

VALUATION OF PRESERVATION & CONSERVATION EASEMENTS

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Summary:

The valuation of Development Rights to preserve agricultural land and open space beyond developed urban areas is a specialized field of real estate valuation. The separation of development rights from the underlying value of land in its historic or traditional use is a division of the common mix of ownership rights in real estate.

The concept of "highest and best use" is an integral component in the valuation of real estate where the existing use may or may not be the best or most profitable use of the land. This may apply only to the current time and place, or may be considered a long term or future perspective.

Where there is a desire to preserve an existing land use, usually associated with agricultural lands or ecologically important open space, the potential for a more intensive "urban" development in the future may justify the acquisition of these future development rights.

The acquisition of development rights through buying a permanent "easement" that prohibits a change in use is the subject of this paper.

Defining the Terms Used in this Paper

1. Easement An interest in real property that conveys a use, but not ownership, of a portion of an owner's property. Examples of easements include access or right-of-way privileges, conservation of open space, and preservation of some existing land use. An easement can convey a right to use another's property for some specific purpose, but can also convey the right to limit or prohibit a property owner from changing some aspect or use that is to be preserved.
2. Conservation The care and preservation of limited natural resources to prolong their use and effectiveness.
3. Conservation Easement A restriction that limits the future use of property to preservation, conservation, or wildlife habitat.
4. Preservation Easement A restriction that prohibits certain physical changes in an historic property: usually based on the property's condition at the time the easement was acquired or immediately after proposed restoration of the property.
5. Development Rights The right to build on or beneath a property, subject to local zoning, building codes, etc. The right to development is fundamental to private property in the United States.
6. Present Worth of Future Value or Benefits, aka Present Value (PV)
The value of a future payment or series of future payments *discounted* to the current date or to "time period zero", e.g., today.

Introduction

Preservation Easements have been in existence in the United States since the 1930s but until relatively recently, were mainly imposed by a government agency on privately owned land, or were created by a property owner who wished to sell a property but require that the new owner preserve some aspect of the property as it exists prior to sale. Property owners can donate certain rights, and, for certain types of donations, there have been significant tax advantages.

Government imposed easements can occur at any level of government, from the smallest community's creation of a zoning ordinance or general planning policy, to federal governments imposition on use of property that is within the public interest to protect. Such restrictions are pre-existing and known before a property is sold or changes ownership. The value of the property encumbered with an easement will typically

G. Michael Yovino-Young

reflect the lesser options of "highest and best use" available to the potential purchaser. Sometimes, these restrictions are tested to determine the diminished value created.

More controversial areas of valuation and the appraisal of conservation easements involve improved property such as historically designated buildings, or portions of buildings, such as the façade. These building elements may be subject to an easement that often is intended to protect the historic street-scape of a block or neighborhood of buildings. These are commonly called "historic preservation easements". Much of the literature on the subject of conservation and preservation easements is directed to the preservation of historic land uses, buildings, and urban properties. This is in part due to the fact that such easements have been encouraged by various federal and state governments with favorable tax offsets and credits. These types of preservation easements are not the subject of this paper.

The Agricultural Property as a Resource to Preserve

The United States is a vast country with huge areas of open agricultural land that are distant from any threat of development or more intensive uses than their traditional agricultural uses. Similarly there are mountainous areas, and forests that are relatively safe from urbanized development in the foreseeable future. It is when such land is located in the path of development, usually surrounding an urban city or region, that the demand for development intensifies.

The ever expanding urbanization of American cities absorbs an estimated 2.2 million acres of farmland every year^{1/} Since 1982, more than 44 million acres have been developed with urban land uses, principally to meet the growth and expansion of our cities. American cities are not protected by "greenbelts" that have played such a significant role in maintaining and protecting open space around English cities.

^{1/} one acre = .4 hectares

one hectare = 2.47 acres

This paper presents the reader with another method of preservation and conservation that has more recent origins, created mainly by local preservation organizations that were formed to protect agricultural property and open space from "urbanization" through acquisition of "development rights".

Development rights are subject to normal land use controls in accordance with local zoning ordinances, land use planning policies, and, by the properties physical characteristics. These factors may or may not favor development beyond the present agricultural use or open space. The more remote the property is relative to the developed urban areas closest to it, the less likely it will be subject to pressure for development. Some properties are not suitable for agricultural use due to adverse terrain features,

limitations of the soil and drainage, lack of water sources, and, in the most remote locations, lack of accessibility.

But millions of acres of productive agricultural land are close to urban areas and are accessible due to the excellent road and highway systems throughout America's most populous states. My experience is mainly in the northern part of the State of California where more than 6 million acres of productive, irrigated farmland and grazing land has been absorbed into urban development since 1982.

Of the total land area in the San Francisco Bay Region's 4.72 million acres, about 2 million acres is in urbanized areas, leaving agricultural and open space lands of about 2.7 million acres. Over 300,000 acres (11%) of this agricultural resource has been absorbed into the urban cities in just the past decade.

Historic Government Effort to Protect Agricultural Land

In 1965, the California legislature recognized that the agricultural lands of the state needed some protection from unbridled development and created the Williamson Act. Any farm or ranch with 100 acres or more can enter into a ten year agreement to restrict land use to its existing agricultural uses. The agreement is legally binding and can be renewed in one year increments indefinitely. The benefit to the owner is a reduced tax assessment that is based solely on the agricultural land value as compared to land valued with development potential. The reduction in annual property taxes ranges from 20% to 75%. These percentages suggest that agricultural land values range from 25% to 80% of the land as valued to include the benefit of potential urbanized development.

Over 16 million acres in California are covered by the Williamson Act. However, the pressure to sell-out to developer interests is intense in locations close to urban centers. Many owners do not renew these agreements, especially in areas where agricultural land values have risen at a faster pace than their counterpart land values in the nearby cities and urban communities.

The Characteristics of the Preservation Easement

The typical Preservation Easement in California will have these primary characteristics .

It may be the result of an acquisition of development rights sold by the agricultural property owner. It may, less often, be the result of the owner donating the development rights as a "gift" for which there are certain tax credits. A twist on the concept of giving

G. Michael Yovino-Young

away development rights is the more complicated transaction where development rights are transferred, that is, sold for a price to another agricultural property owner who may not have the necessary development rights for his own property.

Easements can be individually tailored to meet the particular circumstances of the agricultural property owner. There is considerable latitude in how a rancher or farmer can use the property. Some easements may limit owners from selling product, e.g., beef, harvested crops, milk, cheese, on the premises in a retail sales capacity. Other easements have no such restrictions.

The easement is usually silent on such matters as numbers of buildings, number of residences, and the like, all of which are subject to underlying zoning standards. Generally, the easement applies to the entire property but there are exceptions to this rule.

The easements are almost always in perpetuity and go with the land regardless of changes in ownership, changes in land uses nearby, or any change of heart by the property owner.

The easement is a legal document and enforceable in the U.S. Courts.

The Valuation Process – Measuring The Value of Development Rights

First, Defining the Property to be Appraised

The land area, agricultural land uses, agricultural buildings, residences, and other physical features of the property have to be catalogued as is appropriate for any type of appraisal. Special features, if any, are described, such as number of wells, irrigation ponds, effluent ponds, solar power systems, electronic systems to monitor the agricultural uses such as irrigation systems, and the like. In one case, an unusual feature of a dairy farm is an elaborate methane gas storage and electrical conversion plant that provided 80% of the power needs of the farm.

Second, Research the Applicable Land Use Controls

Any property anywhere in the United States is subject to some level of land use controls, zoning, or general plan. These can range from very general requirements, e.g., minimum property size of 100 acres, to the very detailed, e.g., number and maximum size of residences per some number of acres, number of residents living on the property, number of barns, ponds, etc.

G. Michael Yovino-Young

Research the history of development patterns and the process for changing from agricultural uses to urban land uses. The process of rezoning to allow urban development is well established in California, and most of the United States. It is usually arduous and subject to hostile public hearings and sometimes even to a voting of the residents in a given jurisdiction such as a county or city where the property is located.

It is important to understand that every property has some inherent, legal development potential, no matter how remote the property is, or how unlikely there will be demand for the property as a development site. The long term view is necessary to understand the gradual process of expansion of the urbanized areas of your community and region. A state like California is predicted to double in population size to over 63 million by 2040, well within the lifetime of a middle aged person today. That growth will inevitably require absorption of thousands of acres of new development sites, and these will mainly come from agricultural areas.

Third, Understand Highest and Best Use

Once the applicable zoning and land use constraints on a property are determined, then you need to develop an historical framework for the development patterns in the area. These will influence the future expansion of urban development that could include the subject property, however remote into the future this demand may be.

The usual criteria for highest and best use, e.g., legally permissible, physically possible, financial feasibility and maximally productive land use, are all well defined concepts that need a very broad application in the case of projecting future development rights. These may often be totally unpredictable. It seems to be sufficient to be able to conclude that the property will be in the path of development at some unpredictable future date.

There are examples of more immediate changes in agricultural status for an existing ranch or farm. An example in Marin County, California, where the minimum zoning property size is 100 acres on which a single owners' residence can be built. However, it was only about 15 years ago that these same properties were zoned for 20 acre as the minimum parcel size, and several adjoining 20 acre parcels were assembled in one ownership. Each 20 acre parcel was legally developed with a residence to the density then permitted. Today, the 100 acres has five residences, a density completely inconsistent with the current zoning for this property. This condition significantly influences both the current highest and best use situation and that which might be predicted in the future.

Fourth, Select the Methodology for the Appraisal

There is general agreement in federal agencies including the Internal Revenue Service (IRS) that the best method of estimating the value of an easement is the actual sales of easements for similar properties. This is true whether the easement being valued is to be

G. Michael Yovino-Young

purchased by a non-profit land preservation organization, or if it is to be donated as a gift for which tax credits will be earned. With a history of acquisitions of development rights that now span several decades, there is a body of market activity and history that clearly supports the conclusions needed for an appraisal.

Some agencies also suggest that the "before and after" valuation method is the most appropriate means of estimating the value of the easement. Here, the value of the property before the easement is acquired is estimated, followed by the value of the property after the easement is acquired. This method is more appropriate where there is an actual sale of a portion of the property (a partial acquisition) that reduces the size and presumed value of the "remainder" property. I have found this method to be extremely difficult, as it involves any number of subjective judgments regarding the actual or assumed "bundle of rights" of ownership of the property. This methodology has not found favor with the buyers and sellers of preservation easements in the areas of California I am familiar with.

Market Sales Research

I have been gathering sales data on agricultural and open space property's that have sold with and without Preservation Easements. Much of this data is elusive and difficult to confirm. Many of the acquisitions of Preservation Easements are not publically announced or available through the customary channels in the real estate industry.

The earliest appraisals for these easements relied a great deal on subjective criteria. For example, we would extrapolate value indices taken from sales of land for development which typically ranged from \$5,000. to \$10,000. per acre, and compared this to ranch and farm sales where there was no measurable demand for the properties other than as agricultural land. These sales were usually in the range of \$500. to \$4,000. per acre, much depending on existing farm or ranch uses, infrastructure such as water and fencing, and often whether or not the property was a working ranch with residence and other improvements. An example for a 100 acre dairy ranch in California.

Value of Land for Future Development:		
100 acres at \$6,000. per acre		\$600,000.
Improvement Value - -0-		
Value of Land as Dairy Farm		
100 acres at \$2,000. per acre	\$200,000.	
Plus Improvements	<u>100,000.</u>	
Total Value as Farm		<u>300,000.</u>
Difference Representing Value of Development Rights		\$300,000.
Value Index for Development Rights is \$3,000. per acre.		

A second method was tried where there was urban development taking place in the same regional location and land values for immediate development opportunities were available through actual sales of development sites. An example occurring in 2006 for a 225 acre parcel purchased for immediate entitlement to build 120 residential home sites.

The price was \$4,050,000. or \$18,000. per acre.

We estimated that the subject, a 200 acre cattle ranch, would be in a similar path of development within ten years. At that time, the land value would be at least \$18,000. per acre. (note that probable inflation during the next ten years was ignored in this analysis). The development value of the subject ranch is therefore \$3,600,000. in ten years. The Present Worth of an asset in ten years is discounted at a safe rate (currently) of 7.5%. The calculations are:

Future Value	\$3,600,000.
Term 10 years	
Discount Rate @ 7.5%	
Present Value as Development Site	\$1,750,000. (rounded)

Now we have an indication of the present worth of the potential for development of this property at \$1,750,000. or \$8,750. per acre.

Sales of more remotely located ranches of similar size and capacity for cattle stock have sold for prices ranging from \$3,500. to \$6,000. The value of this ranch is estimated at \$5,500. per acre or \$1,100,000. Ranch improvements add \$350,000. including two residences, barns, and infrastructure such as wells and roads. Total ranch value is \$1,450,000.

The estimated value of the Development Rights is calculated as follows:

Present Value as Development Site	\$1,750,000.
Present Value as Cattle Ranch	<u>1,450,000.</u>
Value of Development Rights	\$ 300,000.
Value per Acre @ \$1,500.	

Actual Market Sales

Development Rights purchased as Preservation Easements are especially well established in Marin County, California, just north of San Francisco. An organization called the Marin Agricultural Land Trust, (MALT) was formed in 1980 and to date has acquired

Development Rights to 68 ranches in Marin County ranging in size from 120 acres to several large ranges with up to 1,500 acres. Included in this total is the 2,538 acre

VALUATION OF PRESERVATION & CONSERVATION EASEMENTS 8
G. Michael Yovino-Young

Skywalker Ranch owned by George Lucas of Star Wars fame. The total acreage encumbered with Preservation Easements by MALT is 41,500 acres of which 30,000 acres is open grasslands and fertile flood plains.

Recent acquisitions of Preservation Easements are listed as follows. I also show my estimated ranking of these properties for potential development in terms of number of years until development potential will attract investor interest.

<u>Size</u>	<u>Type</u>	<u>Purchase Price</u>	<u>Price Index</u>	<u>Path of Development</u>
1,013 acre	dairy ranch.	\$2,300,000.	\$2,270. per acre	10 years
1,214 acre	cattle ranch.	\$2,913,000.	\$2,400. per acre	10 years
208 acre	cattle ranch	\$542,500.	\$2,608. per acre	5 years
1,000 acre	cattle ranch	\$7,250,000.	\$7,250. per acre	Immediate
714 acre	dairy farm	\$1,860,000.	\$2,605. per acre	10 years
1,310 acres	cattle ranch	\$2,330,000.	\$1,779. per acre	20 years

In other locations throughout Northern California, similar acquisitions have been made. Examples include the following purchases of the full ownership to prevent imminent development.

<u>Location</u>	<u>Size</u>	<u>Type</u>	<u>Price</u>	<u>Price Index</u>	<u>Path of Development</u>
Alameda County	850 acres	grassland	\$1,100,000.	\$10,280. per acre	Immediate
San Mateo County	534 acres	farmland	\$3,000,000.	\$5,618. per acre	Immediate
Napa Co.	3,045 acres	ranch	\$18,750,000.	\$6,158. per acre	Immediate

Conclusions

The preceding analyses followed by actual sales of Preservation Easements illustrate value parameters for judging the value of these easements in the context of a dynamic

and active real estate market. The range of value indices for development rights start at \$1,500. per acre and rise to \$3,000. per acre. The average price index from those six

VALUATION OF PRESERVATION & CONSERVATION EASEMENTS 9

G. Michael Yovino-Young

sales presented is \$3,152. per acre. A sensitivity analysis to exclude the one very high index and the one very low index results in an average of \$2,471. per acre.

It is also noted that the acquisition of the full property, including all ownership rights, as demonstrated in the final three acquisitions illustrates a value range from \$5,618. to \$10,280. per acre. This data can be parsed to suggest that the value of development rights ultimately represent from about 25% to 30% of the total value of agricultural properties that are in the long term path of potential development.

The methodology for analyzing these partial interests represented by permanent easements is now well established and there is a body of market evidence to guide the appraiser in estimating the value of Preservation Easements.

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BIOGRAPHICAL NOTES

Michael Yovino-Young's career as an appraiser spans 52 years and his practice has included all types of specialty appraisal and valuation problems, property types, and valuation objectives. Appraisals have been completed on properties throughout the western United States, Canada, and Mexico. His practice has included valuation assignments in England and Italy. He has taught Real Estate Appraisal at University of California - Berkeley, and in the Graduate School of Golden Gate University. He has degrees from Santa Clara University (B.S.C.) and from the University of California - Berkeley (MBA). His professional designations are MAI (Appraisal Institute) FRICS (Royal Institution of Chartered Surveyors), and ASA (Senior Member, American Society of Appraisers).

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