A07. Valuing Conservation Easements

Friday, October 18| 10:30 a.m. - Noon

Room 302C

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Rally 2019: The National Land Conservation Conference
Raleigh, NC

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National Land Conservation Conference | October 17-19 | Raleigh, NC

Appraising Conservation Easements

How Conservation Easements are Valued:

Before and After Appraisals

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October 18, 2019

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Overview

- 1. The Appraisal Process
- 2. Identifying the Property to be Appraised
- 3. The Valuation Process
- 4. Check for Understanding
- 5. Q and A

The Appraisal Process

- An appraisal is the process of developing a credible opinion of value
- An appraisal and an appraisal report are different things
- Conclusions are market driven and backward looking

1. Determine the Scope of Work

- Scope of Work
  - What problem needs to be solved?
  - How will we solve it?
  - What is expected of the appraiser?
  - Who is the client and who are the intended users?

2. Determine the Property to Be Appraised

- Often times the most challenging part of the process
- More details in Part Two

3. Write The Appraisal Report

- Research subject property
- Research market factors
- Determine highest and best use
- Analyze all applicable approaches to value
- Reconcile the approaches to a value conclusion

Who is the Client?

- Land Trust (typical)
- Land owner (donated easements for IRS)
- Is the client the one who ultimately pays for the appraisal? Not necessarily.
- Does the client affect “the number”? NO!
- Appraisers can only be an advocate for their value conclusion

Who Pays for the Appraisal?

- The client pays for the appraisal
- The “upstream” source of the fee is irrelevant
- We answer to the client
- We can discuss values with only the client

Part Two
Identifying the Property to be Appraised

A Vexing Issue, Indeed

So, What Exactly Are We Appraising Anyway?

- Three main categories
  - USPAP – Minimum standards for ALL appraisals. A federal standard
  - IRS – Standard when a non-cash donation is being taken
  - "Yellow Book" (UASFLA) – Standard when federal money is involved

Follow the Money!

- Where the easement money is coming from, or will be used for, helps determine what appraisal standard to use

USPAP Appraisals

- The subject property is ultimately determined by the appraiser with client input
- Subject can be defined as just about anything

IRS Appraisals

- The subject property is called the "Contiguous Family Owned Property" (CFOP) and is defined by law
- "Family" includes siblings (1/2 or 1), spouses, parents, kids, grandparents and grandkids (ascendants and descendants)
- "Family" does not include businesses (people only)
- CFOPs determination is critical when only a portion is being eased

IRS Appraisals, cont.

- Enhancement
  - Potentially Enhanced Properties (PEPs) must be addressed
  - PEPs can be owned by family or related parties including businesses (50% or more ownership)
  - PEPs need not be contiguous
  - If enhanced, a before and after is required to determine value of enhancement

Yellow Book Appraisals

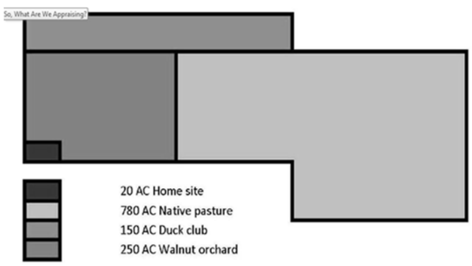
- Used when federal funds are involved
- The subject property is called the "larger parcel" and is also defined by law
- The larger parcel is determined by:
  - Contiguity (i.e. – proximate)
  - Unity of Ownership (can be a business)
  - Unity of Highest and Best Use (read: integrated H&BU)

Therefore, the Vexing Nuance is…

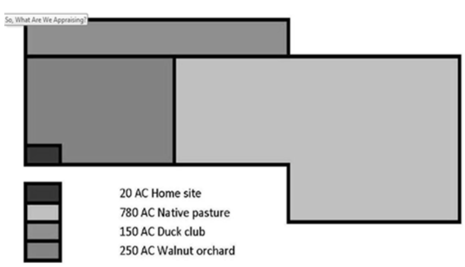
- The subject property being appraised may change depending on the standard to which the appraisal report is written
- USPAP
- IRS
- Yellow Book

USPAP / IRS / Yellow Book

- 1,200 AC Family Owned Ranch. Desire to encumber the green portion



USPAP = Subject is 250 AC
IRS = CFOP is 1,200 AC
Yellow Book = Larger Parcel is 250 AC (or 270 AC)



Part Three
The Valuation Process

Just one of many things to pay attention to in an appraisal report

Approaches to Value

- Cost Approach (Common)
  - Land plus improvements
- Sales Comparison Approach (Common)
  - Substitution
- Income Approach (Uncommon)
  - Capitalization of net income
  - Discounted Cash Flow (development land) – Must be well supported!

Bundle of Rights

Examples of fee simple rights

- Right to use real estate
- Right to sell all or a portion of it
- Right to lease it
- Right to subdivide
- Subject to the 4 powers of government

Property Rights Have Value

- Example – Rental income in a leased fee estate.
- The appraisal process is used to determine the impact from the rights given up.

Conservation Easement Valuation

- They are different. Why?
- Because we are trying to determine the effect the easement has on the surface rights (how much are the given up rights worth?)

“Typical” Easement

- No subdivision of the property
- No development of the property
- One Home Site
- Grazing plan
- Fencing plan
- Others (i.e.- public access?)

How is Value Determined?

- Highest and best use drives value
  - Legally permissible
  - Physically possible
  - Financially feasible
  - Maximally productive
  - Does the current use match the highest and best use?

Valuing Conservation Easements

- Typically use a Before and After format
- Never Flat Percentage!
- Value of the subject before the easement
  - Based on its highest and best use
- Value of the subject after the easement
  - Based on its new highest and best use
- Difference is the effect from the easement
- May have to further subtract enhancement

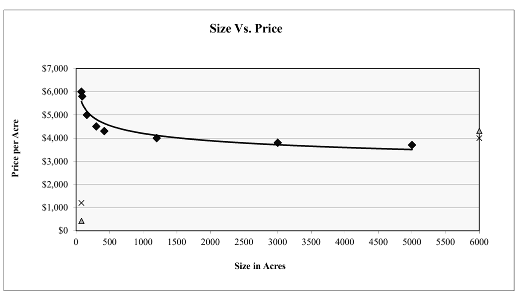
Rules of Thumb

- The loss of a right is worth something
- 10% up to 75% diminution in value
- 30% to 45% diminution is common
- How the subject is defined can greatly affect the dollar amount of the easement

Common Areas of Confusion

- Defining the subject to be appraised
- Accounting for size differences in comparables
- Accounting for the percentage under easement

Size is a Factor



Percentage Under Easement