



May 24, 2004

The Honorable Charles Grassley
Chairman, Senate Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Max Baucus
Ranking Member, Senate Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, DC 20510

Dear Senators:

As professional appraisal and valuation organizations whose missions are to uphold appraisal standards and professional ethics, we commend the Senate Finance Committee for undertaking an investigation of practices surrounding the donation of land and conservation easements in the United States. In addition, we wish to provide you with feedback from our members on this important issue. We hope this information will prove helpful to you as your investigation moves forward.

Our members report that there are a number of concerns relating to the valuation of land donations that need further attention by industry and government. Some of the issues include:

- Engaging a competent appraiser
- Appraisal review
- IRS Valuation Guidelines
- Appraisal documentation
- Data access
- Appraiser independence

Background

An easement is an interest in real property that transfers the right to use, but not ownership of, a portion of an owner's property. The *Dictionary of Real Estate Appraisal, 4th Edition*, defines a conservation easement as "a restriction that limits the future use of a property to preservation, conservation or wildlife habitat."

A conservation easement may be held by a governmental body or certain types of charitable corporations, associations or trusts. A conservation easement allows a landowner to continue to own and use the land and to sell it or pass it on to heirs. A landowner sometimes sells a

conservation easement, but usually easements are donated. If the donation benefits the public by permanently protecting important conservation resources and meets other federal tax code requirements, it can qualify as a tax-deductible charitable donation. Simply stated, the amount of the donation is the difference between the land's market value with the easement and the "as is" value without the easement. Valuation of property involving a conservation easement is based on two appraisals; the first appraisal determines the "Before" market value of the property "as is" without the conservation easement, the second determines the "After" value with the easement. This appraisal technique measures the loss in value of the encumbered property. Or, stated another way, it measures the loss in value due to the easement. This "before and after" appraisal methodology can be used to calculate the income tax deduction taken by a property owner who donates a conservation easement.

A number of controversies have arisen as a result of current conditions. For example, inflated contract prices, such as those based on transfers that are not normal arms length sales, have been used to establish inflated value estimates for tax write-off purposes. By contrast, a credible, professionally prepared appraisal presents accurate data in a manner which ensures both public trust and compliance with IRS guidelines.

Competency to perform the appraisal

A reliable appraisal is crucial to the entire conservation easement and land donation process. It is therefore extremely important to have this service performed by an appraiser who is competent to do this type of assignment. Recent recommendations made by land conservation organizations have focused on requiring a donor's appraiser to be state-certified before signing IRS Form 8283, which is used to document Noncash Charitable Contributions. While we commend the need to identify qualified individuals to perform this type of valuation assignment, we believe this is just a beginning. State certification to perform federally-related transactions is a mere minimum requirement that was established in response to the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA). Because that act deals primarily with lending, it does not take into consideration issues surrounding conservation easement appraisals. There are no requirements for State Certified appraisers to be trained in Before and After easement valuation. Because of this, relying solely on state certification as a means to test an appraiser's ability to perform a conservation easement appraisal is inappropriate and could lead to widespread problems in these types of assignments.

A competent appraiser must have easement appraisal experience, specialized education and professional accreditation together with an understanding of the unique issues involved in appraising properties subject to open space and conservation restrictions. The professional appraisal organizations confer designations on appraisers who have advanced education, training and experience. Many of our members have vast experience in appraising conservation easements and land donations. The requirements to obtain a designation are far more extensive than those for state certification. With this knowledge, conservation organizations should rely on designations from professional appraisal organizations and those designees experienced in easement appraisal, in addition to considering other qualification measures such as state certification.

Appraisal Review

Recommendations have been made by our members to require a “desk review” of all aspects of a proposed conservation transaction, including a review of the donor’s appraisal to determine whether the transaction is appropriate. There are ways to accomplish an appropriate level of due diligence through an appraisal review process, which can include a desk review. The review process should be performed in accordance with the Uniform Standards of Professional Appraisal Practice (USPAP).

Similar to the concerns previously raised relating to competency to perform an appraisal, appraisal review is a complex procedure that requires a full understanding of the appraisal process and related issues. We believe it is critical for the person performing review, whether they are an employee of the conservation organization or a contract appraiser, to be properly trained and experienced to perform such tasks.

IRS Valuation Guidelines

The Internal Revenue Service does not currently recognize the USPAP, and the agency’s current definition of “qualified appraiser” allows individuals to decide for themselves whether they are competent to provide tax-related valuations for specific types of property. The IRS requires contract appraisers and IRS staff reviewers to abide by its Real Property Valuation Guidelines when conducting an appraisal for tax purposes.

Many of our members believe that the Uniform Standards of Professional Appraisal Practice (USPAP) should be the cornerstone of valuations prepared for the IRS and by IRS reviewers. Many federal agencies require adherence to USPAP and minimum qualifications for those who perform appraisals, so the reluctance of the IRS to establish guidelines that recognize USPAP surprises many of our members who feel this allows for inconsistencies. FIRREA requires real property appraisers to be licensed or certified by state appraisal regulatory agencies and to perform specified appraisal assignments in compliance with USPAP. Consequently, many tax returns that contain a deduction for a donation of real property are submitted with an appraisal performed in conformance with USPAP. If under the Real Property Valuation Guidelines the IRS appraiser is not able to attest to compliance with USPAP, the IRS may be at a disadvantage. From the public’s view, without the specific statement of compliance with USPAP the IRS appraiser’s opinion of value may not garner the same credibility as it would with that statement.

It is feasible for the IRS to adopt USPAP and add Supplemental Standards that the agency believes to be necessary. Many other federal agencies such as the Department of Justice or the Department of Veterans’ Affairs have taken this approach. This way, the taxpayer’s appraiser and the IRS appraiser would be valuing the property subject to the same set of standards.

Appraisal Documentation

Documentation in the form of the appraisal report is critical in any donation appraisal. For example, use of a Fannie Mae-type vacant lot appraisal form would not be appropriate for the appraisal of a 1,000-acre property for the IRS. Yet, we are aware that this quite often takes place. This level of

documentation is not appropriate for an appraisal meant to sustain a conservation easement donation before the IRS.

USPAP clearly requires the appraiser to produce a credible analysis as well as a report which conveys adequate documentation to the intended user. A typical USPAP compliant appraisal report would include a letter of transmittal, intended use/user, scope of work, and function and purpose of the appraisal (in this case, the determination of the value of a conservation easement). Appraisals of conservation easements are complex and require additional appraisal training and education to competently perform the assignment. The appraisal report needs to be in enough detail to convey the appraiser's findings of facts and supported market value opinion. Appraisers who are not experts in these assignments and do not understand the complexities of the appraisal problem are those most likely to produce inadequately documented reports.

Data Access

All appraisal assignments rely on access to reliable data sources and public records. However, many conservation easement and land donations are not publicly disclosed and are therefore not available to appraisers looking for comparable transactions. To analyze the market for protected properties, an appraiser must have access to data on sold protected properties. If appraisals are needed for tax purposes, then land trusts and public agencies that acquire conservation easements must be required to publicly disclose lists of the location of every easement they acquire, date of acquisition, the particular conditions associated with each easement, and dates of sale of the protected properties. The current configuration of public records is insufficient for this purpose.

While easements are recorded in public records, they are much more difficult to track than possessory interests. They are not typically electronically selectable. No public purpose has existed for developing an easement database function. The effort an appraiser needs to expend to develop such a database independently is extraordinary. Continual monitoring of public records for these easements is far too daunting for the limited number of conservation easement assignments an appraiser might receive in a given time frame.

Appraiser Independence

As federal bank regulators and the Department of Interior have recently recognized, appraiser independence is crucial to an objective valuation of land. The same holds for valuations of land donations and conservation easements, as appraisers must be allowed to perform their assignments independently from the influence of interested parties, such as the donor.

Concluding remarks

We support the recent attention given to conservation easement and land donation appraisals, and we hope there is further opportunity to discuss the complicated issues that are involved, including increased appraiser education, training and awareness of these issues. Please let us know if our organizations can be of any assistance, and we hope this letter was helpful.

Valuation of Conservation Easements
May 24, 2004

If our organizations can be of assistance, please contact Don Kelly, Vice President of Public Affairs at 202-298-5583 or dkelly@appraisalinstitute.org, Ted Baker, Executive Vice President at 703-733-2109 or tbaker@appraisers.org, or Steve Runyan, Government Relations Chair, American Society of Farm Managers and Rural Appraisers at 661-747-6458 or srunyan@bak.rr.com.

Sincerely,

Appraisal Institute
American Society of Appraisers
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