

SPECIAL ASSESSMENTS REPORT

For many months, the Ways and Means Committee, city staff, and the city attorney have worked together to refine and improve the methods the city uses to calculate special assessments for commercial/industrial and residential properties. In our efforts, we have reviewed special assessment methods used by various Minnesota cities. In addition, numerous Minnesota court cases were studied and analyzed. Attached to this report is a document that provides steps to be used in calculating special assessment amounts for both residential and commercial/industrial properties. The attached document has the support of the Ways and Means Committee, city staff, and the city attorney, and it is recommended that the City Council formally approve the proposed special assessment calculation procedures.

Special assessments are charges levied by local governments against real property to defray the costs of public work or improvements which benefit such property. The theory behind special assessments is that those who benefit from improvements should pay for those improvements. Because only those properties which specially benefit from the improvement bear the cost of the improvement, the general property tax is not burdened. Special assessments are a fee and the rates for special assessments are included in the City's fee schedule.

Under Minnesota law, special assessments must meet the following three requirements: (1) land must receive a special benefit from the improvement being constructed, (2) assessments must be uniform upon the same class of property, and (3) assessments may not exceed the special benefit. Of these three requirements, the most difficult one to meet is that special assessments may not exceed the special benefit to the property. A special assessment that exceeds the special benefit is a taking of property without fair compensation and violates both the Fourteenth Amendment of the United States Constitution and the Minnesota Constitution.

How do we measure the special benefit from an improvement? The special benefit from the improvement is calculated based on the market value of the land before and after the improvement. Four methods are traditionally used by courts to measure the special benefit. These methods are: (1) market-data approach based on comparable sales, (2) income-capitalization approach, (3) reproduction-cost, less depreciation, approach, and (4) development-cost approach. However, these four methods are not exclusive. Any method resulting in a fair approximation of the increase in market value for a benefited parcel may be used. Minnesota law clearly states that the front-footage method of assessment is valid as long as it is based on the cost of the improvement. Whichever method is used, the special assessment may not be arbitrary, capricious or unreasonable.

As indicated before, the Committee and city staff reviewed special assessment policies and procedures for a number of Minnesota cities. Some cities use the front-footage method, some use a per lot method, and some allocate assessments based upon square footage. Of those cities using the front-footage method, the highest commercial/industrial assessment rate was \$190 per frontage-foot and the highest residential assessment rate was \$110 per frontage-foot.

The special assessment calculation procedure developed by the Committee and city staff is basically a front-footage method. However, one of the calculation steps (Step 2.a.(1)) is based upon square footage.

In 2006, the City of Marshall was a party in a court case involving special assessments. As a result of that court case, the City adopted a policy that the maximum special assessment amount per residential parcel would be \$4720. Throughout the years, that maximum special assessment amount for residential property has been increased because of inflation and currently it is at \$5500 per parcel. The special assessment

amount calculation procedures that are being proposed include a provision for a maximum assessable amount.

Under Minnesota law, the special assessment amount may not exceed the lesser of the following amounts: (1) the actual cost of the improvement, or (2) the special benefit realized because of the improvement. Various steps in our proposal are used is to make sure that the requirements of Minnesota law are satisfied.

Step 1 of our proposal allocates the actual cost of the improvement to a particular parcel based on its frontage feet. This step ensures the requirement that the assessment does not exceed the actual cost of the improvement is met.

The purpose of Step 2 to measure the special benefits realized by a particular parcel. Step 2.a.(1) is based upon a maximum fixed amount per parcel. This step incorporates the maximum assessment amount that the City has been using for years for special assessments regarding residential parcels. The policy of having a maximum fixed amount per parcel (currently \$5500) has worked very well for the City in past years. We want to continue this policy for residential parcels and expand it so that we can also use it for commercial/industrial parcels. Under this proposal, Step 2 has been modified so that it now also includes a maximum provision for commercial/industrial parcels. Commercial/industrial parcels are generally larger in size than residential parcels. In order to compensate for the difference in size, a formula was developed to convert commercial/industrial parcels into an equivalent number of residential parcels based upon square feet calculations. The attached procedures document provides further information regarding this step.

In addition to the fixed amount per parcel step (Step 2a.(1)), an additional step (Step 2a.(2)) has been added that is a fixed frontage-foot amount. The purpose of this step is to adjust the maximum amount for such factors as the width of the street and the strength of the street. Having wider streets and stronger streets adds cost to a construction project. On the other hand, it is generally true that commercial/industrial parcels receive benefits from having wider streets and stronger streets. This step helps ensure that those that benefit from wider and stronger streets also pay for the additional costs of the wider and stronger streets.

As indicated before, the law requires that the special assessment may not exceed the lesser of the actual cost amount or the special benefit amount. The purpose of Step 3 is to ensure that the lesser of those two amounts is assessed against the property.

In various improvement projects, it is not unusual for property owners to request that certain improvements be made to their specific property. The purpose of Step 4 is to provide official notification that the cost of any ad-ons requested by certain property owners will be assessed to that particular property in addition to the amount calculated in Step 3.

There is no perfect special assessment calculation procedure. It is a subjective process and it is virtually impossible to measure the exact special benefits derived by the property because of the improvements. The courts have stated that benefits which may be demonstrated by a mathematical exactness are not always required in order to support an assessment. Precise accuracy has never been required.

Attached to this report are illustrations showing how the proposed special assessment procedures would work under a variety of different scenarios. The first three illustrations relate to residential parcels and the last three relate to commercial/industrial parcels. The purpose of these illustrations is to show that there are three possible assessment amounts and that the lowest of the three amounts is always chosen as the

final assessment amount. Again, the law requires that the special assessment may not exceed the lesser of the actual cost of the improvement or the benefit derived by the improvements.

The second recommendation from the Ways & Means Committee relates to the maximum fixed amount per parcel for residential parcels. As stated before, that amount is currently at \$5500. The Committee is proposing that the rate be increased to \$5700. There are a variety of reasons for this recommendation. First of all, it has been a number of years since the rate was last increased. We believe that due to the effects of inflation, that rate should be increased again. The \$200 increase would be a 3.6% increase. Again, it has been a number of years since the rate was last adjusted.

Sometime various levels of government have a policy that tax legislations should be revenue neutral. A revenue neutral policy means that if government lowers taxes in one manner, that they need to increase taxes in another manner so that the total tax revenue collected by the government does not decrease. Special assessments are not taxes. However, the same idea of a revenue neutral policy could be applied to special assessments. In our proposal, we are increasing the maximum fixed amount per parcel from \$5500 to \$5700. However, under our old policy we had one maximum assessable amount. Under the new procedures, we have added a step and we will now have two possible maximum assessable amounts. We will have a fixed amount per parcel (Step 2a.(1)) and a fixed frontage-foot amount (Step 2.a.(2)). By adding this additional step, some property owners will now have a maximum assessable amount less than the current \$5500 amount if the fixed frontage-foot amount step applies. Based upon our calculations, property owners with a frontage of more than 77 feet will end up with a maximum greater than \$5500 while property owners with a frontage of less than 77 feet will have a maximum of less than \$5500 under the proposed assessment procedures. Simply stated, if the assessment procedure is changed and if the maximum assessment amount is increased from \$5500 to \$5700, some property owners will see their special assessment amount go up and some will see it go down. It needs to be pointed out that any decrease in total special assessments will need to be paid out of general property tax revenues.

In the City's special assessment court case, efforts were made to measure the benefit received by property because of street improvements. In its efforts to measure the benefit, the court looked at the values of various properties located in the City of Hutchinson and various properties located in the City of Marshall. At the present time, the City of Hutchinson's special assessment rate is \$80/frontage-foot. For the City of Marshall, we estimate the average frontage-feet for a residential parcel is 80 feet. Based upon its rates, a parcel located in Hutchinson that has a frontage of 80 feet would have a special assessment of \$6400 (\$80/foot X 80 feet). That special assessment amount for a Hutchinson parcel would exceed the \$5700 maximum that we are proposing for the City of Marshall.

An important consideration in any construction project is the financing. For our street projects, we issue Chapter 429 special assessments bonds. Minnesota law specifically states that an election shall be required for Chapter 429 special assessment bonds if less than 20% of the cost of the improvement to the city is to be assessed against benefited property. In other words, if property owners are not assessed for at least 20% of the project cost, the City is required to hold an election and the majority of voters would have to approve the issuance of the bonds. Holding an election would increase the cost of the project and could also cause a delay in the start of construction. In developing our special assessment procedures, the Committee has done its best to try to develop formulas that will have ensure that the 20% requirement will be satisfied so that special elections will not be needed for our various projects. Increasing the maximum amount from \$5500 to \$5700 will help us in those efforts.

Again, the theory behind special assessments is the principle that those who benefit from improvements should help pay for those improvements.

