



JON S. CORZINE
Governor

State of New Jersey

Highlands Water Protection and Planning Council
100 North Road (Route 513)
Chester, New Jersey 07930-2322
(908) 879-6737
(908) 879-4205 (fax)
www.highlands.state.nj.us



JOHN R. WEINGART
Chairman

EILEEN SWAN
Executive Director

DRAFT FOR REVIEW BY THE HIGHLANDS COUNCIL **Land Preservation Program - Innovative Tools**

Background

Public and private investment in land preservation over the years has protected nearly a third of the Highlands Region as perpetual open space and farmland, approximately 268,000 acres. Maintaining the land in a natural condition is necessary to preserve ecosystem integrity and to protect drinking water supplies. Maintaining a land base for agriculture is a prerequisite for agricultural sustainability in the region. The Highlands Act contemplates preservation of additional open space and agricultural resources in order to protect and enhance ecosystem function, protect drinking water resources, sustain the agricultural industry, and preserve natural and recreational lands. The Regional Master Plan (RMP) includes the following objectives, which are further discussed in the Land Preservation Program.

Objective 1H5d	Establishment of an on-going program to seek funding for land acquisition and stewardship from unique sources of funding such as gifts, endowments and donations and federal and state court-imposed fines for natural resource damages.
Objective 1H5e	Establishment of a dedicated source of revenue for the preservation and land stewardship of open space through a surcharge on public water supply system rates for any system that directly or indirectly relies on Highlands water resources for more than 5 percent of their annual needs.

Traditionally, open space has been preserved in the Highlands Region by fee or easement acquisitions through the NJDEP Green Acres Program, the State Agriculture Development Committee Farmland Preservation Program, the County Agricultural Development Boards and land preservation programs, municipal programs, and non-profit programs. In an acknowledgement of the necessity for a dedicated source of funding for the preservation of open lands in the Highlands Region, the Regional Master Plan supports the re-authorization of the Garden State Preservation Trust Fund, capitalization of the Highlands Development Credit Bank and a surcharge on public water supply system rates (water user fee). Implementation of these sources of funding will create more revenue for preservation, but more methods and programs for preservation are also needed. While the Highlands Act and the RMP anticipate that the proposed Highlands Transfer of Development Rights and Cluster Programs will also be vehicles for land preservation, the Highlands Council will need to examine new, innovative, and alternative methods of land preservation.

The purpose of this paper is to outline innovative tools used in other states that may have some potential for the protection and preservation of open space and agricultural resources in the

Highlands Region, and should be further explored to determine whether their use is feasible. The *Land Preservation and Stewardship Technical Report* identifies 10 existing federal, State, county, municipal, and nonprofit land preservation funding programs. All of the tools outlined below would be in addition to the existing programs in New Jersey outlined in the RMP and the technical report. The focus of this paper is on new tools, rather than on new funding sources for the existing tools. There are a myriad of potential funding sources for fee simple and easement acquisition, but the expectation is that the programs discussed above will be the primary sources for the preservation programs. A related, critical issue will be ensuring that the funding sources, regardless of the method selected, are fully and solely applied to the intended purpose of land preservation and landowner equity. It should be noted that the Highlands Council is not endorsing any of the innovative tools described in this paper at this time. Rather, they will be added to the *Land Preservation and Stewardship Technical Report* and subject to further research.

Proposed Land Preservation and Stewardship Program Modification

It is recommended that the Land Preservation and Stewardship Program be modified as follows to address the need for further investigation of innovative preservation tools:

<p>Establishment of Alternative/New <u>Innovative</u> Land Preservation Programs</p>	<p><u>The Highlands Council will examine and assess for use in the Highlands Region a broad range of options and programs developed by other states to create incentives for landowners to keep their properties in agriculture, forests, or natural condition, voluntarily. The following are examples of some of the programs for review by the Council. This list is not exhaustive but is the basis for future research.</u></p> <ul style="list-style-type: none"> • <u>Conservation Tax Credits</u> • <u>Installment purchase Options/Agreements</u> • <u>Property Tax Relief</u> • <u>Next Generation Farmland Acquisition Program</u> • <u>Statewide or Regional Local Land Trust/Fee Simple</u> • <u>Term Conservation Easements</u> • <u>Land Preservation Tontines</u> • <u>Agricultural Conservation Pension</u> • <u>Mandatory Source Water Protection Programs for Water Purveyors</u> <p>The Green Acres Program secures lands for recreation and conservation purposes while the State Agriculture Development Committee's (SADC) Farmland Preservation Program acquires the development rights on privately owned farmland. Consequently, the existing programs do not capture certain important resources in the Highlands Region and steps need to be taken to fill these gaps. For example, the SADC preserves farmland through the purchase of development easements. One criterion for prioritizing farmland is the percentage of land in crop production. As a result, a farm that is heavily forested may not be considered a priority for preservation by the SADC. Additionally, lots that are entirely forested with woodland management plans and are farmland assessed are not considered farms for purposes of SADC preservation. The Green Acres Program is primarily based upon the purchasing of property in fee rather than be easement. Additionally, t <u>The Highlands Council will collaborate with</u></p>
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	<p>NJDEP and SADC to develop an adequate method to preserve forested lands through easements to allow them to remain in private ownership and properly maintained through woodland management, in addition to the Transfer of Development Rights mechanism established through the Highlands Act. Given the fact that the Highlands Region is over 50% forested and maintaining forest land is important to protecting water quality, a program specifically for purchasing forest land easements should be available.</p>
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All of these programs are further detailed in the Land Preservation and Stewardship Technical Report.

Overview of Innovative Land Preservation Tools

The following is a brief summary of a broad range of options and programs developed by other States to create incentives for landowners to keep their lands in agriculture, forests, or a natural condition voluntarily.

1) Conservation Tax Credits

A Conservation Tax Credit is an income tax credit available to landowners who voluntarily preserve their land through the donation of a conservation easement and/or fee title. The donation must protect conservation values as defined by individual states and must be made to an entity qualified to hold such property interest by the terms of the legislation creating the credit. Typically, this includes state and local governments and 501(c)(3) land conservation organizations. Whether stated explicitly or not, Internal Revenue Code (IRC) §170(h), pertaining to federal tax deductions, is often the starting point for setting eligibility guidelines for a program. Most states also add their own layer of requirements to those required by Internal Revenue Service (IRS) guidelines for federal deductibility.

Conservation Tax Credits were developed to complement existing state and federal incentive structures for land conservation. Depending on their value, Conservation Tax Credits can provide greater and more direct financial benefits to landowners than those provided by federal tax deductions. State Conservation Credits, as distinguished from federal deductions, are dollar-for-dollar write-offs of state income taxes. It should be noted that the land value for federal tax purposes is based on its current condition and regulatory constraints, not on its value without implementation of the Highlands Act or other regulations. Prior to recommending this tool, research should be done to determine the base value used in other state tax credit programs.

However, as with federal deductions, landowners with little or no taxable income derive less benefit from tax credits than do wealthier landowners with higher taxable incomes. To partially address this inequity, nearly all Conservation Tax Credit programs allow credits to be carried forward so that the credit may be applied to reduce taxes over a number of years. While this can help, many times landowners still cannot realize the full benefit of their credit. To further address this issue, several states have made their credits transferable or refundable.

Twelve states (California, Colorado, Connecticut, Delaware, Georgia, Maryland, Mississippi, New Mexico, New York, North Carolina, South Carolina, and Virginia) and Puerto Rico currently offer state Conservation Credits to landowners who donate lands for conservation.

www.taxcreditexchange.com/documents/StateConservationTaxCreditsImpactAnalysis.pdf

2) Installment Purchase Options/Agreements (IPA)

An IPA is an innovative payment plan offered by a handful of jurisdictions with easement programs. By using IPAs, local governments can leverage preservation funding while lands are still available and offer landowners financial advantages that developers cannot duplicate. At settlement, the landowner grants the jurisdiction a permanent agricultural conservation easement in exchange for an IPA. IPAs spread out payments so that landowners receive semi-annual, tax exempt interest over a term of years (typically 20 to 30). The principal is due at the end of the contract term. Jurisdictions can purchase zero-coupon U.S. Treasury bonds to cover the final balloon payments. “Zeroes” do not generate regular interest income. Instead, they yield a lump sum when the bond matures. Because zero coupon bonds cost a fraction of their face value, the public entity leverages available funds. Landowners also can sell or securitize IPA contracts at any point to realize the outstanding principal.

The advantages of an IPA program to the landowner are:

- Tax-exempt interest semiannually for up to 30 years on the full value of their sale. They pay no federal or state income taxes on such interest;
- Deferral of taxes on capital gains—landowners entering into IPAs may defer recognition of capital gains until they actually receive the principal amounts of such purchases;
- Better estate planning—by deferring recognition of capital gains indefinitely, selling landowners create the opportunity for IPAs to pass to their estates, where federal estate taxes paid may reduce or eliminate any capital gains taxes that would ultimately be due by the heirs;
- Charitable deduction—landowners can realize deductions that are equal to the difference between the appraised value of the lands or easements sold and the prices the government entity pays.

The advantages of an IPA program to a jurisdiction are:

- Leverage-- by making interest payments over 30 years, the government entity could pay for preservation over the period during which their citizens enjoy the open space, thus pushing conservation costs well into the future. Once land is developed it is lost to conservation forever. Therefore, acting immediately is essential, and an IPA program would allow a jurisdiction to protect significant amounts of land, spreading the costs over a number of years;
- Discount Purchases--It is almost always cheaper to act now than it will be to act later. And, because of the value of benefits offered over a 30-year period, selling landowners may be willing to sell their lands or easements at discounted prices from appraised value. By implementing IPA programs now and thereby locking in to a financial agreement with landowners, a community will be saving money. Land values will only increase over time, thereby increasing the costs for protection;
- Return on Investment--IPAs are an excellent way for communities to increase return on investment. By pushing implementation costs into the future, and at the same time realizing costs savings by acting immediately, the return on investment is increased.

Howard County, Md., Harford County, Md., Burlington County, N.J. and Virginia Beach, Va. have developed IPA programs to stretch public funds for farmland protection.

<http://www.efc.umd.edu/pdf/TalbotReport.pdf>.

www.farmlandinfo.org/documents/27752/tafs-ipa.pdf

3) Property Tax Relief

In addition to the current New Jersey Farmland Assessment Program a property tax relief program would provide an even greater reduction to the landowner. The state would forgive 100% of remaining property taxes owed for land kept in agriculture, working forests, or wild lands (but not buildings or the farmstead); this reduction in property taxes would be in addition to farmland assessment. So that the municipality does not suffer the decrease in property taxes, the state pays the municipality the amount the landowner would have paid to the municipality in taxes; however, the state also places a lien against the property for the value of the forgiven taxes annually (not including any tax reductions related to farmland assessment). If the landowner then converts the property to an impermissible use or sells it, the State collects the lien, i.e., the back taxes, or can use the lien as a down payment on purchasing the remaining value of the land in fee simple or easement.

New York State provides farm families with significant state personal income tax and business tax credit for school property taxes paid on farmland and buildings. The tax credit will exempt the first 250 acres of farmland from school property taxes and provide a tax credit up to 100% of the annual cost of their school property tax.

4) Next Generation Farmland Acquisition Program (NGFAP)

The NGFAP is an innovative program ready to be offered by the Maryland Agriculture and Resource Based Industry Development Corp. (MARBIDCO), working in collaboration with the Maryland Agricultural Land Preservation Foundation (MALPF), the counties, and commercial lenders, to help young or beginning farmers to purchase quality rural working land and permanently preserve this land at the same time. The key advantage with the NGFAP for the young farmer trying to purchase farmland, is the timeliness in getting the external financial assistance. MARBIDCO believes that a 45- to 60-day turnaround is potentially achievable under the NGFAP, whereas participation in a MALPF land easement purchase program can take 2 to 5 years to complete from start to finish. An additional advantage of the NGFAP is that it would help to permanently preserve considerable agricultural land from future development, thus providing significant open space and water/air quality benefits.

Under the NGFAP, commercial lenders would be responsible for qualifying young or beginning farmers for initial eligibility. A commercial lender would review the credit history, equity position, work experience and proposed business plan of a beginning farmer seeking to acquire property for agricultural production, and the lender would decide whether to make a tentative mortgage loan commitment and bring forward a NGFAP application to MARBIDCO to make up the borrower's equity shortfall. With the lender's tentative agreement to finance a portion of the farm property purchase, MARBIDCO, after conducting its own review, would then purchase an easement option for the development rights at 70% of fair market value, with those monies being made available to the young/beginning farmer at the land purchase settlement table.

Because MALPF will serve as the "default easement holder" for the NGFAP, the properties on which MARBIDCO is purchasing easement options must be "MALPF eligible", meaning that the properties must meet the minimum size, location, and soil standards established by MALPF. The parcel of farmland being purchased for permanent agricultural conservation must also receive approval of the respective county government.

The easement seller (i.e., the young farmer who sold MARBIDCO the easement option) would then have three years to sell the easement to a Maryland land conservation program of his/her choosing (e.g., MALPF, Rural Legacy, a county program or a land trust), presumably with the goal of getting a higher return on the sale of the land conservation easement. If, after three years, a permanent easement sale for the property has not been executed, MARBIDCO would then exercise its easement purchase option and convey that easement to MALPF to hold permanently. If the participating young farmer is able to sell an easement, then the monies MARBIDCO provided at settlement would be returned in full, and would go back into the Next Generation Program to be used in making future easement option purchases. The program is not yet funded, but a funding source has been proposed in legislation pending in the Maryland General Assembly. <http://www.marbidco.org/land/nextgen.html>.

5) Statewide or Regional Local Land Trust/Fee Simple

The state, counties, municipalities, and non-government organizations (NGOs) purchase land outright through direct or fee simple acquisition. Fee simple acquisition compensates landowners and allows the government or NGOs to assume total control over the land. However, fee simple can be a very expensive approach and when maintained by the government, the land is removed from the tax roll. Additionally, future administrations may sell the land to entities or individuals whose primary interests are not maintaining and enhancing natural resources.

Several states have statewide or regional land trusts that are incorporated as non-profit tax exempt organizations under section 501(c)(3) of the Internal Revenue Service. Maryland has a statewide local land trust, created by the General Assembly in 1967, which is governed by a citizen board of trustees. The Maryland Environmental Trust (MET) works with over forty private non-profit land trusts to hold conservation easements jointly with MET or independently. As of 2007 MET has preserved over 900 properties totaling more than 115,000 acres of land. The Northern California Regional Land Trust (NCRLT) negotiates conservation easements and facilitates land exchanges and land acquisitions with private landowners, public agencies, and non-profit organizations. Founded in 1990, the NCRLT covers a 5,000 square mile region and currently holds conservation easements on 5,800 acres of land.

6) Term Conservation Easements

Most easements run in perpetuity with the land, but term conservation easements are a voluntary technique that preserves land for a set period of time, such as twenty or thirty years. This concept is similar to the New Jersey Department of Agriculture (NJDA) State Agriculture Development Committee (SADC) 8-year easement program. A government or non-profit entity would pay the landowner a rental fee in exchange for prohibiting activities associated with non-agricultural development on the land for an extended period of time. Landowners wary of long-term commitments may entertain the idea of a term conservation lease. The term lease should be less expensive per year and for the set period of time than Purchase of Development Rights (PDR) programs since there is no permanent commitment. The term conservation easement allows temporary preservation of critical areas at a lower cost when there is insufficient funding for preservation in perpetuity.

Several states allow term conservation easements, but state PDR programs greatly exceed the use of term conservation easements. There are issues regarding federal income and estate tax deductions, monitoring and enforcement. However, as development pressures accelerate and funding becomes

tighter due to budget constraints, this may be a tool that could provide temporary relief for critical areas while funding for permanent preservation is assembled. A possible enhancement of such programs could be to add a purchase option to the term conservation easement, to ensure that the property would be available for preservation within the term of the easement.

7) Land Preservation Tontine

A land preservation tontine is an incentive based tool, which uses a contract to provide incentives for owners to maintain agricultural uses through claims to conversions funds. Landowners lose the right to contract claims if they convert their land to non-agricultural development. Penalties would be distributed among the owners who retain their land in agricultural use. The contract is between landowners and not an interaction between the government and the landowner, but the government would administer the program. As the pool of landowners shrinks the landowners who remain receive a higher payout. Even though the landowner has the right to convert, the conversion decision of one landowner affects the viability of the neighboring landowner's operation.

The tontine is designed to maintain critical contiguous masses of agricultural land and avoid the fragmentation of the agricultural landscape. Maintaining contiguous masses of agricultural land prevents conflicts with non-farm neighbors. The challenges of this program lie in explaining the concept, attracting willing participants, and preventing abuse. One option is to eliminate the government in the tontine scenario and model the concept similar to a cooperative. There is limited information to indicate this technique is being used or considered by other states.

8) Agricultural Conservation Pension

The equity of the owner's land is considered their retirement fund. Agricultural conservation pension is an alternative way to finance retirement in exchange for an easement. Under the pension program retirement income would be guaranteed to farmers who attach an easement to their land and continue farming the land. The land could also be acquired in fee simple and leased back to a farmer. The landowner would decide when payments begin, how long the payments will continue, and what rights would be entitled to survivors. Value would be set at closing and the local government would be responsible for incremental payments to the owner before retirement.

The advantage to the conservation pension is a guaranteed income to the landowner that allows flexibility in retirement; avoidance of a large, one-time and taxable capital gain; and managing of savings prior to retirement. The pension might also be higher than the expected return of selling the land outright. State governments are better positioned to protect owners against the risk of cyclical savings, because the risk would be pooled over the farming population. The pension could be tied to the owner or the land, but the easement restriction would be permanent. The program could also be designed as a reverse mortgage by converting the value of the conservation easement into cash to live on during retirement. A percentage of the land value each year would be extracted to finance living expenses. The government would ensure payments continue for the life of the owner.

9) Mandatory Source Water Protection Programs for Water Purveyors

A major justification for protection of the Highlands Region is the protection of source waters for public community water supplies both within and outside of the Region. However, water purveyors are not required to participate in or contribute to such source water protection efforts, and their activities in this area range from extensive (e.g., the Pequannock Watershed where Newark has very extensive holdings) to minimal. By requiring that water purveyors develop and implement source

water protection plans for their water supply sources, with an objective of achieving a specific level of protection over a lengthy period, a new revenue source and implementation entity could be drawn into both land preservation and the reduction of pollutant sources. Because the water purveyors lack regulatory controls over lands they do not own (as differentiated from the powers of New York State municipal utilities, overseen by the State Department of Health), all actions by the water purveyors would be on a partnership basis or involve willing sellers. Water purveyors with existing protection programs would require fewer expenditures than those with minimal protections in place, which inserts a level of fairness into the program. By making the water purveyors directly responsible for aspects of their own protection (supplemented by State laws and regulatory programs, such as NJDEP rules and the Highlands RMP), protection efforts will be focused on those actions achieving the highest level of protection for the cost. It would be important as a basis for rate making decisions by the Board of Public Utilities and municipal utilities that the source water protection plans be approved by NJDEP and the Highlands Council to ensure quality efforts, and that expenditures from water purveyor rates be limited to those actions included in the approved plans.