



Economic Impact Analysis Virginia Department of Planning and Budget

2 VAC 5-20 – Standards for Classification of Real Estate as Devoted to Agricultural Use and to Horticultural Use under the Virginia Land Use Assessment Law

Department of Agriculture and Consumer Services

October 2, 2002

The Department of Planning and Budget (DPB) has analyzed the economic impact of this proposed regulation in accordance with Section 2.2-4007.G of the Administrative Process Act and Executive Order Number 21 (02). Section 2.2-4007.G requires that such economic impact analyses include, but need not be limited to, the projected number of businesses or other entities to whom the regulation would apply, the identity of any localities and types of businesses or other entities particularly affected, the projected number of persons and employment positions to be affected, the projected costs to affected businesses or entities to implement or comply with the regulation, and the impact on the use and value of private property. The analysis presented below represents DPB's best estimate of these economic impacts.

Summary of the Proposed Regulation

The proposed regulation amends an existing regulation establishing standards to be used to determine whether or not real estate is devoted to agricultural and horticultural use. In order to qualify for the lower tax rates associated with agricultural and horticultural use, the existing regulation requires that the real estate have a history of five consecutive years of use for agricultural and horticultural purposes (barring certain exceptions). The proposed amendment adds another exception to the five-year-history-of-previous-use requirement, allowing localities to waive the requirement in the case of crops that take more than two years from initial planting to commercially feasible harvesting. This part of the regulation is mandated by Chapter 705 of the Acts of Assembly for 2001.

The proposed regulation also makes clarifications and corrections to the existing regulation.

Estimated Economic Impact

The most significant economic aspect of the proposed regulation is the provision that allows localities to waive the history-of-use requirement in the existing regulation for certain types of crops. The existing legislation requires that in order for land to be classified as agricultural or horticultural, and hence qualify for the lower tax rate, it had to have been used for agricultural and horticultural purposes for the previous five years. There already exist a number of exceptions to the history-of-use requirement and the proposed regulation adds another exception. Farming crops that take more than two years from planting to harvesting will qualify the land for lower tax rate associated agricultural and horticultural land, even if the history-of-use requirement is not met.

The regulation will affect 86 localities (out of a total of 97 localities) in Virginia that participate in a land use value assessment and taxation program, providing tax relief for agricultural and horticultural land. Land classified as agricultural and/or horticultural is provided exemptions and assessed at a lower value than it's fair market value, and is taxed accordingly lower. The tax break is significant. On average, localities with exemptions on certain types of real estate collected 15% less in real estate taxes in 2000 than if they had used the fair market value of the land (data on the magnitude of the tax break for various categories of real estate was not available).

However, localities don't have to waive the history-of-use requirement. Even if they participate in a land use value assessment and taxation program for agricultural and horticultural land, localities may or may not give the additional exception. It is not known how many localities will provide the additional tax breaks.

The land area affected by the additional exception to the history-of-use requirement is very small. Less than 1% of farmland is currently used for the production of crops that take more than two years from planting to commercial harvesting (such as apples, grapes, and peaches). Thus, in the event that localities do choose to waive the history-of-use requirement, the potential loss of revenue is not likely to be large.

The net economic impact of this proposal is likely to be negative. While some farmers may benefit from the lower taxes, the regulation creates an incentive to shift land use toward the cultivation of these crops. There is no evidence that shifting resources into the cultivation of these crops will provide higher returns and increase overall profitability compared to other uses

the resources might be put to. In fact, the favorable tax differential will encourage the shifting of land into the production of these particular crops even though the value of the land may be higher in some other use. The shifting of land in this way reduces the net product of resources in the state. Thus, the proposed regulation is likely to lead to inefficient allocation of resources and overinvestment in farms growing these crops.

The extent of overinvestment that will occur is not known because (1) the number of localities that will provide the additional tax break is not known and (2) the number of acres of land that will be shifted into the cultivation of these crops as a result of this regulation is not known. Thus, even though the eventual impact of the regulation may be small, the net effect on the economy will be negative.

Businesses and Entities Affected

The proposed regulation, if localities choose to implement it, would affect farms that are producing crops that take more than two years from planting to harvesting, but do not yet meet the history-of-use regulation and hence do not qualify for the lower taxes associated with agricultural and horticultural land. It could also encourage a shift in land use toward the cultivation of such crops.

Localities Particularly Affected

86 out of 97 localities currently participate in a land use value and assessment program for agricultural and horticultural land. The proposed regulation applies to all 86 if they choose to implement it. However, localities that have a large number of farms producing crops such as apples, grapes, and peaches will be particularly affected by the proposed regulation.

Projected Impact on Employment

The proposed regulation's impact on employment is likely to be negligible. Even if localities choose to implement the regulation, farm employment accounts for less than 1.5% of all employment. The number of workers employed at farms cultivating the exempt crops is an even smaller fraction of the total.

Effects on the Use and Value of Private Property

The proposed regulation will not have any significant effect on the use and value of private property. While some farmers might get the benefit of lower taxes, the vast majority are

likely to be unaffected. There might be some increase in the number of farms cultivating these crops, but the overall effect of the regulation is not likely to be significant.