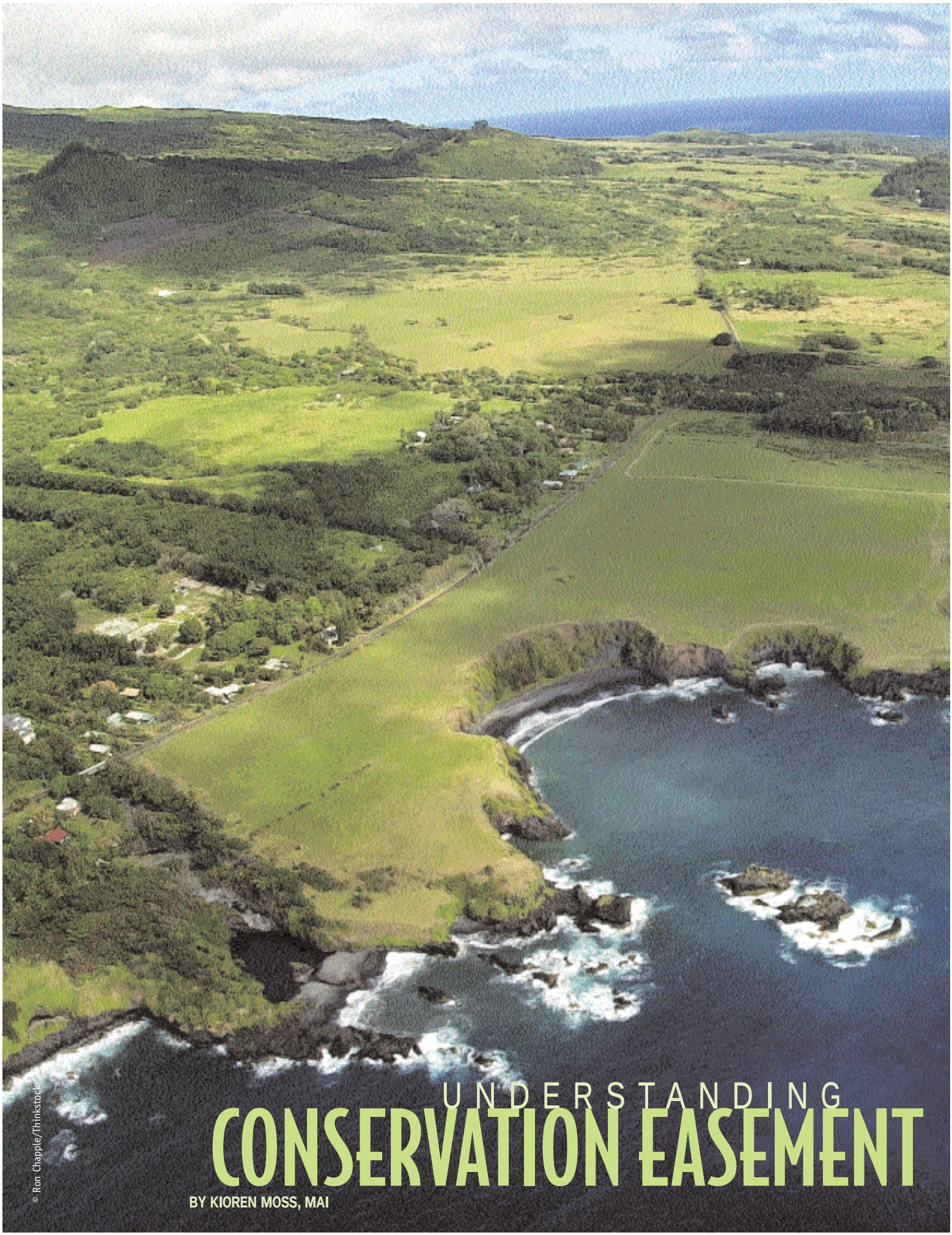

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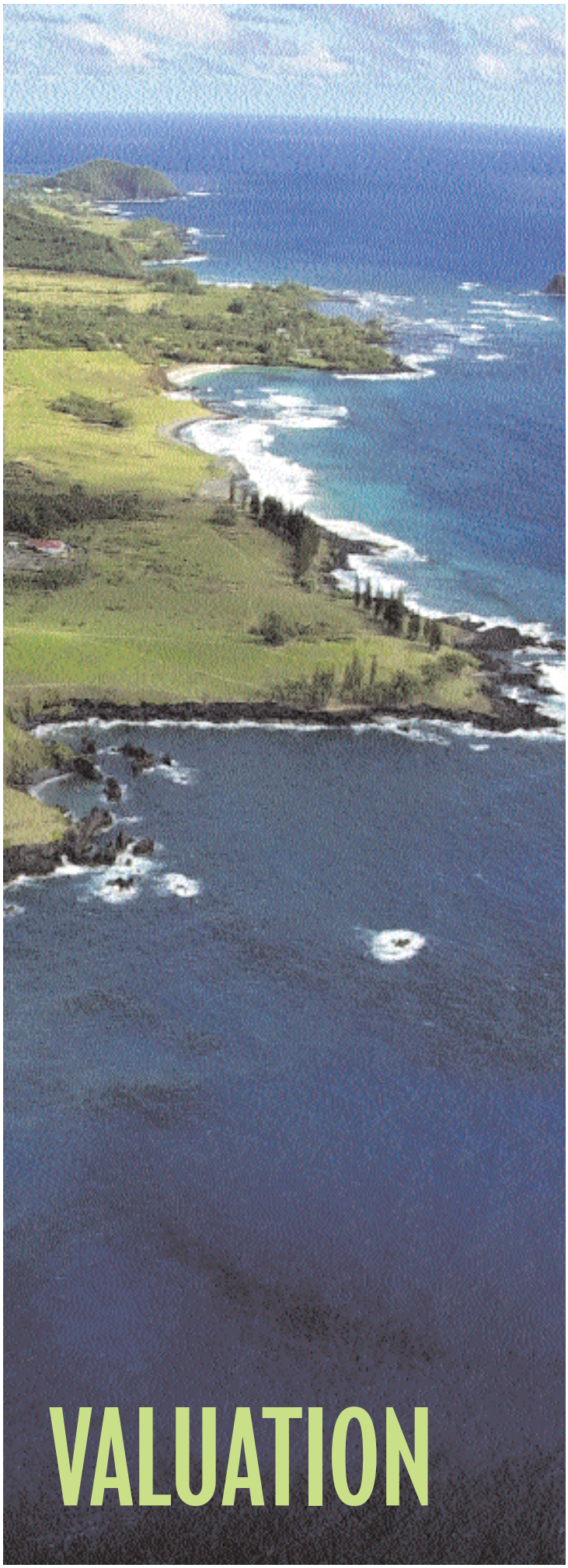
UNDERSTANDING CONSERVATION EASEMENT

BY KIOREN MOSS, MAI



VALUATION

CONSERVATION EASEMENTS can potentially serve both the public interest and private property owners' rights. Since the early 1990s, such easements have become increasingly common throughout the United States and Canada, as well as on other continents. It is inevitable that appraisers, other right of way professionals, property owners, brokers, lenders, insurers, public officials, and the courts will encounter them, and will be required to make specific judgments as to their value. An understanding of the effects of conservation easements on property values is necessary in order for those decisions to be properly made. ✦ Conservation easements are recorded, binding agreements between property owners and either a government agency or an approved non-profit organization for the purpose of preserving in perpetuity a property's agricultural or open-space resources, character, or use. Such properties are intentionally burdened with easements, wherein the agency or organization holds a dominant tenement, and the property owner is left with a servient tenement, for which compensation is paid. ✦ A conservation easement may be defined as: "Any limitation in a deed, will, or other instrument in the form of an easement, restriction, covenant, or condition, which is or has been executed by or on behalf of the owner of the land subject to such easement and is binding upon successive owners of such land, and the purpose of which is to retain land predominantly in its natural, scenic, historical, agricultural, forested, or open-space condition." [1]

California's Civil Code Section 815.2 elaborates:

a) A conservation easement is an interest in real property voluntarily created and freely transferable in whole or in part for the purposes stated in Section 815.1 by any lawful method for the transfer of interests in real property in this state.

(b) A conservation easement shall be perpetual in duration.

(c) A conservation easement shall not be deemed personal in nature and shall constitute an interest in real property notwithstanding the fact that it may be negative in character.

(d) The particular characteristics of a conservation easement shall be those granted or specified in the instrument creating or transferring the easement.

It appears that the California State Legislature intended to avoid having public agencies acquire such easements by condemnation, because it specifically requires them to be "voluntary in nature." If in the future condemnation of conservation easements becomes common, legislative changes may be necessary.

The Minnesota State Law also provides a definition:

"Conservation easement" means a non-possessory interest of a holder in real property imposing limitations or affirmative obligations the purposes of which include retaining or protecting natural, scenic, or open-space values of real property, assuring its availability for agricultural, forest, recreational, or open-space use, protecting natural resources, maintaining or enhancing air or water quality, or preserving the historical, architectural, archaeological, or cultural aspects of real property.[2]

INTERESTED PARTIES

Property owners, conservation organizations, funding sources, government agencies, lenders, taxing agencies, and the courts are all interested parties in such acquisitions. All rely upon professional appraisers for guidance regarding how such easements are valued. Most have difficulty in obtaining credible valuations.

A CONSERVATION EASEMENT MAY BE ACQUIRED EITHER BY A PUBLIC AGENCY OR BY A NONPROFIT ORGANIZATION.

Benefits to the property owner may include a purchase of the easement for cash, a tax-deduction for the gift of the easement, or entitlements for urban uses on the balance of the property, or a combination. The IRS will not allow a deduction for the gift if the benefit received, such as entitlements on the balance of the property, exceed the value of the gift. Conversely, if the sale of the easement is for demonstrably less than its market value, a tax deduction may be available. Such a sale is characterized as a "bargain sale" for tax purposes.

METHODS OF ACQUISITIONS OF CONSERVATION RIGHTS

A conservation easement may be acquired either by a public agency or by a nonprofit organization. Conservation organizations have gained increased prominence and financial capability during the past 30 years, and have actively acquired significant amounts of land. Usually the organizations purchase land outright. One of the oldest and most well-known is The Nature Conservancy, founded in 1951. The Nature Conservancy of Washington, D.C., states that it has preserved, primarily through purchase, but increasingly with conservation easements (11 million acres in North America, including 900,000 acres in California, as well as 59 million acres in Latin America, the Caribbean, the Pacific and Asia). Nearly every state has at least one nonprofit conservation organization dedicated to preservation of undeveloped lands. Many states, such as California, have many.[3]

The focus of such groups has relatively recently changed from seeking fee interests to pursuing easements. The reasons appear to be: 1.) It is thought to possibly be easier to persuade property owners to donate an easement than a fee; 2.) If easements cost less than fee purchases, the organizations' funds go further; 3.) It may be easier to persuade property owners to sell an easement than a fee.

The earliest "ancestral relatives" of conservation easements were scenic and wildlife habitat preservation lands, acquired in fee, primarily by government agencies. It is unclear when the first such easements were created. Reports that may be apocryphal have suggested that conservation easements were employed as early as the 1890s, but efforts to prove this have been unsuccessful.[4,5]

Private individuals have historically conserved land on their own, but have received little credit for doing so, and in most cases have not wanted it. One such couple purchased an approved recreational vehicle (RV) park site near their personal ranch for the sole purpose of preventing the development.[6] The sentiment that motivated these individuals is the same one that drives the conservation organizations.

When large and costly properties are concerned, the owners necessarily possess substantial means, and are in some cases well-known by the public. Several such parties operating agricultural and open space properties larger than 3,000 acres include families or companies (or both) that are household names. For these and other reasons, they have typically not sought to publicize their holdings. The market consisting of this type of individual or family is a central reason why the questions of security and privacy consequent to granting of a conservation easement could substantially affect values.

With regard to public agencies and non-profit organizations, the most common means of preserving land is by outright purchase, for a number of reasons. The most compelling reason is that the purchaser, whether it is a public or private land trust, may exercise complete "site control." At the same time, the tangible appeal of the owning the land may make fundraising easier. Beginning primarily in the mid-1990s, instead of outright purchases of land in fee, such organizations began relying upon the acquisition of preservation easements.

The appeal to property owners of an easement versus a fee may include the ability to continue ownership and stewardship of lands for emotional and/or business reasons, as well as to obtain cash or cash equivalence. The appeal to preservation organizations may include a potentially less-expensive means of achieving its goals, as well as minimized expenses associated with ownership, such as management, security, maintenance, and insurance.

APPRAISAL METHODOLOGIES: SOURCES IN LEGISLATION AND CASE LAW

Clearly, the appraisal of an easement is more complex than the appraisal of a fee simple interest. Each interest has a separate theoretical value. The valuation assignment closely resembles the "before and after" condition of more ordinary easement acquisition in condemnation actions. Review of legislation, including tax regulations, can provide advice in the proper appraisal techniques to utilize. It is important that an appraiser be familiar with the proper laws and regulations governing appraisal methods that may differ among government agencies.

Typically, the property owner gains either cash, development entitlements on the balance of the property, or a tax-deduction in

exchange for the easement. In some cases, the property owner obtains all three of these, in some measured amount, in compliance with applicable laws. To the extent that nearby property may benefit from the contribution in the form of entitlements, the amount of a deduction for a contribution may be reduced.

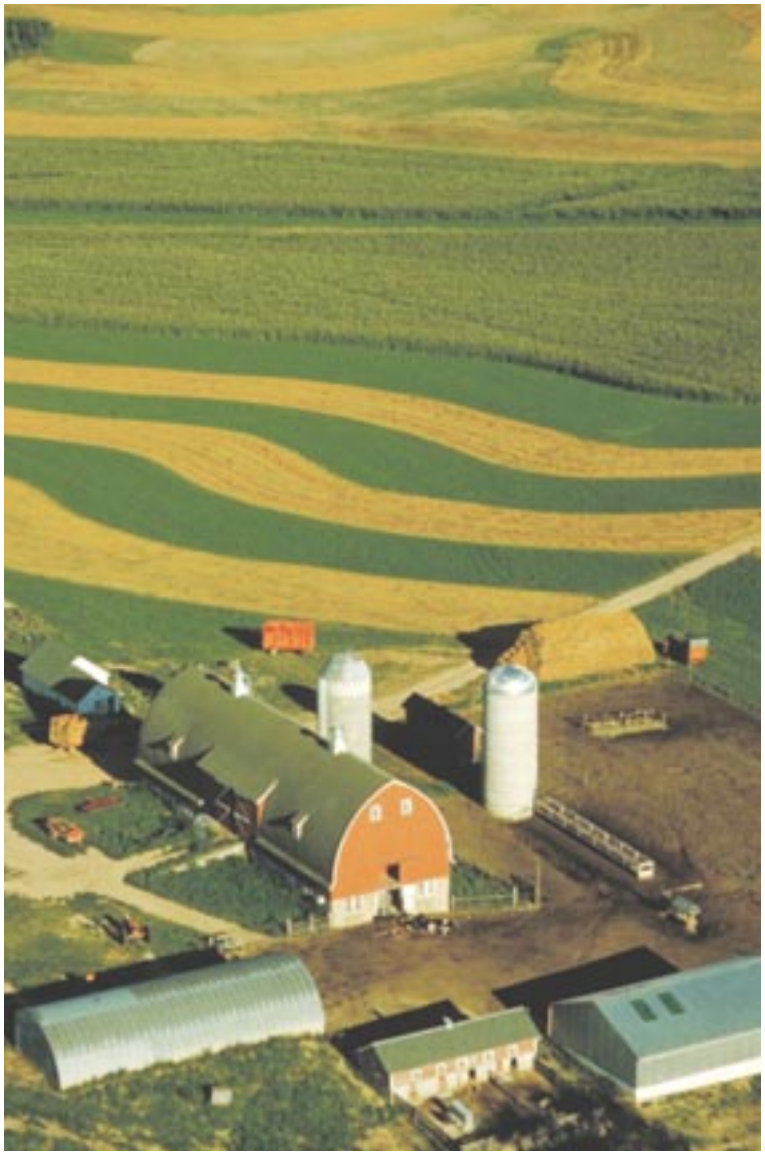
The federal and state governments clearly state that such easements may be created, but there is no particular guidance of how the valuation should proceed. Advice on the matter is best found in the long history of American eminent domain cases and practice. The most reasonable method of appraising a conservation easement is the classic "Federal Rule."

"In its simplest form, the federal rule is: value before taking minus value after taking equals just compensation. Graphically, this would be shown as:

Value of property before taking	$ 1,000,000
Value of remainder property after taking	- 800,000
Difference (just compensation)	$ 200,000

Under the federal rule, no further breakdown is required for trial purposes. However, the Federal Uniform Relocation Assistance and Real Property Acquisition Policy Act of 1970 requires the condemnor to furnish the property owner with a written statement summarizing how the figure offered as just compensation was reached."[7]

The simplicity of the federal rule may belie its importance as a source of guidance and advice for the purpose of appraising conservation easements. The value of the property in the before condition (the minuend) minus the value of the property in the after condition (the subtrahend) must result in an amount (the difference) that is the appropriate payment for an easement. Court decisions primarily regarding condemnation proceedings have over the years clarified the definitions and considerations that also are held to apply to the valuation of property in general.



Chippahua Falls, Wisconsin. Photo by Ron Nichols/USDA.

Other government sources, primarily relating to taxation, provide some guidance on valuation theory and on definitions. The Internal Revenue Code (Section 170 (H)) describes a "qualified conservation contribution" to be one which means "a contribution of a qualified real property interest, to a qualified organization, exclusively for conservation purposes." Qualified real property interest in this case means "a restriction (granted in perpetuity) on the use which may be made of the real property." It must include either the entire property (other than a qualified mineral interest) a remainder interest, or the aforementioned restriction.

The Internal Revenue Service considers "conservation purpose" to mean: "the preservation of land areas for outdoor recreation by, or the education of, the general public; the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem; the preservation of open space (including farmland and forest land) where such preservation is: for the scenic enjoyment of the general public, or pursuant to a clearly delineated Federal, State, or local governmental conservation policy, and will yield a significant public benefit, or the preservation of an historically important land area or a certified historic structure."[8]

The Federal tax laws also have requirements for qualifications of the organizations to which the conservation easements may be granted. Primarily, nonprofit, tax-exempt status is required.

The IRS is very clear that the value of a conservation easement should be based on the sales of such easements, where possible. It even acknowledges that buyers are typically government agencies. Since the "buyers" of such easements are not "typically motivated" in a manner consistent with the definition of market value under treasury regulations, such sales are probably not helpful. The IRS regulation suggests that if such sales are not available, the "before and after" value of the property subject to the easement should be the appraisal model employed, in similar manner to the Federal Rule for condemnation cases.

"The value of the contribution … in the case of a charitable contribution of a perpetual conservation restriction is the fair market value of the perpetual conservation restriction at the time of the contribution … If there is a substantial record of sales of easements comparable to the donated easement (such as purchases pursuant to a governmental program), the fair market value of the donated easement is based on the sales prices of such comparable easements. If no substantial record of market-place sales is available to use as a meaningful or valid comparison, as a general rule (but not necessarily in all cases) the fair

market value of a perpetual conservation restriction is equal to the difference between the fair market value of the property it encumbers before the granting of the restriction and the fair market value of the encumbered property after the granting of the restriction."[9]

For property tax purposes, the states may differ with the Federal guidelines, and they sometimes may contradict themselves. California's Revenue and Taxation Code states that for assessment purposes, the income approach is the appropriate means of appraising open space property subject to conservation easements. It describes them in the same place as properties subject to the 10- and 20-year Land Conservation Act, ("Williamson Act") agricultural preserve contracts. It requires a rental survey that establishes the market rent for the subject property in the after condition. It must be noted that rent is not the same as revenue from agricultural operations: it is the amount of rent that a tenant farmer would pay.[10]

Under California law, excluded from rent is income from trees or vines, or "perennials" present on the site. Open space land suitable only for grazing, for instance, could rent on the basis of $100 to $120 per animal unit per year. In other words, land that supports one cow-calf pair (an animal unit in most venues) per 20 acres would rent for $120/ 20, or $6 per acre per year. The code specifies that rent be based on terms where lessors pay property taxes. It states that if rental data is not sufficiently available, the income shall be that which the land can be expected to earn under prudent management, considering the restriction of the easement.[11]

The code specifies that the capitalization rate should consist of several factors blended. The first is the average yield rate on "long-term United States government bonds," for the previous years and previous four years as of September 1. To this is added a risk component, a component for property taxes, and a component to amortize any investment in perennials. The rate could easily be in the range of 9 percent to 12 percent.[12]

APPRAISAL METHODS: EXAMPLE

Outside the context of the requirements of the property tax code, the valuation methodology for such properties could still include the income approach to value, wherein the difference in market rents is capitalized. For example, presume that a 100 acre farm would normally rent for $2,000 per acre per year, net, in the before condition, and a 5 percent capitalization rate is demonstrated in the marketplace. Suppose in the before condition any type of commercial farming effort could be practiced, including high per-acre yield crops such as strawberries, where significant amounts of pesticides must be used – presuming that only organic or far less than conventional cultivation methods could be allowed in the after condition. If rental data showed that the market rent in the after condition was $1,500 per acre per year, the income approach to valuation could be applied as follows:

BEFORE CONDITION:

Agricultural Rent	/	Capitalization Rate (Ro, or OAR)	=	Value Per acre
$2,000	/	.05%	=	$40,000

AFTER CONDITION:

Agricultural Rent	/	Capitalization Rate (Ro, or OAR)	=	Value Per acre
$1,500	/	.05%	=	$ 30,000

APPLICATION, INCOME APPROACH

BEFORE CONDITION:

Number of Acres	X	Value Per Acre	=	Value
100	X	$40,000	=	$4,000,000

AFTER CONDITION:

Number of Acres	X	Value Per Acre	=	Value
100	X	$30,000	=	$3,000,000

CALCULATION:

Value in the "before" condition:	$4,000,000
Minus Value in the "after" condition:	$3,000,000
Value of the conservation easement:	$1,000,000

Paradoxically, the California code also states that the sales comparison approach is valid. "In assessing land … (with a permanent easement) … the assessor shall not consider sales of otherwise comparable land not similarly restricted as to use as indicative of value of land under restriction, unless the restrictions have a demonstrably minimal effect upon value."[13]

The code permits, in the case where a restriction is expiring but has a remaining life, and in the absence of a sufficient number of sales of properties that are so encumbered, the use of sales of properties not restricted "…but upon which natural limitations have substantially the same effect as restrictions."[14] This has the effect of suggesting that restricted land could reasonably be valued by comparing it with other unrestricted properties whose highest and best use is the same as the uses available to the subject property as restricted. It widens the available sources of comparable sales, which are relatively scarce.

The California Revenue & Taxation Code in summary, states that the methods of appraisal of land encumbered with a conservation easement are 1.) the income approach; 2.) the sales comparison approach, using similarly-restricted land; and 3.) it suggests but doesn't always allow the use of comparable sales of unrestricted land whose highest and best use is the same as the subject property after the restriction is in place.

An example of the latter might be if a property were suitable for high rent-generating crops, such

as strawberries, where a sufficient number of sales of comparable properties established land value. If the conservation easement proposed to restrict the property to the production of alfalfa, for instance, a low rent-generating use, the sale of properties physically suitable only for that crop could properly be used.

The confusion arises when the two property types are not found in the same geographical area, and could also have substantial differences in topography, soil type, and temperature zones, among other differences. Alfalfa is usually grown in arid zones on land that is incapable of providing other, higher-income crops. Strawberries are necessarily grown in areas of rich, well-draining soil, moderate temperatures, and with ample water, particularly in coastal areas of the west.

The point of the California code is: when the restriction is in place, the result is that the property for all practical purposes has been moved to the area where farm properties of low utilization are found. If the lower economic benefits after the recordation of the easement are the same as the lower economic benefits of properties in the other location, then the properties are effectively the same. The difference in location is therefore not as material as the similarity of financial outcome.

This is similar to a transfer of development rights from an urban property, where the height limitation imposed on a *sending* property to benefit a *receiving* property takes place. An example was the transfer from the Los Angeles Central Library of its floor area ratio to the First Interstate Tower in 1985. If the library or a building with a historic preservation restriction limiting height were to be appraised, only properties with the same restriction would be useful as true comparable sales. The reality is that either sales from outside the immediate area or significant adjustments, or both, must be utilized.[15]

Typically, the property owner gains either cash, development entitlements on the balance of the property, or a tax-deduction for the gift of the easement. In some cases, the property owner obtains all three of these, in some measured amount, in compliance with applicable laws. To the extent that nearby property may benefit from the contribution in the form of entitlements, the amount of a deduction for a contribution may be reduced.

The difficulty, in addition to identifying the appropriate methodology, lies in finding enough comparable sales properties or other market evidence to demonstrate and define the difference between the "before" and "after" conditions.

DEFINITION OF MARKET VALUE UNDER TREASURY REGULATIONS

The definition of market value recited in U.S. Department of the Treasury regulations differs slightly from the definition used by federally-insured lending agencies. The definition as applied herein is:

"The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts."[16]

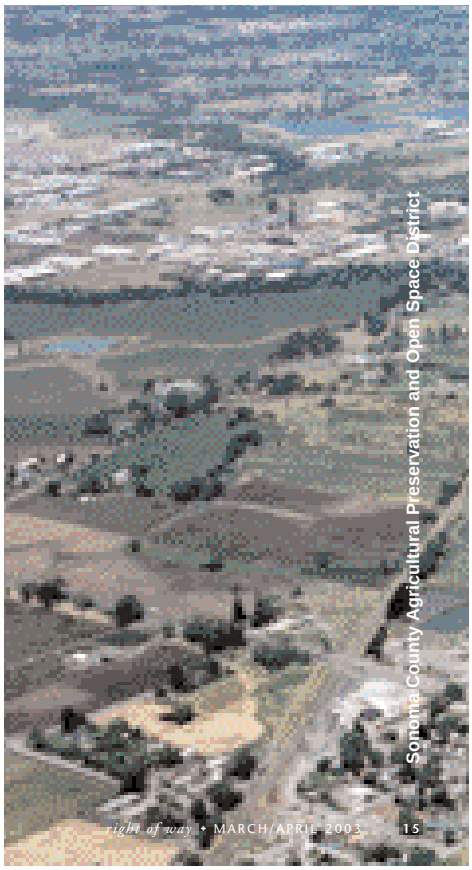
The problem underscored by the definition is that the only buyers for conservation easements are either governments or altruistic organizations, neither meeting the definition of a "typically motivated" buyer.

The value of such an easement is best measured by comparing the sales of properties that are burdened by conservation easements with those that are not. The difference between the "before" and "after" condition of the title to the property is the appropriate arithmetic calculation of easement value. For properties that had high development capability for urban uses in the before condition, the measurement may be readily demonstrated to be substantial.

The appraisal assignment is complicated primarily by the scarcity of sales of properties that are already burdened by conservation easements. Aside from the rarity of sales data, however, to a large extent, this is no different than any other easement appraisal assignment. For example, in the case of an acquisition of a public improvement such as a roadway that causes periodic flooding to the remainder parcel, a search for sales of identical properties in the before condition, as well as sales of properties subject to periodic flooding that are otherwise identical to the before condition property would establish a perfect *paired sales analysis.*

A potential problem arises when an appraiser erroneously concludes that a sale of a conservation easement over a property zoned for a high earning capacity in the before condition indicates that any other conservation easement has the same value. For example, with regard to the "before and after" appraisal of properties subject to conservation easements, it is apparent that the most clearly defined differences and least debatable values for the easements' before and after conditions are those that are overlaid onto land that originally had urban development entitlements available to them.

Consider a 100-acre property that in the before condition was suitable for 500 homes, with per-lot values demonstrated to be worth $35,000 in the raw, bulk state. If the conservation easement had no other effect than to continue the present, pre-development use as agriculture, with all of the laws and regulations affecting agricultural land sales in place, agricultural land value would define the "after" condition. Presuming



Sonoma County Agricultural Preservation and Open Space District

appropriate market evidence that agricultural properties were worth $35,000 per acre, the calculation for the difference between the before and after condition would be as follows:

BEFORE CONDITION:				
Number of Lots	X	Value Per Lot	=	Value
500	X	$35,000	=	$17,500,000
AFTER CONDITION:				
Number of Acres	X	Value Per Acre	=	Value
100	X	$35,000	=	$3,500,000
CALCULATION:				
		Value in the "before" condition:		$17,500,000
Less:		Value in the "after" condition:		- 3,500,000
		Loss in value due to the conservation easement:		$14,000,000

With such an urban property, reduced to agricultural use, there is a clear and substantial, unambiguous difference in market value between the "before" and "after" conditions.

COMMON ERRORS

If an appraiser were to conclude that this sale meant that all conservation easements were valued at this price per acre, it would contradict hundreds of years of condemnation law, as well as demonstrate the *fallacy of hasty generalization*. One error appears to be the straying away from market considerations and into concern for posterity.

"…government entities as a matter of policy routinely pay more than appraised market value to induce a voluntary sale of such (desirable but with no economic use) land. Decision makers typically weight the political repercussions of how much to overpay for land together with the amount of public funds available at any one time to buy land and the expected net positive benefits to the larger community. To assign this public policy making role to unelected real estate appraisers dangerously undermines our form of government. But government agencies and non-profit land trusts do it all the time when they retain appraisers who use comparable sales data from public and quasi-public preservation transactions as comparable sales."[17]

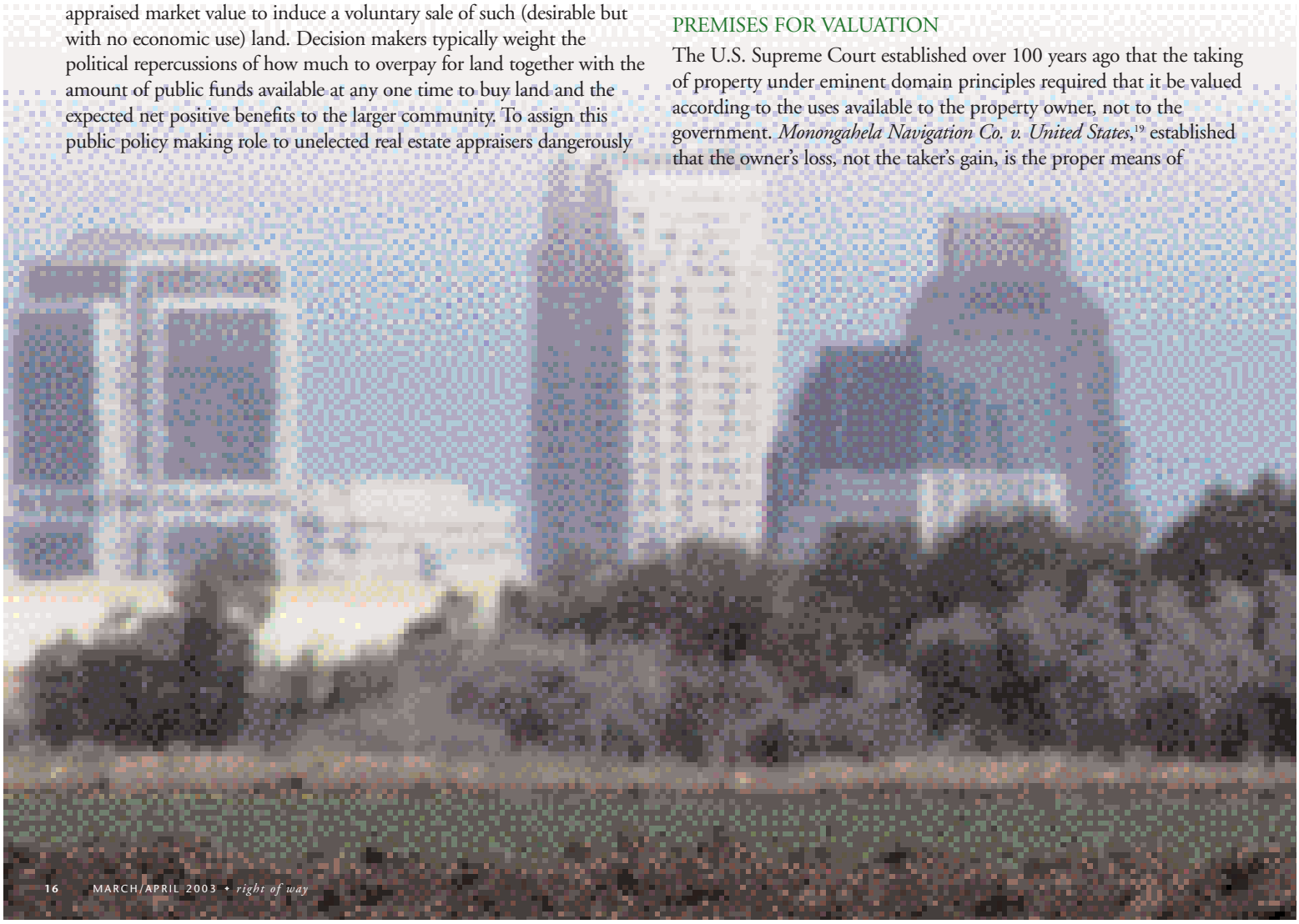
This argument and its obverse were made in various "dueling" magazine articles over the past few years, and may not have been entirely settled among the protagonists and antagonists. But the matter has been settled by the condemnation courts for many years. The "before" and "after" valuation is the proper methodology. To support the "after" condition, the most desirable circumstance would include a prevalence of sales of similar land burdened by similar easements, as well as "puritan" sales, or those that are identical but for the absence of an easement. Because the widespread use of conservation easements has not yet taken place, the sales of properties burdened by them remain scarce. Until such time as they become more common, resales among true arm's length parties will continue to be rare.

Although the term has been increasingly misused by non-appraisers to mean "more desirable," or "more aesthetic," "highest and best use" correctly refers only to financial results. Appraising conservation easements involves classic highest and best use analysis, in both the before and after conditions. The term as used here is defined as:

"The reasonably probable and legal use of vacant land or an improved property that is physically possible, appropriately supported, financially feasible, and that results in the highest value." The four criteria the highest and best use must meet are legal permissibility, physical possibility, financial feasibility, and maximum profitability.[18]

PREMISES FOR VALUATION

The U.S. Supreme Court established over 100 years ago that the taking of property under eminent domain principles required that it be valued according to the uses available to the property owner, not to the government. *Monongahela Navigation Co. v. United States*,[19] established that the owner's loss, not the taker's gain, is the proper means of



measurement of such compensation. The United States Congress proposed to acquire a lock-type dam on the Monogahela River, between Pennsylvania and West Virginia. It wanted to pay the approximate cost of the improvements, rather than a value based on its toll earnings, on the novel theory that the government wouldn't be operating the facility in the same manner as the owners. Justice Brewer, after stating the facts, delivered the opinion of the court:

"The government takes it away from the company, whatever use it may make of it; and the question of just compensation is not determined by the value to the government which takes, but the value to the individual from whom the property is taken…"

The same principle applies to land proposed to be acquired without the power of condemnation, by a conservation organization, whether in fee or through encumbrance with a conservation easement. The goal of preservation for posterity, however noble, is not an economic use and is inapplicable to real property valuation. Unless a large enough market can be shown to exist that includes non-government and non-tax exempt buyers who acquire properties with preservation as a goal, and a given property may be shown to lack other potential uses that provide higher earnings, the agencies, or organizations' activities are not useful to the valuation effort.

ATTENDANT DIFFICULTIES

It is difficult to demonstrate the effect a conservation easement may have on the market value of a property that is already limited in use by laws and regulations. This is often true of farm and range land properties. The differences in market value between the "before" and "after" condition of such properties will normally be much smaller than for higher use urban properties with similar easements.

In general, agricultural properties utilized in paired sales must be carefully examined and understood in order that true comparability is in place. Differences in water costs alone could account for earnings disparities of $200 to $500 per acre or more per year. Capitalized, those figures could cause land value differences of from $4,000 to $10,000 per acre. Other crucial differences between agricultural properties may include topography, soil quality, flood plain, and temperature zones, as well as trees, for lumber or for food production. The appraiser is obliged to identify the features of each sale and to either discard as incomparable or adjust for significant variables.

A true matched pair is difficult to identify among conforming farm properties. The same concerns present in any market survey are also in play with farm properties, including terms of financing, and extraordinary motivations by either buyer or seller.

Agencies are frequently in negotiations to purchase "future development rights" on the agricultural properties that do not currently possess any such rights. An easement for such purposes could have no discernable impact on land value through the methodologies shown above. But the precise language of the easement could result in a market reaction that includes a discount to value, depending upon the document's wording.

What future development rights exist? How many years into the future, and how probable are they? What discount rate is applicable for speculative future benefits? Is there a loss in value as a result of placing a restriction on the property, despite the agricultural zoning and absence of development rights? Do potential buyers respond to the presence of the easement? If so, may that be demonstrated with "before and after" agricultural sales?

Such a property can already have a number of binding legal restrictions affecting it. In California they could include:

1. The city general plan may indicate that it will not annex the property.
2. The county general plan may indicate that it will remain 40-acre minimum, agricultural zoning. An agreement among the city and county governments may prohibit urban uses outside city limits, and utilities may not be available. The policies of the agencies may indicate that there is no history of such zone changes over the past 20 years.
3. There could be a California Coastal Commission designation of the property as agriculture.
4. There could be a "greenbelt agreement" already in place among the agencies of jurisdiction.
5. There are "LCAs," or Land Conservation Act contracts, reducing the property taxes in exchange for an agreement not to develop for 10 to 30 years, in some cases. (Such tax agreements were made possible by

Photo by Todd and Barbara Photography/American Farmland Trust.

legislation that preceded the constitutional amendment in California reducing property taxes to 1 percent of value *at sale,* restricting increases to 2 percent per year thereafter if the property does not re-sell. The cash savings of property taxes under LCAs was minimized, and they are not commonly entered into today.)

6. Slope/density ratios limiting grading.
7. Geologic considerations.

Therefore, the difficulty is clear: there may not be a readily discernable difference between the property in the before and after conditions. This is complicated by the relative scarcity of such easements, and the clear rarity of sales of such properties.

RIGHTS AFFECTED BY THE EASEMENT

It is extremely important for the appraiser to fully understand and explain the language of the easement and what rights it conveys or extinguishes. The presence of legal parcels should be verified in writing by the agency of jurisdiction: certificates of compliance should be obtained whenever possible. If an agricultural property has several legal parcels or the possibility of creating them, and potential home or estate-type sites are given up, the financial results could be substantial.

Qualified legal counsel must be available to the appraiser, to clarify legally required or prohibited methodologies, and to assist in developing a clear knowledge of all of the property's uses before and after recordation, which must be understood and explained.

PRESSURE TO INCREASE VALUES

This zero-sum consequence is a cause of dismay and disagreement among the property owners and agencies on the one hand, and the appraiser on the other hand. Land owners cannot justify granting such a burden for the benefit of the proposed holder of the conservation easement, in the absence of sufficient financial incentive to do so.

It is also a cause of consternation by the conservation easement organizations because in the absence of an appraisal indicating that there is a significant value, there may be no financial incentive for property owners to participate. Conservation organizations may shop around for an appraiser who concludes that the proposed conservation easement has significant value.

This is a unique circumstance, where a potential buyer is actually motivated to try to influence the appraiser to provide an estimate of market value that is higher than might otherwise be demonstrated. Most public agencies that acquire property appear to want to pay actual market value, but some have been known to hire appraisers who "low ball" or undervalue properties to be acquired, in the interest of saving money. Typical buyers want to pay less. The current circumstances are therefore ironic: the agencies may be involved in over-valuing conservation easements in order to motivate sellers to grant them, or to spend funds, or to acquire high-profile properties.

CONDEMNATION OPTION

Conservation easements are nearly always acquired by agencies or organizations that do not have the power of eminent domain. This may not always be the case in the future, if political expediency makes it feasible for public agencies to use condemnation powers to acquire them. California law expressly requires that conservation easements be "voluntarily entered into," which appears to exclude condemnation of them. It is likely that eminent domain law would permit it, however, whether or not it is an "easement" or another type of legal instrument. [20]

California law also requires that conservation easements' grantees be either tax-exempt non-profit organizations qualified under Section 501 (c) (3) of the Internal Revenue Code, whose purpose is:

"…the preservation, protection, or enhancement of land in its natural, scenic, historical, agricultural, forested, or open-space condition or use" "The state or any city, county, city and county, district, or other state or local governmental entity, if otherwise authorized to acquire and hold title to real property and if the conservation easement is voluntarily conveyed. No local governmental entity may condition the issuance of an entitlement for use on the applicant's granting of a conservation easement pursuant to this chapter."[21]

California law expressly prohibits agencies holding jurisdiction for zoning and land-use decisions from requiring the granting of conservation easements as contingencies precedent for the issuance of entitlements on other properties. However, it has long been the practice to require donations of property for preservation purposes, as a contingency of entitlements. This ability remains unchanged.

APPRAISALS REVIEWED

A review was made of three appraisals of agricultural properties, which had been conducted for a major public funding agency. The reports showed a general lack of continuity of methodology and data, and made little or no reference to tax regulations, the courts, or other sources with regard to methodology. Two appraisals defined the "before and after" difference solely by applying a higher capitalization rate for the "after" condition to the same net income to which a lower capitalization rate was applied in the "before" condition. While the income approach is demonstrated to be valid, support for the capitalization rate was absent.

The first appraisal, of a ranch comprising approximately 700 acres, expressed values of approximately: before: $3 million, after: $1,300,000; and of the easement: $1.7 million, a loss in value of approximately 57 percent.

The second appraisal, comprising agricultural row crop properties of approximately 1,300 acres, expressed values of approximately: before: $10 million, after: $7 million; and of the easement: $3 million, a loss in value of approximately 30 percent.

A third appraisal of mixed agricultural land used the sales comparison approach, developing separate sets of sales of farming properties that were intended to show those with more and less development potential, respectively. It was unclear to the reviewer how the "before" and "after" conditions were addressed, with regard to resulting limitations on use. It did not use an income approach. The third appraisal, of approximately 100 acres, expressed values of approximately: before: $3 million, after: $1 million; and of the easement: $2 million, a loss in value of approximately 60 percent.

None of the appraisals identified properties that had sold with conservation easements, except that one of the sales found in the second appraisal was so encumbered. None developed a set of sales on a paired sale basis, where one sale had limitations, and the other did not. None addressed the issue relative to agricultural restrictions, because there were none. There was no foundation in the market for the any of the higher capitalization rates employed.

Until these properties resell in the future, the market effect of the easements will remain theoretical rather than practically based.

LAND SALES WITH CONSERVATION EASEMENTS

The appraiser noted that The Nature Conservancy, a major international conservation organization, purchased and resold the approximately 28,000 acre Romero Ranch in California to a cattle ranching firm,

retaining a conservation easement. The purchase price was approximately $8.7 million, $312 per acre, and the resale price was approximately $6,300,000, $225 per acre. The percentage difference was approximately 28%. The location was detached, far from urban influences, and the topography was steep. The difficulty in using the sale is that the conservancy is not "typically motivated."

The same organization had sold other properties in another area to one of their patrons for more than they had paid for it, after placing a conservation easement upon it, proving perhaps the generosity of the buyer, although perhaps not market value. The sale certainly did not demonstrate a loss of value, but in that case neither the buyer nor the seller was typically motivated.

In another instance, an investor purchased an approximately 1,300 acre hillside property proximate to a Southern California city for approximately $2,350,000 in April of 1998, received a charitable contribution based on an undisclosed appraised valuation for an 880-acre conservation easement, and resold it in September of 2000 to a dot-com millionaire for $2,705,500, a profit of $355,500. Such buyers may not be typically motivated, and have sometimes overpaid with monies that were easily earned. Nonsensically, the resale of the property with a conservation easement was for more than the recent prior purchase price without it. This may be attributable to lack of knowledge of the parties, and if so, the sale does not meet the standard of a fully informed buyer and is not a valid indicator of market value. The increase very likely represents the trend in values during that time, and the steep topography raises the issue of whether anything was truly conserved.

In yet another instance, a federal farm credit organization gave U.S. Fish and Wildlife a preservation easement on portions of foreclosed farm properties it subsequently resold. There may have been a discount in the resale for the lack of privacy, but it was not apparent in the sale itself.

It would appear as if a second resale of each of these properties will be necessary to establish a market response.

CONSERVATION EASEMENT DONATIONS ARE NOT MARKET EVENTS

It is important to note that the donations of conservation easements themselves are not market events or "comparable sale properties," and therefore are not useful for appraisal purposes.

In Maui, Hawaii, for example, the Hana Ranch's owners donated a conservation easement that essentially extinguished seven lots

in 41 oceanfront acres of Maka'alae Point in 2002 (See photo on page 10.) Hana Ranch Partners LLC, a group reportedly including members of the Getty family, donated the easement, public access, and a fund for maintenance to the Maui Coastal Land Trust. [22, 23, 24]

The appraised value of the 41 acres was reportedly $9 million in the "before" condition, a number supported in part by the sale of six other lots comprising 105 acres to television personality, author, and philanthropist Oprah Winfrey for a reported $15.5 million during the same period. The utility of the Maka'alae Point property in the "after" condition is limited to its historic pasture use. It is reasonable to conclude that the difference between the "before" and "after" conditions is the consideration, and the donation's value.

For appraisal purposes, the sale to Winfrey is significant, because it represents an arm's length transaction between knowledgeable parties acting out of self interest, while the donation, which only represents another appraiser's opinion, does not. The creation of the conservation easement is a generous gift, but it is not a comparable sale.

CONSERVATION ORGANIZATIONS AND USE

Some of the most prominent organizations in the business of acquiring or financing the acquisition of conservation easements in California include the David and Lucille Packard Foundation, the Nature Conservancy, the California (State) Coastal Conservancy, the Santa Monica Mountains Conservancy, and the Rangeland Trust. The Packard Foundation contributed $175 million to the project in 1999. Other national and international organizations include the Nature Conservancy again, as well as local organizations, such as The Trustees for Reservations in Boston, and the Ontario Heritage Foundation in Canada. All of these organizations and others will be in need of expert advice on their proposed activities.

Independent of those questions, substantial impacts may be somewhat hidden within easements that appear minimal in description. These could include unintended consequences involving the property owners' rights of privacy and security. For example, if an easement allows large numbers of unspecified persons to come and go at will, for any purpose, it would interfere in a central property right and could significantly affect market value. Large recreational ranches are often owned by persons who possess wealth or fame, or both. Reduction in or loss of control of visitors to the site in such cases could pose a serious security threat.

In some instances, conservation organizations have subsequently assigned their easement to public agencies, such as the U.S. Dept. of Fish and Wildlife. That could constitute an intensification of the easement, or could amount to a de facto condemnation, triggering claims for increased compensation. Including a clause prohibiting assignment without the property owner's reasonably-based approval might be prudent.

SUMMARY AND FORECAST

It would appear as if it is only a matter of time before public agencies begin condemning conservation easements. The United States Supreme Court has already found that condemnation of leased fee land is a "public purpose." [25]

As they increase in popularity, public agencies, utility companies, and others involved in right of way and real property business will encounter properties that bear conservation easements. Condemnations of ordinary roadways and power lines will eventually cross such properties. Appraisers and others will be forced to deal with the issue.

Real estate appraisers must define the legal restrictions that an easement creates, quantify the financial consequences of the restriction, and must have a suitable amount of market data to calculate easement valuations. The present body of knowledge and history of conservation easements are limited in depth and breadth. The shortage of data and increasing demand are going to result in significant over-valuations and under-valuations.

It is clear that with different standards among agencies, there is no guarantee that the assessor's office, for property tax purposes, will agree with the result of the appraisal used for the acquisition, or for the income taxing authorities. There is similarly no guarantee that income taxing authorities will accept any given appraisal or appraisal technique, other than as defined in their own regulations. A universal agreed-upon standard of methodologies for the valuation of conservation easements should be developed. This is highly ambitious, considering that the across-the-fence (ATF) method of valuing rights of way by comparing them with neighboring land values does not even appear as a term in the Appraisal Institutes' standard textbook. *(The Appraisal of Real Estate*, 12th Edition, Appraisal Institute, Chicago, 2001.) Some earlier principles of eminent domain law clearly will apply to the valuations of conservation easements.

"The acquisition of an easement by a condemnor does not give the appraiser a license to guess. The principles and techniques applied in appraising land for easement acquisitions are the same as those applied in other condemnation appraisals. The only difference is that in appraising land for easement acquisitions, by an easement, the landowner will retain the underlying fee interest in the form of a subservient estate. In jurisdictions that use the before and after, or federal rule, the appraiser simply values the property before and after the easement acquisition. As a federal court said in remanding a case for retrial, '…we suggest that the measure of the appellant's detriment should be the difference, if any, between the fair market value of his land immediately before and after the perpetual easements were imposed by the taking.'" [7]

Public financing is often granted to non-profit conservation organizations for the purpose of acquisition of conservation easements. As non-profit corporations, many of the activities of the organizations are available for public inspection. The presence of government funds also triggers the laws applying to public review of those agencies' activities, which will include the appraisals of the conservation easements in question.

For a property so encumbered, if development pressures increase over the years, the theoretical value of the property as if unencumbered by the easement will rise. If the development rights have been granted to the conservation organization, then it is the agency's dominant tenement position, not the servient tenement fee owner's that increases significantly in value. It is probable that the development potential of the property will reach a point where it will be tempting to the conservation agency to sell its right to extinguish the easement. If for instance, the agency concluded that the funds available from a termination of the easement were sufficient to preserve other property deemed more important, then it is likely that it would sell its position.

It is also possible under those circumstances for a city to condemn an existing easement in the interests of a "public purpose," in order to extinguish it. In either case, it is likely that one day many existing conservation easements will be much more valuable: otherwise agencies would not be interested in their purchase. Anticipating that, a grant of an easement could conceivably contain a reversionary clause that would cause abandonment by the conservation agency to require that any future proceeds inure to the heirs and assigns of the original property owner. The question of whether inclusion of such a clause is consistent with the governing laws and regulations remains unclear. The

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speculative nature of any future reversionary interest is clearly not as valuable today as it could be in the future, limiting in significance a mathematical difference today for either donation or sale purposes. It may, however, be inconsistent with the legal requirement that easements be perpetual.

The practice of buying property, then encumbering it with an easement, then reselling it will resolve the agencies' question of how much to pay, and will demonstrate the before and after conditions suitable for appraisals.

CONCLUSION

The number of qualified non-profit organizations and public agencies interested in acquiring conservation easements has increased steadily during the past few years. As they become more common, arm's length sales and resales of properties burdened with such easements will also increase in number, and the problems associated with their appraisal will become fewer. Legal advice on permitted, required, or excluded appraisal methods must be available, and the Jurisdictional Exception under the Uniform Standards of Professional Practice, permitting their use, may subsequently need to be invoked.[26]

The public interest will be best served by making the purchase prices of conservation easements and the sales prices of properties subject to them known through disclosure by the organization holding such rights. Such organizations, although privately held, benefit from tax-exempt status that requires public disclosure of annual activities. Similarly, they are acting in effect as proxies for the government, which would clearly be required to disclose its actions. State, county and city governments, whose endorsements and sanctions are necessary for such non-profits to function for property tax purposes, should require a policy of public disclosure of the organization's activities as a condition of their official recognition.

The relatively recent proliferation of conservation easements necessarily causes their re-sales to be scarce. In the future, when the sales and re-sales of properties subject to conservation easements take place, over time, the financial effects of the restrictions will become clearer and less theoretical. Their valuation will then become better-founded in actual market data, and less controversial.

When conservation easements are created for urban boundary purposes, with the stated purpose of preventing municipal expansion, it is clear that eventually the public interest may require their extinguishment. If Manhattan Island had been subject to a conservation easement as to its wooded areas in the early 19th century, the City of New York would have had to condemn it long ago. The power of eminent domain exists for various agencies that may have conflicts, such as a city versus the state government, or school districts, and may be used by pipeline companies, private hospitals, and private universities.

It is foreseeable that long-term city population growth will necessitate the condemnation of conservation easements, some of which may be held by government agencies. The courts will have to decide which public interest trumps the other. When the need for the dismantling of conservation easements arises, it is possible that friendly acquisitions of them may be made. At that time, appraisals of the property with and without the easement will form the basis of a transaction, as in any real estate "deal." Exchanges for properties of like value, or cash alone may be motivation enough for the holder of the easement.

Court decisions, legislation, and judgments by professional appraisal organizations will clarify many valuation issues pertaining to conservation easements in the future. An increase in the sales and resales of burdened properties will demonstrate the market's actual

response to them. In the meantime, their valuation will remain a complex challenge to prudent, competent appraisers and to other stewards of the public trust. ❖

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