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Local Government Aid 101: 2009 Distribution & Beyond

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The first official LGA program was created in 1971 and provided funds to counties on a per capita basis for allocation to cities in proportion to their property tax levy. Since its inception, LGA has undergone many changes including modifications enacted in the 2008 session for payments made in 2009 and beyond. LGA is distributed using a complex formula that compares a city's spending needs with its ability to raise revenue. The 2008 reforms included the addition of a jobs base aid and modified the small cities base aid. The governor unalloted city aids in 2008, 2009 and 2010 and the 2010 legislature made additional cuts to the 2010 and 2011 LGA payments.

Funding Level

Prior to 2003, the total LGA appropriation was indexed for inflation and automatically increased between 2.5 and 5 percent annually. In 2003, the Legislature reduced funding for LGA by 25 percent, eliminated the inflation index and implemented significant formula changes. While some funding was restored in 2005 and in 2008, the total certified LGA appropriation for 2009 was still approximately 10 percent below the original 2003 funding level. The December 2008 LGA payment was reduced through a process called unallotment. Cities will again lose LGA to unallotment in 2009 and 2010. For 2009 the cut is calculated as 3.31 percent of certified 2009 levy plus certified 2009 LGA plus 2009 taconite aid. The cuts are taken first from LGA and then from MVHC if necessary. In 2010, the cut percentage is 7.64 percent.

The total LGA distribution is shown below for 2000 through 2011. The governor reduced LGA payments through unallotment in 2008, 2009 and 2010. The 2008 reforms built in a 4 percent appropriation increase for 2011, but the 2010 legislature reduced the state appropriation for 2011 LGA

Year	Total LGA $s
2000	394,846,199
2001	411,514,841
2002	565,338,952
2003 certified	586,848,950
2003 final	464,941,977
2004	437,466,461
2005	436,558,200
2006	484,558,200
2007	484,558,200
2008 certified	484,148,487
2008 final	430,638,682
2009 certified	526,148,487
2009 final	481,521,933
2010 certified	536,671,457
2010 post unallotment	434,287,469
2010 post supplemental cuts	426,535,519
2011 appropriation before 2010 legislative actions	558,138,315
2011 post supplemental budget cuts **	527,100,646

**Projected amount

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Formula Basics

A city's share of the LGA distribution is determined by a complex formula that compares a city's *expenditure need* and its *ability to pay*. Each city's expenditure need is measured based on several statistical variables. These variables or factors attempt to identify characteristics that cause differences in the amount cities spend to provide the same level of service. Calculated expenditure need is then compared to the city's ability to pay or revenue-raising capacity (i.e., property taxes). This difference, or gap, is the city's unmet need. A city's LGA payment is a computed as a percentage of that gap plus any applicable aid base for the city (see the section on aid bases below for more information). The percentage of the gap that is funded by LGA is based on the total available appropriation for the program.

Since 2003, the distribution of aid under the formula has become more volatile—in part due to the elimination of the formula grandfather. To address this year-to-year volatility, all data used in the 2009 payment calculations will be based on the data used in calculating aids payable in 2008. For aids payable in 2010 and subsequent years a city's formula aid will be the sum of its jobs and small city aid bases and the average of its unmet need for the most recent two years to help minimize year to year volatility.

Expenditure Need Variables

Prior to 2003, one set of variables was used to estimate *expenditure need* for all cities. As a result of the 2003 changes, separate formulas are used to determine need for cities above and below 2,500. The formula for cities under 2,500 continues to use the variables that were used for all cities prior to 2003. These variables are:

- pre-1940 housing percentage;
- population decline over the past ten years;
- commercial/industrial property market value percentage; and
- population

The new formula for cities over 2,500 in population, enacted in 2003, includes the pre-1940 housing percentage and population decline factors. It also includes four additional variables:

- traffic accidents per capita (three year average);
- average household size (not including institutionalized populations;
- metro or non-metro location; and
- adjusted net tax capacity (ANTC) per capita (control variable)

More detailed information on each variable can be obtained by calling the League or by referring to other materials about the LGA formula available on the League website.

Calculating Unmet Need

To calculate a city's *expenditure need*, the values for each variable are multiplied by fixed coefficients. These coefficients were determined by a statistical process called multiple regression. The coefficients weigh the variables according to their relative importance in explaining differences in city spending need. The sum of these products is a per capita dollar expenditure need. The minimum per capita need of a city over 2,500 population is $285. Multiplying the per capita need by the population gives the total expenditure need, which is then compared to an individual city's ability to pay.

Ability to pay is defined as a city's capacity to raise revenue via property taxes. This is calculated by applying the statewide average city tax rate based on the prior year's levy to the city's tax base.

The difference between a city's total *expenditure need* and its *ability to pay* is its unmet need. The portion of unmet need filled by LGA is adjusted so that the total of all distributions equals the current appropriation.

Aid Bases

Prior to the 2003 reforms, cities received a grandfather distribution each year that ensured that each city received at least as much LGA as it did in 1993. While the grandfather distribution was eliminated in 2003, approximately $26 million was still reserved for aid base for regional centers and other cities that have faced unique circumstances. In 2006, a new aid base for small cities was created. Cities under 5,000 in population received base aid equal to $6 per capita. The 2008 reforms resulted in several other changes and additions to aid base.

Small city aid base is now equal to $8.50 per capita. For aids payable in 2010 and subsequent years, the small city aid base will be increased by the percent change in the overall LGA appropriation. Cities over 5,000 in population do not receive any small city aid base.

The new jobs aid base is distributed to cities over 5,000 based on the ratio of jobs (public and private employment) in the city to population in the city. Jobs aid base is a proxy measure of service overburden to a city. The number of jobs per capita in a city is determined by dividing the average annual number of employees in the city by the city's population for the same calendar year. The average number of employees in a city is obtained from the Quarterly Census of Employment and Wages.

Jobs aid base is equal to $25.20 multiplied by the city's population and by the number of jobs per capita in the city. The $25.20 will be adjusted annually based on the Implicit Price Deflator. The jobs base aid for a city that receives regional center aid is reduced by the lesser of 36 percent of its regional center aid or $1.0 million. The maximum jobs base aid a city may receive is $4,725,000. Like the small city base aid, jobs base aid will be adjusted by the percent change in the total appropriation for aids payable in 2010 and subsequent years.

Formula Aid

A city's formula aid is the sum of its jobs base aid, small city base aid and a percentage of its unmet need. Including these aid bases in the formula aid calculation weighs them against the city's ability to pay.

Adjustments

A city's LGA distribution is the sum of its formula aid and its city aid base, if any. This amount is then adjusted to fall within minimum and maximum amounts. Minimum and maximum rules are designed to phase in formula changes by limiting the amount a city's LGA can change in a single year.

The limits on LGA increases are as follows:

- For aids payable in 2009 only, a city's total aid cannot increase by more than 35% of its net levy for the prior year.
- For aids payable in 2010 and beyond, a city's LGA distribution cannot increase by more than 10% of its net levy for the prior year.

Aid minimums vary based on population:

- For aids payable in 2009 only, a small city (under 2,500 population) cannot receive less than its 2008 distribution. There is one exception to this. If a city's entire 2008 payment was small city base aid ($6 per capita), its 2009 minimum is zero.
- For aids payable in 2010 and beyond, a small city cannot receive less than its certified aid for the prior year minus the lesser of $10 per capita or 5 percent of its 2003 certified aid amount.
- For aids payable in 2009 and subsequent years, a large city (population 2,500 and above) cannot receive less than its certified aid for the prior year minus the lesser of $10 per capita or 10 percent of its prior year net levy.

A city cannot lose more than $300,000 in aid in any year in which the total appropriation for that year is greater than that for the previous year. This cap does not apply if the city's net tax capacity changed due to decertification of one or more TIF districts.

Timing

The Department of Revenue notifies cities of their LGA amounts for the following year by July 31st. Cities receive aid in two equal payments—the first in mid-July and the second in late December.

Policy Issues

Several of the 2003 changes resulted in a much more volatile program. The elimination of both the grandfather provision and the automatic inflationary increase in the LGA appropriation meant that some cities experienced actual decreases from year to year instead of progressively smaller increases. The elimination of the caps on aid increases for Minneapolis, St. Paul and Duluth meant that their distributions could consume a larger (and less predicable) portion of the allocation, decreasing aid available to other cities.

The mix of factors in the 2003 formula also added to the volatility. The formula for large cities no longer includes two traditionally stable variables – population and commercial/industrial market value percentage – and does include a potentially highly variable factor – automobile accidents per capita.

The 2008 changes were intended to eliminate some of this volatility. For example volatility in 2009 was reduced by using 2008 data in calculating a city's LGA payment. In 2010 and thereafter a city's formula aid will include the average need for the previous two years.

The efficacy of certain formula factors as indicators of need is often questioned in reform efforts. For example, is the percentage of pre-1940 housing units the best measure of infrastructure age? Also, this factor can be drastically changed due to natural disasters or other unforeseen events. The use of traffic accident data has been questioned because of potential unevenness in reporting accidents.

The Legislature included a provision in the 2008 bill requiring a study of LGA that will consider these questions. The study group will also consider existing disparities in the LGA distribution, current law and alternative need and capacity factors, analytical methods for determining need, the small cities formula and volatility. The 2010 legislature extended the original deadline for recommendations from December 2010 to December 2012.

Resources

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

- LMC In-Depth Policy Analysis: LGA Volatility
- Local Government Aid: The Technical Details of Calculating a City's Need
- History of Local Government Aid to Cities
- 2009/2010 LGA and MVHC Unallotment FAQ
- Supplemental Budget Cuts FAQ

House Research: Basic Information on State Aids
http://www.house.leg.state.mn.us/hrd/issinfo/tx_aids.htm

Additional information on the LGA formula and aid distributions can be obtained by contacting LMC Policy Analysis staff.