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## **Conservation easements on working lands do not reduce current property tax revenue**

Property taxes are a major source of revenue for county governments. The amount of property tax owed for a given property is based on the assessed value of the property multiplied by the property tax (or millage) rate. While millage rates are generally constant within a given county government's jurisdiction, the manner in which assessed values are computed can vary widely across different types of property.<sup>1</sup> In some cases, assessed values reflect an appraised market value, which represents what the parcel would sell for if the property were sold in an "arm's length" transaction. Although property tax regulations vary widely across the country, assessment based on market value is typically the norm for residential, commercial, and industrial properties. For other uses, such as agriculture and forestry, property tax assessments do not usually reflect the full market value of the property, but rather the level of income the property is capable of yielding in its current undeveloped use.

Conservation easements place restrictions on how a land parcel can be used, with the focus typically on restricting the ability of landowners to convert their agricultural or forest land to developed uses, such as residential housing. To the extent that future development returns are accounted for in the income stream expected to be generated by a parcel of agricultural or forest land, conservation easements may reduce the market value of the property.

As it concerns easements on working farm and forestlands, the argument that conservation easements reduce property tax revenue does not have merit when considering assessment practices for these types of land in many states, including Montana. Due to state-specific legislation enacted at different points between 1956 and 1995, in all 50 states farmland (and often forestland) is given preferential property tax treatment (Anderson and England 2014). The specific policies adopted vary from state to state, but most fall under what is known as use-value assessment (UVA). Under UVA, farmland taxes are based on a hypothetical perpetual stream of income derived solely from agricultural production, referred to as the land's "current use value" or "use value". This contrasts with a property's market value, which is based on the income generated from current and all future potential uses of the land, including those unrelated to agriculture or forestry.

A primary motivation for the adoption of UVA policies was to protect agricultural landowners from having to pay tax on the portion of their land's value attributable to future, unrealized developed uses of the land. UVA thus removes from the taxable land base the capitalized future development rents that form the basis of the value of a conservation easement that keeps land in agricultural use but protects it from future development. As a result, if an undeveloped piece of property is being assessed on use value, the portion of the property's market value that may be

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<sup>1</sup> In some areas, assessed values also vary by the type of landowner, with certain groups of owners, such as senior citizens and military veterans, receiving preferential tax treatment.

reduced by an easement has effectively already been removed from the current taxable property base of the county (Plantinga 2007; Parker and Thurman 2019).

Montana's use value legislation was passed in 1973 and applies to qualifying farm/ranch and forestland owners. Although there have been various amendments to the legislation since its adoption, the current language in the most recent Montana Code Annotated (MCA) 15-7-201 makes clear the intent of the policy:

*“Because the market value of many agricultural properties is based on speculative purchases that do not reflect the productive capability of agricultural land, it is the legislative intent that bona fide agricultural properties be classified and assessed at a value that is exclusive of values attributed to urban influences or speculative purposes.”*

Under Montana's use value assessment policy, bona fide agricultural land includes land in parcels that: (a) comprise a contiguous area of at least 160 acres of land devoted to agricultural use (growing crops or grazing livestock) or (b) comprise an area of least 20 acres and meet one of several agricultural income requirements.<sup>2,3</sup> The use value formula for farm and ranch property in Montana is based on capitalized net income from specific agricultural uses (irrigated cropland, nonirrigated cropland, and grazing land) using a statutory capitalization rate of 6.4%. Property tax assessment of forest lands in Montana are covered under a separate piece of legislation (15-44-103 MCA) that is similar in spirit to that applicable to agricultural lands.

In most states, an agricultural or forest landowner who develops their land after receiving use-value tax treatment for a period must pay some sort of development penalty, which usually represents the reduction in property tax expenses gained from participating in the program over some previous number of years. Montana, along with 20 other states (Anderson and England 2014), however, does not have this type of development penalty provision in its use-value assessment statute. Another important point concerning easements and property taxes in Montana is that an easement, in itself, is insufficient grounds for how land is classified for property tax purposes (Montana Environmental Quality Council 2010). For a reclassification to take place, the easement must be accompanied by a change in how the land is used.

Overall, when considered in light of how agricultural and forest property taxes are generally determined, the argument that conservation easements will reduce current property tax revenue is inaccurate, as most of the taxable market value of property that would be affected by an easement has already been removed from the tax base. In addition, the vast majority of conservation easements are specifically constructed to maintain farm and ranch agricultural production. Certainly, if an agricultural or forest property is not currently receiving use value treatment, property tax revenue could be negatively affected. Given the fairly wide eligibility

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<sup>2</sup> Eligibility details are provided in Montana Code Annotated 2021 15-7-202, “Eligibility Of Land For Valuation As Agricultural”.

<sup>3</sup> For additional context on potential eligibility, as of 2017, 53% of farms in Montana were made up of at least 180 acres; 69% of farms were made up of at least 50 acres; and 91% of farms were made up of at least 10 acres (U.S. Department of Agriculture 2019). A more refined breakdown of farm size based on eligibility under Montana's statute is not available due to how the data are aggregated in the U.S. Department of Agriculture's Census of Agriculture.

requirements under Montana's program, however, it seems unlikely that easement adoption would have a any real impact on current property tax revenue being generated from working agricultural and forest lands. As it relates to future tax revenue, the potential impacts of easements are less clear. If land that receives an easement would otherwise have been developed at some point in the future, then the direct contribution of that property to the future tax base will be reduced.<sup>4</sup> However, previous research has suggested that proximity to land conserved through easements can increase the market value of nearby homes (Reeves et al. 2018). If easements are providing the types of open space and scenic views valued by real estate market participants, they have the potential to be self-financing or at least partly compensate for the potential reduction in future property tax revenue. Research on the self-financing potential of easements in Montana is lacking, however, due to the fact that it is a non-disclosure state, which restricts the ability of researchers and the general public to access information on property transactions.

### **Conservation easements enhance the liquidity of landowner wealth**

Farmland is a fundamental input to agricultural production and represents the primary store of wealth for many producers. The financial significance of agricultural land is difficult to overstate. Farm real estate (land and farm-related buildings) routinely accounts for at least 80% of total asset value on the balance sheet of the U.S. farm sector (U.S. Department of Agriculture, Economic Research Service 2021). Producers who own land often use it as collateral in securing operating loans to finance various farm-related investments, such as land expansion, machinery and equipment purchases/upgrades, and adoption of new or alternative technologies. In 2017, 72% of all interest expenses paid by Montana producers came from loans secured by real estate (U.S. Department of Agriculture 2019). The ability to secure a loan through real estate is particularly important for new and beginning farmers and ranchers, who often lack the credit history and ability to make down payments that lenders require to initiate an operating loan.

Although many farmers use their existing land capital to secure loans, there is uncertainty over the extent to which the land appraisals used by lenders account for future nonagricultural returns that are capitalized into the market value of land. For landowners located in an urbanizing area, future development returns can make up a sizable fraction of land-related wealth (Plantinga et al. 2002). If banks and other financial institutions do not account for this future development-oriented equity when making collateral-based loans, this portion of a landowner's wealth can be considered illiquid from a farm operation standpoint, in the sense that the only way a farmer can access it is by selling their land on the open market. Lenders may deliberately not account for these future development returns, or may discount them heavily, if they are viewed as being too risky or volatile as a source of collateral. To the extent that the value of a conservation easement reflects the future development value of a parcel of land, easements can correct this credit market inefficiency by allowing landowners to access the capitalized value of the foregone development potential of their land (Duke et al. 2016).

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<sup>4</sup> Predicting the total net effect of easements on future local public revenue is more complex, however, because development will increase the costs of county-provided public services, such as public education, law enforcement, fire protection.

Several studies point to patterns indicating that the financial proceeds from easements are reinvested back into farm operations. Based on a national survey of 479 landowners, Esseks and Schilling (2013) report that 84% of surveyed landowners who participated in the Federal Farm and Ranch Protection Program, a USDA program where the federal government partly finances the purchase of easements by land trusts, reinvested at least part of the easement proceeds back into their operation.<sup>5</sup> Other survey efforts yield qualitatively similar results suggesting that many participating landowners use the financial incentives that accompany easements to invest in existing farm operations (Duke and Ilvento 2004; Lynch 2007; Clark 2010). University extension reports also highlight reinvestment of the financial capital from farmland easements as a potential benefit to participating landowners (Keske et al. 2007).

To date, there is fairly little direct evidence on how agricultural lenders operate in a peri-urban setting where farmland owners face pressure to develop their land. In such settings, producers may need to invest more heavily in their operation in order to make their farm-related economic returns competitive with the financial gains from selling land to a developer. In the only analysis to date that directly explores the idea that easements may overcome a credit market inefficiency in urbanizing settings, Duke et al. (2016) provide some evidence that some farm operators used conservation easements to make reinvestments in farm operations that otherwise may not have occurred. The Duke et al. (2016) study, however, should be interpreted as providing suggestive evidence consistent with the idea that easements may relieve a credit market constraint, rather than definitive proof this is occurring. In sum, there is intuitive appeal to the idea that conservation easements are used as a financial tool to invest in farm operations at the rural-urban fringe, but more research is needed to fully investigate this potential role of easements.

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<sup>5</sup> The 2014 Farm Bill consolidated the Farm and Ranch Lands Protection Program, Wetlands Reserve Program, and Grasslands Reserve Program into what is now known as the Agricultural Conservation Easement Program.

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