MINNESOTA ▪ REVENUE

ASSESSMENT AND CLASSIFICATION PRACTICES REPORT

THE AGRICULTURAL PROPERTY TAX PROGRAM, CLASS 2A AGRICULTURAL PROPERTY, AND CLASS 2B RURAL VACANT LAND PROPERTY

A report submitted to the Minnesota State Legislature
pursuant to Minnesota Statutes, section 273.1108

Minnesota Department of Revenue
Property Tax Division
March 1, 2011

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To the members of the Legislature of the State of Minnesota:

I am pleased to present to you this report on the practices of agricultural property assessment and the Agricultural Property Tax Law ("Green Acres") within the State of Minnesota undertaken by the Department of Revenue in response to Minnesota Statutes, section 273.1108.

This report provides a summary of assessment practices of agricultural properties within the State of Minnesota, market values of class 2a and 2b properties, and Green Acres value methodology and determinations.

Sincerely,

Daniel A. Salomone
Acting Commissioner

Per Minnesota Statutes, section 3.197, any report to the Legislature must contain, at the beginning of the report, the cost of preparing the report, including any costs incurred by another agency or another level of government.

This report cost $4,400.

INTRODUCTION

Minnesota Statutes, section 273.1108 requires an annual report on agricultural valuation and classification for property tax purposes, and the methodology and determinations for Minnesota Agricultural Property Tax Law ("Green Acres"):

> *"The commissioner of revenue must study and, by March 1 each year, report to the chairs and ranking minority members of the committees on taxes of the senate and the house of representatives on:*
> *(1) trends in market values of class 2a and 2b properties;*
> *(2) green acres value methodology and determinations; and*
> *(3) assessment and classification practices pertaining to class 2a and 2b property."*

This requirement was enacted in 2009. In large part, the impetus for this report was that the Legislature made numerous changes in 2008 to the agricultural classification and the Green Acres program after reports by the Department of Revenue and the Office of the Legislative Auditor found multiple problems and inconsistencies in the administration of the Green Acres program. After hearing additional public testimony, further changes were made both to agricultural classification law and the Green Acres program in 2009 and 2010.

BACKGROUND TO THE GREEN ACRES PROGRAM

In 1967, the Minnesota Legislature created a property tax program named the Minnesota Agricultural Property Tax Law, which is referred to as "Green Acres". Legislators were attempting to find a method for valuing agricultural property based on its agricultural use only while protecting its value from other non-agricultural influences. At the time, development appeared to be swallowing up agricultural property in the seven-county metropolitan area, driving up the market values used to calculate property taxes. Under this law, qualifying agricultural property enrolled in the Green Acres program is valued using sales data for agricultural property outside the metropolitan area to eliminate the non-agricultural development influences.

Minnesota Statutes, section 273.111, subdivision 2, contains a statement of public policy from the 1967 law that reads:

> *"The present general system of ad valorem property taxation in the state of Minnesota does not provide an equitable basis for the taxation of certain agricultural real property and has resulted in inadequate taxes on some lands and excessive taxes on others. Therefore, it is hereby declared to be the public policy of this state that the public interest would best be served by equalizing tax burdens upon agricultural property within this state through appropriate taxing measures."*

In the original 1967 language (Minnesota Laws 1967, Extra Session, Chapter 60), Green Acres was granted to certain agricultural land, defined as follows:

"Real estate shall be entitled to valuation and tax deferment under this act only if (1) it is actively and exclusively devoted to agricultural use… [and] (2) it is the homestead or contiguous to the homestead or thereafter becomes the homestead of a surviving spouse of the said owner."

Agricultural use was defined for Green Acres purposes as:

"…production for sale of livestock, dairy animals, dairy products, poultry and poultry products, fur bearing animals, fruit of all kinds, vegetables, forage, grains, bees and apiary products by the owner, but not when devoted to processing of such things or meeting the requirements and qualifications for payments or other compensation pursuant to a soil conservation program under an agreement with an agency of the federal government."

The original language also included income requirements for property owners seeking valuation and deferral under this program.

Under 1967 law (Minnesota Laws 1967, Chapter 32, Article 8) land that qualified for the agricultural classification was defined as

"contiguous acreage of ten acres or more, primarily used during the preceding year for agricultural purposes. Agricultural use may include pasture, timber, waste, unusable wild land and land included in federal farm programs.

Real estate of less than 10 acres used principally for raising poultry, livestock, fruit, vegetables or other agricultural products, shall be considered as agricultural land, if it is not used primarily for residential purposes."

Since 1967, both the definitions of agricultural lands (under M.S. 273.13) and the provisions of Green Acres (under M.S. 273.111) have changed multiple times. Green Acres no longer requires "exclusive" agricultural use, but "primary" agricultural use. There is no longer an income requirement for Green Acres. The agricultural classification does not require a "primary" use under current law, and the restriction that property not be "used primarily for residential purposes" has since been removed.

GREEN ACRES VALUE METHODOLOGY, 2010 UPDATE

For assessors, the most significant barrier to implementing Green Acres prior to 2008 law changes was determining the "actual" agricultural value of farmland in their counties. By law (M.S. 273.11), assessors must determine the "highest and best use" of property and then estimate the market value based on that determination. If the highest and best use of agricultural property is for residential, lakeshore, or commercial development, or for recreational purposes, the assessor must value the property as if it were to be converted to the highest and best use and disregard its value as property used agriculturally. Thus, in cases where the highest and best use of the property is for something other than agriculture, the assessor places a value on that property that exceeds its agricultural value, likely resulting in higher property taxes.

Green Acres (M.S. 273.111), however, requires assessors to look at qualifying agricultural property in two ways. First, the assessor must value the property according to its highest and best use (as is done for all properties). Then the assessor must determine the agricultural value of the property based on Department of Revenue guidance. If this agricultural value is below the highest and best use value, the assessor must use the agricultural value for tax purposes. The Department of Revenue is charged with establishing agricultural land values throughout the state.

In 2007, a Green Acres Committee made up of members of the assessment community and the Department of Revenue was formed partly for the purpose of determining Green Acres agricultural values. Based upon available data, the committee located the most recent period in time when the non-agricultural influences on farmland sales were either minimal or non-existent throughout the state, with the exception of the seven-county metropolitan area. The committee found that the southwest counties of Lyon, Murray, Nobles, Pipestone, and Rock were the most indicative of true agricultural sales; these now form what is referred to as the "base counties" for agricultural values.

Next, the 2007 committee established a period of time when farmland property values faced the fewest non-agricultural influences. Each county's median price for farmland sales during the period was compared to that of the base counties to establish a ratio, or factor. This factor could then be applied to the current median sales price per acre in the base counties to establish a current indicator of agricultural value for each county. A map of the Green Acres factor by county is included in Appendix A of this report.

For example, from October 1990 through October 1996, the Green Acres base counties had 653 sales of agricultural land. Those sales yielded a median sales price of $1,058 per acre. During that same timeframe, Dodge County had 109 sales of agricultural land with a median sales price of $1,175 per acre. The Green Acres "factor" for Dodge County was determined by dividing the median sales price per acre for Dodge County ($1,175) by the median sales price per acre for the base counties ($1,058).

Example 1: Dodge County Factor (based on sales occurring 1990-1996)				
Dodge County Median (1990-1996)	÷	Base County Median	=	Dodge County Factor
$1,175	÷	$1,058	=	111.06% (rounded to 110%)

For the 2011 assessment the base county median is $4,300 per acre. The Dodge County factor (110%) is applied to the 2011 base median to determine a 2011 tilled agricultural value for Dodge County of $4,730. If the average tilled value based on local markets for Dodge County exceeds $4,730 per acre, then the Green Acres value is applied to the tilled lands.

Example 1: Dodge County 2011 Base Value				
Base County Median Value per acre	X	Dodge County Factor	=	Dodge County GA Value per acre
$4,300	X	110%	=	$4,730 per acre

During that same time frame (1990-1996), Benton County had 51 sales of agricultural land with a median sales price of $641 per acre. The Green Acres factor for Benton County was determined by dividing the median sales price per acre for Benton County by the median sales price per acre for the base counties.

Example 2: Benton County Factor (based on sales occurring 1990-1996)				
Benton County Median	÷	Base County Median	=	Benton County Factor
$641	÷	$1,058	=	60.59% (rounded to 60%)

For the 2011 assessment the Benton County factor of 60% is applied to the 2011 base median to determine a 2011 tilled agricultural value for Benton County of $2,580 per acre. If the average tilled value per acre based on local sales for Benton County exceeds $2,580, then the Green Acres value is applied to tilled lands.

Example 2: Benton County 2011 Base Value				
Base County Median Value per acre	X	Benton County Factor	=	Benton County GA Value per acre
$4,300	X	60%	=	$2,580 per acre

This process has proved very effective for valuing tilled lands and - with a little blending of the values between counties - provides a fair, uniform and equalized method to value tilled agricultural land throughout the state. Based on the best data available to the Department of Revenue and to Minnesota assessors, the method for establishing agricultural values for tilled agricultural properties in Minnesota that was developed by the Green Acres Committee and used by the Department of Revenue produced values for agricultural land that reflected true agricultural values in the state. Assessors must use the values as the basis for setting agricultural values for qualifying Green Acres properties in their counties.

While not perfect, this method of establishing agricultural values also provide a uniform basis for valuation while still deriving agricultural values from the market. The result is a projection of what the current agricultural value of land would be in the absence of the current non-agricultural market influences. Also, while the Green Acres value for a county is determined by Department of Revenue, the values resulting from the factor may be "feathered" by the assessor to account for different land types throughout a county. While adjustments can be made for higher and lower quality lands, the overall county average value must not to go below the department's guidelines.

Minnesota Statutes, section 273.111, subdivision 4, is effective beginning with the 2012 assessment and reads:

> *"(a) The value of any real estate [qualifying for Green Acres]… shall … be determined solely with reference to its appropriate agricultural classification and value…. Furthermore, the assessor shall not consider any added values resulting from nonagricultural factors. In order to account for the presence of nonagricultural influences that may affect the value of agricultural land, the commissioner of revenue shall, in consultation with the Department of Applied Economics at the University of Minnesota, develop a fair and uniform method of determining the average value of agricultural land for each county in the state consistent with this subdivision. The values must be determined using appropriate sales data. When appropriate, the commissioner may make reasonable adjustments to the values based on the most recent available county or regional data for agricultural production, commodity prices, production expenses, rent, and investment return. The commissioner shall annually assign the resulting countywide average value to each county, and these values shall be used as the basis for determining the agricultural value for all properties in the county qualifying for tax deferment under this section. The county assessor, in consultation with the Department of Revenue, shall determine the relative value of agricultural land for each assessment district in comparison to the countywide average value, considering and giving recognition to appropriate agricultural market and soil data available.*
> *(b) In the case of property qualifying for tax deferment only…, the assessor shall not consider the presence of commercial, industrial, residential, or seasonal recreational land use influences in determining the value for ad valorem tax purposes provided that in no case shall the value exceed the value prescribed by the commissioner of revenue for class 2a tillable property in that county."*

The Department of Revenue has taken a proactive step and began discussing agricultural values with the Department of Applied Economics at the end of 2010 (prior to the 2011 assessment). The department also verified and reviewed the valuation process with members of the assessment community from different areas of the state.

As part of this analysis and review, it became apparent that there has been a shift in the relationships between tilled and non-tilled (e.g., pastureland) agricultural properties. It appears that a statewide factor of 50% of the tilled value per county is no longer appropriate in all cases. The department will further analyze these trends with representatives of the assessment community going forward. The method of valuing pasture lands for the 2011 assessment is discussed in greater detail in the following section of this report.

GREEN ACRES VALUES: 2010 AND 2011 ASSESSMENT YEARS

Agricultural Land Sales Trends 2006-2010
Median sale price per acre and number of sales
Bare land, 34.5+ acres, at least 75% tilled

	Oct. 2006-Sept. 2007	Oct. 2007-Sept. 2008	Oct. 2008-Sept. 2009	Oct. 2009-Sept. 2010
SW Base Counties	$3,000 137	$3,985 155	$4,287 122	$4,289 80
Rest of State	$2,638 1,136	$3,196 1,262	$3,661 688	$3,491 686
Statewide	$2,724 1,273	$3,333 1,417	$3,802 810	$3,670 766

For the 2010 assessment year, sales for the 12-month study (October 2008-September 2009) showed a median per-acre value of $4,287 based on 122 agricultural sales in the five base counties. However, for the first six months of the study period, the median sales price per acre was found to be $4,500 based on 92 sales. The second half of the sale study period showed a decrease in per-acre median value and a decrease in the number of overall sales: $3,970 per acre based on 30 sales. The decline in number of sales from the first half to the second half of the sales study period is a typical, seasonal trend. However, the second-half decline in per acre value is not typical. Based on the trend in median sale values and changes in value methodology, the Green Acres base per-acre value for the 2010 assessment (taxes payable in 2011) was held at $4,000 per acre.

For the 2011 assessment, although the median sales price statewide was $3,670 per acre, the average sales price for the base counties was higher ($4,289 per acre). The base value for Green Acres purposes was set at $4,300 per acre for the 2011 assessment. Referring to the Green Acres factor map (Appendix A), most of the counties' factors throughout the state are below 100%, meaning the tilled values used for those counties will be below $4,300 per acre for Green Acres purposes.

If a county's average estimated market value (EMV) for tilled class 2a acres (based on local sales) exceeds the average tilled agricultural value provided by the department, the county implements Green Acres and uses the department's average value in establishing values on tilled land. For the 2010 assessment, the county would use 50% of this Green Acres value to determine whether the non-tilled agricultural land would also be eligible for Green Acres: if the county's EMV for non-tilled agricultural (e.g., pasture) land exceeded 50% of the Green Acres value, then Green Acres was applied to the non-tilled lands. If the county's average EMV for non-tilled lands was less than 50% of the Green Acres value, the Green Acres value was not applicable to the non-tilled lands.

Thus, using the example above, the Benton County tilled value of $2,580 would be multiplied by 50% to arrive at a value of $1,290 for the non-tilled lands for Green Acres purposes.

Ongoing and recent reviews of this methodology indicate that the 50% value is no longer appropriate for all areas of the state. Particularly, the areas of northwest and southeast Minnesota showed non-tilled agricultural values that were not adequately represented by this 50% factor.

In northwest Minnesota, tilled lands generally carry a lower value per acre than in the base counties due to the decreased length of the tilled farming season, the quality of the soil, and other factors. Conversely, non-tilled agricultural lands (pasturelands) carry higher values relative to the tilled lands due to the economic and physical sustainability of this type of soil use. For some counties in this region of the state, the 50% value was too low to reflect the actual agricultural values of non-tilled lands.

In southeast Minnesota, tilled lands carry a higher value than in the base counties due to higher per-acre yields and productivity. Non-tilled lands carry much lower values relative to the tilled values due to topography, composition of the land, and the very low demand for non-tillable farmland in this area of the state. Consequently, a 50% value for non-tillable lands is too high to reflect the actual agricultural value of non-tilled lands.

The department, along with assessors from different areas of the state including northwest, southeast, and central Minnesota, reviewed and analyzed the data available. After discussions, the department developed a new method for valuing non-tilled agricultural lands. This method is based on comparisons between the average tilled values for each county relative to the values for non-tilled agricultural lands. The result is a compressed range in values when compared to the previous method (the new range is from $775 per acre to $2,235 per acre rather than $430 to $2,795). This compression acknowledges that different regions of the state have different economic forces affecting the values of non-tilled lands. The optional values provided under the new methodology are provided in Appendix B.

The department acknowledges that the process of valuing non-tilled agricultural lands will be further analyzed and studied and has therefore given counties an option for the 2011 assessment. For non-tilled farmland, counties may use one of two values:

1. The value used for the 2010 assessments for non-tilled lands per county. This option would likely be used in areas of the state where the new methodology may cause unintended tax shifts or large changes in the number of eligible properties.
2. The value provided by the department for these counties based on the newly-developed process for valuing non-tilled lands.

Referring again to Benton County, the options are therefore a value of $1,200 per acre (the 2010 non-tilled value based on 50% of the 2010 tilled value per acre) or $1,420 per acre under the new method.

It is possible that a county may only have non-tilled lands receiving Green Acres deferral if the average 2a tilled value does not exceed the 100% Green Acres value but the county's non-tilled value exceeds the Green Acres non-tilled value. Conversely, it is possible to have only tilled lands receiving deferral but not the non-tilled lands. Counties are urged to work with the department's Regional Representatives to determine which option would be most appropriately applied, and to continue the discussions of reviewing local agricultural markets and soil data.

ASSESSMENT AND CLASSIFICATION PRACTICES PERTAINING TO CLASS 2A AND 2B PROPERTY

For property taxes in Minnesota, all land is classified according to use. Land that is ten acres or larger and used for agricultural purposes (by statutory definition) is class 2a agricultural land. Land that is not used for agricultural purposes, not improved with a structure, and which is rural in character is class 2b rural vacant land. The classification rates for 2a and 2b property (homestead and non-homestead) are as follows:

Class Rates for the 2011 Assessment Year (Taxes Payable 2012)		
Class	**Value**	**Class Rate**
2a Agricultural Homestead: House, Garage, and First Acre (HGA)	First $500,000 Over $500,000	1.00% 1.25%
2a Agricultural Homestead Land	First $1,210,000* Over $1,210,000	0.50% 1.00%
2b Rural Vacant Land (part of agricultural Homestead)	First $1,210,000* Over $1,210,000	0.50% 1.00%
2a Agricultural land (non-homestead)	No tier	1.00%
2b Rural Vacant Land (non-homestead)	No tier	1.00%

**The values of 2a and 2b lands on an agricultural homestead are aggregated for tiers. The value of the first tier is annually adjusted. For the 2010 assessment (taxes payable 2011), the first tier value was $1,140,000.*

Implications of Classification on Green Acres

Until the 2008 legislative session, contiguous land under the same ownership but not used for agricultural purposes may have qualified for Green Acres. Since the 2009 assessment, applications for Green Acres tax deferral are only applicable to class 2a agricultural land (under a definition which was also changed) on parcels or contiguous land masses that are primarily devoted to agricultural use. Contiguous land not used for agricultural purposes (i.e., not class 2a agricultural land) is no longer eligible for tax deferral under the program going forward.

Some class 2b rural vacant land that had been enrolled in Green Acres prior to 2008 may be "grandfathered" into the program until as late as the 2013 assessment. Property owners may enroll their 2b acres into the Rural Preserve Property Tax Program at any time between the 2011 and 2013 assessments and not have to pay back taxes deferred under Green Acres. Any class 2b rural vacant lands that remain enrolled in Green Acres through the 2012 assessment will be taxed at full market value and no taxes will be deferred beginning with the 2013 assessment (and taxes deferred under Green Acres will be due as provided in statute).

While the decision on the classification of a property will greatly impact Green Acres eligibility, the classification is made first and without regard to Green Acres implications. The 2a agricultural classification, for example, has specific requirements while the Green Acres program has other specific and separate eligibility requirements (beyond the 2a classification). A property can correctly be classified as agricultural without being eligible for Green Acres. The classification (or split-classification) of the property, however, should not be used as a default mechanism for denying Green Acres.

Under previous law, the agricultural classification itself contained a "primary use" test. This primary use criterion was removed from the classification statute during the 1997 legislative session. However, it is still applicable for determining Green Acres eligibility and is in Minnesota Statutes, section 273.111. (See "Using 'Primarily Devoted to Agricultural Use' to Determine Green Acres Eligibility," on the next page of this report.)

Classification Basics

The classification of agricultural and rural vacant land is based on a visual inspection of the property and the number of acres used for agricultural purposes (as defined by statute). Assessors consider a number of factors to determine eligibility for agricultural classification. In cases where the decisions are based on heavily subjective criteria, assessors are asked to document the rationale for the classification.

Minnesota Statutes, section 273.13, subdivision 23, lists the requirements that must be met for a property to be classified as class 2a agricultural land:

1. At least 10 contiguous acres must be used to produce agricultural products in the preceding year (or be qualifying land enrolled in an eligible conservation program);
2. the agricultural products are defined by statute; and
3. the agricultural product must be produced for sale.

Real estate of less than ten acres in size may qualify for the 2a agricultural classification under Minnesota Statutes, section 273.13, subdivision 23 paragraph (f), if it is used exclusively for agricultural purposes, or if it is improved with a residential structure and is used intensively for one of the following purposes:

> *"(i) for drying or storage of grain or storage of machinery or equipment used to support agricultural activities on other parcels of property operated by the same farming entity;*
> *(ii) as a nursery, provided that only those acres used to produce nursery stock are considered agricultural land;*
> *(iii) for livestock or poultry confinement, provided that land that is used only for pasturing and grazing does not qualify; or*
> *(iv) for market farming; for purposes of this paragraph, "market farming" means the cultivation of one or more fruits or vegetables or production of animal or other agricultural products for sale to local markets by the farmer or an organization with which the farmer is affiliated."*

Although a property less than ten acres in size would qualify for the 2a agricultural classification under the above criteria, it would not qualify for Green Acres deferral.

The Department of Revenue has provided assessors with a list of objective factors that are to be considered before making a classification decision. Criteria used to determine agricultural classification and agricultural homestead based on statutory requirements are included in Appendix C of this report.

USING "PRIMARILY DEVOTED TO AGRICULTURAL USE" TO DETERMINE GREEN ACRES ELIGIBILITY

Beyond classification as 2a agricultural land, Green Acres law requires that property be "primarily devoted to agricultural use" to be eligible for enrollment. The assessor's decision as to whether a property is primarily devoted to agricultural use must be based on a list of objective factors provided by the department. These factors are considered before the decision of whether are Green Acres qualifications are met is finalized.

Assessors put the most weight on physical characteristics of the property, but other criteria such as income may be used. In determining if a property is primarily devoted to agricultural use, the potential exists that in some instances, a reasonable justification may warrant not satisfying one or more of these criteria. A preponderance of the factors and criteria is used to determine if a property is primarily devoted to agricultural use. A discussion of the factors is included in Appendix D of this report.

REVIEW OF ASSESSMENT PRACTICES

The department conducted a survey of all county assessors to gauge the effects of 2008, 2009, and 2010 changes to agricultural property tax laws on properties that were enrolled in Green Acres. Based on responses to the survey, no property owners were removed from Green Acres by the assessor due to those law changes. Some property owners have left the program voluntarily since 2008, but none were removed as a consequence of law changes.

However, many assessors did report that properties were removed from Green Acres in order to correct previous years' assessments. These assessments were incorrect under both pre- and post-2008 law changes. The most common correction made by assessors was removing properties from the agricultural classification (and, consequently, from Green Acres) because the properties did not have ten contiguous acres used for agricultural purposes. This requirement was part of the original Green Acres law in 1967 and has remained a requirement throughout the history of the program.

Other common corrections included removal of properties that were not actually farmed or not primarily used for agricultural purposes. In some cases, the property owners had once farmed the property and been properly enrolled but had since ceased farming the property and never withdrawn from Green Acres. In other cases, use or ownership changes had gone unnoticed by the assessor until a review of properties after 2008. Some counties were affected more than others (one county had between 15,000 and 20,000 acres removed for corrections).

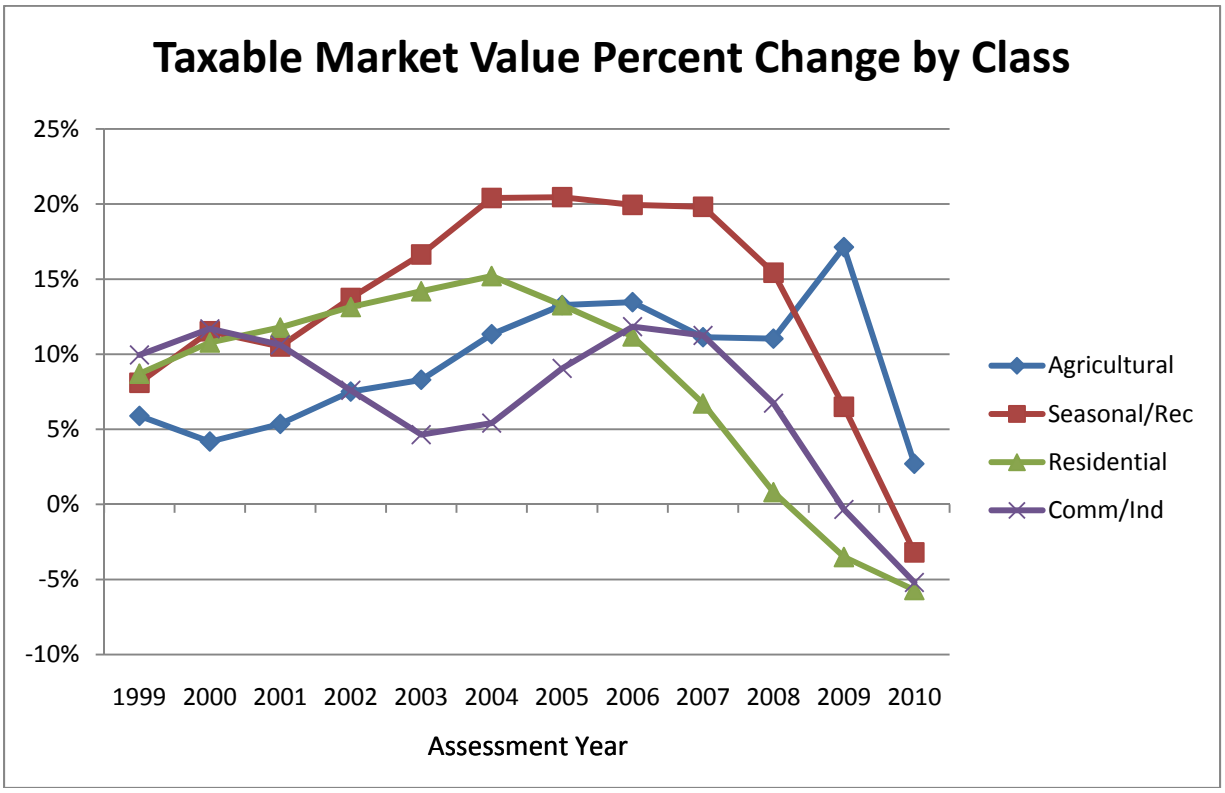
Although these corrections removed the properties from Green Acres, the department advised assessors not to collect the payment of deferred taxes that would typically be required. The department's reasoning was that the ongoing deferral was due to assessor error rather than by any fault of the property owner.

The department will continue to monitor and assist with assessment practices. At recent meetings, many assessors stated that the overall quality and accuracy of their assessments has improved greatly since reviewing properties over the last three years.

TRENDS IN MARKET VALUE OF CLASS 2A AND 2B PROPERTY: 2009 AND 2010 ASSESSMENT YEARS (TAXES PAYABLE 2010 AND 2011)

Minnesota Statutes, section 273.11, requires that all property be valued at its market value. Assessors estimate this market value by studying local sales, and the estimated market value (EMV) should follow changes in local market sales trends. The taxable market value (TMV) is determined after the estimated market value, and is adjusted for exclusions, deferrals, and any other special treatment provided by various property tax programs including Green Acres. Net tax capacity (and, therefore, taxes) are based on the taxable market value.

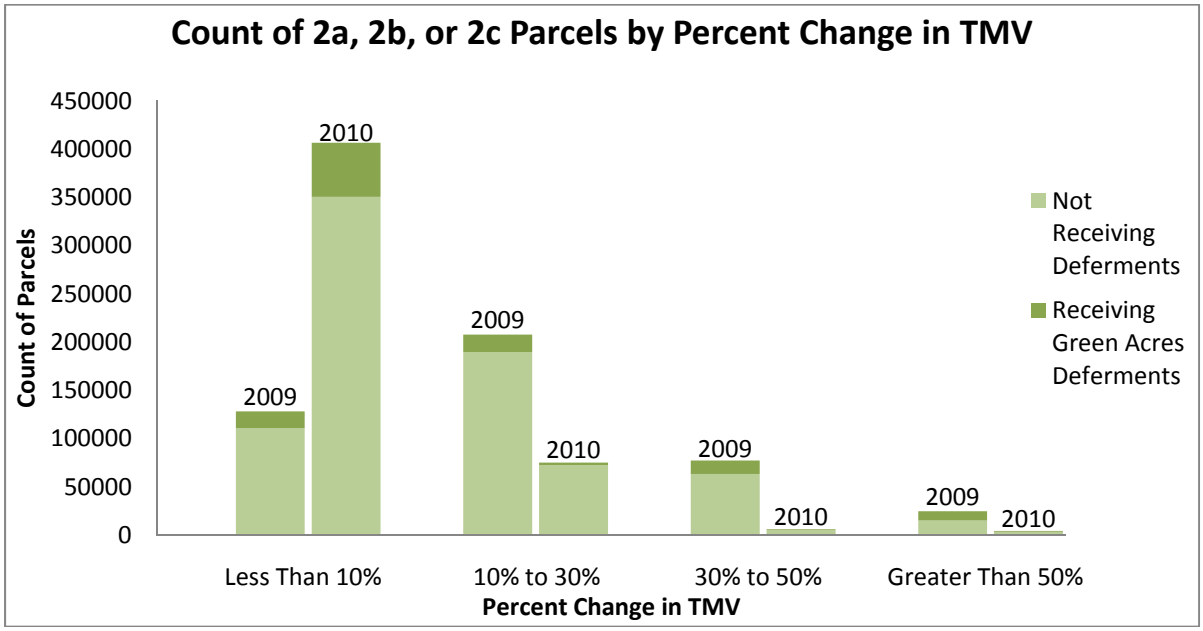
As shown in the following chart, for the 2010 assessment (taxes payable in 2011), TMVs for farm and rural lands increased, but at a much lower rate than in previous years. At the same time, TMVs decreased for other classes of property, meaning that some agricultural properties will bear a greater burden of the local taxes.



This chart includes new construction and class shifts; it is an analysis of the change in the overall tax base rather than the change in value of specific properties over time. The 2009 values were adjusted to account for some changes in class definition that would not have affected other years. The 2010 assessment year shows a decline in the growth of all classes except agricultural classes. The overall growth rate in taxable market value for agricultural properties declined compared to the 2009 assessment year.

While many agricultural properties are therefore seeing tax increases, no single factor alone explains the increased tax burden. Rather, a confluence of factors may cause a tax shift, including levy increases by local taxing jurisdictions, relative decreases in the value of other properties in the taxing districts, changes to tax programs, and the continued strong market for agricultural properties. The levy decisions of taxing jurisdictions statewide may change for any number of reasons, which affects the overall tax burden distributed to properties. The TMV of a given property determines that property's share of the levy.

The following chart highlights the fact that TMVs for classes 2a agricultural land, 2b rural vacant land, or 2c managed forest land increased more from 2008 to 2009 assessments than from 2009 to 2010. For the 2010 assessment, the TMV for these rural lands increased 2.6% (approximately $2.8 billion), while the EMV increased by only 1%. This would reflect an increase in the TMV and a decrease in the amount deferred under the Green Acres program.



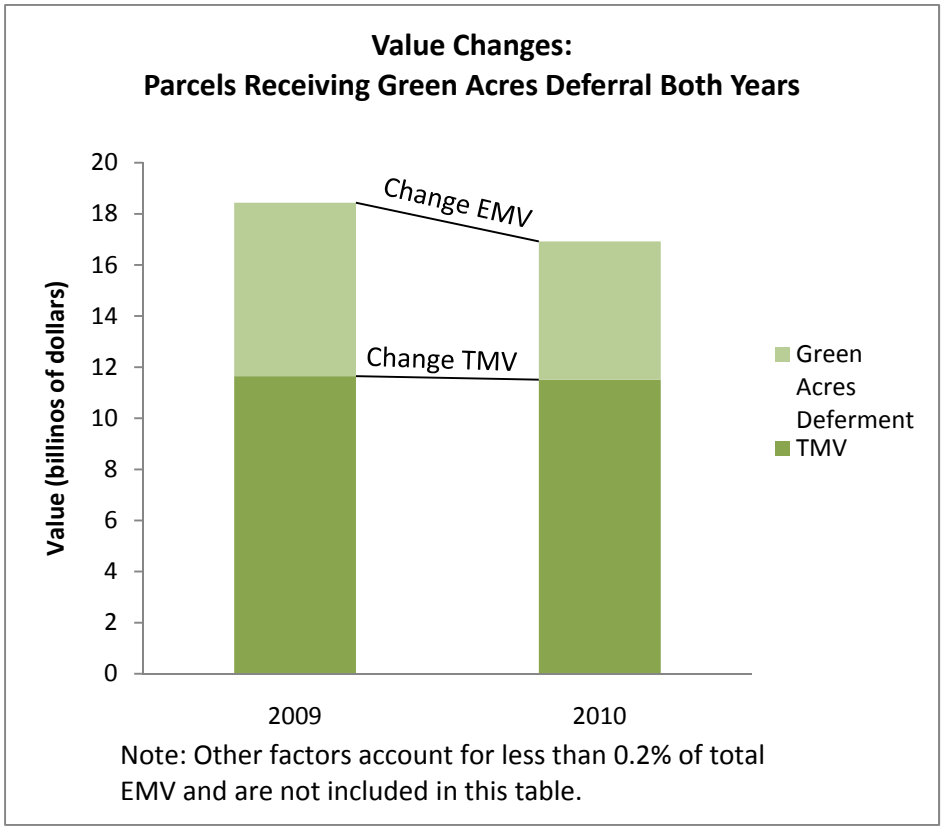
Note: The 2009 assessment was for taxes payable in 2010, while the 2010 assessment will be reflected in taxes payable in 2011.

Agricultural properties enrolled in Green Acres

For the 2010 assessment year (taxes payable in 2011), the base value used for determining Green Acres was the same as the 2009 assessment. For parcels with deferments in both 2009 and 2010, TMV actually decreased slightly from $11.6 billion in 2009 to $11.5 billion in 2010, a decline of approximately 1%.

Changes in EMV and TMV also resulted in an overall change of deferral received under the program. TMV decreased by $130 million between 2009 and 2010, while the "highest and best use" EMV decreased $1.5 billion. This resulted in a net loss in deferral amount of approximately $1.4 billion.

Overall, for taxes payable in 2011, parcels receiving Green Acres deferments in both 2009 and 2010 paid taxes on $11.5 billion of the total $16.9 billion EMV (i.e. 68% of the EMV for these parcels was taxed while the remaining 32% was deferred).



There were a total of 498,042 parcels where the primary class was 2a, 2b, or 2c in both assessment years 2009 and 2010. Of those, 59,952 (12%) received Green Acres deferments in both years while 432,366 (87%) did not receive deferments in either year. The remaining 5,751 parcels had deferments in only one of the two years.

Comparison of changes in TMV and NTC

The TMV of a given property is not the sole determinant of taxes paid. Increases in taxes are also the result of changes in the net tax capacity (NTC) for a given parcel. NTC is determined by multiplying the taxable market value by the class rate:

(Net tax capacity) = (taxable market value) x (class rate)

As an example, consider an agricultural homestead parcel with a TMV of $600,000 and a class rate of .50%, yielding an NTC of $3,000.

Example: Standard NTC Calculation				
Taxable market value	X	Class rate	=	Net tax capacity
$600,000	X	.50%	=	$3,000

There are two primary causes of class rate changes that result in significant NTC increases for parcels classified as agricultural in both 2009 and 2010 assessment years (taxes payable 2010 and 2011) can be identified: the loss of the preferential homestead class rate, and the effects of "chaining" agricultural homestead parcels. Each of these causes is discussed as follows.

1. **Property loses homestead.** For agricultural parcels that changed from homestead to non-homestead, the class rate increased from .50% to 1.00%, effectively doubling the NTC on those parcels. Using the example above, the loss of homestead status would cause the NTC to increase to $6,000. Over 6,600 agricultural parcels (about 1.3%), lost homestead status between the 2009 and 2010 assessments. This may have occurred for a number of reasons, including assessor reviews (an example of agricultural homestead determinations is included in Appendix C of this report).

2. **Agricultural property becomes valued at a new tier.** Agricultural homestead properties have a .50% class rate on the first tier and a 1.00% class rate on the second tier. For the 2009 assessment, the first tier value was $1,010,000. For the 2010 assessment, the tier limit was $1,140,000. (The value of the first tier is annually adjusted and will be $1,210,000 for the 2011 assessment). If a parcel or a portion of a parcel assessed as one agricultural homestead crosses over this tier, the class rate is increased on that parcel and any other parcels valued above. Any additional value is taxed in the second tier at a class rate of 1.00%. Multiple parcels can also be grouped together under a single ownership in a "chain". With chaining, the class rate for a parcel is determined by the value of the entire chain of parcels and not the value of any one individual parcel.

CHANGES TO GREEN ACRES AND AGRICULTURAL PROPERTY ASSESSMENT, 2010

There were two changes of note to agricultural property tax laws that occurred during the 2010 session:

- A provision allowing for the first-tier homestead agricultural rate for non-homesteaded agricultural land owned by a qualifying entity; and
- Changes to the process by which the Department of Revenue determines agricultural values for Green Acres purposes.

Minnesota Statutes, section 273.124, subdivision 8, was amended to add a new paragraph which allows for agricultural property owned by a family farm corporation, joint farm venture, LLC, or partnership that is contiguous to an individual's owner-occupied agricultural homestead (or located in the same township or city, or not farther than four townships or cities or a combination thereof from the homestead) to receive the first tier homestead class rate up to the first tier maximum market value on any remaining market value not received on the shareholder's, member's, or partner's homestead class 2a property.

Under previous law, it was not allowed to link properties owned by different entities for homestead purposes (e.g., an individual's homestead to property owned by a family farm corporation). Under the revised law, if there is unused market value of an individual's agricultural homestead, that individual may apply market value from entity-owned land of which he/she is a member to maximize the first-tier rate on those additional entity-owned

lands. This linkage does not provide for the agricultural market value credit, nor does it allow additional Green Acres deferral eligibility.

The change regarding valuation amended Minnesota Statutes, section 273.111, subdivision 4. This change was discussed in greater depth in a previous section. The language was part of an ongoing effort to clear misconceptions about how Green Acres values are determined, to address the various agricultural economies in the state, to clarify each county's relationship to the base counties for agricultural land values, and acts as a process of verifying or helping tax administrators to change the factors used for Green Acres purposes. It does not represent a move away from sales-based valuations, but does allow the department to consider multiple factors when valuing agricultural properties.

OUTLOOK FOR TAXES PAYABLE 2011 AND THEREAFTER

Minnesota's property tax system - with various components including classification, valuation, and special programs - determines which properties will pay a greater or lesser share of taxes. Agricultural properties, through both classification rates and valuations such as Green Acres, have typically received preferential property tax treatment. Conversely, commercial properties that have a higher class rate will pay a greater share of taxes than a residential or agricultural property of equal value.

Based on preliminary estimates from the 2010 assessment year (taxes payable 2011), agricultural and rural vacant land represented about 17% of taxable property value and paid about 7% of property taxes (see table below). In comparison, commercial properties accounted for 13% of taxable property and paid approximately 31% of property taxes:

Tax Liability Share by Classes of Property
(Assessment Year 2010, Taxes Payable 2011)

Properties by Class	Market Value (in millions)	Net Tax (in millions)	Market Value Share	Share of Net Taxes Payable
Agricultural/Rural Vacant Land	$97,506	$571	17%	7%
Residential	$353,330	$4,460	63%	55%
Seasonal Recreational	$25,797	$221	5%	3%
Commercial/Industrial	$71,122	$2,492	13%	31%
Utility/other	$12,659	$351	2%	4%

As previously stated, the amount of taxes paid by a property owner is not determined solely by the TMV of a given parcel. The fact that agricultural property values have increased while other property values for other classes have decreased has led to a shift in tax burden onto the agricultural classes. Also, the levies of local jurisdictions influence taxes. For taxes payable in 2011, local levies increased statewide 1.9%. This is lower than in recent years, though some individual jurisdictions had higher levy increases.

Appendix E shows the areas of the state where properties are receiving Green Acres deferral. Appendix F shows an estimate of the tax increase on residential properties in areas where Green Acres value deferrals have impacted the local tax base. In a 2008 report by the Office of the Legislative Auditor, the tax impacts were greater overall largely due to the fact that – at the

time - residential and commercial properties were increasing in value and taking on a greater share of the tax burden than properties affected by the artificial Green Acres value. The overall impact of Green Acres tax shifting on residential or commercial properties will change as the estimated and taxable market values of all property types change in relation to each other.

2011 is the first assessment year in which voluntary withdrawals of class 2b rural vacant land from Green Acres will go into effect and when properties may be enrolled in Rural Preserve. Final withdrawal of all 2b land from Green Acres will take place for the 2013 assessment year (taxes payable in 2014).

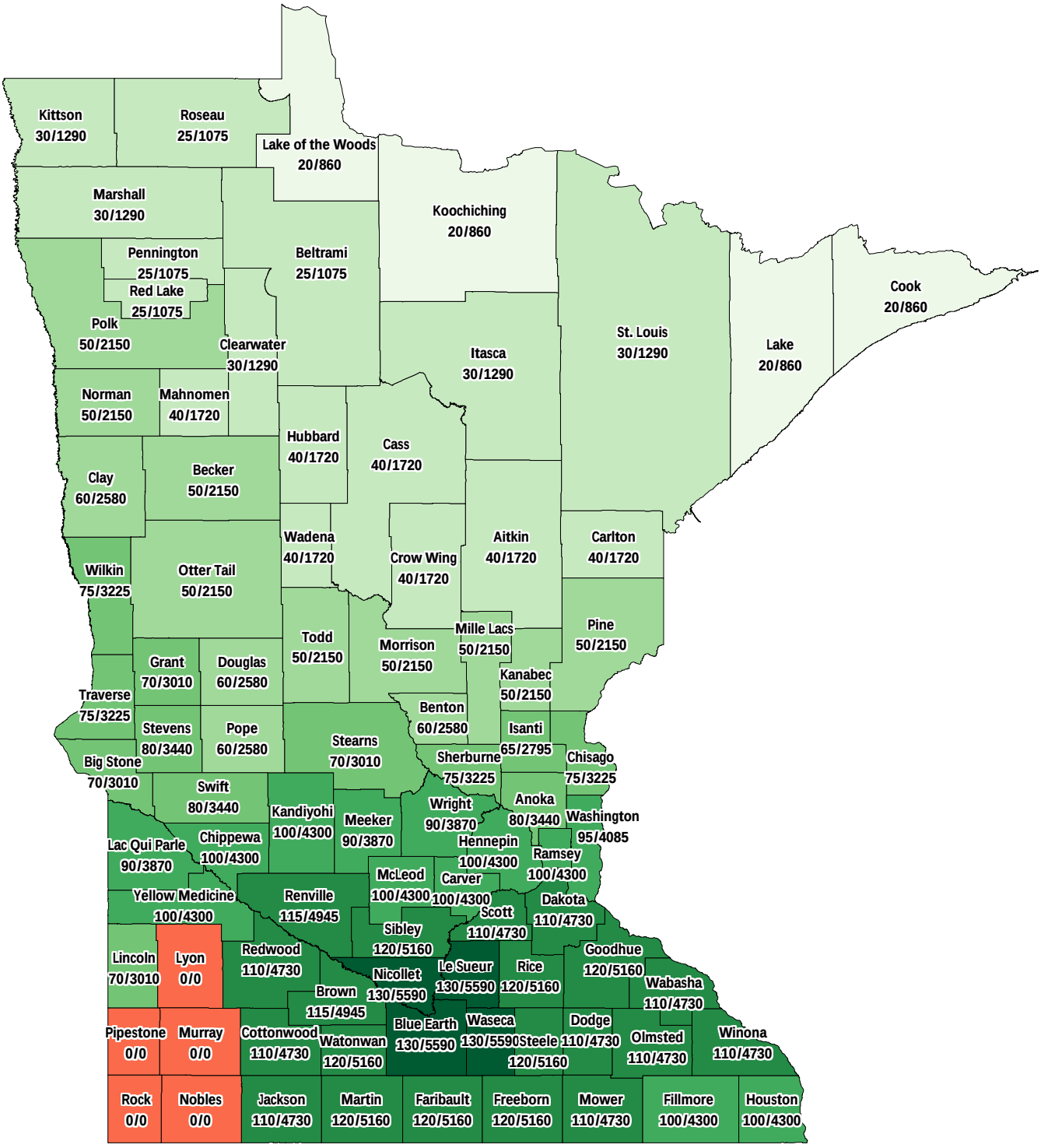
CONCLUSION

For the 2010 report, various compounding factors led to an increase in taxes on agricultural properties statewide. Many of these factors are no longer causing changes in property taxes as we have moved beyond the 2009 assessment year. For example, the 2009 expiration of the limited market value no longer contributes to tax changes. Corrections to assessments that took place for the 2009 assessment will not have the same impact as we move beyond and the quality of assessments has improved.

The Department of Revenue continues the process of reviewing Green Acres with members of the assessment and farm communities. We continue to study our process of valuing agricultural properties without consideration to non-agricultural influences, to determine legitimate values for both tilled and non-tilled farm properties, and to provide oversight of the assessment process statewide so that all farm properties are being treated fairly and equitably for tax purposes.

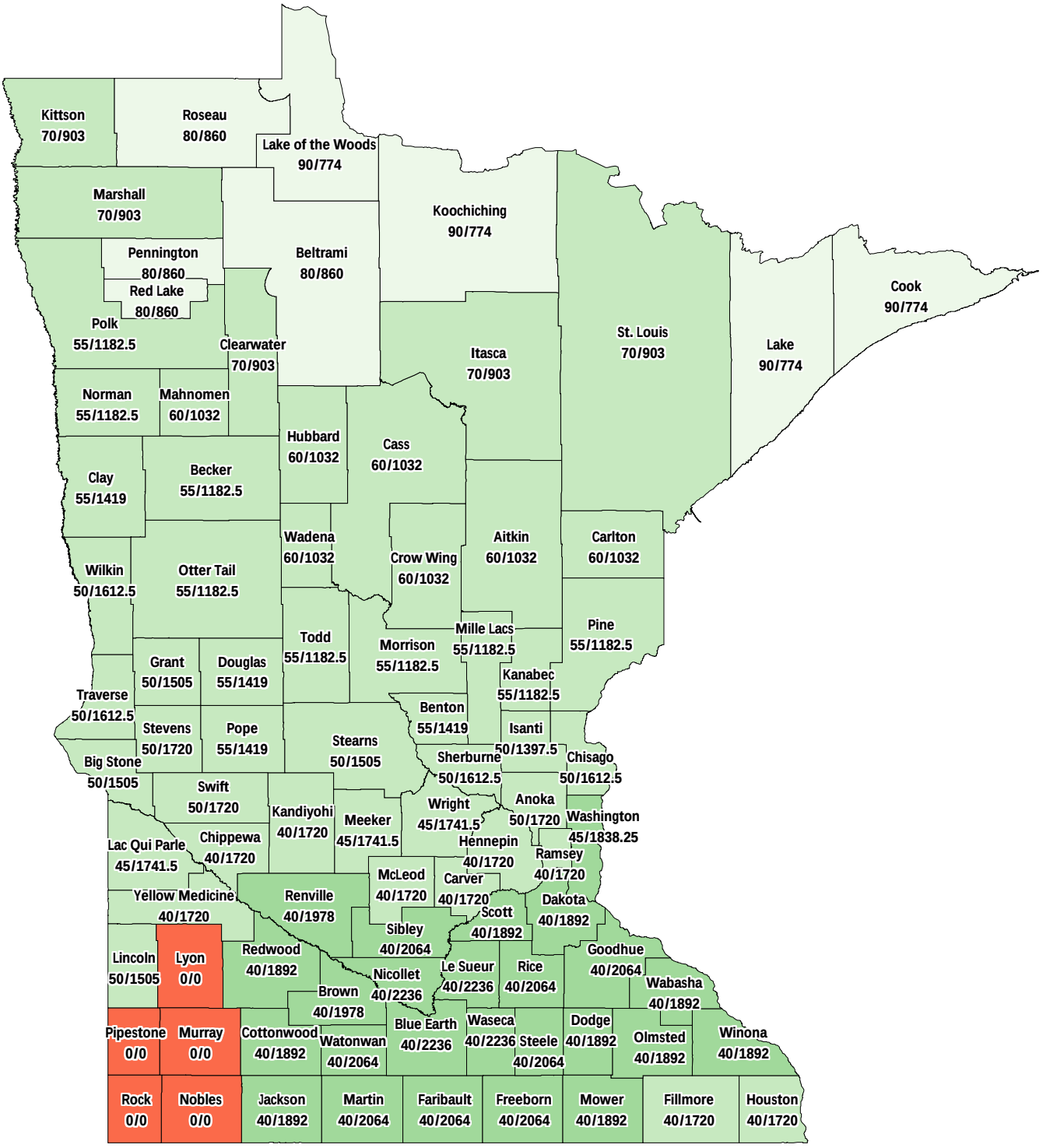
APPENDICES

Appendix A: Tilled agricultural values and factors for Green Acres, 2011 assessment



Each county's factor is multiplied by the base county median ($4,300 for the 2011 assessment) to arrive at the county's average per-acre tilled value for Green Acres purposes. This calculation process is discussed on pages 3 and 4 of the report.

Appendix B: Optional non-tilled agricultural values for Green Acres, 2011 assessment



Under optional new methodology for the 2011 assessment year, the factors shown above are multiplied by the tilled Green Acres value for each county. The product is the county's average non-tilled Green Acres value. The factor represents a percentage of the tilled value. This results in a compression in the range of non-tilled Green Acres values statewide. The optional method for calculating 2011 non-tilled values is discussed on pages 6 and 7 of this report.

Appendix C: Determining the agricultural classification

The Department of Revenue has provided assessors with the following objective factors that are considered before making a classification decision. It should also be noted that these factors are based on the preceding year's use of the land. These factors do not address agricultural land that is less than ten acres in size. Additionally, assessors must classify the land as class 2a if all or a portion of the agricultural use of that property is the leasing to, or use by, another person for agricultural purposes.

1. At least 10 contiguous acres being used to produce agricultural products for sale

Statute requires that there be at least 10 contiguous acres being used to produce an agricultural product for sale in order for a property to be class 2a agricultural land. "Contiguous" is defined by the dictionary provided by law.com as "connected or 'next to', usually meaning adjoining pieces of real estate." This means a property should not typically be classified as agricultural when there is a total of 10 acres if the acres are broken up in small plots.

In some rare circumstances, reasonable justification may warrant classifying smaller land masses as class 2a agricultural land if the agricultural land on the parcel totals at least 10 acres. To justify the classification in these cases, assessors use their expertise and professional judgment in considering certain criteria:

- Overall size (number of acres) of the parcel
- Number of acres used agriculturally in relation to overall acres
- Crop being raised and sold on the agricultural acres
- Composition of agriculturally-used acres (contiguous or noncontiguous)
    - Sizes of the noncontiguous portions used agriculturally or non-agriculturally
    - The locations of the agriculturally used acreage (distance, accessibility, etc.)
    - Whether the configuration of the agriculturally used acreage lend themselves to agricultural production
    - The use of the land separating the noncontiguous agriculturally-used acreage

Parcel lines or separate legal descriptions do not break up the contiguity of land masses used for agricultural purposes as long as the parcels are in the same ownership.

Lands that will be deemed "impractical to separate" (i.e. ditches, waterways, etc.) also do not break up the contiguity of the agricultural land.

2. Property is producing an agricultural product as defined by statute

The following are the agricultural products as defined in Minnesota Statutes 273.13, subdivision 23, paragraph (i):

- livestock, dairy animals, dairy products, poultry and poultry products, fur-bearing animals, horticultural and nursery stock, fruit of all kinds, vegetables, forage, grains, bees, and apiary products by the owner **or** the commercial boarding of horses if the boarding is done in conjunction with raising or cultivating agricultural products as listed in statute;
- fish bred for sale and consumption if the fish breeding occurs on land zoned for agricultural use;
- property which is owned and operated by nonprofit organizations used for equestrian activities, excluding racing;
- game birds and waterfowl bred and raised for use on a shooting preserve;
- insects primarily bred to be used as food for animals;

- trees, grown for sale as a crop, including short rotation woody crops, and not sold for timber, lumber, wood, or wood products; and
- maple syrup taken from trees grown by a person licensed by the Minnesota Department of Agriculture as a food processor.

Land must be being used to produce one of these products in order to potentially qualify as class 2a agricultural land.

3. Agricultural product is produced for the purpose of sale

The agricultural product produced on the land must be produced for the purpose of sale. Although income should not be the sole determining factor, assessors are asked to consider the following criteria:

- Income (Schedule F) of agricultural products (crops, livestock, etc.)
- How the agricultural products were sold (food plots for wildlife do not qualify)
- Income earned in the past year from sale of animals
- The income from the agricultural acres divided by the total acres
- Rental income from agricultural lease

Federal and state conservation programs such as CRP, CREP, RIM, and other similar programs may also qualify for the agricultural classification, but to be eligible for Green Acres the land must have been in agricultural use before enrollment in the conservation program, and perpetual RIM does not qualify for Green Acres.

Split-Classifying Agricultural Property

Beyond land used for agricultural purposes and classified as 2a, assessors identify any acreage that is used for separate uses. If there is no separate use, then the property is classified as class 2a for the agricultural lands and class 2b for any rural vacant lands, and there is a potential for an agricultural homestead.

If there is an identifiable separate use, then the property is split-classified. There are typically five split-classification options, each dependent on the number of acres in agricultural production (therefore class 2a land). The options each have homestead eligibility implications.

1. If there are at least 10 contiguous acres used for agricultural purposes, those acres are classified as 2a land. The remainder of the land is classified according to its identifiable separate use(s) – potentially class 2b rural vacant lands, class 3a commercial, etc. The class 2a and 2b portions of the property may be eligible for homestead.

The following options (2 through 5) apply if there are less than 10 contiguous acres used for agricultural purposes (this does not apply to the intensive or exclusive provisions for properties under ten acres in size discussed earlier in this report). If there are less than 10 contiguous acres in agricultural production, no acres will be classified as 2a land and the property is not eligible for agricultural homestead or Green Acres.

2. If the parcel is <u>less than 20 acres</u> in size, unplatted, rural in character, and is not improved with a structure (unless the structure is minor and ancillary), the entire property is classified as 2b rural vacant land. The property on its own is not eligible for any type of homestead. (It could be linked to an agricultural homestead if the parcel is contiguous to class 2a land

under the same ownership.)

3. If the parcel is less than 20 acres in size, and is improved with a structure (other than a minor or ancillary structure), the property is classified according to the use of the structure. If the structure is a residence, the property may be eligible for a residential homestead.

4. If the parcel is 20 or more acres in size, and is unplatted, rural in character, and not improved with a structure (unless the structure is minor and ancillary), the entire property is classified as 2b rural vacant land. The property on its own is not eligible for any type of homestead. (It could be linked to an agricultural homestead if the parcel is contiguous to class 2a land under the same ownership.)

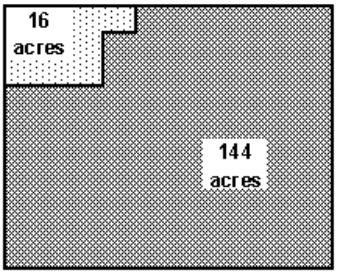
5. If the parcel is 20 or more acres in size, and is improved with a structure (other than a minor or ancillary structure), the structure and the immediately surrounding 10 acres are classified according to the use of the structure. If the structure is a residence, that portion of the property may be eligible for a residential homestead. The remainder of the property is classified as 2b rural vacant land and on its own is not eligible for any type of homestead.

   If, in (2) through (5) above, classification as 2b is not applicable because of enrollment in class 2c Managed Forest Land or some other program, or because another classification is appropriate based on the use of the land, that classification should be used in place of class 2b. There may also be instances where three or more different uses of the parcel are identified (for example, a house, 2b land, and commercial use). In these cases, the parcel may have multiple classifications.

In instances where there is a parcel with less than 10 tilled acres that are not eligible for 2a classification, the department has recommended these parcels be classified according to a statutorily-allowable classification – which is almost always class 2b rural vacant land. The statute for class 2b prohibits land being used for agricultural purposes, but it is our opinion that since there are not at least 10 acres in production, these lands are not used for agricultural purposes. If there is a structure, then the classification would be based on the use of the structure. For example, a parcel with 8 acres and a house would likely all be classified as residential.

Classification Determination Examples:
The following page has some illustrative examples of potential split-classifications when the rural vacant land (class 2b) classification is applicable.

Note: these are simplified examples for illustrative purposes only. They assume the only uses are class 2b rural vacant land or residential when there is a structure on the property. They also assume these parcels are not contiguous to any other parcels under the same ownership. Changing any of these parameters will likely change the results (as described in this document).

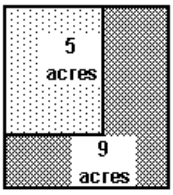


Example 1

A 160 acre unimproved parcel with 16 acres being tilled, and 144 acres of woods. This property would be classified as follows:

Since the parcel has at least 10 contiguous acres used for agricultural purposes, you must classify the land according to its use. The 16 acres would be classified as 2a agricultural land and the 144 acres of woods would be classified as 2b rural vacant land.

The parcel, on its own, would not be eligible for any homestead.

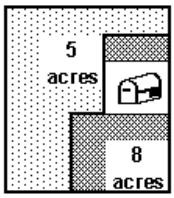


Example 2

A 14 acre unimproved parcel with 5 acres being tilled, and 9 acres of slough. This property would be classified as follows:

Since the parcel is less than 20 acres, is not improved with any non-minor structures, and does not have at least 10 contiguous acres used for agricultural purposes, you must classify the entire property as 2b rural vacant land.

The parcel, on its own, would not be eligible for any homestead.

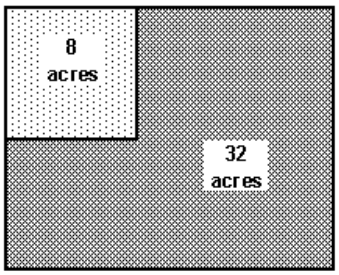


Example 3

A 14 acre parcel with a residence, 5 acres being tilled, and 8 acres of marsh. This property would be classified as follows:

Since the parcel is less than 20 acres, is improved with a non-minor structure, and does not have at least 10 acres used for agricultural purposes, you must classify the entire property according to the use of the structure.

The parcel would be eligible for a homestead.

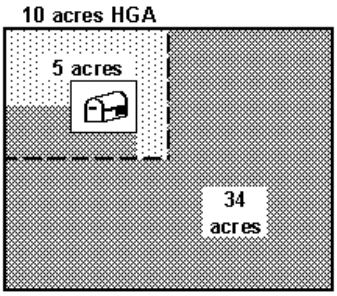


Example 4

A 40 acre unimproved parcel with 8 acres being tilled, and 32 acres of woods. This property would be classified as follows:

Since the parcel is over 20 acres, is not improved with any non-minor structures, and does not have at least 10 contiguous acres used for agricultural purposes, you must classify the entire property as 2b rural vacant land.

The parcel, on its own, would not be eligible for any homestead.



Example 5

A 40 acre parcel with a residence, 5 acres being tilled, and 34 acres of marsh. This property would be classified as follows:

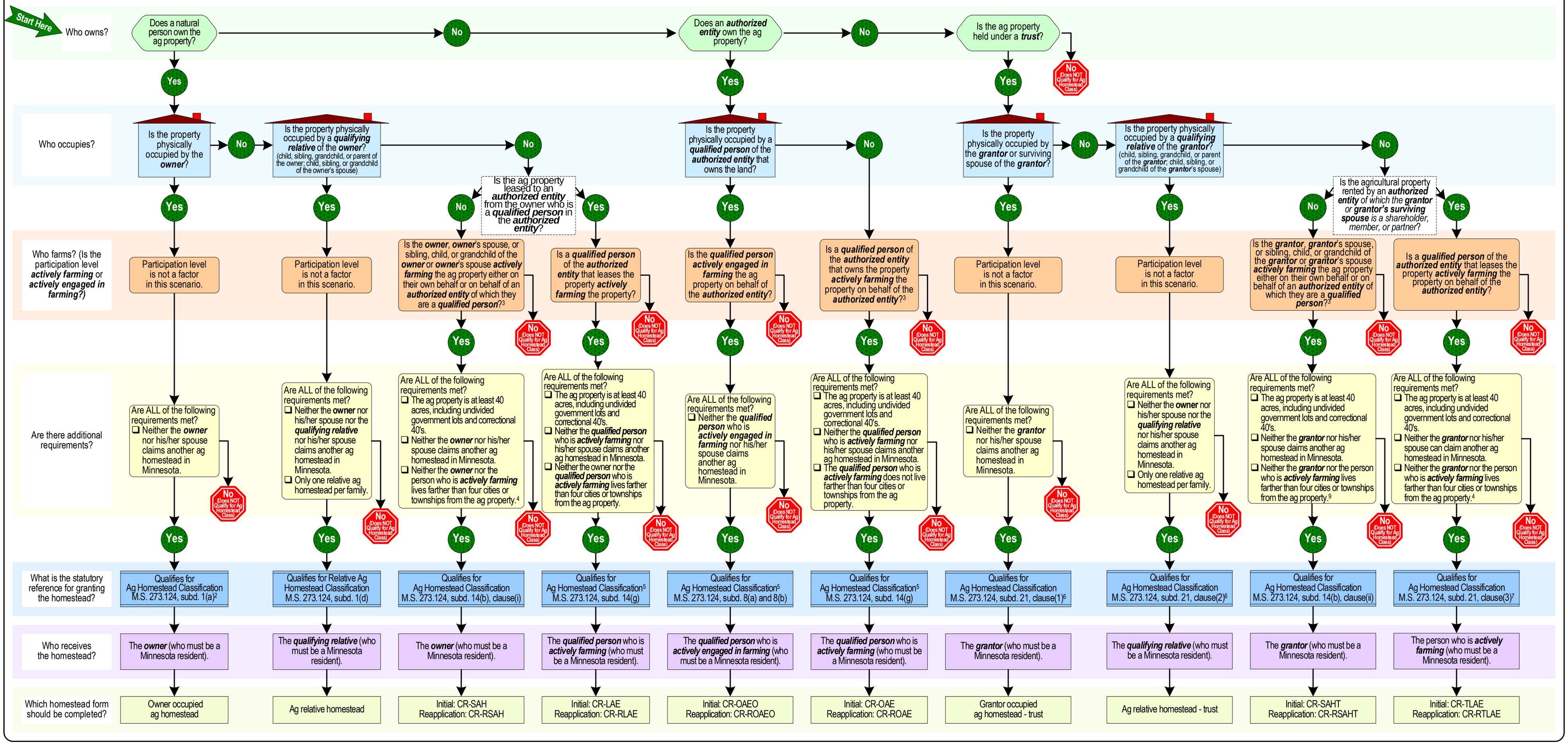
Since the parcel is over 20 acres, contains a non-minor structure, and does not have at least 10 contiguous acres used for agricultural production, you must classify the immediately surrounding 10 acres according to the use of the structure. The remaining acres are classified as 2b rural vacant land.

The 10 acres would be eligible for a residential homestead.

Determining if property qualifies for the agricultural homestead[1] classification

2009 Revisions

Note: Terms in ***bold, italic font*** are defined in the glossary.



Footnotes

Note: Terms in ***bold, italic font*** are defined in the glossary.

[1] The property must first properly qualify as agricultural pursuant to M.S. 273.13, subd. 23.

[2] If the entire property including the HGA is leased, the property must meet the requirements of M.S. 273.124, subd. 8(c) to qualify as an owner occupied ag homestead.

[3] In some cases, the Farm Service Agency number may be in an ***authorized entity***'s name when the person ***actively farming*** is doing so on behalf of the ***authorized entity***.

[4] If the ***owner*** or the ***owner***'s spouse (or ***grantor*** or ***grantor***'s spouse) is required by their employer to live in employer-provided housing, the ***owner*** or ***owner***'s spouse, whomever is ***actively farming*** the agricultural property, may live more than four townships or cities, or combination of four townships or cities from the agricultural property.

[5] This is limited to ***authorized entities*** with 12 or fewer members, shareholders or partners.

[6] If the entire property including the HGA is leased, the property must qualify under M.S. 273.124, subd. 21, clause (3) to qualify as an owner occupied ag homestead.

[7] This statute was amended by Laws 2005, Chapter 151, Article 5, Section 21. Previously, this provision required a ***qualified person*** of the ***authorized entity*** to occupy the property and ***actively farm*** it on behalf of the ***authorized entity*** to receive homestead (the qualified person did not have to be the ***grantor***, spouse of the ***grantor*** or son or daughter of the ***grantor***). Those receiving homestead under this clause for taxes payable in 2005, but no longer qualify due to the 2005 law change, may continue to receive homestead as long as the requirements of this clause as it existed for taxes payable in 2005 are met.

Glossary

Note: Terms used in the flow chart are defined below. See the full glossary in the agricultural bulletin for definitions of ***bold, italic*** words listed below.

actively engaged in farming - participation on the farm on a regular and substantial basis. The person who is actively engaged in farming must be a Minnesota resident.

actively farming - participation in the day-to-day decision making, labor, administration and management of the farm as well as assuming all or a portion of the financial risks and sharing in any profits or losses. The person who is actively farming must be a Minnesota resident.

authorized entity - can be a ***family farm corporation, joint family farm venture, limited liability company,*** or ***partnership*** operating a ***family farm*** (M.S. 273.124, subdivision 8(a)). This is limited to authorized entities with 12 or fewer members, shareholders or partners. The following entities would be eligible for homestead treatment: ***authorized farm limited liability company*** **(operating a** ***family farm*****);** ***authorized farm partnership*** **(operating a** ***family farm*****);** ***family farm; family farm corporation; family farm limited liability company*** **(operating a** ***family farm*****);** ***family farm partnership; general partnership*** **(operating a** ***family farm*****).**

grantor - is defined as the person creating or establishing a testamentary, ***inter vivos, revocable*** or ***irrevocable trust*** by written instrument or through the exercise of a power of appointment (M.S. 273.124, subdivision 21). For property that is held under a trust to receive an agricultural homestead, the grantor must be a Minnesota resident, and neither the grantor nor the spouse of the grantor can claim another agricultural homestead.

owner - is defined as an individual person or multiple people who own the property (i.e. not owned by a business or entity). To receive an agricultural homestead, the owner must be a Minnesota resident, and neither the owner nor the spouse of the owner can claim another agricultural homestead.

qualified person - must be a Minnesota resident and can be a: member in an authorized entity; a shareholder in an authorized entity; or a partner in an authorized entity.

qualifying relative or surviving relative - must be a Minnesota resident. The definition depends on the type of property:
Residential property: a qualified relative of the owner or grantor can be a parent, stepparent, child, stepchild, grandparent, grandchild, sibling, aunt/uncle, or niece/nephew (M.S. 273.124, subdivision 1(c)).
Agricultural property: a qualified relative can be a child, sibling, grandchild or parent of the owner or grantor of the agricultural property or a child, sibling or grandchild of the spouse of the owner or grantor of the agricultural property (M.S. 273.124, subdivision 1(d)).

trust - a fiduciary relationship under which one party holds property for the benefit of another party.

trustee - means the party that holds property rights for the benefit of another party through a trust.

Revised July 2009

Appendix D: "Primarily devoted to" test and considerations

1. PHYSICAL

- The number of acres used agriculturally compared to total acres
- Number of acres used for residential purposes compared to those used agriculturally
- Visible indication of participation in actual farming activity
- Presence of physical structures for livestock, equipment, storage, etc. used to support agricultural activity
- Surrounding uses (i.e. farming versus development), zoning restrictions, etc.
- Historical use, current use
- Local market is highly susceptible to real estate speculation
- Current market trends for property
- The number and type of animals raised as agricultural products in comparison to the overall use of the property
- Length of time animals raised as agricultural products are physically located on the property each year
- Use of the property by the lessee, if rented

2. VALUATION

Although consideration of value is not appropriate for determining class, it still may be considered in determining "primarily devoted to" for Green Acres eligibility. Criteria to consider could be:

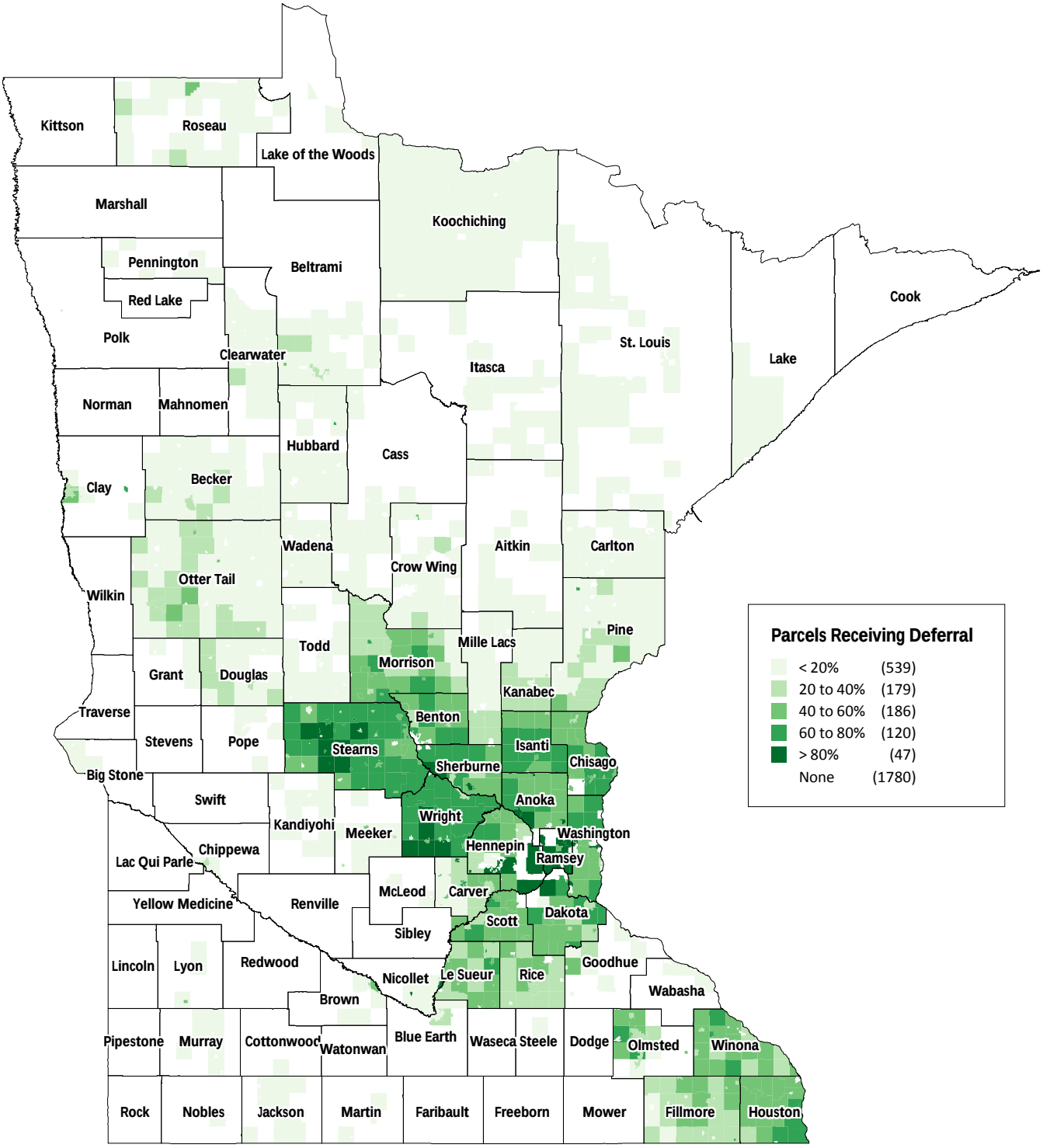
- Value as a residential site compared to the agricultural value
- Ag value compared to overall value of property
- Residential value compared to overall value of the property
- Ag value compared to other use value (e.g. commercial)

3. INCOME

Although income is no longer a required factor for determining Green Acres eligibility, assessors may include income in the list of criteria that could be considered when trying to address the "primarily devoted to" test. Suggested income criteria would be:

- The income from the class 2a acres divided by the total acres
- Income (Schedule F) of agricultural products (crops, livestock, etc.)
- The income from rented acres
    - Number of acres rented agriculturally
    - Number of acres rented for other use
    - Actual rent compared to market rents in the area
    - Rental income from agricultural use
    - Rental income from other use (i.e. commercial storage, house rental, etc.)
- Owner's knowledge of farm markets
- Owner's agricultural income compared to owner's total income and/or other income-producing uses of the land
- Significant agricultural income compared to value of homestead

Appendix E: Percentage of classes 2a and 2b parcels receiving Green Acres deferral, 2010 assessment year



Appendix F: Green Acres deferral impact on residential properties