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Implementing Use Value Assessment-- A Simple Idea Becomes Complicated

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For years it has been argued that the practice of assessing and taxing agricultural land based on its value for development is fundamentally unfair, and is forcing farmers to sell their land for development. Many have viewed "use value assessment" as the logical and simple solution to this problem.

In 1974, the Wisconsin Constitution was amended to allow for preferential assessment of agricultural land. Nevertheless, for 21 years nothing further was done to implement the concept. With passage of Act 27 in 1995, it is clear that use value assessment of agricultural land will finally be put to the test. However, use value assessment will not actually go into effect until 1997, and even then it will take another 10 years to be fully achieved. In 1997, the gap between use value and market value of agricultural land will be narrowed by 10%; in 1998, it will be reduced by 20%, and in 1999 by 30%. Not until the tenth year (2006) will the assessed value of agricultural land equal use value.

This article discusses some of the issues and choices that confront state and local officials as they prepare to implement use value assessment, and why it has been necessary to implement it slowly and in phases, rather than all at once.

The Difficult Task of Reassessment

Before use value assessment can become a reality, new assessed values for agricultural land must be established. Act 27 requires that new assessed values of agricultural land be based on the *rent* agricultural land commands for agricultural use. The agricultural land value is then derived by dividing the agricultural land rent by the prevailing interest rate (capitalization rate) for farm loans.

No single value can be established for farmland statewide, because farm incomes and rents vary greatly, depending on the quality of the farmland, and what crops are planted. By definition, agricultural land values will also vary over time as the farm interest rate (the capitalization rate) rises and falls.

Act 27 directs the Department of Revenue (DOR) to provide assessment guidelines for local assessors, by estimating agricultural land rents for specific types of crops in different parts of the state, and by annually establishing an appropriate capitalization rate. DOR's update of the Wisconsin Property Assessment Manual, including per acre valuation guidelines for each municipality for different categories of agricultural uses, will be ready for use in the 1998 assessment year. However, final responsibility for reassessing agricultural land remains with local assessors. During the interim period while new assessed values for farmland are being established, assessments of agricultural land remain frozen (i.e. agricultural assessments in 1996 stay the same as in 1995).

Reassessing agricultural land will not be a simple task. *Improvements* such as farm houses and associated structures such as barns and silos do not qualify as *agricultural land*, and must therefore be assessed separately. Separating the value of these buildings from the value of the agricultural land will not be easy. Barns and silos, even those in good condition, are likely to have diminished value if no longer part of a farm. (Many farm structures are run-down and may actually have negative value.) Assessing farm houses will also be difficult. Residential property values are typically

determined by examining comparable sales figures. However, farm houses are rarely sold separate from their associated farm land. Thus local assessors will find few comparable sales figures to guide them.

Definitional Issues

Act 27 left unspecified a number of important details related to how use value assessments would be applied in practice-- leaving these matters to be clarified in an administrative rule. Normally the drafting of administrative rules is fairly straightforward. However, drafting and approving a final administrative rule for use value assessment has proven more difficult than originally anticipated. DOR staff prepared an initial draft of a proposed administrative rule, and submitted it for approval to the Joint Committee for the Review of Administrative Rules on November 30, 1995. However, after a contentious meeting, the Committee was unable to reach agreement regarding approval of a permanent administrative rule. Until a permanent administrative rule is approved, implementation of use value assessment is proceeding under an *interim* "emergency" rule. The final administrative rule that is ultimately approved may be very different-- so stay tuned!

Act 27 describes agricultural land as land that is "devoted primarily to agricultural use." However, to administer use value assessment in practice, a somewhat tighter definition is needed. The interim administrative rule initially drafted by DOR proposed that only land which was in agricultural use for three years prior to the date of assessment should qualify for use value assessment. This stipulation was not approved. Instead, the Committee decided that any land classified by local assessors as Agriculture (Class D) in 1995 was agricultural land and should qualify for use value assessment.

The problem with this approach is that classifications of "agricultural land" in the past were not always done with care, because they did not affect land valuations and were therefore of no consequence. Local assessors concentrated instead on establishing the "highest and best use" of land, and the value of the land for that use. Land was classified as "agricultural" only *after* the value of the land had been determined-- often without careful inspection of the land in question. Now,

under use value assessment, the classification of land becomes the most important step in determining value.

When the State Assembly adopted use value assessment, it intended that it would *only* apply to "agricultural land." Act 27 specifically states that "swamp land" and "forest land" are not "agricultural land." However, land currently classified by local assessors as "agricultural" may include swamp land and forest land. As a result, some land that isn't "agricultural" in the sense that the Assembly intended may qualify for use value assessment. It is also possible that some land which should rightly qualify may be excluded.

The main thing to note about the interim administrative rule is what it *doesn't* say. It says nothing about *who* owns the land, and does not require that the land be owned (or leased) by a farmer who derives his/her principal income from farming. Nor does the rule specify that a particular threshold of income be attained from farming. Finally, the definition says nothing about the *zoning* of the land, and whether it is zoned for agriculture. For example, under the current definition and administrative rule, agricultural land could qualify for use value assessment even if it were zoned for commercial development, and even if specific plans for its development had been submitted and approved by a local planning commission.

A second major definitional issue that remains to be resolved is whether a minimum parcel size should be required for land to qualify for use value assessment, and if so, what it should be. In the view of Ed Huck, Executive Director of the Wisconsin Alliance of Cities, defining agricultural land solely based on *use*, with no minimum parcel size, opens the door for people living in cities and villages with back-yard vegetable gardens to qualify for use value assessment. Specifying a threshold minimum parcel size has proven a thorny issue, however. The administrative rule initially submitted by DOR to the Joint Committee in November, 1995 proposed a minimum parcel size of 1 acre. However, members of the Committee were unwilling to accept the recommendation. Some felt that the minimum parcel size should be 10 or 20 acres; others favored 35 or 40 acres (the minimum parcel size for Farmland Preservation Tax Credits); others felt no minimum size should be required. Unable to reach a consensus, the

Committee decided that, during the interim period prior to adoption of a final administrative rule, the minimum size of agricultural land qualifying for use value assessment would be *whatever* county and local land use regulations and ordinances specify as the minimum size of an agricultural parcel. This means there is currently no uniform definition of the minimum size of agricultural land for use value assessment. In some counties it may be 5 acres; in others it may be 35 acres or 40 acres.

Tax Issues

One final issue that may prove troubling is the effect use value assessment will have on local tax collections and tax rates. When the state Farmland Preservation Tax Credit Program was enacted in 1977, additional state funding was appropriated to reimburse qualifying owners of farmland for a portion of the property taxes they paid to local governments. Approximately \$30 million is paid out each year by the state in the form of farmland preservation tax credits. Thus, the tax burden of farmers has been reduced, but there has been no reduction in the amount of tax revenue local governments have collected. However, no additional state money has been earmarked to compensate local governments for the loss of local tax revenue they will experience due the shift to use value assessment. In areas where the total valuation of property is significantly reduced by use value assessment, local tax rates will have to be increased if past and current levels of expenditure are to be maintained. In general, the size of the tax shift will be greatest in communities where the percentage share of total valuation of property comprised by agricultural land is greatest, and where there is a substantial difference between the value of agricultural land for development value and its value for agriculture.

The Wisconsin Department of Revenue conducted a study in 1995 which reveals how total net tax rates of local governments would have changed in 1993 if use value assessment had been in effect at that time. That study provides some indication of the possible future impact of use value assessment on local tax rates. The percent increase in net tax rate due to use value assessment in a majority of communities ranged between 1% and 3%. However, in 43 communities the tax rate increase was greater than 4%-- including 16 communities in Vernon County, 4 in both Kenosha and Sauk

Counties, 3 in both Dodge and Iowa County, and 2 in Columbia, Jackson, Monroe, Manitowoc and Calumet Counties. The increase in tax rates in agricultural communities would have been even greater, were it not for the progressive school aid formula used by the State of Wisconsin, which guarantees each community a minimum tax base per pupil for purposes of funding elementary and secondary education. The state school aid formula means that communities which are tax base poor receive a greater proportion of state funding for elementary and secondary education. Thus, communities whose tax bases are most adversely affected by use value assessment will receive increased school aid funding, which will help to reduce the net revenue loss they experience. (The "bad news" is that urban communities whose tax bases are less affected by use value assessment will receive proportionately less school aid.) The formula used to distribute state Shared Revenue to local governments also tends to give property tax base poor communities a greater proportion of available state aid.

The tax shift occasioned by use value assessment will be softened considerably by the fact that use value assessment will go into effect in the same year state school aid for education is substantially increased. As a result, marginal increases in local property tax rates due to use value assessment are likely to go unnoticed. The phasing in of use value assessment over ten years will also make the tax effects less obvious.

Concluding Comments

The Farmland Preservation Program, established in 1977, grants property tax credits to farmers whose land is zoned for "Exclusive Agriculture," or who sign Agricultural Preservation Agreements. When use value assessment goes into effect farmers will still be able to qualify for farmland preservation tax credits. The big difference is that use value assessment will be granted to agricultural land *even if it is not zoned for agriculture*, and without an indication or assurance that benefiting land is intended to remain in agricultural use. This represents a major departure from past policy-- made all the more significant by the fact that use value assessment will be of much greater financial benefit to many owners of agricultural land than farmland preservation tax credits.

Whether use value assessment will preserve agricultural land and family farms remains to be seen. In fact, a fairly large body of research in other states suggests that use value assessment has little or no impact in terms of farmland preservation unless it is combined with other land use and growth management policies.

An encouraging provision in Act 27 calls for the permanent appointment of a Farmland Advisory Council to "annually report to the legislature on the usefulness of use-value assessment as a way to preserve farmland and reduce conversion."

Citizens and legislators will want to pay attention to the findings contained in the Farmland Advisory Council's annual reports. As this paper has shown, shifting to use value assessment is a major undertaking, and has consequences not only for farmers but also for citizens and communities throughout the state.

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