



MINUTES

Classifications of Real Property Interim Study Committee

First Meeting
2005 Interim
Tuesday, June 28, 2005

LCR 1&2
State Capitol Building
Pierre, South Dakota

The first meeting of the Classifications of Real Property Interim Study Committee was called to order by Senator Jim Lintz, Chair, at 9:00 a.m. on Tuesday, June 28, 2005, 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 Jim Lintz (Chair), Kenneth McNenny and Jim Peterson; and Representatives Joel Dykstra, Art Fryslie, Thomas Glover, Gordon Howie, Barry Jensen, Alice McCoy, Paul Nelson, Larry Rhoden, Charles Turbiville, and Hal Wick (Vice-Chair). Representative Casey Murschel was present following the roll call. Senator Jim Hundstad and Representative Dale Hargens were excused.

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

Several county directors of equalization were present and introduced themselves.

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.

Opening Remarks

Chair Lintz noted that the agenda had been revised; Mr. Dick Kallemeyn was unable to attend and Mr. Bart Krautschun was added to the agenda. Senator Lintz hopes this summer study can broaden everyone's knowledge on what can be done, provide an opportunity to identify the problems, and provide a forum to discuss alternative solutions. He stated the state is too reliant on property taxes to fund education and the general public needs to be educated on where their taxes are spent at the local level.

Vice Chair Wick commented that he had requested this summer study because the voters gave the Legislature the authority to have different classes of property. South Dakota has various types of agricultural land – grazing land, cropland, land used primarily for hunting, flooded land, and prairie dog infested land. He stated that the committee needs to look at these and see what could be done so that they are assessed and taxed fairly. Vice Chair Wick stated that he foresees a court case in the future concerning property assessments and wants to be prepared for that event.

A Review of Property Tax Legislation

Mr. Fred Baatz gave a historic overview of the evolution of property taxes in South Dakota. He stated that in recent years the value of property has escalated along with the increased revenue of property tax. In 1983, the assessed valuation was about \$13 billion and property taxes were about \$281 million. In 2003, the assessed valuation was about \$37.4 billion and property taxes payable in 2004 was \$725 million. In 1994, ag property was over 40% of the total assessed value of the state, today it is less than 35%.

In 1989, a major overhaul of property assessment and taxation occurred. Senate Bill 12 passed amending the procedure for valuing real property by making more tools available to the directors of equalization. Senate Bill 15 passed repealing the use of the taxable percentage and lowering the maximum levies for each unit of government. Senate Bill 121 passed which implemented the property tax freeze. Several other bills concerning property assessment and taxation were also passed that session.

Over the past sixteen years, there were only two years, 1996 and 2004, that changes were not made to Chapter 10-6 *Annual Assessment of Property*. In 1991, Senate Bill 50 amended armslength transactions. In 1992, House Bill 1021 passed which repealed references to personal property and House Bill 1014 passed which defined real and personal property. In 1993, House Bill 1016 passed which required ag property which sold for more than 150% of its ag income value had to be classified separately from other ag property for a period of five years (AG-Y property). House Bill 1016 was later struck down by the courts.

Mr. Baatz also reviewed legislation on property taxes from the last ten years of interim committee studies on property taxation. A copy of Mr. Baatz's presentation will be sent to the committee with the minutes (**Document 1**).

Senator Peterson asked staff if the Legislature has the authority to establish a new class for all properties that sold for more than 150% of the assessed value, i.e. an investment class. Mr. Baatz responded that he did not know the answer to that question.

A Current Perspective of Agricultural Sales

Mr. Harvey Kistler and **Mr. Kyle Helseth**, Department of Revenue and Regulation, analyze property sales for the state and are the department's field representatives for property taxes in their respective areas. Mr. Kistler is assigned Western South Dakota and Mr. Helseth is assigned Southeast South Dakota. They distributed a handout of the department's presentation (**Document 2**).

Mr. Kistler stated that the motivation of buyers and sellers of ag property over the past 40-50 years has not changed on either side of the river. He presented data from 508 recent transfers (last nine months) of ag property from the following counties: Butte, Custer, Dewey,

Haakon, Harding, Jackson, Meade and Perkins. Of the 508 sales, 424 of the sellers and 395 of the buyers were South Dakota residents. The vast majority of the out-of-state buyers were children of South Dakota residents. The average acres transferred was 808. The smallest parcel was 5 acres and the largest parcel was 13,150 acres, which was purchased by a neighboring ranch owner. Of the 508 sales, 269 were transfers between related parties and 239 were arms-length transactions. He did not include estate transfers and transfers that were made correcting names. Mr. Kistler stated that the data confirms that half of the transactions often occur between related parties. Ninety-two percent of the ag property transferred was to South Dakota residents that were going to operate the property. The majority of out-of-state sellers had been South Dakota residents who had inherited the land. Historically, the buyers are relatives and neighbors and the out-of-state buyers are from bordering states.

Mr. Kistler stated that South Dakota is one of the few states left that the land is reasonably priced. Buyers are now purchasing ag land for aesthetic value in the Black Hills region and along the rivers and lakes. In some instances there is little desire to make a profit by farming and ranching; hunting is a major motivator. In the urban areas, the land is being sold for speculation and investment purposes. Mr. Helseth stated that land often comes up for sale every third generation. Currently with low interest rates, buyers are purchasing land for investment and are adding it to existing operations.

Mr. Helseth discussed the Schreurs sale of ag property located in Minnehaha and Moody Counties (strictly farmland, no buildings). Mr. Helseth stated 5,1932.22 acres sold for \$11,344,723.40 over a period of five days. The actual cash rent on the property averaged \$108.99 per acre. The cap rate was determined to be 4.43%. The ratio of the assessed value to market value was 51.99%. Mr. Helseth stated that the land could only be used for ag purposes as the housing units had all been sold. In response to Representative Jensen's question why there is such a difference between the sales price and the assessed value of the Schreurs property, Mr. Kistler stated that is because of the NA-Z, 150%, and 70-acre rules that hold down assessed values.

In response to Senator Peterson's comment that Mr. Schreurs also sold land in Deuel County, Mr. Helseth stated he only used the sales in Minnehaha and Moody for his presentation; a total of 7,000 acres was sold. In response to a question on how close the Schreurs property was to the city of Sioux Falls, Mr. Helseth stated three miles east of Dell Rapids.

Following questions on why homes could not be built on this ag land, Representative Dykstra stated that the new buyer would have to ask for the zoning to be changed and that it may be possible but not without a hearing.

Mr. Helseth also reviewed how Colorado values their ag property. Their cap rate is 13%. They use the soil survey. A brochure is available at Colorado's web site www.dola.state.co.us/propertytax which explains their valuation process.

Chair Lintz asked if Mr. Helseth knew what it would cost to implement Colorado's system. Mr. Helseth stated initially the cost was tremendous so the state provided the money to the counties.

Mr. Kistler reviewed how Arizona values their ag property. They also use the income approach to value ag land.

In response to a question on what North Dakota uses, Mr. Kistler stated that North Dakota is struggling with their valuation system. They use a combination of the market and income approaches.

Representative Jensen inquired if Colorado, which has a state income tax, allows an offset for property tax or if the property owners are paying taxes on both ends. Mr. Helseth stated they did not inquire about the taxation, only how Colorado classifies and values ag property.

Mr. Michael Kenyon, Department of Revenue and Regulation, spoke about changes in ag land value from 2001 to 2004 based on information from the National Agricultural Statistics Service (NASS). In 2001, the NASS value of ag land in South Dakota was \$15 billion compared to an assessed value of \$12.7 billion. In 2004, the NASS value had grown to \$20.8 billion compared to an assessed value of \$15.5 billion. He noted over the four years the NASS value had grown by \$5.3 billion, whereas the assessed values only increased by \$2.3 billion. Mr. Kenyon also provided county by county comparisons of the 2004 assessed and NASS values. South Dakota statute provides for acreage limitations between 20 - 160 acres to be assessed and taxed as ag land. In 2002, the smallest average size of a farm by county in South Dakota was 349 acres in Minnehaha County.

Representative Dykstra commented that it was interesting that the assessed values and the NASS values were not consistent. Mr. Kenyon stated that it was primarily because of the NA-Z, 150%, and 70-acre rules. Representative Dykstra expressed doubt that any conclusions can be drawn from the data.

Senator McNenny commented that land prices often go up and down along with farm programs, taxes, and interest rates.

In response to a question from Representative Glover on where the NASS figures come from, Mr. Kenyon stated the NASS information is compiled from information received from cash rent surveys.

In regards to a comment on how the 150% rule was affecting the owner-occupied classification, Mr. Kenyon stated about \$3.4 billion of sales were being excluded. This information that he was providing today only included ag property. Representative Wick stated that the scope of this committee is to look at classifications for ag land only. Representative Rhoden stated that the committee also needs to understand how the other classes are affected.

Property Classification and Assessment

Mr. Rob Miller, Pennington County Director of Equalization, asked the committee for clear instructions if they create agricultural subclasses. He stated that the markets differ across the state. He asked for a definition for active timber ground and clarification on pasture land. For example, selling one truck load of timber will satisfy the one-third income criteria. Mr. Miller also asked for a clearer definition of production value. He distributed three maps of Pennington County which showed land cover, exempt parcels, and prairie dogs (**Document 3**). He asked the committee if the land should be valued less because of the prairie dogs infestation.

Chair Lintz stated that the prairie dogs have resulted in reduced property value and suggested that there should be provisions to adjust for range conditions and productivity.

Representative Howie inquired about the transferring of property by limited liability corporations (LLC). Mr. Miller stated that this is a loophole that LLC's use. No warranty deed and price is disclosed; only the name change at the Secretary of State's office is filed.

Mr. Kirk Chaffee, Meade County Director of Equalization, stated that the 150% rule is doing exactly what it was suppose to do, keep market values artificially low. He asked the committee to let the market value be what it is. The statutes concerning the 150% rule, manufactured housing, acreage sizes, and animal units need to be reviewed. He distributed a handout that included a map and information regarding tax classification of small acreage ag within Meade County (**Document 4**). Mr. Chaffee stated he dislikes the income system; income value depends on the management of the property. He stated that small acreages are selling for up to 800% more than their current assessment in Meade County. Large tract ag and non-ag properties are assessed within 85% of their estimated market value. This unfair assessment has created unfair taxing. Mr. Chaffee stated that the assessors have the tools to determine market value; they just want to be able to value the property without mandated legislative limitations.

Ms. Mary Worlie, Brown County Director of Equalization, thanked the committee for allowing the assessors to be heard. She asked the committee to look at the counties individually because there is such diversity. She asked that the laws be easily understood as the assessors have to explain the laws enacted by the Legislature. The problem before this committee is a taxation problem. It has two parts - valuation and property tax levies. She stated that if the public has faith in the valuation, they will have less concern with the tax being paid. The assessors need to be able to use all of the sales available to them.

In response to a question if she uses the income method for valuation, Ms. Worlie stated that they are required by law to consider all three approaches; however, some of the approaches do not apply to certain property.

Representative Dykstra stated that what we currently have is a fairness of taxation problem. Some land is imputed to have a value beyond the basic ag value. We are protecting those that are driving up the values. Ms. Worlie stated that they are seeing a shift on who pays the taxes. Ms. Worlie stated that adding more subclasses for agriculture land will not be the cure all, if the assessors are not allowed to use all of the sales.

Land Use Information and Characteristics of the Market

Mr. Don Guthmiller, Hayti, Extension Educator for Hamlin County, distributed information regarding Northeast-East Central South Dakota Land Use Information (**Documents 5**). Mr. Guthmiller stated that area farmers are purchasing the majority of the ag land in his area. In Hamlin County, pastureland sells for a premium price because proportionally there is less pastureland in the county than the surrounding counties.

Mr. Jack Davis, Woonsocket, Area Extension Specialist for Eastern South Dakota, distributed a summary of SDSU's annual Farm Real Estate Survey (**Document 6**). According to the survey, cropland and rangeland values per acre have doubled since 1998 and nearly tripled since 1991. He stated that over the past two to four years, pastureland and rangeland have increased in value more than cropland in the northeastern part of the state. West of the James River pastureland is being converted to cropland; the land is being bought above the value of pastureland. In the Mitchell area, the majority of the ag sales are taking place during the hunting season. If land has a hunting value, it is selling for 20 to 25% higher. According to the survey, ag land increased 20.3% between 2004 to 2005, exceeding the 17.1% increase from 2003 to 2004.

Ms. Stacy Hadrick, Sturgis, Extension Educator for Meade County, stated that the Sturgis rally has impacted land sales in Meade County. A lot of the ag sales are third generation owners selling to their neighbors. The community of Hereford has grown over the past six to seven years; people are buying 160 acres and are commuting the 60 miles to Rapid City. In another area between Rapid City and Sturgis there is a fourth or fifth generation family farm that strictly is an ag operation, but the adjacent land is not being used for ag. In Meade County she is seeing a lot of the next generation of producers coming back to ranch. She stated it takes between 350 to 400 cow/calf pairs per family to make a living which requires 25 to 30 acres of rangeland to run a cow/calf pair (8,750 to 12,000 acres).

Mr. Bart Krautschun, Spearfish, Extension Educator for Butte, Lawrence, and Meade Counties, stated that he also farms and ranches in Lawrence County. He has a neighbor that just turned down an offer of \$15,000 per acre for 200 acres that is going to be developed. The neighbor wants \$20,000 an acre. In Butte County, in an area where it is mainly gumbo, land is selling in large pieces, 5,000 to 10,000 acres at \$120 to \$185 per acre. This land is assessed at about \$100 per acre. He suggested that the 150% rule may need to be adjusted. He also mentioned due to the drought, people are buying land to get water. Mr. Krautschun also talked about a situation approximately twelve miles east of Newell where gumbo land is being sold

over the Internet for \$500 an acre in tracts of 40 or 80 acres. The land is being sold by someone from California who originally bought about 1,000 acres. This land has no electricity and water is at about 4,500 feet below the surface. As far as feasibility of different ag classifications, Mr. Krautschun (referring to SB 4 - 2005 Session) stated that if he was buying land, he would do everything possible to keep it from being classified as recreational. As far as the minimum acreage for an agricultural classification, he thought 160 acres was insufficient and that 320 acres may be a more reasonable size to consider as a farm/ranch operation.

Senator McNenny commented that when land is sold for a value that is much higher than its ag income value, perhaps a rollback tax provision should be enacted and imposed.

Constitutional and Case Law Regarding Property Classifications

Mr. David Wiest, Assistant Attorney General, reviewed and distributed a handout regarding some provisions that may apply from the South Dakota Constitution and the United States Constitution and some passages from selected South Dakota Supreme Court decisions (**Document 7**). He commented that according to the South Dakota Constitution, Article VI, Section 17, "*all taxation shall be equal and uniform*". According to West Two Rivers Ranch v. Pennington County, the court has said everyone has to be assessed in relationship to the market value and the tax rates have to be uniform. He stated it was the duty of the office of Attorney General to defend the legislation that is enacted, therefore he could not comment on whether or not any proposed legislative changes would be constitutional or not. He suggested that the committee use these provisions as a guide when drafting and considering legislation.

Chair Lintz stated that if the Legislature creates another class of property, they must stay fair and equitable within that class.

Public Testimony

There was no one that wished to provide public testimony.

Committee Discussion

For informational purposes, staff distributed a handout listing some of the statutes the committee has under consideration (**Document 8**).

Representative Rhoden asked Mr. Chaffee what would happen in Meade County if the 150% rule was removed. Mr. Chaffee stated it would be devastating. The difference between market value and assessed value is too great to change to straight market value. Market value was tried in the 1990's and nobody liked it. He suggested that they let value be value and take into consideration the property tax levy and the services provided to determine the taxes paid.

Discussion followed regarding maps that were distributed during the 2005 session to the Legislature on what would happen if the 150% rule was repealed or amended.

Representative Wick stated that two of the 150% bills failed this past session. The unfairness issue is becoming worse, tax shifts are occurring, and will continue to occur as we work to address this issue. The purpose of this study committee is to examine the problem and propose alternative solutions.

Representative Glover commented that maybe they should use the sales of 150% or more of assessed value and put them into their own classification.

Senator Peterson commented that removing the 150% rule would also affect commercial and owner occupied classes, not just ag. Perhaps all property should be valued at 100% and then adjust the property tax levies.

Representative Dykstra asked for more information on how much of a tax shift would occur if the 150% rule went away for all classes. Mr. Kenyon stated it would be quite a project to provide that information on a statewide basis. A representative sample of a few counties could be done to show how the tax shift may occur.

Representative Wick asked Mr. Kenyon to pick counties in different areas of the state and classifications that would show some of the inequities that might currently exist.

Representative Jensen stated he would like to see what would happen if the 150% rule was changed to 175% and if more criteria were added to qualify as ag property. Representative Rhoden suggested that more criteria to qualify as ag land should be established and then establish classes based on the number of criteria met. If three of six criteria for ag were met instead of five of six, for instance, the rate of taxation would be set at a higher rate.

Representative Murschel questioned how planning and zoning has impacted market values as it appears the regulations are different statewide. Chair Lintz stated it does contribute to the problem but planning and zoning should be left to the local boards.

Senator McNenny commented that perhaps animal units should be used to measure production on range/pastureland and that the definitions for cropland and pastureland should be tweaked.

Representative Dykstra stated he has a problem with using a percentage of household income as criteria for determining whether land qualifies as ag land. He would like to see a list of property classifications from other states as ideas for the committee to consider. In addition, he would also like to see information from the planning districts statewide on the zoning and planning requirements.

Ms. Shirley Mackey, Harding County Director of Equalization, suggested that the committee invite county auditors to discuss local government budgets and property tax levies.

Chair Lintz set the next meeting for Tuesday, September 13, 2005. A third meeting, if necessary, was tentatively set for Thursday, October 20.

REPRESENTATIVE MCCOY MOVED, SECONDED BY REPRESENTATIVE RHODEN, THAT THE MEETING ADJOURN. MOTION CARRIED UNANIMOUSLY ON A VOICE VOTE.

The meeting adjourned at 4:45 p.m.



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