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Eco-Tourism. Resort Valuation

A Traditional

Appraisal

Methods

Approach



As eco-tourism increases in popularity, eco-tourist resort use may become a factor in highest and best use (HABU) and valuation analysis in appraisals of environmentally significant real estate (ESRE). For those not yet familiar with this field, eco-tourism is defined here as persons taking vacations for the primary purpose of experiencing ESRE.

Eco-tourist resorts (ETRs) are a class of resort emerging to satisfy economic demand for the experience of protected ESRE. ETRs, which range from rustic to luxurious, are designed to minimize the adverse effects on ESRE and maximize tourists' experience of ESRE. ETRs tend to be placed in locations on or near the ESRE that allow resort and habitat managers to channel the tourist's experience in ways that limit harm to the ESRE and to the tourist.

By Donald C. Wilson and Craig D. Hungerford

ETRs may be owned and/or operated by a variety of private sector conservation, investment, hotelier and resort enterprises. For example, a large conservation land trust and a large hotelier plan an ETR in Hawaii. And ETRs are emerging not only in the United States, but also in Africa, Latin America and elsewhere around the world.¹

Basically, ETRs may occur wherever a) there is ESRE that can attract sufficient tourists and tourist spending to justify capital costs of development, and b) this same ESRE can be controlled sufficiently to warrant such real estate investment and development.

Physically, ETRs break down into four components: the environmentally significant land (or water or both) to be experienced, the site for the resort, the resort facility and the resort infrastructure. The resort infrastructure includes not only traditional infrastructure like roads and utilities, but experiencing infrastructure as well, such as, trams, or trails, or roads, or fencing, etc., used to channel the experience of the eco-tourist consumers.

ETR enterprises may own, lease, or simply be granted public rights of access to the land to be experienced depending on the circumstance.²

ETR enterprises may own, joint venture, or lease the site for the resort, the resort improvements, and the resort infrastructure.

For the sake of comparison, an ETR is analogous to a golf resort. The golf resort includes a resort structure where golfing tourists stay. The resort structure is on a site that is usually on, adjacent or near the golf course and the golf course(s), itself, is a combination of landscaping, maintenance and

experiencing infrastructure improvements to land with an environment considered conducive to attracting golfing recreation.

Estimating the market value of ETRs and/or the land they utilize for development financing, long-term financing, transfer, exchange or, for that matter, condemnation hinges significantly on the nature of interests being appraised, of course. Is the ESRE to be acquired, leased or piggybacked via public access rights? Will one entity own everything, or will there be joint ventures or partial interests to consider? Will ownership foot the bill for the entire infrastructure or will government bare part of the

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burden? If the property already exists, complex tax and depreciation issues may arise.

As with golf resorts, it makes sense to value ETRs via the three traditional approaches to estimating market value: the Cost, Sales Comparison and Income Approaches.

Obviously, the Cost Approach offers insight in a new project, but the Cost Approach may also be useful in cases where usefully comparable sales are in short supply.

The Sales Comparison Approach will provide the appraiser with a market benchmark, when sufficient recent sales activity of usefully comparable sales is available. However, as with land uses

like golf resorts, the frequency of sales may often be relatively low, the comparability of the sales may be relatively low (resorts are often significantly differentiated in terms of the quantity and mix of the attributes they offer) and the market may often evidence significant inefficiency. Therefore, the Sales Comparison Approach may often inspire confidence only over a broad range of value.

The Income Approach is usually quite significant, because ETRs generate significant annual cash flows, as do other types of resorts. Any lender or investor should be crucially interested in the ETRs ability to repay debt and/or satisfy equity requirements.

Equity requirements merit a brief comment here in terms of investment and income analysis. Equity requirements may vary considerably depending on the nature of the ownership entity. Specifically, is the ownership entity a for-profit or not-for-profit organization? Either or both entities may be involved in an equity position in an ETR. Either or both entities might be probable buyers or Joint Venture developers. The appraiser needs to research the market and analyze assumptions about probable equity expectations to effectively value ETRs.

Since most appraisers are technically proficient at valuing proposed or existing developments by the three approaches, and since we have distinguished the basic components of an ETR development, an example would be mastering the obvious (one might look to various kinds of resort valuations for models to adapt). Some less familiar situations may arise, however, when the appraiser is asked to appraise land for a proposed ETR development.

Traditional HABU analysis will be critical in such an analysis to establish probable use and to distinguish whether the land is the resort site, or the ESRE to be experienced, or both. A hypothetical example helps bring this appraisal problem into more focus.

Suppose there was an island located near the coast of a major metropolitan area. Next, suppose this island, call it Eco Island, was within a Federal National Recreation Area and was rich and diverse in ecological and historical attributes. Next, suppose three quarters of Eco Island is owned by the Global Nature Trust (GNT) and one quarter is owned by a private individual named Mr. Green. Next suppose that Eco Island is somewhat environmentally degraded by past agricultural activity. Next, suppose that the GNT allows some modest eco-tourism on Eco Island and has done so throughout its tenure.

Let us also, suppose that GNT has opened several ETRs and expects to open more domestically and abroad. Next, suppose that the national government wants to buy the balance of the island to ensure a cooperative land tenure on Eco Island aimed at protecting the island's habitat and rehabilitating it where necessary. Next suppose that Mr. Green is told by the government that their appraisers estimate the value, based on an assumed HABU of marginal land inventory (fill in the exact language that government appraisers might use here for land that has little or no possibility for traditional developments not aimed at fostering ESRE).

Mr. Green is astounded by the value that government appraisers have estimated and asks you to provide him with another opinion to double check the reliability of the estimate made by the government's appraisers. He seeks an estimate of the market value of the fee simple interest of his parcel.

After accepting, you perform a HABU analysis. You formulate three possible scenarios of HABU, a) marginal land inventory, b) economic preservation use of ESRE and c) ETR development use. Your market research

indicates that buyers buy marginal land for long-term speculative holds. It also confirms they buy ESRE for economic preservation use, especially islands. It also confirms that several ETR developers think the subject property would be quite desirable as both a resort site and experiencing land for an ETR or as just the land for experiencing with the resort located on the mainland.

This interest by ETR developers leads you to investigate legal/political constraints on placing an ETR on Eco Island. While you suspect that the GNT plans ultimately to open an ETR on its portion by some kind of reinstatement of the regulatory context, once the national government buys Mr. Green out, you cannot prove it and the GNT refuses to comment. Your research and assessment of the current legal/political constraints on the island lead you to conclude that while the resort probably could not be put on the island on your parcel, at this time, an ETR development linked to the mainland is a strong probability.

The resort could be placed either on the mainland now, or might be placed on the GNT's portion of the island later. This reasoning leads you to consider constraints of financial feasibility and greatest net return relative to the proposed use scenarios.

As an initial cut, you consider valid comparable sales data for each type of use. Marginal land inventory use indicates land sales priced around 1X. Economic preservation use indicates land sales priced around 2X. ETR development use indicates land sales priced around 20X for land including the resort site and around 10X for land excluding the resort site.³

Clearly, ETR development use is the most probable, based on this evidence.

You further analyze the availability of resort sites on the mainland and find at least three possibly feasible sites. Next, you interview a few ETR developers and determine the kinds of infrastructure costs associated with linking a mainland site with Eco Island and the kinds of infrastructure needed

on the island. Next, you do a gross-cut land residual analysis of this proposed ETR to see if the land residual for the island portion of the project equals or exceeds what your comparable sales for such land indicate.

When you find that they are approximately equal, you conclude that the ETR development land use scenario is financially feasible and promises the greatest net return to the land owner, in the form of proceeds from sale of the land. At this point, you complete documentation of your comparable sales data, adjust them, infer value and base your conclusion of a market value estimate on the value inferred from a Sales Comparison Approach.

If the comparable sales data does not inspire sufficient confidence, then complement it with a more detailed land residual analysis based on the research performed in the HABU analysis. Voila!

It is easy to describe, but it is obviously time-consuming to perform. Still, this exercise outlines the basics needed to arrive at a well-reasoned market value estimate of land suited for eco-tourist development.

Having considered the appraisal of ETR properties at some length, it may help the reader now, if we attempt briefly to place the issue of ETR valuation in a broad context of land use.

Essentially, ETR development may be seen as another step in the evolution of use of ESRE. In the beginning, ESRE was exploited and ignored. Next, ESRE came to be recognized as being something worth protecting. In turn, land use regulations were changed to protect it and, thereby, institutionally recognize it as a part of the greater institutionalized land economy, rather than simply as a raw material of development types that destroyed it. Next, monies were appropriated by government and raised by donation in the private sector to fund its acquisition. Mitigation regulations that granted certain ESRE a tactical utility began to significantly influence traditional land developers to fund its acquisition, as well.

Now, a resort industry is organizing

to attract and stimulate eco-tourism, a potentially vast market of recreational spending. Channeling this recreational spending into ETRs dramatically intensifies the economic use of ESRE, even as managers of ETRs employ a wide array of protection techniques to minimize the adverse impacts of eco-tourists' experience of ESRE. This value-adding ETR development is yet another example of the economic and income-producing dimensions of ESRE in the institutionalized land economy.⁴

Appraisers confronting such property for the first time should feel reassured that the traditional appraisal methodology is well suited to estimate the market value of ETR development. ■

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NOTES

¹Africa, in particular, is experiencing a wave of ETR developments designed to attract international tourism to environmentally significant areas.

²ETRs can be located adjacent to, or near, ESRE owned, or controlled, by public agencies. Access to public land for experiencing ESRE can be a long-term lease arrangement.

³These X-values are entirely hypothetical and are intended only to clarify that there are significant value differences in this hypothetical example. As an aside, however, potentially large revenue streams associated with resort style development suggest that economic and market forces might logically trigger quite significant values for ETR development land in certain circumstances in fact.

⁴Although, all ESRE has the potential to provide income, ETR development can, in some circumstances, help facilitate a consistent and regular income stream for ESRE.



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