

# Appraising Temporary Physical Easements: Eliminating the Guesswork

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## STATEMENT OF THE PROBLEM

*Guess* - To form an opinion from little or no evidence.

*Webster's Dictionary, Ninth Edition.*

**T**emporary physical easements are necessary when more space is needed to construct a public improvement than will be needed to operate and maintain it after construction. Examples are temporary construction strip easements, construction staging areas, road access easements, tunnel adits and so on. Most temporary physical easements are partial acquisitions but may entail full acquisitions as well.

What form of compensation is appropriate for the public "taking" of a temporary physical easement? Because there are only vague compensation guidelines in literature and because each temporary easement appraisal is unique, one cannot give a concise and complete answer. What has resulted is a nearly universal practice of appraisal based on improvised approaches and rule-of-thumb methods that do not clearly reflect or convey the fair market value of the temporary property rights acquired.

This state of confusion is so pervasive that relevant market data is virtually ignored in favor of ad hoc compensation. One cannot consider sales data from public entities because their temporary easement acquisitions are usually forced

transactions. Likewise, basing compensation for temporary physical easements on ground rental rates of return required by public agencies or large monopoly property owners for their land holdings typically does not meet the "willing buyer-willing seller" evidentiary tests of market value under eminent domain law. Nor does prevailing law allow for compensation of property owners for temporary construction easements based on the need or demand created by the public project for temporary industrial usage of land.

Nor is there much information in literature about how to appraise temporary physical easements. Although legal statutes and case law provide some guidance, legally credible appraisals methods are needed.

In the December, 1986 issue of *Right of Way* magazine, Dwight Pattison, SR/WA, lists eight approaches to the valuation of temporary construction easements:

1. Full fee
2. Rate of return on land
3. Normal rent
4. Capitalized rent loss
5. Percent of fee value
6. Lump sum
7. No payment
8. Special benefit

In the hands of an inexperienced appraiser this very helpful list of various appraisal methods might be misused as a "grab bag" of approaches. Not knowing what method to apply and the problem of projecting damages over the duration of the easement may often lead to valuations that resemble "guesstimates" more than they do supported appraisals.

Guesstimates not only can do a disservice to one side of a real estate acquisition or another, they can deteriorate into a costly game of

appraisal "one-upmanship" and legal advocacy. Appraisers need not so much rule-of-thumb appraisal methods or an inventory of methods—they need some accepted reasons for the selection of one appraisal method over another.

What Gideon Kanner has stated, quoting the Arizona Supreme Court on the related matter of temporary regulatory easements, may apply equally to the appraisal of temporary physical easements:

"Each of these damage measures works well in some 'takings' cases and inequitably, if at all, in others. This is because no one rule adequately fits each of the many factual situations that may be present in a particular case. Such problems as: whether the losses are speculative; when the taking actually occurred; whether it caused any damage; ... combine to make each measure of damages a 'guessing game' between too little compensation on one hand and a windfall on the other."<sup>1</sup>

This quote is somewhat accurate in describing the current state of the craft of appraising temporary easements.

## ANALYSIS OF THE PROBLEM

A review conducted by this writer, found common errors and deficiencies in appraisals of 35 temporary easement parcels. The public project consisted of a six-mile long major regional pipeline, comprising approximately 75 acres of temporary construction easements in mostly vacant lands, with a total estimated valuation of approximately \$1 million. Eight independent appraisers were used on the project and each parcel was valued by two appraisers.

**FIGURE 1.**

Common Errors and Deficiencies Found in a Sample of Temporary Easement Appraisals (N = 70 temporary easement parcels)

Errors:	Percent:	No. of Parcels
Failed to specify legal interest taken:	100%	70
Failed to justify appraisal method used:	100%	70
Failed to report change to highest use, if any	100%	70
Failed to collect/verify interest rate market data	60%	42
Failed to use market data from voluntary sales	60%	42
Failed to do before and after study of reported value loss	51%	36
Failed to discount lost rents to present worth for 2.5 years	51%	36

The most critical deficiencies found in the appraisals are shown in Figure 1.

Further, there was no consensus among appraisers as to what kind of value was lost from the taking or what land rate of return to apply to the imputed loss caused by the temporary taking. The market data, which was collected and applied to each parcel valuation, gave the impression of a forced appraisal analysis, as shown in Figure 2.

More often than not, inappropriate data is used to estimate the market value of the loss sustained by the taking of a temporary easement. What needs to be analyzed, supported and communicated is the connection between the property interest taken and how this translates into the fair market value of the type of value loss caused by the taking.

This lack of connection between the analysis and value conclusion leaves agency review appraisers guessing as to the basis of the value opinion. Inconsistent appraisals of easements typically do not result from any impropriety or lack of data—they originate from expedience, "unthinking" and forced analysis, non-communication of the basis of the value opinion, and misconceptions of the appraisal problem.

#### PROBLEM CONCEPTION

At the core of the difficulties found in appraisals of temporary easements is a set of misconceptions as to how to define the appraisal problem. If the valuation problem is undefined or inappropriately defined at the outset, it is more likely than not that the reported conclusion of value may be misleading.

One of the reasons for the misconception of the appraisal problem is that, technically speaking, market value is not the proper measure of compensation, since temporary easements are not often bought and sold in the private real estate market. As Gideon Kanner has aptly written: "...it is important to keep in mind that the U.S. Supreme Court ... has refused to make a fetish even of market value, since it may not be the best measure of value in some cases."<sup>2</sup>

The proper valuation question to be answered in appraising temporary easements is:

**The Correct Definition of the Problem;** "What reasonably probable loss will the owner sustain?"

Given that the strict definition of market value does not fit the situations presented in the appraisal of temporary easements, it is not unusual to find appraisers devising

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**FIGURE 2**

Market Data used for Indicating Rate of Return on Land in a Sample of Temporary Easement Appraisals (N = 70 Temporary Easement Parcels)

Market Data used for Rate of Return on Land:	Applied to:	Resulting Implied Value Loss:	No. Parcels (percent)
Interim industrial ground leases	Vacant ind. land	Fair market rental	22 (31.4%)
Public agency going rates for temporary easements	Submarginal raw land	Special use or limited market value	18 (25.7%)
Nonverified ground leases of publicly owned finished commercial lands	Raw residential private land	Noncomparable rental rate of return	18 (25.7%)
Interim industrial ground leases	Commercial raw land	Noncomparable rental rate of return	6 (8.6%)
Interest rates on construction loans	Debt free land pending lease	Loan value or investment value	6 (8.6%)

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their own idiosyncratic definitions of the appraisal problem. Examples of this "Tower of Babel" of legally and economically incorrect definitions of the appraisal problem are:

### Some Often Found Misconceptions of the Problem;

1. "What do other public agencies pay for temporary easements?"
2. "What can the owner charge for temporary industrial usage of his land?"
3. "What do public agencies charge for secondary use of their own (often noncomparable) lands?"
4. "What return on investment does the owner require for temporary use of his property?"
5. "What are the carrying costs (loan, taxes and insurance) that the owner must bear while holding the property for the public benefit?" (This question might be appropriate only in those infrequent instances where the lost marketable property interest corresponds with the owner's investment loss.)
6. "What is the market value of a temporary easement?"

It is often misassumed that the appraisal of temporary physical easements falls under the legal statutes which exempt properties "for which there is no relevant market" from strict adherence to the definition of fair market value. Such exemptions typically specify that use of "any method of valuation that is just and equitable," for nonmarket properties is acceptable. However, recent case law indicates that such exemptions are aimed at valuing "special purpose properties" such as schools, churches and cemeteries and not partial and fractional property acquisitions (Redevelopment Agency vs. Tobriner [Cal. App.] 264 Cal. Rptr. 481, 1990).

Such misconceptions can have dire financial consequences.

### MAGNITUDE OF THE PROBLEM

Appraisal theory and practice

suggest that the standard three approaches for valuation of full-fee title interests in property (costs, comparison and income approaches), in stable markets, tend to converge toward a similar-point estimate of value. This is not usually the conclusion of value indicated by the many methods for valuing temporary easements.

Take a hypothetical example of the eight methods of appraising a temporary physical taking reported earlier and applied to a two-year construction easement comprising two acres out of a 40-acre farm tract. The unit value of the property was reported to be \$2.50 per square foot or \$108,900 per acre. Application of the eight methods described in this article resulted in the following, widely varying value conclusions shown in Figure 3.

As indicated from Figure 3, the selection of a method to value a temporary easement can result in substantial variances in monetary awards for their acquisition. However, there is little in the way of guidance as to when and where these different methods apply.

Eminent domain law typically requires adherence to the "highest price" definitions of market value. However, selecting an inappropriate form of compensation that automatically assumes that the highest form of compensation is owed a property

owner in all circumstances may be misleading in valuing temporary easements. It is little wonder, with the wide spread in values and the uncertainty as to when each different method might apply, that a "wind-fall" or "wipe out" phenomenon is often found in the appraisal of temporary physical easements.

The valuation inconsistencies may be of little consequence to small-scale public improvement projects. In fact, administrative compensation may be desirable in small-scale projects in order to facilitate voluntary settlements. However, the use of non-market or pseudo-market based methods for valuation of temporary physical easements can have an enormous financial bearing on large-scale public improvement projects. This can be further demonstrated by comparing two of the most frequently used appraisal methods for valuing temporary physical easements: the lost rent method and the ad hoc percentage of fee method.

For example, a one-year temporary construction easement, comprising 533 acres, required to enlarge a 22-mile long existing water canal. The taking consisted of dual 100-foot wide construction easement strips in large farm tracts of land. The market was characterized by a two-tiered use of land for interim farming and for speculative investment. Two separate appraisers conducted their valuations

**FIGURE 3**

Hypothetical Magnitude of Value Difference Between Various Appraisal Methods: Temporary Construction Easement

Method:	Value Indicated:	Percent Fee Value:	Mean Value:	Standard Deviation:
Full 100% of fee value	\$217,800	100%	\$37,026	\$84,342
Rate of return on land	\$52,300	24%	—	—
Percentage of fee value	\$21,780	10%	—	—
Administrative lump sum	\$5,000	2.3%	—	—
Normal rent	\$1,200	.5%	—	—
Capitalized rent loss	\$1,014	.5%	—	—
No payment	\$0	0%	—	—
Special benefits	-\$40,000	-18.4%	—	—

of the temporary easements and used different methods as oversimplified, as shown in Figure 4.

Despite the unacceptable spread between these two appraisals, the current state of appraisal practice apparently sees them as corresponding indicators of value. Read on to find out why.

**FIGURE 4**

**Comparison of Two Often Used Appraisal Methods**

Method:	Lost Rights:	Acres:	Data & Analysis:	Value of Take:
Lost rent	Possessory	533	Rents @ \$250/yr	\$133,250
Percent of fee	Beneficial	533	Sales @ \$20,000 x 10% Spread:	\$1,066,000
			Percent Spread:	\$922,750
				700%

**PREVAILING RULE**

The appraisal rule which most often determines which method applies to the valuation of temporary construction easements is as stated by Eaton:

"Compensation for temporary easements is usually based on the economic rent of the affected area for the term of the temporary easement; in the absence of rental data, the appropriate rate of return on the land for the term of the easement for losing the beneficial interest in the property is estimated."<sup>3</sup>

While the above rule is generally useful in many situations, it requires substantial revision and expansion to prevent it from being misinterpreted and misused. It is not so much the non-availability of data that determines which method is selected to value temporary easements, as the Eaton rule may be mistaken to indicate, as much as it is the extent and nature of the taking.

Neither are the methods of compensation for temporary easements as interchangeable as the Eaton rule may imply. Shifting from one method of compensation to another often is legally and conceptually inconsistent and lacks economic logic since the

magnitude of value difference between them may vary greatly.

What is missing from the informal, rule-of-thumb appraisal is recognition that there is a gradation of legal interests in real estate which may be lost due to a taking. Borrowing from Pattison's list of differing methods to valuing temporary construction

easements cited earlier, an implication is that they form a continuum of loss from total to nominal. Nichols' *The Law of Eminent Domain* suggests just such a continuum:

"When real property is taken by eminent domain to be devoted to the use of the condemnor for a temporary period only, it is well settled that the condemnee must be paid the fair market value of possession of the property for the period. Such fair market value is calculated as the difference between the fair market value of the property immediately before the taking, and the fair market value of the property after the taking. In some cases the damages have been declared to be the rental value of the property for the period of occupation. Under certain circumstances, however, the allowance of rental value may fail to constitute just compensation, such as when a greater interest has, in fact, been taken."<sup>4</sup>

Appraisers who are not experienced in valuing temporary physical easements tend to assume that all the potential legal interests in the property are temporarily taken in all cases. There is often little or no recognition that a temporary taking may involve only a loss to the interim

use of a property and may take only a fraction of the marketable property rights.

Moreover, an appraiser may fail to recognize that the real estate market places unequal value on differing fractional property rights. Appraising temporary easements is similar in one respect to appraising permanent easements: One must first determine what specified portion of the land of property rights are lost, and estimate the value the market places on acquiring the same rights.

However, appraising temporary physical easements is unlike the valuation of permanent easements in one critical aspect. When determining the legal interest taken by a temporary easement, a distinction must be made between a reasonable and probable loss of property rights and a speculative loss in rights. Unlike the appraisal of permanent easements, case law in some jurisdictions has indicated that a property owner must be in a vested legal position to exercise certain rights in near time before compensation for the conjectured temporary loss of such rights can be made. (See *Avco Community Developers v. South Coast Regional Commission*, 17C.3d 785;132 Cal.Rptr.386, 553 P., 2nd 546.)

This distinction does not occur in the appraisal of permanent easements, since it is safe to assume that such takings involve the loss of specified rights to a property in perpetuity. Appraisers need to be aware of the fine line between an estimate of a likely hypothetical loss of rights and the prescriptions of the law to avoid speculation in performing a real estate appraisal.

**PROPOSED RULES**

In order to bring about credible appraisals of temporary physical easements, the following general guidelines are proposed:

**Defined Valuation Problem:**

"What reasonably probable loss

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will the property owner sustain from the taking of a temporary physical easement?"

### Appraisal Principle:

The Principle of Proportional Loss. The compensation afforded for a temporary physical easement taking should reflect the value that the market places on the proportional property interests lost by the owner.

### Standard Rules:

Match the reasonably probable interests lost by the owner due to the temporary physical taking with the valuation method which most nearly duplicates the actions of the market to obtain those specified property interests. In reporting the results of a real estate appraisal of a temporary physical taking, an appraiser must communicate the data, analysis and conclusion in a consistent manner that indicates the connection between the property interest taken and how this represents the fair market value of the type of value loss estimated to be caused to the property (investment value, loan value, rental value, leasehold value, special use value, etc.).

### Evidence Rule:

Losses must be shown by demonstrated evidence and with reasonable certainty.

### Economic Rule:

The rate of return on land for differing fractional property interests in varying classes of land has a non-constant relationship to the underlying value of the fee simple estate. (Or, 10 percent is not a constant rate of return for all property rights in all classes of land!)

### Spatial and Temporal Rules:

The longer the period of the temporary easement and the larger the usable area encumbered, the more the likelihood of a greater property interest being taken.

### Practice Rules:

(1.1) The basis of recovery for temporary physical easement takings, exclusive of any damages, which

result in the loss of the possessory interest in economically undivided property, is either:

(A) The fair market rent return for the affected area for the term of the easement where ground rents are found to be related to land value; or

(B) Direct gross rent where there is no relationship between lost rent and land value in the marketplace.

In the absence of a rental market, the appropriate rental rate of return or direct rent loss from land improvement leases (step-up leases, rent concession leases) or leases for holding uses of the land (agricultural leases) should be considered as appropriate.

Where possessory interest in economically divided property is lost, an allocation is typically called for of lost rent to the leased fee estate and damages to the leasehold estate, unless lease provisions specify otherwise.

(1.2) Where a temporary easement is proven to interfere with the greater equitable interests of a property, the basis of recovery is:

(A) The appropriate percentage of the market opportunity costs on the fee value of the land, plus a prorata share of real estate taxes on the land, where the salability of a property is lost.

(B) The appropriate percentage of the market carrying costs on the land should be estimated where the vested developability of a property is lost.

(1.3) Where the purpose for which the property right to be acquired is tantamount to the highest use of the property, the full fee value of the property should be estimated.

(1.4) Where the loss caused to the property reflects a reserved or minor property interest which the market recognizes as having only negligible value, the property should be valued accordingly and/or consultation with the public agency should be made regarding their policy as to any administrative lump sum compensation.

(1.5) If the remainder property

receives benefits in the reasonably foreseeable future due to the construction of the public improvement, the appraiser should seek legal counsel as to how to consider these benefits in various jurisdictions.

### Discount Rules:

Discount the estimated compensation for the temporary physical taking to a present worth estimate to reflect the payment period recognized in the real estate market for the anticipated future lost income stream. The discount rate for any lost rental income from vacant land for which there is no active market should reflect some adjustment for uncertainty and risk.

### RECAP

You cannot reduce the appraisal of temporary physical easements to a neat set of formulas or rules. However, "there ought to be a law," or at least some better rules, to guide appraisers in the valuation of temporary physical easements. With the lack of accepted appraisal guidelines noted in this article, one need not guess why there is a prevailing practice of using contrived rules for valuing temporary easements. (IRWA)

### References

- 1 Gideon Kanner, "Measure of Damages in Non-Physical Inverse Condemnation Cases," *Inverse Condemnation and Related Government Liability*, American Law Institute, ABA, 1989, p. 22.
- 2 Gideon Kanner, "Measure of Damages in Non-Physical Inverse Condemnation Cases," *Inverse Condemnation and Related Government Liability*, American Law Institute, ABA, 1989, p. 10.
- 3 J.D. Eaton, "Real Estate Valuation in Litigation," *AIREA*, 1982, p. 195-196.
- 4 Julius L. Sackman, *Nichol's The Law of Eminent Domain*, rev. ed., New York: Matthew Bender, 1989, p. 12E, 1-4.