



OHIO LEGISLATIVE SERVICE COMMISSION

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Fiscal Note & Local Impact Statement

Bill: S.B. 36 of the 132nd G.A.

Status: As Passed by the Senate

Sponsor: Sen. Hite

Local Impact Statement Procedure Required: Yes

Subject: Changes property tax law governing current agricultural use valuation

State Fiscal Highlights

- Lower taxes on land in the current agricultural use valuation (CAUV) program would be partly offset by higher tax rates, possibly increasing GRF reimbursements for real property rollbacks and the homestead exemption up to \$2 million per year.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 2018	FY 2019	FUTURE YEARS
School Districts			
Revenues	Possible losses up to \$13 million or more	Possible losses up to \$17 million or more	Possible losses up to \$21 million or more/year
Other Local Governments			
Revenues	Possible losses up to \$13 million or more	Possible losses up to \$17 million or more	Possible losses up to \$21 million or more/year

Note: For most local governments, the fiscal year is the calendar year. The school district fiscal year is July 1 through June 30.

- Lower tax values on land enrolled in CAUV would cause annual net losses estimated at up to \$20 million for schools and up to \$20 million for other units of local government.
- Lower values due to reductions for conservation land would cause annual net losses estimated at \$1 million or more for each of schools and other local governments.
- Revenue losses would phase in with sexennial reappraisals and triennial updates, starting in 2017. About 60% of the value of land in the CAUV program is scheduled for revaluation in that year, 20% in 2018, and 20% in 2019.
- For property taxes subject to tax reduction factors, revenue losses would be partly offset by higher effective tax rates, which can rise no higher than voted (gross) rates.
- For property taxes intended to raise fixed sums of money, revenue losses would be offset by higher tax rates on farmers and homeowners, and also on Class II and public utility property subject to those levies.
- Revenue estimates shown in the table above are subject to considerable uncertainty.

Detailed Fiscal Analysis

The bill requires that CAUV calculations exclude appreciation and equity buildup in figuring the capitalization rate used, specifies how the equity yield rate in the calculation is to be determined, and specifies that land "used for a conservation practice or devoted to a land retirement or conservation program under an agreement with an agency of the federal government" be valued at the lowest per-acre amount in the list of values for various soil types published annually by the Department of Taxation.

Summary of findings

The language in the bill regarding the capitalization rate appears sufficiently flexible that its effects would depend on how it is implemented in the CAUV formula. In the first approach, the appreciation and equity buildup terms in the current formula are zeroed out. The alternate case builds on the first case, but changes the term in the formula representing the payment amount on debt so that it is consistent with zero equity buildup.

The two approaches are evaluated using the Department of Taxation's 2016 capitalization rate calculation as the starting point, applied to 2016 data on taxable values.¹ The numbers are necessarily rough, based in part on statewide averages rather than detailed analysis built up from the individual levy or taxing unit level. For the first approach, the net revenue loss to school districts and other units of local government totals \$41 million and the increase in taxes owed by residential property owners is \$86 million. With the alternate case, the net revenue loss to schools and other local governments is \$23 million and the increase in taxes owed by residential property owners is \$48 million.

A requirement in the bill that land used for a conservation practice or enrolled in a federal conservation program, as well as the CAUV program, excluding land planted in cover crops, be assigned a low per-acre value may have a large or small effect, depending on current per-acre valuation of such land and on the number of such acres. This provision may cost schools and other units of local government statewide a total of \$2 million per year, or possibly more, but the estimate is very rough.

The bill's reductions to taxable property values are expected to affect the amount of state foundation aid to schools mostly in FY 2020 and thereafter. Joint vocational school districts, under a different formula, may receive more state aid because of the lower taxable values caused by the bill.

Capitalization rate

The capitalization rate is used to calculate value per acre for more than 3,500 soil characteristics, for both cropland and woodland, a total of more than 7,000 values. The

¹ For public utility tangible personal property (PUTPP) and for CAUV property, 2016 values have not yet been published, and 2015 values are used in the analysis.

calculation involves dividing representative net dollar yields per acre per year by the capitalization rate. Resulting per-acre values are multiplied by acreage in parcels enrolled in the CAUV program, in figuring valuation. Taxable value is 35% of this CAUV valuation. The per-acre values are subject to minimums, consequently, changes in the capitalization rate do not, for all soil types, change those values. So the percentage valuation change due to a capitalization rate change would be less than or equal to that indicated by considering only the change in the capitalization rate.

How much less is indicated, at least roughly, by the following figures on the 2015 CAUV program. The statewide average per-acre value of land in the program was \$2,041 (or taxable value of \$714 at the 35% assessment rate), and about 57% of soil types were valued above minimums of \$230 per acre for woodland and \$350 per acre for cropland. Percent of soil types is not the same as percent of land enrolled in the program, but plausibly a substantial portion of the potential reduction would be realized.

The Department of Taxation figures the capitalization rate using an approach called the Akerson formula. If the term in the Akerson formula for appreciation in the value of the farmland is assumed to be zero, rather than 5% over five years as in the Department's calculations, and the buildup of equity term in the formula is set at zero, capitalization rates are increased. The bill in addition requires that the equity yield rate in the calculation be equal to the 25-year average of the total rates of return on farm equity as figured by the U.S. Department of Agriculture's Economic Research Service (ERS). However, if this average falls below the interest rate used for the debt portion of the calculation, then the debt rate is to be used also for the equity part of the calculation.

The 25-year average of annual total rates of return on farm equity through 2015, reported by ERS, is 7.7%.² If this average is used in the capitalization rate calculation as the equity yield rate, and the terms for land value appreciation and equity buildup are set to zero, then the implied capitalization rate is 9.3%. Increasing the capitalization rate from 6.3%, the 2016 rate, to 9.3% would reduce the valuation placed on the land for tax purposes by as much as 32%, with the actual reduction likely to be less than this, as noted above, because valuations for some soil types would remain unchanged at the minimum values.

An alternative interpretation of the wording in the bill is that, in not including assumed buildup of equity, in keeping with "standard and modern appraisal techniques" as required by the bill, the loan assumed in the valuation model might be presumed to be an interest only loan. The buildup of equity term in the current CAUV formula represents the effect on the capitalization rate of reduction in the amount of the loan that remains due after five years, as a result of payments larger than interest due with the excess applied to principal. No equity buildup would be consistent with payments equal to the amount of interest due. The current capitalization rate formula

² Data are from <http://data.ers.usda.gov/reports.aspx?ID=17838>.

calculates value as if the farmland investor bought the land by investing borrowed funds as well as equity money, realized net revenues (or incurred net costs) for five years, then evaluated the land's value if it was sold and the remaining loan paid off. Owing less at the end of the five years would leave more equity money for the farmland investor, hence would make the land more valuable. Subtracting the equity buildup term reduces the capitalization rate, which implies a higher valuation.

An interest only loan would likely carry a higher interest rate than a loan fully amortized (paid down) over the course of its life, but the calculation here is based instead on an assumption that the interest rate on the debt remains the same as that used in the calculation for an amortized loan. The property value appreciation and equity buildup terms are again set to zero. The effect on the capitalization rate would be an increase to 7.7%. The corresponding effect on land values in the CAUV program would be a reduction of 18%. The actual reduction would likely be less, as noted above.

Effects of capitalization rate changes on school districts and residential property owners

Land valued using the CAUV method in 2015, the latest year published, had taxable value of \$11.5 billion. Reductions in land values of 32% and 18% would reduce taxable values by \$3.7 billion and \$2.1 billion respectively.³

For levies subject to tax reduction factors, on carryover property, the decline in agricultural land values from CAUV formula changes would be offset by higher effective tax rates, but these would be set to raise the same amount of tax revenue from these levies including both residential and agricultural carryover real property in each taxing district, hence farmers generally would gain and residential property owners would lose.⁴ The relative impact would vary enormously depending on the mix of agricultural and residential real property in each taxing district. Class I real property (including agricultural and residential property) in taxing districts around the state ranges from 100% residential to 100% agricultural. Statewide, about 90% of Class I real property taxable value is residential and 10% is agricultural, implying that on average most of the gains to farmers from the lower taxable property values would not be offset

³ All numbers that follow are rounded to no greater precision than the nearest million dollars, reflecting the considerable uncertainties in deriving these numbers.

⁴ Carryover property is real property taxed in the same class of property in both the current year and the preceding year. Some levies are not subject to this adjustment, including unvoted taxes within 1% (10 mills) of taxable value (inside millage), and levies to raise fixed sums of money (bond and emergency levies). Also, tax reduction factors cannot cause a school district's effective current expense millage rate (including inside and outside millage) to fall below 20 mills, or a joint vocational school district's effective current expense millage rate to fall below 2 mills. The 20-mill floor, or the 2-mill floor for JVSDs, does not limit upward adjustments of effective rates if real property valuations fall. The statement that the same amount of revenue would be raised is subject to a limitation however. The effective rate on a levy cannot adjust upward to more than the voted millage rate. Consequently, less tax revenue will be raised from any levies constrained by this ceiling.

by higher effective tax rates, and most of the higher taxes from the effective tax rate increases would be paid by persons not participating in the CAUV program, mostly residential property owners.

Rates on levies designed to raise fixed amounts of money (fixed-sum levies) would need to be adjusted, with CAUV program participants generally gaining from their lower taxable values and other taxpayers losing from the higher rates needed to keep total revenues unchanged. These other taxpayers would include Class II real property owners (real property other than residential and agricultural) and owners of public utility tangible personal property.

For levies not subject to tax reduction factors and not fixed-sum levies, CAUV program participants would gain from their lower taxable values. Residential property owners and owners of agricultural real property not in the CAUV program would be unaffected by the CAUV changes, for these levies.

The valuation reductions of 32% and 18% assumed above, and resulting taxable value reductions of \$3.7 billion and \$2.1 billion, imply potential tax revenue reductions estimated at \$173 million and \$98 million, respectively. These revenue reductions are before account is taken of increases in effective tax rates for levies on carryover property and subject to tax reduction factors, and of rate increases for fixed-sum levies.

These changes are analyzed in what follows using average 2016 tax rates applied to tax year 2016 property taxable values.⁵ Results are summarized in Table 1. The effects are estimated at the individual school district level but the analysis does not drill down to the political subdivision or taxing district level for other units of local government, or to the individual levy level, so is at best only an approximation to outcomes that might be expected from the assumed valuation changes. These estimates are based on the simplifying assumption that reductions in the value of agricultural land resulting from the CAUV changes would be uniform across the state, which would not be the actual outcome if the bill becomes law.

A \$173 million reduction in taxes on agricultural land, from a \$3.7 billion decline in taxable value, would give rise to increases in taxes from levies subject to tax reduction factors estimated at \$110 million and to offsetting increases in revenues from fixed-sum levies on Class I real property estimated at \$18 million. An additional estimated \$4 million for fixed-sum levies would be owed by owners of Class II real property and public utility tangible personal property, mostly to schools. The net tax revenue loss to school districts statewide would be an estimated \$20 million, consisting of \$24 million on Class I real property partly offset by added fixed-sum taxes on Class II real property and public utility tangible personal property. The increase in taxes due on residential real property would be an estimated \$101 million, of which property owners would pay about \$86 million with higher state reimbursements for the 10% and 2.5%

⁵ For PUTPP, values are for 2015 as noted above.

rollbacks and homestead exemption accounting for the rest.⁶ The net impact on the state would be an estimated net increase of \$2 million in reimbursements for the rollbacks and homestead exemption, consisting of a \$14 million reduction on agricultural real property and a \$15 million increase on residential real property,⁷ and higher foundation aid payments. These fiscal effects are summarized in Table 1 below.

Estimates for the analogous fiscal effects if the reduction in taxes on agricultural land is assumed to be \$98 million, from a \$2.1 billion decline in taxable value, are shown in Table 1 alongside those for the first set of estimates described above. Future valuation changes would, in general, differ from those shown here, and would reflect prices, costs, crop yields, and interest rates in future years, as part of the ongoing CAUV calculation process.

Table 1. Estimated Effects on Tax Revenues and Payments of S.B. 36		
	32% or \$3.7 Billion Reduction in Taxable Value	18% or \$2.1 Billion Reduction in Taxable Value
	Millions of Dollars	
Decrease in property taxes paid		
Gross, CAUV program participants (before tax reduction factors & fixed-sum levy adjustment)	\$173	\$98
Net, agricultural real property (after tax reduction factors & fixed-sum levy adjustment)	\$147	\$82
Net, agricultural real property, after 10% rollback	\$133	\$74
Increase in property taxes paid		
Residential owners (before rollbacks & homestead exemption)	\$101	\$57
Residential owners (after rollbacks & homestead exemption)	\$86	\$48
Class II and public utility	\$4	\$2
Decrease in property tax receipts		
Schools	\$20	\$11
Other local governments	\$20	\$11
Increase in GRF payments	\$2	\$1

Effects of provision affecting taxation of land in federal conservation programs

The bill provides that "land . . . used for a conservation practice or devoted to a land retirement or conservation program under an agreement with an agency of the federal government" is to be assigned the lowest of the per-acre values determined as part of the CAUV program.⁸ Land planted in cover crops is excluded. In order to

⁶ The 10% rollback is now effectively a 9.3% rollback because new or replacement levies approved at elections in November 2013 or since are not eligible for the reduction or for state reimbursement.

⁷ The numbers do not sum to the total because of rounding.

⁸ R.C. 5713.31 as proposed to be amended by the bill.

quantify the effect of this provision, LSC would need to know or estimate the values or average value assigned to such land currently, as well as the acreage enrolled in these programs. For land qualifying to be valued at the lowest per-acre value, but already at low per-acre values under the CAUV program, this provision would have little effect. Taxable value and taxes on qualifying land currently at high per-acre values would decline substantially. The statewide effect would depend on the mix of enrolled acreage currently assigned low and high values.

The wording of the requirement in the bill is a further source of uncertainty. Is all land enrolled in the CAUV program and "used for a conservation practice" to be assigned the lowest per-acre value? Or must this land also be "under an agreement with an agency of the federal government" for the requirement to apply? In other words, does the phrase "under an agreement with an agency of the federal government" apply both to "used for a conservation practice" and "devoted to a land retirement or conservation program" or only to the second of these uses? Limiting the requirement to land under an agreement with a federal agency would be less costly than applying it to all land used for a conservation practice.

A contact with the U.S. Department of Agriculture noted a couple of federal programs within that Department's Natural Resources Conservation Service (NRCS) that appear to meet the definition in the bill. The programs take land out of production or create easements that limit development.

The Conservation Reserve Program (CRP) lets land be taken out of production and planted in grass or trees. The owner of the land receives an annual payment based on the soil type. CRP contracts can be for as long as 15 years. A landowner may withdraw from a CRP contract on payment of a penalty. Choices for enrollment include whole field sign-up and enrollment of waterways and buffer strips.

Other NRCS programs are under the Agricultural Conservation Easement Program (ACEP). These include the Wetland Reserve Easement program under which the United States holds either a permanent or a 30-year easement on lands restored to wetlands. Also part of ACEP is the Agricultural Land Easement program, which provides for private trusts to hold permanent easements on working lands. The NRCS can fund as much as 50% of the easement's purchase cost.

Additional NRCS programs were repealed by the Agricultural Act of 2014, with the land previously in these programs now considered enrolled or held under ACEP. These include the Wetland Reserve Program, under which the United States held a permanent or 30-year easement on land restored to wetlands; the Farm and Ranch Land Protection Program, with private land trusts holding permanent easements on working lands; and the Grassland Reserve Program, with grasslands held under easement to be used as grazing land.

Data downloaded from the Department of Agriculture's website indicate that 263,371 acres of land in Ohio were enrolled in CRP as of the end of September 2016. This acreage is 1.6% of the approximately 16.1 million acres that were in the CAUV

program in calendar year 2015. Enrolled acreage varies from year to year. Some of the Ohio acreage in CRP may not have been enrolled in the CAUV program.

Data on easements from the National Conservation Easement Database, accessed on May 11, 2017, show 31,563 acres held in easements in Ohio with the federal government listed as the holder.⁹ The National Conservation Easement Database is a partnership of federal agencies and private conservation organizations and foundations, formed for sharing and managing information about conservation easements. LSC is unable to vouch for the completeness or accuracy of the information. Of the Ohio acreage held in conservation easements by the federal government, most (95%) is listed as held by NRCS. Other federal holders include the National Park Service and the Fish and Wildlife Service. The total Ohio acreage held in conservation easements for which the federal government was the holder is 0.2% of total CAUV acres in 2015.

These figures indicate approximately 295,000 acres that appear to qualify to be valued at the lowest CAUV per-acre valuation. Other acreage may also qualify, under other federal programs or because it is used for a conservation practice. If, at the extreme, all 295,000 acres were valued at the highest 2016 value, \$4,750 per acre for cropland, and would instead be valued at the lowest 2016 value, \$230 per acre for woodland, the reduction in taxes would total about \$22 million at the 2016 statewide average effective tax rate on agricultural property of 46.67 mills. Alternatively, if the acreage was valued at the statewide average value for land in the CAUV program in 2015, \$2,041 per acre, and would instead be valued at \$230 per acre, the reduction in taxes would be about \$9 million. Additional qualifying acreage would imply additional tax revenue losses.

As with valuation reductions resulting from changes in the CAUV capitalization formula, the loss of tax revenue to school districts and other units of local government from lower valuations for land in qualifying conservation practices would be partly offset by increased taxes on residential property owners and others, and likely also by a small increase in state payments from the GRF for rollbacks and the homestead exemption. On the assumption that the reduction in valuation for these acres is, on average, from the statewide average valuation for CAUV land, the net loss of tax revenue for schools statewide might be about \$1 million, and the loss for other units of local government might be similar, but these figures are very rough, given the uncertainties.

Timing

The bill specifies that these changes apply to counties in the first year that a sexennial appraisal or triennial update is performed for each county, beginning in tax year 2017. Approximately 60% of the value of land enrolled in the CAUV program is in

⁹ The Internet address from which this information was obtained is <http://conservationeasement.us/reports/easements>.

counties scheduled for reappraisal or update in TY 2017. The rest is about evenly divided between counties to undergo revaluation in 2018 and 2019.

Real property tax changes in TY 2017 will generally be reflected in payments by taxpayers in the first half of calendar year 2018, in FY 2018 both for schools and for other units of local government. State reimbursements for the property tax rollbacks and homestead exemption lag the due dates for payments by taxpayers, resulting in half of a change in TY 2017 affecting reimbursements in state FY 2018 and half in FY 2019. The effect of changes in TY 2018 and TY 2019 would be similarly lagged.

General effects on state foundation aid for school districts

In general, the bill's reductions to taxable property values will affect the amount of state foundation aid a school district receives. However, it is likely that the state foundation formula will primarily use three-year average property value for TYs 2014, 2015, and 2016 in determining state foundation aid for FYs 2018 and 2019. Thus, it appears that the bill will not begin affecting the state foundation formula in earnest until FY 2020. Because the formula uses three-year averages of valuation, the effect of the reductions will be phased in over time. While the details of the state foundation formula in future years and valuation changes in individual school districts are uncertain, some general observations may be made based on the current formula. In the aggregate, the bill's valuation reductions may direct additional state foundation funds toward rural and some small town school districts while urban and suburban districts may lose funding. Nevertheless, any guarantee and funding limitation provisions in the formula may limit large swings in district funding that may otherwise occur. Additional details are provided below.

The current state foundation formula for traditional districts uses the state share index to account for a district's capacity to raise local revenue when distributing state funds through the Opportunity Grant, the largest portion of state foundation aid, and a number of other formula components. Under the state share index, the relative wealth of a district is determined primarily by comparing a district's property value per pupil with the statewide average property value per pupil. Districts with property value per pupil less than the statewide average tend to have larger state share index values and vice versa. As a result, whether a district's state share index, and associated formula funding, increases or decreases when property values fall depends on whether the district's percentage decrease in property value per pupil is greater or smaller than the percentage decrease in statewide value per pupil. If it is greater, then the district looks relatively less wealthy and its state share index increases. If it is smaller, then the district looks relatively wealthier and its state share index decreases.

Assuming the state foundation formula in FY 2020 and beyond is similar to the current formula, rural and some small town districts would tend to look less wealthy and, therefore, have somewhat higher state share index values due to the bill. Thus, state foundation aid may increase for such districts. Conversely, the state share index may decrease for suburban and urban districts. This is because the statewide three-year

average valuation per pupil decreases with the reduction in property value. This makes school districts with relatively little or no agricultural property, whose property value per pupil would not change significantly, look somewhat wealthier and, in turn, result in somewhat smaller state share index values and potentially less foundation aid.

The bill may also affect the base tier of Targeted Assistance and Capacity Aid, foundation formula components that direct additional funding to districts with lower capacities to raise local revenue and target funding to smaller districts with relatively low total property valuation, respectively. Decreases in valuation under the bill may change the ranking of districts used to calculate certain threshold amounts. Rural and some small town districts may benefit from the reduction in property values due to the bill. Suburban and urban districts may be negatively impacted since valuation in those types of districts may not change significantly but the reduced thresholds mean less funding is needed for equalization. In addition, the current formula includes a supplemental tier of Targeted Assistance for districts with high percentages of agricultural real property. This funding is meant to assist districts that have experienced substantial increases in agricultural valuation in recent years that might otherwise face stagnant state foundation aid. Since the bill's changes counteract the recent growth in such property values, the percentage of agricultural real property may decrease in many districts. This may lead to a reduction in funding through this tier.

The formula for joint vocational school districts (JVSDs) is somewhat different in that it does not use a state share index mechanism like the formula for traditional districts. Instead, it relies on a uniform local charge-off rate to determine the state share of a district's formula costs. JVSDs also do not receive Targeted Assistance or Capacity Aid. As a result, JVSDs may receive an increase in foundation aid due to the bill's taxable value decreases.