

Staff Paper

**Twenty-Four Years of Farmland Preservation in
Michigan, PA 116**

**Kurt J. Norgaard. Ph. D.
Extension Land Use Specialist**

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Department of Agricultural Economics
MICHIGAN STATE UNIVERSITY
East Lansing, Michigan 48824

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norgaar2@pilot.msu.edu

Introduction

Michigan, similar to other states in the Great Lakes and Midwest area, entered the farmland preservation arena in the early 1970's in response to a growing concern over the conversion of farmland to non-agricultural uses. Reports indicated that farmland acreage in Michigan was being converted to non-agricultural uses at a rate of 300 acres per day and 30,000 lots per year were created between 1940-1970. A Governor's Blue Ribbon Commission¹ in 1970 provided evidence that the loss of farmland in the state was an emerging state policy concern and made several recommendations which ultimately lead to "Farmland and Open Space Preservation Act," Public Act 116, 1974, hereafter referred to as the P.A. 116 Program. The purpose of the Program was to slow the conversion of farmland to non-farm uses while at the same time provide property tax relief to farmland owners because farmers claimed that high property taxes were forcing them to sell land for development. Payments from the State were made in exchange for development rights for an agreed upon period.

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Kurt J. Norgaard, Ph.D.
Extension Land Use Specialist
Dept. of Agricultural Economics
Michigan State University

Introduction

Michigan, similar to other states in the Great Lakes and Midwest area, entered the farmland preservation arena in the early 1970's in response to a growing concern over the conversion of farmland to non-agricultural uses. Reports indicated that farmland acreage in Michigan was being converted to non-agricultural uses at a rate of 300 acres per day and 30,000 lots per year were created between 1940-1970. A Governor's Blue Ribbon Commission¹ in 1970 provided evidence that the loss of farmland in the state was an emerging state policy concern and made several recommendations which ultimately lead to "Farmland and Open Space Preservation Act," Public Act 116, 1974, hereafter referred to as the P.A. 116 Program. The purpose of the Program was to slow the conversion of farmland to non-farm uses while at the same time provide property tax relief to farmland owners because farmers claimed that high property taxes were forcing them to sell land for development. Payments from the State were made in exchange for development rights for an agreed upon period.

In 1994, a second Blue Ribbon Commission² on farmland preservation was appointed by the Governor and again a rate of farmland lost to non-agricultural use was included. They reported a farmland loss rate of "10 acres per hour" or 240 acres per day. At that time, 4.5 million acres of the 10 million acres of farmland in Michigan were enrolled in the P.A. 116 Program. The annual

payments from the Program were averaging \$60 million a year with nearly \$800 million credited over the 20 year period to farmland owners to preserve farmland.

However, in 1994, as a result of the enactment of School Finance and Property Tax Reform, property taxes were reduced an average of 40 percent statewide, thus significantly reducing the benefits of the P.A. 116 Program. The amount of payments to P.A. 116 contract holders dropped from \$60 million annually to less than \$20 million annually. Though revenue neutral to P.A. 116 contract holders, the legislators responded to pressure from constituents and created a year-long window for anyone in the P.A. 116 Program to allow an individual to terminate, reduce the time period or adjust the size and number of the contract. In addition, the purchase of development rights program associated with the P.A. 116 Program was reorganized.

The P.A. 116 Program has now been operational for 24 years. Recent tax changes have modified the incentives potentially leading to landowners removing their land from the Program. Though it is difficult to determine what effect the Program has had on farmland retention, some measures can be ascertained by examining acres of enrollment, farmland enrolled, location of enrolled farmland, renewal and termination information, and property tax benefit data. And finally, the future of the P.A. 116 Program is weighed given the recent changes in Michigan's tax law.

Framework

Michigan does not have a state land use policy other than several specific state statutes addressing shorelines, rivers, wetlands and platting. The platting legislation was amended in

1996; however, the provision to split land into several parcels without platting being reset every 10 years was unchanged. This allows dense building development without platting and is limited only by the local zoning. Land use planning and zoning, for the most part are assigned to Michigan's 1,800+ local governments. This fragmentation of authority has led to a patchwork of land use plans and zoning ordinances throughout Michigan.

Basic Elements

Early attempts in the early 1970's to enact legislation to preserve farmland focused on establishing use-value assessment of farmland. The valuation of land for property taxation purposes in Michigan is based on the market value approach with land and structures being taxed at 50 percent of market value (assessed value). The state has a complex equalization process at the township, city, county and state level's to insure that taxing jurisdictions assess land at 50 percent of market value. Due to the enactment of School Finance and Property Tax Reform in 1994, annual assessment increases are capped at 5 percent or the rate of inflation, whichever is less.

Use-value assessment determines the taxable value of land by the ability of the land to provide an income stream to the farmer given the productivity of the land and prevailing crop prices. However, during the legislative process, the bill evolved to a lease of development rights program in exchange for property tax credits applied to the state personal income tax liability of a landowner.

The P.A. 116 Program is modeled after Michigan's circuit breaker approach which was adopted by the state in 1972 and applied to all homestead property. While the threshold level for the Homestead Property Tax Credit Program was 3.5 percent,³ the P.A. 116 Program threshold was established at 7.0 percent with no capping of the amount of a rebate. The 7.0 percent threshold was not determined by a statistical approach as to the appropriate circuit breaker level, but was the result of a politically negotiated settlement. The legislature was striving for a lower threshold while farm interests groups lobbied for a much higher level. Enrollees in the P.A. 116 Program were able to claim both the homestead credit and the farmland credit thus providing additional incentives to enroll in the Program.

Qualifying farmland owners transfer their development rights to the state for a period of not less than 10 years in exchange for the property tax credit. The last seven years of P.A. 116 credits received are placed as a lien (without interest) against the property. The lien is due upon the sale of the land or conversion to non-agricultural uses after the contract period has been fulfilled. The monies received from repaid liens are used to pay for the administration of the Program and for the purchase development rights program, which is described later in the paper.

The P.A. 116 contract remains with the land and can be transferred to another landowner in the event of a sale during the contract period. However, the new owner must agree to continue the contract. Early withdrawal or termination of the developments rights agreement with the state is possible for specific reasons with a 6.0 percent interest penalty applied to accumulated tax credits.

The legislation identified eligible farmland as being: a) 40 acres or more in size; b) 5 acres or more but less than 40 acres with at least \$200 annual gross income per acre of cleared and tillable land for agricultural production; and c) a specialty farm of 15 or more acres producing an annual gross income of \$2,000 or more from agricultural uses and designated by the Michigan Department of Agriculture (MDA) as a specialty farm. Enrollees are required to file at least 50 percent of their land in the Program and the land must be devoted primarily to an agricultural use.

"Devoted primarily to an agricultural use" as defined in P.A. 116 means all land shall have been under agricultural use for at least 1 year during the 36-month period immediately proceeding filing the application. Buildings, structures and other improvements consistent with the agriculture operation are included in the development rights agreement thus adding to the potential tax credits.

Farmland meeting the criteria set forth in the legislation can not be denied entry into the Program. The Michigan Department of Natural Resources (MDNR) serves as the administrating state agency. While local governments, the Soil Conservation, and local or regional planning commissions are involved in the review process of farmland applications, local units are prohibited from denying landowners entry to the Program. MDNR can deny an application only if the farmland application fails to meet eligibility criteria. No determination of the benefits or costs was considered.

The Open Space portion of the P.A. 116 Program is divided into two segments: designated open space and local designated open space. Enrollees of qualifying open space land received a reduction in property taxes for that portion of the value of development rights being exempt from ad valorem taxation. Since only a small fraction of the 4.3 million acres of land enrolled as open space this paper addresses the farmland component.

Changes in the Incentives

The adoption of a major overhaul of Michigan's K-12 educational system of School Finance and Property Tax Reform in 1994 has resulted in a change in the incentive structure of the P.A. 116 Program. Property taxes were reduced an average of 40 percent statewide, thus significantly reducing the paybacks of both the P.A. 116 Program and the Homestead Property Tax Credit Program. To replace the loss in state revenue: a) the state sales tax was raised from 4 percent to 6 percent; b) tobacco taxes were increased; c) a new real estate transfer tax was established; and d) a new tax on interstate telephone calls was established. Although total tax collections for education remained relatively the same after the reform; the incidence of taxes changed from landholder to consumer.

The amount of payments from the State to P.A. 116 contract holders dropped from \$60 million annually to less than \$20 million. As a result, contract holders argued that since either they no longer qualify for tax credits or their credits have been substantially reduced, they should be permitted to terminate their contracts because the rules of the game have changed. This is a more pertinent problem for the holders of the 7,000 contracts enrolled for a 90 year contract period

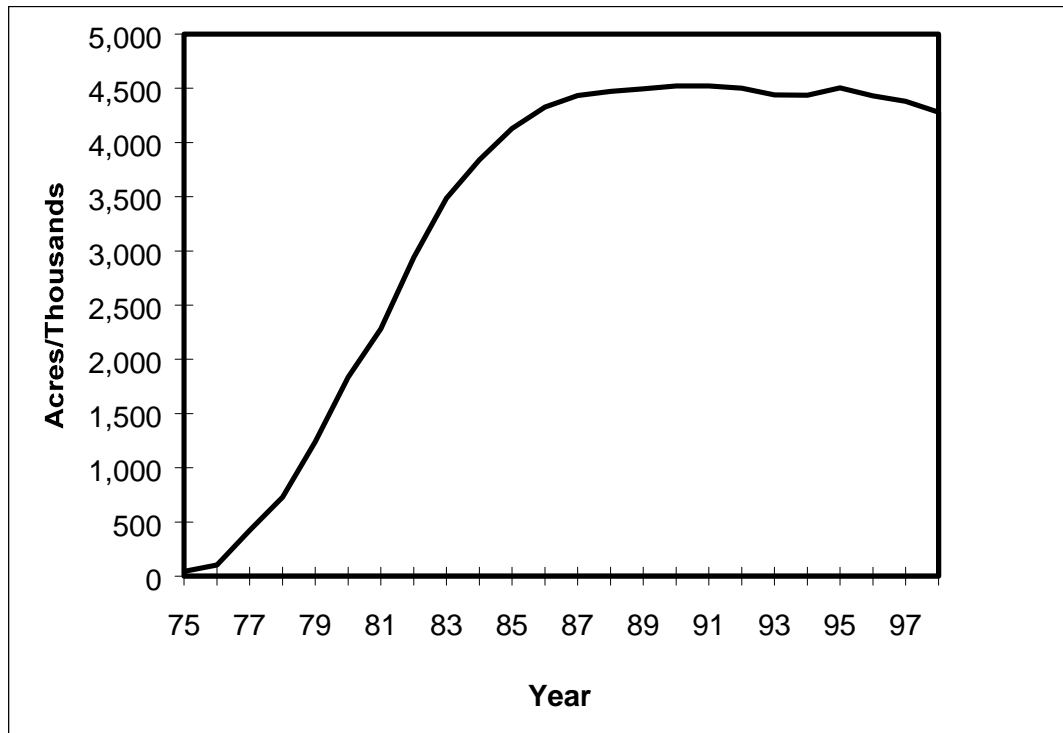
who have 66 years remaining on their contract. Though revenue neutral to P.A. 116 contract holders, the legislators in responding to pressure from constituents, created a year-long window ending April 1, 1997 for anyone in the P.A. 116 Program the opportunity to terminate, reduce the time period or adjust the size of their contract. As a result of this window, there were 3,000 contract terminations, 1,500 partial terminations and 5,500 contract adjustments. The data in the following pages reflect these adjustments.

Enrollment and Acres Enrolled

Originally, as with many new state policy initiatives, many farmers expressed skepticism of the P.A. 116 Program. The new concept of transfer of development rights to reduce property taxation, which resulted in a tax lien being applied to the land, contributed to the reluctance of the part of farmers to enroll. However, after the first five years of operation and after information on the magnitude of the tax reductions was presented statewide, the number of contracts and enrollment acres increased rapidly.

From 1974 to 1987, nearly 4.5 million acres of farmland or 45 percent of the total farmland in Michigan was enrolled in the P.A. 116 Program. Since 1987, the amount of enrolled land has remained relatively constant with only small decreases in recent years (Figure 1).

Figure 1: P.A. 116 Enrollment, 1979-1998



Source: Michigan Department of Natural Resources, Farmland and Open Space Unit

Location of Enrolled Acres

A vital selling point used to secure political support from urban legislators for the P.A. 116 Program centered on preserving farmlands in rapidly urbanizing areas. However, one criticism of incentive-based farmland preservation techniques is that the farmers most likely to enroll are those least likely to develop their land.⁴ Does the P.A. 116 Program follow this pattern?

Analysis of enrollment data supports the criticism. The largest enrollment acres as measured by the percent of eligible farmland are in counties where development pressures are low. Farmland owners near urbanizing areas are least likely to enroll since the opportunity costs for enrolling are high (land cannot be converted to a non-agricultural use), a predictable behavior.

As evidence of low enrollment in high growth areas, the ten fastest growing counties (population growth) in Michigan, have an average of 23 percent of their farmland acres enrolled compared to 45 percent statewide. In contrast, high enrollment in low growth areas, the twenty counties which have the most acres enrolled in the P.A. 116 Program, represents 67 percent of all enrolled farmland. None of these counties are included in the top ten fastest growing counties (population growth).

Renewal and Termination Information

If a development rights contract expires, the last seven years of P.A. 116 Program credits received are placed as a lien against the property. Repayment of the tax lien is required before the development rights agreement is released and the land can be converted to a non-agricultural use. Data is not available to determine the number of landowners who choose not to renew their contract or convert their land to a non-agricultural use. However, the amount of outstanding liens is \$16 million while the rebate fund from lien payments as of January 1998 had deposits of over \$21 million. This does not necessarily mean that this land was developed because evidence indicates that farm operators will pay off the liens and still continue to farm.⁵

Enrollees in the P.A. 116 Program are allowed to enroll for a minimum of 10 years up to a maximum of 99 years. The average contract length in Michigan is 29 years, however in the next five years, 32.2 percent of the total number of contracts representing 53.6 percent of the acres enrolled will expire (Table 1). If incentives are no longer large enough to encourage re-enrollment, a significant amount of farmland acreage will be available for development. This

will have not only implications on farmland preservation but also on the size of the rebate fund. However since the passage of the tax reform, expected lien repayments are at \$2 million per year.

Table 1: Expiration Dates of P.A. 116 Contracts, 1994-2086

	Percent of Total Contracts	Percent of Total Acres
January 1,1998 - December 31, 2003	20.6	40.4
January 1, 2003- December 31, 2008	11.7	13.6
January 1, 2008- December 31, 2013	15.1	7.9
January 1, 2013- December 31, 2018	14.0	8.5
January 1, 2018- December 31, 2086	21.9	23.0

Source: Michigan Department of Natural Resources, Farmland and Open Space Unit

Thirty-three percent of the contracts exceed 30 years in length, accounting for 34.3 percent of farmland enrolled. These long contracts will restrict these acres from conversion to non-agricultural uses. However, long-term contracts limit the flexibility of local communities in land use planning decisions.

Property Tax Benefits

While the P.A. 116 Program may have questionable results on the policy goal of preserving farmland in urbanizing areas of Michigan, the Program was providing substantial property tax relief prior to the tax reform.

In 1993, 73.5 percent of the total property taxes paid by enrollees were paid by the state, leaving landowners with a net tax liability of 26.5 percent. The high percentage of tax reduction is due to P.A. 116 Program enrollees being able to capture both P.A. 116 Program credits (\$64 million) and homestead property tax credits (\$18 million). However, since the School Finance and Property Tax Reform in 1974, the rebates to enrollees has not exceeded \$20 million, thus the request by enrollees for the ability to terminate their contracts. Since the program's inception in 1974, the state has rebated over \$900 million to enrolled landowners.

One can argue that the large rebate percentage is a function of low household income and high property taxes, thus substantiating the need for this Program. Landowners with significant amount of off-farm income tend not to enroll in the P.A. 116 Program, due to the low level of tax benefits received. This reasonable behavior results in the non-uniform enrollment patterns in counties. While the Program was envisioned to protect large tracts of agricultural land from fragmentation, the incentive structure (tax credits) does not yield the desired result. It can be argued that the P.A. 116 Program is viewed by the agricultural community as a property tax reduction program, not land preservation.

Rebate Fund, Purchase of Development Rights

The last seven years of P.A. 116 credits are placed as a lien on the property, due upon sale or change of use. The lien paybacks are used for administration costs and to fund the permanent purchase of development rights. As of January 1998 total receipts equal nearly \$22 million, with

another \$16 million outstanding. When the P.A. 116 Program was amended in 1996, criteria was established for the purchase of development rights on prime farmland, with a cap of \$5,000 per acre for development rights. This was in spite of the fact that the previous prices that the MDNR had paid for development rights were much higher, an average of \$12,085 for 787 acres. A steering committee of farmers, educators, and stakeholders was formed to assist the MDNR in creating an application process to use in the selecting of farmland to buy the development rights. (Lessons learned from P.A. 116 were incorporated, i.e.; local communities need to support the proposal, deductions for location near to public sewer.) Since this change the number of applicants for PDR has risen substantially, from 71 in 1995 to 768 in 1997. Using the new criteria, the steering committee recommended 37 farms for the development rights to be purchased in 1997.

Michigan has been successful in receiving federal monies for the purchase of development rights. The MDNR in partnership with Peninsula Township, which has an active local PDR program, twice received federal grants totaling \$2 million.

Unresolved Policy Issues

In general, land preservation techniques that use tax credits as incentives without connecting them with other forms of preservation tools, such as agricultural zoning, have been widely acknowledged as ineffective in retaining farmland. The reasons for their ineffectiveness are: a) tax rebates reduce the cost of holding the land thus encouraging land speculation; b) enrollments are higher in areas where demand pressure is lower thus rebates are going to areas least likely to

experience urbanization pressure; and c) erratic enrollment can cause development leap-frogging which induce the impermanence syndrome.⁶

The P.A. 116 Program has served to constrain development under certain conditions. One of the benefits to enrolled landowners is the exemption from special assessments for infrastructure improvements such as sewer and water extensions, while the land is under contract. Municipalities and developers are reluctant to extend such improvements since financial support for the improvements cannot be collected from involved land. Conversely, the Program has served to constrain economic development in some communities and generated a moderate amount of public discussion. For example, land situated between a town and a freeway representing prime development property and enrolled in the P.A. 116 Program, has often prevented a community from acquiring needed acreage for growth as well as deterred businesses from establishing themselves in a logical location site.

Concluding Comments

The success of the P.A. 116 Program in achieving the policy objective of preserving farmland through the provision of property tax credits is a function of which stakeholder is considered. For an enrolled landowner who had property taxes reduced by 70 percent, the Program was successful in providing tax relief. If viewed from a state policy objective of preserving farmland and green space around rapidly expanding urban or suburban areas, questionable results remain. With 45 percent of Michigan's farmland acres enrolled presently, as previously discussed,

enrolled acreage is principally in counties least threatened by urban expansion. However, the property tax relief provided by the Program enhances the income stream of agricultural producers by lowering the costs of holding land. Thus, the argument that some farmers stayed in production agriculture rather than selling for non-agricultural uses (capitalizing on higher development values) has preserved farmland.

The long term enrollment of land in the P.A. 116 Program may soon be answered, given the recent changes in the method of school finance thus reducing the incentives plus the large number of contracts ending. In the next 5 years, P.A. 116 contracts accounting for 40 percent of the land in the Program or 1.8 million acres will end. To the degree these contracts will be renewed will indicate how farmers viewed the program as well as the long-term impact of this program on farmland preservation.

ENDNOTES

¹ Governor's Task Force on the Future of Agriculture, Final Report, 1970.

² Michigan Farmland and Agriculture Development Task Force, Policy Recommendations and Options for the Future Growth of Michigan Agriculture, December, 1994

³ Homestead property tax credit is determined by household income X 3.5% with the excess counted as a credit against the state income tax liability with a cap of \$1,200.

⁴ Nelson, Arthur, C., "Economic Critique of U.S. Prime Farmland Preservation Policies," Journal of Rural Studies, Vol. 6, No. 2, 1990.

⁵ Contact with farmers who have fulfilled their contract period indicated that they intended to pay off their lien even though the lien is not accruing interest and they have no intention of converting the land to a non-agricultural use. A property tax lien remains a distasteful concept for those farmland owners who lived through the depression.

⁶ Maurer, George J., "Evaluation of Agricultural Preservation Programs in Maryland, Pennsylvania, and Virginia," Chesapeake Bay Foundation Lands Program, 1993.