

**Comments at the Eastern Lands and Resources Council
And
Western States Land Commissioner's Association
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Appraisal Issues

**Ted Freeman, RPRA
Chief Appraiser
U.S. Forest Service**

Greetings – good to see y'all again. The topic given me today is Appraisal Issues. Now that sounds exciting. Appraisers always have issues. You've got this great project. There's this great piece of property in the middle of a block of state land that you've been salivating over for 15 years. They're willing to part with it....reluctantly.... all kinds of emotional attachments....Great Grandpa first broke this ground in 1875.... And all they want is a fair price. They've even come to the table with an appraisal – it's got pictures and everything! But the dadburn review appraiser has *issues* with it.

What issues are we dealing with today? Since I was here last year, my perspective has changed a bit. Last year I was fairly new in my job as a regional appraiser in Milwaukee. This year, I'm even newer in my job as Chief Appraiser. The title doesn't quite seem to fit yet. As I've passed through the various chairs and locations on the way to DC, my perspective has changed. And while standards have always been important to me... their importance has grown as I've become part of higher levels of the agency. The need for consistency among the various parts of the organization has grown more apparent. This need for consistency emphasizes the role of standards.

Nearly all of our "issues" deal with standards. In my new position, I will be conducting compliance inspections of each of my regional appraisers on a 3 year rotation. I understand Art is in the middle of instituting a compliance inspection schedule for the Department of Interior. It's critical that when we're involved with the spending of taxpayer dollars – and dealing with the private property rights of citizens – that we know, understand, and follow appropriate standards. One of my favorite, and oft-used quotes from the Yellow Book is:

“In acquiring real property or any interest therein, it is United States’ policy to impartially protect the interests of all concerned. The Fifth Amendment of the United States Constitution asserts: ‘nor shall private property be taken for public use, without just compensation.’ Since ‘the courts early adopted, and have retained, the concept of market value’ as the measure of just compensation, the United States, as a matter of general policy, bases its land acquisitions on market value appraisals: ‘[I]t is the duty of the state, in the conduct of the inquest by which the compensation is ascertained, to see that it is just, not merely to the individual whose property is taken, but to the public which is to pay for it.’”¹

In order to protect the rights of all involved, it is critical that standards be known and that they are followed. I was asked to speak a bit about differing standards – that may affect the way you do business back home.

Specifically, IRS regs and the Yellow Book.

The Tax Code is a wondrous thing. As I was doing some research for this topic I ran across some interesting tidbits. Did you know there’s actually an allowable deduction for whaling boat captains buying provisions for their crew while performing traditional whaling activities. Amazing!

There’s a lot going on in the IRS world these days. They recently put out the “dirty dozen” of fiscal year 2006 scams. Among them was:

#10. Abuse of Charitable Organizations and Deductions: The IRS continues to observe the use of tax-exempt organizations to improperly shield income or assets from taxation. Contributions of non-cash assets continue to be an area of abuse, especially with regard to overvaluation of contributed property.

How many of y’all have worked land deals which involved a partial donation of real property rights?

In those deals, did the landowner generally plan on claiming a deduction on their income tax return?

¹ Interagency Land Acquisition Conference, *Uniform Appraisal Standards for Federal Land Acquisitions* (Appraisal Institute, Chicago, 2000), page 5 (see this reference for court cites for above quotations).

Now that transaction is between the landowner, his accountant and the IRS – Why should you care? Well for one thing, you don't want to be part of a transaction which hits the newspapers as a huge tax fraud case. But it's also important that y'all recognize that a single appraisal report may not be appropriate for all aspects of the transaction.

A big thing in the world of IRS-related appraisal is conservation easement donations and fraudulent deductions. Most of y'all have seen or are aware of conservation easement deals which seemed shakey... in other words, the landowner was conveying the right to do something he would never think of doing anyway – but wants to get compensated for the conveyance.

Historic Preservation façade easements have been some of the worst offenders. At a conference once, had a preservation trust official speak of how he knew the building owner could sell his easement-encumbered property for just as much as he could have sold it before the easement – yet the appraisers were able to show a value for the easement as being perhaps 30 – 50% of the value of the whole. HUH? How could this be? Part of it.....leaving aside the fraudulent aspects of these deals.....could be a difference in standards.

Within certain constraints, IRS regs allow deductions for the donation of conservation easements. A deduction has to be supported by a “qualified appraisal” done by a “qualified appraiser.” Now there are a number of differences in the standards of the Treasury Department and the USFS for the appraisal of conservation easements. Here are a couple of critical ones:

Treasury Regs:

“The value of the contribution under section 170 in the case of a charitable contribution of a perpetual conservation restriction is the fair market value of the perpetual conservation restriction at the time of the contribution.”

Sounds straight forward – see any problem with this as it relates to Yellow Book Standards?

The foundation of an appraisal problem is to define the value you are after. For the IRS, they are after the value of the restriction. For a conservation

easement, or any partial acquisition, the Yellow Book is asking for something very different:

“The purpose of the appraisal will be to estimate the market value of the whole property before the acquisition and to estimate the market value of the remaining property after the acquisition.”

The appraiser for IRS purposes is seeking the value of the easement. The appraiser for the federal agency acquisition could care less what the perceived value of the easement is. In fact, those of us steeped in federal appraisal will likely tell you the easement has no market value. When was the last time you saw a re-sale of an easement after it was acquired by a non-profit or government entity (unless it was a re-sale to the government)?

The Yellow Book appraiser seeks to value what is called the larger parcel as if unencumbered by the conservation easement, and then do a second appraisal to develop a value opinion of the same property as though encumbered by the easement. The difference between those two values is generally treated as appropriate compensation for the easement – but is **not** the value of the easement.

Under current rules (though they are now being revised) the IRS appraiser is tasked to first consider sales of similar easements as the best evidence of market value – such as sales to government agencies or non-profits. Only if there is no substantial record of such sales should the IRS appraiser resort to the before and after method. The Yellow Book appraiser has no reason to consider easement sales for they have nothing to do with his appraisal problem. Further – the Yellow Book appraiser must be very careful in the consideration of any sale to a non-profit or government entity. These standards are different.

There are other differences – For example the Yellow Book talks about the appropriate larger parcel to be appraised in a partial acquisition. The appraiser must consider contiguity, unity of highest and best use, and unity of title in determining the appropriate larger parcel to be appraised. The IRS regulations require that the fair market value of the non-cash charitable contribution considers and is offset by any benefits to property also owned by the owner, a spouse, brother, sister, ancestor, or other lineal descendent of the owner transferring the conservation easement. We don't need to get into the details as to how these differences play out, but suffice it to say that you

could very well end up appraising different properties if you properly apply the two standards to this appraisal problem.

In a nutshell then, you don't need to know all the differences between a Yellow Book appraisal and a tax appraisal – you do need to know that they are different – can lead to very different results – and one appraisal generally won't meet the needs of both purposes.

Questions submitted to me:

1. Yellow Book course instructor taught that when federal funds are utilized (including grants) that any non-easement encumbrances will be extinguished automatically as a part of the transaction. This was because the Federal government had the right to extinguish them as a matter of law. The attendee questioned how this would apply since the state has no such authority. The situations that come to my mind involve leases, licenses, life estates and CRP. The course instructors were not able to address the issue. It was merely suggested that federal funds not be involved in any transactions involving anything less than full fee interest (except easements).

Art can speak for Interior's take on this, but I think the instructor was misinformed. Certainly the feds have the authority to acquire the fee – but we often acquire less than fee estates. The quality of the title must meet appropriate standards – must be sufficient for the intended purpose of the acquisition – and the appraisal must match the estate acquired. There are times when the feds may want to condemn the fee simple, and the appraiser is tasked with valuing the fee simple ignoring the various owners of different interests in the property – in that case the court may allocate the overall value among the various interests.

2. I've heard that the federal agencies are looking to add a requirement that require a specific "reviewer designation" from a specific appraisal organization to review transactions with federal funds. Is this true?

Not true for the Forest Service. We do require a professional designation for our senior level in-house reviewers. And we require that designation to mean something, in other words, we're looking for a designation that can

only be obtained after demonstrated experience, educational requirements, comprehensive exam and a demo report.... “Not the you pays your dues, you gets your certificate variety.”

3. What is the current trend, allowing states more authority to review federal transactions or less authority?

Art – this may be more a question for the Interior side. The Forest Legacy program guidelines allow for states to appraise and review appraisal reports. The Legacy Program does have a Quality Assurance program where we want to look to be sure appropriate standards are being met.