

# Appendix G: Potential Funding Sources

## Potential Funding Sources

This section is intended to provide a preliminary assessment of state and federal funding options, as well as development tools the City could consider for the 2nd Street public improvements and redevelopment projects.

Because this is a relatively complex redevelopment project involving multiple stages and design elements, this list should not be considered comprehensive, but rather a starting point to begin to evaluate potential funding sources as the project is programmed for implementation.

Two important notes: First, it should be understood that the federal government's Transportation Finance Act called SAFETEA-LU, which governs the distribution of transportation funding to the states, will expire in 2009. The reauthorization of this Act will have an impact on the types of programs and degree of funding for each federal program governed by the new law.

Second, in almost all cases, grant and loan financing provided by the federal or state government must be made to a public entity, (i.e., a county, city or township). This means that the Rochester Area Foundation will generally have to work with a public sponsor in going after many of these funding opportunities.

### 1. Federal and State Potential Funding Sources

#### a. Federal Transportation Enhancement (TE) Program

The TE program is a competitive program administered by the Mn/DOT District 6 Area Transportation Partnership that offers funding for activities intended to help expand transportation choices and enhance the transportation experience through 12 eligible TE activities related to surface transportation. These activities include landscaping and scenic beautification, pedestrian and bicycle infrastructure programs, historic preservation, and environmental mitigation. One or more of these 12 activities must constitute at least 70 percent of the project cost. Other activities such as paving a parking lot, constructing buildings, or providing restrooms must constitute no more than 30 percent of the project cost.

The next solicitation will take place in the spring and summer of 2010, and Mn/DOT is anticipating that approximately \$2 million will be available for TE projects in the district to be programmed in 2014 and 2015.

#### b. Federal Surface Transportation Program (STP)

Like the federal TE program, the federal STP program also is administered by Mn/DOT and solicits projects every two years. This competitive program typically favors projects that involve new construction/reconstruction resulting in operational or safety improvements. However, transportation enhancements and construction to accommodate other transportation modes (i.e. walking, biking, streetcars, buses) are also eligible to receive funding under this program. Another eligible project type under the STP program that could be applicable is modification of public sidewalks to comply with American with Disabilities Act (ADA) standards.

The next solicitation for federal STP funds will be out in the summer of 2009. Projects selected for funding would be programmed in 2013 and 2014. Once again, the STP program is highly competitive and projects selected for funding are typically roadway improvement projects focusing on safety and mobility improvements.

#### c. Minnesota Transportation Revolving Loan Fund (TRLF)

Minnesota's TRLF operates in much the same way as a commercial bank, offering loans and other types of financial assistance to eligible borrowers to finance transportation projects. (The term "other financial assistance" means loan guarantees, lines of credit, credit enhancements, equipment financing leases, bond insurance, and other forms of financial assistance.) Project types eligible to be funded through the TRLF include streetscaping and other enhancement items, pre-design studies; acquisition of right of way, road and bridge maintenance, repair, improvement, or construction; rail safety projects; signs; guardrails; and protective structures used in connection with these projects.

If a determination is made to pursue TRLF funding, the project sponsors should work with the following organizations to ensure eligibility for funding: 1) Mn/DOT District 6 representatives who oversee the district's Area Transportation Partnership (ATP); and 2) the Minnesota Public Facilities Authority (PFA), who essentially serves as the "banking authority" for the program.

**2. Department of Employment and Economic Development (DEED) Development and Redevelopment Grants and Loans:** The Minnesota Department of Employment and Economic Development (DEED) offers a number of different financial and technical resources grants to communities and businesses for the purpose of fostering business growth and addressing revitalization needs. Eligible activities include certain redevelopment projects, street improvements supporting certain economic development projects, housing and commercial rehabilitation, and cleanup of contaminated sites.

DEED has recently implemented a "one-stop shopping" application for a variety of funding programs intended to foster and promote economic development. The "Business Development/Infrastructure Application" is a process that allows eligible applicants to apply for multiple funding sources through just one application.

There may be future development projects within the Second Street corridor that could be eligible for DEED-administered grants. Once these development plans are firm, DEED staff should be consulted to determine potential eligibility for funding through these grant and loan programs.

**3. Environmental Grants and Loans:** Depending on the specific public benefits anticipated by the project, there may be some additional opportunities to attract grant or low-interest loan funding through programs that address environmental objectives. One DNR source is identified below. Environmental programs such as this are possibilities, but will not likely provide the level of funding that is possible under the federal Transportation Enhancement program, discussed above.

- Department of Natural Resources – Habitat Improvement Grants Habitat Enhancement projects include restoration of native plant communities, reforestation, protection of wetlands, and abatement of soil erosion. Plantings must consist only of native species

## Development Tools

The following section provides a brief discussion of the tools currently available to the City to consider for redevelopment within the Second Street Corridor. A complete examination of the tools available to the City is not possible in this document, but providing an overview of the most commonly used finance tools is helpful. This discussion focuses on the highlights of those tools.

### Overview of Statutory Authority

Every statutory power contains a unique set of authorizations and restrictions. Understanding these provisions is a key to effective use. In some cases, the city may have several options. For example, public improvements can be financed with special assessments, special service districts, housing improvement areas, tax abatement, and tax increment financing.

Some key sources of statutory authority come from the following:

- Constructing public improvements and levying special assessments – Chapter 429
- Constructing, operating, and maintaining water, sanitary sewer, and storm-water utility systems – Section 444.075
- Creating and using special service districts – Sections 428A.01 through 428A.101
- Creating and using housing improvement areas – Section 428A.11
- Establishing and using tax increment financing districts – Sections 469.174 through 469.1791
- Making and using tax abatement levies – Sections 469.1812 through 469.1815
- Powers granted to cities through housing and redevelopment authorities – Sections 469.001 through 469.047
- Powers granted to cities through economic development authorities – Sections 469.090 through 469.1081
- Lease financing for real and personal property – Section 465.71

These statutes are available on the Internet at [www.revisor.leg.state.mn.us/stats](http://www.revisor.leg.state.mn.us/stats).

## Finance Tools

Economic development actions require a framework for financial decision-making. The investment of public dollars to achieve economic development objectives should be guided by several key principles:

- Financial resources are limited. The city has limited funding to apply to economic development initiatives, so the use of resources must be targeted to achieve the greatest effect on the community.
- Financial decisions require long-term perspective. The current use of financial resources may reduce monies available in the future. In evaluating short-term opportunities, it is important to question the long-term impact on community development.
- Public funds should lead to private investment. While this section focuses on public finance actions, economic development cannot become reality without private investment. The use of public funds should be targeted to actions that encourage private investment in Rochester.

**1. Tax Increment Financing:** Tax increment financing (TIF) is the primary development finance tool available to Minnesota cities. TIF is simple in concept, but complex in its application. Through tax increment financing, the property taxes created by new development (or redevelopment) are captured and used to finance activities needed to encourage the development. The challenge in using TIF lies with the complex and ever-changing statutory limitations.

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### *Pooling*

The term pooling refers to the ability to spend money outside of the boundaries of the TIF district. For redevelopment districts, not more than 25% of revenues can be spent on activities outside of the TIF district. The limit is 20% for all other districts. Monies spent on administrative expense count against this limit. This limit reduces the ability of TIF to pay for area-wide improvements and to use excess revenues to support other development sites.

### *Timing Constraints*

Timing factors must be considered in creating a TIF district. Establishing a district too far in advance of actual development may limit future use. Within three years from the date of certification, the City must undertake activity within the district. The statutory criteria of activity include issuance of bonds in aid of a project, acquisition of property, or the construction of public improvements. Without qualifying activity, no tax increment can be collected from the district. Within four years from the date of certification, the city or property owners must take qualifying actions to improve parcels within the district. All parcels not meeting these statutory criteria must be removed (knocked down) from the district. Upon future improvement, any parcel so removed may be returned to the district. After five years from the date of certification, the use of tax increment is subject to new restrictions. Generally, tax increment can only be used to satisfy existing debt and contractual obligations. The geographic area of the TIF district can be reduced, but not enlarged, after five years from the date of certification.

**2. Tax Abatement:** Tax abatement acts like a simpler and less powerful version of tax increment financing. With TIF, the City controls the entire property tax revenue

from new development. Under the abatement statute (Minnesota Statutes, Sections 469.1812 through 469.1815), the City, county, and school district have independent authority to grant an abatement.

### *Uses*

Abatement in Minnesota works more like a rebate than an abatement. The City (and other units abating taxes) adds a tax levy equal to the amount of taxes to be abated. The revenue from the abatement levy can be returned to the property owner or retained and used to finance development activities. Tax abatement can be used to finance the key redevelopment actions in the downtown: land acquisition, site preparation, and public improvements.

Tax abatement is perhaps best suited as an incentive for reinvestment in existing property. While TIF deals with only the value from new development, abatement can apply to both new and existing value. This power provides the means to encourage rehabilitation of commercial buildings and housing. The City could agree to abate all or part of the municipal share of taxes to encourage reinvestment tied to the plan.

The statute grants the authority to issue general obligation bonds supported by the collection of abated taxes. The proceeds of the bonds may be used to pay for (1) public improvements that benefit the property, (2) land acquisition, (3) reimbursement to the property owner for improvements to the property, and (4) the costs of issuing the bonds. These bonds can be issued without an election and are not subject to the debt limit.

### *Limitations*

State law places several important limitations on the use of tax abatement:

- In 2003, the State Legislature increased the total taxes abated by a political subdivision in any year to an amount that may not exceed the greater of 10% of the current levy or \$200,000.
- If one political subdivision declines to abate, then the abatement levy can be made for a maximum of 15 years. If the City, county, and school district all abate, then the maximum period drops to 10 years.

- The duration of the abatement can be extended to 20 years if it is for a “qualified business” as defined in the statute. This provision is targeted toward industrial development applications.
- Taxes cannot be abated for property located within a tax increment financing district.

**3. Special Assessments:** Public improvements are often financed using the power to levy special assessments (Minnesota Statutes Chapter 429). A special assessment is a means for benefiting properties to pay for all or part of the costs associated with improvements, and to spread the impact over a period of years. This tool can be applied to both the construction of new improvements and the rehabilitation of existing improvements.

### *Uses*

Special assessments can be used to finance all of the public improvements resulting from the plan. Eligible improvements include sanitary sewer, water, storm sewer, streets, sidewalks, street lighting, park, streetscape, and parking.

Special assessments provide a means to borrow money to finance public improvements. Chapter 429 conveys the power to issue general obligation improvement bonds to finance the design and construction of public improvements. Important factors in the use of improvement bonds include:

- A minimum of 20% of the cost of the improvement must be assessed against benefited properties.
- Beyond the 20% threshold, any other legally available source of municipal revenue may be used to pay debt service on improvement bonds.
- Improvements bonds are not subject to any statutory debt limit.
- Improvement bonds may be issued without voter approval.

### **Limitations**

The amount of an assessment cannot exceed the benefit to property as measured by increased market value. There are also practical considerations. In growth areas, cities must decide how to allocate costs between current and future development.

Assessment policies must consider how to make this allocation and the financial resources needed to carry future costs until development occurs. For reconstruction, the challenge becomes determining how much benefiting property owners should pay for enhancing an existing improvement. Within this limitation, several factors will shape the amount of the assessment.

- The amount of the assessment must be 20% or more of the improvement cost to allow the issuance of bonds.
- Local improvement policies and/or decisions made on previous projects often create parameters for assessments. Likewise, assessment decisions should be made with consideration of the potential implications for future similar projects.
- The assessment must strike a balance between equity and feasibility. Properties that benefit from improvements should pay a fair share of the costs. The assessment must be affordable for both the property owner and the City. Reducing the assessment to the property requires the City to allocate other revenues to the project.

**4. Special Service District:** A special service district is a tool for financing the construction and maintenance of public improvements within a defined area. Minnesota Statutes, Sections 428A.01 through 428A.10 govern the creation and use of special service districts. This legislation is currently scheduled to sunset in 2009. A special service district provides a means to levy taxes (service charge) and provide improvements and service to a commercial area.

#### *Uses*

A special service district can be applied to both commercial and industrial areas. The district can provide an alternative means of financing the construction of any of the public improvements discussed previously with special assessments. The service district approach avoids the benefits test imposed by special assessments; the test for the district is that the amount of service charges imposed must be reasonably related to the special services provided. The costs of parking, streetscape, or stormwater improvements, for example, may be better spread across a district than through assessments to individual properties.

An important use of the special service district is the maintenance of public improvements. Some of the improvements described in the plan require a level of

maintenance above the typical public improvement. Items such as banners and planted materials must be maintained and replaced. Higher levels of cleaning and snow removal may be needed. Without a special service district, these costs are typically borne through the General Fund of the City or a private group such as a Chamber of Commerce.

#### *Limitations*

The use of a special service district is subject to some important constraints:

- The process to create a special service district and to levy taxes must be initiated by petition of property owners and is subject to owner veto. The use of a special service district requires a collaboration of property owners and the City. There are two separate steps in the process: (1) adoption of an ordinance establishing the service district, and (2) adoption of a resolution imposing the service charges. Neither step can be initiated by the City; the City must be petitioned to undertake the processes to create a special service district and to impose service charges. At a minimum, the petitions must be signed by owners representing 25% of the area that would be included in the district, and 25% of the tax capacity subject to the service charge.
- The actions of the City Council to adopt the ordinance and the resolution are subject to veto of the property owners. To veto the ordinance or the resolution, objections must be filed with the City Clerk within 45 days of initial City Council action to approve. The objections must exceed 35% of area, tax capacity, or individual/business organizations in the proposed district.
- The service charge applies solely to non-residential property. State law limits the application of a service charge to only property that is classified for property taxation and used for commercial, industrial, or public utility purposes, or is vacant land zoned or designated on a land use plan for commercial or industrial use. Other types of property may be part of the service district, but may not be subject to the service charge.

**5. Housing Improvement Area:** The City has the power to establish a special taxing district to make improvements in areas of owner-occupied housing (Minnesota Statutes, Sections 428A.11 through 428A.21). The housing improvement area is similar in concept to the special service district. It is a special taxing district that can be used to finance a variety of improvements. However, there is an important

administrative difference with the housing improvement area. The City has the ability to assign the procedures for imposing “fees” and administering the area to another “authority,” such as the HRA or EDA.

A housing improvement area is a defined collection of parcels. The area may cover a single housing project or a broader area within the downtown.

The City has the power to levy a “fee” on the housing units in the area. This fee may work like a property tax or may be spread using another approach determined by the City. The fee can be collected through the property tax system.

### *Uses*

The statute allows each city to define the nature of housing improvements. This tool can be used to finance any form of public improvement, including streetscape, parking, and trails. A housing improvement area can also be used for private improvements that are part of new or existing housing developments.

### *Limitations*

The City does not have the unilateral power to establish a housing improvement area. The process must be initiated by petition of property owners. In addition, the actions to establish the area and impose the fees are subject to veto by the property owners. These potential complications become moot if the area is set up at the beginning of the development process. Typically, there is a single property owner at this stage of the process. In existing neighborhoods, this tool allows residents to take the initiative to improve local parks.

**6. Utility Revenues:** The City operates three municipal utilities: water, sanitary sewer, and stormwater. The revenues from the operation of these utilities are available to pay for capital improvements in support of community development initiatives. State law (Minnesota Statutes, Section 444.075) gives the authority to pledge these revenues to general obligation bonds for utility system improvements.

**7. Street State Aid:** The City receives state aid for the construction and maintenance of the local streets. This aid can only be used for streets designated for inclusion in the local state aid street system. These revenues can also be pledged to pay debt service on bonds issued for the construction and maintenance of state aid streets (M.S. 162.18).

**8. Street Reconstruction:** A relatively new municipal power is the ability to issue bonds to finance street reconstruction projects (M.S. 475.58). To use this authority, the streets to be reconstructed must be part of a “street reconstruction plan” that describes the streets to be reconstructed, the estimated costs, and any planned reconstruction of other City streets over the next five years. The issuance of the bonds must be approved by a vote of all of the members of the governing body following a public hearing. The issuance is subject to a reverse referendum provision. The City must hold an election prior to issuance if petitioned by voters within 30 days of the public hearing. Unlike most municipal debt, these bonds are subject to the debt limit.

**9. Lease Revenue Bonds:** Public buildings can be financed through the issuance of lease revenue bonds.

This tool combines two pieces of statutory authority. A housing and redevelopment authority (or EDA using these powers) has the ability to issue revenue bonds to finance projects pursuant to a redevelopment plan. These projects can include the construction of public buildings. Most HRAs do not, however, have sufficient revenues to secure these bonds. A city can provide this revenue through a lease purchase agreement with the HRA. The authority for the lease comes from Minnesota Statutes, Section 465.71.

In considering the use of lease revenue bonds, several factors should be noted:

- The lease is not a long-term, binding obligation in the form of most City bond issues. The lease is subject to a statutory “annual appropriation” pledge. In simple terms, the City Council has the right not to appropriate funds to pay the lease in any fiscal year. This action would, however, mean forfeiture of the facilities financed with the lease.
- If the amount of the lease exceeds \$1,000,000, then the obligation is subject to the statutory debt limit. This limit equals 2% of the taxable market value of property.
- A levy by the City to make payments on lease revenue bonds qualifies as a special levy under the current levy limit system. A levy to pay debt of another political subdivision is an eligible special levy. Although an HRA is a part of City government, it is technically a political subdivision.

**10. Capital Improvement Bonds:** Capital improvement bonds are the newest capital finance power for Minnesota cities. This authority was granted by the State Legislature in 2003. Through this authority, the City can issue bonds to finance the acquisition or betterment of a city hall, a public safety facility, or a public works facility. The statute does not define the precise nature of public safety or public works facilities. This debt authority is subject to several procedural requirements and limitations:

- The bonds must be issued pursuant to an approved capital improvements plan.
- The issuance is subject to a reverse referendum petition. The total principal and interest due in any year on all outstanding capital improvement bonds may not equal or exceed 0.05367% of taxable market value of the City.

**11. Local Sales Taxes:** Local governments are generally prohibited by statute from imposing sales taxes. Nevertheless, the legislature has authorized, through special legislation, a number of local sales taxes. These local taxes have differed significantly in their characteristics and administration. In 1997, the legislature adopted model statutory language regarding imposition and administration of new and existing local sales taxes.

#### **Steps That a Local Government Must Follow to Impose a Local Sales Tax**

A political subdivision must get special legislation authorizing the imposition of the sales tax. The statute requires that the governing body of the political subdivision pass a resolution indicating its desire to impose the tax prior to requesting the enabling legislation. The resolution must include information on the proposed tax rate, the amount of revenue to be raised and its intended use, and the anticipated date when the tax will expire. This resolution requirement was added during the 1998 session.

In 1999 the legislature began requiring a political subdivision to hold a local referendum at a general election<sup>2</sup> before imposing an authorized local sales tax. The revenue may only be used to fund specific capital improvements, which must be identified at least 90 days before the referendum. This codified existing practice, since most special legislation authorizing local taxes passed in recent years already imposed this requirement.

It is our understanding a sales tax was authorized in the City of Rochester in 1983.

This tax has been renewed three times, in 1989, 1992, and 1998. Initially enacted at 1.0% to raise \$16 million for a civic center and \$16 million for flood control; the rate was lowered to 0.5% in 1992. The 1998 extension allows the city to raise another \$76 million for various higher education, transportation, and sewer capital projects. The tax was further extended in the 2005 special legislative session to allow another \$40 million to be raised for a joint road project with Olmsted County.

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