Conservation Easement Valuation: Lessons from Recent Tax Court Cases

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Conservation Easement Valuation: Lessons from Recent Tax Court Cases

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Conservation Easement Valuation: Panel Member Topics

Richard Roddewig – Critical issues & problems identified in recent Tax Court cases

Annie O’Connell – How to find & analyze purchases of easements & sales of easement protected properties

Richard Roddewig – Final comments
Conservation Easement Valuation: Topic One

Richard Roddewig – Critical Appraisal Issues & Problems Identified in Recent Tax Court Decisions
Clarion Associates: Expert Testimony Experience

Condemnation – full & partial interests
Charitable donations – full & partial interests
Contamination & environmental risk
Special purpose properties
Involved in More than 300 Conservation & Historic Preservation Easement Assignments Since 1980
Clarion Associates: Conservation Easement Valuation Experience

Clarion Easement Valuation Clients
1980 to 2005

Primarily
Taxpayers
Law firms
Accounting firms
Clarion Associates: Conservation Easement Valuation Experience

Clarion Easement Valuation Clients
Since 2005 have primarily been reviewers for:
The Internal Revenue Service
The Department of Justice
Easement recipient organizations
Clarion Associates: Conservation Easement Valuation Experience

Prepared the AI publication on easement valuation
How important are the technical requirements of the “qualified appraisal” rules?
Does the Tax Court require compliance with USPAP?
How critical is a detailed highest & best use analysis?
What are the implications of the requirements to appraise the entire contiguous property & analyze possible enhancement in value?
Can the cost approach always be dismissed as not important?
What is the Tax Court position on the appropriateness of DCF analysis?
How will the Tax Court review my adjustments in a sales comparison approach?
When should I use the “before and after method”?
Conservation Easement Valuation: Critical Appraisal Issues & Recent Tax Court Cases

Other Critical Questions & Issues

- Can Tax Court judges go “outside the record” and apply their own experience and judgment?

- Are Tax Court decisions “precedent”?

- What should I do if there is a conflict between two or more Tax Court opinions about an appropriate method to use?

- If there is conflict between USPAP requirements and prior opinions of a Tax Court judge, should we invoke the Jurisdictional Exception Rule?
Conservation Easement Valuation: Compliance with Qualified Appraisal Rules

- Required content of a “qualified appraisal”
  - I.R.C. Section 170(a)(4) and (a)(5)(A)
  - Treas. Regs. Section 1.170A-13(c)(3) and (c)(5)
  - Must be completed if value of the charitable donation exceeds $5,000
A qualified appraisal MUST contain

- Description of the property
- Description of physical condition of the property
- Date of the charitable donation
- Terms of any agreement between donor and donee related to the use, sale, or disposition of the property
A qualified appraisal MUST contain:

- Name, address, and taxpayer ID number of qualified appraiser and appraiser’s employer
- Summary of appraiser’s qualifications including background, experience, education, and membership in professional appraisal organizations
- Statement that appraisal was prepared for income tax purposes
A qualified appraisal MUST contain

- Date of the appraisal report
- Appraised fair market value on date of donation
- Method of valuation used
- Specific basis for valuation (e.g., comp sales, before and after method)
- Description of appraisal fee arrangement
Conservation Easement Valuation: Compliance with Qualified Appraisal Rules

- Additional qualified appraisal content requirements added by PPA 2006
  - Declaration that because of background, education, experience, and membership in professional associations, appraiser is qualified to appraise the type of property being valued
  - Photos of all exteriors (if in a historic district)
  - Description of all restrictions on the development of the building if in a historic district
Conservation Easement Valuation: Compliance with Qualified Appraisal Rules

- Timing of a qualified appraisal
  - Cannot be completed any earlier than 60 days before the date of donation OR submitted any later than the date on which the taxpayer files tax return (with extensions) for the year in which donation was made
  - When completing a retrospective appraisal, date of value is the date the easement is donated, NOT the date of report submission
In more than a dozen Tax Court cases, IRS attorneys have attempted to disqualify appraisals for failing to comply with the technical requirements of the “qualified appraisal” rules.
Conservation Easement Valuation: Compliance with Qualified Appraisal Rules

See, for example:

- *Costello v. Commissioner*, T.C. Memo 2015-87
- *Simmons v. Commissioner*, T.C. Memo 2009-2008
- *Scheidelman v. Commissioner*, T.C. Memo 2010-151 (decided July 14, 2010)
Conservation Easement Valuation: Compliance with Qualified Appraisal Rules

- *Simmons v. Commissioner*, T.C. Memo 2009-2008
- IRS argued the taxpayer’s appraisals were not “qualified appraisals” under tax regs.
  - Failed to adequately describe the properties
  - Failed to accurately identify the method of valuation used
  - Failed to adequately describe the specific basis for the valuation
  - Did not include specific wording that the appraisal was done for income tax purposes
  - Did not include the precise dates of the donation
- Tax Court rejects all the IRS arguments
Conservation Easement Valuation: Compliance with Qualified Appraisal Rules

- Appraisal implications of Costello, Brucewicz, Simmons, and Scheidelman cases
  - Check that your appraisal includes all of the requirements to be a “qualified appraisal,” including a statement of your qualifications, education, and experience as they relate to appraisal of preservation easements
  - Carefully describe the specific provisions of the easement as they impact the property
  - Make sure to submit your appraisal within the required time deadlines
Conservation Easement Valuation: Compliance with Qualified Appraisal Rules

  
  IRS “qualified appraisal” regulations apply only to appraisals done for taxpayers and not to appraisals obtained by IRS in support of litigation.
Conservation Easement Valuation: Compliance with USPAP

**Whitehouse Hotel case**

- “Adherence to those (USPAP) standards is evidence that the appraiser is applying methods that are generally accepted within the appraisal profession. Therefore, at a minimum compliance with USPAP is an indication that the appraiser’s valuation report is reliable.”

- “However, a noncompliant valuation report is not per se unreliable. Full compliance with professional standards is not the sole measure of an expert’s reliability.”
Conservation Easement Valuation: Compliance with USPAP

- **Whitehouse Hotel case**
  - “Petitioner essentially asks the Court to supplant its responsibility to assess an expert’s reliability with a rigid standard of reliability.”
  - “Sole reliance on USPAP is a far more inflexible definition of reliability than the definition (depending on ‘reliable principles and methods’) incorporated into Rule 702 of the Federal Rules of Evidence. Therefore, we decline to adopt USPAP as the sole standard for reliability of an appraiser under Rule 702.”
Conservation Easement Valuation: Compliance with USPAP

- **Whitehouse Hotel case**
  - *Whitehouse* decision “leaves easement appraisers with an impossible choice: either follow standards and methodologies consistent with generally accepted appraisal practice and risk an adverse decision from the Tax Court; or follow the methodologies and standards adopted by the Tax Court in *Whitehouse v. Commissioner*, and ignore the professional standards of the appraisal profession.”
Conservation Easement Valuation: Compliance with USPAP

- **SWF Real Estate LLC v. Commissioner, T.C. Memo 2015-63**

  - Compliance with USPAP was also an issue:
    - IRS argued taxpayer’s appraisal “failed to list the proper hypothetical conditions” and “failed to list several details required for self-contained appraisal reports.”
    - Tax Court refused to disqualify the appraisal on USPAP grounds because the IRS “has not demonstrated how the alleged technical errors” rendered the report “unreliable” or “reflective of more significant substantive errors.”
Question: What appraisal standards should appraisals be performed in accordance with?

Answer: The Interim Rule defines a “qualified appraisal” as one, which is conducted in accordance with generally accepted appraisal standards; and it cites, as an example, an appraisal that is consistent with the substance and principles of the Uniform Standards of Professional Appraisal Practice, as developed by the Appraisal Standards Board of the Appraisal Foundation.
Conservation Easement Valuation: Compliance with USPAP

- Scope of Work Rule says measure the acceptability of an appraisal’s scope by what an appraiser’s peers would do in similar assignments
- Appraiser’s peers are those with expertise and competency in “a similar type of assignment”
- FAQ 159 says courses and seminars are one of the sources for becoming knowledgeable about “what an appraiser’s peers would do in a similar assignment”
- Know what peers would do based on courses, seminars, & publications of the appraisal profession
The quality of a conservation easement appraisal, appropriateness of methodology, and compliance with USPAP will be measured by comparison to courses, seminars & books on appraising conservation easements – see specifically the Appraisal Institute’s *Appraising Conservation Easements* course and the *Appraising Conservation and Historic Preservation Easements* book.
Conservation Easement Valuation: Critical Importance of Highest & Best Use Analysis

- Both the *Appraising Conservation Easements* course and the *Appraising Conservation and Historic Preservation Easements* book emphasize the importance of detailed highest and best use analysis.
The *Appraising Conservation Easements* course says the following:

“VI.1. A prominent and frequent criticism in conservation easement appraisals is the level of substantiation of the highest and best use conclusions in the before scenario.

2. An in-depth analysis of each of the four tests, both to the site as though vacant and to the property as improved, is absolutely essential to address this often valid criticism.

B. Must not be a speculative use (although the highest and best use can be for speculative investment)

C. Must be reasonable and probable as of the effective date of the appraisal”
Conservation Easement Valuation: Critical Importance of Highest & Best Use Analysis


Three contiguous parcels

- Parcel 1 – 10 Acres (Northern)
- Parcel 2 – 10 Acres (Southern)
- Parcel 3 – 10.3 Acres (Eastern)

Easement on 8.0 acres on eastern side of the Southern parcel

At time of donation, 2.82 acres of the easement area as well as 8.5 acres of the Northern parcel & all of the Eastern parcel “are forested wetlands falling within the jurisdiction of the U.S. Army Corps of Engineers”
Conservation Easement Valuation: Critical Importance of Highest & Best Use Analysis


Problems in the HABU analysis

Property was zoned R-1 SF at density of 1 to 2.0 units per acre depending on septic vs. sewer

But HABU conclusion was 174 condos in 29 buildings of 6 units each

Failure to consider effect of 50 foot wide gas pipeline utility easement on claimed physically possible location of the 29 buildings
Conservation Easement Valuation: Critical Importance of Highest & Best Use Analysis


Problems in the HABU analysis (cont.)

Error in assumptions about annexation status & zoning of the easement protected area

The “after” value was based on “raw land” value rather than value for SF residential use allowed by the easement
Conservation Easement Valuation: Critical Importance of Highest & Best Use Analysis


Tax Court quoted following language from IRS brief as “aptly” summarizing the HABU errors in the appraisal:

“failure: to properly apply the before and after methodology, to value all of petitioner’s contiguous landholdings, to take into consideration zoning restraints and density limitations and to take into consideration the pre-existing conservation easements. As a result, the . . . Experts saw nothing wrong with a hypothetical development project that could not fit on the land they purportedly valued, was not economically feasible to construct and would not be legally permissible to be built in the foreseeable future.”
Conservation Easement Valuation: Critical Importance of Highest & Best Use Analysis


IRS brief also said the following:

The appraisers’ value was “based on whatever use generates the largest profit, apparently without regard to whether such use is needed or likely to be needed in the reasonably foreseeable future.”
The easement appraisal did not include all of the contiguous property in the “before and after” analysis – appraisers claimed they were not told by the property owner that it owned all of the contiguous parcels.
Why is the cost approach important in many conservation easement assignments?

- Allows separate focus on impact of restrictions on right to subdivide, transfer density, or add horizontal/vertical additions as they relate to land value
- Allows separate focus on impact of restrictions on functional or external obsolescence of improvements
- Facilitates critical analysis of difference between impact on land value and improvement value
- In absence of direct sales of easement properties, facilitates discussion of impact of easement on land and building
 Conservation Easement Valuation: The Cost Approach & the Tax Court

- In conservation easement valuation assignments with historic houses, the cost approach is especially important.
Conservation Easement Valuation: The Cost Approach & the Tax Court

- Inconsistent Tax Court acceptance/rejection of appropriateness of the cost approach
- IRS Publication 561 & the cost approach
Conservation Easement Valuation: The Cost Approach & the Tax Court

- **Whitehouse Hotel case**
- Cost approach “is an inappropriate method for valuing older buildings.”
- “As a precondition to using the (cost) approach, the taxpayer must show that the property is unusual in nature and other methods of valuation, such as comparable sales or income capitalization, are not applicable.”
Kiva Dunes v. Commissioner, T.C. Memo 2009-145

- Decided one month after Whitehouse Hotel decision
- Tax Court in Kiva Dunes applied a cost approach – land value plus cost of converting unimproved land comparables to golf course use – in a situation in which sales approach or income approach could have been used
- Directly contradicts Whitehouse Hotel decision on use of cost approach
5th Circuit decision in Whitehouse case rejects Tax Court exclusion of cost approach & requires it to be considered
- Referenced the cost approach as one of the 3 approaches recognized in USPAP
- Instructed the Tax Court on remand to consider all three approaches to value
Conservation Easement Valuation: The Cost Approach & the Tax Court

- Other Tax Court decisions involving conservation/preservation easements & fee donations relied on the cost approach
  - Thayer v. Commissioner, T.C. Memo 1977-320
  - Hilborn v. Commissioner, 87 T.C. 677 (1985)
  - Nicoladis v. Commissioner, T.C. Memo 1988-163
  - Estate of Palmer v. Commissioner, 839 F.2d 420 (8th Cir. 1988)
  - Crocker v. Commissioner, T.C. Memo 1998-204
Conservation Easement Valuation: The Cost Approach & the Tax Court

- AI easement book (pp. 324-339) contradicts *Whitehouse Hotel* & stresses importance of cost approach for many reasons including:
  - (1) "*The Appraisal of Real Estate* states that the cost approach is ‘particularly useful in valuing . . . properties that are not frequently exchanged in the market.”
  - Sales of easement protected properties are rare in many local markets
Conservation Easement Valuation: The Cost Approach & the Tax Court

- AI easement book (pp. 324-339) on reasons for importance of cost approach (cont.):
  - (2) the easement holder can impose some types of costs on the owner of the protected property – cost approach ideally suited to handle that analysis;
  - (3) easements can impact land & buildings in different ways -- cost approach ideally suited to handle that analysis; and
  - (4) easements can extend useful life of improvements – so cost approach important to analysis of possible enhancement.
Conservation Easement Valuation: The Cost Approach & the Tax Court

- AI easement book (p. 339) includes following quote from Eaton’s AI book *Real Estate Valuation in Litigation (2nd Edition)* as further support for use of cost approach:

  - Appraisers have “an ethical and professional obligation to develop a cost approach to value whenever the results of the approach will assist in estimating the value of the property,” and “the fact that the courts seem to distrust the cost approach and will sometimes exclude testimony based on this approach does not, of course, restrict the appraiser from using it in arriving at a final estimate of value.”
AI easement book (p. 339) concludes as follows in support for use of cost approach:

- “The appraiser needs to address the applicability and appropriateness of the cost approach in the conservation and historic preservation easement appraisal report. When there are improvements on the property, the cost approach should generally be used.”
Conservation Easement Valuation: DCF Analysis & the Tax Court

- *Kiva Dunes v. Commissioner*, T.C. Memo 2009-145
- DCF analysis “before and after” accepted by the Tax Court
- Conservation easement was on a golf course in a residential subdivision in Alabama
Conservation Easement Valuation: DCF Analysis & the Tax Court

- *Kiva Dunes v. Commissioner*

- Easement restricted current and future use to golf course, park, or agriculture

- DCF analysis “before and after” accepted by the Tax Court
Conservation Easement Valuation: DCF Analysis & the Tax Court

- **Whitehouse Hotel case**
  - Tax Court rules DCF method should generally be disregarded as unreliable because of the number of “assumptions” required.
  - Also rules taxpayer’s DCF analysis provided “no measure of the overall risk of error in his assumptions.”
  - Judge ignored the simultaneous appraisal using DCF analysis done for mortgage financing on the same property – judge could have compared inputs in the appraisal **accepted by the lender** to the inputs in the easement valuation appraisal as its own measure of risk of error.
Conservation Easement Valuation: DCF Analysis & the Tax Court

- **Kiva Dunes Case**
  - Tax Court accepted discounted cash flow analysis as appropriate – contradicts 2008 *Whitehouse Hotel* ruling
  - Before easement highest and best use – residential development
    - Taxpayer’s expert – 370 lots absorbed over 10-year DCF period
    - IRS expert – 300 lots absorbed over 15-year DCF period
  - Court did not comment on either a 10-year or 15-year absorption period being too remote or speculative – accepted the 370-lot and 10-year scenario
Conservation Easement Valuation: DCF Analysis & the Tax Court

- **Kiva Dunes** decision directly contradicts *Whitehouse Hotel* decision (decided only a few months earlier) on use of DCF analysis
  - **Kiva Dunes** court accepts DCF analysis as appropriate
  - **Kiva Dunes** court does not conclude that a 10- to 15-year DCF analysis is too remote or speculative
  - **Kiva Dunes** court does not require any testing of the overall risk of error in the DCF assumptions
Conservation Easement Valuation: DCF Analysis & the Tax Court

- 5th Circuit review of Whitehouse Hotel decision
  - Decision & instructions from the 5th Circuit on appeal
  - On remand, the tax court should reconsider all three methods of valuation including the income approach and cost approach
  - Decision recognizes that “reasonably clear and appropriate evidence’ of future income potential and expenses” can be used to value a property
  - Decision recognizes that there was no “track record of earnings because at the time of the donation, the hotel had yet to be constructed” but that does not mean a DCF income approach is inappropriate
Conservation Easement Valuation: DCF Analysis & the Tax Court

- Other conservation easement valuation cases in which DCF analysis has been either utilized or approved by the Tax Court
  - Symington v. Commissioner, 87 T.C. 892
  - Stotler v. Commissioner, T.C. Memo 1987-275
  - Clemens v. Commissioner, T.C. Memo 1992-436
  - Schwab v. Commissioner, T.C. Memo 1994-232
Conservation Easement Valuation: DCF Analysis & the Tax Court

- Other Tax Court real estate valuation cases in which DCF analysis has been either utilized or approved by the Tax Court
  - Glick v. Commissioner, T.C. Memo 1997-65
  - Vesper v. Commissioner, T.C. Memo 1989-358
  - Terrene Investments LLC v. Commissioner, T.C. Memo 2007-218
Conservation Easement Valuation: DCF Analysis & the Tax Court

- Contrary to *Whitehouse Hotel* case decision, prior Tax Court real estate valuation cases have upheld DCF analysis even when no prior “track record” of earnings
  - See, for example, *Estate of Rabe v. Commissioner*, T.C. Memo 1975-26, in which IRS expert used DCF analysis
Conservation Easement Valuation: DCF Analysis & the Tax Court

A variety of other federal cases, especially bankruptcy court decisions, have upheld DCF analysis as appropriate in real estate valuation cases

See, for example:

- *Drakes Bay Land Company v. United States*, 459 F.2d 504 (1972)
- *In re CGE Shattuck, LLC*, 2000 BNH 17 (U.S. Bankruptcy Court, Dist. N.H., 2000)
Conservation Easement Valuation: DCF Analysis & the Tax Court

- See also *Trout Ranch LLC v. Commissioner*, T.C. Memo 210-283

- Same Tax Court judge who decided *Whitehouse Hotel* case

- Did not reject DCF analysis – used it himself & (1) made various “assumptions” in both “before” and “after” subdivision analysis; (2) did not apply any “overall measure of risk of error” in a case in which no prior record of sales of lots at the subject property on date of donation

- Question: are there more or fewer “assumptions” in a subdivision DCF analysis than in an income producing hotel DCF analysis?
The 2011 AI book *Appraising Conservation and Historic Preservation Easements* (Chapter 22, pp. 439-455) discusses what it calls the “central role of discounted cash flow analysis in the valuation of both conservation and historic preservation easements.”
Palmer Ranch Holdings et al. v. Commissioner, T.C. Memo. 2014-79

“An appraiser using the comparable sales method is required to find property sales that meet three criteria: (1) the properties themselves are similar to the subject property; (2) the sales are arm’s length transactions; and (3) the sales have occurred within a reasonable time of the valuation date.”
Sales Comparison Approach

Question: In appraisals done for Tax Court cases, may an appraiser use sales comparables that occurred after the date of value?
Sales Comparison Approach

Question: In appraisals done for Tax Court cases, may an appraiser use sales comparables that occurred after the date of value?

IRS Publication 561 says NO but...
Conservation Easement Valuation: Sales Comparison Approach & Recent Tax Court Cases

Recent Tax court Cases say use of post valuation date sales is appropriate in some circumstances

SWF Real Estate LLC, et al, v. Commissioner (T.C. Memo. 2015-63) footnote 63 citing Estate of Thompson v. Comm. 89 T.C. 619: “it is appropriate to consider sales of property occurring subsequent to the valuation date if the properties involved are indeed comparable to the subject properties.”

See also

Zarlengo v. Commissioner, T.C. Memo 2014-161
Trout Ranch LLC v. Commissioner, T.C. Memo 210-283
Tax Court approval of use of post-date of value sales is particularly helpful in determining “after value” because easement protected property sales are typically few and far between in the relevant local marketplace.
Recent Tax Court decisions have often carefully checked adjustments to comparable sales & criticized comps used & appraisal adjustments

See, for example, *SWF Real Estate LLC*, *et al.* v. *Commissioner*

Easement donation was in Albemarle County, Virginia

IRS expert had appraised over 100 easements, many in Albemarle County

Taxpayer’s expert had appraised more than 75 easements in Albemarle County & over 600 easements “throughout Virginia”
SWF Real Estate LLC, et al. v. Commissioner – Tax Court issues with the selection of comparables used by the IRS appraisal expert

Location of some comparables too far away

Did not use comps that bracketed the size of the subject

Too many of the “before” comps had “topography issues”

Failed to adjust for some of the topography differences

Too many comps with sale dates older than a year prior
SWF Real Estate LLC, et al. v. Commissioner – Tax Court highly critical of the adjustments made by the IRS appraisal expert

Before Value – 8 adjustment categories
- Condition of sale
- Presence of significant buildings
- Market conditions
- Topography
- Location
- Size
- Views
- Other improvements

After Value – 7 categories
- Market conditions
- Topography
- Location
- Size
- Development potential
- Improvements
- Flora
No support for a 10% per annum market condition adjustment

Error in reporting size of two comps that affected calculation of $/acre

Erroneously reported that one after-easement comp could not be further subdivided when in fact it had been subdivided into 21-acre lots

An error in an upward adjustment of one comp due to comparison of flora

Adjusted for a view based on a broker’s photo rather than the on-site inspection in which no views observed
SWF Real Estate LLC, et al. v. Commissioner – Tax Court issues with the adjustments made by the IRS appraisal expert (cont.)

Failure to investigate motivations of one purchaser – adjacent purchaser and never publicly listed

Inconsistent location adjustments

Inconsistent topography adjustments

Failure to adjust one comparable for an admitted great view
When is the “before & after” method appropriate?

SWF Real Estate v. Commissioner

“Under circumstances where there is a substantial record of sales of easements comparable to a donated easement, the fair market value of the donated easement is based on the sale prices of those comparable easements.”
When is the “before & after” method appropriate?

*SWF Real Estate v. Commissioner* (T.C. Memo. 2015-63) (cont.) citing Treasury Regs.

“... 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 ...”
Conservation Easement Valuation: Before & After Method

When is the “before & after” method appropriate?


“... 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.”
Conservation Easement Valuation: Before & After Method

When is the “before & after” method appropriate?

*SWF Real Estate LLC, et al, v. Commissioner* (T.C. Memo. 2015-63) cites long history of Tax Court acceptance of before & after method in easement valuation cases

*Hilborn v. Comm.*, 85 T.C. 677
*Butler v. Comm.*, T.C. Memo. 2012-72
*Simmons v. Comm.*, T.C. Memo. 2009-208
*Kiva Dunes v. Comm.*, T.C. Memo. 2009-145
*Griffin v. Comm.* T.C. Memo 1989-130
Conservation Easement Valuation: Before & After Method

When is the “before & after” method appropriate?

Key Questions

(1) Who PURCHASES conservation easements?

(2) Are there any locations in which there may be a “substantial record” of purchases of EASEMENTS rather than easement protected properties?

(3) How is the Yellow Book relevant to these questions?
Conservation Easement Valuation: Before & After Method

When is the “before & after” method appropriate? Key Questions (continued)

(4) Is a “substantial market” for PURCHASES in a distant geographic location at all relevant?

(5) Is there a way in which I can use easement purchases in a distant market as evidence of the impact of an easement on prices/values?
Conservation Easement Valuation: Topic Two

Annie O’Connell – Identification & Analysis of Sales of Conservation Easement Protected Properties
Identification & Analysis of Easement Protected Property Sales

Sources of conservation easement sales data
Identification & Analysis of Easement Protected Property Sales

Sources of conservation easement sales data
Hypothetical Situation: Paired Sales Analysis of a Conservation Easement Encumbered Property

- Hypothetical Assignment – Appraisal of a conservation easement donation on 300 acres of vacant land
- Located in Henderson County, NC
Hypothetical Situation: 
*Paired Sales Analysis of a Conservation Easement Encumbered Property*

- **Hypothetical Assignment**
- **Research Questions:**
  1. Is there a “substantial” number of direct acquisitions of easements that can be used to establish value of the easement?
  2. If no substantial number of easement purchases, are there easement protected property sales in the relevant local market?
Hypothetical Situation: 
**Paired Sales Analysis of a Conservation Easement Encumbered Property**

- Hypothetical Assignment
- **Research Questions (continued):**
  - (3) What do I do as an appraiser if there are no comparable sales of easement protected properties in the relevant local market?
  - (4) Can I use a paired sales analysis involving properties in other markets to arrive at a conclusion of the effect of the easement on market value?
Hypothetical Situation: Paired Sales Analysis of a Conservation Easement Encumbered Property

- Hypothetical Assignment
- Research Question 1
  - How do I find direct purchases of conservation easements by federal and state agencies and private entities?
Hypothetical Situation: Paired Sales Analysis of a Conservation Easement Encumbered Property

- Hypothetical Assignment
- Research Question 1
  - Check possible state acquisition programs & federal Land & Water Conservation Fund Purchases
Hypothetical Situation: Paired Sales Analysis of a Conservation Easement Encumbered Property

- North Carolina Agricultural Development & Farmland Preservation Trust Fund was established in 2005 and has been awarded 90 preservation easement projects
- North Carolina Clean Water Management Trust Fund began in 1996 and has spent over $19M in acquisitions between 1998 and 2012 in Henderson County
Hypothetical Situation: Paired Sales Analysis of a Conservation Easement Encumbered Property

- Hypothetical Assignment
- Research Question 1
- Federal Land & Water Conservation Fund acquisitions in North Carolina
  - Approximately 114 acquisitions between 1965 and 2011 in North Carolina
Hypothetical Situation: Paired Sales Analysis of a Conservation Easement Encumbered Property

- Hypothetical Assignment
- Research Question 2
  - Assuming no “substantial” record of “comparable” direct purchases, what do I do?
Step 1: Visit the National Conservation Easement Database

- http://www.conservationeasement.us
Step 1: Visit the National Conservation Easement Database

- http://www.conservationeasement.us

- What is the NCED database?

“national database of conservation easement information, compiling records from land trusts and public agencies throughout the United States . . . (providing) a single, up-to-date, sustainable nationwide system for managing and accessing data about conservation easements.”
Step 1: Visit the National Conservation Easement Database

- http://www.conservationeasement.us
- Use the “View Maps” Tool
- Zoom to or search for Henderson County
Step 1: Visit the National Conservation Easement Database

- OR: Navigate to “Download NCED Data”
- Download CSV file with all the CEs in the Nation
Step 2: Explore Conservation Easements & View Details

- NCED website shows 51 conservation easements in Henderson County
Step 2: Explore Conservation Easements & View Details

- Click on the pins to read about individual conservation easements
Step 2: Explore Conservation Easements & View Details

- Click “View Detail Page” to find out more information about the CEs
Step 2: Explore Conservation Easements & View Details

- Then check the Henderson County government website to determine if any of the conservation easement protected properties have sold during the relevant time period

- *In researching protected properties in Henderson County, NC, I was unable to find any with relevant sales during the time period*
Step 2: Explore Conservation Easements & View Details

- Research Question 3: What do I do next if no sales of conservation easement protected properties in relevant local market area?
- Answer: look in nearby counties using NCED database – if find sales, are they comparable?
Step 2: Explore Conservation Easements & View Details

- If not comparable, then last research question becomes relevant

- Question 4: Can I use a paired sales analysis to derive a percentage impact in a conservation easement case study similar to the situation involving my property & assignment?
Step 2: Explore Conservation Easements & View Details

- Key issues in comparing comparability of the easement situations & adjusting for differences:
  - Highest & best use “before” considering the easement
  - Content of the conservation easement document & enforcement
  - Contribution to value of improvements
  - Dates of transactions/comparability of the markets
  - Buyer motivations
  - Topography
Step 3: Search for CE Comps

- Tax Court case law on using this type of “paired sales analysis”

Detailed discussion in *Appraising Conservation & Historic Preservation Easements* book (pp. 253 to 273)
Step 3: Search for CE Comps

- Tax Court has approved of this type of “paired sales analysis”
  - Johnston v. Commissioner, T.C. Memo 1997-475
  - Easement property was near Sheridan, Wyoming
  - IRS appraiser used as “comparables” sales located in Colorado, Montana, Idaho & near Yellowstone Park
  - Taxpayer’s appraiser studied 13 sales in Wyoming & Montana but also did a nationwide “paired sales analysis”
Step 3: Search for CE Comps

- Look for sales of easement encumbered properties in other areas similar to that of the subject property
- In this instance, look at the surrounding counties
Step 3: Search for CE Comps
### Step 3: Search for CE Comps

<table>
<thead>
<tr>
<th>County</th>
<th>Number of Conservation Easements</th>
<th>Online Access to Sales Data</th>
</tr>
</thead>
<tbody>
<tr>
<td>Henderson County, NC</td>
<td>51</td>
<td>Yearly Membership ($600)</td>
</tr>
<tr>
<td>Rutherford County, NC</td>
<td>2</td>
<td>Easement/Sale Deeds Available (no fee)</td>
</tr>
<tr>
<td>Polk County, NC</td>
<td>48</td>
<td>Easement/Sale Deeds Available (no fee)</td>
</tr>
<tr>
<td>Buncombe County, NC</td>
<td>27</td>
<td>Easement/Sale Deeds Available (no fee)</td>
</tr>
<tr>
<td>Greenville County, SC</td>
<td>22</td>
<td>Easement/Sale Deeds Available (no fee)</td>
</tr>
<tr>
<td>Haywood County, NC</td>
<td>10</td>
<td>Easement/Sale Deeds Available (no fee)</td>
</tr>
<tr>
<td>Transylvania County, NC</td>
<td>25</td>
<td>Easement/Sale Deeds Available (no fee)</td>
</tr>
<tr>
<td>Spartanburg County, SC</td>
<td>26</td>
<td>Easement/Sale Deeds Available (no fee)</td>
</tr>
</tbody>
</table>
Step 4: Conduct Paired Sales Analysis

- Use the sales of encumbered and unencumbered properties to conduct a paired sales analysis
- Use the results of the comparison to arrive at an appropriate percentage that should be deducted from the “before” value
- Difference in value is the value of the conservation easement
Step 4: Conduct Paired Sales Analysis

- Include enough paired sales to have a statistically robust and supportable analysis

- Question: Are there enough sales of conservation easement properties to utilize a multiple regression model to determine easement impacts?
An Alternative Paired Sales Analysis

- Use sales in the local market where the property is located (or a nearby market) that has the same highest and best use as the subject property post-easement

- See *Appraising Conservation & Historic Preservation Easements* book (pp. 258-263)

Note: *Whitehouse Hotel* case rejects use of non-local sales
Conservation Easement Valuation: Topic Three

Richard Roddewig – Final Comments
Conservation Easement Valuation: Lessons from the Recent Tax Court Cases

Triple checking your appraisal report for compliance with the technical requirements of the “qualified appraisal” rules is extremely important.
Conservation Easement Valuation: Lessons from the Recent Tax Court Cases

Question: Does the Tax Court require compliance with USPAP?

Answer: Although licensed appraisers are required to comply with USPAP, the Tax Court may or may not follow USPAP in reviewing your appraisal report.
Question: How critical is a detailed highest & best use analysis?

Answer: Extremely important – be sure to analyze HABU of the entire contiguous property and any possible enhancement to value of parts of property not protected by the easement.

Analyze all four prongs of the required analysis – physically possible, legally permissible, financially feasible & maximally productive.
Question: What is the Tax Court position on the appropriateness of DCF analysis?

Answer: Inconsistent Tax Court opinions – appear to be more willing to accept it in conservation easement assignments involving subdivision analysis
Question: How will the Tax Court review my adjustments in a sales comparison approach?

Answer: Very carefully – provide as much support as possible for your adjustments.
Conservation Easement Valuation: Lessons from the Recent Tax Court Cases

**Question:** When should I use the “before and after method”?

**Answer:** Almost always – however, there are purchases of easements in many states that can be searched & sometimes used as direct evidence of easement value.

When using easement protected sales in the “after” analysis, be sure to compare and analyze differences in easement protections and HABU situations.
Other Critical Questions & Issues

**Question:** Can Tax Court judges go “outside the record” and apply their own experience and judgment?

**Question:** Are Tax Court decisions “precedent”?

**Question:** What should I do if there is a conflict between two or more Tax Court opinions about an appropriate method to use?

**Question:** If there is conflict between USPAP requirements and prior opinions of a Tax Court judge, should we invoke the Jurisdictional Exception Rule?
Lessons from Working with the IRS

IRS is not a “monolith”

Internal policy issues re: easement appraisals –
staff attorneys vs. staff appraisers
staff appraisers vs. staff reviewers in appeals
staff licensed appraisers vs. valuation engineers
Lessons from Working with the IRS

Internal IRS policy issues –

**IRS staff attorneys vs. IRS staff appraisers**

Issues caused by fundamental difference in professional obligations

Attorneys – represent their IRS client’s best interests – ethical obligation to be “biased”

Appraisers – licensed appraisers must follow USPAP – ethical obligation to be “unbiased”
USPAP Ethics & Bias

- **Biased** -- Not reasonably supported, and favoring or promoting the cause or interest of the client, one’s self, or another.
Lessons from Working with the IRS

IRS still has some “valuation engineers” who review real estate appraisals although as frequently as in past decades.

Valuation engineers are not licensed real estate appraisers.

Do not always follow USPAP or apply the generally recognized methods of the real estate appraisal profession.
Lessons from Working with the IRS

Internal issues –

IRS staff attorneys vs. IRS staff appraisers

IRS Staff Attorneys
Some not in favor of making USPAP mandatory for all IRS internal appraisals or for reviews of taxpayer appraisals
Taxpayer Choices in Valuation Disputes with the IRS

Decline to pay the amount of tax disputed with the IRS & go through the IRS review process and then U.S. Tax Court – IRS attorneys handle the case

Pay the amount in dispute, and go to Federal District Court in the locale where the property is located – U.S. Department of Justice Attorneys handle the case – overpayment refunded if taxpayer prevails
IRS and Department of Justice Handling of Valuation Issues

Key Differences

The DOJ does not have appraisers on staff
The DOJ does not have attorneys who specialize in conservation easement cases or even specialize in valuation issues

That can have implications for how your appraisal will be reviewed
Tax Court and District Court Handling of Valuation Issues

Key Differences

Tax Court judges more likely than federal District Court judges to have heard prior valuation cases

Tax Court judges sometimes go “outside the record” & substitute their own experience for that of the evidence presented at trial

District Court judges more likely to rule on the record
Key Differences

Tax Court judges refer to prior Tax Court decisions – but do not always treat prior Tax Court decisions as binding “precedents”

Federal District Court judges – much more concerned about following precedents in other federal court decisions
Final Thoughts

Question: What are the most important things a real estate appraiser should do to assure that the IRS will accept a conservation easement value opinion rather than treat it with suspicion?