HB 625

Department of Legislative Services

Maryland General Assembly
2004 Session

FISCAL AND POLICY NOTE

House Bill 625 (Delegate Glassman, *et al.*)
Environmental Matters Education, Health, and Environmental Affairs

Maryland Agricultural Land Preservation Foundation − Grants − Installment Purchase Programs

This bill authorizes the Maryland Agricultural Land Preservation Foundation (MALPF) to provide grants to counties with approved programs for the purchase of easements using Installment Purchase Agreements (IPAs). The bill establishes conditions for MALPF approval. Easements purchased using a grant are perpetual and held jointly by the county and MALPF.

The bill takes effect July 1, 2004.

Fiscal Summary

State Effect: Total MALPF finances would not be materially affected, as grants would be provided out of existing county allocations. While the use of IPAs at the county level could result in more acreage being protected with the same amount of MALPF funds, the bill could result in a decrease in general fund revenues and Transportation Trust Fund (TTF) revenues related to a decrease in income tax revenues.

Local Effect: Counties receiving grants under the bill could benefit from the ability to leverage additional easement purchases with the same initial investment. To the extent the bill results in a decrease in State income tax revenues from individuals, local income tax revenues will also decrease. Because 30% of the revenues distributed to the TTF from corporate income tax revenues are distributed to local governments, local revenues will decrease to the extent the bill results in a decrease in corporate income tax revenues.

Small Business Effect: Potential meaningful.

Analysis

Current Law: The total funds available to MALPF for the purchase of easements are equally divided to provide general allotted funds and State matching funds. The total amount of the general allotted funds is divided equally among the 23 counties during "Round 1" offers, which is the round under which easement purchase requests within each county compete for available funds. The other half of the available funds is used for up to a 60% match in those counties which participate in the State matching funds program. Once general allotted funds are depleted, the State provides up to a 60% match for county easement purchases up to $1 million in any county in any fiscal year. Once these funds are exhausted, the remaining easement requests compete statewide in "Round 2." Round 2 funding consists of unused general allotted funds and unused State matching funds.

At the time of settlement of the purchase of an easement, the landowner and MALPF may agree upon and establish a schedule of payment such that the landowner may receive consideration for the easement in a lump sum or in installments over a period of up to 10 years from the date of settlement. Each installment is fully taxable for capital gains. Any interest earned on the investment of the unpaid balance is taxable as income.

Any time after 25 years from the date of purchase of an easement by MALPF, the landowner may request that the easement be reviewed for possible termination of the easement.

Background: An IPA is a contract between the easement purchaser and the easement seller to pay the principal unpaid at settlement as a balloon payment at the end of the term of the agreement and to pay the seller tax-exempt interest on the unpaid principal during the period of the agreement. These contracts are long-term. At a minimum, an agreement term is 10 or 15 years; more typically, the term is 20 to 30 years.

The two primary elements of an IPA are the interest installment payments and the payment of the principal. Typically, the payment of the principal at the end of the agreement is funded by investment in long-term stripped-coupon or zero-coupon U.S. Treasury obligations (zeros), where the amount of the principal is secured at a discount contingent on the length of the obligation. The longer the term of the zero, the deeper the discount. Taken out to 25 or 30 years, the principal payment can be funded with an investment in zeros of 20 to 30 cents on the dollar. Taking the term out only 15 years requires an investment in zeros of approximately 60 cents on the dollar. The obligation to pay interest on the principal during the period of the agreement is typically met by pledging a percentage of future revenues to pay the installments.

An IPA can be attractive to a seller because of the tax-advantaged nature of the transaction. First, the seller is able to defer capital gains taxes until the payment of the principal. Second, the seller receives a tax-exempt income stream during the term of the agreement. It can also be attractive because the seller may realize more from such a sale than from an easement sale paid in a lump sum at closing or from MALPF's current installment payments option, which provides less of a tax advantage.

For a purchaser, a well-conceived IPA has three potential advantages:

- An IPA system creates the potential for the purchaser to buy more easements upfront for the same amount of funds (or the same for less money) and service the IPAs by pledging future revenues. In effect, it allows the purchaser the possibility of leveraging funds to buy easements upfront in return for the commitment of future revenues (or taking on debt). The longer the agreement, the greater the leveraging potential based on the greater discount in purchasing zeros.

- An IPA system may allow the purchaser to purchase easements on property at current prices (when those properties are still undeveloped) rather than purchase them later at higher prices or lose them to development altogether. (A fundamental problem in strategic land preservation is how to keep from losing critical land to development over the time period necessary to secure the funds to purchase easements on that land.)

- Because offering an IPA option could increase participation by landowners otherwise not interested in selling easements (particularly those landowners most affected by capital gains issues), more competition for offers could lead to greater discounting on the part of sellers seeking an offer. As a result, the purchaser would be able to buy more easement acreage with the same funds.

While IPA installments are typically funded by pledging future revenues, and the payment of the principal at the end of the agreement is typically funded by investing in zeros, IPA installments and balloon payments can be funded in other ways. The form of financing chosen can have an impact on the potential benefits of the program. For example, installment payments can be funded by investing in an interest-paying bond, and the balloon payment can be funded from future revenues. It is possible with a long enough time frame to fund the IPA from the amount of the original easement offer by a combination of zeros and interest-bearing investments (bonds), but such IPAs obviate the benefit of leveraging for the purchaser and can lead to somewhat less attractive interest rates to sellers. Such a self-funded IPA option is the basis for the IPA program in Carroll County. The ability to develop a successful self-funded IPA program depends upon the time frame of the IPA; the longer the time frame, the more likely a self-funded IPA program will succeed.

In a December 2003 report on Maryland's land conservation programs, Governor Ehrlich stated an objective of identifying potential revenue sources for land preservation, including acquiring land with IPAs whenever possible in order to leverage limited State funds and provide tax benefits to participating landowners.

State Fiscal Effect: Because the bill does not specify how grant funding would be allocated in light of the statutory allocation of funds, it is assumed that grant funding would come from each county's existing allocation made from the general allocation and any allocation that results from participation in the State matching funds program. (A property wishing to use the IPA option that would otherwise qualify to receive an offer because of its ranking would instead be pulled from the State program at that point and a grant would be made to the county of the State's share of the offer.) Any impact on MALPF's administrative expenses to implement the grant program is anticipated to be minimal and would likely be offset by the transfer to the counties of some of the costs associated with easement settlements. Accordingly, total MALPF finances would not be materially affected.

Easements purchased under the grant program would be held jointly by the county and MALPF. If counties are able to leverage additional easement purchases with the same amount of MALPF funding, total easement acreage would increase. This is discussed in greater detail under the Local Fiscal Effect section.

The bill could have tax implications for the State if a landowner who would otherwise sell an easement to MALPF under the current lump sum or installment payment option chooses the county IPA option instead. Under an IPA system, all or most capital gains taxes are deferred for the term of the agreement. Further, IPAs are typically structured so that interest payments received by sellers are exempt from federal and State income taxes. The extent to which farmers selling easements are liable for the individual income tax versus the corporate income tax is unknown. Seventy-six percent of all corporate income tax revenues are distributed to the general fund and 24% are distributed to the TTF.

Local Fiscal Effect: According to MALPF, Anne Arundel, Calvert, Carroll, Frederick, Harford, and Howard counties already have IPA programs in place. Washington County is developing an IPA program, and Baltimore County is considering developing one. The bill could encourage additional counties to develop IPA programs. Montgomery County advises, however, that it considered developing an IPA program in the past but decided not to do so because of the need to assume debt; that county's program operates primarily on a cash basis.

Local governments receiving grants under the bill would likely incur additional costs relating to easement settlements (that are now paid by the State). Depending on how a given county's IPA program is structured, however, additional funding for county IPA programs could allow a county to leverage additional easement purchases with the same initial investment. This will depend on a county's willingness to commit future revenues or assume debt to service the installment payments. The use of an IPA system could allow a county to purchase easements on property at current prices (when those properties are still undeveloped) rather than purchase them later at higher prices or lose them to development altogether. In addition, the use of an IPA system could increase participation and competition, which might allow more acreage to be purchased with the same amount of funds.

To the extent the bill results in a decrease in State income tax revenues from individuals, local income tax revenues will also decrease. Because 30% of the revenues distributed to the TTF from corporate income tax revenues are distributed to local governments, local revenues will decrease to the extent the bill results in a decrease in corporate income tax revenues.

Small Business Effect: Under a typical IPA program, all or most capital gains taxes are deferred for the term of the agreement. In addition, farmers who face income variability, need supplemental income, or need additional income in retirement, could use this payment option to provide a guaranteed tax-free income stream for the length of the term. Finally, some IPAs are structured to permit the agreement to be securitized at the landowner's option after an initial restricted period. At that point, landowners could sell IPAs to realize capital gains whenever they choose.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Maryland Department of Agriculture, Allegany County, Montgomery County, Talbot County, Wicomico County, Baltimore City, Department of Legislative Services

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