WHY RESEARCH FARM LAND OWNERSHIP AND FARMLAND VALUES

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(The following invited paper was presented at the Assessment Workshop cosponsored by USDA-ERS-NRED and the International Association of Assessing Officers, Chicago, IL, June 25-26, 1985. Parts II, III, and IV will be published in subsequent issues of GroundSwell.)

I. The many important functions and implications of land data

Why are we interested in "taking inventory" of land? Land is hardly an inventory of the usual kind. My real estate man may speak of "warehousing" vacant land -- we never call it speculating -- and we speak here of "taking stock". It is even true that land values appear on balance sheets along with canned goods as economic "funds" rather than "flows". Yet land is no inventory in the usual sense: it never turns over, but remains constant in physical quantity while real "stocks" or "funds" come and go and come again, like Brahma. Land is not subject to theft, at least in the usual sense, and we do not take inventory to detect pilferage or spoilage.

There is irony in making this point here in the shadow of The Midway because Frank Knight, the granddaddy of Chicago economists, took great pains to destroy the concept of turnover and its reciprocal, the period of investment, and thus to erase the distinction between land and capital. But in this company I can assume we recognize there is something distinctive called land which warrants our interest. But why?

A. Concentrated holding.

The Founding Fathers put great stock in a wide diffusion of landholding as the basis for a viable economy, social welfare, and a workable democratic polity. That ethic has not altogether died, although its detractors are mighty. But the march of concentration and absenteeism, seemingly inexorable at times, has recreated conditions here increasingly like those that Jefferson and his peers found objectionable in the Spanish colonies and in England.

The U.S. Census avoids studying land titles. Its data are organized by operating units, not ownership units, Tenancy and leasing are recognized, but fifty tenants means fifty farm units, be there one landholder or fifty. The Census is not stingy with information about many things, such as the excellent detail on indoor plumbing, but it is silent concerning who holds title to how much of the basic resources that constitute the essence and definition of the nation. It contains little or nothing on the citizenship of landholders, a matter of growing concern as foreign investments flood into our territory. So here is a data vacuum worthy to be filled: a challenge worthy of your steel.

B. Property taxation.

To place values on land and study its characteristics is to realize that it yields an economic surplus. It dawns on some as quickly as a bursting tropical daybreak, and on others more like a boreal twilight, that a surplus may be taxed, and that the property tax on land garners that social surplus for the public treasury without impairing any functional private economic incentive.

It may, indeed, often sharpen incentives. Here we meet a perceptual bias. It is like my family where when father speaks, no one listens; but when he burps, everyone comments. Likewise when the land tax helps the market work better the free-market preachers look elsewhere; but when it drives scarce class -A farm soils into vulgar urban uses, everyone takes notice.

But no one ever said life is fair. So let us just note that the whole movement for preferential assessment of farmland is a grudging tribute to the power of land taxes to sharpen market incentives. If you like the market's decisions you credit private enterprise; if you don't you blame the assessor. Assessors, after all, only make wages and seldom leave large bequests.

For any government to place values on land. Whatever the ostensible purpose, is to provide the infrastructure prerequisite to taxing it, and to refute by demonstration the claim that valuation is impracticable. Hence there is a certain exaggerated sensitivity to land valuation programs. In 1909, indeed, the House of Lords committed virtual kamikaze in a desperate defense -ultimately successful -- to forestall any valuation of land in England.

To some people all taxes are equally terrible. But one unsung virtue of land as a tax base is becoming daily more compelling as the I.R.S., increasingly desperate, grows increasingly importunate, intrusive and unloved. The land tax is not like the income tax a personal liability, but is just *in rem*, levied on the objective thing, not the person as such. That means that the government's remedy for unpaid taxes is limited to seizing the *rem*, the land, and it cannot do even that without following specified legal procedures safeguarding rights of individuals.

The I.R.S. operates under no such carping inhibitions. It seizes land upon simple administrative discretion of collection agents protected from personal liability. It also seizes chattels and intangibles and cash flows and accounts receivable and wages and salaries and you name it. Victims struggling from its nets are labelled as cheats and dishonest and even criminal. It can and does harass and intimidate and threaten and commandeer and close down and garnisee and pry and spy and hire informers.

The garniseed miscreant is allowed to keep personal effects not to exceed $1,500 in value, and current income of $75 a week. Try living on that. You also get $25 for each dependent, a thoughtful touch. Bankruptcy is no excuse or escape. And all this can be credibly threatened over nothing more substantial than a clerk's misreading your social security number or shredding your appeal late Friday afternoon. Next time you see your local property tax assessor as the major threat to traditional American rights and freedoms, think on those things. (continued on page 8)

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Certainly, at any rate, land is the oldest tax base, and we keep coming back to it even after Howard Jarvis and all that. The property tax in the United States now raises some $93 billions/year on a base of $7 trillions, a large share of which is land value (in California nearly half).

C. Land as a credit base.

Everyone knows that federal debt may be "monetized" when bought by banks, and the papers are full of the effect of federal deficits on the money supply. Here we are victims of another perceptual bias. Now as defaults accelerate and the system starts to crumble, we suddenly become aware that most of what banks have been monetizing in recent years is not federal debt at all but, rather -- real estate! Anyone wanting to predict the future of money and banking had better be expert on land valuation because that is what it is now all about.

In 1933 Professor Herbert D. Simpson of Northwestern University told the American Economic Association that the banking collapse was an echo of the real estate collapse, and there was none to deny what none could hide, much as some wanted to. Homer Hoyt drew on Simpson and also adduced much more evidence on the subject in his monumental *100 Years of Land Values in Chicago, 1833-1933*. Hoyt found the same cause producing banking collapses also in 1837, 1857, 1873, and 1893. Philip Cornick's *Premature Subdivision and its Consequences* records the same process in New York State in the 1830s and 1920s. Homer Vanderblue's articles on "The Florida Land Boom" show banking expansion and contraction being led and driven by boom and bust in land values.

One of the crimes of the Chicago School has been to stuff all that down the memory tubes of history. Lloyd Mints in his *History of Banking Theory* pillories and stigmatizes those who have warned against letting land I values be monetized, and many "mainstream" economists dutifully cite him. In Friedman and Schwartz bank expansion and collapse depend on the ideologies and personality quirks of Fed Governors, with all else following along.

Don't you believe it! A giant Chicago bank that did now survives only by virtue of the largest federal bailout in history. The world's largest, our own California pride The Bank of America, is declaring its first losses since The Great Depression. Our whole financial system stands on the brink of disaster or socialization for one main reason; overextension of defaultable loans on the collateral of real estate values whose determinants and trends the bankers obviously did not understand. During the joyride 1976-81 loan officers just plain projected unearned increments into the misty future, farther than the eye could see. It was only a dream, but the ensuing nightmares are real. How much safer we could all feel today had they had more exposure to good solid research in land valuation.

D. Raising consciousness of latent values.

Not all land is allocated all the time to its highest and best use. Whether through ineptitude, somnolence or surfeit of wealth, some landholders doze on their assets. It is often the tax assessor, simply doing his job according to law, who awakens them.

The landholders' first reaction is to attack the assessor, a vulnerable official who does not enjoy the intimidating sovereign power over individuals' total lives and assets and income that Congress has delegated to I.R.S. agents. But the assessor is only doing for a public purpose what corporate raiders like T. Boone Pickens and Carl Icahn do for private profit: ferreting out latent values in misallocated land, to make the market work, better. And in this land of free enterprise we are all supposed to believe in market decisions -- except, of course, when we lose the decision.

The raiders get attacked too, but they need no defense from me; Chicago, naturally, has risen to claim they are simply improving resource allocation. The claim is half true, which is all Chicago needs. But only Heaven protects the poor working assessor and the law he administers, which mandates impartial uniformity in assessment -- or did before preferential assessment came into legislative vogue with never a peep from The Midway.

E. Protecting Federal Revenues.

Income taxation presupposes accurate valuations of land for the simple, basic reason that depreciation is deductible and land is not depreciable. What with accelerated cost recovery of building investments, and even investment tax credits for certain kinds of buildings, the allocation of basis between land and improvements becomes increasingly critical.

Of course the cost of a new building is not that obscure a figure. But I can show you mathematically that the major loss to The Treasury comes not from the first round of accelerated cost depreciation but from the redepreciation of resold buildings by new buyers. And this is where the slippage comes, when the secondary buyer is allowed to depreciate land by undervaluing it, thus allocating land value to depreciable building value.

How do they do it? With all its terrifying powers the I.R.S. fumbles this one. In practice, according to I.R.S. manuals, the non-depreciable portion is not land value in the absolute: it is what the local tax assessor *says* is land value. There follows a heavy total pressure on assessors to undervalue land relative to buildings. The situation is analogous to that in our States in the ancient times now dimly remembered when there were heavy state property taxes based on values determined by local assessors. The situation led to competitive underassessment, which in turn led to state boards of equalization to solve the problem.

Today it is a federal problem. Local assessors help their constituents avoid federal taxes by overvaluing depreciable buildings relative to nondepreciable land. That is today's version of competitive underassessment, one that may only be solved by some sort of national agency charged with valuing land, or monitoring local assessors who do.

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F. Forecasting the future from the cycles of the past.

Only Gypsies predict: economists forecast. Projecting trends is the first forecasting fallacy to foreswear, of course. Projecting cycles is safer because any wave can be called a cycle, but mechanical projection of cycles is as bad as any other mindless procedure. But having said that it is essential to have a good historical data base on which to build. Lacking that we have little basis for forecasting except some totally unrealistic *a priori* assumption such as that expectations are rational. The most cursory review of economic history and social psychology dispels that .

An excellent review of relevant economic history is Homer Hoyt's classic *100 Years of Land Values in Chicago, 1833-1933.* Here we learn that there is (or was) a land value cycle whose amplitude, in the appropriate relative terms, far exceeds that of any other cycle of comparable weight. There is a cycle of value; a cycle of sales (measured by deeds recorded); and a cycle of subdivision or platting, the last being the wildest of all, a matter also researched by Lewis Maverick, Ernest M. Fisher, Herbert D. Simpson, Philip H. Cornick, Benjamin Hibbard, Arthur H. Cole, and others.

Hoyt also documents a social-psychological process of increasing credit financing of land purchases, and monetization of land value collateral, during the upswing of a cycle. In Chicago School terms you could say that an upswing is a period during which the views of Lloyd Mints become increasingly accepted until they totally undermine the quality of bank credit and bring on a collapse. For Lloyd Mints' position, which is central Chicago orthodoxy, is to heap scorn and opprobrium on any concern about qualitative credit control or the vulnerability of banks that borrow short to lend long, especially on the collateral of real estate.

I put more stock in Hoyt, whose analysis suggests we may gauge the vulnerability of both land markets and the banks that finance them *by* the degree of overmortgaging. How much land is overmortgaged today, and what share of our money supply is based on it? After a decade of creative financing and deals with negative cash flows, obviously a lot. In a recent case the Bank of America foreclosed on a vineyard in the County (not the City) of Fresno on which it held notes for $18,000 per acre -- at least twice the market value.

Would it be useful to have more data on such matters? Would it be useful to study how the crowd has reacted to similar stresses in past episodes? Clearly yes, except for those who still believe that sterile postulates about hypothetical rational investors can penetrate the fogs of reality,

G. Finding the real interest rate.

During the soaring seventies it was quite a game to guess at the real interest rate. Hardly anyone noticed that it pops right out of the standard formula *for* capitalizing land values under the assumption of steady future inflation. I will assume you know or can derive the formula:

$$V = \frac{a}{i - g}$$

where a is annual cash flow in the first year

i is the nominal interest rate

g is the annual growth rate of a, in this case the inflation rate

The real interest rate is the denominator, (i-g). But we can immediately solve for (i-g): it is a/V. Therefore the real interest rate is the current cash flow of durable real estate divided by its selling price.

Of course it is not that simple, nothing ever is. But it is the obvious starting place that mainstream economists have missed in their fruitless quests for the real interest rate. And it immediately dispels the notion that so often falls out of mainstream essays that real interest rates are or could be zero or negative. Try solving for V when g=i.

H. Assessment discrimination.

We need better land value data to monitor and correct assessment discrimination. The U.S. Census of Governments has performed a signal service, since beginning in 1957 under the leadership of Allen Manvel, by collecting and publishing assessment/sales ratios, classified by jurisdiction and class of property. Most of you know that this has become a most basic tool to evaluate the accuracy of valuations and the performance of assessors. But the old order passeth, giving way to new, and God fulfills Himself in many ways, lest one good custom should corrupt the world. The Census needs to be improved. It puts too much emphasis on owner-occupied residences; too little elsewhere.

The kind of assessment reform that the last generation gave us has, in my state, led to catastrophe. Assessors just laughed at the bumper stickers reading "BRING BACK THE CROOKED ASSESSOR" and the frustrated fulminations of Howard Jarvis and went back to professionalizing and computerizing and shortening the reassessment cycle and all those good things that would raise their scores in the quinquennial federal Census of Governments. But all this time they were increasingly discriminating against owner-occupied real estate and setting us up for Proposition 13.

Discrimination against owner-occupied real estate is the result, during a long inflationary period, of two factors: differential turnover; and the use of capitalized income for assessing business property in tandem with comparable sales for residential property.

Differential turnover rates during an inflationary period obviously work a bias against the kind of taxable property that turns over faster. Ordinary inventories have always suffered most acutely from this bias, where ownership turnover is inherent in the constant physical turnover. There is constant market evidence of inflation. But the bias has been ameliorated by various kinds of exemption and evasion.

The marathon inflation of the period 1965-81, however, exacerbated a bias, formerly more tolerable, against middle class housing, which turns over faster than commercial and especially industrial holdings. (continued on page 10)

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Coupled with that was the custom of using capitalized income to assess commercial and industrial and "income" property. Perhaps it would have worked out fairly had assessors used cap rates of 3% and 4% as the market was doing, using something like our Eqn. 1.

They should also have taken account of tax shelter values and resale plans and techniques to avoid capital gains taxes and leverage and prepaid interest and so on and on and on. But it is so much easier just to divide by .09, or whatever lenders were asking that year, and so much easier to defend in court. So non-residential assessments lagged behind. Needless to say anything assessed by the third traditional method, historical cost, got a free ride.

The results are documented in a recent paper by John Behrens, "Assessors, Recorders, and Computers and where they now Stand", August, 1984. It is not entirely clear if Behrens is making his point advertently or accidentally. His text might illustrate Winston Churchill's comment that "Many a man stumbles over the truth only to pick himself up and hurry along as though nothing had happened."

Nevertheless he does supply numbers from which we can exhume the following data. From 1956 to 1981 overall assessment ratios in the United States rose from .30 to .37; but ratios for single-family dwellings rose from .30 to .44. (Calculated from the third and fourth pages of Behrens' paper, which lacks page numbers.) Since Behrens is Chief of the Taxation Branch of the U.S. Bureau of the Census his numbers carry authority, and the numbers speak volumes with no further help from me.

I. **Planning public works.**

The main payoff from many public works is their enhancement and sustenance of land values. Benefit/cost analysis, properly pursued, often boils down to finding that the net social benefit of a project is the difference in net land values with and without the project. We are all painfully aware that political forces often make a mockery of economic analysis but, to the extent that economics sways the course of action, it needs land value data.

But if politics be held to be the key, let no one allege that the pursuit of land value enhancement is less than a major force in that field. TIME Magazine has called politics "The Great American System of Public Works for Private Profit", and who can say it better?

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UPDATE TO CG-NYC (from page 5)

for San Francisco and Los Angeles, and even "second tier" hot spots like Miami), while making it impossible for middle or even upper middle class New Yorkers to find affordable housing, let alone the working class and poor.

What is to be done?

Mayor DeBasio rightly made affordable housing the centerpiece of his recent annual State of the City speech. (http://bit.ly/1MBCW00)

The reviews are generally positive, though wary of the program's great cost for 200,000 new or rehabilitated housing units (a bit less than it would take to house the homeless 4X over). In response to a New York Times article (http://nyti.ms/19lpO2W), I left this comment:

> "The solution to NYC's - or any expensive city's - housing affordability problem has been known for over a hundred years. It was even tried partially in NYC in the 1920s and early 1930s and is the reason there are still so may pre-war apartments today.
>
> "It is the Land Value Tax (LVT). If you really want to encourage new home construction and other improvements, untax those, and make up the difference with just the Single Tax on location. This will reward people for building, punish people for hoarding and speculating, and return the fair share of the property tax to those whose demand created it, instead of the land-owner, who did nothing to increase the value of the land, but to be in the right place at the right time. If you still can't see how this works, take a look at this 8-minute video: http://bit.ly/1BFFGrt made by some Single Tax graduate students. Read Professor Mason Gaffney's: "The Taxable Capacity of Land: Enough and to Spare" economics.ucr.edu/papers/papers08/08-12old.pdf
>
> "Or, see my presentation to the Henry George School, here: http://bit.ly/1ySkjA6 "
>
> - Scott Baker, president of Common Ground-NYC

Yet, as the Mayor has said many times, we have the Tale of Two Cities. One that is barely affordable and shrinking. And another that is truly another world, for only the rich and unimaginably wealthy. The last results in ridiculous record-setting like this: (http://www.nytimes.com/ 2015/02/02/nyregion/in-program-to-spur-affordable-housing-100-million-penthouse-gets-95-tax-cut.html)

The 57th Street penthouse is a prime example in the debate over a program that offers generous tax abatements to generate apartments affordable to poor and moderate residents,

Our colleague, Josh Vincent - CEO of the Center for the Study of Economics, has posted an update on the great LVT initiatives his organization is coordinating, as well as an appeal for a small amount of funding (a basic lunch for one of the oligarchs and their friends living at One57 might cost more than he is asking for): Will Connecticut Cities Regain their Balance? (https://www.linkedin.com/pulse/connecticut-cities-regain-balance-joshua-vincent?trk=hb_ntf_MEGAPHONE_ARTICLE_POST)

Funding for LVT Projects in Connecticut have never been more necessary.

But for only $5,000, Connecticut can have more LVT. It is almost ridiculous what small amounts history can be made upon.

(editor's note: For a related article see May-July 2015 issue of GroundSwell. Scott Baker can be emailed at ssbaker305@gmail.com) <<