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BILL ANALYSIS

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House Bill 4325 (Substitute S-2 as passed by the Senate)
Sponsor: Representative Michelle McManus
House Committee: Agriculture and Forestry
Senate Committee: Agriculture and Forestry

Date Completed: 5-14-96

CONTENT

The bill would amend the Natural Resources and Environmental Protection Act's provisions on farmland and open space to revise procedures for withdrawing farmland from a development rights agreement; permit farmland owners currently enrolled in the Act to reduce the term of an agreement; and permit land subject to an agreement to be divided into parcels at least 40 acres in size. In addition, the bill would permit the release of land from a development rights agreement if an individual essential to the operation of a farm died or became totally disabled, or if the quality of the land prohibited agricultural production from being made economically viable.

The bill also would permit a local government, upon termination of a development rights agreement or easement, to impose a special assessment on land previously exempted from the assessment; permit an owner of farmland to request, by April 1, 1997, to have the agreement reduced to seven years if the land had been subject to the agreement for at least 10 years; permit an owner of farmland not subject to an agreement for at least 10 years to request, by December 31, 1996, to have the agreement reduced to 17 years from the initial year of enrollment; and, require the State land use agency to terminate an agreement upon request of a landowner who entered into or renewed a development rights agreement before April 15, 1994, and require that the requests be made by April 1, 1997. The bill also would require the establishment of a scoring system for determining farmland in which the State would acquire development rights.

Overview of Act

The owner of farmland may enter into a farmland development rights agreement with the State. An agreement restricts the landowner's right to develop the land for at least 10 years in return for a credit against his or her income tax (or single business tax for certain taxpayers). A development rights agreement must be relinquished by the State upon its natural termination, and may be relinquished if the State determines that development is in the public interest, or if the landowner requests relinquishment. Upon natural termination, the State must record a lien against the property for the amount of tax credit received by the owner for the last seven years; the lien may be paid at any time without interest. If the agreement terminates upon the owner's request, the lien is for the full amount of credit received and bears interest. In either case, an unpaid lien becomes payable when the land is sold. The Act also provides for open space development rights easements under which the owner of open space land is exempt from paying property taxes on the development rights in the land; lien provisions for open space land are similar to those for farmland, although a lien is recorded by the State or a local unit.

Agreement Duration

Under the Act, the execution and acceptance of a development rights agreement or easement by the State or a local governing body and the land owner constitutes a dedication to the public of the land's development rights for a specified term. A development rights agreement or easement must 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 of more than 90 years.

Determination of Permitted Use

Currently, "permitted use" means any use contained in a development rights agreement or easement essential to the farming operation or that does not alter the open space character of the land. The bill would refer to a use "consistent with", rather than "essential" to the farming operation. Storage, retail marketing, and processing of agricultural products would be a permitted use in a farming operation if more than 50% of the stored, processed, or merchandised products were produced by the farm operation for at least three of the immediately preceding five years. The State land use agency (within the Department of Natural Resources) would have to determine whether a use was permitted pursuant to the Act.

In determining whether a use was a permitted use, the State land use agency would have to consider whether the use did the following: adversely affected the productivity of farmland or adversely affected the character of open space land; materially altered or negatively affected the existing conditions or use of the land; substantially altered the agricultural use of farmland subject to an agreement or substantially altered the natural character of open space land subject to an open space easement; resulted in a material alteration of an existing structure to a nonagricultural use; or, conformed with all applicable Federal, State, and local laws and ordinances.

The Act defines "farmland" as any of the following:

-- A farm of at least 40 acres in one ownership, which has been devoted primarily to an agricultural use.
-- A farm of at least five acres in one ownership, but less than 40 acres devoted primarily to an agricultural use, which has produced a gross annual income from agriculture of at least $200 per year per acre of cleared and tillable land.
-- A farm designated by the Department of Agriculture as a specialty farm in one ownership that has produced a gross annual income from an agricultural use of $2,000 or more.

Under the bill, a farm of either 40 acres or more, or at least five but less than 40 acres, as specified above, would have to have at least 51% of the land area devoted to an agricultural use. In addition, a farm of at least five acres but less than 40 acres that was enrolled in a Federal acreage set aside program or a Federal conservation reserve program would be considered, under the bill, to have produced a gross annual income from agriculture of $200 per year or more per acre of cleared and tillable land.

Currently, "agricultural use" means substantially undeveloped land devoted to the production of plants and animals useful to humans, including forages and sod crops; grains; feed crops; dairy and dairy products; livestock, including breeding and grazing; fruits; vegetables; Christmas trees; and other similar uses and activities. The bill would add field crops, poultry and poultry products, the breeding and grazing of cattle and swine, captive cervidae, and similar animals, berries, herbs, flowers, seeds, grasses, nursery stock, and pulpwood. The management and harvesting of a woodlot would not be an agricultural use under the bill.

The bill would define "prohibited use" as a use that was not consistent with an agricultural use for farmland subject to a development rights agreement or was not consistent with the open space character of the land for lands subject to a development rights agreement.

Currently, if the State land use agency approves an application, it must prepare a farmland development rights agreement that contains certain provisions including prohibiting the building on the land of a structure except for use consistent with farm operations. The bill specifies that this would include a residence for an individual essential to a farm's operation.

Notification of Termination

Currently, all participants owning land under a development rights agreement or easement must notify the State or local governing body holding the development rights, six months before the natural termination date of the agreement or easement, of the owners' intentions regarding future plans for the land. Under the bill, instead of giving notice regarding future plans, the participants would have to give notice of their intentions regarding whether the agreement or easement should be extended or allowed to expire. In addition, the State land use agency would have to notify the landowner by first-class mail at least seven years before the expiration of a development rights agreement or easement that a lien could be placed at the time of expiration on the enrolled land in accordance with the Act if the landowner did not extend the agreement or easement and would have to indicate to the landowner the option of not claiming credits during all or a portion of the next seven years.

Special Assessments

Currently, a city, village, township, county, or other governmental agency cannot impose special assessments for sanitary sewers, water, lights, or nonfarm drainage on land for which a development rights agreement or easement has been recorded except as to a dwelling or a nonfarm structure located on the land unless the assessments were imposed prior to the recording of the development rights agreement or easement. Land covered by this exemption must be denied use of an improvement created by the special assessment until it has paid an amount that would have been paid had the land not been excluded. The land exempted from the assessment must be denied use of the improvement as long as the landowner has a recorded development rights agreement or easement. Under the bill, a local government could not impose a special assessment on land under a development rights agreement or easement except for years before 1995. In addition, the bill would delete the exception for a dwelling or nonfarm structure from the prohibition against imposing special assessments on land under a development rights agreement or easement. Also, the bill would revise provisions requiring use of an improvement to be denied while land is subject to an agreement or easement.

Under the bill, land covered by the exemption would have to be denied use of an improvement created by the special assessment until it had paid that portion of the special assessment directly attributable to the actual use of the improvement created by the special assessment. Upon termination of a development rights agreement or easement that had been exempt from a special assessment, a city, village, township, county, or other governmental agency could impose the previously exempted special assessment. The amount of that assessment, however, could not exceed the amount the special assessment would have been at the initial time of exemption, and would not be subject to interest or penalty.

If a dwelling or a nonfarm structure located on land covered by a development rights agreement or easement were required under the Public Health Code to connect an improvement created by a special assessment, the owner of that dwelling or nonfarm structure would have to pay only that portion of the special assessment directly attributable to the actual use of the improvement created by the special assessment.

Limited Liability Company

A member in a limited liability company would be considered an owner of farm land and related buildings covered by a development rights agreement that were owned by the limited liability company. A member would be considered to pay a portion of the property taxes on that property equal to the member's share of ownership or distributive share of ordinary income as reported by the limited liability company to the Internal Revenue Service.

Relinquishment for Death, Disability

Under the Act, if the owner of land subject to a development rights agreement or easement dies or becomes totally and permanently disabled, the land may be released from the program and is subject to a proration under the Act. The bill would extend this provision to instances when an individual essential to the operation of the farm died or became totally and permanently disabled. Under the bill, the land would be subject to a lien, rather than proration. A request for relinquishment would have to be made within three years from the date of death or disability. A relinquishment request could be made only by the owner in case of a disability or, in case of death, the person who would become the owner through survivorship or inheritance. ("Individual essential to the operation of the farm" would mean a co-owner, partner, shareholder, farm manager, or family member, who, to a material extent, cultivated, operated, or managed farmland under the Act. An individual would be considered involved to a material extent if one or both of the following applied: the individual had a financial interest equal to or greater than one-half the cost of producing the crops, livestock, or products and inspected, advised, and consulted with the owner on production activities; and/or, the individual worked 1,040 hours or more annually in activities connected with production of the farming operation.)

If a landowner became totally and permanently disabled or died, land containing structures that were present before the recording of the agreement could be relinquished from the agreement, upon request of the disabled agreement holder or the person who became an owner through survivorship or inheritance, and upon approval of the local governing body and the State land use agency. Not more than two acres could be relinquished under this provision unless additional land area were needed to encompass all of the buildings located on the parcel, in which case not more than five acres could be relinquished. If the parcel proposed to be relinquished were less in area than the minimum parcel size required by local zoning, the parcel could not be relinquished unless a variance were obtained from the local zoning board of appeals to allow for the smaller parcel size. The portion of the farmland relinquished from the development rights agreement would be subject to a lien pursuant to the Act.

The land described in an agreement could be divided into smaller parcels of land, each of which would be covered by a separate agreement and each of which would be eligible for subsequent renewal. The separate agreements would have to contain the same terms and conditions as the original development rights agreement. The smaller parcels created by the division would have to meet the minimum requirements for enrollment under the Act or be at least 40 acres in size. Farmland could be divided once under this provision without fee by the State land use agency. The agency could charge a reasonable fee not more than the agency's actual cost of dividing the agreement for all subsequent divisions of that farmland. When a division of an agreement was made under this provision and was executed and recorded, the agency would have to notify the applicant, the local governing body and its assessing office, all reviewing agencies, and the Treasury Department.

The State land use agency could charge and collect a $25 fee to process each change of ownership or each division. The agency would have to use the fee to administer the Act.

Upon relinquishment of all of the farmland due to the death or disability of a person essential to the farm's operation, or due to death or disability of the landowner, the State land use agency would have to prepare and record a lien against the property formerly subject to an agreement in an amount calculated as follows:

-- Establishing a term of years by multiplying seven by a fraction, whose numerator was the number of years the farmland had been under the agreement, including any extensions, and whose denominator was the number representing the term of years of that agreement, including any extensions.
-- The lien amount equaled the total amount of the allocated tax credit claimed attributable to that development rights agreement in the immediately preceding term of years as determined above.

<u>Agreement Renewal</u>

Under the Act, if a landowner has complied with the Act's requirements regarding development rights agreements, he or she is entitled to automatic renewal of the agreement upon written request of the owner. Under the bill, a development rights agreement could be renewed for a term of at least seven years. If an agreement were renewed, the State land use agency would have to send a copy of the renewal contract to the governing body of the local government in which the farmland was located.

<u>Relinquishment/Reduction</u>

Currently, a development rights agreement maybe relinquished by the State before a termination date contained in the instrument under the following conditions: the State determines that development of the land is in the public interest and the landowner agrees; or, the landowner applies to the local government having jurisdiction requesting that the agreement be relinquished. The bill would delete these conditions and provides, instead, that farmland could be relinquished before a termination date if approved by the local governing body and the State land use agency, as follows:

-- Land containing structures that had been present before the recording of the agreement could be relinquished from the agreement. Not more than two acres could be relinquished under this provision unless additional land area were needed to encompass all of the buildings located on the parcel, in which case not more than five acres could be relinquished.
-- Up to two acres could be relinquished from the agreement for the construction of a residence by an individual essential to the operation of the farm.

In either case, if the parcel proposed to be relinquished were less in area than the minimum parcel size required by local zoning, the parcel could not be relinquished unless a variance were obtained from the local zoning board of appeals to allow for the smaller parcel size.

Until April 1, 1997, if an owner who entered into or renewed a development rights agreement before April 15, 1994, made a request, in writing, to the State land use agency, to terminate that development rights agreement with respect to all or a portion of the farmland covered by the agreement, the State land use agency would have to approve the request and relinquish that farmland from the development rights agreement. If farmland were relinquished under this provision, the State land use agency would have to notify the local governing body of the local government in which the land was located of the relinquishment.

If an agreement or a portion of an agreement were to be relinquished pursuant to these provisions, the State land use agency would have to record a lien against the property formerly subject to the agreement for the total amount of the allocated tax credit under the State Income Tax Act for the last seven years including the year of termination received by an owner attributable to the property formerly subject to the development rights agreement under the Act plus interest at a rate of 6% per year. Currently, if the property being withdrawn from the agreement is less than all of the property subject to that agreement, the allocated tax credit for the agreement must be multiplied by the property's share of the assessed valuation of the agreement as defined in the Act. Under the bill, the allocated tax credit would have to be multiplied by the property's share of the taxable value of the agreement. The bill would change references to assessed value to taxable value and specifies that taxable value would mean assessed value for years before 1995.

Thirty days before the recording of a lien, the State land use agency would have to notify the farmland owner of the amount of the lien, including interest, if any. If the lien amount were paid before 30 days after the notification, the lien could not be recorded.

When a lien was paid under current and proposed provisions, 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. The lien discharge would have to state specifically that the lien had been paid in full, that it was discharged, that the development rights agreement and accompanying contract were terminated, and that the State had no further interest in the land under that agreement.

An owner of farmland, upon written request to the State land use agency on or before April 1, 1997, could elect to have the remaining term of the development rights agreement reduced to seven years if the farmland had been subject to that agreement for at least 10 years. If the farmland had not been subject to the agreement for at least 10 years, a farmland owner could, upon written request to the State land use agency on or before December 31, 1996, elect to have the term of the agreement reduced to 17 years from the initial year of enrollment.

Within 60 days of the date of the bill's 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 on the date of enactment about all of the following: the ability to terminate an agreement entered into or renewed before April 15, 1994, the ability to reduce the termination agreement to seven or 17 years, and all other significant changes in law contained in the bill.

Economic Viability/Public Use

Upon request from a landowner and a local governing body, the State land use agency would have to relinquish farmland from a development rights agreement if the local governing body determined one or more of the following: that, because of the quality of the farmland, agricultural production could not be made economically viable with generally accepted agricultural and management practices; that surrounding conditions imposed physical obstacles to the agricultural operation or prohibited essential agricultural practices; that there had occurred significant natural physical changes in the farmland that were generally irreversible and permanently limited its productivity; and/or, that a court order restricted the farmland's use so that agricultural production could not be made economically viable. ("Economic viability" would mean that the cash flow returning to the farming operation was positive. The local governing body or State land use agency would have to evaluate an application for relinquishment, and determine the economic viability of the affected farming operation, by doing all of the following:

-- Establishing crop, livestock, or product value of the local 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 development rights

agreement over the immediately preceding five-year period.

- -- Subtracting estimated expenses directly attributed to the production of the crop, livestock, or product, 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 the USDA labor reports.
- -- Subtracting typical capital replacement cost per acre of nonland assets using a useful life depreciation rate for comparable farming operations.)

In addition, upon request from a landowner and a local governing body, the State land use agency would have to relinquish farmland from a development rights agreement if the local governing body determined that the relinquishment was in the public interest and that the farmland to be relinquished met one or more of the following conditions: the farmland was to be owned, operated, and maintained by a public body for a public use; the farmland had been zoned for the immediately preceding three years for a commercial or industrial use; and/or, the farmland was to be owned, operated, and maintained by an organization exempt from taxation under the Internal Revenue Code and the relinquishment would be beneficial to the local community. In determining public interest, the governing body would have to consider all of the following: the long-term effect of the relinquishment upon the preservation and enhancement of agriculture in the surrounding area, including any nonfarm encroachment upon other agricultural operations in the surrounding area; any other reasonable and prudent site alternatives to the farmland to be relinquished; and, any infrastructure changes and costs to the local governmental unit that would result from the development of the farmland to be relinquished.

If an landowner's relinquishment application were denied by the local governing body, the landowner could appeal that denial to the State land use agency. In determining whether to grant the appeal and approve the relinquishment, the agency would have to follow the criteria or consider the factors described above. The agency would have to review an application approved by the local governing body to verify that these criteria were met or these factors were considered. If the local governing body did not render a determination in accordance with this provision, the State land use agency could not relinquish the farmland from the development rights agreement.

A local governing body could elect to waive its right to make a relinquishment determination by providing written notice of that election to the State land use agency. The written notice would have to grant the agency sole authority to grant or deny the application as provided in the bill. A decision by the State land use agency to grant or deny a relinquishment application that adversely affected a landowner or a local governing body would be subject to a contested case hearing as provided under the Act and the Administrative Procedures Act.

<u>Lien Proceeds/Development Rights Acquisition</u>

Under the Act, upon the natural termination of a development rights agreement, the State land use agency must prepare and record a lien against the property for the total amount of the allocated tax credit of the last seven years received by the owner. The agency must use the proceeds of lien payments to administer the Act through October 1, 1999, and to purchase development rights on land that the agency considers to be a unique or critical land area that should be preserved in its natural character but that does not necessitate direct purchase of the land. Under the bill, instead, the agency would have to use lien proceeds to administer the Act through 1999-2000 and, pursuant to the bill's provisions establishing a scoring system for development rights acquisition, to purchase development rights in farmland that did not necessitate direct purchases of the land.

An application for development rights acquisition would have to be evaluated and ranked according to selection criteria and a scoring system approved jointly by the Natural Resources Commission and the Agriculture Commission. In developing a point system for selecting the parcels for purchase of development rights, the State land use agency and Department of Agriculture would have to seek assistance from Michigan State University (MSU), the USDA-Natural Resource Conservation Service, and other appropriate professional and industry organizations. The selection criteria would have to give consideration to the quality and physical characteristics of the parcel as well as surrounding land uses and threat of development.

The State land use agency would have to prepare a notification to persons whose farmland development rights agreements were expiring in the application year or expiring one year after the application year. The notice would have to be completed at least 90 days before an application deadline set by the State land use agency and would have to include written information and details regarding the program. Applications for development rights acquisition would have to be submitted to the State land use agency by the landowner and would have to include written support by the local governing body.

In developing a scoring system, the Natural Resources Commission and Agriculture Commission would have to give points to farmland that met one or more of the following criteria, giving priority to the first criteria over the remaining criteria:

- Productive capacity of farmland suited for the production of feed, food, and fiber, including, but not limited to, prime or unique farmland or farmland of local importance, as defined by the USDA-Natural Resources Conservation Service.
- Lands that were enrolled under the Act.
- Prime agricultural lands that were faced with development pressure that would permanently alter the ability for that land to be used for productive agricultural activity.
- Parcels that would complement and were part of a documented, long-range effort or plan for land preservation by the local governing body.
- Parcels with available matching funds from the local governing body, private organizations, or other sources.

For purposes of these provisions, development rights value would have to be 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 Department of Natural Resources (DNR) Director in consultation with the Director of the Department of Agriculture would have to approve individual parcels for the purchase of development rights based on the adopted selection criteria and scoring process. The Natural Resources and Agriculture Commissions would have to approve a method to establish the price to be paid for development rights, such as via appraisal or bidding process. The DNR Director, after negotiating with the landowner, would have to approve the price to be paid for purchase of development rights. Proper releases from mortgage and lien holders would have to be obtained and executed to ensure that all development rights were purchased free and clear of all encumbrances.

All development rights easements would have to include appropriate provisions for the protection of the farmland and other unique and critical benefits. Development rights easements could be terminated if the land, as determined by the Natural Resources Commission, met one or more of the bill's criteria. An easement or portion of an easement could not be terminated unless approved by the local governing body and the Natural Resources and Agriculture Commissions. If an easement were terminated, the current fair market value of the development rights, at the time of termination, would have to be paid to the State land use agency. Any payment received by the agency under this provision would have to be used to purchase development rights on additional farmland in accordance with the Act.

Whenever a public entity, authority, or political subdivision exercised the power of eminent domain and condemned land enrolled under the Act, the land value would have to include the value of development rights covered by development rights agreements. If the development rights had been purchased under the Act, the value of the rights at the time of condemnation would have to be paid to the State land use agency and any payment received by the agency would have to be used to purchase development rights on additional land.

Life Estate

The Act specifies that a person who owns property for life under a life estate with the remainder to another person or who holds property under a life lease is considered the owner if the property is farmland and related buildings covered by a development rights agreement. The bill provides that, beginning January 1, 1986, if a person possessing property for life under a life estate with the remainder to another person or holding property under a life lease entered into a written agreement with the person holding the remainder interest in that land and the written agreement apportioned the property taxes in the same manner as revenue and expenses, the life lease or life estate holder and the person holding the remainder interest could claim the credit under the Act if it were apportioned to them under the written agreement upon filing a copy of the agreement with the return.

Property Taxes

Under the Act, an owner of farmland and related buildings covered by one or more development rights agreements who is required or eligible to file a State income tax return may claim a credit against the State income tax liability for the amount by which the property taxes on the land and structures used in the farming operation, including the homestead, restricted by the development rights agreement exceed 7% of the household income. The Treasury Department must account separately for payments and not combine them with other credit programs. A payment made to a claimant for a credit must be issued by one or more warrants made out to the county treasurer in each county in which the claimant's property is the located and the claimant, unless a copy of the receipt showing payment of the property taxes that became a lien in the year for which the credit is claimed, or that became a lien in the year before the year for which the credit is claimed, is attached to the income tax or single business tax return filed by the claimant. If a copy of the receipt is attached to the return, the payment must be made directly to the claimant. Under the bill, if a claimant falsely specified that the receipt showing payment of the property taxes was attached to the return and if the property taxes on the land subject to that development rights agreement had not been paid before the return was filed, all future payments to that claimant of credits claimed under the Act attributable to that development rights agreement could be made payable to the county treasurer of the county in which the property subject to the agreement was located and to that claimant.

MCL 342.36106 et al.

Legislative Analyst: L. Arasim

FISCAL IMPACT

The fiscal impact on State and local units would depend on the amount and value of the land involved.

Fiscal Analyst: R. Ross

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