

## M I N U T E S

## SPECIAL COMMITTEE ON USE VALUE APPRAISAL

November 7-8, 1977Room 527 - State HouseMonday, November 7

The meeting was called to order by Chairperson Powell shortly after 10:00 a.m., with all members except Senator Mulich present. Staff present: Bill Edds, Arden Ensley, Roy Johnson, Richard Ryan, and Robert Taylor. Consultants: Raymond Vaughn, Wayne Hundley, and Bob Walters, Division of Property Valuation; Dr. Barry Flinchbaugh and Mark Edelman, K.S.U.; and Dale Dennis, State Department of Education.

Staff called attention to three clerical type errors in the minutes of the October meeting which should be corrected. Also, it was moved by Representative Jarchow and seconded by Senator Simpson that information reported by Representative Jarchow relating to Williams Brothers Pipeline Company be added at the bottom of page 3 of the minutes. Motion carried.

It was moved by Representative Wilkin and seconded by Representative Hineman that the minutes, as corrected, be approved. Motion carried.

Cloud County Study

Mark Edelman presented and explained two additional tables that will be included in the Cloud County Study. One showed a comparison of assessment/sales ratios (30 sales) and assessment/appraisal ratios (51 appraisals) for agricultural investment properties. Conclusions reported were that: (1) the medians were not significantly different (8 and 6.8, respectively); (2) the assessment/sales ratio averages tend to be higher than the median (medians eliminate the effect of extremes) while there was no significant difference between the average and the median in the assessment/appraisal ratio; and (3) the coefficients of deviation are significantly greater for an assessment/sales ratio than for an assessment/appraisal ratio.

The other table compared assessment/use value ratios and net returns per acre as determined under the procedure set out in the bill draft and as estimated using commercial appraisal assumptions. Conclusions reported were that: (1) the median assessment/appraisal ratio was not significantly different from the 30 percent assessment rate, with the two approaches yielding similar use value levels; and (2) net returns were more dispersed under the commercial appraisal, with extremes in net returns under-estimated using the bill's procedure.

Dr. Flinchbaugh summed these tables up as showing that as to assessment/sales ratios the median is satisfactory but the variations are great. Assessment/market and appraisal/market ratios are very similar.

County Impact Study

Dr. Flinchbaugh explained a series of eight additional tables relating to potential shifts in the county tax base under assumptions of (1) adjusting valuations of all locally assessed real estate to 30 percent of sale price; (2) reappraising agricultural lands at use value (9.25 percent cap rate) and all other locally assessed at market value; and (3) reappraising ag land only (9.25 percent cap rate). Following are some of his summary comments.

Table 8 - Irrigated Land. Under any of the assumptions, irrigated land would contribute a larger part of county government tax collections, i.e., there would be a shift to irrigated land.

Table 9 - Dry Crop Land. The results would be mixed, depending on current assessment levels and historical net returns among the counties.

Table 10 - Grassland. Under either complete reappraisal or reappraisal of ag land only, grassland generally would contribute a smaller part of county government tax collections, i.e., a shift from grassland.

Table 11 - Residential Real Estate (including rural homesites). There would be two distinct results. With implementation of use value for ag lands and reappraisal of all other locally assessed real property there would be a shift of taxes to residential property. (Dr. Flinchbaugh estimated that in Shawnee County 75 percent or more of the shift would result from reappraisal and 25 percent or less from the implementation of use value.) If use value of ag lands only was implemented, the general result would be a shift from residential property.

Table 12 - Other Real Estate (primarily industrial and commercial). The results would be generally the same as for residential property.

Table 13 - Oil and Gas. The results would be basically the same as for other personal property.

Table 14 - Other Personal Property. There would tend to be a shift from personal property and basically to real estate.

Table 15 - State Assessed Public Service Companies. The results would be generally the same as for personal property.

Dr. Flinchbaugh commented that Column 8 in the tables shows what use value itself would do, and that a farmer has to look to the long run to support use value. The initial shift from use value alone would tend to be to farmland, but use value would tend to stabilize the taxable values of lands in agricultural use and shield them from inflationary pressures. Thus, under use value appraisal the shift might be reversed 15 years down the road if appraisals of other property were kept up to date.

#### School Finance

Dr. Flinchbaugh explained four tables relating to the impact of use value appraisal on school finance.

Table 16 compared actual general state aid for 1976-77 school year with what it would have been that year had use value appraisal been in effect for four years and fully averaged into district wealth. At the 9.25 capitalization rate in the bill, the general state aid total would have increased by \$24.75 million. Two hundred seventy school districts would have received more state aid, 6 less, and 30 would have received approximately the same. Districts with a relatively large percentage of land in agriculture generally would have received more state aid. Districts with a relatively small percentage of land in agriculture generally would have received little or no increase in state aid.

Table 17 embodied the same assumption as Table 16, but with the LER (local effort rate) adjusted (from 1.77 percent to 1.949 percent) to keep general state aid constant at approximately the 1976-77 level. At the 9.25 percent capitalization rate, 193 school districts would have received more state aid, 73 less, and 40 approximately the same. Districts with a relatively large percentage of land in agriculture generally (but with a few exceptions) would have received more state aid. Districts with a relatively small percentage of land in agriculture would have received less.

Table 18 is similar to Table 16, but with use values included in only one year of the four-year averaging. The results and conclusions were similar to Table 16, but the changes would have been of smaller magnitude. (\$9.5 million additional aid, with 248 districts receiving more, 1 less, and 57 approximately the same.)

Table 19 is similar to 17 but with use values included for one year only. The results and conclusions were similar to Table 17, but with changes of smaller magnitude. (An LER of 1.838 percent, with 172 districts receiving more, 66 less, and 68 approximately the same.)

Dr. Flinchbaugh reported that the impact study (county and school district) results will be published in a bulletin which will be available by the time the next session convenes or shortly thereafter. He summed up by saying that, as long as district wealth includes property and district wealth is a part of state aid, use value would require more state aid or result in a shift in state aid. However, some districts, mainly in southwestern Kansas, still would not receive any state aid because of their high valuations.

Staff noted that, if January 1, 1981, was made the implementation date for the use value bill, it would first affect school aid in the 1982-83 school year, with the full effect after the four years of averaging not seen until the 1985-86 school year. It was noted that substantive changes in school aid now under consideration by the Education Committee could reverse or at least modify some of the shifts indicated by the impact study. Also, the outcome of pending court cases challenging the school finance act could change the situation in the meantime.

As to how the indicated effects of use value on school finance could be tempered, Dr. Flinchbaugh said that one possibility would be to change the capitalization rate. A Committee member replied that school aid is only one factor in the total picture and that it would be better to adjust the LER than the capitalization rate. Dr. Flinchbaugh agreed that the LER affects only schools while the capitalization rate affects other units of government.

#### Committee Discussion

The political implications of approaches which would lead to shifting taxes from other classes of property, including state assessed utilities, to residential property were noted. Some differences of opinion as what comparisons are most valid were indicated. One viewpoint expressed was that the "bottom line" is the change from where we are now. Another viewpoint expressed was that this is not realistic because "we can't stand still." Another opinion expressed was that the choice is to mandate reappraisal or wait for the courts to require that and then implement use value appraisal. Another alternative suggested was to start with use value alone, shifting "who's out on a limb."

Representative Jarchow questioned the inclusion of a 10 percent management allowance in expenses, arguing that this is not an IRS type cost. Dr. Flinchbaugh commented that the political parts of the bill are the rollback tax and the capitalization rate, and that the only arbitrary part of net return is the management allowance. He added that taking management out would change the capitalization rate by less than 1 percent. He also noted that taking management out would tend to increase use value and thus reduce the cost of school aid. When asked about other states, he said that they include a management allowance.

Representative Slattery asked if, assuming the courts do not order equalization, is the present system totally unacceptable. He suggested that what we have now may be preferable to some of the alternatives, and asked whether taking authority out of the hands of local officials is going to be acceptable. Representative Hineman asked if too much local discretion is allowed now, pointing to discrepancies across county lines.

When asked for comments, Bob Walters said that the reason that the present system (K.S.A. 79-503) is not working is that there are too many different interpretations of that section and perhaps not enough recognition of the fact that generally sales are are representative of market value. He also suggested that reappraisal need not be so traumatic if approached by first equalizing within counties and then making percentage adjustments to equalize among counties.

#### County Officials' Bill

Staff reviewed the re-draft of the bill proposed at the October meeting by a joint committee of appraisers and clerks, in which the main body of the proposal had been divided into 21 sections. Some corrections or minor, non-substantive changes were suggested and approved.

In New Section 8 (penalties for late filing of personal property statements) it was moved by Representative Wilkin and seconded by Representative Jarchow that the penalties be changed to 10 percent for late filings of up to 15 days, 25 percent after 15 days, and 50 percent for over 30 days. Motion carried.

Suggestions were made for further staff consideration of certain provisions, such as looking at court unification provisions as a possible guide for budgeting for the appraiser's office.

It was moved by Senator Pomeroy and seconded by Senator Johnston that imprisonment be deleted from the penalties for failure to perform the duties of the office of appraiser (Section 20). Motion carried.

It was moved by Senator Simpson and seconded by Senator Johnston that Section 21 be deleted as obsolete. Motion carried.

It was moved by Senator Pomeroy and seconded by Senator Johnston that the county clerk penalty section (Section 26) be amended to conform to the section applicable to appraisers. Motion carried.

It was moved by Senator Pomeroy and seconded by Representative Jarchow that the last sentence of Section 50 be deleted. Motion carried.

Discussion resulted in consensus that the bill deserves more consideration and hearings than time now available would permit, and further that it is not really directly related to use value appraisal.

Senator Pomeroy volunteered to pre-file the bill, along with any other Senators who might want to join him, so that it would be ready for consideration by the standing committee at the beginning of the next session.

#### Valuation of State Assessed Utilities

At an evening session, Mike Goodwin substituted for Director of Property Valuation Vaughn (who was a victim of car trouble) in presenting a detailed (written) explanation of the assessment of a major utility (Kansas Gas and Electric Company) and answering questions about it.

He also discussed differences between the elements included in the determination of rate base valuations by regulatory bodies and the unit valuations developed by the Division of Property Valuation for property tax purposes. He noted that some items, such as work in process and others, are included for property tax purposes but not for rate making purposes and that consequently the rate bases generally are lower than the DPV valuations.

Tuesday, November 8

The meeting was called to order by Chairperson Powell shortly after 9:00 a.m., with all members present. Staff present: Bill Edds, Arden Ensley, Roy Johnson, Richard Ryan, and Robert Taylor. Consultants: Raymond Vaughn, Wayne Hundley and Bob Walters, Division of Property Valuation; Dr. Barry Flinchbaugh and Mark Edelman, K.S.U.

#### Bill Draft Review

Staff reviewed a new mock-up of H.B. 2631, incorporating all but two of the changes previously decided upon, and including also a new proposal aimed at securing a reappraisal of all other locally assessed real property as of January 1, 1981, with annual updating thereafter.

One of the decisions not incorporated in the draft was a provision making it unnecessary to make any change in the county records until a cumulative change of 10 percent or more has occurred in the valuation within a class of property within a county or homogeneous region, because the staff was uncertain as to just how it was intended to be applied. Further discussion developed more questions than answers as to the possible effects of such a provision, and it was moved by Representative Hineman and seconded by Senator Pomeroy that such provision not be added to the bill. Motion carried.

Another provision, making the Division of Property Valuation a party to appeals from the county board, except for equalization of assessments, inadvertently was omitted but will be included in the next draft.

A new section (No. 7), added to the bill for consideration pursuant to instructions at the prior meeting, incorporated a proposal by Representative Hineman to use the assessment/sales ratio studies to determine whether property is appraised at full market value as required by law, and if not in compliance to order adjustment of any class or subclass to achieve such result using the ratio as the criteria for the adjustment. Provision would be made for hearing of appeals prior to issuance of a final order. Representative Hineman stated that after the previous day's discussions he was not sure he wanted to push the idea.

Staff also reviewed some illustrations of possible ways to make the adjustments: (1) using county ratios only, (2) using county rural and urban medians, and (3) using the subclasses such as residential, commercial, industrial, etc., of urban property and comparable subclasses of rural property. It was noted that the latter would be the most refined but might raise some questions because of the small number of transactions (or lack of any) for some subclasses. Staff also recalled recommendations included in a report of the ratio study technical advisory committee a few years ago to compute the ratio for a class under a procedure essentially incorporating a weighted average of the subclass ratios. It was suggested that such a procedure might be helpful for the proposed purpose as well as to provide a more defensible ratio study generally.

Also suggested by staff for consideration was the incorporation in the Section 7 proposal of a provision similar to K.S.A. 79-1440 (Section 8 of the 1963 law), which provides that where the total assessed valuation of a taxing district is increased or decreased due to a countywide reappraisal existing levy limits are suspended and the total amount levied limited to 105 percent of that previously permitted. A Committee member later suggested that this might be worth looking into, even if the new section was not added to the bill, as an adjustment for statutorily fixed levies affected by use value appraisal.

It was moved by Senator Pomeroy and seconded by Senator Mulich that the proposed Section 7 be added to the bill. However, after discussion indicated that the application intended would mean adjustment of the valuations of individual properties (comparable to a full reappraisal), the motion was withdrawn. After further discussion, the consensus was that tying use value appraisal directly to a reappraisal might prove fatal to the bill. With no action taken, the proposed Section 7 was not added to the bill.

Further discussion of the relationship of the assessment-sales ratio study to use value appraisal included reference to the definition of "adjusted valuation" for school finance purposes in K.S.A. 72-7040, and a report that the Education Committee has decided to continue to use "adjusted valuations" in preference to raw assessed valuations for school finance purposes. It was moved by Senator Simpson and seconded by Senator Pomeroy that Section 72-4040 be amended to treat land in agricultural use the same as personal property and state assessed utilities. Motion carried.

As to the assessment-sales ratio study itself, several alternatives were suggested: (1) continue to determine assessment-sales ratios on agricultural lands, for information purposes only; (2) compute appraisal ratios for ag lands; or (3) completely eliminate ag lands from the ratio study. It was moved by Senator Pomeroy and seconded by Senator Johnston that the ratio study be amended to exclude agricultural investment land from its application. Motion carried.

Dr. Flinchbaugh noted that one of the procedures discussed in the Cloud County Study could be reversed to provide a way of monitoring the operation of use value appraisal. He suggested that auditing could be done to determine whether: (1) land is being classified properly; (2) the valuation schedule is being applied properly; and (3) whether the valuation schedule is in line with how commercial appraisers would value ag lands.

Section 1 (and Section 3). It was moved by Senator Pomeroy and seconded by Senator Mulich that the implementation date be made January 1, 1982. Senator Kerr offered a substitute motion, seconded by Representative Hineman, to make the implementation date January 1, 1981. The substitute motion carried.

Section 2. It was moved by Representative Jarchow and seconded by Representative Wilkin that "typical management fees" be deleted from the definition of the definition of expenses. Motion failed, with Representatives Jarchow and Wilkin voting "Aye".

Section 3. It was suggested that one method of determining agricultural income was specified for irrigated land and dry crop land and another for pasture or rangeland and that this might raise questions as to how other possible types of ag land, such as forest land, would be handled. It was moved by Senator Pomeroy and seconded by Senator Johnston the first procedure be made applicable to all ag lands other than pasture or rangeland. Motion carried.

Section 4. It was moved by Senator Simpson and seconded by Representative Wilkin that a provision be added for distribution of the rollback tax to all funds of the taxing unit. After discussion, the motion was withdrawn. It was moved by Senator Pomeroy and seconded by Representative Hineman that the distribution be to the general fund or any other fund of general application (as in the LAVTRF). Motion carried.

It was moved by Senator Johnston and seconded by Senator Mulich that in the notice of change of use paragraph the words "or by the first day of March following such change in use, whichever date occurs first" be deleted. Motion carried.

Section 12 (formerly 13). It was moved by Senator Pomeroy and seconded by Representative Slattery that the effective date of the act be made publication in the statute book. Motion carried.

Both a revised "balloon" mark-up and a draft of a new "clean" bill were requested for review at the next meeting.

Other Business

Dr. Flinchbaugh stated that a full accounting of the \$12,000 allocated for the impact study would be made at the next meeting on November 17.

He also asked for directions as to whether the Committee desired a print out of the changes in the tables expressed as percentages, and, if so, using what base. It was moved by Senator Pomeroy and seconded by Senator Johnston that this be requested starting with "now" as the base and that it be compared to reappraisal with use value, reappraisal without use value, and use value alone; with the percentages the various classes of property (utilities, etc.) are of the total tax base also shown.

Staff distributed a first draft of a partial Committee report for review prior to the next meeting - on November 17 (and 18 if necessary). The agenda will consist of reviews of the bill draft and report draft.

Prepared by Roy Johnson

Approved by Committee on:

11/17/77  
(date)

RJ/dmb