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, 2013
TIF Audits Concluded for the Year Ended December 31, 2014

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 for 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, 2013
TIF Audits Concluded for the Year Ended December 31, 2014

January 15, 2015

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TAX INCREMENT FINANCING REPORT

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- In 2013, 99 TIF districts were decertified, a 34 percent decrease compared to 2012. (pg. 14)

- Nearly $202 million of tax increment revenue was reported in 2013. Tax increment revenue decreased by approximately $32 million in 2013, a 14 percent decrease compared to 2012. (pg. 16)

- In 2013, development authorities returned $12,167,078 in tax increment revenue to county auditors for redistribution as property taxes to the city, county, and school district. (pg. 19)

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- Between 1996 and 2004, the total number of TIF districts increased. From 2004 through 2013, the total number decreased. The decrease reflects, among other things, a large number of decertifications of older districts. (pg. 11)

- This trend of decreasing tax increment revenue since 2008 is largely driven by the decertification of older districts. Not only were decertifications outpacing new district certifications, but older districts were generally larger than newer districts and generated more tax increment per district. (pg. 18)

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SCOPE AND METHODOLOGY

This 19th Annual Legislative Report (Report) was compiled from information received from the 417 development authorities currently authorized to exercise tax increment financing (TIF) powers in Minnesota. The Report summarizes information reported by these development authorities for 1,732 districts for the calendar year ended December 31, 2013. The Report also provides a summary of the violations cited in the limited-scope reviews concluded by the Office of the State Auditor (OSA) in 2014. 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, 2013, were required from a total of 1,733 TIF districts. To date, the OSA has received reports for 1,732 of the TIF districts.[4] On August 19, 2014, the OSA sent Notices of Failure to File, addressed to the governing boards of the municipalities, and copied to development authorities, advising them that the required reports had not been filed.[5]

For authorities that had not filed a report with the OSA by October 1, 2014, a Notice to Withhold Tax Increment was sent to each of the applicable county auditors instructing them to withhold tax increment.[6]

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[1] 1995 Minn. Laws, ch. 264, art. 5, § 34.
[2] Minn. Stat. § 469.1771. 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] A report has not yet been filed for the City of Hills.
[5] Minn. Stat. § 469.1771, subd. 2a(a).
[6] Minn. Stat. § 469.1771, subd. 2a(a).

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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, development authorities use this tool to finance development activities using the incremental property taxes, or "tax increments," generated by the increased taxable value of new development. The capture of tax increments occurs within TIF districts that are 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. That portion of the property taxes generated by new development (the tax increment), and only that portion, is used to pay for public improvements and qualifying costs that make the new development possible.[6]

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.[7] 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, and the Rural Development Financing Authorities Act. Together with the City Development District Act, these acts are referred to in this Report as the Development Acts.[8]

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.[9] 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.[10] In the City Development District

[6] Minn. Stat. § 469.177, subd. 1(a). Property taxes on already 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. Due to the extraordinary expense involved in cleaning up hazardous substances, however, the entire property tax payment may be used to pay it. Minn. Stat. §§ 469.174, subd. 23, and 469.175, subd. 7.
[7] Counties and towns may also be development authorities in certain instances.
[8] Minn. Stat. § 469.174, subd. 2 (listing the statutory citations for the various development acts).
[9] Minn. Stat. § 469.174, subd. 8.
[10] *See* Minn. Stat. § 469.002, subd. 12.

Act, however, the term "project" means a designated area within a city.[11] The Development Acts do not expressly limit the size of areas that can qualify as projects.

Development Authorities

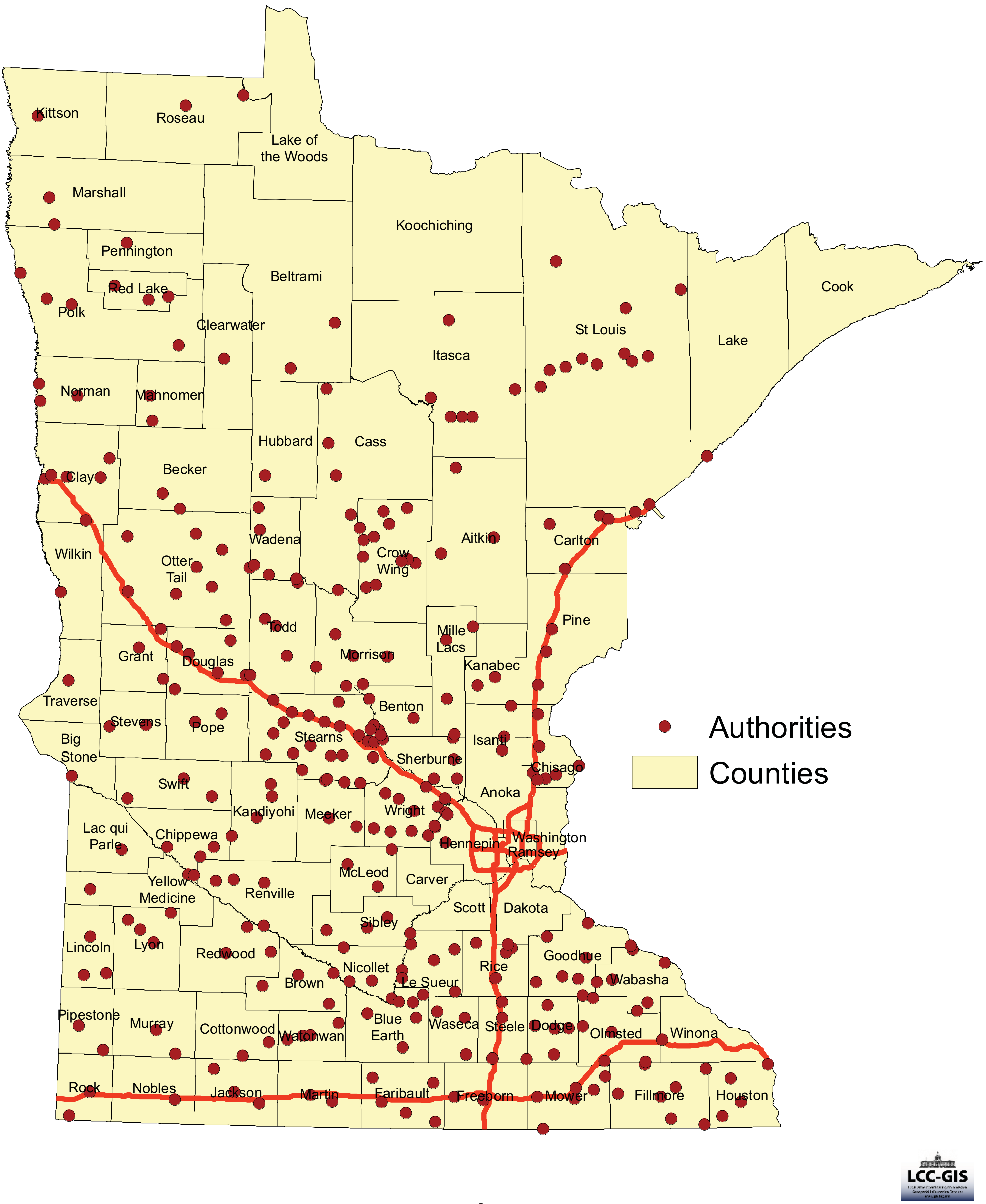
In 2013, there were 417 active development authorities in Minnesota, compared to 427 in 2012; three new city development authorities were created, three inactive development authorities became active again, and sixteen authorities became inactive.

In 2013, of the 417 development authorities reporting, 314 were located in Greater Minnesota and 103 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.[12]

[11] *See* Minn. Stat. § 469.125, subd. 9.
[12] This map does not include the following joint authorities: Bluff Country HRA and Southeast Minnesota Multi-County HRA.

MAP 1

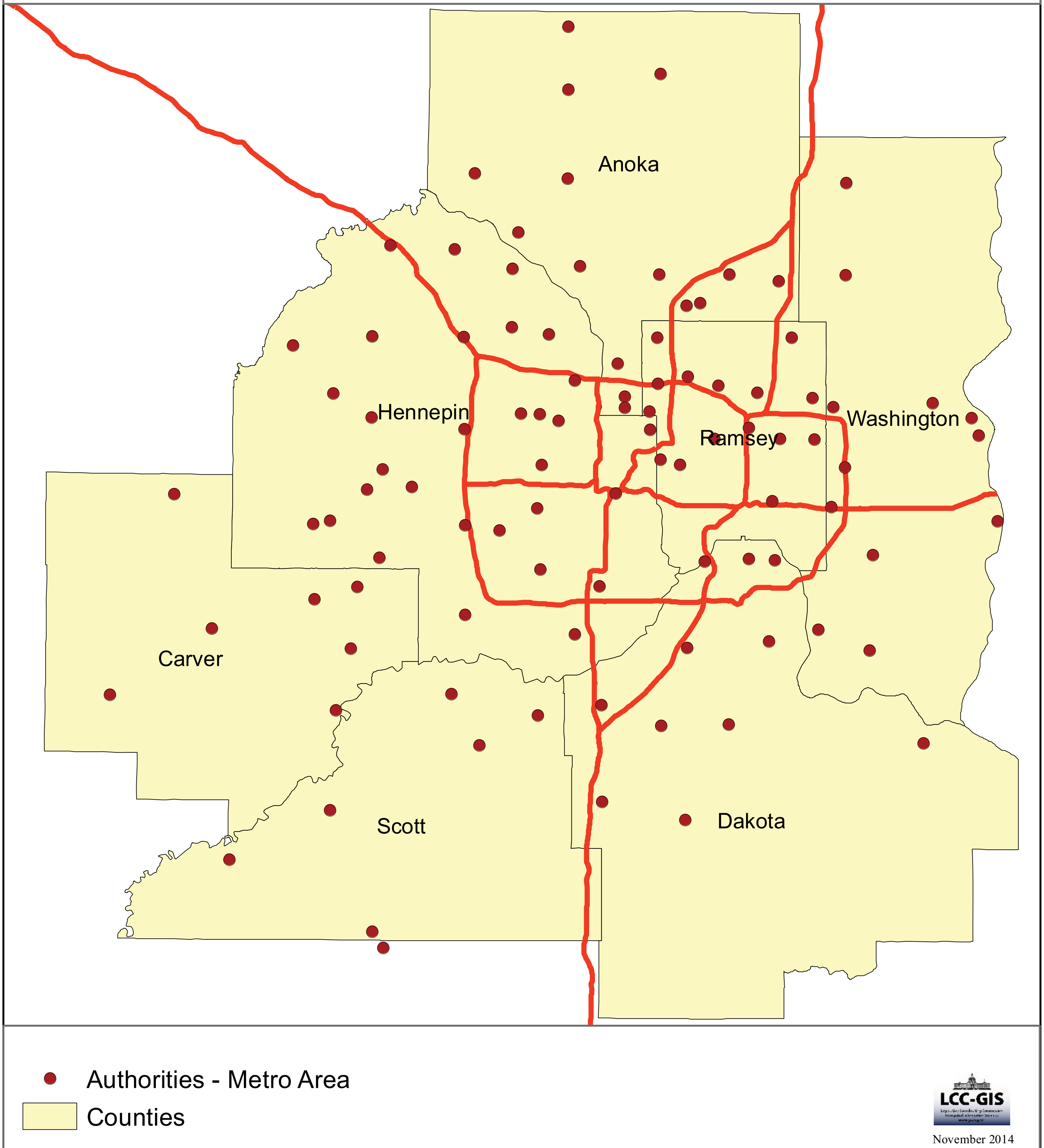
Development Authorities in Greater Minnesota, 2013



November 2014

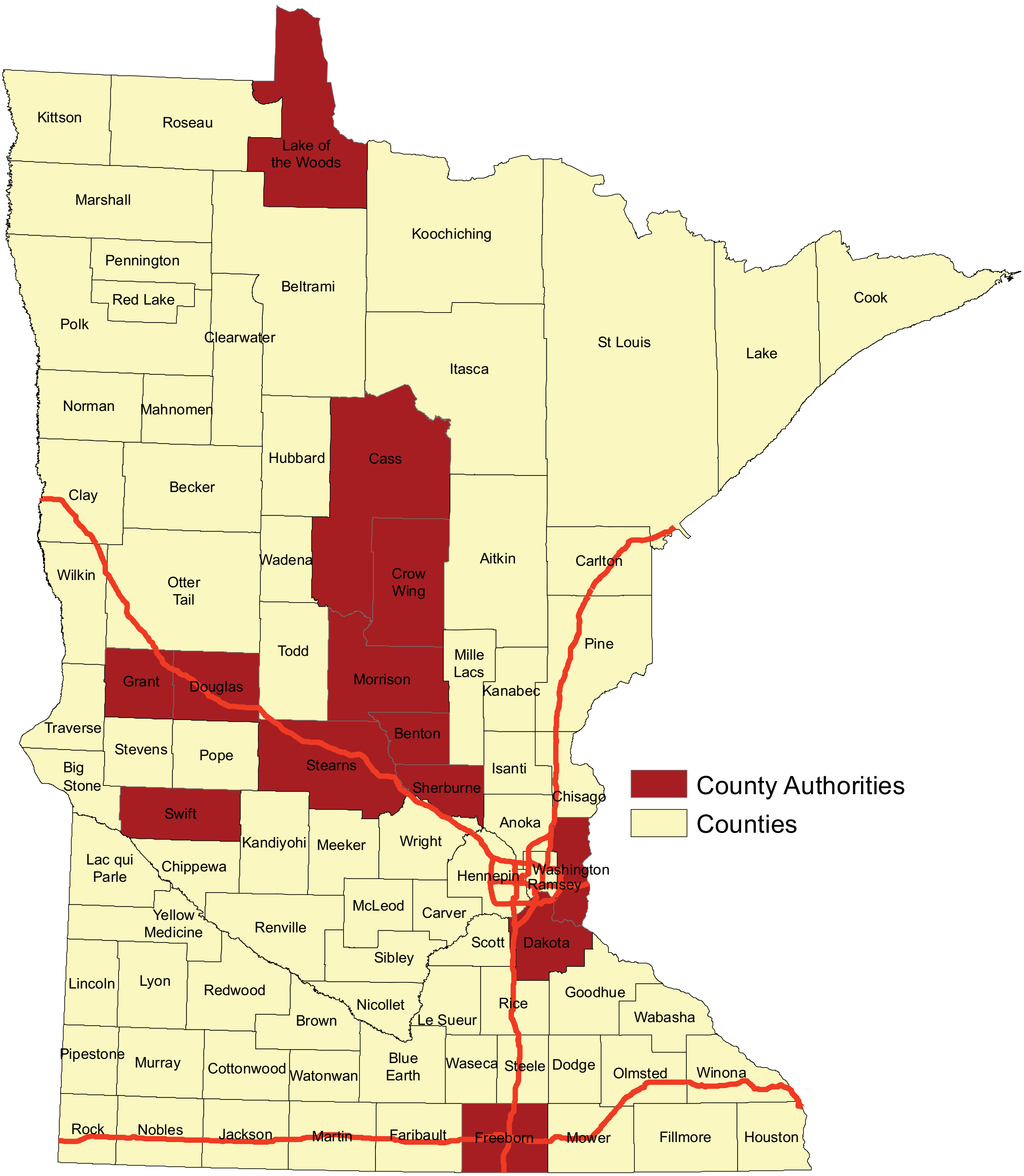
MAP 2

Development Authorities in Metro Area, 2013



MAP 3

County Development Authorities, 2013



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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. Approval of the TIF plan authorizes the use of tax increment to pay TIF-eligible project costs.[13]

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.[14] 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.[15]

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.[16] The county board and school board may comment on the proposed district, but cannot prevent its creation.[17]

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 a different maximum duration limit.

Redevelopment Districts – The purpose of a redevelopment district is to eliminate blighted conditions.[18] Redevelopment districts are designed to conserve the use of existing utilities, roads, and other public infrastructure, and to discourage urban sprawl. Qualifying tax increment

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[13] Minn. Stat. § 469.175, subd. 1.
[14] Minn. Stat. § 469.175, subd. 3.
[15] In many cases, the commissioners of the TIF authority include some or all of the council members.
[16] Minn. Stat. § 469.175, subd. 2.
[17] In those situations in which the county is the municipality that must approve the TIF plan, however, the county board may prevent creation of a TIF district.
[18] 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 for development with bare land. The statutory maximum duration limit is 25 years after first receipt of tax increment.[19]

Economic Development Districts – The purpose of an economic development district is to: (i) discourage commerce, industry, or manufacturing from moving to another state or city; (ii) increase employment in the state; or (iii) preserve and enhance the tax base.[20] 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."[21] Economic development districts are short-term districts with a limit of eight years after first receipt of tax increment.[22]

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.[23]

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.[24]

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.[25] The statutory maximum duration limit is 20 years after first receipt of tax increment.[26]

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[19] 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.
[20] Minn. Stat. § 469.174, subd. 12.
[21] Minn. Stat. § 469.174, subd. 27, and Minn. Stat. § 469.176, subd. 4c.
[22] 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.
[23] 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.
[24] 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.
[25] Minn. Stat. § 469.174, subd. 19.
[26] 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. Many of them still have assets. The assets may still be used to pay administrative expenses, to pay bonds, and to pool for deficits.[27] 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.[28] 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).[29] The HSS captures additional increment by reducing the original net tax capacity (ONTC) by the estimated costs of the removal actions.[30] 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.[31] 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.[32]

Special Legislation

Special legislation has been enacted to allow exceptions to the TIF Act for individual districts. As of 2013, 116 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;[33] (2) extending the duration limits of a TIF district;[34] (3) creating an exception to requirements or findings needed to create a TIF district;[35] and (4) creating an exception to the limitations on the use of tax increment.[36]

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[27] Minn. Stat. § 469.176, subd. 1c.
[28] Minn. Stat. § 469.174, subd. 16; Minn. Stat. § 469.175, subd. 7.
[29] Minn. Stat. § 469.174, subd. 17.
[30] Minn. Stat. § 469.174, subd. 7(b).
[31] Minn. Stat. § 469.176, subd. 4e.
[32] Minn. Stat. § 469.176, subd 1e.
[33] *See* Minn. Stat. § 469.1763, subd. 3.
[34] *See* Minn. Stat. § 469.176, subd. 1b.
[35] *See generally* Minn. Stat. § 469.174 and Minn. Stat. § 469.175.
[36] *See generally* Minn. Stat. § 469.176.

Number of TIF Districts

Of the 1,732 TIF districts that reported in 2013, 36 percent were located in the Metro Area and 64 percent were located in Greater Minnesota. Of these, 97 percent were either redevelopment, economic development, or housing districts. Figure 1 shows the number of TIF districts by type and by location.

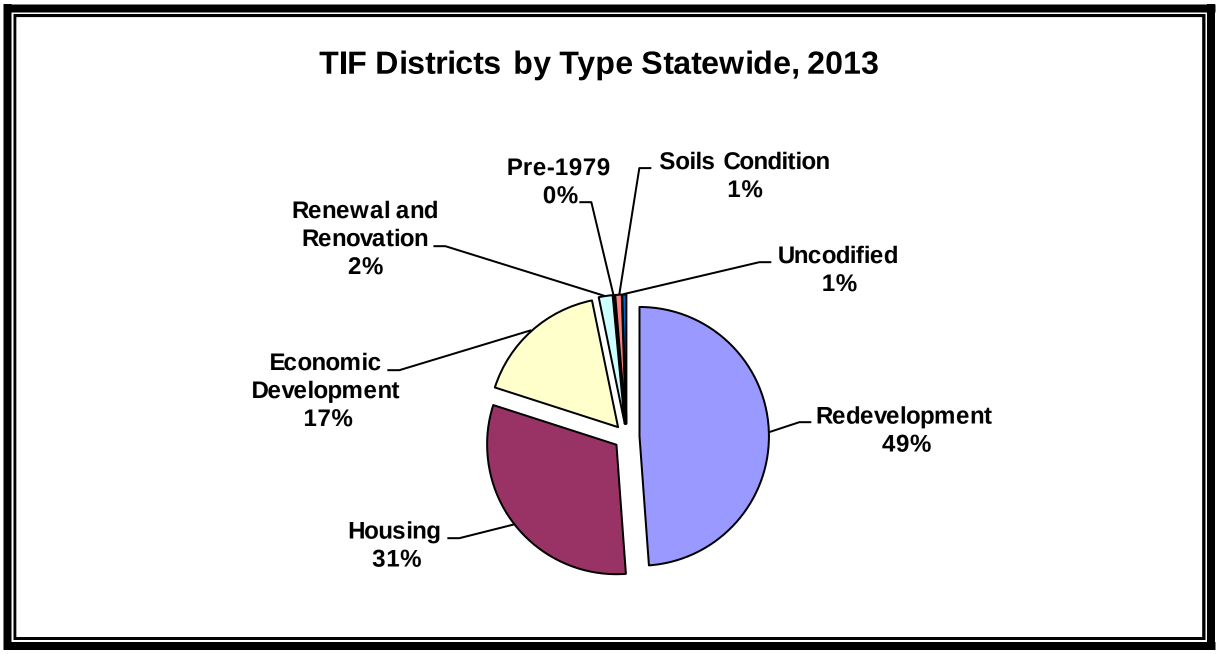
Figure 1.

TIF Districts by Type; Statewide, Greater MN, and Metro Area; 2013						
Type of District	**Statewide**	**% of total**	**Greater MN**	**% of total**	**Metro Area**	**% of total**
Redevelopment	846	49%	468	42%	378	61%
Housing	539	31%	392	35%	147	24%
Economic Development	291	17%	244	22%	47	8%
Renewal and Renovation	30	2%	10	1%	20	3%
Pre-1979	3	0%	1	0%	2	0%
Soils Condition	14	1%	2	0%	12	2%
Uncodified	9	1%	0	0%	9	1%
Total	1,732	100%	1,117	100%	615	100%
Hazardous Substance Subdistricts	25		1		24	

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

Figure 2 on the following page illustrates the percentage of TIF districts by type statewide. Redevelopment districts make up 49 percent of all districts, followed by housing districts at 31 percent and economic development districts at 17 percent.

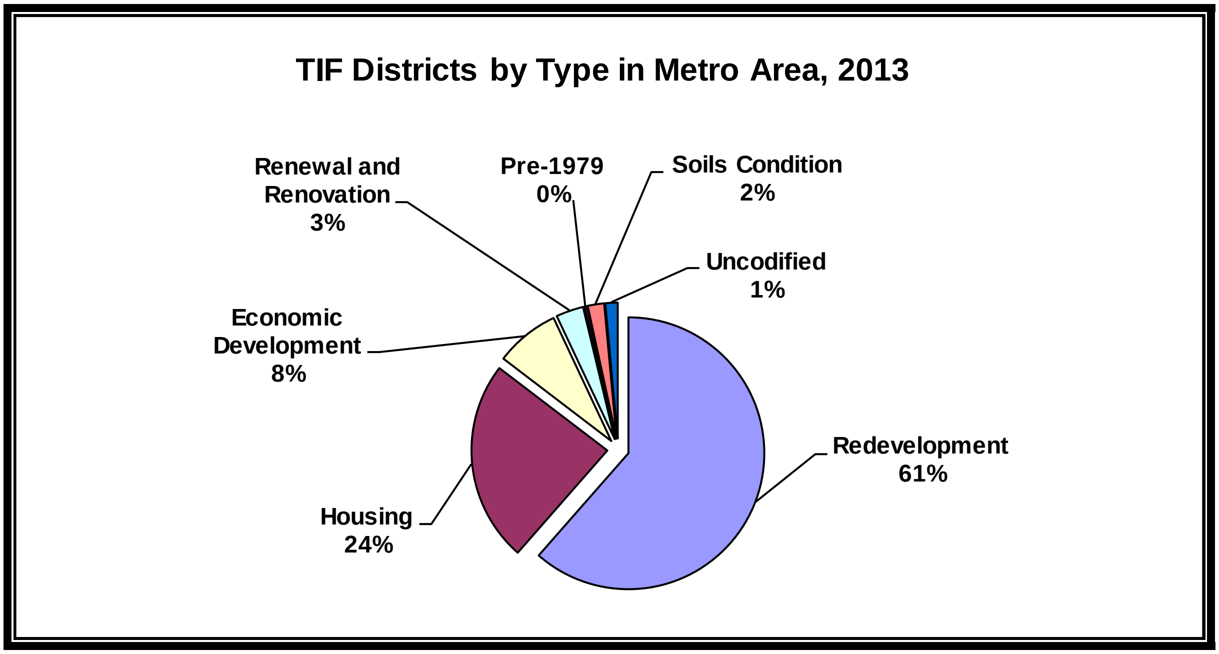
Figure 2.



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

In the Metro Area, as shown in Figure 3, redevelopment districts are more common and make up 61 percent of all districts, followed by housing districts at 24 percent and economic development districts at eight percent.

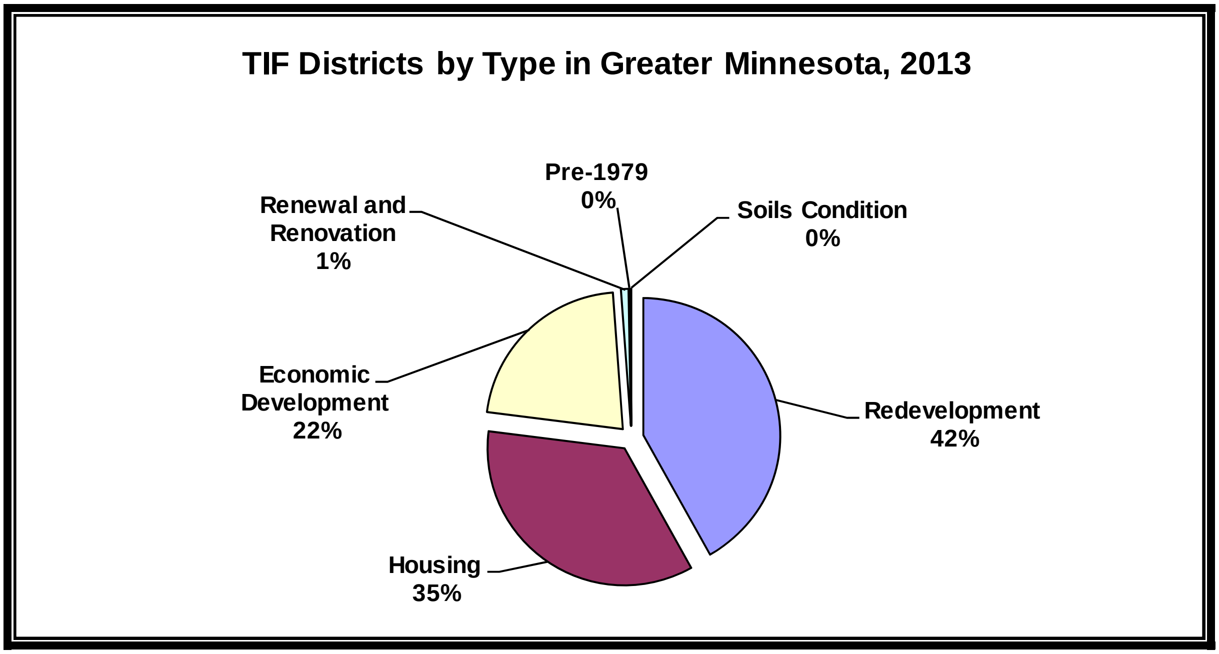
Figure 3.



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

In Greater Minnesota, as shown in Figure 4, housing districts and economic development districts make up larger shares compared to the Metro Area, although redevelopment districts are the most common type in both areas.

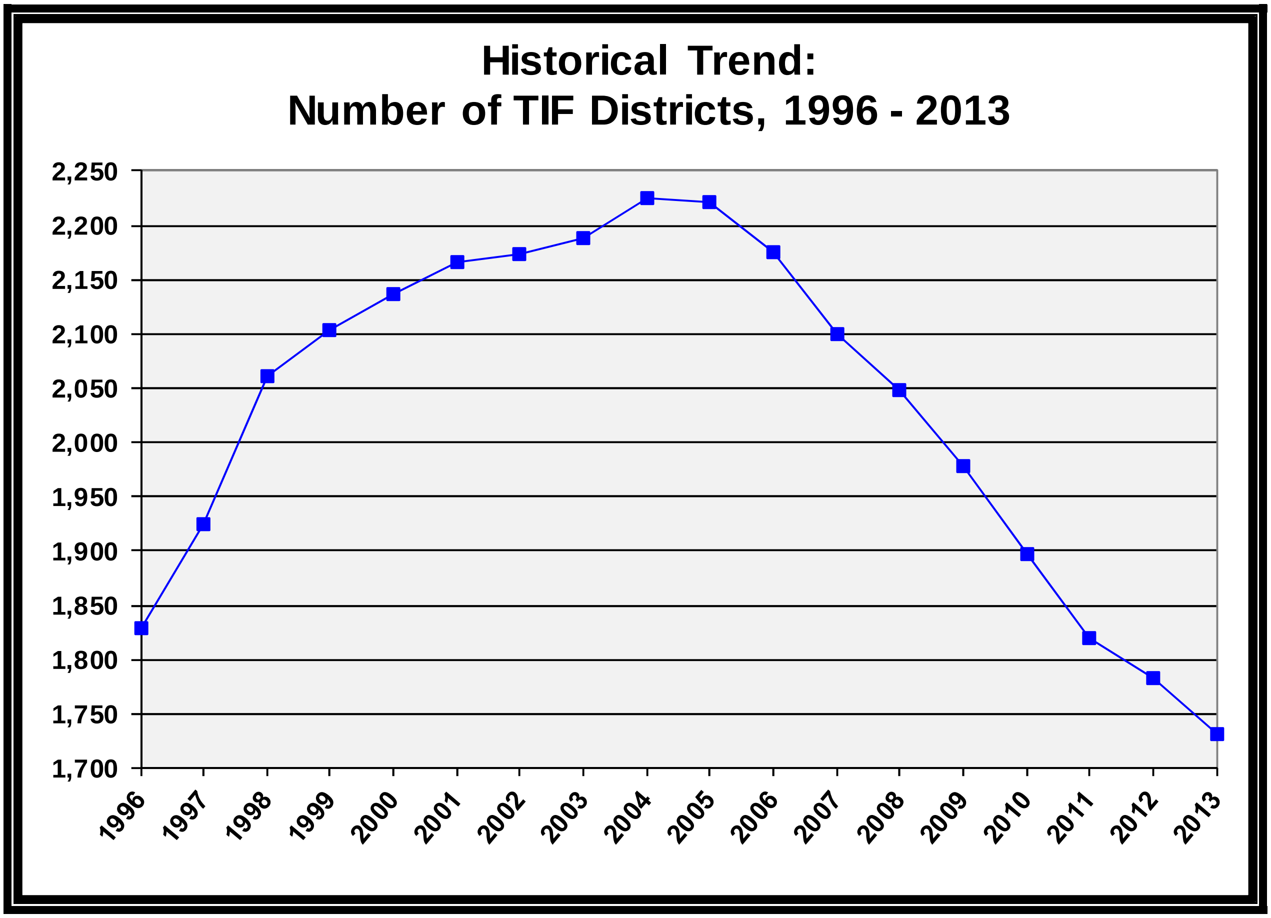
Figure 4.



Trends in the Number of TIF Districts

The OSA began its oversight of TIF in 1996, and Figure 5 on the following page shows the number of districts for each year since 1996. Between 1996 and 2004, the total number of TIF districts increased. From 2004 through 2013, the total number decreased. The decrease reflects, among other things, a large number of decertifications of older districts. A large number of the districts created in the wake of the 1979 TIF Act are now reaching their statutory duration limit and must be decertified. This decertification activity contributes significantly to the decrease in the number of active TIF districts since 2004.

Figure 5.



New Districts Certified

As Figure 6 shows, the number of new TIF districts certified in 2013 decreased by five percent compared to 2012. The decrease occurred in part because the temporary authority enacted in 2010, which allowed economic development districts to be created under relaxed rules, expired.[37] Absent this authority, 11 fewer economic development districts were created in 2013 compared to 2012, but the total number of new districts of all types was only four fewer than the 78 new districts in 2012.

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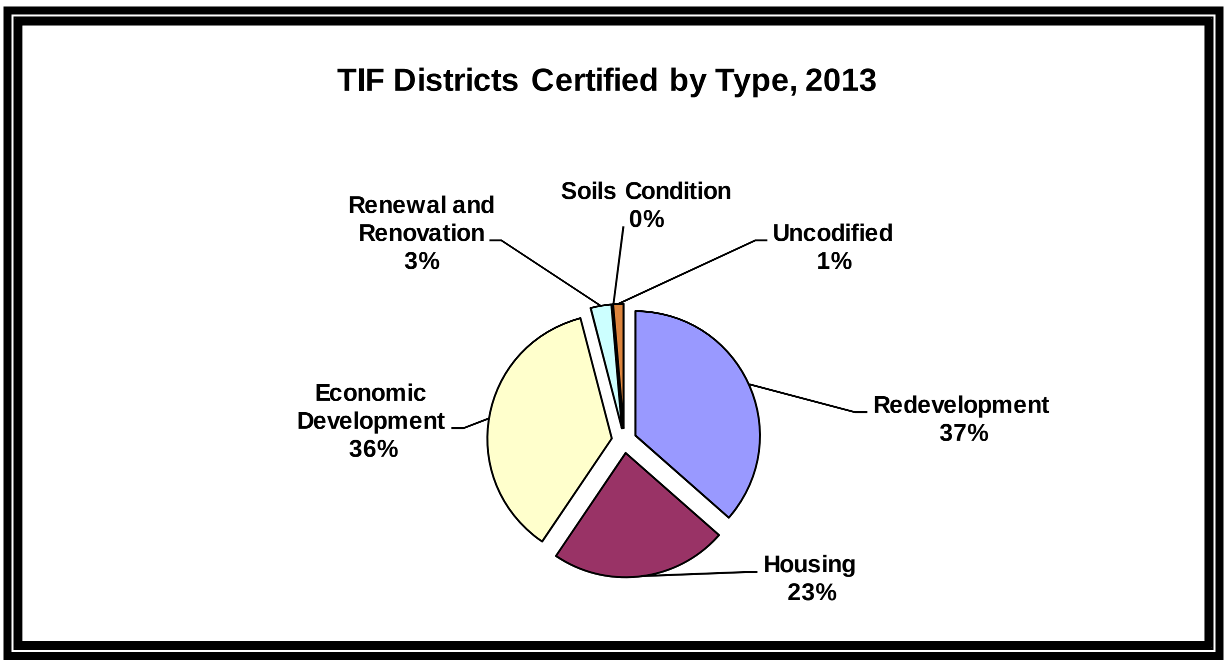
[37] *See* Minn. Stat. § 469.176, subd. 4c(d).

Figure 6.

Number of TIF Districts Certified by Type, 2009 - 2013					
	2009	**2010**	**2011**	**2012**	**2013**
Redevelopment	29	15	19	20	27
Housing	14	11	12	16	17
Economic Development	11	12	32	38	27
Renewal and Renovation	1	0	4	3	2
Soils Condition	0	0	0	1	0
Uncodified	0	1	0	0	1
Total	55	39	67	78	74

Figure 7 shows that economic development districts and redevelopment districts account for 73 percent of all new certifications.

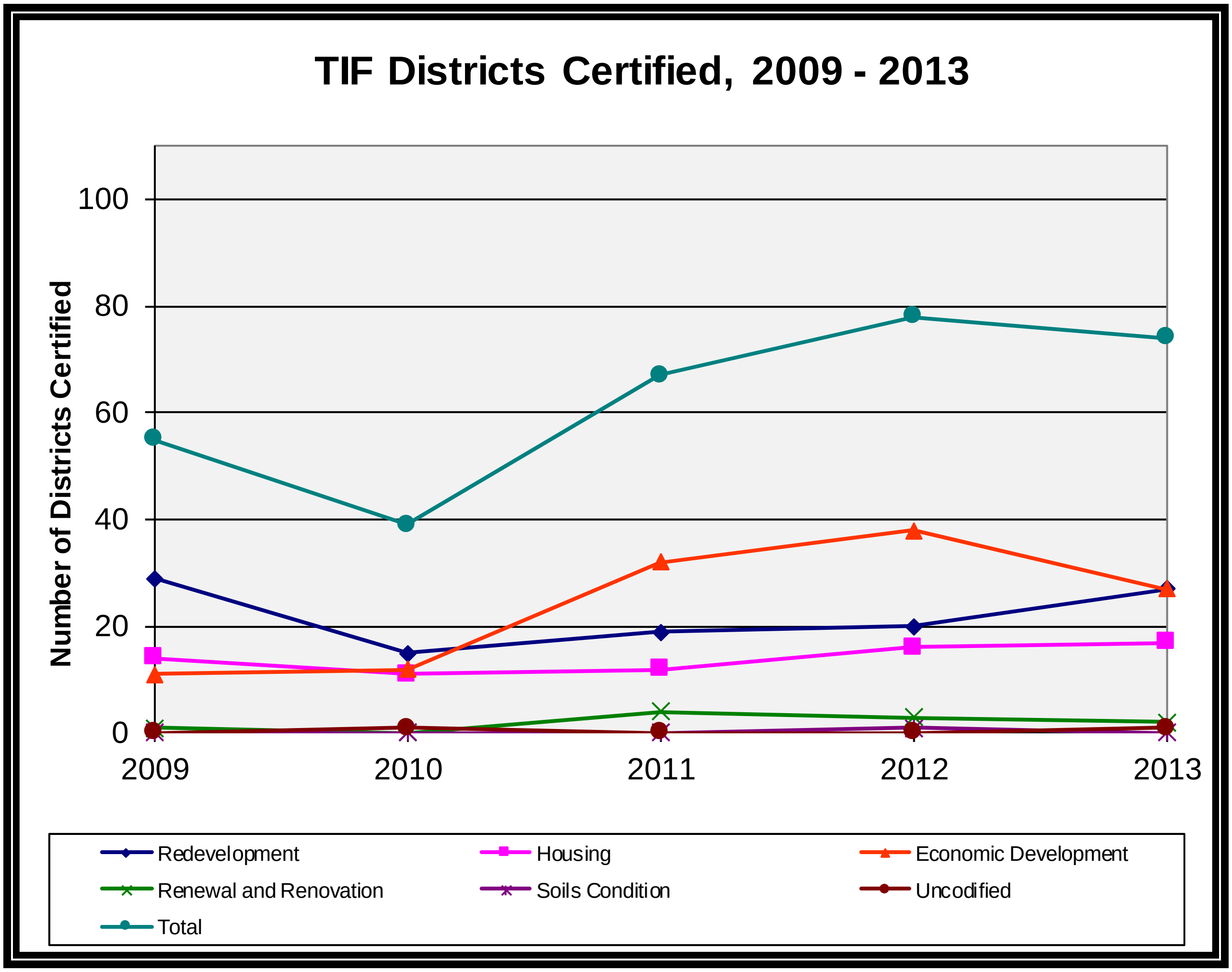
Figure 7.



Certification Trends

The number of TIF districts certified by type from 2009 to 2013 is shown in Figure 8 below.

Figure 8.



Districts Decertified

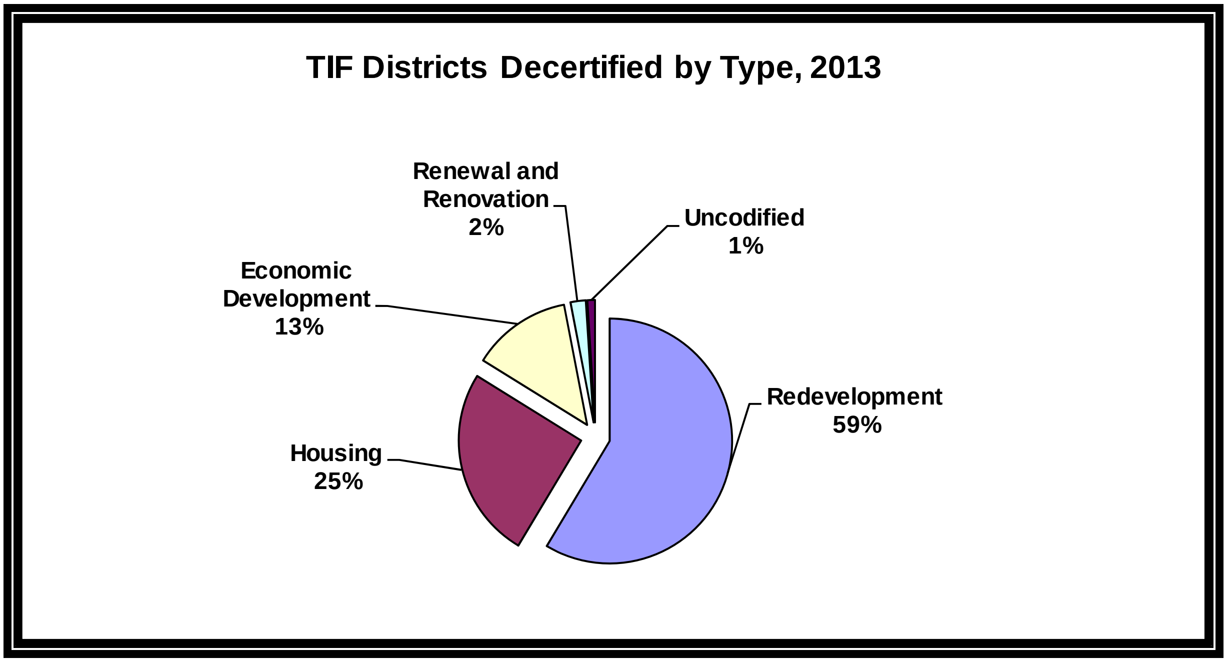
As Figure 9 on the following page shows, 99 TIF districts were decertified in 2013, a 34 percent decrease compared to 2012. The number of economic development districts that decertified in 2013 decreased by over 60 percent. The number of redevelopment districts and housing districts decreased by 23 percent and 32 percent, respectively.

Figure 9.

Number of TIF Districts Decertified by Type, 2009 - 2013					
	2009	**2010**	**2011**	**2012**	**2013**
Redevelopment	39	71	58	75	58
Housing	16	21	22	37	25
Economic Development	68	58	42	33	13
Renewal and Renovation	0	0	3	4	2
Soils Condition	0	0	0	1	0
Uncodified	0	0	0	1	1
Pre-1979	36	1	0	0	0
Total	159	151	125	151	99

Figure 10 shows the number of TIF districts decertified by type in 2013 as a percent of the total. Redevelopment districts made up the majority of decertifications in 2013.

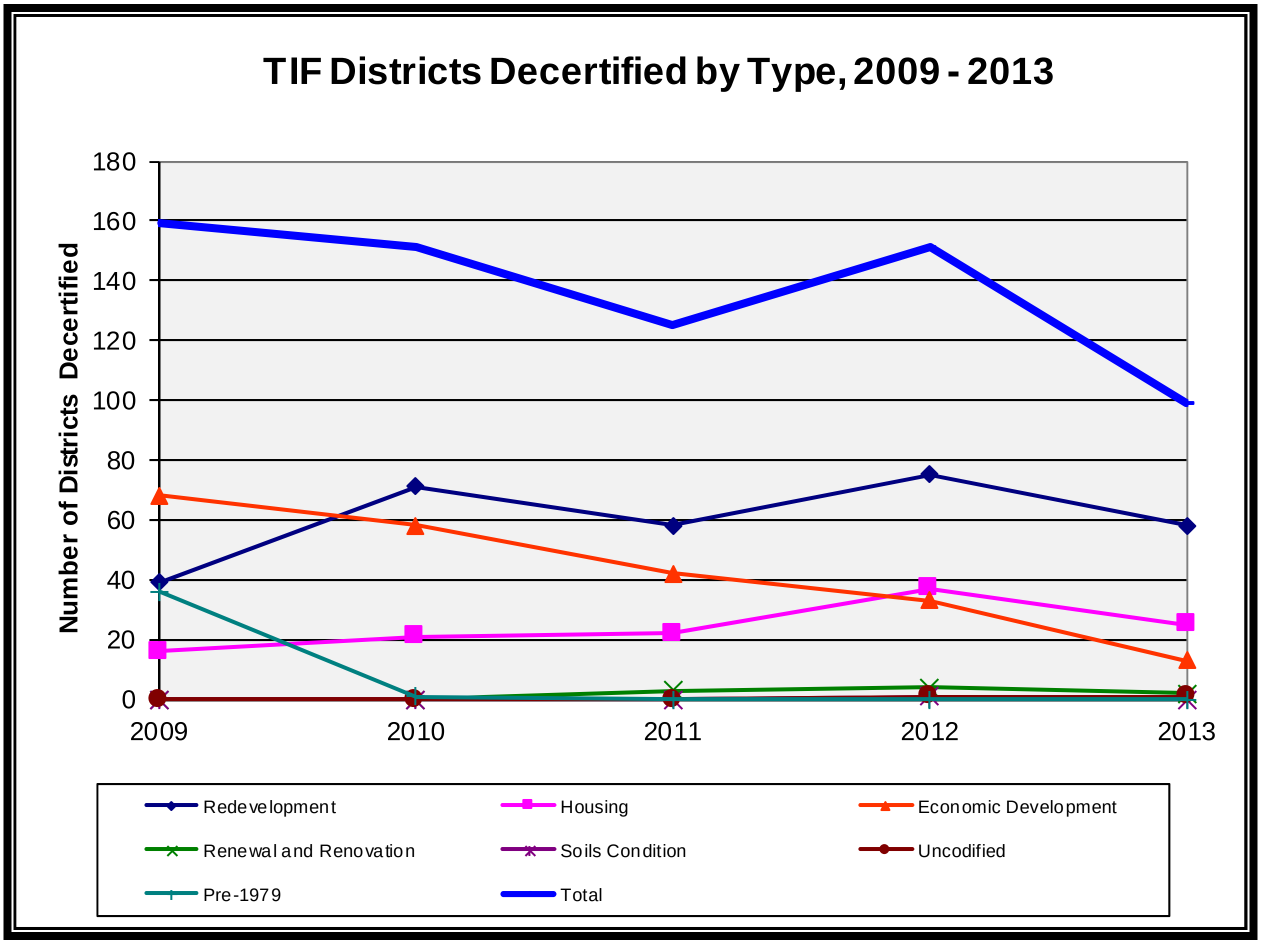
Figure 10.



Decertification Trends

The number of TIF districts decertified by type from 2009 to 2013 is illustrated again in Figure 11 below. One notable trend is that the number of economic development districts decertified each year has steadily decreased over the five-year period.

Figure 11.



Tax Increment Revenue

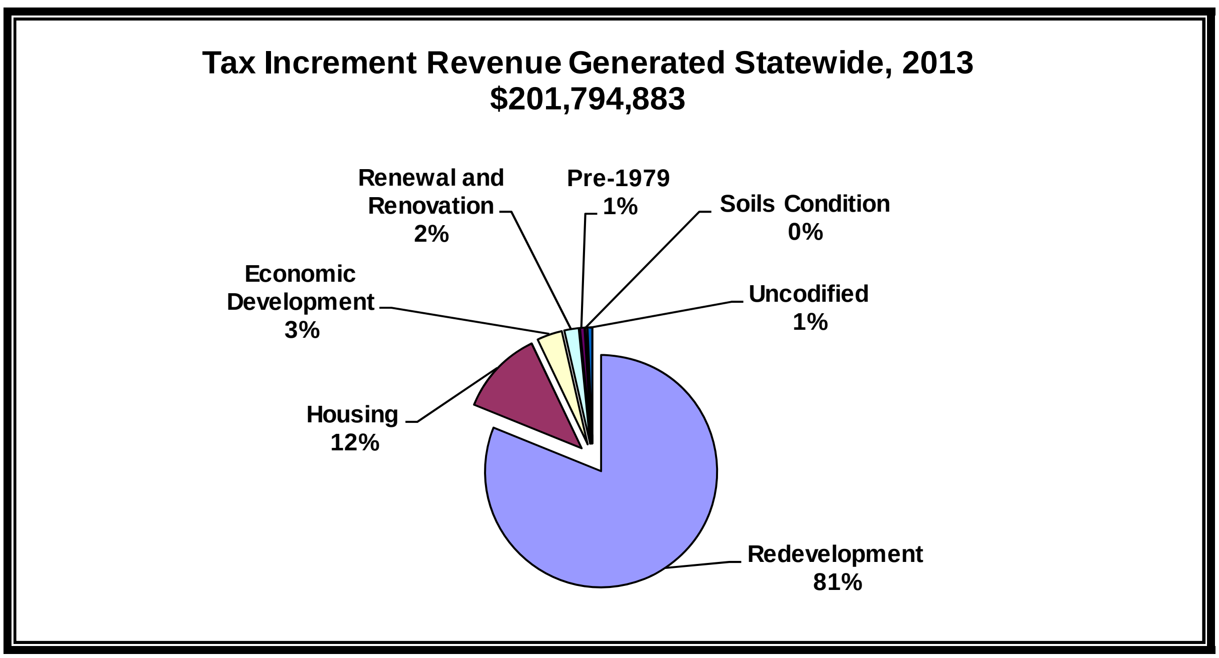
The amount of tax increment revenue generated from within a TIF district depends, in part, on the type of district, the development activity occurring within the district, the duration limit, and the location of the district. Nearly $202 million of tax increment revenue was reported in 2013. Tax increment revenue decreased by approximately $32 million in 2013, a 14 percent decrease compared to 2012. Most of the 2013 decrease is attributable to the 2012 decertification of districts created in the 1980s. Figure 12 on the following page shows the amount of tax increment revenue generated by type of district and by location. Although most districts are located in Greater Minnesota, approximately $164 million of the $202 million of tax increment, or 81 percent, was generated in the Metro Area.

Figure 12.

Revenue Generated by Type; Statewide, Greater MN, and Metro Area; 2013						
Type of District	**Statewide**	**% of total**	**Greater MN**	**% of total**	**Metro Area**	**% of total**
Redevelopment	$163,693,176	81%	$23,816,253	62%	$139,876,923	86%
Housing	$23,790,956	12%	$9,402,444	25%	$14,388,512	9%
Economic Development	$7,058,440	3%	$4,653,976	12%	$2,404,464	1%
Renewal and Renovation	$4,077,140	2%	$410,776	1%	$3,666,364	2%
Pre-1979	$1,247,428	1%	$0	0%	$1,247,428	1%
Soils Condition	$581,195	0%	$0	0%	$581,195	0%
Uncodified	$1,346,548	1%	$0	0%	$1,346,548	1%
Total	$201,794,883	100%	$38,283,449	100%	$163,511,434	100%

In 2013, redevelopment districts made up 49 percent of the TIF districts statewide, and generated 81 percent of total tax increment revenue. Figure 13 illustrates the tax increment revenue generated by type of district as a percent of the total.

Figure 13.



Figures 14 and 15 on the following page show the shares of tax increment revenue as a percent of the total by district type in the Metro Area and Greater Minnesota, respectively.

Figure 14.

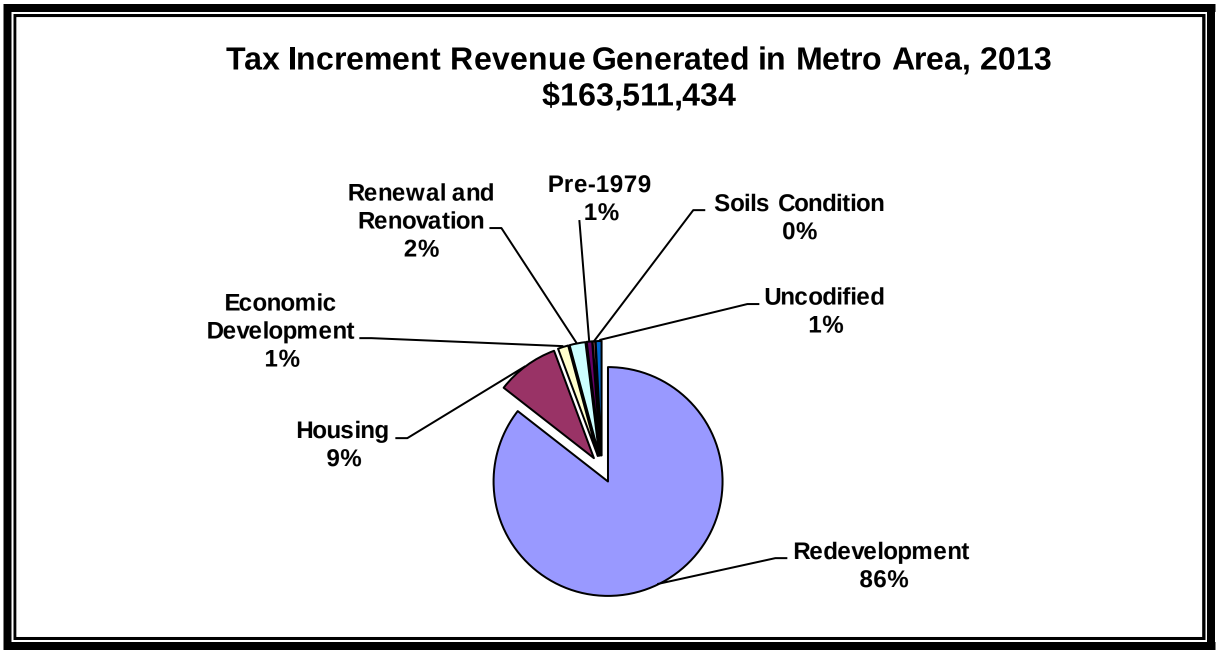


Figure 15.

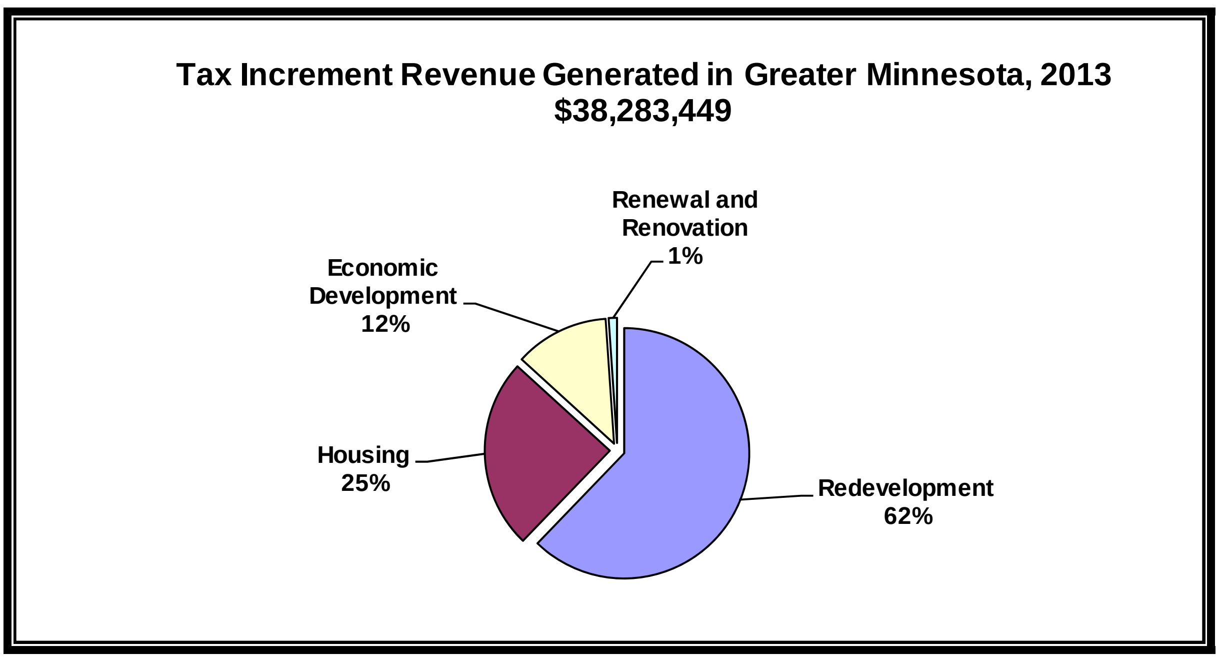
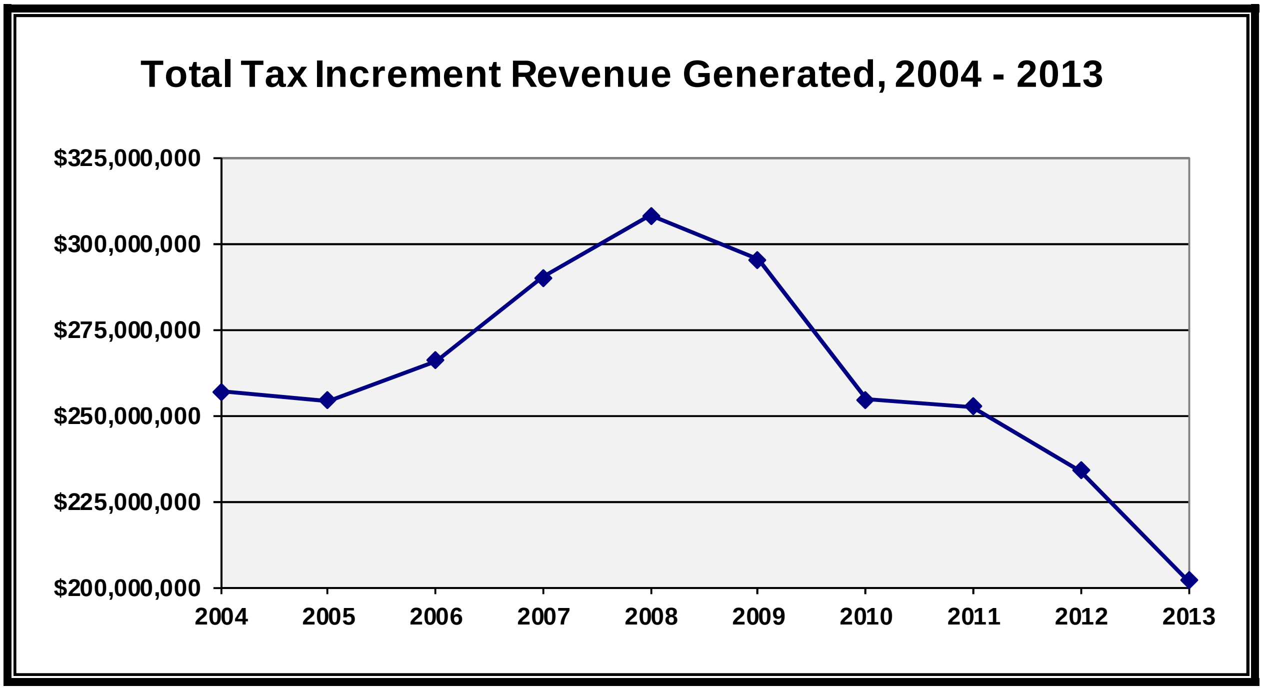


Figure 16 on the following page shows the amount of tax increment revenue generated annually over the last ten years. The trend of decreasing tax increment revenue since 2008 is largely driven by the decertification of older districts. Not only were decertifications outpacing new district certifications, but older districts were generally larger than newer districts and generated more tax increment per district.

Figure 16.



Returned Tax Increment

In 2013, development authorities returned $12,167,078 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). The amount returned in 2013 exceeded the amounts returned in 2011 and 2012 combined.

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 significant 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: [38]

- 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.[39] 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 2013, a total of just under $1.7 billion of outstanding debt was reported. PAYG obligations and GO bonds were the two debt obligations most commonly used to finance qualifying tax increment costs in 2013, with PAYG obligations making up nearly half of the debt. Of these two types of debt, only the GO bonds, secured by the municipalities' full faith and credit, may

[38] Minn. Stat. § 469.174, subd. 3.
[39] Minn. Stat. § 469.178, subd. 7.

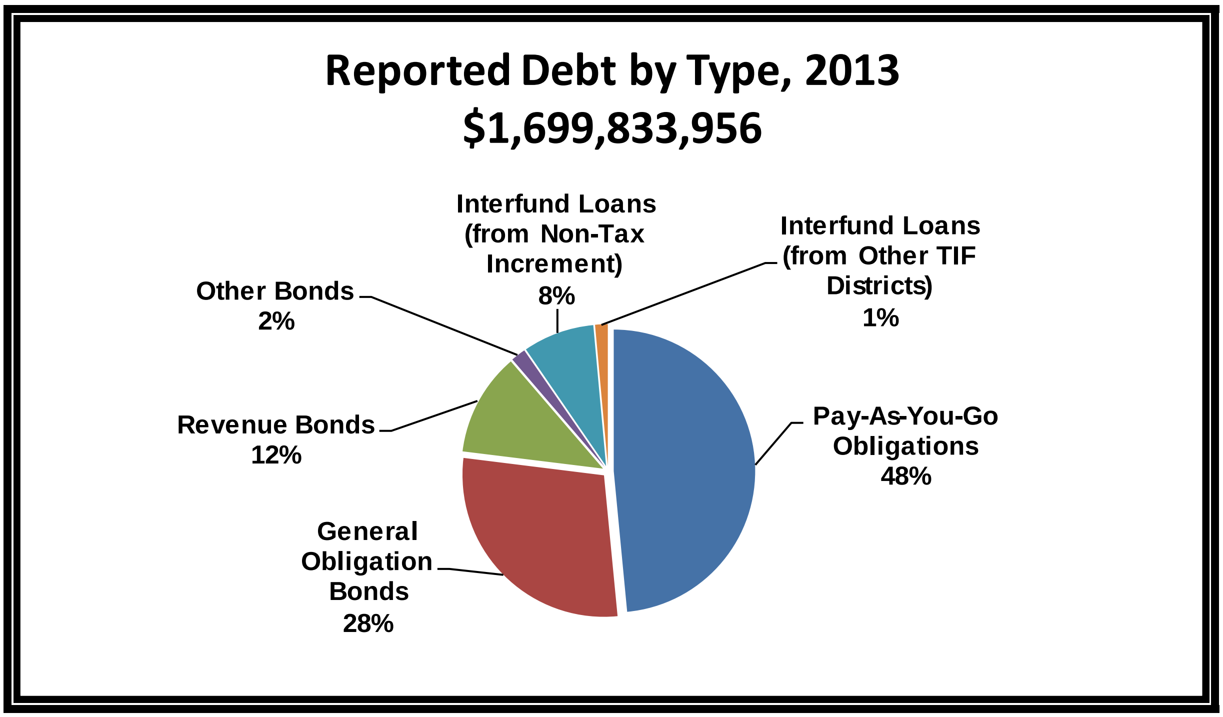
become the taxpayers' responsibility. Of the reported debt, only approximately 28 percent was secured by the municipalities' full faith and credit.

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

Figure 17.

Reported Debt by Type, 2013	
Type of Debt	**Amount Outstanding**
Pay-As-You-Go Obligations	$823,951,786
General Obligation Bonds	$484,104,692
Revenue Bonds	$199,674,366
Other Bonds	$28,963,596
Interfund Loans (from Non-Tax Increment)	$138,571,297
Interfund Loans (from Other TIF Districts)	$24,568,219
Total	$1,699,833,956

Figure 18.



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

FINDINGS AND RESPONSES

The OSA conducts informal reviews and limited formal reviews of development authorities. Generally, if an authority is not in legal compliance with the TIF Act, the Act requires the OSA to send 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.

Communication between the OSA and the development authorities often prompts resolution of issues before the OSA makes a determination of noncompliance.

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.[40] This section of the Report summarizes the TIF legal compliance reviews and investigations concluded as of December 31, 2014. Initial Notices and Final Notices were sent to the following municipality:

1. City of Blue Earth – An Initial Notice was sent on January 31, 2014. A Response from the City of Blue Earth was received on February 10, 2014. A Final Notice was sent on February 14, 2014. (Appendix B.)

Complete copies of the Initial Notices and Final Notices and the municipality's Response is provided in Appendix B.

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

Tax Increment Received After Statutory Maximum Duration

City of Blue Earth

TIF District 5-5 Seneca Foods

In the Initial Notice, the OSA found that the City improperly received $35,819.86 of tax increment revenues from TIF District 5-5 after the statutorily-required decertification date for the TIF district had passed. In its Response, the City agreed and provided documentation confirming that the City had returned $35,819.86 to the Faribault County Auditor in December 2008. In the Final Notice, the OSA acknowledged this finding was resolved and that the amount had been returned rather than spent, as had been reported.

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APPENDIX A

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STATE OF MINNESOTA
OFFICE OF THE STATE AUDITOR

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STATE AUDITOR

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1-800-627-3529 (Relay Service)

January 31, 2014

The Honorable Richard Scholtes, Mayor
The Honorable John Gartzke, Council Member
The Honorable Dan Brod, Council Member
The Honorable Glenn Gaylord, Council Member
The Honorable John Huisman, Council Member
The Honorable Chelsey Haase, Council Member
The Honorable Russ Erichsrud, Council Member
City of Blue Earth
P.O. Box 38
Blue Earth, MN 56013

Re: TIF District No. 5-5 Seneca Foods – Initial Notice of Noncompliance

Dear Mayor Scholtes and Council Members:

The Office of the State Auditor (OSA) examined the 2008 through 2012 Annual Reporting Forms filed by the City of Blue Earth (City) for Tax Increment Financing (TIF) District 5-5 Seneca Foods (TIF District 5-5), an economic development district. After reviewing information provided by the City and obtaining additional information from the Faribault County Auditor, the OSA finds that the City is not in compliance with the TIF Act.[1] This Initial Notice of Noncompliance (Initial Notice) contains the OSA's finding (Finding).

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

State law requires the City to send its Response in writing within 60 days after receipt of the Initial Notice. The Response must state whether the City accepts the OSA's Finding, in whole or in part, and the basis for any disagreement.[3] After reviewing the Response, the OSA is required to forward information on any unresolved issues to the Faribault County Attorney for review.[4]

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[1] *See* Minn. Stat. §§ 469.174 to 469.1799 inclusive, as amended.
[2] *See* Minn. Stat. § 6.715 (Information relating to an examination is confidential and/or protected nonpublic until the audit is complete); Minn. Stat. § 13.03, subdivision 4 (c) (To the extent data is sent to another government entity, the data retains the same classification.).
[3] Minn. Stat. § 469.1771, subd. 1 (c).
[4] Minn. Stat. § 469.1771, subd. 1 (b).

If the City pays to Faribault County (County) an amount equal to the amount found to be in noncompliance, the OSA will consider the Finding to be resolved. Minnesota law provides that the City will receive its proportionate share of the redistribution of the funds that have been returned to the County if the City makes the payment within 60 days after the City receives this Initial Notice.[5]

FINDING OF NONCOMPLIANCE

The OSA's finding of noncompliance regarding TIF District 5-5 is as follows:

Finding. TIF District 5-5 Seneca Foods – Tax Increment Received After Statutory Maximum Duration

The TIF Act in effect at the time TIF District 5-5 was certified required that no tax increment be paid to an authority for an economic development district after nine years from the date of the receipt of the first tax increment or after 11 years from the date of approval of the tax increment financing (TIF) plan, whichever duration is less.[6]

The TIF plan for TIF District 5-5 was approved on March 20, 1997, and TIF District 5-5 received its first tax increment in July 2000. Nine years after the date of receipt of the first tax increment is July 2009. Eleven years after the date of approval of the TIF Plan is March 20, 2008. March 20, 2008, is the lesser duration and therefore serves as the statutory duration limit for TIF District 5-5. No tax increment may be received after March 20, 2008.

TIF District 5-5 was decertified three weeks after reaching its statutory duration limit. The actual decertification date reported to the OSA was June 17, 2008. On June 20, 2008, the county auditor made a payment in the amount of $35,819.86 of tax increment to the City for TIF District 5-5.

We find that the City of Blue Earth improperly received $35,819.86 of tax increment from TIF District 5-5 after the statutory duration limit for TIF District 5-5 had been reached. An amount equal to $35,819.86 must be returned to the county auditor.

When the City provides documentation that it returned **$35,819.86** to the Faribault County Auditor, the OSA will consider this Finding resolved.

CONCLUSION

The City's Response to this Finding must be submitted in writing to the OSA within 60 days after receipt of this Initial Notice. The OSA is available to review and discuss the Finding within this

[5] Minn. Stat. § 469.1771, subd. 5.
[6] Minn. Stat. § 469.176, subd. 1b(a) (1996). Generally, a TIF district is subject to the law in effect at the time it is certified.

letter at any time during the preparation of the Response. After reviewing the Response, the OSA will issue the Final Notice.

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

Sincerely,

/s/ Jason Nord

Jason Nord
Assistant State Auditor
TIF Division Director

cc: Kathy Bailey, City Administrator

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City of
Blue Earth

the earth so rich the city grows

February 7, 2014

State of Minnesota
Office of the State Auditor
Jason Nord, TIF Division Director
Suite 500
525 Park Street
St. Paul, MN 55103-2139

Re: TIF District #5-5 Seneca Foods

Dear Mr. Nord:

As a follow-up to your letter of January 31, 2014 concerning your examination of Blue Earth TIF District No. 5-5 Seneca Foods of noncompliance. I agree with your findings of the approval date on March 20, 1997 and the first increment date of July 2000 and thereby that no increment maybe received by the City of Blue Earth following March of 2008.

In the attached Confirmation of TIF District Decertification we noted in Part A. number 4. That we had returned to the County Auditor's office $35,819.86 of excess increment and noted check # 34805. I have also pulled and attached the canceled check from that transaction.

So it is my conclusion that this will resolve your initial finding and the item will be resolved. If you should require further information, please contact myself at 507-526-7336.

Sincerely,

Kathy Bailey

Kathy Bailey
City Administrator

cc. Mayor Scholtes and Council

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STATE OF MINNESOTA
OFFICE OF THE STATE AUDITOR

REBECCA OTTO
STATE AUDITOR

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February 14, 2014

The Honorable Richard Scholtes, Mayor
The Honorable John Gartzke, Council Member
The Honorable Dan Brod, Council Member
The Honorable Glenn Gaylord, Council Member
The Honorable John Huisman, Council Member
The Honorable Chelsey Haase, Council Member
The Honorable Russ Erichsrud, Council Member
City of Blue Earth
P.O. Box 38
Blue Earth, MN 56013

Re: TIF District No. 5-5 Seneca Foods – Final Notice of Noncompliance

Dear Mayor Scholtes and Council Members:

On January 31, 2014, the Office of the State Auditor (OSA) sent the City of Blue Earth (City) an Initial Notice of Noncompliance (Initial Notice) for Tax Increment Financing (TIF) District 5-5 Seneca Foods (TIF District 5-5). The OSA received the City's response (City Response) on February 10, 2014.

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

FINDING OF NONCOMPLIANCE

One finding of noncompliance was made.

Finding. TIF District 5-5 Seneca Foods – Tax Increment Received After Statutory Maximum Duration – RESOLVED

In the Initial Notice, the OSA found that, after the statutory duration limit for TIF District 5-5 had been reached, the City of Blue Earth improperly received $35,819.86 of tax increment. In the City Response, the City agreed that no increment should have been received following the March 2008 duration limit, and confirmed that an amount equal to the increment received after the duration limit had been returned to the county in December of 2008. The City Response clarified that the returned amount, which had been received in June of 2008 but which had been reported on TIF Annual

Reporting Forms as spent rather than returned, constituted the full amount of increment received after the duration.[1] The OSA considers this finding 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: Kathy Bailey, City Administrator

[1] Although a notation on the stub of the canceled check referred to "2nd half of 2008 tax increments," the City and County agree that no second-half settlement was made for TIF District 5-5.