State of Minnesota
Department of Finance

400 Centennial Building
658 Cedar Street
St. Paul, Minnesota 55155
Voice: (651) 201-8000
Fax: (651) 296-8685
TTY: 1-800-627-3529

April 3,2006

To: Chairman Pogemiller
Senator Belanger

Chairman Krinkie
Representative Lenczewski

From: James Schowalter
Assistant Commissioner

Re: Local Impact Note – **HF2846 (Johnson, J.)**
Eminent Domain

On March 8, the Department of Finance received a request from the Senate Tax Committee chair to prepare a local impact note on HF2846, a bill to define and modify the eminent domain process. We have completed our analysis and a copy of the narrative note is attached.

Local impact notes are similar to the fiscal notes that you are familiar with, but they focus on the fiscal impact of proposed legislation on local governments rather than the State. This process is described in Minnesota Statutes 3.987 and 3.988. This statute requires the Department of Finance to gather and analyze information on local costs of legislation when requested by the chair or ranking minority member of either tax committee.

To complete this specific local impact note, we examined the state fiscal note prepared by Mn/DOT. We also solicited information from 113 individual cities and counties, and from four local government associations. Nine cities and six counties responded to our request for information.

Unfortunately, the **department was unable to develop a reasonable or reliable statewide estimate of future local government costs or saving under this bill**. Data on current eminent domain practices from responding local governments was very limited and highly variable between entities. And while there was consensus on which local cost areas would be affected by the bill language, predicting future behavior relative to those changes required far too much speculation to achieve any reliable cost estimates.

So for this local impact note, the department has been limited to a qualitative discussion of the cost issues involved. We still believe this analysis can be useful in helping inform legislative discussions on the bill.

Please be aware that our discussion focuses on HF2846 as introduced. As with most legislation, this bill has undergone changes since introduction, and we understand that there are significant differences between the current version of HF2846 and its Senate companion, SF2750, but we did not attempt to evaluate each individual change or the current differences.

If you or your staff has any questions regarding the local impact analysis for this bill, please contact Alexandra Broat, Executive Budget Officer at 651-296-1700.

Attachments

cc: Representative Jeff Johnson
Senator Thomas Bakk
Legislative Staff (email)

Local Impact Note Discussion

Eminent Domain Changes
HF 2846 (Johnson, J.)

The department has organized this local note discussion of the House eminent domain bill according to the various future revenue and cost issues raised by the local governments responding to our inquiries. **Please note: It does not address all of the issues raised by local governments.** The local note process focuses only on the financial impact of a bill. Comments on the merits of the policy represented are outside of the scope of the Department of Finance local impact note analysis.

Cost Concern One: Lost opportunity costs in the form of foregone future local tax revenues because the bill will restrict the number of opportunities for future economic development or redevelopment. [Mostly Affects Cities]

What the bill does:
There are two major provisions within the bill that could potentially limit the amount of economic development or redevelopment conducted by local governments in the future because it will be more difficult or impossible to use the eminent domain tool for these purposes.

1. **Elimination of economic development as a sole justification for using eminent domain:** Under the bill, local governments would no longer be able to use eminent domain solely for economic development purposes, such as for an increase in the tax base, tax revenues, employment, or general economic health. It would have to be linked to some other purpose such as eliminating blight or cleaning up contaminated land.
2. **Stricter definitions of blighted and environmentally contaminated areas:** The legislation continues allowing the use of eminent domain to redevelop blighted and environmentally contaminated areas. However, it provides stringent definitions of these types of areas. Under the bill, a blighted area is defined as an area that at the time condemnation is commenced, is zoned and used for urban use and where more than 50 percent of the buildings are dilapidated. According to this bill, a building that was inspected and cited for building code violations at least 12 months before the condemnation began, that has not been fixed by the beginning of the condemnation, and that is unfit for human use is dilapidated. An environmentally contaminated area is defined as one where more than 50 percent of the parcels contain contamination and for which the estimated costs of investigation, monitoring, testing, and clean-up are more than the estimated market value of the parcel, or where a court has issued a clean up order and the owner has not complied within a reasonable time.

Information Provided by Local Governments:

- Of the 15 local governments that responded, only one city had used economic development purposes as a sole justification for using eminent domain over the last six years. That city reported that it had used that as justification for six projects over that period.
- No quantitative information relative to the new definition of blight and environmental contamination was submitted by the responding local governments. They did provide

some anecdotal comments that these new requirements would restrict, slow, and perhaps prevent future redevelopment projects.

Department of Finance Comment/Conclusion:
Regarding the elimination of purely economic development purpose: The information provided implies that this aspect of the law would have minimal impact on local government costs or operations because it is removing an option that is rarely used under current practice.

Regarding the new stricter definitions of blighted area and environmentally contaminated area: The impact of these new definitions is fairly clear. It is likely that the new standards will limit future redevelopment efforts. Future redevelopment project may be slower to develop or perhaps smaller in scope than current projects. In some case, current projects may be deemed impossible under the new definitions.

Figuring out the financial impacts on local governments is more problematic. These limitations will, as the local governments pointed out, likely reduce or slow future tax revenue increases associated with the redevelopment projects. However, in the short term, local governments will have less property that they will be able to acquire under the new stricter definitions. While that will slow redevelopment, it will actually reduce the costs local government face for property acquisition. Unfortunately, the department has been unable to find any statewide data source on the total cost of property acquired under current guidelines. And determining the magnitude of the change under the new definitions (i.e. 30%, 40%, 50%) would be highly speculative.

These changes may simply result in a shift of redevelopment projects from one local government to another. In response to stricter rules regarding eminent domain that make it harder to complete redevelopment projects in developed areas, redevelopment projects might move outside of the core cities and suburbs to where there is vacant land. The effect would simply shift development costs and benefits to different local governments. Some local governments argue, though, that these shifts will increase costs overall by contributing to sprawl.

It should also be pointed out that the opportunity costs of state-funded economic development projects are not counted under current fiscal "scoring" rules. For example, if there is a sales tax exemption proposed for a new manufacturing plant, only the state revenue loss from the exemption is scored and tracked. No attempt is made to quantify or count any change in income or sales tax revenue collected because of the new workers at the plant. Based on state scoring rules, one could argue that even if there are forgone future revenue increases at the local level, those should not be factored into the financial analysis.

Cost Concern Two: Provisions within the bill would create higher costs for eminent domain property acquisition, both for redevelopment and other public purposes such as roads or parks. [Affects Cities and Counties]

What the Bill Does:
There are two major provisions within the bill that would affect all eminent domain proceedings, not just those for economic development projects, and would likely raise the cost of property acquisition under future eminent domain proceedings. They are the following:

1. **Mandatory Attorney Fees**: Requirements that mandate awarding of attorney fees, litigation expenses, appraisal fees, other experts fees, and other related costs when the final judgment or award in an eminent domain proceeding for damages is more than 20 percent greater than the last written offer of compensation made by the condemning authority prior to the filing of the petition or when the court determines that the taking is not for a public use or is unlawful.

2. **Automatic "Going Concern" Compensation**: This bill provides the owner of a business or trade compensation for loss of going concern related to the taking of real property unless the condemning authority can show by clear and convincing evidence either that the loss is not due to the taking, the loss could have been avoided with reasonable measures, or that the going concern compensation would duplicate compensation otherwise being awarded. Going concern is defined in the bill as "the benefits that accrue to a business or trade as a result of its location, reputation for dependability, skill or quality, customer base, good will, or any other circumstances resulting in probable retention of old or acquisition of new patronage."

Information Provided by Local Governments:

- The use of eminent domain for non-economic development purposes is highly variable between local governments. The 15 responding local governments report 450 cases of eminent domain within the last six years. However, two local governments accounted for 333 of this total. In other words, **12.5% of the responding entities accounted for 75% of the eminent domain takings**.
- Seven of the fifteen local governments that responded (47%) had at least one case in the last 6 years where the final judgments or awards for damages, as determined at any level in the eminent domain process, were more than 20 percent or greater than the last written offer of compensation made prior to the filing of the petition.
- Of the total reported 450 eminent domain cases by the responding local governments, 315 or 70%, had final judgments or awards for damages, as determined at any level in the eminent domain process, that were more than 20 percent or greater than the last written offer of compensation made prior to the filing of the petition. However, if you remove the two local governments with significantly larger numbers of these cases, the percentage falls to 14.5%.
- Cities and counties were unable to provide any **usable** quantitative information in the area of attorney's fees. Two cities did attempt to predict how much they thought mandatory legal fees might add to typical eminent domain costs, but it was not specific to project size.
- One county stated a single increased cost estimate, but it was not differentiated between litigation expenses and loss of going concern costs, nor were there any method or assumptions provided.
- Local governments provided many anecdotal statements that these two provision, either separately or together, will fundamentally alter the "balance of power" in eminent domain proceedings. They claim that the new system would create incentives for property owners to go to litigation rather than negotiate a settlement. Once in litigation, they claim property owners and lawyers would hold out longer to make sure the 20% threshold was reached, both increasing the number of eminent domain proceedings and making existing proceedings more difficult and expensive to settle.

Department of Finance Comments/Conclusions:

The department believes that the cities and counties make a reasonable case that the changes in this bill **could** alter the current incentive system in eminent domain. These provisions **could** result in increased acquisition costs or litigation expenses. But these claims are made based on an assumed change in future behavior, and future behavior change is always very speculative and difficult to quantify.

Assuming no change in behavior of property owners and their representatives, the historical information provided indicates these new provisions would have widely different impacts on different local governments. For example, the two reporting local governments responsible for 95% of the reported cases exceeding the 20% threshold would likely expect major impacts. The majority of the reporting local governments would not face major problems with the 20% rule.

No parallel information on the loss of going concern was provided.

On the other hand, if we assume that there will be a major behavioral change driving up the number of cases that would go to litigation and the length and expense of that litigation, we would also have to assume that there would be **some** behavioral change on the part of local governments on how they approach negotiation prior to entering eminent domain proceedings. It is difficult/impossible to predict what the behavior of local governments and private property owners will be if this bill passes. How these two behavioral changes would interact with each other is also unknown.

Again, it is worth noting, that in general, behavioral changes are not factored into most financial analysis of state cost implications.

Some local governments raised a type of "double dipping" concern about mandatory awards of going concern compensation. The department does think that financial implications of this issue should be examined more closely. Generally, future profitability or going concern issues would be addressed in the good-faith negotiation process preceding eminent domain decisions. The market value of a business property already includes future income considerations for that property, and this would generally be the basis of any local government offer. It might also be addressed through such things as relocation agreements (i.e. reduced rents in new space until profitable). If the present value of going concern revenue is a part of the base or settlement offers, adding it on top at the end would reflect the local government paying twice, and by definition, that would increase the local government cost. Again, the costs of this provision are difficult to predict, and any statewide number presented would be highly speculative.

Information Supplied by Local Governments

Eminent Domain (HF 2846)

Scope of E-Mail Survey

	Number Contacted	Number of Responses	Response Rate
Cities	98	9	9.2%
Counties	15	6	40.0%
Total	**113**	**15**	**13.3%**
Associations	4		

Results

Name of Political Subdivision	Type	Eminent Domain Use (from January 2000 to February 2006)	Eminent Domain Solely for Economic Development Purposes	Judgment or Award 20% or Greater than Final Offer	Percentage of ED Cases where Award was 20% or Greater than Final Offer
Brooklyn Park	City	13	6	0	n/a
Burnsville	City	0	0	0	n/a
Coon Rapids	City	4	0	4	100.0%
Minneapolils	City	10	0	4	40.0%
Minnetonka	City	19	0	6	31.6%
Mound	City	1	0	0	n/a
Robbinsdale	City	1	0	0	n/a
St.Paul	City	33	0	23	69.7%
White Bear Lake	City	1	0	0	n/a
Cass	County	2	0	0	n/a
Dakota	County	300	0	275	91.7%
Jackson	County	0	0	0	n/a
Morrison	County	4	0	2	50.0%
Sherburne	County	12	0	1	8.3%
Washington	County	50	0	0	n/a
Total	**Both**	**450**	**6**	**315**	**70.0%**
* w/o Dakota County and St. Paul		117		17	14.5%

Eminent Domain: HF 2846
Comments from Local Governments
(Informational Only)

Cost Estimates Provided by Local Governments

Increased Legal Costs

- *St. Paul*: They estimate that for a given condemnation case, attorney fees, other expert fees, court costs and higher appraisal reimbursement could easily exceed $10,000.

- *Dakota County Transportation Department*: For the cost of compensation for loss of going concern, attorney fees, litigation expenses, appraisal fees, and other expert fees, they estimate $600,000 to $1,000,000 per year.

- *Minnetonka*: They estimate that attorney fees would be $118,500 per year under current frequency: 3 @ $39,500 per parcel ($35,000 for owner attorney fees, $3,500 in additional owner appraisal costs, and $1,000 in owner expert witness costs).

- *Morrison County*: They estimate adding about 10% to project costs for increased attorney fees and other legal expenses.

Increased Acquisition Costs

- *White Bear Lake*: They predict that the price of future acquisition could go up between 50 and100%.

- *Brooklyn Park:* On a current project under consideration, they predict that the inability to use "current" condemnation could increase acquisition costs by over 30%, primarily due to prepayment provisions attached to the property's existing financing and tax implications that could be relieved through eminent domain.

Economic Development Benefits

- *Brooklyn Park*: Taxes generated for one large redevelopment project, Village Creek, are projected to go up by $600,000 (450%) from the pre-redevelopment conditions and to generate approximately 250 permanent jobs.

- *Minnetonka:* Their 2006 TIF project is contractually estimated to add additional taxes over 15 years of $4,500,000 in present value dollars. Of those additional taxes, $1,000,000 is contractually budgeted to accrue to the city for public safety and transportation improvements and for non-profit provided community services.

Other Potential Cost Comments from Local Governments

Lost Economic Development Opportunities

- The cost of losing the ability to use eminent domain as a negotiating tool
- High costs that may be incurred to acquire the last hold-out in a redevelopment area; currently the eminent domain tool helps keep that last participant from reneging on the deal and raising the price
- This bill could cause development to move outside of core cities and suburbs to where there is vacant land, adding infrastructure costs and contributing to sprawl
- Cities would lose the ability to induce the construction of affordable housing in many development projects, because affordable housing would no longer be defined as an eligible public purpose in this bill
- One city commented that if this law had existed in 2001, they would not have been able to do a project that resulted in $10M in new development.
- Property acquisition costs are increased because of prepayment and tax penalties that would otherwise be relieved through eminent domain

Effects on Transportation Projects

- If the additional 60+ days required for public hearing and council approval delayed a modest $4 million road project across a second construction season/year, an approximate 3% inflation rate would apply for an additional $130,000 per project
- Public safety costs due to delay and/or stoppage of transportation improvements. Projects will at best just be delayed, but some will not be completed due to the summation of all increased costs.
- Loss of federal and state road funding if standards cannot be met ($2-3 million per year)
- Increased litigation due to inadequate and unsafe road construction
- Delays in process will result in increased prices for road construction
- Right of way costs will snowball with attorney and appraisal fees on an average road project; this could easily increase one county's costs by hundreds of thousands of dollars, which the landowner would not benefit from

Costs of Public Hearing Requirements

- A lengthening of the condemnation process would occur if a 30-day public hearing notification and 30-day waiting period after the public hearing were imposed. Currently, one city must notify property owners by mail 10 days in advance, with official establishment of the hearing date 20 days in advance. This city typically approves a final order authorizing use of eminent domain during the public hearing, not 30 days later.

- There would be additional costs associated with delaying construction projects in order to conduct the newly required public hearing and associated public and property owner notice related to condemnation to acquire public R.O.W. easements for streets and drainage utility easements

- Costs of hearings, publications, recording, advertising, and mailings

Additional Legal Costs

- The need to provide clear and convincing evidence to a district court that the taking is necessary and for the designated public use

- Section 7, "Minimum Compensation," requires payment of damages sufficient to allow a property owner to purchase another building of equivalent size in the community. If the property being acquired is of lesser value due to its condition or location, the cost of acquiring a similar property in a better condition or location could be several thousand dollars more.

- Additional city attorney and real estate staff time would be required to respond to new compensable items (e.g., attorney fees, going concern loss) in a condemnation proceeding. This may not be an out-of-pocket expense, but it is nonetheless an added cost.

- The quick take process will no longer be used for some projects. Agencies will use the regular eminent domain process and get a value determined before acquiring the property. This increases the amount of litigation.

- Increased county staff and state court expenses with increased litigation