

# Conservation Resource Center's Tax Credit Exchange

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## Tax Credit Update Topic: Conservation Easement Appraisals

There has been a great deal of discussion about conservation easement appraisals – within the conservation community as well as by the IRS and the Colorado Department of Revenue. This past March, a three day course on appraising conservation easements was held in Greeley, Colorado and attended by over 80 professional appraisers.

The Conservation Resource Center (CRC) presented its Policies for Conservation Easement Appraisals to this group of appraisers. After positive feedback from the group, CRC has adopted the policies below in order to effect consistency and certainty to our review of conservation easement appraisals.

### Policies for Conservation Easement Appraisals

The Conservation Resource Center's policies and requirements apply to all appraisal reports submitted for purposes of conservation tax credit transfers. The sheer volume of reports we review each year as well as stricter scrutiny by the IRS and the Colorado Department of Revenue has necessitated the need for us to implement a consistent policy.

While this is in no way an exhaustive list of the requirements of a "Qualified Appraisal" as defined by the IRS, the Conservation Resource Center requires that all appraisal reports include:

#### 1. Purpose of the Appraisal

Treas. Reg. §1.170A-13(c)(3)(ii)(G) requires that a "Qualified appraisal shall include a statement that the appraisal was prepared for *income tax purposes*. We suggest the following language:

**"The purpose of the Appraisal is to provide an opinion of the fair market value of the subject property. The intended use of the appraisal is for federal and state income tax purposes."**

#### 2. Market Value

The IRS also requires that the appraisal shall indicate the appraised fair market value of the subject property. Fair Market Value is defined by Treas. Reg. §1.170A-1(c)(2). Accordingly, we suggest the following definition of Fair Market Value be included in the appraisal report:

**"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 sell and both having reasonable knowledge of the facts."**

### 3. Highest & Best Use

All appraisal reports must include a conclusion of highest and best use of the entire property both *before* the conservation easement has been placed on the subject property and *after* the conservation easement has been placed on the subject property. Both highest and best use conclusions shall be consistent with legal uses, physically possible uses, financially feasible uses and maximally productive uses of the subject property.

### 4. Value Analysis

#### A. Comparable Sales Analysis

CRC recognizes that appraisers use different approaches to valuation. **However, CRC requires that all appraisals include a true comparable sales analysis;** i.e. use of comparable parcels of the same total size as the subject property.

By way of example, if an appraiser is appraising a 40-acre parcel, and believes that the highest and best use is four 10-acre home sites, a true comparable analysis would require looking at sales of other parcels of approximately 40 acres in size (that could have been divided into four 10-acre parcels, but that were sold as a single, larger parcel). Frequently, appraisers note that they are unable to find “good” true comparables and can only find comparables that do not comply with typical appraisal standards; e.g. out of area sales, sales that are “too old,” etc. In such cases we still ask that the less-than-optimal true comparables be included, if only to illustrate why the appraiser may have relied more heavily on other valuation methodologies.

If another analysis (development analysis, subdivision analysis, etc.) is the primary basis for the valuation, the appraisal *must* include an explanation of why the comparable sales analysis was not ultimately relied upon or a reconciliation of the differing analyses that produced the value conclusion.

#### B. After Value

In determining the value of the subject property *after* the placement of the conservation easement, it is necessary for the appraiser to use comparable properties upon which development is restricted similar to the restriction(s) of the conservation easement.

In addition to properties that are restricted by conservation easement, other appropriate comparable properties for after value include properties upon which development is restricted for practical reasons; e.g. steep slope, size limitations, flood plains, etc.

### 5. Enhancement/Benefit to Donor

The appraiser needs to determine if an enhancement valuation, pursuant to Treas. Regs. §1.170A-14(h)(3), is required to take account of potential off-site benefits to land not encumbered by the

easement. There are essentially two situations where such an analysis is required: one involves contiguous land, and the other non-contiguous land.

**A. Contiguous Property Owned by Donor (or Donor's Family or Business):**

If there is land not encumbered by the easement that is contiguous to the easement parcel, and is owned by the donor, members of the donor's family (direct ancestors, descendants, siblings and spouses) or a business that is more than 50% owned by the donor, an enhancement analysis is required. Beginning January 1, 2005, CRC requires that, in the case of contiguous parcels, the appraiser must conduct a full appraisal of the *whole* contiguous parcel (easement encumbered land and non easement encumbered land) before the placement of the conservation easement and the *whole* contiguous parcel after the placement of the conservation easement. The value of the conservation easement is the difference in these two values. Enhancement value, if any, is therefore automatically captured by this calculation. It will not suffice to merely appraise the easement parcel, and then do a separate analysis for the unencumbered portion of the contiguous parcel.

**B. Non-contiguous Property Owned by Donor (or Donor's Family or Business):**

An enhancement analysis is also required if there is non-contiguous property (not subject to the easement) that is owned by the donor (or donor's family or business), and which could be "reasonably expected" to enjoy economic benefit from the easement. In almost all cases the donor or the donor's family will own some land somewhere that is not subject to the easement. Thus, the appraiser will need to exercise his or her judgment in making an initial decision of whether it can be "reasonably expected" that such non-contiguous property will be affected by the easement. Typically, this will depend on proximity: if the land is almost contiguous or very near to the easement property, further analysis may be required. If the land is some distance from the easement parcel, the appraiser may conclude that benefit could not be "reasonably expected" and that no analysis is required. Note that if enhancement analysis is required in the case of non-contiguous land, the analysis will probably be different from that of contiguous land, since the contiguous land requires a "whole parcel" before and after analysis, but such a "whole parcel" approach can probably not be applied to non-contiguous parcels.

If the appraiser determines there is no land that requires an enhancement valuation pursuant to Treas. Regs. §1.170A-14(h)(3), the appraisal should include a statement to that effect in the appraisal report. We suggest the following:

**"The appraiser has determined that there is no land owned by the Donor or related parties that requires an enhancement valuation pursuant to Treas. Regs. §1.170A-14(h)(3)."**

**6. Licensure/USPAP**

Although it is not currently required by federal or Colorado law, in order to assure the highest standards, we now require that all appraisers be licensed by the Colorado Board of Real Estate

Appraisers and that the appraisals comply with Uniform Standards of Professional Appraisal Practice (USPAP). The appraisal report should contain licensure information and a statement certifying that the appraiser prepared the report in conformity with USPAP.

**DISCLAIMER:**

*Please note that these alerts are summary in nature and are not intended to serve as professional advice. Recipients of this information should not rely on the information presented here, but rather should consult their conservation easement and tax credit professionals if they believe they are affected by the legislation or policies discussed.*