

LOWER CROP PRICES AND CHANGES TO FORMULA POINT TO LOWER CAUV VALUES IN THE FUTURE

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Owners of Agricultural land enrolled in the Current Agricultural Use Valuation (CAUV) property tax program in the twenty-four counties that are experiencing a reappraisal or triennial update in 2015 (payable in 2016) will see the highest CAUV values in history, based on preliminary numbers from the Ohio Department of Taxation. Similar to prior years, increases in values will be in the vicinity of 100% to 200%. However, lower crop prices and changes made to the CAUV formula by the Ohio Department of Taxation point to lower CAUV values in the future.

WHAT IS CAUV?

In 1972, Ohio voters approved a constitutional amendment that allowed qualified agricultural land to be valued at its current agricultural use value for real property tax purposes rather than fair market value. The home, home site and outbuildings are still valued at fair market value.

Current agricultural use value can be determined by the capitalization of the typical net income from agricultural crops on a given parcel of land assuming typical management, cropping patterns, and yields for the types of soil present on the tract.

HOW IS CAUV CALCULATED?

The CAUV values are based upon a formula containing five factors applied to three crops: corn, soybeans, and wheat, the three most prevalent crops in Ohio. Hay was dropped from the formula in 2010. The five factors are:

- 1.) Cropping pattern- based upon the acres of corn, beans and wheat compared to the total acres of those three crops. These percentages are based upon statewide averages.
- 2.) Crop prices- based upon a survey by NASS of elevators in Ohio
- 3.) Crop yields- based upon 1984 NRCS/NASS per acre yield estimates for each soil type, adjusted for actual average yields in Ohio for the past ten years.
- 4.) Non-land production costs- based upon farmer surveys by The Ohio State University.
- 5.) Capitalization rate- based upon the interest rate for a 15-year fixed rate mortgage at Farm Credit Services, with 40% attributed to equity and 60% to debt.

The crop prices, non-land production costs and capitalization rate are calculated by taking the previous seven years of numbers, eliminating the highest number and the lowest number, and then averaging the remaining five numbers. Cropping pattern is based on an average of the last

five years of acres planted. The prices, cropping pattern, costs and yields are then multiplied, added and subtracted to determine the net profit per acre of soil type, and that number is then divided by the capitalization rate to arrive at the final value. This calculation is performed for each of the 3500 soil types in Ohio.

LOWER CROP PRICES IN 2014

For the second consecutive year, the price for corn, beans, and wheat that came into the formula is lower than the prior year. The price for corn that came into the formula for 2014 is \$3.65/bu. compared to \$4.41 for 2013. Similarly, the 2014 price for soybeans that came into the formula is \$10.40 compared to \$13.00 for 2013. Likewise, the new 2014 wheat price is \$5.55 versus \$6.54 for 2013.

NOT AN IMMEDIATE EFFECT

One or two years of lower crop prices will not produce a noticeable decrease in CAUV values. There needs to be a trend lasting several years to substantially reduce the values. A trend is required because the crop prices used in calculating CAUV values are based on a seven-year rolling average, with the highest price and the lowest price during that seven-year period thrown out.

Using corn as an example, the corn prices used in the 2015 calculation for the last seven years are:

2008 - \$4.21
2009 - \$3.55
2010 - \$5.45
2011 - \$6.44
2012 - \$7.09
2013 - \$4.41
2014 - \$3.65

Since \$3.55 is the lowest price and \$7.09 is the highest price, they are removed from the calculation. The average of the remaining five numbers is \$4.79. After a management allowance of 5%, which is allowed in the formula, the price for corn used in the 2015 formula is \$4.55. Please remember that these numbers are preliminary and may change before finalization of the 2015 values. There is a similar trend for the calculation of the prices for soybeans and wheat.

Continuing to use corn as an example, it will take several years of lower crop prices to substantially lower land values for CAUV purposes. Real property is revalued every three years for tax purposes. Therefore, property being revalued in 2015 will not be revalued again until 2018. During that time, three years' worth of crop prices will drop out of the formula and will be replaced by three new years'. If the three new years' crop prices are lower than \$6.44, it is

likely that there will be a decrease in CAUV values. Based on experts' opinions and forecasts, such appears to be the case.

CHANGES TO THE FORMULA BY THE OHIO DEPARTMENT OF TAXATION

In response to the alarming increases in CAUV values over the past several years, attorneys at the Ohio Farm Bureau Federation researched and reviewed the CAUV formula in greater detail than it has ever been reviewed since its inception. As a result of this review, Ohio Farm Bureau made several recommendations to the Ohio Department of Taxation to update portions of the formula to more accurately reflect current values. These recommendations do not substantially change the way that CAUV is calculated, but rather to update the data contained in the formula.

The Ohio Department of Taxation has agreed with several of the recommendations forwarded by Ohio Farm Bureau. Therefore, the changes that will appear in the 2015 CAUV calculations are:

1. **TIMELINESS OF DATA** – There has always been a two-year lag period between the collection of the data used in the CAUV formula and the finalization of the values for use by county auditors. This became especially troublesome in a year like 2014 when the price of soybeans fell from \$13.00/bu. to \$10.40/bu., but CAUV values doubled. Soybean prices dropped even lower by the end of the year and continue to fall in 2015. Because of the two-year lag period, it took two years for these lower prices to appear in the formula. Then, the lower number may be thrown out of the calculation if it was the lowest during the seven-year look back period.

By adjusting the schedule of when CAUV values are calculated, the Ohio Department of Taxation was able to cut the two-year lag period to one year. Therefore, lower crop prices, and potentially higher costs, will come into the formula more quickly and CAUV values will be more current. One consequence of this change is that county auditors will not receive the updated values until later in the year of reappraisal or update.

2. **CAPITALIZATION RATE** – CAUV values are calculated by dividing the projected net income per acre by the capitalization rate for each of the 3500+ soil types in Ohio. A small change in the capitalization rate can have a big impact on CAUV values. For example, a \$200 per acre net return divided by a capitalization rate of 6% results in a \$3,333 value. If the capitalization rate increases to 7%, the same \$200 per acre net return divided by 7% results in a \$2,857 value. Low capitalization rates are good if you are borrowing money; they are not beneficial when calculating CAUV.

The Ohio Department of Taxation adjusted the calculation of the capitalization rate to more accurately reflect current borrowing patterns. The capitalization rate is now based upon a ratio where 80% is considered debt and 20% is considered equity. This is compared to a 60/40 ratio used in prior years. Furthermore, the mortgage interest rate (which is the starting point of the capitalization rate calculation) is based on a 25-year

fixed multi-flex rate for loans \$25,000 or greater at Farm Credit Services. The prior years' mortgage interest rate was based on a 15-year loan period.

Although the capitalization rate used in the 2015 calculation went down from 7.5% in 2012 (the previous time CAUV was calculated for counties in this cycle) to 6.5% (contributing to the increase in CAUV values), the capitalization rate between 2014 and 2015 increased from 6.2% to 6.5%. As previously stated, higher capitalization rates contribute to lower CAUV values.

3. **WOODLAND VALUES** – Woodland values have increased more dramatically than cropland values, especially if the woodland is located in a high-productivity geographic region. Woodland values are calculated by the same process used to calculate cropland values, with the additional step of subtracting the cost of drainage per acre (for Class I and II soils) and the cost of clearing the land per acre. Since the inception of the program, once the cropland value is determined, there has been a reduction in value for woodlands of \$500 per acre for subsurface tile drainage for somewhat poorly drained, poorly drained, and very poorly drained soils. In addition, for 37 soil types, there has been a \$250 per acre reduction for surface drainage. There is a \$500 per acre reduction allowed for clearing the land for all soil types.

What has occurred in recent years is that the calculation of cropland values is so high that, even with the aforementioned reductions, woodland values have been bumped from minimum value to a value similar to crop producing soils. This scenario is exacerbated if the woodland happens to be located in a high-productivity geographic region.

The Ohio Department of Taxation has increased the reductions for woodland from \$500 to \$770 per acre for subsurface tile drainage in somewhat poorly drained, poorly drained, and very poorly drained soils; from \$250 to \$380 per acre for surface drainage in 37 soil types; and from \$500 to \$1,000 per acre for land clearing in all soil types.

SUMMARY

If the trend of lower crop prices continues, couple with the changes to the formula made by the Ohio Department of Taxation, CAUV values will decrease in the future. Nobody likes paying taxes and it is hard to prepare for tax increases of 100% to 200%. But if CAUV landowners can swallow the bitter pill of paying higher property taxes through 2015, while receiving lower crop prices, the CAUV formula will work to decrease property taxes to more accurately reflect the farm economy. Think of it as a roller coaster with crop prices in the front car and CAUV values in the back car. Ultimately, the roller coaster ends up in the same place.

