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Farmland Preservation: Law and Economics

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Recent data from the U.S. Census Bureau indicate that North Carolina's urban population grew by more than 750,000 between 1990 and 1999. As more and more rural and urban residents live in close proximity, policy makers as well as concerned citizens grapple with land-use management issues.

One subject that surfaces regularly in land-use debates is the extent to which policies need to be implemented to preserve farmland. This issue of the *NC State Economist* examines the legal basis for farmland preservation policies, as well as key economic aspects of the various policy options available to state and local policymakers.

Legal Possibilities for Farmland Preservation

A substantial body of law (federal and state) regulating farmland preservation already exists. Legal tools include agricultural districts, right to farm laws, use value taxation, conservation easements, purchase of development rights programs (PDRs), and transfer of development rights programs (TDRs), and agricultural area zoning.

Agricultural Districts

North Carolina has an active agricultural district program. The General Assembly has authorized counties to implement voluntary agricultural district programs through adoption of appropriate county ordinances. It serves

chiefly to give farming areas in counties that have adopted ordinances some additional recognition, a voice in county government, waiver of water and sewer assessments in some counties, a way to address condemnations of agricultural land, and record notice to buyers of property in proximity to an agricultural district. Participation in the program is strictly voluntary on the part of farmers. Farmers who choose to participate sign voluntary conservation agreements with the county where the land is located.

Right to Farm Laws

Although varied in form, the general purpose of right-to-farm laws is to protect agriculture from urban encroachment. To date, North Carolina's General Assembly has enacted two such laws. Both protect farmers from tort actions based upon a nuisance theory. The premise of tort actions based upon a nuisance theory is that the farmer is interfering with a neighboring landowner's use of his or her land, e.g., as the result of dust from land preparation. At common law a landowner that bought land next to a farm and built a house upon it, even with full knowledge of the farming operation, could still sue the farmer for nuisance.

One North Carolina right-to-farm law protects existing farms from suits that result from changes in the use of neighboring land. Existing farms are protected if they have been in business for more than one year, have made

no major changes to their operation in the past year, are operated non-negligently, and do not pollute water or cause its overflow onto neighboring property. The other right-to-farm law requires that any person who wishes to file a nuisance suit against a farmer must engage in a pre-filing mediation. Failure to do so results in automatic dismissal of the suit. Mediation requires all parties meet with an individual trained in dispute resolution (a mediator) who may guide the participants to a resolution of their dispute. If no resolution can be reached, the lawsuit may proceed.

Use Value Taxation

Under North Carolina's use value taxation program, qualifying land used in agriculture, forestry, and horticulture is taxed on its use value rather than its fair market value. In rapidly urbanizing counties, this program may result in substantially reduced property taxes. Application for participation in the program is made to the tax office in the county where the property is located. Back taxes for up to three years may be recaptured by the county if it is determined that the land no longer qualifies for the program.

Not to be confused with the use value program for local property taxes, the federal estate tax also contains provisions to reduce the value of agricultural property in an estate to its agricultural value rather than its fair market value. There is an upper limit on the reduction in valuation that may be taken.

Conservation Easements

Conservation easements are deed restrictions designed to ensure that farmland remains in agriculture use either for a fixed term or in perpetuity. A PDR program is a local government program designed to use tax, grant, or donated funds to purchase conservation easements on agricultural property. Conservation

easements may either be donated by the landowner or purchased from the landowner. Governments and private, nonprofit land trusts may hold conservation easements.

The creation of a conservation easement is a real property transaction and as such is subject to all common law and statutory requirements for such transactions unless specifically exempted. The landowner is obligated to disclose any condition that might materially affect the conservation agency's achievement of its goals and objectives. Examples of such conditions might include existing liens against the property, rights of others in the property, or the presence of any hazardous waste subject to the federal Comprehensive Environmental Response, Compensation and Liability Act or any similar state law.

The Conservation and Historic Preservation Agreements Act is the primary state law governing conservation easements in North Carolina. Although easements may be created under other laws, in order to qualify for most tax benefits, conservation easements must be perpetual and thus created under the Conservation and Historic Preservation Agreements Act because this state law has been coordinated with the federal tax law.

Tax benefits are often substantial. The reduction in value associated with transfer of the conservation easement will generally result in a lower valuation for property tax purposes. If the easement is donated during lifetime, it may qualify as a charitable deduction, valued at its appreciated fair market value, for both federal and state income tax purposes. In addition it may also qualify, if the Department of Environment and Natural Resources approves, for the North Carolina Conservation Tax Credit. There may also be federal estate tax benefits.

Agricultural Zoning

Agricultural area zoning (large lot zoning) may be used to discourage residential development by requiring the use of large lots. There is some confusion about the application of this in

North Carolina because counties are prohibited from zoning agricultural activities (municipalities may zone agricultural activities). While counties may not zone agricultural activities, any non-agricultural activity, such as building residential housing, placed on agricultural land is subject to county zoning.

Transfer of Development Rights Programs

A transfer of development rights (TDR) program allows transfer of density from one zone to another through a system of marketable credits. A prerequisite for any TDR program is a comprehensive zoning program. TDR programs are not authorized under North Carolina law. Additionally, in those states where they are authorized, many TDR programs are coercive in nature and may be subject to challenge under the Takings Clause of the Fifth Amendment of the Due Process Clause.

Economic Aspects of Farmland Preservation Policies

At the local or state level, the primary economic justification for farmland protection is the amenities that farmland provides to the local community (or society at large). Chief among these are the open spaces and visual amenities that farmland provides. In addition, some proponents of farmland preservation point to the value to communities of having a viable local farm sector. Well planned farmland preservation programs also can assist local governments in encouraging a locational pattern of non-farm development that minimizes the cost of providing public services such as fire and police protection.

Widespread awareness of the value of these amenities probably underscores growing implementation nationwide of the kinds of

farmland protection measures described above. It also has fueled the growing interest in comprehensive land-use planning currently being witnessed in many counties of North Carolina. Assigning a dollar value to these amenities is not an easy task, however, since there is no market in which they are traded. Nevertheless, economists have tools for determining citizens' willingness to pay for non-market goods such as open spaces. Non-market valuation studies that have been conducted indicate that the social value of these amenities can be large in some cases.

From an economic perspective, the benefits to the community of the existence of farmland provide a *possible* justification for public actions to preserve that farmland. However, determining whether or not such public actions are *desirable* requires parallel information on the costs of various farmland preservation policies. These costs may take the form of what economists term *market distortions* – actions or phenomena that cause the prices and/or quantities of goods exchanged in a market to deviate from the levels that maximize the overall well-being of all market participants. In addition, farmland preservation policies may engender significant public finance costs, either in the form of foregone public tax revenues or program administration costs.

Farmland preservation policies typically change the conditions in local land markets; exactly what form these changes takes depends on the type of policy. Agricultural zoning directly limits the quantity of land that can be supplied to the market. As with any market supply restriction, these tend to increase the price of land as well as giving rise to so-called “dead weight losses.” Dead weight losses result from government policies (such as taxes or supply restrictions) that drive a wedge between potential buyers and sellers, thereby reducing the overall benefits to all market participants.

Use value taxation of farmland also has a distorting effect on local land markets. By subsidizing agricultural landowners, use value taxation facilitates land uses that differ from what they

would be were a uniform tax applied to all property. This effectively benefits farmers at the expense of non-agricultural property owners. But quite apart from these distributional consequences, this sort of two-tiered property tax structure engenders dead weight losses that reduce the overall well being of market participants as a whole.

From an economic point of view, PDR and other conservation easement programs represent the least distortionary farmland preservation policy. Such programs purchase development rights at a price that is mutually agreed upon by buyers (local governments or non-profit land trusts) and sellers. It is reasonable to suppose that that price accurately reflects the amenity value of land, since the buyers are largely motivated by an interest in preserving those amenities. As such, PDR programs may effectively *internalize* the positive social values of farmland that may not be usually be reflected in the price of land.

Most of the farmland preservation policies that have been listed here carry with them significant public finance costs. Obviously, the concessionary tax rates implied by use value taxation lowers the amount of tax revenue that local governments collect. This negative impact on local tax revenues is intensified in the presence of other policies – agricultural zoning, agricultural districts, right to farm laws – that provide incentives for land owners to keep their land in agricultural uses.

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