MINUTES

Agricultural Land Assessment Implementation and Oversight Advisory Task Force

Representative Kirk Chaffee, Chair
Michael Wiese, Vice Chair

First Meeting, 2022 Interim
Tuesday, August 16, 2022

Room 413 – State Capitol
Pierre, South Dakota

The first interim meeting of the Agricultural Land Assessment Implementation and Oversight Advisory Task Force was called to order by Representative Kirk Chaffee at 10:00 a.m. (CDT) on Tuesday, August 16, 2022, via electronic conference and in Room 413 of the State Capitol, Pierre, South Dakota.

A quorum was determined with the following members answering roll call: Representatives Kirk Chaffee, Chair, Spencer Gosch (remote), Jennifer Keintz (remote), and Oren Lesmeister; and Senator Gary Cammack; and Public Members Kennith Gosch (remote), David Owen, Lee Qualm, and Michael Wiese, Vice Chair. Representatives Senators Red Dawn Foster, Troy Heinert, and Erin Tobin; and Public Members Greg Endres and David Fremark were excused.

Staff members present included William Steward, Research Analyst; and Kaitlyn Baucom, Administrative Specialist.

NOTE: For the purpose of continuity, the following minutes are not necessarily in chronological order. Also, all referenced documents distributed at the meeting are attached to the original minutes on file in the Legislative Research Council office. This meeting was web cast live. The archived web cast is available on the LRC website at sdlegislature.gov.

Opening Remarks

Representative Chaffee welcomed everyone to the task force meeting and touched on the scope.

Department of Revenue

Mr. Michael Houdyshell, Secretary, Department of Revenue (DOR), shared a presentation (Document 1) on the responsibilities of the DOR that also provided information on the Property Tax Division's ongoing modernization project. He stressed the state does not collect or spend any property tax dollars, and those dollars are used by local governments to fund local services. Mr. Houdyshell said DOR is responsible for the oversight and administration of the state property tax system, and for making sure county property tax systems are being administered according to state law to ensure fair and equitable taxation across the state.

Mr. Houdyshell stated their division is responsible for a lot of functions, and among other things they certify all valuations, do levy verification and approval, are responsible for centrally-assessed company valuations like utilities and railroads, and for the agricultural valuation and productivity system. He said they only have a small staff of nine people responsible for every one of those processes, many of which are manually driven, and those manual processes involve 14 different reports, 16 different county software products, and 2,500 division staff hours annually. Mr. Houdyshell said with their small staff managing and validating tens of thousands of data points provided by hundreds of local taxing jurisdictions to meet statutory duties and requirements, their ability to support and offer training to county officials and staff, respond to legislative and public inquiries, and stay on top of current trends across the country to bring best practices to South Dakota had been affected.

To address that, Mr. Houdyshell said that DOR had been looking for a web-based solution for the collection, management, and certification of property tax data, as well as a way to collect and store data electronically and automate the validation of information. DOR worked with Axiomatic to develop a more modern, transparent statewide database of assessment information that would allow them to rededicate their focus and staff hours to other areas and provide public access to data to promote transparency. The result was the new public South Dakota Property Tax Portal. Mr. Houdyshell shared 65 of the 66 counties have been able to submit their information electronically in the new system, but DOR was running a dual manual process this year to verify accuracy. He shared part of the plan for the next phase is to add a map layer and integrate a Geographic Information System (GIS).

Mr. Houdyshell shared DOR's focus going forward will be education and public awareness and shared a letter he had sent to all Directors of Equalization (DOEs) (Document 2) encouraging them to make ag land adjustments to keep the productivity formula viable and ensure fairness. He said DOR was upping efforts to provide guidance to DOEs, and had hired a dedicated education specialist to provide them more training. Mr. Houdyshell shared DOR was also working with counties on the implementation of HB 1325 and encouraging them to utilize that adjustment tool, and so far nine counties had said they intended to utilize and reclassify some of their class four soils.

Mr. Owen asked how many districts assess property tax. Ms. Semmler responded that there are around 1,800 districts that assess a levy, but that does not include special assessments. Mr. Houdyshell added that is a tremendous volume of data for even just one county, and DOR has to manage that data for all 66 counties.

Ms. Wendy Semmler, Director, Property Tax Division, DOR, provided a memo (Document 3) that summarized the 2023 assessment year data and stated the statewide change in average dollar per acre for crop and non-crop, with crop decreasing .08%, and non-crop increasing 2.99%, which she said was consistent with what they have seen the last couple of years. She also provided the change in valuation (Document 4), a snapshot of the average statewide change in average dollar per acre for crop and non-crop by county.

Ms. Semmler also provided the crop olympic averages (Document 5) and the non-crop olympic averages (Document 6), historical lookbacks at the revenue per acre by county in the last decade based off of the U.S. Department of Agriculture's (USDA's) National Agricultural Statistics Service (NASS) production data for crop land, and commodity data or cash rent for non-cropland. She also shared the commodity price history (Document 7) providing data back to 2000 for all commodity prices that have been used in the productivity formula.

Representative Gosch asked how DOR calculates olympic average, commodity prices, and yield, and if how well or poorly crops do is taken into account. Mr. Houdyshell responded they use an 8-year olympic average, looking at the last eight years and then throwing out the highest and lowest year and averaging the remaining six to come up with gross revenue per acre, which for non-crop is cash rents, and for crop is commodities. He added that when South Dakota State University (SDSU) compiles productivity numbers they look at a county as a whole and all the yield data that is reported at the county macro level. Mr. Houdyshell said there have been multiple discussions over the years about the data source, but it currently comes from National Agricultural Statistics Service (NASS), which is all self-reported data received from surveys, and the statewide commodity average prices are what is reported to the USDA. He said DOR looks at commodities reported by NASS for that area, and use an individualized gross acre calculation specific to that county. Mr. Houdyshell said if something is not reported, it is ignored in the formula. He said the formula is based on a calculation of what average production would be in a specific county and does not take into account variations in farming practices and being a good or bad farmer has no bearing on property taxes because it is an income-driven formula. Mr. Houdyshell shared an income approach is one of three approaches to value, and other types of property like commercial are also assessed using an income approach.

Representative Chaffee asked if calf prices could be looked at and utilized for the formula. Mr. Houdyshell responded that if the data is readily available, it could be included in the list of commodity prices. He said language in statute requires cash rents be used in the non-crop formula, so how it could be used in the formula needed to be researched, but calf prices could be used for information purposes.

Senator Cammack asked how things would be if they had stayed with the old system instead of moving to the productivity system. Mr. Houdyshell replied things would be worse, and that when they first went to the productivity formula there was 19 billion dollars of total ag valuation in the state and now there is 40 billion dollars of total ag valuation in the state, and a tremendous amount of value was added to better reflect the market value. He said there was underassessment going on under the old system, and now the system is more fair, transparent, and the burden is more equitably spread across all tax properties. Mr. Houdyshell said the new productivity system has now been challenged in court three times, and prevailed all three times.

Mr. Wiese said that in his experience in Brown County, the calculation was pretty accurate for residential, commercial, and crop, but non-crop was about 20%. He said non-crop was a hybrid that has been pushed because what was done with crop ground a few years ago and there were many variations if it was a leased property. He said he does not like to see fluctuations in the marketplace but they happen, and he was not sure statutorily what a solution might be, but tax was pushing those values for assessments artificially and needed to be looked at.

Mr. Owen asked if assessments went up when they first implemented the productivity formula in large part because they had been using a system with suppressed market values. Mr. Houdyshell responded that was correct, and there were a multitude of factors leading to ag land assessments being inconsistent and values being different and suppressed under the old broken market system. He said DOEs were handcuffed to come up with good assessments on ag land in the 2011-2012 timeframe, and strong commodity prices, strong yield years, and pent-up value caused spikes the first several years. He said they were limited in how much valuation could go up on a countywide system and there was a lag before they could get up to what the productivity system said values should be.

Representative Chaffee asked why rye did not have data as a commodity. Ms. Semmler said that she was not sure why they started with those commodities for pricing, but they have continued to be reported since.

Representative Chaffee asked if there had been any discussion on non-crop going up 3% on average and being tied directly to cash rents which also have a property tax component. Mr. Houdyshell replied there is a property tax component tied to cash rents and it was a concern if non-crop values would plateau or continue to go up incrementally every year. Mr. Houdyshell said looking at adjustments and factors in the formula needed to be an ongoing discussion, and looking at ways to incorporate some other data point into the non-crop formula to address that concern was something that needed to continue to be looked at.

Testimony

Mr. Matthew Elliot, Associate Professor, SDSU Ness School of Management and Economics, talked about the productivity formula and SDSU's role in it (Document 8). He said with the original legislation SDSU was given some responsibility for collecting some of the values for and maintaining the integrity of the productivity formula. Mr. Elliott shared that the productivity formula is based on an income capitalization approach to appraisals, and is calculated by taking the county eight-year olympic averages per acre for cropland times the landlord share, divided by the capitalization rate to come up with the county average assessment. Statutorily, he said the landlord share is specified for cropland as 35% and the capitalization rate for crop and non-crop is specified as 6.6%. Mr. Elliott stated if the landlord share is decreased and nothing else is changed in the formula, assessments decrease, and if the landlord share increases, assessments increase. Inversely, if the capitalization rate goes up, assessments go down, and if the capitalization rate goes down, assessments go up.

Mr. Elliott shared some things to consider are whether adjustments need to be made to make a more appropriate formula and if statutorily those changes are appropriate given the macro economy. Landlord share percentages of revenue per acre tend to be higher than cash rent as a percentage of revenue to account for assuming revenue risk, but he said the statutory landlord share still appears high even adding in a risk premium factor, especially when viewing the central and western districts of South Dakota. Mr. Elliott added that to determine their capitalization rate, many other states utilize the Federal Reserve fixed rate for farm real estate, but since the inception of the productivity formula in South Dakota the capitalization rate has been higher than the average fixed interest rate for farm real estate. He said fixed real estate loan rates have averaged about 4-4.5%, but more recently with high inflation have gone up in the last quarter about 1-1.5% and are roughly now 5.4%.

Mr. Elliott stressed both the landlord share and capitalization rate were high, and said 30% might be a more appropriate value for landlord share if South Dakota would like to continue using a universal statewide value, and the statewide capitalization rate would also need to be lowered if they wanted it to be more in line with the market for farmland real estate loans. He said if you decreased the landlord share by 5% to about 30%, land value assessments would decrease by 75 dollars per acre for every 100 dollars revenue, and if you decrease the capitalization rate by 1% to 5.6% percent, that would increase land value assessments by 95 dollars per acre for every 100 dollars revenue. Mr. Elliott said the net effect is nearly offsetting and there would be no dramatic differences in assessments, so if one is changed both should be changed. He said different approaches could also be considered, and that many other states use floating values for their capitalization rate, and in North Dakota they do not use a landlord's share but look at expenses and calculate how much is left over after.

Mr. Wiese commented to keep in mind that when making statewide changes they might be keeping everything very similar within a class on a global level, but there still could be significant shifts within counties or for different individual owners.

Representative Chaffee asked what components were in the landlord share. Mr. Elliott responded that it is a third to the landlord, two thirds to the tenant type of equilibrium number, but there are different share rates depending on what expenses are included and they can vary from 20% up to 40% depending on how many expenses are coming to it and how much risk. He added some of it is how many expenses the landlord is covering, the risk amount they are assuming, and the type of crops involved in the share ratio. Mr. Elliott said for the inception of the 35% landlord share in South Dakota, that percentage was backed into to get assessments to where they were at the time.

Mr. Owen commented that the 6.6% capitalization rate was chosen to keep the revenue neutral element of the conversion, and it was acknowledged at the time they were not sure how to move forward with that.

Senator Cammack asked if there was a simple way to describe the capitalization rate to a constituent. Mr. Elliott responded that the shortest answer was what the borrowing rate for real estate was, assuming you could borrow 100% and buy that asset. He said if you based it off the Federal Reserve rate it would be about 5.4%, but if you look at market values and what producers are willing to put up to buy land, implied capitalization rates are around 2-3% if South Dakota wanted to get productivity values more where market was on an assessment level. Mr. Elliott said you can also figure out implied capitalization rates by taking the cash rent value divided by the market value.

Representative Chaffee asked if there was a way to get regionalized instead of statewide prices on commodities. Mr. Elliott said you could include other price data and local prices, add in basis levels for different commodities, and adjust the revenue to make it more reflective of prices being received at the regional level or local cash prices. However, he said including additional data sources besides USDA NASS has been one of the major obstacles because in the statutory language there are restrictions on what prices can be used, and they must come from USDA NASS who does not report county-level crop prices information and does not report consistently.

Mr. Nathan Jones, State Soil Scientist, USDA SD State Office, shared a presentation on the Soil Web Survey and soil quality and classifications in South Dakota (Document 9). He stressed that the soil survey was originally developed as an aid to resource and conservation planning, but has been stretched to be used in many other ways since. Mr. Jones shared the K Factor quantifies how susceptible a soil is to erosion, and values range from 0.02 for the least erodible soils to 0.64 for the most erodible. He said the K Factor works well in the eastern part of South Dakota where it is mostly glacial till soil, but falls apart west river where it is mostly Pierre shale soil. Calculations showed the soils in western South Dakota to have a K Factor of .15-.19, or as non-erosive, but Mr. Jones said when they were tested in a lab the K Factor was actually .42 or very erosive, so soils for western South Dakota had to be hand-populated. Because the soils are twice as bad, twice as much erosion is taking place. He said soil develops naturally in South Dakota an inch every 750 years, and management is crucial in mitigating erosion. Mr. Jones added another concern is salty soils, which happens when soils are dry and water evaporates depositing salt at the top and limiting water infiltration. He stressed tillage is bad because it increases that evaporation.

Mr. Jones said there are eight land capability classes within the soil survey, and they were meant to help producers make the best decision for the land they were operating. He said class one is the safest to use under intense cultivation, and by class three there are severe limitations and special conservation practices necessary, and at class four there are very severe limitations and very careful management is necessary. Mr. Jones stressed the remaining classes should never be utilized for cultivation. He said with highly erosive soils you want to grow grass and rotate wisely to do no harm. Mr. Jones said another method of classification is major land resource areas (MLRAs) which help map and manage soils across the country and are determined by climate, physiography, geology (parent material), water and precipitation, soil moisture and temperature regime, biological resources, and type of land use. He said in South Dakota, the East is cooler and gets more precipitation and is more conducive to farming, while the West is hotter and receives less precipitation. Mr. Jones stated water is the most-limiting factor, and most class four soils are not getting the rain they need when they need it.

Mr. Jones shared that soil surveys across the state have big age differences, from the 1900s to the 2000s, and the printed manual is out of date. He said all the newest information is included online in Web Soil Survey, and at the end of October the Web Soil Survey is updated with soil survey information from across the state and nation. Mr. Jones said with better understanding of soils, there is a better understanding of what should be done with them. He shared his concern with telling someone with a class four soil it was farmable, and feared that by taxing them as crop soil, they will feel the need to crop to make money to pay those taxes and could severely erode their soil to the point it becomes a six or seven. Mr. Jones said ideally soil survey would never be used for some of the purposes it has been used for because soil scientists were never able to spend the time necessary to map everything specific enough, especially west river which is generally an order 3 map that should mostly be used for grazing land.

Senator Cammack commented how he remembered his grandfather being told the soil survey would never be used for taxation and that it was the truth at the time. Mr. Jones agreed that for his purposes it has nothing to do with taxes, but rather for conservation planning and providing good information to producers as far as management.

Mr. Owen said it sounded like the productivity system was designed to try to minimize management decisions, but instead is being used to determine productive value based on productivity.

Representative Chaffee said he had several conversations as an assessor about the soil survey and agreed it was not purposed for taxation, but he could not think of a better organization that had scientific principles on soils and the productivity of it to use for the productivity formula. Representative Chaffee asked if there was a way within the web soil survey to be able to rank or order soils based on productivity or highest yields, that could take into consideration the K Factor. Mr. Jones responded that yield used to be populated based on soils within map units, but in a lot of cases soils have become less productive without adding extra nutrients. He added no is reporting yields to them so there is no way to collect that data and they have moved away from yields. Mr. Jones said local soil scientists back in 2000 did define soils across the state in a productivity index with a ranking of 0-100 based on

productivity from their experience, and that could be found in web soil survey. Mr. Jones added there was also the National Commodity Crop Productivity Index (NCCPI), but he was not as sold on it.

Representative Gosch asked how long it takes to change soil composition either way with good or bad management. Mr. Jones responded the mineral part of soil composition cannot be restored without bringing in dump trucks, but management is important for soil properties. He said the first time a plough is put in 40-60% of the organic matter is lost because oxidation takes place and a soil can go from 5% organic matter to 2-3% organic matter. With good management, Mr. Jones said you may be able to build back a tenth of a percent of organic matter a year, but it goes away much faster than it can be brought back.

Mr. Wiese said another factor to consider was the compression of same soil types and making sure they were porous enough for things to wash through and not be totally compressed. Mr. Jones said compaction comes from livestock and management is key.

Senator Cammack said bale grazing, or having a lot of cattle per acre for a short time, seemed to accelerate the process. Mr. Jones replied adding anything four-legged back to the surface increases the benefits of the other four principles exponentially. He said they cannot recreate what the buffalo used to do, but bringing livestock back and feeding them where they need to be fed can help. Mr. Jones cautioned though that each farm or ranch is unique and each has different needs and requires different approaches.

Mr. Owen asked about the impact of drought on erosion, and how long drought could be sustained and how long it takes to recover. He also asked if asked if poor management decisions decreased the quality of the soil. Mr. Jones responded that rain is the most limiting factor for grass and crops, but looking back over geologic time soil should recover. He said there is no way to define a time for it to return because first is waiting for rain to come back, and then the first thing to come back is weeds, and then it needs additional time to recover. Mr. Jones responded yes, that when soil is not managed and just bled dry, it lowers the value and productivity of the soil and that is his fear with class four soils being farmed, especially west river. Mr. Jones said you could take a good producer with poor ground, and they would be more productive than a poor producer on good ground based on management.

Representative Chaffee asked if there was a way to measure the drop in productivity from poor management. Mr. Jones said water is the number one limiting resource, and when a soil is tilled, its ability to infiltrate water is inhibited. He said every inch of water in grassland equals about 250 pounds of production, and east of the river every inch of water in a farming situation is about 20,000 gallons of water per acre. Mr. Jones added corn is water hungry, and if most water is lost to runoff, production suffers.

Representative Lesmeister asked how urban sprawl and commercialization of land have had an impact. Mr. Jones replied that the biggest impact is what is lost in farmland. He said a lot of farmland is being lost to houses, and not only is production lost, but Kentucky bluegrass is also being planted which requires a lot of water and does not infiltrate water fast, so there is often runoff.

Public Testimony

Mr. Matthew Elliot, Associate Professor, SDSU Ness School of Management and Economics, said he wanted to add that NRCS soil data is commonly used in state legislation but is overly relied upon, and NRCS soil data should not be the one data source to make highest and best use determinations to appraise ag land. Mr. Elliott said they should utilize multiple data sources like appraisers, where soil survey is one data point while other data points could include satellite imagery, insurance records, or others, and then those data points could be combined to try to find highest and best use. He said his recommendation is finding multiple data sources that come from objective sources to build into a formula to make a better assessment and help local adjustors make that determination, but localized appraisal of a property could not be beat.

Representative Chaffee asked if counties are required by statute to use the published soil survey, or if they could use the updated web soil info. Mr. Houdyshell replied that current law states counties are to use soil ratings as determined by DOR which was the impetus of the soil tables and original soil surveys. He said the basis of county tables currently being used in the state were derived from the original soil surveys and tables from SDSU in the 70s and 80s.

Representative Chaffee asked if something could be done to bring web soil survey into the GIS system. Mr. Houdyshell responded that currently, regardless of that information, the soil rating is going to be whatever the rating is in the soil table until there is an update by DOR or the Legislature on what the soil tables should look like or how they should be developed. He said there is a place to incorporate that data if it could help counties make better assessment decisions.

Task Force Discussion

Representative Lesmeister said he was grateful for DOR's new transparency portal which would allow the public to be able to get knowledge on how, why, and when they are being assessed, and help take legislators out of that discussion so they could focus more on correcting other issues.

Representative Gosch said he still did not like the current model and still felt they had a way to go. He said it still felt like an opportunity income tax, even though they called it a property tax with income influence, and ag seemed to be the only entity taxed for what they could potentially do. Representative Gosch said he heard the concerns about conservation and erosion, and commented he had seen that people tended to treat land they rented differently than they might have if it was land they owned. He said he personally had a neighbor that had broken up pastureland, and as a result, caused a giant waterway to go across his field.

Mr. Owen said they have watched the productivity system for over a decade since it has been implemented, and he believed the system was proving itself out and that was progress. He said the bill from last session addressing soil quality was also an important step.

Senator Cammack agreed HB 1325 was huge, as well as the legislation a year prior that required assessors to look and document findings if there was a request. He said they were developing a pattern of success, and it would be good if they could continue to pick one issue a year to address that would not cause a huge tax shift between commercial, residential, and agriculture, but continue to make a difference and move in the direction of their goal.

Mr. Qualm agreed little things had been done that made big changes. He said the DOR portal was beneficial and allowed the public to have access to a lot of new information and could help people understand that money stays local. He said learning there were over 1,800 taxing districts helped put things in perspective.

Mr. Wiese said he was excited to utilize the web tools. He added he would also like to see what would happen and what the impact would be if they took the information from Dr. Elliott and made some changes in the productivity formula, and said if it would not take too much time he wanted to see some mockups or a table that showed if one factor was changed or variation was made what the results would be.

Representative Chaffee said that overall the productivity model seemed to be doing well from an assessor's point of view, if not a taxpayer point of view, and had stood up to litigation, but there were still ways to make it a better system. He said he did not see any major shifts in the capitalization rate happening because it would fall outside of the tolerance threshold, but added the way the economy was going it might be self-fixing. He said he would also like to take a closer look at the difference in capitalization rates between regions and compare those to MLRA regions to see if there were any similarities there. Representative Chaffee said there did need to be updates in commodities and in the table one they use soil survey for, and they needed to find a way to make a table that was

easily explainable to the public and counties could have a hand in developing. He agreed there needed to be multiple data sources, and also agreed the best fine-tuning mechanism they already had was local assessors. He said for the next meeting he would like to see DOR work with Mr. Jones to start developing ideas for a new table one that could incorporate more already published data. He said he would also like to see the historical data for calf prices and have them added in with commodities.

Adjournment

David Owen moved, seconded by Senator Cammack, that the Agricultural Land Assessment Implementation and Oversight Advisory Task Force be adjourned. Motion prevailed unanimously on a voice vote.

The committee meeting adjourned at 2:04 p.m.