



Legislative  
Research  
Council

# MINUTES

## Property Assessment Study Committee

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**Second Meeting**  
**2004 Interim**  
**Monday & Tuesday, August 16-17, 2004**

**LCR 1 & 2**  
**State Capitol Building**  
**Pierre, South Dakota**

The second meeting of the interim Property Assessment Study Committee was called to order by Senator Dave Knudson, Chair, at 10:40 a.m. on Monday, August 16, 2004, in Legislative Conference Rooms 1 and 2 of the State Capitol Building in Pierre, South Dakota.

A quorum was established with the following members answering the roll call: Senators Tom Dempster, Brock Greenfield, Dave Knudson (Chair), Frank Kloucek, and Paul Symens; and Representatives Thomas Deadrick, Art Fryslie, Jim Hundstad, Jim Lintz, Casey Murschel, Jim Peterson, Larry Rhoden (Vice-Chair), Lou Sebert, and Keri Weems. Representative Dale Hargens was present following the roll call. Senator Drue Vitter and Representative Daryl Christensen were unable to attend the meeting.

Staff members present included Fred Baatz, Principal Research Analyst; James Fry, Director; and Kris Schneider, Legislative Secretary.

All material distributed at the meeting is attached to the original minutes on file in the Legislative Research Council (LRC). For the purpose of continuity, these minutes are not necessarily in chronological order.

### **Approval of Minutes**

*Representative Sebert moved, seconded by Representative Hundstad, that the minutes of the June 9, 2004, meeting be approved. Motion prevailed unanimously on a voice vote.*

### **Chair's Remarks**

**Chair Knudson** shared with the committee a letter he had received from Carol Fox regarding the Kingsbury-Clark Assessment Task Force. Also included with his handout were two decisions from the Office of Hearing Examiners; one was in favor of the appellant and the other one was in favor of the county (**Document #1**).

### **Staff Report**

**Mr. Fred Baatz** distributed an article entitled "Counties Face Problems Setting Land Values - Too Few Sales to Determine Property Taxes" that appeared in the *Aberdeen American News*

on July 8, 2004 (**Document #2**). Mr. Baatz stated that it summarized the problems and the facts discussed at the committee's June 9 meeting.

### **Property Assessment - The Process**

**Mr. Michael Kenyon**, Department of Revenue and Regulation, and **Ms. Colleen Skinner**, Department of Revenue and Regulation, gave a brief overview of the main principles of the tax valuation system. Mr. Kenyon stated that the key principle that everyone needs to understand is there is no such thing as a tax break, only a tax shift. Someone will always pay more. He distributed a handout entitled "Ratio Analysis" (**Document #3**) which was a comparison by counties showing if the 150% rule for ag and non-ag properties was amended to 175% and all sales over 175% of assessed value were thrown out; if the 150% rule was repealed; and capping the ratio at 150% but still using the sale at the 150% capped rate of the assessed value, not actual sale. He explained that the numbers used were in relationship to taxable value (which is 85% of market value) and that the numbers are based upon the 2002 and 2003 sales figures. The analysis shows that in some counties there is a disparity between ag and non-ag property within the county and that it does not always favor the ag property. Mr. Kenyon stated that the disparity between counties distorts the distribution of state aid dollars for education because the state aid formula takes into account that everyone is at the 85% level. The 150% rule makes some counties look poorer than they actually are. When the Legislature sets the school tax rates, they base the tax rate on the total taxable property in the state. He stated that the 150% rule is hiding taxable value in the state.

Mr. Kenyon distributed two maps which showed what the ag and non-ag levels of assessment would be if all sales were used (**Document #4**). He explained that some counties are blank because they did not have fifteen useable sales in two years. In response to a question on what is a usable sale, Mr. Kenyon stated that 75% of the sales statewide are not arms-length transactions.

Representative Lintz asked if the department is able to show the amount of taxes owed based upon production; i.e., per calf or bushel of corn. Mr. Kenyon stated they may be able to use the soil survey and show the average tax per acre.

In response to a request, Mr. Kenyon distributed a handout of the ratio analysis of the 150% rule statewide (**Document #5**).

Following discussion of the definition of an arms-length transaction, staff distributed a copy of SDCL 10-11-56 (**Document #6**).

Mr. Kenyon distributed and reviewed a handout entitled "Explanation of Estimation of Value Changes" which is the department's estimate of what the school general fund maximum levies will do if changes are made to the 150% rule (**Document #7**). Representative Peterson asked if the department could show the effects on the entire tax bill, not just the school general fund. Discussion followed on how the proposed change would affect different classifications.

Staff distributed a copy of the Certificate of Real Estate Value (SDCL 7-9-7(4) (**Document #8**).

### **Directors of Equalization**

**Mr. Kirk Chaffee**, Whitewood, Meade County Director of Equalization, distributed and reviewed a handout entitled "Meade County's annalist of cash rents used as basis for the valuation of Ag Land" (**Document #9**). He stated that Meade County is geographically the largest county in the state. They use market rental rates as an alternative to recent sales data because market rents are typically more stable and uniform within their county. The Department of Revenue and Regulation, as per ARSD 54:04:01:22, states that the "rent" be based on the USDA - South Dakota Agricultural Statistical Services, which for Meade County would be \$15.80; however, the actual average crop rent as surveyed by Meade County was \$10.00. He stated that you cannot take one rent type and apply it throughout. The soil survey should be used as a tool only; it was compiled for reasons other than valuing ag property. In Meade County, when ag property is sold, the buyer is sent a survey asking for information such as rental information, terms, crops, arms-length transaction, etc.

**Mr. James Sundall**, Kennebec, Lyman County Director of Equalization, stated that the total land mass of Lyman County is just over seventeen hundred square miles; 44% is cropland. Since 1998, the assessments have risen 33% and the value of cropland has risen 80%. People are willing to pay more to own hunting land. He stated that ag land that sold for \$350 to \$400 per acre in 1998 is now selling for \$650 to \$700 per acre. So far in 2004, Lyman County has had thirty-two arms-length transactions -- twelve have fallen into the NA-Z classification. Only four of the NA-Z sales were to local residents. Mr. Sundall is concerned for the local farmers and ranchers -- how can they competitively bid on land and pay taxes based on these prices? He suggested that SDCL 10-6-31.3 be amended so that all three of the criteria must be met in order to be classified as agricultural. He stated that the ag criteria could be added to the certificate of real estate value. Once you determine what is ag land, you can let the market set the values. He stated that Lyman County has had very few sales thrown out because of the 150% rule; this is happening primarily in the Oacoma area with regard to commercial property.

**Mr. Dick Kallemeyn**, Sioux Falls, Minnehaha County Director of Equalization, stated that he has problems with the 70 acre rule. He is getting a lot of short acres, i.e., 68 acre sales. In his county, 40 acres can be farmed. He asked the committee to consider this issue. With regard to the NA-Z, he has not had any good sales this past year and has had to bridge to other counties. He has concerns with the income approach and doesn't believe the cap rate should be the same statewide. He would also like some of the restrictions that have been put on assessors loosened up so they have the opportunity to value property more in line with the market value. He gave an example of ag land that sold for commercial development; it sold for more than 150% of the assessed value. The ag land was assessed at \$2500 per acre, it sold

for \$4 per sq. ft. The land was developed and the frontage property was later sold for \$10 per sq. ft. He stated he could not catch up.

### **Property Appraisers**

**Mr. Alan Hatzenbeller**, Mitchell, Appraiser, was unable to attend the meeting. Mr. Baatz read a statement on behalf of Mr. Hatzenbeller which stated private appraisers and county assessment offices need to work together. He believes the 150% rule is not good for the counties in developing fair and equitable assessments. There are so many sales being rejected; counties will never reach market values.

**Mr. Wade Buck**, Rapid City, Appraiser with Farm Credit Services of America, gave a presentation on "What Drives the Market." He stated that there is a blending of the different types of properties and in western South Dakota it is getting harder to see the difference. He discussed the ranch factors and stated that productivity is not as important as it used to be in determining value. As far as recreational factors, the importance of location and improvements vary depending upon whether it is a large or small parcel. Farm land factors are the ease of farming, productivity, and government payments. Rural residential factors are accessibility to utilities, location, aesthetic features, covenants, and improvements. Mr. Buck stated that values are increasing at a higher rate than are rental rates/income. He believes that people see land as a good investment, since land has appreciated over the years and investors anticipate that trend to continue. He distributed a copy of his presentation to the committee **(Document #10)**.

### **Public Testimony**

**Mr. Jim Orris**, Clark, and **Ms. Lori Elie**, Clark, testified in support of the 150% rule. They also asked that the definition of an arms-length transaction be amended to include all private non-family sales and that the use of the soil survey needs to be adjusted. They distributed information in support of their testimony **(Document #11)**.

**Mr. Rory King**, Aberdeen, an attorney representing Mr. Orris and others from Clark County, testified that the use of the soil survey is inappropriate. In Clark County, there were four hundred appeals; forty have been appealed to circuit court and they are currently awaiting a decision. Mr. King stated that the current interpretation of the law allows the assessor to take into account soil characteristics and not other topographical factors and conditions. He stated that this is the issue being challenged in court and how the Department of Revenue and Regulation is interpreting the current law.

**Mr. Rob Miller**, Sturgis, Pennington County Director of Equalization, testified regarding capitalization rates. He distributed and reviewed a handout that explained how a cap rate is actually used in valuing property (**Document #12**).

Senator Dempster commented that he had received a report regarding the estimated rates of return on South Dakota agricultural land for the years 1991 - 2004. He asked staff to distribute a page from the article entitled, "South Dakota Agricultural Land Market Trends 1991 - 2004" (**Document #13**).

**Mr. Jeff Madison**, Iroquois, and **Mr. Bill Albrecht**, DeSmet, representing the Kingsbury County Assessment Task Force, distributed a handout that included additional Kingsbury appeals and information on how the soil surveys are being applied unfairly (**Document #14**). Mr. Albrecht stated that, according to the judge, the soil survey is good; the problem develops on the interpretation of the information and the assignment of ratings. Mr. Madison stated that the map included in their handout was obtained from the FSA office. If the map was combined with a soil map (by using Arc View), the county should be able to obtain the same information.

### **Review of Past and Proposed Legislation**

**Mr. Kenyon** spoke to the committee on Senate Bill 86 - Owner-Occupied Requirements. Senator Symens reviewed the problem the bill was trying to address which is out-of-state residents claiming their "summer residence" as an owner-occupied dwelling thereby receiving a tax break. Senator Knudson stated that it would also apply to a married couple where a husband claims the home in town and the wife claims the lake property, both as owner occupied. Senator Dempster stated that we would not be able to discriminate against a property owner from another state just on the basis of the owner not being a South Dakota resident. Mr. Baatz stated a "principal place of residence" is a term often used by other states; however, it is not clearly defined.

The committee recessed at 4:40 p.m.

The committee reconvened at 8:35 a.m. on Tuesday, August 17, 2004, with the same members and staff present except the following: Senators Brock Greenfield and Frank Kloucek were excused.

### **Property Assessment 101**

**Mr. Garth Thimgan**, La Junta, Colorado, gave a presentation entitled, "Elements of a Good Property Valuation System" (**Document #15**). He stated that according to the International Association of Assessing Officers the key components of property assessment are:

- Pertinent legal & administrative regulations;
- Accurate property data;
- Accurate sales data;
- Accurate income data;

- Accurate valuations;
- Taxpayer remedies;
- Complete maps and files;
- Modern data processing;
- Adequate budget;
- Adequate and competent staff; and
- Open public relations.

Mr. Thimgan presented information on how agricultural land is assessed in Arizona and Colorado. Arizona uses the income approach to value agricultural land based on net cash rental whereas Colorado uses a production method.

In Arizona the definition of agricultural land means the cropland consists of at least twenty acres; permanent crops that comprise at least ten acres; grazing land acreage sufficient to provide a minimum carrying capacity of forty animal units; high density land use; land and improvements used in the processing of cotton for marketing; or land and improvements devoted to use in processing wine grapes for marketing. The agricultural land is valued using only the income approach which is determined using the average net cash rental, excluding taxes, collected for a five year period prior to the year of valuation. The valuation of agricultural land is determined by capitalizing the average annual net cash rental at a rate one and one-half percentage points higher than the average long-term annual effective interest rate for all new Federal Land Bank loans for the five year period prior to the year for which the valuation is being determined.

In Colorado, the definition of agricultural land means the land was used the previous two years and presently is used as a farm or ranch and such land continues to have agricultural use. If the land does not meet the definition, the agricultural land is classified as "other agricultural property" and is valued using appropriate consideration of the three approaches to value based on the actual use of the land on the assessment date. Colorado has developed a statewide classification system for agricultural land which is based on the NRCS soil survey guidelines. The survey divides the land into two groups: land suitable for cultivation or not suitable for cultivation. The actual value of the land is determined by dividing the landlord net income by the statutory capitalization rate of 13%.

In a response to a question on how specific interests are assessed in Colorado when they are severed from the property, i.e., mineral rights, perpetual easements, Mr. Thimgan stated he would obtain the guidelines used in Colorado and forward them on to staff.

In response to a question on how farmland which is now underwater would be classified, Mr. Thimgan stated in Colorado it would be classified as wasteland if you could not farm or graze it.

## **Property Assessment**

**Representative Claire Konold**, Watertown, Appraiser, presented information on the difference between buyers who base their decision on the return on investment versus the return on operation. He stated that in Clark County, since November 1, 2003, there had been forty-five sales. Based on the current law, only one sale is usable as a comparison (**Document #16**). He distributed a copy of cash rent data collected by SDSU College of Agriculture and Biological Sciences that he uses when doing ag land appraisals (**Document #17**). Representative Konold stated that the assessed value on agricultural land has not gone up like other categories have; the assessors need to be able to be fair and equitable in their valuations. He distributed a list of ag sales from Clark, Codington, Hamlin and Roberts Counties that substantiated his statement (**Document #18**). He stated that buyers involved in a 1031 tax exchange, in many instances, do not care how much the property costs.

### **Public Testimony (continued)**

**Former Representative Kenneth McNenny**, Sturgis, gave a history of the evolution of the property tax system in South Dakota. He suggested making a separate class for those properties falling in the 150% rule. He also feels there is a lot of ag land that should be taxed as commercial.

**Mr. Arden Moen**, Sisseton, Roberts County Director of Equalization, testified that he cannot keep up with the increased values with regard to agricultural land and lake property. He stated that the NA-Z classification eliminates sales from the sales ratio study thereby holding down ag valuations. As far as residential property, Roberts County residents are being assessed fairly and are paying their fair share of the taxes.

### **Review of Past and Proposed Legislation (continued)**

**Mr. Baatz** reviewed HB 1195 and SB 10 that were not included in past legislation at the first meeting (**Document #19**).

Mr. Baatz also reviewed three drafts of proposed legislation (**Document #20**). Draft Bill #1 - *An Act to classify certain property as special provisional nonagricultural property* would create another class of property. If any property sold for more than 150% of its assessed value, it would be classified as special provisional nonagricultural property and would remain classified as such for one year. The tax rate proposed is 130% of the rate as to what the property was previously taxed.

Draft Bill #2 - *An Act to revise the method on how certain real property sales are used to assess real property* would bring back the sale for purposes of valuing property by adjusting the sale price to 125% of its previously assessed value.

Draft Bill #3 - *An Act to permit adjustment for certain factors that may affect the agricultural income value of land* would address the issue concerning those counties using cash rent data and which are not allowed to make adjustments on topography, climate, etc.

**Ms. Joyce Dragseth**, Brookings, Brookings County Director of Equalization, testified that Draft Bill #3 would add flexibility but without the sales data, they would have nothing to explain their position if challenged in court. As to Draft Bills #1 and #2, she foresees needing additional staffing in order to implement the legislation.

### **Committee Discussion and Directives**

**Senator Dempster** would like a bill drafted that would change the cap rate for NA-Z (currently 7  $\frac{3}{4}$ %) to a floating rate.

**Representative Peterson** liked Draft Bill #3 as it addresses the problem of equalization of tillable and non-tillable land across the county.

**Representative Rhoden** would like SDCL 10-11-56 (arms-length transactions) better defined so more sales are used as comparables; only throw out sales between related parties.

**Representative Hundstad** suggested a bill similar to Colorado's practices where a sale is presumed to be good until proven bad.

**Representative Murschel** stated that if all of the key components in Mr. Thigman's presentation this morning were used, the assessments would be fair. The 150% rule should be repealed because it was only a band aid and it is not working.

**Chair Knudson** asked staff to draft a bill that would use elements of the Arizona system. He also requested a bill that would eliminate the 150% rule, NA-Z, and other factors that eliminate sales and adjust the school levies and other factors to balance the taxes paid by the various classifications.

**Representative Peterson** asked that the numbers include everything, not just the school levy.

**Representative Weems** would like information on what impact the Arizona cash rent system would have.

Mr. Baatz stated that the simplified cash rent currently in statute only allows certain counties to use it. If the Arizona system was implemented, confidential income and mandatory reporting rules and guidelines may be necessary.

Mr. Kenyon stated that as far as HB 1192 provided for the study of productivity as a means to value ag property, the department has the numbers for each county.

**Senator Symens** stated that a classification system would have to be set up if we implemented the Arizona plan. He also stated that we need to address the classification system even if we stay with the market data.

**Representative Lintz** explained that the cash rent was initially set up for counties that could not use sales data. The Arizona plan was studied previously and it has been a position that this would be a good way to value ag land.

**Representative Hundstad** stated that the ag land problems caused the 150% rule; if we repeal it, what will it do to the other classifications?

In response to Representative Hundstad's question, Mr. Kenyon explained that the median is used to reflect the average of whatever you are looking at; most typically the median ends up at 85%. He stated that the department looks at the median and the coefficient of dispersion to evaluate property assessments.

**Representative Weems** asked that a bill be drafted that would throw out every sale less than 50% of assessed value and every sale over 150% of the assessed value.

**Senator Symens** asked that a bill be drafted that deals with severed property rights, mineral rights, conservation easements, etc., and the assessment of same.

**Ms. Shirley Mackey**, Buffalo, Harding County Director of Equalization, testified that there had been prior legislation dealing with mineral rights; however, it is very hard to locate owners and the expense involved was higher than the revenue that would be received from the actual taxes.

**Senator Dempster** asked to see an analysis on the relative tax burdens of those that reside in an apartment versus owner occupied dwellings.

**Representative Fryslie** stated that we should keep the sales over 150% and cap them at 150%.

**Representative Hundstad** stated that there is a difference between a renter and a home owner. He would like to see how much of the property taxes are paid by ag property. Senator Knudson stated that there is a fifteen year history of the total property taxes paid by classification that was distributed at the first meeting.

**Representative Lintz** would like to see the total number of farmers paying the property taxes compared to years prior.

### Next Meeting Date

**Chair Knudson** stated that the next meeting will be on Monday, September 13, 2004, beginning at 10:30 a.m. If necessary, the meeting may continue to Tuesday, September 14, 2004.

### Adjournment

*Representative Weems moved, seconded by Representative Lintz, that the meeting adjourn. Motion carried unanimously on a voice vote.*

The meeting adjourned at 2:37 p.m.



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