



CITY OF RAPID CITY

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July 1, 2013

Mr. Don Frankenfeld
Consulting Economist

Re: Proposed Tax Increment District #74

Dear Don:

Thank you for your inquiry regarding tax increments and specifically the proposed Tax Increment District #74. You referenced several state law statutes and I will address those questions first. (I have included your questions/comments in bold.)

Related to SDCL 11-9-7: What is the aggregate assessed value of taxable property within the city? What is the tax incremental base of all other existing districts? I know the aggregate limit is 10% of assessed value, and that Rapid City's percentage far exceeds that of any other community, but I do not know the precise magnitude of our use.

As of October 2012, the City's taxable valuation is \$4,193,511,047.00. The current base for all tax increment districts within Rapid City is \$140,045,633 or 3.34%. This also includes \$109,900 for the base valuation of Tax Increment District #66 that was recently dissolved.

Related to SDCL 11-9-8: Can you identify the 25% of the affected area that is blighted, and explain why it is blighted? The map of the proposed district seems to show a small area that already has been developed for residences. How will the creation of this district improve the real property values for these residences, as the law seems to require. Have appraisals or other economic analyses been performed to demonstrate that "substantially all" of the remaining district will show increases in value?

SDCL 11-9-8 does not require that the 25% blighted area be specifically identified by parcels. However, over 60% of the property has been identified to "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" as identified in SDCL 11-9-8(1) based on the zoning designations and the Master Plan submitted with the application.

Related to SDCL 11-9-9: What diseases or crimes have been reported in the proposed district over, say, the last five years? In particular, have cases of West Nile disease been



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reported which can be linked to the district in any way? What other evidence exists to prove that the existing area is "...detrimental to the public health, safety, morals or welfare..." of the area? Note that blight is defined by the conditions of "...structures, buildings or improvements..." Raw or undeveloped land is not mentioned in the definition of blight. To my knowledge, there are few structures, buildings or improvements within the identified area (save a small number of up-to-date residences). Can you identify "structures, buildings or improvements" which meet the statutory requirement for defining blight?

The proposed Tax Increment District is considered to be an economic development district, based on the economic welfare and prosperity percentage reference in SDCL 11-9-8, and therefore, SDCL 11-9-9 would not apply.

Related to SDCL 11-9-10: This section of statute survives without amendment from the time I wrote it in 1978. In my view, the language I wrote does not justify defining the TIF 74 property as blighted. Legislative intent has weight on the decision to call this a blighted area. (Since I was not the only legislator, maybe you should ask former Senator Lyndell Petersen, who was present at the creation, for his interpretation of blight.)

The proposed Tax Increment District is considered to be an economic development district, based on the economic welfare and prosperity percentage reference in SDCL 11-9-8, and therefore, SDCL 11-9-10 would also not apply.

Related to SDCL 11-9-13: Subsection (2) of this section requires "An economic feasibility study." Such a study, prepared by an independent third party, would bear heavily on the vital question whether this project is feasible without a taxpayer subsidy. In searching the documents submitted with the TIF application, I have found no such independent study. Does one exist as the law requires, and if so, is it not in the public domain? (I acknowledge that it may exist, and that I have simply overlooked it. If so, please tell me where to look.)

Although an independent third party did not prepare the study, it was completed for this project and is included in the Project Plan as required. There have been some discussions about including a third party feasibility study with some of the proposed changes to the existing tax increment policy proposals.

Related to SDCL 11-9-42: This section is entitled, "Tax Increments not to be used for residential structures." While arguably this TIF is devoted to infrastructure, it is clear that nearly all of the underlying development is for residential construction. According to the applicant, these residential structures will not be built but for the TIF. Clearly, the TIF is being "used for residential structures," however artfully one may try to avoid this fact. Is the City prepared for litigation arising from thumbing its nose at the law?

The Project Plan identifies the infrastructure improvements (Minnesota Street, sewer, irrigation pipe, overhead power lines) utilizing the tax increment funds. Although residential development is part of the improvements creating portions of the increment within this District, it does not appear that residential structures are part of the improvements completed with the tax increment.

First, the development project envisions \$25 million in commercial development and \$10 million in industrial development, yet there seems to be no documentation or justification for these figures. They seem to materialize out of thin air (with a vague reference to development in 2017 and 2020). These figures do not seem to be reflected, as required, in

pro forma projections. If the figures are realistic and can be documented, the financing schedule could be substantially reduced from the astonishing 20 years that is now contemplated.

You are correct. The information submitted did not include actual documentation for the commercial and industrial development. As such, the projections included in the Project Plan only reflect the increment based on the residential units constructed. As you indicated, if additional commercial and/or industrial development materializes, the District payoff will occur sooner.

Second, there are other developers in the area who are developing without a TIF subsidy. This suggests that the “increment” argument associated with this TIF is suspect, since other developers are developing without it. And how does the City justify subsidizing one developer at the competitive expense of another? One of the criteria developers claim they meet is that “The project will not provide direct or indirect assistance to retail or service businesses competing with existing businesses in the Rapid City trade area.” Clearly, the project competes with other developers, who are of course service businesses. Also, while we can’t know for sure because the developers won’t tell us, the unspecified “retail” sector (claimed in Exhibit 8 of the application to create nearly 80% of the 102 “new” jobs) will likely compete with other retailers. As is almost always the case, “new” retail jobs are seldom really new. Unless a new retailer creates new retail trade in the community (very unlikely; will you buy more food if a new grocery store opens?) they simply shift jobs from an old employer to a new one. That is why retail development is almost always prohibited by TIF laws (and South Dakota’s omission of this is a serious oversight on my part as the author).

You are correct. Other development has occurred in the area and wages depend on the trade created.

Third, the defining characteristic of a TIF is that incremental taxes generated by the occupants of the district will go not to the City but (indirectly) to developers; in the case of TIF 74 this diversion of tax dollars continues for a breathtaking 20 years, with apparent financing costs in excess of \$10 million. Yet the project, which calls for 470 residential units and \$35 million of commercial and industrial development, will clearly require city services, including police, fire, utilities and the like. Providing these services without compensation will create an inevitable drain on the City treasury. The rest of us taxpayers must therefore make do with fewer services (unlikely), or pay higher taxes for the same services (highly likely). Any project analysis should include *both* costs and benefits, yet here only benefits are asserted.

The Project Plan includes an amortization schedule with payments on the developer’s loan balance to begin December 2021, with a payoff estimated to be December 2027. The estimated cumulative interest is expected at \$3,104,457.25.

Finally (for now), I invite your careful inspection of BankWest’s financial “commitment,” which is highly conditional. Even if all conditions are met, including some that the bank hasn’t yet specified, the loan is for three years only, not the twenty called for in the project. It specifies an interest rate of 6% if the loan is closed by June 1, 2013. That date is now passed, and interest rates are substantially higher than they were on January 31, 2013 when the bank’s letter was issued. There remains the unresolved question of whether 6% or 9% is the operative rate, as various documents are inconsistent in this regard.

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One benefit of a tax increment district is that the city does not assume any financial responsibility for the improvements identified in the Project Plan (unless specifically identified as a developer within the Project Plan). If the proposed district does not generate adequate increments to cover the principal and interest for the improvements, the developer is still required to make the payments until the increment is sufficient. However, the interest on loans associated with a tax increment district cannot exceed 9%.

Please let me know if you have any other questions.

Sincerely,

Patsy Horton, Division Manager
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