Dear Neighbor,

We are writing to update you on the issue of property taxes. We strongly believe that reducing the spiral of property taxes in Southwest Minneapolis must be a top priority for elected officials at all levels of government.

We wanted to share our perspectives as state legislators on the causes of this crisis, and our ideas for addressing the issue during the current legislative session. In addition, we are providing you a thorough analysis of how property taxes are calculated and classified to assist you in your advocacy efforts.

<u>The issue of rising property taxes is one of our top legislative priorities</u>. Minnesota property taxes have increased by $3 billion since 2002. In all, property taxes now comprise a whopping 32 percent of total of Minnesota taxes. By 2013, that number is projected to jump to 33 percent, eclipsing total sales tax collections and falling just 2 percent behind total income taxes collected in our state.

For cities, property taxes now make up about 37 percent of their total budgets – an inflation-adjusted 41 percent increase since 2000, and a direct result of serious cuts in state aids paid to cities during that same time period. Today, state aid makes up just 26 percent of cities' budgets.

<u>How property taxes are calculated</u>:

A property's *taxable* market value, or *estimated* market value, is the value amount that is subject to taxation. The taxable market value is multiplied by the property's *class rate* (set by state statute) to determine the property's *net tax capacity* (expressed as a dollar amount). Taken as a whole, the net tax capacity for all of the properties in a jurisdiction is called the *tax base*.

Each local taxing jurisdiction independently determines the dollar amount needed from property taxes for the coming year's budget. This is called the *levy*. From there, each jurisdiction determines what percentage of the net tax capacity for each property is needed to obtain the *total levy*. In other words, the levy is divided by the total tax base to determine the percentage of each property's net tax capacity that is needed. That percentage is uniform for each property in the jurisdiction. (It is important to know that every jurisdiction – city, school district, county, etc. – does this math and applies a levy to a property. Adding the percentages from each jurisdiction may exceed 100 percent. Thus, what a property might pay may be more than its tax capacity.)

Added to the standard levy are levies that have been approved by a vote of the citizens (referendum levy). These are most typically used by school districts to augment education funding. That amount is a set percentage of each property's taxable market value. Adding the regular levies and the referendum levies gives one the *gross tax*.

Subtracted from the gross tax are credits authorized by the state based on the value and type of the property (note, this is distinct from state aids paid to cities, and refunds paid to taxpayers via their income tax. Those items are discussed later.) The most common credit subtracted from the gross tax is the *residential market value homestead credit*, which is a direct subtraction from the property taxes payable for a particular homesteaded residence. The resulting amount is the *net tax* payable for that year.

So, how is it possible to pay more in taxes than the previous year when the property's value is steady or declining? Likewise, how can one pay more in taxes than the percent by which a jurisdiction's levy has increased for that year?

A given year's levy is a <u>set dollar amount</u> that the jurisdiction has determined it needs to raise for that year. Each property is then required to pay the exact same percent of its net tax capacity as every other property to come up with the total amount needed. If every property's value increases uniformly, and each jurisdiction raises their levy by the exact same percentage, changes to the levy would be applied perfectly and evenly for each property.

But take, for example, a hypothetical city that has only two properties in it. If one property's value held steady, but another property's value declined, the amount that would be levied from the first property has to make up the difference from the second property's decline to raise the total dollar amount needed by the city. In this case, it is easy to see that the percentage increase from the previous year for that first property would be greater than its value increase (which was zero), as well as greater than the percentage increase in the overall levy.

This circumstance is further exacerbated by the differences in class rates applied to different types of properties. It is also important to remember that the multiple local jurisdictions that use property taxes (city, park board, school district, county, Metropolitan Council, etc.) determine their budgets and corresponding levy on the same tax base, but independently from one another.

Other factors that affect property taxes:

A number of other state programs and policies affect the computation of property taxes. Some types of properties have unique features or ownership characteristics for which special rules allow their taxes to be deferred to a later date, or to have some of their value be totally excluded from net tax capacity calculation (and thus not part of a jurisdiction's tax base). A few examples include improvements made for lead and mold problems, property owned by senior citizens or disabled veterans, and agricultural property that has significant development pressure on it. Excluded from paying property taxes are those owned by the public and by non-profit organizations such as churches.

Tax Increment Financing (TIF) is another mechanism that affects property taxes. In this case, redeveloped properties result in increased value, and the additional taxes that result are captured for a specific public purpose to help support the new development (the city, county and school portion of those taxes are included). Those additional taxes are a part of the overall levy, and might not even exist if the project didn't occur, but it does represent a portion of taxes excluded for general local purposes. The contribution to the regional Fiscal Disparities pool (discussed below) is often shifted to other properties, and this property value is excluded for the purpose of determining the state's contribution toward Local Government Aid and school funding (a net benefit for local property tax payers).

Fiscal Disparities is a mechanism in which the a portion of new property taxes generated from commercial and industrial property redevelopment in the metropolitan area are pooled together, then redistributed on an equitable basis (based on a formula containing a number of variables) to metropolitan cities and placed in their general fund. The goal is to allow cities to share in the overall improvement to regional economic development and forgo competing with each other by providing unproductive commercial property tax breaks (and resulting increases on residential properties). In some years some cities are net contributors to the pool, other years they may be net recipients.

Local Government Aid (LGA) is a revenue-sharing arrangement whereby the state takes from its general fund pool (comprised of income and sales taxes) and returns funds to cities large and small to help offset the cost of basic services paid for by property taxes (water, sewer, garbage, streets, police, fire, etc.). It is designed to help alleviate property taxes and bring parity to basic quality-of-life services from city to city. Other states don't share this value – they let local communities either go it alone, or allow those with greater wealth and economic resources enact sales and income taxes. This balkanization creates big disparities between communities that is very damaging to state livability and economic competiveness.

For Minneapolis specifically, LGA is an important recognition of the fact that it is a net contributor to the state's coffers, sending hundreds of millions of dollars more in sales, income and state property taxes than it receives in LGA. It is also an important recognition of the fact that Minneapolis provides a great number of core services to surrounding communities, and provides a number of services that are regional in nature, hosting literally thousands of workers and visitors from beyond the city every day. Even so, Minneapolis is only in the middle of the pack in the amount of LGA it receives per resident.

County Aid is similar in concept to Local Government Aid, but paid to counties.

Property tax relief programs:
A number of property tax relief and refund programs are in place. The most well known for homeowners with household income at or below $99,240 is the Property Tax Refund (PTR), also known as the "circuit breaker." It is paid to those whose property taxes are high relative to their incomes. A similar refund is available for renters under the Renters Credit program, with household income at or below $53,540. An individual must file in order to receive this refund.

Another refund, known as "Targeting," provides up to $1,000 to homeowners whose property taxes increase by more than 12 percent from the previous year. This refund is not tied to a homeowner's income.

Senior citizens below a certain income are able to request that a portion of their property taxes be deferred until some future point in time. The unpaid portion takes the form of a lien against the property. The lien is then paid before the title can be transferred when the property ultimately changes hands. This program is not used by very many people.

Property taxes are deductible from federal and state income taxes for those who itemize their deductions.

<u>There are a number of other state laws that affect property taxes.</u>

From time to time the state will impose local general fund levy limits on cities and counties, and tie state aid payments inversely to those limits. The idea is to better link aid payments to lowering property taxes. Some analyses argue that this provides a reverse incentive for cities and counties to levy the maximum allowable.

Also from time to time, the state changes the factor by which different types of property (also known as "classes" of property) multiply their market value to determine their net tax capacity. The most dramatic of these changes was in 2001 when commercial/industrial (C/I), multifamily residential (apartments), high value homestead residential, and seasonal recreational (cabins) properties saw their factors ("classifications") lowered significantly. This had a direct result on the increasing the portion of local levies that homestead residential properties pay.

Another significant change in 2001 came from the gradual elimination of what was known as limited market value. At one time, the value of a property for the purpose of determining its net tax capacity was only a portion of its estimated market value (not all of the growth in value from the previous year would necessarily be recognized.) That limitation was removed in 2001 and phased in over a period of years. That phase-in is now complete and properties are taxed on the portion of their full estimated market value that their classification prescribes.

The state pays for a number of services that had been, at one time, paid for by local property taxes. The state's financial commitment to those services varies from year to year. With those variations, the amount that is carried by local property taxes also varies. An example includes the Hennepin County property tax contribution needed for safety-net health care provided at Hennepin County Medical Center (often for impoverished citizens from around the entire state who lack insurance).

For K-12 education, the state pays most of the basic "per-pupil formula" as well as a number of additional funds that are needed to address specific and unique needs for our students to receive a decent education (integration, poverty concentration, adult basic education, interest payments on building improvements, transportation, early childhood education, etc.). The departure of hundreds of students under open enrollment provisions and charter schools has resulted in a substantial loss of "per-pupil" funds.

In transportation, Municipal State Aid (MSA) and County State Aid for Highways (CSAH) are funds that help local units pay for the construction and maintenance of their major arterial roads through their communities.

<u>The property tax increases being experienced by Minneapolis homeowners, particularly those in our district this year are the result of a number of the state factors described above, and a few factors unique to Minneapolis.</u>

From 2002 to 2010, Governor Tim Pawlenty successfully pushed through state budgets that made significant cuts to Local Government Aid, County Aid, and Market Value Homestead Credit reimbursements with the assistance of lock-step, then minority-party Republican legislators, and in the absence of a veto proof DFL majority. In addition, the permanent commitment made by the 2001 legislature to fund the basic per-pupil formula for K-12 public education was slowly eroded by his failure to fully fund the per-pupil formula. As specific education items were carved out, school boards were forced to levy all or a portion of those. A cut of 14% to education occurred during his time as governor.

Programs designed to offset the resulting property tax increases, Property Tax Refund, Renters Credit, and Targeting, were never fully funded by Pawlenty. Cuts to health and human service budgets forced the county to rely on its own levy to provide safety-net, crisis health care and other core services.

In the last few years, Local Government Aid has dropped from funding 40% of the Minneapolis' general fund (with property taxes comprising about 30%) to 22% (with property taxes having to make up the difference and now comprising 44%).

Homesteaded residences in our legislative district have not experienced the same level of property value losses as other areas of the city. That fact, along with the reduction of commercial/industrial (C/I) and apartment taxes in 2001 (at the same time phasing out the limited market value), and the fact that C/I and apartment values have declined more than have single family residences mean that our district's residential homesteads are experiencing greater levy increases, outpacing both the changes in their value and the overall percentage of the levy increases. Since 1996, the homestead residential tax base of Minneapolis has moved from funding 33% of the city's general fund paid for by property taxes, with C/I funding 56% (most of that downtown), to the exact reverse.

Pawlenty's real, per-capita budgets have cut LGA by 49%. He even went so far as to unilaterally "unallot" LGA to cities, an action that was later found to be illegal.

A portion of the taxes generated by downtown Minneapolis C/I property from several tax increment financing districts were extended by the city with the permission of the state in order to help continue paying for the neighborhood-led initiatives that residents value (and assist with retiring the debt from purchasing the Target Center). Those increments expired for one year, and then were brought back online. During the one year the increment was mixed back into the general fund, property owners saw the corresponding proportional drop in their share of the levy, so when it came back online this year, it was additive to the larger dynamic.

Property taxes and the pension issue

A number of years ago, the City of Minneapolis moved its employees to statewide public employee retirement plans that are based on the defined contribution model – a 401K or similar program, where benefits are paid from investment returns, employee and employer contributions, with no guarantee of benefits paid beyond market performance. There remain a number of active employees and retirees in the older, "closed pensions" that did promise their employees a guaranteed benefit when those employees entered employment, in many cases, decades ago.

Because of a number of factors, including poor investment returns, expensive administrative costs, and benefit calculations that may be flawed (an issue being decided by the courts), the city has been forced to levy property taxes to meet those obligations to pensioners. We have, and will continue to support efforts to better govern and manage the funds and reign in excessive costs. In the past two years, we have succeeded in reforming two significant funds, and await further action by the city in negotiating a legal or legislative solution for the final two. **We have pledged our support to the city as soon as city leaders decide to step forward with their plan.**

Many of you have asked us about the status of bills in the legislature pertaining to property taxes, particularly as they relate to Minneapolis' closed pension fund. As of this writing, **the city of Minneapolis has not proposed any legislation related to the pension issue, nor have officials approached any Minneapolis legislator with specific language to address the pension issue.** We stand ready to assist the city of Minneapolis with any legislation that will rectify this problem, however.

Where do we go from here?

As we write this, Republican legislative leaders have announced their intention to pursue a devastating ***total elimination of local government aid for Minneapolis, St. Paul and Duluth***. It is apparent that they want to perpetuate Governor Pawlenty's approach of divisiveness and hiding behind "no new taxes" rhetoric and cynically shifting those tax increases to residential property tax payers by more than $600 million per year. As Pawlenty did before them, their budget will endanger our fragile recovery, there will be less university research with fewer innovations that create new industries, the decline in performance from public education and higher education will continue, higher tuition, higher fees for basic services, a worsening credit rating, worsening public heath, more taxes paid by the poor and middle class and fewer taxes paid by the most wealthy will result. Under their plan for the next budget, tens of thousands will lose their health care, hospitals and clinics will close their doors, hundreds will be laid off from our universities while tuition will increase 10 to 15 percent, local governments will be forced to slash public works and public safety and increase property taxes.

Overall spending for public services on a per capita basis has gone down. The most wealthy, despite accumulating an ever growing share of the state's wealth -- the people who have prospered from our investments in an educated workforce, in public university research and new ideas, and in the infrastructure that allow our communities to function -- pay less than they ever have in taxes. The rest of us are paying more in taxes and new “fees”.

As we have for a number of years now, in response to the best advice economists can give us, the way to get our state moving again is by a prudent and multifaceted approach. That includes tax relief for the middle class and lower income folks (real tax relief that includes holding the line on property taxes) who will immediately spend their dollars on the economy, rebalancing the tax system so it is fair once again (asking the wealthy to pay their fair share), and reforming the way government delivers services so they are more efficient (including health care reform – the biggest cost driver of all), and investing in the essential public services that bring a high quality of life and prosperity (good health, great education systems, world class transportation, a clean environment, safe cities).

Those are the hallmarks of Governor Dayton’s budget proposal, and our commitment to you.

What can you do?

From our perspective, the most valuable thing Southwest Minneapolis residents can do is to ensure that your friends and associates in suburban and rural communities are aware of the issues surrounding LGA and pensions and that they contact their own legislators to support statewide fairness and our reform efforts. The Minneapolis delegation has worked collaboratively with our legislative colleagues with our around related pension issues in the past. Your efforts to assist us with our Greater Minnesota legislators will be very helpful. We also encourage you to phone or e-mail the legislative Republican leadership: Senate Majority Leader Amy Koch, 651-296-5981, sen.amy.koch@senate.mn; Senate Tax Chair Julianne Ortman, 651-296-4837, sen.julianne.ortman@senate.mn; House Speaker Kurt Zellers, 651-296-5502, rep.kurt.zellers@house.mn; House Tax Chair Greg Davids, 651-296-9278, rep.greg.davids@house.mn.

Once the city has decided on its legislative strategy on the pension matter and submitted language for a bill, we will send you a text of the bill, its bill number, names of the House and Senate authors, and a bill summary to assist you in your advocacy efforts.

We strongly appreciate your interest and passion on this issue. Reducing excessive property taxes for Minneapolis residents is critical to our city's future and our quality of life. We will continue to make this issue a high priority in the current legislative session.

Sincerely,

Senator Scott Dibble
Representative Frank Hornstein
Representative Marion Greene

Below are some links that you can peruse if you’d like to delve into even more detail.
A number of well written and concise briefs on a variety of property tax and K-12 education finance subjects from House Research:
http://www.house.leg.state.mn.us/hrd/topics.asp?topic=21
http://www.house.leg.state.mn.us/hrd/pubs/mnschfin.pdf

Budget and process information from the City of Minneapolis:
http://www.ci.minneapolis.mn.us/city-budget/
http://www.ci.minneapolis.mn.us/city-budget/2011adopted/index.asp

Appealing your property values from Hennepin County:
http://tinyurl.com/4lh3pas

Budget material and briefings on various topics from the City of Minneapolis:
http://www.ci.minneapolis.mn.us/city-budget/why.asp

Governor Dayton’s budget recommendations:
http://www.mmb.state.mn.us/rec-2011

Minnesota Department of Revenue overviews, tax fairness, price of government:
http://taxes.state.mn.us/LegislativeUpdate/LegUpPDF/Tax_System_Overview_121710.pdf
http://tinyurl.com/2cej3la
http://www.mmb.state.mn.us/doc/budget/report-pog/nov10.pdf

An online property tax course from the Department of Revenue:
http://taxes.state.mn.us/property_tax_administrators/Pages/taxcalccourse.aspx

Budget and tax analyses from Minnesota Budget Project
http://www.mncn.org/bp/index.html

Trends in fiscal policy, tax fairness, and property taxes, from Minnesota2020:
http://www.mn2020.org/assets/uploads/article/economic_development/propertytax_2010.pdf
http://www.mn2020.org/issues-that-matter/fiscal-policy/minnesotas-tax-fairness-retreat
http://www.mn2020.org/issues-that-matter/fiscal-policy

Tax policy proposals from Minnesota Growth & Justice
http://www.growthandjustice.org/Facts_Fixes_Taxes.html

Marion Greene
State Representative, District 60A (Minneapolis)
MN House of Representatives
311 State Office Building
100 Rev. Dr. Martin Luther King Jr. Blvd
St. Paul, MN 55155
651-296-0171 Direct
651-296-3208 Fax
rep.marion.greene@house.mn Email
www.house.mn/60a Web