HOUSE RESEARCH | Short Subjects

Joel Michael **Updated: October 2010**

Tax Increment Financing

What is TIF?

Tax increment financing (TIF) uses the increased property taxes that a new real estate development generates to finance costs of the development. In Minnesota, TIF is used for two basic purposes:

- To induce or cause a development or redevelopment that otherwise would not occur—e.g., to convince a developer to build an office building, retail, industrial, or housing development that otherwise would not be constructed. To do so, the increased property taxes are used to pay for costs (e.g., land acquisition or site preparation) that the developer would normally pay.
- To finance public infrastructure (streets, sewer, water, or parking facilities) that are related to the development. In some cases, the developer would be required to pay for this infrastructure through special assessments or other charges. In other cases, all taxpayers would pay through general city taxes.

How does TIF work?

When a new TIF district is created, the county auditor certifies (1) the current net tax capacity (i.e., property tax base) of the TIF district and (2) the local property tax rates. As the net tax capacity of the district increases, the property taxes (i.e., the "tax increment") paid by this increase in value is dedicated and paid to the development authority. The tax increment is limited to the tax derived from the certified tax rate. Increases in value that generate increment may be caused by construction of the development or by general inflation in property values. The authority uses the increment to pay qualifying costs (e.g., land acquisition, site preparation, and public infrastructure) that it has incurred for the TIF project.

How is TIF used to pay "upfront" development costs?

There is a mismatch between when most TIF costs must be paid—at the beginning of a development—and when increments are received—after the development is built and begins paying higher property taxes. Three basic financing techniques are used to finance these upfront costs:

- **Bonds.** The authority or municipality (city or county) may issue its bonds to pay these upfront costs and use increment to pay the bonds back. Often, extra bonds are issued to pay interest on the bonds ("capitalizing" interest) until increments begin to be received.
- **Interfund loans.** In some cases, the authority or city may advance money from its own funds (e.g., a development fund or sewer and water fund) and use the increments to reimburse the fund.
- **Pay-as-you-go financing.** The developer may pay the costs with its own funds. The increments, then, are used to reimburse the developer for these costs. This type of developer financing is often called "pay-as-you-go" or "pay-go" financing.

What governmental units can use TIF?

Minnesota authorizes development authorities to use TIF. These authorities are primarily housing and redevelopment authorities (HRAs), economic development authorities (EDAs), port authorities, and cities. In addition, the "municipality" (usually the city) in which the district is located must approve the TIF plan and some key TIF decisions. TIF uses the property taxes imposed by all types of local governments. But the school district and county, the two other major entities imposing property taxes, are generally limited to providing comments to the development authority and city on proposed uses of TIF. The state-imposed tax on commercial-industrial and seasonal-recreational properties is not captured by TIF.

What is the but-for test?

Before an authority may create a TIF district, it and the city must make "but-for" findings that (1) the development would not occur without TIF assistance and (2) that the market value of the TIF development will be higher (after subtracting the value of the TIF assistance) than what would occur on the site, if TIF were not used.

What types of TIF districts may be created?

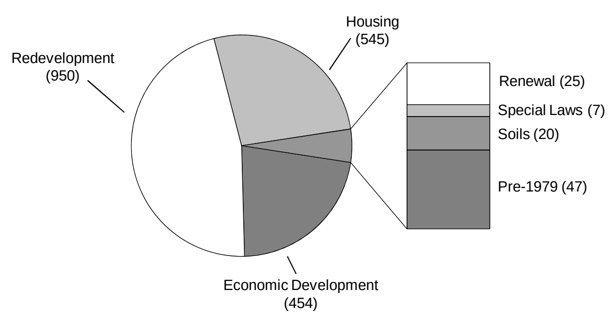
Minnesota allows several different types of TIF districts. The legal restrictions on how long increments may be collected, the sites that qualify, and the purposes for which increments may be used vary with the type of district.

District type	Use of Increment	Maximum duration
Redevelopment	Redevelop blighted areas	25 years
Renewal and renovation	Redevelop areas with obsolete uses, not meeting blight test	15 years
Economic development	Encourage manufacturing and other footloose industries	8 years
Housing	Assist low- and moderate-income housing	25 years
Soils	Clean up contaminated sites	20 years
Compact development	Redevelop commercial areas with more dense developments	25 years

How many TIF districts exist?

According to the 2010 report of the Office of State Auditor (OSA), there were 2,048 active TIF districts in 2008. The graph shows the relative shares by type of district.

TIF Districts by Type in 2008
(2,048 districts)



Source: 2010 Report of the State Auditor

For more information: Contact legislative analyst Joel Michael at 651-296-5057. Also see the House Research web site for more information on TIF at www.house.mn/hrd/issinfo/tifmain.htm.

The Research Department of the Minnesota House of Representatives is a nonpartisan office providing legislative, legal, and information services to the entire House.

House Research Department | 600 State Office Building | St. Paul, MN 55155 | 651-296-6753 | www.house.mn/hrd/hrd.htm

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TIF 101

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1

What is TIF?

Tax Increment Financing (TIF):

The ability to capture and use most of the increased local property tax revenues from new development within a defined geographic area for a defined period of time without approval of the other taxing jurisdictions.

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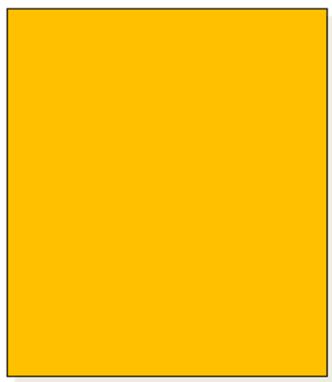
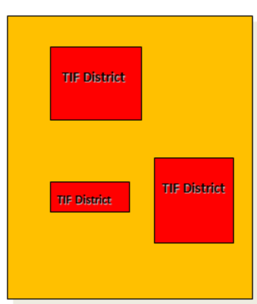
Project Area: Where Increment may be Spent

Project Area



- TIF Districts must be located in a Project Area or Development District
- Multiple TIF Districts can be in a Project Area
- “Pooled increment” can be spent outside District in Project Area

TIF District: Where Increment is Collected



- Defines parcels whose increased value will be captured
- Parcels do not have to be contiguous, but usually are
- Must meet criteria in State law for type of District being established

Building Blocks of TIF

The original ('base") market value established when District created

Tax revenues continue to go to all local governments

Original Tax Capacity

Building Blocks of TIF

TIF District "captures" increased value from new development

Development occurs = New Tax Capacity

Original Tax Capacity

TIF = Captured Tax Capacity x Local Tax Rate

TIF District Approval

- Can be established by City, County, HRA or EDA
- TIF Plan and Project Area Plan
  - State policy objectives
  - Provide maximum budget authority for TIF revenues and expenditures
- Must have approval of elected officials following public hearing

Types of Districts

- Redo substandard / obsolete buildings
  - Redevelopment TIF District
  - Renovation and Renewal TIF District
- Affordable housing
  - Housing TIF District
- Job and tax base creation
  - Economic Development TIF District

Redevelopment District

- Parcels consisting of 70% of area must be improved
  - Improved area equals 15% area of parcel
- More than 50% of buildings must be substandard
- 90% of TIF used to correct redevelopment issues
- Reasonable distribution of conditions
- 25 years maximum duration

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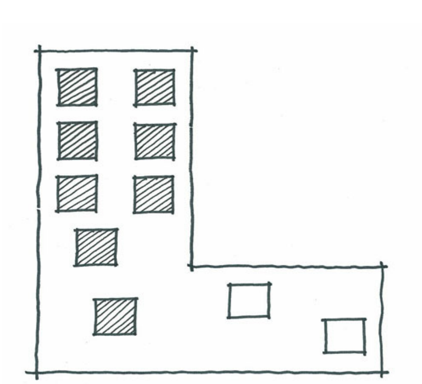
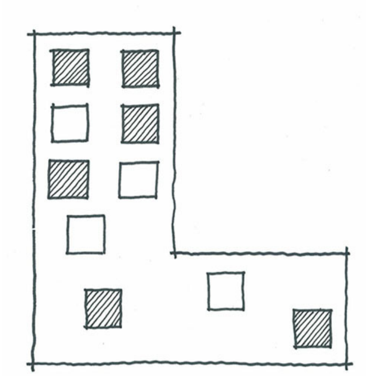
Reasonable Distribution



80% Substandard buildings
80% Coverage



60% Substandard buildings
80% Coverage

10

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Renewal and Renovation

- Parcels consisting of 70% of area is improved
- 20% of buildings are structurally substandard
- 30% of other buildings require substantial renovation or clearance
  - To remove inadequate street layout, incompatible uses or land use relationships, overcrowding of buildings, excessive dwelling unit density, obsolete buildings not suitable for improvement or conversion, etc.

- 15 years maximum duration

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Housing District

- Affordable Housing - Income test is main qualification
  - TIF law references federal rules on income limitations
  - More liberal rules on pooling
- 100% tax increment used for affordable housing; 20% of project's value can be used for commercial/ industrial development

25 years maximum duration

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Economic Development

- At least 85% of new building space must be:
    - Manufacturing
    - Warehousing, storage, distribution
    - Research and development
    - Telemarketing

8 years maximum duration

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“But For” Test

- The development is only possible ***but for*** the use of tax increment
- Elected body has to make this finding

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Gap Analysis

- *How much* assistance is needed?
  - *Pro forma* Analysis
  - Cost comparison of raw land vs. developed land

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How can increment be spent?

•Must meet policy objectives in TIF Plan

•Must be in TIF Plan Budget

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How Can Increment be Spent?

- Must Be Costs Associated with New Development
  - Land Acquisition
  - Demolition and Relocation
  - Site improvements
  - Utilities, Streets, Sidewalks
  - Environmental Clean-up
  - Parking
  - Buildings (only for housing districts)

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