

How Far Away Can a Comparable Sale Be?

by Donald C. Wilson and Craig D. Hungerford

In the appraisal of environmentally significant real estate (ESRE), debate exists over how far away a comparable sale can be from a subject property and still be a valid comparable sale.

Though relevant to the appraisal of all types of property, the question arises repeatedly in the appraisal of ESRE put to economic preservation use for at least three reasons:

1. Many appraisers are still relatively new to the appraisal of ESRE and rightly question all the traditional valuation assumptions being applied to it.
2. Observed sales of ESRE properties put to comparable economic preservation use are often fewer in number, and located farther apart, than appraisers are used to observing in certain other classes of highest and best use (e.g., single family homes) and
3. Buyers of ESRE properties put to economic preservation use often choose and substitute among properties located farther apart than do buyers of certain other classes of highest and best use (e.g., single family homes again). For instance, government agencies and land trusts sometimes make regional purchasing choices between properties.¹

Logically, these three factors lead prudent appraisers to question whether or not the wide area of purchasing choice constitutes buyers participating in several segmented sub-

markets, or buyers participating in a single unsegmented market? The experience of the authors indicates that some markets are regional and some are more localized, depending on the property and on the buyers participating.

Less logically, these factors lead some appraisers (and many government agencies) to assume that a comparable sale for a subject property being purchased for economic preservation use of ESRE ought necessarily to come from a pool of sales as near the subject as possible, regardless of whether these properties were purchased for the same or different uses than the subject.

A HYPOTHETICAL EXAMPLE

As a hypothetical example, let us take a canyon in the grasslands of Colorado with geographical, biological, archaeological, paleontological, and recreational significance. This canyon controls key access into and out of a national grassland preserve. The federal government wants to buy it to preserve its significance and to include it in an adjacent national grassland preserve, but wants to pay based on what has been paid for grassland in the same county, not for what has been paid for properties with similar significance put to similar use elsewhere in Colorado.

The landowner views grazing as less than the highest and best use. Since the federal government wants to buy the land for economic preservation use through a negotiated purchase and does not threaten to condemn his property if negotiations fail, the landowner reasons that economic preservation use must be its highest and best use. In support of his conclusion, the landowner has investigated and found that land trusts, agencies at several levels of government, resource companies, a few development companies, and wealthy celebrities have been involved in transacting environmentally significant properties for economic preservation use for several years in Colorado. Furthermore, prices paid for these environmentally significant properties bring two to 10 times the prices paid for grassland being offered the landowner by the Federal government for his canyon property.

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The landowner retains an appraiser to survey the market for ESRE properties and discovers a half-dozen properties purchased for identical economic preservation use and having similar attributes—four in Colorado and two in Utah. The appraiser adjusts these properties for locational and other differences, (including differing land value gradients in differing regions. Since all the properties are located in thinly populated, remote, arid regions, they are actually found to vary relatively little), Using distance from subject and similarity of location as significant criteria, three properties in Colorado are judged the most similar to the subject. The value

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estimate arrived at, based on a highest and best use determination of economic preservation use of ESRE is \$3x per acre. In contrast, the federal government is offering \$1x per acre based on a highest and best use determination of grazing land using comparable sales of grazing land located within the county.

The federal government's review appraiser rejects the validity of the landowner's appraisal on the grounds that the sales are not comparable. He says that they are too far away from the subject of be valid. The landowner's appraiser reasons that given the economic preservation use, he did rely on the nearest comparable sales. He reminds the review appraiser that the federal government is making a negotiated purchase, not a condemnation acquisition, so there is no project influence to consider; and even if project influence were a factor, the highest and best use of the property prior to project influence

would still be economic preservation use. He has the market transactions to prove the property would be more valuable for preservation use than for grazing use. The review appraiser is unmoved. The comparable sales, he insists, are too far away to be comparable.

This illustrates the question in the title of this article: how far away can a comparable sale be? As the example implies, at least two schools of thought exist on how to answer it.

TWO SCHOOLS OF THOUGHT

The first school, referred to here as the use irrelevant school, reasons that comparable sales for an ESRE property being acquired through negotiated purchase for economic preservation use should be as close to the subject property as possible, based on whatever use is nearest and most similar. The use irrelevant point of view leads to the absurdity of using nearby comparable sales purchased for grazing, farming, or commercial development, as substitution alternatives for a subject parcel being put to economic preservation use. The use irrelevant point of view is untenable, because the principle of substitution logically requires that properties with the same, or at least the most similar, highest and best use be relied on for purposes of valid deduction of price and value. In the case of economic preservation use of ESRE, other purchases of ESRE put to economic preservation use are typically available, so ignoring them and relying on sales with less similar highest and best uses would probably lead to less precise deductive inferences under the principle of substitution. Unfortunately, many appraisers and government agencies act in accord with the use irrelevant school of thought.²

The second school of thought, referred to here as the use dependent school, reasons that the highest and best use of a subject property (i.e., economic preservation use) is crucial to determining the comparability of a sale. The logic of this school goes something like this: one would not use an office building sale (purchased for use as an office building, and located across the street from a shopping center) to appraise a shopping center, simply because it was close and recent. One would seek out the most comparable shopping center sale, regardless of how far away one had to look.³ In part, one does this to compare apples and apples, and in part because one knows that buyers of

shopping centers often choose among widely dispersed properties when making a purchase decision. The use dependent school reasons that circumstances are often essentially the same with purchasers of ESRE as with purchasers of shopping centers or other property types. Purchasers are often able to choose and substitute among many properties when buying, and the properties are often widely dispersed spatially.

Therefore, the use dependent school asserts that if ESRE buyers operate in and choose among ESRE properties dispersed over a wide area, then the most similar properties with the most similar highest and best uses in that wide area are comparable properties, and the ones with the most similar locational attributes are apt to be among the most comparable of sales. Alternatively, if ESRE buyers operate in and choose among narrowly dispersed properties, then the most similar ESRE properties with the most similar highest and best uses in that narrowly dispersed area are valid comparables, and the properties with the most similar locational characteristics within that narrow area are apt to be among the most comparable of sales.

Locational similarity, not lineal distance, is a key criterion in the use dependent school of thought. Lineal distance may well be a significant factor in determining locational similarity, but it is not the only one. And the use of a property certainly predicated the delineation of the market area from which comparable sales may be drawn. If one thinks for a moment, it is mind boggling to conceive a market area for a use different than the highest and best use of the subject property—but that is precisely what the logic of the use irrelevant school requires.

To conclude this section, the use dependent school of thought is consistent with traditional valuation method's reliance on comparing apples with apples, based on the principle of substitution. In contradistinction, the use irrelevant school of thought is inconsistent with the principle of substitution. In fact, it baldly contradicts valuation tradition by encouraging comparison of properties with unlike uses, i.e., it encourages comparison of apples and oranges. Under the use irrelevant school, one might actually try to justify using the recent sale of an office building across the street from a shopping center as a comparable sale for a shopping center, or recently purchased grazing land adjacent to a

canyon property as a comparable sale for a canyon property being purchased for economic preservation use.

WHAT THE FOUR INSTITUTIONAL CORNERSTONES OF APPRAISAL SAY ABOUT THE DISTANCE OF COMPARABLES SALES FROM THE SUBJECT

Nevertheless, because the seemingly more logical and traditional use dependent school meets resistance from some appraisers and public agencies, the authors investigated the Uniform Standards of Professional Appraisal Practice (USPAP), the Financial Institutions Reform and Recovery Act (FIRREA), the Uniform Appraisal Standards for Federal Land Acquisitions (UASFLA), and The Appraisal of Real Estate—the four institutional cornerstones of appraisal—to learn if there were any institutional constraints determining how far was too far for a comparable sale to be from a subject property. Such a constraint might explain the resistance to the traditional use dependent school of thought and the adherence to the seemingly absurd position of the use irrelevant school.

HOW FAR IS TOO FAR?

Significantly, investigation finds that not one of these institutions specifies how far from a subject property is too far for a comparable sale to be (either for an ESRE property put to economic preservation use or any other class of property and use). To the contrary, these institutions suggest that for any given highest and best use, the comparability of a sale is a function of many factors—distance being but one of them. And to reiterate, no linear distance is ever specified as singularly disqualifying a sale for use as a comparable sale in an analysis based on the principle of substitution.

MUST THE NEAREST SALES REGARDLESS OF HIGHEST AND BEST USE BE RELIED UPON?

Since the four institutional cornerstones of appraisal offered no constraint concerning distance that would render the logic of the use dependent school invalid, the authors next investigated the same four institutions to determine if there were an institutional constraint that required use of the nearest sales for purposes of comparison without regard to the intended use of the

purchaser. Such an institutional constraint might explain the embrace of the use irrelevant school of thought.

Review found no such requirement.

To the contrary, these four institutions suggest appraisers ought to determine the highest and best use of a subject property and then seek comparable sales purchased for the same highest and best use, when possible, to estimate the market value of a subject. They all suggest this because they are all based on the same fundamental logical principle of deductive reasoning in appraisal—the principle of substitution. This principle requires that appraisers seek out the sales which are most similar to a subject property to simulate the substitution decision a probable buyer makes.

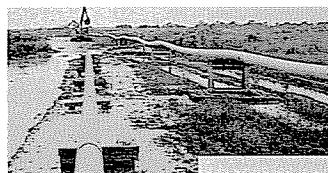
To return to the hypothetical example presented earlier, since it is highly unlikely that buyers seeking ESRE for economic preservation use would substitute grazing land (or farm land, or shopping center land, or office building land, etc.) for the canyon property in the earlier hypothetical example, it would be logically inconsistent with the principle of substitution to substitute grazing land sales to appraise the canyon.

In the hypothetical example, sales of properties with more similar highest and best uses are available and should be relied upon.

A CAVEAT ON THESE FINDINGS

The authors are not lawyers and are not capable of giving a legally binding and transactionally certain answer to the question of how far a comparable sale can be from a subject property in the case of ESRE properties. The reader will have to consult with legal counsel, representatives of transacting agencies, and political representatives to make a determination for themselves.

And just as clearly, the authors may have missed or accidentally misinterpreted an institutional constraint regarding the acceptable distance of a comparable sale in the four institutional cornerstones. The four institutional cornerstones are detailed and, as with many written institutions, they are sometimes vaguely or ambiguously worded. In the spirit of professionalism and in the interest of clarifying and advancing this debate, the authors would appreciate readers relaying any citations specifying the acceptable distance of comparables from subjects that may have been missed or mistakenly interpreted. To be feasible,



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appraisal judgements about the acceptable distance of comparable sales from subject properties must conform with the constraints of these institutional cornerstones.

Nevertheless, a good faith effort has been made by the authors to research, analyze and interpret these documents and the preceding discussion relates the essential findings and conclusions.

CONCLUSION

Recognizing the above caveat, the authors' research and analysis suggests the following:

1. The lineal distance a comparable sale can be from a subject property is not explicitly defined in the four institutions of appraisal reviewed.

2. The lineal distance a comparable sale can be from a subject property is logically a function of the market area within which buyers might consider substitution of other properties to meet selection criteria.

3. Lineal distance itself is a partial and imperfect indicator of comparability, because comparability is often not linearly related to distance.

4. About all one can reasonably say about lineal distance as a factor in determining comparability of sales is that if all the sales being considered are quite similar in use and attributes, if buyers would probably consider substituting any of them, and if locational characteristics grow increasingly and linearly different from the subject property in every direction throughout the market area, then one would prefer the closer sale for purposes of comparison.

5. The highest and best use of a subject property significantly determines where the appraiser must look for the comparable sale. If the only sales with similar highest and best uses and similar attributes that buyers would substitute were far away, then these distant properties would be valid sales for comparable sales analysis: conversely, if the only sales with similar highest and best uses and similar attributes that buyers would substitute were near, then these nearby sales would be valid for comparable sales analysis.

6. Therefore, appraisers and government agencies that suggest sales of ESRE put to economic preservation use are invalid comparable sales because such sales are

too far away, and that recommend using closer sales with different highest and best uses from the subject, are acting inconsistently with traditional valuation logic and the four institutional cornerstones of appraisal.

In lieu of an explicit institutional standard of how far is too far,⁴ perhaps the best answer to the question of this discussion is this: a comparable sale can be as far away as buyers have been willing to go to substitute a similar property for the use they intend on the subject property. For this reason, highest and best use is ultimately a crucial determinant in how far away a comparable sale can be from a subject. For this reason, too, the use irrelevant school is untenable and the use dependent school is on sound logical and institutional footing. □

NOTES

¹Some land trusts make national or even international purchasing choices such as economic preservation of the rain forests of one state vs. another.

²Space does not allow the authors to present their thesis on the reasons for this behavior. Future articles will attempt to clarify this seemingly irrational position, should a need arise.

³The same holds true for many types of property. For example, recently in Madison, Wis., a national insurance company was contesting the assessed value of their corporate headquarters. In response, the assessor's office retained an MAI appraiser who concluded the market area for similar properties was not local but multi-regional. As a result, he relied on sales from Illinois, Colorado, and North Carolina.

⁴It should also be pointed out here that trying to establish such a standard would probably introduce significant pricing inefficiency in markets. Imagine the distortion in appraised value that would occur if the appraiser had to appraise a shopping center based on the prices of surrounding single family home sales, rather than on other shopping centers much farther away.

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