

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

November 1, 2007

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

THE YEAR IN SUMMARY

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

Conservation Easement Stewardship. The use of conservation easements continues to grow. The Department (DENR) continued monitoring of some of its conservation easements this year, and plans to expand its activities for stewardship. DENR also has taken the role of administering the monitoring of Ecosystem Enhancement Program (EEP) preservation mitigation easements. A Stewardship Program Director has been hired to coordinate these specific activities. The broader category of stewardship, including management for ecological values, remains largely unaddressed.

Conservation Tax Credit Program. The number of acres and estimated value of donations of interests in real property donated for conservation purposes remains stable, but has not grown in several years. Over the last year, applications for certification have been approved for the conservation of 11,500 acres, which brings the total conserved acreage to 168,000 acres for the duration of the program.

Conservation Grant Fund. Only one of this conservation tool's grants programs received funds this year – the annual stewardship monitoring grant for conservation easements held by the Ecosystem Enhancement Program. This was the second year of funding for this program. The Military Support Act provided funds for the first time in 2006, which were used for transaction costs associated with the buffering of military training areas with compatible land uses. However, this grant program did not receive funding in 2007.

ANNUAL PROGRAM UPDATE

Conservation Easement Program 113A-230. Having been 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 are a key element of the Clean Water Management Trust Fund, Conservation Reserve Enhancement Program, and Ecosystem Enhancement Program as a mechanism for water quality protection. There is also growing acceptance of conservation easements within the farming and forestry communities.

In 2005 the Department began taking steps toward funding conservation easement quality assurance related activity. 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. This was begun in 2006 as a centralized receipts-based program supported by any agency prepared to make payments into the Conservation Grant Fund Endowment to cover administrative/management costs. The intent is to expand this Stewardship

Program incrementally until all conservation easements held by the State are assured proper monitoring and management of their public purposes and values. Two agencies have contracted to participate in the Stewardship Program: the Ecosystem Enhancement Program, and the Conservation Reserve Enhancement Program. At this writing, EEP is paying into the program. For the CREP easements, the Clean Water Management Trust Fund is incrementally contributing to an endowment, to build monitoring capacity.

In its initial year, the Stewardship program administered 71 properties in a pilot project. Monitoring costs alone for these 71 properties – which did not include enforcement or management -- was \$29,000. This exceeded interest earned from endowment, meaning that the current endowment per property is inadequate. Additionally, two easement violations were reported as a result of the monitoring in 2007, and the enforcement costs will exacerbate the funding shortfall.

Additional stewardship monitoring expansions need to be pursued, including having DENR agencies that hold interest in properties received through the NCCTC program to submit annual stewardship monitoring reports, as well as all private nonprofit land trusts to confirm their stewardship monitoring of conservation easements received through the NCCTC program.

The program is learning from the pilot project, and it demonstrates that much work remains to be done to accomplish maximum use of conservation easements by private landowners, balancing their related economic advantages with maintenance of the intended conservation benefits. In the past, the Department has combined the CE Program with the Conservation Tax Credit Program, and thus operated a limited CE Program (of promotion and outreach). While a more substantial and in-depth outreach program could greatly increase the use of conservation easements, it will also require more attention to the costs and complexities of conservation easement drafting and stewardship.

Conservation Tax Credit Program 113A-231. The State's Conservation Tax Credit was established in 1983, and this Department's role was passive, to respond to donor's applications for certification of their gifts of interests in real property for conservation purposes. In 1997 the Department received the authorization to begin a non-regulatory program of education/promotion to increase the use of conservation tax credits. Presentations have been made at workshops organized by other groups for landowners and land-related professionals, and there is a NCCTC display often set up at workshops and conferences. The website receives regular visits, but needs to be updated.

There is sustained interest in the NCCTC program. Cumulatively, more than 168,000 acres valued in excess of \$732 million have been donated. (See attached graphs). Over the duration of Conservation Tax Credit use, it has leveraged the donation of over \$240 million of excess value that was above the amount that could be used to create the maximum credit allowed. Further, 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. Over the duration of the

program, all grantees (state, local and non-profits) have saved more than \$152 million through bargain sales facilitated by the tax credit initiative.

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 monitoring (quality assurance) program discussed under Conservation Easement Program, above, needs to be expanded incrementally to all conserved properties (both CE and fee simple). The current absence of permanent, full-time staff and line item budget prohibit implementation of these activities to further protect the public's conservation assets.

The increasing benefits from the Conservation Tax Credit Program have been derived mostly from increases in the maximum tax credit allowed. Nevertheless, steadily increasing land values reduce the incentive offered by the Conservation Tax Credit over time. Therefore, the maximum credit allowed must increase periodically to retain the program's effectiveness.

The Conservation Tax Credit is currently applied against State income taxes. Yet, there are landowners that cannot use this conservation incentive because they are required to pay other types of taxes. Consideration might be directed toward broadening the types of taxes to which the credit can be applied.

A more substantial and in-depth outreach program could greatly increase donations of real property for conservation purposes from the use of conservation tax credits. To date the Department has provided minimum support for this function while the Conservation Tax Credit Program has operated in a limited fashion in the absence of permanent, full-time staff or line item operating budget. This is a continuing limitation on the program's potential success.

Conservation Grant Fund 113A-232. Established in 1997, it was intended 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. To date the Department has not received an appropriation to actualize the complete menu of Conservation Grant Fund activities and address the structural weaknesses it was intended to correct.

In 2005, actions were taken to start up two of the Conservation Grant Fund's functions. (1) The General Assembly approved one-time funding in the amount of \$1,000,000 for the transaction cost function. This was directed to the conservation of land that buffers military bases and training areas with compatible land uses. The funds were expended. (2) The Department began the process of creating a centralized program that assures proper quality assurance (monitoring and management) of the conservation easements held by its agencies, as part of the stewardship cost function. The Stewardship Program

became operational in 2006 as a receipts-based operation involving the Ecosystem Enhancement Program and the Conservation Reserve Enhancement Program. An administrative position for this program was approved and filled, and as noted above, this program's initial year involved 71 easement properties in a pilot project. Further Stewardship Program expansion involves DENR agencies and nonprofit private land trusts being asked to report their annual stewardship monitoring of conservation easements received through the NC Conservation Tax Credit program, at no cost to the Conservation Grant Fund. Until a continuing source of funding can be secured, additional expansion of this program of conservation quality assurance in perpetuity will be constrained.

RESULTS FROM 2007 LEGISLATIVE SESSION

In June the General Assembly passed HB 463: An Act to Modify the Credit for Certain Real Property Donations. Its effective date is January 1, 2007. Four primary changes in the amendment:

- Conservation Benefits. DENR certifies that donations of real property will meet one or more of the conservation purposes required by the statute. The amendment replaces one of the previously listed benefits: "other similar land conservation purposes", with a more specific list: "forestland or farmland conservation, watershed protection, conservation of natural areas as that term is defined in G.S. 113A-164.3(3), conservation of natural or scenic river areas as those terms are used in G.S. 113A-34, conservation of predominantly natural parkland, or historic landscape conservation."
- Value Documentation with Tax Filing. A new requirement was added, specifying that any tax filing that includes a conservation tax credit must be accompanied by documentation of the donations value, prepared to specified standards.
- Increased Maximum Credit Allowed for Corporate Pass-Through Entities. All corporations now have the same (\$500K) maximum allowed credit. Pass-through entities, such as partnerships and LLCs typically distribute tax liability/benefits among their members, and this maximum allowed credit remains unchanged (\$250K) per member up to the cumulative corporate maximum.
- Increased Maximum Credit Allowed for Married Couples. Formerly, married couples claiming a conservation tax credit were required to file jointly. The amendment changes this to allow them to file separately (\$250K each) or jointly to a new maximum (\$500K).

ADDITIONAL TOPICS FOR CONSIDERATION

Through management of the NCCTC Program and observation of evolving approaches to conservation through incentives, a number of topics may deserve consideration. The following could improve administration of the NCCTC and/or the incentive offered by the State for donation of interests in real property for conservation purposes.

- A. **Reports**. Since its inception, Fiscal Notes for proposed amendments to the NCCTC have been problematic because of the limited available data. DOR and DENR have previously agreed to several achievable data items that could be

- reported annually. This includes the: (1) number of taxpayers that claimed a credit; and, (2) the total cost to the General Fund of the credits claimed. This is useful information in its own right and is worth pursuing. Nevertheless, it would be greatly enhanced by knowing the difference between the total value of credit available, and the total value actually used to offset tax liability. This information would provide a depth of insight needed for ongoing refinement of the NCCTC.
- B. **Corporate Incentive to Donate.** Since its creation in 1983, the NCCTC has only been applied against income taxes. With the sunset provision for how corporate pass-through entities claim tax credit, some of the incentive for conservation donations will be eliminated. One approach for regaining the breadth of NCCTC applicability would be to allow the credit to be used against Franchise Tax and Gross Premium Tax. This would appeal to corporate landowners that may be otherwise constrained from considering the donation of real property for conservation purposes, because they are not required to pay income taxes or they have limited income tax liability.
- C. **NCCTC Refundability.** The NCCTC was created as an incentive for landowners to donate interests in real property for conservation purposes. While the concept has been very successful and has been emulated in other states, there is still a category of landowner that finds little incentive in the program. “Land-rich and cash-poor” landowners [typically owners of working landscapes such as farms and forests] receive disproportionately low return from their conservation donation for a tax credit. Several states with more recent conservation tax credit programs have addressed this issue by authorizing “transferability” for their tax credits, but this involves a considerable administrative workload. The issue could be addressed more simply through “refundability,” where those donors with larger income tax liabilities will have the option of electing a credit, while those donors with lower income tax liabilities will have the option of electing a partial refund. As proposed, a 50% refund of any remaining credit amount would be authorized after the second year of carry forward (third year including the year of donation). In this way, land-rich and cash-poor landowners would have more incentive to donate interests in real property for conservation purposes. If enacted, it would be three years before any refunds were paid.
- D. **Index Credit Cap.** Since its establishment in 1983, the maximum credit allowed for the NCCTC has been raised three times (1989, 1997, and 1999). Further requests for increases are inevitable as increasing property values decrease the incentive provided by the NCCTC. These dynamics can be addressed by indexing the credit cap. The incentive to donate would then be stabilized relative to land value, and repetitive legislated increases would be avoided. As proposed, an increase equal to 75% of the Consumer Price Index (CPI) would be calculated from the last year of credit cap increase, with the cap increasing incrementally in the year following a cumulative increase of \$25,000 for individuals and \$50,000 for corporations. If previously enacted: since the last credit cap increase occurred in 1999, the index threshold would have been passed in 2004, would have been announced in 2005, and 2006 would be the year an automatic indexed increase took effect. Thus, a credit cap increase is due, to avoid a loss of incentive for voluntary donations of interests in real property for conservation purposes. In the

absence of indexing authority, an increase in existing credit caps to \$275,000 for individuals and \$550,000 for corporations is timely.

- E. **Evaluation of Donation Quality.** With an increased interest in “conservation development,” NCCTC applications have ranged in perceived quality, especially in regard to fragmentation and “edge effect.” Not all donations are the same, obviously, and it seems unfair to offer the same incentive to a prospective donor of a “forever wild” easement for a contiguous and ecologically important natural area as to a developer who chooses to donate interest in land that is not cost-effectively developed, such as a combination of steep slopes and wetlands. The resulting irregularly-shaped donations do not offer the same habitat value, and might be similar to an easement with multiple reserved rights that reduce the overall conservation value. The NCCTC would like to look at tools such as the One NC Naturally Strategic Conservation Planning effort, to see where perhaps donations for conservation could be evaluated and even pro-rated.
- F. **Funding for Ecological Management.** Attention recently given to red-cockaded woodpeckers (a federally listed species) on military bases has emphasized the lack of tools that would provide landowners the incentive for ecological management, especially those with conservation easements. In order to maximize their military lands for training, base managers have looked for help increasing red-cockaded woodpecker populations off-site. Much as was done for transaction costs with the Military Support Act, the Conservation Grant Fund could provide the structure to competitively award grants to the most beneficial land management around military bases, if funded.