How Did This Happen?  
The “Evolution” of Economic Development Tools

EDAM Winter Conference  
January 20, 2017

The information in this presentation is based on sources believed to be reliable, but does not purport to be complete and is not warranted by Northland Securities, Inc. (RC 17-18, MUNI 17-15).
It is a BIG Day!
Happy 65 Paul Stanley!
Introductions

- A bit about me
  - Almost 38 years working with Minnesota cities and counties
  - Public finance and community planning consultant since 1983
  - Worked with almost everything in the toolbox
  - Lived through tremendous changes and a lot of sameness
Introductions

- How many of you are younger than 40 years old?

- You have missed a lot of the “fun”
Gather ‘round for a story...
I will try to make it interesting!
Overview

- Much more than TIF
- Amazing how many things are connected
- Current “Rules of the Game” have evolved (not necessarily improved) over past 40 years
- How did we get to 2017?
- What does history tell us about the future?
A Decade-By-Decade Review

1980  1990  2000  2010
The Good Old TIF Days

- Tax Increment Financing (TIF) statutes enacted
- No limits on pooling
- No specific “structurally” substandard test
- Economic Development is anything not Redevelopment or Housing
Pre-Tax Reform Tools

- Late 1970’s – Mid 1980’s hay day of federal assistance
  - Revenue Sharing
  - Urban Development Action Grants (UDAG)
- Viable sources of federal funding
- Little limit on tax-exempt bonds for private purposes
TEFRA 1982

- Tax Equity and Fiscal Reform Act
- Focus on IDBs
  - Almost 50% all state/local borrowing in 1982 for IDB
- Significant limits on small issue IDB
- Public approval process (TEFRA hearing)
- Banks get tax benefit for funds used to buy tax-exempt securities.
  - Limited in 1986 (bank qualified bonds)
Tax Reform Act of 1986

- Seismic changes
- Many current aspects of municipal bonds originated from 1986 Act
- Limits on use of tax-exempt bonds, particularly for private purposes
Private Activity Bonds

- Private use/private revenue test
  - 10%+ of proceeds for private use, and
  - 10%+ revenues from private source
  - Meet test and interest is taxable unless...

- Exempt facilities
  - Uses include transit, airports, waste disposal
  - State-by-state annual volume cap

- “Qualified” private activity
  - 501c3, mortgage revenue bonds, small-issue industrial development bonds, student loans
Private Activity Bonds

- Fundamental change in tax-exempt bond as economic development tool
- Public-private partnerships much more difficult
  - Developer guarantees often exceed 10%
  - Cities unwilling to borrow without guarantees
- Leads to use of taxable bonds
Other Outcomes

- Bank qualified bonds
- Arbitrage rebate
- Single use of tax-exempt advance refunding
- Low income housing tax credit
Property Tax System Overhaul

- 1987-1989
- Tax capacity system replaces assessed value and mill rate
- Truth in Taxation
- HACA (Homestead and Agricultural Credit Aid) replaces homestead and ag credits
Property Tax System Overhaul

- Confusion and a bit of chaos
- Complete redo of TIF budgets and cash flows
- Foreshadow of impacts of tax system
  - Changes in property tax system becomes tangible risk for TIF projects
1987-1990 – period of significant changes to TIF Act

Many current rules enacted during this period

Highlight key changes and not comprehensive review
Prior planned improvements
Knockdown
End date for pre-1979 districts

Soils out of Redevelopment
- Soils Condition District established

Limit non-housing uses in Housing District

Inclusion of county road costs

30-day notice of fiscal implications

Reclassification change in base value
1988

- Original “Mill” Rate
  - Changed to tax capacity
- Payment to schools for referendum levies
- Current year values cutoff from October 10 to July 1
- Redevelopment criteria
  - 70% of area (was 70% of parcels)
  - Occupied defined – 15% of parcel area
  - Non-contiguous criteria
- Map in published notice
- Annual reporting requirements
- At least 90% revenues in redevelopment district used to correct redevelopment conditions
- Income requirements for Housing District
Economic Development Authorities

- EDA statute adopted in 1987
- Specific economic development powers
- Levy for EDA purposes
- TIF authority
- Restricted borrowing powers
Renewal/Renovation TIF
- Created in 1990
- Redevelopment-lite
- Last new type of TIF district
  - 27 years!

Current Redevelopment test established (1990)
- 50% substandard / 15% cost threshold
1990

- Limits on pooling
- 5-year rule
- LGA/HACA Penalty
- Economic Development Districts limited to “industrial” uses
- Enforcement of violations
“Best” of the Rest

- Increase in Market Value in “but for” (1995)
- Definition of tax increment expanded (1997)
- Parks and recreational facilities prohibited (1999)
Special Taxing Districts

- Special Service District
  - Fund improvements and enhanced services in commercial areas
  - Special legislation to general law in 1996

- Housing Improvement Area
  - Finance improvements for owner-occupied housing
  - Created in 1996
Tax Abatement

- Created in 1997
- Tool supplement TIF
- Tax abatement is a designated special levy under prior levy limitations
  - Not in original statute
  - Added in 1998
・ 1997 starts five year series of class rate reductions

・ “Class Rate Compression”

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<tr>
<td>&gt; $150,000</td>
<td>4.60%</td>
<td>3.50%</td>
<td>3.40%</td>
<td>3.40%</td>
<td>2.00%</td>
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Change in Tax Capacity Value 1997-2000
Impacts

- Captured value in TIF districts fall
- Cash flow shortfalls
- Temporary pooling fixes
- Emphasized risks of tax system changes
- Shift to pay-as-you-go
Business Subsidies

- Legislation adopted in 1999
- Laws setting process for approval and reporting of certain forms of financial assistance to private parties
State K-12 Levy

- State property tax levy enacted in 2001
- Applies to commercial/industrial, seasonal residential recreational, certain non-profit
- Pay 2016 C/I rate = 48.64%
- Not captured by TIF district
  - Disconnect between taxes paid and increment generated
Eminent Domain

- 2005 Supreme Court decision
- 2006 State Law
- Eminent domain may only be used for a public use or public purpose
- Fundamentally altered ability of cities to assemble sites for development
Great Recession

- Development grinds to a halt
- Key players disappear
  - Banks
  - Developers
  - Construction companies
- Property values tumble
American Recovery and Reinvestment Act (ARRA)

- 2009 Federal initiatives to stimulate economy
- Build America Bonds (BABs)
- Recovery Zone Bonds
Build America Bonds

- Taxable bonds with interest expense write down from Federal government
  - Initially 35%
  - Reduced to 32% by 2013 Sequester
- Governmental purposes only
Recovery Zone Bonds

- Similar to BABs but interest reimbursement at 45%
- Use must be in a designated “recovery zone”
- Obtain allocation from State
- RZ Economic Development Bonds
- RZ Facility Bonds
1980  1990  2000  2010
2010 TIF Legislation

- Temporary expansion of TIF powers
- New “compact development” TIF districts
- Expanded use of economic development TIF districts
- Ability to use TIF to stimulate construction
- All expired at end of 2012
Transit Improvement District

- Attempt to gain TIF power to facilitate development and improvements along “qualifying” transit lines
- Build on momentum from Green Line
  - Construction start 2010 and open 2014
- Legislation proposed (and failed) in 2010 and 2013
Low Interest Rates

- Actions by Federal Reserve
- Sustained period of historically low interest rates
- Encouraged public and private investment
BBI* 2010 to Today

*Bond Buyer's GO 20-Bond Index
Morphing of Abatement

- Morphed away from original TIF alternative focus
- Swiss Army Knife of public finance tools
- Wide range of public uses
  - Community centers
  - Recreational facilities
  - Broadband systems
2016 Elections

- Sailing in uncharted waters
- Tax reform
- Infrastructure investment
- Federal Reserve actions
- Growth and the Economy
- Role of government
- TIF Act Changes
- Tax Abatement
- Great Recession
- 2016 Elections

1980:
- Tax Reform
- Property Tax Reform

1990:
- Rate Compression

2000:
- Eminent Domain

2010:
- Recovery Tools
Lessons Learned

- S#*! Happens
  - Legislative change
  - Tax reform
  - Recession
- Be conservative in projections and plans
- Think about what could go wrong
Lessons Learned

- We are creative
  - Made good use of inadequate toolbox
  - MacGyver would be proud!
Outlook

- Need new/different tools
  - Economic “blight” as important as physical blight
  - More housing needs than low/mod income
  - Development needs vary across the State
  - No good tool for broadband

- Watch Washington
  - Tax reform
  - Interest rates
  - Job creation
  - Infrastructure investment
More incentive for cities to be strategic and forward-looking

Need to change the conversation
- Not “subsidy” but investment to achieve a public benefit
Thank You

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