

STATE OF MINNESOTA

Office of the State Auditor



**Rebecca Otto
State Auditor**

TAX INCREMENT FINANCING LEGISLATIVE REPORT

**TIF Reports for the Year Ended December 31, 2010
TIF Audits Concluded for the Year Ended December 31, 2011**

Description of the Office of the State Auditor

The mission of the Office of the State Auditor is to oversee local government finances for Minnesota taxpayers by helping to ensure financial integrity and accountability in local governmental financial activities.

Through financial, compliance, and special audits, the State Auditor oversees and ensures that local government funds are used for the purposes intended by law and that local governments hold themselves to the highest standards of financial accountability.

The State Auditor performs approximately 160 financial and compliance audits per year and has oversight responsibilities for over 3,300 local units of government throughout the state. The office currently maintains five divisions:

Audit Practice - conducts financial and legal compliance audits for local governments;

Government Information - collects and analyzes financial information for cities, towns, counties, and special districts;

Legal/Special Investigations - provides legal analysis and counsel to the Office and responds to outside inquiries about Minnesota local government law; as well as investigates allegations of misfeasance, malfeasance, and nonfeasance in local government;

Pension - monitors investment, financial, and actuarial reporting for approximately 730 public pension funds; and

Tax Increment Financing - promotes compliance and accountability in local governments' use of tax increment financing through financial and compliance audits.

The State Auditor serves on the State Executive Council, State Board of Investment, Land Exchange Board, Public Employee's Retirement Association Board, Minnesota Housing Finance Agency, and the Rural Finance Authority Board.

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TAX INCREMENT FINANCING LEGISLATIVE REPORT

TIF Reports for the Year Ended December 31, 2010
TIF Audits Concluded for the Year Ended December 31, 2011



February 1, 2012

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TAX INCREMENT FINANCING REPORT

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EXECUTIVE SUMMARY

Current Trends

- In calendar year 2010, development authorities returned **\$17,189,994** in tax increment revenue to the county auditor for redistribution to the city, county, and school district as property taxes. (p. 13)
- Thirty-nine TIF districts were certified in Minnesota during calendar year 2010, while 147 TIF districts were decertified. (p. 16)
- In 2010, 34 percent of the total number of TIF districts were located in the Metro Area; 66 percent were located in Greater Minnesota. However, 82 percent of the tax increment revenue generated in 2010 was from districts located within the Metro Area. (p. 13)
- In 2010, development authorities were given temporary expanded authority under the Jobs Stimulus Program to use tax increment in ways not previously authorized. As of the date of this Report, the OSA has received TIF plans for 31 economic development districts created, and 35 spending plans have been submitted to the OSA under the Jobs Stimulus Program. (pgs. 22 and 23)

Long-Term Trends

- The total number of TIF districts certified between 2006 and 2010 decreased by 57 percent. (p. 15)
- During the five-year period between 2006 and 2010, the number of economic development districts certified decreased by 57 percent. The number of housing districts certified decreased by 67 percent. The number of redevelopment districts certified decreased by 46 percent. (p. 15)
- Over the ten-year period covering 2001 through 2010, the number of districts certified decreased by 74 percent. (p. 17)

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Scope and Methodology

This sixteenth Annual Legislative Report (Report) was compiled from information received from the 430 municipalities and development authorities currently authorized to exercise tax increment financing (TIF) powers in Minnesota. The Report summarizes the data received from the 1,886 unaudited TIF reports for the year ended December 31, 2010, and provides a summary of the violations cited in the limited-scope reviews concluded by the Office of the State Auditor (OSA) in 2011. This Report contains a summary of the TIF reports and reviews and is provided annually to the chairs of the legislative committees with jurisdiction over TIF matters.¹

In 1995, the Minnesota Legislature assigned legal compliance oversight for TIF to the OSA.² This oversight involves examining and auditing the use of TIF by political subdivisions, as authorized by the Minnesota Tax Increment Financing Act (TIF Act).³

The TIF Act requires an authority to file annual financial reports for each of its TIF districts with the OSA. This reporting requirement applies to all TIF districts regardless of when they were created. An authority must submit its reports on or before August 1 of each year, starting in the year in which the district is certified. In 2009, the Legislature amended the statute containing the reporting requirements. This legislative change made it necessary for the OSA to change the reporting forms for the 2010 reporting year. As a result, comparisons of annual financial data obtained by the OSA from the forms cannot accurately be made between 2010 and previous years.

A total of 430 development authorities had 1,897 TIF districts for which they were required to file TIF reports with the OSA for the year ended December 31, 2010. To date, the OSA has received reports for 1,886 of the TIF districts. On August 16, 2011, the OSA sent letters to the remaining development authorities, addressed to the governing board of the municipality, advising them that the required reports had not been filed.⁴

For authorities that had not filed completed reports by October 1, 2011, a notice was mailed to each of the applicable county auditors to withhold tax increment that otherwise would have been distributed to the authorities.⁵ A list of the authorities who have not submitted the required TIF reports as of the date of this Report can be found in Appendix A.

¹ 1995 Minn. Laws, ch. 264, art. 5, § 34.

² Minn. Stat. § 469.1771.

³ Minn. Stat. §§ 469.174 through 469.1799 inclusive, as amended.

⁴ Minn. Stat. § 469.1771, subd. 2a(a).

⁵ Minn. Stat. § 469.1771, subd. 2a(a).

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TAX INCREMENT FINANCING LEGISLATIVE REPORT

BACKGROUND

Tax increment financing (TIF) is a tool created by the Legislature to support economic development, redevelopment, and housing development in areas where it would not otherwise occur. A development authority, which could be a city, an entity created by a city, or an entity created by a county, “captures” the property tax revenues generated by an increase in net tax capacity. New development within a designated geographic area, called a TIF district, generates the increase in tax capacity. The development authority uses the tax increment revenue to finance public improvements and other qualifying costs related to the new development.

Tax increment financing is not a property tax abatement program. The owner of the property located in the TIF district continues to pay the same amount of property taxes that would have otherwise been paid. Instead of being paid to the local taxing jurisdictions for their general use, the portion of property taxes generated by the new development is used to pay for public improvements and qualifying costs that made the new development possible. Examples of such costs include: land and building acquisition, demolition of structurally substandard buildings, removal of hazardous substances, site preparation, installation of utilities, and road improvements. The costs that may be paid from tax increment revenue depend on the type of development activity taking place, the type of TIF district created, and the year in which the TIF district was created.

Development authorities within municipalities may create TIF districts.⁶ Development authorities derive their powers from the Housing and Redevelopment Authorities (HRA) Act, the Port Authorities Act, the Economic Development Authorities (EDA) Act, and the Rural Development Financing Authorities Act.⁷ Any municipality administering a city development district or the powers of a port authority under any general or special law is also a development authority.⁸ City council members may also serve on the board of an HRA, an EDA, or a port authority established by the city they serve. Counties do not have independent development powers but can establish county HRAs and EDAs on which county board members may serve. A development authority must be in place before a TIF district can be created.

Each underlying development entity has unique development powers which come from the development authority. These powers identify the purposes for which tax increment can be used. The TIF Act, however, limits the powers of the development authority.⁹

⁶ Minn. Stat. § 469.174, subd. 2 and subd. 6. Counties are defined as “municipalities” for projects undertaken by county development authorities.

⁷ Minn. Stat. § 469.174, subd. 2, lists the statutory citations for the HRA Act, the Port Authorities Act, the EDA Act, the City Development Districts Act, and the Rural Development Financing Authorities Act.

⁸ Minn. Stat. § 469.174, subd. 2. HRAs, port authorities, and EDAs are public bodies, corporate and politic; rural development financing authorities are public nonprofit corporations; city development districts are designated areas within the corporate limits of a city.

⁹ Minn. Stat. §§ 469.174 to 469.1799, as amended. The Act also provides procedures for establishing TIF districts and for the administration of districts, as well as providing additional development powers.

The development authority laws and the TIF Act are linked through the term “project.”¹⁰ The term “project” is used differently in each of the development authority laws. A project can be (1) any combination of a housing project, a housing development project, or a redevelopment project; (2) property/cash/assets/funds held or used in connection with the development or operation of a project in the HRA Act;¹¹ or, (3) a designated area within a city in the City Development Districts Act.¹²

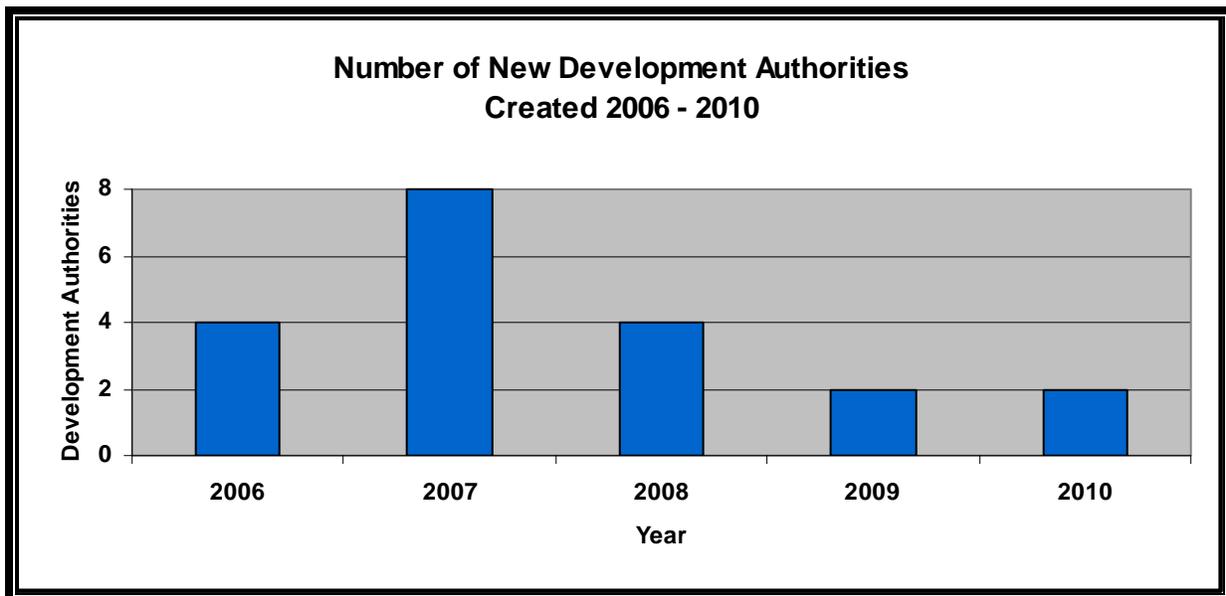
When the TIF Act was enacted in 1979, the Legislature intended a TIF district to be the parcel on which new development activity was occurring. The geographic area of a project was intended to be only modestly larger than the TIF district to permit tax increment revenue to be spent outside the district but within a larger area. Tax increment could then be used to connect utilities and other infrastructure from the developed area of the community to the site. However, no specific statutory limits were placed on the size of the geographic area of a project, and the development authority laws themselves do not contain explicit limits on the size of areas that can qualify as projects.

Development Authorities

In 2010, two new development authorities were created, for a current total of 430 active development authorities.

Figure 1 below shows the number of new development authorities created over the past five years.

Figure 1.



¹⁰ Minn. Stat. § 469.174, subd. 8.

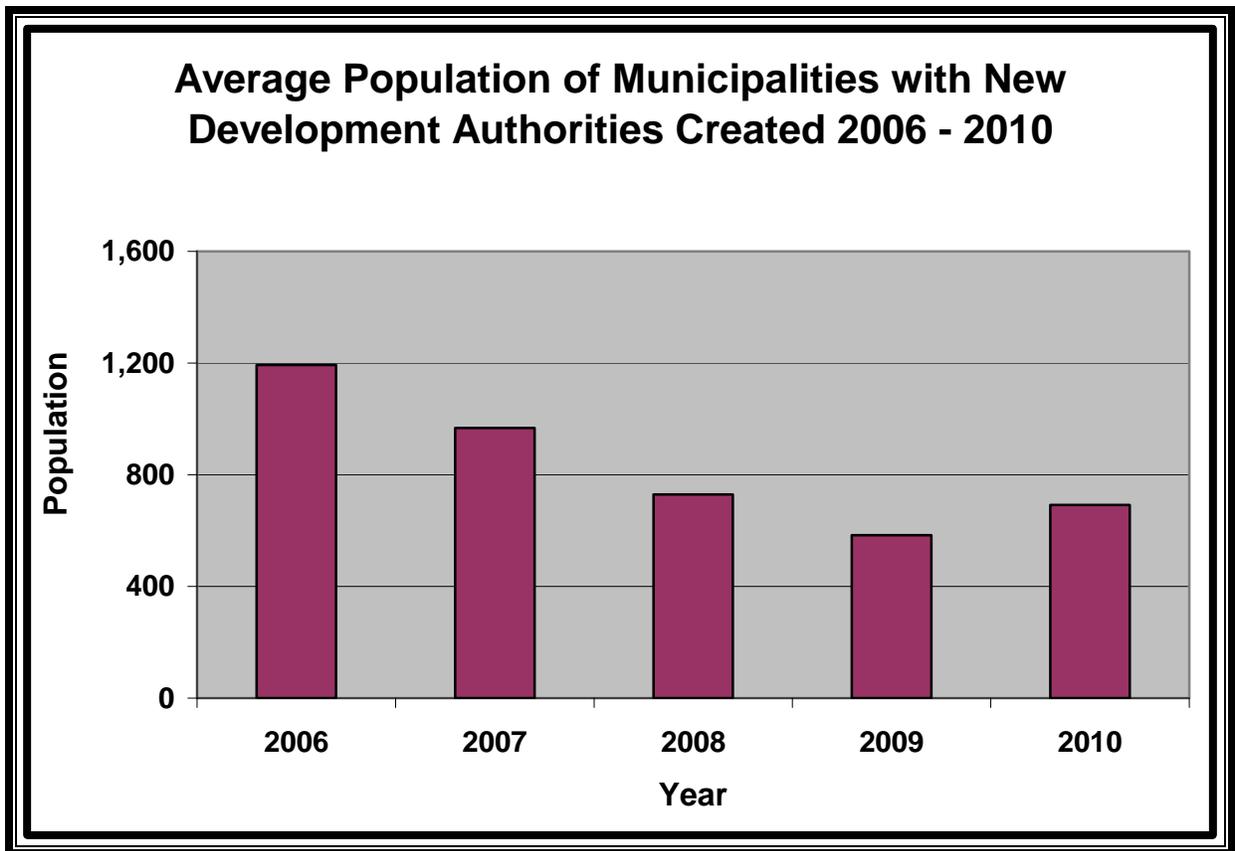
¹¹ Minn. Stat. § 469.002, subd. 12.

¹² Minn. Stat. § 469.125, subd. 9.

Since 2006, 20 new authorities have been created.¹³ The average population of the municipalities in which these new development authorities were created is approximately 899.

Figure 2 below shows the average population of the municipalities with new development authorities. In 2010, the average population of the municipalities in which two new development authorities were created is 692.

Figure 2.



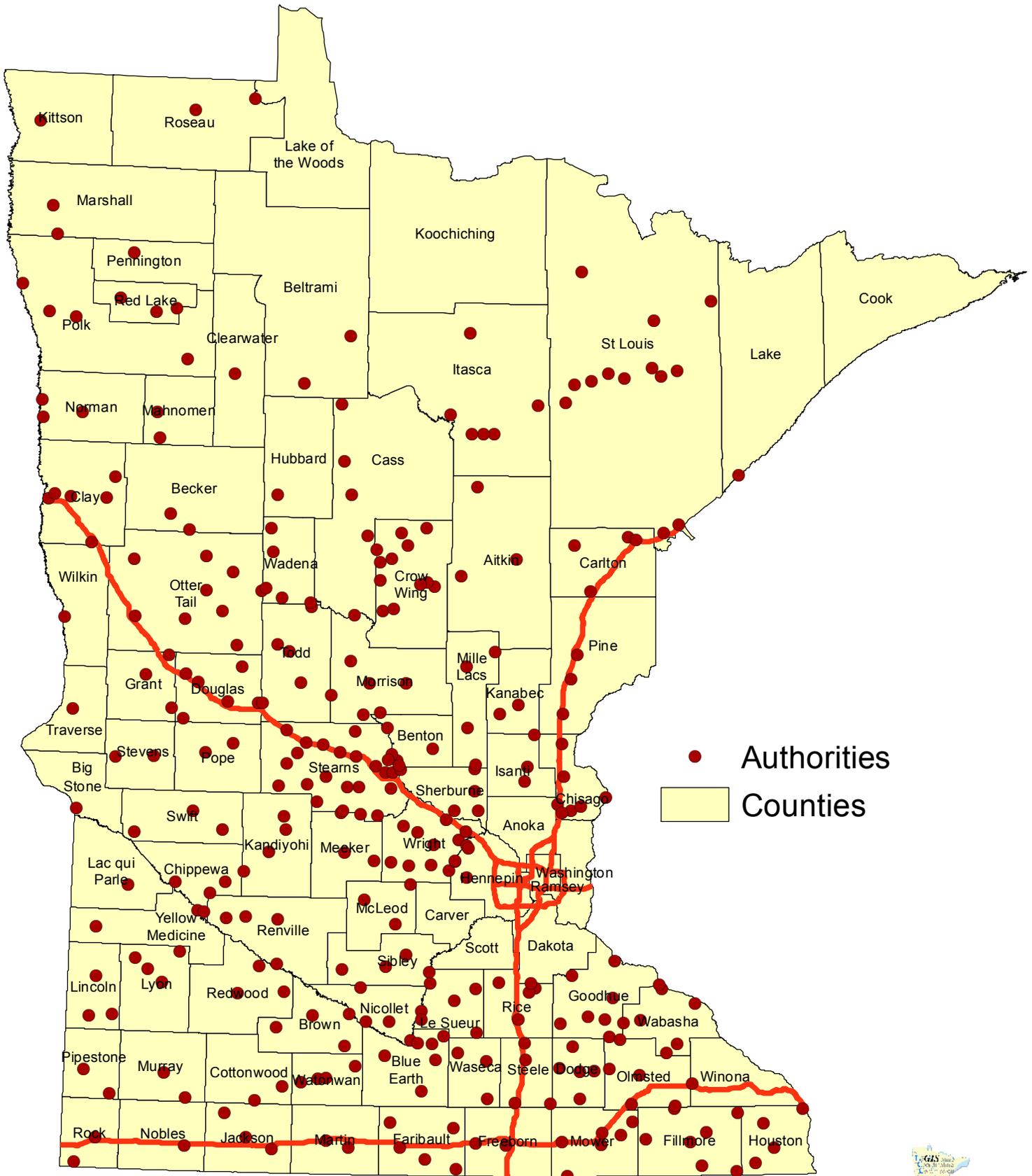
Development Authorities by Location

Development authorities using TIF powers are located throughout the State of Minnesota. Of the 430 development authorities required to submit reporting forms for 2010, 325 are located in Greater Minnesota and 105 are located in the Seven-County Metropolitan Area (Metro Area). Maps 1 and 2 on the following pages show the locations of these authorities. Map 3 identifies the various counties throughout the state that have created a separate authority for development purposes.¹⁴

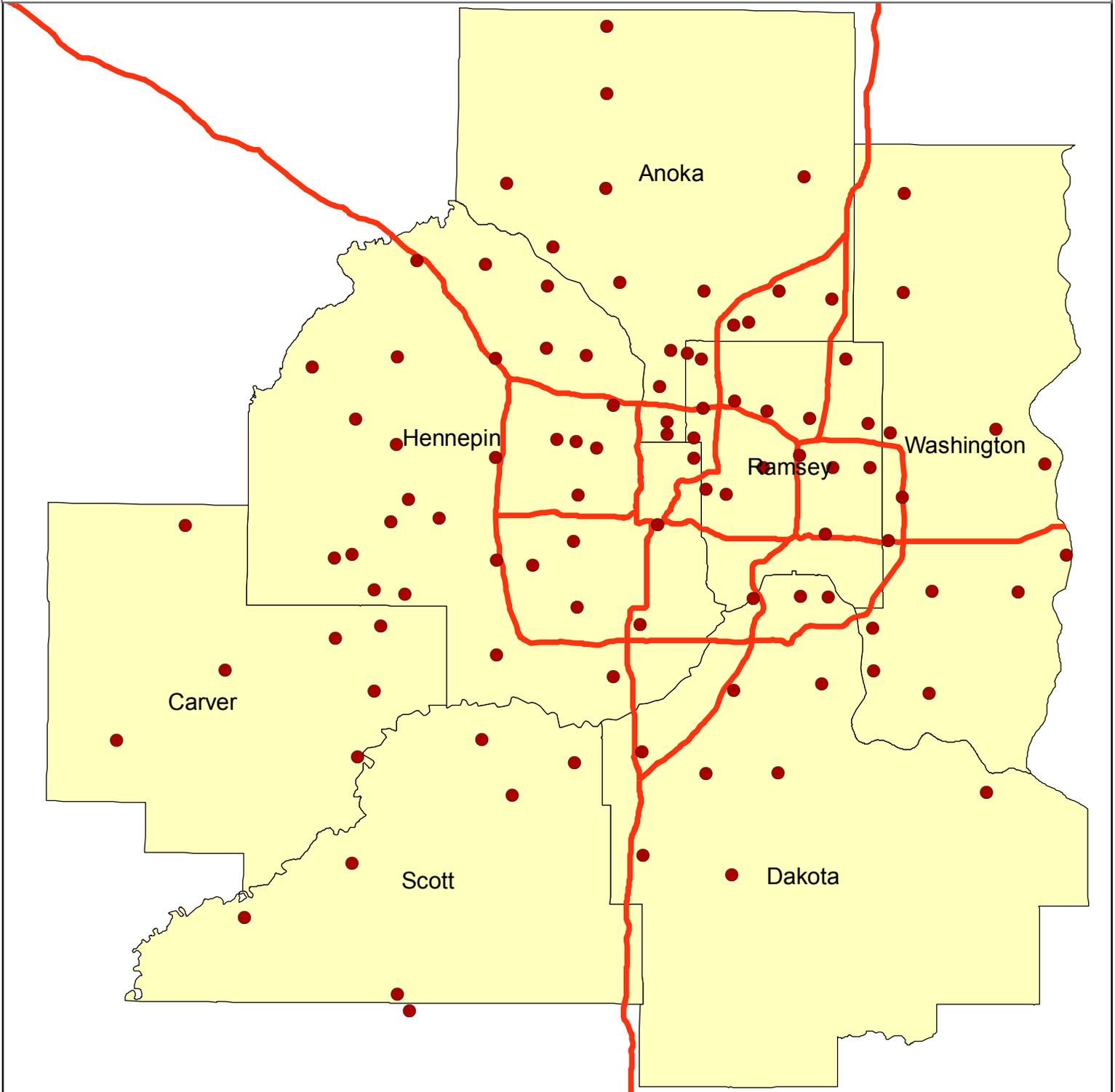
¹³ This number does not include the two new authorities created by municipalities already using TIF. This number also does not include the municipalities that had used tax increment in the past and have recently begun using tax increment once more.

¹⁴ This map does not include multi-county authorities.

Development Authorities in Greater Minnesota 2010



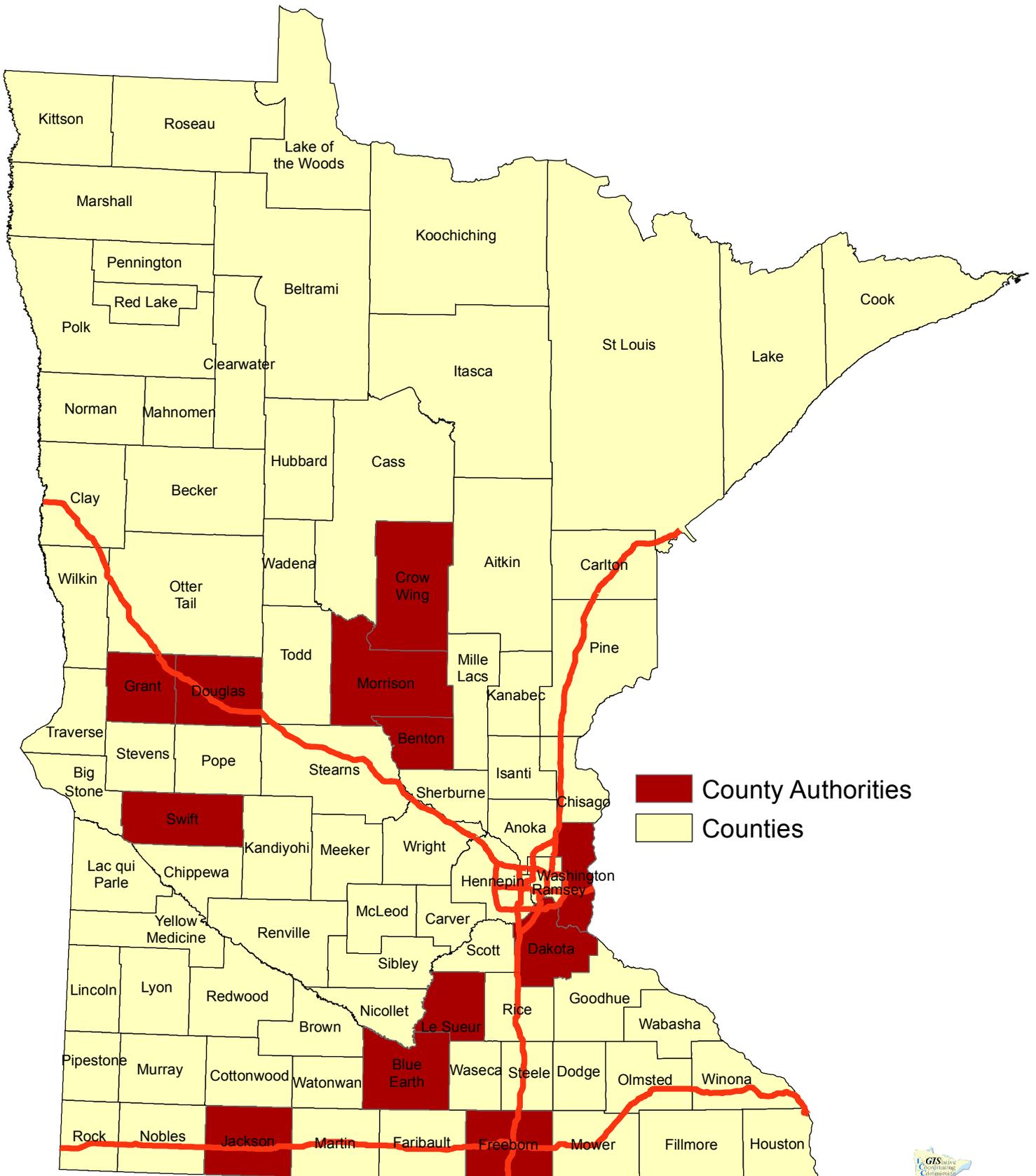
Development Authorities in Metro Area 2010



- Authorities - Metro Area
- Counties



County Development Authorities with Active TIF Districts in 2010



Creation of TIF Districts

The first step a development authority takes in creating a TIF district is to adopt a TIF plan. The TIF plan outlines the development activity to be funded with tax increment and authorizes the use of tax increment to pay TIF-eligible project costs.¹⁵

An authority must obtain approval of the TIF plan from the governing body of the municipality in which the TIF district is to be located after the municipality has published a notice for and held a public hearing.¹⁶ For example, if a city's port authority proposes creating a TIF district in the city, the city council must first approve the TIF plan for the district.¹⁷ If a county HRA proposes creating a TIF district in a township in the county, the county board must approve the TIF plan.

Before a TIF district is created, the development authority must provide a copy of the proposed TIF plan to the county auditor and the clerk of the school board who, in turn, provide copies of these documents to the members of the county board of commissioners and the school board.¹⁸ The county board and school board may comment on the proposed district, but cannot prevent its creation.¹⁹

Types of TIF Districts

TIF districts are divided into the following categories based on the physical condition of the site and on the type of construction that is to occur:

- Redevelopment districts
- Economic development districts
- Housing districts
- Renewal and renovation districts
- Soils condition districts
- Compact development districts

In addition to the types of districts listed above, there are districts that were created prior to the enactment of the TIF Act (called "pre-1979 districts") and districts that have been created under special laws. Each type of TIF district has different requirements for its creation. Each type of district also has different maximum duration limits and different restrictions on the use of tax increment revenue.

¹⁵ Minn. Stat. § 469.175, subd. 1.

¹⁶ Minn. Stat. § 469.175, subd. 3.

¹⁷ In many cases, the commissioners of the TIF authority include some or all of the council members.

¹⁸ Minn. Stat. § 469.175, subd. 2.

¹⁹ In those situations in which the county is the municipality that must approve the TIF plan, the county board may prevent creation of a TIF district.

Redevelopment Districts – The primary purpose of a redevelopment district is to eliminate blighted conditions.²⁰ Qualifying tax increment expenditures include acquiring sites containing substandard buildings, streets, utilities, paved or gravel parking lots, or other similar structures; demolishing and removing substandard structures; eliminating hazardous substances; clearing the land; and installing utilities, sidewalks, and parking facilities. This activity, paid for with tax increment, is often referred to as “leveling the playing field.” It allows developed cities to compete for development with outlying cities with bare land. Redevelopment districts are intended to conserve the use of existing utilities, roads, and other public infrastructure, and to discourage urban sprawl.

Economic Development Districts – An economic development district need not meet the requirements of any other type of district. It is a type of district that consists of a project which an authority considers to be in the public interest because it will: (i) discourage commerce, industry, or manufacturing from moving to another state or city; (ii) increase employment in the state; or (iii) preserve and enhance the tax base.²¹ Economic development districts are short-term districts (eight years).²² Tax increment revenue from economic development districts is used primarily to assist manufacturing, warehousing, storage and distribution, research and development, telemarketing, and tourism. Commercial development (retail sales) is excluded by law, except in “small cities.”²³

In 2010, development authorities were given temporary expanded authority to use tax increment in ways not previously authorized. In 2011, the Legislature extended this authority by one year. The purpose of the expanded authority is to stimulate the economy through assistance to private development with an emphasis on creating and retaining jobs, including construction jobs, within the state. To underscore the immediacy of the need to create and retain jobs, the statute requires that construction commence no later than July 1, 2012, and the temporary authority to expend tax increment expires on December 31, 2012.

Housing Districts – The purpose of a housing district is to encourage development of owner-occupied and rental housing for low- and moderate-income individuals and families by using tax increment revenue as a type of financial assistance. Tax increment revenue can be used in the construction of low- and moderate-income housing, as well as to acquire and improve the housing site. The TIF Act’s low- and moderate-income limits are the same income limits found in the Internal Revenue Code.²⁴ However, the income limits for “qualified” housing districts are tied to the stricter federal low-income tax credit guidelines, regardless of whether tax credits are used. The 2008 Minnesota Legislature repealed the definition of “qualified housing.” Nevertheless, this more restrictive type of housing district designation continues to be used for qualified housing districts created prior to March 8, 2008.

²⁰ Minn. Stat. § 469.174, subd. 10(a)(1).

²¹ Minn. Stat. § 469.174, subd. 12.

²² Minn. Stat. § 469.176, subd. 1b(a)(3).

²³ Minn. Stat. § 469.174, subd. 27, and Minn. Stat. § 469.176, subd. 4c.

²⁴ Minn. Stat. § 469.1761. Income limits for owner-occupied housing units are identified in section 143(f) of the Internal Revenue Code. Income limits for rental housing units are identified in section 142(d) of the Internal Revenue Code.

Renewal and Renovation Districts – The purpose of a renewal and renovation district is similar to that of a redevelopment district, except the amount of blight to be removed may be less, and the development activity is more closely related to inappropriate or obsolete land use.

Soils Condition Districts – The purpose of a soils condition district is to assist in the redevelopment of property which cannot otherwise be developed due to the existence of hazardous substances, pollutants, or contaminants. The presence of these materials requires removal or remedial action before the property can be used, and the estimated cost of the proposed removal and remediation must exceed the fair market value of the land before the remediation is completed.²⁵

Pre-1979 Districts – Districts created prior to the enactment of the TIF Act on August 1, 1979, are called pre-1979 districts. On April 1, 1990, many of the pre-1979 districts still in existence had significant amounts of debt outstanding. Tax increment from these districts could then be used only to retire that debt. Since August 1, 2009, pre-1979 districts can no longer receive tax increment payments.²⁶ Exceptions are districts that were extended through special legislation or districts with hazardous substance subdistricts having terms longer than the TIF district.

Uncodified Districts – A special law may be enacted that permits the generation of tax increment revenue from a geographic area not meeting the definition of a type of TIF district authorized by the TIF Act. This type of district is referred to as an “uncodified” district. Examples of uncodified districts are housing transition districts for the cities of Crystal, Fridley, St. Paul, and Minneapolis, and a district with distressed rental properties in Brooklyn Park.

Compact Development Districts – The purpose of a compact development district is to increase the square footage of the commercial/industrial buildings by three times or more. This type of district must meet a coverage test similar to redevelopment districts in that 70 percent of the area of the district must be occupied by buildings or similar structures classified as commercial/industrial property. The authority to create a compact development district expires on June 30, 2012. As of the date of this Report, the OSA has no record that any compact development district has been established.

Special Legislation

In some cases, special legislation has been enacted to allow an exception to the general law for a development authority. As of 2010, 122 TIF districts reported having received one or more pieces of special legislation. The most common reasons for enacting special legislation are: (1) extending the five-year deadline for entering into contracts or issuing bonds;²⁷ (2) extending

²⁵ Minn. Stat. § 469.174, subd. 19.

²⁶ Minn. Stat. § 469.176, subd. 1c.

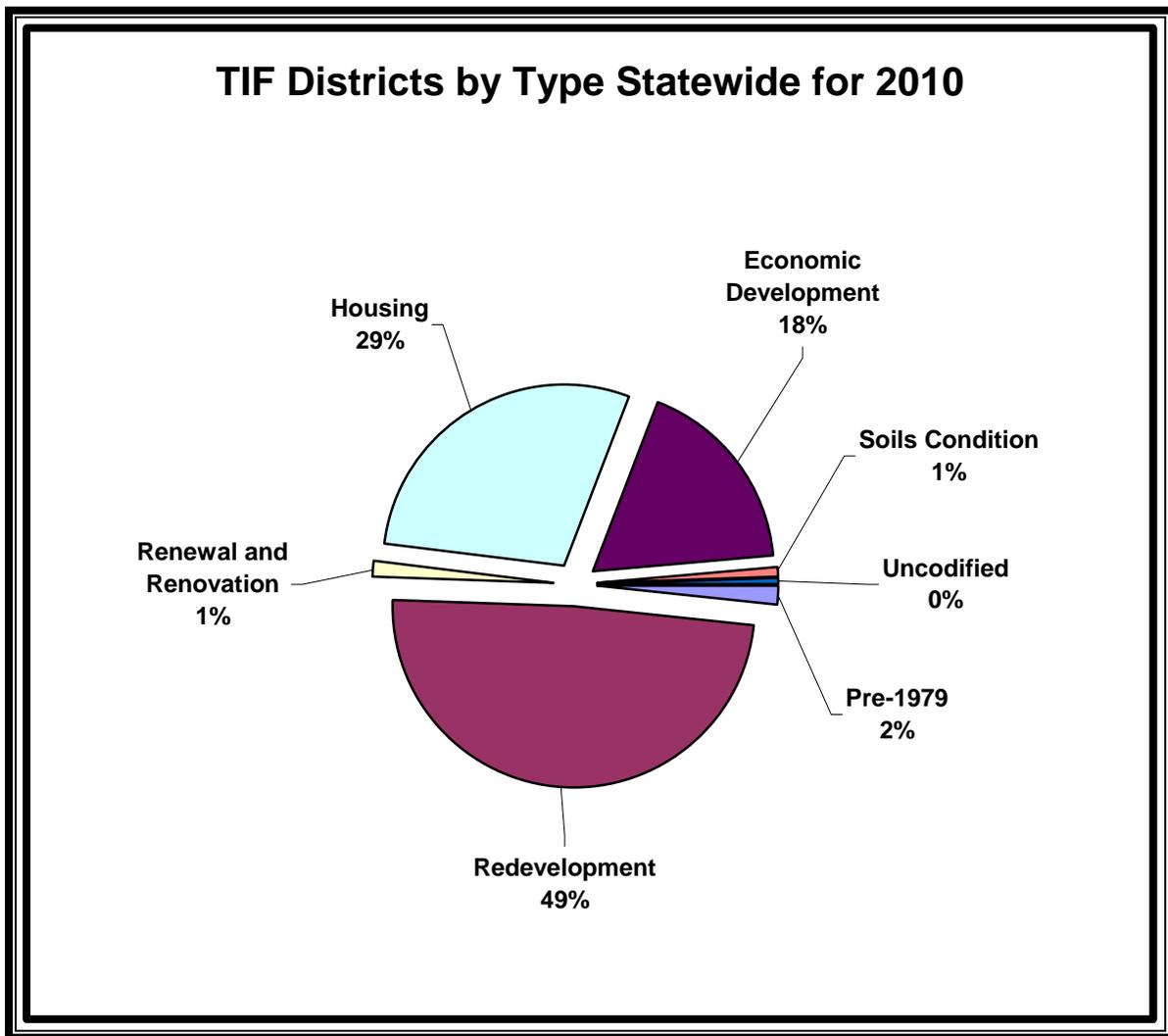
²⁷ See Minn. Stat. § 469.1763, subd. 3.

the duration limits of a TIF district;²⁸ (3) creating an exception to requirements or findings needed to create a TIF district;²⁹ and (4) creating an exception to the limitations on the use of tax increment.³⁰

Number of TIF Districts

In 2010, 96 percent of the TIF districts were redevelopment, economic development, and housing districts. Figure 3 below shows TIF districts by type statewide.

Figure 3.



As shown in Figure 4 and Figure 5 on the following page, redevelopment districts make up the largest percentage of districts in both the Metro Area and in Greater Minnesota.

²⁸ See Minn. Stat. § 469.176, subd. 1b.

²⁹ See Minn. Stat. § 469.174 and Minn. Stat. § 469.175.

³⁰ See Minn. Stat. § 469.176.

Figure 4.

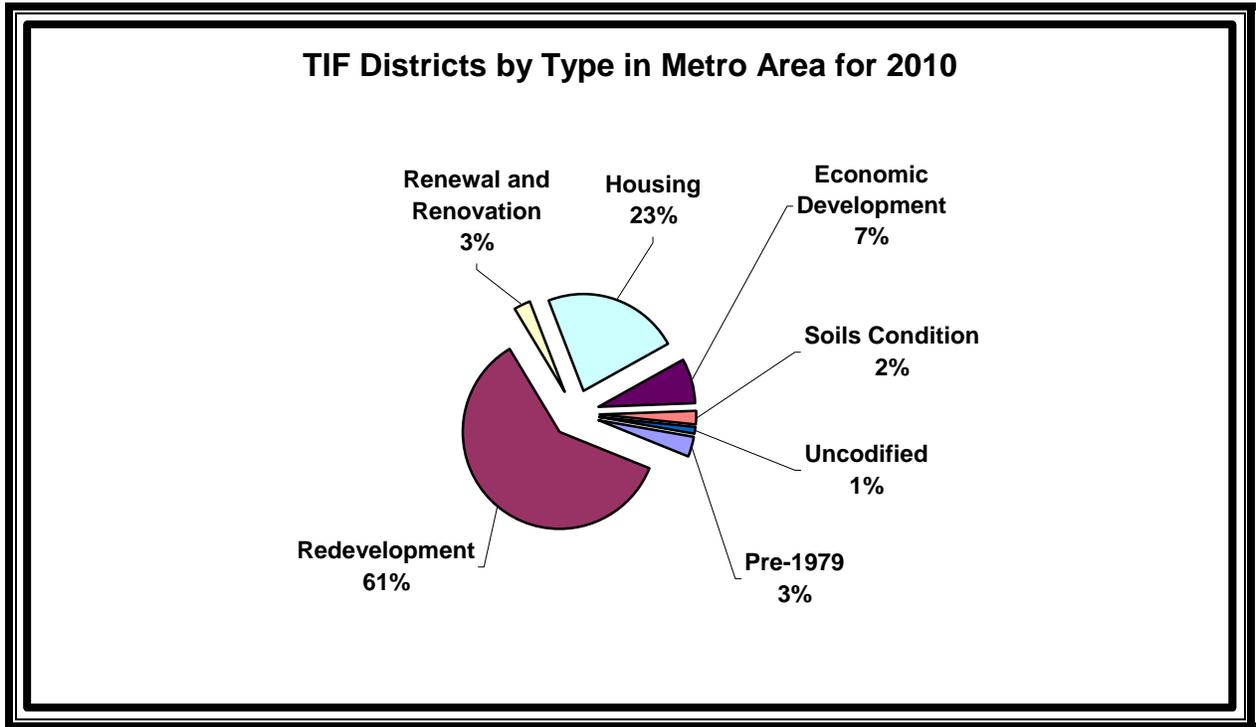
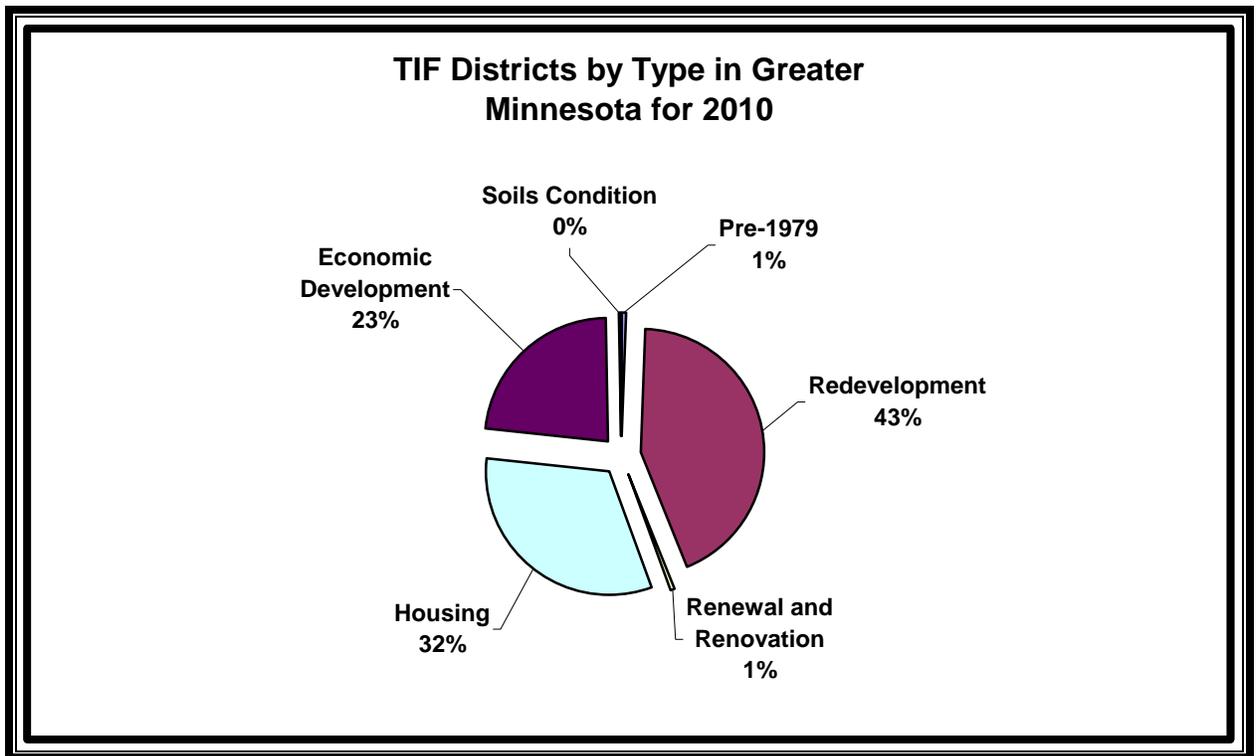


Figure 5.



Economic development districts focus on job production rather than on clearance and preparation of a development site. Therefore, Greater Minnesota, with open space and a critical need for employment, uses economic development districts more frequently than the more fully-developed Metro Area. The land on which an economic development district is established may be bare land. The eight-year term of the district is generally sufficient as less tax increment is needed to pay for site preparation.

Tax Increment Revenue by Type of District

The amount of tax increment revenue generated from within a TIF district depends, in part, on the type of the district, the development activity occurring within the district, the length of its term, and the location of the district.

In 2010, redevelopment districts made up 49 percent of the TIF districts in the state, but generated 81 percent of the state’s tax increment revenue. Housing districts made up 29 percent of the TIF districts in the state, but generated only 10 percent of the tax increment revenue. Economic development districts made up 18 percent of the state’s TIF districts, but generated only five percent of the tax increment revenue.

As shown in Figure 6 below, redevelopment districts accounted for 82 percent of the tax increment revenue generated in 2010.

Figure 6.

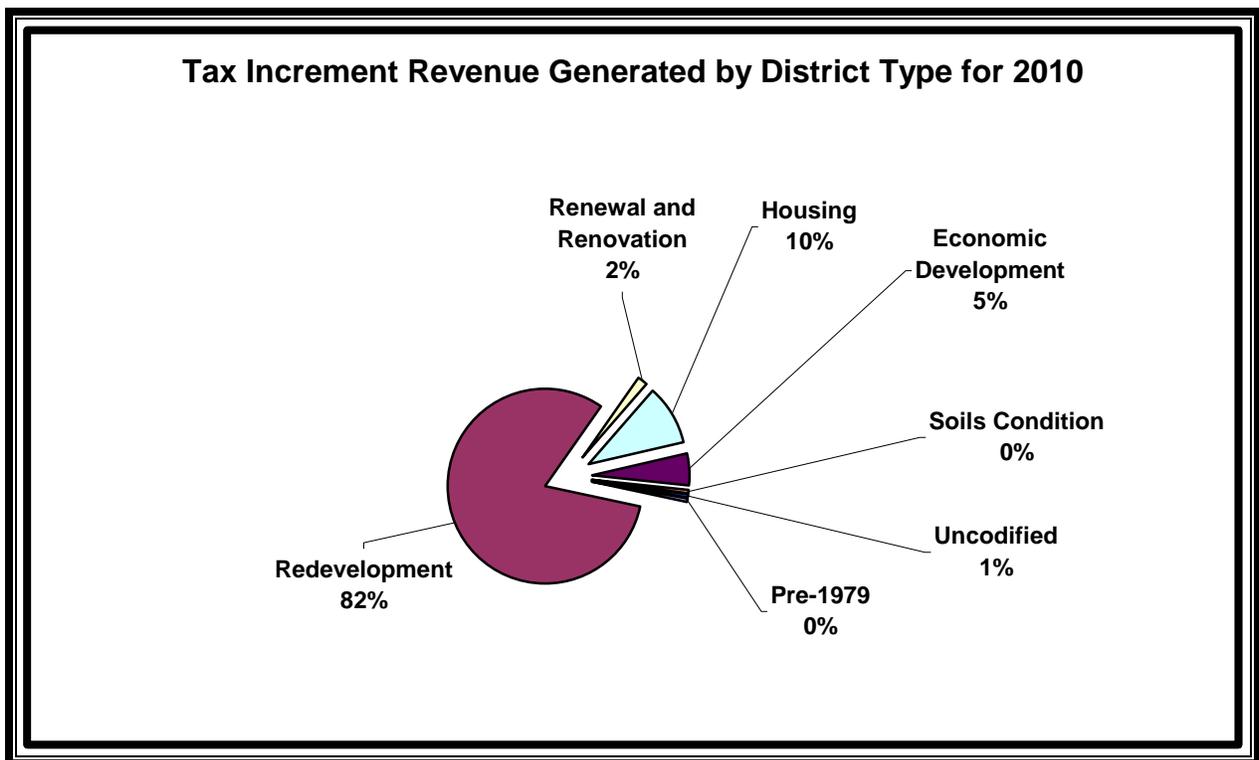
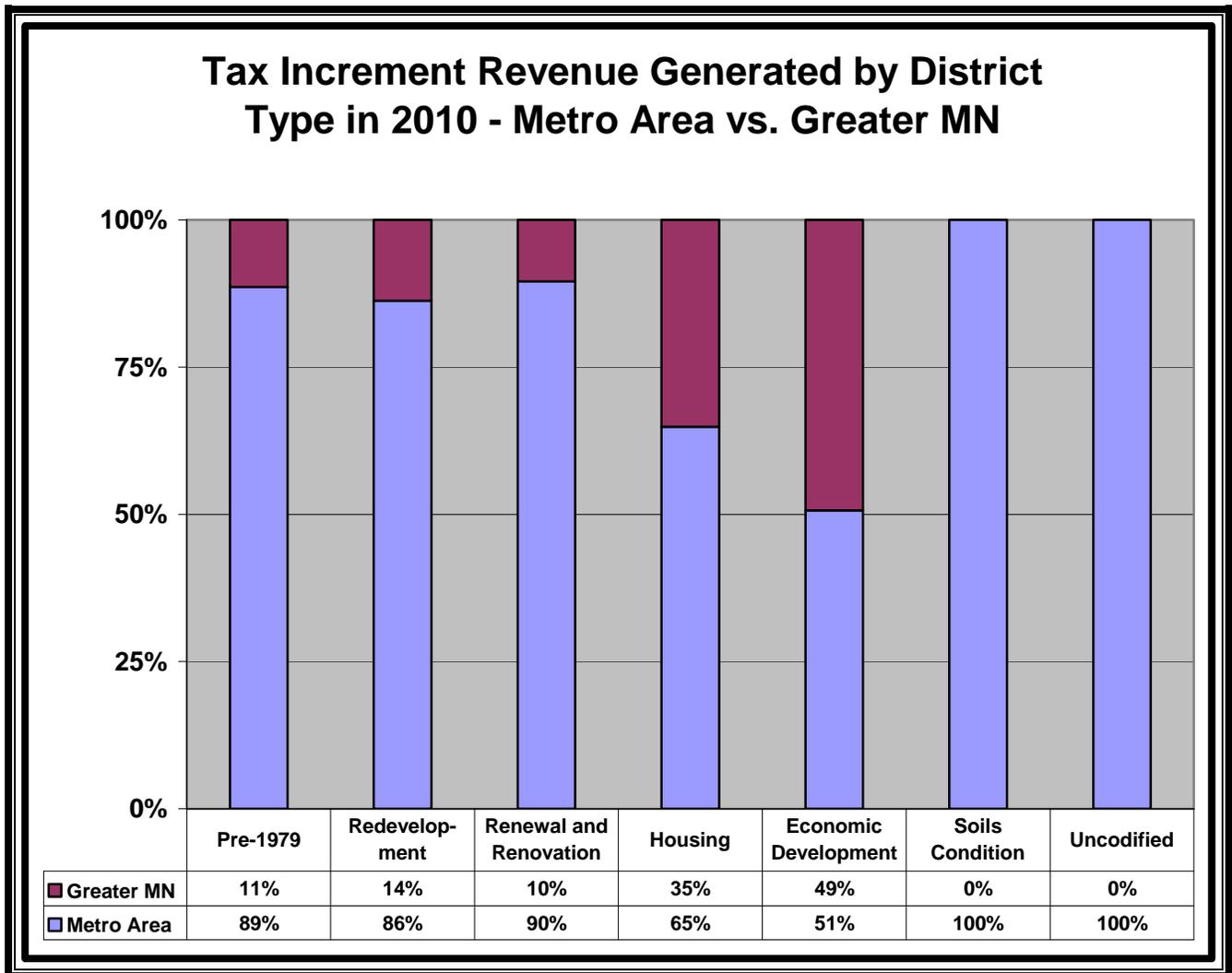


Figure 7 below shows the tax increment revenue generated by district type as a percentage of the total tax increment in the Metro Area and Greater Minnesota. In 2010, 34 percent of the total number of TIF districts were located in the Metro Area; 66 percent were located in Greater Minnesota. However, 82 percent of the tax increment revenue generated in 2010 was from districts located within the Metro Area.

Figure 7.



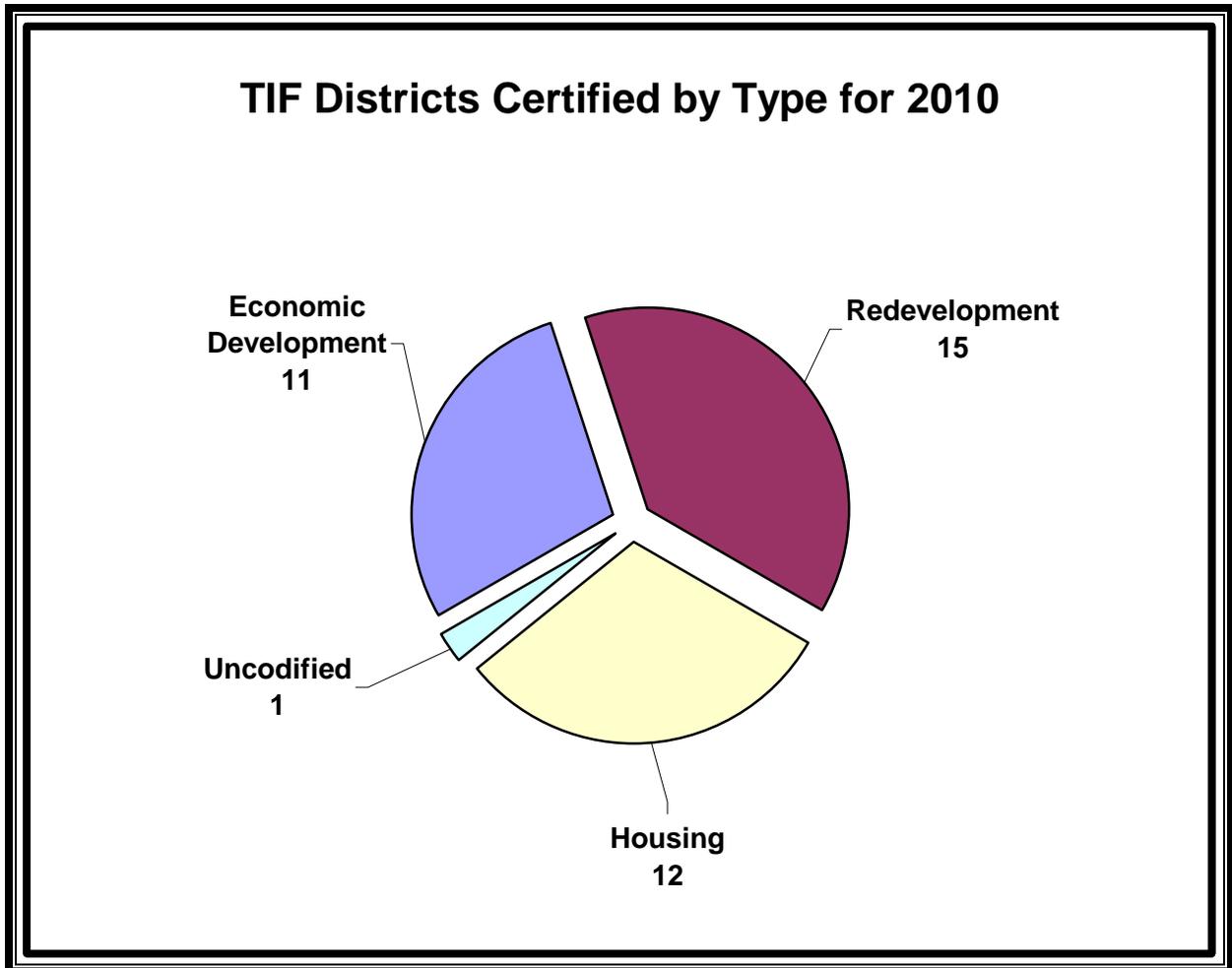
Returned Tax Increment

In calendar year 2010, development authorities returned \$17,189,994 in tax increment revenue to the county auditor for redistribution to the city, county, and school district as property taxes. Some of the reasons tax increment revenue is returned include receiving excess tax increment revenue or improperly receiving tax increment revenue.

Districts Certified for Calendar Year 2010

Once a municipality approves the creation of a TIF district, the county auditor certifies the original net tax capacity.³¹ From the date it is *certified*, the increase in property taxes generated by new development is sent to the TIF authority to pay qualifying development costs. Figure 8 below shows the number of TIF district certifications by type in 2010.

Figure 8.



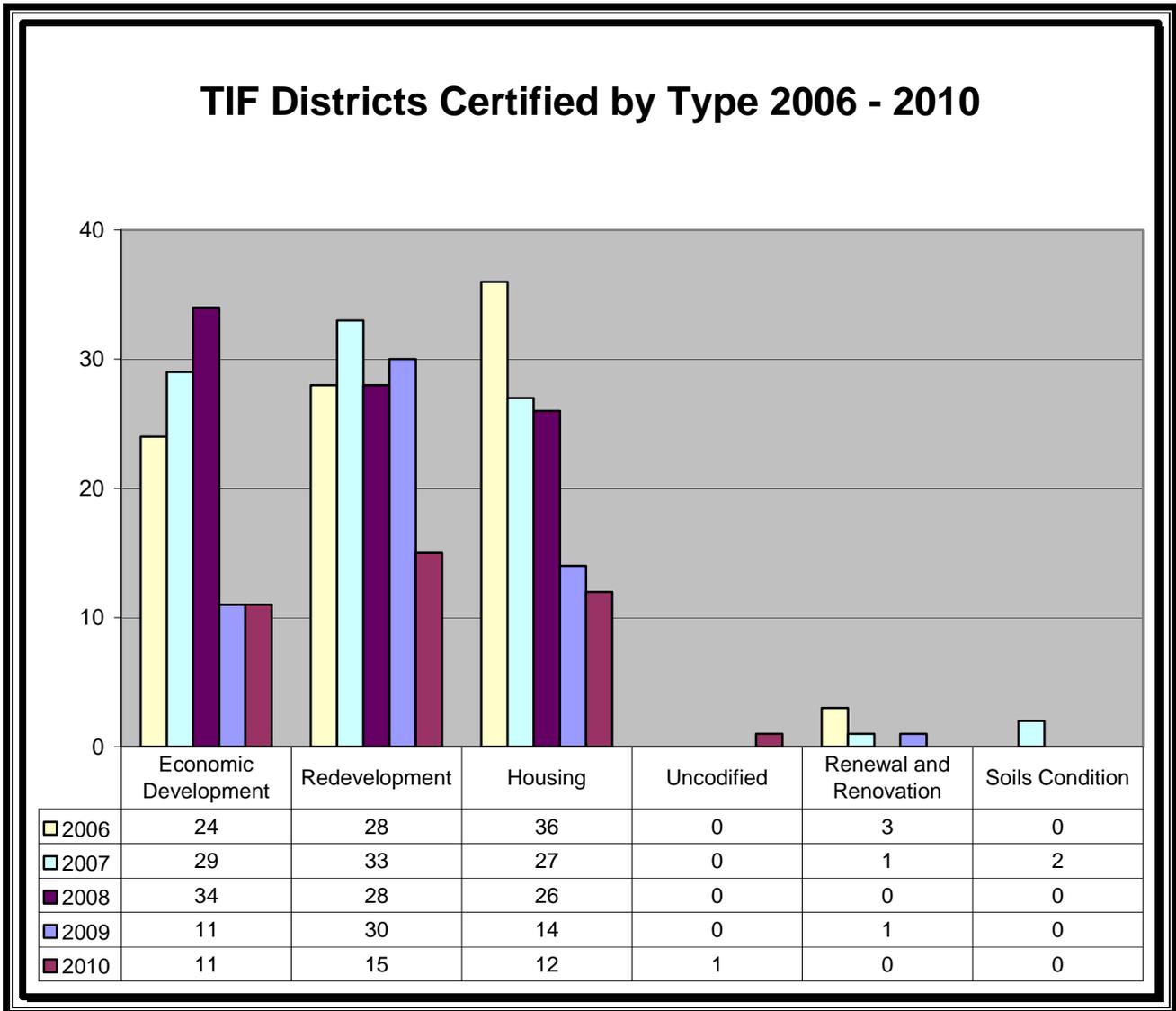
Certification Trends – Current and Five-Year

The total number of TIF districts certified between 2009 and 2010 decreased by 30 percent. There was no change in the number of economic development districts certified. The number of housing districts certified decreased by 14 percent, while the number of redevelopment districts certified decreased by 50 percent.

³¹ Minn. Stat. § 469.177, subd. 1.

The total number of TIF districts certified in the five-year period between 2006 and 2010 decreased by 57 percent. The number of economic development districts decreased by 54 percent. The number of housing districts certified decreased by 67 percent. The number of redevelopment districts certified decreased by 46 percent.

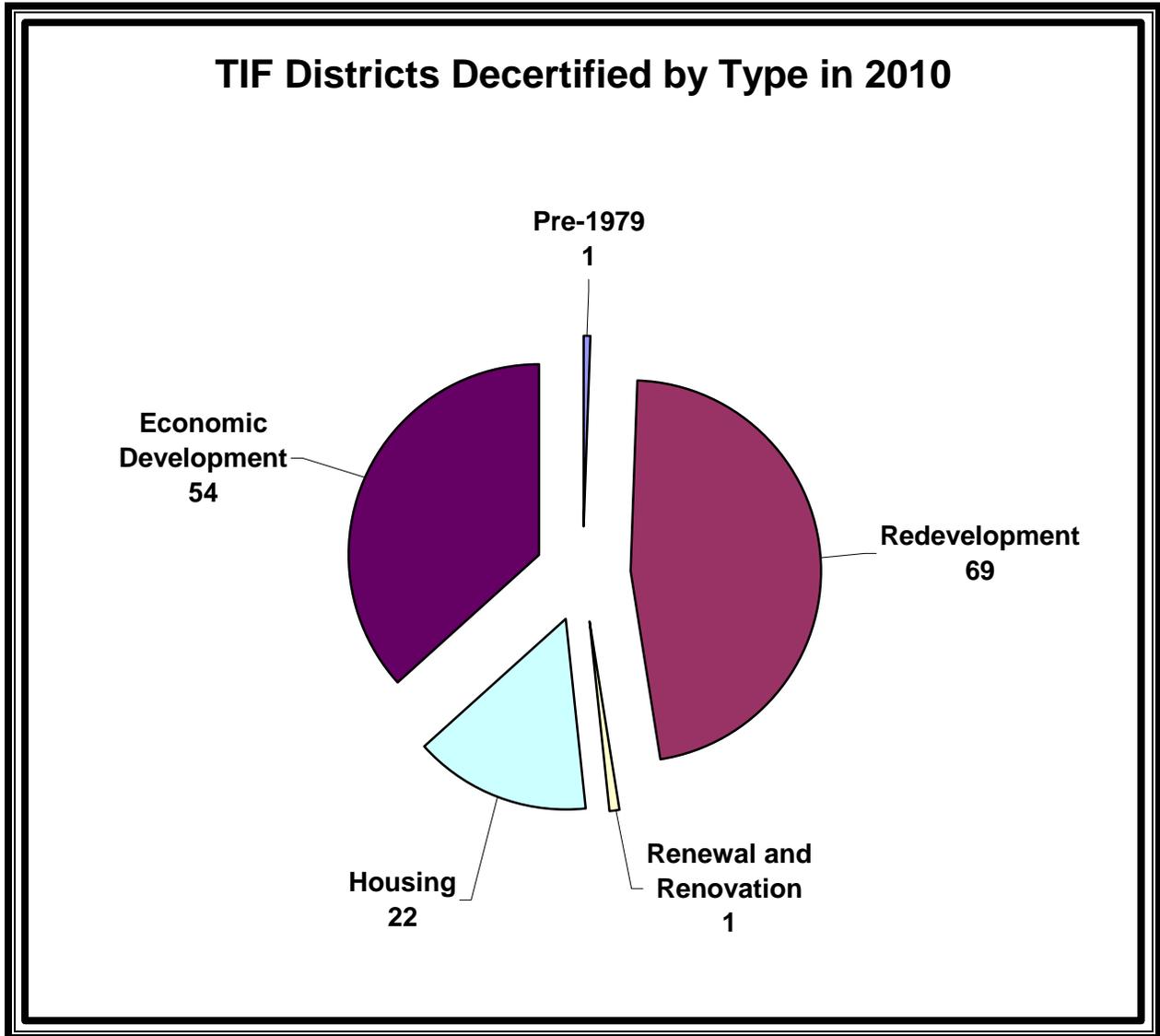
Figure 9.



Districts Decertified in Calendar Year 2010

After a TIF district’s statutory term expires and the development costs have been paid, the district is *decertified*, and all future tax payments are redirected as property taxes to the city, county, and school district. The tax payments are no longer TIF revenues and are no longer subject to tax increment limitations. As Figure 10 on the following page shows, most of the districts decertified in 2010 were redevelopment districts.

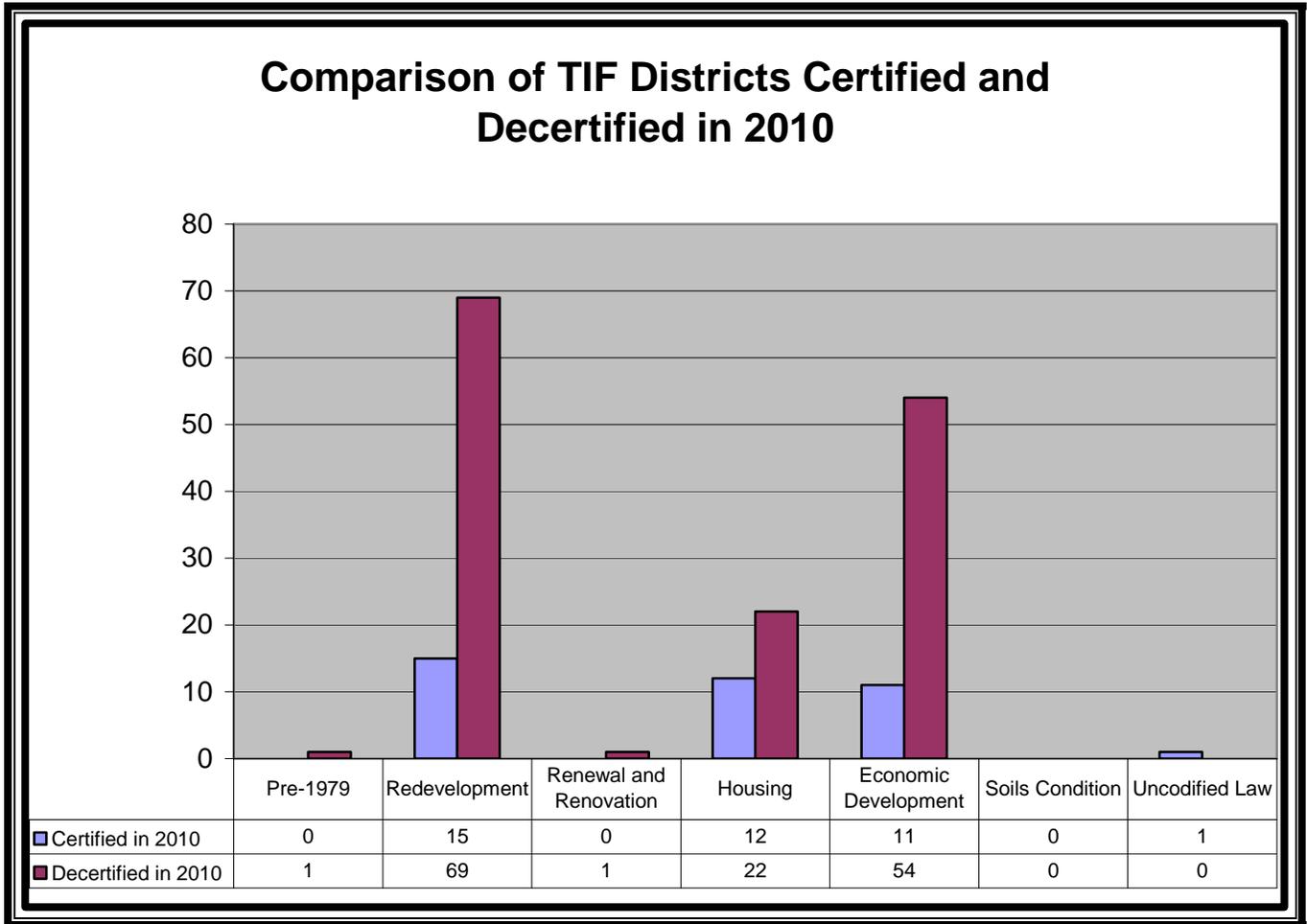
Figure 10.



Comparison of TIF Districts Certified and Decertified

In 2010, 39 TIF districts were certified, and 147 TIF districts were decertified. Figure 11 on the following page compares the number of districts certified and the number of districts decertified by type.

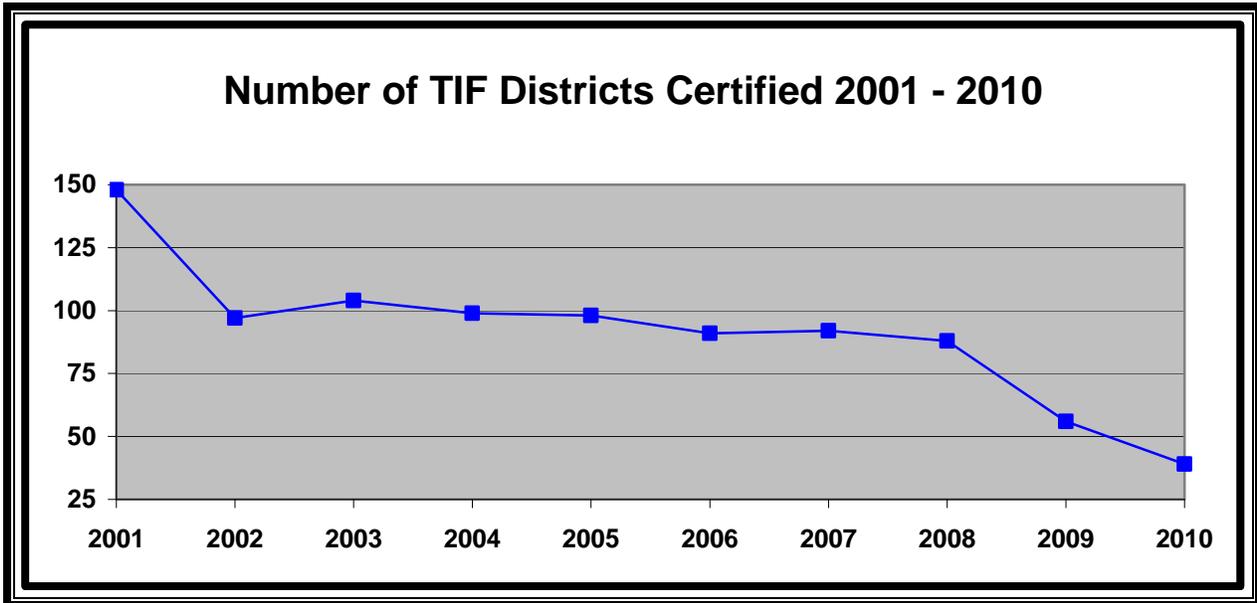
Figure 11.



Ten-Year Trends

Figure 12 on the following page shows the number of TIF districts certified over the last ten years. The number of districts certified dropped sharply between 2001 to 2002. The 2001 Tax Reform Act redirected the school district portion of commercial and industrial property taxes to the state. These property taxes were no longer available for use by development authorities. The redistribution of property taxes was likely a factor in the decline in TIF districts certified. Despite a slight increase in 2003, the number of districts certified has continued to decrease. Over the ten-year period covering 2001 through 2010, the number of districts certified decreased by 74 percent.

Figure 12.



As shown in Figure 13 below, the total number of TIF districts increased until 2004. Since 2004, there has been a steady decline.

Figure 13.

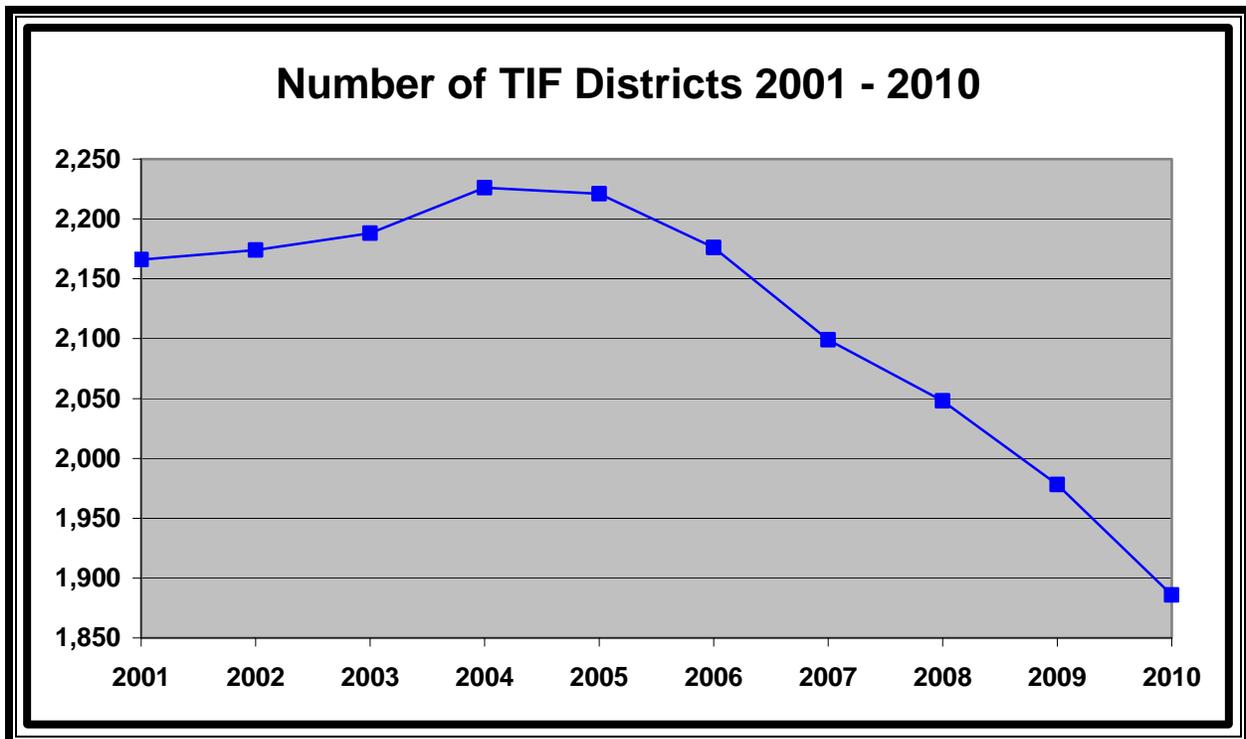
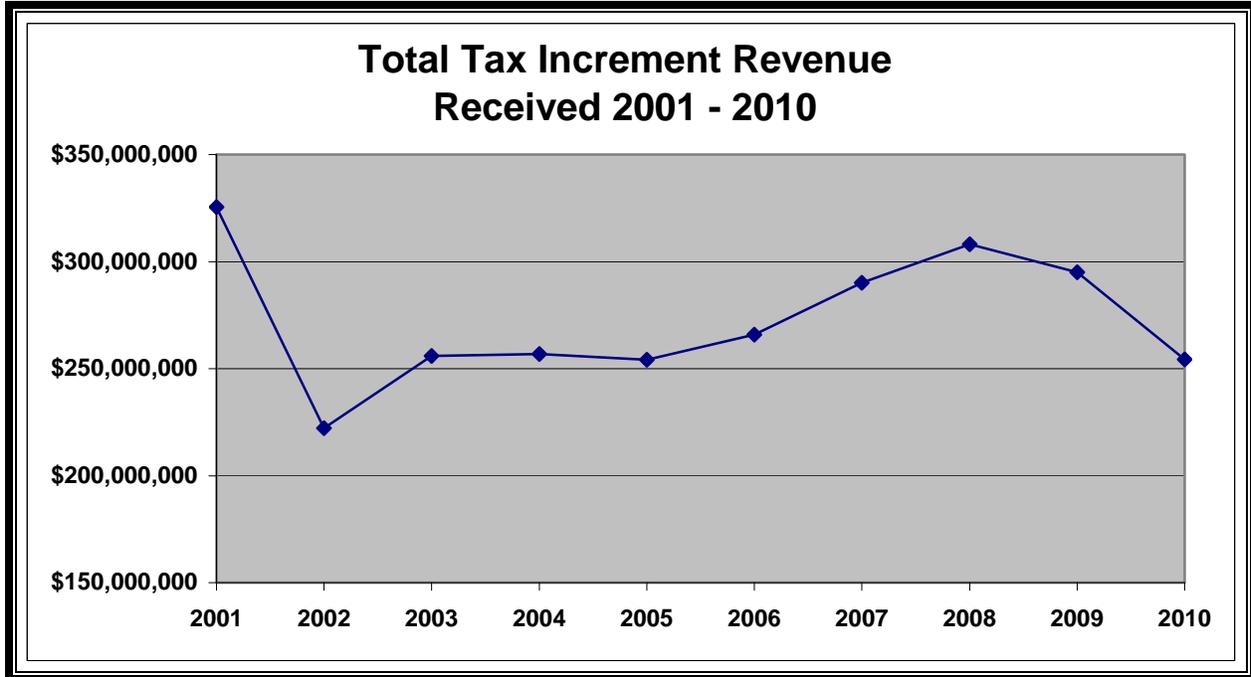


Figure 14 below shows the total amount of tax increment revenue received over the last ten years.

Figure 14.



In 2002, tax increment revenue declined sharply, which was likely due to the 2001 changes to the property tax laws caused by the 2001 Tax Reform Act. After about three years of slow growth, tax increment revenue rose until 2009. Increase in local property taxes could be a factor in the increase of tax increment generated. The sharp decline in 2010 may have been caused by pre-1979 districts no longer collecting tax increment payments after August of 2009.

Reported Debt

Tax increment is property tax revenue generated from new development that would not occur but for the use of tax increment. Tax increment revenue is used primarily to pay for acquisition and site improvement costs necessary before new development can start. Tax increment revenue, however, is not generated until after the new development is completed, assessed, and paying property taxes. Therefore, tax increment costs are paid with debt obligations. If the new development does not generate the amount of tax increment revenue anticipated, the entity assuming the risk is the entity ultimately responsible for paying the debt. Debt obligations and how these obligations are secured become major factors in financing economic development.

General obligation bonds and PAYG bonds are the two primary debt obligations used to finance qualifying tax increment costs. Although the 1,886 annual TIF forms report a total of \$1,742,562,179 of outstanding debt in 2010, taxpayers are responsible only for that debt secured

by the municipalities' full faith and credit. Of the reported debt, approximately 24 percent is secured by the municipalities' taxpayers. Approximately 76 percent of the debt is secured by other revenue sources.

Bonds are usually issued by a municipality or development authority to finance development activity, like land acquisition, site improvements, and public utility costs. The TIF Act defines bonds to include obligations such as the types of obligations currently reported to the OSA:³²

- General Obligation Bonds (G.O.)
- Revenue Bonds
- Interfund Loans
- Pay-As-You-Go Obligations (PAYG)
- Pooled Debt Obligations
- Other Bonds

General Obligation Bonds – A G.O. bond pledges the full faith and credit of the municipality as security for the bond. If tax increment is not sufficient to make the required debt service payments, the municipality must levy a property tax to generate the funds to pay the required debt service payments.

Revenue Bonds – A revenue bond requires only the revenue generated from the TIF district to be used for the required debt service payments and does not pledge the full faith and credit of the municipality as security for the bond.

Interfund Loans – An interfund loan is created when an authority or municipality loans or advances money from its general fund or from any other fund for which it has legal authority. The loan or advance must be authorized by resolution of the governing body before money is transferred, advanced, or spent. The terms and conditions for repayment of the loan must be provided in writing and include, at a minimum, the principal amount, the interest rate, and maximum term.³³ The interfund loan may be forgiven if the tax increment generated is not sufficient to repay the interfund loan.

Pay-As-You-Go Obligations – Under pay-as-you-go (PAYG), the development costs are initially paid by the developer pursuant to the terms of a (re)development agreement. After the qualifying costs are substantiated, the developer is then reimbursed pursuant to the terms of the PAYG note if and when tax increment is generated by the TIF district. Generally, in PAYG financing, the developer accepts the risks of failed development. If sufficient tax increments are not generated as anticipated, the developer does not get reimbursed.

³² Minn. Stat. § 469.174, subd. 3.

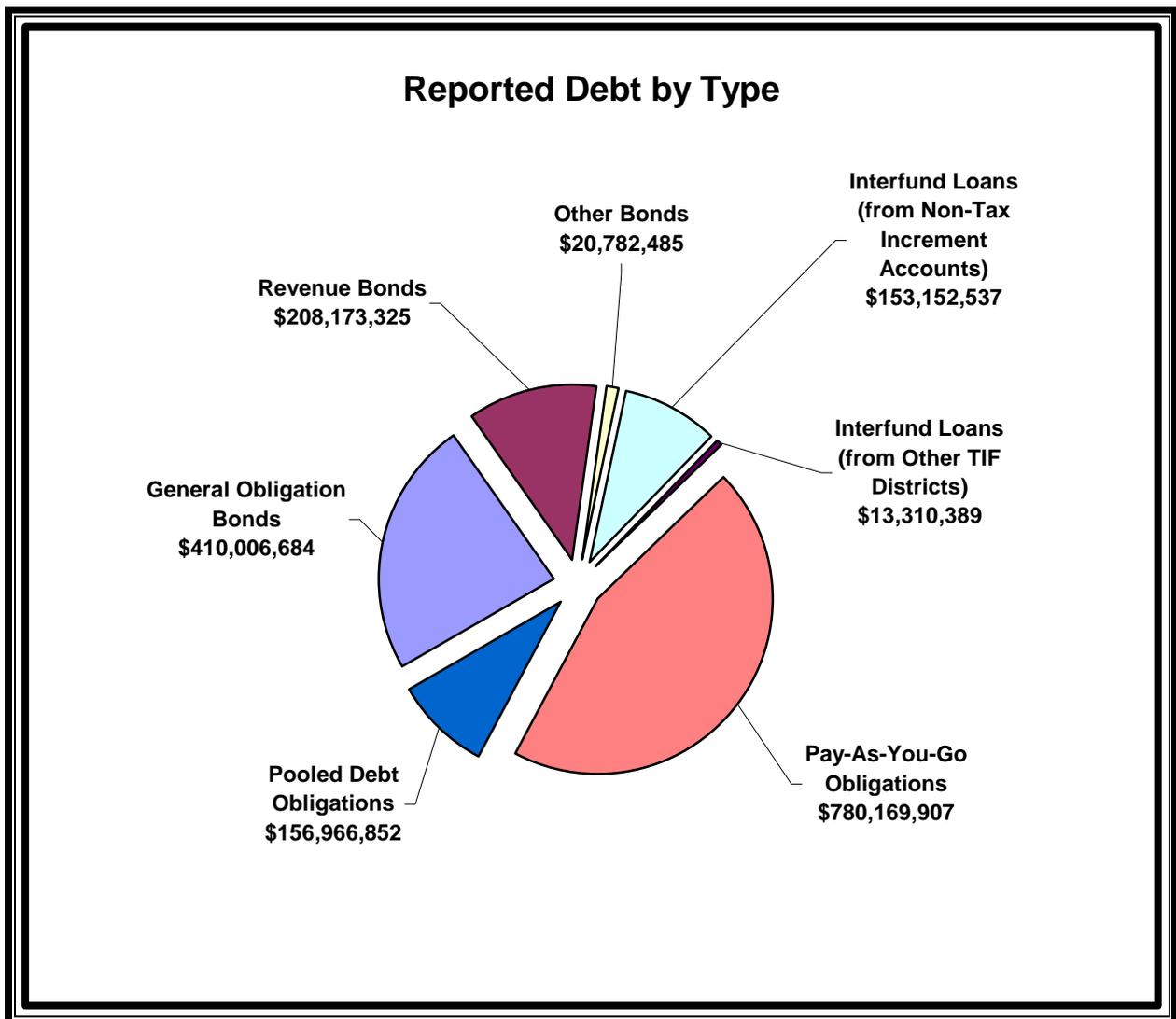
³³ Minn. Stat. § 469.178, subd. 7.

Pooled Debt Obligations – A pooled debt obligation is any bond that is authorized to be paid with tax increment from two or more TIF districts, or any obligation to which the tax increment from two or more TIF districts has been pledged or is used to make debt service payments. Pooled debt obligations may include general obligation bonds, revenue bonds, or any other type of debt legally defined as a bond in the TIF Act.

Other Bonds – Other bonds include all other bonds that a municipality or development authority may legally issue for which tax increment may be pledged to pay the required debt service payments.

Figure 15 below shows the types of debt obligations reported as being used to finance improvements paid with tax increment revenue.

Figure 15.



2010 JOBS STIMULUS PROGRAM

In 2010, development authorities were given temporary expanded authority under the Jobs Stimulus Program to use tax increment in ways not previously authorized. In 2011, the Legislature extended this authority by one year. The purpose of the expanded authority is to stimulate the economy through the assistance to private development with an emphasis on creating and retaining jobs, including construction jobs, within the state. To underscore the immediacy of the need to create and retain jobs, the statute requires that construction commence no later than July 1, 2012, and the temporary authority to expend tax increment expires on December 31, 2012.

The tax increment to be used for this temporary Jobs Stimulus Program comes from one of two sources: tax increment generated (1) from expanded authority through an economic development district,³⁴ or (2) through the use of available tax increment generated from existing districts.³⁵ The use of tax increment varies slightly depending on which of the two options is chosen.

Revenue from Economic Development Districts

In general, tax increment generated from economic development districts may be used only for manufacturing, warehousing, research and development, telemarketing, and tourism facilities.³⁶ The Jobs Stimulus Program allows a development authority to create an economic development district and use the tax increment generated to provide subsidies or assistance in any form to developments consisting of buildings and ancillary facilities if (i) the project will create or retain jobs in the state; (ii) construction of the project begins no later than July 1, 2012; and (iii) the request for certification of the district is made after June 30, 2009, and no later than July 1, 2012.³⁷

Development authorities are required to submit copies of the approved TIF plans for all newly created TIF districts. As of the date of this Report, the OSA has received TIF plans for 31 economic development districts created under the Jobs Stimulus Program. A summary of the economic development districts created under the Jobs Stimulus Program can be found in Appendix B.

Revenue from Existing Districts

Under the Jobs Stimulus Program, development authorities were given temporary authority to use available and uncommitted tax increment revenue from any type of existing TIF district to create jobs. Assistance provided by the Jobs Stimulus Program includes direct investments in businesses to finance the development.³⁸ The temporary authority to expend tax increment expires December 31, 2012.

³⁴ Minn. Stat. § 469.176, subd. 4c(d).

³⁵ Minn. Stat. § 469.176, subd. 4m.

³⁶ Minn. Stat. § 469.176, subd. 4c(a)(1) to (7).

³⁷ Minn. Stat. § 469.176, subd. 4c(d)(1) to (3).

³⁸ Minn. Stat. § 469.176, subd. 4m.

Before an authority can use tax increment from an existing TIF district for the Jobs Stimulus Program, a written spending plan must be approved by the municipality that approved the original TIF district.³⁹ As of the date of this Report, 35 spending plans have been submitted to the OSA. A summary of the spending plans approved under the Jobs Stimulus Program can be found in Appendix C.

FINDINGS AND RESPONSES

The OSA conducts informal and limited reviews of development authorities. If an authority is not in legal compliance with the TIF Act, an initial notice of noncompliance (Initial Notice) is sent to the governing body of the municipality that approved the TIF district in which the violation arose. The Initial Notice provides the findings, the basis for the findings, and describes the possible consequences of the noncompliance.

The municipality is required by law to respond in writing within 60 days after receiving the Initial Notice. In its response (Response), the municipality must state whether it accepts the findings, in whole or in part, and must indicate the basis for any disagreement with the findings. After consideration of the Response, the OSA submits its final notice of noncompliance (Final Notice) to the municipality. The OSA forwards information regarding unresolved findings of noncompliance to the appropriate county attorney who may bring an action to enforce the TIF Act.⁴⁰ If the county attorney does not commence an action against the authority within one year after receiving a referral of a Final Notice, the Final Notice is referred to the Attorney General.

Summary of Findings and Responses

State law requires the OSA to provide a summary of the Responses it received from the municipalities and copies of the Responses themselves to the chairs of the legislative committees with jurisdiction over tax increment financing.⁴¹ This section of the Report summarizes the TIF legal compliance reviews and investigations concluded as of December 31, 2011. Initial Notices and Final Notices were sent to the following municipalities:

1. Duluth Economic Development Authority – An Initial Notice was sent on January 5, 2011. A Final Notice was sent on March 11, 2011. (Appendix D.)
2. City of Stillwater – An Initial Notice was sent on August 30, 2011. A Final Notice was sent on October 21, 2011. (Appendix E.)
3. St. Paul Housing and Redevelopment Authority – The OSA completed a review of three TIF districts within the Saint Paul Housing and Redevelopment Authority. A letter acknowledging no findings of noncompliance was sent on August 18, 2011. (Appendix F.)

³⁹ Although the Jobs Stimulus Program does not mandate filing the spending plan with the Office of the State Auditor, we request them pursuant to existing authority. Minn. Stat. § 6.74; *see also* §§ 6.48 to .51.

⁴⁰ All information and communications remain confidential until the Final Notice is submitted. Minn. Stat. § 6.715.

⁴¹ Minn. Stat. § 469.1771, subd. 1(c).

Complete copies of the Initial Notices and Final Notices and the municipalities' Responses are provided at the end of this Report.

Failure to Comply with the Four-Year Rule

Duluth Economic Development Authority

TIF District 17 Bayfront

In the Initial Notice, the OSA found that the Duluth Economic Development Authority (DEDA) improperly retained \$81,436.27 of tax increment received from parcels in TIF District 17 Bayfront that did not qualify for retention. DEDA did not provide documentation to substantiate that qualifying improvements were made to any of the parcels in TIF District 17 Bayfront within four years from the date of certification, as required by the TIF Act's Four-Year Rule. Therefore, no tax increment should have been received from these parcels after October 3, 1999.

In its Response, DEDA provided documentation to substantiate that qualifying improvements were made to two of the three parcels in the TIF district in the amount of \$4,155.80. In addition, DEDA returned the remaining \$77,280.47 to St. Louis County. In the Final Notice, the OSA considers this finding resolved.

Improper Use of Tax Increment

City of Stillwater

TIF District No. 1

In the Initial Notice, the Office of the State Auditor found that the City was in violation of the TIF Act when it donated \$80,000 of tax increment from TIF District No. 1 to the St. Croix River Crossing, a nonprofit corporation.

In its Response, the City asserted that the \$80,000 was not a "donation" to a nonprofit. Instead, the City re-characterized the money as a pass-through to lobbyists under an implied contract with the nonprofit. In the Final Notice, the Office of the State Auditor rejected the City's effort to re-characterize the nature of the payment for purposes of its Response. The City returned the \$80,000 to Washington County. The OSA considers this finding resolved.

APPENDIX A

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Development Authorities That Did Not Submit Complete 2010 Annual TIF Reports

- Appleton Economic Development Authority^{*}
- Biwabik
- Dassel
- Le Seuer Economic Development Authority
- Murdock
- Raymond

^{*} The Appleton Economic Development Authority has also not filed the required reporting forms for 2008 and 2009.

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APPENDIX B

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Jobs Stimulus Program
TIF Revenues from Economic Development Districts

Minn. Stat. § 469.176, subd. 4c (d)

Self-reported to the Office of the State Auditor as of January 30, 2012

City of Alden, TIF 1-1 Arnold Companies

The City of Alden established an economic development district for the purposes of property acquisition and making site improvements for a sales & service facility to be operated by Arnold Companies for agriculture, light construction, and consumer products. The estimated amount of tax increment to be expended is \$213,536.

City of Baxter, Isle Drive TIF District

The City of Baxter established an economic development district to facilitate the improvement and extension of Isle Drive in conjunction with proposed medical office projects, including the construction of a 40,000 square foot two-story medical clinic. The estimated amount of tax increment to be expended is \$1,091,439.

City of Bloomington HRA, Penn and American TIF District

The City of Bloomington HRA established an economic development district to finance a mixed-use development. Phase I of the project is expected to include rental housing and retail uses; the second phase is expected to include restaurant and retail uses plus office use. It is anticipated that the project will result in peak employment of 250 construction workers, with long-term job creation expected to exceed 60 jobs in the first phase of the project. The estimated amount of tax increment to be expended is \$5,738,000.

City of Cambridge, TIF Districts 6-11 and 6-12

TIF 6-11

- The City of Cambridge established an economic development district to facilitate construction of a dentistry clinic and a future office building in the City. The construction will take place in two phases. The estimated amount of tax increment to be expended is \$500,000.

TIF 6-12

- An economic development district was established by the City of Cambridge to facilitate the construction of a 40,000 square-foot facility on the site that will include manufacturing, office and warehouse space occupied by National Recycling, Inc. The district will be located on a 3.97 acre site from the City of Cambridge. The new facility will retain 7 full-time employees and create 13 new full-time positions at an average rate of \$14/hour. The estimated amount of tax increment to be expended is \$2,700,000.

City of Carver, TIF 1-8 Mills Fleet Farm

The City of Carver established an economic development district to finance the site preparation and streets and sidewalks costs related to the construction of a Mills Fleet Farm retail facility, including a gas station, car wash, and convenience store. The City anticipates the construction of the facility will

create approximately 140 full-time jobs, plus additional construction jobs. The estimated amount of tax increment to be expended is \$1,676,084.

City of Chisago City, TIF 1-11 Hwy 8 & Sportsman Drive

The City of Chisago City established an economic development district to facilitate the construction of a strip mall and other retail facilities on the corner of Highway 8 and Sportsman Drive. The initial development will include a drive-in restaurant (McDonald's) and other retail business. The estimated amount of tax increment to be expended is \$1,500,000.

City of Cloquet, TIF 3-1 Daqota Systems

The City of Cloquet established an economic development district to facilitate construction of a manufacturing facility for Daqota Systems, Inc. The proposed facility will be used for manufacturing and engineering related to factory automation, research & development, and energy-related engineering. The estimated amount of tax increment to be expended is \$256,000.

City of Colombia Heights, City-Wide Scattered Housing TIF District

The City of Colombia Heights established an economic development district to facilitate the redevelopment and sale of new single-family homes in Anoka County and through the Greater Metropolitan Housing Corporation. The estimated amount of tax increment to be expended is \$1,573,000.

City of Faribault, TIF 11 Mike's Garage

The City of Faribault established an economic development district to assist in the land purchase, clean-up, and new construction of an automotive service station located on the City's main gateway corridor. As a result of the project, four jobs will be retained and 5 new jobs created immediately, with an additional 20 or more jobs added over time. The estimated amount of tax increment to be expended is \$127,045.

City of Fergus Falls, TIF 4-9

The City of Fergus Falls established an economic development district to assist in the construction of a 34-unit assisted living facility on property occupied by the Lakeland Hospice & Home Care Facility, located at 394 and Woodland Drive. Job creation is expected, and the estimated amount of tax increment to be expended is \$374,432.

City of La Crescent, TIF 6-1

The City of La Crescent established an economic development district to assist in the development of a 3,500 square-foot funeral home. The estimated amount of tax increment to be expended is \$51,894.

City of Lindstrom, TIF 1-6 NABPCO Auto Parts

The City of Lindstrom established an economic development district to assist in the construction of a retail auto parts facility. Tax increment from the proposed district will finance the infrastructure needs and site improvement costs to relocate the NABPCO Auto Parts business. The costs will be incurred due to the realignment of Highway 8. The estimated amount of tax increment to be expended is \$85,000.

City of Little Falls, TIF 1-38 AirBorn Expansion and Relocation Project

The City of Little Falls established an economic development district to facilitate a 50,000 square-foot facility for AirBorn. Employment will be expanded. The estimated amount of tax increment to be expended is \$3,952,936.

City of Long Prairie TIF 1-10

The City of Long Prairie established an economic development district to assist Long Prairie Packing with the installation of a methane digester on an 8.16-acre parcel adjacent to Trunk Highway 71 on the North side of the City. The estimated amount of tax increment to be expended is \$1,324,709.

City of Melrose, TIF 7-1

The City of Melrose established an economic development district to facilitate the construction of a 10,000 square foot facility used to manufacture and assemble fiberglass fishing boats by Warrior Boats. The estimated amount of tax increment to be expended is \$1,831,458.

City of New York Mills, TIF 1-11

The City of New York Mills established an economic development district to construct a 10-12,000 square-foot facility to retain businesses and jobs in the community. The estimated amount of tax increment to be expended is \$188,391.

City of Nisswa, TIF 1-12

The City of Nisswa created an economic development district for the purpose of renovating, expanding, and equipping an existing facility for a 12-bed assisted-living facility and adult day care program. The estimated amount of tax increment to be expended is \$54,653.

City of North Mankato Port Authority, TIF Districts 1-20, 1-21 and 1-22

TIF 1-20 Ziegler Caterpillar Project

- The Port Authority of the City of North Mankato established an economic development district to assist with the construction of a sales, service, and warehouse facility for Ziegler Caterpillar. The company estimates that 12 new jobs will be created over the next five years, which are in addition to the employees already working at the existing North Mankato location. The estimated amount of tax increment to be expended is \$765,736.

TIF 1-21 Allstate Peterbilt Project

- The Port Authority of the City of North Mankato established an economic development district to assist with the construction of a 17,260 square-foot truck and trailer parts and service facility for Allstate Peterbilt Group. The company estimates that 15-20 new jobs will be created over the next two years. The estimated amount of tax increment to be expended is \$228,063.

TIF 1-22 Lindsay Expansion Project

- The Port Authority of the City of North Mankato established an economic development district to assist with a 20,000 square-foot expansion of Lindsay Window and Door. The company estimates that 15 new jobs will be created over the next two years. The estimated amount of tax increment to be expended is \$148,525.

City of Pipestone, TIF 1-12

The City of Pipestone established an economic development district to facilitate the development of a 35,000 square-foot Coborn's grocery superstore. The estimated amount of tax increment to be expended is \$652,300.

City of Prior Lake, TIF 1-4

The City of Prior Lake established an economic development district to facilitate a 7,000 square-foot expansion of the River Valley Vet Clinic. The estimated amount of tax increment to be expended is \$96,000.

City of Rochester, TIF Districts 38-1 and 40-1

TIF 38-1

- The City of Rochester established an economic development district to develop a 47 unit multi-family rental housing development. The estimated amount of tax increment to be expended is \$1,013,376.

TIF 40-1

- The City of Rochester established an economic development district to facilitate the construction of a 27,600 ground floor grocery store with 62 units of market-rate rental apartments on the top 3 floors of the building. The estimated amount of tax increment to be expended is \$3,345,550.

City of Roseville, TIF 19 Applewood Pointe Senior Cooperative Housing

The City of Roseville created an economic development district to finance a multi-phase development comprised of a 94-unit senior cooperative building and 93-unit assisted-living facility. The estimated amount of tax increment to be expended is \$2,450,551.

City of Saint Louis Park, Hardcoat TIF District

The City of Saint Louis Park EDA established an economic development district to assist Hardcoat, Inc., complete renovation of a manufacturing facility to be used for high-tech surface coating applications. The City determined that this renovation will ensure the retention of 14 employees from its current location and anticipates that additional construction jobs will also be created or retained. The estimated amount of tax increment to be expended is \$376,186

City of Saint Paul HRA, Cossetta Project

The City of Saint Paul HRA established an economic development district to facilitate the expansion of an existing restaurant and food market known as Cossetta's Italian Market and Pizzeria. Specifically, the project includes the construction of a new building, the renovation and internal reconfiguration of existing space, and related parking improvements. The estimated amount of tax increment to be expended is \$641,155.

City of Sartell, TIF 5-4

The City of Sartell established an economic development district to facilitate the construction of 75 market-rate apartments in the City within the Grand View Estates South complex. The estimated amount of tax increment to be expended is \$876,213.

City of Sauk Rapids HRA, TIF 20 Torberg Apartments

The City of Sauk Rapids HRA established an economic development district to facilitate the construction of a market-rate rental housing development consisting of 16 townhome units and 138 apartment units. Tax increment will be used to assist with the cost of site improvements and infrastructure. The development is expected to add 35 full-time jobs over a two-year period. The estimated amount of tax increment to be expended is \$1,826,525.

City of Shoreview, TIF 7 Southview Senior Living

The City of Shoreview established an economic development district to assist with demolition, site improvements and other improvements to construct a 105 unit congregate, assisted living and memory care facility. The development is expected to create 33 full-time equivalent jobs and an estimated 110 construction jobs. The estimated amount of tax increment to be expended is \$1,215,000.

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Jobs Stimulus Program
TIF Revenues from Existing Districts

Minn. Stat. § 469.176, subd. 4m

Self-reported to the Office of the State Auditor as of January 30, 2012

City of Bloomington HRA, Oxboro 0-1 and Oxboro 0-3 TIF Districts

The City of Bloomington HRA approved a spending plan to authorize the use of available tax increment funds to provide assistance for housing and commercial projects, including parking facilities, in the Normandale Lakes District, South Loop District, and the Penn & American Phase I Redevelopment Area. The maximum amounts of tax increment to be available are \$600,000 and \$450,000 from the Oxboro 0-1 and Oxboro 0-3 TIF Districts, respectively.

City of Breckenridge, TIF 4

The City of Breckenridge approved a spending plan to authorize the use of available tax increment funds to provide assistance for exterior, façade, accessibility, code and energy efficiency improvements that will serve to preserve the existing buildings. At the time the spending plan was approved, the City had identified one specific project to receive assistance: A forgivable loan in the amount of \$100,000 will assist the Greenquist Building Project in funding several exterior improvements. Additional projects will be discussed by the council. The specific amount of tax increment to be made available from TIF District 4 is \$300,000.

City of Brooklyn Center, TIF 2

The City of Brooklyn Center approved a spending plan authorizing financing of the costs that link a local hotel to businesses close by. The spending plan did not identify a specific amount of tax increment to be available.

City of Brooklyn Park EDA, TIF 15, TIF 16, and TIF 18

The City of Brooklyn Park EDA approved a spending plan authorizing the use of available tax increment from TIF Districts 15, 16, and 18 to fund the City's Construction Assistance Program, providing assistance for private development projects requiring a minimum of \$50,000 in financing. The spending plan did not identify a specific amount of tax increment available from the TIF districts.

City of Cambridge, TIF Dist 6.8 SE Cambridge Industrial Area

The City of Cambridge approved a spending plan authorizing the use of available tax increment, up to \$72,000, from TIF 6.8, for purposes consistent with the law. The spending plan did not identify a specific project.

City of Coon Rapids, TIF Districts 1-6, 1-29, and 3-1

The City of Coon Rapids approved two spending plans to authorize the use of available tax increment from three TIF Districts for the projects described below.

TIF 1-6 MFI:

- Assistance to Autumn Glen Senior Living, LLC, in the amount of \$420,000 for the construction of a 100-unit senior housing campus. The project is expected to create at least 25 new jobs with an average hourly wage of \$12.

TIF 1-29 Oak Manor:

- Assistance to Biovest International, Inc., in the amount of \$103,000 for the rehabilitation of its current facility to accommodate an increased production of its vaccine for non-Hodgkin's lymphoma. The City anticipates this project to retain at least 24 full-time positions, and to create at least 14 new positions paying no less than \$15 per hour.
- Assistance to MEDRAD, Inc., in the amount of \$27,000 for the expansion of its current facility. The project is estimated to retain 220 full-time positions and to create at least 30 new positions paying an average wage of \$33.65 per hour.

TIF 3-1 Oppidan – Village 10

- Assistance to MEDRAD, Inc., in the amount of \$313,000 for the same project identified above.

City of Delano, Honeytree TIF District and Hwy 12 Hardees TIF District

The City of Delano approved a spending plan to authorize the use of available tax increment from two TIF Districts to fund an incentive program for new construction (residential or commercial) offering of \$5,000 to write-down permitting fees. The City estimates available tax increment to be \$93,807 and \$62,150 for the Honeytree and Hwy 12 Hardees TIF Districts, respectively.

City of Detroit Lakes, Various TIF Districts

The City of Detroit Lakes approved a spending plan to authorize the use of available tax increment from seven TIF Districts to provide assistance for (i) commercial projects, including but not limited to, the DLM Downtown Properties Project, (ii) property acquisition, building demolition, site improvement, and utilities costs in the Crescent Redevelopment Area, and (iii) parking facilities, including but not limited to, the parking lots and improvements in the Central Business District. The specific amount of tax increment to be made available from the TIF Districts is \$488,703.

City of Duluth EDA

The City of Duluth EDA approved a spending plan to authorize the use of available tax increments for potential future projects qualifying under the Jobs Bill. The spending plan does not identify a specific project or amount of assistance to be made available.

City of Elk River HRA, TIF 16 King and Main

The City of Elk River HRA approved a spending plan authorizing the use of available tax increment for construction or rehab of buildings for (i) outpatient medical clinics, (ii) Class I restaurants of at least 50 seats, (iii) green manufacturing or other renewable energy facilities, and (iv) general light industrial or manufacturing. The spending plan does not identify a specific project or amount of assistance to be made available.

City of Farmington, Downtown Redevelopment TIF District

The City of Farmington approved a spending plan to authorize the use of available tax increment from the Downtown TIF District to provide assistance to a developer for the construction of a medical/office building. The specific amount of tax increment to be made available from the TIF districts is \$65,000.

City of Fosston, TIF 7 Post Office Project

The City of Fosston approved a spending plan to authorize the expenditure of available tax increment from TIF District 7 to provide assistance to Overmoe & Nelson, Ltd. The funds will be used to acquire and redevelop a site for a 2,160 square-foot office building. The City will require the developer to agree to create at least one full-time job. The specific amount of tax increment to be made available from the TIF district is \$24,900.

City of Glencoe, TIF 15 Industrial Park Expansion

The City of Glencoe approved a spending plan to authorize the use of available tax increment from TIF 15 to assist Midwest Research Swine, Inc., in financing certain equipment and improvements to the Developer's laboratory space. Construction of the improvements will create or retain at least two full-time jobs. The specific amount of tax increment to be made available from the TIF district is \$60,000.

City of Inver Grove Heights, TIF 4-1 SE Quadrant

The City of Inver Grove Heights approved a spending plan to authorize the use of available tax increment from TIF 4-1. The tax increment will be used to provide assistance to Inver Grove Heights Investment, LLC, to finance development of the Argenta Hills area, including the completion of a 135,000 square-foot retail anchor store together with 15,000 square-feet of additional commercial space. The project will create or retain at least 14 new full-time construction jobs at the site. The specific amount of tax increment to be made available from the TIF district is \$1,250,000.

City of Isanti, TIF Districts 8, 9, and 10

The City of Isanti approved a spending plan to authorize the use of available tax increments from three TIF districts for the amounts and purposes listed below.

TIF 8 ICC Industrial Park:

- Assistance to Prairie Senior Cottages of Isanti, LLC, in the amount of \$200,000 for the land acquisition and construction of senior memory-care facility. The project will create approximately 10-15 jobs with an average wage of \$25 per hour including benefits.
- Assistance to H.M. Chris, LLC, in the amount of \$50,000 for land acquisition and for construction of a childcare center. Approximately three new jobs with average wages of \$7-\$9 per hour will be created.
- Assistance to Stawski & Stawski, Inc., in the amount of \$35,000 for the construction of a restaurant expansion to Wintergreen Golf and Grill. The expansion will create 3 to 10 new jobs with wages from \$8 to \$20 per hour including benefits and tips.

TIF 9 CBD Revitalization:

- Assistance to Stawski & Stawski, Inc., in the amount of \$15,000 for the project described above.

TIF 10 Restart Industrial Park:

- Assistance to C.L. Hough, LLC, in the amount of \$50,000 for the construction of an industrial manufacturing expansion. The project will create approximately 5-8 new jobs with wages ranging from \$10-\$12 per hour.

City of Lindstrom, TIF 1-2

The City of Lindstrom approved a spending plan to authorize the city to use available increments from TIF 1-2, for any of the uses outlined in the statute. The spending plan does not identify a specific project. The specific amount of tax increment to be made available from the TIF district is \$475,000.

City of Little Canada, TIF 3-2 Rice Street Redevelopment

The City of Little Canada approved a spending plan to authorize the use of available tax increment from TIF 3-2 to assist in completing build-outs of rental space for a multi-tenant building. The building, a former Knox lumber site that had been converted to an office/warehouse. The developer/owner had been unable to obtain financing to finish the build-outs to attract new tenants. The spending plan does not identify a specific project or amount of assistance.

City of Minnetonka EDA, TIF 1-2 Boulevard Gardens

The City of Minnetonka EDA approved a spending plan to authorize the use of available tax increment from TIF 1-2 to defray a portion of certain City utility charges owed by Glen Lake Senior Housing Development, LLC, in connection with construction of an approximately 150-unit senior rental housing development in the City. Construction will create approximately 30 new jobs. The specific amount of tax increment to be made available from the TIF district is \$100,000.

City of Monticello EDA, TIF 1-22 Downtown Dist

The City of Monticello EDA approved a spending plan to authorize the use of available tax increments from TIF 1-22 for purposes allowed under the law. According to the council meeting minutes, tax increment will be used to help finance infrastructure costs associated with the Semper Development/Walgreens project, provided that the recipient create or retain at least three full-time jobs for \$400,000 of assistance provided. The spending plan does not identify a specific project or amount of assistance.

City of Montrose, TIF 2-1 Jeff-Ex Proj

The City of Montrose approved a spending plan to authorize the use of available tax increment from TIF 2-1 for (i) assistance for new commercial construction; (ii) assistance with the rehabilitation of the former Stock Lumber building; and (iii) administration associated with TIF 2-1. The specific amount of tax increment to be made available from the TIF district is \$23,200.

City of New Brighton, TIF Districts 23, 25, 27, 28, 30, and 33

The City of New Brighton approved a spending plan authorizing the use of available tax increment in the amount of \$1,200,000 from six TIF districts for the construction of a 120-unit apartment building. The spending plan authorizes the City to expend approximately \$300,000 of available tax increment to reimburse itself for costs associated with the development.

City of Plymouth, TIF 7-4 Hoyt - Tech Park

The City of Plymouth approved a spending plan to authorize the use of available tax increment from TIF 7-4 to provide a loan or other form of assistance for the construction of a 67-unit affordable housing development. The specific amount of tax increment to be made available from the TIF district is \$600,000.

City of Ramsey, TIF Dist 1 and TIF Dist 2

The City of Ramsey approved a spending plan to authorize the use of available tax increment from TIF District 1 and TIF District 2, for the purpose of providing assistance to F & C Ramsey LLC for the construction of a mixed-use development consisting of market rate rental housing and retail. The specific amount of tax increment to be made available from the TIF districts is \$1,400,000 and \$2,400,000, respectively.

City of Richfield HRA, Interchange TIF District and Lyndale Gateway West TIF District

The City of Richfield HRA approved a spending plan to authorize the use of available tax increment from two TIF districts to provide assistance to Lyndale Gardens, LLC, to finance the acquisition and redevelopment of the Lyndale Garden Center. The project is expected to create or retain at least 25 new construction jobs. The HRA estimates available increment from the Interchange and Lyndale Gateway West TIF Districts to be \$951,445. The specific amount of tax increment to be made available to Lyndale Garden Center from the TIF districts is \$650,000.

City of Saint Joseph, TIF 1-4 St. Joseph Development, LLC

The City of Saint Joseph approved a spending plan to authorize the use of available tax increment from TIF 1-4 for the purpose of (i) assisting St. Joseph Meat Market with an expansion to the current facility and (ii) assisting Mill Stream Shops/Lofts to construct improvements to their facility to accommodate a new restaurant. The City anticipates providing assistance in the form of a deferred loan, which will be forgiven if the owner continues ownership for 10 years. The specific amount of tax increment to be made available from the TIF district is \$60,000.

City of Saint Louis Park, Various TIF Districts

The City of Saint Louis Park EDA approved a spending plan to authorize the use of available tax increment from nine TIF districts to fund the City's Construction Assistance Program. The program was created to spur the immediate construction, expansion, or rehabilitation of commercial/industrial/mixed use buildings. The spending plan does not identify a specific project. The specific amount of tax increment to be made available from the TIF district is \$1,600,000.

City of Saint Paul, Housing and Redevelopment Authority

The City of Saint Paul approved a spending plan to authorize the use of available tax increment to fund housing projects, health care facilities, and other various uses. The specific amount of tax increment to be made available is \$7,700,000.

City of Saint Paul Port Authority, Westminster Junction and Energy Lane TIF Districts

The City of Saint Paul Port Authority approved a spending plan to authorize the use of available increments from two TIF districts for potential future projects qualifying under the Jobs Bill. The spending plan does not identify specific projects. The specific amount of tax increment to be made available from the TIF district is \$1,300,000 of available increment from the Westminster Junction District, and \$518,000 from the Energy Lane District.

City of Saint Peter, TIF 1-15 Washington Terrace

The City of Saint Peter approved a spending plan to authorize the use of available tax increment from TIF 1-15 to assist the private redevelopment project being undertaken by Kwik Trip, specifically to

provide safe vehicular access and reconstruction of utilities. The specific amount of tax increment to be made available is \$300,000.

City of Sauk Rapids HRA, TIF 16 and TIF 18

The City of Sauk Rapids HRA approved a spending plan to authorize the use of available increments from TIF 16 for the construction of a commercial building and infrastructure within the real property known as VL Properties. The specific amount of tax increment to be made available is \$149,999.

The City later approved an additional spending plan to authorize an increase in the amount of available tax increment from TIF 16 to \$280,000. This spending plan also authorizes the use of approximately \$50,000 from TIF 18. The spending plan does not identify a project.

City of Shoreview, TIF 5 Mun Dev Dist 2 Victoria Ctr – Shoreview Mall

The City of Shoreview approved a spending plan to authorize the use of available tax increment from TIF 5 for the following uses: (i) To create a business loan program; (ii) To write-down the costs of the permitting fee for new construction projects; (iii) To provide funds to facilitate commercial (re)development; and (iv) To offset the cost of public infrastructure needed to support development - including Owasso Blvd, Lexington Ave, and Red Fox Road. The specific amount of tax increment to be made available is \$1,653,078.

City of Stillwater, TIF 1 Downtown

The City of Stillwater approved a spending plan to authorize the use of available tax increment from TIF 1 to help fund the City's Downtown Façade Program and Commercial Building Fund. The City intends to approve the guidelines for a specific program prior to any of the increment being expended. The specific amount of tax increment to be made available is \$3,000,000.

City of West St. Paul, TIF 1-1 South Robert Street

The City of West St. Paul approved a spending plan to authorize the use of available tax increment from TIF District 1-1. The EDA used the tax increment for its "housing replacement program." The EDA purchased two lots, demolished the existing structures, and sold the lots to housing developers at a write-down. Developers have now begun construction on each of the parcels. Construction jobs have been created. The specific amount of tax increment to be made available is \$150,000.

Town of White Bear EDA, TIF Districts 1, 2, 9 and 12 through 20

The Town of White Bear EDA approved a spending plan to authorize the use of tax increment to redevelop the Ayde property (1201 Birch Lake Boulevard North) and any other private development in the town for which the EDA finds that the private development will create or retain jobs. The spending plan does not identify a specific amount of assistance.

City of Winsted, TIF 6 Downtown Redevelopment

The City of Winsted approved a spending plan to authorize the use of available tax increment from TIF 6 to be spent for the implementation of a loan program to provide incentive financing for the exterior beautification of commercial/mixed use buildings in the downtown area. The specific amount of tax increment to be made available is \$40,000.

APPENDIX D

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REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

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1-800-627-3529 (Relay Service)

January 5, 2011

The Honorable Don Ness, Mayor
The Honorable Jeff Anderson, Council Member
The Honorable Patrick Boyle, Council Member
The Honorable Tony Cuneo, Council Member
The Honorable Todd Fedora, Council Member
The Honorable Jay Fosle, Council Member
The Honorable Sharla Gardner, Council Member
The Honorable Dan Hartman, Council Member
The Honorable Jim Stauber, Council Member

City of Duluth

411 W 1st St.
Duluth, MN 55802

Re: Duluth EDA's TIF Districts—Initial Notice of Noncompliance

Dear Mayor Ness and Council Members:

On September 21 through September 23, 2009, the Office of the State Auditor (OSA) performed an on-site examination of the tax increment financing (TIF) district records of the City of Duluth's Economic Development Authority (EDA). The examination covered the following districts: TIF District 17 Bayfront, TIF District 19 Tech Village, TIF District 20 NW Corridor-United Health Care, TIF District 21 Garfield Bus Ctr, TIF District 22 First Street Medical Facilities Development, and TIF District 23 Fifth Street Development District. The examination resulted in one finding that the EDA has not complied with state law governing the use of tax increment financing. The EDA failed to comply with the four-year rule. This Initial Notice of Noncompliance (Notice) contains our finding and comments regarding the examination.

All data relating to the examination, including this Notice and the City's response (Response), are not public until the OSA has issued its final report.¹

¹ Minn. Stat. § 6.715.

OFFICE OF THE STATE AUDITOR

Mayor and Council, City of Duluth
January 5, 2011
Page 2

State law requires the City send its Response in writing within 60 days after receipt of this Notice. The Response must state whether the City accepts the finding, in whole or in part, and the basis for any disagreement. After reviewing the Response, the OSA is required to forward information on any unresolved issues to the St. Louis County Attorney for review.²

If the City pays to the County an amount equal to the amount in noncompliance indicated in this Notice, the OSA will consider the finding to be resolved. Minnesota law provides that the City will receive its proportionate share of the redistribution of the funds that have been returned to the County, if the City makes the payment within 60 days after the City receives this Notice.³

FINDING OF NONCOMPLIANCE

The OSA's finding of noncompliance regarding the EDA's TIF districts is as follows:

Finding. TIF District 17 Bayfront— Failure to Comply with Four-Year Rule

A TIF authority must perform certain activities (qualifying improvements) on each parcel in the TIF district in accordance with the TIF plan within four years from the date the TIF district was certified, or the parcel(s) must be removed from the TIF district. This provision is known as the "four-year rule."⁴

If, after four years from the date of certification of the original net tax capacity of the tax increment financing district pursuant to section 469.177, no demolition, rehabilitation, or renovation of property or other site preparation, including improvement of a street adjacent to a parcel but not installation of utility service including sewer or water systems, has been commenced on a parcel located within a tax increment financing district by the authority or by the owner of the parcel in accordance with the tax increment financing plan, no additional tax increment may be taken from that parcel.

TIF District 17 Bayfront was certified on October 3, 1994. The EDA did not provide documentation to substantiate that qualifying improvements were made to all of the parcels in TIF District 17 Bayfront within four years from the date of certification.

² Minn. Stat. § 469.1771, subd. 1.

³ Minn. Stat. § 469.1771, subd. 5.

⁴ See Minn. Stat. § 469.176, subd. 6.

OFFICE OF THE STATE AUDITOR

Mayor and Council, City of Duluth
January 5, 2011
Page 3

We find that the EDA retained parcels in TIF District 17 Bayfront that did not qualify for retention under the four-year rule and, therefore, no tax increment was to have been received from the parcels after October 3, 1999. Any tax increment that was received must be returned. Based on information received from St. Louis County, the EDA received \$81,436.27 of tax increment for TIF District 17 Bayfront. The city decertified TIF District 17 Bayfront on November 18, 2009, but has not returned any tax increment from this district as of the date of this letter.

CONCLUSION

The Response to this finding must be submitted in writing to the OSA within 60 days after receipt of this Notice. We are available to review and discuss the findings within this letter at any time during the preparation of the Response. After reviewing your response, the OSA will issue the Final Notice of Noncompliance.

If you have any questions, please call me at (651) 296-7979. We look forward to receiving your response.

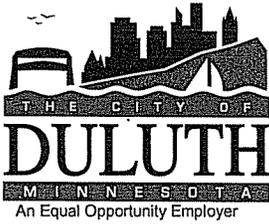
Very truly yours,

/s/ Arlin Waelti

Arlin Waelti
Assistant State Auditor
TIF Division Director

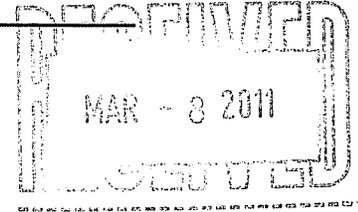
cc: John Heino, EDA Commissioner
Don Monaco, EDA Commissioner
Christine Townsend, EDA Commissioner
Nancy Aronson Norr, EDA Commissioner
Wayne Parson, City Auditor
Kevin Scharnberg, Financial Analyst
Brian Hanson, Executive Director
David Montgomery, Chief Administrative Officer
Adele Hartwick, Chief Financial Officer

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City Auditor • Wayne Parson, CPA (inactive)

411 West First Street • Room 107 • Duluth, Minnesota • 55802-1190
218-730-5450 • Fax: 218-730-5919
wparson@duluthmn.gov • www.duluthmn.gov



March 4, 2011

Ms. Arlin Waelti
Assistant State Auditor
TIF Division Director
Office of the State Auditor
Suite 500
525 Park Street
Saint Paul, MN 55103-2139

Dear Ms. Waelti:

This letter is in response to your Initial Notice of Noncompliance for certain Duluth EDA TIF Districts dated January 5, 2011. Your notice had a finding for TIF District 17 (Bayfront). The finding was that qualified redevelopment activities had not occurred on each parcel in the TIF district in accordance with the TIF plan within four years from the date the District was certified and, therefore, tax increment collections totaling \$81,436.27 should be returned by DEDA.

We have researched our records and have discovered that a significant road improvement project in excess of \$2 million to Railroad Street was commenced by the City within four years of the certification date. The Railroad Street improvement project was adjacent to two of the three parcels located in TIF District 17. Accordingly, tax increment received from those parcels, \$4,155.80, can be retained by DEDA. For the remaining parcel, we could not ascertain that qualifying improvements occurred within four years of the certification date of the District. Tax increment from this parcel was \$77,280.47.

On August 30, 2010, DEDA returned unspent tax increment totaling \$16,351.00 from TIF District 17 to Saint Louis County. This leaves a balance of \$60,929.47 in tax increment from the parcel that had no qualifying improvements. That amount, \$60,929.47, is being returned to Saint Louis County as of the date of this letter.

Sincerely;

Wayne Parson, CPA (inactive)
City Auditor

Citizens and Government working together to provide an environment in which
our community can enhance its quality of life and continue to prosper

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REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

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March 11, 2011

The Honorable Don Ness, Mayor
The Honorable Jeff Anderson, Council Member
The Honorable Patrick Boyle, Council Member
The Honorable Tony Cuneo, Council Member
The Honorable Todd Fedora, Council Member
The Honorable Jay Fosle, Council Member
The Honorable Sharla Gardner, Council Member
The Honorable Jacqueline Halberg, Council Member
The Honorable Dan Hartman, Council Member
The Honorable Jim Stauber, Council Member

City of Duluth

411 West First Street.
Duluth, MN 55802

Re: Final Notice: Audit of the Duluth Economic Development Authority (DEDA)
Tax Increment Financing Districts (TIF Districts).

Dear Mayor Ness and Council Members:

On January 5, 2011, the Office of the State Auditor (OSA) sent the City of Duluth (City) an Initial Notice of Noncompliance (Initial Notice) regarding the following TIF Districts of DEDA: TIF District 17 Bayfront, TIF District 19 Tech Village, TIF District 20 NW Corridor-United Health Care, TIF District 21 Garfield Bus Ctr., TIF District 22 First Street Medical Facilities Development, and TIF District 23 Fifth Street Development District. The OSA received the City's response (Response) in a letter dated March 4, 2011, from Wayne Parsons, City Auditor.

This letter is the final notice (Final Notice) of the Office of the State Auditor. It summarizes the initial finding of the OSA and the City's Response, and provides the final conclusion of the OSA regarding the issue raised by the review. A detailed discussion of the basis for the finding can be found in the Initial Notice.

OFFICE OF THE STATE AUDITOR

Mayor and Council, City of Duluth
March 11, 2011
Page 2

INITIAL NOTICE OF NONCOMPLIANCE

Only one finding of noncompliance was made.

Finding. Tax Increment Financing District No. 17 Bayfront Failure to Comply with Four-Year Rule

As stated in the Initial Notice, the OSA found that DEDA improperly retained \$81,436.27 of tax increment received from parcels retained in TIF District 17 Bayfront that did not qualify for retention. DEDA did not provide documentation to substantiate that qualifying improvements were made to any of the parcels in TIF District 17 Bayfront within four years from the date of certification, as required by the TIF Act's Four-Year Rule. Therefore, no tax increment was to have been received from these parcels after October 3, 1999.

RESPONSE OF THE CITY

In the City's Response, Wayne Parson, City Auditor, stated that the Railroad Street improvement project of the City was commenced within four years of the certification date of the district. The street improvements, however, were adjacent to only two of the three parcels in TIF District No. 17. The City forwarded documentation to substantiate these improvements and to demonstrate that the road improvements were adjacent to two of the three parcels in the TIF district. Thus, two parcels were in compliance with the Four-Year Rule; one parcel was not.

Tax increment in the amount of \$4,155.80 was received from the two parcels in the district that were in compliance with the Four-Year Rule. Tax increment revenues from these parcels were retained by DEDA.

No documentation was provided to show that improvements made to the third parcel in the district complied with the Four-Year Rule. The tax increment received by DEDA from this parcel totaled \$77,280.47. On August 30, 2010, DEDA returned to St. Louis County (County) unspent tax increment from TIF District 17 totaling \$16,351.00. On March 4, 2011, \$60,929.47 was returned to the County for a total of \$77,280.47.

FINAL NOTICE – RESOLVED.

The documentation submitted by the City has been reviewed by the OSA. The documentation showed that two of the three parcels in TIF District 17 Bayfront were in compliance with the Four-Year Rule. Additional documentation showed that \$77,280.47 in tax increment was returned to the County as a result of the failure of the third parcel to comply with the Four-Year Rule. The Office of the State Auditor thereby considers this finding resolved.

OFFICE OF THE STATE AUDITOR

Mayor and Council, City of Duluth
March 11, 2011
Page 3

The tax increment was returned to the County within 60 days from the date the City received its Initial Notice. The County Auditor's Office confirmed receipt of the money. Consequently, the City is entitled to receive its proportionate share of the County's redistribution.

CONCLUSION

If you have questions, would like additional information, or if we can be of assistance in the future, please do not hesitate to contact me. I can be reached at (651) 296-7979.

Very truly yours,

/s/ Arlin Waelti

Arlin Waelti
Assistant State Auditor
TIF Division Director

cc: John Heino, DEDA Commissioner
Don Monaco, DEDA Commissioner
Christine Townsend, DEDA Commissioner
Nancy Aronson Norr, DEDA Commissioner
Wayne Parson, City Auditor
Kevin Scharnberg, Financial Analyst
Brian Hanson, Executive Director
David Montgomery, Chief Administrative Officer
Adele Hartwick, Chief Financial Officer

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APPENDIX G

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REBECCA OTTO
STATE AUDITOR

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1-800-627-3529 (Relay Service)

August 30, 2011

The Honorable Ken Harycki, Mayor
The Honorable Micky Cook, City Council Member
The Honorable Doug Menikheim, City Council Member
The Honorable Mike Polehna, City Council Member
The Honorable James Roush, City Council Member
City of Stillwater
216 – 4th Street North
Stillwater, Minnesota 55082-4807

Re: City of Stillwater's TIF District No. 1 – Initial Notice of Noncompliance

Dear Mayor Harycki and Council Members:

The Office of the State Auditor (“OSA”) reviewed the City of Stillwater’s (“City”) donation of \$80,000 in tax increment from the City’s TIF District No. 1 to the Coalition for the St. Croix River Crossing (“Coalition”), a nonprofit corporation. After reviewing publicly available documents and documents the OSA received from the City, and after discussing the matter with the City, the OSA finds that the City is not in compliance with the TIF Act.¹ This Initial Notice of Noncompliance contains the OSA’s finding.²

Minnesota law requires the City to respond in writing to the OSA within 60 days after receipt of this Initial Notice. The response must state whether the City accepts the finding, in whole or in part, and must indicate the basis for any disagreement. At the conclusion of the OSA’s review, if the finding remains unresolved, a Final Notice of Noncompliance will be submitted to the City. If the OSA finds that the City violated a provision of the TIF Act for which a remedy is provided, the relevant information will be forwarded to the Washington County Attorney for review.³ All data relating to this review, including this letter and its response, are not public until the OSA has issued its final report.⁴

1 See Minn. Stat. §§ 469.174 to 469.1799 (2010).

2 The OSA’s findings regarding issues related to the donation, other than the City’s compliance with the TIF Act, are found in the OSA’s public letter to the Mayor dated August 30, 2011.

3 See Minn. Stat. § 469.1771, subd. 1 (b) (2010).

4 See Minn. Stat. § 6.715 (2010).

OFFICE OF THE STATE AUDITOR

Mayor and Council, City of Stillwater
August 30, 2011
Page 2

BACKGROUND

The Coalition is a nonprofit corporation formed to support the construction of a new bridge over the St. Croix River. The Coalition describes itself as a bi-state alliance of local government, business, community, and labor leaders, whose purpose is to educate citizens and to advocate in Wisconsin, Minnesota, Washington, D.C., and the media for the new bridge.⁵ The bridge supported by the Coalition is located, on the Minnesota side of the River, in the City of Oak Park Heights.⁶

The Coalition came to the City Council on July 5, 2011, and requested the City's financial support.⁷ In its presentation, the Coalition stated that its "message point" is that the current Lift Bridge (located on the Minnesota side of the River in the City of Stillwater) is obsolete, fracture-critical and unsafe, and the proposed bridge is "the right project in the right location." The Coalition described its purpose as allowing supporters of the new bridge to be organized, to speak with one voice, to make project decisions as public as possible, to lobby for congressional action and funding in Minnesota and Wisconsin, and to "win this time."⁸ The Coalition explained that it had three lobbyists doing "double duty" at the state and federal level.⁹ If successful, the Coalition anticipated that the project would be ready to begin in July 2013.

The City approved a donation of \$80,000 to the Coalition. More specifically, the City agreed that \$80,000 in tax increment would be paid from the City's TIF District No. 1, a redevelopment district established in 1985 that is required to be decertified at the end of 2011.¹⁰ According to the City Administrator, the funds were paid to the Coalition, but the City has no contract with the Coalition, and the City does not direct the Coalition's actions.

FINDING OF NONCOMPLIANCE

Finding: TIF District No. 1 – Improper Use of Tax Increment

The City's \$80,000 donation to the Coalition from tax increment generated by TIF District No. 1 appears to be based upon advice the City received from the City Attorney. Specifically, the City Attorney wrote the following in an email with the subject "Bridge Consultant Expenses":

⁵ See Coalition's website (www.stcroixcrossing.org) and the Coalition's presentation included in the City Council agenda packets for the July 5, 2011, City Council meeting.

⁶ Other bridge designs and locations have been proposed. See, e.g., Coalition's presentation included in the City Council agenda packets for the July 5, 2011, City Council meeting, available on the City's website.

⁷ The presentation was made by the Coalition's Executive Director, who is also one of the Coalition's lobbyists.

⁸ See Coalition's presentation included in the City Council agenda packets for the July 5, 2011, City Council meeting.

⁹ See City Council Meeting Minutes for July 5, 2011, at page 4.

¹⁰ See Minn. Stat. § 469.176, subd. 1b(a)(4) (2010).

OFFICE OF THE STATE AUDITOR

Mayor and Council, City of Stillwater
August 30, 2011
Page 3

TIF District No. 1, Development District No. 1, was established to gather increment for use in the Downtown Historic area of the City. The Interstate [Lift] Bridge rests on land in the Historic Downtown that is also in this District. One of the stated purposes in the Plan for the District is: “to provide for financing and construction of public improvements in and adjacent to the Development District, necessary for the orderly and beneficial development of the District and adjacent areas of the City.”

Mn. Stats. Sec. 469.174 Subd. 14 allows for the payment of “amounts paid to contractors or others providing services directly connected to the physical development of real property within the project.” The construction of a new crossing for Stillwater and the conversion of the interstate [Lift] bridge to a pedestrian walkway qualifies as a development of real property within the project as envisioned by the Plan. Based upon this reasoning, it is my opinion that the payment of contractors providing consulting services in support of state and federal legislation in support of the new bridge construction could be lawfully made from available increment generated by TIF District No. 1.¹¹

The OSA disagrees with the City Attorney’s conclusion that tax increment could be used for “the payment of contractors providing consulting services in support of state and federal legislation in support of the new bridge construction.” The Coalition is involved in lobbying. The OSA has long taken the position that the use of tax increment for lobbying efforts is not authorized.¹²

Furthermore, the \$80,000 tax increment expenditure was neither paid to a contractor nor paid for consulting services. The City has no contract with the Coalition. The \$80,000 was simply a donation to a nonprofit organization.¹³

Under Minnesota law, tax increment must be used to finance or otherwise pay the capital and administration costs of the TIF district.¹⁴ The Coalition’s lobbying efforts are primarily in

¹¹ See Email dated June 9, 2011, from Dave Magnuson forwarded to City Administrator on June 18, 2011. See also City Council Meeting Minutes for July 5, 2011, at pages 2 – 3.

¹² For examples of the OSA’s long-standing position that lobbying costs are not eligible for payment with tax increment, see the OSA’s March 8, 2000, Tax Increment Financing Report at pages 19-22 (Cities of Faribault and Cambridge), available on the OSA’s website. The OSA is aware that tax increment has been used when the lobbying efforts are so closely related to a TIF district or project that the lobbying costs would constitute administrative expenses, such as seeking special legislation to extend the life of a TIF District. No such close relationship exists in the Coalition’s lobbying efforts.

¹³ For further discussion of problems with a donation by a City, see the OSA’s public letter to the Mayor dated August 30, 2011.

¹⁴ See Minn. Stat. § 469.176, subd. 4 (2010), referencing Minn. Stat. §§ 469.124 to 469.134. City TIF development districts must be within the corporate limits of the city. See, e.g., Minn. Stat. §§ 469.125, subd. 9, and 469.126, subd. 1 (2010).

OFFICE OF THE STATE AUDITOR

Mayor and Council, City of Stillwater
August 30, 2011
Page 4

support of the construction of a bridge located outside the City. In addition, the Coalition's presentation to the City Council mentioned other improvements outside the City, such as the restoration of bluff cuts in Wisconsin and the removal of an old power plant coal barge terminal located in the City of Oak Park Heights.

The City Attorney appears to conclude that the use of tax increment for the donation would be a permissible "administrative expense." However, the statutory provision cited by the City Attorney prohibits "amounts paid to contractors or others providing materials and services, including architectural and engineering services, directly connected with the physical development of the real property in the project" from being included as TIF District "administrative expenses."¹⁵ Therefore, the donation may not be characterized as an "administrative expense." In addition, the Coalition's efforts are not directly connected with the physical development of the real property in the project.

The Office of the State Auditor finds that the City was in violation of the TIF Act when it donated \$80,000 of tax increment from TIF District No. 1 to the Coalition.

CONCLUSION

The City's response to the OSA's finding must be submitted in writing to the OSA within 60 days after receipt of this Initial Notice. The OSA is available to review and discuss the findings at any time during the preparation of the City's response.

If you have any questions, please feel free to call me at 651-296-7979, or Deputy State Auditor/General Counsel Celeste Grant at 651-297-3673. We look forward to receiving the City's response.

Very truly yours,

/s/ Arlin Waelti

Arlin Waelti
Assistant State Auditor
TIF Division Director

cc. Mr. Larry Hansen, City Administrator
Ms. Sharon Harrison, City Finance Director
Mr. David Magnuson, City Attorney

¹⁵ See Minn. Stat. § 469.174, subd. 14 (2) (2010).

MAGNUSON LAW FIRM

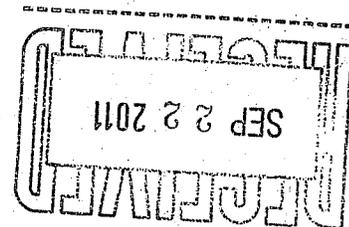
LICENSED IN MINNESOTA AND WISCONSIN

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DAVID T. MAGNUSON
DTMAGNUSON@MAGNUSONLAWFIRM.COM

JOHN D. MAGNUSON
JDMAGNUSON@MAGNUSONLAWFIRM.COM

September 21, 2011



✓Ms. Arlin Waelti
Ms. Celeste Grant
Assistant State Auditors
TIF Division Director
Office of the State Auditor
525 Park Street, Suite 500
St. Paul, MN 55103-2139

Re: Response of the City of Stillwater to City TIF District No. 1 –
Initial Notice of Noncompliance.

Dear Ms. Waelti and Ms. Grant:

The long standing policy of the Auditor's Office that Tax Increment should not be used to fund the efforts of a lobbyist and has been applied with few exceptions. This response, however, will demonstrate that in this instance the City had authority to use Tax Increment to fund lobbying efforts based on unusual and unique circumstances.

1982 Laws of Minn. 888-91, ch. 523, art. 38 §§ 3, 6, established the distinction between a TIF "district" and a "project area." Based upon the 1982 legislation, the city established Municipal Development District No. 1 and TIF District No. 1. The Development District and the TIF District were certified on June 10, 1985 and modified on April 30, 1990 to create what was termed a "Master Plan", that authorized tax increment generated in TIF Financing Districts 1, and other Districts, to be used to pay project costs anywhere in the "project area" of Development District No. 1.¹

The map attached as Exhibit "A" is a copy of Figure 2-1 from the 2006 Supplemental Final EIS and 4(f) evaluation for the New St. Croix River Crossing and prepared by the U.S. Department of Transportation (FHWA), MnDOT and WisDOT. Superimposed on figure 2-1 for purposes of this response, and shown in yellow, is Development District No. 1 and TIF District No. 1.

¹ In addition to a qualifying certification date, to qualify as a pre-1990 district, the city had to do one of the following by June 1, 1991: (1) enter into a development agreement for acquisition of a site in the district, (2) issue bonds, or (3) acquire property in the district. Bonds were issued in TIF Dist. 1. before June 1st, 1991, \$700,000 General Obligation Tax Bonds, Series 1989 B (INCSTAR project). 1990 Laws of Minn., ch. 604, art. 7 §§ 21, 30 and 31(a)

Exhibit "A" was annotated by FHWA to indicate the number of factors cited as evidence of the purpose and need of the new crossing; as evidence of the transportation problems in the District. The following transportation problems are referenced:

1. Lifts of the existing bridge limit capacity and cause delays and problematic queuing in the District and connected neighborhoods, all within the District.
2. Maintenance activities caused by the poor physical conditions of the bridge cause delays and traffic diversion to low capacity roads in the District.
3. Narrow streets within the District and limited space due to river bluffs within the District and residential and historic commercial property within the District limit possibility for alternate routes.
4. Pedestrians in the District add to congestion and safety problems.
5. Restricted geographics in Downtown Stillwater (in the District) limit traffic flow to one lane in each direction and limit ability of large vehicles to make turns.
6. Traffic volumes at Downtown intersections of Nelson/Main , Olive/Main, Myrtle/Main and Main and Third and Chestnut exceed capacity (all within the District) and queuing on all these streets cause intersections to be blocked at peak hours of traffic.
7. The crash rate in the District is about 90% higher than average crash rate for two lane urban highways in Minnesota.
8. Queuing spillback from Downtown Stillwater typically extends from Downtown Stillwater to Sunnyside area (from the Bridge to the south edge of the District).
9. Proximity of the Bridge to the Downtown area (the District) precludes the possibility of major elevation changes, of raising the height of the Bridge or eliminating the need for a Lift Bridge.
10. Emergency response times for Hospital, Fire Department and Sheriff Department are affected during peak periods.

All of these problems are noted as present conditions that FHWA predicts to get worse. Daily bridge traffic is now counted at 19,000 Annual Average Daily Traffic

(AADT) on summer weekends. For a peak hour regular commute, the delay results in 19 hours in total delay over the course of a year. The predicted average in vehicular traffic, if realized by 2030, will degrade traffic operations in Downtown Stillwater on the River Crossing and arterial approaches and will double average delay, queue length and daily hours of congestion. For the daily commuter, almost a work week out of every year would be spent in stalled traffic in the District. Exhibit "B" pages 2-1 through 2-16.

Minn. Stat. §469.126 (within Minn. Stat. §469.124 to §469.134) grants to the City within Development District No. 1, the power to "(1) promote developments aimed at improving the quality of . . . transportation" (emphasis added). Minn. Stat. §469.174 grants authority to the City to administer a Development District created pursuant to §469.124 to §469.134 and authority to finance and pay the capital and administration costs of a Development District as defined in Minn. Stat. §469.125, subd. 9. Minn. Stat. §469.176, subd. 4, allows tax increment to be used by the City to finance or otherwise pay the capital and administrative costs of a Development District pursuant to §469.124 to §469.134. In plain language, the City was granted express authority to spend Tax Increment to fund development aimed at improving the quality of transportation within TIF District No. 1.

The TIF law, therefore, contains an express grant of authority to address the very deficiencies that exist within the District. Authorization is given not only to use TIF funds to fund development aimed at improving transportation problems, but also to promote development aimed at addressing the quality of transportation in the District.

Lobby Costs Are Promotion Costs

A further unique circumstance that justifies the use of a lobbyist to promote the New River Crossing is the need for passage of a Congressional Act to exempt the New Crossing from Section 7(a) of the Wild Rivers Act. The full text of the latest 7(a) analysis is not included with this material since the analysis and supporting data contains 104 pages. What is enclosed as Exhibit "C" is the cover letter that was sent along with the 7(a) analysis to the St. Paul office of the FHWA by Ernest Quentono, Regional Director of the National Park Service, a division of the U.S. Department of Exterior dated October 15, 2010. In that letter the National Park Service concluded that the New Crossing simply cannot be built, no matter the extent of mitigation, without violating Section 7(a). The letter also gives the FHWA an explanation regarding just how to seek Congressional authority to exempt this project from the Wild River Act. In plain language, without an exemption from Congress the new crossing cannot be built.

There is no alternative but to seek the passage of a special law. Acts of Congress require the aid and skill of professionals to assist in the promotion of the special law needed to build this project aimed at improved transportation in the District. To promote means to urge the adoption of, to attempt to sell or popularize, to advocate. By giving authority to "promote", authority is expressly given to secure the services of a promoter,

an active supporter and advocate. A “promoter” is practically synonymous with “lobbyist”. Below are the definitions of both lobbyist and promoter from Black’s Law Dictionary, 4th Addition.

LOBBYIST. One who makes it a business to procure the passage of bills pending before a legislative body. One “who makes it a business to ‘see’ members and procure, by persuasion, importunity, or the use of inducements, the passing of bills, public as well as private, which involve gain to the promoters.” 1 Bryce, Am. Com. 156.

PROMOTER. One who promotes, urges on, encourages, incites, advances, etc. *Martin v. Street Improvement Dist. No. 324 of the City of Little Rock*, 167 Ark. 108, 266 S.W. 941, 942. One promoting a plan by which it is hoped to insure the success of a ... venture. *Caskie v. State Corporation Commission*, 145 Va. 459, 134 S.E. 583, 584.

“Lobbyist” is defined by Minnesota Statutes only for the purpose of defining who must register with the state.² There are many exceptions to the registration rules. For instance, elected officials who lobby the legislature or congress are permitted to lobby without registering with the state. Further, a city staff member who lobbies may do so without registering with the state, provided they spend less than 50 hours per month on lobbying efforts. The word lobbyist is not a precise term. Therefore, a lobbyist is also a promoter of the law needed to allow this transportation project to move forward.

A series of circumstances result in authority to pay a lobbyist promoting approval of a New River Crossing with funds generated from TIF District No. 1 because most of the area within the District has problems with traffic congestion from the old bridge. The TIF Act gives express authority to promote development aimed at improving transportation and the one and only path to a New River Crossing is the passage of a law by Congress. A lobbyist is essential to the purpose of passing this required act of congress.

Expenses Are Closely Related

The Initial Notice describes OSA’s long standing position that lobbying costs are not eligible for payment with Tax Increment, but admits that OSA is aware that Tax Increment has been used when the lobbying efforts as so closely related to the TIF District or policy that the lobbying costs would constitute administrative expenses, such as seeking special legislation to extend the life of a TIF District. OSA then concludes that “no such close relationship exists in the coalition lobbying efforts.”

² Minn. Stat. §19A.01, Subd. 21

The OSA cites as evidence of the lack of closeness of purpose that a new bridge will be located outside of the City and that part of the Environmental Mitigation Plan is to remove an old barge terminal in the City of Oak Park Heights and the restoration of bluff cuts in Wisconsin. While this information is true, it has little or no relevance to the aim of improving traffic problems in District 1. First of all, the only feasible way to improve transportation is to close the Historic Lift Bridge to traffic. The closing of the bridge is the development aimed at improving traffic in the District. The location of a new crossing is not important as long as the new crossing is located outside the District. What the OSA does not mention, is that the Mitigation Plan also includes removal of the Terra Terminal Building (within the District) and the preservation of the site for relocation of a historic building that will be displaced from its present location in Oak Park Heights to the former Terra Terminal site (within the District), and the construction of a looped trail system that will enhance pedestrian and bike opportunities within the District.

Mitigation efforts are important to the project, but are incidental to development of a project that is aimed at improving transportation within the District, the closing of the Historic Lift Bridge to vehicular traffic. It is difficult to imagine a project that is more closely related to an expressly authorized District purpose.

And, since lobby expenses are for promoting a transportation project, the expenses are not directly connected with the physical development of real property in the project. Therefore, Minn. Stat. § 469.174, subd. 14(2) (2010) does not prohibit the expense from being characterized as an administrative expense.

The Lack of an Express Written Contract Does Not Prohibit the Payment of TIF Proceeds for an Expressly Permitted Purpose

Even though a written contract should have been made between the Coalition and the City, the TIF Act does not require that a written contract be made with a consultant before TIF funds, otherwise authorized, may be made to them. A violation occurs when funds are expended for "a purpose that is not a permitted purpose under Section 469.176." For instance, Bond counsel services and other legal services related to the financing of TIF Bonds are administration expenses, and payments are routinely made to Bond counsel and other expert lawyers. The special relationship between TIF authority and their lawyers are usually long standing, but written retainer agreements are uncommon. Payments to these professionals do not violate the TIF Act. If the OSA requires a written contract to be in place between an authority and all third party consultants, a new level of scrutiny would be required to insure compliance. Each District would require an audit to insure that a written contract is in place with each lawyer, consultant, planner, engineer or architect that provides services to a TIF District, a burdensome requirement for all Districts.

A Contract Need Not Be In Writing

A written contract for those providing services is often not in place because the authority and the consultant are acting pursuant to a contract implied in fact. In Minnesota, the distinction between an express written contract and one implied in fact involves no difference in legal effect, but lies merely in the mode of manifesting assent. *Capital Warehouse Co. v. McGill-Wainer-Farnham Co.*, 276 Minn. 108, 149 N.W.2d 31 (1967).

In the present instance, the assent was manifested by the presentation of the Coalition to the City Council on July 5, 2011 and the City's acceptance of that proposal by action of a majority of the City Council. The implied contract was not for a donation, but for the Coalition as a non-profit created solely for the purpose of promoting a New River Crossing to pass-through funds from this TIF District and other entities such as Washington County, to Lobbyists under contract with the Coalition for the purpose of lobbying Congress for a new crossing. Further, Minn. Stat. §16C.05 contains state regulations for local government contracts such as the requirement of an "audit clause." The statute also recognizes "implied" contracts. The statute states, "Contracts made by a unit of local government must include express or implied, an audit clause."³ It is agreed that the best practice is to have express written contracts with all third party vendors and, in the future, this City is committed to a policy that requires a written contract before any payments are made to any third party providing services. Whether a "purpose" is a permitted project under section 469.176, should not be determined on the basis that the Coalition and the City did not have a written contract.⁴

Conclusion

We trust that the additional information set forth in this response will prove helpful to your review. We have shown transportation problems are spread throughout Development District No. 1, and that the City has authority to promote developments aimed at improving transportation. Therefore, it has the authority to pay lobbyist services

³ Minn. Stat. §16C.05, subd. 5.

⁴ Minn. Stat. §469.1771, subd. 3

Ms. Arlin Waelti and Ms. Celeste Grant

September 20, 2011

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because in this unusual and unique instance, the passage of a law is the single path to a New Crossing.

Respectfully yours,



David T. Magnuson
Stillwater City Attorney

DTM/dq
Enclosures

ccs: The Honorable Ken Harycki, Mayor
The Honorable Micky Cook, City Council Member
The Honorable Doug Menikheim, City Council Member
The Honorable Mike Polehna, City Council Member
The Honorable James Roush, City Council Member
Mr. Larry Hansen, City Administrator
Ms. Sharon Harrison, City Finance Director
LarsonAllen, LLP, City's Auditors
Mr. Michael Wilhelmi, Coalition's Executive Director

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October 21, 2011

The Honorable Ken Harycki, Mayor
The Honorable Micky Cook, City Council Member
The Honorable Doug Menikheim, City Council Member
The Honorable Mike Polehna, City Council Member
The Honorable James Roush, City Council Member
City of Stillwater
216 – 4th Street North
Stillwater, Minnesota 55082-4807

Re: City of Stillwater's TIF District No. 1 – Final Notice of Noncompliance

Dear Mayor Harycki and Council Members:

The Office of the State Auditor (“OSA”) reviewed the City of Stillwater’s (“City”) donation of \$80,000 in tax increment from the City’s Tax Increment Financing (“TIF”) District No. 1 to the Coalition for the St. Croix River Crossing (“Coalition”), a nonprofit corporation. The OSA found that the City was not in compliance with the TIF Act, and issued the City an Initial Notice of Noncompliance on August 30, 2011 (“Initial Notice”).¹ The Coalition returned the \$80,000 to the City.² The City responded to the OSA’s Initial Notice in a letter dated September 21, 2011 (“Response”). In its Response, the City disagreed with the factual and legal bases of the OSA’s Initial Notice. The City did not return the \$80,000 to Washington County for redistribution.³

This letter is the OSA’s Final Notice of Noncompliance (“Final Notice”). It provides the OSA’s final conclusions regarding the issues raised during this review.

1 See Minn. Stat. §§ 469.174 to 469.1799 (2010).

2 See City Council Meeting Minutes for September 13, 2011, at page 3.

3 The authority must pay the county auditor an amount equal to the expenditures made in violation of certain TIF laws. See Minn. Stat. § 469.1771, subd. 3 (2010). See also the OSA’s Statement of Position (“SOP”) on Redistribution of Tax Increment, available on the OSA’s website (www.auditor.state.mn.us). The OSA reminded the City of this requirement and enclosed a copy of the SOP in a letter to the City Attorney dated September 8, 2011.

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City's TIF District No. 1

The City's TIF District No. 1 is a redevelopment district established in 1985. The District must be decertified at the end of 2011.⁴ According to the most recent report the City filed with the OSA, the District had a tax increment balance of \$4,419,121 as of December 31, 2010. The City, as the development authority, may spend tax increment from the District after the District has been decertified, in accordance with the TIF Plan for approved project costs.

FINDING OF NONCOMPLIANCE

Finding: TIF District No. 1 – Unauthorized Use of Tax Increment

The OSA finds that the City's \$80,000 donation to the Coalition from tax increment generated by TIF District No. 1 was an unauthorized use of tax increment.

1. A donation to a nonprofit is not a qualified expenditure of tax increment.

A donation of tax increment to a nonprofit corporation is not a permitted purpose under the TIF laws. Therefore, the \$80,000 payment was not a qualified expenditure of tax increment from TIF District No. 1.

In its Response, the City asserts for the first time that the \$80,000 was not a "donation" to a nonprofit. Instead, the City re-characterizes the money as a pass-through to lobbyists under an implied contract with the nonprofit.⁵ The OSA rejects the City's effort to re-characterize the nature of the payment for purposes of its Response.

The City is wrong on the facts. During the OSA's review of this matter, the City and the Coalition repeatedly and consistently described the City's payment to the Coalition as a "donation." The Coalition's Executive Director, the City Administrator, and the City Attorney each described the payment as a "donation."⁶ In addition, the City Administrator and the City Attorney each specifically denied that the City had a contract with the Coalition.⁷

The Coalition's presentation to the City Council on July 5, 2011, does not discuss entering into a contract with the City, either express or implied. The City Council was not engaged in contract negotiations. Instead, the Coalition came to the City Council to solicit a donation. According to the meeting minutes, the Coalition was "requesting funding from various sources to continue

⁴ See Minn. Stat. § 469.176, subd. 1b(a)(4) (2010).

⁵ See City's Response, at pages 5 and 6.

⁶ See enclosed Statement of Nancy J. Bode regarding telephone conversations with Coalition's Executive Director Michael Wilhelmi, City Attorney David Magnuson, and City Administrator Larry Hansen.

⁷ See *id.*

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with the mission.”⁸ The Coalition’s Executive Director requested \$80,000 in financial support from the City, and the City Council approved “\$80,000 TIF funding to the Coalition.”⁹ No limitations or conditions were imposed on the payment approved by the City Council.¹⁰ Therefore, as a factual matter, the City had no contract with the Coalition.

The City is also wrong as a legal matter. The Coalition’s presentation to the City Council was not a contractual offer, and the City’s approval of the donation was not an acceptance of the offer. No terms on which any implied contract could have been based were provided. The Coalition never agreed to provide goods or services to the City.

The case cited by the City, *Capital Warehouse Co., Inc. v. McGill-Warner-Farnham Co.*, 276 Minn. 108, 149 N.W.2d 31 (1967), does not support the City’s contention that the City had an implied contract with the Coalition. In that case, the appellant stored commercial furniture in a warehouse. The appellant paid monthly storage bills submitted by the warehouse.¹¹ The Minnesota Supreme Court affirmed the lower court’s decision that the warehouse was entitled to receive payment for additional labor and services furnished to the appellant. Given the facts presented, the Court had no problem finding that the warehouse had provided appellant a commercial service that was not gratuitous.

In sharp contrast, no commercial transaction existed between the Coalition and the City. The City did not pay the Coalition based upon invoices submitted by the Coalition for services rendered to the City. The City’s payment to the Coalition was purely gratuitous.

Under the City’s view, any donation of funds to a nonprofit would create an implied contract between the donor and the nonprofit – even where no limitations were placed by the donor on the use of the donated funds. The OSA knows of no support for the City’s novel position, and the City offers none.

Minnesota law generally requires a written itemization of claims prior to payment, and the vendor must declare that the money is owed and no part of it has been paid.¹² The lack of

⁸ See City Council Meeting Minutes for July 5, 2011, at page 2. For example, one City Council member asked what the City’s Independent Business Association was doing to raise funds for the Coalition. See *id.*, at page 5 (Council Member Menikheim’s question).

⁹ See *id.*, at pages 2 and 5.

¹⁰ See *id.*, at page 5.

¹¹ See *Capital Warehouse Co., Inc. v. McGill-Warner-Farnham Co.*, 276 Minn. 108, 111, 149 N.W.2d 31 (1967).

¹² See Minn. Stat. § 471.38, subd. 1 (2010). The statute provides, in relevant part:

[W]here an account, claim or demand against any county, local social services agency, county board of education for unorganized territory, school district, town or home rule charter city of the second, third or fourth class, or any park district, for any property or services can be itemized in the ordinary course of business, the board or officer authorized by law to audit and allow claims shall not audit or allow the claim until the person claiming payment, or the person’s agent, reduces it to writing or an electronic transaction

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supporting documentation for expenditures has historically resulted in OSA findings of noncompliance with the TIF Act.¹³ The City's \$80,000 payment was not made in response to a claim/invoice for services rendered. It was a donation, and the City had no assurance of what, if anything, it might receive from the Coalition in return.

The City's assertion that lobbying contracts are often not in place is also contrary to the City's own prior conduct. According to reports the City provided to the OSA, the City has expended \$728,193 for contracted lobbyists from 1996 – 2008.¹⁴

The City fails in its effort to re-characterize the donation as a pass-through to lobbyists under an implied contract with the Coalition. The City had no recourse if the Coalition failed to use the donation to pay lobbyists.

If accepted, the City's argument that the \$80,000 was a pass-through to lobbyists under an implied contract with the nonprofit would thwart Minnesota's lobbying disclosure laws. While the Coalition's Executive Director is registered as a lobbyist for the Coalition, he is not registered as a lobbyist for the City.¹⁵ Furthermore, the Coalition has claimed that any contracts it may have with lobbyists are "non-public, trade secret" documents. Under the City's new theory, a city could hire lobbyists through another entity, and the lobbyist would never need to report that the lobbying was being done on the city's behalf.

The City had no contract, implied or otherwise, with the Coalition for lobbying services. A donation of tax increment to a nonprofit corporation is not a qualified expenditure of tax increment from TIF District No. 1.

2. Payment to a nonprofit organization that states it is lobbying for the construction of a bridge located outside the City is not a qualified expenditure of tax increment from the City's TIF District No. 1.

record, in items and signs a declaration to the effect that such account, claim, or demand is just and correct and that no part of it has been paid.

The City is a home rule charter city of the third class. *See* Minn. Stat. 410.01 (2010). *See also* Minn. Stat. § 412.271 (2010) (statutory cities).

¹³ *See, e.g.*, Cities of Gaylord and St. Michael described in the OSA's 2004 TIF Legislative Report, or City of Coleraine described in the OSA's 2007 TIF Legislative Report, available on the OSA's website.

¹⁴ *See* OSA's annual Local Government Lobbying Services reports available on the OSA's website. *See also* the City's Legislative Consultant Contract dated April 19, 2011, between the City and The Conach Group discussed in the OSA's public letter to the City dated August 30, 2011. According to the City Attorney, the City has paid lobbyists \$871,000 since 1992. *See* City Council Meeting Minutes for September 6, 2011, at page 3.

¹⁵ *See* Minnesota Campaign Finance and Public Disclosure Board's website at: <http://www.cfboard.state.mn.us/lobby/lobbassc.html#W>.

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Simply entering into a contract with the Coalition would not resolve the OSA's finding of noncompliance. The OSA has long taken the position that the use of tax increment for lobbying efforts is not authorized.¹⁶ In 2000, the OSA reported this position to the Legislature in matters regarding the Cities of Faribault and Cambridge.¹⁷ If the Legislature disagreed with the OSA's interpretation of the TIF Act, it could have amended the TIF Act. It did not. Therefore, it appears the Legislature agrees with the OSA's position.

The City acknowledges that tax increment may only be used for the purposes contained in Minn. Stat. § 469.176, subd. 4. Under that statutory subdivision, a city development authority may only use tax increment "to finance or otherwise pay the capital and administration costs of a development district pursuant to sections 469.124 to 469.134."¹⁸

The City concedes, as it must, that lobbying expenses are not capital costs of the development district.¹⁹ Therefore, the City attempts to argue that lobbying expenses are administrative costs of TIF District No. 1.²⁰ In support of its position, the City notes that lobbying costs are not listed in Minn. Stat. § 469.174, subd. 14. The City then argues that lobbying expenditures are authorized under Minn. Stat. § 469.126, subd. 2 (1), because payments to the Coalition "promote" a development within TIF District No. 1.

First, the City tries to divert attention from the construction of a new St. Croix River bridge located outside the City to the closing of the City's Historic Lift Bridge.²¹ However, the Coalition's stated lobbying effort is to obtain an exemption from the Federal Wild Rivers Act to allow construction of the new bridge.²² No change in the Wild Rivers Act is needed to close the Lift Bridge. Therefore, the closing of the Lift Bridge does not require the Coalition's services.

¹⁶ The OSA has provided TIF compliance oversight since 1995. As part of its oversight responsibilities, the OSA submits annual TIF Legislative Reports summarizing data received from development authorities and violations cited during the OSA's reviews.

¹⁷ See OSA's March 8, 2000, TIF Legislative Report, at pages 19-21. The OSA is aware that tax increment has been used for legislative work by city consultants directly related to TIF district terms. Specifically, the OSA issued a Final Notice of Noncompliance to the City of Gaylord for over \$4 million in TIF Act violations. See OSA's 2004 TIF Legislative Report. The OSA did not include in the violations \$2,822.25 that the City spent in 1997 on successful lobbying efforts to extend the duration of a TIF District. See 1997 Minn. Laws ch. 231, section 16 (extension passed).

¹⁸ See Minn. Stat. § 469.176, subd. 4 (2010).

¹⁹ See City's Response, at page 5. As stated by the City: "[S]ince lobby expenses are for promoting a transportation project, the expenses are not directly connected with the physical development of real property in the project." See *id.*

²⁰ See City's Response, at page 5.

²¹ According to the City: "The closing of the bridge is the development aimed at improving traffic in the District." See City's Response, at page 5.

²² See City's Response, at page 3. See also City Council Meeting Minutes for July 5, 2011, and the Coalition's presentation included in the City Council agenda packet for the July 5, 2011, City Council meeting, available on the City's website.

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Second, Minn. Stat. § 469.126, subd. 1, authorizes a city to designate development districts “within the boundaries of the city.”²³ Subdivision 2 (1) provides:

Within these districts the city may: (1) adopt a development program consistent with which the city may acquire, construct, reconstruct, improve, alter, extend, operate, maintain, or promote developments aimed at improving the physical facilities, quality of life, and quality of transportation.²⁴

The powers granted to an authority apply only “within these districts.” Therefore, the powers granted to the City apply only within the City’s boundaries. The Coalition’s lobbying efforts are aimed at the construction of a specific bridge crossing the St. Croix River that is located, on the Minnesota side of the River, in the City of Oak Park Heights.²⁵ Indeed, according to the City: “The location of a new crossing is not important as long as the new crossing is located outside the District.”²⁶ The City may not use powers granted under Minn. Stat. § 469.126 outside the boundaries of the City.

The City contends that use of tax increment to lobby for the construction of a bridge outside the City will result in benefits within TIF District No. 1.²⁷ Using the City’s logic, the City would be able to use tax increment from TIF District No. 1 for the construction of a bridge located anywhere outside TIF District No. 1. This expansive view of authorized tax increment expenditures would effectively eliminate the TIF Act’s clearly stated geographic limitations. Indeed, any city authority could expend tax increment on local, state, or federal projects located outside the city, or outside the State, if the city perceived it would benefit from those projects. Such an expansive use of tax increment for activities outside a city’s boundaries would be unprecedented and is not authorized by the TIF Act.

Third, Minn. Stat. § 469.174, subd. 14, prohibits certain payments from being included as TIF administrative expenses. The City now claims that lobbying costs are not listed in Minn. Stat. § 469.174, subd. 14. However, the advice the City received when it approved the donation justified the payment to the Coalition by claiming that it was for one of the activities listed in Minn. Stat. § 469.174, subd. 14. More specifically, at the time the donation was approved, the City tried to justify the payment because it would be “paid to contractors or others providing services directly connected to the physical development of real property within the project.”²⁸

²³ See also Minn. Stat. § 469.125, subd. 9 (2010) (“development district” defined as “an area within the corporate limits of a city”).

²⁴ See Minn. Stat. § 469.126, subd. 2 (2010) (emphasis added). The City fails to quote the critical introductory clause to Subdivision 2 (1) (“Within these districts”) on page 3 of its Response.

²⁵ See City Council Meeting Minutes for July 5, 2011, and the Coalition’s presentation included in the City Council agenda packet for the July 5, 2011, City Council meeting.

²⁶ See City’s Response, at page 5.

²⁷ See City Council Meeting Minutes for July 5, 2011, at page 3; City’s Response, at pages 2 – 3.

²⁸ See Email dated June 9, 2011, from Dave Magnuson forwarded to the City Administrator on June 18, 2011

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Only after the OSA pointed out in its Initial Notice that subdivision 14 specifically prohibits such payments from being included in administrative expenses, did the City reverse its position for purposes of its Response.

Finally, the City attempts to equate lobbying efforts by the nonprofit Coalition for a new bridge located outside the City with promoting developments within a district. Minnesota has long distinguished lobbying from mere promotion. Lobbying involves the direct communication with elected officials or the urging of others to contact public officials, and is strictly regulated by the State.²⁹ The Coalition claimed that its efforts were attempting to influence federal legislative action by obtaining a change in the Federal Wild Rivers Act – lobbying activity at the national level. The authorization granted in Minn. Stat. § 469.126, subd. 2(1), to promote developments within a district, does not extend to attempts to influence federal elected officials.

A donation of tax increment to a nonprofit corporation that states it is lobbying to change federal law so a bridge can be constructed outside TIF District No. 1 is not a qualified expenditure of tax increment from the City's TIF District No. 1.

(quoted in full in the OSA's Initial Notice dated August 30, 2011), and City Council Meeting Minutes for July 5, 2011, at pages 2 – 3. Minn. Stat. §469.174, subd. 14(2) (2010) provides:

“Administrative expenses” means all expenditures of an authority other than: . . . (2) amounts paid to contractors or others providing materials and services, including architectural and engineering services, directly connected with the physical development of the real property in the project.

²⁹ See, e.g., Minn. Stat. ch. 10A and Minnesota's Campaign Finance and Public Disclosure Board's Findings and Order in the Matter of the Complaint by Karl Bremer regarding The Conach Group and Mike Campbell (August 16, 2011). That matter reviewed the City's contract with The Conach Group.

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CONCLUSION

The City failed to resolve the OSA's finding of noncompliance. As a result, this matter is being forwarded to the Washington County Attorney as required by Minn. Stat. § 469.1771, subd. 1(b).

If you have any questions, please feel free to contact me at 651-296-7979 or Arlin.Waelti@osa.state.mn.us, or Deputy State Auditor/General Counsel Celeste Grant at 651-297-3673 or Celeste.Grant@osa.state.mn.us.

Very truly yours,

/s/ Arlin Waelti

Arlin Waelti
Assistant State Auditor
TIF Division Director

Enclosure

cc. The Honorable Pete Orput, Washington County Attorney
Mr. Larry Hansen, City Administrator
Ms. Sharon Harrison, City Finance Director
Mr. David Magnuson, City Attorney

**STATEMENT OF NANCY J. BODE
IN THE MATTER OF THE OFFICE OF THE STATE AUDITOR'S FINAL
NOTICE REGARDING CITY OF STILLWATER'S TIF DISTRICT NO. 1**

Nancy J. Bode states as follows:

1. I am an Assistant Legal Counsel with the Minnesota Office of the State Auditor ("OSA"). In that capacity, I assisted in the OSA's review concerning the City of Stillwater's ("City") donation of \$80,000 in tax increment to the Coalition for the St. Croix River Crossing ("Coalition"), a nonprofit corporation. As a result of that review, I signed a letter dated August 30, 2011, to the City, providing the City with the OSA's findings and recommendations.
2. As part of the review, I had a telephone conversation with Larry Hansen, the City Administrator, on July 27, 2011. During that telephone conversation, Mr. Hansen told me that the City did not have a contract with the Coalition. I also had a telephone conversation with Mr. Hansen on July 28, 2011. During that telephone conversation, Mr. Hansen told me that the City's payment of \$80,000 to the Coalition was a "donation."
3. As part of the review, I had a telephone conversation with David Magnuson, the City's Attorney, on August 2, 2011. During that telephone conversation, Mr. Magnuson told me that the City's payment of \$80,000 to the Coalition was a "donation." He also told me that the City did not have a contract with the Coalition.
4. As part of the review, I had a telephone conversation with Michael Wilhelmi, the Coalition's Executive Director, on August 8, 2011. During that telephone conversation, Mr. Wilhelmi told me that the City's payment of \$80,000 to the Coalition was a "donation." He also told me that, if the City paid the Coalition's filing fee with the Minnesota Secretary of State's Office, that payment was also a "donation" by the City to the Coalition.

Nancy J. Bode

Date: October 20, 2011

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APPENDIX H

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REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

SUITE 500
525 PARK STREET
SAINT PAUL, MN 55103-2139

(651) 296-2551 (Voice)
(651) 296-4755 (Fax)
state.auditor@state.mn.us (E-mail)
1-800-627-3529 (Relay Service)

August 18, 2011

The Honorable Chris Coleman, Mayor
The Honorable Dan Bostrom, Council Member
The Honorable Melvin Carter, Council Member
The Honorable Patrick Harris, Council Member
The Honorable Lee Helgen, Council Member
The Honorable Kathy Lantry, Council Member
The Honorable Russ Stark, Council Member
The Honorable Dave Thune, Council Member

City of St. Paul

15 Kellogg Blvd W, Rm 390
Saint Paul, MN 55102-1606

Re: Audit of Three Housing and Redevelopment Authority TIF Districts

Dear Mayor Coleman and Council Members:

In June through August of calendar year 2011, the Office of the State Auditor (OSA) performed an examination of certain records of three tax increment financing districts (TIF Districts) of the Saint Paul Housing and Redevelopment Authority (HRA) located in the City of St. Paul (City). The audit (Audit) covered the Shepard Davern Owner Occupied, Shepard Davern Rental Housing and Shepard Davern Senior Rental TIF Districts. The districts are currently active.

The Audit examined, on a test basis, evidence supporting the HRA's compliance with the TIF Act.¹ The OSA reviewed and/or tested the TIF Districts' reports filed with the OSA through the year ended December 31, 2009, TIF plans, general ledgers, invoices, and other supporting documents.

No findings of noncompliance were noted regarding the three TIF districts audited.

The OSA appreciates the time and attention the HRA staff devoted to responding to our questions and concerns. If you have any questions or comments, please call me at (651) 297-3673.

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

OFFICE OF THE STATE AUDITOR

Mayor and Council, City of Saint Paul
August 18, 2011
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Very truly yours,

/s/ Celeste Grant

Celeste Grant
Deputy State Auditor and General Counsel

cc: Cecile Bedor, Director of Planning & Economic Development
Patricia Lilledahl, Director of Business Development & Finance
Diane Nordquist, Project Manager
Joan Rutten, Accountant