Agriculture and Land-Use: Understanding the Purchase and Transfer of Development Rights

Conference Summary Report

"Are land development and land protection mutually exclusive?" asked Brad Steinke of the City of Mequon at WEI's conference, *Agriculture and Land-Use: Understanding the Purchase and Transfer of Development Rights,* on September 3, 1997. This was certainly a question on the mind of some of the 420 attendees who came to the conference to learn more about the purchase and transfer of development rights.

"I think in reasonable communities we can come to a middle ground. But, what is the middle ground, and how can we arrive there?" The purchase and transfer of development rights have been used by some commmunities to find this "middle ground". Brad Steinke and the other speakers at WEI's conference spoke about the pros and cons of these programs. The following is a summary of their responses.

Defining the Purchase and Transfer of Development Rights

Presented by Bob Wagner, American Farmland Trust

In a Purchase of Development Rights (PDR) program, a landowner voluntarily sells his development rights to a governmental agency or a land trust. The agency or trust pays the farmer the difference between the agricultural value of the land and the land's potential development value. For example, if a farmer's land is worth $2000 an acre for agricultural use and $5000 for development, the farmer can sell his development rights for $3000 an acre. When the sale occurs, a legal document called a conservation easement is created. This easement restricts the use of the land to farming, open space or wildlife habitat. The farmer retains private ownership of the land and can sell it, hold it or pass it on to heirs. There are several benefits and drawbacks to PDR programs:

- **Benefits**—It is a volunteer program. No one is forced to sell his development rights. It permanently protects the land from development (Although some easements have clauses that allow the landowner to repurchase the development rights under specific circumstances). It converts land equity to cash. It helps keep farmland affordable for the next generation. Finally, protected farmland helps local governments balance their budgets by contributing more in tax revenue than it demands in community services.
- **Drawbacks**— Since the program is voluntary, it is sometimes difficult to protect large contiguous blocks of land because a landowner surrounded by other protected farms may not want to sell his development rights. The program is expensive, and it cannot meet farmer demand—for every farmer who has participated in a PDR program, there are six more waiting to sell their development rights. Finally, property owners must pay taxes on the sale of development rights. The transfer of development rights is a market-based farmland protection program. Governmental agencies establish sending areas (land to be protected) and receiving areas (land to be developed). Landowners in the sending areas sell their development rights to

developers who use them in the receiving areas to build at higher densities than allowed under existing zoning. There are several benefits and drawbacks to TDR programs:

- **Benefits**—TDR gives equity compensation to landowners whose land is zoned for agriculture. It promotes private financing of land protection rather than public financing. Finally, it ties farmland conservation to growth management, downtown revitalization and infrastructure efficiency by directing growth to appropriate areas (This promotes the idea of building what should be built and saving what should be saved).
- **Drawbacks**—TDR programs are very complicated to develop and administer. It requires a great deal of "buy-in" from farmers, homeowners accepting increased density in their area, and developers who pay for TDR's. Finally, it relies on an active real estate market to maintain the balance between land protection and compensation. Without land to develop, a TDR program does not work.

Bob Wagner has recently been involved in the production of a book entitled Saving American Farmland: What Works. If you are interested in receiving a copy, call American Farmland Trust at (800) 370-4879. The cost of the book is $34.95 plus shipping and handling.

Purchasing Development Rights: The Experience in Lancaster County, PA
Presented by Tom Daniels, Agricultural Preserve Board

Lancaster County, located 60 miles from Philadelphia and with a population of 450,000 people, has preserved 25,000 acres of farmland through its purchase of development rights (PDR) program. Although 25,000 acres is an impressive number, it is not simply the number of acres preserved that makes Lancaster County's PDR program successful. According to Daniels, simply purchasing development rights does not adequately preserve farmland and protect agriculture. "One has to be strategic about which land to save and which land to develop. You cannot save it all." Therefore, Lancaster County uses a package approach to farmland protection to create large blocks of economically viable farmland:

- **Effective Agricultural Zoning**—320,000 acres (over half the county) are zoned for agriculture. Unlike standard agricultural zoning of one house per 25 acres where the whole 25 acres is carved off, Lancaster County's agricultural zoning allows one building lot of no more than 2 acres per every 25 acres. For example, on a 100 acre parcel, a maximum of 4 building lots equaling a total of 8 acres can be carved off. This leaves 92 acres for farming or open space.
- **Urban/Village Growth Boundary**—A growth boundary is an invisible line beyond which development is discouraged. The line is drawn so that the land within the boundary is large enough to accommodate growth for the next 20 years (this area receives urban services such as sewer and water). The land outside the boundary is zoned for agriculture and is the main target of Lancaster's PDR program. According to Daniels, the growth boundary approach has created peace between the preservationists and the developers. "The developers have plenty of land to build on, and they don't have to fight re-zoning because the land is not agriculturally-zoned. This saves time, and in the developing world, time is money. In return, we agree not to buy development rights within the growth boundary."

- **Purchase of Development Rights**—PDR is used to preserve land along the growth boundary and in large contiguous blocks (For example, 900 and 1300 acre blocks of land have been preserved). Acceptance into the program is determined by the farm's conversion pressure, proximity to nonfarm zoning, road frontage and proximity to another preserved farm. The PDR program is funded through state and county sources. Bonds and a two-cent tax on cigarettes are two revenue generating mechanisms that have been used. Lancaster County's PDR program would not be successful if farmers were not interested in selling their development rights. Educating farmers about the tax implications of participating in a PDR program has helped to increase farmer participation. Daniels summarized the different tax implications as follows:
- **Straight Cash Payment**—When a landowner sells his development rights, the cash he receives for the development rights is taxed as a capital gains. However, the basis (the original price paid for the land plus improvements minus depreciation) is used to reduce the taxable portion of this income. For example, if a farmer receives $250,000 and the basis is $170,000, the taxable portion of the income is $80,000. With a capital gains tax of 20%, the tax owed is $20,000. Therefore, the farmer's net revenue is $250,000 minus $20,000 which equals $230,000.
- **Like Kind Exchanges**—Some farmers do not have a lot of basis; therefore, a capital gains tax on the income received would significantly reduce the farmer's net revenue. To protect their earnings, these farmers can engage in a like-kind exchange in lieu of receiving a cash payment. It works like this: The Agricultural Preserve Board pays a check to an intermediary (the bank or attorney). The intermediary invests the money in a like-kind property (i.e. any real estate involved in business, trade or investment), on behalf of the landowner. For example, the money can be used to purchase additional farmland or an investment property that provides a nest egg for retirement. The capital gains tax is deferred until this exchanged property is sold. One farmer in Lancaster County invested his easement money in townhouses. Subsequently, he sold his land to his son at its agricultural value. This enabled his son to purchase the farm without incurring major debt.
- **Bargain Sale**—Sometimes the Agricultural Preserve Board does not have enough money to buy development rights at their full appraised value. The Board may offer $200,000 even though the appraised value is $250,000. In this case, the farmer is allowed to take a $50,000 charitable donation which, in addition to the basis, will reduce the capital gains tax. Although this scenario is not quite as good financially as a straight cash payment, iit does work well in some situations.

Tom Daniels has written a book entitled *Holding our Ground: Protecting America's Farms and Farmland.* If you are interested in purchasing a copy for $35, call Island Press at (800) 828-1302.

Transferring Development Rights: The Experience in Montgomery County, MD
Presented by Jeremy Criss, Manager of Agricultural Initiatives

In the 1970's, Montgomery County, situated just north of Washington DC, became interested in preserving agriculture and controlling residential growth. As a result of this interest, the County created the Rural Zone, a 100,000 acre area of agricultural land that was zoned one house per five acres. It was soon apparent, however, that one house per five acres did not preserve agriculture and, under this zoning, the entire agricultural base would be gone by 2000. Therefore, in 1980, the County rezoned 90,000 acres (approximately 1/3 of the county) of the Rural Zone to one house per 25 acres. This area was named the Agricultural Reserve. The downzoning resulted in a tremendous outcry from the farm community because of the lost equity from the reduction in development potential. The County responded to this outcry by creating a mechanism to build back a portion of the lost equity. This mechanism is known as the transfer of development rights. The system works in the following way: Farmers sell TDR's to developers at a rate of 1 TDR per five acres (this ratio is based on the original Rural Zone density) minus the number of buildable lots allowed in the Agricultural Reserve. This means that the number of TDR's a farmer can sell plus the buildable lots is equal to the number of houses he was allowed to construct prior to the creation of the Agricultural Reserve. Developers have an incentive to buy the TDR's because TDR's allow them to increase the development density in designated areas outside of the Agricultural Reserve. These areas are known as receiving areas.

For example, a farmer with a 100 acre farm can sell 16 TDR's to developers. This number is obtained by doing the following calculation:

- Total TDR's (1 TDR per 5 acres) 20 TDR's
- Ag Reserve Zoning (allows 4 houses) - 4 TDR's
- TDR's available to sell to developer 16 TDR's

At today's price of $11,000 per TDR, the farmer in the above example would receive $176,000 from the sale. Furthermore, additional income can be acquired by selling the four buildable lots that exist due to the 25-acre zoning in the Agricultural Reserve.

Although one TDR sells for $11,000 today, the price was not always so high. In the early stages of Montgomery County's program, the price was as low as $2,000 per TDR. This low price was a result of too many farmers wanting to sell TDR's at a time when there were not enough receiving areas. From this experience, Montgomery County learned how important it is to create TDR receiving areas that are large enough to accommodate the entire supply of TDR's that can be sold by farmersin the sending area. This will ensure a proper supply-demand equation resulting in favorable TDR sale prices for farmers.

In addition to the TDR program, Montgomery County has a PDR program that accounts for $20 million of public funds. Mr. Criss believes that it is important to have both programs because "the more tools you have in a toolbox, the better off you will be in addressing the various needs of landowners." In addition, the PDR program complements the TDR program because it helps to establish a floor price for TDR's. If farmers do not get enough money from developers, they sell their development rights to the County instead. To date, over 47,000 acres of farmland have been protected under easement as a result of Montgomery County's TDR, PDR and easement donation programs.

The Next Step:

WEI is committed to continuing the dialogue on agriculture, land-use and development. As we develop programs for 1998 and beyond, we welcome your input to ensure that we create an agenda that meets your needs.

Contact WEI at (608) 280-0360 or email info@wi-ei.org. We look forward to hearing from you!