PAYMENT OF PROPERTY TAXES ON LAND ACQUIRED WITH OUTDOOR HERITAGE COUNCIL FUNDS
CONCERNS WITH HF 1706/SF 1654
(By David Hartwell) March 25, 2015

The current PILT payment issue is the result of HF 1706/SF 1654 which would redefine land acquisition cost by including "onetime trust fund payments" of 30 times current property taxes into a special fund to be used to then pay counties an amount equal to the taxes that would otherwise have been paid. This would replace PILT payments for these properties.

http://www.house.leg.state.mn.us/comm/docs/9b93cd72-db5f-4498-8076-cfb2a89ba403.pdf

There are a number of concerns about this. The two most significant are:

1) **NOT CONSISTANT WITH THE CONSTITUTIONAL RESTRICTIONS ON THE FUNDS**

The constitutional language of the legacy amendment states:

"33 percent of the receipts shall be deposited in the outdoor heritage fund and may be spend only to restore, protect and enhance wetlands, prairies, forests and habitat for fish, game and wildlife"

It is hard to see how funds that are directed to be used according to this meets the constitutional language since it is clear that it is not for restoring, protecting or enhancing habitat but rather, to pay the county funds in place of the taxes they would collect. The bill states:

"a county board must withdraw an amount equal to the taxes that would be owed based on the appraised value of the land in the county for which the county received a trust fund payment under this subdivision." Further, it goes on to say *"The county treasurer must allocate the withdrawn funds among the county, the school district, the town or home rule charter or statutory city, and special districts on the same basis as if the funds were taxes on the land received in that year."*

There is no question in the language that the intent is to provide funds to local units of government for their general expense rather than for manage of land acquired with funds provided by the constitutional amendment.

The attorney general's office was asked for their opinion on this matter shortly after the Amendment was passed and they did offer an advisory letter (not a formal opinion) saying there were significant concerns with using these funds for PILT. These constitutional concerns were reiterated by the Legisaltive Auditor in a 2010 report on Natural Resource Lands (p. 52)(http://www.auditor.leg.state.mn.us/ped/pedrep/nrland.pdf)

Additionally, the language of the amendment also states:

The dedicated money under this section must supplement traditional sources of funding for these purposes and may not be used as a substitute.

The use of Legacy Amendment dollars to pay amounts to counties that would normally be paid through General Fund PILT seems in conflict with the constitutional language. No other source of acquisiton funding (such as the game and fish fund, the RIM critical habitat match fund, the natural resource fund, or bonding) has ever been required to pay PILT as part of land acquisition costs – in every case, the traditional source of funding for PILT has been the General Fund.

2) FORMULA

Even if the use of the funds were determined to meet the constitutional requirement, the language to determine the amount states "The Trust Payment is equal to 30 times the property taxes assessed in the year prior to the year in which the land is acquired."

Assuming the fund pays out 5.5% annually, the amount required to make that payment would be 17 times the current taxes. When questioned about this, the authors refer to a document prepared by Patrick McCormick from House Research to justify the amount. However, this memo (which is attached at the bottom of this document) makes two critical mistakes:

A) The increase in property taxes over the last 9 years corresponds to the significant reduction in LGA payments from the state which in turn required local taxing authorities to increase property taxes at a rate significantly faster than inflation. Since that cannot be repeated, using the 9 year historic number as a window is not appropriate.

B) The numbers used assume there is no investment of the principal dollars that will grow beyond the rate of distributions from the fund. If you look at the historic rate of distribution and investment return by the state board of investment, there is significant appreciation beyond the distribution rates and has exceeded the rate of inflation for some time. For the last 10 years, the inflation rate has averaged 2.3% while the state board of investments average return after fees is 7.8%. Assuming a payout rate of 5.5%, the payout and inflation have equaled the investment return. But the analysis does not take that into consideration. See http://mn.gov/sbi/Combined%20Funds%20Performance.html and http://www.usinflationcalculator.com/inflation/historical-inflation-rates/ for information on performance and inflation.

So, the increase in taxes over the last 9 years is not likely to be repeated and the rate of return on investment of funds is overlooked in the analysis. **Therefore, the 30 times number is not accurate.**

3) LCCMR

This bill refers to lands acquired through the Outdoor Heritage Account and the LCCMR.

4) WHAT MIGHT BE NEXT

The bill does not at this point apply to funds from the Clean Water or Parks accounts. It also does not use the same logic for other conservation lands purchased with bonding or other dollars but it seems likely that if this effort is successful, those types of acquisitions will be next.

5) PILT OBLIGATION FROM THE OUTDOOR HERITAGE COUNCIL

It is estimated that after 25 years, the PILT obligation from legacy habitat dollars will be roughly $5M annually which while not insignificant, is but a small fraction of total PILT expenditures and certainly not enough that it will hinder the state's other programs.

6) JUST A WAY TO DISCOURAGE STATE OWNERSHIP OF LANDS

There are some legislators that are supporting this out of concern about state PILT obligation. However, it is also likely that there is some strong support for this measure as a way to reduce the dollars available for land acquisition generally from those opposed to state ownership of land.

7) WHERE IS LAND ACQUISITION TAKING PLACE WITH OHF DOLLARS

Interestingly, the counties that have large public ownership are the ones where land acquisition is not as active. Most of the Outdoor Heritage Funds spent in these counties go for restoration and enhancement work while the land acquisition dollars are spent in the prairie region where wildlife habitat is under severe threat. So the opposition to land acquisition comes from counties where there is high public ownership but the activity is predominately elsewhere. In general, the counties that will benefit from the proposal in HF 1706 are not the counties that already have the largest amounts of state land.

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Minnesota House of Representatives

March 18, 2015

TO: Representative Steve Drazkowski

FROM: Pat Dalton

RE: Reasonable amount to use to fund perpetual tax payments for natural resource land

You wanted to know if the 30 years of current tax payments is a reasonable amount to place in an account to fund perpetual payments in lieu of taxes on property removed from the tax rolls. How much needs to go into the fund initially depends on two major assumptions:

- the anticipated rate of return on investment and
- the anticipated annual growth rate in property taxes

What we are talking about is a variation of what financial experts call a perpetuity. At its simplest a perpetuity is "a stream of equal payments that does not end." There is a simple formula to calculate how much needs to be put aside to make perpetual payments, depending on the assumed return on investment which is:

$$\text{The present value (amount that needed today to fund a perpetuity)} = \frac{\text{Payment amount}}{\text{annual rate of return}}$$

However this formula assumes no growth in payments over time. Actually property taxes in towns in Minnesota grew from $934.7 million to $1,506.7 million over the last nine years (2006 – 2015)[1]. This translates into an annual growth rate of 5.44% per year. The projected average growth in local property taxes needs to be added to the required annual rate of return in the formula above to calculate how much needs to be deposited in the fund to make sure that the payments can keep up with the growth in property taxes in the future.

The table on the next page shows estimated total annual rate of return needed to adequately fund a perpetual stream of property tax payments depending on the amount of money put into the fund

[1] This was the only period that I could quickly get a breakout of growth in taxes in townships only.

in the first year, assuming an average annual growth rate of 5% and of 2% in rural property taxes.

Estimated Annual Rate of Return Needed to Fund property taxes in perpetuity

Multiple of the current property taxes	Annual rate of return needed assuming 5% annual growth in property taxes	Annual rate of return needed assuming 2% annual growth in property taxes
10 times current taxes	15%	12%
15 times current taxes	11.67%	8.67%
20 times current taxes	10%	7%
25 times current taxes	9%	6%
30 times current taxes	8.33%	5.33%

As the table shows the assumption on annual growth rate in property taxes has a major impact on the amount of initial seed money needed to make perpetual property tax payments. Assuming a relatively low growth in property taxes in the future, funding at 30 times current taxes may be a little high but if rural property taxes continues to grow at the same rate as seen in the last 9 years this could be a very reasonable funding amount.

PD/sk