GREATER MINNESOTA PROPERTY TAX REPLACEMENT AID STUDY

A Report to the Minnesota Legislature on the Property Tax Replacement Aid Program

Final Report

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On behalf of:
Minnesota Department of Transportation

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EXECUTIVE SUMMARY

The Property Tax Replacement Aid Program has been a positive step toward stable transit funding for Greater Minnesota. Those involved in the Program universally believe that it would be difficult if not impossible to go back to local jurisdictions to reinstate the prior local property tax funding. Participating transit systems, therefore, believe that improvements and/or new alternatives to the Property Tax Replacement Aid Program should be the focus going forward.

Study Purpose

The 2001 Minnesota Legislature passed a combination of property tax relief legislation, including dedication of a percent of the sales tax on motor vehicles to partially replace property taxes as a funding source for transit operating expenses in Greater Minnesota. The Greater Minnesota Transit Fund was created to provide property tax replacement aid payments to public transit systems in Greater Minnesota for calendar years 2002 and 2003.

"The commissioner of transportation, in consultation with the commissioner of revenue, shall make a report to the legislature containing recommendations for integrating the grant program under section 174.24 with the property tax repl acement aid program…The recommendations shall attempt to restructure the method of financing transit operations in greater Minnesota in such a way as to minimize reliance on property taxes, while allowing the necessary flexibility to accommodate growth in service demands."

(Minnesota Statutes, Section 174.242. Subd.4.)

According to the legislation creating the Property Tax Replacement Aid Program, the Minnesota Department of Transportation (Mn/DOT) is required to provide a report to the Legislature with recommendations to integrate the Public Transit Participation Grant Program under Minnesota Statutes Section 174.24 with the new Property Tax Replacement Aid Program under Minnesota Statutes Section 174.242. Consistent with the statute, the purpose of this report is to offer recommendations "to restructure the method of financing transit operations in greater Minnesota in such a way as to minimize the reliance on property taxes, while allowing the necessary flexibility to accommodate growth in service demands."[1]

This report is the culmination of a study entered into by the Mn/DOT Office of Transit in response to the request of the Legislature.

Study Team and Methodology

The Property Tax Replacement Aid Study was conducted by TransTech Management, Inc., under the direction of an internal Mn/DOT working group and with regular input from an advisory committee comprised of transit system managers and personnel from Mn/DOT and the Department of Revenue. The study was comprised of four analytical phases: (1) evaluation of

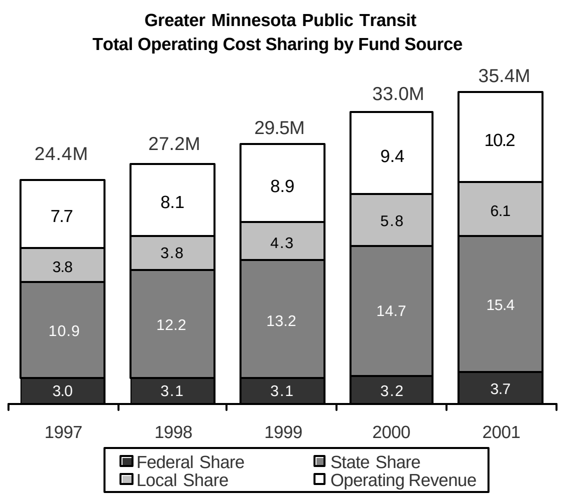
[1] Minnesota Statutes, Section 174.242.

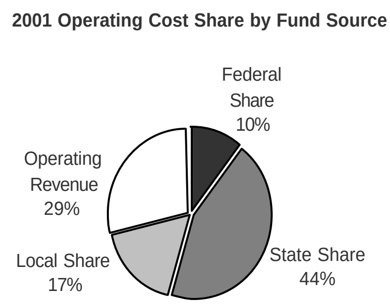
the current Greater Minnesota Transit Fund; (2) development of alternative funding options to the current funding framework; (3) assessment of the funding alternatives; and (4) development of recommendations. In carrying out the study, the consultant team conducted a series of outreach activities, including a workshop and individual interviews with transit system managers and state personnel responsible for providing oversight and technical assistance to benefiting systems. These outreach efforts informed the analytical phases of the study and provided the foundation for the assessment framework applied by the study team.

Background

Public transportation programs in Greater Minnesota are funded through a federal-state-local partnership. Mn/DOT is responsible for the administration of state and federal transit assistance funds for these Greater Minnesota systems. Exhibit ES-1, below, shows the costs borne by each level of government between 1997 and 2001 and the percentage breakdown of the cost sharing for 2001.

Exhibit ES-1. Distribution of Operating Cost Responsibility by Government Level





Public Transit Participation Grant Program

Under the Public Transit Participation Grant Program, all transit systems in Greater Minnesota receive state operating assistance through a fixed share funding formula. This formula sets a fixed local share of the total operating cost. The current fixed local shares are 40 percent for small and large urban systems and 35 percent for rural systems and for systems structured to serve the elderly and disabled. The remaining 60 - 65 percent of funding for system operations is provided via a combination of state and federal grant assistance.

Property Tax Replacement Aid

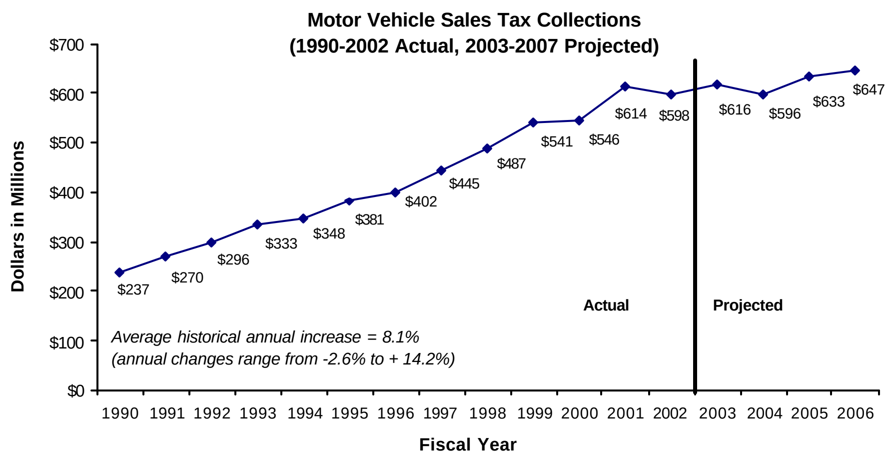
The 2001 Legislature created the Greater Minnesota Transit Fund to provide property tax replacement aid payments public transit systems Greater Minnesota for calendar years 2002 and 2003 (per Minnesota Statutes, Section 174.242). Under this statute, each transit system receiving assistance under the Public Transit Participation Grant Program was required to report the amount of its local share revenues for 2001 that was derived from property taxes to

Mn/DOT. Mn/DOT was then required to certify the property tax amounts and the certified amounts were subsequently deducted from each jurisdiction's levy limit.

Beginning July 1, 2002 and continuing thereafter, 1.25 percent of the State's motor vehicle sales tax (MVST) receipts is deposited to the Greater Minnesota Transit Fund (per Minnesota Statutes, Section 297B.09). Money in the Fund is appropriated annually to the Commissioner of Transportation for assistance to transit systems outside the metropolitan area (per Minnesota Statute, Section 16A.88).

The motor vehicle sales tax is subject to swings in the general economy and, in particular, to the sale of automobiles and automobile parts (see Exhibit ES-2 for a summary of historical and projected motor vehicle sales tax receipts). As shown, the average annual increase in tax receipts between 1990 and 2002 has been 8.1 percent, with annual changes ranging from –2.6 percent to + 14.2 percent. The projected average annual increase over the projected four-year period is just under two percent.

Exhibit ES-2. Historical and Projected Motor Vehicle Sales Tax Collections



Source: Minnesota Department of Finance. *November 2002 Forecast. Price of Government. State and Local Revenues. 1990-2006.*

Study Findings – Evaluation of Property Tax Replacement Aid

Following is a summary of the primary advantages and disadvantages of Property Tax Replacement Aid, as identified through the study.

Primary Advantages

- Anticipated improved funding predictability and stability.
- Potential increased funding to facilitate transit service expansion based upon MVST receipts.
- Potential increased independence of systems vis a vis operational decisions.

Primary Disadvantages/Concerns

- Adverse impact on local taxing control.
- Funding equity concern based on relative treatment of operating revenues and local property taxes in certification process.
- Static nature of certifications and associated complexity of accommodating changes in the mix of transit systems and participating jurisdictions as well as system expansions.

This assessment forms the foundation for consideration of alternative funding approaches.

Alternative Approaches to Achieve Integration

Working closely with the Mn/DOT Office of Transit, the consultant team has identified two alternative approaches to meet the dual charge of integrating Property Tax Replacement Aid with other state-administered transit funding programs and providing the necessary flexibility to accommodate anticipated growth in service demand:

(1) *Secure minimum programmatic fixes* to operationalize Property Tax Replacement Aid and coordinate it with the Public Transit Participation Grant Program; or

(2) *Fully integrate Property Tax Replacement Aid with the Public Transit Participation Grant Program* by developing a holistic funding program (hereafter referred to as the "Equitable Share Approach") that achieves the basic objective of property tax relief and provides a framework for carrying the program forward in time.

Property Tax Replacement Aid Programmatic Fixes

At a minimum, and if more ambitious approaches are not pursued at this time, there are a number of essential actions that must be taken simply to operationalize Property Tax Replacement Aid and to coordinate it to the greatest extent possible with the Public Transit Participation Grant Program. This study identifies legislative and administrative actions required simply to extend Property Tax Replacement Aid beyond the two years (2002 and 2003) covered by the original legislation and to address needed programmatic refinements (see summary of legislative and administrative actions in Exhibit ES-3 at the conclusion of this Executive Summary).

Fully Integrated Programs: The Equitable Share Approach

An alternative to extending Property Tax Replacement Aid in its current construct is to expand upon the current framework to a more fully integrated cost share approach. Under such an approach, the State could provide (via a combination of State and federal funds) up to 80 percent of eligible operating costs for urban systems and up to 85 percent of costs for rural systems and those serving elderly and disabled populations with the systems responsible for generating the remaining 15-20 percent. Under this approach, State funds would continue to be derived from a combination of General Fund support and MVST receipts, at levels consistent with current funding programs. The local share would be achieved primarily through system-generated operating revenues (e.g., passenger fares, operating contracts, and ancillary revenues).

This fully integrated approach has the following general advantages:

- Achieves the original legislative intent of reduction in local property tax burdens, with significantly less administrative complexity.
- Addresses equity concerns associated with Property Tax Replacement Aid such that those systems that have achieved the objective of generating a healthy percentage of their operating budgets from operating revenues are no longer disadvantaged relative to those that historically relied more heavily on local property tax support.
- Achieves full integration of public transit funding programs and associated program flexibility.
- Stabilizes funding for transit systems and prepares for expansion needs.
- Focuses activities on transit service delivery via reduced administrative burden on systems, jurisdictions, and the State.
- Encourages “farebox” funding (i.e., from operating revenues) of entire local share requirement, consistent with the Department’s stated objectives.

Potential disadvantages or concerns regarding this approach include the following:

- To the extent that some systems will receive less state funding under this approach and are unable to increase operating revenues, a small number of these systems may have to go back to local partners for substitute funding.
- The potential for further reductions in operational input by local jurisdictions.

As it does for continuation of Property Tax Replacement Aid, this study identifies key legislative and administrative actions required to institute the Equitable Share Approach as an alternative to Property Tax Replacement Aid (see summary in Exhibit ES-3 at the conclusion of this Executive Summary).

Fiscal Impact of Alternative Approaches

Fiscal Impact on State Program

The two alternative approaches considered in this study are achievable with currently available (and projected) funding. The extent to which system operating costs associated with system expansions and/or new systems can be met will depend on the level of annual increases in the base state and federal funding programs as well as increases in annual MVST receipts. MVST revenues are currently projected to increase at an average of less than two percent per year through 2007. This will constrain the ability to expand the program.

Fiscal Impacts on Transit Systems and Sponsoring Jurisdictions

Continuation of the current funding framework or introduction of the Equitable Share Approach will have similar impacts on local jurisdictions that have historically provided funding to transit systems serving their communities – by replacing what was once provided via property tax contributions with funding provided through an allocation of MVST receipts.

Under both approaches, it is the expectation that transit systems should be able to generate the remaining required local share through operating revenues and thus the obligation of the local jurisdictions is minimized. There will be a transition period for some systems as they move their operations toward fully meeting the objective of generating 15-20 percent of operating costs through operating revenues.

To the extent that Property Tax Replacement Aid is not extended beyond its original two-year timeframe, it is assumed that levy limits imposed under the Property Tax Replacement Aid Program will be lifted. This also would be necessary if the Equitable Share Approach is implemented as an alternative to direct replacement aid.

Study Conclusions and Recommendations

The Property Tax Replacement Aid Program represents a positive step toward stable transit funding for Greater Minnesota. Those involved in the Program almost universally believe that it would be difficult, if not impossible, to go back to local jurisdictions to reinstate the previously provided local funding if the replacement aid were not continued.

Both of the approaches considered in this study achieve the dual objectives of providing an alternative to property tax funding and achieving an appropriate degree of integration with the State's other transit funding programs. There are significant implementation hurdles, however, to applying the Property Tax Replacement Aid construct to meet the State's expansion goals. The Equitable Share Approach is designed to address these obstacles.

Looking to the future, the study team recommends that Mn/DOT work with the Legislature to further study the possibility of instituting a Dedicated Transit Fund to fully carry out the objectives of providing a stable source of funding for Greater Minnesota transit systems and to facilitate service expansion consistent with the Department's objective of meeting at least 80 percent of the need in all 80 Minnesota counties by 2010.[2]

[2] *Greater Minnesota Public Transportation Plan*. Final Report. 2001.

Exhibit ES-3. Legislative and Administrative Actions to *Operationalize Property Tax Replacement Aid Program or Institute Alternative Equitable Share Approach*

Issue	Action	
	Continuation of Property Tax Replacement Aid	**Equitable Share Approach**
	Legislative Actions	
Program Continuation or Establishment	The Legislature would need to enact legislation that continues Property Tax Replacement Aid beyond 2002 and 2003 and links Program to Greater Minnesota Transit Fund and related MVST receipts.	The Legislature would need to enact legislation to link the Greater Minnesota Transit Fund with overall state transit funding program and allow MVST receipts to be used to meet the State's share of operating costs (i.e., up to 80-85% of total system operating costs).
Funding Sources	The established ongoing funding source is MVST revenues. It is recommended that MVST revenues continue to be the primary funding source. It also is recommended that a one-time funding allocation beyond the designated 1.25 percent of MVST revenues be provided to account for the 1st half year of the Property Tax Replacement Aid Program (January – July 2002) when Mn/DOT was responsible for providing replacement aid funding for which Mn/DOT had not yet received MVST revenues (receipt commenced in July 2002).	The established ongoing funding source(s) are state general funds and federal operating assistance. MVST receipts would be included as a funding source for the comprehensive program. It also is recommended that a one-time funding allocation beyond the designated 1.25 percent of MVST revenues be provided to account for the 1st half year of the Property Tax Replacement Aid Program (January – July 2002) when Mn/DOT was responsible for providing replacement aid funding for which Mn/DOT had not yet received MVST revenues (receipt commenced in July 2002).
Fund Use	Appropriate uses of the Greater Minnesota Transit Fund beyond local share contribution for existing transit systems should be established in statute. To ensure that the Fund is available to serve its intended purpose, it is recommended that the Fund be used only to fund transit operations and related program administration, at the discretion of the Commissioner of Transportation. To the extent there are resources in excess of a given year's replacement aid payments and reasonable assurance of future capacity, the Fund should be available for operational costs associated with system expansions and new starts, at the discretion of the Commissioner of Transportation.	Appropriate uses of the Greater Minnesota Transit Fund beyond property tax replacement for existing transit systems should be established in statute. To ensure that the Fund is available to serve its intended purpose, it is recommended that the Fund be used only to fund transit operations and related program administration, at the discretion of the Commissioner of Transportation.
Inflationary Increases	The Minnesota Legislature established the funding level for the Greater Minnesota Transit Fund at 1.25 percent of total MVST receipts. The payments are intended to be adjusted for inflation and were authorized to reflect up to a 6 percent increase over the prior year's replacement aid payments, based on fund revenues and at the discretion of the Commissioner of Transportation. It is recommended that Mn/DOT be given the discretion to set future years' inflation-related increases, based upon Mn/DOT's existing cost indices and available funding.	

Issue	Action	
Timing of Funding Commitments and Funding Levels	As prescribed in the current statute, the Commissioner of Transportation "must certify the replacement aid amounts for calendar years 2002 and 2003 to the Commissioner of Revenue by system and by taxing jurisdiction by August 15th of the preceding year," meaning that the certified replacement aid amounts were established by August 15, 2001 and August 15, 2002 for the following calendar year. Continuation of the program requires establishment of a cycle for future funding commitments. The August 15th date fits well with current operations.	Creation of the integrated approach would require establishment of a cycle for future funding commitments. This would simply be the same as the Public Transit Participation Grant Program.
Timing of Distribution of Payments to Systems	A schedule needs to be established for future payment disbursements to transit systems. A disconnect between funds receipt and distribution under Property Tax Replacement Aid resulted in Mn/DOT borrowing funds to make system payments on designated dates. The current distribution also resulted in a misalignment with transit system needs and required borrowing by a handful of systems. It is recommended that replacement aid payments follow the Public Transit Participation Grant Program payment schedule, with Mn/DOT discretion to adjust schedules as appropriate.	It is recommended that all payments be made consistent with the current Public Transit Participation Grant Program payments, currently with payments in January (50%), July (40%), December (9%), and Post-Audit (1%). Mn/DOT should have the discretion to adjust these schedules as appropriate.
Management of Fund Balance	While there are no major issues regarding the management of Greater Minnesota Transit Fund balances at this time, it is important to note the general need to manage Fund balances to minimize borrowing costs and optimize fund use. The Legislature should provide for interest earnings on Fund balances to be maintained in the Fund for the benefit of the program. This is consistent with the practice of charging Mn/DOT for inter-fund borrowing to meet cash flow requirements.	
	Administrative Actions	
Inflationary Increases	Mn/DOT should apply its existing cost inflation index as the basis for establishing future years' inflationary increases, provided sufficient funds are available.	
System Eligibility and Cost Eligibility	Both system and cost eligibility dovetail with the Public Transit Participation Grant Program.	All systems would be eligible for the Program. Criteria for cost eligibility would be drawn from current program rules.
Certification Procedures	It is recommended that Mn/DOT review and update previously developed certification guidelines. It also is necessary to fix any discontinuities in certifications to date. A method is needed to certify new funding providers (both for new and existing systems). An annual certification process also is needed for new systems and expansions. The only readily identifiable option to do this is to allow jurisdictions to certify an amount by which they are willing to have their property tax levy further reduced. This	Certification procedures are not required under the Equitable Share Approach. Instead, the Legislature may choose to restore levy limits imposed under the two-year Property Tax Replacement Aid Program.

Issue	Action	
	supplemental certification has a number of problems and presents opportunities for gaming the system. Without such an avenue, however, the program is hamstrung by the original certifications. Mn/DOT also should develop policies regarding de minimus certification (i.e., those for very small property tax amounts) and for de-certifications (i.e., for systems that no longer require the level of funding originally provided).	
Timing of Funding Commitments and Funding Levels	Funding commitments with transit systems should be entered into by Mn/DOT as part of the annual contracting process.	
Timing of Distribution of Payments to Systems	It is recommended that all payments be made consistent with the current Public Transit Participation Grant Program payments, currently with payments in January (50%), July (40%), December (9%), and Post-Audit (1%). Mn/DOT should have the discretion to adjust these schedules as appropriate.	
Program Rules	Mn/DOT should promulgate rules that encapsulate the administrative changes to fully implement the Property Tax Replacement Aid Program.	Mn/DOT should promulgate rules that encapsulate needed administrative changes to fully implement the Equitable Share Approach.

I. INTRODUCTION

Context and Purpose of Study

The 2001 Minnesota Legislature passed a combination of property tax relief legislation that included class rate reductions across all property types, elimination of the state-determined general education levy, elimination of the Metropolitan Council's authority to levy property taxes to pay for the operating costs of transit systems, and dedication of a percent of the sales tax on motor vehicles to partially replace property taxes as a funding source for transit operating expenses in the metropolitan area and in Greater Minnesota.[3] The Greater Minnesota Transit Fund was created to provide for these property tax replacement aid payments for public transit systems in Greater Minnesota for calendar years 2002 and 2003.

"The commissioner of tr ansportation, in consultation with the commissioner of revenue, shall make a report to the legislature containing recommendations for integrating the grant program under section 174.24 with the property tax replacement aid program…The recommendations shall attempt to restructure the method of financing transit operations in greater Minnesota in such a way as to minimize reliance on property taxes, while allowing the necessary flexibility to accommodate growth in service demands."

(Minnesota Statutes, Section 174.242. Subd.4.)

According to the legislation, the Minnesota Department of Transportation (Mn/DOT) is required to provide a report to the Legislature with recommendations to integrate the Public Transit Participation Grant Program under Minnesota Statutes Section 174.24 with the Property Tax Replacement Aid Program under Minnesota Statutes Section 174.242. Consistent with the statute, the purpose of this report is to offer recommendations "to restructure the method of financing transit operations in greater Minnesota in such a way as to minimize the reliance on property taxes, while allowing the necessary flexibility to accommodate growth in service demands."[4]

This report is the culmination of a study entered into by the Mn/DOT Office of Transit in response to the request of the Legislature. The study was conducted under the direction of an internal Mn/DOT working group and with regular input from an advisory committee comprised of Greater Minnesota transit system managers and personnel from Mn/DOT and the Department of Revenue. The focus of the study and this report is identification of possible refinements to Property Tax Replacement Aid and to the Greater Minnesota Transit Fund and to their integration with other transit funding programs administered by the State.

[3] Minnesota House of Representatives. Public Information Office. *New Laws 2001 – A Complete Summary of the Regular Legislative Session and Special Session.*
[4] Minnesota Statutes, Section 174.242.

Report Overview and Organization

This report is divided into six sections, as follow:

I. Introduction. Describes the context and purpose of the Property Tax Replacement Aid Study and provides an overview of this report to the Legislature.

II. Background. Provides a general overview of Greater Minnesota transit funding programs, including an overview of Property Tax Replacement Aid and the Public Transit Participation Grant Program.

III. Study Team and Methodology. Describes the overall approach of the study team and introduces the assessment framework applied in the study.

IV. Study Findings – Evaluation of Property Tax Replacement Aid. Further discusses the assessment framework and provides a synthesis of findings regarding Property Tax Replacement Aid, specifically as it relates to its integration with the Public Transit Participation Grant Program administered by Mn/DOT.

V. Options for Integrating Property Tax Replacement Aid with the Public Transit Participation Grant Program. Offers alternative funding approaches for Greater Minnesota transit, focused on integration of Property Tax Replacement Aid with other programs administered by the State, and identifies potential legislative and administrative adjustments to achieve program integration.

VI. Study Conclusions and Recommendations. Offers the study team's general conclusions and recommendations regarding the funding framework for transit service operations in Greater Minnesota and, more specifically, integration of Property Tax Replacement Aid with other State-administered funding programs.

Appendix. Provides a listing of the Advisory Committee members that provided input throughout the course of the study.

II. BACKGROUND

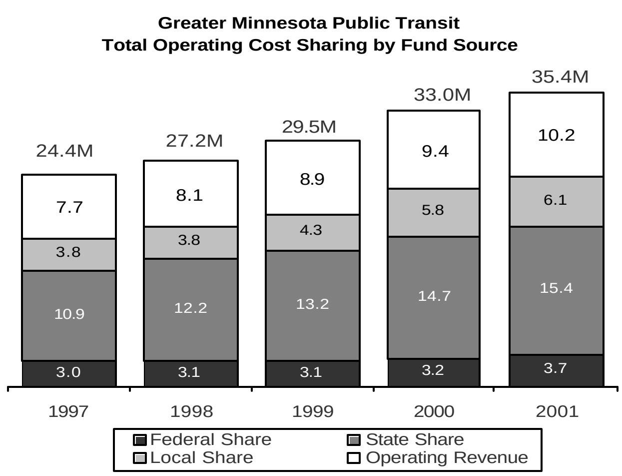
This section provides a general overview of Greater Minnesota transit funding programs including an overview of Property Tax Replacement Aid and the associated Greater Minnesota Transit Fund and of the Public Transit Participation Grant Program.

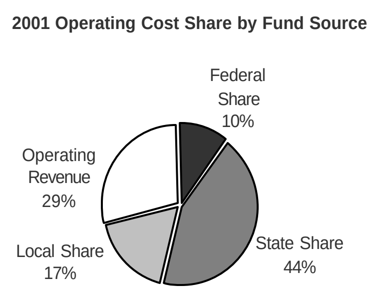
Overview of Greater Minnesota Transit Funding Programs

The Minnesota Department of Transportation is responsible for the administration of state and federal transit assistance funds for transit systems in Greater Minnesota. The Department also has statewide responsibility for administration of the Federal Transit Administration's Section 5303 Metropolitan Planning, Section 5309 Capital, Section 5310 Elderly and Persons with Disabilities, Section 5311 Non-urbanized Area, and Section 5313 State Planning and Research Programs.[5]

As noted above, public transportation programs in Greater Minnesota are funded through a federal-state-local partnership. Exhibit II-1, below, shows the operating costs borne by each level of government between 1997 and 2001 and the percentage breakdown of the cost sharing for 2001.

Exhibit II-1. Distribution of Operating Cost Responsibility by Government Level





Source: Mn/DOT. *2001 Transit Report.*

[5] Minnesota Department of Transportation. *2001 Transit Report: A Guide Book to Minnesota's Public Transportation Network.* p. 9.

Public Transit Participation Grant Program

Law enacted in 1977 (Minnesota Statutes, Section 174.24) created the Public Transit Participation Grant Program. Activities eligible for assistance under the Program include, but are not limited to:

- Planning and engineering design for transit services and facilities;
- Capital assistance to purchase or refurbish transit vehicles and other capital expenditures necessary to provide transit service;
- Operating assistance; and
- Other assistance for public transit services that furthers the purposes outlined above per Minnesota Statutes, Section 174.21.

Under the Public Transit Participation Grant Program, all transit systems in Greater Minnesota receive state operating assistance through a fixed share funding formula. This formula sets a fixed local share of the total operating cost. The currently imposed fixed local shares are as follows:[6]

Fixed Local Share Funding Formula

Systems serving the elderly and disabled	35%
Rural systems	35%
Small urban systems	40%
Urbanized systems	40%

Funds are distributed via annual operating contracts between the transit systems and Mn/DOT such that the percentage of total operating cost paid by any recipient system from local sources will not exceed the percentage for that recipient's classification, except as provided in an undue hardship case in which the Commissioner of Transportation may adjust the local share amounts, with offsetting adjustments to other systems.[7] The remainder of the total operating costs is to be paid from state funds less any federal assistance received by the recipient.

As of calendar year 2002, "local sources" are comprised of any property tax replacement aid payments (per Minnesota Statutes, Section 174.242) and all locally generated funds. If a system has operations outside of its operating contract with Mn/DOT, revenues from those operations may be excluded from the local share computation at the discretion of the Commissioner of Transportation (per Minnesota Statutes, Section 174.24 Subdivision 3b).

For the purposes of the operating contract, **allowable operating costs** include the following expenses (as defined in Minnesota Rule 8835.0280):

- Personnel services
- Administrative charges
- Vehicle charges
- Operations charges
- Insurance charges
- Taxes and fees

[6] Per the statute, the Commissioner of Transportation has discretion to reduce the State share in each classification to the extent that adequate funds are not appropriated.
[7] Per the statute, a system may not have its local share adjusted for more than two consecutive years under the undue hardship provision.

Unallowable operating costs include the following expenses (as defined in Minnesota Rule 8835.0290):

- General purpose equipment
- Interest and other financial costs
- Fines and penalties
- Contingencies
- Bad debts
- Donations and entertainment expenses
- Unrelated costs

Payments of state operating assistance are made according to the following schedule:

Payment Schedule for State Operating Assistance

Month of Operation	Percentage of Total Contract Amount
January	50%
July	40%
December	9%
After the final audit	1%

Federal funds are dispersed by Mn/DOT to individual systems only after Mn/DOT receives the monthly system reports for the quarter. Federal funding is provided according to the following schedule:[8]

Payment Schedule for Federal Funds

Quarter	Earliest Date of Receipt
January – March	April
April – June	July
July – September	October
October – December	January (Latest - April)

Property Tax Replacement Aid

The 2001 Minnesota Legislature created the Greater Minnesota Transit Fund to provide property tax replacement aid payments for public transit systems in Greater Minnesota for calendar years 2002 and 2003 (per Minnesota Statutes, Section 174.242). Under this statute and for the purpose of establishing funding levels, each transit system receiving assistance under the Public Transit Participation Grant Program was required to report the amount of its local share revenues for 2001 that were derived from property taxes to Mn/DOT. For the purposes of this provision, all general fund revenues provided by a local government unit in Minnesota are considered property tax revenues, except for revenues received by systems from school districts.

Mn/DOT was required to certify the property tax amounts by August 15th of the year preceding the funding year and the certified amounts were deducted from each jurisdiction's levy limit. The statute includes a provision for payments to be adjusted each year, up to a maximum of six percent. The 2002 payments included a six percent increase over the amount of property taxes

[8] The monthly report for the year-end must be submitted by March 31st of the following year. As a result, a system could receive their federal funds as late as April of the subsequent year.

certified by each taxing jurisdiction for 2001. Similarly, the payments in 2003 will include up to a maximum six percent increase over the 2002 replacement aid payments, based on fund revenues and at the discretion of the Commissioner of Transportation. According to the statute, payments to each system in 2002 and 2003 must be made according to the following schedule:

Payment Schedule for Property Tax Replacement Aid

July 20th	50%
November 20th	50%

The source of funding for the property tax replacement aid payments is a designated portion of the State's motor vehicle sales tax (MVST) receipts.[9] This tax is imposed on the purchase price of motor vehicles registered in Minnesota. Beginning July 1, 2002 and continuing thereafter, 1.25 percent of the funds collected from this tax must be deposited in the Greater Minnesota Transit Fund (per Minnesota Statutes, Section 297B.09). The Greater Minnesota Transit Fund is established within the State Treasury. Money in the Fund is appropriated annually to the Commissioner of Transportation for assistance to transit systems outside the metropolitan area (per Minnesota Statutes, Section 16A.88).

Should the Greater Minnesota Transit Fund have insufficient revenues to fully fund all certified property tax replacement aid amounts and planned inflation-related increases, each system will receive property tax replacement aid payments in an amount calculated according to the following proportional funding formula:

Replacement Aid Payment Calculation

$$\text{Property Tax Replacement Aid Payment} = \frac{\text{Certified System Property Tax Amount}}{\text{Total Certified Property Tax Amount For All Systems}} * \text{Greater Minnesota Transit Fund Projected Total Revenues (for the full FY that begins in the CY in which the aid is payable, up to an established limit)}$$

The statute (Minnesota Statutes, Section 174.242) also calls for Mn/DOT, in consultation with the Department of Revenue, to provide a report to the Legislature with recommendations for integrating the Public Transit Participation Grant Program with the Property Tax Replacement Aid Program. The recommendations are intended to "restructure the method of financing transit operations in Greater Minnesota in such a way as to minimize reliance on property taxes, while allowing the necessary flexibility to accommodate growth in service demands."[10] This document serves as the response to that request from the Legislature.

[9] Also referred to as the Motor Vehicle Excise Tax (MVET).
[10] Minnesota Statutes, Section 174.242.

III. STUDY TEAM AND METHODOLOGY

This section provides a description of the team that carried out the Property Tax Replacement Aid Study as well as an overview of the oversight structure and analytical framework for the study.

Study Team and Oversight Structure

The Property Tax Replacement Aid Study was conducted by TransTech Management, Inc., under the direction of an internal Mn/DOT working group and with regular input from an advisory committee comprised of Greater Minnesota transit system managers and personnel from Mn/DOT and the Department of Revenue (see Appendix for a listing of Advisory Committee members). The consultant team was selected based upon its national reputation in the arena of infrastructure finance and its specific knowledge of transit operations and funding. The study structure was developed to optimize input from participating transit systems but also to provide necessary independence and objectivity.

Analytical Process

The study was comprised of four analytical phases:

(1) Evaluation of the Greater Minnesota Transit Fund;

(2) Development of alternative funding options to the current funding framework;

(3) Assessment of the funding alternatives; and

(4) Development of conclusions and potential recommendations for integrating Property Tax Replacement Aid with other state-administered transit funding programs.

In carrying out the study, the consultant team conducted a series of outreach activities, including a workshop and individual interviews with transit system managers and state personnel responsible for providing oversight and technical assistance to benefiting systems. These outreach efforts informed the analytical phases of the study and provided the foundation for the assessment framework applied by the study team.

Assessment Framework

Prior to embarking on the program assessment, the consultant team in concert with Mn/DOT staff developed a set of assessment factors to use in evaluating early implementation of the Greater Minnesota Transit Fund and of Property Tax Replacement Aid. These factors, refined over the course of the study, focused on the actual or perceived impacts on the following elements:

- Local taxing control;
- Funding predictability and stability;
- Funding equity across systems;
- Transit systems' ability to secure other revenues;
- System-level cash flow;
- System and local jurisdiction administrative burden and costs;
- State administrative burden and costs;
- Planned service enhancement and expansion; and
- Distribution of operational control.

To determine the effect that Property Tax Replacement Aid has with respect to each of the assessment factors, various research activities were carried out including a workshop and individual interviews with systems managers and state personnel from MN/DOT's Office of Transit and the Departments of Revenue and Finance responsible for technical and financial management of the program. The workshop and interviews served to ensure that the correct criteria and issues were captured, including the appropriate weighting of the criteria, and to obtain a thorough understanding of perceptions regarding the advantages and disadvantages of the Property Tax Replacement Aid approach.

IV. Study Findings – Evaluation of Property Tax Replacement Aid

This section presents the results of the consultant team's assessment of the implementation and current administration of the Property Tax Replacement Aid Program. The assessment was conducted with a focus on the anticipated impacts on Greater Minnesota transit systems, local government funding partners, and the State of the new funding method.

Synthesis of Results

Reactions of workshop participants and interviewees regarding the impact of Property Tax Replacement Aid on transit in Greater Minnesota were somewhat guarded – given the relative newness of the program – but generally positive. Specific findings are summarized below. For each assessment criteria, a discussion of the effect that Property Tax Replacement Aid has, or may have, with respect to the assessment factor is discussed.

Ramifications for Local Taxing Control

Property Tax Replacement Aid reduces the control that individual systems and the jurisdictions that they serve have on the sources of funding, including but not limited to local property taxes, that can be applied to funding transit operations. Reducing levy limits also limits local jurisdictions' ability to exercise their discretion to use property tax revenue for other purposes.

As noted earlier, the Property Tax Replacement Aid Program treats as property taxes any general revenues provided by a jurisdiction to an eligible transit agency. Based upon the certification of such revenues, the general revenue funding is replaced – or offset – with replacement aid and the jurisdiction's tax levy limit is reduced by a comparable amount. In an instance where a locality has chosen to use a particular funding source such as a water or wastewater fee, an impact fee, or any number of charges imposed by the jurisdiction to fund its transit services but has done so through a general fund account, such funding is replaced with replacement aid and the jurisdiction's levy limit reduced by a comparable amount. It may be the case, however, that such non-property tax charges cannot be used for any other purpose and thus cannot be used to replace funding previously provided by the now reduced tax levy.

While this appears to be an issue in only a handful of instances, it is of concern to at least some jurisdictions. Depending on how the program is continued, it also could have a more extensive impact in the future.

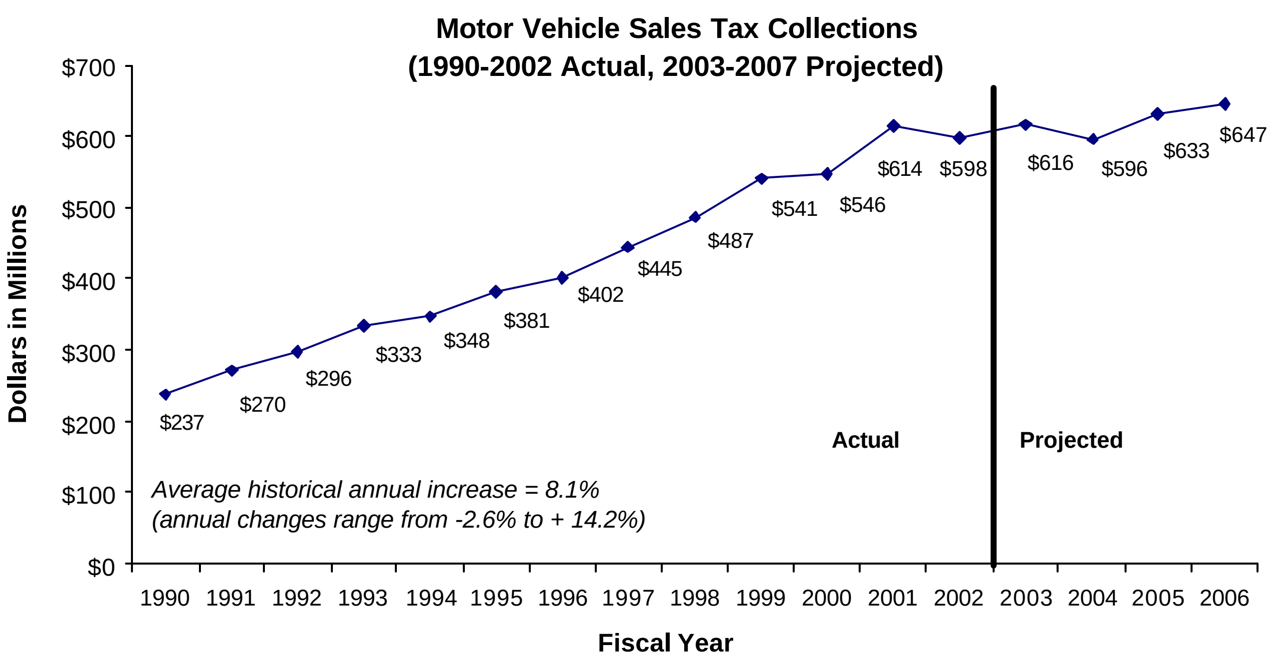
Ramifications for Funding Predictability and Stability

Prior to Property Tax Replacement Aid, many transit systems obtained a considerable portion of their funding from local general funds. As a result, each year these transit systems would compete for funding with other local programs, making their funding relatively unpredictable. In some instances, however, the funding became fairly stable from year to year as communities carved a slice in the budget for the transit system. It is important to note that following implementation of Property Tax Replacement Aid, local jurisdictions discontinued setting aside a portion of their budgets for the transit systems. At this point, if Property Tax Replacement Aid were discontinued, this former source of funding would not necessarily be available for transit systems, given the level of competition for such funds among local programs.

Some systems also expressed concern over the ability of MVST revenues to match transit expansion needs in Greater Minnesota. The motor vehicle sales tax is largely viewed as a relatively predictable revenue source, with economists at the state and national levels focused on providing the best possible forecasts of future year receipts. Motor vehicle sales tax receipts, however, are subject to changes in the overall economy and, specifically, automotive sales. Significant economic downturns that cause significant reductions in automobile sales, adversely affect the stability of such revenues. The total revenues collected from the MVST for the period 1990 through 2002 are shown in Exhibit IV-1, below. As illustrated, the average annual increase over the 12-year timeframe was 8.1 percent. The graph also shows projected receipts, as reported by the Department of Finance. Current projections show less than a two percent average annual increase over the next several years, with considerable variation from one year to the next.

System managers reported that, if replacement aid funds were to be cut, they would be unable to generate local funds to fully substitute for the replacement aid funds. As noted previously, the level of competition for such funds would prohibit transit systems from reclaiming slices of local budgets formerly used for transit but now designated for other critical purposes.

Exhibit IV-1. Historical and Projected Motor Vehicle Sales Tax Collections



Source: Minnesota Department of Finance. November 2002 Forecast. Price of Government. State and Local Revenues, 1990-2006.

Related to the overall stability of the fund is the provision for regular inflation-related increases. While it is understood that these annual increases may not continue at the current six percent level, transit system managers see the inclusion of this facet of the program very positively.

Impacts on Funding Equity Across Systems

Through the Greater Minnesota Public Transportation Plan's performance objectives, Mn/DOT encourages transit systems to collect at least 20 percent of their operating costs via operating revenues (i.e., from passenger fares, operating service contracts, and ancillary revenues such as advertising). How much operating revenue is generated, however, is determined solely at the transit system's discretion, in consultation with the jurisdictions that they serve. Reliance on this local discretion has an adverse side effect of creating an inequity in local funding support across systems. This inequity has, in turn, passed through to and been incorporated into the Property Tax Replacement Aid Program, as described further below.

Transit systems that achieved higher operating cost recovery ratios (i.e., recouped a higher percentage of their operating costs from operating revenues) prior to the 2001 Property Tax Replacement Aid certification process are now receiving proportionately less funding from the new program than systems that had lower operating revenues and received a greater percentage of their funding from local funding providers. Property tax replacement aid as a percentage of a system's required local share ranges from zero percent for some systems to as much as 99 percent in another. Similarly, as a percentage of total operating expenses, property tax replacement aid ranges from zero percent to 40 percent of individual systems' total operating costs.

As shown in Exhibit IV-2, a system that received a greater amount of farebox revenue and relied less on local funding, such as property taxes, does not receive as much replacement aid as a system with lower fares that relied more heavily on local funds, specifically property taxes. This runs counter to the Department's objectives of encouraging greater recovery of operating costs through system operations.

Exhibit IV-2. Equity Across Systems – Hypothetical Comparison

		System A	System B
	Total Local Share	$10,000 (100%)	$10,000 (100%)
Before Property Tax Replacement Aid	Farebox Receipts	$5,000 (50%)	$3,000 (30%)
	Property Tax Revenues/Other Local Funding	$5,000 (50%)	$7,000 (70%)
Under Property Tax Replacement Aid	Property Tax Replacement Aid	*$5,000 (50%)*	*$7,000 (70%)*
	Farebox Receipts	$5,000 (50%)	$3,000 (30%)

As shown in this hypothetical example, System B will receive $2,000 more in property tax replacement aid than System A even though their original local share amounts were both $10,000.

Impacts on Ability to Secure Other Revenues (e.g., farebox, other local sources)

It was anticipated that Property Tax Replacement Aid could have a direct impact on systems' abilities to secure other local funding and even to gain authorization for increases in farebox revenues, based upon the expectation of local jurisdictions that the local share is "taken care of" via the replacement aid. While the consultant team has not discovered direct evidence to support this concern, except with respect to transit systems' apprehension regarding the ability to secure local funding in the future, given the newness of the program it is a legitimate consideration.

Similar to the concern regarding the ability to secure funding from local funding partners, there is concern that some systems may view replacement aid funds as an alternative to increasing operating revenues (for example, by increasing fares or boosting ridership), again running counter to the Department's stated objective of increased direct operating cost recovery.

Impacts on System-Level Cash Flow

The distribution of funding from the Greater Minnesota Transit Fund to individual systems as prescribed in statute (i.e., 50 percent in July and 50 percent in November has caused some cash flow shortages for individual systems and required several systems to borrow funds until the property tax replacement aid payments are received. The cash flow shortage is caused by a difference in the distribution schedule of the property tax replacement aid payments from individual systems' cash flow needs, with replacement aid funds coming only ½-way through the systems' operating years. Compounding the adverse impact, the interest and other financing costs that a system incurs when borrowing funds are ineligible expenses for cost sharing under the Public Transit Participation Grant Program.

Those systems that did not face cash flow shortages under the new program relied upon their relationships with localities that could provide funding in the interim, cash reserves, or the ability to manage cash flow requirements to match the new program's payment schedule. Localities that provided interim funding, however, also were adversely affected by the costs and administrative burdens associated with providing the advance.

Impacts on Administrative Burden and Costs at the System and Local Level

While implementation of Property Tax Replacement Aid created some initial administrative burden and costs on transit systems, these do not appear to be significant on an ongoing basis. In fact, beyond the certification process, the administrative costs and burdens of the new program are likely to be significantly less for many systems than previously. For example, multi-county and multi-city systems previously had to appear in front of various city councils and county boards to request funding or to continually justify existing funding. Such appearances may have been necessary at the beginning of budget processes to request funds, at the end of budget cycles to request remaining operating funds be transferred to capital funds, and any time there was a change in elected officials. One transit system, for instance, received local funding from 22 jurisdictions (15 city councils and 7 county boards) spread throughout the region. With the new program there is only one funding source.

The Property Tax Replacement Aid Program does place some – albeit limited – new administrative burden and costs on local jurisdictions. Local jurisdictions were required to certify their property tax levies for the transit system, causing some accounting burdens. In some cases, this certification effort was completed for insignificant amounts of funding. In such cases, a structure may be needed to determine what constitutes a de minimus amount and how this would be treated in the future.

Impacts on State Administrative Burden and Costs

At the State level, there are new administrative requirements and costs associated with implementing the Property Tax Replacement Aid Program. This includes management of the certification process; promulgation of rules; expansion of the audit process to include the additional funds; tracking of Greater Minnesota Transit Fund revenues, outlays, and cash balances; and management of future years' funding distributions consistent with the Fund's financial capacity. These administrative activities are generally manageable in the context of the overall transit program administered by Mn/DOT.

In addition to the newly required administrative activities, the timing of the required distribution of replacement aid payments to participating transit systems forced Mn/DOT to borrow funds and to incur related future interest costs, estimated to be approximately $100,000. As the program was established, Mn/DOT was required to distribute one-half year of replacement aid payments prior to the accumulation of associated tax receipts in the Fund. If continued on its current course, the program will continue to lag in revenues by one-half year relative to the timing of required payments, with additional internal borrowing reasonably anticipated.

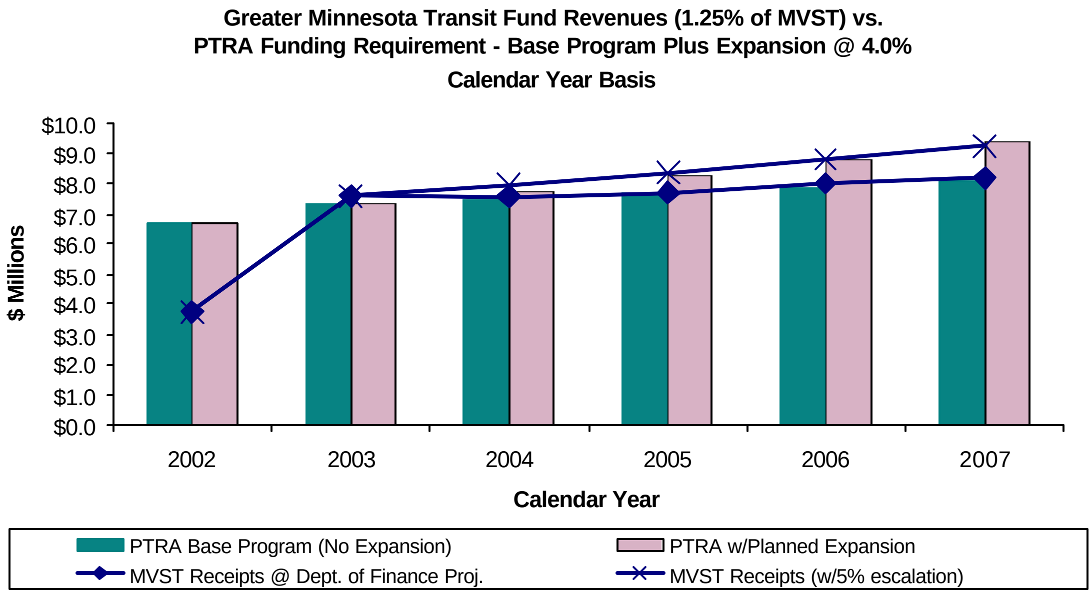
Impacts Related to Planned Service Enhancement and Expansion

The static nature of the Property Tax Replacement Aid approach does not adequately allow for service expansion and/or new systems. Because the program depends upon the amounts of property taxes originally certified, it is not clear how the system can be carried forward in time and adequately provide for changes in transit service levels. For instance, a transit system could decide to expand services and a local jurisdiction could wish to provide increased funding for the expansion, but the property tax replacement aid funding is set and would not account for the expansion.

A re-certification process – to include new systems, new funding providers, and expanded local funding for existing systems – needs to be developed. As currently implemented, only those funding providers that provided a local aid contribution in 2001 are included in the Property Tax Replacement Aid distribution formula. If a provider is not formally listed as a provider of local match in the system's Management Plan, they are not included in the funding distribution. For example, if the required match was fully met by the County, any other local funding provided (for example, by the City) was not noted as a match in the Management Plan and thereby may not have been included in the certification process. In addition, if a new funding provider relationship was formed after 2001, that provider is not included in the certification. A process needs to be established to adjust for such circumstances and to enable a system to request additional replacement aid funding but the path to doing so is not clear.

An additional, and important, issue relates to the capacity of the motor vehicle sales tax (particularly the 1.25 percent allocated to the Greater Minnesota Transit Fund) to support operating costs associated with planned system expansion and new starts in the State. Based upon current forecasts which project average annual increases in funding of less than two percent over the next four years, the funding capacity will be a real constraint on the State's ability to meet its expansion targets, as articulated in the Greater Minnesota Public Transportation Plan. To be consistent with the State's expansion goals, an average annual increase of approximately five percent in MVST receipts is required (see Exhibit IV-3).

Exhibit IV-3. Funding Capacity of Projected MVST Receipts Relative to Property Tax Replacement Aid Funding Requirement



Impacts on Distribution of Operational Control

Prior to Property Tax Replacement Aid, local jurisdictions had significant control over transit system funding and, therefore, indirectly over transit operations and key operational decisions. Under the Property Tax Replacement Aid construct, local jurisdictions do not control the funding and, therefore, may not have as much of a voice regarding operational decisions. Conversely, Mn/DOT, as administrator of the Fund, may have more influence on operational decisions. Depending on how the program is administered, it also is possible that control over operating decisions shifts more to the transit systems themselves. It is premature to judge how this sharing of influence and control will evolve but it is an important factor to bear in mind when considering further programmatic adjustments.

Evaluation Summary

The preceding discussion highlights a number of advantages and disadvantages of Property Tax Replacement Aid relative to predecessor local funding arrangements and identifies general areas of concern of program participants regarding the future of the program. These advantages and disadvantages are listed below and addressed further in Section V of this report.

Primary Advantages

- Anticipated improved funding predictability and stability, including planned inflationary adjustments of revenues and freeing systems from annual solicitation of local funds.
- Potential increased funding to facilitate transit service expansion based upon MVST receipts.
- Potential increased independence of systems vis a vis operational decisions.

Primary Disadvantages/Concerns

- Adverse impact on local taxing control.
- Funding equity concern based on relative treatment of operating revenues and local property taxes in original certifications.
- Static nature of certifications and associated complexity of accommodating changes in the mix of transit systems and participating jurisdictions and system expansions.

This assessment forms the foundation for consideration of alternative funding approaches presented in the next section of this report.

V. Options for Integrating Property Tax Replacement Aid with The Public Transit Participation Grant Program

This section presents two options to integrate Property Tax Replacement Aid with the Public Transit Participation Grant Program, to continue to fulfill the objectives of the Legislature in enacting Property Tax Replacement Aid, and to do so in the most efficient and effective manner.

Alternative Approaches to Achieve Integration

Based upon the results of the outreach phase of the study and working closely with the Mn/DOT Office of Transit, the consultant team has identified two alternative approaches to meet the dual charge of integrating Property Tax Replacement Aid with other state-administered transit funding programs and providing the necessary flexibility to accommodate anticipated growth in service demand. These options are:

- *Secure minimum programmatic fixes* to operationalize Property Tax Replacement Aid and coordinate it with the Public Transit Participation Grant Program; or
- *Fully integrate Property Tax Replacement Aid with the Public Transit Participation Grant Program* by developing a holistic funding program (referred to as the "Equitable Share Approach") that achieves the same basic objective of Property Tax Replacement Aid with significantly less administrative burden and the greatest possible stability and flexibility for Greater Minnesota transit funding going forward.

Property Tax Replacement Aid Programmatic Fixes

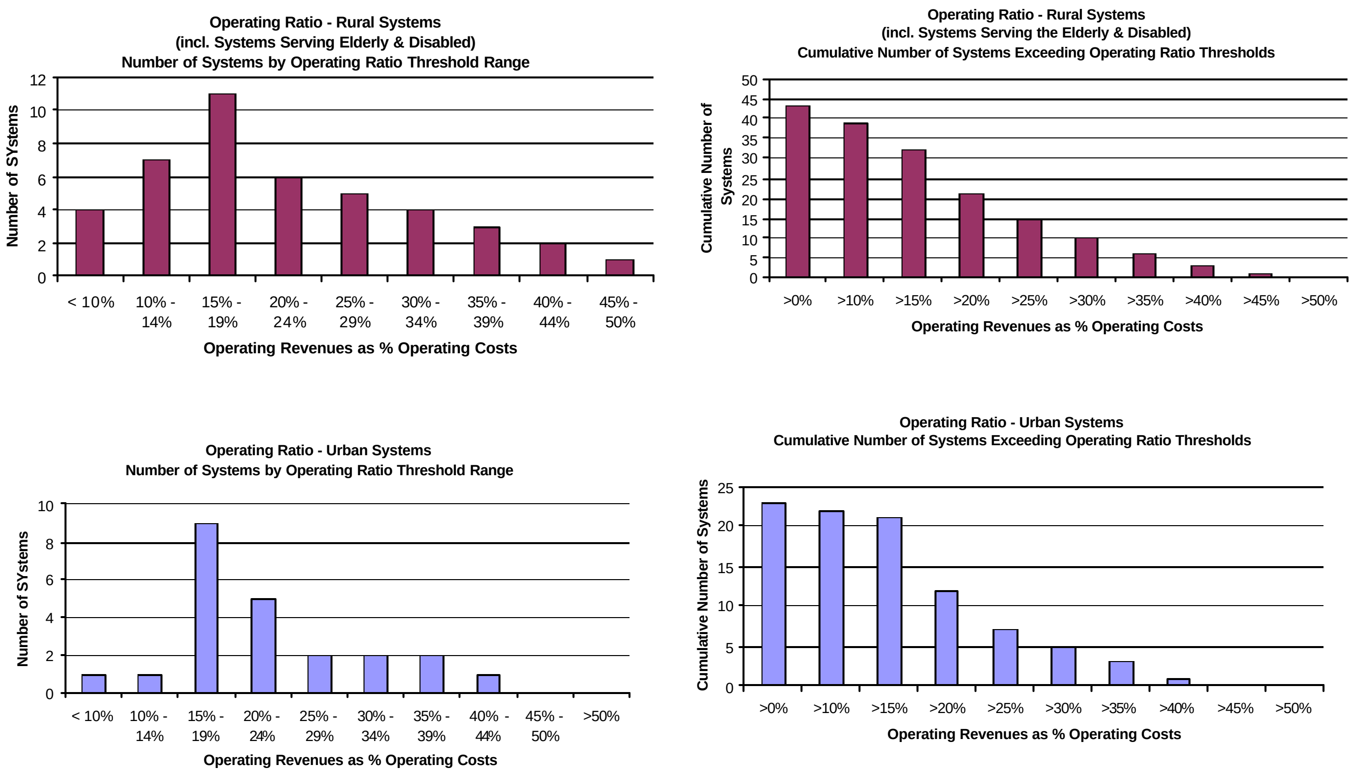
At a minimum, and if more ambitious approaches are not pursued at this time, there are a number of essential actions that must be taken simply to operationalize Property Tax Replacement Aid and to coordinate it to the greatest extent possible with the Public Transit Participation Grant Program. This study identifies a series of legislative and administrative actions required simply to extend Property Tax Replacement Aid beyond the two years (2002 and 2003) covered directly by the original legislation and to address needed programmatic refinements (see summary of legislative and administrative actions summarized in Exhibit V-1).

Fully Integrated Programs: The Equitable Share Approach

An alternative to extending Property Tax Replacement Aid in its current construct is to expand upon the current framework to a more fully integrated cost share approach. Under such an approach, the State could provide (via a combination of State and federal funds) up to 80 percent of eligible operating costs for urban systems and up to 85 percent of costs for rural systems and those serving elderly and disabled populations. The transit systems would be responsible for generating funds to pay for the remaining 15-20 percent of operating costs. Under this approach, it is envisioned that State funds would continue to be derived from a combination of General Fund support and MVST receipts, at levels that are consistent with current funding programs. The local share would be achieved primarily through system-generated operating revenues (e.g., passenger fares, operating contracts, and ancillary revenues).

Exhibit V-1 illustrates the current status of system operations in terms of their recovery of operating costs through operating revenues and serves as the basis for the 15 percent and 20 percent cutoffs. The operating ratios (i.e., operating revenues divided by operating expenses) are consistent with systems of a comparable nature in other states and demonstrate the relatively limited capacity of these systems to be self-funding.

Exhibit V-1. Operating Ratios for Rural and Urban Systems (based on 2002 Actual Operating Years)



The Equitable Share Approach has the following general advantages:

- Achieves the original legislative intent of reduction in local property tax burdens, with significantly less administrative complexity.
- Addresses equity concerns associated with Property Tax Replacement Aid such that those systems that have achieved the objective of generating a healthy percentage of their operating budgets from operating revenues are no longer disadvantaged relative to those that historically relied more heavily on local property tax support.
- Achieves full integration of public transit funding programs and associated program flexibility.
- Stabilizes funding for transit systems and prepares for expansion needs.

- Focuses activities on transit service delivery via reduced administrative burden on systems, jurisdictions, and the State.
- Encourages “farebox” funding (i.e., from operating revenues) of entire local share requirement, consistent with the Department’s stated policy objectives.

Potential disadvantages or concerns regarding this approach include the following:

- To the extent that some systems will receive less State funding under this approach and are unable to increase operating revenues, a small number of these systems may have to go back to local partners for substitute funding.
- The potential for further reductions in operational input by local jurisdictions.

As it does for continuation of Property Tax Replacement Aid, this study identifies key legislative and administrative actions that would be required to institute the Equitable Share Approach as an alternative to Property Tax Replacement Aid (see summary in Exhibit V-2).

Exhibit V-2. Legislative and Administrative Actions to *Operationalize Property Tax Replacement Aid Program or Institute Alternative Equitable Share Approach*

Issue	Action	
	Continuation of Property Tax Replacement Aid	**Equitable Share Approach**
	Legislative Actions	
Program Continuation or Establishment	The Legislature would need to enact legislation that continues Property Tax Replacement Aid beyond 2002 and 2003 and links Program to Greater Minnesota Transit Fund and related MVST receipts.	The Legislature would need to enact legislation to link the Greater Minnesota Transit Fund with overall state transit funding program and allow MVST receipts to be used to meet the State's share of operating costs (i.e., up to 80-85% of total system operating costs).
Funding Sources	The established ongoing funding source is MVST revenues. It is recommended that MVST revenues continue to be the primary funding source. It also is recommended that a one-time funding allocation beyond the designated 1.25 percent of MVST revenues be provided to account for the 1st half year of the Property Tax Replacement Aid Program (January – July 2002) when Mn/DOT was responsible for providing replacement aid funding for which Mn/DOT had not yet received MVST revenues (receipt commenced in July 2002).	The established ongoing funding source(s) are state general funds and federal operating assistance. MVST receipts would be included as a funding source for the comprehensive program. It also is recommended that a one-time funding allocation beyond the designated 1.25 percent of MVST revenues be provided to account for the 1st half year of the Property Tax Replacement Aid Program (January – July 2002) when Mn/DOT was responsible for providing replacement aid funding for which Mn/DOT had not yet received MVST revenues (receipt commenced in July 2002).
Fund Use	Appropriate uses of the Greater Minnesota Transit Fund beyond local share contribution for existing transit systems should be established in statute. To ensure that the Fund is available to serve its intended purpose, it is recommended that the Fund be used only to fund transit operations and related program administration, at the discretion of the Commissioner of Transportation. To the extent there are resources in excess of a given year's replacement aid payments and reasonable assurance of future capacity, the Fund should be available for operational costs associated with system expansions and new starts, at the discretion of the Commissioner of Transportation.	Appropriate uses of the Greater Minnesota Transit Fund beyond property tax replacement for existing transit systems should be established in statute. To ensure that the Fund is available to serve its intended purpose, it is recommended that the Fund be used only to fund transit operations and related program administration, at the discretion of the Commissioner of Transportation.
Inflationary Increases	The Minnesota Legislature established the funding level for the Greater Minnesota Transit Fund at 1.25 percent of total MVST receipts. The payments are intended to be adjusted for inflation and were authorized to reflect up to a 6 percent increase over the prior year's replacement aid payments, based on fund revenues and at the discretion of the Commissioner of Transportation. It is recommended that Mn/DOT be given the discretion to set future years' inflation-related increases, based upon Mn/DOT's existing cost indices and available funding.	

Issue	Action	
Timing of Funding Commitments and Funding Levels	As prescribed in the current statute, the Commissioner of Transportation "must certify the replacement aid amounts for calendar years 2002 and 2003 to the Commissioner of Revenue by system and by taxing jurisdiction by August 15th of the preceding year," meaning that the certified replacement aid amounts were established by August 15, 2001 and August 15, 2002 for the following calendar year. Continuation of the program requires establishment of a cycle for future funding commitments. The August 15th date fits well with current operations.	Creation of the integrated approach would require establishment of a cycle for future funding commitments. This would simply be the same as the Public Transit Participation Grant Program.
Timing of Distribution of Payments to Systems	A schedule needs to be established for future payment disbursements to transit systems. A disconnect between funds receipt and distribution under Property Tax Replacement Aid resulted in Mn/DOT borrowing funds to make system payments on designated dates. The current distribution also resulted in a misalignment with transit system needs and required borrowing by a handful of systems. It is recommended that replacement aid payments follow the Public Transit Participation Grant Program payment schedule, with Mn/DOT discretion to adjust schedules as appropriate.	It is recommended that all payments be made consistent with the current Public Transit Participation Grant Program payments, currently with payments in January (50%), July (40%), December (9%), and Post-Audit (1%). Mn/DOT should have the discretion to adjust these schedules as appropriate.
Management of Fund Balance	While there are no major issues regarding the management of Greater Minnesota Transit Fund balances at this time, it is important to note the general need to manage Fund balances to minimize borrowing costs and optimize fund use. The Legislature should provide for interest earnings on Fund balances to be maintained in the Fund for the benefit of the program. This is consistent with the practice of charging Mn/DOT for inter-fund borrowing to meet cash flow requirements.	
	Administrative Actions	
Inflationary Increases	Mn/DOT should apply its existing cost inflation index as the basis for establishing future years' inflationary increases, provided sufficient funds are available.	
System Eligibility and Cost Eligibility	Both system and cost eligibility dovetail with the Public Transit Participation Grant Program.	All systems would be eligible for the Program. Criteria for cost eligibility would be drawn from current program rules.
Certification Procedures	It is recommended that Mn/DOT review and update previously developed certification guidelines. It also is necessary to fix any discontinuities in certifications to date. A method is needed to certify new funding providers (both for new and existing systems). An annual certification process also is needed for new systems and expansions. The only readily identifiable option to do this is to allow jurisdictions to certify an amount by which they are willing to have their property tax levy further reduced. This	Certification procedures are not required under the Equitable Share Approach. Instead, the Legislature may choose to restore levy limits imposed under the two-year Property Tax Replacement Aid Program.

Issue	Action	
	supplemental certification has a number of problems and presents opportunities for gaming the system. Without such an avenue, however, the program is hamstrung by the original certifications. Mn/DOT also should develop policies regarding de minimus certification (i.e., those for very small property tax amounts) and for de-certifications (i.e., for systems that no longer require the level of funding originally provided).	
Timing of Funding Commitments and Funding Levels	Funding commitments with transit systems should be entered into by Mn/DOT as part of the annual contracting process.	
Timing of Distribution of Payments to Systems	It is recommended that all payments be made consistent with the current Public Transit Participation Grant Program payments, currently with payments in January (50%), July (40%), December (9%), and Post-Audit (1%). Mn/DOT should have the discretion to adjust these schedules as appropriate.	
Program Rules	Mn/DOT should promulgate rules that encapsulate the administrative changes to fully implement the Property Tax Replacement Aid Program.	Mn/DOT should promulgate rules that encapsulate needed administrative changes to fully implement the Equitable Share Approach.

Fiscal Impact of Alternative Approaches

Consideration of the fiscal impact of the alternative approaches must address the relative impacts on the State, sponsoring localities, and individual transit systems. This section provides a review of the full range of fiscal impacts of the two alternative approaches.

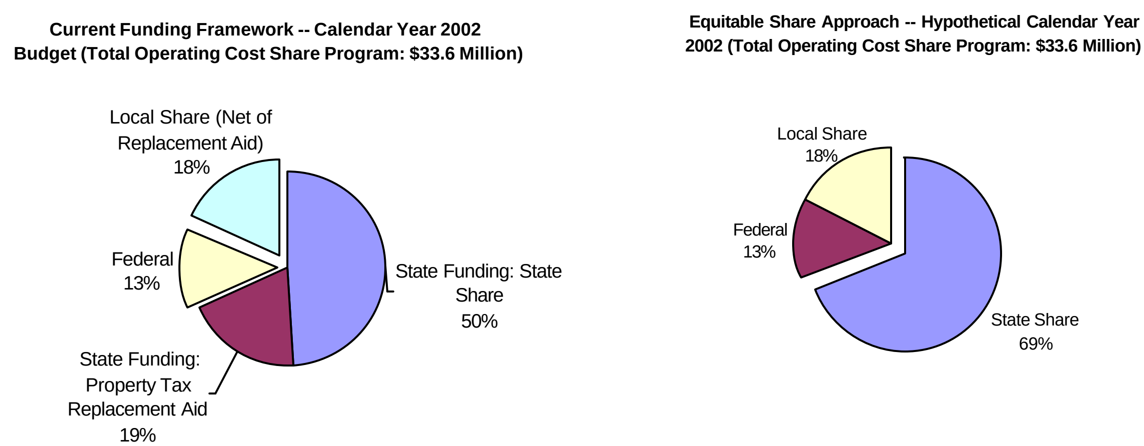
Fiscal Impacts on State Program

The two alternative approaches considered in this study are generally achievable with currently available (and projected) state funding. The extent to which system operating costs associated with system expansions and/or new systems can be met, however, will depend upon the level of annual increases in the base state and federal funding programs as well as increases in annual MVST receipts. MVST revenues are currently projected to increase at an average of less than two percent per year through 2007. This will constrain the ability to expand the program.

Exhibit V-2 provides a comparison of the relative mix of funding under each of the two approaches – based upon 2002 contracts between the transit systems and the State. As shown for 2002, based upon a state and federal cost share of 80 percent for urban systems and 85 percent for rural systems and those serving the elderly and disabled, the State's total share (including General Fund and MVST revenues) would remain at 69 percent under both approaches, with the federal share assumed to remain at the same dollar level and 13 percent, for a combined state/federal share of 82 percent.[11] The dollar value difference in state funding between the two scenarios is only $260,000.

Under current statute, the Department may reduce the State share based upon the level of appropriated funding and thus would be able to continue to manage the program to the same aggregate funding level, as is demonstrated here. Alternatively, the sharing percentages can be adjusted to bring the program to the same aggregate funding level.

Exhibit V-2. Comparison of Current Funding Framework and Equitable Share Approach



[11] Excluded from this analysis are those systems that receive no state funding but that receive federal funding that is administered by the State.

Fiscal Impacts on Transit Systems

The Equitable Share Approach is designed to minimize any adverse impact on individual transit systems relative to the current funding framework with Property Tax Replacement Aid. Preliminary analysis conducted on a retrospective basis for calendar year 2002 shows that if the Equitable Share Approach were in place in that year (and no adjustments were made to the sharing levels), 36 systems would receive less state funding (15 would experience a decrease of more than 10 percent) and 30 more state funding (11 with more than a 10 percent gain) than under Property Tax Replacement Aid.

Based upon estimates of operating revenues, 17 systems would not generate the required 15-20 percent local share with current operating structures. Only five of these systems, however, would have greater than a five percent shortfall to make up through changes in their operations. The combined total value of the shortfall is only $124,000 (see summary in Exhibit V-3).

Exhibit V-3. Summary of System-Level Impacts of Equitable Share Approach (based on 2002 Contract Data)

	Number of Systems	Percentage of Systems
Systems w/ Funding Decrease	36	55%
Systems w/Funding Increase	30	45%
Systems w/ >10% Reduction	15	23%
Systems w/ > 10% Increase	11	17%
Systems w/Funding Deficit	17	26%
Systems w/Funding Deficit > 5%	5	8%

As with the current funding framework, there are a considerable number of systems that, with operating revenues and state and federal funding have funding levels that exceed the operating costs covered by their contracts with the State. The systems are permitted to use these funds for operations outside of the contract with the State or to place the funds in reserve accounts for future use as long as the funds are applied to transit purposes. Under the Equitable Share Approach, a similar number of systems would have fund balances that could, in turn, be applied to transit purposes outside of the State contract.

Fiscal Impact on Sponsoring Jurisdictions

The design of the Equitable Share Approach is intended to alleviate the property tax burden on local jurisdictions as is achieved in the current funding framework with Property Tax Replacement Aid, with the objective of offsetting what was previously provided by these local jurisdictions via property tax and other general fund support with MVST funding. Continuation of the current funding framework or introduction of the Equitable Share Approach will have similar impacts on local jurisdictions that have historically provided funding to transit systems serving their communities – by replacing what was once provided via property tax contributions with state funding provided through an allocation of MVST receipts.

Under both approaches, it is the expectation that the transit systems should be able to generate the remaining required local share through operating revenues and that the remaining obligation of the local jurisdictions would be minimized. As discussed above, there will be a transition period for some systems as they move their operations toward fully meeting the objective of generating 15-20 percent of operating costs through operating revenues.

To the extent that Property Tax Replacement Aid is not extended beyond its original two-year timeframe, it is assumed that levy limits imposed under the Property Tax Replacement Aid Program will be lifted. This also would be necessary if the Equitable Share Approach is implemented as an alternative to direct replacement aid.

VI. Study Conclusions and Recommendations

This section offers the recommendations of the study team with respect to the options to integrate Property Tax Replacement Aid with other transit funding programs and to meet the dual objectives of providing an alternative to property tax funding and securing the required flexibility to meet future service demands.

Conclusions Regarding Program Integration

The Property Tax Replacement Aid Program has been a positive step toward stable transit funding for Greater Minnesota. Those involved in transit funding for Greater Minnesota universally believe that it would be difficult, if not impossible, to go back to local jurisdictions to reinstate the previously provided local funding if the replacement aid was not continued.

Based upon the results of the study and working closely with the Mn/DOT Office of Transit, the consultant team has identified two forward-looking options:

- Operationalizing Property Tax Replacement Aid and coordinating it with the Public Transit Participation Grant Program; or

- Fully integrating the two programs via the extension of the replacement aid concept to the Equitable Share Approach presented in this report.

Both of the approaches considered in this study achieve the dual objectives of providing an alternative to property tax funding and achieving an appropriate degree of integration with the State's other transit funding programs. There are significant implementation hurdles, however, to applying the Property Tax Replacement Aid construct to meet the State's expansion goals. The Equitable Share Approach is designed to address these obstacles.

Both options also are achievable within currently available and projected funding levels. The extent to which system operating costs associated with system expansions and/or new systems can be met, however, will depend upon the level of annual increases in the base state and federal funding programs as well as increases in annual MVST receipts. Current projections for MVST revenues will act as a constraint on the ability to sustain and expand transit operations.

Longer-Term and Broader Funding Initiatives

Looking to the future, the study team recommends that Mn/DOT work with the Legislature to further study the possibility of instituting a Dedicated Transit Fund to fully carry out the objectives of providing a stable source of funding for current Greater Minnesota transit systems and to facilitate service expansion consistent with the policy objective of meeting at least 80 percent of the need in all 80 Minnesota counties by 2010.[12]

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[12] Minnesota Department of Transportation. *Greater Minnesota Public Transportation Plan*. Final Report. 2001.

APPENDIX – ADVISORY COMMITTEE

Dennis Jensen, Duluth Transit Authority
John Groothuis, Kandiyohi Area Transit
Eugene Krosschell, City of Morris Transit
Karen DeBoer, Noble County Heartland Express
Stanley Groff, Steele County Area Transit
Linda Elfstrand, Tri-CAP Heartland Express
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John Tocho, Mn/DOT, Office of Transit
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