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REVISED
MEMORANDUM

SUBJECT: Metropolitan tax-base sharing (fiscal disparities) and tax-increment financing in development districts.

Background--The metropolitan tax-base sharing law, also known as the fiscal disparities law, requires that every municipality in the metropolitan area contribute to the regional fiscal disparities pool of valuations an amount equal to 40% of the net growth in commercial-industrial valuation over 1971, including amounts attributable to growth in valuation in a development district. The contribution is made in such a manner that all commercial-industrial properties make the same percentage contribution, irrespective of the amount of growth or decline that occurred on a given parcel. That contribution percentage is known as the "contribution ratio." The contribution ratio always will be less than 40%. The ratio currently averages about 9% among all municipalities in the metropolitan area.

The tax-increment financing law as applied to development districts in the metropolitan area, and as interpreted by the Commissioner of Revenue, permits 60% of the growth in valuation in a development district to be "captured" for purposes of paying the governmental expenses of the development district. The remaining 40% becomes part of the local tax base. The placement of the 40% in the local tax base is intended to replenish the local tax base for an equivalent contribution from the local tax base to the metropolitan pool of valuations on behalf of the growth which has occurred in the development district.

The effect of present requirements is to give a development district in the metropolitan area the opportunity to utilize 60% of the increment, in contrast to outstate development districts which have access to 100% of the increment.

From the viewpoint of the large, older cities in the metropolitan area, it is desirable that the tax-base sharing program be maintained and that redevelopment be allowed to proceed on an equitable basis.

The Citizens League adopted a statement two years ago which points out that the two programs can be made fully compatible. That is, the municipality can continue to make a full contribution of 40% of its net commercial-industrial growth to the regional tax-base sharing pool and, assuming a change in law or ruling by the Commissioner of Revenue, all the growth in a development district could be captured for tax-incrment purposes. The compatibility of the two laws can be seen once it is understood that the tax-base sharing program doesn't deal with growth of specific parcels of property but with growth in the municipality as a whole. On the other hand, the development district is financed from the taxes paid by specific parcels within the district.

Current issues involving the Minneapolis City Center development district--A central question is whether the project will generate sufficient revenues so that

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taxpayers of the city will not be required to pay higher taxes because of the project. There are two types of answers to this question, both operating under different assumptions: (1) One group of people including some members of the Minneapolis City Council and its financial consultants, contend higher taxes will not be required. The consultants estimate that the growth in valuation in City Center will far exceed original projections, so that the expenses will be met by capturing only 60% of the growth. They also argue that taking their original projections of growth, a tax levy would be required, but this tax levy would not represent a tax increase to the citizens of Minneapolis They cite two reasons why the tax levy would not be a net tax increase. First, they argue that the mill rates for city, school and county purposes are reduced because the remaining 40% which is not captured for tax-increment purposes enters the local tax base. Second, they argue that while Minneapolis must make a contribution to the regional pool of valuations, the city receives considerably more back from the pool than it contributes. That means the city's tax rate is lower than it otherwise would be because the city is a "winner" in the disparities pool.

(2) A second group of people, including Thomas Fulton, director of the Minneapolis-St. Paul Study for the State Planning Agency, and Jay Kiedrowski, the mayor's budget director, city of Minneapolis, argue that taxpayers of Minneapolis will be required to pay $25 million to $30 million more over the life of the bonds for the tax increment project. In their calculations they assume that the City Center project would not have occurred if it weren't for the tax-increment plan. To illustrate their point, let's assume that the growth in City Center is $100 million in assessed valuation (which actually would have to be $232 million in market value). <u>Of that $100 million, $60 million (or 60%) is "captured" for</u> purposes of financing the development district. The remaining $40 million (or 40%) is made a part of the local tax base which, in effect, replenishes the city's tax base for its required contribution to the regional pool of $40 million. Minneapolis then receives its share of the regional pool, which, under the current formula of apportionment is approximately one-fifth of the total. Thus it receives back about one-fifth of the $40 million it contributed, or about $8 million. (Persons who argue from this perspective say that it is irrelevant for purposes of the analysis to point out that Minneapolis receives one-fifth of everyone else's contribution, too.) This group of people, therefore, states that the City Center project will enrich the city's tax base by only $8 million during the period of paying off the bonds. If, as consultants have projected, a tax levy is required for the project, that tax levy won't be offset by a growth of only $8 million in valuation. Thus, these people claim a tax increase will be required.

<u>Issues involved in possible changes in state law</u>--Broadly speaking, the issue of change in state law relates to fundamental assumptions about what is a viable finance plan for a development district in the metropolitan area. Some persons contend that henceforth all development districts in the area should be planned on the assumption that only 60% of the increment in taxes will be available to pay the public's expenses in a development district. Under this approach, if it can't be demonstrated that the project will be viable with 60% of the increment, then the project shouldn't proceed. Supporters of this position contend no change in state law is needed, but they acknowledge that a change in attitude toward the financing of development districts would be needed. Cities in the metropolitan area would have to plan their development districts in such a way that only 60% of the increment ever will be available. This kind of thinking has not been widely present to date.

Another group of people contend that development districts should be planned on the assumption that an amount equal to or close to the entire increment tax dollars, not just 60%, should be available to pay for development district expenses. Persons who urge that the full increment be available claim that development districts just won't work out financially any other way. Four options are present to make such a change:

Option 1. **Make no change in state law, but plan for a special tax levy**--Under this approach, only 60% of the increment in taxes will be available to pay for the expenses of the project. But the city would levy an additional tax to raise the dollars that would have been available if 100% of the increment were utilized for the development district.

Option 2. Exempt development districts from coverage under the tax-base sharing law--If this happened a city would not be required to make a contribution to the regional pool of valuations on behalf of growth occurring in development districts. However, cities might opt to "shelter" new commercial-industrial growth from coverage under the tax-base sharing law by placing the growth in development districts, even if there were no need for such districts in a given area. The effect would be to restrict the overall size of the tax-base sharing pool, thereby reducing the amount which cities would receive in return. As a matter of fact, the metropolitan pool will total $258 million in valuation for taxes payable in 1979, up from $200 million in 1978.

Option 3. Allow development districts to capture all of the increment except the contribution ratio percentage--This approach was under serious consideration in 1978 Legislature. It was part of a conference committee report which, because of other controversies, did not become law. The conference committee approach would retain the requirement that every metropolitan area municipality make a contribution to the regional pool of valuations equal to 40% of the net growth in commercial-industrial valuation over 1971, including growth in tax increment districts. But within the development district itself, all growth could be "captured" for tax-increment purposes, except the contribution ratio percentage. In the case of Minneapolis, this means that for the next several years, more than 95% of the growth could be used for the development district.

This approach makes the economic "rules of the game" for development districts in the metropolitan area more on par with those of the rest of the state.

The approach makes only a slight change in the overall tax burden, although it substantially reduces the potential of needing a special levy. (What happens is that the mill rates of city, school, county and other districts are increased slightly because the tax base is smaller.)

This approach makes it possible for a small portion of the burden to be shared with taxpayers in other jurisdictions. Moreover, because it involves a reduction in the size of the tax base, it does not follow automatically that the same number of dollars would be levied. It is possible that fewer dollars would be levied.

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Finally, this approach has the effect of enlarging the contribution ratio percentage. This means a higher proportion of the value of commercial-industrial valuation will bear the areawide mill rate which, in the case of Minneapolis and St. Paul, is lower than the local mill rate. Thus, a large contribution ratio in communities with above-average local mill rates is beneficial to commercial-industrial taxpayers.

Option 4. Allow development districts to capture the entire increment--This approach is incorporated in a draft of a bill now being considered by the Minnesota League of Cities/NAHRO Task Force. It is a slight variation of Option 3. It, too, would retain the requirement that every municipality make a full contribution to the regional pool of valuations equal to 40% of the net growth in commercial-industrial valuation over 1971, including growth in development districts. However, under this option all metropolitan cities would be treated alike. All could capture 100%. Under the contribution ratio approach in Option 3, the amount that can be captured varies as the contribution ratio varies from city to city. Option 4 would place development districts in the metropolitan area fully on part with those in outstate Minnesota. Both could capture 100%.