

Economic Preservation Use— Is it Highest and Best Use?

INTERPRETING THE LATEST
INTERAGENCY LAND ACQUISITION CONFERENCE POSITION PAPER

by Donald C. Wilson and Craig D. Hungerford



Appraisers of environmentally significant real estate (ESRE) put to preservation use recently received some more useful institutional clarification about how *not* to value such property.

On April 14, 1995, the Interagency Land Acquisitions Conference (ILAC) issued a position paper that said in part:

"...a non-economic highest and best use is not a proper basis for the estimate of market value and, accordingly, that a highest and best use of conservation, preservation, or other use that requires the property to be withheld from economic production in perpetuity, is not a valid use upon which to estimate market value. Such an estimate is, therefore, not in conformance with the Uniform Appraisal Standards for Federal Land Acquisitions."¹

The authors applaud ILAC's articulation of what not to do, and in the spirit of professional cooperation, seek to interpret what the negative declaration may imply appraisers can do re-

sponsibly to estimate the market value of ESRE put to preservation use. But first, some clarification of ILAC is helpful.

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Who Is the Interagency Land Acquisition Conference, and Why Do Their Position Papers Matter?

ILAC describes itself as:

"...an organization composed of representatives of Federal agencies engaged in the acquisition of real estate for public uses. The Conference [ILAC] was established on November 27, 1968, by invitations issued by the Attorney General."²

It is nothing if not an exclusive organization.

ILAC goes on to say:

"The Conference conducts its business by ad hoc committee called into session as land acquisition issues arise that affect the federal land acquiring agencies. For example, when the Freedom of Information Act (FOIA) was enacted, the Conference was called into session and developed a position paper regarding the release of government appraisal reports under FOIA.³ The Conference was also responsible for the development of the Uniform Appraisal Standards for Federal Land Acquisitions published in 1972, as well as the 1973 and 1992⁴ revi-

sions thereof, which establish guidelines for appraisals prepared for federal land acquisition. When the subject under Conference consideration is valuation, as here, the agencies are generally represented on the Conference by their Chief Appraisers."⁵

In essence, ILAC interprets the operational implications of alterations of certain institutions for federal agencies (such as occurred with the passage of the FOIA), much as the authors are trying to interpret ILAC's alteration of the appraisal institution for appraisers. ILAC also sometimes makes up⁶ institutions such as the Uniform Appraisal Standards for Federal Land Acquisitions (UASFLA). In the case of UASFLA, these made-up institutions sometimes even claim to supersede legislated standards like USPAP and FIRREA, in some cases.

Agencies represented include: U.S. Department of Justice, U.S. Army Corp of Engineers, General Services Administration (FPRS), General Services Administration (PBS), Housing and Urban Development (MF), Housing and Urban Development (SF), Bureau of Land Management, U.S. Fish and Wildlife Service, U.S. Forest Service, Department of Transportation (FHWA), National Park Service, U.S. Navy, Western Area Power Administration, U.S. Postal Service, Bureau of Indian Affairs, and Bureau of Reclamation.

Hence, an ILAC position paper, regarding appraisal standards, matters because: it articulates an appraisal position that each member agency can follow based on its interpretation of ILAC's interpretation. You follow? The multi-billion dollar question, of course, is how to interpret ILAC's interpretation of an appraisal issue that has probably not yet been precisely enough legislated and litigated to require no further interpretation. What follows are the authors' interpretations of what some of ILAC's recent position paper may mean. Readers, of course, will have to consult legal counsel, relevant constituent agencies of ILAC and their elected representatives to make an informed decision for themselves.

First Interpretation: Some Preservation Uses Are Non-Economic, and Some Are Economic

Clearly, one cannot estimate market value for any "non-economic" preservation use, because, not only highest and best use analysis, as the ILAC's position paper rightly suggests, but the entire deductive method of appraisal is based on first principles of economic logic requiring an economic use for appraisal. Hence, any non-economic use violates the deductive principles of appraisal and renders the analysis logically invalid.

Contrariwise, any "economic" preservation use of ESRE would necessarily be logically consistent with the first principles of appraisal and, so, could validly be found to be a highest and best use having a market value (assuming it were found to be physically possible, legally permissible, financially viable, and capable of generating the greatest net return to the owner over time).

Clearly, many preservation uses of ESRE meet a reasonable economic use criterion. Wilson and Hungerford have previously defined an economic use criterion for real estate as 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? ... 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 and government agencies. Significant acreages are acquired for preservation use annually. 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. Economic use of environmentally significant real estate even ex-

tends 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)"⁸

Wilson and Hungerford also have noted:

"... many preservation uses of ESRE generate significant annual operating revenues and eco-tourist resort development may trigger more ... Environment has a well documented economic dimension that supports the notion of preservation use being an economic use ... [and] 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."⁹

Wilson has also articulated an exhaustive, four-criterion method for determining whether a preservation use can be a highest and best use and concludes many preservation uses of ESRE can meet these criteria.¹⁰

Therefore, since preservation use of ESRE often has the characteristics of an economic use, one must interpret the ILAC position paper to apply only to particular non-economic preservation uses. If it were to apply to economic uses also, then no property could be estimated to have a market value. After all, appraisal rests on deductive first principles of economic logic—not non-economic logic—determining choice among items valued and priced for their utility within constraints of supply and demand.¹¹

Second Interpretation: The Phrase "Withheld From Economic Production In Perpetuity" Is Probably an Irrelevant Criterion For an Economic Preservation Use

ILAC'S phrase "withheld from economic production in perpetuity," cited at the beginning of this paper, suggests that anytime an economic preservation use of ESRE, or any other economic use of real estate, for that matter, is withdrawn from economic production forever, then it cannot be determined a highest and best use, nor found to have a market value.

Whatever the logical merit of this criterion, the authors find the criterion only marginally relevant because:

1. Few if any transactions have "withheld from economic production in perpetuity" clauses written into their sales contracts and titles. No federal agencies in the authors' experience have entered into such contractual agreements. And even if federal agencies have entered into such transactions, there are also many, many transactions where they have not.

"...anytime an economic preservation use of ESRE, or any other economic use of real estate, for that matter, is withdrawn from economic production forever, then it cannot be determined a highest and best use, nor found to have a market value.

2. Even if all economic preservation uses of ESRE were transacted subject to such clauses, the authors know of no body of economic logic, or persuasive body of economic scholarship, or body of applicable law that makes certain that ESRE "withheld from economic production in perpetuity" ceases to have an economic use. It is possible, after all, that the economic use of a property could in fact be withheld from economic production in perpetuity. For instance, certain types of real estate actually gain market value when taken out of economic production, (marginal farm land placed in a subsidy program of non-production).

3. Finally, if one assumes the logic of ILAC (i.e., that ESRE sold with clauses that withhold it from economic production in perpetuity cannot have a market value, because they are non-economic), then what kind of value can ESRE have? A non-economic, non-market value? The appraisal profession will have to develop an entirely new methodology to deal with non-economic, non-market value, because, lamentably for ILAC, appraisal's first principles deal only with economic uses. It would seem that ILAC may ac-

identally be painting themselves and ESRE valuation into a methodological corner here.

It is hoped that the preceding interpretations will commence a spirited and informed debate among the several forms of organizations involved in transaction of such property, as well as among appraisers, consultants, and other professionals contributing to the process. By making clear that non-economic preservation use of ESRE can be neither a highest and best use, nor have

a market value, ILAC has, perhaps unintentionally, finally brought into focus the use of ESRE that can have a market value-economic preservation use. □

¹Lois J. Schiffer, Conference Chairperson, and William J. Kollins. "Interagency Land Acquisition Conference Position Paper: On the issue whether a non-economic highest and best use can be a proper basis for the estimate of market value" (Washington, D.C.: Interagency Land Conference, April 14, 1995), 4.

²Ibid., 1.

³One assumes the position paper encouraged release of government appraisal reports in a responsible fashion consistent with the letter and spirit of the FOIA, at least so appraisers can readily access all the comparable sales data to improve the quality of their estimates when needed.

⁴Interestingly, these standards supersede USPAP and FIRREA in certain areas.

⁵Ibid., 1.

⁶No disrespect is intended here. By this, the authors simply mean that the institutions ILAC creates are distinguishable from specific acts legislated by the Congress, such as the Financial Institutions Reform and Recovery Act.

⁷In fact, the legal definition for condemnation is in some cases considerably less stringent, refer-

ring only to use and enjoyment. However, since most of ESRE is transacted voluntarily, rather than via taking, condemnation standards have little actual bearing in many transaction circumstances.

⁸Donald C. Wilson and Craig D. Hungerford. "Public Interest Value: Toward an Analytic Understanding of the Appraisal Institute's Proposed Definition of Value for Environmentally Significant Real Estate" Right of Way (February/March 1995), 26-27.

⁹Ibid., 27.

¹⁰Donald C. Wilson. "Preservation Use of Environmentally Significant Real Estate," working paper, 1994. The criteria are: the commodity criterion, the economic use criterion, the real property rights market criterion, and the market value definition criterion.

¹¹The authors speculate the term "non-economic use" may be confused with the term "non-income producing use" by ILAC; that is, if a use does not produce income, it is "non-economic." But a single family house would certainly refute this interpretation, as well. A single family house generates no income and still has a market value.



Craig D. Hungerford



Donald C. Wilson