December 17, 2012

Rep. Kurt Zellers
Speaker, Minnesota House of Representatives
463 State Office Building
100 Rev. Dr. Martin Luther King Jr. Blvd.
St. Paul, MN 55155

Sen. David Senjem
Majority Leader, Minnesota Senate
121 Capitol
75 Rev. Dr. Martin Luther King Jr. Blvd.
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Speaker Zellers & Majority Leader Senjem,

Pursuant to Minnesota Laws 2008, Chapter 366 as modified by Minnesota Laws 2010, Chapter 215, below are recommendations for modifications to the Local Government Aid program.

The Local Government Aid Study Group (the "Study Group") was originally appointed and convened in 2009. Following a two year hiatus, the deadline for the recommendations was extended by a year and the Study Group was reappointed and reconvened. This reconvened Study Group met five times and focused primarily on the city Local Government Aid ("LGA") program.

Minnesota has a long history of providing aid to local governments. It also provides a greater amount of general purpose aid than other states. LGA was created in 1971 as part of the "Minnesota Miracle" and was originally distributed to counties, which then dispersed the money to other local units of government. LGA underwent several changes in the following decades including eliminating payments to counties in 1991 and townships in 2002. As of tax year 2011, 760 of Minnesota's 854 cities receive LGA.

LGA is currently distributed using a complex spending formula comparing a city's spending needs with its ability to raise revenue. The formula pays a percentage of each city's unmet need defined as:

- a city's average "need per capita" for the last two years measured on a number of factors multiplied by population; and
- a city's adjusted net tax capacity multiplied by the average city tax rate for all cities.

Large (over 5,000 in population) and small (under 5,000 in population) cities each have a respective list of factors for calculating need. These are:

- Percentage of housing built before 1940 (Large & Small)
- Percentage of population decline over last ten years (L&S)
- Three year average number of road accidents per capita (L)
- Average household size (L)
- Subtract $35 per capita if in seven-county metro area (L)
- Percentage of property value classified as commercial or industrial (S)
- Transformed population (S)

Further, large cities have their need increased by "jobs aid" and small cities by "small city aid". When need exceeds the amount a city can raise in property taxes by imposing the average city tax rate it receives aid under the formula. Payments are also affected by other limits, such as a minimum yearly decline.

The LGA program has received a variety of criticism in recent years. Some of the most prevalent criticisms are:

- The formula is too complex and hard to understand.
- There is a lack of predictability in the program making it difficult to budget.
- Some of the factors are out of date or make no sense.

Based on the history of LGA, the current formula, criticisms of the program and discussion in Study Group meetings, we, the LGA Study Group, make the following recommendations:

- Examine current special appropriations outside of the formula for continued relevance. There are 19 special permanent appropriations for certain cities since 1995. If these are no longer appropriate and necessary they should be eliminated. Remaining special appropriations and new special appropriations should have sunset dates to ensure periodic review. This will help make the program simpler and more equitable.
- Current data used in the formula should be examined for stability over time and either be averaged over time or be replaced with other factors if the data is too volatile.
- Similarly, updating need factors, such as the age of housing stock or jobs aid, should be closely examined prior to making any changes in the formula.
- The caps on maximum annual aid increases or decreases to individual cities should be examined to better:
    - (1) increase the simplicity of the formula,
    - (2) increase equity of payments between cities, and
    - (3) reduce the impact of levy decisions on future aid changes.
- Any changes to the aid formula should take into account how service needs and available revenue sources differ between cities.

- The program appropriation should be stabilized so cities are able to rely on the amount certified to them.
- Any changes made to the formula should increase its stability and transparency and discourage factor manipulation.

LGA remains an important program in terms of state-local fiscal relations and should not be eliminated. Enacting, or considering, these recommendations should make the LGA program more viable and further its goal of maintaining strong cities throughout our great state.

Sincerely,

Rep. Linda Runbeck
Co-Chair
LGA Study Group

Sen. Roger Chamberlain
Co-Chair
LGA Study Group

cc: Governor Mark Dayton
Rep. Greg Davids, Chair, House Taxes Committee
Sen. Julianne Ortman, Chair, Senate Taxes Committee
Rep. Paul Thissen, Speaker-designate, Minnesota House of Representatives
Sen. Tom Bakk, Majority Leader-elect, Minnesota Senate
Rep. Anne Lenczewski
Sen. John Marty
Rep. Jim Davnie
Sen. Rod Skoe
Sen. Ann Rest
Rep. Kurt Daudt
Sen. David Hann