A Conservation Easement Appraisal Guide:

A Brief Overview of Easement Valuation

Colorado Coalition of Land Trusts

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This document was produced to provide individuals involved in conservation transactions with general information regarding conservation easement appraisals. It is not intended to provide specific professional advice. If legal advice, appraisal advice or other expert assistance is required, the services of a competent professional should be sought.
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INTRODUCTION

This past decade has seen banner years for conservation easement activity throughout the State of Colorado and, increasingly, the nation. This is due in large part to the financial incentives put in place by several states, all designed to incentivize landowners to protect more private land using conservation easements. This program, along with other conservation programs such as Great Outdoors Colorado (GOCO) along with Federal income tax benefits, has helped landowners and conservation groups to protect many thousands of acres of cherished and productive landscapes. All of this activity has greatly benefited Colorado's residents and visitors alike.

With this increase in activity came increased scrutiny of conservation easements, appraisers and easement-holding organizations. While easement deals and easement donors vary dramatically, if landowners intend to make a charitable contribution and take advantage of the Federal and state tax benefits, the conservation easement's value must be substantiated by a “qualified appraisal” supporting its “fair market value.” The qualified appraisal is also the single item that comes under the most intense scrutiny from the IRS, the Colorado Department of Revenue, the Colorado Department of Regulatory Agencies through its Division of Real Estate, conservation project funders, and brokers and buyers of tax credits. Therefore, it is absolutely critical that easement appraisals be done by competent appraisers who thoroughly understand the very complicated process of valuing a conservation easement.

This Guide has one primary purpose: to help ensure that Colorado has the most sound conservation easement transactions possible by reminding conservation practitioners and landowners about the fundamentals of the appraisal process. Poorly drafted or fraudulent appraisals not only damage the integrity of the particular easement transaction; they also can dent the reputation of important conservation programs such as the easement tax credit. And most importantly, bad transactions betray public trust in and support of conservation in general.

The primary audiences for the Guide are:

1) Landowners who are considering donating or selling an easement;
2) Conservation organization staff or volunteers; and
3) Other professional, including appraisers and attorneys.

This Guide assumes readers have a general understanding of what conservation easements are and what the respective roles are of easement grantors, their advisors, and holders of the easement. For more information regarding land trusts, conservation easements and other conservation activity, visit the Land Trust Alliance’s www.lta.org, and see Section V of this Guide for additional references.

While the Guide is somewhat Colorado-centric, we believe there is useful information here for landowners and practitioners in every state.
Landowners should use this Guide to familiarize themselves with the appraisal process and resulting document. It should provide them with several appropriate questions to ask when hiring an appraiser, help them communicate with their appraiser, and increase their basic understanding of the resulting easement appraisal document.

For land trusts and government open space programs, this Guide provides a quick overview of things to consider when hiring their own appraisers and provides them with a template to review the resulting document. More importantly, it also provides staff or volunteers with a point of departure for discussing appraisals with potential easement donors.

Finally, for appraisers, attorneys and consultants, this Guide—though basic—provides a checklist of many of the factors that should be considered when conducting an appraisal. However, it is not intended as a training manual in and of itself, nor is it intended to supplant existing information, standards or educational materials designed for appraisers. The Guide is organized into five primary sections following this introduction:

Section I, "Frequently Asked Questions about Appraisals" lists just that: a few selected questions that landowners and others may find useful in understanding some of the basic principles of easement appraisals.

Section II, "Hiring an Appraiser", addresses specific questions that landowners and others should ask when hiring an appraiser. Appraisers that offer the highest land values or those with the lowest price are not necessarily the best or most appropriate.

Section III, "A General Outline of Conservation Easement Appraisal Contents," is intended to provide a concise outline of the necessary contents of a conservation easement appraisal. This outline is best used a checklist when reviewing an actual appraisal. Its development was facilitated by input from several experienced conservation easement appraisers and has also had important contributions from other appraisers and several experienced attorneys.

Section IV, "Frequently Committed Sins in Valuing Conservation Easements", presents a few basic issues that are often associated with incomplete or incorrect appraisals. Sadly, this list, first prepared in 2004, has changed little in the past six years.

Section V, "Suggested Reading and Reference Tools" provides a brief list of resources for additional reading about conservation easements and appraisals.

This Guide is a work in progress, one that we continue to refine as information changes and as time and resources allow. As such, we welcome your thoughts and comments on this draft and wish you the very best in your conservation endeavors.

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I. FREQUENTLY ASKED QUESTIONS ABOUT APPRAISALS

As of January 1, 2010 all non-profit entities that hold a conservation easement for which a Colorado Income tax credit is claimed must be certified by the Division of Real Estate. Starting January 1, 2011 all entities including historic preservation and government entities that hold a conservation easement for which a tax credit is claimed are required to be certified.

1. What is a conservation easement?

A conservation easement is a tool used to preserve important lands and water features on a given property. It is a voluntary, recorded agreement between a landowner and a “holder” of the easement, which can either be a qualified charitable organization—typically a land trust—or a unit of government. A conservation easement identifies important historic, scenic, natural or agricultural characteristics of the property which benefit the general public (collectively known as the “conservation values”) and then establishes a set of restrictions on use of that property which will ensure that those conservation values are protected. In signing an easement, the landowner is granting to the easement holder the right to enforce those restrictions. The land stays in private ownership and the landowner typically reserves certain rights to the property such as the ability to maintain a residence, continue to farm or ranch, or use the property for limited recreational purposes. Most Federal or state tax incentives or easement purchase programs require that the easement be perpetual. That is, easements are intended to be in place on the property forever, and as such, the easement restrictions transfer with the title of the property to subsequent owners. For further discussion of easements and their complexities, see Section V for additional resources.

2. What rights are typically restricted through an easement?

Conservation easements are relatively flexible tools, and as such, the restrictions on use can vary depending upon landowners’ needs, the goals of the easement holder, and most importantly, on the conservation needs of the property. Typical easement restrictions include limitations on further subdivision or development of the property, commercial or industrial use, mining and many other uses. The restrictions are intended to preserve the conservation values of the property as set forth in the easement document as well as an accompanying document known as the baseline documentation or present conditions report. The easement holder must also have the capacity and commitment to enforce the particular restrictions that are desired.

Many conservation easements include provisions restricting the sale or transfer of water rights. This is especially true for properties where the conservation values include irrigated crop lands, wetlands or other water features that are dependent upon
the water. As such, the water rights are required to stay with the property and be exercised so as to not be lost through abandonment. For more information on restricting certain water rights through a conservation easement, seek the advice of attorneys and other professionals knowledgeable about water issues. The Colorado Water Trust also has valuable information on their website at www.coloradowatertrust.org.

3. **What are the benefits of conservation easements?**

From the perspective of the public, conservation easements can be a very valuable and cost-effective preservation tool. Many landscapes that are important to the daily lives of residents and visitors are largely privately owned. Whether it is scenic ranchland in a mountain valley, a fruit orchard on the western slope, or a high-value waterfowl habitat along a river on the eastern plains, many of these landscapes have scenic, cultural or natural value to the public. Many of these lands are inappropriate for public ownership—or even public access. However, the protection of these private lands can have immense benefits to the surrounding communities.

For landowners considering an easement, the primary benefit of placing an easement on their property is having the peace of mind knowing that their beloved property will be forever protected, even once it transfers out of their hands. In addition, there are several financial incentives available to landowners, including a few that are not available in all states. These incentives include *easement purchases*, available through several Federal and state conservation programs such as Great Outdoors Colorado. The financial incentives also include Federal and state tax programs for *easement donations*. These include potential Federal income deductions or reductions in estate taxes, as well as a state income tax credit. This Guide cannot go into detail over these programs (see Section V for additional resources). However, these financial incentives are the driving force behind needing to value a conservation easement.

Because of their potential to reduce the estate tax burdens for working ranch and farmland families, conservation easements can also be an important tool to keep the land in family hands.

4. **Why do conservation easements need to be appraised?**

Not all conservation easements need to be appraised. Examples where appraisals are not needed include cases in which a landowner does not intend to utilize any tax benefits or if the easement does not have any "gift" status, such as a required easement within a development.

However, if landowners intend to take advantage of the available public incentives for donating a conservation easement, such as a state income tax credit or a Federal income tax deduction, the easement must be valued to determine its worth. Conservation easements are considered an asset that has value which can be "gifted"
to a qualified easement holder. IRS publication 561 "Determining the Value of Donated Property" spells out the guidelines for determining the value of this gift, necessary for all gifts of real property greater than $5,000.

In addition, if a landowner intends to sell an easement, in most cases a buyer will need to substantiate its value through an appraisal. Most local, state or Federal programs that fund easement purchases have specific requirements for their appraisals.

When condemnation of all or part of a conservation easement-encumbered property occurs, modern easements are required to provide that the easement holder receive a percentage of the proceeds equivalent to the conservation easement's value at the time of donation. As such, these cases would also require the documentation of value through an appraisal.

5. How are easements valued?

While there may be other methods of determining an easement's value, the IRS, most state tax incentives, and most easement purchase programs, require the use of a qualified appraisal to determine an easement's value. The various methodologies for completing an easement appraisal are explored in more detail in Section III: "A General Outline of Conservation Easement Appraisals." In summary, there are three primary approaches to determining the value of real estate, the sales comparison approach, the cost approach, and the income approach.

The sales comparison approach--in which appraisers base their opinion of the value of the donated easement on sales of other conservation easements on similar properties with roughly similar restrictions--is the mandated approach in the Treasury Regulations § 1.170A if "... there is a substantial record of sales of easements comparable to the donated easement (such as purchases pursuant to a government program) ..." However, in most areas, such market data have not been available in sufficient quantity, at least not presently. Therefore, most easements are valued through the "before and after" process. The appraiser:

- Determines a before-easement property value, an opinion of the fair market value of a property unencumbered by the proposed easement (for example, the "before" value is $1,000,000);
- Determines an after-easement property value, an opinion of fair market value of the same property, but now as encumbered by the easement (for example, the "after" value is $400,000); then
- Subtracts the "after" value from the "before" to arrive at the estimate value of the conservation easement:

| Before-easement value | $1,000,000 |
| After-easement value  | 400,000    |
| Value of the conservation easement | 600,000 |
There are exceptions to this methodology, as will be seen in the third section.

6. **What are the requirements for appraisals?**

The requirements for appraisals depend upon the program or purpose for valuing an easement. If the easement is intended to qualify as a charitable contribution under Federal tax code, the value must be substantiated with a "qualified appraisal." To be qualified, the appraisal must 1) be made not earlier than 60 days prior to the date of contribution; 2) not involve a prohibited appraisal fee (such as a fee based on the percentage of the deduction); 3) include certain information (which is outlined in Section III); and 4) must be prepared, signed and dated by a "qualified appraiser."

If the easement is intended to qualify as a donation under state income tax credit programs, the appraisals also need to follow these Federal guidelines.

However, many easement purchase programs, especially those funded by Federal agencies, have different requirements for valuing easements. After the Savings and Loan scandals of the 1980s, Congress passed legislation in 1989 requiring states to license appraisers. At the same time, *the Uniform Standards of Professional Appraisal Practice* (USPAP) were created to set the ethical and technical standards for appraisals for "Federally-related transactions." It is only recently that the IRS has begun to recognize the existence of USPAP, even though it has been the required minimum standard for appraisers and appraisals since adoption. For example, Federal land acquisition and direct lending agencies have been required by the Office of Management and Budget (OMB) to use appraisals in conformance with USPAP standards since 1992. Information on USPAP can be found at [www.appraisalfoundation.org](http://www.appraisalfoundation.org).

In addition, most agencies acquiring easements using Federal funds must adhere to the *Uniform Appraisal Standards for Federal Land Acquisitions* (UAS or "Yellow Book"), updated periodically by the Interagency Land Acquisition Conference. UAS is not applicable to appraisals prepared for income tax purposes.

7. **What is a "qualified appraiser"?**

According to the IRS Publication 561, a "qualified appraiser" is an individual that

1) Holds himself or herself out to the public as an appraiser or performs appraisals on a regular basis;
2) Is qualified to make appraisals of the type of property being valued because of his or her qualifications that are described in the appraisal;
3) Is not an excluded individual (such as the donor or the donor's relative); and
4) Understands that an intentionally false overstatement of value of property may subject him or her to the penalty for aiding and abetting an understatement of tax liability.

This “qualified appraiser” definition has been fine-tuned in the past few years, and as of this writing (May 2010) the U.S. Department of Treasury may be preparing new Regulations that will simplify the current alphabet soup comprised of the 2004 Jobs Creation Act, the 2006 Pension Protection Act, and IRS Notice 2006-96 (see Suggested Reading, Section V).

For mortgage purposes, appraisers must be licensed by the State of Colorado. Not all states have requirements for appraisers to be certified or licensed for conservation easement donation appraisals.

Because the requirements to be a "qualified appraiser" are relatively loose and left to the judgement of the appraiser, being certified by the state (or holding membership in a recognized professional organization) is an indication that an appraiser has taken steps to become more knowledgeable and professional. However, because there is no licensure or certification based solely on an appraiser's knowledge of easement valuation, neither state certification nor private designation verifies that a particular appraiser is competent in conservation easement valuation or any of the other specialized valuations. Caveat emptor.

8. What is “Fair Market Value”?

Appraisals set forth appraisers’ opinions of the “fair market value” of a given property or easement. The Tax Code describes fair market value as “the price the property would sell for on the open market. It is the price that would be agreed on between a willing buyer and willing seller, with neither being required to act, and both having reasonable knowledge of the relevant facts.”

9. What property is generally valued in an easement appraisal?

Conservation easement valuations must take into consideration all of the restrictions and reserved rights outlined in the conservation easement, as well as any pre-existing restrictions such as zoning and existing easements (conservation and otherwise). This includes any restrictions on future development or subdivision and any limitations on the sale of water rights, minerals or sand and gravel. In addition to valuing the same area legally described in the conservation easement, it must also value any contiguous property owned by the donor or members of the donor’s family (many landowners place easements on portions of their contiguous property). Appraisals also must to take into consideration all of the other property owned in the area by the landowner, members of the landowner’s family, and “related persons” (related in a business sense). This is because of the "enhancement rule." If a landowner places an easement
on property near her father’s, the father's property may benefit (or is enhanced) by the adjacent conservation easement. If this is the case, the amount of the increase must be deducted from the amount claimed as a charitable contribution by the easement donor. The “entire contiguous property” and “other property owned by related persons” rules are among the most frequently misunderstood aspects of planning and valuing easements.

10. How accurate are easement appraisals?

Conservation easement appraisals are often described as part science, part art. It is important to note that appraisals are opinions of value. As a result, appraisal values may vary depending on the education, training and experience of the appraiser. However, competent appraisers using the same set of facts and valuation methods accepted by their peers should arrive at roughly similar assignment results. In addition, appraisals that follow format and content guidelines such as those outlined in Section III are likely to reflect a more thorough assessment of the easement’s value.

11. What are the ramifications of bad or erroneous appraisals?

Appraisals with minor technical or formatting flaws can be corrected relatively easily without major ramifications. However, grossly inaccurate or purposefully misleading overstatements of value are indeed serious and should not be tolerated by any party to the transaction. Such appraisals—and their resulting tax implications or excessive purchase prices—can erode the public’s trust in conservation easements in general and in the particular tax benefit or conservation program specifically. The news of either inaccurate or fraudulent valuations can make it difficult to gain or retain local support for important conservation initiatives.

Both the Federal and state tax systems contain penalties for the overvaluation of donated property, for underpayment of estate or gift taxes, and for the promotion of abusive tax shelters. It is beyond the scope of this Guide to go into detail over these penalties, but readers should be aware that such penalties are real and substantial.

Finally, appraisers who have prepared fraudulent appraisals may have their state licensure or private professional organization certifications revoked. They may also be prohibited by the IRS from having their appraisals considered "qualified appraisals," and they may be fined by a state or by the Federal government.
12. What role do land trusts or other conservation entities have regarding easement appraisals?

A land trust's role regarding easement appraisals may differ depending on the nature of the transaction and the easement holder's philosophy. With the donation of gifts to a charitable organization, such as a painting to a museum, it is important that the organization receiving the gift stay at arm's length from the valuation process to avoid the perception that they are influencing the value of the gift. While the same is true with the donation of conservation easements, easement holders should ensure to the greatest extent possible that donors are aware of Federal or state requirements.

For easement donations that are claimed as charitable contributions, easement holders will be asked to sign IRS Form 8283. This form was developed in response to the Tax Reform Act of 1984, and it requires that easement holders be furnished with, and acknowledge receipt of, the donor's appraisal and gift of the easement. The easement holder's acknowledgement of the gift does not indicate that it agrees with the value claimed.

There is not consensus as to the extent that land trusts should be involved in the appraisal and tax processes. An example of this is split opinions on whether or not a land trust should sign a Form 8283 in which the claimed value is considered to be excessive. However, every easement holder has an interest in ensuring that landowners receive credible appraisals. This is not only important for maintaining good relationships with the easement donors, but it is also critical to maintain the integrity of the tax benefits for charitable easement contributions.

Finally, in the event of easement purchases, a trust or easement holder may be the client retaining an appraiser. In these cases, the client will become much more involved in the valuation process, and should be aware of the important questions to ask when hiring an appraiser.
II. HIRING AN APPRAISER

One of the first steps towards securing a sound appraisal is to hire a knowledgeable and competent appraiser. In addition to securing the services of a good appraiser, it is important that you stay in close contact with him or her throughout the valuation process. For example, the landowner may be negotiating the terms of the easement without telling the appraiser, who in turn provides an appraisal based on the wrong set of facts. Below are several questions you might consider when pursuing the services of an appraiser.

1. Where do I find out about potential conservation easement appraisers?

There is no formal association of conservation easement appraisers, and many real estate appraisers are not familiar with conservation easements. As a result, several of the best sources of names of potential conservation easement appraisers are:

- Other appraisers who you may already know,
- Lawyers that are experienced in drafting and negotiating conservation easements, and
- Land trusts who have had occasion to hire appraisers for their own purposes or who work with landowners that have had easement appraisals.

Recommendations or word of mouth from other landowners who have worked with a particular appraiser are also helpful. However, most landowners do not have extensive background in easements or appraisals; as a result, they often will have few points of comparison or reference when discussing an appraiser with whom they have worked.

2. When do I need to secure the services of an appraiser?

Treasury regulations state that valuation dates in conservation easement appraisals must be on or within 60 days prior to the date of donation, and the appraisal must be in the hands of the taxpayer no later than the date of filing Federal income taxes, including extensions.

Because good conservation easement appraisals can take time, it is necessary to contact an appraiser as soon as you are considering donating or selling an easement. That appraiser can advise you as to the timeframe for securing the necessary documents and other aspects of the appraisal process.

It is also important to note that it is possible to ask an appraiser for a preliminary estimate of value. While it would not be considered a complete appraisal for tax
purposes, a preliminary valuation might be helpful if you are determining whether or not to pursue an easement.

3. What questions should I ask a potential appraiser before hiring one?

Before retaining an appraiser, it is a good idea to engage potential candidates in a wide-ranging discussion about their work experience, education, professional background and general attitude about conservation easements. Some pertinent questions that you may want to ask are:

- Do you hold a current certified general appraisal license? It is unwise to retain an appraiser who has not achieved this level of professionalism. In Colorado, it is a requirement.

- Do you have any private appraisal association designations such as the Appraisal Institute’s RM or MAI, the American Society of Farm Managers and Rural Appraisers ARA, or the Royal Institute of chartered Surveyor’s MRICS or FRICS? Why or why not? Neither state licensure nor private certification necessarily indicates a familiarity with easements, but it may indicate a level of professionalism on the part of the appraiser.

- Can you explain to me what are a “qualified appraisal” and a “qualified appraiser”? Appraisers who are valuing easements for Federal or state tax purposes should have a working understanding of the regulations regarding appraisals.

- Have you appraised property in this county recently? Though not essential, this helps indicate a familiarity with local markets (or geographic competency).

- Have you appraised property similar to mine recently (development land, ranch land, farm land, etc.)? Though not essential, this helps indicate competency.

- How long have you been an appraiser? Time in the business does not necessarily equate to competency, but it provides you with a general understanding of their experience.

- Have you appraised property for the purpose of valuing a conservation easement? This is perhaps one of the more important questions. Even if they have not completed an easement valuation, the appraiser should be familiar with the technical requirements and procedures for valuing easements. While all appraisers need to do their first valuations at some point, you should recognize that there is some inherent risk involved.
• If not, what steps will you take to familiarize yourself with this type of appraisal? Would you consider affiliating with a more experienced appraiser? Affiliating with a more experienced appraiser may help reduce some of the risks in hiring an inexperienced appraiser. Hiring a second appraiser to perform a review of the first appraiser's report is also common.

• If so, how many appraisals of this type have you completed, and have you worked for easement donors, land trusts or other entities? This will provide a greater sense of their experience and competency.

• Do you have experience with the IRS in defending any of your appraisals? Being required to defend an easement appraisal is not necessarily a negative thing, as easement donations can be flagged for review on any number of issues. However, you should be interested in the results of such a defense.

• In your opinion, what are the best techniques for appraising conservation easements? See the outline in Section III for the techniques and methodologies.

• Please tell me how you propose to address my water rights that I am / am not planning to encumber with my easement. Water rights, as suggested above, are frequently restricted through the use of conservation easements. In some areas, they also represent substantial value. However, not all appraisers are familiar with valuing water rights.

• What do you need from me to complete the appraisal (documents, etc.)? See below.

• What are the fees and timeline to complete the appraisal? See below.

• Finally, please provide three references of past clients. Like all services, it is important that you feel comfortable with the appraiser on a number of fronts, including their level of professionalism, timeliness, and technical expertise.

4. What will my appraiser need to complete the appraisal?

Individual appraisers may request different documents. However, below are the basic documents generally required to complete an appraisal:

• Legal Descriptions of the entire property, the area subject to the easement, and any property owned by the landowners, their family, or "related persons" that is in the vicinity.
• **Copies of closing documents** (if recent enough to be meaningful), related purchase agreements/contracts, and copies of deeds and deeds of trust.

• **Recent title insurance policy or title insurance commitments**, including copies of material exceptions to title.

• **Maps, surveys and sketches** that identify the subject property, any specific building envelopes or restricted zones, and any other property owned by the landowners, their family, or "related persons."

• **Draft or final version of the proposed conservation easement**, or at least a summary of the intended restrictions and retained rights.

• Depending on the complexity of a property or assignment, **additional consultants** (land planner, engineer with expertise in land development, water engineer, etc.) may be appropriate.

5. **What is a reasonable cost for a conservation easement appraisal?**

The costs associated with easement appraisals may vary widely, depending on property's location, the particular appraiser, the level of easement complexity and other factors. They can typically range between $5,000 and $20,000. Please note that is a general estimate only, and you will need to speak directly with your appraiser to determine a range of his or her fees.

6. **What do I do if I have misgivings about the resulting easement value or process, or more importantly, if I feel that the appraisal value might cause my donation or sale of the easement to be questioned?**

As stated above, appraisals are opinions of value, based on a certain set of facts and experiences. Should you feel that an appraisal's value is exceptionally high or low, you should discuss your concerns with your appraiser. Should you still not be satisfied with his or her explanation, it is always possible to secure the services of another appraiser.

*Remember: if you are donating a conservation easement and intend to seek financial benefits, it is your responsibility to minimize the risks of the transaction and secure the most sound appraisal possible. Also, the taxpayer is the one who pays the back taxes, interest and possibly penalties in the event the valuation is found by the IRS to be “incorrect!”*

Should you have extreme concerns about an appraiser's ethical conduct, consider filing a complaint with the state board of real estate appraisers. In Colorado, you can access this process at [http://www.dora.state.co.us/real-estate/Complaints/Complaints.htm](http://www.dora.state.co.us/real-estate/Complaints/Complaints.htm)
III. A GENERAL OUTLINE OF EASEMENT APPRAISAL CONTENTS

Introduction to Outline

This outline summarizes the “Before and After” appraisal process as it pertains to valuing conservation easements in gross. It is based generally on the very useful format found in the Uniform Appraisal Standards for Federal Land Acquisition, or UAS (see Section V: Suggested Reading & Reference Tools). It is intended to provide a detailed overview of the components of a “qualified appraisal” for Federal income tax purposes as defined at Treasury Regulations 1.170A-13.

While the appraisal report formatting presented here is only a suggestion (appraisers value their status and ability to present data and analysis in ways of their own choosing), the appraisal contents outlined, unless noted, must be addressed in a qualified appraisal.

Most of this material pertains to valuation of one or more types of open space or wildlife habitat easements. These are the types of conservation easements most frequently encountered in Colorado and can include easements permitting agricultural production, protection of fish, wildlife or plant habitat, or simply preservation of open space and agriculture. Each of these types of easements can accommodate limited residential, agricultural and recreational uses, as long as they are conveyed exclusively for conservation purposes and offer significant public benefit.

There are some things not addressed here. One is the appraisal of historic façade easements, a flavor of conservation easement not as common here as the more popular conservation easement. This outline does not address in any detail the issues associated with the appraisal of post mortem easements under Internal Revenue Code Section 2031(C). Also, it does not address in detail the issues associated with basis-limited gifts of conservation easements, where the donor has owned the real property for less than 12 months.

This Outline can be used in several ways. For appraisers, it can provide a brief refresher on the content of conservation easement appraisals. For landowners and land trusts hiring an appraiser, it can help familiarize them with the appraisal document and point them to potential questions they may ask about the document itself. And for all parties, the Outline is perhaps best used with a copy of an appraisal in hand to verify that the various components of the conservation easement appraisal are indeed covered.
Easement Appraisals
Suggested Contents (annotated, citations omitted)

A. LETTER OF TRANSMITTAL

1. May summarize value conclusion
2. States date of value
3. Identifies property and purpose of appraisal
4. Highlights any unusual assumptions or limiting conditions
5. States that appraisal is prepared for income tax purposes of the easement donor
6. Provides appraiser’s identifying number (SSN and/or EIN)

B. TABLE OF CONTENTS

C. INTRODUCTION

1. Certification
   a) Acknowledges assistance of others who made significant professional
      contribution to development of the appraisal
   b) Assures readers of the report that appraiser did (or did not) inspect the
      property
   c) Indicates that the appraisal report is in compliance with the Uniform
      Standards of Professional Appraisal Practice (USPAP), the UAS
      "Yellow Book" or any other applicable standards

2. Summary of Salient Facts
   a) Identifies Owner/Donor
   b) States location, brief legal description and/or property address
   c) Reviews the purpose and function of appraisal
d) Establishes the date of value

e) Identifies the property rights appraised

   (1) Fee simple before grant of easement, subject to exceptions to title including pre-existing conservation restrictions

   (2) Fee simple after grant of easement, subject to newly-created perpetual restrictions and pre-existing restrictions or exceptions

   (3) Value of the conservation easement

f) Includes a brief description of subject site and improvements, including water rights and minerals estate

g) Includes as part of the subject all contiguous property owned by the donor, the donor’s family, or "related persons", even if only a portion of the property is encumbered by the easement.

h) Identifies any other property owned by donor or a related person, whether or not such property is contiguous – may or may not require an appraisal of this other property

i) Highlights any extraordinary assumptions or hypothetical conditions relied on in the appraisal

j) Summarizes the easement

   (1) Consistent and inconsistent activities (sometimes called restrictions and permissions)

   (2) Conservation or historic preservation values

k) Summarizes conclusions of highest and best use

   (1) Before grant of easement

   (2) After grant of easement

l) Summarizes value estimates of all property owned by the donor and the donor’s family, and possibly the value of other property owned by the donor or a related person

   (1) Before grant of easement
(2) After grant of easement

m) States the market value of the conservation easement

3. Purpose and Function of Appraisal

   a) Indicates that the appraisal is prepared for the Federal and state income tax purposes of the donor, for use by funding agencies in support of grant-making decisions, etc. (it is acceptable to have multiple purposes)

   b) Provides the correct value definition, such as the following for income-tax purposed appraisals:

      “. . . 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 a reasonable knowledge of the facts.” (Treas. Reg. § 1.170A-1(c)(2))

4. Property Rights Appraised

   a) Defines fee simple and easement interests

   b) Addresses water rights that may be associated with or appurtenant to the property

   c) Addresses fractional interests, interests of tenants in possession and mortgage holders

   d) Addresses mineral estate

5. Describes Scope of Work for the Appraisal

   a) Summarizes the steps taken in preparing the appraisal

   b) States the type of report format (Self-Contained or Summary; a Restricted report by definition is not acceptable)

   c) Restates any extraordinary assumptions of hypothetical conditions relied on in the appraisal
6. Property Identification

   Restates information about the property, possibly with greater detail

7. Important Dates

   a) States Date of Value – current or retrospective
   b) Restates Date of Report
   c) Identifies Date(s) of property inspection

8. Assessment and Taxation Data

   a) Provides schedule and/or parcel number (if available)
   b) Summarizes information available from county assessor and treasurer
   c) Discusses assessment classification, likelihood of change, effect on future tax burden

9. Property History

   a) Summarizes and analyzes leases, sales within at least the past three years, and current or recent listing agreements, contracts or options
   b) Discusses history of use
   c) The appraiser may request data pertaining to last sale of the property, no matter how long ago it occurred

10. Contingent and Limiting Conditions

    a) Limits reliance on or use of the appraisal report
    b) Disclaims responsibility for issues, facts and studies outside the purview of the appraisal
    c) Restates prominently and in detail any extraordinary assumptions or hypothetical conditions
D. FACTUAL DATA BEFORE GRANT OF EASEMENT

1. Legal Description
   a) Provides detailed description using metes and bounds, aliquot portions and/or lots & blocks
   b) May include map(s) or survey, overlain on USGS 7.5° quadrangle maps, tax maps, recorded plats, etc. as appropriate

2. Area Data
   Provides enough information about the immediate neighborhood and market area for the property to create a context for subsequent sections of the report discussing the property, its highest and best use and the valuation. Defines market area through a determination of what other properties reasonably compete with the subject in the market. Reports and analyzes local market trends, such as historic and forecast population changes (up, down, or level), any market for water rights separate from land, employment trends, etc.

3. Property Data
   a) What property is appraised - Appraisals being prepared for income tax purposes must
      
      (a) contain value opinions of all contiguous property owned by the easement donor or the donor’s family

      (b) address any increase or decrease in the value of any other property owned by the donor or a related person – this may require one or more additional appraisals

   b) Site or Land - Describes in detail the property under study, beginning with the site. Depending on property type, it will emphasize features key to value and use. For example, the appraisal of a rural parcel would address, at a minimum:

      (1) Location
      (2) Size and shape
      (3) Topography
(4) Soils

(5) Minerals estate

(6) Environmental hazards / nuisances or hazards / endangered species

(7) Floodplain and drainage

(8) Legal and physical access

(9) Existing easements or deed restrictions

(10) Status of public utilities

(11) Water rights, ditches, ditch and water companies, etc.

(12) Land use regulations

(13) Surrounding ownership and uses

c) Improvements

(1) Many open space or scenic easements do not affect the use of existing improvements; they were there before imposition of the easement, and they will be there afterward.

(2) Improvements need be addressed in detail only when the easement will have an effect on the utility, hence value, of the structures, or if required by client or intended users. For example, many historic façade easements require extraordinary upkeep, maintenance or renovation, calling for archaic techniques or materials that may be very costly. In cases like this, the improvements may turn out to be extremely important, creating a burden on the land or site.

(3) Depending on the circumstances, there may be little need to do more than give passing mention to buildings in place at the time of the grant of easement. However, once an easement is in place, the buildings may take on more significance. For example, in some areas, a large component of the market value (or at least cost) of a property may be attributable to the value of existing structures (often second or third homes).
(4) Appraisals should not attribute (without market support) a percentage loss in value to the whole property (land, water and buildings), when typically only the value of the land, or land and water components, is affected by the easement.

E. DATA ANALYSIS AND CONCLUSIONS OF PROPERTY VALUE BEFORE GRANT OF EASEMENT

1. Highest and Best Use of the Property – this means the land and water and improvements and minerals

   a) Site As Vacant

   (1) Legal Uses - considers current zoning (and reasonable probability of it changing), existing deed restrictions or conservation easements, building codes and environmental regulations. Specifically for water, appraisals consider the landowner’s ability to put the water to a use different from the current use (ditch company bylaws, water court involvement, etc.).

   (2) Physically Possible Uses – considers physical factors, utilities availability and site improvements. As to the water, can its point of diversion be changed, or are there physical limitations on what can be done with the specific shares appurtenant to a specific property under a particular ditch or canal?
(3) Financially Feasible Uses – market demand must be evaluated. Just because state law permits a landowner to divide the property into parcels 35 acres and larger does not mean it is financially feasible to do so. Similarly, a board of county commissioners may approve zoning or a plat that permits a retirement home and a hospital – the appraiser must investigate the financial feasibility of such a permitted use, as it could contribute no value at all to a parcel. The same is true for the water. This is an excellent place in an appraisal report to highlight the disparity between the value of mutual ditch company water for irrigation and the value of the same water for municipal or industrial use, if the criteria of legal permissibility and physical possibility are satisfied. For example, if the landowner is seeking more than an in-place, irrigated land value and there is not an immediate, functional and transparent market for the specific rights, there may be a need for a substantially greater analysis of the various markets and in any engineering and/or legal limitations to determine value.

(4) Maximally Productive Use – that use from those considered that survives all these tests and produces the greatest financial return to the land

b) Site as Improved

(1) Considers the same four tests itemized above

(2) Explains whether the improvements require demolition or modification or if they are consistent with the highest and best use of the site or land

c) Conclusion of Highest and Best Use of the Entire Property (Land, Improvements, Water and Minerals)

(1) Must be consistent with the four criteria outlined under E 1.a. above

(2) Does not need to bear any relationship to the present use, but if it does not, it must be a use that could reasonably be achieved (and the appraisal needs to contain evidence that is sufficient to support the claim of reasonableness)

(3) States the highest and best use of the property without consideration of the proposed restrictions contained in the conservation easement
2. Approaches to Valuation

   a) Introduces the concept of valuation, defines the three recognized methods of valuation (Sales Comparison Approach, Cost Approach and Income Approach), and sets forth the procedure to be used in the report. For each method not used, the appraiser must explain why the method was omitted.

   b) Land or Site Valuation. In many open space or wildlife habitat easement appraisals, most of the property value before and after the easement derives from the "vacant" land itself (and not necessarily from additional development potential, etc.) Thus in many easement appraisals, this will be the principal valuation question to be solved. In these cases, often the Sales Comparison approach is the most likely to be used.

   (1) There are six interrelated techniques for valuing land as vacant:

      (a) *Sales Comparison*

      (b) *Allocation*

      (c) *Extraction*

      (d) *Subdivision Development* **NOTE** – This technique results in very misleading indications of property value when it is not used extremely carefully. This technique should not be used unless the highest and best use of a property is for division and development within a reasonably short period of time, when costs of development can be accurately identified, when potential sale prices of resulting parcels can be estimated, and when realistic absorption rates can be supported by market evidence.

      (e) *Land Residual*

      (f) *Ground Rent Capitalization*

   (2) The Land or Site Valuation process can be incorporated into the Sales Comparison approach when the subject property:

      (a) is vacant,
(b) is considered to have a highest and best use as if vacant, or

(c) is minimally improved with the improvements being addressed as items of contributory value.

(3) It can form the initial part of the Cost Approach when the subject property’s improvements are being valued based on their replacement or reproduction cost. However, as described below, the Cost Approach alone is not relevant to vacant property in which there are no substantial improvements.

(4) In valuing certain properties, other experts’ opinions (water and minerals are the most common) may be valid. However, if the opinions of other experts are relied on, the appraiser must be aware of USPAP requirements regarding use of consultant’s reports (Standards Rule 2-3)

- c) Cost Approach. This approach is not relevant to a vacant property, for it is requires that the property have substantial improvements.

- d) Income Approach. This approach may not be relevant to a vacant property, for it is based on the income a particular property generates, such as professionally operated guest ranches.

- e) Correlation and Conclusion of Value. In this section, appraisers will compare the values obtained using the three methods if appropriate and determine a conclusion of value.
F. FACTUAL DATA AFTER GRANT OF EASEMENT

1. The Conservation Easement

   a) Describes in detail the restrictions and retained permissions contained in the easement in adequate detail to set the stage for the analysis of highest and best use.

   b) When possible, the appraisal includes a recorded copy of the deed of conservation easement as an exhibit to the report. If this is not available, it should include a draft copy. If no easement document is available, why are you writing an appraisal?

G. DATA ANALYSIS AND CONCLUSIONS OF PROPERTY VALUE AFTER GRANT OF EASEMENT

1. Highest and Best Use

   It may not be necessary to reanalyze highest and best use in detail. Normally, the easement will be specific enough so that a statement or two will suffice. However, it is good practice to re-consider the legally permissible, physically possible, and financially feasible land uses in order to support the conclusion of what use(s) is the maximally productive land use after grant of easement.

2. Valuation

   Introduces the concept of valuing a restricted parcel, sets forth and explains the specific procedure(s) to be used in the report, such as:

   a) An appraiser may consider valuing the easement itself by comparing it with the sale of other conservation easements. This technique is required by the Treasury Regulations “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.”
b) The Regulations also state “If no substantial record of marketplace 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.” This suggests valuation of the property subject to the easement using as many of the traditional approaches to value as are applicable.

(1) Using the Sales Comparison technique, compare the property under study to sales of other properties already subjected to similar restrictions (due to easements, restrictive covenants, and physical or location considerations) at time of their sale. This should result in an estimate of property value after easement conveyance.

(a) an appraiser should reflect appropriates units of comparison (such as per building site retained on the encumbered parcel, per-acre, or perhaps others). This requires knowledge of the details of the easements affecting each sale considered and their affect on value, including:

(i) what Subdivision (as meant in Colorado per statute, tracts less than 35 acres), division or parceling potential remains;

(ii) the number of houses and/or structures that can be built, limitations on their size, height, occupancy, and limitations on their ability to be conveyed separately from the parent tract;

(iii) any restrictions on use of the protected land (fencing, construction of outbuildings, grazing practices, use of riparian areas, public access, special land management requirements related to weed control, modification of natural drainage, prohibitions on commercial timber harvesting, mining, sand and gravel extraction, etc.);

(iv) the effect of the easement on the land owner’s ability to convey water separately from the protected land or to change the use of that water;
(a) identifies and analyzes the impact of any requirement to keep the land in irrigation, as some easements may prohibit the separate conveyance of all or some of the water;

(b) identifies and analyzes the impact of any change in the highest and best use of the water, even though water per se cannot typically be encumbered by a conservation easement;

(v) rights of first refusal (often recorded in conjunction with but separate from a conservation easement) retained by the grantee.

(2) Appraisers may apply a “percentage loss in value” to the subject property. This technique can be used effectively when a subject property’s local market does not have sales of restricted properties, necessitating analysis of the relationship of encumbered and unencumbered (but otherwise comparable) sales in other areas;

(a) An appraiser cannot rely on listings of unencumbered but otherwise comparable properties – these are not facts

(b) Great care should be exercised when relying on other appraisers’ before-easement opinions of value in such analyses.

(3) If using a Subdivision Development technique, appraisers should consider the reduced number of units or parcels that can be created on the subject property. NOTE: As in Before-Easement valuation, the development technique is valid only when some type of development is in fact the highest and best use of the property, when that development is fairly imminent, when costs of development can be identified accurately, and when absorption rates can be supported by market evidence.

(4) Cost Approach (if applicable)

(a) Requires care, as the effect of the permanent restrictions on the site must be considered.
(b) May not be useful in determining market value, as the easement restrictions may make it virtually impossible to account for obsolescence

(5) Income Approach (if applicable)

(a) May be the best method for establishing baseline value of restricted but still productive agricultural lands as well as properties with income-producing characteristics

(b) Care should be taken in development of pro forma effective gross and net operating income estimates, as well as overall capitalization rates and discount rates

(c) Requires caution due to potential “premium value” that many buyers may associate with scenic, recreational or secluded properties. Such factors suggest a greater reliance on the Sales Comparison approach than on the Income Approach during reconciliation of the different values derived from the approaches.

c) Correlation and Conclusion of Value

(1) General considerations can include

(a) difficulty or increased expense of obtaining mortgage financing, if documented;

(b) Difficulty in dealing with the easement-holding organization, sometimes described as a loss of part of the right of “quiet enjoyment,” if there is market evidence to this end

(c) potential for change in marketing time due to easement restrictions, if there is market evidence showing this;

(2) Appraisers must address increase or decrease in the value of other contiguous property owned by donor or donor’s family;

(a) Required by Treasury Regulations;

(b) If the appropriate property was appraised, whatever change in value may have occurred to the contiguous property will already be included in the Before and
After difference, even if all the contiguous property was not burdened by the easement;

(3) Appraisers must address any increase (the IRS doesn’t care if there is a decrease) in the value of other contiguous or non-contiguous property owned by donor or a “related person;”

(a) If there was no effect, a logical yet detailed explanation should suffice;

(b) If such property was affected, it needs to be appraised in order to conclude the effect on its value (increase only) resulting from the easement

H. ANALYSIS AND VALUATION OF THE EASEMENT

1. As more data become available, it is expected that direct valuation of easements by Sales Comparison will become more prevalent. However, as described in H.2 below, because adequate market data do not exist in most areas, the most common approach remains the Before and After method.

a) Use of the Sales Comparison approach to value easements is mandated by the Treasury Regulations §1.170A-14(h)(3)(i) which provide that “If there is a substantial record of sales of easements comparable to the donated easement (such as purchases pursuant to a government program), the fair market value of the easement is based on the sales prices of such comparable easements.” While this statement may offend many appraisers who would contend that purchases pursuant to a government program would by definition not be reliable comparables, the Treasury Regulations are clear and unambiguous. Only in markets where such government programs are not established (which is almost everywhere) does the “before and after” rule apply.

b) Appraisers must be cautious in analyzing sales of easement interests or fee interests in easement-burdened properties, as any units of comparison developed often would not reflect damages or benefits imposed on unburdened remainders, contiguous or not. Also, as illustrated in the Browning v. Commissioner Tax Court ruling, analysts must be aware that many easement sales are intended to be bargain sales, reflecting some donative intent on the part of both grantor and grantee.
2. As described above, the most common approach remains the Before and After, where

\[
\text{Value Before the Easement} - \text{Value After the Easement} = \text{Value of the Conservation Easement}
\]

I. EXHIBITS

1. A Self-Contained appraisal report should include those of the following exhibits necessary to inform a reader who is not familiar with the subject property area. Such exhibits are not required by the Treasury Regulations, and may not appear in many Summary appraisal reports:

   a) Maps: All maps shall be highly legible with properties clearly identified, highlighted if necessary, and depicted in contrasting colors (e.g., subject – red, blue, or green; comparable sales – purple, etc.). Maps should be of sufficient detail, with legend, scale, north arrow, geographic features and ground-control information, so properties may be readily located on-the-ground.

      (1) Area Map: Small-scale map showing general location of the subject neighborhood.

      (2) Neighborhood Map: This map shall show the appraised property and its immediate neighborhood.

      (3) Tract or Plat Map: This shall be a large-scale (2-inches per mile or larger) map clearly showing the appraised property and pertinent physical features, such as roads, streams, improvements, etc. If portions of the appraised property are assigned separate values, these various areas shall be delineated on this map, or a separate map may be prepared.

      (4) Comparable Sales Location Map: This shall show the location of the appraised property and the sales used in the appraisal. Scale shall be a minimum of ¼-inch per mile. Where appropriate, the Comparable Sales Map may be combined with the Area Map or Neighborhood Map.
b) Photographs: Each copy of the appraisal should contain color photographs of the appraised property and all comparable sales relied upon. Each photograph shall be identified as follows:

(1) Identify the scene – Appraisers should identify features shown and, if applicable, the purpose of the photograph.

(2) Appraisers should identify location where photograph take, direction of view, etc. This may be done on map.

c) Comparable Sale Data Sheet: For all sales used in the appraisal, it should show detailed information concerning each transaction. Photograph and map of each sale is required.
IV. FREQUENTLY COMMITTED SINS IN VALUING CONSERVATION EASEMENTS

While many if not most appraisals are developed and communicated in a manner that is meaningful, not misleading, there remain common mistakes or red flags. This is a summary of some common problems found in reviews of more than 150 “qualified appraisals” of easements prepared since 2003.

Many, while not fatal, highlight appraisers’ lack of familiarity with the Treasury Regulations; these are easy to correct. Others are more serious technical flaws. Foreknowledge of these "sins" can assist practitioners, easement holding organizations and landowners.

1. Serious Technical Issues

   A. Appraising the wrong property.
      1. Care should be taken that the legal description of the appraised property reflects the area covered by the easement.
      2. There are instances when the appraiser does not value all of the contiguous property owned by the donor and members of the donor’s family before and after imposition of the easement.
      3. There are instances when the appraiser does not disclose the existence of, nor appraise, other property, whether contiguous or not, owned by the donor, members of the donor’s family, or related persons.

   B. Total reliance on Subdivision Development Analysis. This technique bases the property’s value on the present worth of the net revenue generated by the hypothetical development of the property. In order for this technique to be credible, the subdivision development plan must be a permitted use according to local zoning (if any), must be economically and physically doable, and must be supported by local market research.

   C. Many improper Subdivision Development Analyses are “supported” by:

      • inadequate land use plans with neither engineering support nor substantiated development costs
      • poorly supported forecasts of lot sale prices,
      • poorly supported absorption forecasts,
      • poorly supported discount rates,
      • inadequate developer’s (entrepreneurial) profit allocation
D. Appraisals of easements on a property already partially encumbered with prior easements, where the impact of the earlier easements is improperly accounted for. This is one of the common problems associated with the chronological phasing of easements (placing an easement on only a portion of the property, with the intention of conveying additional easements in coming years).

E. Ignoring or omitting existing zoning or property restrictions, such as covenants, deed restrictions, rights-of-way, or other pre-existing limitations on use of the property.

2. Lack of Familiarity with the USPAP, the Yellow Book and the Treasury Regulations

A. Using a definition of market value inapplicable to the intended use of the appraisal

B. Failure to state that the appraisal was prepared for the income tax purposes of the donor, as required by the regulations

C. Appraisals with effective valuation dates older than the 60-day “shelf life” permitted by the regulations

3. Other More Serious Issues Not Necessarily Related to Appraisals

A. Appraisals of conservation easements without evident conservation purpose. Easements without conservation values and purpose risk not qualifying under Internal Revenue Code 170(h). While this is not an “appraisal problem,” competent appraisers should advise clients of their concerns.

B. “Too good to be true” programs. Appraisers and everyone else should be leery of involvement with these schemes. We have seen promotional materials offering investments in partnerships and LLCs that claim an investor “can expect to get a tax deduction from a conservation easement” that is larger than their initial investment. Warning signs include quick and guaranteed returns expressed in dollar of percentage amounts – how do the promoters know this in advance? Keep in mind that the value of any conservation easement is only a portion of the value of land, and the most reliable indicator of the value of land is a recent sale of that land. If you can buy an interest in land for $X thousand dollars and a short time later a conservation easement encumbering some or all of the land is worth twice or more of the amount of the investment, this is counter to common sense.
V. SUGGESTED READING AND REFERENCE TOOLS

*Uniform Appraisal Standards for Federal Land Acquisition (the Yellow Book)*
usdoj.gov/enrd/land-ack/toc.htm

*Uniform Standards of Professional Appraisal Practice (USPAP) – published annually*


All Land Trust Alliance publications are available from:
http://www.landtrustalliance.org/learning/publications/publications-1

*Department of Treasury Regulations 1.170A-13* Recordkeeping and Return Requirements for Deductions for Charitable Contributions

*Department of Treasury Regulations 1.170A-14* Qualified Conservation Contributions

*Determining the Value of Donated Property (IRS Publication 561)*

*The Internal Revenue Code Section 170(h)*

*IRS Conservation Easement Information – In General*
http://www.irs.gov/charities/article/0,,id=137244,00.html

*IRS Notice 2006-96 - Guidance Regarding Appraisal Requirements for Noncash Charitable Contributions*

Also, watch for the upcoming authoritative monograph (expected late 2010) to be published by the Appraisal Institute, *Appraising Conservation and Historic Preservation Easements.*