House Legislative Analysis Section

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FARMLAND AND OPEN SPACE PRESERVATION AMENDMENTS

House Bill 4325 as enrolled
Public Act 233 of 1996
Second Analysis (8-13-96)

Sponsor: Rep. Michelle McManus
House Committee: Agriculture & Forestry
Senate Committee: Agriculture & Forestry

THE APPARENT PROBLEM:

Under statutory provisions formerly contained in Public Act 116 of 1974, which was known as the Farmland and Open Space Preservation Act, a landowner and the state may enter into a contract--known as a "development rights agreement"--that grants a property tax credit to the landowner in return for a promise to keep farmland in agricultural use or open space undeveloped. (This act was incorporated into the Natural Resources and Environmental Protection Act of 1994, which codified all of the state's natural resources and environmental protection statutes into one comprehensive law.) Under the act, a landowner whose land is enrolled under a development rights agreement is eligible for a credit on the state income tax equal to the amount the property taxes on the land and buildings, including the homestead, exceed seven percent of the taxpayer's household income. This tax incentive has worked to lure thousands of landowners, mostly farmers, to enroll over 4.5 million acres of undeveloped land in the program. In addition, landowners who participate must agree to enroll their land for a minimum of 10 years; if they fail to renew an agreement, a lien is recorded against the property equal to the total amount of tax credits the landowner received while the land was enrolled, and the amount must be repaid. The repaid money is then used by the state to purchase development rights on other agricultural or open space lands.

Though the act has worked well to encourage farmers to participate in the program, some enrollees contend the program is inflexible, primarily in the areas of early termination of agreements. For example, some farmers are experiencing financial difficulties despite having enrolled in the program. In an attempt to become financially viable, some of them would like to withdraw their land from the program and reorganize their farm operation; however, the state land use agency, within the Department of Natural Resources, apparently has not been responsive to these kinds of problems. Another problem raised is the fact that, due to passage of Proposal A in 1994, property taxes no longer are so high to make it worthwhile to participate in the program. Early in 1995, the House Agriculture and Forestry Committee formed a special subcommittee to study both the impact of Proposal A's passage on enrollment in former PA 116 and what might be done to address the concerns of farmers enrolled in the program. Legislation has been proposed that would incorporate into the Natural Resources and Environmental Protection Act many of the changes suggested by the subcommittee.

THE CONTENT OF THE BILL:

The bill would amend that portion of the Natural Resources and Environmental Protection Act (MCL 324.36101 et al.) that deals with the preservation of farmland and open space, formerly known as the Farmland and Open Space Preservation Act or Public Act 116 of 1974. Among other things, it would grant those currently enrolled in the act until April 1, 1997, the opportunity either to terminate or reduce the term of an agreement, clarify procedures for withdrawing from a development rights agreement under the act, and permit land subject to an agreement to be divided into parcels at least 40 acres in size. The bill also would establish a scoring system that would have to be used to determine which lands the state may buy under a development rights acquisition agreement, and would limit use of certain state funds acquired under the act only to purchasing farmland development rights. (At present, so-called lien fund money may be used to buy development rights on both farmland and open space land. When enrollees in the act fail to renew an agreement, the state may put a lien on their property for the repayment of tax credits issued to them during enrollment, and this money is used to purchase development rights elsewhere.)

Window to terminate, reduce length of agreement. The bill specifies that, until April 1, 1997, if an owner who had entered into or renewed a development rights agreement before April 15, 1994, made a written request to the state land use agency to terminate the agreement for all or a portion of the farmland covered by it, the state land use agency would have to approve the request and relinquish the farmland from the agreement. If farmland was relinquished under this provision, the agency would have to notify the local governing body of the municipality in which the land was located of the relinquishment, and if terminated the agency would have to prepare a lien, if any, against the property formally subject to the agreement for the total amount of the allocated tax credit of the last seven years received by the owner.

In addition, an owner of farmland enrolled in the act, upon written request to the state land use agency on or before April 1, 1997, could elect to have the remaining term of an agreement reduced to seven years if the farmland had been subject to the agreement for at least 10 years. An owner of farmland that did not meet this criteria could elect to have the term of the agreement reduced to 17 years from the initial year of enrollment, upon written request to the state by this date.

Currently, the act specifies that an agreement or easement entered into is for a term of at least 10 years; under the bill, an agreement or easement entered into after the bill's effective date could not be for a term exceeding 90 years. In addition, an agreement could be renewed for a term of not less than seven years, and if renewed, the land use agency would have to send a copy of the renewal contract to the governing body of the local unit in which the land is located.

Require to notify enrollees. Within 60 days of the bill's date of enactment, the state land use agency would have to notify by first-class mail all owners of farmland that had a development rights agreement in effect as determined by the agency on this date about 1) the ability to terminate an agreement, 2) the ability to reduce the "termination agreement" (this apparently refers to the *term of the* agreement), and 3) all other significant changes made to the act by the bill.

Ending a development rights agreement. The act at present generally provides that a development rights agreement ends when the contract for it expires. An agreement, however, may be ended early if the state determines that developing the land is "in the public interest" and the landowner agrees, or the landowner applies for relinquishment to the local government body in which the land lies and the application is approved. In cases where an agreement is terminated by the state for the public interest, the development rights revert back to the owner without interest or penalty; the bill would delete this provision from the act.

The bill would clarify that, if requested by a landowner and a local government body, the state land use agency would have to relinquish farmland from a development rights agreement if one or both of the following occurred:

* The local governing body determined that 1) agricultural production could not be made "economically viable" (i.e., could produce positive cash flow) with generally accepted agricultural and management practices due to the farmland's quality; 2) surrounding conditions made it difficult to farm or prohibited essential farming practices; 3) major physical changes to the farmland had occurred that were irreversible and permanently limited its productive capacity; and/or 4) a court order restricted use of the land such that farming it would not be economically viable.

* The local body determined that relinquishment was in the public interest and that farmland to be relinquished 1) was to be owned, operated, and maintained by a public body for public use, 2) had been zoned for the immediately prior three years for a commercial or industrial use, and/or 3) was to be owned, operated, and maintained by a nonprofit organization, as defined under the Internal Revenue Code, and relinquishment would benefit the local community.

For purposes of determining public interest, a local governing body would have to consider 1) the long-term effect of relinquishment upon the preservation and enhancement of agriculture in the vicinity, including any nonfarm encroachment on other nearby farming operations; 2) any other "reasonable and prudent" site alternatives; and 3) any infrastructure changes and costs to the local governmental unit that would result if the farmland were developed. A governing body could elect to waive its right to decide whether or not to relinquish land by providing written notice to the state land use agency, which would grant the state sole authority to grant or deny the application.

The bill specifies that, in evaluating an application for relinquishment, a local governing body or the DNR land use agency would determine the economic viability of an affected farming operation by doing the following:

* estimating crop, livestock, or product value of the farmland using locally accepted production methods and local U.S. Department of Agriculture (USDA) yield capabilities for the specific soil types and average price for crop, livestock, or product over the past five years;

* adding average yearly property tax credits afforded by the agreement over the immediately preceding five-year period;

* subtracting estimated expenses directly related to agricultural production, including, but not limited to, seed, fertilizer, insecticide, building and machinery repair, drying, trucking, and property taxes;

* subtracting the estimated cost of the operator's labor and management time at rates established by the USDA for "'all labor,' great lakes area," as published in USDA labor reports; and

* subtracting typical capital replacement cost per acre of nonland assets using a useful life depreciation rate for comparable farming operations.

Relinquishment for residential buildings. Alternatively, the bill provides that, if approved by a local governing body and the DNR, up to two acres of land containing structures that were present before a development rights agreement was recorded could be relinquished; and, if needed to encompass all of the buildings located on the parcel, up to five acres could be. The bill also would permit up to two acres of land to be relinquished, with approval by both the state and a local unit, for the construction of a residence by someone "essential to the operation of the farm," which would mean an individual (i.e., co-owner, partner, shareholder, farm manager, or family member) who had a financial interest of at least one-half the cost of the farm production, who advised and consulted with the owner on production, and/or who worked at least 1,040 hours annually on the farm. If a parcel proposed for relinquishment was smaller than the minimum parcel size required by local zoning laws, it could only be relinquished if a variance was obtained from the local zoning board of appeals permitting the smaller parcel size. Similar provisions would apply to persons owning land who became disabled or inherited land from an owner who died.

For relinquishment that occurred due to the existence of, or plans to build, residential structures, the state would record a lien against the relinquished property for the total amount of allocated tax credits issued to the landowner under the Income Tax Act for the immediately preceding seven years, plus six percent simple interest charged from the time the credit was received until the lien was placed on the property. Thirty days before a lien was recorded, the state would have to notify the owner of the amount of the lien, including any interest. If the lien amount was paid before 30 days after the owner was notified, the lien could not be recorded.

Relinquishment for death or disability. The act currently permits land enrolled in the act to be relinquished from enrollment upon the death or permanent disability of the landowner, in which a lien is placed on the land to reimburse the state for tax credits issued under the act. The bill specifies that a request to relinquish for these reasons would have to be made within three years from the date either occurred, and could only be made by the disabled owner or someone who became owner through survivorship or inheritance.

Upon relinquishment of all or a portion of farmland for reasons of death or disability, the land use agency would have to prepare and record a lien against the formerly enrolled property, calculated according to the following formula: the term of years under the agreement would be established by multiplying the number of years the land was actually enrolled--including any extensions--by seven and dividing this product by the number of years originally called for under the agreement, where the lien amount would be equal to the total amount of the allocated tax credit claimed that was attributable to that agreement in the immediately preceding term of years.

When a lien was paid, the state land use agency would have to prepare and record a discharge of lien with the register of deeds in the county in which the land was located, which would have to state specifically that the lien had been paid in full, that it was discharged, that the agreement and accompanying contract were terminated, and that the state had no further interest in the land under the agreement.

Appeals of relinquishment denials. If a landowner's application for relinquishment was denied by a local governing body, he or she could appeal the denial to the state land use agency. In determining whether to grant the appeal and approve relinquishment, the agency would have to follow the same criteria set forth in the bill that the local unit considered in reviewing the request for relinquishment The agency would have to review an application for relinquishment that was approved to ensure the criteria had been met and factors considered in approving the application; if not, the land could not be relinquished from an agreement. A decision by the agency to grant or deny relinquishment that adversely affected a landowner or local governing body would be subject to a contested case hearing.

Special assessments. At present, the act specifies that municipalities "may not" impose special assessments for sanitary sewers, water, lights, or nonfarm drainage on land under a development rights agreement or easement, except on a nonfarm structure located on the land, unless the assessments were imposed before the agreement or easement had been recorded. The bill would clarify that municipalities "shall not" impose such assessments for these purposes on such land, except for years prior to 1995 on a dwelling or nonfarm structure on the land.

In addition, land exempt under these provisions is currently denied use of the improvement created by the special assessment until it has paid at least the amount that would have to be paid if the land was not excluded, or as long as the landowner has a recorded agreement or easement. The bill would delete these provisions and, instead, specifies that use of an improvement would be denied until the land had paid that portion of the special assessment directly attributable to the actual use of the improvement created by the special assessment. Moreover, if an agreement or easement that had been exempt from a special assessment was terminated, a municipality could impose the previously exempted special assessment; however, the amount could not exceed the amount it would have been at the initial time of exemption, and would not be subject to interest or penalty. And if a dwelling or nonfarm structure located on land under an agreement/easement was required under the Public Health Code to connect to such an improvement, its owner would pay only that portion of the special assessment directly attributable to the actual use of the improvement.

Division of enrolled lands. The bill would permit enrolled land to be divided into smaller parcels, each of which would be covered by a separate agreement and be eligible for subsequent renewal. The separate development rights agreement would have to contain the same terms and conditions as the original agreement, and smaller parcels created by the division would have to meet the minimum requirements for enrollment or be at least 40 acres in size. An initial division of land would not incur a fee, but the state land use agency could charge a reasonable fee not greater than its actual costs in dividing an agreement for each subsequent division; the agency also could charge a $25 fee to process a request to divide land under an agreement, which would be used to administer the act. When division of an agreement was executed and recorded, the land use agency would have to notify the applicant, the local unit and its assessing office, all reviewing agencies, and the Department of Treasury.

Development rights acquisition, scoring system. The act currently specifies that proceeds from lien payments made when land is withdrawn from the program must be used by the DNR to administer the act and to buy development rights on "land that is considered . . . to be unique or critical land area that should be preserved in its natural character." The bill would replace this language with the word "farmland" and, thus, would allow this money to be used only for the purchase of development rights on farmland.

The bill would require an application submitted for development rights acquisition to be evaluated according to selection criteria and a scoring system approved jointly by the natural resources and agriculture commissions. In developing this system, the land use agency and agriculture department would have to seek assistance from Michigan State University, the U.S. Department of Agriculture-Natural Resources Conservation Service (USDA-NRCS), and other appropriate professional and industry groups. The selection criteria would have to consider the quality and physical characteristics of the parcel as well as surrounding land uses and threat of development.

In developing a scoring system, points would be given to farmland that met one or more of the following criteria, with priority given to the first criterion:

* farmland with productive capacity suited for producing feed, food, and fiber, including, but not limited to, farmland that was prime or unique or of local importance, as defined by the USDA-NRCS;

* land that was currently enrolled in the act;

* prime agricultural land faced with development pressure that would permanently alter its ability to be used for productive farming activity;

* parcels that would complement and were part of a documented, long-range effort or plan for land preservation by the local governing body; and

* parcels with available matching funds from the local governing body, private groups, or other sources. A waiver of reimbursement by the state for local property taxes would be considered matching funds.

The DNR director, in consultation with the agriculture department director, would approve individual parcels for development rights acquisition based on the adopted selection criteria and the scoring system. In addition, the NRC and agriculture commission would approve a method to establish the price to be paid for those rights, such as appraisal or a bid process, and would have to establish the maximum price to be paid on a per-purchase basis from the lien fund. The DNR director, after negotiating with the landowner, would have to approve the purchase price for the rights, and proper releases of mortgage holders and lienholders would have to be obtained and executed to ensure all development rights were acquired free and clear of all encumbrances.

All development rights easements would have to include appropriate provisions to protect farmland and other "unique and critical benefits," and these rights could be terminated if the land no longer could be reasonably used for agricultural use. An easement or portion of one could not be terminated unless approved by the local governing body and the NRC and agriculture commission. If an easement was terminated, the current fair market value of the development rights would have to be paid to the state land use agency at the time of termination. The bill specifies that this value would be determined by subtracting the current fair market value (FMV) of the property without development rights from its current FMV with development rights. In addition, whenever a public authority exercised the power of eminent domain and condemned land enrolled in the act, its value would include the value of development rights; if the state bought those rights, their value at condemnation would have to be paid to the land use agency and used to buy such rights on other land.

Requirement to notify landowner. A landowner enrolled in the act, within six months of the termination of an agreement or easement, currently must notify either the local unit or the state about whether he or she intends to extend the agreement/easement or allow it to expire. Under the bill, the state land use agency would have to notify the landowner via first-class mail at least seven years before the expiration of an agreement/easement that a lien could be placed on the enrolled land at the time of expiration if the landowner failed to extend the agreement/easement, and that the landowner could choose not to claim credits during all or a portion of the next seven years.

Permitted uses. Under the act currently, a "permitted use" refers to "any use contained within [an agreement or easement] essential to the farming operation or that does not alter the open space character of the land." The bill would add to this definition the storage, retail or wholesale marketing, or processing of farm products if more than 50 percent of the product was produced by the farm operator for at least three of the immediately preceding five years.

The bill specifies the state land use agency would determine whether a use was permitted, and that in doing so would have to consider whether a proposed use would materially affect the farmland's productivity or adversely affect the open space land's character; materially alter or negatively affect the land's existing conditions or use; substantially alter the agricultural use or natural character of enrolled farmland or open space; result in a material alteration of an existing structure to a nonfarm use; and conform with all applicable federal, state, and local laws and ordinances.

The bill also would define a "prohibited use" as one that is "not consistent with an agricultural use for farmland subject to [an agreement] or . . . with the open space character of the land or lands subject to [an easement]."

Other provisions. The act currently specifies that someone who owns property for life under a life estate with remainder to another person or who holds property under a life lease is considered its owner if the property is farmland and related buildings enrolled in the act. The bill provides that, beginning January 1, 1986, both the person who owned land under a life estate or held it under a lease--who entered into a contract with the person who held remainder interest in the land--and the person with remainder interest, could claim a credit under the act in proportion to the amount of property taxes either was required to pay under the contract.

Under the bill, a member in a limited liability company would be considered an owner of farmland and related buildings covered by an agreement that were owned by it, where the member was to pay a proportion of the property taxes on the property equal to his or her share of ownership or distributive share of ordinary income as reported by the company to the Internal Revenue Service.

In addition, the bill specifies that if a credit claimant under the act indicated on a tax return, falsely, that property taxes on enrolled land had been paid when they, in fact, had not been paid prior to the return being filed, all future payments to the claimant for credits under that agreement could be made payable to both the county treasurer in which the land was located and to the claimant.

FISCAL IMPLICATIONS:

The House Fiscal Agency says the bill would not affect state or local budget expenditures. (8-7-96)

ARGUMENTS:

For:

The act formerly known as the Farmland and Open Space Preservation Act or Public Act 116 of 1974--which is now contained in the omnibus Natural Resources and Environmental Protection Act--has generally worked well to encourage landowners throughout the state, primarily those owning agricultural land, to enter into agreements with the state that require them to keep their land in agricultural use or as undeveloped open space land in return for property tax credits issued to them by the state. At present, over 4.5 million acres of farmland and other natural areas are either enrolled in the act or the development rights to them have been purchased outright by the state with money raised under the act when former enrollees failed to renew agreements. However, after Proposal A passed in 1994, property taxes were cut dramatically, rendering the tax incentives provided by the act less attractive. This prompted the House Agriculture and Forestry Committee to establish a working subcommittee early in 1995 to investigate ways in which the act might be amended both to attract new enrollees to the program while maintaining current enrollment. Generally, the subcommittee has recommended changes that would make the program more flexible by allowing current enrollees, until April 1, 1997, the opportunity to totally withdraw from the program or, if their land had been subject to an agreement for at least 10 years, to reduce the term of an agreement to seven years. Also, it would enable enrollees to subdivide their enrolled parcels under separate agreements that would be similar to the original except that others who participated in the farm operation could build their own dwelling on the property and operate under their own contract, and clarify the process the DNR follows in evaluating requests for relinquishment from the act. Many of the provisions in the bill were suggested by the DNR to bring the act into conformity with the way it currently administers the program.

For:

One of the concerns raised by participants in the farmland and open space program is its inflexibility. In order to qualify for a property tax credit under a development rights agreement, a landowner must sign on for at least 10 years. The average length of an agreement is 22 years, however, and some agreements may run for 90 years. Reasons for which relinquishment is allowed under the act are limited: a landowner's total or permanent disability or death, a determination by the state that development of the land is in the public interest, or state approval of an owner's request for relinquishment. Despite having joined the program, some farmers apparently are struggling financially or even facing bankruptcy; in some instances, the passage of Proposal A only made the situation worse since these landowners are bound to the act even though the tax credits offer little relief now that property taxes are generally lower. Some farmers would like to withdraw their land from the act and reorganize their operation in an attempt to become "economically viable." While rules promulgated by the DNR specify that economic inviability qualifies one to have his or her land relinquished from the act, the definition is not clear and has resulted in what some landowners argue is a subjective determination of criteria for an agreement's early termination. The bill would permit the relinquishment of an agreement if the state determined that compliance was causing economic hardship for the landowner. In addition, although the act permits land to be released from the program when a landowner dies or is totally and permanently disabled, it limits this provision only to the landowner without considering persons who may be integral to a farm's operation, such as a spouse or relative; the bill also would apply this provision to anyone considered "essential" to the farm's operation.

For:

The bill would eliminate use of money raised under the act when persons fail to renew agreements, known as "lien fund" money, for purchasing development rights on open space land. Since 1974 up to the present, nearly all of the land (i.e., 99 percent) enrolled in the act has been agricultural land, which means those who fail to renew agreements are generally farmers who must repay tax credits issued them during enrollment. Thus, if farmers are paying nearly all of the money that accumulates in the lien fund, it makes sense to limit use of fund money only to acquisition of development rights on farmland. In addition, it has been pointed out that the Natural Resources Trust Fund, which contains a substantially larger pool of money than the lien fund, could be used to purchase development rights on open space lands, even though it has never been used in this way. (The bill, it should be noted, would not affect lands already enrolled in the act as open space land.) Moreover, the bill would create a new scoring system that would have to be used in the process of acquiring new lands under the act, where land judged as quality farmland would be given highest priority over other lands, and would require the state to reimburse local governments for property taxes lost due to newly acquired lands unless a local government waived its right to reimbursement. This provision, itself, would enable local units to participate in the acquisition process by offering to waive all or a portion of reimbursement from the state in order to help increase the amount of land acquired under the act, but generally would put the burden of paying for acquisition of development rights onto the state.

Response:

By restricting use of the lien fund only to the purchase of farmland development rights, the bill in fact would alter one of the primary purposes of the act--i.e., to protect *open space* land from development. Though it's true that most of the land currently, or ever, enrolled in the act is or was agricultural, it is misleading to say the act is primarily funded by farmers. In fact, tax credits paid to farmers who participate in the program come directly from the general fund. Thus, all taxpayers support the program with the expectation that preserving both agricultural and open space land will benefit everyone by reducing development sprawl, preserving land for food production, and protecting the natural environment. By limiting use of lien fund money only to acquiring farmland development rights, the bill would restrict the program only to certain areas of the state where farming is practiced and, thus, would prevent some taxpayers from benefitting from the goal of preserving land in its natural state. Furthermore, shifting acquisition of development rights on open space land to the NRTF may be a reasonable idea; however, it would be premature to prevent money from the lien fund to be used in this way until a change in state policy regarding use of that fund was made.

For:

Language added to the bill by the Senate would clarify that farmland enrolled in the act generally would not be subject to special assessments imposed by local governments for sanitary sewers, water, lights, or nonfarm drainage. Apparently, Monroe County attempted to impose such an assessment against the property of a farmer enrolled in the program whose land abutted a drain that had recently been installed, despite the fact that the act currently indicates that a local government "may not" do this. Reportedly, Monroe has maintained that use of the word "may" in this provision gives local governments authority to levy such assessments. The bill not only would clarify the matter by replacing the word "may" with "shall," but also specifies that if a development rights agreement was terminated, a local government could subsequently impose the previously exempted special assessment against that property without interest or penalty to the landowner, which only seems fair.

Against:

By providing a short "window of opportunity" (until April 1, 1997) for enrollees in the act to totally opt out of the program or reduce the term of a development rights agreement from 10 or more years to just seven years, and expanding the criteria that would allow agreement holders to request early termination from the program, the bill could significantly reduce participation in the program. It seems strange that the state would pursue the preservation of farmland and open space using tax credits that primarily have benefitted farmers, only to later allow farmers to renege on these agreements because the program--in the wake of Proposal A--no longer offers the same financial benefits to them. It should be noted that Proposal A and its implementation legislation provided generous tax treatment to farmers.

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