

Conservation Easement Appraiser Update Course



Division of Real Estate



Dora
Department of Regulatory Agencies

Department of Regulatory Agencies

2nd Edition

Conservation Easement Appraiser Update Course



Division of Real Estate
1560 Broadway, Suite 925
Denver, CO 80202

<http://www.dora.state.co.us/real-estate>

Notice

Completion of the Conservation Easement Appraiser Update Course and receipt of a Certificate of Completion does not certify the competency of the appraiser to perform conservation easement appraisals. The Division of Real Estate, Curriculum Task Force and course providers do not assume any responsibility for the services provided by course participants, or any other person or entity.

The completion of the Conservation Easement Appraiser Update Course shall not be construed by any party to be an endorsement of any appraiser or their work product by the Division of Real Estate, Board of Real Estate Appraisers, Conservation Easement Oversight Commission, Department of Revenue, Internal Revenue Service, Curriculum Task Force or course providers.

Course Material is for Educational Purposes Only

The materials presented in this course represent the opinions and views of the Curriculum Task Force, course developers, contributors and/or reviewers. Although these materials may have been reviewed by staff or members of the Division of Real Estate, Board of Real Estate Appraisers, Conservation Easement Oversight Commission, Department of Revenue, Internal Revenue Service, Great Outdoors Colorado and other organizations, the views and opinions expressed herein are not endorsed or approved by these organizations as policy unless officially adopted by the organizations in accordance with State Law or other requirements. **Course material, including but not limited to the course book and opinions expressed by presenters, is not endorsed by the Colorado Department of Revenue or the Internal Revenue Service.**

While it is assumed accurate and current information is presented, the Division of Real Estate, Curriculum Task Force, course developers, contributors, reviewers and course providers do not warrant the accuracy of the information contained herein. All principles and conclusions presented in the course are subject to court decisions, and local, state, and federal laws and regulations. The course is for educational and informational purposes only. The Division of Real Estate, Board of Real Estate Appraisers, Department of Revenue, Curriculum Task Force, course developers, contributors, reviewers, course providers and any other persons or entities involved in the creation or presentation of this course are not rendering legal, accounting, or any other professional advice or services. **These materials are not to be construed as offering legal, accounting, or any other professional advice or services. Course participants should seek expert advice or services as necessary or required and are responsible for obtaining such advice or services from appropriate professionals.**



Acknowledgements

Curriculum Taskforce:

Colorado Department of Revenue

Ted Wiatr – Income Tax Accounting Services, Conservation Easement Section

Colorado Division of Real Estate

Jordan Beezley – Conservation Easement Program Investigator

Harold Ovsowitz – Conservation Easement Program Investigator

Conservation Easement Oversight Commission

Mark Weston – Certified General Appraiser

Great Outdoors Colorado Trust Fund

Steve Nagy – Program Manager for Land Acquisitions

Members of the Public

Jody Barbour – Tax Credit Broker

Bill Boortz – Certified General Appraiser

Larry Harvey – Attorney at Law

Kevin McCarty – Certified General Appraiser

John Norton – Certified General Appraiser

Anne Renaud-Wilkinson – Certified General Appraiser

Ariel Steele – Tax Credit Broker, Attorney at Law

Course Developers:

Jordan Beezley – Conservation Easement Program Investigator, Division of Real Estate

Hollis Glenn – Conservation Easement Program Manager, Division of Real Estate

Harold Ovsowitz – Conservation Easement Program Investigator, Division of Real Estate

Mark Weston – Certified General Appraiser, Hunsperger & Weston Ltd

Larry Harvey – Attorney at Law, Larry D. Harvey P.C.

Reviewers and/or Contributors:

Carolynne Dionesse-Wright – Colorado Division of Real Estate

Peter Nichols – Trout, Raley, Montañó, Witwer & Freeman, P.C.

Peter Sartucci – Sartucci Appraisals

Stephen J. Small – Law Office of Stephen J. Small, Esq., P.C.

Table of Contents

Course Background	1
Course Goals	1
Engagement Process	2
Information required from client.....	2
Professional fees and costs.....	3
Quid Pro Quo (impermissible private benefit).....	4
Definition of the Problem / Scope of Work	5
Make any required appraiser disclosures in terms of USPAP.....	5
Identify and limit client, intended users and uses of the report.....	5
Determine applicable assignment conditions.....	5
Determine what needs to be appraised (UASFLA).....	7
Determine what must be appraised as part of the Contiguous Property Owned by the Donor and the Donors Family [Treasury Regulations].....	8
Determine what must be appraised and/or considered for enhancement (Treasury Regulations).....	9
Examples: Determining what must be appraised.....	14
Partial Encumbrance (Phasing).....	23
Hypothetical Conditions and Extraordinary Assumptions.....	28
Highest and Best Use	29
Introduction.....	29
Four tests of Highest and Best Use.....	30
Before and After.....	34
Water Rights.....	35
Phasing.....	35
Common red flag issues.....	36
Examples: Highest and Best Use Analysis.....	38

Valuation	42
General Considerations	42
Special Rules for the State of Colorado	47
Qualitative vs. Quantitative	48
After Easement Valuation	49
Phasing	51
Summation: Potential Errors to Avoid.....	52
Valuation of Additional Property Rights	53
Water Administration in Colorado	53
Valuation of Water Rights	56
Minerals (Oil and Gas)	58
Gravel Permitting in Colorado	59
Valuation of Gravel Reserves.....	60
Division of Real Estate Forms and Requirements	62
Appraisal Submission.....	62
Tax Credit Cap	63
Division’s Review of Conservation Easement Appraisals.....	63
Additional Resources	65
General.....	65
Phasing	65
Water	65
Gravel	67
Minerals.....	68

Course Background

Pursuant to section 12-61-719 (7), C.R.S. the Board of Real Estate Appraisers (BOREA) has the authority to establish classroom education and experience requirements for an appraiser who prepares a conservation easement appraisal. Such requirements shall be established to ensure that appraisers have a sufficient amount of training and expertise to accurately prepare appraisals that comply with the Uniform Standards of Professional Appraisal Practice and any other provision of law related to the appraisal of conservation easements.

A tax credit shall not be allowed unless the appraiser who prepared the appraisal has met all requirements established in accordance with section 12-61-719 (7), C.R.S. in effect at the time the appraisal was completed.


The Conservation Easement Appraiser Update Course provides the education requirement envisioned by the Colorado Legislature when they enacted HB08-1353. The course is designed to satisfy the requirements of section 12-61-719 (7), C.R.S. and BOREA Rule 16.4.

Course participants are assumed to have an extensive knowledge of appraisal practice. The Course is designed for Certified General Appraisers with the knowledge and experience to appraise conservation easements. While others may take this course it is not designed to provide an introduction to appraising conservation easements and should not be construed as a comprehensive review of conservation easement appraisal practice.

Course Goals

In creating the Conservation Easement Appraiser Update Course, the Division of Real Estate strives to:

- provide a credible and effective course;
- present relevant information in a constructive environment;
- focus on specific issues and not create a 'how to' conservation easement appraisal course;
- identify and correct common mistakes made by conservation easement appraisers;
- identify confusing and/or unclear requirements and how to appropriately address them;
- provide an open forum for participants to discuss issues they encounter.

Note: When you see this symbol,  the course material under that heading applies exclusively to appraisals completed using the Uniform Appraisal Standards for Federal Land Acquisitions (UASFLA or “Yellow Book”), NOT Treasury Regulations requirements. Unless specifically stated in the text, course material relates to appraisals compliant with Treasury Regulations.

Engagement Process

Information required from client

- 1) Signed contract
- 2) Retainer if required
- 3) Property information (title, water, improvements, minerals, history of ownership & use, land use plans, etc.)
- 4) Conservation Easement
 - a) Read the conservation easement and scan for loopholes, which might weaken the restrictions or enforceability by mutual agreement of the parties – e.g. is subdivision really precluded?
 - b) Obtain recorded Conservation Easement (CE) and attach to the report if the CE has been recorded at the time the appraisal is drafted. If not obtain a draft copy of the CE.
- 5) Title Insurance Documentation
 - a) Appraisers should require a title commitment and review all exceptions to title; these could show other restrictions on the property that could impact value.
 - i) Examples are deed restrictions that limit the highest and best use, life estates, pre-existing easements or rights of others to use the property.
 - ii) It should be current – preferably within 3 months. If older, the appraiser may use an extraordinary assumption.
 - b) It is necessary for a credible report.
- 6) Other information as necessitated by the assignment

Professional fees and costs

- 1) Professional fees for valuation services & appraisal services - flat fee or otherwise
 - a) Retainer
 - b) Payment schedule
 - i) Periodic
 - ii) On delivery
 - iii) Other
 - c) Response and/or corrections based on reviews of the appraisal report
 - i) Included
 - ii) Extra
- 2) Post-completion
 - a) Filling out forms
 - b) Additional copies of appraisal
 - c) Future consulting or appraisal services
 - i) Meetings
 - ii) Professional services associated with litigation or administrative matters
- 3) Cost and expenses (initial and post-completion)
 - a) Consultants
 - b) Mileage, travel, license, copies, etc.
 - c) Filing fee for Division of Real Estate
- 4) Appraisers need to charge an appropriate amount to complete the assignment competently.

Quid Pro Quo (impermissible private benefit)

- 1) Quid Pro Quo is an issue that should be considered for appraisals with a charitable purpose, funded transactions where a funder (e.g. GOCO) may interpret a quid pro quo as violating above-fair market value policy, or for appraisals of amendments to existing easements where the appraisal is used to determine whether the amendment is permissible.
 - a) “Red Flags”:
 - i) Local government grantee and zoning issues;
 - ii) Developer grantor and charitable donation purpose appraisal e.g. required for approval of development; and
 - iii) Side-deals in the purchase contract (either explicit or implied) e.g. access easements.
 - b) When you see something suspicious what next? No willful blindness!
 - i) Document it!
 - ii) Suggest that your client investigate, e.g. hire tax attorney to look into implications, raise the issue to funders.
 - c) How to approach appraisals of amendments:
 - i) read and understand the easement itself;
 - ii) read and understand grantee’s policies (cannot do the assignment if you don’t have them and understand them);
 - iii) read and understand the policies of all parties and funders with approval power.
 - (1) Key to “and understand” in the above is that you seek help if something isn’t clear. If you assume something that turns out later to be incorrect, it could cost all involved a lot of time and money.

Definition of the Problem / Scope of Work

Make any required appraiser disclosures in terms of USPAP

- 1) Competency
- 2) Prior services regarding property within three years

Identify and limit client, intended users and uses of the report.

- 1) At the beginning of the appraisal process it is vital to determine who will be using the appraisal and for what purpose. A conservation easement appraisal prepared for income tax purposes can be substantially different from an appraisal of the same conservation easement for other purposes, such as a federally funded acquisition.
- 2) Anticipated review
 - a) Tax Credit Broker
 - b) GOCO or other funding agency
 - c) The State and Internal Revenue Service

Determine applicable assignment conditions

- 1) Appraisal standards in addition to USPAP
 - a) Treasury Regulations - if an intended use of the report is for state or federal income tax purposes
 - b) Yellow Book (UASFLA) - if required by assignment conditions, e.g. partially funded transaction by a federal agency or entity utilizing federal funds
 - c) The combination of Treasury and Yellow Book may require two separate appraisals:
 - i) If “Larger Parcel” (Yellow Book definition) differs from what is required to be appraised under Treasury Regulations; or
 - ii) Because of assignment conditions imposed by the client or other intended users.
- 2) Identify potential extraordinary assumptions, hypothetical conditions, and any laws or regulations that may require jurisdictional exceptions.
- 3) Identify all property that may be impacted before determining exactly what must be appraised, or considered for enhancement
 - a) Property owned by the grantor of the conservation easement

- b) Property owned by the grantor's family members
 - c) Property owned by related persons to the grantor
 - i) Entities affiliated with the grantor
 - d) Obtain information for all properties that may be appraised and/or considered for enhancement, including:
 - i) Legal description of the land
 - ii) Maps, aerial photographs
 - iii) Acreage (survey)
 - iv) Information about improvements
 - v) Other property to be appraised
 - (1) Water rights
 - (2) Mineral rights
- 4) Consultant or services of other appraisers that are needed
- 5) Deliverables & Schedule
- a) Valuation services (consulting) phase – verbal or written
 - b) Appraisal report(s)
 - i) Verbal
 - ii) Written
 - (1) Do you provide a draft to the client? What are the review expectations?
 - (2) Be careful to identify the intended use or uses of the draft appraisal. The following list is an example of intended uses associated with a draft appraisal:
 - (a) *The intended use of this draft copy is for fact checking and internal review purposes only, and is not intended to solicit any input on the value opinion or to influence the appraiser in any way.*
 - (b) *The intended uses of the final appraisal report have been stated in this draft copy. However, those uses are only intended upon completion of the final report.*

(c) *This draft report is not considered a “qualified appraisal” and any uses normally associated with a qualified appraisal are not intended.*

(d) *A final value is not being certified in this draft copy and any preliminary value conclusions are subject to change based on further research, analysis and review.*

iii) Final appraisal reports

(1) Number of paper copies

(2) Electronic file

(3) Final report format

(a) Summary

(b) Self contained

Note: When assignment conditions require both UASFLA and Treasury Regulations compliant appraisal it is necessary to complete two separate appraisals when the Larger Parcel (UASFLA, “Yellow Book”) is not the same as the contiguous property owned by the donor and the donor’s family (Treasury Regulations). However, they can be contained within the same report if clearly delineated.



Determine what needs to be appraised (UASFLA)

1) USPAP applies to the development and reporting of every appraisal. Additional requirements and/or jurisdictional exceptions may be posed by the Uniform Appraisal Standard for Federal Land Acquisitions (UAS, UASFLA, or the “Yellow Book”).

a) If your appraisal must be prepared in compliance with the “Yellow Book,” the Property to be appraised is referred to as the “Larger Parcel.” The Larger Parcel must contain all property related to the Grantor of the conservation easement which has:

i) Unity of Ownership; and

ii) Unity of Highest and Best Use.

b) It is important to note that, unlike Treasury Regulations requirements, the property DOES NOT have to be contiguous to be a part of the Larger Parcel.

Determine what must be appraised as part of the Contiguous Property Owned by the Donor and the Donors Family [Treasury Regulations]

- 1) USPAP applies to the development and reporting of every appraisal. Treasury Regulations may impose additional requirements and/or jurisdictional exceptions.
- 2) Identify property to be encumbered with easement
- 3) Identify property not encumbered by the conservation easement that needs to be appraised as part of the property owned by the donor and the donor's family.
 - a) Any real property, contiguous to the property to be encumbered, which is owned by the grantor or family members of the grantor (natural persons), must be appraised and is part of the "subject" property (property owned by the donor and the donor's family).
 - i) The amount of a deduction in the case of a charitable contribution of a perpetual conservation easement restriction covering a portion of the contiguous property owned by a **donor and the donors family** (as defined in I.R.C. §267(c)(4)) is the difference between the fair market value of the entire contiguous parcel of the property before and after the granting of the restriction. Use of the term donor and donor's family is confusing, but a donor's family is defined as including the donor's spouse, ancestors, descendants, and siblings of the whole- or half-blood.
 - (1) Note: Different interpretations of the Treasury Regulations may lead to different value opinions. It is up to the appraiser to determine what interpretation is used. It may be necessary to seek legal advice.
- 4) Family as used in the Treasury Regulation
 - a) The family members referred to in I.R.C. § 267(c)(4) are:
 - i) Brothers and sisters
 - ii) Spouse
 - iii) Ancestors
 - (1) Parents and grandparents
 - iv) Lineal descendants
 - (1) Children and grandchildren
 - v) In determining whether any of these relationships exist, full effect shall be given to a legal adoption.

Determine what must be appraised and/or considered for enhancement (Treasury Regulations)

- 1) If the granting of a perpetual conservation restriction has the effect of increasing the value of any other property owned by the **donor or a related person**, the amount of deduction for the conservation contribution shall be reduced by the amount of the increase in the value of the other property whether or not such property is contiguous. Related person has the same meaning in IRC § 267(b) or 707(b).
- 2) Other real property, owned by grantor or related persons (persons or entities), whether or not contiguous with the property to be encumbered may need to be appraised to determine the value of the enhancement.
- 3) If the value of any other property owned by the donor or a related person will not be enhanced by the conservation easement and thus not appraised, the property should be described, and the rationale for not appraising it should be explained in the appraisal report.
- 4) If there are entities with common ownership, no enhancement must be considered unless the common ownership is more than fifty percent (50%). If other parcels of land are owned by individuals or persons owning less than fifty percent (50%) of a given entity, enhancement need not be considered.
- 5) Related persons as used in the Treasury Regulation
 - a) The persons referred to in § 267(b) are:
 - i) Members of a family, as defined in subsection § 267(c)(4);
 - ii) An individual and a corporation when more than fifty percent (50%) in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for such individual;
 - iii) Two corporations which are members of the same controlled group (as defined in subsection (f));
 - iv) A grantor and a fiduciary of any trust;
 - v) A fiduciary of a trust and a fiduciary of another trust, if the same person is a grantor of both trusts;
 - vi) A fiduciary of a trust and a beneficiary of such trust;
 - vii) A fiduciary of a trust and a beneficiary of another trust, if the same person is a grantor of both trusts;

- viii) A fiduciary of a trust and a corporation when more than fifty percent (50%) in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for the trust or by or for a person who is a grantor of the trust;
 - ix) A person and an organization to which section 501 [IRC § 501] (relating to certain educational and charitable organizations which are exempt from tax) applies and which is controlled directly or indirectly by such person or (if such person is an individual) by members of the family of such individual;
 - x) A corporation and a partnership if the same person own
 - (a) more than fifty percent (50%) in value of the outstanding stock of the corporation, and
 - (b) more than fifty percent (50%) of the capital interest, or the profits interest, in the partnership;
 - xi) An S corporation and another S corporation if the same persons own more than fifty percent (50%) in value of the outstanding stock of each corporation;
 - xii) An S corporation and a C corporation, if the same persons own more than fifty percent (50%) in value of the outstanding stock of each corporation; or
 - xiii) Except in the case of a sale or exchange in satisfaction of a pecuniary bequest, an executor of an estate and a beneficiary of such estate.
- b) Section 707(b)(1)
- i) A partnership and a person owning, directly or indirectly, more than 50 percent of the capital interest, or the profits interest, in such partnership, or
 - ii) Two partnerships in which the same persons own, directly or indirectly, more than 50 percent of the capital interests or profits interests.
- c) Rules of Attribution
- i) The Internal Revenue Code creates fictional ownership in entities that must be considered when applying the rules on related persons. Those rules are as follows: For ownership of stock –
 - 1) Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries;

- 2) An individual shall be considered as owning the stock owned, directly or indirectly, by or for his family;
 - 3) An individual owning any stock in a corporation shall be considered as owning the stock owned, directly or indirectly, by or for his partner; and
 - 4) The family of an individual shall include only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.
- 2) These rules therefore require that an appraiser know the ownership of any entity when enhancement may need to be considered. It is not relevant for a contiguous parcel or parcels, rather, its application is limited to enhancement. What may appear to be an entity that does need to be considered for enhancement purposes (e.g., a corporation with less than fifty percent (50%) common ownership) might actually require consideration if application of the rules of attribution causes the ownership to exceed the fifty percent (50%) threshold. These rules can drastically affect the analysis and application of the rule.

Various forms of entities may be used to hold property and convey conservation easements. Those entities could include a general partnership, limited partnership, limited liability company (which is classified as a partnership for Federal income tax purposes), a limited liability limited partnership, etc. **A discussion of differences within these entities is beyond the scope of this course, and you are advised to obtain competent, legal advice in the event that you encounter such a situation.**

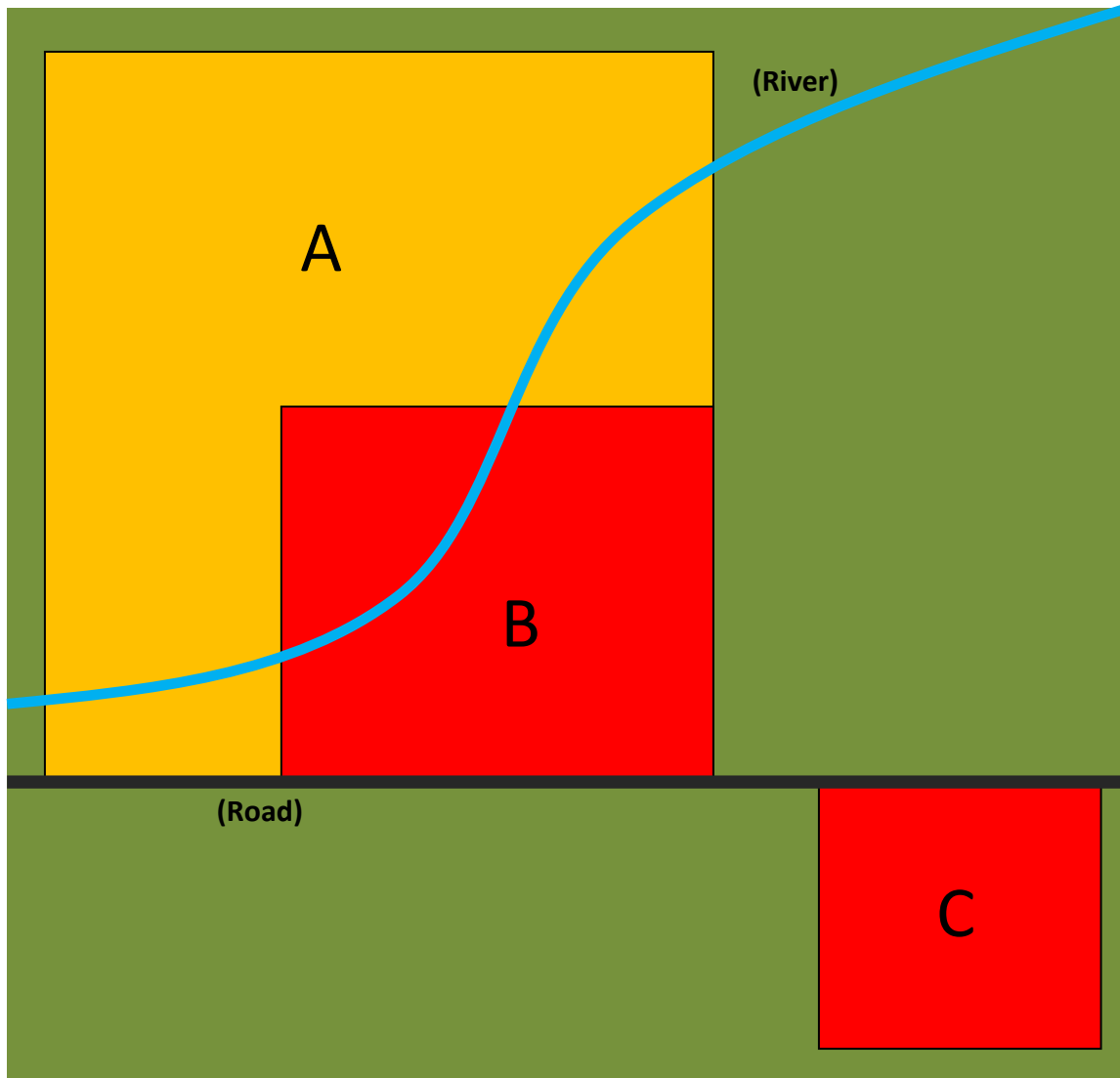
- 3) Miscellaneous Relationship Issues
 - a) Effect of marriage and co-ownership
 - i) Appraisers should treat the co-owner of property as an owner for purposes of enhancement.
- 4) Application and Consideration of Enhancement Rules
 - a) Contiguous Property
 - i) An appraiser must determine the impact, if any, that the grant of the easement has on the value of neighboring property owned by the donor.
 - ii) The Treasury Regulations viewpoint is that the easement, while decreasing the value of the encumbered property, may be simultaneously increasing the value of other property to the benefit of the donor.

- iii) For purposes of the enhancement rule, an appraiser must distinguish between two different types of property:
 - 1) Land that is contiguous to the encumbered property; and
 - 2) Land that is noncontiguous but located within the vicinity of the encumbered property.
 - iv) Contiguous property includes property that is legally part of the parcel (“subject property”) with respect to which the easement is granted, as well as property that is not.
 - v) If the donor or a member of the donor's family owns property that is contiguous to the encumbered property, the appraiser must aggregate the contiguous property with the encumbered property for purposes of the before and after computation.
 - vi) The appraiser must value the “entire property,” the encumbered property and any contiguous property, to determine both the before value and the after value of the property. This should not be done by summation unless adequate support and analysis of why the summation approach is necessary is presented in the appraisal report.
 - vii) This ensures that any decrease in the value of the encumbered property is offset by any increase in the value of the contiguous property.
- b) Noncontiguous
- i) The impact of a conservation easement on neighboring but noncontiguous property owned by the donor, or by a related party, is important only if the value of the noncontiguous property is enhanced as a result of the grant of the easement.
 - ii) It is important to note that any increase in the value of noncontiguous property does not impact the value of the conservation easement and must not be deducted by the appraiser. However, it must be addressed and clearly stated in the appraisal and appropriately dealt with on applicable tax forms.
 - 1) The effect of the above is that it will affect the amount of the charitable contribution deduction that the donor can claim. The taxpayer is the one responsible for subtracting any increased value to noncontiguous property from the appraised value of the contiguous property owned by the donor and the donor’s family on their tax forms.
 - iii) Consequently, an appraiser does not aggregate noncontiguous property with the encumbered property when performing the before and after

valuation of the encumbered property. Instead, the appraiser should separately account for and report any increase in value (enhancement) to the non-contiguous property.

- iv) Note that the enhancement rule applies to noncontiguous property if the noncontiguous property is owned by the donor or by a related party.
- c) Analyzing and estimating enhancement
 - i) If it is the appraiser's opinion that no enhancement has occurred the reasoning must be adequately explained.
 - 1) Any data or analysis must be included in the appraisal report
 - ii) If the appraiser believes there could be enhancement of other related properties due to the subject conservation easement, then a separate before and after analysis may be required to determine the enhancement value.

Examples: Determining what must be appraised



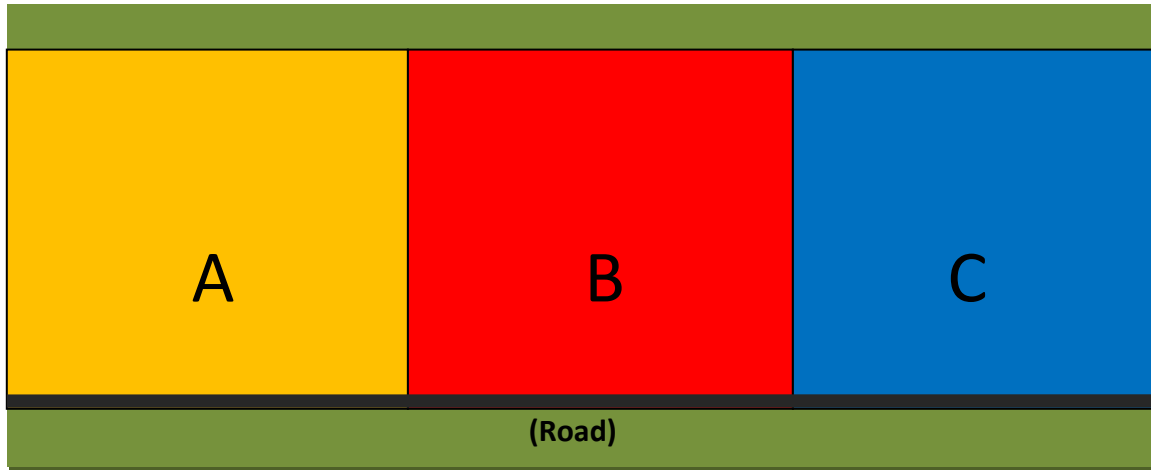
Mr. Jones owns parcel A, B and C. Parcel B and C have the same highest and best use. Mr. Jones donates a conservation easement on parcel B.

What must be appraised for Treasury Regulations?

Mr. Jones owns parcel A, B and C. Parcel B and C have an integrated highest and best use. A federal agency purchases a conservation easement on parcel B.

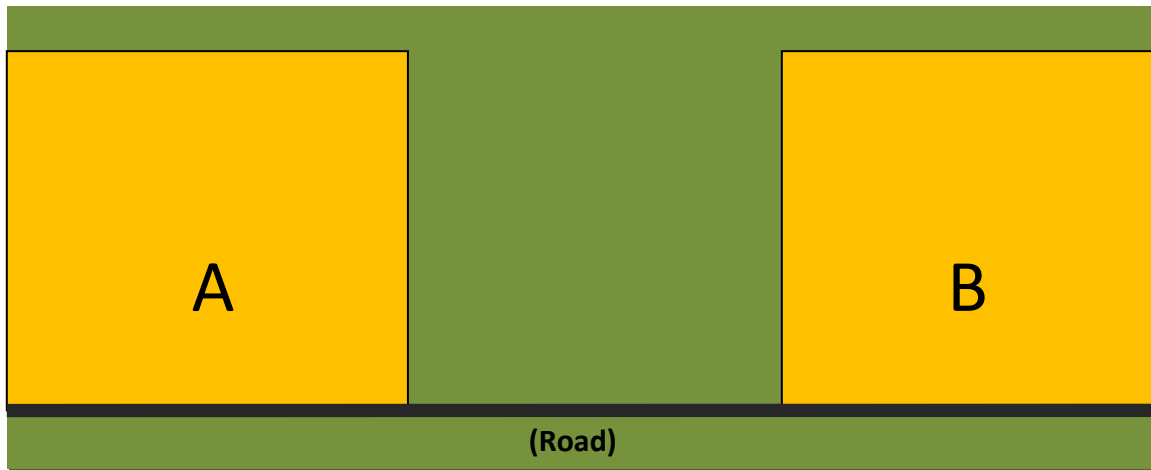
What must be appraised for UASFLA (“Yellow Book”)?

Examples: Determining what must be appraised



Mr. Smith owns parcel A, Parcel B is owned by John, Mr. Smith's son and Parcel C is owned by Anne, Mr. Smith's daughter. Mr. Smith donates a conservation easement on parcel A.

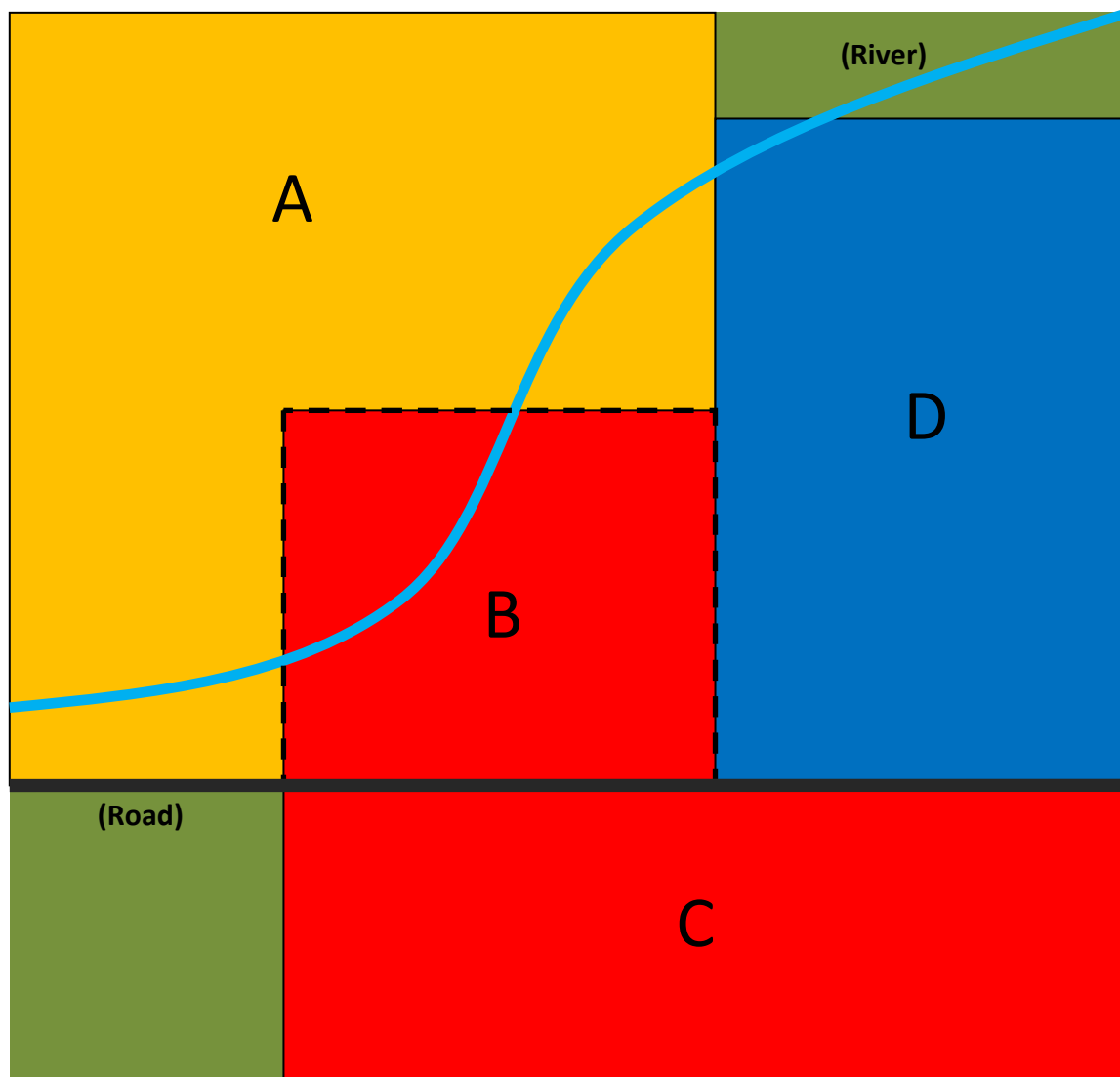
What must be appraised for Treasury Regulations?



Mr. Smith owns parcel A and B. Mr. Smith donates one conservation easement that encumbers both parcel A and parcel B.

What must be appraised for Treasury Regulations?

Examples: Determining what must be appraised



Ms. Phillips owns parcels B and C. Parcels B and C have the same highest and best use. Mr. Phillips (husband of Ms. Phillips) owns parcel A. Mr. Phillips Jr. (son of Mr. and Ms. Phillips) owns parcel D. Ms. Phillips donates a conservation easement on parcel B.

What must be appraised for Treasury Regulations?



Ms. Phillips owns parcels B and C. Parcels B and C have an integrated highest and best use. Mr. Phillips (husband of Ms. Phillips) owns parcel A. Mr. Phillips Jr. (son of Mr. and Ms. Phillips) owns parcel D. A federal agency purchases a conservation easement on parcel B.

What must be appraised for UASFLA (“Yellow Book”)?

Exercise: Conservation Easement Appraisal Rules and Questions

Material in this exercise is adapted with permission from *Conservation Easement Appraisal Rules and Questions* prepared by Stephen J. Small, Law Office of Stephen J. Small, Esq., P.C.

Perpetual conservation restriction [**bold text below has been inserted for the purpose of this exercise; it does not appear in the text of the regulation**]

(i) In general

The value of the contribution under section 170 in the case of a charitable contribution of a perpetual conservation restriction is the fair market value of the perpetual conservation restriction at the time of the contribution. See section 1.170A-7(c). **(Rule 1)** 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. **(Rule 2)** If no substantial record of market-place 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. **(Rule 3)** The amount of the deduction in the case of a charitable contribution of a perpetual conservation restriction covering a portion of the contiguous property owned by a donor and the donor's family (as defined in section 267(c)(4)) is the difference between the fair market value of the entire contiguous parcel of property before and after the granting of the restriction. **(Rule 4)** If the granting of a perpetual conservation restriction after January 14, 1986, has the effect of increasing the value of any other property owned by the donor or a related person, the amount of the deduction for the conservation contribution shall be reduced by the amount of the increase in the value of the other property, whether or not such property is contiguous. If, as a result of the donation of a perpetual conservation restriction, the donor or a related person receives, or can reasonably expect to receive, financial or economic benefits that are greater than those that will inure to the general public from the transfer, no deduction is allowable under this section. However, if the donor or a related person receives, or can reasonably expect to receive, a financial or economic benefit that is substantial, but it is clearly shown that the benefit is less than the amount of the transfer, then a deduction under this

section is allowable for the excess of the amount transferred over the amount of the financial or economic benefit received or reasonably expected to be received by the donor or the related person. For purposes of this paragraph (h)(3)(i), related person shall have the same meaning as in either section 267(b) or section 707(b). (See example (10) of paragraph (h)(4) of this section.)

What are some observations one could make about these rules?

“First, a **person** donor can have related family members that can trigger rule three or rule four.”¹

“Second, a **person** donor can have related entities that can trigger rule four, but not rule three.”²

“Third, a donation by an **entity** on a portion of the contiguous property owned by that donor can trigger rule three.”³

“Fourth, a donation by an **entity** could trigger rule four.”⁴

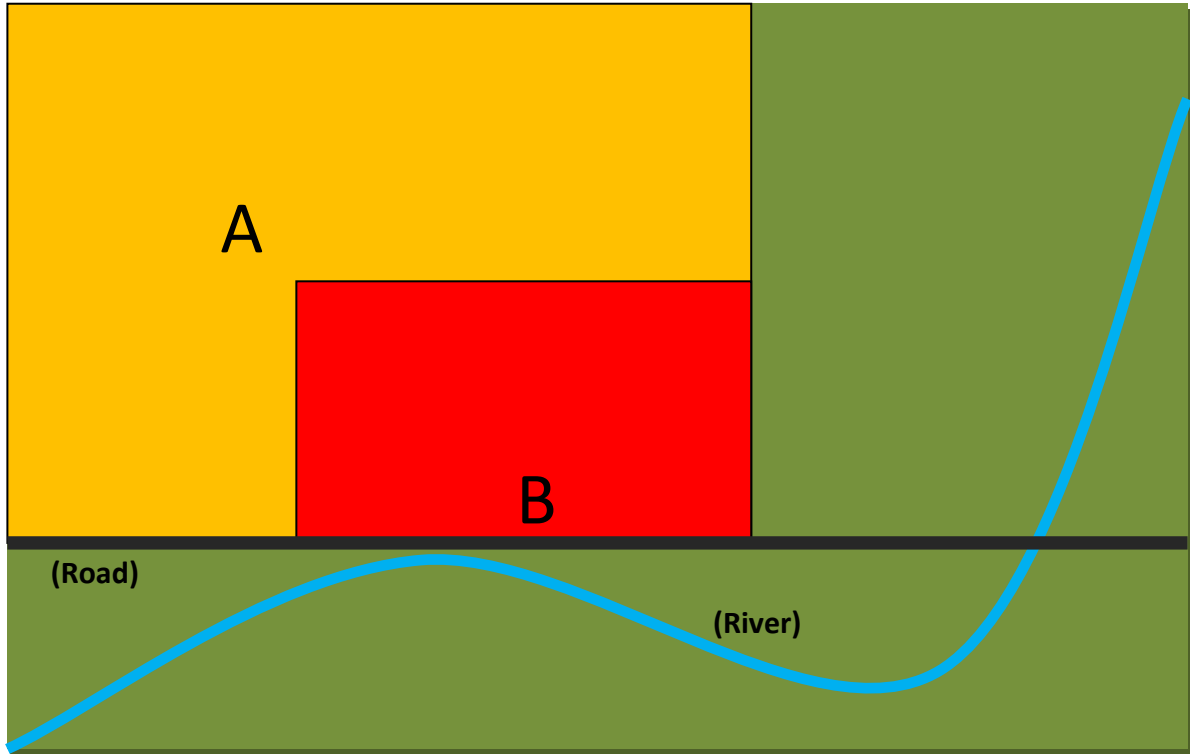
Fifth, two different entities typically cannot trigger rule three (exceptions to this observation may exist).

¹ Stephen J. Small, Law Office of Stephen J. Small, Esq., P.C., *Conservation Easement Appraisal Rules and Questions*, Page 9.

² Id.

³ Id.

⁴ Id.



Aunt Sally donates a conservation easement on Lot A. What does the appraiser need to value (before and after, enhancement, etc.) to comply with the Treasury Regulations. Assume Lots A and B are owned as follows.

1. A – Aunt Sally
B – Aunt Sally

2. A – Aunt Sally
B – Sally’s daughter Connie

3. A – Aunt Sally
B – Sally’s Family LLC #1 (Sally 60%; Connie 20%, Sally’s son Bob 20%)

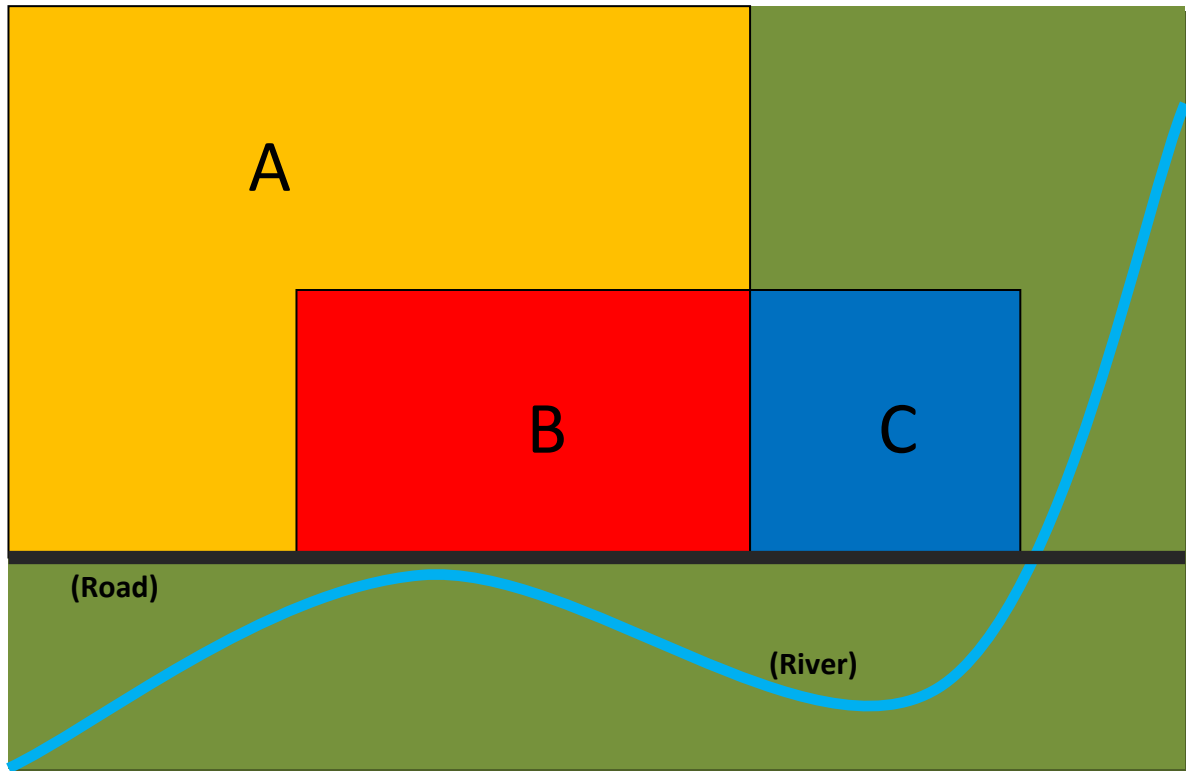
4. A – Aunt Sally
B – Sally’s Family LLC #2 (Sally 34%; Connie 33%, Sally’s son Bob 33%)

5. A – Aunt Sally
B – Wentworth Family LLC #1 (Sally 60%; Cousin Alice 20%, Cousin Bertie 20%)

6. A – Aunt Sally
B – Wentworth Family LLC #2 (Sally 34%; Alice 33%, Bertie 33%)

7. A – Sally’s Family LLC #1 (Sally 60%; Connie 20%, Sally’s son Bob 20%)
B – Wentworth Family LLC #1 (Sally 60%; Cousin Alice 20%, Cousin Bertie 20%)

8. A – Sally’s Family LLC #1 (Sally 60%; Connie 20%, Sally’s son Bob 20%)
B – Wentworth Family LLC #2 (Sally 34%; Alice 33%, Bertie 33%)



Aunt Sally donates a conservation easement on Lot A. What does the appraiser need to value (before and after, enhancement, etc.) to comply with the Treasury Regulations. Assume Lots A, B and C are owned as follows.

1. A – Aunt Sally
 B – Connie (Sally’s daughter)
 C – Bob (Sally’s son)

2. A – Aunt Sally
 B – Connie
 C – Bob’s son Willie

3. A – Aunt Sally
 B – Bob
 C – Sally’s Family LLC #1 (Sally 60%; Connie 20%, Sally’s son Bob 20%)

4. A – Aunt Sally
B – Bob
C – Wentworth Family LLC #1 (Sally 60%; Cousin Alice 20%, Cousin Bertie 20%)

5. A – Aunt Sally
B – Bob
C – Wentworth Family LLC #2 (Sally 34%; Alice 33%, Bertie 33%)

Partial Encumbrance (Phasing)

1) Purpose

- a) Phasing can provide the necessary economic incentive to protect lands in such a way as to maximize the amount of state tax credits and federal deductions earned for donating conservation easements.
- b) Phasing can provide the necessary economic incentive to protect lands in such a way as to maximize the amount of funds granted for the purchase or bargain sale of conservation easements.

2) Phases are developed through negotiations between grantor and grantee

- a) Appraisers should be cautious about consulting with the grantor and/or grantee concerning the value of different phase configurations.
 - i) Indicating that a change in the transaction (phase configuration ex. additional home site) increases or decreases the value of the conservation easement is a value opinion requiring USPAP compliance.
 - ii) A verbal value opinion as with a written value opinion is an appraisal report subject to applicable laws and regulations including all provisions of USPAP.
 - iii) Draft appraisals⁵ (verbal or written) are still subject to the Definitions, Preamble, Ethics Rule, Competency Rule and Jurisdictional Exception Rule of USPAP.⁶

3) Appraiser Ethical Obligations Related to Phasing

a) USPAP

- i) “An appraiser must not advocate the cause or interest of any party or issue.”⁷
- ii) “An appraiser must not accept an assignment that includes the reporting of predetermined opinions and conclusions.”⁸
- iii) “It is unethical for an appraiser to accept an assignment, or to have a compensation agreement for an assignment, that is contingent on any of the following.
 - 1) the reporting of a predetermined result (e.g., opinion of value);

⁵ BOREA Rule 1.34 – Draft Appraisal: An appraisal that does not bear the appraiser's signature and is identified and labeled as a "draft". The purpose of issuing a draft appraisal cannot be to allow the client and/or the intended user(s) to influence the appraiser.

⁶ USPAP 2008-2009 FAQ 196

⁷ USPAP 2010-2011 Ethics Rule

⁸ Id.

- 2) a direction in assignment results that favors the cause of the client;
 - 3) the amount of a value opinion;
 - 4) the attainment of a stipulated result; or
 - 5) the occurrence of a subsequent event directly related to the appraiser's opinions and specific to the assignment's purpose."⁹
- b) An appraiser who works with a client to determine what should be encumbered in a partial encumbrance (phased) transaction should maintain documents in their work file which shows they acted ethically and were not acting as an advocate for the client. Documentation may include copies of all correspondence and notes of meetings or conversations.
- c) Potential Problems
- i) Consulting with your client to determine the provisions and/or scope of a conservation easement in order to achieve a specified value conclusion can probably be achieved without violating USPAP. However, because of the difficulty in interpreting some provisions of USPAP, appraisers should exercise extreme caution when undertaking this type of assignment. It may be prudent to seek legal counsel in such cases.
- d) A Possible Solution
- i) One approach to a scope of work that is unlikely to violate USPAP would be for the client to provide the appraiser with several different scenarios and ask for a value opinion (appraisal) for each. Once the client receives the value opinion (appraisal), they use that information to determine the final provisions of the conservation easement. When the grantor and grantee agree to the conservation easement terms, the appraiser is requested to prepare a further appraisal for signature and delivery to the client.
- e) Example Scenarios
- i) An appraiser is asked by the client to provide a value estimate of a proposed partial encumbrance by a conservation easement (phase) for transaction planning purposes. If the appraiser provides a value estimate (not a signed appraisal) to the client for this purpose, it is an appraisal which must comply with USPAP and is regulated by the Division. However, it does not need to be submitted to the Division along with the prescribed fee.¹⁰

⁹ Id.

¹⁰ BOREA Rule 16.2 A draft appraisal, as defined by board rule 1.34, does not have to be submitted to the Division of Real Estate pursuant to §12-61-719(1), C.R.S.

- ii) An appraisal is prepared based on a draft conservation easement supplied to the appraiser by the client. The appraiser submits a “draft appraisal” as defined by Board Rule 1.34 to the client. The client changes the easement terms in order to maximize the tax credit (independent of any consultation with the appraiser). The appraiser is asked to reappraise the property based on the new easement terms. The appraiser submits a new draft appraisal to the client. The client then executes the easement with the new terms and asks the appraiser to finalize the report. The first and second draft appraisals are regulated by the Division however, they do not need to be submitted to the Division. The final signed appraisal which is delivered to the client must be submitted to the Division along with the prescribed fee.
- iii) The client, in discussions with the prospective conservation easement holder devises several potential versions of the conservation easement. One encumbering 200 acres, another encumbering 300 acres and yet another encumbering 400 acres of the 700 acre property. The appraiser prepares a draft report with the three different scenarios concluding values of \$600,000 for the 200 acres, \$700,000 for the 300 acres and \$900,000 for the 400 acres. The client uses that information to enter into an agreement to donate a conservation easement encumbering 375 acres of the property. The appraiser then appraises the 375 acre conservation easement and concludes a value of \$775,000. Only the final appraisal report (signed and delivered to the client) is submitted to the Division with the prescribed fee. However, the draft report is an appraisal and would be subject to USPAP.
- iv) If a property is identified and the client requests a predetermined value (for example \$750,000 to maximize the state tax credit) this would have USPAP implications.
 - (1) Note: A value of exactly \$750,000 (or the amount for the maximum current tax credit) can be a “red flag,” however, it is not necessarily inappropriate.

4) Types of Phasing

a) Adding New Acreage each year

- i) Example – Farmer John owns a 400 acre ranch. In discussions with the land trust it is decided that a conservation easement will be donated on 200 acres this year and 200 acres next year.
- ii) Pay attention to:

- (1) Value lost per phase
 - (a) The value of a conservation easement may change with each phase.
 - (i) The value of unencumbered property changes as a result of previous phases due to increased desirability of developable land.
 - (b) It is unlikely that without guidance from the appraiser that the client (and easement holder) will chose phase acreages that will result in the same value each time (maxing out the credit).
- (2) Amending previous deed (one parcel) vs. separate deeds/parcels
 - (a) Must analyze all previous deeds of conservation easement and their impact on highest and best use for the entire property.
- b) Putting land under different ownership (for donation in the same year)
 - i) Example – Corporation XYZ owns a 1,000 acre ranch. XYZ transfers half the property into Corporation ABC. Both XYZ and ABC have the same ownership and management. XYZ and ABC each donate a conservation easement on their 500 acres at the same time.
 - ii) This type of transaction is a red flag and will likely be closely analyzed by regulatory agencies for adherence to all applicable laws and regulations.
 - iii) The transaction should be discussed with the grantee and grantor (unless specifically directed not to by the client in which case you should ask why that request was made).
 - iv) Pay attention to:
 - (1) Identity of naturalistic ownership
 - (a) Identify ownership interests in LLCs, Corporations, Trusts, and Partnerships
 - (2) It is the responsibility and duty of the appraiser to understand and present transaction and ownership details so that every intended user can understand.
 - (3) Phasing often leads to difficulties identifying the contiguous property owned by the donor and the donor’s family and/or parcels considered for enhancement.

c) Increasing Restrictions each year (acreage stays the same)

- i) Example – Farmer Jane owns a 400 acre ranch. In discussions with the land trust it is decided that a conservation easement on all 400 acres, reserving the right to divide the property into two parcels with a 5 acre building envelope on each part, will be donated this year. Next year the conservation easement will be amended to remove the right to subdivide the property and will remove one building envelope.
- ii) Pay attention to:
 - (1) Valuing multiple reserved home sites
 - (a) How additional reserved home sites are viewed in the property's market?
 - (b) Techniques for valuing additional reserved home sites.
 - (c) How many additional reserved home sites are too many (no impact on value and/or no conservation value)?
 - (d) Can the property be subdivided or divided to allow separate sales of reserved home sites?

Hypothetical Conditions and Extraordinary Assumptions

1) Hypothetical Conditions¹¹

- a) If the conservation easement is not recorded
 - i) Hypothetical Condition is that the conservation easement was recorded in the after valuation
- b) If the conservation easement is recorded
 - i) Hypothetical Condition is that the conservation easement was not recorded in the before valuation
- c) Any other Hypothetical Condition necessary for credible assignment results or legally required
 - i) Examples (as applicable)
 - (1) Zoning
 - (2) Title
 - (3) Entitlements

2) Extraordinary Assumptions¹²

- a) If the conservation easement is not recorded
 - i) The conservation easement will conform in substance to the draft.
- b) Any other assumption made by the appraiser which if found false, could alter the appraiser's opinions or conclusions
 - i) Examples (as applicable)
 - (1) Legal Opinions
 - (2) Title Issues
 - (3) Property Boundaries
 - (4) Client's representations about ownership of other property, etc. are true

¹¹ See USPAP for further information

¹² Id.

Highest and Best Use

Introduction

“The reasonably probable and legal use of vacant land or an improved property that is physically possible, appropriately supported, financially feasible, and that results in the highest value. The four criteria the highest and best use must meet are legal permissibility, physical possibility, financial feasibility, and maximum productivity.” *The Dictionary of Real Estate Appraisal, Fifth Edition, Appraisal Institute, 2010.*

- 1) Must be reasonably probable and market driven
- 2) Analyzed for the subject property both before and after granting the conservation easement
- 3) Extent of the subject property depends upon nature of assignment: contiguous property owned by the donor and the donor’s family for Treasury Regulations and *larger parcel* for Yellow Book
- 4) Applied to the entire subject property as determined by the particular assignment, not just the portion of the subject property encumbered by the conservation easement
- 5) Includes any water, gravel, mineral rights associated with property and existing improvements
- 6) Can be different than the current use of the property if the land use change is reasonably probable (“reasonable probability” must be supported by market evidence)
- 7) A conservation easement in most cases must have a negative impact on the highest and best use of the subject property for the easement to have significant value. Without a negative impact upon highest and best use, there is likely little or no reduction in the subject property’s after value and therefore by definition little or no conservation easement value.
 - a) This is something that the Division and Internal Revenue Service looks for and is a “red flag”

Four tests of Highest and Best Use

1) Legally permissible

a. Legal access to subject property

- i. Public roads by definition are rights-of-way available for use by the general public and include county roads, city streets, state & U.S. highways, and may include federal agency roads such as the U.S. Forest Service & Bureau of Land Management.
- ii. Easements are the perpetual private right to use the land of another for a specific use and are created by grant, reservation or implication. They may be exclusive or non-exclusive to the easement grantee. Nature of easement must be determined. What is width? Is it wide enough to allow subdivision via applicable local government regulations? Does it allow vehicles? Does it allow utilities? Is it limited only to historic uses such as grazing? Does it cross U.S. Forest Service or BLM lands therefore requiring adherence to special federal requirements? Is the easement in dispute? Is there a cloud on clear title? Can it be adequately relied upon without invoking the use of an extraordinary assumption?
- iii. Licenses to cross the lands of another are by nature a personal, unassignable, and typically revocable privilege to conduct an activity on the land of another. They convey no interest in the underlying property and often have a limited time duration. The grantor of a license may specify the nature of uses on the benefited property. Access via license is significantly less desirable than perpetual easement and is not acceptable by most local governments for subdivision approval purposes.

b. Private legal restrictions

- i. Deed restrictions
- ii. Restrictive covenants
- iii. Existing easements including conservation easements
- iv. Lease agreements particularly if arms length and long term in nature

c. Public legal restrictions

- i. All subdivisions of land creating a parcel(s) containing less than 35 acres must proceed through the applicable local government subdivision process.
- ii. Land use regulations vary widely among various local governments. Some local governments are very restrictive in nature while others apply only minimal regulations.
- iii. Zoning and comprehensive plans provide the best indication of potential public legal land use for a property. Care must be taken to ensure that the “official” representation on the map reflects the most probable legal use. Practical legal land uses may differ from what is depicted on official documentation; often significantly. If that is the case evidence must be presented by the appraiser to show why the use is a practical legal land use.
- iv. The existence of any flood plain designations and resultant impact on legal land uses should be considered.
- v. Specific local development regulations involving such issues as utility service areas, slope requirements and ridge top development among other issues should be considered.
- vi. When local governments have weak or no zoning and/or no meaningful comprehensive plan the assignment can be particularly challenging as there is no “official” guidance as to potential legal land uses.
- vii. Any federal laws impacting land values should be considered (such as endangered species or jurisdictional wetlands).
- viii. Potential for legal land use changes must be carefully investigated. At times, the potential for legal land use changes are realistic and widely reflected in prices paid by buyers. Other times, the potential for land use changes can be nearly zero. Any potential for a legal land use change must be determined by the appraiser to be a reasonable probability in order to factor such a change into the valuation analysis.
- ix. Cost, time and risk involved in seeking a land use change should be considered in this analysis.
- x. Historic land use changes allowed by the jurisdiction in question can be studied.

- xi. Building moratoriums and the likelihood that they will be lifted must be considered.
- xii. The impact of any transferable development rights program(s) that may exist must be considered.

2) Physically possible

- a. Size, shape, topography, & vegetation
- b. Physical access (Does a satisfactory road need to be constructed? Can one be constructed? Are existing roads maintained or in primitive condition?)
- c. Spatial location of property relative to other properties and the larger defined market area (reflects relative physical proximity/remoteness)
- d. Availability of public/private infrastructure such as roads, domestic water & sanitary sewer, electricity, telephone, etc.
- e. Adequacy of groundwater supplies; water critical areas & limitations placed on well permits
- f. Existence and potential uses of surface water rights
- g. Significant flood plain issues
- h. Analysis of physically possible uses can involve quantification of resources (land use acreages, developable land, volume of water, volume of gravel, etc.). These quantifications may require modification when legally allowed uses and financial feasibility are considered.
- i. The mere physical existence of a natural resource does not imply that it is a maximally productive use or that it is even financially feasible.

3) Financially feasible

- a. Applied to uses that are physically possible and legally permissible
- b. **Must be based on observable/quantifiable market evidence**
- c. The simplest analysis is identification of demand in the subject market area. It is best accomplished by denoting similar subdivisions and noting the success or lack thereof.
- d. Conclusions for subject property should be similar to demand experienced by competing properties. The further the property is from central population centers, the more likely that the most likely financially feasible use is lower densities. This will also be reflected by generally lower land values.

- e. Costs associated with proposed land use changes, including risk and time, must be factored into any such analysis.
- f. The minimum 35 acre density floor to avoid local land planning regulation has substantial implications for financial feasibility. Generalizations cannot be made regarding demand for subdivisions of this type. Many regions of the state are very amenable and have high demand for this development type while others have demonstrated less demand. It is critical to look to the local market for evidence of demand for this subdivision type and density prior to concluding such a density is financially feasible. Any such conclusions without market support are not acceptable.
- g. The maximally productive use in the before condition, may not necessarily be for development. Agricultural and recreational uses are often maximally productive uses.
- h. It is possible to have a mixed highest and best use that includes limited development along with recreational and/or agricultural uses.

4) Highest and Best Use (Maximally Productive Use)

- a. Applied to uses that are physically possible, legally permissible and financially feasible
- b. The use that results in the highest value is by definition the highest and best use.
- c. **Must be supported by market data** and cannot be a speculative use (however, speculative holding for future price appreciation can be a valid conclusion)
- d. Linked to the Sales Comparison Approach in that the comparable sales utilized should have the same, or similar, highest and best use as the subject property

Before and After

- 1) The highest and best use analysis is applied to the subject property before granting the conservation easement and again after granting the easement. All of the same factors are addressed under both circumstances in order to determine the impact of the conservation easement on the highest and best use of the subject property and therefore its market value. The conservation easement could potentially negatively affect the highest and best use of a portion of the subject property not encumbered by the easement. If the appraiser concludes that the conservation easement may not negatively impact the subject property's highest and best use, then the easement likely does not have significant value.
- 2) It is possible for the highest and best use to be the same in the before and after condition, with changes taking place relating to the level of allowed development (density) or other land use activity. It is important to define highest and best use in a detailed, rather than a broad manner, as the following examples show:
 - a. Example 1: A 320 acre parcel in a county with a cluster development program has an easement placed on it allowing, the clustering of three home sites. In the before condition, the highest and best use would be for an 18 lot rural residential development and agricultural use. The after highest and best use would also be described as residential and agricultural use, although it would involve a lower level of allowed development, thus changing the highest and best use.
 - b. Example 2: Conservation Reserve Program land is placed in an easement and the land cannot be re-enrolled or converted to dry cropland. The highest and best use in both the before and after condition is for agricultural use, although further refinement of the highest and best use demonstrates the change that has taken place.

Water Rights

- 1) If water rights are associated with the subject property, reasonable diligence should be applied to determine whether these rights have a highest and best use to be transferred from the subject property to use elsewhere. Such a transfer is most typically for municipal purposes. An understanding of the character and potential of any water rights associated with the subject property is critical to highest and best use analysis.
- 2) The highest and best use of water rights is often integral to the highest and best use of the land. Therefore, the highest and best use of water rights should be consistent with the land's highest and best use, when appropriate.
- 3) If a change of use is concluded to be the highest and best use of the water rights, the resultant impact to land use must be considered.
- 4) It is possible for speculative influences to impact water values, even in cases where no water right changes have occurred under a specific ditch system. Such influences are typically found in locations where other neighborhood water rights are being purchased for changes of use. Documentation that speculative influences that are present may require comparison to appurtenant and/or easement-restricted water rights.
- 5) The appraisal of water rights is a highly complex and specialized field. Water rights specialists may need to be consulted.

Phasing

- 1) Have prior phases, or the proposed phase, altered the highest and best use of the property?
 - a. Have non-development uses, including recreational or agricultural uses been fully considered in highest and best use and valuation?
 - b. See *Partial Encumbrance (Phasing)* in the Definition of the Problem / Scope of Work section

Common red flag issues

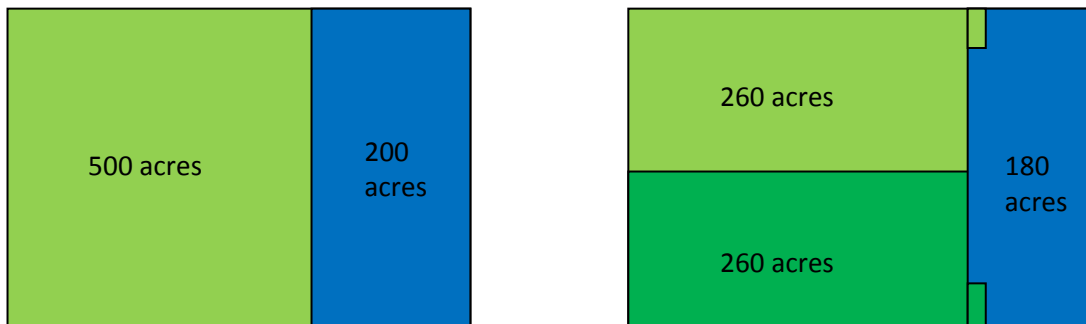
- 1) **Lack of market support and/or a conclusion that contradicts existing evidence**
- 2) Assumption that 35 acres represents optimal subdivision density
- 3) Inadequate development and presentation of analysis
- 4) Errors in describing and analyzing local market conditions and/or land use regulations (relates to geographic competency)
- 5) Lack of adequate analysis and/or understanding of the impacts of the conservation easement on the property's highest and best use
- 6) Concluding a particular subdivision density for a property while not recognizing that the conservation easement in no manner reduces the potential density. For example, prior to the conservation easement, the highest and best use of the property was for five 80 acre parcels while the conservation easement allows five 80 acre parcels. Thus, the highest and best use of the property both before and after the easement may remain unchanged depending on specifics of the easement such as locations of building envelopes.
- 7) All financially feasible uses should be considered. In some portions of the state, a recreational ranch may have similar financial feasibility compared to land division. Even if land division is removed as an allowed use, the financial feasibility of the recreational ranch, which is still an allowed use, may result in limited value loss.
- 8) Not addressing all possible land configurations
 - a. Appraisers must pay attention to the possibility of adding small amounts of unencumbered acreage to otherwise unbuildable encumbered acreage to create building sites that would otherwise not be possible.

Examples

- i. If a landowner has 40 acres of land and decides to place a no structures permitted conservation easement on 35 acres, the appraiser cannot assume that one home site is removed because the CE does not allow development (zoning requires a minimum 35-acre lot size). The landowner can potentially combine the five unencumbered acres with the 35 to allow for one building site. The only difference in the before and after scenario here is that it limits construction to a five acre site. In this case, it may be more appropriate to think of the unencumbered property as a building envelope within a 40 acre tract.

ii. A landowner has a 700 acre ranch with 500 acres encumbered by a conservation easement which allows no development but it may be subdivided into two 250-acre tracts. The appraiser cannot assume that the highest and best use is a ranch with 500 acres encumbered with no development potential and five 35-40 acre home sites on the 200 acre unencumbered portion. In order for the landowner to maximize the sale of that property, they would likely add several unencumbered acres (say 5 to 10 acres) to each of the 250-acre restricted parcels prior to selling. This would change the use of the property to two approximately 260-acre recreational ranches with an unrestricted building envelope and 250 encumbered acres and five 35-acre unencumbered home sites. In many areas of the state two 260-acre encumbered recreational ranches would sell for more than 500 acres with no development potential.

1. This scenario can have many configurations but the key to remember is that as the appraiser you must take the time to perform a proper highest and best use analysis, including an examination of all reasonably possible configurations of the property.



Examples: Highest and Best Use Analysis

1) Partially encumbered property

Scenario

A conservation easement is placed on 65 acres of a 70-acre parcel. There are currently no buildings on any part of the property. It is zoned for a minimum lot size of 35 acres and the highest and best use is one house per 35 acres. The conservation easement allows for the property to be divided once, but no buildings may be constructed on the encumbered portions.

What is the highest and best use before the conservation easement? And after?

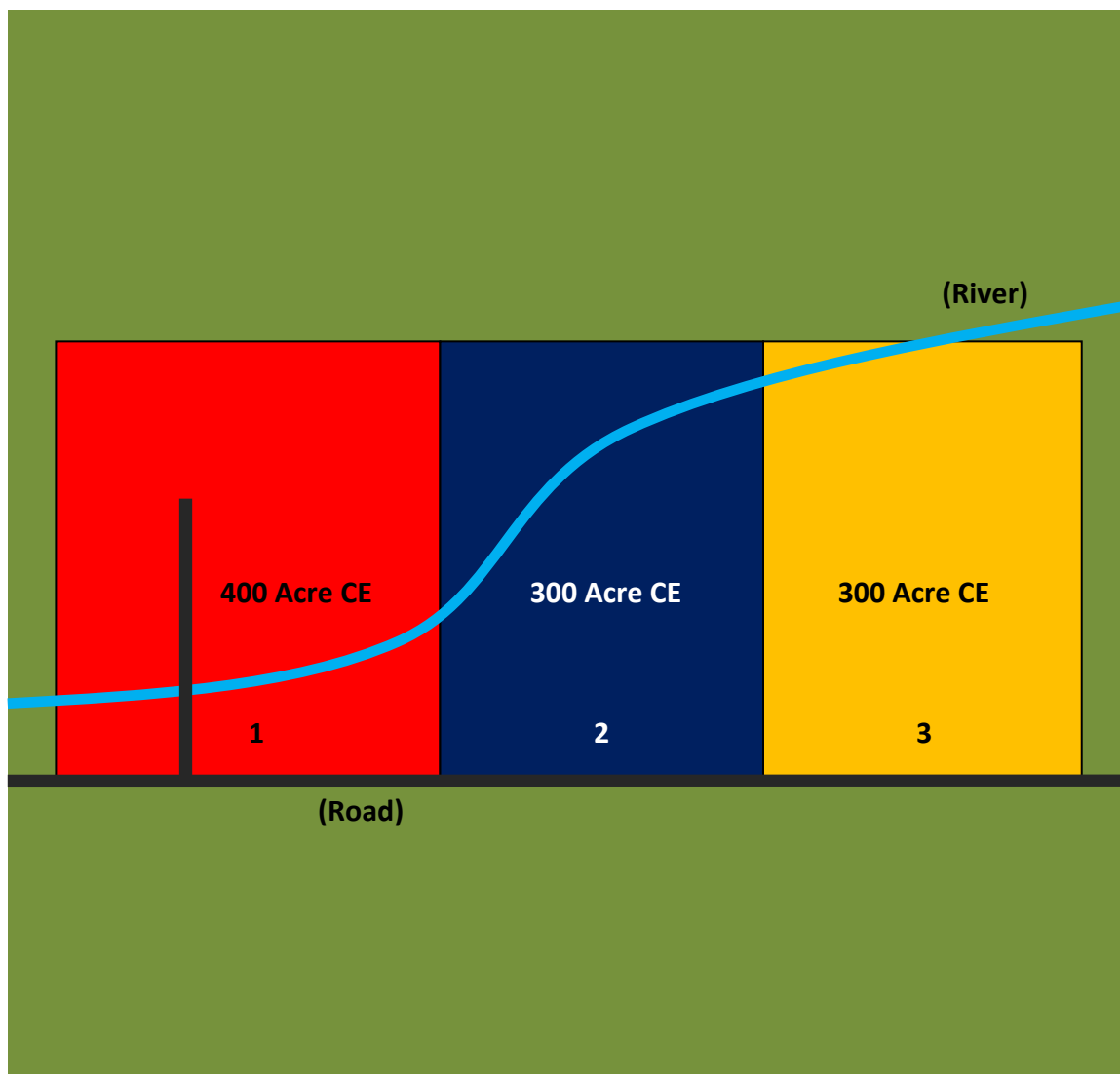


2) River access

Scenario

A 1,000-acre property is encumbered by conservation easements over a period of three years. The first year parcel 1 is encumbered, in year two parcel 2 is added to the existing easement and in year three parcel 3 is added to the existing conservation easement. The easement prohibits all subdivision, division, construction of roads and development. There are currently no buildings on any part of the property. It is zoned for a minimum lot size of 35 acres and the highest and best use is one house per 35 acres.

What is the highest and best use before each conservation easement phase?

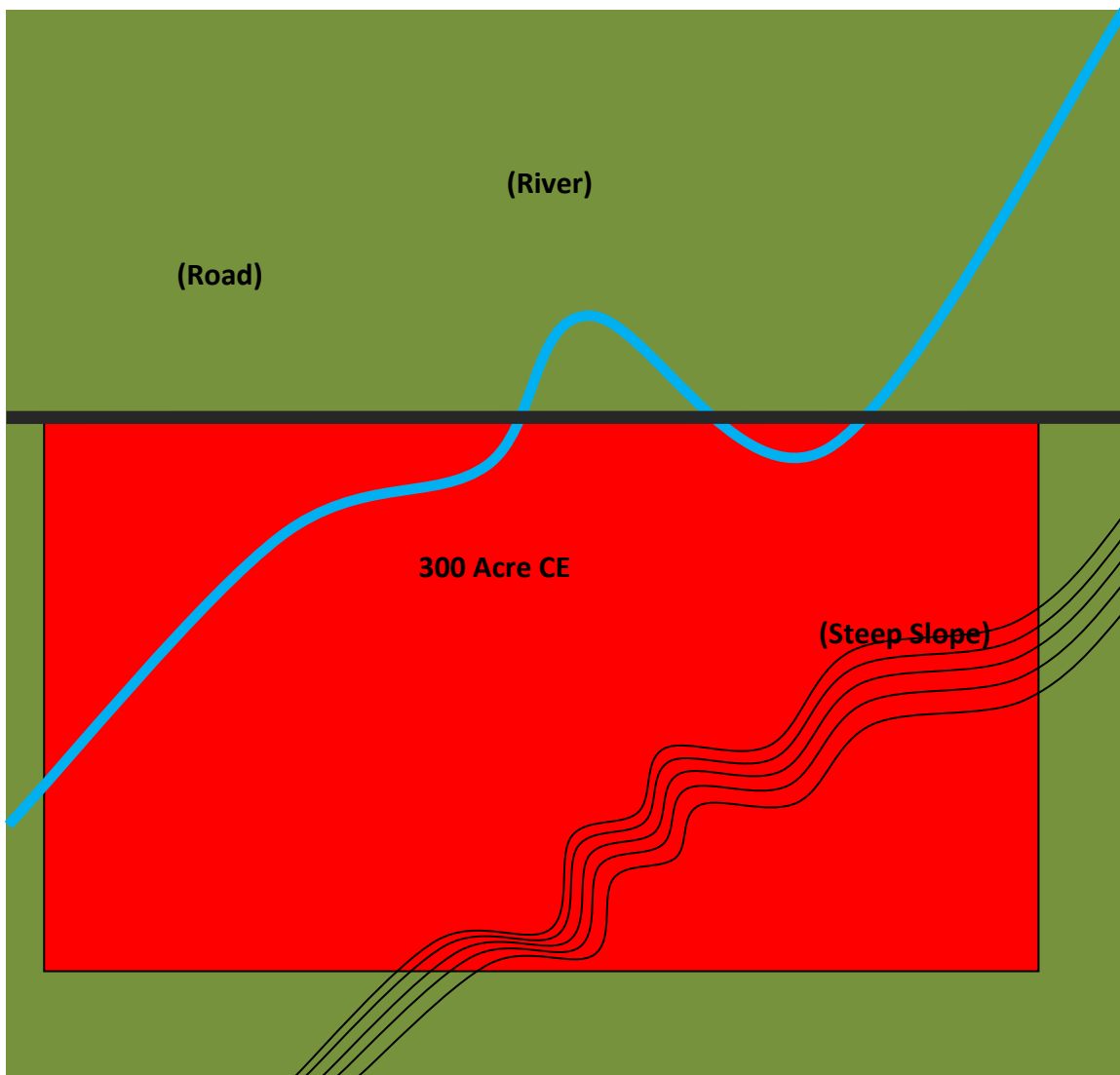


3) Physically possible

Scenario

A conservation easement is placed on a 300-acre parcel. There are no buildings on any part of the property. It is zoned for a minimum lot size of 35 acres and the highest and best use is one house per 100 acres. The Steep Slope is not suitable for construction of buildings or roads.

What is the highest and best use before the conservation easement? And after?

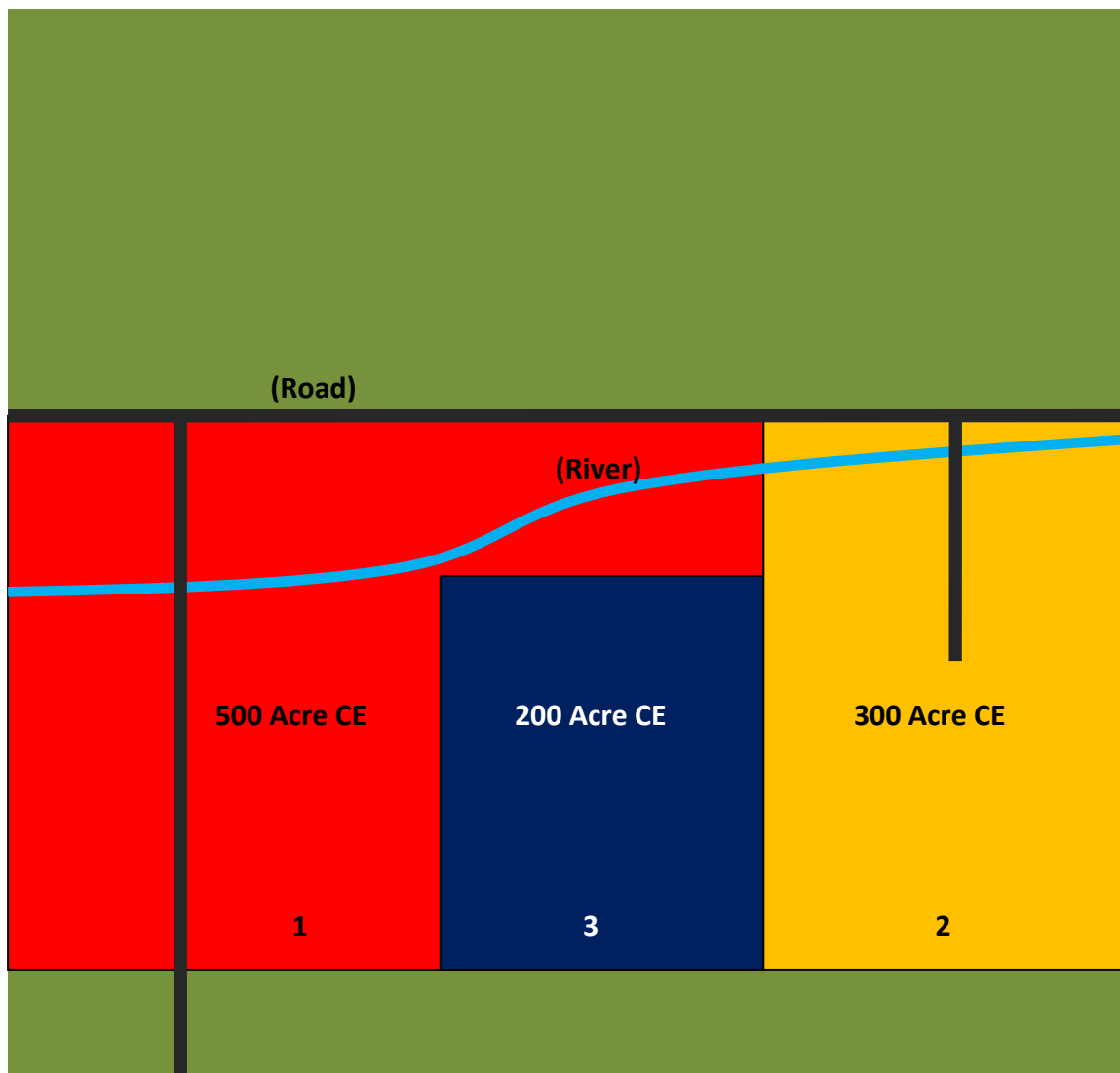


4) Land that is surrounded by encumbered parcels (No legal access)

Scenario

A 1,000 acre property is encumbered by conservation easements over a period of three years. The first year parcel 1 is encumbered, in year two parcel 2 is added to the existing easement and in year three parcel 3 is added to the existing conservation easement. There are no buildings on any part of the property. It is zoned for a minimum lot size of 35 acres and the highest and best use is one house per 100 acres.

What is the highest and best use before each conservation easement phase?



Valuation

Note: The following section contains a summary of information taken from Treasury Regulations, tax court decisions and other sources. Comprehensive information has not been presented in this section. Please refer to the full text of referenced documents for further information. It may be necessary to seek additional information and the expertise of competent legal counsel.

General Considerations

- 1) Valuation methodology varies according to the purpose for which the appraisal is made (i.e., Yellow Book, traditional appraisal [USPAP only], Internal Revenue purposes).
- 2) Valuation for Federal Income Tax and State Tax Credit Purposes

Note: The Department of Treasury may promulgate new regulations 1.170A-16 and 1.170A-17. If done, these new regulations would generally implement relevant provisions of the Jobs Act (the American Jobs Creation Act of 2004, Public Law 108-357 (118 Stat. 1418)) and the PPA (Pension Protection Act of 2006, Public Law 109-280 (120 Stat. 780)). This means that requirements in the following section may change. It is your responsibility to stay informed about any potential changes to these requirements.

- a) At this time, two Treasury Regulations and IRS Notice 2006-96 must be considered. Treasury Regulation §1.170A-13 etc. prescribes mandatory requirements that must be met in order to satisfy the substantiation requirements for a charitable contribution. Treasury Regulation §1.170A-14 (h)(3) sets out the appraisal methodology under federal regulations for valuing the conservation easement.

Notice 2006-96 provides transitional guidance relating to new definitions of the following terms found in § 170(f)(11) and new § 6695A of the Code regarding substantial or gross valuation misstatements, as added by the PPA:

1. qualified appraisal;
2. qualified appraiser;
3. generally accepted appraisal standards;
4. appraisal designation;
5. education and experience in valuing the type of property; and
6. minimum education and experience.

b) Qualified Appraisal – excerpts from Treasury Regulation §1.170A-13(3):

(3) *Qualified appraisal*—(i) *In general.* For purposes of this paragraph (c), the term “qualified appraisal” means an appraisal document that—

(A) Relates to an appraisal that is made not earlier than 60 days prior to the date of contribution of the appraised property nor later than the date specified in paragraph (c)(3)(iv)(B) of this section;

(B) Is prepared, signed, and dated by a qualified appraiser (within the meaning of paragraph (c)(5) of this section);

(C) Includes the information required by paragraph (c)(3)(ii) of this section; and

(D) Does not involve an appraisal fee prohibited by paragraph (c)(6) of this section.

(ii) *Information included in qualified appraisal.* A qualified appraisal shall include the following information:

(A) A description of the property in sufficient detail for a person who is not generally familiar with the type of property to ascertain that the property that was appraised is the property that was (or will be) contributed;

(B) In the case of tangible property, the physical condition of the property;

(C) The date (or expected date) of contribution to the donee;

(D) The terms of any agreement or understanding entered into (or expected to be entered into) by or on behalf of the donor or donee that relates to the use, sale, or other disposition of the property contributed, including, for example, the terms of any agreement or understanding that—

(1) Restricts temporarily or permanently a donee’s right to use or dispose of the donated property,

(2) Reserves to, or confers upon, anyone (other than a donee organization or an organization participating with a donee organization in cooperative from the contributed property or to the possession of the property, including the right to vote donated securities, to acquire the property by purchase or otherwise, or to designate the person having such income, possession, or right to acquire, or

(3) Earmarks donated property for a particular use;

(E) The name, address, and (if a taxpayer identification number is otherwise required by section 6109 and the regulations thereunder) the

identifying number of the qualified appraiser; and, if the qualified appraiser is acting in his or her capacity as a partner in a partnership, an employee of any person (whether an individual, corporation, or partnerships), or an independent contractor engaged by a person other than the donor, the name, address, and taxpayer identification number (if a number is otherwise required by section 6109 and the regulations thereunder) of the partnership or the person who employs or engages the qualified appraiser;

(F) The qualifications of the qualified appraiser who signs the appraisal, including the appraiser's background, experience, education, and membership, if any, in professional appraisal associations;

(G) A statement that the appraisal was prepared for income tax purposes;

(H) The date (or dates) on which the property was appraised;

(I) The appraised fair market value (within the meaning of § 1.170A-1(c)(2)) of the property on the date (or expected date) of contribution;

(J) The method of valuation used to determine the fair market value, such as the income approach, the market data approach, and the replacement cost- less-depreciation approach; and

(K) The specific basis for the valuation, such as specific comparable sales transactions or statistical sampling, including a justification for using sampling and an explanation of the sampling procedure employed.

(iii) *Effect of signature of the qualified appraiser.* Any appraiser who falsely or fraudulently overstates the value of the contributed property referred to in a qualified appraisal or appraisal summary (as defined in paragraphs (c) (3) and (4), respectively, of this section) that the appraiser has signed may be subject to a civil penalty under section 6701 for aiding and abetting an understatement of tax liability and, moreover, may have appraisals disregarded pursuant to 31 U.S.C. 330(c).

(vi) *Special rules-*

***** (A), (C) and (D) intentionally omitted from course book*****

(B) *Time of receipt of qualified appraisal.* The qualified appraisal must be received by the donor before the due date (including extensions) of the return on which a deduction is first claimed (or reported in the case of a donor that is a partnership or S corporation) under section 170 with respect to the donated property, or, in the case of a deduction first claimed (or reported) on an amended return, the date on which the return is filed.

- c) Treasury Regulation §1.170A-14(h)(3) sets forth the rules for valuing a conservation easement.
- i. The value of a conservation easement under §170 in the case of a charitable contribution of a perpetual conservation restriction is the fair market value of the perpetual conservation restriction at the time of contribution.
 - ii. 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.
 1. Sales of conservation easement interests used for analysis must be arm's length transactions.
 - a. Bargain sales of conservation easements may or may not be considered arm's length transactions.
 - b. The appraiser must make the decision whether or not an easement sale or bargain sale is an arm's length transaction.
 - c. Bargain sales may lack market exposure.
 - d. Bargain sales often are based on an appraised value and might not reflect market value.
 2. While a significant number of arm's length conservation easement purchases might not exist to perform a proper analysis, it is still necessary to analyze the market data and state in the appraisal whether or not there exists substantial records of arm's length conservation easement sales to analyze.
 - a. It is good appraisal practice to analyze conservation easement purchases and bargain sales whether or not the data is ultimately used in determining a value opinion.
 - iii. 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.

- iv. Methodology issues with contiguous parcels - “The amount of the deduction in the case of a charitable contribution of a perpetual conservation restriction covering a portion of the contiguous property owned by a donor and the donors family as defined in section 267(c)(4) is the difference between the fair market value of the entire contiguous parcel of property before and after the granting of the restriction.”¹³

2) Using a previous appraisal as the basis for a new appraisal

- a. Must confirm that the information, analysis and conclusion of the previous report(s) is reliable and relevant
- b. Circumstances often change necessitating new data and analysis
- c. Appraisers must address the above in the appraisal
- d. Consider the intended use and users of other appraisals used
 - i. The appraiser may be required to provide a true copy of the other appraisals used.

3) Valuing improvements

- a. Existing improvements must be considered in conservation easement valuation.
- b. An analysis of whether or not the contributory value for any improvements has changed before and after encumbrance by the conservation easement must be performed.
 - i. The appraiser must include the contributory value before and after if: (list is not exhaustive)
 - 1. the value has changed;
 - 2. the appraiser is uncertain if the contributory value will change;
 - 3. the appraisal is for Yellow Book standards.
 - ii. The appraiser should include the contributory value before and after if the appraisal is being submitted to the IRS or Colorado Department of Revenue.

¹³ Treasury Regulation § 1.170A-14(h)(3)(i)

- iii. In specific situations it may be necessary to include the value of improvements in the before and after valuation. The value of improvements should be clearly identified in each scenario.
- iv. Great Outdoors Colorado requires the value of improvements be clearly separated from the value of the land, water, etc. because they do not grant funds for improvements.

Special Rules for the State of Colorado

- 1) For the calendar years commencing on or after January 1, 2008, an appraisal for a conservation easement in gross for which a credit is claimed shall be a qualified appraisal from a qualified appraiser, as those terms are defined in § 170(f)(11) of the Internal Revenue Code. **The appraisal shall be in conformance with the Uniform Standards for Professional Appraisal Practice promulgated by the Appraisal Standards Board of Appraisal Foundation and any other provision of law.**

Qualitative vs. Quantitative

- 1) The preferred method of adjusting comparable sales is through appropriately supported quantitative adjustments expressed either as a dollar amount or as a percentage.
- 2) The most reliable data to support quantitative adjustments is paired sales analysis.
- 3) Qualitative adjustments where the appraiser classifies the comparables as similar, inferior or superior to the subject are to be used only when market variables cannot be appropriately quantified. When the appraiser resorts to qualitative analysis, extensive support and discussion of the appraiser's reasoning as to why a comparable is classified as similar, inferior or superior to the subject property is required.
- 4) All adjustments, whether quantitative or qualitative must be supported by clear, appropriate and credible analysis based on documented market research.
- 5) Mere references to undisclosed trends or reliance on the appraiser's opinion and judgment without market support is an unacceptable appraisal practice.
- 6) Market support includes, but is not limited to, discussions with buyers/sellers, potential investors, real estate brokers, county assessors and other market participants.
- 7) Appraisers should recognize that variances in sales prices may be caused by multiple factors and should not double count overlapping items when making such adjustments.
- 8) Appraisers should not overlook the value of relying on fundamental statistical concepts such as regression analysis to extract adjustments for the sales comparison approach.
- 9) When quantitative and qualitative adjustments are both used quantitative adjustments should be made first.
- 10) When using qualitative adjustments appraisers must recognize that this often requires more extensive discussion of the appraisers reasoning.
- 11) It is essential when using qualitative analysis that comparables utilized include sales that are overall superior and inferior to the subject.¹⁴

¹⁴ See Uniform Appraisal Standards for Federal Land Acquisitions, Part III A-17

After Easement Valuation

- 1) Consideration of Conservation Easement Sales
 - a) This is the suggested method by the Treasury Regulations
 - b) Difficult to rely solely on these transactions because many are bargain sales and/or many may not be arms length transactions
 - c) Requires a detailed examination of the transaction and identification of various benefits received by the seller
- 2) Direct Sales Comparison – this technique involves the direct comparison of the encumbered subject property, with other restricted sales. If reliable data is available this approach is considered by many appraisers to be more reliable than the percent diminution approach.
 - a) Does not have to include only conservation easement encumbered property
 - b) Other encumbrances such as deed restrictions or right of way easements may also be considered
 - c) Differences in use potential must be considered
 - d) Location influences must be considered
- 3) Percent Diminution Approach – This methodology requires an in-depth analysis of properties that have sold after being encumbered by perpetual conservation easements or other use restrictions. The following steps must be taken to adequately perform such an analysis, including:
 - a) An analysis of the comparable property, including physical characteristics, highest and best use, market appeal and valuation both before and after encumbrance
 - b) An analysis of the use restrictions imposed upon the property and a determination as to their impact on that property's highest and best use, such as development potential. E.g. two CE sales, both with one reserved homesite – one was 70 acres and only had two homesites to begin with, the other was 350 acres and may have had ten potential homesites. Do you treat them the same way?
 - c) It is not appropriate to ignore geographic location because some areas have, for example, more development pressure than others do. If similar development pressure exists in different locations, that may be acceptable. Other factors such as hunting, fishing or agriculture may have a substantial impact on market value in varying geographic locations.

- d) An analysis of any other factors which may have influenced the transactions involved - For example, buyer motivation, water rights needed by a local municipality and access to the buyer's property
 - e) A well explained and adequately supported opinion of the market value of the comparable property with consideration of the use restrictions imposed upon that property
- 4) Other analyses
- a) Value implications of development units foregone
 - b) Valuation/income related to various uses
 - i) Agricultural
 - ii) Wind
 - iii) Oil/gas extraction
 - iv) Hunting/outfitting
 - v) Fishing
 - vi) Other recreational uses
 - vii) Impact of public access/use
 - viii) Possibility for additional encumbrances

Phasing

- 1) How do phases impact the value of the property
 - a) It may be that less value loss occurs in early phases, particularly when there is a large volume of reserved development. Unrestricted land would still provide many years of development opportunity. From a time value of money standpoint, the “tail end” of land to be developed would have a lower present worth than the final few development rights to be restricted. This theory is generally supported by discounted cash flow modeling, particularly when a platted subdivision is being considered.
 - b) As always, the value of a phased easement must be determined through diligent analysis of the subject and sales. Whether value losses are lower in earlier phases is dependent on that analysis. Strong consideration should be given to the level of value loss indicated by partially restricted sales in making the determination of value loss in a phased easement appraisal.
- 2) Protected land adjacent to potential developable land may increase the value of the developable land, and should always be analyzed.
- 3) Deciding phase boundaries based on value (maximizing the tax credit)
 - a) Speak with your client, the grantor and grantee during the engagement process to determine the property to be appraised.
 - b) Understand that similar value phases are likely to have dissimilar acreages.
- 4) Yellow Book
 - a) If the highest and best use changes because of the placement of an easement on part of the property, the larger parcel may change in the appraisal of subsequent phases.

Summation: Potential Errors to Avoid¹⁵

- 1) Adding values (timber, water etc.)
- 2) Adding values of restricted land and unrestricted land (Component Analysis)

Example

Farmer Joe owns a 200-acre property. Joe is granting a conservation easement that eliminates all development on 100 acres of the property. In the before scenario the appraiser determines a highest and best use of development into four 50-acre rural home sites. The appraiser determined a value of \$1,000,000 based on comparable sales. In the after scenario the appraiser says that the 100 unencumbered acres is worth \$500,000 because 50-acre rural home sites sell for \$5,000 per acre. In another analysis, the appraiser determines that the encumbered property is worth \$1,000 per acre because fully encumbered properties that do not allow for any development sell for \$1,000 an acre in that market. To determine the final after value, the appraiser aggregates the \$500,000 (\$5,000 per acre multiplied by 100 acres) for the unencumbered land and the \$100,000 (\$1,000 per acre multiplied by 100 acres) to arrive at a final after value of \$600,000.

The appraiser should have used comparable sales of partially encumbered properties instead of adding the separate values for unencumbered property and encumbered property to conclude a single value, unless a typical purchaser would approach the property in that manner.

- 3) Adding different land types with different values together
 - a) There are times when this is appropriate, however the appraiser must make sure that the conclusion he or she renders reflects the actions of the market and isn't an unsupported conclusion. The appraiser should fully explain and document this in the appraisal report. An adjustment to the sum of values may be required to reflect the market.
- 4) Using Land Class Ratio analysis may be helpful in determining a value when different land types with different values are to be valued.

¹⁵ See USPAP Standard Rule 1-4(e)

Valuation of Additional Property Rights

Water Administration in Colorado

- 1) Like most other western states, Colorado is a prior appropriation state
 - a) Prior appropriation is often described as “First in time, first in right”
 - b) Under this system, junior water right diversions are stopped or reduced in order to insure that senior water users can divert their full quantity of decreed water. Water rights must be in priority to be exercised. Priorities are administered based first on adjudication date (date of the court decree) and second on appropriation date (date on which the first substantial step was taken toward initiation of the appropriation).
 - c) The Colorado Division of Water Resources assigns an administration number which becomes the basis for determining whether a water right must be “called out” to avoid reduction to the allowed quantity of water available for senior water users. Some water rights are so senior they are available throughout the irrigation season. Other water rights may only be periodically called out while the most junior water rights may be routinely called out and are typically not available during most of the summer, fall and winter.
 - d) Most portions of the state are over-appropriated (Arkansas, Rio Grande, Gunnison, Colorado mainstem, South Platte and La Plata River basins and others) and junior water rights are routinely called out. Conversely, some drainage basins (White, Yampa and Animas for example) rarely experience calls.
- 2) The state is divided into seven drainage basins (Water Divisions) for purposes of water administration.
 - (1) South Platte
 - (2) Arkansas
 - (3) Rio Grande
 - (4) Gunnison, including Lower Dolores & San Miguel
 - (5) Colorado (Except Gunnison & Yampa/White)
 - (6) Yampa/White, including the North Platte
 - (7) San Juan/Upper Dolores

- b) Each Division has a water court which is responsible for adjudicating water rights. The Division of Water Resources is also divided into the same water divisions. The Division of Water Resources is responsible for enforcing water decrees and the prior appropriation system. Water divisions are further divided into water districts. Districts have water commissioners who are in charge of administering and enforcing calls. Water commissioners work for the Division of Water Resources under their particular division engineer.
 - c) Besides state laws relating to the administration of water rights, many local policies can impact water values. Municipal water dedication policies have a profound impact on certain water rights. Various jurisdictions have developed Denver Basin aquifer policies, including El Paso County, which has adopted a “300 year” policy as contrasted to the state law allowing withdrawals at a 100 year rate.
 - d) Interstate river compacts can have an impact on potential uses of water and ultimately the value of water rights. Interstate compacts are in place for the Colorado, Arkansas, Rio Grande, South Platte, Republican and La Plata rivers. While a compact is not in place for the North Platte, a Supreme Court decision dictates water use between Colorado and Wyoming.
 - e) Various federal issues can impact water use and water values, particularly if a new water development is being contemplated. A variety of issues may arise, including endangered species and jurisdictional wetlands among others. The Bureau of Reclamation, Corps of Engineers and the Environmental Protection Agency among other federal agencies often play an important role in western water use.
- 3) Groundwater is legally identified as follows:
- a) *Tributary* – This is groundwater that has a hydrologic link to surface water and is administered under the prior appropriation system along with surface water. Because irrigation wells are junior to most surface water, a substitute supply plan (augmentation plan) is necessary to avoid injury to senior water users.
 - b) *Non-tributary* – This groundwater is declared by the State Engineer to not have a link to surface water. The owner of the overlying land has the right to appropriate such water.
 - c) *Designated* – Various designated groundwater basins are found throughout the eastern plains. These basins operate independently, but augmentation may still be required for junior water rights in over-appropriated basins.

- d) *Not Non-tributary* – This is a specific legal term associated with Denver Basin Aquifers. Denver basin aquifers are subject to specific requirements under state laws, but are allocated on the basis of land ownership.
- 4) Exempt Well Permits in Water Critical Areas:
- a) Many drainages in Colorado are over-appropriated meaning that there are more claims to water than the physical supply can sustain. In such situations, junior water rights are routinely curtailed to satisfy more senior rights. These areas are classified by the Division of Water Resources as water critical and the Division imposes limitations on the issuance of exempt water well permits (exempt from augmentation requirements) for wells that tap tributary groundwater. Within water critical areas, a parcel must have at least 35 acres in order to be issued a well permit which will allow the well to service a maximum of three residences. The division has no limitations against subsequent subdivision of the 35 acre parcel as long as no more than three residences are served by the well. Parcels containing less than 35 acres that were created prior to June 1, 1972 can receive a well permit to service one residence with no outdoor use. Parcels containing less than 35 acres that were created after June 1, 1972 and thereafter that are not located within a subdivision will not be issued a well permit without an augmentation plan. The issuance of a well permit does not guarantee the existence of an adequate physical water supply in terms of either quantity or quality.
 - b) Water critical areas create complicated situations due to limitations on the issuance of exempt well permits. Local market participants active in water critical areas are generally sophisticated and understand the limitations imposed. Implications for highest and best use analysis are significant and the appraiser must understand the limitations imposed by designated water critical areas.
- 5) Please refer to education and reference material for more information concerning the administration of water rights in Colorado.

Valuation of Water Rights

1) Real Property Right

- a) A water right is a real property right under Colorado law. Mutual ditch company shares, which represent the shareholder's ownership interest in the underlying water right, also have attributes of personal property. A contract right, however, is considered personal property only.
- b) Certain water rights were adjudicated as a part of a federal project. The project itself typically holds the water right with fractional shares allocated to private landowners. Some federal projects such as the Colorado-Big Thompson allow for the sale and transfer of water interests in the project. Others such as the Dolores Project are an allocation of water tied to a particular parcel of land that cannot be sold separately from the land. Allocations such as these can only be turned back to the project for reallocation to other properties. The Fryingpan-Arkansas Project allocates water amongst municipal and agricultural users based on certain guidelines, although water users do not obtain ownership. Each federal project has unique characteristics and the character and potential use of water supplied via a federal project must be fully understood.

2) Research and documentation

- a) The *Water Rights Handbook* (see "Education and Reference Material") identifies various research strategies, including but not limited to the following:
 - i) Colorado Division of Water Resource records (diversions, decrees, augmentation status, etc.);
 - ii) Deeds of record filed with the county clerk (Water rights are often conveyed with land, or independently, commonly via quitclaim deed. The transfer of a water right, unlike land, is not required to be recorded.);
 - iii) Interview with property owner regarding historic use;
 - iv) Interview water commissioner;
 - v) Interview with ditch company officials;
 - vi) Contacting water attorneys, water engineers, water brokers, water appraisers and real estate brokers.

3) Appropriate Methodology

- a) Actions of market participants should be the basis for the water rights valuation methodology.

- b) Valuation of water rights along with the land.
 - i) Many areas of the state have decreed surface water rights or groundwater rights which typically sell with the land. If market participants do not recognize a separate value for water rights, it is appropriate to value land and water together.
 - ii) Even in areas where most water rights are municipally-influenced, certain water rights may lack potential for a change of use. This is due to a water right being junior or having to spread change of use costs (engineering and legal fees) over a small quantity of water. In these cases, it is appropriate to value land and water together.
- c) Valuation of water rights with potential for the water to be removed from the land
 - i) Mutual ditch company shares are often recognized as having values separate from the land, primarily due to their ability to be sold and readily transferred from the land. It is appropriate for a separate water value to be assigned to mutual ditch company shares where the market recognizes separate values (this may not be applicable to mutual ditch company shares where the market does not recognize separate values). Some mutual ditch companies, however, restrict the transfer of shares, which affects their value.
 - ii) In cases where a water right is influenced by existing or near term potential for a change of use from agricultural to municipal or industrial use, the market likely will recognize price per acre foot of historic consumptive use as the only relevant unit of measure.
 - iii) If historic consumptive use is an appropriate measure of value, the following considerations must be made:
 - (1) Has historic consumptive use been properly measured on the sales and subject property?
 - (a) Use of a water engineer to evaluate historic consumptive use should be strongly considered.
 - (2) The water rights valuation should be based on the “as is” contributory value of the water rights.
 - (a) Use of contracts contingent on a change of use do not reflect current values and would not be appropriate without substantial adjustment.

(b) Non-contingent water sales based on a dry-up covenant may need to be adjusted to reflect the cost to the landowner to implement the dry-up covenant.

d) Highest and Best Use

i) The highest and best use of the water rights should be addressed in the appraisal. This may entail on-site use of the water or selling the water off the land. If the highest and best use is to remove the water, the subsequent impact to the highest and best use of the land should be considered.

e) Highest and best use of the water rights in the after valuation should be addressed.

4) Water Rights Education –

a) Periodically water appraisal education is available through the Society of Farm Managers and Rural Appraisers. Water law courses are taught by various Colorado universities, including a recent course on water law for non-lawyers through Colorado State. CLE International features a two day Colorado Water Law class most years. This course is available for continuing education for appraisers. It typically provides considerable insights regarding changing water administration issues.

b) Beyond the limited available classes, water-rights appraisers must rely on self-directed study and professional experience.

Minerals (Oil and Gas)

1) Available documentation should be reviewed. This may include the following:

a) Minerals report;

b) Deeds;

c) Leases; and/or

d) Colorado Oil and Gas Conservation Commission website (www.cogcc.state.co.us).

2) Mineral (oil and gas) appraisals

a) When a separate appraisal is conducted for minerals, the appraiser should ensure mineral values have been treated consistently on comparable sales.

- b) The mineral valuation should determine the contributory value of the minerals.
 - c) If the mineral valuation is a stand-alone value, the appraiser should consider whether an adjustment needs to be made to reflect contributory value.
 - d) Mineral rights appraisals should be based on market leases and/or purchases of mineral interests when available.
- 3) Consider the impact of minerals on sales
- a) Appraisers must take great care to research the contribution of mineral rights to sales in areas with active oil and gas exploration. Inquiring about mineral rights during the sales confirmation process is critical in these situations.
 - b) A review of data and mapping available from the Colorado Oil and Gas Conservation Commission website can be a sound research strategy.

Gravel Permitting in Colorado

- 1) Gravel mining permits are issued by local governments
- a) Gravel permits are typically issued by counties, although municipalities can issue permits within their boundaries.
 - b) Permits issued by local governments focus on issues of local concern, including access, noise, dust suppression and hours of operation.
- 2) Reclamation permits are issued by the Division of Mined Land and Reclamation Safety.
- a) A warranty bond is issued to insure the land is properly reclaimed.
 - b) A reclamation plan is submitted and must be approved before this permit is issued.
 - c) If surface water is to be exposed as part of the mining plan, the Division of Water Resources is notified and a substitute supply plan (augmentation plan) is developed.

Valuation of Gravel Reserves

1) Highest and best use

- a) The mere physical existence of gravel resources on a property does not insure that gravel production is the highest and best use.
- b) Market evidence must be presented to demonstrate gravel production is reasonably probable in the foreseeable future.

2) Valuation must be “as is”

- a) Appraisals of property with gravel must be based on the “as is” value of the property, and should not be based on the hypothetical condition that the property is permitted for gravel production. Lack of permitting does not necessarily eliminate gravel production from being the highest and best use of a property.

3) Gravel Reserve Estimates

- a) If gravel production is concluded to be the highest and best use, the quantification of gravel reserves on the subject and sales should be consistent.
 - i) Core sampling is the preferred method to estimate reserves, although comparisons with nearby properties or examination of published data may also be used.
 - ii) Mining setbacks and mining impediments must be considered in reserve calculations.
 - iii) The quality of material (sand vs. rock, hardness of rock) should be considered.
 - iv) The impact of overburden on sales and the subject should be considered.

4) Sales Comparison Approach

- a) A sales comparison approach should be considered in the valuation of gravel land.
- b) If permitted gravel sales are compared to an unpermitted subject property, appropriate adjustments must be made to account for permitting costs, risk and time value of money. If the subject is not permitted, comparisons to unpermitted sales with similar potentials are preferred.

5) Discounted Cash Flow Modeling

- a) Discounted cash flow modeling is only appropriate if it can be demonstrated through market evidence that the highest and best use of the subject is for gravel production.
- b) If discounted cash flow modeling is an appropriate technique, it should be properly employed.
 - i) Production projections should be based on market evidence.
 - (1) Annual countywide production is available from the Department of Local Affairs, Division of Taxation.
 - (2) Production from individual pits can be estimated using production tax records along with county-wide production statistics.
 - ii) Royalty rates should be based on market evidence.
 - iii) Expense projections should be based on expenses typically borne by the landowner.
 - (1) These include, but are not limited to production taxes and augmentation
 - iv) Reversion values should be based on the best available market data.
 - (1) Discounted cash models based on creation of water storage after mining are only appropriate in locations where the market and geologic conditions support such a conclusion.
 - v) Discount rates should be developed from the market.
 - (1) Development of discount rates from comparable sales is preferred.
 - (2) If the subject is not permitted, this should be reflected in the discount rate and/or the cash flow projection period (discount rates should not be based on permitted sales without adjustment).
 - (3) Published rates are unacceptable if they do not reflect the market parameters associated with the subject property.

Division of Real Estate Forms and Requirements

Appraisal Submission

1) Affidavit for Conservation Easement Appraisals

- a) If an affidavit is incomplete or not properly filled out the Division will refuse receipt.
- b) Appraisers must submit a separate signed copy of the affidavit (not electronic or physically attached to the appraisal).

2) Fees

- a) The submission fee will be adjusted every year on January 1st.
 - i) For appraisals submitted after January 1st the adjusted fee must be submitted or the Division will refuse receipt.
 - ii) Fees are typically set in November for the following year.
- b) If the wrong fee amount is attached the Division will refuse receipt.

3) Appraisals

- a) What to submit:¹⁶
 - i) Any and all signed appraisals that assess the value of a conservation easement;
 - ii) Any and all amendments to appraisals that assess the value of a conservation easement; or
 - iii) Any signed review of an appraisal that contains an opinion of value.
- b) What not to submit
 - i) Draft appraisals¹⁷, that are not signed, do not need to be submitted to the Division with the prescribed fee.¹⁸
- c) All appraisals including drafts and verbal value opinions are subject to specific provisions of USPAP

¹⁶ *Board of Real Estate Appraisers Rule 16.3* Pursuant to §12-61-719(1), C.R.S, the following appraisals are required to be submitted to the Division of Real Estate with the prescribed fee:

- A. Any and all appraisals that assess the value of a conservation easement;
- B. Any and all amendments to appraisals that assess the value of a conservation easement; or
- C. Any review of an appraisal that contains an opinion of value.

¹⁷ *Board of Real Estate Appraisers Rule 1.34* Draft Appraisal: An appraisal that does not bear the appraiser's signature and is identified and labeled as a "draft". The purpose of issuing a draft appraisal cannot be to allow the client and/or the intended user(s) to influence the appraiser.

¹⁸ *Board of Real Estate Appraisers Rule 16.2*: A draft appraisal, as defined by board rule 1.34, does not have to be submitted to the Division of Real Estate pursuant to §12-61-719(1), C.R.S.

Tax Credit Cap

1) Appraiser's role and responsibility

- a. Provide signed Conservation Easement Appraisal Affidavit to your client for submission by your client to the Division with the Application for a Conservation Easement Tax Credit Certificate.
 - i. Discuss and agree upon the terms with your client in the engagement process.
 - ii. The affidavit cannot be completed and signed until you have completed the appraisal.
 - iii. Complete the affidavit only for appraisals that will be submitted to the Division in accordance with § 12-61-719 C.R.S.
 - iv. All information on the signed affidavit supplied by the client must match the affidavit and appraisal submitted to the Division by the appraiser.
- b. Appraisers must submit the signed Conservation Easement Appraisal Affidavit, prescribed fee and signed appraisal to the Division within 30 days of signing and delivering it to the client.

Division's Review of Conservation Easement Appraisals

- 1) The Division will review any appraisal upon receipt of a complaint.
- 2) The Division will review conservation easement appraisals when requested to do so by other government agencies.
- 3) The Division will review appraisals submitted in accordance with §12-61-719 C.R.S.
 - a. All affidavits and appraisals are reviewed by staff.
 - b. The Division reviews the following items in appraisals submitted to the Division (Note: this is not a review checklist, the level of review may vary, as such this list is not comprehensive):
 - i. Affidavit
 1. Complete
 2. Signed
 3. Information matches the appraisal;
 - ii. Signed and dated engagement letter;

- iii. Signed Certification;
- iv. Hypothetical Conditions and Extraordinary Assumptions;
- v. Scope of Work;
- vi. The correct property is appraised;
- vii. Analysis of comparable conservation easement sales;
- viii. Highest and Best Use analysis in the before scenario;
- ix. Before Valuation
 - 1. Methodology
 - 2. Data (sales)
 - 3. Analysis of previous donations;
- x. Analysis of conservation easement restrictions;
- xi. Highest and Best Use analysis in the after scenario;
- xii. After Valuation
 - 1. Methodology
 - 2. Data (sales)
 - 3. Increased value to unencumbered portions of the contiguous property owned by the donor and the donor's family or larger parcel;
- xiii. Analysis of enhancement to non-contiguous property owned by the donor or related persons and to contiguous property owned by related persons (Treasury Regulations appraisal);
- xiv. Qualification of the Appraiser;
- xv. Deed of Conservation Easement;
- xvi. Title documentation;
- xvii. Other documentation necessitated by assignment conditions;
- xviii. Maps
 - 1. Subject property
 - 2. Sales used in the analysis;
- xix. Information provided on comparable sales (data sheets).

Additional Resources

General

CCLT Appraisal Guide <http://cclt.org/Downloads/education/ccltappraisalguide.pdf>

Phasing

CCLT Phasing Guidelines

<http://cclt.org/Downloads/education/Guidance%20on%20the%20Phasing%20of%20Conservation%20Easements.pdf>

Water

Statewide Water Supply Initiative

Colorado Water Conservation Board, 2004

Note: This comprehensive report includes substantial data and mapping for each of the state's drainage basins. It provides a detailed overview of water use and water supply in Colorado.

Colorado Real Estate Manual (Chapter 13 – Water Rights)

Colorado Division of Real Estate (available on website)

Note: Concise review of Colorado water law and water administration.

Water Rights Handbook for Colorado Conservation Professionals

Nichols, Browning, Wright, Flood, Weston

Bradford Publishing, 2005

Note: Discussion of both research and valuation techniques.

Colorado Water Law for Non Lawyers

Cech, Jones

University Press of Colorado, 2009

Note: Publication authored by instructors who teach the course by the same name.

Guidelines for the Appraisal of Water Rights in California

Herzog, CH2MHill & US Fish and Wildlife Service, 2006

Note: While much of this report is geared towards California water law, there are many important insights regarding valuation techniques.

Guide to Colorado Well Permits, Water Rights, and Water Administration

Division of Water Resources, Department of Natural Resources, State of Colorado, 2008

Note: Comprehensive and useful guide developed by State Engineer's office.

Citizens Guide to Colorado Water Law, 3rd Edition

Colorado Foundation for Water Education, 2004

Note: User friendly introduction to Colorado water law.

Water Law in a Nut Shell, Fourth Edition

Getches, David H.

West Publishing Company, 2008

Note: Places Colorado's prior appropriation doctrine within context of broader water law principles.

Vranesh's Colorado Water Law, Revised Edition

Corbridge, Jr., James N. & Teresa A. Rice

University Press of Colorado, 1999

Note: Extensive treatment of Colorado water law. Supplemental updates available. Advanced.

Groundwater and Wells, Second Edition

Driscoll, Fletcher G.

Johnson Screens, 1986

Note: Detailed treatment of all aspects of groundwater well development.

Ground Water Atlas Of Colorado

Colorado Geological Survey, Department of Natural Resources, State of Colorado, 2003.

Note: Good overall treatment of Colorado's groundwater resources.

Colorado Division of Water Resources www.water.state.co.us

Colorado Water Conservation Board www.cwcb.state.co.us

US Geological Survey (Water Information)

www.waterdata.usgs.gov/co/nwis/nwis

Colorado Geological Survey www.geosurvey.state.co.us

Colorado Foundation for Water Education www.cfwe.org

Colorado Water Trust www.coloradowatertrust.org

Gravel

Mineral Law, Sixth Edition

Maley, Terry S.

Mineral Land Publications, 1996

Note: Comprehensive guide to all aspects of mineral law in the United States

Messages in Stone

Matthews, Vincent, Katie Kellerlynn, & Betty Fox

Colorado Geological Survey, Department of Natural Resources, State of Colorado, 2003.

Note: Good introduction to geology of Colorado.

Colorado Division of Minerals and Geology (www.mining.state.co.us).

Colorado Geological Survey www.geosurvey.state.co.us

US Geological Survey Information of Colorado Front Range Aggregate Resources (www.rockyweb.cr.usgs.gov/frontrange)

US Geological Survey Minerals Information (www.minerals.usgs.gov/minerals)

Colorado Dept. of Local Affairs/Division of Taxation

(www.dola.colorado.gov/dpt/publications/annual_report_index.htm)

Note: "Earth and Stone Products" includes sand and gravel resources.

International Valuation Standards, Guidance Note 14, Valuation of Properties in the Extractive Industries

(www.ivsc.org).

American Institute of Minerals Appraisers (www.mineralsappraisers.org)

Additional links to gravel industry information can be found at the Valuation Resources website

(www.valuationresources.com/Reports/SIC1400CrushedStoneSandGravelMining.htm)

Minerals

Mineral Law, Sixth Edition

Maley, Terry S.

Mineral Land Publications, 1996

Note: Comprehensive guide to all aspects of mineral law in the United States

Messages in Stone

Matthews, Vincent, Katie Kellerlynn, & Betty Fox

Colorado Geological Survey, Department of Natural Resources, State of

Colorado, 2003.

Note: Good introduction to geology of Colorado.

Mineral Development and Land Conservation A Handbook for Conservation Professionals

Colorado Coalition of Land Trusts, 2009

Colorado Division of Minerals and Geology (www.mining.state.co.us).

Colorado Geological Survey (www.geosurvey.state.co.us)

US Geological Survey Minerals Information (www.minerals.usgs.gov/minerals)

American Institute of Minerals Appraisers (www.mineralsappraisers.org)

DORA is dedicated to preserving the integrity of the marketplace and is committed to promoting a fair and competitive business environment in Colorado.

Consumer protection is our mission.



Division of Real Estate
1560 Broadway, Suite 925
Denver, CO 80202

<http://www.dora.state.co.us/real-estate>