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M E M O R A N D U M

SUBJECT: Update on metropolitan tax-base sharing

I. History -- The concept of tax-base sharing was originated by F. Warren Preeshl. Preeshl, a bond consultant who at that time also was a member of a suburban school board, wrote down his ideas in an uncirculated three-page memorandum dated June 14, 1968. Preeshl at that time was serving as a member of the Citizens League Fiscal Disparities Committee. He did not reveal the memorandum's existence until December 1968, when the committee was debating alternative solutions for giving units of government of the Twin Cities area access to the tax resources of the entire region. Preeshl's idea, one of several debated during December, survived committee debate and became the major proposal in the Citizens League report, "Breaking the Tyranny of the Local Property Tax", issued in March 1969. Meanwhile, State Representative Charles R. Weaver of Anoka had outlined his thoughts to the Citizens League committee in late 1968. His letter talked about the need to share part of the return from industrial and commercial development with the areas in need.

A. The policy test -- Representative Weaver was named chairman of a House subcommittee on Fiscal Disparities in the 1969 Legislature. When the Citizens League report was issued, Weaver's subcommittee drafted a bill to implement the tax-base sharing idea. The bill passed the 1969 House by a wide margin, but time ran out before it could be considered by the Senate. The bill was re-introduced in 1971, passed the Legislature in July and was signed into law by Governor Anderson.

B. The judicial test -- In late 1972, as the implementation steps were under way, the city of Burnsville challenged the constitutionality of the base-sharing law in Dakota County District Court. The District Court ruled the act unconstitutional in early 1973. An appeal was taken to the Minnesota Supreme Court, but the District Court declined to allow the act to remain in effect pending outcome of the appeal. Thus the act was inoperative during the time of the Supreme Court appeal. In September 1974, the Minnesota Supreme Court over-ruled the District Court and upheld the constitutionality of the act. Subsequently, the U. S. Supreme Court declined to hear Burnsville's appeal of that decision.

C. The administrative test -- Representative of county auditors' offices had been involved in discussions of the mechanical steps of implementation since early 1969. Upon passage of the act, the Minnesota Department of Revenue issued a series of memorandums and suggested forms to assist county officials in implementation. The Anoka County Auditor was elected Administrative Auditor by the seven metropolitan county auditors. Following the Minnesota Supreme Court decision in September 1974, the county officials began implementation in earnest, despite the fact that many of them had been reported to be less than anxious to go through the additional administrative steps required by base-sharing. In a remarkably short period of time, they worked out the details.

Tax base distribution was completed in mid-January, and all mill rates calculated by February and early March. Later, the collection of taxes and distribution of revenue to taxing districts took place as it had in the past.

II. National response -- The Citizens League *amicus curiae* brief filed with the Minnesota Supreme Court in 1973 mentioned the tremendous amount of national attention the act already had received. Since its constitutionality has been upheld, the interest seems to have intensified. Here are just a few examples:

* Governor Milliken of Michigan in his message to the 1976 Michigan Legislature has called for adoption of the base-sharing plan for the Detroit metropolitan area. A bill already has been proposed to the Maryland Legislature.

* The Denver Regional Council of Governments currently has a study under way on possible application of base-sharing in that metropolitan area. The Puget Sound Governmental Conference is planning a study.

* The Economic Development Administration, Washington, D. C. has begun a study of base-sharing.

* The National Council on Urban Economic Development soon will publish a research report on base-sharing.

* A consultant with the Rand Corporation has called base-sharing the most innovative and potentially important idea in American public finance in the last generation.

In addition, favorable comments frequently appear in publications around the country. The base-sharing law was highlighted in Fortune magazine's article on the Twin Cities area in January 1976. Another article in the December 1975 Fortune also mentioned base-sharing.

III. Essential mechanics -- Base-sharing affects a city's *capacity* to raise revenue, but base sharing, by itself, raises no revenue whatsoever. Sometimes the law is mis-interpreted as a revenue-raising or revenue-distribution measure. Primarily, base-sharing affects the proportionate shares which taxpayers assume for a given amount of revenue being raised. If through base-sharing a city gains tax base, it can spread its revenue needs over a larger valuation, thereby reducing the burden on each individual taxpayer below what it would have been otherwise.

Part of the mis-interpretation of base-sharing may have its roots in a mis-understanding of how the tax system works. Some persons believe that a unit of government decides on a mill rate which then is applied to whatever tax base that unit of government has. If such were the case, then a given mill rate would raise more money on a larger tax base and, conversely, less money on a smaller tax base. But, in Minnesota, at least, units of government decide to raise so many dollars from the property tax. The mill rate then is derived by dividing the dollars to be raised by the tax base, whatever it happens to be.

Briefly, then, here are the steps in base-sharing:

1. An amount equal to 40% of the net growth of commercial-industrial assessed valuation after 1971 is excluded from the local tax base of every city and township in the seven-county metropolitan area. The 40% net growth does not

apply to specific parcels of property. It is figured off the "bottom line" -- that is, the cumulative growth in the city or township, taking into consideration both increases and decreases in value of individual parcels occurring as a result both of physical changes and of assessors' valuations.

It is necessary, of course, to attribute the amounts excluded to specific parcels of commercial-industrial property. This is accomplished by excluding a proportionate amount of the valuation of every parcel of commercial-industrial property, regardless of whether the particular property gained, cost or remained the same in valuation. This amount is sufficient to total 40% of the net growth in commercial-industrial value.

2. The amounts excluded from the valuation of each city and township in step (1) are added together to form a metropolitan pool of valuations.

3. Every city and township receives back an assigned share from the metropolitan pool. That assigned share will be either more or less (or in a rare case it could even be the same as) than the amount excluded from each city and township in step (1).

   Each city and township's share is based on population, with an adjustment which gives a larger-than-per capita share to a city or township which is below-average in valuation and a smaller-than-per-capita share to one which is above-average.

4. Every city and township's official assessed valuation then becomes the sum of (a) all local valuation *except* the 40% of the net growth in commercial-industrial valuation which was excluded, and (b) the city or township's assigned share from the metropolitan pool.

5. Each unit of government then decides to levy so many dollars of property taxes. When the dollars of levy are divided by the official assessed valuation, the local mill rate is derived. The local mill rate is applied against all the local valuation with the result being the taxes payable on that valuation.

6. When the local mill rate is applied against the assigned share from the metropolitan pool, a dollar figure results, which becomes the local unit of government's levy against the areawide pool. All units' levies against the areawide pool are added together. (For taxes payable in 1975, the sum of these levies was $16.5 million). The result is then divided by the assessed valuation of the areawide pool (for taxes payable in 1975, that figure was $137 million).

7. When the sum of the local levies against the areawide pool is divided by the valuation of the areawide pool, the areawide mill rate results (for taxes payable in 1975, the rate was 121 mills). The areawide mill rate is a weighted average of all the local mill rates.

8. The areawide mill rate then is applied against the portion of every parcel of commercial-industrial property which was made part of the areawide pool (see step (1) above). The local mill rate applies to the balance of the valuation of every parcel of commercial-industrial property.

IV. The results

A. Redistribution of the tax base -- The $137 million of commercial-industrial valuation which was redistributed for taxes payable in 1975 represented the impact of three years' cumulative growth in valuation. The impact of redistribution is cumulative.

Only the crudest of estimates can be made for the redistribution for taxes payable in 1976. The exact figures will be known within a month. It can be safely assumed that the amount will be greater than $137 million. The $137 million represents only 2% of the total assessed valuation (residential as well commercial-industrial) in the seven-county metropolitan area. This percentage will increase gradually year-by-year, but is likely never to exceed 20% of the total valuation of the seven-county area. Commercial-industrial valuation is about one-half of the region's valuation, and, unless the law itself is changed, the proportion of commercial-industrial subject to redistribution can approach, but never actually reach, 40%.

Among communities which contributed the most to the $137 million pool in 1975 were Inver Grove Heights, Edina, Eagan, Plymouth and Fridley. Among communities which received the most net gain were Stillwater, South St. Paul, Richfield, St. Paul, and Minneapolis.

Even after the redistribution, the communities with the greatest per capita gain in commercial-industrial valuation over 1971 (counting both the growth which remained local plus the share of the pool), were the communities which "lost" the most in the redistribution. And, the localities with the least per capita gain over 1971 were those which "gained" the most in the distribution.

Thus the act is functioning as intended: to reduce, partially and gradually, the impact of differential growth in commercial-industrial valuation around the metropolitan area.

B. Mill rate differentials -- Net gainers in valuation have lower, and net losers higher, mill rates than they otherwise would have had. Overall, mill rates are closer together than they would have been without the law. For taxes payable in 1975, local mill rates were from about 1 to 8 mills higher or lower as a result of base-sharing.

However, the most significant -- and probably not widely anticipated -- mill rate impact is felt by commercial-industrial property. In so-called low-tax communities, such property is paying more, and in the high-tax communities, such property is paying less than other properties in their respective communities.

The actual impact on commercial-industrial property is dependent on two equally-important factors: (1) the amount of the difference between the local mill rate and the areawide mill rate and (2) the proportion of the commercial-industrial property in each municipality which bears the areawide rate. The greatest impact is felt where the difference between the two mill rates is large and the proportion of commercial-industrial property bearing the areawide rate is large, as well.

The community of Inver Grove Heights falls in this category. It has one of the lowest local mill rates in the metropolitan area. Consequently, a large difference exists between that rate and the areawide mill rate. Inver Grove Heights also has had one of the largest proportional increases in commercial-industrial valuation over 1971; consequently, the proportion of commercial-industrial property bearing the areawide mill rate is relatively large.

In St. Paul, the difference between the local and areawide mill rate is large, but only a small proportion of commercial-industrial property is subject to the areawide mill rate. Somewhat of a contrasting situation is present in Shakopee. The difference between the local and areawide mill rates is not too large, but a large proportion of commercial-industrial property is subject to the areawide mill rate.

In summary, commercial-industrial property in municipalities with comparatively low local mill rates combined with considerable commercial-industrial valuation growth since 1971 is experiencing the largest increase in taxes. Conversely, such property in municipalities with comparatively high local mill rates, combined with considerable growth in valuation is experiencing the largest decrease in taxes. But in those municipalities where *either* the mill rate differential or the growth in valuation since 1971 is slight, the impact on commercial-industrial taxes also is slight.

C. Non-fiscal impacts -- The law was intended to change the incentives lying on local officials, to permit them to move away from the practive known as 'fiscal zoning'. Some of the effects of the law, then, should appear in a changing pattern of behavior in local government -- moving away, gradually, tax-base considerations as the principal factor in decisions about local development.

The key word probably is 'gradually'. These effects take time to become a pattern. And, in fact, some time is required for the changed incentives even to be perceived. The fundamental change in thinking represented by the base-sharing law -- that the jurisdictional location of the buildings and the jurisdictional location of the tax base are no longer one and the same -- is not absorbed quickly, by everyone involved.

So it is not surprising that no definitive assessment of the 'results' of the law is yet possible. About as much as we can do, at this point, is to identify the areas in which we should be looking, and watching for effects; and to begin collecting and examining decisions in these areas as they begin to come along.

1) Land-use effects -- The law would be expected to reduce somewhat the pressure to permit development in environmentally marginal areas. Also, it should somewhat facilitate county or metropolitan decisions, that have tax-base impacts, in cases where a choice must be made between competing municipalities. The truth is we just do not know very much about the cases involved. Perhaps the most important thing is the absence of evidence that (as was once predicted) the law would impede the process of commercial and industrial site-location.

2) Governmental organization -- Tax-base considerations traditionally have been important to the Minnesota Municipal Commission in laying out new or revised governmental boundaries. A few years ago, the MMC apparently did to a different decision about the boundaries in the Apple Vally/Farmington area in Dakota County because of its understanding that the base-sharing program would be taking effect.

3) Administrative procedures -- The base-sharing law gives every jurisdiction an interest in the efficiency of everyone else's financial-management procedures, and specifically in the quality of everyone else's property assessment. It sets up incentives for the standardization of forms, for the meeting of statutory deadlines and for uniformity of assessment. Effects of this sort may be the easiest to document, early.

4) Housing costs -- Developing municipalities, when required to finance their services exclusively from the property they can persuade to locate physically within their own borders, have every incentive to run a calculation to ensure that the service-cost of a development does not exceed the tax revenues it will generate. Thus, in the 1950s and '60s, municipalities did consciously try to hold down their populations, and to push up, annually, the minimum price of housing built within their jurisdiction. With base-sharing, the distribution from the metropolitan pool reflects basically population: the more people, the more dollars. It is possible this was a factor in the much-noted decision by Bloomington recently to begin reducing lot sizes and other standards which contributed to relatively high minimum prices for housing in that city.

V. Issues

A. General unpopularity of equalization -- Base-sharing inevitably produces controversy because, necessarily, some municipalities each year will receive more base and some less than if the act were not in effect. Consequently, it is not unlikely that calls for repeal will be made by the "losers". It is also possible that organizations which have been created to attract new commercial-industrial development within the borders of certain communities may feel that a major factor in their receiving continued support is jeopardized because base-sharing enables "tax base" to grow even though buildings may be physically located elsewhere.

B. Relationship to tax increment financing -- This issue has produced considerable discussion in recent weeks and months. A number of sub-issues make up the general issue:

1. Whether base-sharing hinders the tax-increment process -- Under tax increment financing, the incremental value in designated districts is withheld from taxation by units of local government. But the full mill rate still falls on the incremental value. The revenues are dedicated to pay for certain public expenditures incurred to prepare property for development. They do not flow to government budgets.

   Since every city owes the pool 40 per cent of the net growth of its total commercial-industrial valuation, any city that is holding out the tax increment to finance a redevelopment must (at least if the project is set up under the 'development district' law or under the powers of a port authority) make a contribution from the remainder of the city equal to somewhat more than 40 per cent of the growth.

Although not expressly provided in law, it has been commonly interpreted that the municipality should be "compensated" by its own development district and port authority-type projects for the extra contribution to the metropolitan pool. Thus, only 60% of the incremental value in such projects has been interpreted as being eligible for tax-increment purposes. The "compensation" to the municipality then becomes the remaining 40% which becomes part of the municipality's valuation which is subject to taxation by units of government. In effect, such an interpretation makes it appear as if base-sharing prevents all of the increased tax revenues in a tax-increment district from being made available for tax-increment purposes.

Under another interpretation, however, the two programs could simply be kept separate. The city would then make a full contribution of 40 per cent of the net growth of its commercial-industrial valuations to the areawide pool including an amount equal to the growth occurring within the redevelopment district. And the full value of the tax increment within the redevelopment area could be reserved for repayment of the redevelopment costs. No effort would be made to transfer tax base from the redevelopment area to the general city account. This means the city's mill rate would be somewhat higher. But the tax-increment project would be completed, and its tax base made available for general city services, sooner than would otherwise be the case. And if the distribution to the city from the areawide pool exceeds its contribution, the tax base is increased and the mill rate correspondingly lowered.

2. Whether HRA tax increment districts should be treated differently -- The base-sharing law expressly exempts tax increment districts established by housing and redevelopment authorities (HRAs). The municipality is not required to contribute more than 40% of the commercial-industrial growth outside HRA tax-increment areas to make up for valuation kept out of the base for tax increment areas. Also, the entire incremental value in the HRA district is available for tax-increment purposes. Some questions have been raised whether HRA, development district and port authority-type projects should all be treated the same relative to base-sharing. This would raise the question of whether the municipality ought to contribute more than 40% of its commercial-industrial growth outside the HRA area as well as the question of making 100% of the increment available for tax-increment purposes as discussed above in (1).

3. How the mill rates should be applied to commercial-industrial property in tax increment areas -- Under one interpretation, the valuation which is held out of the tax base for tax-increment purposes should bear only the local mill rate. If such a practice were followed, it is possible that two properties having the same valuation would have a different tax bill, which raises constitutional issues. Under another interpretation, the valuation which is held out of the tax base would be subject to the local mill rate and the areawide mill rate in the same proportion as the balance of the commercial-industrial valuation. In such a situation the properties within and outside tax-increment areas would be treated the same for taxation purposes, thereby eliminating constitutional issues. Of course, if the local mill rate is higher than the areawide mill rate, a tax-increment area receives slightly less revenue if both mill rates are applied proportionately rather than the local mill rate exclusively.

C. Whether some "wealthy" municipalities should receive any share of the metropolitan pool -- Essentially upper-income bedroom communities such as North Oaks, Sunfish Lake and Woodland all share in the pool, despite the fact that they are not likely to make any substantial contribution. (Interestingly, however, North Oaks contributed more than many persons realize. In the first year, it contributed $79,275 of valuation and received $81,654 in return, a gain of $2,379).

In the aggregate, the amount received by such bedroom communities is very small relative to the total size of the pool. Moreover, the other taxing districts where these localities are located, such as counties and school districts, receive the major benefit of any growth, because such bedroom communities' budgets are usually very small. Base sharing is one of many laws (others include federal revenue sharing and state revenue sharing) which provide some funds to the very wealthy communities along with everyone else. Finally, these communities are high in valuation per capita and, therefore, receive a smaller-than-per-capita share of the metropolitan pool.

D. Raising revenue -- Some exploratory efforts have been made to try to turn base-sharing into a revenue-raising tool for municipalities with local mill rates above the level of the areawide mill rate. That is, commercial-industrial property would pay the local mill rate or the areawide mill rate, *whichever is higher*, on that portion of valuation attributable to the areawide pool. While this would serve to increase tax revenues in the above-average taxing districts, it would be directly contrary to a major goal of the base-sharing act -- to make the tax rates on commercial-industrial property more even throughout the metropolitan area so that new development would be less influenced by tax considerations in deciding where to locate.

E. Complexity -- In the name of "simplification", some suggestions have been made to exempt certain units of government from base sharing. For example, the suggestion has been made to exempt watershed districts, because their taxing level is so small as to be insignificant from base-sharing standpoint. Others have urged that school districts be made exempt because the school aid formula has accomplished most of the equalization. Still others have urged that cities be exempt because city governments need all the revenue from commercial-industrial tax base located within their borders to provide the services such tax base requires.

Several responses to such criticism can be made. First, it undoubtedly would become more complex -- and alost impossible to understand -- if the definition of taxable value is not the same for all taxing units. Second, base-sharing operates independently of units of government. In a legal sense, although not in a physical sense, base-sharing moves parts of commercial-industrial buildings from one location to another in the metropolitan area. After this juggling has been accomplished, the taxing units impose their levies, whereever they happen to be.

It is true that a significant amount of school district equalization has occurred through the school aid formula, but the formula does not cover a substantial amount of other school aid costs, such as capital outlay and debt retirement.

It is also true that city governments have costs associated with serving new developments. But it is rare that these costs begin to approach the amount of new revenue generated by such developments.

From the Reader of the Conference on Alternative State & Local Public Policies held June 10-13, 1976 in Austin, Texas. The reader was edited and compiled by Derek Shearer, California Public Policy Center Los Angeles, California and Lee Webb, Professor of Public Policy, Goddard College Plainfield, Vermont.