

November 4, 2011

MEMO TO: Members of the Budget and Finance Committee

F R O M: Mike White, Chair 
Temporary Investigative Group

SUBJECT: **DISPARITY OF REAL PROPERTY ASSESSMENTS FOR AGRICULTURAL VERSUS NON-AGRICULTURAL LANDS** (BF-70)

The Temporary Investigative Group (“TIG”) of the Budget and Finance Committee, having met on October 8, 10, 16, 21, 23, 24, 28, and 30, and November 1, 2011, makes its report as follows.

I. Purpose

The TIG was formed to make findings and recommendations on policies relating to the apparent disparity of real property assessments for agricultural use versus non-agricultural use.

II. Scope of Investigation

The scope of the TIG’s investigation was limited to the following:

- Review of the current and historical methodologies and practices related to assessments of agricultural and non-agricultural real property in Maui County;
- Review and analysis of real property assessment practices, tax rates, policies, codes, and ordinances of municipalities outside of Maui County;
- Interviews and discussions with personnel related to the County’s assessment of real property;
- Interviews and discussions with representatives from agricultural associations and community or homeowner associations, which represent neighborhoods that are located on agriculturally zoned lands; and
- Interviews and discussions with real property mass appraisal and tax policy industry experts.

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III. Resources

The TIG consulted with representatives from the County of Maui's Department of Finance and the Department of the Corporation Counsel, as well as the Budget Director. In particular, the TIG relied heavily upon the expertise of the Real Property Tax Division, including the Administrator of the Division and the Real Property Technical Officer. With their assistance, the TIG reviewed current practices relating to agricultural use assessments and agricultural dedications, their impacts on agricultural preservation and revenue generation, and possible options for amending those policies.

The TIG met with the real property tax administrators from the City and County of Honolulu and the County of Hawaii, who provided valuable information concerning their respective County's approaches on agricultural assessment practices and policies. To better appreciate how options being considered might impact agricultural operators, the TIG also sought input from representatives of the Maui Cattlemen's Association, Inc.; the Hawaii Farm Bureau Federation, Maui County; and the United States Department of Agriculture.

IV. Findings

The TIG finds that it is in the best interest of the County to protect and promote active agricultural use of property. Such use provides an opportunity to make the County more self-sustaining; preserves green belts and open space for all to enjoy; and requires less intense infrastructural requirements than denser developments would require, with the possible exception of water requirements. Active agriculture promotes Maui's main economic driver – tourism – by complementing the aesthetic attributes of Maui that continue to draw visitors to the County.

A. Valuation of Homesites on Parcels with Agricultural Use

1. The TIG confirmed significant inequities between homesite values in residential districts vs. homesite values for parcels receiving agricultural use assessments, despite comparable character, size, and use of the homesite.
2. The methodology employed in establishing homesite land values should be applied equitably regardless of surrounding or adjacent agricultural use on the parcel.
3. Rule 4(c), "Rules and Regulations of the Director of Finance relating to the Assessment of Agricultural Lands and the Imposition of the Deferred Tax under Section 3.48.325, Maui County Code" (1981), provides:

“When lands within the agricultural district are not put to any agricultural use, including any portion of the land being used as a homesite, such lands shall be assessed at their highest and best use based upon comparable values of similar lands being put to similar uses as reflected in the market.” The rule has not been codified or implemented.

4. Currently, if a parcel in the agricultural district has both an active agricultural use and a homesite on it, the entire parcel receives the discounted tax treatment. The TIG found that the agricultural tax benefit should be limited to the portion of the parcel in active agricultural use.
5. There is, therefore, a need for the County’s assessment practices to be refined by establishing a means of valuing the homesite independently from the portion that is in active agricultural use.

B. Agricultural Dedications

1. One way to encourage agricultural use is by providing tax incentives for such use. However, the current system of assessing agricultural parcels has proven to be a weak tool for preserving agricultural land and open space. The TIG found that, for real property tax purposes, from 2001 to 2011, 16,544 acres have moved out of active agricultural use (although the actual “loss” of agriculture as a whole is likely much larger). In addition, from 2001 to 2011, the average increase in assessed land value and taxes for all real property tax classifications, except Agricultural, was 90.1 percent and 89.4 percent, respectively, while changes to assessed land value and taxes for the Agricultural tax classification for the same period remained essentially flat.
2. Currently, properties claiming an agricultural use assessment or agricultural dedications are not uniformly being used for agricultural purposes.
3. A system of requiring property owners to dedicate their land for agricultural use in order to receive the significant tax benefit associated with agricultural use is appropriate. Further, establishing a penalty such as a “rollback” of taxes for violating an agricultural dedication is a common practice throughout the nation, and is meant to discourage an owner from changing the use of dedicated agricultural land.

4. The County currently offers 10- or 20-year agricultural dedications. However, only a small percentage of agricultural owners have dedicated their lands for agricultural use. Under the current benefits provided, limiting dedications to these two options is not practical for many. The County would be more responsive to owners who wish to pursue agriculture by offering a wider range of dedication options. If the public interest is best served by maintaining agricultural use and open space in the long term, extending the dedication period is in the public interest. While 5- and 10-year dedication periods provide flexibility to the property owner, these options do not necessarily support the public benefit of long-term preservation of agricultural land and open space.
5. While all agricultural dedications will receive tax incentives, the TIG finds that the public subsidy for long-term dedications should provide a more significant discount than the subsidy for shorter-term dedications.
6. “Agricultural use”, “homesite”, and other terms should be defined for real property tax purposes in the Maui County Code (“MCC”). The MCC currently lacks adequate definitions to effectively administer the system recommended by the TIG.
7. Section 3.48.320, MCC, provides the basis for the Director to calculate the agricultural use value for property being used for agricultural purposes. In pertinent part, agricultural use value means the value of land dedicated for agricultural use, as determined by the Director, taking into consideration rent, productivity, nature of actual agricultural use, the advantage of factors such as location, accessibility, transportation facilities, size, shape, topography, quality of soil, water privileges, availability of water and its cost, easements and appurtenances, and the opinions of persons who may be considered to have special knowledge of land values.
8. Currently, assessments are based on the type of agriculture conducted on the property. Agriculture is classified into one of four types – pasture, diversified agriculture, sugar, and pineapple. The Real Property Tax Division uses a per-acre value based on a soils classification study done in 1967, which factors in location of the property and type of agriculture to be conducted. The values do not significantly differ between types.
9. The TIG finds that the current agricultural use assessment system is based on values that are over 40 years old, and the system has not been updated

to accommodate more current values or new technologies and crops, such as hydroponics and seed crops.

10. However, the TIG finds that the agricultural assessment methodology requires more study than permitted by the timeframe within which the TIG must complete its work. The TIG, therefore, finds that the process of requiring agricultural dedications may proceed, with the current agricultural use values remaining until a new valuation method can be adequately determined.

V. Recommendations

The TIG's recommendations fall into two tiers. The recommendations in the first tier include policies for immediate consideration. Legislation incorporating these policies may be feasible by year's end, with petitions for agricultural dedications due in 2012. The recommendations in the second tier include certain policies that should be more fully explored in the near future. The TIG does not consider these second-tier options to be viable without additional study. Phasing of implementation would allow for adequate public notification. It would also allow staff, who would administer changes, the time to do the necessary groundwork, including the promulgation of any administrative rules.

A. First Tier

The TIG recommends that the following system be established relating to assessments of real property being used for agriculture.

1. Purpose. The purpose of the revised methodology is to protect and promote agricultural use of property in the County by focusing on tax incentives for agriculture, while eliminating the ability of properties not engaged in agriculture to claim such incentives. The agricultural dedication system would thereby continue to offer farmers, ranchers, and others engaged in agriculture an opportunity for significant discounts in real property tax assessments, based on a requirement that lands be dedicated.
2. Methodology. To implement the revised methodology, the Council must enact appropriate legislation to amend agricultural assessment practices. The Real Property Tax Division will administer the system by proposing necessary budgetary requirements and will launch public education campaigns to notify the public of changes to take effect.

3. Framework for legislation. These recommendations are merely recommendations of the TIG, as authorized by Section 92-2.5, Hawaii Revised Statutes. As required by this statute, deliberation and decision making on the matter investigated, if any, must occur only at a duly noticed meeting of the board held subsequent to the meeting at which the findings and recommendations of the investigation are presented to the board. Therefore, TIG's recommendations will be presented to the Budget and Finance Committee, and if appropriate, the Budget and Finance Committee will make its recommendations to the Council.

a. Valuation of Homesites on Parcels with Agricultural Use

(1) Define terms for real property tax purposes:

- "Homesite" means those portions of the parcel excluding: (a) the portion in agricultural use, and (b) the portion that is unusable or unsuitable land for agricultural use.
- "Unusable or unsuitable land for agricultural use" means land that is not usable or suitable for any agricultural use, such as gulches or eroded bedrock. The Director shall have discretion to determine what constitutes unusable or unsuitable land for agricultural use.

(2) The homesite shall be assessed independently from the portion of the parcel in agricultural use, as determined by the Director, based on highest and best use of comparable values of similar lands being put to similar uses, as reflected in the market.

(3) The application of the home exemption and homeowner tax rate will not be affected should these recommendations be enacted.

b. Agricultural Dedications

(1) To receive the significant tax benefits associated with agricultural use, all land shall be dedicated.

(2) Define terms for real property tax purposes:

- “Agricultural use” means the active, commercial, and primary use of land for aquaculture; crop production; livestock production; grazing of animals used in livestock production; and production of livestock byproducts and plants for food, fiber, or energy; flowers and foliage; tree farms; aquatic animals and plants; bees and related natural byproducts; biomass; nuts; and seeds. Agricultural use does not include the use of areas primarily as yard space; setbacks; or landscaping; or the planting of fruit or ornamental trees, flowers, and vegetables primarily for home use.
- “Department” means the Department of Finance.
- “Director” means the Director of Finance of the County or the Director’s authorized representative.
- “Family subdivision” means the subdivision of a parcel for the sole and limited purpose of authorizing a transfer of interest or title from: (1) an owner who is a parent who intends to transfer property to a spouse or children, or (2) owners who are siblings who intend to divide among themselves property received from a parent or grandparent. The transfer shall be immediate and shall be limited to the following persons who are related to the owner by blood, adoption, or marriage: spouse, children, brothers, or sisters. The intended transferee(s) shall be designated by the owner at the time of the subdivision application. Proof of the relationship shall be verified by the Director of Public Works.
- “Land use change” means, for land dedicated for a specific agricultural use, a change or subdivision initiated or authorized by the owner, as follows: (a) a change in the State land use classification from agricultural to urban or rural district, (b) a change in the County zoning from

agricultural district, or (c) final subdivision approval of the land dedicated for a specific agricultural use into parcels of five acres or less, provided that a family subdivision shall not constitute a land use change.

- “Land use change cancellation” means a written notice of cancellation, filed by the owner with the Director, due to a land use change whereby the land or a portion thereof dedicated for a specific agricultural use is no longer being maintained as agricultural land. The notice shall specify the nature of the land use change, the acreage and location of the land removed from the dedication, and the acreage and location of the dedicated land remaining, if any.
- “Livestock production” means the raising of cattle, sheep, swine, goats, elk, deer, rabbits, or poultry for food or for the production of food.
- “Maintain as agricultural land” means that the land dedicated for a specific agricultural use shall remain in substantial and continuous agricultural use throughout the dedication period, unless the owner files with the Director a land use change cancellation.
- “Owner” or “property owner” means the fee simple owner of the real property, provided that for government-owned real property, “owner” or “property owner” means a lessee of the land where the lease allows the specific agricultural use.
- “Property” or “real property” means and includes all land and appurtenances, buildings, structures, fences, and improvements, including all machinery and other mechanical or other allied equipment and the foundations thereof, erected on or affixed to the same, whose use is necessary to the utility of, or whose removal cannot be accomplished without substantial damage to, such land, buildings,

structures, fences, and improvements, excluding, however, any growing crops.

- “Revenue-generating” means producing income from the agricultural use of the property.
- “Substantial and continuous agricultural use” means the dedicated land shall be in active, continuous, and revenue-generating agricultural use throughout the period of the dedication. The term shall include necessary and customary fallowing periods.
- “Tree farm property” and “tree farm” means land classified as tree farm property under Chapter 186, Hawaii Revised Statutes.

(3) Assessments. Land for which the Director has approved a petition for dedication for a specific agricultural use must be in substantial and continuous agricultural use. Such land shall be classified and assessed for real property tax purposes as follows:

- Land dedicated for five years shall receive a 50 percent discount from its fair market value;
- Land dedicated for ten years shall receive an 80 percent discount from its fair market value; and
- Land dedicated for twenty years shall be assessed at one-half of its agricultural use value. Land dedicated for use as a tree farm shall be limited to a 20-year dedication option.

(4) Who may petition:

- (a) An owner of land may petition for dedication, or with the written authorization of the owner, a lessee, permittee, or licensee may petition for dedication of the owner’s land. For purposes of this provision, an “owner” shall mean owners representing more than a 50 percent interest in the land. In order to qualify for a dedication, the parcel must be either (1) at

least two acres in size; or (2) if less than two acres and not within the County agricultural district, the land dedicated shall have been in substantial and continuous agricultural use for the immediate past five years and the annual gross income derived from the agricultural use shall not be less than \$5,000 per acre.

- (b) During the term of a dedication, an owner of dedicated land, or with the written authorization of the owner, a lessee, permittee, or licensee, may petition to dedicate land for a longer term than originally provided. If the petition is granted, the longer term shall begin anew.
- (5) Contents of petition. The petition for dedication for a specific agricultural use shall require a signed declaration that if the petition is approved by the Director, the land shall be used for the specific agricultural use for the duration of the dedication period, unless the owner files with the Director a land use change cancellation. The petition for a dedication for a specific agricultural use shall be supported by an agricultural plan. The Director shall prescribe the form of the petition and of the agricultural plan. The agricultural plan shall include the following:
- A description of the specific agricultural use;
 - The tax map key numbers for each parcel containing land to be dedicated;
 - A description of the total acreage of the land;
 - A description of the acreage to be utilized for the specific agricultural use;
 - A description of the homesite, if any, excluded from the dedication;

- Three dated photos taken within 30 days of submitting the petition, as follows:
 - An overall view of the parcel;
 - A medium view of the rows of irrigation, maintained plants, fences, or water troughs; and
 - A close-up view of the maintained plants or animals.
 - Proof that the land dedicated for agricultural use is currently being used as specified in the petition, as determined by the Director;
 - A copy of a valid State of Hawaii general excise tax license obtained for the agricultural purpose, and a transcript of the applicable Federal tax return, including Schedule F; and
 - Processing fees for the petition, as set forth in the annual budget.
- (6) Review of petition. Upon receipt of a petition as provided in (5) above, the Director shall make a determination as to whether the land in the petition area is reasonably well suited for the designated specific agricultural use. The determination shall be based upon a study of the ownership, size of operating unit, present use of surrounding similar lands, State and County use restrictions for the land, an inspection of the land to be dedicated, and other criteria as may be appropriate. The Director shall also make a determination as to whether the designated specific agricultural use conforms to the development plan for the area. The Director shall also make a determination as to the economic feasibility of the designated specific agricultural use of the land. If all the determinations are favorable, the Director shall approve the petition and declare the land to be dedicated for the designated specific agricultural use.

- (7) Timing. A petition to dedicate land or a portion thereof for a specific agricultural use shall be filed with the Director by September 1st of any calendar year. If approved, the assessment based upon the use requested in the petition for dedication shall be effective on January 1st of the calendar year following the filing of the petition. The notice of assessment shall serve as notice of approval or disapproval of the petition for dedication.
- (8) Forfeiture of right to change use. Upon approval by the Director of the petition to dedicate, the owner shall forfeit any right to change the use of the owner's land to a use other than the specified agricultural use for the period of the dedication, except where the owner files with the Director a land use change cancellation.
- (9) Interim reporting. The owner of any parcel of land dedicated under this section shall submit a report to the Director upon the Director's request. The report may be rejected by the Director in the event the report is incomplete or contains incorrect information. The Director shall prescribe the form of the report. The report may include but is not limited to the following:
 - An updated description of the agricultural use of the land during the immediately preceding and current tax years;
 - A copy of State income and general excise tax returns, and a transcript of the Federal tax return, including Schedule F, for the immediately preceding tax year concerning activities conducted on the parcel of land dedicated for a specific agricultural use;
 - The acreage and percentage of the parcel utilized for the specified agricultural use during the immediately preceding and current tax years; and
 - A declaration, if applicable, that the owner will keep the land in substantial and continuous

agricultural use through the remaining period of the dedication.

Any part of the report containing confidential commercial or financial information, including income statements or tax statements, shall be clearly labeled by the owner as such, and shall not be open to inspection by the public unless required by law.

- (10) Inspection of dedicated land. Upon the Director's request for an inspection of land dedicated for agricultural use, the owner shall provide the Director access to the dedicated land. Failure to comply with the Director's request shall be grounds for denying or terminating the agricultural dedication. Termination shall result in an adjustment of the taxes for the current assessment year.
- (11) Rollback tax and penalty.
 - When applicable.
 - If the Director determines, upon inspection, that land dedicated for agricultural use has not been maintained as agricultural land; that the owner failed to file the report requested by the Director within 30 days of the request; or that the report must be rejected, the owner shall be notified of the determination and the owner shall have 30 days to address the determination. If the owner fails to address the determination to the Director's satisfaction, the dedication shall be canceled and the owner shall be subject to a rollback tax and penalty.
 - Upon receipt of a land use change cancellation, the dedication shall be canceled or amended, as the case may be, and the land affected by the land use change shall be subject to rollback tax and penalty.

- Amount of rollback tax and penalty.
 - The rollback tax shall equal the difference between the taxes owed for the dedicated land at 100 percent of the land's fair market value and the taxes actually imposed on the land, retroactive from June 30th of the tax year in which the dedication was canceled to July 1st of the initial year of the dedication, at the tax rate applicable for the respective tax years.
 - The penalty shall be calculated by multiplying the number of years the rollback tax applies by 10 percent of the total rollback tax owed.
 - The rollback tax and penalty shall be a paramount lien on the property.
- (12) If land dedicated for agricultural use undergoes a change, not initiated or authorized by the owner, which changes the State land use classification from agricultural to urban or rural district, or changes the County zoning from agricultural district, the dedication shall continue unless the owner files a written notice of cancellation with the Director within 60 days of the change. Such cancellation shall be effective the following assessment (calendar) year.
- (13) Recordation of cancellation. If a dedication is canceled, the Director shall execute and record a cancellation of the dedication. Costs of recordation shall be borne by the owner.
- (14) Appeal. The owner may appeal any disapproved petition for dedication, rejection of the report, cancellation of the dedication, or imposition of a rollback tax in the same manner as an appeal from an assessment.
- (15) Events that may trigger cancellation of the dedication without rollback tax or penalty. Notwithstanding any

provision in this section to the contrary, the occurrence of any of the following events may cause the dedication to be canceled without the imposition of any rollback taxes or penalties whatsoever:

- The death of any owner; or
 - Events beyond the owner's control which make it infeasible to continue the agricultural use of the dedicated land, including:
 - A serious or debilitating long-term illness or injury suffered by the owner;
 - A natural disaster such as a windstorm, flood, disease, or infestation that destroys the crop or livestock on the dedicated land;
 - The loss of adequate water to continue the agricultural use for which the land was dedicated; or
 - The taking of the dedicated land or any portion thereof by a governmental entity, provided that where only a portion of the dedicated land is taken, the cancellation shall be effective only as to the portion taken.
- (16) Family subdivisions. In the case of a family subdivision, no rollback tax or penalty shall apply, provided that the dedicated land is maintained as agricultural land for the remainder of the dedication period. If any portion of the dedicated land is not maintained as agricultural land, a rollback tax and penalty shall apply for the portion that is not maintained as agricultural land, as provided in section (11).
- (17) Grace period. Notwithstanding any provisions in this section to the contrary, the Director may grant a grace period, not to exceed two years, to an owner of land

dedicated for a specific agricultural use if a bank or other lending institution acquires possession of the dedicated land as a result of a default of a mortgage on the property; if the agricultural use of the dedicated land is terminated because a lessee has abandoned or terminated a lease prior to the end of the lease term and the owner has not found another lessee; or if taxes on the parcel are delinquent. The grace period shall be subject to the following conditions:

- During the grace period, the owner shall not be required to use the dedicated land for the specified agricultural use. The dedicated land shall be assessed at 100 percent of market value.
 - At the end of the grace period, the owner shall use the dedicated land in substantial and continuous agricultural use for the entire remaining period of the dedication. The grace period shall not be counted in determining the owner's compliance with the dedication.
 - No grace period shall be granted for a parcel within five years following the expiration of a prior grace period.
4. Tools for Real Property Tax Division. Explore budgetary requirements for staffing necessary to: (a) inspect all properties subject to a petition for an agricultural dedication prior to a determination as to whether the dedication should be granted; (b) conduct routine inspections to ensure the dedicated use is active and ongoing for the period of the dedication; and (c) otherwise administer and enforce resulting legislation. Also invest in pictometry software, geographic information systems ("GIS") software, and related hardware and training; encourage the Administration to allow the Division access to County zoning information; and encourage the Division to pursue options for obtaining access to the County's multiple listing service ("MLS") database.
 5. Public outreach. Significant public outreach efforts should be made prior to implementation of these changes. Deadlines should be well publicized.

B. Second Tier

The TIG recommends the following considerations be pursued in the near term to further address the disparities identified and improve the process of assessing lands in agricultural use.

1. Consider alternative methods of assessing values for lands dedicated for agricultural use, including the following: (a) a fixed percentage of market value, based on type of agricultural use; or (b) an income-based approach (values derived from productivity of crop generation).
2. Further evaluate the possibility of extending the dedication timeframes and adding greater incentives for longer terms.
3. Explore tax treatment for conservation easements on agricultural lands.
4. Explore options relating to the purchase of development rights.
5. Consider a broader system of controls to protect agriculture in the County.
6. Further refine the rollback tax and penalties.
7. Consider establishing a special fund for agricultural purposes, to be funded by rollback taxes and penalties.