Tax Increment Financing

Tax Increment Financing (TIF) is one of the more commonly used tools that communities use for assisting with development and redevelopment efforts. TIF is the ability to capture and use most of the increased local property tax revenues from new development within a defined geographic area for a defined period of time without approval of the other taxing jurisdictions. It allows the increase value of a project to be directed to assist with specific project expenses and allows the existing value (at the time of the establishment of a TIF district) to continue to be distributed to the taxing entities.

Project Areas and TIF Districts

A TIF district must be located within a specific geographic area created under the development statutes. This area is typically a Project Area, Development District or Redevelopment Project, depending on the authority under which it was established. Typically, the following types of authorities can administer TIF districts: City Councils, City or County Housing and Redevelopment Authorities, and Economic Development Authorities. All projects require a general development or redevelopment plan, which must be approved after a public hearing held by the City Council. The boundaries tend to be large areas within which the authority intends to promote development or redevelopment.

TIF Districts are the specific parcels within a Project Area from which tax increment will be generated and captured. Multiple TIF districts may be located within a project area.

Common Types of TIF Districts

Minnesota Statutes allows for several types of tax increment district and sub-districts, but there are four types of district that are most commonly established.

Economic Development TIF Districts

Economic development TIF districts are established to assist with projects increase the tax base and create employment. At the time of establishment of the TIF district, the authority must find that the district will (1) discourage business from moving to another state or municipality; (2) increase employment in the state; or (3) preserve and enhance the tax base of the state. An economic development TIF district has a maximum term of 9 years of increment.

Tax increment from an economic development district may be used to assist the following types of development:

- Manufacturing and processing
- Warehousing, storage and distribution
- Research and development related to manufacturing, warehousing, storage and distribution
- Telemarketing
- Tourism facilities
- Qualified border retail facilities; or
- Space necessary for and related to the activities listed above

No more than 15% of the buildings and facilities (on a square foot basis) may be used for purposes other than those outlined above.
Housing TIF Districts
Housing TIF districts are established to assist with projects intended for occupancy, in part, by persons or families of low and moderate income. Low to moderate income is defined by the Minnesota Housing Finance Agency and is adjusted annually. A housing TIF district has a maximum term of 26 years of increment and can assist either single family, owner occupied housing or rental housing projects.

Tax increment from a housing district can only be spent on costs which are directly related to low and moderate income housing. No more than 20% of the square footage of buildings that receive assistance from tax increment may consist of commercial, retail or other nonresidential uses; therefore, housing tax increment cannot be used to assist a commercial building. The cost of public improvement directly related to the housing projects and the administrative expenses may be included in the cost of a housing project.

Redevelopment TIF Districts
Redevelopment TIF districts are established to assist with redeveloping sites that contain substandard buildings. A redevelopment TIF district has a maximum term of 26 years of increment. Two criteria must be met in order for a proposed tax increment financing (TIF) district to qualify as a redevelopment district:

- Land parcels consisting of 70% of the TIF district must be occupied by buildings, streets, utilities, paved or gravel parking lots
- More than 50% of the buildings, not including outbuildings, must be structurally substandard to a degree requiring substantial renovation or clearance and reasonably distributed throughout the geographic area

A minimum of 90% of the increment must be used to correct the conditions causing the need for redevelopment.

Renovation and Renewal TIF Districts
Renovation and renewal TIF districts are established to assist with redeveloping sites that contain substandard buildings and buildings that require substantial renovation and clearance. A renovation and renewal TIF district has a maximum term of 16 years of increment. Three criteria must be met in order for a proposed tax increment financing (TIF) district to qualify as a renovation and renewal district:

- Land parcels consisting of 70% of the TIF district must be occupied by buildings, streets, utilities, paved or gravel parking lots.
- More than 20% of the buildings, not including outbuildings, must be structurally substandard to a degree requiring substantial renovation or clearance and reasonably distributed throughout the geographic area.
- 30% of the other buildings must require substantial renovation or clearance to remove existing conditions such as: inadequate street layout, incompatible uses or land use relationships, overcrowding of buildings on the land, excessive dwelling unit density, obsolete buildings not suitable for improvement or conversion, or other identified hazards to the health, safety, and general well-being of the community.

A minimum of 90% of the increment must be used to correct the conditions causing the need for redevelopment.
What is the Authority's Process for Establishing a TIF District?
The use of increment must be spelled out in a TIF plan approved by the City Council (or County Board for a county HRA) after a public hearing. The TIF Plan must include a statement of objectives, list of property to be acquired, a list of proposed development activities, identification of property to be included in the district, and a list of supporting studies and reports. In addition, the plan must include estimates of the costs associated with the project, sources of revenue, amount of bonded indebtedness, most recent net tax capacity of property within the district, estimate of captured net tax capacity upon completion, duration of the district and impact on other taxing jurisdictions.

- The county commissioner representing the area of a proposed housing or redevelopment TIF district must be notified at least 30 days before the date of publication of the public hearing notice that a TIF district is being proposed.
- The county has 45 days after receipt of the TIF plan to notify the authority if tax increment is required to pay all or a portion of the cost of county road improvements.
- The county and the school district must receive a notice of the proposed TIF district including the proposed TIF plan and estimated fiscal implications a minimum of 30 days prior to the public hearing.
- A public hearing notice with a map showing the project area and TIF district must be published between 10 and 30 days prior to the public hearing date.
- The planning commission must review the TIF plan to conform to the general plans for the development and redevelopment of the City as a whole.
- The EDA or HRA must review and approve the TIF plan.
- A public hearing must be held by the City Council (or County Board), and findings must be made, including that the proposed development would not reasonably be expected to occur solely through private investment in the reasonably foreseeable future (the "but for" finding).

TIF Plans may be modified using the same process as for approval of the initial plan. Generally, modifications that do not increase expenditures or debt or call for new land acquisition may be approved simply by resolution. Modifications will not trigger application of current statutes unless the boundary of the TIF district is expanded.

The Project will not Occur "But For" the Assistance of TIF
Prior to establishing a TIF district, the City Council (or County Board) must consider the But For Test. Simply stated, the “But For” Test states that, the project will not go forward “but for” the requested assistance.

The municipality must find that the increased market value of the site that could reasonably be expected to occur without the use of tax increment financing (a hypothetical figure) would be less than the increase in the market value of the proposed development after subtracting the present value of the projected tax increments for the maximum duration of the district permitted by the TIF Plan (this requirement does not apply to qualified housing districts).

In addition, the municipality typically considers specific economic and site factors affecting the development.
Economic Development and Redevelopment

TIF Starts with Calculating the Captured Tax Capacity

Market values are established annually by the county assessor with a valuation dated January 2. For the most part, this value reflects only real property (land and buildings); equipment value is not taxes. Ehlers encourages working with the local assessor to determine estimated market values prior to proceeding with a TIF project.

The first step in calculating TIF is to calculate the captured tax capacity, or increase in tax capacity, due to a new development. Tax capacity is calculated by multiplying the market value by the class rate, based on property type and as set by the Minnesota legislature.

Assuming a commercial development with a current market value of $900,000 and a market value of $4,452,000 after new development, the captured tax capacity is 71,036.

<table>
<thead>
<tr>
<th>New Market Value</th>
<th>Class Rate</th>
<th>New Tax Capacity</th>
</tr>
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<tbody>
<tr>
<td>$4,452,000</td>
<td>Commercial/ Industrial (2%)</td>
<td>89,040</td>
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<tr>
<td>Base Market Value</td>
<td>Class Rate (Future Use)</td>
<td>Base Tax Capacity</td>
</tr>
<tr>
<td>$900,200</td>
<td>Commercial/ Industrial (2%)</td>
<td>18,004</td>
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</tbody>
</table>

New Tax Capacity (90,040) – Base Tax Capacity (18,004) = Captured Tax Capacity (71,036)

Captured Tax Capacity is Used to Calculate the Gross Tax Increment

The annual gross tax increment is calculated by multiplying the captured tax capacity by the local tax rate, which includes the city, county, and school district tax rates as well as other smaller taxing jurisdictions. Using the example above and assuming a local tax rate of 140.0%, the gross annual tax increment is $99,450.

Captured Tax Capacity (71,036) X Local Tax Rate (140.0%) = Gross Annual Tax Increment ($99,450)

What is Excluded from Tax Increment?

Only a portion of a property tax payment can be captured with tax increment. Using the example above, the property tax payment is $182,002, but the gross tax increment is $99,450. The Statewide commercial/industrial tax along with market value taxes cannot be captured with tax increment. In addition, the base value taxes will continue to be distributed to the local taxing jurisdictions.
What Is Excluded From TIF?

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Property Taxes</td>
<td>162,002</td>
</tr>
<tr>
<td>Less State-wide Taxes</td>
<td>(40,544)</td>
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<tr>
<td>Less Fiscal Disp. Adj.</td>
<td>0</td>
</tr>
<tr>
<td>Less Market Value Taxes</td>
<td>(16,801)</td>
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<tr>
<td>Less Base Value Taxes</td>
<td>(25,206)</td>
</tr>
<tr>
<td>Annual Gross TIF</td>
<td>99,450</td>
</tr>
</tbody>
</table>

How Much of the Gross Tax Increment Can be Used for a Project?

Not all of the gross tax increment can be used for financing a development. The Office of the State Auditor (OSA) receives 0.36% of the increment. In addition, the authority can retain up to 10% of the increment for administration of the district. Using the example above and assuming the authority retains the full amount for administration, the net annual tax increment is $89,183. This amount is multiplied by the term of the district to determine the amount of available TIF.

Annual Gross Increment: $99,450  
Less State Auditor Fee (0.36%): ($358)  
Less Administration Fee (10%): ($9,909)  
Annual Net Increment: $89,183

What Expenses Are Eligible TIF Expenses?

In addition to the specific limitations for each type of TIF District, tax increment may be spent only for specified purposes permitted in the underlying development statutes. Such purposes generally include:

- Land acquisition
- Site improvements
- Public and on-site utilities
- Demolition and relocation
- Administration

If the authority owns a project, increment may be used to finance essentially any aspect of the project. Since the development statutes are often ambiguous, whether a particular activity is TIF-eligible may depend on the facts in each case.

Administrative expenditures are limited the lesser of 10% of the expenditures authorized in the TIF Plan, or 10% of actual increment expenditures. They are defined to mean all expenditures of the authority other than land acquisition and relocation costs and costs "directly connected with the physical development of the real property in the district."

Increment may not be used to finance buildings that are used "primarily and regularly for conducting the business" of any unit of government (except for parking structures); a common area used as a public park; or a facility used for social, recreational or conference purposes.

4 and 5 Year Rules

The 4-year knock down rule states that increment will not be collected from a particular parcel unless, within four years after the date of certification, demolition, rehabilitation or renovation of property or other site improvements has taken place by either the authority or the owner in accordance with the TIF Plan.

Construction or major construction of an adjacent street qualifies as an improvement to a parcel, but utility
improvements do not. If the parcel is "knocked-down" and later improved, it is re-instated in the TIF District but at the market value at the time of the reinstatement.

The 5-year rule requires that in order for increment to be considered a spent expenditure within the TIF District, one of the following must occur within five years after certification of the district:

- Increment is paid to a "third party" for a TIF-eligible "activity";
- Bonds, the proceeds of which are used to finance an activity, are sold to a third party and proceeds are reasonably expected to be spent within the five-year period (with certain limited exceptions);
- Binding contracts are entered with a third party for performance of an activity, and increment is spent under the contract;
- Costs are incurred by a "party" and revenues are spent to reimburse a party; or
- Expenditures are made for housing purposes.