

TECHNICAL MEMORANDUM

To: Leslie Little, City of Morgan Hill

From: Teifion Rice-Evans and Rebecca Benassini,
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House Agricultural Consultants

Subject: Draft Morgan Hill Agricultural Mitigation Fee Nexus Study;
EPS#12116

Date: December 2, 2013

The Economics of Land Use



This memorandum provides the technical documentation to support the establishment of a City of Morgan Hill Agricultural Mitigation Fee. The memorandum includes the policy context for fee adoption, the fee program parameters identified by City staff, the assumptions and analysis used to determine the mitigation fee level, and the nexus findings to support fee adoption. This technical memorandum was developed under the direction of and with input from City staff, including legal counsel. This technical memorandum is intended to support agricultural mitigation fee adoption through the City's Agricultural Mitigation Fee Ordinance and Resolution.

This memorandum is divided into five sections: (1) summary of findings; (2) background; (3) nexus findings; (4) fee program parameters; (5) mitigation cost estimates; and (6) fee calculation and updating.

Appendix A provides the detailed assumptions and analysis used to develop the planning level estimates of agricultural easement acquisition costs.

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Summary of Findings

The City of Morgan Hill is proposing to adopt an agricultural mitigation program that requires mitigation at a ratio of 1:1, meaning one acre of in-perpetuity farmland preservation (along with necessary funding for stewardship and program administration) for each acre of farmland development/conversion.¹ Developers can either mitigate at a 1:1 ratio on site and pay the stewardship fee or can pay a land mitigation fee in-lieu of the on-site set-aside and pay the stewardship fee. The mitigation fee will be applied to conversion of all farmland captured under the Department of Conservation categories of prime farmland, farmland of Statewide importance, and farmland of local importance. The fee levels developed in this technical study are shown in **Table 1**.

Table 1 Agricultural Mitigation Fee Per Developed/Converted Acre

Fee Component	Fee Level (1:1 mitigation ratio)
Easement Acquisition	\$12,750
Transaction Costs ¹	\$255
City Fee Program Admin. ²	\$255
Subtotal – Land Fee	\$13,260
Stewardship ³	\$1,665
City Fee Program Admin. ²	\$35
Subtotal – Monitoring/Outreach Fee	\$1,700
Total Mitigation Fee	\$14,960

- (1) Easement transactions costs assumed at average of 2.0 percent per transaction.
- (2) Cost to City administering fee program, including collection, reporting, and updating costs estimated at additional 2.0 percent of base cost for each fee program element (i.e. easement acquisition; monitoring/outreach).
- (3) Represents sufficient funding to generate an average of about \$50 per acre per annum in perpetuity in interest payments.

Background

The Open Space and Conservation Element of the City of Morgan Hill General Plan, adopted in July 2001, includes the goal of a “viable agricultural industry”. Associated with this goal are a series of policies and actions. Selected agricultural policies and actions include:

¹ The City of Morgan Hill initially explored the possibility of purchasing mitigation in both the Morgan Hill and Gilroy areas at different land ratios. In response to comments from the community at large, the conservation/mitigation program was established with a single mitigation ratio of 1:1.

- **Policy 3a.** Support programs and techniques, including conservation easements and purchase of development rights to encourage the retention of agricultural activities and to minimize conflicts in transition from agriculture to urban uses.
- **Policy 3j.** Maintain the economic viability of agriculture using a variety of methods, such as: contiguous urban development, the designation as agricultural lands those lands that are outside of planned urban areas, minimum lot size designations in agricultural areas, the limitation of land uses in agriculturally designated areas to agriculture and uses necessary for the support of agriculture, and the encouragement of direct marketing methods.
- **Policy 3k.** Establish areas for permanent preservation of agricultural lands and programs to accomplish that objective, such as exclusive agricultural zoning, transfer of development rights programs, and right to farm legislation.
- **Policy 3l.** Preserve some prime agricultural lands in South County for agricultural use through appropriate agricultural land preservation tools, such as exclusive zoning, transfer of development rights programs, and right to farm legislation.
- **Policy 3p.** Convert agricultural land that has been designated for urban growth in an orderly manner to retain stability and viability of remaining agricultural land as long as possible.
- **Action 3.1.** Use a variety of techniques to protect agricultural land, including land use regulation, urban development policy, conservation easements, and transfer or purchase of development rights.

Since the initial adoption and publication of the 2001 General Plan, the City of Morgan Hill has explored available techniques to support the goal of a viable agricultural industry, including the adoption of an agricultural mitigation program. In November 2006, the City Council directed staff to develop a set of City-wide policies that would address the conversion of agricultural and open space lands. In January 2008, City staff published an Agricultural Mitigation Working Paper, envisioned as "the first step towards development of a City-wide program for the mitigation of the significant loss of agricultural land."

As a next step, in 2009/2010, the City of Morgan Hill directed a consulting team to evaluate agriculture viability within the Morgan Hill Sphere of Influence (SOI) over the long term as well as the development feasibility challenges and limitations associated with requiring mitigation in the Southeast Quadrant of the City. The consulting team concluded that agriculture was viable over the long term if agricultural land were preserved and that the cost of acquiring new agricultural conservation easements in the Southeast Quadrant was likely to be significant. Based on the technical analysis and a number of meetings between the consulting team and City staff over the 2010/2011 period, a public review draft entitled Morgan Hill Agricultural Policies and Implementation Program (December, 2011), including recommendations for an agricultural mitigation program, was published for review and comment by the community. Subsequent to further consideration by City staff and feedback from stakeholders and the community, the City has decided to adopt an agricultural mitigation program, with some refinements from the program outlined in the public review draft. The public review draft also outlined a series of General Plan policy and action recommendations for potential inclusion in the General Plan update.

Nexus Findings

The Agricultural Mitigation Program will require new development and other activities resulting in the conversion of agricultural land to either: (1) provide the City with an agricultural conservation easement on a portion of the agricultural land within the proposed development area and pay the Monitoring/Administration component of the Agricultural Mitigation Fee or (2) pay an Agricultural Mitigation Fee that will allow the City to acquire agricultural conservation easements on other agricultural land and to fund the associated mitigation program monitoring and administration.

The nexus findings for this fee program are provided below and address: (1) the ***purpose*** of the fee, (2) the specific ***use*** of fee revenue, 3) the ***relationship*** between the type of development and the fee's use, (4) the ***need*** for the fee revenue, and (5) the ***proportionality*** between the amount of the fee and the cost specifically attributable to new development.

Purpose

The City of Morgan Hill General Plan policy goals include supporting a vital agricultural industry and preserving agricultural land. The agricultural mitigation program and the agricultural mitigation fee as a part of this program will support these goals. In addition, the mitigation program will help meet the Santa Clara County LAFCo guidelines concerning farmland conversion and annexation in the County as well as to help address agricultural impacts identified by CEQA, recognizing that full mitigation of agricultural conversion is not feasible.

Use of Fee

Fee revenues will be used to preserve agricultural farmland in perpetuity and to cover the costs of the fee program. This will include the acquisition of agricultural conservation easements and the on-going monitoring of these easements along with the administration of the fee program (costs of collecting fees, reporting on fee use, and updating fees).

Relationship

Mitigation requirements and the agricultural mitigation fee will only apply to new development that converts agricultural land. As a result, there will be a direct relationship between the development/conversion activities that pay the fee and the use of the fee for agricultural land preservation purposes.

Need

The ongoing conversion of farmland in Morgan Hill, by permanently removing land from agricultural production, creates challenges to farmland operations in and around Morgan Hill. City policies, State law (CEQA), and Santa Clara County LAFCO guidelines call for agricultural mitigation or support as new development and annexations occur in the City of Morgan Hill. The agricultural mitigation program and associated fee, by helping to permanently protect areas of farmland, will support the continuation of agriculture in the region.

Proportionality

The agricultural mitigation program requires mitigation for farmland conversion at a ratio of 1:1. The payment of the agricultural easement acquisition component of the fee (where the developer does not elect to set aside agricultural land) as well as the payment of the monitoring/administration portion of the fee are both tied to (1) this mitigation ratio and (2) planning level estimates of the average per acre cost of acquiring an agricultural conservation easement and of monitoring/administering the agricultural mitigation program. As such, there is a direct and

proportional relationship between the impact of a development project on farmland and the level of the mitigation fee.

Fee Program Parameters

The nature of the fee program and the underlying drivers of the fee level are directly tied to the purpose of the fee program, the associated definition of the program parameters, and pertinent legal, regulatory, and policy requirements/guidelines. In addition to legal and regulatory requirements, the fee program parameters were developed based on, but not limited to, outreach to landowners and the broader community conducted by City staff, the approaches of other California jurisdictions, the California Environmental Quality Act treatment of farmland conversion, and Santa Clara County LAFCo agricultural preservation policies.

- **General Concept.** The primary purpose of the agricultural mitigation program is to support the City's goals of supporting a vital agricultural industry by helping to secure permanent protection for selected agricultural lands. In addition, the agricultural mitigation program seeks to respond, as possible, to the relevant requirements for agricultural mitigation under the California Environmental Quality Act (CEQA) and to the Santa Clara County LAFCo guidelines on farmland conversion.
- **General Structure.** Developers will have the option of dedicating an agricultural easement on site or paying an agricultural mitigation fee to cover the costs of acquiring an agricultural conservation easement of other agricultural land. In addition, all forms of farmland conversion will pay a fee to support the monitoring of the agricultural easements (whether dedicated or supported through fee payment) as well the administration of the agricultural mitigation program. Fee revenues paid for agricultural preservation will be used for the acquisition of agricultural easements on a voluntary basis from agricultural landowners.
- **Activities Affected.** All new development/activities under the jurisdiction of the City of Morgan Hill that directly result in the conversion of farmland will be included in the agricultural mitigation program. It does not matter whether the converted land has or has not been used for agriculture.
- **Definition of Agricultural Land.** For the purposes of this fee program, agricultural land is defined as land meets the Santa Clara County definition of Prime Farmland, Unique Farmland, or Farmland of Statewide Importance as interpreted by the USDA-NRCS. This is basically the same as the agricultural land addressed in Appendix G of the CEQA guidelines.
- **Definition of Agricultural Easement.** At the conclusion of the mitigation process, the agricultural mitigation land will be encumbered with a conservation easement similar in all essential details to the California Model Agricultural Conservation Easement.² This easement prohibits subdivision, urban development, and non-agricultural uses. It is assumed that one area of the property is cut out from the easement where existing improvements are located or where future improvements, such as a home or agricultural structures, could occur. The allowable improvements will need to be consistent with existing zoning. The easement will effectively prohibit uses that hamper agricultural use, though will not require the land to be farmed.

² See www.conservation.ca.gov/dlrp/cfcp/overview/Pages/cfcp_model_easement.aspx

- **Easement Value.** The agricultural easement acquisition component of the mitigation fee is based on a current estimate of the average value of agricultural easements at the time of the fee study. The actual sales price of agricultural easements will be based on individual negotiations between the implementing entity and the landowner and on appraisals of value at that time. All easement acquisitions will be on a voluntary basis and purchased from willing sellers only.
- **Mitigation Ratio.** The mitigation ratio will be set at 1:1. In other words, for every acre of important farmland converted, the mitigation program, and associated mitigation fees, will need to result in the permanent preservation of an acre of agricultural land through an agricultural easement along with a proportionate contribution to the resources required to monitor the easement and administer the program. This mitigation ratio is consistent with the Santa Clara County LAFCO Agricultural Mitigation guidelines and is the most common mitigation ratios used by other California City/County agricultural mitigation programs.

The City of Morgan Hill initially explored the possibility of purchasing mitigation in both the Morgan Hill and Gilroy areas at different land ratios. For example, if the mitigation occurred in Morgan Hill, the ratio would have been 0.5 acre conserved to 1.0 acre converted. If proposed in Gilroy, the mitigation ratio would have been 2 acres conserved to 1 acre converted. This formula was intended to create a framework for the encouragement of agricultural conservation near Morgan Hill, where Morgan Hill residents would most benefit. In response to comments from the community at large, there was an expressed desire that the conservation/mitigation program be established at a ratio of 1:1. While this ratio responds to public policy from LAFCO and commenting interests, it recognizes that mitigation may not take place in the Morgan Hill target area where the cost of property per acre is several times more expensive.

- **Agricultural Land Preservation.** Mitigation fee revenues for agricultural easements will be used to acquire easements on farmland in Santa Clara County. The agricultural mitigation land will have equal or better soil quality and equal or better access to water and sufficiency of water relative to the converted agricultural land.³

Mitigation Cost Estimates

Along with the fee program parameters, the cost assumptions are the other critical component that determines the level of the fee. This section summarizes the cost assumptions and estimated mitigation costs. Mitigation costs include the costs of securing the agricultural easements (where set-asides are not provided) and the costs to cover easement monitoring/outreach in perpetuity as well as the administrative costs of covering the fee program.

Easement Acquisition Costs

Appendix A provides the detailed analysis and development of the planning-level value estimate of the average cost of acquiring an agricultural conservation easement in Santa Clara County. As described in **Appendix A**, agricultural easement values will vary for different locations in the

³ Equal or better soil quality defined by the Code of Federal Regulations Title 7, Part 657 (see <http://soils.usda.gov/technical/handbook/contents/part622.html>, Exhibit 622-1) and as interpreted by the USDA-NRCS.

County with easements on agricultural land surrounding Morgan Hill substantially more costly than easements in the Gilroy area. For the purposes of fee setting, because the fee program parameters allow for the use of fee revenues to acquire easements on farmland throughout Santa Clara County, the estimated easement acquisition costs in the farmland around Gilroy are used as the basis of the fee. As described in **Appendix A**, the agricultural easement cost is the difference between the fee title value of the land and the value of the land once it is encumbered with an agricultural easement.

Table 2 Per-Acre Easement Acquisition Costs

	Formula	Average Per Acre Value
Fee Title Value	A	\$25,500
Encumbered Value @50%	$b = a * 50\%$	\$12,750
Easement Value	$c = a - b$	\$12,750
Acquisition Cost (1)	$d = c * 1.02$	\$13,005

(1) Includes 2 percent transaction cost.

As shown in **Table 2**, House Agricultural Consultants estimated an average planning-level value of \$25,500 per acre for fee title acquisitions of farmland in the Gilroy area. Their research on typical easement costs as a percent of fee title value revealed a typical range from 15 percent to 75 percent, with 50 percent considered an appropriate estimate for southern Santa Clara County. As a result, the easement cost of agricultural conservation easements in the Gilroy area was estimated at \$12,250 and the encumbered land value (value of land once easement is in-place) was also estimated at \$12,250.

In addition to the expected, average easement cost of \$12,250 per acre, an additional transaction cost will be incurred. The transaction cost will include costs associated with due diligence on potential sales, obtaining an appraisal, and drawing up the easement documents among others and typically represents about 2.0 percent or more of the easement acquisition cost. As a result, transaction costs are estimated at an average of \$255 per acre for a total acquisition cost of \$13.005 per acre.

Other Costs

The other costs associated with an agricultural conservation easement program are associated with the stewardship of the agricultural mitigation program and the management of the fee program. Stewardship costs typically include administrative costs, monitoring costs, landowner interaction costs, and contingencies. For the purposes of this fee study, these additional costs associated with the mitigation program are divided into stewardship costs and fee program administrative costs.

Stewardship Costs

Per-acre stewardship (monitoring/outreach) costs vary substantially by program and depend both on the types of activities required of the implementing entity, the levels of interaction with and outreach to landowners owning encumbered land, and the scale of the mitigation program and the associated economies of scale. Stewardship costs associated with different types of mitigation and preservation programs show a broad range of annual stewardship costs from as

low as \$20 per acre to as high as \$1,000 per acre.⁴ In the case of the City of Morgan Hill agricultural mitigation program, the agricultural nature of its mitigation program will push its per acre figure towards the lower end, while the relatively modest scale of the program will push the per acre costs up. At this point in time, an average annual monitoring/outreach cost of about \$50 per acre is likely a modest and appropriate level of funding.

The establishment of an interest-bearing, non-depleting endowment will ensure that these costs can be met on an annual basis. Consideration of the assumptions being used by other mitigation and conservation programs in California concerning the long-term, average net real interest rate suggests that an of 3 percent might be obtained from the establishment and investment of an endowment. Using this interest rate to capitalize the annual monitoring/outreach costs results in a total monitoring/outreach cost of about \$1,665 per acre.

Fee Program Administration Costs

Mitigation fee program administration requires fee collection and disbursement, annual reporting, and periodic updates. These fee administration costs can be covered in the mitigation fee. California jurisdictions often add between 1 percent and 3 percent for fee program administration. Consistent with this range, the City of Morgan Hill will add a 2 percent to the base fee for administration. As a result, for those paying the land portion of the fee, there will be an additional \$255 per acre fee (administration charge is not applied to the transaction cost portion of the fee), while for all conversions of agricultural land, there will be an additional \$35 per acre fee associated with.

Fee Calculation and Updating

Based on the per acre cost estimates and the fee program parameters described above (including the 1:1 mitigation ratio), the per acre mitigation fee is the same as the per acre mitigation cost. The agricultural mitigation fee schedule is shown below. All conversions of agricultural land will be required to pay the \$1,700 per acre stewardship fee, with the option of then setting aside land at a 1:1 mitigation ratio on-site or paying the additional mitigation fee of \$13,260 associated with funding an agricultural conservation easement purchase.

Table 3 Agricultural Mitigation Fee per Developed/Converted Acre

Fee Component	Fee Level (1:1 mitigation ratio)
Easement Acquisition	\$12,750
Transaction Costs ¹	\$255
City Fee Program Admin. ²	\$255
Subtotal – Land Fee	\$13,260
Stewardship ³	\$1,665

⁴ E.g. the 2004 report prepared by the Center for Natural Lands Management surveyed 28 preserves in the western United States to evaluate stewardship costs. The report found that the average annual management cost ranged from \$25 per acre to \$1,000 per acre, with an average of about \$51 per acre.

City Fee Program Admin. ²	\$35
Subtotal – Stewardship Fee	\$1,700

Total Mitigation Fee	\$14,960
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- (1) Easement transactions costs assumed at average of 2.0 percent per transaction.
- (2) Cost to City administering fee program, including collection, reporting, and updating costs estimated at additional 2.0 percent of base cost for each fee program element (i.e. easement acquisition; monitoring/outreach).
- (3) Represents sufficient funding to generate an average of about \$50 per acre per annum in perpetuity in interest payments.

Fee Update Procedure

The agricultural mitigation fee estimates developed in this technical study provide estimates of the per acre cost of meeting the mitigation requirements 2013 dollar terms based on information available. Over time, inflation and market cycles will affect mitigation costs. In addition, program-specific evidence will be obtained concerning the costs of stewardship, fee program administration, and agricultural easement acquisitions. For these reasons, a fee updating process is important. Consistent with many other mitigation programs, a two-component updating process is suggested. This includes annual adjustment to the agricultural mitigation fee based on a measure of inflation, the Consumer Price Index (CPI) (the CPI is published monthly by the Bureau of Labor Statistics and is a measure of the average change over time in the prices paid by urban consumers for goods and services.) The CPI for the western region will be used to update both components of the agricultural mitigation fee every six months.⁵ Every three years, rather than automatically updating the agricultural mitigation fee based on the CPI, a more detailed review of the fee program will be conducted. The fee review will consider the actual costs incurred by the implementing entity and compare them to the current fee levels. If there is sufficient program data available, the mitigation fee will be updated based on the actual experience. If the information is limited or insufficient to draw broad conclusions the CPI will continue to be used until the next more detailed periodic fee update.

⁵ Consumer Price Index – All Urban Consumers, West Region, <www.bls.gov>.

APPENDIX A:

Agricultural Conservation Easement Cost Estimates and Assumptions

Appendix A
Morgan Hill Nexus Study
Estimated Cost to Acquire an Agricultural Conservation Easement
in Southern Santa Clara County
by
House Agricultural Consultants
December 20, 2012
revised December 2, 2013

Revision note: This report was originally prepared on December 20, 2012 based on information researched at that time. No new data has been developed for this revision; the purpose of this revision is to reinterpret the 2012 data in light of Morgan Hill's decision to seek a 1:1 mitigation strategy for agricultural land conversion as described below. This revision remains in conformance with the assumptions noted in the October 28, 2012 memorandum from House Agricultural Consultants to the City of Morgan Hill and Economic Planning Systems regarding real property and conservation easement characteristics for mitigation of agricultural land in Morgan Hill. This memorandum is appended to this study document.

Summary

Our research indicates that the cost to acquire an agricultural conservation easement in the Morgan Hill area would cost approximately \$47,500 per acre, and in the Gilroy and Hollister area approximately \$12,750 per acre. These estimates are based on our finding that conservation easements in the Morgan Hill and Gilroy area are likely to trade at approximately one-half of the fee simple value of the real estate, as discussed in this report.

The City of Morgan Hill has expressed its desire to explore the possibility of purchasing mitigation in both the Morgan Hill and Gilroy areas at a 1:1 ratio (that is, one acre conserved via an agricultural conservation easement for each one acre of agricultural land converted to urban use). Therefore the values noted in the preceding paragraph are appropriate in planning for the proposed mitigation program.

Land Values in the Morgan Hill Area

Our research indicates values for raw land *unencumbered* by a conservation easement (also referred to as the “fee simple” value) to range from approximately \$50,000 per acre to \$140,000 per acre in the Morgan Hill area. Table 1 lists 9 recent sales in the Morgan Hill area (see Map # 1) which have been selected from a compilation of over 50 transactions between 2010 and now. A simple mathematical average of the two range parameters is \$95,000 per acre.

Land Values in the Gilroy Area

Our research indicates values for fee simple, raw land unencumbered by a conservation easement to range from approximately \$15,000 per acre to \$36,000 per acre in the *agricultural area* of Gilroy. We have excluded sales overly influenced by urban development as being inappropriate for this study, as the point is to find and conserve land that can viably remain in agriculture. Table 2 lists 8 recent sales in the Gilroy area which have been selected from a compilation of over 25 transactions between 2010 and now. A simple mathematical average of the two range parameters is \$25,500 per acre.

Land Values in the Hollister/San Juan Bautista Area

The Hollister and San Juan Bautista area of San Benito County is the closest agricultural area to Morgan Hill, excluding Gilroy; this area continues to have intensive agricultural production and is therefore useful as a second look at local agricultural land values. We therefore examined sales transactions in this area as a check on the agricultural land values found in the Gilroy area.

Our research indicates values for raw land unencumbered by a conservation easement to range from approximately \$17,000 per acre to \$32,000 per acre in the *agricultural area* of Hollister and San Juan Bautista. Table 3 lists 6 recent sales in the Hollister/San Juan Bautista area between 2008 and now. A simple mathematical average of the two range parameters is \$24,500 per acre. This finding is therefore supportive of the finding of \$25,500 per acre average for Gilroy of current agricultural land value.

Cost of Agricultural Conservation Easements

To estimate the cost of acquiring an agricultural conservation easement in either the Morgan Hill or Gilroy area, we conducted several lines of investigation. Our first line of inquiry was to search for agricultural conservation easement purchases in the southern Santa Clara County area. This being very limited (we found one), in our second line of inquiry we broadened the search to other counties, eventually examining conservation easement purchases in 7 northern and central California counties. Table 4 lists 23 agricultural conservation easements in these 7 counties occurring over a 12 year period. All of the properties conserved are classed as prime farmland by United States Department of Agriculture (USDA) criteria. Their size varies from 49 to 928 acres. For the most part the properties were being used for row crop farming, similar to the land uses in the Gilroy and Hollister areas (Morgan Hill has somewhat more tree crops but is generally similar as well).

The threat to agricultural continuity by urban development is estimated in Table 4 for the 23 easements listed as either "Medium" or "High". We place Morgan Hill in the "High" range, and therefore place more emphasis for this study on those easements characterized as having a "High" threat.

Easement Cost Calculated by a Percentage Method

In the absence of sufficient agricultural conservation easement transactions in southern Santa Clara County, in Table 4 we have calculated the ratio of the easement cost to the land value before the easement encumbrance as an indicator of what is likely to prevail for the local southern Santa Clara County area. The 23 transactions in seven counties indicate a range of 15.6 percent to 73.3 percent for the ratio of conservation easement cost to raw, unencumbered land value. In applying this to southern Santa Clara County, we tend toward the higher end, as southern Santa Clara County is experiencing a very strong threat to the continuance of agriculture. We find that 50 percent is the likely average to be encountered by the City of Morgan Hill as the easement acquisitions get underway.

Applying this 50 percent diminution in value to the Morgan Hill land average of \$95,000 per acre yields an estimated agricultural conservation easement cost of \$47,500 per acre in Morgan Hill; applying the 50% diminution in value to the Gilroy land average of \$25,500 per acre yields an estimated agricultural conservation easement cost of \$12,750 per acre in Gilroy.

Easement Cost Estimated by an Income Approach

A third line of inquiry to estimate the cost of agricultural conservation easements in southern Santa Clara County is a more traditional Income Approach appraisal method. We have examined a set of eight properties on which conservation easements have been placed, their agricultural income (as rent) is known, and their conservation easement encumbered land value is known (the land was sold shortly after the placement of the conservation easement). From these eight properties actively being used for agriculture after the imposition of the easement, we derived a capitalization rate range of 2.3 percent to 5.6 percent; and from this range selected 5.0 percent as the most appropriate for the study at hand.

We conducted another survey to estimate current agricultural rents and landlord expenses in southern Santa Clara County. The results indicate a rent range of \$450 to \$1,200 per acre for prime farmland in the Gilroy and Hollister/San Juan Bautista areas. Through calculation and comparison of these local farm properties we estimate \$650 per acre as the current typical net rent figure (net of taxes and other landlord expenses). The capitalization rate of 5.0 percent is then divided into the net rent of \$650 per acre, yielding a value indication of \$13,000 per acre for the agricultural conservation easement encumbered land. This is reasonably close to the \$12,750 per acre land value indicated by the percentage method calculated above for Gilroy, and supportive of that finding.

Conclusion

We have established that the fee value of land in the Morgan Hill area suitable for purchase of agricultural conservation easements is approximately \$95,000 per acre and in the Gilroy area is approximately \$25,500 per acre.

As discussed in this report, applying the estimated ratio that agricultural conservation easements in this area will cost approximately 50 percent of the fee value, we conclude that budgeting \$47,500 per acre for purchase of agricultural conservation easements in the Morgan Hill area, and \$12,750 per acre in the Gilroy area are reasonable figures as of December, 2012. These values can be expected to fluctuate in the future depending on both agricultural and non-agricultural factors that influence real estate values.

TABLE 1: MORGAN HILL LAND SALES

Acres	Sale Date	Price	Buildings price w/o Imps	Price/Acre	Land Use type	Zoning	Location	No. lots	Soil class	
4.65	2012-10-29	\$550,000	\$41,500	\$508,500	\$109,355	nursery & grhouses	A20A	40 Kalana Avenue	1	I
9.82	2012-07-31	\$1,200,000	\$310,000	\$890,000	\$90,631	nursery & grhouses	AW	400 Peebles Ave	1	II & III
14.23	2012-02-01	\$2,200,000	\$200,000	\$2,000,000	\$140,548	Nursery & grhouses	A40A	315 Kirby Avenue	1	I, II & III
5.00	2011-11-04	\$750,000	\$75,000	\$675,000	\$135,000	Agricultural	A20A	240 Palm Avenue	1	I
14.50	2011-06-15	\$800,000	\$0	\$800,000	\$55,172	dry land hay	A20A	San Pedro Av 800 ft west of Hill Rd	1	II
11.50	2011-04-21	\$575,000	\$0	\$575,000	\$50,000	Agricultural	A-40A	Monterey Highway	2	I
8.50	2010-08-23	\$750,000	\$128,381	\$621,619	\$73,132	Agricultural	A20A	765 Maple Ave adj Hwy 101	1	I
7.42	2010-08-12	\$540,000	\$10,000	\$530,000	\$71,429	Greenhouses	A	340 Kirby Ave just north of MH	1	I to III
8.50	2010-07-22	\$570,000	\$128,381	\$441,619	\$51,955	Agricultural	A20A	765 Maple Ave adj Hwy 101	1	I

TABLE 2: GILROY LAND SALES

Acres	Sale Date	Price	Improvements Price w/o Imps	Price/Acre	Land Use type	Zoning	Location	No. lots	Soil class	
18.53	2012-10-26	\$600,000	\$200,000	\$400,000	\$21,587	dry hay & residence	AW	2726 Ferguson Road	1	hilly
11.49	2012-05-11	\$551,000	\$151,000	\$400,000	\$34,813	row crops	AW	615 Bolsa Road	1	I
17.52	2012-04-24	\$625,000	\$65,000	\$560,000	\$31,963	row crops	AW	6780 Holsclaw Road	1	I
65.89	2011-11-30	\$965,000	\$0	\$965,000	\$14,646	Vegetable crops	AW	Fraser Lake Rd good veg land	1	II
21.60	2011-09-09	\$800,000	\$30,000	\$770,000	\$35,648	Agricultural	A40	1990 Buena Vista Avenue	1	II
10.00	2011-07-29	\$350,000	\$11,160	\$338,840	\$33,884	row crops	AW	2425 Dunlap Ave	1	I & III
14.75	2011-05-16	\$680,000	\$68,123	\$611,877	\$41,483	Agricultural	A	9480 Murray Ave	1	I
9.80	2011-01-18	\$445,000	\$135,000	\$310,000	\$31,633	Vineyard	AG-5	11395 Center Avenue	1	III

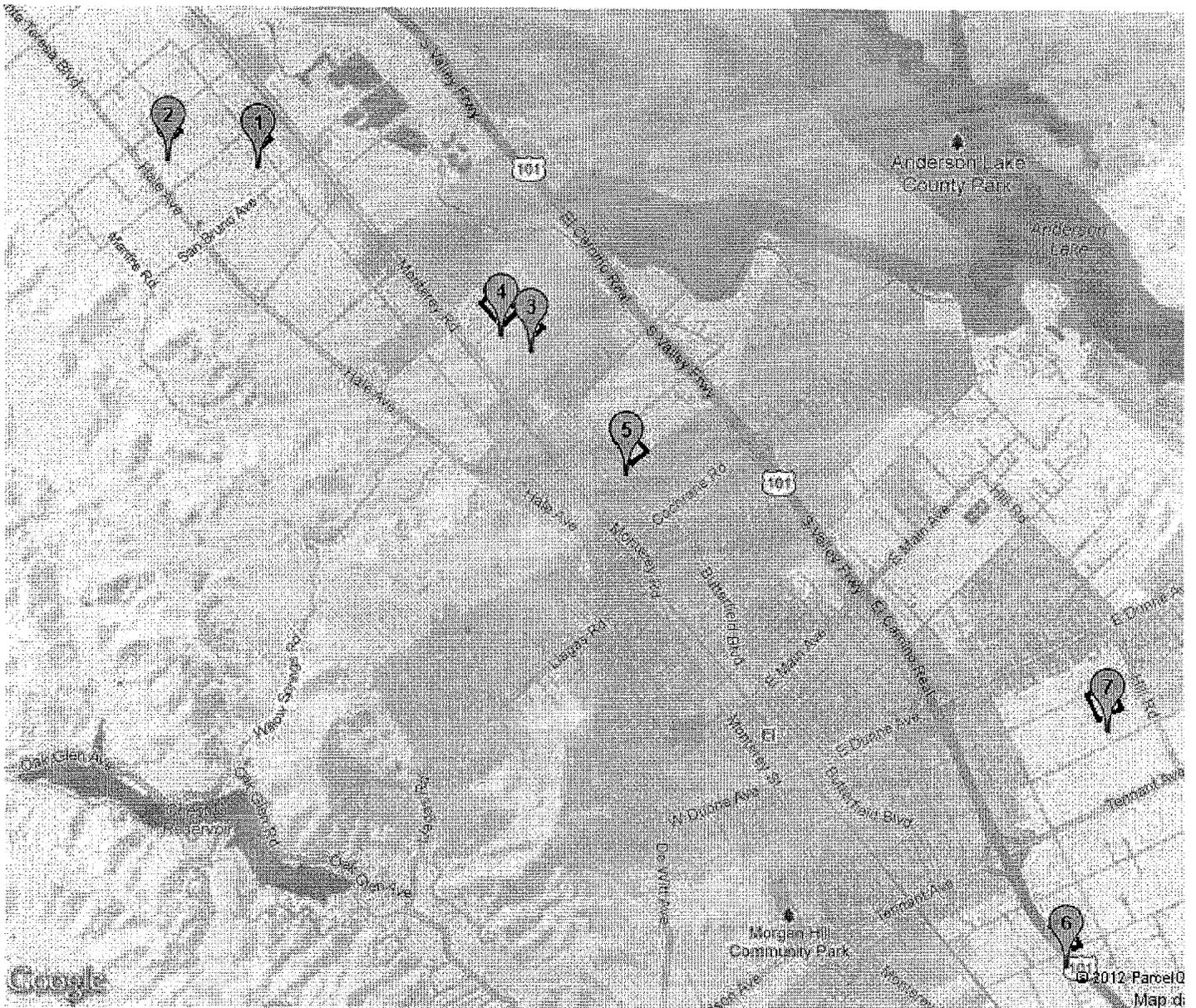
TABLE 3: SAN BENITO CO. LAND SALES

Acres	Sale Date	Price	Buildings price w/o Imps	Price/Acre	Land Use type	Zoning	Location	No. lots	Soil class	
120.90	2009-09-28	\$2,650,000	\$0	\$2,650,000	\$21,919	Vegetable crops	A5	Duncan Ave and San Justo Road San Jaun Bautista	5	I
315.70	2009-10-20	\$6,850,000	\$0	\$6,850,000	\$21,698	Vegetable crops	A5	Mission Vineyard Road, San Jaun Bautista	5 (WA)	II, III & IV
123.80	2008-03-21	\$3,714,600	\$0	\$3,714,600	\$30,005	Vegetable crops	A5	Union Rd and San Juan Hollister Highway, Hollister	1	I and II
44.70	2008-03-21	\$1,200,000	\$50,000	\$1,150,000	\$25,727	Vegetable crops	AP	811 Wright Rd, Hollister	1	I
68.54	2009-12-14	\$1,200,000	\$0	\$1,200,000	\$17,508	Vegetable crops	A5	991 San Juan Hwy, San Jaun Bautista	1	I
102.44	2008-08-29	\$3,366,000	\$100,000	\$3,266,000	\$31,882	Vegetable crops	AP	Union Road, Hollister	1	I

85% farmable

Table 4
Northern and Central California Conservation Easement Sales

Month/Year	Land Trust	County	Farmland Class	Acres	Before Value	After Value	Easement	Easement %	Threat Level	Crops
11/11	YLT	Yolo	Prime	390	\$3,800,000	\$1,550,000	\$2,250,000	59.2%	High	Row crops
09/10	YLT	Yolo	Prime	90	\$1,590,000	\$910,000	\$680,000	42.8%	Medium	Row crops
07/10	YLT	Yolo	Prime	140	\$2,615,000	\$1,600,000	\$1,015,000	38.8%	Medium	Row crops
12/08	YLT	Yolo	Prime	300.59	\$2,705,500	\$1,352,620	\$1,352,880	50.0%	Medium	Row crops
07/07	YLT	Yolo	Prime	151	\$1,385,000	\$850,000	\$535,000	38.6%	Medium	Row crops
08/12	CVFT	Merced	Prime	210	\$2,835,000	\$1,785,000	\$1,050,000	37.0%	Medium	Row crops
12/08	CVFT	Merced	Prime	211	\$3,075,000	\$1,998,750	\$1,076,250	35.0%	High	Row crops
02/07	CVFT	Merced	Prime	78	\$1,950,000	\$1,365,000	\$585,000	30.0%	High	Almonds
11/08	CVFT	Merced	Prime	244	\$2,985,000	\$1,791,000	\$1,194,000	40.0%	High	Almonds
09/07	CVFT	Merced	Prime	289	\$4,200,000	\$2,900,000	\$1,300,000	31.0%	Medium	Row crops
05/11	CVFT	San Joaquin	Prime	254	\$6,597,500	\$5,322,500	\$1,275,000	19.3%	Medium	Walnuts / Cherrys
05/10	CVFT	San Joaquin	Prime	49	\$1,170,760	\$837,093	\$333,667	28.5%	Medium	Walnuts / Cherrys
08/10	CVFT	San Joaquin	Prime	175	\$5,300,000	\$3,710,000	\$1,590,000	30.0%	High	Walnuts / Cherrys
08/10	CVFT	San Joaquin	Prime	206	\$2,685,000	\$1,745,000	\$940,000	35.0%	High	Row crops
05/10	CVFT	San Joaquin	Prime	242	\$1,934,640	\$1,209,150	\$725,490	37.5%	Medium	Row crops
05/06	San Joaquin Co.	San Joaquin	Prime	928	\$6,959,250	\$1,929,104	\$4,867,763	69.9%	High	Row crops
06/07	CVFT	Stanislaus	Prime	160	\$3,607,460	\$2,456,395	\$1,151,065	31.9%	High	Walnuts / almonds
07/08	CVFT	Stanislaus	Prime	151	\$3,520,000	\$2,815,000	\$705,000	20.0%	High	Almonds
01/05	Silicon Valley	Santa Clara	Prime	286.1	\$3,807,000	\$2,387,000	\$1,420,000	37.3%	High	Row crops
01/00	Ag Land Trust	Monterey	Prime	460.8	\$8,882,381	\$7,499,981	\$1,382,400	15.6%	Medium	Row crops
12/05	SLT	Solano	Prime	145.8	\$2,350,000	\$400,000	\$437,400	18.6%	Medium	Row crops
03/06	SLT	Solano	Prime	299	\$4,595,000	\$1,228,890	\$3,366,110	73.3%	High	Row crops
03/06	SLT	Solano	Prime	235	\$1,700,000	\$800,000	\$900,000	52.9%	High	Row crops



MAP # 1

Memorandum

To: City of Morgan Hill
Leslie Little, Assistant City Manager for Community Development
Mitch Oshinsky, Community & Economic Development Director
Danny Wan, City Attorney
Rebecca Tolentino, Senior Planner

Economic & Planning Systems
Teifion Rice-Evans
Rebecca Benassini

From: Gregory House, Henry House, House Agricultural Consultants

Re: Nexus Study

Assumptions of Property and Conservation Easement Characteristics for Mitigation of Agricultural Land in Morgan Hill

Background

The purpose of this memorandum is to layout the parameters and assumptions under which the Nexus Study will estimate the fees to be charged by the City of Morgan Hill for the conversion of agricultural land to urban, non-agricultural uses on land within its jurisdiction. These fees will be used to fund the agricultural land mitigation program of the city, which will fulfill its responsibility to oversee the mitigation by purchasing agricultural conservation easements on land in Santa Clara County.

Of specific interest at this time is the acquisition cost of agricultural conservation easements in Santa Clara County. To estimate these costs, it is necessary to state the prohibitions and requirements of the conservation easement, define the land quality requirements, and state the location where the mitigation can occur.

The assumptions discussed in this memorandum will eventually become part of the city's formal policy for the program, and are summarized from a telephonic conference call between the City of Morgan Hill, House Agricultural Consultants (HAC), and Economic and Planning Systems (EPS) on October 23, 2012.

Previous reports by EPS and HAC have revealed that Morgan Hill agricultural land:

- Is primarily in the South-East Quadrant of Morgan Hill (SEQ).
- Contains Prime Farmland, Unique Farmland and Farmland of Statewide Importance as determined by the County of Santa Clara, which uses the definitions, identifications, and determinations of the United States Department of Agriculture Natural Resource Conservation Service (USDA-NRCS).
- Generally has access to irrigation water through wells (recharged by water district).
- Generally has small parcel size (5,10 and 20 acres).

Assumptions for the Nexus Study

For the Nexus Study and the proposed mitigation policy, *mitigation land* (that is, land on which the agricultural easement will be placed as mitigation for agricultural land conversion in Morgan Hill) *must*:

1. Be located in Santa Clara County.
2. As compared to the property it is mitigating the loss of, have equal or better soil quality as defined by the Code of Federal Regulations Title 7, Part 657, Prime and Unique Farmlands (see <http://soils.usda.gov/technical/handbook/contents/part622.html>, Exhibit 622-1) and as interpreted by the USDA-NRCS.
3. As compared to the property it is mitigating the loss of, have equal or better access to and sufficiency of irrigation water.
4. Be encumbered at the conclusion of the mitigation process with a conservation easement similar in all essential details to the California Model Agricultural Conservation Easement (see www.conservation.ca.gov/dlrp/cfcp/overview/Pages/cfcp_model_easement.aspx) that prohibits subdivision, urban development, and non-agricultural uses, with the exception that the same number of residential-building entitlements shall be allowed on property used for mitigation as allowed by the pre-existing county agricultural zoning. As it is anticipated that the land selected as mitigation will be in a county agricultural zone, generally “ the same number of residential-building entitlements” will be one residential-building entitlement per legal lot of the newly easement-encumbered mitigation property.
5. It will *not be* a requirement that the land on which the easement is placed be farmed in any particular manner, or for any duration of time. In this sense, and in agreement with the California Model Agricultural Conservation Easement, the easement is essentially a list of prohibitions that permits continuing agricultural use, but does not require it.

6. Likewise, for purposes of mitigation, it does not matter whether the converted land has or has not been recently, or ever *used* for agriculture as long as it meets the Santa Clara County definition of Prime Farmland, Unique Farmlands, or Farmland of Statewide Importance as interpreted by the USDA-NRCS.

Procedure for estimating cost of acquiring agricultural conservation easements

HAC will conduct a survey of agricultural conservation easement costs in Santa Clara County by:

- Collecting sales data on the direct acquisition costs of conservation easements (we anticipate this data to be limited in Santa Clara County and therefore may require supplemental data from other California counties);
- Collecting sales data on fee land values (unencumbered by conservation easements) in 1) within and immediately adjacent to Morgan Hill, and 2) in the greater Santa Clara County area with emphasis on the Gilroy area;
- Collecting sales data on the value of land that sold as-encumbered by an agricultural conservation easement;
- Reconciling these data into two recommended values to be included in the mitigation fee requirement: one value will be the current cost of purchasing an agricultural conservation easement within the City of Morgan Hill, and the other will be the current cost of purchasing an identical easement in outlying agricultural areas of Santa Clara County, with special emphasis on the Gilroy area.