

# A Conservation Easement Appraisal Guide:



## A Brief Overview of Easement Valuation in Colorado

Colorado Coalition of Land Trusts

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*This document was produced to provide individuals involved in conservation transactions with general information regarding conservation easement appraisals. It is not intended to provide specific professional advice. If legal advice, appraisal advice or other expert assistance is required, the services of a competent professional should be sought.*

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## INTRODUCTION

By most measures, the past several years have been banner years for conservation easement activity throughout the State of Colorado. This is due in large part to the financial incentives designed into Colorado's unique state income tax credit for conservation easement donations. This program, along with other conservation programs such as Great Outdoors Colorado (GOCO) or the federal income tax benefits, has helped Colorado's landowners and conservation entities to protect many of Colorado's most cherished landscapes. All of this activity has greatly benefited Colorado's residents and visitors alike.

With this increase in easement activity has come an increased scrutiny of conservation easement valuations. While easement deals and easement donors vary dramatically, if landowner's intend to make a charitable contribution and take advantage of the federal and state tax benefits, the conservation easement's value must be substantiated by a qualified easement appraisal that determines its fair market value. The appraisal is also the single item that can come under the closest scrutiny from the IRS, the Colorado Department of Revenue, conservation funders or potential brokers and buyers of tax credits. *Therefore, it is absolutely critical that easement appraisals be done by qualified appraisers who thoroughly understand the very complicated process of valuing a conservation easement.*

This Guide has one primary purpose: to help ensure that Colorado has the most sound conservation easement transactions possible by introducing conservation practitioners and landowners to the fundamentals of the appraisal process. Poorly drafted or fraudulent appraisals not only damage the integrity of the particular easement transaction; they also can dent the reputation of important conservation programs such as the easement tax credit. And most importantly, bad transactions can betray the public's trust and support for conservation in general.

The primary audiences for the Guide are: 1) landowners who are considering donating or selling an easement; 2) conservation organization staff or volunteers; and 3) conservation consultants, including appraisers and attorneys. *This Guide assumes readers have a general understanding of what conservation easements are and what the respective roles are of easement donors, their advisors, and holders of the easement.* For more information regarding land trusts, conservation easements and other conservation activity, visit **[www.lta.org](http://www.lta.org)** or see Section V for additional references.

Landowners will hopefully utilize this Guide to familiarize themselves with the appraisal process and resulting document. It should provide them with several appropriate questions to ask when hiring an appraiser, help them communicate with their appraiser, and increase their basic understanding of the resulting easement appraisal document.

For land trusts and government open space programs, this Guide provides a quick overview of things to consider when hiring their own appraisers and provides them with a template to review the resulting document. More importantly, it also provides staff or volunteers with a point of departure for discussing appraisals with potential easement donors.

Finally, for appraisers and other conservation consultants, this Guide—though basic—provides a checklist of many of the factors that should be considered when conducting an appraisal. However, it is not intended as a training manual in and of itself, nor is it intended to supplant existing information, standards or educational materials designed for appraisers.

The Guide is organized into five primary sections following this introduction:

Section I "Frequently Asked Questions about Appraisals" lists just that: a few selected questions that landowners and others may find useful in understanding some of the basic principles of easement appraisals.

Section II, "Hiring an Appraiser", addresses specific questions that landowners and others should ask when hiring an appraiser. Appraisers that offer the highest land values or those with the lowest price are not necessarily the best or most appropriate.

Section III, "A General Outline of Conservation Easement Appraisal Contents," is intended to provide a concise outline of the necessary contents of a conservation easement appraisal. This outline is best used a checklist or comparison when reviewing an actual appraisal. Its development was facilitated by input from several experienced conservation easement appraisers and has also had important contributions from other appraisers and several experienced attorneys.

Section IV, "Frequently Committed Sins in Valuing Conservation Easements", provides readers with a few basic issues that are often associated with incomplete or erroneous appraisals.

Finally, the last section, "Suggested Reading and Reference Tools" provides a brief list of resources for additional reading about conservation easements and appraisals. One useful reference that provides a much more extensive overview of easement valuation is the Land Trust Alliance's *Appraising Easements*, which can be ordered from [www.lta.org](http://www.lta.org)

This Guide is a work in progress, one that we hope to refine as information changes and as time and resources allow. As such, we welcome your thoughts and comments on this draft and wish you the very best in your conservation endeavors.

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## **I. FREQUENTLY ASKED QUESTIONS ABOUT APPRAISALS**

### **1. What is a conservation easement?**

A conservation easement is a tool used to preserve important lands and water features on a given property. It is a voluntary, recorded agreement between a landowner and a “holder” of the easement, which can either be a qualified charitable organization—typically a land trust—or a unit of government. A conservation easement identifies important historic, scenic, natural or agricultural characteristics of the property which benefit the general public (collectively known as the “conservation values”) and then establishes a set of restrictions on use of that property which will ensure that those conservation values are protected. In signing an easement, the landowner is granting to the easement holder the right to enforce those restrictions. The land stays in private ownership and the landowner typically reserves certain rights to the property such as the ability to maintain a residence, continue to farm or ranch, or use the property for limited recreational purposes. Most Federal or State tax incentives or easement purchase programs require that the easement be perpetual. That is, easements are intended to be in place on the property forever, and as such, the easement restrictions transfer with the title of the property to subsequent owners. For further discussion of easements and their complexities, see Section V for additional resources.

### **2. What rights are typically restricted through an easement?**

Conservation easements are relatively flexible tools, and as such, the restrictions on use can vary depending upon the landowner’s needs, on the goals of the easement holder, and most importantly, on the conservation needs of the property. Typical easement restrictions include limitations on further subdivision or development of the property, commercial or industrial use, mining and many other uses. The restrictions are intended to preserve the conservation values of the property as set forth in the easement document as well as an accompanying document known as the Baseline Documentation or property report. The easement holder must also be able to enforce the particular restrictions that are desired.

More recently in Colorado, many conservation easements have included provisions restricting the sale or transfer of water rights. This is especially true for those properties in which the conservation values include irrigated crop lands, wetlands or other water features that are dependent upon the water. As such, the water rights are required to stay with the property and be exercised so as to not be lost through forfeiture. For more information on restricting certain water rights through a conservation easement, seek the advice of attorneys and other professionals knowledgeable about water issues. The Colorado Water Trust also has valuable information on their website at [www.coloradowatertrust.org](http://www.coloradowatertrust.org).

### 3. What are the benefits of conservation easements?

For the general public, conservation easements can be a very valuable and cost-effective preservation tool. Many landscapes that are important to the daily lives of Colorado residents and visitors are largely privately owned. Whether it is a scenic ranchland in a mountain valley, a fruit orchard on the western slope, or a high-value waterfowl habitat along a river on the eastern plains, many of these landscapes have scenic, cultural or natural value to the public. Many of these lands are inappropriate for public ownership—or even public access. However, the protection of these private lands can have immense benefits to the surrounding communities.

For landowners considering an easement, the primary benefit of placing an easement on their property is having the peace of mind knowing that their beloved property will be forever protected, even once it transfers out of their hands. In addition, there are several financial incentives available to landowners, including a few that are unique to Colorado. These incentives include *easement purchases*, which are available through several Federal and State conservation programs, including Great Outdoors Colorado. The financial incentives also include Federal and State tax programs for *easement donations*. These include potential Federal income or estate tax deductions for the charitable contribution of a conservation easement, as well as the unique State of Colorado income tax credit. This Guide cannot go into detail over these programs (see Section V for additional resources). However, these financial incentives are the driving force behind needing to value a conservation easement.

Because of their potential to reduce the estate tax burdens for working ranch and farmland families, conservation easements can also be an important tool to keep the land in family hands.

### 4. Why do conservation easements need to be appraised?

Not all conservation easements need to be valued or appraised. Several examples include cases in which a landowner does not intend to utilize any tax benefits or if the easement does not have any "gift" status, such as an easement on open space within a development.

However, if landowners intend to take advantage of the available public incentives for donating a conservation easement, such as a state income tax credit or a federal income tax deduction, the easement must be valued to determine its worth. Conservation easements are considered an asset that has value which can be "gifted" to a qualified easement holder. IRS publication 561 "Determining the Value of Donated Property" spells out the guidelines for determining the value of this gift, which is necessary for all gifts of real property greater than \$5,000.

In addition, if you intend to sell a conservation easement on your property, in most cases a buyer will need to substantiate the value through a conservation easement

appraisal. Most local, state or federal programs that fund easement purchases have specific requirements for their appraisals.

In rare cases of condemnation of all or part of a conservation easement property, most easements have a provision in which the easement holder will receive a percentage of the proceeds equivalent to the conservation easement's value at the time of donation. As such, these cases would also require the documentation of value through an appraisal.

## **5. How are easements valued?**

While there may be other methods of determining an easement's value, the IRS, most state tax incentives, and most easement purchase programs, require the use of a qualified appraisal to determine an easement's value. The various methodologies for completing an easement appraisal are explored in more detail in Section III: "A General Outline of Conservation Easement Appraisals." In summary, there are three primary approaches to determining the value of real estate: The Sales Comparison approach, the Cost approach, and the Income Approach.

The Sales Comparison approach--in which appraisers base the value of the easement on comparable easement sales on similar properties with roughly similar restrictions--is the mandated approach in the Treasury Regulations § 1.170A if ". . . there is a substantial record of sales of easements comparable to the donated easement (such as purchases pursuant to a government program). . ." However, in most areas of Colorado, such market data are not sufficiently available, at least not presently. Therefore, most easements are valued through the "before and after" process, in which an appraiser:

- Determines a "before" property value, which is an estimate of fair market value of a property as if the landowner were to sell it without placing an easement on it (for example, the "before" value is \$1,000,000)
- Determines an "after" property value, which is an estimate of fair market value of a property as if the landowner were to sell the property with the easement restrictions in place. (for example, the "after" value is \$400,000)
- Subtracts the "after" value from the "before" to arrive at the estimate value of the conservation easement (in this case,  $\$1,000,000 - \$400,000 = \$600,000$  conservation easement value).

As stated above, there are exceptions to this methodology, as will be seen in the third section.

## **6. What are the general requirements for conservation easement appraisals?**

The requirements for appraisals depend upon the program or purpose for valuing an easement. If the easement is intended to qualify as a charitable contribution under Federal tax code, the value must be substantiated with a "qualified" appraisal. To be qualified, the appraisal must 1) be made not earlier than 60 days prior to the date of

contribution; 2) not involve a prohibited appraisal fee (such as a fee based on the percentage of the deduction); 3) include certain information (which is outlined in Section III); and 4) must be prepared, signed and dated by a "qualified appraiser."

If the easement is intended to qualify as a donation under the Colorado State Income Tax Credit Program, the appraisals also need to follow these federal guidelines.

However, many easement purchase programs, especially those funded by federal agencies, have more stringent requirements for valuing easements. After the Savings and Loan scandals of the 1980s, Congress passed legislation in 1989 requiring states to license or certify appraisers. At the same time, *the Uniform Standards of Professional Appraisal Practice* (USPAP) was created to set the ethical and technical standards for appraisals for "federally-related transactions." While neither Internal Revenue Service nor the Tax Code recognize USPAP, it has been the recognized cornerstone of accepted appraisal standards throughout the country. For example, federal land acquisition and direct lending agencies have been required by the Office of Management and Budget (OMB) to use appraisals in conformance with USPAP standards since 1992. Information on USPAP can be found at [www.appraisalfoundation.org](http://www.appraisalfoundation.org).

In addition, most agencies acquiring easements using federal funds must adhere to the *Uniform Appraisal Standards for Federal Land Acquisitions* (UAS or "Yellow Book"), which is updated periodically by the Interagency Land Acquisition Conference. Though not technically required by the Tax Code for valuing conservation easement donations, UAS has become the standard format followed and taught by many easement appraisers. As such, the outline in Section III follows the UAS format.

## 7. What is a "qualified appraiser"?

According to the IRS Publication 561, a "qualified appraiser" is an individual that 1) holds himself or herself out to the public as an appraiser or performs appraisals on a regular basis; 2) is qualified to make appraisals of the type of property being valued because of his or her qualifications that are described in the appraisal; 3) is not an excluded individual (such as the donor or the donor's relative); and 4) understands that an intentionally false overstatement of value of property may subject him or her to the penalty for aiding and abetting an understatement of tax liability.

For mortgage purposes, appraisers must be licensed by the State of Colorado. However, only 27 states have requirements for appraisers to be certified or licensed for conservation donations. Colorado is among the states in which an appraiser of conservation easements does not have to be licensed by the state licensing board (the Colorado Board of Real Estate Appraisers). Nor are appraisers of conservation easements required to be a member of one of the five major private appraisal associations that have some form of designation (the American Society of Farm Managers and Rural Appraisers; the American Society of Appraisers; the Appraisal

Institute; the National Association of Independent Fee Appraisers; and the National Association of Master Appraisers).

Because the requirements to be a "qualified appraiser" are relatively loose and left to the judgement of the appraiser, being certified by the state (or holding membership in a professional organization) is an indication that an appraiser has taken important steps to become more knowledgeable and professional. However, because there is no licensure or certification based solely on an appraiser's knowledge of easement valuation, neither state certification nor private designation verifies that a particular appraiser is competent in conservation easement valuation or any of the other specialized valuations.

## **8. What is "Fair Market Value"?**

Appraisals set forth estimates of the "fair market value" of a given property or easement. The Tax Code describes fair market value as "the price the property would sell for on the open market. It is the price that would be agreed on between a willing buyer and willing seller, with neither being required to act, and both having reasonable knowledge of the relevant facts."

## **9. What is generally valued in an easement appraisal?**

Conservation easement valuations should take into consideration all of the restrictions and reserved rights outlined in the conservation easement. This includes any restrictions on future development or subdivision and any limitations on the sale of water rights. The appraisal should cover the same legal area described in the conservation easement (many landowners only place easements on portions of their entire property). Appraisals also need to take into consideration all of the other property owned in the area by the landowners and their family. This is because of what is known as "enhancement" value. If a landowner places an easement on property adjacent to her father, the father's property benefits (or is enhanced) by the adjacent conservation easement. Therefore it must be reflected in the easement's value.

## **10. How accurate are easement appraisals?**

Conservation easement appraisals are often described as part science, part art. It is important to note that appraisals are only *estimates* of value. As a result, appraisal values may vary depending on the appraiser and his or her methodology. However, competent appraisers using the same set of facts and similar guidelines should arrive at roughly similar results. In addition, appraisals that follow format and content guidelines such as those outlined in Section III are likely to reflect a more thorough assessment of the easement's value.

## **11. What are the ramifications of bad or erroneous appraisals?**

Appraisals with minor technical or formatting flaws can be corrected relatively easily without major ramifications. However, grossly inaccurate or purposefully misleading overstatements of value are indeed serious and should not be tolerated by any party to the transaction. Such appraisals—and their resulting tax implications or excessive purchase prices—can erode the public’s trust in conservation easements in general and in the particular tax benefit or conservation program specifically. The news of either inaccurate or fraudulent valuations can make it difficult to gain or retain local support for important conservation initiatives, even if the news is from another part of the state.

Poorly constructed or inaccurate appraisals can also make it difficult for landowners to market and sell their tax credits, as was recently seen in Colorado. After conducting their due diligence, the buyers of credits may have reservations about purchasing a particular credit if they are not confident in the integrity of the appraisal. This is a particularly unfortunate situation that should be avoided at all costs.

In addition, both the federal and state tax systems contain penalties for the overvaluation of donated property, for underpayment of estate or gift taxes, and for the promotion of abusive tax shelters. It is beyond the scope of this Guide to go into detail over these penalties, but readers should be aware that such penalties are real and substantial.

Finally, appraisers who have prepared fraudulent appraisals may have their state licensure or private certifications revoked. They may also be prohibited by the IRS from having their appraisals considered "qualified appraisals."

## **12. What role do land trusts or other conservation entities have regarding easement appraisals?**

A land trust's role regarding easement appraisals may differ depending on the nature of the transaction and the easement holder's philosophy. With the donation of gifts to a charitable organization, such as a painting to a museum, it is important that the organization receiving the gift stay at arm's length from the valuation process to avoid the perception that they are influencing the value of the gift. The same is largely true with the donation of conservation easements. However, easement holders should ensure to the greatest extent possible that easement donors are aware of federal or state requirements should they intend to claim a tax deduction or credit, such as the need to obtain a qualified appraisal.

For easement donations that are claimed as a charitable contributions, easement holders will be asked to sign I.R.S. Form 8283. This form was developed in response to the Tax Reform Act of 1984, and it requires that easement holders be furnished with, and acknowledge receipt of, the donor's appraisal summary and gift of the

easement. The easement holder's acknowledgement of the gift does not indicate that they agree with the value claimed.

There is currently no consensus as to the extent that land trusts should be involved in the appraisal and tax processes. An example of this is split opinions on whether or not a land trust should sign a Form 8283 in which the claimed value is considered to be excessive. However, every easement holder has an interest in ensuring that landowners receive sound appraisals with reasonable valuations. This is not only important for maintaining good relationships with the easement donors, but it is also critical to maintain the integrity of the tax benefits for charitable easement contributions.

Finally, in the event of easement purchases, a trust or easement holder may be the entity hiring an appraiser. In these cases, the trust or easement holder will become more involved in the valuation process, and like all landowners, they should be aware of the important questions to ask when hiring an appraiser.

## **II. HIRING AN APPRAISER**

One of the first steps towards securing a sound appraisal is to hire a knowledgeable and competent appraiser. In addition to securing the services of a good appraiser, it is important that you stay in close contact with him or her throughout the valuation process. For example, the landowner may be negotiating the terms of the easement without telling the appraiser, who in turn provides an appraisal based on the wrong set of facts. Below are several questions you might consider when pursuing the services of an appraiser.

### **1. Where do I find out about potential conservation easement appraisers?**

There is no formal association of conservation easement appraisers, and many real estate appraisers are not familiar with conservation easements. As a result, several of the best sources of names of potential conservation easement appraisers are:

- Other appraisers who you may already know,
- Lawyers that are experienced in drafting and negotiating conservation easements, and
- Land trusts who have had occasion to hire appraisers for their own purposes or who work with landowners that have had easement appraisals.

Recommendations or word of mouth from other landowners who have worked with a particular appraiser are also helpful. However, most landowners do not have extensive background in easements or appraisals; as a result, they often will have few points of comparison or reference when discussing an appraiser with whom they have worked.

### **2. When do I need to secure the services of an appraiser?**

Under IRS rules, conservation easement appraisals must be completed no sooner than 60 days prior to the date of donation, and no later than the date of filing federal income taxes, including extensions.

Because good conservation easement appraisals can take time, it is necessary to contact an appraiser as soon as you are considering donating or selling an easement. That appraiser can advise you as to the timeframe for securing the necessary documents and other aspects of the appraisal process.

It is also important to note that it is possible to ask an appraiser for a preliminary estimate of value. While it would not be considered a complete appraisal for tax purposes, a preliminary valuation might be helpful if you are determining whether or not to pursue an easement.

### 3. What questions should I ask a potential appraiser before hiring one?

Before retaining an appraiser, it is a good idea to engage potential candidates in a wide-ranging discussion about their work experience, professional background and general attitude about conservation easements. Some pertinent questions that you may want to ask are:

- Do you hold a current Certified General appraisal license from the State of Colorado? *Though not technically necessarily to value conservation easements in Colorado, such licensure indicates a level of professionalism on the part of the appraiser.*
- Do you have any other special designations such as the Appraisal Institute's RM or MAI or the American Society of Farm Managers and Rural Appraisers ARA? Why or why not? *As stated above, neither state licensure nor private certification necessarily indicates a familiarity with easements, but it may indicate a level of professionalism on the part of the appraiser.*
- Can you explain to me what are a "qualified appraisal" and a "qualified appraiser"? *Appraisers who are valuing easements for federal or state tax purposes should have a working understanding of the regulations regarding appraisals.*
- Have you appraised property in this county recently? *Though not essential, this helps indicate a familiarity with local markets (or geographic competency).*
- Have you appraised property similar to mine recently (development land, ranch land, farm land, etc.)? *Though not essential, this helps indicate competency.*
- How long have you been an appraiser? *Time in the business does not necessarily equate to competency, but it provides you with a general understanding of their experience.*
- Have you appraised property for the purpose of estimating the value of a conservation easement? *This is perhaps one of the more important questions. If they have not completed an easement valuation before, the appraiser should be still be familiar with the technical requirements and procedures for valuing easements. While all appraisers need to do their first valuations at some point, you should recognize that there is some inherent risk involved.*
- If not, what steps will you take to familiarize yourself with this type of appraisal? Would you consider affiliating with a more experienced appraiser? *Affiliating with a more experienced appraiser may help reduce some of the risks in hiring an inexperienced appraiser.*

- If so, how many appraisals of this type have you completed, and have you worked for easement donors, land trusts or other entities (such as GOCO, the Forest Service, and the BLM)? *This will provide a greater sense of their experience and competency.*
- Do you have experience with the IRS in defending any of your appraisals? *Being required to defend an easement appraisal is not necessarily a negative thing, as easement donations can be flagged for review on a number of issues. However, you should be interested in the results of such a defense.*
- In your opinion, what are the best techniques for appraising a perpetual conservation easement? *See the outline in Section III for the techniques and methodologies.*
- Please tell me how you propose to address my water rights that I am / am not planning to encumber with my easement. *Water rights, as suggested above, are more frequently being restricted through the use of conservation easements. In some areas, they also represent substantial value. However, not all appraisers are familiar with valuing water rights.*
- What do you need from me to complete the appraisal (documents, etc.)? *See below.*
- What are the fees and timeline to complete the appraisal? *See below.*
- Finally, please provide three references of past clients. *Like all services, it is important that you feel comfortable with the appraiser on a number of fronts, including their level of professionalism, timeliness, and technical expertise.*

#### **4. What will my appraiser need from me to complete the appraisal?**

Individual appraisers may request different documents. However, below are the basic documents generally required to complete an appraisal:

- Legal Descriptions of the entire property, the area subject to the easement, and any property owned by the landowners, their family, or "related persons" that is in the vicinity.
- Copies of closing documents (if recent enough to be meaningful), related purchase agreements/contracts, and copies of deeds and deeds of trust.
- Recent title insurance policy or title insurance commitments, including copies of material exceptions to title.

- Maps, surveys and sketches that identify the subject property, any specific building envelopes or restricted zones, and any other property owned by the landowners, their family, or "related persons."
- Draft or final version of the proposed conservation easement, or at least a summary of the intended restrictions and retained rights.
- Depending on the complexity of a property or assignment, additional consultants (land planner, engineer with expertise in land development, water engineer, etc.) may be appropriate.

#### **5. What is a reasonable cost for a conservation easement appraisal?**

The costs associated with easement appraisals may vary widely, depending on property's location, the particular appraiser, the level of easement complexity and other factors. They can typically range between \$5,000 and \$20,000. Please note that is a general estimate only, and you will need to speak directly with your appraiser to determine a range of his or her fees.

#### **6. What do I do if I have misgivings about the resulting easement value or process, or more importantly, if I feel that the appraisal value might cause my donation or sale of the easement to be questioned?**

As stated above, appraisals are only estimates of fair market value, based on a certain set of facts and experiences. Should you strongly feel that an appraisal's value is exceptionally high or low, you should discuss your concerns with your appraiser. Should you still not be satisfied with his or her explanation, it is always possible to secure the services of another appraiser.

*Remember: if you are donating a conservation easement and intend to take a tax deduction or credit, it is your responsibility to minimize the risks of the transaction and secure the most sound appraisal possible.*

Should you have extreme concerns about an appraiser's ethical conduct, there is a process for filing a complaint with the Colorado Board of Real Estate Appraisers. You can find a description of this process at [www.dora.co.us/real-estate](http://www.dora.co.us/real-estate).

### **III. A GENERAL OUTLINE OF EASEMENT APPRAISAL CONTENTS**

#### **Introduction to Outline**

This outline summarizes the “Before and After” appraisal process as it pertains to valuing conservation easements in gross. It is based generally on the very useful format found in the *Uniform Appraisal Standards for Federal Land Acquisition*, or UAS (see Section V: Suggested Reading & Reference Tools). It is intended to provide a detailed overview of the components of a “qualified appraisal” for federal income tax purposes as defined at Treasury Regulations 1.170A-13.

While the appraisal report formatting presented here is only a suggestion (independent appraisers value their status and ability to present data and analysis in ways of their own choosing), the appraisal contents outlined, unless noted, must be addressed in a qualified appraisal.

Most of this material pertains to valuation of one or more types of open space or wildlife habitat easements. These are the types of conservation easements most frequently encountered in Colorado and can include easements permitting agricultural production, protection of fish, wildlife or plant habitat, or simply preservation of open space. Each of these types of easements can accommodate limited residential, agricultural and recreational uses, as long as they are conveyed exclusively for conservation purposes and offer significant public benefit.

There are some things not addressed here. One is the appraisal of historic façade easements, a flavor of conservation easement not as common here as the more popular conservation easement. This outline does not address in any detail the issues associated with the appraisal of post mortem easements under Internal Revenue Code Section 2031(C). Also, it does not address in detail the issues associated with basis-limited gifts of conservation easements, where the donor has owned the real property for less than 12 months.

This Outline can be used in several ways. For appraisers, it can provide a brief refresher on the content of conservation easement appraisals. For landowners and land trusts hiring an appraiser, it can help familiarize them with the appraisal document and point them to potential questions they may ask about the document itself. And for all parties, the Outline is perhaps best used with a copy of an appraisal in hand to verify that the various components of the conservation easement appraisal are indeed covered.

## **Easement Appraisal Contents**

### **A. LETTER OF TRANSMITTAL**

1. May summarize value conclusion
2. States date of value
3. Identifies property and purpose of appraisal
4. Highlights any unusual assumptions or limiting conditions
5. States that appraisal is prepared for income tax purposes of the easement donor
6. Provides appraiser's identifying number (SSN and/or EIN)

### **B. TABLE OF CONTENTS**

### **C. INTRODUCTION**

1. Certification
  - a) Acknowledges assistance of others who made significant professional contribution to development of the appraisal
  - b) Assures readers of the report that appraiser did (or did not) inspect the property
  - c) Indicates that the appraisal report is in compliance with the *Uniform Standards of Professional Appraisal Practice* (USPAP), the UAS "Yellow Book" or any other supplemental standards set forth by a particular funding source or private professional associations with which the appraiser is affiliated
2. Summary of Salient Facts
  - a) Identifies Owner/Donor
  - b) States location, brief legal description and/or property address
  - c) Reviews the purpose and function of appraisal

- d) Establishes the date of value
- e) Identifies the property rights appraised
  - (1) Fee simple before grant of easement, subject to exceptions to title including pre-existing conservation restrictions
  - (2) Fee simple after grant of easement, subject to newly-created perpetual restrictions and pre-existing restrictions or exceptions
  - (3) Value of the conservation easement
- f) Includes a brief description of subject site and improvements, including water rights and minerals estate
- g) Includes as part of the subject all contiguous property owned by the donor, the donor's family, or "related persons", even if only a portion of the property is encumbered by the easement (to reflect the "enhancement" value described above).
- h) Identifies any other property owned by donor or a related person, whether or not such property is contiguous – may or may not require an appraisal of this other property
- i) Highlights any unusual or important assumptions made in appraisal
- j) Summarizes the easement
  - (1) Consistent and inconsistent activities (sometimes called restrictions and permissions)
  - (2) Conservation or historic preservation values
- k) Summarizes conclusions of highest and best use
  - (1) Before grant of easement
  - (2) After grant of easement
- l) Summarizes value estimates of all property owned by the donor and the donor's family, and possibly the value of other property owned by the donor or a related person
  - (1) Before grant of easement

(2) After grant of easement

- m) States the market value of the conservation easement

3. Purpose and Function of Appraisal

- a) Indicates that the appraisal is prepared for the federal and state income tax purposes of the donor, for use by funding agencies in support of grant-making decisions, etc. (it is acceptable to have multiple purposes)
- b) Provides this value definition:

“ . . . the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having a reasonable knowledge of the facts.” (Treas. Reg. § 1.170A-1(c)(2))

4. Property Rights Appraised

- a) Defines fee simple and easement interests
- b) Addresses water rights that may be associated with or appurtenant to the property
- c) Addresses fractional interests, interests of tenants in possession and mortgage holders
- d) Addresses mineral estate

5. Scope of Appraisal

- a) Summarizes the steps taken in preparing the appraisal
- b) States whether or not the appraisal has departed from USPAP’s guidelines, thus invoking USPAP’s Departure Provision (for example, appraisals prepared for use by the State Board of the Great Outdoors Colorado Trust Fund (GOCO) in support of funding decisions must be Complete Appraisals, which means they must contain all of the required provisions)
- c) States the type of report format (Self-Contained or Summary; a Restricted report by definition is not acceptable)
- d) Restates any unusual or important assumptions made in appraisal

6. Property Identification

Restates summary information about the property, possibly with greater detail.

7. Important Dates

- a) States Date of Value – current or retrospective
- b) Restates Date of Report
- c) Identifies Date(s) of property inspection

8. Assessment and Taxation Data

- a) Provides schedule and/or parcel number (if available)
- b) Summarizes information available from county assessor and treasurer
- c) Discusses assessment classification, likelihood of change, effect on future tax burden

9. Property History

- a) Summarizes and analyzes leases, sales within at least the past three years, and current or recent listing agreements
- b) Discusses history of use
- c) The appraiser may request data pertaining to last sale of the property, no matter how long ago it occurred

10. Contingent and Limiting Conditions

- a) Limits reliance on or use of the appraisal report
- b) Disclaims responsibility for issues, facts and studies outside the purview of the appraisal
- c) Restates prominently and in detail any unusual or important assumptions made in the appraisal

## D. FACTUAL DATA BEFORE GRANT OF EASEMENT

### 1. Legal Description

- a) Provides detailed description using metes and bounds, aliquot portions and/or lots & blocks
- b) May include map(s) or survey, overlain on USGS 7.5° quadrangle maps, tax maps, recorded plats, etc. as appropriate

### 2. Area Data

Provides enough information about the immediate neighborhood and market area for the property to create a context for subsequent sections of the report discussing the property, its highest and best use and the valuation. Defines market area through a determination of what other properties reasonably compete with the subject in the market. Reports and analyzes local market trends, such as historic and forecast population changes (up, down, or level), any market for water rights separate from land, employment trends, etc.

### 3. Property Data

#### a) What should be appraised

##### (1) Appraisals being prepared for income tax purposes must

*(a) contain a value estimate of all contiguous property owned by the donor or the donor's family*

*(b) address any increase or decrease in the value of any other property owned by the donor or a related person*

##### (2) When selecting what property to value, prudent appraisers will follow accepted practice for eminent domain appraisals and appraise the larger parcel (to be appraised before and after the easement) defined by

*(a) unity of title*

*(b) physical contiguity*

*(c) unity of use*

b) Site or Land - Describes in detail the property under study, beginning with the site. Depending on property type, it will emphasize features key to value and use. For example, the appraisal of a rural parcel would address, at a minimum:

- (1) Location
- (2) Size and shape
- (3) Topography
- (4) Soils
- (5) Minerals estate
- (6) Environmental hazards / nuisances or hazards / endangered species
- (7) Floodplain and drainage
- (8) Legal and physical access
- (9) Existing easements or deed restrictions
- (10) Status of public utilities
- (11) Water rights, ditches, ditch and water companies, etc.
- (12) Land use regulations
- (13) Surrounding ownership and uses

c) Improvements

- (1) Many open space or scenic easements do not affect the use of existing improvements; they were there before imposition of the easement, and they will be there afterward.
- (2) Improvements need be addressed in detail only when the easement will have an effect on the utility, hence value, of the structures. For example, many historic façade easements require extraordinary upkeep, maintenance or renovation, calling for archaic techniques or materials that may be very costly. In cases like this, the improvements may turn out to be extremely important, creating a burden on the land or site.

- (3) Depending on the circumstances, there may be little need to do more than give passing mention to buildings in place at the time of the grant of easement. However, once an easement is in place, the buildings may take on more significance. For example, in some areas, a large component of the market value (or at least cost) of a property may be attributable to the value of existing structures (often second or third homes).
- (4) Appraisals should not attribute (without market support) a percentage loss in value to the whole property (land, water and buildings), when typically only the value of the land, or land and water components, is affected by the easement.

## E. DATA ANALYSIS AND CONCLUSIONS OF PROPERTY VALUE BEFORE GRANT OF EASEMENT

### 1. Highest and Best Use of the Property – this means the land and water

#### a) Site As Vacant

- (1) Legal Uses - considers current zoning (and reasonable probability of it changing), existing deed restrictions or conservation easements, building codes and environmental regulations. Specifically for water, appraisals consider the landowner's ability to put the water to a use different from the current use (ditch company bylaws, water court involvement, etc.).
- (2) Physically Possible Uses – considers physical factors, utilities availability and site improvements. As to the water, can its point of diversion be changed, or are there physical limitations on what can be done with the specific shares appurtenant to a specific property under a particular ditch or canal?

- (3) Financially Feasible Uses – market demand must be evaluated. Just because state law permits a landowner to divide the property into parcels 35 acres and larger does not mean it is financially feasible to do so. Similarly, a board of county commissioners may approve zoning or a plat that permits a retirement home and a hospital – the appraiser must investigate the financial feasibility of such a permitted use, as it could contribute no value at all to a parcel. The same is true for the water. This is an excellent place in an appraisal report to highlight the disparity between the value of mutual ditch company water for irrigation and the value of the same water for municipal or industrial use, if the criteria of legal permissibility and physical possibility are satisfied. For example, if the landowner is seeking more than an in-place, irrigated land value and there is not an immediate, functional and transparent market for the specific rights, there may be a need for a substantially greater analysis of the various markets and in any engineering and/or legal limitations to determine value.
- (4) Maximally Productive Use – that use from those considered that survives all these tests and produces the greatest financial return to the land

b) Site As Improved

- (1) Considers the same four tests itemized above
- (2) Explains whether the improvements require demolition or modification or if they are consistent with the highest and best use of the site or land

c) Conclusion of Highest and Best Use of the Entire Property (Land, Improvements and Water)

- (1) Must be consistent with the four criteria outlined under E 1.a. above
- (2) Does not need to bear any relationship to the present use, but if it does not, it must be a use that could reasonably be achieved (and the appraisal needs to contain evidence that is sufficient to support the claim of reasonableness)
- (3) States the highest and best use of the property without consideration of the proposed restrictions contained in the conservation easement

## 2. Approaches to Valuation

- a) Introduces the concept of valuation, defines the three recognized methods of valuation (Sales Comparison Approach, Cost Approach and Income Approach), and sets forth the procedure to be used in the report. For each method not used, the appraiser must explain why the method was omitted.
- b) Land or Site Valuation. In many open space or wildlife habitat easement appraisals, most of the property value before and after the easement derives from the "vacant" land itself (and not necessarily from additional development potential, etc.) Thus in many easement appraisals, this will be the principal valuation question to be solved. In these cases, often the Sales Comparison approach is the most likely to be used.

(1) There are six interrelated techniques for valuing land as vacant:

*(a) Sales Comparison*

*(b) Allocation*

*(c) Extraction*

*(d) Subdivision Development* NOTE – This technique results in very misleading indications of property value when it is not used extremely carefully. This technique should not be used unless the highest and best use of a property is for division and development within a reasonably short period of time, when costs of development can be accurately identified, when potential sale prices of resulting parcels can be estimated, and when realistic absorption rates can be supported by market evidence.

*(e) Land Residual*

*(f) Ground Rent Capitalization*

(2) The Land or Site Valuation process can be incorporated into the Sales Comparison approach when the subject property:

*(a) is vacant,*

*(b) is considered to have a highest and best use as if vacant, or*

*(c) is minimally improved with the improvements being addressed as items of contributory value.*

(3) It can form the initial part of the Cost Approach when the subject property's improvements are being valued based on their replacement or reproduction cost. However, as described below, the Cost Approach alone is not relevant to vacant property in which there are no substantial improvements.

(4) In valuing certain properties, other experts' opinions (water and minerals are the most common) may be valid. *However, if the opinions of other experts are relied on, the appraiser must be aware of USPAP requirements regarding use of consultant's reports. Standards Rule 2-3, states as follows:*

*“When signing appraiser(s) has relied on work done by others who do not sign the certification, the signing appraiser is responsible for the decision to rely on their work.*

*“The signing appraiser(s) is required to have a reasonable basis for believing that those individuals performing the work are competent and that their work is credible.”*

- c) Cost Approach. This approach is not relevant to a vacant property, for it requires that the property have substantial improvements.
- d) Income Approach. This approach may not be relevant to a vacant property, for it is based on the income a particular property generates, such as professionally operated guest ranches.
- e) Correlation and Conclusion of Value. In this section, appraisers will compare the values obtained using the three methods if appropriate and determine a conclusion of value.

## F. FACTUAL DATA AFTER GRANT OF EASEMENT

### 1. The Conservation Easement

- a) Describes in detail the restrictions and retained permissions contained in the easement in adequate detail to set the stage for the analysis of highest and best use.
- b) When possible, the appraisal includes a recorded copy of the deed of conservation easement as an exhibit to the report. If this is not available, it should include a draft copy. If no easement document is available, it should include a statement identifying the source of the terms and conditions described above.

## G. DATA ANALYSIS AND CONCLUSIONS OF PROPERTY VALUE AFTER GRANT OF EASEMENT

### 1. Highest and Best Use

It may not be necessary to reanalyze highest and best use in detail. Normally, the easement will be specific enough so that a statement or two will suffice. However, it is good practice to re-consider the *legally permissible, physically possible, and financially feasible* land uses in order to support the conclusion of what use(s) is the *maximally productive* land use after grant of easement.

### 2. Valuation

Introduces the concept of valuing a restricted parcel, sets forth and explains the specific procedure(s) to be used in the report, such as:

- a) An appraiser may consider valuing the easement itself by comparing it with the sale of other conservation easements. This technique is required by the Treasury Regulations "if there is a substantial record of sales of easements comparable to the donated easement (such as purchases pursuant to a governmental program), the fair market value of the donated easement is based on the sales prices of such comparable easements."

b) The Regulations also state “If no substantial record of marketplace 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 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.” This suggests valuation of the property subject to the easement using as many of the traditional approaches to value as are applicable.

(1) Using the Sales Comparison technique, compare the property under study to sales of other properties already subjected to similar restrictions (due to easements, restrictive covenants, physical or location considerations) at time of their sale. This should result in an estimate of property value after easement conveyance.

*(a) an appraiser should reflect appropriate units of comparison (such as per building site retained on the encumbered parcel, per-acre, or perhaps others). This requires knowledge of the details of the easements affecting each sale considered and their affect on value, including:*

- (i) what Subdivision (as meant in Colorado, tracts less than 35 acres), division or parceling potential remains;
- (ii) the number of houses and/or structures that can be built, limitations on their size, height, occupancy, and limitations on their ability to be conveyed separately from the parent tract;
- (iii) any restrictions on use of the protected land (fencing, construction of outbuildings, grazing practices, use of riparian areas, public access, special land management requirements related to weed control, modification of natural drainage, prohibitions on commercial timber harvesting, mining, sand and gravel extraction, etc.);
- (iv) the effect of the easement on the land owner’s ability to convey water separately from the protected land or to change the use of that water;



(5) Income Approach (if applicable)

- (a) May be the best method for establishing baseline value of restricted but still productive agricultural lands as well as properties with income-producing characteristics*
- (b) Care should be taken in development of pro forma effective gross and net operating income estimates, as well as overall capitalization rates and discount rates*
- (c) Requires caution due to potential “premium value” that many buyers may associate with scenic, recreational or secluded ranches. Such factors suggest a greater reliance on the Sales Comparison approach than on the Income Approach during reconciliation of the different values derived from the approaches.*

c) Correlation and Conclusion of Value

(1) General considerations can include

- (a) difficulty or increased expense of obtaining mortgage financing;*
- (b) perception of future (or present) difficulty in dealing with the easement-holding organization, sometimes described as a loss of part of the right of ‘quiet enjoyment’.*
- (c) potential for change in marketing time due to easement restrictions;*

(2) Appraisers should address increase or decrease in the value of other contiguous property owned by donor or donor’s family;

- (a) Required by IRS Regulations;*
- (b) If appropriate property was appraised, whatever change in value may have occurred to the contiguous property should already be included in the Before and After difference, even if all the contiguous property was not burdened by the easement;*

(3) Appraisers should address increase or decrease in value of other non-contiguous property owned by donor or a related person;

*(a) If there was no effect on either contiguous or noncontiguous property, a logical explanation should suffice;*

*(b) If such property was affected, it may also need to be appraised in order to conclude the effect on its value (increase or decrease) resulting from the easement*

## H. ANALYSIS AND VALUATION OF THE EASEMENT

1. As more data become available, it is expected that valuation of easements by Sales Comparison will become more prevalent. However, as described in H.2 below, because adequate market data do not exist in most areas of Colorado, the most common approach remains the Before and After method.
  - a) Use of the Sales Comparison approach to value easements is mandated by the Treasury Regulations §1.170A-14(h)(3)(i) which provide that “If there is a substantial record of sales of easements comparable to the donated easement (such as purchases pursuant to a government program), the fair market value of the easement is based on the sales prices of such comparable easements.” While this statement may offend many appraisers who would contend that purchases pursuant to a government program would by definition not be reliable comparables, the Treasury Regulations are clear and unambiguous. Only in markets where such government programs are not established (which is almost everywhere) does the “before and after” rule apply.
  - b) Appraisers must be cautious in analyzing sales of easement interests or fee interests in easement-burdened properties, as any units of comparison developed often would not reflect damages or benefits imposed on unburdened remainders, contiguous or not. Also, as illustrated recently in the *Browning v. Commissioner* Tax Court ruling, analysts must be aware that many easement sales are intended to be bargain sales, reflecting some donative intent on the part of both grantor and grantee.

2. As described above, the most common approach remains the Before and After, where

$$\frac{\text{Value Before the Easement} \\ - \text{Value After the Easement}}{\text{Value of the Conservation Easement}}$$

## I. EXHIBITS

1. A “Self-Contained” appraisal report should include those of the following exhibits necessary to inform a reader who is not familiar with the subject property area. Such exhibits are not required by the Treasury Regulations, and may not appear in many Summary appraisal reports. These are the types of exhibits required in some government agency and private concern appraisal contracts:

- a) Maps: All maps shall be highly legible with properties clearly identified, highlighted if necessary, and depicted in contrasting colors (e.g., subject – red, blue, or green; comparable sales – purple, etc.). Maps should be of sufficient detail, with legend, scale, north arrow, geographic features and ground-control information, so properties may be readily located on-the-ground.

*(1) Area Map: Small-scale map showing general location of the subject neighborhood.*

*(2) Neighborhood Map: This map shall show the appraised property and its immediate neighborhood.*

*(3) Tract or Plat Map: This shall be a large-scale (2-inches per mile or larger) map clearly showing the appraised property and pertinent physical features, such as roads, streams, improvements, etc. If portions of the appraised property are assigned separate values, these various areas shall be delineated on this map, or a separate map may be prepared.*

*(4) Comparable Sales Location Map: This shall show the location of the appraised property and the sales used in the appraisal. Scale shall be a minimum of 1/4-inch per mile. Where appropriate, the Comparable Sales Map may be combined with the Area Map or Neighborhood Map.*

- b) Photographs: Each copy of the appraisal should contain color photographs of the appraised property and all comparable sales relied upon. Each photograph shall be identified as follows:
  - (1) Identify the scene – Appraisers should identify features shown and, if applicable, the purpose of the photograph.
  - (2) Appraisers should identify location where photograph take, direction of view, etc. This may be done on map.
- c) Comparable Sale Data Sheet: For all sales used in the appraisal, it should show detailed information concerning each transaction. Photograph and map of each sale is required.

## **IV. FREQUENTLY COMMITTED SINS IN VALUING CONSERVATION EASEMENTS**

While almost all conservation easement appraisals are done in an ethical, technically sound manner, common mistakes or red flags may appear from time to time. Below is a short list of some common problems found in limited scope reviews of more than 80 purported “qualified appraisals” of conservation easements at the end of 2003.

Many, while not fatal, highlight appraisers’ lack of familiarity with the Treasury Regulations; these are easy to correct. Others are considered to be more serious technical flaws. These "sins" can be informative when completing or reviewing easement appraisals.

### **1. Serious Technical Issues**

- A. Appraising the wrong property. Care should be taken that the appraisal's legal description reflects the area covered by the easement. In addition, there are instances in which the appraiser does not value all of the donor’s and their family’s property before and after imposition of the easement (thus it doesn't reflect "enhancement" value as described above).
- B. Relying entirely on the Subdivision Development Analysis technique (which bases the easement's "before" value on revenues generated by the development of the property). In order to be valid, the subdivision development plan must be a permitted use according to local zoning codes, must be technically feasible, and must be a likely form of development given the local market. Many Subdivision Development Analyses are frequently supported by:
  - inadequate land use plan without engineering input and lacking substantiated development costs.
  - poorly supported forecasts of lot sale prices,
  - poorly supported lot absorption forecasts,
  - poorly supported discount rates,
  - inadequate profit allocation
- C. Appraisals of second- or third-phase easements where the impact of the earlier easements was improperly accounted for. This is one of the common problems associated with the phasing of easements (placing an easement on only a portion of the property, with the intention of doing additional easements in the coming years).
- D. Ignoring or omitting existing zoning or property restrictions, such as covenants, deed restrictions, rights-of-way, or other pre-existing limitations on use of the property.

**2. Lack of Familiarity with the Treasury Regulations**

- A. Using the wrong definition of market value
- B. Failure to state that the appraisal was prepared for the income tax purposes of the donor
- C. Easements with effective dates beyond the 60-day shelf life of their appraisal's effective dates of value

**3. Other More Serious Issues Not Directly Related to Appraisals**

- A. Appraisals of conservation easements without evident conservation purpose. Easements without obvious conservation values and purpose risk not qualifying under Internal Revenue Code 170(h) and as such, risk not qualifying for Colorado's state income tax credit.
- B. Clever division of family-owned lands intended to maximize donors' tax credits and to avoid the issue of "enhancement" values. The phasing of easements is not uncommon and should only be considered by a land trust if each phased easement can stand alone on conservation values and purpose. However, it is not acceptable to shelter properties through various names or other methods in order to skirt the constraints of the tax credit rules or to avoid the enhancement values.

## V. SUGGESTED READING AND REFERENCE TOOLS

*Appraising Easements, 3<sup>rd</sup> edition*; Land Trust Alliance and the National Trust for Historic Preservation; Washington D.C.; 1999.

[lta.org/publications/apprea.htm](http://lta.org/publications/apprea.htm)

*Conservation Options: A Landowner's Guide*; Land Trust Alliance, Washington D.C.; 1999.

*Department of Treasury Regulations 1.170A-13 Recordkeeping and Return Requirements for Deductions for Charitable Contributions*

*Department of Treasury Regulations 1.170A-14 Qualified Conservation Contributions*

*Determining the Value of Donated Property (IRS Publication 561)*

<http://www.irs.gov/pub/irs-pdf/p561.pdf>

*The Internal Revenue Code Section 170(h)*

*Preserving Family Lands, Book II*; Stephen J. Small; Landowner Planning Center; Boston, MA; 1997

*Preserving Family Lands, Book III*; Stephen J. Small; Landowner Planning Center; Boston, MA; 2002

*The Standards and Practices Guidebook: An Operating Manual for Land Trusts*; Land Trust Alliance, Washington D.C.; 1993

*Uniform Appraisal Standards for Federal Land Acquisition (the Yellow Book)*

[usdoj.gov/enrd/land-ack/toc.htm](http://usdoj.gov/enrd/land-ack/toc.htm)

*Uniform Standards of Professional Appraisal Practice (USPAP) – published annually*

[http://www.appraisalfoundation.org/html/standards.asp?FileName=current\\_uspap](http://www.appraisalfoundation.org/html/standards.asp?FileName=current_uspap)

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*The mission of the Colorado Coalition of Land Trusts is to promote and support land conservation excellence in Colorado through leadership, advocacy, education and outreach.*