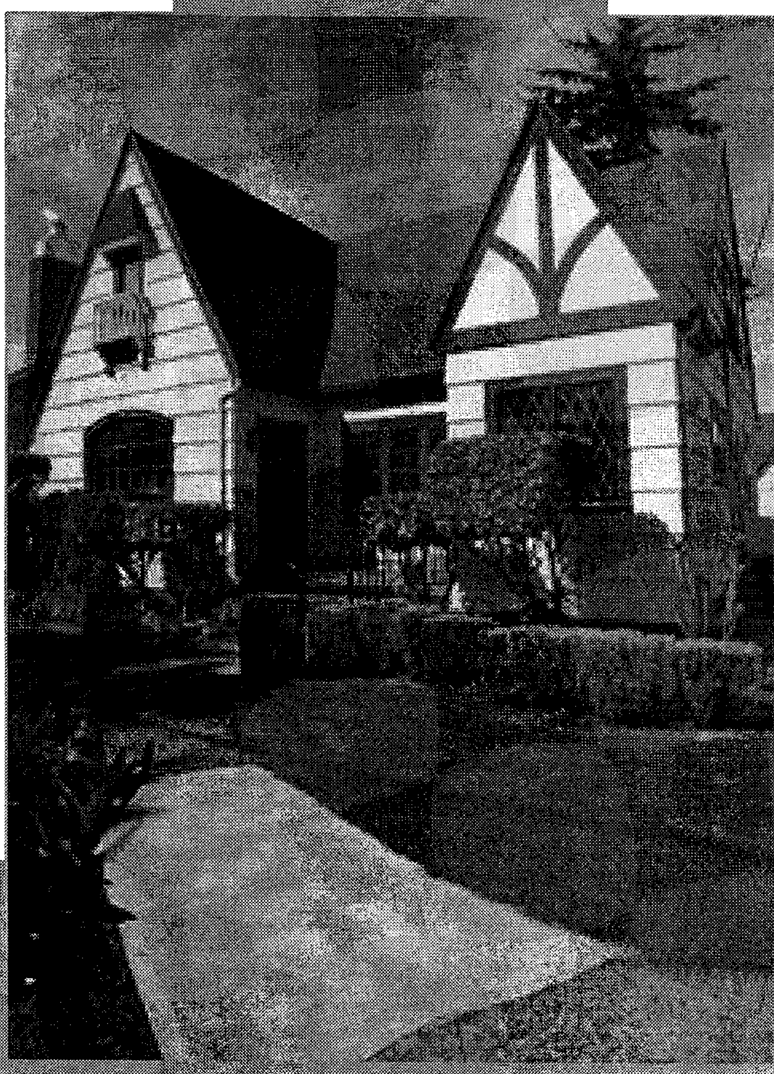
Assessing Minnesota's Property Tax:
Ensuring Affordability for Homeowners



A report

to the

Minnesota Department of Revenue

by

THE CITIZENS LEAGUE

Property Tax Study Committee

August 2000

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A Citizens League Research Report
Prepared for the Minnesota Department of Revenue

Assessing Minnesota's Property Tax:
Improving Affordability for Homeowners

A final report by the Citizens League
Property Tax Study Committee

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Executive Summary

In fiscal year 2000, local governments in the state of Minnesota were expected to collect $4.6 billion dollars in property tax revenue. This accounts for 26.2% of all state and local tax revenue, making the property tax the second largest source of public funds. Revenue from the property tax is used by cities, counties, townships, school districts, and numerous special taxing jurisdictions to fund local services such as police and fire protection, road and bridge maintenance, various health and human services programs, and K-12 public education.

Despite its important role, Minnesota's property tax is extremely complicated and heavily criticized. Its critics argue that property wealth has nothing to do with a person's ability-to-pay taxes and that market value changes, which are beyond the owner's control, are unfairly driving up property tax bills.

As part of a larger tax reform effort being conducted by the Minnesota Department of Revenue, this Citizens League report examines the issues of rising market values yielding higher property tax bills and what can be done to address property tax affordability for owners of homestead and seasonal recreational properties whose tax bills exceed their ability-to-pay. The report also considers Minnesota's assessment methods and appeals process.

Market Values and Property Taxes

The market values of homestead and seasonal recreational property have been rising rapidly in recent years. But property taxes are not rising at anywhere near the same pace. For taxes payable in 2000, property taxes increased by just 3.3 percent for homesteads, while market values increased by 9.5 percent. Furthermore, taxes on seasonal recreational property were projected to decline by 1.4 percent, while market value grew by 11.9 percent.

Based on these and other findings, the report concludes that:

• The problem of market value increases driving property tax bills beyond an owner's ability-to-pay is not widespread (or well-documented) enough to warrant either broad reform or a complete overhaul of the existing system.

In fact, increasing market values do not automatically yield higher property tax bills — increased local spending and the shifting of property tax burdens from one type of taxpayer to another yield higher property taxes.

• Additional targeted relief is needed for those individuals whose property tax bills consume an excessive percent of their income.

Currently, only 10 percent of the state's property tax relief is targeted to those most in need of assistance. At the same time, 14.5 percent of Minnesota homeowners pay more than 5 percent of their income in property taxes. This is more than twice the statewide average of 2.3 percent of income.

• There are many problems with policies that artificially limit market values.

Market value limitations fail to target relief to those most in need of assistance, provide no guarantee that tax bills won't increase as a result of changes in the tax rate, and result in an unfair shifting of tax burdens.

The report's recommendations are based on the idea that if we are going to have a tax based on market value, we should have a tax based on market value. Distorting market values, through the use of limited market values provisions, unfairly shifts the tax burden and only makes the system more complex. The committee felt strongly that property tax relief should be targeted directly to those low and moderate income taxpayers whose property tax bills consume an excessive percent of their income.

Therefore, the report's recommendations include:

• Eliminating the cap on property tax refunds for homeowners.

This is the best way to reduce the number of taxpayers devoting more than 5 percent of their income to property taxes. For most income ranges, the maximum refund amount currently stands at $500, and approximately 34% of refund recipients are bumping up against this ceiling. Eliminating the cap on refund amounts will increase the cost of the program by approximately $43.3 million, from $78.8 to $122.1 million annually. In return, the average percent of income devoted to property taxes will fall below five percent for all income categories, with the most significant benefit befalling homeowners with incomes under $10,000.

• Allowing the current limited market value law to sunset, as scheduled, and not enacting any other limited market value provisions.

• Opening the property tax deferral program up to homestead property owners of all ages, while eliminating the additional property tax refund.

Assessment Practices and the Appeals Process

The fact that local governments are using assessed values to raise $4.6 billion from Minnesota taxpayers makes accurate and uniform assessments crucial to a fair tax.

The fact that the property tax is the only tax that both starts and ends with government, with property owners being told what the value of their property is, then what the tax rate will be and finally what their tax bill equals, makes taxpayer confidence in those assessments equally important.

While there is no "smoking gun" to point to, the report highlights several findings that result in a strongly shared concern that Minnesota's property assessments are lacking the uniformity and consistency that is crucial to a fair system. Statistical tools used by the Minnesota Department of Revenue to measure the accuracy and uniformity of assessments suggest a disturbing lack of uniformity in residential assessments. In 1999, 23 counties fell into the unacceptable range on the uniformity measure, as did 25 in 1998.

Responsibility for ensuring quality assessments, and thereby fair taxation, lies jointly with the Minnesota Legislature, the Department of Revenue, local assessors and local officeholders. Each of these entities needs to carry-out their responsibilities through a more open and regular review of assessment practices and outcomes.

In order to do this, the report recommends that:

- **The Legislature conduct formal, biennial reviews of the state's assessment practices and outcomes; and that**

- **The Department of Revenue step-up its oversight of local assessment practices and outcomes, with a specific focus on improving the uniformity of assessments.**

The report also recommends:

- **More thorough collection of data related to property tax appeals.**

Currently there is no tracking of appeals by property type or value, area of the state or division of Tax Court — information that would provide valuable insight into taxpayer confidence and early identification of potential problems.

- **Use of existing data to develop a performance measurement system for individual assessors applying to renew their licenses.**

This will ensure that assessors have not only sat through several hours of continuing education, but are actually producing assessments that meet the state's standards for both accuracy and fairness.

- **Increased use of independent citizen boards of review and equalization.**

Cities and counties currently have the option of appointing such boards, but few do. This is an important step that local jurisdictions can take to improve taxpayer confidence in the property tax, while clearly establishing appeals hearings as an independent judicial function, rather than a political one.

Summary

In the end, the report clearly points to generous and targeted tax refunds, based on the percent of income consumed by property taxes, as the best policy for addressing tax affordability. It is equally clear in its rejection of policies, such as limited market value, that distort the market value base.

However, this is not to be interpreted as a resounding endorsement of the market value tax. It more accurately reflects a desire to focus on true relief, rather than shifting, and the current lack of well-developed alternatives that would improve both the fairness and simplicity of the tax.

Introduction

The property tax is the tax Minnesotans love to hate — and for understandable reasons. It is only paid twice a year, but in large amounts. It is a tax separate from any other transaction and a tax on unrecognized gains. Compare this to the state sales tax which is collected in six cent increments on every day purchases or the income tax which is withheld from regular paychecks before it is ever seen, and it starts to become clear why the property tax is the tax people most often complain about.

One common complaint goes something like this:

> A husband and wife in their 70's have lived in their modest home for more than 30 years. They've worked hard, paid their taxes, raised their family, and kept up their property and have now paid off their mortgage. But the house that they paid $30,000 for in the 1960s, is now worth $200,000 — according to the county assessor. The couple lives off a fixed income, composed primarily of social security and a modest pension, and can no longer afford to pay their escalating property taxes. It's not their fault that their property value has gone up. And they can't get at this so-called "wealth" that the assessor says they have, unless they sell their house - something they don't want to do.

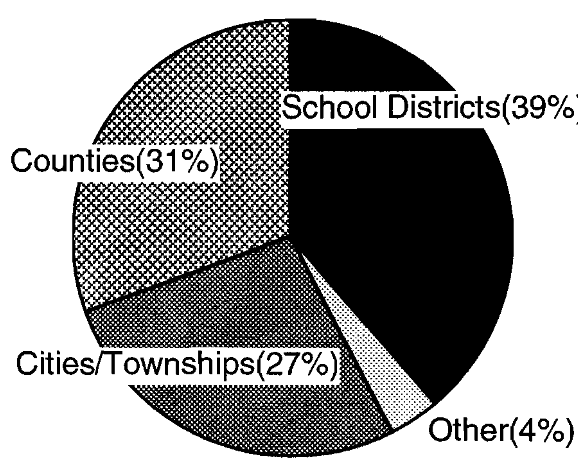
While it is easy to sympathize with the plight of this couple, the issue of escalating property values driving property tax bills beyond the owner's ability-to-pay requires additional investigation.

The Big Picture

For fiscal year 2000, local governments in the state of Minnesota are expected to collect $4.6 billion dollars in property tax revenue. [1] This accounts for 26.2 percent of all state and local tax revenue, making the property tax the second largest source of funds. The individual income tax, which is expected to produce 31 percent of all state and local revenues in FY2000, is the largest source of public funds, while the sales tax, which is expected to produce 21.7 percent, is the third largest.

Of this $4.6 billion collected through the property tax, 39 percent will go to school districts, 31 percent will go to counties, 27 percent will go to cities and townships and the remaining 4 percent will go to special taxing jurisdictions. While the state is heavily involved in structuring the property tax system and administering various refunds and credits, none of the money collected in property taxes is actually spent by the state.

Distribution of Property Tax Revenues



Source: MN Department of Revenue.

[1] Unless otherwise noted, all statistical data in this report was compiled by the Minnesota Dept of Revenue.

Property owners send their tax payments to the county in which they live and the county distributes the appropriate share of each check to the taxpayer's school district, city or township, and special taxing jurisdictions.

Local governments across the state use the revenue collected from property taxes, combined with state aid payments and various fees and charges, to fund local services such as police and fire protection, road and bridge maintenance, various health and human services programs, and K-12 public education. On average, property tax revenues make up 42 percent of county budgets, 33 percent of city/town budgets and 29 percent of school district budgets.[2]

Over the years, Minnesota has come to rely less and less on the property tax, which at the time of statehood was the only tax collected. In 1962, the property tax accounted for 53.6 percent of all state and local revenues, while the income tax (which had been created in 1933) accounted for only 14.5 percent. The sales tax was not imposed until 1967.[3] Today these three sources of revenue — the sales, income and property taxes — are much more balanced, forming what is often referred to as the "three-legged stool."

Overall, Minnesota's property tax ranks 15th in the nation, putting it somewhere in the middle on a regional level, with Wisconsin (7th) and Iowa (13th) ranking higher and South Dakota (18th) and North Dakota (27th) ranking lower. For moderately priced homes worth around $80,000, Minnesota property taxes rank 28th nationally and for homes worth approximately $200,000, Minnesota ranks 19th nationally.

The Task at Hand

As part of a larger tax reform effort, the Minnesota Department of Revenue has contracted with the nonpartisan, nonprofit Citizens League to gather citizen input on the question of:

> *Which policies should Minnesota pursue to best address the issue of property tax affordability among owners of homestead and seasonal recreational properties whose growth in taxes, due to increases in valuation, significantly exceed their ability-to-pay?*

Furthermore, how extensive is the problem? Is it extensive enough to warrant a broad-based policy approach or should a policy (or set of policies) be adopted which targets assistance to those who are most in need? Should different consideration be given to owners of homesteads and owners of recreational property? Additionally, the Department asked for input on the fairness of Minnesota's assessment methods and its current appeals process.

A committee of engaged citizens, working over the course of several months, researched these issues and produced the following findings, conclusions and recommendations, in response to the Department's charge. To answer the specific questions posed by the charge, the committee worked from the assumption that local governments in Minnesota will continue to need to collect approximately the same amount of revenue to fund approximately the same mix of public services for the foreseeable future.

[2] *Report of the Citizens Jury on Property Taxes*, The Jefferson Center August 1999.
[3] John P. James, Resource Testimony to the Citizens League, May 2000.

Section I: Market Values and Property Taxes

Background

There are two primary principles of taxation — the ability-to-pay principle and the benefits-received principle. The first states that taxes should be collected based on a person's ability-to-pay, so that those with a greater economic well-being pay more than those with less economic well-being; and the second states that a person should be taxed in relationship to the value of the benefits they receive from government-funded services.

Economists believe a "good" tax should be equitable (or fair), neutral, visible, simple, and competitive. It should also be administratively efficient and provide a stable and adequate source of revenue. The tax that fully meets all of these criteria has yet to be discovered, but they continue to be used in evaluating both proposed and existing tax policies.

A tax that is fair, or equitable, should have horizontal equity, meaning it taxes similar people similarly, and vertical equity, meaning it taxes different people differently. A good tax should also be neutral, causing as little distortion of people's economic decisions as possible, and visible, so that the taxpayer knows how much they are paying and to what jurisdiction. Without this visibility, taxpayers cannot hold government accountable for taxing and spending decisions. The simplicity criteria is strongly tied to visibility and the idea that taxpayers need to know when they are paying a tax and how much they are paying in order to hold government accountable.

Competitiveness is becoming an increasingly important tax criteria in a time when corporations and individuals can easily cross local, state and even national borders in search of the tax climate most favorable to their needs. Finally, a good tax should be administratively efficient, so that governments don't spend a lot of money to collect money, and it should provide a stable and adequate source of revenue to support ongoing government responsibilities and services.

Minnesota's property tax is often criticized for failing to meet many of these criteria, but the lack of simplicity is probably its most often cited fault. There are numerous classes and tiers, a variety of credits and refunds, a combined county - city - school tax rate that typically exceeds 100%, and it is all based on an estimated market value.

The property tax calculation begins with city and county assessors determining the market value of each parcel of property and then multiplying that market value by the appropriate "class rate." This determines the "tax capacity" of the property, which is then multiplied by the locally-set "tax rate" to determine the actual tax amount owed. In most cases this gross tax is reduced by one or more tax credits, such as the education homestead credit in the case of homesteads, to yield the net tax due.

While different types of property have different "class rates," all properties within a given jurisdiction have the same "tax rate," regardless of the property's use. The tax rate applied to any given property is the sum of the individual tax rates set by the county, city or township, school district and any special taxing jurisdictions that the property sits within.

The Classification System

Perhaps the most often debated component of Minnesota's property tax is the classification system, which groups properties according to use and then controls the percentage of market value that is exposed to taxation. The classification system is set in state law and must be applied to all properties in the state.

There are currently twelve groups or "classes" of property, including residential homestead, residential non-homestead, market-rate apartments, low-income apartments, commercial / industrial, seasonal recreational commercial, seasonal recreational residential, and agricultural. This report will focus solely on property taxes as they relate to two classes — residential homestead (from here on referred to as "homestead") and seasonal recreational residential (from here on referred to as "seasonal recreational").

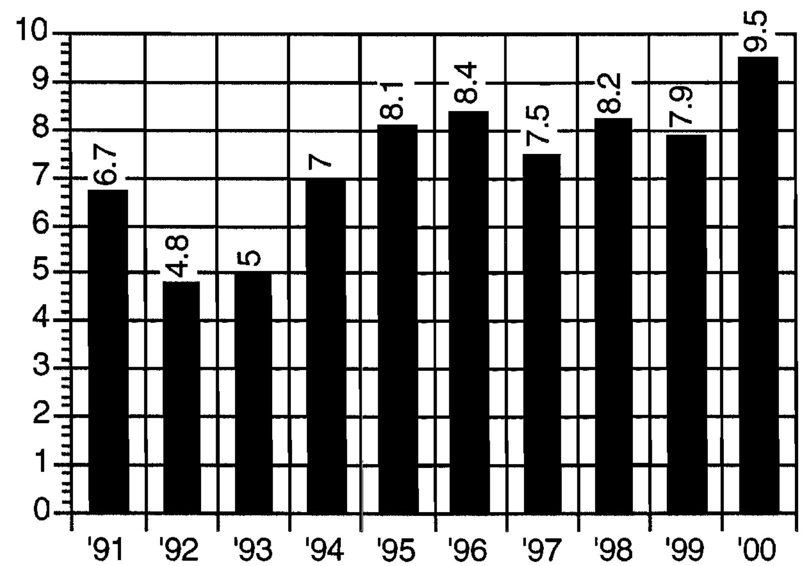
Within each class of property, there are also anywhere from one to three tiers or value groupings. For example, homestead and seasonal recreational property both have two tiers, with one class rate for the market value in the first tier (<$76,000) and a second rate, which is higher, for any market value that falls into the second tier (>$76,000). Currently, homestead property has the lowest class rates, and therefore the smallest percentage of market value exposed to taxation.

For a complete list of current classes, tiers and rates, as well as a sample tax calculation, please see Appendix A.

Findings

1. The market values of homestead and seasonal recreational property have been rising rapidly in recent years.

Table 1: Annual Percent Change in Unlimited Market Value of Homesteads



Source: MN Department of Revenue

Over the last decade, the average annual increase in homestead market values was 7.3 percent, and it hit 9.5 percent for taxes payable in 2000. Meanwhile growth in market value for seasonal recreational property has been even stronger, reaching 11.9 percent for taxes payable in 2000.

Limited Market Value

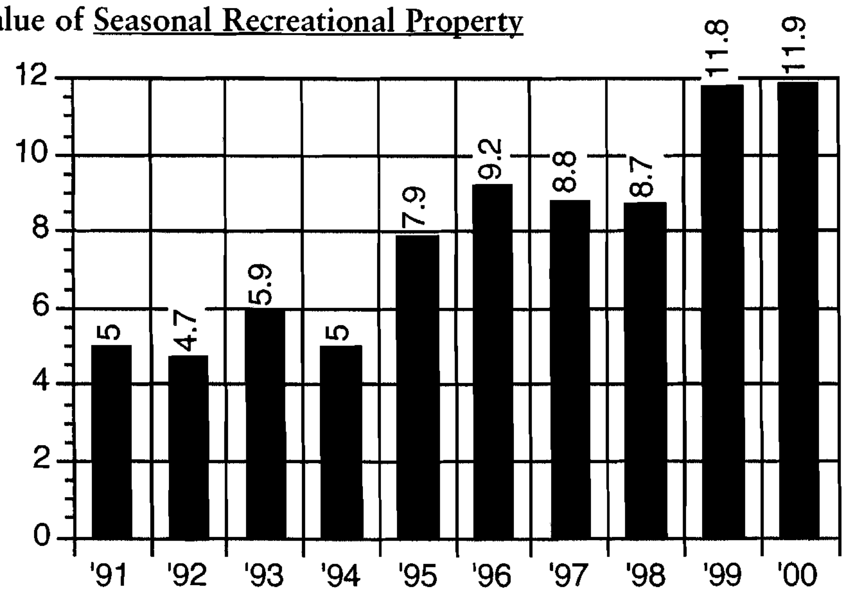
It is important to note, however, that this is growth in unlimited market value and since 1994, state law has limited the amount of market value growth that can be counted for the purpose of property taxes. Up until 1999, taxable market value could increase no more than 10 percent in any one year, but beginning with the taxes payable in 2000, annual growth in taxable market value is limited to 8.5 percent. However, this 8.5 percent limitation applies only to homestead, seasonal recreational and agricultural property and it is scheduled to sunset with taxes payable in 2002.

According to the Department of Revenue, 2 percent of the total market value of homesteads and 10.8 percent of the total market value of seasonal recreational properties are being kept off the tax rolls this year because of the limited market value law. One of the major problems with this is that limiting market values does nothing to limit the amount of money local governments need to raise. Therefore, it results in a shift of the tax burden from those classes of property that qualify for limited market value to those that do not.

Why are market values rising so rapidly?

For many property owners, especially those who have not been in the real estate market for several years, the statement of assessed value that they receive from their local assessor is the most visible indication that their property value is changing. This can often

Table 2: Annual Percent Change in Unlimited Market Value of Seasonal Recreational Property



Source: MN Department of Revenue.

lead to the misperception that their market value is determined by the local assessor, rather than actual market conditions. Furthermore, property owners typically view an increasing market value with the assumption that it will automatically bring higher taxes, even though that is not necessarily the case. Increasing market values do not yield higher property taxes, increases in local government spending and shifting from one type of property to another yield higher property taxes.

At tax time it is also easy for people to forget that increasing market values reflect growth in the value of their investment — which is a good thing.

In reality, there are numerous economic factors leading to rising market values, and they all boil down to the fact that the demand for housing and lakeshore properties is exceeding the supply.

The demand side is being driven largely by the current economic boom, both here in Minnesota and nationally. In addition to realizing significant gains from investments in the stock market, potential homebuyers are experiencing record high levels of employment and rising incomes. Combined with this rising ability-to-pay for a home or the luxury of a cabin on the lake, is the fact that low interest rates are yielding very affordable monthly mortgage payments. And finally, there is the fact that the rental market is extremely tight in both the Twin Cities and Greater Minnesota. Rents are increasing to the point that many people find it cheaper to buy than to rent.

On the supply side, the cost of construction materials is on the rise and construction workers are hard to find. In the case of seasonal recreational property, there is a permanently fixed supply of lakeshore property facing increased demand.

All of these factors are combining to yield the increased market values reflected by local property assessments.

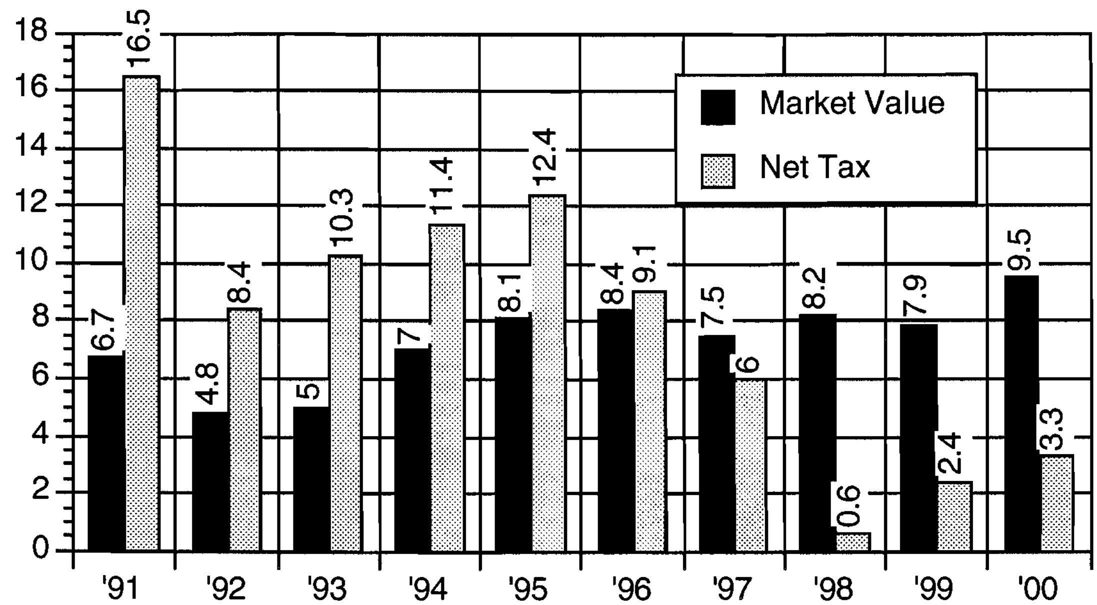
2. Net property taxes on homestead and seasonal recreational property have not increased in lock-step with market values.

Not surprisingly, net property taxes did increase during the 1990's. In 1991, when homestead market values grew by 6.7 percent, net property taxes grew by 16.5 percent. This trend, of net tax growth exceeding market value growth, lasted through 1996, when homestead market values grew by 8.4 percent and net property taxes by 9.1 percent.

But beginning in 1997, the same year that the legislature instituted the Education Homestead Credit, the growth in net taxes dropped off significantly, while market values continued to rise. For the past four years, net property tax growth has been significantly less than the growth in market values.

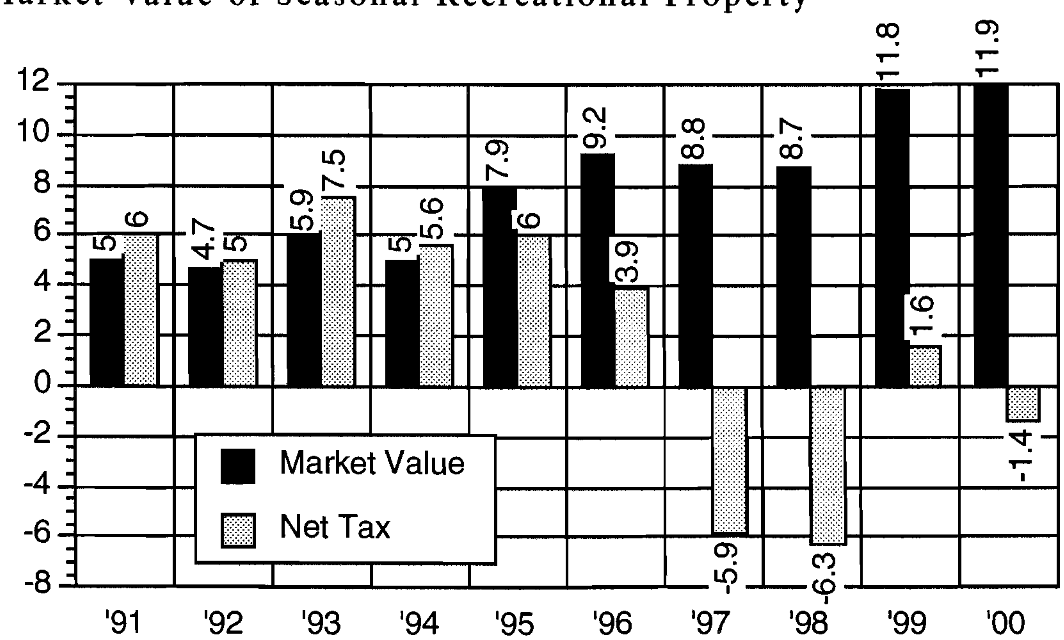
The same is true for seasonal recreational properties, but to an even larger degree. Growth in net taxes only exceeded growth in market values through 1994, and even then by less than 2 percent. Since 1995, market value growth has increased rapidly for properties in this classification, ranging anywhere from 7.9 percent growth in 1995 to 11.9 percent growth in 2000. Meanwhile, growth in net taxes has fallen off to the point that seasonal recreational property owners, as a group, had net tax declines of 5.9 percent in 1997 and 6.3 percent in 1998.

Table 3: Annual Percent Change in Net Tax and Unlimited Market Value of Homesteads



Source: MN Department of Revenue.

Table 4: Annual Percent Change in Net Tax and Unlimited Market Value of Seasonal Recreational Property



Source: MN Department of Revenue.

3. The state currently has a variety of programs in place that are meant to keep property taxes affordable, especially for homeowners.

Minnesota has demonstrated a long-standing political reluctance to allow high homestead property taxes, relative to other types of property taxes. Historically, the legislature has countered any change in the property tax system that threatens homeowners' privileged status with a new benefit or program specifically for homeowners.

For starters, all homestead property owners receive an "education homestead credit," which is automatically deducted from their property tax bill. Under the credit, the state pays 83% of each homestead's general education tax, up to a maximum of $390. This cost the state $396 million for fiscal year 2000.

A second, more targeted relief program is the property tax refund (ptr), or "circuit breaker," which provides assistance to low and moderate-income homeowners and renters whose property tax bills exceed a certain percentage of their income. Homeowners with household incomes of less than $68,510 and renters with household incomes of less than $39,960 can qualify for the refund. However, property owners cannot apply for a refund for taxes paid on seasonal recreational property.

Under the program, once a homeowner's property tax reaches a certain percentage of household income, the state will pay a percentage of the remaining tax. The refund is progressive, with more assistance going to those with lower incomes and relatively higher tax bills. People must apply for this refund at the time they file their income tax returns, and about 90% of eligible homeowners do. Current statistics show that 239,000 homeowners, or 21% of all homesteads, received refunds in fiscal year 2000, costing the state $78 million.

The state also operates a program known as the "additional property tax refund," or "targeting." Only homeowners are eligible for this refund, but there are no income limits. It is designed as a final safety-net for people with homestead property tax increases of more than 12 percent in any one year. The property owner is responsible for paying the first 12 percent in increase, and the state pays 60 percent of the remaining increase. Current cost to the state is approximately $3 million a year.

In an effort to reduce the tax penalty for making improvements to a property, the state also has a program called "This Old House." Under the program, the owner of a house that is at least 45 years old, who completes more than $5,000 in improvements can have those improvements excluded from their market value for ten years and then gradually added in. There are no income limits, but homes valued over $400,000 do not qualify.

The state's newest property tax relief program, which began with taxes payable in 1999, is the "senior property tax deferral." The program is open to people age 65 and over with a household income of less than $60,000, for taxes on their homestead property only. The homeowner must have lived in the house for at least 15 years and cannot have a mortgage on the property of more than 70% of its estimated market value. The property owner then pays no more than 3% of their income in property taxes and the remaining portion of the tax is deferred — but not forgiven. A lien is placed on the property for the amount of the deferred tax, plus 5% interest. This lien must be paid when the house is sold or the owner dies. Participation in this program has been limited, possibly due to the restrictions on who qualifies for a deferral and/or seniors' reluctance to have a lien placed on their property. In its first year of existence, 14 homeowners took advantage of the program, costing the state $70,000 in up front costs, which will eventually be repaid when the liens are settled.

4. Only ten percent of the property tax relief provided to Minnesota homeowners is targeted to people determined to be in need of assistance.

Targeted relief efforts, which include the property tax refund, the additional property tax refund and the senior deferral program, total approximately $81 million, while untargeted relief, which benefits all homeowners, regardless of income, wealth or actual tax bill, exceeds $1 billion. The classification system alone provides homeowners with a subsidy worth $620 million, at the expense of other property owners, and the Education Homestead Credit provides another $396 million across-the-board benefit, which comes from the state's general fund.

Furthermore, this 10 percent targeted / 90 percent untargeted figure only includes tax relief specifically for homeowners. Homeowners of all incomes, along with owners of all other property types, also benefit from state aids to local government, such as LGA ("Local Government Aid") and HACA ("Homestead Agricultural Credit Aid"), which reduce the total amount of money local governments must raise from the property tax.

5. Even with all of these property tax relief efforts, 14.5 percent of Minnesota homeowners are paying more than 5 percent of their income in property taxes.

The average Minnesota homeowner pays 2.3 percent of their income in property taxes and 57 percent of homeowners pay less than 3 percent of their income. But another 14.5 percent of homeowners have property tax bills that exceed 5 percent of their income and 3.5 percent have bills that exceed 10 percent of their income, even after all the credits have been applied and the refunds paid out. (*See Table 5.*)

Furthermore, the property tax is regressive, meaning that low-income residents pay a higher percentage of their income in taxes than upper-income residents. The Minnesota Department of Revenue's *1999 Tax Incidence Study* shows that, on average, homeowners with incomes of $6,817 to $11,166 are paying 4.9 percent of their income in property taxes, while those households with incomes of $57,697 to $78,618 are only paying 2.4 percent.

To its frustration, the committee was unable to more precisely determine who is paying such a large percentage of their income in property taxes. While the state does calculate data specific to senior taxpayers, it does not do so for other types of taxpayers, such as young families, who might also be considered to have a limited ability-to-pay.

6. There are several proposals for reform that aim to reduce or eliminate the perceived impact of rising market values.

One of the most commonly proposed reforms to the property tax system is to further limit market value growth by capping annual market value increases at five percent or the Consumer Price Index (CPI), whichever is less, for all types of property. Advocates of this change argue that it would make property taxes more predictable for the taxpayer. They also argue that it would create more accountability in local government spending because it would be harder for local officials to increase their revenue without voting to increase the tax rate. Currently, increases in a jurisdiction's total market value allow local governments to collect more money by apply ing the same rate to a larger base. Limiting the growth of the base would make this more difficult.

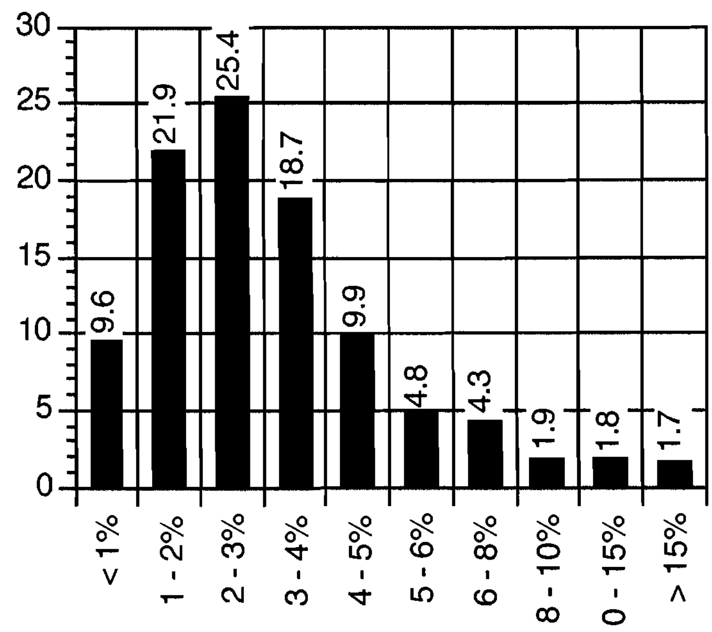
However, opponents of the proposed 5%/CPI cap point out several drawbacks. First of all, as proposed, the cap would only apply until the property was sold and then the market value used for tax purposes would jump up to the full sale price. The new owners would then have their market value growth capped at 5%/CPI for future years, based on the price they paid for the house. This would result in an increased tax burden for first-time homebuyers compared to more established homeowners and create a competitive disadvantage for new businesses or those that recently relocated. Secondly, it would worsen already existing problems with horizontal equity. Two homeowners, living in comparable houses on neighboring lots, would be paying drastically different tax bills, while enjoying the same public services, all depending on when they purchased their home.

The committee also heard arguments for basing homestead property taxes on household income rather than market value, and for basing all property taxes on the square footage of the land and buildings rather than the market value. They learned about "site-value" taxation which taxes the value of land at a different rate than the value of the buildings on that land and the impacts of making

Table 5:
Net Property Taxes as a Percent of Income for Homestead Property Owners, 1996.

Approximately one-quarter of all Minnesota homeowners pay between two and three percent of their income in property taxes. But 14.5 percent pay more than 5 percent of their income.

Source: MN Department of Revenue



various changes to the classification rates and tiers currently applied to homestead property.

7. For the purpose of property taxation, the state of Minnesota currently treats homestead and seasonal recreational property differently.

Homestead property is given preferential treatment over seasonal recreational property in three significant ways. First of all, there is a higher classification rate for seasonal recreational property, making more of its value exposed to taxation. The classification rate for seasonal recreational property is currently 1.2 percent for the first tier (all value under $76,000) and 1.65 for the second tier (any value over $76,000), compared to 1 percent and 1.65 percent for the first and second tiers of homestead property. The classification rates for seasonal recreational property have been lowered over the past several years, though. For taxes payable in 1997, the class rates were 1.75 for the first tier and 2.5 for the second tier.

Secondly, only homestead properties receive the Education Homestead credit. Seasonal recreational properties cannot receive this credit, which equals 83 percent of the education portion of the tax bill, up to a maximum of $390. And finally, only homestead properties qualify for property tax refunds, seasonal recreational properties do not.
However, there is one significant state policy that does benefit both seasonal recreational and homestead property owners and that is limited market value. For the purpose of property taxation, the market values of both types of property, along with agricultural property, can increase no more than 8.5 percent in any one year. (This limit is currently scheduled to sunset in 2002.)

Conclusions

1. In and of itself, the problem of market value increases driving property tax bills beyond an owner's ability-to-pay is not widespread (or well-documented) enough to warrant either broad reform or a complete overhaul of the existing system.

The evidence just does not support the claim that rising market values are automatically yielding higher property tax bills (see Tables 3 and 4). Market values have been rising, especially in specific regions of the state and on specific classes of property, but for the past several years taxes have not been rising at anywhere near the same pace.

This is not to say that there are not other problems with the property tax system that do justify broad reform — only that the perception of rising market values driving increasing tax bills, alone, should not be the basis of a complete overhaul.

2. However, additional targeted relief should be provided to those individuals whose property tax bills consume an excessive percent of their income.

Existing property tax relief programs do provide a safety net for Minnesota homeowners, but it is a net with rather large holes and numerous unintended consequences. As a general principle, the state should always target assistance to those individuals most in need, rather than using a broad-brush approach that affects entire categories of people. In the case of residential property taxes, those people most in need are low and moderate income homeowners who are paying an excessive percent of their income in property taxes.

What is the maximum percent of income that should be paid in property taxes? Minnesota's existing property tax refund program offers some insight into the issue. Currently, 21% of all homestead property owners qualify for a refund because the state has determined they are paying too much of their income in property taxes. How much is too much? Under the existing program, tax bills only have to exceed 1.2 to 4.0 percent of household income before state assistance kicks-in. For example, a homeowner with a household income of $13,000 would qualify for a property tax refund if their property tax bill exceeded 2.5 percent of their income, while someone with a $40,000 household income would qualify for a refund when their tax bill exceeded 3.7 percent of their income.

If the circuit breaker is triggered when a property tax bill consumes somewhere between 1.2 and 4.0 percent of household income, how can 14.5 percent of homeowners still be paying more than five percent of their income in property taxes? There are two reasons. The first is that some of these people have incomes that exceed the $69,690 limit and therefore do not qualify for assistance.

The second explanation is that the state only pays a portion of the tax bill that exceeds the qualifying threshold — not all of it; and there is a maximum refund amount that the state will pay, even if the formula suggests additional state assistance. In the example given above, of someone with a $13,000 income, the property owner would be responsible for all of the bill up to 2.5 percent of their income and then the state would pay 70% of the remaining bill, via a property tax refund, up to a maximum refund of $500. So the taxpayer ends up paying all of the bill up to 2.5 percent of their income, plus 30 percent of the remaining bill — plus anything that falls beyond the maximum refund.

3. Artificially limiting market values is not the answer to the problems that do exist.

There are numerous flaws to policies that artificially limit market values. They do not target relief to those most in need of assistance. They only serve to artificially limit the tax base, while providing no guarantee to the taxpayer that their tax bill won't increase as a result of changes in the tax rate. And they result in an unfair shifting of the tax burden to other properties.

If the legislature wants to provide property tax relief to homeowners, it should do so by using money from the state budget to fund targeted relief programs like the circuit breaker. It should not claim to be providing property tax relief by limiting market value growth. This is not property tax relief — it is property tax shifting, with relief for some coming at the expense of others.

4. Continuing to differentiate between homestead and seasonal recreational properties is a justifiable public policy.

The conventional wisdom suggests that homesteads, and especially the first $76,000 worth, are part of the basic human necessity for shelter, and therefore deserve to be taxed less than other types of property. (A similar logic has been applied to the sales tax, which exempts basic necessities such as food and clothing.) Meanwhile seasonal recreational property is a luxury for those who can afford it, and not something the state should provide public assistance for.

Despite the argument of some that a house is a house, no matter what the owner uses it for, the majority of the committee concluded that the above distinction between a necessity and a luxury is a justifiable reason to continue taxing homestead and seasonal recreational property differently.

5. Despite its many shortcomings, eliminating the property tax is not a viable option.

In the year 2000, a tax based on the market value of real property has numerous flaws. While the property tax was originally created at a time when the value of a person's property was, in fact, a good estimate of their wealth, this is no longer the case today.

If the state of Minnesota was starting from scratch to create a tax system for funding local government services — and the sole purpose was to design a simple and fair method of raising revenue — few arguments could, or would, be made in favor of creating the system we currently have.

But the reality is we are not starting from scratch and our tax system is regularly used as a tool for both social and fiscal policy. And in addition to being simple and fair to the taxpayer, it must be a stable source of revenue for local governments and keep Minnesota competitive with other states.
Therefore, it is not practical to consider eliminating the property tax — which yields $4.6 billion a year (or more than a quarter of all state and local revenues) — and replacing it with either increased sales or income tax revenues. From a competitiveness standpoint alone, Minnesota is already collecting the second highest income tax in the country, while ranking somewhere in the middle on property taxes, especially for homesteads.

6. Faced with the continued need to levy a property tax, the alternatives to a tax based on market value are undeveloped and untested.

The state should not enact property tax reform just for the sake of change. Instead it should hold out for that tax which will more fully meet the criteria for a "good tax." The majority of this committee does not see such a tax on the immediate horizon. Therefore, the state should take immediate steps to improve upon the existing market value tax, while continuing to develop and study alternatives.

Recommendations

The following recommendations are based on the idea that if we are going to have a tax based on market value, we should have a tax <u>based on market value</u>. Distorting market values, through the use of limited market values provisions, unfairly shifts the tax burden and only makes the system more complex. What property tax relief is necessary, should be distributed in a targeted manner directly to those low and moderate income taxpayers whose property tax bills consume an excessive percent of their income.

1. The state should eliminate the $500 cap on property tax refunds for homeowners.

The property tax refund, or "circuit breaker," is the most targeted method available for providing property tax relief. But under the existing guidelines, too many Minnesotans are still paying an excessive percent of their income in property taxes, even after receiving a refund.

After considering several options for improving the circuit breaker, the committee decided that eliminating the cap on refunds would be most effective in achieving the desired outcomes. In addition to removing the cap, the committee also considered increasing the income limit so that households with incomes above $69,690 would qualify and/or removing the current co-pays to make the property tax refund more of an absolute circuit breaker.

The committee decided against raising the upper income limit because that would only expand the number of eligible taxpayers, while doing nothing to better serve those who already receive a refund but still pay an excessive percent of their income in property taxes. With the current income limit, which is automatically indexed for inflation, already exceeding the median household income for every county in the state, the committee felt that those in need of state assistance are already receiving it — just not enough.

The committee decided against eliminating the current co-pay structure of the refund for both cost and accountability reasons. If the property tax refund had no co-pay provision and simply paid all of the tax bill that exceeded a certain percent of income, the accountability link between taxpayers and local officials would be broken. A city council or county board could raise taxes, knowing that the state would pick-up the increased tab for all those low and moderate income residents receiving a refund.

For example, if a homeowner is protected from all property taxes that exceed four percent of their income, it won't matter to them if their tax bill goes up to four and a half or even five percent of their income. They wouldn't pay a higher tax and are therefore less likely to question the need for increased spending or weigh the benefits of increased services.

Eliminating the cap on refund amounts is the best way to reduce the number of taxpayers devoting more than 5 percent of their income to property taxes. For most income ranges, the maximum refund amount currently stands at $500, and approximately 34% of refund recipients are bumping up against this ceiling. This is a significant increase over previous years. In 1985, only 20.8 percent of refund recipients were bumping up against the maximum. By 1993, that number had increased to 31.8 percent and by 1999 it had reached 34 percent. In comparison, the percentage of renters bumping up against the refund cap has ranged between just one and three percent since 1985.

Those individuals who are maxing out the refund are paying all of their tax bill up to the qualifying threshold, plus their share of the co-pay and that part of the state's share that exceeds the maximum. In the end, this results in a net tax bill that still consumes an excessive percent of income.

Eliminating the cap on refund amounts will increase the cost of the program by approximately $43.3 million, from $78.8 to $122.1 million annually. In return, the average percent of income devoted to property taxes will fall below five percent for all income categories, with the most significant benefit befalling homeowners with incomes under $10,000. Currently, the average homeowner in this income range is paying 14.3 percent of their income in property taxes prior to receiving a refund, and 8.7 percent after receiving a refund. Elimination of the cap on refunds will bring the average after-refund tax down to five percent of their income.

2. The property tax deferral program should be opened up to all homestead property owners.

Currently the option of deferring property taxes in excess of three percent of household income is available only to individuals over the age of 65. The committee believes that state funded property tax assistance should be based on need, regardless of age.

The goal of the deferral program should be to provide homeowners threatened by unforeseeably large property tax bills, with an option other than selling their home. Therefore the state should remove the age criteria, while retaining the requirements that the taxpayer must have lived in the home for at least 15 years, can have a mortgage of no more than 70 percent of the value of the home and a household income of no more than $60,000.

Society should not encourage or condone the over-consumption of housing by allowing people to begin deferring their taxes only one or two years after they make the decision to purchase a house. Citizens should take into account both their ability-to-pay for their housing choice as well as the tax price of living in various jurisdictions before they purchase any piece of property. Keeping the 15 year residency requirement and 70 percent mortgage limitation in place will limit the deferral option to those who are in danger of being driven out of their homes by unforeseeable changes in their property tax bills.

3. The legislature should allow the current limited market value law to sunset, as scheduled, and not enact any other limited market value provisions.

The state's existing limited market value law only shifts the tax burden from those types of properties that qualify to those that do not. And it provides so-called property tax "relief" to entire categories of people, rather than targeting it to those most in need of assistance.

Proposals to further limit market value and extend it to all types of property only serve to artificially limit the tax base, but provide no guarantee that taxes won't increase due to changes in the tax rate. Furthermore, proposals that allow market values to jump up to full price following a sale will result in neighboring homeowners paying drastically different property tax bills, depending on when they purchased their homes.

4. After removing the cap on property tax refunds and expanding the deferral program, the additional property tax refund should be eliminated.

It is an unofficial fact of government that once created, a public program or benefit is almost never eliminated. The tendency to layer one public program on top of another is what leads to the complicated mess so aptly demonstrated by our current property tax system.

The committee believes that property tax relief should be aimed at one crucial point in the process — when a final tax bill arrives in the mail and the taxpayer must draw on their income to pay that bill. Increases in market value and changes in the tax bill from one year to the next are secondary. Property tax relief should be distributed based on the percentage of income that ultimately has to be devoted to paying a property tax bill.

If the state improves the existing property tax refund program to protect low and moderate income homeowners and opens up the deferral program to homeowners of all ages, society will be meeting its responsibility to those truly in need of assistance. Additional programs are unnecessary.

Section II: Assessment Practices and the Appeals Process

Background

Assessment Practices

Minnesota currently allows three different systems of property assessment. Some counties have all of their properties assessed by the county assessor, others have each city either employ or contract with an assessor to assess the properties in their jurisdiction and still others use a mix of city and county assessors. A 1996 Best Practices Review of Minnesota's assessment practices, conducted by the Legislative Auditor's Office, found that 23 of the state's 87 counties used county-wide assessment, 10 used only local assessment and the remaining 54 used a mix of local and county assessment.

All assessors working in the state of Minnesota must be licensed by the State Board of Assessors. Individuals must fulfill education and training requirements in order to initially qualify for a license and then they must take continuing education courses in order to renew their licenses annually.

The role of an assessor is to determine two things: 1) the market value of each piece of property in the jurisdiction; and 2) the classification of that property (i.e. is it a homestead? a business?, etc.). Assessors do not determine the amount of tax to be levied.

There are three major methods of determining a property's value: 1) Cost Approach Less Depreciation, 2) Sales Comparison /Market Approach, and 3) Income/ Capitalization Approach. A combination of methods one and two are commonly used for the type of mass home appraisals conducted by city and county assessors.

State law requires that all properties be visited by an assessor at least once every four years. During the years between site visits, most jurisdictions use recorded information about each property — such as its age, location, size, style and features — along with data about current market trends and recent sales to update property values every year. Some jurisdictions use sophisticated computer tools such as CAMA ("computer-assisted mass appraisal") and GIS ("geographic information systems") to regularly and uniformly update assessed values, but these systems are expensive and not in use statewide.

Once the assessor has determined the classification and full market value of each piece of property, he or she must then apply the state's limited market value law to all homestead, seasonal recreational and agricultural properties that experienced more than 8.5 percent growth in their market value since the previous year. In that case, the assessor records both the full market value and the limited market value of the property, but only the limited market value figure is used to determine the property tax bill. Every year, statements of assessed value are mailed to property owners who experience an increase in market value.

Oversight

While the county assessor is responsible for overseeing all assessments in the county, including those conducted by city and contract assessors, and elected officials at both the city and county level oversee their assessors; a more formal, or statistical, oversight of the assessment system is carried out by the Minnesota Department of Revenue. Every year, the Department conducts a sales-ratio study, which is essentially a "report card" for local assessors. The study looks at every property in a given jurisdiction that sold during a twelve month period and compares the selling price to the assessed value recorded for that property. The goal is for the assessed value to be at least 90 percent, but not more than 105 percent, of the selling price. This ratio, of the assessed value to the selling price, is called the "sales-ratio."

Once the Department has calculated a sales-ratio for every property sold, it then determines the median sales ratio for each type of property in a given jurisdiction. For example, the Department would look at all arms-length sales of homestead property in the city of Lakeville, calculate the sales-ratio for each parcel, rank those sales-ratios from lowest to highest and then determine the median sales-ratio (the one that falls in the middle).

In order to be acceptable, that median ratio must fall between 90 and 105 percent. By accepting assessed values up to ten percentage points below the selling price, but only accepting up to five percentage points above, the state is essentially saying it would rather error on the side of under-assessing property, versus over-assessing.

In addition to determining the median sales ratio for a particular class of property in a particular jurisdiction (i.e. "homesteads in Lakeville" or "agricultural land in Maywood Township"), the Department of Revenue also calculates the "coefficient of dispersion" which indicates the distribution of individual properties around the median.

Despite the complicated-sounding terminology, sales-ratio and coefficient of dispersion figures can be fairly easily summed up as measures of accuracy and uniformity. A jurisdiction's median sales ratio indicates how accurately a particular class of property is being assessed, while the coefficient of dispersion highlights how uniformly the properties are being assessed. (The lower the coefficient the more uniform the assessments.) A coefficient under 12.9 is considered "good," between 13.0 and 17.9 is "acceptable," and greater than 18 "needs improvement."

Jurisdictions with unacceptable median sales-ratio figures can face a "board order" issued by the State Board of Equalization (a role fulfilled by the Commissioner of Revenue) to adjust the assessed value of all properties in a particular classification. Board orders can mean across-the-board increases or decreases, by 5, 10, 15 or even 20 percent, for every property of a particular type within a particular jurisdiction. In extreme cases, the state can order the re-assessment of entire jurisdictions found to have unacceptable assessment levels.

The Appeals Process

Property owners who disagree with the assessed value of their property have one informal and two formal options for appeal. As an informal first step, property owners can schedule a meeting with their local assessor to discuss their assessed value. Often times the taxpayer and assessor can clear-up misinformation and come to an agreement without ever filing a formal appeal.

The first option in a formal appeals process is to appeal to the Local Board of Review, which in most places is the city council. At their annual appeals hearing, the Local Board of Review will hear from both the property owner and the local assessor. The Board has the power to change the classification of a property, as well as reduce, increase or sustain the original assessed value.

If the taxpayer is not happy with the outcome at this level, he or she can then appeal to the County Board of Equalization. If the taxpayer is still not satisfied following the hearing before the County Board of Equalization, he or she can go to the Minnesota Tax Court. There are two divisions to the Tax Court. In the small claims division, taxpayers generally represent themselves. Only properties valued under $100,000 or classified as homesteads can be appealed to the small claims division and all decisions in the small claims division are final. Taxpayers also have the option of going to the Regular Division, where they are usually represented by a lawyer and can appeal the decision to the Minnesota Supreme Court.

The second option is for the taxpayer to file an appeal in the regular division of the Tax Court from the very beginning, and skip the Local Board of Review and County Board of Equalization.

Findings

1. In 1999, the Department of Revenue found one county to have an unacceptably high median sales ratio and two to have unacceptably low median sales ratios for residential property.

On the surface, these numbers suggest that Minnesota's assessment system is yielding pretty accurate results. But several qualifiers are necessary. First of all, these are countywide figures which can hide problems at the city or township level. However, the Department of Revenue does take a more detailed look than was feasible by this committee, calculating sales-ratio data for each individual city and township and issuing board orders accordingly.

Secondly, and more importantly, these are "adjusted" sales ratio figures. Prior to issuing any board orders to address unacceptable sales ratios, the Department of Revenue adjusts the raw data to give local assessors credit for any updates that have been made to assessments since the time of the sales. But these adjusted figures fail to account for any corresponding changes in the real estate market. This creates the potential for jurisdictions to constantly be playing catch-up, where their initial sales ratio figures are unacceptable, but their adjusted figures are okay, so they receive no board order, but end up right back in the unacceptable range again next year.

In 1999, 52 counties were initially found to have unacceptable median sales ratios, but after the adjustment, only three were still considered unacceptable. In 1998, 44 counties were initially found to have unacceptable median sales ratios, but after the adjustment only four were still considered unacceptable. This creates the concern that poor assessments are being allowed to slip through the system.

2. The Department of Revenue's coefficient of dispersion figures show that 23 counties had unacceptable coefficients of dispersion in 1999 and 25 had unacceptable figures in 1998.

This suggests a disturbing lack of uniformity in assessments in more than a quarter of Minnesota counties. Uniform assessment is crucial to a fair property tax — perhaps even more important than accuracy. If all properties in a given jurisdiction are assessed at 70 percent of true market value, the tax burden is still distributed evenly, but if some of the properties are assessed at 100 percent of market value, while others are assessed at 70 percent and still others are assessed at 110 percent, individual property owners end up paying either more or less than their fair share.

This lack of uniformity, highlighted by taxpayer complaints comparing their assessment to the one for the place next door or the house down the street, undermines confidence in the property tax and gives credence to complaints that it is unfair.

Furthermore, this lack of uniformity is going uncorrected in many cases because state-issued board orders are triggered by a jurisdiction's median sales-ratio. And while the state takes coefficients of dispersion into account in these cases, it does not take action toward those jurisdictions with acceptable median sales ratios, but unacceptable coefficients of dispersion.

Conclusions

1. Taxpayer confidence in the assessment system is crucial to overall acceptance of the property tax.

The property tax is the only tax that both starts and ends with government. Property owners are told what the value of their property is, then what the tax rate will be and finally what their tax bill equals. This is unlike either the income or sales tax, where the tax base (income earned and sale price, respectively) is independently established and government only sets the rate. This fact (that government informs the taxpayer of both the property tax base and rate), makes taxpayer confidence in that base crucial to acceptance of the overall system.

When people complain about the complexity of the property tax, they are often referring to the numerous classes and tiers, credits and refunds. But it can be argued that the property tax's true complexity lies in property assessments. After all, the state income tax code also contains numerous different income brackets, deductions and credits that the average taxpayer does not understand, yet people don't think of the income tax as being nearly as complicated as the property tax. The difference? The base from which the income tax is determined is independently established and reported to the government by the taxpayer and their employer, while the base for the property tax is determined through this mysterious practice known as assessment.

2. Minnesota's assessment practices and outcomes need improvement.

Given the fact that local governments are using assessed values to raise \$4.6 billion from Minnesota taxpayers, "pretty accurate," and "roughly uniform" assessments are not good enough.

While there is no smoking gun to point to, there is a strongly shared concern that Minnesota's property assessments are lacking the uniformity and consistency that is crucial to a fair system.

3. Responsibility for ensuring quality assessments (and thereby fair taxation) lies jointly with the Legislature, Department of Revenue, local assessors and local officeholders. Each of these entities needs to carry-out their responsibilities through a more open and regular review of assessment practices and outcomes.

Recommendations

1. The Minnesota Legislature should conduct formal, biennial reviews of the state's assessment practices and outcomes.

While the legislature conducts its annual debates over half-point or quarter-point reductions in particular class rates and holds hearings on whether to further limit market value growth, assessments, which are the foundation of our property tax system, go largely unnoticed. Legislative oversight currently consists of a summary of state board orders being mailed to the chairs of the House and Senate tax committees. This is insufficient.

Understanding and evaluating assessment practices and outcomes is a messy and difficult task, as this committee experienced first-hand. But it is the responsibility of our elected officials to ensure that the burden of a $4.6 billion tax is being fairly distributed.

Formal, biennial reviews should include an analysis of assessment practices and outcomes over time, placing equal weight on accuracy and uniformity. The Legislature should also consider whether the Department of Revenue has the appropriate power and tools to carry out its oversight responsibility, whether local assessors have the resources to access the latest technology, and whether particular assessment structures are yielding better outcomes.

2. The Department of Revenue must step-up its oversight of local assessment practices and outcomes, with a specific focus on improving the uniformity of assessments.

In addressing unacceptable sales-ratio figures, the Department issues board orders to increase or decrease all assessments in a particular class, in a particular jurisdiction, by a set amount. However, this does nothing to address uniformity; it simply moves all properties up or down the scale while leaving the difference between properties the same. It is unclear exactly what actions the Department will have to take to address the lack of uniformity that currently exists in approximately one-quarter of Minnesota's counties, but it is clear that the current level of variation is unacceptable.

3. The Department of Revenue should begin an annual collection of data related to property tax appeals.

This committee was unable to find any significant or reliable data regarding use of the appeals process.

The Minnesota Tax Court reported that there were 1121 property tax cases filed in Tax Court for payable 2000, which was down from 1240 the year before. Beyond that, they had no records of how many of those appeals came from homestead property owners versus commercial / industrial or agricultural property owners. They had no records of what cities or counties the appeals were coming from, or how many were filed in small claims division versus the regular division.

There is a similar lack of information regarding taxpayers' progression through the appeals process. According to a 1996 Legislative Auditor's survey of people who appealed their property assessments to their city boards of review, 92 percent stopped there and did not go any further in the appeals process. Similarly, a survey of people who appealed their property assessments to their county board of equalization found that 84 percent stopped there and did not continue their appeal in Tax Court.

However, what these figures don't tell us is why these taxpayers did not proceed to the next step in the appeals process. Was it because they received a satisfactory resolution at their board of review or equalization or was it because they were frustrated with the process and didn't feel it was worth their time to continue?

Continuously tracking the number of property tax appeals by type of property and area of the state, as well as periodic surveys of taxpayers use of and satisfaction with the appeals process will provide valuable insight into taxpayer's confidence in the quality of property assessment. This information might also provide early insight into potential assessment problems in particular areas.

4. The State Board of Assessors should use the Department's sales-ratio and coefficient of dispersion data to develop a performance measurement system for individual assessors applying to renew their licenses.

Currently, the State Board of Assessors renews individual assessor's licenses if they have taken the required continuing education classes and the Department of Revenue has not notified the Board of a problem with that assessor.

The Board should expand its licensing process to take advantage of the data already available in the Department's sales-ratio studies. Using this data in the licensing process will ensure that assessors have not only sat through several hours of continuing education, but are actually producing assessments that meet the state's standards for both accuracy and fairness.

This is not to suggest that a single year of bad sales-ratio numbers should be used to terminate an assessor's license. But rather that a system of performance measurement should be developed that takes into account performance over the course of several years and gives proper weight to an individual's role in the assessment of an entire jurisdiction.

5. Whenever possible, cities and counties should appoint independent citizen boards of review and equalization.

Currently, cities with populations over 5,000 and all counties have the option of using either their city council/county board to judge appeals or an appointed citizen board. At the time of the Legislative Auditor's 1996 Best Practices Review, only 5 counties and 12 percent of eligible cities were using appointed boards of review and equalization.

While recognizing that it can be difficult to find enough citizens to serve on all the various advisory boards and commissions that already exist, the committee believes citizen boards of review and equalization are an important step that local jurisdictions can take to improve taxpayer confidence in the property tax. Furthermore, hearing appeals of property assessments is really a judicial function, not a political or policy-making one. Therefore, it belongs with an impartial panel.

Independent citizen boards of review and equalization will provide property owners with a "jury of their peers," rather than an intimidating panel of officials. Local assessors would be responsible for convincing the citizen boards of the accuracy of their assessment in a manner understandable to the average citizen, and taxpayers will have the opportunity to make their case before a group of fellow residents and property owners. These independent citizen boards of review and equalization would receive education and training on the assessment process from a neutral state entity, such as the Department of Revenue or State Board of Assessors.

As it stands now, assessors and their local officials have previously established employer-employee relationships and elected officials face the catch-22 that lowering assessments reduces their tax base. Given these conditions, it becomes easy for an assumption of accuracy to follow the assessor, at the expense of the taxpayer.

Section III: Conclusion

So, what policies should Minnesota pursue to best address the issue of property tax affordability among owners of homestead and seasonal recreational properties? The consensus of this committee is that the best policy is to focus on the percent of income that must be devoted to paying a property tax bill. Therefore, the current cap on property tax refunds should be eliminated, so that, on average, no income group pays more than five percent of their income in property taxes.

And secondly, this committee agreed that if we are going to have a tax based on market value, we should have a tax based on actual market value. Therefore, the state should stop artificially limiting market values, which only serves to unfairly shift property tax burdens.

However, this position should not be seen as a resounding endorsement of a tax based on market value. The committee's position more accurately reflects the current lack of well-developed alternatives that would improve both the fairness and simplicity of the tax.

Therefore, the committee sees a strong need for continued research into:

- **Alternatives to a market value base.** What measure could replace market value, as the base of a property tax, to make it better comply with the criteria for a "good tax"? What would be the impact of switching to a more physical measure of property, such as square footage?

- **The appropriate mix of sales, income and property tax collections.** Are the three legs of the three-legged stool sufficiently balanced? Given its inherent flaws, a strong argument can be made for reducing our reliance on the property tax, possibly making it the third largest source of state and local revenue, rather than the second. What would be the impact of such a change, particularly on sales and income tax collections?

Appendix A-1 : MN Class Rate Schedule

Property Type	Payable 1997	Payable 1998	Payable 1999	Payable 2000
Residential Homestead:				
<$76,000	1.00%	1.00	1.00	1.00
>$76,000	2.00%	1.85	1.70	1.65
Residential Non-homestead				
Single Unit:				
<$76,000	2.30	1.90	1.25	1.20
>$76,000	2.30	2.10	1.70	1.65
2-3 unit and undeveloped land	2.30	2.10	1.70	1.65
Market-rate Apartments				
Regular	3.40	2.90	2.50	2.40
Small city	2.30	2.30	2.15	2.15
Low-income Apartments:				
Title II	2.30	2.00	—	—
Farmer's Home Administration	2.00	1.90	—	—
New Class 4d	—	—	1.00	1.00
Commercial/Industrial/Public Utility:				
<$150,000	3.00	2.70	2.45	2.40
>$150,000	4.60	4.00	3.50	3.40
Seasonal Recreational Commercial:				
Homestead resorts (1c)	1.00	1.00	1.00	1.00
Seasonal resorts (4c)	2.30	2.10	1.80	1.65
Seasonal Recreational Residential:				
<$76,000	1.75	1.40	1.25	1.20
>$76,000	2.50	2.50	2.20	1.65
Agricultural Land & Buildings				
Homestead:				
<$115,000	0.45	0.40	0.35	0.35
$115,000-$600,000:				
<320 acres	1.00	0.90	0.80	0.80
>320 acres	1.50	1.40	1.25	0.80
>$600,000:				
<$320,000	1.00	0.90	0.80	1.20
>$320,000	1.50	1.40	1.25	1.20
Non-homestead	1.50	1.40	1.25	1.20

Appendix A-2 : Sample Tax Calculation

The property tax on a homestead with an assessed valued of $120,000, would be calculated as follows:

	First Tier	*Second Tier*
Assessed Market Value	$76,000	$44,000
x Classification Rate	x 1.00%	x 1.65%
= Tax Capacity	= $760	= $726
First Tier	$760	
+ Second Tier	+ $726	
= Total Tax Capacity	= $1486	
Total Tax Capacity	$1486	
x Total Local Tax Rate	x 126%	
= Gross Property Tax	= $1,872	
Gross Property Tax	$1872	
— Education Homestead Credit	— $390	
= Net Property Tax	= $1,482	

Appendix B: Work of the Committee

Background for Study

As part of the Ventura administration's work to present a major tax reform proposal to the 2001 Minnesota Legislature, the Minnesota Department of Revenue is interested in collecting citizen input on a wide variety of taxation issues. Through a contract with the Department, a Citizens League committee will examine one of those issues — the affordability of residential property taxes.

Charge to Committee

While there are many important issues surrounding Minnesota's property tax system, this Citizens League committee was charged with addressing the following specific research questions:

> **<u>Core Question:</u> Which policies should Minnesota pursue to best address the issue of property tax affordability among owners of homestead and cabin properties whose growth in taxes, due to increases in valuation, significantly exceed their ability-to-pay?**

- How extensive is the problem? Is it extensive enough to warrant a broad-based policy approach or should a policy (or set of policies) be adopted which targets assistance to those who are most in need?
- Should different consideration be given to owners of homesteads (primary residences) and owners of recreational property (cabins)?
- Are Minnesota's value assessment methods and procedures fair?
- Is Minnesota's current appeals process fair to the taxpayer?

When examining these core questions, the committee also considered the following questions:

- To what extent should the property tax be rationalized, in part, as a tax on wealth? For example, if two homes have different market values but benefit equally from the same set of service, should a higher tax be levied on the higher valued home than levied on the lower valued home?
- Will the recommended policy have any unintended economic or tax consequences? For example, in what ways, if any, will the recommended policy by the committee affect the affordability of housing for new buyers or reduce the amount of equity in the property for sellers?

Committee Membership

The Property Tax Study Commitee was co-chaired by Mary Anderson and Bill Kelly. A total of 37 individuals took an active part in the work of the committee. In addition to the chairs, they were:

Gay Bakken
David Black
Allan Burdick
Ken Carlson
Calvin Clark
Tom Darling
Reginald Edwards
Vernae Hasbargen
Hugh Hawkins
Lincoln Hudson
Richard Johnson
Suzanne Kennedy
Jay Kiedrowski
Carolyn Kompelien
Clyde Miller
Barbara Nelson
David Newhall
Steve O'Malley
Mary Ogren
David Pence
Mark Pridgeon
Craig Rapp
Ken Reine
Peter Ries Jr.
Phil Ruggiero
Jim Schneider
Robert Teetshorn
Orlan Thorbeck
Gedney Tuttle
Laurie Davis Van Wert
Kathleen Vellenga
Donn Waage
Norman Werner
Paul Zerby Sr.
Jonette Zuercher

Meetings and Resource Testimony

The committee met for the first time on March 13, 2000 and concluded its deliberations on July 31, 2000. The committee met fifteen times, studied a large and varied amount of printed materials and heard from the following resource speakers:

Karen Baker, *House Research.*

Glenn Dorfman, *Chief Operating Officer, MN Association of Realtors.*

Gordon Folkman, *Minnesota Department of Revenue.*

Marlowe Hamerston, *Minnesota Senior Federation.*

Mark Haveman, *Minnesota Planning.*

John James, *1000 Friends of Minnesota.*

Hal Lofgren, *Professor of Economics, St. Cloud State University.*

Tom May, *Hennepin County Assessor.*

Leonard Peterson, *Minnesota Department of Revenue.*

Dan Salomone, *Executive Director, Minnesota Taxpayers Association.*

Marty Schmidt, *Crow Wing County Assessor.*

Dick Wray, *Minnesota Seasonal Recreational Property Owners Coalition.*

Jeff Van Wychen, *Property Tax Study Project.*

Meetings to gather additional input from residents of Greater Minnesota were hosted by **the Lifelong Learning Center at Fergus Falls Community College** in Fergus Falls and the **Blandin Foundation** in Grand Rapids.

Staffing

This report was prepared by Kristine Lyndon Wilson. Administrative support was provided by Trudy Koroschetz and Gayle Ruther.

WHAT THE CITIZENS LEAGUE IS

The Citizens League promotes the public interest in Minnesota by involving citizens in identifying and framing critical public policy choices, forging recommendations and advocating their adoption.

The Citizens League has been an active and effective public affairs research and education organization in the Twin Cities metropolitan area for more than 45 years. Volunteer research committees of League members study policy issues in depth and develop informational reports that propose specific workable solutions to public issues. Recommendations in these reports often become law. Over the years, League reports have been a reliable source of information for governmental officials, community leaders, and citizens concerned with public policy issues of our area. The League depends upon the support of individual members and contributions from businesses, foundations, and other organizations throughout the metropolitan area.

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