PROPERTY TAX ASSESSMENT STUDY COMMITTEE

Study Assignment

A study to examine and evaluate the use of an agricultural productivity measurement system to determine the assessed value of agricultural property and to include the limitations on the sales that may be used to value real property and the potential impacts if these limitations are amended or repealed.

Summary of Interim

During the first meeting on June 28, Michael Kenyon, Director of the Division of Property and Special Taxes for the Department of Revenue and Regulation, discussed the property assessment process and distributed a handout regarding taxable valuations. The handout showed for 2007, the total amount of property valuation was $47,556,756,733, comprised of 35% agricultural, 39% owner-occupied, 24% nonagricultural, and 2% utilities. The total amount of property taxes paid statewide was $848,661,919 in 2007. Another handout stated that 25% of the total property tax revenue went to the counties, 13% went to the municipalities, 58% to the schools, and 2% to both the townships and special assessments.

Mr. Kenyon described the limitations on sales used to value property. Property assessments are based on arms-length transactions or good usable sales to determine the market. Most of the sales, about 75% of the total sales, are sales that are not able to be included in the process because they are transfers or sales between family members or involve some other factors that disqualify the sales as arms-length transactions. Of the remaining 25% of the total sales evaluated by the department, a number of the sales are removed from the process for three rules established by the Legislature:

- 70 Acres – Sales of agricultural land of 70 acres or less;
- NA-Z – Sales of agricultural land for more than 150% of the agricultural income value; and
- 150% Rule – Sales of agricultural land or nonagricultural property for more than 150% of its assessed value.

Mr. Kenyon distributed a document showing the numbers of usable sales that assessors were able to process through October 31, 2007. Statewide, there are 200 agricultural sales and 12,130 nonagricultural sales for assessors to use to assess property. He stated that 33 of the 66 counties have one or less agricultural sales to use assess the agricultural land in the county. Any county with fifteen or less usable agricultural sales during the last two years has two choices: bridge (using sales from surrounding counties) to value the agricultural land or use the cash rent productivity system. In 1998 before many of these rules were in place and an escalating market, the statewide number of usable agricultural land sales was 1,426, which averaged about 21 agricultural land

sales per county.
For 2005, there were over 12,000 usable nonagricultural sales statewide. Due to the 150% Rule, the number of sales that were omitted between 2004 and 2005 almost doubled; about 2,500 sales were lost in 2004 and over 5,000 sales in 2005.

Charts were distributed illustrating the percentage increase and additional assessment value if the 150% Rule was repealed. The agricultural land assessment value would increase by $3,562,183,742 (23.72%); the owner-occupied classifications would increase by $1,100,470,718 (6.47%); and nonagricultural classification would increase by $663,537,240 (5.59%). If assessors were able to use all agricultural land (those omitted from the NA-Z, 70 Acre Rule, and 150% Rules), there would be an increase of $8,558,251,599, or 56.99%.

Dr. Richard Shane, Department of Economic at South Dakota State University, presented an overview of the 2002 statewide study regarding a comprehensive productivity valuation of agricultural land for each county. The study was based on a previous pilot study of nine counties, which was then extended to all 66 counties. The study derived South Dakota agricultural land value based on the production of agricultural commodities. The study then compared land values using productivity to land values based on the market system.

Dr. Larry Janssen, Department of Economics at South Dakota State University, provided presented a publication entitled “SDSU – South Dakota Farm Real Estate Survey, 1991-2007. He said that the survey has been performed for the last seventeen years. The purpose of the SDSU Farm Real Estate Survey was to provide annual information on land values and cash rental rates and to establish rates of returns based on the types of agricultural land. The survey will also provide annual information about the major reasons for the sale or purchase of agricultural land and for respondent assessment of positive and negative factors in South Dakota agricultural land markets.

Carter Anderson, State Director for the National Agricultural Statistics Service (NASS), reported on to two of the data series performed by NASS. Information on land values and cash rents for state and US level estimates began in 1910. Through a USDA Federal Program, data has been collected for almost 100 years. Collection of South Dakota County Level data began in 1994 at the request of and funded by the Department of Revenue and Regulation. The survey is conducted by collecting data from 3,500 respondents, who are farm and ranch operators. Questions on the survey pertain to private and nonirrigated land used for agricultural purposes. Mr. Anderson stated that there are about 32,000 farm and ranch operators in South Dakota. With the 3,500 responses, the study is evaluating about 10% of the farm and ranch operators across the state.

Mr. Anderson stated that in recent history the average farm real estate values were at a low point in 1987 with a rate of $599 per acre for the US and $238 per acre for South Dakota. Cropland values in South Dakota were at $585 per acre in 2000 and increased 86% by 2006. Although cropland rentals have increased, the rate of increase is not similar to that of the land value. In 2000, cropland rentals were at a rate of $40 per acre and it increased to $53 in 2006; a 33% increase. Over the same time frame, pasture rentals increased 17%.

Fred Baatz, Legislative Research Council, reported on how the other states classify, assess, and tax agricultural property. The conclusion was that each state is unique and has designed its assessment system to fit its special circumstances. Many states require an annual application or an initial application if agricultural land ownership changes. This would be similar to South Dakota's owner-occupied class. Some states require a fee to apply for the agricultural land classification. Other states require the owner to notify the assessor when the use of the property has changed. A number of states use an advisory council or committee to assist in the valuation of agricultural property. In some instances, the advisory council or the department gives the assessor certain ranges of agricultural land values to be used in the assessment process. Several states have rollback tax provisions or a change-in-use tax. A change in use tax which could range from as low as 1% to as high as 20% of the fair market value of the land.

Mr. Baatz state that every state provides preferential treatment for valuing agricultural property, based on either the income system or the market system. Most states use an income valuation system based on production, prices, and expenses or landlord share. Several states use rent data to value agricultural land. The capitalization rates vary from state to state, but many capitalization rates are over 7% and a number are over 10%. Some rates are tied to long term financing for farms and ranches plus a risk factor and also have an adjustment for property taxes paid and others rates are set by the Legislature. Mr. Baatz stated that according to the Kansas study, about 43 states use an income based system to value agricultural land.

The interim committee held its second meeting on September 17. Mr. Kenyon provided a chart showing a decrease of 500,000 acres of farm land and 3,000 farms during the last 10 to 15 years. A chart was distributed listing the minimum number of acres each county uses for property to qualify as agricultural land. Mr. Kenyon also provided an updated chart showing the impact on property assessments if the 150%, NA-Z, and the 70 acre rules were repealed.

Zoe Gehr, the Agricultural Use Value Coordinator for the State of Kansas, gave a presentation on the Kansas special use appraisal system for agricultural land. Kansas implemented its program in 1989. Kansas uses an eight year average for expenses, yields, and prices and the Legislature sets a range for the capitalization rate between 11% and 12%. Cash rent data is used to determine the assessed value for grassland. Kansas uses a soil rating for plant growth index which contains seven components: surface structure and nutrients, water features, toxicity, soil reaction (ph), climate, physical profile, and landscape.

Jim Millar, a soil scientist with the Natural Resources Conservation Service (NRCS), explained how the soil surveys used in the assessment process were developed and how they are being utilized. The state uses a soil productivity index to determine a comparable crop and range rating for every soil map which reflects the highest and best use of each soil mapping unit. The same soil type has the same rating irregardless of where it is mapped in the county. When the soil surveys were first completed, the surveys did not weigh such issues as climate, salinity, surface obstructions, etc. as much as they would today. The NRCS is constantly working to upgrade the soil survey data. Rob Miller, the Pennington County Director of Equalization, explained how the soil survey data is used in determining assessed valuations at the county level and making adjustments to the valuations as permitted by law.

The final interim committee was held on October 29, 2007. Dr. Richard Shane gave an overview of the Productivity Valuation for Agricultural Land pilot study based on the North Dakota model. The annual earning capacity of the land was based on the landlord's share which was set at 25% of the annual gross income after analysis of several landlord shares. Dr. Shane stated there is more data available on livestock compared to 7 years ago, while sources of cropland data have remained the same. However, the cropland statistics have changed dramatically, for example, the production of soybeans has increased by 50% since the mid 1990s .

Mr. Kenyon distributed two maps entitled concerning a revenue neutral market system and a productivity system. If all the rules eliminating sales are repealed, the market system would lower the taxable value from 85% to 57.23% for agricultural land if revenue neutrality is kept between classifications. However the changes in assessed valuations that would occur between counties are significant. The fluctuations between counties were not as significant with a productivity based system used to assess agricultural land.
The committee reviewed six bill drafts concerning the assessment of agricultural land based on cash rents, a productivity model, and the market. Several of the drafts included a repeal of the 150% rule and the NA-Z rule and the current alternative system for using cash rents to value agricultural land. One draft provided the framework for creating additional classifications of agricultural land. Another draft made adjustments to certain school levies to hold taxpayers and school districts harmless from certain shifts in property assessment valuations. The committee approved two of the drafts.

A number of agricultural related associations addressed the committee concerning the draft legislation. Most of the associations supported a system assessing agricultural land based on cash rents or a productivity model. The South Dakota Association of Assessing Officers presented testimony concerning a resolution that they passed supporting the use of full and true market value system, as it is the easiest to explain and document to the taxpayers.

Listing of Legislation Adopted

1. *An Act to revise certain provisions concerning the assessment of real property, to assess agricultural land based on its agricultural income value, to create an implementation and oversight advisory task force, to repeal certain provisions regarding the assessment of property, and to repeal the nonagricultural acreage classification.*

   The legislation phases out the 150% rule and repeals the NA-Z rule and the alternative system for valuing agricultural land based on cash rents. The draft provides for the establishment of a model based on productivity for cropland and noncropland to be developed and maintained by South Dakota State University. The data from the model would be used as the basis for determining the assessed valuations for agricultural land.

2. *An Act to revise certain tax levy limitations and property tax levies for school districts.*

   The legislation holds taxpayers and school districts harmless from certain potential tax shifts if the 150% rule is phased out and the NA-Z rule is repealed and revenue neutrality is kept between the classifications of property.

Summary of Meeting Dates & Places and Listing of Committee Members

The committee met on June 28, September 17, and October 29. The committee meetings were located in Pierre.

Committee Members Were: Dave Knudson, Chair, Larry Rhoden, Vice Chair Representative Rhoden; Senators Tom Hansen, Gary Hanson, Jim Lintz, Kenneth McNenny, and Jim Peterson; and Representatives Jamie Boomgarden, H. Paul Dennert, Dale Hargens, Roger Hunt, Kent Juhnke, Kristi Noem, Al Novstrup, David Sigdestad, Steve Street, and Kim Vanneman, and Directors of Equalization Kirk Chaffee, and Mary Worlie.

Staff members were: Fred Baatz, Principal Research Analyst and Lisa Shafer, Legislative Secretary.