

**CONSERVATION EASEMENT PROGRAM
ANNUAL REPORT
TO THE
ENVIRONMENTAL REVIEW COMMISSION**

Fall 2009

Pursuant to NC G.S. §113A-235(c), the Department of Environment and Natural Resources reports to the Environmental Review Commission each year on the implementation of Article 16, the Conservation Easement Program. This Article, §113A-230 through §113A-235, includes enabling legislation for a program for conservation easement promotion/education, conservation tax credit promotion/education and quality assurance of conserved lands, and enabling legislation for a conservation grant fund. The following reports on these programs.

North Carolina Department of Environment and Natural Resources

Conservation Easement Program G.S. §113A-235 (c), Article 16 (also known as the Conservation Incentives Program) includes three components:		
§113A-230 Conservation Easement Program	§113A-231 Conservation Tax Credit Program	§113A-232 Conservation Grant Fund
Stewardship program monitors state-owned easements, currently Ecosystem Enhancement Program and Conservation Reserve Enhancement Program properties	Certifies donor gifts of interests in real property for conservation purposes	Currently holds funds for stewardship program; potentially applicable to other conservation programs

THE YEAR IN SUMMARY

Significant progress has been made in the development and integration of the programs within Article 16 during the past year.

Conservation Tax Credit Program

The number of donations, number of acres and estimated value of donations of interests in real property donated for conservation purposes declined the past year. For fiscal year 2008-09, 115 applications for certification were approved for the conservation of 13,000 acres, which brings the cumulative total to 201,000 acres.

Conservation Grant Fund

This program houses the endowment established to support monitoring and management of wetland and stream mitigation sites, as well as sites protected through the Conservation Reserve Enhancement Program of the Division of Soil and Water Conservation. These monitoring activities are managed by the DENR Stewardship Program. More information about this program is provided below.

Conservation Easement Program

The use of conservation easements continues to grow. The Department of Environment and Natural Resources (DENR) has taken the role of administering the monitoring of Ecosystem Enhancement Program (EEP) preservation mitigation easements. The Stewardship Program director coordinates these monitoring activities, and is advancing several strategies that will increase the program's efficiency and effectiveness. In 2009, DENR expanded these stewardship activities to include monitoring permanent conservation easements for the Conservation Reserve Enhancement Program (CREP). A computer-based monitoring tracking database was implemented. Several DENR and non-DENR agencies have expressed an interest in using the application to track property monitoring. The broader category of stewardship, including management for ecological values, remains largely unaddressed.

ANNUAL PROGRAM UPDATE

Conservation Easement Program §113A-230

Established in 1997, this program is intended to use promotion, education and quality assurance to increase the use of conservation easements as a tool to accomplish conservation goals, such as the Million Acre Initiative. The use of conservation easements continues to grow, especially as they provide a key mechanism for water quality protection used by the Clean Water Management Trust Fund, the Conservation Reserve Enhancement Program and the Ecosystem Enhancement Program. To date, the NCDENR agencies hold approximately 600 conservation easements covering more than 70,000 acres. In response, there is now a working group comprised of representatives of most of the state agencies that utilize conservation easements. Among the goals of the working group is to communicate issues and concerns to each other, and develop consistent responses to common situations. The working group is also making an effort to anticipate and address potential problems, and make sure that the public's investment in conservation is maintained for the future.

There is also continued growing acceptance of conservation easements within the farming and forestry communities, due to increased incentives provided by several programs. The General Assembly's 2007 legislative changes to G.S. §105-130.34 and G.S. §105-151.12 explicitly identifies farmland and forestland conservation as a public benefit for the conservation tax credit. The N.C. Agricultural Development and Farmland Preservation Trust Fund has further promoted easements on working lands. The expanded federal conservation tax incentive (Income Tax Charitable Contribution Deduction) gives particular inducement to farmers and ranchers. As a result, an increasing number of farmland easement donations are being submitted for conservation tax credit certification, accounting for a significant proportion of donations this past year for conservation tax credit (see graph 1 at end of report).

Stewardship of Conservation Easements

With the growing number of conservation easements generated through the Clean Water Management Trust Fund, Ecosystem Enhancement Program, Conservation Reserve Enhancement Program and other programs, comes a growing responsibility for monitoring and effective management of their conservation values. In 2005 the department began taking steps toward funding monitoring activities for DENR-related conservation easements. In 2006 the DENR Stewardship Program was established. Funds for the programs are generated through payments into the Conservation Grant Fund Endowment to cover administrative/management costs. The intent is to expand this endowment and the Stewardship Program incrementally until all conservation easements held by the state are assured proper monitoring and management of their public purposes and values. Currently two agencies have contracted to participate in the Stewardship Program: the EEP and CREP. Through EEP, there are currently 100 projects on 12,732 acres. The current CREP totals are 1,075 projects on 25,162 acres.

In its initial year, the Stewardship Program administered 71 properties in a pilot project. The cost to conduct monitoring visits to each of these properties to document site condition was \$29,000, which did not include enforcement or management. Since this

amount exceeded the available interest earned from the Conservation Grant Fund Endowment, the current endowment per property is inadequate. Additional expenses resulted from enforcement of two easement violations reported as a result of the monitoring in 2007, which exacerbated the funding shortfall.

Partly in response to having an inadequate endowment, 15A NCAC 02R .0402 was amended. As of 2008, properties and easements donated to the N.C. Department of Environment and Natural Resources require a fee of \$1,064 per acre at the time the land or easement is transferred to the department's Conservation Grant Fund Endowment. For properties that are less than one acre in size, the minimum payment shall be \$1,064. This charge applies only to properties and easements donated to the department for the sole purpose of property or easement maintenance. This does not apply to properties or easements donated to the department in association with restoration projects conducted by the department.

One of the main projects the DENR Stewardship Program took on this year was the development and implementation of an Internet-accessible database to track the monitoring of conservation easements. Several DENR and non-DENR agencies have expressed interest in using the application to track property monitoring. The broader issue of long-term stewardship, including management for ecological values, remains largely unaddressed due to limited financial resources.

Conservation Tax Credit Program 113A-231

The state's Conservation Tax Credit was established in 1983 to respond to donors' applications for certification of their gifts of interests in real property for conservation purposes. In 2007, changes in the Conservation Tax Credit legislation (G.S. §105-130.34 and G.S. §105-151.12), as well as problems reported in other states' programs, led to a comprehensive review of the policies and guidelines used to implement the N.C. Conservation Tax Credit program. In 2008, program staff worked with resource agency reviewers, qualified recipients and others to review the Conservation Tax Credit program. The resulting improvements include a revised application, a new Web site and development of reviewer guidelines. These guidelines should help our conservation partners understand the expectations for qualified tax credit properties, simplify the certification process and reduce confusion. Potential donors or recipients are encouraged to contact the department with questions. The process for reconsideration of rejected applications was also formalized as part of the review. A Conservation Tax Credit Certification Review Committee was established, comprised of representatives of the resource agency reviewers. An added benefit of the Conservation Tax Credit Certification Review Committee is that it encourages communication among reviewers, and should help maintain consistency in the review process.

There is sustained interest in the N.C. Conservation Tax Credit program:

- o Over the past year, 127 applications were reviewed for eligibility, of which 115 were certified. (Graph 2 shows only 96 applications for 2008, because 31 of the reviews conducted during 2008 were for donations that had been made in 2007 or earlier.)

- o The certified projects totaled more than 13,000 donated acres of property interests, worth an estimated \$177 million. (See graphs 3 and 4 at end of report).
- o Since its establishment, more than 200,000 acres have been donated, and the applicants have reported to the Conservation Tax Credit program an estimated value of \$1 billion for these donations over the duration of the program.

As shown in Graphs 2, 3 and 4, the number of donations, number of acres and estimated value of donations of interests in real property donated for conservation purposes declined the past year. It should be noted that it was a difficult time for conservation overall, due to economic stress at national and state level, which among other things limited available conservation funding.

In response to 2007 legislative changes that clarified public benefits and made other changes to the Conservation Tax Credit, reviewers have increased scrutiny of donations. The number of applications that did not receive favorable review was overall low this past fiscal year. Four that were initially disapproved secured approval during the reconsideration process and by providing additional information. For the 12 applications that were not certified to provide public conservation benefit, the reasons for rejection included:

- Eight donations contained provisions in recorded instruments of transfer (such as a provision for the parcel to revert to the grantor, or retained mineral rights), that are not consistent with the requirement of perpetuity. Thus, the donations would not be eligible for the Conservation Tax Credit.
- The recipient was not qualified, as defined in G.S. §105-130.34 and G.S. §105-151.12. In this case, the recipient was the federal government.
- No significant fish or wildlife habitat provided; no public access to public trails and waters. The donation was a conservation easement on a golf course. Subsequently, the Attorney General's office provided an informal opinion that the use of land for golf courses is not entitled to certification of a public benefit under either N.C.G.S. §105-130.34 or N.C.G.S. §105-151.12. This relates to tees, fairways, traps, greens, areas for in-bounds play, cart paths and any other areas modified for golf course use.
- Multiple building areas were reserved within the conservation area. If exercised, the associated development would fragment and degrade habitat, compromising the contribution to fish and wildlife conservation.
- The donation did not merit certification as providing the public benefit needed to qualify for a Conservation Tax Credit. The Review Committee examined the donation with respect to the public benefits defined in G.S. §105-130.34 and §105-151.12.

Reviewers are working diligently to ascertain public benefits of donations. One of the perceived strengths of conservation easements is that they are flexible and can be tailored to individual landowner's preferences. However, numerous or extensive retained rights within a conservation easement can create a challenge for reviewers, as they evaluate the public benefit of a donation. With multiple rights retained, the reviewers will continue to look for the balance of public benefit and resource protection with the cumulative

potential impact of the retained rights. Keeping in mind that the current, well-intentioned landowner will not always own the property, the reviewer must ascertain not only whether the donation provides one or more of the public benefits defined in the legislation, but also if the instrument of transfer adequately protects/conserves the public benefit(s).

The conservation tax credit remains a value to taxpayers, as demonstrated in Graphs 5 and 6. While the CTC program has reduced revenue to the state between \$15 and \$25 million each year over the past five years, during the same period the program has leveraged donations of conservation land with values between \$80 and \$195 million per year – representing a significant savings to the state. And, the conservation tax credit is an effective leveraging tool. When used in conjunction with bargain sales, the conservation tax credit can yield substantial savings for conservation trust funds, local governments and nonprofit organizations purchasing land. At least 210 of the 1,200 certified donations made in the past 25 years have included some bargain sale component, such as the 63-acre bargain sale to Guilford County in 2008 that will be used to double the size of a new nature park. The new applications are providing information that documents how the conservation tax credit is being used to leverage multiple funding sources, from federal (e.g. USDA Forest Legacy), to state (e.g. Clean Water Management Trust Fund or Agricultural Development and Farmland Preservation Trust Fund) to local open space funds. For example, in the past year, the Conservation Tax Credit Program helped the Upper Neuse Clean Water Initiative, Buncombe County Land Protection Grants and the Guilford County Parks and Open Space Bond all stretch limited resources further.

The department has the statutory responsibility to protect real property and interests in real property conserved in perpetuity by state incentive programs. Fulfillment of this responsibility will require monitoring of these properties to assure that their conservation purposes are not jeopardized. The new but limited stewardship program discussed earlier under the Conservation Easement Program needs to be expanded incrementally to provide quality assurance for all conserved properties. The current absence of permanent, full-time staff and line item budget prohibit implementation of those stewardship activities that would fully protect the public's conservation assets, but progress is being made. During the past year, advancements toward monitoring conservation tax credit properties include:

- Mapping the conservation tax credit donations certified by DENR through May 2009. The Center for Geographic Information and Analysis (CGIA) was contracted for this task. The dataset is available to the public through the NC OneMap database (www.nconemap.com) and the data download function.
- Maintenance of two databases: one for tracking current applications under review; and, one that contains all projects that have been certified in the past 25 years. This second database is understandably large, but almost populated, and greatly helps in compiling numbers for reports such as this.
- Progress on contacting recipients to ascertain the status of properties, and to ensure that conservation easements are being monitored annually.

- Added case study information for the Web site, under “Conservation Success Stories” (http://www.onencnaturally.org/pages/Success_Stories.html), and presented at continuing education seminar dealing with conservation easements. The intended audience at the seminar was private landowners, financial planners, appraisers, attorneys, real estate professionals and foresters.

Work remains to further refine the Conservation Tax Credit program. One question from the review of the program that has not yet been addressed concerns the qualifications of recipients. This question, and some clarification of conservation in perpetuity, are further addressed in the “Recommendations and Additional Topics for Consideration” at the end of this report.

Conservation Grant Fund 113A-232

The Conservation Grant Fund was established in 1997 to stimulate the use of conservation easements, to improve the capacity of private nonprofit land trusts and agencies to successfully accomplish conservation projects, to better equip real estate-related professionals to pursue opportunities for conservation, and to provide an opportunity to leverage private or other public monies for the stewardship of conservation easements.

In 2005, the General Assembly approved one-time funding in the amount of \$1 million directed to the conservation of land that buffers military bases and training areas with compatible land uses. Sixteen projects were funded, benefiting all North Carolina military installations. The Conservation Grant Fund has proven to be a sound framework for moving conservation projects forward, and it could be utilized to a greater extent. Staff will explore possible applications of this tool to provide further public benefits.

RECOMMENDATIONS FOR CONSIDERATION

Through management of the Conservation Tax Credit program and observation of evolving approaches to conservation through incentives, a number of topics have surfaced that may deserve consideration. However, there is one issue that stands out. The following recommendation could improve the administration of the Conservation Tax Credit program and/or the incentive offered by the state for donation of interests in real property for conservation purposes, and enhance its effectiveness in maintaining the public trust.

Recommendation

Clarify Definition of “Qualified Recipient” and Conservation in Perpetuity

During the review of the N.C. Conservation Tax Credit program by staff, and through conversations with reviewing agencies, the Department of Revenue, and the public, it was noted that the current legislation does not clearly require that the recipient of the donation must maintain the conservation values of the property and whether the recipient

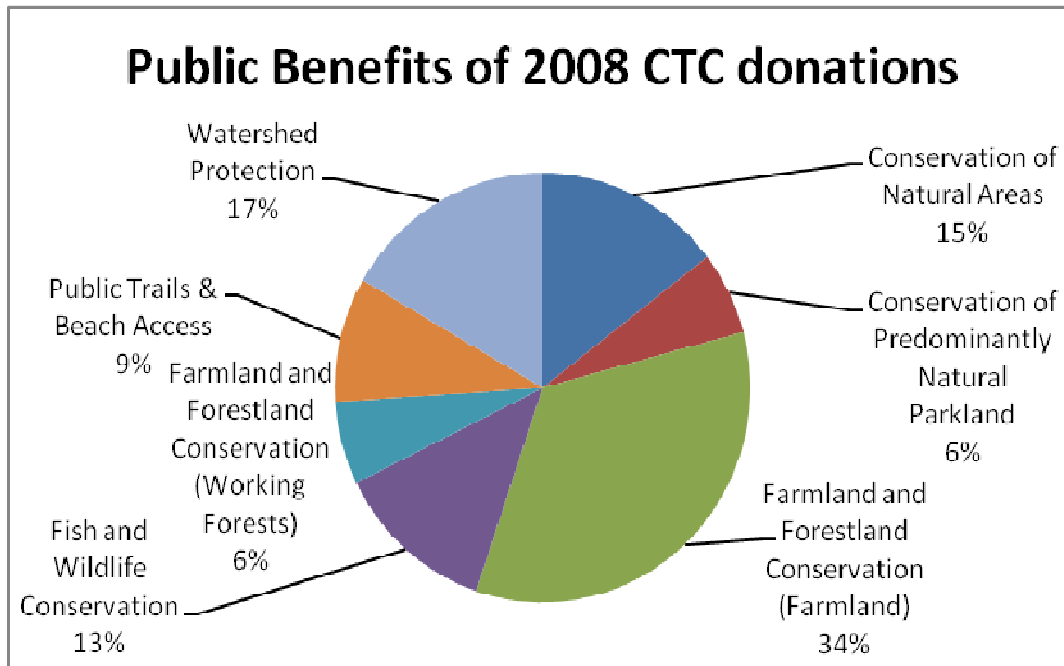
must be able to demonstrate that it has the ability to meet that expectation. Updating the legislation to clarify that point would help North Carolina remain in line with federal requirements to ensure adequate conservation and stewardship.

The Department of Environment and Natural Resources looks forward to working with the Department of Revenue to determine the best approach to review and, perhaps seek legislative clarification on this matter.

DATA REGARDING N.C. CONSERVATION TAX CREDIT PROGRAM

Graph 1: Primary public benefits for 2008 conservation tax credit donations (under G.S. §105-130.34 and G.S. §105-151.12). Note that most donations provide multiple additional public benefits.

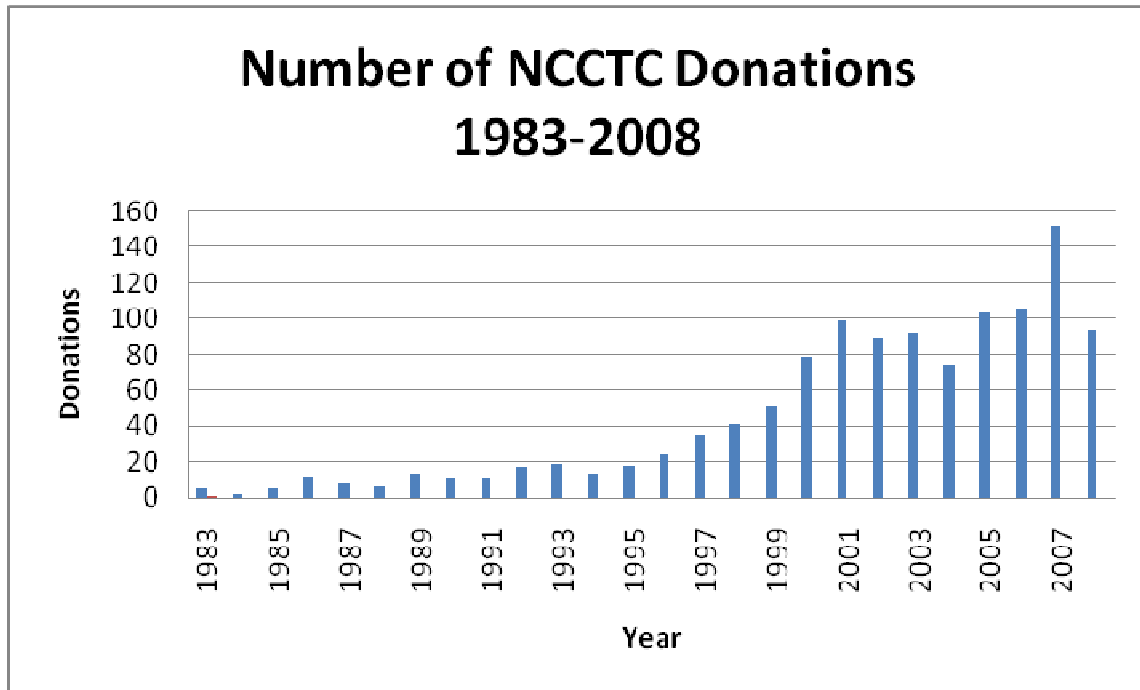
Graph 1



Graph 2: Cumulative Number of Donations since Inception of NCCTC Program

Over the past year, 127 applications were reviewed for eligibility, of which 115 were certified. (Graph 2 shows only 96 donations for 2008, because 31 of the reviews conducted during 2008 were for donations that had been made in 2007 or earlier.)

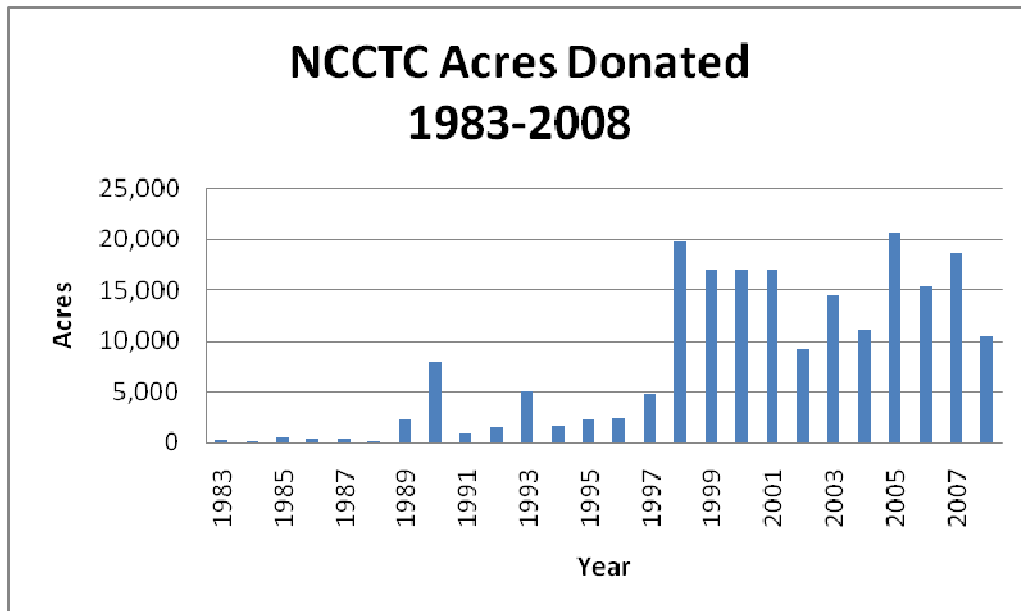
Graph 2



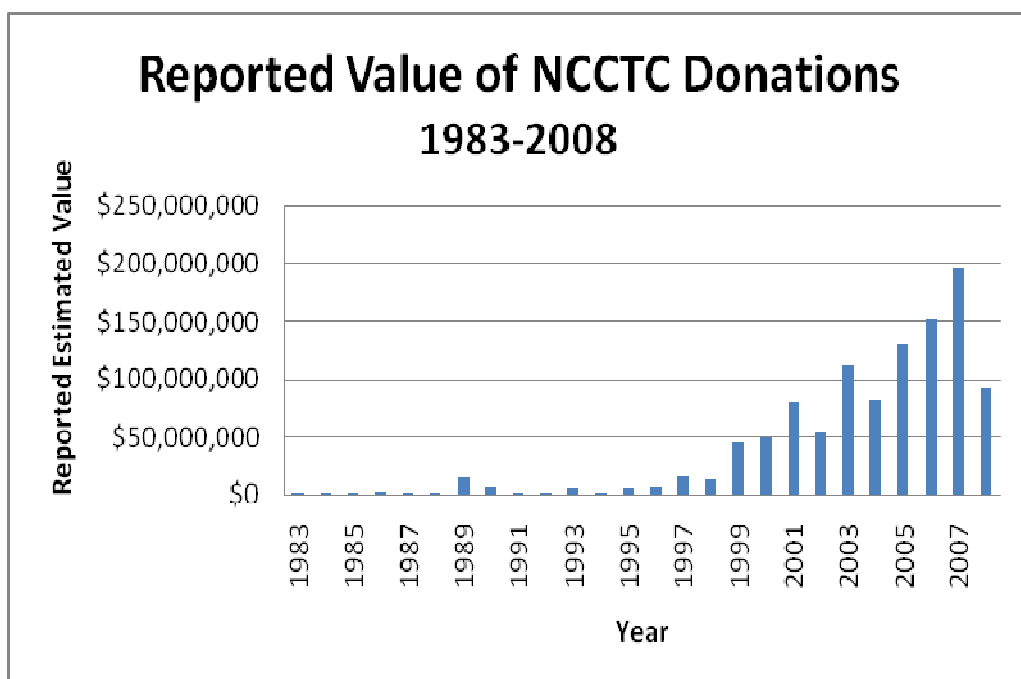
Graphs 3 and 4: Acreage Donated and Estimated Value over time

For 2008, the certified projects totaled more than 13,000 donated acres of property interests. These are worth an estimated \$177 million.

Graph 3



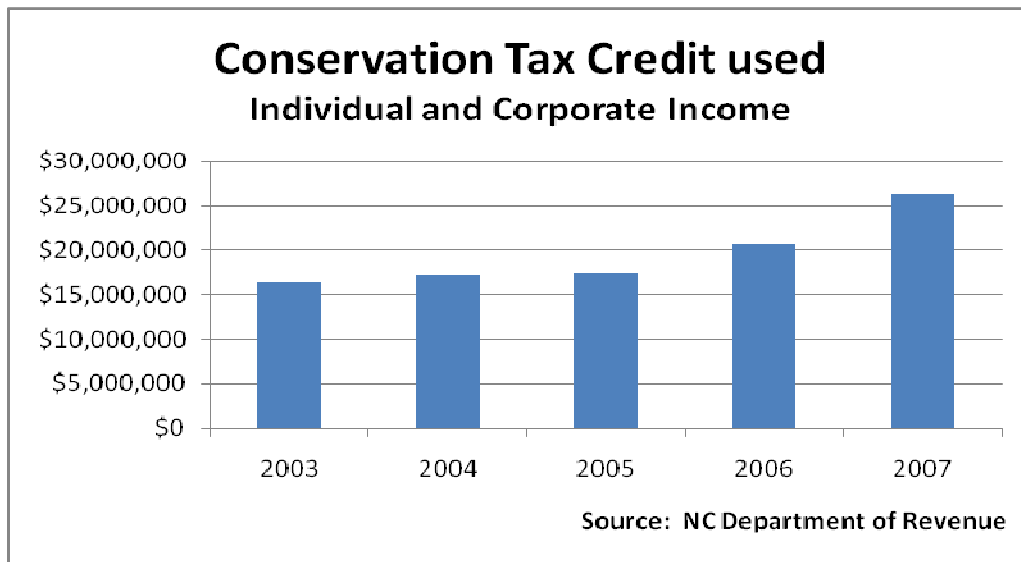
Graph 4



Graphs 5 and 6: Individual and Corporate Tax Credit Used 2003 – 2007 and Reported Value

These graphs demonstrate the relative value of the Conservation Tax Credit, comparing the actual credit used by donors (Graph 5) and the credit used in comparison to the reported values of the donations (Graph 6)

Graph 5



Graph 6

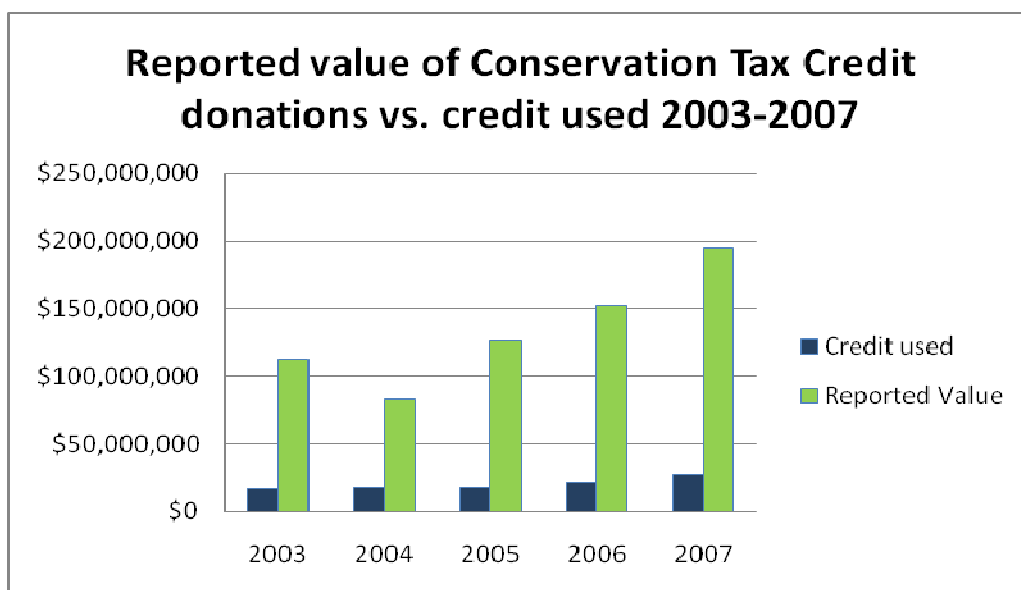


Figure 1

Distribution of Conservation Tax Credit properties

