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By Wayne C. Lusvardi

What Is It Worth?

No recent public sector real estate issue has been as controversial to those involved with the purchase of land suitable for environmental preservation as what has been called the "Public Interest Value" (PIV) debate. Moreover, no concept in the appraisal profession has been as difficult to define or resolve as PIV. The holding of a nationally advertised seminar on the PIV issue sponsored by *The Appraisal Institute*, with speakers from various professional appraisal organizations and representatives of many levels of government, presumes that the central question of the seminar "What Is It Worth?" can be answered by the real estate appraisal profession.

It seems doubtful that the appraisal profession alone can answer what mainly amounts to be a public policy issue. However, the author believes that the appraisal profession can be helpful in separating market appraisal from public policy. Furthermore, the appraisal profession needs to understand that PIV does have an economic calculus to it in urban real estate markets that prompts

public support, but that it is an unappraisable non-economic concept in wilderness areas that has wreaked havoc in rural land markets.

What Is PIV?

The PIV phenomenon has historically centered on whether real estate appraisers can consider premiums paid above appraised market value for preservation land by government agencies, land trusts

and nature land conservancies, as valid market data in a real estate appraisal. This premium is erroneously believed to serve as a market proxy or public bid for what the preservation of environmental resources is worth. Actually, PIV is a much deeper issue.

The unidentified root cause of the PIV issue pervades into land markets by not only creating market premiums for land voluntarily purchased

for preservation, but can also cause a "blight" on market demand and lack of normal land sales data for properties acquired for public park land by condemnation. The situation where there is a preservation-induced inflation of market prices for land may be called a "windfall market" reflecting "Public Interest Value." The converse situation where there is a deflation of market demand and abnormal land sales data may be called a "wipeout" market or the "Public Interest Blight" (PIB) issue.

What causes the two land market distortions of a "windfall" and a "wipeout" land market? The root cause of the PIV issue can best be explained by an unmentionable word - the "N" word. Most of the public is unaware of this word and few want to admit or even discuss it: "nationalization."¹

The gradual de facto nationalization of natural resource land is a phenomenon resulting from: (a) the compound actions of the public policy to preserve natural resource land at any cost; (b) the preservation activities of government and quasi-public entities to preserve the environment by land purchases, condemnation, lawsuits and regulation; (c) the governmental creation of artificial non-economic market mechanisms for preservation; (d) the usurpation of local land use control by national and state regulatory agencies; (e) and the government's "one size fits all" preservation policy that does not differen-

Public Interest Value Versus Market Value

Why Public Policy Makers Pay More Than Market Value For Preservation Land

"We could say that from this point forward we won't buy anything for more than \$10,000 an acre, but then we're not going to buy anything."

Michael Jiminez, Political Aide, L.A. City Council

tiate urbanized and rural land markets.

We are unaccustomed to talking in the United States about the term “nationalization.” Nationalization is something that other countries do like Mexico when it took over its oil industry or socialist countries that have taken over banking, transportation or electric utilities. But nationalization best describes what is slowly resulting from current public policies that call for the preservation of natural resource land “at any cost.”

Real estate markets and especially land markets, are always fragile economic organisms. With the gradual process of nationalization of vacant land markets, open, private and competitive land markets are gradually becoming extinct. In its place are limited, closed and government-syndicated markets for land that make the market appraisal process difficult or sometimes impossible. Because of the compound intrusiveness of preservation activities, markets are unbalanced and an equilibrium price for vacant land is becoming increasingly difficult to find.

Asking the Wrong Question

We always have to be reminded of the obvious. How real estate appraisers are supposed to determine Market Value for properties in de facto nationalized preservation areas is an obvious self-contradiction. Re-framing the PIV issue in terms of the nationalization of resource land for environmental preservation turns the question around. *The re-framed question becomes not just “what is it worth?” but “how do we value land*



suitable for preservation in environmentally nationalized markets under a policy of preservation ‘at any cost’ when such a policy is antithetical to the whole legal concept of Market Value?”

The appraisal issue in such unbalanced land markets is to find the market value of land unaffected by either preservation “blight” or price inflation. Conversely, it is the role of the public sector to establish the pure premium that is to be paid to implement public preservation policy. To better understand PIV we must first study a test-tube case of it that is often found in urban real estate markets.

A Classic Case of PIV

A newspaper article in the February 14, 1999 issue of the *Los Angeles Times* newspaper, summarizes the “windfall part” of the Public Interest Value debate more aptly than all the professional or governmental position statements, theory papers, counter positional statements and other written articles on the subject that the author has encountered. Excerpts of that article are quoted on the following page. (see “News Headline”)

It is obvious from reading

that newspaper article that the dilemma of what to pay to preserve nature land is as much a public policy issue as it is an appraisal issue. What unit value should be paid for the land? Is it \$7,500 per acre, \$10,000 per acre, \$20,000 per acre, or \$57,000 per acre?

There is no honest way that an appraiser can tell you because nearly all of these unit values reflect public policy, not necessarily Market Value. Even if we instruct appraisers to report both traditional market value and “Public Interest Value” in their appraisal reports, which premium should be paid? In the above example, premiums of \$2,500, \$10,000, \$12,500, \$37,000, \$47,000, \$54,500, \$108,000, \$145,000, \$155,000 and \$157,500 per acre can be extracted from the face prices of the sales transactions.

Even the city’s own purchases reflect an inconsistent public policy premium of \$11,392 per acre in the Deervale Canyon sale and \$26,984 per acre in the Fryman Canyon sale for an absolute dollar difference of 135 percent. Some appraisers who claim to be experts in the valuation of preservation land love such exotic valuation issues and chaotic markets. Who can prove

them wrong? Pick a number, any number will work possibly depending on who your client is.

Contrary to many who believe that appraisals need to incorporate a “public interest value” premium to facilitate the preservation of precious natural resources, government entities as a matter of policy routinely pay more than appraised market value to induce a voluntary sale of such land. Decision-makers typically weigh the political repercussions of how much to overpay for land together with the amount of public funds available at any one time to buy land and the expected net positive benefits to the larger community. To assign this public policy making role to unelected real estate appraisers dangerously undermines our form of government. But government agencies and non-profit land trusts do it all the time when they retain appraisers who use comparable sales data from public and quasi-public preservation transactions as comparable sales.

The entire notion that market data from public and quasi-public acquisitions of natural resource land reflect a premium that can be used by appraisers for establishing

"L.A.'s Land Purchases in Mountains Criticized"

"The city of Los Angeles has gone on a shopping spree for open space in the Santa Monica mountains, sparking a heated debate over whether officials are paying too much in the name of preserving the wilderness.

Faced with the threat of housing developments on pristine hillsides, the city has recently purchased or is in the process of buying half a dozen properties totaling nearly 2,000 acres in the Santa Monica mountains so they can be maintained for hikers, bikers and nature lovers.

For many, the question is not preservation, but cost.

'The developers are getting dream deals. It's outrageous,' said Patricia Bell Hearst, past president of the Federal of Hillside and Canyon Associations.

The concerns raised about costs follow charges by many city leaders that scarce park funds should not be spent on open space in affluent areas in the first place - not when there is a dearth of parks in the city's poor neighborhoods.

At the center of the current debate is a proposal to buy 239 acres in Mandeville Canyon from San Fernando Valley car dealer and political power broker Bert Boeckmann.

City officials say they have a 'handshake' agreement with Boeckmann to buy the Brentwood property for \$5 million, although the sale is contingent on a city appraisal. Boeckmann purchased the property in 1978.

Any purchase requires city council approval because funds from Proposition K, the \$750 million special tax approved by voters for park projects, are involved.

Boeckmann planned to build 34 mansions on the property dubbed Mandeville Canyon Estates. His appraisal values the land at \$13.9 million.

Boeckmann did not respond to requests for comment, but he has said in the past that at the request of Mayor Richard Riordan he is willing to do the city a favor and let go of the property for \$5 million, plus \$8.5 million in tax write-offs.



'Obviously the property is appraised at far in excess of that,' said George Mihisten, an attorney for Boeckmann. 'I think it would be an incredible deal for the city. It's a fabulous piece of property.'

The price amounts to \$20,900 per acre, nearly triple the \$7,500 per acre cost of adjacent land purchased by the Santa Monica Mountains Conservancy late last year. Court documents and conservancy records place a value on an adjoining parcel, the 1,525-acre Eastport property, at \$11.5 million (\$7,541/acre).

Hearst and others say the Eastport property could be developed more easily than Boeckmann's land, which has landslide problems that a geologist for a neighboring property owner estimated would require \$2 million to \$6 million to resolve, according to city records.

City records indicate that the Department of Building and Safety issued an 'order to comply' in 1980 and a certificate of substandard property in 1981, both of which required that steps be taken to stabilize the soil on Boeckmann's land.

Those orders still stand and concerns about the instability of the property have blocked city approval of Boeckmann's application for a tract map to develop the land, according to Luke Zamperini, a city building official.

In contrast, the Eastport property had development entitlements, officials said.

City real estate manager Robert Halloway said that an appraiser hired by the city rejected Boeckmann's value and that the city is likely to set the price below the \$5 million he has offered.

But Boeckmann has told city officials that \$5 million is as low as he will go.

'The price is not outrageous,' said Michael Jimenez, an aide to city council member Cindy Miscikowski. He said other recent city acquisitions cost more than \$20,000 per acre, including the city purchase of 79 acres last year in Deervale Canyon in Sherman Oaks for \$4.5 million.

That deal worked out to \$56,962 per acre, which Jimenez said is the standard against which the Boeckmann deal should be judged.

'We could say (that) from this point forward we won't buy anything for more than \$10,000 an acre, but then we're not going to buy anything,' Jimenez said.

The Deervale purchase did not escape criticism. The city paid \$4.5 million despite a city appraisal that fixed the value at \$3.6 million, city records show.

Hearst said the city's willingness to spend \$900,000 more than its own appraisal for the Deervale property gives her misgivings about how the city will handle the Boeckmann proposal.

In 1991, the city council approved a deal that provided a developer with \$10.4 million in cash and land for 63 acres in Fryman Canyon south of Studio City, despite an appraised value of \$8.7 million.

Councilmen Mark Ridley Thomas and Mike Hernandez said they are also concerned that the city may be spending more than necessary for mountain land, when funds for inner city parks are in short supply."

“There are probably 700 different species that are found only in Southern California that have the potential to be listed” as threatened; about “100 species” of which are “spiders.” Southern California is an environmental “ground zero.” People who are going to be making demands for open space will have endangered species as a legal vehicle ad infinitum.”²

appraised values for subsequent land acquisitions creates a circular “house of cards” market and sometimes even the compound inflation of land prices for preservation. This happens when public agencies add another premium to the already inflated appraised values. Such a situation is not likely if land appraisal standards are scrupulously adhered to.

The Value Capture Model

This paper proposes what might be called a value capture framework to understanding why policy makers use PIV to buy preservation land and how PIV penetrates into real estate markets and the market appraisal process.

Before we can describe why PIV is used as a compensation policy for the public acquisition of open space land, we have to be rational and honest about environmental protection policy. It is the contention of many land economists and environmentalists that the majority of environmental protection policy is principally about open space, not the preservation of endangered species.

Despite some notable exceptions to the contrary, it is unconvincing that there is mass extinction of plants or animals necessitating the urgent interdiction of markets for vacant land. Even if the opponents are wrong and the survival of many species is endangered, it is difficult to get the public behind protection of such mundane creatures as bugs, flies, rats and spiders or their remote and unattractive habitats. Nevertheless, endangered species provide the rationale for existing urban property owners to advocate for open space value capture as long as they don't have to pay for it. As University of California at Riverside biologist Tom Scott is quoted:

“There are probably 700 different species that are found only in Southern California that have the potential to be listed” as threatened; about “100

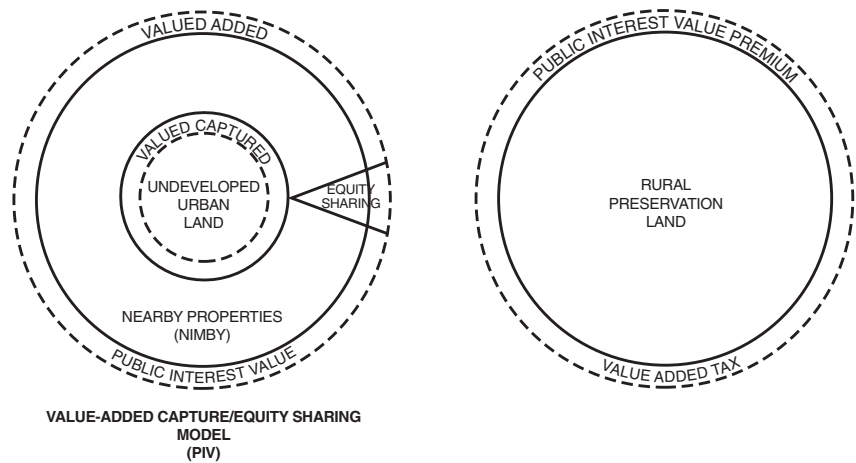
species” of which are “spiders.” Southern California is an environmental “ground zero.” People who are going to be making demands for open space will have endangered species as a legal vehicle ad infinitum.”²

The Endangered Species Act and the California Environmental Quality Act (CEQA) gives nearby property owners the legal ability to delay, frustrate, or stop any proposed development on land with almost any kind of natural resources on them. This is called the NIMBY (Not-In-My-Back-Yard) phenomenon.³ NIMBY originates with the legal authorization to trump any development affecting residential neighborhoods, to arrest urbanization in rural areas and to frustrate or to buy out land proposed

regulation in urban areas is tantamount to value capture by the majority of existing residential property owners at the expense of the minority of vacant landowners.

The reason why this NIMBY phenomenon is legally allowed to persist, despite the obvious regulatory taking and inverse condemnation issues involved, is that landowners are promised a “bonus” PIV value as part of the bargain. A downside to this policy is that all too often small landowners with stranded assets in active preservation areas must wait for the next allotment of HCP funds or government budgetary allocation to sell their blighted land.

Another reason that government is more apt to regulate land is that those



for development in estate home markets within scenic coastal, desert and mountain areas.

As economist William A. Fischel states, environmental “regulations do transfer wealth from one class of people, owners of undeveloped land, to another class of people, owners of already existing houses. The absence of a coherent regulatory taking doctrine policy promotes this transfer of wealth in a majoritarian context.”⁴ In other words, environmental

affected by the regulation, other than the bought-out landowner, are absentee future homeowners that are discounted in the local political process. Nearby residents are the beneficiaries of such preservation activities because the view amenity values of their properties will be enhanced and the cost for land purchase will mostly be shifted to the public. This is a regressive form of environmental taxation when it occurs outside a designated land preservation project area.

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Leslie attended the Oregon College of Education (WOU) and holds an Oregon Mediation Certificate and a pending IRWA SR/WA designation. She has additionally attended many technical and management training programs in property acquisition, appraisal and leadership. She is a former IRWA Chapter 3 President and a member of many IRWA Chapter 3 and Regional Committees.

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Petty Larceny Analogy

A possible economic analogy to help understand this value capture phenomenon can be found with the ticket pricing policies of some movie theaters outside the United States and in Broadway plays in New York as described by economist Yoram Barzel in his book the *Economic Analysis of Property Rights*.⁵ Where theater seats are sold in several price classes, buyers of lower-priced tickets can capture the value difference to the extent they are not prevented from occupying higher-priced seats. Theater owners can call in the police to exclude movie theatergoers who pay for inferior seats but by arriving early occupy better seats. If squatters are not excluded from occupying higher price seats, the higher-priced tickets are diminished in value.

The situation with land suitable for environmental preservation is the reverse of the movie theater example, but the economic consequences are the same. With urban environmental preservation, surrounding property owners do not need to occupy vacant land but merely need to keep absentee landowners from occupying it. With obstructionist environmental preservation policies, the majority of incumbent residential property owners can capture value from vacant landowners by calling in the regulatory police to exclude development resulting in the transference of view amenity values and seclusion premiums to their properties.

Equity Sharing

A related concept to value capture in explaining why government pays more for land for environmental preservation in urban areas can be found in the book entitled *Takings: Private Property and the Power of Eminent Domain* by University of Chicago law professor Richard A. Epstein.⁶ Epstein advocates an equity-sharing principle that government should pay some gains to owners of

undeveloped land that accrue to the public from public projects. Typically, this value enhancement or “project influence” factor is denied under most eminent domain laws. But with PIV we are talking about the voluntary acquisition of land in urban areas where an inducement price must be offered if preservation is to be accomplished “at almost any cost.”

Contrary to the criticisms about land purchase costs expressed in the above case study, the PIV premium prices often paid to landowners for preservation of their land can be seen as “bargains” when compared to the sometimes enormous value added to surrounding urban properties. For example, recent research has shown that value added to the price of the average vacant residential lot varies from 39 percent for a golf course view, 115 percent for a marsh or creek view and 147 percent for an ocean view.⁷

That is why politicians and government agencies are often cautious about what is paid for open space, but nonetheless still prepared to pay what appears to the public as outrageous or “dream” prices to landowners. By employing an equity sharing model rather than an eminent domain market model, government and quasi-public entities forego lawsuits for regulatory takings while they recompense the landowner for the base market value of their property and at least some of the bonus value transferred to the public.

The equity-sharing model is a form of government based on social contract where property rights are a “government delivered service” and the protection of property values is another entitlement program.⁸ But there is a hidden “value-added” tax on such residential value captures in urban areas that occurs on the back end of this social contract in the form of inflated prices paid by taxpayers to preserve land in rural areas.

The government’s social contract won’t allow incumbent urban property owners to preserve view sheds and seclusion near their properties unless they also assent to higher taxes for the protection of habitats for “ugly” species

and less appealing environments in rural and wilderness areas as part of the bargain. This equity sharing preservation policy is disastrous to rural land markets when applied in “one size only” fashion to preservation land purchases where there is no surrounding real estate market economy to capture and redistribute value.

Space does not permit the detailing


of a full value-capture/equity-sharing model for appraisal purposes.^{9, 10, 11} The accompanying concentric ring diagram depicts how value is captured from owners of undeveloped land and transferred to owners of existing residential properties, or to nearby future residential properties in the case of HCPs. As shown in the diagram, the value of undeveloped land shrinks while the value of the outer ring

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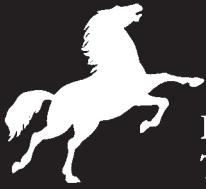
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of nearby residential property owners is enlarged. Equity sharing is shown when a slice of the pie of enhanced values of nearby property owners is paid up-front to the property owner of the undeveloped land. The "value-added" tax that must be paid for inflated prices of rural land by all taxpayers is shown in the second drawing.

HCPs

The same sort of value transfer occurs in designated Habitat Conservation Plan (HCP) Areas. Developers in HCP areas must pay a mitigation fee to develop their parcels. These fees are used to acquire open space within the HCP. The Habitat Conservation Authority is designated as the single buyer in HCP areas. This prevents the escalation of prices for vacant land by competition from many developers. Because of these price control measures, land transactions inside an HCP can't be considered a market in the traditional sense of the term.

Moreover, because an HCP is a public project, purchases of land inside HCP areas are considered "project influenced sales." Owners of properties with stranded property equity in HCPs are often compensated more than market value for their land in return for its permanent designation as open space. This "preservation loaded price" is passed along to the ultimate residential property owners of surrounding development in the form of view amenity premiums for their improved properties.

Most developers realize that they ultimately benefit from the resulting higher price of homes created by the open space amenity. HCPs are the inverse of "redevelopment projects," but use some of the same value enhancement mechanisms. In this sense, HCPs might be termed "de-development" projects. Like redevelopment projects, large land developers use HCPs to transfer the open space burden to typically smaller property owners while retaining the maximum density on their adjacent properties and avoiding delay.

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Economic Complements

With the growing trend toward de facto public co-ownership of vacant land, it is becoming increasingly difficult to separate preservation land values from surrounding residential land values in urban areas or to distinguish between Market Value and PIV in rural areas with active preservation markets. This leads to the problem of the transformation of land into an economic complement instead of an economic substitute. What appraisers typically value are economic substitutes. Economic substitutes are analogous to butter and margarine. Economic complements are analogous to eggs and cereal. For example, impacted land and mitigation land is an economic complement. Land that is an economic complement can not be easily appraised as a stand-alone parcel as conventional appraisal standards and methods require.

Coerced "Voluntary" Sales

The value-sharing model also explains why the use of sales prices paid for preservation land do not meet any of the legal tests of market value such as willing, arm's length parties that are knowledgeable about the magnitude of the PIV premium that is paid to preserve land. These paradoxical sales transactions defy categorization. Preservation land sales voluntarily coerce landowners to sell their properties for preservation with an economic carrot of an above market value price rather than the large stick of condemnation. Strangely, even though public policy makers in urban areas use a value-sharing calculus to justify PIV, they typically do not inform themselves with the help of appraisers whether this premium fully compensates for any value lost to the undeveloped parcel or exceeds the pro rata share of the value captured by surrounding improved properties.

Counterfeit Markets

It is apparently unrecognized by real estate appraisers that public policy makers use a value-capture/equity-sharing calculus for urban open space preservation rather than the conventional

condemnation market value model. The market premiums paid for prior public preservation purchases are often erroneously thought to establish a market demand and a market price reflecting PIV in lieu of explicitly establishing public policy for payment of such a premium. In reality, PIV sales reflect a counterfeit market, the sales data from which should not be used to compensate landowners either under the equity sharing model or the conventional market value model.

Implementation of the value-sharing model in rural land markets has been disastrous because it simultaneously over-inflates land prices for voluntary purchases of land; and blights land that may be subject to condemnation by extinguishing demand and nullifying most of the possible market sales data that could be used to value such lands under government appraisal standards.

Because of the large costs of conducting mass appraisals of view amenities,

government decision-makers often use a shorthand method to administratively establish the amount of price inducement they are willing to pay over traditional market value.

This oftentimes includes the reliance on appraisals using pseudo-sales price comparables to cloak public policy making. Moreover, using PIV-loaded land sales comparables in appraisals is tantamount to one level of government setting compensation policy for other public entities.

Preserving Standards

Real estate appraisers need to understand that government appraisal standards are their best friend. If appraisals become nothing more than an exercise in bending the rules to "make the deal," it won't be long before government agencies and land trusts establish a de minimus rule that appraisals are not required at some arbitrary limit like \$1 million or \$5 million per parcel. That is

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Value capture is analogous to the situation where theater seats are sold in several price classes and buyers of lower-priced tickets can capture the value difference by arriving early to occupy better seats.

what happened with residential house appraisals in the lending industry.

Lenders or brokers just wanted appraisers to validate their sales prices and appraisers largely did so. House appraisals below a set value limit became unnecessary. If the PIV price premium paid above traditional market value reflects a public policy premium, then public and quasi-public entities may eventually come to understand that they can best set this policy themselves without even a market value appraisal and save the cost and delay.

Government agencies and land trusts or conservancies that re-sell land to the government should not use the PIV model of compensation that is only suited to urban markets where there is some economic rationale by policy makers for preserving views and open space for a value premium. Disturbingly, this writer has recently been informed that some public wildlife agencies have already adopted a two-value appraisal reporting policy ('traditional market

value" and "public interest value"), where the second value is predicated on "project influenced sales" or sales containing PIV. Another disturbing practice of many land trusts and conservancies is "appraisal shopping" by the reported use of a phased appraisal process to see if the appraiser is going to come in with the desired value. If the appraiser does not, the appraisal assignment is terminated early and another appraiser is retained until the desired result comes about.

However, a particularly difficult dilemma for government real estate personnel and independent real estate appraisers is that the rigorous application of government land appraisal standards for condemnation of land in environmentally active markets may inadvertently result in under-compensation because of blighted demand and lack of evidence of normal market sales transactions from which to derive a value indication.

The ethical dilemma facing the real estate appraiser who is undertaking valuation assignments of land suitable for environmental preservation in nationalized land markets is the difficulty of applying land appraisal standards either too stringently in condemnation or too loose in voluntary land acquisitions. ■

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JOB BANK

IRWA has a free service for right-of-way employers and for those seeking employment. The Job Bank, which includes job postings of prospective employers and resumes of job seekers, has had very positive response. Anyone can access and update information on the Job Bank through the IRWA web page at <http://www.irwa.com>.

The voice recorded Job Hotline is no longer in service. For questions about these employment services, contact Anna at International Headquarters.

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