



# Public Interest Value

Toward an Analytic Understanding  
of the Appraisal Institute's Proposed Definition  
of Value for Environmentally Significant Real Estate

*Tens of millions of acres of  
environmentally significant real estate  
(ESRE) worth perhaps billions of dollars  
need to be appraised for acquisition and  
protection in coming years.*

*How this property will be valued and  
values that may be estimated, may change  
significantly in the near future.*

*by Donald C. Wilson and Craig D. Hungerford*

The Appraisal Institute is contemplating endorsement of a precept that a public interest value definition be used by its members to appraise ESRE put to preservation use.<sup>1</sup> This new definition would effectively replace use of the traditional market value definition. If it is endorsed, non-market-driven mechanisms of valuing ESRE may replace market-driven mechanisms and efficiencies and safeguards of market value estimates may be lost. Adding gravity, this change may occur at a time when society seeks to massively expand its portfolio of protected ESRE.

The Appraisal Institute has been considering the new precept for over a year, and current indications are that the debate may come to a head during an Appraisal Institute conference in Atlanta, Ga., in April, 1995.

In light of such a radical departure from the market value tradition by the Appraisal Institute, an analysis of the conceptual coherence of the proposed public interest value definition is in order. Certainly, evaluation of the legal, political, and business coherence is also in order, but such analyses are left to others more qualified than the authors. The analysis begins with a summary of the public interest value precept contemplated by the Appraisal Institute.

### *Proposed Public Interest Value Definition*

The Appraisal Institute's Subcommittee on Public Interest Value proposes that Appraisal Institute members value ESRE according to a public interest value definition. The subcommittee proposes to define public interest value as:

"...the value of a specific property to a public agency or other entity that purchases property based upon the purchaser's determination that the acquisition is in the public interest. Public interest presumes a negotiated purchase,

as opposed to a condemnation action. In the latter case a property is acquired by a condemning authority under the right of eminent domain, subsequent to a judicial finding of public necessity. It is the most probable price which a specified interest in real property is likely to bring under all of the following conditions:

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1. Consummation of a sale as of a specified date.
2. An open and competitive market for the property interest does not exist.
3. Buyer and seller each acting prudently and knowledgeably.
4. Seller not under compulsion to sell.
5. Buyer's motivation differs from that of the typical market participant. That motivation may include legislation, public policy or social goals.
6. Both parties acting in what they consider their own best interests or those of their constituency.
7. There is little or no marketing effort, since the transaction is negotiated between only one buyer and the seller.
8. Payment is made in cash in U.S. dollars or in terms of financial arrangements comparable thereto.
9. Price represents the consideration for the property sold unaffected by special or creative financing or non-realty

considerations."<sup>2</sup>

According to the subcommittee, public interest value differs from market value with regard to the following assumptions about transaction activity:

1. No competitive and open market exists for preservation use. Transactors are aware of a competitive and open market for other uses of the property, but choose to transact independent of it.
2. Price is affected by undue stimulus, i.e., price does not reflect market forces.
3. The buyer is not typically motivated. He's seeking non-economic benefits such as the desire to preserve natural land, habitat for wildlife, cultural resources, or aesthetic values, as well as the opportunity to achieve better management of public lands.
4. There are little or no marketing efforts assumed. The exposure time for marketing (the period of negotiation between the transactors) is assumed to be completed as of the date of value, instead of projected forward as in market value.

Further, the subcommittee recommends that:

1. Highest and best use analysis is irrelevant, because: a.) highest and best use is a market driven concept; and b.) public interest value is not a result of market forces.
2. The sales comparison approach is the only valid approach.
3. The income approach is expressly prohibited.

Finally, the subcommittee says that appraisers can justify use of the public interest value definition under USPAP by invoking the "Departure Provision" on the grounds that:

1. Economic demand cannot be considered; and
2. The land cannot be appraised for development to its highest and best use.

Before analyzing the conceptual coherence of the new value definition, it is helpful to first understand what prompted the need for such radical change.

## Why a Public Interest Value Definition?

Society preserves ESRE to protect the environment from harmful human activity. Preservation of significant attributes of environment, archaeology, paleontology, history and culture often involves purchasing real property rights controlling such ESRE. Government agencies, land trusts and individuals often acquire these rights. They tend to acquire them through negotiated purchase rather than through condemnation. There are three reasons why.

1. Condemnation requires proof of public necessity, something often difficult to prove in the case of environmental preservation.

2. Condemnation often has higher transaction costs than a negotiated purchase.

3. Condemnation sets legal precedents of value and valuation methodology that may impede public agencies' subsequent buying activities.

ESRE acquired through negotiated purchase typically requires an appraisal. Among other things, an appraisal must define property rights purchased, the definition of value relied on, and the intended use expected, in order to validly estimate value for transaction.

Government agencies, historically the most frequent purchasers, typically have standards requiring appraisers to value the real property rights acquired, based on a traditional market value definition, premised on a highest and best use determination, that permits an estimate of market value, arrived at using comparable sales. The Federal agencies' appraisal standards are articulated in the Uniform Standards for Professional Appraisal Practice (USPAP), Uniform Appraisal Standards for Federal Land Acquisitions (UASFLA), and the respective "appraisal handbooks" of certain federal agencies.

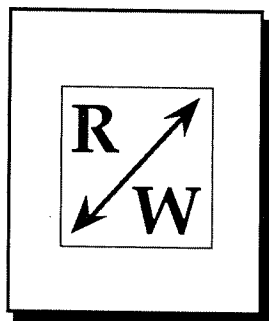
These standards generally pose few difficulties for valuing properties with traditional uses. The same is not always true, however, for properties purchased for preservation use.

With significant frequency, some Appraisal Institute members, attempting to execute appraisals consistent with the standard market value definition, conclude that preservation use, the most probable use of much ESRE, cannot be considered a highest and best use with a market value.<sup>3</sup> The typical logic, as articulated by the Subcommittee on Public Interest Value, is that preservation use is not an economic activity shaped by market forces, so it can neither have a market value, nor be determined a highest and best use.

As a result, Appraisal Institute members sometimes propose totally improbable uses that are traditionally considered economic uses and conclude these improbable uses to be highest and best. This tactic leads to appraisals based on improbable, sometimes absurd, and highly subjective determinations of use. (The selection of improbable uses facilitates use of easily accessible comparable sales.) The subjectivity, in turn, leads to widely varying use scenarios and those widely varying use scenarios lead to widely varying estimates of market value. The disparity in market value estimates can lead to difficulties in concluding transactions.

Another problematic result, according to the Appraisal Institute's Subcommittee on Public Interest Value, is that Institute members using the market value definition often estimate market values far below what is typically paid for preservation use properties. This under-valuation can prevent or delay government agencies successful negotiation of price with sellers.

Other problematic results flow specifically from the marketing period assumption of the market value definition. They are particularly troublesome to land trusts and government agencies. Under the marketing period assumption, the market value esti-



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mated for the specified date of value anticipates a marketing period and sale closing some specified time period in the future. A future sale closing is problematic for land trusts and public agencies for at least three reasons.

1. Land trusts often buy a preservation use property and simultaneously resell it at a significant mark-up to a government agency. These are called double-escrow transactions. The simultaneity, or near simultaneity, of such transactions flatly contradicts the marketing period assumption of a market value appraisal.

2. The scale of the instant mark-up in double-escrow transactions is also difficult to rationalize under the marketing period assumption of the market value definition. How can a property's market value inflate any amount immediately (mark-ups of 6 percent are not unusual and significantly higher ones have been noted in research done by

the federal government), when the market value estimate assumes both sales will not even close for, say, three to six months in the future, and then close simultaneously?

3. Finally, if appraisers estimate market values that one or both sides reject, the marketing period assumption creates a significant period of time before government agencies can rationalize recognizing higher values under reappraisal.

The three problems caused by the marketing period assumption of the market value definition, cumulatively build to an even more embarrassing and fundamental problem with the market value definition, at least in so far as land trusts and public agencies are concerned. Quite simply, how do they rationalize two market value appraisal estimates of the same property, with similar dates of value—one documenting the sale of the property from

the original land owner to the land trust, the other documenting the sale of the property from the land trust to the government agency—differing in amounts that consistently yield a lower value for the former and a higher value for the latter? Clearly, one cannot ethically do so unless one distinguishes market value based on probable buyer, something the Appraisal Institute has been historically loathe to endorse, or by creating two value definitions—market value and public interest value—thereby allowing land trusts to buy, say, under the market value definition and sell to the government agencies under the public interest value definition. It is at least a clever solution.

Hence, the value gap, the fundamentally illogical appraising of a preservation use property based on another use, the problems springing from the marketing period assumption, and the contradiction of simultaneous, but systematically differing market value estimates, seem to have triggered the Appraisal Institute's search for an alternative approach to valuing ESRE.<sup>4</sup>

To reiterate briefly, the alternative approach proposed by the subcommittee is this: assert that preservation use is not an economic use and that the body of preservation transactions do not constitute a market consistent with the traditional market value definition. From such a premise, the Appraisal Institute reasons that attempts to estimate a market value based on a highest and best use assumption of preservation use are unjustified. Accordingly, they abandon notions of market value and highest and best use, and advocate the public interest value definition, allowing estimation of public interest value using a sales comparison approach. While they do not specify, it appears they condone use of comparable sales purchased at arm's length for preservation use by any entity including condemning authorities who negotiate rather than take.

With the context of the proposed public interest value definition clarified and the definition reiterated, it is now helpful to distinguish between the precept and concept of the public interest value definition.



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## Public Interest Value: Precept vs. Concept

A precept is a rule of action for doing something technical. It is also a rule of moral conduct.

A concept is a generalized idea—a building block, or premise of systematic thinking and activity.

Clearly, the proposed precept of public interest value is that members of the Appraisal Institute are to use the definition of public interest value to appraise environmentally significant real estate. Further, they are to use only the sales comparison approach to do so.

Just as clearly, the proposed concept is the idea of a public interest value definition, and its use as a value definition for ESRE.

Regarding the precept, the Appraisal Institute seems well within its rights to direct its members to use the new value definition, and it is to be lauded for attempting some systematic thinking regarding a significant valuation issue. However, it is worth noting that the blanket direction of its members to treat the thousands of negotiated ESRE transactions as something other than market transactions erodes the traditional autonomy of its appraisers to make such decisions on their own.

Traditionally, government agencies and appraisal organizations have established value definition criteria for appraisers to use as guides to make their own determinations in the field. This precept basically interprets the market value definition criteria for their appraisers, and prevents them from making their own assessment. In doing so, it suggests the subcommittee doubts the ability of Institute members to interpret the market value definition criteria on their own. Such doubt seems unfounded.

Regarding the concept of the public interest value definition, one must be rather more critical.

### Conceptual Criticism

The concept of a public interest value definition, as proposed, has at least

eight significant short-comings.

#### 1. Inadequate Definition of "Public Interest"

The term "public interest," if it is to be used, needs to be defined. Does it mean public interest, precisely according to case law? If so, cite the case law and demonstrate how the law sets a precedent broad enough to justify an entirely new value definition. Or is public interest meant more as a term of art indicating a benefit to the public, or use by the public? If so, it needs to be defined beyond simply saying public interest is whatever a government agency calls the public interest. Or does it mean a property right held by the public, i.e., a public right retained by the sovereign in the bundle of property rights such as escheat, eminent domain, taxation, and police power? If this is the meaning, dubious constitutional grounds may be being treaded upon by broadly recognizing a right that may not yet be thoroughly adjudicated and legislated into existence.

Each meaning has significantly different implications for valuation. In essence, public interest needs to be precisely defined to give the public interest value definition coherent meaning.

#### 2. Misleading Connotation of Public Interest

Regardless of how "public interest" is define, the connotation of "public interest value" is misleading. To the uninitiated, public interest value may wrongly suggest the public interest is being valued. Actually, private real property rights for real estate put to preservation use are being valued. This may or may not be in the public interest, depending on the motives and effects of the preservation use and the values of those who judge those motives and effects. More specifically, the environmentally significant attributes of a site are not being purchased; the property rights to all attributes of the site—environmentally significant and otherwise—are being purchased to be put to preservation use.

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3. Inaccurately Denoted Pricing Process

A value definition denotes a pricing process, but the public interest value definition denotes no tangible pricing process. "Market value" denotes the value of private real property rights likely to occur in a market pricing process. "Value-in-use" denotes value of such rights likely to occur in a use pricing process. "Assessed value" denotes value of such rights likely to occur in an assessment pricing process. "Liquidation value" denotes the value of such rights likely to occur in a liquidation pricing process. "Insured value" denotes the value of such rights likely to occur in an insurance pricing process. Therefore, "public interest value" must denote the value of such rights in a public interest pricing process. But, in fact, there is no public interest pricing process one can point to the way one can point to markets, assessors, users, liquidators, and insurers. What exists are hundreds of government agencies, thousands of land trusts and wildlife organizations, and countless corporations and individuals transacting private real property rights to millions of acres annually for billions of dollars for the purposes of establishing preservation use at each location acquired. In short, what exists is a public sector/private sector hybrid of a market pricing process, involving not-for-profit and for-profit organizations pricing private real property rights for preservation use through negotiated purchase. The public interest is what is being served. It is not a pricing process.

4. A False Assumption That Government Transactions Cannot Be Part of Market Activity

The Subcommittee's public interest value definition seems to be based in part on an assumption that government agency transactions cannot be part of market activity, according to the market value definition. In fact, the market value definition, considered in non-condemnation processes, makes no such claim. It merely lists criteria that individual appraisers are to use on a case-by-case basis to determine whether the conditions of a market are met and whether transactions may be

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used as comparable sales indicating market value. The Subcommittee's assumption that acquisitions of ESRE made by government agencies to serve the public interest resolves nothing. And it contradicts the fact that much government transaction activity in other markets, including real estate, is routinely considered part of market activity. For example, the government is a significant transactor and a major owner in several real estate markets (e.g., certain office and low income housing markets). And the government also transacts routinely in grain, financial and currency markets to name a few. Clearly, government transaction activity in a market does not preclude the activity from being market activity. Just as clearly, government transaction activity in ESRE does not prevent the body of ESRE transactions from being market activity.

5. A False Assumption that Preservation Use of ESRE Is Not an Economic Use

Underlying the Subcommittee's decision to propose a public interest value definition is another false assumption—that preservation use of ESRE is not an economic use. The assumption does not hold up under careful analysis, however.

An economic use may be defined variously, but in real estate, it basically means a use of a real estate parcel that buyers will pay for to gain: 1.) utility during ownership; and 2.) the opportunity of consideration at disposition. For example, buyers pay cash for the ownership right to use a shopping cen-

ter to generate cash benefits during operation (investment utility) and cash benefit at disposition. Alternatively, buyers pay cash for the ownership right to use a single family residence that generates a place to live (residential utility) and cash benefits at disposition.<sup>5</sup> The example of a single family residence illustrates an important point: economic uses are not necessarily managed to generate cash benefit during operation.

Looking at preservation use, one sees that transactors frequently pay cash for the ownership right to use environmentally significant real estate for preservation (environmental preservation utility) and to receive consideration on disposition (typically cash, donative, and/or trade benefits). Transactors include individuals, corporations, land trusts<sup>6</sup> and government agencies. Significant acreages are acquired for preservation use annually.<sup>7</sup> Government agencies acquire the most acreage and tend to hold it indefinitely. Nevertheless, government agencies retain the right to dispose of such property for consideration and do so from time to time.<sup>8</sup> Economic use of environmentally significant real estate even extends to buyers paying for the right to keep certain water, air and protected areas unpolluted, in exchange for the right to pollute water, air and protected areas elsewhere (mitigation utility).

It is also worth noting, at this point, that many ESRE parcels do generate annual operating revenues in the form of user fees. And as eco-tourist resort development evolves, many others can be expected to generate annual operating revenues on a scale approaching investment real estate development.

Preservation use meeting an economic use criterion should not surprise one, either; since environment, itself, has a fundamentally economic dimension. A large and growing literature of environmental economics documents this dimension in terms of the economic costs and benefits of preservation, pollution and destruction of environment.<sup>9</sup>

Environment in all its varied forms is a basic raw material of human economy. The human economy consumes

environment for free until demand for some aspect of it coupled with a perception of sufficient scarcity, moves society to allocate economic resources toward managing scarcity. Preservation of environmental significance simply reflects the perception of society that sufficient scarcity exists to trigger inclusion of environmentally significant aspects of the environment in to the human economy. Demand, perceived scarcity, patented property rights of ownership, capital allocation and management organization are conditions for any use being a part of the human economic process; i.e., being an economic use. These conditions are present in the case of preservation use of ESRE.

Still, some may argue that preservation use fails to qualify as an economic use, because it cannot compete for land with many development uses without regulatory advantage (i.e., without regulation excluding competing uses). This argument ignores that reliance on regulatory advantage does not disqualify a use as economic. In fact, many economic uses of real estate have regulatory advantages over competing economic uses (e.g., zoning prevents high rise office buildings from competing with single family housing in residential neighborhoods).

The findings of this section may be summarized as follows:

1. Preservation use of environmentally significant real estate meets a basic definition of economic use; i.e., it offers utility during ownership and disposition benefits buyers will pay for.<sup>10</sup>

2. Many preservation uses of ESRE generate significant annual operating revenues and eco-tourist resort development may trigger more.

3. Environment has a well-documented economic dimension that supports the notion of preservation use being an economic use.

4. Preservation use should not be disqualified as an economic use simply because it has certain regulatory advantages over competing uses, as many economic uses have such advantages.

These findings support the conclusion that preservation use of ESRE meets a reasonable economic use crite-

*An economic use means a use of a real estate parcel that buyers will pay for to gain: 1) utility during ownership; and 2) the opportunity of consideration at disposition.*

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tion. And the large number of transactions and the large acreage of parcels already put to preservation use indicate it is a fairly ubiquitous economic use, at that.<sup>11</sup>

#### 6. An Unpersuasive Conclusion that ESRE Transactions Do Not Constitute Market Activity

The subcommittee concludes that ESRE transactions do not constitute market activity. Let us consider an implication of this conclusion. If these thousands of negotiated transactions of ESRE are not a market, then what are they? All an economy can have is markets of negotiated transactions and non-markets of non-negotiated transactions. What else can there be? In ESRE transactions, transactors routinely act as market transactors act. They consider what has been paid before and what alternative transactions may be substituted now. They strategize, market, fight over and negotiate for short and long periods of time.

Transaction times range from impulsive sales to 25-year war-of-attrition bargaining. ESRE properties are often offered to more than one preservation use buyer, despite what the Subcommittee's report suggests. ESRE buyers compete, too. They pay cash frequently. True, government agencies are the chief buyers, today, but their prominence has been increasingly supplemented by private not-for-profit activities. Clearly, ESRE transactions constitute some kind of market activity, whether the Subcommittee finds it inconsistent with the market value definition or not.

#### 7. Distinctions of ESRE Transactions

#### Triggers Unnecessary and Undesirable Abandonment of Traditional Benefits of Markets

The subcommittee's perception that the body of ESRE transactions differs significantly from the body of transactions of other real estate markets is legitimate. Fewer potential buyers often (but not always) exist for an ESRE parcel than for most commercial, industrial, residential, and agricultural parcels. There are different marketing mechanisms, too. Often, no broker or land banker is involved. Instead, land trusts sometimes fulfill the broker's, or land banker's, role and make commensurate fees through mark-ups. And government agencies probably do buy a larger percentage of property rights for ESRE than they do in markets of other types of real estate. They also probably have different agendas than many private sector buyers. Further, government agencies seem to resell what they acquire much less frequently (often times never) than many other buyers in other real estate markets (although it might also be said that car plants, oil refineries, hydroelectric dams, family farms, certain office buildings in New York, London, Tokyo, and Hong Kong, etc., are also acquired without the intent to dispose). Given these distinctions, it is understandable<sup>12</sup> that the subcommittee might conclude that ESRE transaction activity fails to precisely and consistently fit the criteria of the traditional market value definition. (Individual appraisers have been finding both ways for some time now.) It is not understandable, however, how the committee can conclude that ESRE transaction activity is not market activity of any kind, when clearly it is.

Abandoning the notion of ESRE market activity completely also abandons the basic benefits of markets. First, markets often produce sustained supply more cost effectively than non-markets. Second, markets are self-correcting feedback mechanisms that incrementally facilitate supply, price and demand and, thereby, avoid the inertia and inflexibility of non-market mechanisms. Third, markets permit consolidations and dispersions of power and

control to fit economic circumstance, rather than inflexibly structuring power and control regardless of circumstance. Fourth, markets often stimulate competition that leads to development and management of supply and demand to attract capital and enhance yield. Non-market mechanisms often eliminate competition and lessen the quality of supply. All four of these market benefits would be extremely desirable to have influencing the formation of the nation's portfolio of ESRE put to preservation use. The Subcommittee's abandonment of these market benefits is unnecessary and undesirable.

8. A Problematic Rejection of Highest and Best Use Analysis

The Subcommittee's rejection of highest and best use analysis in ESRE valuation is also problematic. How can an estimate of public interest value be the most probable price, as the subcommittee claims it is supposed to be, if there is no systematic determination of highest and best use. Most probable

price is inextricably a function of some kind of most probable, or highest and best use determination.

*Three Conceptual Alternatives to the Public Interest Value Definition*

The short-comings of the proposed public interest value definition point to three conceptual alternatives.

1. Retain the Traditional Market Value Definition Without a Precept

One alternative is to retain use of the traditional market value definition without a precept of how to interpret the body of ESRE transactions. This strategy would preserve the traditional autonomy of the individual appraiser, maintain the traditional market value definition as the cornerstone for appraisal of this type of property, and place the onus of change on land trusts and public agencies (i.e., they would have to seek legislative change in

USPAP and UASFLA standards to gain the permission and benefits of the kind of transaction activity they would like to pursue) rather than on the appraisal community. This strategy would also perpetuate existing conflicts over how to appropriately appraise such property, which, given the apparent lack of professional consensus at present, is perhaps not a bad thing. Society needs professional appraisers and real estate scholars to pursue aggressively and reach a rational consensus on appraisal methodology based on the knowledge, skill and traditions of the appraisal discipline far more than it needs entities like land trusts, government agencies and influential land owners advocating solutions serving their own agendas.

2. Retain the Traditional Market Value Definition With a Precept

Another alternative is to retain use of the traditional market value definition with a precept that appraisers should view the body of ESRE transactions as a real estate sub-market fitting the constraints of the market value definition. This strategy would only require the subcommittee to broaden its interpretations of the market value definition criteria on the issues of market competition, undue stimulus, buyer motivation, and marketing efforts. Such a loosening of interpretation seems inconsequential in comparison to the subcommittee's demonstrated willingness to completely abandon the notion of market activity and highest and best use analysis in the appraisal of ESRE.

This strategy would impose the cornerstone of appraisal, the traditional market value definition, on the appraisal of ESRE, and retain the traditional notions of markets, market benefits, and market value. Value estimated would be a most probable price based on a most probable use—highest and best use. The precept would significantly reduce conflict over how to appraise ESRE within in the appraisal profession, too. It would not, however, solve some of the problems of land trusts and public agencies alluded to previously.

3. Adopt a Hybrid Market Value Definition for ESRE

A third alternative is to adopt a new

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value definition that treats the thousands of negotiated ESRE transactions as inconsistent with the traditional market value definition, but indicative of another kind of market activity deserving a separate market value definition. This strategy would retain notions of markets, market benefits, and market value in a hybridized form that recognizes the distinctions flowing from the public sector/private sector transaction activity. A brief description of the premises for such a definition follows.

*a. A Hybrid Market*

A case may be made that ESRE transactions constitute an entirely different kind of market activity; one characterized primarily by private-to-public sector transactions of the kind described by the Subcommittee—with the primary objective being facilitation of the supply of a public use, i.e., preservation use of real estate with environmentally significant attributes. This market may be thought of as a hybrid produced by the interaction of public and private sector economics. A “hybrid market” is something that could be pointed to and it could be coherently defined to: facilitate supply of ESRE put to preservation use; price private real property rights of ESRE put to preservation use; serve demand for ESRE; and occur within constraints of government regulation. A hybrid market would fundamentally retain the traditional notions of market dynamics and efficiencies, although these notions might be modified to reflect the agendas and constraints of public and private sector organizations in transaction. A hybrid market would be distinct from a traditional market.

*b. The Hybrid Market Value Definition*

A value definition could be used that combines a description and relevant criteria much as the market value definition does. For example, hybrid market value might be defined as:

The most probable price which a property should bring in a competitive and open hybrid market, under all conditions requisite to a fair sale in a hybrid market, with the buyer and seller each acting prudently, knowledgeably, and assuming the price is not affected

*This market may be  
thought of as a hybrid  
produced by the interaction  
of public and private sector  
economics.*

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by stimulus atypical for a hybrid market.

Such a definition is far more in keeping with the traditions and economic roots of appraisal, than is the proposed public interest value definition, if for no other reason than it keeps appraisers, transactors, and society grounded in the reality of some kind of market activity, rather than pretending none exists.

The criteria specified for the definition could probably be the same as the criteria for the traditional market value definition, though referring instead to a hybrid market. But the criteria could also be that cited by the Subcommittee, or some new criteria, for that matter.

*c. The Hybrid Highest and Best Use Concept*

“To have value, a site must have a utility [read use] which is in demand by prospective purchasers, i.e., one which will produce amenities or net income to the user,” says The Appraisal of Real Estate in a discussion of highest and best use. Clearly, all ESRE put to preservation use produces amenities to the user. And some ESRE produces net income derived from user fees and ecotourist development. Therefore, preservation use of ESRE meets a fundamental condition for it to have a value under highest and best use analysis.

Hence, if a “hybrid market” and a “hybrid market value definition” were assumed by the subcommittee, and if it recognized that ESRE put to preservation use produces amenities and occasional net income, then the Subcommittee might logically articulate a “hybrid highest and best use” concept. The concept could have the traditional four-rule test: physical possibility, legal permissibility, financial feasibility, and greatest net benefit to the owner over

time. Each rule could be refined for the constraints and circumstances of the hybrid market, since these are heuristics, anyway. Still, little if any adaptation would probably be required.

Retaining some form of highest and best use analysis in ESRE appraisal is critical to the integrity of the appraisal process and critical to society’s efficient formation of a portfolio of ESRE put to preservation use. “Hybrid highest and best use analysis” would allow evaluation of various preservation uses (many ESRE parcels can be put to different kinds of preservation use) to determine the most probable use and would select toward the one that best meets the four rules of highest and best use. Without hybrid highest and best use analysis, there can be no skewing of the appraisers use determination toward a most probable use. Without a skewing toward most probable use, accuracy of value estimates will probably suffer, because the use premises considered by appraisers may vary significantly. Further, “pork barreling” of environmental projects will have no check and balance in the appraisal process without some form of highest and best use analysis.

*d. The Three Approaches*

Given a hybrid highest and best use determination, it then becomes logical for the appraiser to search out comparable sales reflective of the hybrid highest and best use, drawn from the hybrid market, that are consistent with the hybrid market value definition. Many of these transactions involve negotiated purchases by condemning authorities. The Uniform Appraisal Standards for Federal Land Acquisitions already articulate that such transactions may be used for estimating market value.<sup>13</sup> There probably would be no problem in using them for estimating a hybrid market value.

Further, with hybrid market concepts mentioned above, there would be no need to limit appraisers consideration of the Income and Cost Approaches, so long as they drew their data from the hybrid market. While most ESRE can probably be adequately valued through a sales comparison approach, certain kinds of ESRE in the fu-

ture may benefit from cost or income analyses. For example, as eco-tourist resorts are developed on ESRE, it will become increasingly useful to analyze the income streams to understand the value of ESRE. The Cost Approach may also be informative in cases where ESRE to be acquired is also subject to significant contamination requiring clean-up.

Change is traumatic and risky. Large change is exponentially traumatic and risky. When the subcommittee abandons the market value definition, totally rejects calling the thousands of ESRE transactions annually any kind of market activity, abandons the traditional notions of highest and best use as a premise of valuing ESRE, and rejects completely the appraisal traditions and economic efficiencies of looking at large bodies of negotiated purchases as market activities, then exponential change is being contemplated. Such exponential change almost certainly traumatizes the appraisal process for ESRE and puts at risk that accuracy and integrity of the value estimates made by appraisers, required by transactors, and relied upon by society. The trauma and risk are unwarranted. The committee should stick with the traditional market value definition for valuing ESRE put to preservation use, because it can work effectively. But if change is essential for reasons unrevealed by the subcommittee's report, the subcommittee should adopt something like a "hybrid market value definition" that: 1.) avoids completely divorcing ESRE, appraisers, transactors and society from the traditional, beneficial dynamics of regulated market processes; and 2.) "incrementalizes" change to a manageable, prudent degree.

Presently, the Federal Land and Water Management Fund has billions of dollars available for buying ESRE. States have millions or billions to spend. Land trusts like The Nature Conservancy (with links to ARCO and BLM), The Wilderness Society (a link to The Rockefeller Foundation), and The Conservation Fund (a link to the Mellon Foundation) have large donor and institutional fund raising bases that give them vast buying power. At the

same time, tens of millions of acres of wetlands remain to be acquired. Tens of millions of acres of federal and state lands must be exchanged to satisfy federal policy on land ownership consolidation. And millions of acres of other types of ESRE are also targeted for acquisition, or will be. Society stands on the brink of the greatest systematic preservation of environment in human history. Will it happen efficiently or inefficiently? Will it happen with integrity or fraud? Will it be a market activity, or a non-market one? Will the taxpayers get their money's worth, or will they be bilked, as they have all too frequently in government procurement processes? The subcommittee's decision regarding an appropriate value definition for ESRE may profoundly influence the answers to these questions in the short term. In the long term, the market prevails. □

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*Change is traumatic and risky. Large change is exponentially traumatic and risky.*

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## REFERENCES

<sup>1</sup> Draft of the "Report of the Appraisal Standards Council Subcommittee on Public Interest Value" circulated September 26, 1994.

<sup>2</sup> Ibid.

<sup>3</sup> Of course, some other members of the Appraisal Institute do conclude that preservation use, or some comparable use concept, may be a highest and best use.

<sup>4</sup> We are also told representatives of certain federal agencies also appeared at an Appraisal Institute meeting near the beginning of the Subcommittee's formation and expressed a strong interest in seeing change in appraisal methods related to ESRE.

<sup>5</sup> Some may argue that persons buy homes for annual after tax benefits also, thus approximating an investment scenario, but of course persons bought homes to live in before such benefits existed. Hence, the presence of annual operating benefits is not necessarily a criterion of an economic use.

<sup>6</sup> Land trusts numbered well over a thousand nationally by 1993.

<sup>7</sup> Aggregate annual acquisition figures were not found, but a conservative estimate is a million acres per year during the 1990s.

<sup>8</sup> For example, the federal government's policy of consolidating land ownership patterns triggers some federal disposition of environmentally significant real estate among federal agencies, to state agencies, and to Native American Reservations.

<sup>9</sup> See the Journal of Environmental Economics for a steady stream of scholarly articles articulating, documenting, and measuring the economic costs and benefits of preserving and destroying environment.

<sup>10</sup> The utility is analogous to that of a single family house's; that is it does not necessarily generate annual cashflow benefits, but rather reduces the cost of living in the long run. In the case of a house, the cost reduction is the increment between the net present cost of renting and owning. In the case of preservation use, the increment is the difference between the net present cost of de-

veloping and replacing environmentally significant real estate and the net present cost of preserving it.

<sup>11</sup> Approximately 20 percent of the land mass of the United States subject to some form of federal preservation. For more detail on this subject, see Donald C. Wilson. "A Case for an Environmental Real Estate Market," *Real Estate Issues* (Chicago: American Society of Real Estate Counselors, Fall/Winter 1991), 44-49.

<sup>12</sup> It is understandable, but not agreed with by the authors.

<sup>13</sup> Donald C. Wilson and Craig D. Hungerford. "Purchases By Condemning Authorities as Comparable Sales: Interpreting the New federal Appraisal Standards for the Valuation of Environmental Real Estate," *Right of Way* (Gardena, CA: International Right of Way Association, June/July 1994), 18-21.



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