The Appraisal Journal

SPRING 2022
Volume XC, Number 2

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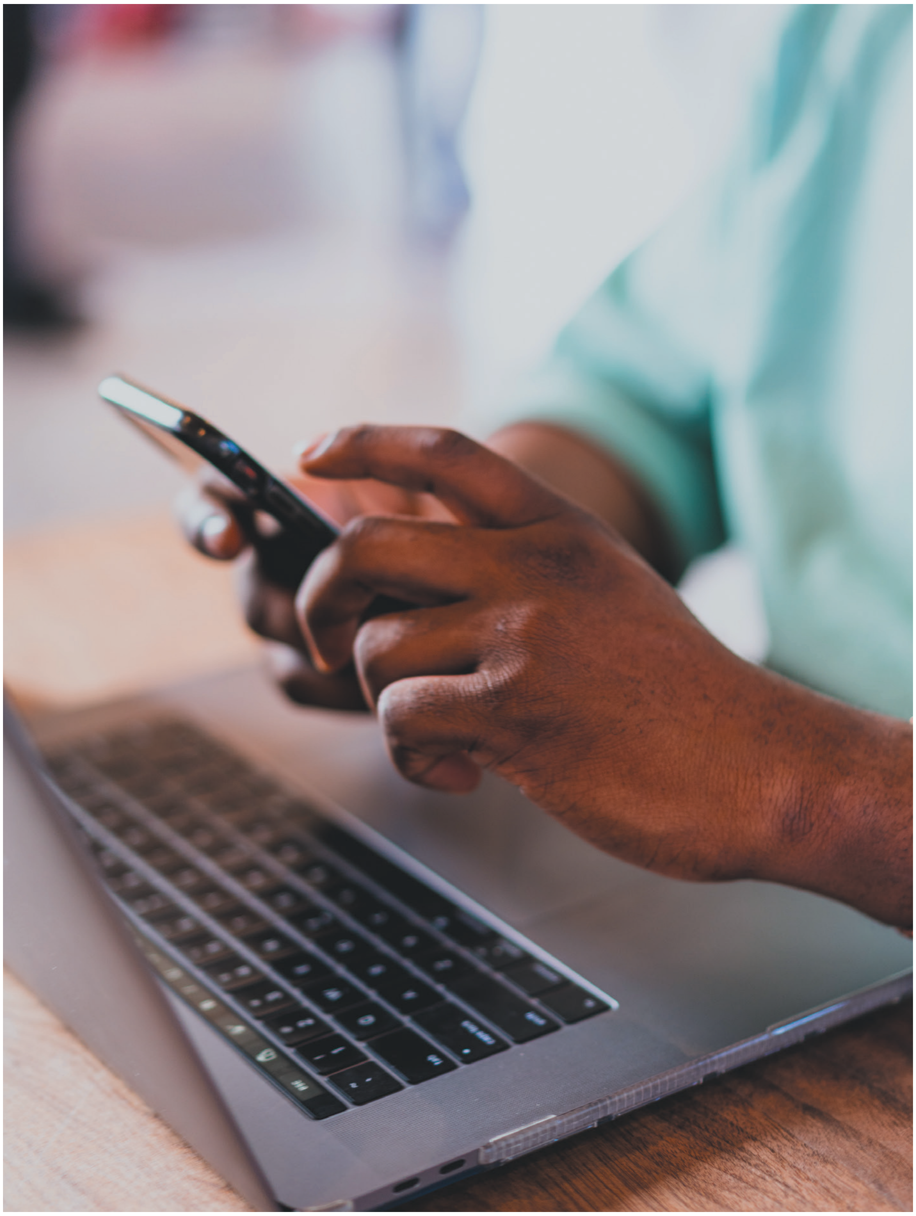

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The Appraisal Journal

Published by the Appraisal Institute

The Appraisal Journal (ISSN 0003-7087) is published quarterly (Winter, Spring, Summer, and Fall).

Periodical postage paid at Chicago, Illinois, and at additional mailing offices. **Annual Subscription Rates**: Domestic—$60 standard rate, $120 library rate, $38 AI rate, $30 student rate, $35 single copy. **International**—$120 standard rate, $175 library rate, $75 student rate. **Telephone orders**: 888-756-4624. **Online Store**: http://www.appraisalinstitute.org. Postmaster: Send address changes to Order Fulfillment Department, *The Appraisal Journal,* 200 W. Madison, Suite 1500, Chicago, Illinois 60606. Allow six weeks for changes. To opt out of print copy delivery, email taj@appraisalinstitute.org.

Design and production services provided by Grayton Integrated Publishing: www.graytonpub.com.

Mission Statement: *The Appraisal Journal* is published to provide a peer-reviewed forum for information and ideas on the practice and theory of valuation and analyses of real estate and related interests. *The Appraisal Journal* presents ideas, concepts, and possible appraisal and analytical techniques to be considered; some articles are for the development and expansion of appraisal theory while others are useful in the evolution of practice.

The Appraisal Institute advances professionalism and ethics, global standards, methodologies, and practices through the professional development of property economics worldwide.

Stephen T. Crosson, MAI, SRA

Thought Leadership

Dear Readers:

Each year, the Spring issue of *The Appraisal Journal* recognizes exceptional work within this forum for ideas on real estate valuation, and on the following pages you will see the announcement of our 2021 article awards. It is important that we pause and acknowledge these outstanding articles and their authors. In addition, we recognize the outstanding service of Kenneth M. Lusht, PhD, MAI, SRA, who during the past year has contributed valuable volunteer hours to the *Journal* as a member of *The Appraisal Journal* Academic Review Panel and Statistics Work Group.

We also have three peer-reviewed feature articles in this issue discussing both new and enduring concerns for real estate appraisers.

The cover article, "Understanding Desktop (Bifurcated or Hybrid) Appraisals," examines the new opportunities for appraisers to provide narrow-scope appraisal services in light of the latest pronouncements by Fannie Mae and Freddie Mac on acceptance of desktop, bifurcated, and hybrid appraisals. The authors summarize the circumstances where such services are allowed and the relationship between the two steps in the related appraisal processes.

The second feature, "Stigma: A Case Study Analysis of Long-Term Environmental Risk Effect," points out that while stigma is sometimes a temporary negative perception, that is not always the case. The article presents an environmental case study reporting that stigma can continue more than twenty years.

The third feature, "Market Rent and Highest and Best Use: Joined at the Hip?," delves into the definitions of market value and market rent and the relationship between each of these concepts and highest and best use. The article discusses how the concepts interact with use rent and use value. New definitions are proposed to clarify the relationships and to result in more accurate analyses.

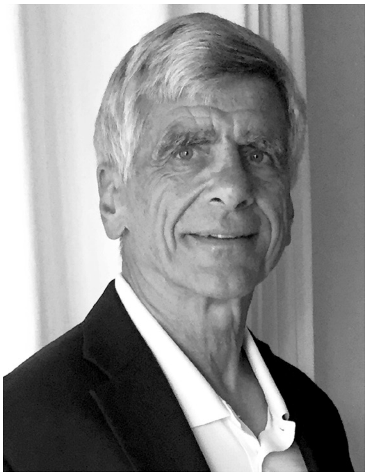
Also, in this issue you will find the inaugural edition of *The Appraisal Journal*'s "Economic Perspectives" column. In the "Economic Perspectives" column, readers will find insights by guest columnists on factors currently at play in economics, real estate, and financial markets. This first edition of "Economic Perspectives" looks at the interrelationship of environmental concerns and investments.

We appreciate the dedication of all who have contributed to *The Appraisal Journal*'s peer review process as well as the authors who have shared their knowledge with our readers. As always, we welcome your manuscript submissions and comments.

Stephen T. Crosson, MAI, SRA
Editorial Board Chair and Editor-in-Chief
The Appraisal Journal

Kenneth M. Lusht, PhD, MAI, SRA

Kenneth M. Lusht, PhD, MAI, SRA, is the winner of *The Appraisal Journal*'s 2021 Outstanding Service Award. This award recognizes the member of the *Journal*'s Editorial Board, Review Panel, or Academic Review Panel who during the previous year showed exceptional commitment to *The Appraisal Journal* through outstanding service.



Kenneth M. Lusht, PhD, MAI, SRA

Lusht is a member of *The Appraisal Journal*'s Academic Review Panel and its Statistics Work Group. He is a professor and associate dean emeritus at Penn State University and currently is a professor of real estate at Florida Gulf Coast University. Lusht's research interests include valuation theory and practice, and the measurement of value impacts of externalities. He has published three texts and over forty articles.

Lusht was instrumental in developing the real estate program of the Smeal College of Business at the Pennsylvania State University. There he served as Smeal College interim dean, Smeal College associate dean for research and director of doctoral and master of science programs, academic program director for the continuing education program in real estate, and director of the Institute for Real Estate Studies. He also served on the Education Advisory Committee to the Pennsylvania Real Estate Commission.

Lusht has developed and taught numerous seminars and courses for the Appraisal Institute and also has served as a faculty associate of the Lincoln Institute of Land Policy.

Lusht is a Fellow of the Homer Hoyt Institute and a past president of the American Real Estate and Urban Economics Association. He has served as a trustee of the Appraisal Foundation and a member of the board of trustees of the Center for Economic Studies. Throughout his career he served as a visiting scholar at universities in Australia, New Zealand, Hong Kong, Singapore, Turkey, and Finland.

Winning Article: "National Park Concessions: Valuation Concepts, Issues, and Controversies"

Richard J. Roddewig, JD, MAI, CRE, FRICS

Richard J. Roddewig, JD, MAI, CRE, FRICS, is the winner of the 2021 Armstrong/Kahn Award for his article, "National Park Concessions: Valuation Concepts, Issues, and Controversies," published in the Summer 2021 issue of *The Appraisal Journal*.

The Armstrong/Kahn Award is presented by *The Appraisal Journal*'s Editorial Board for the most outstanding original article published in *The Appraisal Journal* during the previous year. Articles are judged on the basis of pertinence to appraisal practice; contribution to the valuation literature; provocative thought; thought-provoking presentation of concepts and practical problems; and logical analysis, perceptive reasoning, and clarity of presentation.

In "National Park Concessions: Valuation Concepts, Issues, and Controversies," Roddewig takes a deep look into the National Park Service's concession program and its various attempts to compensate concessioners for the value of physical improvements put in place during the tenure of a concession contract. The discussion examines the evolution of valuation concepts from "sound value" to the latest compensation concept, "leasehold surrender interest value," highlighting the elements and challenges as the park service tries to balance the interests of outgoing and incoming concessioners and the interests of park users.

Richard J. Roddewig, JD, MAI, CRE, FRICS, is a managing director at JLL Valuation Advisory and is national director of the firm's Complex Real Estate Analysis and Litigation Support practice. Much of his valuation work over the past forty-five years has involved heritage properties across the United States, and in South America and Australia. Roddewig has authored, coauthored, edited, or contributed to nineteen books, including a number of Appraisal Institute books. He has authored or coauthored more than sixty-five articles in professional journals, including more than fifteen articles in *The Appraisal Journal*. He has an undergraduate degree in history and government from the University of Notre Dame and both a master of arts degree in political science and a juris doctor degree from the University of Chicago.

To read the award-winning article, go to http://bit.ly/Appraisal_Journal.

Winning Article: "Valuation of Accessory Dwelling Units"

Sandra K. Adomatis, SRA

Sandra K. Adomatis, SRA, is the winner of the 2021 Swango Award for her article, "Valuation of Accessory Dwelling Units," published in the Fall 2021 issue of *The Appraisal Journal*.

The Appraisal Journal's Editorial Board presents the Swango Award to the best article published during the previous year on residential, general, or technology-related topics, or for original research of benefit to real estate analysts and valuers. The article must be written by an appraisal practitioner. Articles are judged based on practicality and usefulness in addressing issues faced by appraisers in their day-to-day practice; logical analysis, perceptive reasoning, and clarity of presentation; and soundness of methodology used, especially in an area of original research.

"Valuation of Accessory Dwelling Units" examines the growing acceptance of accessory dwelling units (ADUs) as a strategy to address demand for more affordable housing in metropolitan areas. The article highlights changes in zoning and mortgage market guidelines that impact valuations and highest and best use analysis and discusses the strengths and weaknesses of data sources that might be used in developing an opinion of value. The article presents examples demonstrating techniques for addressing valuation dilemmas when the subject property is an ADU.

Sandra K. Adomatis, SRA, is the 2022 vice president of the Appraisal Institute. Her one-year term as vice president will be followed by one year each as president-elect in 2023, president in 2024, and immediate past president in 2025. She will serve on AI's Executive Committee and the policy-setting Board of Directors all four years. She also serves as chair of the Finance Committee in 2022 and will serve as chair of the National Nominating Committee in 2025. Adomatis is a real estate appraiser and consultant of Adomatis Appraisal Service in Punta Gorda, Florida. She is also an Appraisal Institute instructor, developer of seminars and courses, contributor to textbooks, and author of the text *Residential Green Valuation Tools*. Additionally, she is a national spokesperson to state and federal government agencies, energy organizations, REALTOR groups, state coalitions, national and local homebuilder groups, and utility companies. Adomatis contributed to the 2011 "Appraisal Institute Residential Green and Energy Efficient Addendum," and to the 2014 "Appraisal Institute Commercial Green and Energy Efficient Addendum." Internationally, she is also working with Canada to adopt the AI "Green and Energy Efficient Addendum" to their residential properties.

Adomatis is a member of the Appraisal Institute's national Government Relations Committee. She previously served on the national Admissions Designation and Qualifications Committee, and on the national Education Committee as chair, vice chair, and member. She also served as president of the West Coast Florida Chapter and as education liaison for the Appraisal Institute's Region X. She served as member, vice chair, and past chair of the Residential Demonstration Report Writing Committee, and as a grader of demonstration reports and writing assignments for the Advanced Residential Report Writing course, the demonstration alternative.

She previously has received the Appraisal Institute's Lifetime Achievement Award, Outstanding Service Award, President's Award, and Dr. William N. Kinnard Jr. Award; *The Appraisal Journal*'s Armstrong/Kahn Award and Swango Award; the Henry C. Entreken Lifetime Achievement Award; and Region X Volunteer of Distinction (2010).

To read the award-winning article, go to http://bit.ly/Appraisal_Journal.

Winning Article: "Land Values and External Obsolescence"

Stanley D. Longhofer, PhD, is the winner of the 2021 Richard U. Ratcliff award for his article, "Land Values and External Obsolescence," published in the Spring 2021 issue of *The Appraisal Journal*.

The Richard U. Ratcliff Award is presented annually for the best original article published in *The Appraisal Journal* written by an academic author. Articles are judged on the basis of pertinent appraisal interest, provocative thought, logical analysis, perceptive reasoning, clarity of presentation, and overall contribution to the literature of valuation. To be eligible for this award, an article must have been peer reviewed by members of *The Appraisal Journal*'s Academic Review Panel, and an author must be primarily engaged in teaching at a college or university.

"Land Values and External Obsolescence" highlights underlying sources of external obsolescence and how a structure suffers external obsolescence if the current use is not the property's highest and best use. Longhofer demonstrates application of this concept in a variety of situations where allocating the impact of external factors between land and structure values might otherwise be difficult. The article uses case study examples to show how if a structure maximizes the land's value, then any loss in value due to external factors is attributable to the land, not the building. The article suggests that by paying careful attention to the highest and best use of the site, the appraiser can more accurately allocate the impact of the external factors.

Stanley D. Longhofer, PhD, is a full professor and holds the Stephen L. Clark Chair of Real Estate and Finance in the W. Frank Barton School of Business at Wichita State University. He is also the founding director of the WSU Center for Real Estate, through which he provides research and educational services to real estate professionals in the Central Plains region, and is the author of the Center's annual Kansas Housing Markets Forecast series. He holds a BBA in economics from Wichita State University and MS and PhD degrees in economics from the University of Illinois.

Stanley D. Longhofer, PhD

To read the award-winning article, go to http://bit.ly/Appraisal_Journal.

Topics in Need of Authors

Since 1932, *The Appraisal Journal* has been the leading peer-reviewed forum for appraisal professionals. Consider becoming an author for the *Journal* and use your professional knowledge and experience to benefit yourself and your profession.

Manuscript Review
Each manuscript submitted to *The Appraisal Journal* is considered in a double-blind review. Manuscripts may be reviewed by members of the Editorial Board, Review Panel, or Academic Review Panel, or by outside specialists when appropriate.

See the Manuscript Guide for information about submitting a manuscript.

Articles Needed

The Appraisal Journal welcomes manuscripts on all topics related to real estate valuation. We are especially interested in receiving manuscripts on

- Banquet facilities, clubs, and venues
- Communications tower value
- Corporate campuses
- Easements
- Fixtures, furniture, and equipment
- Industrial properties
- Market delineation
- Opportunity zones
- Recreational facilities
- Residential appraisal
- Value impacts of covenants or deed restrictions

Case study analyses are encouraged.

Incentives

Awards
The Appraisal Journal presents the Armstrong/Kahn Award, the Swango Award, and the Richard U. Ratcliff Award each year for exceptional articles published in the *Journal*.

Continuing Education Credits
Appraisal Institute Designated members and Practicing Affiliates may earn up to 125 points (25 hours) of AI CE credit (per five-year cycle) under the category of Service to the Appraisal Institute for authoring articles published in *The Appraisal Journal*.

by Benjamin A. Blair, JD

Recent Court Decisions on Real Estate and Valuation

Request to compel condemning authority to purchase in fee simple requires reasonable timing

George Mitola purchased 67 acres of undeveloped land in North Scituate, Rhode Island, for $325,000 in 2002. His intention was to subdivide it into eight parcels, and develop them as individual homesites, while keeping some for his family.

In 2005, the Providence Public Buildings Authority (Authority) sought to acquire the development rights of Mitola's property. The Authority retained an appraiser to determine the value of the development rights to be taken and notified Mitola of that fact. Mitola did not initially hire an appraiser, and the Authority sued to compel the appointment of an appraiser, leading to several years of litigation about the constitutionality of the Authority's actions.

Separately, the Authority in 2012 filed a petition requesting that the trial court determine the sum of money that would satisfy the claims of all persons interested in the development rights. In March 2012, the court set that amount at $775,000 (later reduced to $485,000), and the Authority promptly deposited that amount into the court registry. Further litigation ensued.

In April 2015, Mitola filed a Petition for Assessment of Damages, stating that he did not agree with the amount offered by the Authority as just compensation for the taking of the development rights, and asserting that the taking of development rights instead of taking the property in fee simple was unconstitutional. In December 2015, Mitola filed a petition to compel the Authority to purchase his property in fee, pursuant to a statute allowing for that procedure. The trial court rejected the petition as untimely, and then conducted a bench trial on the assessment of damages. Ultimately, the trial court adopted the appraisals offered by the Authority, which rejected the use of a sales comparison approach for a property whose highest and best use was for subdivision and development, awarding Mitola $492,000.

Mitola appealed to the state supreme court, arguing that the trial court committed reversible error by denying Mitola's petition to compel purchase in fee, and also in rejecting the sales comparison approach in determining the value of the property. The state supreme court found the first argument dispositive.

Rhode Island law provides that when an authority initiates condemnation proceedings for development rights, the affected owner may notify the authority and the superior court of his request that the authority take a fee simple interest in the land. The terms of the statute clearly indicate that the authority "shall" acquire property in fee simple if the property owner properly notifies the authority and court of that request. However, the statute does not make clear how much time is afforded to a property owner to notify the appropriate entities of that election.

Noting the novelty of this issue, the court expressed its opinion that the obligation of the Authority to purchase property in fee simple, if an owner so requests, is not everlasting. That interpretation would produce the "nonsensical" result that an authority acquiring development rights must anticipate the chance that a property owner could request the property be purchased in fee simple at any time after the original acquisition occurred. Statutes of limitation are imposed to eliminate that very element of surprise.

The court instead construed the statute to impose an element of reasonableness in the timing of such a request. The question therefore became whether Mitola filed his petition in a reasonably timely manner.

The court rejected the Authority's argument that the timing should begin in 2006 when the Authority notified Mitola of its intent to hire an appraiser. While the legal proceedings in the case date back to 2006, the condemnation proceedings did not commence in 2006. Rather, it was not until 2012 that the Authority filed a petition requesting the trial court to determine the amount that would satisfy the claims of the persons interested in the development rights. The court interpreted the initiation of the condemnation proceedings in March 2012 as beginning the clock for Mitola to file a petition to compel.

The court was unpersuaded that a lapse of less than four years was an unreasonable amount of time.

Mitola filed his petition for assessment of damages in April 2015 and filed the petition to compel purchase in fee simple in December 2015. The court was unpersuaded that a lapse of less than four years was an unreasonable amount of time. Accordingly, the court held that Mitola's filing of his petition in December 2015 was timely.

The supreme court vacated the trial court's judgment and remanded with an instruction to enter an order compelling the Authority to take Mitola's property in fee. Further proceedings to value the fee simple interest in the property as of March 2012—the date that the condemnation proceedings began—were also ordered.

Mitola v. Providence Public Buildings Authority
Rhode Island Supreme Court
May 9, 2022
273 A.3d 618

Conveyance to government of interest with reverter not subject to time limitations

In 1974, Allen Morris and his company 1000 Brickell Ltd. (1000 Brickell) deeded a property to the City of Miami (City) for the creation of a public park. The deed granted the City a fee simple interest in the property but also contained a clause providing that if any part of the property should ever be used for any purpose other than as a public park, "the estate hereby granted to the grantee shall automatically and immediately terminate, and all right, title and interest in and to such property shall thereupon revert to the grantor."

Initially, the City used the property as intended. Then in 1999, the City requested permission from 1000 Brickell to use a portion of the property for outdoor seating of a neighboring restaurant. 1000 Brickell gave its consent for that limited use of a portion of the property, but the City then allowed the restaurant to unilaterally expand its footprint and erect permanent improvements, ultimately allowing the restaurant to appropriate substantially more of the property for its exclusive private use.

1000 Brickell filed suit, asserting that under the express language of the deed, the fee simple estate terminated automatically and immediately, and thus all rights to the property reverted to 1000 Brickell. The City moved for summary judgment, arguing that a statute barred the lawsuit because the deed was executed more than thirty years before the complaint was filed. That statute, Florida Stat. 95.36, provides, in relevant part, that it is "in the best interest of the public that ancient dedications of lands to municipalities for park purposes for a period of thirty years or more shall not hereafter be disturbed or challenged in law or equity." The trial court granted summary judgment to the City, and 1000 Brickell appealed.

The court of appeal noted that, read in a vacuum, the City's contention that the statute precludes a claim to a reversionary interest after thirty years might appear to have merit. But when read in light of the various types of property conveyance methods recognized by common law, Section 95.36 is inapplicable.

By its plain terms, Section 95.36 is limited to "ancient dedications of lands to municipalities for park purposes." A common law dedication is the setting apart of land for a public use, in which property is granted to a municipality for a public purpose. But a dedication is not the same as a fee simple conveyance. Rather, a dedication is simply an easement for public use, entrusted to the municipality with the fee simple title remaining with the grantor and the public having the right of use, but nothing more. So, an acceptance of a dedication does not pass the fee in land, and the dedicator retains the fee simple title.

Conversely, when a grantor conveys property in fee simple to a municipality, with a deed restriction that requires the property to be used for a public park, the municipality holds a "fee simple determinable estate," which terminates automatically upon the happening of a specified event. This estate interest is sometimes referred to as a fee simple subject to an automatic reverter.

Since there was no dispute that 1000 Brickell as conveyed in the 1974 deed was a fee simple determinable estate subject to a restriction and not a dedication of land, the time limitation of Section 95.36 was inapplicable. But the court did not stop its analysis there, because another statute also confirmed the court's analysis.

Florida Statute 689.18 provides that, in general, "no reverter or forfeiture provision contained in any deed conveying real estate or any interest therein" executed after 1951 "shall be valid or binding more than 21 years from the date of such deed." However, all conveyances of real property made to governmental, educational, or charitable organizations are expressly excepted from that provision. Thus, while the legislature has made it clear that a reverter provision contained in a deed conveying real estate in Florida is deemed null, void, and unenforceable after 21 years, conveyances to municipalities and certain charitable organizations were excepted from that rule.

The City's construction of Section 95.36 would mean that though the legislature expressly stated its intent to exempt conveyances to a municipality from the application of the 21-year limitation on actions, it simultaneously allowed for that same municipality to obtain fee simple absolute title after thirty years, irrespective of any restriction imposed by the grantor. The court concluded that the deed executed by 1000 Brickell in favor of the City was a fee simple conveyance with an automatic reverter clause, and thus the trial court erred in granting summary judgment to the City under Section 95.36. The case was remanded for further proceedings.

1000 Brickell Ltd. v. City of Miami
Florida Court of Appeal, Third District
April 13, 2022
2022 WL 1099410

Improper use of quick take where taking scope is beyond easement

Brenda and Gene Sauvageau own 7.8 acres of land in Cass County, North Dakota. In 2019, they learned that the Fargo-Moorhead Diversion flood control project would flood their property. The Case County Joint Water Resource District (District) had the property appraised in fee simple in December 2020 for $460,000. In February 2021, the District offered the Sauvageaus $460,000 to purchase the property in fee simple, which the Sauvageaus declined. In April 2021, the District offered the Sauvageaus $460,000 to purchase a right-of-way easement over their property, but again the Sauvageaus declined.

In October 2021, the District sued the Sauvageaus, seeking to use its quick take eminent domain power to acquire a permanent right-of-way easement covering all of the Sauvageaus' property and arguing that the easement over the property was necessary for the flood control project. Shortly thereafter, the District told the Sauvageaus that they would be required to vacate their home in March 2022.

The Sauvageaus moved to dismiss the District's complaint, claiming that the District could not use quick take because it sought more than an easement. They also moved for a preliminary injunction prohibiting the District from evicting them and destroying their home. The district court denied the Sauvageaus' motion to dismiss and requested injunction. The Sauvageaus petitioned the state supreme court to exercise supervisory jurisdiction, which is an authority to issue supervisory writs to rectify errors and prevent injustice in extraordinary cases.

The North Dakota Constitution allows for the taking of private property for public use upon payment of just compensation. It also expressly authorizes the state to acquire a right of way by quick take, which allows the state to take possession of property upon making an offer to purchase and by depositing the amount of the offer with the clerk of the district court. Quick take offers an owner less protection than traditional takings because the condemnor can take possession of the property before trial on the amount of just compensation due.

The District's complaint alleged it followed the procedures enumerated in the quick take statute, including identifying the property and stating that the right of way would encompass the entire property. The complaint also stated that the District sought a permanent right-of-way easement over the Sauvageaus' property for the purpose of constructing and maintaining the diversion project, including inundating the property with water and removing structures from the property.

In their motions, the Sauvageaus included the District's appraisal report valuing the fee simple interest in their property at $460,000. The appraisal noted the appraiser's opinion that a buyer and seller of a property via permanent easement would consider the property rights

Quick take offers an owner less protection than traditional takings because the condemnor can take possession of the property before trial on the amount of just compensation due.

transferred to be akin to a transfer of fee title. The appraisal valued the Sauvageaus' reverter interest in the property at $0, though at oral argument the District's attorney argued they could use the property for bird watching or hunting if it did not conflict with the District's use.

In denying the Sauvageaus' motion to dismiss, the district court concluded that on the basis of the pleadings taken as true, the District could use quick take to acquire a permanent right-of-way easement over the Sauvageaus' property as a necessary component of and incidental feature of a flood control project. The Sauvageaus' argument that the District's taking left them with no value in the property went to the issue of damages rather than the authority of the District to take a right-of-way easement. The supreme court found this analysis flawed.

Property rights in a physical thing have been described as the rights to possess, use, and dispose of it. To the extent that the government permanently occupies physical property, it effectively destroys each of those rights. Even though the owner may retain the bare legal right to use the property or dispose of it by transfer or sale, the permanent occupation of the space by a stranger will ordinarily empty the right of any value.

Here, the court concluded that the District was taking much more than an easement or right of way in the Sauvageaus' property. The District was not acquiring a strip or a parcel of the property for a right of way. Rather, the District intends to close the public road, remove all structures from the property, engage in disturbance of the surface and subsurface, and inundate the property with water. The District is, in reality, taking the entire property for full value while leaving the Sauvageaus with only a reverter interest with no value. Thus, the District's taking goes beyond the scope for acquiring a right-of-way easement by quick take. Instead, by labeling the interest of the Sauvageaus' property as a "permanent right-of-way easement," the District was attempting to evade the requirements and owner protections of the eminent domain statutes.

Accordingly, the state supreme court agreed with the Sauvageaus that the district court erred by denying their motion to dismiss the District's quick take complaint.

Sauvageau v. Bailey
North Dakota Supreme Court
April 28, 2022
973 N.W.2d 207

No constitutional requirement that quasi-public entity have specific eminent domain powers to implicate de facto condemnation

In 2009, UGI Storage Company (UGI) filed an application with the Federal Energy Regulatory Commission (FERC) seeking a certificate enabling UGI to acquire and operate certain facilities used in the interstate transportation and sale of natural gas. One of those facilities was a 1,216-acre underground storage facility in Tioga County, Pennsylvania, referred to as the Meeker storage field. In its application, UGI also sought to include a 2,980-acre protective zone around the storage field as a buffer zone. That area included a number of properties owned by others (the Landowners).

FERC ultimately granted the application to permit UGI to acquire and operate the Meeker storage field, but it denied the request for a cohesive buffer zone. The denial was based on a lack of detail in the application about the zone, and because while UGI's predecessor operated the storage facility, it did not own the property rights to the entire proposed buffer zone. UGI also failed to comply with FERC's landowner notification requirements. As a result, FERC certified only those portions of the proposed buffer zone for which UGI had acquired the necessary property rights or would be able to acquire them.

To provide the additional information to FERC, UGI stated that it would pursue a comprehensive evaluation of its property rights and would pursue a land acquisition program for acquiring contractual storage rights from the Landowners. UGI had not yet acquired any rights to the Landowners' properties within the proposed buffer zone, however, resulting in a partial, non-intact buffer zone.

In November 2015, the Landowners filed petitions seeking an appointment of a board of viewers to assess damages for an alleged de facto condemnation of their property under a Pennsylvania statute establishing the procedural avenue for securing just compensation in inverse condemnation scenarios or upon a de facto taking. The basis for the Landowners' claim was that UGI applied for approval of the buffer zone because UGI wanted to ensure that there would be no gas extraction activities in proximity to the Meeker storage field.

A storage field buffer is necessary to protect the security and integrity of a gas storage reservoir. When exploration or production companies operate in proximity to a storage field, the stored gas can migrate to the drilled wells, taking gas belonging to the owners of the gas in the storage field.

By virtue of UGI's application for a proposed buffer zone, the Landowners claimed that UGI had effectively prohibited all hydraulic fracturing activities on properties in the buffer zone, so leasing entities would not lease oil and gas rights nor drill for the exploitation of those rights in the buffer zone. While the Landowners recognized that their properties had been excluded by FERC from the buffer zone, UGI signaled—but never acted upon—its intention to apply for additional certifications to obtain property rights in the entire buffer zone. Those actions were sufficient to prevent exploration and production on the Landowners' properties, which the Landowners claimed constituted a de facto condemnation.

On appeal to the state supreme court, the Landowners argued that the lower decisions provided a "playbook" for how public utilities like UGI could enjoy the benefits and protections of a buffer zone without providing any compensation to affected landowners.

Pennsylvania employs a three-part test for whether a de facto taking has occurred: (1) the condemnor must possess the power of eminent domain, (2) the property owner must be substantially deprived of the use of their property through exceptional circumstances, and (3) the damages sustained must be an immediate, necessary, and unavoidable consequence of the condemnor's exercise of its eminent domain power. This case involved the first prong.

Based on the Landowners' petitions, the county court initially found that a de facto taking had occurred and appointed a board of viewers to assess damages. But UGI lodged objections, arguing that in order to be liable for a de facto taking, an entity must possess the power of eminent domain relative to the plaintiffs' property. But UGI had never been granted such a certificate in relation to the Landowners' properties. The county court agreed and dismissed the Landowners' petitions.

The intermediate appellate court affirmed. Unlike the county court, the majority regarded the first prong as encompassing an inchoate power of eminent domain, rather than as requiring a property-specific power. Because UGI was precluded from exercising eminent domain powers over the Landowners' properties in the absence of federal certification, the Landowners could not establish that any asserted deprivation of the use of their property was a consequence of the exercise of the power to condemn.

On appeal to the state supreme court, the Landowners argued that the lower decisions provided a "playbook" for how public utilities like UGI could enjoy the benefits and protections of a buffer zone without providing any compensation to affected landowners. It was left entirely to UGI to decide whether and to what extent to pursue further federal regulatory approval with respect to properties within the buffer zone, affecting the Landowners' property without compensating them.

The court began by noting that to condemn means to take, injure, or destroy property by authority of law for a public purpose. The statutory definition of *condemnor* interjects the concept of an *acquiring agency*, defined as "an entity … vested with the power of eminent domain" by the laws of Pennsylvania. In that discrete context, there was no requirement of a nexus between this power and a specific property. Rather, to effect an actionable taking, it is enough that the condemnor has proceeded by authority of law for a public purpose.

Accordingly, the court did not discern a constitutional requirement that a quasi-public entity alleged to have invoked governmental power to deprive landowners of the use and enjoyment of their property for a public purpose must be invested with a power of eminent domain in order to be held to account for a de facto condemnation. Given that finding, the county court erred in preliminarily dismissing the Landowners' de facto taking claims on the basis that UGI did not have eminent domain powers with regard to the Landowners' property specifically.

The case was returned to the lower courts for further proceedings.

Hughes v. UGI Storage Co.
Pennsylvania Supreme Court
November 29, 2021
263 A.3d 1144

Declaratory judgment not proper where insurer already terminated appraisal process

Travelers Indemnity Company of America (Travelers) issued an insurance policy to Townes of Cedar Ridge Condominium Association (Cedar Ridge), which represented the residents of a forty-building complex, for direct physical loss or damage to the buildings. The policy included an appraisal provision that set forth a procedure for when Travelers and Cedar Ridge disagreed on the value of the property or the amount of loss, which allowed either party to make a written demand for an appraisal of the loss. But even if there was an appraisal, Travelers retained the right to deny the claim. The policy also excluded coverage for wear and tear and for deterioration.

In May 2019, Cedar Ridge informed Travelers that its buildings had suffered hail damage from a storm in March 2019. Travelers inspected the property and found that some gutters, air conditioning units, and one shingle on one roof had sustained hail damage but concluded the rest of the damage was the result of wear and tear. Travelers issued a check for $17,140.88 for the damages it found were covered and informed Cedar Ridge of the denial of the remainder of its claim.

Cedar Ridge responded by providing to Travelers an estimate of $2,078,657.08 to repair the damage to its buildings it maintained was caused by the hailstorm. Cedar Ridge demanded an appraisal to resolve the dispute regarding its claim. But Travelers rejected the appraisal demand on the basis that it had denied Cedar Ridge's claim because it found no wind or hail damage to the buildings, not because it disagreed with the amount of loss. Thus, according to Travelers, Cedar Ridge was disputing coverage, which was precluded under the appraisal provision.

Travelers thereafter sought declaratory judgment concerning the scope of the appraisal provision. Cedar Ridge moved to dismiss, arguing that Travelers had already rejected its demand for an appraisal, thus forfeiting its opportunity to have the trial court declare whether Cedar Ridge's appraisal request and Travelers' denial were appropriate under the policy. The trial court granted the motion to dismiss, and Travelers appealed.

Declaratory judgment allows a court, in cases of actual controversy, to make binding declarations of rights having the force of final judgments. A declaratory judgment action allows the court to address a controversy one step sooner than normal after a dispute has arisen, but before steps are taken that would give rise to a claim for damages or other relief. A declaratory judgment action is not the vehicle for a declaration of nonliability for past conduct, as it deprives the potential plaintiff of its right to determine whether it will file and when and where.

The appellate court first concluded that Travelers had a tangible legal interest in upholding the provisions of its insurance policy, including rejecting Cedar Ridge's appraisal request. It also agreed that Cedar Ridge had an opposing interest in that it wanted to use the appraisal procedure. But Travelers could not show that there was an actual controversy between the parties, because once Travelers denied Cedar Ridge's appraisal request, there was no longer an actual controversy regarding the applicability of the appraisal provision. Thus, Travelers could not fulfill the requirements necessary for a declaratory judgment.

Travelers argued that it had shown an actual controversy. First, Cedar Ridge never withdrew its appraisal request after Travelers denied it, leaving in limbo the coverage issue. But the appellate court disagreed with Travelers' reasoning. Travelers undisputedly denied Cedar Ridge's request to use the appraisal procedure. There was no need for Cedar Ridge to withdraw its appraisal request when it had been denied. No further action was required by Cedar Ridge regarding the denial other than to file a breach of contract action.

Travelers also argued that a declaration from the court would guide the parties' future conduct regarding the appraisal process. But Travelers' denial of the appraisal request terminated any controversy regarding its applicability. Had Travelers wanted guidance on the scope of the appraisal provision as it maintained, it should have sought a declaration prior to making a determination about Cedar Ridge's appraisal request.

The issue here was whether a declaratory judgment action is the proper vehicle for review of Travelers' conduct. A declaratory judgment action is not the proper vehicle to review past conduct. Travelers already terminated the option of the appraisal procedure and then asked the court to approve its conduct. If Travelers wanted confirmation of its denial of the appraisal request, it should have first filed its declaratory judgment complaint seeking guidance on whether Cedar Ridge's claim fell under the appraisal provision. Instead, it denied first and sought guidance later.

Accordingly, the appellate court affirmed the trial court's dismissal of Traveler's declaratory judgment complaint.

Travelers Indemnity Co. of America v. Townes of Cedar Ridge Condominium Assoc.
Illinois Appellate Court, Third District
April 25, 2022
2002 IL App (3d) 200542

Hydroelectric water rights forfeited for nonuse and converted to in-stream water rights

Oregon has a complex and extensive set of laws governing water rights. Historically, two common law doctrines have governed the use of surface water: riparianism, which assigns water rights based on the ownership of the land appurtenant to the water source, and prior appropriation, in which available water is allocated on a first-in-time, first-in-right basis to anyone who puts the water to a beneficial use. Oregon water rights law includes elements of both systems.

As now codified, Oregon law provides that all water in the state belongs to the public, but it can be appropriated for beneficial use as provided by law. Once a water right certificate is issued, the rights continue as long as the water is put to a beneficial use. But, if a water right holder does not put the water to a beneficial use for any five successive years, the right is subject to forfeiture to the state.

Recognizing the incentives of this use-it-or-lose-it system, Oregon also enacted an In-Stream Water Rights Act, which acknowledges the validity of in-stream water rights that allow the amount of water specified in the right to be left flowing instead of diverted, i.e., the water is left "in stream." The water right is then held in trust by the Oregon Water Resources Department (OWRD). The system also allows rightsholders to lease all or part of their rights for conversion to an in-stream right while maintaining their original priority date and forestalling forfeiture for nonuse. Those with existing water rights may lease them to others in five-year increments.

Rock Creek is a small stream in eastern Oregon that eventually flows into the Snake River. A hydroelectric project was originally built on the site in 1903 by an operator who received a water right certificate for the purpose of generating power. Eventually, in 1995, the project was shut down and stopped diverting water, and the project's Federal Energy Regulatory Commission license expired the next year. The then-owner briefly leased its hydroelectric water right to the state as an in-stream water right, then eventually transferred the remaining components of the project and water rights to another company, which renewed the in-stream water lease to the state.

Eventually the project was acquired by Warm Springs Hydro LLC (WSH). An environmental watchdog group, WaterWatch, grew concerned that WSH intended to restart the project after the next lease term ended, twenty-five years after it had last diverted water. WaterWatch petitioned for judicial review of OWRD's approval of the lease renewal. WaterWatch contended that the periodic lease renewals were an attempt to circumvent the conversion statute, so OWRD was required to convert WSH's water right into an in-stream water right held by the state.

The trial court concluded that any beneficial use of water under WSH's water right restarted the five-year clock in the conversion statute, and that beneficial use had occurred at least once every five years since diversion stopped. The trial court dismissed WaterWatch's action against OWRD and WSH, and the appellate court affirmed. WaterWatch appealed to the Oregon Supreme Court.

The question before the state supreme court was whether the hydroelectric right held by WSH, which had been leased to the state periodically for over twenty years, became subject to conversion to an in-stream water right under the conversion statute. The answer depends on whether the "use of water under the hydroelectric water right ceased." To OWRD and WSH, the right was being used as an in-stream right during the periodic leases, and thus use had not ceased.

The court began by discerning what it means to use water under a hydroelectric water right. Water can be appropriated only with a state-issued permit, and whether or not an application is approved depends on the nature of the proposed use. Once a permit is issued, water rights-holders may only appropriate water at the rate, time, and place specified and cannot use the water for an unpermitted purpose. The court determined that the adjective "hydroelectric" describes the use permitted by a hydroelectric water right. Here, WSH's right authorizes the use of water for "power." That right does not permit other beneficial uses.

Once a water right certificate is issued, the rights continue as long as the water is put to a beneficial use. But, if a water right holder does not put the water to a beneficial use for any five successive years, the right is subject to forfeiture to the state.

Having established what it means to use water under a hydroelectric water right, the court next considered what it means for that use to cease. Emphasizing the connotation of permanence in the definitions of *cease*, the court concluded that the conversion statute was triggered once five years have passed during which water was not used under a hydroelectric water right. If the use of the water resumes within five years of a stoppage, then that stoppage was temporary; if the hydroelectric use does not resume within five years, then the stoppage is permanent, and use has ceased.

OWRD and WSH conceded that the water associated with the hydroelectric water right held by WSH had not been used for hydroelectric purposes since 1995, so that use had ceased. OWRD and WSH argued, however, that the lease statute has the effect of tolling the five-year period in the conversion statute. The court rejected that argument. Any water right leased under the statute is converted to an in-stream water right—either temporarily if leased or permanently following a transfer. Once a hydroelectric right has been converted to an in-stream water right, it is no longer a hydroelectric right for the duration of the conversion. After conversion, use of water for hydroelectric purposes is no longer permitted.

Applied to the facts of this case, the Rock Creek project had not used water for hydroelectric purposes since 1995, so the water right for the project was subject to conversion in 2000. When its owners leased the water right to the state, it was temporarily converted to an in-stream water right, but only use under the hydroelectric right tolls forfeiture under the conversion statute. So, after 1995, there was no use under the hydroelectric right, and the conversion statute was thus triggered. Accordingly, the trial court erred in dismissing WaterWatch's petition, and the state supreme court remanded for further proceedings.

WaterWatch of Oregon v.
Water Resources Department
Oregon Supreme Court
December 23, 2021
369 Or. 71

Just compensation in partition of property may balance equities between parties

Willis Cavanagh owned a property in Norwalk, Connecticut, with various members of the Bloom family and related businesses (Bloom Defendants). The property is a 0.7-acre waterfront property with frontage on the Norwalk Harbor. Land comprises about 75% of the parcel, with the remaining 25% extending into the harbor. The property is improved with a small building, bulkhead, boat lift, sixty-foot dock, and pier.

In 2011, Cavanagh, who owned a one-third interest in the property, commenced an action to partition the property by sale. Initially the Bloom Defendants agreed that a partition by sale, with an equitable distribution of the proceeds, would better serve the interests of the co-owners than a partition in kind. But the Bloom Defendants later argued that a partition by sale would not be in the interest of the owners. They alleged that Cavanagh's interest in the property was minimal, and therefore they were entitled to an order requiring him to convey his interest in the property to it for fair compensation. They also asserted the right to a setoff for the amounts they had spent for the maintenance and improvement of the property.

The trial court evaluated whether a partition by sale or an equitable distribution was appropriate. The court found that although Cavanagh owned an undivided one-third interest in the property, he had a minimal interest in it because he had failed to contribute to the cost of cleaning up the property or constructing and installing the improvements. He also failed to pay any portion of the real estate taxes or insurance on the property, and never sought to access the property. So, while Cavanagh acted to assert his ownership interest in the property by prosecuting a partition action, he had done nothing to enhance, protect, or preserve the property itself. He was purely a passive owner of the property.

The trial court evaluated whether a sale would promote the interests of the Bloom Defendants. The court concluded that the sale of the property would not promote the interests of the Bloom Defendants, and it accordingly found that the equitable distribution of the interest of Cavanagh, in return for just compensation, would better promote the interests of the owners than partition by sale.

With an appraisal setting the value of the property at $1,325,000, the court concluded that the value of Cavanagh's interest would be $441,667, absent any setoff or credit for equitable adjustments. But the Bloom Defendants presented evidence that the other owners had expended considerable resources improving the

In a partition action, a court is required to balance the equities between the parties. It is not always true that each joint owner is entitled to equal shares in the real estate.

property, spending $893,900 between 2001 and 2019 so it could support a marine-based business. After adjusting for Cavanagh's portion of that expense, as well as property taxes over that period, the court ordered Bloom Defendants to pay just compensation to Cavanagh of $130,042 in return for his one-third interest in the property. Cavanagh appealed.

On appeal, Cavanagh argued that the trial court abused its discretion in calculating the plaintiff's just compensation by granting the credit for one-third of the costs the Bloom Defendants claimed for improvements. Cavanagh argued that he was not consulted about the expenditures or improvements to be made to the property. He also argued the credit should be measured by the enhancement to the value of the property rather than in the amount of the expenses. The appellate court disagreed.

In a partition action, a court is required to balance the equities between the parties. It is not always true that each joint owner is entitled to equal shares in the real estate. A trial court has authority to determine an unequal award on the basis of the evidence presented. Here, the trial court properly exercised its discretion.

Cavanagh's claim that he should have been consulted before improvements were made to the property or expenses were incurred was based on a case involving a marital relationship, which the appellate court rejected as inapplicable. Rather, the court reiterated its own line of cases holding that a court may consider contributions that the parties have made to the property in determining just compensation.

The appellate court likewise found Cavanagh's arguments about the proper measure of the credit unpersuasive. The trial court reasonably considered the costs and labor associated with the improvements, repairs, and maintenance made by the Bloom Defendants during their occupancy of the property. When the property was acquired in 2000, the property was in such disrepair that it could not be used to operate a marine-related business. But the Bloom Defendants undertook significant renovations to make it usable, including removing old improvements and derelict boats, replacing the bulkhead, and dredging the seabed. The property was only usable because the Bloom Defendants made those investments.

While it would be inequitable to permit the Bloom Defendants to set off costs that were incurred solely for their benefit against the just compensation due to Cavanagh, it would also be inequitable to allow Cavanagh to contribute nothing when much of the Bloom Defendants' investment was necessary for the property to be usable at all. Thus, the trial court reasonably found that those expenses benefited all of the co-owners of the property. In a case in equity, the trial court acted within its discretion to balance the equities. The trial court's determination of the just compensation owed to Cavanagh was affirmed.

Cavanagh v. Richichi
Connecticut Appellate Court
May 10, 2022
212 Conn. App. 402

Valuation of a big-box store calls for analysis of impact of deed restrictions and use of cost approach

Menard Inc. (Menards), a home improvement retailer, owns a 166,196-square-foot big-box store in Escanaba, Michigan. Menards challenged its property's tax assessments for 2012, 2013, and 2014. In earlier proceedings before the Michigan

Tax Tribunal, Menards' appraiser used the sales comparison and income approaches to value Menards' property. Most of the comparable properties had deed restrictions but no adjustments were made by the appraiser for that condition. The City of Escanaba (City) criticized that decision and argued for the cost-less-depreciation approach instead.

The Tribunal found in favor of Menards, but the state court of appeals reversed that decision. The court noted that Menards owned the fee simple interest in its property without use restrictions, but its appraiser had not adjusted for the existence of deed restrictions. The court also cited an earlier case that concluded that when a property's highest and best use is its existing use and was built-to-suit its user, then the strict application of the sales comparison approach would undervalue the property, so the cost approach would be more appropriate. The court remanded to the Tribunal with instructions to determine the market impact of deed restrictions and to allow the development of cost approach evidence.

On remand, the parties' experts offered competing cost approach valuations, and the Tribunal ruled in favor of Menards' appraisal. The City again appealed.

The City first argued that the Tribunal had failed to comply with the remand order by finding that deed restrictions had no effect on the fair market value of comparable properties. But the court noted that the Tribunal did not ultimately rely on deed-restricted sales, so any error did not affect the outcome. Moreover, the court had simply instructed the Tribunal to analyze the impact of deed restrictions, not to reject them outright as the City would have preferred.

The primary issue in the second appeal related to the amount of obsolescence impacting Menards' property. The City argued that the Tribunal erred by accepting the obsolescence calculations of Menards' expert because that analysis was purportedly flawed in several respects. The court disagreed with the City as to each point.

Menards' appraiser determined, and the Tribunal agreed, that the property's highest and best use was for continued use as a freestanding retail building. In that analysis, Menards' appraiser concluded that the property had high obsolescence because a purchaser would most likely need to make heavy modifications to the property for it to function for the purchaser's needs because each big-box retailer's store fit highly standardized brand models. Accordingly, functional obsolescence began immediately because big-box stores were built with a specific user in mind and not readily adaptable to other uses. Upon purchase, big-box stores are either demolished and replaced, or high conversion costs are needed to modify the building to the buyer's needs.

Functional obsolescence began immediately because big-box stores were built with a specific user in mind and not readily adaptable to other uses.

The City's argument centered on its assertion that the property's highest and best use was as a home-improvement store, and therefore a hypothetical buyer would not need to make substantial modifications to the store. Also, the property was located in a good market for a home-improvement store. The City's appraiser thus opined that the property had no obsolescence at all because there was demand for home-improvement big-box stores in the Escanaba area, and so the most likely purchaser of the store would be another home-improvement big-box retailer who would not need to make many modifications to Menards' property for it to function.

The court concluded that a reasonable person would accept the evidence as supporting the Tribunal's conclusion that a buyer would be required to make extensive modifications to the property, and therefore the value of the property to a potential buyer was significantly less than the property's replacement costs.

The City argued that there was no evidence of external obsolescence because the competition for home-improvement retailers in Escanaba was functionally nonexistent. But the court noted that the Tribunal's decision regarding obsolescence was plainly based on the significant modifications and retrofitting that a buyer would expect. Considering the Tribunal's decision in context, its obsolescence calculations were based on functional obsolescence—the costs of a buyer to retrofit or replace the building—rather than external obsolescence—the external market demand for the property. So even if the court were to accept the City's argument that there was no evidence of external obsolescence, it would not provide a basis to reverse the Tribunal's decision.

Finally, the City argued that the Tribunal erred by excluding leased fee sales because those sales were really "fee simple sales" using a legal definition. The court found this argument inconsistent with valuing the property as owner-occupied property. In Michigan, what must be valued is what would actually be sold, regardless of whether the definition of *fee simple* in an appraisal dictionary differs from the definition of *fee simple* related to estate law. Menards owner-occupies its property. Had the Tribunal relied on the City's data, it would have valued the property as if it had a lease in place, when there is no such lease in place, and a hypothetical buyer would not be buying a property that was subject to a lease.

Because none of the City's arguments against the Tribunal's decision were availing, the Court affirmed the Tribunal's decision in favor of Menards.

Menard Inc. v. City of Escanaba
Michigan Court of Appeals
February 10, 2022
2022 WL 413892

Simply abutting navigable waters insufficient to confer riparian rights following ambiguous property transfer

In 1880, the federal government conveyed to the State of Florida (State) a tract of land (Parent Tract) along the South Fork of New River, the legal description of which included uplands and submerged lands to the center of the river as well as riparian rights along the entire riverfront. Over time, the Parent Tract was subdivided and transferred to other owners, some of whom dredged and improved it, altering the amount of land above and below water. Those improvements included construction of a boatlift with an artificial covered basin surrounding it.

In 1983, the Florida Department of Transportation (FDOT) brought a condemnation action for a portion of the Parent Tract owned by Choate to construction the I-595 bridge. Ultimately, FDOT compensated Choate for the taking of a large piece of submerged land that included all access rights in the corridor starting at a plane forty feet above ground level. FDOT's taking did not include any ground level access rights or riparian rights. FDOT also obtained a sovereign submerged land easement over an adjacent parcel (Parcel 108).

Choate replatted his remaining upland property, and although FDOT's taking eliminated the covered basin and some of the seawall where large boats docked, Choate continued to operate a boatyard for smaller boats. Those boats needed to travel over Parcel 108, but FDOT never objected to Choate's use of the boatlift or his access to New River.

In 2016, Lauderdale Boat Yard (LBY) bought the property from Choate, but the title did not include the remaining submerged lands between the boatlift seawall and the boundary with Parcel 108. It was unclear whether Choate intended to retain any ownership interest in those dredged, submerged lands. A year later, FDOT informed LBY that it had no riparian rights of access to

New River since those rights were previously condemned. That meant LBY had no legal right to use the boatlift, and LBY sued.

LBY sought a declaratory judgment against FDOT, asserting that it retained riparian rights of access to New River; Choate was not a party to the legal proceedings. The trial court issued a final judgment in favor of LBY with alternative rulings. First, the court ruled that the mean high-water line was located at the boatlift seawall, so all submerged land between the seawall and New River were subject to LBY's riparian access rights. Alternatively, the court found that use of the boatlift and travel over Parcel 108 was essential to boatyard operations, so LBY had riparian right of access from the boundary between Choate's property and Parcel 108, with an implied easement of necessity over Choate's remaining property. FDOT appealed.

In Florida, the boundary between public lands and private lands is the mean high-water line, with the State owning all land below that line. Those who own land extending to the high-water line of navigable waters are riparian holders who have a right of access from the water to the riparian land. However, bodies of water that become navigable by artificial means are not converted from private ownership into State lands, even in cases like dredging that makes artificially navigable waterways.

Given that legal background, the court of appeal rejected the trial court's first conclusion that the seawall was the high-water line. When the basin area and boatlift were dredged, the land became privately owned submerged land. LBY's tract is separated from New River by the submerged property still owned by Choate. The trial court's placement of the high-water line allowed for LBY's riparian rights of access to prevail over Choate's rights as a possible submerged landowner bordering New River. But because the State never held that submerged land in trust, it cannot be treated as sovereign land because it was artificially submerged.

As for the alternative ruling, it was undisputed that the Parent Tract had riparian rights to the entire river frontage before it was developed. But for LBY's property to have riparian rights, simply abutting navigable waters is insufficient; property ownership must extend to the mean high-water line. Nothing in the record showed LBY's parcel extended to the boundary with Parcel 108, and because Choate was not a party to the trial, there was no evidence of what property interests he intended to convey. Moreover, because Choate was not a party, it was improper for the trial court to declare an implied easement over submerged land in which Choate may still have an interest.

Accordingly, the court reversed the declaratory judgment in favor of LBY and remanded for further proceedings.

Florida Dept. of Transportation v.
Lauderdale Boat Yard LLC
Florida Court of Appeal, Fourth District
January 5, 2022
336 So. 3d 28

Redevelopment contract with unambiguous exchange for developer incentives constitutes an equitable mortgage, not a sale

Munster Steel Co. (Munster Steel) owned a property in Munster, Indiana. In 2011, Munster Steel entered into a real estate sale contract with CPV Partners LLC (CPV) to sell the property to CPV, but the sale did not actually occur until 2014. The contract between Munster Steel and CPV contained a subsequent sale provision, which provided that if CPV or any of its affiliates entered into a contract for sale of all or a portion of the property within two years of closing, CPV must pay a subsequent fee to Munster Steel. It would not be deemed a subsequent sale if there were nominal or no consideration passing between CPV and the transferee. The subsequent fee would be based on the gross sale price.

In 2013, the Town of Munster (Town) determined that a redevelopment project would be in the best interest of town residents, so it created the Ridge Road Calumet Avenue Economic Development Area. In September 2013, the Town entered into an agreement with CPV to redevelop the economic development area into Centennial Village, a walkable mixed-use lifestyle center including retail, hotel, and residential condominiums and townhouses. A portion of Centennial Village was to consist of the former Munster Steel property that CPV acquired.

To effectuate this plan, the Town and CPV entered into a development agreement providing CPV financial incentives of $14.2 million plus a ten-year tax abatement for the residential component, as well as additional land adjacent to the Munster Steel property. The Town issued bonds to pay for the cash incentive. Regarding the former Munster Steel property, the development agreement provided that CPV would be required to cause Munster Steel to convey title to the property to the Town as security for performance of CPV's obligations under the development agreement. After CPV deposited its private finds into a certain trust, the Town would then convey to CPV all of its interest in the Munster Steel property, excluding the right of way.

In February 2017, Munster Steel sued CPV, claiming that the transfer of the property between CPV and the Town constituted a sale triggering the subsequent sale provision and requiring that CPV pay Munster Steel a fee. The trial court granted summary judgment to CPV, finding that the deed was procured for the purpose of securing funding for the project, and thus the transfer of the property was not a sale but rather an equitable mortgage. Munster Steel appealed.

On appeal, Munster Steel argued that the trial court erred by granting summary judgment to CPV because the transfer was a sale. Initially, Munster Steel argued that the development agreement was ambiguous, and thus the court should have considered evidence outside the contract in interpreting its character. The parol evidence rule generally prohibits courts from considering extrinsic evidence for the purpose of varying or adding terms to a written contract. While it is true that parol evidence can be admissible to determine whether an absolute deed was intended as a mortgage, that applies only where the terms are ambiguous. Here, Munster Steel admitted at trial that the agreement was unambiguous, so the argument was waived on appeal.

It has long been the law in Indiana that a deed, even if absolute on its face, executed contemporaneously with an agreement to reconvey upon performance of conditions is a mortgage.

The court then turned to the question of whether the transfer of the property by CPV to the Town in exchange for developer incentives was intended to be a sale or equitable mortgage, basing its review solely on the contract itself. Munster Steel argued that because CPV transferred absolute title to the Town in exchange for $14.2 million, 12 acres of new real estate, and tax incentives, there was necessarily a sale rather than an equitable mortgage. In making this argument, Munster Steel relied on an earlier case as denying the possibility that an equitable mortgage may be created when absolute title is transferred. The court found that not to be the case. An equitable mortgage necessitates the passing of absolute title and the equitable right to a reconveyance, because where an absolute deed was intended as a security it is not a proper mortgage.

The development agreement here defined its purpose and the nature of the transfer. A portion of the bond proceeds were to be made available to CPV "in order to provide funds… for the purpose of enabling [CPV] to acquire" the Munster Steel property. The development agreement also made clear that the property and title would be transferred as security and that it would revert back to CPV if specific conditions were satisfied. Moreover, the subsequent sale fee would be based on the gross sale price, but the substantial benefits CPV received under the development agreement were not a gross sale price; they were an incentive for the development of the project.

It has long been the law in Indiana that a deed, even if absolute on its face, executed contemporaneously with an agreement to reconvey upon performance of conditions is a mortgage. No matter what form the transaction may assume, if it appears that the instrument was executed to secure a subsisting debt, it will be adjudged a mortgage. Thus, the development agreement created an equitable mortgage, and the trial court was correct to conclude that the development was not a sale triggering the subsequent sale provision. The judgment was affirmed.

Munster Steel Co. Inc. v. CPV Partners LLC
Indiana Court of Appeals
March 28, 2022
Case No. 21A-PL-1154

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Understanding Desktop (Bifurcated or Hybrid) Appraisals

by Sandra K. Adomatis, SRA, and Dawn Molitor-Gennrich, SRA, AI-RRS

Abstract

This article discusses the parameters of valuation services that do not require a personal physical inspection of the subject property by the state-credentialed real estate appraiser selected for the valuation assignment. The market uses a number of terms for such valuation services with a narrow scope of work; depending on the client, the term used may be *bifurcated*, *hybrid*, or *desktop* valuation. Although the process of each of these alternative services may be slightly different, essentially in such services the property data collection and the valuation analysis, if any, are separate. The purpose of this article is to equip appraisers with the knowledge necessary to meet the demand for such valuation services in the current market. The discussion will cover important considerations, including the appropriate scope of work, state laws, regulations, standards, and governmental agency guidelines that apply to these types of valuations.

Introduction

Appraisers as well as lenders and regulators find it challenging to stay abreast of the rapidly evolving market needs, legislation changes, and guidelines that affect appraisal practice. Competently developed desktop valuation services by state-credentialed real estate appraisers appropriately measure risks for these entities. This article will address opportunities for residential appraisers and commercial appraisers serving lenders to offer a new type of appraisal services in addition to the traditional appraisal.[1]

Lender Client Perspective

Let's look at the alternative valuation services from the lender client perspective. We'll start by looking at the commercial side of this equation—the loans that fit this product and the role of the commercial appraiser. Appraisers can view this as an opportunity to gain a new book of business, if they are equipped to provide the valuation service determined appropriate by the lender, for the lender's risk. Starting with commercial lenders, the type of commercial loans that will fit this kind of valuation service are those already on the books that may carry lower risk, and therefore are potentially eligible for something less than a traditional appraisal. It is important to recognize that commercial lenders associate the risk with the appropriate valuation service for each transaction. Lenders have increasingly reliable data and algorithms to analyze the risk and determine the valuation service appropriate for a particular property, investor, and loan circumstance.

Conversely, on the residential lending side, refinance means a new loan and not a renewal of an existing mortgage. Residential lenders compete in the market for mortgage loans. To be competitive, the lender client requires a faster closing with lower closing costs than their competition. Borrowers can easily compare rates, closing costs, and closing times in today's tech-savvy world. If the residential appraiser is not prepared to offer services that meet the lender client's needs in the competitive lending market, using narrow scopes of work, then their clients have no choice but to seek out alternatives.

1. For purposes of this article, the term *traditional appraisal* refers to an appraisal where the credentialed appraiser does a complete interior and exterior view, develops the appraisal, and communicates the opinions and conclusions in an appraisal report.

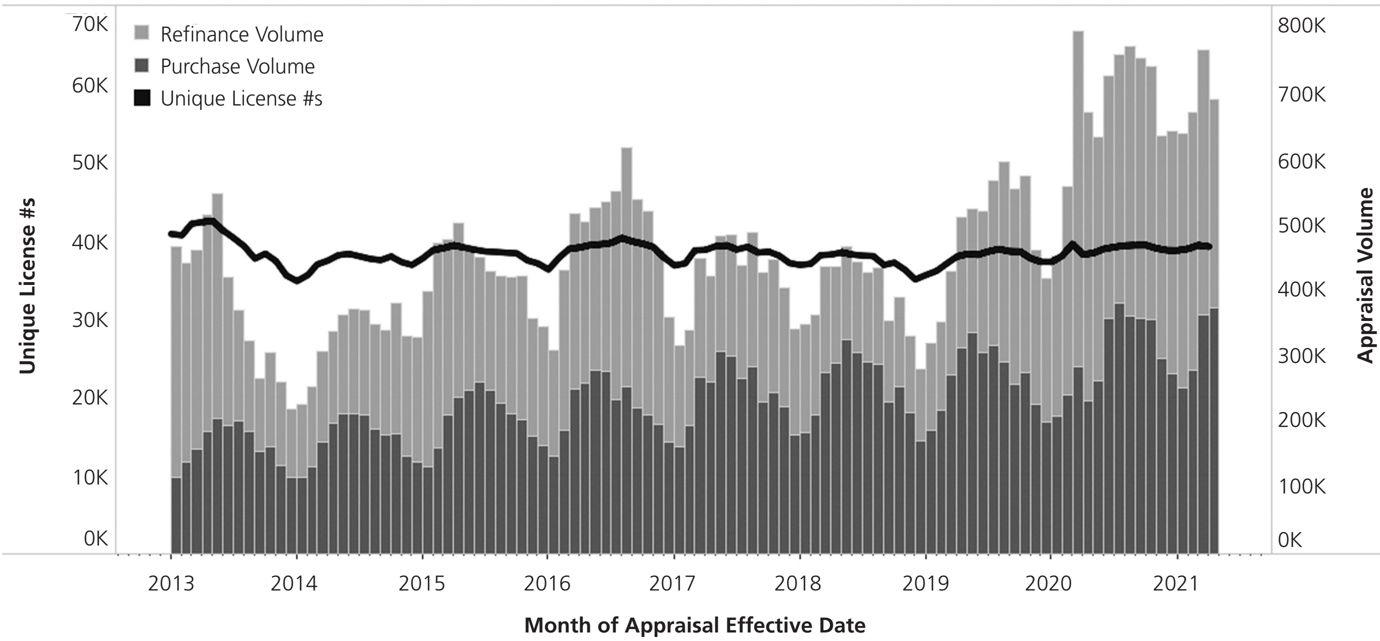
Residential Markets

Residential appraisers who are well informed of the applicable guidelines, standards, and governmental agency rules and skilled in developing scopes of work can offer their clients narrow-scope valuation services. Some appraisers have already extended their business to include appraisal services with other narrow scopes of work. These narrow scopes of work assignments are a rapidly growing trend and book of business for residential as well as commercial appraisers. This article will address ways to meet the challenges of such assignments and how to mitigate the liabilities that come with all appraisal work.

Governmental agencies have directed attention to *appraisal modernization*, with a goal of finding solutions that could bring efficiency and technology to the current appraisal process in situations where the risk is lower or equivalent to the current process and results in greater efficiency and reduced turnaround times.[2] In fact, some lender clients are already using non-appraisers for property inspections and use companies that provide services with narrow scopes of work.

The graph in Exhibit 1 illustrates the challenges in the current residential real estate market. Lenders face increased volume, competition, and time demands without a concomitant increase of licensed appraisers. As the horizontal line in the graph clearly shows, the number of unique appraiser licenses in the Uniform Collateral Data Portal (UCDP) has not increased for many years, but the appraisal volume has increased. This imposes a time challenge on the lenders who strive to be competitive in an environment where buyers can easily shop loan interest rates, points, and time to closing. It is hoped that the increased use of narrow-scope assignments will help reduce the wait times for lenders and their customers.

Exhibit 1 UCDP Volume and Unique Appraiser Licenses



Unique appraiser license numbers in UCDP, per month. Appraisal and license volume for all form types (not limited to 1004/70).

Source: Danny Wiley, "Spotlight on Appraiser Capacity during the Pandemic," Freddie Mac (June 16, 2021), https://bit.ly/3nsLrGv.

2. Freddie Mac describes *appraisal modernization* as its "independent research, assessment and planning for appraisal process modernization. FHFA [Federal Housing Finance Agency] has also provided a directive for the joint GSE efforts to update the UAD and appraisal reporting forms." See Freddie Mac Single-Family, "Appraisal Modernization FAQ," https://bit.ly/3yxTel1.

The federal agencies' guidelines and standards discussed in this article address the complexities in lending as they impact appraisers working for and with lenders. Understanding these complexities and applying the appropriate appraisal requirements are key to providing a credible valuation service. This article specifically focuses on the valuation report types that are defined by Fannie Mae and Freddie Mac as follows:

- **Hybrid appraisal.** "An appraisal assignment consisting of a desktop appraisal for which the scope of work includes reviewing a recent interior/exterior property data report."
- **Desktop appraisal.** "An appraisal assignment for which the scope of work does not include field work by the appraiser and does not include reviewing a recent interior/exterior property data report."
- **Traditional appraisal:** "An appraisal assignment for which the scope of work includes an interior and exterior personal, onsite inspection of the subject property completed by the appraiser who signs the certification, and the effective date of the appraisal is the date of the appraiser's inspection."[3]

As will be discussed later, the actual terms used for narrow-scope valuation services may vary by client and governmental or regulatory entity.

Governmental Agencies

Federally regulated lending institutions are subject to regulations regarding real estate appraisals and evaluations. A "federally related transaction" (FRT) is any real estate–related financial transaction that "(a) a federal financial institutions regulatory agency[4] (Agency) or the Resolution Trust Corporation engages in, contracts for, or regulates; and (b) requires the services of an appraiser."[5] Fannie Mae and Freddie Mac are not regulated by the entities referenced in the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA),[6] and therefore are not subject to FIRREA. According to FIRREA, a transaction does not need an additional appraisal that meets FIRREA, *if* the lender obtains one that meets Fannie Mae and Freddie Mac's appraisal guidelines. Under FIRREA, this is mandatory, even if the institution does not plan to sell loans to either type of entity.

Appraisal Thresholds

If the loan amount (i.e., transaction value) is under the federal/state agencies loan transaction threshold or underwriting guidelines, something less than a traditional appraisal may be a viable option. An appraisal is *not* required on a residential real estate transaction that falls within the following transaction amount categories.[7]

- A transaction value of $400,000 or less; at a minimum, an institution must obtain an evaluation of the real property collateral if no other exemption applies.[8]
- The $400,000 cap is for 1–4-unit residential properties only.
- Other property types have a threshold of $500,000.

Keep in mind, however, lenders and the secondary mortgage market have guidelines that may exceed the thresholds identified above.[9]

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3. Fannie Mae and Freddie Mac, *Uniform Residential Appraisal Report: Hybrid and Desktop Appraisal Forms*, updated February 2022 (first published July 2020), https://bit.ly/3cbJICO.
4. A lender's Federal Financial Institutions Regulatory Agency ("Agency" or "Agencies") consists of the regulatory entity that oversees the financial institution and institution adherence to banking laws and regulations that are applicable. Such Agencies include the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), and the National Credit Union Administration (NCUA).
5. Federal banking law (12 U.S.C.A § 3350).
6. The federal Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) was enacted in response to the savings and loan crisis of the 1980s.
7. *Transaction value* for loans or extensions of credit is not the property value, but the amount of the loan or extension of credit. 12 CFR §722.3.
8. 12 CFR Part 34, "Real Estate Appraisals Final Rule" (October 8, 2019, effective January 1, 2020). See Federal Register available at https://bit.ly/3PerH5N and https://bit.ly/3cmaUz3.
9. For additional discussion, see Appraisal Institute Guide Note 13, "Performing Evaluations of Real Property Collateral for Lenders" (effective October 31, 2012, minor revisions 2017, 2018, 2020), https://bit.ly/3IywXi5.

Tools for Adaptation and Evolution

The sophisticated data and tools available in the market present an opportunity for appraisers to review and add to the types of services they offer. This will involve adapting to software and technical tools that enable appraisers to more efficiently produce a valuation service that is credible for the intended use and user.

Today, partly because of the secondary mortgage market (e.g., Fannie Mae, Freddie Mac), market participants have access to robust databases of residential property sales that supply data and estimates of value for collateral and consequently for loans. Lenders can assess the mortgage risk of loans using such databases along with sophisticated algorithms. Further, this risk analysis tool has proven to accurately access the valuation service needed to meet the commensurate risk appetite and/or regulatory requirements of a specific lender.

It is important to understand how lender clients assess risk and what laws, regulations, standards, and guidelines control a lender's loan capacity, which in turn drives demand for certain valuation services. Appraisers who add narrow-scope valuation services to their current services are adapting to market demand. There are laws, regulations, standards, and guidelines that lenders/clients and appraisers are obligated to adhere to in such assignments, so knowledge is key to successful outcomes.

As previously noted, if the loan amount is below the federal and/or state regulatory Agencies' transaction (loan) threshold or exempt from an appraisal by a state-certified appraiser, something other than a traditional appraisal is likely a viable option for the lender. One current example of this is the waiver allowed for government-sponsored enterprise (GSE)[10] refinance transactions. Also, according to FIRREA, a transaction does not need an additional FIRREA appraisal *if* the lender obtains one that meets Fannie Mae and Freddie Mac's appraisal guidelines, even if the institution does not plan to sell loans to either entity.[11]

Narrow-Scope Assignments: A Two-Step Process

Lenders use a variety of terms to describe appraisal assignments with a narrow scope of work, including bifurcated, hybrid, or desktop appraisal. Simply put, these terms are referencing a valuation service or assignment that involves a two-step process: the data collection and the analysis. These terms encompass an appraisal service in which two individuals, who may or may not know each other, complete the appraisal process in two steps independently, or in which the same appraiser completes the two steps—the data collection and the analysis—as two separate assignments.

Step 1, Data Collection. The first step in a narrow-scope valuation service commonly includes a non-appraiser or credentialed appraiser making the property inspection; this person is identified as a "property data collector" (PDC). At the time of the data collection, it is not yet known whether an appraisal will be required.[12] Step 1 assists the lender, or appraisal management company (AMC) in conjunction with the lender client, in deciding if Step 2 is necessary ordering the correct type of valuation service. The reasoning is that the PDC report is expected to provide valuable and detailed information about the subject property, such as condition, quality, location, as well as current photographs that will allow the lender (with an AMC) to make an informed risk management decision as to the most appropriate valuation product combined with the borrower's loan data. The lender will assess the borrower's creditworthiness, risk assessment–based data in the Uniform Collateral Data Portal (UCDP),[13] and the PDC report to determine if the risk is

10. A *government-sponsored enterprise* is "an agency, such as Fannie Mae, Ginnie Mae, or Freddie Mac, formed by the federal government to provide a secondary market for residential real estate loans." Appraisal Institute, *The Dictionary of Real Estate Appraisal*, 7th ed. (Chicago: Appraisal Institute, 2022), s.v. "government-sponsored enterprise."

11. Recall that Fannie Mae and Freddie Mac are not lenders subject to FIRREA.

12. Fannie Mae, "Desktop Appraisals, Assumptions, and Hypothetical Conditions," in *Appraiser Update* (September 2019), https://bit.ly/3uUXGj0.

13. The Uniform Collateral Data Portal (UCDP) is the appraisal portal shared by Fannie Mae and Freddie Mac. Appraisals are uploaded to this database, and property data is stored in this portal for the GSE's use in assessing risk and monitoring appraiser consistency. See Fannie Mae, "Applications and Technology: Uniform Collateral Data Portal," https://bit.ly/3bzqTct.

such that a Step 2 appraisal by a credentialed appraiser is needed. Borrower and loan information are uploaded to the UCDP by the lender, and the UCDP response may give the option of an appraisal waiver, or a desktop appraisal, or require a traditional appraisal based on the data uploaded.

Currently, only a small number of credentialed appraisers are accepting Step 1 work; yet demand is real. Recognize some states do not allow non-appraisers to inspect a property for valuation purposes. Here it is important to be educated about local as well as federal regulations in order to mitigate professional risk. It is the appraiser's responsibility to know their state's laws and/or regulations for these types of valuation services. Be prepared—the AMC or lender may ask for a service that is *not* allowed under local state laws and/or regulations for narrow-scope services. The appraiser who is educated can help direct a client away from noncompliance, ensure the correct scope of work is applied to the valuation service, and build a working relationship with the AMC or lender.

Technology tools are available that can provide data beyond what could be captured in the typical residential property inspection. Sophisticated technology can scan interior and exteriors of structures, measure spaces, draw floor plans, create 3D models, and record appliance and mechanical labels to identify age and characteristics.[14] Once a property has been scanned, the file is uploaded to a portal and within a short period, it produces a detailed plan that compares or rivals most appraiser sketches, along with detailed photographs and property description. The photographs are geocoded to ensure they are from the given location. This technology supplies robust data that is credible for use by other valuation professionals and the lender client base.

Step 2, Desktop Appraisal. A Step 2 may occur after the lender receives the property inspection data and assesses the mortgage risk. Depending on the results of that assessment, a decision may be made to move to the next step, a desktop appraisal by a credentialed appraiser. If the decision is made to move to Step 2, the desktop appraisal becomes a second assignment if the same appraiser does Step 1. Step 1 and Step 2 are two different assignments.

If the appraiser performs both parts of this two-step process, the appraiser must acknowledge the previous service(s) provided in the desktop appraisal report, and any subsequent appraisal assignments and reports.

A Reminder about Terminology. As previously mentioned, the terms used to identify these narrow scope of work assignments vary by the client and client-type. For example, Fannie Mae's publications use the term "desktop appraisal" and reference the portion completed by the PDC as akin to other resources appraisers use, such as flood maps, property assessment records, and information provided by others. Exterior appraisals or desktop appraisals increased during the COVID-19 pandemic as a way to lessen exposure to the virus. This trend is not expected to change in the post-pandemic era. Even before the pandemic, lenders were seeking out individuals to provide valuation services with narrow scopes of work based on the mortgage risk assessment. Fannie Mae announced desktop appraisals as an option for some loan transactions beginning in March 2022.[15] Similarly, Freddie Mac accepts desktop appraisals for some loan transactions beginning in March 2022.[16]

In general, the term "bifurcated appraisal" usually means the person collecting the property data (i.e., the PDC measuring the structure, photographing the subject, completing the interior and exterior inspection) is *not* the same person as the appraiser who completes the additional research, verification, analysis, and value opinion. The property inspection or services of the PDC is a separate engagement.

Because terms and definitions for narrow-scope valuation services can be inconsistent, the appraiser should clarify with the client how it

14. For example, INvision Your Home is a trademarked technology used by Class Valuation, an appraisal management company, https://bit.ly/3IOdBFJ. This is not the only technology available, but it provides an example of how technology can supply the tools needed to enhance data collection.

15. Fannie Mae, "About Desktop Appraisals," Single-Family News Center (January 19, 2022), https://bit.ly/3PAz7Qx.

16. National Association of Mortgage Processors, "Freddie Mac Announces Permanent Acceptance of Desktop Appraisals" (February 8, 2022), https://bit.ly/3AVat96.

defines and uses such terms. For example, suppose a lender client orders an "exterior only" appraisal on a residential property, and the client requests that the appraiser research and analyze the multiple listing service (MLS) and sales data for a period at least one year prior to the effective date of value. The assignment also

Appraisers draw opinions on comparable condition and quality based on secondary data; narrow-scope assignments require similar appraiser analysis, using the available data to assess quality and condition of the subject property.

includes a telephone interview of the owner and listing agent to obtain a description of the subject's interior condition, including specific questions about any recent updating or remodeling and whether building permits were obtained for that work. This is an example of an appraisal assignment that requires an explicit scope of work, including identifying the sources of information, results of the research and analysis of the data, and limitations and details in the report regarding how the property's condition and quality were determined. In some cases, an extraordinary assumption may be necessary, depending on the data available to the appraiser to affirm quality and condition.

Appraisers draw opinions on comparable condition and quality based on secondary data; narrow-scope assignments require similar appraiser analysis, using the available data to assess quality and condition of the subject property. Exterior-only appraisal assignments have been around for decades. Today, these assignments may go by various client terms like "hybrid," "drive-by," or "exterior" appraisal.[17]

In essence, the difference between a desktop appraisal and exterior appraisal is the desktop appraisal may be completed using two appraisal assignments and may include two individuals, while the exterior appraisal is one assignment completed by the same person viewing the property from the street or an exterior walkaround. In the above exterior-only appraisal example, the client paid a fee similar to a traditional appraisal, because extensive research was required to develop credible opinions and conclusions. Recognize that appraisal fees for these services vary based on the scope of work expected.

In contrast to the exterior-only appraisal, when a desktop appraisal is ordered, the client commonly requests the appraiser use a specific Fannie Mae report form that is similar to the first page of the Uniform Residential Appraisal Report (Fannie Mae 1004/Freddie Mac 70). The appraiser uses photographs completed by a PDC, who may or may not be an appraiser depending on the circumstance. This desktop appraisal assignment is an example of the two-step process—the appraiser uses the PDC data and photographs for the property description to develop a credible opinion of value given the intended use. Here, the desktop appraisal assignment's scope of work called for a process that included researching and verifying the PDC data from sources such as the MLS and public record (if applicable), selecting comparable sales based on the verified PDC information, and developing an opinion of value. Note, the scope of work must detail what is to be confirmed/verified, along with the sources to be used and the limitations to the confirmation/verification,[18] and the property condition and quality description process. While the client in the example did not require confirmation/verifica-

17. During interviews with the GSEs for this article, it was stated that the term "drive-by" is not considered a proper term and is no longer used; an alternative and acceptable phrase is "exterior only" appraisal.

18. In valuation practice, *verification* is "the process of validating or establishing the truth about information from another source, which is critical to credible assignment results. A valuer or reviewer may confirm information directly with a party knowledgeable about the property or the transaction involving the property or with another credible source to determine the reliability of that information for use in the assignment." *The Dictionary of Real Estate Appraisal*, 7th ed., s.v. "verification." In common parlance, "to verify" something means being able to provide convincing evidence that it is true; "to confirm" something usually means providing some additional evidence that something is true.

tion of the PDC data information, this step is necessary to comply with the Statement of Assumptions and Limiting Conditions section in which the appraiser makes assumptions about the data sources that were necessary to develop a credible and reliable opinion of value.[19]

Form 1004 lists assumptions that are allowed for desktop assignments. Fannie Mae has indicated that only two additional assumptions are allowed for desktop appraisals:

1. If the date of the property data collection is not the same as the effective date of the appraisal, the appraiser may assume the property characteristics have not changed in the interim.
2. The appraiser may assume there are no material omissions in the property data.

Fannie Mae states that it only accepts these assumptions when there is no evidence contrary to known facts (i.e., no hypothetical conditions are allowed).[20] This is done through confirmation or verification of the PDC data provided.

This discussion is a reminder to appraisers to review, in detail, all report forms to ensure the work performed and reported meets the needs of the client and is compliant with laws and regulations, standards, and governmental agency guidelines for the appraiser and the valuation assignment.

Residential appraisers providing desktop appraisals have reported anecdotally that they can complete such appraisals in less time than it takes to complete one traditional appraisal. This suggests that desktop appraisals help meet lenders' and GSEs' goals for greater efficiency and reduced turnaround times.

In the previous desktop appraisal example, the Step 2 PDC data was easily researched and confirmed/verified through recent MLS photographs and public record. What happens, however, when the PDC or property data provided by the client or obtained from sources other than an inspection of the property by the appraiser are believed to be unreliable and cannot be researched and confirmed or verified? If it cannot be assumed that the data is reasonable or believable, then the data must not be relied upon. In other words, if the property data provided by the PDC, the client, or other entities is not believable, the appraiser should discuss the concerns with the client and request a modification of the scope of work to a level that will produce credible assignment results, which the client can rely on for the intended use. Adjusting the scope of work should also include appropriately adjusting the appraisal fee for the time involved in producing a credible assignment result.

Appraisers completing desktop appraisal assignments and lenders ordering them report that the name and contact information for the PDC is provided in case further clarification is needed. If the contact information for a PDC is not provided, the appraiser should contact the client if issues arise regarding the PDC or other data. In such cases, the appraiser explains to the client why the data is not considered believable and therefore not reliable. Options to resolve this issue may include requesting access information for the PDC or modifying the scope of work to a level in which the property condition and quality description are reasonable, and the PDC data believable and reliable.

Residential appraisers providing desktop appraisals have reported anecdotally that they can complete such appraisals in less time than it takes to complete one traditional appraisal.

19. Fannie Mae Form 1004 Desktop, Statement of Assumptions and Limiting Conditions. Freddie Mac's new form is 70D. For a comparison of desktop and hybrid report content, see Fannie Mae, "Hybrid and Desktop Appraisal Forms," https://bit.ly/3PcqoEr. For additional detailed discussion, see *Fannie Mae Single Family Selling Guide*, B4-1.2-02 (April 6, 2022), https://bit.ly/3ckvQpT. State-certified real estate appraisers are responsible for accepting or rejecting data collected by a third party. Appraisers are not required to accept all data available from a third-party PDC.

20. Fannie Mae, "Desktop Appraisals, Assumptions, and Hypothetical Conditions," *Appraiser Update* (September 2019), 3, https://bit.ly/3uUXGj0.

While the PDC data may be reasonably complete, appraisers may face challenges in identifying external factors affecting the site and improvement obsolescence, particularly in markets that are less familiar. However, technology offers appraisers many more tools to gather information about external factors. Helpful tools include aerial imagery programs (e.g., Bing Maps, Google Maps, Google Earth), online photographs, public records, building permits, etc. Many real estate websites offer virtual tours of properties that can provide valuable information for assessing condition and quality.

Narrow-Scope Commercial Assignments

Desktop, hybrid, and bifurcated appraisal assignments are not limited to residential properties only. A review of various commercial appraiser websites clearly shows similar assignments have been in the commercial world for many years. Commercial appraisers, like residential appraisers, have been willing to expand their business into areas with narrow scopes of work. In commercial lending, the risk analysis is typically based on the borrower's credit strength, cash flows, and liquid assets. For narrow-scope valuation services, the commercial property inspection often has been completed by a bank employee or staff appraiser. This data is then sent to a state-credentialed fee appraiser to develop an opinion of value on a lower-risk loan. In cases where the borrower's credit assessment suggests a higher-risk loan or a loan in pre-foreclosure, a credentialed appraiser is required to make the inspection and develop a credible value opinion.[21]

Until the users of valuation services agree on universal definitions for desktop, bifurcated, and hybrid appraisal assignments, it is important for appraisers to ask their clients to explain what the client means when it uses such terms. This ensures a clear understanding of the requirements for such an assignment and the appropriate scope of work. No matter what the client may call these assignments, when an individual is acting as an appraiser, the assignment is an appraisal service with a narrow scope of work. Appraisers must be proficient in developing such a scope of work and avoid relying on boilerplate[22] scopes of work that are prevalent in appraisal software products because they can be generic, inadequate, or contradictory to the actual scope of work necessary for credible opinions and conclusions for narrow scope of work assignments.

Until the users of valuation services agree on universal definitions for desktop, bifurcated, and hybrid appraisal assignments, it is important for appraisers to ask their clients to explain what the client means when it uses such terms.

Conclusion

Professional appraisers are seeking additional ways to meet the changing needs of their lender clients in the modern real estate market. Innovation in the types of services offered can benefit not only appraisers' lender clients, but also the lenders' customers—the potential borrowers. Narrow scope of work valuation services are one approach that appraisers can use to work with clients in the years ahead.

This article offers valuable insights to familiarize appraisers with the various narrow-scope options to expand their valuation services. The topics covered here have included important

21. 15 US Code §1639h, "Property Appraisal Requirements," available at https://bit.ly/3OenKMP.

22. Under USPAP Standard 2, an appraiser must not use generic, boilerplate language that fails to reflect the observations and analysis of the subject property including its marketability. See Appraisal Standards Board, *Uniform Standards of Professional Appraisal Practice*, 2020–2021, Standards Rule 2-2(a)(viii) [summarize scope of work] and Standards Rule 2-2(b)(x) [state scope of work] and Comments; see also Appraisal Institute, *Review Theory and Procedures: A Systematic Approach to Review in Real Property Valuation* (Chicago: Appraisal Institute, 2015), 82–85, Table 7.2 ("Boilerplate," "[d]iscussion that is clearly boilerplate," and "[b]oilerplate statements" are common issues of concern in appraisal reports that reviewers should watch for).

considerations in the scope of work and the necessity for a good understanding of state laws, regulations, standards, and governmental agency guidelines that apply to such services. The benefits and risks of offering desktop, hybrid, or bifurcated valuation services need to be considered before an appraiser can make an informed business decision about potentially adding this type of valuation service to their book of business.

Staying relevant in the lending world will require embracing technology and adapting to innovative tools and software. The Appraisal Institute seminar *Desktop Appraisals (Bifurcated, Hybrid) and Evaluations* delves deeper into the practical pros and cons of offering narrow scope of work assignments and provides information essential for knowledgeable engagement in narrow-scope valuation services.

About the Authors

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Additional Resources

Suggested by the Y. T. and Louise Lee Lum Library and the Authors

Appraisal Foundation

- Uniform Standards of Professional Appraisal Practice (USPAP)
- USPAP Advisory Opinions
- USPAP Frequently Asked Questions

Appraisal Institute

- **Education**
  Desktop Appraisals (Bifurcated, Hybrid) and Evaluations
- **Lum Library, Knowledge Base [Login required]**
  Appraisal practice
- **Professional Practice**
  https://www.appraisalinstitute.org/professional-practice/ethics-and-standards/

Fannie Mae

- "About Desktop Appraisals"
  https://singlefamily.fanniemae.com/media/30361/display
- Selling Guide, B4-1.2-02, Desktop Appraisals, p. 566
  https://singlefamily.fanniemae.com/media/31751/display
- Uniform Residential Appraisal Report: Hybrid and Desktop Appraisal Forms—Overview
  https://singlefamily.fanniemae.com/media/23566/display
- Uniform Residential Appraisal Report: Hybrid and Desktop Appraisal Forms—Quick Reference
  https://singlefamily.fanniemae.com/media/23561/display

Interagency Appraisal and Evaluation Guidelines

https://www.fdic.gov/regulations/laws/rules/5000-4800.html

Stigma: A Case Study Analysis of Long-Term Environmental Risk Effect

by Michael Tachovsky, PhD

Abstract

In real estate valuation, *stigma* is a term used to describe a negative perception associated with a property or group of properties. From a complex valuation perspective, stigma is considered to be synonymous with a risk effect. Appraisal literature discusses the development of stigma and risk, including some literature on temporary stigma, a situation where negative perceptions diminish and properties eventually return to full market value. For example, brownfield redevelopment sites are generally examples of temporary stigma situations. Yet, temporary stigma is not always the case. This article presents an environmental case study using multiple regression and paired sales that finds stigma can continue more than twenty years after the discovery of an environmental issue. The case study reports a risk effect ranging from –10% to –42% with lingering concerns about market disclosures, demolished homes that were never rebuilt, and so forth.

Stigma: Temporary versus Ongoing

A negative effect on market value based on adverse public perception is sometimes referred to as *stigma*.[1] *Environmental stigma* is "an adverse effect on property value produced by the market's perception of increased environmental risk due to contamination."[2] Additionally, as with other detrimental conditions, this can be derived from perceived risks and uncertainties surrounding a detrimental condition and may result in a diminution in value.[3] The term *stigma* emerged in *Appraisal Journal* literature with Peter Patchin's article "Valuation of Contaminated Properties."[4] In 1991, Patchin addressed the topic again with his *Appraisal Journal* article "Contaminated Properties—Stigma Revisited."[5] As additional articles emerged on stigma, discussion continued on the evolving topic of real estate damages, leading to numerous articles, textbooks, seminars, and advice such as Appraisal Institute Guide Note 6, "Consideration of Hazardous Substances in the Appraisal Process," Appraisal Institute Guide Note 10, "Developing an Opinion of Market Value in the Aftermath of a Disaster,"[6] and USPAP Advisory Opinion 9, "The Appraisal of Real Property That May Be Impacted by Environmental Contamination."[7]

Stigma has been referred to in many ways in the literature, incorporating terminology such as

1. Appraisal Institute, *The Dictionary of Real Estate Appraisal*, 7th ed. (Chicago: Appraisal Institute, 2020), s.v. "stigma."
2. Appraisal Standards Board, Advisory Opinion 9 (AO-9), "The Appraisal of Real Property That May Be Impacted by Environmental Contamination" in *USPAP Advisory Opinions*, 2020–2021 ed. (Washington, DC: The Appraisal Foundation, 2020), Lines 85–86.
3. Appraisal Institute, *The Appraisal of Real Estate*, 15th ed. (Appraisal Institute, 2021), 184.
4. Peter J. Patchin, "Valuation of Contaminated Properties," *The Appraisal Journal* (January 1988): 7–16.
5. Peter J. Patchin, "Contaminated Properties—Stigma Revisited," *The Appraisal Journal* (April 1991): 167–172.
6. *Guide Notes to the Standards of Professional Practice of the Appraisal Institute* are available at https://bit.ly/3xjFnFT.
7. Appraisal Standards Board, Advisory Opinion 9.

residual damages,[8] *uncertainty factor*, *project incentive*, *market resistance*,[9] and *risk*.[10] *Risk* tends to be the more formal reference, as it is one of the three components to consider when determining any effects on value from a detrimental condition—the three components being cost, use, and risk effects.[11] When considering any risk effects associated with a detrimental condition, the duration of the effects, if any, may either be temporary or ongoing.[12] Temporary stigma refers to a residual loss that eventually disappears; the appraisal literature has at times described certain temporary stigma issues under the model and phrase "diminishing diminution."[13]

While there are some studies that find temporary price effects that diminish after contamination is remediated, this is not always the case. For example, in 1999, Reichert reported that residential properties surrounding a Superfund landfill in Ohio experienced ongoing market value impacts as prices continued to react to the contamination even after announcement of a remediation plan.[14] Further examples of ongoing price effects include the Love Canal in New York, Uravan in Colorado, Hinkley in California, Picher in Oklahoma, Wittenoom in Australia, and Chernobyl in Ukraine.

Although real estate valuers may discuss temporary stigma, in a valuation assignment this can be a diversion from the current situation since an opinion of value (and any possible diminution thereof) is typically given as of a specific point in time.[15] This raises the question as to whether identifying if risk effects are temporary or ongoing is pertinent when providing a value or diminution in value opinion *as of a specific date*. For example, if a real estate valuation professional finds that a property incurred a risk effect as of the date of value, the fact of the matter is that the property incurred a loss and therefore was damaged; the converse applies in assignments where no risk effects are identified. Speculating whether a risk effect is temporary or ongoing does not negate a conclusion that a loss does or does not exist.

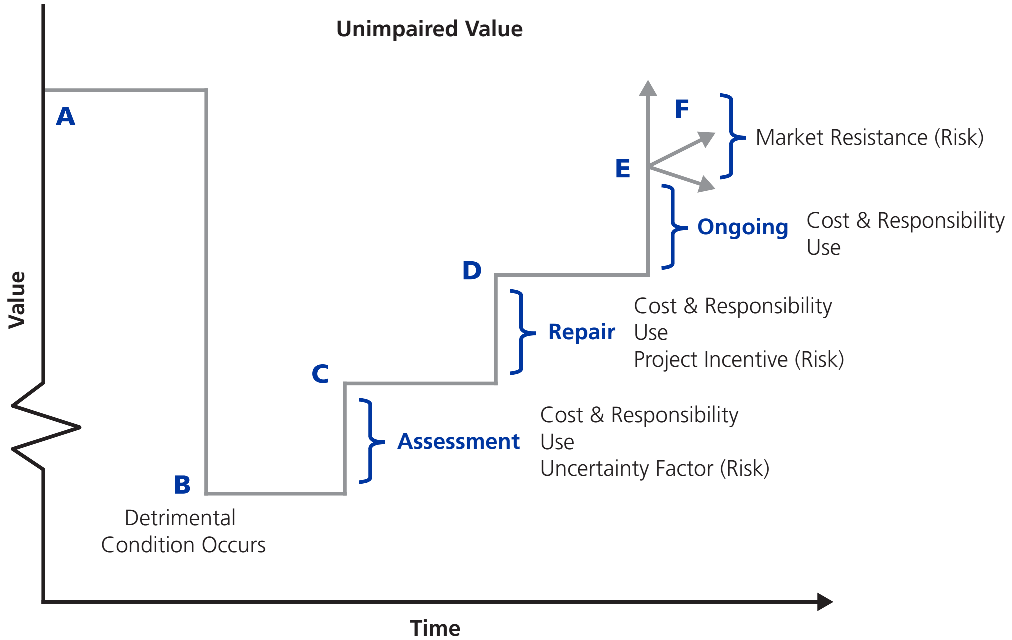
The text *Real Estate Damages*, third edition, presents numerous detrimental condition models that describe the relationship between a property's unimpaired market value and impaired market values at different stages of a detrimental condition lifecycle.[16] While there are numerous models that can be used to describe the relationship, that does not mean every model is relevant to an assignment. Rather, the numerous detrimental condition models serve as a visual aid to describe possible market value relationships overtime. *Real Estate Damages* offers a general detrimental condition model that indicates stigma (or risk) may diminish or increase in the ongoing stage of the remediation lifecycle (Exhibit 1).

Temporary and Ongoing Use Effects

As previously mentioned, three considerations have been identified as potentially impacting value of contaminated real estate: cost, use, and risk effects.[17] Similar to developing an unimpaired opinion of market value where the sales, income, and cost approaches are considered, the consideration of cost, use, and risk effects may be applicable to any assignment involving properties that are or may be impacted by a detrimental

8. Phillip S. Mitchell, "Estimating Economic Damages to Real Property Due to Loss of Marketability, Rentability and Stigma," *The Appraisal Journal* (April 2000): 169.
9. Randall Bell, *Real Estate Damages*, 3rd ed. (Appraisal Institute, 2016), 27.
10. Appraisal Standards Board, Advisory Opinion 9, Lines 77–96.
11. Randall Bell, "The Impact of Detrimental Conditions on Property Values," *The Appraisal Journal* (October 1998): 380–391; Appraisal Standards Board, Advisory Opinion 9, Lines 161–171.
12. An ongoing stigma may be referred to as "long-term" or "permanent" stigma in some texts. A temporary stigma may be referred to as "short-term." See discussion in *The Appraisal of Real Estate*, 15th ed., 184.
13. Richard A. Neustein and Randall Bell, "Diminishing Diminution: A Trend in Environmental Stigma," *Environmental Claims Journal* (Autumn 1998).
14. Alan Reichert, "The Persistence of Contamination Effects: A Superfund Site Revisited," *The Appraisal Journal* (April 1999): 126–135.
15. Michael V. Sanders, "Post-Repair Diminution in Value from Geotechnical Problems," *The Appraisal Journal* (January 1996): 64.
16. Bell, *Real Estate Damages*, 3rd ed., 29.
17. Appraisal Standards Board, Advisory Opinion 9, Lines 142–171.

Exhibit 1 General Detrimental Condition Model



Source: Adapted from Randall Bell, *Real Estate Damages*, 3rd ed. (Chicago: Appraisal Institute, 2016), 29.

condition.[18] Like risk effects, use effects may be temporary or ongoing.

An impairment to the conventional use and enjoyment of a property or its rights is typically reflected as a temporary use effect, and highest and best use issues typically reflect ongoing use effects. USPAP Advisory Opinion 9 describes *use effects* as follows:

> *Use effects* reflect impacts on the utility of the site as a result of the contamination. If the contamination and/or its cleanup rendered a portion of the site unusable, or limited the future highest and best use of the property, then there could be a use effect on value.[19]

When calculating a temporary use effect, questions may arise regarding what a property owner or renter does at the property during the time of impairment; however, from a real estate valuation perspective, the pertinent question is in regard to the effects on real estate and property rights. In other words, it is not a real estate valuation professional's duty to value people—it is their duty to value real estate. For example, if a property owner is on vacation and their house becomes the site of an environmental spill, that does not automatically mean that they did not incur a real estate damage because they were absent at the time of the spill. In a situation where a sudden disaster strikes and property owners remain bunkered down in their home, this is not necessarily evidence that there was no loss of use. Although the homeowners remained in their home, a use effect can still exist as this does not constitute conventional use and enjoyment of a property or its rights. Ultimately it comes down to if a property or its rights are impacted, not necessarily how the property owner reacts.

The bundle of rights concept further illustrates this perspective. In real estate, property rights are referred to as the "bundle of rights," because ownership of a parcel of real estate may embrace a great many rights, such as the right to its occupancy and use; the right to sell it in whole or in

18. Michael Tachovsky, "Environmental Dead Zones: The Evaluation of Contaminated Properties," *The Appraisal Journal* (Spring 2021): 115.

19. Appraisal Standards Board, Advisory Opinion 9, Lines 165–167.

part; the right to bequeath; the right to transfer, by contract, for specified periods of time; and the benefit to be derived by occupancy and use of the real estate.[20] *The Appraisal of Real Estate*, fifteenth edition, presents some of the many property rights, such as the right to use the real estate, sell it, lease it, enter it, and give it away.[21] The bundle of rights is the right to do any of these, whether or not they have been exercised. For example, "'the right to refuse to exercise any property rights,' as the absence of compulsion to use any right merely rounds out and makes complete the freedom of will in the enjoyment of property ownership."[22] Moreover, "it is also generally recognized that property encompasses the entire bundle of rights inherent in the ownership of the real estate and that the taking or infringement on these rights often constitutes a taking, even if no part of the physical real estate is taken."[23] Accordingly, use issues may not always be visible or apparent.

Temporary use effects are generally calculated using a loss of use technique where *market rent × time = use effect*. *Market rent* can be derived from different sources, including but not limited to standard monthly rates or short-term rates. *Time* is the period in which conventional use and enjoyment of a property (or its rights) is impaired, whether in part or in whole.

Measuring temporary use effects generally centers upon market rents, but it is not centered upon whether there has been an impact to market rental rates. Rather the issue is whether there is an impact to the conventional use and enjoyment of the property or whether the bundle of rights has been infringed. In this context, "conventional" relates to a customary or traditional usage or custom.[24] There may be situations such as displacement during and after an event, periods of trespass, periods of assessment, periods of repair, environmental assessment and remediation, delays, periods of nuisance, or as a result of many other situations that may impact the temporary conventional use or enjoyment of a property.

The definition of *diminution in value* in USPAP Advisory Opinion 9 references risk and/or costs; Advisory Opinion 9 defines *diminution in value* as follows:

> The difference between the unimpaired and impaired values of the property being appraised. This difference can be due to the increased risk and/or costs attributable to the property's environmental condition.[25]

This definition indirectly addresses a flawed perspective that may come up—that is, that use effects are always related to cost and risk effects. However, a use effect may be present even though a cost or risk effect is absent. Accordingly, an impaired property may not sell at a discount, yet it may still have incurred a use effect. An example would be properties surrounding the Three Mile Island nuclear facility during the 1979 partial meltdown incident, where a spectrum of risk effects was observed, from losses to no impact to even a positive impact;[26] nevertheless, there were evacuations in the surrounding areas.[27]

Diminution in Value

Typically, a real estate damage assignment involves computing the diminution in value of a property or group of properties. *The Dictionary of Real Estate Appraisal*, seventh edition, incorporates the USPAP Advisory Opinion 9 definition of *diminution in value*, referencing "the difference between the unimpaired and impaired values of the property being appraised"; however, a real estate damage assignment does not require both

20. JD Eaton, *Real Estate Valuation in Litigation*, 2nd ed. (Chicago: Appraisal Institute, 1995), 45.

21. Appraisal Institute, *The Appraisal of Real Estate*, 15th ed., 4.

22. Leonard C. Smith, "The Bundle of Property Rights," *The Appraisal Journal* (October 1956): 487.

23. JD Eaton, *Real Estate Valuation in Litigation*, 2nd ed., 16.

24. *Black's Law Dictionary*, 11th ed., s.v. "conventional."

25. Appraisal Standards Board, Advisory Opinion 9, Lines 71–73. See also *The Dictionary of Real Estate Appraisal*, seventh ed., s.v. "diminution in value."

26. Bell, *Real Estate Damages*, 3rd ed., 389–390

27. Susan Cutter and Kent Barnes, "Evacuation Behavior and Three Mile Island," *Disasters* 6, no. 2 (June 1982): 116–124.

an unimpaired and impaired value, let alone either of them. In fact, the Appraisal Institute's Guide Note 6, "Consideration of Hazardous Substances in the Appraisal Process," specifies that property value diminution is the sum of cost effects, use effects, and risk effects,[28] without regard to an unimpaired and impaired value. For example, a real estate valuation professional may opine that there is no diminution in value, which is an opinion of value, and an unimpaired and impaired valuation may not be necessary. Likewise, using pricing to draw a conclusion about how market behavior is reacting to a detrimental condition is also an opinion of value, though an unimpaired or impaired value is not developed. Pricing behavior is used to measure if property values have been diminished.[29] Simply stating that prices were studied (or opined upon) and not value does not void adherence to professional standards and guidance.

Real estate damage can also be computed on a percentage basis that is applied to an unimpaired value, similar to adjustments in the sales comparison approach.[30] Then, dollar damages or an impaired value can be deduced. In these scenarios, multiple sets of data may be analyzed, presenting a range of data. A real estate valuation professional can reconcile these data sets to estimate a single or straight-line opinion of value for a property or across a group of properties. In any of these valuation scenarios, a real estate valuation professional considers USPAP Standards 1 and 2, or Standards 5 and 6 if involving a mass appraisal assignment.[31]

The definition of *diminution in value* set forth by *The Dictionary of Real Estate Appraisal*, seventh edition, and USPAP Advisory Opinion 9 premises that it is a result of "increased risk and/or cost," whereas Guide Note 6 considers cost, use, and risk effects. The different definitions may create confusion as to what constitutes a diminution in value, like discussions regarding the definition of *market value*.[32] The definition of *diminution in value* set forth in *The Dictionary of Real Estate Appraisal*, seventh edition, and USPAP Advisory Opinion 9 does not mention use effects, nor does it mandate both cost and risk effects. One way to address this potential confusion is to set forth which of the three effects—cost, use, and risk—are developed in an assignment. Accordingly, this article examines how the environmental issues from a former oil production site in Hobbs, New Mexico, led to long-term risk effects for properties in a residential subdivision.

Permian Basin Case Study

Hobbs, New Mexico, lies within the Permian Basin, part of the southwest portion of the United States that is recognized for its oil and gas production. The Permian Basin "is one of the largest structural basins in North America," comprising approximately 86,000 square miles between West Texas and southeast New Mexico.[33] Hobbs was founded in 1907, and an oil boom in the 1920s began drawing many newcomers to Hobbs.[34] Since then, Hobbs has continued as a location for oil and gas exploration.

The contamination in this case study derives from the former site known as the Grimes Tank Battery (Grimes) site. The site operated from 1946 to 1993, with further oil production dating back to the initial boom in the 1920s. In the 1970s, the land adjacent to the Grimes site was developed into a single-family residential subdivision, known as Westgate. The homes in Westgate were typically three-bedroom, two-bathroom residences with attached garages. The composition and style of homes generally conforms with

28. Appraisal Institute, Guide Note 6: "Consideration of Hazardous Substances in the Appraisal Process" (Appraisal Institute, July 26, 2013, rev. 2020), 7, https://bit.ly/2RLm8mN.

29. Thomas O. Jackson, "Methods and Techniques for Contaminated Property Valuation," *The Appraisal Journal* (October 2003): 317.

30. Appraisal Institute, *The Appraisal of Real Estate*, 15th ed., 342.

31. Appraisal Standards Board, Standard 1, "Real Property Appraisal, Development," Standard 2, "Real Property Appraisal, Reporting," Standards 5 and 6, "Mass Appraisals, Development and Reporting" in *Uniform Standards of Professional Appraisal Practice* (USPAP), 2020–2021 ed. (Washington, DC: The Appraisal Foundation, 2020).

32. For more discussion on the definitions of *market value*, see Michael V. Sanders, "Market Value: What Does It Really Mean?" *The Appraisal Journal* (Summer 2018): 206–218.

33. Mahlon M. Ball, "Permian Basin Province (044)," USGS, 1, https://bit.ly/3zs5I66.

34. "Hobbs Comprehensive Community Development Plan," 2-2, last modified June 16, 2004, https://bit.ly/3xs7Uco.

competing residential developments built in Hobbs around that time.

The shutdown of the Grimes site in 1993 was part of a Stage 1 Abatement Plan. Approximately four years after the shutdown, in 1997, soils were excavated at the former Grimes site and removed.[35] Later that same year, residents of the Westgate subdivision filed complaints related to illness with the New Mexico Department of Health. The complaints led to investigations and discovery of crude oil sludge layers near residents' homes.[36] Further testing revealed elevated levels of benzene, methylene chloride, and phenols.[37] After the discovery, a Notice to Prospective Purchasers was drafted in June 1998 and a lawsuit was filed in 1999 by residents of Westgate.

Following the discovery, Shell Oil Company was identified as a responsible party. Shell performed several phases of remedial activities, including a Stage 2 Abatement Plan and the demolition of four residences within the subdivision, which have not been rebuilt.[38] After initial remediation and demolition, additional environmental testing was performed, revealing the presence of aromatic hydrocarbons, including benzene, toluene, ethylbenzene, xylene, pristane, and phytane in soil and air.[39]

The oil company later attempted to donate a portion of the former Grimes site to the City of Hobbs. In 2007, a scientist with Cordilleran Compliance Services wrote a letter to the City of Hobbs' attorney, recommending that the city not move forward with the proposed donation. The letter cited risks associated with the soil and groundwater contamination from the former Grimes site, including potential human exposure issues. The City of Hobbs turned down the donation offer. From a real estate valuation perspective, the environmental contamination issues associated with the former Grimes site present an opportunity to evaluate any effects on market value in the neighboring Westgate subdivision.

Analysis of Ongoing Risk Effects

Analyses of single-family residential homes in the Westgate subdivision of Hobbs were conducted to study long-term risk effects associated with environmental contamination issues. In the analysis, the homes in Westgate are considered "non-source"[40] properties and the former Grimes site is considered the "source"[41] property. Remediation efforts were conducted, indicating that the Westgate homes are in the "ongoing" stage of the remediation lifecycle. Although the Westgate homes are in the ongoing stage as of this analysis, if future assessment or remediation is required, the remediation lifecycle stage may change.

For this assignment, like any involving environmental contamination, USPAP Advisory Opinion 9 should be consulted. USPAP Advisory Opinion 9 sets forth guidelines for analyzing properties that may be impacted by environmental contamination, specifically the consideration of cost, use, and risk effects. Although USPAP Advisory Opinion 9 expressly addresses environmental contamination, cost, use, and risk effects are applicable to other detrimental condition assignments.

To assist in identifying and analyzing the stages and issues of a detrimental condition assignment, real estate valuation professionals can use the Detrimental Condition (DC) Matrix (Exhibit 2). Using a DC Matrix helps minimize potential confusion regarding the stages and issues of an analysis. As different characteristics of the valuation problem are identified, a DC Matrix[42] may

35. Phillip Services Corp., "Westgate Subdivision, Grimes Battery and Tasker Road Stage 1 Abatement Plan, Prepared for Shell Exploration and Production Technology Company" (May 1998).

36. James Dahlgren, Harpreet Takhar, Pamela Anderson-Mahoney, Jenny Kotleman, Jim Tarr, and Raphael Warshaw, "Cluster of Systemic Lupus Erythematosus (SLE) Associated with an Oil Field Waste Site: A Cross Sectional Study," *Environmental Health* 6, no. 8 (February 2007).

37. Dahlgren et al., "Cluster of Systemic Lupus Erythematosus (SLE) Associated with an Oil Field Waste Site."

38. Shell Exploration and Production Company, News Release, "Shell Enters Final Phase of Westgate Abatement Project" (February 21, 2002).

39. Dahlgren et al., "Cluster of Systemic Lupus Erythematosus (SLE) Associated with an Oil Field Waste Site."

40. USPAP Advisory Opinion 9 states, "Non-source sites are sites onto which contamination, generated from a source site, has migrated," Line 98.

41. USPAP Advisory Opinion 9 states, "Source sites are the sites on which contamination is, or has been, generated," Lines 97–98.

42. Orell C. Anderson, "Environmental Contamination: An Analysis in the Context of the DC Matrix," *The Appraisal Journal* (July 2001): 322–332.

Exhibit 2 DC Matrix

Detrimental Conditions Issues		Detrimental Condition Stages: Assessment	Repair	Ongoing
	Cost	Cost to assess and responsibility Engineering Phase I, II, III studies	Repair costs and responsibility Repairs Remediation Contingencies	Ongoing costs and responsibility Operations and maintenance monitoring
	Use	All loss of utility while assessed Disruptions Safety concerns Use restrictions	All loss of utility while repaired Income loss Expense increase Use restrictions	Ongoing use disruptions Alterations to highest and best use
	Risk	Uncertainty factor Discount, if any, where extent of damage is unknown	Project incentive Financial incentive, if any, to complete repairs	**Market resistance** **Residual resistance, if any, due to situation**

provide a useful visual aid throughout the process. In the current case study, the focus of the analysis is on the quadrant reflecting the ongoing stage and risk effect issues. In some instances, more than one quadrant of the detrimental condition matrix might be applicable.

When determining risk effects, if any, there are numerous potential methodologies to consider. Potential methodologies include, but are not limited to, regression analysis, paired sales analysis, sale/resale analysis, literature review, surveys, case study analysis, market trends, and many more.[43] While there are numerous techniques available to real estate valuation professionals, it is not necessary to use them all; some or even one technique can produce credible opinions in an assignment.[44] In this case study, a multiple regression analysis and paired sales analysis were conducted to evaluate any risk effects as of 2018.

In developing the studies, a search was conducted for improved single-family residential arm's-length transactions in Hobbs, New Mexico, since 2015[45] using the local multiple listing service (MLS). These areas were generally similar in property type and other characteristics. Once the data were identified, they were downloaded and geocoded to identify properties that sold within the Westgate subdivision (test properties) versus properties that sold outside of the Westgate subdivision (control properties). If the market value of properties in Westgate had been reduced by stigma related to the risk of the environmental issues, this would be reflected in a reduction of prices in the test area relative to prices of otherwise similar properties in control areas.

Market awareness was also analyzed to verify whether market participants were knowledgeable of the environmental issues in the subdivision.

43. Appraisal Institute, *The Appraisal of Real Estate*, 15th ed., 188; and Bell, *Real Estate Damages*, 3rd ed.

44. Tachovsky, "Environmental Dead Zones," 114.

45. The Federal Reserve Economic Data (FRED) for housing prices in New Mexico note growth in housing market prices for the period in which transactions were collected and analyzed.

Investigation into the matter revealed that buyers were provided a Notice to Prospective Purchasers, which summarized the detrimental environmental issue.[46] The notice also mentioned the neighboring subdivision, Dale Bellemah; because of the mention, sales within Dale Bellemah were not used in the analysis. Rather, Dale Bellemah was considered a buffer zone between the test property sales within Westgate and the control property sales outside of Westgate.

Regression Analysis

Three regression models are generally used in an analysis of environmental stigma. They are (1) property-level models (before/during/after an event), (2) proximity analyses (distance from a location), and (3) control area analyses (test/impaired versus control/unimpaired).[47] A control area analysis was conducted in this case study using a hedonic pricing ordinary least-squares model. Identifying the control area(s) is one of the initial steps in this type of analysis; the test and control areas do not need to be identical.[48]

In this study, the dependent variable is *Sale Price*. A log transformation is applied to *Sale Price*, so that the coefficients in the summary output table are presented as percentages, whereas an unlogged regression would present the summary output coefficients as dollar amounts. If the coefficients in a logged regression are being used to estimate property values or market rents, they can be unlogged after running the analysis to convert any indicated values to dollar amounts. In this regression, logarithmic transformations are useful to the overall case study because the regression risk effect coefficient is then presented on a percentage basis, allowing for a simpler comparison and reconciliation with any percent risk effect in the paired sales analysis. Moreover, a log transformation is sometimes used to control for statistical issues that may occur, such as heteroskedasticity.[49]

The general specification of the multiple regression model equation takes the following form:

$$\begin{aligned}\ln(SP) = \alpha &+ \beta_1\, \mathit{SALE\ DATE} + \beta_2 \ln \mathit{LIVING} \\ &\mathit{AREA} + \beta_3\, \mathit{BATHROOMS} \\ &+ \beta_4\, \mathrm{GARAGE} + \beta_5\, \mathit{FIREPLACES} \\ &+ \beta_6\, \mathit{AGE} + \beta_7\, \mathit{WESTGATE} + \varepsilon\end{aligned}$$

where:

$\ln(SP)$ = natural logarithm of the sale price,

SALE DATE = a discrete variable for the year of the sale,[50]

ln *LIVING AREA* = natural logarithm of square feet of living area,

BATHROOMS = number of bathrooms,

GARAGE = number of garage spaces,

FIREPLACES = number of fireplaces,

AGE = age of improvements,

WESTGATE = location in or outside of Westgate (test or control),

β = coefficient to be estimated,

α = a constant term, and

ε = the random error term.

These independent variables (Exhibit 3) are designed to capture any influences and marginal effects they may have on the value of real estate. The variable for *Living Area* was logged, like the

46. "Notice to Prospective Purchasers," drafted in June 1998. The notice is used as a disclosure by sellers and local real estate agents to inform potential buyers of the contamination concerns, potential exposure to environmental hazards, and potential health concerns such as cancer and immune disorders associated with purchasing a property in the subdivision or nearby. Accordingly, the notice also mentioned the neighboring subdivision, Dale Bellemah.

47. Thomas O. Jackson, "Evaluating Environmental Stigma with Multiple Regression Analysis," *The Appraisal Journal* (Fall 2005): 366–367.

48. Jackson, "Evaluating Environmental Stigma with Multiple Regression Analysis," 367.

49. Appendix B, "Regression Analysis and Statistical Applications," in *The Appraisal of Real Estate*, 15th ed. (Appraisal Institute: 2021), available at https://bit.ly/3wxsZlI.

50. In this study, using a discrete variable for the year of sale helped to capture effects due to market conditions that vary by year and to control for any heterogeneity that may have been in the data.

logarithmic transformation used for *Sale Price*, resulting in a log-log model. An independent variable that was considered but not ultimately used was lot size because MLS data did not report lot size for numerous properties. Jackson (2005) addresses this issue in a discussion on omitted variable bias:

> For example, lot size is frequently missing from multiple listing service (MLS) information and other property records. The influence of lot size on price could be picked up and indirectly accounted for by house size since they tend to be correlated. The model's overall prediction of sale price would still be unbiased.[51]

Some control area analyses may include a variable for an event, such as the release of a contaminant or remediation.[52] However, the purpose of this analysis is to measure any ongoing risk effects more than twenty years after the discovery of the environmental issues; therefore, an event variable was not used.[53] Ultimately, the independent variable of interest is the *Westgate* variable, as it is designed to measure any risk effect from the environmental issues. Thus, a binary variable was used; the properties in Westgate (test area) were coded with a "1" and the properties in the control areas were coded with a "0." Using the binary variable in the same regression allows for the measurement of any marginal effect on sale price that a certain attribute may have on market value.

The regression analysis indicates a long-term risk effect from the environmental contamination of approximately −28% for properties in the Westgate subdivision, which is indicated by the *Westgate* coefficient (Exhibit 4). The standardized residuals of this model appeared to have a generally random pattern, with 95% of the data between ±2 standard deviations and 99% between ±3 standard deviations.[54] The overall statistical indicators of this model were generally good, with the independent variable coefficients for *Sale Date*, *Bathrooms*, and *Fireplaces* indicating less confidence and significance.[55] Nevertheless, the *Westgate* variable used to measure any risk effect was statistically and economically significant.

Multiple regression has been used by real estate valuation professionals to estimate the effects of environmental contamination issues (or other detrimental condition issues) on property values,[56] as it has been conducted for this case study. In addition, regression can also be used to estimate unimpaired values, impaired values, and market rents.[57] As the Appraisal Institute course *Quantitative Analysis* states, "a regression analysis

Exhibit 3 Descriptive Statistics

Variable	Minimum	Maximum	Mean	Standard Deviation
Sale Price	$78,000	$235,000	$168,313	$34,552
Sale Date (Year)	2015	2018	2017	407
Living Area (SqFt)	923	2,197	1,740	277
Bathrooms	1	3	2	0
Garage Capacity	0	4	2	1
Fireplaces	0	2	1	1
Age (Years)	31	48	38	4
Westgate	0	1	0.06	0.23

51. Jackson, "Evaluating Environmental Stigma with Multiple Regression Analysis," 366.

52. Jackson, "Evaluating Environmental Stigma with Multiple Regression Analysis," 367.

53. An analysis of risk effects does not require an event; an analysis of data with and without a detrimental condition (test and control analysis) can be developed, regardless of a specific event. An example includes the study design in Jackson, "Evaluating Environmental Stigma with Multiple Regression Analysis," 368.

54. Appraisal Institute, *Quantitative Analysis* coursebook, Part 8–227.

55. *t* Stats >2 or <−2 and *P*-values >0.1 or 0.05.

56. See discussions in Appraisal Institute, *The Appraisal of Real Estate*, 15th ed., 188; Bell, *Real Estate Damages*, 3rd ed.; Jackson, "Evaluating Environmental Stigma with Multiple Regression Analysis," 363–369; Alan Reichert, "The Impact of a Toxic Waste Superfund Site on Property Values," *The Appraisal Journal* (October 1997): 381–392; Alan Reichert, "The Persistence of Contamination Effects," 126–135; Jackson and Yost-Bremm, "Environmental Risk Premiums and Price Effects in Commercial Real Estate Transactions," *The Appraisal Journal* (Winter 20018): 48–67; Mark Dotzour, "Groundwater Contamination and Residential Property Values," *The Appraisal Journal* (July 1997): 279–285.

57. Marvin Wolverton, *An Introduction to Statistics for Appraisers* (Chicago: Appraisal Institute, 2009), 345; Appendix B, "Regression Analysis and Statistical Applications" in *The Appraisal of Real Estate*, 15th ed., 8; and Appraisal Institute, *Quantitative Analysis* coursebook, Exercise 3.2 Question 1, Practice Test 6 and 7 Question 11, and Part 12 Question 6.

Exhibit 4 Summary Output Table

Regression Statistics	
Multiple *R*	0.840644353
R Square	0.706682928
Adjusted *R* Square	0.694461383
Standard Error	0.124094832
Observations	176

ANOVA

	df	*SS*	*MS*	*F*	*Significance F*
Regression	7	6.233097668	0.890442524	57.82271764	0.00000000
Residual	168	2.587120602	0.015399527		
Total	175	8.82021827			

	Coefficients	Standard Error	*t* Stat	*P*-value	Lower 95%	Upper 95%
Intercept	6.002374574	0.445600346	13.470309488	0.000000000	5.122676969	6.882072180
Sale Date (Year)	0.017577597	0.009229802	1.904439301	0.058561967	–0.000643741	0.035798935
Living Area (SqFt – Log)	0.845074246	0.064161586	13.171031158	0.000000000	0.718407393	0.971741099
Bathrooms	–0.016675790	0.045339251	–0.367800299	0.713485110	–0.106183869	0.072832288
Garage Capacity	0.051919923	0.018061114	2.874680046	0.004567750	0.016263940	0.087575906
Fireplaces	–0.000434555	0.011763425	–0.036941160	0.970575780	–0.023657734	0.022788624
Age (Years)	–0.009467577	0.002359533	–4.012479102	0.000090310	–0.014125732	–0.004809422
Westgate (Risk Effect)	**–0.283552424**	0.041566467	–6.821662860	0.000000000	–0.365612327	–0.201492520

can be used to form the basis for an opinion of value by direct sales comparison. If the data are representative, the resulting regression equation can be seen as a means of estimating market value that is fully consistent with the principle of contribution."[58] To further analyze any ongoing risk effects, a paired sales analysis was also conducted.

Paired Sales Analysis

A paired sales analysis compares the sale price of a property with a feature of interest, here environmental contamination risk, to the sale price of a similar property sold without the feature. Paired sales analyses can be conducted as a before-and-after analysis or as a test-and-control analysis. A before-and-after paired sales analysis looks at sales before a period of time or event and compares them to otherwise similar sales after a period of time or event. The period of time may be determined as the single date of an event or a date range. A test-and-control paired sales analysis compares test properties with a detrimental condition to otherwise similar control properties without a detrimental condition. Like the regression analysis, a test-and-control analysis was conducted through a search of single-family residential properties in Hobbs, New Mexico, that were developed around the same time as residences in the Westgate subdivision.[59] The table in Exhibit 5 summarizes the paired sales study.

The paired sales analysis indicated a risk effect ranging from −10% to −42%, whereas the regres-

58. Appraisal Institute, *Quantitative Analysis* coursebook (Chicago: Appraisal Institute), Part 3-46.

59. This is one consideration that may be made when developing paired sales.

Exhibit 5 Westgate Analysis Summary

Westgate – Hobbs, New Mexico, Paired Sales Summary												
Test (Impaired)						Control (Unimpaired)						
No.	Sale Date	FRED Index	Sale Price ($)	SqFt	Price per SqFt ($)	No.	Sale Date	FRED Index	Sale Price ($)	SqFt	Time Adj. Price per SqFt ($)	Risk Effect
1	May-16	299.63	103,000	1,437	72	1A	Jun-18	320.55	152,000	1,426	100	–28%
						1B	Sep-15	293.89	158,000	1,608	100	–28%
						1C	Jun-18	320.55	165,500	1,540	100	–29%
						1D	Jun-18	320.55	175,000	1,581	103	–31%
						1E	Sep-16	301.56	187,000	1,588	117	–39%
						1F	Dec-15	292.83	171,000	1,680	104	–31%
						1G	May-17	307.45	155,000	1,484	102	–30%
						1H	Jun-17	307.45	158,000	1,532	101	-29%
						1I	Jul-16	301.56	162,000	1,680	96	–25%
						1J	Jun-16	299.63	165,000	1,621	102	–30%
						1K	Apr-18	320.55	180,000	1,627	103	–31%
2	Jun-18	320.55	135,000	1,819	74	2A	Feb-16	294.96	167,900	1,706	107	–31%
						2B	Apr-18	320.55	153,000	1,756	87	–15%
						2C	Apr-16	299.63	175,000	1,798	104	–29%
						2D	Jun-18	320.55	175,000	1,999	88	–15%
						2E	May-17	307.45	185,000	1,722	112	–34%
						2F	Jun-15	290.87	190,000	1,961	107	–30%
						2G	Feb-18	315.78	197,000	1,954	102	–27%
						2H	Aug-16	301.56	200,000	1,900	112	–34%
						2I	Sep-17	313.42	206,000	1,936	109	–32%
						2J	Aug-15	293.89	210,000	1,786	128	–42%
3	Nov-16	305.76	117,000	1,629	72	3A	Mar-18	315.78	145,000	1,426	98	–27%
						3B	Sep-15	293.89	165,000	1,590	108	–33%
						3C	Apr-18	320.55	149,500	1,600	89	–19%
						3D	Jul-18	324.01	186,000	1,699	103	–30%
4	Aug-15	293.89	129,000	1,800	72	4A	Apr-18	320.55	153,000	1,756	80	–10%
						4B	Feb-16	294.96	167,900	1,706	98	–27%
						4C	Apr-16	299.63	175,000	1,798	95	–25%
						4D	May-17	307.45	185,000	1,722	103	–30%
						4E	Jun-15	290.87	190,000	1,961	98	–27%
						4F	Feb-18	315.78	197,000	1,954	94	–24%
						4G	Aug-16	301.56	200,000	1,900	103	–30%
						4H	Sep-17	313.42	206,000	1,936	100	–28%
						4I	Aug-15	293.89	210,000	1,786	118	–39%
5	Feb-17	304.48	122,000	1,760	69	5A	Apr-18	320.55	153,000	1,756	83	–16%
						5B	Feb-16	294.96	167,900	1,706	102	–32%
						5C	Apr-16	299.63	175,000	1,798	99	–30%
						5D	Jun-18	320.55	175,000	1,999	83	–17%
						5E	Mar-18	315.78	180,000	1,718	101	–31%
						5F	May-17	307.45	185,000	1,722	106	–35%
						5G	Feb-18	315.78	197,000	1,954	97	–29%
						5H	Aug-16	301.56	200,000	1,900	106	–35%
						5I	Sep-17	313.42	206,000	1,936	103	–33%

sion indicated a risk effect of approximately −28%. The findings among the two analyses generally reconciled. In real estate economic and valuation analyses, a single percentage or numerical risk effect, a range, and a not less than or not greater than opinion[60] can be derived from a set of data for application to a property or properties impacted by a detrimental condition. Case study findings across different geographies and times can be considered in real estate economic and valuation studies.[61] Furthermore, both the regression and paired sales methods used in this case study are property-by-property and mass appraisal techniques. Accordingly, in class action lawsuits, mass appraisal techniques can be used to evaluate real estate damages on individual and aggregate bases. As Jackson states, "with reasonable similarities in property, market, and environmental characteristics, property interests defined in a class action can be meaningfully analyzed."[62]

When any risk effect techniques in mass appraisal assignments, such as the regression and paired sales in this case study, are conducted on a percentage basis (e.g., −20% for view impairment), the findings can be then be applied to unimpaired values generated by regressions or other techniques on both an individual and aggregate basis.[63] Likewise, with use effect calculations, market rents can be determined using regression or other techniques, and the time period of impact can be applied to the results on both an individual and aggregate basis.[64]

The paired sales analysis made market (or time) adjustments using the Federal Reserve Economic Data (FRED) for housing prices in New Mexico. While real estate valuation professionals may consider trending prices in a neighborhood(s), using the FRED index is an appropriate approach. The Federal Reserve Bank of St. Louis is a leading, respected resource for economic and financial information.[65] FRED market data includes a house price index for numerous markets across the country, including housing price indices on a national, regional, statewide, metropolitan, and citywide basis. Sometimes there is not a citywide FRED index for an area of study; therefore, it may be appropriate to consider the statewide index when developing market or time adjustments.

The adjustment process in a paired sales is similar to making an adjustment in the sales comparison approach, where a comparable sale is adjusted in comparison to the subject property. Likewise, the test property is analogous to the subject property, and the control property is like the comparable sale. To calculate the market-adjusted price per square foot in the paired sales, the change in the FRED index was calculated and applied to the control sale price.[66]

Furthermore, when measuring any impacts of a detrimental condition, entire local markets may also be impacted—for example, after a widespread wildfire or flooding. In such instances, local market trends may not serve as the best indicator for a market adjustment. In these instances, the statewide housing index may serve as an appropriate measurement, and at times as an indicator of unimpaired market trends. Housing trend indices may also be used to estimate prospective market values, by projecting future market trends.

60. Appraisal Standards Board, *Uniform Standards of Professional Appraisal Practice*, 2020–2021 ed., Lines 64–66. "Comment: An appraisal is numerically expressed as a specific amount, as a range of numbers, or as a relationship (e.g., not more than, not less than) to a previous value opinion or numerical benchmark (e.g., assessed value, collateral value)."

61. Tachovsky, "Environmental Dead Zones," 112; and Sanders, "Post-Repair Diminution in Value from Geotechnical Problems," 61.

62. Jackson, "Real Property Valuation Issues in Environmental Class Actions," 149.

63. Wolverton, *An Introduction to Statistics for Appraisers* , 345; Appraisal Institute, *Quantitative Analysis* coursebook, Part 3-46; and Exercise 3.2 Question 1, Practice Test 6 and 7 Question 11, and Part 12 Question 6 in *Quantitative Analysis* coursebook.

64. Appendix B, "Regression Analysis and Statistical Applications" in *The Appraisal of Real Estate*, 15th ed., 8.

65. Dan L. Swango, "Economic Research Resources," *The Appraisal Journal* (Spring 2017): 148.

66. The following formula illustrates a general calculation that may be used: [(Test Sale Index/Control Sale Index) × Control Sale Price]; there are other calculations that can also be considered. Excel was used in this case study and numbers rounded to the nearest whole number; any noted discrepancies are a result of rounding.

Conclusion

Early real estate valuation literature on contaminated properties introduced the term *environmental stigma* in reference to an adverse effect on property value produced by the market's perception of increased environmental risk due to contamination.[67] As the research literature further addressed evaluation of contaminated properties, discussions arose regarding temporary versus permanent stigma. However, the issue of stigma endurance may not be important where an opinion of value or diminution in value is given as of a specific point in time. If a real estate valuation professional finds that a property incurred or did not incur a risk effect as of a date of value, that is what is relevant. Speculating whether that risk effect is temporary or permanent does not negate that a measured loss (or no loss) occurred as of that date of value.

Like risk effects, use effects may be temporary or ongoing. With use effects, an impairment to the use and enjoyment of a property (or its rights) is typically reflected as a temporary use effect, and highest and best use issues typically reflect ongoing use effects. Measurement of temporary use effects generally centers on market rents. It is not centered on whether there has been an impact to market rental rates or whether a property is used, but rather on whether there is an impact to the conventional use and enjoyment of the property or its rights or whether the bundle of rights has been impaired.

In this article, a case study with ongoing stigma was analyzed. In Hobbs, New Mexico, past oil production and storage activities at the former Grimes Tank Battery site led to contamination issues in the neighboring Westgate subdivision. A multiple regression analysis and paired sales analysis were conducted, which indicated that ongoing stigma (or risk effects) persist more than twenty years after the discovery of the environmental issues in Westgate. The analyses found a risk effect ranging from −10% to −42%.[68] The findings also demonstrate that stigma is not always temporary and in cases may be ongoing.[69]

About the Author

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SEE NEXT PAGE FOR ADDITIONAL RESOURCES >

67. Appraisal Standards Board, Advisory Opinion 9, Lines 85–86.

68. In real estate economic and valuation analyses, a single percentage or numerical risk effect, a range, and a not less than or not greater than opinion can be derived from a set of data for application to a property or properties impacted by a detrimental condition.

69. Locations that suggest ongoing stigma include Love Canal in New York, Uravan in Colorado, Hinkley in California, Picher in Oklahoma, Wittenoom in Australia, and Chernobyl in Ukraine.

Additional Resources

Suggested by the Y. T. and Louise Lee Lum Library

Appraisal Institute

Lum Library [Login required]

- Knowledge Base Information Files—Real estate damages
- *Diminution Valuation Assignments: Enhance the Importance of Highest and Best Use* (Conference presentation, 2019)

US Environmental Protection Agency

- **Chemicals and Toxics Topics**
  https://www.epa.gov/environmental-topics/chemicals-and-toxics-topics
- **Cleanups at Federal Facilities: Land Use Controls**
  https://www.epa.gov/fedfac/land-use-controls-lucs
- **Laws and Regulations**
  https://www.epa.gov/laws-regulations
- **Report on the Environment: Land Use**
  https://www.epa.gov/report-environment/land-use
- **Superfund: Institutional Controls**
  https://www.epa.gov/superfund/superfund-institutional-controls

Market Rent and Highest and Best Use: Joined at the Hip?

by Barry A. Diskin, PhD, MAI, AI-GRS, David C. Lennhoff, MAI, SRA, AI-GRS, Richard L. Parli, MAI, and Stephen D. Roach, MAI, SRA, AI-GRS

Abstract

It is well established that market value must be premised on the property's highest and best use. What about market rent? This article investigates the relationships between highest and best use and market value and market rent and presents evidence and the rationale for a conclusion that as with market value, market rent also must be based on the property's highest and best use. As a part of the investigation, three mini case studies are presented to illustrate the importance of carefully labeling and developing the appropriate rent. In conjunction with this investigation, *use value* will be redefined and a new definition of *use rent* proffered as an aid in diminishing confusion among the different types of rent.

Introduction

One of the most important steps in an appraisal is the determination of the type of value to be estimated. This is one of the assignment elements to be determined as part of problem identification, which is the first step in the valuation process.[1] Furthermore, it is well established that market value must be estimated in terms of the property's highest and best use. Although other legitimate value estimates can be made—for example, use value and investment value—for it to be *market value* it must be based on the property's highest and best use. This fact is supported in appraisal texts and standards, including the Uniform Standards of Professional Appraisal Practice (USPAP) and the Uniform Appraisal Standards for Federal Land Acquisitions (UASFLA). This connection to highest and best use is critical because, as noted in *The Appraisal Journal*, "it is axiomatic that 'you can't get the value right if you get the highest and best use wrong.'"[2] But what about market rent? Must the rent be based on the property's highest and best use for it to represent *market rent*? Does it matter? In order to answer these questions, it is necessary to first investigate the relationship that value and market value have with highest and best use. The following discussion includes a clarifying case study and proposes a new definition of *use value*. The discussion then turns to the relationship of rent and market rent to highest and best use. Two additional clarifying case studies are then presented. Finally, a definition is proffered for a new term, *use rent*.

Value, Market Value, and Highest and Best Use

It is well established that market value and highest and best use are connected—the market value of a property is the value of the property at its highest and best use. This is in spite of the fact that there are various definitions of *market value*

1. Appraisal Institute, chapter 6, "Identifying the Type of Value and Its Definition," in *The Appraisal of Real Estate*, 15th ed. (Chicago: Appraisal Institute, 2020), 47–57.

2. David C. Lennhoff and Richard L. Parli, "Timing Is Everything: The Role of Interim Use in the Highest and Best Use Conclusion," *The Appraisal Journal* (Summer 2020): 198.

as well as numerous ways to express highest and best use. The mixing and matching of the description of the two concepts does not change the relationship. *The Appraisal of Real Estate*, fifteenth edition, expresses the relationship succinctly: "Market value opinions are based on the highest and best use of a property."[3]

This relationship is repeated in numerous authoritative texts,[4] as well as in USPAP[5] and UASFLA.[6] Nonetheless, this relationship is not self-evident and is not explicit in any of the numerous definitions of *market value*, including the definition used by government agencies that regulate federally insured financial institutions:

> *Market value* is the most probable price that a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller, each acting prudently, knowledgeably and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:
> - Buyer and seller are typically motivated;
> - Both parties are well informed or well advised, and acting in what they consider their own best interests;
> - A reasonable time is allowed for exposure in the open market;
> - Payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and
> - The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.[7]

To appreciate the connection, it is necessary to understand the basic definitions of real estate value.

On the one hand, *value* is a generic term, referring to the power of a good or service to command other goods and services in exchange.[8] Value as a generic term can be applied to anything tangible or intangible. The determination of the value of something is normally quite simple because the something is usually, within its population, both uniform and transportable, and operating in an active market. The simplicity arises from the fact that little analysis is required of the demand and supply for the something because the market is typically universal.

When the market in question is a real estate market, however, *value* is defined as "the monetary relationship between properties and those who buy, sell, or use those properties."[9] Real estate is distinct from other markets in that real estate is neither uniform nor transportable. Consequently, the market is unique for each property. Not only is the market unique for each property, but the valuation of each property can be uniquely tailored to match the value question being asked. For instance, the value of a property can be determined based upon a particular use (use value); based upon particular investment terms or motivation (investment value); and/or based upon a property being a portion of a larger enterprise (value-in-use).[10] In each case, the real estate remains the same but the value is different because the appraisal does not focus on the entire property, but on a particular characteristic of the property. In essence, the focus on each characteristic limits the analysis, which in turn limits the results by restricting the considerations. For use value, the analysis prevents consideration of other, possibly more valuable, uses. For investment value, the analysis prevents specific consideration of market terms (except by coincidence).

3. Appraisal Institute, *The Appraisal of Real Estate*, 15th ed., 52.
4. See, for example, J. D. Eaton, *Real Estate Valuation in Litigation*, 2nd ed. (Chicago: Appraisal Institute, 1995), 18; Appraisal Institute, *Real Property Value in Condemnation* (Chicago: Appraisal Institute, 2018), 75; James H. Boykin, *Land Valuation: Adjustments Procedures and Assignments* (Chicago: Appraisal Institute, 2000), 39.
5. Appraisal Standards Board, Standards Rule 1-3 (a) and (b) in *Uniform Standards for Professional Appraisal Practice* (Washington, DC: The Appraisal Foundation, 2020–2021).
6. Interagency Land Acquisition Conference, Section 4.3, "Highest and Best Use" in *Uniform Appraisal Standards for Federal Land Acquisition*s (UASFLA), 2016 ed. (Washington, DC: US Government Printing Office, 2016), http://bit.ly/UASFLA.
7. Appraisal Institute, *The Dictionary of Real Estate Appraisal*, 7th ed. (Chicago: Appraisal Institute, 2022), s.v. "market value."
8. Arthur A. May, *The Valuation of Residential Real Estate*, 2nd ed. (New Jersey: Prentice-Hall, 1953), 12.
9. Appraisal Institute, *The Dictionary of Real Estate Appraisal*, 7th ed., s.v. "value."
10. See discussion in *The Appraisal of Real Estate*, 15th ed., 52–54.

For value-in-use, the analysis prevents the consideration of all but its value in contribution to a greater enterprise.

Market value, on the other hand, is not a generic term; it refers to a value that has no artificial conditions or limits imposed.[11] Because of this, market value is not subjective. It is the value that is strictly market-determined; that is, the value is the outcome of the competitive and open interactions of buyers, sellers, and users, who combine to create market value. These three component interactions are unique to market value. Users interact to identify the most-productive use of the property; buyers interact with other market participants to identify demand characteristics and affordability; and sellers interact to identify the availability of similar property types. Combined, this interaction indicates the most productive use of the property (i.e., the highest and best use) and the value of the property for that use.

The market, in this sense, includes all components expected in a competitive, open market. *Open* means that all relevant market participants can engage equally. *Competitive* indicates that there is a critical level of supply and demand so as to assure that the market participants have choices. Out of the choices, the market participant who offers the highest price for a property will become the buyer. In short, market value implies that the owner of the property (the hypothetical seller) should be able to maximize profit by marketing the property to the highest bidder (the hypothetical buyer).

Only a competitive and open market allows transactions that are not artificially limited. This recognition is embedded in the definition of *market value* quoted earlier. Like all *market value* definitions, there is no "use" referenced; it is implied that the "competitive and open market" will determine the use. This is the case no matter whether the property is land that is vacant or land that is improved. It is the market that determines the use (and, in turn, it is the use that determines value). And the market-determined use is the use that is valued to arrive at market value.

The market-determined use for a particular property is the property's highest and best use. The product of a highest and best use analysis is identification of the most probable use of the property that results in the highest value—in other words, the use that will attract the buyer willing to pay the highest price for the property. After all, if the hypothetical seller wants to maximize its return, that can only be accomplished by selling to the highest bidder. A bidder will pay the highest price because its use is the most productive use after consideration of all reasonable alternatives. Any limitation on use is market dictated—whether it be a legal, physical, or financial limitation. Whatever the limitation is, it is not an artificial limitation. This distinguishes market value from other values and prevents it from being a generic term and a subjective conclusion. Consequently, any reference to market value unambiguously refers to the value of the use that is the property's highest and best use. In addition, market value unambiguously must be determined by a competitive and open market. These two conditions produce a result that is market driven and void of hypothetical conditions.

If the use is the highest and best use, then the value will be market value; however, if the use is a specified use, then the value will be use value. There can be no mixing of market value and use value.

Ignoring these two conditions can result in an erroneous value. This is shown in the following case study, which introduces the fundamental relationship between the type of use and the type of value. If the use is the highest and best use, then the value will be market value; however, if the use is a specified use, then the value will be use value. There can be no mixing of market value and use value.

11. For a good discussion on the history of issues surrounding *market value*, see Michael V. Sanders, "Market Value: What Does It Really Mean?" *The Appraisal Journal* (Summer 2018): 206–218.

Case Study 1—Market Value

For at least a decade, an argument has continued about the value of nationally or regionally known drugstores. The crux of the dispute centers on whether assessors should use sale-leaseback and build-to-suit transactions (without adjustment) as indications of market value.

As previously pointed out, understanding the connection between market value and highest and best use is critical. To illustrate, the following case study presents a common circumstance that accompanies the mislabeling of market value.

In some areas, there are but two major drugstore retailers—for this example assume CVS and Walgreens. Furthermore, assume, by law, the property assessor must come to an estimate of the market value of the real estate used by a CVS store. How is that to be accomplished?

The assessor will find, for instance, that if a CVS store is sold without the typical CVS lease in place, the likely purchaser is not Walgreens. There are two reasons for this. First, even a cursory observation will show that the two firms (for example, CVS and Walgreens) typically locate their stores near each other. A CVS store is often on an opposite corner or in the same or next block. This phenomenon is an example of the principles of cumulative attraction, retail agglomeration, and Hotelling's law.[12]

Second, even if the two retailers are not located near each other, most top-tier retailers have their own building prototype and will not want to be associated with the competitor's image. Walgreens will not choose to be in a building once used by CVS.

So, who is the probable purchaser in an open and competitive market? We know that there has to be a probable purchaser, because by definition *market value* presumes a transaction—the owner transfers title to a purchaser. Generally, the transfer of the real estate with a lease to CVS in place most likely would be to another investor interested in buying the bond-like arrangement.[13] This is true even if the store is vacant since the real estate is of secondary importance. Determining the market value of the fee simple interest in such a property requires first looking to the highest and best use of the property, which requires a determination of the most likely purchaser assuming that the property would be exposed to a competitive and open market. Market observation reveals that most sales of property developed under build-to-suit arrangements are purchased for a secondary use, such as a non–brand-name retailer, or modified for an adaptive reuse.[14]

The crux of the dispute centers on whether assessors should use sale-leaseback and build-to-suit transactions (without adjustment) as indications of market value.

Buildings for some businesses, especially retail and restaurants, have design features and improvements that are valuable only to a single business/user, because they are part of the business's branding. Examples of this are common and include fast-food franchises (e.g., McDonald's with their golden arches), and dine-in restaurants (e.g., Cracker Barrel); the building design is so immediately recognizable that it does not even require a sign.[15] Although these special components contribute to the business, they rarely have value in the marketplace. Instead, these items are segments of the going concern of the business.[16]

As noted, Walgreens and other similar retailers often enter into long-term leases; they choose not to tie up their capital in real estate. A common agreement between the lessor and lessee for CVS or Walgreens includes a sale-leaseback agreement whereby the retailer owns a finished store that meets their needs, sells the property, and then leases the store back on a net basis.

The concern with this arrangement from a valuation perspective is clearly expressed in *The Appraisal of Real Estate*, fifteenth edition:

> Sale-leaseback transactions must be used with caution because the lease is usually negotiated as part of the

12. According to Hotelling's law, there is an "undue tendency for competitors to imitate each other in quality of goods, in location, and in other essential ways." "Hotelling's Law," in *The Palgrave Encyclopedia of Strategic Management*, 2018 ed., https://bit.ly/3PLxbEF.
13. The analogy of a national brand lease to a corporate bond is common. Discussions with brokers who specialize in the sale of these arrangements confirm that typical buyers view the transactions as having strong similarities to bonds. Interviews with investors/buyers corroborate the broker information.
14. In fact, when CVS absorbed Eckerd's, the majority of the closed stores quickly found lessees, including car dealerships, grocery stores, and other specialty retailers.
15. Barry A. Diskin and Jack P. Friedman, "Taxation of 'Branding' Leasehold Improvements," *Property Tax Alert* 4, no. 1 (March 2006).
16. See Douglas D. Lovell, "Does Your Client Really Need a Market Value Estimate?" *The Real Estate Appraiser* (May 1991): 11.

> sale rather than as an independent, market-based lease negotiation. Sale-leasebacks that are negotiated as financing vehicles may reflect motivations of the tenant and landlord that are not typical of the market.[17]

Some assessors assert that drugstores with national recognition create their own highest and best use category. There is a viewpoint that the real estate needs for users like major drug retailers are profoundly different from other retail users. That argument holds that market value for CVS and Walgreens should be higher because these stores tend to locate at high-traffic corners at traffic-controlled intersections. The evidence indicates otherwise, however. Other retail users also need a specific-size building at high-traffic intersections. Examples include fast-food restaurants, banks, convenience stores with gasoline pumps, and shopping centers. Many businesses operate with a particular prototype building on a preferred site size. The concept is not unique to nationally known drugstores, and the relationship of their initial sale price to market value also is not unique.

It is noteworthy that the definition of *market value* quoted earlier not only describes market value but also provides the rules (components) for determining market value. No other type of value is defined in this way. For instance, *use value* is described as follows:

> *Use value* is "the value of a property based on a specific use, which may or may not be the property's highest and best use. If the specified use is the property's highest and best use, use value will be equivalent to market value. If the specified use is not the property's highest and best use, use value will be equivalent to the property's market value based on the hypothetical condition that the only possible use is the specified use.[18]

This definition is silent regarding the rules for applying the definition. No mention is made requiring a competitive and open market, no mention is made of conditions requisite to a fair sale, no mention is made of dictating actions by the buyer and seller. In short, the *use value* definition places no restrictions on the details of the transaction. For these reasons—and in order to distinguish and standardize the application of *use value*—the following definition is proposed:

> *Use value* is the most probable price that a property put to a specified use should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller, each acting prudently, knowledgeably and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:
>
> - buyer and seller are typically motivated;
> - both parties are well informed or well advised, and each acting in what it considers its own best interest;
> - a reasonable time is allowed for exposure in the open market;
> - payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and
> - the price represents the normal consideration for the property sold, unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

Note that the specified use is the only difference from market value. A competitive and open market is required, and the actions of the buyer and seller are defined, but the use is presumed to be limited to less than the property's highest and best use.

Rent, Market Rent, and Highest and Best Use

If highest and best use determines market value, what determines highest and best use? In large part, it is market rent. It is axiomatic that a property's highest and best use will have the highest rent of the alternative uses, all else being equal. But, market rent can be determined as an independent calculation. Is it also tied to highest and best use similar to market value? The discipline associated with the application of *market value* should be duplicated with *market rent*. The current definition of *market rent* is as follows:

> The most probable rent that a property should bring in a competitive and open market under all conditions requisite to a fair lease transaction, the lessee and lessor each acting prudently and knowledgeably, and assum-

17. Appraisal Institute, *The Appraisal of Real Estate*, 15th ed., 438.

18. Appraisal Institute, *The Dictionary of Real Estate Appraisal*, 7th ed., s.v. "use value."

ing the rent is not affected by undue stimulus. Implicit in this definition is the execution of a lease as of a specified date under conditions whereby

- Lessee and lessor are typically motivated;
- Both parties are well informed or well advised, and acting in what they consider their best interests;
- Payment is made in terms of cash or in terms of financial arrangements comparable thereto; and
- The rent reflects specified terms and conditions typically found in that market, such as permitted uses, use restrictions, expense obligations, duration, concessions, rental adjustments and revaluations, renewal and purchase options, frequency of payments (annual, monthly, etc.), and tenant improvements (TIs).[19]

This definition is modeled like the definition of *market value*. Both assume *knowledgeable participants*, which is a key component of the market in both market value and market rent. For the same reasons that market value is tied to highest and best use, market rent is tied to highest and best use. In addition, market rent unambiguously must be determined by a *competitive and open market*. These two conditions produce a result that is market driven and void of hypothetical conditions imposed on the market. As with market value, ignoring these two conditions can result in an erroneous rental rate. This is shown in the following case study.

Case Study 2—Market Rent

This second case study looks at determination of market rent, with an emphasis on the build-to-suit market and the related rents.

As with sale-leaseback arrangements, national retailers including CVS, Walgreens, and others often enter into build-to-suit agreements whereby a developer is retained to produce the finished store, and upon completion, the retailer leases the property at an agreed upon rate of return from the developer. Retailers enter into these agreements to avoid tying up their capital in real estate development when it would be better deployed within the business. These build-to-suit arrangements are rarely, if ever, exposed to the market and, therefore, do not meet the criteria for market rent. The rent is simply a function of cost to construct and may include non-realty components.

In his *Appraisal Journal* article Robert W. Hartmann states, "Sale-leaseback and build-to-suit transactions are, in essence, financing vehicles and not necessarily market-derived transactions."[20] The income streams associated with build-to-suit and sale-leaseback arrangements, by default, contain the effect of financing. *The Appraisal of Real Estate* and the Appraisal Foundation include language supportive of this contention.[21]

For CVS and Walgreens, there is a great likelihood the rent figures are based on the cost of a turnkey finished property, include a component for financing, and are influenced by the intangible of a lease that is guaranteed by a nationally known retail firm. If any of these elements are present, the rental rate includes non-realty components.[22] For this reason, such rents are not market rent and, therefore, should not be used to estimate the market rent of the fee simple interest. The results of doing so can be dramatic. Consider the following build-to-suit example.

Suppose the valuation assignment involves real estate with the following characteristics:

- Freestanding retail pharmacy on 1.7 acres of land
- Parking for 78 cars
- Highly visible site with easy access and traffic control
- Single-story facility with gross building area of 13,000 square feet
- Cost of construction was $2,300,000, including numerous business-specific custom features
- Site cost was $1,250,000. (The high land-to-total cost ratio is not unusual. Frequently freestanding pharmacies buy improved sites and raze the improvement, as business value more than covers the above-market cost.)
- All-in cost was $3,550,000
- Annual rent is based on 8% of all-in cost—$284,000 or $21.85 per square foot

Current rental comparables in the immediate area for freestanding retail properties range from $15–$18. These are all second-generation store uses, but with similar freestanding retail highest and best uses.

A few years after construction the property owner sold the leased fee to a group of dentists at a 6% capi-

19. Appraisal Institute, *The Dictionary of Real Estate Appraisal*, 7th ed., s.v. "market rent."
20. Robert W. Hartmann, "Valuation for Loans on Restaurants," *The Appraisal Journa*l (October 1996): 411.
21. Appraisal Institute, *The Appraisal of Real Estate*, 15th ed., 438; and Appraisal Practices Board, *APB Valuation Advisory 2: Adjusting Comparable Sales for Seller Concessions* (Washington, DC: The Appraisal Foundation, March 7, 2012), 15, https://bit.ly/3cxhtii.
22. Moreover, accurately segregating these non-realty elements from the total lease payment is difficult because the lack of data prevents any systematic method to segregate the elements.

talization rate, or $4,733,333. The successfully operated store is reassessed, in fee simple (meaning, *available* to be leased at market), for real estate tax purposes at $5,000,000, based mostly on capitalization of the build-to-suit rent. In this example, substituting build-to-suit rent for market rent results in a value obviously well above market value of the fee simple interest.

Case Study 3—Market Rent

The third case study involves a condemnation action in California that presented several interesting issues related to market rent. It concerns the determination of the market rent for a project that is mixed use by timing.[23]

The property is a 50,000-square-foot parcel located along a major street in a major city. The site is improved with a 20,000-square-foot, forty-year-old retail building occupied by a discount retailer that is the original tenant in the building. The balance of the site is devoted to surface parking. The business conducted on the property has been highly successful and profitable; the sales per square foot are among the highest in the forty-store chain.

The land use regulations permit a wide variety of commercial and residential uses, and the height and density regulations would permit a building up to about twenty stories. Several similar nearby properties had recently been redeveloped with condominium towers having residential units over ground-floor retail space. Analysis of these properties, nearby sales, and other market metrics led to a conclusion that the highest and best use would be redevelopment with a twenty-story mixed-use commercial/residential tower. Although the development would have been physically possible and economically feasible, the timing of development could not have been "now" because the site was not entitled for that use. An entitlement expert who had processed entitlements for a number of properties in the immediate area opined that it would take about six years to process environmental approvals and building plans, and to obtain actionable entitlements to build the project.

In the condemnation action, the property was valued by appraisers retained by both the public agency and the property owner. Although there was disagreement over the value of the property, the appraisers reached very similar highest and best use conclusions, including conclusions regarding the height, bulk, and mixed-use nature of the building, and conclusions regarding the timing of the use. In other words, both appraisers concluded that the highest and best use of the property was redevelopment of the property in about six years when entitlements could be obtained and retention of the retail interim use until that time. Consistent with their conclusions regarding the timing of the highest and best use, both appraisers relied solely on the sales comparison approach to appraise the property. However, the appraisers were also requested to provide an opinion of the market rent for the property, which was a required input into business goodwill valuations that were being conducted by forensic accountants (loss of business goodwill is a compensable element of compensation in condemnation cases in California).

The third case study involves a condemnation action in California that presented several interesting issues related to market rent.

Keeping these facts in mind, what is the market rent for the property on the date of appraisal for the period of time during which the retail use would remain pending redevelopment? The issue can be illuminated by examining the positions of the two parties:

The appraiser for the public agency concluded that the market rent for the property was $2,400,000 per year,[24] or $120 per square foot of building area per year. The appraiser reached this conclusion by applying a 6% rate of return (extracted from the market) to the $40,000,000 value conclusion for the property. The conclusion was silent regarding additional terms of the market rent.

The appraiser for the property owner concluded that the market rent was $840,000 per year, or $42 per square foot per year. The appraiser reached this conclusion by analyzing recent leases of similar retail properties devoted to similar uses, including several leases to the same user. Additional concluded terms included a six-year lease, rent escalation of 3% per year, tenant paying all utilities and minor maintenance, and no landlord concessions.

To help bridge the gap between the valuation conclusions, consider the positions of the respective appraisers in light of the recognition that market rent must be based on the highest and best use of the property for which the market rent is being determined.

23. Lennhoff and Parli, "Timing Is Everything: The Role of Interim Use in the Highest and Best Use Conclusion," *The Appraisal Journal*.

24. All rental figures used in this example are net.

The agency's appraiser's conclusion does not reflect that the highest and best use of the property has two components—the retention of the retail use for six years, and then redevelopment of the property.[25] This situation is an example of an interim use. In this case, the interim use is due to a delay in legal permissibility. Here, the highest and best use of the property as of the effective date of the appraisal was not solely continued retail use nor was it solely future mixed-use redevelopment—it was both.[26]

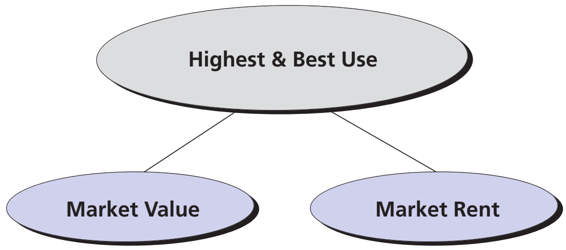
Since the highest and best use of the property for the six years following the effective date of the valuation included retention of the improvements on the property, the only way to harmonize the concepts of market rent and highest and best use is to conclude that the market rent on the date of appraisal was for retail use. Applying a return on the value of the property, as the agency's appraiser did, improperly merged the components of highest and best use and commingled the timing of the interim use and the future use.

Market rent, like market value, is as of a specific date. The highest and best use determination mandated that, in this case, market rent was for retail use consistent with the existing building. The probability that use of the property in the future may change should not influence the conclusion of market rent in the present.

Now suppose some of the facts of the case study are changed to further illustrate the linkage between market rent and highest and best use. Assume the same property and the occupant but no six-year delay to obtain entitlements, the property is fully entitled for redevelopment, and the value of the land for redevelopment far exceeds the value of the property under the current discount retail use. Given that the highest and best use timing is now under this scenario, there is no interim use and the market rent would be based on the development highest and best use.

Case Study 3 demonstrates that all highest and best use conclusions are on a timeline that progress through component uses. This is especially the case with a proposed mixed-use property when one of the uses is an interim use. Even with a "single use" project, the use is "single" only because of the inability to predict far enough in the future. In this sense, all uses are interim uses.

Exhibit 1 Relationship between Highest and Best Use, Market Value, and Market Rent



This recognition mandates that the market rent associated with a highest and best use is the use that is immediately operative. In other words, a highest and best use has a macro level and a micro level. The macro level addresses the three highest and best conclusions (use, timing, market participants), while the micro level addresses the use that is the result of the timing dictated by the macro highest and best use. In this way, both market value and market rent are connected at the hip to highest and best use, with market value based on the macro highest and best use and market rent based on the micro highest and best use, i.e., the immediate use of the property. The flowchart in Exhibit 1 shows that both market value and market rent are equally dependent on a property's highest and best use.

Just as there are many types of value, e.g., use value, insurable value, and investment value, there are a number of types of rent. In fact, *The Appraisal of Real Estate* lists eight different types of rent:[27]

- Market rent
- Contract rent
- Effective rent
- Excess rent
- Deficit rent
- Base rent
- Percentage rent
- Overage rent

The important distinction between *use value* and *market value* is that use value is based on a specific use, which may or may not be the property's highest and best use. "If the specified use is the

25. The purpose of the market rent estimate in this matter was to support a valuation of the business goodwill of the retailer. Since the retailer would have been displaced upon redevelopment, only the referenced six-year period is at issue.

26. "There are not two highest and best use conclusions. An interim use is not in itself a highest and best use. Rather, an interim use is part of a highest and best use." Appraisal Institute, *Real Property Valuation in Condemnation* (Chicago: Appraisal Institute, 2018), 83–84.

27. Appraisal Institute, *The Appraisal of Real Estate*, 15th ed., 420.

property's highest and best use, the use value will be equivalent to market value."[28] However, although they are equivalent, they are not synonymous. Just as a capitalization rate and a yield rate might be the same number (as when no change in income or value is projected over the holding period), they are also not synonymous. There is no formal term "use rent," but perhaps there should be, as the issue of market rent is really a labeling issue. Absent the distinction between use rent and market rent, however, appraisers may not consider the difference between the two and end up estimating the use rent when they are supposed to be estimating the market rent.

Under the paragraph heading "Market Rent and Highest and Best Use," UASFLA states as follows:

> [I]n developing an appraisal for a leasehold, the appraiser must use the definition of *market rental value* [in Section 1.5.4.1]. As part of the development of an appraisal for a leasehold acquisition, the appraiser must determine the highest and best use of the property (as improved) that is the subject of the leasehold. This requirement is critical to the selection of comparable rents used in the valuation process."[29]

This indicates that the UASFLA recognizes market rent must be premised on the property's highest and best use. And just as the market value depends on getting the highest and best use right, so does market rent. The market rent cannot be right if the highest and best use conclusion is wrong, or if the highest and best use is ignored and market rent is estimated based on the existing use. This relationship is further confirmed in *The Appraisal of Real Estate*, fifteenth edition, which states "if the current rent and terms of a leased parcel correspond to market rent and terms for comparable leased parcels *with similar highest and best uses* [emphasis added] then only a property rights adjustment would be necessary."[30]

The connection to highest and best use is what distinguishes market rent from other rent types. Consequently, any reference to market value unambiguously refers to the rent of the use that is the property's highest and best use. In addition, market rent unambiguously must be determined by a competitive and open market. These two conditions produce a rent that is market driven and void of hypothetical conditions imposed on the market.

As noted earlier, one way to diminish confusion about what *market rent* means would be to formulate a definition of *use rent* to differentiate it from *market rent*. To achieve that goal, the following *use rent* definition is proposed:

> The most probable rent that a property limited to a specific use would bring in a competitive and open market under all conditions requisite to a fair lease transaction, the lessee and lessor each acting prudently and knowledgeably, and assuming the rent is not affected by undue stimulus. Implicit in this definition is the execution of a lease as of a specified date under conditions whereby
> - Lessee and lessor are typically motivated;
> - Both parties are well informed or well advised, and acting in what they consider their best interests;
> - Payment is made in terms of cash or in terms of financial arrangements comparable thereto; and
> - The rent reflects specified terms and conditions typically found in that market, such as permitted uses, use restrictions, expense obligations, duration, concessions, rental adjustments and revaluations, renewal and purchase options, frequency of payments (annual, monthly, etc.), and tenant improvements (TIs).

To summarize, the key to *market rent* is the "market," which implies the most probable rent the market would pay, which in turn implies the property's highest and best use. This is because the market rent estimate, as with a market value estimate, would be the "highest value reflected by detailed analyses of all logical potential use and development alternatives."[31]

28. Appraisal Institute, *The Dictionary of Real Estate Appraisal*, 7th ed., s.v. "use value."
29. Interagency Land Acquisition Conference, *Uniform Appraisal Standards for Federal Land Acquisitions* (UASFLA), 2016 ed. (Washington, DC: US Government Printing Office, 2016), 39.
30. Appraisal Institute, *The Appraisal of Real Estate*, 15th ed., 345.
31. Harold D. Albritton, *Controversies in Real Property Valuation: A Commentary* (Chicago: American Institute of Real Estate Appraisers of the National Association of Realtors, 1982), 9–10.

Summary and Conclusions

This article demonstrates how both market value and market rent are inextricably tied to the highest and best use of the asset being valued. Although there are other types of value and other types of rent, if the wrong value or the wrong type of rent is estimated, then the result will be the wrong answer to the appraisal problem. As the mini case studies illustrate, that answer could be significantly different than the correct one. Just as there is no concept of "market value in use," there is no such thing as "market rent in use." To clarify this point, a definition of *use rent* has been suggested in this article. Note that use rent might be higher or lower than market rent or equal to market rent—however, it is never synonymous with market rent, although they may at times be the same number. As explained, the type of value sought will influence the type of rent estimated and together they define the appraisal problem to be solved or the question to be answered. Clarifying the distinction among value types and rent types should reduce the likelihood of an appraisal unintentionally answering the wrong question related to market rent.

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Additional Resources

Suggested by the Y. T. and Louise Lee Lum Library

Appraisal Institute

- **Education**
  http://www.appraisalinstitute.org/assets/1/7/aiedcat.pdf
- **Guide Notes to the Standards of Professional Appraisal Practice**
  https://www.appraisalinstitute.org/assets/1/7/AI_Guide_Notes.pdf
- **Lum Library, Knowledge Base [Login required]**
  Value
- **Property Rights Symposium Discussion Paper**
  http://bit.ly/SymposiumPaper

by Hugh F. Kelly, PhD, CRE

Environmental Risks and Investments

About This Column

The "Economic Perspectives" column offers insights by guest columnists on factors currently at play in economic, real estate, and financial markets. This edition of "Economic Perspectives" looks at the interrelationship of environmental concerns and investments.

Studying Change in Real Estate

Stephen Jay Gould was an evolutionary biologist and distinguished academic with a career at Harvard and at the American Museum of Natural History, and he was an essayist for *Natural History* magazine for almost thirty years. Gould's writings inspire individuals to pay attention to detail while seeking to grasp broader fundamental principles, to integrate data into a coherent perspective, and above all, to keep an open mind toward evidence as it presents itself. Today, those attributes apply to economics as it studies a world in flux. The attributes also apply to analysis of real estate. Real estate is often thought of as being characterized by its invariance, because it is fixed in its location; land and structures suggest permanence and solidity. Yet, developers, lenders, investors, and appraisers know all too well that real estate values are anything but permanent. The study of real estate markets is a study of change.

Measuring Risk from Environmental Change

Among the numerous modern-day changes, environmental change is one that can cause profound and pervasive alterations in economic and real estate conditions. To measure these impacts, the Federal Emergency Management Agency (FEMA) has created the National Risk Index, with data by county and census tract that indicate communities most at risk for eighteen natural hazards.[1] The data quantify risk based on expected financial losses, social vulnerability, and community resilience (Exhibit 1). Another measure of the economic impact of environmental change can be found in the data of the property and casualty insurance industry, which provides risk protection for real estate. For example, Swiss RE estimates that insured losses from natural disasters were $90 billion in 2020, exceeding the ten-year annual average of $74 billion. Those losses represent the total physical devastation experienced by properties due to hurricanes, tornadoes, winter storms, floods, wildfires, and other damages inflicted by Mother Nature.[2]

As a result, appraisers face the challenge of addressing environmental change impacts in both the physical and the financial arenas. There are numerous studies suggesting the possible implications of climate change on real estate. The Research Institute for Housing America, founded by the Mortgage Bankers Association, recently published a special report detailing the exposure of residential real estate to physical risks now and to transitional risks ahead. In addition to changes in storm patterns, higher temperatures, and rising sea levels, housing markets face financial impacts from increasing insurance premiums and utility costs. In addition, there are supply-chain risks from supply disruptions and

1. More information on the FEMA National Risk Index can be found at https://hazards.fema.gov/nri/.
2. Lucia Bevere and Federica Remondi, "Sigma 1/2022 Natural Catastrophes in 2021" (Zurich, Switzerland: Swiss RE Management Ltd., January 2022). Additional data and analysis are available on the Swiss RE Institute website, at https://bit.ly/3xzdmdN.

demand-side risks stemming from workforce disruptions. Moreover, policy and legal changes impact building codes and new technologies, and public awareness alters the desirability of at-risk market locations.[3]

Investments and ESG Policies

Keep in mind, commercial property is as exposed to physical risk as residential properties, and that exposure is being systematically quantified by researchers. Institutional investors, in particular, require metrics to evaluate the impact of environmental change on the risk-return profiles they depend on to make portfolio investment decisions. Appraisers considering the impact of debt financing on a commercial property will benefit from awareness of environmental, social, and (corporate) governance (ESG) policies. An illustrative case is MetLife Investment Management's ESG policy related to commercial mortgage lending. MetLife's ESG standards vis-à-vis its mortgage platform call for it to

- Track the sustainability attributes of assets,
- Evaluate borrower ESG performance,
- Incorporate ESG into due diligence and loan approval,
- Track and improve resilience to climate change and other natural hazards,
- Collaborate with the lending industry to improve ESG practices,
- Maintain strong governance practices.[4]

MetLife is not alone in adopting such standards, and these standards are important as appraisers have long sought to understand and reflect institutional underwriting practices, a key to factoring the availability and price of debt capital as an influence on capitalization rate in the weighted average cost of capital (WACC) equation. At present, it seems essential to be

Exhibit 1 FEMA National Risk Index Components

Expected Annual Loss
is a *natural hazards component* that represents the average economic loss in dollars resulting from natural hazards each year.

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Social Vulnerability
is a *consequence enhancing risk component and community risk factor* that represents the susceptibility of social groups to the adverse impacts of natural hazards.

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Community Resilience
is a *consequence reduction risk component and community risk factor* that represents the ability of a community to prepare for anticipated natural hazards, adapt to changing conditions, and withstand and recover rapidly from disruptions.

=

NRI

Risk Index
represents the potential for negative impacts resulting from natural hazards.

Source: FEMA National Risk Index, "Determining Risk," https://hazards.fema.gov/nri/determining-risk

3. For example, see Sean Becketti, *Special Report: The Impact of Climate Change on Housing and Housing Finance* (Washington, DC: Mortgage Bankers Association and Research Institute for Housing America, September 2021), https://bit.ly/3aUIADc. Appendix B to the report provides useful links to private and public data sources that should be of interest to appraisers, including the First Street Foundation (https://firststreet.org), a research and technology group, and the Moody's ESG group (https://bit.ly/3mzk799).

4. The overall MetLife ESG investment policy statement can be found at https://bit.ly/3xFaFr6. Details about the MetLife ESG commercial mortgage lending statement can be found in "Commercial Mortgage Lending Environmental, Social and Governance Investment Policy," https://bit.ly/3NJljCz.

aware of ESG policy in consideration of commercial property debt. MetLife Investment Management states it "believes that responsible real estate lending can improve communities, increase financial performance and reduce risk, while generating positive environmental impact."[5]

On the equity side there are reports of strong consonance in investor perspective. Publicly traded REITs have accelerated their environmental activism. NAREIT's 2021 ESG REIT report explicitly states, "the business imperative surrounding sustainability has evolved from a 'nice-to-have' expectation to a 'have-to-have' priority."[6] Thus, the impetus in the immediate term has been from the investment community itself, although the long-run advocacy of the environmental activist community cannot be denied. NAREIT reports that 55% of its members have publicly disclosed ESG goals, integrating such factors into their strategic and financial planning.

Private equity investors are expressly on board with ESG investments as well. Larry Fink, CEO of BlackRock ($10 trillion in assets under management, including more than $60 billion in real estate), has said that awareness of climate risk is growing rapidly, placing capital markets "on the edge of a fundamental reshaping of finance."[7] A 2021 global investors survey by CBRE indicates that 60% of respondents have already adopted ESG criteria, reflecting a more robust approach to sustainability risks. According to CBRE, "Investors are embedding ESG considerations at every stage of the property lifecycle, from due diligence to acquisitions and from leasing to asset management."[8]

Institutional investors, in particular, require metrics to evaluate the impact of environmental change on the risk-return profiles.

Research on ESG returns is becoming more available. For example, a recent paper funded by the Real Estate Research Institute (RERI) examined fund returns in the NCREIF ODCE Index[9] in relation to the Global Real Estate Sustainability Benchmark (GRESB).[10] The research suggests that GRESB participation was a significant predictor of fund returns, associated positively with higher price appreciation in total fund returns (though not in the income component).[11] At a

5. MetLife ESG, "Commercial Mortgage Lending Environmental, Social and Governance Investment Policy," 4.

6. See NAREIT, *2021 REIT Industry ESG Report* (Washington, DC: NAREIT, 2021), 8, https://bit.ly/3zxpBJ4.

7. Tammy Whitehouse, "Climate-Driven Financial Risks Hard to Ignore," WSJ Risk & Compliance Journal, Deloitte Services Insights (February 2, 2020), https://bit.ly/39f5Zic. The Fink quotation comes from his 2020 "Letter to CEOs," which was addressed to the executives of firms in which BlackRock has investments but was widely followed in the broader business community.

8. See CBRE Research, "ESG and Real Estate: The Top 10 Things Investors Need to Know" (CBRE, January 3, 2022), 3, https://bit.ly/3zVPeDG.

9. Open-ended diversified core equity (ODCE) funds in the National Council of Real Estate Investment Fiduciaries (NCREIF) database. At the time of the study's analysis (Q2 2021), ODCE contained 24 funds with a total of $218 billion in assets in approximately 190 US CBSAs (core-based statistical areas).

10. The GRESB is a voluntary ESG performance reporting platform, providing standardized and validated data to the capital markets. As of 2020, GRESB covered some 1,200 funds/firms, in 64 countries, with $4.8 trillion (USD) in assets.

11. Avis Devine, Andrew Sanderford, and Chongyu Wang, "Sustainability and Private Equity Real Estate Returns" (preprint submitted to RERI, December 18, 2021), https://bit.ly/3mDumsY.

minimum, such research shows the behavior of large private-market investors in real estate is motivated by ESG factors and that private-market investors are substantially influenced by metrics relating to environmental sustainability. Prior research also has shown that ESG-certified assets have outperformed traditional comparable assets (both buildings and securitized mortgages).[12]

Environmental Risk in the Marketplace

Appraisers understand that their charge is to reflect the mind of the marketplace. As both debt and equity market participants become increasingly sensitive to environmental considerations, valuations will continue evolving to reflect the changes in the physical world and in the world of investments. For many, the sense that all such changes are compressed economically by the discounting process into the final price may be the impetus for further research and investigation by academics.

Location is a complex economic characteristic. Research into natural disasters reveals that the structure of the local economic base affects both the amplitude and the duration of changes in real estate demand and, consequently, price movements. In the residential sector, severe storms can impact household incomes, increase out-migration, and reduce home prices over a period of years by 2.5% to 5.0%.[13] Such effects can be magnified or mitigated by the diversity of the local economy, suggesting that such diversity should be addressed in the market study component of appraisal report of at-risk communities.

Although there's increased focus on the economic and financial implications of climate change, relatively "less attention is devoted to understanding how *commercial* real estate markets respond to natural disasters, which is surprising given the size of US commercial real estate."[14] Looking across the major property types, one study reports that "being subject to natural disasters… leads to an immediate and non-trivial reduction to commercial market valuations… [but] regardless of which property type is considered, the negative responses in these outcomes are muted when regional economies are diverse along the dimension of industrial composition."[15]

Appraisers sensitive to the relative probability of a location's natural disaster exposure can perhaps begin by referencing FEMA's risk maps (Exhibit 2), which not only discuss the hazard risk itself but also measure a location's capacity to rebound from severe events. All this can lead to more comprehensive decision making.

Within the technical task of income-expense projection and discounting to present value, appraisers can reflect not only the thinking of insurers and lenders in terms of rates but also the exposure of the property to mitigation needs. Such mitigation needs may be satisfied in advance by a cost-to-cure where a particular

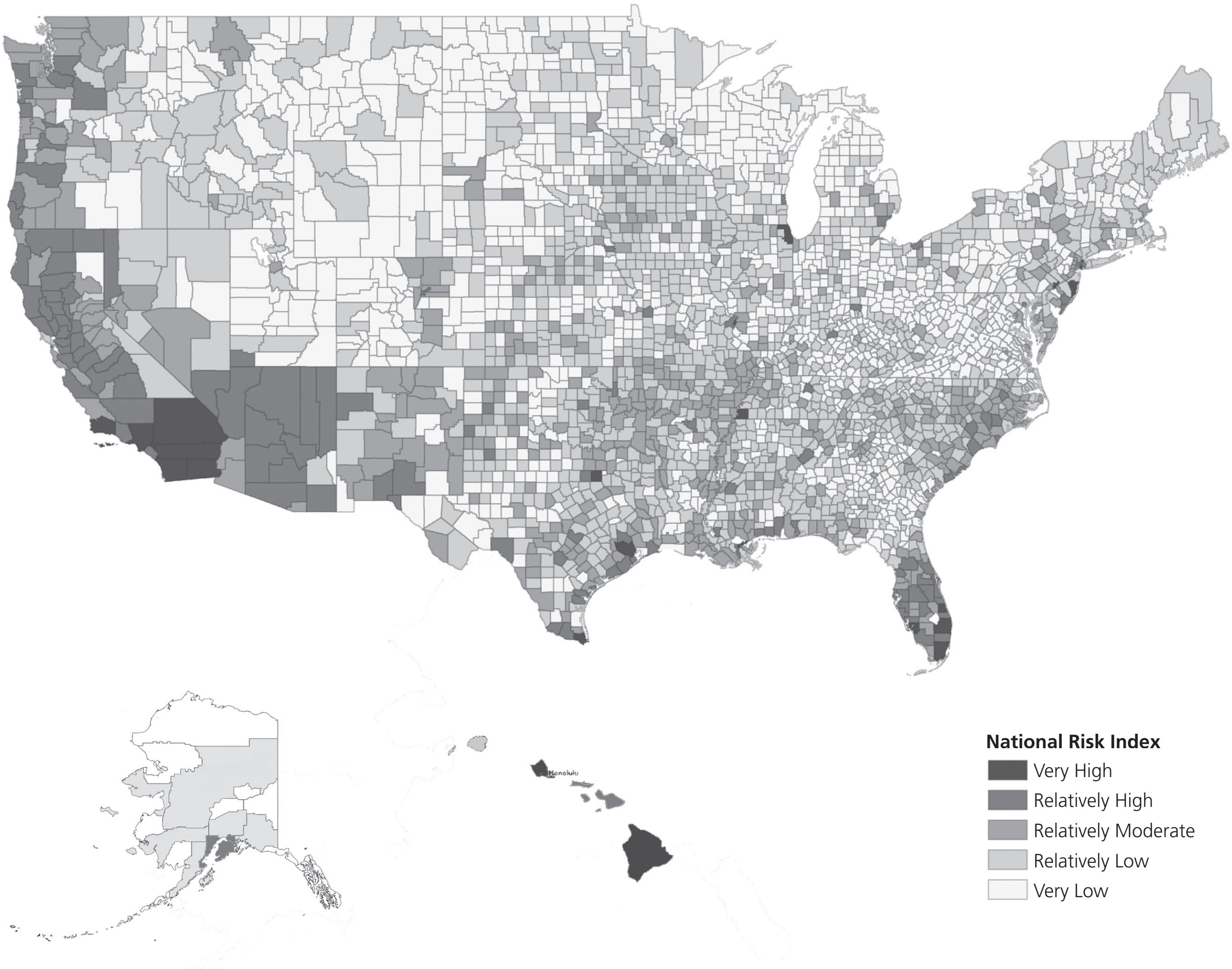
12. Piet Eichholtz, Nils Kok, and John M. Quigley, "Doing Well by Doing Good? Green Office Buildings," *American Economic Review* 100 (2010): 2492–2509; Piet Eichholtz, Nils Kok, Erkan Yonder, "Portfolio Greenness and the Financial Performance of REITs," *Journal of International Money and Finance* 31 (2012): 1911–1929.

13. L. P. Boustan, M. E. Kahn, P. W. Rhode, and M. L. Yanguas, "The Effect of Natural Disasters on Economic Activity in US Counties: A Century of Data," *Journal of Urban Economics* 118 (2020). FEMA states that higher community resilience reduces community risk; see FEMA, "Community Resilience," https://bit.ly/3I4HjG4.

14. Shaun A. Bond, Shawn J. McCoy, and Ian K. McDonough, "Natural Disasters, Regional Economic Structure and Commercial Real Estate" (RERI working paper, April 14, 2022), 1–2, https://bit.ly/3aJknzw. Emphasis added.

15. Bond, McCoy, and McDonough, "Natural Disasters, Regional Economic Structure and Commercial Real Estate," 20.

Exhibit 2 FEMA National Risk Index Map



Source: FEMA, National Risk Index, all natural hazards, county view, https://hazards.fema.gov/nri/map/

problem is identified (e.g., basement mechanical equipment rooms at flood-prone sites); mitigation may also be anticipated by replacement reserve allowances adjusted for natural risk. And, if cumulative exposure to climate change is shown to be a concern of institutional providers of equity or debt capital, perhaps that concern should be reflected—or at least discussed—in the selection of a terminal capitalization rate.

All such appraisal considerations are taken from the market, just like estimates of market rent, vacancy and collection loss, or capitalization rates.[16] Intelligent weighing of such variables contribute to improved decisions. In this way, the appraisal report contributes to improved judgments by players in commercial investments.[17]

About the Author

Hugh F. Kelly, PhD, CRE, has been the principal of Hugh Kelly Real Estate Economics, based in Brooklyn, New York, since early 2001. From 1978 to 2001 he worked in Landauer Associates' Valuation and Technical Service division and was the principal author of the firm's annual real estate market forecast and served as its chief economist. Kelly holds a PhD in real estate and the built environment from the University of Ulster, Northern Ireland. A member of the Counselors of Real Estate since 1989, he served as its international chair of the board in 2014. His book, *24-Hour Cities: Real Investment Performance, Not Just Promises*, won the 2017 Gold Award from the National Association of Real Estate Editors. **Contact: hughkelly@hotmail.com**

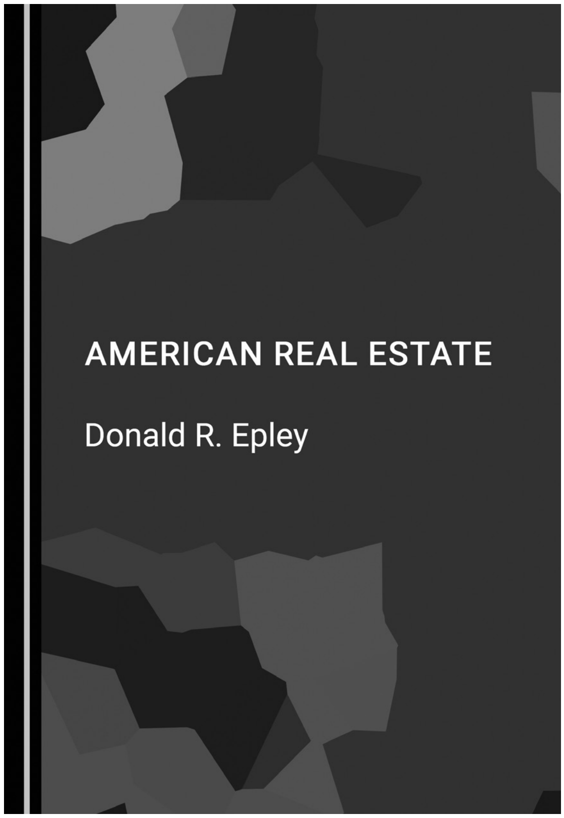
16. This has long been appreciated in the appraisal literature. See, for example, John B. Bailey, "Market Analysis—Fundamental to Defensible Valuations," *The Appraisal Journal* (October 1972): 644–649; and John B. Bailey, Marilyn Kramer Weitzman, and Peter F. Spies, "Market Study + Financial Analysis = Feasibility Report," *The Appraisal Journal* (October 1977): 550–577.

17. Real estate economic research is a dynamic process that follows deep structural relationships in human thinking. For a detailed discussion, see Hugh F. Kelly, "Dimensions in Real Estate Research," *Real Estate Review* 21, no. 1 (Fall 2001): 52–56.

by Mark R. Linné, MAI, SRA, AI-GRS

Journeying through the Real Estate Process

The first challenge of writing a book about a topic as broad as real estate in the United States is the breadth of the topic itself and the manner in which the information is presented to a reader. Where should the text start, where should it end, and how detailed should it be? The second challenge is how to make the material both relevant and interesting to the reader. A final challenge is presented when the author is an academic with comprehensive knowledge and previous textbooks, who now must curate that information for a general audience. In *American Real Estate*, Donald R. Epley, PhD, MAI, SRA, has successfully taken his educational and academic background and created a text that is both comprehensive and eminently readable.



American Real Estate
by Donald R. Epley, PhD, MAI, SRA

Published by Cambridge Scholars Publishing, Lady Stephenson Library, Newcastle upon Tyne, UK, 2022, 446 pages; $99.95 hardcover; $119 ebook

Dr. Epley is an internationally known scholar who has coauthored five books and over 100 journal articles, and many industry publications. His work on local market analysis has appeared in *The New York Times*, Bloomberg News, and many internet publications. The author holds designations from the Appraisal Institute and from the Commercial and Investment Institute. He holds a PhD in regional economics and has served as a Distinguished Professor of Real Estate-Emeritus and director of the Center for Real Estate and Economic Development at the University of South Alabama. Epley has historically written books that focus on introductory level topics such as *Basic Income Property Appraisal*; *Basic Real Estate Finance and Investment*; and *Principles of Real Estate Decisions*, and his skill in clear, straightforward presentation is evident in his latest text, *American Real Estate*.

A typical reader might assume material about real estate to be a dry topic. Quite the opposite can be said for *American Real Estate*. While certain elements familiar to academia begin and end each chapter, i.e., “Questions to Be Answered,” “Objectives,” “Chapter Summary,” and “Discussion Questions,” what lies between is far richer and livelier than the discussion in traditional textbooks.

Each chapter is self-contained, yet there is a continuing thread that leads the reader along on a journey through the real estate process. The author notes that the structure is deliberate:

> Most real estate texts are topic oriented. Typically, each chapter covers one topic in detail without much discussion of the reasons for studying one topic before or after another. For example, why are deeds examined before the settlement statements? Why are property taxes examined after a discussion of estimating the market value of a parcel? Why are license laws examined in the first chapter of the book? (Page 2)

The author adds clarity by following a strategy of presenting information on a need-to-know basis—that is, topics are presented and discussed in the order in which a typical consumer would encounter the need to use that information in a real estate transaction. In addition, information is presented in a decision-making framework that the reader can use to make decisions. The author concludes with the thought that the purpose of presenting the information in this manner is so a consumer can use the data to understand a typical real estate transaction and to make intelligent decisions.

Epley notes that the term "consumer" is really a synonym for "reader" and explains that the consumer may be a buyer, seller, interested citizen, potential agent, or actual agent. The typical transaction is the same for all of these potential consumers. Similar questions arise and must be answered in approximately the same order. Exceptions may exist in the order of the topics encountered for a particular transaction, but the steps remain essentially the same for the majority of transactions.

While there are fifteen chapters, the author observes that they all relate to the typical six steps in a real estate transaction. The author notes each of these general steps with pertinent observations and commentary for the consumer:

1. **The decision to acquire knowledge about real estate business.** "The consumer must understand the nature of real estate by first examining both the definition and meaning of real estate as a commodity." (Page 3)
2. **The decision to estimate market value.** "A question that a consumer asks very early is, What is my property worth?" (Page 3)
3. **The decision to finance the transaction.** "All of the earlier decisions assume the buyer can raise necessary cash to pay the negotiated purchase price. Later material covers the residential and commercial loan application process and presents the types of information that the consumer will need to know to evaluate the loan application process and the contracts used in residential financing." (Page 3)
4. **The decision to invest.** "A typical consumer will inquire early about the chance of receiving a capital gain and will ask whether the property is a good buy. In addition, a typical consumer may be interested in investment real estate to receive a tax shelter or a capital gain from either price appreciation or mortgage reduction." (Page 4)
5. **The decision to buy, sell, or manage.** "If an agent is involved, the typical buyer or seller needs to know the economic motivations behind the agent's actions to evaluate the circumstances." (Page 4)
6. **The decision to transfer the title.** "One chapter covers the preparation for the closing when the title is transferred. Every party should be able to verify the accuracy of the settlement statements." (Page 4)

As the author notes, every chapter contains the information that the typical buyer, seller, or agent needs to know about that step of a real estate transaction. In addition, the steps follow a central theme of "need-to-know" that presents information to the consumer in the order they would encounter it as the transaction progresses. Completion of the text would allow a consumer to make decisions about the particular set of circumstances in a particular transaction.

Given the broad topic area and the fact that valuation and appraisal are important components to the book, comparisons to *The Appraisal of Real Estate* are inevitable. *The Appraisal of Real Estate* is a more comprehensive examination of real estate as it pertains specifically to appraisers. *American Real Estate* is more focused on general practitioners within the real estate profession who need a single source for a certain base level of knowledge. Both books are valuable, and in many ways they are complementary.

American Real Estate (like *The Appraisal of Real Estate*) begins with an overview of real estate ownership rights, and asks questions that it in turn then answers: What is real estate? What is the nature of the real estate business? What is the relationship among its participants?

One clever device that the author employs is a rhetorical question that coincides with each chapter's title. This rhetorical device engages the reader and ultimately makes the materials more accessible. The chapters and their explanations provide an understanding of the journey the consumer/reader will undertake:

- **Chap. 1, Real Estate Ownership:** *What do I own?*
- **Chap. 2, Private and Public Restrictions:** *Can I do anything I want to do?*
- **Chap. 3, Value:** *What is it worth?*
- **Chap. 4, Residential Appraisal:** *What does the appraiser do?*
- **Chap. 5, Commercial Appraisal:** *Is commercial appraisal different?*
- **Chap. 6, Mortgages and Debt:** *What is a real estate loan?*
- **Chap. 7, Home Loans:** *What are the ways to borrow money?*
- **Chap. 8, Commercial Ownership and Rental:** *What is the difference between renting and owning?*
- **Chap. 9, Basic Investments:** *What are the tools for selecting an investment?*
- **Chap. 10, Residential Taxation:** *How much are the taxes?*
- **Chap. 11, Agency and Brokerage Management:** *Why would I need an agent?*
- **Chap. 12, Contracts:** *What are the contracts I will need to use?*
- **Chap. 13, Due Diligence: Anti-Trust, Civil Rights Fair Housing, RESPA, Truth-in-Lending, Fair Trade, Property Disclosure:** *What do I need to know about finding the truth in the transaction?*
- **Chap. 14, The Lease and Property Management:** *Should I rent and what does the property manager do?*
- **Chap. 15, Deed, Title Insurance, and Settlement:** *What happens at the closing? When is money paid for the deed?*

Perhaps one of the most engaging features of *American Real Estate* is the question and answer style of the discussion in each chapter. Rather than simply presenting general knowledge, the reader is presented with a series of general questions, followed by detailed answers. For example, in the discussion of commercial leases, the chapter asks and answers the following pertinent questions: What is the nature of the commercial lease? What types of leases are available? What are other types of leases? What is the sale and leaseback agreement?

If the book has any shortcomings, it would be that the section on Commercial Appraisal is fairly brief and considers only the gross rent multiplier technique. Direct capitalization is not covered, and topics such as property expenses, vacancy, and collection loss and capitalization are not mentioned. This is surprising from the author of *Basic Income Property Appraisal*, but this is a small item in an otherwise strong text. Other than this omission, the remainder of the book provides an appropriate overview of real estate that includes development, management, purchase, and disposition.

An especially helpful feature of the text is the summary of important terms and phrases at the beginning of each topic, which allows the reader to learn the language of the business and identify learning objectives.

In addition to the primary content, the book concludes with a useful glossary of typical terms, offering an essential reference tool, and provides review questions covering several points from the prior material to inform the reader if any skills need to be improved.

American Real Estate provides an excellent survey of the particular aspects of the US real estate system. This text would be valuable to all participants in the real estate markets, whether as buyers, seller, developers, agents, lenders, and yes—even appraisers. It presents topics involved in the typical buying transaction, with answers to common questions that may arise related to purchases, as well as leasing issues.

The content of *American Real Estate* is accessible, the questions covered are helpful, and the topics addressed are of interest to the beginner, but frankly also may fill gaps for even an experienced practitioner.

About the Reviewer

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