A07. Valuing Conservation Easements

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

Room 302C

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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

Size Vs. Price

Percentage Under Easement