

STATE OF MINNESOTA

Office of the State Auditor



Rebecca Otto
State Auditor

TAX INCREMENT FINANCING LEGISLATIVE REPORT

TIF Reports for the Year Ended December 31, 2014
TIF Audits Concluded for the Year Ended December 31, 2015

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 700 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, 2014
TIF Audits Concluded for the Year Ended December 31, 2015



February 25, 2016

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TAX INCREMENT FINANCING REPORT

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EXECUTIVE SUMMARY

Current Trends

- In 2014, of the 1,711 TIF districts, 1,096 (or 64 percent) were located in Greater Minnesota and 615 (or 36 percent) were located in the Metro Area. (pg. 9)
- In 2014, redevelopment districts made up 48 percent of all districts statewide, followed by housing districts at 31 percent, and economic development districts at 18 percent. (pg. 9)
- In 2014, 96 new TIF districts were certified, representing a 30 percent increase compared to the number certified in 2013. (pg. 12)
- In 2014, 132 TIF districts were decertified, a 32 percent increase compared to 2013. (pg. 13)
- In 2014, nearly \$214 million of tax increment revenue was generated. Although most districts are located in Greater Minnesota, approximately \$179 million of tax increment, or 84 percent, was generated in the Metro Area. (pg. 15)
- In 2014, redevelopment districts made up 48 percent of the TIF districts statewide and generated 81 percent, or \$173 million, of total tax increment revenue. (pg. 15)
- In 2014, development authorities returned \$11,421,388 in tax increment revenue to county auditors for redistribution as property taxes to the city, county, and school district. (pg. 18)

Long-Term Trends

- Between 1996 and 2004, the total number of TIF districts increased. From 2004 through 2014, the total number decreased. The decrease reflects, among other things, a number of decertifications of older districts. (pg. 11)
- In examining certifications over the five-year period from 2010 to 2014, the largest number of districts were created in 2014. Also, the number of new districts certified in 2014 was 146 percent more than the number certified in 2010. (pg. 13)
- In reviewing decertifications from 2010 to 2014, housing districts decertified early more frequently than other statutory types of districts, with 76 percent decertifying early. Redevelopment districts decertified early 54 percent of the time. Economic development districts, with their shorter maximum durations, decertified early only 22 percent of the time. (pg. 14)

- When reviewing the ten-year period from 2005 to 2014, tax increment revenue generated steadily declined from a high of \$307.8 million in 2008 to \$201.8 million in 2013. The \$12 million increase of tax increment revenue generated in 2014 was the first increase in six years. (pg. 17)

SCOPE AND METHODOLOGY

This 20th Annual Legislative Report (Report) was compiled from information received from the 416 development authorities currently authorized to exercise tax increment financing (TIF) powers in Minnesota. The Report summarizes information reported by these development authorities for 1,711 districts for the calendar year ended December 31, 2014. The Report also provides a summary of the violations cited in the limited-scope reviews conducted by the Office of the State Auditor (OSA) in 2015. This Report is provided annually to the chairs of the legislative committees with jurisdiction over TIF matters.¹

In 1995, the Minnesota Legislature assigned legal compliance oversight for TIF to the OSA.² 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).³

The TIF Act requires development authorities to file with the OSA annual financial reports for each of their TIF districts. This reporting requirement applies to all TIF districts regardless of when they were created. Reports must be submitted on or before August 1 of each year, starting the year in which a district is certified.

TIF reports for the year ended December 31, 2014, were required from a total of 1,719 TIF districts. Eight reports were not submitted from six development authorities: Baudette, Dassel (2), Hills, Maynard, New Hope Economic Development Authority (2), and St. Clair.⁴

¹ Minn. Stat. § 469.1771, subd. 1(c).

² 1995 Minn. Laws, ch. 264, art. 5, § 34. The OSA's oversight began in 1996.

³ 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.

⁴ Hills also did not file a 2013 report.

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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. 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.⁵

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.⁶ 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.⁷

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.⁸ 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.⁹ In the City Development District Act, however, the term “project” means a designated area within a city.¹⁰ The development acts do not expressly limit the size of areas that can qualify as projects.

⁵ Property taxes on existing value at the time the district is created, often referred to as the “frozen base,” continue to be distributed by the county to the city, county, and school district. However, due to the extraordinary expense involved in cleaning up hazardous substances, the entire property tax payment may be captured when hazardous substance subdistricts are used. Minn. Stat. §§ 469.174, subs. 7(b) and 23; 469.175, subd. 7.

⁶ Counties and towns may also be development authorities in certain instances.

⁷ Minn. Stat. § 469.174, subd. 2 (listing the statutory citations for the various development acts).

⁸ Minn. Stat. § 469.174, subd. 8.

⁹ See Minn. Stat. § 469.002, subd. 12.

¹⁰ See Minn. Stat. § 469.125, subd. 9.

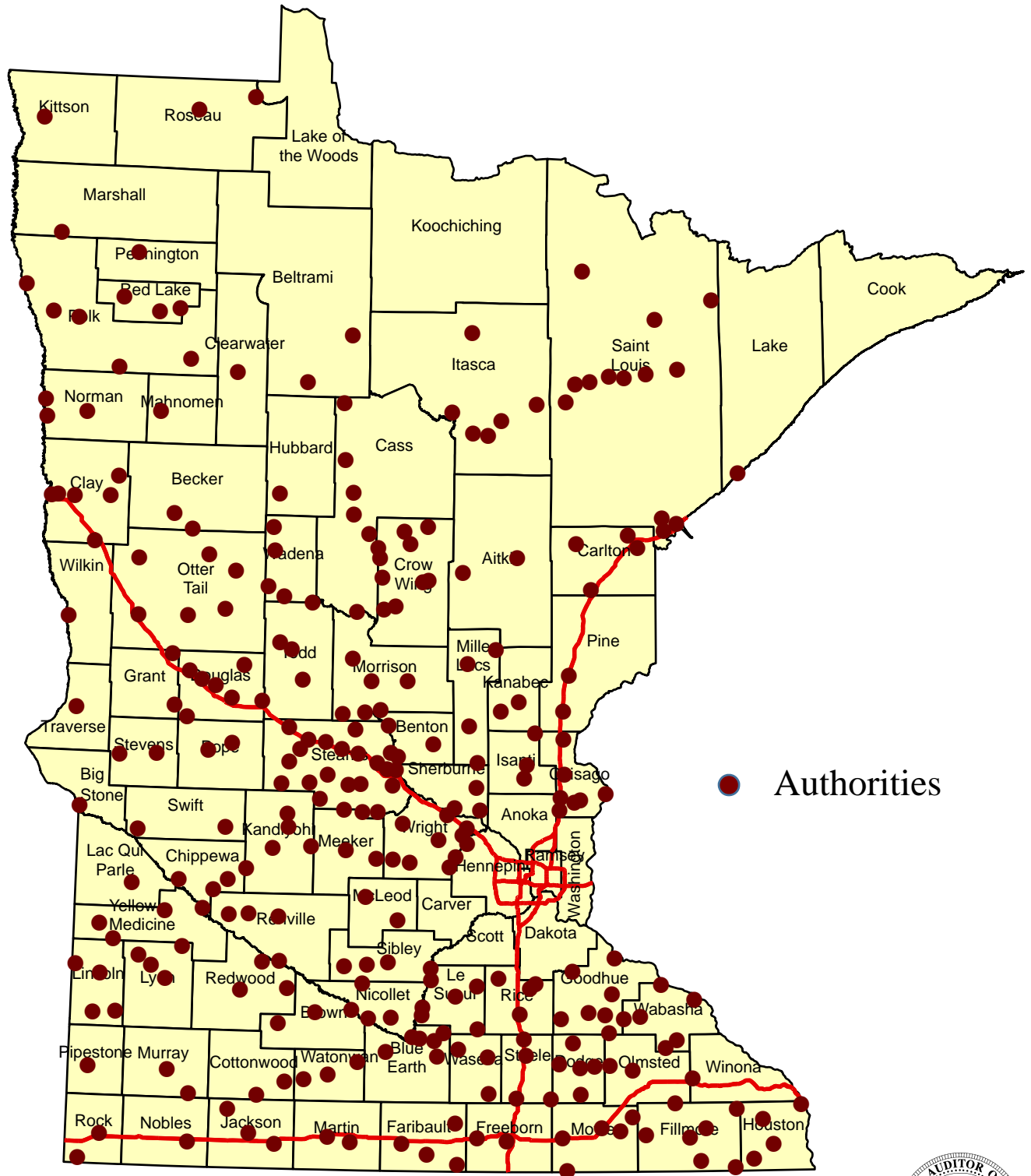
Development Authorities

In 2014, there were 416 active development authorities in Minnesota, one less than the number active in 2013. Four new city development authorities were created, four inactive development authorities became active again, and nine authorities became inactive.

In 2014, of the 416 development authorities reporting, 314 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 the various counties throughout the state that have a separate authority for development purposes.¹¹

¹¹ This map does not include the following joint authorities: Bluff Country HRA and Southeast Minnesota Multi-County HRA.

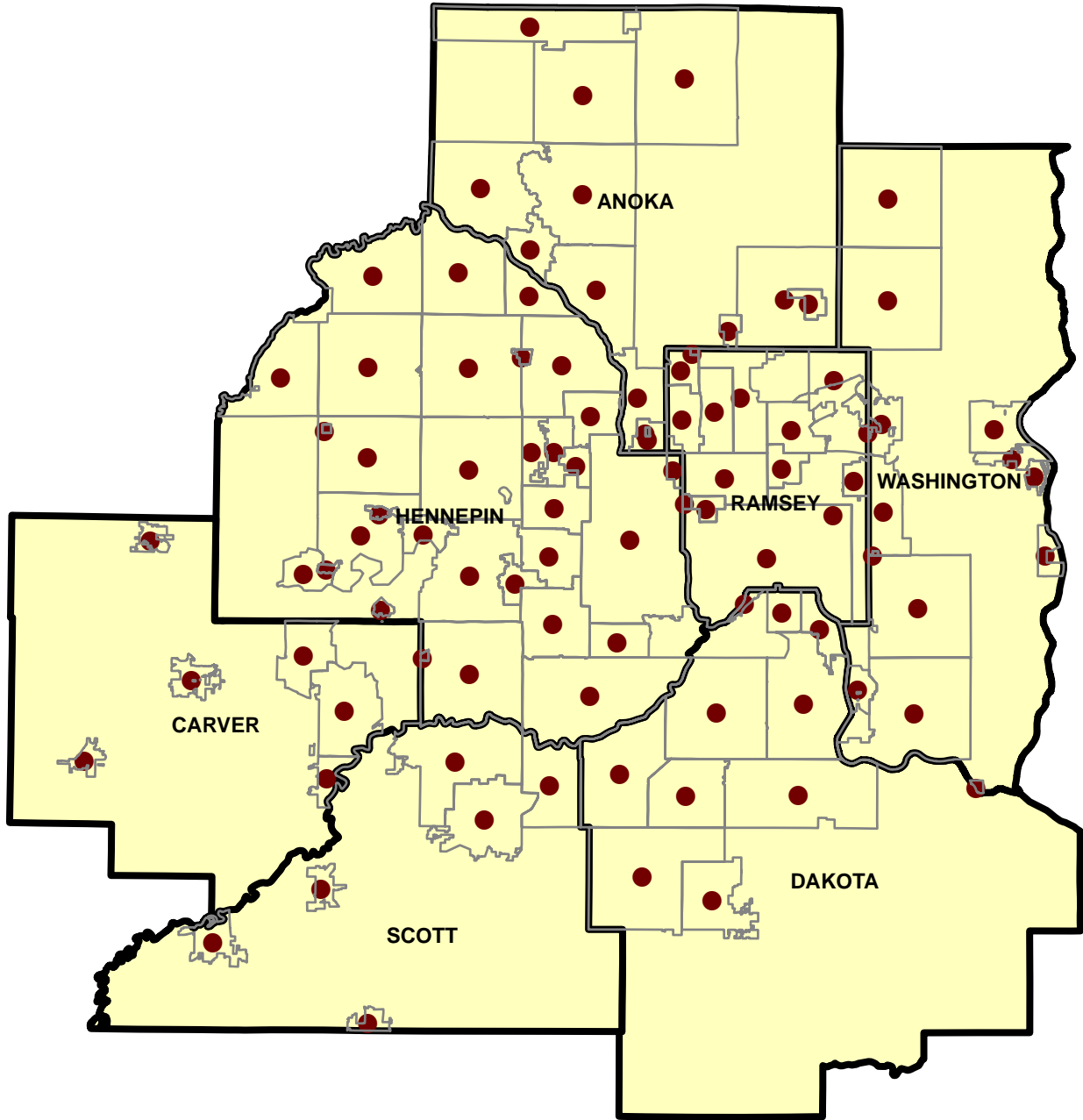
Development Authorities in Greater Minnesota, 2014



● Authorities



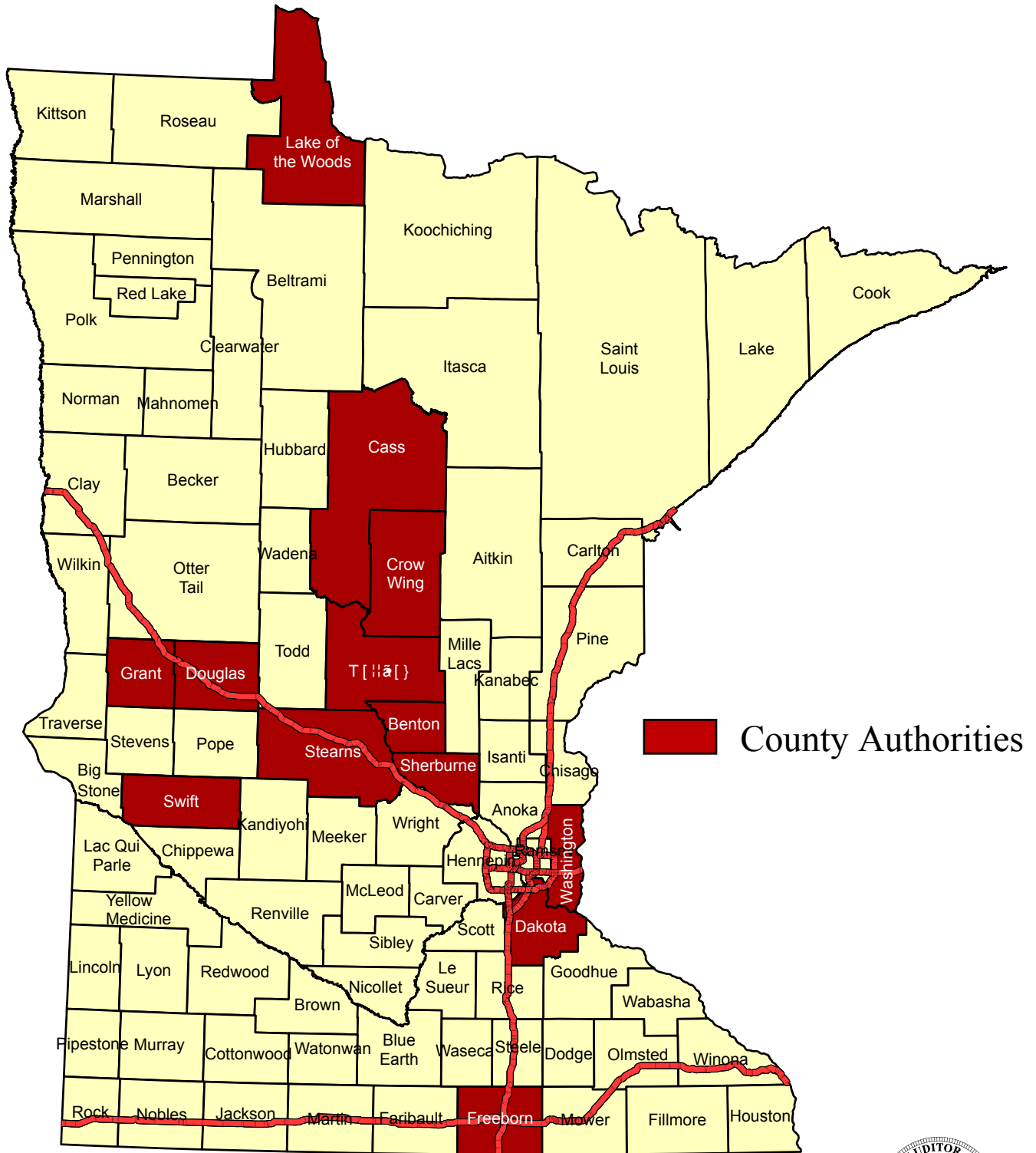
Development Authorities in Metro Area, 2014



● Authorities



County Development Authorities, 2014



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.¹² 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 for and hold a public hearing.¹³ 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.¹⁴

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, provide copies of these documents to the members of the county board of commissioners and the school board.¹⁵ The county board and school board may comment on the proposed district, but cannot prevent its creation.¹⁶

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 blighted conditions.¹⁷ Redevelopment districts are designed to conserve the use of existing utilities, roads, and other public infrastructure, and to discourage urban sprawl. Qualifying tax increment

¹² Minn. Stat. § 469.175, subd. 1.

¹³ Minn. Stat. § 469.175, subd. 3.

¹⁴ In many cases, the commissioners of the TIF authority include some or all of the council members.

¹⁵ Minn. Stat. § 469.175, subd. 2.

¹⁶ When the county is the municipality that must approve the TIF plan, the county board may prevent the creation of a TIF district.

¹⁷ Minn. Stat. § 469.174, subd. 10(a)(1).

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. The statutory maximum duration limit is 25 years after first receipt of tax increment.¹⁸

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; or (3) preserve and enhance the tax base.¹⁹ Tax increment revenue from economic development districts is used primarily to assist manufacturing, warehousing, storage and distribution, research and development, telemarketing, and tourism. Commercial development (retail sales) is excluded by law, except in “small cities.”²⁰ Economic development districts are short-term districts with a limit of eight years after first receipt of tax increment.²¹

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. The statutory maximum duration limit is 25 years after first receipt of tax increment.²²

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 is 15 years after first receipt of tax increment.²³

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.²⁴ The statutory maximum duration limit is 20 years after first receipt of tax increment.²⁵

¹⁸ 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.

¹⁹ Minn. Stat. § 469.174, subd. 12.

²⁰ Minn. Stat. § 469.174, subd. 27, and Minn. Stat. § 469.176, subd. 4c.

²¹ 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.

²² 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.

²³ 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.

²⁴ Minn. Stat. § 469.174, subd. 19.

²⁵ 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.

Pre-1979 Districts – These districts were created prior to the 1979 TIF Act and have all been decertified. A few still have assets. The assets may still be used to pay administrative expenses, to pay bonds, and to pool for deficits.²⁶ This Report continues to identify these districts in many of the tables and graphs because Annual TIF Reporting Forms are required to be filed until all tax increments have been used for qualifying expenditures or returned.

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, St. Paul, and Minneapolis, 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.²⁷ 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).²⁸ The HSS captures additional increment by reducing the original net tax capacity (ONTC) by the estimated costs of the removal actions.²⁹ 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.³⁰ 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.³¹

Special Legislation

Special legislation has been enacted to allow exceptions to the TIF Act for individual districts. As of 2014, 117 TIF districts reported having obtained 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 limits 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.

²⁶ Minn. Stat. § 469.176, subd. 1c.

²⁷ Minn. Stat. § 469.174, subds. 16 and 23; Minn. Stat. § 469.175, subd. 7.

²⁸ Minn. Stat. § 469.174, subd. 17.

²⁹ Minn. Stat. § 469.174, subd. 7(b).

³⁰ Minn. Stat. § 469.176, subd. 4e.

³¹ Minn. Stat. § 469.176, subd 1e.

Number of TIF Districts

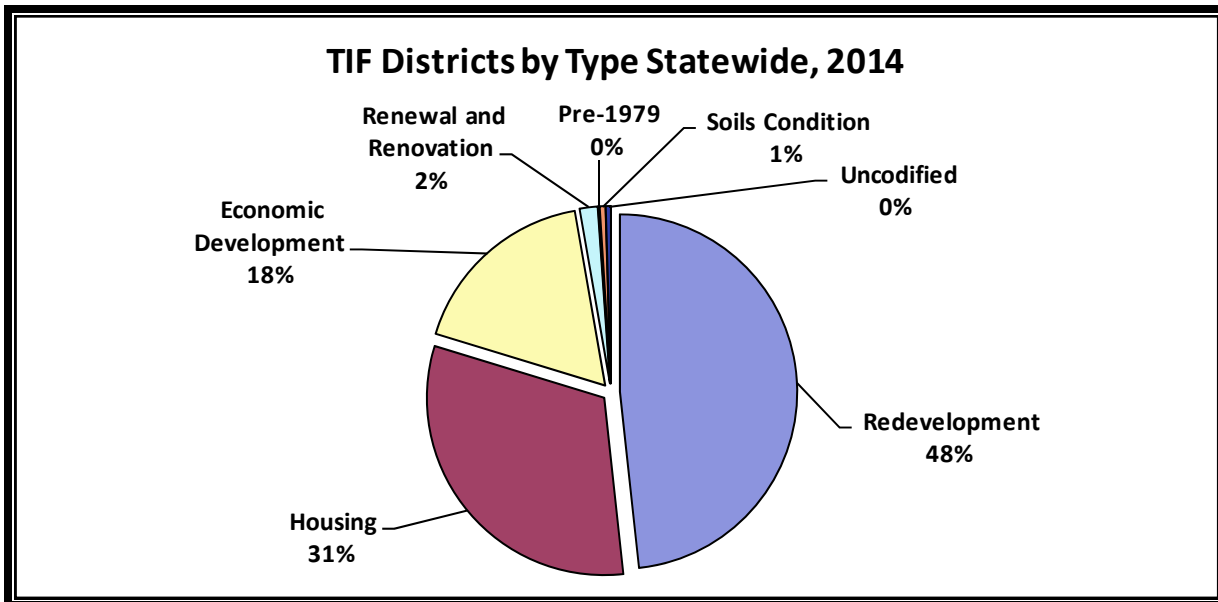
In 2014, of the 1,711 TIF districts, 1,096 (or 64 percent) were located in Greater Minnesota and 615 (or 36 percent) were located in the Metro Area. (See Figure 1.)

Figure 1.

TIF Districts by Type; Statewide, Greater MN, & Metro Area; 2014			
Type of District	Statewide	Greater MN	Metro Area
Redevelopment	826	452	374
Housing	538	385	153
Economic Development	300	248	52
Renewal and Renovation	28	9	19
Pre-1979	2	1	1
Soils Condition	9	1	8
Uncodified	8	0	8
Total	1,711	1,096	615
Hazardous Substance Subdistricts	26	2	24

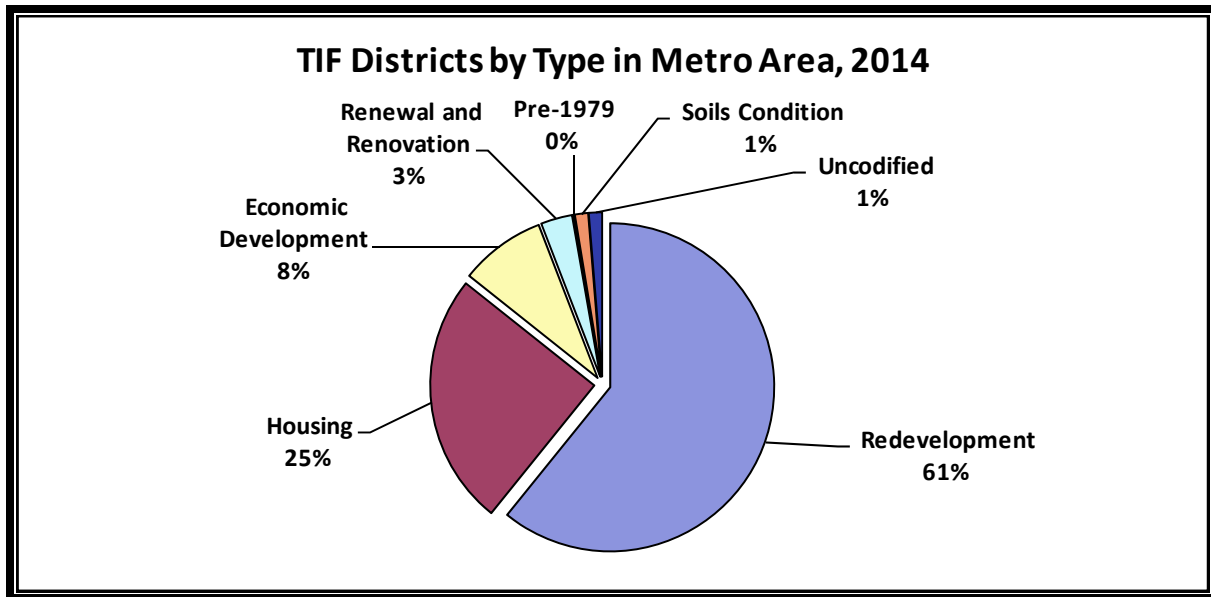
In 2014, redevelopment districts made up 48 percent of all districts statewide, followed by housing districts at 31 percent, and economic development districts at 18 percent. Combined, redevelopment, economic development, and housing districts made up 97 percent of all districts. (See Figure 2.)

Figure 2.



In the Metro Area, redevelopment districts made up 61 percent of all districts, followed by housing districts at 25 percent and economic development districts at eight percent. (See Figure 3.)

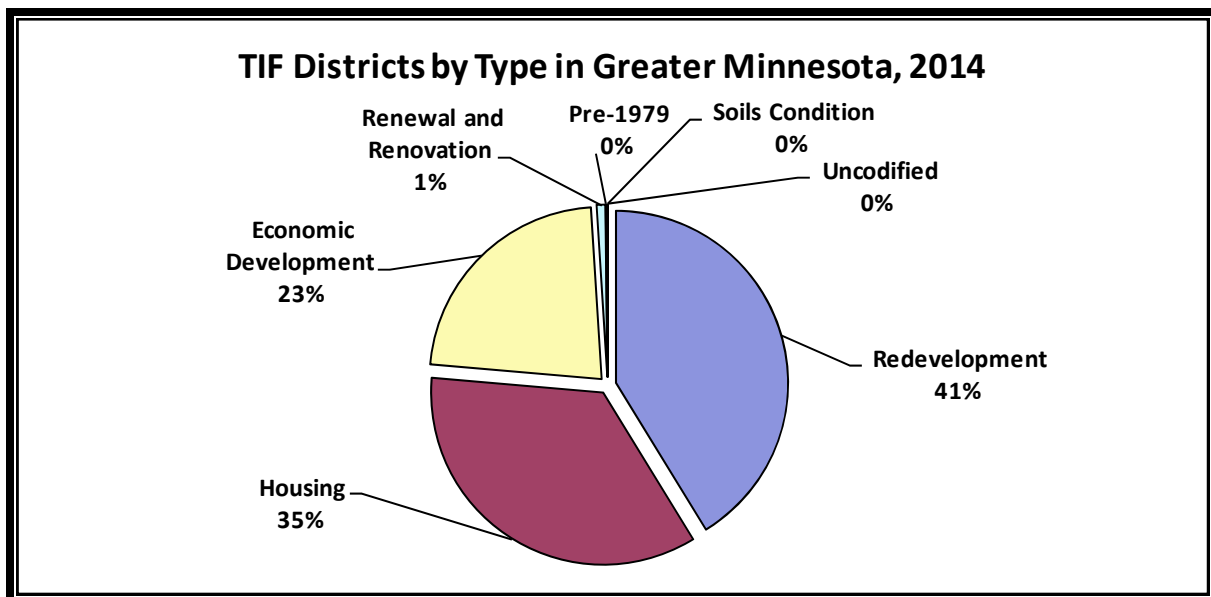
Figure 3.



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

In Greater Minnesota, as in the Metro Area, redevelopment districts were the largest type of district, 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.)

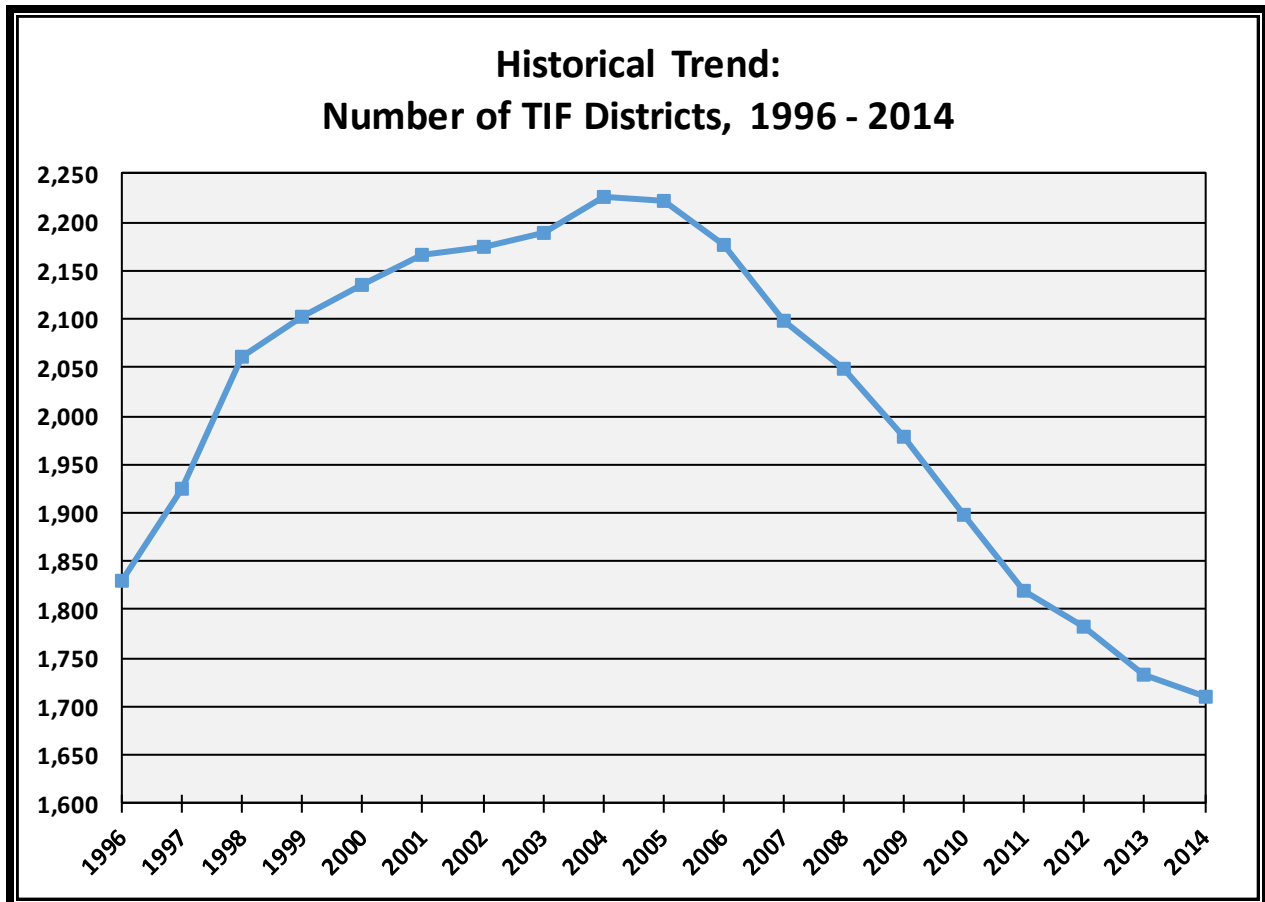
Figure 4.



Trends in the Number of TIF Districts

The OSA began its oversight of TIF in 1996, and Figure 5 shows the number of districts for each year since 1996. Between 1996 and 2004, the total number of TIF districts increased. From 2004 through 2014, the total number decreased. This decrease reflects, among other things, a number of decertifications of older districts. A large number of the districts created in the wake of the 1979 TIF Act have been reaching their statutory duration limit over recent years and have been decertifying.

Figure 5.



New Districts Certified

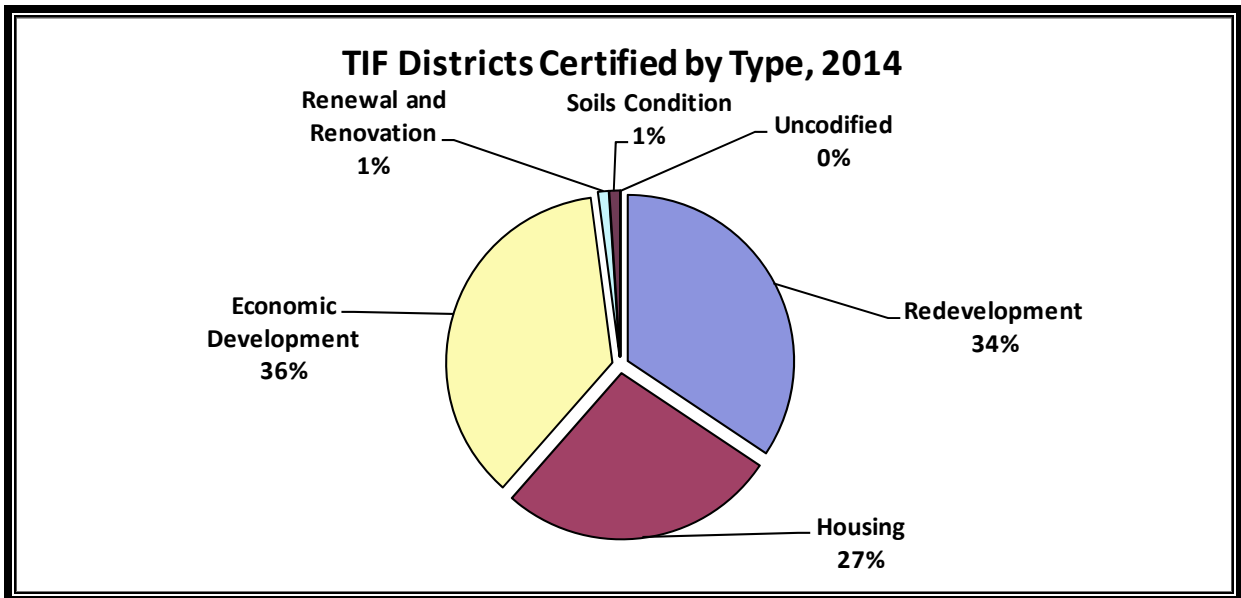
In 2014, 96 new TIF districts were certified, representing a 30 percent increase compared to the number certified in 2013. (See Figure 6.)

Figure 6.

Number of TIF Districts Certified by Type, 2014	
Redevelopment	33
Housing	26
Economic Development	35
Renewal and Renovation	1
Soils Condition	1
Uncodified	0
Total	96

In 2014, economic development districts and redevelopment districts accounted for the largest portions of all new districts at 36 percent and 34 percent, respectively. (See Figure 7.)

Figure 7.



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

Certification Trends

During the five-year period from 2010 to 2014, the largest number of districts were created in 2014. Also, the number of new districts certified in 2014 was 146 percent more than the number certified in 2010. (See Figure 8.)

Figure 8.

Number of TIF Districts Certified by Type, 2010 - 2014					
	2010	2011	2012	2013	2014
Redevelopment	15	19	20	27	33
Housing	11	12	16	17	26
Economic Development	12	32	38	27	35
Renewal and Renovation	0	4	3	2	1
Soils Condition	0	0	1	0	1
Uncodified	1	0	0	1	0
Total	39	67	78	74	96

Districts Decertified

The decertification of a TIF district generally occurs for four reasons: the district has met its statutory maximum duration limit, the district has met a duration limit specified by the authority in the TIF plan for the district, the district has no remaining outstanding debt and must decertify early under the Six-Year Rule, or the authority voluntarily decides to decertify the district early.³²

In 2014, 132 TIF districts were decertified, a 32 percent increase compared to 2013. (See Figure 9.)

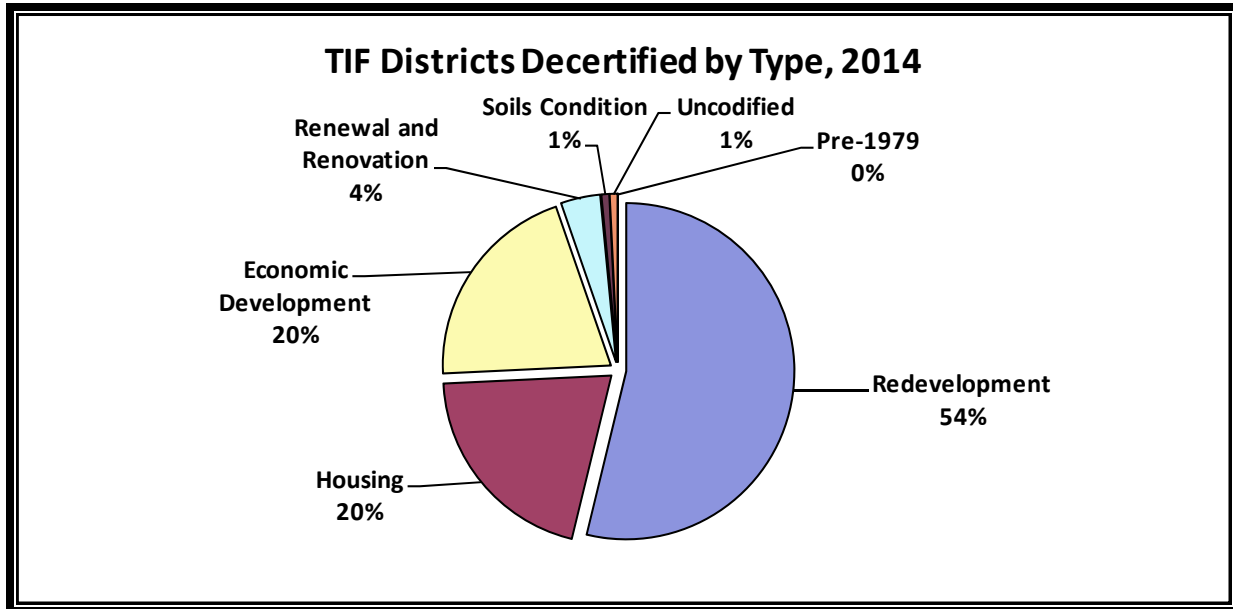
Figure 9.

Number of TIF Districts Decertified by Type, 2014	
Redevelopment	71
Housing	27
Economic Development	27
Renewal and Renovation	5
Soils Condition	1
Uncodified	1
Pre-1979	0
Total	132

³² The Six-Year Rule's decertification requirement is found in Minn. Stat. § 469.1763, subd. 4(b).

In 2014, 54 percent of decertified districts were redevelopment districts. Economic development districts and housing districts each accounted for 20 percent of decertifications. (See Figure 10.)

Figure 10.



Decertification Trends

While many decertifications occur as a result of a district reaching its duration limit (as set by statute or by the authority in its TIF plan), authorities frequently decertify districts early, either by choice or pursuant to the Six-Year Rule that requires decertification once all in-district obligations have been satisfied.³³ In reviewing decertifications from 2010 to 2014, housing districts decertified early more frequently than other statutory types of districts, with 76 percent decertifying early. Redevelopment districts decertified early 54 percent of the time. Economic development districts, with their shorter maximum durations, decertified early only 22 percent of the time. For districts that decertified early, redevelopment districts decertified an average of 11 years early and housing districts averaged 13 years early. (See Figure 11.)

³³ 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 11.

Decertifications 2010 - 2014: Full Duration vs. Early Decertification				
District Type / (Max Duration)³⁴	Decertified Districts	Lasted Full Duration	Decertified Early	
			Percent	Average Years
Redevelopment (25 yrs)	333	46%	54%	11
Housing (25 yrs)	132	24%	76%	13
Economic Development (8 yrs)	174	78%	22%	2
Renewal and Renovation (15 yrs)	14	57%	43%	7
Soils Condition (20 yrs)	2	0%	100%	17

Durations are 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 in statute. Year of required decertification is self-reported by the development authority.

Tax Increment Revenue

The amount of tax increment revenue generated from within a TIF district depends, in part, on the type of district, the development activity occurring within the district, the duration limit, and the location of the district. In 2014, nearly \$214 million of tax increment revenue was generated. Although most districts are located in Greater Minnesota, approximately \$179 million of tax increment, or 84 percent, was generated in the Metro Area. (See Figure 12.)

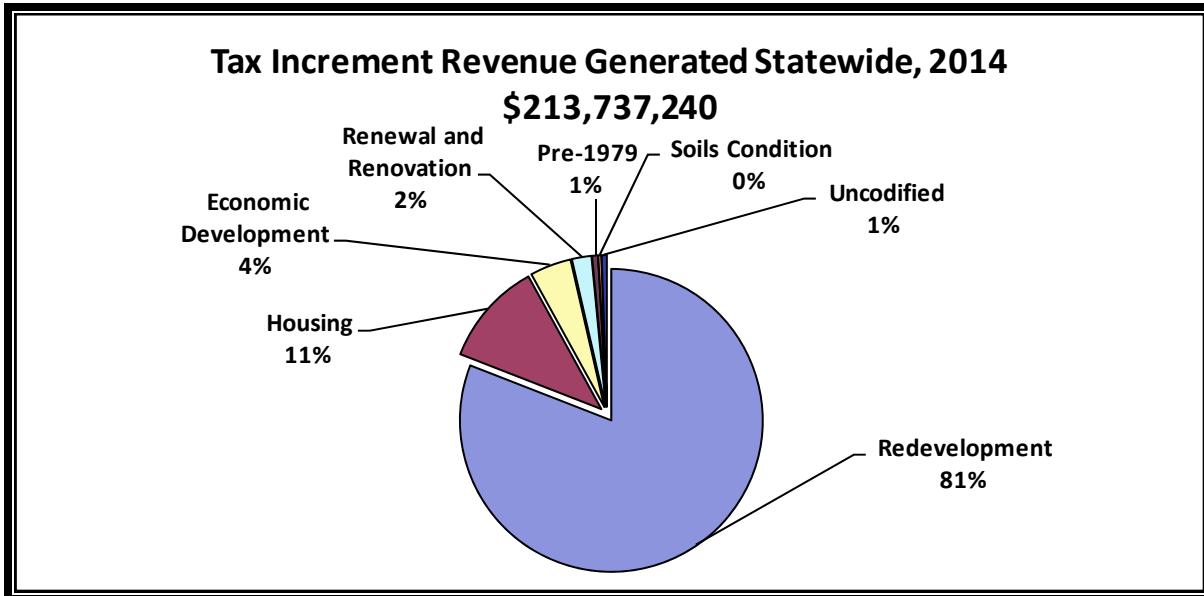
Figure 12.

Revenue Generated by Type; Statewide, Greater MN, & Metro Area; 2014			
Type of District	Statewide	Greater MN	Metro Area
Redevelopment	\$ 172,930,244	\$ 20,445,757	\$ 152,484,487
Housing	\$ 23,711,867	\$ 9,004,641	\$ 14,707,226
Economic Development	\$ 9,400,471	\$ 5,263,991	\$ 4,136,480
Renewal and Renovation	\$ 4,430,393	\$ 311,568	\$ 4,118,825
Pre-1979	\$ 1,348,776	\$ -	\$ 1,348,776
Soils Condition	\$ 714,436	\$ 44,205	\$ 670,231
Uncodified	\$ 1,201,053	\$ -	\$ 1,201,053
Total	\$ 213,737,240	\$ 35,070,162	\$ 178,667,078

In 2014, redevelopment districts made up 48 percent of the TIF districts statewide and generated 81 percent, or \$173 million, of total tax increment revenue. Figure 13 illustrates the tax increment revenue generated by type of district.

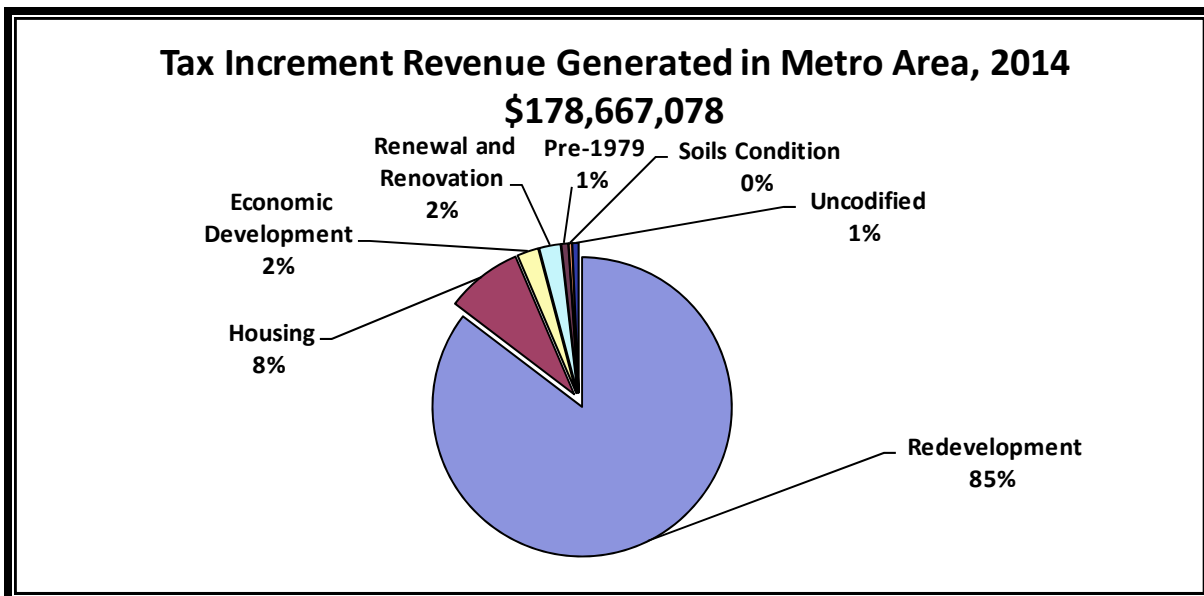
³⁴ The durations listed are the number of years after first receipt of tax increment that a district may collect. The year of first receipt is an additional year of tax increment for each type of district.

Figure 13.



In the Metro Area, redevelopment districts accounted for 61 percent of districts but generated 85 percent of the tax increment revenue. Housing and economic development districts made up about a third of Metro Area districts but generated about 10 percent of its tax increment revenue. (See Figure 14.)

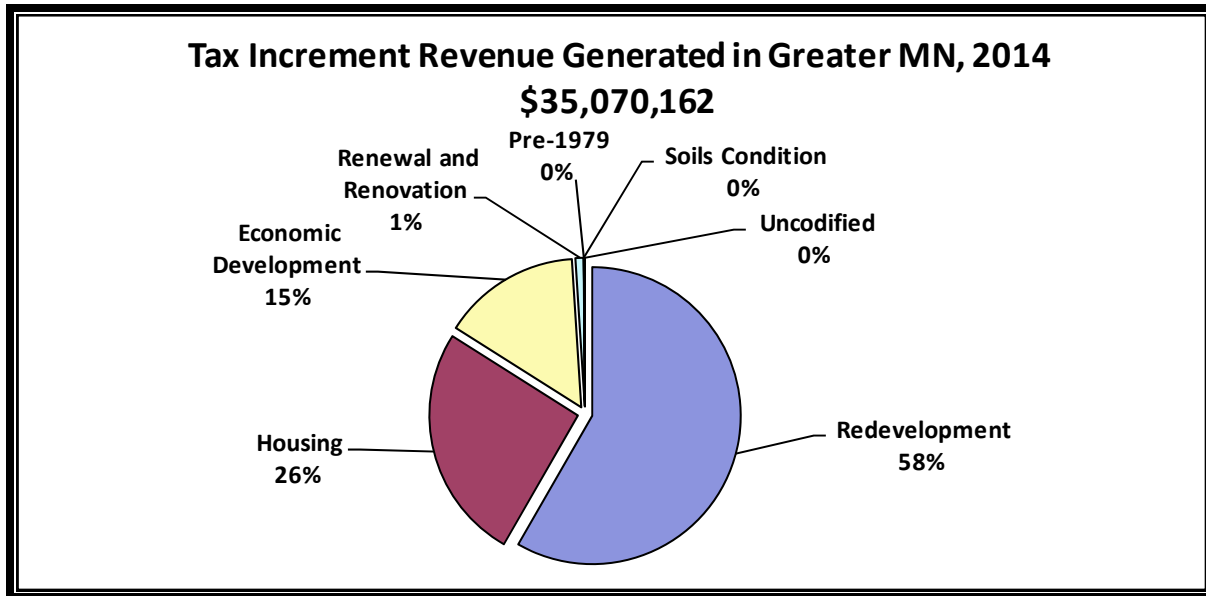
Figure 14.



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

In Greater Minnesota, although redevelopment districts accounted for 41 percent of districts, they generated 58 percent of tax increment revenue. Housing and economic development districts made up 58 percent of Greater Minnesota districts and they generated 41 percent of the tax increment revenue. (See Figure 15.)

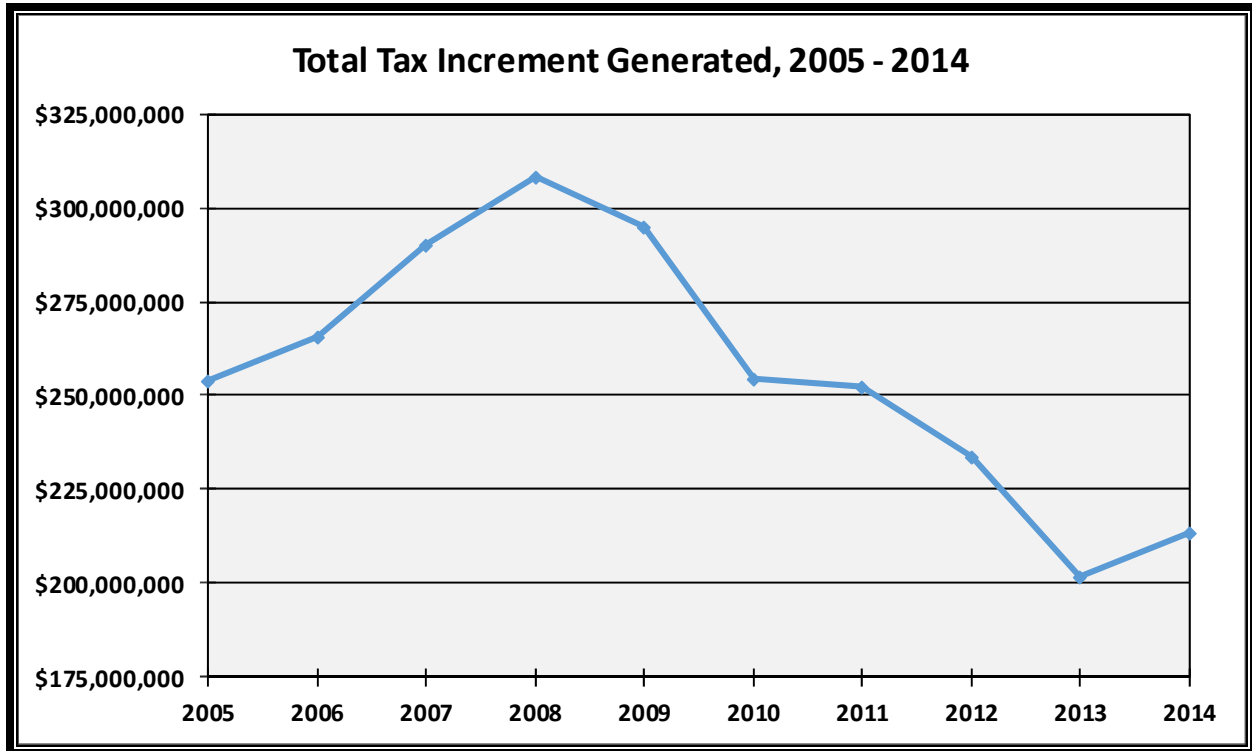
Figure 15.



Tax Increment Revenue Trends

When reviewing the ten-year period from 2005 to 2014, tax increment revenue generated steadily declined from a high of \$307.8 million in 2008 to \$201.8 million in 2013. The \$12 million increase of tax increment revenue generated in 2014 was the first increase in six years. (See Figure 16.)

Figure 16.



Returned Tax Increment

In 2014, development authorities returned \$11,421,388 in tax increment revenue to county auditors for redistribution as property taxes to the city, county, and school district. 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).

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:³⁵

- 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 before 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.³⁶ 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 of failed development. 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.

In 2014, there was a total of \$1.6 billion of outstanding debt. PAYG obligations made up over 50 percent of the debt reported. GO bonds, which are secured by the municipalities' full faith and credit, made up about 25 percent of total debt. Revenue bonds and interfund loans from non-tax increment accounts each made up 10 percent of total debt, while other bonds and interfund loans from other TIF districts made up the rest.

³⁵ See Minn. Stat. § 469.174, subd. 3.

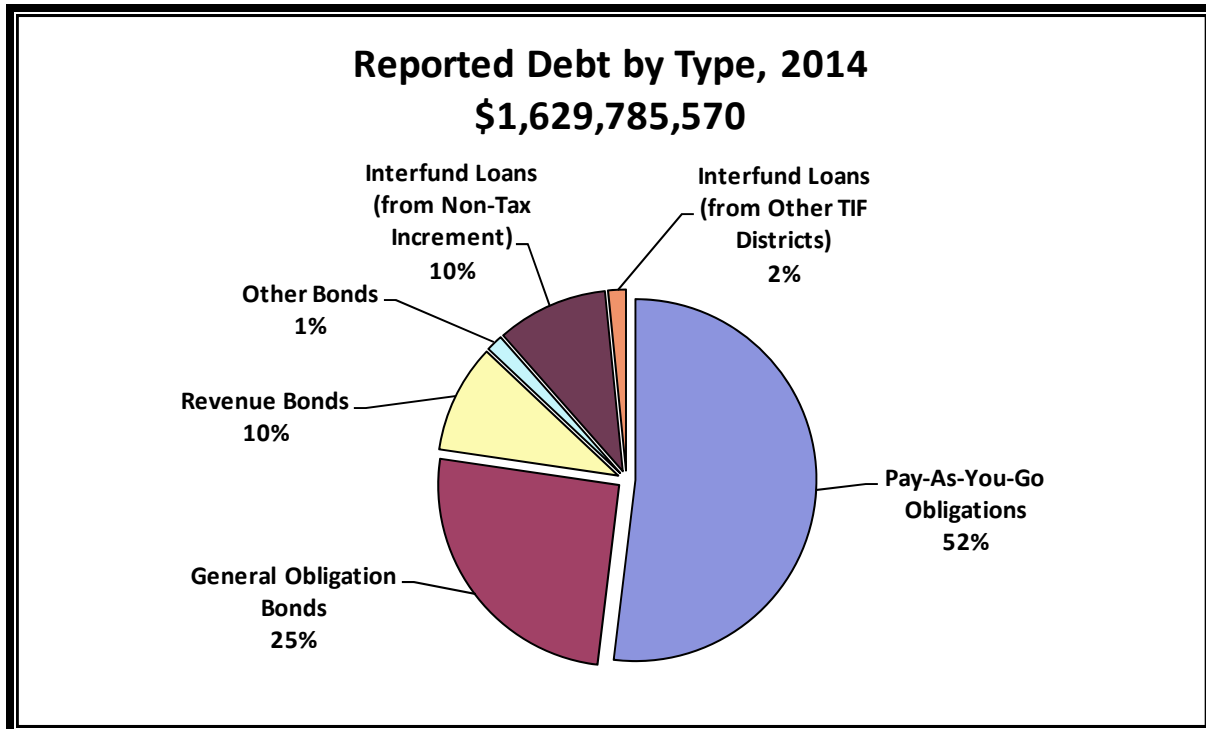
³⁶ Minn. Stat. § 469.178, subd. 7.

Figures 17 and 18 show the types of debt obligations being used to finance improvements to be paid with tax increment revenue in 2014.

Figure 17.

Reported Debt by Type, 2014	
Type of Debt	Amount Outstanding
Pay-As-You-Go Obligations	\$846,183,419
General Obligation Bonds	\$414,013,696
Revenue Bonds	\$158,099,843
Other Bonds	\$24,267,224
Interfund Loans (from Non-Tax Increment)	\$161,466,183
Interfund Loans (from Other TIF Districts)	\$25,755,205
Total	\$1,629,785,570

Figure 18.



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. 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, if the findings are not resolved, the OSA sends its final notice of noncompliance (Final Notice) to the municipality. 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 it received from the municipalities and copies of the Responses themselves to the chairs of the legislative committees with jurisdiction over tax increment financing.³⁷ This section of the Report summarizes the TIF legal compliance reviews and investigations concluded as of December 31, 2015. An Initial Notice and Final Notice were sent to the following municipality:

1. City of Dassel – An Initial Notice was sent on January 21, 2015. A Response from the City of Dassel was received on March 23, 2015.³⁸ A Final Notice was sent on March 27, 2015. (Appendix A.)

Complete copies of the Initial Notice, Final Notice, and the municipality's Response are provided in Appendix A.

³⁷ Minn. Stat. § 469.1771, subd. 1(c).

³⁸ The letter is dated March 23, 2014, but was received March 2015.

FAILURE TO DECERTIFY TIF DISTRICT

City of Dassel

TIF District 6-1

In the Initial Notice, the OSA found that the City failed to decertify TIF District 6-1 when all obligations it had incurred had been paid, as required by Minn. Stat. § 469.1763, subd. 4(b). In its Response, the City agreed and the council unanimously approved the decertification of the district effective immediately. In the Final Notice, the OSA acknowledged this finding was resolved.

IMPROPER RECEIPT OF TAX INCREMENT

City of Dassel

TIF District 6-1

In the Initial Notice, the OSA found that the City improperly received tax increment after the date on which the district should have been decertified. In addition, the City was required to return the \$92,514 of tax increment reported as distributed by Meeker County from 2011 to 2013, plus any tax increment received in 2014, and any interest earned on tax increment since 2010. In its Response, the City agreed and returned \$125,026.73 of tax increment to the county. In the Final Notice, the OSA acknowledged this finding was resolved. Although the City Response did not detail how this amount was determined, a follow-up conversation with the City confirmed that this amount included the amounts received after the district should have decertified (as detailed below). In the Final Notice, the OSA acknowledged this finding was resolved.

EXCESS INCREMENT

City of Dassel

TIF District 6-1

In the Initial Notice, the OSA found that the City received excess tax increment in the amount of \$1,370 from TIF District 6-1. In its Response, the City agreed. The City Response provided substantiation that \$125,026.73 of excess increment had been returned. The City confirmed that this amount included \$1,370 for excess increment as of the end of 2010, \$92,514 for tax increment distributed by Meeker County from 2011 to 2013 as was identified in the Initial Notice, \$30,817.82 of tax increment that Meeker County had subsequently reported as being distributed in 2014, and \$325.91 of interest earned on tax increment since 2010. In the Final Notice, the OSA acknowledged this finding was resolved.

APPENDIX A

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REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

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

January 21, 2015

The Honorable Jeff Putnam, Mayor
The Honorable Sharon Asplin, Council Member
The Honorable Sherilyn Bjork, Council Member
The Honorable Sara Nelson, Council Member

City of Dassel

P.O. Box 391
Dassel, MN 55325

Re: TIF District No. 6-1 – Initial Notice of Noncompliance

Dear Mayor Putnam and Council Members:

The Office of the State Auditor (OSA) reviewed the Annual Reporting Forms filed by the City of Dassel (City) for Tax Increment Financing (TIF) District 6-1 for 2010, 2011, 2012, and 2013; the comprehensive annual financial reports (CAFRs) of the City for 2011, 2012, and 2013; and tax increment distribution data for the years 2011, 2012, and 2013 provided by Meeker County. Based on this review, and lacking certain relevant additional information because of the City's failure to respond to multiple inquiries, the OSA finds that the City is not in compliance with the TIF Act.¹ This Initial Notice of Noncompliance (Initial Notice) contains three OSA findings (Findings) and one additional comment (Comment).

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.²

Minnesota law requires the City to respond in writing to the OSA 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 must indicate the basis for any disagreement.³ At the conclusion of the OSA's review, if a Finding remains unresolved, a Final Notice of Noncompliance will be submitted to the City. If the OSA finds that the City violated a provision of the TIF Act for which a remedy is provided, the relevant information will be forwarded to the Meeker County Attorney for review.⁴

¹See Minn. Stat. §§ 469.174 to 469.1799 inclusive, as amended.

²See 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.).

³Minn. Stat. § 469.1771, subd. 1 (c).

⁴Minn. Stat. § 469.1771, subd. 1 (b).

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Mayor and Council, City of Dassel
January 21, 2015
Page 2

If the City pays to Meeker County (County) an amount equal to the amount found to be in noncompliance, the OSA will consider the Findings 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.⁵

FINDINGS OF NONCOMPLIANCE

The OSA's Findings of noncompliance regarding TIF District 6-1 are as follows:

Finding 1. TIF District 6-1 – Failure to Decertify the District

The TIF Act requires a TIF District to be decertified and the pledge of tax increment discharged when sufficient money has been set aside to pay, based on the increment to be collected through the end of the calendar year, qualifying obligations incurred within the first five years of the district.⁶

TIF District 6-1 was certified on June 15, 2006. The District's sole obligation, a pay-as-you-go (PAYG) note, was reported as paid in full in 2010. Because no other obligations remained and because the District had a positive fund balance of \$7,425 on December 31, 2010, TIF District 6-1 should have been decertified at the end of 2010.

We find that the City of Dassel failed to decertify TIF District 6-1 when all obligations it had incurred had been paid, as required by Minn. Stat. § 469.1763, subd. 4(b).

The City must **immediately decertify TIF District 6-1**. When the City submits to the OSA a Decertification Form documenting that the District has been decertified, the OSA will consider this Finding resolved.

Finding 2. TIF District 6-1 – Improper Receipt of Tax Increment

The TIF Act requires that tax increment payments received by an authority after a district is decertified be repaid to the county.⁷ The City continued to receive tax increment in 2011, 2012, and 2013. The increments were received after December 31, 2010, the date on which the District was required to have been decertified. Meeker County reported distributing \$92,514 to the District during these three years.⁸

⁵Minn. Stat. § 469.1771, subd. 5.

⁶Minn. Stat. § 469.1763, subd. 4 (b).

⁷Minn. Stat. § 469.1771, subd. 4a.

⁸Meeker County initially reported distributing \$94,502 to the District but, upon follow-up communication, the OSA learned that \$1,988 of the 2013 distribution was actually for TIF District 7-1 as reported by the City. See also the Additional Comment.

OFFICE OF THE STATE AUDITOR

Mayor and Council, City of Dassel
January 21, 2015
Page 3

We find that the City of Dassel improperly received tax increment after the date on which the District should have decertified.

The City must return the **\$92,514 of tax increment reported as distributed by Meeker County from 2011 to 2013, plus any tax increment received in 2014, and any interest earned on tax increment since 2010.** When the City provides documentation as to the final amount to be returned, an amount that must be approved by the State Auditor, and documents that it has returned this amount to the Meeker County Auditor, the OSA will consider this Finding resolved.

Finding 3. TIF District 6-1 – Excess Increment

Excess increment is the amount of increment over the amount of total costs authorized in the TIF plan. The amount of excess increment is calculated by subtracting the amount of total costs authorized from the total tax increment received through the end of the calendar year. Excess increment must be returned to the county auditor within nine months after the end of each year.⁹

The City reported excess tax increment on the TIF Annual Reporting Forms every year since 2010. The TIF plan authorizes a total of \$75,168 of TIF expenditures.¹⁰ The Reporting Forms show \$76,538 of total tax increment received through 2010. The difference is excess increment, totaling \$1,370 as of December 31, 2010.¹¹

We find that the City received excess tax increment from TIF District 6-1 that has not yet been returned to the County. The amount of excess increment equals the \$1,370 of excess increment existing as of 2010 plus the tax increment received since 2010 (\$92,514 of tax increment distributed from Meeker County from 2011 to 2013, tax increment received in 2014, and interest earned on tax increment since 2010). Finding 3 provides a second basis in law for returning tax increment received since 2010.

The City must return to Meeker County the amount of excess increment received to date: **the \$1,370 of excess increment for 2010 plus the \$92,514 of tax increment reported as distributed by Meeker County from 2011 to 2013, plus any tax increment received in 2014, and any interest earned on tax increment since 2010.** When the City provides documentation as to the final amount of excess increment to be returned and documents that it has returned this amount to the Meeker County Auditor, the OSA will consider this Finding resolved.

⁹ See Minn. Stat. § 469.176, subd. 2.

¹⁰ The City reported the total estimated tax increment expenditures authorized in the TIF plan as being \$64,710. See the Additional Comment.

¹¹ The City reported \$11,828 of excess increment as of December 31, 2010. Subsequent amounts of excess increment also differ from the amounts reported by the City.

OFFICE OF THE STATE AUDITOR

Mayor and Council, City of Dassel
January 21, 2015
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ADDITIONAL COMMENT

In addition to making the Findings set forth above, the OSA makes the following observation:

Additional Comment: TIF District 6-1 – Inaccurate Reporting

The City reported receiving a total of \$62,092 of tax increment from Meeker County for 2011, 2012, and 2013. The City also reported \$63 of interest in 2012. These amounts are inconsistent with data reported by Meeker County and with data in the City's CAFRs.

Specifically, no interest is reported on the 2011 TIF Annual Reporting even though \$100 of interest is reported in the TIF Funds on the CAFR.¹² The 2012 TIF Annual Reporting Form shows receipt of \$16,534 of tax increment, an amount equal to one of the two distributions of tax increment in 2012. It does not include the second 2012 tax increment distribution or the 2012 receipt of released tax increment withheld in 2011 and reported by Meeker County.¹³ The amount of tax increment reported as received by the City differs from the amount of tax increment reported as distributed to the City by Meeker County by \$30,423. In addition, the City's 2012 CAFR identifies miscellaneous revenue of \$34,987 in the TIF Funds that needs explanation.

The City reported that the total estimated tax increment expenditures authorized in the TIF plan for the TIF District is \$64,710. The TIF plan, however, authorizes \$75,168 of TIF expenditures.¹⁴

The City is not required to respond to this Comment.

CONCLUSION

The City's Response to these Findings 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 Findings within this letter at any time during the preparation of the Response. After reviewing the Response, the OSA will issue the Final Notice.

¹²The "TIF Funds" on the CAFR combines funds from TIF District 6-1 and TIF District 7-1. The interest was not reported in either district's TIF Annual Reporting Form.

¹³The second half distribution of 2011 increment was withheld, and subsequently released, pursuant to Minn. Stat. § 469.1771, subd. 2a, due to the City's failure to file the 2010 TIF Annual Reporting Form in a timely manner.

¹⁴The total expenditures are shown in Exhibit C of the TIF Plan as \$80,668, of which \$5,500 is from a developer deposit, leaving \$75,168 of TIF expenditures.

OFFICE OF THE STATE AUDITOR

Mayor and Council, City of Dassel

January 21, 2015

Page 5

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: Terri Boese, City Administrator

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CITY OF DASSEL

March 23, 2014

State of Minnesota
Office of the State Auditor
Attn: Jason Nord
525 Park Street, Suite 500
St Paul, MN 55103-2139

Re: TIF District No 6-1 Notice of Noncompliance

Dear Mr. Nord:

The City Council of the City of Dassel has received and reviewed the initial notice of noncompliance for TIF District 6-1. The council unanimously approved decertification of the district effective immediately and notified the Meeker County Auditor's office to record the decertification. A copy of the council resolution is attached for your records.

The City Council also unanimously approved repayment of the excess tax increment that was received from TIF District 6-1 plus applicable interest from 2010 through 2014. A check was received by Meeker County Auditor's office and a copy of that receipt is attached for your records.

Meeker County Auditor's office has been instructed to redistribute the excess funds to the entities that are entitled to the funds from 2010-2014.

Please let me know if you need any additional information regarding the decertification and refund of the excess increment for TIF District 6-1 in the City of Dassel.

Sincerely,

Terri Boese
City Clerk/Treasurer

This institution is an equal opportunity provider and employer.

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1-800-627-3529 (Relay Service)

March 27, 2015

The Honorable Jeff Putnam, Mayor
The Honorable Sharon Asplin, Council Member
The Honorable Sherrie Bjork, Council Member
The Honorable Sara Nelson, Council Member
The Honorable Ron Hungerford, Council Member
City of Dassel
P.O. Box 391
Dassel, MN 55325

Re: TIF District No. 6-1 – Final Notice of Noncompliance

Dear Mayor Putnam and Council Members:

On January 21, 2015, the Office of the State Auditor (OSA) sent to the City of Dassel (City) an Initial Notice of Noncompliance (Initial Notice) regarding the City's Tax Increment Financing (TIF) District 6-1. The OSA received the City's Response (Response) on March 24, 2015.

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

FINDINGS OF NONCOMPLIANCE

Three Findings of Noncompliance were made.

Finding 1. TIF District 6-1 – Failure to Decertify the District – RESOLVED

In the Initial Notice, the OSA found that the City failed to decertify TIF District 6-1 when all obligations it had incurred had been paid, as required by Minn. Stat. § 469.1763, subd. 4(b). The City Response included a copy of a resolution approved February 17, 2015, authorizing the decertification of the district as well as a copy of the Confirmation of Decertification Form signed by the City and the County Auditor. The OSA considers this Finding resolved.

Finding 2. TIF District 6-1 – Improper Receipt of Tax Increment – RESOLVED

In the Initial Notice, the OSA found that the City improperly received tax increment after the date on which the District should have decertified. The City Response indicated that the excess increment for the district was returned to the County Auditor's office for redistribution.

OFFICE OF THE STATE AUDITOR

Mayor and Council, City of Dassel
March 27, 2015
Page 2

Enclosed with the response was a receipt for the return of \$125,026.73. Although the City Response did not detail how this amount was determined, a follow-up conversation with the City confirmed that this amount included the amounts received after the district should have decertified (as detailed below). Finding 2 is considered resolved.

Finding 3. TIF District 6-1 – Excess Increment – RESOLVED

Finding 3 in the Initial Notice concluded that the City received excess tax increment from TIF District 6-1 that had not been returned to the County. The amount of excess increment for 2010 was found to equal \$1,370, and the excess increment statute was identified as a second basis for returning tax increment received since 2010. The City Response provided substantiation that \$125,026.73 of excess increment has now been returned. The City confirmed that this amount included \$1,370 for excess increment as of the end of 2010, \$92,514 for tax increment distributed by Meeker County from 2011 to 2013 as was identified in the Initial Notice, \$30,817.82 of tax increment that Meeker County has subsequently reported as being distributed in 2014, and \$325.91 of interest earned on tax increment since 2010. Finding 3 is considered resolved.

CONCLUSION

The OSA appreciates the City's cooperation in the resolution of this matter. 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: Terri Boese, City Administrator