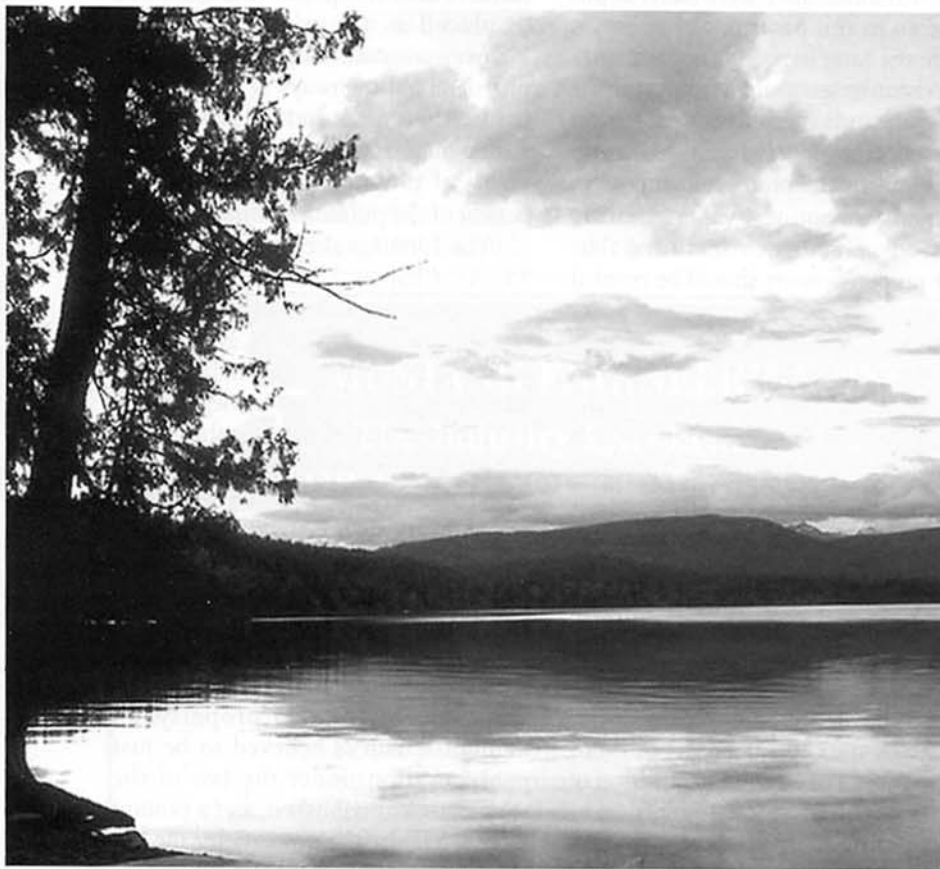


By Donald C. Wilson and Craig D. Hungerford

TOWARD JUST AND FEASIBLE SOLUTIONS

The Economic Preservation Use Debate Rages On



A Critique of the Latest Non-Position on Appraising Environmentally Significant Real Estate

Certain leadership in the Appraisal Institute is sending its members vexing messages about how not to value environmentally significant real estate (ESRE). It would be nice if these individuals would take a stand on how appraisers ought to value ESRE put to economic preservation use; but, until they do, appraisers, right-of-way professionals and the rest of us are left to decipher the merit of these negative declarations.

So here we go again, sleuthing our way through their negatives in search of something positive.¹

Point of agreement: Public interest value and non-economic highest and best use are inappropriate concepts for estimating the market value of ESRE

Woodward S. Hanson, MAI, Chair, Appraisal Standards Council writes that public interest value and non-economic highest and best use are inappropriate concepts for use by appraisers valuing ESRE.²

So far, so good.

The authors are on record as identifying public interest value and non-economic highest and best use as patently woolly, potentially metaphysical concepts; the latter of which baldly contradicts instituted principles of traditional, deductive appraisal methodology.

How, as we have asked so often, could one even have a non-economic highest and best use value to talk sensibly about? The very notion of private property rights worth money based on use and enjoyment is economic utility by any traditional standard. Non-economic highest and best use value is simply an oxymoron (to say nothing of being an unpardonable grammatical offense) that probably boggles Mr. Hanson's mind (we know it boggles ours).

If individuals and organizations pay money for ESRE, after negotiations, to put it to a use of preservation, then it has to be an economic preservation use, why else would they pay the money? If it were non-economic, they would not need to pay money for it, because it would have no money value. They could, instead, allocate their dollars to something else with monetized economic value, like shopping centers, treasury

bills, a house, a weapons system, or an acre of wheat land where one is paid not to grow things.³

The authors are perhaps not yet old and grey with experience, but we have, at least, lost some hair on our heads. And in our combined 32 years of professional experience, we have never seen a non-economic highest and best use, much less one with a value that has billions of dollars being spent via negotiated purchases to acquire it each year.

(Interestingly, Mr. Hanson's home state of Florida appropriates about \$1 billion a year to acquire and protect the environment. And spending this money is so crucial an activity to environmentalists that former employees of natural land trusts are reportedly now directly involved in administering the spending of this money for the good of all Floridians. Lest someone thinks we are picking on Florida, note also that the former head of The Nature Conservancy has served as head of The Wildlife Conservation Board, the state of California's organization specializing in acquiring ESRE. Thank heavens altruists like former natural land trust employees are unsusceptible to conflicts of interest, or Floridian and Californian tax payers might get fleeced. But we digress.)

Returning to the absurdity of the concept of non-economic highest and best use value, let us distill it to its ridiculous essence by asking a question that is a logical extension of the concept.

If economic highest and best uses have money values, then what do non-economic highest and best uses have?

Money values? Nope. Why pay money for something lacking economic value. Non-money values? It is at least logically consistent, but in the case of ESRE, individuals and organizations are paying money and a lot of it to own it. This leaves only the following absurdity: non-money-value money values.

Non-money-value money values? Stop the madness!

Appraisal does not need conundrums like non-money-value money value, but embracing a hair-brained concept like non-economic highest and best use

induces them. It even tempts nutty assertions like: the state of Florida is "non-appropriating" a "non-one billion dollars per year" to "non-buy" ESRE for "non-market value" based on a "non-economic highest and best use" of "non-economic preservation."

Ouch! Our heads hurt just writing it down.

So we, like Mr. Hanson, are only too willing to bid public interest value and, in particular, non-economic highest and best use an unsentimental farewell.

Points of Disagreement: Where do we begin?

What we cannot laud about Mr. Hanson's comments, and the Institute's apparent position, are: a.) Mr. Hanson's apparent placement of the Institute in an unethical position of endorsing price bias about ESRE; and b.) Mr. Hanson's near complete muddying of the waters regarding what appraisers should do to appraise ESRE in a rational, ethical manner. (We have other criticisms, but space prevents their fair assessment.)

We suspect Mr. Hanson focuses on what not to do, because he and his colleagues are not yet sure what appraisers should do, but more about that later. First, let us examine the ethical problem that has been created for the Institute.

Putting the Institute in the Unethical Position of Arbitrarily Deciding What Price Is Too High for ESRE

Mr. Hanson runs a-muck when he attempts to characterize the position of opponents of public interest value (which he and we claim to be). He writes, "A paramount argument is that the application of PIV [public interest value] concepts invariably results in value estimates that are demonstrably far beyond those that are derived from economic highest and best use analyses."

This characterization is problematic, because:

a.) it implies that all appraisers opposing PIV do so unethically on the grounds that PIV concepts produce values that are **too high** [Since when are appraisers supposed to inject their biases and decide what price levels are

too high for a type of real estate? Their traditional, instituted function is to estimate the most probable price in terms of money that a buyer and seller will negotiate on a date of value consistent with conditions of a value definition; not arbitrarily decide when the pricing of a class of properties is too high, or too low.];

b.) this unethical position is precisely the one endorsed by Mr. Hanson in behalf of the Institute in the article! Mr. Hanson and the Institute reject PIV and its non-economic highest and best uses, and he thereby lumps himself and the Institute in as advocates of this unethical point of view; and

c.) this position is not what we and some others of our persuasion think.

Hence, with a few short strokes on his word processor, Mr. Hanson has called into question his own ethics, the Institute's ethics and anyone else's ethics who opposes PIV on such grounds. Surely he did not mean to do this, but it is exactly what he has done. Until further clarification, though, it looks like he and the Institute have an unethical bias that ESRE ought to sell for much less than it does.

We, of course, oppose public interest value for quite different reasons than Mr. Hanson and some of his colleagues.

We could care less what price levels the class of ESRE ought to sell for; that is for buyers and sellers in the market place to decide. What we do care about is developing methods that help appraisers estimate what ESRE put to economic preservation use probably will sell for in that market place.⁴

We oppose the concept of public interest value, because, as we have already said, it is a woolly and potentially metaphysical concept that does not contribute to accurate estimates.⁵ And we suspect some other decent, sensible appraisers and real estate professionals think so, too. But you would not guess this from Mr. Hanson's article, because, in it, Mr. Hanson often over-generalizes, deals simplistically with complicated issues and inaccurately lumps points of view together in ways that defy reality, but serve the dubious arguments he tries to make.

To be blunt, we think differently

about ESRE put to economic preservation use than Mr. Hanson and some of his colleagues.

Here is what we think: ESRE put to economic preservation use can often be a highest and best use with a market value. Appraisers should use the most similar sales of ESRE put to economic preservation use for comparison, "adjust them in a grid (or analyze them in some other sensible fashion when one can be found) and infer market value based on the principle of substitution. And not one negative declaration is required.

An Ambiguous Assertion That Any Preservation Use of ESRE Cannot Be a Highest and Best Use

Returning to Mr. Hanson's article, having compromised the Institute's ethics, he concludes with two problematic assertions about how not to appraise ESRE. (Note: both of these assertions lack supporting arguments even to



Donald Wilson

examine. It is as if Mr. Hanson has come from some fiery session on a mountain with two tablets etched with precepts and says, "don't ask why, just believe." As a result, we must puzzle over the assertions themselves.)

First, he riddles us with the following ambiguity: "Preservation and conservation are not recognized as economic alternatives to be considered in the highest and best use analysis."

If by this assertion, Mr. Hanson means he and the current Appraisal Institute leadership do not recognize such alternatives, while some other MAIs do, and while some other "licensed appraisers do, and while some real estate professionals do, and while some courts do, and while some academics do, then we would agree (though we emphatically suggest Mr. Hanson and his colleagues quickly reconsider their position).

Or if by this assertion, Mr. Hanson means that preservation and conservation are not recognized as economic alternatives, but that preservation use and conservation use are recognized as economic uses, why, then, we would heartily agree.

Or if by this assertion, Mr. Hanson suggests preservation and conservation uses are not *recognized* by certain *self-interested* players in the ESRE market as *economic alternatives*, why, then, yes, we might agree again.

Anyone who is in the business of buying ESRE for economic preservation use might benefit from ignoring market prices at times (i.e., they might be able to buy cheaper from John Q. Citizen, or pay more to a special interest, if a seller could not ask for the market value the preservation land market indicates for his ESRE), and so might be tempted *not to recognize conservation and preservation as economic alternatives*.

Buyers of ESRE put to economic preservation use are only human, after all. Skirting an unfavorable market dynamic might be quite beneficial to their cash cycle and some might fall prey to the temptation to say, "I don't care what I paid for a protected habitat similar to this one a month ago. I'm going to try to rationalize another use that is less expensive and pay based on that one, so long as no one calls attention to the fact that the logic of what I am doing is absurd; to say nothing of being indefensible in an appraisal making valid use of the principle of substitution." (We, of course, feel compelled to point out the absurdity of this logic every chance we get.)

On the other hand, if Mr. Hanson means that ESRE put to economic preservation use is not an economic use, why, then, we are back in conundrumsville. It is a paradox: A does not equal A.

ESRE put to economic preservation use is being acquired for cash via negotiated purchases every day (and has been for several decades now, as Mr. Hanson and his colleagues must be aware).

What are the values of these thousands of economic preservation use properties that organizations and individuals transfer (via negotiations) for billions of dollars, if they are not economic values?

And don't say non-economic highest and best use values, Mr. Hanson, because we have already bid that concept an unsentimental farewell.

The answer is: they are economic highest and best use values, the only kind that make common sense, given the fact that ESRE has private real property rights that are traded for money by competitive individuals and organizations in a money economy.

A Wrongheaded Assertion That No Sales Purchased for Preservation Use May Be Used As Comparable Sales To Appraise Any ESRE

Amazingly, Mr. Hanson and his colleagues are not content to fall only on the sword of ambiguity. He makes a second assertion (again sans supporting argument) that goes them with the dull edge of wrongness:

"Transactions involving purchasers whose intent is to preserve/conservate privately owned natural lands should not be considered as reliable evidence in support of the market value estimate."

This unconditional precept flatly contradicts even what federal standards, ambiguous though they have been, at times, suggest. The standards at least say there are certain conditions when such transactions may be included.⁶

Further, the flatness of the assertion implies that even when a private individual or organization buys ESRE from another private individual or

organization expressly to preserve the habitat that that sale should not be considered as reliable evidence in support of a market value estimate.

Really, rejecting cash transactions among private individuals may put the Appraisal Institute on the radical fringe of appraisal theorists, though we are not sure whether it is the radical right or the radical left. The fact is we have never heard *anyone* else say one cannot use cash transactions among private individuals to estimate the market value of ESRE put to economic preservation use.

It seems to us that Mr. Hanson and his colleagues ought to be searching for a well-reasoned, middle ground for the Appraisal Institute, as we are doing, rather than take bizarre, probably unprecedented and inflammatory positions that may undermine the application of traditional appraisal methods not only to ESRE, but to other classes of real estate, as well.

After all, if one ill-conceived precept can cavalierly rule out cash transactions among private individuals and organizations regarding ESRE, who knows what class of real estate a similarly ill-conceived precept might strike next.

To be generous to Mr. Hanson and his colleagues, perhaps they are once again impaled on their own ambiguity. Perhaps what they really mean is that the concept of public interest value should not be used and that preservation and conservation use sales put to public interest uses should, therefore, not be used to estimate public interest value.

Perhaps they mean it is quite alright to use *economic* preservation use sales when one estimates the *market value* of ESRE put to economic preservation use.

But what it really sounds like he and his colleagues are saying is that appraisers should not use *any* economic preservation use sales period, regardless of what value definition is used, until institutional rules change fundamentally (in the interim, we suspect appraisers are supposed to subject ESRE to the ethers of the departure

provision, but who knows for sure at this point?).

If appraisers are not supposed to use sales of ESRE put to economic preservation use, then we disagree emphatically.

The rules do not need to be changed one iota, i.e., they can stay the same. They simply need to be interpreted with at least a thimble full of good sense and that thimble should hold at least a traditional amount of respect for one of appraisal's foundation principles—the principle of substitution.

Not using valid comparable sales of ESRE purchased for economic preservation use, when the highest and best use of a subject property is economic preservation use, violates the principle of substitution. The principle says more or less that individuals set price based on the cost of equal substitution opportunities. It also is fair to assume that they need some free choice to do this, though, we readily admit, it is not explicitly stated in *The Appraisal of Real Estate*.⁷

How, then, can the money value of ESRE put to an economic preservation use be inferred (i.e., deduced validly, according to the principle of substitution) from the value of a piece of grazing land, or from an office building, or from any kind of use which is something other than economic preservation use? Buyers of ESRE put to economic preservation use simply do not go out and freely choose to substitute an office building when they cannot make a deal for some parcel of wetland. Instead, they go buy some other parcel of wetland. And they pay based significantly on what the cost would be to substitute the purchase of another similar, available wetland. (This is why buyers of ESRE put to economic preservation use are often heard to say, "You want too much for your wetland Mr. X." This is also why these buyers are also often observed to buy other similar wetlands until either Mr. X decides to sell for less, or the buyers decide to pay more. There is substitution going on in a strategic, competitive context.)

The trouble with violating the principle of substitution.

Mr. Hanson would surely have a con-
ception if one of his young appraisers
walked into his office and said, "Mr.
Hanson, I have estimated the value of
the regional shopping center site using
comparable sales of surrounding single

*The principle says
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opportunities.*

family home sites, because housing
could replace the shopping center if it
weren't for the retail zoning." Rightfully
red-faced, Mr. Hanson would listen
incredulously. "And, Boss, it's also
significant that using these residential
site sales as comparable sales makes the
purchase price of the shopping center
far cheaper for our client to buy."

At this point, Mr. Hanson would
upbraid his young assistant for ignoring
highest and best use, for arbitrarily
assuming an alternative use, for not
using comparable sales of shopping
centers sites, and for biasing the esti-
mate in favor of their client; then, if the
assistant persisted, he would no doubt
fire him. And if he caught him doing it
on his own, he would probably charge
him with an ethics violation.

Ironically, however, Mr. Hanson
and his colleagues at the Institute seem
to imply appraisers should act toward
ESRE put to an economic preservation
use rather like the young assistant did
about the shopping center. The following
hypothetical scenario helps demonstrate:

*Boss, I have just finished appraising
10 acres of endangered species habitat in
a coastal zone in south Florida. I could
have used economic preservation use
transactions indicating \$10x per acre as
comparable sales, but I did not for two
reasons: a.) an inadequately reasoned*

new Institute precept says I can't; and b.) our client, a natural land trust that often buys ESRE to flip it to government agencies for a profit, doesn't want me to.

I could also have used some comparable sales of high-density, luxury residential development land that indicated \$100x, because they are comparable except for one thing: the comparable sales could be developed and the subject could not be. The subject is encumbered with regulatory overlays that protect the habitat by preventing virtually all feasible development. I rejected the development comparable sales, because who would pay development prices if they could not develop, right?

So, since the subject is probably going to be acquired to put it to economic preservation use, Boss, I infer that the buyer will probably leave it vacant so as not to destroy the significant habitat.

As a result, I have picked comparable sales of marginal land uses near by

(none, however, is encumbered with environmental constraints precluding development as is the subject; they are just parcels no one can feasibly build on right now). They indicate a value of \$1x. You know the kind; uses like equipment yards, vacant lots too small to build on, landlocked parcels that can't be built on, anything where economic utility is kind of marginal. I figured if economic marginal use does not develop the site, and if economic preservation use does not develop the site, then they are sort of similar, kind of alike, if you know what I mean.

And by the way, Boss, the resulting value won't cost our client, the NLIPB-WWTPALAP Land Trust (the initials stand for Natural Land Is Priceless But We Want To Pay As Little As Possible), near as much as they paid six months ago to protect the same kind of habitat just up the beach.

And, Boss, the government agency they flip it to should be really happy, too,

because then the cost they have to pay to NLIPBWWTPALAP Land Trust (including the 15 percent hog-factor that the trust euphemistically calls a surplus⁸) to take them out will be much less, too. So do I get a raise or what?

Before we say we think the reasoning above stinks, please rest assured, that we do not think Mr. Hanson, or any other respectable appraiser, would act in such a dubious way, for unethical purposes. We do say, however, that honest, ethical appraisers who are not allowed to use economic preservation use transactions to value a subject being put to economic preservation use have to wrestle with the illogical substitution issues suggested in the example.

We say further that unethical appraisers can routinely exploit these illogical substitution issues in behalf of buyers who want to pay the least they possibly can (or the most when quid pro quos are involved), while still paying

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lip service to the notion that they are paying fair market value as required by law (not the fair market value of the subject's probable use, of course, but the fair market value of some other less probable use).

But regardless of whether the young appraiser in the example above is perceived to have virtuous or deceitful motives, or to be just plain stupid, the reasoning often would wrongly equate the utility (and hence price and value) of economic marginal use with economic preservation use. We know it often would, because buyers are often observed to pay more money to use and enjoy ESRE put to economic preservation use than for property put to economic marginal use.⁹

Also, before we say we think the reasoning in the example stinks, we want to reiterate, for clarity's sake, that we do not think Mr. Hanson would act this way under any circumstances. Nor do we think the leadership of the Appraisal Institute intends to encourage appraisers to reason as fallaciously as the appraiser in the example reasons about substitution issues. The above example is simply a hypothetical one used to illustrate our point that the Appraisal Institute's position, as articulated by Mr. Hanson, has an unintended tendency to put appraisers in an undesirable position of invalid reasoning, regarding the principle of substitution. The exaggeration of the example is intended only to make some implications of the problem starkly apparent.

Now, however, we have to say what we think of the reasoning in the example.

We think it stinks.

The reasoning stinks, because it contradicts the principle of substitution on which traditional appraisal method rests. It compares apples with oranges (i.e., economic preservation use with economic marginal use), when it could easily and validly compare apples with apples (economic preservation use with economic preservation use).

ESRE put to economic preservation use is just another class of real estate that is purchased, traded or donated.



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There is *no logical* need to make a special case of it, unless one absolutely does not want economic and market forces to bear on its pricing during transfer.

Oooops! Excuse us. We are beginning to define things in terms of negative declarations that cloud issues.

What we mean to say is: the only reason to make a special case of ESRE put to economic preservation use is if one wants the latitude to set price more arbitrarily than market forces would otherwise allow; that is, if one wants to be able to disregard totally what is being paid for a comparable property when negotiating for a subject property.

Now, the only economies we know of where the price of a comparable property has no bearing on the value/price of a similar subject is where real property rights have not evolved, or where they have been abolished; that is, where the freedom to choose to substitute property rights does not exist.

Since we know property rights for ESRE put to economic preservation use exist, we can only infer that proponents of making such property a special case prefer transactors and appraisers not be allowed to choose freely to substitute comparable property rights.¹⁰ This smacks of planned economies, totalitarianism and the "C" word.

Now the last kind of thinking Mr. Hanson, or his colleagues at the Appraisal Institute, wants to align themselves with is thinking that condones economies without free choice by individuals, without property rights and without the right to substitute real property rights freely, at prices influenced by market forces. But their precepts align them with this kind of thinking nonetheless.

The coming debate, choices between principle and precepts, and leading from the center

As a result, we look forward to the coming debate on this subject that Joseph R. Stanfield, Jr., MAI, Vice President of the Appraisal Institute, encouraged at the recent national conference of the

International Right of Way Association in San Diego.

Further, we strongly encourage right-of-way professionals to pay careful attention to the Appraisal of Real Estate, the Uniform Standards of Professional Appraisal Practice, and the Uniform Appraisal Standards for Federal Land Acquisitions, and consider the following: in the courtroom and in your consciences, will it be a greater error to contradict the principle of substitution that is a cornerstone of traditional appraisal methodology and market economies, than to contradict a muddled, ambiguous and on certain points, we think, anyway, a wrongheaded precept proffered during a period of particularly confusing transition for the Appraisal Institute?¹¹

The answer, as always, is up to you, dear readers.

In this free society, when traditional, sound, and long-instituted principles are contradicted (wittingly or unwittingly) by recent, half-baked precepts, it is the moral obligation and sacred duty of a professional to choose responsibly between them, using reason and common decency as his or her guide.

But, as we have said before, we are not lawyers capable of giving adequate legal counsel about what you should do. We can only appeal to your reason, encourage you to seek legal counsel, and then we must trust in your ultimate judgement, something the precept makers seem afraid to do.

We are simply real estate professionals who advocate that sound, traditional principles of real estate appraisal and market analysis be applied to ESRE put to economic preservation use. We think the price of such property rights often reflects substitution choices made freely by individuals acting alone or through organizations. We think ESRE put to economic preservation use often has strategic and environmental utility that buyers often pay cash to enjoy the use and benefit of. We think the Appraisal Institute is struggling to do the right thing, but infer that it is being pulled in many directions by many

organizations with many agendas (some perhaps quite parochial). We think, as Abraham Lincoln is supposed to have said, that you can't please all the people all the time.

Therefore, we trust Mr. Hanson and his colleagues at the Appraisal Institute will soon rediscover the virtue of the principle of substitution in traditional appraisal methodology, a principle the Institute has long defended. If they do, we suspect they will soon comment with clarity that: appraisers ought to keep comparing apples with apples, so individuals choosing freely in a free country can continue to have a valid and meaningful value standard; one that is useful in making their price substitution choices regarding ESRE put to economic preservation use.

Negative declarations about what not to do, over-generalizations that imply the Appraisal Institute is making arbitrary value judgements about what price levels are appropriate for ESRE, negative declarations that no preservation use can be a highest and best use, and negative declarations that no sale bought with the intent of preservation can be a comparable sale, may not make Mr. Hanson and his colleagues at the Appraisal Institute seem like objective, rational, centrists to working appraisers.

Darn! These negative declarations are contagious.

What we mean to say is these negative declarations may make them look like biased, irrational, environmental extremists to ordinary appraisers.

Since we sincerely hope they are not, we invite them to join with us at the center of the debate (at the principle of substitution) to articulate just and feasible solutions for valuing ESRE.

Sometimes, gentlemen, the leading edge is smack dab in the heart of tradition.

Aren't we lucky this is one of those times?!■