FARMLAND INFORMATION CENTER

FACT SHEET

INSTALLMENT PURCHASE AGREEMENTS

DESCRIPTION

Purchase of Agricultural Conservation Easement (PACE) programs compensate property owners for restrictions on the future use of their land. One of the biggest challenges in administering PACE programs is figuring out how to pay for them. This fact sheet describes an innovative financing plan that helps jurisdictions stretch available funds while offering unique benefits to landowners.

What It Is

An installment purchase agreement (IPA) is an innovative payment plan offered by two states and more than a dozen localities with PACE programs. 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. Landowners also can sell or securitize IPA contracts at any point to realize the outstanding principal. The IPA financing plan won the Government Finance Officers Association Award for Excellence in 1990.

How It Works

The day before settlement, the jurisdiction sets the rate for the interest paid to the IPA holder. The rate is typically pegged to the current return on U.S. Treasury bonds. However, counties and local governments can set a minimum interest rate, or "floor," to provide participating farmers with additional security.

Jurisdictions can purchase zero coupon 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. Zeroes with a face value equal to the purchase price are usually purchased the day before settlement.

At settlement, the landowner grants the jurisdiction a permanent agricultural conservation easement in exchange for an IPA. Then the jurisdiction begins making tax-exempt interest payments twice a year. The balance of the purchase price is paid to landowners at the end of the agreement. The landowner may sell or "securitize" the IPA on the municipal bond market to recover the outstanding principal before the end of the agreement.

HISTORY

Howard County, Maryland, pioneered IPA as a strategy to fund its PACE program in 1989. By 1987, the county's five-year-old farmland protection program had stalled. Lump-sum payments were no longer a competitive option for farmers due, in part, to dramatic increases in land prices. Later that year, county officials met with a financial advisor to explore ways to make the most of accumulated tax revenues and reinvigorate the program. The advisor combined installment payments and the purchase of zero coupon bonds with the county's traditional funding mechanisms. Working with the county executive, county agencies and bond counsel to refine the proposal, the plan was announced in May 1989. Workshops were held for interested property owners over the next few months, and the County Council approved the first round of IPAs in November. To date, 100 agreements have been executed in Howard County, adding 9,987 acres to the 7,500 protected before the IPA program was created.

Based on the Howard County model, six other counties in Maryland, four in New Jersey and three local governments in Virginia have developed IPA programs to stretch public funds for farmland protection. In addition, statewide farmland protection programs in Maryland and Pennsylvania have developed IPA programs.

FUNCTIONS AND PURPOSES

IPAs are intended to make PACE programs competitive with developers by providing unique financial and tax advantages. In addition, this payment option enables jurisdictions to use accumulated and future dedicated revenues to protect land while it is still available and relatively affordable.

ISSUES TO ADDRESS

Authority and Approvals

In general, state and local governments can enter into IPAs if they have the authority to issue general obligation bonds. Because IPAs constitute long-term debt, agreements typically require the same approval process as bonds. Laws governing the

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For additional information on farmland protection and stewardship, contact the Farmland Information Center. The FIC offers a staffed answer service, online library, program monitoring, fact sheets and other educational materials.

www.farmlandinfo.org

(800) 370-4879

For more information on installment purchase agreements contact:

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issuance of bonds vary from state to state. Some states require approval by the legislature, the voters or both. For more information, contact state agencies that regulate municipal bond issuance, bond counsel or independent investment banking or public financial advisory firms.

Funding

An IPA program requires dedicated funds to cover the interest and principal payments. Howard County uses proceeds from a local real estate transfer tax and the county's share of a statewide agricultural transfer tax to support its program. Virginia Beach relies on revenue from a property tax increase and a tax on cellular phone use. Burlington County, New Jersey, dedicates an incremental property tax increase.

BENEFITS

· Landowners may defer capital gains taxes until they receive the principal for the purchase price. This keeps a larger proportion of the proceeds "working" or earning interest.

· The semi-annual interest paid on the outstanding balance of the purchase price is exempt from federal, state and local income taxes and can provide a supplementary income stream.

· Landowners can liquidate their IPA prior to the end of the agreement.

· IPAs can be transferred to heirs and are useful in estate planning.

· The package of financial and tax benefits offered to landowners could enable them to net more than they could through a traditional cash sale. These benefits may encourage landowners to accept less than the appraised value for their easements.

· IPAs stretch public funds. By deferring principal payments, public entities can buy more easements while land is available and relatively affordable. Also, by purchasing zeroes, jurisdictions spend a fraction of the negotiated purchase price at closing and leverage available funds.

DRAWBACKS

· IPAs require a dedicated funding source to cover the interest payments.

· An IPA program may take up to six months to develop.

· Bond counsel, a paying agent and a financial advisor will have to assist in each settlement. The estimated cost of each transaction ranges from $5,000 to $20,000. These costs can be higher—on a percentage basis—than the costs to issue bonds for a cash-purchase program.

· Because IPAs are backed by the full faith and credit of the jurisdictions, each agreement may require the same approval process as general obligation bonds.