How green was their valley

The proposed reform in the betterment tax on farmland threatens to stifle investment, and could have a particularly harsh effect on the periphery.

By Ranit Nathum-Idelov | Jan 16, 2012 | 5:51 AM

It’s hard to miss the aggressive campaign that’s been launched to sell agricultural land, and the slogans that are being used - like "a grain of sand will soon be worth its weight in gold." The Eisenberg Group, for one, enlisted actor and comedian Sefi Rivlin to convince you to buy plots of farmland in Hadera and Afula. "Only a donkey wouldn’t recognize the opportunity here: It happened to my family, it could happen to yours too," Rivlin quips. "You could make a pile of money."

Really?

An entire market based on the dream of striking it rich from such investments is being fueled by stories of property bought in the early days of the state and subsequently rezoned for housing. Such transactions are long-term in nature, and no one knows for sure that the land involved will actually be rezoned. But conventional wisdom maintains that it’s cheap and "at least something will be left for the grandchildren."

As if the uncertainty isn’t enough, such investments will become much riskier under a proposed reform to the Planning and Construction Law. The change would considerably boost betterment taxes paid by landowners if, and when, their property is rezoned. The difference could amount to hundreds of thousands of shekels.

A half dunam (1/8 acre) of agricultural land currently costs between NIS 90,000 to NIS 300,000, on average. For example, a plot that size, which sold a year-and-a-half ago for NIS 150,000 in Elyakim, just south of Hadera, is now on the market at NIS 270,000; undeveloped plots in Hadera's industrial zone are being offered at NIS 260,000; and in the Pardes Hannah-Karkur area, near the Trans-Israel Highway, 400-square-meter plots cost between NIS 90,000 and NIS 120,000 - depending on their proximity to established neighborhoods. In Binyamina 400-square-meter plots are going for NIS 180,000 to NIS 210,000.

While the transactions reflect market values of hundreds of thousands of shekels for a half dunam, under the proposed reform the government will assign a flat value of just NIS 20,000 per dunam for all agricultural land when it comes to tax. The government doesn’t view the land as designated for habitation: It intends to ignore the fact that a different value could be attributed to it should it be used for other purposes. After all, farmland is essentially the same, whether it’s situated near Ra’anana, Hadera, or Arad.

The new standard value per dunam would also be used to calculate compensation for expropriated agricultural property. Valuable open land in desirable areas could therefore be seized for a pittance. For families that bought land as part of their savings, they could lose most of their investment if their property is taken away.

The new provision still hasn’t been ratified but it is already affecting government assessments of confiscated land for the Israel National Roads Company (M’atz), the Metropolitan Mass Transit System (NTA) and Israel Railways.

Damaging to the periphery

Until now betterment has been calculated as the difference between the land value after rezoning has been approved, and its previous market value as farmland. The reform will now fix the lower value at a "standard" NIS 20,000 per dunam regardless of whether the owner paid more than that, or a higher value had been determined by a professional land appraiser.

"Israel’s betterment tax is the most sophisticated in the world," says Prof. Rachelle Alterman, consultant to the Knesset's Internal Affairs and Environment Committee on the Planning and Construction Procedures Bill. The expert on land use law asserts that such a tax is justified, explaining that local authorities can "spread the wealth around" by using the proceeds from granting building rights, for example, to develop infrastructure and put up public buildings.

"The tax on the difference between agricultural property's status before rezoning and afterward is quite stiff, and it is precisely here that the legislation comes and digs deeper in the investor's pocket," Alterman maintains.

Betterment taxes on agricultural land could rise by as much as 40%, depending on location. Take, for example, a half-dunam plot of farmland in the Afula area going for NIS 90,000. The market value for similar pieces of property that are designated for development nearby average about NIS 300,000 - according to Israel Land Administration marketing tenders. Tax collected in this instance, 50% of the difference, would equal NIS 105,000. But this would change if the government ignored market value and based the agricultural value at just NIS 10,000 per half dunam: The tax would soar to NIS 145,000 - a 38% increase.

Another example, though, provides a clearer picture: Agricultural land some seven kilometers from Ra’anana Junction are being offered at NIS 290,000 per dunam. Similar properties zoned for construction of five residential units are being sold at NIS 8 million. Currently the tax would stand at half the difference - about NIS 2.35 million. The tax that would be based, as proposed, on a uniform pre-improvement value of NIS 20,000 per dunam, would come to NIS 2.49 million - meaning a NIS 140,000 increase according to the new regulations, but just 6% higher than the previous calculation.

From this we can see that, percentage-wise, the change in betterment taxes would impact the periphery to a much greater degree than the central region. The value of land in the center that is designated for development is very high at present, and the added betterment tax is as well. However, despite the fact that the new reform will increase the tax, the rise is quite moderate in percentage terms. The percentage increase in tax is much greater in the periphery where betterment potential is much lower, as seen in the Afula example.

"We still haven’t encountered this type of problem," say Shaike Nafha, vice president at Effi Capital, a real estate marketing firm that sells agricultural land. "But I expect that, should the reform proposal be approved, it will affect the market, shake it up, and perhaps even freeze it a while. I don’t think people are really interested in investing in agricultural property is: What happens when it is improved? They want to know how much they are going to make off the deal."

"The change in calculation will raise the tax by dozens of percent, which could discourage investors from entering this market," continues Alterman. "On the other hand this could compel local councils with agricultural land to act more quickly to change its designation."

NIS 50 billion in damage

Ohad Danan, chairman of the Real Estate Appraisers Association in Israel, doesn’t think the market will be affected critically by the new regulation.

"Obviously the change in law could raise the betterment tax, but it wouldn’t be very dramatic," he says. "You need to keep in mind that the betterment tax is assessed when land is ameliorated and the investor profits: Without profit there is no tax. Even if the tax rose by NIS 100,000 the investor still receives more value than he did before. What [the reform] might do is make investors choosier and put the agricultural land market into its proper proportion - something that has never yet happened."
"As of now the country's agricultural land market is propped up by the existing boom in the housing construction market," continues Dannus. "This situation allows various business elements to fuel expectations in all kinds of remote areas, selling farmland to naive investors at inflated prices while promising the land will be rezoned within several years - which is far from realistic is some cases. Introducing a certain increase in betterment tax as something additional to consider should actually help naive investors in deciding how to invest and risk their money."

But the important point, according to Dannus, isn't the betterment-tax increase, rather that setting farmland value at NIS 20,000 per dunam will also serve as the basis for calculating compensation in the event of land expropriation.

Buyers of undeveloped land who aren't in the real estate business - which is most of them - tend to forget that, to build homes in the area where their property is located, roads need to be paved, infrastructure must be laid out, public buildings need to be built, and open public areas need to be taken into account. All this requires seizure of large amounts of land. Indeed, expropriation generally accounts for around 50% of a tract's area.

Expropriation takes two forms: reappropriation of the land (with owners receiving much smaller plots than they originally bought) or simply seizing it. In both cases the property buyers are left with much smaller areas than they actually bought, but only the second scenario entitles them to compensation. This is currently calculated according to market value, but only vis-a-vis any area that exceeds 40% of the owner's plot. Under the new law the calculation will completely change and, as with the betterment tax, the landowner will be worse off.

"If the legal provisions are enacted and the component reflecting the land's [market] potential is cancelled - this will mean a 'haircut' for Israel's agricultural land owners, which will come into play due to the calculation of the betterment tax, but even more due to the expropriation issue," says Dannus. "Owners of agricultural land, instead of receiving full compensation for expropriation at the market price they paid for the land, will receive just minimal compensation of about NIS 20,000 per dunam.

"Our calculations found that this would mean enormous damage amounting to about NIS 50 billion for owners of farmland throughout the country due to reduced compensation for expropriation," concluded Dannus. "There is significant damage here to property rights."