



North Carolina Department of Environment and Natural Resources

Beverly Eaves Perdue
Governor

Dee Freeman
Secretary

October 3, 2011

MEMORANDUM

TO: ENVIRONMENTAL REVIEW COMMISSION
The Honorable David Rouzer, Chair
The Honorable Mitch Gillespie, Co-Chair
The Honorable Ruth Samuelson, Co-Chair

FROM: Kari Barsness *KKB*
Director of Legislative and Intergovernmental Affairs

SUBJECT: Conservation Easement Program Annual Report

Pursuant to G.S. 113A-235(c), the Department of Environment and Natural Resources shall report on the implementation of Article 16, the Conservation Easement Program. This report shall be submitted to the Environmental Review Commission by October 1 of each year. Please consider the Conservation Easement Program Annual Report as the department's formal submission.

If you have any questions or need additional information, please contact me by phone at (919) 715-4189 or via e-mail at Kari.Barsness@ncdenr.gov.

cc: David Knight, Assistant Secretary for Natural Resources
Linda Pearsall, Director, Office of Conservation, Planning and Community Affairs
Kristin Walker, Fiscal Research Division
Lanier McRee, Fiscal Research Division
Claire Hester, Fiscal Research Division
Mariah Matheson, Research Division

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

Fall 2011

North Carolina Department of Environment and Natural Resources

EXECUTIVE SUMMARY

Pursuant to G.S. 113A-235(c), the Department of Environment and Natural Resources (DENR) 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.

Conservation Easement Program

The use of conservation easements continues to grow, including for farmland preservation. DENR was instrumental in development of a conservation easement guidance document for the Soil and Water Conservation Districts, and is also building capacity for monitoring of conservation easements through the Stewardship Program

Conservation Tax Credit Program

For fiscal year 2010-11, 58 applications for certification were approved for the conservation of 7,000 acres, bringing the cumulative acreage to 220,000 acres. The economic downturn has contributed to the reduced number of donations of interest in real property donated for conservation purposes during the past fiscal year, and a corresponding decline in the number of acres donated. The department continues to improve implementation of the tax credit program, including S.L. 2010-167, which clarified the conservation tax credit's requirement for conservation in perpetuity.

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. These monitoring activities are managed by the DENR Stewardship Program.

ANNUAL PROGRAM UPDATE

Conservation Easement Program - G.S. 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 easements 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, these DENR agencies hold approximately 600 conservation easements covering more than 70,000 acres. A working group comprised of representatives of most of the state agencies that utilize conservation easements coordinates agency actions involving 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 ensure that the public's investment in conservation is protected into the future.

There is 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 identify 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, a 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). However, that trend is expected to slow to some degree, as the federal tax incentive expired in December of 2009. The enhanced federal tax deduction for conservation easement donations was recently renewed, but will expire again at the end of 2011. In response to increased demand for conservation easements for agricultural lands, the DENR was instrumental in the development of the "Working Lands Conservation Easement Guidance Document" for the Soil and Water Conservation Districts. The document is available from the North Carolina Association of Soil and Water Conservation Districts.

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 2006 the department established the DENR Stewardship Program. Program funds are generated through payments into the Conservation Grant Fund Endowment to partially offset administrative/management costs. The monitoring aspect of conservation easements is receiving attention, and from all appearances is moving in the right direction; however, the broader issue of long-term stewardship, including management for ecological values, remains largely unaddressed due to limited financial resources.

Conservation Tax Credit Program - G.S. 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. Last year's report highlighted the need to clarify that the recipient of the donation must maintain the property's conservation values. The General Assembly addressed this issue of conservation in perpetuity with S.L. 2010-167, which clarifies the conservation tax credit's requirement for conservation in perpetuity, and helps to protect the public investment. The new legislation is changing how donations are reviewed, and potential donors and recipients are encouraged to contact the Conservation Tax Credit Program with questions.

Evidence of sustained interest in the Conservation Tax Credit Program:

- Over the past year, 59 applications were reviewed for eligibility, of which 58 were certified. (Graph 2 shows only 42 projects for 2010, because 16 of the reviews conducted during FY 2010-11 were for donations that had been made in other years, primarily 2009).
- The certified projects totaled 7,000 donated acres of property interests, worth an estimated \$42 million. (See graphs 3 and 4 at end of report).
- Since its establishment, 220,000 acres have been certified by the Tax Credit Program; and the applicants have reported to the Conservation Tax Credit program an estimated value of more than \$1.2 billion for these donations.
- In an effort to improve the program's customer service and improve the quality of the applications for certification, DENR now provides upon request a preliminary review of a potential project as a way to exchange information prior to implementing a gift and recording a deed or conservation easement. Seven preliminary reviews were conducted during the past year. Four of the seven preliminary applications were acceptable to reviewers with no changes recommended. On three additional projects, reviewers provided suggestions that would enhance the ability of the reviewers to certify the projects. These suggestions were implemented in one of the projects, where the property interests were subsequently transferred, and the other two are awaiting transfer.

As shown in Graphs 2, 3 and 4, the number of donations, the number of acres, and the estimated value of donations of interests in real property declined during the past year. These declines correspond to the national economic downturn that has not spared North Carolina. Still, from 2007 to present, 420 donations have been certified for a range of beneficial conservation projects, totaling almost 56,000 acres. The smallest of those was less than one acre for a public beach access in Dare County. The largest in area during that same time was a 3,176-acre bargain sale at Grandfather Mountain for a new State Park. The average donation from 2007 to present was 134 acres, and the median was 62 acres. During this same time, 309 of the 420 donations in real property were conservation easements (74 percent); the remaining donations were fee simple gifts.

In response to 2007 legislative changes that clarified public benefits and made other changes to the Conservation Tax Credit Program, agency reviewers have increased their scrutiny of donations. There have been significantly fewer donations overall the past fiscal year, and only one application did not receive initial approval; that application is currently going through the reconsideration process. The reason the initial resource agency reviewer would not support certification included:

- The donation did not meet the guidelines for conservation of natural areas as that term is defined in G.S. 113A-164.3(3). The natural portion of the protected area was not large, and fragmented by roads, railroad track, impounded stream channels, and planted pine stands. The retained rights -- including multiple building locations for houses, other buildings, tennis courts, and associated development for roads, driveways, and utilities -- offered the high probability of further loss of the integrity of the remaining natural habitat, especially as the building locations were not specified.

One of the perceived strengths of conservation easements is that they are flexible and can be tailored to meet 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) after the current landowner has transferred the property.

The conservation tax credit provides significant benefits to the state, as demonstrated in Graphs 5 and 6. From 2003 to 2008, the CTC program reduced revenue to the state on average \$20 million each year; during the same period the program leveraged donations of conservation land with an estimated value over \$120 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 245 of the 1,300 certified donations made since the inception of the conservation tax credit have included some bargain sale component. For example, 15 of the 58 transactions reviewed and certified the past year had a bargain sale component, including: conservation easements for farms in Sampson, Randolph, Buncombe, Chatham, Lincoln and Catawba Counties; a 35-acre parcel that will be added to the Blue Ridge Parkway; a 1,330-acre property along the Cape Fear River for a Wildlife Resources Commission Game Land; smaller parcels that will be added to greenways in Durham and Mecklenburg Counties; and, a 135-acre parcel that is part of a larger effort to protect water quality and buffer the training mission of Marine Corps Air Station Cherry Point. New Conservation Tax Credit application forms are documenting how the conservation tax credit is also being used to leverage multiple funding sources, from federal (e.g. U.S. Department of Defense Legacy, USDA Farm and Ranchland

Protection Program,), to state (e.g. Clean Water Management Trust Fund, DOJ Environmental Enhancement Grant, and Agricultural Development and Farmland Preservation Trust Fund) to local open space funds. For example, in the past year, the Conservation Tax Credit Program supported projects funded by the above-mentioned conservation funds as well as the Upper Neuse Clean Water Initiative, private individual and corporate donations to North Carolina land trusts, 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 requires 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. Staff and resources are stretched thin, but progress is being made. During the past year, advancements toward monitoring conservation tax credit properties include:

- Continued mapping of the conservation tax credit donations certified by DENR. The dataset through May 2009 is available to the public through the NC OneMap database (www.nconemap.com). Donations through August 2011 are mapped, and the NC OneMap database will soon be updated.
- Maintenance of two databases: one for tracking current applications under review; and, one that contains all projects that have been certified. This second database contains more than 1,300 records, and greatly helps in compiling reports such as this.
- Progress continues on contacting recipients to ascertain the status of properties, and to ensure that conservation properties are being monitored, and that the properties continue to provide public benefits. The conservation status of over 900 properties has been verified. The properties yet to be verified are predominantly those donated to local governments for public access. Work has begun to verify the status of those properties.

Three properties have been identified which no longer provide public benefits. In one case, a fraudulent conveyance resulted in the loss of a conservation easement that had been granted to a North Carolina land trust. While the loss of the easement is regrettable, DENR considers the loss of the conservation interest through the criminal prosecution and bankruptcy as a one-time occurrence that was unavoidable. The NC Department of Revenue and the NC Department of Justice were made aware of the incident. In a second incident, the monitoring of Conservation Tax Credit properties revealed that investigation into gift valuation had brought about legal proceedings, subsequently resulting in the loss of one conservation easement (the conservation easement was rescinded and declared void by the Judge of Superior Court in March, 2010), and the imminent transfer of the recipients' two other property interests to qualified recipients. Lastly, the past fiscal year also saw continued effort to transfer a 13-acre conservation property held by the National Audubon Society to a non-qualified recipient, and the potential new owners moving to convert the property to land uses that do not provide conservation purposes; this proposed transfer contributed to the legislative changes noted below.

In July 2010, the General Assembly passed S.L. 2010-167, the purpose of which, among other things, was to “CLARIFY THAT REAL PROPERTY DONATED FOR A CONSERVATION PURPOSE CAN BE USED ONLY FOR THAT PURPOSE.” It became effective in August 2010. In the legislation, to obtain the tax credit, the interest in real property must be “donated in perpetuity for one of the qualifying uses listed in this subsection and accepted in perpetuity for the qualifying use for which the property is donated...” In order to comply with the new legislation, the recipient now must record in the chain of title how the property will be conserved in perpetuity. The Conservation Tax Credit web site <http://www.onencnaturally.org/pages/ConservationTaxCredit.html> offers multiple options for the recipient to comply with this requirement, allowing them to choose what is most appropriate depending on the particular factors associated with the transfer of property interests.

Conservation Grant Fund – G.S. 113A-232

To conserve, protect and enhance the natural resources of North Carolina, DENR and related agencies protect restored or high-quality natural areas through easement purchases or fee simple acquisitions. These state-held conservation lands must be managed in perpetuity to protect water quality, wildlife habitat and open space. As noted above, the department has set up the Stewardship Program under the Conservation Grant Fund to ensure responsibility for long-term stewardship of lands with conservation easements held by the state of North Carolina. To protect the ecological integrity of these conservation properties, stewardship activities include:

- monitoring,
- legal protection and enforcement, and
- site-management activities

The department 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 the past two years, DENR expanded these stewardship activities to include monitoring permanent conservation easements for the Conservation Reserve Enhancement Program (CREP). A web-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 Stewardship Program reports annually to the EEP. The reports are available at http://www.onencnaturally.org/pages/ST_Overview.html. The broader category of stewardship, including management for ecological values, remains largely unaddressed.

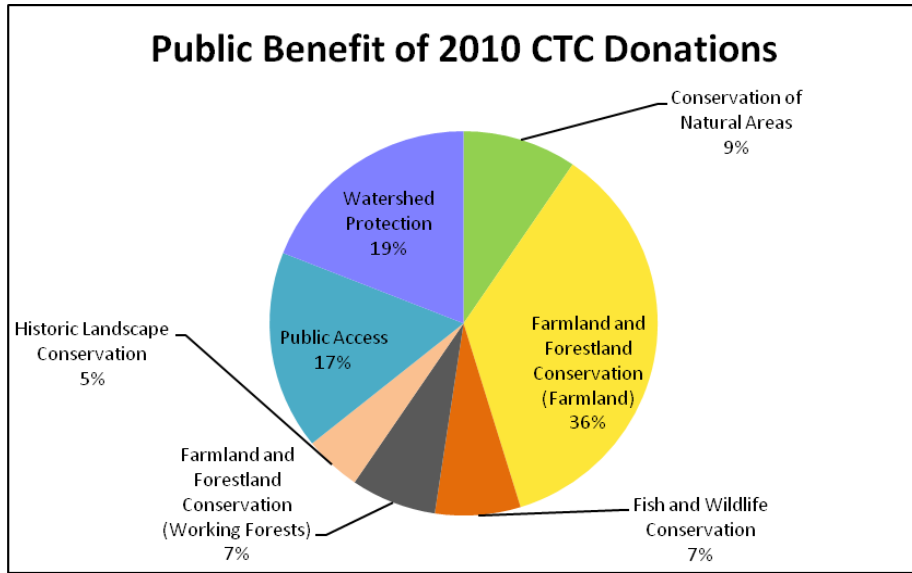
CONCLUSION

As described in this report, the acquisition of conservation lands is supported by tax incentives and the work of partners and willing landowners. Conservation lands are important for a number of reasons, including quality of life, economic well-being, and providing ecosystem services such as clean water. The program will continue working to ensure that tax benefits are provided to those properties that truly provide public benefits.

DATA REGARDING N.C. CONSERVATION TAX CREDIT PROGRAM

Graph 1: Primary public benefits for 2010 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.

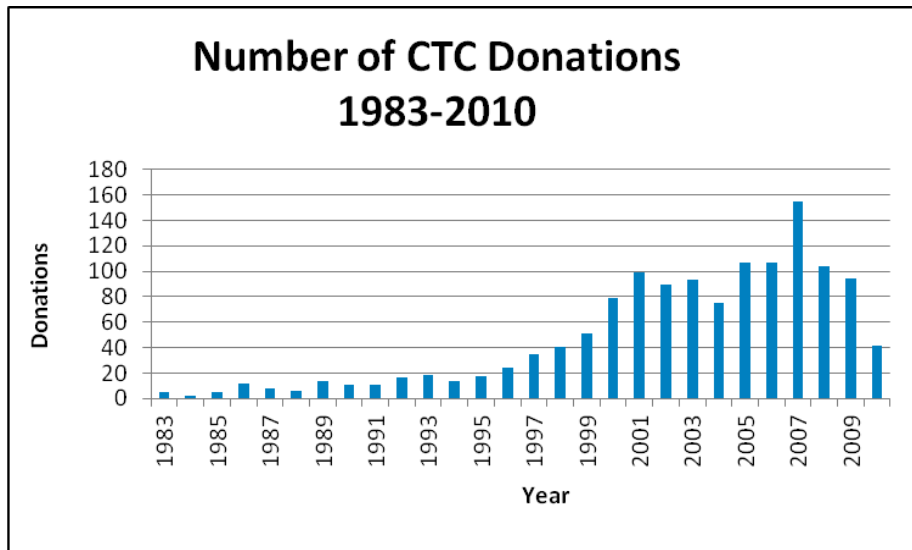
Graph 1



Graph 2: Cumulative Number of Donations since Inception of CTC* Program

Over the past year, 59 applications were reviewed for eligibility, of which 58 were certified. (Graph 2 shows only 42 donations for 2010, because 16 of the reviews conducted during 2010 were for donations that had been made in 2009 or other years.)

Graph 2

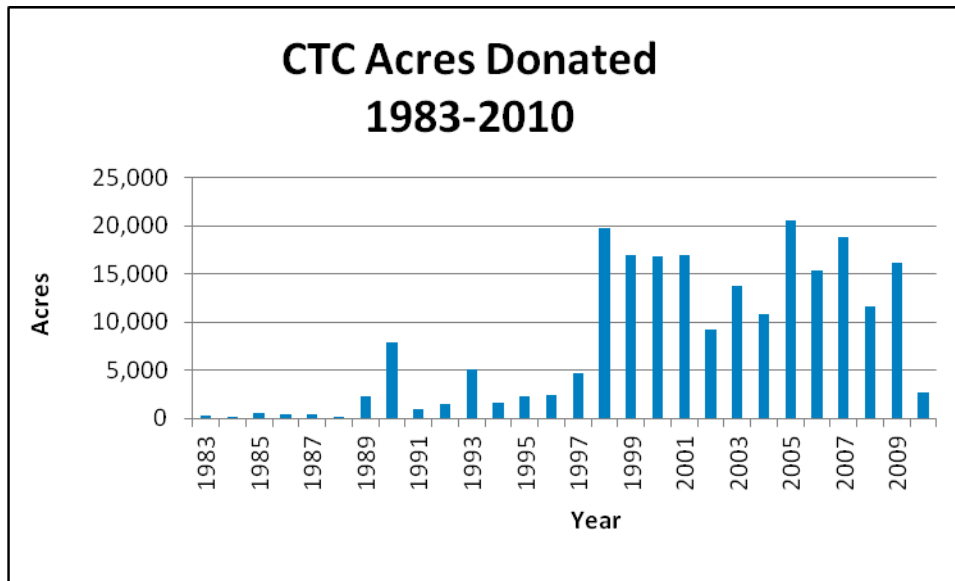


*Conservation Tax Credit

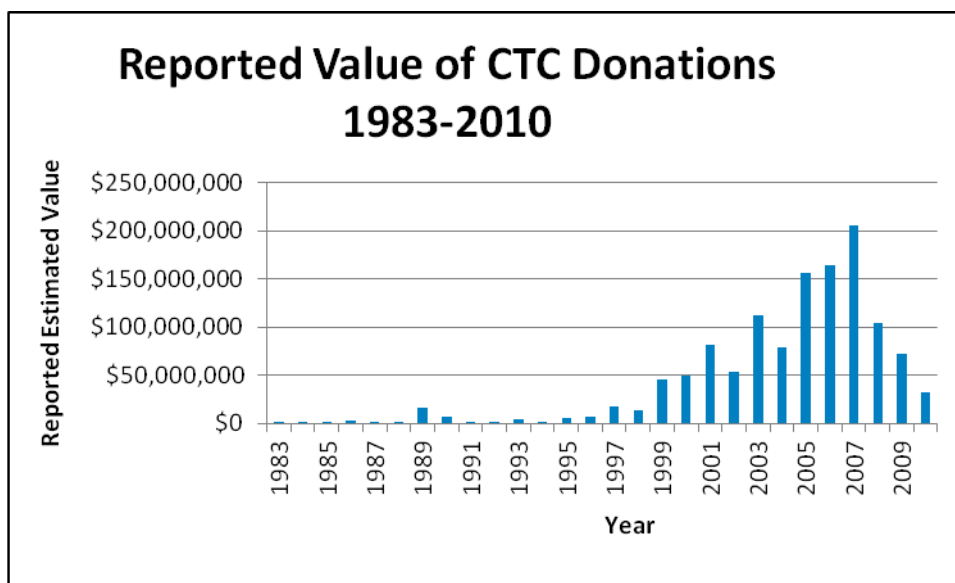
Graphs 3 and 4: Acreage Donated and Estimated Value over time

For 2010, the certified projects totaled more than 7,000 donated acres of property interests, worth an estimated \$42 million. (Note that some donations reviewed fiscal year 2010-11 were gifted in years other than 2010).

Graph 3



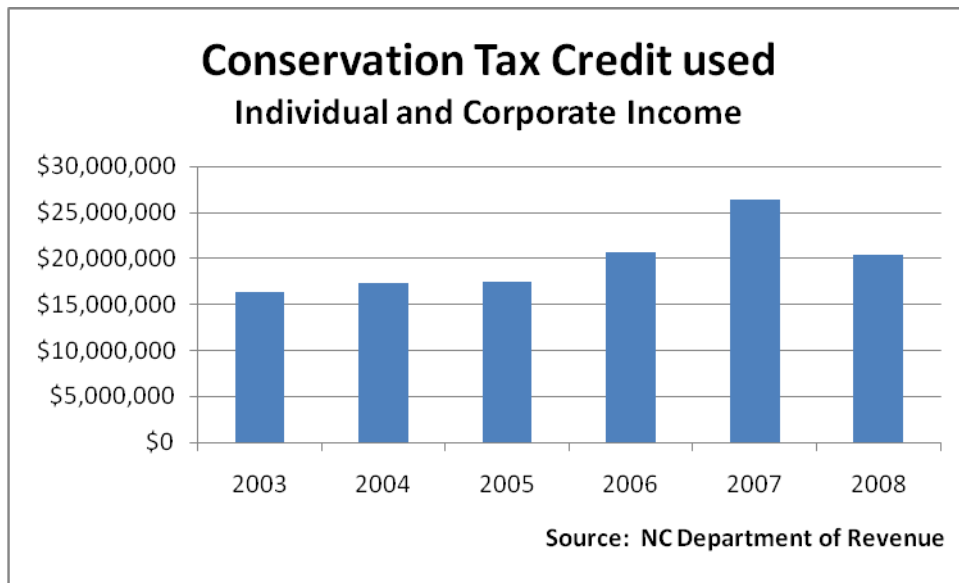
Graph 4



Graphs 5 and 6: Individual and Corporate Tax Credit Claimed 2003 – 2008 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

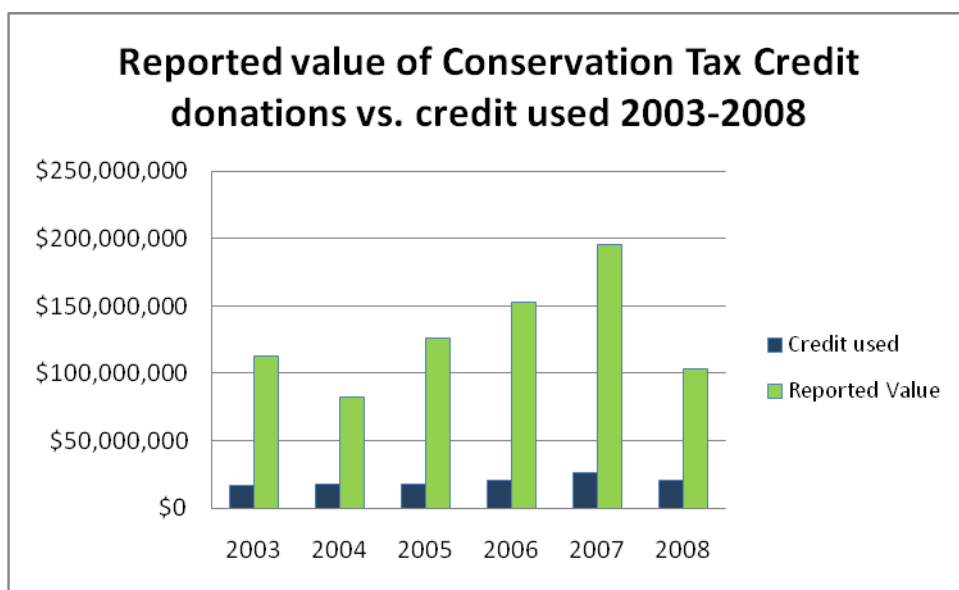


Figure 1

Distribution of Conservation Tax Credit properties

