Tenant Owned Improvements Revisited

by Dick Pyatt

The novelty and complexity of acquisitions involving tenant owned improvements compound the chance of error and owner/tenant complications.

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Acquisition of tenant owned improvements is required by the Uniform Relocation Assistance and Real Property Acquisition Policy Act of 1970. The following article is a synopsis of the Nevada Department of Transportation's experience in developing a policy and procedure to implement this aspect of the Act of 1970.

Acquisition of tenant owned improvements seems to have four distinct phases:

1. Discovery phase.
2. Preappraisal phase.
3. Appraisal phase.
4. Negotiation phase.

Discovery Phase

The discovery phase takes place early in the overall acquisition process. For the Nevada Department of Transportation, it seems to be more convenient just prior to requesting permission from the local office of the FHWA to appraise and acquire. We have found that properties with tenant owned improvements, on occasion, tend to "fall through the cracks", and the fact that tenant owned improvements exist on a particular parcel is not discovered until later on in the acquisition. This discovery phase consists of simply identifying those parcels with tenant owned improvements on them and reporting this fact to Right-of-Way Headquarters in Carson City prior to requesting permission to appraise and acquire. This requirement puts the District Right-of-Way Office on notice as to which parcels in the project contain tenant owned improvements.

Preappraisal Phase

The second phase in the acquisition of a parcel containing tenant owned improvements is the preappraisal phase. This phase consists of the Department designating an agent to meet with the fee owner and tenant or tenants together or separately to explain the concept of tenant owned improvements.

At the conclusion of this explanation, the agent asks the parties to supply an inventory of those items that they consider tenant owned. Agreement and delivery of this inventory is given a specified period of time. The completed inventory must contain a certification of ownership from the tenant or tenants and a release of interest statement from the fee owner.

The receipt of this inventory does not require the Department to acquire all the items of the agreed upon inventory. Once the completed inventory has been received, it is reviewed by the agent, the assigned reviewer, and the District Supervisory Right-of-Way Agent. Only those items that meet the Department's definition of tenant owned improvements are allowed to remain on the list.

Appraisal Phase

The approved inventory is supplied to the assigned appraiser. In those cases in which specialty items need to be valued, a specialty appraisal may be ordered by the Department. Upon completion, the specialty report is supplied to the real property appraiser for inclusion in his report. The appraiser is instructed to provide an inventory of items that contribute to the overall value of the real estate. The sum of the fee owner's portion, and the tenant's portion cannot equal more than the value of the whole property. (An exception to this statement would be when salvage value exceeded contributory value.) In estimating the value of the various parts, the State of Nevada does not compensate for leasehold/lease fee values, however, the appraiser can consider the terms contained in the lease. Again, that is not to say that the appraiser is to value leasehold/lease fee, but he is to consider the terms contained in the lease, i.e., the total term of the lease and the re-

maining term specifically.

The appraiser's final estimate of value is divided into the fee owner's portion and the tenant's portion. The inventory of items contributing to the overall value are likewise segregated. The final appraisal document is sent to review. Review follows their normal review procedure, except that they check the items claimed as tenant owned improvements to insure they comply with the Department's definition of tenant owned improvements, and that double payment does not occur. The finalized report is turned over to negotiations through the normal channels.

Negotiation's Phase

For a number of reasons, the agent involved in the preappraisal phase should probably be the assigned negotiating agent. The assigned negotiating agent must keep in mind that the tenant has all the same rights as the fee owner. Therefore, the negotiator must prepare a negotiations package for each of the tenants concerned. This includes a letter of offer, a public highway agreement, an approved inventory of tenant owned improvements to be acquired, and a title transfer document, i.e., Quitclaim Deed, or bill of sale.

Barring any kind of unforeseen problem, the negotiations and closing should be handled as any other acquisition.

Tenant Owned Improvement Complications

The novelty and complexity of acquisitions involving tenant owned improvements compounds the chance of error and owner/tenant complications.

One of the first areas for potential errors is in the discovery phase. Specifically, the Right-of-Way District concerned fails to discover the existence of tenant owned improvements on a particular parcel. This error is not normally discovered until the appraisal phase of acquisition. The discovery, at this late date, requires that the appraisal of the property in progress be placed on hold while the preappraisal obligations are fulfilled. Once this phase has been accomplished, it must be recognized that the appraisal assignment has changed and will require a change in the appraisal instructions and possibly renegotiations of the appraisal fee.

There are a number of complications that can arise during the preappraisal phase. As mentioned earlier, the concept of tenant owned improvements is relatively new. Many leases contain clauses which state that at the termination of the lease all improvements revert to the lessor. In conjunction with this thought, most fee owners feel very strongly on this point. The State must acquire title from the fee owner first, and secondly, the tenant. No progress on the acquisition can be made without the fee owners accepting or rejecting an offer. Therefore, in the case of a failure to gain an understanding of the tenant owned improvements concept, the Department must work solely with the fee owner.

A. The tenant or owner refuses to accept the tenant owned improvement concept in general.
B. The owner or tenant refuses to provide a list of tenant owned improvements.
C. The owner and tenant fail to come to agreement on the inventory of tenant owned improvements.

The Nevada Department of Transportation must first come to an agreement or understanding with the fee owner on tenant owned improvements. This agreement is a key to the progress and success of the total acquisition. Therefore, the assigned agent must insure that he or she has adequately explained the concept of tenant owned improvements to all parties concerned. If agreement cannot be obtained between the parties, the Nevada Department of Transportation has no alternative but to conduct the remaining negotiations with the fee owner. If agreement cannot be reached, the acquisition is headed for possible condemnation. The lack

of agreement makes the appraisal phase somewhat more difficult. The appraisal instructions must insure that a detailed inventory of improvements that contribute to the real estate to be acquired is included in the report. Once the appraisal has been completed and reviewed, the assigned negotiator must again explain the concept of tenant owned improvements. If an agreement has not been obtained, this is an excellent opportunity for the negotiator to "try again". This explanation must emphasize the fact that agreement between the parties must be achieved before the acquisition process can be completed. If agreement cannot be obtained, the approved offer must be made to the fee owner. If the offer is accepted, but no agreement on tenant owned improvement has been reached, then the only alternative is again a condemnation action.

Another area of potential problem that might occur in the preappraisal phase is submission of items on the inventory that do not conform to the Department's definition of tenant owned improvements. This problem is discovered after the agreed upon list, the release of interest and the certification of ownership has been obtained. The list is reviewed by the assigned agent, the reviewer, and the Supervisory Right-of-Way Agent. At this time, if an item or items are found on the list that do not conform to the Department's definition of tenant owned improvements, the item is omitted from the list. At this time, it is determined if the item claimed can be handled in the relocation process.

These are three potential areas of concern that come to mind in the appraisal phase.

1. The property to be appraised contains items designated as tenant owned improvements, such that basic real estate appraisers are unfamiliar with their method of valuation.

   The key to solving this problem is early identification of acquisitions containing tenant owned improvements. Early identification allows the Department to find a specialty appraiser to handle the "specialty" improvements and order their valuation to be included in the real estate valuation.

2. Valuation of tenant owned improvements - leasehold/lease fee, summation approach, and the income approach.

   The Nevada Department of Transportation adheres to the undivided fee rule in these matters and strict adherence to this concept is the key to these questions. That is to say simply "the sum of the parts cannot equal more than the whole". The second part in this difficult area is "contributory" value. Does the item under consideration contribute to the overall value of the subject and to what extent.

   The summation approach or income approach can be used as long as it is used to determine contributory value.

3. In valuing tenant owned improvements, to what extent are the terms and term of the lease considered.

   In encountering these questions, again common sense must prevail. The Department is not a party to the contract agreement and is required by law to reimburse the tenant or tenants for their contribution to the overall value of the property to be acquired.

   The intent of the lease is a big question, what is the term; is there an option to renew the lease; do the tenant owned improvements revert to the fee owner; how much time is remaining on the lease? All these questions must be individually fielded before the questions can be answered.

This local, heavy frame straightening, brake, and wheel alignment shop specializes in service to heavy equipment and large trucks. The fee owner furnished the building shell and the tenant furnished all the specialized built-in equipment, large access doors, reinforced concrete floor, and frame straightening concrete reinforced pits.

Finally, upon successful completion of negotiations, the title to the items being acquired must be transferred to the Department. The standard Public Highway Agreement serves to delineate the agreement between the Department, fee owner, and the tenant or tenants.

(see Tenant, pg. 29)

Final Location

The "final" location as determined by engineering studies and easement acquisition considerations is the first stage of facility siting but certainly cannot be considered the last. Twenty years or more ago, pipeline routes were based on engineering and acquisition considerations. Today the route of a facility is influenced by Snail Darters, Eagles' Nests, Black Footed Ferrets, Indians, Indian ancestors, flowers, politicians, bureaucrats, historical societies, funeral directors, air samples, water samples, soil samples, and economic models. The list goes on and on. Today's complex requirements associated with the final routing of a facility are best satisfied when the routing is accomplished by an organization maintaining an awareness of the current regulations and codes of the various agencies or groups which have an impact on routing. Active files describing the requirements of permitting agencies must be maintained.

Preliminary contact should be made to introduce the project to private and public agencies. However, the pipeline designer or operator should have an indepth understanding of the appropriate regulations and should not be caught in the trap of asking an agency what is necessary in order to receive a permit. Public agencies are frequently under the pressure of special interest groups and may require information, reports or hearings in excess of the codes. I am aware of archaelogical surveys being required by an agency simply because the approval of the pipeline construction permit provided a convenient means of forcing the pipeline operator to conduct an archaelogical survey in an area where previous archaelogical data did not exist. It may interest you to know that the $40,000 archaelogical survey didn't provide evidence of one significant site. But, it did add to the cost of natural gas.

I strongly recommend that those persons involved in environmental and permitting decisions have a detailed first-hand knowledge of the regulations affecting a project and not depend on the respective agencies to dictate activities they feel are in the public interest. Depending entirely on the agencies frequently results in problems associated with overlapping jurisdiction, intra-agency politics, etc. If you elect to short cut your preliminary work in today's environmental or permitting situation, your project will surely experience unnecessary delay. Time is money.

Determination of Value

Determination of land values as a basis for right-of-way and damage compensation can be the result of experience in the project area or contract appraisals. The individuals involved in acquisition must know the area and the people.

The agent should be prepared to consider and discuss soil conditions, current crop damage, long term crop damage, hunting, wildlife, streams, soil erosion, sedimentation, land development, individual safety, safety of domestic animals, irrigation, timber, drain tile, access roads, dust, noise, right-of-way maintenance after construction, water wells, litter, fences, pipeline depth, etc. If these and a multitude of other questions are not addressed to the satisfaction of the property owner or his attorney, the right-of-way agreement may not be executed. The cost of time and effort spent in satisfying the concerns of the land owner and determining the true economic impact on the property is money well spent. The number of condemnations will be reduced, and construction extras will also be reduced. Spending a few dollars to establish a fair right-of-way agreement is certainly less expensive than construction extras and completion delays. The days of $3/rod right-of-ways are gone.

The preliminary activity of determination of land values is critical to a cost effective acquisition project. Right-of-way agents, please don't give the land owner the right to pick a pipeline route across the property. He will invariably want it 10' off the property line and through the swamp or in the other locations requiring special construction methods or fittings. These routes can double or triple the per foot cost of construction. I had to establish a pipeline route 5 feet off the property line and the property line location had never been determined. We found ourselves in the midst of a property line dispute.

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Title to the property is transferred by Quitclaim Deed with attached inventory or by bill of sale with attached inventory, depending on the nature of the property to be acquired. The Quitclaim Deed is used for property more closely resembling real estate while a bill of sale is used for those items that resemble personalty.

In summary, early identification of acquisition with tenant owned improvements, a clear explanation to the owner and tenant on the tenant owned improvements concept, and an early, accurate, agreement between the owner, tenant or tenants, and the Department on what constitutes the tenant owned improvements is the key to the acquisition of a property with tenant owned improvements.