Diversify Revenues WITH Franchise Fees

BY NICK ANHUT AND JESSICA COOK

Have you ever wondered why cities across the nation have more revenue options than we do in Minnesota? New York City has an income tax; Colorado cities collect most of their budgets from local sales taxes.

Minnesota cities rely on a complicated property tax system as their main source of revenue. The property tax is predictable compared to income and sales tax, but many consumers of city services do not pay property taxes. Franchise fees are an often overlooked alternative for Minnesota cities to diversify their revenue streams.

Many cities have been collecting a cable franchise fee for years. Under Minnesota Statutes, section 216B.36, a city may also impose a fee on a gas or electric utility in exchange for the use of public rights-of-way.

Pros & Cons of Franchise Fees

PROS	CONS
Local control	Raises utility costs
Easy to administer after first year	Initial coordination with utilities and/or public can be complex
Diversifies revenues; flexible funding source	Perception by public as another tax
Growth in revenues proportional to growth in business activity and development	May require periodic review or adjustment
Not subject to loss of revenue resulting from loss of state aid	Opposition from nonprofit users

The utility companies collect the fee from their customers and remit it to the city every billing cycle. Cities can determine the amount, structure, and use of franchise fees. There is no cap on the franchise fee rate on gas and electric utilities.

Use of the fees

Franchise fees can be used for any public purpose. Recently, many cities have directed franchise fees to specific capital improvements such as pavement management programs. One reason is that proving benefit for special assessments has become more difficult in a time of declining residential property values.

The City of Morris has collected franchise fees for about 10 years and dedicates them entirely to road maintenance. "Over 30 percent of our city is comprised of tax-exempt property," says City Manager Blaine Hill. "Before franchise fees, we had two-thirds of the property owners paying for 100 percent of the streets."

The City of Edina recently adopted franchise fees in lieu of raising taxes to fund sidewalks, trails, bike paths, and other pedestrian-related improvements. The fees will provide a stable funding source to undertake projects on a pay-as-you-go basis. While there is no specific statutory authority to issue bonds based on franchise fee revenues, cities can use the revenues to write down annual debt levies.

If your city is interested in implementing franchise fees, there are three primary steps you should take.

STEP 1: Establish the need

To avoid getting mired in a fee vs. tax discussion, take the time to clearly articulate and develop consensus around the need for a new revenue source. In Champlin, the City Council had established the goal of a 0 percent tax rate increase. As capital needs grew and property values stalled, new revenue sources were needed.

Staff identified various funding options, including additional property tax levy, a stormwater utility, and franchise fees. The council chose to add franchise fees because they give the city a more balanced approach to budgeting.

STEP 2: Structure the fee to suit city needs

There are two broad options for structuring the franchise fee: as a fixed charge per account or as a percentage of the customer's bill. Forest Lake charges its electric utility customers $4 per month for a residential account. The council selected a flat fee because it assigns the cost of road maintenance to properties at a fixed amount, and it provides a steady revenue stream for the city.

Alternatively, franchise fees can be structured to correlate with the customer's energy use. Coon Rapids charges all users 4 percent of their utility bill. Other cities choose a fixed charge per therm or kilowatt hour. With these structures, revenue will expand and shrink with the business cycle and seasons but, over time, will keep pace with inflation.

STEP 3: Adopt an ordinance

The only authorizing action required to establish a franchise fee is the adoption of an ordinance. The ordinance establishes the terms of the fee: the structure, collection schedule, and the effective dates. Once adopted, utility providers may need to undergo a 90-day filing period through the Minnesota Public Utilities Commission before the fee can be imposed.

While there is no statutory public hearing or notice requirement, some cities opt to provide opportunities for public comment and education. Forest Lake informed its residents of the proposed fees by creating a handout and providing news updates. Hastings leaders added a sunset provision so that new action must be taken after five years to extend the fee. MC

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