



Legislative Fiscal Bureau

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Joint Committee on Finance

Paper #686

Use Value Assessment of Agricultural Land (Shared Revenue and Tax Relief -- Property Taxation)

CURRENT LAW

Since 2000, agricultural land has been valued solely on the basis of its use in farming under use value assessment provisions. While local assessors continue to be responsible for classifying and assessing agricultural land, the Department of Revenue (DOR) has a number of administrative duties related to use value assessment. First, DOR's property assessment manual includes guidelines for categorizing and valuing agricultural land. Second, DOR annually develops agricultural land values under the use value approach on a per acre basis for each municipality containing agricultural land and publishes the per acre amounts in a supplement to the manual. Local assessors use the per acre values as guidelines in assessing parcels of agricultural land. Third, DOR has adopted administrative rules to implement use value assessment. Finally, DOR provides staffing to the Farmland Advisory Council, which consists of the DOR Secretary and nine other individuals. The Council assists the Department in administering the use value assessment requirements.

GOVERNOR

No provision.

DISCUSSION POINTS

1. Property other than agricultural land is value according to the principle of "highest and best use," or the use that will produce the greatest net return to the property owner over a reasonable period of time. This means that properties are valued with respect both to their current use and to other possible uses. A 1974 amendment to the Wisconsin Constitution permits agricultural property to be valued differently, and a 1995 law change requires agricultural land to be

valued based on its use for farming. Specifically, state law provides "agricultural land shall be assessed according to the income that could be generated from its rental for agricultural use." [s. 70.32(2r)(c), Wisconsin Statutes]

2. The procedures used in valuing agricultural land have been adopted by the Farmland Advisory Council and incorporated into a DOR administrative rule (Chapter 18, Subchapter II, Wisconsin Administrative Code). Those procedures estimate values on a per acre basis for each municipality containing agricultural land, under a formula that estimates the income that could be generated by the land, divided by a capitalization rate. Income is measured on a county-by-county basis and equals the average corn yield (bushels per acre) multiplied by the average price per bushel, minus average operating expenses. Each of these measures utilizes a five-year average, ending three years prior to the assessment year. For example, 2003 values will be based on yields, prices, and expenses for the period between 1996 and 2000. Averaging these measures is intended to remove short-term fluctuations due to weather and market factors that do not significantly influence land buyers' long-term decisions. Data on yields, prices, and expenses is compiled annually by the Wisconsin Agricultural Statistics Service and the U.S. Department of Agriculture. The capitalization rate equals the sum of two components. The first component is the five-year average interest rate on one-year, medium-sized agricultural loans extended by federal land credit associations and agricultural credit associations operating in Wisconsin. The second component is the effective property tax rate. A separate tax rate is calculated for each municipality, equal to the total taxes levied for all purposes within the municipality, net of state property tax credits, divided by the municipality's equalized value, as determined by DOR. While net income is calculated on a county-by-county basis, variation in municipal tax rates results in unique capitalization rates for the underlying municipalities, which produce different per acre values for municipalities within each county.

3. The use value assessment provisions were phased-in over the period from 1996(97) to 1999(00), and use value became fully effective in the 2000(01) property tax year. From 1995 to 2002, the equalized value of agricultural land decreased from over \$9 billion to less than \$3 billion, or by 69.3%. Over the same period, the value of property included under other classifications increased by 72.7%. As a result, the percentage of total tax base comprised of agricultural land declined from 4.5% to 0.8%, on a statewide basis. Table 1 portrays the estimated effect of these tax base changes on the allocation of property taxes. The percentage of taxes borne by agricultural land has decreased from 4.2% in 1995(96) to 0.9% in 2002(03), and the estimated, net taxes on agricultural land have decreased by 74.5% during this seven-year period. Over the same period, the estimated, net taxes on other types of properties have increased by 33.4%. Estimated, net taxes on residential property increased by 38.0%.

TABLE 1

**Statewide Estimated, Net Property Taxes by Type of Property, 1995(96) to 2002(03)
(\$ in Millions)**

	<u>Property Tax Net of State Credits</u>	<u>Percent of Total Taxes</u>	<u>Change from 1995(96)</u>
Agricultural Land			
1995(96)	\$220.1	4.2%	
2000(01)	105.9	1.8	-51.9%
2001(02)	101.3	1.7	-54.0
2002(03)	56.1	0.9	-74.5
All Other Property Categories			
1995(96)	\$5,047.0	95.8%	
2000(01)	5,940.8	98.2	17.7%
2001(02)	6,370.4	98.3	26.2
2002(03)	6,730.7	99.1	33.4

4. Several points should be noted about the tax shift shown in Table 1. First, there is less agricultural land subject to property taxation today because of changes in property use. In 1995(96), there were 14.4 million acres of land taxed under the agricultural class, but there were less than 13 million acres in that class in 2002(03). Second, a portion of the taxes on agricultural land has been shifted to other types of properties engaged in an agricultural use. Agricultural buildings and improvements and the land necessary for their location and convenience are included under the "other" classification of property. In a study completed in 2002, DOR estimated that the net taxes on agricultural land and improvements decreased from \$283.1 million in 1996(97) to \$211.9 million in 2002(03), or by 25.2%. On a per acre basis, the estimated net taxes on agricultural land and improvements decreased from \$20.59 in 1996(97) to \$17.59 in 2002(03), or by 14.6%. These percentage reductions are considerably less than those shown for agricultural land in Table 1. Nonetheless, these statistics illustrate that use value assessment has resulted in a significant reduction in agricultural taxes. DOR estimates that net taxes on agricultural land would have been \$251 million higher in 2002(03) if agricultural land had been valued according to the principle of highest and best use.

5. While use value assessment has been effective in providing property tax relief, there are indications that the valuation formula may not accurately measure the value of land employed in an agricultural use. Corn prices and production costs from the period between 1997 and 2001 will be used to calculate 2004 agricultural land values. Over that period, the price of corn has declined, and production costs have increased. In 2004, the combination of these factors is expected to produce negative values for agricultural land. DOR staff indicate that the negative values will occur throughout the state and that values are expected to remain negative for the near-term. Department staff have estimated that the average value of Grade 1 agricultural land will decrease to -\$253 per acre in 2004 and drop to below -\$400 per acre by 2007. Table 2 displays the use value calculation

for one acre of land in 2004 using statewide factors, without regard for the grade of farmland.

TABLE 2

Use Value Calculation for 2004 Based on Statewide Averages

Data Elements:

<u>Year</u>	<u>Average Corn Yield (Bushels per Acre)</u>	<u>Corn Price Received (\$ per Bushel)</u>	<u>Cost of Production (\$ per Bushel)</u>
1997	132	\$2.531	\$1.900
1998	137	2.154	2.105
1999	143	1.805	2.141
2000	132	1.851	2.191
2001	127	1.860	2.538
Average	134	\$2.040	\$2.175

Calculation:

Gross Income Per Acre	$\$2.040 \times 134 =$	\$273.79
Minus Operating Expenses Per Acre	$\$2.175 \times 134 =$	-291.88
Minus Return to Management Per Acre	$\$273.79 \times 2.5\% =$	<u>-6.84</u>
Equals Net Income Per Acre		-\$24.93
Divided by the Income Capitalization Rate		9.23%
Equals Value Per Acre		-\$270

6. There are additional indications that the use value model understates agricultural values. Table 3 displays the reduction in the equalized value of agricultural land since 1995 and estimates the per acre value of agricultural land based on acreage totals reported by local assessors. For 2003, the estimated per acre value is estimated to decrease an additional 29% to \$157, based on the valuation guidelines published by DOR for 2003. In addition, the table reports the average sales price of agricultural land, according to statistics reported by the Wisconsin Agricultural Statistics Service. These amounts are based on data compiled by DOR and reflect sales of agricultural land, without buildings, where the buyer indicates that the land will continue in an agricultural use. The table indicates that the ratio of the average, equalized per acre value of agricultural land to the average sales price of agricultural land has declined from 83% in 1995 to 12% in 2002. A use valuation formula could be developed that is based both on the income capitalization approach to valuation and on farmer-to-farmer land sales.

TABLE 3

Estimated Per Acre Values of Agricultural Land

<u>Year</u>	<u>Equalized Value Agricultural Land*</u>	<u>Number of Acres*</u>	<u>Value Per Acre</u>	<u>Agricultural Land Sales**</u>	
				<u>Price Per Acre</u>	<u>Year</u>
1995	\$9,017.4	14.4	\$626	\$752	1994
1996	8,512.8	14.1	606	778	1995
1997	8,519.1	14.0	610	900	1996
1998	7,967.2	13.2	602	993	1997
1999	7,643.9	13.0	587	1,173	1998
2000	5,129.1	12.8	401	1,324	1999
2001	5,070.1	12.8	397	1,633	2000
2002	2,769.9	12.6	220	1,867	2001

* These amounts are in millions.

** DOR uses sales from one year to set equalized values for the succeeding year.

7. Although all states extend some type of property tax relief to agricultural property owners, 43 states employ a form of use value assessment, oftentimes based on formula calculations somewhat similar to Wisconsin. Data collected by DOR from other states that employ use value assessment procedures indicate that the Wisconsin formula produces lower per acre values than the other states' formulas. Some of these states have classified property tax systems that assess agricultural land at a percentage of the values reported below. However, other types of property are also valued at reduced percentages after their initial value is determined.

TABLE 4

Average Per Acre Agricultural Values in Four Use Value States

Illinois	\$965
Indiana	1,050
Iowa	723
Missouri	985

8. The Wisconsin formula utilizes data that is available to the general public. Some of the data is multi-state, regional data from the U.S. Department of Agriculture, as opposed to data specific to Wisconsin. Illinois, Iowa, and Missouri involve resources from their university systems to generate formula inputs that are specific to their states. In Illinois, gross income per acre is converted to net income per acre by subtracting non-land production costs, as computed by the University of Illinois' College of Agriculture. Every two years, Iowa State University publishes a productivity study that covers each county's actual crop yields, prices, and expenses, averaged over five years. In Missouri, land is categorized by "grade" and is assessed according to the productive

value certified for that grade, based on a university study. The use valuation formula could be modified to be based on data elements that are specific to Wisconsin.

9. The Wisconsin valuation formula is based entirely on farm income that can be earned by selling corn. The Wisconsin Agricultural Statistics Service reports that 3.4 million acres of Wisconsin farmland were used to grow corn in 2001. That represents only 27% of the 2001 agricultural acreage reported in Table 3. In addition, some of the corn produced in Wisconsin is used as feed for cattle and, therefore, is an input to production, rather than an output. In Illinois, gross farm income is based on five-year average prices for corn, soybeans, wheat, and oats and takes into account crop rotation practices. A valuation formula could be developed that reflects a wider array of the state's agricultural production.

10. Wisconsin's use value assessment statute reads, "agricultural land shall be assessed according to the income that could be generated from its rental for agricultural use." After determining that it would be costly to obtain standardized rental data, DOR instead adopted a valuation formula based on net production income. In Indiana, agricultural land is equally divided between land that is rented by farmers and land that is owned by farmers. In recognition of this pattern, Indiana's valuation formula employs two measures of net income. Net income is defined as the average of net operating income received from the sale of crops and net cash rental income, defined as gross cash rent for an acre of farmland, less property taxes. The current formula could be changed to reflect both types of farm income. However, developing a reliable sample of rental agreements would require additional resources.

11. DOR has indicated that it intends to revise the valuation formula so that negative values are not published as valuation guidelines for 2004. The Department has examined modifying the use value calculation formula by altering the measures of income, production, and the rate of return to management. One change would be to define gross income per acre to also incorporate other income sources, such as federal support payments from the U.S. Department of Agriculture. The Department could phase in these changes to prevent abrupt shifts in taxable values.

12. The Department believes that the modifications it intends to make can be made administratively. If the Committee decides that the Legislature should have a role in the revision, two options could be considered. One option would be to specify that any modifications to the valuation formula be approved through the administrative rule process. Another option would be to direct DOR to submit, by September 30, 2003, a report to the Joint Committee on Finance that indicates the modifications that the Department proposes to make to the formula. The modifications proposed by DOR in the report could be subject to the Committee's approval under a 14-day passive review process.

13. If the Committee wants the Department to consider the use value modifications described in Discussion Points 6, 8, 9, and/or 10, the Committee could direct the Department to specifically address them in the September 30 report described above. In doing so, DOR could be directed to provide information on the impact each would have on use values and to explain why the Department recommends either including or excluding each of them in its recommended

modifications. Since current law includes a reference to rental income, greater flexibility to incorporate alternate procedures could be achieved by amending the state statutes to read "agricultural land shall be assessed according to its use."

14. In addition to use value assessment, property tax relief is extended to owners of agricultural land through the farmland preservation program (GPR-funded) and the farmland tax relief credit program (SEG-funded). Relief under the farmland preservation program is provided as a credit reducing income tax liability or as a cash refund if the credit exceeds the income tax due. The credit formula is based on household income, the amount of property tax, and the type of land use provisions protecting the farmland. To be eligible for a credit, the farmland must be covered by a farmland preservation agreement or be located in an exclusive agricultural zone. Farmland preservation credits are paid from a sum sufficient appropriation, estimated at \$13.5 million in 2003-04 and \$13.9 million in 2004-05 under the Governor's budget. Farmland tax relief credits are extended through the state income tax system, although credit amounts are not affected by an individual's income. Credits are calculated by multiplying a credit reimbursement rate by the first \$10,000 in net property taxes on agricultural land. The maximum allowable credit is \$1,500. DOR sets the reimbursement rate each year at a rate that is intended to produce average expenditures of \$15,000,000 annually over the life of the program. These credits, which SB 44 budgets at \$15 million annually, are funded with lottery and gaming proceeds.

15. Use value assessment has been an effective mechanism for extending property tax relief to farmers. If the policy objective of use value is believed to be duplicative to the policy objectives of the two farm tax credit programs, either, or both, of those programs could be sunset. Farmland preservation credits are funded with general purpose revenues. If the Committee's goal is to generate GPR savings, then the farmland preservation program could be sunset effective after the 2002 property tax year. Due to contractual obligations to landowners who have entered farmland preservation agreements with the state, an estimated \$2.1 million in claims would continue to be paid annually. Consequently, the sunset would result in cost savings estimated at \$23.2 million GPR in 2003-05. Besides funding farmland tax relief credits, lottery and gaming proceeds are also used to fund the lottery and gaming credit for homeowners. If the Committee's goal is to lower residential property tax bills, then the farmland tax relief credit could be sunset effective after the 2002 property tax year. This would have the effect of increasing the sum sufficient appropriation for lottery and gaming credits by \$15 million annually and increasing the average tax credit for homeowners by about \$11 annually in 2003(04) and 2004(05).

ALTERNATIVES

1. Maintain current law (allow the Department of Revenue to modify the use value formula administratively).

2. Direct DOR to submit, by September 30, 2003, a report to the Joint Committee on Finance for approval under a 14-day passive review process that indicates the modifications that the Department recommends making to the use value formula. Direct the report to address one or more

of the following modifications to the use value formula: (a) defining farm income both in terms of the sale of crops and net cash rental income; (b) reflecting sales of crops comprising, in total, at least two-thirds of the acreage classified as agricultural land; (c) utilizing measures that are specific to Wisconsin, rather than measures that are regional in nature; and/or (d) basing the formula both on the income capitalization approach to valuation and on farmer-to-farmer land sales. Direct the Department to include a discussion of the valuation procedures that were considered, but not incorporated, into its recommended formula modifications, including information on the impact each would have on use values.

3. Specify that any modifications to the use value formula be approved through the administrative rule process before they take effect.

4. Modify current law provisions related to the assessed value of agricultural land by deleting the reference to rental income and, instead, specifying that agricultural land be assessed according to its use.

5. Sunset claims under the farmland preservation program, effective with claims related to taxes after the 2002 tax year. Allow landowners who have entered into farmland preservation agreements with the state to continue to receive credits as long as their agreements are in effect. Reduce costs related to the program by an estimated \$11,400,000 in 2003-04 and \$11,800,000 in 2004-05.

<u>Alternative 5</u>	<u>GPR</u>
2003-05 FUNDING (Change to Bill)	- \$23,200,000

6. Sunset claims under the farmland tax relief credit program, effective with claims related to taxes after the 2002 tax year. Reduce costs related to the program by an estimated \$15,000,000 SEG annually and increase the sum sufficient appropriation for the lottery and gaming credit by \$15,000,000 SEG annually.

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