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ISSUE PAPER

PRESERVING MICHIGAN FARMLAND THROUGH PURCHASE OF DEVELOPMENT RIGHTS

by

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INTRODUCTION

The loss of farmland to nonagricultural uses (e.g., residential, commercial, and industrial uses) over the past three decades has been an issue of increasing concern to the agriculture community as well as public policy-makers. According to the United States Department of Agriculture, total land in Michigan dedicated to farming declined from 12.7 million acres to 10.4 million acres between 1970 and 1999, a reduction of 18%. While the conversion of agricultural property for nonagricultural uses can be explained, in part, by factors directly related to the economics of farming, including commodity prices and increased productivity (e.g., output per acre), the loss of farmland also has been fueled by a variety of external factors, including population growth, demographic changes, transportation and other infrastructure investment decisions, and economic prosperity.

The State of Michigan has developed a number of programs to protect farmland and restrict its development. Some of these programs are temporary in nature, such as Farmland Development Rights Agreements authorized under Public Act (PA) 116 of 1974 and commonly referred to as PA 116 agreements. Currently, Michigan has about 50,000 Farmland Development Rights Agreements in effect, covering approximately 4.3 million acres. These agreements range from 10 years to 90 years. In addition to temporary programs, the State offers permanent farmland preservation programs involving the acquisition of agricultural conservation easements and the purchase of development rights.

The State has spent nearly $24 million on the purchase of development rights (PDR) since fiscal year (FY) 1994-95, permanently protecting almost 13,000 acres at an average cost of nearly $1,800 per acre. While this property is classified as unique or prime farmland, the total amount of land protected to date represents only about one-tenth of one percent of Michigan's farmland. Michigan policy-makers must weigh the costs and benefits of the PDR program versus other farmland preservation tools and determine the best use of limited State resources. This analysis examines Michigan's PDR program by providing a brief program description, highlighting revenues and expenditures, and listing appropriations. This paper does not attempt to cover all Michigan farmland preservation efforts or to evaluate such activities, but rather it reviews one specific farmland preservation tool available to land owners and the State.

PURCHASE OF DEVELOPMENT RIGHTS PROGRAM

Public Act 116 of 1974, which was recodified in PA 451 of 1994 as Part 361 of the Natural Resources and Environmental Protection Act (NREPA), authorizes the State of Michigan to purchase the development rights of certain agricultural land in order to preserve the land permanently. Purchase of development rights programs are based on the concept that a piece of property has a bundle of different rights associated with it. These rights include the right to possess, use, modify, develop, lease, or convey all or a portion of the property. Specifically, the development rights associated with a piece of property represent the right of a land owner to develop the land in any manner permissible under the law. Development rights, similar to the other rights associated with a piece of property, can be separated from the property and conveyed or sold to other parties. Michigan's PDR program allows the State to purchase the development rights of a piece of property and effectively limit the development of the land. Michigan's program ensures that the land will be restricted to

agricultural uses in perpetuity. Under Michigan's PDR program, only the development rights are affected while the other rights associated with the land remain intact.

Michigan's PDR program provides land owners with a financially competitive alternative to development. Maintaining the land for agricultural uses as opposed to development also may mitigate the development pressure on neighboring property owners, assuming their development rights have not been purchased by the State. Another advantage to the land owner of the PDR program is a reduction in property taxes. This occurs because the market value of the property, without the development rights, is reduced. Similarly, reduced market value can help prevent property taxes from rising as rapidly as taxes on the land with the development rights attached. A reduction in the market value of farmland also can make it much easier for an owner to pass the land on to an heir to use for agricultural purposes, as the inheritance taxes will be lower.

The Michigan Department of Agriculture (MDA), as the "state land use agency" under Part 361 of NREPA, administers the PDR program. Prior to the enactment of PA 262 of 2000, the program was administered by the Michigan Department of Natural Resources. Program responsibility was transferred to the Department of Agriculture in PA 262, which changed the definition of "state land use agency" in Part 361 from the Department of Natural Resources to the Department of Agriculture.

Participation in the PDR program is entirely voluntary. Land owners submit applications on a per-parcel basis to the MDA, which in turn evaluates and ranks them based on criteria contained in Part 361 of NREPA. The highest priority under the criteria is productive farmland that is considered prime or unique, as determined by the United States Department of Agriculture, Natural Resources Conservation Service. The Michigan Department of Agriculture approves the applications and establishes a price to be paid per parcel, based on negotiations with the land owner.

The value of development rights under the PDR program is determined by subtracting the current fair market value of the property without the development rights from the current fair market value of the property with all development rights. The Michigan Department of Agriculture contracts with a certified appraiser to complete the appraisal of the development rights. A PDR contract with a land owner may be terminated only when specific criteria are met and upon approval by the local governing body, the Michigan Commission of Natural Resources, and the Michigan Commission of Agriculture. Upon termination, the land owner must repay to the State the current fair market value of the development rights.

Revenues and Expenditures

Although Michigan's PDR program was created in 1974, sufficient funding for development rights purchases was not amassed until 1994. State funding for the PDR program comes from the repayment of tax credits and interest associated with the termination of Farmland Development Rights Agreements. These agreements, also established under PA 116 of 1974, are temporary farmland preservation tools that provide land owners with income tax and single business tax credits and special assessment exemptions in exchange for an assurance that the land will remain in an agricultural use for a minimum of 10 years and will not be developed in a nonagricultural use. Upon natural termination of an agreement, the

total amount of State tax credits over the last seven years received by the land owner is due the State.

Table 1 lists the number of tax credits and their value for each tax year since 1979. The table also includes the State revenue generated (on a fiscal-year basis) from the termination of Farmland Development Rights Agreements. Until FY 2000-01, this revenue was dedicated exclusively for the State's PDR program. Recent changes to Part 362 of NREPA give farmland preservation funding priority to local government programs for the acquisition of agricultural conservation easements. This should help stretch the limited State resources since at least a portion of the cost must be paid by the local grant applicant or another person. It appears that the annual State revenue available for purchase of development rights has leveled off at around $2 million.

Table 1

Farmland Tax Credits and State Revenue Generated from the Termination of Farmland Agreements

Year	Tax Credits	Amounts	Average Credit	State Revenue*
1979	5,400	$15,577,200	$2,885	$0
1980	8,300	24,271,700	2,924	29,600
1981	12,000	37,950,300	3,163	52,100
1982	14,800	53,638,100	3,624	83,200
1983	15,100	62,981,300	4,171	104,500
1984	17,000	71,674,600	4,216	115,000
1985	18,200	77,568,300	4,262	236,200
1986	19,600	71,464,800	3,646	231,200
1987	17,300	58,215,700	3,365	372,600
1988	17,100	54,932,500	3,212	771,000
1989	16,700	54,294,900	3,251	809,700
1990	15,400	53,278,100	3,460	1,545,600
1991	15,600	62,443,100	4,003	1,598,300
1992	15,300	60,452,100	3,951	2,324,100
1993	15,100	64,689,300	4,284	2,265,100
1994	13,700	18,883,900	1,378	2,361,600
1995	11,400	18,900,000	1,658	3,036,700
1996	12,800	17,600,000	1,375	2,501,300
1997	8,200	17,733,900	2,163	2,599,100
1998	7,700	18,018,600	2,340	2,573,300
1999	7,200	17,333,900	2,407	3,132,400
2000	7,400	19,051,100	2,574	2,175,000
2001	na	na	na	2,061,800
Total	**291,300**	**$950,953,400**		**$30,979,400**

* Fiscal Year

Source: Michigan Department of Treasury, Michigan Department of Natural Resources, Michigan Department of Agriculture.

Under Part 362 of NREPA, the funds generated from the repayment of tax credits associated with Farmland Development Rights Agreements are deposited in the Agricultural Preservation Fund. The Fund also receives revenue from the "agricultural recapture tax" resulting from the transfer and conversion of qualified agricultural property. (Note: No revenue from the agricultural recapture tax, authorized under PA 260 of 2000, has been deposited in the Fund yet.) The Fund is used first to pay the costs of the Department of Agriculture in the administration of Parts 361 and 362 of NREPA.[1] The second priority for the use of the Fund is to provide grants to local units of government for the acquisition of agricultural conservation easements under a local program, pursuant to Part 362 of NREPA.[2] After expenditures for administrative costs and local government grants, and if the amount of money in the Fund exceeds $5.0 million, the Fund may be used to purchase development rights or acquire agricultural conservation easements under Part 361 of NREPA.

Table 2 lists State funds spent for the purchase of development rights program and the acres permanently protected. Through FY 2000-01, the State had purchased the development rights on 55 parcels of property covering 12,881 acres. On average, the State paid $1,835 per acre to purchase the development rights of the 55 unique or prime parcels. The maximum price paid was $38,257 per acre and the minimum was $529 per acre.[3] The largest purchase covered 1,033 acres, while the smallest area protected under the PDR program was 20 acres. On average, parcel purchases covered 234.2 acres. Figure 1 shows the total acres protected under purchase of development rights agreements by county. Currently, there are no PDR agreements in the Upper Peninsula.

Table 2

Purchase of Development Rights Expenditures and Acres Protected

Fiscal Year	Expenditures	Acres Protected	Cost Per Acre
1994-95	$709,600	79	$8,982
1995-96	0	0	0
1996-97	728,500	96	7,589
1997-98	1,269,000	531	2,390
1998-99	4,466,525	1,478	3,022
1999-2000	5,894,569	2,895	2,036
2000-01	10,565,029	7,802	1,354
Total	**$23,633,223**	**12,881**	**$1,835**

Source: Michigan Department of Agriculture

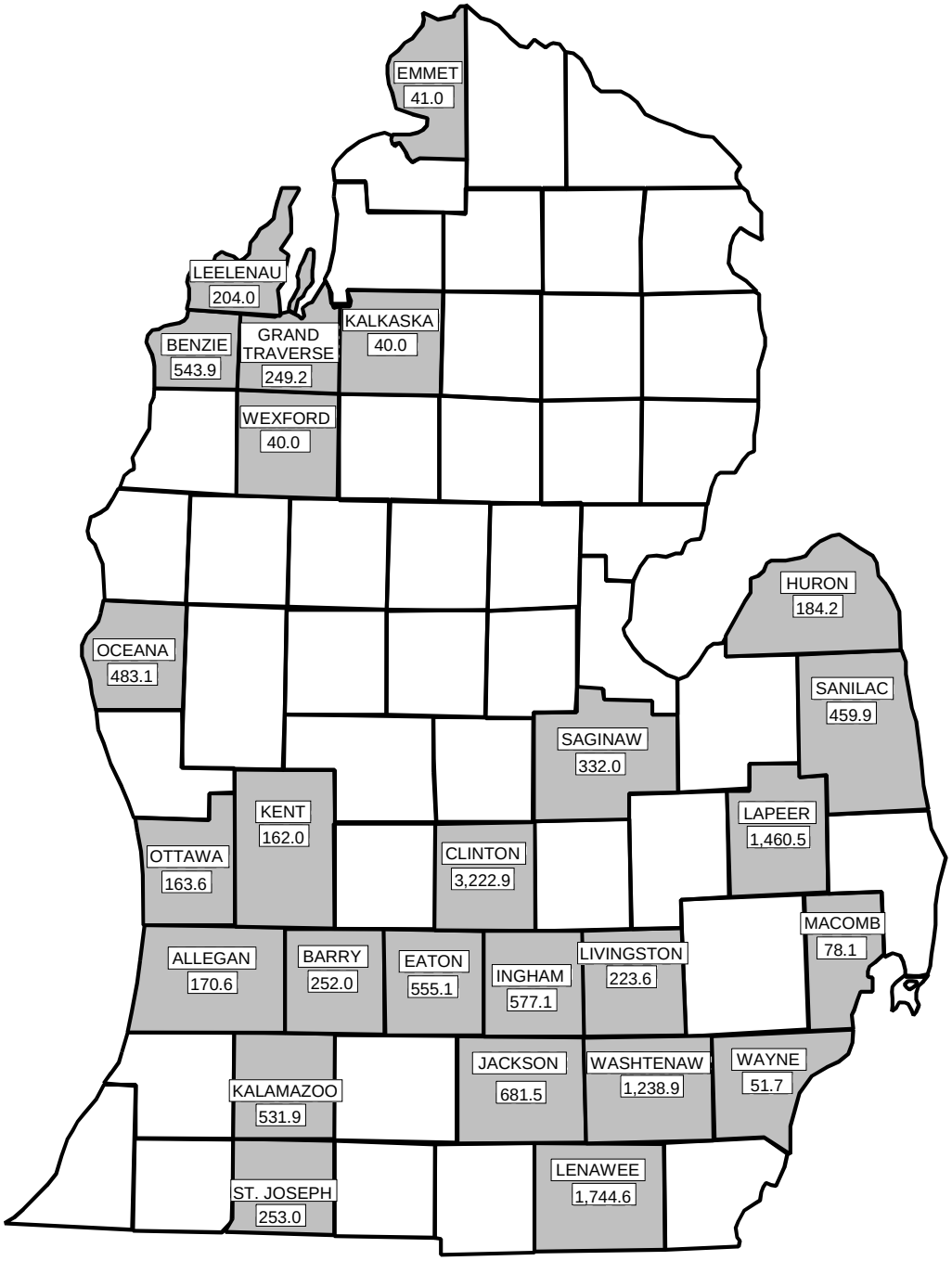
[1] Up to $700,000 annually is allowed for administrative costs; however, if deposits in the Fund exceed $8,750,000 in any fiscal year, then up to 8% of the deposits may be spent for administrative costs.

[2] To date, the Agricultural Preservation Fund Board has not finalized the grant program selection criteria; therefore, money from the Fund has not been spent on grants to local governments for the purchase of agricultural conservation easements (in which the land owner permanently relinquishes to the public his or her development rights and makes an agreement, binding on future owners of the land, not to develop it).

[3] In November 1997, the Michigan Agriculture Commission and the Michigan Natural Resources Commission established a maximum limit of $5,000 per acre to be paid under a PDR agreement.

Figure 1

State of Michigan Purchase of Development Rights
Total Acres Protected by County
(as of 7/8/02)



In addition to tax credit repayments, Michigan's program has received Federal funding from the United States Department of Agriculture, Natural Resources Conservation Service. The Farmland Protection Program works with state, tribal, and local governments and nongovernmental organizations to provide up to 50% of the cost of development right purchases. Michigan competes against other states for a share of the available Federal funds each year. State allocations are based on national and state criteria and distributed on a per-parcel basis. Since FY 1995-96, Michigan's PDR program has received $2.03 million through the Federal program. (Note: An additional $791,500 was allocated directly to Peninsula Township in Grand Traverse County for the purchase of development rights.) The State has used Federal funds to purchase development rights on five parcels covering 1,602.4 acres. Michigan anticipates receiving $2.2 million in FY 2002-03 from the Federal government for its PDR program.

Appropriations

Table 3 lists the appropriations history for the PDR program. Appropriations for the PDR program are contained in the capital outlay budget and therefore authorized for three fiscal years.

Table 3

Purchase of Development Rights Appropriations History

Fiscal Year	State Restricted	Federal	Total
1993-94	$2,100,000	$0	$2,100,000
1994-95	1,250,500	0	1,250,500
1996-97	6,000,000	700,000	6,700,000
1997-98	7,000,000	230,000	7,230,000
1998-99	10,000,000	556,500	10,556,500
1999-2000	5,000,000	0	5,000,000
2000-01	5,000,000	0	5,000,000
2001-02	5,000,000	2,000,000	7,000,000
2002-03	5,000,000	2,500,000	7,500,000
Total	**$46,350,500**	**$5,986,500**	**$52,337,000**

Source: Appropriation Acts.

CONCLUSION

Although Michigan's PDR program enjoys a dedicated revenue source as opposed to relying on annual appropriations for funding, some proponents of the program believe that the current funding level is insufficient given the development pressure facing many land owners and the increasing cost of property. It is argued that the current funding stream results in long waiting lists and missed opportunities to protect valuable farmland. The options to increase the current PDR revenue stream are somewhat limited. An increase in PDR funding would result from an increase in the number of Farmland Development Rights Agreements that are terminated (not renewed), either at the end of their term or early. While the termination of such temporary agreements and the repayment of the associated tax credits would provide

additional resources to the PDR program, it would suggest that property owners and the State were opting for development over preservation. It is unknown, at this time, whether terminating temporary preservation agreements in favor of PDR agreements would benefit the long-term public policy goal of protecting agricultural land.

Other states have employed various methods of financing their PDR programs. According to the American Farmland Trust, as of February 2001, at least 20 states had state-sponsored PDR programs.[4] Most of these states are located in the Northeast. Eleven states rely on state appropriations to finance a part, if not all, of their program. Another popular funding mechanism, used to some degree in nine states, is the use of bond proceeds. Other financing methods employed across the country include the use of lottery, lawsuit settlement, sales tax, cigarette tax, property transfer tax, and/or sales tax revenue. Michigan could explore another revenue source for its PDR program, possibly using the annual revenue generated from Farmland Development Rights Agreements to support the debt service costs associated with a long-term borrowing program.

One Michigan local unit of government has developed its own PDR program, funded from local property taxes. Residents of Peninsula Township in Grand Traverse County approved a millage and use the funds generated to preserve farmland. More local units of government are expected to develop programs as a result of the changes to Part 362 of NREPA, which directs funds from the Agricultural Preservation Fund for grants to local units of government for the purchase of agricultural conservation easements. A local match program will allow the limited State resources to be used to protect additional acres without expanding the fiscal liability of the State. It is expected that local units of government will rely primarily on local millages to generate revenue for farmland preservation.

Since 1974, only 12,881 acres of Michigan's 10.4 million acres dedicated to farming have been protected under the State's PDR program. This represents barely one-tenth of one percent of Michigan's farmland at a cost of nearly $24 million. It is conservatively estimated that it would cost the State at least $10 billion to purchase the development rights on one-half of Michigan's current farmland. While the success of Michigan's PDR program could be measured by the number of acres protected or funds spent, it is difficult to do so without specific preservation goals. Without such goals, it is also difficult to determine the priority of the program in light of limited State resources. Similarly, it is difficult to assess the efficacy of the PDR program relative to other farmland preservation programs, as the PDR program is unique in that it is the only one that protects agricultural land from development permanently, as opposed to protecting it for a set amount of time.

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[4] American Farmland Trust, "Fact Sheet: Status of State PACE Programs", January 2002.