Appraising Public Utility Easements in a Railroad Corridor

BY JOHN SCHMICK

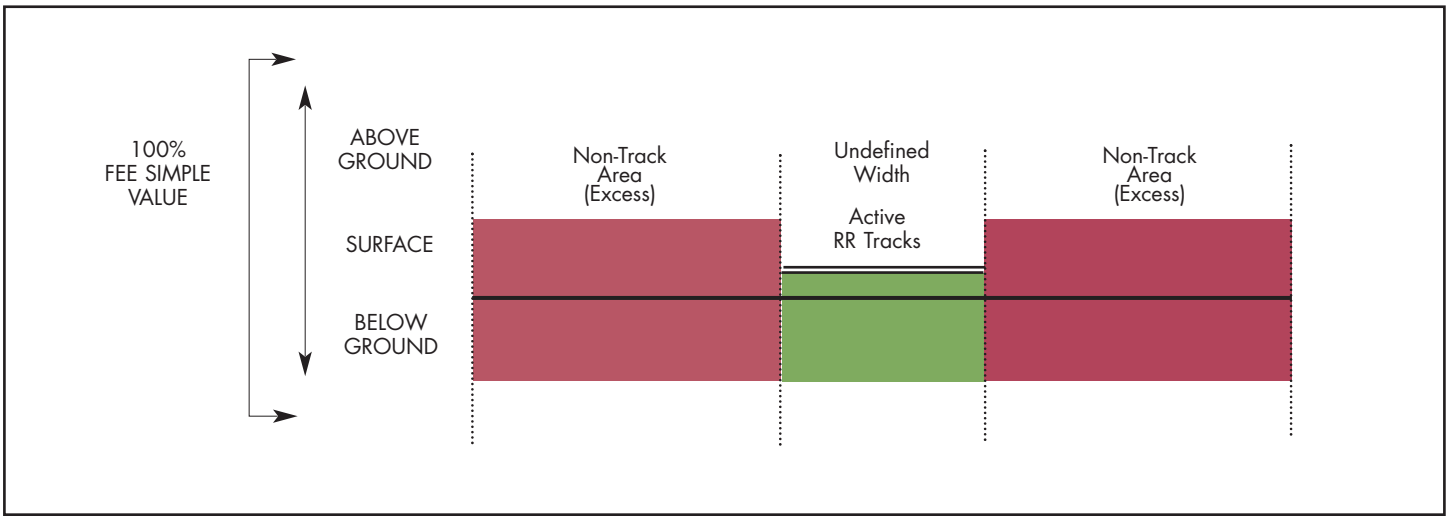
As the debate continues, are we comparing apples to cows?

It was interesting to read the response by Arthur G. Rahn in the January/February 2007 issue of Right of Way (Railroad Right of Way, Appraising Public Utility Easements, a Response) to my two-part article published in January/February and March/April 2006. Mr. Rahn has a long history of working for railroads and it is understandable that his writings have promoted the existing corridor theory we see commonly used and abused in the appraisal industry today. But like any professional, he is open to, and encourages, discussion of other points of view. We even agree on some points.

Like Mr. Rahn, I too would like to dispel some inaccuracies and misinformation contained in his response.

Mr. Rahn's response begins with a discussion of terminology regarding the use of "corridor" or "right of way." It is not uncommon for clients, users and appraisers to use these terms interchangeably regardless of their correct legal application. For the purpose of this response, I will continue to use the terms interchangeably. The function of this article is not to serve as a dictionary, but to convey a methodology that is market supported and applicable to many day-to-day appraisal assignments. In some respects, Mr. Rahn's clarification of terms highlights the need to follow Dr. Karvel's decision tree in order to understand the highest and best use of a given railroad property. If there are active tracks in the corridor, clearly the railroad is the primary user and any land left over is available for secondary users. Mr. Rahn refers to this as an "active railroad right of way" within the corridor. Having active tracks within the corridor is one of the four highest and best use outcomes identified in Dr. Karvel's decision tree. As a result, every valuation assignment of railroad corridors necessarily requires the appraiser to understand the current uses of the land and Dr. Karvel's decision tree becomes a necessary part of that analysis.

100% Fee Simple Interest and Railroad Corridors



One problem I encounter in valuation assignments related to railroad corridor utility easements is the unrealistic and often unsupported demands for rents when it comes time for periodic adjustments as required by the easement, lease or grant, etc. It would be one thing if, over a 10-year adjustment period, both parties could agree on a general growth rate in land values subject to local influences. For example, if local land values went up 50% over the past ten years, it would be reasonable for the parties to agree to some type of increase that considered the general rate of growth. Where the problem comes in is when one party demands a 4000% increase or more when the general growth rate is 50%. I have yet to encounter a client who will not pay some realistic increase in rent at the adjustment period. But this kind of astronomical demand causes the client to pause and ask, "What am I paying for?" Mr. Rahn and I both agree that rents should be based on market evidence. We disagree on what that evidence is and how it should be interpreted. This is not advocacy; rather, this is honest debate on proper methodology and professional analysis of the market. Indeed, let the chips fall where they may.

Mr. Rahn's clarification of the difference between the enhancement factor and the ATF (across the fence) value is partially correct. The argument that corridors have value greater than the land across the fence does reflect a belief in a synergistic effect created by a corridor. However, the base value, or ATF, of a corridor is itself based on the belief of a synergism in the assemblage of land pieces into a corridor. This synergism is expressed in the belief that once assembled, the corridor has a value at least equal to the land across the fence. Small, narrow pieces of land seldom have the same functional utility as typical lots in the area and therefore often reflect a lower market price. But when combined to create a corridor, they may have greater functional use, depending on market conditions. This is an assumption that is almost never disclosed to readers of appraisal reports of railroad corridors and when not disclosed, I believe, constitutes a violation of professional standards. Uniform Standards of Professional Appraisal Practice (USPAP) require that hypothetical conditions and major assumptions which impact the valuation of a property must be disclosed.

Powerline easement over a private road easement over a pipeline easement. Space is available for additional uses in the non-track area.

The concept of industry-appropriate occupancy factors is interesting especially when some uses overlap other uses. Let's start with the assumption that the railroad owns 100% fee simple interest in the land. Now take the examples given in the response of a 20% occupancy factor for a power line easement and a 75% occupancy factor for an underground pipeline easement. Assume, for a moment, that the pipeline runs directly underneath the power line. Now add a surface parking lot over the pipeline and also underneath the power line. If you accept that fee simple interest represents 100% of value, you would have to conclude that the parking lot can only represent a 5% occupancy factor. Now add a second overlapping underground pipeline easement and apply the industry-appropriate occupancy factor of 75% and what do to you get? A massive overvaluation. How many times do we see a valuation using "industry-appropriate" occupancy factors that add up to 150% of fee simple or more when uses overlap? In such cases, either the fee simple value is wrong or the occupancy factors are wrong.

Inconsistency of 'Industry Appropriate' Occupancy Factors

		% Of FEE SIMPLE
100% FEE SIMPLE VALUE	Overlapping Overhead Powerline Easement	20%
	Overlapping Parking Lot Use	5%
	Overlapping Underground Pipeline Easement	75%
	Underground Pipeline Easement	75%
	Total % of Fee Simple Value Captured	175%

When trying to measure the impact of a particular use on the non-track area of a railroad corridor (sometimes referred to as excess land), a standard before and after comparison can be applied. The amount of value captured by the use can then be used to form the basis for a market rent. The problem is that such a standard approach often is unsupportive of the use of "industry-appropriate" occupancy factors. In reality, occupancy factors have very little to do with AFT values, enhancement factors and corridor values. As such, they should be measured like any other easement, license, etc.

Mr. Rahn incorrectly attributes a 'maximum right of way width' to my article. At no time have I ever stated maximum width. Early in his response, Mr. Rahn recognizes that "…no one can place an easement on an active railroad right of way since that is the portion of the corridor where the trains operate." My discussion refers to the minimum width needed to support those trains. Laws and regulations referring to a safety margin specify the minimum width needed for the safe operation of trains. To date, I am not aware of any common agreement within the appraisal industry as to what the minimum width needed for an active train operation is, other than the safety margins mentioned in the article. The very fact that secondary users are located in the corridor is evidence that something less than the full width of the corridor is needed for safe operation of the trains. This is indisputable. The question remains as to what portion is necessary for train operations and what part is available for other uses? This brings us back to the need to use Dr. Karvel's decision tree in every railroad corridor appraisal so that you can demonstrate knowledge of the appraisal subject.

Mr. Rahn also incorrectly credits me with the statement that the "loss or diminution should be measured only by the amount of income that was lost." What I did say was that, "In this case, the most appropriate measure of damage from a public utility ….easement is the loss of revenues and/or the increase in operation expenses for the railroad." The term "most appropriate" does not equal "only." In any other field of real estate appraisal this statement is correct. However, since most railroads fail to provide the financial records necessary to measure the impact of a new easement, this means of analysis is seldom available to the appraiser.

Finally, Mr. Rahn comments on how just compensation is measured and the notion that nominal value is inappropriate. The reader should note that the example provided on the fifth page uses a taking of fee simple interest. This is substantially different from the taking of an easement, license or grant, etc. If, in any given taking of a public utility easement, there is a failure to identify or measure damages, a nominal award may be appropriate. To argue this is wrong and to use a fee simple taking as an example is to compare apples to cows. It simply is not a valid argument. Furthermore, citing a 1917 legal case as settled law in this area is not convincing. Case law is not static and evolves over time. A court decision yesterday may be contradicted tomorrow.

As a practical matter, neither Mr. Rahn nor I will be the final arbitrator of how to appraise the impact of a utility easement in a railroad right of way (corridor). While there have been many court cases and decisions in many states over the years, I anticipate there will be many more cases in the future. I appreciate Mr. Rahn's historic perspective and knowledge, and look forward to other contributors bringing their experiences to the pages of this publication. ◉