

Journey to the Center of the Earth

Misconceptions in Appraising Subsurface Easements

by Wayne C. Lusvardi

A Fable of Lost Easement Value

Once, two real estate appraisers, having valued a few subsurface easements, thought they might figure out how to better appraise such easements if they viewed the 1959 movie, *Journey to the Center of the Earth*. Having heard of their newly gained knowledge, a public agency client asked both appraisers if they could value some near-surface, semi-deep and very deep underground easements. Two separate appraisals of each easement parcel were requested to establish a negotiating range of value. Appraiser one used the conventional "before-and-after" method in appraising the easements based on the conventional definition of fair market value for eminent domain purposes. Appraiser two employed a more subjective percentage approach based on the alternative "just and equitable" definition of market value used for non-market properties. The two appraisals closely concurred as to the value of the near-surface underground easements, but diverged widely as to the value of the semi-deep and very deep easements. Both having the same training, they nonetheless disagreed on the proper interpretation and its application. The public agency was left in a quandary, not knowing which appraisal was correct. Finally, the agency purchased the easements based on the contrived values in Appraisal two. Thus, Appraisal two created an artificial price for easements, which then became accepted as the "going price" by others. The true market value of easements was lost and forgotten.

Into a Dark Tunnel

This article is intended to briefly correct professional misconceptions about how to appraise some surface easements and to shine a light at the end of the tunnel to guide such appraisals.

Right of Way has published two recent articles on the appraisal of subsurface easements.¹ Reading one more article on the appraisal of subsurface easements may be like viewing a rerun of the 1959 *Journey to the Center of the Earth*, inspired by Jules Verne's science fiction novel. Reviewing the topic may be redundant and presumes one does not have tunnel vision regarding the issues involved. Moreover, which interpretation is right may depend more on what one wants to believe than any notion of professionally recognized correctness or objectivity. Indeed, the appraisal profession is often accused of producing valuations that are entirely subjective. Users of appraisals are often suspicious that the inconsistencies between different appraisers as to meth-

ods and conclusions of value are due to the personal predilections of appraisers rather than any variation in the real estate market.

Appraisers are viewed as fabricators or inventors of value rather than interpreters of market perceptions and behavior. One of the reasons for the over-subjectiveness of appraisals is the tendency for appraisers to interpret applicable law themselves and contrive their own valuation methods. However, with the establishment of professional standards and licensing, it is the task of the appraiser to illuminate the correct and professionally recognized path out of the dark tunnel of appraising subsurface easements (Standard Rule 1, USPAP).

One of the major professional misconceptions in appraising subsurface easements, which may lead to "semi-deep" trouble, is that the standard definition of Fair Market Value in the associated "before-and-after" method, are not valid because they are "impossi-

ble" and "rarely practicable" to use. This misconception often originates from misuse of the two-part definition of Fair Market Value used in most eminent domain acquisitions.

Standard definition of Fair Market Value for Eminent Domain Acquisition:

a. *The Fair Market Value of the property is the highest price on the date of valuation that would be agreed to, by a seller being willing to sell, but under no particular or urgent necessity for so doing, nor obliged to sell, and a buyer, being ready, willing and able to buy, but under no particular necessity for so doing, each dealing with the other with full knowledge of all the uses and purposes, which the property is adaptable and available.*

b. *The Fair Market Value of property taken for which there is no relevant, comparable market is its value on the date of valuation as determined by any method of valuation that is just and equitable.*

Many appraisers misconstrue that easements are to be appraised under part "b" of the above definitions rather than part "a." The oft-used rationale for part "b" of the definition is:

Misconceptions:

- Easements are typically "not offered on the open market" and thus, fall within part "b" of the definition of market value which applies to non-market properties.

- Appraising easements by the "before-and-after" method, although seemingly "simple and straightforward" is "impractical" and "impossible" in practice.

- Typically, there is no open market data available on conveyances of easements. The only date available are closed market transactions "exclusively limited to public and semi-public agencies."

It mistakenly follows from the above-cited reasons that it is up to the discretion of the appraiser to choose any method in valuing a subsurface easement just as long as it is "just and equitable."

According to the above rationale, the standard "before-and-after" method of appraising easements can be discarded in favor of a rule-of-thumb "percentage



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of fee value" method or some other non-other empirically based method. The problem with using such contrived methods is that the estimated percentage of value loss for acquisition of an easement is fiction, just as much as the Jules Verne novel or its movie adaptation. It is a contrivance of the appraiser rather than the real estate market. The fact that this fabrication may then become regarded by others as sound and usable does not make reliance on this method defensible or proper.² Use of rule-of-thumb percentages of value diminution for easements is substituted for empirical evidence, reasoning or market logic. Thus, a distorted fiat price³ for easements substitutes for their actual market value.

Tunnel Cave-ins and Traps

Use of rule-of-thumb or strip appraisal method in appraising easements may be warranted to save costs if the easement acquisition is minimal and peripheral to the affected property. However, use of such short-cut methods may dig an appraiser into a hole he

can't get out of on larger scale easement acquisitions. The problems with using overly subjective percentage of value methods with large-scale easement acquisition appraisals are:

- Prevailing case law in many jurisdictions has expressly forbidden the use of part "b" of the definition of market value for appraisals of fractional property rights such as easements, leaseholds or co-ownership interests. The alternative definition of market value under part "b" is exclusively reserved for special use properties for which there is truly no market. (city halls, customized manufacturing plants, water treatment plants, electric transmission stations, operational pipelines, rail corridors for continuing use). (*Redevelopment Agency v. Tobriner*, 153 Cal.App.3d. 367, 200 Cal.Reptr. [Mar. 1984]).

- The substitution of the rule-of-thumb percentage of value method for the "before-and-after" method explicitly violates federal land appraisal standards and implicitly vio-

lates the Uniform Standards of Professional Appraisal Practice (USPAP). In particular, federal land appraisal standards strictly forbid the use of "going rates" for the valuation of easements.

- The use of totally subjective percentage of value methods in valuing easements is likely to be indefensible in a court of law and may be perceived to be arbitrary to a property owner in a negotiation. Sound appraisals of easements should facilitate voluntary negotiated acquisitions and be empirically supportable for litigation.

- Use of rule-of-thumb methods in valuing easements may expose an appraiser to legal liability for failure to conform to prevailing law and professional standards (Mark Lee Levine, *Real Estate Appraisers Liability*, New York: Clark, Boardman and Callahan, 1991.)

- Use of the "Percentage of Unencumbered Value" appraisal method arrived at by entirely subjective means may complicate the acquisi-



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tion of an easement and result in windfall or wipeout monetary awards to property owners, the establishment of an artificial fiat price for easements, and unnecessary litigation.

Because of the above drawbacks, use of the "just and equitable" definition of market value together with a hackneyed percentage of value method in appraising easements should be avoided unless legally instructed otherwise, or a departure from professional standards is made by the Jurisdictional Exception under the USPAP.

Light at the End of the Tunnel

Whatever the reasons for the variation in professional opinions as to how to appraise easements properly (competent, legal interpretation, underbidding, professional custom), the following suggestions may shine some additional light on the problem:

- The appraisal of subsurface easements is really the valuation of whole properties, not easements *per se*. What the appraisal should measure is the effect, if any, an easement has on the value of the entire property. Sales transactions of whole properties, not easements, should be used as comparables. Public utility easements most often do not sell on the open real estate market; larger properties burdened by such easements do. The only private

transactions for easements are typically for a closed market of adjacent property owners such as easements appurtenant. However, this does not necessarily make an easement a non-market property right. A proof of this is that property owners often create easements on deeds or tract maps when they sell their lands. To appraise the "easement" rather than the whole property is a technical misnomer, and is to commit a gross error in determining the "larger parcel." For such reasons, purchases of easements by public entities on a contrived percentage of value basis almost always cannot be used for comparison purposes, especially in court.

- Where possible, compare sales of whole properties similarly burdened by subsurface easements with those not so burdened (the Direct Method). Because the land adjacent to the property being appraised may not have sold or may be incomparable as to zoning, topography, etc., the search for comparable sales should be widened geographically. Some subsurface easements retain the right of surface entry, and others do not. Make sure the comparable sale properties are similarly burdened.

- Where sales of properties with and without similar easements are not available or discoverable, make a proxy study of the percentage of value difference between properties with dissimilar zoning or buyer motivations that reflect a similar loss in use to that created by an easement (The Indirect Method).

Appraisals of subsurface easements can be difficult because the extent of the surface rights, which remain after the taking, may vary from negligible, to tantamount, to total. One back-up method, which may be useful in appraising subsurface easements where the property owner still retains some uses over the ground surface, is to assume a full diminution in value for the area affected by the easement and then find sales of marginal use land (farming, open space, storage, parking), to indicate the value remaining after the taking. Consultation with legal counsel is recommended, however, before using this supplemental approach in a litigation.

- In valuing near-surface or semi-deep easements, check with the zoning officials to determine if the area above a subsurface easement still counts for development density purposes.

- Check the proposed easement deed to ascertain the all-important effect on value of the remainder parcel as to the following:

- Right of surface entry
- Burden of relocation
- Access rights across surface area above an underground easement
- Drainage and air rights across surface area affected by subsurface easement
- Inventory remaining rights, if any, left to the property owner over the subsurface easement (ground lease, farming, storage)

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- Determine which easement interest will have the continuing burden of maintenance of the surface area (dominant or servient tenement).

• If a very deep underground easement is to be acquired, with no interruption of surface or near-surface rights, check with local lending institutions and title insurance companies to ascertain if properties burdened with such easements are financeable and title is marketable. For analytic purposes, hypothesize what the value impact would be to above-ground properties if a deep tunnel easement was abandoned and quitclaimed back to the overlying owner.

• In assessing damages to the remainder as a result of a subsurface easement taking where surface rights are retained by the owner, ascertain if the placement of buildings or structures over the affected area will entail any special construction techniques (concrete spans, piers).

• Estimating the loss in value to a property created by the imposition of a subsurface easement by the State Rule (Value of Take Plus Damages Rule), as opposed to the Federal Rule (before-after-rule), does not excuse an appraiser from studying and estimating the value impact of an easement on the whole property. Merely adding up a subjectively estimated lost percentage of property value for the easement area taken and any damages, as the state rule misimplies, does not conform to appraisal standards and will often lead to the dangerous error of double compensation. This error may be exposed upon cross examination if the valuation is litigated in a court of law. The misconceived "summation mindset" of the state rule often can result in misleading values.

• If the proposed easement acquisition is minor and peripheral to the property, an appraiser may possibly use short-cut appraisal methods to save costs, provided the appraiser discloses this departure from professional standards in their appraisal. The only exception to using standard "before-and-after" methods to appraising easements is if a public agency adopts a compensation policy for their acquisition under the Jurisdictional Exception

to appraisal standards. Even so, it is doubtful this compensation can be used for appraisal of other easements or for litigation purposes.

• Appraising the market value of a subsurface taking where the right of surface entry is also acquired, such as a

tion could arise if the entity acquiring an underground easement with reserved surface access allows nonintensive improvements such as streets, parking and landscaping to be placed atop of the right of way. Diligent appraisers should verify if nonintensive

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pipeline, can be more complex than is readily apparent. Depending on the physical and legal circumstances, the larger parcel may suffer no probable actual loss in use or density upon future build-out of the land. This situa-

uses are permitted over subsurface utility structures within the easement, and who has the burden of relocation/restoration of such surface improvements if the right of surface entry to repair or replace the underground

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facilities needs to be exercised. The fact that there may be "no probable net loss" in density to a parcel of land due to a subsurface taking may explain the mystery of why "paired sales" comparisons of lands with and without such easements sometimes may result in no conclusive finding that might have indicated a difference in value. And the frequently reported irrational reaction by property owners to the acquisition of a subsurface easement (hysteria, fears and prejudices against the project) may be better understood as resulting from appraisers' use of overly subjective, contrived valuation methods that fail to adequately communicate and support the basis of an estimated loss with comparable sales data and a land engineering study. This failure to meaningfully research and communicate the basis of the probable loss caused by an easement may result in unsuccessful negotiations, needless up-front legal settlements or unnecessary litigation.

A problem with properly conducting easement appraisals is that the resulting valuations may often be considered by public agencies as "politically incorrect." Because subjective-based appraisals (trust-me appraisals) are most often used, empirical support for their conclusions can't be made to convince a property owner, attorney, reviewer or arbitrator one way or another. Public entities with "deep pockets" of resources often don't want to offer a property owner a small amount of consideration for an underground easement that nonetheless encompasses a seemingly large surface area for access but does not substantially change the highest use of the property. In such situations, where the valuation and damages are ambiguous, public agency staff are prone to want an appraiser to invent extra amounts of compensation for expediency reasons. Thus, "science fiction" appraisals of underground easements abound. Low bid appraisal policies and the eagerness of agency counsel for settlements often militate against correctly employing recognized methods and techniques required by appraisal standards and case law. This inconsistency between law and standards on one hand, and appraisal customs and agency policies on the other hand, may lead to an unnecessary amount of "appraiser bashing," "fishing" for second-opinion appraisals, and other actions intended to influence the outcome of what is often viewed by non-appraisers as entirely subjective, unprovable appraisals anyway. A possible way out of this dilemma is to obtain proper easement appraisals in the first place. In so doing, agencies will avoid using overly subjective appraisals that are difficult to use for negotiations (unless they over-appraise the value of the easement) and, which are often viewed by legal counsel as indefensible.

End of the Tunnel

One might learn as much about appraising underground easements from watching late night movie reruns as using subjective percentage methods to appraising easements sometimes inappropriately advocated for under the alternate "just and equitable" definition of Fair Market Value. There is no substitute for an in-depth appraisal (Deep Appraisal) for large scale underground easements without departing from professional standards and prevailing case law. Appraisers' misuse

of relevant law and over-reliance on totally subjective methods in appraising underground easements, once exposed to the light of scrutiny, are likely to eventually provoke criticism from their clients similar to that stated by Mark Twain on such subterranean matters:

"He is useless on top of the ground; he ought to be under it, inspiring the cabbages."—Mark Twain, in Puddin'-head Wilson's Calendar. □

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3. Flat price. A price established by an authoritative order or arbitrary opinion.

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