

# Declining Home Values and Minnesota Property Taxes

With the decline in home values many homeowners expect their property taxes will decline too. Unfortunately, this is largely a false expectation. It is based on a misperception of the nature of the tax, that is, from thinking the property tax works like an income or sales tax. Income and sales taxes are rate-based taxes. The law sets their tax rates and applies them to the amount of the taxpayer's income or taxable purchases to determine tax liability.

## Property tax is levy-based

The Minnesota property tax, however, does not work that way.<sup>1</sup> Rather, it is a levy-based tax. Taxing districts (cities, counties, school districts, and special taxing districts) determine how much money they will raise in property taxes. This "levy" amount is then used to determine the tax rate. Changes in the tax base (the value of the taxable property) affect the distribution of the total tax liability (that is, what each property's share is), but not total revenues.

## Factors affecting a parcel's property tax

So what, then, affects or determines an individual parcel's property tax? Given the nature of a levy-based tax, three basic factors determine an individual parcel's property tax liability:

1. **The levy decisions of the local taxing districts**—i.e., how much the taxing districts decide to levy or impose in property taxes for the year. These decisions determine the total amount of revenue to be raised from the property tax.
2. **The parcel's share of the total property tax base** in each of the taxing districts. In Minnesota this is not a straightforward or simple matter. Relevant factors that determine this share include the property's and all other properties' estimated market values,<sup>2</sup> the portion of this value that is taxable,<sup>3</sup> and the class rate.<sup>4</sup>
3. **Applicable tax credits** paid by the state. For many homes and farms, Minnesota law provides tax credits. Credit amounts are subtracted from the tax liability. They are based on the taxable market value of the property. The state reimburses the local taxing districts for these credits, so they receive the full amount of their levies.

### Property Tax Time Lags

Because of inherent delays in the property tax system, changes in market values take some time to have effects on property taxes. Because of the assessment cycle, it typically takes assessors six months or more to take new sales into account in valuing properties. Once they do so, there is another lag of a year before these values are used to calculate property taxes. These lags (of one and a half to two years) may be compounded by limited market value described in the box on the next page.

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<sup>1</sup> Property taxes in some other states are rate-based and will directly be affected by changes in value.

<sup>2</sup> "Estimated market value" is the assessor's estimate of the price that the property would sell for in a market transaction.

<sup>3</sup> For some properties, special state programs may exempt a portion of the value from tax – for example, limited market value (described in the box on the next page), and the "Green Acres" program.

<sup>4</sup> Class rates are a set of statutory rates that vary by property type or legal class and are used to determine each type of property's relative share of the property tax base.

## Effects of a decrease in market value on property tax

What happens to the property tax, then, if a property's market value decreases? The answer is that it depends. It depends upon several variables and how they interact with one another.

1. **What happened to the value of other properties in the taxing districts?** Because the property tax is levy-based, the value of all properties must be considered. The tax calculations apportion the levy among all properties based on their shares of the local tax base.<sup>5</sup> Thus, to determine the tax impact of a change in a home's taxable value (increase or decrease), one must compare it to the change in the overall tax base. If the change is higher than overall tax base, the property will pay a larger share of the total tax. If it is lower, it will pay a smaller share of the total tax.

2. **Did the taxing districts increase their levies?** Increasing levies increase the likelihood that a property will pay higher tax, even if its value dropped. But a levy increase alone does not determine whether an individual property's tax will rise or fall.

Taxing districts set their levies based on how much they wish to spend, and on the amount of state aid or other revenue that is available to pay for that spending.

3. **Does the drop in value affect state tax credits?** Many homes and farms qualify for state credits. The market value credit is calculated as a percentage of the taxable market value; however the credit change is small enough that the impact of this effect is minimal.

### Limited Market Value or LMV

Minnesota limits or phases-in large increases in market value under the limited market value (LMV) program. The details of LMV are complex, but it generally applies to year-over-year increases that exceed 15 percent. The net effect is to delay when these increases in market value actually show up in the taxable value of the property. Some homeowners who in past years benefited from LMV may now simultaneously experience (1) a decrease in their estimated market value—in other words, their home is actually going down in value—and (2) an increase in their taxable value because the LMV law is now recognizing valuation increases that occurred in previous years. Minnesota's limited market value law is due to expire after taxes payable in 2009.

## Bottom Line

The change in a home's market value alone does not determine the change that it will see in tax liability. It also depends upon what happened to the values of other properties in the taxing districts, the levy decisions made by taxing districts, and the effect of the value change in the state credit formula.

## Examples

The examples on the following page show the effects of value reductions in combination with different levy scenarios on parcels' property taxes. These examples are greatly simplified—e.g.,

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<sup>5</sup> In Minnesota the technical term for this is net tax capacity. It is determined by multiplying the statutory class rate(s) for the property by its taxable market value, as determined by the assessor.

only four properties and one taxing district is used. But they illustrate the complexity of the effects. The examples ignore the small effects the credits have on tax liability.

<b>HOME #1'S VALUE REDUCED 10%; OTHER VALUES AND LEVY UNCHANGED</b>						
	<b>Market Value</b>		<b>Class Rate</b>	<b>Tax</b>		<b>Change</b>
	<b>Base Year</b>	<b>Year #2</b>		<b>Base Year</b>	<b>Year #2</b>	
<b>Home #1</b>	200,000	180,000	1.0%	2,308	2,093	-9.3%
<b>Home #2</b>	200,000	200,000	1.0%	2,308	2,326	0.8%
<b>Farm</b>	400,000	400,000	0.5%	2,308	2,326	0.8%
<b>Business</b>	1,000,000	1,000,000	2.0%	23,077	23,256	0.8%
<b>Levy or total tax</b>				30,000	30,000	
<b>Tax rate</b>				115%	116%	

<b>HOME #1'S VALUE REDUCED 10%; OTHER VALUES UNCHANGED; LEVY INCREASES 10%</b>						
	<b>Market Value</b>		<b>Class Rate</b>	<b>Tax</b>		<b>Change</b>
	<b>Base Year</b>	<b>Year #2</b>		<b>Base Year</b>	<b>Year #2</b>	
<b>Home #1</b>	200,000	180,000	1.0%	2,308	2,093	-0.2%
<b>Home #2</b>	200,000	200,000	1.0%	2,308	2,326	10.9%
<b>Farm</b>	400,000	400,000	0.5%	2,308	2,326	10.9%
<b>Business</b>	1,000,000	1,000,000	2.0%	23,077	23,256	10.9%
<b>Levy or total tax</b>				30,000	33,000	10.0%
<b>Tax rate</b>				115%	128%	

<b>ALL VALUES INCREASE 10%; LEVY UNCHANGED</b>						
	<b>Market Value</b>		<b>Class Rate</b>	<b>Tax</b>		<b>Change</b>
	<b>Base Year</b>	<b>Year #2</b>		<b>Base Year</b>	<b>Year #2</b>	
<b>Home #1</b>	200,000	220,000	1.0%	2,308	2,308	0.0%
<b>Home #2</b>	200,000	220,000	1.0%	2,308	2,308	0.0%
<b>Farm</b>	400,000	440,000	0.5%	2,308	2,308	0.0%
<b>Business</b>	1,000,000	1,100,000	2.0%	23,077	2,308	0.0%
<b>Levy or total tax</b>				30,000	30,000	0.0%
<b>Tax rate</b>				115%	105%	

<b>ALL VALUES REDUCED BY 10%; LEVY INCREASES 10%</b>						
	<b>Market Value</b>		<b>Class Rate</b>	<b>Tax</b>		<b>Change</b>
	<b>Base Year</b>	<b>Year #2</b>		<b>Base Year</b>	<b>Year #2</b>	
<b>Home #1</b>	200,000	180,000	1.0%	2,308	2,538	10.0%
<b>Home #2</b>	200,000	180,000	1.0%	2,308	2,538	10.0%
<b>Farm</b>	400,000	360,000	0.5%	2,308	2,538	10.0%
<b>Business</b>	1,000,000	900,000	2.0%	23,077	25,385	10.0%
<b>Levy or total tax</b>				30,000	33,000	10.0%
<b>Tax rate</b>				115%	141%	