



Bloomington, Minnesota, officials Schane Rudlang, Larry Lee and Matt Gersemehl

State assistance for Mall of America expansion will prove beneficial to region

A Civic Caucus Focus on Competitiveness Interview

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Present

Dave Broden (vice chair), Pat Davies, Matt Gersemehl, Paul Gilje (coordinator), Randy Johnson, Sallie Kemper, Larry Lee, Dan Loritz (chair), Paul Ostrow, Schane Rudlang, Dana Schroeder. By phone: Amir Gharbi, Clarence Shallbetter.

Summary

The 2013 Legislature passed a law diverting the Mall of America's (MOA) Fiscal Disparities contribution from the regional property-tax-base sharing pool to the Mall's two tax-increment financing (TIF) districts. According to Bloomington city officials Matt Gersemehl, Larry Lee and Schane Rudlang, the Fiscal Disparities (FD) diversion will last for 20 years and should fully fund public investment in infrastructure for the second half of the Mall-area expansion project.

Gersemehl says in supporting the 2013 legislation, Bloomington officials and State Rep. Ann Lenczewski (DFL-Bloomington) argued the Mall actually benefits the entire region and state through the payroll, property and sales taxes generated there. So, rather than having Bloomington taxpayers shoulder the burden of paying for the MOA's Phase 2 infrastructure through TIF, Lenczewski and city officials maintained using the portion of the regional FD revenue generated by the Mall to pay those costs would be more appropriate.

Lee says without this public subsidy for infrastructure, i.e., parking, roads, water and sewer, the Mall-area expansion would be built, but it would be less dense. He asserts that developing at a lower density would underutilize public investments already made in the area, such as the airport and the

light-rail transit line. Rudlang points out that two important factors in increasing the density of the development are building publicly-funded parking ramps, rather than surface parking, and reducing the number of parking spaces needed by using shared parking and access to transit.

Issues to address

Prior to the meeting, Bloomington officials Matt Gersemehl, Larry Lee and Schane Rudlang were asked to be prepared to address the following issues: background on Bloomington's proposal to the 2013 Legislature for authority to use fiscal disparities taxes paid by Mall of America for public improvements related to additional development at the Mall and for tax-increment financing changes at the Bloomington Central Station development and what came out of it; the function of the city's Port Authority; what the special changes are in the Fiscal Disparities program's treatment of Bloomington relative to the Mall of America's expansion; how the uncertainties about whether there will be enough qualified workers to fill jobs by the end of the decade will affect Bloomington; what companies considering expanding or locating in Bloomington are looking for; and how state incentives and investment in economic development, highways and the airport have paid off for Bloomington, the region and the state of Minnesota.

Biographies

Matt Gersemehlis is the city assessor for the City of Bloomington, a position he has held since May 2010, after serving as acting city assessor since October 2009. He came to Bloomington in 2005 as a commercial property appraiser and became chief commercial property appraiser in 2009. Prior to his service with Bloomington, he was a commercial property appraiser for Hennepin County from 2003 to 2005 and an associate appraiser at Patchin Messner & Dodd in Burnsville from 2002 to 2003. He is a certified general real estate appraiser and a licensed real estate broker with the State of Minnesota and a senior accredited Minnesota assessor with the State Board of Assessors. He has a B.S. degree in real estate from St. Cloud State University.

Larry Lee is director of community development for the City of Bloomington, a position he has held since 1987. He has served as a planner, assistant city manager and community development director in Bloomington for a total of 36 years. He is currently responsible for the city's planning, code compliance and economic development functions, which are carried out by the Planning, Building and Inspection, Environmental Health, and Fire Prevention Divisions, the Housing and Redevelopment Authority and the Port Authority. He serves on the board of directors for Destination Bloomington (the Bloomington Convention and Visitors Bureau) and is a member of the Urban Land Institute. Lee has bachelor's degrees from the University of Wyoming and a master's in Town and Regional Planning from the University of Sheffield (England).

Schane Rudlang is the Port Authority administrator for the City of Bloomington, a position he has held since 2011. The Bloomington Port Authority coordinates orderly commercial and industrial development throughout the city. As administrator, Rudlang plans infrastructure and helps finance sustainable, mixed-use, transit-oriented development, primarily in the city's South Loop District. Prior to becoming Port Authority administrator, he worked as a civil engineer for Bloomington. He holds a B. S. degree in civil engineering from North Dakota State University.

Discussion

The initial phase of the Mall of America (MOA) was 4.2 million square feet when it was completed and opened in 1992, about half of the 9.8 million square feet phased-development concept originally conceived in the late 1980s. According to Schane Rudlang, tax-increment financing (TIF) was to be the financing tool to pay for public improvements to facilitate the MOA's dense development. The 2001 property tax reform reduced TIF revenue by half for the project and left a financing hole for the second half of the development.

NOTE: Using TIF over a period of years, a city captures the local government share of property taxes (which would otherwise go to the city, school district, county and other local taxing jurisdictions) on the increased property values in an area that includes a new development or redevelopment project. The captured taxes help finance public infrastructure costs of the project.

Matt Gersemehl explained that the 2001 Legislature created the state general property tax to help fund education and reduced the property-tax class rates from 3.40 percent to 2.0 percent for commercial-industrial (C-I) property and also reduced the class rates for apartments.

NOTE: The classification rate for a particular type, or class, of property is the percentage of market value set by state law that establishes a property's tax capacity subject to the property tax. For example, for taxes payable in 2014, the class rate for a residential homestead property valued up to \$500,000 is 1.0, while over \$500,000 is 1.25 percent. In comparison, the class rate for a commercial-industrial property valued over \$150,000 is 2.0 percent.

Due in large part to the class-rate reduction, effective C-I property tax rates (total tax divided by assessor's estimated market value) went down from six percent in the mid-1990s to three percent by 2008, Gersemehl said. Larry Lee added that the 2001 Legislature also protected the part of C-I property taxes going to the new state general property tax from TIF. But TIF is the revenue source for bonds for infrastructure at the MOA and, as such, the 2001 property-tax reform reduced TIF revenue to pay off the public infrastructure bonds.

Since 2001, the city and the Mall have been looking for a way to fund the shortfall created by the 2001 property-tax reform. Rudlang said one way would be to lengthen the term of TIF districts, but that would have been a burden on the other taxing jurisdictions impacted by TIF districts, mainly counties and school districts. He said State Rep. Ann Lenczewski (DFL-Bloomington), current chair of the House Tax Committee, did not want these local jurisdictions to bear the burden of paying for the MOA's Phase 2 infrastructure. She argued the Mall is actually of regional and state tax-revenue significance, through the payroll, property and sales taxes generated there. A bill to lengthen the term of TIF districts was vetoed by Gov. Mark Dayton in 2012.

The 2013 Legislature passed a law diverting the MOA's Fiscal Disparities contribution from the regional property-tax-base shared pool to the Mall's two TIF districts. "In 2013, the stars aligned, with a Democratic House and Senate and a Democratic governor who wanted to do the Mall expansion project without burdening local governments with TIF funding," Rudlang said. "We ended up with legislation that funds the MOA into the future by taking the Mall's Fiscal Disparities (FD) taxes and putting them into a Port Authority account managed and governed by the same TIF rules we've always been under." The FD diversion will last for 20 years and should fully fund eligible public

investments in the project. Rudlang noted that although TIF is a great tool for economic development, it does not work well for big, phased projects because of time limitations in the law.

NOTE: Fiscal Disparities (FD) is a program created by the Legislature in 1971 that requires all communities in the seven-county metro area to contribute into a shared pool each year 40 percent of the growth since 1971 in their commercial-industrial tax base. Tax revenues generated by that shared pool are then redistributed among the metro area communities, according to a formula based largely on population and property-tax-base wealth per capita. (There is also a Fiscal Disparities program on the Iron Range.)

In promoting the 2013 legislation, Lenczewski and Bloomington officials argued that, while the MOA benefits the city, it brings much more benefit to the region and the state by generating various tax revenues that flow to the state, not Bloomington. In the 1980s, the officials said, the city took "the enormous risk" of selling bonds to finance public infrastructure, mainly the MOA parking ramps, and paying off the bonds through TIF. The officials argued that since the project is a regional benefit, it is more appropriate for the region to share in financing infrastructure for the second half of the MOA development by diverting the Mall's FD contribution to do that, rather than using TIF.

In 2014 the MOA (including expansion sites like IKEA and Radisson Blu) will pay \$34 million in total property taxes, with the FD portion of those taxes amounting to \$10.8 million. The diverted increment portion of the Mall's FD taxes (\$10.2 million in 2014) will be funneled to the Port Authority and then to two existing MOA TIF districts. "Think of it as Fiscal Disparities Increment Financing," said Lee. Gersemehl explained it by saying, "What the MOA would contribute to FD is being converted to TIF-like dollars."

NOTE: According to Steve Hinze of Minnesota House Research, Bloomington's contribution to the regional FD tax capacity (i.e., property tax base) sharing pool was reduced by \$6.3 million in 2014. Instead, that tax-base contribution was diverted from the MOA's FD contribution and given instead to the two existing MOA TIF districts, as provided in the 2013 legislation. Even with that diversion, Bloomington is still the largest net contributor of tax capacity to the FD pool, at \$15.3 million in 2014.

Hinze said the size of the 2014 FD metro-wide shared tax-capacity pool is \$360.6 million. Bloomington's diverted contribution amounts to 1.74 percent of the total pool. The total shared tax-capacity pool raises \$588.2 in tax revenues in 2014 and Bloomington's diverted FD tax revenue amounts to \$10.2 million. Because of this diversion, other metro communities will receive less shared FD tax base and tax revenue than they otherwise would.

Hinze explained that the diverted FD tax funds will go into the Mall's two existing TIF districts to pay off bonds for infrastructure improvements and parking ramps. The two MOA TIF districts will have run for 25 years; the district that includes the initial building and the Radisson Blu will close in 2016 and the district north of the existing building will close in 2018. After these dates, the local portion of taxes on the increased property-tax base will be available to fund all levels of local government. From payable 2017 to 2033, in the case of one MOA TIF district, and from payable 2019 to 2033, in the case of the other, the diverted FD taxes will become the only source of revenue for the TIF districts' public improvements.

So, for the extended run of the two TIF districts, Hinze said, it is the area-wide tax base that will be reduced, not the local tax base.

The MOA's FD taxes, which will go directly into TIF financing for 20 years, rather than into the FD regional property tax-sharing pool, will increase over time, depending on how quickly the Mall develops. If the Mall develops quickly, Rudlang said, the FD contribution could increase from \$10 million to \$15 million a year. The city projects that over the 20 years, the total MOA FD tax contribution that will be diverted into financing the Mall's expansion will amount to a total of approximately \$240 million to \$250 million. If the Mall develops more slowly than projected, the amount would be less.

The MOA expansion is part of a larger development area in east Bloomington called the South Loop, where two-thirds of the city's projected new commercial and residential growth will occur. The South Loop is defined by I-494 and the airport to the north, Hwy. 77 to the west and the Minnesota River and its valley to the east and south.

The MOA expansion started with IKEA, with 330,000 square feet, and the Radisson Blu Hotel, with over 300,000 square feet. Rudlang said a \$250 million expansion is currently under construction between Sears and Nordstrom on the north side of the mall, with a 342-room JW Marriott Hotel and 290,000 square feet of additional retail expansion of the Mall itself.

"When you think of the Mall expansion," Rudlang said, "think of other uses besides retail. There will be retail expansion, but don't think another mall, think lots of different uses." He said the Mall will decide this summer whether a large office building will be part of the development on the north side. "There will be lots of hotel rooms and office and even the possibility of residential units," he said.

Triple Five Group, a shopping mall owner and operator, hotel operator and real estate company owned and operated by the Ghermezian family of Canada, owns the MOA and is doing the Mall expansion. "We work closely with them on both the city and the Port Authority sides," Rudlang said. He administers the Port Authority, but is a city employee. "The Port Authority functions as an economic development arm of the city," he said.

According to Lee, "The media has really confused coverage of the MOA's current expansion. It's implied in the coverage that, because the Mall intends to double its size over 20 years or so, what's under construction right now is doubling the size. But it's only one phase of the expansion they dream of over 20 years."

Lee said another distinction of future expansion is that the original MOA was built with financing from a small number of big investors. "That form of funding large developments is just not available in the world anymore," he said. Instead, the Mall has been working with partners: Carlson Companies and Mortenson Construction for the Radisson Blu Hotel; the Shakopee Mdewakanton Sioux Community for the J.W. Marriott Hotel, which will be right by Sears; and the Mall itself for the retail expansion. "It's going to be a new way of financing development, where MOA plans phases and takes on individual financing partners for those phases. Triple Five is not going to be raising financing for a multi-million square-foot building by itself," he said.

In economic development now, it's fairly common to have a review of a developer's financial results and to put "clawback" provisions in project contracts. Rudlang said with every new project, including the one that's under construction now, the public invests in streets and sewers and parking through Fiscal Disparities or TIF. "The city looks at each developer to make sure the developer is not making more than a market-rate profit," he said. "The 2013 legislation is not a windfall to the developer to make them richer. The city spends a lot of time looking at a project's financial *pro forma* to make sure the developer makes only a market-rate profit." He said if the developers make excessive profits, which the city defines with input from its consultants, the developers must give some of the money back—the "clawback."

"It isn't like it was 20 years ago, where the money goes in and we hope it all works out well and if the project goes gangbusters, the public never gets any of its money back," Rudlang said. "The city's money goes into public infrastructure and we have two mechanisms, the initial review to make sure the developers aren't asking for money when they don't need it, and the clawback provisions in five or 10 years to make sure the developer has not realized a profit in excess of a reasonable return. This is a key part of how we make sure the public's interest in these projects is protected."

Without the public subsidy, the Mall-area expansion would be built, but it would not be as dense. Lee said there are some public investment "sunk costs" around the South Loop District already: the airport, the light-rail line, the transit station that serves 10-plus bus routes and is going to serve up to five bus rapid-transit routes, a well-developed freeway system and the sanitary sewer system. He noted that the amount of developable land near all these investments is limited.

"The city's argument on developing the South Loop is that regional investment and city investment has created lots of capacity here," he said. "Developing at lower density, whether retail, office or residential, is underutilizing public investments that have already been made."

"It's more of a regional planning question," Rudlang added. "The Metropolitan Council and the region have generally agreed that building density around public investments like transit helps control urban sprawl and create sustainable development. We are simply trying to implement that policy. We agree with the Met Council and lots of other urban planners. We could let the projects happen on their own, but the result would look a lot different," he said.

Land values around an LRT line probably do increase, but not as much as some people believe they will. To the extent that transit and infrastructure increase land value, Lee said, the higher land value, in turn, increases the cost of development, sometimes leaving a gap between the desired higher density development and what developers can afford to build. Rudlang added that investment and development along light rail always lags when the first line is built. But, he said, after a number of LRT lines are built, there gets to be more of a critical mass, so that development starts to precede the building of the LRT and its stations. He said the metro area's rail transit system still isn't at that critical mass. He said in the future, Bloomington hopes to promote a light-rail connection between the South Loop/airport/MOA and downtown St. Paul. Many South Loop property owners have commented that this connection would greatly enhance development.

Rudlang said some people have a general dislike of bus routes and developers can't rely on the routes, because they can change. "Once you get enough rail lines that aren't moving anywhere," he said, "people can start to get down to one car. We're having our lunch money taken by cities like

Denver and Portland, because the young, creative people don't want cars. We're losing them by not building out the transit system."

When I-494 was built in the 1960s, the Bloomington City Council and Planning Commission were foresighted and decided not to allow residential development along the freeway. Instead, they zoned the land for commercial use. Lee said Bloomington was not doing public economic development subsidies during the 1960s, '70s and '80s and didn't have any minimum requirements for density. So Target, Rainbow, the Southtown Shopping Center, etc., developed at relatively low densities and were served by surface parking. When McGough purchased the former Control Data campus, the company proposed a development plan that will "harvest the surface parking lots," he said. As part of its 50-acre Bloomington Central Station development, McGough will transform surface parking into office, hotel and residential buildings. The parking will be provided in structured parking, i.e., parking ramps. The city is projecting that, because the area is well served by transit, 20 percent of the trips there will be made by transit, so the development will need proportionally fewer parking spots.

Lee said the old development patterns resulted in auto-oriented commercial development that was not high density. In the South Loop, he said, the city is choosing to pay a portion of the costs for structured parking development. "It's a very good investment on the public's part," he said, "because the state, the city, the school district and the county all have a stake in the value of that denser development: the higher annual property taxes they'll get from it." Also, he said, services like sewers and transit will be less expensive to provide in a high-density development. And much of this infrastructure is already in place.

Rudlang said when the 500-room Radisson Blu Hotel was built, city code would have required 700 to 800 parking stalls. But because there was excess MOA parking space, the requirement was reduced to 140 new parking stalls. "We've done a lot of work on shared parking," he said, "and we know we can reduce the total number of parking spaces in the South Loop by about 30 percent. The Mall is a great example of shared parking."

Bloomington is seeing rapid growth in hotel rooms. Rudlang said there are about 8,300 hotel rooms in Bloomington right now and in two years, there will be 9,500 rooms. The trend line for hotel rooms in the city since the 1950s has been an increase of an average of 150 hotel rooms per year. That average takes into account the loss of hotel rooms when the airport's north-south runway was built, the lack of hotels built after 9/11 and during the recent recession, and the rapid growth in hotel rooms recently. "The hotel industry is doing well right now," he said.

Lee added that the Radisson Blu has proved the market for upscale hotels in the South Loop area. "Carlson Companies is doing extremely well selling hotel rooms and meeting space there," he said.

High density development plans for the South Loop have not attracted opposition. "We're a little bit different from other places in the metro area that are adding density," Lee said. "The South Loop district is isolated from residential areas, so there aren't neighborhoods being adversely affected by the district's vision. We don't have natural opponents to the vision and the density we're talking about."

This market can't support pay-for-parking in a suburban development until it's the higher density of an urban-style area. Rudlang commented that paid parking in the Mall area is beginning at the Radisson Blu parking ramp. There are time limits for free parking in the ramp and people must pay a fee for parking beyond that time. He said structured parking is very expensive, but because it's infrastructure, the city can pay to build it. He said there are two challenges: to get developers to build fewer parking spaces through use of shared parking; and to decide eventually that it's appropriate to pay for parking. He said one of his key jobs is to not build too much parking and to make sure the parking the city does build gets used.

We're now competing for young, creative people, as opposed to companies. According to Lee, "Cities used to think we were competing for companies, that we would go out and chase smokestacks and bring a company in. More realistically now, we understand that we're competing for individuals our businesses want to hire, the young creatives, who will often move to a place and say, 'I'll find a job when I get there.' We want to create a place that's attractive for young people. That's why we're competing with Denver, Portland and Chicago. This metro area is number 10 in the U.S. in competing for young creatives, so we're not doing so horribly. We're not so far behind that we can't make adjustments and do better."

Rudlang said we must build out the rail transit system. "It's what other cities have where these young professionals are going," he said. "We have lots of jobs and lots of art experiences, but we don't have the transit system. These young people just don't love cars. They want to sit on the train and work on their smart phones."

Public subsidies are needed for South Loop development. Rudlang said the South Loop has two economic development disadvantages: airplane noise and the adjacent large wildlife refuge. Because of the airplane noise, a large area is not zoned for residential development. "Our hope is that through public subsidy, we can aid development in the area for some years and then move away from subsidy," he said. "We don't love subsidy, but this area hasn't developed on its own."

Rudlang said the wildlife refuge and airport are disadvantages because no customers live there. When certain service uses such as grocery stores or drug stores look at the customer base in a two-to five-mile radius, the numbers are very unappealing, compared to a location completely surrounded by development.

The state must perform its core functions well to provide a good environment for economic development. Lee said in a perfect world, he would like the state to give cities more development tools, in addition to TIF and to the Fiscal Disparities exemption Bloomington now has. But, he added, "The city doesn't expect the state to rise to our assistance. The city wants to make maximum use of what's available to us. If the state does its core functions well-if it keeps highways maintained and built; if it invests in the key parts of transit; if the state and the counties provide the social services that a strong community needs-then we can figure out how to do economic development within that."