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# TIF: Deficit Reduction Provisions

***Property tax reforms in the late 1990s and 2001 reduced TIF revenues significantly***

Property tax changes enacted by the legislature in 1997, 1998, and 2001 reduced the revenues of many tax increment financing (TIF) districts. This occurred because the changes generally reduced property taxes, and tax increments are ultimately property taxes. The effects on TIF districts were larger than on overall property taxes because:

- Each of the "reforms" were focused on reducing property taxes on commercial-industrial (C-I) and apartment properties, the main types of property in TIF districts; and
- The 2001 reform converted a portion of the general education tax, a tax imposed by school districts that contributed to TIF revenues, to a state-imposed tax on C-I properties, which did not contribute to TIF revenues.

The 2001 property tax changes reduced TIF revenues (between taxes payable in 2001 and in 2002) by approximately 30 percent. TIF revenues have increased significantly since 2002, but in 2007 are still down 12 percent from 2001 (or about $41 million). Some of these revenues are attributable to new districts and are not available to pay obligations of old districts.

***Reduced TIF revenues may impair the ability to pay TIF obligations or create deficits***

These reductions in increments may cause "deficits" or the inability to pay debt with the pledged increments. Revenues of TIF districts are commonly pledged to pay debt; TIF authorities often borrow money to pay upfront development costs, such as a land acquisition and public improvements in the district. This debt can be a general obligation of the local government (i.e., supported also by a pledge to levy enough property taxes to pay the bonds, if necessary), a revenue bond, or a developer obligation (often called a "pay-as-you-go" note). The consequences of a deficit vary with the type of TIF obligation:

- For general obligations, the local government must make up the deficit by levying property taxes.
- For revenue bonds, the bondholders may suffer the loss, unless the authority or others have pledged other revenues. The authority or city may feel compelled to pay revenue bonds to maintain its creditworthiness.
- Developer obligations are usually limited to the amount of increment; thus, the developer or the holder of the obligations will suffer the loss.

***The legislature has enacted a variety of tools to help reduce or eliminate deficits***

The legislature has enacted several mechanisms to help local governments offset deficits caused by property tax reforms. All of these mechanisms use one of three basic approaches:

- **Pooling**: Allowing more flexibility to take increments from one of a city's TIF districts to pay obligations of another district
- **Increasing increments revenues**: Allowing methods by which the authority or city could increase the total amount of increment revenues collected

- **State grants**: Appropriating state money to pay grants to offset deficits

***Pooling allows surplus increments from one district to offset a deficit in another district***

The TIF law imposes legal restrictions (commonly called "pooling" limits) on using increments from one district to pay for activities outside of that district. Thus, extra increments from one district frequently cannot be used to pay the debt of another district. To give authorities and cities more flexibility to deal with deficits caused by property tax changes, the legislature allowed cities to use increments from one district to pay obligations of another district, if the shortfall was caused by property tax reform. Use of pooling originally was a prerequisite to using the other deficit reduction techniques. That is no longer required, except as a condition of using the authority to extend a district's duration limit.

***Various mechanisms can increase increments to offset deficits***

The second approach uses mechanisms that increase a TIF district's increments. These mechanisms all rely, directly or indirectly, on property tax increases to help pay the deficits. These techniques either convert existing property tax revenues of the city, county, or school into increments or capture tax base that would have paid regular taxes. Three basic mechanisms have been authorized:

- "**Unfreezing" the original tax capacity rate**: This is the local tax rate in effect when the district was certified. If local tax rates have risen since this certification, unfreezing the rate will increase the amount of increment.
- **Changing fiscal disparities options**: For TIF districts in the metropolitan area or the taconite tax relief area, the city can elect to have the fiscal disparities contribution paid by property taxpayers in the city, county, and school, rather than using the district's increment to do so.
- **Extending the duration of the district**: The city can elect to extend the duration limit for the TIF district under a formula based on the percentage drop in the district taxes caused by tax reform. The maximum extension is four years, although the commissioner of revenue can authorize an additional two years. To use this authority, the city must have fully used all of the other deficit reduction mechanisms.

***The state grant fund was repealed as part of the 2002 budget cuts***

The 1997, 1999, and 2001 legislatures made general fund appropriations to a state grant fund to help offset TIF deficits caused by property tax reform. The table shows the amounts. Two separate funds were established, one in response to the 1997-98 property tax changes, and one for the 2001 changes. Grants were paid out under the first fund, but the remainder of the money in that fund and all of the funding for the 2001 fund was repealed in response to the state's budget deficit in the 2002 legislative session. This means cities must deal with TIF deficits using mechanisms that shift TIF funds from other districts or that increase TIF revenues, as described above.

**TIF Grant Appropriations**

| Session | Amount (millions) |
|---|---|
| 1997 | $2 |
| 1999 | 4 |
| 2001 one-time | 91 |
| 2001 ongoing per year | 38 |

**For more information:** Contact legislative analyst Joel Michael at 651-296-5057. Also see the House Research publication *TIF Duration Extensions to Offset Deficits,* October 2003.