The Appraisal of Easements

By Albert N. Allen, SR/WA

In recent years, the increased level of easement acquisition, particularly by energy and telecommunication companies, has prompted a number of reasons for easement appraisal to include proposed easement acquisition, appraisal of property encumbered with one or more easements, and analysis of property sales already encumbered with easements. This article primarily focuses on easement acquisition across individual properties: the methodology rather than application. The scope of the article also includes some background consisting of definitions, a discussion of proper easement valuation methodology, and finally some comments on misused alternative methodology.

BACKGROUND

A brief discussion of basic terms related to the eminent domain valuation framework will probably prove helpful before addressing easement valuation methodology. There are many excellent sources for valuation-related definitions, and several have been included in the references at the end of this article. No attempt has been made to advance precise definitions in this article, but rather to relate the terms to each other and to show how they fit within the easement valuation framework.

MARKET VALUE — The appraiser should be aware of the market value definition of the particular jurisdiction of the subject property. Any proper definition will include the willing seller/willing buyer concept. The courts are seeking just compensation and market value is generally accepted as a basis for just compensation. When appraising the impact of an easement on a particular property, care should be exercised not to arrive at a conclusion of value other than market value. Market value is related to the value of the subject property itself (in rem) to typical market participants and not to the individuals or entities (in personam) that own the property.

Examples of other types of value include use value (value particular to the owners of the property) usually associated with a special use property, and investment value (value to the buyer).

HIGHEST AND BEST USE — This is probably the single most important appraisal principle and is fundamental when estimating market value. Land is always appraised based on its highest and best use as theoretically vacant and available for development at the date of the appraisal. The existing (current) use, particularly of improved property, is not necessarily the standard; rather it is the physically possible, appropriately and legally supported, financially feasible, and resulting in

the highest value of the land as of the date of valuation. A potential (future) highest and best use is not the standard used unless that use is reasonably probable. Highest and best use concerns the use of land and not the owners or buyers of property. Business value is outside of the scope of highest and best use.

WHOLE PROPERTY — Sometimes referred to as the entirety, the larger parcel, or the parent tract. Some appraisers distinguish between the three. The term whole property as used in this report means a property under a single ownership, physically contiguous and with one highest and best use throughout. Cases of common ownership, physical contiguity and more than one highest and best use indicate more than one economic unit and thus, more than one whole property. The market value of the whole property places the ceiling on just compensation. That is to say, the market value of a part taken cannot exceed the market value of the whole property, although the taking can result in damages in excess of the market value of the partial acquisition.

PARTIAL ACQUISITION — Also variously referred to as the part taken, take, or partial take. A fee taking involves all of the rights of ownership; however, an easement involves a partial taking of rights, and, in many cases, the interest taking involves but a portion of the total property. Different kinds of partial takings include 1) the fee taking of a part of the total property; 2) an easement taking affecting the total property; and 3) an easement taking of part of the total property.

An easement acquisition is always a partial acquisition. Even if the proposed easement physically covers the entire subject whole property, the underlying fee estate is not acquired. The underlying fee owner still has a beneficial interest in the property. A partial acquisition can involve physical property or legal rights (such as access rights), or both. The appraisal of easements requires identification of the type of easement and the physical parts of the total property affected.

REMAINDER PROPERTY — The remainder property includes those portions of the total property not taken plus the property rights remaining to the owners of the easement area itself. For example, a pipeline easement across a farm will leave the landowner with land areas not within the easement, plus the right to use the surface area of the easement area after construction for crops. As a result of some easement acquisitions, the remainder property may have a different highest and best use than that of the original whole property.

RIGHT OF WAY — As used in this article, right of way will refer to the area within the boundaries of the easement in which the utility, pipeline, or telecommunication facility is installed. For example, the pipeline right of way width may be 50 feet. A right of way may be across a particular property. A right of way can also be a route across many different properties, as in the case of a pipeline or a fiber optic line. A right of way can also include fee simple property. A right of way should not be confused with an easement. In most cases, a right of way will cross multiple properties and will consist of several easements. An easement is unique to one property. Both terms, as they relate to the subject property, should be discussed within the appraisal report. Another common mistake is to confuse a right of way with a corridor. A corridor is always a right of way, but a right of way is not necessarily a corridor. Corridors are discussed later in this article.

In the valuation of easements for public acquisition, the measure of value is always the loss in the value of the burdened property, not the value of the easement to the taker.

EASEMENT — An easement is a specifically defined interest (estate) in property and is owned by someone other than the owner of the underlying fee simple interest. It is a dominant estate and the underlying fee is a servient estate. The easement document specifically delineates what property rights are involved and should be included in the appraisal report. No two easements are exactly alike. Each easement is associated with a particular property and is unique from other easements on that property and to easements situated on other properties. Easements are not a type of highest and best use. An individual easement is not a right of way system or corridor.

USER IMPROVEMENTS — These are the physical improvements or structures placed within the right of way such as a pipeline, electric transmission line, telecommunications cable, etc. This facility may be situated on a single property or may extend across many separate properties.

The user improvements in easement areas are owned and operated by someone other than the underlying fee owner. Any value, cost, profit or revenue from operation of the user improvements goes to its owner and not to the underlying fee owner. Revenue from operating the infrastructure is a business venture separate from the value of the land burdened by an easement.

PROJECT INFLUENCE — In the partial taking of a right of way for a given project, the purpose of the project and the proposed user improvements can impact the value of the remainder property. It can lower the value of the remainder (damage), raise the value (benefit), or have no impact on the remainder value. The project influence rule says that any impact on value affects only the remainder and should not be considered when appraising the whole property value. Valuation of the whole property and the partial acquisition is estimated before considering the project influence. The remainder property is valued after considering the impact of the project.

CORRIDOR — Corridors should not be confused with easements. A corridor is a property use rather than an estate. Stated another way, a corridor is a type of highest and best use, while an easement is generally an estate or interest in land. A highest and best use as a corridor is market driven as opposed to an arbitrary delineation, and the reasonable probability of users is necessary.

Rights of way across an individual property are typically in the form of an easement; however, the user may own in fee some portions in a given length of right of way (across multiple properties). Only when the land across a given length of right of way is in the absolute control of a one entity, may the length be defined as a right of way corridor (and this assumes that other tests are met as well). In some circumstances, the individual existing rights of way easements are not in the control of an individual entity, and changes and sale of the corridor for additional users is not possible without the additional consent of the individual owners of the underlying fee simple estate. For example, if a railroad is situated within a physical corridor but owns only the right to use as a railroad, and the individual fee owners control other uses (such as laying a pipeline or fiber optic line), then that right of way cannot be defined as a marketable corridor in an economic sense.

A corridor has a number of characteristics. Any corridor connects important demand points while an easement extends to the boundaries of only one property. A corridor avoids congestion to the extent that it bypasses many properties, allowing a user to avoid buying right of way from many different owners. That is to say a corridor provides a distance advantage due to transport across many ownerships. The corridor owners provide services such as engineering, maintenance and surveillance. Corridors are typically marketed as an entity.

Owners of corridors rent or sell right of way within the corridor to users who wish to place their user improvements within it. However, the physical corridor is not classified as a right of way corridor unless the rights to use can be obtained from a single entity without the necessity of getting also the same rights from all the basic fee owners of the land. There is considerable literature on the subject of corridor valuation and some has been included in the bibliography.

VALUATION CONSIDERATIONS

The proper valuation methodology for easements is the "before and after" rule. A variation of this rule is the "take plus damages" rule. Generally, case law and appraisal literature support this methodology. Strictly speaking, the appraiser does not appraise an easement but rather measures the impact of the easement on the burdened property. The measure and impact (value) of an easement is the loss in value to the remainder property after imposition of the easement. This diminution is comprised of both the easement acquisition and damage (if any) to the remainder. Different jurisdictions have different laws governing the valuation of partial takings and the appraiser should be careful to use that methodology applicable in the subject property's jurisdiction.

In the valuation of easements for public acquisition, the measure of value is always the loss in the value of the burdened property, not the value of the easement to the taker. Appraisal methodology is focused on the market value of the property and should be consistently applied. The valuation methodology used should not vary regardless of the nature of the proposed project, who the buyers will be, or who the owner is. Additionally, it should not vary whether a governmental agency is involved or if it takes place in the private sector.

VALUATION OF THE WHOLE PROPERTY — The whole property is appraised before any consideration of the proposed project. The whole property is not burdened by the proposed project in the before scenario and the market data collected for the whole property value estimate should not reflect any project influence.

VALUATION OF THE PARTIAL ACQUISITION — The proposed acquisition area to be burdened by the easement is appraised in the before situation and will have the same per unit value as that of the whole property. All easement acquisitions are partial

acquisitions because some beneficial interest remains with the underlying fee owner. Accordingly, the value of the proposed easement impact on the remainder will be less than the value of the fee simple that it burdens, and cannot be more. The market value of the easement acquisition is directly related to the market value of the property it burdens. If the purchase price of an easement exceeds that of the underlying fee simple value, this is an indication of the presence of other considerations, such as damages to the remainder, business decisions, time restraints, administrative settlements, improvements within the acquisition area, unusual physical characteristics, engineering factors, etc. If the area of the proposed easement were worth more on a per unit basis than the value of the fee simple estate, then it would follow the properties burdened with easements would sell for more than properties having no easements. The market does not bear this out.

VALUATION OF THE REMAINDER — The remainder is appraised in the after scenario because it is now burdened with the easement. The remainder consists of all property outside of the acquisition area and the underlying fee simple interest. Paired sales analysis is the proper way to measure the impact of the easement. By comparing properties similar to the subject with an easement to similar properties without an easement, an estimate of the differences can be abstracted.

TOTAL BEFORE AND AFTER METHOD — When the law of the subject property's jurisdiction requires a before and after valuation, the appraiser performs an appraisal of the property before considering the impact of the take and the project. Next a new appraisal is made of the remainder property under the theoretical assumption that the proposed project has been completed. The appraiser takes into account in the after value the impact upon value of the use of the easement area by the project and the benefits of the easement area remaining to the underlying fee owner. Also taken into consideration is the impact on the

remainder of the taking. Sales of properties burdened by a similar easement are compared with similar properties not affected by the same type of easement.

ALTERNATIVE METHODOLOGIES

On occasion valuation methodologies other than the "before and after" method are advocated both in practice and in appraisal literature. These alternative methodologies have arisen in part from the hectic nature of utility right of way (telephone, electricity, pipeline, fiber optic, etc.) acquisitions in recent years and some have serious flaws. Three of these alternative methods will be discussed: use of easement transactions as comparables, linear rules of thumb, and incorrect use of corridor valuation theory.

EASEMENT TRANSACTIONS COMPARABLES — Generally speaking, easement transactions are not reliable for use as comparable data and should not be used when appraising the impact of an easement on the burdened property. Even though the use of easement transactions seems very straight forward, there are a number of reasons why they should not be used to estimate market value.

Easements are not economic units in and of themselves. An economic unit must stand alone on its own. They are not traded individually on the open market. A user purchases easements in order to assemble a system and most easement transactions represent gain to the buyer as opposed to loss in value to the burdened property. Because the buyer is putting together a right of way system, many non-realty considerations could be involved in an easement transaction including administrative costs, engineering factors, project timing and other business decisions. For example, a natural gas supplier facing a contractual deadline might pay an inflated price for a particular easement in order to complete the project. Another example would be when valuing partial acquisitions for a road-widening project; sales of strips of land to the condemnor on other road projects are not used as comparable sales. The appraisal methodology should be consistent regardless of the type of project.

For some types of easements, such as those acquired by utility companies for electric, telephone, cable lines and pipelines, there may be an established going rate per pole, per line-mile, per rod, and the like. In appraising a similar type of easement for government acquisitions, the appraisal should not be based on such going rates but should be based upon the usual "before and after" appraisal method. It therefore goes without saying that sales of easements based on such measures cannot be considered valid comparable sales.

The use of easement sales introduces project influence (an after scenario) to the before valuation. Any valuation of an easement impact should be in the after situation. In the before scenario, there is no easement. Using easement transactions as comparables might indicate a pre-determined opinion that the proposed easement area represents an economic unit (separate highest and best use). The probability of an easement being placed on a particular property at the precise location across the property in anticipation of a project in the future is probably remote. Accordingly, the reasonable probability component of highest and best use is violated.

Easement transactions are complex and obtaining all of the information necessary to make a direct comparison to the subject easement is extremely difficult. Confirmation by the appraiser of the amounts paid for each easement along a right of way project is very difficult. Even if the sales prices are available, identifying and abstracting the various components of each transaction such as land value, damages to the remainder, business decision, etc. are hard to obtain. Accordingly, the comparison is usually unreliable.

Each burdened property is unique. An easement across one property will probably reflect a different impact when compared to the impact of an easement acquisition on the subject property. For example, there may have been improvements within the easement areas of one easement sale and none in the subject easement area. There may be damages to the remainder as a result of the easement on one property and no damages to the remainder on the subject property. The highest and best use of one property may be different than that of the subject whole property.

Each easement is unique. For example, one easement may involve a 50-foot right of way compared to only 30-feet for the subject easement. Another easement may extend diagonally across one property unlike the subject easement that may extend along the property boundary. One easement may have a term of ten years while the subject easement may have an indefinite term.

Each user improvement is unique. The size of the pipeline, the number of pipelines allowed, the product, etc. all may differ between one easement transaction and the facility to be built on the subject easement area. These

differences are important because the potential for damages to the respective remainders may differ between the easement transactions used for a comparable and the subject easement.

Each purchase is unique to that buyer. It is difficult to compare a transaction involving one buyer with a particular set of needs and objectives to another situation involving another buyer with a different scenario of potential gain.

The most compelling reason that the prices paid for rights of way should not be the basis of establishing market value of an easement is that such acquisitions are not made by a willing buyer and willing seller. The utility or pipeline company is a forced buyer and the sellers are under the threat of condemnation. Even if the purchaser does not have the power of eminent domain, they are still a forced buyer. Such sales do not represent open market value.

LINEAR RULES OF THUMB — Although in practice, easement purchases are often made based on linear units of value such as, per rod, per mile, per foot, etc., this is not appropriate appraisal methodology. As pointed out earlier, each easement is quite unique and a linear measurement (per unit expression of value) does not take into account the differences between properties. An easement across an individual property is only one component of a right of way project that may extend for many miles across dozens, if not hundreds, of individual properties. Often the linear measurement represents value to the buyer. To the extent that the buyer is assembling a right of way system, prices paid for individual easements may reflect a business decision rather than a market value decision. Accordingly, the linear measurement will usually represent a use value such as investment value, rather than market value.

IMPROPER USE OF CORRIDOR THEORY — In those cases where highways, pipelines, electric transmission lines extend from one point to another, there obviously exists a physical corridor. The user of the land areas in the physical corridor may own fee title to the lands in the right of way, for example, the state highway department. In such cases, the land from one point to another is a true, saleable or rentable right of way corridor providing the user the right to sell or lease rights to others to place their improvements, such as a coaxial cable, in the corridor. In some cases, the land was acquired from the landowners for the sole purpose of the highway and the state may not have the right to sell or lease the restricted corridor to others.

There are instances where railroads, with fee title to the right of way, abandon their service to a particular right of way and then sell or lease the land to others. Roads owned in fee may be undedicated and the fee lands become available for sale or lease to others. Frequently, there is no demand for the rights of way abandoned by the utility or railroad and the land is divided and sold (where possible) to the adjacent owners. Where railroads own the fee title to their right of way, they may be able to lease or sell portions of the right of way to others such as a pipeline. Interstate highways probably are the largest supply of true, merchantable corridors.

The methodology of appraising true, saleable right of way corridors depend upon a demand by some entity and the ability of the buyer to pay. When a demand exists, the lower limit of value typically is the across the fence unit value adjusted down for the property rights retained by the seller. The upper limit is usually the across the fence land value sometimes including an increment (usually a multiple) above the across the fence land value as adjusted for plottage.

When the ownership and control of additional usage of a physical right of way is vested in a number of landowners in addition to the easement holder for the original use, there is no merchantable right of way corridor. It is improper to use the "corridor concept" in those cases of physical corridors since there is no savings of time and expense. The existing landowners may even demand more compensation than owners in a new right of way.

The attempt to place a "corridor" premium on proposed individual easements because they are a part of or adjacent to an existing right of way, by classifying it as "corridor value" is incorrect. Several courts have confirmed this.

SUMMARY

In the final analysis, the traditional, land-based, before and after methodology is the best measure of the impact of an easement on a particular piece of property. If market value is being sought, then the impact on the value of the property and not gain to a buyer (whether individual or entity) is the appropriate measure. To use other techniques will almost invariably lead to an estimate of some value other than market value. This is a particularly important consideration in the eminent domain framework.

The market value of easements does not relate to the value to the user. The "use" of highest and best use is the economic use of the property without regard to the benefits to the condemnor. Typically, the partial acquisition may involve specifically defined interest over the total property, such as an avigation easement covering the entire property; or, it may involve certain rights to merely part of the whole property, such as a driveway access.

The market value of a corridor can be totally owned in fee by a single entity, such as a railroad or state highway, or, the physical corridor can be a number of parcels with the underlying fee owned by individual property owners. There may be a plottage increment above the "across the fence" value when portions of the total corridor can be sold or rented to others by a single owner; however, there is no rationale for a value increment when every property in the corridor must be acquired from the individual owners.

In the direct sales comparison approach, transactions involving rights of way acquired by others are not considered valid because they are not open market transactions. Such acquisitions are by a condemnor forced to acquire and by a condemnee forced to sell under the threat of eminent domain. The price per rod, per acre, or per mile under these conditions is not bona fide data that can be used to arrive at market value.

REFERENCES

"Valuation of Transportation/Communication Corridors," John P. Dolman, MAI, CRE and Charles F. Seymour, MAI, CRE, *The Appraisal Journal*, October 1978, Pages 509-522.

"Railroad Right of Way Appraisal," James D. Jennings, *Right Of Way*, October 1994, Pages 4-10.

"Rail Corridor Sales," Clifford A. Zoll, MAI, *The Appraisal Journal*, July 1985, Pages 379-387.

"Rail Corridor Markets and Sale Factors," Clifford A. Zoll, MAI, *The Appraisal Journal*, October 1991, Pages 504-512.

"Valuing a Corridor Within a Corridor," Richard J. Zulaica, *Right Of Way*, November/December 1998, Pages 6-10.

B-1: "The Enhancement Factor in Transportation Sales and Appraisals," Arthur G. Rahn, *The Appraisal Journal*, January 1999, Pages 89-92.

B-2: Reprinted *The Appraisal Journal*, May/June 1999, Pages 14-17.

"Appraising a Transportation Corridor," Gary S. Valentine, *Right Of Way*, November/December 1998, Pages 6-10.

"Lessons Learned from Two Decades of Corridor Appraising," Charles F. Seymour and David W. Anderson, *The Appraisal Journal*, April 1997, Pages 179-182.

"Valuing a Gas Pipeline Easement Part 1, A History and Synthesis of Methodology," William R. Lang, MAI and Brett A. Smith, *Right Of Way*, September/October 1998, Pages 24-33, 47.

"Setting Value on a Gas Pipeline Easement Part 2, Case Studies of Potential Dangers," William R. Lang, MAI and Brett A. Smith, *Right Of Way*, January/February 1999, Pages 19-27.

"Easement to Fee Simple Value Ratios for Electric Transmission Line Easements: A Common Sense Approach," Gordon Green, MAI, *The Appraisal Journal*, July 1992, Pages 399-412.

"Measuring Residential Price Impacts from Proximity to Natural Gas Transmission Lines," Dr. William N. Kinnard, Jr., REGC, Inc., June 1991, P.O. Box 558, Storrs, CT 06268; (203) 429-1005.

"Appraisal of Pipeline Right of Way," Carr T. Dowell, III, *Right Of Way*, June, 1984.

"The Big Fiber Pull," Vicky Uhland, *ZDNet*, October 22, 2000.

"Final Report Fair Market Value Analysis for a Fiber Optic Cable Permit in National Marine Sanctuaries," Author Unknown, *National Ocean Service, National Marine Sanctuaries*, December, 2000.

Exxon v. Hill, Supreme Court of Louisiana, No. 00-C-2535 (2001).