Fiscal Note & Local Impact Statement

125 th General Assembly of Ohio

Ohio Legislative Service Commission
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BILL: **Sub. H.B. 414** DATE: **December 8, 2004**

STATUS: **As Enacted – Effective May 18, 2005** SPONSOR: **Rep. Core**

LOCAL IMPACT STATEMENT REQUIRED: **Yes**

CONTENTS: **Provides for establishment of agricultural security areas and for tax exemptions on qualifying improvements in those areas**

State Fiscal Highlights

STATE FUND	FY 2005	FY 2006	FUTURE YEARS
General Revenue Fund			
Revenues	- 0 -	- 0 -	- 0 -
Expenditures	Potential minimal increase	Potential minimal increase	Rising potential increase that eventually could reach the tens of millions

Note: The state fiscal year is July 1 through June 30. For example, FY 2005 is July 1, 2004 – June 30, 2005.

- The bill permits exemption of up to 75% of the value of qualifying investments in an agricultural security area, for up to ten years with the possibility of renewal. This could reduce taxable property valuation relative to what it would otherwise have been, increasing foundation aid payments to school districts from the state beginning no earlier than FY 2008. Costs to the state would rise over time as areas were made eligible and as facilities were constructed. Costs would be dependent on thousands of local decisions on the establishment of areas and the amount of exemptions granted, and on the extent to which availability of the tax exemption led to investments which would not otherwise have been made. Potential state costs could rise over time into the tens of millions of dollars annually.

- Under current law, taxes on all real property are reduced 10%, which is reimbursed to local governments by the state. Lower taxable property value as a result of the tax exemption in the bill would reduce the state's reimbursement payments. The increase in school foundation aid payments would be much larger than this reduction.

- The Department of Agriculture could incur increased expenditures as a result of this bill. The Department is required to provide technical assistance, when requested, regarding agricultural security area applications. The Director is required to submit an annual report concerning the number of acres enrolled in agricultural security areas and their location and any tax exemptions granted. According to the Department, the increase should be minimal, as long as the technical assistance requirement can be met by providing an informational assistance package and by addressing the topic of agricultural security areas in public meetings (assuming this topic could be addressed during meetings already scheduled by the Department regarding other matters).

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 2005	FY 2006	FUTURE YEARS
School Districts			
Revenues	- 0 -	- 0 -	Potential loss rising over time, partly offset by state aid gain for most districts
Expenditures	- 0 -	- 0 -	- 0 -
Other Local Governments			
Revenues	- 0 -	Potential loss	Potential loss rising over time that eventually may reach the tens of millions
Expenditures	Potential minimal increase	Potential minimal increase	Potential minimal increase

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

- The bill permits exemption of up to 75% of the value of qualifying investments in an agricultural security area, for up to ten years with the possibility of renewal. This could reduce taxable property valuation relative to what it would otherwise have been, resulting in loss of tax revenues. It might also encourage investments which would not otherwise have been made, augmenting tax revenues. Annual agricultural new construction that might be partially abated was $420 million in 2002, with a taxable value of $147 million, and property tax payments of $5 to $7 million per year for the one year's construction. Abated tax payments could be $4 to $5 million per year.

- Revenue losses would depend on local exemption decisions, on the total land area approved as agricultural security areas, and on the effect of availability of tax abatements on investment decisions. Revenue losses would rise over time as facilities are constructed year by year. Annual losses could rise into the tens of millions of dollars after ten years. Losses would continue to increase relatively rapidly thereafter if renewals of abatements were widely granted.

- The reduction in taxable property valuation would increase foundation aid payments to most school districts from the state beginning no earlier than FY 2008. These payments would partially offset the loss of tax revenues for most districts, with about a one-year lag. School district net losses depend on the effective rate for real property for continuing levies above the state foundation program.

- For emergency and bond tax levies, the reduction in taxable value would be offset by a tax rate increase, to ensure that the specific amount of tax revenue required by the levies is raised. The agricultural property owner granted the exemption would pay less taxes and other property owners would pay more taxes. New levies of all types would require a higher tax rate than current law to raise the same amount of revenue.

- The bill could increase expenditures for counties and townships by requiring these entities to, among other things, review agricultural security area applications and hold public hearings regarding these applications. According to the Ohio Township Association, this increase should be minimal in nature. Counties and townships may require that costs of public notice and certified mail be paid by the applicant. Activities might be heaviest during the first half dozen years the bill is effective as farms or groups of farms apply for agricultural security area status.

Detailed Fiscal Analysis

The bill allows a property owner to apply for land to be designated as an agricultural security area, within which qualifying investments may be partially exempted from real property taxes for up to ten years with the possibility of renewal. The exemption from tax of as much as 75% of taxable value is subject to agreement by boards of county commissioners and township trustees in whose jurisdictions the land proposed as an agricultural security area is located. These boards may also set a maximum value to which the tax exemption may apply. Other units of local government, however, would not have a role in deciding on the exemption, under the terms of the bill. Only land located in unincorporated areas, and not proposed for annexation to a municipal corporation, may be included in an agricultural security area. A hearing must be held on the application, and all school districts that would be affected and the public must be notified of the hearing. Township trustees and county commissioners may impose reasonable fees on applicants to cover costs of public notice and certified mail for any proceedings. Investments qualifying for the tax exemption include a building, structure, improvement, or fixture used exclusively for agricultural purposes, worth $25,000 or more, and first added to the tax list in a year when the property is enrolled in an agricultural security area.

There is no clear basis for forecasting either the amount of investment that might take place in response to the bill, adding to tax revenues, or the amount of investment that would take place whether or not the bill becomes law but which would be partly exempted from tax as a consequence of the bill, reducing tax revenues. Legislative Service Commission's presumption is that other factors generally would outweigh tax considerations in such investment decision-making, and that the net impact of the bill could be expected to be a loss of tax revenues. The tax exemption would not apply to land, and would be incremental, applying only to new construction in the agricultural security area, not current value. These characteristics would tend to limit its cost in forgone local government tax revenues. Also, a board or boards of county commissioners and of township trustees would need to be persuaded of the merits of the application for designation as an agricultural security area, and would need to agree on the percentage of tax exemption, which could also tend to limit the amount of local government revenues forgone.

Department of Taxation records show about $420 million of new agricultural construction in Ohio, with a tax value of $147 million, in tax year 2002. Incremental real property taxes would have been about $5 million to $7 million, depending on the effective tax rates in the parts of the state in which the land is located. If all of this amount of investment had been in agricultural security areas, with the 75% maximum tax exemption under the bill, forgone real property tax receipts might have totaled $4 million to $5 million per year. New agricultural construction has been growing, and assuming this continues, each year's new construction would add a similar but growing amount to forgone tax receipts. The potential annual loss of tax receipts after ten years could total $50 million to $70 million. Growth in the loss of tax revenues would slow thereafter if agricultural security area tax exemptions generally were not renewed, but could continue to grow rapidly if renewals were the norm. Availability of the tax reduction might encourage additional construction. However, actual loss of tax receipts probably would be less than this potential because the counties and townships losing revenue would have to approve the loss and not all construction on agricultural land would be in areas that meet the definition of an agricultural security area. If the bill becomes law, the key determinant of resulting tax exemptions would be the behavior of the boards of county commissioners and township trustees deciding on applications to enroll in agricultural security areas.

Description of Agricultural Security Areas

In order to qualify land to be enrolled in an agricultural security area, a landowner must apply to all boards of county commissioners and township trustees within whose counties and townships the land proposed for enrollment is located. Agriculture is broadly defined, including farming, ranching, aquaculture, beekeeping, winemaking, sod production, forestry, and other activities. The land area must include 500 or more acres of farmland that is contiguous, defined in the bill to allow separation of parts of the area by rights-of-way or bodies of water. Two or more landowners may aggregate their land in an agricultural security area to meet the acreage requirement. The land must be in an agricultural district or districts (ORC Chapter 929.) and must be valued for real property tax purposes at its current agricultural use value. About 16 million acres, or 61% of the state's land area, is valued for real property tax purposes at its current agricultural use value. Current agricultural use valuation applies only to land used directly for agricultural purposes. All homes and other structures on an agricultural property, plus a one-acre home site, are appraised at fair market value. Both land valued at current agricultural use value and other real estate valued at fair market value are assessed at 35% to calculate taxable value.

Each applicant must commit to use the land in the agricultural security area only for agricultural purposes, with certain limited exceptions, for the next ten years. Each application must include a statement from an approved conservation professional that the applicant is complying with best agricultural management practices. In approving an application, each board must require land owners to continue to use best management practices, and must commit not to "initiate, approve, or finance any development for residential, commercial or industrial purposes, including construction of new roads and water and sewer lines" in the agricultural security area for ten years. However, a limited amount of residential development is permitted on agricultural security area land for individuals related to the landowner. Whether this residential investment might be considered to be for an agricultural purpose, and therefore qualified for partial tax exemption, is not made clear. Following approval of an agricultural security area, each board must send a copy of its resolution of approval to the county auditor and the Director of Agriculture. The county auditor is responsible for maintaining records of any agricultural security area real property that is exempt from taxation.

Failure of a landowner to comply with the commitment in the agricultural security area application not to "initiate, approve, or finance any new development on the land for nonagricultural purposes" or failure to send certain required notices is subject to a $500 fine, payable through a court to the boards of county commissioners and township trustees within whose jurisdiction the land is located. A tax incentive review council in each county or township that grants such a tax exemption would review each agreement's conformance with the requirements for establishment of an agricultural security area, and whether specified subsequent events make the property no longer eligible for tax exemption.

Effective Tax Rates on Real Property in Predominantly Agricultural Areas

Average effective tax rates on real property in nonmetropolitan areas of the state are usually lower than the statewide average of 51 mills for residential and agricultural (Class I) property, and average tax rates in metropolitan counties are usually above this average. Tax rates in agricultural areas typically are 35 to 45 mills, with some exceptions. Millage rates in some areas are lower because school district income taxes substitute for 5 to 10 mills worth of property taxes. About 20% of Ohio school districts have an income tax and most of these districts are in rural areas.

Department of Agriculture Role

The bill requires the Director of Agriculture to create an application for agricultural security areas and to distribute copies of these forms to county auditors. The bill also requires the Director to provide guidance and technical assistance to landowners, boards of township trustees, and boards of county commissioners, when requested, regarding the establishment of agricultural security areas. The Director is required to prepare and submit an annual report on agricultural security areas to the Governor, the President of the Senate, and the Speaker of the House of Representatives. According to the Department of Agriculture, these expenses should be minimal in nature as long as the requirement concerning technical assistance can be covered with an informational assistance package and by addressing the topic of agricultural security areas in public meetings (assuming this topic could be addressed during meetings already scheduled by the Department regarding other matters). The expenses will come out of the General Revenue Fund.

Local Costs for Review Procedures

The bill specifies the procedures necessary for establishing land as an agricultural security area. Some of the procedures and requirements concerning local governmental entities are listed. The bill allows land to be enrolled in an agricultural security area by submitting an application to boards of township trustees and county commissioners of each county or township in which the land is located. Within 60 days of the submission of the application, the boards shall hear the application at the next regularly scheduled meeting. The time and place of the meeting shall be published in a newspaper of general circulation and be sent to the superintendent of each school district within the proposed agricultural security area, as well as the county engineer of each county in which the proposed area would be located, and the Director of Transportation. Costs for public notice and certified mail associated with these proceedings may be charged to the applicant, at the discretion of each board of township trustees and county commissioners. The board of township trustees of each township and the board of county commissioners of each county required to hear an application, may conduct a joint meeting regarding the application and submit a single public notice. Each respective board shall adopt a resolution approving or disapproving the application within a specified time constraint. If it is determined that the application is incomplete or incorrect, the application shall be returned by certified mail to the applicant. The board shall also notify the applicant by certified mail, of the board's decision and send a copy of the resolution by certified mail to the Directors of Agriculture and Transportation, the superintendent of each school district within the area, the county engineer, and the county auditor.

The bill also addresses the role of local governments regarding the renewal of the area and the violations concerning the agricultural security area law. According to the Ohio Township Association, minimal costs will be incurred by local governments as a result of the above provisions. In fact, the requirements regarding the reviewing of applications and public hearings are similar to requirements in already existing code sections. Thus, this process of review and hearings is not novel. Most costs of establishing agricultural security areas would probably be incurred in the first half dozen years the law is effective.

Effect of Tax Exemptions on the State

State aid for school districts includes a foundation or basic aid program that provides greater assistance to districts with lower tax capacity. Each district's capacity is measured as 23 mills (2.3%) times the district's taxable property value. The formula determining state assistance compares this measure of capacity with the product of a per-pupil foundation level of funding—$5,169 in FY 2005—times the district's average daily membership. A further adjustment, the cost of doing business factor, is made for local costs. Any shortfall is filled by state aid. Under this formula, a decline in taxable property value, such as might result from H.B. 414, would increase annual state aid to most school districts by 2.3% of the property value reduction. Per-pupil property values in about 4% of school districts are high enough that they do not receive state base cost funding based on the formula calculation alone, but most of these districts have little agricultural lands. If any of these districts included property qualified for tax exemption under the bill, the resulting reduction in tax receipts would not be partly offset by an increase in state funding.

Taxes on all real property are subject to various reductions from voted or administered millage rates. One of these reduces taxes by 10%, which is reimbursed to local governments by the state. Lower taxable property value as a result of the tax exemption in the bill would reduce the state's reimbursement payments. As discussed above, the effective tax rate on agricultural real property is typically 35 to 45 mills. The state's 10% reimbursement therefore would cost about four mills, and a reduction in taxable agricultural property values as a result of tax exemption would save the state an estimated four mills times the amount of the reduction. The increase in school foundation aid payments, at 23 mills times the amount of the reduction in 96% of school districts, would be larger than this reduction.

Effect of Tax Exemptions on Local Governments

The bill provides that after the "tax exemption is granted, the qualifying agricultural real property shall become exempt in the tax year following the year in which the construction of the property is completed." As a nonemergency measure, the bill would have an earliest possible effective date in the first half of 2005. The earliest possible period of tax exemption, for agricultural security areas approved promptly thereafter with construction completed expeditiously following that approval, would be tax year 2006. The earliest date when local governments would be due to receive reduced tax payments, relative to what those payments would otherwise have been, is December 31, 2006, the first payment date for tax year 2006. The language in the bill appears to create the possibility that the investment might be fully taxable during construction, if the process of building the qualifying investment extended over two or more tax years.

As described above in the discussion of state aid for schools, loss of part of the property tax base because of partial tax exemption would be partly offset for most school districts by an increase in state aid. The increase in state aid corresponding to reduced tax payments due for tax year 2006, the earliest that such a reduction could take place under the terms of the bill, would be received by school districts in their FY 2008, beginning July 1, 2007.

For some types of real property taxes, a reduction in taxable property values as a result of investments in agricultural security areas would trigger adjustments in tax rates. Emergency levies are enacted to raise a specific amount of tax revenue. Bond levies must raise enough tax revenue to service outstanding bonds. For emergency and bond tax levies, tax rates are set annually to raise the required amounts of revenues. A reduction in taxable value under the provisions of H.B. 414 would be offset by a tax rate increase, to ensure that the specific amount of tax revenue required by the levies is raised. The agricultural property owner granted the exemption would pay less taxes, and other property owners would pay more taxes.

Example of Tax Effects

An example may help to clarify the workings of these various tax effects. Assume a qualifying investment of $1 million by a landowner in an agricultural security area, for which a tax exemption of 50% was granted, with no maximum exemption. Assume further that the net or effective tax rate where the agricultural security area is located is 45 mills, that 70% or 31.5 mills is levied by local schools, and that the remaining 30% or 13.5 mills is levied by other local governments.

Apart from any tax exemption, the $1 million investment would have a taxable value of $350,000, since real property is assessed for tax purposes at 35% of true value. The assumed 45 mill effective tax rate implies taxes charged of $15,750 per year, before the 10% reduction. Net taxes collectible by local governments would be $14,175, and the state would pay local governments an additional $1,575 in reimbursement of the 10% reduction. The share of the total payable to local governments other than schools would be $4,725, and the share payable to schools would be $11,025. However, the additional school district property value would reduce state aid for schools by 23 mills times $350,000, or $8,050, implying a net increase in funds available to schools of $2,975.

With the 50% tax exemption, most of these numbers would be reduced by half. The sum of net property taxes payable to schools plus state reimbursement of the 10% reduction would fall to $5,512.50. The reduction in state aid to schools would also be smaller, i.e., more favorable to the schools, by $4,025. Netting these two changes implies a $1,487.50 increase in funds available to schools, half of the increase without the exemption. Other local governments would gain $2,362.50, also half of the increase with no exemption.

If, in the absence of the incentives offered under the agricultural security area program, the $1 million qualifying investment would not have been made, the net amounts in the previous paragraph are the increases in tax revenues to local governments as a result of the program. However, if the investment would have been made even if the program incentives had not been available, the tax abatements result in the loss of tax revenues to local governments noted in the previous paragraph.

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