

# Northeast SARE Sustainable Community Grant CNE08-056

## *Leveraging Community Financing for Farm and Farmland Protection*

### **Farmland Protection Challenges in New Hampshire**

It is well documented that New Hampshire has been the fastest growing state in the Northeast for the last four decades.<sup>1</sup> Unfortunately, this growth has occurred primarily in the areas of the State that contain its best agricultural soils, which are inherently very limited.<sup>2</sup> Numerous factors have contributed to the loss of prime and important farmland in New Hampshire, namely its adjacency to several major metropolitan regions<sup>3</sup>, the high quality of life and favorable tax structure that attract commuters, second-home buyers, and retirees, zoning ordinances that are largely ineffective in reducing residential densities, and lastly, limited funding to offer landowners as an incentive to preserve their land rather than develop it.

Although New Hampshire perennially has one of the highest median household incomes in the country<sup>4</sup> along with one of the lowest income-to-poverty ratios of any state,<sup>5</sup> government funding for land conservation has been limited. Undoubtedly, this is due in large part to its tax structure, which results in one of the lowest tax burdens in the nation<sup>6</sup> and is the state determined to have the highest overall economic and personal freedom in a recent study published by George Mason University.<sup>7</sup> However, in its *Grading the States* report published by The Pew Charitable Trusts and Governing Magazine, New Hampshire earned a recent mark of D+, down from its C mark in 2005, for government performance.<sup>8</sup> And in its report assessing states' effectiveness at open space protection, the Sierra Club ranked New Hampshire 43<sup>rd</sup> out of the 50 states.<sup>9</sup> Limited public funding for land protection has resulted in New Hampshire having the lowest per capita expenditures on farmland preservation in the Northeast and consequently the third lowest percentage of farmland protected in the region (*Figure 1*).<sup>10</sup>

Because public funding in New Hampshire has been difficult to procure, land conservation often is an eleventh-hour proposition, where a threatened property is identified and a town conservation commission, state agency, and/or land trust must scramble to come up with the necessary funds to protect it--a formidable task, particularly when the areas under the most intense development pressure are characterized by high land values. Exacerbating the problem is the reliance on cash as the preferred payment method, requiring full payment of the purchase price at the settlement table. Rather than being a treatise on how to generate additional funding per se, this report instead is concerned with how limited funds can be used in the most efficient

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<sup>1</sup> [http://www.spnhf.org/research/papers/nhcl2005es\\_hi.pdf](http://www.spnhf.org/research/papers/nhcl2005es_hi.pdf)

<sup>2</sup> [http://www.farmland.org/resources/fote/states/map\\_newhampshire.asp](http://www.farmland.org/resources/fote/states/map_newhampshire.asp)

<sup>3</sup> [http://www.census.gov/geo/www/maps/msa\\_maps2007/msa2007\\_previews\\_html/cbsa\\_us\\_wall\\_1107.html](http://www.census.gov/geo/www/maps/msa_maps2007/msa2007_previews_html/cbsa_us_wall_1107.html)

<sup>4</sup> [http://factfinder.census.gov/servlet/GRTTable?\\_bm=y&-\\_box\\_head\\_nbr=R1901&-ds\\_name=ACS\\_2007\\_1YR\\_G00\\_-&-\\_lang=en&-format=US-30&-CONTEXT=grt; http://www.census.gov/hhes/www/income/income04/stategrid04.xls](http://factfinder.census.gov/servlet/GRTTable?_bm=y&-_box_head_nbr=R1901&-ds_name=ACS_2007_1YR_G00_-&-_lang=en&-format=US-30&-CONTEXT=grt; http://www.census.gov/hhes/www/income/income04/stategrid04.xls)

<sup>5</sup> <http://www.census.gov/prod/2008pubs/acs-09.pdf>

<sup>6</sup> <http://www.taxfoundation.org/taxdata/show/336.html>

<sup>7</sup> <http://www.mercatus.org/uploadedFiles/Mercatus/Publications/Freedom%20in%20the%2050%20States.pdf>

<sup>8</sup> <http://www.governing.com/gpp/2008/nh.htm>; [http://www.pewcenteronthestates.org/report\\_detail.aspx?id=32742](http://www.pewcenteronthestates.org/report_detail.aspx?id=32742)

<sup>9</sup> <http://www.sierraclub.org/sprawl/report99/openspace.asp>

<sup>10</sup> Deborah Bowers, ed., *Farmland Preservation Report* (Street, MD: Bowers Publishing, Inc.), January 2007.

manner possible, resulting in more farmland being protected. Specifically, the report will address how conservation transactions through an Installment Purchase Agreement (IPA) can be more financially beneficial not only to the conservation community,<sup>11</sup> but also to landowners. While farmland will be the primary resource that is being addressed, there is applicability to other resource lands. Also, while conservation easement acquisition will be the primary vehicle discussed for carrying out IPAs since agricultural land is primarily privately owned, the potential for fee simple purchases will also be examined because of their importance to New Hampshire's approach to land conservation. For the benefit of readers of this report, a glossary of financial and legal terms is appended, the proper term being used in this report in order to familiarize the conservation community and landowners with the relevant lexicon associated with IPAs. While this report strives to avoid being esoteric in nature, it necessarily must delve into the minutia of conservation finance and dissect a typical land transaction in order to reveal the shortcomings of the current methodology in place and the benefits to introducing the IPA acquisition paradigm into the Granite State's repertoire.

## **Existing Infrastructure for Farmland Protection in New Hampshire**

New Hampshire has a strong tradition of land conservation and has achieved many successes in the face of intense development pressure and chronic funding shortages. In 1979, it became one of the first states to create a state-funded farmland preservation program, administered by the New Hampshire Department of Agriculture. In 1987, it created one of the earliest publicly-funded land protection programs designed to protect multiple resource lands, the New Hampshire Land Conservation Investment Program (LCIP). The New Hampshire Land and Community Heritage Investment Program (LCHIP), created in 2000, has been another innovative public-private partnership that has protected a variety of natural, cultural, and agricultural resources.

Unfortunately, the last agricultural preservation easement acquired by the State's Agricultural Land Preservation Program (ALPP) was in 1991 and after a successful run, LCIP sunsetted in 1993. After an eight-year hiatus, LCIP's successor program, LCHIP, acquired its first agricultural preservation easement (*Figures 2, 3, and 4*). Funding for LCHIP has been sporadic throughout its history, and is periodically raided by the General Court to make up for shortfalls in the State's budget. Nevertheless, the statutes are still in effect for the ALPP, and LCHIP is still accepting grant applications, bolstered by a recordation fee enacted in 2008.<sup>12</sup> In addition, many towns have active conservation commissions that engage in fee and easement acquisition. Augmenting these publicly-funded land conservation programs is the strong presence of land trusts, preeminent among which is the Society for the Protection of New Hampshire Forests, one of the oldest and most successful land trusts in the nation. In addition, thirty-two other statewide and local land trusts are currently operating in New Hampshire, not including national land trusts such as American Farmland Trust, the Trust for Public Land, and the Nature Conservancy.<sup>13</sup>

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<sup>11</sup> In the context of this report, the term conservation community refers to state and local governments as well as land trusts. However, because of various fiscal and legal constraints, state and local governments may be the only entities engaged in various aspects of IPA transactions, in which case, the term state and local government entities will instead be used.

<sup>12</sup> <http://www.lchip.org/uploads/pdf/news/NH%20Registry%20Collection%20Info.pdf>

<sup>13</sup> [http://www.ltanet.org/landtrustdirectory/alpha.tcl?state\\_id=newhampshire33#local](http://www.ltanet.org/landtrustdirectory/alpha.tcl?state_id=newhampshire33#local)

This report will dovetail with the existing framework of public-private partnerships that characterizes land conservation in New Hampshire, clearly defining the roles of each sector based on legal requirements that are endemic to IPA transactions. While the farmland protection infrastructure in place can continue to be utilized without drastic changes, there are some concessions that need to be made if IPA is to be successfully implemented.

### **Installment Purchase Agreements as a Farmland Protection Financing Tool**

The current *modus operandi* in New Hampshire is the payment of cash by the conservation community to landowners in return for securing fee or easement interests in land. Unfortunately, this arrangement is typically not advantageous to landowners and rarely benefits the conservation community. In this type of transaction, the conservation community must come up with the full purchase price at settlement, which is daunting, particularly where public dollars for conservation are limited as in New Hampshire. On the landowner's end, cash payments are subject to income taxes, which results in significantly less proceeds remaining in their pocket. Since the average age of a farmer in New Hampshire is 56.2, having increased nearly every census year over the past thirty years,<sup>14</sup> capital gains taxes are likewise a major issue. In essence, because the vast majority of these farmers purchased their land many years ago and therefore have a low basis in their property, capital gains taxes can be quite sizable when they sell their land or a conservation easement.

As a response to the dual issues of limited funding for purchasing conservation easements and landowners' concern over taxes, a concept known as an Installment Purchase Agreement was first utilized in Howard County, Maryland, in 1989 by the County's Agricultural Land Preservation Program with advisement by Daniel Patrick O'Connell, a former Wall Street investment banker who gravitated towards conservation finance. Maryland, like New Hampshire, is a relatively small state along the Eastern Seaboard with a significant portion of its land area accessible to heavily populated metropolitan areas, creating growth pressures that can negatively impact the retention of agricultural land. Indeed, many New Hampshire municipalities are today experiencing the very same growth pressures that lead Howard County to pioneer the IPA model twenty years ago.

### ***Advantages of IPAs to the Conservation Community***

IPAs benefit the conservation community through the unique structuring of payments to the landowner in return for protecting their land. As opposed to cash payments, which require full payment of principal to landowners at the time of settlement, or (regular) installment sales, where principal payments are typically spaced out only over a couple years, IPAs defer the payment of principal until the end of a longer term, usually 10 to 30 years, giving the conservation community more time to pay off the purchase price. Rather than issue general obligation bonds to finance the principal payment, which requires state and local government entities pay interest to purchasers of the bonds because they are borrowing from these purchasers to pay off debt (thereby increasing the cost of the transaction), IPAs instead utilize U.S. Treasury

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<sup>14</sup> [http://www.agcensus.usda.gov/Publications/2007/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/New\\_Hampshire/st33\\_1\\_001\\_001.pdf](http://www.agcensus.usda.gov/Publications/2007/Full_Report/Volume_1,_Chapter_1_State_Level/New_Hampshire/st33_1_001_001.pdf)

Securities to finance the principal amount. Specifically, there is a type of Treasury security called STRIPS, also known as Zero Coupon Bonds, which do not pay periodic interest (coupon) to purchasers, but instead pay a lump sum upon their maturity, hence the term “Zero Coupon.” Because purchasers of Zeros--in this context, state and local government entities--do not receive payment until their investment matures in 10 to 30 years, Zeros can be purchased at a deep discount from their face value. The longer the maturity, the deeper the discount, allowing Zeros to be purchased at a fraction of the cost of other types of bonds.<sup>15</sup> As *Figure 5* illustrates, a property with an easement value of \$600,000 can be purchased for an initial cost of only \$300,000, as Zero Coupon Bonds that mature in 15 years cost only 50 cents on the dollar.

By reducing the initial costs by half, purchasing Zeros allows an entity to pay for exponentially more acquisitions in a given fiscal year with the same amount of funding, which helps counteract land escalation, a major impediment to reaching preserved acreage goals. *Figure 6* illustrates the substantial increase in easement prices in Carroll County, Maryland--one of the leading local farmland preservation programs in the nation--from Fiscal Year (FY) 1980 to the present, with peak prices occurring in FY 2007. However, in FY 2008, the average easement cost was nearly halved due to the County's implementation of a revamped IPA Program mid-year.

Although landowners agree to defer receipt of principal until the Zeros mature, they are paid semi-annual interest payments by state and local government entities until the maturity date. Because an IPA is considered a state or local government bond, the interest paid to landowners is exempt from federal and usually state and local income taxes, depending on the locale. The commitment to pay both principal and interest to landowners is backed by the full faith and credit of the state or local government entities, just as the commitment to pay the full face amount of the Zeros purchased by these entities (with financial assistance from land trusts if applicable) is backed by the full faith and credit of the federal government. To provide assurances to landowners that they will indeed receive both principal and interest payments and to certify that the interest payments are tax-exempt, a bond counsel is hired to help consummate the transaction. In addition, financial advisors are often hired to assist government entities in purchasing the Zeros, and paying agents are sometimes solicited for those entities who have limited staff in their finance departments.

### *Summary of Advantages of IPAs to the Conservation Community*

**Discounted Sales Price** - Because of the tax benefits IPA offers, landowners are more willing to accept a lower purchase price with IPAs than with a cash offer, particularly those who may owe significant income and capital gains taxes. More discussion of discounting occurs later in this report.

**Zeros Purchase** - Because Zeros can be purchased at less than face value, there is more buying (leveraging) power in a given fiscal year, particularly when coupled with a discounted sales price.

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<sup>15</sup> <http://www.treasurydirect.gov/instit/marketablestrips/strips.htm>; <http://www.sec.gov/answers/zero.htm>. For current market data for U.S. Treasury Strips, Stripped Coupon Interest, see [http://online.wsj.com/mdc/public/page/2\\_3020-tstrips.html](http://online.wsj.com/mdc/public/page/2_3020-tstrips.html)

**Current Market Value** - Since costs are initially reduced through discounting and are further reduced through the purchase of Zeros, more acquisitions can take place in a given fiscal year. Consequently, acquisitions, which would not have been possible without IPA, are less costly to an entity because they are purchased at current fair market values rather than future values, when enough funds would finally be available for cash transactions.

**Goal Obtainment** - The nation's best land conservation programs set goals and work diligently to achieve them. IPAs enable an entity to reach their prescribed goals by shortening the acquisition period--thereby significantly reducing their costs--resulting in goal obtainment rather than falling short due to lack of funds.

**Dovetailing with Other Acquisitions** - IPAs free up cash for other transactions where cash may be the only feasible option (estate settlements, properties at auction, etc.).

### ***Advantages of IPA to Landowners***

Just as the concept of leveraging additional dollars to consummate multiple purchases within a given year is attractive to the conservation community, the concept of earning tax-free interest is attractive to landowners, particularly when combined with the other tax benefits of IPA. Because the receipt of principal is deferred until a future date, capital gains taxes may be deferred, resulting in higher interest earnings, as the IPA interest payments are based on a principal amount before capital gains taxes are taken out. Conversely, cash easement payments do not allow for a deferral of capital gains taxes, which results in landowners retaining a smaller portion of the original purchase price.

Aside from income tax and capital gains tax considerations, the other significant tax benefit associated with IPAs is the potential for claiming a charitable contribution for the purposes of receiving a federal tax deduction on any difference between the appraised value and what the landowner accepted as payment. Because demand for land conservation dollars nearly always exceeds the supply of available funding, the potential for bargain sales should be, and often is, part of the equation, rather than limiting tax deductions to only donated easements. This is particularly true with Discounted IPAs, discussed later in this report. Needless to say, the prospect of paying less tax is attractive to all landowners, and should particularly resonate with New Hampshire residents, making IPAs an attractive option for the Granite State. Other benefits to landowners include the ability to leave the IPA to their heirs, or securitizing it before maturity if access to principal is desired before then. In situations where some access to cash is necessary in order to pay down existing mortgages or purchase farm equipment, a limited amount of cash may be paid by the conservation community at the time of settlement, with the remainder of the purchase price subject to the IPA. And of course one of the major advantages to landowners with IPAs is the ability to receive an offer when one might not otherwise exist due to limited (cash) funding.

### *Summary of Advantages of IPAs to Landowners*

**Tax Exempt Interest Payments** - Section 103 of the Internal Revenue Code (IRC) permits the interest received from state and local government bonds to be exempt from taxation. Because state and local governments are pledging their full faith and credit to make both principal and interest payments to a landowner, IPAs can be viewed as a safe investment on the landowner's part.

**Deferral of Capital Gains Taxes** - Section 453 of the IRC permits deferral of capital gains taxes until the principal amount is received, hence, the interest payments are earned on pre-capital gains dollars.

**Charitable Contribution** - Section 170(h) of the IRC permits a potential bargain sale of the purchase price for gifting purposes.

**Estate Planning** - The IPA can be incorporated into the landowner's will and the payments will continue to be made to their heirs.

**Marketability** - If access to principal is desired prior to maturity, IPAs can be securitized after a prescribed holding period.

**Inclusivity** - Opportunity to receive an offer when it might not otherwise exist in a given year due to limited land acquisition budgets within the conservation community.

### *Disadvantages of IPA to the Conservation Community*

No land conservation tool is without flaws, and IPAs are no exception. Until recently, a dedicated funding source has almost been a prerequisite for engaging in IPAs because of the need to cover future interest payments with reliable revenue sources rather than leaving the process to unpredictable budget allocations. In other words, purchasing Zeros covers the principal payment (the fee or easement purchase price), but the interest payments are another matter altogether; they must be covered by future revenues generated by the conservation community, and dedicated funding sources are the most predictable sources of revenue. Nevertheless, Carroll County, Maryland, implemented the nation's first IPA program that relies solely on general funds (such as income and property taxes) rather than a special funding source. Regardless of the nature of the funding source, state and local government entities must be committed to future debt service, as they are pledging their full faith and credit to pay landowners both principal and interest.

Once acreage goals have been reached and/or all available projected funds have been committed, state and local government entities must continue paying debt service even though acquisitions are no longer taking place. Significant time inputs are necessary to ensure that projected future revenues will cover debt service, but this is no different than any other capital projects such as the construction of public schools, roads, etc., that hopefully a successful IPA program can help render unnecessary. Ascertaining whether or not enabling legislation exists or needs to be

introduced to engage in IPAs likewise requires significant time and energy. Aside from upfront costs involved in setting up an IPA Program, there are ongoing transactions costs involved in consummating IPA transactions. These typically hover around \$4,000 per transaction for government entities who only need to secure the services of bond counsel (taking care of purchasing the securities themselves and acting as their own paying agents), costs can reach up to \$10,000 per transaction if all of the IPA functions are contracted out.

#### *Summary of Disadvantages of IPAs to the Conservation Community*

**Debt Service** - While Zero Coupon Bonds purchased today are used to finance the principal amount, enough funds must be available in future years to cover the interest payments, which requires a significant (political and financial) commitment to land conservation, as well as careful financial planning on the part of the conservation community.

**Enabling Legislation** - Not all state and local government entities currently have the authority to engage in IPA, and there is a considerable amount of time that must be dedicated to researching legal parameters prior to implementing a program.

**Transaction Costs** - Ongoing costs are part of the equation in administering an IPA Program, particularly in finding qualified bond counsel and a financial advisor well-versed in the semantics of IPA transactions.

#### *Disadvantages of IPAs to Landowners*

IPAs may not be attractive to all landowners, particularly those with significant debt that needs to be paid down in a short time period or landowners looking to expand their farm operations by purchasing additional land. However, as mentioned in the preceding paragraph, IPAs can help free up available cash so that the conservation community can engage with certain landowners on a selective basis. For programs that assist landowners in acquiring properties in fee in return for a conservation easement, see Carroll County, Maryland's Critical Farms Program, which was the first of its kind in the nation when it was created in 1992.<sup>16</sup> In essence, rather than limit easement payments to landowners who currently own a particular property, the Critical Farms Program provides funding at the settlement table to help landowners acquire a farm.

#### *Summary of Disadvantages of IPAs to Landowners*

**Not One-Size-Fits-All** - IPAs are the not ideal financial solution for every landowner, particularly those who require immediate access to cash to pay down existing debt, or are in certain tax situations.

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<sup>16</sup> <http://ccgoverment.carr.org/ccg/agpres/default.asp>; [http://www.tpl.org/tier3\\_cd.cfm?content\\_item\\_id=20496&folder\\_id=2867#md](http://www.tpl.org/tier3_cd.cfm?content_item_id=20496&folder_id=2867#md)

## Improvements to Traditional IPA Methodology

Since Howard County devised the nation's first IPA Program twenty years ago, a number of local and state farmland preservation programs have followed, suit, although they have been generally confined to the Mid-Atlantic States.<sup>17</sup> Many follow the "traditional" IPA model where Zero Coupon Bonds are used to fund the principal, which is typically the same easement price that would be paid if it were a cash offer, and interest on the outstanding principal (not funded by the Zero Coupon Bonds) is paid semi-annually at a market rate determined at settlement; typically, the rate is the same as the asked yield of the security purchased by a state or local government entity, although some entities set a floor slightly higher than the anticipated yield to provide predictability to the landowner as well as ensure that arbitrage is avoided. Despite the leveraging ability of Traditional IPAs, the prospect of future debt service (interest payments) above and beyond the purchase price of the easement has caused some entities to shy away from the concept, particularly since several of the mature IPA programs have had to take a hiatus from purchasing additional easements until some of the debt service was paid down. This hiatus can be counterproductive to leveraging since land values usually continue escalating while entities have to sit and watch from the sidelines. It also erodes landowner confidence that funds will be available when they are ready to sell.

### *Self-Funded IPAs*

In response to concerns over future debt service associated with Zero Coupon Bonds, Carroll County, Maryland developed an approach known as a "Self-Funded" IPA in 2002, adopted in 2007 by the Maryland Agricultural Land Preservation Foundation (MALPF), Maryland's state-funded farmland preservation program. Both principal and interest are paid for at settlement, obviating the need to commit future revenues to cover debt service. Rather than relying solely on Zeros to cover the principal amount, leaving interest payments unaccounted for, Self-Funded IPAs use a combination of Zeros and Treasury Bonds to finance both principal and interest. Unlike Zeros, Treasury Bonds, also known as T-Bonds, pay semi-annual interest to the state and local government entities that purchase them, who in turn use these funds to make interest payments to the landowner. To offset any premium that the purchase of the T-Bonds costs these entities--1.22 cents on the dollar currently--purchasing Zeros to cover a portion of the principal amount can reduce the total securities price to 100 cents on the dollar since Zeros are purchased at a discount from face value. Using sophisticated spreadsheets that calibrate the exact amount of Zeros and T-Bonds necessary to equal a cash offer, Carroll County, Maryland, pioneered the use of Self-Funded IPAs.

In contrast, MALPF purchases one hundred percent State and Local Government Series (SLGS) Securities issued by the Federal Government to finance their Self-Funded IPA Program. SLGS, which are only available to state and local governments, likewise cost 100 cents on the dollar, with the interest rate earned on the investment being passed through to the landowner. However, unlike the hybrid Zeros/T-Bond approach, SLGS do not pay semi-annual interest to state and local government entities, both interest and principal being paid at maturity. So while Self-Funded IPAs under this scenario cost the conservation community no more than a cash offer

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<sup>17</sup> For a list of entities that currently engage in IPAs, see [http://www.farmlandinfo.org/documents/37868/Local\\_PACE\\_2009.pdf](http://www.farmlandinfo.org/documents/37868/Local_PACE_2009.pdf)



would at the time of settlement, debt service is still a factor since interests payments must be paid to the landowner from future revenues before the investment matures.

With either version of Self-Funded IPAs, landowners reap all the tax benefits endemic to IPA transactions, but this type of IPA does nothing to help the conservation community leverage funds. Because the full purchase price for each acquisition needs to be funded before the deal can take place, fewer acquisitions can be consummated in a given year.

### *Discounted IPAs*

To address the shortcomings of both Traditional IPAs and Self-Funded IPAs, the author of this report developed a “Discounted IPA” methodology for Carroll County, Maryland, in 2008. In this model, Zeros are purchased for maximum leveraging potential, which is further enhanced by requiring landowners to discount the purchase price beyond what they normally would if they received a cash offer. In return for discounting the principal, the County has guaranteed an interest rate floor significantly above current yield on Zeros, generating substantial tax-exempt interest for the landowner. Although paying a higher interest rate than current yield appears to be counterproductive to reducing backend acquisition costs, i.e. interest payments, the math actually works out so that principal and interest together still cost no more than a cash easement offer would, yet the initial costs are exponentially cheaper than with a cash offer. In essence, Discounted IPAs are both leveraged and self-funded.

While the upfront and backend costs with a Discounted IPA are less expensive than with cash, Traditional IPAs, or Self-Funded IPAs, in many instances the total value to the landowner is greater than with any other methodology. The attached spreadsheet illustrates how a Discounted IPA paradigm is superior to other acquisitions financing methods (*Figure 7*). While different tax circumstances might make the other financing methods more favorable to a particular landowner, it must be remembered that these methods invariably cost more money, particularly in initial costs, which creates the potential for that same landowner not receiving an offer due to limited funds.

Ideally, a dedicated fund source can pay for future interest payments, while existing cash on hand can be used to purchase the Zeros. It must be remembered that non-bond revenues (general funds) have to be used to purchase Zeros and pay the attendant debt service to avoid arbitrage. If incurring debt service is either impermissible under current statutes (or politically unpalatable to change them to permit it) or unfeasible because of concern over the availability of future funds, Self-Funded IPAs offers an alternative to Discounted IPAs, but only if Self-Funded IPAs are revamped; in return for receiving favorable tax treatment, a landowner might be willing to discount the purchase price of the easement. However, landowners may be less willing to substantially discount the purchase price because the interest rate paid with a Self-Funded IPA is typically the current yield on securities rather than a higher floor that is paid with a Discounted IPA, though the current economic climate may compel landowners to do what is necessary to receive an easement offer. While not attempted to date, this revamped Self-Funded IPA methodology may be seen as a less risky proposition than Discounted IPAs because the debt service is paid for upfront from revenues on hand. Of course, there is less leveraging power because one hundred percent Zeros are not purchased, but government entities need to assess the

potential reward of using all Zero Coupon Bonds for maximize leveraging potential versus the potential risk of not having funds available in the future to make interest payments.

Regardless of the types of securities purchased, discounting should be part of the equation with any IPA Program. Indeed, many farmland preservation programs in the Mid-Atlantic already require discounting in order to receive cash offers since demand for easement dollars nearly always exceeds the supply of available funds, although this requirement is not always well received in all locales due to the tax consequences of receiving cash on the barrelhead. The Discounted IPA approach is innovative, because it requires landowners to think about the total bottom line with all of the various tax consequences rather than immediate gratification that comes with seeing a large (cash) offer on the table. Landowners need to realize that it is not important what the offer appears to be, but what will ultimate wind up staying in their pocket once all is said and done.

## **Mechanics of IPA Implementation in New Hampshire**

In a region with high land prices, significant development pressure, and largely ineffective zoning, coupled with numerous constraints to profitable farming, significant aversion to paying taxes, and very limited funding for land conservation, the potential for IPAs, particularly the discounted variety, holds great promise. While successfully used in the Mid-Atlantic, IPAs have not been utilized in New England for whatever reason. This section of the report will therefore address the opportunities and constraints for the implementation of IPAs in New Hampshire, and in doing so, move beyond theory and into practice of how an IPA Program might effectively function in the Granite State.

### *Vehicle for Carrying Out IPAs*

Land trusts have been a major player in land conservation in New Hampshire for over one hundred years, and there is no reason to believe that they cannot play a role in IPAs. However, because of the structure of IPAs, namely, the prospect of tax-exempt interest that is tied to state and local government bonds, their role may be very specific, which is described in detail later in this section of the report. So too has LCHIP been a major player in the land conservation scene, and their role would continue as it has been, which is the awarding of grants to towns wishing to engage in acquisitions with cost-share assistance. Hence, it is envisioned that perhaps the best vehicle for carrying out IPA is town governments, who can solicit grant money from LCHIP as well as private funding from land trusts. Not only does this keep the process local and therefore culturally acceptable, it is the most logical and perhaps legally sound method of administering an IPA Program in New Hampshire. In essence, town governments could use LCHIP grant funds to cover the cost of the Zeros the town would purchase to fund the principal amount of the purchase price and set aside any land trust grant funds to assist in paying down future debt service (interest payments), which in large part could be covered by the town's share of the LCHIP match (***Susan Slack - research any necessary modifications to Chapter 33 of NH Statutes for town governments engaging in installment purchases, specifically, the feasibility of utilizing the NH Municipal Bond Bank for purchasing STRIPS on behalf of town governments***).

As *Figure 8* illustrates, a property with an appraised easement value of \$600,000 could be discounted to \$400,000, and therefore could be acquired for an upfront cost of \$200,000, leaving \$400,000 available for other acquisitions in a given fiscal year. With LCHIP contributing 50% of the appraised easement value, \$100,000 would be left over, even with the purchase of Zeros along with fifteen years of interest payments, to apply towards another acquisition by the Town. It is a win-win situation for both the Town and LCHIP, not to mention the landowner, who will collect \$300,000 in tax-free interest payments in addition to \$400,000 in principal. Because the landowner was able to sell the easement at a discount, he or she could seek a federal tax deduction for a bargain sale, adding significantly more value to the deal.

The duration of the IPA, the amount of discount, and the interest rate can all be calibrated to achieve the desired results. Negotiating a longer maturity date for the IPA means a lower cost of Zeros and therefore more leveraging potential for engaging in numerous acquisitions in a given fiscal year, but it also means more debt service on the backend, which needs serious consideration if LCHIP is funding 50% of the acquisition cost. Although requiring a higher percentage of landowner discounting may likewise mean more leveraging ability, it also may necessitate offering a higher interest rate to landowners in order to compel them to participate, which has the same result of more debt service.

A simple rule of thumb for navigating the myriad choices of IPA terms is to ascertain the average percentage of fair market value paid for a cash easement offer and not to exceed this percentage with both principal and interest paid under an IPA (*Figure 9*). As previously mentioned, several farmland preservation programs in the Mid-Atlantic did not fully consider the long term debt service implications of Traditional IPAs and had to stop buying new easements until some of that debt service was paid down. Requiring landowner discounting to a greater degree would have remedied this. Thus, it is recommended that a Discounted IPA Program be the model IPA approach in New Hampshire, where careful consideration must be made to achieve the proper balance between amount of discount necessary to compel the landowner to sell an easement versus the initial and final costs to the town that is purchasing it.

### *Role of Land Trusts*

Whereas land trusts have played a major role in land conservation efforts in New Hampshire, it is not feasible for them to engage in IPA transactions on their own. Rather, their role could be one of contributing funds and conservation expertise in these acquisitions, serving as a co-holder or holder of an executory interest. A major impediment to land trusts acting independently in acquiring IPA is the issue of tax-exempt interest payments, since only state and local government bonds are tax-exempt. Since land trusts are not political subdivisions, their debt would have to be issued on behalf of state or local governments to qualify as tax-exempt.<sup>18</sup> Perhaps as important is the issue of land trusts being unable to pledge their full faith and credit (based on their power to tax) to make sure landowners will receive their interest payments in years to come. Thus, if land trusts desire to play a role in IPA, it is suggested that they help raise funds to assist in paying down the debt service, which was described in the LCHIP/Town Government

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<sup>18</sup> See § 1.103-1 of the Treasury Regulations and IRS private letter rulings, which can be found in part at <http://www.irs.gov/taxexemptbond/article/0,,id=134366,00.html>

methodology in the preceding paragraphs. In essence, land trusts would continue to do what they have been doing well in New Hampshire for years.

### *Role of State Government*

Some state agencies charged with conservation missions have dedicated funding sources, albeit modest, such as the New Hampshire Fish and Game Department. Although some acquisitions have been funded with 100% state revenues, it is more common for projects to be funded with any combination of local, state, federal, and private funds. In these instances, it is suggested that IPA acquisitions take place on the local level through a conduit such as the New Hampshire Municipal Bond Bank. An alternate model for state agencies using their own funds or, if deemed acceptable by federal agencies, a combination of state and federal funds, is to utilize the New Hampshire State Treasurer's Office for a bonding conduit (*Susan Slack--research enabling legislation.*) The state agencies would retain autonomy of the selection and funding of projects, but the Treasurer's Office would provide much needed financial expertise in purchasing the securities from brokers and making the semi-annual interest payments and balloon principal payment to landowners as paying agent.

### *Approach to Fee Simple Acquisitions*

Just as land trusts' involvement in land conservation has been a part of the culture in New Hampshire for over one hundred years, so too has public land been a part of the conservation equation. Fee simple acquisitions of property interests funded by IPA have been few and far between, but they are possible, and this approach holds great promise in the Granite State. Given that acquiring fee interests is necessarily more expensive than acquiring less than fee (easement) interests, it is prudent that as much leveraging take place as possible. Although the benefits under an IPA are nearly the same to the landowner as an easement acquisition would be, the approach needs to be different on the conservation organization's end. Specifically, there has to be caution concerning the private use of public land acquired with bonds, which, under certain circumstances, would disqualify the interest earnings as tax-exempt. Guidance for using IPA for fee simple acquisitions is provided via an IRS Private Letter Ruling (*Figure 10*).<sup>19</sup>

## **Conclusion**

While IPAs have not been used to a great extent north of the Mason-Dixon Line, they are ideally suited to the culture of New Hampshire, where taxes remain a concern for the landowner, while funding remains a concern for the State and its municipalities. IPA are not an elixir for poor land use planning or inadequate land conservation funding, but they help to stretch limited dollars, particularly when landowner discounting is part of the equation. Like any perpetual conservation easement, landowners should hire a financial advisor to ascertain if it is a proper fit for their long range plans; because of the various tax implications of IPA, it is particularly prudent that financial advice is sought. Nevertheless, it quickly becomes apparent that IPA are a financially attractive approach from both a cash flow as well as a tax benefit perspective. Conversely, IPAs

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<sup>19</sup> See § 141 of the Internal Revenue Code regarding private activity bonds.

are attractive to government conservation agencies and land trusts whose mission is protecting the rural landscape. It is not difficult to imagine the additional acreage LCHIP could have preserved if IPAs were utilized at the inception of the program. While implementing and committing to an IPA program is a substantial undertaking, the dividends will pay off for generations to come.