Legislative Research Council
SouthDakota

MINUTES

Agricultural Land Assessment Implementation and Oversight Advisory Task Force

First Meeting **Room 413**
2012 Interim **State Capitol**
June 18, 2012 **Pierre, South Dakota**

Senator Larry Rhoden, Chair called to order the first 2012 interim meeting of the Legislative Research Council Agricultural Land Assessment Implementation and Oversight Advisory Task Force at 10:30 a.m. (CT), June 18, 2012, in Room 413 of the State Capitol, Pierre, South Dakota.

A quorum was determined with the following members answering the roll call: Representatives H. Paul Dennert, James Schaefer, and Steve Street; Senators Jason Frerichs, Tom Hansen, and Billie Sutton; Public Members Kirk Chaffee, Curt Everson, Larry Gabriel, Dave Knudson, Ron Olinger, and Jim Peterson; and Representative Justin Cronin (Vice-Chair) and Senator Larry Rhoden, Chair. Staff members present were Fred Baatz, Principal Research Analyst and Rena Ortbahn, Secretary.

(Note): *For the purpose of continuity, these minutes are not necessarily in chronological order. Also, all material distributed at the meeting is attached to the original minutes on file in the Legislative Research Council (LRC). This meeting was web cast live. The archived web cast is available at the LRC web site at http://legis.state.sd.us under "Interim Information – Minutes and Agendas."*

Approval of Minutes - Representative Cronin moved, seconded by Senator Frerichs to approve the minutes of the October 11, 2011 meeting. The motion was unanimously approved by voice vote.

Senator Rhoden**,** Chair welcomed the task force and gave some background history of the task force. He and Vice-Chair Cronin have identified two issues for this interim: easements and actual use versus highest and best use. The task force will also have opportunity to look at other areas. The focus of today's meeting is easements.

Representative Cronin, Vice-Chair said actual use legislation is an important issue that didn't garner much support last session, perhaps because all the information wasn't available. Easements are a complex issue, but several experts concerning easements are at this meeting.

Senators Hansen and Rhoden provided background information on changes in property assessments and the general fund levy for school districts. There were changes in the assessed valuation for each of the three classes of property - Agricultural, Non-agricultural, and Owner-occupied. The agricultural levy has been separated from non-agricultural and

owner-occupied levies whereas previously they were all treated the same. Because of the lack of increase in other property values and the significant increase in agricultural property, the mill levies for agriculture went down slightly while the mill levies for the other classifications went up slightly.

Mr. Olinger said with the property assessment being based on gross revenue on agricultural and crop land and with agricultural production costs going up, it is time to look at the landlord's share. He thinks the task force needs a body of information on these rapidly increasing input costs.

Department of Revenue

Mr. David Wiest, Deputy Secretary of the Department of Revenue spoke to the task force. He said one component of a good state aid formula is a good and sound valuation system for all types of properties including agricultural.

Legislation has changed us from a market value system to a productivity value system for agricultural land. The Department started with nineteen billion dollars in statewide ag land value for property tax purposes under the market system, and wanted to end up, after a year of implementing the productivity-based system, with nineteen billion dollars in value for tax purposes. The following assumption were made: that 85% of that nineteen billion dollar valuation was in the crop side and 15% was in the non-crop side of the equation; for cropland value it was decided to go with a productivity model; and for non-cropland it was decided cash rents are the best method for determining value; the landlord share of the equation was set at 35% for crop and 100% for non-crop; and finally a cap rate or multiplier was set at 6.6% - all to make the nineteen billion dollar value. The previously described components all go into the mix when implementing a productivity-based system. If one number is changed, that change affects everything else.

The 2010 assessment year was the first assessment year under the productivity system for taxes payable in 2011. The productivity system remains in transition. No one forecasted the commodity price increases experienced over the last few years. Also the previous market system was broken with some counties doing better than others in keeping up with their ag land assessments.

The task force and DOR are constantly looking at the productivity system and trying to make improvements.

Overview of Conservation Easements - DOR

Mr. Michael Houdyshell, Director of Property and Special Taxes Division, Department of Revenue spoke to the task force. (Document 1)

He identified two frequent concerns expressed by the county directors of equalization - adjustments and conservation easements. Last fall DOR provided the directors of equalization with directions, including different scenarios and examples, to help them make proper and valid ag land adjustments on a case by case basis. Mr. Houdyshell said he realizes that the issue of conservation easements is complex; and that there are various federal agencies and private land trusts - all different with a different purpose.

Mr. Houdyshell provided the task force with a quick overview of easements. He briefly reviewed the state statutes relating to conservation easements, specifically SDCL 1-19B-56 to 1-19B-60, inclusive. He listed the conservation easement programs available through the USDA Natural Resources Conservation Program, the US Fish and Wildlife Service, and other types of conservation easements available in South Dakota (Land Trusts, SD Parks & Wildlife Foundation, Riparian Buffers, and USDA Farmers Home Administration deed restrictions).

USDA National Resources Conservation Service Program

Ms. Sara Thompson, Administrator, USDA Natural Resources Conservation Service provided the task force with an overview of the wetland and grassland conservation easement programs available through the USDA (Document #2). She said all easement programs were voluntary; the Wetland Reserve Programs can be for 30 years or perpetual while the Grassland Reserve Program is perpetual; and the two emergency programs are perpetual. These programs are available mainly in East River South Dakota. Later in the meeting Mr. David Wiest listed the following USDA easement acres in South Dakota: 62,225 Wetland Reserve Program acres; about 17,000 Grassland Reserve acres; 49,963 Emergency Watershed Protection Program acres; and about 12,000 Emergency Wetlands Reserve Program acres.

The Wetlands Reserve Program is the most popular, particularly because in recent years it includes a flooded pothole category in that WRP can take in any land area that has been flooded. There is no limitation on crop history for USDA programs, for example if the wetland was cropped 40 years ago, that property would be eligible. When USDA makes an offer, it is separated into cropland and non-cropland. Values offered are usually 15% to 20% less than the market value. She referred the task force to a sample warranty deed provided in Document 2 saying NRCS purchases nearly all the rights, returns only those listed on page two of the warranty, and referred to extensive prohibitions listed on page three of the deed. She discussed compatible uses by landowners.

Ms.Thompson responded to questions on the Wetland Reserve easement program. She described how NRCS determines the value of property and said their offer is based on the approximate market value of those lands in that county or geographical area. She said the NRCS easements are all voluntary and that their easements are more restrictive than those of the US Fish and Wildlife Service. She said the WRP program prohibits cropping and although NRCS can give back certain rights, for example grazing as a management tool - they can't give back cropping. The application process includes putting in writing what the management scheme will be - the only guarantees are those that are in writing.

Ms. Thompson continued by briefly explaining the Grassland Reserve Program easements, referring the task force to the sample easement deed found in Document 2. This popular program offers either permanent easement or rental contracts. The program allows no development or conversion to anything other than grass. A grazing management plan is required prior to recording a deed and the landowner retains only a small bundle of rights.

Senator Rhoden said the issue before the task force is the whole area of why people enter into easements and the consequences of those decisions. USDA easements strip a significant portion of rights away from the land, yet the agency doesn't deal with the consequences and has no tax responsibilities.

Ms. Thompson said their easements do not have a direct impact on the adjacent landowners and they will work with adjacent landowners if there is a need. She said the purpose of the wetland reserve is to restore wetlands that have been drained or altered and when restoring such property, they make sure adjacent property will not be affected.

She said if there are noxious weeds on a property, NRCS has a cost-share program whereas they initially restore the land so that it is noxious weed free and thereafter if the landowner fails to act, there are steps the agency can take through the federal government.

Mr. Olinger commented that each county does have a weed board and a weed supervisor. The biggest problem is after receiving an upfront fee, then landowner never addresses the weed problem. Ms. Thompson said they do have ability to make easement payments over thirty years, and she has seen landowners take this option.

U.S. Fish and Wildlife Office

Mr. Bill Mulvaney, Senior Realty Specialist with the U.S. Fish and Wildlife Office spoke with the task force. He introduced **Mr. Harris Hoistad**, Project Leader with the USFWS, Sand Lake National Wildlife Refuge.

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Mr. Mulvaney said his agency works with two easements, Wetland and Grassland (Document 2). Wetland easement is basically a no drain, no burn, no fill. Grassland easements are to maintain natural vegetation and have no grazing restrictions; however, to hay the land the owner must wait until after July 15. Criteria for both easements have remained the same for years and both are perpetual easements.

Mr. Mulvaney responded to task force questions. He said through FY 2011 the following U.S. Fish and Wildlife acres were administered in South Dakota: 524,509 wetland acres; 797,432 grassland easement acres; and 41,266 FMHA conservation easement acres.

As for easements affecting property values, Mr. Mulvaney said he has not noticed wetland easements making a difference in the land sale price; while grassland easements, with their limiting the use of the land, do affect the land sale price.

Mr. Mulvaney explained the agency's process to value easements. They offer a percentage of the estimated market value of the property. Right now that percentage is 30%, but the percentage varies depending on the number of applications.

In response to a question about whether there is a decrease in interest in grassland easements since the value of tillable ground has increased; Mr. Mulvaney said they have at least three or four hundred grassland easement applications pending.

Mr. Mulvaney spoke of a cost share program that is not required, but if requested they will fence, establish water sources, and set up grazing management systems.

Mr. Mulvaney said in regards to building a house on easement property, that although permanent vegetative cover must be maintained; they do allow case by case exceptions. Mr. Hoistad further explained. He said during the initial easement negotiations, there are discussions on whether the landowner has any intentions on developing in the future. If they

do, the Fish and Wildlife Office works with them to exclude acres to build additional buildings. If the owner has acquired land with an easement, there is a process to allow the owner to develop reasonable accommodations, while minimizing the impact.

Mr. Mulvaney said with their easements, the agency purchases a bundle of rights, and they have no mechanism to address infrastructure issues that are the landowners.

The task force recessed at 11:50 a.m. and resumed at 1:15 p.m.

In response to a comment from Mr. Olinger, Mr. Mulvaney agreed that in the past, when cattle prices were depressed, easements were a benefit for livestock producers facing difficult economic times. As for problems with thistles, he said it often depends whether the manager is a good operator or not.

Mr. Mulvaney stated that the U.S. Fish and Wildlife easement programs along with the National Resources Conservation Services easements are authorized in counties East River, not West River South Dakota.

Department of Revenue (continued)

Mr. Michael Houdyshell, Department of Revenue resumed his presentation (Document 1 - page 3). He said there are basically four issues dealing with agricultural land that has been encumbered by conservation easements in South Dakota 1) How should this land be assessed for purposes of property taxation under the productivity system? 2) Should such land be assessed at a reduced valuation? If so, how should the amount of the reduction be determined? 3) Does current state law allow for a reduced valuation of such land? 4) How significant would the tax shift be if adjustments were made to account for conservation easements?

Mr. Houdyshell referred the task force to SDCL Chapter 10-6-33.31. He said this statute does allow the county director of equalization to make adjustments in the assessed value of agricultural land. He said the adjustments for conservation easements vary widely by county: some are not making any adjustments for conservation easements; some, regardless of whether the property with the conservation easement has crop-rated soils or not, use the county non-crop top dollar as a starting point; and some counties have developed a multi-pronged approach, for example, Brown County.

Mr. Houdyshell responded to questions. He said although there is an overlap between reasons land is put into easement and allowable adjustments that can be made by statute, easements aren't specifically addressed by statute.

Mr. Jim Peterson said it appears wetland easements aren't a concern, that the biggest problem is grassland easements. He asked whether DOR could promulgate administrative rules providing adjustments similar to those made by Brown County. Mr. Houdyshell said although the department could, there are two concerns: 1) the approach and 2) the tax shift in counties that have a lot of grassland easements. He thinks it is a policy decision and the department would like to see guidance concerning this particular area from this task force and the Legislature.

Senator Rhoden said the task force should take lead on these issues, and the Department of Revenue's role is to provide input.

Mr. Gabriel sees nature conservancy districts as being a big problem in West River. They buy land, but don't pay the property taxes. Mr. Houdyshell said that Ms. Coleen Skinner has documents that shows county by county the acreage impacted by the easements discussed today, assumptions she made to make adjustments, and the effect both on the county and the entire state. He said the document is limited to just easements, but for next meeting he asked if the department could show the shift from highest and best use to actual use.

Mr. Houdyshell indicated that DOR didn't approve or disprove of Brown County's assessment method. He would like to see some consistency statewide when addressing easements. Landowners in different counties shouldn't be treated differently.

Mr. Houdyshell thought it's difficult to come up with blanket rules concerning easements because of the different terms of each type of easement.

Ms. Colleen Skinner, Department of Revenue, Property Tax Division, (Document 3) appeared before the task force. She presented detailed information to the task force explaining that if certain assumptions were made and different types of easements were taken into account, what the agricultural land value change would be by county. This information was summarized in a chart entitled "Acres – Assessed, US Wildlife Easements, NRCS Easements and School and Public Lands and Value Change." If those assessments were made, there would be a change in the property taxes, and this information is contained in a chart entitled "Change in Taxes – County Taxes Only" – also presented by county. Ms. Skinner also presented information from a "Soil Survey Table Data" with information again by county.

Mr. Peterson commented that if adjustments for easements are allowed during a period when property values are increasing, there won't be devaluation in ag property, just a smaller increase.

Ms. Skinner said that for the purpose of these examples, all easements, whether wetland or grassland, were treated the same. Ms. Skinner said they are looking to the task force for guidance as to whether easements should affect property assessment value or not.

Ms. Skinner said that DOR's goal is to have adjustments that all sixty-six counties can use. Counties are already making adjustments differently; DOR is trying to get more consistency.

Public Testimony

Ms. Mary Worlie, Brown County Director of Equalization, described the method of assessing agricultural land in Brown County and said this has been developed after meetings with and the input from townships, land owners, county commissioners, and others.

Ms. Worlie said restrictive easements have been taken into account in assessing the land and that different adjustments have been made for different easement categories. She said many easement acres had already received a low valuation because of flooded farmland; however,

the owner had to apply every year. If the application deadline was missed, the assessment for that property went up substantially.

She has on file every easement by category in Brown County that she can find, separated by legal description and owner. No adjustments have been made for wetland easements, CRP easements, and 30 year restrictive easements. As for grassland easements, in assessing parcels of land they have taken into account crop rating for every soil type and compared crop and non-crop rating.

Mr. Chaffee made the point that there is not one scenario that will work in all 66 counties.

Mr. Matt McCaulley, representing SD Corn Growers spoke to the task force. SD Corn Growers are opposed to an actual use system of valuation. If the assessed value is changed down for some, then someone else has to pick up the difference. The issue is crop soils that aren't being used for crop land.

He said easements are voluntary and they are a management decision. The question is should a management decision affect taxable value? He said the SD Corn Growers are opposed to perpetual easements.

Mr. McCaulley is not convinced that existing assessment statutes are being applied as they should on a statewide basis. He would like to see present statutes allowing for adjustments enforced and adjustments made before there is talk about major shifts such as moving from soil based assessment to actual use valuation.

Mr. Gabriel said if the directors of equalization don't make a change in adjustments, then taxpayer has to go to court. Mr. McCaulley said, concerning a situation described by Mr. Gabriel, that the county director of equalization has the discretion to make changes in adjustments, and if that's not being done, it's a problem, not with the law, but the application and enforcement of the law.

Senator Rhoden expressed that if the county directors of equalization aren't applying the existing statues fairly now, we aren't going to make them change by adding language in statute. He thinks this task force and the Department of Revenue should work together with the assessors; educate the assessors; and allow them to apply local control.

In response to Mr. Peterson, Mr. McCaulley said that by statute there is existing law to address rough terrain situations with cropland in certain areas that shouldn't be cropped. The assessors have the tools; it's a change in application that is needed.

Mr. Rick Vallery, SD Wheat, Inc. said that in the easement discussion, the non-profits affecting mainly West River South Dakota need to be considered. For example Dakota Grassland Initiatives has a goal to get six million acres into grassland easements. We need to continue the research and discussion as to how we look at easements.

Mr. Jim Faulstich, a farmer/rancher from Highmore said first the task force needs to get facts and figures and not assume anything; and second others believe wetland easements are not a factor as far as valuation, he believes they are. As for easement issues discussed today, much would be immaterial if actual use was implemented. He said we do need to take care of

natural resources and some assessment and taxation practices are not in best interest of the land.

Mr. David Wiest, Department of Revenue made final comments. Why all the work on assessments? State aid to educations formula is one reason; another is for uniformity, accountability, and fairness in counties when paying property taxes.

He indicated the productivity model needs to be looked to see if it needs to be fine tuned in regards to easements. He said, for example, there are some differences between the wetlands and grasslands easements administered by the U.S. Fish and Wildlife Office versus the USDA National Resources Conservation Service and there is a need to account for these differences.

Time needs to be spent considering: How do you do an adjustment and what is the basis for doing it? He wasn't sure whether public versus private easements make a difference. He said an easement is a restriction on the private property owner, no matter who made it.

Mr. Wiest indicated there are different points of view as to how to adjust for easements, for example should grassland easements containing cropland acres get an adjustment? He said that the task force should make that policy decision; determine whether to make adjustments for easements and provide guidance to the Department of Revenue and taxpayers.

Senator Rhoden said he sees the priority issues before the task force being: easements, actual use versus highest and best use, and the landowner's share.

Representative Dennert indicated he favors actual use. He thinks the DOR ratio of 85% of ag land value being in cropland and 15% in grassland needs to be studied. He is seeing significant acres being taken out of grassland to raise corn and also the costs of production going up.

Mr. Chaffee asks the Department of Revenue to look into the definition of highest and best use, all components of it; splitting highest and best use from a soil survey perspective and an easement perspective. He said the constitution bars any assessment being above market value.

Mr. Peterson said if tools exist for county directors of equalization to apply assessment changes to grassland, he hopes the counties receive direction on how to implement, use, and make adjustments. He stated many grassland owners are being taxed unfairly.

Mr. Gabriel said it is imperative if the task force advocates something that it be doable and affordable. He is an advocate of actual use, but only if it is doable. He wandered what would happen if the language in state statute allowing for adjustments was simply changed from "may" to "shall".

Mr. Everson said if land classification for tax purposes has to be the rule, then the task force should debate highest and best use versus actual use. He suggested relying less on adjustment factors as opposed to enacting better rules on land classifications.

Senator Frerichs sees easements taking a significant amount of rights away from the landowner by being diverted to a separate entity which then takes no responsibility for the taxes. He sees perpetual easements as being problematic and said ninety-nine years should be the maximum limit for easements.

Mr. Knudson requested from DOR an analysis of the shift in cost involved in going to an actual use model and feasibility of that; second on easement data that Ms. Skinner presented, he would like to see it be limited strictly to grassland; third the task force needs know the size (acres) of private easements in West River to determine if that is an issue; and lastly he would like a discussion from DOR to the suggestion of changing “may” to “shall” in the state statute concerning adjustment factors for assessing agricultural land.

Adjournment - Senator Hansen moved, seconded by Mr. Chaffe that the meeting be adjourned. The motion prevailed unanimously on a voice vote.

The task force was adjourned at 3:30 p.m.

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