



Paul Gilje, Civic Caucus Coordinator

Interview with The Civic Caucus

8301 Creekside Circle #920, Bloomington, MN 55437

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Notes of the Discussion

Present : Verne C. Johnson, chair (phone), John Adams, Janis Clay, Bob DeBoer, Rick Dornfeld, Paul Gilje, Steve Hinze, Nancy Homans, Sallie Kemper, Ted Kolderie, Dan Loritz, Jim Olson (phone) , Bill Schreiber, Dana Schroeder, and Clarence Shallbetter

Summary of Discussion: Paul Gilje, former Citizens League research director and now Civic Caucus coordinator, describes the evolution of the 1971 Metropolitan Tax-Base Sharing Law and the effects of its implementation. He contends that the law has effectively functioned as a tax-base insurance policy, assuring a share of metro-wide tax-base growth for all communities in the seven-county metro area, irrespective of where in the area the growth occurs. He sees recent proposals to limit or abolish the law as detrimental to the long-term financial stability of the metropolitan area.

Introduction of guests . Guests with various interests in the metropolitan tax-base sharing law, popularly known as the fiscal disparities law, were introduced: John Adams, retired professor of geography, University of Minnesota; Bob DeBoer, director of policy development, Citizens League; Nancy Homas, mayor's office, city of St. Paul; Steve Hinze, Minnesota House of Representatives research staff, and Bill Schreiber, government relations, Messerli & Kramer.

Introduction of interviewee. Paul Gilje staffed the Citizens League committee in 1968-69 that developed the recommendations for the metropolitan tax-base sharing law. After passage of the law he prepared several annual analyses of the law for the Citizens League. Gilje served as research director and later associate director of the Citizens League from 1964-1988. He has through the years held positions in fund-raising for a church, for a consultant, and for a senior housing firm. He has been coordinator of the Civic Caucus since 2005.

The Original Problems.

Gilje outlined the major problems in 1969-1971 that caused the tax-base sharing to be proposed, considered, and enacted into law:

Skewed fiscal incentives -Faced with a "winner-take-all" development landscape, cities were reluctant to accept land uses that didn't pay their own way in property taxes, such as lower-priced housing and large public open spaces. Conversely, they engaged in major competition for offices, industries, and other business properties. The resulting process was labeled "fiscal zoning".

Accidents of location -Cities lucky enough to have interstate freeway interchanges or a major airport in or near their boundaries were favored with a more beneficial tax base.

Anticipated impact of the Metropolitan Council -Having just been established in 1967, the Metro Council was expected to be playing a major role in metropolitan land use decisions. Cities not likely to benefit from such decisions feared they'd be on the short end of property tax revenues.

Wide differences in local rates and spending levels -Some metro cities, with little tax base, but lots of children in schools, were encountering high property tax rates but still inadequate revenues for schools. Meanwhile other cities, highly favored with tax base, had lower property tax rates and enjoyed higher per pupil spending for schools. The Citizens League helped create public awareness of these differences when in 1967 it began city-by-city metro-wide comparisons of homestead taxes.

To see the Citizens League report in 1969 that proposed tax-base sharing: <http://bit.ly/y1N7PL> .

The Goals. The League report identified the following objectives:

- reduce the winner-take-all reward in the metro-area competition for tax base;
- limit the portion of tax base subject to sharing;
- work within the existing government structure;
- retain the independent autonomy of cities;
- refrain from creating any new metro taxing authority.

The Strategy. The Citizens League recommended:

1. Take into account only tax base growth after 1971, so that no one loses what already is in the local tax base.
2. Share only a part of actual growth: 40 percent of commercial-industrial growth, none of residential values. Retain the traditional discipline that elected officials must know the potential burden on residents/homeowners when taxes are levied.
3. Redistribute the shared growth immediately back to the same governmental units that made the contribution. Don't try to solve every social problem with distribution; a simple per capita approach would be adequate.
4. Apply to the entire seven-county area, and to all units of government that levy property taxes, i.e., cities, townships, school districts, counties, and special districts.

The Result. The 1971 metropolitan tax-base sharing law, popularly known as "the fiscal disparities law," functions as a tax-base insurance policy, Gilje said, assuring a share of metro-wide tax-base growth for all communities in the seven-county metro area, irrespective of where in the area the

growth occurs. No matter what happens within its own borders, each community is guaranteed a share of the growth since 1971 in the combined metro area commercial-industrial tax base.

Gilje outlined the underlying principle: Everyone contributes; everyone shares. The law requires that 40 percent of the growth since 1971 in the taxable value of commercial-industrial property be excluded (temporarily) from the tax base of local communities. The amounts excluded are pooled and immediately fully redistributed to all metro area communities based primarily on current population, with a slight adjustment favoring communities with a below-average tax-base value.

Another illustration was offered by Gilje: "Figuratively," he suggested, "lift up in the air 40 percent of the growth in commercial industrial value in every metro area city and township, flatten it out, and drop it back down again."

For those curious about the details of the tax rate calculation under tax-base sharing, an example is provided at the end of these notes.

The Problem in 2012. Opposition to tax-base sharing is centered in metro area cities that contribute more commercial-industrial value to the metro area pool than they receive in return. Bills were introduced in the 2012 Legislature and might be considered in 2013 that would severely limit or abolish the law. See summary of HF 3040, authored by Rep. Jennifer Loon: <http://bit.ly/OA2JOt> . Among other changes this bill would lower the percentage contribution, thereby reducing the size of the metro pool. The pool would also be used to finance metro light rail transit operating expenses. Also see summary of HF 398, authored by Rep. Ann Lenczewski: <http://bit.ly/Sv2nYw> . This bill would abolish tax-base sharing as part of comprehensive changes in the state-local fiscal relationship.

A detailed analysis of the tax-base sharing law was prepared by a consultant for the Minnesota Department of Revenue in 2012. See: <http://bit.ly/QxY0ld> .

How the Strategy is Working Today . Gilje enumerated the on-going benefits of the tax-base sharing law and considered some recent concerns.

Gradually and partially, the law reduces differences in commercial-industrial tax base per capita. Cities with the highest per capita commercial-industrial tax base still are highest, and lowest cities still are lowest, but differences are narrowed. In 2012, for example, with sharing, the maximum ratio of per capita commercial industrial value among metro area cities over 10,000 population, is 3 to 1, that is, the city with the highest commercial-industrial value per capita has three times that of the lowest-ranked city, according to Minnesota House Research. Without sharing that ratio would be 9 to 1 today. In 1975, the first year the law was implemented, and when the amount of tax base shared was much less than at present, the ratio in per capita commercial-industrial value among cities over 10,000 population was narrowed from 6 to 1 to 5 to 1.

Gilje described another way to illustrate both the concentration of tax base in a few communities and the law's only partial reduction of the differences. It is instructive to compare how communities fall relative to the metro average commercial-industrial net tax capacity per capita. Without the impact of the tax-base sharing law, in 2012, 29 of 193 communities would be above average per capita and 164

would be below average. With the law in effect, only four more communities, a total of 33, are ranked above average. The rest are below. Again, as contemplated, the law makes slight adjustments in local property tax base, in order to slightly adjust rewards for fiscal zoning.

Gilje noted that over the last 37 years, had the law not been in effect, the gap between cities at the top and the bottom in per capita commercial-industrial tax base would have widened.

Taxes on commercial-industrial property now are more uniform across the metro area. Gilje pointed out a significant, but usually overlooked, impact of tax-base sharing. He noted that the actual taxes paid per \$1,000 of value by commercial-industrial property are much closer together across communities than would be the case without the law. The reason is that a uniform tax rate—a weighted average of all local property tax rates in the metro area—is derived and applied to all the shared tax-base value, now approaching 40 percent of all commercial-industrial value in the metro area.

Consequently, a business considering a new location anywhere in the seven-county metro area can know that—for up to 40 percent of its value—its property taxes will be the same, no matter which location is selected. This is an impact that affects all localities the same, regardless of whether they are net contributors or net gainers.

Administrative change on property tax statements would help ease some concern . Gilje noted that some concern over the law has resulted from a misunderstood line on the tax statements. Commercial-industrial tax statements in the metro area have a separate line titled "fiscal disparity", which can imply, however incorrectly, that the property owner is paying an additional tax. The "fiscal disparity" does nothing more than identify the tax on that portion of the property owner's value which assumes the metro average property tax rate. The balance of value assumes the local rates. Some participants suggested that clearer labeling could and should replace the term "fiscal disparity" on tax statements.

The law affects the capacity of cities, counties, and school districts to levy taxes, but by itself the law doesn't raise revenue. The amount of shared tax base under the fiscal disparities law that is assigned to each local taxing jurisdiction doesn't yield revenue automatically. The city, county or school district must levy taxes against that shared tax base, just as it levies taxes on property physically located within its borders. The city, county or school district can't just "raid" its shared tax base either by levying a higher rate against it. The same rate is applied to all property that remains local, both residential and commercial-industrial.

No annual or biennial appropriations or new or higher taxes are necessary, unlike conventional revenue sharing arrangements. Gilje noted that the law functions automatically without legislative action. Only administrative actions are required. No policy decisions are made beyond the law itself. Localities report their growth over 1971; the amounts are added together by an administrative auditor and immediately distributed back to the same localities, consistent with requirements of the law. This differs from conventional revenue sharing: when cities, counties and school districts receive revenue directly from the state, new legislation must be enacted with every biennial budget.

In the long run no one really loses. Gilje added that today much public policy discussion focuses mistakenly on so-called "winners" (localities that receive more from the pool than they contribute) and "losers" (who contribute more than they receive). But the so-called "winners" still rank low in per-capita commercial-industrial base. And the so-called "losers" are still winners, because they still rank high.

Moreover, a city that today contributes more than it receives back may see that situation change in years to come, as it becomes a built-up city and has a lesser amount of new growth, plus, probably, more write-down in value. It, too, will share in growth elsewhere in the metro area. Over the long term no one really loses or wins.

Even in the short run, losses aren't that great. Gilje cited the 2012 Minnesota Department of Revenue study which revealed that if tax-base sharing were eliminated, actual property taxes in Hennepin County, the biggest contributor, would decline only by 2.6 percent.

Be careful not to make winner-loser conclusions only by looking at the impact on city governments. Gilje pointed out that it's not at all uncommon that a city can be a net contributor of tax base but the larger school district or county of which it is a part could be net gainers. Cumulative tax bills for taxpayers in that city, therefore, could be less than without the law, even though the city is a net contributor of tax-base growth.

Some debate under way over whether certain properties create "municipal overburden" and should not be subject to sharing. Some opponents of tax-base sharing contend that retail businesses should be removed from the tax-base sharing pool because the Department of Revenue study found that city government expenses to serve retail exceed the tax revenue produced by such businesses. However, Gilje said, those same retail businesses are located in and pay property taxes to school districts and counties and don't create county or school district overburden.

A participant noted that some states, not including Minnesota, attack the municipal overburden issue directly by allowing cities to impose what are called "development impact" fees directly on properties to pay for selected services.

Cities clearly have more than tax base in mind when encouraging commercial-industrial development. Widespread use of tax-increment financing indicates how willing cities are to forego taxes on new development for many years, and to accept whatever "municipal overburden" might occur, to get such development to locate within their borders, Gilje observed. Among the reasons for doing this are: promoting overall growth of the community, providing more jobs, and offering shopping convenience for residents. Cities aren't allowed to escape making a tax-base sharing contribution by placing property in tax-increment districts.

Summing up. The law has functioned for 37 years exactly as intended, Gilje concluded. Cities within the seven-county metro area still compete aggressively for tax base. But the rewards or the losses if development occurs on one side of the freeway rather than the other are no longer winner-take-all. Everyone in the metro area can look at commercial-industrial property anywhere in the area and legitimately claim, "We've got a piece of that."

Depending upon the law's impact at a given time in a given locality, proposals are always likely to be made to share more or less tax base, to change the method of distribution, or even to "steal" the tax base for other use. But, according to Gilje, there's no compelling need to change a law that has and continues to function as effectively and as fairly as the 1971 metropolitan tax-base sharing, or "fiscal disparities" law.

See item **E. Addendum**, below, for an example of the calculation of property tax under the tax-base sharing law.

E. Addendum

Property tax calculation under the tax-base sharing law.

Consider an example: City A has taxable residential property value totaling \$10 million and taxable commercial-industrial property value also totaling \$10 million, of which \$9 million represents growth since 1971. Without tax base sharing City A's total taxable property value would be \$20 million. With tax base sharing here's how the city's taxable value is determined:

\$10 million, its entire residential taxable value,

- Plus \$1 million, its pre-1971 commercial-industrial taxable value.
- Plus \$5.4 million, which is 60 percent of its \$9 million growth in commercial- industrial taxable value since 1971. (The other 40 percent, or \$3.6 million, is combined with the 40 percent of commercial-industrial tax-base growth from all communities in the metro area to form the sharable pool.)
- Plus its share of the pool. The share is proportional to City A's population as a fraction of the metro area population.

Depending upon its share of the pool's distribution, City A's final valuation will be something more or something less than \$20 million.

With a few minor exceptions, taxable value is determined this way for every metro-area unit of government with the right to levy property taxes, i.e., cities, townships, school districts, counties, and special districts.

Dividing the local unit's total adjusted taxable value, (including its share of the metro commercial-industrial pool) into its spending budget, each local taxing unit computes its local tax rate. This rate is then applied against the local unit's adjusted taxable value to determine its total tax revenue (equal to its spending budget).

Finally, the local taxes resulting from the total commercial-industrial shared pool are added together and a metro rate is calculated as the ratio of those total taxes to the metro-wide pooled growth in property values since 1971, giving a weighted average of all local rates.

As a result of tax base sharing then, the resultant tax rate on commercial-industrial property might be greater than or less than the local tax rate applied to residential property. Each parcel of commercial-

industrial property has two parts (a) the local portion (60%), to which the local tax rates apply, and (b) the metropolitan portion (40%), to which the metro tax rate is applied. If the metro-wide tax rate on a parcel of commercial-industrial property is less than the local tax rate, that parcel's effective (local plus metro) tax rate will be lower than the (local only) tax rate applied to all residential property in its local community. Conversely, if local tax rates are less than the metro tax rate, that parcel's effective tax rate will be higher than the (local only) tax rate applied to all residential property in the community.