

Tax Increment Financing



ISSUE
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Introduction

Tax Increment Financing (TIF) is a tool for financing public improvements. The statutory authority for TIFs was created in 1978 and was only available to municipalities, with counties added in 1991. The TIF statutes have changed over the years, while the original intent has morphed. TIF was originally created as a tool for local governing bodies to improve blighted areas, with blighted meaning impairing growth due to dilapidation, age, overcrowding, sanitation, obsolete platting, deterioration of structures, etc...¹ The Legislature in 2004 and again in 2011 added economic development provisions to the TIF statutes where there does not necessarily need to be blighted property if the district will provide for the general economic welfare.

What is a Tax Incremental District?

Tax Incremental District (TID) is defined as a contiguous geographic area within a municipality defined and created by resolution of the governing body². The TID is the area where the improvements will be made and where the increment in property taxes will be used to pay for the improvements. A TID is also commonly referred to as a "TIF district" and the terms are used interchangeably.

Process for Creating a Tax Increment Financing (TIF) District

State statute outlines procedural steps in the creation of a TIF district including a project plan, project costs, a public hearing and other factors. First, findings of blighted areas or economic development is required. A finding is required that at least 25% of the real property within the district to be blighted or at least 50% of the real property in the district will be developed for economic development purposes and the improvement will significantly enhance the value of all other real property in the district.³

The next step involves the creation and adoption of a project plan⁴. The project plan must include the following:

- 1) The kind, number, and allocation of all proposed public works or improvements within the districts;
- 2) An economic feasibility study;
- 3) A detailed list of estimated project costs;
- 4) A fiscal impact statement showing the tax impact of the district until repaid;
- 5) A description of the methods of financing for all estimated project costs;
- 6) Several maps for improvements, changes in zoning, and existing uses and conditions;
- 7) A list of nonproject costs; and
- 8) A statement of a proposed method for the relocation of persons to be displaced.

The planning commission of the governing body then must hold a public hearing and provide interested parties the opportunity to express their views on the proposed creation of the TIF district and its boundaries. The planning commission considers the project plan and public input and then makes a recommendation to the governing body.⁵ The governing body (council, commission) considers all the information, makes any necessary changes, and adopts an official resolution to create the district, which formally sets the boundaries, date of creation, and the name and number for the TIF district, with a length of time not to exceed 20 years.⁶

¹ SL 1978, ch 91, §2(1) to (3)

² SDCL 11-9-1

³ SDCL 11-9-8

⁴ SDCL 11-9-13 and 11-9-16

⁵ SDCL 11-9-3 and 11-9-4

⁶ SDCL 11-9-5 and 11-9-25

Once the governing body decides to create a TIF district, the tax increment base must then be calculated. The tax increment base is the aggregate assessed value of all taxable property located within the TIF district on the date the district is created.⁷ Once the base is established, the tax increment, which is the difference between the base and the current year's assessed value of taxable property, will utilize the property tax difference to pay off the project costs within the district.⁸

The governing entity is allowed several options to pay for the project costs within the TIF district. A special fund, municipality's funds, municipal bonds, revenue bonds, or tax increment bonds.⁹ A TIF district automatically dissolves after 20 years, or when the governing body passes a resolution acknowledging that all project costs have been paid. The table below provides the procedural steps in the creation and implementation of a TIF.

Procedural Steps in the creation and implementation of a Tax Increment Financing (TIF) District

1. Planning Commission Hearing on Creation of a District	A public hearing is held in which interested parties are provided a reasonable opportunity to express their views on the proposed creation of a tax incremental district and its proposed boundaries.
2. Recommendation by Planning Commission	Planning commission sends recommendation to the governing body.
3. Governing Body Resolution on Creation of a District	The governing body adopts a resolution which describes the boundaries, creates the district on a specific date not to exceed 20 years, and assigns a name and number to the district.
4. Determination of Tax Incremental Base for New District	The aggregate assessed value of all taxable property located within the district on the date it is created.
5. Yearly Tax Increment Amount	The tax increment amount of assessed value for the property taxes in the district goes to pay for the project costs within the district.
6. Payment of Project Costs	Allows for several methods to pay for the project costs within the district.
7. Termination of TIF District	The TIF district terminates after 20 years or after all project costs have been paid.

Types of TIF Districts

TIFs can be classified into three categories – local, industrial, and economic development. The total number of TIF districts in South Dakota is currently about 172, classified as 50 local, 20 industrial, and 102 economic development. The number of dissolved TIF districts is 137 since 1978.

Local TIF districts

Local TIF districts are not presently defined in codified law and are the default classification unless the TIF district meets the statutory definition of industrial or economic development purpose as provided in SDCL 13-13-10.2. Local TIF districts typically benefit the local government rather than having a regional or statewide benefit; however, the local government has complete control over the classification of a TIF. Local TIF districts are typically used to make public infrastructure improvements for a variety of projects, including infrastructure for housing development. The use of tax increments for construction of residential structures is prohibited.¹⁰ However, Attorney General Larry Long in 2008, opined that TIF districts could utilize tax increments for the construction of infrastructure in a residential development, since the expenses were not for the physical residential structures.¹¹

⁷ SDCL 11-9-20

⁸ SDCL 11-9-26 and 11-9-27

⁹ SDCL 11-9-30 to 11-9-41

¹⁰ SDCL 11-9-42

¹¹ SD Atty. Gen. Op. 08-01



Industrial TIF districts

Industrial TIF districts include those activities generally recognized as industrial by zoning authorities within the state, including any factory or any business engaged primarily in the manufacturing or assembly of goods, the processing of raw materials, and the wholesale distribution of products for resale.¹² Industrial TIF districts could be created to finance public infrastructure for ethanol plants, manufacturing facilities, or industrial parks.

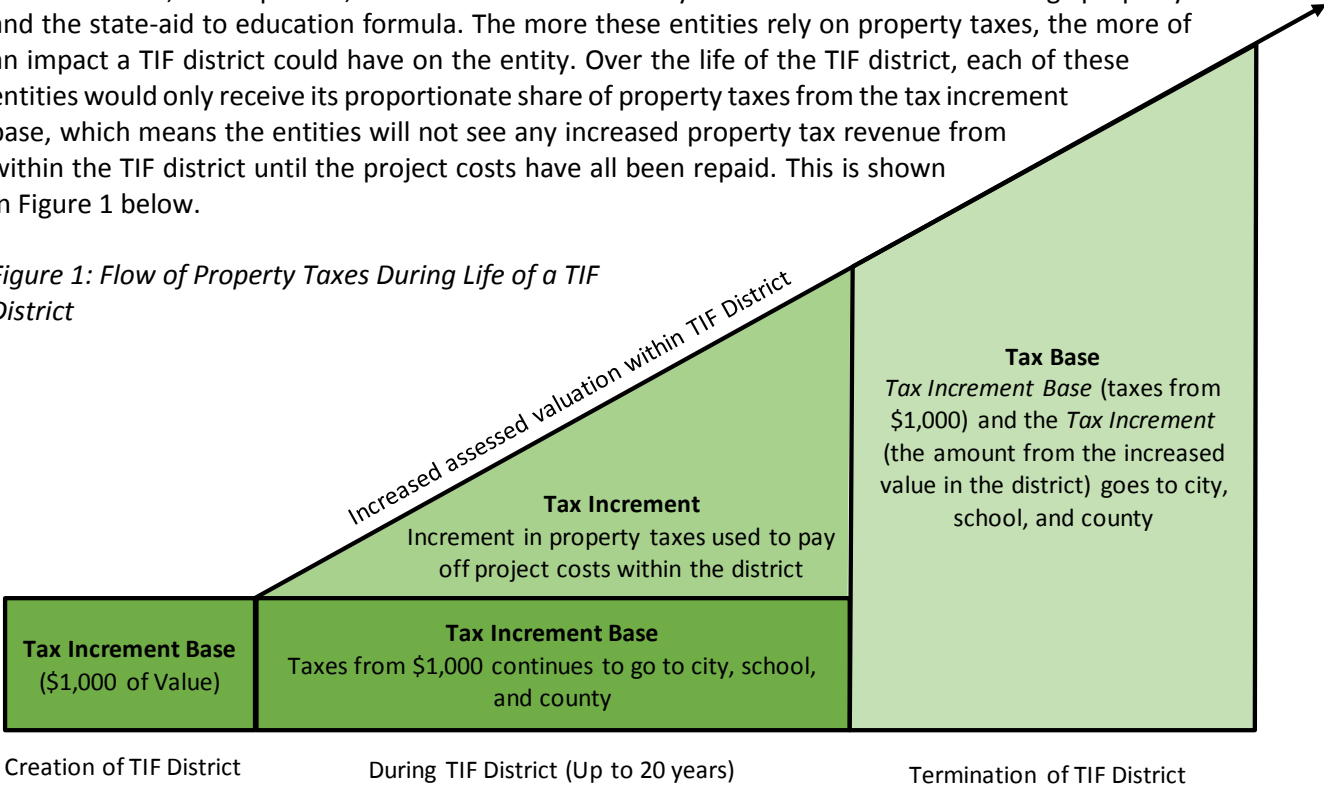
Economic development TIF districts

Economic development TIF districts include any area where there is or will be one or more business engaged in any activities defined as commercial or industrial by the governing body within the district.¹² The definition of an economic development TIF district is broad enough that most projects could be reasonably considered economic development. Attorney General Mark Meierhenry in 1985 opined that multiple unit rental housing is more appropriately classified as commercial housing and cited the DR 76-3 ruling by the Secretary of Revenue, which held apartment houses of all sizes should be classified as commercial property.¹³ Therefore, the governing body could create an economic development TIF district for commercial housing purposes. The broad definition of economic development could explain why the clear majority of new TIF districts are classified as economic development.

Implications of TIF District Classification on Funding for School Districts, Municipalities, and Counties

School districts, municipalities, and counties are affected by TIF district classification through property taxes and the state-aid to education formula. The more these entities rely on property taxes, the more of an impact a TIF district could have on the entity. Over the life of the TIF district, each of these entities would only receive its proportionate share of property taxes from the tax increment base, which means the entities will not see any increased property tax revenue from within the TIF district until the project costs have all been repaid. This is shown in Figure 1 below.

Figure 1: Flow of Property Taxes During Life of a TIF District



¹² SDCL 13-13-10.2

¹³ SD. Atty. Gen. Op. 85-05



However, the school districts recover their lost revenue to the school general fund and special education fund through an additional tax levy. The Legislature in 1996 required an additional tax levy be imposed to compensate school districts for the lost revenue to the school general fund and special education fund for the creation of TIF districts after 1994. This additional tax levy is not subject to the referendum provisions of SDCL 10-12-43.¹⁴ The current administrative practice of applying the additional tax levy is industrial and economic development TIF districts are exempt and the additional tax levy only applies to Local TIF districts; however, nothing in codified law specifically allows industrial and economic development TIF districts to be exempt from the additional tax levy.

The tax increment amount for industrial and economic development TIF districts is not counted towards the local effort calculation for the state-aid to education formula.¹⁵ The reason generally given is that industrial and economic development TIF districts have a broader regional or statewide impact. Statewide property tax payers provide a subsidy through the state-aid to education formula for industrial and economic development TIF districts. The Department of Revenue estimates the exemption in the tax increment amount adds a cost to state property tax payers of approximately \$5.8 million dollars.

Case Studies of TIF Districts in South Dakota

Due to the ambiguity in some South Dakota TIF laws, several atypical examples exist. Three of these are as follows:

Rapid City, TID #79 – The Village on Monroe

The Rapid City TIF district #79 was classified and created as a Local TIF district in June 2017. The TIF district was created to promote affordable workforce housing, where the project costs were used for land acquisition. The developer's intent was to construct five new townhomes. The tax increment base for the TIF district was \$26,500. The map, at right, shows highlighted in yellow the TIF district boundary.

Village on Monroe
Proposed Tax Increment District
Boundary Map



There is no statutory minimum for the size or tax increment base of a TIF district and the use and classification were allowed. SDCL 11-9-8 implies a two-part finding to implement a TIF district. The first part, SDCL 11-9-8(1), identifies blight or economic development in the proposed area. The second part, SDCL 11-9-8(2) states, "the improvement of the area is likely to enhance significantly the value of substantially all of the other real property in the district." SDCL 11-9-8(2) seems to imply the existence of more

than one parcel of real property within a TIF district, which raises the question of whether SDCL 11-9-8(2) assumes there will be more than one parcel of real property within a TIF district prior to its creation. The TIF committee in Rapid City originally denied the application and the Rapid City Planning Commission overturned the decision and recommended approval of the new TIF district to the City, which later approved it.

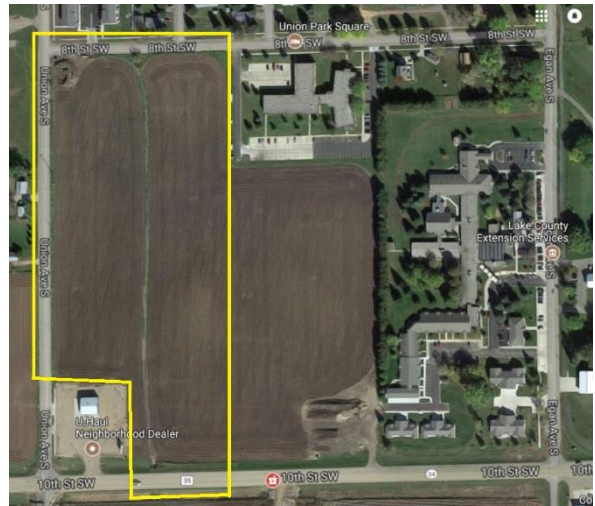
¹⁴ SDCL 10-12-44

¹⁵ SDCL 13-13-10.2



Lake County, TID #4 –

The Lake County TIF district #4 was classified and created as an economic development TIF district in April 2016. The TIF district was created to alleviate a housing shortage in the City of Madison by constructing two 14-unit multi-family townhome type apartment buildings, where the project costs were used for the acquisition of land and public infrastructure. The tax increment base for the TIF district was \$75,600. The map, at right, shows highlighted in yellow the TIF district boundary.



Like the previous case study, Lake County TID #4 had only one property within the TIF district prior to creation of the TIF district; therefore, it raises the same question of whether SDCL 11-9-8(2) assumes there will be more than one parcel of real property within a TIF district prior to its creation. The original intent of TIF was the redevelopment of an area that impaired growth, not for the new development of green space, which has no impairments or blight. The other difference is the classification as an economic development TIF instead of a Local TIF, even though the TIF district purpose was for housing. These TIF districts were created at a similar time yet both had different classifications, indicating there are no clear guidelines or codified law specifically indicating how a TIF district should be classified.

Rapid City, TID #77 – Rushmore Gateway Corridor

The Rapid City TIF district #77 was classified and created as an economic development TIF district in April 2016. The TIF district was created to stimulate job creation by expanding employment opportunities, where the project costs were granted to the developer in the amount of \$3.2M to provide office space for an additional 150 people and another \$2.8M for interest expense. Of all the eligible project costs for the TIF district, 99% were discretionary grants for a total of \$6M. The developer's intent was to construct a new corporate headquarters with a total project cost of \$77.5M. The tax increment base for the TIF district was \$4.5M. The map, at right, shows highlighted in yellow the TIF district boundary.



Grant is defined as, "the transfer for a governmental purpose of money or property to a transferee that is not a related party to or an agent of the municipality".¹⁶ Payments and grants made at the discretion of the governing body, which are found to be necessary or convenient to the creation of the TIF district, the implementation of the project plans, or to stimulate and develop the general economic welfare and prosperity of the state are allowed by South Dakota codified law.¹⁷ The South Dakota Constitution also states, "Taxes shall be uniform on all property of the same class, and shall be levied and collected for public purposes only."¹⁸

¹⁶ SDCL 11-9-1(3)

¹⁷ SDCL 11-9-15(8)

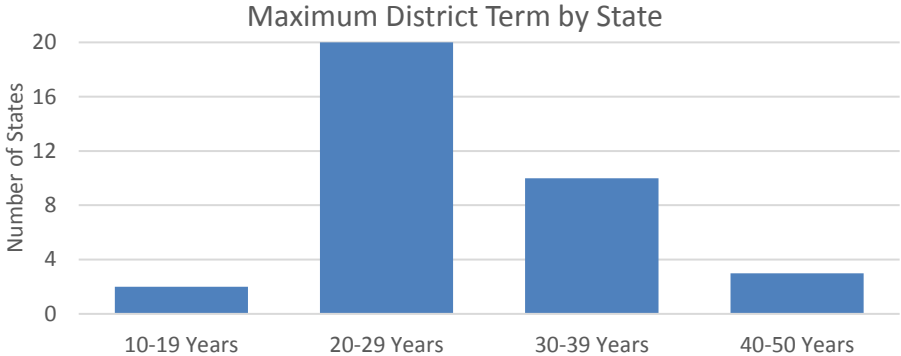
¹⁸ Art. XI, §2, SD Constitution



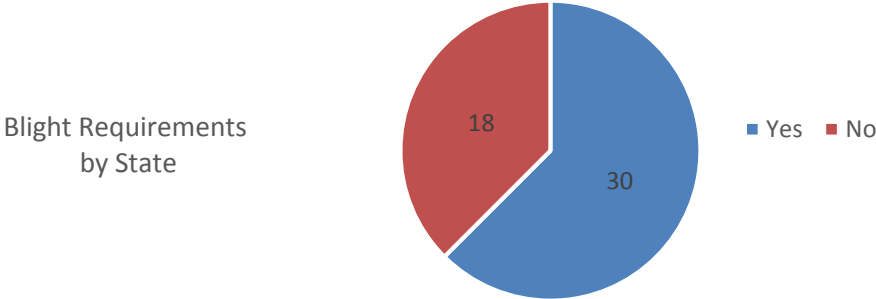
The leading case in South Dakota relating to TIF districts is the 1984 South Dakota Supreme Court case, Meierhenry vs City of Huron, which held the acquisition of land in blighted areas and the sale or leasing of the land for private redevelopment is deemed a legitimate public purpose, and thereby, did not violate the South Dakota Constitution. The project costs in Meierhenry vs City of Huron were for the acquisition of land and private redevelopment, not the addition of office space and interest for a private building. However, in a prior decision released by the Court, Clem vs. City of Yankton, the "promotion, stimulation, and development" of the state's general economic welfare and prosperity, including expansion of employment opportunities, "serves a public purpose."

Nationwide Reliance on TIF

TIF is one of the leading economic development tools nationwide. Every state in the nation except Arizona and Wyoming has legislation allowing local governments to utilize some form of TIF. The frequency of use, implementation process, and factors for use vary widely. Use of TIF districts in Minnesota, Wisconsin, and Illinois are commonplace, whereas, New York rarely creates a new district.

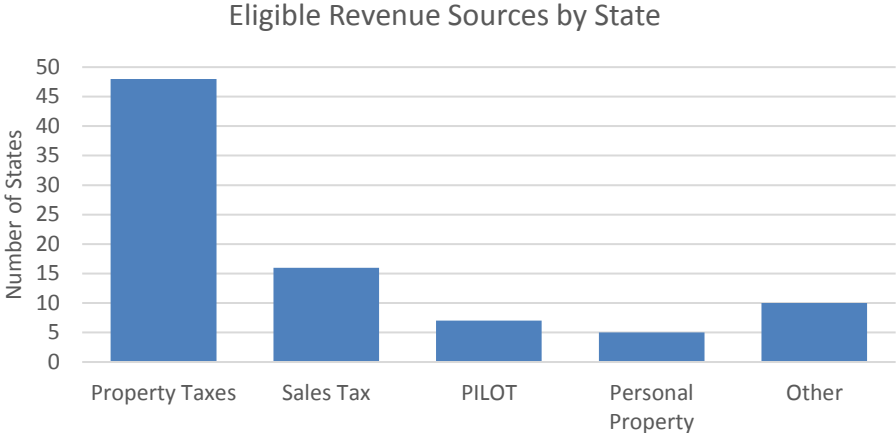


The factors for the creation and use of TIF vary across the states. The maximum amount of time a TIF district can exist varies by state with a range of 10-50 years. Most states have a maximum length of 20-29 years, with 30-39 years as the next commonly used range for TIF districts.



Most states also have a blight requirement as part of the finding for TIF district creation, while 18 states do not. The definition of blight also varies widely with different factors in support of finding if blight exists. The states without a blight requirement typically require a "but for" test, meaning "but for" the TIF assistance, growth or development in the proposed area would not occur.





All states allow property taxes as a source of revenue to pay off the TIF district costs, however, 16 states also allow sales tax within the TIF district to go towards such costs. Some states also use other revenue sources to pay TIF district costs, such as hotel, entertainment, utility, and employment taxes.

States allow several different types of TIF districts for a variety of purposes like housing, recreation, industrial, tourism, or infrastructure. TIF legislation in California, Indiana, and Texas is targeted toward the construction of low and moderate priced housing. TIF districts in Oregon and Tennessee can target recreational uses. Florida allows TIF districts to support coastal and tourism revitalization, while Michigan allows TIF districts for educational projects.

Conclusion

TIF districts have been an important and vital tool to the economic growth of South Dakota since the addition of industrial and economic development TIF districts. However, the case studies mentioned in this issue memo may demonstrate the ambiguity, inappropriate use, or gray area surrounding the creation and implementation of TIF districts in South Dakota. In September 2017, the Department of Revenue released guidelines for the creation, classification, and annual certification of TIF districts in South Dakota. While guidelines will help, South Dakota codified laws on the classification of TIF districts are very broad and lead to the creation and classification of different TIF districts for the same purpose, which affect local property taxes and the state-aid to education formula differently.

Over the years, the legislation has morphed the original intent of TIF districts from redevelopment of blighted and impaired areas to the development of green space for economic and industrial purposes. Given the overlap and ambiguity of TIF laws, and the boundary-pushing nature of some TIF districts, the Legislature may wish to consider a comprehensive review of TIF statutes.

This issue memorandum was written by Jeffrey Mehlhaff, Fiscal Analyst, on 12/29/2017 for the Legislative Research Council. It is designed to supply background information on the subject and is not a policy statement made by the Legislative Research Council.

