
APPENDIX E

**INFORMATION RE:
CONSERVATION BUYER PROGRAM**

JUL 25 2003

QUESTION 1: Conservation Buyer Program

The Conservancy's Conservation Buyer Program is the sole program by which the Conservancy or its related organizations have sold to non-government entities land, interest in land, or water rights that are subject to a conservation easement or option of conservation easement. As noted in your letter; the Conservancy is also involved in sales of land to government, tradelands, and purchases of easements. However, one of the most important and largest programs of The Nature Conservancy is the acquisition of land and interests in land to be held permanently as conservation lands. While in most instances these lands are owned and managed by The Nature Conservancy, occasionally the Conservancy will transfer these lands by gift or sale to other non-governmental organizations or governmental agencies for management purposes.

JUL 25 2003

QUESTION 1: Conservation Buyer Program

“Lastly, the Board of Governors announced on June 13, 2003 that all CBP transactions must be ‘legally documented as part of the transaction.’ Please explain specifically what that means and what information will be available to the public and the IRS.”

A summary of the decisions made June 13, 2003, by the Board of Governors states that "all charitable gifts associated with a conservation buyer transaction must be legally documented as part of the transaction." This summarizes the Board's decision that all charitable gifts associated with a conservation buyer transaction will be a legally enforceable element of the transaction and explicitly documented. This action was taken to ensure that in cases where the buyer makes a gift, there is an explicit link between the sale of the property and the gift.

TNC makes information relating to sales of property and donations available to the IRS in accordance with the requirements of the Internal Revenue Code. For example, on Schedule B of Form 990, with respect to contributions of 2% or more of its contributions, grants and similar amounts received, TNC reports the name and address of the contributor, the contributor's aggregate contributions, type of contribution, description of noncash property given, and fair market value or estimate of noncash property given. TNC would provide comparable information for other contributions if requested by the IRS in the context of an IRS examination of TNC tax returns. At the request of its donors, TNC typically does not make information relating to sales of property and donations available to the public. The Board of Governors' action will not change the foregoing practices.

Senate Finance Committee Letter 3/3/04
I. #6 Conservation Buyer Program

APR 15 2004

Attached please find the Resolution adopted by The Nature Conservancy's Board of Governors on June 13, 2003 creating new standard operating procedures for Conservation Buyer transactions which includes the requirement that "all charitable gifts associated with a conservation buyer transaction must be legally documented as part of the transaction." The Board's consideration and adoption of these procedures was made in an effort to ensure that conservation buyer projects are undertaken in accordance with the highest standards of conservation, real estate finance and practice, law and ethics as well as to provide greater openness and transparency in such transactions. The discussion at the Board meeting where these procedures were adopted and approved reflected the Board's desire to achieve those goals.

**RESOLUTION
CONSERVATION BUYER TRANSACTIONS
STANDARD OPERATING PROCEDURE**

Conservation buyer transactions are those in which TNC buys land with conservation significance and resells the land to a private individual, partnership or corporation subject to an agreement by the new owner to use the property in accordance with certain specified conservation objectives, typically in the form of a permanent conservation easement (which restricts the uses of the land and therefore reduces its fair market value). Transactions where the resale is to a public agency or another private conservation charity such as a land trust or where the resale is a tradeland are not included in this definition.

To ensure that all TNC conservation buyer transactions (CBT's) comply with the highest standards of conservation, finance, law and ethics, the following procedures are required to be followed:

1. All CBT transactions must be consistent with Conservation by Design: All CBT must advance TNC's conservation goals. A CBT shall be undertaken only when it A) meets standards for TNC action at priority conservation sites, B) achieves specific conservation goals and objectives, and C) uses conservation mechanisms that are appropriate and effective.

To accomplish item A), above, any transaction must be located within an identified ecoregional portfolio site or within a site for which TNC has a site or area conservation plan. Any exceptions must be approved by the relevant division director, who must find that, based on new scientific information, the property would meet the foregoing standards or that it will advance TNC's work in an area in tangible, measurable ways.

To meet items B) and C), above, a TNC scientist responsible for work in the project area, must provide a written assessment of the conservation buyer transaction, prior to the sale, that includes the following:

- a) the specific conservation goals that are sought to be achieved at the site;
- b) how the protection of the particular tract or property proposed for sale to a conservation buyer will achieve those goals;
- c) what specific threats must be prevented to be able to achieve the conservation goals;
- d) the specific conservation easement terms that are needed to meet the conservation goals (the operating unit must also give adequate consideration as to how conservation purposes might be achieved in the proposed transaction that are other than those relating strictly to biodiversity goals, including for example, those relating to assuring best management practices and/or other environmental standards for compatible human use of the land and natural resources); and
- e) a monitoring plan (including costs and responsibilities) that will ensure that the conservation goals will be met and the easement terms will be enforced.

2. All CBT transactions must assure appropriate valuation of the property interests in CBTs: TNC must receive the full value for restricted land being sold. To assure this, TNC must obtain for its own use, a recent, independent, and qualified appraisal of the property as restricted before the property is sold. This requirement can be fulfilled with the following sequence of steps in a project process:

- a) Determination of the terms of an easement to protect the conservation values of the property (see 1(d) above);
- b) Draft appraisal (or letter of opinion or similar documentation of value) of the property documenting its value before and after the imposition of proposed easement restrictions;
- c) Negotiation and agreement with proposed conservation buyer to accept such terms; and
- d) Final appraisal by an independent appraiser of the property documenting its value before and after the imposition of proposed easement restrictions.

(The order listed above represents the ideal, but the sequence may not be followed in every instance.)

3. All CBT transactions must adequately expose the property to the market through open marketing: TNC must sell any property in a manner that both maximizes the financial return and assures appropriate conservation through an open and equitable marketing process. To ensure that this dual objective is achieved, wide exposure of the property to the marketplace is required. Therefore, the following marketing procedures must be followed in all CB transactions:

- a) Conservation easement terms and financial objectives must be clearly stated for all TNC conservation buyer properties before marketing commences;
- b) Information on all TNC conservation buyer properties will be available on TNC's web site;
- c) Properties will be offered for sale using the most appropriate and practical methods that allow for fair competition and broad exposure. Methods considered should include listings with real estate brokers, advertisements in local/national media outlets, articles in TNC newsletters, articles in community media outlets, use of other internet outlets in addition to TNC's web site, use of comprehensive TNC conservation buyer lists, and use of "word of mouth" as appropriate;
- d) A minimum time frame of thirty (30) days for exposure of the property to the real estate market is required, prior to a contract being accepted, unless a shorter time frame has been approved by a Division or Regional Director; and
- e) All efforts to market the property are required to be documented.
- f) There is an expectation that TNC will receive at least appraised value for the property or interests that are sold.

4. All CBT transactions must assure standards of both legality and "Integrity Beyond Reproach": Each CBT project must achieve the multiple objectives of assuring permanent conservation protection for the land; securing the needed project costs; and adhering to TNC standards of transparency, compliance with laws and policies as well as "Integrity Beyond Reproach." Therefore, TNC will participate only in those CB transactions where:

- 1) permanent conservation results from TNC's involvement.
- 2) TNC can document and will provide to the buyer a statement of the link between the gift and the sale in the transaction.
- 3) TNC has structured the transaction so as not to relieve the buyer of the responsibility for substantiating the value of the easement.

To meet TNC's commitment to "Integrity Beyond Reproach" in arranging CBT's, TNC should urge buyers/donors to use and will only participate in any one of the following forms of transaction:

The "Premium Sale" Approach
The "Gift Option" Approach

The "Sale and Separate Gift of Easement" Approach
The "Straight Conservation Sale with Private Fundraising" Approach
The "Straight Conservation Sale with Public Funding" Approach

Detailed explanations of above five forms of transaction are attached hereto and are available from the General Counsel's office.

5. All CBT transactions must assess community considerations to assure that proposed uses of conservation buyer property do not impair TNC's reputation: Prior to the transaction, TNC must assess the likely community reaction to the proposed land uses that will be permitted under the conservation buyer arrangement and balance the conservation benefit with the risk to the community's good will toward TNC.

The "Premium Sale" Approach: Sale by TNC of real estate subject to conservation restrictions, at a price significantly in excess of the appraised value of the restricted land, with (a) restricted use fair market value stated as sales price for the restricted land with the gift amount stated separately or (b) without separate statements of price and gift amount. In a variation, the purchase agreement could contain an obligation to deliver at closing a charitable pledge for a cash gift. This is similar to the purchase of items at charity auctions for a premium price. The IRS recognizes any contribution above the fair market value of the item as a tax-deductible charitable contribution. The buyer has the obligation to substantiate the value of the gift and the value of the restricted land for tax purposes with an appraisal which may be reviewed by IRS. The buyer runs the risk that the donation value may not be approved as claimed. TNC has the obligation to substantiate the value of the restricted land sold.

The "Gift Option" Approach: Sale by TNC of unencumbered real estate at a price based on its unrestricted value; simultaneous grant by the buyer to TNC of a long term option to buy conservation restrictions for a nominal (but legally enforceable) purchase price. (In practice, the option will always be exercised unless the buyer donates the easement on or before the option exercise date.) If the option is exercised, the difference between the option price and value of the easement is a tax-deductible contribution and the transaction would be considered to be a "bargain-sale." If the option is not exercised, and the buyer has first donated the easement to TNC, then the buyer may receive a deduction equal to the full value of the easement. In either case, the buyer would have the obligation to substantiate the value of gift for tax purposes with an appraisal which may be reviewed by IRS. The buyer runs the risk that the donation value may not be approved as claimed.

The "Sale and Separate Easement Gift" Approach: Sale by TNC of unencumbered real estate at a price based on its unrestricted value; simultaneous grant of a (legally enforceable) pledge to make a gift of the conservation easement separately or at a later date. This approach requires the donor to obtain an appraisal of the easement value to substantiate the value of the gift for tax purposes which may be reviewed by IRS. The buyer runs the risk that the donation value may not be approved as claimed.

The "Straight Conservation Sale with Private Fundraising" Approach: Sale by TNC of real estate subject to conservation restrictions for value as restricted; no gift component from buyer. Separate contributions are sought to cover project costs, including the

difference between TNC's original purchase price and the sales price with restrictions. TNC would continue to hold and monitor the conservation easement or might transfer the easement to a local land trust.

The "Straight Conservation Sale with Public Funding" Approach: Sale by TNC of real estate subject to conservation restrictions for value as restricted; sale of restrictions/easement at appraised easement value to third-party public agency, which would then permanently hold and monitor the conservation easement.

Approved
Board of Governors
The Nature Conservancy
June 13, 2003

April 15, 2004

Responses

to

Senate Finance Committee Questions on Conservation Buyer Program

This memorandum responds to seven of the questions concerning “conservation buyer” transactions set forth in Part I of the letter dated March 3, 2004 to The Nature Conservancy (the “Conservancy”) from Senators Grassley and Baucus on behalf of the Committee on Finance of the United States Senate (the “Committee”).¹ Part I of this memorandum contains a brief overview of conservation buyer transactions; Part II responds to the Committee’s questions concerning the Conservancy’s general practices and procedures with respect to conservation buyer transactions; and Part III provides detailed responses to the Committee’s questions with respect to four specific transactions.

I.

Overview of Conservation Buyer Transactions

The mission of the Conservancy is to preserve the plants, animals and natural communities that represent the diversity of life on Earth by protecting the land and waters they need to survive. As described more fully elsewhere in this memorandum, the Conservancy has developed and uses a strategic science-based process called “Conservation by Design” to identify lands and waters for inclusion in the Conservancy’s conservation programs.

In the United States, the Conservancy traditionally has used land acquisitions as a principal tool to accomplish its conservation mission and today owns and manages more

¹ The remaining four questions contained in Part I of the Committee’s letter (i.e., Questions 1, 2, 7 and 11) request data on documents that do not require explanation or elaboration. Responses to those requests, and the data and documents requested in connection with the questions addressed in this memorandum are being provided to the Committee separately. The Committee is also being provided with all documents referred to in this memorandum.

than 1,500 preserves throughout the United States. In many instances, however, the Conservancy's conservation mission may be accomplished in other ways. In such cases, the Conservancy employs a broad range of alternatives to the "purchase and hold" strategy. Conservation buyer transactions are one such alternative.

Many conservation organizations, including the Conservancy, participate in conservation buyer transactions. In its simplest form, a conservation buyer transaction is one in which a conservation organization purchases land and re-sells it to a private sector buyer subject to a conservation restriction, in the form of an easement, intended to ensure achievement of the organization's conservation objectives with respect to the land on a permanent basis. These transactions thus permit important conservation objectives to be achieved while the land remains in private ownership, subject to State and local property taxes and available for those human uses that are compatible with the conservation objectives with respect to the land. The Conservancy completed its first conservation buyer transaction in 1979. During the 10-year period encompassed by the Finance Committee's inquiry, the Conservancy engaged in more than 10,000 land transactions (including direct purchases of land and acceptances of easements) and, of these, 169 were conservation buyer transactions.

A. Selection of Land for Conservation Buyer Projects.

From its organization in 1951, the Conservancy has focused its conservation programs on high priority conservation areas. In 1995, the Conservancy adopted the "Conservation by Design" planning process to identify lands and water for inclusion in its various conservation programs². In this process, the Conservancy focuses on "ecoregions", large areas of land or water defined by distinct climate, geography and native species. Within each such "ecoregion", the Conservancy identifies a "portfolio" of high priority sites that collectively capture the biological diversity of the region. If these

² A pamphlet describing the Conservation by Design methodology in detail has been provided to the Committee. In years prior to implementation of the Conservation by Design methodology, the Conservancy selected land for acquisition based on the best available science, focusing on lands harboring significant occurrences of threatened or endangered plants and animal species.

portfolio sites are properly managed, the long term survival of all the ecoregion's native plant and animal life should be ensured even if most of the property within an ecoregion is not the subject of organized conservation strategies.

The Conservation by Design methodology does not simply define "where" the Conservancy works. It also defines "how" the Conservancy works. The Conservancy develops specific, science-based strategies for the proper protection of each portfolio site. For example, these strategies may involve land acquisition; agreements to manage lands owned by others; early detection and eradication of invasive species; reintroduction of fire and other restoration activities; support of public policies based on sound science; promotion of compatible human uses; and conservation education. In some cases, the Conservancy may itself acquire and retain ownership of the core conservation areas within a portfolio site in order to ensure that they receive the highest level of protection. The Conservancy may also pursue alternative strategies for these core areas, including working with governmental units at all levels to facilitate the public acquisition of selected parcels of land.

The principles of the Conservation by Design methodology are now applicable to the selection of parcels of land for the conservation buyer program. For example, in those parts of a portfolio site that surround core conservation areas, the Conservancy may acquire land for use in its conservation buyer program to ensure that there are adequate buffers to protect environmentally sensitive land.³ All of the parcels of land involved in the specific conservation buyer transactions identified in the Committee's letter of March 3, 2004 (and described in Part III of this memorandum) were within sites identified as conservation priorities by the Conservancy before they were acquired and re-sold to a conservation buyer, subject to a conservation easement. Some of these sites were identified in accordance with the Conservation by Design methodology, while others were

³ The use of conservation easements by the Conservancy as a tool in furtherance of its conservation mission is discussed more fully in a separate memorandum (the "Conservation Easements Memorandum") being provided to the Committee in response to the Committee's questions on conservation easements, as set forth in Part VI of the Committee's letter dated March 3, 2004.

similarly identified in earlier years based on the procedures used at the time by the Conservancy.⁴

B. Basic Structure of Conservation Buyer Transactions.

In virtually all of its conservation buyer transactions to date, the Conservancy has identified the land to be acquired before it has located a suitable buyer. In an effort to accomplish its conservation objectives at the least possible cost, the Conservancy typically first acquires an option to purchase the land and uses the option period to identify conservation-minded potential buyers who are willing to abide by the restrictions on use and development that are necessary to enable the Conservancy to accomplish its conservation objectives. The acquisition of an option is not always feasible (e.g., where there are competing bidders some of whom may seek to subdivide and develop the land). In such cases, the Conservancy may complete the purchase of the land in order to ensure its preservation before a suitable buyer is identified.

When land is sold by the Conservancy to a conservation buyer, it typically is encumbered by a conservation easement as part of the sale transaction.⁵ A conservation easement is a voluntary agreement by a landowner to surrender irrevocably certain rights that are otherwise inherent in the ownership of land (e.g., the right to subdivide and develop the land or the right to use the land for certain purposes). A private organization, such as the Conservancy, or a public agency holds the right to enforce the terms of the

⁴ In years prior to the development of ecoregional plans and full implementation of the Conservation by Design methodology, conservation buyer transactions almost universally involved properties where the Conservancy scientists and staff determined that the land had important conservation attributes. As discussed elsewhere in this memorandum, under policies adopted by the Conservancy's Board of Governors on June 13, 2003, all conservation buyer properties must fall within a priority conservation site established in accordance with the Conservation by Design criteria.

⁵ In a limited number of cases, the Conservancy has purchased the land and sold it to a conservation buyer for its unrestricted full fair market value, subject to a legally enforceable option entitling the Conservancy to purchase a conservation easement for nominal value. Following the sale, the buyer either contributes an agreed upon easement to the Conservancy or the Conservancy exercises its option to purchase the easement. In other instances, the Conservancy has acquired an option to purchase from the original landowner and transferred the option to a conservation buyer subject to a contractual commitment by the buyer to impose an agreed-upon conservation easement of the land and provide the Conservancy with the right to enforce the easement in perpetuity.

easement in perpetuity. Even where the current landowner has no intention of taking actions prohibited by the conservation easement (e.g., subdividing and developing the land), the conservation easement still serves important purposes. This is because a conservation easement “runs with the land” and is thus binding on the current and all future owners of the land. In essence, valuable rights surrendered in a conservation easement are forfeited permanently and effectively no longer exist.⁶ As a result, the fair market value of the restricted land acquired by a conservation buyer is less than the fair market value of the unrestricted land at the time of its acquisition by the Conservancy.

With increasing frequency in recent years, the Conservancy has solicited contributions from conservation buyers to enable the Conservancy to recover all or a portion of its original cost in acquiring the property involved in a particular transaction. For example, if the Conservancy purchases land for \$100x and sells it to a conservation buyer for \$60x (the appraised fair market value of land following imposition of a conservation easement), the Conservancy often will seek a contribution, ideally equal to the value of the easement (here \$40x), from the buyer. Such a contribution, when added to the purchase price received from the buyer for the restricted land (here \$60x), will enable the Conservancy to recover all or part of its original acquisition cost. In some cases, the Conservancy may achieve the same economic result by selling the restricted land to the conservation buyer for an amount equal to its value without regard to the easement (here \$100x) in what is commonly known as a “premium purchase” transaction.

As discussed more fully in Part III of this memorandum, in those cases where the conservation buyer is unwilling or unable to make an additional contribution (or makes a contribution that is insufficient to enable the Conservancy to recover its costs fully), the Conservancy must either use unrestricted donations or seek additional donations from third parties to make up the difference. From the Conservancy’s point of view, however, the

⁶ Treas. Reg. § 1.170A-14(g)(6)(i), states: “If a subsequent unexpected change in the conditions surrounding the property [that is the subject of a conservation easement] . . . can make impossible or impractical the continued use of the property for conservation purposes, the conservation purpose can nonetheless be treated as protected in perpetuity if the restrictions are extinguished by a judicial proceeding”

most important objective is to be able to sell the land subject to a strong conservation easement.

II.

Committee Questions on General Practices and Procedures

A. Tax Advice on Conservation Buyer Transactions.

In Part I, **Question 8**, the Committee requested information concerning advice obtained by the Conservancy with respect to the tax consequences of conservation buyer transactions. The Conservancy has been advised by independent legal counsel on multiple occasions that a conservation buyer who makes payments to the Conservancy in excess of the fair market value of the restricted property is entitled to a charitable deduction for the excess payment.⁷ As described more fully below, there are four principal written legal opinions that the Conservancy obtained with respect to the federal income tax consequences of the types of conservation buyer transactions in which it has participated. Three of these opinions were rendered by the law firm of Steptoe & Johnson LLP (collectively the “Steptoe Opinions”) and the fourth opinion was rendered by Jerry L. McCoy (the “McCoy Opinion”).

The first Steptoe Opinion was issued to the Conservancy in draft form on January 31, 1992 in connection with a proposed conservation buyer transaction involving land in Georgia. Citing judicial decisions, rulings of the Internal Revenue Service and other authorities, the draft opinion concluded that, on the facts presented, the buyer of the land would be entitled to a charitable contribution deduction under section 170 of the Internal Revenue Code (the “Code”), subject to the general limitations contained therein, to the extent that the payments made by the buyer exceeded the fair market value of the land at the time of its acquisition by the buyer (as determined by an independent appraisal and

⁷ In accordance with the Committee’s request, copies of all opinions and advice obtained by the Conservancy with respect to the tax consequences of conservation buyer transactions to the Conservancy or others (and a list of the persons who provided such opinions or advice) are being provided to the Committee separately. These materials were collected by the Conservancy as part of a field survey of its legal staff undertaken in connection with the preparation of its responses to the questions set forth in the Committee’s letter of March 3, 2004.

taking into account the permanent restrictions set forth in the conservation easement to be placed on the land by the Conservancy prior to the sale). The draft opinion stated that this conclusion was equally applicable whether the transaction was structured as a premium purchase of the land or as a purchase of the land for its fair market value and a separate payment designated as a charitable contribution.⁸

The second Steptoe Opinion was issued to the Conservancy on March 10, 1997 in connection with proposed conservation buyer transactions at Davis Mountains, Texas.⁹ The 1997 opinion reached the same substantive conclusions as were set forth in the January 31, 1992 draft opinion. It also addressed the federal income tax consequences to the buyer if appreciated securities were substituted for cash for a portion of the buyer's payments to the Conservancy. The third Steptoe Opinion was issued on September 26, 2002. This opinion was requested by the Conservancy to update the March 10, 1997 opinion. Consistent with the Conservancy's request, the 2002 opinion did not discuss any specific conservation buyer transaction, but discussed the then current rules generally applicable to charitable contributions involving a purchase of property from an organization such as the Conservancy for a price in excess of the fair market value of the property.

The McCoy Opinion was issued to the Conservancy on January 20, 2003. It was requested by the Conservancy and provided to *The Washington Post* on January 29, 2003 following discussions between Conservancy representatives and the *Post* concerning the deductibility of contributions made in connection with certain conservation buyer transactions. The McCoy Opinion was subsequently posted on the Conservancy's web site for the information of all interested persons. Mr. McCoy reached the same substantive conclusions as did the Steptoe Opinions: the excess of the amount paid to the Conservancy by a conservation buyer over the fair market value of the restricted land when acquired by

⁸ It does not appear that this draft opinion was ever issued in final form.

⁹ In accordance with the Committee's request, two of the Davis Mountains conservation buyer transactions are discussed in detail in Part III of in this memorandum.

the buyer (i.e., as encumbered by the conservation easement) is properly treated as a contribution to the Conservancy under section 170 of the Code, whether the buyer makes a premium purchase of the restricted land or, alternatively, purchases the restricted land for its fair market value and makes a separate payment to the Conservancy designated as a contribution.

A Conservancy policy established in 1996 (and based on prior practice) states that Conservancy personnel “shall not provide legal or financial advice to anyone and shall encourage prospective donors to seek their own professional counsel as appropriate”. This policy has been interpreted by the Conservancy to include tax advice and it has been the Conservancy’s practice to inform prospective donors, and others with whom conservation transactions have been discussed, that they should seek their own tax and financial advice and rely on that advice in connection with any specific contribution to, or transaction with, the Conservancy.

Consistent with practices of many tax-exempt organizations, the Conservancy has provided information to prospective donors and others concerning the tax benefits of contributions to, and certain transactions with, the Conservancy. This information has included copies of opinions of counsel, as well as various worksheets to illustrate the effects of these transactions. The worksheets contain statements, based on the Conservancy’s “no tax advice” policy, urging the recipients to consult their own professional advisors.¹⁰ Similarly, when tax opinions, such as the Steptoe Opinions, were shared by Conservancy staff with prospective conservation buyers, Conservancy policy (as quoted above) required that any such disclosures be accompanied by an admonition that the prospective conservation buyers should consult their own professional counsel.

B. Tax Indemnities to Conservation Buyers.

In Part I, **Question 9**, the Committee asked whether the Conservancy has provided tax indemnities to conservation buyers with respect to the availability or amount of a charitable deduction. The Conservancy has *not* entered into any agreements with

¹⁰ Copies of these materials, and of the 1996 policy statement, have been provided to the Committee.

conservation buyers under which the Conservancy agreed to indemnify or reimburse the buyer for lost tax benefits resulting from the loss or reduction of the charitable contribution claimed by the buyer.¹¹

C. Board of Governors' Actions.

In Part I, **Question 6**, the Committee requested a copy of the resolutions adopted by the Conservancy's Board of Governors on June 13, 2003 with respect to the solicitation and receipt of contributions in connection with conservation buyer transactions. At its June 13, 2003 meeting, the Board of Governors was advised that all of the Conservancy's conservation buyer transactions had been structured to comply with all applicable laws. The Board nevertheless concluded that seven policy changes should be adopted.¹²

First, if a contribution is solicited in connection with a conservation buyer transaction, the Conservancy must document and provide to the buyer a statement of the link between the gift and the sale; and the transaction must be structured by the Conservancy so as not to relieve the buyer from responsibility for substantiating the value of the contribution for tax purposes. *Second*, conservation buyer transactions with members of the Board of Governors, State Chapter Trustees, employees and other related parties are now prohibited by Conservancy policy even though they are permitted under current tax law if structured in conformity with so-called "arm's-length" standards.¹³ *Third*, conservation buyer transactions with major donors (as defined under Conservancy policy) to the Conservancy may be undertaken only after advance review and approval

¹¹ As discussed more fully in Part III of this memorandum, the Conservancy did enter into a tax indemnity agreement with a party to the Herring Creek transaction, but the indemnified party was not a conservation buyer. Based on the field survey of the Conservancy's legal staff referred to previously in this memorandum, the Herring Creek transaction appears to be the only transaction involving a tax indemnity granted by the Conservancy.

¹² Copies of the resolutions adopting these new policies are being provided to the Committee separately.

¹³ Of the 169 conservation buyer transactions closed by the Conservancy during the 10-year period encompassed by the Committee's inquiry, 19 transactions were identified as involving buyers who were "related parties" as defined under Conservancy policy. As discussed more fully in Part III of this memorandum, under the Conservancy's prior conflicts of interest policy, conservation buyer transactions with State Chapter trustees and other related parties were subject to advance review and approval by the Conservancy's General Counsel.

under the Conservancy's strengthened conflicts of interest procedures. This review is intended to ensure full compliance with the arm's-length standard. *Fourth*, all lands involved in conservation buyer transactions must fall within a priority conservation site established in accordance with the Conservation by Design criteria and the terms of the easement, and the plans to monitor compliance with those terms, must be structured to achieve the desired conservation result on a permanent basis. *Fifth*, the Conservancy must obtain its own independent "qualified appraisal" (as defined by the Internal Revenue Service) documenting the value of the land both before and after the imposition of the conservation easement. *Sixth*, the land must be offered for sale in a manner that allows for broad exposure and fair competition among interested potential conservation buyers. *Seventh*, community input must be obtained regarding permitted future uses of the land.

III.

Specific Conservation Buyer Transactions

A. Davis Mountains.

In Part I, **Question 3**, the Committee asked a series of specific questions concerning two conservation buyer transactions involving Ms. Caroline Alexander. Both transactions involved land located in the Davis Mountains region of Texas and each tract of land was within a portfolio site designated as such by the Conservancy prior to its acquisition of the land. Davis Mountains is an intact desert "sky island" ecosystem, which is an important habitat for many rare plants and animals, as well as migrating birds.

The first transaction (the "1997 Transaction") involved 5,854 acres. This land was part of a larger parcel of approximately 32,500 acres acquired by the Conservancy. The Conservancy retained direct ownership of a core conservation area of approximately 11,000 acres. The Conservancy sold the remaining acreage in six separate conservation buyer transactions subject to conservation easements to restrict incompatible uses and development in perpetuity. The 1997 Transaction was one of those transactions. The Conservancy had first acquired a one-year option to purchase the 32,500 acre tract and used the option period to seek suitable conservation buyers. In this instance, the

Conservancy sought buyers through a broad range of activities, including contacts with brokers and media advertisements.

In the 1997 Transaction, Ms. Alexander paid a purchase price of \$1,160,834. She also pledged to make two contributions to the Conservancy (**Question 3a**). The first was a contribution of \$730,000, which was equal to the appraised value of the easement, and thus enabled the Conservancy to recover its original acquisition cost of the land sold to Ms. Alexander. The second was a contribution of \$140,000 to establish an endowment to underwrite monitoring of the land. The first pledge amount was reduced by the Conservancy to \$712,452 following discovery of certain title encroachments on the land. Ms. Alexander satisfied both of her contribution pledges in full and on a timely basis. On December 23, 1997, she transferred marketable securities to the Conservancy to satisfy the first pledge. The Conservancy sold the securities for a realized price of \$736,247.¹⁴ The excess of the amount realized on the securities sale over the adjusted contribution amount (\$23,795) was retained by the Conservancy and applied against the second pledge, reducing the amount payable thereunder from \$140,000 to \$116,205. Ms. Alexander transferred marketable securities to the Conservancy to satisfy the second pledge, the securities were sold by the Conservancy for a realized price of approximately \$117,225, and the Conservancy retained the excess.

The second transaction (the "1999 Transaction") involved a different (27,133 acres) tract of land located in the same vicinity and, but for the Conservancy's intervention, would likely have been sold for subdivision and development. This tract was within the same portfolio site as the land involved in the 1997 Transaction and the Conservancy concluded it would constitute an important buffer zone for the core conservation area. Davis Mountains Land & Cattle Company, an entity wholly-owned by Ms. Alexander purchased this acreage in its entirety, subject to a conservation easement imposed by the Conservancy, for a purchase price of \$5,426,632 (**Question 3e**). The Conservancy

¹⁴ The Conservancy has a standard operating procedure requiring that all securities received as contributions be sold promptly. Due to fluctuations in market prices, the actual realized proceeds may differ from the amount of the pledge by a modest amount.

marketed this tract widely, as in the 1997 Transaction. As part of the 1999 Transaction, Ms. Alexander made a charitable pledge of \$2,839,717, which was equal to the appraised value of the easement.

At the request of the Conservancy, a portion of this pledge was satisfied by the transfer by Ms. Alexander of a portion of the land (3,696 acres) she had acquired in the 1997 Transaction (**Question 3b**). The land acquired by Ms. Alexander in the 1997 Transaction is located between the 27,133 acres acquired in the 1999 Transaction (lying to the north) and the Conservancy's Davis Mountain Preserve (lying to the south). Upon further analysis, the Conservancy was increasingly interested in the 3,696 acre parcel because it was contiguous to the Preserve and had substantial ecological and land management significance. The actual configuration of this tract was designed and negotiated based on an identification of important landscape-scale natural features. This tract also included Locke's Gap, an important topographical feature; a large, intact stand of native Ponderosa Pine woodlands that had not been infected by bark beetles; and the headwaters of both Cherry Creek and Right Hand Creek.

Ms. Alexander honored the Conservancy's request and transferred the 3,696 acre parcel in October 1999. There are substantial differences between the 3,696 acre parcel transferred to the Conservancy and the 2,161 acre parcel (the balance of the acreage involved in the 1997 Transaction) retained by Ms. Alexander (**Question 3c**). As noted above, the transferred acreage is more significant ecologically and of greater potential as a migratory bird habitat. In contrast, the retained acreage, which is contiguous to the 27,133 acre tract involved in the 1999 Transaction, is primarily pasture land and has more frontage along a highway. With respect to improvements, the land transferred to the Conservancy had one solar water well, a hunting camp (consisting of a small metal building with no utilities) and an abandoned mobile home. The acreage retained by Ms. Alexander had minor ranch improvements, including two water wells and associated troughs; a windmill; two small working cattle pens in poor condition; and a shack used to store salt for livestock. Following the transfer of the 3,696 acre parcel to the Conservancy, a fence was built to delineate the two tracts.

Thus, Ms. Alexander ultimately paid \$1,160,834 for the land she retained from the 1997 Transaction (**Question 3d**). Consistent with the pledge agreement executed in connection with the 1999 Transaction (which contemplated contributions of cash, securities or property totaling \$2,839,717), Ms. Alexander made the following transfers (**Question 3f**) in addition to the transfer of the 3696 acres, which were valued at \$200 per acre (\$739,286):

August 31, 1999 Marketable Securities (Value \$509,137.52)

November 23, 1999 Marketable Securities (Value \$1,652,098.93)

Ms. Alexander thus ultimately contributed \$2,900,522.45 to the Conservancy in satisfaction of her pledge of \$2,839,717.

Ms. Alexander does not and has not held a position with the Conservancy as a “director, officer, or employee” (**Question 3g**). During the period from January 31, 1992 through June 30, 2003, Ms. Alexander provided valuable volunteer assistance to the Conservancy as a trustee of the Conservancy’s Texas Chapter. At various times during that period, she served as co-chair of the Chapter’s Conservation Committee, Chapter Secretary, Second Vice Chair and Vice Chair.

The Conservancy is a single legal entity and its State and local Chapters thus do not have independent legal authority to act on behalf of the Conservancy. As a result, while the work of Chapter trustees is quite important to the success of the Conservancy’s conservation mission, their functions are properly described as advisory and supportive in nature, and they have no legal authority or fiduciary duty with respect to the Conservancy. They are unpaid, very involved and valuable volunteers. Although Chapter trustees thus do not have duties and authorities comparable to those of directors, officers or employees, they are and have been classified as “related parties” under the Conservancy’s conflicts of interest policy. As a result, both the 1997 Transaction and the 1999 Transaction were subject to advance review and approval by the Conservancy’s General Counsel.

Ms. Alexander is currently assisting the Conservancy as a member of its San Antonio Development Board, an advisory committee with respect to fundraising. In this

capacity, and as the owner of land on which the Conservancy holds conservation easements, she is in regular contact with the Conservancy.

B. Thompson Hill.

In Part I, **Question 4**, the Committee asked a series of specific questions concerning the Thompson Hill conservation buyer transaction. The Thompson Hill property consists of approximately 9.38 acres and is located immediately adjacent to the Conservancy's Mashomack Preserve on Shelter Island, New York. The Preserve is of substantial environmental importance (**Question 4c**). It consists of approximately 2,039 acres of diverse habitat necessary for the survival of many rare and significant species of plants and animals. It also contains nearly 1,500 acres of intact oak forest and its largely unbroken landscape provides habitat for sensitive neo-tropical migrant birds. The Pine Swamp complex at the western edge of the Preserve has been designated by the New York State Department of Environmental Conservation as a freshwater wetland of "unique local importance". The coastal environs that constitute the Preserve's perimeter include an assemblage of documented rare species and significant natural communities. Seven largely undisturbed tidal creeks and associated salt marshes cover nearly 300 acres and are the breeding grounds for some of the smallest links in the marine food web. Miss Annie's Creek, located on the western edge of the Preserve, has the most extensive tidal eelgrass beds within the Preserve. Ten miles of undisturbed beach with associated bluffs, low dunes and shrub lands provide habitat for beach-dependent species and rare beach plants. Not only is the Preserve of extraordinary ecological significance, it is also located in the heart of one of the most densely developed areas of the Eastern Seaboard of the United States.

The bulk of the Preserve, which is included in the Conservancy's North Atlantic Coast Ecoregion as a portfolio site, was acquired in 1980. At the sellers' request, the purchase of the Mashomack property was accomplished through the purchase of all of the stock of Aeon Realty Company, Inc. ("Aeon") from members of the Gerard family for approximately \$12 million. Aeon owned the Mashomack property and certain other real estate assets. These other assets were disposed at the time of or following the stock

purchase and Aeon was ultimately liquidated by the Conservancy. Prior to its acquisition by the Conservancy, the property that now comprises the Preserve was used for hunting and was slated for intensive residential development over the long term. (The Conservancy also purchased a small tract (2.43 acres) from a different party (Hickey) in 1981.) A valuation of Aeon at the time of the Conservancy's purchase of its stock indicated that the Conservancy's purchase price was less than the fair market value of the property acquired. Some members of the Conservancy's staff understood that one or more members of the Gerard family who sold shares of Aeon stock to the Conservancy may have intended to treat their sales as "bargain sales" and thus may have claimed a tax deduction based on treating the transaction as involving a contribution (**Question 4b**).¹⁵

The Thompson Hill property was not owned by Aeon at the time its stock was acquired by the Conservancy. Rather, it was owned by members of the Gerard family in their individual capacity and had been retained by them following the sale of the Aeon stock for possible resale or development. The Thompson Hill property was purchased by the Conservancy on an unrestricted basis from members of the Gerard family on September 2, 1999 for \$2.1 million. The Conservancy has no knowledge that the sellers claimed a charitable deduction with respect to the sale (**Question 4e**). At the time of its acquisition, the protection of the Thompson Hill property had been the subject of years of ongoing negotiations involving the Conservancy. From the early 1980s and throughout the 1990s, Conservancy staff and the owners of the property engaged in extensive discussions regarding a purchase of the property either by the Conservancy or a third party conservation buyer (who would take the property subject to a conservation easement). During this period, the Conservancy made at least one offer to purchase the property, as did the Doughertys (the ultimate conservation buyers) and several others. In addition, Conservancy staff discussed the property and its ecological value with numerous parties and the property was listed with local real estate brokers. Conservancy staff met with

¹⁵ Both the Aeon and Hickey transactions predated the imposition of the current requirement of donee acknowledgements on Form 8283.

some of these brokers to inform them of the Conservancy's desire to have a conservation easement on the property and provided draft easement language in several instances (**Questions 4g, 4h**).

Once the Conservancy finally secured an agreement in principle from the owners to enable the Conservancy to purchase the Thompson Hill property, time was of the essence lest the owners close a sale with a different (non-conservation) buyer. Given the substantial values of property in this area, the Conservancy concluded that it was in its best financial interest to locate a willing conservation buyer who could close promptly. Based on the marketing activities described in the preceding paragraph, the Conservancy's staff was aware of two potential buyers (both of whom were and remain Mashomack Preserve Trustees). One of the potential buyers decided not to proceed following a review of the Conservancy's proposed easement terms and the land was sold to the Doughertys on October 28, 1999 for \$500,000 (the appraised value of the land as restricted by the conservation easement by the Conservancy was \$506,000). The appraisal was conducted by an independent appraisal firm (Givens Associates) with substantial experience in appraisals in the relevant geographic area for both private and public sector clients. The appraisal was jointly commissioned by the Conservancy and the Doughertys, but the Conservancy was responsible for contracting and communicating with the appraiser (**Question 4i**).

As part of the conservation buyer transaction, the Doughertys made a separate charitable pledge to donate \$1.652 million to the Conservancy. The pledged amount was received by the Conservancy in a series of contributions of marketable securities within the stated 15-month time period (**Question 4f**). Because of the speed with which the Conservancy was required to respond in order to be successful in securing the property and given its substantial purchase price, the local Chapter of the Conservancy was required to fund the acquisition from the Conservancy's Land Preservation Fund. As a result, from the date of the purchase until repayment of the intra-Conservancy loan, the Chapter incurred an internal interest or capital charge. The ability to obtain this internal bridge funding was based in part on the Doughertys' pledge. The memorandum dated August 6,

1999 (**Question 4d**) was intended simply to ensure that the Doughertys clearly understood that satisfaction of the pledge on a timely basis was important. The pledge, when made, was for a fixed amount and the memorandum was not intended to modify, and did not modify, the terms of the pledge to add an interest element. It was intended merely to inform the Doughertys that the local chapter would incur additional costs if the pledge was not fulfilled in a timely basis.

With respect to statements attributed to Mr. Dougherty by *The Washington Post* (**Question 4j**) regarding his dual “intent” to acquire and protect the land, the Conservancy has no basis for specific comment. The commitment of the Doughertys to the Conservancy’s mission cannot be questioned and the Conservancy was and remains grateful for their commitment, which enabled the Thompson Hill property to remain in private ownership, and subject to local property taxes, while important conservation objectives were achieved on a permanent basis.¹⁶

The Conservancy strongly disagrees with the implication in *The Washington Post* that, because the conservation easement did not affect the Doughertys’ own plans for the land, important conservation objectives were not achieved. The conservation easement is perpetual. Thus, the transaction resulted in the *permanent* extinguishment of development and use rights that would otherwise have had significant economic value to the Doughertys *and* any and all subsequent owners. After nearly 20 years of uncertainty about the fate of this critical in-holding in a vitally important conservation preserve, the transaction ensured that the land will protect sensitive habitat and be used only for compatible uses in perpetuity.

C. Lake Huron.

In Part I, **Question 5**, the Committee asked a series of specific questions regarding the Lake Huron conservation buyer transaction. The Northern Lake Huron, Michigan, shoreline is portfolio site located within the Great Lakes ecoregion. It was identified as

¹⁶ Under the conservation easement, development is restricted to the construction of one residential and ancillary structures. It requires that all structures (other than a small writer’s cabin) be located within a designated development envelope placed well away from the bluffs and a nearby creek.

one of the richest and most productive biological areas in the United States by the Conservancy, and as a critical Biodiversity Investment Area by the Environmental Protection Agency. The shoreline features nine globally rare communities and at least 13 species that have been designated as endangered, threatened or listed under applicable federal and/or State laws. The site also contains at least 21 globally rare species of plants and animals, and 60 species that are rare within the State of Michigan. More than 250 species of migratory birds and waterfowl use the shoreline as a critical resting and feeding site.

The land that was the subject of this conservation buyer transaction was part of a parcel of approximately 210 acres located on the shoreline. Prior to its acquisition by the Conservancy, the land was slated for development as a golf course with 27 residential housing units. The Conservancy purchased the land in order to prevent habitat fragmentation.¹⁷

The structure of this transaction did not differ materially from the Conservancy's other conservation buyer transactions. The Conservancy acquired the property by purchasing two parcels of land for a total consideration of \$2,574,500 in October 2000 and April 2001. Independent appraisals obtained at the time indicated that fair market value of the unrestricted land was \$2,632,000. The Conservancy sold the larger parcel, 184.5 acres of the property, on December 9, 2002 to the conservation buyer (Jerrod Jung, a Chapter Trustee from 1995 through 1998, as trustee for the Jerrod M. Jung Trust). As part of the sales transaction, a comprehensive conservation easement was placed on the land and, as so restricted, it was sold for \$1,062,000. Under the easement, the then existing structures

¹⁷ The land was comprised of two parcels, one owned by an entity named Chi-Mac and the other by a Mr. Shillingburg. A Mr. Harmon acquired an option with respect to the Shillingburg parcel and the Conservancy entered into negotiations with all three parties to acquire the land. In response to the Committee's questions, and to the best of the Conservancy's knowledge, Mr. Harmon did not claim any charitable contribution deduction with respect to either the Harmon-Shillingburg tract or the Chi-Mac tract. Mr. Shillingburg did not make a contribution to the Conservancy, but instead conveyed his property to Mr. Harmon who then conveyed it to the Conservancy. The Conservancy did not provide Mr. Shillingburg with a blank Form 8283 and did not provide him with a letter stating that his conveyance to Mr. Harmon was a bargain sale. Finally, while the Conservancy believes that Chi-Mac claimed a charitable deduction for the \$98,700 reported on Form 8283, it has no direct knowledge that such deduction was in fact claimed.

(one residence, one log cabin, one pole barn and one boat dock) may be replaced in the same locations, but the log cabin may not be replaced if it is destroyed or voluntarily removed. The easement also prohibits any commercial use of the property; disturbance of native vegetation, agriculture or forestry; and restricts other changes to and economic uses of the land. An independent appraisal indicated that, as of January 1, 2002, that the value of this parcel, as restricted by the conservation easement, was \$1,062,000 and that the value of the easement was \$1,236,500. The balance of the land (approximately 24.8 acres) was sold, subject to appropriate conservation limitations structured as deed restrictions, to an independent non-profit organization in December 2002 for \$200,000.

The conservation buyer made a cash gift of \$650,000 to the Conservancy within two weeks after completing the purchase. The contribution did not fully reimburse the Conservancy for its original outlay in acquiring the land. Additional fundraising activities are still being conducted, but there remained an outstanding project debt of approximately \$353,400 as of June 2003. As noted earlier in this memorandum, the Conservancy seeks contributions from conservation buyers with increasing frequency. In fact, however, many conservation buyers are not in a position to make a contribution in an amount sufficient to cover all of the Conservancy's initial costs. The most important criterion is the ability to sell the property subject to a strong conservation easement and, if this can be done, the Conservancy often seeks a buyer who is willing and able to make at least a meaningful contribution.

Mr. Jung's agreement to make a cash contribution of \$650,000 was considered by the Conservancy the most favorable option available to ensure protection of the land and recoup a significant portion of its initial acquisition cost. The Conservancy has no knowledge with respect to the contribution deductions actually claimed by Mr. Jung either individually or through the Jung trust. The Conservancy received a cash gift of \$650,000 from Mr. Jung and, in accordance with applicable tax law requirements, provided Mr. Jung with written acknowledgement of that gift. The property was sold to Mr. Jung at its appraised value, as restricted by the easement.

D. Herring Creek Farm.

In Part I, **Question 10**, the Committee asked for a narrative description of the Herring Creek conservation buyer transaction, together with comments on the characterization of the transaction by *The Washington Post* in an article published on May 6, 2003.

1. Purpose and Effect. At the time of its acquisition by the Conservancy on or about July 21, 2001, Herring Creek Farm (the “Farm”) consisted of approximately 215 acres of land. There were six residential structures on the Farm (five of which were occupied), a large horse barn in the so-called “Central Field”, and a group of farm buildings associated with one of the six residential structures. The Farm is within an area that had previously been designated by the Conservancy as a portfolio site within the North Atlantic Coast ecoregion and the Conservancy had been interested in protecting it from development for many years.

The Farm includes an extensive shoreline and related wetlands habitats, but it was originally of interest to the Conservancy because it includes substantial areas of native coastal sandplain grasslands. These grasslands are located in close proximity to other native coastal sandplain grasslands (Katama Plains), which had previously been purchased by the Conservancy jointly with its governmental partners, and were being restored and maintained by the Conservancy. The coastal sandplain grasslands remaining on Martha’s Vineyard are part of one of the most threatened natural systems in the world, with less than one percent of the original global acreage remaining.

The acquisition of the Farm was the product of extensive and often contentious multi-party negotiations that lasted for more than a year. The Conservancy initially made an offer to the owners of the Farm (the “Wallaces”)¹⁸ to purchase the entire 215 acres for \$35 million. This offer was rejected by the Wallaces, who at the time had pending with the

¹⁸ In 2000, substantially all the Farm was owned by the Herring Creek Farm Trust (“HCFT”). Neil and Monte Wallace owned directly or indirectly substantially all of the beneficial interests in HCFT and the owners of the remaining comparatively small portion of the Farm were all members of or closely connected to the Wallace family. In this description of the transaction, HCFT and the other owners are referred to collectively as the “Wallaces”.

local government authorities a request for approval of a 33-lot subdivision on the Farm. That request was granted, with conditions, in November 2000. The Conservancy resumed substantive negotiations with the Wallaces' representative in December 2000. At the Wallaces' insistence, the Conservancy's negotiations with the Wallaces were expanded to include MV Regency Group LLC ("Regency")¹⁹ and F.A.R.M. Institute (the "Institute").²⁰ The Conservancy also conducted extensive negotiations with Herring Creek Acquisition Company LLC ("HCAC"), which held a pre-emptive option to purchase the Farm should the Wallaces seek to sell it.²¹ All of these negotiations were conducted at arm's length, they were often acrimonious and each participant was represented by its own counsel.

In the transaction, as finally completed, the Conservancy acquired title to the entire 215 acres comprising the Farm and was thus able to ensure that a comprehensive and permanent conservation restriction (the "Conservation Restriction") was placed on the entire property. In accordance with concession agreements previously negotiated, the Conservancy then transferred portions of the Farm (and other consideration) to HCAC, the Institute (which by prior agreement transferred a portion of land it received to Regency) and Roger Bamford ("Bamford"), who provided substantial financial assistance to enable the Conservancy to acquire the Farm. The terms of these transfers collectively permit the

¹⁹ Regency was a development company managed by Mr. David Peters and owned by the David M. Letterman Trust. The Conservancy understood, and press accounts of the transaction confirmed, that the Owners had previously engaged in discussions with Regency regarding a possible sale of the Farm.

²⁰ The Institute is a non-profit organization that seeks to preserve farms and promote agricultural education. The Conservancy understood, and press accounts of the transaction confirmed, that the Institute was a possible participant in the sales transaction apparently discussed by the Owners with Regency.

²¹ Most of the Farm had been acquired by the Wallaces in 1969 from two families, who also owned additional land adjacent to the Farm. At that time, the parties entered into an agreement which, among other things (1) assured that certain rights of way between the Farm and neighboring properties still owned by members of the two families were preserved; (2) assured that development of the Farm would be limited through 2009; and (3) granted to both parties purchase rights with respect to the other party's property in the event of a proposed sale by either prior to 2009. Under this third provision, if the Wallaces wished to sell the property between January 1, 2000 and December 31, 2009, the two families had a right of first refusal to purchase the Farm at \$10,000 per acre plus the fair market value of the then existing residences and other structures on the land. At some time before the summer of 2000, these pre-emptive rights had been transferred by the two families to HCAC.

construction of six new houses (instead of 33). Following these transfers, the Conservancy retained title to approximately 102 acres, consisting of a 62-acre parcel known as the East Field and a 40-acre parcel known as the Central Field. The Conservancy provided the Institute with a 99-year ground lease on the Central Field, subject to a restriction that it be used only for farming and other agricultural and educational uses. The Conservancy has undertaken a project to restore the 62-acre East Field to native sandplain grasslands. All 215 acres remain subject to the Conservation Restriction, which will be administered and enforced jointly by the Conservancy and the Conservation Commission of Edgartown, Massachusetts.

2. Description of the Transaction. The transaction was completed pursuant to the terms of a series of final agreements among the parties. The Conservancy was a party to written agreements with the Wallaces, the Institute and HCAC; and to an arrangement with Bamford. It was not a party to a contract with Regency. At the closing, the following transfers occurred:

a. Purchase of the Farm by the Conservancy. Pursuant to its agreement with the Wallaces,²² the Conservancy purchased the Farm from the Wallaces for \$64 million, payable as follows: cash received from the Institute (\$27 million); cash received from Bamford for the purchase of one of the existing residences (\$7,250,000); a portion of the proceeds of a Bank of America loan obtained, guaranteed and collateralized by Bamford and non-recourse to the Conservancy (\$9,250,000); a credit for the Conservancy's initial deposit (\$1 million) for which the Conservancy was reimbursed from the Bank of America

²² "Definitive Agreement Regarding Herring Creek Farm, Edgartown, Dukes County, Massachusetts, between The Nature Conservancy and Herring Creek Farm Trust". Under the terms of this agreement, the Wallaces had the right to specify the final purchase price based on a final appraisal (ultimately appraised at \$78 million), but the Conservancy was not obligated to pay more than \$45,500,000 from its own resources. If the final purchase price designated by the Wallaces exceeded this amount (as it did), the Conservancy had no obligation to complete the purchase unless it received additional contributions in an amount equal to the excess. The appraisal of the Farm was made by Coleman and Sons Appraisal Group ("Coleman"), which was selected by the Wallaces with the prior approval of the Conservancy. The Conservancy had the right to conduct a review appraisal of the Coleman appraisal and it retained Meredith & Grew Incorporated ("Meredith") to do so. Meredith informed the Conservancy that the purchase price of \$64 million did not exceed the fair market value of the Farm. Meredith also provided valuations to the Conservancy with respect to other components of the transaction.

loan; a promissory note secured by a mortgage on the Farm Lot (\$1 million); and an amount equal to a gift received by the Conservancy from the Wallace Foundation on July 18, 2001 (\$18.5 million). In connection with the purchase, the Conservation Restriction was placed on the Farm and all subsequent transfers of portions of the Farm (as described below) by the Conservancy were made subject to that restriction.

b. Transfers to the Institute. Pursuant to its agreement with the Institute,²³ and in exchange for \$27 million in cash and the Institute's assumption of the \$1 million promissory note secured by the Farm Lot, the Conservancy made the following transfers to the Institute: title to the Farm Lot; a 99-year ground lease on the Central Field (pasture land); and title to four building lots, one of which was the site of one of the existing Wallace residences. All of the consideration received by the Conservancy from the Institute was used by the Conservancy to finance the purchase of the Farm from the Wallaces. By prior agreement, the Institute transferred the four lots to Regency. Thereafter, Regency transferred one or more of the lots and retained the others. The Conservancy was not a party to the Institute's agreement with Regency or to Regency's subsequent transfers of certain of the lots.

c. Transfers to Bamford. Pursuant to its arrangement with Bamford,²⁴ and in exchange for \$7,250,000, the Conservancy transferred to Bamford a lot on which the second existing Wallace residence is situated. A second, buildable, lot was sold

²³ "Purchase and Sale Agreement between The Nature Conservancy as Seller and The F.A.R.M. Institute, Inc. as Purchaser Regarding a Portion of Herring Creek Farm, Edgartown, Dukes County, Massachusetts".

²⁴ The purpose of the arrangement with Bamford was to enable the Conservancy to complete the transaction without out-of-pocket costs either for the acquisition of the Farm or securing waiver of HCAC pre-emptive rights. Under this arrangement, Bamford would purchase two lots for their final appraised values. One of these lots was the site of an existing Wallace residence. Bamford also undertook to arrange a non-recourse (to the Conservancy) loan from Bank of America, which Bamford would guarantee and collateralize. This loan was intended to provide the Conservancy with the funds it needed to fund fully the \$45,500,000 purchase price, make cash payments to HCAC and recover its other transactional costs such as legal fees and transfer taxes. The Conservancy agreed that if it received any net sales proceeds from the sales to Bamford or the Institute in excess of the total costs of the transaction, that excess would be used to reduce the Bank of America loan. Bamford agreed to make a contribution to the Conservancy in an amount sufficient to enable the Conservancy to pay off the loan.

subsequently to Bamford for \$4,750,000 in December 2003 and the proceeds were used to reduce the Bank of America loan. No construction has been commenced on this lot.

d. Transfers With Respect to Pre-Emptive Rights. Pursuant to its agreement with HCAC,²⁵ the Conservancy made certain transfers in consideration of the waiver by HCAC of its pre-emptive rights. Meredith determined that these rights had a fair market value of approximately \$14 million, which was approximately equal to a second appraisal of those rights obtained by the Conservancy from Appraisal Economics, Inc.

In exchange for the waivers of the pre-emptive rights, the Conservancy made transfers valued at \$11,931,755 representing: (a) \$1,700,000 to reimburse prior legal expenses of the two families and HCAC in connection with litigation with the Owners concerning the validity of the 1969 agreement and contesting attempts by the owners to secure 50-lot and 33-lot subdivision approval with respect to the Farm; (b) \$402,755 in payment of HCAC's current legal expenses; (c) payment of \$1,484,000 as a gross up payment reflecting anticipated taxes on the consideration received for waiver of the pre-emption rights; (d) conveyance to HCAC for no consideration of two buildable lots having a total value of \$4,750,000; (e) conveyance to HCAC for no consideration of the Sanderling lot valued at \$1 million; (f) conveyance to one of the family members (as HCAC's assignee) for no consideration of the Blue Heron lot valued at \$625,000; (g) conveyance to HCAC for no consideration of beach rights and other property enhancements valued at \$750,000; and (h) release by the Conservancy of the pre-emptive rights encumbering properties of the two families under the 1969 agreement, which were valued at \$1,222,000. The values ascribed to items (d), (e), (f) and (h) were provided to the Conservancy in written appraisals by Meredith.

As noted earlier in this memorandum, the Conservancy agreed to provide a tax indemnity in order to secure HCAC's agreement to waive pre-emptive rights, but it was understood from the outset that Bamford would back the indemnity. The Conservancy understood that HCAC intended to treat the waiver as a bargain sale and claim a deduction

²⁵ "Agreement Regarding Transfer of Herring Creek Farm".

based on the excess of the value of the rights surrendered over the value of the consideration received. The tax indemnity was based on the sum of the anticipated tax on the taxable portion of the transaction and the tax benefit of the contribution to be claimed.

HCAC insisted on the indemnity as the only acceptable alternative to payment by the Conservancy of consideration having a total value of \$14 million, the appraised value of the pre-emptive rights. The Conservancy concluded that providing the tax indemnity was the least costly alternative and that the sum of the value of the indemnity and \$11,931,755 in paid consideration was less than the appraised value of the pre-emptive rights.

e. Transfer to Herring Creek Farm Landowners' Association. The Conservancy had the right to retain ownership of the roadways at the farm and the Beach Lot, subject to travel and use easements in favor of the other landowners at the Farm. In order to avoid the risk of liability as owner in the event of personal injury or death, the Conservancy transferred these portions of the Farm to the Association, a non-profit corporation, for no consideration.

3. Description of Conservation Restriction. The Conservation Restriction replaced the proposals previously advanced by Owners in securing approval of the proposed 33-lot subdivision, restricts in perpetuity the number of homes that may be built on the Farm and ensures that permissible development will have the least impact on the sensitive grasslands, wetlands and beach habitats on the Farm.

The Conservation Restriction is a permanent encumbrance on the entire Farm and, in pertinent part: (a) establishes pristine areas of the Farm with exceptional wildlife and plant species habitat where no development will ever be permitted; (b) establishes on those lots within the Farm where limited residential development will be permitted so-called "development envelopes" outside of which no improvements will be permissible and joins

together the resulting open space on each lot into meaningful tracts of contiguous habitat;²⁶ (c) imposes key restrictions on the Farm, including limiting public access to sensitive grasslands and beach areas, limitations on the types and numbers of domesticated pets that may be kept on the Farm, on the planting of non-native grasses and plant species outside the development envelopes and on the types of improvements that may be constructed within the development envelopes; (d) incorporates the Conservancy's science-based habitat management techniques, such as prescribed burning of certain grassland areas and beach management activities; and (e) prohibits development of shore-hugging mansions that would irreparably alter the character of the Farm and its unique vistas and "viewsheds".

In agreements with the Town of Edgartown, the Conservancy has reserved for itself the right to enforce the terms of the Conservation Restriction. To ensure meaningful enforcement, the Town and the Conservancy have entered into a Memorandum of Understanding concerning the individual and collective enforcement of the Conservation Restriction. The Town and the Conservancy will meet at least annually at an Open Space Management Meeting to review and discuss ongoing monitoring and enforcement activities. The Conservancy has prepared a baseline report to document the condition of the Farm upon its acquisition, which will be used as the basis for future enforcement and to measure the success of the program. The Conservancy and the Town will also cooperate in implementing aggressive conservation strategies, including soil and water conservation, restoration of native grasslands, active management of the beach area and open spaces (as set forth in separate management plans attached to the Conservation Restriction), and selective cutting and clearing of vegetation for habitat protection.

²⁶ There are 14 development envelopes. Three were established to permit the construction, relocation and/or expansion of previously existing barns and other farm-related structures and five related to previously existing residences. The remaining six were established to permit six new buildable lots. The total acreage encompassed by these envelopes is 16 acres. Once a structure is sited within one of these development envelopes, the remaining area within that envelope is significantly restricted as to its use and development. Thus, of the approximately 215 acres of the Farm initially acquired by the Conservancy only slightly more than six acres (the six development envelopes for the new buildable lots) was effectively opened for new development.

5. The Washington Post Description. The Committee asked the Conservancy to discuss the *Post's* description of the transaction in its article of May 6, 2003. The Conservancy disagrees with the *Post's* description of the transaction in several important respects, and representatives of the Conservancy so informed the *Post* prior to publication.

As the preceding description in this memorandum makes clear, the transaction enabled the Conservancy to restore the globally rare sandplain grasslands habitat and prevented the 33-lot subdivision originally approved for the Farm. Because the land on Martha's Vineyard is among the most expensive in the country, the Conservancy had no choice but to work with other parties having sufficiently significant financial resources to enable the project to proceed. While the transaction necessarily will result in limited new development, the Conservation Restriction prohibits any beachfront development, and only six new homes may be constructed on former farm pasture and previously cleared land nearby. None of these new homes may be built on actual sandplain grasslands and they are subject to size limitations. Thus, the Conservancy disagrees with the *Post's* reference to "Gatsbyesque" homes built on "pristine beach and grasslands". In the Conservancy's view, the *Post* more accurately described the effect transaction in its earlier July 27, 2001 article, a copy of which is being provided to the Committee, together with an article dated May 11, 2001, as published in the *Vineyard Gazette*.

The *Post's* description of the transaction in its May 6, 2003 article implies that the Conservancy was an active participant in the Wallaces' financial and tax planning for the transaction. This was not the case. As Conservancy representatives informed the *Post* before publication, the Conservancy did not work closely with the sellers and buyers to create a structure for all aspects of the transaction. The sellers and buyers worked independently of the Conservancy and, consistent with its policy (described earlier in this memorandum) the Conservancy made no tax or financial representations to the sellers or buyers. These parties had their own advisors and counsel and made their own judgments.

The Conservancy also disagrees with the implication that it actively assisted the Owners in securing approval of the 33-lot subdivision and thereby increasing the value of the Farm. The subdivision was approved by the Martha Vineyard's Commission on

November 16, 2000 and the Conservancy did not participate in the Commission's proceedings until May 2001, when it presented testimony concerning modification of the wastewater treatment system planned for the Farm. The gift to the Conservancy from the Wallace Foundation was not subject to an explicit binding condition that it be used only to finance the acquisition of the Farm. A copy of the Foundation's letter transmitting the gift has been provided to the Committee.

If the Herring Creek conservation buyer transaction had not occurred, it is doubtful that the Farm could have been preserved. As an editorial in the May 11, 2001 edition of the *Vineyard Gazette* observed: "The [Herring Creek] farm sale agreement brings peace and an important close to more than a decade of political warfare and lawsuits between developers and conservationists over this sensitive farmland" The editors went on to recognize the Conservancy and "its critical conservation buyers" for their "supremely important role in the agreement and in the future conservation stewardship of this treasured piece of the Vineyard."

* * *

The Conservancy stands ready to respond to any additional questions the Committee may have with respect to conservation buyer transactions.

NOV 23 2004

October 27, 2004
Senate Finance Committee Letter

Question 14

Please provide any private letter rulings or other written advice sought or obtained by TNC from the IRS with respect to its CBP.

With respect to its Conservation Buyer Program, The Nature Conservancy relied on written opinions of independent and well qualified outside legal counsel, all of which have been provided previously to the Committee. The Conservancy did not seek or obtain any private letter rulings or other written advice from the IRS with respect to its Conservation Buyer Program.

April 21, 2005
Senate Finance Committee Letter

Question 2

Regarding the current list of conservation buyer program properties listed on your website (available at http://nature.org/conservation_buyer/) please provide a narrative description of the efforts TNC is making to market these properties to the general public. Of the properties on this list, how many (and which ones, if any) were acquired from persons or entities with which TNC had or has a relationship of some sort (e.g., State or local trustee, financial contract).

In June, 2003, the Conservancy adopted a new comprehensive standard operating procedure for conservation buyer transactions that has been previously described to the Committee. One of the key requirements of that procedure is to ensure that conservation buyer properties are marketed widely. To meet that requirement, conservation buyer properties have been listed on the Conservancy's web-site.

As of May 1, 2005, the Conservancy had 52 properties listed for sale on its website. To the best of our knowledge, none of these properties were acquired from a related party (employee, Board member, Chapter Trustee, close relative of the foregoing, and related organizations). All of these properties are specifically listed on the web site to make sure that they are widely exposed to the general public at large. The Conservancy's web site received 3.8 million site visitors and 16.6 million page views during 2004. Our Conservation Buyer pages received 24,339 page views during 2004. We require all properties to be listed on our web site for a minimum of 30 days before we will contract to sell a property to assure equal access for all parties interested in purchasing conservation lands from TNC.

In addition to this substantive effort to expose all our conservation buyer properties to the public at large electronically, each state pursues marketing and exposure outlets. While the level, intensity, and type of the marketing depends on the size, value, and location of the property being marketed, in virtually every case, the property is listed with a local real estate broker who places the property on the MLS listing service, the brokers' website, and runs advertisements in local newspapers, local real estate magazines, and regional and national advertising venues as appropriate. To illustrate how this marketing works, *Rancho Canada de Pala*, one of the properties currently listed on the Conservancy's website, has been listed with a broker. Under the listing agreement, the broker lists the property on his website, other reputable websites, and local real estate magazines showing property for sale. Thus far, this property has been advertised on the CCIM network, Loopnet, "Homes and Land in Santa Clara" magazine, Ag Alert, Ranch and Country Magazine, the broker's website, MLS and California Farm Link.

In addition, most state offices post “for sale” signs on the property, list the property as being for sale in state-wide Conservancy newsletters, and place property for sale notices in state-wide circulation outdoor publications.

April 21, 2005
Senate Finance Committee Letter

Question 4

Please provide an estimate of the number of section 1031 like-kind exchanges that TNC has been a party to that have involved conservation buyer program properties in the last five years. We are seeking only those exchanges of which TNC has knowledge – and not asking the TNC to contact buyers to determine whether they were involved in a 1031 like-kind exchange.

To the best of the Conservancy's knowledge, during the five years of Fiscal 2000 through Fiscal 2004, the Conservancy completed approximately 20 like-kind exchanges as part of a transfer-out of property in a conservation buyer transaction. In every such case, the property owned by the Conservancy was transferred to the conservation buyer in exchange a) for a conservation easement over other land owned by the individual conservation buyer (typically, a neighboring landowner) that TNC sought to protect based on its conservation priorities, or b) for non-conservation land owned by the individual conservation buyer that the Conservancy would later sell for cash. There have been approximately five like-kind exchange transactions for the acquisition-in of property. In these cases, the Conservancy acquired land by trading other land to the seller. The land that the Conservancy acquired in the exchange was subsequently sold to a conservation buyer

In all cases, such exchanges were structured on a value for value basis and where values were not equal, cash was included as part of the transaction so that equal values could be obtained.

To put such transactions in context, during this same period, from FY00 to FY04, TNC completed some 7,718 conservation real estate transactions and approximately 170 conservation buyer transactions.