

Finding The Missing Piece Of The Puzzle In Appraising Temporary Physical Acquisitions

by Wayne C. Lusvardi

Wayne Lusvardi is Senior Real Estate Representative/Review Appraiser for the Right of Way & Land Division of the Metropolitan Water District of Southern California (MWD). He holds a certificate in real estate appraisal from the School of Business and Management at the University of California in Los Angeles (UCLA).

THE PIECES OF THE PUZZLE

One of the most puzzling problems encountered by real estate appraisers who are retained by public agencies is how to value temporary physical acquisitions. The reason why temporary acquisitions present such a puzzle is that they are given as much importance as appraising the proverbial molehill. Indeed, temporary acquisitions for many public works projects are so small that they are often valued by rule of thumb methods rather than some systematic framework. However, use of such contrived methods in large public works projects can lead to windfall, or wipe out monetary awards as well as contributing to unnecessary litigation.

Dwight Pattison, SR/WA, and the Valuation Committee of the International Right of Way Association have contributed a helpful inventory of eight methods for valuing temporary physical acquisitions as follows:¹

1. Full 100 percent fee value
2. Rate of return on land
3. Normal rent
4. Capitalized rent loss
5. Percentage of fee value
6. Lump sum
7. No payment
8. Special benefit

However, merely inventorying and describing how the market value of a temporary acquisition is calculated by each of the above appraisal methods is insufficient to gaining a competent understanding of how to employ the methods correctly.

What the above inventory lacks is a coherent framework which gives an appraiser, property owner, right-of-way agent, or attorney some reasonable idea of what constitutes fair compensation for the temporary use of private property. Without such a framework for valuing temporary acquisitions there is no meaningful way to negotiate for their acquisition or to defend the appraised valuation in a court of law. And without such a framework what results is what has been called a "trust-me" appraisal which lacks any reasoning, logic, or support as to the method of appraisal or conclusion of value (i.e., "Trust me, I know I am correct"). It is little wonder that with such entirely subjective types of appraisals that jokes abound that there are basically three kinds of real estate appraisals: 1) a guess, 2) a wild guess, and 3) a sophisticated wild guess. What is often lacking in the appraisal of temporary acquisitions is a supported estimate or educated guess that can credibly communicate the basis of the value conclusion.²

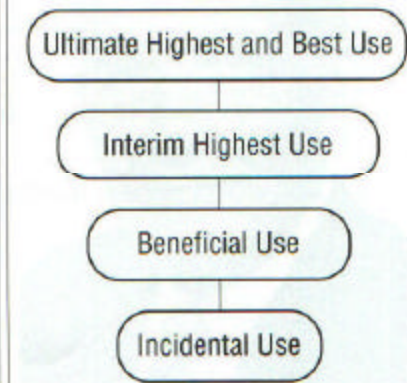
THE MISSING PIECE OF THE PUZZLE

The pieces in a jigsaw puzzle are not interchangeable. And neither are the eight methods of valuation of temporary acquisitions listed above equivalent to each other. However, there is no professionally recognized way of specifying the circumstances under which each method of appraising a temporary acquisition should be used. This is critical if an appraiser is to meet the requirements of Standard Rule 1-1 of the Uniform Standards of Professional Appraisal Practice which requires that:

"In developing a real property appraisal an appraiser must be aware of, understand, and correctly employ those recognized methods and techniques that are necessary to produce a credible appraisal."

Real estate appraisal is a problem-solving process. And in order to solve a problem you must first define it prop-

FIGURE A HIERARCHY OF LAND USES



erly. If the valuation problem is framed incorrectly the entire analysis will be irreparably flawed from the outset. Standard Rule 1-2 of the Uniform Appraisal Standards specifies that:

"Each appraisal must set forth the analysis in a manner that is not misleading."

This means appropriately framing the valuation problem and disclosing any implied assumptions which substitute for a systematic analysis of a property's highest use.

The missing piece of the puzzle that dictates which method is appropriate to the valuation of a temporary acquisition is, as in all real estate appraisal, the concept of highest and best use. It has often been stated that if the highest use analysis is wrong in an appraisal then the entire valuation is wrong. This is no less so for appraisals of temporary acquisitions. What is needed in the appraisal of temporary acquisitions is an analysis of what reasonably probable loss of use the temporary physical occupation of property has caused (see Figure A).

What distinguishes the professional real estate appraiser from the inexperienced and the incompetent is the ability to ask the right questions. The central valuation questions to be answered in an appraisal of a temporary acquisition, in

order of their impact on the highest use of a property, are:

1. Has the temporary acquisition caused a demonstrable loss to the ultimate highest and best use of a parcel of land that the market recognizes?
2. Has the temporary acquisition caused a loss only to the interim market usage of the land?
3. Does the temporary acquisition result in only an interference with the owner's proprietary and beneficial use of the land?

4. Does the temporary acquisition result in only an incidental interference with the market usage or the owner's beneficial use of the land?

Sequentially answering these four questions properly should result in a credible framing of the valuation problem. The valuation method selected should flow from this preliminary framing of the problem and the concrete circumstances of the temporary acquisition and not from rule-of-thumb guidelines or from legal instructions.

If the inventory of methods cited above is viewed as a continuum of

losses from total (full 100 percent fee value) to incidental (no payment) that a property may sustain due to a temporary taking, then the rationale for selection of a valuation method can become sufficiently understandable to meet professional standards. The appraisal method selected should correspond with the degree of loss caused to the property. This can be shown in the Loss Continuum For Valuing Temporary Acquisitions shown in Figure B. Without the framework of this loss continuum we are left with round puzzle pieces which are forced to fit in square spaces.

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FIGURE B LOSS CONTINUUM FOR VALUING TEMPORARY ACQUISITIONS

Degree of loss	Valuation Method	Typical Uses Lost	Legal Interest	Example
<p>TOTAL</p> <p>INCIDENTAL</p>	100% Fee value	Permanent loss to ultimate highest use	Fee simple	Borrow site construction easement
	Rate of return on land	Temporary loss to ultimate highest use	Beneficiary Interest	Construction easement on primed development land
	Normal rent	Temporary loss to interim use	Lease interests	Construction easement on farmland with highest use for speculative holding
	Capitalized rent loss	Recurring periodic loss in use	Easement interest	Seasonal flowage easement
	Percentage of fee	Varied uses	Easement interest	Fiat price set for temporary construction easement
	Lump sum	Beneficial use to owner	Easement/License	License to enter to conduct intrusive environmental studies
	No payment	Incidental uses	License, easement	Entry permit for observation-only environmental studies

Finding the Missing Piece

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PIECING THE PUZZLE TOGETHER

With the above framework in hand, what is needed is to provide some representative examples of the circumstances under which each of the different valuation methods might apply. Unlike other appraisal assignments where the three traditional methods of valuation can be used (Cost, Income, Comparison Approaches), appraising temporary acquisitions typically requires that only one preferred method of valuation be employed. Matching the right method to the valuation problem at hand is like finding the one piece of a jigsaw puzzle that fits.

There are four basic categories of methods for appraising temporary acquisitions: 1) pure market-based methods, 2) hybrid market-administrative methods, 3) pure administrative methods, and 4) methods to value/offsets for damages or benefits. The market-based methods measure loss in the market value to the ultimate or interim highest use of a property. The hybrid and administrative methods best measure losses to the beneficial use or use value of a property by its owner. It is crucial to understand that temporary acquisitions do not always result in a loss to the market value of a parcel of land. Nonetheless, compensations should be administratively provided for the loss in the use value of a property.

PURE MARKET-BASED METHODS

Full 100 percent Fee Value. A temporary taking is more likely to result in a total loss when the loss caused is permanent. Changes in grade, drainage, or access to a parcel of land may bring about a total loss of a property's current highest use. The classic example of a full loss in value is the taking of land for borrow material for earthwork purposes. If the highest use of a parcel of land is for rock and gravel uses or mineral processing, and the earth material is removed under a temporary construction easement, the probable loss would be total. However, if the highest use of a parcel of land is enhanced by changing its topography from a hill to level at grade, then there may be no loss but a betterment. The proper method of valuation depends on the loss in use to the

FIGURE C DAMAGES MEASURE RULES—TEMPORARY VERSUS PERMANENT ACQUISITIONS

	Area Damaged	Damage Measure Rule
Temporary Acquisition	Part Taken & Remainder	Before, During and After Rule
Permanent Acquisition	Remainder Only	Before and After Rule

affected land.

Rate of Return on Land. This method for valuing temporary acquisitions is used all too frequently in unthinking fashion even when it may be inappropriate to the situation at hand. For this method to apply, there must be a temporary change in the ultimate highest use of a parcel of land. The clearest example of when use of this method is appropriate is a temporary construction easement within a parcel of land with building permits obtained and a construction loan in place. Because the property cannot be readily adapted to its ultimate highest use due to the temporary easement, the appropriate compensation would be to reimburse the owner for carrying costs (i.e., loan interest, property taxes, etc.) plus any severance damages which may occur due to a delay in market timing (i.e., absorption). However, this method should not be employed when it is not reasonably probable that the property could be put to its highest use during the period of the temporary taking. In such cases, civil engineers, market economists, and lenders should be consulted to ascertain if development is realistic within the time frame of the temporary easement.

It must be noted that the fact that the property owner has normal carrying costs on the land is not a sufficient enough reason to compensate him for these costs. The burden on the property must have been caused by the temporary taking for it to be compensable.

A misconception when employing this approach is automatically assuming that the market-ability of a parcel of land is somehow impaired by a temporary acquisition. This should be proven from hard market evidence and not just assumed. Assuming a loss in marketability

would not meet the requirements of the Evidence Code in most jurisdictions and would have to be disclosed to meet professional standards. Although the unique circumstances surrounding each acquisition must be individually considered, it has been this writer's empirical observation that parcels of land in rural areas encumbered with temporary part takings readily sell for full market price. Where indicated, it may be worthwhile to consider the amount of liquidated damages provided for in standard purchase and sale contracts as a market indicator of any loss caused to the salability of a property by a temporary acquisition. Moreover, appraisals lack credibility when they assume that there is a loss in marketability to a parcel of land when there is no binding offer to sell the property at a realistic market price in the first place.

An inconsistency in using the Rate of Return Method for valuing major partial temporary acquisitions may arise when it is assumed that there is a loss of marketability to the part taken and not to the remainder as well. This unthinking assumption can often backfire on an appraiser under the test of litigation and can lead to court awards all out of proportion to the reasonable loss sustained.

Normal Rent. Because most temporary acquisitions interrupt only the interim use of a property and not its ultimate highest use, this is the most appropriate method of appraisal in most circumstances. This method is particularly well suited to those situations where the highest use of the land is to hold for long-term investment purposes (i.e., speculative investment). In such situations, only the interim use of the land will be interrupted (i.e., farming), not its present highest use (i.e., speculation).

Accordingly, the appropriate compensation in such situations is to find ground leases for the use that the land could be put to in the interim. If there are no ground leases in the vicinity of the property, then the geographic search for market data should be expanded. If it is not likely that there is any remote demand for interim use of the parcel, then an administrative lump sum form of compensation should be recommended to the agency. The mere fact that there are no ground leases is not a sufficient reason to substitute the Rate of Return Method for the Normal Rent Method as is the frequent practice of many appraisers and as is incorrectly advocated in some real estate valuation textbooks.³ This would violate the appraisal principle of Consistent Use, would result in valuing a loss to the wrong property interest (beneficiary versus leasehold interest) and would abrogate professional appraisal standards.

Capitalized Rent Loss. Capitalizing the ground rent loss on a property in perpetuity is inappropriate except in those rare situations where there is some form of recurring temporary use of a parcel. For this method to apply there must be a connection between ground rents and land sales prices. A seasonal but perpetual flowage easement across rural agricultural land is the prototypical example of a situation where this method might most apply. However, if the land is sought for use as a ground-water recharge basin, water pipeline emergency blow-off basin, or flood basin on infill land, then it might be more appropriate to appraise it as a permanent fee taking. Once again, the method of appraisal is dictated by the loss in use to the property and not the other way around.

HYBRID METHODS

Percentage of Fee. This is a hybrid method of valuation which provides that a percent of the market value of the effected land area be employed as an estimate of just compensation. The ratio applied under this method is a flat percentage and should not be confused with an annual percent of investment return. This method provides an equi-

table basis of compensation to each property owner. In order to comply with professional appraisal standards, the percentage should be set by an agency's administrative policy although it is sometimes inappropriately established by an independent appraiser. While this method is allowable under the Jurisdictional Rule to the Uniform Standards of Professional Appraisal Practice, technically it may not reflect the actual market value of the loss caused by a temporary acquisition. This method is best applied on minimal temporary acquisitions or when no estimated actual market loss in value can be established because the type of land impacted by the temporary acquisition does not rent (i.e., single family residence or a gasoline service station affected by a temporary easement for street widening purposes). Caution should be used with this approach because it is often used as an expedient method of appraisal by agency staff appraisers or independent appraisers who do not know how to competently appraise a temporary acquisition by any other method.

PURE ADMINISTRATIVE METHODS

Lump Sum. This method involves use of an entirely administrative award of funds usually involved in minor temporary acquisitions where it would be uneconomic to have it appraised, or where the taking is de minimus. This method may also be considered where the impacted property does not rent and the taking only interrupts the interim market usage or the property owner's beneficial usage of the land.

No Payment. Non-payment of compensation may be called for if the temporary occupation of the property is brief in duration, and does not entail any physical disturbance or interruption with the continual use of the land.

FIGURE D

Before And After Format (Federal Rule):

Valuation Date:	_____
Highest Use:	_____
Loss In Use:	_____
Value Before Take:	\$ _____
Value After Take:	-\$ _____
Difference =	\$ _____
Interim Loss During Take	-\$ _____

Value Of Take Plus Damages Format (State Rule):

Valuation Date:	_____
Highest Use:	_____
Loss In Use:	_____
Value of Taking:	\$ _____
Plus Damages:	+\$ _____
Estimated Just Compensation:	= \$ _____

Examples where no compensation may be appropriate are entry permits to conduct observation only environmental investigations, permits to erect common boundary fencing, etc.

DAMAGE ADD-ON/OFFSET METHODS

The inventory of valuation methods listed earlier in this article included consideration of the possibility that a temporary acquisition could result in an enhancement to the market value of a property (i.e., special benefit). This is obviously a rare occurrence and hard to prove in a court of law. The more frequent impact of a temporary acquisition is a damage rather than a benefit.

It is not unusual for the estimate of damages in a temporary acquisition to greatly exceed the value of the part taken. The proper valuation of temporary acquisitions requires that an appraiser not confuse "loss" (i.e., value of the take) with "damages" (i.e., severance damages).

Estimating damages in a temporary taking requires special considerations not found in the valuation of permanent partial acquisitions with respect to how they are measured and the legal evidence standard which must be adhered to.

Measurement of Damages. Normally damages apply only to the loss in value to the remainder of a property. However in temporary acquisitions, damages can occur to both the part taken or to the remainder of a property. A frequent example of this is a temporary construction easement in

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value. If there is no demonstrable loss to a property's market value which would result from a temporary taking, then the reasonable loss to the owner's beneficial use of the property may be considered by appraising the loss by one of the administrative methods of valuation. Applying valuation methods used to value permanent easements to appraise temporary acquisitions may be likened to trying to fit pieces from one picture puzzle to another. They just won't fit. Or if perchance they do fit, they will lead to a garbled puzzle picture.


PERCEIVING THE PICTURE IN THE PUZZLE

In summary, the missing piece of the jigsaw puzzle in appraising major temporary physical acquisitions is a proper highest use/loss analysis. The main reason appraisals of temporary acquisitions are flawed is an unthinking application of valuation methods which omits any consideration of the loss in use to a property and is inconsistent with the physical circumstances involved with the taking. The most frequent and flagrant error involved with the appraisal of temporary acquisitions is to assume that all of the uses and rights inherent in land held long-term for speculative investment purposes are lost during the taking.

A peculiar aspect of appraising temporary acquisitions is that they often may not impact the market value of a parcel of land at all. Current appraisal rules and methods are insufficient in ascertaining the appropriate losses and damages resulting from a temporary acquisition involved with a permanent taking. In cases where there is no reasonably probable loss to a property's market value, it is more professionally honest to have the property appraised by the hybrid flat Percentage of Fee Value Method or by an administrative Lump Sum Method than to resort to a forced appraisal analysis. However, it is incumbent upon the real estate appraiser to properly disclose that there is no estimated actual loss in

market value to the property rather than contriving or assuming a loss by a flawed and highly speculative appraisal. Without such disclosure, we are left with puzzling appraisals which may make negotiations impossible and which may backfire under the test of litigation.

Conversely, appraising major temporary acquisitions in an unsystematic manner using rule of thumb methods may lead to gross undervaluations, especially if damages are superficially analyzed.

A proper framing of the valuation problem from the onset will avoid misuse of the many methods by which to appraise temporary acquisitions. Unless the picture puzzle of a temporary acquisition appraisal is framed correctly, what may result is the pieced together photograph of a property which can only resemble a puzzle palace.⁴ 

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