MINUTES

Classifications of Real Property Interim Study Committee

Second Meeting | **LCR 1&2**
2005 Interim | **State Capitol Building**
Thursday, September 8, 2005 | **Pierre, South Dakota**

The second meeting of the Classifications of Real Property Interim Study Committee was called to order by Senator Jim Lintz, Chair, at 9:05 a.m. on Thursday, September 8, 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 Hundstad, Jim Lintz (Chair), Kenneth McNenny and Jim Peterson; and Representatives Joel Dykstra, Art Fryslie, Thomas Glover, Dale Hargens, Barry Jensen, Alice McCoy, Paul Nelson, Larry Rhoden, Charles Turbiville, and Hal Wick (Vice-Chair). Representatives Gordon Howie and Casey Murschel were excused.

Staff members present included Fred Baatz, Principal Research Analyst, James Fry, Director, 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.

Approval of Minutes

REPRESENTATIVE DYKSTRA MOVED, SECONDED BY REPRESENTATIVE TURBIVILLE, THAT THE MINUTES OF THE JUNE 28, 2005, MEETING BE AMENDED ON PAGE 4, PARAGRAPH 5 BY ADDING AT THE END OF THE PARAGRAPH "REPRESENTATIVE DYKSTRA EXPRESSED DOUBT THAT ANY CONCLUSIONS CAN BE DRAWN FROM THE DATA." MOTION TO AMEND PREVAILED UNANIMOUSLY ON A VOICE VOTE.

REPRESENTATIVE DYKSTRA MOVED, SECONDED BY SENATOR HUNDSTAD, TO APPROVE THE MINUTES OF THE JUNE 28, 2005, MEETING AS AMENDED. MOTION PREVAILED UNANIMOUSLY ON A VOICE VOTE.

Opening Remarks

Chair Lintz noted that Mr. Doug Hansen would be speaking on behalf of Secretary Cooper, Department of Game, Fish and Parks. He asked the committee to be thinking about any possible legislation. Chair Lintz briefly reviewed the role of the committee. He also proposed assessing and taxing an interest when it is severed from the property, i.e. hunting, fishing,

taking of wood, taking of minerals, etc. He proposed that all contracts be recorded and that the tax apply to any interest sold after 2005.

Vice-Chair Wick commented it may be difficult to determine the value paid for land for purposes other than producing agricultural products because of family history or other interests that may motivate a buyer. A person's intended use of the land and the value that each use may have is difficult to assess. He does not expect any legislation to come out of the committee and that perhaps the 150% rule should be studied in the near future.

For informational purposes, staff distributed handouts listing some of the statutes the committee has under consideration (**Documents 1 and 2**).

Recreational Property – Hunting Preserves and Game, Fish and Parks Land

Mr. Doug Hansen and **Mr. Paul Coughlin**, Department of Game, Fish and Parks, presented information concerning the types of land that the department owns and manages, the tax status of the land, and the acres enrolled in private shooting preserves. Mr. Hansen stated that the obligation for the Division of Wildlife to pay property tax on Game Production Areas is governed by the SD Const. Art. XI § 5 and SDCL 41-4-8. Game Production Areas (175,533 acres) are classified as agricultural lands as per SDCL 10-6-31.3. However, Water Access Areas (7,000 acres) are exempted from property taxes. In addition, land owned by the Division of Parks and Recreation (99,952 acres) are not taxed. In 2005, the Division of Wildlife will have paid $675,477.83 in property taxes on the Game Production Area land. When land is leased by the department, the property owner is responsible for paying the taxes on the land leased by the department. An itemized list by school district of acres owned and leased by the department and acreage information on licensed shooting preserves was distributed (**Document 3**).

In response to a question on how property taxes paid by the department are determined, Mr. Coughlin stated that the property taxes are assessed, levied, and paid in the same manner as taxes are paid by other landowners in the county.

A Primer on Planning and Zoning

Mr. Brian McGinnis, Yankton, Third Planning & Development District, stated that in the 1970's zoning was first initiated, especially in the eastern part of the state. Because of the diversity throughout the state, zoning for agriculture districts vary from a minimum lot size of 40 acres down to 1 acre. Counties that want to encourage people to move to the country tend to have a smaller lot size requirement. There often is a conflict between agriculture producers and rural residents as residents construct homes in rural areas. Counties are often faced with additional demands for services for rural residents. He spoke how some of the different zoning regulations have impacted Brookings, Brown, Lawrence, Minnehaha, Pennington, Sully and Yankton counties.

Mr. Phil Kappen, Sioux Falls, Minnehaha County Assistant Planning Director, spoke on the importance of developing a comprehensive plan for an area. In Minnehaha County, they use density zoning to allow mixing of different land uses. A residential building eligibility is

assigned to each quarter-quarter section (approximately 40 acres) in the agricultural zoning district. The minimum lot size is 1 acre and they must have an eligibility to construct a home. He stated that the density zoning concept has worked well in Minnehaha County. It offers assurance that farming will continue as the dominant land use in agriculturally zoned areas. The conflicts between farmers and homeowners are somewhat reduced due to the limited density of homes. A farmer is allowed to convert less productive farmland to residential. The lower density of population that initially attracted residents to the rural areas is better preserved and there is less potential that population densities will exceed the existing level of services.

Mr. Sam Trebilcock, Sioux Falls, Transportation Planner for the City of Sioux Falls, stated that the City of Sioux Falls, along with Lincoln and Minnehaha Counties, adopted a growth management strategy to manage the growth and keep the rural areas rural. They have addressed the following development areas:

- Urbanized Areas (existing development)—emphasis is on maintaining the existing and making sure the taxpayer is not paying for new development;
- Planned Urbanized Area (development has been approved but not completed)—emphasis is on future development and placement of utilities;
- Future Urbanized Area (agricultural land along the urban fringe)—emphasis is on development over the next ten to fifteen years where the land has limited rural uses; and
- Rural Area (agricultural uses outside city limits)—emphasis is maintaining the rural character.

A handout entitled "Land Use and Zoning Testimony" was distributed which included information from Mr. McGinnis, Mr. Kappen, and Mr. Trebilcock (**Document 4**).

In response to a question on how farm land is taxed when it is being developed for housing, Mr. McGinnis stated that the preference of the local officials is to have the plat recorded at one time, not as each individual lot is sold. Mr. Trebilcock stated that the developers try to keep the agriculture assessed value on the land until it is developed. Mr. Kappen stated that in some instances, people buy farm land and then sell off the housing eligibilities to help pay for the land.

Ag Land Statistics

Mr. Carter Anderson, Sioux Falls, State Director of the National Agricultural Statistics Service (NASS), stated that they are the data collection arm for the U.S. Department of Agriculture. He distributed a copy of the 65th South Dakota Agriculture 2005 bulletin, the South Dakota 2005 County Level Land Rents and Values - April 2005 edition, and a copy of his presentation (**Documents 5, 6,** and **7**). Over the past six years the value of South Dakota's cropland increased 55% and pasture land increased 53%. Over the same time period, cash rents for cropland increased 27% and pasture land increased 12%. He stated that 3,500 surveys are mailed to farmers and ranchers and they work to obtain a minimum of thirty responses per county. The descriptive statistics include the averages for the most recent year, the three year

average, the minimum and maximum value, and the most frequently reported value. Mr. Anderson stated that it is a statewide survey and is not broken down into townships or regions of a county. Mr. Anderson stated that additional information is available on their web site at www.nass.usda.gov/sd.

In response to a question about the quality of the data and the limitations, Mr. Anderson stated that the survey asks for the value and the rent for their own farm/ranch and for their area. Because of the variations within the county, these numbers alone should not be used to set rental rates. As far as quality of the data, Mr. Anderson stated that he believes that if someone is going to respond to the survey, they will do so to the best of their knowledge.

Property Taxes and Assessments – The Relationship

Ms. Kathy Glines, Buffalo, Harding County Auditor, described how the tax law changes over the past ten years have affected the valuation system and tax requests in Harding County, which has only four taxing districts and no overlapping school districts. She stated that the county tax request remains fairly stable and any increase is the result of growth and the index factor, which is Consumer Price Index (CPI) or 3%, whichever is less. A copy of Harding County's taxation history over the past ten years was distributed (**Document 8**).

In response to a question on why the total taxable value dropped from 1999 to 2000 when there was some land that sold in the county for a high price, Ms. Glines stated that it was because of the NA-Z and 150% rules. Therefore, that sale was not used to value property.

In response to a question on how state-owned school land affects the taxes in Harding County, Ms. Glines stated she treats the land as fee simple. All of the land is leased and is taxed as pasture land.

Ms. Julie Pearson, Rapid City, Pennington County Auditor, explained that the auditor uses the valuations when applying the various levies for the taxing levying entities in the county. She stated that any changes in the process in the equalization that develops the values will change the amount of levies per thousand dollars of value but will not change the total taxes collected. Property taxes may shift from one classification to another, both positive and negative. Under the current tax cap, it is the property tax dollars that are frozen not the levies. No matter what is done with values, the county will continue to collect its taxes. She stated that in Pennington County values have increased more than the CPI, thus automatically driving down the property tax levies.

In response to a question whether there is a need for a different classification for land/investments to address the problem that some people are paying a significant amount of money for property, Ms. Pearson stated that the auditors deal with spreading the taxes on the values that the assessors set. It is not the responsibility of the auditor to set property values. However, she would like the Legislature to quit messing with mobile homes.

The committee recessed at 11:55 a.m. for lunch and reconvened at 1:20 p.m.

Property Assessment – A Director's Perspective

Mr. Joel Wendell, Hot Springs, Fall River and Shannon County Director of Equalization, distributed a handout entitled "Fall River County Assessed Value and Market Changes" (**Document 9**). Currently Fall River County assesses property at 99.5% of its value based on the data the county is permitted to use pursuant to state law. In reality Fall River County is at 41.6% of actual market value. The ag land value has remained very stable because of the NA-Z, 150% and 70 acre rules. He explained that the county was very depressed in the early 1990's; however, recently there has been a very active real estate market. The non-ag property is assessed in the high 60% range of actual market value, even though the sales to the assessment show that the county is above 99% because of the 150% rule. Mr. Wendell stated that ag land will never be valued at market value. The NA-Z rule is doing a good job in removing those higher sales. We tend to lump the NA-Z and the 150% rule together; however, they are different concepts and formulas. It is the 150% rule that is causing the greatest problem and needs to be corrected. Many counties do not have enough "good" ag sales to value property; either the income approach or bridging must be used. He stated that the sooner the 150% rule is repealed, the better.

Mr. Wendell stated that if additional classifications of land are added, the system needs to be simple and easy to explain. He proposed a minimum of 160 acres be used for ag classification. If it is a small parcel of ag property or it does not meet all three of the criteria it should be based on market value, not production. The value of income produced from the land has little relationship to the current market values. He also proposed changing the income criteria in subdivision 10-6-31.3(1) from a percent of gross family income to a set amount of assessed value, i.e. 5% of the assessed value of the land.

Representative Jensen commented that Mr. Wendell's chart very clearly shows future problems with our taxation system and why the 150% rule should be reviewed.

In response to a question on how much of the taxes are paid by the different classifications, Mr. Wendell stated it was about a 50-50 split in Fall River County and the percentage of ag property is decreasing every year.

In response to a request to further explain his proposed separate classification for smaller ag operations and development land, Mr. Wendell stated that usually ag land that is being developed has a poorer soil rating than land that is actively farmed or ranched. If the land does not meet all three of the criteria (currently only two of the three have to be met), then it would be put into a transitional type of property. This proposal would need to be discussed and evaluated further because many of the counties do not use 160 acres for a minimum size to qualify as agricultural land.

Mr. Arden Moen, Sisseton, Roberts County Director of Equalization, stated that Roberts County has many different land uses and a variety of values. The county's assessed value was closer to the actual sales ratio in 2000 than 2004. In 2004 the assessed value was about

50% or less if you use all of the arms-length sales to determine the relationship to market value. In one respect, this is in violation of state law which requires assessment notices to list full and true value of property. In his written testimony which he provided, Mr. Moen presented some scenarios that are occurring in Roberts County and asked the committee to change some of the existing throw-out rules (**Document 10**).

Representative Dykstra commented that Mr. Moen's remarks are exactly the committee's dilemma. He is in favor of removing the impediments for using certain sales to value property. He asked if the amount paid relative to the assessed value for the different classifications has changed over the past few years. Mr. Moen responded, yes, and that in Roberts County the tax shift is away from ag land.

Representative Rhoden commented that if a change was made so that all three of the criteria would have to be met instead of just two for property to be qualified as agricultural property, it would affect the person who is, for example, a cattle buyer and makes a majority of his income from that activity.

In response to a question if some ag land would qualify under the NA-Z rule, Mr. Moen stated that the NA-Z rule is applied first, then the 150% rule.

Mr. Dick Kallemeyn, Sioux Falls, Minnehaha County Director of Equalization, stated that 150% rule was a major mistake and the longer it is used, the harder it will be to correct. He stated the neighborhood difference in Minnehaha County is 30%. If he was able to use all of the sales, the difference would be 40%. He has not had a good ag sale this year or last year because of the NA-Z, 150%, and 70 acre rules.

The building eligibility that Mr. Kappen discussed earlier has a great effect on the value of the property. If the property is within six miles of Sioux Falls it is worth about $40,000 more with the building eligibility. He stated that this value is not included in his valuation.

In response to an earlier question if the budget controls are keeping taxes under control, Mr. Kallemeyn stated that on an 80 acre parcel, the value is up 57% but property taxes are up only 18%. The county, municipalities, townships, and the special purpose districts are limited to the rate of inflation or 3%, whichever is less. With the new growth and the sales that are used, Minnehaha County had $285 million in growth in assessed value over the last year.

Representative Wick requested a copy of Mr. Kallemeyn's data.

Representative Jensen commented that the ramifications of a shift would have to be reviewed county by county to show what would happen if the 150% rule was repealed.

Senator Lintz reminded the committee that studying the 150% rule was not part of the committee's assignment.

Real Property Assessment and Taxation

Mr. Michael Kenyon, Department of Revenue and Regulation, distributed a handout entitled "Implementation of Tax Reduction" and "Repeal of 150% Statute" (**Document 11**). Mr. Kenyon stated that in Pennington County from 2004 to 2005 there was a 10.39% increase in the value, however, there was only a 6.31% increase in property taxes. Because of the 5.15% growth in the county, the mil levy actually went down. The comparison between keeping the 150% rule and repealing the 150% rule showed that the amount of property tax money collected would remain the same whether the rule existed or not. Some classifications would pay more and some would pay less. Mr. Kenyon also provided two examples concerning the taxes generated by local effort for two school districts. The Avon School District, for example, would receive less state-aid-to-education for their school and the property taxes generated by local effort would increase if the 150% rule was eliminated. However, the Douglas School District would receive more state-aid-to-education for their school and the property taxes generated by local effort would decrease if the 150% rule was eliminated.

Chair Lintz commented that the data does not tell the whole story. There may be spikes in the assessed values within each county that may cause hardships. Mr. Kenyon acknowledged that there would be some spikes; however, when the valuation increases, the tax rates decrease.

Representative Dykstra commented that we are allowing this artificial factor (the 150% rule) to suppress the market in some areas. Mr. Kenyon agreed that as certain factors are used to suppress the valuations, the tax burden is being shifted from one taxpayer to another. This is the core problem that we are facing.

Representative Glover commented that the purpose is to make the taxes fair. The 150% rule was a protection for certain aspects. If you repeal the 150% rule, you allow outside factors to set values for ag land.

In response to a question on how the NA-Z property is taxed, Mr. Kenyon stated that for one year, the property is taxed one dollar higher than ag land and assessed at the sales price. After that year the land may be reclassified as ag land or for whatever classification the property is so qualified.

For informational purposes, staff distributed a copy of the scope of the committee assignment (**Document 12**).

Public Testimony

There was no one that wished to provide public testimony.

Committee Discussion
Requests for Further Information

Staff Directives

Chair Lintz opened the discussion up to the committee and asked if any member had any proposed legislation related to the study topic and if there was a need for an additional meeting.

Senator Hundstad commented that there has been good information provided to the committee and would like to see the discussions continue. He thinks it is unfair for 17% of the state's population (agriculture) to be paying 39% of the taxes because they do not consume 39% of the services. He believes the 150% rule needs to be repealed. There needs to be other property classifications that concern recreational and investment properties.

Representative Dykstra disagreed with Senator Hundstad's comments that property taxes should be viewed as fees for services provided. Based on the information provided at the last meeting, ag values are going up because ag revenue is going up and the majority of the ag land is being bought by ag producers. Having a separate classification for ag recreational property could be very complicated and may not stand up in court. He stated that we should have a transparent understandable property tax system with market rate assessment and adjust the tax burden with levies. He commented that the committee has seen no evidence that people are losing their homes because they can not afford the taxes.

Representative Rhoden commented that perhaps Mr. Wendell, Senators Lintz and McNenny, and himself work on bill drafts regarding ag classifications and the criteria used to create such classifications. Chair Lintz stated that would be within the criteria of the committee.

Representative Wick commented that there are other classifications of ag property that should also be considered. If the 150% rule is repealed, we need to have other things in place to lessen the potential impact.

Representative Glover stated that there are other factors that influence prices. The simplest way is to change and improve the NA-Z classification criteria so it will withstand any legal challenge.

Senator Hundstad commented that 43% of the total population use to be involved in farming and ranching; the population has shifted from agricultural to urban over time. He suggested creating an investment classification by using the NA-Z classification as a guide.

Senator Peterson commented that creating an investment classification did not receive a positive response concerning its constitutionality from the Attorney General's office at the first meeting.

Representative Dykstra asked the auditors and directors of equalization to bring forward suggestions at the next meeting. He also asked how other states are assessing ag property and what classifications are being used.

Mr. Baatz stated that other states often use the productivity system as a means to hold down ag values and reduce the tax burden.

Representative Dykstra suggested market values could be used to assess property if the rate of taxation or the taxable percentage is appropriately adjusted.

Chair Lintz stated that because of the diversity within the state, the taxable percentage would need to be set county by county which would be hard to do with the school funding formula.

Senator McNenny noted that politics plays a major role in resolving the property assessment dilemma. Everyone has their own solution for property assessments; however, there needs to be concessions to make it work statewide. We have created other ag criteria. Perhaps we need to provide additional criteria and consider how the state school formula changes.

Chair Lintz set the next meeting for Thursday, November 3, 2005, at 10:00 a.m. He stated that the next meeting will be limited to the interim committee's assigned study topic.

Adjourn

REPRESENTATIVE TURBIVILLE MOVED, SECONDED BY SENATOR MCNENNY, THAT THE MEETING ADJOURN. MOTION CARRIED UNANIMOUSLY ON A VOICE VOTE.

The meeting adjourned at 3:50 p.m.

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