ohioline.ag.ohio-state.edu -- your Link to Information, News, and Education

Ohio State University Fact Sheet

DEPARTMENTCommunity Development

700 Ackerman Road, Columbus, OH 43202-1578

Purchase of Development Rights

CDFS-1263-98

Land Use Series

Joe Daubenmire
Thomas W. Blaine

Background

The loss of farmland and open space throughout the country has become a very important issue in recent years. As more and more land becomes developed, an increasing number of tools have been created to preserve the land that remains. One of the tools that has captured the imagination of planners, elected officials, and others is the purchase of development rights (PDR). Currently 18 states have active PDR programs. The purpose of this fact sheet is to describe this program.

What is PDR?

We may consider the ownership of land to be the possession of a "bundle of rights" associated with that land. These rights include the right to possess, use, modify, develop, lease, or sell the land. Mineral rights constitute one of the items in the bundle with which most people are aware. If the mineral rights have been separated from the remaining items in the bundle, the owner is prohibited from drilling for oil or from mining the land. The right to develop a piece of land for residential, commercial, or industrial purposes is also a right within the bundle. The purchase of development rights involves the sale of that right while leaving all the remaining rights as before.

PDR is a voluntary program, where a land trust (see OSU Extension Fact Sheet CDFS 1262-98, Land Trusts) or some other agency usually linked to local government, makes an offer to a landowner to buy the development rights on the parcel. The landowner is free to turn down the offer, or to try to negotiate a higher price. Once an agreement is made, a permanent deed restriction is placed on the property which restricts the type of activities that may take place on the land in perpetuity. In this way, a legally binding guarantee is achieved to ensure that the parcel will remain agricultural, or as open (green) space forever. This is because the agency involved retires the development rights upon purchase. The deed restriction may also be referred to as a conservation easement, or, since most PDR programs are designed to preserve agricultural use, an agricultural conservation easement (see OSU Extension Fact Sheet CDFS 1261-98, Conservation Easements). As a result, PDR programs are occasionally called PACE programs (purchase of agricultural conservation easements).

How is the price of the development right determined?

The principal reason that more and more farmland and open space has been converted to other uses is because in most areas at the rural urban fringe, the current agricultural value associated with land is substantially lower than the value that land has for development. For example, consider a piece of land that generates a net income of $100 per acre per year in agriculture. This amount is typical of much farmland in the U.S. To obtain a fair market value for that parcel in agriculture, we simply divide that annual income flow by the interest rate, say 5%. This procedure, called income capitalization, yields a value of $2,000 per acre in this example. Now suppose that this parcel comes under development pressure as a place to build housing or some type of retail establishment. A developer may be willing to pay $5,000 an acre for it. In this case the development value of the parcel would be $3,000 per acre, simply the difference between the overall market value and the agricultural value. With this type of differential, it is very unlikely that the parcel will remain in agriculture in the future, even if the current owner is dedicated to keeping the land as it is.

If the local agency in charge of operating the PDR program makes an offer of $3,000 an acre to the landowner, then that landowner has the opportunity to realize the economic benefits accrued from the development potential of the land, while having the ability to keep the land as agricultural. At any time after selling the development rights, the landowner may sell the property itself, lease it, or pass it on to heirs with the deed restriction attached.

This is a significant change from the situation that farmers usually face as being "cash poor - land rich" and limited to the option of selling the land for development versus owning a very valuable piece of property while realizing none of the financial benefits.

Why should a community consider farmland preservation programs?

If, as stated above, it is primarily market forces which are driving land out of agricultural and open space uses, then it is only natural to ask, why interfere with this process? If land achieves its "highest and best use" only when developed, should this not be allowed to happen? Why not allow the free market in real estate to determine land use?

Studies have shown that many U.S. citizens are deeply concerned about the loss of farmland and open space. Many are concerned that increasing urban and suburban encroachment will lead to a host of environmental problems, ranging from loss of wildlife habitat to a decline in water quality. Also, many people enjoy the aesthetic beauty and sense of place that rural landscapes provide. The provision of environmental and aesthetic amenities is typically not incorporated into the values of private markets. There is simply no way that most landowners can achieve financial rewards for providing these types of "public goods." Finally, some Americans are concerned that the nation's future capacity to produce its own food and fiber, and thus national security, will be compromised if the trends in loss of farmland and open space are not slowed down or stopped.

There are other economic arguments for farmland protection programs. An enormous amount of evidence has emerged over the past decade that indicates that farmland conversion has been subsidized by government taxation and transportation policies. If this is correct, the development values of real estate at the rural urban fringe have been inflated as a result of these policies, and thus really do not reflect true "free market" values.

What are the advantages and disadvantages of PDR, as compared to other policy mechanisms to protect farmland, such as zoning, building moratoria, or tax breaks for agriculture?

Restrictions on land use, including zoning have been used to protect agriculture. One of the main benefits of PDR however, is that it is completely voluntary. Under PDR, the landowner is not deprived of any of the value of the property. This is very important because many farmers rely on their property in order to fund their retirement. Simply depriving them of the opportunity to realize the full economic value of their property has important ethical, socioeconomic, and perhaps legal ramifications. Moreover, zoning regulations may be easily changed in the future. Other regulatory mechanisms such as building moratoria have similar disadvantages to zoning.

Programs that provide tax breaks for farmers, such as current agricultural use valuation have been in place for years, and have not proven effective in keeping land, particularly at the rural-urban fringe, from being converted from agricultural to nonagricultural uses. This is because the tax breaks received by the landowner may be small compared to the price differentials between the development and agricultural land use values.

PDR has several advantages over these other policies. First, since it is completely voluntary, no landowner is coerced into giving up or selling the land or the development rights. Second, it involves a permanent agreement that guarantees that the deed restriction will apply in perpetuity. Clauses for the extinguishment of the agreement typically involve requirements that the landowner demonstrate that surrounding development or economic conditions have made farming on the land impossible.

Another benefit of PDR is that it makes it much easier for one farmer to pass the farm on to an heir interested in continuing to farm. Once the development rights have been separated from the land, the value of the parcel typically declines to its agricultural value. This generally has an enormous effect on reducing the inheritance tax liability. If taxed at the full development value, many parcels are simply taxed out of agriculture, because the heirs are not able to pay the taxes without selling the land.

The primary disadvantage of PDR is the cost involved. In all of the states with PDR programs, these purchases are funded by some sort of tax. Taxes used range from cigarette excise taxes assessed at the state level to local property, income, and sales taxes. The topic of instituting new taxes for virtually any program is always controversial. Opponents to these taxes are usually quite vocal as well. Moreover, the public has become cynical about public programs designed to "subsidize" agriculture, and some critics have come to see PDR as another, and even more radical step in that direction.

However, in the regions of the country that have instituted PDR, the program has received generally favorable responses from the public. Surveys of residents in numerous parts of the country indicate that many citizens who are concerned about the loss of farmland and open space do place measurable values on publicly operated farmland protection programs. It is very likely that considerable discussion regarding the implementation and or continuation of PDR programs will continue to be a subject for debate in the future.

How to Establish and Operate a PDR Program

The establishment of a PDR program often begins at the local level, accompanied by enabling and/or funding legislation at the state level. An agricultural preserve board is usually a county-wide organization consisting of a few members of the community who act as volunteers on the board. Membership may be by appointment by elected officials, such as county commissioners, and should reflect the makeup of the community, with representatives from agriculture, industry, etc. The board is in charge of reviewing applications of landowners who wish to sell development rights, obtaining appraisals, prioritizing parcels, negotiating agreements, and ensuring that deed restrictions are enforced.

It is up to the members of the board to determine how to operate the program so that the public gains the most from its investment. The PDR programs which seem to have had the most success have been those where the objective has been to use this tool to create large contiguous areas with permanently preserved open space and farmland as opposed to selecting individual parcels piecemeal. This type of strategy has several advantages. One is that it allows for a "critical mass" of farms which have the potential to preserve agriculture as a viable industry. If the number of farms in an area becomes too small, there is not enough demand for agricultural supplies (fertilizer, equipment, etc.) to sustain the industry. Another advantage to this approach is that the preservation of large contiguous areas maintains open space and the sense of place that many Americans believe are the goals which are most appropriate for farmland protection programs.

Suggested Reading

Buist, H., C. Fischer, J. Michos and A. Tegene, 1995. *Purchase of Development Rights and the Economics of Easements*. Economic Report No. 718, U.S.D.A.: Washington DC.

Daniels, T., 1991. "The Purchase of Development Rights: Preserving Agricultural Land and Open Space," *Journal of the American Planning Association*, 57 (Autumn):421-431.

Daniels, T. and D. Bowers, 1997. *Holding Our Ground: Protecting American Farms and Farmland*, Island Press: Washington, DC.

Duncan, M. 1984. "Toward a Theory of Broad-Based Planning for the Preservation of Agricultural Land," *Natural Resources Journal*, 24 (January):61-135.

Kinsley, M.J. 1997. *Economic Renewal Guide: A Collaborative Process for Sustainable Community Development*. Rocky Mountain Institute: Snowmass, CO.

Kline, J. and D. Wichlens, 1994. "Using Referendum Data to Characterize Public Support for Purchasing Development Rights to Farmland," *Land Economics*, 70 (May):223-233.

You can read about purchase of development rights on the world wide web!

http://www.farmlandinfo.org

http://www.ypsi1.com/coalit.html

http://www.consrv.ca.gov/olc/alspnet.html
