

# Tax Increment Financing and Tax Incremental Districts in South Dakota: Guidelines for Creation, Classification, and Annual Certification

Prepared by the South Dakota Department of Revenue  
Property and Special Taxes Division  
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## INTRODUCTION

Tax Increment Financing (“TIF”) is a means of financing public improvements in a defined geographic area, known as a tax incremental district or “TIF district.” A TIF district can be created by either a municipality or county (“governing body”).

TIF district creation and operation in South Dakota requires consistency in project process and statutory classification. To this end, Governor Dennis Daugaard issued an “Executive Directive Pertaining to Tax Incremental Finance Districts” to the Department of Revenue (“Department”) on March 6, 2017, directing the Department to develop guidelines for local authorities to utilize to eliminate inconsistencies in TIF project process and classification. In addition, the Department was directed to create an annual report of all TIF projects to provide better transparency for the public and policymakers.

The following guidelines are divided into three general categories related to TIF projects: creation, classification, and annual certification. **Section 1** explains the statutory process for creating a TIF district. **Section 2** establishes the procedure for classifying a TIF district for purposes of the state-aid to education formula. This procedure includes a pre-submission process for the governing body to consult with the Department regarding TIF district classification *prior to* governing board approval of the district. **Section 3** details the annual certification process, including a description of TIF project information that must be submitted to the Department for compilation of an annual report of all TIF projects in South Dakota.

## SECTION 1: CREATING A TIF DISTRICT

The specific procedures for creating a TIF district are outlined in SDCL ch. 11-9. The following is a brief summary of the process. Governing bodies should consult legal counsel throughout the process of creating a TIF district.

### Preliminary Steps

- The planning commission of the governing body is required to hold hearings on the necessity of the TIF district. SDCL 11-9-3.
- Notice of the hearing must be published not less than ten nor more than thirty days from the date of the hearing. In addition, notice must be mailed to the chief executive officer of every entity authorized to levy taxes on property within the proposed boundaries of the TIF district. SDCL 11-9-3.

- If the planning commission determines the TIF district is needed, the commission must recommend creation of the district, designate the proposed boundaries of the district, and submit such recommendations to the governing body. SDCL 11-9-4.

### **Governing Body Approval**

- The governing body receives the recommendations from the planning commission and considers whether to approve the recommendations.
- If the recommendations of the planning commission are accepted, the governing body is required to adopt a resolution officially creating the TIF district. The resolution creating the TIF district must name the TIF district, specify the legal description boundaries of the TIF district, and adopt a project plan for the public improvements within the TIF district. SDCL 11-9-5.
- Additionally, SDCL 11-9-8 requires that the resolution must contain the following specific findings:
  - (1) Not less than twenty-five percent, by area, of the real property within the district is a blighted area or not less than fifty percent, by area, of the real property within the district will stimulate and develop the general economic welfare and prosperity of the state through the promotion and advancement of industrial, commercial, manufacturing, agricultural, or natural resources; and
  - (2) The improvement of the area is likely to enhance significantly the value of substantially all of the other real property in the district.

### **Certification of Base Value**

- The municipal Finance Officer or County Auditor must submit a written request to the Department to certify the **base value** of the TIF district. SDCL 11-9-20. This is the assessed value of the property that is within the TIF district as of the date it was created, as last certified by the Department as of the date the request for determining the base value is received.
- The request to certify the base value should be submitted as soon as possible after the creation of the TIF district and must include all pertinent information related to the district (resolution, project plan, and certification request form).

## **SECTION 2: TIF DISTRICT CLASSIFICATION**

TIF district classification, a vital component of the TIF process, is widely misunderstood and has led to inconsistent classification across South Dakota. The sole purpose of classification is determining how the increment value generated within the TIF district is treated in the state-aid to education formula.

The assessed value of a TIF district for state-aid purposes is the total assessed value of the district (base + increment = total assessed value). SDCL 13-13-10.2. What this means is that the total assessed value of a TIF district is counted as “local effort” when calculating the amount of state-aid any school district within a TIF district will receive. However, since the school district does not receive any tax revenue from the increment value, the County Auditor is required to impose an additional levy on all real property within the school district to hold the district harmless. SDCL 10-12-44(1). The effect is that all property owners within an impacted school district pay slightly higher school property taxes during the life of a TIF district.

An exception exists for TIF districts created for industrial and economic development purposes. SDCL 13-13-10.2. For these types of TIF districts, the assessed value for state-aid purposes is only the base value as certified by the Department. Any increment value is lost local effort and is not factored into the state-aid to education formula. The effect is that all real property owners across the entire state pay slightly higher school taxes to make up for the lost local effort.

The current classification scheme has resulted in inconsistent classification of nearly identical TIF district projects and, in some instances, classification that is contrary to statutory definitions. As a result, the Department is providing the following guidelines to ensure proper classification of all TIF districts across the state, including special guidance for housing development. Further, the Department is establishing a pre-submission process to assist local authorities with TIF district classification prior to governing body approval of a district.

The three types of TIF districts are Local, Industrial, and Economic Development.

### **Local**

Local TIF districts are created for purposes other than industrial or economic development. Many communities have used Local TIF districts to make public infrastructure improvements for various reasons, including housing development. The defining feature of a Local TIF district is that the project generally is for the benefit of the local government creating the district, as opposed to having a regional or statewide benefit.

Local TIF districts are not presently defined in statute. Rather, a Local TIF district is the default classification. Unless the TIF district meets the statutory definition of an Industrial or Economic Development TIF district as provided in SDCL 13-13-10.2, it is a Local TIF district.

The assessed value of a Local TIF district for purposes of the state-aid formula is the total assessed value of the district. The County Auditor is required to impose an additional school levy on all real property within any impacted school district to hold the district(s) harmless.

### **Industrial**

Pursuant to SDCL 13-13-10.2, “industrial includes only 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.”

Industrial TIF districts are created for industrial purposes and are exempt from the provisions of SDCL 10-12-44(1) that require the County Auditor to impose an additional school levy on real property within the district. Any increment value in an Industrial TIF district is lost local effort in the state-aid to education formula.

Examples of Industrial TIF districts include districts created to finance public infrastructure for ethanol plants and manufacturing facilities.

### **Economic Development**

Pursuant to SDCL 13-13-10.2, “economic development includes any area where there is or will be one or more businesses engaged in any activity defined as commercial or industrial by the governing body that has zoning authority over the land contained within the tax incremental district.”

Like Industrial TIF districts, Economic Development TIF districts are exempt from the provisions of SDCL 10-12-44(1) that require the County Auditor to impose an additional school levy on real property within the district. Any increment value in an Economic Development TIF district is lost local effort in the state-aid to education formula.

Examples of Economic Development TIF districts include districts created to finance public infrastructure for commercial/retail development.

### **Housing Development**

Perhaps the most-widely misunderstood classification of TIF districts relates to housing development projects. Many communities have created TIF districts for housing development, but classification has been inconsistent depending on when and where the district was created.

In general, the Department does not believe housing development meets the definition of “economic development” as defined in SDCL 13-13-10.2, and TIF districts created for this purpose should be classified as Local TIF districts. However, the Department is cognizant of the fact that many communities face a lack of affordable housing options that may hinder potential economic development within the community. Given that reality, the Department may consider housing development to be economic development for purposes of TIF district classification in the following circumstances:

- The original selling price of all houses in the TIF district will be at or below the first-time homebuyer purchase price limit as determined by the South Dakota Housing Development Authority as of the date the TIF district is created; or
- The monthly rental rate of all multi-family housing units in the TIF district will be at or below the calculated rent for the state’s eighty percent area median income, as determined by the South Dakota Housing Development Authority, as of the date the TIF district is created, for a minimum of five years following the date of first occupancy.

**Please note that the Department intends to work with interested stakeholders and the legislature to further clarify how housing development TIF districts should be classified.**

### **Pre-Submission Classification Process**

To ensure consistent and uniform TIF district classification, the Department will now require local authorities to request that the Department make a preliminary classification determination

prior to the TIF district being approved by the governing body. This requirement applies to any TIF district created on or after June 1, 2017.

The request must be in writing and include the following:

- Proposed boundaries and map of the TIF district;
- The purpose of the proposed TIF district, including a description of the proposed public improvements; and
- Contact information of any person(s) who can provide additional information to the Department if necessary.

**Requests should be sent to:**

**SD Department of Revenue  
Property and Special Taxes Division  
445 E. Capitol Avenue, Pierre SD 57501**

Upon receipt of the above-information, the Department will promptly determine the preliminary classification of the proposed TIF district and communicate its decision to the local authorities in writing. This determination will be binding unless there are substantive changes made to the purpose of the TIF district prior to final governing body approval.

### **SECTION 3: ANNUAL CERTIFICATION**

The Department is required to annually certify the total assessed value of all TIF districts. SDCL 11-9-24. This ensures that both the Department and local authorities have accurate information regarding the amount of **increment value** in each TIF district. The **increment value** is any value above the **base value**. SDCL 11-9-1(9). The following example shows how it works:

- A TIF district is created and the total assessed value of all the properties within the boundaries of the TIF district is \$100,000. This would be the **base value**.
- The following year, construction takes place within the TIF district and now there is a total assessed value of all properties within the boundaries of the TIF district of \$450,000.
- This would produce an **increment value** of \$350,000 (current value of \$450,000 less the base of \$100,000 = \$350,000).

Property taxes generated from the **base value** are distributed to all of the taxing districts that can tax the property. Property taxes generated from the **increment value** are dedicated to the repayment of the project costs related to the TIF district. Note that the **base value** and **increment value** are taxed the same. Only the distribution of tax revenues varies in a TIF district.

The annual certification occurs in the fall after the Department has certified the aggregate assessed value of all real property in the state. SDCL 10-11-51.

As part of the annual certification, the Department will be compiling an annual report of all TIF districts. This annual report will include project descriptions and timelines, financial information,

and an analysis of the fiscal impact of TIF districts on the state-aid to education formula. Most of the information necessary for compiling the annual report will be collected at the time of initial certification. However, the Department may request additional information from local authorities if needed.

The TIF district annual report will be submitted to the Governor and Legislature prior to the legislative session and will also be available on the Open SD website. It is anticipated that the first TIF district annual report will be published prior to January 1, 2018.

## **CONCLUSION**

The use of TIF districts in South Dakota has increased significantly over the last decade. Due to this rapid growth in the number of TIF districts in the state and the impact of TIF districts on property owners and the state-aid to education formula, it is critical that a consistent process and uniform classification is occurring throughout the state. These guidelines are designed to give local authorities and interested stakeholders the knowledge to satisfy these requirements.

**For more information on TIF districts, please contact the SD Department of Revenue, Property and Special Taxes Division, at 605.773.3311.**