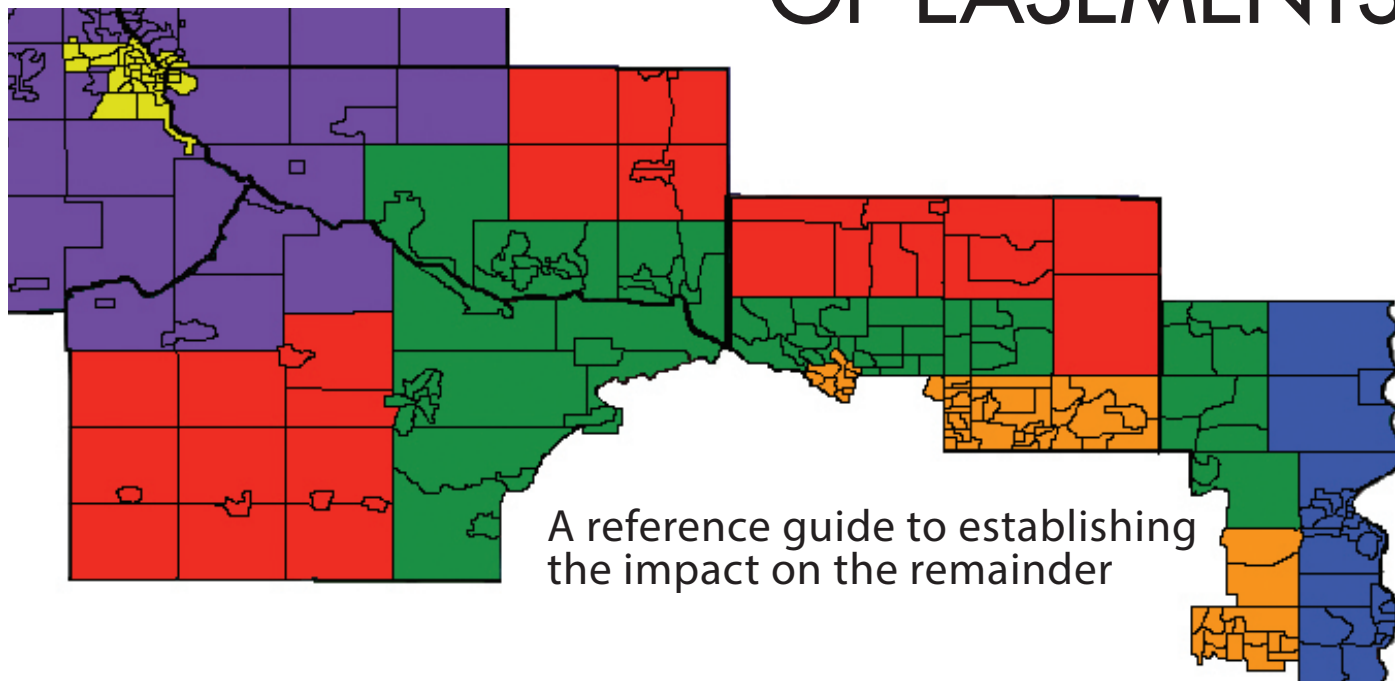


THE VALUATION OF EASEMENTS



A reference guide to establishing the impact on the remainder

BY DONNIE SHERWOOD, SR/WA, MAI, FRICS

Appraisers are often tasked with evaluating easement rights being acquired and determining the impact on the remainder property. Since real estate exists in a marketplace that characteristically has many variables, an easement may be just one of many factors that affect a property's value.

According to the Dictionary of Real Estate Appraisal, an easement is "an interest in real property that conveys use, but not ownership, of a portion of an owner's property." By definition, the ownership of real estate is endowed with a bundle of rights. The bundle of rights concept maintains that like a bundle of sticks, real property ownership may be wholly intact (fee simple estate) or may be unbundled and conveyed in part to a third party.

A property owner has the inherent right to use the property, sell it, lease it, enter it, give it away, or even refuse to do any of these things. For example, the creation of a lease conveys to the tenant a portion of the owner's rights for the specific term and space occupied by the tenant according to the lease terms. During the lease period, the tenant may have a measurable interest in the property. The creation of an easement is somewhat similar to a lease in that both are dealing with the

concepts of time and space. By definition, the creation of an easement conveys a portion of the total bundle of rights to a third party. The challenge before the appraiser is the measurement — in terms of dollars — of the market value of the rights conveyed.

Classes of Easements

With respect to time, easements may be permanent or temporary in nature, with either specific or indefinite time frames. Temporary construction easements are fairly common and will terminate at either a specific time or at the end of construction and restoration. In pipeline or other linear type projects, there may be a permanent easement, but it is usually not of sufficient width to accommodate material or equipment for the actual construction. In such a case, the creation of a temporary construction easement may be necessary. With permanent easements, these are perpetual and therefore have a permanent effect on the title of the property — regardless of whether there are future owners — until the termination of the easement or abandonment. Since the rules regarding the ending of a permanent easement may vary by jurisdiction, legal counsel should be consulted.

In terms of space, three broad classes of easements exist – surface, sub-surface and overhead. Subsurface easements may be required for the construction of water and sewer lines, petroleum pipelines, communication lines or tunnels. During construction, surface disturbance may occur and some above ground appurtenances may be present, however, the bulk of the project will remain below the surface and largely unseen. Common surface easements may allow for drainage, flowage, access, railroads and highways. These types of easements generally have a larger impact on the property’s surface area. Typical overhead easements include electrical transmission lines or aviation easements. Easements may involve a combination of two or even all three types of space. For example, an overhead transmission line may require a surface area for the placement of a tower or pole structure. Some subsurface easements may require surface space for valves or metering stations. Thus, while generally classified as one of the three broad classes of easements, most easements involve multi-space occupancy.

Principles and Methodologies

The task before the appraiser is to evaluate the “rights conveyed” by the creation of the easement and to properly measure these rights. The principles and methodology applied to appraising property for partial acquisitions also apply to the valuation of easements. All easement valuations are partial acquisitions under the theory that the property owner retains some residual rights within the easement area. The value of an easement is measured by what the property owner has lost from the bundle of rights, not by what the grantee has gained.

The before and after methodology (also known as the federal method) is the appraisal procedure cited in the Yellow Book and used in federal acquisitions as well as by some states. The value of the easement is based on the difference between the value of the whole property before the taking and its value after the taking with the easement in place.

In the following example, the \$60,000 in total compensation includes both the value of the easement rights being acquired and any damages to the remainder property that may result due to the placement of the easement. Under this method, if the remainder after value shows an enhancement or benefit, it can result in zero dollars in compensation.

Before and After Methodology

Value of Whole Property before Acquisition	
120 acres @ \$10,000 per acre	\$1,200,000
Value of Remainder Property after Acquisition	
120 acres @ \$9,500 per acre (Encumbered with 10 acres in easement)	<u>\$1,140,000</u>
Total Compensation	\$ 60,000

The summation method has been adopted by many states and will indicate the same compensation value as the before and after methodology, except where benefits are present in the remainder property after the acquisition. Using this method, benefits can offset damages, but the landowner is always entitled to the value of the part acquired. In easement acquisitions, rarely would one encounter situations where there are benefits. Thus, both methods will indicate the same opinion of compensation. Using this approach, the appraiser will be required to estimate the value of the easement plus damages to the remainder, if any. For example:

The Summation Method

Value of Whole Property	
120 acres @ \$10,000 per acre	\$1,200,000
Value of Part Acquired	
10 acres @ \$10,000 per acre @ 50%	\$50,000
Value of Remainder before Acquisition	
\$1,200,000 - \$50,000	\$1,150,000
Value of Remainder after Acquisition	
120 Acres @ \$9,500 per acre (Encumbered with 10 acres in easement)	<u>\$1,140,000</u>
Damages	\$10,000
Part Acquired	\$50,000
Total Compensation	\$60,000

The challenge for the appraiser is ascertaining where these figures come from. The answer is the market! The appraiser’s task is to see what effect, if any, an easement has on the sale of property encumbered with similar easements. In the case of residential property, most urban properties within platted subdivisions are likely encumbered with common utility easements. In most situations, these easements extend along the property line and have little effect, if any, on the sale of the home. Thus, the market tells us that the easement has little value, if any. This is because the presence of the easement does not affect the use or utility of the property and does not place any undue burden or hardship on the property owner.

To support an opinion of compensation, appraisers often use matched pair sales analysis. Using this approach, an appraiser will attempt to find two similar sales, one encumbered with an easement and one without, and measure the impact the easement has on value. Care must be used, as one example may not sufficiently apply to all situations. By having multiple pairings, an appraiser can establish a general trend of the measured impact. It should be noted that the total difference between encumbered and unencumbered includes both the easement and its effect (damages).

Matched pair sales analysis can also be employed to establish the percentage of rights acquired. However, care must be taken in this analysis as the unit price differential may include not only the easement rights, but the damages to the unencumbered remainder as well.

Value Matrix

To assist appraisers and right of way professionals, an easement valuation matrix can be used as a general guide to assess the effect an easement may have on the total bundle of rights. This is not an exclusive list of easements types and the effect on the total bundle of rights, but rather a guide to general effects on the total fee ownership.

In establishing this matrix, the impact the easement has on the use and utility of the real property is what counts. For example, the seller of an office site negotiated an easement based on purchasing 50 percent of the rights in a sewer line easement. The buyer negotiated the sale using an unencumbered value of \$7.27 per square foot. At 50 percent, the area within the easement totaled \$3.64 per square foot. In this situation, the buyer and seller concluded that the easement rights amounted to a 50/50 balance, where 50 percent of the property rights were included with 50 percent remaining. And while this office site abutted a high voltage electrical transmission line right of way, the presence of this adjoining easement did not appear to affect its value, use or utility.

Contributory Value

To ascertain the contributory value of an easement using the matched pair sales analysis, the first step is to find sales that were encumbered with similar easements to those being appraised. While

it is important to find out what rights were acquired, this can often be difficult to ascertain, as the easement may be either undefined or difficult to locate in the public records. Once the encumbered sale has been located, the next step is to find similar unencumbered sales in the same market area. Ideally, one would locate an unencumbered sale that is identical except for the encumbrance. However, this is rarely possible.

In the following example, the encumbered property is a 100.112-acre rural tract that sold in June 2012 in north central Texas. At the time of sale, the property was encumbered with two monopole high-voltage transmission lines, with 9.40 acres that traversed the property in a southwest/northeast direction. The tract also had extensive road frontage and the easements crossed the property in a way that left a similar amount of acreage and road frontage on either side of the easement. The property sold for \$300,336 or \$3,000 per acre.

The comparison sale containing 84.34 acres sold in December 2010 for \$269,888, or \$3,200 per acre. The market did not indicate a change in market conditions, and this sale was found to be highly similar except for its road frontage. The sale required an upward adjustment of five percent for its frontage along a gravel road. Thus, its adjusted price was increased to \$3,360 per acre.

The encumbered sale had a net unencumbered area of 90.712 acres (100.112 acres less 9.40 acres). Utilizing the unencumbered value of \$3,360 per acre, the value of the unencumbered area would be \$304,792. Subtracting this number from the actual sale price of \$300,336 would indicate that the contributory value of the easement area was negative \$4,456. Assigning a value of 90 percent to the easement, the contributory value of easement would be \$3,158. Adding the unencumbered value of \$304,792 plus the easement value

of \$3,158 indicates a total of \$307,950. Subtracting this figure from the actual sale price of \$300,336 indicates damages of \$7,614.

While this example supports the numbers in the easement valuation matrix, it assumes that the easement had residual rights of only 10 percent. If in fact the rights remaining in the easement were increased to 20 percent (indicating 80 percent of the rights were acquired), the amount of damages would increase to \$10,773.

In interviewing the buyers, sellers and/or brokers in these situations, some observed little or no damages from the presence of the easements while others stated that substantial damages were present when the market indicated otherwise. One particular broker stated that the encumbered sale's extensive road frontage

Easement Valuation Matrix

Percentage of Fee	Comments	Potential Types of Easements
90% - 100%	<ul style="list-style-type: none"> Severe impact on surface use Conveyance of future uses 	Overhead electric, flowage easements, railroad right of way, irrigation canals, exclusive access easements
75% - 89%	<ul style="list-style-type: none"> Major impact on surface use Conveyance of future uses 	Overhead electric, pipelines, drainage easements, railroad right of way, flowage easements
51% - 74%	<ul style="list-style-type: none"> Some impact on surface use Conveyance of ingress/egress rights 	Pipelines, scenic easements
50%	<ul style="list-style-type: none"> Balanced use by both owner and easement holder 	Water or sewer lines, cable lines, telecommunications
26% - 49%	<ul style="list-style-type: none"> Location along a property line location across non-usable land area 	Water or sewer line, cable lines
11% - 25%	<ul style="list-style-type: none"> Subsurface or air rights with minimal effect on use and utility Location with a setback 	Air rights, water or sewer line
0% - 10%	<ul style="list-style-type: none"> Nominal effect on use and utility 	Small subsurface easement

Matched Pair Sales Analysis

Value of Whole Property

100.112 acres @ \$3,360 per acre \$336,376

Value of Part Acquired

9.40 acres in easement @ \$3,360 per acre @ 90% \$28,426

Value of Remainder before Acquisition

\$336,376 - \$28,426 \$307,950

Value of Remainder after Acquisition

100.112 Acres @ \$3,000 per acre \$300,336

(Encumbered with 9.40 acres in easement)

Damages \$7,614

Part Acquired \$28,426

Total Compensation \$36,040

Damages resulting from a temporary and permanent easement are difficult to measure. A key question is whether the easement affects the use and/or the utility of the property that results in a change in highest and best use. Also, the easement may include accessory rights, such as the ability to access the easement or expand its use, for example placing additional pipes in the future. From a physical standpoint, most activity occurs on the surface. Thus, impacting the surface area tends to affect value to a greater degree compared to a subsurface easement where there may be little, if any, impact on surface use.

By nature, real estate exists in an imperfect market. The presence of an easement on a property is only one of many factors that buyers and sellers will encounter during the sales process. While some buyers may react negatively toward an easement, others may view this same easement with total disregard. For example, on heavily vegetated hunting land, having a cleared area may provide an opportunity to develop a viable hunting stand with a clear field of fire. Others might view this same easement as aesthetically offensive.

“...the easement will impact the ownership title and may affect both current and/or future uses.”

seemed to negate any damages. While these perceptions may reflect actual market reactions, care should be taken with unsupported claims of damages. This example illustrates the difficulties in reaching an empirical figure. It also illustrates the need for a greater sampling of market data. Additional sales may indicate greater or lesser rights and/or damages.

Legal and Physical Rights

When investigating an easement, the appraiser will want to address some important questions. In doing so, understanding the nature of both the legal and physical rights being sought is imperative. Some questions to address may include:

- What is the proposed use?
- Where is the easement located? Can it be moved?
- Is the easement located along a property line or within a setback area?
- What construction method will be used?
- Who will maintain the easement and how often?
- Does the easement leave a remnant or gap?
- Will the easement be surveyed and monumented?
- May either party alter the construction or grade after completion?
- Will the landowner have to obtain permission to use the easement area?
- Can the landowner cross the easement with roads or utilities?
- How will the easement holder access the easement?
- Who pays property taxes and insurance?
- Will the easement cause a loss in view or security?
- Will the easement benefit the owner in any way?

The answers to these questions are often found within the easement document, but may require discussion with the condemner. In terms of legal encumbrance, it is important to recognize that the easement will impact the ownership title and may affect both current and/or future uses.

In Summary

The rights included in an easement can vary depending on multiple considerations, such as the type of structure, the location of the easement and other physical factors. This stresses the importance of a good and thorough confirmation of the easement rights, verification of the easement's location, determination the easement size and ensuring an adequate number of comparisons from which one can surmise general trends. Even with all this information, the imperfections of the real estate market must be tempered by the skill and experience of the appraiser.

In every situation, the appraiser must explore the rights being acquired and allow the market to dictate the effect the easement will have on the remainder property. In most cases, the presence of an easement may be one of many deciding factors affecting value. Isolating the effect that an easement has on a given property requires extensive research and a comprehensive evaluation. 🌟



Donnie is a Director with Integra Realty Resources in Dallas/Fort Worth, Texas. He has been an appraiser of real property since 1978 and is an IRWA certified instructor for all valuation courses.