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APPROVED: Board of Directors
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TO: Members, Board of Directors

FROM: Tax & Finance Task Force, Earl F. Colborn, Jr., Chairman

SUBJECT: Statement on regional financing

STATEMENT OF THE PROBLEM

A. Some early-warning signs indicate growing difficulties for the Legislature in solving fiscal problems affecting primarily the Twin Cities metropolitan area.

1. The problem of the property tax is most acute here -- Property tax relief programs financed by the Legislature apply statewide, but property taxes are particularly high in the metropolitan area. Only one-fourth of homesteads outside the seven-county metropolitan area paid more than $397 in net homestead taxes in 1978, compared with three-fourths of the metropolitan area homesteads at this level. It is likely that the Legislature will continue to receive considerable pressure for statewide action for property tax relief, primarily because of higher taxes prevailing in the Twin Cities metropolitan area.

Some of the reasons for lower property taxes outside the Twin Cities area are: (a) lower salary and service levels in some locations, (b) an agricultural mill rate credit, (c) a 1 per cent piggy-back sales tax imposed exclusively by the city of Duluth, and (d) a special homestead credit available on the Iron Range, financed by state taconite taxes.

2. The question of what is "local" adds to the problem of financing redevelopment here -- A degree of local effort in providing the necessary financing is a common ingredient in any redevelopment project. The terms "municipal" and "local" have been used interchangeably. This is usually appropriate when the municipal border encompasses essentially the entire urban area, such as in Rochester or Moorhead. But the situation is different in the Twin Cities metropolitan area, where the locations which are in acute need of redevelopment are located in municipalities covering only a small portion of the entire urban area. The municipalities of Minneapolis and St. Paul have been thought to be responsible for the "local" financial support for redevelopment of the Metropolitan Centers (the downtowns and the immediate surrounding area). But the revenues which the central cities commit to redevelopment cut into the revenues which otherwise would help pay for growing operating expenses. Thus, the central cities seek higher levels of state aid for the operating expenses of city government, which, in turn, has produced considerable controversy because of generally higher staffing and salary levels in these cities. Such a peculiar definition of "local" for purposes of redevelopment would not likely be adopted elsewhere in the state. It is difficult to imagine that only the inner city portion of a Rochester or a Moorhead would be called on to provide the local financing for redevelopment of their central areas.

Three years ago, the Citizens League recommended a direct aid program to help pay for major redevelopment projects in the metropolitan area. In that statement the League pledged to continue to work on this issue, with particular emphasis on finding a revenue source for major redevelopment financing in the Twin Cities area, and for other areawide services, which is the reason for this new statement.

3. The 1979 Legislature is being asked to provide additional financing for regional services -- The Metropolitan Transit Commission is seeking a $5 million increase in funding from the Legislature for the next two years to help cover an anticipated deficit. In a separate transit request, the Legislature is being asked to authorize $9 million in capital funds plus about $500,000 annually in operating assistance for a proposed fixed-guideway people-mover in downtown St. Paul. The Metropolitan Parks and Open Space Commission is asking for another $27 million to acquire and develop more metropolitan parks. In the future, the Commission may seek funds for operation and maintenance of these parks.

4. It is likely more proposals related to regional services in the Twin Cities area will be presented to the Legislature in future years -- Two possibilities are metropolitan solid waste disposal and metropolitan airports. Efforts have begun both in Hennepin and Ramsey Counties to build multi-million-dollar plants that would help recover the usable value from solid waste. It is too early to know exactly what kind of action the Legislature will be asked to take. With airports, the issue may relate to how to pay for expansion of smaller airports around the Twin Cities area, since user charges are likely to be sufficient to pay for major expansion planned at Twin Cities International Airport. It is less certain that airlines will pay the user charges needed to help expand smaller airports which, if not utilized more, will produce serious overcrowding at the main airport.

5. Use of the state general revenue fund for regional services in the metropolitan area has some real limitations -- As needs for metropolitan transit and park funds have increased, the Legislature has begun to appropriate dollars from the state general revenue fund for these purposes. This has been largely a satisfactory arrangement so far. Transit and parks funding in the metropolitan area have "balanced" certain transportation and state parks funding in the non-metropolitan parts of the state. Consequently, all parts of the state have received shares from the state general revenue fund. But needs are continuing to grow for financing of regional services in the metropolitan area. It is not likely that the nature of these needs nor their level will necessarily have counterparts in the non-metropolitan parts of the state. The Legislature should be protected from a situation in which the financing of a need in one part of the state results in comparable expenditures automatically elsewhere in the state, strictly for "balancing" purposes. A risk exists that the present system would require more money be spent in total than actually is needed.

6. Absence of a general fund for regional services requires a function-by-function approach -- To date, the Legislature has acted on regional functions largely separate from each other. What this means is that priorities on spending really aren't established by weighing the relative value of one regional function against another. It also is difficult to determine the total dollars being spent on regional services in the Twin Cities area, because expenditures are not assembled in one place on a regular basis. In 1972,

the Citizens League, in a report on metropolitan public improvements, first recommended that the Metropolitan Council should propose to the Legislature an integrated request for financing authority on behalf of the region, both as to dollar totals and funding sources. No action has been taken on that proposal.

A total of approximately 2 3/4 mills is being levied in the Twin Cities metropolitan area for taxes payable in 1979 for regional services, raising a total of about $22 million. The money is used: (a) to help pay operating expenses of the MTC (1.742 mills); (b) to pay principal and interest on MTC bonds (.365 mills) and some regional park bonds (.069 mills; (c) to help pay the operating expenses of the Metropolitan Council (.339 mills); and (d) to pay the operating expenses of the Metropolitan Mosquito Control District (.195 mills). The precise millage will vary slightly from county to county because of tax equalization. The mills used here are those which apply in Minneapolis. Each of these millage authorizations is set independently of the others. Funds may not be shifted among the functions. Separate appropriations from the state general revenue fund also are provided for the MTC and for regional parks. As this statement was being prepared, the Legislature repealed another funding source for a regional service in the Twin Cities metropolitan area: a controversial 2% on-sale liquor tax intended to provide the Metropolitan Sports Facilities Commission with back-up financing for a new sports stadium. In 1978 the tax raised $4 million.

B. <u>An opportunity is present, in 1979, for the Legislature to take significant action on these problems</u>.

1. <u>As in 1971, when other future problems were anticipated, several changes are being contemplated this year</u> -- In 1971 the Legislature took several steps which had the effect of anticipating difficulties which might otherwise have led to a major property tax revolt in Minnesota. In that year the Legislature significantly rearranged the formulas which provide state aid to cities and schools, and increased the amount of aid distributed through these formulas. It imposed strict limits on local property tax increases and prohibited municipal sales and income taxes. It passed a law providing for partial sharing of the growth in metropolitan area commercial-industrial property tax base. Finally, it increased two major state taxes, sales and income, to accomplish a significant decrease in local property taxes.

Similarly, today, in 1979, the Legislature is contemplating significant restructuring and reduction of state income taxes. It is evaluating possible ways to reduce local property taxes. It is considering major modifications in the formulas which aid cities and schools. The time is, therefore, particularly appropriate to make some adjustments in financing of regional services in the Twin Cities area to avoid more serious difficulties in coming years.

2. <u>Much of the concern in the 1979 Legislature is related to problems in the Twin Cities area</u> -- A significant portion of the property tax problem is centered here. The Legislature must decide on state appropriations for regional functions here. It is here, in the Twin Cities area, that the problem of defining local effort for financing redevelopment is most difficult. Unquestionably, the most controversial -- but not the biggest in dollars -- regional financing question concerns a back-up tax for the Metropolitan Sports Facilities Commission. There now is no regional financing context into which such an issue can be placed. In such a context, it is not difficult to see the controversy over an on-sale liquor tax imposed in 1977. Nor is it surprising to see such alternatives being proposed as a liquor tax that would "blink" on and off in different parts of the metropolitan area, depending upon the need for revenue.

<u>C. The Legislature should now move to unify the budgeting of regional services in the metropolitan area and adopt a general regional tax to help finance them</u> -- We suggest here a way which (a) does not diminish the Legislature's role in controlling the financing of regional functions, (b) does not rely on property taxes, (c) develops the concept of a general budget for regional services without changing the structure of regional agencies, and (d) includes a significant role for the Metropolitan Council, the governmental agency which represents all of the areawide interests of the people of the metropolitan area.

1. The Legislature would instruct the Metropolitan Council to present annually or biennially a comprehensive advisory proposal which includes (a) a consolidated report on proposed capital and operating budgets of regional functions and services, disclosing all revenues and expenditures from whatever sources; (b) recommendations on whatever legislative action would be required to raise the revenue necessary to finance these budgets; and (c) recommendations on all other regional revenue needs that the Council feels are necessary, including such functions as financing the redevelopment of the Metropolitan Centers and financing property tax relief.

The advisory proposal would include the budgets of the Metropolitan Transit Commission, Metropolitan Parks and Open Space Commission, Metropolitan Waste Control Commission, Metropolitan Airports Commission, Metropolitan Sports Facilities Commission, and the Metropolitan Mosquite Control District.

The Legislature should instruct the Metropolitan Council to prepare such an advisory proposal regardless of the arrangement the Legislature adopts for financing regional functions and services -- including a refusal to change the current way.

The Legislature would act on the Council's proposal -- deciding which needs are regional and what level of financing is appropriate for these needs. Financing for these regional functions and services would come from two sources: (a) The current dollar level of funds going into metropolitan services from the state general revenue fund would be maintained. We do not see any compelling reason for the Legislature to withdraw or reduce the present dollar amount. (b) Additional revenues necessary to finance regional functions and services would come from a general tax imposed in the metropolitan region only.

2. The Legislature should adopt a fraction-of-a-penny increase in the state sales tax to be imposed only in the metropolitan area. Receipts should be placed in a special tax account to keep them separate from other state tax receipts. The Legislature would determine the appropriations from the special account. A ½-cent increase in the metropolitan area would raise about $40 million annually over the next biennium, based on current projections of sales tax revenue during that period.

3. The revenue from a metropolitan sales tax could be used as follows:

- To replace current metropolitan-wide tax levies, which could be as high as $22 million, if all metropolitan-wide property tax levies were replaced with revenue from a metropolitan sales tax. This would provide property tax relief throughout the metropolitan area and help reduce the difference between metropolitan and outstate property tax levies.

- To finance incremental increases in expenses of regional functions, such as transit.

- To help pay for major public capital projects and major publicly-assisted private redevelopment projects in the metropolitan area.

4. Non-metropolitan regions also may have need for revenues to finance increases in existing regional functions and services and in new regional functions and services. The Legislature maintains the power to determine which needs should be financed by a regional tax and which needs, because they are clearly statewide or reflect a problem in ability to pay, should be financed through state general revenues. However, in no instance should the incremental expenditures for a particular function be financed through a regional tax in one region and through state general revenues for other regions.

DISCUSSION OF RECOMMENDATIONS

A. The Legislature has several precedents for taking action addressed to the particular financing needs of certain areas.

1. Homeowners on the Iron Range receive an extra homestead credit, based on the sharing of taconite taxes -- A portion of taconite production tax receipts is used to provide a taconite homestead credit of up to $350 to homesteads in certain Iron Range areas. This credit is deducted before a statewide homestead credit, paid for from state general revenues, is applied.

2. An extra 1 per cent sales tax is imposed by the city of Duluth -- In 1969 the Legislature gave Duluth permission to levy a 1 per cent piggy-back sales tax, with the revenues used for city government purposes. In effect, the revenues from this tax enable Duluth to finance services that otherwise would be paid for from higher property taxes. In 1971 the Duluth tax was 'grandfathered' in when a prohibition on further municipal sales or income taxes was imposed.

3. The Twin Cities area has been treated as a unit in a statewide municipal aid formula -- For the past eight years the state municipal aid formula has recognized the existence of the Twin Cities area as a single unit for purposes of distribution of aids. In the 80 non-metropolitan counties, aid is first apportioned to each county area on a population basis. It then is distributed among the cities and townships in each county by formula. The seven metropolitan counties are treated as one county, in effect, for purposes of the aid formula. A per capita distribution is made to the metropolitan area. Then that amount is distributed among the cities and townships in the metropolitan area as if they all were part of the same county.

As noted earlier in this statement, several special taxes for regional services have been adopted by the Legislature for the metropolitan area.

B. The need now is for the Legislature to treat the Twin Cities area as a community and to get the area's fiscal house in order for regional services -- It is important that we not be misunderstood. The metropolitan area is needed to help pay its share -- based on the resources located here -- of those services which are statewide in character. This should be continued irrespective of whether the metropolitan area happens to raise more money than actually is spent on services delivered here. A statewide funding approach for statewide services inevitably requires that some parts of the state will contribute proportionately more than others.

But our concern in this statement goes to those problems which are essentially confined to the metropolitan area.

C. The Legislature can attack problems in the metropolitan area without disruption of its present decision-making framework, and use the Metropolitan Council for the purpose for which it was created in the first place.

1. Five options were available for us to consider:

-- Maintain the status quo, with the Legislature continuing to establish the revenue/expenditure policy for each regional function, independent of the other.

-- Maintain the status quo, with one modification, that the Metropolitan Council make an annual or biennial proposal to the Legislature.

-- Unify revenue/expenditure policy for regional services by providing that the Legislature impose a regional non-property tax, that the Legislature decide the appropriation of the funds from the revenues from this tax, and that the Metropolitan Council make an annual or biennial proposal to the Legislature.

-- Provide that the Legislature would impose the regional tax but that the Metropolitan Council decide on how to apportion the revenues.

-- Provide that the Metropolitan Council be given authority to levy the tax and apportion the revenues.

2. We rejected options that would give the Metropolitan Council revenue-raising or revenue-distribution authority -- Either of the last two options above would have the effect of shifting from the Legislature to the Council authority over revenues and/or expenditures. The strongest reason against considering such a step is that the Council is non-elective. However, we would not necessarily make a recommendation that the Council be given revenue-raising authority even if it were elective. The Legislature must remain in central control of the overall tax picture. It is possible we might support giving the Council authority over apportioning revenues if it were elected.

3. We also rejected options that would not correct for the fragmentation of the present system -- The first option, of course, would make no change in the present system. The second option would only provide that the Council make a proposal. The Legislature would continue to make revenue/expenditure decisions on each regional service separate from the other.

4. Our preferred option is the middle ground -- The third option above keeps the Legislature in the central role of raising revenue and making appropriations. It makes it possible for the Legislature to unify the system through a general regional tax. It provides a role for the Metropolitan Council to make proposals to the Legislature, which is what the Council was created to do in the first place -- to help the Legislature with decisions that must be made in the metropolitan area.

D. The Metropolitan Council is beginning to show increased interest in the financial problems of the metropolitan area -- Its recently-adopted Investment Framework document is designed to develop better understanding of the total overlapping governmental debt of the region. A special Fully-Developed Areas Task Force of the Metropolitan Council recommended a reinvestment fund to assist in redevelopment of older areas. Most recently, a renewed interest in tax and finance matters has been pledged by Charles Weaver, new chairman of the Metropolitan Council. This interest also is reflected in other new appointees to the Council.

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1. *What is the urgency for a regional tax now?* To help the Legislature with some of its most vexing problems of financing services. Four major issues in front of the 1979 Legislature could be addressed by this proposal: the problem of the metropolitan liquor tax, the financing for the downtown people mover, metropolitan property tax relief, and financing of major redevelopment projects. And, in the process, the Legislature can bring some rationality to the system of financing services in the metropolitan area.

2. *Why the sales tax?* We want a general, non-property source of revenue, and we feel a sales tax is preferable to an income tax surcharge for financing the services outlined in this statement. The income tax is more difficult to administer on a sub-state basis, because of the problems such as whether to tax income based on location of residence or location of employment. Also, we are aware of considerable concern over the overall level of the income tax in Minnesota today. By contrast, Minnesota ranks among the nation's lowest in sales tax collections. Finally, the Duluth sales tax provides some precedent for use of this source on a sub-state basis.

   We want to make it clear, however, that our proposal in no way supersedes our long-standing opposition to municipal sales or income taxes in the Twin Cities area. Areawide imposition of such taxes overcomes the negative impact on development and equity which would exist if municipalities in the area were to capture revenues from sales or incomes within their own borders.

   A ½-cent increase in the state sales tax would generate about $40 million a year in the metropolitan area. A 7 per cent surcharge on state individual income tax collections in the metropolitan area would raise approximately the same amount.

3. *Wouldn't taxes be lower if the regional tax were not imposed?* No. The questions we are facing in this report concern how to pay for functions the Legislature determines should be financed. We believe the greater reliance on regional sources for regional functions, combined with a system which enables priorities to be set more rationally among competing functions, will mean fewer dollars will be spent than if no change were made.

4. *Will this change encourage people to move outside the metropolitan area?* No. Property taxes have been higher in the metropolitan area than outstate. This proposal would reduce those differences. We doubt the sales tax has anywhere near the impact on people's choices of where to live as the property tax does, and certainly not at the levels of difference envisioned in this report.

5. *Won't non-metropolitan area residents have to pay extra for purchase of taxable items in the metropolitan area?* For some purchases, yes. If so, this could encourage them to do more of their shopping at home. The law could provide that non-metropolitan area residents of the state could be exempt from the higher tax for major purchases, such as a car, where proof of residence is obtainable. Groceries and clothing are exempt from the state sales tax and also would be exempt from a metropolitan piggy-back tax.

6. *Doesn't the proposal undercut efforts to give the metropolitan area a fair share of state general revenues?* No. According to our proposal, the existing commitment of state general revenues for metropolitan transit and metropolitan

parks would continue at present levels and not be reduced or eliminated. Legislators recognize that such financing continues to be necessary to assure equitable treatment of all parts of the state for essential programs of transportation and recreation/open space. But, as the need for financing grows for regional services largely confined to the metropolitan area, we think the area itself -- not state general revenues -- should be the first source of providing such additional financing. As a result, statewide taxes can be lower than if the state general revenues were used, because less statewide spending would be required.