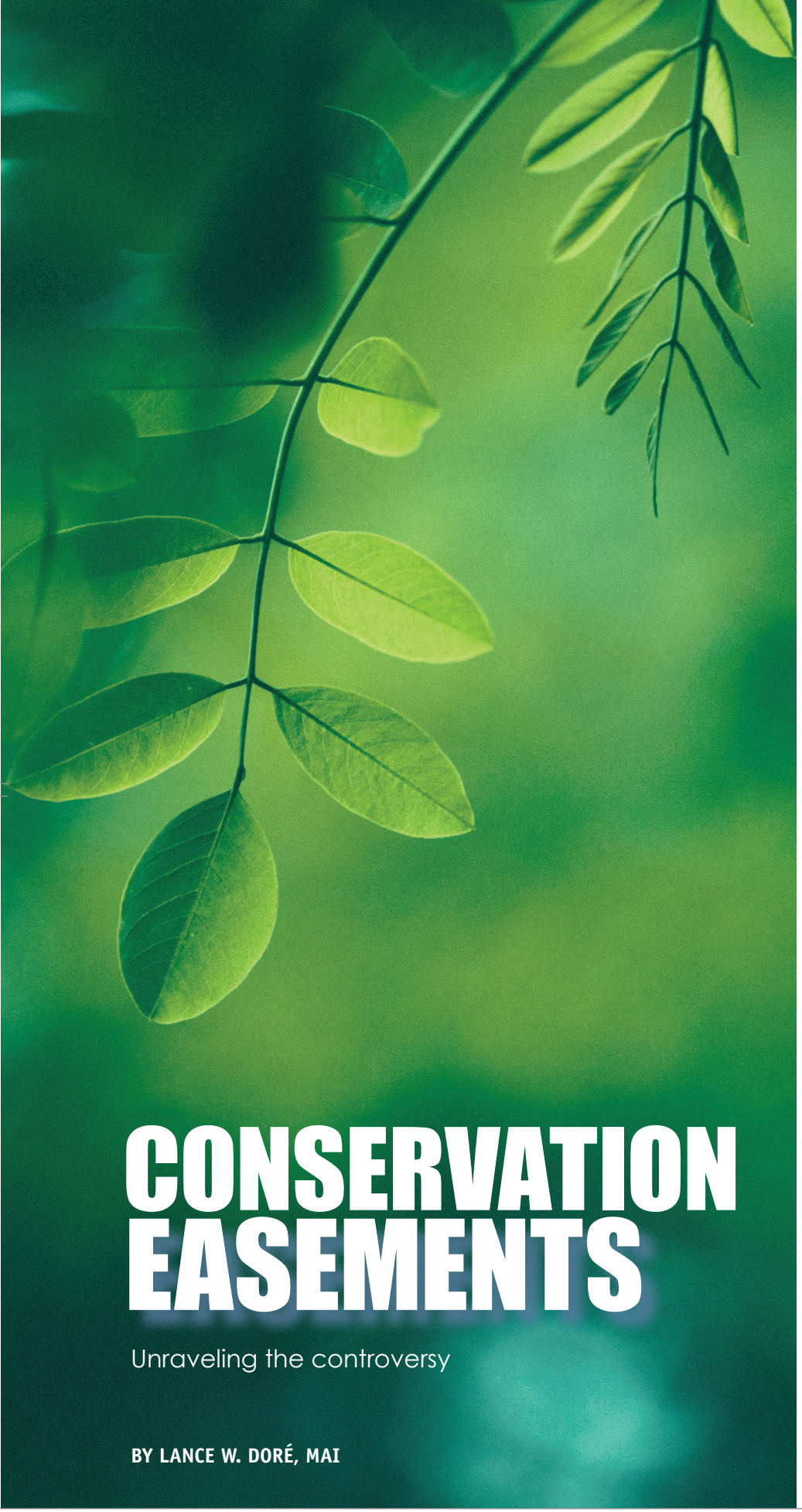

CONSERVATION EASEMENTS

Unraveling the controversy

BY LANCE W. DORÉ, MAI

Conservation easements are not a new topic to the appraisal world. Many appraisers have discussed the issues surrounding conservation easements and have worked to find a solution. There is a common methodology of Before and After that is well documented and accepted. The Before valuation should determine the market value of the property "as is," without the conservation. The After appraisal is a valuation of the land when the easement is in place.

This common approach is proper and clear, but there seems to be a lack of clarity surrounding *how* and *what* exactly affects the value of land encumbered by a conservation easement. What factors reflect the diminution in value to support the discount?

The Basics

Understanding the characteristics of a conservation easement is important when deciphering where its value comes from. A conservation easement is a voluntary legal agreement between a landowner and another party—usually the government—which restricts the development of a piece of land. These lands are typically donated or sold by the landowners to the government or another land trust. In return, the landowners receive tax benefits. In a conservation easement, the landowners will sell their rights to the land, which allows the land trusts or government agency to use the land for recreational services, preservation of historic lands, open spaces or natural habitats.

There are two distinguishable characteristics of conservation easements. First, conservation easements "run with the land," meaning they are perpetual regardless of a change in landowners or external influences. Perpetuity is also the only way for landowners to receive tax benefits. It must be recognized by both the landowner and the land trust that once the land is donated or sold, it will forever be used for preservation and/or conservation. Second, after the

conservation easement is signed, the landowner remains the landowner. What they are donating or selling is their rights to the land.

Controversy

Controversy surrounding conservation easements continues with the actions of both government agencies and private land trusts. The "prearranged flip" is known infamously by landowners. This occurs when land trusts enter a conservation easement with the intent to sell it later to federal or state government agencies. Often, land trusts will buy a conservation easement for less than what they will sell it to the government, earning them their profit. This vehicle of transfer is not uncommon and reflects an often unstated or assumed premise on which conservation easements are created—there is a finite and limited market for conservation easements that are almost exclusively public agencies or private groups that act as quasi-public conduits for agencies.

The Internal Revenue Service (IRS) stepped into the foray, expressing its concern regarding conservation easements for several years. While the public tends to be wary of the intentions of the private land trusts and government agencies, the IRS believes the landowners play a significant role in the controversy surrounding conservation easements. The IRS stated that they have "seen abuses of this tax provision that compromise the policy Congress intended to promote." Tax benefits do serve as incentive for landowners to enter into conservation easements, but the IRS speculates that taxpayers have taken "inappropriately large deductions for easements." They have also claimed that taxpayers have taken deductions when they are not entitled to any at all. The IRS is not in support of conservation easements because they maintain that taxpayers are abusing the tax relief incentive.

The improper tax deductions often derive from an inaccurate valuation of the property. Landowners claim deductions for amounts that exceed the fair market value of a donated easement. The mistake here is either on the landowner's side or on the initial appraisal of the property. In response, the IRS says it may impose penalties on all parties involved in an improper transaction concerning a conservation easement. This may include the landowner, promoters, appraisers and anyone else involved.

How and Why Conservation Easements Affect Value

Ultimately, the purpose of a conservation easement is to protect lands. The intent behind this agreement is positive but easements have been abused by grantees, grantors and the market place. To stop the abuse of conservation easements, grantees and grantors must understand *the highest and best use* of a property, so that the value of a property Before and After the easement is agreed upon by both parties. The highest and best use of a property Before a conservation easement typically holds a different value than the property After an easement is in place. This is because property rights given or taken away from the landowner in a conservation easement directly affects the highest and best use of a property, thus affecting the value. This is the fundamental concept in the *bundle of rights*.

Gathering the tangible market evidence reflecting discounts between the Before and After values is the next step. A sales comparison approach can be used and the best approach is paired sales in the Before and After. However, data can be very limiting and often subjective, especially in the After condition. Motivators can include tax incentives, markets and the relationships of the parties. This can be difficult to ascertain, but when available, the sales comparison approach is the primary accepted method to determining discounts. The issue with this is the absolute lack of *same transfer* pairing where a comparable sold without a conservation easement and the same property sold with the conservation easement.

Cross comparable pairing can be completed, but this can be subjective in light of the limited market data set. Ideally, if Comparable A sold at $1,000 per acre without a conservation easement and Comparable B sold for $800 per acre with a conservation easement, the value of the conservation easement would be $200 per acre, which shows a 20 percent discount from the unencumbered Before value. However, what often happens is due to the lack of comparables, the agency will often "imply" the discount based on an appraisal. The conservation arena has by and large attributed "standard" discounts for conservation easements based on internal appraisals and accepted "rules of thumb."

Sonoma County—Conservation Easement History

Sonoma County has an active program of acquiring both fee and conservation easements for their open space and conservation program. Stuart Miller of Sonoma County provided overviews of their acquisition history for roughly 20 years (1992 to 2012). The current activity has slowed but has been active. It is reasonable to conclude that this agency's involvement represents a very strong basis for market support in this area.

By comparison, I have analyzed two data sets over the past 20 years. In this data set, there are purchases of conservation casements for 1) Greenbelts and Scenic Hillsides and 2) Wildlife and Natural Areas. This activity was compared to the fee acquisitions, which are 100 percent of the ownership and the conservation easements are the partial acquisitions.

Conservation Easement Discounts - Sonoma County Overall Averages for 20 years					
Conservation Easements (Allow for grazing and vegetative management)					
Primary Category	**# of Projects**	**Acres Protected**	**Market Value**	**Price Per Acre**	**CE Discounts**
Greenbelts & Scenic Hillsides	40	7,914	$ 38,928,000	$ 4,918.73	**19.30%**
Water, Wildlife & Natural Areas	40	58,199	$ 100,631,150	$ 1,729.08	**12.63%**
Totals	80	66,113	$ 191,302,150	$ 2,893.55	**14.28%**
Fee Acquisition	**# Projects**	**Acres Protected**	**Market Value**	**Price Per Acre**	
Greenbelts & Scenic Hillsides	17	1,939	$ 49,405,200	$ 25,479.73	
Water, Wildlife & Natural Areas	4	1,539	$ 21,060,000	$ 13,688.57	
Totals	21	3,478	$ 70,465,200	$ 20,263.12	

The comparison of the two provides a market basis of discounts. This is shown in the graph provided. This data compares 80 conservations easements and 21 fee acquisitions. While the comparisons are not direct (same property comparison), the quantity of data does provide support for discounts when the same highest and best use is applied to the properties (aka scenic hillsides and Wildlife). As shown, the total discount for Scenic Hillsides is 19.30 percent. This accounts for an expanded highest and best use that would likely allow for residential uses. The discount for wildlife and natural areas was 12.63 percent where the highest and best use in the Before and After is similar but still reduces the allowed uses. The combined discount was 14.28 percent.

In this data set, there are unencumbered sales with a highest and best use ranging from greenbelt/scenic hillsides to wildlife. The same highest and best use data is presented but were purchased through a conservation easement.

Highest and Best Use Comparison

The conservation easement agreement will identify the uses that can and cannot be used on the property. They are identified as permitted uses and prohibited uses. This comparison in the highest and best use will help you determine the impacts in the Before and After condition. Specific areas of prohibited uses often include subdividing and construction, while specific areas of permitted uses include agriculture, grazing and building envelopes.

In concluding on a final discount, it is important to reflect the nature and character of the area specific, as well as a detailed highest and best use comparison in the Before and After. A common difference noted in the highest and best is the ability to subdivide. This is important because many of the issues in case law surrounding conservation easements specifically address future uses or potential uses of the land. When the land does have a "probable" or likely transitional use to a higher development potential, there is a requirement to reflect this in the determination of the encumbered value (discount). In other words, when the land has a future probable use for more development, the discount is higher. This is an important discussion because it is easy to assume that all conservation easements are the same and that all restrictive easements impose a heavy impact on development rights. This is simply not the case.

Overall, the basis for discounts is reflected in the loss in value due to reduced property rights which is the bundle of rights. The bundle of rights includes the right of possession, the right of control, the right of exclusion, the right of enjoyment and the right of disposition. When considering the discount for conservation easements, the main loss in the bundle of rights is the right of control, the right of exclusion and to some degree, the right of enjoyment. Without considering any loss of development rights, this would inherently reflect a discount. When development rights have not substantially changed but there is an inherent loss of property rights, discounts range from two percent to 15 percent. The other significant category of consideration is the loss of development rights. When this occurs, discounts can range from 15 percent to 55 percent.

In Summary

Conservation easements began as an effective tool to conserve lands but over time, they have raised controversy. It is important to reflect the distinction between loss of property rights without loss of development rights versus loss of property rights and loss of developmental rights. Ultimately, all parties must understand that the higher impact on loss of property and development rights, the less value the encumbered land holds, resulting in a greater discount due to the conservation easement. ✪

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