

February 11, 2015

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House Legacy Funding Finance Committee  
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St. Paul, MN 55155

RE: Alternatives to Payments-In-Lieu of Tax Payments Study

Dear Senators and Representatives:

The Laws of Minnesota 2015, 1st Special Session, Chapter 2, Article 1, Section 10 directs Minnesota Management & Budget to prepare the attached report and submit to the chairs and ranking members of

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February 11, 2016

each of the Senate and House committees having jurisdiction over the environment and natural resources, legacy funds, and taxes.

Questions regarding this report may be directed to John Pollard at (651) 201.8039

Sincerely,

A handwritten signature in black ink, appearing to read "Myron Frans", written in a cursive style.

Myron Frans  
Commissioner

cc: Eric Nauman, Senate Counsel, Research & Fiscal Analysis  
Bill Marx, House Fiscal Analysis



# Alternatives to Payment-in-Lieu of Tax Payments

**A Report to the Minnesota Legislature**

Laws of 2015, 1st Special Session, Chapter 2, Article 1, Section 10

January 15, 2016

## **Acknowledgments**

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## Executive Summary

The 2015 Minnesota Legislature directed Minnesota Management and Budget (MMB) to consult with the Department of Natural Resources (DNR), the Department of Revenue (DOR), the Association of Minnesota Counties, and the Minnesota Association of Townships to examine alternative ways to pay payment-in-lieu of taxes (PILT) for natural resources lands and to submit recommendations. The report was required to:

1. Examine alternatives for PILT payments under Minnesota Statute § 477A.10 – 477A.14, including a trust fund approach, that would apply to land acquired with outdoor heritage fund and other dedicated funds.
2. Take into account the ongoing costs to the state and local units of government associated with the acquisition of land, including law enforcement, fire, rescue, other emergency services, and related transportation infrastructure.
3. Take into account any constitutional constraints.
4. Submit recommendations to the chairs and ranking minority members of the house of representatives and senate committees and divisions with jurisdictions over environment and natural resources, legacy funds, and taxes.

To meet this requirement, MMB convened the state agency, county and township representatives to analyze funding options for PILT. Two meetings were held in 2015 to review the current payment system, examine alternative funding options, and develop recommendations to the commissioner of MMB.

There are approximately 8.5 million acres of state-owned or leased natural resource lands in Minnesota for which counties receive PILT. In 2015, \$31.4 million was paid to counties, from a low of \$13,927 to Red Lake County to a high of \$3,394,463 to St. Louis County. Of these lands, the state acquired 25,390 acres in whole or in part with money from the outdoor heritage fund.<sup>1</sup> The payments are governed by Minnesota Statutes §§ 477A.10-477A.17. State payments to the counties are distributed to the counties, townships and school districts in accordance with Minnesota Statutes §§ 477A.14 and 477A.17.

### Examination of alternative payment approaches

The group reviewed the current approach to paying PILT and alternatives using criteria of efficiency, stability, adequacy, equity, and legality. The following alternative approaches were discussed:

- Using a trust fund approach for new acquisitions and prior acquisitions
- Using the current approach with language in law guaranteeing PILT be paid annually
- Using revenues generated from state-owned land to pay PILT and provide a general fund appropriation to supplement
- Dedicating a new sales tax or a portion of the existing sales tax charged statewide to pay PILT

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<sup>1</sup> Land Acquisition Report, Lessard-Sams Outdoor Heritage Council, January 15, 2016: p. 7.

## **Conclusion of the group**

The group was unable to come to consensus on which approach to recommend to the commissioner of MMB. The group focused on both the current approach and the trust fund approach for new acquisitions. There was support of the trust fund approach for new acquisitions by local government representatives and support for continuation of the current approach by state agencies.

While the group was unable to come to consensus, all agreed there is a need to protect the stability of the PILT program, ensuring the purposes of PILT set forth in Minn. Stat. § 477A.10 are met.

## **Recommendation**

After consulting with the commissioners of the Departments of Natural Resources and Revenue, the Association of Minnesota Counties and the Minnesota Association of Townships, the Commissioner of Minnesota Management and Budget recommends no changes to the current PILT payment system for three primary reasons:

1. The current mechanism for funding PILT is one of the most stable in state government.
2. The PILT program is not unique among general purpose local aids or other state programs.
3. The alternatives do not sufficiently exceed the current program's administrative efficiency and long-term financial stability to warrant a change.

More detail regarding this recommendation is found in the Recommendations section of the report, beginning on page 33. If the legislative or executive branch pursued an alternative approach, like the trust fund approach to fund PILT-related obligations, questions regarding the value of the initial trust fund payment, guidance outlining the annual payment distributions, and administrative procedures and costs would need to be more fully explored. These questions are outlined on page 37 of the report.

While the commissioner does not recommend changes to the existing PILT program, an aspect of the program that warrants further study to address local representatives' concerns, explored in more detail on page 38 of the report, is to review the distribution of PILT payments at the local level.

## Introduction

Whenever the State acquires land from a private party, property is taken off local government tax rolls, limiting the local government's ability to maintain or expand its tax base. Payment-in-lieu of taxes (PILT) payments compensate local government for state-owned and some state-leased natural resource lands. There are approximately 8.5 million acres of state-owned or leased natural resource lands in Minnesota for which counties receive PILT, which is governed by Minnesota Statutes §§ 477A.10-477A.17. Of the 8.5 million acres, 892,000 were acquired (i.e., taken off the tax rolls). The remaining lands eligible for PILT include 2.8 million acres of tax-forfeited land, 4.9 million acres of other lands, including school trust lands that were tax exempt at the time the land was acquired by the state.

The 2015 Minnesota Legislature directed Minnesota Management and Budget (MMB) to consult with the Department of Natural Resources (DNR), the Department of Revenue (DOR), the Association of Minnesota Counties, and the Minnesota Association of Townships to examine alternative ways to pay payment-in-lieu of taxes (PILT) for natural resources lands and to submit recommendations. Specifically, the law (Laws 2015, 1<sup>st</sup> Special Session, Chapter 2, Article 1, Section 10) provides:

### Sec. 10. PAYMENT-IN-LIEU OF TAX ALTERNATIVES; RECOMMENDATIONS.

The commissioner of management and budget, in consultation with the commissioners of natural resources and revenue, the Association of Minnesota Counties, and the Minnesota Association of Townships, shall examine alternatives to payment-in-lieu of tax payments under Minnesota Statutes, sections 477A.10 to 477A.14, including a trust fund approach, that would apply to land acquired with money from the outdoor heritage fund and other dedicated funds. The examination must take into account the ongoing costs to the state and local units of government associated with the acquisition of the land and any constitutional constraints. The commissioner of management and budget shall submit recommendations to the chairs and ranking minority members of the house of representatives and senate committees and divisions with jurisdiction over the environment and natural resources, legacy funds, and taxes no later than January 15, 2016.

To meet this requirement, MMB convened the collaborators to analyze funding options for PILT.

## Methodology

The group examined approaches to pay PILT using five criteria:

1. **Efficiency:** The group evaluated efficiency from an administrative perspective to understand how easy or complicated the option is to implement and manage from the state's standpoint, a county's standpoint, and, where appropriate, a private business's standpoint.
2. **Stability:** The group evaluated whether a funding source generated varying levels of funding from year to year.
3. **Adequacy:** The group evaluated if the funding source was sufficient to pay PILT obligations as outlined in current law.

4. **Equity:** The group evaluated whether the administrative level of effort at the state and county level would be impacted differently, and if so, if those impacts were equitable. In cases where multiple funding sources are used for acquisition, the group evaluated if costs were equitably distributed among those sources based on a fund's ability to pay.
5. **Legality:** The group identified, when applicable, whether there were any changes to law needed to implement the approach and whether there were any constitutional impediments for the funding approach.

## Report structure

This report is comprised of the following sections:

- Current PILT payment and distribution system
- Background of PILT program
- Approaches to fund PILT, including the current approach and alternatives
- Recommendations

In addition to examining alternative funding approaches for PILT, the law requires the analysis take into account the ongoing costs to the state and local units of government associated with the acquisition of land and any constitutional constraints. Given the previous volume of work outlining the ongoing costs of land acquisition, this report focuses on the current and potential payment structures for PILT.<sup>2</sup>

Regarding constitutional constraints, there are two primary funding sources for land acquisition from constitutionally-dedicated funds: the Outdoor Heritage Fund and the Environment and Natural Resources Trust Fund. To date, there have been no court cases to determine whether or not PILT is an allowable expenditure from these funds under the constitution. This report identifies potential constitutional concerns.

For purposes of this report, the phrase "PILT program" refers to the collective payments in lieu of taxes paid to counties.

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<sup>2</sup> See Natural Resources Land, Office of the Legislative Auditor Evaluation Report, March 2010, and Payment in Lieu of Taxes for State Natural Resources Land, Department of Natural Resources Report to the Minnesota Legislature, December 1, 2012.

## **Current PILT Payment and Distribution System**

This section provides a brief overview of statewide PILT payments and lands subject to PILT, including descriptions of land classes and associated rates, and the payment and distribution process.

### **Overview**

In 2015, the State of Minnesota made statewide payments in lieu of taxes in the amount of \$31,355,813 for 8,520,098 acres of natural resources land. The source of payment is the state general fund. The state made payments to all 87 counties, from a low of \$13,927 to Red Lake County to a high of \$3,394,463 to St. Louis County.



## Land classes

Payments are made for the following natural resources lands:

- All lands owned by the state in fee title and administered by the commissioner of natural resources (acquired natural resources land, wildlife management land, other DNR administered land, Lake Vermilion-Soudan Underground Mine State Park)
- Land utilization project (LUP) land owned by the United States, leased by the state and managed by the DNR for wildlife (land utilization project)
- Tax-forfeited lands, other than platted lots within a city, administered by counties (other county administered land)
- Land acquired by the state from private owners and administered by the Department of Transportation for the purpose of replacing wetland losses caused by transportation projects (transportation wetland)
- Camp Ripley Game Refuge administered by the Department of Military Affairs (military refuge land)

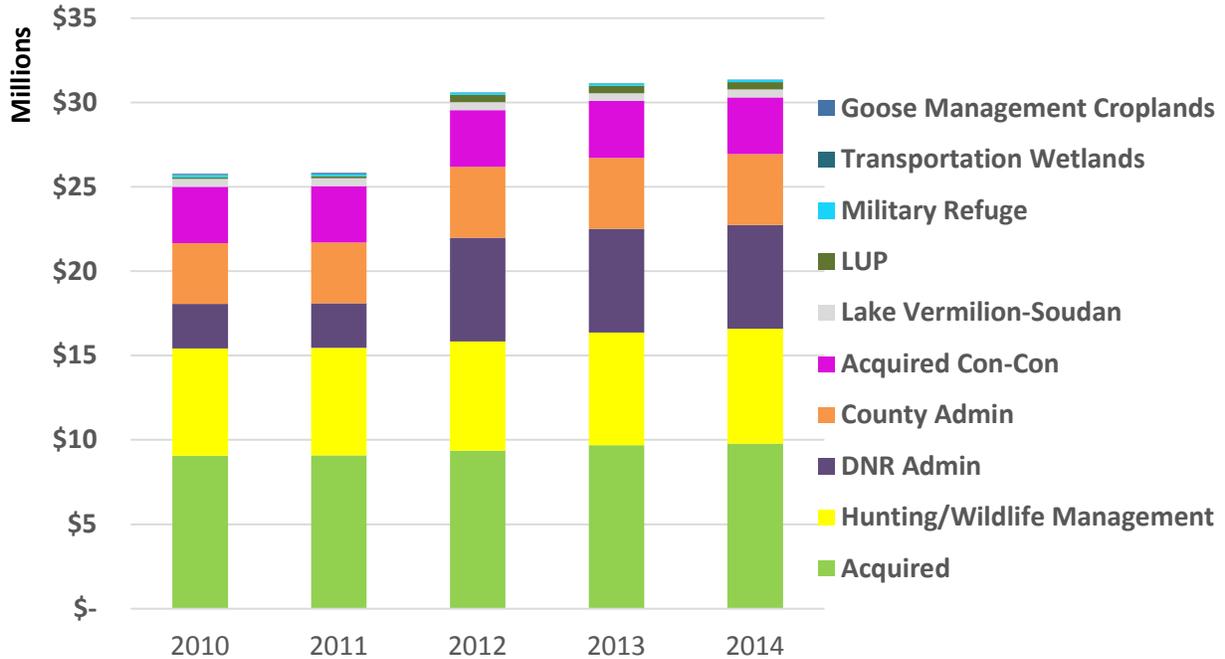
Land values, on which several land class payment rates are based, are reassessed by county assessors every six years.

**Table 1 : Land classes, payment rate, and distribution**

Land Class	Examples or purpose	Minn. Statute	Payment Rate	Distribution
<b>Acquired Natural Resources Land</b>	Land purchased and managed by DNR (includes state parks, recreation areas, scientific and natural areas, certain consolidated conservation lands, etc.)	MS § 477A.12, subd. 1(1)	The greater of \$5.133/acre or ¼ of 1% of appraised value of all acquired natural resources land in the county	Per formula in MS § 477A.14, subds. 1, 2
<b>Transportation Wetland</b>	Land acquired by state from private owners and administered by MnDOT to replace wetland losses caused by transportation projects	MS § 477A.12, subd. 1(2)	The greater of \$5.133/acre or ¼ of 1% of appraised value of all transportation wetland in the county	Per formula in MS § 477A.14, subd. 1
<b>Wildlife Management Land</b>	Land owned by the state and administered by DNR and used as a wildlife management area	MS § 477A.12, subd. 1(3)	The greater of \$5.133/acre or ¼ of 1% of appraised value of all wildlife management land in the county	Among counties, townships, and school districts consistent with distribution of property taxes on the land

<b>Land Class</b>	<b>Examples or purpose</b>	<b>Minn. Statute</b>	<b>Payment Rate</b>	<b>Distribution</b>
<b>Military Refuge Land</b>	Game refuge/hunting lands administered by Military Affairs	MS § 477A.12, subd. 1(4)	\$2.5665/acre	Among counties, townships, and school districts consistent with distribution of property taxes on the land
<b>Other Natural Resources Land</b> County-Administered	Tax-forfeited lands (other than platted lots within a city)	MS § 477A.12, subd. 1(5)	\$1.50/acre	Per formula in MS § 477A.14, subd. 1
<b>Land Utilization Project Land</b>	Land owned by the US, leased by the state, administered by DNR for wildlife	MS § 477A.12, subd. 1(6)	\$5.133/acre	Per formula in MS § 477A.14, subd. 1
<b>Other Natural Resources Land</b> DNR-Administered	Owned by the state and administered by DNR other than acquired natural resources lands or wildlife management land	MS § 477A.12, subd. 1(7)	\$1.50/acre	Per formula in MS § 477A.14, subs. 1, 2
<b>Vermilion/Soudan</b>	Land that comprises the Lake Vermilion-Soudan Underground Mine State Park	MS § 477A.17	1.5% of appraised value of the land	1/3 each to county, township, and school district

Figure 2: Five-Year History of PILT Payments by Land Class



**PILT payment process**

The amount of PILT to be paid annually is calculated by DNR using the land records system and is verified by DOR. Through an open appropriation in the general fund, DNR transfers that money to DOR to make the payments. DOR pays counties on July 20 with the first installment of local government aid. Counties distribute the payments to the county, townships, and school districts based on land class.

Table 2 : Latest PILT payments by land class

Land Class	FY14 Acres	% of Acres	FY14 Payment (paid July 2015)	% of Payment
Acquired Natural Resources Land	1,013,796	12%	\$13,154,797	42%
Transportation Wetland	1,825	0%	\$9,368	0%
Wildlife Management Land	458,846	5%	\$6,793,160	22%
Military Refuge Land	50,626	1%	\$129,932	0%
Other Natural Resources Land County-Administered	2,802,762	33%	\$4,204,143	13%
Land Utilization Project Land	86,105	1%	\$441,978	1%
Other Natural Resources Land DNR-Administered	4,102,018	48%	\$6,153,027	20%
Vermilion/Soudan	4,120	0%	\$469,409	1%
<b>PILT Totals</b>	<b>8,520,098</b>	<b>100%</b>	<b>\$31,355,813</b>	<b>100%</b>

## **PILT distribution**

Payment in lieu of tax payments are distributed in the following way:

- Payments for wildlife management lands and military game refuge lands are distributed among counties, townships, and school districts as if the payments were property taxes on the land
- Payments for Lake Vermilion-Soudan Underground State Park are distributed 1/3 to the county, township, and school district
- All other payments are distributed among counties and townships using the formula set forth in Minnesota Statutes § 477A.14, subdivision 1. There is a special distribution for consolidated conservation lands under Minnesota Statutes § 477A.14, subdivision 2.

**Table 3: Distribution formula in Minnesota Statute § 477A.14, subdivision 1**

**County receives PILT payment, and distributes the payment between the county and township as follows for:**

- Acquired natural resource lands
- Transportation wetlands
- Other natural resource land, county-administered
- Land Utilization Project land
- Other natural resource land, DNR-administered

<b>Order of payment</b>	<b>Entity</b>	<b>Amount</b>	<b>Deposited to</b>	<b>Purpose</b>
1	County	40% of total county PILT payment	County general fund	To reduce dramatic property tax shifts when parcels are removed from local tax rolls.
Remaining 60% of county PILT payment is distributed as follows:				
2	County	\$0.642/acre of county-administered other natural resources land	Resource development fund at county (unless county receives less than \$5,000 annually, in which case, can be deposited into county general fund)	For use in resource development, forest management, game and fish habitat improvement, and recreational development and maintenance of county-administered other natural resources land.
3	Township	10% of county payment for (1) acquired natural resources land, (2) transportation wetland, (3) county-administered other natural resources land, (4) land utilization project land, and (5) DNR-administered other natural resources land	Township's general fund (except for lands not located in organized township, which are deposited in county general revenue fund)	To reduce dramatic property tax shifts when parcels are removed from local tax rolls.
4	County	Any remaining funds	County general fund	If the distribution exceeds \$35,000, excess used to provide property tax levy reduction.

## **Background of PILT**

### **Origins of PILT**

The main PILT law (Minnesota Statutes §§ 477A.10-477A.14) was enacted in 1979 and provided for payments for all state-owned, DNR-administered lands and for state-owned tax-forfeited land. Prior to this law, the earliest payments reflected in 1933 law, with minor changes, were to defray costs of managing lands designated as public hunting grounds and game refuges. Major changes since enactment of the 1979 PILT law include adding eligible types of land, authorizing acquired lands payments to be based on land value, adding and later repealing an inflation adjustment for flat payment rates, including raising flat payment rates to 2011 inflationary levels.

### **Concerns from local units of government**

The State of Minnesota makes annual payments in lieu of taxes (PILT) to counties in which state-held natural resources lands and certain county-managed tax-forfeited lands are located. According to Minnesota Statutes § 477A.10, one of the purposes of PILT is “to compensate local units of government for the loss of tax base from state ownership of land and the need to provide services for state land.” Payment rates and allocations vary by land class. Local governments rely on these state payments because state-owned natural resources are exempt from property taxes, precluding the local governments from raising revenue through property taxation.

Local units of government generally have four main concerns with the current PILT program:

1. The stability of PILT payments
2. The adequacy of PILT payments
3. The rate of continued state acquisition of land
4. The definition of land acquisition costs

### **Stability of PILT payments**

PILT payments are provided through an open appropriation in the state’s general fund. An open appropriation means that whatever amount is necessary to meet the requirements outlined in PILT statute (Minnesota Statutes §§ 477A.10-477A.14 and 477A.17) is appropriated to the commissioner of natural resources for transfer to the commissioner of revenue. Because an open appropriation is codified in statute, this authority is ongoing and is not dependent of the passage of an appropriations bill each biennium.

PILT payments are like any statutory state program in that the legislature can change the purpose or funding at any time with a revision to statute. Given that the program is funded by the general fund, local governments are concerned about a future potential reduction. Historically, the legislature has not reduced the appropriation for PILT payments, and, in fact, overall payments have increased by about 470% (unadjusted for inflation) since the main PILT law was enacted in 1979 (inflation has been 329%

since 1979, according to the US Bureau of Labor Statistics). Legislative changes to the PILT program have resulted in changes to payment amounts or changes to the distribution of payments.

As the population of Minnesota slowly shifts from rural to urban areas, there is also concern from the local government representatives that policymakers will be less focused on the needs of greater Minnesota, and that the PILT program may receive less attention and support.

### **Adequacy of PILT payments**

The local government representatives questioned whether PILT payments adequately compensate local government for state-owned lands. There have been some major changes to the PILT program since the main PILT law was passed in 1979. For example, when the legislature enacted an inflationary adjustment for lands paid at per acre rates, the adjustment was applied retroactively to the first quarter of 1994 rather than 1979 when the main PILT law was passed<sup>3</sup>. The law was subsequently repealed in 2011<sup>4</sup>. Some of the local government representatives assert, because the inflationary adjustment was not applied retroactively to the passage of the main PILT law and because the adjustment was later repealed, that the historical PILT payments have been less than what is necessary to cover the cost of state land ownership. Additionally, some argue the PILT payment does not take into account lost development opportunities, such as the potential for construction of residential cabins, which would increase local tax base.

However, based on the Office of Legislative Auditor (OLA) evaluation of natural resource land, PILT for acquired natural resource land was higher than the county-town property tax rate for 77 of 87 counties for taxes payable in 2009.<sup>5</sup> With the passage of a 1995 law<sup>6</sup>, the legislature allowed counties to receive the greater of a flat rate for acquired lands or three-fourths of one percent of the appraised value of all acquired natural resources land in the county. This law requires county assessors to reassess the market value of natural resources land on a regular six-year cycle.

### **Continued state acquisition of land**

In addition to the land set aside at the inception of statehood, almost a million acres have been acquired by the state for a variety of natural resources purposes, including parks and wildlife management areas. Historically, acquisition was funded through a combination of general fund, dedicated agency funds such as the game and fish fund, and general obligation bonding. After the Legacy Amendment passed in 2008, a new pool of funding for land acquisition became available. Local governments are concerned about the continued state purchase of land, especially in the northern portion of the state, erosion of tax base, and limitation of development opportunities.

The legislature determines the rate of land acquisition by the amount of money they appropriate for this purpose in appropriations bills, and, as shown in figure 3 on the following page, the gradual trend of acres acquired by the state (see Figure 3) has not increased at the same rate as the comparatively faster

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<sup>3</sup> Laws of Minnesota 2000, Chapter 490, Article 6, §14

<sup>4</sup> Laws of Minnesota 2011, 1<sup>st</sup> Special Session, Chapter 7, Article 6, §§ 1, 19-21, 27

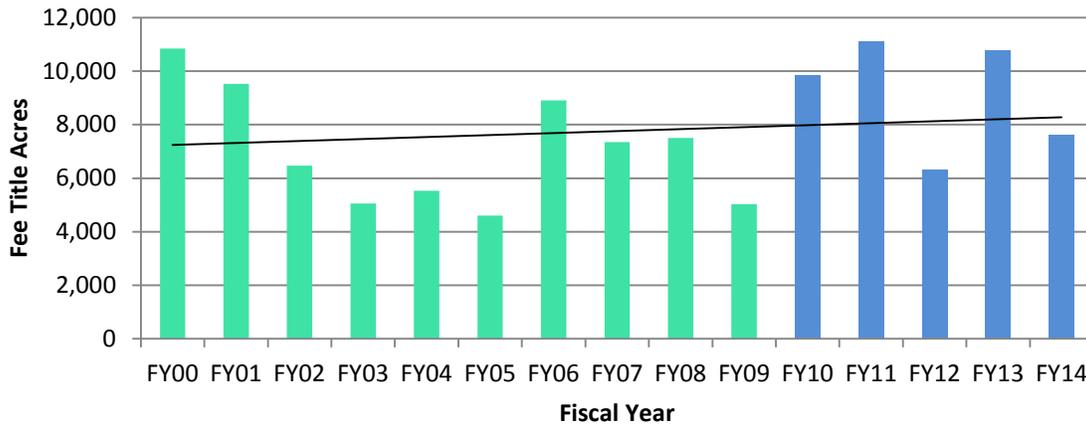
<sup>5</sup> Minnesota Office of Legislative Auditor, Natural Resources Land, March 2010, p. 68-69

<sup>6</sup> Laws of Minnesota 1995, Chapter 220, § 125

increase in the cost of the overall PILT program covering both state acquired and non-acquired lands, as shown in Figure 4. The option for counties to receive the greater of appraised value or a fixed dollar amount on acquired lands has allowed for large increases in PILT payments over the last twenty years.

It is estimated, based on historical acquisition provided for by the outdoor heritage fund, approximately 122,000 acres worth \$511 million will be acquired over the life of the Legacy Amendment, and, assuming all counties choose to be paid the appraised value, an additional \$5.1 million of cost will be added to the PILT program<sup>7</sup>. In comparison, there are currently 8.5 million acres of state-owned or leased natural resource lands in Minnesota for which counties receive PILT.

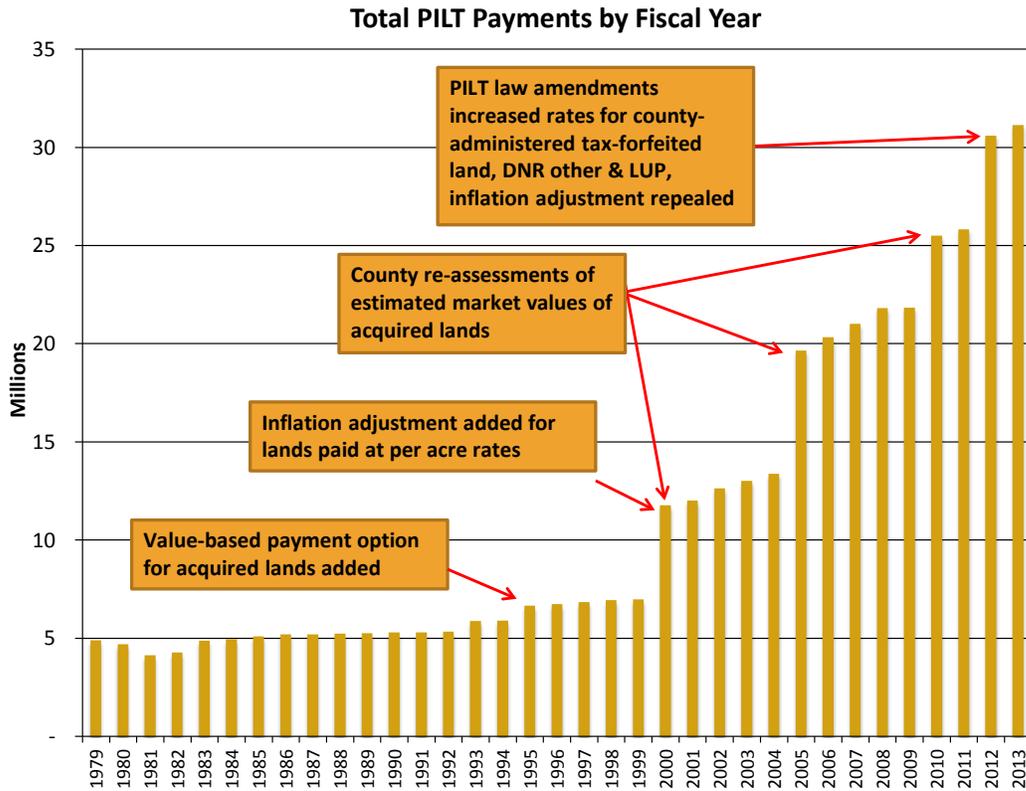
**Figure 3: DNR Fee Title Acres Acquired by Fiscal Year<sup>8</sup>**



<sup>7</sup> Land Acquisition Report, Lessard-Sams Outdoor Heritage Council, January 15, 2016: p. 23

<sup>8</sup> Source: Department of Natural Resources

Figure 4: Total PILT Payments by Fiscal Year<sup>9</sup>



### Definition of land acquisition costs

From the local perspective, land acquisition costs include both the purchase or acquisition price of the land as well as the ongoing PILT payments as a cost of land acquisition. Concerns have been raised that funds such as the outdoor heritage fund and environment and natural resources trust fund do not pay the ongoing PILT obligations, which are paid from the general fund. Some feel this arrangement may allow for more state land acquisition than if funds used to acquire the land paid both the one-time acquisition costs and ongoing PILT payments. This is due to the belief that the state may be underestimating the cost of acquiring land by separating the source of funds from land acquisition from the ongoing PILT obligations.

The state has not historically included ongoing PILT obligations in its definition of land acquisition costs since it is considered a form of local aid. Given that land acquisition is intended to benefit all Minnesotans, the general fund is an appropriate source of funding payments-in-lieu-of-taxes. State-owned lands, including both acquired and non-acquired lands, comprise about 17% of the total acreage of the state and PILT payments comprise less than 0.2% of all general fund expenditures.

<sup>9</sup> Source: Department of Natural Resources

The state has provided for PILT through an open appropriation from the general fund, which is the most stable kind of appropriation and is different than other forms of local aid such as county program aid, city local government aid, and township local government aid. These local aids receive statutory appropriations where the legislature defines the amount for each year of a biennium. This is in contrast to the open appropriation for PILT where whatever amount is necessary to pay PILT obligations is appropriated without needing legislative action.

### **Most recent changes**

Following the release of the DNR PILT study in December 2012, the legislature made a number of amendments<sup>10</sup> to Minnesota Statutes § 273.18 and 477A.10-.17, resulting in a total increase in PILT payments of \$4.46 million. These changes included:

- Adding a purpose statement to PILT (Minnesota Statutes § 477A.10)
- Increasing rates for three classes of land (Minnesota Statutes § 477A.12):
  - DNR-administered other natural resources land increased from \$0.642 per acre to \$1.50
  - County-administered other natural resources land increased from \$1.283 per acre to \$1.50
  - Land Utilization Program (LUP) land increased from \$1.283 per acre to \$5.133 per acre
- Merging two PILT statutes (Minnesota Statutes § 477A.11-.12, 477A.14)
- Lengthening the cycle for county reappraisals from once every five years to once every six years to follow the required assessments on exempt land (Minnesota Statutes § 273.18)
- Revising the land class definitions (Minnesota Statutes § 477A.11)
- Amending distribution provisions (Minnesota Statutes § 477A.14), including increasing the share of PILT payments distributed to townships under Minn. Stat. § 477A.14, subd. 1

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<sup>10</sup> Laws of Minnesota 2013, Chapter 143, Article 2, §§22-32 and 36; Laws of Minnesota 2014, Chapter 308, Article 1, §§ 7-9; and Laws of Minnesota, Chapter 217, §4

## Approaches to fund PILT

At the direction of the 2015 legislature, Minnesota Management and Budget (MMB) consulted with the Department of Natural Resources (DNR), the Department of Revenue (DOR), the Association of Minnesota Counties, and the Minnesota Association of Townships to examine alternative ways to pay payment-in-lieu of taxes (PILT) for natural resources lands. The group used five criteria to evaluate various approaches to funding PILT:

1. **Efficiency:** The group evaluated efficiency from an administrative perspective to understand how easy or complicated the option is to implement and manage from the state's standpoint, a county's standpoint, and, where appropriate, a private business's standpoint.
2. **Stability:** The group evaluated whether a funding source generated varying levels of funding from year to year.
3. **Adequacy:** The group evaluated if the funding source was sufficient to pay PILT obligations as outlined in current law.
4. **Equity:** The group evaluated whether the administrative level of effort at the state and county level would be impacted differently, and if so, if those impacts were equitable. In cases where multiple funding sources are used for acquisition, the group evaluated if costs were equitably distributed among those sources based on a fund's ability to pay.
5. **Legality:** The group identified, when applicable, whether there were any changes to law needed to implement the approach and whether there were any constitutional impediments for the funding approach.

## Current approach

### Description

PILT payments are governed by Minnesota Statute § 477A.10 - 477A.14 and § 477A.17, and are paid on all natural resources land classes with an open appropriation from the general fund. DOR pays PILT to counties based on data from DNR, counties, Minnesota Department of Transportation, and the Department of Military Affairs.

### Efficiency

From a state administrative perspective, the current payment system is the most efficient approach. DNR's land records system is producing reliable calculations of PILT payments, which are verified by DOR and paid to counties on time. Additionally, counties are receiving details about the PILT payment in user-friendly formats.

County and township representatives had no concerns about the administrative efficiency of the current approach.

### Stability

The PILT program is subject to volatility from two sources. One source is legislative – as with any state program, the legislature and governor may make statutory changes to the program that change

payment rates and amounts. The second source is market-based – since these lands are reappraised every six years, changes in the real estate market may drive PILT payments up or down.

However, volatility from these two sources is relatively limited. As a statutory appropriation, the PILT appropriation is one of the most stable in state government, because it doesn't need a biennial appropriations bill to be passed for the money to be appropriated and spent. Instead, the statute appropriates sufficient funds to make PILT payments annually and automatically and the payments are planned for in each November and February revenue and expenditure forecast. The program has not been reduced, even during recessionary periods, although changes have been made to reduce the rate of growth in the program, such as the repeal of the inflationary adjustment in 2011 for lands paid at per acre rates. For the most part however, the statutory changes enacted in the past fifteen years have supported consistent growth in the program and include adding an option for a value-based payment for acquired lands and the addition and later repeal of an automatic inflationary increase for lands paid at per acre rates.

Market-based volatility has historically been low. By tying PILT payments to the value of state-owned natural resource lands in 1995, the program has seen growth that's tracked with the overall increase in real estate values.

### **Adequacy**

The current system is adequate to cover the costs of the PILT program under current law because the amount necessary to make PILT payments is statutorily appropriated from the general fund<sup>11</sup>. However, local units of government suggest that, while the appropriation is sufficient to meet the requirements of the program, the program as it is currently constructed may not provide adequate reimbursement for lost taxes in some counties and towns. During the period of 1980 to 2001, overall per-acre PILT payments did not keep pace with inflation, and local units of government by and large were not fully compensated for their lost tax base.

This has largely been counteracted since 2001, when changes to PILT payment rates pushed PILT payments upward, such that, in most counties, PILT payments now are greater than their original value after adjusting for inflation<sup>12</sup>. However, depending on the composition of state-owned land in a given jurisdiction, some counties have seen a decline in inflation-adjusted PILT payments<sup>13</sup>. Even so, a 2010 OLA report indicates that most state payments in lieu of taxes were higher than property taxes. For example, it found that the effective PILT rate for acquired natural resource land equaled or exceeded county-town property tax rates for 77 of 87 counties in 2009.

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<sup>11</sup> Minnesota State § 477A.12, subdivision 1

<sup>12</sup> Evaluation Report: Natural Resource Land, Office of the Legislative Auditor, March 2010: p. 61.

<sup>13</sup> Evaluation Report: Natural Resource Land, Office of the Legislative Auditor, March 2010: p. 62.

## **Equity**

The group has no concerns regarding the distribution of administrative effort between the state and counties.

From the county and township representatives' perspective, there was concern that the general fund is paying a portion of land acquisition costs by paying the ongoing PILT obligation associated with land acquired using other funds, such as outdoor heritage fund or environment and natural resources trust fund. This is primarily because local governments define ongoing PILT payments as being part of the cost of land acquisition. By delinking the PILT payment from the initial land acquisition cost, there is concern the state could be underestimating the ongoing obligation related to land acquisition.

In addition to the disconnection between the initial payment source and the ongoing PILT obligation, local government representatives indicated a concern over the equity of the distribution of PILT payments, noting that the current PILT payment system creates "winners" (those that receive higher PILT payments than they might receive in local property taxes) and "losers" (those that receive lower PILT payments than they might receive in local property taxes, or those whose payments haven't kept pace with inflation).

## **Legality**

There are no changes to statute needed and no constitutional concerns with the current payment system.

## **Conclusion**

The current payment system adequately covers the cost of the PILT program. Due to potential legislative changes and six-year reassessments of market value, there is risk of programmatic cost volatility. However, these changes have historically resulted in program growth, as opposed to program reductions. This approach would require no statutory changes and there are no constitutional concerns.

From the state agencies' perspective, the current approach is the most efficient approach and adequately covers the cost of the PILT program. The appropriations are statutory, meaning payments are made automatically and don't require passage of an appropriations bill, and the scheduled 6 year market value reappraisal means that payments are tied to real estate values, just as property taxes are tied to real estate values. Finally, they point to the 2010 OLA Audit Report which found that state PILT payments are generally higher than the equivalent estimated property taxes, and pay an effective rate that is equal to or higher than local property tax rates in 77 of 87 counties<sup>14</sup>.

From the county and township representatives' perspective, there is continued concern about assuring both that PILT is paid annually and that it is paid at the level to fully compensate local government for the lost tax base. In the case of acquisitions being made by the outdoor heritage fund or environment and natural resources trust fund, there is a perception by some that the state is not considering the full cost of land acquisition by separating the source of funding for the purchase price of the land from the

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<sup>14</sup> Evaluation Report: Natural Resource Land, Office of the Legislative Auditor, March 2010: p. 69.

PILT payments needed necessary to cover ongoing costs. Local representatives had no concerns about administrative efficiency.

State agencies noted there are aspects of the current program that could be revisited including the historical lost inflation and the distribution of PILT at the local level to reflect the current property tax distribution.

## **Alternative #1: Trust fund approach: New acquisitions**

### **Description**

At the time of a land acquisition, funds would be set aside to be transferred to a county trust and invested by the State Board of Investment (SBI). The trust would pay property tax on those lands acquired after the law goes into effect; in other words, this approach would apply only to new acquisitions of land. Lands covered under the trust would not be eligible to be part of the PILT program.

This approach has been discussed over the past several years including during the 2015 legislative session.<sup>15</sup> The discussion was focused on land acquired with outdoor heritage fund (OHF) or environment and natural resources trust fund (ENRTF) dollars. There were various iterations of the approach discussed.

For purposes of this report, the following assumptions were made and reflect further development of the approach. Note that these assumptions differ from the bills introduced in the 2015 session.

Assumptions for a trust fund approach for new acquisitions:

- At the time of acquisition, a one-time trust fund payment would be made proportionate to funding, with the following exceptions:
  - If OHF or ENRTF funds comprise 10% or less, the land would be ineligible for a trust fund payment.
  - If OHF or ENRTF funds comprise between 10% and 90%, the trust fund payment would equal the same percentage as is contributed by those funds.
  - If OHF or ENRTF funds comprise 90% or more, OHF or ENRTF would make 100% of the trust fund payment.
- The one-time trust fund payment would be 30 times the property taxes on the eligible property in the year prior to acquisition.
- If, in the future, the land is no longer used as intended, the original payment excluding earnings, or some portion of the original payment, would be returned to the original funding source.
- At the local level, the funding must be used for “land related services,” meaning that schools would not be eligible for payments under this approach.
- The State Board of Investment (SBI) would invest one trust fund on behalf of all counties to maximize earnings and reduce administrative overhead.

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<sup>15</sup> From the 2015 Legislative Session, see House File 1706 and House File 1707

- The one-time trust fund payment would be appropriated to DOR, and DOR would be the fiscal agent for counties, making one annual payment to the trust for land acquired the preceding year and one annual withdrawal from the trust to pay counties the lesser of the amount certified by the counties or 5.5% of the market value of the trust.
- Statutory language would be adopted that would appropriate funds to DOR, authorize DOR to establish a trust, authorize DOR to enter into contracts with counties, and authorize DOR to include language in the contracts that would prevent the state from impairing the trust.
- Annual payments from the trust fund to local units of government would be equal to the annual taxes owed based on the appraised value of the land in the county that received the trust fund payment or the taxes assessed on comparable, privately owned adjacent land.
- DNR would track and certify, based on information from counties, (1) which land is eligible, (2) the number of acres, (3) the total purchase price, and (4) the amount of OHF or ENRTF revenue used to purchase the land.
- If there were insufficient OHF or ENRTF dollars to cover the one-time payment to the trust fund in a particular biennium, those dollars appropriated for land acquisition could not be used for said acquisition in that biennium. Alternatively, if the trust fund payments were structured as an open appropriation, dollars would automatically be appropriated at the time of acquisition.
- If the one-time payment were found unconstitutional, OHF or ENRTF dollars could not be used for acquisition in the future unless another funding source were used to make the one-time payment.

## **Efficiency**

From the state agencies' perspective, creating a trust fund would make the process of calculating PILT substantially more complex. When multiple funding sources are involved in an acquisition, DNR would need to track additional information including which parcel or portion of a parcel was acquired with outdoor heritage fund or environment and natural resource trust fund dollars. This would determine whether the acquisition's PILT payment would be covered by the general fund or covered by the trust fund. This would require reprogramming of the land records system to add additional fields and may cause delays in the timing of the annual PILT calculation, particularly in the first year that the new process would be in place. DNR's land record system consultants, MNIT and DNR staff estimate that total cost of reprogramming the system would be about \$60,000 on a one-time basis.

A complicating factor is that, currently, the funding source may change after the land is acquired due to the availability of federal aid, for example. If a trust fund payment were needed at the time of acquisition and if the funding could not be changed at a later date, the trust fund approach would reduce DNR's current flexibility to change funding sources based upon funding availability.

Under this approach, DOR would administer two separate payments: one payment for all prior acquisitions funded by the general fund and one payment for all new acquisitions with OHF or ENRTF

funded by the trust fund. DOR estimates the additional effort to cost approximately \$8,000 annually to administer payments as well as provide outreach and training<sup>16</sup>.

Because the current process does not involve splitting parcels of land based on the source of funding for an acquisition, county assessors would need to submit individual statements for parcels or portion of parcels acquired with OHF or ENRTF after the trust fund approach was enacted. While several counties currently track this level of detail, current law only requires counties to provide aggregate data to DOR and DNR. This approach may change the workload for some counties.

There would be little administrative impact to SBI because the trust would be managed internally and administrative costs would be charged quarterly to the fund. For fiscal year 2015, for example, if the fund had an average balance of \$1 million, SBI's administrative fee would be about \$15 per quarter or \$60 per year<sup>17</sup>.

It is important to note that while we have assumed the adoption of provisions in law to create an irrevocable trust, there is no guarantee that a future legislature would not undo the trust.

### **Stability**

From the county and township representatives' perspective, the trust fund approach is the most stable approach because funds to pay PILT in the future are in a trust appropriated to the county, are invested by the State Board of Investment, and once, appropriated, are more difficult for the legislature to redirect for other purposes. In addition, payments are intended to equal the value of each local unit of government's estimated property taxes on the land in the trust, so would correlate to its actual lost tax base.

The relative volatility of this approach stems from two areas: first, the group acknowledged that without a constitutional amendment establishing the trust fund, the legislature has authority to change the one-time payments and redirect funds at a future date. Additionally, a future legislature could enact a clause requiring the one-time trust payments to be paid back to the state. Such an action could be challenged in court. There are several instances where past legislatures and governors have made changes to financing structures intended to be permanent to redirect funds for another purpose. For example, in 2015 the legislature and governor enacted legislation redirecting legally mandated general fund payments to the closed landfill investment fund to be used for other spending on environment and agriculture programs. In 2011, to balance a projected \$5 billion deficit the state pledged future revenue from annual tobacco settlement payments to sell bonds to close the budget deficit.

The trust fund approach also introduces some level of volatility due to its investment mechanism. As such, the growth and sustainability of the trust fund would parallel any growth or loss resulting from fluctuations in the financial market. In some years, annual earnings may exceed the annual distribution from the trust fund, and in other years, earnings or losses may not be sufficient to make the anticipated 5.5% of the market value of the trust annual payment. In those years, the assumption is that a portion of

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<sup>16</sup> Source: Department of Revenue

<sup>17</sup> Source: State Board of Investment

the corpus of the trust would be used to make the annual payment. Depending on the long-term performance of the financial markets, in a prolonged economic downturn where the trust was realizing either very low returns or actual losses, repeated use of the corpus of the fund to make annual property tax payments could put the sustainability of the trust at risk.

### **Adequacy**

From the county and township representatives' perspective, this approach provides greater adequacy to some local government units since local governments would receive an amount equal to their actual property taxes lost through state land acquisition. This would eliminate any gap between the lost property taxes and the PILT payments, where PILT does not currently compensate local governments for lost property taxes.

With this approach, however, there is the risk that annual investment returns will not be sufficient to make the entirety of the property tax payment from annual investment earnings alone because of potential investment market volatility. While this approach assumes that if this were to happen, a portion of the corpus of the trust would be used to supplement the annual payment, it would, as mentioned previously, put additional pressure on the value of the trust in those years when investment returns are low or negative.

Conversely, by requiring an upfront payment equal to 30 years of property tax, funds for the payment are no longer available for other purposes in the near-term.

If the trust fund generated only as much as was needed to pay PILT obligations for new acquisitions, the trust would marginally reduce growth over time to the PILT program in the general fund. For example, the Department of Revenue currently estimates an annual \$225,000 increase in PILT payments as result of state land acquisition. If 60% of the value of the acquired land was paid for using Outdoor Heritage Fund dollars, then 60% of the annual increase in PILT payment would be covered by the trust fund payment, reducing the annual increase in PILT by \$135,000. This increment represents 0.4% of the total PILT program in 2016.

### **Equity**

From the county and township representatives' perspective, requiring outdoor heritage fund or environment and natural resources trust fund dollars to pay for PILT is more equitable than the current system in which the general fund takes on future obligations of land acquisition. By more clearly tying land acquisition to ongoing obligations by requiring that both expenses are paid from the same source and at the time of acquisition, local governments perceive their ongoing need for operating funds will be better addressed. This approach does not take into account land that may be acquired with other funding sources, such as the clean water fund, the natural resources fund or state general obligation bonds.

In addition, the approach as it's currently discussed would also change payment distribution. Currently, PILT payments are calculated using a percentage of appraised value, or a per-acre payment rate. The trust fund approach would shift annual payments from a PILT formula, to payments based upon actual

property tax payments, eliminating the existence of winners and losers under the current PILT payment formula.

From a statewide perspective, this proposal would make PILT (a form of local aid) inconsistent with other similar general purpose local aids, which do not have a dedicated revenue source and are subject to legislative appropriation. On the contrary, they are funded out of general revenues because their purpose is to provide resources that benefit the whole state. In addition, since the purpose of these lands is to provide statewide economic benefit by producing commodities like timber, gravel and minerals and supporting tourism and recreation based economies, it is logical that the funding for these activities would come from the general fund, like other general purpose local aids.

### **Legality**

Statutory changes to the current PILT statutes would be required to exclude new acquisitions from the current PILT payment system as well as statutory changes to the outdoor heritage fund and environment and natural resources trust fund to allow for trust fund accounts to be created and for payments to be made to those accounts.

There was disagreement within the group as to whether the trust fund approach for new acquisitions paid for with funds from constitutionally dedicated funds like the Outdoor Heritage Fund and the Environment and Natural Resources Trust Fund would be constitutional. From the state agencies' perspective, the Minnesota constitution prohibits PILT to be paid with outdoor heritage fund or environment and natural resources trust fund dollars. The constitution limits the use of environment and natural resources trust fund dollars to protection, conservation, preservation, and enhancement of the state's air, water, land, fish, wildlife, and other natural resources.<sup>18</sup> It limits the use of outdoor heritage fund dollars to restoration, protection, and enhancement of wetlands, prairies, forests, and habitat for fish, game, and wildlife.<sup>19</sup> The state agency perspective has been that PILT payments made to local governments do not meet the intent of the constitutional language because PILT payments can be used for property tax levy reduction, for services other than natural resource protection, and for management or for services not directly tied to the land acquired.

From the county and township representatives' perspective, PILT payments meet the constitutional purpose of these funds because PILT is a cost of land acquisition, an activity interpreted by the state to meet the intent of the constitution, and because PILT funds local services provided for these lands.

Without a court decision to determine what uses of the Outdoor Heritage Fund and Environment and Natural Resources Trust Fund are allowable under the constitution, these will continue to be ongoing constitutional concerns.

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<sup>18</sup> Minnesota Constitution, Article XI, § 14

<sup>19</sup> Minnesota Constitution, Article XI, § 15

## **Potential variations to the trust fund approach**

In addition to discussing the assumptions of the trust fund approach outlined in the “Description” section, the group considered the following variations of the trust fund approach.

### ***Land acquired with project partner match***

In this variation of the trust fund approach, lands acquired in partnership with an external party, such as a non-profit organization, could fund the trust fund payment with a match from the external party. This would address the legal concerns raised if the source of trust fund payment was from a constitutionally-dedicated fund.

### ***Land acquired with statutorily-dedicated dollars***

In this variation of the trust fund approach, lands acquired with statutorily-dedicated dollars, such as DNR’s natural resources fund, would not have the same degree of legal concern as with the constitutionally-dedicated funds or general obligation bond proceeds. However, there would need to be changes to statute in some cases to allow for land acquisition costs to include a one-time trust fund payment.

### ***Land acquired with general fund dollars***

In this variation of the trust fund approach, land acquisition and trust fund payments made with general fund dollars would have no legal concerns. However, because of the other demands for general fund dollars, it is unknown how much general fund funding would be available for land acquisition and for associated trust fund payments.

## **Conclusion**

As this approach would apply only to new acquisitions, the majority of PILT payments would remain subject to legislative changes and market value reassessments. Additionally, the PILT payments generated from the trust would be subject to fluctuations in the investment market, which could result in inadequate funding for PILT payments for new lands acquired. Statutory changes to the current PILT statutes would be required to exclude new acquisitions from the current PILT payment system as well as statutory changes to the outdoor heritage fund and environment and natural resources trust fund to allow for trust fund accounts to be created and for payments to be made to those accounts.

The group had varying opinions regarding this approach and could not come to consensus. From the state agencies’ perspective, the trust fund approach would make the process of calculating and administering the PILT program more complicated and may change the workload for some counties based on the data needed at the time of acquisition. They were concerned that this approach excludes schools from PILT distribution as these entities currently receive a PILT distribution for certain land classes. If the legislature did not appropriate a one-time trust fund payment, the state agencies had concerns about the impact to land acquisition in a given biennium.

From the township representative perspective, this approach is the most stable because funds would be appropriated to counties and invested by SBI. They acknowledged that, without a constitutional amendment, this approach would remain subject to legislative changes in the future. Additionally, from the township perspective, requiring outdoor heritage fund or environment and natural resources trust fund dollars to pay for PILT would be more equitable than the current system in which the general fund takes on future obligations of land acquisition. Township representatives felt this approach should continue to be pursued with state agency input.

From the county representatives' perspective, their primary concern is whether an approach is stable and sustainable. County representatives noted that whichever approach provides stability and sustainability should be pursued.

There was disagreement within the group as to whether the trust fund approach for new acquisitions would be constitutional. Without a court decision to determine what costs are allowable under the constitution, these will continue to be ongoing constitutional concerns.

If a trust fund approach on new acquisitions is pursued, the group agreed further work needs to be done related to specific provisions and assumptions in a potential bill. Specifically, the group believes further work needs to be done regarding the potential prohibition of using constitutionally-dedicated funds to acquire land, and the calculation of the one-time trust payment.

## **Alternative #2: Trust fund approach: All state-owned land**

### **Description**

This approach would create a trust fund to pay the entire current PILT program, which totaled about \$31 million for fiscal year 2014 paid in July 2015. In order to generate investment earnings needed to pay for annual PILT obligations of approximately \$31 million, the size of the trust fund would need to be about \$570 million<sup>20</sup>.

This approach assumes the trust would be invested by the State Board of Investment (SBI) to maximize earnings.

### **Efficiency**

There would be an administrative impact to SBI because the trust would be managed internally and administrative costs would be charged quarterly to the fund. For fiscal year 2015, for example, if the fund had an average balance of \$570 million, SBI's administrative fee would be about \$8,600 per quarter or \$34,400 per year<sup>21</sup>.

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<sup>20</sup> Source: Minnesota Management and Budget. Using the environmental trust fund as a proxy, this assumes the spendable portion of the trust fund, in this case the July 2015 PILT payment of \$31,355,813, would equal 5.5% of the market value of assets, or \$570,105,689.

<sup>21</sup> Source: State Board of Investment

For DNR and DOR, this approach would function similarly to the current approach in that costs of the entire PILT program would be covered with one annual payment. Because of this, the group had no concerns about administrative efficiency.

### **Stability**

The group had some concerns about the stability of this approach because, if the trust was created in session law or in statute, future legislatures could make changes, including redirecting the funding for a different purpose. This could be remedied if the trust was established in the constitution.

Additionally, the trust fund would be subject to fluctuations in the investment market.

### **Adequacy**

This approach is assumed to cover the entire cost of the current PILT program because the corpus would be calculated in a way to ensure investment earnings would provide sustained funding for the program. The corpus of the fund is assumed to be sufficient to cover minor fluctuations in the investment market. If not, the state may need to increase the corpus.

### **Equity**

Other than an increased administrative cost in SBI, which would be offset by charging administrative fees to the trust, there would not be a change to administrative effort at the state or county level compared to the current system.

Because of the size of the corpus needed, the group assumed the trust would be created with a one-time general fund deposit. Under this assumption, the general fund would be the sole source funding the trust, while funds other than the general fund have historically been used for land acquisition<sup>22</sup>.

As stated above, this proposal would make PILT (a form of local aid) inconsistent with other similar general purpose local aids. Other general purpose aids do not have a dedicated revenue source and are subject to legislative appropriation. On the contrary, they are funded out of general revenues because their purpose is to provide resources that benefit the whole state. In addition, since the purpose of these lands is to provide statewide economic benefit, primarily by supporting tourism and recreation based economies, it is logical that the funding for these activities would come from the general fund, like other general purpose local aids with similarly broad purposes.

### **Legality**

A trust fund would need to be created in statute. There would be no constitutional concerns with a trust fund approach for all state-owned land provided the general fund were the source of funding for the corpus because the general fund receives non-dedicated revenues whereas the outdoor heritage fund and environment and natural resources trust fund receive constitutionally-dedicated revenues.

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<sup>22</sup> See Alternative #4a: Pay PILT with a new dedicated sales tax for a variation that would fund a trust with dedicated sales tax revenues rather than from non-dedicated revenues in the general fund

## **Conclusion**

Given the size of corpus needed, the group felt this approach was too costly to establish and did not provide a stable funding source for the PILT program due to potential investment fluctuations and potential changes by future legislatures. While functionally this approach would be similar to the current payment system, there would be an administrative impact to SBI offset by fees charged against the trust. Provided the corpus of the trust was established using non-constitutionally dedicated funding, there were no legal concerns.

If this approach were pursued, further consideration would need to be made as to whether a trust fund approach for PILT payments on all state-owned land should include those lands not subject to taxation when originally acquired by the state. These would include such lands as school trust fund lands, which were granted to the state by the federal government for the benefit of the schools and have never been on the tax rolls, as well as lands that were acquired by the state due to tax forfeiture. Local governments have been paid PILT on lands not subject to taxation when originally acquired by the state since the main PILT law was enacted in 1979. The primary concern of some local governments is the land more recently acquired by the state, which is taking real estate off of the property tax rolls that used to be there, as opposed to lands that have never been on the tax rolls, like school trust fund lands.

## **Alternative #3: Current approach with language in law guaranteeing PILT be paid annually**

### **Description**

Language would be enacted in session law or statute directing PILT be paid annually to local governments. There would be no change to the current payment approach to PILT.

### **Efficiency**

Because there would be no changes to the current payment system, the group had no concerns with administrative efficiency.

### **Stability**

There would be no changes to the current funding structure, meaning this approach would be as stable as any other statutorily funded program, which could be changed by a future legislature.

### **Adequacy**

Because there would be no changes to the current payment system, there would be adequate funding for PILT obligations currently set forth in law.

### **Equity**

Because this approach would not change the current payment system, the group had no concerns regarding the distribution of administrative effort between the state and counties.

As with the current system, local governments would continue to be concerned with the general fund paying ongoing PILT payments, which, from their perspective, is part of the cost of land acquisition.

## **Legality**

While there are no changes to statute needed and no constitutional concerns with the current payment system, the language guaranteeing PILT be paid would need to be enacted in session law, added to statute, or amended into the constitution. Any change enacted in session to guarantee PILT payments could be changed by a future legislature.

## **Conclusion**

The intent of this approach would be to guarantee that PILT be paid in the future. There would be no change to the current payment system, meaning no change in administrative effort. However, the program could change with future legislatures. Unless the language were amended into the constitution, the group felt it would not meet the intended purpose as future legislatures could make changes to the statutory language. Additionally, as with the current approach, the county and township representatives expressed concern with the general fund making ongoing PILT payments, which, from their perspective, is part of the cost of land acquisition and should be funded out of the same funding source as the acquisition.

## **Alternative #4: Pay PILT using revenue generated from state-owned lands**

### **Description**

PILT payments would be funded through revenue generated from state-owned, DNR administered lands, primarily from leases, and would be supplemented by the general fund. This approach would exclude revenues from school trust lands. For fiscal year 2014, approximately \$817,000 was generated for the state from non-school trust lands<sup>23</sup>, which is about 2% of the total PILT payment of \$31 million. Revenues from these lands are currently deposited in the game and fish fund, the general fund, and the state parks working capital account and are designated for specific purposes, such as DNR's Fish and Wildlife Division programs.

### **Efficiency**

From the state agencies' perspective, this approach would add some complexity because, in addition to the land records system, DNR would need additional data from the state's accounting system to calculate the PILT payment.

Because there would be no change in how local governments received a PILT payment, county and township representatives had no concerns about administrative efficiency.

### **Stability**

The amount of revenues generated from state-owned lands fluctuates annually. The general fund supplement would bring stability to the overall PILT obligations. The amount needed from the general fund would fluctuate annually along with the generated revenues.

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<sup>23</sup> Source: Department of Natural Resources

## **Adequacy**

Relying solely on revenues generated on state-owned lands would be insufficient to meet the current needs of the PILT program as revenues generated total a fraction of the obligation. This would necessitate an ongoing general fund appropriation to pay for future PILT obligations.

This trend will continue because current land acquisitions for DNR are almost exclusively for units of the outdoor recreation system. Lands acquired for the outdoor recreation system are used primarily for conservation, recreation and other purposes described in Minnesota Statute Chapter 86A, rather than for income generation. In addition, most DNR acquisitions are now funded through the Outdoor Heritage Fund, the Parks and Trails Legacy Fund and the Environment and Natural Resources Trust Fund, which prohibit or severely restrict income generation from the acquired lands. All revenues except timber receipts from lands acquired for state forest purposes are credited to the general fund under Minnesota Statute § 89.035.

## **Equity**

There would be increased administrative effort at the state to incorporate revenue data into PILT calculations. Local governments would see no change in administrative effort.

Under this approach, the general fund would continue to pay the majority of the cost of the PILT programs. Additionally, redirecting revenue from existing funds to pay for PILT would reduce funding for DNR programs that currently use those funds to operate.

## **Legality**

This approach would require changes to state statutes in order to redirect revenues. However, even with changes to state law, redirecting revenues from some DNR-administered lands to pay PILT may not be authorized because of federal aid restrictions. For example, the DNR manages its Wildlife Management Areas through a Statewide Habitat Management grant funded with federal dollars from the Pittman-Robertson Wildlife Restoration program. All income on these managed WMA's is considered program income under the grant and must be used for purposes of the grant. In addition, the constitution stipulates any revenues generated from the environment and natural resources trust fund must be deposited back into the fund. While revenue generation on land acquired with environment and natural resources trust fund dollars is rare, to implement this approach, either the constitution would need to be amended, or the environment and natural resources trust fund would be excluded from using this earned revenue in the fund to pay the ongoing obligations related to land acquisition.

## **Conclusion**

Given the continued need for general fund support resulting from insufficient revenue generation on state-owned lands coupled with additional state administrative complexity and reduced funding for state programs, the group concluded this was not a viable option. From the group's perspective, if additional revenue generation was statutorily allowed on state-owned lands, this could be revisited. This approach would require changes to statute to redirect revenues and potentially the constitution related to revenues generated as a result of environment and natural resources trust fund spending.

## **Alternative #5: Pay PILT with a new dedicated sales tax**

### **Description**

A new sales tax would be created specifically to pay the costs of the PILT program. The current general statewide sales tax rate of 6.500% would need to be raised by 0.035 to 0.04 percentage points to between 6.535% and 6.540% to generate the amount needed to fully fund the current PILT program<sup>24</sup>.

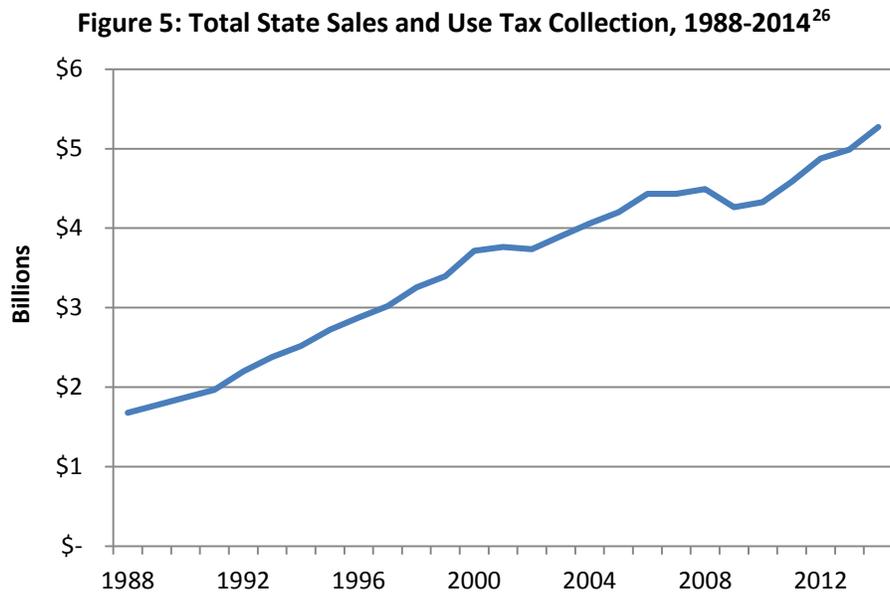
### **Efficiency**

This approach would result in additional administrative expense for both the state and private businesses. As the collector of sales taxes, Minnesota business owners must be aware of changes to the tax code, including rate changes and what products and services are and are not taxable. This approach would increase one-time costs for businesses to adjust for the tax code changes and would vary from business to business based on a variety of factors, including the number of locations the business has and its current technological capacity. DOR would have one-time costs of approximately \$97,000<sup>25</sup> provide support to businesses including outreach, printed communication materials, and IT updates.

Because there would be no change in how local governments received a PILT payment, county and township representatives had no concerns about administrative efficiency.

### **Stability**

Sales tax is a relatively stable revenue stream as shown in figure 5. However, sales tax revenues may fluctuate with changes in consumer spending.



<sup>24</sup> Source: Department of Revenue

<sup>25</sup> Source: Department of Revenue

<sup>26</sup> Source: Department of Revenue

This approach could be potentially unstable due to the ability of future legislatures to redirect the tax increase for a different purpose. There is historical precedent for this kind of sales tax as well as the redirection for a different purpose. In the 1991 legislative session, a local government trust fund was established in which the legislature, provided all counties passed a resolution, would add 0.5 percent sales tax to cover the cost related to the homestead and agriculture credit and other local aids.<sup>27</sup> The trust fund was repealed in the 1994 session<sup>28</sup>, while the increased sales tax was shifted into the general fund.

### **Adequacy**

Assuming continued relative stability in sales tax revenues and assuming future legislatures made no changes to the sales tax increase, this approach would adequately fund the costs of the PILT program.

### **Equity**

There would be increased administrative costs at both the state and at private businesses. Local governments would see no change in administrative effort.

The sales tax is a regressive tax, meaning that it falls disproportionately on those with lower incomes. Low income Minnesotans spend more of their income on sales taxes than those with higher incomes. Thus, an increase to the sales tax would make Minnesota taxes more regressive overall.

Because much of the sales tax base in the state is concentrated in the metropolitan area and state land holdings are concentrated in northern Minnesota, there is the potential for perceived inequity in what geographic groups are funding PILT payments. According to the most recent sales tax data available, 56% of the statewide sales tax was generated in the seven-county metropolitan area<sup>29</sup> and 28% generated by greater Minnesota, while the seven-county metropolitan area received only 5.8% of PILT payments and the remaining 94.2% went to greater Minnesota counties.<sup>30</sup>

This proposal would make PILT (a form of local aid) inconsistent with other similar general purpose locals aids. Other general purpose aids do not have a dedicated revenue source and are subject to legislative appropriation.

### **Legality**

While there are no constitutional concerns with dedicating a new sales tax, this approach would require revisions to the sales tax statute<sup>31</sup>.

### **Potential variation to the approach dedicating a new sales tax**

The group considered the following variation:

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<sup>27</sup> Laws of Minnesota 1991, Chapter 291, Article 2

<sup>28</sup> Laws of Minnesota 1994, Chapter 587, Article 3, §21

<sup>29</sup> The seven-county metropolitan area includes Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, and Washington counties

<sup>30</sup> Source: Department of Revenue; note: 16% of the statewide sales tax is generated by non-Minnesota counties, which includes all non-Minnesota businesses

<sup>31</sup> Minnesota Statute § 297A.62, subdivision 1

***Dedicating a new sales tax above what is currently needed to fund existing PILT to set aside in a trust fund***

This variation would set a new sales tax charged statewide at rate above what is needed to fund the current PILT program to be set aside in a trust that could pay future PILT obligations. This approach would have one-time costs as well as ongoing administrative costs to DOR to calculate amount to be deposited in the trust.

**Conclusion**

The group concluded, while this is a potentially viable option, there would be increased administrative costs to both the state and private businesses as well as increased cost to consumers in the form of an increased sales tax. Additionally, sales tax, while being a relatively stable revenue stream, may fluctuate with changes in consumer spending and would be at risk to be redirected for different purposes by future legislatures. Increasing the state sales tax would require revisions to statute, would be regressive, and would provide dedicated funding to a general purpose aid.

As the majority of sales tax is generated in the metro area while the majority of land holdings are in greater Minnesota, there may be perceived geographical inequity in who would be generating revenues to pay PILT. The benefits of increasing the sales tax should be further weighed against the drawbacks from the increased state and private administrative costs, potential instability, and potential inadequacy.

**Alternative #6: Pay PILT by dedicating portion of existing sales tax**

**Description**

A portion of the revenues generated from the existing sales tax rate of 6.5% would be used to pay for the current PILT program. This would not increase the overall existing state sales tax rate of 6.5% and would instead dedicate 0.004% to pay for the PILT program<sup>32</sup>. This approach would reduce available dollars in the general fund by the same amount.

**Efficiency**

Because there would be no change in how local governments received a PILT payment, county and township representatives had no concerns about administrative efficiency.

**Stability**

There would be little change to the general fund from the current payment system because this approach would dedicate a portion of the current sales tax revenue to paying the costs of the PILT program. However, instead of PILT obligations being funded by multiple types of non-dedicated revenues as it is under the current system, changes in the amount of sales tax revenue collected would impact the amount available to make PILT payments.

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<sup>32</sup> Source: Department of Revenue

Additionally, this approach could be potentially unstable if future legislatures reduce the general statewide sales tax rate or redirect this portion of revenues.

### **Adequacy**

There is a possibility the amount dedicated from the existing sales tax would not generate the level of funding needed to cover the costs of the PILT program. In that case, the dedicated amount would need to be pro-rated to counties and would not cover the current PILT obligations.

### **Equity**

The group had the same concerns about equity with a new tax as dedicating an existing tax.

Because much of the sales tax base in the state is concentrated in the metropolitan area and state land holdings are concentrated in northern Minnesota, there is the potential for perceived inequity in what geographic groups are funding PILT payments.

This proposal would make PILT (a form of local aid) inconsistent with other similar general purpose local aids. Other general purpose aids do not have a dedicated revenue source and are subject to legislative appropriation.

### **Legality**

While there are no constitutional concerns with dedicating a new sales tax, this approach would require revisions to sales tax statute<sup>33</sup>.

### **Conclusion**

The group concluded, while this is a potentially viable option, there is no functional difference from the current approach except for the potential of the dedication to generate less revenue than needed to pay the PILT obligation. The source of funding differs from the current approach in that PILT would be tied to one revenue stream, requiring revisions to statute. Similar to creating a new sales tax, as the majority of sales tax is generated in the metro area while the majority of land holdings are in greater Minnesota, there may be perceived geographical inequity in who would be generating revenues to pay PILT. The benefits of dedicating a portion of the existing sales tax should be further weighed against the drawbacks from the increased state administrative cost, potential instability, and potential inadequacy.

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<sup>33</sup> Minnesota Statute § 297A.62, subdivision 1

## Recommendations

In considering its recommendation, MMB evaluated the key goals of both participating local government representatives and state agencies. Local governments were particularly interested in addressing two primary issues regarding the current PILT program:

1. To ensure that the program is safeguarded from future funding reductions.
2. To ensure that the program provides adequate resources to local governments, to appropriately compensate them for the services they provide.

State agencies were particularly interested in maintaining two components of the current PILT program:

1. The relative administrative efficiency that currently exists for the program.
2. The consistency in program structure and funding mechanism with other general purpose local aids.

Based on these goals, we articulate the benefits and drawbacks of each approach below.

<b>Current Approach: Statutory Annual Appropriation for PILT Program</b>	
<b>Benefits</b>	<b>Drawbacks</b>
<ul style="list-style-type: none"> <li>• As a statutory appropriation, the PILT appropriation is one of the most stable in state government, because it doesn't need a biennial appropriations bill to be passed for the money to be appropriated and spent. Instead, the statute appropriates sufficient funds to make PILT payments annually and automatically.</li> <li>• According to a 2010 OLA report, the PILT program is more beneficial to most local governments than local property tax payments would be.</li> <li>• State agencies are able to implement the program efficiently.</li> <li>• The program is consistent in structure and funding mechanism with other local aid programs.</li> </ul>	<ul style="list-style-type: none"> <li>• The program is subject to change by the legislature.</li> <li>• While most local governments receive more benefit from the PILT program than would be provided through local property taxes, some do not.</li> </ul>
<b>Alternative Approach #1: Trust Fund for New Acquisitions</b>	
<b>Benefits</b>	<b>Drawbacks</b>
<ul style="list-style-type: none"> <li>• From the county and township representatives' perspective, the trust fund approach is the most stable approach because funds to pay PILT in the future are in a trust appropriated to each county and are invested by the State Board of Investment, making</li> </ul>	<ul style="list-style-type: none"> <li>• This approach would not preclude the legislature from changing the program to eliminate future one-time trust fund payments for new acquisitions after the program's enactment.</li> <li>• Unless the trust fund approach is established in the constitution, the legislature could seek</li> </ul>

<b>Current Approach: Statutory Annual Appropriation for PILT Program</b>	
<b>Benefits</b>	<b>Drawbacks</b>
<p>them more difficult to be redirected for other purposes in the future.</p> <ul style="list-style-type: none"> <li>The current structure of the trust fund approach would address the allocation of funds to local governments because it assumes replacing the current payment structure with a payment structure that would directly tie each local unit of government’s payment amount to the amount of their lost property taxes.</li> </ul>	<p>repayment of the funds appropriated in the trust, although this action could be considered a breach of contract, depending on the nature of the program’s enacting language.</p> <ul style="list-style-type: none"> <li>A trust fund would be subject to market volatility. During recessionary periods, the corpus of the fund may lose value.</li> <li>The program will increase the administrative complexity of the program.</li> <li>The program will establish a substantially different funding mechanism for this local aid in comparison with other local aids. It is not clear why PILT would be funded differently from other general purpose local aids.</li> </ul>
<b>Alternative Approach #2: Trust Fund for All State-owned Land</b>	
<b>Benefits</b>	<b>Drawbacks</b>
<ul style="list-style-type: none"> <li>See benefits of Alternative Approach #1.</li> </ul>	<ul style="list-style-type: none"> <li>See drawbacks of Alternative Approach #1.</li> <li>The value of a corpus sufficient to fund the entire PILT program is estimated at \$570 million, an amount deemed unlikely to be appropriated from the general fund given other programmatic funding needs.</li> </ul>
<b>Alternative Approach #3: Current Approach with Language in Law Guaranteeing annual PILT Payments</b>	
<b>Benefits</b>	<b>Drawbacks</b>
<ul style="list-style-type: none"> <li>This would address a key concern of local government representatives, to ensure that the PILT program be fully funded in the future.</li> </ul>	<ul style="list-style-type: none"> <li>Unless this guarantee was amended into the Constitution, any legislative language guaranteeing PILT payments could be changed by future legislatures. This approach is functionally no different than the current program, which statutorily appropriates funding for PILT.</li> <li>This approach does not address the allocation of funds to local governments. Questions about the equity of distribution would remain.</li> </ul>
<b>Alternative Approach #4: Pay PILT Using Revenue Generated from State-owned Lands</b>	
<b>Benefits</b>	<b>Drawbacks</b>
<ul style="list-style-type: none"> <li>This would align revenues generated from state-owned land with local governments’ loss of tax base from the state’s acquisition of land.</li> <li>It would supplement general fund dollars with an annual revenue source.</li> </ul>	<ul style="list-style-type: none"> <li>Revenues generated from state-owned, DNR-administered lands are grossly insufficient to fund PILT obligations. A general fund appropriation would be needed to supplement these revenues. As such, it would not address</li> </ul>

<b>Current Approach: Statutory Annual Appropriation for PILT Program</b>	
<b>Benefits</b>	<b>Drawbacks</b>
	<p>local government representatives' goal of ensuring the PILT program's long-term sustainability any more than the current program does.</p> <ul style="list-style-type: none"> <li>• This approach would redirect revenues currently used to support other natural resource programming, reducing funding for those programs.</li> <li>• This approach would increase administrative complexity, since, in addition to the land records system, DNR would need additional data from the state's accounting system to calculate the PILT payment.</li> <li>• The program will establish a unique funding mechanism for this local aid in comparison with other local aids. It is not clear why PILT would be funded differently from other general purpose local aids.</li> <li>• This approach does not address the allocation of funds to local governments. Questions about the equity of distribution would remain.</li> </ul>
<b>Alternative Approach #5: Pay PILT with a new dedicated sales tax</b>	
<b>Benefits</b>	<b>Drawbacks</b>
<ul style="list-style-type: none"> <li>• This approach would create a dedicated funding stream solely for the PILT program.</li> </ul>	<ul style="list-style-type: none"> <li>• This approach by itself does not sufficiently address local government concerns regarding the long-term security of a PILT funding stream. Future legislatures could redirect funding from this dedicated sales tax for a different purpose.</li> <li>• This approach would create additional administrative complexity, both for state agencies and private business owners.</li> <li>• This would introduce greater regressivity into the Minnesota tax code, by increasing the state sales tax.</li> <li>• The program will establish a unique funding mechanism for this local aid in comparison with other local aids. It is not clear why PILT would be funded differently from other general purpose local aids.</li> <li>• This approach does not address the allocation of funds to local governments. Questions about the equity of distribution would remain.</li> </ul>

<b>Current Approach: Statutory Annual Appropriation for PILT Program</b>	
Benefits	Drawbacks
<b>Alternative Approach #6: Pay PILT by Dedicating a Portion of the Existing Sales Tax</b>	
Benefits	Drawbacks
<ul style="list-style-type: none"> <li>This approach would create a dedicated funding stream solely for the PILT program.</li> </ul>	<ul style="list-style-type: none"> <li>This approach by itself does not sufficiently address local government concerns regarding the long-term security of a PILT funding stream. Future legislatures could redirect funding from this dedicated sales tax for a different purpose.</li> <li>This approach adds unnecessary rigidity to the PILT Program. Currently, the program is funded through multiple non-dedicated sources. By dedicating a portion of those existing revenues for PILT payments, there is a risk that the single dedicated source may, in a given year, be insufficient to fulfill the funding obligation.</li> <li>This approach would create additional administrative complexity and cost for state agencies.</li> <li>The program will establish a unique funding mechanism for this local aid in comparison with other local aids. It is not clear why PILT would be funded differently from other general purpose local aids.</li> <li>This approach does not address the allocation of funds to local governments. Questions about the equity of distribution would remain.</li> </ul>

After considering the implications of each payment option and the goals of both local governments and state agencies, the commissioner of Minnesota Management and Budget recommends the state make no changes to the current PILT payment system for several reasons:

- The current mechanism for funding PILT is one of the most stable in state government.**
  - The manner in which PILT is currently appropriated provides for the full obligation to be automatically paid from the general fund on an annual basis. In comparison with appropriations made in session law, which must be renewed every two years, PILT is funded through a standing statutory appropriation that does not require enactment of a biennial appropriations bill to be appropriated and spent. To date, the legislature and governor have not reduced this appropriation.
  - As a statutory open appropriation, the amount appropriated to be paid is determined by the PILT funding formula and is forecasted as part of the state’s November and February revenue and expenditure forecast. The open appropriation authorizes the state to spend

whatever the obligation is based on DNR's calculation of the amount outlined in statute and DOR's verification of that amount.

- The PILT program includes a six year market value reassessment component, which means program funding grows as market values grow to acknowledge and accommodate inflationary cost pressures. The majority of similar forecasted programs do not have similar mechanisms to address inflationary growth.
- Past experience suggests using a trust fund investment approach does not necessarily reduce the risk of future legislatures using funds for other purposes, so does not assure that this approach will "protect" the funds from being redirected for another use in the future.

2. **The PILT program is not unique among general purpose local aids or other state programs.** There is no clear, compelling reason to fund PILT differently from other general purpose local aids or other state programs. Non-dedicated general fund revenues are used to fund programs that benefit all Minnesotans on an ongoing basis. Each Legislature and Governor may propose changes to programs funded in this way, based on their priorities. PILT is not substantively different from other programs intended to benefit all Minnesotans, and as such, should be subject to the same priority-setting process.

3. **The alternatives do not sufficiently exceed the current program's administrative efficiency and long-term financial stability to warrant a change.** Any change from the current payment system would need to exceed the current administrative efficiency and long-term financial stability. From a state perspective, the programmatic value of changing how PILT is managed is not sufficiently compelling, for the reasons described above, to warrant the change.

If the legislative or executive branch pursued an alternative approach, such as a trust fund approach, for the PILT program, the following questions would need to be addressed:

- How much needs to be contributed for each acquisition and how will the fund need to be structured to ensure long-term financial stability of the fund?
- What will happen if insufficient funds are appropriated for the land acquisition and trust fund payment? Will trust fund payments be structured as an open appropriation, to ensure that trust fund payments are available for all eligible land acquisitions?
- If trust fund contributions are made from the outdoor heritage fund or environment and natural resources trust fund, how will the payments meet the constitutional purpose of these funding sources?
- How will contributions to the trust fund be tracked?
- How will increased state administrative costs be paid for?

While the commissioner of Minnesota Management and Budget doesn't recommend altering PILT's financing mechanism, one aspect of the program warrants further study to address local representatives' concerns, which is to review the distribution of PILT payments at the local level. The 2010 OLA report highlighted that the majority of local governments benefited from the PILT program by

receiving higher payments than they would under their local property tax rate. However, this was not true for all local governments, and one of local representatives' primary concerns was to ensure adequate resources to compensate local governments for their loss of property tax base. From their perspective, one of the major benefits of the trust fund approach specifically was the ability to be reimbursed for the actual loss of property tax base, instead of receiving PILT payments that are based on a percent of appraised value that may or may not correspond to the local government's actual property tax rate. These payment rates do not adequately compensate some local units of government for their estimated property tax loss, while disproportionately compensating others<sup>34</sup>. However, using a trust fund approach is not the only way to address this concern. The commissioner of Minnesota Management and Budget recommends the legislature direct local representatives to further examine how to best distribute PILT payments to ensure equitable distribution of PILT at the county, township, and school district level within the parameters of the existing PILT program.

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<sup>34</sup> Evaluation Report: Natural Resource Land, Office of the Legislative Auditor, March 2010: p. 62.