STICKER SHOCK:

WHY PROPERTY TAXES ARE GOING THROUGH THE ROOF IN MINNESOTA

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**KEY FINDINGS**

- The average Minnesota homestead property tax has increased by approximately 70 percent from 2002 to 2008. Even after adjusting for inflation in government purchases, the average homestead property tax increase has been nearly 30 percent.

- Growth in homestead property taxes from 2002 to 2008 cannot be attributed to growth in local government revenue. Total statewide real per capita county and city/town revenue and real per pupil school revenue have all fallen over this six year period.

- While homestead values have increased since 2002, this does not explain the growth in homestead property taxes on a statewide basis. The homestead share of statewide estimated market value has declined modestly over the last six years.

- The primary cause of homestead property tax increases from 2002 to 2008 is cuts in local governments. Local governments have struggled to make up for the loss of state aid through a combination of cuts in public services, reductions in infrastructure investment, and increases in property taxes.

- Real per capita local government revenue has fallen much more rapidly than real per capita state government revenue since 2002. The burden of dealing with state budget deficits has fallen disproportionately on local governments and local property taxpayers.

- Structural changes to the property tax system enacted by the legislature have also shifted a larger share of the property tax burden away from businesses and apartments and on to homesteads.

- State policies are the primary cause of real homestead property tax increases over the last six years. State leaders who are truly interested in accountability must start by recognizing this fact.
INTRODUCTION

The average property tax on a Minnesota homestead is expected to increase by 71 percent from 2002 to 2008. Even after adjusting for inflation in the cost of government services, the increase is nearly 30 percent. Statewide, real homestead property taxes have grown over four times more rapidly than that of other classes of property.

The explosion in homestead property taxes has been mistakenly blamed on increases in local government spending and on a rapid growth in homestead values. The real culprits are tax policies enacted by state government leaders.

The graph below compares the growth in the average Minnesota homestead property tax to changes in local government revenue from 2002 to 2008.

Statewide Growth in Average Homestead Property Taxes

Compared to Change in Per Capita City/Town & County Total Revenue and Per Pupil School Total Revenue

Percent Change from Pay 2002 to 2008 in Inflation-Adjusted Dollars

![Graph showing growth in average homestead property tax compared to changes in local government revenue and school revenue.]

Total revenue for counties, cities/towns, and school districts from the November 2007 “Price of Government” report from the Minnesota Department of Finance.

School enrollment amounts (for per pupil calculations) based on average daily membership (ADM) from the Minnesota Department of Education.

Population estimates and projections (for per capita calculations) derived from data from the State Demographer’s Office.

Average residential homestead property tax calculated using Revenue Department data. 2008 based on preliminary levies.

LOCAL GOVERNMENTS NOT TO BLAME

After adjusting for inflation, the average homestead property tax in Minnesota grew at an average rate of 4.4 percent annually, for total growth of 29.8 percent from 2002 to 2008. Meanwhile, the inflation-adjusted revenue of counties, cities, and public schools fell. In real dollars per capita, county and city/town revenues fell by 12.5 percent and 10.0 percent respectively, while real per pupil school revenues fell by 2.9 percent.

On a statewide basis, growth in local property taxes cannot be blamed on growth in local budgets. The fact that homestead property taxes can increase so dramatically at the same time that revenue for local services and infrastructure is falling speaks volumes as to how badly Minnesota’s property tax system is broken.

Some have attributed the rapid growth in homestead property taxes to rapid growth in home values relative to other types of property. In the May-June 2007 issue of Fiscal Focus, the Minnesota Taxpayers Association argues that the period since 2002 “marked a rapid increase in home values relative to other properties and their corresponding assumption of a greater share of the property tax burden.”

The MTA’s statement is half right. Homeowners have assumed a greater percentage of the total property tax burden since 2002, but homestead estimated market value (EMV) as a percentage of total EMV has fallen since 2002, as demonstrated in the following graph.

Homestead EMV as a percent of total EMV in Minnesota increased modestly from 2002 to 2004, but since 2004 has fallen significantly. By 2008, homestead EMV as a percent of total EMV was nearly three percent less than it was in 2002. This could only occur if homestead EMV was growing less rapidly than the EMV of other types of property. Thus, growth in homestead EMV does not explain the statewide growth in homestead property taxes.
THE REASONS BEHIND THE INCREASE

So growth in local spending and growth in homestead values do not explain the rapid growth in real homestead property taxes. What does?

Large reductions in state aid to Minnesota counties, cities, and school districts are certainly a primary contributor. Real per capita state aid to Minnesota local governments has fallen by 23 percent from 2002 to 2008, forcing local governments to cut local services at the same time that they are increasing property taxes.

From 2002 to 2008 (corresponding to state fiscal years 2003 to 2009), total real per capita local government revenue fell by 8.7 percent. Over the same period, real per capita state government revenue—excluding the dollars that the state shares with local governments—increased by 6.6 percent. This provides ample proof that the state’s budget problems have been passed on to local governments (and local property taxpayers) by means of large state aid cuts.

However, state aid cuts do not explain why homestead property taxes are growing more rapidly than that of other types of property. Other factors are at work.
In 2001, the Minnesota legislature and Governor Ventura revamped the Minnesota property tax system. These changes involved increasing the share of the local property tax burden paid by homesteads and reducing the share paid by commercial, industrial, and apartment properties. However, the state also eliminated all general education and transit property taxes in the same year, so statewide homestead property taxes declined significantly from 2001 to 2002 despite the increase in the share of local property taxes borne by homeowners.

While the 2001 property tax changes provided one-time relief to homeowners in 2002, it also changed the property tax system in ways that would cause homestead property taxes to increase in subsequent years even if local spending remained constant. Proponents of these changes were quick to take credit for the homestead property tax relief in 2002, but failed to tell homeowners “the rest of the story.”

Among the features of the 2001 tax act that contributed to homestead property tax increases in subsequent years are the following:

• As noted above, the changes enacted in 2001 shifted a larger share of the local property tax burden on to homesteads. The shift in tax burden on to homesteads was “bought off” in the first year through the elimination of general education and transit property taxes. However, subsequent shifts on to homesteads resulting from the 2001 tax act occurring in 2003 and 2004 were not bought off, thereby resulting in homestead property tax increases.

• The 2001 tax act included the phase-out the limited market value program beginning in 2003. This program reduced the taxable value of homesteads that had experienced rapid growth in values in preceding years. The increase in homestead taxable value resulting from the phase-out of the limited market value program contributed significantly to the average homestead property tax increase from 2002 to 2008.*

• The 2001 tax act created a new “homestead market value credit.” A feature of this credit that was not widely publicized is the fact that the amount of the credit shrinks as homestead values increase. From 2002 to 2008, the amount of this credit declined by 19 percent in nominal dollars and by 39 percent in real dollars. As the amount of the credit decreases, homestead property taxes increase.

The homestead property tax increases resulting from these features of the 2001 tax bill were foreseen at the time the act was being debated in the legislature. However, proponents of the tax act—in an attempt to sell the proposed changes to the public—focused on the homestead property tax relief given in 2002 and dismissed the legitimate concerns over future homestead property tax increases.

In additions to the provisions of the 2001 tax act that were first implemented in 2002, reductions in school aid have also contributed to a shift of property tax burden on to homesteads. From 2002 to 2008 (corresponding to school fiscal years 2003 to 2009), real per pupil state aid to Minnesota school districts declined by nearly 13 percent. In response to these aid cuts, school districts have both cut services and increased property taxes.

* Most of the homestead property tax increases resulting from the phase-out of the limited market value program have already occurred. Most homesteads in Minnesota no longer benefit from a reduction in taxable value under the limited market value program and thus will not experience any additional tax increases as a result of the limited market value phase-out. According to Minnesota Department of Revenue information for taxes payable in 2007, only about 16 percent of Minnesota homesteads still benefit from the limited market value program.
More than half of school property tax increases since 2002 have been in the form of “referendum market value” levies. Unlike ordinary levies, referendum market value levies provide no preferential tax treatment to homestead properties. Consequently, an increase in referendum market value levies results in a larger percentage increase in homestead property taxes relative to other classes of property. From 2002 to 2008, school referendum market value levies in Minnesota have increased by 147 percent even after adjusting for inflation.

The 2001 tax act did provide large homestead property tax relief. However, since 2001 this relief has vanished. Even after adjusting for inflation, the average Minnesota homestead property tax is at least eight percent greater than it was in 2001—the year before the 2001 tax act took effect.

**CONCLUSION**

The rapid growth in average homestead property taxes over the last six years—more than double the rate of inflation—cannot be attributed to real growth in local government budgets or growth in homestead values. Rather, this growth is due to state policies, specifically (1) features imbedded in the 2001 tax act and (2) subsequent cuts in aid to local governments.

The Governor and other state leaders claim to be champions of fiscal transparency and tax accountability. This being the case, they should come clean to Minnesota taxpayers about the real causes of homestead property tax increases and take actions to make sure that homestead property taxes do not continue to increase at the same time that revenue for local services is declining.