

Midway Property Tax Report

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The physical form of a community is determined by the interplay of a variety of complex elements including city comprehensive plans, zoning, market conditions, architectural and construction trends, historical tradition, and even tax policy. University UNITED recently conducted a study of property taxes of a cluster around the Midway shopping centers to determine how the property tax system is being applied. We were also interested in exploring possible modifications of the property tax system that could help promote development that would be more in alignment with city and community goals.

This report can also hopefully provide the basis for a larger conversation about the tax system itself. Are property taxes an effective and fair way of raising revenue? Should the property tax system be aligned with development objectives of a city? Is the current land use classification system, with its different tax rates, helping the city attain its larger policy objectives?

This is a complex topic that does not lend itself to broad conclusions or simple recommendations. We are posting the results of the study on our website at www.universityunited.com, and are inviting comments and observations as to both the current tax system and whether it is being fairly and consistently applied, as well as suggestions as to how it can be improved.

What is a Property Tax?

Property (land and improvements) is subject to taxes by government at a number of levels including city, county, school district, watershed district, etc. The mechanism for collecting property taxes is through one bill typically sent by the county. Properties can be exempted from taxes if they are owned by a charitable institution, such as a church, or if they are publicly owned such as a library.

There are three things that determine the amount of property tax: the real estate classification and rate as defined by the state legislature; the assessed (fair market) valuation, as determined by the county assessor; and the levy (total) amount to be raised, as determined by the local government jurisdictions.

Classifications and Rates:

There are several different classifications of properties, and they are taxed at different rates. The most common classifications are Residential Homestead, including single family homes; Nonresidential Homestead, including multifamily homes, apartment buildings, and condominiums; Commercial/Industrial; and Recreational which includes

cabins and other recreational structures. The rates range from 1% for homestead residential classification, to 1.25% for apartments, to 2% for commercial/ industrial. Over the past several years the tax rate among the different tax classifications has considerably narrowed, resulting in a major shift of property taxes away from commercial property towards residential.

Taxes are based on property values within a given classification. For example, a \$500,000 factory will be assessed at the same level as a \$500,000 fast food restaurant because they are both within the same commercial-industrial classification. However, a \$500,000 house would be taxed at a substantially lower rate than a commercial property of the same value, because it is in a different classification. Property taxes are not related to the amount of municipal services used.

Classifications and rates are subject to change as part of the political process. As noted, there has been a considerable decrease in the tax rate of industrial and commercial properties bringing them closer to residential rates. This year the legislature reinstated the 4d class for affordable apartment housing, reducing the tax rate on low income housing from 1.25% to 0.75%. Affordable housing qualifies for this rate if at least 75% of the units in the development meet one of the following criteria: Low Income Housing Tax Credits; Project Based Section 8; financed through Rural Housing Service/rental assistance; or through other governmental rent and income restrictions (MHFA). Advocates for affordable housing continue to press for a waiver of the way assessed value is determined. Currently, affordable housing developments are valued as though they generate market level rents, even though most affordable housing projects are locked in to lower rents because of financing restrictions and government programs.

Assessments:

The county assessor assigns each property a market value and property classification as provided by state statute. Assessors determine values by examining comparable sales, and in the case of an investment property, evaluating such things as rental rates, vacancy levels, and/or store sales. Property values are divided into two parts - land and improvements/ buildings - and both are taxed at the same rate. By law, county assessors are required to view each parcel of real estate to appraise its market value every four years, although adjustments in value are also typically made every year.

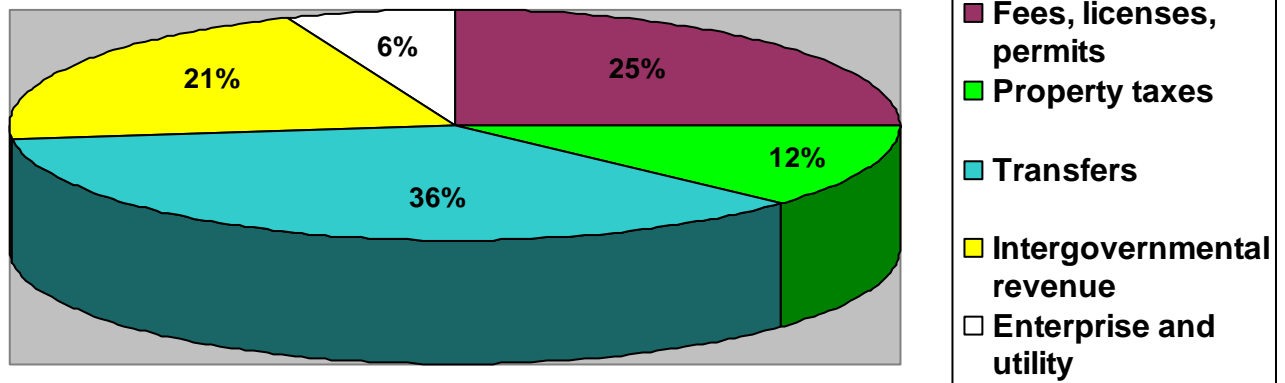
Levy Value:

The levy is the total amount of property tax to be raised, as determined by the local jurisdictions as part of their annual budget process. Individual property taxes are determined by working backwards from the levy, as the total amount needed is apportioned among all properties according to the rate and assessed market value.

In St. Paul, the property tax and other special assessments brings the city of St. Paul

roughly 12% of its annual operating revenue. Other sources include transfers; fees, licenses, and permits; and intergovernmental revenue. The property tax is also shared with the school district, county, and state general fund. While the percentage of property tax is relatively low, it should be noted that this is probably the one revenue source over which the city has the most control. Cities shape tax base through land use and building controls and infrastructure improvements.

St. Paul City Revenue



Currently, in St. Paul, about 35% of the total property valuations in the city are in the commercial and industrial classification, with the balance being residential. Approximately 65% of the actual taxes paid are from residential properties.

Cities are becoming increasingly more sophisticated in the way they approach land use because it has a direct bearing on the amount of property taxes generated. It has been said that suburban communities favor retail development and housing projects with large “McMansions” in order to maximize tax base and minimize operating expenses. Many recent studies, however, have shown that the most cost effective pattern of development is the classic “Main Street” model, and that national fast food outlets typically pay less in property taxes than they consume in municipal services.

One very important point to underscore is that the tax actually paid on a property is dependent on a formula involving all three variables - tax classification and rate, property assessment, and tax levy. An increase in property value, for instance, does not mean there is an automatic increase in property tax.

The underpinning of the property tax system is the complex task of establishing an assessment (fair market value) on different properties. Determining fair market value is part science and part art, especially in such a volatile and dynamic environment as University Avenue. Owners of properties that are perceived to be similar may see wildly different tax bills. For that reason, there is an elaborate system of appeals. Of late, owners of large commercial properties in downtown Minneapolis and St. Paul have increasingly

been challenging their assessments, with success in the vast majority of cases. In addition to individual appeals, commercial property owners have effectively utilized their trade associations such as the National Association of Industrial & Office Properties – Minnesota Chapter, and the Building Owners and Managers Association to lobby for tax policy changes.

The property tax system is intended to raise revenues for government jurisdictions and not accomplish specific governmental policies or objectives. However, as with the income tax, there are a number of variables that are incorporated into the system that reflect both politics and policy. In Minnesota there are tax exemptions, preferential class rates, and reductions in estimated market value. The land use classification system is politically popular with voters because it shifts more of the tax burden away from the homeowner to commercial properties. There are other programs including “Green Acres” which provides relief for agricultural land, the Open Space provision for private outdoor recreational land, the Wetlands Program, the “This Old House Program”, the Senior Citizens Property Tax Deferral Program, the Affordable Housing Program, and the like. These are all clearly responding to policy objectives, as well as political considerations..

Methodology Of This Study:

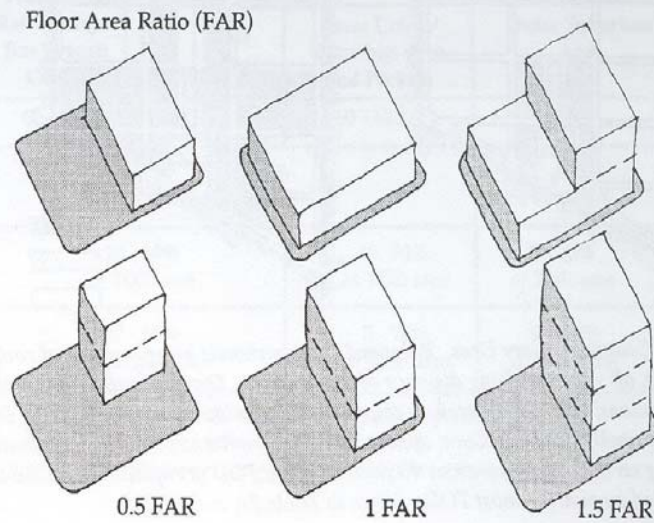
The study area consists of 139.8 acres or 6,089,849 sq. ft. of the Midway retail area, and is bounded by Snelling Avenue on the west, Lexington Parkway on the east, I-94 on the south, and the north side of University Avenue on the north. The area encompasses 139 parcels, which when aggregated by contiguous parcels under the same ownership results in 88 properties. For example, Skyline Tower and the parking lots that serve the building are 4 different parcels, but 1 property for purposes of this study.

Property tax data was collected from the Ramsey County GIS Users Database. Assessed market values were taken for both 2006 and 2005, in order to track changes. The data on taxes collected was for 2005—the latest available. The built up area, number of stories, and the usage of the site data were taken in the most current form available.

In order to analyze the extensive data base several formulas were applied. Among these is **Floor to Area Ratio (FAR)**, which is a measurement of density derived by dividing the building area by the total land area. For example, a 1 - story structure built out on the entire site has an FAR of 1. (Refer to diagram below, from the Metropolitan Council’s Handbook on Transit Oriented Development (TOD).)

The diagrams at left show two different examples of meeting various FAR requirements. For example, a 1.0 FAR can be met with a one-story building occupying the entire lot (middle top), or a two-story building with a footprint of half the lot (middle bottom).

These diagrams are very simplified and do not reflect other appropriate features of a pedestrian-scaled building such as doors, windows, and variation in massing.



Metropolitan Council

44

In order to allow for comparison among properties, much analysis was done on a “per square foot” basis including:

- **Assessed market value (AMV)** per square foot of land which was derived by dividing the total assessed market value for the property/parcel, by its land area.
- **Assessed land value** per square foot of land was taken by dividing just the land valuation (excluding improvements) by the land area.
- **Tax yield** per square foot, for each property/parcel was calculated by dividing the taxes collected by the total land area.
- **Effective tax rate** was calculated by dividing the tax yield by the 2005 assessed total market value, (from which the taxes were collected), and multiplying by 100, for a percentage rate. This is the effective rate, meaning that, after collection, this is the percentage of its AMV, that that property/parcel paid, as opposed to the rate at which these taxes were levied. Because taxes are levied at different rates in different years, based on the need, the rates may vary from year to year.

Several presentations of the preliminary findings of this study were made to Ramsey County assessors and other land use, taxation, and valuation specialists who provided considerable advice both as to methodology and analysis. (Nonetheless, University UNITED assumes full responsibility for all information in this report, including possible errors and omissions.) The University of St. Thomas Geography department made

several GIS maps of our parcel data, which we used in this presentation.

Highlights of the Study:

- The total 2006 assessed market value for the study area is \$199,131,100, a gain of \$23,398,600 over 2005, an increase of 11.8%..
- 80 of the 88 properties in the study area increased in value. The average property increased in value by \$265,893, mostly generated by increases in land value offsetting a decline in building value. On average, land increased by \$450,438 per parcel, and building values lost \$184,545 per parcel. On a per-square foot basis, the average land assessment gained \$6.51, while building assessments lost \$2.67.
- Walmart's assessed valuation increased by 28% to \$11.5 million. This reflected their recent purchase and significant improvements to the building. 429 Pascal St., a vacant lot adjacent to the "Bus Barn" site, increased by 47% to \$3.1 million, without any improvements.
- The average assessed land valuation per square foot in the study area is \$16.21, and the median value is \$19.85 suggesting that several very low land valuations are bringing the average down considerably. In 2005, the average assessed land valuation per square foot was \$9.58, with a median value of \$9.87, both considerably lower than this year.
- Skyline Tower, an affordable housing project owned by CommonBond Communities, a non-profit housing developer, is ranked third in property tax assessments at \$126 per square foot. As a comparison, the Midway Shopping Center (Rainbow, Office max, etc.) is assessed at \$27 per square foot.
- Midway Books at Snelling and University, is paying the second highest tax per square foot at \$2.83. As a comparison, Target is paying \$0.93 cents per square foot.
- The study compared tax assessments among different land uses. It went outside the study area to show that Hamline-Midway, an adjacent residential neighborhood, had a higher assessed value per square foot than any other land use in the study area including industrial, commercial or retail.

General Conclusions and Observations

1. Over the years, inefficient development characterized by low density and expansive parking lots has been favored with lower tax bills per square foot than high

density development. The property tax system is essentially in conflict with policy objectives of many communities seeking to encourage building to the “highest and best use”.

2. There has been a considerable recent upsurge in land value. This can be attributed to the “CVS bounce”. National chain stores, such as CVS Pharmacy, are locating on the Avenue and are paying a premium price for the land. Menards paid approximately \$1 million per acre for their site at University and Prior. A year later CVS paid approximately \$2 million per acre for their site at Snelling and University.

While the full purchase price is not immediately applied to the assessed valuation of individual parcels like CVS (see below), there is, over time, a significant upward pressure on the value of all land in the adjoining areas. Clearly, the large jump in valuations and taxes between 2005 and 2006 can be attributed to recent developments such as CVS. This increase in land assessments has both positive and negative consequences. Higher value shows an improving asset, but it may also bring higher taxes and operating costs. Higher land values also promote more intense development as it becomes too costly to hold land in an undeveloped or under-developed state. For the city, rising land assessments help raise the potential for increasing property tax revenues – although as noted above, the actual property tax paid is not solely dependent on assessed valuation

3. National chains utilize a completely different economic model in acquiring property than local developers as they are more concerned with “market share” than “making the rent numbers work”. In addition, chains typically use Wall Street equity capital, rather than the local bank for financing. When CVS decided to enter the Minnesota market with dozens of new stores, they immediately sought the 100% corner at Snelling and University Avenues. As the most heavily trafficked intersection in the state, the site had considerable “billboard” value, which is reflected in their high purchase price.

We have considerable concerns about this trend. Developers who are interested in building quality mixed-use dense projects, or locally owned businesses, simply cannot compete with the national chains who are operating with a different economic model. Ironically, even as the chain stores are driving up the price of land, property assessors are reluctant to value the property at the new purchase price because it is not the “real” market value based upon what others would pay for the property. So, even as the chains are distorting the local property valuations, they are not being immediately impacted through their own property tax bill.

4. We support modifications to the property tax system to bring it more in alignment with community objectives, specifically transit-oriented development. As previously noted, there are already a number of programs within the current property tax system that favor various policy objectives, such as agricultural or wetlands preservation, so this would not be a new approach. We would also favor moving towards a system that more closely connects property taxes to the actual cost of municipal services.

Several recent proposals and trends move in this direction. Over the past several years bills have been introduced at the legislature calling for a “split rate tax”, which would tax land at a higher rate than buildings. Commonly referred to as a “Land Valuation Tax”, this system would encourage a property owner to make building improvements as he would not be taxed on it, and discourage holding land undeveloped as it would be more heavily taxed.

A variation of the property tax is an assessment, which is typically added to a property tax bill for an improvement which directly benefits a property. Common assessments include streets, sidewalk and sewers. The Kelly administration recently enacted a new street assessment in St. Paul based on the amount of frontage of a property. Exempt properties such as churches and schools must also pay this fee, which goes toward snow plowing, public tree trimming, and streetlights. While some have argued that this is actually a property tax in disguise, it does have the benefit of more directly connecting the tax to the cost of maintaining streets.

The League of Minnesota Cities is promoting a “transportation utility fee”, which would be based upon the number of vehicle trips each type of land use generates, whether by customers, employees or the number of people who live in a residential property.

Another option, which we are exploring, is a possible transportation component of the property tax that would apply to parcels that are improved or enhanced by a major public transportation improvement, whether it be bus, light rail, or highway. Properties within a defined “transportation zone” would have a higher tax rate, reflecting the benefit of the public investment. To eliminate the possibility of unintentionally creating a resistance to any future transportation improvements by property owners, the transportation tax could be waived or scaled down if the development meets community land use and design objectives.

Another possible variation is to create a surcharge formula that would penalize properties that have not built to a level of density deemed appropriate by the city. This could be based upon physical form as in the Floor Area Ratio, or perhaps an economic form, which could be a ratio of building value to land value. In the case of projects like the new CVS at Snelling where they are building a structure that has less value than the underlying land, this can be seen as an “extraction” of value from the site rather than a contribution. The larger community should be able to recapture some of that “extraction” through a surcharge.

We at University UNITED hope this study will help stimulate an awareness of the impact of the property tax system. We will continue to examine ways that the property tax can be modified to more effectively meet community objectives, and we welcome your feedback.