

APPRAISAL OF  
CONSERVATION EASEMENTS

For:

NC State University Workshop

Conservation Easements  
and other  
Land Preservation Techniques

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Charles J. Moody III, MAI  
Realty Service of Eastern Carolina, Inc.  
2313 Grace Avenue  
Post Office Box 15069  
New Bern, NC 28561-5069

## APPRAISAL OF CONSERVATION EASEMENTS WORKSHOP OBJECTIVES

Introduce participants to the appraisal process.

Assist participants in understanding the regulatory and ethical environment in which appraisers work.

Assist participants in understanding what is required to produce a credible conclusion of value for a conservation easement.

## CHOOSING AN APPRAISER

Appraiser ***must*** be licensed or certified in the jurisdiction in which the property is located.

In North Carolina, the North Carolina Appraisal Board is responsible for licensing and certification.

Appraiser ***must*** abide by standards as stated in current issue of Uniform Standards of Professional Appraisal Practice (“USPAP”).

Under USPAP guidelines, appraisal may be reported in a manner that is not misleading and must include specific items. These guidelines are mandatory. Within these guidelines, the appraiser may report the value in a self-contained report, a summary report or a restricted report. The level of detail contained in the report varies, but the same appraisal process to support the value conclusion must be followed. Sufficient data must be contained in either the text of the report or in the appraiser’s file to support the value conclusion reached.

Appraiser ***should*** have the background and experience to value the easement properly.

Should have a working knowledge of the property type.

Should have knowledge of easement valuation.

## DEFINITION OF AN APPRAISAL

An unbiased estimate of the nature, quality, value or utility of an interest in, or aspect of, identified real estate and related personalty.

An appraisal is not:

- ♦ a guess,
- ♦ a hunch,
- ♦ what you want the value to be, or
- ♦ the report itself.

An appraisal is:

- ♦ an opinion of value,
- ♦ an estimate of value,
- ♦ unbiased, and
- ♦ based on market-supported facts.

## APPRAISAL NEEDS

- ♦ Factual
- ♦ Unbiased
- ♦ Complete
- ♦ Statement of limiting conditions
- ♦ Statement of existing or contemplated interest (if any).  
If none, so state.
- ♦ Present basis for reasoning
- ♦ Present applicable market data, cost estimate and/or  
capitalization computation as appropriate.

## THE APPRAISAL PROCESS

A systematic procedure to answer a specific question regarding Real Estate Value.

The process moves from general to specific through the following steps:

- ♦ Appraisal premise
- ♦ Area and neighborhood analysis
- ♦ Property description and data
- ♦ Highest and best use
- ♦ Application of approaches to value
- ♦ Final value reconciliation

## APPRAISAL PREMISE

- ♦ Identification of the property
- ♦ Objective of the appraisal
- ♦ Definition of value
- ♦ Property rights appraised
- ♦ Date valuation applies

## APPRAISAL PREMISE

### Identification of the property

- ♦ Appraisal must contain an adequate legal description of the property being valued
- ♦ Client must also be identified

## APPRAISAL PREMISE

Objective of the appraisal

- ♦ Measure the value of the easement rights conveyed

## APPRAISAL PREMISE

### Market value definition

*Market value* is defined in The Appraisal of Real Estate as follows:

"The most probable price which a specified interest in real property is likely to bring under all the following conditions:

1. Consummation of a sale occurs as of a specified date.
2. An open and competitive market exists for the property interest appraised.
3. The buyer and seller are each acting prudently and knowledgeably.
4. The price is not affected by undue stimulus.
5. The buyer and seller are typically motivated.
6. Both parties are acting in what they consider their best interest.
7. Marketing efforts were adequate and a reasonable time was allowed for exposure in the open market.
8. Payment was made in cash in U.S. dollars or in terms of financial arrangements comparable thereto.
9. The price represents the normal consideration for the property sold, unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

Source: The Appraisal of Real Estate, Eleventh Edition, published by the Appraisal Institute, 875 North Michigan Avenue, Chicago, Illinois.

The objective of the appraisal is to measure the amount a typical informed buyer would pay for the property.

1. Prior to conveyance of the easement rights, and
2. With the easement rights conveyed.

## APPRAISAL PREMISE

### Property rights appraised

Ownership of real property includes a number of intangible rights which are recognized by law.

The term "Bundle of Rights" is used to describe property rights.

An easement conveys a portion of the bundle of rights to another party.

## APPRAISAL PREMISE

Date valuation applies

Appraisal is for a specific point (date) in time.

In the context of a Conservation Easement the date of value coincides with the date the easement is granted.

The appraisal can be completed before or after the date the easement is granted, but the report must clearly state if the valuation is for a prospective date or a retrospective date.

There are specific guidelines with respect to a value date for tax deduction purposes.

## AREA AND NEIGHBORHOOD ANALYSIS

Description of the economic setting in which the property is located

Economic and demographic forces shape the market value of real property.

Should consider past, present and future economic and demographic trends.

## SITE DATA

A complete physical description of the property

- ♦ Size, shape and dimensions
- ♦ Allocation of area among uses
- ♦ Topography
- ♦ Soils
- ♦ Timber and other permanent plantings
- ♦ Physical access to the public road
- ♦ Structural and other man-made improvements
- ♦ Available utility service
- ♦ Mineral resources
- ♦ Other features

## PUBLIC AND PRIVATE RESTRICTIONS

### Current zoning classification

- ♦ Consider permitted uses
- ♦ Assess potential for a change in zoning classification
- ♦ Current use - conforming or nonconforming
- ♦ Is nonconforming use legal?

### Other Legislative Restrictions on Use

- ♦ Zoning overlay districts
- ♦ Wetlands and other environmental regulations
- ♦ Watershed rules
- ♦ Required setbacks
- ♦ Endangered species
- ♦ Hazardous waste

### Private Restrictions and Covenants

Assessed Value for Ad Valorem Taxes, Tax Rate and Annual Tax Burden

## HISTORY

Present owner and most recent conveyance to this owner.

If conveyed within five years of the date of value, must determine if the conveyance is a market-based transaction.

If so, prior conveyance must be considered as an indicator of value for the property.

If applicable, rental and lease history must be disclosed and discussed.

## APPRAISAL PREMISE

## ANALYSIS OF THE AREA AND NEIGHBORHOOD

## SITE DATA

## PUBLIC AND PRIVATE RESTRICTIONS

## HISTORY

- ♦ These sections require a fair amount of time to complete
- ♦ These sections involve investigation seemingly unrelated to the valuation of the property
- ♦ What is the purpose of these sections?
- ♦ They lead to:

## HIGHEST AND BEST USE

## HIGHEST AND BEST USE

Highest and best use is defined as:

1. The reasonable and probable use that supports the highest present value of vacant land or improved property, as defined, as of the date of the appraisal.
2. The reasonably probable and legal use of land or sites, as though vacant, found to be physically possible, appropriately supported, financially feasible and that results in the highest present land value.

## HIGHEST AND BEST USE

Appraisal should contain a statement of highest and best use

- ♦ As if vacant and unimproved, and
- ♦ As if improved

Should also state if

- ♦ Present use conforms with highest and best use
- ♦ Present use is a legally conforming use, and
- ♦ If existing improvements make a positive contribution to the highest and best use.

## HIGHEST AND BEST USE

In the context of conservation easement appraisal conveyance of the easement rights results in a change in highest and best use.

The appraisal should appropriately state two conclusions of highest and best use:

- ♦ Highest and best use prior to conveyance of the easement rights, and
- ♦ Highest and best use after conveyance of the easement rights.

The appraisal should summarize the easement rights conveyed and the effect conveyance of the easement rights will have on the use and utility of the property.

## HIGHEST AND BEST USE

The definition of Highest and Best Use has four elements or tests which must be met.

1. Physically Possible
2. Legally Permitted
3. Financially Feasible
4. Maximum Productivity

The best method to reach the highest and best use conclusion is to consider each element or test individually.

## HIGHEST AND BEST USE

The focal point of the appraisal

Determines, more than any other part of the appraisal process, the final value conclusion which will be reached.

The remainder of the appraisal can be technically correct, but will lead to the wrong value indication if an incorrect highest and best use conclusion is reached.

You will get the right answer to the wrong question.

## HIGHEST AND BEST USE

- Often the highest and best use is fairly obvious
- For transitional properties, the highest and best use is less obvious
- With transitional properties, WHEN becomes a key consideration in value
- Highest and best use must be consistent with area and neighborhood
- Avoid inconsistent use when valuing the property

## HIGHEST AND BEST USE

Conservation easement appraisals often involve unimproved or under-improved properties.

Typical situation is the present use does not conform with the highest and best use.

Economic and demographic forces in the market indicate when and if a change in use will occur.

The timeline for this change may be immediate or some future date.

If the change is a future date, the value conclusion reached must appropriately reflect a discount for the time value of money.

The highest and best use conclusion for the property before the easement rights are granted must rely on market-based reasoning and be consistent with all of the elements of the highest and best use definition.

Conveyance of the Conservation Easement will impose additional limitations on the legally-permitted uses to which the property may be placed.

## THE THREE APPROACHES TO VALUE

1. Cost  
Typically for improved properties
  2. Sales Comparison of Market  
All property types
  3. Income  
Typically improved property that is rented or leased
- ♦ The appraiser is not required to use all three approaches to value in every appraisal.
  - ♦ Good appraisal practice dictates consideration be given to the use of all three approaches to value.
  - ♦ Each approach to value has its strengths and weaknesses.
  - ♦ It is the appraiser's decision to decide which of the three approaches are applicable to the appraisal problem and choose the appropriate approach or approaches to value that are applicable to the appraisal problem.

## THE THREE APPROACHES TO VALUE

In conservation easement appraisal practice the property is valued twice by application of the valuation techniques appropriate to the property.

If the easement encompasses only a portion of the property, consideration must be given to the impact of the easement on the value of the unencumbered remainder.

## RECONCILIATION OF VALUE INDICATIONS

Each approach to value used in the appraisal process is developed independent of any other approach used.

Each approach to value should lead to a value indication similar but not the same as any other approach used.

Use of two or more approaches to value acts as a check on the reasonableness of the other approach(es) used.

In the last step of the appraisal process, the appraiser must reach a final value conclusion.

There will be a value conclusion reached for the property prior to granting of the easement rights and after the easement rights are granted.

The value of the easement rights conveyed is the difference between the two value conclusions.

## ESTABLISHING BASE LINES

Employ the services of a person licensed and qualified to perform the assignment.

Allow adequate time to complete the assignment--30 to 60 days is a minimum.

Provide as much factual data as you have available.

- ♦ Maps
- ♦ Aerial photographs
- ♦ Timber inventories
- ♦ Deeds
- ♦ Tax assessment data
- ♦ Local zoning or land use regulations
- ♦ Draft of the easement
- ♦ Name of property contact person
- ♦ Knowledge of any sales transactions

Fees are based on the time required to complete the assignment. The fee should be negotiated before the assignment is authorized.

If time is critical make the appraiser aware of the time constraint at the outset. Avoid trying to schedule the appraisal at year-end if at all possible.

Involve the appraiser early in the easement process. The appraiser may be able to offer suggestions that will enhance the value of the easement.

The use of an engagement letter is highly recommended.

## ESTABLISHING BASE LINES

Reaching a credible highest and best use conclusion for the property unencumbered by the easement is the key step in the valuation process.

The highest and best use conclusion must be reasonable, supported by the market and not highly speculative.

Valuing the easement requires that two appraisals be made of the property:

Value Unencumbered by the Easement  
Less: Value Encumbered by the Easement

Value of Easement Rights Conveyed

Intangible property rights are being valued, not actual real estate.

The easement defines the rights being surrendered. The easement must be drafted prior to the appraisal being completed.