



Legislative Fiscal Bureau

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Joint Committee on Finance

Paper #532

Aids in Lieu of Property Taxes (DNR -- Forestry and Parks)

[LFB 2005-07 Budget Summary: Page 364, #2]

CURRENT LAW

Since 1992, when DNR acquires land, the state pays aids in lieu of property taxes on the land to the city, village or town in which the land is located in an amount equal to the tax that would be due on the estimated value of the property at the time it was purchased (generally the purchase price), adjusted annually to reflect changes in the equalized valuation of all land, excluding improvements, in the taxation district. The municipality then pays each taxing jurisdiction (including the county and school district) a proportionate share of the payment, based on its levy.

GOVERNOR

Delete \$1,473,000 GPR in 2005-06 and \$302,000 GPR in 2006-07 for payment of aids in lieu of property taxes. Instead, provide an additional \$2,000,000 SEG annually for this purpose from the forestry account. Payments for aids in lieu of property taxes would be estimated at \$7.15 million in 2005-06 and \$8.32 million in 2006-07 (with \$4 million annually from forestry account SEG).

DISCUSSION POINTS

1. The 1999-01 biennial budget act (1999 Act 9) provided \$460 million in bonding for a 10-year reauthorization of the Warren Knowles-Gaylord Nelson stewardship program beginning in 2000-01 for the purpose of acquiring land to expand recreational opportunities and protect environmentally-sensitive areas. The annual bonding authority under the program was \$46 million, ending in fiscal year 2009-10. The 2001-03 biennial budget (2001 Act 16) increased the overall bonding authority to \$572 million and the annual bonding allocation from \$46 million to \$60

million beginning in 2002-03 (with \$45 million each year available for the land acquisition subprogram and \$15 million available for property development and local assistance subprogram).

2. The Department of Natural Resources has a variety of options with respect to land acquisition under the Stewardship 2000 program. It may purchase the land outright using funds allocated for that purpose. The Department may also purchase conservation easements on property, essentially buying certain rights from the landowner. These rights are typically purchased in perpetuity – the landowner may sell the property, but the conditions of the easement are attached to the deed. Easements can include (but are not limited to) public access rights for hunting and fishing, rights-of-way for trails, and development restrictions for ecologically valuable property. The DNR may also provide matching grants to non-profit conservation organizations (NCOs) or units of local government to acquire land. Any land acquired with the help of stewardship dollars may not be converted to uses inconsistent with uses approved by DNR. When DNR purchases land directly, the state becomes obligated under current law to make payments in lieu of property taxes to local taxing districts. With the purchase of an easement, the responsibility for payment of property taxes and most of the costs of maintaining the property remain with the landowner.

3. DNR provides aids to cities, villages, or towns in lieu of property taxes for DNR-owned land within each municipality. Aids in lieu of property taxes are paid on property the tax year after it is purchased, and payments vary depending on when land was purchased. The aid payment for land purchased prior to July 1, 1969, is 88¢ per acre. For land purchased after July 1, 1969 but prior to December 31, 1991, payments are based on the statewide average property tax rate for municipal, county, and school taxes for the tax year after purchase applied to the land's assessed value. For this category of land, each year after the initial year the payment is reduced by 10% of the first year amount until the greater of 10% or a payment of 50¢ per acre is reached in the tenth and subsequent years. Land purchased beginning in 1992 is subject to current regulations for the determination of aids in lieu of taxes payments.

4. As with other state-owned property, land purchased by the DNR is exempt from property taxes. However, DNR land purchases are generally subject to aids in-lieu of property taxes. Land acquired by the DNR beginning in 1992 is subject to a state payment made primarily from a sum-sufficient GPR appropriation. Those payments are calculated under a tax equivalency formula intended to compensate local governments for the taxes that would be paid on the property if it were taxable. Total payments are calculated by multiplying the property's estimated value by a mill rate. The estimated value is generally based on the property's purchase price. Each year, that value is adjusted, based on the percentage change in equalized value of unimproved real property in the municipality where the property is located, as determined by the Department of Revenue. The mill rate used in the calculation is the current tax rate for all purposes, net of state tax credits, that is applied in the municipality where the property is located. The municipality receiving the payment is required to share it with overlying local governments, such as the school district, county and technical college district.

5. The following table shows aids in lieu of property taxes payments made by the state to local units of government over the last nine fiscal years. Under the bill, aids in lieu of property tax

payments are estimated at \$7.15 million in 2005-06 and \$8.32 million in 2006-07.

TABLE 1

Aids in Lieu of Property Tax Payments

| <u>Fiscal Year</u> | <u>GPR</u> | <u>SEG</u> | <u>Total</u> |
|--------------------|-------------|-------------|--------------|
| 1996-97 | \$1,735,600 | | \$1,735,600 |
| 1997-98 | 1,873,000 | | 1,873,000 |
| 1998-99 | 2,374,200 | | 2,374,200 |
| 1999-00 | 2,537,900 | | 2,537,900 |
| 2000-01 | 3,393,500 | | 3,393,500 |
| 2001-02 | 3,906,100 | | 3,906,100 |
| 2002-03 | 4,755,400 | | 4,755,400 |
| 2003-04 | 4,349,000 | \$1,000,000 | 5,349,000 |
| 2004-05* | 4,312,000 | 2,000,000 | 6,312,000 |
| 2005-06* | 3,152,000 | 4,000,000 | 7,152,000 |
| 2006-07* | 4,323,000 | 4,000,000 | 8,323,000 |

*Estimated

6. Although this formula is intended to produce a state payment that is equivalent to what is paid in property taxes, in practice, state payments typically exceed the property taxes that would have been paid on the property because the purchase price of conservation land has routinely exceeded the property's assessed value. In October of 2000, the Legislative Audit Bureau (LAB) released an evaluation of the Warren Knowles-Gaylord Nelson Stewardship program. The report found that within a sample of 74 property acquisition grants, the average appraised value per acre of the property was more than double (120% greater) than the average assessed value per acre. When adjustments were made to make comparisons on a per-property rather than a per acre basis, the average difference increased to 305%. The Legislative Audit Bureau noted that the sample was specifically selected to include large grants. Since it was not a random sample, the result could not be projected to all grants. While these wide discrepancies in appraised and assessed valuations have raised questions by some about the fair market value of stewardship properties, the report also notes that infrequent updates in assessed values also raise questions about fairness in local property taxes.

7. When acquiring land with stewardship funds, DNR generally hires private real estate appraisers to determine the fair market value of prospective land purchases. A large disparity between assessed and appraised value may result from local assessors significantly undervaluing all property, not having updated assessments, or as a result of local land use policies. Assessors and appraisers generally determine the value of property based on the property's highest and best use, which is that use which will produce the greatest net return to the property owner over a reasonable period of time. Commonly-accepted definitions of highest and best use utilized by appraisers generally take into account four different factors when making the determination: physical possibility, (taking into account the size, terrain, soil composition and utility availability for the parcel that may limit the use of the land); legal permissibility, (including applicable zoning regulations, building codes, deed restrictions, historic district controls and environmental

regulations); financial feasibility, (meaning any use that produces a positive rate of return based on the characteristics of the property); and maximum productivity, (under which no other use of the land would provide a greater net return to the owner based on land costs, physical characteristics, legal constraints and the economic characteristics of the surrounding area).

8. For a particular piece of property, there may be some difference of opinion among those doing the property valuation relating to any of these factors. The physically possible uses of the parcel, for example, would be influenced by the proximity of a sewer line to the parcel. The legally permissible uses of a parcel of land could be affected by current zoning designations and a particular municipality's history of approving zoning changes that affect the ability of land in the municipality to be developed. In these cases, assessors and appraisers (and potential buyers) must make certain assumptions related to these factors to be able to determine a value for the property.

9. Providing less than the fair market value for land could be considered a taking without just compensation in violation of the Fifth and Fourteenth Amendment to the U.S. Constitution. Further, under Wisconsin Statutes s. 32.09(5)(b), any increase or decrease in the fair market value of a property caused by any public improvement for which property is acquired, or the likelihood that the property would be acquired for such an improvement, may not be taken into account in determining just compensation for the property.

10. Assessed value is the value placed on a property by the local unit of government for property tax purposes. Most assessors value property at some fraction of market value, despite a statutory requirement that property be assessed at full value. A series of court cases, dating back to the nineteenth century, has interpreted statutes to allow assessed values at a fraction of market value, provided the same fraction applies to all property in the taxation district. As a result, local assessors can assess property at a level below market value without violating the state constitution's requirement of uniform taxation.

11. Provisions of 2001 Act 16 required DNR to provide the appraisals of any property acquired under the stewardship program to the clerk and the assessor of the local unit of government where the property is located within 30 days of acquiring the property. In addition, assessors are directed to include the information in the appraisal (including comparable sales) when setting land values. This provision is intended to encourage local assessors to bring local assessed property values more in line with market value.

12. To the extent that the purchase price paid by DNR for land is based on appraised values and to the extent that appraised values exceed assessed values, the resulting aids in lieu payments made under state ownership of land may be greater than the property taxes that would be paid if the property remained under private ownership. Further, in some cases, lands purchased by the state were fully or partially exempted from property taxation before purchase (such as managed forest lands, railroad rights-of-way or properties owned by certain tax-exempt corporations). When the DNR property being purchased (a) is exempt from local property taxes (such as when owned by certain nonprofits or public utilities), (b) is subject to preferential tax treatment (such as under the managed forest law or agricultural use value), or (c) has a purchase price that exceeds the local

assessed value, transferring the property to DNR results in a net gain in revenues for the affected local governments.

13. The following table compares the estimated aids in lieu payment due on a range of properties acquired by DNR under the stewardship program to the amount paid in taxes for the year prior to the state acquiring the property. Selected examples are based on an August, 2001, expiration date of the state's option to purchase. In some cases, properties benefited from agricultural use value assessment, which would result in a lower than expected tax bill in the previous year. In cases where the property acquired was a fraction of a larger parcel, the tax attributed to the smaller parcel is estimated.

TABLE 2
Selected 2001 State Land Purchases

| <u>Property Category</u> | <u>County</u> | <u>Purchase Price</u> | <u>2000 Taxes</u> | <u>Aids in Lieu Estimation*</u> | <u>Change</u> |
|--|---------------|-----------------------|-------------------|---------------------------------|---------------|
| North Fish Creek Fishing Area | Bayfield | \$40,000 | \$130 | \$845 | 550% |
| South Shore Lake Superior Fish and Wildlife Area | Bayfield | 30,000 | 254 | 662 | 161 |
| Statewide Natural Area | Buffalo | 260,100 | 2,400 | 6,240 | 160 |
| Ludwig Woods Natural Area | Calumet | 43,000 | 68 | 832 | 1,124 |
| Statewide Natural Area | Calumet | 28,500 | 167 | 551 | 230 |
| Chippewa Moraine State Recreation Area | Chippewa | 26,000 | 418 | 463 | 11 |
| Tom Lawin Wildlife Area | Chippewa | 130,000 | 308 | 1,963 | 537 |
| Kickapoo Wildlife Area | Crawford | 345,000 | 1,675 | 7,887 | 371 |
| Rush Creek State Natural Area | Crawford | 57,000 | 869 | 1,320 | 52 |
| Statewide Natural Area | Crawford | 400,000 | 37** | 9500 | 25,576 |
| Ice Age Trail | Dane | 557,460 | 2,400 | 11,300 | 371 |
| North County Trail | Douglas | 28,000 | 65 | 415 | 539 |
| Statewide Natural Area | Green Lake | 64,500 | 806 | 1,195 | 48 |
| White River Wildlife Area | Green Lake | 18,000 | 109 | 325 | 198 |
| Governor Dodge State Park | Iowa | 335,000 | 3,375 | 8,499 | 152 |
| Streambank Protection | Iowa | 100,000 | 977 | 2,537 | 160 |
| Waterloo Wildlife Area | Jefferson | 30,400 | 96 | 582 | 506 |
| Newwood Wildlife Area | Lincoln | 198,000 | 237 | 3,683 | 1,454 |
| Statewide Spring Ponds | Marathon | 6,000 | 51 | 119 | 132 |
| Lower Chippewa State Natural Area | Pepin | 308,275 | 5,460 | 7,765 | 42 |
| Nine Mile Island State Natural Area | Pepin | 280,000 | 1,715 | 5,508 | 221 |
| Western Prairie Habitat Restoration Area | Polk | 288,000 | 1,400 | 5,011 | 258 |
| Dewey Marsh Wildlife Area | Portage | 26,700 | 360 | 473 | 31 |
| Paul Olson Wildlife Area | Portage | 135,200 | 964 | 2,373 | 146 |
| Willow Creek Fishing Area | Richland | 57,800 | 770 | 1,400 | 82 |
| Navarino Wildlife Area | Shawano | 11,710 | 216 | 228 | 6 |
| Onion River Streambank Protection | Sheboygan | 615,000 | 4,100 | 9,900 | 141 |
| Western Prairie Habitat Restoration Area | St. Croix | 374,500 | 3,075 | 5,917 | 92 |
| Kettle Moraine State Forest | Waukesha | 569,913 | 1,100 | 11,300 | 927 |
| Statewide Habitat Areas | Waupaca | 126,000 | 1,026 | 2,727 | 166 |
| Glacial Habitat Area | Winnebago | 252,000 | 1,286 | 5,133 | 299 |
| Rat River Wildlife Area | Winnebago | 56,700 | 310 | 987 | 218 |
| Total | | \$5,798,758 | \$36,224 | \$117,640 | 225% |

*Aids in lieu estimation is calculated using the purchase price multiplied by the effective tax rate of the taxing district for 2000.

**Property enrolled in forest crop law.

14. In most cases, the aids in lieu payment to municipalities greatly exceeds revenues previously generated by property taxes. The Department indicates that the current formula has led to a reduction in the number of local objections to state acquisition of land. However, it may be argued that the intent of the formula was to establish a fair level of compensation, rather than to create a financial incentive, for municipalities to cooperate with state land acquisition.

15. The current aids in lieu formula is calculated by multiplying the estimated value of the property (generally the purchase price) by the effective tax rate of the taxation district, and is adjusted annually to reflect changes in the equalized valuation of all land, excluding improvements, in the taxation district. It may be argued that if the goal is to compensate municipalities for lost tax revenue, that the formula should be modified to instead define the estimated value as the equalized value of the property in the year prior to purchase by the state or the purchase price, whichever is less. In cases where the property had previously been tax exempt, the last recorded equalized value could be used, or a payment of \$1 per acre would be made (such as in a case where a historical assessed value could not be determined), whichever amount was greater. The amount determined under this revised formula could then continue to be adjusted annually to reflect changes in the equalized valuation of all land, excluding improvements, in the taxation district. This formula would provide local governments with an amount approximating the lost level of tax revenue. Such a formula could more closely meet the state goal of protecting local governments from a loss in property tax revenues. However, even under this formula, in some cases (such as for previously tax-exempt land or when the property has been enrolled under the managed forest law program), payments in lieu of property taxes would increase over what the taxation district had been receiving previously. Although, in these cases other additional payments (such as a portion of the timber harvest revenue for MFL property) would be lost.

16. The fiscal effect of this formula change would depend on how much the equalized values for the area where DNR purchases land varies from the purchase price. As previously mentioned, the sample analyzed by LAB indicated that, on average, appraised values were two to four times higher than assessed values. For the 32 properties shown in Table 2, aids in lieu of property tax payments would more than triple the tax revenues previously received by local taxation districts. Neither the LAB sample nor Table 2 constitutes a random sample, so the results cannot be reliably generalized across all cases in order to precisely predict the level of savings that the state would experience. However, both the LAB and the selected sample would indicate that it would be reasonable to expect that GPR payments of aids in lieu of taxes would be reduced by between one-half and two-thirds for state land purchases.

17. Alternatively, it may be argued that current property tax relief programs (such as agricultural land under use value assessment) provide an incentive for land owners to engage in desirable land use practices. Adjusting the aids in lieu formula in this manner would maintain local revenues at the same level while potentially limiting the previously targeted benefit (the preservation of farm land). However, permanent preservation of the land as park or greenspace may be viewed by some as consistent with the goals of these other programs. Further, municipalities may argue that while the aids in lieu of taxes payment may provide more revenue than previously received, the payment could be much less than the potential revenues to the taxation district should

the property be sold to a party intent on capitalizing on its development potential. In addition, the payment would not increase above the average rate of growth for the taxation district, limiting its potential for greater revenue generation through future development.

18. On the other hand, it may be argued that the benefits of state ownership (such as increased public access, resource management, tourism, and recreation), may exceed the perceived cost. Recreational opportunities such as public hunting, fishing, snowmobiling, hiking, biking, and nature appreciation can increase tourism-related revenue to the region, and the modified aids in lieu of property tax payments would ensure that local governments do not experience a reduction in the support that they had been experiencing (and would see an increase in the case of certain tax-exempt properties). Further, local government infrastructure costs associated with developed property would be avoided. In addition, property values of land surrounding the protected greenspace may increase to the benefit of the local taxing districts.

19. It should be noted that as current costs associated with the payment of aids in lieu of taxes are due to previous land purchases, modifying the formula to determine payment levels would affect future land acquisitions and would not significantly affect expenditures in the 2005-07 biennium. Aids in lieu of taxes payments for properties purchased in the latter part of calendar year 2005 would be expected to reduce the 2006-07 state payment by approximately \$115,000 GPR. However, future GPR expenditures would be expected to be reduced substantially (by one-half to two-thirds) to generally reflect actual property tax levels of properties being purchased by the state.

20. Alternatively, to ensure that all units of local government receiving payments in lieu of property taxes for land acquired since 1992 are treated equally, the adjustment to the calculation of aids in lieu could be applied retroactively to all payments made for land acquired since January, 1992. This option would apply changes to existing payments, generating expected annual aids in lieu of property tax payments of not more than \$3,576,000 in 2005-06 and \$4,161,500 in 2006-07.

TABLE 3

Aids in Lieu of Property Tax Payments

| <u>Fiscal Year</u> | <u>Bill</u> | <u>Based on Equalized Value</u> | <u>Based on Equalized Value, Retroactive</u> |
|--------------------|-------------|-------------------------------------|--|
| 2005-06 | \$7,152,000 | \$7,152,000 | \$3,576,000 |
| 2006-07 | 8,323,000 | 8,208,000 | 4,161,500 |

Sources of Funding

21. Aids in lieu of property tax payments are primarily made from a sum sufficient, GPR appropriation. It may be argued that since the acquisition of land by the state is a benefit broadly shared by the state's citizens, the cost of reimbursing communities for the removal of the land from property tax rolls should be likewise shared. From this perspective, it could be argued that

GPR is an appropriate funding source.

22. Under the 2003-05 biennial budget, a portion of the aids in lieu of property tax payments (\$1 million in 2003-04 and \$2 million in 2004-05) were shifted from GPR to forestry account SEG. The forestry account of the conservation fund is largely funded (82% in fiscal year 2003-04) by revenues generated from the statewide forestry mill tax. This tax of 20¢ per \$1,000 of property value is collected with other property taxes; from the perspective that revenue to the forestry account is largely generated through a state-wide property tax, it may be reasonable to direct these funds to be used in place of GPR for aids in lieu of property tax payments for forestry-related land purchases. Under the bill, an additional \$2 million annually from the forestry account would be used for this purpose.

23. In a similar fashion, the forestry account currently supports a portion of the annual debt service payments related to land acquisition under the Warren Knowles-Gaylord Nelson Stewardship program. Under the bill, \$20 million in 2005-06 and \$19.5 million in 2006-07 and annually thereafter would be shifted from GPR to the forestry account of the conservation fund for the payment of principal and interest related to the acquisition and development of forest lands under the Warren Knowles-Gaylord Nelson Stewardship program. In addition, the prior four biennial budgets also appropriated conservation fund revenues for stewardship debt service.

24. Under the budget bill, the forestry account would have a balance of over \$400,000 at the end of the 2005-07 biennium. Traditionally, a balance of \$1.0 million is maintained in the forestry account as a contingency for forest fire emergencies. Further, it is argued that dry conditions across much of the state warrant maintaining a significant balance. It should be noted that the state has already experienced a large fire this season, when a forest fire swept through almost 4,000 acres of Adams County on May 5, 2005. However, the forestry program now maintains a forest fire emergency fund that currently contains \$1.0 million, therefore maintaining an additional balance of \$1.0 million for forest fire emergencies may not be as necessary.

25. The Department has supported the current formula for determining aids in lieu of property tax payments primarily because the increased payments have countered past negative perceptions of the impact of state-owned land on local tax bases. Department officials indicate that the improved public perception of the stewardship program has led to a reduction in the number of local objections to state acquisition of land. However, it may be argued that the intent of the formula was to establish a fair level of compensation, rather than to create a financial incentive, for municipalities to cooperate with state land acquisition. If DNR wishes to maintain the incentive benefit that it perceives itself to be receiving as a result of these payments, an adjustment could be made to the appropriations from which aids in lieu of property taxes are funded. Currently, the payments are made primarily from a GPR sum sufficient appropriation, and supplemented from a sum certain forestry account appropriation. A specific amount of forestry account SEG is made available on an annual basis, and any remaining payments required under the formula are made from GPR to ensure payments to local governments are fully funded. Instead, the GPR appropriation could be made sum certain and set at an established amount, providing a set annual portion of the aids in lieu of property tax payment, while the forestry SEG-supported appropriation

could be made sum sufficient. Under this option, changes in annual funding levels required under the formula would be supported by the forestry account, rather than by GPR. Under Alternative B1, GPR payments would be restricted to the budgeted level (rather than steadily rising to meet required payments) and forestry SEG payments would vary based on actual payment requirements (rather than being restricted to the budgeted amount currently).

ALTERNATIVES

A. Aids in Lieu Calculation

1. Adopt the Governor's recommendation to delete \$1,473,000 GPR in 2005-06 and \$302,000 GPR in 2006-07 for payment of aids in lieu of property taxes and instead provide an additional \$2,000,000 SEG annually for this purpose from the forestry account. Total payments for aids in lieu of property taxes are estimated to be \$7.15 million in 2005-06 and \$8.32 million in 2006-07 (with \$4 million annually being paid from forestry account SEG).

2. For lands purchased after the effective date of the budget act, adjust the current aids in lieu of property taxes formula by defining the estimated value of the property to mean the lower of the equalized value of the property in the year prior to purchase by the Department or the purchase price (instead of the purchase price, as currently provided in statute). In cases where the property had previously been tax exempt, the last recorded equalized value would be used, or a payment of \$1 per acre would be made, whichever amount was greater. The amount determined under this formula would continue to be adjusted annually to reflect changes in the equalized valuation of all land, excluding improvements, in the taxation district. (While savings of only \$115,000 would be realized in 2006-07, GPR payments for aids in lieu of property taxes would be expected to decline by more than one-half for future purchases.)

| <u>Alternative A2</u> | <u>GPR</u> |
|---|-------------|
| 2005-07 FUNDING (Change to Bill) | - \$115,000 |

3. Adopt Alternative 2, but specify that that this formula be applied to the calculation of aids in lieu of taxes payments for all lands purchased beginning January 1, 1992. In addition, delete \$3,152,000 GPR and \$424,000 forestry SEG in 2005-06 and \$4,161,500 GPR in 2006-07.

| <u>Alternative A3</u> | <u>GPR</u> | <u>SEG</u> | <u>TOTAL</u> |
|---|---------------|-------------|---------------|
| 2005-07 FUNDING (Change to Bill) | - \$7,313,500 | - \$424,000 | - \$7,737,500 |

4. Adopt Alternative 2, but specify that that this formula be applied to the calculation of aids in lieu of taxes payments for all lands purchased beginning January 1, 1992. In addition, delete \$3,576,000 SEG in 2005-06 and \$161,500 GPR and \$4,000,000 SEG from the forestry account of the conservation fund in 2006-07.

| <u>Alternative A4</u> | <u>GPR</u> | <u>SEG</u> | <u>TOTAL</u> |
|---|-------------|---------------|---------------|
| 2005-07 FUNDING (Change to Bill) | - \$161,500 | - \$7,576,000 | - \$7,737,500 |

B. Appropriation Structure for Aids in Lieu Payments

1. Change the current appropriation for aids in lieu of property taxes funded by the forestry account of the conservation fund [s. 20.370 (5)(dr)] from sum-certain to sum sufficient. Further, change the current sum sufficient GPR supported appropriation for aids in lieu of property tax payments [s.20.370 (5)(da)] to sum-certain. Specify that the first draw for payments related to aids in lieu of property taxes be taken from the GPR appropriation, with remaining payments made from the sum-sufficient SEG appropriation.

2. Take no action.

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