

**TAX INCREMENT  
FINANCING REPORT**

March 2002

# TAX INCREMENT FINANCING REPORT

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## **Tax Increment Financing Division Office of the State Auditor State of Minnesota**

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# TAX INCREMENT FINANCING REPORT

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# TAX INCREMENT FINANCING REPORT

## EXECUTIVE SUMMARY

### *Description of TIF*

Tax increment financing (TIF) is a statutory tool to promote economic development, redevelopment, and housing in areas where it otherwise would not have occurred. A TIF authority—typically a city, an entity created by a city, or an entity created by a county—“captures” the increase in net tax capacity resulting from new development within a designated geographic area called a TIF district. The TIF authority uses the tax increments, which are the property taxes paid on the captured increase in net tax capacity, to finance some or all of the TIF-eligible costs of the new development that generated the increase in net tax capacity. Frequently, the TIF authority will use some of the tax increment to finance costs outside the TIF district, which are not part of the new development that generated the increase in net tax capacity.

The property taxes on the captured net tax capacity are paid to the TIF authority rather than to the city or town, county, and school district. The school district, however, might recover some of the property tax revenue it loses to the TIF authority through an increase in state education aid payments.

### *OSA’s Role in TIF*

In the 1995 Omnibus Tax Act, the Legislature transferred authority for legal compliance oversight of all TIF districts in the state to the Office of the State Auditor (OSA). Local governments were required to file reports with the OSA for more than 2,100 TIF districts for the year ended December 31, 2000. The TIF Act authorizes the OSA to examine and audit the accounts and records of TIF authorities on a random basis to determine whether they have complied with the TIF Act. The OSA is required to provide an annual summary of its findings of noncompliance with the TIF Act and the responses to those findings by the governing bodies of the relevant municipalities. The following report is submitted to the chairs of the legislative committees with jurisdiction over tax increment financing.

### *Violations of TIF Act*

This report summarizes the findings of noncompliance made by the OSA and the municipalities’ responses. For example, the OSA made the following findings.

- **TIF authorities included parcels in TIF districts that were not entitled to be included, or for which there was no evidence that they were entitled to be included.**

The TIF Act’s “but for” test requires a municipality to find that the proposed development, in the opinion of the municipality, would not reasonably be expected to occur solely through private investment within the reasonably foreseeable future. The OSA found that a proposed development was included in a TIF district

even though it was anticipated that the proposed development would occur solely through private investment and the development did, in fact, occur solely through private investment.

As part of the process for creating a TIF redevelopment district, the TIF Act requires a municipality to set forth in writing the reasons and supporting facts for its determination that a sufficient number of structurally substandard buildings occupy parcels in the TIF district. The OSA found that a municipality did not set forth in writing the reasons and supporting facts for this finding for two redevelopment districts.

For a TIF district with a certification request date after June 30, 1995, to qualify as a soils condition district, the TIF district must contain hazardous substances, pollution, or contaminants. The OSA found that a TIF authority created a soils condition district with a certification request date after June 30, 1995, that contained none of these things.

- **TIF authorities did not follow the procedures for creating TIF districts.**

For TIF districts with certification request dates after May 1, 1988, the TIF Act requires the TIF authority to send its estimate of the fiscal and economic implications of a proposed TIF district to the county and school boards at least 30 days before public hearing on approval of the TIF plan for the new TIF district. The OSA found that a TIF authority failed to do this for three of its TIF districts with certification request dates after May 1, 1988.

For TIF districts with certification request dates after October 3, 1989, the TIF Act requires the notice of the public hearing on approval of the TIF plan for a proposed new TIF district to include a map of the district and, if tax increment will be spent on activities outside the district, a map of the project area in which tax increment will be spent. The OSA found that the public hearing notice for a TIF district with a certification request date after October 3, 1989, did not include any maps.

- **TIF authorities received tax increment from TIF districts after the statutory maximum duration limits for the districts.**

The “three-year rule” in the TIF Act requires a TIF district to be decertified unless the TIF authority performs qualifying activities within the three-year period after certification of the TIF district. The OSA found that two TIF authorities received tax increment from TIF districts after the districts should have been decertified under the “three-year rule.”

For TIF economic development districts with certification request dates before June 1, 1993, the TIF authority may not receive tax increment from the TIF district after eight years from receipt of the first tax increment or ten years from approval of the TIF plan. This report discusses the OSA’s findings that four TIF authorities received tax increment from five economic development districts after their statutory maximum duration limits. In addition, the OSA informed many other TIF authorities that they improperly received tax increment from economic development districts after their statutory maximum duration limits, and these TIF authorities voluntarily returned the tax increment.

- **TIF authorities spent tax increment on costs not eligible for payment with tax increment.**

The TIF Act requires tax increment and TIF bond proceeds from soils condition districts with certification request dates after June 30, 1995, to be spent only to pay for costs of removing or remediating hazardous substances, pollution, or contaminants; acquiring property on which the removal or remediation will take place; and administrative expenses. The OSA found that a TIF authority spent the TIF bond proceeds from a soils condition district with a certification request date after June 30, 1995, on water and sewer lines and site preparation costs.

The TIF Act prohibits spending tax increment or TIF bond proceeds on costs of constructing a city hall. The OSA found that a TIF authority spent tax increment and TIF bond proceeds on costs of constructing a city hall.

- **TIF authorities spent tax increment and TIF bond proceeds to acquire property that was not designated in the TIF plans as property the TIF authorities intended to acquire.**

The TIF Act requires a TIF plan to contain a statement as to the development program for the project, including the property within the project, if any, that the authority intends to acquire. The OSA found that four TIF authorities spent tax increment or TIF bond proceeds to acquire property that the TIF plans did not designate as property the TIF authorities intended to acquire. Furthermore, these TIF authorities did not obtain municipal approval of a TIF-plan modification designating the additional property before the property was acquired, as required by the TIF Act.

### *Statutory Issues*

In addition, this report discusses the following statutory issues.

- **Is there a need for the OSA to continue auditing and investigating to determine whether local governments that use TIF have done so in compliance with the TIF Act?**

The 2001 Senate omnibus tax bill included provisions that would have eliminated the OSA's responsibilities for auditing local governments for compliance with the TIF Act and receiving their annual TIF reports. The bill transferred responsibility for receiving the annual TIF reports back to the Department of Revenue, which had that responsibility prior to it being transferred to the OSA. The bill completely eliminated state auditing of local governments for compliance with the TIF Act.

From January 1, 1996, to date, the review of reports by OSA staff and subsequent contact with reporting local government units, plus the TIF legal compliance audits and investigations performed by OSA, have resulted in over \$3.3 million being paid or returned to county auditors voluntarily or as the result of settlement agreements with county attorneys. This amount was redistributed to the cities, towns, counties, and school districts in which the relevant TIF districts were located. In addition, the OSA's TIF enforcement activities may have prompted internal examinations that resulted in additional voluntary payments to county auditors of which the OSA is unaware.

The OSA's TIF legal compliance audits and investigations do not duplicate activities performed by independent auditors during annual audits of Minnesota cities and counties. If the OSA's TIF Division is eliminated, we will return to pre-1996 status, where local governments' uses of TIF are not subject to regular state oversight. Such a policy decision rests within the discretion of the Legislature. It is, however, the OSA's position that its oversight of TIF serves the best interests of our taxpayers and, ultimately, assists local governments in using TIF in a manner consistent with state laws.

- **Should the Legislature clarify whether the TIF Act contains a remedy for failing to create a record to establish that a TIF district met the substantive and procedural requirements for creating a TIF district?**

The OSA received a letter from the Attorney General's Office stating it had concluded that the TIF Act does not provide a remedy for a municipality's failure to set forth in writing the reasons and supporting facts for its finding that a TIF district met the "but for" test. The OSA had suggested that a remedy was provided by a provision of the TIF Act that requires the TIF authority to make a payment to the county auditor equal to the amount of tax increment the TIF authority received from any parcel or parcels that are included or retained in a TIF district but do not qualify for inclusion in a TIF district. The OSA had concluded that if the TIF authority and municipality did not follow the procedure for creating a TIF district, none of the parcels included in the TIF district qualified for inclusion. In contrast, the Attorney General's Office concluded that the failure to follow the statutory procedure for creating a TIF district, including the requirement to create a record to substantiate that the TIF district met the substantive requirements for creation, does not make the parcels unqualified for inclusion in the TIF district.

Subsequently, in a case involving the Best Buy corporate headquarters project in the City of Richfield, the Minnesota court of appeals held that if a TIF authority or municipality does not create a record to substantiate that a TIF district met the substantive requirements for creation, the creation of the TIF district is not valid. In addition, the court of appeals held that if a TIF authority retains parcels in a TIF district that was not validly created, Minnesota Statutes § 469.1771, subd. 2 applies to all of the tax increment received from parcels in the district. This case currently is on appeal to the Minnesota Supreme Court.

- **Should the Legislature amend the TIF Act (1) to expressly provide that a TIF authority may retain tax increment it receives from a TIF district after the statutory maximum duration limit of the district, (2) to clarify that the TIF Act already contains a remedy to recover tax increment received after the statutory maximum duration limit, or (3) to clarify that the remedy for recovering tax increment received after the statutory maximum duration limit already exists in statutes outside the TIF Act?**

Until it was amended in 2000, the duration limit for economic development districts was complex and frequently required an economic development district to be decertified in between the first-half and second-half settlements of a taxes-payable year. The OSA discovered many instances where TIF authorities received tax increment from economic development districts after the districts' statutory maximum duration limits. In most instances, when the OSA or the county auditor contacted the TIF authority and informed



it of the error, the TIF authority voluntarily returned the tax increment received after the statutory maximum duration limit.

When the OSA has sent findings of noncompliance on this issue to the municipalities that approved the TIF plans for the economic development districts, the municipalities have responded by stating that the TIF Act entitles their TIF authorities to retain the tax increment received after the statutory maximum duration limit.

A provision of the TIF Act requires a TIF authority to pay to the county auditor an amount equal to the amount of tax increment received by the TIF authority as a result of including or retaining parcels in a district that were not entitled to be included or retained. The last sentence of this provision states that it does not apply to tax increment received after the duration limit stated in the TIF plan. Some municipalities have stated this sentence means that their TIF authorities are entitled to retain tax increment they improperly received after the statutory maximum duration limit of the TIF district that generated the increment. The OSA disagrees.

- **Should the Legislature amend the TIF Act in response to the attorney general's conclusion that the TIF Act does not require a TIF plan to include a budget containing at least certain categories of costs set forth in the TIF Act?**

The OSA received a letter from the Attorney General's Office stating it had concluded that the TIF Act does not require a TIF plan to include a line-item budget, even though the TIF Act requires the line-item budget in the TIF plan to be reported to the OSA. The letter stated that the TIF Act requires only that the TIF plan include an estimate of the total cost of the project.

The TIF Act requires tax increment to be spent in accordance with the TIF plan. If the TIF Act does not require an enforceable budget to be included in the TIF plan, then the requirement to use tax increment in accordance with the TIF plan is difficult, if not impossible, to enforce. Furthermore, the inclusion of an enforceable budget in the TIF plan would enhance the ability of elected officials to effectively oversee and control their staff's decisions about uses of tax increment after the elected officials approve the TIF plan.

### ***TIF Reporting Statistics***

Exhibit 1, beginning on page 41 of this report, reviews the statutory reporting requirements for TIF districts and details the statistics on TIF reporting for the year ended December 31, 2000.

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# TAX INCREMENT FINANCING REPORT

## I. GENERAL INFORMATION

### A. INTRODUCTION

In the 1995 Omnibus Tax Act, the Legislature transferred authority for legal compliance oversight of all tax increment financing (TIF) districts in the state to the Office of the State Auditor (OSA). Local governments were required to file reports with the OSA for more than 2,100 TIF districts for the year ended December 31, 2000. The OSA is required to provide an annual summary of its findings of noncompliance with the Minnesota Tax Increment Financing Act and the responses to those findings by the governing bodies of the relevant municipalities.<sup>1</sup> This report is submitted to the chairs of the legislative committees with jurisdiction over tax increment financing.

### B. BACKGROUND

#### 1. What Is Tax Increment Financing?

Tax increment financing is a statutory tool to promote economic development, redevelopment, and housing in areas where it otherwise would not have occurred. A TIF authority—typically a city, an entity created by a city, or an entity created by a county—“captures” the increase in net tax capacity resulting from new development within a designated geographic area called a TIF district. The TIF authority uses the tax increments, which are the property taxes paid on the captured increase in net tax capacity, to finance some or all of the TIF-eligible costs of the new development that generated the increase in net tax capacity. Frequently, the TIF authority will use some of the tax increment to finance costs outside the TIF district, which are not part of the new development that generated the increase in net tax capacity.

The property taxes on the captured net tax capacity are paid to the TIF authority rather than to the city or town, county, and school district. The school district, however, might recover some of the property tax revenue it loses to the TIF authority through an increase in state education aid payments.<sup>2</sup>

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<sup>1</sup> Minn. Stat. § 469.1771, subd. 1(c) (2000).

<sup>2</sup> Increases in state education aid payments as a result of TIF districts’ capturing net tax capacity is a less significant issue after enactment of the 2001 omnibus tax law, which eliminated the general education levy and replaced it, in part, with a state property tax that is not captured by TIF districts. *See* Laws 1 Sp. 2001, ch. 5, art. 15, sec. 18. There are a few remaining non-voter-approved school district levies, some of which are partially equalized, so when a partially equalized levy is captured by a TIF district, state education aid payments might increase slightly. Under certain circumstances, the state will pay greater state education aids to a school district for equalization of a voter-approved bond levy than the state would otherwise pay if the TIF district were not created and the proposed development occurred anyway.

TIF is not a property tax abatement program. The owner of the property in the TIF district continues to pay the full amount of property taxes. The portion of those property taxes generated by the new development, however, is used to pay some of the development costs that the owner, developer, or local government otherwise would have paid.

Examples of TIF-eligible costs are land and building acquisition, demolition of structurally substandard buildings, removal of hazardous substances, site preparation, installation of utilities, road improvements, and construction of low- or moderate-income housing. The costs that are eligible to be paid from tax increment vary depending on the type of project created, the type of TIF district created, and the year in which the TIF district was created.

In some TIF districts, bonds are sold by the municipality or development authority at the outset of the project so that funds are available for front-end costs such as land acquisition. The bonds are then retired with tax increment revenues from the TIF district.

An alternative to bonded debt or loans, known as pay-as-you-go financing, also may be used. Under a pay-as-you-go financing arrangement, the property owner or developer pays the development costs up front and is reimbursed if, and when, tax increment is generated by the TIF district.<sup>3</sup> Generally, in a pay-as-you-go TIF district, the developer accepts the risk of failed development.<sup>4</sup> If the tax base does not increase, and tax increments are not generated as anticipated, the developer does not get paid.

In addition, some TIF authorities have borrowed from their own or their municipalities' funds to finance up-front development costs, even though the use of internal financing was not explicitly authorized by the TIF Act. In 2001, the Legislature amended the TIF Act to include interfund loans in the definition of "bonds" and ratified interfund loans made before the effective date of the amendment. *See* Laws 1 Sp. 2001, ch. 5, art. 15, sec. 3 and 21.

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<sup>3</sup> The TIF authority may use tax increment to reimburse only those costs that are TIF-eligible and that the property owner or developer actually has incurred, plus reasonable interest. The TIF authority must obtain from the developer and retain in its files documentation of the costs being reimbursed.

<sup>4</sup> Even in situations where bonds are issued or the TIF authority receives an advance of funds, TIF authorities frequently structure the financing arrangements to shift the risk of insufficient tax increment from the TIF authority to the property owner or developer.

## 2. Overview of Tax Increment Financing Act

The Minnesota Tax Increment Financing Act<sup>5</sup> (TIF Act) governs the creation and administration of TIF districts. The following is a summary of the provisions of the TIF Act:

- Minn. Stat. § 469.174 Definitions
- Minn. Stat. § 469.175 Contents of TIF plans, procedures for approving and amending TIF plans, and reporting requirements
- Minn. Stat. § 469.176 Limitations on expenditure of tax increment and maximum duration limits for TIF districts
- Minn. Stat. § 469.1761 Income requirements for housing projects
- Minn. Stat. § 469.1762 Arbitration of disputes over county costs
- Minn. Stat. § 469.1763 Pooling restrictions and the five-year rule; additional pooling authority to eliminate deficits
- Minn. Stat. § 469.1764 Ratification of pooling from 1979-82 TIF districts
- Minn. Stat. § 469.1765 Rules governing guaranty funds
- Minn. Stat. § 469.1766 Restrictions on developer payments
- Minn. Stat. § 469.177 Computation of tax increment, requirement to repay excess increment, and deduction to fund OSA enforcement function
- Minn. Stat. § 469.1771 Remedies for violations and OSA enforcement authority
- Minn. Stat. § 469.178 Tax increment bonding
- Minn. Stat. § 469.1781 Required expenditures of tax increment for a neighborhood revitalization program where certain bonds have been refunded
- Minn. Stat. § 469.1782 Provisions applicable to TIF districts with extended durations as a result of special laws
- Minn. Stat. § 469.179 Presumptions regarding the effective dates of amendments to the TIF Act
- Minn. Stat. § 469.1791 Authority to levy additional property taxes on certain property within TIF districts to eliminate deficits
- Minn. Stat. § 469.1792 Special powers to eliminate deficits
- Minn. Stat. § 469.1793 Developers obligated to continue to make payments to reimburse state aid offset after offset is repealed
- Minn. Stat. § 469.1799 TIF grants to eliminate deficits

The TIF Act has been amended frequently since its creation in 1979. A TIF district is usually governed by the laws in effect in the year in which the district was created.

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<sup>5</sup> Laws 1979, ch. 322. Initially, the TIF Act was codified at Minnesota Statutes §§ 273.71 through 273.78. In 1987, the TIF Act was recodified at Minnesota Statutes §§ 469.174 through 469.179. In 1998 and 2001, the Legislature enacted Minnesota Statutes §§ 469.1791–.1793 and 469.1799.

The TIF Act divides TIF districts into several types:

- C Pre-1979 districts
- C Redevelopment districts
- C Renovation and renewal districts
- C Soils condition districts
- C Housing districts
- C Economic development districts
- C Hazardous substance subdistricts

Each type of TIF district has different requirements for the creation of a district, different maximum duration limitations, and different restrictions on the use of tax increment from the district. In addition, uncodified legislation has authorized the creation of a wide variety of special-purpose TIF districts.

### **3. Who Uses Tax Increment Financing?**

The TIF Act authorizes TIF authorities to create TIF districts. TIF authorities include cities, housing and redevelopment authorities, port authorities, economic development authorities, municipal redevelopment agencies, and rural development financing authorities. The TIF authority takes the first step in creating a TIF district by adopting a TIF plan for the district. The TIF plan provides information about the project being funded by tax increment from the TIF district and authorizes the use of tax increment from the district to pay TIF-eligible project costs.<sup>6</sup>

### **4. Creation of TIF Districts**

To create a new TIF district, the TIF authority must obtain approval of the TIF plan for the district from the governing body of the municipality in which the TIF district is located after the municipality has published a notice and held a public hearing.<sup>7</sup> For example, if a city's port authority proposes to create a TIF district in the city, the city council must approve the TIF plan for the district. If a county's housing and redevelopment authority proposes to create a TIF district in a township in the county, the county board must approve the TIF plan.<sup>8</sup>

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<sup>6</sup> Minn. Stat. § 469.175, subd. 1 (2000).

<sup>7</sup> Minn. Stat. § 469.175, subd. 3 (2000).

<sup>8</sup> If a county's housing and redevelopment authority proposes to create a TIF district in a city, it is not clear whether the municipality that must approve the TIF plan is the city, the county, or both. *See* Minn. Stat. § 469.174, subd. 6 (2000).

Before a TIF district is created, the TIF authority must provide a copy of the proposed TIF plan and certain information about the proposed TIF district 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.<sup>9</sup> The county board and school board may comment on the proposed district, but cannot prevent the creation of the district (except that the county board may prevent creation of the TIF district if the county is the municipality that must approve the TIF plan).

Minnesota local governments' use of TIF is a controversial subject, as is evident from the frequent letters, published in newspapers around the state, criticizing or defending uses of TIF. Recently, controversies over uses of TIF have spawned litigation in Minnesota and throughout the United States.<sup>10</sup> For example, Walser Auto Sales, Inc., the City of Richfield, and the Richfield HRA engaged in litigation over the HRA's condemnation of Walser Auto Sales' property and the HRA's use of TIF in connection with the redevelopment of an area of the city as a new corporate headquarters for Best Buy.<sup>11</sup>

## 5. Statistics on Use of Tax Increment Financing

A total of 442 TIF authorities had active TIF districts for which they were required to report information to the OSA for the year ended December 31, 2000. These TIF authorities were required to file reports regarding 2,136 TIF districts. According to the information municipalities filed with the OSA, these 2,136 TIF districts consisted of the following types of TIF districts:<sup>12</sup>

Pre-1979 districts	89
Economic development districts	695
Housing districts	367
Redevelopment districts	923
Renewal and renovation districts	21
Soils condition districts	38
Districts authorized by uncodified laws	<u>3</u>
 Total	 <u><u>2,136</u></u>

<sup>9</sup> Minn. Stat. § 469.175, subd. 2 (2000).

<sup>10</sup> See, e.g., *Minneapolis Community Dev. Agency v. Opus Northwest, LLC*, 582 N.W. 2d 596 (Minn. Ct. App. 1998); J. Gibeaut, "The Money Chase," *ABA Journal*, March 1999, p. 58.

<sup>11</sup> See *Housing & Redev. Auth. in and for the City of Richfield v. Walser Auto Sales, Inc.*, 630 N.W.2d 662 (Minn. Ct. App. 2001), review granted (Minn. Sept. 25, 2001); *Walser Auto Sales, Inc. v. City of Richfield*, 635 N.W.2d 391 (Minn. Ct. App. 2001), review granted (Minn. Jan. 24, 2002).

<sup>12</sup> This is unaudited information. The OSA has determined through TIF legal compliance audits and investigations that a number of municipalities incorrectly reported the types of their TIF districts.

Over the years, the number of TIF districts created annually has fluctuated. Table 1 below lists the number of each type of TIF district grouped by the year of each TIF district’s certification request date (CRD), starting in 1990.<sup>13</sup> This unaudited information was reported by TIF authorities for the year ended December 31, 2000, and therefore does not include information about TIF districts which were decertified and not required to report for the year ended December 31, 2000.

**TABLE 1—Number of TIF Districts Created by Type and Year of Certification Request**

CRD Year	Economic Development	Housing	Redevelopment	Renewal & Renovation	Soils Condition	Total
1990	54	11	44	0	1	110
1991	22	8	17	0	1	48
1992	32	12	28	3	7	82
1993	50	13	46	3	7	119
1994	49	21	42	3	4	119
1995	63	42	53	3	7	168
1996	58	31	68	1	2	160
1997	82	35	60	4	0	181
1998	67	29	63	2	1	162
1999	52	36	49	2	1	140
2000	<u>43</u>	<u>31</u>	<u>52</u>	<u>0</u>	<u>0</u>	<u>126</u>
Total	<u>572</u>	<u>269</u>	<u>522</u>	<u>21</u>	<u>31</u>	<u>1,415</u>

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<sup>13</sup> Table 1 does not include TIF districts reported to be pre-1979 districts, mined underground space districts, districts authorized by uncodified laws, districts for which no type was reported, and districts for which no certification request date was reported. TIF districts with certification request dates before 1990 also were excluded. Many economic development districts created before 1990 were no longer required to report for the year ended December 31, 2000. Therefore, including TIF districts with certification request dates before 1990 would have created the false impression that few economic development districts were created during those earlier years.



Tables 2 and 3 below summarize unaudited financial information reported to the OSA for the year ended December 31, 2000.<sup>14</sup>

**TABLE 2—Revenues and Other Financing Sources (OFSs)**

	<b>Prior Years</b>	<b>Calendar 2000</b>	<b>Total</b>	<b>% of Total</b>
Tax increment revenue	\$2,830,075,139	\$293,370,294	\$3,123,445,433	38%
Interest on invested funds	420,927,689	29,194,462	450,122,151	5%
Bond proceeds	2,732,890,181	101,446,683	2,834,336,864	34%
Loan proceeds	185,679,538	5,508,031	191,187,569	2%
Sale/lease proceeds	223,933,432	21,377,951	245,311,383	3%
Grants	164,599,564	24,634,029	189,233,593	2%
Transfers in	474,079,856	86,693,531	560,773,387	7%
All other sources of funds	501,142,752	128,696,035	629,838,787	8%
Total of reported revenues and OFSs	<u>\$7,533,328,151</u>	<u>\$690,921,016</u>	<u>\$8,224,249,167</u>	<u>100%</u>

**TABLE 3—Expenditures and Other Financing Uses (OFUs)**

	<b>Prior Years</b>	<b>Calendar 2000</b>	<b>Total</b>	<b>% of Total</b>
Land/building acquisition	\$1,169,774,390	\$82,927,265	\$1,252,701,655	16%
Site improvement/ preparation costs	567,304,483	43,300,713	610,605,196	8%
Installation of public utilities	329,332,651	17,601,333	346,933,984	4%
Parking facilities (publicly owned)	162,012,078	6,356,781	168,368,859	2%

<sup>14</sup> The ratios in Tables 2 and 3 are rounded to the nearest percent. These tables do not include data regarding a small number of TIF districts for which the OSA had not received 2000 TIF reports as of the date of this report.

	<b>Prior Years</b>	<b>Calendar 2000</b>	<b>Total</b>	<b>% of Total</b>
Streets and sidewalks	215,656,529	11,371,732	227,028,261	3%
Social, recreational, conference facilities (publicly owned)	172,405,805	103,745,557	276,151,362	4%
Bond principal payments	1,079,200,707	85,035,804	1,164,236,511	15%
Bond interest payments	798,468,921	52,389,876	850,858,797	11%
Loan principal payments	106,716,262	56,116,619	162,832,881	2%
Loan/note interest payments	67,257,206	15,306,353	82,563,559	1%
Administrative expenses	260,267,266	18,138,354	278,405,620	4%
Transfers out	1,481,658,280	133,126,752	1,614,785,032	20%
All other uses of funds	798,068,614	51,025,700	849,094,314	11%
Total of reported expenditures and OFUs	<u>\$7,208,123,192</u>	<u>\$676,442,839</u>	<u>\$7,884,566,031</u>	<u>100%</u>

### C. STATE AUDITOR'S ROLE IN TIF

The 1995 Omnibus Tax Act transferred the responsibility for investigating and reporting whether local governments are in compliance with the TIF Act from the Department of Revenue to the OSA.<sup>15</sup> The OSA may examine and audit the accounts and records of TIF authorities on a random basis to determine whether they have complied with the TIF Act.<sup>16</sup> The 1995 act also transferred to the OSA the responsibility for collecting the information that TIF authorities and municipalities are required to report annually about their TIF districts.<sup>17</sup>

<sup>15</sup> Laws 1995, ch. 264, art. 5, sec. 34.

<sup>16</sup> Minn. Stat. § 469.1771, subd. 1(b) (2000).

<sup>17</sup> Laws 1995, ch. 264, art. 5, sec. 19 and 21. Prior to 1995, TIF authorities and municipalities reported certain statutorily required information to the Department of Revenue and other required financial information to the OSA.

In 2000, the Legislature transferred responsibility for auditing for compliance with the TIF housing district income requirements in Minnesota Statutes § 469.1761 from the Department of Revenue to the OSA.<sup>18</sup>

This change was effective for violations occurring after July 1, 2000. In 2001, the Legislature expanded the OSA's TIF oversight responsibility to include checking for compliance with Minnesota Statutes §§ 469.1791–.1793, which authorize special levies on certain property in TIF districts and special powers to eliminate deficits, or require developers to continue to make payments to reimburse the state aid offset even after the state aid offset has been repealed.<sup>19</sup>

The OSA created a TIF Division to perform the TIF enforcement and data-collection functions that the Legislature assigned to the OSA. The TIF Division began its enforcement activities on January 1, 1996. The operations of the TIF Division are funded exclusively from revenue derived by deducting a percentage of all tax increment that county auditors or treasurers distribute to TIF authorities and municipalities.<sup>20</sup> The county treasurers deduct the revenue before distributing the tax increment to the local governments, and then pay the deducted revenue to the state treasurer. The amount of revenue to fund the TIF Division will vary with the number of TIF districts and the amount of tax increment they produce.

The TIF Division currently consists of a director, eight TIF auditors, a legal analyst, and an office and administrative specialist. The TIF Division focuses on annual collection and review of TIF reports, conducting legal compliance audits and investigations, and education.

The OSA reviews all TIF reports it receives each year for substantial completeness and returns reports that are not substantially complete. Exhibit 1 to this report, beginning on page 41, reviews the statutory reporting requirements for TIF districts and details the statistics on TIF reporting for the year ended December 31, 2000.

In addition to reviewing all TIF reports for completeness, the TIF Division staff reviews the contents of many of the TIF reports each year for reporting accuracy and potential legal compliance issues. During the course of these in-depth reviews, the TIF Division staff may find situations where a TIF authority has received tax increment after the TIF district was required to be decertified or has made unauthorized expenditures of tax increment. From January 1, 1996, to date, the review of reports by the TIF Division

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<sup>18</sup> Laws 2000, ch. 490, art. 11, sec. 27.

<sup>19</sup> See Laws 2001, ch. 5, art. 15, sec. 20.

<sup>20</sup> Effective for taxes payable in 2002 and thereafter, the commissioner of revenue must calculate a new, increased TIF enforcement deduction rate for the appropriation that finances the OSA's TIF-oversight function. The new rate must be equal to the existing rate (0.25 percent) times the amount that the statewide TIF levy for taxes payable in 2002 would have been but for the class rate compression and elimination of the general education levy in Laws 1 Sp. 2001, ch. 5, divided by the actual statewide TIF levy for taxes payable in 2002. Minn. Stat. § 469.177, subd. 11 (Supp. 2001).

staff and subsequent contact with reporting local government units, plus the legal compliance audits and investigations performed by the TIF Division staff, have resulted in over \$3.3 million being paid or returned to county auditors voluntarily or as the result of settlement agreements with county attorneys. This amount was redistributed to the cities, towns, counties, and school districts in which the relevant TIF districts were located.<sup>21</sup> In addition, the OSA's TIF enforcement activities may have prompted internal examinations that resulted in additional voluntary payments to county auditors of which the OSA is unaware.

The TIF Division also has worked actively in the area of tax increment financing education on a statewide level. In June 2001, the OSA provided five workshops in four locations around the state to assist local governments with completing the TIF reports. This is the third year that the OSA has conducted workshops on TIF reporting. In September and October of 2001, the TIF Division presented a day-long seminar on tax increment financing and related economic development issues in two locations, Alexandria and Minnetonka. These seminars were attended by over 150 local government officials and staff, state employees from the executive and legislative branches, and professional TIF advisors. This is the fourth year that the OSA has conducted these day-long seminars.

Section II of this report discusses details of the various TIF legal compliance audits and investigations completed in the past year. Complete copies of the initial and final notices of noncompliance and the municipalities' responses are provided in the separately bound appendices to this report.

## **II. VIOLATIONS OF TIF ACT**

If the OSA finds that a TIF authority is not in compliance with the TIF Act, the OSA must send a notice of noncompliance to the governing body of the municipality that approved the TIF district in which the violation arose.<sup>22</sup> The notice of noncompliance provides the facts and law upon which the OSA relied in making its finding that the TIF authority is not in compliance. In addition, the notice of noncompliance informs the municipality that under some circumstances, the TIF Act requires the TIF authority to pay an amount of money to the county auditor equal to the amount of tax increment or TIF bond proceeds improperly received or spent.<sup>23</sup>

The governing body must respond in writing to the OSA within 60 days after receiving the notice of noncompliance. In its response, the municipality must state whether it accepts, in whole or in part, the OSA's findings. If the municipality does not accept any part of the findings, its response must indicate the

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<sup>21</sup> See Minn. Stat. §§ 469.176, subd. 2, and 469.1771, subd. 2 and 3 (2000). Some of the school districts that received these redistributions had their state aid decreased by the amount received from the redistributions, which resulted in a savings to the state's General Fund.

<sup>22</sup> Minn. Stat. § 469.1771, subd. 1(c) (2000).

<sup>23</sup> See Minn. Stat. § 469.1771, subd. 2 and 3 (2000).

basis for its disagreement with the findings.<sup>24</sup> The OSA must provide all information regarding unresolved findings of noncompliance to the county attorney, who may bring an action to enforce the TIF Act.<sup>25</sup>

If the county attorney does not commence an action against the TIF authority within one year after receiving a referral of a TIF notice of noncompliance from the OSA, the OSA must refer the notice of noncompliance to the attorney general.<sup>26</sup> If the attorney general finds that the TIF authority or municipality violated a provision of the TIF Act and the violation was substantial, the attorney general must commence an action in the tax court to suspend the authority of the TIF authority and municipality to use TIF.<sup>27</sup> Before commencing the action in the tax court, however, the attorney general must attempt to resolve the dispute using appropriate alternative dispute resolution procedures.<sup>28</sup> If the attorney general commences an action and the tax court finds that the TIF authority or municipality violated the TIF Act and the violation was substantial, the tax court must suspend the authority of the TIF authority and municipality to use TIF for a period of up to five years.<sup>29</sup> The enforcement mechanism involving the attorney general applies only to final notices of noncompliance issued by the OSA after December 31, 1999.<sup>30</sup>

In addition, the OSA must provide a summary of the responses it receives from the municipalities, and copies of the responses themselves, to the chairs of the legislative committees with jurisdiction over tax increment financing.<sup>31</sup> Appendices A through L of this report contain copies of notices of noncompliance and the municipalities responses regarding the cities of Albertville, Brooten, Henning, Mahtomedi, New York Mills, St. Charles, and Waubun; the Burnsville Economic Development Authority (EDA); the Columbia Heights EDA; the Lake County Housing and Redevelopment Authority (HRA); the Mounds View EDA; and the St. Cloud HRA. Appendices M, N, and O contain copies of a letter from the attorney

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<sup>24</sup> Minn. Stat. § 469.1771, subd. 1(c) (2000).

<sup>25</sup> Minn. Stat. § 469.1771, subd. 1(b) (2000). The county attorney may seek a court order requiring the TIF authority to pay an amount to the county auditor under Minnesota Statutes § 469.1771, subd. 2 or 3. A court may abate all or part of the amount that must be paid under Minnesota Statutes § 469.1771, subd. 2 or 3 if the action that violated the TIF Act was taken in good faith and making the payment would work an undue hardship on the municipality. Minn. Stat. § 469.1771, subd. 4(b) (2000).

<sup>26</sup> Minn. Stat. § 469.1771, subd. 1(d) (2000).

<sup>27</sup> Minn. Stat. § 469.1771, subd. 2b(a) (2000).

<sup>28</sup> Minn. Stat. § 469.1771, subd. 2b(b) (2000).

<sup>29</sup> Minn. Stat. § 469.1771, subd. 2b(c) (2000).

<sup>30</sup> Laws 1999, art. 10, sec. 5, 6, and 29.

<sup>31</sup> Minn. Stat. § 469.1771, subd. 1(c) (2000).

general to the OSA regarding the matters of the Cook County/Grand Marais Joint EDA, City of McGregor, and City of Lewiston and a Minnesota court of appeals decision in the litigation about the Best Buy corporate headquarters project in Richfield.<sup>32</sup> This section discusses the more significant findings, in terms of financial impact and frequency of occurrence, contained in these notices of noncompliance.

## **A. PROPERTY FAILED TO MEET QUALIFICATIONS FOR TIF DISTRICT**

### **Burnsville EDA**

On September 20, 2001, the OSA sent the Burnsville City Council a notice of noncompliance. In the notice, the OSA found that certain property included in the Burnsville Economic Development Authority's (EDA) TIF District 2-1 did not meet the "but for" test and the city council did not set forth in writing the reasons and supporting facts for its findings that the TIF district met the "but for" test. Prior to or at the time it approved the TIF plan for a new TIF district, the municipality was required to find—

[T]hat the proposed development or redevelopment, in the opinion of the municipality, would not reasonably be expected to occur solely through private investment within the reasonably foreseeable future and therefore the use of tax increment financing is deemed necessary.

Minn. Stat. § 469.175, subd. 3(2) (1990). This statutory provision is known as the "but for" test. The TIF plan contained information that indicated that a new development—construction of a refuse transfer station—would occur on property in the TIF district solely through private investment, and this proposed new development did, in fact, occur solely through private investment.

The same statute provided that the "municipality . . . shall set forth in writing the reasons and supporting facts for [its] determination" that the new TIF district met the "but for" test. Minn. Stat. § 469.175, subd. 3 (1990). In this case, the city was the municipality that approved the TIF plan for TIF District 2-1. Therefore, the city council, as the governing body of the municipality, was required to set forth in writing the reasons and supporting facts for its determination that TIF District 2-1 met the "but for" test. Neither the TIF plan nor the city council resolution approving it contained or incorporated by reference a statement by the city council of its reasons and supporting facts for its "but for" finding.

The city council's response did not dispute that an exhibit to the TIF plan for TIF District 2-1 indicated that a refuse transfer station would be constructed within the TIF district, and the uses of public funds identified in the TIF plan did not include any assistance for construction of the refuse transfer station. Instead the council's response stated—

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<sup>32</sup> The attorney general's letter and the Minnesota court of appeals decision have been included because they address statutory issues which may be of interest to the Legislature in reviewing the TIF Act.

- The city was entitled to apply the “but for” test only to part of the proposed development in TIF District 2-1, and as long as the selected part met the “but for” test, the city was free to include in the district other proposed development that did not meet the “but for” test.
- Another provision in the TIF Act made it ambiguous whether the “but for” test prohibited the city from including in TIF District 2-1 proposed development that did not meet the “but for” test.
- The city council’s finding that TIF District 2-1 met the “but for” test is conclusive.
- The city council set forth in writing its reasons and supporting facts for its finding that TIF District 2-1 met the “but for” test.
- Special legislation enacted in 1998 made TIF District 2-1 exempt from the requirement to meet the “but for” test.
- The alleged violation of the “but for” test occurred before the effective date of the applicable violation-payment statute, Minnesota Statutes § 469.1771, subd. 2.

On February 11, 2002, the OSA issued its final notice of noncompliance. The OSA reiterated its findings that the proposed development of the refuse transfer station on property in TIF District 2-1 did not meet the “but for” test and the city council did not set forth in writing the reasons and supporting facts for its finding that the TIF district met the “but for” test. The OSA based this finding on the undisputed fact that at the time of approval of TIF District 2-1’s TIF plan, there was a known, existing proposal to construct a refuse transfer station in the TIF district solely through private development and without any TIF assistance. The OSA concluded that the applicable statute provides that “proposed development” must meet the “but for” test, not merely the part of the proposed development that the city selected for application of the test; the alleged conflict between another provision of the TIF Act and the “but for” test had been eliminated by statutory amendment before TIF District 2-1 was created; the city’s response did not identify any document that set forth in writing the city council’s reasons and supporting facts for its “but for” finding; the special legislation did not exempt TIF District 2-1 from the “but for” test; and the city or EDA retained the parcel containing the privately financed refuse transfer station in TIF District 2-1 after the effective date of Minnesota Statutes § 469.1771, subd. 2. Finally, the OSA concluded that the issue of whether the conclusiveness of the city council’s “but for” finding shields the EDA and city from liability is best left to the county attorney, the attorney general, and the courts.

The OSA referred this matter to the Dakota County Attorney by letter dated February 20, 2002. Copies of the OSA’s notices of noncompliance and the city council’s response regarding this matter are included in Appendix A.

### **City of Mahtomedi**

On January 26, 2001, the OSA sent the Mahtomedi City Council a notice of noncompliance. In the notice, the OSA found that the city council did not set forth in writing the reasons and facts supporting its findings

that the parcels in TIF Districts 2 and 4 met the requirements for inclusion in a redevelopment district. The city council found that certain parcels in TIF Districts 2 and 4 were occupied by buildings that were structurally substandard. In addition to requiring these findings, the TIF Act provides that the “*municipality* . . . shall set forth in writing the reasons and supporting facts for [its] determination” that the buildings were structurally substandard. Minn. Stat. § 469.175, subd. 3 (1992) (emphasis added). Neither the TIF plans nor the resolutions that approved them set forth in writing the city council’s reasons and supporting facts for these findings.

The city council responded that it relied upon a certificate signed by the developer of property in TIF District 5 when it made this finding regarding TIF District 2, because much of the property in TIF District 2 was included in TIF District 5 after TIF District 2 was decertified. The council’s response, however, provided no documentation that indicated on its face that it was the council’s statement of reasons and supporting facts for its findings regarding TIF District 2.

The council also responded that when it found that buildings in TIF District 4 were structurally substandard, it relied on a parcel map and notes prepared by the former city administrator. The council’s response, however, provided no documentation to indicate that the map and notes were the city council’s own statement of the reasons and supporting facts for its finding.

On August 1, 2001, the OSA sent the city council a final notice of noncompliance. The OSA reiterated its finding that the city council failed to set forth in writing the reasons and supporting facts for its findings that TIF Districts 2 and 4 contained sufficient numbers of structurally substandard buildings, because the documentation provided by the city did not indicate it was the council’s statement of reasons and supporting facts.

The OSA referred this matter to the Washington County Attorney by letter dated August 13, 2001. Copies of the OSA’s notices of noncompliance and the city council’s response regarding this matter are included in Appendix B.

### **Lake County HRA**

On May 4, 2001, the OSA sent the Lake County Board of Commissioners a notice of noncompliance. In the notice, the OSA found that the Lake County Housing and Redevelopment Authority’s (HRA) TIF District 3 did not meet the applicable statutory requirements for creation of a soils condition district. In 1994, the county board found that TIF District 3 qualified as a soils condition district because of unusual terrain and bedrock soils conditions. The HRA, however, did not promptly request certification of the district. In 1995, the Legislature amended the definition of “soils condition district” to remove all references to unusual terrain and bedrock soils conditions and to require instead that the district contain hazardous substances, pollution, or contaminants. By operation of statute, this statutory amendment applied to TIF districts with certification requests after June 30, 1995. The HRA requested certification of TIF District 3 in 1996.



The county board's response agreed that the amended version of the definition of "soils condition district" applied to TIF District 3, because the HRA requested certification of the district after the amendment's effective date. In addition, the board's response agreed that TIF District 3 did not contain hazardous substances, pollution, or contaminants, which was required by the amended version of the definition.

The board, however, disagreed with the OSA's finding. The board's response stated that the finding by the county board that TIF District 3 qualified as a soils condition district correctly applied the statute in effect at the time the board made the finding, and that the TIF Act provides that the board's findings are conclusive. According to the board, this means there is a conflict of law, and under the rules of statutory interpretation, this conflict should be resolved to conclude that TIF District 3 was validly created as a soils condition district.

On November 6, 2001, the OSA sent the county board a final notice of noncompliance. The OSA reiterated its finding that TIF District 3 did not meet the applicable statutory requirements for a soils condition district. The OSA did not dispute the accuracy of the findings the county board made about unusual terrain and bedrock soils conditions in the TIF district. These findings, however, were not sufficient to qualify the TIF district as a soils condition district under the statute applicable to this district.

The OSA referred this matter to the Lake County Attorney by letter dated November 14, 2001. Copies of the OSA's notices of noncompliance, the county board's response, and certain correspondence regarding this matter are included in Appendix C.

## **B. FAILURE TO FOLLOW PROCEDURE FOR CREATING TIF DISTRICT**

### **Mounds View EDA**

On July 18, 2001, the OSA sent the Mounds View City Council a notice of noncompliance. In the notice, the OSA found that the Mounds View Economic Development Authority (EDA) did not provide members of the county board and school board the EDA's estimates of the fiscal and economic implications of TIF Districts 1, 2, and 3 before the city council approved the TIF plans for these districts, as required by the TIF Act. The EDA was unable to provide OSA audit staff with copies of the letters the EDA sent to the county and school boards in conjunction with the formation of these TIF districts.

The city council responded that subsequent city council resolutions stated that the required information had been provided to the school board and county board. The council's response further stated that these resolutions were some evidence that the required information was provided, although they were not sufficient to demonstrate that information was provided. The response did not enclose copies of the letters the EDA sent to the county and school boards in conjunction with the formation of TIF Districts 1, 2, and 3.

On November 27, 2001, the OSA sent the city council a final notice of noncompliance. The OSA reiterated its finding that the EDA did not provide the school board and county board with the EDA's

estimate of the fiscal and economic implications of TIF Districts 1, 2, and 3 before the city council approved the TIF plans for these districts, as required by the TIF Act.

The OSA referred this finding to the Ramsey County Attorney by letter dated November 27, 2001. Copies of the OSA's notices of noncompliance and the city council's response regarding this matter are included in Appendix D.

### **City of St. Charles**

On August 1, 2001, the OSA sent the St. Charles City Council a notice of noncompliance. In the notice, the OSA found that the city did not provide the county board and school board with the city's estimate of the fiscal and economic implications of TIF Districts 1 and 2 before the city council approved the TIF plans for these districts, as required by the TIF Act. In addition, the OSA found that the published notice regarding the public hearing on approval of the TIF plan for TIF District 3 did not include a map of the TIF district or a map of the project area in which the tax increment from the district may be spent, as required by the TIF Act. Finally, the OSA found that the city did not publish a notice regarding the public hearing on approval of the July 14, 1992, TIF-plan modifications for TIF Districts 1, 2, and 3, as required by the TIF Act. The city council's response agreed with these findings, but stated they were not intentional.

The OSA referred this matter to the Winona County Attorney by letter dated November 27, 2001. Copies of the OSA's notices of noncompliance and the city council's response regarding this matter are included in Appendix E.

## **C. TAX INCREMENT RECEIVED AFTER MAXIMUM DURATION LIMIT**

### **Burnsville EDA**

On September 20, 2001, the OSA sent the Burnsville City Council a notice of noncompliance. In the notice, the OSA found that the Burnsville EDA's TIF District 2-1 did not meet the "three-year rule," which requires a TIF district to be decertified if qualifying activity does not occur within the three-year period ending three years after certification of the district. The EDA reported it had spent tax increment from TIF District 2-1 only on administrative expenses and a net decrease in the fair market value of investments. When the OSA asked the EDA to identify the activities and costs that allowed TIF District 2-1 to meet the three-year rule, the EDA responded that it had obtained a right of entry onto property in the TIF district for one dollar. The OSA concluded that obtaining the right of entry did not constitute acquiring property in the TIF district.

The city council responded that the right of entry was the equivalent of an easement, an easement is property, and therefore obtaining the right of entry constituted acquiring property. The city noted that the right of entry gave the city the right to construct and maintain park and trail improvements on property in the TIF district.

On February 11, 2002, the OSA sent the Burnsville City Council a final notice of noncompliance. The OSA reiterated its finding that TIF District 2-1 did not meet the “three-year” rule. The city did not exercise its right under the right of entry to construct public improvements on property in the district and did nothing to further development of property in the district during the three-year period after certification of the district.

The OSA referred this matter to the Dakota County Attorney by letter dated February 20, 2002. Copies of the OSA’s notices of noncompliance and the city council’s response regarding this matter are included in Appendix A.

### **City of St. Charles**

On August 1, 2001, the OSA sent the St. Charles City Council a notice of noncompliance. In the notice, the OSA found that TIF District 3 did not meet the “three-year rule,” which requires a TIF district to be decertified if qualifying activity does not occur within the three-year period ending three years after certification of the district. All of the activities and costs that would have allowed TIF District 3 to meet the “three-year rule” occurred before the district was certified.

The city council responded that under the “three-year rule,” qualifying activity may occur anytime before three-years after certification of the TIF district, including activity that occurs before certification of the district. The council’s response stated that it is absurd not to allow activities occurring before a TIF district is certified to be qualifying activities for purposes of the “three-year rule,” because the TIF authority has no control over when the county auditor certifies a TIF district.

On November 26, 2001, the OSA sent the city council a final notice of noncompliance. The OSA reiterated its finding that TIF District 3 did not meet the “three-year rule,” because that statute requires qualifying activity to occur within the three-year period ending three years after certification of the district.

The OSA referred this matter to the Winona County Attorney by letter dated November 27, 2001. Copies of the OSA’s notices of noncompliance and the city council’s response regarding this matter are included in Appendix E.

### **Columbia Heights EDA**

On January 26, 2001, the OSA sent the Columbia Heights City Council a notice of noncompliance. In the notice, the OSA found the Columbia Heights Economic Development Authority (EDA) improperly received \$97,663 of tax increment from the Sullivan Lake District after the statutory maximum duration limit for the district. The Sullivan Lake District was an economic development district. According to the applicable statute, this district reached its maximum duration limit on June 15, 1997, which was ten years after approval of the TIF plan.

In its response, the city council did not dispute that the maximum statutory duration limit of this district was reached on June 15, 1997, nor did the council dispute that the EDA received \$97,663 of tax increment

from this district after June 15, 1997. Instead, the council’s response stated that approximately half of the \$97,663 of tax increment that the EDA received after June 15, 1997, was from property taxes collected by the county before June 15, 1997, and the county held those property tax proceeds in trust for the EDA and was required to distribute them to the EDA as tax increment. The council’s response stated that it was impossible for the county to distribute tax increment from the first-half property taxes for a particular taxes-payable year and not distribute tax increment from the second-half property taxes, and the Department of Revenue had advised the county that distributing a full year’s tax increment is the only practical solution. Finally, the council’s response stated that Minnesota Statutes § 469.1771, subd. 2 did not require the EDA to pay back the increment received after the maximum statutory duration limit, because that statute does not require a violation payment in the event of “a failure to decertify a district at the end of the duration limit specified in the tax increment financing plan.”<sup>33</sup>

On June 21, 2001, the OSA sent the city council a final notice of noncompliance. In the final notice, the OSA reiterated its finding that the EDA improperly received \$97,663 of tax increment from Sullivan Lake District after the statutory maximum duration limit for the district. The applicable statute provided that—

[n]o tax increment shall in any event be *paid* to the authority . . . after eight years from the date of the [first] receipt [of tax increment], or ten years from approval of the tax increment financing plan, whichever is less, for an economic development district.

Minn. Stat. § 469.176, subd. 1(e) (Supp. 1987) (emphasis added). The statute did not allow for *payment* of any tax increment to a TIF authority after the duration limit, regardless of when the property taxes were collected by the county. The county had a statutory duty to distribute in July 1997 the property taxes from the Sullivan Lake District that were collected on or before May 15, 1997. This duty, however, was to distribute the collected money as property tax revenue to the county, city, and school district, not as tax increment to the EDA. Therefore, this was not a situation where the county was required to distribute tax increment from the first-half property taxes for taxes payable in 1997 and not to distribute tax increment from the second-half property taxes.

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<sup>33</sup> It is the OSA’s position that the exception for exceeding the duration limit “specified in the tax increment financing plan” applies only to situations where the TIF authority or municipality chose to include in the TIF plan a maximum duration limit that was earlier than the otherwise applicable statutory limit. The last sentence of Minnesota Statutes § 469.1771, subd. 2 is worded as an exception to a general rule. The general rule is that section 469.1771, subd. 2 applies to any receipt of tax increment after the maximum duration limit of the TIF district. The exception applies only to the amount of tax increment received after the maximum duration limit specified in the TIF plan, but before the otherwise applicable statutory maximum duration limit. Furthermore, the OSA knows of no provision in the TIF Act that permits a TIF authority to retain tax increment that it was not entitled to receive, thereby depriving the city, county, and school district of property tax revenue they were entitled to receive.

The OSA referred this matter to the Anoka County Attorney by letter dated June 22, 2001. Copies of the OSA's notices of noncompliance and the city council's response regarding this matter are included in Appendix F.

### **St. Cloud HRA**

On May 31, 2001, the OSA sent the St. Cloud City Council a notice of noncompliance. In the notice, the OSA found the St. Cloud Housing and Redevelopment Authority (HRA) improperly received \$162,684 of tax increment from TIF District 24 and \$312,672 of tax increment from TIF District 27 after the statutory maximum duration limits for the districts. TIF Districts 24 and 27 were economic development districts. According to the applicable statute, TIF District 24 reached its maximum duration limit on September 26, 1998, and TIF District 27 reached its maximum duration limit on April 18, 1998, ten years after the approval of each district's TIF plan.

In its response, the city council did not dispute that the statutory maximum duration limit of TIF District 24 was reached on September 26, 1998, or that the statutory maximum duration limit of TIF District 27 was reached on April 18, 1998, nor did the council dispute that the EDA received \$162,684 from TIF District 24 and \$312,672 from TIF District 27 after these dates. Instead, the council stated that the county could not distribute tax increment from the first-half property taxes for a particular taxes-payable year and not distribute tax increment from the second-half property taxes, and the Department of Revenue had advised the county that distributing a full year's tax increment is the only practical solution. The council's response noted that during the 2000 session, the Legislature amended the duration limit for economic development districts to eliminate the possibility of needing to decertify a TIF district in between the first- and second-half settlement in a taxes-payable year in response to complaints about the practical difficulties of decertifying a TIF district in the middle of a taxes-payable year. Finally, the council's response stated that Minnesota Statutes § 469.1771, subd. 2 did not require the HRA to pay back the increment received after the maximum statutory duration limit, because requiring such a payment would work an undue hardship on the HRA.

On August 29, 2001, the OSA sent the city council a final notice of noncompliance. The OSA reiterated its findings that the HRA improperly received \$162,684 of tax increment from TIF District 24 and \$312,672 of tax increment from TIF District 27 after the statutory maximum duration limits for the districts.

TIF District 27 reached its statutory maximum duration limit on April 18, 1998, before the May 15, 1998, due date for the first half of property taxes payable in 1998. The HRA was not entitled to receive any tax increment from TIF District 27 from taxes payable in 1998, but it received all \$312,672 of this tax increment.

In contrast, for TIF District 24, the HRA was entitled to receive tax increment from the first-half 1998 property taxes but not from the second-half taxes. The amendment to the statutory maximum duration limit for economic development districts referenced in the council's response applies only to districts with

certification request dates after June 30, 2000.<sup>34</sup> Thus, the Legislature determined that economic development districts with earlier certification request dates, such as TIF District 24, should continue to be subject to decertification in the midst of a taxes-payable year. Finally, with regard to the council's hardship argument, the OSA noted that the TIF Act's penalty provision authorizes courts to abate all or part of a penalty if the court determines that the TIF authority acted in good faith and the penalty would impose an undue hardship on the municipality.<sup>35</sup> This provision is best addressed by the courts, since the OSA serves only as a fact finder.

The OSA referred this matter to the Stearns County Attorney by letter dated September 25, 2001. Copies of the OSA's notices of noncompliance and the city council's response regarding this matter are included in Appendix G.

### **City of Henning**

On September 18, 2001, the OSA sent the Henning City Council a notice of noncompliance. In the notice, the OSA found that through January 2, 2001, the city improperly received \$130,843 of tax increment from TIF District 1. The city and county auditor mistakenly believed TIF District 1 was a redevelopment district. The TIF plan referred to the TIF district in some places as a redevelopment district and in others as an economic development district. In the resolution approving the TIF plan, however, the city council made the findings necessary to create an economic development district, not a redevelopment district. The city received tax increment from this economic development district after its statutory maximum duration limit.

The city council responded that TIF District 1 met the substantive requirements for a redevelopment district, another TIF district created at the same time was a redevelopment district, and the county auditor had determined that TIF District 1 was a redevelopment district. Therefore, the council's response stated that TIF District 1 should be considered a redevelopment district. Nevertheless, the council's response also stated that the city would enter into an agreement with the county auditor to repay over three years the tax increment received from TIF District 1 after the statutory maximum duration limit for an economic development district, pursuant to Minnesota Statutes § 469.1771, subd. 4a. Subsequently, the city repaid to the county auditor the full amount of tax increment received after the statutory maximum duration limit.

Therefore, the OSA did not issue a final notice of noncompliance, and did not refer this matter to the county attorney. Copies of the OSA's notice of noncompliance and the city council's response regarding this matter are included in Appendix H.

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<sup>34</sup> Laws 2000, ch. 490, art. 11, sec. 25.

<sup>35</sup> See Minn. Stat. § 469.1771, subd. 4(b) (2000).

## **City of Albertville**

On September 18, 2001, the OSA sent the Albertville City Council a notice of noncompliance. In the notice, the OSA found that the city improperly received \$20,913 of tax increment from TIF District 6, an economic development district, after the district's statutory maximum duration limit. The city council responded that the city paid \$20,913 to the county auditor, and the Office of the Wright County Auditor confirmed this fact.

Therefore, the OSA did not issue a final notice of noncompliance, and did not refer this matter to the county attorney. Copies of the OSA's notice of noncompliance and the city council's response regarding this matter are included in Appendix I.

### **D. COSTS NOT ELIGIBLE FOR PAYMENT WITH TAX INCREMENT**

#### **Lake County HRA**

On May 4, 2001, the OSA sent the Lake County Board of Commissioners a notice of noncompliance. In the notice, the OSA found that the Lake County HRA improperly spent \$533,085 of TIF bond proceeds. The HRA had pledged tax increment from TIF District 3, a soils condition district, to pay debt service on the TIF bonds. Therefore, the TIF bond proceeds were subject to the same spending restrictions as TIF District 3's tax increment. Under the applicable statute, TIF District 3's tax increment could be spent only to pay for costs of removing or remediating hazardous substances, pollution, or contaminants; acquiring property on which the removal or remediation will take place; and administrative expenses. The HRA spent the TIF bond proceeds on water and sewer lines and site preparation costs. The county board responded that the expenditures of TIF bond proceeds were legal under the statute in effect when the board approved the TIF plan for TIF District 3.

On November 6, 2001, the OSA sent the county board a final notice of noncompliance. In the final notice, the OSA reiterated its finding that the HRA improperly spent \$533,085 of TIF bond proceeds, because the bond proceeds were spent on costs of installing public utilities and site improvements that were not permitted to be paid with TIF District 3's tax increment under the applicable statute. Tax increment and TIF bond proceeds from a soils condition district with a certification request date after June 30, 1995, were permitted to be spent only on costs of removing or remediating hazardous substances, pollution, or contaminants; acquiring property on which the removal or remediation will take place; and administrative expenses. The board's response did not dispute that the HRA requested certification of TIF District 3 after June 30, 1995.

The OSA referred this matter to the Lake County Attorney by letter dated November 14, 2001. Copies of the OSA's notices of noncompliance, the county board's response, and certain correspondence regarding this matter are included in Appendix C.

## City of St. Charles

On August 1, 2001, the OSA sent the St. Charles City Council a notice of noncompliance. In the notice, the OSA found that the city improperly spent \$48,597 of TIF District 3's tax increment to pay debt service on bonds. TIF District 3 was a housing district, and its tax increment could be spent only on a housing project, including administrative expenses. The bond proceeds were spent on streetscaping costs not associated with a housing project. The city council's response stated that the \$48,597 of debt service payments were made with TIF District 2's tax increment, not TIF District 3's tax increment.

On November 26, 2001, the OSA sent the city council a final notice of noncompliance. In the final notice, the OSA reiterated its finding that the city improperly spent \$48,597 of TIF District 3's tax increment to pay debt service on bonds, because the bond proceeds were spent on streetscaping costs not associated with a housing project. The council's response did not provide any documentation to demonstrate that TIF District 2's tax increment, rather than TIF District 3's tax increment, was used to make the debt service payments. The city commingled tax increment from TIF Districts 2 and 3 and spent \$48,597 of commingled tax increment on the debt service payments, thus making it impossible to determine which district's tax increment was used to make the debt service payments. The TIF Act required the city to segregate TIF District 3's tax increment from all other kinds of cash, including TIF District 2's tax increment. In addition, generally accepted accounting principles required the city to have an accounting system that would produce sufficient information that it used TIF District 3's tax increment in accordance with the TIF Act.

In the initial notice of noncompliance, the OSA also found that the city spent \$4,000 of TIF District 1's tax increment, \$6,000 of TIF District 3's tax increment, and \$107,888 of TIF bond proceeds on costs of constructing a new city hall. The TIF Act prohibits the use of tax increment and TIF bond proceeds to pay for costs of constructing a city hall.

The city responded that the new city hall contained a community center, and the tax increment and TIF bond proceeds were spent on the costs of constructing the community center, not on the costs of constructing the rest of the city hall. The council's response stated that the TIF plan and the bond documents indicated that the community center portion of the city hall would be financed with tax increment. The council's response, however, confirmed that the city's accounting records did not allow it to demonstrate whether tax increment, TIF bond proceeds, or non-increment was used to pay for the costs of constructing the portions of the city hall that were not for the community center.

In the final notice of noncompliance, the OSA reiterated its finding that the city improperly spent \$4,000 of TIF District 1's tax increment, \$6,000 of TIF District 3's tax increment, and \$107,888 of TIF bond proceeds on costs of constructing a new city hall, because the OSA could not verify that the tax increment and TIF bond proceeds were spent on costs of constructing the portions of the new city hall that were for the community center.



In addition, the OSA found in the initial notice that the city improperly spent \$222,366 of TIF District 2's tax increment and \$55,149 of TIF bond proceeds on costs not authorized by the TIF Act, such as the costs of purchasing police vehicles and an ambulance.

The council's response stated that the tax increment and TIF bond proceeds deposited in that fund were spent on TIF-eligible costs. The council's response, however, confirmed that the city's accounting records did not allow it to demonstrate whether tax increment, TIF bond proceeds, or non-increment was used to pay for costs not authorized by the TIF Act, such as the costs of purchasing police vehicles and an ambulance.

In the final notice of noncompliance, the OSA reiterated its finding that the city improperly spent \$222,366 of TIF District 2's tax increment and the \$55,149 of TIF bond proceeds on costs not authorized by the TIF Act.

The OSA referred this matter to the Winona County Attorney by letter dated November 27, 2001. Copies of the OSA's notices of noncompliance and the city council's response regarding this matter are included in Appendix E.

## **E. COSTS OF ACTIVITIES OUTSIDE VALID PROJECT AREA**

### **City of Mahtomedi**

On January 26, 2001, the OSA sent the Mahtomedi City Council a notice of noncompliance. In the notice, the OSA found that the city improperly spent \$107,123 of TIF District 1's tax increment on costs of activities outside the project area for TIF District 1. The city amended the TIF plan for TIF District 1's TIF plan to include the costs of activities outside the project area, but the city's legal counsel advised the city that it was not necessary to enlarge the project area.

The city council's response did not dispute that these tax increment expenditures were for activities outside the project area. Instead, the council's response stated that these expenditures were for activities adjacent to, and for the benefit of, property within the project area, and therefore the expenditures for activities outside the project area were the equivalent of expenditures for activities inside the project area. The council's response also stated that, for many years, bond counsel and many practitioners in the TIF area have interpreted the TIF Act to permit spending tax increment on public improvements adjacent to the project area.

On August 1, 2001, the OSA sent the city council a final notice of noncompliance. The OSA reiterated its finding that the city improperly spent \$107,123 of TIF District 1's tax increment on costs of activities outside the project area for TIF District 1, because the TIF Act provides that tax increment may be spent only on a project.

The OSA referred this matter to the Washington County Attorney by letter dated August 13, 2001. Copies of the OSA's notices of noncompliance and the city council's response regarding this matter are included in Appendix B.

### **Lake County HRA**

On May 4, 2001, the OSA sent the Lake County Board of Commissioners a notice of noncompliance. In the notice, the OSA found that the Lake County HRA improperly spent \$585,261 of TIF District 1's tax increment and \$52,729 of TIF District 2's tax increment on costs of activities outside of the valid project areas for these TIF districts.

The county board's response agreed that the HRA spent \$52,729 of TIF District 2's tax increment on costs of activities outside of the valid project area for this district, and the HRA paid \$52,729 to the county auditor. The Office of the Lake County Auditor confirmed that it received this payment from the HRA. Therefore, the OSA did not refer this finding to the county attorney.

The board's response stated that \$162,976 of TIF District 1's tax increment was spent on debt service rather than the costs of activities outside of the TIF district's project area. The board's response also stated that due to commingling of cash from different sources, it was difficult to determine which costs were paid with TIF District 1's tax increment.<sup>36</sup> The board's response stated that a significant amount of TIF District 1's tax increment might remain unspent, and the HRA would use this unspent tax increment to cover a shortfall of revenue needed to pay debt service on bonds.

On November 6, 2001, the OSA sent the county board a final notice of noncompliance. The OSA stated that there was sufficient documentation to demonstrate that \$105,000 of TIF District 1's tax increment was spent on debt service rather than the costs of activities outside of the TIF district's project area. Therefore, the OSA reduced the amount of the finding from \$585,261 to \$480,261. The OSA reiterated its finding that this amount of TIF District 1's tax increment was spent on costs of activities outside of the TIF district's project area. In addition, the OSA stated that even if the HRA had accounting records to demonstrate that some of this \$480,261 of TIF District 1's tax increment remained unspent, the unspent cash would be excess tax increment. Spending this allegedly unspent tax increment on the bonds with a shortfall of revenue to pay them, as the HRA indicated it intended to do, would violate the restrictions on the use of excess tax increment.

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<sup>36</sup> The board's response suggested that the OSA was in part responsible for this problem, since the county maintained the HRA's accounting records, and the OSA annually audited the county. The OSA notes that a local government's annual financial audit, whether conducted by the OSA's Audit Practice Division or privately employed auditors, will not determine compliance with the TIF Act. Auditing for compliance with the TIF Act falls outside the scope of the annual audit requirements.

The OSA referred this matter to the Lake County Attorney by letter dated November 14, 2001. Copies of the OSA's notices of noncompliance, the county board's response, and certain correspondence regarding this matter are included in Appendix C.

## **F. COSTS NOT AUTHORIZED IN TIF PLAN**

### **City of Waubun**

On August 10, 2000, the OSA sent the Waubun City Council a notice of noncompliance. In the notice, the OSA found that the city improperly spent \$110,500 of Downtown Redevelopment District 1's TIF bond proceeds on land acquisition and \$15,000 on site improvement/preparation costs, because the TIF-plan budget did not authorize a specific amount for these kinds of expenditures. The OSA also noted that the TIF plan did not designate any property that the city intended to acquire.

The city council's response stated (1) the TIF Act did not require the city to include specific budget amounts for categories such as land/building acquisition and installation of public utilities, (2) the city made a good faith effort to comply with the law, and (3) the TIF plan designated the property to be acquired. The council's response also made reference to an amended 1998 TIF Authority Report for Downtown Redevelopment District 1, which the OSA received from the city on September 11, 2000. The amended report indicated that the city spent only \$10,000 on land acquisition rather than the amount the city previously had reported. The OSA sent the council a letter requesting documentation to substantiate the expenditures of tax increment and TIF bond proceeds reported in the amended 1998 TIF Authority Report. In response, the council sent the OSA copies of a ledger and bank statements for the city's TIF district account.

On April 2, 2001, the OSA sent the city council a final notice of noncompliance. The OSA reiterated its finding that the city improperly spent \$110,500 of Downtown Redevelopment District 1's TIF bond proceeds on land acquisition, because the TIF plan stated that the city did not intend to acquire any property. The OSA noted that the documentation provided by the city did not demonstrate that the city spent less than \$110,500 of TIF bond proceeds on land acquisition. The OSA withdrew the finding regarding expenditures for unbudgeted site improvement/preparation costs after further research and reviewing the city's response.

The OSA referred this matter to the Mahnomens County Attorney by letter dated April 3, 2001. Copies of the OSA's notices of noncompliance and the city council's response regarding this matter are included in Appendix J.

### **City of Mahtomedi**

On January 26, 2001, the OSA sent the Mahtomedi City Council a notice of noncompliance. In the notice, the OSA found that the city improperly spent \$87,703 of TIF District 1's tax increment to acquire land, because the TIF-plan budget did not include an amount for land acquisition and the TIF plan did not designate the property acquired as property that the city intended to acquire. The OSA also found that the city improperly spent tax increment on other unbudgeted categories of costs.

The city council responded that the TIF Act does not require a TIF plan to include a budget containing specific line items, such as land acquisition. The council's response did not dispute that the city used tax increment to acquire property that the TIF plan did not designate as property the city intended to acquire. Instead, the city stated that the TIF plan included an amount for "Southwest Park Improvements," and the cost of acquiring the property was included in this category of estimated project costs.

On August 1, 2001, the OSA sent the city a final notice of noncompliance. The OSA reiterated its finding that the city improperly spent \$87,703 of TIF District 1's tax increment to acquire property that the TIF plan did not designate as property the city intended to acquire. The OSA withdrew the findings regarding expenditures for other unbudgeted categories of costs after further research and reviewing the city's response.

The OSA referred this matter to the Washington County Attorney by letter dated August 13, 2001. Copies of the OSA's notices of noncompliance and the city council's response regarding this matter are included in Appendix B.

### **Mounds View EDA**

On July 18, 2001, the OSA sent the Mounds View City Council a notice of noncompliance. In the notice, the OSA found that the EDA spent \$1,165,046 of TIF District 1's tax increment and \$125,771 of TIF District 2's tax increment to acquire property that the TIF plans for these districts did not designate as property the EDA intended to acquire.

The city council responded that text in the original and modified TIF plans described the kind of property that the EDA intended to acquire to meet the goals stated in the project plan and the acquired parcels fit this description. Therefore, according to the council's response, the acquisition of the parcels was authorized in the TIF plan.

On November 27, 2001, the OSA sent the city council a final notice of noncompliance. The OSA reiterated its findings that the EDA improperly spent \$1,165,046 of TIF District 1's tax increment and \$125,771 of TIF District 2's tax increment to acquire property that the TIF plans did not designate as property the EDA intended to acquire. The original TIF plan and modified TIF plans designated the specific property within the project that the EDA intended to acquire by listing the parcel identification numbers or street addresses of the property. In contrast, the original and modified TIF plans did not designate the parcels at issue in this finding by parcel identification number, street address, boundaries, legal description, or any other means that would allow a reader of the TIF plan to know that the EDA intended to acquire that specific property. The statements in the project plan of the EDA's goals and objectives and the description of the kinds of property that the EDA intended to acquire to attain those goals and objectives did not designate the property within the project, if any, that the EDA intended to acquire; it merely informed a reader of the plan that the EDA intended to acquire property. If the EDA decided to

acquire property not previously designated in the TIF plan, it was required to obtain municipal approval of a TIF-plan modification designating the additional property.<sup>37</sup> The EDA did not do so.

The OSA referred this finding to the Ramsey County Attorney by letter dated November 27, 2001. Copies of the OSA's notices of noncompliance and the city council's response regarding this matter are included in Appendix D.

### **City of St. Charles**

On August 1, 2001, the OSA sent the St. Charles City Council a notice of noncompliance. In the notice, the OSA found that the city improperly spent \$43,548 of TIF District 2's tax increment to acquire property that the TIF plan did not designate as property the city intended to acquire.

The city council responded that the TIF plan provided that the city would acquire land to accomplish certain objectives and the city needed the property it acquired to accomplish these objectives. Therefore, according to the council's response, the acquisition of the property was authorized in the TIF plan.

On November 26, 2001, the OSA sent the city council a final notice of noncompliance. The OSA reiterated its finding that the city improperly spent \$43,548 of TIF District 2's tax increment to acquire property that the TIF plan did not designate as property the city intended to acquire. The original and modified TIF plan for TIF District 2 did designate specific property within the project that the city intended to acquire by listing the parcel identification numbers. In contrast, the original and modified TIF plan did not designate parcels at issue in this finding by parcel identification number, street address, boundaries, legal description, or any other means that would allow a reader of the TIF plan to know that the city intended to acquire those specific properties.

The OSA referred this matter to the Winona County Attorney by letter dated November 27, 2001. Copies of the OSA's notices of noncompliance and the city council's response regarding this matter are included in Appendix E.

### **City of New York Mills**

On October 13, 2000, the OSA sent the New York Mills City Council a notice of noncompliance. In the notice, the OSA found that the city improperly spent tax increment on unbudgeted administrative expenses and transfers out. The budgets in the TIF plans included amounts for certain categories of costs, but not for administrative expenses or transfers out. The city council's response stated that the TIF plans contained budget amounts for administrative expenses and that the transfers out reported by the city never occurred.

The OSA withdrew these findings after further research and reviewing the city's response. Consequently, the OSA did not refer this matter to the county attorney. Copies of the OSA's notice of noncompliance,

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<sup>37</sup> See Minn. Stat. § 469.175, subd. 4(a) (2000).

the city council's response, and the OSA's letter withdrawing the findings in this matter are included in Appendix K.

### **City of Brooten**

On December 26, 2000, the OSA sent the Brooten City Council a notice of noncompliance. In the notice, the OSA found that the city improperly spent \$19,947 of tax increment from TIF Districts 1, 2, and 6-1 on costs the TIF plans stated would be paid with grant proceeds rather than tax increment. The OSA also found that the city or its housing and redevelopment authority improperly spent tax increment on unbudgeted interest and site improvement costs.

The city council did not dispute that the TIF plans did not authorize the city to use tax increment to pay these costs. Instead, the council's response provided documentation that, according to the council, demonstrated that certain of these costs were paid with grant proceeds rather than tax increment. The council's response also stated that the TIF Act did not require the city to include in the TIF plan specific budget amounts for categories such as interest and site improvements costs.

On April 23, 2001, the OSA sent the city council a final notice of noncompliance. The OSA reduced the amount of the finding regarding paying grant-eligible costs with tax increment from \$19,947 to \$15,232 based on a reexamination of the city's records of receipts and disbursements for the fund into which tax increment and grant proceeds were deposited. The OSA reiterated its finding for this lesser amount, because the documents enclosed with the council's response demonstrated only that the city applied for a grant to pay these costs, and the grant proceeds were received after the costs had been paid with tax increment. The OSA withdrew the findings regarding expenditures for unbudgeted interest and site improvement costs after further research and reviewing the city's response.

The OSA referred this matter to the Stearns County Attorney by letter dated April 24, 2001. Copies of the OSA's notices of noncompliance and the city council's response regarding this matter are included in Appendix L.

## **G. EXCESS TAX INCREMENT**

### **City of Mahtomedi**

On January 26, 2001, the OSA sent the Mahtomedi City Council a notice of noncompliance. In the notice, the OSA found that the city received \$521,119 of excess tax increment from TIF District 1. When the city received TIF District 1's tax increment from the first-half property taxes for taxes payable in 1989, a portion of this tax increment exceeded the amount necessary to pay all remaining costs authorized by the TIF plan. The city continued to receive tax increment from TIF District 1. The city modified the TIF plan for TIF District 1 a number of times to increase the costs authorized by the plan, but it was not until a June 12, 1995, modification that the city increased the costs authorized in the TIF plan sufficiently to cause subsequently received tax increment not to be excess tax increment. In the meantime, the city had received \$521,119 of excess tax increment, which the city was permitted to use only (1) to prepay any outstanding

bonds, (2) to discharge any pledge of tax increment to such bonds, (3) to pay into an escrow account dedicated to the payment of such bonds, or else the city was required to return the excess tax increment to the county auditor to be redistributed. The city did none of these things with this excess tax increment.

The city council's response stated that as long as all of the project costs authorized in the TIF plan had not yet been paid, the city had a right to amend the TIF plan to increase the authorized project costs and to spend previously received tax increment on those project costs. The council's response also stated that the city, not the language of the applicable statute, should determine whether excess tax increment existed. Finally, the council's response questioned the OSA's inclusion of non-tax increment revenue received by TIF District 1 in its analysis.

On August 1, 2001, the OSA sent the city council a final notice of noncompliance. The OSA reiterated its finding that the city received \$521,119 of excess tax increment from TIF District 1. While the city had the right to amend the TIF plan to increase the project costs, any such amendment was not retroactive in effect. The statute regarding excess tax increment provides that the determination of whether excess tax increment exists is made in every year of the existence of a TIF district, not when all of the authorized project costs have been paid. The OSA included non-tax increment revenue received by TIF District 1 in its analysis because the statute does not require non-tax increment revenue to be excluded. If, as occurred here, the TIF district had sufficient cash from tax increment and non-tax increment sources dedicated to the project to pay all remaining costs authorized by the TIF plan, then any tax increment received after that point in time exceeded the amount necessary to pay costs authorized by the tax increment financing plan.

The OSA referred this matter to the Washington County Attorney by letter dated August 13, 2001. Copies of the OSA's notices of noncompliance and the city council's response regarding this matter are included in Appendix B.

### **City of St. Charles**

On August 1, 2001, the OSA sent the St. Charles City Council a notice of noncompliance. In the notice, the OSA found that the city received \$8,405 of excess tax increment from TIF District 1. By December 31, 1987, TIF District 1 had sufficient cash to pay all costs authorized in the district's TIF plan. On April 30, 1990, the city modified the TIF plan to substantially increase the total authorized costs. In the meantime, the city had received \$8,405 of excess tax increment, which the city was permitted to use only (1) to prepay any outstanding bonds, (2) to discharge any pledge of tax increment to such bonds, (3) to pay into an escrow account dedicated to the payment of such bonds, or else the city was required to return the excess tax increment to the county auditor to be redistributed. The city did not use this excess tax increment to prepay these bonds or to pay into an escrow account dedicated to pay these bonds, and the bonds have been paid in full in accordance with their payment schedule. Therefore, the only permitted use of this excess tax increment would be to return it to the county auditor.

The city council's response did not dispute that throughout the period from December 31, 1987, through April 29, 1990, TIF District 1 had sufficient public funds to pay all remaining costs authorized by the TIF

plan. Instead, the council's response stated that the city could have amended the TIF plan to increase the costs that the TIF plan authorized to be paid, and therefore until the city determined that there were no more public redevelopment activities to undertake, there is no excess tax increment. According to the council's response, the TIF Act gives a TIF authority the power to determine when there is excess tax increment.

On November 26, 2001, the OSA sent the city council a final notice of noncompliance. The OSA reiterated its finding that the city received \$8,405 of excess tax increment from TIF District 1. While the city had the right to amend the TIF plan to increase the project costs, any such amendment was not retroactive in effect. The statute regarding excess tax increment provides that the determination of whether excess tax increment exists is made in every year of the existence of a TIF district, not when all of the authorized project costs have been paid.

The OSA referred this matter to the Winona County Attorney by letter dated November 27, 2001. Copies of the OSA's notices of noncompliance and the city council's response regarding this matter are included in Appendix E.

## **H. FAILURE TO SEGREGATE TAX INCREMENT**

### **City of St. Charles**

On August 1, 2001, the OSA sent the St. Charles City Council a notice of noncompliance. In the notice, the OSA found that the city failed to segregate tax increment received from two TIF districts in special accounts on the city's official books and records, as required by the TIF Act. From 1984 through 1989, the city recorded that tax increment from TIF Districts 1 and 2 and cash from other sources were deposited in Funds 303 and 402. The city's ledger coding system did not identify which expenditures from Funds 303 and 402 were made with TIF District 1's tax increment, TIF District 2's tax increment, or non-tax increment. Consequently, the OSA was not able to verify that the expenditures of TIF District 1's and TIF District 2's tax increment from Funds 303 and 402 were made in compliance with the TIF Act.

The city council responded that according to the court in the *Nielsen v. City of Roseville* case, the City of St. Charles did not violate the TIF Act by failing to segregate TIF District 1's tax increment from TIF District 2's tax increment. In the *Nielsen* case, a federal trial court addressed the issue of the burden of proof in a lawsuit brought by a citizen against a city.

On November 26, 2001, the OSA sent the city council a final notice of noncompliance. The OSA reiterated its finding that the city failed to segregate TIF District 1's tax increment from TIF District 2's tax increment. Generally accepted accounting principles require the city's accounting system to be structured to produce documentation that demonstrates which costs were paid and which were not paid with each



district's tax increment in order to be able to demonstrate compliance with the TIF Act.<sup>38</sup> The OSA was not able to verify that the expenditures of TIF District 1's and TIF District 2's tax increment from Funds 303 and 402 were made in compliance with the TIF Act due to the commingling of tax increment in those funds. The OSA concluded that determining whether Minnesota courts will agree with the federal trial court's interpretation of Minnesota's TIF Act in the *Nielsen* case, and if so, how they would apply that interpretation to the facts of this case, are issues that are best addressed by the county attorney and the courts.

The OSA referred this matter to the Winona County Attorney by letter dated November 27, 2001. Copies of the OSA's notices of noncompliance and the city council's response regarding this matter are included in Appendix E.

### III. STATUTORY ISSUES

Through municipalities' responses to notices of noncompliance and questions received from city and county officials and employees, the OSA has identified certain issues regarding the TIF Act. This report to the legislative committees with jurisdiction over TIF identifies some of these issues in order to facilitate public policy discussion and allow for legislative action.<sup>39</sup>

#### A. NEED FOR CONTINUED TIF OVERSIGHT BY OSA

The 2001 Senate omnibus tax bill included provisions that would have eliminated the OSA's responsibilities for auditing local governments for compliance with the TIF Act and receiving their annual TIF reports. The bill transferred responsibility for receiving the annual TIF reports back to the Department of Revenue, which had that responsibility prior to it being transferred to the OSA. The bill completely eliminated state auditing of local governments for compliance with the TIF Act.

From January 1, 1996, to date, the review of reports by the TIF Division staff and subsequent contact with reporting local government units, plus the legal compliance audits and investigations performed by the TIF Division staff, have resulted in over \$3.3 million being paid or returned to county auditors voluntarily or as the result of settlement agreements with county attorneys. This amount was redistributed to the cities, towns, counties, and school districts in which the relevant TIF districts were located.<sup>40</sup> In addition, the

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<sup>38</sup> See Governmental Accounting Standards Board's Codification of Accounting and Financial Reporting Standards as of June 30, 2000, §§ 1100.101 and 1200.106.

<sup>39</sup> The OSA's *Tax Increment Financing Reports* to the Legislature in prior years contain discussions of additional ambiguities and conflicting statutory interpretations.

<sup>40</sup> See Minn. Stat. §§ 469.176, subd. 2, and 469.1771, subd. 2 and 3 (2000). Some of the school districts which received these redistributions had their state aid decreased by the amount received from the redistributions, which resulted in a savings to the state's General Fund.

OSA's TIF enforcement activities may have prompted internal examinations that resulted in additional voluntary payments to county auditors of which the OSA is unaware.

The OSA's TIF legal compliance audits and investigations do not duplicate activities performed by independent auditors during annual audits of Minnesota cities and counties.<sup>41</sup> The Minnesota Legal Compliance Audit Guide for Local Governments does not require independent auditors to check for compliance with the TIF Act; this function is performed solely by the OSA's TIF auditors.

If the OSA's TIF Division is eliminated, we will return to pre-1996 status, where local governments' uses of TIF are not subject to regular state oversight. Such a policy decision rests within the discretion of the Legislature. It is, however, the OSA's position that its oversight of TIF serves the best interests of our taxpayers and, ultimately, assists local governments in using TIF in a manner consistent with state laws.

## **B. REMEDY FOR FAILING TO FOLLOW PROCEDURES FOR CREATING TIF DISTRICTS**

As discussed in the OSA's 2001 TIF Report to the Legislature, the OSA sent a notice of noncompliance to the Cook County Board of Commissioners regarding the Cook County/Grand Marais Joint Economic Development Authority's (Joint EDA) TIF districts. The OSA found that the county board did not set forth in writing the reasons and supporting facts for its findings that two of the Joint EDA's TIF districts met the "but for" test, as required by the TIF Act.<sup>42</sup>

The OSA referred the findings of noncompliance to the Cook County Attorney, who declined to commence an action against the Joint EDA. The OSA then referred the finding of noncompliance to the attorney general, as the OSA is required to do under Minnesota Statutes § 469.175, subd. 1(d).

In an April 26, 2001, letter, the Attorney General's Office informed the OSA that it agreed that the county board had not complied with the TIF Act by failing to set forth in writing the reasons and supporting facts for its finding, but that the TIF Act does not provide a remedy for this violation of the TIF Act. The OSA had suggested that a remedy was provided by a provision of the TIF Act which requires the TIF authority to make a payment to the county auditor equal to the amount of tax increment the TIF authority received from any parcel or parcels that are included or retained in a TIF district but do not qualify for inclusion in a TIF district.<sup>43</sup> The OSA had concluded that if the TIF authority and municipality did not follow the procedure for creating a TIF district, none of the parcels included in the TIF district qualified for inclusion.

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<sup>41</sup> Regardless of whether the independent auditor performing an annual audit is a private CPA firm or the OSA's Audit Practice Division, the scope of the annual audit does not include checking for compliance with the TIF Act.

<sup>42</sup> See Minn. Stat. § 469.175, subd. 3 (1990).

<sup>43</sup> See Minn. Stat. § 469.1771, subd. 2 (2000).

In contrast, the Attorney General's Office concluded that the failure to follow the statutory procedure for creating a TIF district, including the requirement to create a record to substantiate that the TIF district met the substantive requirements for creation, does not make the parcels unqualified for inclusion in the TIF district. A copy of the letter from the Attorney General's Office regarding this matter is included in Appendix M.

Subsequently, in a case involving the Best Buy corporate headquarters project in the City of Richfield, the Minnesota Court of Appeals held that if a TIF authority or municipality does not create a record to substantiate that a TIF district met the substantive requirements for creation, the creation of the TIF district is not valid.<sup>44</sup> In addition, the court of appeals held that if a TIF authority retains parcels in a TIF district that was not validly created, Minnesota Statutes § 469.1771, subd. 2 applies to all of the tax increment received from parcels in the district.<sup>45</sup> A copy of the court's decision is included in Appendix N.

The OSA brings these facts to the Legislature's attention to allow it to consider clarifying whether Minnesota Statutes § 469.1771, subd. 2 applies to a situation where the TIF authority and municipality have not created a record to substantiate that a TIF district met the substantive requirements for creation, and if this statute does not apply, whether the TIF Act should be amended to provide a remedy if a TIF authority or municipality does not create such a record. The OSA also requests that the Legislature consider whether the TIF Act already contains or should contain a remedy for failure to follow other procedural requirements for the creation of a TIF district, such as the requirement to publish a notice containing maps of the TIF district and project area before the public hearing on approval of a TIF plan.

### **C. REMEDY FOR TAX INCREMENT RECEIVED AFTER STATUTORY MAXIMUM DURATION LIMIT**

Until it was amended in 2000, the duration limit for economic development districts was complex and frequently required an economic development district to be decertified in between the first-half and second-

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<sup>44</sup> *Walser Auto Sales, Inc. v. City of Richfield*, 635 N.W.2d 391 (Minn. Ct. App. 2001), *review granted* (Minn. Jan. 24, 2002).

<sup>45</sup> Under the TIF Act, the findings made by a municipality when approving a TIF plan are conclusive. Minn. Stat. § 469.175, subd. 3 (2000). The court of appeals did not address whether the conclusiveness of the municipality's findings preclude a plaintiff from obtaining equitable relief or money damages based on a TIF authority's ongoing receipt of tax increment from retention of parcels in an improperly created TIF district under Minnesota Statutes § 469.1771, subd. 2. In contrast, the court held that the conclusiveness of the municipality's findings does *not* preclude a plaintiff from obtaining equitable relief or money damages for a TIF authority's improper expenditures of tax increment under Minnesota Statutes § 469.1771, subd. 3. *Walser Auto Sales, Inc. v. City of Richfield*, 635 N.W.2d 391, 399, n. 4 (Minn. Ct. App. 2001), *review granted* (Minn. Jan. 24, 2002).

half settlements of a taxes-payable year.<sup>46</sup> The OSA discovered many instances where TIF authorities received tax increment from economic development districts after the districts' statutory maximum duration limits. In most instances, when the OSA or the county auditor contacted the TIF authority and informed it of the error, the TIF authority voluntarily returned the tax increment received after the statutory maximum duration limit.<sup>47</sup>

When the OSA has sent findings of noncompliance on this issue to the municipalities that approved the TIF plans for the economic development districts, certain municipalities have responded by stating that the TIF Act entitles their TIF authorities to retain the tax increment received after the statutory maximum duration limit.

The disagreement between these municipalities and the OSA involves the meaning of the last sentence of the following provision of the TIF Act:

If an authority includes or retains a parcel of property in a tax increment financing district that does not qualify for inclusion or retention within the district, the authority must pay to the county auditor an amount of money equal to the increment collected from the property for the year or years. The property must be eliminated from the original and captured tax capacity of the district effective for the current property tax assessment year. *This*

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<sup>46</sup> For economic development districts with certification request dates after July 31, 1979, and before June 1, 1993, the statutory maximum duration limit was eight years from receipt of the first tax increment or ten years from approval of the TIF plan, whichever was earlier. *See, e.g.*, Minn. Stat. § 273.75, subd. 1 (1980). For economic development districts with certification request dates after May 31, 1993, and before July 1, 2000, the statutory maximum duration limit is nine years from receipt of the first tax increment or ten years from approval of the TIF plan, whichever is earlier. *See, e.g.*, Minn. Stat. § 469.176, subd. 1b(a)(4) (1998). The duration limit measured from first receipt of tax increment is extended through the end of the taxes-payable year, but the duration limit measured from approval of the TIF plan is not. For economic development districts with certification request dates after June 30, 2000, the statutory maximum duration limit is simply eight years from receipt of the first tax increment from the district. Laws 2000, ch. 490, art. 11, sec. 25.

<sup>47</sup> The following TIF authorities voluntarily returned tax increment received from an economic development district after its statutory maximum duration limit after being informed of the error by the OSA or the county auditor: the Battle Lake Housing and Redevelopment Authority and the cities of Alexandria, Apple Valley, Aurora, Cokato, Detroit Lakes, Foley, Hayfield, Hector, Luverne, Mankato, Moorhead, Northfield, Red Lake Falls, Rice, Staples, and Waite Park. Because these TIF authorities voluntarily returned the tax increment, the OSA did not make a finding of noncompliance. In addition, the cities of Faribault, Henning, and Albertville repaid tax increment received after the statutory maximum duration limit after the OSA made a finding of noncompliance.

*subdivision does not apply to a failure to decertify a district at the end of the duration limit specified in the tax increment financing plan.*

Minn. Stat. § 469.1771, subd. 2 (2000) (emphasis added).

According to the municipalities, the “duration limit specified in the tax increment financing plan” can be, and often is, the same as the statutory maximum duration limit, and therefore this provision of the TIF Act does not apply to tax increment received after the statutory maximum duration limit. These municipalities conclude that because this provision of the TIF Act does not apply to tax increment received after the statutory maximum duration limit, their TIF authorities are entitled to retain tax increment received after the statutory maximum duration limit.

Minnesota Statutes § 469.1771, subd. 2 used to say that it did not apply to tax increment received after the statutory maximum duration limit, but the Legislature amended the provision to say otherwise:

If an authority includes or retains a parcel of property in a tax increment financing district that does not qualify for inclusion or retention within the district, the authority must pay to the county auditor an amount of money equal to the increment collected from the property for the year or years. The property must be eliminated from the original and captured tax capacity of the district effective for the current property tax assessment year. This subdivision does not apply to a failure to decertify a district ~~required by~~ at the end of the duration limit under section 469.176, subd. 1 limit specified in the tax increment financing plan.

Laws 1991, ch. 291, art. 10, sec. 14. The duration limit specified in the TIF plan and the statutory maximum duration limit (*i.e.*, the limit under section 469.176, subd. 1) are not always the same. TIF authorities sometimes provide in a TIF plan that the duration limit for a TIF district will be shorter than the statutory maximum duration limit, and the municipality that approves a TIF plan can require a shorter duration limit than the otherwise applicable statutory maximum duration limit.<sup>48</sup>

During the 2000 session, legislation was introduced that would have protected the Chanhassen Economic Development Authority (EDA) from having to pay back tax increment the EDA received from one of its

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<sup>48</sup> Minn. Stat. § 469.176, subd. 1(a) (2000).

economic development districts after the district's statutory maximum duration limit.<sup>49</sup> Instead, the Legislature enacted the following statute to assist the Chanhassen EDA and other similarly situated TIF authorities in repaying the tax increment they received after the statutory maximum duration limits of their TIF districts:

- (a) This subdivision applies to payments made by the county auditor as tax increments that:
  - (1) were received by the authority before July 1, 2000, for a tax increment financing district after the maximum duration limit for the district; and
  - (2) were not permitted to be made under section 469.176, subdivision 1f, or any other provision of law as tax increments after the duration limit of the district.
- (b) The authority or the municipality may enter an agreement with the county to repay these amounts in installments, without interest, over a period not to exceed three years.
- (c) If a repayment agreement is entered or the authority or municipality otherwise voluntarily repays the amounts, then distributions of these repayments under subdivision 5 must be made to each of the taxing jurisdictions, including the municipality.

Minn. Stat. § 469.1771, subd. 4a (2000). If TIF authorities such as the Chanhassen EDA are not required to repay tax increment they have received after the statutory maximum duration limit for one of their TIF districts, then there was no purpose served by enacting Minnesota Statutes § 469.1771, subd. 4a.

The OSA brings these facts to the Legislature's attention to allow it the opportunity to review the relevant statutes and determine whether it wishes (1) to expressly adopt the municipalities' view that a TIF authority is entitled to retain tax increment it receives from a TIF district after the statutory maximum duration of a

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<sup>49</sup> As discussed in the OSA's 2001 TIF Report to the Legislature, the OSA found that the Chanhassen EDA received \$711,168 of tax increment from TIF District 2-1, an economic development district, after 10 years from approval of the TIF plan, which was the statutory maximum duration limit for the TIF district. If the statutory maximum duration limit for TIF District 2-1 had been eight years from the receipt of the first tax increment from the TIF district, the Chanhassen EDA would have received this \$711,168 of tax increment *before* the statutory maximum duration limit. Bills were introduced that would have *retroactively* amended the duration limit for economic development districts to be eight years from receipt of the first tax increment, instead of the earlier of eight years from receipt of the first tax increment or ten years from approval of the TIF plan. See H.F. 3835 (Feb. 23, 2000); S.F. 3492 (Feb. 24, 2000). The Legislature amended the duration limit for economic development districts to be eight years from receipt of the first tax increment, but it did so prospectively rather than retroactively, so the amendment does not apply to the Chanhassen EDA's TIF District 2-1. See Laws 1990, ch. 490, art. 11, sec. 25.

TIF district, (2) to clarify that the TIF Act already includes a remedy for recovering tax increment received after the statutory maximum duration limit, or (3) to clarify that the remedy for recovering tax increment received after the statutory maximum duration limit already exists in statutes outside the TIF Act.

#### **D. NO REQUIREMENT TO INCLUDE LINE-ITEM BUDGET IN TIF PLANS**

As discussed in the OSA's 2001 TIF Report to the Legislature, the OSA sent a notice of noncompliance to the McGregor City Council regarding one of the city's TIF districts. The TIF plan for the district listed a variety of categories of costs as "alternative expenditures," but did not provide any specific budget amount for each of these categories of costs. Instead, the TIF plan included only an estimate of the total cost of the project.

The same report discussed a notice of noncompliance the OSA sent to the Lewiston City Council regarding two of the city's TIF districts. The TIF plans for these districts discussed costs that would be paid with tax increment, such as waterlines, sanitary sewers, storm drainage, property acquisition, clearance activities, landscape and lighting, related site improvements, and development of a neighborhood park, but did not provide any specific budget amount for each of these categories of costs. Instead, each TIF plan included only an estimate of the total cost of the project.

The OSA found that these cities violated the TIF Act by not including in the TIF plan a budget that contained at least certain categories of costs, based on the following statute:

For the reporting period and for the duration of the district, *the amount budgeted under the tax increment financing plan*, and the actual amount expended *for, at least, the following categories*:

- (i) acquisition of land and buildings through condemnation or purchase;
- (ii) site improvements or preparation costs;
- (iii) installation of public utilities or other public improvements;
- (iv) administrative costs, including the allocated cost of the authority[.]

Minn. Stat. § 469.175, subd. 6(c)(4) (1988) (emphasis added). The OSA concluded that the line-item budget was required to be included in the TIF plan because the city could not comply with the requirement to report the line-item budget in the TIF plan unless the TIF plan included the budget.

The OSA referred the findings of noncompliance to county attorneys, who declined to commence an action against the cities. The OSA then referred the findings of noncompliance to the attorney general, as the OSA is required to do under Minnesota Statutes § 469.175, subd. 1(d).

In letters dated August 29, 2001, and December 10, 2001, the Attorney General's Office informed the OSA it had concluded that the TIF Act does not require a TIF plan to include a line-item budget, even though the TIF Act requires the line-item budget in the TIF plan to be reported to the OSA. The letter stated that the TIF Act requires only that the TIF plan include an estimate of the total cost of the project,<sup>50</sup> and the TIF plan for this district included that estimate. Copies of the letters from the Attorney General's Office regarding these matters are included in Appendix O.

The TIF Act requires tax increment to be spent in accordance with the TIF plan.<sup>51</sup> If the TIF Act does not require an enforceable budget to be included in the TIF plan, then the requirement to use tax increment in accordance with the TIF plan is difficult, if not impossible, to enforce. Furthermore, the inclusion of an enforceable budget in the TIF plan would enhance the ability of elected officials to effectively oversee and control their staff's decisions about uses of tax increment after the elected officials approve the TIF plan. It is questionable whether a budget included in a TIF plan is legally enforceable if the TIF plan is not required to include such a budget.

The OSA brings these facts to the Legislature's attention to allow it to consider whether the TIF Act should be amended to include specific, enforceable requirements for the contents of a TIF plan. If the Legislature determines that the TIF Act should not require a TIF plan to include amounts budgeted for the categories of costs identified in the TIF Act, the OSA requests that the Legislature repeal the requirement to report the amount budgeted in the TIF plan for these categories.

#### IV. CONCLUSION

The TIF Division may be contacted at the following addresses and telephone/fax numbers:

Office of the State Auditor  
Tax Increment Financing Division  
505 Spruce Tree Centre  
1600 University Ave. W.  
St. Paul, MN 55104  
Telephone: (651) 642-0767  
Fax: (651) 642-0769  
email: [tifdivision@osa.state.mn.us](mailto:tifdivision@osa.state.mn.us)

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<sup>50</sup> See Minn. Stat. § 469.175, subd. 1(5)(i) (Supp. 2001).

<sup>51</sup> Minn. Stat. § 469.176, subd. 4 (2000).



The TIF Division's staff is available to answer questions you may have relating to TIF. Please feel free to contact any of our staff at the telephone numbers listed below.

Bill Connors, TIF Division Director	(651) 642-0837
Marsha Pattison, Office and Administrative Specialist	(651) 642-0767
Matthew Gaetz, Legal Analyst	(651) 643-2132
Hassan Bastani	(651) 642-0775
Thomas Carlson	(651) 642-0824
Lisa McGuire	(651) 642-0815
Kurt Mueller	(651) 642-0832
Suk Shah	(651) 642-0719
James Silen	(651) 642-0823
David Stallworth	(651) 642-0892
Linda Thomas	(651) 642-0836

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## EXHIBIT 1

### Statistics on TIF Reporting for Year Ended December 31, 2000

The TIF Act requires TIF authorities to file annual reports with the OSA about their TIF districts.<sup>52</sup> This reporting requirement applies to all TIF districts regardless of when they were created. TIF authorities must submit the required information to the OSA on or before August 1 of each year. In addition to filing TIF reports, a TIF authority must publish certain statutorily required financial information about each of its TIF districts in a newspaper of general circulation on or before August 15 of each year.<sup>53</sup>

In 1998, the Legislature enacted Minnesota Statutes § 469.1771, subd. 2a, which establishes a procedure for tax increment to be withheld by the county auditor if the TIF authority or municipality fails to file reports containing the required TIF information, or a copy of the annual disclosure statement, by the statutory deadline.<sup>54</sup> The withheld tax increment will be released and distributed whenever substantially complete TIF reports eventually are filed. These changes were effective starting with the TIF reports and annual disclosure statement that were required to be filed in 1999.<sup>55</sup>

A total of 442 TIF authorities had TIF districts for which they were required to file TIF reports with the OSA for the year ended December 31, 2000, which were due by August 1, 2001. These TIF authorities were required to file reports for 2,136 TIF districts.

The OSA returns TIF reports that are not substantially complete and treats them as not filed. Of the 442 TIF authorities with TIF districts for which reporting was required, 269 had substantially complete TIF reports for all their TIF districts and copies of their annual disclosure statements filed with the OSA by the August 1, 2001, deadline.<sup>56</sup> In addition, 82 TIF authorities had at least some of the required TIF reports filed with the OSA by the August 1, 2001, deadline, but either (1) not all of the required reports

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<sup>52</sup> See Minn. Stat. § 469.175, subd. 6 (2000).

<sup>53</sup> See Minn. Stat. § 469.175, subd. 5 (2000).

<sup>54</sup> See Laws 1998, ch. 389, art. 11, sec. 8.

<sup>55</sup> Laws 1998, ch. 389, art. 11, sec. 29.

<sup>56</sup> The percentage of TIF authorities with substantially complete 2000 TIF reports for all their TIF districts filed by the August 1, 2001, deadline was 60.9 percent. In comparison, the percentage of TIF authorities with substantially complete 1999 TIF reports for all their TIF districts filed by the August 1, 2000, deadline was 69.7 percent, the percentage of TIF authorities with substantially complete 1998 TIF reports for all their TIF districts filed by the August 2, 1999, deadline was 70.4 percent, and the percentage of TIF authorities with substantially complete 1997 TIF reports for all their TIF districts filed by the July 1, 1998, deadline, was 42.4 percent.

were filed, (2) not all of the required reports were substantially complete, or (3) the copy of the annual disclosure statement was not filed by the deadline.<sup>57</sup>

In contrast, the following 91 TIF authorities had no reports for their TIF districts filed with the OSA by the August 1, 2001, deadline:

Bagley HRA	Garrison, City of	Montrose, City of
Barnum, City of	Grand Meadow, City of	Mountain Lake, City of
Baxter, City of	Grant County HRA	Nashwauk, City of
Benson, City of	Hayfield, City of	New Brighton, City of
Blooming Prairie, City of	Hector, City of	North Branch, City of
Blue Earth, City of	Henning, City of	Olivia EDA
Browns Valley, City of	Hinckley, City of	Parkers Prairie, City of
Byron, City of	Howard Lake, City of	Pillager, City of
Cannon Falls, City of	Hutchinson, City of	Plainview, City of
Carver, City of	Isanti, City of	Racine, City of
Cass County HRA	Jordan, City of	Renville, City of
Cass Lake, City of	Kasson, City of	Rogers, City of
Centerville, City of	Kellogg, City of	Sacred Heart, City of
Claremont, City of	La Crescent, City of	St Francis, City of
Coleraine, City of	La Prairie, City of	St Joseph, City of
Cologne, City of	Lake Benton, City of	St Martin, City of
Coon Rapids, City of	Lanesboro, City of	Sartell, City of
Crookston, City of	Le Roy, City of	Shorewood, City of
Dexter, City of	Lewiston, City of	Sleepy Eye, City of
Dodge Center, City of	Lino Lakes, City of	Spicer, City of
Dundas, City of	Mabel, City of	Spring Lake Park, City of
East Grand Forks, City of	Madison, City of	Starbuck, City of
Eden Valley, City of	Mahnomen, City of	Tower, City of
Edgerton, City of	Manhattan Beach, City of	Verndale, City of
Elysian, City of	Maple Grove, City of	Virginia, City of
Fisher, City of	Maple Plain, City of	Wabasha, City of
Freeport EDA	Montgomery EDA	Wabasso, City of

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<sup>57</sup> The percentage of TIF authorities without substantially complete 2000 TIF reports for all their TIF districts, but which filed something by the August 1, 2001, deadline was 18.6 percent. In comparison, the percentage of TIF authorities without substantially complete 1999 TIF reports for all their TIF districts, but which filed something by the August 1, 2000, deadline was 9.2 percent, the percentage of TIF authorities without substantially complete 1998 TIF reports for all their TIF districts, but which filed something by the August 2, 1999, deadline was 15.0 percent. The percentage of TIF authorities without substantially complete 1997 TIF reports for all their TIF districts, but which filed something by the July 1, 1998, deadline was 34.7 percent.

Waldorf, City of  
Waseca, City of  
Watertown, City of  
Waubun, City of

Wells, City of  
Willmar, City of  
Windom, City of

Winthrop, City of  
Woodbury, City of  
Yellow Medicine Cty EDA

On August 15, 2001, the OSA mailed notices to 179 TIF authorities informing them that the OSA had not received substantially complete 2000 TIF reports for one or more of their TIF districts as of August 1, 2001, and that tax increment from those districts would be withheld pursuant to Minnesota Statutes § 469.1771, subd. 2a.

As of November 20, 2001, the OSA had not yet received substantially complete 2000 TIF reports for certain TIF districts from the following 41 TIF authorities:

Baxter, City of  
Big Lake, City of  
Browns Valley, City of  
Cass Lake, City of  
Centerville, City of  
Cold Spring, City of  
Coleraine, City of  
Cologne, City of  
Coon Rapids, City of  
Dodge Center, City of  
Dundas, City of  
Edgerton, City of  
Elysian, City of  
Fisher, City of

Glencoe, City of  
Hills, City of  
Hutchinson, City of  
Kasson, City of  
Kellogg, City of  
Lake Benton, City of  
Lake County HRA  
LeSueur EDA  
Lewiston, City of  
Madison, City of  
Manhattan Beach, City of  
Maple Lake, City of  
Montgomery EDA  
Oakdale, City of

Parkers Prairie, City of  
Renville, City of  
Sacred Heart, City of  
St. Francis, City of  
Sauk Centre, City of  
Shorewood, City of  
Sleepy Eye, City of  
Starbuck, City of  
Virginia, City of  
Wahkon, City of  
Waldorf, City of  
Waseca, City of  
Yellow Medicine Cty EDA

Consequently, on November 21, 2001, the OSA mailed notices to county auditors to withhold tax increment that otherwise would have been distributed to these 41 TIF authorities from the identified TIF districts.

As of February 28, 2002, the following 20 TIF authorities had not filed substantially complete 2000 TIF reports for certain TIF districts:

Baxter, City of  
Browns Valley, City of  
Coleraine, City of  
Cologne, City of  
Dundas, City of  
Edgerton, City of  
Elysian, City of

Fisher, City of  
Lake Benton, City of  
Lake County HRA  
LeSueur EDA  
Lewiston, City of  
Madison, City of  
Maple Lake, City of

Oakdale, City of  
Shorewood, City of  
Starbuck, City of  
Virginia, City of  
Waldorf, City of  
Yellow Medicine Cty EDA

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