



HANDBOOK FOR MINNESOTA CITIES

Chapter 25
Financing public improvements

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This material is provided as general information and is not a substitute for legal advice. Consult your attorney for advice concerning specific situations.

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HANDBOOK FOR MINNESOTA CITIES

Chapter 25 Financing public improvements

Read about commonly used and authorized financing tools for cities to fund local improvements and economic development. Includes discussion on issuing debt, reserve funds, improvement and special service districts, fees and connection charges, and state and federal road and bridge funding sources, among others.

RELEVANT LINKS:

[Minn. Stat. § 412.221.](#)
“Financing Infrastructure
Projects.” *Minnesota Cities*
(Aug. 2009, p. 6).

[Handbook, Chapter 21.](#)

[Handbook, Chapter 24.](#)
“Municipal Borrowing
Authority.” *Minnesota Cities*
(July, 2001 p. 19)
[Minn. Stat. § 475.52.](#)

I. Financing and planning overview

Cities use a variety of funding techniques to construct, maintain, or improve local infrastructure made up of the basic facilities, services, and systems a city needs to function. Local infrastructure varies greatly from one city to the next but may include buildings, libraries, water and sewer systems, transportation and communications systems, parks, and public thoroughfares such as sidewalks, trails, streets, bridges, and parking facilities. Money to fund local improvements comes from a variety of sources and often combines the following income generating methods and situations. This chapter focuses on the most commonly used legislatively authorized financing tools available to cities.

Consider combining the financing tools described in this chapter with a long-term capital budgeting plan. A capital budgeting plan (sometimes referred to as a capital improvement plan or CIP) typically lists five or six years of needed capital improvements (sewer and water infrastructure, public buildings, equipment, or land purchases), their order of priority, and the means of financing. A plan allows a city to build up a fund balance for these projects. Priorities in the capital budget program remain tentative, and the council reviews them annually. Although capital improvement budgeting may appear cumbersome and unwieldy to small cities, this is actually not the case. A capital budget plan provides protection to small cities, avoiding unforeseen infrastructure failures and expensive emergency repairs.

II. Issuing debt

A. Bonds

A person gets a loan from a bank to finance the purchase of a car -- but cities may not borrow money from banks through conventional loans to finance local improvements. Cities commonly raise capital to pay for local improvements by issuing debt.

This material is provided as general information and is not a substitute for legal advice. Consult your attorney for advice concerning specific situations.

RELEVANT LINKS:

[Minn. Stat. § 475.53, subd. 1.](#)

[Handbook, Chapter 21.](#)

[Minn. Stat. § 412.301.](#)
[Minn. Stat. § 410.32.](#)

Specifically, cities incur debt and borrow money by issuing and selling municipal bonds also known as general obligation (GO) bonds. GO bonds often create funding tied to a specific use (such as water systems) but are backed by the taxing power of the city.

Municipal bonds are low risk because all city assets and resources, including the unlimited power to tax, back the city's contract to pay back the amount of the bond with interest. The security for a GO bond is the pledge of those resources and taxing powers.

There are limits on the amount of debt a city may incur through the issue and sale of bonds. Currently the "net debt" limit is 3 percent of the estimated market value of taxable property in the city. In some situations, residents must vote in favor of a bond before a city may issue them, however, there are many exceptions to this requirement.

There are other types of bonds, each requiring specific legal procedures, for example:

- Revenue bonds—tied to a specific funding stream.
- GO revenue bonds—tied to both the full faith and credit of the city and a specific funding stream.
- Bonds by purpose—GO bonds issued for a specific purpose. This is not a legal requirement but used for convenience in identifying bonds with an improvement.
- Bonds by user—also known as "private activity bonds" and used partially or entirely for private purposes, but still tax exempt.

Municipal bonds are attractive to buyers because they are low risk and usually tax exempt. When using bonds to finance local improvements, cities must work with the city attorney and bond counsel to maintain the tax-exempt status of the bonds and ensure compliance with all state and federal financing and bond law.

B. Certificates of indebtedness

Statutory and charter cities may issue debt in the form of capital notes or certificates of indebtedness to purchase:

- Public safety equipment.
- Ambulance and other medical equipment.
- Road construction and maintenance equipment, and other capital equipment.
- Computer hardware and software, whether bundled with machinery or equipment or unbundled.

RELEVANT LINKS:

[Minn. Stat. § 410.32\(d\).](#)

[Minn. Stat. § 412.301\(e\).](#)

[LMC Property Tax 101, August 2015.](#)

[State of the Cities Report 2016.](#)

[Minn. Stat. § 471.572.](#)

The purchased equipment or machinery must have an expected useful life at least as long as the certificates or notes.

In charter cities, the notes must be payable in 10 years or less and the total principal amount of the capital notes issued in a fiscal year must not exceed 0.03 percent of the estimated market value of taxable property in the city for that year.

In statutory cities, certificates or notes must also be paid in 10 years or less. But if the amount of the certificates or notes to be issued to finance any qualifying purchase exceeds 0.25 percent of the estimated market value of taxable property in the city, then publication and reverse referenda provisions in state law may apply.

III. Property tax related tools

A. Local general fund

City general levies collected with property taxes may fund local improvements. Cities identify local improvement needs in the annual budgeting process and may assign a percentage of the general city levy to fund ongoing capital improvements. Property taxes fund essential infrastructure needs. Cities sometimes have shortfalls in the amount of property taxes they expect to collect. However, in 2015, the number of cities reporting a shortfall in property taxes fell slightly or stayed flat for the fourth year in a row. Thirty-five percent of cities reported a shortfall in property tax revenues in 2015, down from 36 percent in 2014 and 43 percent in 2013

B. Infrastructure replacement reserve fund

Another financing mechanism is the creation of an infrastructure replacement reserve fund. A city council may establish a reserve fund by a two-thirds vote of all its members through ordinance or resolution, and may annually levy a property tax for the support of the fund. The city must hold a public hearing on the question and comply with other procedural requirements.

The proceeds of property taxes the city levies specifically to support this fund must go into the reserve fund. The city may dedicate any other additional monies to the fund. Before levying property taxes for the reserve fund, the city must publish an initial resolution authorizing the tax levy in its official newspaper. If, within 10 days after the publication, voters file a petition with the clerk, the council must submit the levy question to the voters at a regular or special election.

RELEVANT LINKS:

[Minn. Stat. §§ 444.16 - 444.21.](#)

[Minn. Stat. § 444.19.](#)

[Minn. Stat. § 444.18, subd. 3.](#)

For the petition to be valid, it must be signed by a number of qualified voters greater than 10 percent of the number who voted in the last general city election.

If the city establishes a reserve fund, the council may submit a question to the voters asking if the city should dedicate the fund to a particular type of capital improvement. If a majority vote in favor of the restriction, the reserve fund may only be used for that purpose.

C. Storm sewer improvement districts

Creating a storm sewer improvement district (SSID) provides another tool to fund specialized city infrastructure. After two weeks published notice and a public hearing, the council of any city may, by a two-thirds vote of council members, pass an ordinance establishing an SSID. After passage, the council must record the ordinance with the county auditor and/or the county recorder.

After establishing the district, the council may acquire, construct, reconstruct, extend, maintain, and otherwise improve, storm sewer systems and related facilities within the district. The city may also acquire, maintain, and improve stormwater holding areas and ponds within and outside city limits for the benefit of the district.

Tax levies on property in the district pay for the improvements, including principal and interest on bonds. A council may, by resolution, decide to issue GO bonds to assure payment of the principal and interest in the event the proceeds of the tax levy in the district are insufficient to pay the principal and interest. The sale of such bonds must comply with Chapter 475, except that such bond sale requires no election. The amount of the obligations, or bonds, is not included in determining the net indebtedness of the city. After all obligations issued to finance improvements within the district are retired, the council may choose to dissolve the district, but is not required to do so.

Once the council establishes an SSID, it must follow statutory procedures before awarding a contract for an improvement in such a district. The council must hold a public hearing on the proposed improvement after giving published notice twice in the city's official newspaper. The notice must include:

- The time, date, and place of the hearing.
- The general nature of the improvement.
- The estimated cost of the improvement.
- Which areas in the city the levy will cover.
- The amount of time to recover the costs of the improvements.

RELEVANT LINKS:

[Minn. Stat. § 444.18, subd. 3.](#)

Before awarding a contract for an improvement, a city must publish notice of a public hearing two times, at least a week apart. The hearing must occur at least three days after the last publication.

The owners of property within the district must also receive mailed notice of the public hearing at least 10 days before the hearing occurs. Such mailed notice must include the estimated tax levy each parcel pays in the first year.

[Minn. Stat. § 444.18, subd. 3.](#)

Before the hearing, the council must secure a report from the city's engineer, advising the council as to:

- The feasibility of the proposed improvement.
- Whether it should be made as proposed or in connection with some other improvement.
- The estimated cost of the improvement.

[Minn. Stat. § 444.18, subd. 3.](#)

The council must pass a resolution adopting the improvement. The resolution may be adopted at any time within six months after the hearing.

D. Urban and rural service districts

State law allows cities to divide their area into an urban service district and a rural service district. Cities in a metropolitan county where there is a first class city cannot use this statutory tool.

[Minn. Stat. § 272.67.](#)
[Minn. Stat. § 410.01.](#)

1. Urban service district

The urban service district must include all lands within the boundaries of the city, which are not included in the rural service district, discussed below. The ordinance determines the approximate ratio that exists between the benefits resulting from tax-supported municipal service to parcels of land of similar market value and in the urban service district. The council may amend the ordinance to change this benefit ratio.

2. Rural service district

The rural service district includes only such unplatted lands, or parcels, that the city council determines are rural in character, and are not developed for commercial, industrial, or urban residential purposes. For these reasons, land in the rural service district does not benefit from city services to the same degree as other lands. The rural service district may include parcels of land that are not contiguous to one another. The ordinance may also designate lands outside the city, which, if annexed, will be included within the rural service district. Parcels may be added to or removed from the rural service district, but the ordinance may not require an amendment to remove lands from a rural district.

RELEVANT LINKS:

[Minn. Stat. §§ 469.1812 - 1815.](#)

[“Property Tax Abatements for Economic Development,” House Research Short Subjects, June 2012.](#)

[Handbook, Chapter 15.](#)

[Minn. Stat. § 469.1813.](#)

[Minn. Stat. §§ 469.174 - 179.](#)

[Handbook, Chapter 21.](#)

[“Tax Increment Financing,” House Research Short Subject, June 2014.](#)

The county auditor then allocates levies (other than those for payment of bonds and judgments) between the areas in amounts proportionate to benefits ratios determined for the separate districts.

In theory, this division into urban and rural service districts generates additional tax dollars from developed properties in the city, which can be used to pay for municipal services and fund local improvements that benefit those properties.

E. Tax abatement

This financing tool authorizes the issuance of bonds to be paid back with the funds collected by tax abatements. The term “abatement” is misleading, as the tax is not forgiven or abated. The tax is paid normally, but the amount of property tax levied by the city is used to pay for the bonds. For example, a city may “abate” all or a portion of city property tax on one or more parcels of real or personal property, including machinery, for economic development purposes. And cities may issue general obligation or revenue bonds to construct public improvements. As the property owners pay the abated taxes, rather than the local property taxes, the payments go directly to paying off the bonds.

Abatement bonds are not subject to referendum approval and are excluded from debt limits. In any year, the total amount of property taxes abated by a city may not exceed 10 percent of the net tax capacity of the political subdivision for the taxes payable year to which the abatement applies or \$200,000, whichever is greater.

F. Tax increment financing

Tax increment financing (TIF) is a broadly applicable financing tool that funds more than local improvements. Basically, it segregates certain tax dollars from a defined area in the city for use in developing and improving the area, which can include local improvements. TIF takes advantage of the increases in tax capacity and property taxes from development or redevelopment before the development actually occurs to pay for public development or redevelopment costs. The difference in the tax capacity and the tax revenues the property generates after new construction has occurred, compared with the tax capacity and tax revenues it generated before the construction, is the captured value. The taxes paid on the captured value are called “increments.” Unlike property taxes, increments are not used to pay for the general costs of cities, counties, and schools. Instead, increments go directly to the development authority to repay public indebtedness or upfront costs the city incurs in acquiring the property, removing existing structures, or installing public services.

RELEVANT LINKS:

[Minn. Stat. § 444.075.](#)
[Minn. Stat. § 444.075, subd. 2.](#)
[Minn. Stat. § 444.075, subd. 3\(b\).](#)
LMC information memo, *Securing Payment of Utility Charges*.

[Minn. Stat. § 444.075.](#)

[Minn. Stat. § 444.075, subd. 3\(h\).](#)

[Minn. Stat. § 444.075, subd. 3c \(b\).](#)

[Minn. Stat. § 444.075, subds. 3-4.](#)
Minnesota Rural Water Association, [Water Rate Analysis Spreadsheet](#).
“Water and Sewer Rates,” by Ruth Hubbard, *Minnesota Rural Water Today*, June 6, 2000.

TIF requires extensive planning, implementation, and reporting in consultation with the appropriate financial and legal professionals.

IV. Funds for specific purposes

A. Waterworks systems

Cities may acquire and operate waterworks systems including sewer systems and storm sewer systems. Cities may use any of the following tools or a combination of them to fund construction, maintenance, or improvement of any of these systems or parts of these systems. Cities may also use special assessments to pay for waterworks, sewer and storm sewer systems, discussed subsequently. In statutory and charter cities, even if a charter indicates otherwise, charges made for services must be, as nearly as possible, proportionate to the cost of furnishing the service.

1. Availability fees

Water and sewer availability fee, sometimes known as WAC and SAC fees, may be set to cover the eventual costs of improvements to local waterworks infrastructure including construction, reconstruction, repair, or enlargement of the system. Cities may charge use and availability fees for waterworks services even against properties not currently connected to the system. Collecting charges to build up revenue is reasonable, according to the law, even well before a city starts a planned waterworks or sewer project.

Availability fees for waterworks, sanitary sewers, or storm sewer must pay for the construction, reconstruction, repair, enlargement, improvement, or other obtainment; the maintenance, operation, and use of the facilities, and of obtaining and complying with permits required by law.

2. Use fees for water, sewer, and storm sewers

a. Water fees

In addition to availability fees, a city may use a combination of methods to set rates for water, including, but not limited to, flat rates, rates based on usage, and different rates based on a reasonable classification of property (for example, commercial or residential property). Cities may consider doing a rate study to ensure that collections cover debt, depreciation, reserve, operating, and maintenance costs.

RELEVANT LINKS:

[Minn. Stat. § 444.075, subd. 3a \(4\).](#)

[Minn. Stat. § 444.075, subd. 3b \(4\).](#)

[Minnesota Pollution Control Agency: Stormwater Program.](#)

[Minn. Stat. § 444.075, subd. 3.](#)
[Crown Cork & Seal Co., Inc. v. City of Lakeville, 313 N.W.2d 196 \(Minn. 1981\).](#)

b. Sewer fees

Cities may charge for sanitary sewer according to the amount of water consumed or by reference to a reasonable classification of the types of premises receiving the service.

Cities may also combine these formulas to set sanitary sewer charges based on the type of property and the amount of water used. Sanitary sewer charges must not be based on the size, or square footage, of the property served.

c. Storm sewer fees

Storm sewers are systems built to prevent flooding and to separate stormwater from sanitary sewer systems. Stormwater is the runoff from rain and melted snow that picks up dirt, grease, fertilizer, and many other pollutants as it makes its way into streams and lakes. Minnesota law currently defines “storm sewer” as storm sewer systems, including mains, holding areas and ponds, and other accessories and related facilities for the collection and disposal of stormwater. Storm sewer charges may be fixed according to the size of the property (adjusted for a reasonable calculation of the stormwater runoff) or by referring to the same reasonable classification of the type of property as discussed above. Storm sewer charges may also be calculated by referring to the quantity and quality of pollutants and the difficulty of disposing of the stormwater runoff. Storm sewer charges must not be based on the amount of water consumed at a particular property.

3. Connection charges

Cities may use connection charges (in addition to use and availability charges) to finance the construction and operation of water and sewer systems. Cities cannot base connection charges on the square footage of the property served. Connection charges may be set by reference to any of the following criteria:

- The actual cost of connection.
- Assessments paid by the connecting property.
- At the council’s discretion, by any other method, as long as the connection charge is “just and equitable.”

Cities may also use connection charges to pay for obtaining and complying with permits required by law (for example, permits that the National Pollutant Discharge Elimination System requires).

RELEVANT LINKS:

[Minn. Stat. § 444.075, subd. 5.](#)

[Minn. Stat. § 471.191.](#)

[Minn. Stat. § 475.58, subd. 3b.](#)

[Minn. Stat. § 475.58, subd. 3b.](#)

[Minn. Stat. § 475.521.](#)

4. Contracts

Cities may contract with individuals, companies, or corporations to either use or construct waterworks facilities. The company or individual need not be a resident or inside city limits. Cities may also contract with other cities or counties to obtain or use waterworks facilities.

B. Recreation facilities

Any city operating playgrounds or a program of public recreation may issue bonds to acquire, lease, or maintain land, buildings, and other recreational facilities. These include, but are not limited to, indoor swimming pools, skating rinks, athletic fields, golf courses, marinas, concert halls, museums, and facilities for other kinds of athletic or cultural participation, contests, or exhibitions, and related parking facilities. Revenue or general obligation bonds may fund such facilities but they are subject to a vote.

C. Street reconstruction

If a city has a street reconstruction plan that describes the street reconstruction to be financed and covering at least five years, it may issue bonds to do so without a vote, but only after a public hearing. Street reconstruction includes utility replacement and relocation and other activities incidental to the street reconstruction, turn lanes, and other improvements having a substantial public safety function, realignments, other modifications to intersect with state and county roads, and the local share of state and county road projects. Street reconstruction does not include costs of widening a street or adding curbs and gutters where none previously existed. Voters may petition for a referendum, or vote, on issuing the bonds within 30 days of the public hearing.

A unanimous vote of all the city council members present at a meeting (as long as there are enough members present to constitute a quorum) may now authorize street reconstruction bonds rather than the previous requirement of a unanimous vote of all members of the council.

D. Capital improvement

Cities may issue capital improvement bonds for specific purposes. It is essential that cities follow statutory procedures (such as providing notice and a public hearing) when issuing this, or any, type of bond. In this context, “capital improvement” means acquisition or betterment of public lands, buildings, or other improvements for the purpose of a city hall, town hall, library, public safety facility, and public works facility.

RELEVANT LINKS:

[Minn. Stat. § 475.521, subd. 2.](#)

[Minn. Stat. § 462.358.](#)

LMC information memo,
Zoning Guide for Cities.

Handbook, Chapter 21.

[Minn. Stat. § 462.358, subd. 2b.](#)

Ruzic v. City of Eden Prairie,
479 N.W.2d 417 (Minn. Ct. App. 1991).

LMC information memo,
Subdivisions, Plats and Development Agreements.

[Minn. Stat. § 462.358, subd. 2b.](#)

LMC information memo,
Subdivisions, Plats and Development Agreements.

The term “capital improvement” includes expenditures incurred by a city before approval of a capital improvement plan, in certain situations. An improvement must have an expected useful life of five years or more to qualify. Three-fifths, or three of five, members of a five-member governing body must vote yes to approve the bonds.

In the case of a governing body having more or less than five members, at least two-thirds of the council must vote to approve them. Capital improvement does not include light rail transit or any activity related to it, or a park, road, or bridge.

City halls or town halls qualify as capital improvements as well as the land for any of these public facilities. These bonds are not subject to a vote of the residents unless voters petition for a reverse referendum. Special considerations apply if a city receives a petition for such a reverse referendum.

V. Land use related tools

A. Development contracts

Cities may, by ordinance, regulate subdivisions of land encouraging orderly development and planning for all the related necessities such as streets, parks, water, sewer, stormwater, and open spaces. City authority to adopt a subdivision ordinance includes setting out the standards and requirements to subdivide land in the city. As part of this process, cities may enter into development contracts requiring that a developer install local improvements in a new subdivision. Or, the city may enter into an agreement with a developer, requiring that the developer pay the special assessments if the city puts in the improvements. Development agreements are sophisticated, legally binding contracts that may govern everything from lampposts to financial protections for the city and the developer. Seek legal advice from the city attorney long before entering into a development agreement.

B. Land and park dedication or fees

As another way to fund local improvements in a newly developing area, a city subdivision ordinance may require that a developer dedicate a reasonable portion of buildable land of any proposed subdivision to the public for use as:

- Streets, roads, sewers, electric, gas, and water facilities, stormwater drainage and holding areas or ponds, and similar utilities.
- Parks, certain recreational facilities, playgrounds, trails, wetlands, or open space.

RELEVANT LINKS:

[Minn. Stat. § 462.358, subd. 2b \(c\).](#)

[Minn. Stat. § 462.358, subd. 1a.](#)
[Minn. Stat. § 462.358, subd. 1a.](#)

[Concept Properties, LLP v. City of Minnetrista](#), 694 N.W.2d 804 (Minn. Ct. App. 2005) (rev. denied July 19, 2005).

[Minn. Stat. ch. 429.](#)

LMC information memo,
[Special Assessment Toolkit.](#)

Alternatively, cities may accept a “cash fee” instead of land. The ordinance must specifically describe these dedication requirements and the alternative fees. The city must seek legal advice and carefully follow the laws procedural mandates, especially if a city requires dedication of land for park purposes.

C. Adequate public facilities

State law gives cities authority to manage development of land to protect and promote public health, safety, and general welfare. Some cities focus on this authority and adopt subdivision ordinances based on adequate public facilities standards.

Some cities posit that this allows a city to approve or deny a subdivision application by focusing on public infrastructure facilities such as roads, stormwater ponds, sewer, water, and trails. If developers so choose they may enter into development agreements to address the lack of adequate public facilities before development occurs.

Similarly, establishing transportation improvement districts (TID) in a city recognizes the need for funding to address substandard infrastructure near new developments. Using these land use related approaches to financing local improvements in a city requires ongoing legal advice.

VI. Statutory financing tools

A. Special assessments

Chapter 429 allows special assessments, which theoretically ease the problem of financing local improvements. Special assessments are charges a city levies against real property for a local improvement that provides special benefits to the charged properties. The city may finance all or part of an improvements cost in this manner, but only by strict compliance with the law.

The most typical use is to pay for infrastructure in undeveloped areas of a city, particularly when the city is converting new tracts of land to urban or residential use. Special assessments frequently pay for opening and surfacing streets; installing utility lines; and constructing curbs, gutters, and sidewalks. Special assessments may partially underwrite the cost of major maintenance programs. Cities often use special assessment to finance, in part, large-scale repairs and maintenance operations on streets, sidewalks, sewers, and similar facilities. Another use of special assessments is the redevelopment of existing neighborhoods. Cities use special assessments when areas age and the infrastructure needs updating.

RELEVANT LINKS:

[Special Assessments: An Overview](#), House Research, Short Subjects, Oct. 2014.

[Special Assessments](#), House Research Information Brief, Sept. 2008.

[Minn. Stat. §§ 216C.435-.436.](#)
[Minn. Stat. § 429.021, subd. 1.](#)

Contact the Minnesota Department of Commerce: [Pace program](#). Or call 651-539-1886 or 800-657-3710 (Minnesota only).

[Minn. Stat. §§ 216C.435-.436.](#)
MN Dept. of Commerce: [FAQs about PACE](#) (Voluntary Energy Improvement Financing Program).

[Minn. Stat. §§ 428A.01 - 428A.101.](#)

[Minn. Stat. § 428A.02.](#)

[Minn. Stat. § 428A.08.](#)

[Minn. Stat. § 428A.02, subd. 2.](#)
[Minn. Stat. § 428A.03, subd. 1.](#)

The special benefits test limits how much an area of a city pays for local improvements through special assessments. The measure of the benefit is the increase in the market value of the land because of the improvement.

Under the special benefit test, special assessments are presumptively valid if the land receives a special benefit from the improvement, the assessment does not exceed the special benefit measured by the increase in market value due to the improvement, and the assessment is uniform as applied to the same class of property in the assessed area.

To ensure full protection for property owners, state law and courts applying Chapter 429 insist on strict compliance with complex procedural requirements. Because these requirements have legal implications, city councils should have the city attorney guide assessment proceedings.

Cities may encourage energy improvements on private property. Residents may use the Voluntary Energy Improvements Financing Program to make energy improvements to their qualifying real property in the city. If a city chooses to institute this program, the city issues revenue bonds to procure funds that residents then use. A city may also establish, acquire, and use additional or alternative funding sources for this program, but those additional or alternative funding sources do not include issuance of general obligation bonds. In addition, the law allows economic development authorities (EDAs) and housing redevelopment authorities (HRAs) to do this with city approval. Cities secure repayment of the bonds with a lien (similar to a special assessment) against the qualifying real property, and owners repay the borrowed money as a special assessment added to their property taxes.

B. Special service districts

Another way to fund local improvements in business areas of a city is by use of special service districts (SSDs). An SSD is any defined area in a city where the city delivers special services for which the city imposes and collects special charges. Only land zoned for business purposes (commercial, industrial, land for public utility purposes, or vacant land similarly zoned) is subject to the special charges.

Landowners, not the city, initiate establishment of an SSD. Twenty-five percent or more of the owners of the land area of property subject to service charges and owners of 25 percent or more of the net tax capacity of property subject to the district must file a petition with the city clerk, calling for a public hearing. The city council may decide to establish the SSD based on the petition, but is not required to do so.

RELEVANT LINKS:

[Minn. Stat. § 428A.101.](#)

[Minn. Stat. §§ 428A.11 - 428A.20.](#)
[Housing Improvement Areas,](#)
House Research, July 2014.

[Minn. Stat. § 428A.03, subd. 1a.](#)

[Minn. Stat. § 471.345.](#)

[Minn. Stat. § 428A.12.](#)

[Minn. Stat. § 428A.20.](#)

[Minn. Stat. § 428A.14, subd. 1.](#)

Before the imposition of service charges in a district, for each calendar year, a hearing must be held according to law and notice must be given and must be mailed to any owner, individual, or business organization subject to a service charge.

SSDs are another tool cities may use to make, and pay for, local improvements in certain areas of a city if business owners request it and where special services are rendered and paid for with revenues collected from service charges. Service district charges are not property tax levies, even though they are based on net tax capacity and are payable and collected in the same manner as property taxes. The service charges are not included in computations of tax increments, fiscal disparities, or any other law that applies to general ad valorem levies. Note: The establishment of a new special service districts after June 30, 2028, requires special legislation.

C. Housing improvement areas

In a very similar manner to SSDs, cities may use housing improvement areas (HIAs) to fund local improvements in common areas of townhouses or condominium neighborhoods. The establishment of a new housing improvement area after June 30, 2028, requires enactment of a special law authorizing the establishment of the area. Prior to establishment of a housing improvement area, the governing body of the city must:

- Provide full disclosure of public expenditures, as well as the terms of any loans, bonds, or other financing arrangements for housing improvement area projects; and
- Determine whether the association or the city will contract for the housing improvements, and ensure that any contracts made by the implementing entity are subject to municipal contracting law.

A petition from landowners initiates establishment of an HIA, not the city council. At least 50 percent of the affected property owners of the housing units potentially subject to fees in the proposed HIA must file a petition with the city clerk. The petition, filed with the city clerk, requests a public hearing on the establishment of an HIA and on the proposed fees. Additional statutory procedures apply to HIAs.

The city council may specially assess housing improvements to property in an HIA in addition to the fees for improvements made pursuant to the HIA ordinance. If a fee is imposed on a basis other than the tax capacity or square footage of the housing unit, the council must make a finding that the alternative basis for the fee is more fair and reasonable. (Of course, a city doing so must follow all special assessment procedures in Chapter 429).

RELEVANT LINKS:

[Minn. Stat. § 428A.18, subd. 2.](#)

[Minn. Stat. § 428A.13.](#)

[Minn. Stat. § 428A.14.](#)

[Minn. Stat. § 435.44.](#)

[Minn. Stat. §§ 469.090 – 469.1081.](#)

[Handbook, Chapter 15.](#)

However, both an HIA ordinance and an HIA resolution setting fees may be vetoed. If 45 percent of the residents of housing units subject to the fees file an objection to the ordinance with the city clerk before the effective date of the ordinance, it does not take effect.

In addition, if owners of 45 percent or more of the housing units' tax capacity subject to the fee set by resolution file an objection with the city clerk before the effective date of the resolution, it does not become effective.

D. Sidewalk improvement districts

A city may establish, by ordinance, a sidewalk improvement district to pay all or part of the cost of sidewalk construction and repair by apportioning the cost throughout the property in the district on a “direct or indirect benefit basis.” The council may establish districts in order to provide all areas with safe pedestrian walkways to and from schools, school bus stops, public transportation facilities, and other neighborhood and community services.

The total cost may be apportioned and assessed to all property in the district on a uniform basis as to each classification of property. An indirect benefit assessment may involve all property in the district without regard to location of sidewalks. A direct benefit may be assessed to abutting property for the additional cost of an extra sidewalk width. Assessments may be spread over a five-year period, but there is no provision in the statute for issuing obligations initially, to finance the cost, nor is any procedure prescribed for making the assessments. The law makes no mention of Chapter 429 or special assessments. Best practice suggests working with the city attorney on implementing a sidewalk improvement district.

E. Economic development authority

Economic development authorities (EDAs) possess additional funding power that may help cities fund certain local improvements. An in-depth examination of EDAs is beyond the scope of this chapter, but in general an EDA can issue lease revenue bonds (without a vote or referendum requirement and not subject to net debt limits) to construct public facilities such as a fire hall or a city hall, and lease it back to the city. In the lease, the city agrees to cover the bond payments and eventually purchase the public facility.

RELEVANT LINKS:

[Minn. Const. art. XIV, § 4.](#)
[Minn. Stat. §§ 162.09 – 162.18.](#)

[Minn. Stat. § 162.09, subd. 4\(a-f\).](#)
[Minn. R. ch. 8820.](#)

[MnDOT State Aid for Local Transportation.](#)

[Minn. Stat. § 162.145.](#)

[LMC, Small Cities Assistance, July 28, 2015.](#)

VII. State funding sources for roads and bridges

The state provides funding to Minnesota cities for local roads and bridges in a number of ways:

- The municipal state aid program (MSA).
- The local road improvement program.
- State bonding.
- Regular state general fund appropriations.

A. Municipal state aid (MSA)

The MSA program, administered by the Minnesota Department of Transportation (MnDOT) provides funding to support qualifying city roads and bridges in cities with a population of 5,000 or more, based on the last federal census or a special census, done by contract with the U.S. Bureau of the Census and paid for by the city. A city with a population that drops below 5,000 in the most recent federal decennial census may still qualify for MSA funds in certain situations. MnDOT decides what city roads fit the criteria as defined by rule. Cities use these funds to construct, improve, and repair MSA streets in any of the following ways:

- Use current allocations to pay for projects.
- Borrow against the city's future MSA allocation.
- Issue bonds that will be repaid with MSA funds.
- Use MSA funds to meet participation requirements on county or MnDOT projects.
- Combine MSA dollars with money collected through special assessments.

City engineers work with the state to identify and procure MSA funding for qualifying streets. A screening board, appointed by the commissioner of Transportation, includes one city engineer from each of the eight MnDOT districts, two engineers from the Metro Division, and one engineer from each of the first class cities (populations of 100,000 or more). The board annually reviews all information as to the financial needs of the MSA system and submits its recommendations to the commissioner on or before the first day of November of each year.

B. Small cities assistance

In 2015, a small cities assistance account provided funds intended for construction and maintenance of roads located within the 704 cities that do not receive municipal state aid.

RELEVANT LINKS:

[House Research: Small Cities Assistance](#), Sept. 2015.

[Minn. Stat. § 174.52. State Aid for Local Transportation \(SALT\)](#).

[Minn. Stat. § 174.40.](#)

[MnDOT: Safe Routes to Schools Program: Infrastructure Implementation Program. Minn. Stat. § 174.40, subd. 4a.](#)

[MnDOT State Aid.](#)

The cities that received the assistance do not meet the 5,000 population eligibility threshold for dedicated funds (gas tax, tab fee, and motor vehicle sales tax revenues) established in the state's constitution. This was a onetime amount with no base appropriation. No money was included or appropriated for 2017.

C. State funded local road improvement program

Two types of accounts provide financial assistance to cities in construction, reconstruction, or reconditioning of roads and bridges with regional significance:

- Trunk highway account.
- Routes of regional significance account.

Each account has unique criteria in how and when the funds become available and how they may be spent. MnDOT and the State Aid for Local Transportation Division (SALT) administers these programs and provides oversight and approval of all projects using funds from these programs.

1. Safe routes to school

According to the Minnesota Department of Transportation, the state's Safe Routes to School program provides funding to community and school groups to make improvements to the routes children use to walk and bike to school. A statutory or home rule charter city, county, or town is eligible to receive funding under this section only if it has adopted subdivision regulations that require Safe Routes to School infrastructure in developments authorized on or after June 1, 2016.

Schools, in partnership with cities or counties, may receive grants to support infrastructure that improves safety or access for children walking and biking to school.

2. Trunk highway account

According to MnDOT, this account funds loans or grants to cities to assist in paying the local share of MnDOT trunk highway projects that have local costs related to the trunk highway improvement and are not funded or are only partially funded with other state and federal funds. The Legislature authorizes the use of GO bonds for this account.

RELEVANT LINKS:

[MnDOT State Aid.](#)

[Minn. Stat. § 174.50.](#)

[Minn. Stat. § 174.50, subds. 6 and 7.](#)
[Minn. Stat. § 174.50, subd. 6c.](#)

[Minn. Stat. § 174.50 subd. 7.](#)

3. Routes of regional significance account

Grants from this state account may help cities pay the costs of constructing or reconstructing city streets with statewide or regional significance that have not been fully funded through other state, federal, or local funding sources. The SALT Office selects projects for these grants based on established procedures and criteria.

4. Local bridge replacement program

MnDOT and SALT administer funding programs exclusively for local bridge projects, including the Federal Aid Bridge Replacement Program and State Transportation Fund (Bridge Bonds). Although the state manages these programs, the funds are not state aid funds. MnDOT must cooperate with local road authorities to develop rules, procedures for application for grants, conditions of grant administration, standards, and criteria for local bridge projects and specifications. In addition, MnDOT must develop rules that establish criteria for determining priorities and amounts of grants. The basis of the criteria must consider the following factors:

- Effectiveness of the project in eliminating a deficiency in the transportation system.
- Number of persons affected by the deficiency.
- Economic feasibility.
- Effect on optimum land use and other concerns of state and regional planning.
- Availability of other financing capability.
- Adequacy of provision for proper operation and maintenance after construction.

As part of the standards or rules, MnDOT must, in consultation with local road authorities, establish a minimum distance between any two bridges that cross over the same river, stream, or waterway, so that only one of the bridges is eligible for a grant. As appropriate, MnDOT may establish exceptions from the minimum distance requirement or procedures for obtaining a variance.

Cities must apply for the money and win approval on a project-by-project basis. MnDOT may make a grant to any city for replacement or rehabilitation of a fracture-critical bridge.

Cities may use these grants to construct or reconstruct bridges, including but not limited to:

RELEVANT LINKS:

[Minn. Stat. § 174.50, subd. 6b.](#)

- Matching federal aid grants to construct or reconstruct key bridges;
- Paying the costs to abandon an existing bridge that is deficient and in need of replacement but where no replacement will be made; and
- Paying the costs to construct a road or street to facilitate the abandonment of an existing bridge if the commissioner determines that the bridge is deficient, and that construction of the road or street is more economical than replacement of the existing bridge.

The commissioner may make grants from the state transportation fund to a home rule or statutory city with a population of 5,000 or less for design engineering, and construction of bridges on city streets. Grants may be used for the following purposes:

- 100 percent of the design and engineering costs that are in excess of \$10,000;
- 100 percent of the bridge approach work costs that are in excess of \$10,000;
- 100 percent of the bridge construction work costs

State bridge bonds generally match or supplement other bridge repair and replacement resources such as federal aid, county state aid (CSA) and MSA allotments, and local property tax revenue. Bond funds are often the catalyst that allows replacement or rehabilitation of a bridge.

D. State highway user taxes

The Minnesota Constitution establishes the Highway User Tax Distribution Fund (HUTDF). Revenue comes from the state motor fuel tax, or gas tax, and vehicle registration fees. Nine percent of the revenue goes to the MSA system, 62 percent to the trunk highway fund, and 29 percent to the CSA highway fund. The state parcels out remaining funds to a number of different transportation programs based on a legislatively determined formula that changes no more than once every six years. Sometimes, but not often, the state appropriates general fund dollars for specific local road and bridge programs.

[Minn. Const. art. XIV, § 5.](#)

E. Transportation revolving loan fund

The state transportation revolving loan fund provides below-market financing to local governments and MnDOT for transportation-related projects. MnDOT also administers this program in conjunction with the

[Minn. Stat. § 446A.085.](#)

[Minn. Stat. § 446A.085, subd. 15.](#)

Public Facilities Authority (PFA). PFA may loan money to a city for transportation infrastructure projects even if the city is not eligible for federal or state financing.

RELEVANT LINKS:

[MnDOT Transportation Funding, 2016.](#)

[Minn. Stat. § 475.522.](#)

[Public Facilities Authority. Minn. Stat. ch. 446A.](#)

[Minn. Stat. § 446A.07. Minn. Stat. § 446A.07, subd. 7.](#)

The loan must be repaid by the city from the proceeds of special assessments, tax increments, or other local taxes, such as sales taxes, lodging taxes, liquor taxes, admissions and recreation taxes, and food and beverage taxes, authorized to be used for purposes of the project.

VIII. Federal road and bridge funding sources

Funds for roads and bridges come to Minnesota from the federal highway trust funds and from federal motor fuel taxes.

There are eight area transportation partnerships (ATPs), which include representatives from cities and counties, the state, and other transit-related agencies. A substantial amount of federal highway revenue goes to local government projects. Typically, this is about \$100 million or more per year.

IX. Grant anticipation financing of transportation or transit projects

Cities may borrow in anticipation of the receipt of federal transportation grants by issuing bonds (known as GARVEE bonds). With this funding tool, a city can borrow on behalf of a state agency that is to receive the federal grants. The state agency pledges to pay the grant money to the city or county that issued the bonds. The proceeds of the bonds then finance the transportation projects, which the grants will eventually fund as well as debt service, issuance costs, and funding a reserve for the project.

X. Funding sources for infrastructure

A. Public Facilities Authority

The Minnesota PFA is responsible for the administration and financial management of revolving loan funds and other programs to assist local governments and others with the construction of public infrastructure. The programs administered, in part, by PFA are:

- Clean Water Revolving Fund, providing below-market financing to local governments to upgrade and construct wastewater treatment and collection facilities, administered in conjunction with the Minnesota Pollution Control Agency and based on criteria in state law.

RELEVANT LINKS:

[Minn. Stat. § 446A.072 subd. 1.](#)

[Minn. Stat. § 446A.073, subd. 1 \(1\).](#)

[Minn. Stat. § 446A.075, subd. 1a.](#)

[Minn. Stat. § 446A.081, subd. 9.](#)

[Minn. Stat. § 446A.081, subd.8.](#)

[Minn. Stat. § 446A.087.](#)

[USDA Rural Development, Program Fact Sheets.](#)

- Wastewater Infrastructure Fund (WIF), providing supplemental assistance to local governments for predesign, design and construction of cost-effective wastewater treatment projects, including purchase of land and easements. Supplemental assistance, including point source implementation grants, is provided in conjunction with the clean water revolving fund.
- Total Maximum Daily Load (TMDL) Grants, providing money to assist municipalities with costs for water infrastructure projects required by TMDL implementation plans.
- Small Community Wastewater Treatment Program, providing loans and grants to assist local governments with costs to replace non-complying Subsurface Sewage Treatment Systems (SSTS) (commonly known as septic systems) with new subsurface sewage treatment systems, or publicly owned and operated small cluster sewage treatment systems. If a governmental unit receives preliminary approval by the Pollution Control Agency of its feasibility report the state may make a partial construction award for eligible design costs.
- Drinking Water Revolving Fund, providing below-market financing and in some situations, loan forgiveness, to local governments and other public water suppliers to upgrade and construct drinking water treatment, distribution, and storage facilities. The Minnesota Department of Health (MDH) also administers this program based on criteria in state law.
- Credit Enhancement Program, providing a limited state guarantee for certain types of general obligation bonds issued by cities for purposes specified in state law.

B. USDA rural development

As it relates to local infrastructure, USDA Rural Development provides funding to rural communities for clean water, hospitals, clinics, community centers, day-care facilities, first responder needs and other essential community infrastructure. Rural development prioritizes public entities, in areas with less than 5,500 people, to restore a deteriorating water supply, or to improve, enlarge, or modify a water facility or an inadequate waste disposal facility. Small facilities and those serving low-income communities receive preference.

C. Financing tools for water-related projects

Cities often encounter timing issues when working with federal grants or financing water-related projects. The money may not be available when the city needs to start water, sewer, and wastewater projects.

RELEVANT LINKS:

[Minnesota Rural Water Financing.](#)

[Minnesota Rural Water Financing.](#)

[National Rural Water Association Revolving Loan Fund.](#)

[Greater Minnesota Public Infrastructure Program.](#)

[Minn. Stat. § 116J.431.](#)

Minnesota Rural Water in conjunction with others, offers a number of financing tools to help cities fund water, sewer, and wastewater projects:

- The Minnesota Rural Water Finance Authority (MRWFA) is an interim construction loan program providing funding at a very low cost of borrowing for communities receiving a permanent loan commitment from the U. S. Department of Agriculture, Rural Development (RD).
- Minnesota Rural Water Association’s Micro Loan Program provides low-cost loans from \$30,000 to \$200,000, repayable in seven years, to members for small projects.
- National Rural Water Association (NRWA) Revolving Loan Fund (RLF) provides financing to eligible utilities for pre-development costs associated with proposed water and wastewater projects. RLF funds can be used on existing water/wastewater systems and the short-term costs incurred for replacement equipment, small-scale extension of services or other small capital projects that are not a part of regular operations and maintenance.

D. Funding for infrastructure in greater Minnesota

The purpose of the Greater Minnesota Business Development Infrastructure Grant program is to stimulate new economic development and/or create or retain jobs in greater Minnesota through public infrastructure investments. The program provides grants to cities, on a competitive application basis, of up to 50 percent of the capital costs of industrial park development or other projects that will keep and/or enhance jobs, increase a city’s tax base, and expand or create new economic development. Eligible applicants are statutory or home rule cities outside of the seven-county metropolitan area. Eligible projects are publicly owned infrastructures that include, but are not limited to, wastewater collection and treatment, drinking water, storm sewers, utility extensions, and streets that support economic development projects. Projects include manufacturing, technology, warehousing and distribution, research and development, and agricultural processing.

“Public infrastructure” means publicly owned physical infrastructure necessary to support economic development projects, including, but not limited to, sewers, water supply systems, utility extensions, streets, wastewater treatment systems, stormwater management systems, and facilities for pretreatment of wastewater to remove phosphorus.

Funding for the program comes from state issued general obligation bonds and the amount available varies each bonding year.

RELEVANT LINKS:

See [Handbook Chapter 23](#),
Sec. VII. *Emergency
Contracts*.

[Minn. Stat. § 12.26, subd. 2.](#)
[Minn. Stat. § 12.26, subd. 3.](#)

[Minn. Stat. §273.1231 -
273.1235.](#)

Minnesota Department of
Revenue:
[Truth in Taxation for taxes
payable in 2017.](#)

[Minn. Stat. § 475.754.](#)

[Minn. Const. art. XI, § 6.](#)

[Handbook, Chapter 24.](#)
[Minn. Stat. § 412.751.](#)
See LMC information memo:
[Extraordinary Expense
Coverage.](#)

XI. Emergencies

Many state and federal agencies may offer various types of aid to cities in case of natural disasters.

While most of this is beyond the scope of this chapter the following tools may assist funding infrastructure repair or replacement after a disaster occurs.

A. Levy for emergencies

Cities may annually levy for emergency management purposes in excess of and over and above all taxing limitations to pay expenditures incurred for emergency management purposes.

In order to purchase additional infrastructure equipment (partially paid through federal funding), a political subdivision may levy an additional tax with the governor's approval.

The Minnesota Department of Revenue may decide to extend levy due dates for cities requesting a special levy to *prepare* infrastructure or other property for or *repair* the effects of natural disaster including the occurrence or threat of widespread or severe damage, injury, or loss of life or property resulting from natural causes. Levy increases for costs of clean up relating to a natural disaster are allowed beyond the amount certified for the tax notification process (also known as truth in taxation) with the approval of the Commissioner of Revenue. Costs for preparing for the flood in addition to costs for repairing the effects of the flood could be included in the levy increase (beyond the preliminary levy certified for truth in taxation). In large-scale disasters, like floods, the Department of Revenue would allow the natural disaster special levy to include local costs for the disaster abatement. However, local costs for the abatement for one or minimal number of properties, for example, due to individual disaster like a fire, would not qualify for the special levy.

B. Issuing debt in an emergency

Cities experiencing extraordinary expenditures, including infrastructure repairs, due to any natural disaster may issue emergency certificates of indebtedness. The city council may authorize the sale of certificates of indebtedness to mature within three years and to bear interest at a rate not to exceed the amount prescribed in law. The certificates may be issued with or without advertising for bids on such terms and conditions as the council may determine. The state auditor prescribes forms for these certificates.

RELEVANT LINKS:

[Minn. Stat. § 475.58, subd. 1\(11\).](#)

[44 C.F.R. § 201.](#)

[Disaster Mitigation Act of 2000.](#)

[Minn. Stat. ch. 410.](#)

[Minn. Stat. ch. 429.](#)
[Minn. Stat. § 429.111.](#)
[A.G. Op. 59B14, \(June 26, 1956\).](#)

[Minn. Stat. § 429.021, subd. 3.](#)

The certificates must be repaid by a levy that, according to the Department of Revenue, is not subject to or included in a city's levy limit, if any are in place. (For 2016 and taxes payable in 2017, no levy limits are in place.) If these certificates are used to compensate for unallotment or reduction of other state aid, the same amount cannot be again recouped under a separate special levy. The certificates may be issued without holding a bond election.

C. Federal disaster relief

Congress has a long history of funding disaster relief, recovery, and some hazard mitigation planning through the Federal Emergency Management Agency (FEMA). The Disaster Mitigation Act of 2000 (Public Law 106-390) reinforces the importance of mitigation planning in both pre- and post-disaster situations, and emphasizes planning for disasters before they occur. States and communities must have an approved mitigation plan in place prior to receiving Hazard Mitigation Grant Program funds.

A local mitigation plan may ensure a city's eligibility for federal grant dollars to replace local infrastructure.

XII. How this chapter applies to home rule charter cities

Charter cities may use any of the financing tools described in this chapter unless the city's charter provides otherwise. Some charters limit or alter a city's authority to use a particular financing tool, making it most important that charter cities consult the city attorney and the charter before embarking on a local improvement project.

A. Special assessments in charter cities

The constitutional special benefit rule applies to charter cities. Again, the special benefit rule requires that the amount of special assessments to a parcel of property cannot exceed the increase in market value of that property because of the improvement.

Generally, any city operating under a home rule charter may proceed either under Chapter 429 or under its charter in making an improvement, unless a home rule charter or amendment taking effect after April 17, 1953, provides for an improvement under Chapter 429 or the charter exclusively.

If an option exists, the city council must determine whether to proceed under its charter or Chapter 429.

RELEVANT LINKS:

[Minn. Stat. § 429.021, subd. 3.](#)

[Minn. Stat. §§ 435.193 - 435.195.](#)

[Minn. Stat. § 429.021, subd. 3.](#)

Even if the city follows charter procedures, state law requires that notices of proposed assessments inform property owners of the procedures they must follow under the charter in order to appeal the assessments to district court. The notices must also inform property owners of the provisions of the senior citizen deferment law, military or disability related deferments, and the existence of any deferment procedure established by the city.

Charter provisions must require that the council issue the contract for all or part of the work, or order all or part of the work done by day labor, no later than one year after the adoption of the resolution ordering such improvement—unless the council specifically states a different time limit in the resolution ordering the improvement.

B. Funding for infrastructure

Some charters may limit the city’s authority to use state law funding mechanisms or may include voting requirements that differ from state law. Each charter is a unique local constitution, which charter city councils must follow. Consult the city attorney for interpretation of local charters as they relate to financing local improvements.

XIII. Conclusion

Funding local infrastructure improvements poses significant challenges to city councils. Careful planning, capital improvement plans, and fees that comport with all the costs of providing services help cities fund essential infrastructure expenditures.