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Tracking the Effects of Conservation Easements on Property Tax Valuations

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on Property Tax Valuations

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Abstract

We establish a procedure to track the tax valuation history of properties that are fully or partially restricted with conservation easements to test the assertion that easements result in lower property valuations. Easements didn't decrease property valuations; they merely decreased the rate of value for the affected properties. On average, the restricted properties' valuations increased at a rate lower than did those for unrestricted properties—but not always, and certainly not uniformly. Valuation policy is specific to the local tax assessor: no sweeping assertions about easements and property taxes is warranted.

Introduction

It is a truth universally acknowledged—at least among economists—that conservation easements result in a lower market value for the subject property because future use of the property is constrained by the terms of the easement. The larger is the set of easement restrictions, the larger should be this value reduction. It follows that there should be an associated decrease in the property's valuation (its “assessed value”) for tax purposes. Anecdotal evidence abounds, but we are not aware of any systematic attempt to trace the valuation history of conservation easements over time. Does Practice support Theory? Do property owners actually experience a decline in assessed values?

We report here the results of a recent study that examined the valuation histories of a set of properties restricted by conservation easements donated to a nonprofit land trust in a Minnesota metropolitan area county. We tracked valuations over the (to-date) life of the easements, starting with the immediate pre-easement valuation. In this report, we summarize our findings and discuss some of the procedural complexities that we faced.

The bulk of the conservation easement literature simply asserts that “easements reduce valuations.” King and Anderson (2004) is the only empirical study we could locate that examined the effect of development rights restrictions on property taxes. Using Vermont towns as the unit of analysis, they found that easements are tax neutral or tax-diminishing in the long run. We are aware of no studies that track individual restricted properties over time. Taff (2004) shows market value effects from a different class of conservation easements, those that restrict cropping use rather than development use, in Minnesota, and Shultz and Taff (2004) show similar effects for wetland easements in North Dakota, but both these are cross-section and not temporal studies.

Observed market value effects such as those analyzed in these studies may or may not translate directly into property tax valuation changes: assessors *estimate* values, they don't *measure* values.

Market values and assessed values

How do development rights restrictions affect property valuations? Economists generally ask a different question: How do restrictions affect market prices? Prices are felt to be the best indicator of the economic value of a property. From this analysis, economists can

estimate both marginal prices and—if necessary assumptions hold—economic welfare associated with changes in property or underlying characteristics of that property.

However, sales of relevant properties are relatively sparse: less than 5% of the properties in most areas sell each year, and very few of these properties have easements attached. When the number of interesting—those with conservation easements, in our case—properties is very small in the first place, the probability of one of these interesting properties selling in any given year—and so being of use to traditional economic analysis—is very small indeed.

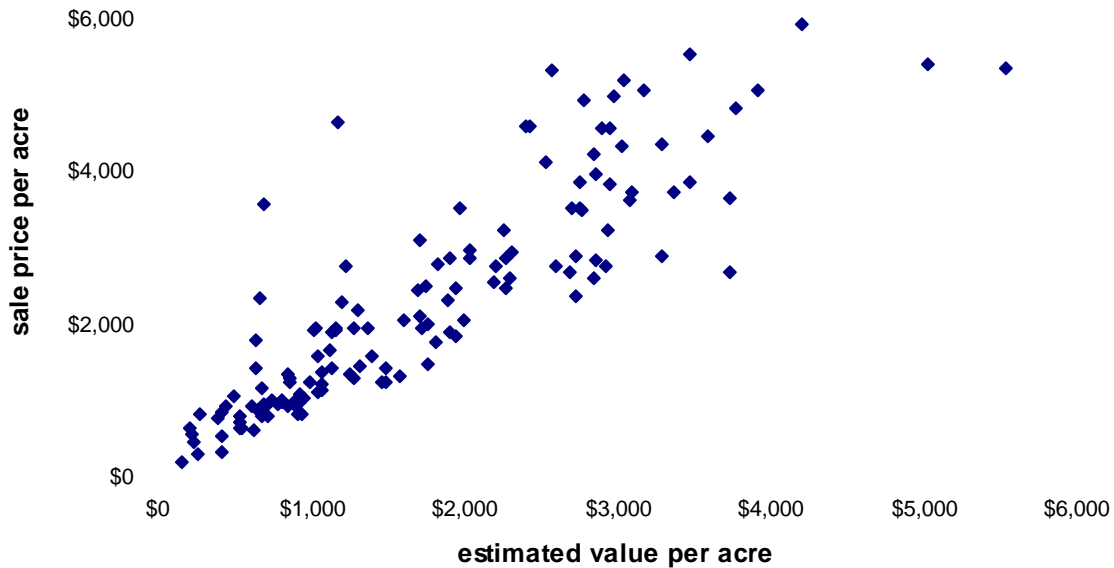
This sparseness of easement sales is not as much of a problem for property appraisers, who generally require only a handful “comparable sales” to accomplish their task of placing a value on a particular property. But economic analysts and property tax assessors need to make inferential statements about the value of a large set of properties with varying structural and location characteristics. Such inferences require more sales—30 - 50, or more, depending on the size and characteristics of the property markets being examined.

Because we usually have on hand too few easements—more precisely, properties on which an easement has been placed—being sold, we must instead use another indicator of “true” economic value: estimated market value. (Even sales prices are only *indicators* of true economic value, but we usually assume they’re pretty close approximations.)

Estimated values are generated every year for every property in a taxing jurisdiction. They can be thought of as the assessor’s best estimate of what price the property would fetch if it were sold tomorrow—although, of course, in almost all cases it *won’t* be sold.) This holds for those taxing jurisdictions, as are all in Minnesota, that estimate full market values: what the property would see for in an open market, given whatever legal and technical constraints to changing land use might apply. What the property is currently used for is irrelevant in a full market value assessment system.

How good are the EMVs as indicators? We don’t know what the true economic value of a property is: it’s not observable, only inferable. Since we assume that sales prices are the better indicator, our question then becomes, “How well do EMVs match prices when properties do happen to sell? It’s reassuring to discover that—in general—the two aren’t that far apart, at least for the geographic area we examine here. Figure 1 shows the relationship between the price of sold properties and the EMV that had been assigned to that property prior to the sale for the multi-county region that includes our study county. The relationship is not exact, but it’s not that bad, either. This could be because the assessors are really good at predicting prices—that’s their job after all—or because buyers and sellers are using the (publicly known) EMV as a reasonable level at which to start negotiating. It’s probably some of both.

Figure 1: Farmland sales prices and prior estimated market value, East Central Minnesota, 2003



The very strong advantage of using EMVs as market value indicators is that they are available for all properties in the jurisdiction—including those on which an easement is placed. The disadvantage is that the EMV is the product of one official’s professional real estate judgment, not the collective judgments of the buyers and sellers who jointly determine property sales prices. But, in our case, the EMV is the appropriate measure of value, because it, and not the “true” value, lies at the core of the entire property tax system.

Assessed values and property taxes

The EMV is one of three critical numbers used to calculate property taxes. There is a discipline of sorts exercised when property owners argue for a lower EMV, and so pay lower taxes, while the local government argues for a higher EMV, and so raise more taxes. The other two critical numbers are the tax rate and the class rate. The latter is called different things in different states, and its use varies considerably. Few if any states practice strictly uniform taxation, uniform in the sense that a single tax rate is multiplied by the estimated market value of every type of property. Most adjust either the valuation or the tax rate (or both) by some factor to ensure that some property types (usually agricultural and residential) pay less proportionately than do others. In Minnesota, the EMV is multiplied by a class rate, the product of which multiplication is then multiplied by a tax rate that is the same for all properties. Obviously, this is no different in effect

from that achieved in states that adjust tax rates by different factors and apply the product uniformly to the full market value of each property.

Ultimately, a conservation easement might alter an owner's property tax bill if it results in a different estimate of market value, a different tax rate adjustment, or both. To estimate the local tax implications of these easements, then, we need to know what policies the local tax assessors are following. In Minnesota, the State Department of Revenue, which has assessor oversight responsibilities, has issued periodic "guidance letters" on the subject of valuing properties with conservation easements. However, the guidance is intended to cover easements in agricultural areas only: the metropolitan area easements we examine here are subject to no such guidance from the State.

Data

Washington County, Minnesota, forms the eastern edge of the Twin Cities Metropolitan area. It remains partly rural but not overly agricultural. Much of the low-density development is made up of large-lot residential areas or hobby farms. The easements we examined were drawn from those donated to the Minnesota Land Trust since the early 1990s. MLT describes these easements as "protecting natural, scenic, and open space values." All were donated by property owners. The principal property rights transferred under the easements are for development.

We examine here all MLT easements in Washington County as of July 2004. We exclude a few easements obtained under the terms of the County's cluster zoning provisions, whereby a developer is permitted to build houses at a density higher than would be otherwise be allowed, in exchange for leaving a certain portion of the whole property undeveloped—and under easement. These "cluster easements," which run between 1 and 10 acres in most cases, await further study.

Washington County operates under a "mixed" assessor program: several townships and cities have their own assessors, while the remaining areas are assessed by the County Assessor. The County Assessor is responsible for standardizing all the local assessors' protocols, as well as assembling and reporting all assessments in the county on an annual basis.

The assessor annually assesses and assigns the land valuation for each landowner. If we have a time series of per-acre valuations for each property, we can compare among valuation histories for restricted and unrestricted properties to see what changes a conservation easement causes.

Current county policy is that land is always valued at its highest-and-best use, its HBU, but its tax class reflects the principal actual use. The class will change if the principal use changes. So the simple fact of an easement being placed upon a property will probably not change its tax class, but it may change its assessed value. In most cases in Washington County, conservation easement lands have remained agricultural; they change to a managed forest (Timber 2b) classification only if there are no improvements on the land and if the owner adopts a state-approved timber management plan. If a property is placed into a farmland preservation program (Green Acres or Metropolitan

Agricultural Preserves; see Taff (2002)), it is assessed at its hypothetical “pure agricultural” value, regardless of its HBU value.

Our approach in this paper is to allocate an estimated market value to the specific land that is under restriction. When the restricted portion is smaller than the whole property, some approximations, detailed below, are necessary.

Dataset assembly

MLT records include for each easement its location, its owner (at the time the easement was signed), easement date, the extent of the easement (acres), a detailed property description (for legal recording purposes), any existing structures, and specific easement restrictions. To link these data to the County records system, we associated each easement with an appropriate Property Identification Number (PIN), using the Twin Cities MetroGIS Parcel GIS database and the County’s on-line address-match system. Some of the easements had a single PIN and thus were easy to track down, but some were associated with two or more PINs, reflecting subsequent (to the easement signing) transformations of the property’s boundaries (see below) or historical property designators in the County records.

We then used these PINs to tie the easement to the County’s property value records system. Washington County property records are computerized from 1997 onward. For the pre-1997 records, we examined the property books where valuations were recorded prior to the computerized system. The newer system tracks property valuations by “tax year,” the year in which the valuation applies, whereas the books are organized by the year in which the valuation was made. This discontinuity was dealt with in the summaries reported here.

The County records include both a land and a building estimated market value for each parcel (each PIN), parcel size, and separate estimates for “limited market values” of land and building. Until recently, Minnesota law required that property valuations could not increase more than a stated percent annually, so dramatic increases were spread over time. Had we wanted to trace the specific property tax implications of easements, we would have used the limited market value, because that serves as the valuation on which taxes are actually levied. But because we are instead interested in changes in the valuation itself, the proxy for the (unknown) market value, we track in this report the full valuation.

We created per acre land valuations for each of the parcel by dividing land EMV by the acreage. Where restricted properties were joined (see below), we summed up the estimated land market values for each of the “parent” parcels and divided that sum by the sum of all parent parcels’ acreages in each year. This weighted average valuation is then comparable to the valuations of the succeeding “child” parcel.

Parcel boundaries, especially in urbanizing areas such as Washington County, frequently change over time. This complicates valuation analyses because the portion of the property restricted by a conservation easement may also change over time. Figure 2 shows how we handled the analyses for each of the five broad classes of parcel boundary shifting. The assessor’s valuation for the land portion of the property, the “LMV per

restricted acre” in the figures, is the number we track in subsequent analysis. This is the “valuation of the easement” for our purposes. (Note that the restructurings shown here might occur more than once in the life of an easement.) In our dataset, fifteen of the recorded easements had a simple history; the remaining six easements contained elements of one or more of the other classes.

Simple. The property boundary is unchanged over time and there is no improvement (structure) on the property. The per-acre valuation of the easement (the restricted land) is simply the annually-assigned EMV divided by the number of acres.

Partial. The property boundaries are unchanged over the period of the analysis, but only part of the property is restricted. We take the total property’s land EMV per acre and apply it to the acres under easement.

Split. Some time after the easement was signed, the property was divided into two or more parcels, each (all) of which then receive new and separate EMVs. In some cases, the restricted land was separated from developable or developed land; in other cases, the restricted land was also sundered. In the former case, we can follow the restricted land with relative ease, tracking its new EMV. In the latter case, we applied the land EMV per acre for the new parcels to the restricted (and now sundered) land. In the figure, parcels that are wholly or partially restricted are shaded.

Joined. When a previously separate parcel is joined to a restricted property, the amount of restricted land might increase, if the new property is also (at least in part) restricted, or it might stay the same if the new parcel is unrestricted. In either case, we apply the land EMV per acre for the joined parcel to all the restricted land. If the previously separate parcels were separate easements in the MLT database, their previously separate valuation histories would of course converge to the new single joined property’s valuation.

Figure 2: Easement transition categories

Simple

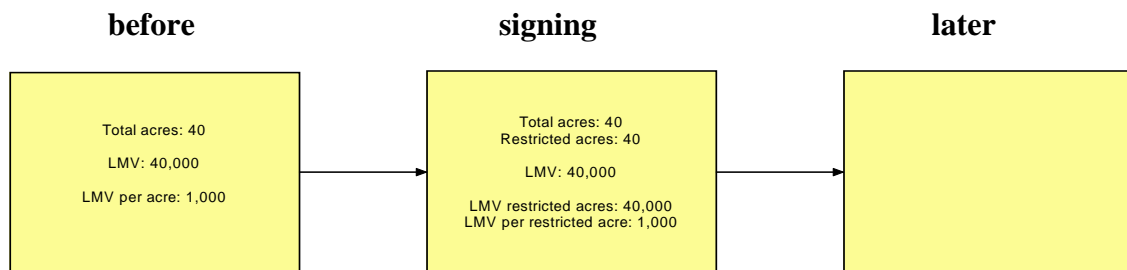
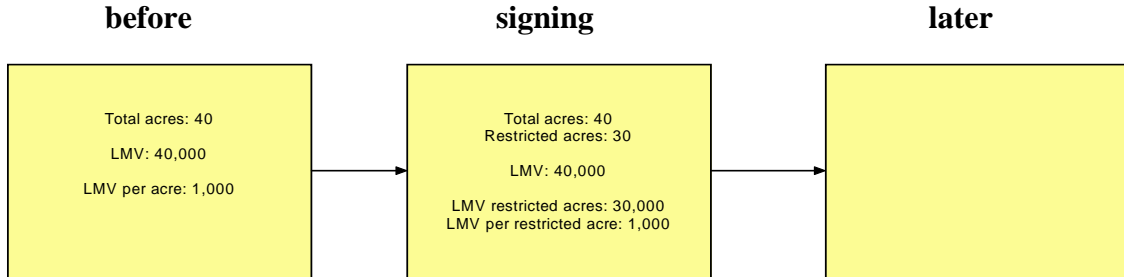
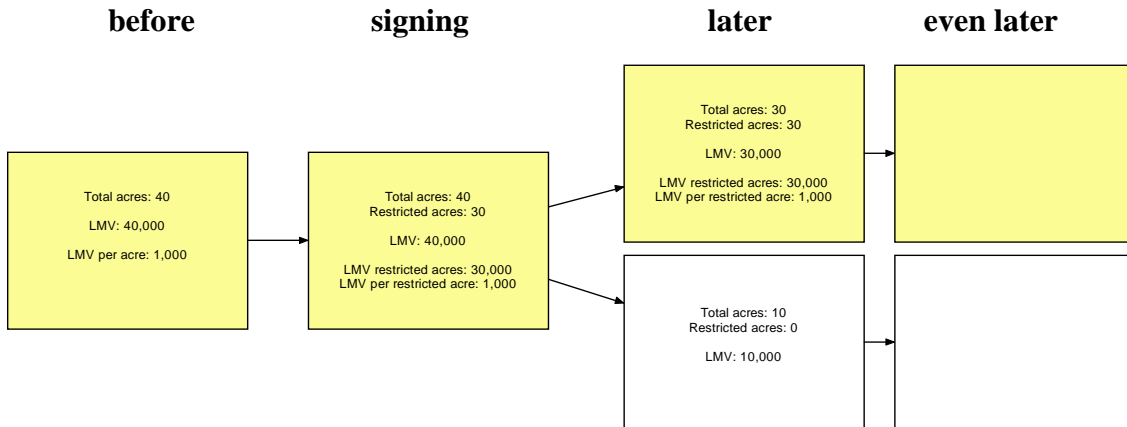


Figure 2 (continued): Easement transition categories

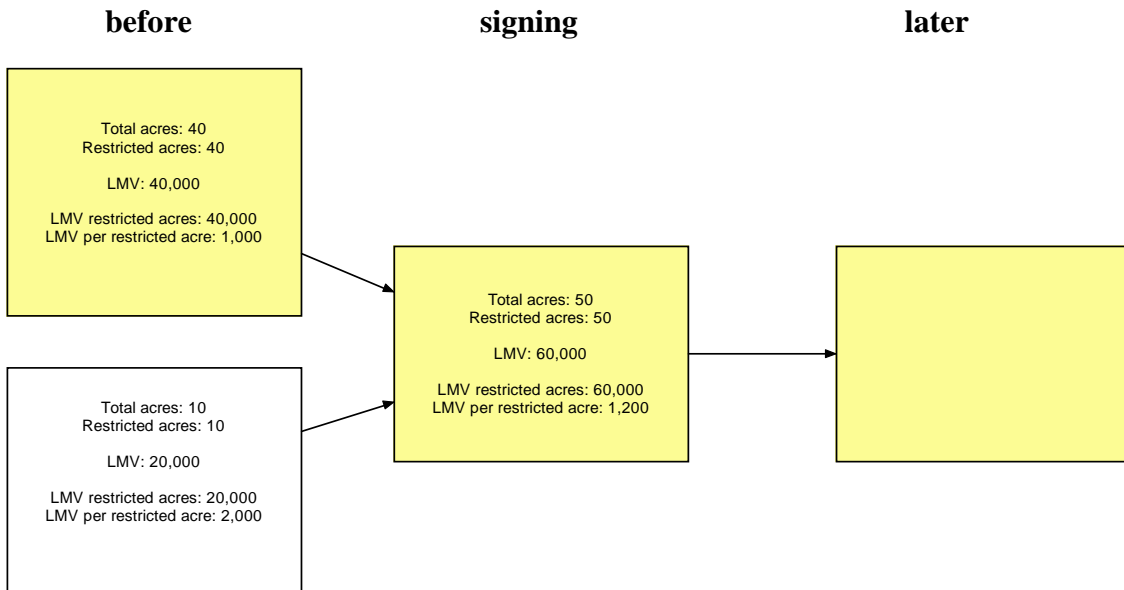
Partial



Split



Joined



Results

Figure 3 shows the current per-acre valuation (for the land portion) of each easement, arrayed against the size of the easement. (In the figure, we do not show one property with an extremely large valuation per acre. This easement affects a small, already developed residential parcel located along a scenic river.)

Figure 3: Relationship between size of easement and current per-acre valuation

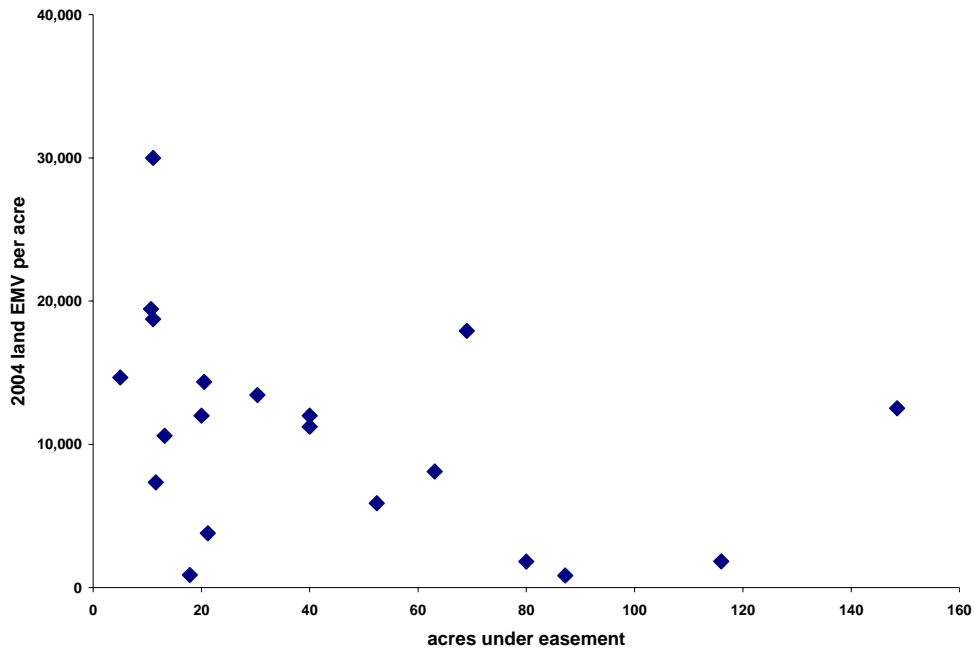


Figure 4 shows the valuation history for each MLT easement, where the value is the per-acre land EMV, calculated as in the previous section. The horizontal axis is the number of years since each easement was signed, so older easements have longer traces in the figure. All valuations have been adjusted for inflation. What is significant in the figure, we think, is the wide variation in the valuation histories. Some easements have gone up quite dramatically, especially the newer (shorter trace) easements, which also tended to have had the highest values to begin with.

Figure 4: Changes in easement valuation per restricted acre, adjusted for inflation

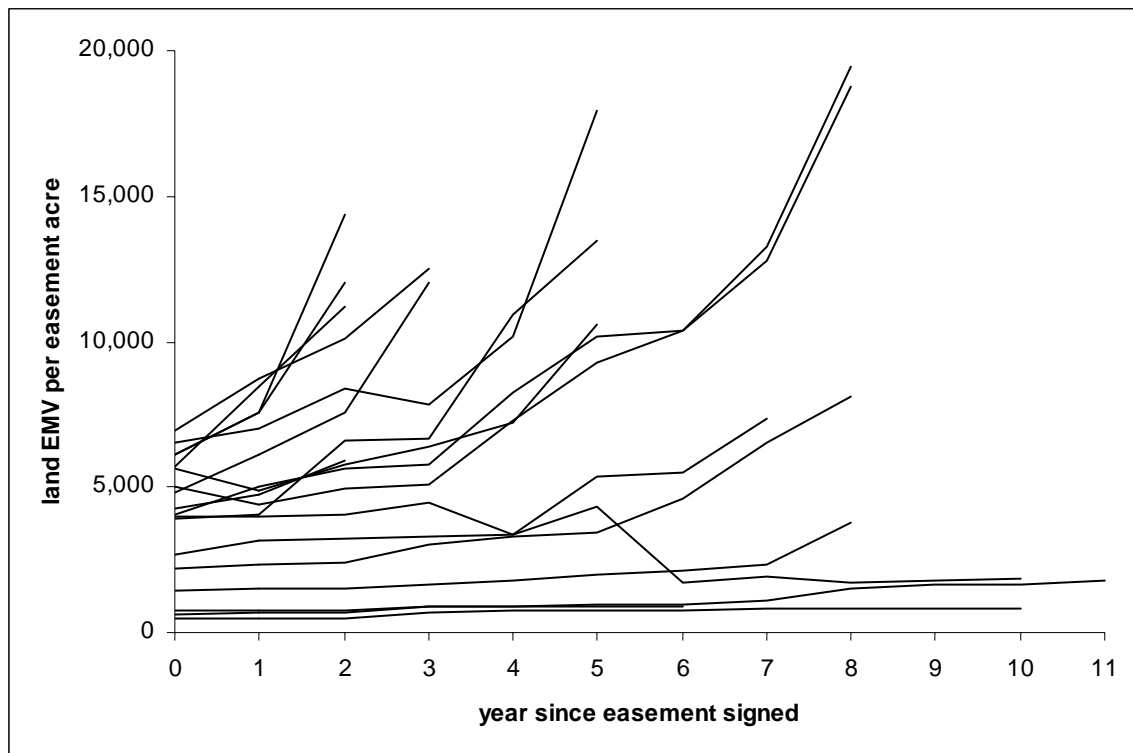
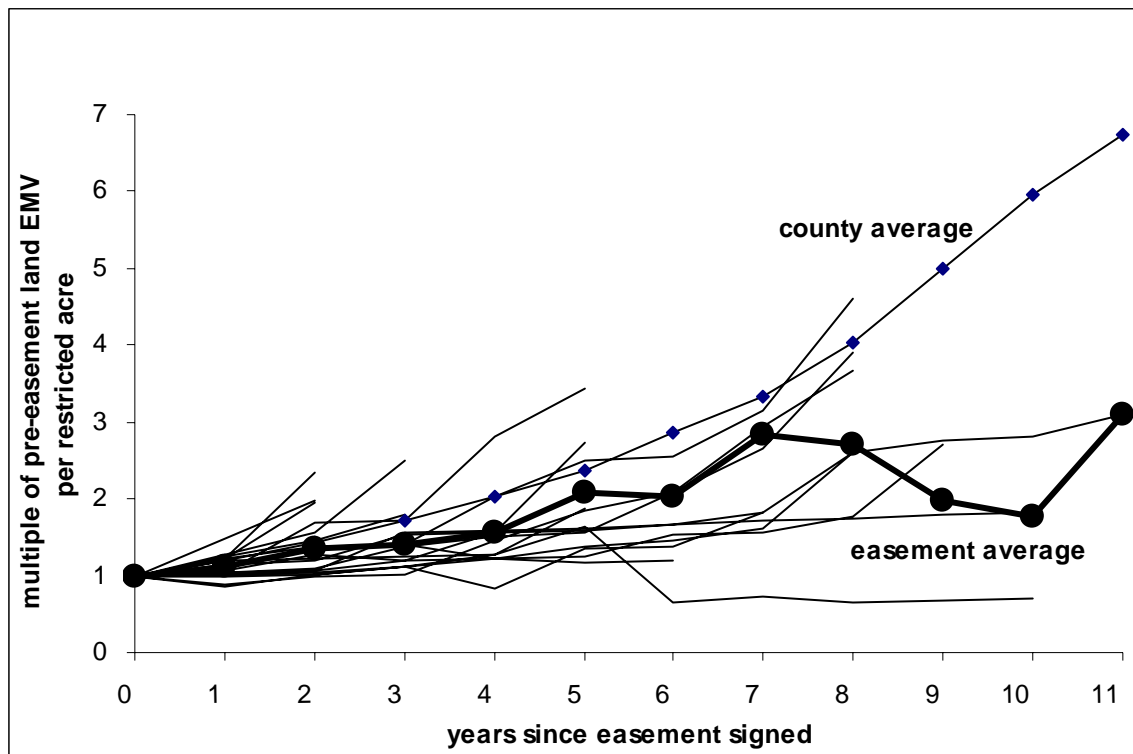


Figure 5 further adjusts the valuation histories by normalizing each valuation to its year-0 magnitude in the year of signing (Year 0). Valuations that take the easement into account start in Year 1. The wide range in movements is still evident, but all except a few went up at a rate lower than did the county average for non-restricted land. The simple average movement (the heavy line) increases slowly over the first several years, then exhibits more volatility because there are increasingly fewer easements over which to calculate an average.

Figure 5: Changes in indexed easement valuation per acre, adjusted for inflation



Discussion

In theory, easements because they restrict the options of current and future owners, ought to reduce the market value of a property, compared to what it would have been in its unrestricted state at the same point in time. But the valuation of an eased property could still go up over time: its total valuation could be just going up slower than comparable properties that are not restricted. This is the case with the bulk of the easements tracked in Figure 5. But there are other possible reasons for failing to observe a drop in property valuation once an easement is applied.

Just our observing that a property's valuation has increased doesn't necessarily mean that the Assessor thinks that its "true" market value has increased. The observed rise might be an artifact of assessment office administrative procedure. The assessor could be catching up on properties on some regular basis, and the eased property's turn happened to have come. This catching-up is a frequent occurrence in rapidly developing areas like Washington County, where full-scale re-assessments may not occur for three or four years until the office work load stabilizes. Or the property's valuation could change because the Assessor has changed the area-wide multipliers for different land classes used in standard assessment practice. This, too, is catching-up routine. Finally, if the parcel has been entered into the Metropolitan Agricultural Preserves, a farmland preservation program, it is to be assessed at its hypothetical agricultural value, whatever is its market value. A property, then, that exits one of these programs will be immediately assessed at the higher market value (as are all other properties not in the program).

Recommendations

No sweeping conclusions can be drawn from this study; none were expected. We examined all the non-cluster easements in the county, but this was only one county, and there were only 21 easements. The County has a highly professional, highly computerized property tax assessment office, but it still took us quite a bit of time to extract the data necessary to support this study. Part of that time can be assigned to our learning the structure of the records systems and the most efficient methods to gather the data. But even so, we estimate that, even now knowing how to do it, we would require an additional hour to pull together the relevant data for each additional easement in any future study.

To make the lot of the researcher simpler in the future (to improve our ability to extend this type of research), it would help if:

- The land trust recorded the PIN of each eased property when the easement is conveyed.
- The land trust recorded the boundaries of the initial conveyance on a large-scale plat book.
- The land trust entered each easement's boundaries into a GIS that was compatible with that of the County.
- The County recorded easement boundaries in its own GIS so that the assessor could more easily assign appropriate valuations to restricted lands.

To better serve both land trust and land owner interests, the land trust should:

- Track property changes over time, either through a requirement that the property owner report any changes or through annual reconciliations with the county's property tax records.
- Require the owner to submit the full appraisal report that is submitted to the IRS for income tax deductions.
- Encourage the land owner to submit the donated easement's appraised value to the county assessor, so that the property can be appropriately re-valued.

These steps would permit researchers to more quickly extract relevant property tax information from the County records. The land trust would also be able to better inform potential donors about the property tax implications of easement application.

Conclusion

This study examined only one aspect of the fiscal impacts of conservation easements. On average, valuations of properties with development rights restrictions increased over the years at a rate lower than did those of unrestricted properties. There was a wide divergence in the valuation histories of individual parcels, however, suggesting that easement advocates need to be cautious about claiming that easements lead to reductions in taxes.

With the easement data we examine here, which cover one county in Minnesota over a 10-year period, we can obviously only begin to estimate the longer run tax implications of easements. Different assessors will apply different policies. It is not our intention to prescribe the "proper" re-valuation procedure. Our intent was to demonstrate how one might go about doing such an analysis in any particular taxing jurisdiction. Alas, the procedure proved less straightforward than we'd anticipated: real property markets, such as that examined here, are more complicated than those portrayed in our textbooks. As a result, analysis involving data from real property markets, such as that described here, is more complicated than would at first blush seem necessary.

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