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SFA BILL ANALYSIS

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Senate Bill 692 (as enrolled) **PUBLIC ACT 75 of 2002**
Sponsor: Senator Bev Hammerstrom
Senate Committee: Farming, Agribusiness and Food Systems
House Committee: Land Use and Environment

Date Completed: 8-13-02

RATIONALE

The Natural Resources and Environmental Protection Act (NREPA) gives the State several ways to preserve agricultural property. Under Part 361 of the Act, the State and a land owner may enter into a farmland development rights agreement (FDRA), which entitles the owner to a tax credit in exchange for keeping the land in agricultural production for the term of the agreement. Part 361 also authorizes the State to purchase the development rights of farmland. In addition, under Part 362, eligible local units of government may purchase agricultural conservation easements. In either case involving a purchase, the land owner permanently relinquishes the right to develop the land for nonagricultural purposes.

Although a land owner who is enrolled in the FDRA program may sell the development rights to the State or a local unit, doing so meant that the landowner would incur a financial liability. Under the Act, if an FDRA is not renewed when its term expires, the land owner must repay the State for the tax credits received during the last seven years of the agreement. If the amount is not paid within 30 days, the State must record a lien against the property for the amount due. Also, if an FDRA is relinquished before its term expires, the land owner is liable for interest on the amount due. According to the Attorney General's office, an FDRA *had to* be terminated when the State and a land owner entered into a purchase of development rights (PDR). As a result, the land owner was liable for the repayment of tax credits, as well as interest in some cases, and no longer was eligible for a tax credit under the FDRA program. Some people saw this as a disincentive for farmers to sell their development rights, and suggested that the repayment and lien requirements should not apply in these situations.

CONTENT

The bill amended Part 361 (Farmland and Open Space Preservation) and Part 362 (Agricultural Preservation Fund) of the Natural Resources and Environmental Protection Act to do the following:

-- **Provide for the automatic termination of a farmland development rights agreement when the farmland becomes subject to an agricultural conservation easement or purchase of development rights.**
-- **Provide that farmland is not subject to a lien for tax credits received by the owner if, upon expiration of an FDRA, the farmland becomes subject to an agricultural conservation easement or purchase of development rights agreement or if the FDRA is automatically terminated when the farmland becomes subject to a development rights easement.**
-- **Extend the income tax and single business tax credits to property subject to an agricultural conservation easement or PDR.**
-- **Require the State, upon request, to release farmland from a development rights agreement if the land is zoned for commercial or industrial use and releasing it will be mitigated by certain means.**

Under the bill, a farmland development rights agreement will be automatically relinquished when the farmland becomes subject to an agricultural conservation easement or purchase of development rights under Part 361 or 362. The bill also provides that farmland is not subject to a lien for seven years of tax credits if, upon expiration of the term of an FDRA, the farmland becomes subject to an agricultural conservation easement or purchase of development rights under Part 361 or 362, of if an FDRA is automatically relinquished as provided in the bill.

The NREPA permits the owner of land covered by an FDRA to claim a credit against the State income tax or single business tax for the amount by which the property taxes on the land and structures exceed 3.5% of the owner's household income or adjusted business income, as applicable. Under the bill, the tax credit also is available to the owner of land subject to a purchase of development rights or an agricultural conservation easement under Part 361 or 362.

The NREPA requires the State, upon the request of a land owner and a local governing body, to relinquish (release) land from a farmland development rights agreement if the local governing body determines that the farmland is no longer productive or agricultural production is no longer viable, or determines that relinquishment is in the public interest and the farmland meets one or more conditions described in the Act. The bill expanded those conditions. Specifically, the State must relinquish farmland from an agreement, upon request, if a local governing body determines that relinquishment is in the public interest, the farmland is zoned for commercial or industrial use, and the relinquishment will be mitigated in one of the following ways:

-- For every one acre of farmland to be relinquished, an agricultural conservation easement will be acquired over two acres of farmland of comparable or better quality located within the local unit of government where the farmland is located. The agricultural conservation easement must be held by that local unit or, if the local governing body declines to hold the easement, by the State land use agency (the Michigan Department of Agriculture).
-- If an agricultural conservation easement cannot be acquired, an amount equal to twice the value of the development rights to the farmland being relinquished, as determined by a certified appraisal, will be deposited into the State Agricultural Preservation Fund.

MCL 324.36105 et al.

BACKGROUND

Part 361

Farmland Development Rights Agreement. The FDRA program was created in 1974 upon the passage of the Farmland and Open Space Preservation Act (which later became Part 361 of the NREPA). Farmland eligibility for an agreement is based on the size of the farm and, in some cases, on its income. A land owner who wants to participate in the program must apply to the local governing body having jurisdiction (e.g., the legislative body of a city, if the land is located in a city), which then must notify various local agencies and approve or reject the application. If the application is approved, the local governing body must send it to the Michigan Department of Agriculture (MDA) for approval or rejection. If the MDA approves the application, it must prepare a farmland development rights agreement for execution by the land owner and the Department, and for recording with the register of deeds.

While an agreement is in effect, the land owner may claim a credit against the State income tax or single business tax for the amount by which the property taxes on the land and structures used in the farming operation restricted by the agreement exceed 3.5% of the land owner's household income or adjusted business income, as applicable. The land also is exempt from special assessments for sanitary sewers, water, lights, or nonfarm drainage unless the assessments were imposed before the agreement was recorded.

An FDRA must be for an initial term of 10 years and may not exceed 90 years. When its term expires, the agreement must be relinquished by the State unless it is renewed with the consent of the land owner. A land owner who has complied with Part 361 may renew the agreement for a term of at least seven years. Under certain circumstances, an FDRA or a portion of the land covered by an agreement may be relinquished before the termination date. The State must record a lien for the amount of the last seven years of tax credits, when an agreement is relinquished. The lien may be paid and discharged at any time, and is payable at the time the land is sold.

Until October 1, 2000, the proceeds from lien payments were used by the State to administer Part 361 and to purchase development rights on farmland. Since that date, the unappropriated proceeds of lien payments have been forwarded to the State Treasurer for deposit in the Agricultural Preservation Fund created under Part 362.

Purchase of Development Rights. Part 361 also authorizes the State to purchase development rights to farmland and to acquire agricultural conservation easements. The land owner must submit an application for a PDR or an easement to the Department of Agriculture, and include written support by the local governing body. The MDA must evaluate applications and rank them according to selection criteria and a scoring system approved by the Agriculture Commission. In the scoring system, points are given to farmland that meets certain criteria, including land that is enrolled in an FDRA. After negotiations with the land owner, the MDA must approve the price to be paid for the purchase of development rights or the acquisition of an agricultural conservation easement.

The NREPA defines "agricultural conservation easement" as a conveyance in which, subject to permitted uses, the owner permanently relinquishes to the public his or her development rights and makes a covenant running with the land (binding on future owners of the land) not to undertake development. Under certain circumstances, an easement may be terminated with the approval of the local governing body and the Agriculture Commission. If an easement is terminated, the current fair market value of the development rights must be paid to the MDA, which must use the payments to acquire agricultural conservation easements on additional farmland.

Part 362

Public Act 262 of 2000 added Part 362 to the NREPA. Public Act 262 created the Agricultural Preservation Fund and required the Department of Agriculture to establish a program in which eligible local units may receive grants for the purchase of agricultural conservation easements. (Public Act 262 also added the agricultural conservation easement provisions of Part 361.)

To be eligible for the grant program, a local unit must have adopted a development rights ordinance providing for a PDR program. The local unit also must have adopted a comprehensive land use plan (or be within a regional plan) that includes a plan for agricultural preservation. Upon receiving a local unit's application, the MDA must forward it to the Agricultural Preservation Fund Board for consideration. After the Board decides which grants should be awarded and their amount, the MDA distributes the grants, conditioned upon its approval of the easements being acquired. An agricultural conservation easement acquired under Part 362 must be held jointly by the State and the local unit of government in which the land is located.

Money in the Agricultural Preservation Fund may be spent, upon appropriation, for the following purposes:

-- To pay administrative costs of the MDA and the Board in implementing Parts 361 and 362 (subject to limits in the Act).
-- After the payment of administrative costs, to provide grants to local units of government for the purchase of agricultural conservation easements.
-- After the first two expenditures, if the amount of money in the Fund exceeds $5 million, to purchase development rights or acquire agricultural conservation easements under Part 361.

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

In recent years, the Attorney General's office made it clear, through a title opinion letter and in memoranda, that a farmland development rights agreement had to be terminated when the State purchased the same development rights that were subject to the FDRA. This requirement was likely to affect the majority of cases in which a land owner transferred from an FDRA to a PDR, since land owners have been enrolled in the FDRA program in nearly all PDR cases. Upon termination of the FDRA, the land owner became liable for seven years of tax credits (plus interest, if the transfer occurred before the agreement had expired), and the State had to record a lien for the amount that was not repaid within 30 days. At the same time, the land owner lost the FDRA tax credit. Although these consequences were legally required, they created a disincentive for land owners in the FDRA program to transfer to a PDR.

The bill addressed this situation by exempting farmland from the lien requirement if the land becomes subject to a PDR or an agricultural conservation easement, either during the term of the FDRA or when the agreement expires. In addition, the land owner will remain eligible for the tax credit allowed under the FDRA program. Encouraging farmers to sell their development rights in this way not only will benefit the individual land owners, but will help promote the State's interest in preserving agricultural property. While land subject to an FDRA must continue to be farmed, that agreement is only temporary. When development rights are purchased, the land is permanently protected from nonagricultural development.

Supporting Argument

According to the September 1999 report of the Senate Agricultural Preservation Task Force, the advantages of enrolling land in the FDRA program declined significantly due to the 1994 passage of Proposal A, which reduced average property taxes on homestead and agricultural property by almost one-half. Since the value of the tax credit is lower than it used to be, there is less incentive for farmers to enroll in the program or to re-enroll when their agreement expires. Moreover, since tax credits are smaller, less money is paid into the Agricultural Preservation Fund when FDRAs terminate, which means that fewer funds are available to purchase development rights.

Along with other legislation addressing concerns raised by the Task Force, Public Act 421 of 2000 reduced the income threshold for a land owner to participate in the FDRA program. By increasing the amount of the credit and extending it to some taxpayers who did not previously qualify, Public Act 421 should help restore the program's effectiveness as a tax-cutting incentive. Senate Bill 692 builds on these reforms by preserving the tax credit for land owners who transfer from an FDRA to a PDR, as well as by extending the credit to farmland owners who sell their development rights without first being enrolled in an FDRA.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bill will decrease State revenue by extending the tax credits formerly available only to land owners enrolled in an FDRA to land owners who are enrolled in a purchase of development rights or an agricultural conservation easement.

The bill will increase the cost of the farmland preservation tax credit, and therefore reduce net income tax revenue, by expanding the tax credit to land owners who transfer from an FDRA to a purchase of development rights or an agricultural conservation easement. According to Department of Treasury data, the average tax credit under the FDRA program in 2000 was $2,479. This figure is expected to increase in 2001 as a result of Public Act (PA) 421 of 2000, which decreased, from 7% to 3.5%, the income threshold for a land owner to participate in an FDRA. This increase in the tax credit due to PA 421 will result from two factors: 1) Taxpayers already receiving a credit, will experience an increase in the amount of their credit, and 2) some taxpayers who did not qualify for the credit will be eligible under the lower household income threshold. Factoring in the estimated impacts of the changes from PA 421, the estimated average tax credit will increase to $4,000.

The Department of Agriculture received over 300 applications for development rights purchases and 12 were selected for funding in 2001. A total of $5 million was available. Using these figures and the estimated 2001 average tax credit of $4,000, the bill will result in a total loss of revenue of $48,000 to $56,000. The actual impact will be based on the household income and property taxes of the land owners selected for the purchase of development rights. Future impacts will be contingent on the number of PDR applications selected for funding and the associated household income and property tax levels. It is estimated that almost all of this loss in revenue will affect General Fund/General Purpose revenue.

In addition to the General Fund/General

Purpose revenue impact, the bill will decrease deposits to the Agricultural Preservation Fund by exempting land owners from the repayment requirements when they transfer their property from an FDRA to a purchase of development rights. Based upon the 12 purchases of development rights selected in 2001, the impact on the Agricultural Preservation Fund will be a loss of revenue of nearly $200,000, excluding any interest payments for early termination of an FDRA. Again, the future impact will be contingent on the number of PDR applications selected for funding and the associated household income and property tax levels. This revenue will not be available for future purchases of development rights.

The provision requiring the State, upon request, to release farmland from a development rights agreement if the land is zoned for commercial or industrial use, will result in additional State revenue for the Agricultural Preservation Fund. Under this provision, a land owner will be responsible for depositing into the Fund an amount equal to twice the value of the development rights to the farmland being relinquished. This revenue will be used for future purchases of development rights.

Fiscal Analyst: Craig Thiel

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