



Legislative
Research
Council

MINUTES

Property Assessment Study Committee

First Meeting
2004 Interim
Wednesday, June 9, 2004

LCR 1&2
State Capitol Building
Pierre, South Dakota

The first meeting of the interim Property Assessment Study Committee was called to order by Senator Dave Knudson, Chair, at 10:05 a.m. on Wednesday, June 9, 2004, in Legislative Conference Rooms 1 and 2 of the State Capitol Building in Pierre, South Dakota.

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

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

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

Property Assessment - The Process

Mr. Michael Kenyon, Department of Revenue and Regulation, distributed a draft copy of the "Property Tax User Guide" brochure which the department is in the process of revising (**Document #1**). He asked if anyone has suggestions for the brochure to please contact him.

Ms. Colleen Skinner, Department of Revenue and Regulation, distributed and reviewed a handout entitled "Appraising Property for Tax Purposes" (**Document #2**). She stated it is the director of equalization's responsibility to appraise all property within their jurisdiction at its full and true market value and to treat every property owner equally and fairly under the laws. The first step in the assessment process is for the assessor to discover the property. Secondly, the assessor inventories the property. Once this information is gathered, they use procedures prescribed by law and administrative rule to value the property. For improvements to residential structures, the assessor is mandated by law to use the Marshall & Swift Residential Cost Handbook; and for commercial structures, the Marshall and Swift Valuation Service is used to determine "replacement cost new" value. The manuals also give a suggested adjustment for depreciation. For agricultural land, the soil survey is used and for other land, they use the lot value, sq. ft. value, front foot value, etc. Ms. Skinner stated that this is the

starting point for valuing property. Next the assessor makes market adjustments pursuant to § 10-6-33. The assessor determines the true and full value by using cost, market, and income approaches to appraisal. She stated that the four forces at work that affect value are: physical, economic, governmental (legal), and social. With regards to the income approach, the capitalization rate is set by industry.

Factors that Limit the Number of Sales Used to Value Property

Mr. Kenyon stated that one of the critical elements in valuing property is sales. If there is a lack of sales, it affects the assessment process. There are three rules that assessors must apply that affect the value of the property: 70 acres, NA-Z, and the 150% rule. Mr. Kenyon distributed handouts entitled "Ag Sales - Good and Rejected" and "Non-Ag Sales - Good and Rejected" (**Documents #3 and #4**). Mr. Baatz provided a listing of the five statutes relating to these tests (**Document #5**).

The 70 acres rule (§ 10-6-33.20) means that the assessor can not use the sale of ag land to value other ag land if 70 acres or less is sold. In 2003, 225 ag sales were rejected statewide because of the 70 acres rule, compared to 49 rejections in 1998.

The NA-Z classification (§ 10-6-33.14) states that if any agricultural land sells for more than 150% of its agricultural income value, the property is classified as NA-Z and is taxed for one year at the value it sold for. The following year the property is classified and assessed according to its current use. The NA-Z sales are not used as sale comparisons. SDCL 10-6-33.15 states that the annual cash rent shall be capitalized at seven and three-fourths percent. SDCL 10-6-33.25 states how each county obtains the cash rent information and that the cash rent is adjusted according to the soil survey statistics, if available. In 2003, 696 ag sales were rejected statewide because of the NA-Z rule, compared to 319 rejections in 1998.

The 150% rule throws out both ag and non-ag sales when property sells for more than 150% of the assessed value (§ 10-6-74). The assessor may not use these sales for market comparisons. In 2003, 287 ag sales were rejected pursuant to this rule, compared to 2 in 1998. There were 2,469 non-ag sales rejected in 2003, compared to 27 in 1998.

Mr. Kenyon stated that good sale numbers are continually dropping. In 2003, fifty-one of the sixty-six counties had less than ten usable ag sales per county. Mr. Kenyon stated that seventy-five percent of the statewide sales are not-arms-length transactions and are not used for assessing property which makes it more difficult to find enough sales to establish the market.

Ms. Skinner explained that the assessor has to use the market value (at least fifteen usable sales over a three year period) for ag land. If the county does not have fifteen usable sales, then the assessor may use the cash rent or ag income approach. Of the sixty-six counties, approximately fourteen counties do not have enough sales to use the market value approach.

Some counties have used bridging (taking sales information from other adjacent counties for comparable property) to use under the market value approach.

In response to a question on why we look at sales and not the income value, Mr. Kenyon stated that the whole system is based upon the question what would a piece of property sell for--not how much income can be earned. He stated that property taxes are capped; therefore, if everyone's property value increased by fifty percent, their taxes would not.

Senator Dempster stated that the capitalization (cap) rate has a significant impact on the estimate of the income value and that cap rate may need to be changed in the statute.

Mr. Kenyon distributed and reviewed a handout entitled "Explanation of Estimation of Value Changes" (**Document #6**). It is the department's estimate on the effects of changing the 150% rule.

Mr. Kenyon also distributed the FY 2002 Property Tax Statistical Report (**Document #7**). He noted that the statewide value by county is listed on pages 44 and 45.

Equalization - How it is Working

Ms. Joyce Dragseth, Brookings, Brookings County Director of Equalization, distributed a handout listing her concerns with the NA-Z and 150% rule statutes (**Document #8**). Because of the restrictions, the counties are getting further and further away from true and full market value. She stated the assessors need to have a firm cash rent value to use for the NA-Z classification. Brookings County has had fifty-one good ag sales thus far in 2004; forty-seven are classified as NA-Z. The collection of the cash rents in the USDA survey is also a concern. In 2003, Brookings County used an average cash rent value of \$74.10/acre (37 replies to the survey). In 2004, the cash rent dropped to \$71.00/acre (40 replies). She stated that the lower the cash rent, the more NA-Z sales there will be. She asked, "Are we getting and using correct numbers?" She stated that the 7.75% cap rate seems too high. As to the 150% rule, Ms. Dragseth stated there is no penalty. A NA-Z sale is penalized at a higher tax rate for one year.

Ms. Dragseth distributed a letter listing the factors for some of the counties from the U.S. Fish and Wildlife Service (**Document #9**). U.S. Fish and Wildlife Service contacted each director of equalization and obtained all of the arms length transactions to establish each factor. According to their statistics, Brookings County as well as many other counties are assessing property substantially lower than the market values.

Ms. Mary Worlie, Aberdeen, Brown County Director of Equalization, distributed a copy of the Department of Revenue & Regulation's 2002 Assessment & Sales Information report (**Document #10**) and stated this information is a report card for the assessors. She stated that sales information is one of the most important tools they have. Sales tell them where they are right or wrong in their assessments. As to income, she does not feel they are getting the best

information for the cash rent. She stated that before you even get to the three tests established by statute, sales are rejected because of non-arms-length transactions. As to the cap rate, she stated that 7.75% is not realistic. When you account for the property taxes paid as required by statute, the effective cap rate is around 9%.

Ms. Rhonda Rowen, Miller, Hand County Director of Equalization, invited the legislators to stop in and visit the offices of their local assessors. Her concerns are the same as the others - inaccurate cash rent data and keeping the assessments at full and true market value. In Hand County this year there have been seven arms length transactions, only four of the sales can be used and they are barely under the 150% rule. Since 1998, the assessments in Hand County have risen seventy-two percent because of the market trend.

Mr. Rob Miller, Sturgis, Pennington County Director of Equalization, stated that the 70 acres rule is a good thing for his county. He has concerns with valuing ag land at market value - it will drive the family ranches out. He stated that sometimes the highest and best use of land is not agricultural. He talked about some of the problems with the 150% rule. He stated that it was a temporary fix when the legislation was passed - assessments are not at true and full value. As to cap rates, they should vary from one region to another.

Property Tax Limitations - On Local Governments

Mr. Deene Dayton, Legislative Audit, distributed a handout entitled "Property Tax Limitations" (**Document #11**). He stated that the three elements that come into play are: total assessed value, dollars per thousand, and levy in dollars. He reviewed four scenarios in his handout: basic, reappraisal, decline, and growth. As to the budgeting aspects for local governments, the tax limitation impacts the property tax levy in dollars, not the budget. The impact of the tax limitation varies for each entity because the portion of the budget financed by property taxes varies from government to government. He stated that most counties are not at the maximum of the levy limits.

Review of Past Legislation

Mr. Baatz distributed a handout that Chair Knudson asked him to prepare (**Document #12**). It includes the assessed valuations by classification and the percentage of what each class makes up the total assessed value, a breakdown of property taxes paid by classification, the taxes levied by local units of government for the years 1994 - 2003, and the general fund levies of a school district for the years 1996 - 2004.

Mr. Baatz distributed and reviewed past legislation regarding property assessment issues from 1998 through the present (**Document #13**).

Representative Lintz gave a brief background on why the legislation was initially introduced to permit valuation of agricultural property based on productivity.

Public Testimony

Senator H. Paul Dennert, Columbia, District 2, testified that the 7.75% cap rate should be changed. He stated that 8% was too high, 5% was too low, and suggested a 6.5% cap rate. Senator Dennert stated that there may also need to be a bill to permit county budgets to increase up to three percent annually, without the limitations of the consumer price index (CPI) that was recently 1.6%. The CPI limitation really affects counties because fifty-six percent of their money comes from property taxes.

Mr. Roger Lee, DeSmet, Kingsbury County Assessment Task Force, testified that that using the soil survey with cash rent for assessment purposes is not fair and equal. He stated that using soil surveys only does not take into consideration rainfall amounts and other topographical characteristics. Members of the task force have talked to the Department of Revenue and Regulation and the director of equalization and were told that the assessor may only make changes for standing water. The assessors need to have the tools to make changes that impact productivity. He asked the committee for clarification and assistance.

Mr. Bill Albrecht, DeSmet, Kingsbury County Assessment Task Force, testified about using soil surveys in the equalization process and how unfair it is. He distributed a handout regarding his property that has a soil type of Ethan-Clarno (ETC) (**Document #14**). The soil survey rated two parcels of land as ETC soil; however, one parcel is crop land and the other is very rocky land. In Kingsbury County there were 200 appeals and they were all denied because the department would not allow the assessor to make changes based on conditions of the property.

Mr. Jeff Madison, Iroquois, Kingsbury County Assessment Task Force, testified in support of allowing the director of equalization to have more local control and mechanisms to make adjustments. He suggested a three-prong approach to assessments: sales, rent, and production. If the 150% rule causes sales to be lost, you have the other two methods to fall back on.

Representative Lintz stated that § 10-6-33.1 needs to be amended so that location, climate, and other factors may be used when using cash rent to value property.

Ms. Gail Brock, Huron, South Dakota Association of Towns and Townships, testified that the local township boards are very frustrated with the inequities of the tax system. They know the land and are willing to make adjustments; however the county often over rules them later. Her association would like to see this problem resolved.

In response to the question about the soil type where one is rocky and one is not, Mr. Kenyon explained the difference may be determined through an analysis of land selling prices. The department doesn't know what adjustment to the assessed value is unless you have a comparable sale. The problem lies in the fact that there are not enough sales to demonstrate to the assessor how much adjustment may be made. You need to have something to tell you what to base your decision on.

Committee Discussion

Representative Hundstad stated that is in our best interests to keep the counties equalized. The current system is not working--using cash rents seemed reasonable; however, in reality it is not.

Representative Weems suggested that the penalty tax should apply to both the NA-Z and the 150% rule for the first year; that those properties that are kicked out need to be brought back into the mix at some level; and the Kingsbury issue needs to be fixed legislatively by removing sales from the wording.

Representative Sebert stated that one of the key functions is to keep the entire state within 85% of the true and full market value; otherwise, you have areas that are not being taxed fairly.

Chair Knudson sympathized with the landowners in the Black Hills area where the land prices are going up; however, in other areas property values are also going up. He stated the trick is balancing both sides of the issue.

Senator Dempster stated it is important to maintain the integrity of the tax system. The land should be valued at its true and full market value. If we are going to provide tax breaks to certain areas or classifications of land, discuss it openly, make it apparent, and then give the directors of equalization the tools to do their job.

Representative Rhoden stated that the discussion on the fairness issue was good; however, the cost of services associated with the ag and non-ag property also needs to be looked at along with assessing at full and true market value.

Representative Jim Peterson stated that property tax is a fairness and ability to pay issue. The amount of tax collected on one home in some of the smaller communities in the state is not enough to educate one child. He would like to see more information on non-ag property.

Chair Knudson asked the committee to carefully review Mr. Baatz's handouts. He noted that in 1996, ag was paying 30% of the property tax; in 2003, that number had decreased to 24%.

Representative Sebert commented that there are inequities in all classes and that the committee needs to look at the changes that make adjustments that are necessary for operating and maintaining a good system.

Representative Lintz stated that some of changes made in the past have been to "put out fires." The committee needs to focus on the cash rent problems, homeowners, and business limitations. The solution needs to be something that the public is willing to accept.

Representative Murschel would like information on the commercial aspect when school districts opt out and how that affects the property taxes that are paid in the district.

Senator Vitter would like the committee to discuss commercial property assessments and taxes and possible changes for them.

Senator Greenfield commented that the estimates of valuations change. He asked the department: "What if we capped it at 150% instead of rejecting those sales of 150%?" Mr. Kenyon responded that it was possible.

Chair Knudson stated that there are a number of questions that he would like additional information on and that the challenge would be incorporating it into legislation. He encouraged members to have their ideas drafted as soon as possible. He would like the committee to address the owner-occupied status issue that was proposed in SB 86 this past session.

Chair Knudson commented that he planned to have a speaker from outside South Dakota address assessment procedures in other states. The next meeting was set for August 16 - 17, 2004, in Pierre. The chair also tentatively set September 13 - 14, 2004, as the final meeting.

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

The meeting adjourned at 4:45 p.m.



