



**First Meeting
2007 Interim
July 12, 2007**

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

Thursday, July 12, 2007

The first meeting of the Property Tax Assessment Study Committee was called to order by the Chair, Senator Dave Knudson, at 10:00 a.m. (CDT) in Legislative Conference Room 1 & 2 of the State Capitol, Pierre, South Dakota.

A quorum was determined with the following members answering the roll call: Senators Tom Hansen, Gary Hanson, Dave Knudson (Chair), Jim Lintz, Kenneth McNenny, and Jim Peterson; and Representatives Jamie Boom garden, H. Paul Dennert, Dale Hargens, Roger Hunt, Kent Juhnke, Kristi Noem, Al Novstrup, Larry Rhoden (Vice Chair), David Sigdestad, Steve Street, and Kim Vanneman, and Directors of Equalization Kirk Chaffee, and Mary Worlie.

Staff members present included: Fred Baatz, Principal Research Analyst; Jim Fry, Director; and Lisa Shafer, Legislative Secretary.

(NOTE: For 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 (LRC)).

Approval of Agenda

SENATOR LINTZ MOVED, SECONDED BY REPRESENTATIVE RHODEN, TO APPROVE THE AGENDA. The motion passed unanimously by a voice vote.

Opening Remarks from the Chair

Senator Knudson said that the study topic is of high importance and he is pleased to have all the members present. The testimony today will be primarily informational. There is the potential for more advocated information presented at the next meeting in September when people discuss possible solutions. At the final meeting in October, the committee will be reviewing draft legislation and making recommendations for the 2008 Legislative Session. The 150% Rule is a serious problem for property tax fairness in the state, and is getting worse each year. There have been multiple attempts to resolve the issue, and he hopes that committee will be able to reach an agreement to improve the accuracy and fairness of the property tax assessments.

Opening Remarks from the Vice Chair

Representative Rhoden stated that he is looking forward to some profitable discussions. Although there have been previous studies on this topic, every interim property tax committee has brought closer a solution to the problem. The information gained from the committee

discussion and testimony is valuable in developing a plan to resolve the issue. He asks the committee members to be open-minded to new and different alternative solutions.

History of Property Assessment and Taxation Numbers

Michael Kenyon, Director of the Division of Property and Special Taxes for the Department of Revenue and Regulation, discussed the macro-evaluation process and distributed a handout entitled “Taxable Valuations” (**Document #1**). The chart on page 1 of Document #1 shows the total valuation for each property classification and the percentage of the total state-wide valuation. For 2007, the total amount of valuations was \$47,556,756,733, comprised of 35% agricultural, 39% owner-occupied, 24% nonag, and 2% utilities. The amount each classification pays in taxes is displayed on page 2 of the document. The total amount of property taxes paid statewide was \$848,661,919 in 2007. The final chart in the document demonstrates where the property tax revenue is distributed. For 2007, 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. In response to Senator Knudson’s question, Mr. Kenyon stated that the information includes capital outlay, bond payments, and opt outs.

Mr. Kenyon stated, in response to **Senator McNenny’s** question, that special assessments are assessments added to your property tax bill for certain purposes. For example, if the city needs to improve the curb and gutters around a house, there may be a special assessment based on a front footage and not the value of the house. That amount is then added to the property taxes.

Senator Peterson asked to have explained the reason for the increase in owner-occupied taxes paid and decrease in agricultural taxes paid. In response, Mr. Kenyon stated that it is a combination of different tax levy rates, the growth of cities and owner-occupied units, and decreases in agricultural acres.

Factors Limiting the Number of Sales Used to Value Property

Mr. Kenyon distributed a handout entitled “Limitations on Sales Used to Value Property:” (**Document #2**). Property assessments are based on the market sales. Currently, the method used to value property is through arms-length transactions or good usable sales. 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 for some other reason that made the sales not arms-length transactions.

Of the remaining 25% of the sales evaluated by the department, some 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 ag income value; and
- 150% Rule – Sales of agricultural or nonag land for more than 150% of the assessed value.

Mr. Kenyon stated that if the land sells for more than 150% of its agricultural income value, then the land is classified as NA-Z. Any property that has this classification is valued at the purchase price for tax purposes for the first year, taxed at a rate that is higher than agricultural

land (a tax levy rate for the general fund of a school district which is \$1 higher than ag land), and the sale is never used to value other property.

The 150% Rule looks at the assessed value of the property and this rule applies to ag, nonag, and owner-occupied property. If the property sells for more than 150% of its assessed value, then the sale is not used in the assessment process.

In response to **Representative Dennert's** question pertaining to the one year a property is taxed at a higher rate once classified as NA-Z, Ms. Worlie stated until about 2003, NA-Z property was taxed at a higher rate for a period of five years.

Mr. Kenyon said that page 2 of Document #2 shows the impact the rules have had on the assessment process. Listed are the numbers of usable sales that assessors are able to process through October 31, 2007. Statewide, there are 200 agricultural sales and 12,130 nonag sales for assessors to use. He stated that 33 of the 66 counties in the state have one or less agricultural sales to be used to value all the agricultural land in the county. Any county with fifteen or less usable agricultural sales during the last two years has two choices: bridge (use sales from surrounding counties) to value the agricultural land or use the cash rent productivity system currently set in law. One problem that arises with bridging is when all the counties in an area have less than fifteen sales. There were only two counties that had enough agricultural sales in one year to value their agricultural land.

A history of agricultural sales for each county from 1998 through 2005 is shown on pages 3 and 4 of Document #2. In 1998, the statewide number of usable ag sales was 1,426, which averaged about 21 ag sales per county. For 2005, the total statewide number of usable ag sales was 340, and in 2006 the number was 200 ag sales (which is an average of about 3 ag sales per county).

Mr. Kenyon told the committee that pages 5 and 6 demonstrate the nonag sales for each county from 1998 through 2005. For 2005, there were over 12,000 usable nonag 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.

The median sales to assessment ratio must be understood to know how the loss of sales impacts the system. It is determined by looking at the sales to assessment ratio for each sale, and arranging the individual ratios in order from the lowest percentage to the highest percentage. The value that is in the middle is the median sale. The state law says that the median level of assessment must be at least 85% of market value.

The charts on pages 8 and 9 of Document #2 demonstrate 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%) and owner-occupied land would increase \$1,100,470,718 (6.47%). If assessors were able to use all agricultural land (those omitted from NA-Z, 70 Acre Rule, and 150% Rule), there would be an increase of \$8,558,251,599, or 56.99%.

Mr. Kenyon stated, in response to Senator Knudson's question, that the counties without information in the chart did not meet the minimum required number of sales (fifteen sales) to assess ag land. In some counties, even after all the omitted arms-length sales were included, there were not enough sales to estimate the assessed value of ag land.

In response to **Representative Al Novstrup's** question about Hughes County, Mr. Kenyon stated that the information on page 8 of Document #2 is incorrect. The correct information was presented to the committee before the end of the meeting. This problem was a typographical problem and was only applicable to Hughes County.

Representative Dennert asked about the counties that do not have data showing the change from adding all the land sales lost to the 150% and the NA-Z rules. In response, Mr. Kenyon stated that those counties even with the repeal of the 150% Rule and the NA-Z classification do not have enough sales to make a projection.

Review of SB 173 and HB 1308

Fred Baatz, Principal Research Analyst for the Legislative Research Council, provided an overview of two bills introduced in the 2007 Legislative Session that addressed property tax assessments. He distributed copies of Senate Bill 173, House Bill 1308, and an amendment to HB 1308 (**Documents #3 - #5**). Senate Bill 173 would switch the state to an income production system to value ag land and House Bill 1308 would continue to use the market system but makes some changes to put more sales back in the assessment system.

Senator Knudson said that one of the most important features of SB 173 was that it integrated the cash rent and soil survey information. The process consisted of collecting the rent information to obtain an average cash rent for each county as it applies to various soil ratings. Then depending on the individual soil rating for each parcel, the cash rent would be adjusted to reflect the soil rating. The local assessors have the ability to do the climatic and other adjustments. One strength of the bill was that it allowed for adjustments in the tax levies for school districts to hold taxpayers and school districts harmless from increased or decreased ag land assessments, respectively.

Senator Peterson stated that SB 173 does not address a problem in his district for land that is only 50% tillable regardless of soil type and the land is not being valued fairly.

Mr. Kirk Chaffee stated that the committee needs to state in the legislation how the assessors should value land. There should be consistent guidelines for all assessors to apply.

Referring to HB 1308 and the amendment, **Senator Lintz** said that it is almost impossible to be fair within a county because one side of the county may be assessed higher than the other. With this legislation, the state will not be able to equalize individual counties.

The committee recessed at 11:49 a.m. and reconvened at 1:06 p.m.

Mr. Kenyon distributed a revised chart of the 150% Rule information presented in the morning testimony (**Document #6**). A second handout was distributed to the committee; a chart that shows for each system what the tax shift per county would be if either of the bills presented were adopted (**Document #7**). Both bills were able to achieve the same point in total agricultural values in the state. However, both bills have significant tax shifts between counties, but not necessarily the same effect on each county.

Agricultural Productivity and Agricultural Rent Data

Dr. Richard Shane, Department of Economic at South Dakota State University, provided a PowerPoint presentation to the committee entitled “Productivity Valuation of Agricultural Land” (**Document #8**) and distributed a handout entitled “Key Finds / Points from SD Ag Land Valuation Study” (**Document #9**).

In 2002, South Dakota State University (SDSU) was asked by the Legislature to do 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 in the documents produced. The study was looking to derive South Dakota agricultural land value based on the production of agricultural commodities. The study then compared land values derived using productivity to land values derived from market that are currently being used across the state.

In addition, shifts from one county to another or within counties were evaluated. To accomplish this, two different shifts were looked at: comparing magnitude and direction of valuation shifts between agricultural and nonagricultural property, and comparing magnitude and direction of valuation shifts between crop land and noncrop land.

The formula used to calculate agricultural land value per acre is agricultural income per acre divided by the capitalization rate. Dr. Shane stated that the county agricultural income (CAI) is the total from all revenue from cropland production, government payments, CRP payments, and all revenue from noncropland production. After two studies, the CAI attributable to land is 25%. He said that the capitalization rate is constant. By using the formulas, the agricultural land values by county, market, and income using the capitalization approach to valuation, the percentage valuation shift from agricultural to nonag property when changing from market to income capitalization method, and the percentage valuation shifts from noncropland to cropland when changing from market to income capitalization method were discovered. Dr. Shane noted that the income capitalization method and the productivity value are the same concept.

In response to committee questions, Dr. Shane stated that the information in the documents is based on data from 1994 through 2001. There is more detailed data available today, so the charts could be updated with additional factors, but this information is primarily for the purpose of showing the process and method used, and the results at that point in time.

Dr. Shane stated, in response to Mr. Chaffee’s question, that the information used were the acres reported for the ag census. When they made adjustments for market value, they used the acres reported from the equalizations offices across the state.

Dr. Larry Janssen, Department of Economics at South Dakota State University, provided a Power Point presentation entitled “SDSU – South Dakota Farm Real Estate Survey, 1991-2007 (**Document #10**). 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.

The survey is conducted in February through mailing the survey to agricultural lenders, FSA offices, appraisers, assessors, and extension educators. The survey is voluntary and an average of 230 people respond to the survey. Given the number of respondents, the survey is not able to provide county level estimates. The surveys provide many uses including:

- Practical training for students;
- Assignments in economic classes;
- Respondents can use the information in their work;
- Meet information requests;
- Provide data for research programs and graduate thesis work;
- Examine long term trends in land markets; and
- Use as a cross-check for other sources of land market data.

Dr. Janssen stated that the survey results are presented initially in the SDSU Agricultural Experiment Station (**Document #11**) and economics commentators. The information is later published in farm and business magazines, newspapers, and on the radio and television.

Since the land in western South Dakota is mostly range land and the land in the eastern part of the state is cropland, the data cannot be used to specifically identify values for the entire state. However, the results help to explain trends in agricultural land over a seventeen year period.

In response to Senator Knudson's question, Dr. Janssen stated that the data is good quality statewide because of the number of respondents. However, the main issue he has with the survey is that only about 80 people responded from the three western regions of the state. Therefore the results are not suited for individual counties.

Carter Anderson, State Director for the U.S. Department of Agricultural, provided a Power Point presentation entitled "National Agricultural Statistical Service" (**Document #12**). The mission is to provide timely, accurate, and useful statistics in service to the U.S. Agriculture. The National Agricultural Statistical Service (NASS) publishes over 400 national reports and over 9,000 state-level reports annually.

Two different data series are 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.

Mr. Anderson stated that 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. The value has steadily increased over time and the current rates are \$1,900 per acre for the US and \$710 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%.

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. Any land that is not used for agricultural is not included in the results. Mr. Anderson said that NASS is trying to provide descriptive statistics including a three year

average, minimum and maximum values, most frequently reported value, and averages. The results are printed in the “South Dakota 2007 County Level and rents and Values” (**Document #13**).

In response to **Mary Worlie’s** question, 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.

In response to committee questions about the correlation amongst the different surveys, Dr. Shane stated that the surveys provide a three tier evaluation involving respondents that are active and know the going rates for rents to respondents that may have long-term leases.

Committee members asked about the potential increase in the number of respondents and the accuracy of the information submitted if the survey response was dependent on taxes. In response, Mr. Anderson stated that it could be assumed that more people would respond to the surveys. However, the accuracy of the information is not guaranteed in that some people may respond with values and rental rates lower than the actual amount.

Senator McNenny asked if there will be any impact on land values with new government programs, and in response, Dr. Shane stated that the results from survey performed about three years ago showed 35% of the value of the land was attributable to the US government programs.

The committee recessed at 2:46p.m. and reconvened at 3:02p.m.

Survey of Systems Used by Other State to value Agricultural Property

Mr. Baatz distributed a chart entitled “Property Classification and Assessment by State” (Document #14) to the committee. He said that the chart is an indicator on how each state assesses property. The committee should only use the chart as a tool to determine which states could be further researched.

The data included in this chart comes from several sources. The first is a document published by CCH Incorporated which provides a synopsis of the tax structure for each state on many issues, property assessment and taxation being one of them. Information was also obtained from the NCSL study, a Kansas study, and State Legislatures’ websites. The chart includes information where an application process, an advisory council or committee, rollback taxes, or change in use taxes were noted.

After researching how the other states classify, assess, and tax agricultural property, Mr. Baatz’s concluded that:

- Each state is unique and has designed its assessment system to fit its special circumstances;
- Many states require an annual application or at least an initial application when ownership changes. This would be similar to South Dakota’s owner-occupied class. Some states even require an application fee. 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;

- A number 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; and
- Several states respond in surveys that they have no classifications of real property, yet they treat agricultural land differently from other property. In South Dakota we primarily use classifications of property for school taxation purposes. In many states, classifications are used to establish differing levels of taxable value.

No two states assess property using the same procedure, although, a few may look very similar. The valuation of Agricultural Property especially, differs from one state to the next. Every state provides preferential treatment for valuing agricultural property, based on either income system or the market system. Most states use an income valuation system based on production, prices, and expenses over a period of years. Several states use rent data as the primary means to value property. The capitalization rates for both methods vary, but many cap rates are over 7% and a number are over 10%. Some are tied to long term financing for farms and ranches plus a risk factor and adjustment for property taxes paid and others are set by the Legislature.

Mr. Baatz distributed a handout entitled "Certain South Dakota Statutes related to Classification, Assessment, and Taxation of Real Property" (**Document #15**). In South Dakota, there are many twists to value and assess property. There are three different statutes that define several classifications of property: Ag, NonAg, NA-Z, and owner-occupied single-family dwelling class. The state also has a number of sections in law requiring the director of equalization to assess property at 85% or more of its market value and the Department of Revenue and Regulation provides each director of equalization a factor to adjust property to 85% of market for taxation purposes. However, we also have a number of laws that prevent the directors of equalization from achieving that point or directive, i.e. the 150% rule and NA-Z rule. We also, permit certain qualified counties to assess agricultural land based on rent income rather than a market based system.

In response to Senator Knudson's question concerning how other states value ag land, Mr. Baatz stated that according to the Kansas study, about 43 states use an income based system to value ag land.

Mr. Baatz stated, in response to Senator Lintz's question about the cost of implementation, that most states have a state university involved in the process that helped to create the model. It was suggested that maintenance cost of the model also be researched.

Senator Lintz asked about comparing cost for property tax in neighboring states for ag land. In response, Mr. Kenyon stated that there may be studies that already have made such comparisons.

Senator Peterson said that the Illinois system has a 10% limiting factor, and he would like further information about the Illinois tax assessment structure for ag land.

Committee Discussion

Representative Dennert stated that he has talked to a multi-peril insurance agent from Brown county who is willing to come to the next meeting and discuss proving yields.

Senator Peterson would like to explore the concept of more classifications of real property.

Senator Knudson suggested the committee look at the states that are not income tax states to determine how they value real property. Also, he suggested a study of the arrangements used in other states that have a rent driven valuation system and how they address the verification issue with the data.

Senator Hanson asked to have more information about the Kansas system provided at the next committee meeting.

Senator Lintz stated that he would like to know the cost of implementation of the Kansas system.

Senator McNenny requested information about the minimum acreage size in all South Dakota counties and the number of farms to see if they are declining.

Representative Boomgarden wanted to know more about the factors for the various soil types that can be used to assess ag land.

Meeting Dates

The next meeting is scheduled for September 17 and 18, 2007 in Pierre. The final meeting of the committee is scheduled for October 29 and 30, 2007 in Pierre.

Adjourn

Senator Knudson adjourned the committee.

The committee adjourned at 4:08p.m.



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