

A Sustainable Chesapeake

BETTER MODELS FOR CONSERVATION

Edited by David G. Burke and Joel E. Dunn

THE CONSERVATION FUND



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CHAPTER 4 INCENTIVE DRIVEN CONSERVATION

Introduction 134

Virginia's State Tax Credit for Land Conservation 135

Protecting Virginia's Landscapes With Tax Credit Incentives

By Philip M. Hocker and Joseph H. Maroon

Ecosystem Payments at Work 145

Conserving Land in Virginia's Great Dismal Swamp

By Shannon Meyer

Patuxent Greenway Reforestation Bank 153

Making Up for Lost Forestland in Anne Arundel County, Maryland

By Milton McCarthy and Joel E. Dunn

Effective Forest Banking 159

Forest Conservation in Carroll County, Maryland

By James E. Slater, Jr. and Glenn D. Edwards

A Residential Subdivision Designed for People and Wildlife 167

Incorporating Wetlands Creation and Forest Protection on Cooke's Hope at Llandaff, Near Easton, Maryland

By Lynda Eisenberg, David G. Burke and Joel E. Dunn

Virginia's State Tax Credit for Land Conservation

Protecting Virginia's Landscapes With Tax Credit Incentives

Virginia's transferable state tax credit for land conservation represents an effective, voluntary, free-market mechanism that has proven to vastly increase donations of conservation easements, which protects the integrity of the landscape and benefits the Chesapeake Bay watershed.

CASE STUDY SUMMARY

The Commonwealth of Virginia has created a powerful incentive for land conservation, a transferable credit to pay state income tax. Virginia's tax credit program operates state-wide, and in only nine years it has generated over 2,000 individual land conservation donations, protecting over 434,000 acres of land. The appraised value of the protected land is over \$2.2 billion and represents more than \$970 million in tax credits. The total area conserved continues to rise significantly each year.

Virginia loses 120 farms per year and over 20,000 acres of forest land per year to development for housing and commercial interests.¹ If current trends continue, Virginia is predicted to lose a million acres of forest in the next 25 years.² These escalating losses often include thousands of acres of land with high ecological and historical importance. These land use changes have contributed to population declines in the 55 species listed as endangered or threatened (40 animals & 15 plants) in Virginia. Nevertheless, the state ranks near the

bottom nationally in natural resource conservation spending and does not have a dedicated source of funding for land conservation purchases, which makes the tax credit program one of the most important conservation tools in the state.

In 1999, the Virginia General Assembly passed the "Virginia Land Conserva-

tion Incentives Act," to grant a credit against its state income tax to property owners who donated land or easements to protect conservation values in Virginia. The original tax credit granted was 50% of the value of a qualifying conservation donation in the state. Getting the original tax credit law enacted was a collective effort by the Virginia conservation



A stream at a private property protected using Virginia's tax credit program.

community, starting with a model proposed by Philip Tabas of The Nature Conservancy.

In 2001, two Virginia conservationists, architect Philip Hocker and attorney Charles Davenport, proposed that the tax credit should be made transferable in order to make it a more compelling and flexible stimulus for conservation donations. A transferable tax credit is one that can be sold to other taxpayers, in addition to being usable by the conservation donor alone in lieu of cash to pay taxes. Making the credit transferable makes it a much more powerful incentive for conservation gifts. Thanks to support from Delegate William Howell (R-28th District), the Virginia Land Conservation Incentives Act was amended accordingly in 2002.

To address the unexpected popularity of the program and concerns regarding the return to the state in conservation value, legislative amendments were made to the program in 2006 that placed greater financial and oversight controls on the properties claiming the tax deduction. The Virginia Department

of Conservation and Recreation was formally brought into the process to provide state government review of conservation easements claiming over \$1 million in tax credit and to produce an annual reporting of the program accomplishments.

The transferable state income tax credit has proven to be a flexible, politically popular, and dramatically effective tool to leverage significant private investment to accomplish conservation objectives. It provides both the wealthy landowner and the land-rich, cash-poor landowner with conservation options. Virginia's income tax program may provide other states in the Bay watershed and elsewhere with a model for a new and effective way to increase land conservation where consistently appropriated or dedicated funds for natural resource conservation are unavailable or limited.

RESOURCE MANAGEMENT CHALLENGE

Widespread development has overwhelmed farms, forests, and riparian habitat in many areas of the

TAX CREDIT VS. TAX DEDUCTION

The Federal government has offered a tax deduction for easement donations since 1964, but state tax credits for conservation originated in 1983, and were widely enacted in 1999 and afterwards.

Tax credits lower a taxpayer's bill dollar for dollar. Whereas, a tax deduction reduces a taxpayer's taxable income, so the value will depend upon the taxpayer's tax bracket.

For example, a \$10,000 credit lowers the bill by the full \$10,000, regardless of the tax bracket. A \$10,000 deduction will lower a taxpayer's bill in the 25% tax bracket by only \$2500.

Commonwealth. Twenty-five percent of all the development in Virginia has occurred within the last 15 years and the conversion of open space is increasing faster than the population as a whole.³ By some estimates, Virginia is slated to develop more land in the next 40 years than it did in the previous 400 since the founding of the Jamestown colony. Even with the recent economic slowdown, it is clear that development has negatively affected water quality, reduced habitat for threatened and endangered species, and destroyed historic, cultural, scenic and economic resources.

As a part of the Chesapeake 2000 Agreement, Virginia's government agreed with its regional partners to place conservation protections over 20% of its portion of the Chesapeake Bay watershed by 2010. Furthermore, in April 2006, Virginia's Governor, Tim Kaine, announced an aggressive goal



Photo of a Largeleaf grass-of-Parnassus (*Parnassia grandifolia*), an imperiled species in Virginia. This population was protected by an easement established through Virginia's tax credit program.



Aerial photo showing development encroaching upon rural farm and forest lands near Manassas, Virginia.

to protect 400,000 additional acres during his four-year administration, which represented a near doubling of past efforts annually.⁴ While Virginia is on track to meet the Governor's ambitious short-term objective, it will still be several hundred thousand acres short of its 2010 Bay goal.⁵

Although the *Virginia Outdoor Survey* found that 94% of respondents believed protecting Virginia's natural and open space resources was either important or very important,⁶ the Virginia General Assembly has been reluctant to appropriate funds for land or easement purchases. Since the early 1990s, Virginia conservationists have sought a dedicated fund established by state law - to provide a reliable, self-renewing source of funding to pay for land conservation - with no success. Special budget appropriations for conservation have been made, but these have been difficult year-by-year fights, and the amounts appropriated have been small relative to the need. The lack of consistent state funding for land conservation has made accomplishing conservation objectives and commitments tremendously difficult. For a rapidly developing state that covers

25 million acres with a strong conservation need, a new complementary strategy was needed.

CONSERVATION VISION

Offering tax benefits, rather than actual cash payment, to encourage people to do something government desires is an old concept. In the mid-Thirteenth Century, King Louis IX of France granted tax credits to encourage people to move to the new Mediterranean port he built at Aigues-Mortes. In the United States, charitable donations of land for conservation have been encouraged by federal tax deductions since 1917. Donations of conservation easements have been formally recognized as tax-deductible by the Internal Revenue Service since 1964.

To further increase the rate of land protection, some states have elected to offer more than tax *deductions* to encourage land conservation. North Carolina was the first state to offer the added incentive of a tax *credit* for land conservation, starting in 1983. Next, Virginia was the first of four states to legislate a state income tax credit for conservation in the year

1999. In 2000 and since, seven more states have established state tax credit conservation programs. The forms and details of the programs vary widely from state to state.⁷ Virginia's is one of the simplest, and the dollar volume of conservation achieved by the Virginia program is roughly double that of the runner-up, Colorado. Other states' programs have caps on the dollar amount of credit that can be claimed by any single donation, or other financial constraints, that limit their impact.

While the original 1999 state income tax credit was a very powerful first step, many conservation donations earned so much tax credit for the donors that they could not use it all. The top Virginia income tax rate is 5.75%, so state income taxes are often not large compared with the development value of a farm. Although the 1999 law allowed donors to carry unused tax credit forward for up to five tax years after the year of the original donation (paralleling federal treatment of tax deductions for charitable gifts), many land-rich, cash-poor landowners were unable to use the tax credit they had earned even over the six years allowed.

A transferable credit is a much more attractive conservation option because it can be sold by a cash-poor landowner to someone with substantial tax responsibility and provides added flexibility. For example, the tax credit is helpful to the cash-poor farmer who, after donating an easement, can sell the credit and receive cash, perhaps for new equipment or for their spouse's urgent medical treatment. It is also helpful to the problematic family estate with multiple second-generation owners, some of whom want to conserve their heritage, while others want cash benefits. Lastly, it is more appealing to free-market conservatives than special budget appropriations for land

conservation, which provides vital insulation from cutbacks during times of budget pressure. Davenport and Hocker set out to change the Virginia Land Conservation Incentives statute to make the tax credits transferable and to create a reliable market so landowners trust that they can convert the tax credit they earn for the donation into cash.

IMPLEMENTATION RESOURCES

There are two primary costs for the conservation tax credit program: operating costs and a reduction in the income taxes collected by the state.

Operating costs: The Department of Taxation administers the program, with assistance from the Virginia Department of Conservation and Recreation. Operating costs are modest. Under the 2006 amendments, a fee is levied only on the transfer of credit, to be used to cover state administrative costs. This fee is 2% of the value of credit transferred, up to a cap of \$10,000 per donation for any stage of transfers. Credit that is transferred once, and then re-transferred, is subject to a fresh levy each time it is conveyed. This fee has been acceptable to landowners, and does not appear to be a serious disincentive for participating in the program. Someone who uses the tax credit to offset their own tax liability and does not transfer the credit is not assessed a fee.

Reduction in Virginia's income taxes:

If the allowed maximum is used, the total tax cost to the Commonwealth of the credit program each year is capped by state law at \$100 million (adjusted each year for inflation since 2007) in foregone tax revenue. The table "Virginia Land Conservation Tax Credit History" shows how much credit has been issued. However, there is no firm data on how much of this issued credit has actually been

VIRGINIA LAND PRESERVATION TAX CREDIT PROGRAM

Following is a hypothetical example of the tax credit:

\$1,000,000 = Land value pre-easement

\$600,000 = Land value post-easement

\$400,000 = Easement value (EV)

\$160,000 = State income tax credit (40% of EV)

Maximum credit use is \$50,000/taxpayer/year and unless the Assembly changes the code, this will revert to \$100,000 in tax year 2011 and afterwards. A "married filing jointly" couple may use two times the maximum credit per tax year. Unused credit may be carried over for a maximum of 10 taxable years, following the taxable year in which the credit originated, until fully expended.

claimed – that is, returned instead of cash, on taxpayers' returns. Donors now have 10 years from the original donation to claim credits. It is likely that there is a significant decrease in the final cost of the tax credit program to the state, because part of the tax credit that is issued might never actually be submitted in lieu of payment on tax returns. The tax credit program has created a pro-conservation buzz in Virginia that has led to conservation donations being made for which some donors may never claim tax credit at all.

CONSERVATION STRATEGY

In 1999, the Virginia General Assembly enacted the Virginia Land Conservation Incentives Act, which is now codified in the *Code of Virginia* at § 58.1-510 et seq. The land preservation tax credit authorized under the Act provided an income tax credit of 50% of the fair market value for a donation of land or an easement to public or private conservation agencies for conservation and preservation purposes. The Act allowed for a carry-forward period, allowing credits to be applied to future state income tax, for a period of 5 years. The Act

required that eligible taxpayers must ensure that the use of the easement qualifies as a charitable deduction under Internal Revenue Code (I.R.C.) § 170(h) (i.e. exclusively for conservation purposes). It also requires that the donee must be a tax-exempt organization under the provisions of I.R.C. § 501(c)(3) and a private foundation under I.R.C. § 509(a)(2). The monumental effort to pass this legislation was led by The Nature Conservancy and a wide variety of Virginia land conservation advocates.

In 2001, Davenport and Hocker approached Delegate William Howell, currently Speaker of the Virginia House of Delegates, to lead an effort in the General Assembly to make the tax credits transferable. Delegate Howell was personally interested in seeing free-market tools used to advance the public policy goal of land protection and agreed to pursue the amendment. In 2002, the ability to transfer credits under the Act was codified in the *Code of Virginia* at §58.1-513(C), which provides that "[a]ny taxpayer holding a credit under this article may transfer unused but otherwise allowable credit for use by another taxpayer on Virginia income



A view of a private property in Nelson County, Virginia, protected using Virginia's tax credit program.

tax returns.” The phrase “unused but otherwise allowable credit” authorized the transfer of the total amount of the tax credit allowed by law and there was initially no cap placed on the amount of credit a given donation could claim.⁹

The original tax credit legislation effective at the start of 2000 allowed a credit of 50% of the appraised value of a conservation donation. Amendments enacted in 2006 reduced that ratio to 40%, effective at the beginning of 2007, and extended the carry-over period to 10 years. However, the rate of easement donations has stayed high even with the lowered credit ratio. Each year's total credit is dispensed on a first-come, first-served basis. The simplicity of this approach has been a great aid to the program's appeal to landowners. The 2006 amendments also placed a cap on the total amount of credit that may be issued in any year.

A unique aspect of the Virginia Land Preservation Tax Credit Program is the oversight review provided by the Virginia Department of Conservation

and Recreation (DCR). Beginning in 2007, amendments to state law tasked DCR with, among other things, compiling an annual report on all less-than-fee interest (conservation easement) donations for which a tax credit was requested. As a result of this record keeping, Virginia can now track the intended conservation purpose of these donations statewide. For example, in 2007, 22,765 of the 59,423-acres protected were donated with the expressed intent of preserving water quality.

In addition, the legislature assigned the director of DCR the role of verifying the conservation value of all donations where the donor requests more than \$1 million in tax credits. This verification is based on Conservation Value Criteria (Criteria) developed by DCR and adopted by the Virginia Land Conservation Foundation, a state citizen board made up of appointees by the Governor and the legislature. The Criteria include a review of the donation's conservation purpose, public benefit, and protections for water quality and forest stewardship. The DCR director must

verify that each qualifying donation has conservation value before the Department of Taxation can issue the tax credits. The DCR review has helped give confidence to the market that the tax credits will withstand IRS scrutiny.

Transferability has made a big difference in the state's land conservation efforts. After the law allowing transferability was passed, it took some time for a working market to be developed. Land trusts and agencies found the transferable credit to be an appealing marketing tool to interested landowners. Several private companies were formed to assist conservation donors, so there is now a reliable way for credit sales to be completed. Because there is some risk that a tax audit could challenge the validity or amount of the tax credit claimed, sellers usually must offer their credit for sale at a discount from its full face value. Buyers of the transferable tax credit also need to have trust that their expenditure will be valid.

The tax credit market developed slowly, starting in 2003. The first sales were made at a deep discount, because buyers were wary. The first transfer was made at a price of \$0.45 paid per dollar of tax credit value. However, the price paid for credit has risen as buyers' trust has grown. Transfers are now generally made at prices between \$0.75 and \$0.85 per dollar of credit value. Keeping the program stable and predictable has been essential to building buyer trust.

Although significant amendments were made to the statute since its inception, the Virginia tax credit program remains a remarkable success.

RESULTS

The Virginia Department of Taxation maintains a cumulative database of all conservation donations for which tax credit is claimed and the Virginia Department of Conservation and Recreation produces an annual report on the results of the program.¹⁰ As of mid-July 2009, the tax credit program has protected 434,657 acres and issued \$971 million worth of tax credits since 2000. From other sources, one can infer that a number of Virginia conservation donations

are made for which tax credit may never be claimed. Cumulatively, these figures clearly indicate that most of the acreage protected since Governor Kaine announced his 400,000 acre land conservation goal has been made possible by donations of conservation easements that qualified for the tax credit.

In considering the Virginia land conservation tax credit history (see table), several things should be noted: The Virginia *non-transferable* tax credit was enacted in 1999, and took effect for donations made on or after January 1, 2000. This actually led to a reduction in easement donations in 1999, because donors waited until their gift would qualify for the tax credit. The General Assembly's enactment of tax credit transferability in 2002, led to a startling increase in the rate of conservation gifts (mostly in the form of easements).

The volume of conservation donations grew steadily in 2003, '04, and '05. Donations exploded in 2006 when donors rushed to take part in the program before the legislative amendments took effect in 2007. Nevertheless, since the start of 2007, conservation donations have

continued at a rapid pace. Data from the Department of Taxation and the Virginia Outdoors Foundation indicate that 2008 garnered the second highest acreage of conservation donations ever seen, behind the "land-rush" year of 2006 (see Virginia Land Conservation Tax Credit History table).

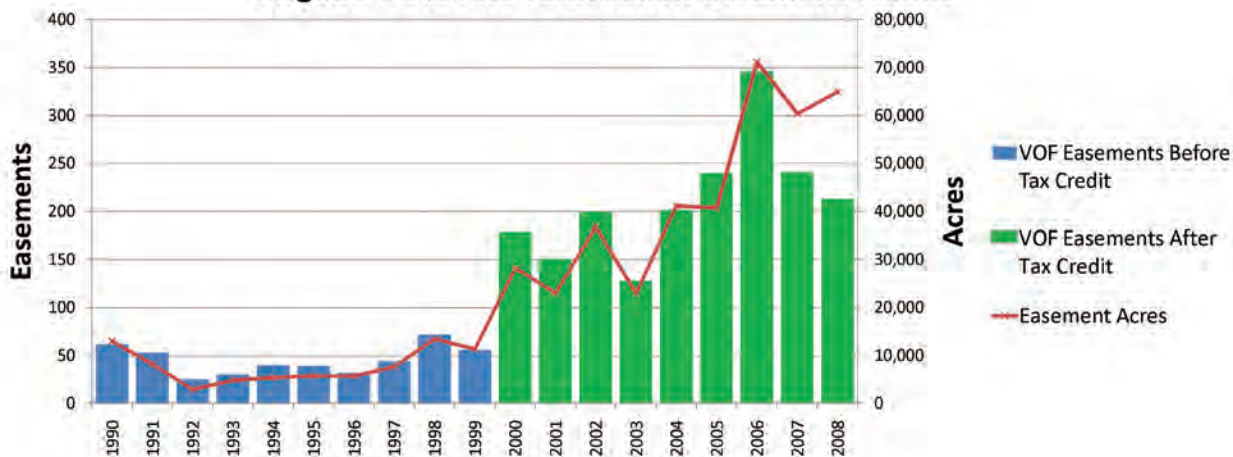
The *rate* of easement donations can be measured through statistics of the Virginia Outdoors Foundation ("VOF"). Approximately 93 percent of conservation easements in Virginia are donated to VOF. Many agencies and independent land trusts in the state work to encourage landowners to donate easements, but prefer that the donations be held by VOF because it is believed that VOF will have a more reliable ability to enforce easements over time.

Through the decade 1990 through 1999, the Virginia Outdoors Foundation received an average of 45 easement donations each year (see Virginia Outdoors Foundation Easement Trends graph). This amounted, to an average of 7,855 acres of land protected each year. In 2000, with the non-transferable tax credit, donations to VOF jumped to 179 individual easements, and a total of

Virginia Land Conservation Tax Credit History				
Tax Year	Number of Donations	Number of Acres	Appraised Value	Tax Credit Issued
2000	126	17,441	\$51,941,891	\$25,970,946
2001	94	13,534	\$53,531,727	\$26,765,864
2002	214	34,791	\$124,520,613	\$62,260,307
2003	139	28,059	\$150,717,414	\$75,358,707
2004	237	49,379	\$283,011,440	\$141,505,720
2005	277	55,914	\$310,875,751	\$155,437,875
2006	455	93,605	\$493,992,166	\$246,996,083
2007	254	59,423	\$249,862,906	\$99,945,164
2008	224	60,199	\$255,717,705	\$102,287,084
mid-2009	92	22,312	\$88,553,720	\$35,421,489
Total to Mid-July 2009	2,112	434,657	\$2,062,725,333	\$971,949,239

*Data from VA Department of Taxation, updated 13 July 2009.

Virginia Outdoors Foundation Easement Trends



28,300 acres. This dropped slightly in 2001. Then when transferability was granted in 2002, the VOF total rose to 199 easements and 36,800 acres. As more landowners and their advisers learned how to use the transferable tax credit and with the visibility and encouragement of the Governor's land protection goal, the rate of conservation easement donations to VOF has risen so that in both 2007 and 2008, VOF protected over 60,000 acres a year.

In 2007, as part of their new oversight role, DCR reviewed 20 potential donations within an average of 22 business days, while providing valuable feedback to the donor and the holder on the conservation terms of the donation. These 20 donations represented \$28 million of the \$100 million in land preservation tax credits requested in 2007. Since many different entities, ranging from The Nature Conservancy to a new local land trust, help to broker and hold conservation easements, DCR's review has proven to be valuable in improving the quality of the conservation easements in Virginia. For example, the Department's preliminary review of easement documents has resulted in improvements such as those listed below to the final donations:

- ▶ Providing consistent protection of forestland by requiring a forest management plan;
- ▶ Ensuring that scenic easements contain visual access;
- ▶ Requiring that water quality be protected by the development and implementation of a farm conservation plan where applicable;
- ▶ Improving the Chesapeake Bay and its tributaries by requiring the establishment of riparian buffer areas along perennial streams and water bodies;
- ▶ Ensuring that historic resources on conserved lands are protected from demolition and alteration if listed on state and national registries; and
- ▶ Requiring the protection of documented rare, threatened, or endangered resources found on the property.

All of these protections were added to donations that otherwise likely would not have protected these significant natural resources. For example, as originally submitted to DCR, one application claiming agricultural use as its sole conserva-



Photo of an Appalachian Jewelwing (Calopteryx angustipennis), an imperiled species in Virginia. This population was protected by an easement established through Virginia's tax credit program.



The Walters placed an easement on their Virginia farm and used the money they received from the transferable tax credit to improve their waste treatment facilities.

tion purpose would have allowed substantial development of the property under the terms of the proposed easement. DCR's review required that the overall development of the property be limited to protect the future agricultural use of the land prior to recordation of the easement and submission of a final application.

Virginia's wealth of unique places is nowhere more apparent than in the lands that were protected using the land conservation tax credit program. Recent examples include the following:

- The program was used to protect a small 40-acre farm in northern Virginia dedicated to organic farming. This farm, which is in the Chesapeake Bay watershed, is within 1,000 feet of several municipal groundwater wells, and protects drinking water for the community.
- The program has been used to protect another property in the coastal region of the Bay watershed that is not only the site of several significant moments in the nation's history, but also contains a rare southern upland hardwood forest and an active agricultural operation.

- An easement on a 1,700-acre family farm along the Mattaponi River not only helped ensure the continuation of high-quality farming and forestry practices, but the tax credits also enabled the elderly owner to be able to afford a nursing home while preserving the farm for her family.
- Tax credits from preservation of a dairy farm on a tributary of the Pamunkey River helped the family pay down debt on new milking facilities, including some state-of-the-art manure and waste treatment facilities, thus, helping this Bay area farm to remain in farming.

Almost every property reviewed in 2007 had some form of agricultural activity at the time of donation, ranging from row crops in Loudoun County to cattle farming in the Tidewater region and equine breeding in Albemarle County. In a number of instances the applicant's stated goal in preserving the property and requesting the tax credit was to provide the financial wherewithal to enable the transition of the next generation of the family into the management of the agricultural operation.

KEYS TO SUCCESS

Fostering a land conservation ethic:

A successful program builds upon and helps cultivate heartfelt concern by local landowners for the beauty and conservation value of their lands.

Creating a simple state tax

credit program: Programs should be designed to be a simple incentive, not a complex directive. The rules for qualifying should generally parallel the federal rules for a tax-deductible conservation donation, however, Virginia's special emphasis on water quality and forest stewardship show that state level priorities can be successfully incorporated. In addition, the state level review if handled properly such as in Virginia can provide greater consistency in the value of lands donated, and offer additional predictability to credit buyers and donors alike. Any concerns over the loss of state income taxes can be overcome by placing an annual program-wide ceiling on the amount of credit to be issued.

Managing a program on a first-come

first-served basis: Fair and equal access is crucial to the integrity of the

program. Applications for credit that are made after the annual ceiling is reached should be placed in a queue, and credit allowed for them in the next year. Virginia does this.

Maintaining a level playing field:

Over the history of Virginia's tax credit program, there have been several proposals to grant higher rates of tax credit to specific kinds or categories of conservation gifts. Targets for favored treatment have included: smaller farms, recreational lands, gifts that allow public access to the protected land (which most conservation easements do not include), or lands in specific watersheds. Thus far, the Commonwealth has resisted such proposals while recognizing their merit. Attempts to grant special treatment to parts of the land conservation could undermine public support for the entire effort if adopted.

Ensuring transactions earning credits deserve public investment:

Beginning in 2007, DCR was given the responsibility for administering a review of conservation value for conservation donations that claim

\$1 million of credit or more. DCR, led by its Director, Joseph Maroon, has worked hard to develop procedures for this review process that are workable and responsive to landowner needs. Of special note is the pre-approval process that DCR created to help landowners determine whether the terms of proposed conservation easements would qualify *before* the landowner had made the irreversible commitment of donating an easement and reducing the property's market value.

Remembering that conservation

progress takes time: Making a conservation easement donation is a complex process. A program on the scale of Virginia's depends on building a level of professional expertise among attorneys, public accountants, appraiser, agencies, and others, in addition to developing trust on the part of landowners. This takes time. The pace of easement donations, as measured by gifts to the Virginia Outdoors Foundation, has grown as the landowner and professional-service community have developed more comfort with the program.

Developing essential partnerships and government agency support:

The tax credit by itself is only an incentive to action; it does not actually protect any land. The fact that hundreds of thousands of acres have been protected through this program is due to a fine cooperative effort by many people, nonprofit organizations and government agencies.

In Virginia, the Department of Taxation has played an especially helpful role. This surprises many folks – after all, the tax credit *reduces* state revenues. An agency dedicated to collecting taxes would not be expected to be an ally. But the staff and leadership of the Department of Taxation have understood that the General Assembly wants the tax credit program to be “user-friendly,” and the Department has worked hard to comply. The Department has been concerned about possible abuse of the program, but in the authors' judgment it has done a good job of balancing the need for solid enforcement of the rules with the need to make the program responsive and accessible to landowners.



Photo of a smooth purple coneflower (Echinacea laevigata), an imperiled species in Virginia. This population was protected by an easement established through the Virginia's tax credit program.

PHOTOS AND FIGURES

Page 135, 136, 139, 141, 143: Photos, Irvine Wilson, Virginia Department of Conservation & Recreation, Natural Heritage Program
 Page 137: Image, Google Earth
 Page 141: Figure, Joel Dunn
 Page 142: Photo, Virginia Department of Conservation and Recreation

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