

- SUBJECT:** Setting a minimum interest rate for tax appraisal of timber land
- COMMITTEE:** Local Government Ways and Means — committee substitute recommended
- VOTE:** 6 ayes — Hill, Laubenberg, McReynolds, Mowery, Puente, Quintanilla
0 nays
1 absent — Hegar
- WITNESSES:** For — J.W. “Bill” Carlsen, nonindustrial private owners of timberland; George Scott Christian, Texas Forest Industries Council; Douglas Dvorman, Louisiana Pacific Corp.; Lee Flowers, Cherokee County Appraisal District; James S. Houser and Ron Hufford, Texas Forestry Association; Larry M. Jordan, International Paper; Dale Morton, Wells ISD; Tony Bennett, Temple-Inland

Against — R.C. “Chris” von Doenhoff, Houston County; Joe Folk, Jasper County; David W. Luther; Jerome Owens, Tyler County; John Thompson, County Judges and Commissioners Association of Texas and Polk County Judge; Truman Dougharty, Newton County Judge

On — Susan Combs, Texas Department of Agriculture; Dan Hart, Taxpayers For Equal Appraisal; James B. Hull, Texas Forest Service; (*On committee substitute:*) Wayne Pierce, The Equity Center
- BACKGROUND:** Tax Code, ch. 23, subchapter E governs timber land appraisal for ad valorem tax purposes. Sec. 23.71(2) defines “net to land,” in part, as the five-year average net income that a category of timber land would have earned under the ordinary prudence management standard. “Stumpage value,” an element of income, refers to the combined value of various timber commodities based on prices at the time the value is estimated. Sec. 23.74 designates the capitalization rate used in calculating timber land values for appraisal purposes as the six-month variable interest rate issued on December 31 of the preceding tax year by the Farm Credit Bank of Texas (formerly the Federal Land Bank), plus 2.5 percentage points.

DIGEST:

CSHB 3395 would create a mechanism to phase in a calculation method that would incorporate a five-year rolling average using annual Farm Credit Bank interest rates to determine the capitalization rate used to calculate qualified timber land's productivity value for property-tax valuation purposes.

Initially, the bill would set the capitalization rate by requiring a comparison between two rates: the bank's annual interest rate plus 2.5 points and the rate used for the preceding tax year. The higher of the two rates would be designated the capitalization rate for inclusion in the mathematical formula used to calculate timber land values for property valuation.

The target capitalization rate triggering implementation of the rolling average would be 10 percent. Until the rate reached 10 percent, however, the capitalization rate would continue to be the annual bank rate plus 2.5 points, unless the rate declined, in which case the previous year's rate would be used. Once the rate reached 10 percent, that year would become the base year for the rolling average, and the rate comparison method would cease. After the base year, each year's capitalization rate would be the average of that year's bank rate plus 2.5 points and the capitalization rates used in preceding years, up to four. Capitalization rates for years before the base year could not be used in the rolling average.

CSHB 3395 also would amend the definition of "net to land." Applicable information from pertinent federal agencies would have to encompass the East Texas timber-growing region as a whole. In calculating net annual income, three types of forests would replace three general types of produced timber as a factor. Stumpage value, expressed in price per ton, would apply to large pine sawtimber, small pine sawtimber, pine pulpwood, hardwood sawtimber, hardwood pulpwood, and any other significant timber product. The definition would apply prudent manager and maximized return standards to costs and expenses. Stumpage prices would reflect all types of timber sales, including (negotiated) cutting contracts and gatewood (at the mill) sales. Stumpage value no longer would be averaged, and timber growth and prices would be expressed in tons.

The bill would take effect January 1, 2004, and would apply only to appraisal of qualified timber land for tax years beginning on or after that date.

**SUPPORTERS
SAY:**

CSHB 3395 would bring stability to what have become extraordinarily volatile timber land property values in Texas' 44-timber producing counties. The bill would not set an arbitrary capitalization rate minimum but would treat timber more like other agricultural products. The mechanism it would create allows rates to fluctuate once they reach a reasonable level.

Federal monetary policy and the national economic downturn have combined to pummel interest rates during a prolonged timber price slump. This has produced historically low capitalization rates, now at 6.4 percent compared to the 22-year average of 11.5 percent. This anomaly has increased timber property values astronomically because of the way the values are calculated. As a result, many East Texas school districts that depend on timber industry property taxes are losing state aid under the school finance formulas.

The bill would take a graduated approach to redressing the rate collapse. The 10 percent target mirrors the rate used for other agricultural land value calculations but not available for timber under current law. Schools need the consistency this rate structure would bring. Counties eventually would benefit as well, because they stand to lose tax revenue once rates inevitably rebound and property values decline.

Combining the two timber-growing regions into one for purposes of determining net income would apply uniform growth factors to timber land valuation and would remove unnecessary skewing that causes discrepancies in the capitalization rate. Most of the other changes to the net-to-land definition would reflect recent revisions to comptroller rules as well as standard industry practices that would broaden the types of factors considered.

**OPPONENTS
SAY:**

The current method of determining rates for property valuation of timber land has served Texas well for 22 years. It should not be changed simply because of a temporary convergence of negative economic conditions. If the current situation is indeed an anomaly, it will work itself out in due course. Timber producers, like other businesses and government, must deal with the consequences. Some local governmental entities are benefitting from the situation and should not be penalized for it. Those who are not, notably school districts, should seek to remedy the school finance system, the root cause of their fiscal problems.

**OTHER
OPPONENTS
SAY:**

Timber land should be treated like agricultural land uniformly throughout state law. It should benefit from the same rates for determining property valuations, and those rates should be raised immediately to relieve the economic pressure threatening Texas' third largest commodity industry, behind oil and cotton.

NOTES:

The bill's fiscal note projects that school districts would gain \$626,000 in fiscal 2005 and \$725,000 through fiscal 2008. Counties would gain \$197,000 in fiscal 2005 and \$849,000 through fiscal 2008. Cities and special districts also would realize additional revenue. The state's general revenue gain from 2006 through 2008 would total almost \$2 million.

The committee substitute changed the filed version of HB 3395 by redefining net to land and by setting up an interim rate determination process using a comparison favoring the greater of two rates.

The companion bill, SB 1646 by Staples, passed the Senate by voice vote on May 6 and has been referred to the Local Government Ways and Means Committee. A similar bill, HB 2938 by McReynolds, has been referred to the House Ways and Means Committee.