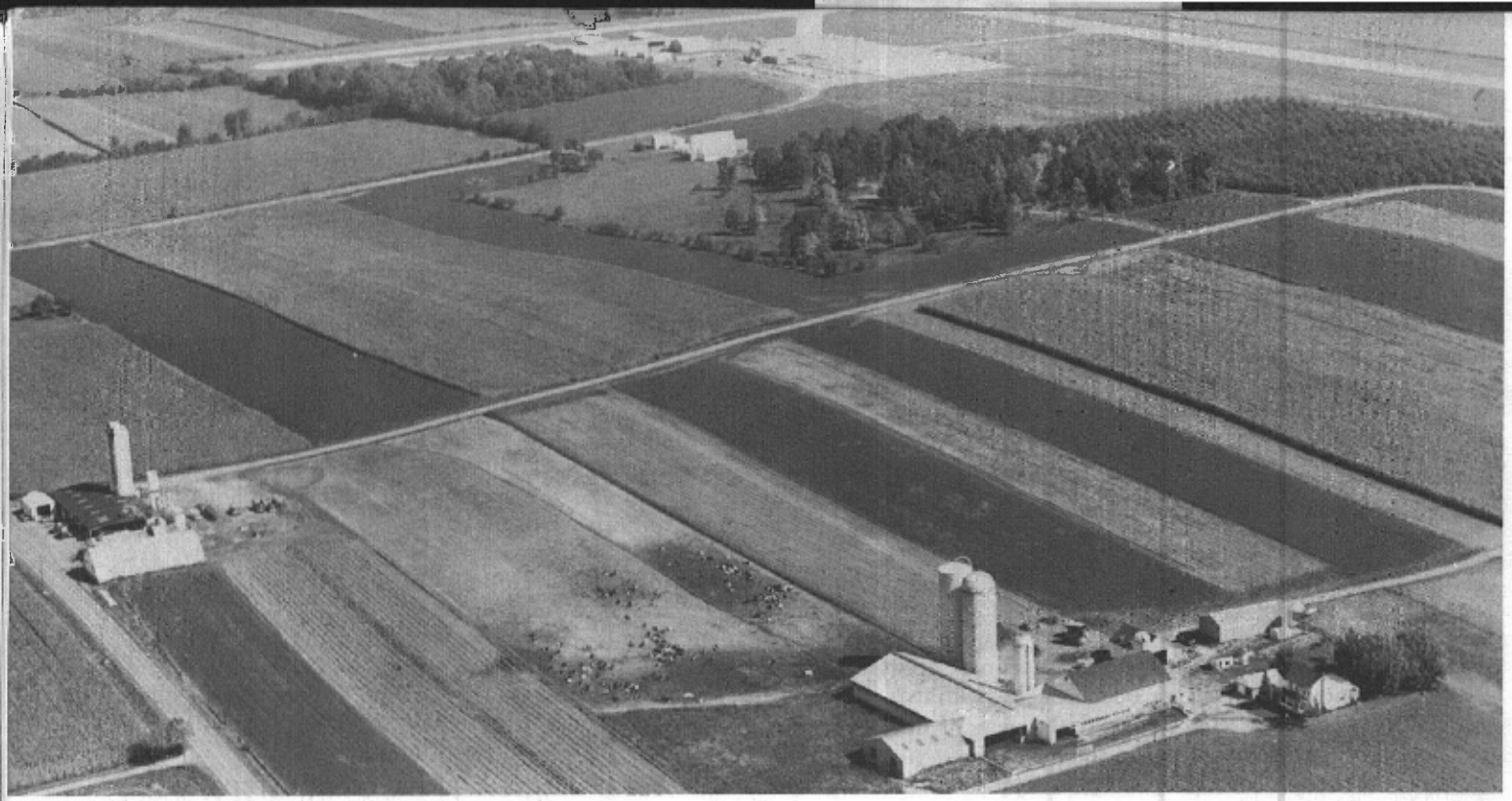

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Controlling development rights: The alternatives

LESLIE SMALL and DONN A. DERR

COMMUNITIES constantly face a multitude of needs for their scarce tax dollars—education, welfare, housing, recreation, roads, and open space. Currently, there is considerable concern about the difficulty of providing adequate open space to meet the social, ecological, economic, and aesthetic needs of people in densely populated areas. There is also a great deal of concern about the continued conversion of prime agricultural land to urban and other uses.

Recognizably, more effective land use controls are needed, or open land may be greatly reduced where it is needed most. During the past few years, interest has been expressed in the separation of development rights from the fee simple bundle of rights. A number of proposals have been put forward for legislative action and implementation.

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Compensation, Development Rights

Any land use control measure designed to preserve open space must limit the landowner's right of use. Because such limitations adversely affect the market value of land, the issue of compensation becomes paramount. Depending upon how this issue is handled, there are three basic approaches to the control of land through the separation of development rights from the fee simple bundle of rights (Figure 1).

For purposes of illustration, assume that the limitations placed on land use reduce the value of a given parcel by $1,000. One approach to the compensation issue is for the development rights to be eliminated or abolished by the police power with no compensation paid to the landowner (Figure 1, point O). This approach is a form of zoning. A second approach is to convey the development rights to a unit of government through condemnation under the power of eminent domain. Under this approach (Figure 1, point A), the fee owner is paid, entirely from public funds, the $1,000 that represents the constitutional requirement of "just compensation" for "taking" under the power of eminent domain. Finally, the development rights may be conveyed through a private market transaction from one owner to another, with the amount received by the fee owner determined by the forces of supply and demand for the development rights. Point B in figure 1 represents this private market approach in the case where the amount received by the fee owner ($1,000) is the same as he would have received under the exercise of eminent domain.

In the private market, however, there is no guarantee that this level of compensation will be achieved. If there is inadequate demand for de-

velopment rights, the payment will be less than $1,000 (Figure 1, point C). In an extreme case the market in development rights might fail to operate at all, resulting in no compensation to the fee owner (Figure 1, point O) (*18*). On the other hand, the price for development rights might exceed the value that would be paid under a public program (Figure 1, point D).

Figure 1 also suggests that combinations of approaches are possible in controlling development rights. One possibility is that a governmental unit might pay a portion of the value of rights taken, with the expectation that the private market would provide the remainder. For example, the government might acquire half the development rights and establish a program for the transfer of development rights (TDR) to permit the fee owner to sell the other half (Figure 1, line EF).

A second combination might involve the establishment of a TDR mechanism coupled with a guaranteed minimum price for the development rights. Under such an arrangement, compensation would be through the private market so long as the cost of development rights exceeds the minimum price. Government payments would come into play whenever the market price falls below the minimum. If the minimum price were $500, the outcome could be depicted as some point on the horizontal axis between G and B in figure 1, when market prices are above $500, and at point E, when market prices fall below $500.

Some Basic Issues

There are a number of basic issues that need to be considered in choosing among these approaches to the control of development rights (Figure 2). The primary issue is whether the proposed control is a legitimate use of the police power (to protect and promote public health, safety, morals, and the general welfare), or whether it represents a taking of private property for public use. No compensation need be paid for a loss suffered as a result of using the police power, but just compensation must be paid for private property taken for public use. The distinction, of course, between legitimate regulation and a taking is not clear and has changed over time as society's needs have changed (*1*).

But even if the proposed control mechanism is deemed to be a legally valid exercise of the police power, there remains the important question of whether it is a politically acceptable exercise of this power. Significant political opposition is likely to arise against a proposed land use control measure that creates substantial uncompensated "wipe-outs." Unless arrangements for compensation are made, such a proposal may never receive enough support to be implemented. It is partially for this reason that various proposals for creating a private market for development rights have been made (*4*).

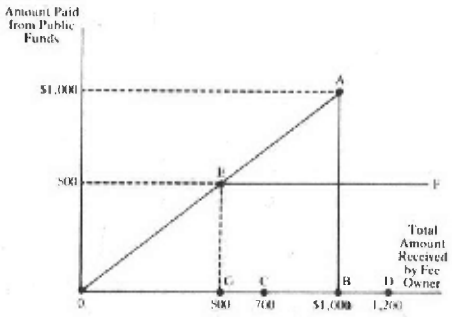

Figure 1. Alternative approaches to compensation for development rights.

If the proposed regulation based on the police power is both legally and politically acceptable, then the development rights are effectively abolished without compensation to the landowner (Figure 2). Zoning to control land use basically uses this approach. Zoning abolishes certain types of development rights. For example, the right to develop a parcel of land for industrial use is abolished when that parcel is placed in a residential zone.

More recently, this approach has been used in a number of situations involving environmentally sensitive areas. An example is the regulation of filling and dredging activities in the San Francisco Bay. The San Francisco Bay Conservation and Development Commission was empowered to regulate such activities in conjunction with the development of an overall plan for conservation of the bay's shoreline. The resulting regulations have been upheld in court as a valid exercise of the police power (*2*). In addition, zoning ordinances limiting the permitted uses of shoreland have been upheld in Wisconsin (*7*), and New Jersey has passed legislation severely limiting the use to which coastal lands can be put, with no provision for compensation to the landowners (*9, 10*).

If use of the police power is considered legally or politically inappropriate, then arrangements must be made to provide compensation for the development rights taken. This leads to the issue of who will pay the compensation. Historically, the government has paid the compensation; however, there is now increasing interest in programs that would provide for compensation to be paid by private individuals operating through a market mechanism.

If compensation is to be paid by the government, two approaches are possible. Participation in the control program may be voluntary, with landowners selling their development rights to the government for a mutually acceptable price. If participation is not voluntary, then the government institutes eminent domain proceedings, with the landowner being required to exchange his development rights for a sum of money that is determined to be fair and just. Whether participation is voluntary or not, a transfer takes place in which the government acquires development rights in exchange for just compensation.

One proposed program using the voluntary approach is the Farmland Preservation Program of Suffolk County (Long Island), New York (*12*). Under this program, landowners submit bids to the county for the sale of the development rights to their land. A select committee reviews the bids and, based on several criteria, recommends to the county legislature the acceptance of certain bids. If the legislature approves the bids, the county then purchases the development rights from the farmer for the agreed price.[1] New Jersey recently announced plans to undertake, on a pilot basis, a similar program in four municipalities of Burlington County.

Other voluntary programs are less ambitious. In some states, such as California and Maine, open space easements or scenic easements can be accepted by cities or counties for a certain period of time. The landowner benefits from his donation through a lower tax assessment that reflects the

[1]The select committee has recommended to the County Legislature the acceptance of bids on some 13,800 acres of land at a total cost of $82.3 million (*13*). However, on May 11, 1976, the County Legislature tabled the proposed bonding authorization for the program. It is anticipated that authorization will be considered again this fall.

land's value in its restricted use (*16*).

In Maryland, a conservation easement program is being operated by a quasi-public agency known as the Maryland Environmental Trust. A landowner can donate the right to develop his land, "preventing the landowner from changing the natural, scenic, or historical value of the land" (*8*).

A proposal has been introduced in the Vermont legislature that would permit either the donation or the leasing to the state of development rights by qualified landowners (*17*). Under the lease provision, the development rights could be returned to the original landowner at any time he chooses; however, he would be required to pay a lease-termination price of one-third the capital gains accruing to these development rights while they were leased to the state. This provides flexibility in land use, but limits the effectiveness of government control.

New Jersey and Connecticut are considering statewide programs involving nonvoluntary approaches. These proposals involve the delineation of open space preserves and the purchase of the development rights under eminent domain. Legislation was introduced in the Connecticut legislature in January 1975, but was not reported out of the Finance Committee (personal communication with Representative Dorothy McCluskey, Connecticut House of Representatives, who sponsored Committee Bill No. 7598, "An Act Concerning the Preservation of Connecticut Agricultural Lands"). A substitute bill that provided for an inventory of agricultural lands and approved the principle of state acquisition of development rights, but did not provide a financing mechanism for this acquisition, became law in June of 1975 (*3*). In the New Jersey legislature, a joint resolution calling for a constitutional amendment was introduced, but no action was taken on the bill (*11*). The purpose of these programs is the maintenance of relatively large acreages of prime agricultural lands, thereby giving permanence to a given land base as a means of revitalizing agricultural communities.

If compensation is not to be paid by the government, then a mechanism must be created that encourages the exchange of ownership of development rights among private individuals (Figure 2). Such a mechanism must also provide for the transfer of the use of the development rights from the land on which no development is permitted to land that can be developed.

Once the mechanism for the private exchange of development rights is established, there remains the important question of whether or not this mechanism will result in payments that are reasonably comparable to the amounts that would have been received under eminent domain.

If not, it is unreasonable to expect that a voluntary TDR program would provide any substantial control over land use, while a compulsory program would almost certainly sustain serious legal challenge, except in cases where the control is clearly a legitimate exercise of the police power.

If a reasonable level of compensation is provided, however, then the program would result in the landowner exchanging his development rights for a cash payment from another individual, who would be able to use the development rights of another parcel of land (Figure 2).

There are numerous examples of proposals for the transfer of development rights. The status of the many proposals and programs is well documented (*19*). Although there are cases where TDR programs designed to preserve open space have been established through the passage of enabling legislation, there are no known cases where significant exchange has occurred. For example, South Hampton Township in Suffolk County, New York, adopted a zoning ordinance in 1972 that provided for a voluntary TDR program, but to date no transfers have taken place (personal communication with Dave Newton, New York State Cooperative Extension Service, Suffolk County, June 1976).

Transactions Costs and TDR

This raises the important question of the constraints placed on the TDR

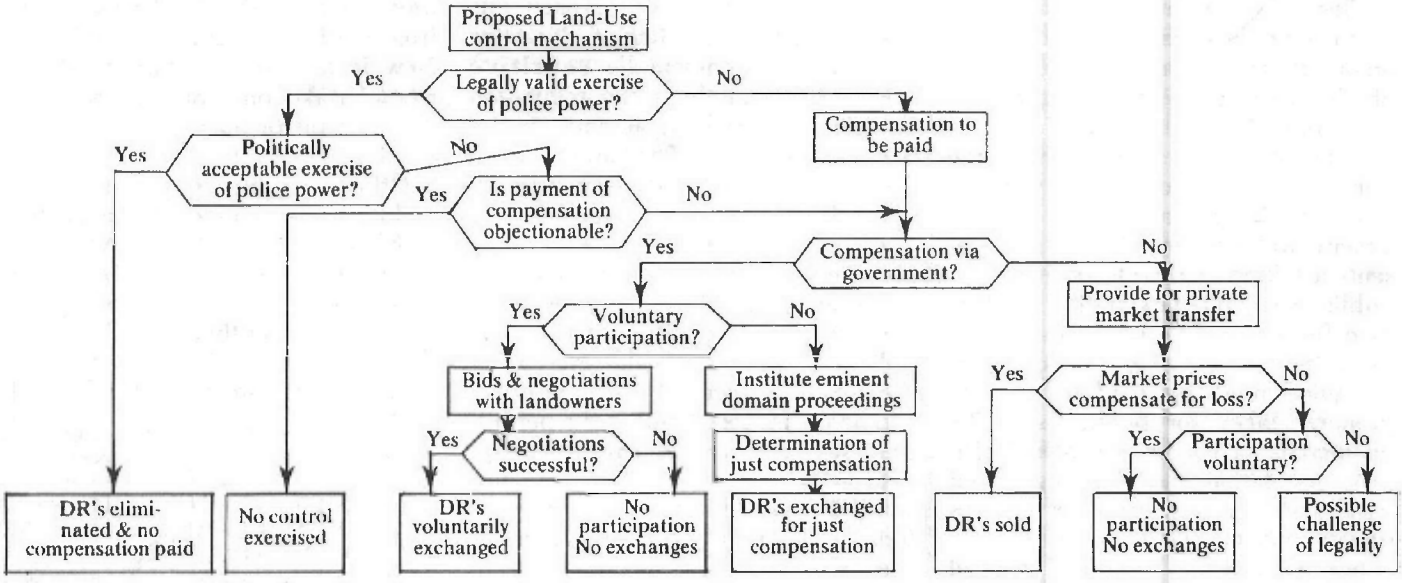

Figure 2. Alternative approaches to the control of development rights.

mechanisms for preserving open space. While no definitive answer can be given at this time, the following points should be considered. TDR mechanisms must rely on some form of police power regulation to artificially create a demand for the purchase of development rights (*4*). In most TDR proposals this is accomplished through modification of the zoning ordinance to permit two different densities of development in a specially designated area. Unless the developer purchases additional development rights, he can develop only to the lower density limit. The developer presumably has an incentive to purchase the development rights in order to take advantage of economies of scale inherent in the greater density of development that would then be permitted.

But a developer must consider more than the potential increase in profits that could result from the economies of higher density development. He must also consider the additional costs he would incur in acquiring the necessary development rights. The costs can be divided into two components: First, the cost of the development rights themselves (the purchase price times the number of rights required) and, second, the transactions costs incurred in the acquisition of these rights.

Transactions costs are the costs of making and enforcing a decision (*14*). Some transactions costs of a TDR program will be borne by government, while others will be borne by the individual buyers and sellers of development rights. Transactions costs borne by the government include (a) administration costs (policy formulation and staff functions), (b) master plan modification, (c) zoning ordinance modification, (d) public hearings, (e) revaluation (before and after value), (f) creating and distributing the supply of transferrable development rights, (g) monitoring the performance of the market for development rights, (h) enforcement of the restrictions, and (i) providing due process for hardship situations. Costs borne by the buyer and seller include (a) gaining information to establish a bargaining position, (b) locating a prospective buyer or seller, (c) negotiating costs, (d) preparing and recording the legal decouments, (e) realty transfer fees, (f) property surveys, and (g) other legal fees, such as those for clearing a clouded title.[2]

The transactions costs that the developer, as a potential buyer of development rights, incurs will reduce the profitability of the higher density development, and thus the amount that he is able to pay for development rights. If the transactions costs were to approach or exceed the potential increase in profit from higher density development, the developer would have no incentive to develop at the higher density, and there would be no demand for development rights.

It appears that a developer's transactions costs may be quite high in the early stages of creation of a new market for development rights and then decrease after a substantial number of transactions have taken place. This may be one reason why TDR programs have not yet become operational. Initial exchange of development rights via a TDR may require a government subsidy to encourage participation. This, of course, would raise the governmental transactions costs. It also seems plausible that transactions costs will increase as the size of the potential trading area increases, thus lending credence to locally administered programs.

Selecting the Approach

The basic purpose of controlling development rights is to maintain the present character of existing open space uses, such as prime agricultural land, woodlands, water recharge areas, scenic views, historic sites, and ecologically sensitive areas.[3] The difficulty is determining what approach is most applicable. Useful criteria include (a) the type of land use to be preserved, (b) the size of the area to be maintained, (c) current and future intensity of development, (d) the degree of permanence, (e) the unit of government to administer the program, (f) the total cost of the program, and (g) who should pay for the program (*5*). These criteria, however, cannot be considered independently of each other.

Of major concern throughout the nation is the maintenance of prime agricultural lands. Programs designed to achieve this objective must take into account soil productivity, location, contiguity, and the minimum size of an area needed to support agribusiness (*6*). This suggests that purely voluntary programs are not likely to meet the needs for agricultural preservation in urbanizing areas.

Many programs to preserve agricultural land involve a considerable acreage. If the TDR approach were used, the supply of development rights would tend to be large relative to demand. This might lead to low prices and/or inadequate functioning of the development rights market unless the government were to provide some form of price guarantee or outright purchase of offers to sell. In contrast, programs for air rights transfers (on which the TDR programs for agricultural land have been based) have involved trading for very intensive use among a small number of highly informed buyers and sellers.

The size of agricultural preservation proposals also leads to problems with the eminent domain approach. The cost of administration and valuation needed upon inception of a program would be very great and could strain the capacity of local units of government to successfully implement the program.

The TDR program would be well suited for built-up areas and where local control is desired. Demand would be strong relative to the supply of development rights, thus assuring a viable market. By keeping the potential trade or exchange area small, there would be fewer buyers and sellers, thus minimizing transactions costs. Buyers and sellers could more easily keep abreast of market activity also. The TDR approach would be difficult to implement on a regional or state-

[2]Although there has been no careful study of the magnitude of various transactions costs associated with the TDR mechanism, there is good reason to believe that the total would be substantial. For a study that has attempted to measure governmental transactions costs of purchasing fee simple rights and easements see (*15*). These researchers found that the average governmental transactions costs incurred by agencies buying scenic and fishery easements ranged from $69 to $102 per acre (at 1970 prices). The importance of these costs becomes apparent by noting that the average value of the easements acquired ranged from $55 to $116 per acre (again at 1970 prices). Thus, the transactions costs to the government frequently approached or exceeded the value of the easement that was acquired.

[3]For certain types of open space, like scenic areas, the removal of development rights will leave the fee owner with virtually no value. In contrast, removal of development rights from prime agricultural land will still provide the owner with agricultural use value.

wide basis because of the transfer of taxable property across political boundaries.

The degree of permanence is also an important consideration. Zoning is notorious for its impermanence. Eminent domain or TDR should provide substantial permanence, but there may be a considerable lack of flexibility in releasing preserved lands for development at some future time if this were deemed desirable. Connecticut and Vermont have provided for the reverse flow of development rights in their proposals, however.

If flexibility in land use control is desired, then the leasing approach for a given period might be desirable. But this greater flexibility comes at the cost of possibly losing some of the desired control.

Preserving large tracts of prime agricultural land cuts across local political boundaries and thus becomes more than a local concern. For this reason, it would be desirable to have a preservation program administered on a regional or statewide basis. If local governments (town, township, city, borough) were the basic units of administration, efforts to maintain large tracts could be thwarted by a failure of some municipalities to take appropriate measures.

The final issues are who shall pay and how much. With private transfers, the buyer and seller of development rights would bear the direct cost of preserving open space. However, there would be governmental transactions costs in the form of adopting enabling legislation, master plan modifications, public hearings, and administration, including enforcement. There would still be costs of providing due process to those adversely affected also.

For government programs via eminent domain, major costs (administration and the purchase or lease of rights) would be borne by the public. Such arrangements as user fees in the form of building permit fees, real property transfer fees, and capital gains tax could be used to finance the program. Regardless, both public and private costs are involved, irrespective of the method used.

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STATES' ROLE IN PRESERVING FARMLAND

State governments should adopt a definite policy toward the preservation of agricultural lands and other areas needed to keep agricultural endeavors economically viable. There is a need for visible and convincing leadership with a commitment to the concept of agricultural preservation. Federal funds are needed to assist the states with the development of guidelines and planning policies.

All regions of the state need to develop a good comprehensive land use plan to serve as a basis for zoning. All land, including agricultural land, should be zoned. Lands to be preserved (not developed) should be identified in the plan, based on state guidelines and policy.

Legislation is needed to allow for the purchase or transfer of development rights, based on zoning. The transfer of development rights should be limited within specific geographic areas. The opportunity should be provided to donate development rights for tax deduction purposes, and to establish the right of municipalities to accept such donations.

Agricultural districts should be established to protect agricultural lands against an expanding tax base resulting from the development of facilities—sewers, water lines, roads, and the like—and from nuisance problems.

A new philosophy of taxation is needed: (a) Agricultural land should be taxed according to its use value, not its market value. Preferential assessment is only a holding tactic, however. (b) Inheritance and estate taxes should be modified to encourage retention of the land in agricultural use. (c) The tax assessment policy of increasing taxes on improvements should be changed. This present policy encourages developers to abandon developed land and move on to virgin land.

A joint legislative committee should be created to prepare comprehensive legislation on the preservation of agricultural land in Pennsylvania. This committee should consider a wide variety of approaches to the problem, since it is a multifaceted situation and will require many kinds of responses. — *ELEANOR W. BLAKELY, from a summary of the workshop on "The Preservation of Lands for Agricultural Endeavors," held March 4-5, 1976, in Lebanon, Pennsylvania.*