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Money Matters

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Economic Development Tools

Abstract: State and local governments share responsibility for making the best use of a wide variety of economic development tools. Some of the tools are funded with appropriations, while others are provided in property tax laws. This papers describes some of those economic development tools and how they were impacted by actions during the 1997 legislative session.

Introduction

The phrase, "economic development," encompasses a wide range of governmental activities. Included in "economic development" is the financing of basic infrastructure such as roads, drinking water systems, sewers, and wastewater treatment plants. For businesses to expand, they need adequate municipal infrastructure.

This paper, however, will focus on higher levels of economic development, such as financing the expansion of existing businesses, fostering start-up companies, or luring businesses from other locations. The competition among nations, states and cities for new economic development opportunities makes it difficult for the State of Minnesota and its local governments not to provide financial incentives to businesses. New economic development means increased tax base and new jobs. If a community or state chooses not to offer financial incentives to compete for new economic development opportunities, the increase in tax base and new jobs may pass by the community or state in favor of other communities or states that offer such incentives.

This article describes some examples of tools the state and its local governments have available to promote economic investment. In other words, it is an overview of the programs that provide financial incentives to businesses that are considering locating or expanding in the state. Some of these programs are financed by appropriations from the state and local treasuries:

- Contamination Cleanup Development Grants Program
- Metropolitan Council's Tax Base Revitalization Account
- County Cleanup and Redevelopment Funds
- Minnesota Investment Fund
- Rural and Urban Challenge Grants Program
- Minnesota Agricultural and Economic Development Board Bonds

Others are financed by diverting property tax dollars from their usual purposes, or by forgoing collection of property taxes:

- Tax Increment Financing

- Property Tax Abatements

Brownfields Cleanup and Redevelopment

One of the most significant economic development issues that the Legislature faced during the 1997 was how to fund cleanup and promote redevelopment of "brownfields." Brownfields are parcels of land that in the past were used for industrial or manufacturing purposes and now are underutilized or have been abandoned, often because the soil under them has been contaminated with pollutants. Some brownfield sites have no significant, documented soil contamination, but the fear that an abandoned industrial parcel is contaminated is enough to make the parcel unattractive. Brownfield sites also frequently suffer from—

- Crumbling infrastructure;

- Traffic congestion;

- Cramped lots; and

- High crime rates in the surrounding low-income, residential neighborhoods.

When a business is looking for a location to build a new facility, it has a choice between purchasing a brownfield site or a bare parcel of land in a rural or suburban area, known as a "greenfield" site. Unlike a brownfield site, a greenfield site need not be cleared of existing structures, does not pose a risk of expensive-to-clean-up contamination, and does not suffer from crumbling infrastructure, traffic congestion, small lot sizes or high crime rates. If brownfields cannot be made competitive with greenfields, most businesses will chose to locate new facilities on greenfield sites.

Most brownfields in Minnesota are located in Minneapolis, St. Paul and their inner-ring suburbs, although brownfields can be found in cities throughout the state. Minneapolis, St. Paul and their inner-ring suburbs, however, have little if any property available for new economic development other than brownfields. For those cities to be able to compete for new economic development opportunities, and the new jobs that come with those opportunities, they will need to clean up and clear their brownfields so that businesses may acquire them at a cost that is competitive with greenfields. Those cities also will need to do something to rectify the infrastructure, traffic congestion, parcel assembly and crime problems, whether real or perceived, that are associated with brownfields.

During the 1997 session, the Legislature refunded, enhanced, and created a number of tools for promoting brownfields cleanup and redevelopment. The tools that involve state or local appropriations are discussed in the following section. Additional tools, such as tax increment financing and property tax abatements, are discussed later in this article.

State Contamination Cleanup Development Grants Program

For the FY 1998-99 biennium, the Legislature appropriated $7.0 million to the existing contamination cleanup development grants program under Minn. Stat. §§ 116J.551 through 116J.558. Applications for the grants are made

to the Department of Trade and Economic Development. The $7.0 million appropriation will be included in the agency's base for the FY 2000-01 biennium.

A site is eligible for a grant if it meets three conditions:

- It is not scheduled for funding under the federal or state superfund programs;
- The appraised value of the site is (i) less than 50 percent of the estimated cleanup costs, or (ii) is less than or equal to the cleanup costs and the cleanup costs exceed three dollars per square foot; and
- If the site is cleaned up, it will be improved with buildings that substantially increase the property tax base or the site will be used for an important publicly owned or tax-exempt facility.

The 1997 Omnibus Capital Investments Act (1997 Laws, Chapter 246) reduced the required local match from one-half to one-fourth of the project costs, which include the cost of demolishing existing structures and other activities necessary to clear the site for redevelopment.

Of that $7.0 million appropriation, $5.6 million will come from the General Fund and $1.4 million will come from motor vehicle transfer fee revenues. That fee was scheduled to sunset, but the Legislature repealed sunset provision. Revenues from the fee had been used to clean up waste tire dumps. Following repeal of the sunset provision, revenues from the fee will be used for the contamination cleanup development grants program and the state's superfund cleanup program.

In addition, the 1997 Omnibus Economic Development and Housing Finance Act (1997 Laws, Chapter 200) extended the sunset of the fee that funds the Petroleum Tank Release Cleanup Fund ("Petrofund"). The Legislature created a statutory appropriation of $12.4 million per biennium from the Petrofund for cleanup of sites with petroleum-related contamination, even if that contamination was not from an identifiable tank release. The $12.4 million appropriation will add approximately one extra month each year to the duration of the fee.

Table 1. FY 1998-99 Sources of Funding for Contamination Cleanup Development Grants Program

Source of Funds	Biennial Appropriation
General Fund	$5.6 million
Motor Vehicle Transfer Fee	$1.4 million
Petroleum Tank Release Cleanup Fund	$12.4 million
Total	$19.4 million

The 1997 Omnibus Tax Act (1997 Laws, Chapter 231) directed the Commissioner of Trade and Economic Development to designate the NL Industries/Tara Corporation/Golden Auto site in St. Louis Park to be eligible for a state contamination cleanup redevelopment grant and directed the Metropolitan Council to designate the same site to be eligible for a grant from the tax base revitalization account. The designation that the site is eligible for grants under both programs is contingent on Hennepin County and St. Louis Park entering into an agreement to acquire the site and to use a portion of the site for a rail right-of-way as a substitute for the 29th Street line in Minneapolis. The provisions discussed in this paragraph were contained in a separate House file after being added by amendments in

Senate committees. The bill was vetoed by the Governor, but its provisions reappeared in the taxes conference committee report.

Contamination Tax Revenues

Additional funding for the contamination cleanup development grants program is supposed to come from the revenues generated by the contamination tax. The contamination tax is a property tax applied to the "contamination value" of a parcel of land. The "contamination value" is the amount by which the assessor has reduced the value of the parcel for property tax purposes specifically because of the presence of contaminants on the parcel. The revenues from the contamination tax are deposited in an account in the General Fund called the contaminated site cleanup and redevelopment account ("CSCR Account"). The funds in the CSCR Account are dedicated for funding the contamination cleanup development grants program, but the funds are available for the program only if the Legislature makes a direct approprtiation from the account for the program. In 1995, the Legislature failed to make that direct appropriation.

During the 1997 session, the House Economic Development and Housing Finance Bill (H.F. 2158) directed all future revenues from the contamination tax to be deposited into an account in the Special Revenue Fund and created a statutory appropriation from that Special Revenue account to the contamination cleanup redevelopment grants program. The bill also appropriated the accumulated funds in the CSCR Account in the General Fund to the grants program, making up for the failure to directly appropriate those funds in 1995.

The economic development and housing finance conference committee, however, adopted the Senate position. The conference committee report appropriated $500,000 from the CSCR Account in the General Fund to the City of Andover to clean up a contaminated site in that community. A direct appropriation from the CSCR Account to the contamination cleanup development grants program still is necessary for those funds to be used for their dedicated purpose. Just as happened during the 1995 session, no such direct appropriation was made during the 1997 session.

Metropolitan Council's Tax Base Revitalization Account

In addition to being eligible for contamination cleanup development grants through the statewide program, contaminated sites in the seven-county metropolitan area are eligible for grants from the Metropolitan Council. The Metropolitan Liveable Communities Act (1995 Laws, Chapter 255) created a tax base revitalization account ("TBR Account") from which the Metropolitan Council may make grants to municipalities or development authorities for cleanup of contaminated sites in the seven-county metropolitan area. A grant from the TBR Account may be used as the local match for a state contamination cleanup development grant. The Metropolitan Council expects to make grants from the TBR Account totaling between $5.0 million and $6.5 million each year.

The funds in the TBR Account come from a Metropolitan Council property tax levy. Initially, the council was authorized to levy for the TBR Account an amount equal to the unused portion of the council's authority to levy for the right-of-way acquisition fund ("RALF"). In 1996, the Legislature authorized the council to levy for the TBR Account an amount equal to the total RALF levy authority. That increase in the TBR Account levy will be effective for property taxes payable in 1998.

The City of Andover would have been eligible for a grant from the TBR Account to clean up its contaminated site if the city had elected to participate in the Metropolitan Council's local housing incentives account program established in the Metropolitan Liveable Communities Act. A municipality that elects to participate in that program is subject to certain affordable and life-cycle housing goals. It appears that the City of Andover meets those housing goals, but

it nonetheless refused to participate in the housing program. Because the city refused to participate in the housing program, it was not eligible for a grant from the TBR Account. The city, however, was able to avoid the consequences of its decision because a pool of money was available in the CSCR Account. That pool of money was not being used for its dedicated purpose, and hence was available for the Legislature to appropriate to the City of Andover.

County Cleanup and Redevelopment Funds

The Legislature authorized Hennepin and Ramsey Counties to impose an additional 0.01 percent tax on mortgage registrations and deed recordings. The tax revenues must be deposited in a fund which may be used—

- To acquire polluted or contaminated properties;
- To indemnify purchasers of properties for liability related to pollution;
- To clean up polluted or contaminated land; or
- To develop the acquired or cleaned-up property, whether for private or public uses.

The first priorities for the Hennepin County fund are cleanup of the NL Industries/Tara Corporation/Golden Auto site in St. Louis Park and to acquire adequate railroad right-of-way to replace the 29th Street line in Minneapolis. First priority for the Ramsey County fund is cleanup of the Dale Street Shops and Maxson Steel site or other blighted sites at or near rail lines.

State Programs to Subsidize Businesses

The state appropriates funds for low-interest loans and grants that are used as incentives to lure businesses to Minnesota or to prevent Minnesota businesses from being lured away by other states. The state also provides other forms of subsidies to businesses, such as issuing low-interest, tax-exempt revenue bonds to finance new manufacturing facilities.

Minnesota Investment Fund and Other Business Development Programs

The Minnesota Investment Fund is the state's largest single source of financial incentives for businesses that are considering whether to locate or expand in Minnesota or some other state. The fund is administered by the Department of Trade and Economic Development. Grants or loans from the fund are subject to certain restrictions:

- The maximum grant for a single project is $500,000;
- A grant or loan from the fund may not used to operate or expand a casino, facility that is used primarily for retail sales, or a project related to a professional sports stadium or arena; and
- Recipients of a grant or loan from the fund must pay each employee total compensation, including benefits not mandated by law, at least equal to 110 percent of the federal poverty level for a family of four.

A Minnesota community, including a city or a recognized Indian tribal government, that is seeking to attract a new business may apply for a grant to pay for infrastructure necessary to support the new business. The community also may use some or all of the grant it receives to make a low-interest loan to the business. If the community makes a loan to

the business, however, the community may keep only the first $100,000 in loan repayments; the loan repayments in excess of $100,000, if any, must be repaid to the state. The loan repayments that the state receives are deposited in the General Fund. The General Fund is forecast to receive loan repayment deposits totaling $1.23 million each year during FY 1998-99, the same as projected for FY 97.

Because loan repayments are deposited in the General Fund, the Legislature must make new appropriations to the Minnesota Investment Fund each biennium. In FY 1994-95, the Legislature appropriated $11.034 million for the Minnesota Investment Fund's predecessor, the Economic Recovery Grants program. The Legislature, however, authorized up to $1.0 million of that appropriation to be used for the Capital Access program. In FY 96, the Legislature appropriated $6.017 million for the Economic Recovery Grant program (with $500,000 available for the Capital Access program), but it appropriated only $17,000 for the program in FY 97. During the 1996 session, the Legislature created the Minnesota Investment Fund and added $4.0 million to the appropriation for FY 97, bringing the total FY 1996-97 appropriation for the program to $10.034 million.

During the 1997 session, the Legislature appropriated $13.034 million for the Minnesota Investment Fund in FY 1998-99. Of the FY 1998-99 appropriation, $1.0 million is earmarked for a single, Fortune 500 company in the event it chooses to locate a new facility in Minnesota. The agency's General Fund appropriation base for the program will be $8.034 million for FY 2000-01. The Minnesota Investment Fund also receives federal funds from the U.S. Department of Housing and Urban Development's Community Development Block Grant.

The Capital Access program, mentioned above, provides credit enhancements to small- to medium-sized businesses that experience difficulty obtaining conventional financing for start up or expansion because they do not meet all of the lenders' underwriting standards. The program pledges $100,000 to $125,000 each year as security for loans. The program still has a balance remaining in its Special Revenue Fund account from its last appropriation, $500,000, in FY 96. Funds are returned to the program's account as the loans they secure are repaid, which makes the returning funds available to pledge as security for new loans.

Regional Development Initiatives

In contrast to the Minnesota Investment Fund, other programs such as the Rural and Urban Challenge Grant programs received one-time appropriations to establish revolving loan funds. During the 1993 session, the Legislature transferred $6.0 million to the revolving loan fund of the Urban Challenge Grant program, and during the 1994 session transferred $6.0 million the Rural Challenge Grant program's revolving loan fund. Both transfers were effective in FY 1994. The Legislature has not made another transfer to either program's revolving loan fund since then. When loans made by those programs are repaid, the repayments are deposited in the appropriate revolving loan fund so that resources are available to make new loans.

Both programs are administered by the Office of Regional Initiatives ("ORI") of the Department of Trade and Economic Development. The Rural Challenge Grant program promotes economic development in rural areas, especially by assisting low-income individuals to start their own businesses. Loans from that program are matched by funds from the McKnight Foundation. The Urban Challenge Grant program promotes economic development and job creation in designated low-income areas of the Twin Cities, especially by assisting minority-owned and operated businesses. Loans from that program are matched by funds from 16 certified non-profit organization that provide financial assistance to qualified businesses.

Minnesota Agricultural and Economic Development Board

Minnesota businesses may obtain subsidies in the form of reduced borrowing costs from the Minnesota Agricultural and Economic Development Board. State law gives the board unlimited authority to issue revenue bonds on behalf of Minnesota businesses. For some businesses, the board issues tax-exempt bonds, which have a lower interest rate than taxable bonds. The lower interest rate reduces the business' borrowing costs. But even when the board issues taxable bonds, the business' borrowing costs can be reduced. Usually, bonds issued by the board are "enhanced" by the state in that they are backed by the assets of a state loan guarantee reserve. The state credit enhancement saves the business the cost of obtaining a letter of credit or some other form of private credit enhancement.

Federal law places certain limits on the issuance of tax-exempt revenue bonds. Each year, federal law allocates each state, including Minnesota, an aggregate amount of tax-exempt revenue bond authority. Minnesota law provides a mechanism for allocating that authority among competing applications, so that the aggregate total of tax-exempt revenue bonds issued by Minnesota governments and agencies does not exceed the state's aggregate limit under federal law. In addition, federal law imposes limits on the size of projects for which tax -exempt revenue bonds may be issued. To qualify for tax-exempt status, the bond issue must meet one of two requirements:

- The amount of the issue is less than $1 million; or

- The amount of the issue is less than $10 million and the total capital expenditures for the project of a six-year period are less than $10 million.

Tax-exempt revenue bonds, however, may be issued without regard for those limits if they are issued on behalf of a not-for-profit business.

Between 1984 and 1991, the board issued bonds to finance a variety of production facilities. For example, in 1990, the board issued $2.2 million in tax-exempt bonds on behalf of Paulucci International to finance a frozen foods manufacturing plant in Duluth. The board did not issue any bonds from 1992 through 1994. It issued bonds for only one project in 1995, and then became more active again in 1996.

In April, 1997, the board made an extremely large, controversial bond issue on behalf of Fairview Hospitals. Fairview wanted to refinance its tax-exempt debt with a new issue of tax-exempt revenue bonds. The City of Minneapolis had tentatively agreed to issue refinancing bonds on Fairview's behalf, but then refused to do so. The city withdrew because Fairview became embroiled in a labor dispute that arose from its merger with the University of Minnesota Hospital and Clinic. When the city withdrew, Fairview turned to the board for assistance. The board issued $175 million on Fairview's behalf, much of which was used to refinance Fairview's existing tax-exempt debt. The bonds that the board issued on behalf of Fairview were not enhanced by the backing of the state loan guarantee reserve. Because Fairview is a not-for-profit entity, the bonds issue was not subject to the state's tax-exempt bond allocation process.

In May, 1997, the board issued $3.0 million in tax-exempt bonds on behalf of Endres Processing to finance acquiring land and constructing and equipping a feed processing facility in Rosemount. More recently, the board has announced plans to issue bonds for two new projects:

- Up to $7.0 million in taxable bonds on behalf of Excelsior-Henderson Motorcycle Manufacturing Company to finance purchases of equipment for a motorcycle manufacturing plant in Belle Plaine; and

- Up to $4.0 million in tax-exempt bonds on behalf of Sparta Foods to purchase equipment for a food products manufacturing plant in New Brighton.

Tax Increment Financing and Property Tax Abatements

Tax increment financing ("TIF") allows development authorities, usually associated with cities, to "capture" part of the tax capacity of a property and then use property taxes collected from that captured tax capacity to finance development. When part of the tax capacity within a TIF district is captured, it means part of the property taxes paid by that property is not distributed to the county, city/town, or school district, as would ordinarily be the case. Instead, that part of the property taxes is paid to the development authority.

Usually, the amount of tax capacity captured is based on the amount by the which the tax capacity increased as a result of a new development financed with the property taxes from the captured tax capacity. For example, if the property in a TIF district has a tax capacity of $25,000 before development and a tax capacity of $65,000 after development, then the captured tax capacity is the $40,000 increase. Part of the $40,000 increase is financed with the property taxes paid by the captured tax capacity over a number of years. The development authority or the developer borrows money to finance the development, and the debt is repaid by the future stream of property taxes paid by the captured tax capacity.

Counties, cities/towns, and school districts lose property tax revenues to TIF districts, unless the revenues from those districts are used to finance developments that would not have occurred but for the incentives financed with the TIF revenues. But TIF districts have varied impacts on different kinds of local governments:

- Cities usually control TIF districts, so the property tax revenues they "lose" are for used for projects they choose; TIF allows cities to pay pennies on the dollar for city-chosen projects because cities can force counties and school districts to contribute revenues to the city-controlled TIF districts;

- School districts recover much of the property tax revenues they lose to TIF districts through increased state education aids; consequently, TIF districts represent a drain on resources for state education funding; and

- Counties lose significant amounts of property tax revenues to city-created TIF districts.

Property tax abatements are an alternative to TIF for providing financial incentives to developers. Unlike TIF incentives, abatements provide incentives in the form of decreased (abated) property taxes. With TIF, the full amount of property taxes are collected, but some of the revenue is invested in the project that pays the property taxes, thus providing a financial incentive to the developer.

Loosened Restrictions on Tax Increment Financing

During the 1997 session, the Legislature significantly loosened some of the most important restrictions on tax increment financing ("TIF"). First, the Legislature loosened the definition of "cost of correcting conditions" for redevelopment and renovation/renewal districts.

Before the "cost of correcting conditions" restriction was imposed, a development authority could identify blighted structures as justification for creating a redevelopment or renovation/renewal district but then use the TIF revenue from the district to finance development that went substantially beyond correcting the blight. For example, the Bloomington Port Authority used a few run-down farm buildings to justify creating a redevelopment district on a valuable parcel

known as the "Kelley Farm" property, which now is adjacent to the Mall of America. TIF revenues from that district will be used to finance development on the bare land surrounding those now-demolished farm buildings (unless the location of the district is transferred to the former Met Center property north of the mall, as authorized by a law enacted in 1996).

In 1989, the Legislature imposed a requirement that 90 percent of TIF revenues from a redevelopment district "must be used to finance the cost of correcting conditions," *i.e.*, the blighted structures, that justified creating the district. The law specified that those costs of correcting conditions could include the cost of acquiring parcels containing blighted structures, demolition of structures, clearing of land, and construction of public improvements or parking facilities. In 1990, the Legislature imposed the same conditions on renewal/renovation districts.

A controversy arose regarding the proper interpretation of that requirement. The State Auditor took the position that the statute provided an exhaustive list of examples, and therefore it would not be a valid "cost of correcting conditions" to use TIF revenues to finance the construction of new buildings after the blight structures had been cleared and the land prepared for redevelopment. Development authorities and their attorneys and financial advisors objected to the State Auditor's interpretation. The 1997 House Tax Bill (H.F. 2163) amended the statute to affirm the State Auditor's interpretation. The 1997 Senate Tax Bill (H.F. 493) amended the statute to overrule the State Auditor's interpretation. The conference committee adopted the Senate's position, retroactive to all TIF districts regardless of when they were created.

That change in the law may have substantially weakened the "cost of correcting conditions" requirement. Those who advise development authorities may suggest that TIF revenue from a redevelopment district may be used to finance construction of a shopping mall near the blighted structures that justified creation of the district if construction of the shopping mall would make correction of the blight more likely. The State Auditor may object to that interpretation of the law, but once cities and other development authorities have created the districts and made investments in reliance on the advice of their attorneys and advisors, it is difficult politically to require a reversal of those decisions.

In addition, the Legislature added to the "cost of correcting conditions" list the costs of renovation and cleaning up hazardous substances, pollution or contaminants. It is reasonable to include the cost of renovation as a "cost of correcting conditions" for a renovation/renewal district, because that is the purpose of such districts. But including costs of renovation for a redevelopment district blurs the distinction between those two kinds of districts. Redevelopment districts are permitted to remain open more years than renovation/renewal districts. If the distinctions between redevelopment and renovation/renewal districts are eliminated, then development authorities whenever possible will choose to create the longer-duration redevelopment districts rather than renovation/renewal districts. Similarly, the addition of the costs of cleaning up hazardous substances, pollution or contaminants blurs the distinction between redevelopment districts and soils correction districts, the latter of which have a shorter duration (although the Legislature also significantly lengthened the duration of soils condition districts).

TIF for Commercial Development in Small Cities

During the 1997 session, the Legislature made two exceptions to the statute that prohibited using economic development districts to finance commercial development on bare ground. First, TIF revenues from an economic development district in a "small city" may be used to finance construction of a commercial facility up to 15,000 square feet in size. A city is a "small city" if, at the time the request for certification of the district is made, the city has a population of 5,000 or fewer and is located more than 10 miles from the nearest city with a population of 10,000 or greater.

Second, TIF revenues from an economic development district may be used to finance development of a "qualified border retail facility," which must meet the following requirements:

- The facility is in a "small city" located within one mile of the state boarder;
- It is located outside of the seven-county metro area;
- It contains at least 25,000 square feet of retail space; and
- The proposed new retail facility or a competitive facility will be located in a bordering state or province if TIF revenues are not used to finance the development in the small Minnesota border city.

Tightened Restrictions on Tax Increment Financing

The Legislature also enacted a few additional restrictions on the use of TIF:

- Under a new definition of "tax increments," the proceeds of tax increments must be treated as tax increments, which will prevent tax increments from losing their character (and thus prevent them from being freed from applicable restrictions) as a result of purchases, sales, loans, repayments, or investments.
- Interior inspections of buildings are required before a determination can be made that they are sufficiently blighted to justify creation of a redevelopment or renovation/renewal district.
- Written records of how the blight requirements were met must be retained to demonstrate that the creation of a redevelopment or renovation/renewal district was proper.
- Fiscal disparities contributions attributable to new commercial/industrial development in a TIF district must be paid out of TIF revenue rather than from the tax capacity of other commercial /industrial properties in the city, county and school district.

Tax Increment Issues Not Addressed

In March, 1997, the Legislative Auditor released a report evaluating the application of TIF laws. The report found significant problems with TIF districts created after 1984 and before significant restrictions were imposed in 1988, 1989, and especially 1990.

The report found that frequently a district created during that time period is allowed to remain in existence after sufficient TIF had been generated to complete the financing of the initial development. It was the initial development that was required to meet the "but for" test; the city had justified creating the TIF district by making a finding that the initial development would not have occurred but for the use of TIF. The report further found that in such situations, the additional TIF revenues (over and above what was necessary for the initial development) were used for a wide variety of city general government expenses. In other words, county property tax payers and the state General Fund (through the education aids formula) were being forced to pay for city services that should have been paid for with city funds, and city property tax payers were paying for a portion of those services even though the revenues and expenditures were not included in the city's budget.

The 1997 House Tax Bill (H.F. 2163) included a provision that would have made the "but for" test apply to proposals to spend additional TIF revenue after the initial development had been fully financed. That change would have been applicable to new spending decisions after June 1, 1997 for all existing or newly created TIF districts, except qualified housing districts were exempt and the rule would not have applied to spending under existing commitments or spending of bond proceeds. That provision, however, was not adopted by the conference committee.

Property Tax Abatements Authorized as a Substitute for TIF

A city, town, county or school district may grant an abatement of its own share of the property taxes on a structure (but not the land on which it is situated) for up to 10 years. The political subdivision may grant the abatement only if it expects the benefit it receives to be at least equal to the costs it will bear under the proposed abatement agreement ***and*** it finds that granting the abatement is in the public interest because it will—

- Increase or preserve the tax base;
- Provide employment opportunities in the political subdivision;
- Provide or help acquire or construct public facilities;
- Help redevelop or renew blighted areas; or
- Help provide the residents of the political subdivision with access to services.

A school district is limited in the amount of abatement it may grant, and if it grants an abatement the state will not increase education aids to make up for the lost property tax revenue. An abatement may not be granted for property in a TIF district.

Granting an abatement is a less expensive, more accountable alternative to TIF. Under both an abatement and TIF, the city loses property tax revenue. In the case of an abatement, the property taxes are not collected; in the case of TIF, the property taxes are collected but are invested in the new development. The significant difference between an abatement and TIF involves the impact on counties and school districts. Under an abatement, the county or school district in which the property is located loses property tax revenue only if it agrees to participate; under TIF, the city may unilaterally cause the county and school district to lose property tax revenues. Under an abatement, state education aids do not increase to offset the property tax revenues lost by the school district; under TIF, state school aids automatically increase.

Conclusion

Proponents of subsidies to businesses argue that providing them is essential to keeping Minnesota competitive for new economic development opportunities; because everyone else seems to be giving money away, our state and communities have to give money away as well to remain competitive. Opponents point out that subsidies provide an unfair advantage to some Minnesota businesses over their Minnesota competitors. It also is ironic that in this era that public policy is making it imperative for poor individuals to compete for jobs from private sector businesses rather than to rely on government handouts, those private sector businesses are becoming increasingly accustomed to receiving government support for financing their new manufacturing facilities.

It also may be prudent to question the need for subsidizing business expansion in Minnesota when the most significant limitation on economic growth is a shortage of skilled workers and workers to take entry-level positions. Minnesota's unemployment rate is far below the national average, and the unemployment rate for the seven-county metro area is even lower. A shortage of workers has caused the state economy's growth rate to slow down. Analysis of demographic trends indicates that the shortage of workers is not just a product of the state's strong economy, but will continue for the foreseeable future. Except in isolated pockets of persistent high unemployment, job creation is not the issue. Perhaps the Legislature should consider shifting some of the emphasis of the state's economic development strategy away from job creation and toward worker training.

For more information on economic development tools, contact Bill Connors, House Fiscal Analyst, at 296-5813.