State of Minnesota

Julie Blaha
State Auditor

Tax Increment Financing Legislative Report

TIF Reports for the Year Ended December 31, 2019
TIF Reviews Concluded for the Year Ended December 31, 2020

Description of the Office of the State Auditor

The mission of the Office of the State Auditor is to oversee local government finances for Minnesota taxpayers by helping to ensure financial integrity and accountability in local governmental financial activities.

Through financial, compliance, and special audits, the State Auditor oversees and ensures that local government funds are used for the purposes intended by law and that local governments hold themselves to the highest standards of financial accountability.

The State Auditor performs approximately 100 financial and compliance audits per year and has oversight responsibilities for over 3,300 local units of government throughout the state. The office currently maintains five divisions:

Audit Practice - conducts financial and legal compliance audits of local governments;

Government Information - collects and analyzes financial information for cities, towns, counties, and special districts;

Legal/Special Investigations - provides legal analysis and counsel to the Office and responds to outside inquiries about Minnesota local government law; as well as investigates allegations of misfeasance, malfeasance, and nonfeasance in local government;

Pension - monitors investment, financial, and actuarial reporting for Minnesota's local public pension funds; and

Tax Increment Financing - promotes compliance and accountability in local governments' use of tax increment financing through financial and compliance audits.

The State Auditor serves on the State Executive Council, State Board of Investment, Land Exchange Board, Public Employees Retirement Association Board, Minnesota Housing Finance Agency, and the Rural Finance Authority Board.

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Tax Increment Financing
Legislative Report

TIF Reports for the Year Ended December 31, 2019
TIF Reviews Concluded for the Year Ended December 31, 2020

February 11, 2021

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TAX INCREMENT FINANCING LEGISLATIVE REPORT

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Highlights and Trends

- In 2019, approximately $243 million of tax increment revenue was generated statewide, which is an increase of almost six percent from 2018 and exceeds the total in each of the last seven years. (Pages 16 - 19)

- In 2019, 403 development authorities submitted reports to the OSA for 1,648 TIF districts. The total number of districts has largely plateaued over recent years. (Pages 9 - 12)

- In 2019, 91 new TIF districts were certified, two fewer than the number of new districts certified in 2018. In 2019, the number of districts decertified dropped to 66, a decrease of 29 percent from 2018 and the fewest number of decertifications in any of the last five years. The drop in 2019 decertifications likely reflects past periods of reduced certifications. (Pages 13 - 15)

- From 2015 to 2019, housing districts decertified early more frequently than other district types, with 79 percent decertifying early. Redevelopment districts decertified early 63 percent of the time (a rate that seems to have been increasing over recent years). Economic development districts, with their shorter maximum durations, decertified early 30 percent of the time over this latest five-year period (which is also an increase over prior trends). (Page 16)

- In 2019, development authorities returned $8,613,151 in tax increment revenue to county auditors for redistribution as property taxes to the cities, counties, and school districts. (Page 20)

- In 2019, there was a total of nearly $1.7 billion of outstanding debt associated with TIF districts. Pay-As-You-Go (PAYG) obligations were the predominant type of debt, making up 64 percent of the debt reported (up from 58 percent in 2018). General Obligation (GO) bonds comprised about 16 percent of the total debt. Interfund loans (mostly from non-tax increment accounts) made up over 12 percent of total debt. (Page 22)

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SCOPE AND METHODOLOGY

This 25th Annual Legislative Report (Report) was compiled from information received from development authorities currently exercising tax increment financing (TIF) powers in Minnesota. The Report summarizes information reported by 403 development authorities for 1,648 districts for the calendar year ended December 31, 2019.[1] TIF reporting for the year ended December 31, 2019, was required for a total of 1,654 TIF districts from 406 development authorities, but six reports were not received and are therefore not reflected in the data.[2]

The Report also provides a summary of any violations cited in the limited-scope reviews conducted by the Office of the State Auditor (OSA) in 2020. This Report is provided annually to the chairs of the legislative committees with jurisdiction over TIF matters.[3]

In 1995, the Minnesota Legislature assigned legal compliance oversight for TIF to the OSA.[4] The OSA's oversight authority extends to examining and auditing the use of TIF by political subdivisions, as authorized by the Minnesota Tax Increment Financing Act (TIF Act).[5]

The TIF Act requires development authorities to file with the OSA annual financial reports for each of their TIF districts. Reports must be submitted on or before August 1 of each year, starting the year in which a district is certified.[6] Reporting continues until the year following the year in which the district is both decertified and all remaining revenues derived from tax increment have been expended or returned to the county auditor.[7] Because new certifications and decertifications are not always reported in a timely manner, the data for prior years contained in this Report may differ from data presented in previous reports.

[1] The summarized information reflects reported activity as of the end of calander year 2020. Late and resubmitted reports may result in slight changes. Likewise, prior year data in some of the tables and charts may have changed slightly from previously published reports.

[2] Canby failed to report for two of its districts. Lakeland failed to report for both of its districts. Ironton and St. Clair each failed to report for their single districts. Ironton and St. Clair have outstanding reports for previous years. The TIF Act provides for tax increment to be withheld when reports are not filed.

[3] Minn. Stat. § 469.1771, subd. 1(c).

[4] 1995 Minn. Laws, ch. 264, art. 5, § 34. The OSA's oversight of TIF began in 1996.

[5] The TIF Act can be found at: Minn. Stat. §§ 469.174 through 469.1799 inclusive, as amended. The OSA's oversight authority can be found at: Minn. Stat. § 469.1771.

[6] Minn. Stat. § 469.175, subd. 6.

[7] Minn. Stat. § 469.175, subd. 6b.

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TAX INCREMENT FINANCING LEGISLATIVE REPORT

BACKGROUND

Tax increment financing (TIF) is a financing tool established by the Legislature to support local economic development, redevelopment, and housing development. As its name suggests, TIF enables development authorities to finance development activities using the incremental property taxes, or "tax increments," generated by the increased taxable value of the new development.

TIF is not a tax reduction; taxes are paid on the full taxable value. The original taxable value continues to be part of the tax base that supports the tax levies of the city, county, school district, and other taxing jurisdictions.[8] The new, additional value from development activity is "captured" from the tax base; tax increments are the taxes paid on the captured value. Tax increments are reserved and used to finance qualifying costs that make the new development possible.

TIF districts are comprised of the land parcels on which development activity occurs. In order for a municipality to finance development with TIF, it must find that, without the use of TIF, the development would not be expected to occur.[9]

The expenditures that qualify to be paid from tax increment depend on the type of development activity taking place, the type of TIF district created, and the year in which the TIF district was created. Examples of qualifying costs include: land and building acquisition, demolition of structurally substandard buildings, removal of hazardous substances, site preparation, installation of utilities, and road improvements.

A TIF district is created by a development authority. A development authority can be a city, an entity created by a city, or an entity created by a county.[10] Development authorities derive their authority to use TIF and assist projects from various development acts that underlie and are incorporated into the TIF Act by reference: the Housing and Redevelopment Authorities (HRA) Act, the Port Authorities Act, the Economic Development Authorities (EDA) Act, the City Development District Act, and the Rural Development Financing Authorities Act.[11] These acts govern the development projects, whereas the TIF Act governs the use of tax increments. Project areas can be larger than a TIF district and can contain multiple TIF districts.

[8] A hazardous substance subdistrict may capture original value due to the higher expense involved in cleaning up hazardous substances. Minn. Stat. §§ 469.174, subds. 7(b) and 23; 469.175, subd. 7.
[9] Minn. Stat. § 469.175, subd. 3(b)(2). This is often referred to as the "But-For Test," (i.e. development would not happen but for the use of TIF).
[10] Counties and towns may also be development authorities in certain instances.
[11] Minn. Stat. § 469.174, subd. 2 (listing the statutory citations for the various development acts).

TIF districts are terminated, or decertified, when they reach the earliest of the following times: (1) the applicable maximum duration limit provided in the TIF Act for each type of TIF district; (2) a shorter duration limit established by the authority in the TIF plan; (3) upon defeasing, paying, or setting aside sufficient increment to pay all in-district obligations pursuant to the Six-Year Rule; or (4) upon written request by the authority to the county auditor to decertify the district.[12] Decertification ends the collection of increment, but many districts remain active and continue to report until all remaining tax increment revenues have been expended or returned to the county auditor.

Development Authorities

In 2019, there were 406 development authorities in Minnesota actively using TIF, which is six less than the number active in 2018. Fifteen authorities became inactive, four inactive development authorities became active again, and five new city development authorities approved their first TIF district.

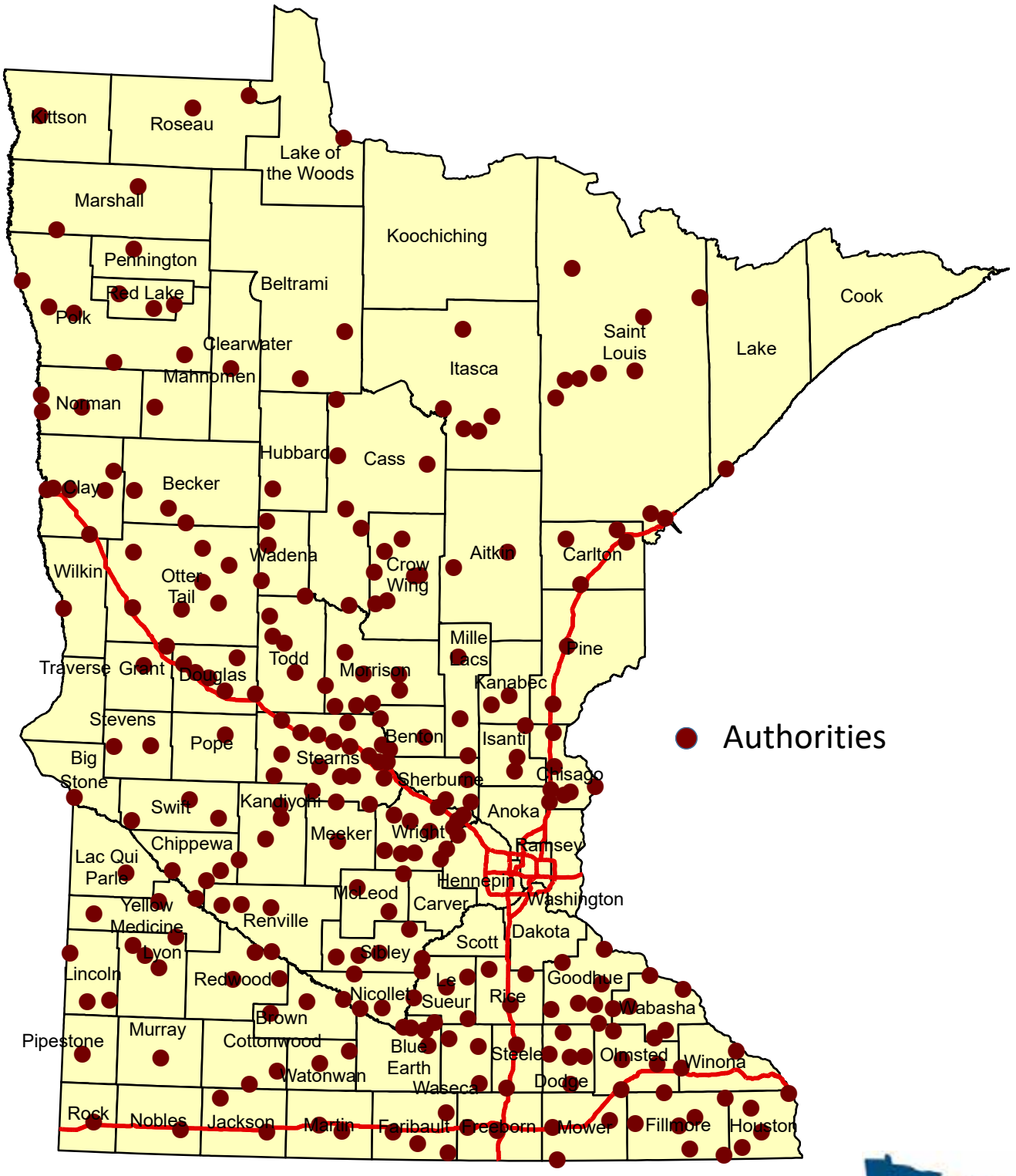
In 2019, of the 406 active development authorities, 304 were located in Greater Minnesota and 102 were located in the Seven-County Metropolitan Area (Metro Area). Maps 1 and 2 on the following pages show the locations of these authorities. Map 3 identifies counties that have a development authority using TIF.[13]

[12] Minn. Stat. § 469.177, subd. 12.

[13] This map does not include the following joint authorities: Bluff Country HRA and Southeast Minnesota Multi-County HRA.

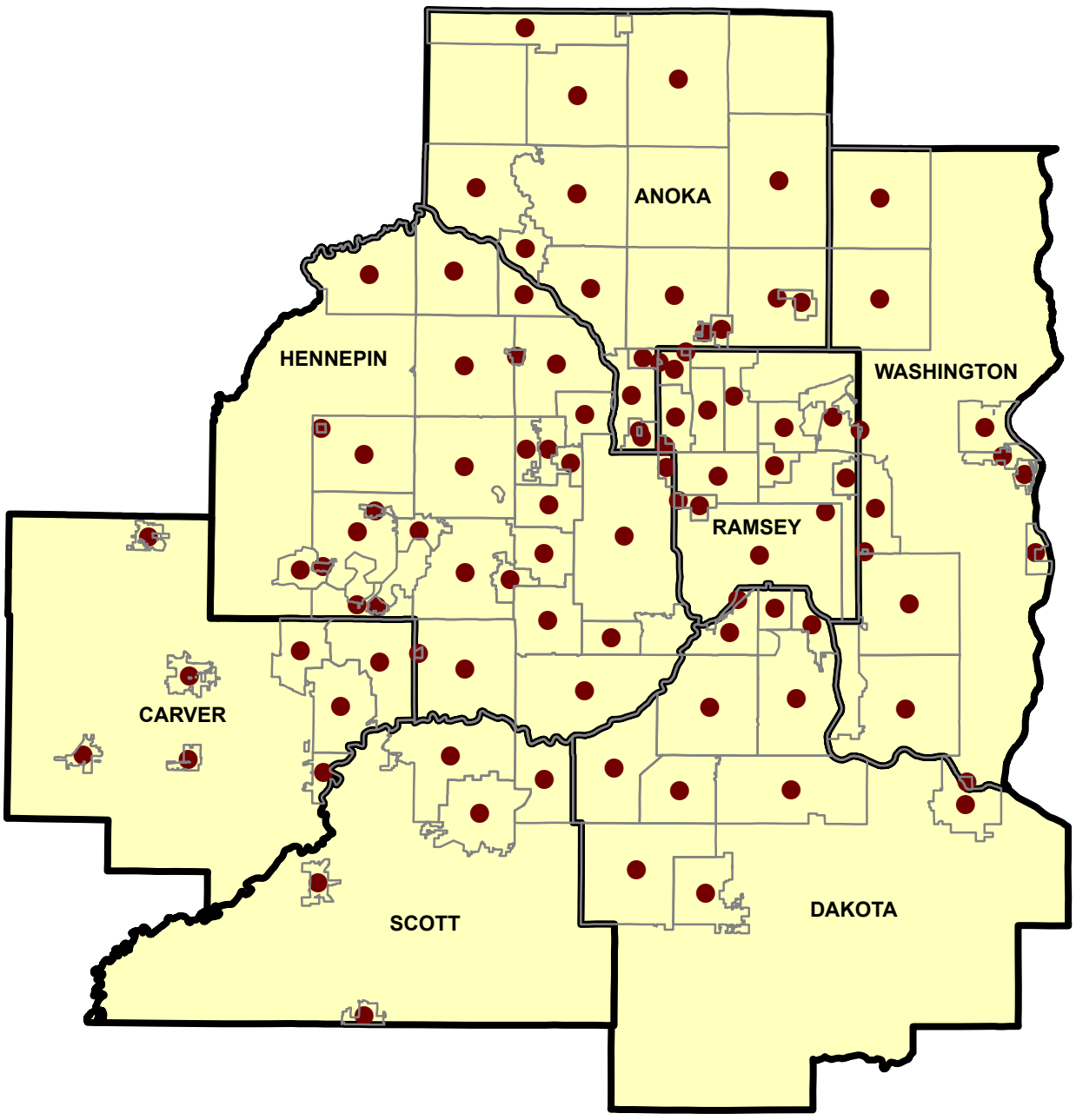
MAP 1

Development Authorities in Greater Minnesota, 2019



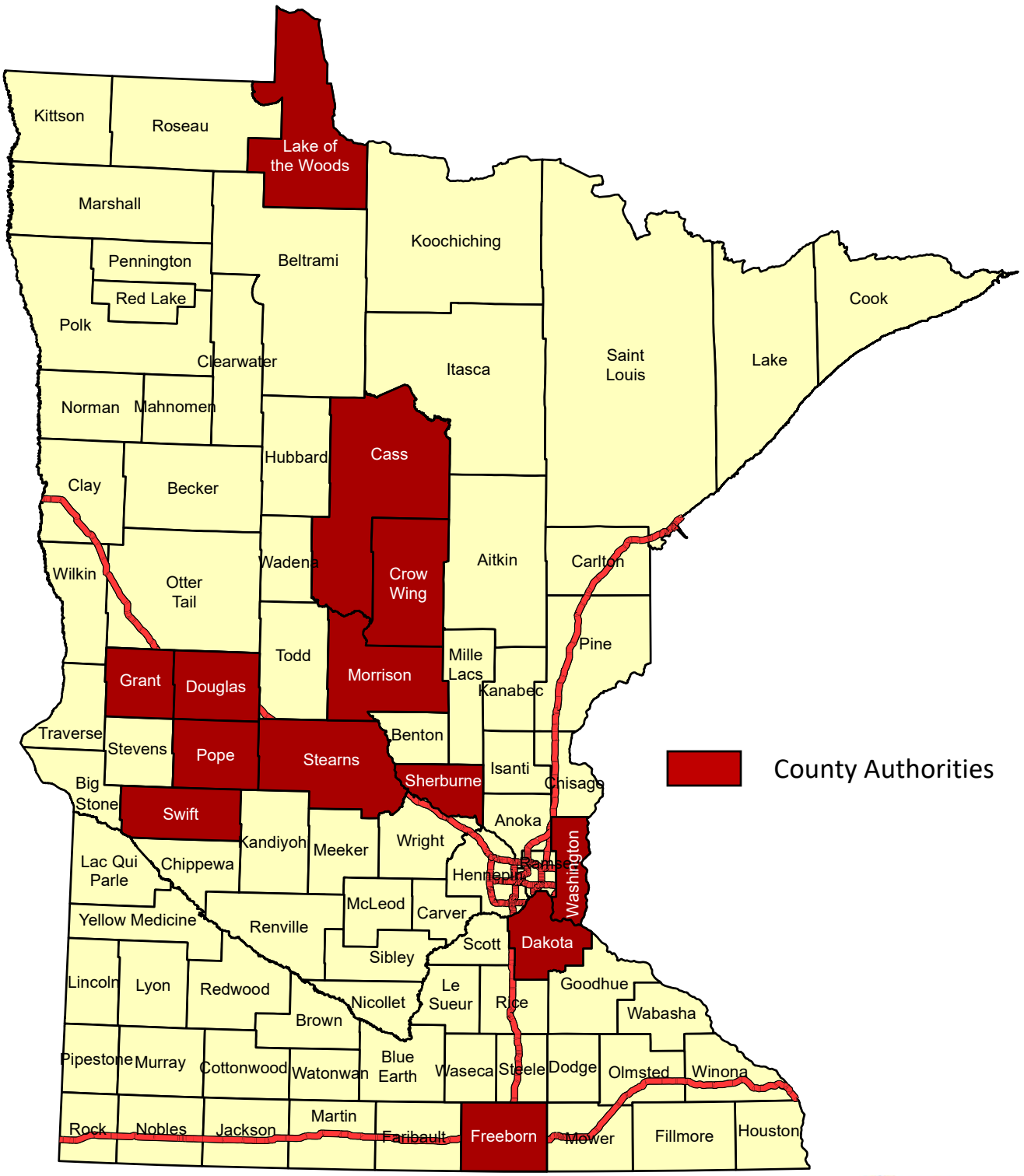
MAP 2

Development Authorities in Metro Area, 2019



MAP 3

County Development Authorities, 2019



Creation of TIF Districts

The first step a development authority takes in creating a TIF district is to adopt a TIF plan. The TIF plan outlines the development activity to be funded with tax increment.[14]

A development authority must obtain approval of the TIF plan from the governing body of the municipality in which the TIF district is to be located. Approval of the TIF plan authorizes the use of tax increment to pay TIF-eligible project costs. Before approving a TIF plan, the municipality must publish a notice and hold a public hearing.[15] For example, if a city's port authority proposes creating a TIF district in the city, the city council must first approve the TIF plan for the district.[16]

Before the notice for a public hearing is published, the development authority must provide a copy of the proposed TIF plan to the county auditor and the clerk of the school board who, in turn, must provide copies of these documents to the members of the county board of commissioners and the school board.[17] The county board and school board may comment on the proposed district, but cannot prevent its creation.[18]

Types of TIF Districts

Five different types of TIF districts are currently authorized by the TIF Act:

- Redevelopment districts;
- Economic development districts;
- Housing districts;
- Renewal and renovation districts; and
- Soils condition districts.

There are two other general types of districts: districts created prior to the enactment of the TIF Act ("pre-1979 districts") and districts created by special law ("uncodified districts"). There is also one type of subdistrict that can be created within a TIF district, a hazardous substance subdistrict.

Each type of TIF district has different requirements for its creation, different restrictions on the use of tax increment revenue, and different maximum duration limits.

[14] Minn. Stat. § 469.175, subd. 1.
[15] Minn. Stat. § 469.175, subd. 3.
[16] In many cases, the commissioners of the TIF authority include some or all of the council members.
[17] Minn. Stat. § 469.175, subd. 2.
[18] When the county is the municipality that must approve the TIF plan, the county board may prevent the creation of a TIF district.

Redevelopment Districts – The purpose of a redevelopment district is to eliminate certain blighted conditions.[19] Redevelopment districts are designed to conserve the use of existing utilities, roads, and other public infrastructure, and to discourage urban sprawl. Qualifying tax increment expenditures include: acquiring sites containing substandard buildings, streets, utilities, parking lots, or other similar structures; demolishing and removing substandard structures; eliminating hazardous substances; clearing the land; and installing utilities, sidewalks, and parking facilities. These TIF-financed activities are generally considered a means to "level the playing field" so that blighted property can compete with bare land for development. These districts have a statutory maximum duration limit of 25 years after first receipt of tax increment.[20]

Economic Development Districts – The purpose of an economic development district is to: (1) discourage commerce, industry, or manufacturing from moving to another state or city; (2) increase employment in the state; (3) preserve and enhance the tax base; or (4) satisfy requirements of a workforce housing project.[21] Tax increment revenue from economic development districts is used primarily to assist manufacturing, warehousing, storage and distribution, research and development, telemarketing, and tourism, but can also be used for workforce housing projects (as of 2017 and sunsetting in 2027).[22] Use of tax increment in these districts for commercial development (retail sales) is excluded by law, except in "small cities."[23] Economic development districts are short-term districts with a limit of eight years after first receipt of tax increment.[24]

Housing Districts – The purpose of a housing district is to encourage development of owner-occupied and rental housing for low- and moderate-income individuals and families. Tax increment revenue can be used in the construction of low- and moderate-income housing and to acquire and improve the housing site. These districts have a statutory maximum duration limit of 25 years after first receipt of tax increment.[25]

Renewal and Renovation Districts – The purpose of a renewal and renovation district is similar to that of a redevelopment district, except the amount of blight to be removed may be less, and

[19] Minn. Stat. § 469.174, subd. 10(a).
[20] Minn. Stat. § 469.176, subd. 1b(a)(4). Note that a duration of 25 years *after* first receipt of tax increment permits 26 years of collection.
[21] Minn. Stat. § 469.174, subd. 12.
[22] Minn. Stat. § 469.176, subd. 4c, identifies allowable purposes. Minn. Stat. § 469.175, subd. 3(g), contains the sunset, barring districts from being certified for requests made after June 30, 2027.
[23] Minn. Stat. § 469.174, subd. 27 (defining small cities as, generally, those with a population of 5,000 or less located ten miles or more from a city of 10,000 or more), and Minn. Stat. § 469.176, subd. 4c.
[24] Minn. Stat. § 469.176, subd. 1b(a)(3). Note that a duration of eight years *after* first receipt of tax increment permits nine years of collection.
[25] Minn. Stat. § 469.176, subd. 1b(a)(4). Note that a duration of 25 years *after* first receipt of tax increment permits 26 years of collection.

the development activity relates more to inappropriate or obsolete land use. The statutory maximum duration limit for these districts is 15 years after first receipt of tax increment.[26]

Soils Condition Districts – The purpose of a soils condition district is to assist in the redevelopment of land which cannot otherwise be developed due to the presence of hazardous substances, pollutants, or contaminants. The estimated cost of the proposed removal and remediation must exceed the fair market value of the land before the remediation is completed.[27] The statutory maximum duration limit for these districts is 20 years after first receipt of tax increment.[28]

Pre-1979 Districts – These districts were created prior to the 1979 TIF Act and have all been decertified.[29]

Uncodified Districts – Special laws have been enacted to address unique issues and permit the use of TIF for a geographic area that does not meet the statutory definition of a TIF district. This type of district is referred to as an "uncodified" district. Examples of uncodified districts are housing transition districts for the cities of Crystal, Fridley, Minneapolis, and St. Paul, and a district addressing distressed rental properties in Brooklyn Park.

Hazardous Substance Subdistricts – The purpose of a hazardous substance subdistrict (HSS) is to finance the cleanup of hazardous substance sites within a TIF district so that development or redevelopment can occur.[30] The subdistrict may be established at the time of approval of the TIF plan, or added later by modification, and requires certain findings and a development response action plan approved by the Minnesota Pollution Control Agency (PCA).[31] The HSS captures additional increment by reducing the original net tax capacity (ONTC) by the estimated costs of the removal actions.[32] The payment of these costs comes from the frozen property tax base of the district and yields immediate increment without requiring any increase in property value. The additional increment may be used only to pay or reimburse specified costs, such as removal or remedial actions, pollution testing, purchase of environmental insurance, and related administrative and legal costs.[33] The statutory maximum duration limit for an HSS can extend beyond that of the overlying district and is 25 years from the date the extended period began or the period necessary to recover the costs specified in the development response plan, whichever occurs first.[34]

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[26] Minn. Stat. § 469.176, subd. 1b(a)(1). Note that a duration of 15 years *after* first receipt of tax increment permits 16 years of collection.

[27] Minn. Stat. § 469.174, subd. 19.

[28] Minn. Stat. § 469.176, subd. 1b(a)(2). Note that a duration of 20 years *after* first receipt of tax increment permits 21 years of collection.

[29] Minn. Stat. § 469.176, subd. 1c. Princeton's TIF 1 Downtown Redevelopment District is the last pre-1979 district reporting.

[30] Minn. Stat. § 469.174, subds. 16 and 23; Minn. Stat. § 469.175, subd. 7.

[31] Minn. Stat. § 469.174, subd. 17.

[32] Minn. Stat. § 469.174, subd. 7(b).

[33] Minn. Stat. § 469.176, subd. 4e.

[34] Minn. Stat. § 469.176, subd. 1e.

Special Legislation

Special legislation allowing exceptions to the TIF Act for individual districts is enacted with some frequency. As of 2019, 116 TIF districts reported having special laws. The most common types of special legislation include: (1) extending the five-year deadline for entering into contracts or issuing bonds, (2) extending the duration limit of a TIF district, (3) creating an exception to requirements or findings needed to create a TIF district, and (4) creating an exception to the limitations on the use of tax increment.

Number of TIF Districts

In 2019, 403 development authorities submitted reports to the OSA for 1,648 TIF districts. Of these districts, 1,043 (63 percent) were located in Greater Minnesota and 605 (37 percent) were located in the Metro Area.[35] (See Figure 1.)

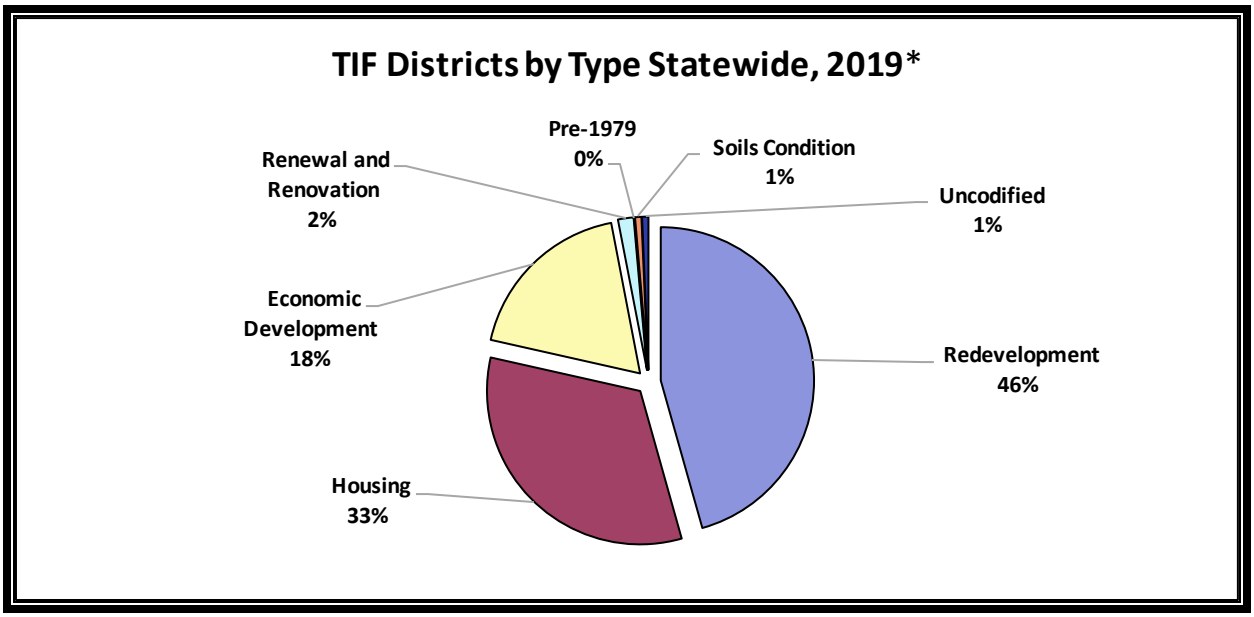
Figure 1.

TIF Districts by Type: Statewide, Greater MN, & Metro Area; 2019			
Type of District	**Statewide**	**Greater MN**	**Metro Area**
Redevelopment	752	408	344
Housing	542	373	169
Economic Development	304	249	55
Renewal and Renovation	27	9	18
Pre-1979	1	1	0
Soils Condition	11	3	8
Uncodified	11	0	11
Total	1,648	1,043	605
Hazardous Substance Subdistricts	22	2	20

In 2019, redevelopment districts made up 46 percent of all TIF districts statewide, followed by housing districts at 33 percent and economic development districts at 18 percent. Combined, these three types made up 97 percent of all districts. (See Figure 2.)

[35] The number of districts being reported includes districts that are decertified but must continue to report due to remaining tax increment assets.

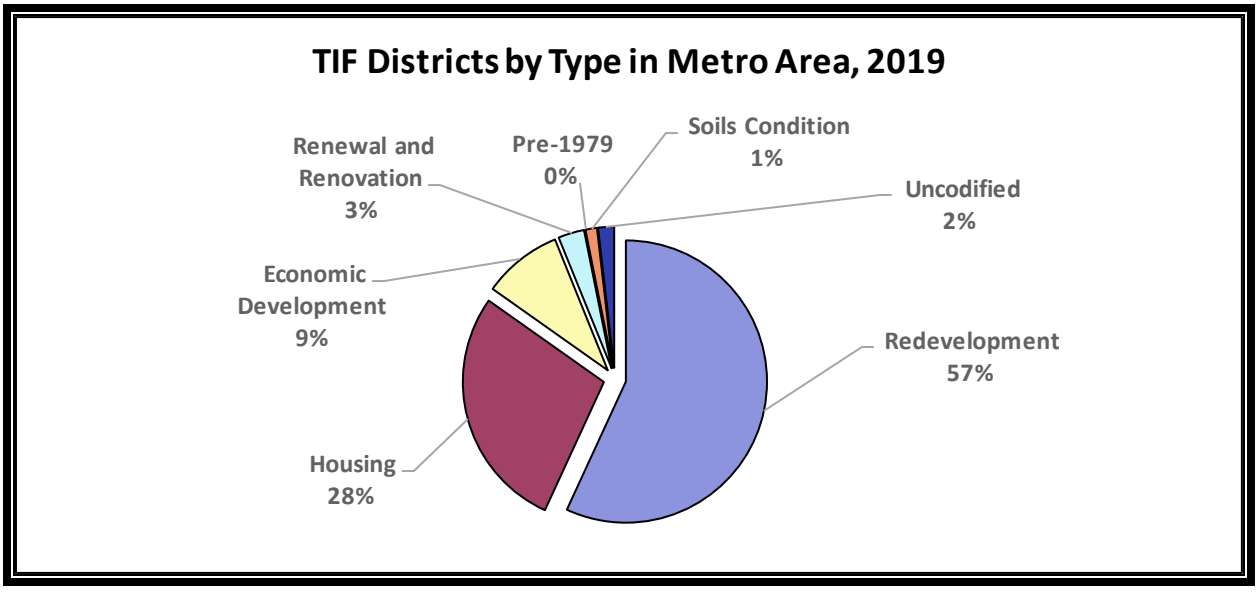
Figure 2.



*Due to rounding, the sum of the percentages does not equal 100 percent.

In the Metro Area, redevelopment districts made up over half (57 percent) of all districts, followed by housing districts at 28 percent and economic development districts at nine percent. (See Figure 3.)

Figure 3.



In Greater Minnesota, redevelopment districts were also the largest type of district, again followed by housing and economic development districts. However, redevelopment districts made up a smaller portion compared to the Metro Area, and housing and economic development districts each made up much larger portions. (See Figure 4.)

Figure 4.

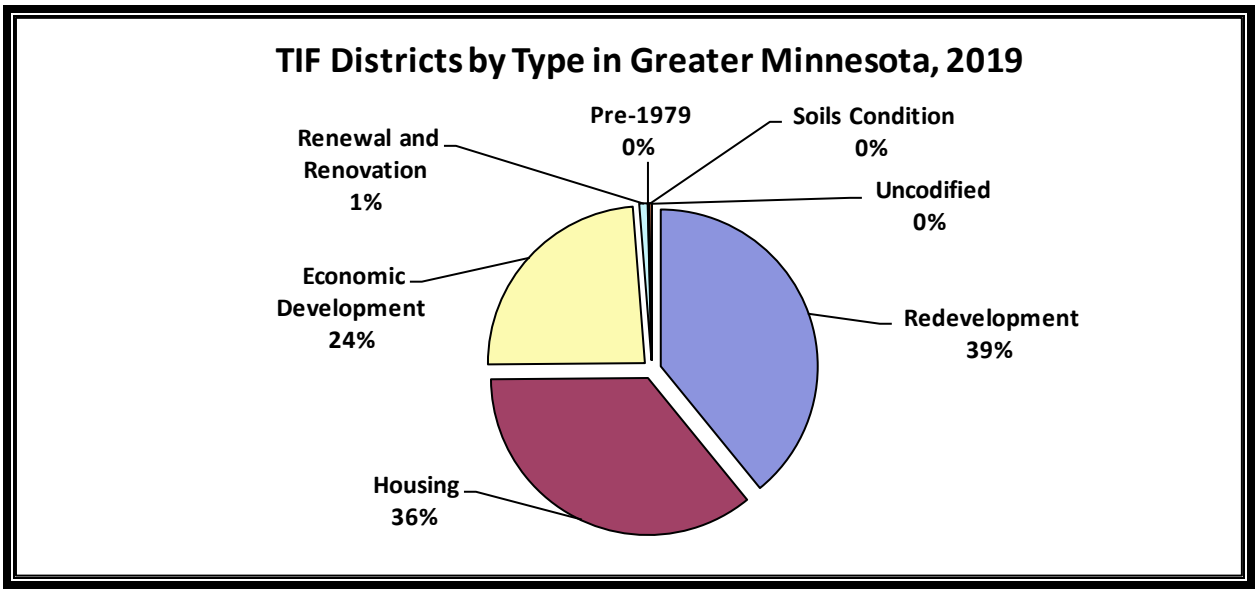
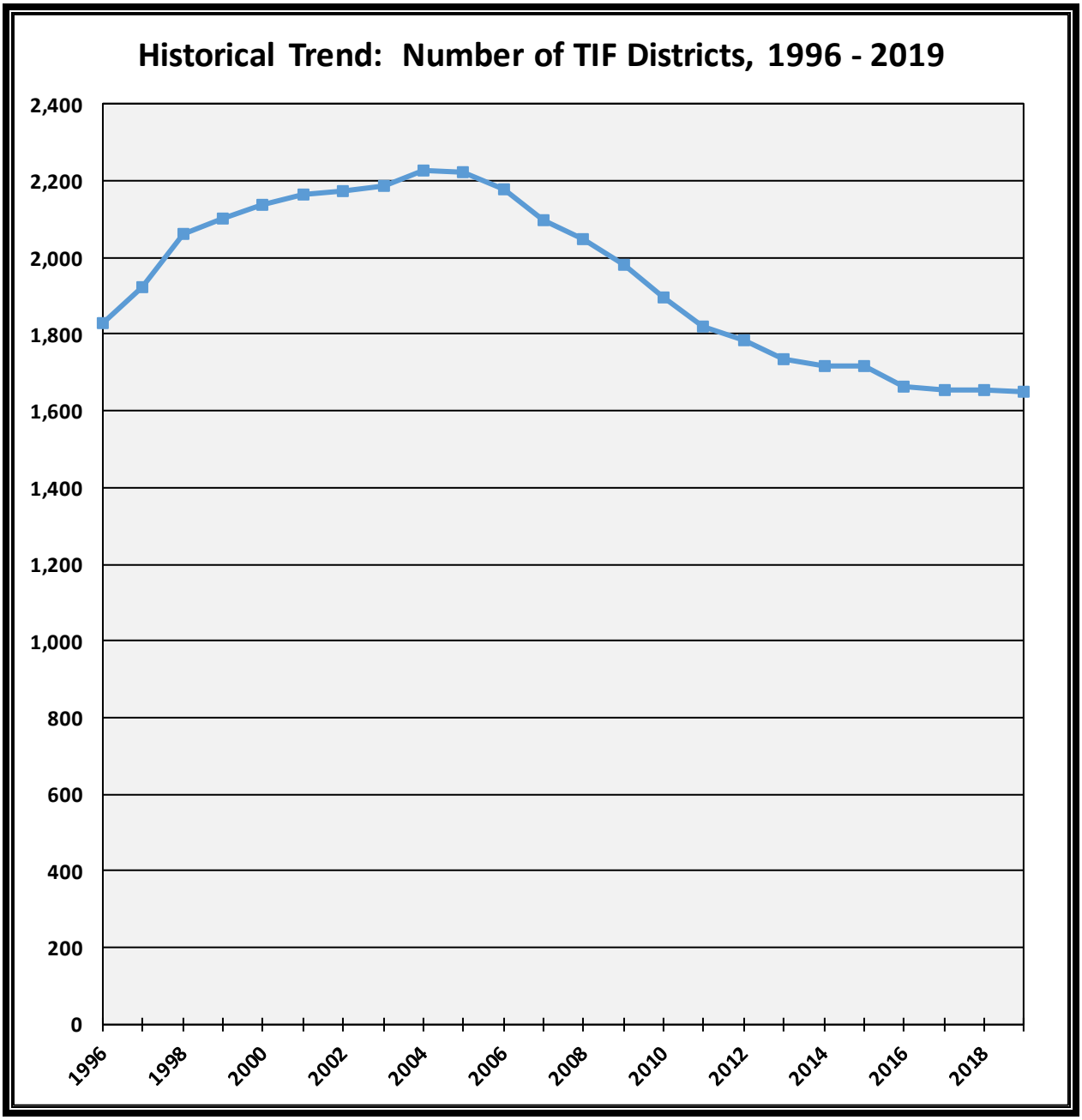


Figure 5 shows the total number of districts reporting to the OSA for each year since 1996, which is when the OSA began oversight of TIF. Between 1996 and 2004, the number of TIF districts increased each year. Since 2004, the total number has declined each year, except for a very slight increase of two districts in 2015. This decline reflects, among other things, large numbers of older districts created in the wake of the 1979 TIF Act (and prior to moderating reforms in 1990) reaching their statutory duration limits. As the majority of pre-1990 districts have decertified, the trend line has largely plateaued over recent years.

Figure 5.


Historical Trend: Number of TIF Districts, 1996 - 2019
2,400
2,200
2,000
1,800
1,600
1,400
1,200
1,000
800
600
400
200
0
1996
1998
2000
2002
2004
2006
2008
2010
2012
2014
2016
2018

New Districts Certified

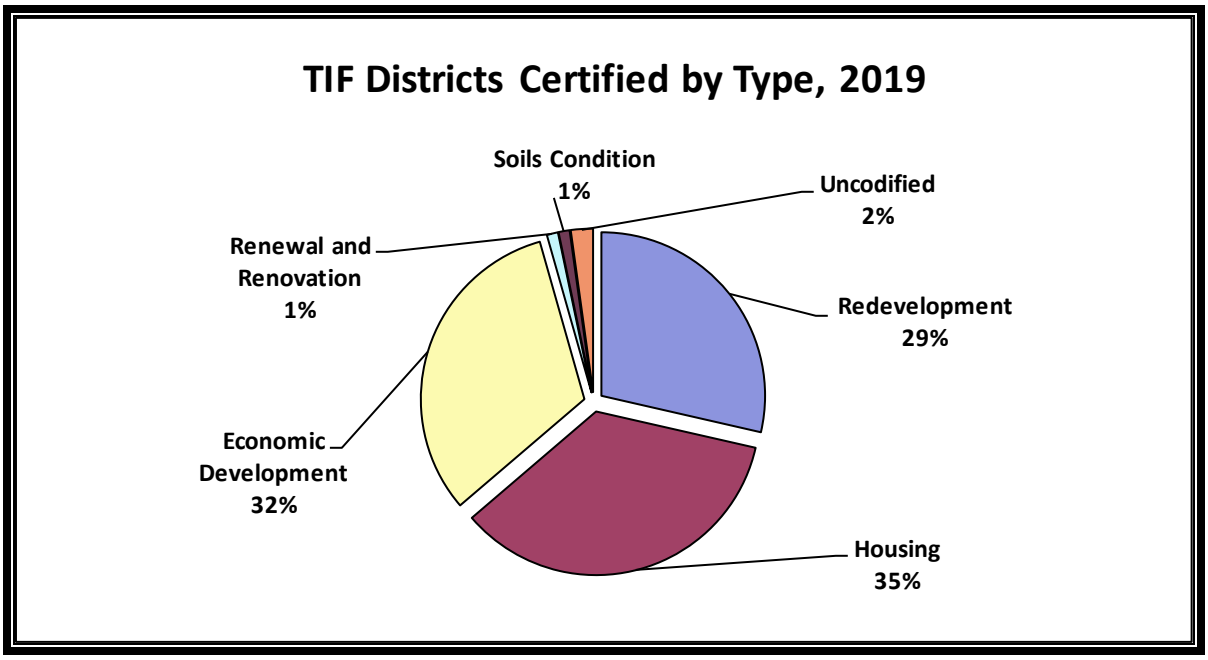
In 2019, 91 new TIF districts were certified, two fewer than the number of new districts certified in 2018. Figure 6 shows new district certifications by type over the past five years. While the number for each type of district has varied, the total amount of new certifications each year has been largely consistent other than a dip in 2016.

Figure 6.

Number of TIF Districts Certified by Type, 2015 - 2019					
	2015	**2016**	**2017**	**2018**	**2019**
Redevelopment	38	29	34	32	26
Housing	24	18	29	34	32
Economic Development	33	21	28	22	29
Renewal and Renovation	0	3	1	2	1
Soils Condition	0	1	0	2	1
Uncodified	0	1	0	1	2
Total	95	73	92	93	91

In 2019, housing districts accounted for the largest portion of all new districts at 35 percent, with economic development districts following closely at 32 percent. Redevelopment districts made up 29 percent, with other types making up the remainder. (See Figure 7.)

Figure 7.



Districts Decertified

Unlike the full discretion involved in creating new districts, decertifications are more often the result of duration limits (either statutory or plan-specified), or the Six-Year Rule, which requires decertification once all in-district obligations have been satisfied.[36]

In 2019, the number of districts decertified dropped to 66, a decrease of 29 percent from 2018 and the fewest number of decertifications in any of the last five years. Figure 8 shows the number of decertifications by type of district for the last five years. The drop in 2019 decertifications likely reflects past periods of reduced certifications. The number of district certifications dipped following reforms in 1990, and redevelopment and housing districts created during those years are now reaching their statutory duration limits.[37] The number of economic development district certifications dropped during the years of the great recession, and those districts are also beginning to reach their maximum duration limit.[38]

Figure 8.

Number of TIF Districts Decertified by Type, 2015 - 2019					
	2015	**2016**	**2017**	**2018**	**2019**
Redevelopment	62	60	36	40	27
Housing	39	33	12	23	23
Economic Development	19	25	28	29	14
Renewal and Renovation	1	1	1	1	1
Soils Condition	0	0	0	0	1
Uncodified	0	0	0	0	0
Pre-1979	0	0	0	0	0
Total	121	119	77	93	66

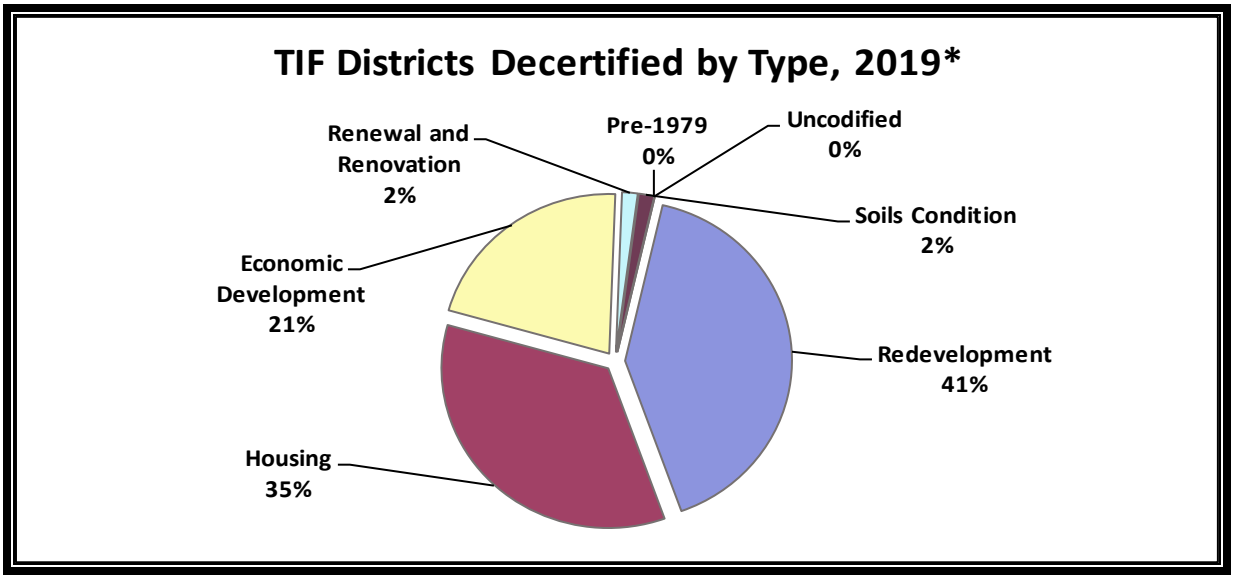
In 2019, 41 percent of decertified districts were redevelopment districts, while housing and economic development districts accounted for 35 percent and 21 percent, respectively. (See Figure 9.)

[36] In-district obligations are determined pursuant to the Five-Year Rule (Minn. Stat. § 469.1763, subd. 3), which generally limits "in-district" obligations to those established in the first five years. The Six-Year Rule (Minn. Stat. § 469.1763, subd. 4), generally requires that beginning in the sixth year, an authority must use a certain portion of increment to pay, or set aside to pay, the in-district obligations, and to decertify when the in-district obligations are paid or when enough increment has been set aside for their payment.

[37] Durations run from first receipt of increment, which typically lags their certification year by a couple of years. While not shown in this report, the number of districts expected to reach their statutory maximum duration limits in the next couple of years also appears to be less than in years past and in years to follow. Early decertifications would affect actual decertification totals.

[38] Prior editions of this report show economic development district certifications were 11 and 12 in 2009 and 2010, compared to certifications in the 20's and 30's in surrounding years.

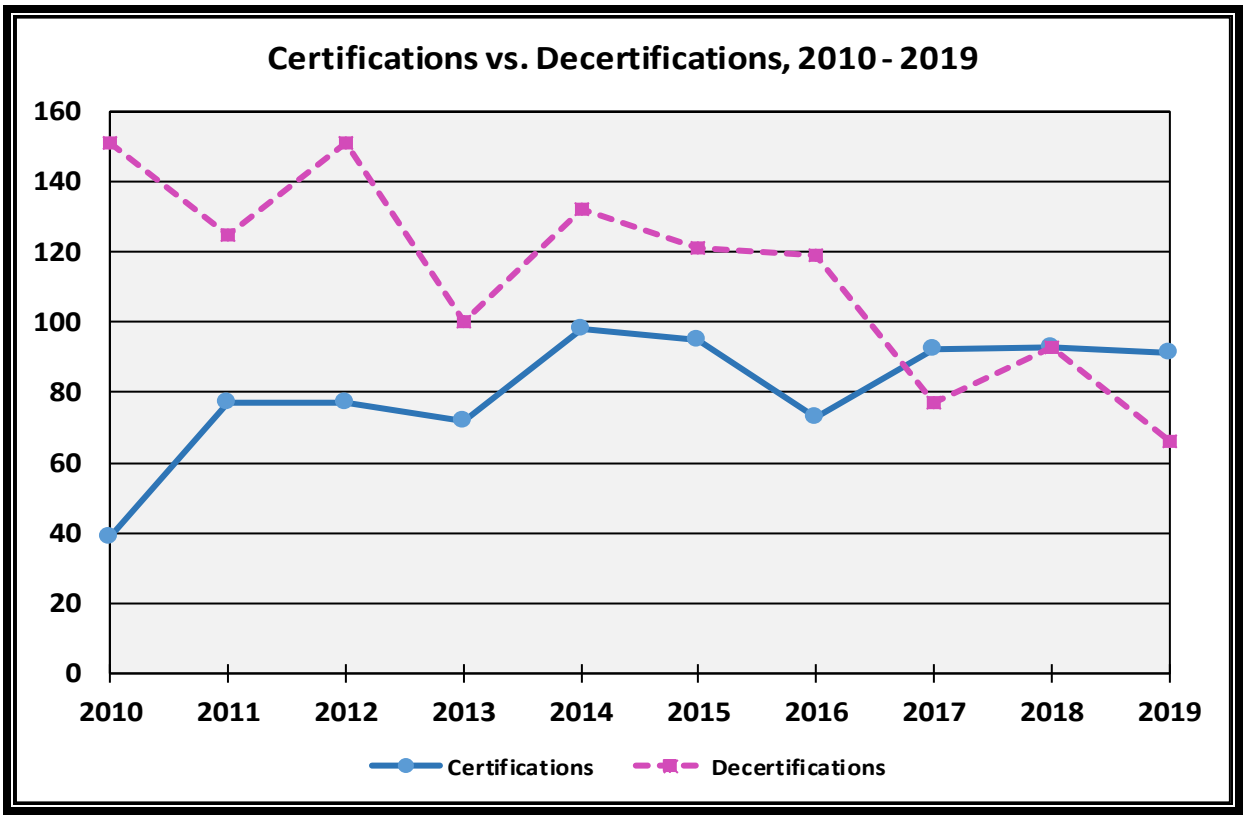
Figure 9.



*Due to rounding, the sum of the percentages does not equal 100 percent.

Prior to 2019, the convergence of trends in both decertifications and new certifications suggested the overall volume of TIF districts was perhaps stabilizing. (See Figure 10.) The drop in 2019 decertifications, however, may suggest less predictability.

Figure 10.



The Six-Year Rule, with its early decertification requirement, was enacted in 1990 for districts that followed. Its impact is reflected, in part, in Figure 11, which compares, for districts that decertified from 2015 through 2019, the number of districts that decertified early versus those that ran for their full statutory maximum duration.

Figure 11.

Decertifications 2015 - 2019:
Full Duration vs. Early Decertification*

District Type / (Max Duration)	Decertified Districts	Lasted Full Duration	Decertified Early	
			Percent	Average Years
Redevelopment (25 years)	225	37%	63%	10
Housing (25 years)	130	21%	79%	11
Economic Development (8 years)	115	70%	30%	4
Renewal and Renovation (15 years)	5	80%	20%	15
Soils Condition (20 years)	1	0%	100%	6

*Durations are measured by comparing "year of actual decertification" to "year of required decertification" reported by the authority based on the statutory maximum duration limit or an earlier final year identified in the TIF plan. Early decertifications may be voluntary or may be required by the Six-Year Rule.

From 2015 to 2019, housing districts decertified early more frequently than other district types, with 79 percent decertifying early. Redevelopment districts decertified early 63 percent of the time (a rate that seems to have been increasing over recent years).[39] Economic development districts, with their shorter maximum durations, decertified early 30 percent of the time over this latest five-year period (which is also an increase over prior trends).[40] For districts that decertified early, redevelopment districts decertified an average of ten years early, and housing districts decertified an average of 11 years early.

Tax Increment Revenue

In 2019, approximately $243 million of tax increment revenue was generated statewide. Although most districts are located in Greater Minnesota, approximately $207 million of tax increment, or 85 percent, was generated in the Metro Area. (See Figure 12.)

[39] While not displayed herein, previous reports for years 2015 through 2018 identified five-year rates of early decertification for redevelopment districts as 48 percent, 51 percent, 54 percent, and 60 percent, respectively.

[40] While not displayed herein, previous reports for years 2015 through 2018 identified five-year rates of early decertification for economic development districts as 23 percent, 23 percent, 25 percent, and 23 percent, respectively.

Figure 12.

Revenue Generated by Type: Statewide, Greater MN, & Metro Area; 2019			
Type of District	**Statewide**	**Greater MN**	**Metro Area**
Redevelopment	$ 180,587,039	$ 16,207,901	$ 164,379,138
Housing	$ 34,201,949	$ 11,108,616	$ 23,093,333
Economic Development	$ 20,590,108	$ 8,551,002	$ 12,039,106
Renewal and Renovation	$ 6,286,399	$ 466,922	$ 5,819,477
Pre-1979	$ -	$ -	$ -
Soils Condition	$ 256,081	$ 56,480	$ 199,601
Uncodified	$ 1,310,532	$ -	$ 1,310,532
Total	$ 243,232,108	$ 36,390,921	$ 206,841,187

Figures 13, 14, and 15 illustrate the mixes of tax increment revenue generated in 2019 by type of district for the whole state, the Metro Area, and Greater Minnesota, respectively. Statewide, redevelopment districts made up 46 percent of the TIF districts but generated 74 percent of total tax increment revenue. This is driven by districts in the Metro Area, where redevelopment districts generated 79 percent of the tax increment revenue. By contrast, the distribution of tax increment revenue in Greater Minnesota is more similar to the distribution of the types of district, with a smaller but notable skew toward redevelopment districts.

Figure 13.

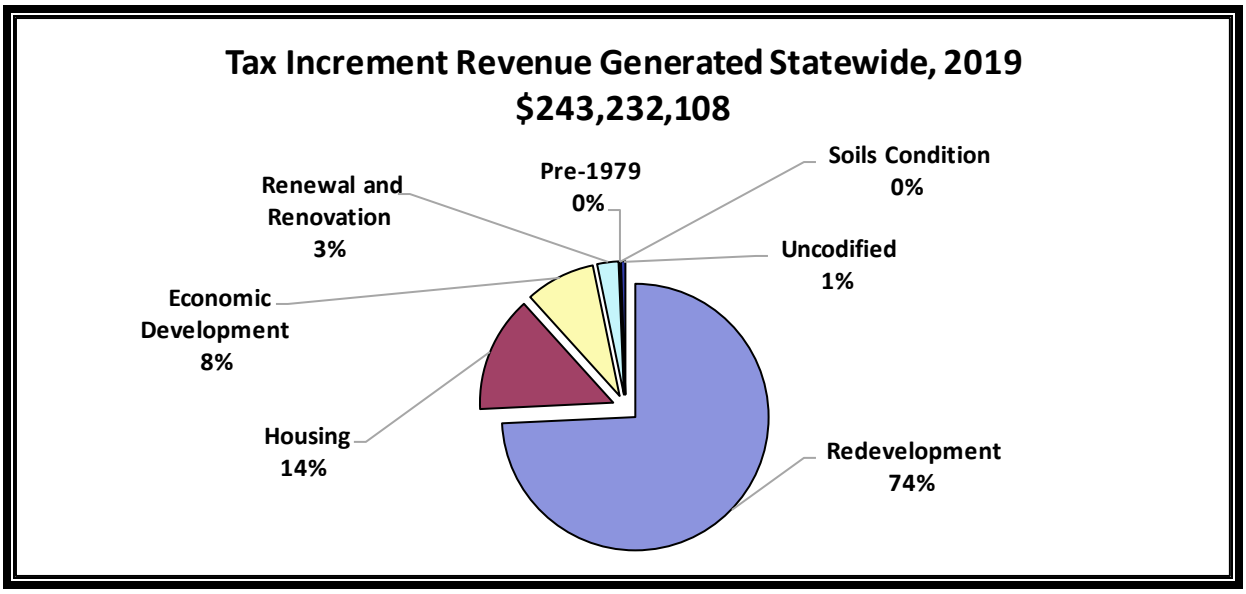


Figure 14.

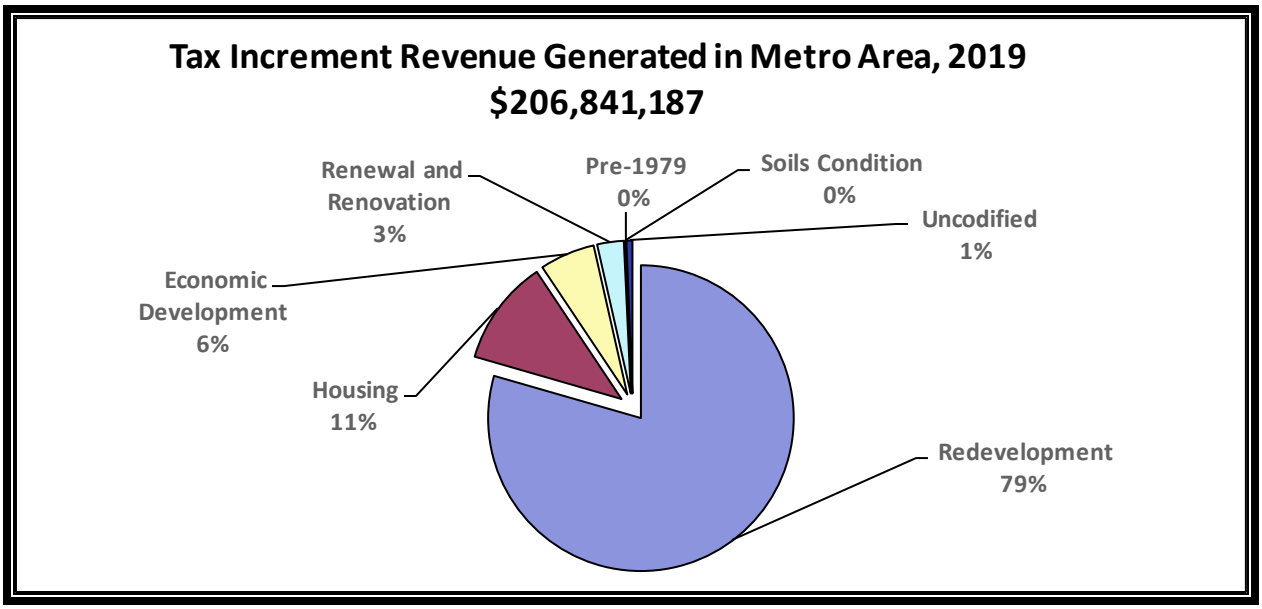
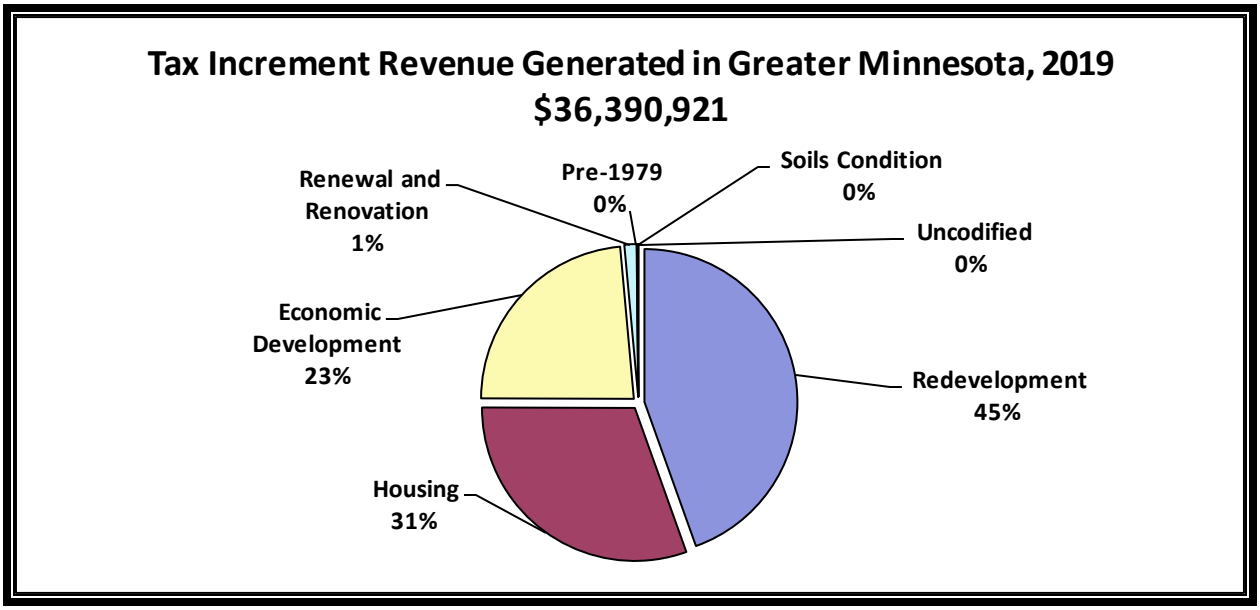


Figure 15.



In 2019, tax increment revenue increased almost six percent over the approximately $230 million generated in 2018. As seen in Figure 16, the 2019 total exceeds each of the last seven years.

Figure 16.

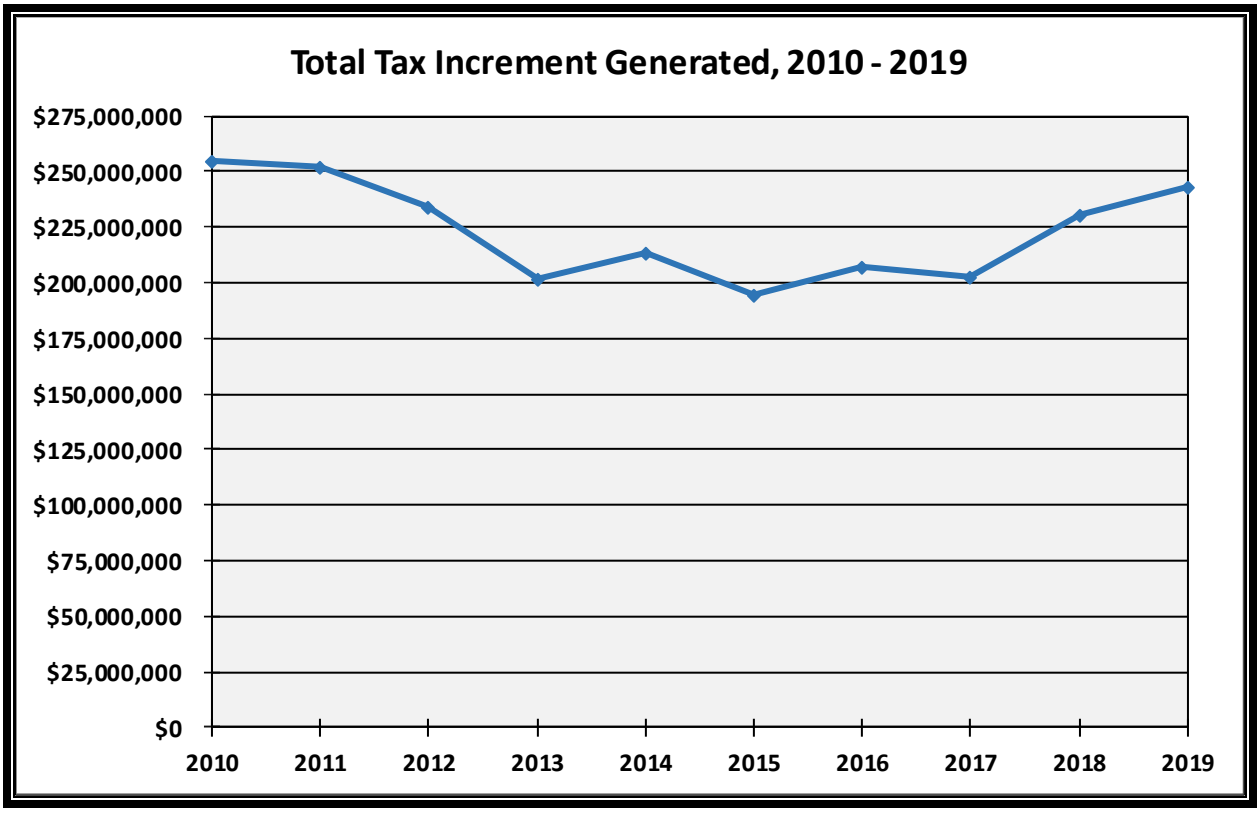
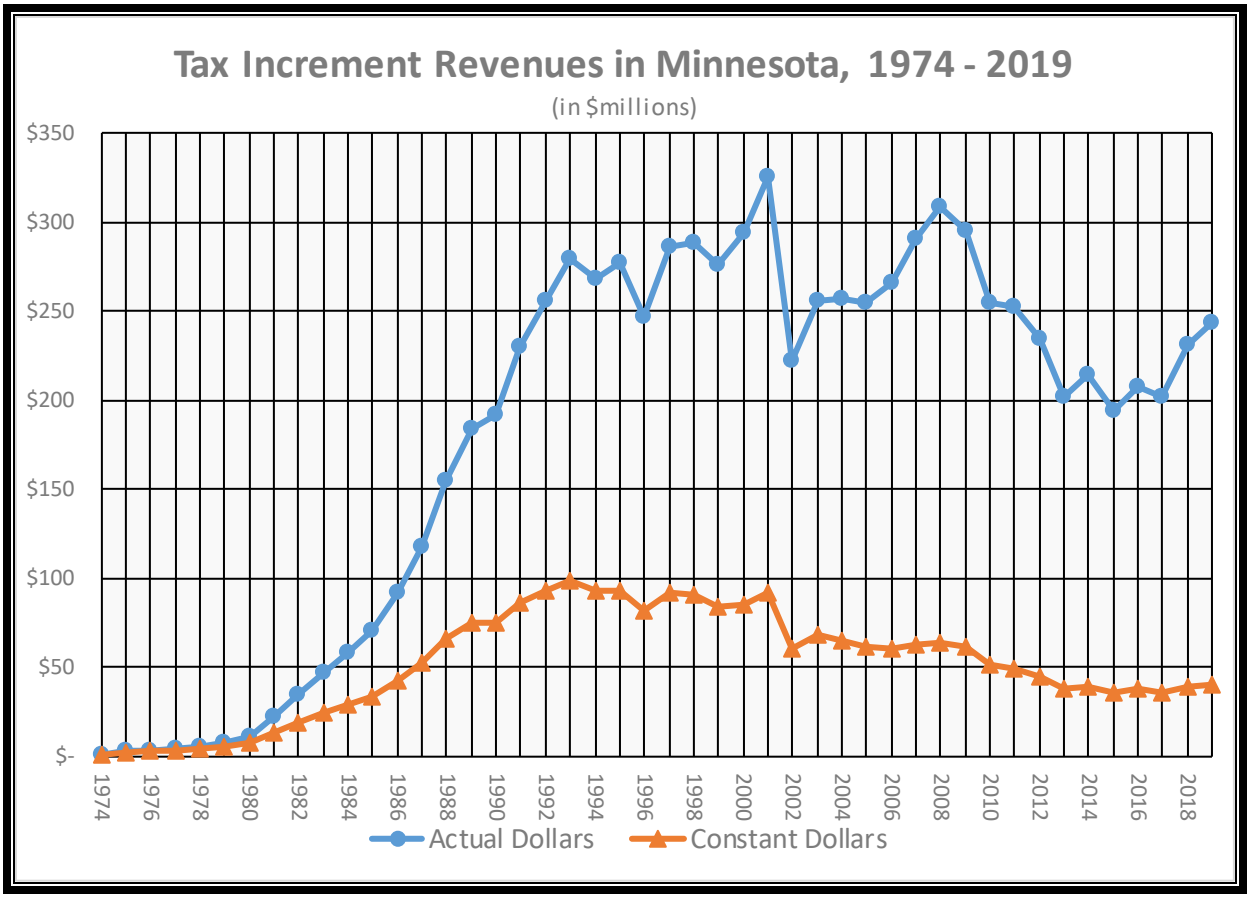


Figure 17 provides a longer view of tax increment revenue, illustrating the fully-recorded span of TIF usage in Minnesota, both in actual dollars and inflation-adjusted, or constant, dollars.[41] The substantial decline in revenue in 2002 reflects the impact of class rate reductions from the 2001 property tax reforms. Otherwise, actual tax increment revenues were generally rising until they reached a peak in 2008, just a few years after the number of districts peaked in 2004. The 2019 increase is the second consecutive increase after a five-year stretch of modest ups and downs.

[41] "Inflation-adjusted" and "constant dollars" refer to data adjusted for inflation using the Implicit Price Deflator for State and Local Governments setting 1974 as the base year (N.I.P.A. Table 1.1.9, October 2020).

Figure 17.



Sources: Minnesota Department of Revenue, *Property Taxes Levied in Minnesota*; 2003 Assessments, Taxes Payable 2004; Property Tax Bulletin No. 33; Table 22 (for 1995 and prior year actual dollars); and TIF annual reporting by development authorities to the OSA (for 1996 - 2019 actual dollars).[42] Constant dollars have been calculated by the OSA.

Returned Tax Increment

In 2019, development authorities returned $8,613,151 in tax increment revenue to county auditors for redistribution as property taxes to the cities, counties, and school districts. Tax increment revenue must be returned when a district receives excess tax increment revenue (increment in excess of the amount authorized in the TIF plan for expenditures) or when tax increment revenue is improperly received (such as increment received after the district should have been decertified) or improperly spent (such as for purposes not permitted by law).

[42] The actual dollars for 1995 and prior are the reported tax increment taxes payable, as compiled by the Department of Revenue from county reporting. This differs slightly from 1996 and later data, which reflects the tax increment revenues received by development authorities, as reported to the OSA. The drop in 1996 may reflect some of this discrepancy in the data, but the data is otherwise similar enough to illustrate the overall trends.

Reported Debt

Tax increment is used primarily to pay for the up-front qualifying costs (such as land acquisition, site improvements, and public utility costs) that make new development a reality. Tax increment revenue, however, is not generated until after the new development is completed, assessed, and property taxes are paid. Therefore, up-front qualifying costs are paid with debt obligations, or bonds. The types of bonds used, and the associated risk if tax increment revenues are insufficient to pay the bonds, are important topics in tax increment financing.

The TIF Act defines bonds broadly to include:[43]

- General Obligation (GO) Bonds
- Revenue Bonds
- Interfund Loans
- Pay-As-You-Go (PAYG) Obligations
- Other Bonds

General Obligation Bonds – A GO bond pledges the full faith and credit of the municipality as security for the bond. If tax increment is not sufficient to make the required debt service payments, the municipality must use other available funds or levy a property tax to generate the funds to pay the required debt service payments.

Revenue Bonds – A revenue bond generally includes a pledge of only the tax increment revenue generated from the TIF district (and possibly other revenues like special assessments) to be used for the required debt service payments and does not pledge the full faith and credit of the municipality as security for the bond.

Interfund Loans – An interfund loan is created when an authority or municipality loans or advances money from its General Fund or from any other fund for which it has legal authority. The loan or advance must be authorized by resolution of the governing body not later than 60 days after money is transferred, advanced, or spent. The terms and conditions for repayment of the loan must be in writing and include, at a minimum, the principal amount, the interest rate, and maximum term; and the terms may be modified or amended.[44] The interfund loan may be forgiven if the tax increment generated is not sufficient to repay the interfund loan.

Pay-As-You-Go Obligations – With a PAYG obligation, development costs are initially paid by the developer pursuant to the terms of a (re)development agreement. After the qualifying costs are substantiated, the developer is reimbursed from tax increments pursuant to the terms of the PAYG note. Generally, in PAYG financing, the developer or note holder accepts the risks, and will not be reimbursed in full if sufficient tax increments are not generated as anticipated.

[43] *See* Minn. Stat. § 469.174, subd. 3.
[44] Minn. Stat. § 469.178, subd. 7.

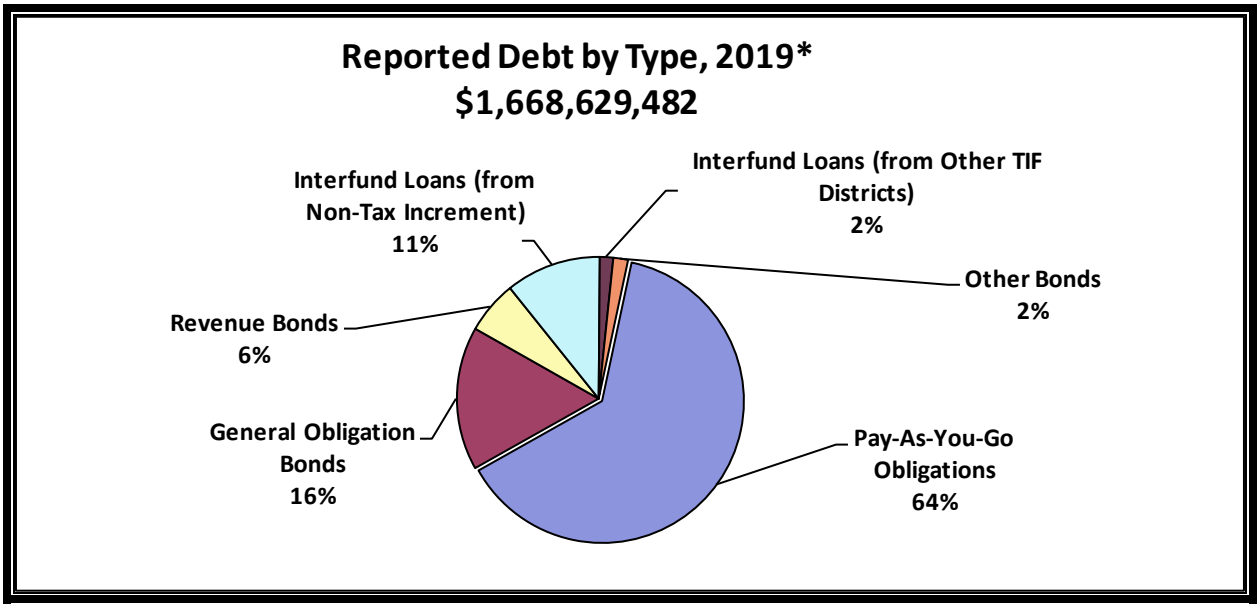
Other Bonds – Other bonds include various loans and other miscellaneous reported debts.

Figures 18 and 19 identify and illustrate the amount of debt by type of obligation for 2019. In 2019, there was a total of nearly $1.7 billion of outstanding debt associated with TIF districts. PAYG obligations were the predominant type of debt, making up 64 percent of the debt reported (up from 58 percent in 2018). GO bonds comprised about 16 percent of the total debt. Interfund loans (mostly from non-tax increment accounts) made up over 12 percent of total debt. Revenue bonds made up six percent of total debt, while other bonds made up the rest.

Figure 18.

Reported Amount of Debt by Type, 2019	
Type of Debt	**Amount Outstanding**
Pay-As-You-Go Obligations	$1,059,882,709
General Obligation Bonds	$272,855,669
Revenue Bonds	$100,827,448
Interfund Loans (from Non-Tax Increment)	$181,592,693
Interfund Loans (from Other TIF Districts)	$25,447,217
Other Bonds	$28,023,746
Total	$1,668,629,482

Figure 19.



*Due to rounding, the sum of the percentages does not equal 100 percent.

FINDINGS AND RESPONSES

The OSA oversees TIF and conducts reviews on the use of TIF by development authorities. Communication between the OSA and the development authorities often resolves issues identified in these reviews. Proactive steps by an authority to remedy potential problems often eliminates the need for the OSA to make formal findings and pursue compliance remedies. However, if an authority is not in legal compliance with the TIF Act, the OSA generally sends an initial notice of noncompliance (Initial Notice) to the governing body of the municipality that approved the TIF district in which the violation arose. The Initial Notice provides the findings and their bases, and describes the possible consequences of the noncompliance.

The municipality is required by law to respond in writing within 60 days after receiving the Initial Notice. In its response (Response), the municipality must state whether it accepts the findings, in whole or in part, and must indicate the basis for any disagreement with the findings. After consideration of the Response, the OSA sends its final notice of noncompliance (Final Notice) to the municipality indicating whether issues are considered resolved. In addition, the OSA forwards information regarding unresolved findings of noncompliance to the appropriate county attorney who may bring an action to enforce the TIF Act. If the county attorney does not commence an action against the authority or otherwise resolve the finding(s) within one year after receiving a referral of a Final Notice, the OSA notifies the Attorney General and provides materials supporting the violation determinations.

Summary of Findings and Responses

State law requires the OSA to provide a summary of the responses to notices of noncompliance it received from the municipalities and copies of the responses themselves to the chairs of the legislative committees with jurisdiction over tax increment financing.[45] This section of the Report summarizes the TIF legal compliance reviews and investigations concluded as of December 31, 2020. An Initial Notice and Final Notice were sent to the following municipality:

1. City of North Branch – An Initial Notice was sent on September 9, 2020. A Response from the City of North Branch was received on October 14, 2020. A Final Notice was sent on October 28, 2020. (Appendix A.)

Unauthorized Expenditures

City of North Branch

Housing District 2003-A (Kelly Housing Project)

In the Initial Notice, the OSA found that the City of North Branch Economic Development Authority had expended $178,201 from the Housing District 2003-A (Kelly Housing Project) TIF

[45] Minn. Stat. § 469.1771, subd. 1(c).

district for a purpose not permitted under Minn. Stat. § 469.176. Continued payments totaling $178,201 were made toward a Pay-As-You-Go Note (Note) after the Note had terminated and the obligation ceased.

In the City Response, the City accepted the Finding. The OSA subsequently received confirmation that $178,201 was returned to the Chisago County Auditor. The OSA considers this Finding resolved.

APPENDIX A

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JULIE BLAHA
STATE AUDITOR

STATE OF MINNESOTA
OFFICE OF THE STATE AUDITOR

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SAINT PAUL, MN 55103-2139

(651) 296-2551 (Voice)
(651) 296-4755 (Fax)
state.auditor@state.mn.us (E-mail)
1-800-627-3529 (Relay Service)

September 9, 2020

The Honorable Jim Swenson, Mayor
The Honorable Kathy Blomquist, Council Member
The Honorable Kelly Neider, Council Member
The Honorable Brian Voss, Council Member
The Honorable Joel McPherson, Council Member
City of North Branch
PO Box 910
North Branch, MN 55056

Re: Housing District 2003-A (Kelly Housing Project) – Initial Notice of Noncompliance

Dear Mayor Swenson and Council Members:

The Office of the State Auditor (OSA) examined the TIF plan, development agreements, and TIF Annual Reporting Forms filed by the Economic Development Authority of the City of North Branch (Authority) for Tax Increment Financing (TIF) Housing District 2003-A (Kelly Housing Project). After reviewing this information, the OSA finds that the Authority is not in compliance with the TIF Act.[1] This Initial Notice of Noncompliance (Initial Notice) contains one OSA finding (Finding).

State law requires the City of North Branch (City) to send its response (Response) in writing within 60 days after receipt of the Initial Notice. The Response must state whether the City accepts the OSA's Findings, in whole or in part, and the basis for any disagreement.[2] After reviewing the Response, the OSA is required to forward information on any unresolved issues to the Chisago County Attorney for review.[3]

If the Authority pays to Chisago County (County) an amount equal to the amount found to be in noncompliance, the OSA will consider the Finding to be resolved. Minnesota law provides that the City will receive its proportionate share of the redistribution of the funds that have been returned to the County if the Authority makes the payment within 60 days after the City receives this Initial Notice.[4]

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[1] *See* Minn. Stat. §§ 469.174 to 469.1799 inclusive, as amended.
[2] Minn. Stat. § 469.1771, subd. 1 (c).
[3] Minn. Stat. § 469.1771, subd. 1 (b).
[4] Minn. Stat. § 469.1771, subd. 5.

All data relating to this examination, including this Initial Notice and the City's Response, are not public until the OSA has issued its Final Notice.[5]

FINDING OF NONCOMPLIANCE

The OSA's finding of noncompliance regarding Housing District 2003-A (Kelly Housing Project) is as follows:

Finding 1. Housing District 2003-A (Kelly Housing Project) – Unauthorized Expenditures

The TIF Act's general limitation on the use of tax increment provides that tax increment revenues must be used in accordance with the TIF plan and, generally, may be solely used: (1) to pay the principal and interest on bonds (including pay-as-you-go notes) issued to finance a project, or (2) to finance or pay capital and administrative costs pursuant to the various development acts found in Minnesota Statutes Chapter 469.[6] If an authority expends tax increment revenues for a purpose not permitted under this and other limitations, the authority must pay to the county auditor an amount equal to the expenditures made in violation of the law.[7]

The Authority entered into a contract, dated October 9, 2003, for private development in Housing District 2003-A (Kelly Housing Project) with Ash Street, LLC, a Minnesota limited liability company (the Development Agreement). In the Development Agreement, the Authority agreed to provide tax increment assistance in the principal amount of $500,000.00 "through the issuance of the Tax Increment Note under and subject to the terms and provisions as further set forth in this Agreement. Tax increment assistance shall be paid to the Developer on a pay-as-you-go basis…." The agreement stated that principal and interest "shall be payable solely from" the "Pledged Tax Increments," defined to mean, "ninety percent (90%) of the Tax Increments received each year."[8]

The Development Agreement, including the form of the note set forth in Exhibit B to the Development Agreement, provided a simple interest rate of six percent (6%) per annum to be paid on each Note Payment Date.[9] Note Payment Date was defined to mean "February 1 and August 1 of each year commencing August 1, 2006 and continuing through and including August 1, 2015 or the date the Developer has received ten (10) full years of Pledged Tax Increments whichever is later."[10] The Development Agreement specified that the Authority's "obligation to make payments

---

[5] *See* Minn. Stat. § 6.715 (Information relating to an examination is confidential and/or protected nonpublic until the audit is complete); Minn. Stat. § 13.03, subdivision 4 (c) (To the extent data is sent to another government entity, the data retains the same classification.).
[6] *See* Minn. Stat. § 469.176, subd. 4.
[7] Minn. Stat. § 469.1771, subd. 3.
[8] Development Agreement, § 3.2.
[9] Development Agreement, § 3.2, and Exhibit B.
[10] Development Agreement, § 1.1.

shall, so long as the Tax Increment District is in existence, continue until the Developer has received ten (10) full years of Tax Increment or the principal amount of the Note plus accrued interest whichever first occurs."[11] In Exhibit B to the Development Agreement, this was defined as the "Final Payment Date." Exhibit B specifically stated that "[t]his Note shall terminate and be of no further force and effect following the Final Payment Date."

Based on the references to "full years," February 1, 2016, would be the final payment date that provides ten full years of payments, as opposed to the referenced August 1, 2015, date.[12] This is consistent with the Authority reporting a maturity date of February 1, 2016, for this pay-as-you-go obligation.

According to the Authority's annual reporting, the Authority paid ten full years of Pledged Tax Increments during the period 2006 through the first payment in 2016, thereby satisfying the Authority's obligation to make payments on the Note, and making that payment date the Final Payment Date, after which the Note terminated and had no further force and effect.

Despite the satisfaction of the Note, however, the Authority reported making payments beyond the maturity date through 2018. In initial communication, the City indicated that continued payments did not exceed the principal amount and identified that Exhibit V of the TIF plan contained a "Projected Pay-As-You-Go Note Report" with a projected payment schedule extending through August 1, 2020.

Because the obligation for continued payment of tax increment had ceased after February 1, 2016, payments made by the Authority to the Developer after that time were expenditures not in compliance with TIF Act. Accordingly, the Authority must return **$178,201**, to the county auditor.

When the Authority provides documentation that it returned **$178,201**, to the Chisago County Auditor, the OSA will consider this Finding resolved. Additionally, as noted above, if the Authority makes such payment within 60 days of this Initial notice, Minnesota law allows the City to receive its proportionate share of the redistribution of the funds that have been returned to the County.

CONCLUSION

The City's Response to this Finding must be submitted in writing to the OSA within 60 days after receipt of this Initial Notice. The OSA is available to review and discuss the Finding within this letter at any time during the preparation of the Response. After considering the Response, the OSA will issue the Final Notice.

---

[11] Development Agreement, § 3.2; *see also* Exhibit B

[12] For purposes of this analysis, the OSA has disregarded the contrary and earlier expiration date of February 1, 2014, found in section 5.8 of the agreement.

If you have any questions, please contact me at (651) 296-7979 or Jason.Nord@osa.state.mn.us. We look forward to receiving your Response.

Sincerely,

/s/ Jason Nord

Jason Nord
Assistant State Auditor
TIF Division Director

cc: Renae Fry, City Administrator
Joe Starks, Finance Director

CITY OF EST. 1881 NORTH BRANCH

October 14, 2020

The Office of the Minnesota State Auditor

Re: Housing District 2003-A (Kelly Housing Project) – Initial Notice of Noncompliance

Dear OSA,

Pursuant to state law, the City of North Branch must send its response in writing within 60 days after receipt of the Initial Notice (September 9, 2020). The City of North Branch accepts OSA's findings. We will be remitting a payment in the amount of $178,201 payable to the Chisago County Auditor. This response was approved by City Council at the 10/13/2020 regular council meeting. If anything additional is needed please feel free to contact us.

Very truly yours,

Renae Lillegard Fry
City Administrator

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STATE OF MINNESOTA

Julie Blaha
State Auditor

Office of the State Auditor

Suite 500
525 Park Street
Saint Paul, MN 55103

October 28, 2020

The Honorable Jim Swenson, Mayor
The Honorable Kathy Blomquist, Council Member
The Honorable Kelly Neider, Council Member
The Honorable Brian Voss, Council Member
The Honorable Joel McPherson, Council Member
City of North Branch
PO Box 910
North Branch, MN 55056

Re: Housing District 2003-A (Kelly Housing Project) – Final Notice of Noncompliance

Dear Mayor Swenson and Council Members:

On September 9, 2020, the Office of the State Auditor (OSA) sent the City of North Branch (City) an Initial Notice of Noncompliance (Initial Notice) containing one OSA finding (Finding) for the Housing District 2003-A (Kelly Housing Project) Tax Increment Financing (TIF) District. The OSA received the City's Response (City Response) on October 14, 2020.

This letter is the Final Notice of Noncompliance (Final Notice) of the Office of the State Auditor. It summarizes the initial finding and the City Response, and provides the OSA's final conclusion regarding the issue raised by the review.

FINDING OF NONCOMPLIANCE

One finding of noncompliance was made:

Finding 1. Housing District 2003-A (Kelly Housing Project) – Unauthorized Expenditures -- RESOLVED

In the Initial Notice, the OSA found that the City of North Branch Economic Development Authority, had expended $178,201 from the Housing District 2003-A (Kelly Housing Project) TIF district for a purpose not permitted under Minn. Stat. § 469.176. Continued payments totaling $178,201 were made toward a Pay-As-You-Go Note (Note) after the Note had terminated and the obligation ceased.

In the City Response, the City accepted the Finding. The OSA subsequently received confirmation that $178,201 was returned to the Chisago County Auditor. The OSA considers this Finding resolved.

CONCLUSION

The OSA considers the Finding resolved and appreciates the City's cooperation.

If you have any questions, please contact me at (651) 296-7979 or Jason.Nord@osa.state.mn.us.

Sincerely,

/s/ Jason Nord

Jason Nord
Assistant State Auditor
TIF Division Director

cc: Renae Fry, City Administrator
Joe Starks, Finance Director