

SD DEPARTMENT OF REVENUE AND REGULATION

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TO: House Taxation Committee

FROM: Michael Kenyon, Director
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RE: SB 173

This bill does two things: phase out the 150% of assessed value rule over five years and require that all ag land in the state be valued based upon its productivity. The original bill also contained a “green acres” tax, but the Senate Taxation Committee removed that portion of the bill.

Phase Out of 150% Rule (Sections 1-2 of the bill).

The 150% rule throws out any sale from the assessment process when the sale price is more than 150% of the assessed value. Statewide, \$5.2 billion of value is not taxed because of this rule (\$3.5 billion of ag value and \$1.7 billion of owner-occupied and commercial value). If the bill passes, ag land will no longer be assessed using sales, so the repeal of the 150% rule will **not** affect ag values at all.

However, the repeal of the 150% rule would still have a significant impact in some areas on owner-occupied and commercial properties. The bill works by allowing in all of the sales previously excluded because of the 150% rule. However, those new sales cannot increase valuations more than 5% a year.

- So, if your property is under assessed 20% because of this rule, and your property is increasing at 3% a year because of the market, you would face a valuation increase of 8% the first year (3% because of the market increase and 5% to catch you up to “real” market value).

Productivity Valuation (Sections 3-10 and 14-21 of the bill).

The bill also shifts to productivity valuation for all ag land. Ag land would be valued based upon a formula using cash rents. The department would determine the source of the cash rents. The formula deducts taxes from the cash rent, and capitalizes the adjusted rent at 6.16%. This capitalization rate was picked to make the **statewide** valuation of ag land approximately revenue neutral.

How it Works: The average crop rent is associated with the median (typical) crop soil rating in the county. The taxes are subtracted from the rent, and the numbers are then projected up to reach the 1.0 rated soil (the best in the county). That calculation gives you a projected cash rent for the 1.0 rated soil. That projected cash rent is capitalized at 6.07%. People owning property with a rating less than 1.0 would pay a proportionate

amount. So, if you own land with a .7 rating, its value would be 70% of the 1.0 rated soil.

Example. A county has an average cash rent of \$60 an acre, taxes per acre of \$10, and a median soil rating of .5. That projects to a top dollar cash rent of \$100 for a property with a soil rating of 1.0 (\$60 rent minus \$10 in taxes = an adjusted rent of \$50 for the .5 rated soil, multiplied by 2 to attain the rent for the 1.0 rated soil). The value of the 1.0 rated soil would be \$1,647 an acre ($\$100 / .0607$). The owner of property with a rating of .7 would be valued at 70% of the 1.0 rated soil.

The value produced from the formula is the base value of the property. Section 6 allows the assessor to make common-sense adjustments to the value. Once a final value is determined, the property owner pays taxes on 85% of the value.

The attached chart shows the changes, both increases and decreases, in each county's ag valuations. To put a brake on the counties that would dramatically increase, the bill caps any increase from 2009 (the first year values will be impacted by the bill) through 2011 at 15% a year.

Because each school district's capital outlay fund is not capped, schools in counties where values drop would lose a lot of revenue; schools in counties where values increase could gain a lot of revenue. To account for this, we placed a 5-year property tax cap, like we have for the counties and cities, upon each school district's capital outlay revenue. We also suspended the maximum levy rate of \$3 / \$1,000 of assessed value for the same 5-year period. This allows each school district to get approximately the same capital outlay revenue they could have gotten under the old system, even with ag values significantly changing.

The bill will also cause tax shifts within some counties. However, the tax shifts will not be as severe as the percentages on the attached chart.

Example of SB 173 Tax Shift. A County has about \$273 million of ag value, and another \$50 million of commercial and owner-occupied value. The county applies a tax levy of \$4 / \$1,000 of value to \$323 million of taxable value to collect \$1.29 million in taxes. Assume SB 173 would cause the ag values to go up 10% to \$300 million and the value of owner occupied and commercial property goes up 6% to \$53 million. Because of the tax caps, the county can only get \$1.33 million in taxes. Therefore, the county levy has to go down to \$3.77/\$1,000 of value ($.00377 \times \$353 \text{ million} = \1.33 million).

- If you own \$100K of ag land in the county, you paid $\$100K \times .004 = \400 the first year. The next year, your value is at \$110K, but the levy goes down, you will pay $\$110K \times .00377 = \414.7 . Therefore, your value increased 10%, and your county taxes increased about 3.7%.
- If you own \$100K of commercial land in the county, you paid $\$100K \times .004 = \400 the first year. The next year, your value is at \$106K, but the levy goes down, you will pay $\$106K \times .00377 = \399.62 . Therefore, your value increased 6%, but your county taxes actually decrease because of the increased ag values.

The impact on each county will depend upon the county's percentage of ag land and the change in valuation by going to a productivity value.