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Real Estate Assessment and Tax Breaks: Reality or Myth?

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CORNHUSKER ECONOMICS

Real Estate Assessment and Tax Breaks: Reality or Myth?

Market Report	Yr Ago	4 Wks Ago	6/9/06
<u>Livestock and Products,</u>			
<u>Weekly Average</u>			
Nebraska Slaughter Steers, 35-65% Choice, Live Weight	\$84.92	\$78.43	\$80.60
Nebraska Feeder Steers, Med. & Large Frame, 550-600 lb	141.16	126.85	130.48
Nebraska Feeder Steers, Med. & Large Frame 750-800 lb	115.72	101.97	113.13
Choice Boxed Beef, 600-750 lb. Carcass	144.00	146.29	154.27
Western Corn Belt Base Hog Price Carcass, Negotiated	67.23	66.13	73.14
Feeder Pigs, National Direct 45 lbs, FOB	51.88	52.10	49.16
Pork Carcass Cutout, 185 lb. Carcass, 51-52% Lean	67.25	68.90	72.23
Slaughter Lambs, Ch. & Pr., 90-160 lbs., Shorn, Midwest	114.62	72.00	80.00
National Carcass Lamb Cutout, FOB	257.68	210.25	212.17
<u>Crops,</u>			
<u>Daily Spot Prices</u>			
Wheat, No. 1, H.W. Imperial, bu	2.87	4.36	4.34
Corn, No. 2, Yellow Omaha, bu	1.81	2.19	2.05
Soybeans, No. 1, Yellow Omaha, bu	6.52	5.66	5.56
Grain Sorghum, No. 2, Yellow Columbus, cwt	2.77	3.27	2.98
Oats, No. 2, Heavy Minneapolis, MN, bu	1.65	2.21	2.15
<u>Hay</u>			
Alfalfa, Large Square Bales, Good to Premium, RFV 160-185 Northeast Nebraska, ton	115.00	130.00	130.00
Alfalfa, Large Rounds, Good Platte Valley, ton	62.50	65.00	65.00
Grass Hay, Large Rounds, Good Northeast Nebraska, ton	57.50	55.00	55.00
* No market.			

Nebraska continues to be one of the highest states in terms of its dependency on property taxation for funding governmental functions. For agricultural real estate property owners, this tax can, and often does, become quite burdensome since it does not relate directly to the level of income earnings (off the land) or the benefits received (the majority of property tax obligations are for public schools and not property-enhancing services like police and fire protection, roads/bridges, etc.). It is little wonder that rural citizens are particularly concerned about it.

So it came as no big surprise that the 2006 Nebraska Legislature passed (and the Governor signed) a rather comprehensive tax reform package that included a component designed to reduce the tax burden of agricultural land owners. Under the previous system, which has been in place since the early 1990s, agricultural land in Nebraska was to be assessed for tax purposes at 80 percent of its market value. For example, an agricultural land parcel with a value of \$2,000 per acre in today's market would be assessed for tax purposes at \$1,600 per acre ($\$2,000 \times .8 = \$1,600$). The 2006 legislation changed the assessed proportion from 80 percent to 75 percent. So the same land parcel in the example above will now be assessed at \$1,500 per acre ($\$2,000 \times .75 = \$1,500$). This represents a 6.25 percent reduction in assessed value.

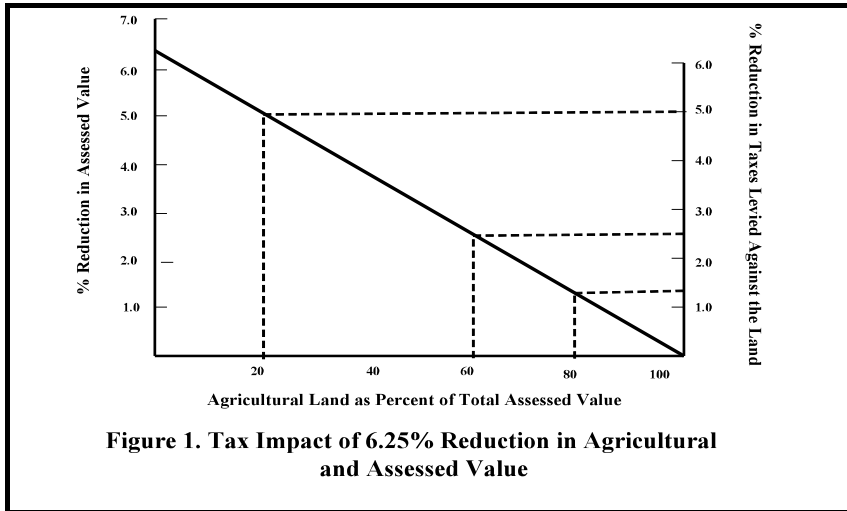
Now, just how much of an economic impact this change has on the level and distribution of property tax collections is much more uncertain than this tax policy shift infers. In fact, at this point we need to point out two myths of conventional wisdom.

Myth #1. Lower assessed valuation of property leads to a proportionally lower property tax obligation.

If I, as a rural property owner, can make a convincing case to my county assessor that 10 of my 100 acres of a Class 1D cropland parcel are totally nonproductive year after year due to a drainage problem, I might be able to get those acres designated as waste ground of little or no value. In turn I could

logically expect a 10 percent reduction in my property tax on the parcel, other things being equal. However, when a reduction in assessed value is applied to a whole class of property (like agricultural land) in that taxing district, then the actual percentage change in tax obligation will be something less than the assessed value decrease. Why is this so? Simply because tax needs still need to be met from a declining assessed valuation, the *local tax levy* (percentage of \$100 of total assessed value) must be adjusted upward accordingly.

Figure 1 illustrates this interaction of a 6.25 percent reduction in assessed value of agricultural land with differing proportions of total assessed value that agricultural land represents. If the agricultural land is just 20 percent of the total assessed value of property in the taxing district, then, given no change in tax revenue requirements for local units of government, rural land owners would experience a 5 percent reduction of their property tax obligation ($6.25\% \times .80 = 5.00\%$). However, if the taxing jurisdiction is primarily agricultural with 80 percent of the total valuation being agricultural land, then the actual tax reduction falls to just 1.25 percent ($6.25\% \times .20 = 1.25\%$).



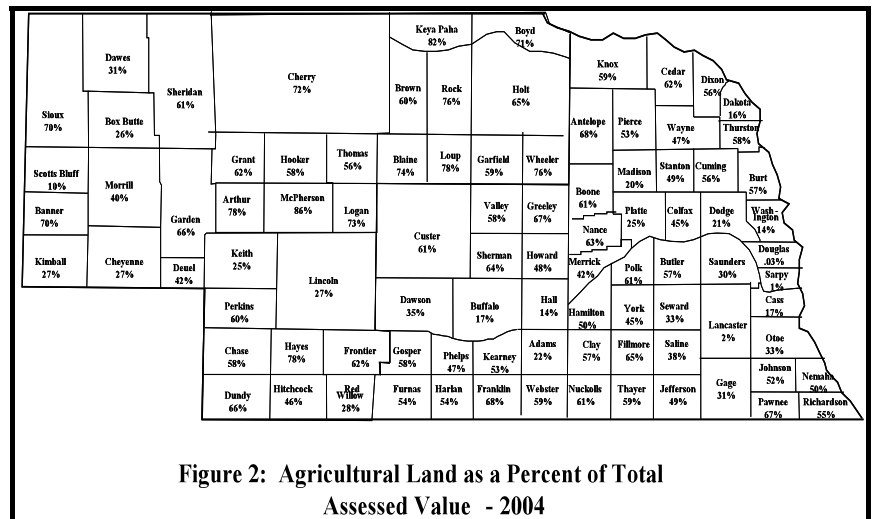
Throughout much of rural Nebraska, in fact in more than half of the 93 counties, the agricultural land component represents from 60 percent to nearly 90 percent of the total assessed value of real estate (see Figure 2). So in reality, this 2006 policy change will convert to a property tax reduction of 1 to 2.5 percent in most counties. Take Keya Paha County as an example. With 87 percent of assessed valuation being agricultural land, the tax shift to the remaining components is very limited; and rural land owners will experience only a .81 percent decrease in their property taxes from the recent legislative change ($6.25\% \times .13 = .81\%$). In contrast, rural agricultural land in the state's metro counties would see percentage reduction of property taxes similar to their valuation reduction.

Myth #2. A lower percentage assessment level of market value and the varying degrees of property tax reductions for rural land owners will be a permanent advantage for the long run future.

Why is this a myth? Simply because in the dynamic of the real estate market, any new economic advantage, large or small, will quickly tend to become *capitalized* into the value of the real estate. In short, the awareness of lower property taxes leads to expectations of somewhat higher income earnings from the property. Thus, potential buyers will bid the land higher on the basis of that higher expected return. What this implies is that current owners of agricultural land receive a two-fold effect: (1) some reduction in property taxes while they own the land, and (2) somewhat higher value of their real estate assets when they sell it. In contrast, the whole 2006 policy change is a *wash* for future owners who must pay more for the land – whatever property tax reduction there is, they will be making higher land payments to match the reduction.

In summary, any tax break from the 2006 legislation changing the assessment process for agricultural land is probably more of a myth than a reality. Relative to what it will be, a few percentage points reduction in property taxes is about all that most current land owners can expect to see. And that will soon be capitalized into the value by the market, never to be experienced by future owners.

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