STATE OF MINNESOTA

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Statement of Position
TIF Five-Year Rule and Six-Year Rule

The Tax Increment Financing (TIF) Act was amended in 1990 to include a Five-Year Rule and a Six-Year Rule.[1] The general rationale for these Rules was to require an early commitment to the scope of costs needed to facilitate a development so that additional spending is not triggered merely by the availability of an increment revenue stream, and to require earlier decertification to make the new value of development more quickly available to the tax base.[2]

I. The Five-Year Rule

The Five-Year Rule establishes a "five-year period" whereby activity must occur before or within five years after certification of the district in order to be considered "in-district" expenditures of the district. The Rule works in concert with both the overall pooling restriction, which limits the amount of tax increment that may be used to pay "out-district" expenditures, and the Six-Year Rule, which requires districts to be decertified when, generally, sufficient increment is received to pay in-district obligations.[3] Tax increment revenues expended on an activity within the district will instead be considered to have been expended on an activity outside the district unless:

1. the revenues are actually paid to a third party within the five-year period;[4]
2. bonds are issued and sold to a third party within the five-year period, tax increment revenues are spent to repay the bonds, and the bond proceeds, in general terms, are expected to be used for the activity within the five-year period;[5]
3. binding contracts with a third party are entered into for performance of the activity within the five-year period and the revenues are spent to satisfy the contractual obligation;
4. activity costs are paid within the five-year period and revenues are spent to reimburse a party for payment of the costs, including interest on unreimbursed costs; or

[1] Minn. Stat. § 469.1763. The Five-Year Rule and the Six-Year Rule were enacted at the same time and in the same bill as Pooling Restrictions. *See* 1990 Laws of Minn. ch. 604, art. 7, §§ 21, 30 and 31(a).
[2] Minnesota House of Representatives, House Research, Five-Year Rule in TIF.
[3] The overall pooling limit on the amount of tax increment that may be spent "out-district" is 20% or 25% (depending on the type of district), and an election permits an additional 10% of pooling for affordable housing. *See* Minn. Stat. § 469.1763, subd. 2, and the OSA's Statement of Position on TIF Pooling.
[4] A "third party" is an entity that is not the party who benefits from the tax increment assistance and is not the development authority. Minn. Stat. § 469.1763, subd. 1(c).
[5] *See* Minn. Stat. § 469.1763, subd. 3(a)(2). The expectation to use bond proceeds to finance the activity is to be held on the date of issuance and can extend for a "reasonable temporary period" beyond the five-year period within the meaning of the use of the term under Section 148(c)(1) of the Internal Revenue Code. Alternatively, bond proceeds may be deposited in a reasonably required reserve or replacement fund.

Reviewed: November 2023
Revised: November 2023

5. revenues of a housing district are spent for housing purposes at any time during the duration of the district (and not limited to the five-year period).[6]

Expenditures to pay obligations entered into after the first five years are "out-district" expenditures, even if they are for costs actually incurred within the area of the district. In addition, direct expenditures that are separate from obligations that meet the Five-Year Rule and that occur after the first five years are "out-district" expenditures even if they are spent within the area of the district.

The Five-Year Rule extends for five years from the date of certification of the TIF district. For example, a district certified July 5, 2022, would have its five-year period end on July 5, 2027. The period runs from the actual certification date, not the request for certification date or the approval date.

For redevelopment districts or renewal and renovation districts that were certified after June 30, 2003, and before April 20, 2009, the Legislature extended the Five-Year Rule to ten years.[7] For redevelopment districts that were certified after April 20, 2009, and before June 30, 2012, the Five-Year Rule was extended to eight years.[8] For redevelopment districts that were certified after December 31, 2017, and before June 30, 2020, the Five-Year Rule was also extended to eight years.[9]

Only the "revenues derived from tax increments paid by properties in the district" are subject to the Five-Year Rule (and the Six-Year Rule).[10] Proceeds from the sale or lease of property purchased with tax increments, principal and interest received on loans or advances made with tax increments, interest or other investment earnings on or from tax increments, and repayments to an authority are not subject to the Rules, even though they are all tax increments.[11]

II. The Six-Year Rule

Once in-district expenditures and obligations are established under the Five-Year Rule, the Six-Year Rule serves to promote early decertification of TIF districts so that captured value can become part of the tax base as soon as possible.

2023 Changes and Clarifications, Applicability

The Six-Year Rule was significantly changed and clarified in 2023.[12] A prior requirement was removed that had imposed, beginning in the sixth year, an annual limit in addition to the overall or cumulative pooling limit.[13] The remaining requirements pertaining to decertification were substantially clarified and expanded with new provisions. The changes largely took effect for all districts with a request for

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[6] Minn. Stat. § 469.1763, subd. 3.
[7] Minn. Stat. § 469.1763, subd. 3(c).
[8] Minn. Stat. § 469.1763, subd. 3(c). The effective date for this extension also requires that the request for certification be made after April 20, 2009. Both of extensions in subdivision 3(c) were provided to accommodate delays in development activities that occurred in the Great Recession.
[9] Minn. Stat. § 469.1763, subd. 3(d). The effective date for this provision also requires that the request for certification be made after December 31, 2017. This extension was provided to accommodate delays in development activities due to the COVID-19 pandemic.
[10] Minn. Stat. § 469.1763, subd. 1(d). The definition's reference to "taxes paid by the captured net tax capacity" includes both distributions of tax increment collections by the county (the net amount paid by property owners) and any TIF credit distributions reimbursing the reductions of the gross taxes on captured value.
[11] Tax increment revenues as defined in Minn. Stat. § 469.174, subd. 25, clauses (2) to (5) are expressly excluded from "revenues derived from tax increment paid by properties in the district." *See* Minn. Stat. § 469.1763, subd. 1(d).
[12] 2023 Minn. Laws, ch. 64, art. 9, sec. 8.
[13] *See* Minn. Stat. § 469.1763, subd. 3(a) (2022).

certification after April 30, 1990, on May 25, 2023, except some of the new provisions pertaining to districts with a pay-as-you-go contract and note (PAYG note).[14]

The Six-Year Rule does not apply to housing districts.[15] Generally, housing districts must use increment for housing purposes and such uses are considered in-district activities under the Five-Year Rule, so pooling is effectively a moot issue for housing districts.

Decertification Requirement

Beginning with the sixth year following certification of the district, a district must be decertified when the in-district percentage of the cumulative revenues derived from tax increments collected through the end of the calendar year, equals or exceeds an amount sufficient to pay the following:

(1) any costs and obligations meeting the Five-Year Rule requirements for being expended on in-district activities, *excluding* those under a qualifying PAYG note;

(2) any accrued interest on the costs and obligations for these costs and obligations, payable in accordance with their terms; and

(3) any administrative expenses that fall within an exception in the overall pooling limit provisions that allow them to be considered in-district expenditures.[16]

In simpler terms, when the in-district share of cumulative tax increment revenues equals or exceeds the amount to pay in-district obligations other than PAYG notes, the district must be decertified. For districts with PAYG notes, a deferral of this decertification requirement is included in special provisions. (See the PAYG Provisions section that follows.)

Calculation Details

The in-district percentage of revenues derived from tax increments is determined as the product of the applicable in-district percentage multiplied by the cumulative revenues derived from tax increment paid by properties in the district that have been collected through the end of the calendar year.

The "applicable in-district percentage" means the percentage of tax increments that is restricted for expenditures within the district, as determined under the overall pooling limit provision, which sets different percentages for different types of districts and also permits extra pooling for qualifying affordable housing purposes if an election is made in the TIF plan.[17] Therefore, the applicable in-district percentages are as follows:

Redevelopment districts:	75% if no extra pooling for affordable housing, or 65% if TIF plan permits extra pooling for affordable housing.
All Other Districts:	80% if no extra pooling for affordable housing, or 70% if TIF plan permits extra pooling for affordable housing.

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[14] *See* Minn. Stat. § 469.174, subd. 30, for the definition of "pay-as-you-go contract and note," which will herein be simply referenced as "PAYG note."

[15] Minn. Stat. § 469.1763, subd. 4(h).

[16] Minn. Stat. § 469.1763, subd. 4(a). The year following any extension of the five-year period under the Five-Year Rule statute would substitute for the sixth year. *See* Minn. Stat. § 469.1763, subd. 2(c) for the administrative expense exception.

[17] Minn. Stat. § 469.1763, subd. 4(d). The pooling percentages specified for the types of districts are contained in Minn. Stat. § 469.1763, subd. 2(a). The election to pool an extra 10% for affordable housing is contained in Minn. Stat. § 469.1763, subd. 2(d), and is sometimes referred to as the "2(d) election" or "2(d) pooling."

The "cumulative revenues … collected through the end of the calendar year" includes any final distributions made by the county in the following January as those January distributions include increment received by the county through the end of the calendar year.[18]

If the authority has returned excess increment to the county or returned amounts to the county to remedy an improper receipt of tax increment, these amounts should be subtracted from the amount of cumulative revenues before making this calculation.[19] Doing so ensures that the percentages apply only to properly received increment revenues within the amounts authorized by the TIF plan.

As was noted in regards to the Five-Year Rule, this measure is limited to "revenues derived from tax increment paid by properties in the district" (or distributions of taxes on captured value), and does not include other revenues (such as interest earnings or sales and lease proceeds) that are defined as tax increment.[20]

The statute does not explicitly address the impact on the decertification calculation when other revenues besides this measure of cumulative tax increment revenues are used to pay in-district obligations. However, the "amount sufficient to pay" language, implies that any amounts of in-district obligations that are paid by non-increment revenues (like special assessments), or by other increment revenues (such as interest earnings or sales and lease proceeds), should be subtracted from the total in-district obligations so that it remains a measure of what is needed to be paid from the cumulative tax increment revenues.

Projecting the Revenue Benchmark Requiring Decertification

This reconstituted specification of the Six-Year Rule's early decertification requirement allows an authority to generally identify, in the sixth year following certification, the revenue benchmark upon which decertification will be required. Because all in-district obligations should be known in year six, dividing the total in-district obligations by the applicable in-district percentage should equal the total cumulative revenue mark upon which the decertification requirement would apply.[21]

> *Example*
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> The only obligation of a redevelopment district in the first five years for in-district activities was a $200,000 bond. The TIF plan did not elect extra pooling for affordable housing. In year six it could be determined that the district will need to decertify when tax increment revenues reach $266,667 (where $200,000 ÷ 75% = $266,667). It is at that amount of cumulative tax increment revenues where the in-district share of tax increment revenues will equal or exceed the amount needed to pay in-district obligations.

PAYG Provisions

For districts with an outstanding qualifying pay-as-you-go (PAYG) contract and note, there are two special provisions that apply.[22]

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[18] Minn. Stat. § 469.1763, subd. 4(f).

[19] Minn. Stat. § 469.1763, subd. 4(f). For specifics regarding returned amounts to remedy improper receipts of tax increment, *see* Minn. Stat. § 469.1771, subd. 2.

[20] *See* footnotes 10 and 11.

[21] It is possible that an obligation may contain variables (such as variable interest rates or other details) that could require continued, annual monitoring to identify the precise revenue benchmark requiring decertification.

[22] A qualifying PAYG note means the PAYG note is considered to be for activities within the district under the Five-Year Rule. (*See* Minn. Stat. § 469.1763, subd. 4(e)).

Reviewed: November 2023
Revised: November 2023

First, the required decertification is deferred until the end of the remaining term of the last outstanding PAYG note is reached and the in-district percentage of cumulative tax increment revenues are sufficient to pay the in-district obligations.[23] If a district's only obligation is a PAYG note, the district would not have to decertify until the PAYG termination is reached. If a district has a PAYG note and some other in-district obligation, the decertification would be deferred until the PAYG termination is reached and the in-district share of cumulative tax increments is also sufficient to pay the other in-district obligation (as might be the case if the PAYG terminates before the other obligation).

Second, during the deferral, there is a new annual requirement (which applies only to districts for which the request for certification was made after May 25, 2023) to either:

remove parcels that will no longer have their tax increment pledged or subject to a qualifying PAYG note or other in-district obligation after the end of the year, or

use the applicable in-district percentage of tax increments received from such parcels to prepay an outstanding PAYG note or other in-district obligation, or to accumulate and use tax increments received from such parcels as permitted for provisions related to the extra pooling for affordable housing.[24]

In other words, parcels that are not subject to a PAYG note or another in-district obligation should be removed from the TIF district and returned to the tax rolls rather than continue to generate unneeded increment. However, they may be kept in the district if they are used to help prepay obligations (which can lead to an earlier decertification of the whole district), or if they accumulate amounts permitted to be pooled for affordable housing. Note that not all PAYG notes or other in-district obligations have a prepayment provision that make the later choice permissible. (More on the affordable housing option in the following section.)

The removal of parcels must be done as a modification of the TIF plan and the county auditor must be notified by the end of the calendar year in which the removal is required. The modification must be communicated to the OSA using a TIF Plan Collection Form for Modified Districts. A modification solely for this purpose is not subject to the notice, discussion, public hearing, and finding requirements for approval of the original plan.[25]

Extra Pooling Election for Affordable Housing Implications

A special provision is included in the Six-Year Rule that applies only to districts for which the authority has made the election in the TIF plan to pool an extra ten percent for affordable housing.26 It is meant to prevent the Six-Year Rule from constricting the amount that is permitted or authorized for such purposes. It provides that the requirements to decertify or remove parcels under the Six-Year Rule, shall not apply prior to such time that the accumulated tax increment revenues that are eligible to be expended for the purposes permitted under the authority to pool an extra ten percent for affordable housing, equals the lesser of:

(1) the amount the authority is permitted to expend for housing purposes under that authority, or
(2) the amount authorized for such purposes in the TIF plan.[27]

[23] Minn. Stat. § 469.1763, subd. 4(b).
[24] *Id*.
[25] *Id*. *See* Minn. Stat. § 469.175, subd. 4(b), for the customary plan modification approval requirements.
[26] Minn. Stat. § 469.1763, subd. 4(i).
[27] The tax increment revenues here again refers to "revenues derived from tax increments paid by properties in the district." (*See* footnotes 10, 11, and 22). *See* Minn. Stat. § 469.1763, subd. 2(d) for the authority to pool an extra ten percent for affordable housing.

Reviewed: November 2023
Revised: November 2023

Although the latter of these two amounts should be easy to identify, the first of these amounts is often going to be the lesser amount because actual tax increment revenues and expenditures are often less than the amounts estimated in TIF plans. Statute does not identify a specific method for determining this "permitted amount." The OSA recommends determining this amount as follows:

(1) Identify the revenue benchmark at which point decertification will be required (by dividing the in-district obligation amounts by the applicable in-district percentage).
(2) Multiply that revenue benchmark by the maximum pooling percentage to identify the total authorized pooling amount.
(3) Subtract from the authorized pooling amount any pooling amounts for other purposes (including administrative costs unless all pooling is for the permitted affordable housing purposes and the administrative costs are considered in-district costs).

Example

For example, consider an economic development district comprised of two parcels with a TIF plan that estimates $200,000 of tax increment to be used as follows:

$140,000 in-district development costs
$20,000 administrative expenses
$20,000 pooling for affordable housing
$20,000 other pooling.

As of year six, a single PAYG note for $70,000 on one of the two parcels is the district's only in-district obligation. The revenue benchmark at which decertification will be required (step 1) is $100,000 (where $70,000 ÷ 70% = $100,000).

The total authorized pooling amount (step 2) is $30,000 (where $100,000 x 30% = $30,000).

The authority decides to limit its administrative expenses to $5,000 and its pooling for other purposes to $12,000 so that the remainder can be used to pool for affordable housing.

The district cannot decertify and the extra parcel that is no longer subject to any in-district obligations need not be removed prior to collecting poolable revenues equaling $13,000 (where $30,000 - $12,000 - $5,000 = $13,000).

Note that this is lesser than the amount identified for pooling for affordable housing in the TIF plan as actual activities were less than the original estimates.

The intent of this provision is to ensure that the full poolable share of tax increment (relative to the actual in-district share) is received. It might often be the case that the full poolable share will be received when the benchmark revenue amount is reached and this special provision is not needed to delay decertification or the removal of parcels, but it offers that assurance should unique situations otherwise prove limiting. One example might be where parcels are required to be removed in year six for a longer running district and the parcels left in the district are subject to a PAYG note that requires 90 percent of the increment from those parcels to be paid to the developer for in-district costs. This provision would delay those parcel removals until sufficient amounts to pool for affordable housing are collected.

Timing and Procedures for Decertification

When a decertification is required and not deferred due to a PAYG note, the authority must, as soon as practical and no later than the final settlement date of January 25th following the end of the calendar year, make the decertification by resolution effective for the end of the calendar year and communicate the decertification to the county auditor.[28]

[28] Minn. Stat. § 469.1763, subd. 4(g)(1).

Reviewed: November 2023
Revised: November 2023

Example

In 2025 the district receives cumulative revenues sufficient to require decertification. The authority must pass a resolution to decertify the district (effective for December 31, 2025) and notify the county auditor of the decertification no later than January 25, 2026.

It is important to emphasize the "as soon as possible" part of this requirement rather than the January date. County auditors are well into the process of preparing for tax calculations for the following year in December and January. Some counties may not be able to avert tax increment calculations from continuing for the following year if they are not made aware well before January 25th. While some counties can accommodate the January date, others might not. Once an authority receives its first-half distribution of tax increment for a year, it should be able to reasonably assess that decertification will be required and act prior to the busy end of the year.

When a decertification is deferred due to a PAYG note, the authority must, by December 31 of the year in which the last qualifying PAYG note reaches termination, make the decertification by resolution effective for the end of that calendar year and communicate the decertification to the county auditor.[29] Again, earlier action is preferable to waiting to the end of the year.

In either case, the communication of the decertification to the county auditor should be accompanied by a Confirmation of Decertified TIF District Form and the authority should ensure that the OSA receives a copy of the fully completed form (after the county completes its section).

Tax Increments After Effective Decertification

If a county auditor is unable to prevent tax increments from being calculated for taxes payable in the year following the year for which the decertification is made effective, the county auditor may redistribute the tax increments in the same manner as excess increments without first distributing them to the authority.[30]

If this isn't done and tax increments are distributed to an authority for a taxes payable year after the year for which the decertification was required to be effective, the authority must return the amount of the distribution to the county auditor for redistribution in the same manner as excess increments.[31]

III. Summary

Authorities should annually monitor the need to decertify a district under this requirement of the Six-Year Rule and notify the county auditor of any need to decertify the district. Adopting a decertification resolution and completing the Office of the State Auditor's Confirmation of Decertified District Form are required to comply with this provision.

[29] Minn. Stat. § 469.1763, subd. 4(g)(2).
[30] Minn. Stat. § 469.1763, subd. 4(g)(3). *See* Minn. Stat. § 469.176, subd. 2(c)(4) for redistributions procedures for excess increments.
[31] Minn. Stat. § 469.1763, subd. 4(g)(4). *See* Minn. Stat. § 469.176, subd. 2(c)(4) for redistributions procedures for excess increments.

Reviewed: November 2023
Revised: November 2023