



CONSERVATION EASEMENT VALUATION

PURPOSE

The purpose of this guideline is to ensure equitable and consistent assessment of property subject to a conservation easement. Research required reviewing Arizona's and other states' case law, guidelines and statutes regarding valuing and classifying property subject to an easement in general, and a conservation easement specifically.

CONSERVATION EASEMENT DEFINED

An easement is an interest in real property that conveys use, but not ownership, of a portion of an owner's property. The real property interest of the easement holder is termed the dominant estate and the encumbered property the servient estate. An entity that acquires an easement is the beneficiary of additional rights; the property that is subject to an easement is burdened with a loss of rights.

When applied to real estate, conservation is the protection of neighborhoods and structures from blight or other influences that might affect desirability or value adversely. A conservation easement is a restriction that limits the future use of a property to preservation, conservation, or wildlife habitat.¹

The Uniform Conservation Easement Act in A.R.S. § 33-271 defines conservation easement as "a non-possessory interest of a holder in real property imposing limitations or affirmative obligations for conservation purposes or to preserve the historical, architectural, archaeological or cultural aspects of real property." Typically, conservation or preservation easements are in effect in perpetuity. These easements are also known as Conservation Restriction in Perpetuity (CRP).

Open space [conservation] easements set land aside for non-building uses and may encumber land in three ownership categories: 1) private open space adjacent to dwellings owned by individual residents; 2) public open space owned by the government; and

¹The Dictionary of Real Estate Appraisal," 3rd Ed., Appraisal Institute, 1993.



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3) common open space owned by a community association and set aside for the use of residents.²

INCOME TAX BENEFIT

Under federal law, a conservation/preservation easement can be deeded to a qualified nonprofit organization or government agency. In such instances, the property owner donates the easement and receives an income tax deduction that can be equal to, but not more than, the market value of the real property rights donated.³ Public access is generally not a requirement for the income tax deduction.

Typical holders of permanent conservation easements are 501(c)(3) nonprofit organizations. For the purpose of income tax deductions, the easement benefits the property owner as a charitable deduction for gifts of easements to charitable organizations.

VALUATION CONSIDERATIONS

The impact on value of the typical conservation easement is based on the restricted use of the property. Measurement of the restricted use is contingent upon the effect the easement has on the ability to develop, rent (or lease) and sell the property.

The economic theory on which the valuation of a conservation/preservation easement is based is generally the same as that which governs eminent domain appraising, although the acquirer of a conservation easement receives rather than takes rights. Each easement document is unique and contains specific controls and restrictions that must be carefully analyzed to determine how it affects that particular encumbered property.⁴

It should be noted that the value of the property associated with a servient estate may be increased as a result of the use of the easement of the dominant estate. The impact of the easement may be positive to both the dominant and servient estates. This is known as a shared benefit and the loss in value to the servient estate is mitigated by the benefit. The

²"The Appraisal of Real Estate," 10th Edition, Appraisal Institute, 1992.

³Id.

⁴Id.



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case of shared benefits resulting from an easement is considered an enhancement to the property.

Therefore, it is necessary for assessments in Arizona to consider servient easements in relation to the effect such easements have on that property, both in terms of reducing value and/or enhancing value. The Assessor is only concerned with the value after the imposition of the conservation easement.

In the assessment process, an appeal by the owner will normally be the trigger to review the property valuation. Assume an owner/petitioner has created a voluntary conservation easement on residential land and the easement is to be held by a 501(c)(3) nonprofit organization. Furthermore, assume the easement prohibits the development of residential units on a portion of the larger parcel. The loss in value is a reflection of the inability to market the property with the same potential for residential development. Further, assume a recently active market for residential lands in the market area, and immediate development is feasible. An estimate of the present value of the residential units lost to the easement can be determined by the standard application of the direct sales comparison approach.

An easement may have little or no effect on the underlying fee. If the location of the easement and the prohibited uses are otherwise covered by other restrictive instruments or are not physically adaptable to development, the additional imposition of an easement may have no impact on value (i.e., undevelopable property in a flood-plain, on a mountain-side, etc.). This scenario can be seen in the same situation described above with the exception that the owner of the property occupied the parcel in a single family residence and the development units lost to the easement were for multi-family use. There would be no basis for a change in the property value. The current use remains constant.

It is also useful to consider a situation as described above, with the exception that the land is vacant and immediate development feasibility is not supported; assuming the development parameters were in the distant future (i.e., over twenty years), the impact on value may not be measurable.



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Alternatively, an easement may be associated with some betterment, amenity or public/private good which, over time, increases the value of the surrounding properties and remaining subject property. In this case, the reduction for the imposition of the easement from the market value of the encumbered property is offset by the enhancement in value to other property owned by the taxpayer or related parties.⁵ In the future, this may be reflected in an adjustment for enhancement or location.

Agriculturally classified land, encumbered with a conservation easement, will revert to a non-agricultural value if the easement prohibits agricultural uses. If the easement does not restrict agricultural uses, then the property should be valued pursuant to A.R.S. § 42-141(A)(5). This will normally result in no change.

LOSS IN VALUE PARAMETERS

An outcome where there is no loss in value is routinely possible, while value losses of more than 50% are improbable. The complete loss of value, or a near total loss in value from the imposition of a conservation easement, is essentially without merit. Land always retains some value even under conditions of restricted uses. In similarity to conservation easements, electric transmission line easements prohibit development, however they also impose an unattractive and undesirable structure within the easement and proximate to the lands surrounding the location of the easement. This is in contrast to conservation easements whose purpose is usually stated to retain pristine environments (i.e., enhance the environment).

Conservation easements typically do not affect the value of the underlying property beyond the contributing value of the lost development potential (measured in dollars per unit). Additionally, the loss in value should not be estimated on a pro rata basis. The law of decreasing or diminishing returns⁶ assigns a lower unit value to the potential development lost to the easement than to the value of the remaining or unaffected potential development. This lesser value must also be offset for the remaining value of the land and any contributions to

⁵Treasury Regulation section 1.170A-14(h)(3)

⁶The law of decreasing or diminishing returns is the premise that additional expenditures beyond a certain point (the point of decreasing returns) will not yield a return commensurate with the additional investment ("The Dictionary of Real Estate Appraisal," 3rd Ed., Appraisal Institute, 1993).



density elsewhere on the site, as well as the potential of satisfying open space or water retention requirements. Finally, the possibility of additional value associated with the creation of an amenity enhancement must also be considered as offsetting the loss (at least in part).

VALUATION PROCEDURE

Although the valuation process for conservation easements ultimately reflects a case by case approach, the generic appraisal procedure can be used for the assessment processes:

1. Define the Appraisal Problem/Identify the Property

The problem can typically be phrased as a question.

What is the FCV of the underlying fee interest, taking into account the effect (if any) of the conservation easement?

The property is identified according to standard appraisal practice and the Assessment Procedures Manual. Along with determining the assessment classification and the physical characteristics of the parcel(s), the easement itself must be identified and located. This will involve acquiring and reading the easement document to discover the prohibited uses or restrictions, the duration of the easement, the nature of the agreement (voluntary or coercive) and the accessibility provision (can the general public access the property or is this restricted also). Is the easement held by a 501(c)(3) nonprofit organization or governmental body? Are the prohibited uses physically and legally possible and economically feasible? Does the easement involve a change in current use?

2. Collect and Analyze Data

Once it has been determined that the easement does restrict the current use of the property, it is necessary to collect sales data on properties that are most similar to the subject. If there are no comparable properties similarly encumbered with a conservation easement, the next best substitutes are lands with similar restrictions, whether they be the result of adverse physical attributes, zoning or legal deed restrictions.



3. Apply the Applicable Approaches to Value

If applicable, the easement will only affect the land value since improvement restrictions represent the most common constraint. Of those properties encumbered with conservation easements that do affect the value of the underlying fee interest, the valuation problems will be reducible to the valuation methodology associated with surplus land. This effectively redefines the problem to a surplus land appraisal. Sales of land that include both relatively small and large areas as well as those affected by physical limitations or other restrictions should facilitate sales comparison.

Note: The prohibited use(s) must be otherwise physically and legally possible and economically measurable (i.e., feasible). If the location of the easement follows the contours and dimensions of a prior restraining or constraining barrier to development (i.e., flood-plain, wash, etc.), the easement may not be affecting the property in any measurable way.

4. Reconcile the Final Value

CLASSIFICATION

Each easement is unique and contains specific controls and restrictions that specify how the easement affects each property. In most cases, property subject to a conservation easement should be classified as Legal Class 4 due to the non-building use. Conservation easements typically preserve the pristine nature of the land by restricting development of the property and limiting the use of a property to preservation, conservation, or wildlife habitat.

CASE STUDY EXAMPLES

It is important to acknowledge that conservation easements can influence value in a positive or negative manner, or not at all. This should be recognized in the valuation process using standard appraisal methods and techniques. Listed below are examples of typical valuation and classification problems that could result from the imposition of a conservation easement.



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Example I

A vacant 40 acre parcel of land, backing up to a mountain preserve, contains a conservation easement that restricts the owner from building any type of improvement on the land. Parcels of land adjacent to the subject property have recently sold for \$2,500 per acre for development purposes. Parcels of land that do not enjoy the benefit of the proximity to the mountain preserve have recently sold for \$1,500 per acre. Also, parcels of land with severe topographic problems that would restrict the normal development of these properties recently have sold for \$500 per acre.

Knowing these facts, what is the estimated market value of the 40 acre parcel?

Example II

A taxpayer comes to your office and asks, "I have a section of land that has been historically classified as agricultural grazing land. I am exploring the possibility of donating a conservation easement on this property to protect the natural resources of the land. The preservation organization wants to restrict the use of my property from grazing cattle for three months each year. From March to May, I would be prohibited from grazing my cattle because that is the breeding season for quail. Can I retain my agricultural status under these restrictions?"

Knowing these facts, what would your answer be?

SUGGESTED SOLUTIONS

Solution I

The land may be valued within the range of \$500/acre minimum (topographically challenged parcels) to \$835/acre maximum (i.e., $\$500/\text{acre} \times \$2,500/\$1,500 = \833.33). Note: $\$2,500/\$1,500 = 1.67$ factor for proximity to the mountain preserve, which is then applied to the minimum value for properties with severe topographical problems.

Solution II

Yes, the agricultural status is unaffected by the three months of prohibited use. Pursuant to A.R.S. § 42-167(A), property is eligible for classification as agricultural if the primary use is agricultural and the property has been in active production in conformance with generally



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accepted agricultural practices for at least seven of the ten prior years. Further, grazing land that has been in active production may still qualify if it is inactive or partially inactive due to reduced carrying capacity or generally accepted range management practices; preventing the cattle from grazing for three months of the year may be prudent range management.