

FISCAL DISPARITIES 101

SEPTEMBER 2019

Local government units within the Twin Cities metropolitan area, which is comprised of the counties of Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, and Washington, have participated in a property tax base sharing program known as Metropolitan Fiscal Disparities since 1975. A similar program began in 1996 for local government units in the Taconite Area, which includes portions of the counties of St. Louis, Itasca, Crow Wing, and Aitkin, and all of Lake and Cook counties. Under these programs, a portion of the growth in commercial, industrial, and public utility property value of each community is contributed to a tax base sharing pool. Each community receives a distribution of property value from the pool based on the market value and population of each city.

Contribution

The contribution to the pool is equal to 40 percent of the growth in commercial, industrial, and public utility value since the base year (1971 for the Twin Cities; 1995 for the Taconite Area). This measure of growth includes both new construction and inflationary increases in existing property values. In 2019, for example, the total amount of tax capacity contributed to the Metropolitan fiscal disparities pool was \$447 million. The contribution value is not available for local tax purposes and therefore, the contribution value must be subtracted from the total tax capacity of each community before the local tax rate is computed. The Taconite Area program is much smaller, with just over \$11.3 million of tax capacity contributed in 2018.

Distribution

The tax capacity contributed to the pool is based on a distribution index. This index compares each city's total market value per capita to the average market value per capita for all cities and towns in the seven counties.

Cities that have relatively less market value per capita receive a relatively larger distribution from the pool than cities with greater market value wealth per capita.

How are property taxes generated?

The tax capacity contributed to the pool ultimately translates into property tax dollars for each local government. These property taxes, also known as the distribution levy, are computed for each local government by multiplying its distribution value by its prior year tax capacity rate. The distribution levy represents the amount of each local government's certified levy raised through the fiscal disparities program. The balance of the certified levy is used to compute the local tax rate.

How are commercial/industrial and utility parcels taxed?

Commercial and industrial properties are not taxed twice. Instead, a portion of each commercial or industrial property's tax capacity is taxed at the area-wide tax capacity rate and the balance is taxed at the total local

tax rate. As a simple example, in a community where exactly 40 percent of all commercial, industrial, and utility property is contributed to the fiscal disparities pool, 40 percent of each parcel's value is taxed at the area-wide tax rate and 60 percent is taxed at the total local tax rate. In 2016 (most recent data available), for example, the Twin Cities area-wide tax rate was 150.262 percent and the Taconite Area-wide tax rate was 160.736 percent.

Policy Issues

The original intent of the program was articulated through the following six objectives:

- Provide a way for local governments to share resources generated by regional growth;
- Encourage orderly urban development by reducing competition for commercial and industrial development;
- Establish incentives for regional cooperation;
- Provide a way for regional resources to be available through the existing system of local governments;
- Make resources available to communities at the beginning stages of development or redevelopment; and
- Encourage environmental protection.

Descriptions of the program, such as those offered by the Minnesota House of Representatives Research Department and the Metropolitan Council, often highlight two main goals that encapsulate several of the original objectives:

- Promote orderly urban planning and development; and
- Work towards a more equitable distribution of fiscal resources.

Assessment of the program's success in accomplishing the second of these goals often points out the "winners," cities that are net recipients, and "losers," cities that are net contributors. Proponents of the program focus on the relative uniformity of the taxation of commercial and industrial property across the metropolitan area and the stability the net contributors provide to the region as a whole. They argue that greater uniformity and stability give the entire region a competitive edge in national and global marketplaces.

The critics of the system argue that the contribution rate of 40 percent is arbitrary and that the distribution formula is solely based on the relative property tax base wealth of each city. Also, the formula uses non-adjusted assessment levels. Cities with high assessment levels contribute more tax base than cities with lower levels, creating a disincentive to raise the assessment level.

Within cities, property classes can experience the impacts of tax base sharing differently. Declines in the market values for Twin Cities area commercial/industrial properties in the early 1990's not only directly shifted property tax burdens to other types of property, they also reduced the amount of commercial and industrial valuation contributed to the fiscal disparities pool. As a result, the total distribution levy generated through the fiscal disparities program was also reduced. In the mid-1990's, market value rebounds reversed this trend. But reductions in the commercial/industrial and public utility property tax class rates by the 1997-2001 Legislatures slowed growth in the tax capacity of both the Metropolitan and Taconite Area fiscal disparities pools. When the amount of this distribution levy declines or grows more slowly than the total tax base, a greater share of the local tax bill is paid by other types of properties, including the

portion of each commercial, industrial, and utility property value taxed at the local tax rate.

Resources

House Research:

<http://www.house.leg.state.mn.us/hrd/topics.asp?topic=21>

The Metropolitan Council

<https://metro council.org/Communities/Planning/Local-Planning-Assistance/Fiscal-Disparities.aspx>