OHIO LEGISLATIVE SERVICE COMMISSION

Bill Analysis

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Sub. S.B. 36*

132nd General Assembly
(As Reported by S. Ways and Means)

Sens. Hite, Obhof, Gardner, Beagle, Peterson, Coley, Hoagland, Hottinger, LaRose, Hackett, Williams, Brown

BILL SUMMARY

- Prescribes in statute certain additional factors that must be considered in computing the current agricultural use value (CAUV) of agricultural land for property tax purposes, and deletes reference to one existing factor.
- Prescribes in statute that the method used to compute CAUV values must employ a capitalization rate and prescribes certain factors that must be included or excluded in the calculation of that rate.
- Places a ceiling on the per-acre taxable value of CAUV land if the land is also used for conservation purposes by requiring the land to be valued as though it included soil of the least productive type.
- Applies CAUV formula changes to each county in the next tax year in which the county undergoes a reappraisal or triennial update, beginning with counties undergoing a reappraisal or update in tax year 2017.

CONTENT AND OPERATION

Overview

The bill changes some elements of the state's policy for valuing agricultural land for property tax purposes (known as current agricultural use valuation, or CAUV). Specifically, it prescribes one factor, and precludes the use of two other factors, in the

* This analysis was prepared before the report of the Senate Ways & Means Committee appeared in the Senate Journal. Note that the list of co-sponsors and the legislative history may be incomplete.

calculation of the capitalization rate that is used to determine CAUV values. The bill also effectively places a ceiling on the per-acre taxable value of CAUV land that is also used for conservation purposes, thereby reducing the taxable value of any such land not currently valued according to the lowest-valued soil type.

Current agricultural use valuation is a departure from the general rule governing how land and other real property must be valued for property tax purposes. Generally, real property must be valued according to its fair market value for property tax purposes.[1] An exception to this rule is authorized in the Ohio Constitution, permitting land devoted exclusively to agricultural use to be valued according to its CAUV rather than its fair market value for tax purposes.[2]

Current method of valuing CAUV land

Neither the Constitution nor current law prescribes the specific method for determining CAUV values. Instead, current law requires the Tax Commissioner to adopt a method by administrative rule that "reflect[s] standard and modern appraisal techniques that take into consideration: the productivity of the soil under normal management practices; the average price patterns of the crops and products produced to determine the income potential to be capitalized; the market value of the land for agricultural use; and other pertinent factors."[3] The method adopted by the Commissioner is published annually and the values for each soil type are set forth in CAUV "land tables," which apply to CAUV land in counties undergoing reappraisal or update that year and continue to apply in those counties for the following two years until the ensuing reappraisal or update year.

The administrative rules provide guidance and objectives for the valuation method, but the actual method is devised each year by the Tax Commissioner after consultation with an Agricultural Advisory Committee appointed by the Commissioner and composed of representatives of farm-related organizations and public agencies who are knowledgeable in the field.[4] The objective of the CAUV valuation method is to derive a taxable value for farmland based on the price a hypothetical purchaser would pay for farmland in Ohio when viewed strictly as an investment that generates income from farming. Other factors that might influence the potential purchase price – such as

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[1] Section 2, Article XII, Ohio Constitution.

[2] Section 36, Article II, Ohio Constitution; R.C. 5713.31.

[3] R.C. 5715.01(A).

[4] Ohio Admin. Code sec. 5703-25-32.

speculative possession of the land for commercial or residential development – are disregarded.

Generally, the valuation formula estimates the net income that can be derived from typical farmland, adjusted to account for the productivity (i.e., crop yield) of the various soil types as well as slope, drainage, and erosion. Factors contributing to estimated net income include crop prices, cost of inputs, crop patterns (corn, soybeans, or wheat), and crop yields. These quantities are drawn from actual market data and averaged over a period of time or geographically across the state to derive averages that are then applied to all CAUV land. The net income figure is capitalized to derive land value by dividing the figure by a capitalization rate that is supposed to reflect typical financing terms and land investor return requirements.

Because the formula is based largely on average or typical quantities, it does not account for every peculiarity that might influence the net income actually derived from a given farm or for the actual financing terms or return requirements of every landowner. Instead, the formula is intended to calculate the value of CAUV land based on typical or representative factors, except for adjustments for variations attributable to soil type, slope, and a few other land features.[5] For example, some farms might have higher or lower input costs, different crop rotations, or more or less favorable financing terms than the respective averages; however, the formula disregards these variations in order to approximate the value that a typical prospective landowner might place on a farm in a given part of the state.

Modification to general valuation method

The bill codifies the inclusion of some of the factors currently and traditionally used in the CAUV formula. It states that the valuation method must take into consideration "typical cropping and land use patterns" and "typical production costs," both of which are required by the current administrative rules but are not currently required by statute. The bill deletes the current statutory requirement that market value of land for agricultural purposes be taken into consideration, but doing so is not expressly prohibited. (In the administrative rules, it is the objective to be achieved by the valuation method.[6])

Capitalization rate

Current law does not expressly provide for the capitalization rate; it is incorporated into the CAUV method by administrative rule. The bill expressly requires

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[5] Ohio Admin. Code sections 5703-25-30(B)(11) and 5703-25-33(B) and (C).

[6] Ohio Admin. Code section 5703-25-31(C).

the Tax Commissioner to determine the CAUV capitalization rate using "standard and modern appraisal techniques" and to change the current determination in three specific ways explained below. The bill also expressly requires the capitalization rate (before considering taxes) to be added to a "tax additur," which reflects the statewide effective property tax rate on agricultural land.[7] (The current CAUV calculation includes such a tax additur.) The bill states that the sum of the pre-tax capitalization rate (without the appreciation and equity buildup) and the tax additur "shall represent as nearly as possible the rate of return a prudent investor would expect from an average or typical farm in [Ohio] considering only agricultural factors."

The computation of the capitalization rate employed in the current formula adopts a real estate valuation formulation known as the "Akerson mortgage-equity method," and is computed as follows (the 2016 inputs are in square brackets):

(Loan % [80%] × Annual payments as % of loan amount)

plus

(Equity % [20%] × Owner's required rate of return [5.25%]

minus

(Equity build-up over 5 years—i.e., Loan % × % of loan paid off × Sinking fund factor)

minus

(Land value appreciation over five years × Sinking fund factor)

plus

Effective tax rate as % of land market value (known as the "tax additur.")[8]

Under the CAUV calculation, taxable land value is computed by dividing net income by the capitalization rate. Accordingly, any factor that increases the capitalization rate reduces taxable land value, and vice versa. Since the bill's changes to the capitalization rate have the effect of increasing the capitalization rate from what the rate would be under the current formula, the changes will have a uniformly downward

[7] R.C. 5713.31 and 5715.01.

[8] "Explanation of the Calculation of Values for Various Soil Mapping Units for Tax Year 2016," Ohio Department of Taxation, June 2, 2016, available at http://www.tax.ohio.gov/Portals/0/personal_property/Explanation 2016.pdf.

effect on the taxable value of CAUV farmland. This effect would tend to reduce property tax revenue derived from unvoted levies ("inside millage"), shift some tax liability to all non-CAUV property (both real and utility tangible personal) to the extent of fixed-sum levies, and shift some tax liability from other levies to residential property and non-CAUV agricultural land through the operation of the "H.B. 920" tax reduction factor mechanism.

Equity yield rate

The bill statutorily prescribes the manner in which the landowner's required rate of return ("equity yield rate") is calculated. Under current CAUV methodology, the equity yield rate equals the seven-year average of the prime rate plus 2% from the Wall Street Journal's bank survey with the highest and lowest rates for those years disregarded, a method that rendered an equity yield rate of 5.25% for 2015. The bill instead specifies that the equity yield rate equals the 25-year average of the "total rate of return on farm equity" determined by the United States Department of Agriculture – a rate that would have equaled 7.9% if used for 2015 – but cannot exceed the loan interest rate used in the debt factor of the capitalization rate computation, which was 6.15% for 2015.[9]

Had this new method of calculating the equity yield rate been in effect for 2015, the equity yield rate would have increased, ultimately increasing the capitalization rate and decreasing the calculated taxable value of CAUV land for that year.

Equity build-up

The bill statutorily removes the equity build-up deduction from the current formula, which increases the capitalization rate and decreases the calculated taxable value of CAUV land.[10]

The equity build-up deduction is meant to account for the increasing equity a landowner gains as part of the loan principal is paid off over a given period of the loan term (assuming, as is typical, that part of the loan principal is being paid – i.e., amortized – with each loan installment). The rationale for the equity build-up factor is that, since the loan principal is partly repaid by the time the land is eventually sold, the part of principal that has been repaid by that time – the built-up equity – is a positive cash flow to the landowner realized at the time the landowner sells the land. (The CAUV capitalization rate formula assumes the land is to be sold five years after it is

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[9] The 7.9% rate was calculated from annual rates available from the USDA's Economic Research Service at https://data.ers.usda.gov/reports.aspx?ID=49641.

[10] R.C. 5715.01(A)(2).

purchased – i.e., a five-year holding period.) In other words, the loan repayments should not be treated entirely as a cost or a negative cash flow for the landowner because the principal repayments are recovered when the land is sold and the loan balance is paid off.

Land value appreciation

The bill statutorily removes the land value appreciation deduction from the CAUV formula. As with the equity build-up deduction, that removal effectively increases the capitalization rate and decreases the calculated taxable value of CAUV land.[11]

The land value appreciation deduction reflects changes in farm values in Ohio as measured by the U.S. Department of Agriculture. The administrative rules call for this measure to be adjusted to disregard the influence of speculation so that it indicates land value changes brought about by improvements in technology and farming practices.[12] The Department of Taxation's explanation of its function in the formula is "to address the increase in farmland values due to the demand for additional land in an increasingly efficient [farming] operation." Under the CAUV formula, the appreciation rate is set at 5% over the five-year holding period.[13]

Conservation land

One of the factors that influence a farm's CAUV is the soil type or types underlying the farm. There are about 3,500 soil types, each with an associated productivity, plotted according to a soil map of Ohio. A given farm's soil type is determined according to where the farm appears on that map. Each year, the Tax Commissioner determines the per-acre value associated with each soil type.[14]

The bill requires land devoted to conservation practices or enrolled in a federal land retirement or conservation program on the first day of a tax year to be valued as though the land's soil type is the lowest valued of all soil types according the Tax Commissioner's annual determination. For the purposes of the formula, such land

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[11] R.C. 5715.01(A)(2).

[12] Ohio Admin. Code section 5703-25-33(M).

[13] "Explanation of the Calculation of Values for Various Soil Mapping Units for Tax Year2016," Ohio Department of Taxation, June 2, 2016, available at http://www.tax.ohio.gov/Portals/0/personal_property/Explanation2016.pdf.

[14] Several recent CAUV soil value tables are available on the Ohio Department of Taxation's website at http://www.tax.ohio.gov/real_property/cauv.aspx.

would be considered to consist of that soil type even if the soil map indicated otherwise.[15] This change effectively reduces the CAUV of such lands that overlie any soil type other than the soil type or types with the least associated value for the year. If a county auditor discovers that such land has ceased to be used for those purposes, the bill requires the county auditor to levy a charge on the land equal to the extra tax savings for the most recent three years that the land was valued at the lowest-valued soil type.[16]

Under continuing law, farmland in a federal land retirement or conservation program is eligible for CAUV. Land used for conservation practices is eligible for CAUV if such land comprises 25% or less of the landowner's total CAUV land. Conservation practices are farm management practices to abate soil erosion, including the installation, construction, development, planting, or use of grass waterways, terraces, diversions, filter strips, field borders, windbreaks, riparian buffers, wetlands, and ponds.[17] The use of cover crops is also considered a conservation practice that qualifies land for CAUV (if such land comprises 25% of less of the landowner's total CAUV land); however, the bill specifies that such practice does not qualify for the land to be automatically valued at the lowest soil type.

Publication of capitalization rate

The bill explicitly requires the Tax Commissioner to annually publish the capitalization rate and tax additur and the individual components used in computing those amounts at the same time the Commissioner publishes the values for each soil type.[18] Under current practice, the Commissioner publishes this information annually in the explanation accompanying the land tables.[19]

Application of CAUV formula changes

The bill requires the changes to the CAUV formula to be applied in each county in the next tax year in which the county undergoes a reassessment or triennial update, beginning with counties that undergo a reassessment or update in tax year 2017.[20]

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[15] R.C. 5713.31.

[16] R.C. 5713.34.

[17] R.C. 5713.30, not in the bill.

[18] R.C. 5715.01(A)(2).

[19] Ohio Department of Taxation, "Current Agricultural Use Value (CAUV)," http://www.tax.ohio.gov/real_property/cauv.aspx.

[20] Section 3.

HISTORY

ACTION	DATE
Introduced	02-07-17
Reported, S. Ways & Means	---

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