

**EXECUTIVE SUMMARY**

# Grounds for Confusion

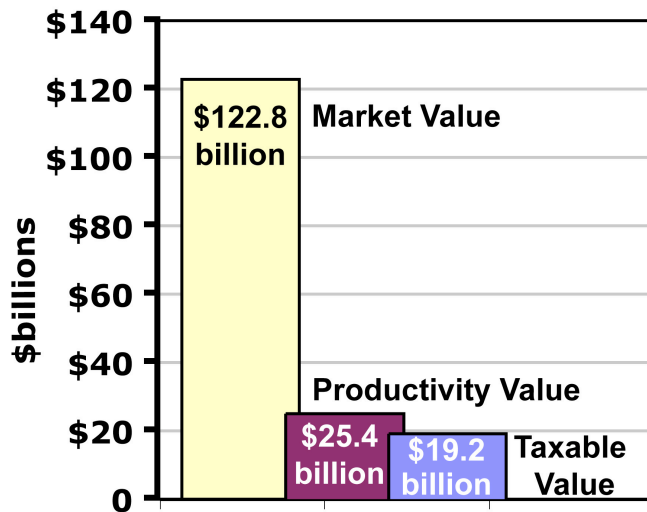
## *Iowa's Distorted Assessment of Farm Property*

By Beth Pearson and Peter Fisher

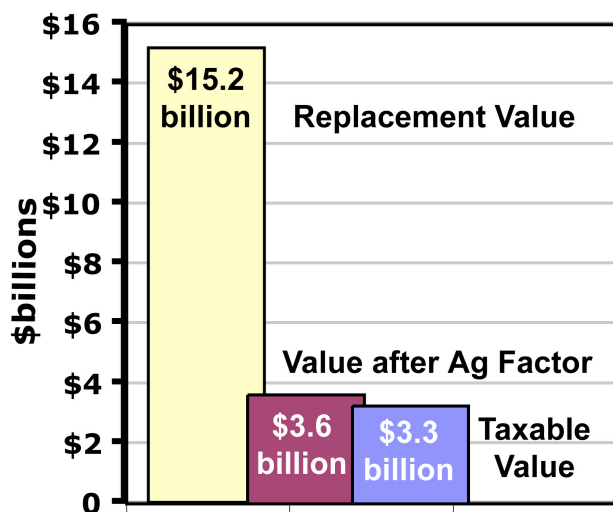
Agricultural production in Iowa has changed significantly over the past several decades as it has become more specialized and more consolidated. Although these processes have resulted in significant changes for patterns of agricultural land and building use, Iowa's agricultural property assessment and tax system has not changed the way it measures the value of these types of property. As a result, the current system contains numerous distortions that inhibit the fair and accurate assessment of the value of agricultural property. One of these distortions is a wide disparity among Iowa counties in the assessment of both land and buildings.

As shown in Figures 1 and 2, farmland in Iowa is taxed on approximately 16 percent of its market value and farm buildings are taxed on approximately 22 percent of their market value. This is largely a result of Iowa's system of assessing agricultural property on its productivity value — intended to measure its capacity to generate farm income — rather than on its market value; all other classes of property are assessed at market value. While there is some justification for the productivity approach when market prices are not an accurate indication of the income that can be derived from a parcel of land, the logic breaks down when applied to buildings. Furthermore, Iowa has a peculiar and outdated tie between land and buildings that leads to the assessment and taxation of industrial agriculture buildings such as concentrated animal feeding operations (CAFOs) as if they were cropland. This is one of several features of the complicated formula used to evaluate farmland productivity, combining to create an assessment system that is neither straightforward nor fair.

**Figure 1. Taxable Value of Land About 1/6 of Market Value**



**Figure 2. Taxable Value of Farm Buildings About 1/5 of Market Value**



## ***Assessment in Iowa***

Property in Iowa is assessed locally by either city or county assessors. In determining the value of agricultural property, the assessor must rely on the productivity formula, which is meant to approximate the value of land based on its recent past capacity to generate farm income. This protects farmers from paying taxes based on land values inflated by speculative pressures due to anticipated future development potential or future crop prices rather than values reflecting current income capacity. Productivity value is determined through a formula that uses data on the yield and prices for corn and silage, soybeans, wheat, oats, and hay, along with the costs of production, to come up with a figure for net annual farm income per acre. This historical data on net income (actually a five-year rolling average) is then capitalized at 7 percent — which means converting the annual income to its present value equivalent. Land value per acre — based entirely on income from cropland rather than livestock production — is then used to calculate the total assessed value of a county’s agricultural property.

Agricultural property includes both agricultural land and agricultural buildings. The second step of the assessment process is to determine separately the value of agricultural buildings, which starts with an estimate of replacement cost less depreciation. The peculiar and most problematic feature of Iowa’s assessment process is that regardless of the resulting assessed value of buildings, the total assessed value of land and buildings combined remains fixed at the value based solely on the productivity of cropland. This creates a “closed system” in which any change in the assessed value of agricultural buildings results in an equal and opposite change in the assessed value of agricultural land. This closed system means that the construction of a new building in a county will not add to the county tax base since overall value is based on a productivity formula that is designed to measure the value of crop production. And the fact that land values are dependent on the number and value of buildings in a particular county can create disparities among counties in the assessment of both land and buildings.

## ***Attempts to Address Disparities***

In 2007, the Department of Revenue acted to address significant disparities in assessed values of farm buildings among Iowa counties by issuing “agricultural factors” to be used by local assessors in the assessment of agricultural buildings. An agricultural factor is the ratio of the productivity value of land to the market value of land in each county. So, for instance, if a county had an average productivity value of \$750 per acre and an average market value of land of \$3,000 per acre, the agricultural factor for that county would be 25 percent ( $\$750/\$3,000$ ). Applying the agricultural factor to buildings would mean that a building’s assessed value would be 25 percent of its market value. The taxable value of a building will be lower than its assessed value due to the application of the rollback or if the owner claims a pollution-control exemption.

The Department’s rule change affected the way that many counties assess both land and buildings. Between 2006 and 2007, only 25 counties saw a drop in their building assessments as a result of the Department’s rule change, while 74 counties saw at least a slight increase in their building assessments. However, the size of the adjustment made by counties experiencing drops in their building assessments has been more dramatic than for counties that saw their building assessments increase. While the counties increasing their building assessments between 2006 and 2007 experienced a median increase in assessed value of 13 percent, those counties decreasing their building assessments had a median level of change of 31 percent.

Following the Department’s rule change related to the assessment of agricultural buildings, the majority of the increase in overall agricultural property value that occurred between 2006 and 2007 was attributable to increases in the value of land rather than buildings. Although agricultural buildings

accounted for 14 percent of the total assessed value of agricultural property in Iowa in 2006, they accounted for only 3 percent of the total increase in this value between 2006 and 2007, with land absorbing 97 percent of this increase.

### **Conclusions and Recommendations**

Changes by the Department of Revenue to the assessment of agricultural buildings were necessary responses to an out-of-balance system. But more fundamental changes are needed to fairly and accurately assess agricultural property in Iowa.

- ***Agricultural buildings and land should be assessed and taxed as two, separate types of agricultural property.***

This is the most important change to meet the goal for fair and accurate assessment. Eliminating inter-county disparities in assessment levels is severely constrained by the existing tie between land and building assessments since any change in building assessments in a county with a relatively large amount of commercial livestock operations will cause a corresponding shift in that county's land assessments that may not occur in a neighboring county.

- ***Actual value of agricultural buildings should be assessed with reference to market value rather than productivity value.***

Particularly because buildings historically accounted for a small and consistent share of each agricultural property owner's overall property value, it may originally have made sense to simplify the assessment process by using the productivity formula as a way of determining the value of all agricultural property in the state. But the productivity formula is built on a set of inputs that exclusively measure the productivity of agricultural land and have, at best, an indirect and uncertain relationship to the productivity of agricultural operations that now rely heavily on the use of buildings rather than land.

- ***Other changes in the productivity formula would more accurately and fairly assess the income-generating capacity of agricultural land.***

The productivity formula arrives at the productivity value by subtracting operating expenses from farm income. However, once income is calculated by multiplying average yields for different types of crops by the number of acres under production and the price of each crop, the gross income from corn, soybeans, oats, and non-tillable pasture is then reduced by 50 percent before expenses are applied to arrive at a bottom line. Income from hay and tillable pasture acres is reduced by 75 percent. There is little justification for these adjustments, particularly when the argument for using the productivity formula to arrive at the value of agricultural property is that it can measure the actual components of this value in ways that market conditions cannot. In effect, the formula counts only half the gross income from farm land but all of the expenses, including those that are typically the landlord's responsibility (such as property taxes and liability insurance).

- ***Simplify assessment of agricultural land by moving to a cash-rent approach.***

While the previous recommendations could enhance the productivity formula's capacity to fairly measure the value of agricultural land, cash rent approach is more transparent and would better reflect the productive potential of the land. Cash rent measures the value of farmland to a farmer — how much the farmer can afford to pay to rent the land and still farm it profitably. Iowa State University conducts an annual cash rent survey for every county in the state, adjusted for land of low, medium and high quality for different kinds of crops. In addition to being vastly simpler than the current productivity formula, cash rents also have the virtue of reflecting the current value of land in farming, devoid of any speculative component based on possible future, nonfarm uses and future farm prices.

■ ***Discourage land speculation by land owners not actively farming.***

A system that assesses farmland preferentially (at below market value) should do so for the benefit of farmers actively engaged in farming, not for nonfarm speculators betting on future development. This is best accomplished by recapturing taxes when land is converted to another use. The difference between taxes based on productivity value and taxes based on market value for some period of time prior to the conversion of land would be due upon conversion. This should discourage land speculation by making it more expensive, and ensure that the higher taxes on the development value of the land are paid precisely at the time when the owner can afford to pay them — out of the profits from development — and do not prevent farming the land in the interim.

All of these recommendations would substantially raise the assessed value of agricultural buildings and land. Obviously taxable values could not be allowed to rise dramatically; the rollback formula in fact would prevent taxable value statewide from rising more than 4 percent in any year. Furthermore, changes to the assessment process could also be phased in over a number of years. Increased assessments and taxable values of agricultural property in Iowa would help generate additional revenue for the local governments that depend on property taxes to fund city and county budgets and essential local services. Simplifying the agricultural property system by separating the assessment of buildings and land, and using measures of productivity value appropriate for each type of property are crucial to ensuring fairness and stability in Iowa's agricultural property assessments.

## Iowa Fiscal Partnership

The Iowa Fiscal Partnership is a joint initiative of the Iowa Policy Project and the Child & Family Policy Center, two nonprofit, nonpartisan Iowa-based organizations that cooperate in analysis of tax policy and budget issues facing Iowans. IFP reports are available on the web at <http://www.iowafiscal.org>.

The Iowa Fiscal Partnership is part of the State Fiscal Analysis Initiative, a network of state-level organizations and the Center on Budget and Policy Priorities to promote sound fiscal policy analysis. IFP work is supported by the Stoneman Family Foundation and the Annie E. Casey Foundation.

### **The Iowa Policy Project**

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 Founded in 2001, the Iowa Policy Project produces fact-based analysis to inform and engage Iowans on policy alternatives on economic opportunity, budget issues, energy and the environment. IPP's principal office is in Iowa City, with reports at <http://www.iowapolicyproject.org>.

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 The Child & Family Policy Center was established in 1989 to "better link research and policy on issues vital to children and families and to advocate for evidenced-based strategies to improve child outcomes." CFPC, based in Des Moines, is on the web at <http://www.cfpciowa.org>.