

2004 Property Tax Report

In 2004, cities continued to struggle with reductions in local government aid (LGA) and in market value homestead credit (MVHC), in addition to shortfalls in other city revenues.

Cities over 2,500 population also faced very strict levy limits, which expire in 2005.

By Rachel Walker and Eric Willette

This is the 12th annual property tax report produced by League staff. As in last year's report, the table accompanying the 2004 report features an expanded city levy section. This enables us to show the impact of the market value homestead credit (MVHC) reduction on actual city property tax revenues received. Again this year, data on tax capacities and market values by property type can be found in a separate table available on the LMC web site at: www.lmnc.org (click on "Library" then "Policy Research Division"). Also featured with the online version of the report are the following documents: *Property Taxation 101*, *Fiscal Disparities 101*, *Market Value Homestead Credit 101*, and the *Property Tax Calculator Glossary*.

Revenue sources

In fixing the state budget deficit in May 2003, the Minnesota Legislature enacted cuts to 2003 aid payments and made a permanent reduction to local government aid (LGA). The LGA program is funded at \$437 million for 2004 and beyond, approximately a 25 percent reduction from certified 2003 amounts. The 2003 Legislature enacted new formulae for distributing the aid payments, and cities will begin to see the effects of these in 2004 as the fixed pool of aid is redistributed among cities. Transition mechanisms put in place mean that it will be several years until all cities are fully "on" the new formulae.

As in 2003, those cities where LGA cuts were less severe are facing cuts in MVHC reimbursement from the state during 2004. Cities will lose almost

\$20 million in reimbursements. The 2003 Legislature enacted these reductions as part of its work to balance the state budget. The reimbursement is fully restored for 2005. Homeowners received the full value of the credit in 2004, but many cities will not receive the full reimbursement amounts. Since the reimbursement makes up a portion of the certified levy, these cities will not realize the total amount of their certified levies in 2004. While the 2004 certified levy for all cities was \$1,215 million, the reduction in MVHC reimbursement means cities will receive only \$1,196 million (see Table A).

Table A
City Revenue Base 2001 to 2004
(in millions of dollars)

	2001	2002	2003 certified	2003 after cuts	2004
LGA	\$612*	565	587	465	437
Certified levy:	912	1,060	1,129		1,215
• Fiscal disparities	91	104	98	98	104
• MVHC reimbursement	NA	86	86	66	66
• Local taxpayers	821	870	945	945	1,026
Total Revenue Base	1,524	1,625	1,716	1,574	1,633

*Includes HACA, which was eliminated for 2002.

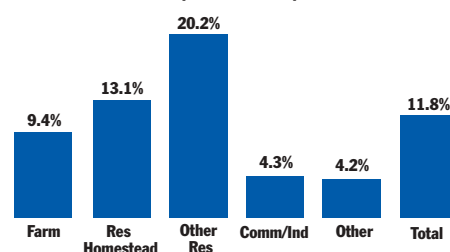
Despite a \$150 million reduction in aids and credits midway through the 2003 budget cycle and a \$170 million reduction for 2004, city certified levies increased by only \$86 million—7.6 percent above 2003 levels. In a typical year with no aid or credit cuts, city certified levies increase by about \$70 million to account for inflation and growth pressures. In 2004, cities over 2,500 population had strict levy limits; of these cities, 78 of them certified final levies that were below the maximum allowed. Collectively, these cities were \$21.6 million below their limit.

Responses to the League's 2004 Fiscal Conditions Survey demonstrated that cities used a wide range of strategies to cope with aid cuts and shortfalls in other revenues. These strategies included spending decreases, increasing contracting out and cooperative efforts with other local governments, reducing the size of the city workforce, and cutting services.

Market value trends

Real and personal property market value in cities increased slightly more between 2003 and 2004 (11.8 percent) than it did between 2002 and 2003 (11.7 percent). New construction, inflation in value, reclassifications, and increases in tax base from annexations and incorporations drive up market value. Overall, growth in property values has generally remained strong. The largest increases in market value were for other residential (non-homestead residential) property at 20.2 percent and homestead property at 13.1 percent. These two categories of property saw similar rates of increase between 2002 and 2003. Market value growth for all other categories of property, however, was at a slightly slower

Chart A
Growth in Total City Market Values
(2003 to 2004)

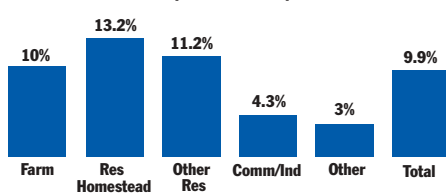


pace than between 2002 and 2003. Commercial/industrial market value grew 4.3 percent compared to 7.2 percent, which is likely the impact of the recession of 2001 and the slow economic recovery that has followed.

Tax capacity trends

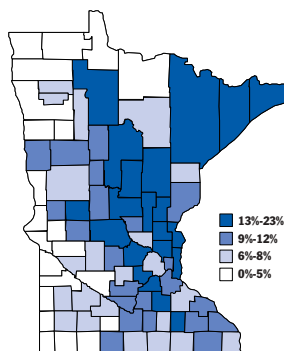
City tax capacity increased by 9.9 percent between 2003 and 2004. Tax capacity growth mirrored market value growth except that residential homestead tax capacity increased more than other residential property tax capacity (13.2 percent and 11.2 percent respectively). For taxes payable in 2004, there was additional rate compression for apartment properties as part of the 2001 property tax reform.

Chart B
Growth in Total City Tax Capacities (2003 to 2004)



The city change in tax capacity from 2003 to 2004 is shown on a county-by-county basis in Map A. Counties in the growth corridor, stretching from the St. Cloud area to Rochester, and counties in the central Lakes country saw some of the largest increases in tax capacity. The Arrowhead counties were also included in the 12 percent to 23 percent growth group. Slightly slower tax capacity growth was seen in parts of the southeast and west central areas of the state. Counties in the west and northwest saw very slight increases in tax capacity

Map A
City Tax Capacity Change (2003 to 2004)



or lost tax capacity. Note that county totals may mask important variations from city to city within a county, especially in counties where one large city makes up a significant share of the tax base of all cities in that county.

The different class rates used in Minnesota's property tax system means that some types of property have higher tax capacities, and therefore pay more taxes per market value dollar than others (see Charts C and D). Most of the local property tax burden is spread based on tax capacity. For example, while commercial/industrial properties make up 18 percent of total city market value, they represent 28 percent of city tax capacity. For residential homesteads, the pattern is reversed. In 2004, this type of property made up 67 percent of market value and 56 percent of tax capacity.

Chart C
Total City Tax Capacities 2004

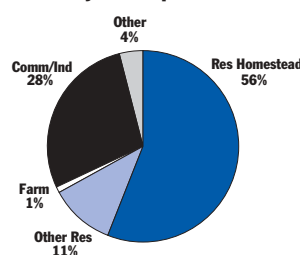
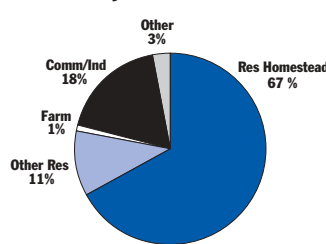


Chart D
Total City Market Values 2004



Tax increment financing tax capacity

The share of city tax base that is captured by tax increment financing (TIF) districts has steadily declined since the early 1990s. Total city tax capacity has grown 23.6 percent since 1992, while city TIF tax capacity has grown by only 6.7 percent. Because of these trends, the percent of city tax capacity captured by TIF districts has declined from 7.9 percent in 1992 to 6.8 percent in 2004 (see Table B). Most of the decline occurred as a result of the 2001 tax reforms, which reduced TIF tax capacity by almost 29 percent through changes in property classification rates. The

Table B
City Tax Capacity Captured by TIF Districts (1992-2004)

Year	TIF Tax Capacity (millions)	TIF Share of Total Tax Capacity
1992	208	7.9%
1993	213	8.3%
1994	199	7.8%
1995	200	7.6%
1996	210	7.5%
1997	228	7.6%
1998	222	7.6%
1999	219	7.6%
2000	234	7.6%
2001	268	7.8%
2002	191	7.1%
2003	209	7.1%
2004	222	6.8%

strong growth since 2002 will need to continue for three more years to get in TIF tax capacity back to 2001 levels.

In addition to 2001 legislative changes to the property classification system, the Legislature assumed a greater share of K-12 education funding, which reduced the actual TIF tax collections by reducing the total tax rate applied to TIF tax capacity.

The long-term decline of TIF as a share of city tax base can be attributed to a number of factors. The majority of TIF properties are commercial or industrial. Class rate compression that has reduced commercial/industrial tax capacity has reduced TIF tax capacity more than overall tax capacity. Similarly, in times of recession commercial/industrial market values have declined or grown more slowly than those of other types of property.

A third important factor in the decline is that changes to TIF laws over the years have resulted in new TIF districts being smaller than their historical counterparts. Newer TIF districts, even when they mature, represent a smaller share of the overall tax base.

This decline is likely to continue. Many of the oldest, largest TIF districts are scheduled to decertify in the next five years, which will reduce the share of city tax base captured in TIF districts even more.

Table C shows the market value and tax capacity totals for residential homestead property and commercial/industrial property in 1994 and in 2004. The change from 1994 to 2004 shows

Table C
Changes in Market Value and Tax Capacity
for Residential and C/I Property
(1994-2004)

	Residential Property	Commercial Industrial Property
1994 Market Value	64%	20%
2004 Market Value	67%	18%
1994 Tax Capacity	37%	41%
2004 Tax Capacity	56%	28%

the shift of the local property tax burden from commercial/industrial property to homesteads. This shift is primarily due to changes in the property classification rates, particularly in 1997 and 2001. While the portion of total market value made up by residential homesteads has only changed slightly since 1994 (64 percent to 67 percent), the portion of tax capacity that this type of property represents grew from 37 percent in 1994 to 56 percent in 2004. The reverse pattern is seen with commercial/industrial property. Again, the change in the commercial/industrial portion of market value is very slight, but the tax capacity of commercial/industrial property fell from 41 percent to 28 percent.

Where property tax dollars go

Charts E and F show the distribution of property taxes paid by city property owners in 2003 and 2004. The portion of property taxes going to cities decreased somewhat, from 29 percent to 27 percent. Both the county portion and the

Chart E
Where Property Taxes Go 2004

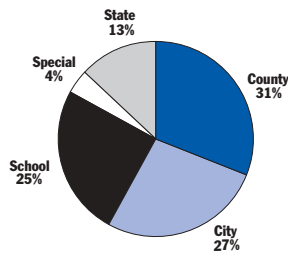
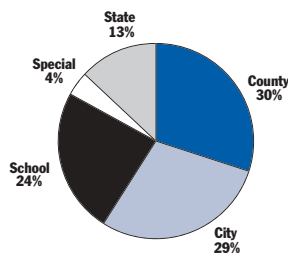


Chart F
Where Property Taxes Go 2003



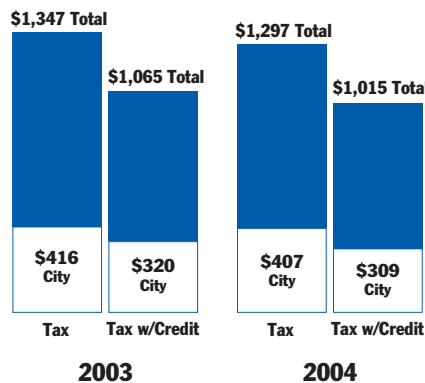
school portion grew slightly. The state property tax on commercial/industrial, seasonal, and utility real property within cities generated \$547 million in 2004, up from \$527 million in 2003. Total school market value levies increased to \$345 million from \$299 million in 2003.

The tax distribution charts do not include TIF levies, which are paid only by property within TIF districts and earmarked for specific purposes, or fiscal disparities levies, which are paid by commercial/industrial properties in the Twin Cities metropolitan and taconite relief areas. The charts also do not show the effect of the MVHC, which credits homesteads for a portion of their local tax bill, or cuts to the MVHC, which reduce revenues received by cities and counties in 2004.

Tax burdens

The average city property tax bill for a homestead valued at \$100,000 in 2004 is \$407, down slightly from \$416 in 2003 (see Chart G). The city portion of the MVHC reduces the 2004 city bill to \$309.

Chart G
Tax on \$100,000 Home
Taxes Payable 2003 and 2004



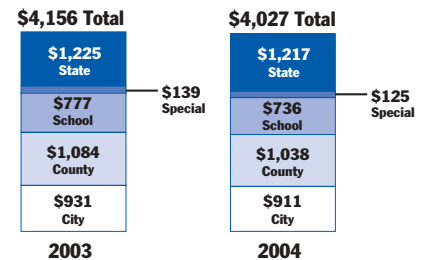
While reductions to the market value credit program meant that many cities were not fully reimbursed for the credits, homeowners continued to receive the full value of the market value credit. For a \$100,000 homestead in 2004, the total average tax bill was \$1,297 before the credit and \$1,015 after the credit. This is somewhat lower than the average total in 2003, \$1,347 before the credit and \$1,065 after.

These calculations do not account for the increase in homestead values over time. Between 2003 and 2004,

the average homestead value for all cities increased 11.8 percent from \$145,292 to \$162,471.


Chart H illustrates the average tax on a \$150,000 business in 2004. The city property tax decreased from \$931 in 2003 to \$911 in 2004. The school tax decreased from \$777 to \$736, and is still significantly lower than the \$2,029 paid in 2001. The new state property tax on a \$150,000 business fell slightly from \$1,225 in 2003 to \$1,217. The total tax decreased from \$4,156 in 2003 to \$4,027; this is much lower than the \$4,615 paid in 2001.

Chart H
Tax on \$150,000 Business
Taxes Payable 2003 and 2004



Property tax information

This report represents a subset of the entire scope of property tax information collected annually by the League of Minnesota Cities. In addition to providing data in greater detail for all cities, the League also maintains data on townships, school districts, and counties. If you have any suggestions for improvements to the report, or questions about the content of the report, please contact Eric Willette or Rachel Walker at the League office (651) 281-1200 or (800) 925-1122.

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