PAYG, obligations); and
- interfund loans or advances.

Municipality General Obligation Bonds[3]

General obligation tax increment (GOTI) bonds are secured by both pledged tax increments and the issuing municipality's full faith and credit. If pledged revenues are insufficient to pay debt service, the municipality must use other funds and, if necessary, must levy ad valorem taxes to make the bond payments. GOTI bonds are issued by the municipality rather than the development authority. If the authority and municipality are not the same, the authority must pledge the tax increment from the district to the municipality. The pledge must be by written agreement and filed with the county auditor. If the authority and municipality are the same, the municipality may pledge tax increment by covenant and file the resolution containing the covenant with the county auditor.

GOTI bonds are issued in the same manner and are subject to the same conditions as municipal bonds issued under Chapter 475. Approval by the electorate is not required for the issuance of GOTI bonds for

[1] The TIF Act (found at Minn. Stat. §§ 469.174 to 469.1794 inclusive, as amended) defines bonds to include refunding bonds, notes, interim certificates, debentures, and interfund loans. Minn. Stat. § 469.174, subd. 3. Although listed in the definitions, interim certificates and debentures are rarely, if ever, used.
[2] Minn. Stat. § 469.178, subd. 1.
[3] Minn. Stat. § 469.178, subd. 2.

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project costs if the municipality is entitled to reimbursement from tax increment and not less than 20 percent of the cost is estimated to be paid from tax increments.[4]

Historically, GOTI bonds were commonly issued to finance the upfront construction costs of the development activity for public improvements. These bonds were generally tax exempt even if they financed private activities. Changes in federal tax law in 1986, however, sharply curtailed the ability of local government to issue such bonds on a tax-exempt basis unless the proceeds are to be used only to finance public improvements such as roads and utilities. In addition, the recession of the early 1980s led to tax increment revenue shortfalls, which forced some issuers to levy a general ad valorem tax to pay debt service on GOTI bonds.

Authority General Obligation Bonds[5]

These bonds may be issued only when the development authority and the municipality are not the same entity. The bonds are issued by an economic development authority, a housing and redevelopment authority or a port authority. In addition to the pledged tax increments, the bonds are secured by the full faith and credit of the authority, not by the municipality. These bonds are almost never issued because development authorities have limited taxing powers, making a pledge of their full faith and credit not very meaningful.

Authority Revenue Bonds[6]

Revenue bonds are secured solely by tax revenues (including by tax increments), by assessments, and by any other revenues derived from a TIF district. Such bonds are issued by the authority or, if the municipality itself is the "authority," by the municipality. Tax increment revenue bonds are difficult to market until construction is completed and the tax increment revenues are flowing. Revenue bonds carry a significantly higher interest rate than GOTI bonds, and the bond market requires more tax increment coverage than is needed to pay the debt service on the bonds. If the project is a public improvement that is also assessable under Chapter 429, it is possible to combine tax increment and special assessment financing. Special assessments are generally a stronger form of security because the assessments are a lien on the benefitted property.

Limited availability of tax-exempt bonds and the unwillingness of municipalities to secure development activities with their full faith and credit led to the practice of financing a large percentage of tax increment projects with PAYG obligations.

Pay-As-You-Go (PAYG) obligation

A PAYG obligation is a form of revenue obligation. The developer pays for certain qualified costs, and is reimbursed for those costs by tax increments over time. The municipality or authority enters into a (re)development agreement to reimburse, with tax increment revenues, eligible TIF costs incurred by the developer, together with interest at an agreed-upon rate. Reimbursement with tax increment revenues occurs when and to the extent tax increment revenues become available. Initially, the developer uses its own funds or borrowed funds from a bank to finance public improvement costs. The developer then submits invoices to the municipality or authority to substantiate the costs incurred as eligible tax increment costs. The authority issues a PAYG note to the developer for the principal amount

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[4] Minn. Stat. § 475.58, subd. 1 (3).
[5] Minn. Stat. § 469.178, subd. 3.
[6] Minn. Stat. § 469.178, subd. 4.

equal to the eligible costs incurred. Tax increment revenues generated from the new development are then used to pay the debt service on the bond. If tax increment revenues sufficient to pay the PAYG note are not generated as anticipated, the developer does not get reimbursed and the authority has no obligation to pay the shortfall. With PAYG notes, it is the developer who has accepted the risk of failed development.[7]

Interfund Loans[8]

Interfund loans (within the context of tax increment financing) occur when an authority or municipality advances or loans money to finance project costs from its general fund or from any other fund under which it has legal authority to do so. The loan or advance must be authorized by resolution of the governing body or of the authority, whichever has jurisdiction over the fund from which the advance or loan is authorized. The terms and conditions of the interfund loan must be provided in writing and, at minimum, include the principal amount, the interest rate to be paid, and the maximum term.[9]

Use of TIF in Relation to Bonds

Bond Proceeds

Section 469.178 mandates that the proceeds of tax increment bonds must be treated "as if the proceeds were tax increment" and, as a result, bond proceeds can be used only for tax increment qualifying purposes.[10] With GOTI bonds, all the proceeds must be spent for qualifying tax increment purposes, even if only 20 percent of the debt service is estimated to be paid with tax increments. Tax increment bonds, whether GOTI or revenue bonds, are not included for purposes of computing the net debt of any municipality.[11]

Pooled Increments

Pooled increments are tax increments pledged to pay or used to make debt service payments on a bond when the bond proceeds were spent on an activity outside of the boundaries of the district from which the tax increments were collected. Authority to pool varies depending on the type of district and on when the district was created. Not all districts have authority to pool.[12]

TIF Bonds, TIF Plans and Reporting Requirements

Bonds are so central to the practice of tax increment financing that an estimate of the amount of bonds a development authority intends to issue, or to have issued on its behalf, is required to be included in every TIF plan for a district.[13] The estimated amount of bonded indebtedness is expressed as a single number. Alternative financing sources or alternative types of bonds that are being considered may be identified but the estimate to be authorized in the TIF plan is a single number. In addition, an increase in the bonded indebtedness above that authorized in the TIF plan requires a formal plan modification.[14]

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[7] For additional information on PAYG bonds, see the OSA's Statement of Position: TIF Pay-As-You-Go Obligations.
[8] Minn. Stat. § 469.178, subd. 7.
[9] For additional information on interfund loans, see the OSA's Statement of Position: TIF Interfund Loans.
[10] Minn. Stat. § 469.178, subd. 1.
[11] *Id*.
[12] For additional information on pooling, see the OSA's Statement of Position: TIF Pooling.
[13] Minn. Stat. § 469.175, subd. 1(a) (5) (ii).
[14] Minn. Stat. § 469.175, subd. 4(b) (2).

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If, however, an initial bond (of any type) is later refinanced by another type of bond, the refunding bond is not added to the authorized principal amount of bonds. For example, if the principal amount of an interfund loan is repaid through the issuance of a GOTI bond, the interfund loan and the GOTI bond are not added together. The principal amount of the debt remains the same. In this situation, no TIF plan modification would be required because there would be "no increase in amount of bonded indebtedness to be incurred."

Finally, a development authority must file annual reporting forms with the Office of the State Auditor.[15] The annual report includes, among other things, detail of all bonding activity.

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[15] *See* Minn. Stat. § 469.175, subd. 6.

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