Market Value Exclusion 101

October 2011

The Market Value Exclusion (MVE) program (hereafter referred to as "the exclusion") replaced the Market Value Homestead Credit (MVHC) program for taxes payable in 2012 and beyond. This guide describes how the exclusion works and highlights some of the issues that cities should keep in mind when examining the effects of the new program on their communities. Many of the issues relate to the ways that different aspects of the property tax system interact. A detailed description of the overall property tax system can be found in the "Property Taxation 101" guide. An overview of the new exclusion program and will be available on the League's site.

Background

During the 2011 special session, legislators eliminated the MVHC program, creating a savings of more than $260 million for the state budget. Cities had experienced years of cuts to the reimbursement payments from the state, leaving them with shortfalls in their property tax levies at the end of the year. The table below shows the amount cities expected to receive in reimbursement and the actual amount paid by the state for each year of the program (2002 through 2011). The state fully reimbursed cities for the amount of credit going to homeowners in only two years since the program's inception (2002 and 2007). The elimination of the program means that cities will no longer have to deal with the unpredictability and in consistency of reimbursement payment amounts. The new exclusion program, however, has created a lot of questions for local officials and property owners. The exclusion program begins with taxes payable in 2012.

Year	Original Amount (cities)	Final Amount (cities)
2002	87,512,765	87,512,765
2003	85,539,919	65,425,091
2004	85,290,722	66,279,257
2005	82,636,505	65,087,094
2006	78,921,393	62,809,103
2007	75,935,548	75,935,548
2008	75,810,435	63,310,311
2009	76,770,261	57,204,103
2010	82,053,176	12,106,217
2011 est.	60,246,987	12,148,508

145 UNIVERSITY AVE. WEST
ST. PAUL, MN 55103-2044

PHONE: (651) 281-1200 FAX: (651) 281-1299
TOLL FREE: (800) 925-1122 WEB: WWW.LMC.ORG

How it works for homeowners:

Much like in the MVHC program, homeowners will not have to take any action in order to benefit from the market value exclusion. It is applied automatically. The maximum exclusion will go to homes valued at $76,000 or less. The exclusion at that level is 40% of market value. For a $76,000 home, that means $30,400 of value is not taxable. In other words, all property taxes are applied only to the remaining $45,600 of market value. As home value increases, the portion of market value eligible for exclusion phases out and is at zero percent for homes valued at more than $413,778. Note that market values are determined in the year prior to the year in which taxes are paid. For example, values used to calculate taxes payable in 2011 were set in early 2010. Property owners will receive notices stating the value of their property for 2012 taxes early in the spring of 2012. That will be the first time that homestead owners see the amount of their value excluded.

Below is a sample calculation of total taxes due (city, county, and school district taxes) before and after the exclusion from the Department of Revenue:

Sample Home Market Value		$76,000	$150,000	$300,000	$450,000
Previous Law: MVHC					
	Net Tax Capacity (market value x 1% class rate)	$760	$1,500	$3,000	$4,500
	Gross Tax at rate of 105.81% (rate x tax capacity)	$804.16	$1,587.15	$3,174.30	$4,761.45
	Current MVHC	$304.00	$237.40	$102.40	$0
	Net Tax (total tax less credit)	*$500.16*	*$1,349.75*	*$3,071.90*	*$4,761.45*
New Law: Exclusion					
	Market Value Exclusion	$30,400	$23,740	$10,240	$0
	MV after exclusion	$45,600	$126,260	$289,760	$450,000
	Home Net Tax Capacity (market value x 1% class rate)	$456	$1,263	$2,898	$4,500
	MVHC Credit	$0	$0	$0	$0
	Net Tax at rate of 110.92% (rate x tax capacity)	*$505.80*	*$1,400.48*	*$3,214.02*	*$4,991.40*

*the total tax rates used in this example are statewide averages before and after the effects of the exclusion

What it means for cities

The immediate effect of the exclusion is a decrease in the tax base. The valuations used for calculating taxes owed in 2012 were set in early 2011. They won't be updated until early 2012 for taxes payable in 2013. So, a portion of homestead value will be excluded and values for other kinds of property will not be updated. The extent of the decrease in tax base depends on the portion of homestead property each city has.

The tax base decrease will mean that in order to generate the same amount of city property tax dollars as in 2011, city tax rates will have to go up. For example, if prior to the conversion a city's tax base was 1000 and its tax levy was 100, the tax rate would be 10%. Now, in that same city the tax base has been reduced 40% to 600. The city still needs to generate 100 in property taxes. The rate climbs to almost 17%. For many cities, it will likely be very difficult to hold levies flat given the repeated cuts to Local Government Aid (LGA) payments and to ongoing cost pressures, like the cost of healthcare, fuel and infrastructure maintenance.

The exclusion will result in a shift in tax burden from homestead properties to other kinds of property. The extent of this shift will be influenced by the portion of all homestead property made up of lower value homes. The more lower-value homes a city has as a portion of its tax base means more tax burden shifting.

In many communities, lower value homes will pay more in taxes even if the levy remains flat. This is because of the increase in tax rate necessary to generate the same amount of tax levy. This effect is more likely in cities where a high portion of property is lower value homes.

Property tax bills, of course, reflect the levy decisions and tax bases of not just the city, but also the county, the school district and any special districts. The tax bases of all local governments will be affected by the new exclusion program. A given city may not see a big decrease in its city tax base and therefore experience little shifting of city tax burden. The county containing that city may have a lot of lower-value homes and therefore experience a big tax base loss. That will affect property owners within the city.

Other issues to consider

The new HMVE program will interact with other aspects of the tax system, namely Tax Increment Financing (TIF), Local Government Aid (LGA), and market value levy limits. The interactions are described briefly below:

MVE and TIF: The new program will mean that current values of TIF properties will be adjusted but the Dept. of Revenue has indicated that the base year values will NOT be adjusted. This will result in a decrease in the increment captured and may cause problems for cities in paying off debt associated with the TIF district.

MVE and LGA: The current LGA formula takes city tax base into account in distributing the LGA appropriation. The exclusion will reduce tax capacity in each city. That will mean a reduction in the capacity side of the need vs. capacity comparison the formula makes.

MVE and market value levy limits: The Dept. of Revenue has indicated that market values for determining HRA and EDA levy limits and certain debt limits will be the values after the effects of the exclusion.

Resources

League of Minnesota Cities
http://www.lmc.org/page/1/property-tax-state-funding-fiscal-issues.jsp