

# STATE OF MINNESOTA

## Office of the State Auditor



**Rebecca Otto**  
**State Auditor**

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## **TAX INCREMENT FINANCING LEGISLATIVE REPORT**

**TIF Reports for the Year Ended December 31, 2017**  
**TIF Reviews Concluded for the Year Ended December 31, 2018**

## 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 150 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 approximately 650 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, 2017  
TIF Reviews Concluded for the Year Ended December 31, 2018



January 2, 2019

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# TAX INCREMENT FINANCING LEGISLATIVE REPORT

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**APPENDIX A**

Office of the State Auditor Initial Notice of Noncompliance – City of Ivanhoe

Response to the Initial Notice of Noncompliance – City of Ivanhoe

Office of the State Auditor Final Notice of Noncompliance – City of Ivanhoe

**APPENDIX B**

Office of the State Auditor Initial Notice of Noncompliance – City of Perham

Response to the Initial Notice of Noncompliance – City of Perham

Office of the State Auditor Final Notice of Noncompliance – City of Perham

# EXECUTIVE SUMMARY

## Highlights and Trends

- In 2017, approximately \$203 million of tax increment revenue was generated statewide. Although most districts are located in Greater Minnesota, approximately \$171 million of tax increment, or 84 percent, was generated in the Metro Area. (pg. 15)
- In 2017, redevelopment districts made up 47 percent of all TIF districts statewide, followed by housing districts at 31 percent, and economic development districts at 19 percent. (pg. 9)
- In 2017, 88 new TIF districts were certified, which was 21 percent more than the number of new districts certified in 2016. (pg. 12)
- In 2017, 76 TIF districts were decertified, a drop of 34 percent from 2016. (pg. 13)
- 2017 marks the first year in over a decade where the number of decertifications was less than the number of new district certifications. (pg. 13)
- In 2017, development authorities returned \$10,800,926 in tax increment revenue to county auditors for redistribution as property taxes to the cities, counties, and school districts. (pg. 19)
- In 2017, there was a total of \$1.7 billion of outstanding debt associated with TIF districts. Pay-as-you-go (PAYG) obligations made up 57 percent of the debt reported. General obligation (GO) bonds, which are secured by the municipalities' full faith and credit, made up about 21 percent of the total debt. (pg. 20)

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## SCOPE AND METHODOLOGY

This 23rd 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 413 development authorities for 1,651 districts for the calendar year ended December 31, 2017. TIF reporting for the year ended December 31, 2017, was required for a total of 1,654 TIF districts from 415 development authorities, but three reports were not received and are therefore not reflected in the data.<sup>1</sup>

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 2018. This Report is provided annually to the chairs of the legislative committees with jurisdiction over TIF matters.<sup>2</sup>

In 1995, the Minnesota Legislature assigned legal compliance oversight for TIF to the OSA.<sup>3</sup> 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).<sup>4</sup>

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.<sup>5</sup> 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.<sup>6</sup> New certifications and decertifications are not always reported in a timely manner, so the data for prior years contained in this Report may differ from data presented in previous Reports as it will include the new data for the corresponding year.

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<sup>1</sup> Canby, Hills, and St. Clair each failed to report for one district for 2017. Hills and St. Clair have outstanding reports for previous years. The TIF Act provides for tax increment to be withheld when reports are not filed.

<sup>2</sup> Minn. Stat. § 469.1771, subd. 1(c).

<sup>3</sup> 1995 Minn. Laws, ch. 264, art. 5, § 34. The OSA's oversight of TIF began in 1996.

<sup>4</sup> 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.

<sup>5</sup> Minn. Stat. § 469.175, subd. 6.

<sup>6</sup> 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. The capture of tax increments occurs within TIF districts comprised of the parcels on which development activity occurs. In order for a municipality to finance development with TIF, it must find that the development would not otherwise be expected to occur without the use of TIF.

Owners of property located in the TIF district pay property taxes. Generally, only the portion of the property taxes generated by new development (the tax increment) is used to pay for public improvements and qualifying costs that make the new development possible.<sup>7</sup>

The expenditures that qualify to be paid from this 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 development authority initiates the creation of a TIF district, and the municipality must approve it for it to move forward. An authority can be a city, an entity created by a city, or an entity created by a county.<sup>8</sup> Development authorities derive their authority 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.<sup>9</sup>

The TIF Act is referenced in the development acts primarily through the use of the term “project,” although the term is used differently in each of the development acts.<sup>10</sup> In the HRA Act, for example, the term “project” can mean any combination of a housing project, a housing development project, a redevelopment project, or property/cash/assets/funds held or used in connection with the development or operation of a project.<sup>11</sup> In the City Development District Act, however, the term “project” means a designated area within a city.<sup>12</sup> The development acts do not expressly limit the size of areas that can qualify as projects.

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<sup>7</sup> Property taxes on existing value at the time the district is created, often referred to as the “frozen base,” continue to be distributed to the city, county, and school district. However, due to the higher expense involved in cleaning up hazardous substances, the entire property tax payment may be captured for hazardous substance subdistricts. Minn. Stat. §§ 469.174, subds. 7(b) and 23; 469.175, subd. 7.

<sup>8</sup> Counties and towns may also be development authorities in certain instances.

<sup>9</sup> Minn. Stat. § 469.174, subd. 2 (listing the statutory citations for the various development acts).

<sup>10</sup> Minn. Stat. § 469.174, subd. 8.

<sup>11</sup> See Minn. Stat. § 469.002, subd. 12.

<sup>12</sup> See Minn. Stat. § 469.125, subd. 9.

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.<sup>13</sup> 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 2017, there were 415 development authorities in Minnesota actively using TIF, which is three more than the number active in 2016. Five authorities became inactive, four inactive development authorities became active again, and four new city development authorities approved their first TIF district.

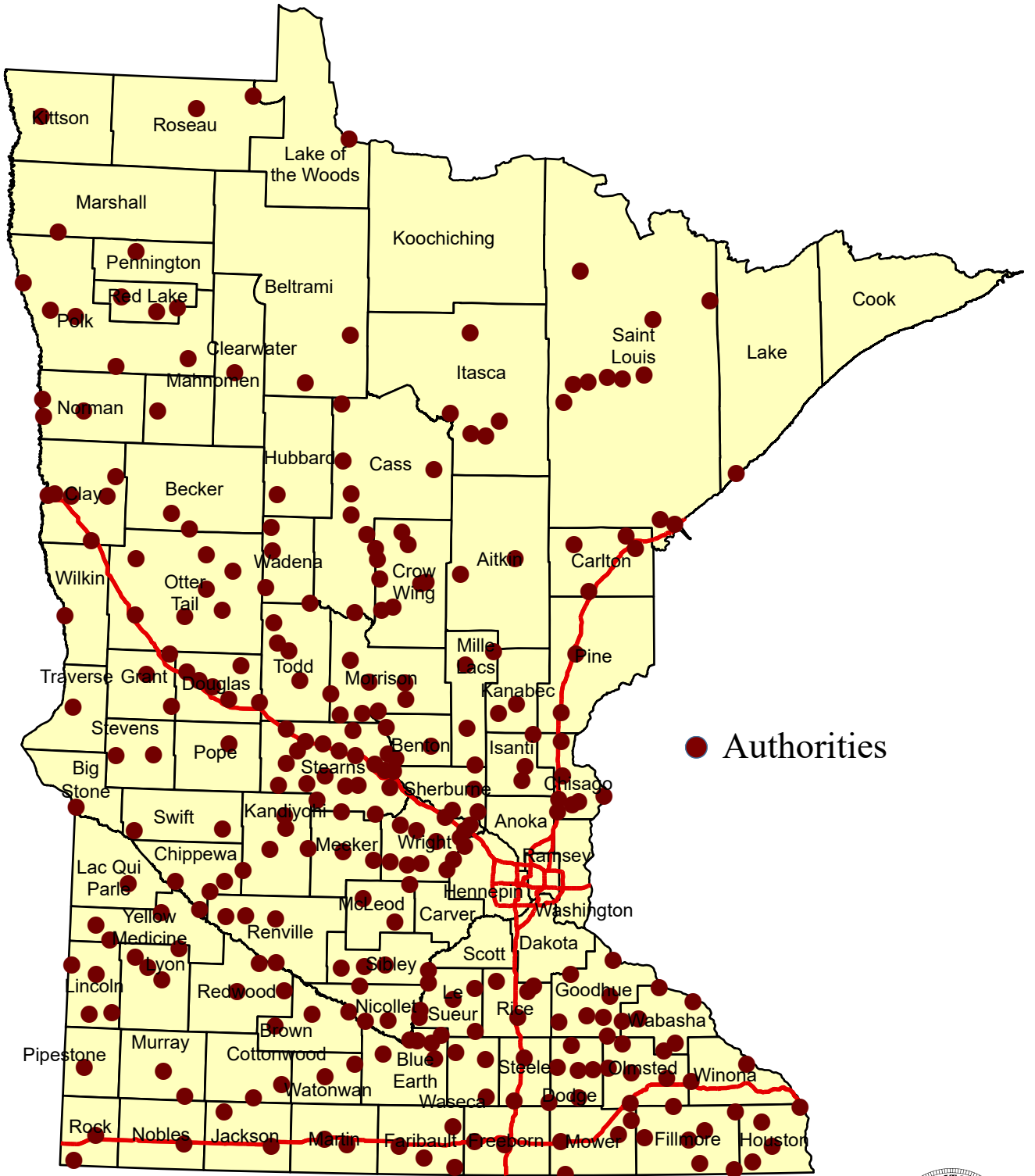
In 2017, of the 415 active development authorities, 316 were located in Greater Minnesota and 99 were located in the Seven-County Metropolitan Area (Metro Area). Maps 1 and 2 on the following pages show the locations of these authorities. Map 3 identifies counties that have a separate authority for development purposes.<sup>14</sup>

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<sup>13</sup> Minn. Stat. § 469.177, subd. 12.

<sup>14</sup> This map does not include the following joint authorities: Bluff Country HRA and Southeast Minnesota Multi-County HRA.

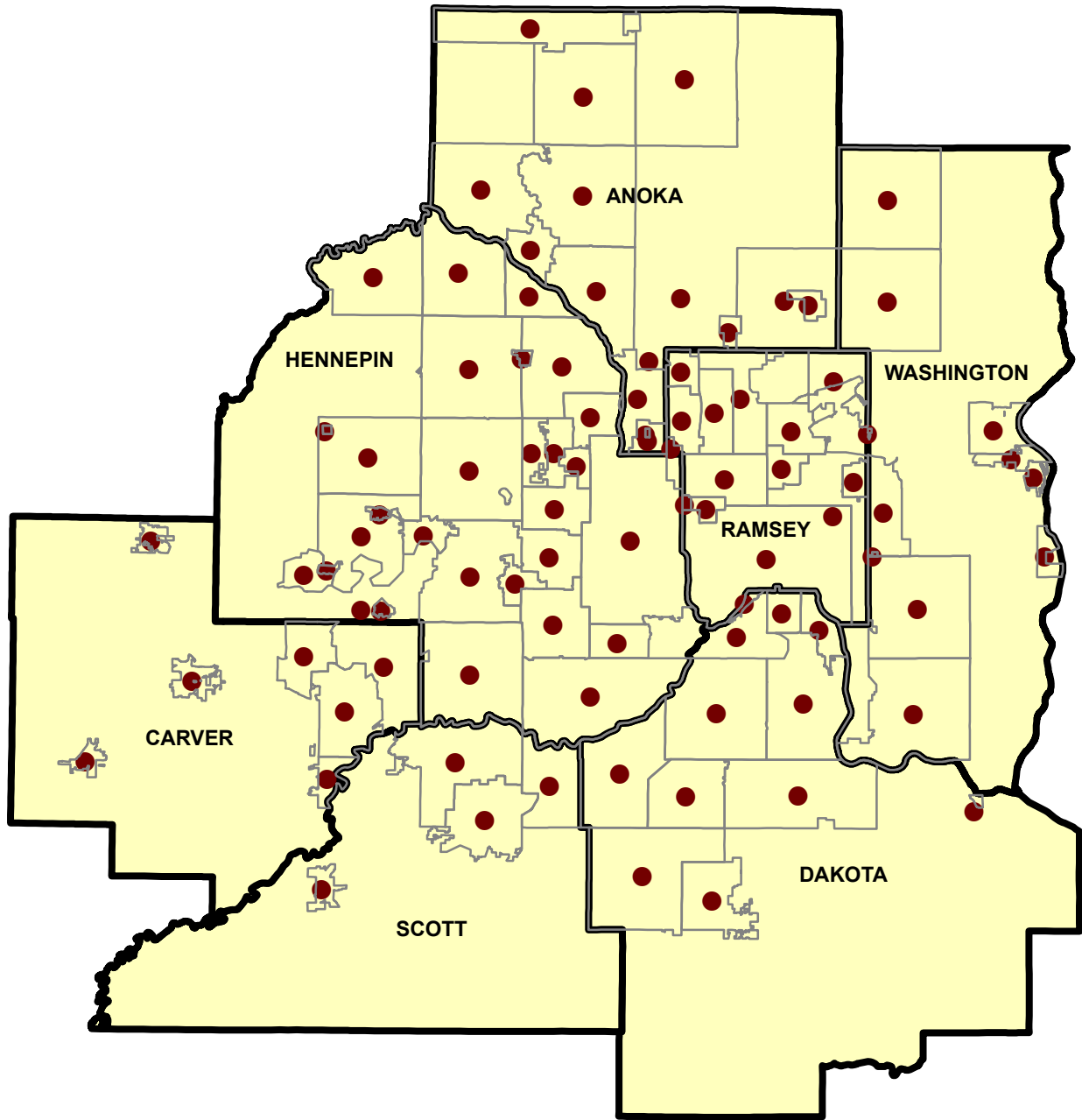
# Development Authorities in Greater Minnesota, 2017



● Authorities



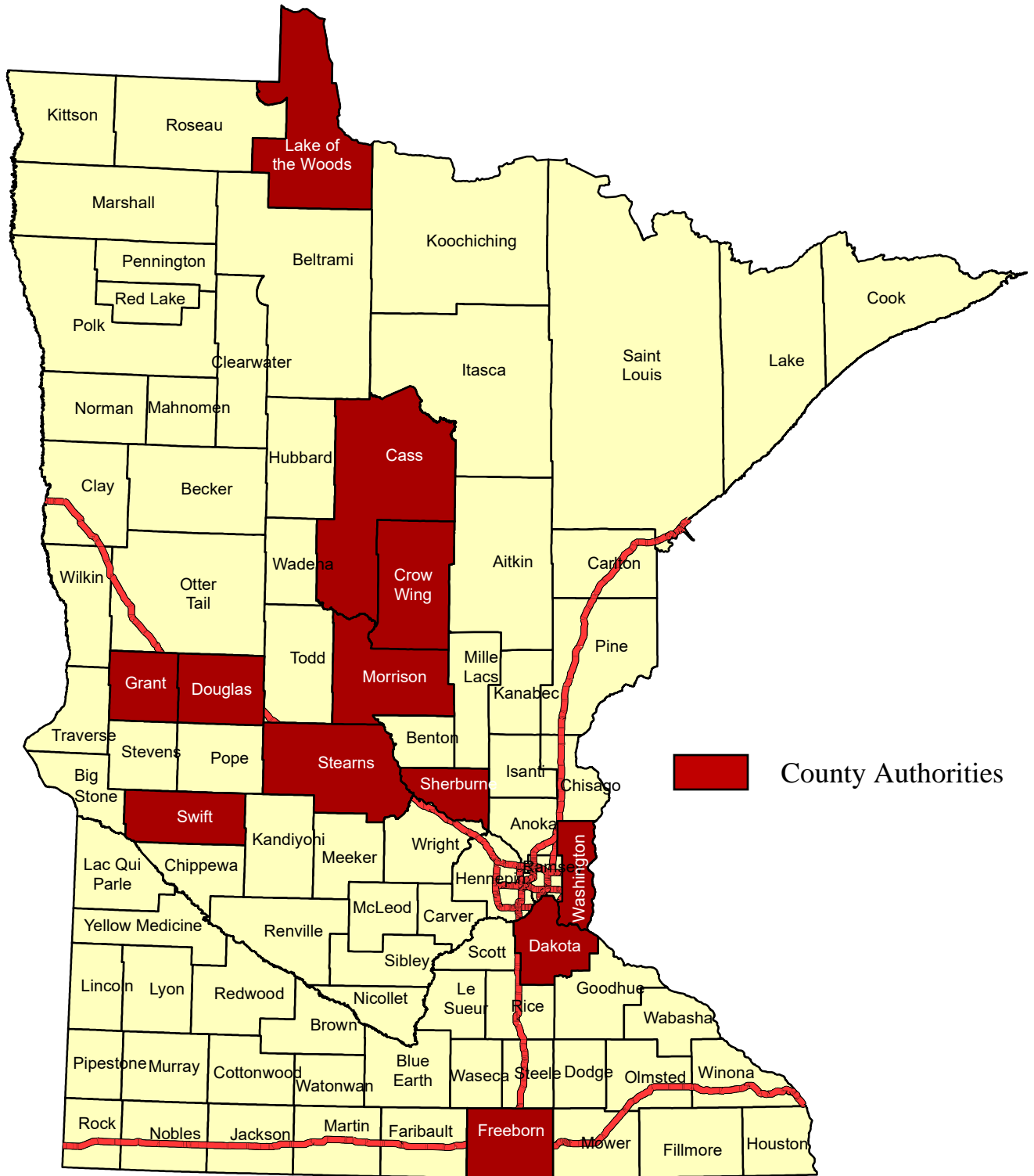
# Development Authorities in Metro Area, 2017



● Authorities



# County Development Authorities, 2017



## 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.<sup>15</sup> Approval of the TIF plan authorizes the use of tax increment to pay TIF-eligible project costs.

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. Before approving a TIF plan, the municipality must publish a notice and hold a public hearing.<sup>16</sup> 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.<sup>17</sup>

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.<sup>18</sup> The county board and school board may comment on the proposed district, but cannot prevent its creation.<sup>19</sup>

## 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.

**Redevelopment Districts** – The purpose of a redevelopment district is to eliminate certain blighted conditions.<sup>20</sup> Redevelopment districts are designed to conserve the use of existing utilities, roads, and other public infrastructure, and to discourage urban sprawl. Qualifying tax

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<sup>15</sup> Minn. Stat. § 469.175, subd. 1.

<sup>16</sup> Minn. Stat. § 469.175, subd. 3.

<sup>17</sup> In many cases, the commissioners of the TIF authority include some or all of the council members.

<sup>18</sup> Minn. Stat. § 469.175, subd. 2.

<sup>19</sup> When the county is the municipality that must approve the TIF plan, the county board may prevent the creation of a TIF district.

<sup>20</sup> Minn. Stat. § 469.174, subd. 10(a).



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.<sup>21</sup>

**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.<sup>22</sup> 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 sunset in 2027).<sup>23</sup> Use of tax increment in these districts for commercial development (retail sales) is excluded by law, except in “small cities.”<sup>24</sup> Economic development districts are short-term districts with a limit of eight years after first receipt of tax increment.<sup>25</sup>

**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.<sup>26</sup>

**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 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.<sup>27</sup>

**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

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<sup>21</sup> 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.

<sup>22</sup> Minn. Stat. § 469.174, subd. 12.

<sup>23</sup> Minn. Stat. § 469.176, subd. 4c, identifies allowable purposes.

<sup>24</sup> Minn. Stat. § 469.174, subd. 27, and Minn. Stat. § 469.176, subd. 4c. Minn. Stat. § 469.175, subd. 3(g), contains the sunset, barring districts from being certified for requests made after June 30, 2027.

<sup>25</sup> 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.

<sup>26</sup> 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.

<sup>27</sup> 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.

remediation must exceed the fair market value of the land before the remediation is completed.<sup>28</sup> The statutory maximum duration limit for these districts is 20 years after first receipt of tax increment.<sup>29</sup>

**Pre-1979 Districts** – These districts were created prior to the 1979 TIF Act and have all been decertified.<sup>30</sup>

**Uncodified Districts** – Special laws have been enacted to address unique problems that permit the generation of tax increment revenue from 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.<sup>31</sup> 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).<sup>32</sup> The HSS captures additional increment by reducing the original net tax capacity (ONTC) by the estimated costs of the removal actions.<sup>33</sup> 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.<sup>34</sup> 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.<sup>35</sup>

## Special Legislation

Special legislation has been enacted to allow exceptions to the TIF Act for individual districts. As of 2017, 113 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.

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<sup>28</sup> Minn. Stat. § 469.174, subd. 19.

<sup>29</sup> 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.

<sup>30</sup> Minn. Stat. § 469.176, subd. 1c. Princeton’s TIF 1 Downtown Redevelopment District is the last pre-1979 district reporting.

<sup>31</sup> Minn. Stat. § 469.174, subs. 16 and 23; Minn. Stat. § 469.175, subd. 7.

<sup>32</sup> Minn. Stat. § 469.174, subd. 17.

<sup>33</sup> Minn. Stat. § 469.174, subd. 7(b).

<sup>34</sup> Minn. Stat. § 469.176, subd. 4e.

<sup>35</sup> Minn. Stat. § 469.176, subd. 1e.

## Number of TIF Districts

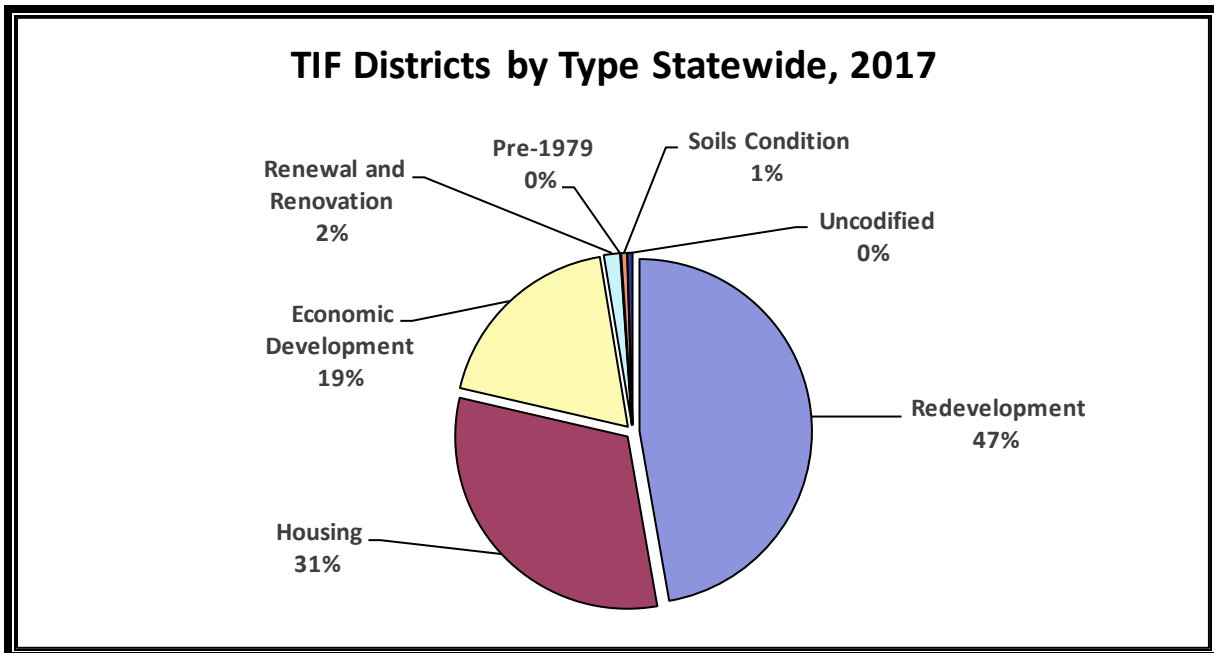
In 2017, 413 development authorities submitted reports to the OSA for 1,651 TIF districts. Of these districts, 1,048 (63 percent) were located in Greater Minnesota and 603 (37 percent) were located in the Metro Area. (See Figure 1.)

**Figure 1.**

<b>TIF Districts by Type: Statewide, Greater MN, &amp; Metro Area; 2017</b>			
<b>Type of District</b>	<b>Statewide</b>	<b>Greater MN</b>	<b>Metro Area</b>
Redevelopment	780	423	357
Housing	518	360	158
Economic Development	310	254	56
Renewal and Renovation	25	8	17
Pre-1979	1	1	0
Soils Condition	9	2	7
Uncodified	8	0	8
<b>Total</b>	<b>1,651</b>	<b>1,048</b>	<b>603</b>
Hazardous Substance Subdistricts	24	2	22

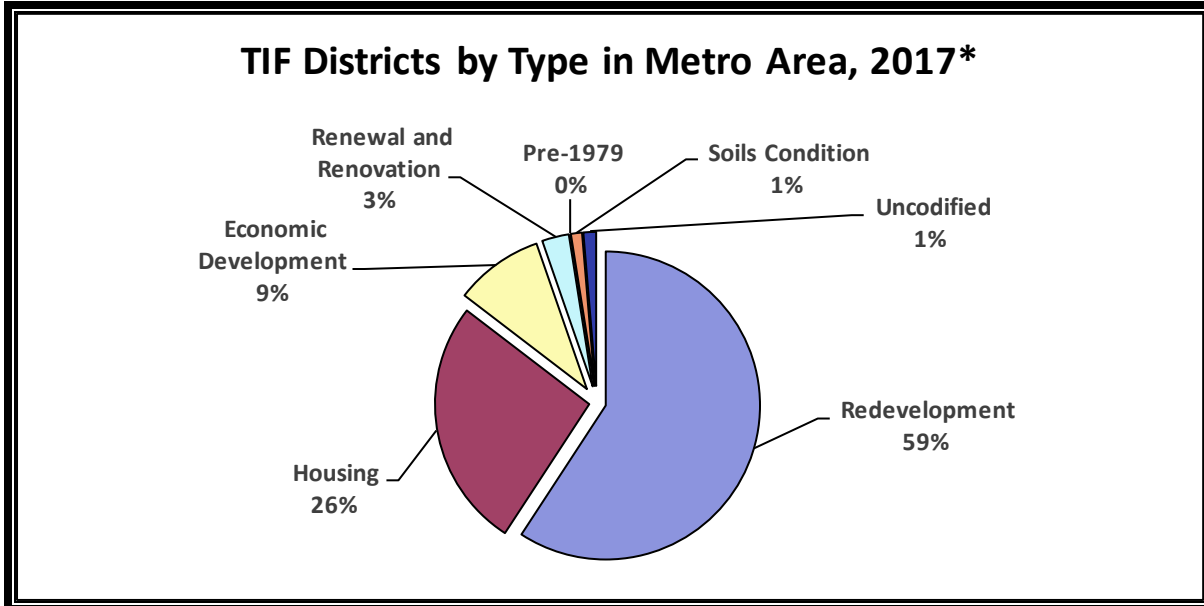
In 2017, redevelopment districts made up 47 percent of all TIF districts statewide, followed by housing districts at 31 percent, and economic development districts at 19 percent. Combined, redevelopment, economic development, and housing districts made up 97 percent of all districts. (See Figure 2.)

**Figure 2.**



In the Metro Area, redevelopment districts made up 59 percent of all districts, followed by housing districts at 26 percent and economic development districts at nine percent. (See Figure 3.)

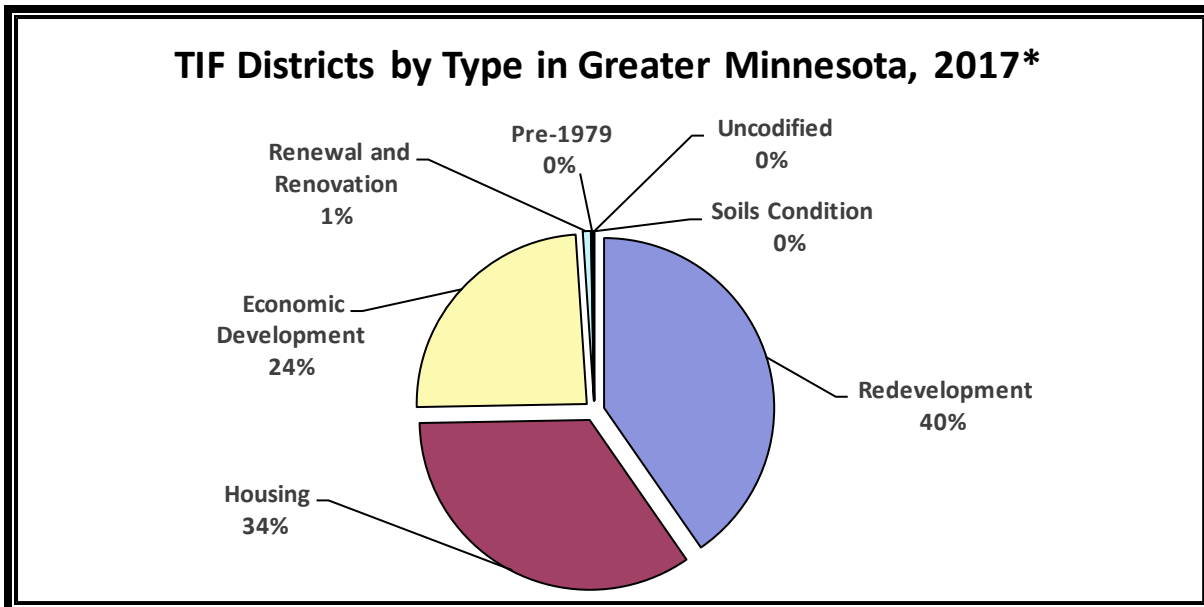
**Figure 3.**



\*Due to rounding, the sum of the percentages is less than 100 percent.

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 made up larger portions. (See Figure 4.)

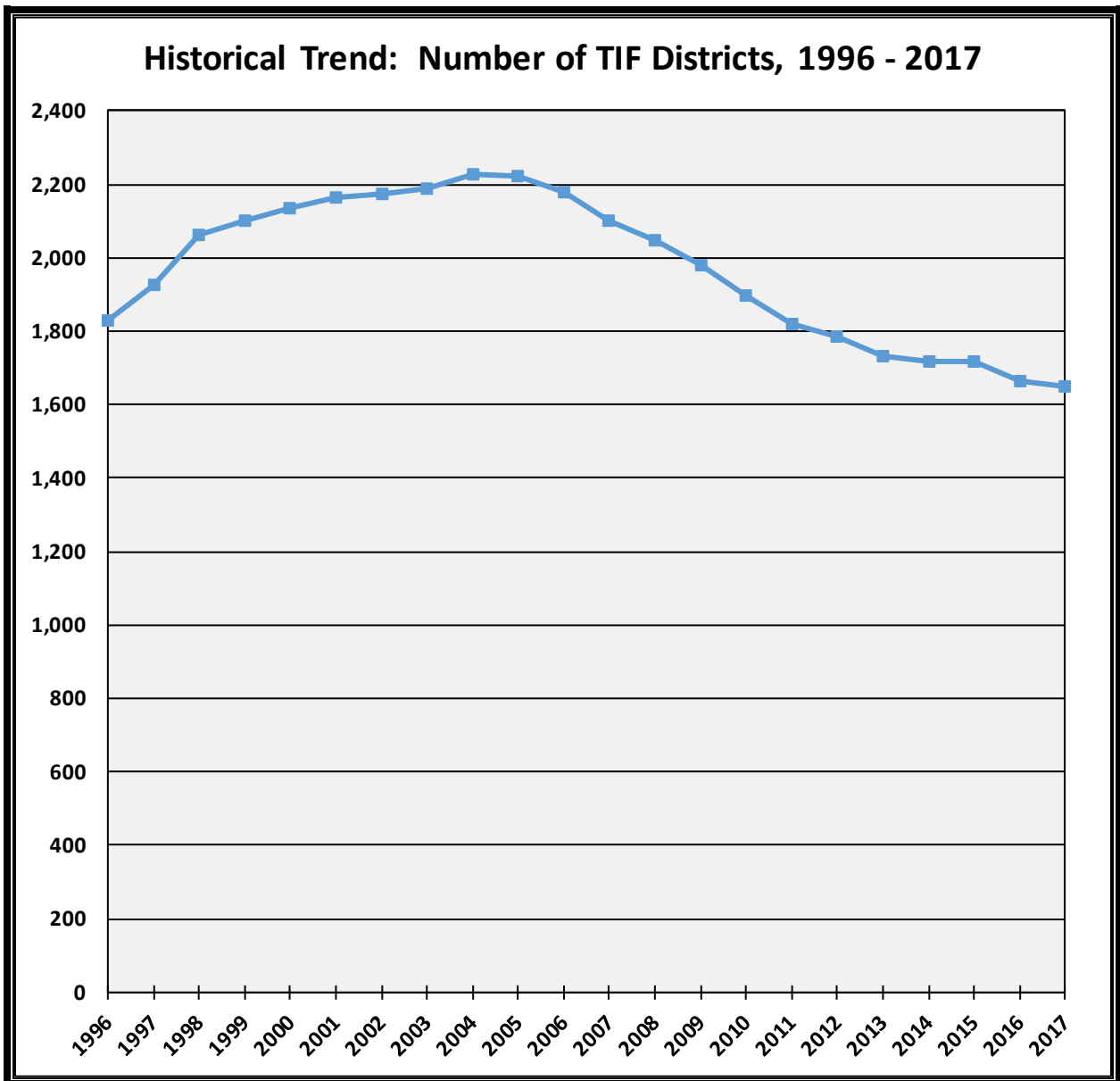
**Figure 4.**



\*Due to rounding, the sum of the percentages is less than 100 percent.

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. From 2004 through 2014, the total number declined. The decline reflected, among other things, large numbers of decertifications as older districts created in the wake of the 1979 TIF Act reached their statutory duration limits. Changes in recent years have been more modest, and 2017 saw a decrease of less than one percent. The number of districts being reported includes districts that are decertified but must continue to report due to remaining tax increment assets.

**Figure 5.**



## New Districts Certified

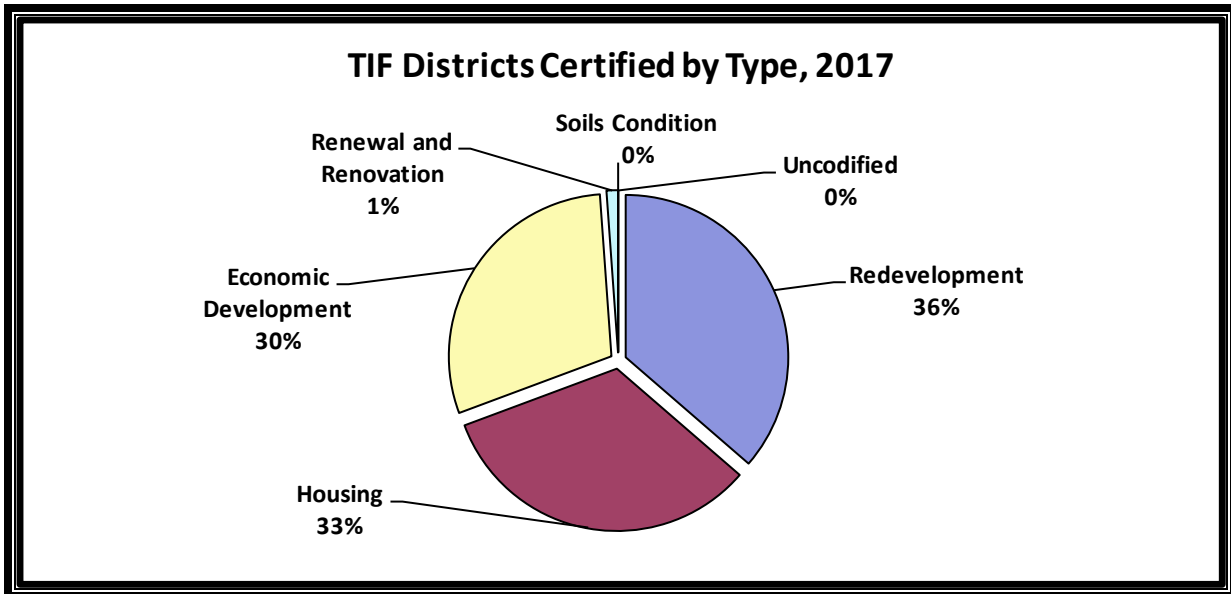
In 2017, 88 new TIF districts were certified, which was 21 percent more than the number of new districts certified in 2016. Figure 6 shows new district certifications by type over the past five years.

**Figure 6.**

<b>Number of TIF Districts Certified by Type, 2013 - 2017</b>					
	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>
Redevelopment	25	34	38	29	32
Housing	17	27	24	18	29
Economic Development	27	35	33	21	26
Renewal and Renovation	2	1	0	3	1
Soils Condition	0	1	0	1	0
Uncodified	1	0	0	1	0
<b>Total</b>	<b>72</b>	<b>98</b>	<b>95</b>	<b>73</b>	<b>88</b>

In 2017, redevelopment districts accounted for the largest portion of all new districts at 36 percent, with housing and economic development districts following closely at 33 percent and 30 percent, respectively. (See Figure 7.)

**Figure 7.**



## Districts Decertified

In comparison to the decision to create 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.<sup>36</sup>

In 2017, 76 TIF districts were decertified, a drop of 34 percent from 2016. Figure 8 shows decertifications by type over the last five years.

**Figure 8.**

<b>Number of TIF Districts Decertified by Type, 2012 - 2016</b>					
	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>
Redevelopment	58	72	62	58	35
Housing	25	26	38	32	12
Economic Development	14	27	19	24	28
Renewal and Renovation	2	5	1	1	1
Soils Condition	0	1	0	0	0
Uncodified	1	1	0	0	0
Pre-1979	0	0	0	0	0
Total	100	132	120	115	76

The drop in redevelopment and housing district decertifications in 2017 is noteworthy. Many of the districts decertifying in recent years were redevelopment and housing districts created in the 1980s that reached their 25-year duration limit, and now those districts created in the 1990s are decertifying. Due to TIF restrictions enacted from 1988 to 1990, the volume of districts created in the 1990s was lower than the previous decade, so a drop in the amount of decertifications is not surprising.

In 2017, 46 percent of decertified districts were redevelopment districts, while housing and economic development districts accounted for 16 percent and 37 percent, respectively. (See Figure 9.)

It is interesting to note that 2017 marks the first year in over a decade where the number of decertifications was less than the number of new district certifications. (See Figure 10.)

<sup>36</sup> 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.

Figure 9.

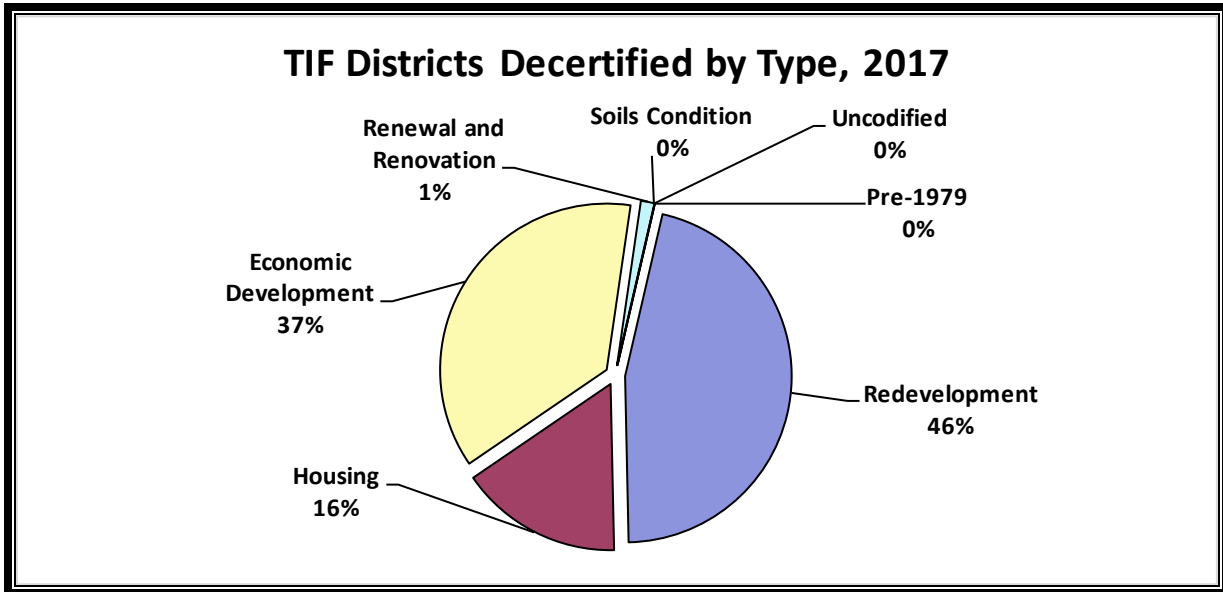


Figure 10.

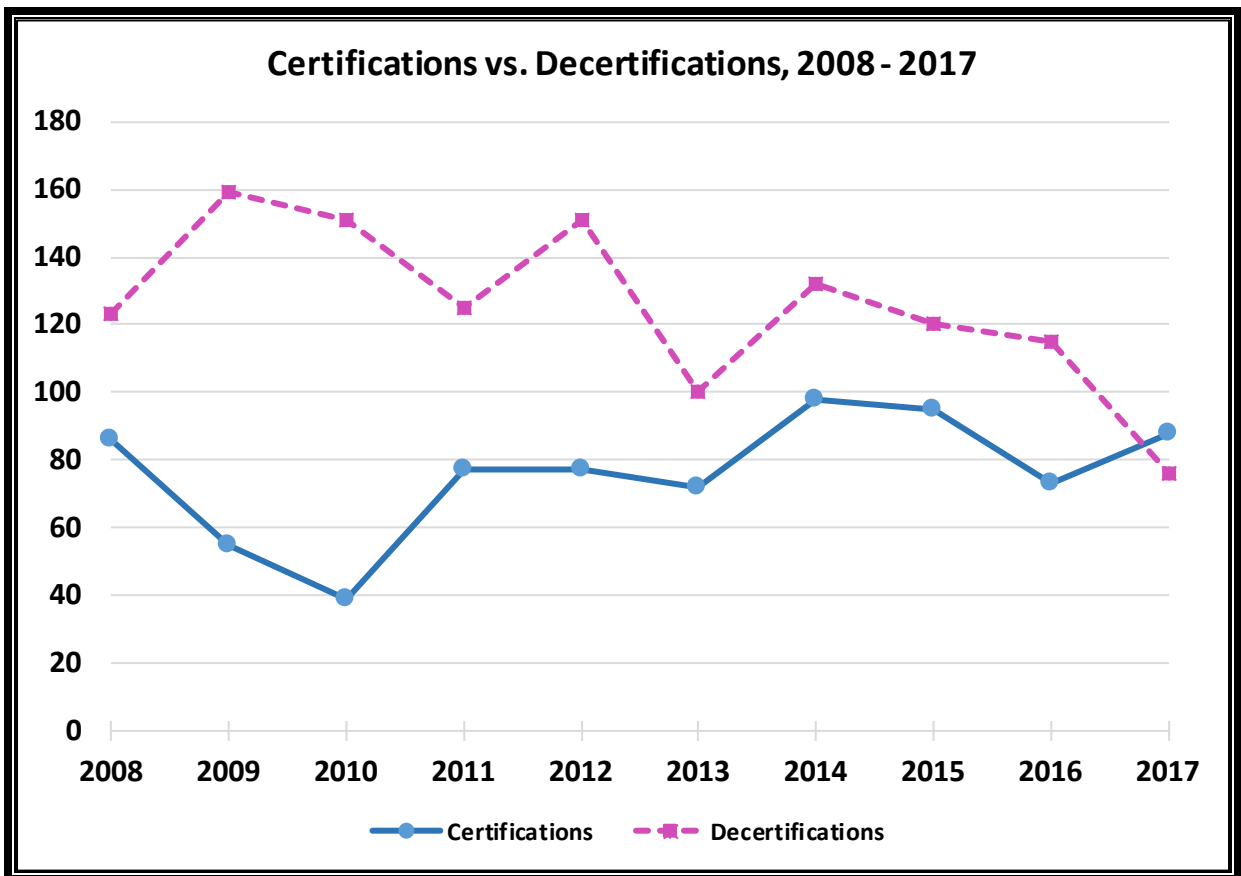




Figure 11 shows early decertification (prior to statutory maximum duration limits). From 2013 to 2017, housing districts decertified early more frequently than other district types, with 81 percent decertifying early. Redevelopment districts decertified early 54 percent of the time. Economic development districts, with their shorter maximum durations, decertified early only 25 percent of the time. For districts that decertified early, redevelopment districts decertified an average of 11 years early, and housing districts decertified an average of 12 years early.

**Figure 11.**

<b>Decertifications 2013 - 2017: Full Duration vs. Early Decertification*</b>				
<b>District Type / (Max Duration)</b>	<b>Decertified Districts</b>	<b>Lasted Full Duration</b>	<b>Decertified Early</b>	
			<b>Percent</b>	<b>Average Years</b>
Redevelopment (25 years)	285	46%	54%	11
Housing (25 years)	133	19%	81%	12
Economic Development (8 years)	112	75%	25%	4
Renewal and Renovation (15 years)	10	60%	40%	8
Soils Condition (20 years)	1	0%	100%	14

\*Measured by comparing “year of actual decertification” to “year of required decertification” based on the maximum duration limit and/or the year identified in the TIF plan as the maximum. Early decertifications may be voluntary or may be required by the Six-Year Rule. Year of required decertification is self-reported by the development authority.

### **Tax Increment Revenue**

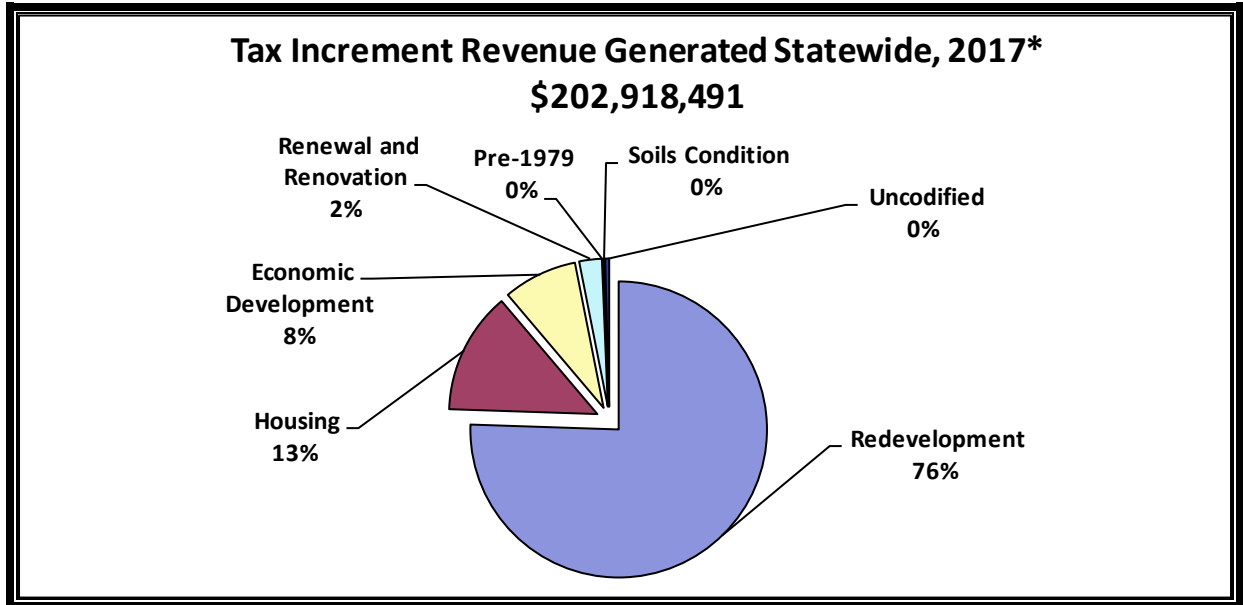
In 2017, approximately \$203 million of tax increment revenue was generated statewide. Although most districts are located in Greater Minnesota, approximately \$171 million of tax increment, or 84 percent, was generated in the Metro Area. (See Figure 12.)

**Figure 12.**

<b>Revenue Generated by Type: Statewide, Greater MN, &amp; Metro Area; 2017</b>			
<b>Type of District</b>	<b>Statewide</b>	<b>Greater MN</b>	<b>Metro Area</b>
Redevelopment	\$ 153,256,226	\$ 15,114,142	\$ 138,142,084
Housing	\$ 26,982,809	\$ 9,560,667	\$ 17,422,142
Economic Development	\$ 16,383,687	\$ 7,004,141	\$ 9,379,546
Renewal and Renovation	\$ 4,998,707	\$ 331,413	\$ 4,667,294
Pre-1979	\$ -	\$ -	\$ -
Soils Condition	\$ 410,246	\$ 10,121	\$ 400,125
Uncodified	\$ 886,816	\$ -	\$ 886,816
<b>Total</b>	<b>\$ 202,918,491</b>	<b>\$ 32,020,484</b>	<b>\$ 170,898,007</b>

In 2017, redevelopment districts made up 47 percent of the TIF districts statewide but generated 76 percent, or \$153 million, of total tax increment revenue. Figure 13 illustrates the tax increment revenue generated by type of district.

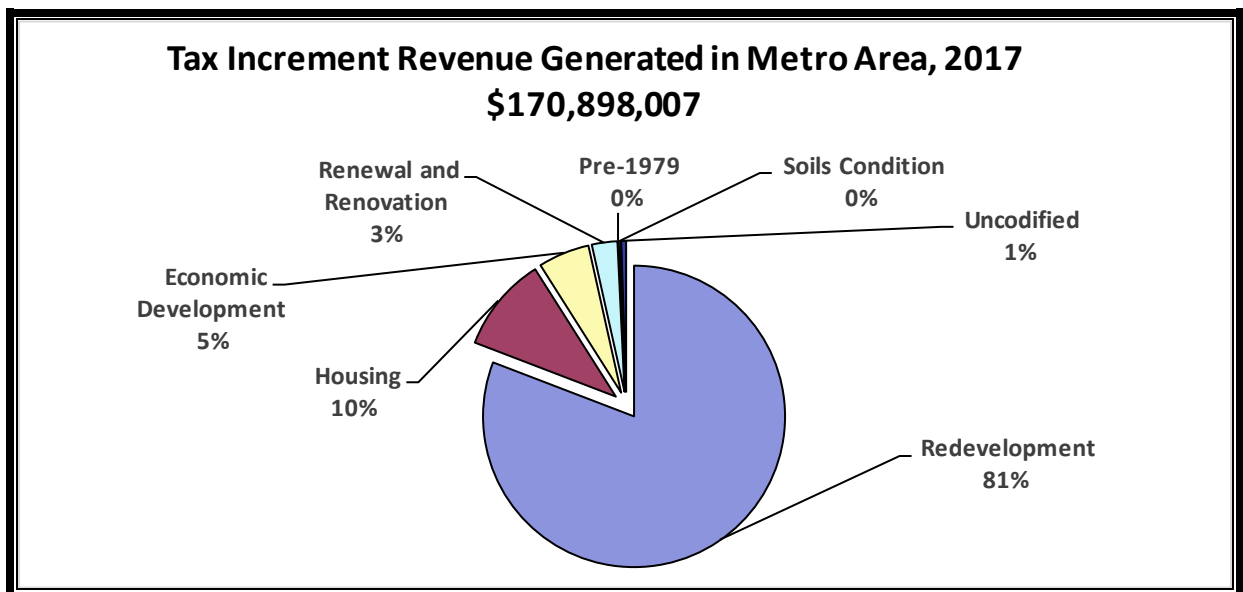
**Figure 13.**



\*Due to rounding, the sum of the percentages is less than 100 percent.

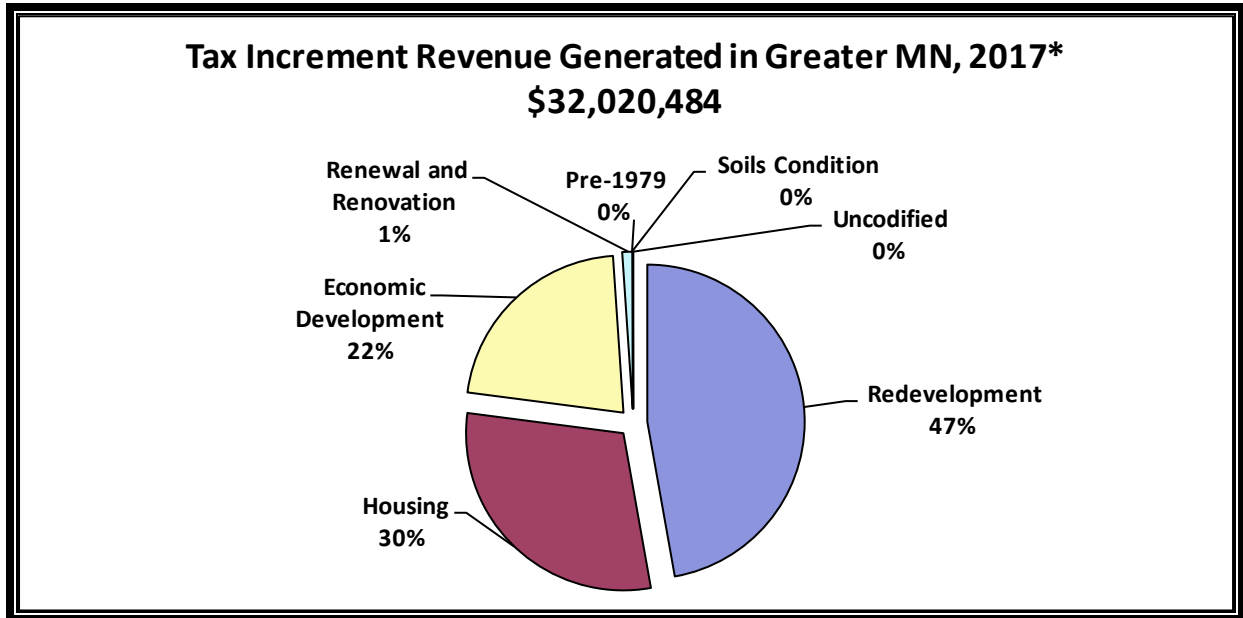
In the Metro Area, redevelopment districts represented 59 percent of the districts but generated 81 percent of the tax increment revenue. Housing and economic development districts made up about one-third of Metro Area districts and generated about 15 percent of the tax increment revenue. (See Figure 14.)

**Figure 14.**



In Greater Minnesota, redevelopment districts represented 40 percent of the districts and generated 47 percent of tax increment revenue. Housing and economic development districts made up 59 percent of Greater Minnesota districts and generated 52 percent of the tax increment revenue. (See Figure 15.)

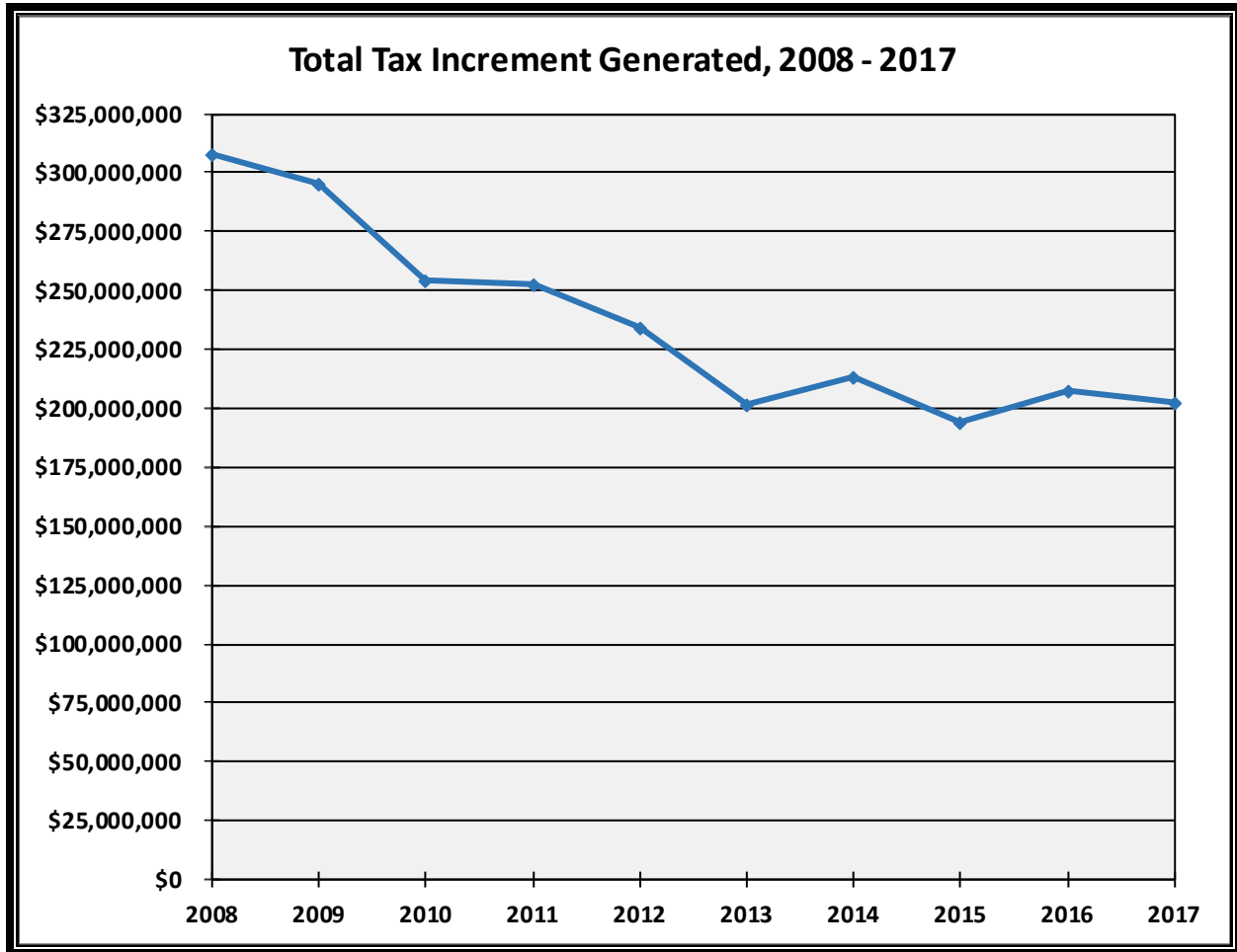
**Figure 15.**



\*Due to rounding, the sum of the percentages is less than 100 percent.

The amount of tax increment revenue declined two percent from the nearly \$208 million generated in 2016. Over the ten-year period from 2008 to 2017, the amount of tax increment revenue generated statewide declined through 2013, but has been relatively stable over the last four years. (See Figure 16.)

Figure 16.



### Returned Tax Increment

In 2017, development authorities returned \$10,800,926 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).

### Reported Debt

Tax increment is property tax revenue generated from new development and is used primarily to pay for acquisition and site improvement costs necessary for new development to begin. Tax increment revenue, however, is not generated until after the new development is completed and assessed and property taxes are paid. Therefore, up-front qualifying costs are paid with debt obligations. If the new development does not generate the amount of tax increment revenue

anticipated, the entity assuming the risk of the debt is the entity that ultimately absorbs the loss. Debt obligations, how these obligations are secured, and who assumes the risk are all issues in financing economic development.

Bonds are issued by a municipality or development authority usually to finance development activity, like land acquisition, site improvements, and public utility costs. The TIF Act defines bonds broadly to include:<sup>37</sup>

- 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 requires only the tax revenue pledged, generally the tax increment generated from the TIF district, 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.<sup>38</sup> 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, the 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 then reimbursed pursuant to the terms of the PAYG note, if and when tax increment is generated by the TIF district. Generally, in PAYG financing, the developer accepts the risks. If sufficient tax increments are not generated as anticipated, the developer does not get reimbursed in full.

**Other Bonds** – Other bonds include all other bonds that a municipality or development authority may legally issue, including those for which tax increment may be pledged to pay the required debt service payments.

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<sup>37</sup> See Minn. Stat. § 469.174, subd. 3.

<sup>38</sup> Minn. Stat. § 469.178, subd. 7.

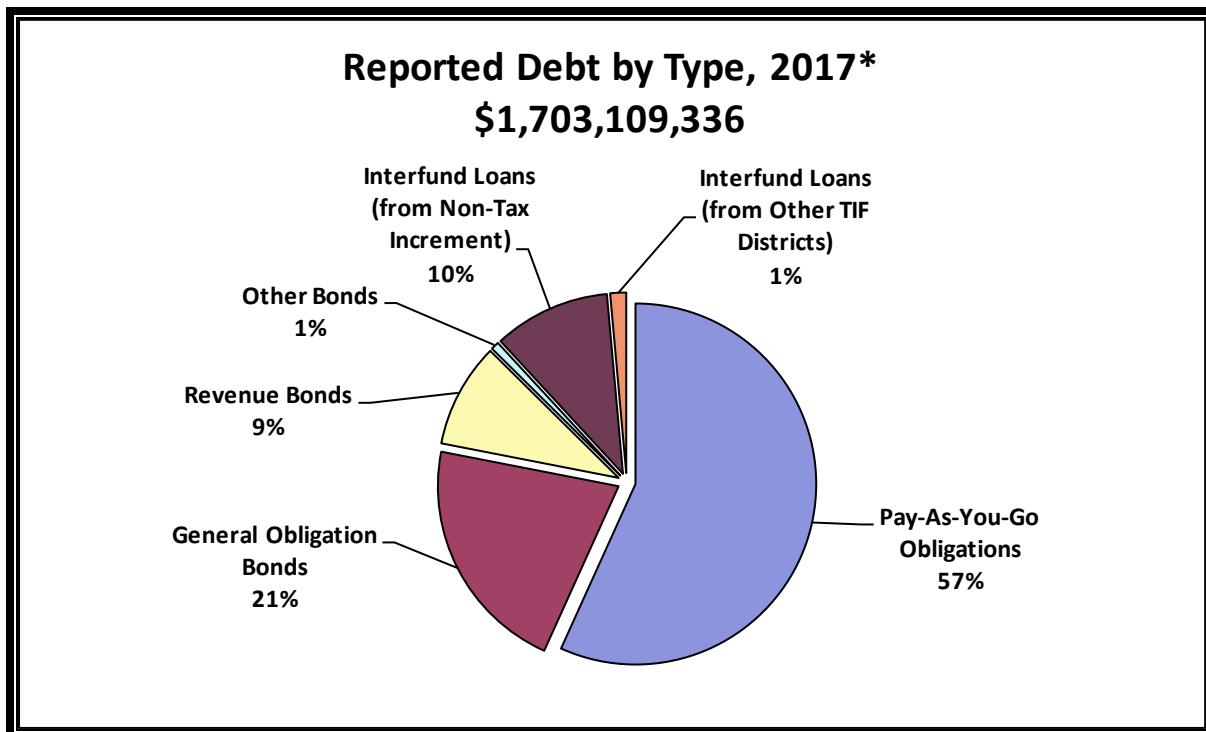
In 2017, there was a total of \$1.7 billion of outstanding debt associated with TIF districts. PAYG obligations made up 57 percent of the debt reported. GO bonds, which are secured by the municipalities' full faith and credit, made up about 21 percent of the total debt. Interfund loans from non-tax increment accounts made up over 10 percent of total debt. Revenue bonds made up 9 percent of total debt, while other bonds and interfund loans from other TIF districts made up the rest.

Figures 17 and 18 show the amount and relative distribution of the types of debt obligations used for tax increment financing in 2017.

**Figure 17.**

<b>Reported Amount of Debt by Type, 2017</b>	
<b>Type of Debt</b>	<b>Amount Outstanding</b>
Pay-As-You-Go Obligations	\$966,655,488
General Obligation Bonds	\$362,898,091
Revenue Bonds	\$159,316,576
Other Bonds	\$12,334,070
Interfund Loans (from Non-Tax Increment)	\$177,666,264
Interfund Loans (from Other TIF Districts)	\$24,238,847
<b>Total</b>	<b>\$1,703,109,336</b>

**Figure 18.**



\*Due to rounding, the sum of the percentages is less than 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, the bases for the findings, 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.<sup>39</sup> This section of the Report summarizes the TIF legal compliance reviews and investigations concluded as of December 31, 2017. Initial Notices and Final Notices were sent to the following municipalities:

1. City of Ivanhoe – An Initial Notice was sent on August 6, 2018. A Response from the City of Ivanhoe was received on August 31, 2018. A Final Notice was sent on September 13, 2018. (Appendix A.)
2. City of Perham – An Initial Notice was sent on August 6, 2018. A Response from the City of Perham was received on September 14, 2018. A Final Notice was sent on September 21, 2018. (Appendix B.)

Complete copies of the Initial Notices and Final Notices and the municipalities' Responses are provided in Appendices A and B.

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<sup>39</sup> Minn. Stat. § 469.1771, subd. 1(c).

## **Administrative Expense Limit Exceeded**

### **City of Ivanhoe**

#### *TIF District 1-1*

In the Initial Notice, the OSA found that the City of Ivanhoe had expended \$4,362 of tax increment from TIF District 1-1 in violation of the limit on administrative expenses. In the City Response, the City provided documentation that \$4,362 was returned to the Lincoln County Auditor. The OSA considered this finding resolved.

## **Expenditure in Excess of Pooling Limit**

### **City of Perham**

#### *TIF District 2-19*

In the Initial Notice, the OSA found that the City of Perham had expended \$21,672 of tax increment from TIF District 2-19 in violation of the 25 percent limit on out-district (pooling) expenses. In the City Response, the City agreed with the OSA's interpretation of Minn. Stat. § 469.1763, subd. 3, but suggested that the calculation was incomplete. The City Response indicated that tax increment was returned to the county in July 2015. The City stated that the amount returned to the county exceeded the amount of excess pooling and, therefore, no additional increment needed to be returned.

In the Final Notice, the OSA stated that the July 2015 return of tax increment occurred prior to, and was therefore unrelated to, the pooling violation. The pooling violation occurred due to subsequent pooling expenditures in 2016. The 2016 violation occurred because during that year, the City exceeded the out-district expenditure limit, an impermissible condition that could not have been rendered permissible by the prior return of in-district increments. The OSA reiterated its finding that the City of Perham has expended \$21,672 of tax increment from TIF District 2-19 in violation of the limit on out-district (pooling) expenses. The OSA subsequently received documentation that the City returned \$21,672 to Otter Tail County and the OSA considers this finding resolved.



# **APPENDIX A**

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REBECCA OTTO  
STATE AUDITOR

# STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

SUITE 500  
525 PARK STREET  
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)

August 6, 2018

The Honorable Dennis Klingbile, Mayor  
The Honorable John Bowyer, Council Member  
The Honorable Craig Hansen, Council Member  
The Honorable Brenda Koopman, Council Member  
The Honorable Leonard VanOverbeke, Council Member  
**City of Ivanhoe**  
P.O. Box 54  
Ivanhoe, MN 56142

Re: TIF District No. 1-1 – Initial Notice of Noncompliance

Dear Mayor Klingbile and Council Members:

The Office of the State Auditor (OSA) examined the TIF plan and TIF Annual Reporting Forms filed by the City of Ivanhoe (City) for Tax Increment Financing (TIF) District 1-1, a redevelopment district decertified as of 12/31/2015 for which a final reporting was made for 2017. After reviewing this information, the OSA finds that the City is not in compliance with the TIF Act.<sup>1</sup> This Initial Notice of Noncompliance (Initial Notice) contains one OSA finding (Finding).

All data relating to this examination, including this Initial Notice and the City's Response (Response), are not public until the OSA has issued its Final Notice.<sup>2</sup>

State law requires the City to send its 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.<sup>3</sup> After reviewing the Response, the OSA is required to forward information on any unresolved issues to the Lincoln County Attorney for review.<sup>4</sup>

If the City pays to Lincoln 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 City makes the payment within 60 days after the City receives this Initial Notice.<sup>5</sup>

---

<sup>1</sup>See Minn. Stat. §§ 469.174 to 469.1799 inclusive, as amended.

<sup>2</sup>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.).

<sup>3</sup>Minn. Stat. § 469.1771, subd. 1 (c).

<sup>4</sup>Minn. Stat. § 469.1771, subd. 1 (b).

<sup>5</sup>Minn. Stat. § 469.1771, subd. 5.

## OFFICE OF THE STATE AUDITOR

Mayor and Council, City of Ivanhoe  
August 6, 2018  
Page 2

### FINDING OF NONCOMPLIANCE

The OSA's finding of noncompliance regarding TIF District 1-1 is as follows:

#### **Finding 1. TIF District 1-1 – Administrative Expense Limit Exceeded**

The TIF Act limits the amount of tax increment that may be used for administrative expenses, which for TIF District 1-1 is limited to 10 percent of total estimated tax increment expenditures authorized by the TIF plan or the total tax increments distributed from the county, whichever is less. In this case, ten percent of the \$49,084 of tax increments distributed from the county, or \$4,908, is the limit.<sup>6</sup> The City reported \$9,270 of administrative expenses for TIF District 1-1.<sup>7</sup>

We find that the City of Ivanhoe has expended \$4,362 of tax increment from TIF District 1-1 in violation of the limit on administrative expenses. An amount equal to \$4,362 must be returned to the county auditor.

When the City provides documentation that it returned **\$4,362** to the Lincoln County Auditor, the OSA will consider this Finding resolved.

### 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.

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: Carol Renken, City Administrator

---

<sup>6</sup>Ten percent of the total estimated tax increment expenditures authorized by the TIF plan equals \$160,097.

<sup>7</sup>This amount reflects the reported administrative expenditures of \$15,486 minus \$6,216 of project costs reported as paid with other public funds.



# CITY OF IVANHOE

*"The Storybook Town"*

PO Box 54, Ivanhoe, MN 56142

Ph: (507) 694-1738 Fax: (507) 694-1278

TTY MN Relay Service 7-1-1 or (800) 627-3529

Email: [cityivan@frontiernet.net](mailto:cityivan@frontiernet.net)

Website: [www.ivanhoe-mn.com](http://www.ivanhoe-mn.com)



August 28, 2018

Office of the State Auditor  
525 Park Street Suite 500  
St Paul, MN 55103-2139

Dear Sir/Madam:

Enclosed please find a copy of our check #45722 payable to the Lincoln County Auditor, in the amount of \$4,362.00. This payment is regarding our Initial Notice of Noncompliance of our TIF District 1-1. I have included a copy of the initial notice.

If you should have any questions regarding this payment, please do not hesitate to contact me at your earliest convenience.

Sincerely,

Carol A. Renken  
City Administrator

Attachments Omitted

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REBECCA OTTO  
STATE AUDITOR

**STATE OF MINNESOTA**  
**OFFICE OF THE STATE AUDITOR**

SUITE 500  
525 PARK STREET  
SAINT PAUL, MN 55103-2139

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(651) 296-4755 (Fax)  
[state.auditor@state.mn.us](mailto:state.auditor@state.mn.us) (E-mail)  
1-800-627-3529 (Relay Service)

September 13, 2018

The Honorable Dennis Klingbile, Mayor  
The Honorable John Bowyer, Council Member  
The Honorable Craig Hansen, Council Member  
The Honorable Brenda Koopman, Council Member  
The Honorable Leonard VanOverbeke, Council Member  
**City of Ivanhoe**  
P.O. Box 54  
Ivanhoe, MN 56142

Re: TIF District No. 1-1 – Final Notice of Noncompliance

Dear Mayor Klingbile and Council Members:

On August 6, 2018, the Office of the State Auditor (OSA) sent the City of Ivanhoe (City) an Initial Notice of Noncompliance (Initial Notice) for Tax Increment Financing (TIF) District 1-1. The OSA received the City's response (City Response) on August 31, 2018.

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. TIF District 1-1 – Administrative Expense Limit Exceeded – RESOLVED**

In the Initial Notice, the OSA found that the City of Ivanhoe had expended \$4,362 of tax increment from TIF District 1-1 in violation of the limit on administrative expenses. In the City Response, the City provided documentation that \$4,362 was returned to the Lincoln County Auditor in response to the Initial Notice of Noncompliance. The OSA considers this finding resolved.

**CONCLUSION**

The OSA considers the finding resolved and appreciates the City's prompt resolution of this matter.

**OFFICE OF THE STATE AUDITOR**

Mayor and Council, City of Ivanhoe  
September 13, 2018  
Page 2

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

Sincerely,

*/s/ Jason Nord*

Jason Nord  
Assistant State Auditor  
TIF Division Director

cc: Carol Renken, City Administrator



# **APPENDIX B**

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REBECCA OTTO  
STATE AUDITOR

STATE OF MINNESOTA  
OFFICE OF THE STATE AUDITOR

SUITE 500  
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(651) 296-4755 (Fax)  
[state.auditor@state.mn.us](mailto:state.auditor@state.mn.us) (E-mail)  
1-800-627-3529 (Relay Service)

August 6, 2018

The Honorable Tim Meehl, Mayor  
The Honorable James Johnson, Council Member  
The Honorable Fred Lehmkuhl, Council Member  
The Honorable Brad Schmidt, Council Member  
The Honorable Eric Spencer, Council Member  
**City of Perham**  
P.O. Box 130  
Perham, MN 56573

Re: TIF District No. 2-19 – Initial Notice of Noncompliance

Dear Mayor Meehl and Council Members:

The Office of the State Auditor (OSA) examined the TIF plan and TIF Annual Reporting Forms filed by the City of Perham (City) for Tax Increment Financing (TIF) District 2-19, a redevelopment district decertified as of 1/12/2015 for which reporting is complete. After reviewing this information, the OSA finds that the City is not in compliance with the TIF Act.<sup>1</sup> This Initial Notice of Noncompliance (Initial Notice) contains one OSA finding (Finding).

All data relating to this examination, including this Initial Notice and the City's Response (Response), are not public until the OSA has issued its Final Notice.<sup>2</sup>

State law requires the City to send its 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.<sup>3</sup> After reviewing the Response, the OSA is required to forward information on any unresolved issues to the Otter Tail County Attorney for review.<sup>4</sup>

If the City pays to Otter Tail 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 City makes the payment within 60 days after the City receives this Initial Notice.<sup>5</sup>

<sup>1</sup>See Minn. Stat. §§ 469.174 to 469.1799 inclusive, as amended.

<sup>2</sup>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.).

<sup>3</sup>Minn. Stat. § 469.1771, subd. 1 (c).

<sup>4</sup>Minn. Stat. § 469.1771, subd. 1 (b).

<sup>5</sup>Minn. Stat. § 469.1771, subd. 5.

## OFFICE OF THE STATE AUDITOR

Mayor and Council, City of Perham  
August 6, 2018  
Page 2

### FINDING OF NONCOMPLIANCE

The OSA's finding of noncompliance regarding TIF District 2-19 is as follows:

#### **Finding 1. TIF District 2-19 – Expenditure in Excess of Pooling Limit**

For redevelopment districts, the TIF Act requires that at least 75 percent of the total revenue derived from tax increments paid by properties in the district must be expended on activities in the district and not more than 25 percent of these revenues may be expended on activities outside of the district.<sup>6</sup> Expenditure of increment on activities outside the district is commonly known as “pooling,” and this limitation is generally referred to as the “pooling limit.” TIF 2-19 received \$211,140 of revenues derived from tax increments paid by properties in the district, yielding a pooling limit of \$52,785.<sup>7</sup>

The TIF Act's “Five-Year Rule” further specifies circumstances in which tax increments are considered to have been expended on an activity within the district, adding a timing parameter in addition to the physical location of activity.<sup>8</sup> Generally, expenditures and obligations must be tied to activity occurring within five years after the certification of the district to be considered in-district activity. TIF District 2-19 was certified June 27, 2002, and has a Five-Year Rule date of June 27, 2007. Any new expenditures, obligations, or activities after this date are considered out-district (pooling) expenditures. Administrative expenses are also specified as being out-district (pooling) expenditures.<sup>9</sup>

We identify \$77,248 of total pooling expenditures for TIF 2-19, exceeding the limit of \$52,785. The City's reporting explicitly identifies \$50,666 of project costs for activities outside the TIF district, which includes \$21,394 of administrative costs and \$29,272 for other public improvements expended in 2016. However, the City also reported \$26,582 of project costs for other public improvements expended in 2012 that, by virtue of the Five-Year Rule, should be identified as pooling expenditures.<sup>10</sup> We assume that \$2,791 of the pooled expenditures were paid by interest earnings, which are considered tax increment revenue but are not included as “revenue derived from tax increments paid by properties in the district.” Therefore, the actual amount of pooling paid from revenue derived from tax increments paid by properties in the district is \$74,457, which is \$21,672 in excess of the pooling limit.

---

<sup>6</sup>See Minn. Stat. § 469.1763, subd. 2(a).

<sup>7</sup>The revenue amount includes tax increment revenues distributed from the county (totaling \$207,175) and the TIF share of property tax credits (totaling \$3,965), both of which are part of the gross taxes “paid by properties in the district.” The county distributions are paid by property owners and TIF credit reimbursements come from the State.

<sup>8</sup>See Minn. Stat. § 469.1763, subd. 3.

<sup>9</sup>See Minn. Stat. § 469.1763, subd. 2(c).

<sup>10</sup>The City provided an invoice for the 2012 expenditures, (which were for the demolition of houses, a garage, curbs, and sidewalk; tree and stump removal; grading; fill; and disposal), and indicated that the activity occurred in 2012.

## OFFICE OF THE STATE AUDITOR

Mayor and Council, City of Perham  
August 6, 2018  
Page 3

We find that the City of Perham has expended this \$21,672 of tax increment from TIF District 2-19 in violation of the limit on out-district (pooling) expenses. Therefore, the City must return \$21,672 to the county auditor.

When the City provides documentation that it returned **\$21,672** to the Otter Tail County Auditor, the OSA will consider this Finding resolved.

### 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.

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: Patti Stokke, Interim City Manager

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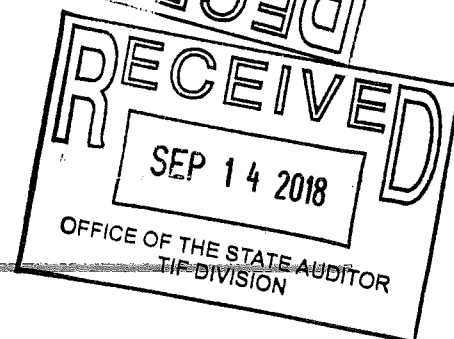
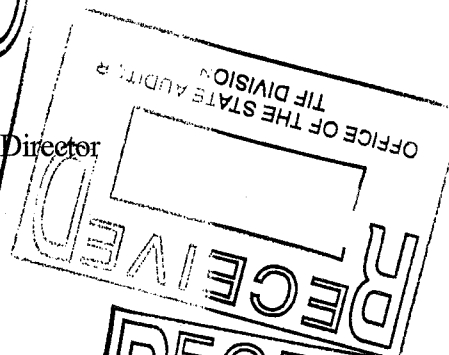
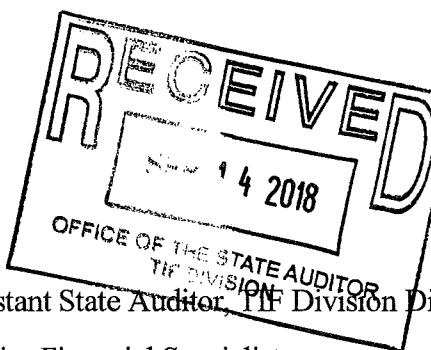
# Memo



**EHLERS**

LEADERS IN PUBLIC FINANCE

**To:** Jason Nord, Assistant State Auditor, TIF Division Director  
**From:** Jeanne Vogt, Senior Financial Specialist  
Todd Hagen, Senior Municipal Advisor  
**Cc:** Mayor and Council, City of Perham  
Jonathan Smith, City of Perham  
Patti Stokke, City of Perham  
**Date:** September 6, 2018  
**Subject:** OSA Finding of Non-Compliance for TIF 2-19



Mr. Nord,

The City of Perham ("City") has requested Ehlers to respond to the TIF District No. 2-19 Initial Notice of Non-Compliance ("Notice") dated August 6, 2018. As part of Finding 1, the Notice states that under the Five-Year Rule, at least 75% of total revenue derived from tax increments paid by properties in the district must be expended on activities inside the district and not more than 25% may be expended outside the district. Expenditure of increment on activities outside the district is commonly referred to as "pooling" and this limitation is generally referred to as the "pooling limit". It is this pooling limit the OSA has determined was exceeded.

TIF 2-19 received \$211,140 of revenues derived from tax increments paid by properties in the district yielding a pooling limit of \$52,785. Finding 1 goes on to state you have identified \$77,248 of total pooling expenditures for TIF 2-19, exceeding the limit of \$52,785. This is broken down between Administrative costs of \$21,394 and project costs of \$55,854. This is reduced by \$2,791 of interest income, which is considered tax increment, but is not "revenue derived from tax increments paid by properties in the district." Thus, the actual amount of pooling paid for from tax increments is \$74,457, which exceeds the pooling limit by \$21,672.

The letter also states the City must return \$21,672 to the county auditor in order to consider this Finding closed.

The City agrees with your interpretation of M.S. 469.1763 subd. 3. However, we believe the calculation to be incomplete. Please find the calculation the City believes to be correct on the following page.



Detail Calculation

1) Tax Increment Received:	\$211,140
2) <b>Maximum Pooling Allowed (25%)</b>	<b><u>52,785</u></b>
3) Pooling Expenditures:	
a) Administrative Costs	\$21,394
b) 2012 Project Costs	26,582
c) 2016 Project Costs	29,272
d) Less: Interest Income	<u>(2,791)</u>
e) <b>Total Pooling Expenditures</b>	<b><u>\$74,457</u></b>

Summary

4) Maximum Pooling Allowed (25%) (Line 2)	\$52,785
5) Total Pooling Expenditures (Line 3e)	<u>(74,457)</u>
6) <b>Pooling Remaining</b>	<b><u>(\$21,672)</u></b>
7) Tax Increment Returned in 2015	<u>38,065</u>
8) <b>Additional Tax Increment to be Returned</b>	<b><u>(\$16,393)</u></b>
<i>Cannot be less than \$0</i>	

The City returned \$38,065 to the Ottertail County Auditor in 2015. *This exceeds the \$21,672 in excess pooling by \$16,393.* Therefore, the City does not believe any additional tax increment needs to be returned at this time. A copy of the check is enclosed for your convenience.

We hope this helps to resolve this Finding. Please feel free to contact Jonathan Smith, Perham City Administrator at (218) 346-9799 or [jsmith@cityofperham.com](mailto:jsmith@cityofperham.com), if you have any additional comments or would like to discuss further.

Attachments Omitted





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September 21, 2018

The Honorable Tim Meehl, Mayor  
The Honorable James Johnson, Council Member  
The Honorable Fred Lehmkuhl, Council Member  
The Honorable Brad Schmidt, Council Member  
The Honorable Eric Spencer, Council Member  
**City of Perham**  
P.O. Box 130  
Perham, MN 56573

Re: TIF District No. 2-19 – Final Notice of Noncompliance

Dear Mayor Meehl and Council Members:

On August 6, 2018, the Office of the State Auditor (OSA) sent the City of Perham (City) an Initial Notice of Noncompliance (Initial Notice) for Tax Increment Financing (TIF) District 2-19. The OSA received the City's response (City Response) on September 14, 2018.

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. TIF District 2-19 – Expenditure in Excess of Pooling Limit – NOT RESOLVED**

In the Initial Notice, the OSA found that the City of Perham had expended \$21,672 of tax increment from TIF District 2-19 in violation of the 25-percent limit on out-district (pooling) expenses. In the City Response, the City, via its advisors, agreed with the OSA's interpretation of Minn. Stat. § 469.1763, subd. 3, but suggested that the calculation was incomplete. The City Response identified that the City had returned \$38,065 to Otter Tail County in July 2015. Because the returned amount exceeded the amount of excess pooling, the City Response asserted the belief that no additional tax increment needs to be returned.

The OSA finds that this July 2015 return of in-district increment occurred prior to and is unrelated to the pooling violation, which happened due to subsequent pooling expenditures of \$26,481 in

## OFFICE OF THE STATE AUDITOR

Mayor and Council, City of Perham  
September 21, 2018  
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2016. The 2016 violation occurred because during that year the City spent too much increment on out-district expenditures, an impermissible condition that could not have been rendered permissible by the prior return of in-district increments.

The City's position would lead to a result disfavored under the law. It amounts to an argument that would permit expenditures in excess of the statutory pooling limitation to the full extent of any in-district increments returned in prior years. This would effectively render the pooling limitation a nullity – an absurd and unreasonable result presumed not to have been intended by the Legislature. See Minn. Stat. § 645.17 (1) (“the legislature does not intend a result that is absurd, impossible of execution, or unreasonable”).

We reiterate that the City of Perham has expended \$21,672 of tax increment from TIF District 2-19 in violation of the limit on out-district (pooling) expenses. Therefore, the City must return \$21,672 to the County Auditor.

### CONCLUSION

The OSA finds that the City has failed to resolve the Finding and that the City must return \$21,672 to the County Auditor to achieve such resolution. As a result, this matter is being forwarded to the Otter Tail County Attorney as required by Minn. Stat. § 469.1771, subd. 1(b).

Please note, if the City makes payment of this amount to the County Auditor on or before 60 days from the receipt of the August 6<sup>th</sup> Initial Notice of Noncompliance, (and the County Attorney has not taken action to compel payment), the City will receive its share of the county auditor's distribution of the payment. The City is not eligible to receive a distribution of any subsequent payment.

If you have any questions, please contact me at (651) 296-7979 or Jason.Nord@osa.state.mn.us, or Deputy State Auditor/General Counsel Ramona Advani at 651-297-3673 or Ramona.Advani@osa.state.mn.us.

Sincerely,

*/s/ Jason Nord*

Jason Nord  
Assistant State Auditor  
TIF Division Director

cc: Patti Stokke, Interim City Manager