



The Private and Public Economics of Land Trusts

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As people become increasingly concerned about the effects of urbanization on their quality of life, the land conservation movement has moved to center stage. Land trusts are key actors in the movement and their influence is rapidly expanding. Almost 1,300 land trusts now operate at state and local levels compared with about 535 in 1984. While the highest concentration of trusts and conserved acreage is found in the Northeast, rapid growth is occurring throughout the country. In North Carolina, we estimate that land trust acreage increased 15-fold over the 1984-2000 period, reaching approximately 50,000 acres in 2000.¹

While trusts are private organizations, government policies influence the scope of their activities. Federal and state initiatives both compete with and complement their efforts, and government tax policy is a major force driving their growth. Previous issues of the NC State Economist have dealt with the tax implications of conservation easements (van der Hoeven and King) and the variety of legal approaches to farmland preservation (Feitshans and Renkow). The current issue discusses the economics of public policy toward land trusts.

The Economic Function of Land Trusts

A tract of land provides both public and private goods. The public goods from land—those that once provided to some are available for the enjoyment of all—include scenery, wildlife habitat, and historic heritage. The private goods from land include housing services and commercial income, which accrue only to the land owner or renter.

We rely upon voluntary exchange through markets to channel the demand for private goods, and elicit supply based on the costs of their provision. But markets are less adept at eliciting the supply of public goods. If I contract with you to leave your land undeveloped, thus providing me with bucolic scenery, my

neighbor can enjoy the same good for free. The implication is that all of my neighbors—and I—will tend to free ride on the provision efforts of a few. While there may be a large willingness to pay for scenery added across individuals, it is difficult for private providers to benefit from, and hence be motivated by, their potential demand. As a consequence, markets tend to provide less of the public good than society is willing to pay for.

The extent of the public good problem in land markets varies with the good considered. Perhaps the purest public good is the knowledge that land is being farmed. My satisfaction in that fact does not require me to contribute to Willie Nelson's or Neil Young's efforts to provide it. Also public to a degree is natural scenery, although the benefits of scenery are more localized and distant residents are effectively excluded. Other open space amenities are less public. Wildlife produced for hunting are the products of the land, but the benefits of bagging a trophy deer cannot be shared. The same holds for hiking and biking on trails, although mechanisms requiring users to pay can be expensive.

Into this complex scene enter land trusts—private organizations, without the coercive power of government, that address through voluntary means the problems of public good supply. Land trusts purchase, or accept donations for, property interests in land. Most commonly they acquire development rights in the form of conservation easements—perpetual restrictions on development. Land trusts raise money from private donors and can be thought of as intermediaries between their donors (demanders of land-based public goods) and landowners (suppliers of the goods). They serve to mitigate the free rider problem by coordinating and representing willing

payers and by privatizing to some extent the public goods. Membership, itself, is a private good that brings benefits not available to non-donors.

The Public Role in Land Trusts

Land trust activities are shaped by their relationship with government in a variety of ways. We discuss here the implications of their partnership with public land management agencies and their dependence on the tax code to compensate donors of land.

Some land trusts serve as conduits of land from private parties to government. They buy land or easements to hold only temporarily, eventually transferring ownership of the land to federal and state agencies. While some observers laud these transfers as leveraging private conservation dollars, there are drawbacks. Transfers to government agencies effectively dump the management burden for local open-space amenities—which can be substantial—on taxpayers. Yet, as we have noted, most open-space amenities are not pure public goods.

There is a more pragmatic concern. Because government management of public land is subject to interest group pressures and bureaucratic constraints, there is no assurance that valuable amenities will be managed effectively. For example, recent studies show that land trusts are better stewards of conservation easements than government agencies (See Guenzler, 1999, and Pentz 2001).

As to the influence of tax incentives on land trusts, they can be sizeable. In the appendix we describe the extent of the tax benefits encouraging land trust activity. But not only do tax benefits affect how many acres are held by land trusts, they also affect which lands are preserved and how they are preserved. To illustrate why, consider two land trusts. Trust A compensates land donors only with available tax benefits. Trust B has a land-acquisition budget and buys property rights from willing sellers.

Trust B is better suited to conserve amenities produced on contiguous parcels, such as wildlife habitat. With money to buy land or conservation easements, trust B can work to forge mutually agreeable deals with the relevant landowners. In contrast, trust A can only offer tax benefits, for

which landowners qualify to varying degrees. Landowners without sufficient income will not be motivated by income tax benefits and some may already be exempt from estate taxes. Even if trust A is able to acquire donated easements on targeted parcels, IRS rules will further hamper its efforts over the long haul. Because donated easements cannot readily be amended or extinguished, trust A has little flexibility to adjust to future conditions.

Land trusts purchasing property rights also have stronger incentives to weigh economic costs and benefits. For trust B, inefficient use of its budget will reduce the quantity and quality of amenities it can provide. Trust B has incentives to carefully consider, for example, whether it makes better sense to pay to restrict allowable development to two houses per hundred acres, or one house per hundred acres. In contrast, trust A does not have strong incentives to make such assessments. It does not bear the full costs of acquiring different land use restrictions because such restrictions are funded through the tax code. The resulting density of housing and acreage devoted to conservation will not be subject to cost-benefit scrutiny and conservation dollars will be used less efficiently.

Conclusion

To be sure, all but the most ardent proponents of markets would agree that some provision of land-based amenities by government is appropriate. Central Park in New York, the lakefront parks of Chicago, and the smaller scale benefits of greenways and parks in Raleigh are large. And because of the publicness of the goods, it is hard to imagine private marketers being able to charge those who enjoy the amenities enough to cover the required land acquisition and maintenance costs. Nonetheless, relying on government provision unrealistically assumes that most land-based amenities are purely public and foregoes the efficiency advantages provided by markets.

Land trusts are private organizations that address through voluntary means the problems of public good supply. Appreciating this fact should not blind one to the fact that while trusts are decidedly private, voluntary, and local in important respects, the level of land trust activity is greatly expanded by the involuntary participation of taxpayers and that conservation decisions are driven, in part, by factors that have little to do with the local costs

and benefits of land use. We should applaud land trusts for their accomplishments, but promote policies that better enable them to respond to local demand and cost conditions, thus promoting more effective land conservation.

Appendix. The Extent of Taxpayer Subsidy to Conservation Easements

Land trusts accept donations of conservation easements from landowners. These are perpetual restrictions that forbid subdivision and development. While public monies are not directly involved in such transactions, some donors receive extensive tax benefits. Such benefits are complex, but they flow from easy to identify sources: the federal income tax, state income tax, federal estate tax, and local property tax. An example illustrates just how inexpensive it can be to place conservation restrictions on one's land. (We note that not all properties are eligible for the tax benefits described in the following example.)

Consider a farm parcel worth \$2.0 million that, because of its proximity to an urban area, is attractive to developers. Suppose that the land is worth \$1.2 million if its future use is restricted to farming through a conservation easement. These figures imply that the value of development rights to the land is \$800,000. Now imagine that you currently farm the parcel but are nearing retirement. You have heirs to whom you would like to leave the land.

Consider two options for your property. Under a Do-Nothing option you simply leave the land to your heirs. They can do with the land what they wish. It is worth to them the \$2.0 million less an estate tax, assumed here to be 45% of the \$500,000 excess value over the 2004 exclusion of \$1.5 million, implying a net value to your heirs of \$1.775 million.²

Under a Preserve-the-Land option, you donate a perpetual conservation easement to the local farmland preservation trust, allowing the land to be farmed into perpetuity but allowing no other commercial use. If you have taxable income then there are sizeable and immediate tax benefits from the Preserve-the-Land option.

First, there are federal income tax benefits. The Internal Revenue Service considers you to have made a charitable contribution to the land trust, valued at the difference between the \$2.0 million your land is worth unencumbered and the \$1.2 million it is worth after the easement donation. If your marginal federal tax rate is

33%, then the value of reducing your taxable income by the \$800,000 difference is the tax savings of 33% of \$800,000, or \$240,000. (This deduction is limited to 30% of your adjusted gross income in the current year, but can be carried over for five more years.)

Next there are state tax benefits. As under federal law, North Carolina tax law allows you to consider the easement donation as an \$800,000 charitable contribution, the value of which to you is the reduction in your state income tax bill. If your marginal state income tax rate is 8.25% (the current top state rate) then the deduction makes you better off in the current year by 8.25% of \$800,000 or \$66,000. In addition to receiving a tax deduction, state law might allow you a tax credit of 25% of the value of your contribution, which can be deducted directly from what you owe the state. If your property qualifies, the Conservation Tax Credit is worth 25% of \$800,000 or \$200,000 (again subject to limitations relative to income).

The total potential federal and state income tax benefit is $\$240,000 + \$66,000 + \$200,000 = \$506,000$. This is an immediate or short-term increase in your after-tax income if your taxable income is high enough.³

What is the diminution in value of the gift that you leave your heirs under Preserve the Land? Because of the perpetual restriction to farming, your land is worth \$1.2 million, which in 2004 would be subject to no estate tax.

Now compare the bottom lines. Under Do Nothing, your heirs receive an asset worth \$1.775 million after estate taxes. Under Preserve the Land, your heirs receive an asset worth \$1.2 million after estate taxes. The difference between the two values, \$575,000, is the cost of pursuing a strategy that can yield you the immediate and near-term tax benefits of \$506,000. It is almost a break-even proposition to take actions to preserve your land and forever prevent its development. If you have a taste for such assurance, the combined tax breaks make it inexpensive to indulge them. From a different perspective, ensuring that your wishes with respect to the land are honored into perpetuity can be accomplished largely with other people's money—other taxpayers.

Endnotes

¹This estimate uses data from the 2000 and 1985 Land Trust Alliance Censuses. The statistics exclude acres held by The Nature Conservancy, which is by far the nation's largest land trust.

²The federal estate tax is scheduled to phase out in 2010, but to reappear in 2011. Many political commentators, but not all, predict that the estate tax repeal will be made permanent prior to 2011. Many financial planners advise that it would be prudent to take into account the possibility that it will not.

³An additional tax benefit might result from the above as well. If your property currently is taxed at an assessed value representing its value as developed land, then placing the easement on the land could induce the county assessor to reduce its assessed value in line with its use in farming. If your property already is taxed at its use value in farming, then there is no additional property tax benefit from creating the easement.

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