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Technical Report 34

Purchase of Development Rights and Conservation Easements: Frequently Asked Questions



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Purchase of Development Rights and Conservation Easements: Frequently Asked Questions

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INTRODUCTION

Agriculture in the United States has changed dramatically over the last several decades. It is often a productive activity conducted on the urban fringe. Agricultural land regularly is converted from farming to suburban development. The value of land in agricultural use often is significantly less than the value of land sold for development. For many agricultural landowners in urban fringe areas, there appears to be only one long-run choice—sell the farmland for development. However, purchase of development rights (PDRs) and conservation easement tools may provide other options. PDRs and conservation easements also have been applied to farm and ranch properties in areas where land values have increased dramatically as a result of purchases by individuals whose primary financial interest is not agricultural production.

OBJECTIVE

The objective of this report is to answer many of the questions agricultural landowners often have when they first learn about PDRs and conservation easements.

What is the nature of land ownership in the United States?

Property ownership in the United States is based on the principle of fee simple title. A landowner is vested with all necessary rights to treat land as a fully market-

able commodity. Land ownership rights may be separated and legally conveyed in the marketplace. Water, mineral, and timber rights commonly are bought and sold.

Land ownership involves having title to some or all of a bundle of rights. For instance, ownership may involve the right to farm or live on a property, but not the right to extract subsoil minerals. Also, land ownership often involves utility and road easements.

What is a development right?

A development right is the right to subdivide property. For example, larger tracts of agricultural land are divided into smaller properties, which are then sold as rural residences or “ranchettes.” Nationally, almost 5 million acres of agricultural (crop and livestock producing) land have had their development rights severed.

How is the value of development rights determined?

Roughly, the value of development rights is the difference between what agricultural land would sell for if it were sold for development and its value in agricultural use. The agricultural use value and development value are determined through traditional appraisal processes. The value of development rights can range from 10% to more than 90% of the full market price, depending on development pressure.

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How can development rights be severed from agricultural lands?

Throughout the United States, development rights have been severed from agricultural lands in two primary ways. Development rights have been purchased by different entities (usually a nonprofit land trust), and they have been donated by landowners to nonprofit land trusts or conservation organizations. The severance of development rights is a perpetual deed restriction, and future landowners must uphold easement terms.

What happens to the development rights after they are severed from agricultural land?

The buyers of development rights do not acquire the right to build anything on the land. Rather, they hold the right and responsibility to prevent development of the land. After the development rights are severed from agricultural land, the landowner retains all other rights of ownership, including the right to keep the land in agricultural production, apply chemical fertilizers and pesticides, prevent trespassing, sell the land, or pass on the land to heirs.

What happens to the value of agricultural land once development rights are severed?

The value of the land decreases to reflect its agricultural production value, since subdivision or development of the land is no longer possible. The market value of the property is not frozen, and fluctuates with market conditions for agricultural properties.

How is agricultural land taxed if the development rights have been severed?

Most agricultural land in the United States, including farmland and rangeland in New Mexico, currently is taxed at a lower rate as long as the land remains in agricultural production. This preferential taxation structure does not change if the development rights are severed.

What is a nonprofit land trust?

A land trust usually is a local organization that holds title to development rights that have been severed from agricultural properties. Each land trust has its own goals

related to land protection. A land trust may be dedicated to preserving the agricultural land base in a particular region, or it may be primarily concerned with maintaining open space or wildlife habitat. Land trusts hold development rights, which, if exercised, would damage the agricultural productivity, health, and beauty of a property.

Land trusts that hold development rights can never use the rights and must monitor the land to assure that land-use agreements are upheld. For instance, if agricultural landowners transferred their development rights to a land trust and then attempted to develop the land, the land trust would respond through civil, legal action due to breach of contract.

What is the history of land trusts in the United States?

The first U.S. land trusts were established in Massachusetts in the 1890s. More than a thousand land trusts currently exist in the United States, with most of the growth in numbers of land trusts occurring since the early 1980s. Currently, land trusts exist in every state but they are more concentrated in the eastern United States, the Great Lakes region, the Pacific Northwest, California, and Colorado. The Colorado Cattlemen's Association Land Trust holds development rights on more than 30,000 acres of agricultural land. Growth of land trusts in the intermountain West has been increasing steadily for the last 20 years. New Mexico currently has seven organizations, including the Southern Rockies Agricultural Land Trust based in Capitan.

There are a small number of large, nationally active land trusts. The Nature Conservancy has been active throughout the United States (and internationally) in its efforts to maintain biological diversity. The American Farmland Trust is a national organization dedicated to the conservation of the nation's best farmland. The trust's activities involve public education, policy development, and holding title to farmland development rights.

What other organizations can receive development rights?

In recent years, receivers of development rights also have expanded to include some quasi-governmental organizations in areas where public funds have been

used to purchase development rights. Federal land management agencies, cities, and counties also can and have received title to development rights.

Can development rights be severed from agricultural lands in New Mexico?

Yes, New Mexico statutes are typical of other states. Development rights can be transferred legally from agricultural land to nonprofit land trusts. These nonprofit organizations also can be established according to currently existing Internal Revenue Service (IRS) regulations.

What are the similarities and differences between PDRs and conservation easements?

Both are *voluntary* means by which agricultural land can be protected from development or subdivision. In both cases, *landowners* decide if they want to involve their property in the process. Both involve the transfer, in perpetuity, of development rights to a third party, for the purpose of protecting open space, and scenic, ecological, recreational, agricultural, or historic resources.

A conservation easement involves the donation of development rights by a landowner. When a conservation easement is paid for, and traded in a market between a willing buyer and a willing seller, it is called a “purchase of development rights” or PDR. Typically, the severance of development rights is referred to as a “conservation easement,” without reference to whether or not it was a market transaction or a donation process. PDR also is sometimes referred to as “purchase of agricultural conservation easement” or PACE, usually when public funds are used to purchase development rights.

What are the tax implications of a PDR versus a conservation easement?

Severing development rights from or creating conservation easements on agricultural land has numerous tax implications. If development rights are purchased from the landowner through a market transaction, the seller is responsible for paying taxes on the gain from the sale.

If the development rights are donated in the form of a conservation easement to a nonprofit organization, there are large potential tax savings. Landowners may deduct the full fair market value of a perpetually con-

veyed conservation easement. The deduction in any tax year cannot exceed 30% of the taxpayer’s adjusted gross income. If the value of the gift exceeds this limit, the excess may be carried forward for up to five additional years. Corporations are limited to a 10% deduction.

A landowner can donate a conservation easement for a property prior to selling it to another agricultural land user. This provides the prior owner shelter from capital gains taxes derived from the sale. The donated conservation easement is treated as a charitable gift by the IRS.

A conservation easement also can be used to reduce the value of an estate that is subject to taxation. Easements may help people keep land in the family without selling off large tracts to pay estate taxes. By IRS code, heirs have nine months after the death of the landowner to develop a conservation easement donation. Estate taxes can be huge unless actions like easement donations are taken.

Recent acts by Congress (i.e., the Taxpayer Relief Act of 1997) have provided additional tax benefits for conservation easements. Further tax benefits also are available when easements are established for specific purposes, such as the provision of wildlife habitat.

A temporary or term conservation easement (i.e., one with an expiration date) provides no tax benefits.

Clearly, if agricultural landowners are interested in establishing conservation easements, they should consult early with both an accountant and an attorney!

Is there a “one-size-fits-all” conservation easement?

No. Conservation easements (whether PDR or donation) must be tailored to individual properties and landowners’ needs. The enabling legislation for donating development rights is flexible. The decision to sever development rights is voluntary, and landowners do not have to accept a conservation easement if they do not accept the terms of the agreement. For example, some agricultural landowners might want to establish conservation easements on only part of their property. Or they may want to reserve the right to have future homesites for several family members or the right to construct other farm buildings or structures.

A conservation easement is established through negotiation between the grantor of the development rights (the landowner) and the grantee of the development rights (the land trust). Obviously, the agreement must be mutually acceptable.

Does a conservation easement place restrictions on how or what agricultural practices can be conducted on the land?

A conservation easement can be written to include current and future (undetermined) agricultural practices. Or it can be written to restrict certain agricultural practices. This is the landowner's decision. A conservation easement also might be written to preserve a landowner's right to allow fee hunting or other recreational or agri-tourism activities.

Do I have to allow public access after my development rights are severed?

No. Public access is not automatically related to conservation easements. A landowner may *choose* to allow public access, but the landowner also can establish public access limits or guidelines in the conservation easement agreement.

Does a conservation easement involve zoning or regulations?

No. A conservation easement (whether donated or through the PDR process) has no link to zoning. Special regulations to create agricultural zones or zoning rules designed to keep agricultural land in agricultural production involve police powers and the government.

How are conservation easements different from agricultural zoning?

Regulatory systems (or zoning) that attempt to preserve agricultural lands have been tried in many states and regions around the country. Agricultural zoning regulations have proven to be temporary and also have been very unpopular with agricultural landowners. Agricultural zoning involves an uncompensated "taking" of property away from landowners (specifically, their development rights). A conservation easement is voluntary and can provide financial compensation or tax savings.

Can conservation easements be vacated or are they perpetual?

Unlike zoning, conservation easements provide a means to keep land in agricultural use in perpetuity. However, if the original purpose of the easement can no longer be met through no fault of the landowner, the

easement can later be vacated. For example, if irrigation water were to become unavailable to a parcel of land that is dependent on the water for production, the easement would no longer be valid. In a case such as this, the easement holder and the landowner would jointly petition the court to dissolve the easement.

Some landowners have chosen to engage in temporary or term easements. These conservation easements impose restrictions for a specified number of years. In these cases, there are no tax advantages to establishing the easement.

How can conservation easements be "good" for agriculture?

As described above, donated conservation easements can provide significant tax benefits to agricultural landowners, particularly to those with sizable estates and who wish to have agricultural land remain in production and/or in the family.

When landowners are financially compensated for their development rights, the sale of the easement allows them to cash in part of their equity. This money can be used to pay off mortgages, establish secure retirement funds, expand, or recapitalize the farming or ranching operation.

In areas facing heavy development pressures, many younger or would-be farmers are unable to purchase farmland because land prices are so much greater than the value of the land in agricultural production. A supply of good, agricultural land that does not carry development rights could help new or young people enter farming.

How can conservation easements be "good" for communities?

Conservation easements keep land on the tax rolls, because the land stays in private ownership. The land also remains in agricultural production, which for some commodities may help maintain the critical level of regional output necessary to support agricultural processing, agricultural input suppliers, and related agricultural industries. Jobs and output in these sectors are retained.

Research also has found that extensive, large-lot subdivisions on agricultural lands cost much more in government-provided services than the amount paid in property taxes. In contrast, government-provided services to agricultural areas have been shown to cost less than the amounts paid in agricultural property taxes.

If a state assesses agricultural land at its *use* value, as New Mexico does, the “removal” of development rights will not affect property taxes collected.

Keeping land in agricultural production helps to preserve open space and provides natural amenities (such as wildlife) that may be incompatible with development. In many U.S. communities, the agricultural sector is an essential part of local heritage, history, culture, and social activities.

What are some problems with conservation easements?

Some agricultural landowners may not need the tax benefits provided by donating conservation easements. When donating a conservation easement, a landowner must be prepared to pay for the legal and accounting expertise required to design an easement that fully protects the landowner. However, these expenses also are tax-deductible.

PDRs require willing sellers and willing buyers. Often, sellers are interested in selling development rights for financial gain. However, buyers with available funds are scarce.

The holders of development rights (the nonprofit land trusts) must be willing and able to engage in perpetual monitoring and legal enforcement of conservation easement provisions. The majority of local land trusts have small annual budgets. However, litigation between landowners and land trusts has been extremely rare, due primarily to the participating landowners’ commitment to the objectives of the conservation easements.

In areas where there is already extensive subdivision development, conservation easements on remaining agricultural properties may not be feasible due to neighboring nonfarm residents’ intolerance of traditional agricultural practices.

How have conservation easements been paid for in other states?

Some areas and states have used public funds raised through voter-approved bond issues to purchase development rights. Local communities that have done this include King County, Washington; Suffolk County, New York; Boulder County, Colorado; and several towns in Vermont. States that have used public funds to purchase development rights include Connecticut, Maryland, Massachusetts, New Hampshire, New Jersey, and Rhode Island.

Funds provided by the federal Farmland Protection Program (FPP) have been used to purchase development rights in California, Michigan, Wisconsin, Maryland, Pennsylvania, and several other states. The FPP was authorized for six years under the 1996 Farm Bill. The program was funded with \$35 million to match local funds (at 50%) raised for the purpose of protecting farmland threatened by development.

In 1998, the U.S. Congress passed the Southern Nevada Public Land Management Act (Public Law 105-26). This new law provides for sale of up to \$1 billion of public lands in the Las Vegas Valley by the Bureau of Land Management (BLM). More than 80% of the funds generated from sales of BLM land in the Las Vegas area will be used to purchase environmentally sensitive private land and development rights in Nevada (with preference to the Las Vegas area) and improve parks and recreation areas around Las Vegas. The 1998 act is a departure from previous regulations that have permitted the BLM to only engage in land trades, rather than land sales.

Some thought has been given to the idea that a similar piece of legislation might be obtainable for New Mexico. Funds generated from the sale of BLM lands in the state could be used to purchase development rights from agricultural landowners in areas facing heavy development pressure. BLM lands sold into the private market would then be available for development and further relieve development pressure on the limited irrigated farmland in the state.

Where can I find more information about PDRs, conservation easements, land trusts, etc.?

There are many resources available online. The American Farmland Trust is an excellent place to start becoming more informed about the subject. The World Wide Web site is at www.farmland.org. The Trust also can be contacted through its national office at the address and phone below:

American Farmland Trust
National Office
1920 N. Street, NW, Suite 400
Washington, DC 20036
Phone: 202-659-5170
Fax: 202-659-8339

Much information also can be located by using keywords such as “farmland protection,” “farmland preser-

vation,” and “conservation easement” with any good Internet search engine. The Alta Vista search engine is highly recommended. Internet searches using these key words will return hundreds of web pages, many providing information for specific states, communities, legislative initiatives, and land trusts.

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