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The Use of the Federal Concept on the Before and After Techniques in Partial Takings for Privatization

James LaMantia

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**THE USE OF THE FEDERAL CONCEPT
ON THE BEFORE AND AFTER TECHNIQUES
IN PARTIAL TAKINGS FOR PRIVATIZATION**

James LaMantia, B.A.

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James LaMantia, B.A.



**An Abstract Presented to the Faculty of the Graduate
School of Lindenwood College in Partial Fulfillment of the
Requirements for the Degree of Master of Science**

1995

ABSTRACT

Chapter 1. Introduction

The Field of Valuation

A general overview of the field of valuation with a U.S. Constitutional base - the Fifth and Fourteenth Amendment applied to the valuation process.

Thesis Research and Methodology

The thesis will develop the technique of the "Before and After" concept as it can relate to unique and special purpose analysis and valuation. The thesis will take the broad base of valuation under federal requirements and develop the "Before and After" concept from that base. A methodology will be developed from this conception. The methodology will then be applied to a classic case study. Finally the methodology will be applied to a unique and special purpose analysis and valuation of a case study. The

case study will demonstrate that the application of the “Before and After” concept is the proper and best approach to use.

Thesis Statement

The concept of valuation is legally supported in the Constitution of the United States. The federal area of Eminent Domain has created a field of use through case law and federal administrative policies and requirements. The federal case law and court decisions have created a whole field of legal terminology. The areas of Eminent Domain and its Just Compensation requirements have developed legally accepted methodology. One of the required methodologies for partial federal takings is the “Before and After” concept. The “Before and After” methodology is used to measure the difference between two sets of valuation facts. This concept when used properly can be used to measure changes in use and rights.

Chapter 2. Key Terms and Their Legal Usage

General

The use of the Federal concept is used because of: the U.S. Constitutional base; the large amount of case law, federal administrative procedure and legislation data available.

Key Terms

Specific terms are defined with support data and a rationale when applicable. These key terms are:

Fair Market Value - Rationale

Highest and Best Use - Rationale

Bundle of Rights Theory - Rationale

Partial Taking - Rationale

Severance Damages - Rationale

Other Terms - whole or larger parcel; take; remainder

Summary

Chapter 3. Application of Key Terms

General

Once the terminology is defined its use and application comes into play. A "how to" starts to form. A

sense of priority and analysis is developed for the use and application of the terms. Specific use of the terminology is done by analysis.

Bundle of Rights Theory

A system of analysis is set out for the determination of the present rights and burdens of the subject property. This system allows us to logically know all the present rights and burdens in the “Before” condition and in the “After” condition. Specific examples are given of unique and high impact “sticks”: Long Term Leases; Mineral Rights; Air Rights.

Summary

Highest and Best Use Analysis

It is necessary to understand that two separate Highest and Best Use Analyses must be made when the “Before and After” concept is used. It is noted that the Highest and Best Use can be different for each of the use conditions. An analysis is made of the defined use and its

importance to value. For the purposes of this analysis the following three elements are identified as:

- 1. Physical adaptability**
- 2. Reasonable possibility**
- 3. Use needed (market demand)**

Examples of the three elements are:

Element 1 - A huge underground rail system under a big city;

Element 2 - A environmentally and politically sensitive 350 acre R&D parcel that couldn't be developed;

Element 3 - A resort development on the side of the Big Island, Hawaii, for which there was no market demand.

Other Terms Specific to Eminent Domain

These following terms have been developed over the years by court decisions on these specific issues: the whole or larger parcel and what constitutes it; the remainder; the Take - when is the take effective?

Inverse Condemnation and/ or Regulatory Taking

This is the top issue in property rights. Recent Supreme Court decisions support this issue for the "property rights people."

Chapter 4. In Search of Use

To this point, a taking of land has been presented as an example of the "Before and After" concept. In this chapter the "stick" taken from the bundle of rights is something other than ground. Some takings are identified in both the federal and private sector. These uses are acceptable and the "Before and After" is the basis for the valuation. The concept is used in the easement valuation and use.

Federal acquisitions involve a wide variety of easement types ranging from the traditional to the exotic and they are: road; pipe line; electric transmission line; levee, flowage; clearance; navigation, scenic; conservation; tunnel; sewer line; safety zone easements.

Land Trust Alliance and the National Trust for Historic Preservation in the United States defines the value before

the easement and the value after the easement concept as follows: Historic Preservation Easements on Urban Properties; Historic Preservation Easements on Open Lands; Scenic Easements; Farmland Easements; Timberland Easements; Natural Habitat Easements; Easements to Protect Land Areas for Public Outdoor Recreation and Education.

Case Study

An actual appraisal for the taking of water rights in a desert environment. The selections are taken directly from the report and comments are interjected throughout the report to illustrate specific concepts and issues.

Summary

The "Before and After" concept is a detailed process. The appraiser finds himself doing research and in-depth analysis.

There are very few assumptions that can be made in this concept. The bundle of rights must be identified as correctly as possible. The Highest and Best Use of the "Before and After" must be real market use.

Chapter 5. Thesis Evolution

The Thesis Statement is restated and a summary of each chapter is analysed. This prepares and sets the stage for the application of the "Before and After" concept to unique and special purpose projects. The privatization of a marina is used for the case study. This was a project in Guam prepared for a Japanese investor.

As in the previous case study the selections are taken directly from the report. Comments are then interjected throughout the report. This allows the thesis to illustrate specific concepts and issues.

Case Study

This was the privatization of a public resource and the analysis of a sensitive political issue on the island of Guam. The sensitive issue of privatization demanded that the interests of the public, government, and developer be identified and determined. The analysis went beyond valuation.

All positive and negative impacts had to be identified and measured. Utilizing the land to more than its present

use, exceeding the existing level of service, creating a positive cash flow into the Government of Guam treasury, stopping a negative cash flow from the Government of Guam treasury, and creating full use of a natural resource were components that were all considered.

Chapter 6. Case Study Summary and Thesis Statement

Case Summary

A “Before and After” methodology was used on cash flows, services and uses. Based upon this methodology a comparative analysis was made in the “Before and After” condition measuring a positive or negative conclusion of each cash flow, service, and use. Based upon these separate conclusions, an overall conclusion was made.

Thesis Conclusion

The thesis statement is confirmed. The privatization case study is tied into the thesis statement. From the first decisions based upon the U.S. Constitution to today’s federal court decisions, a whole field of legally accepted concepts and methodology has developed. The “Before and

After” concept to measure the difference between two sets of valuations is legally accepted by the courts. Based upon the Thesis Statement, the “Before and After” concept is used to demonstrate other potential uses.

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**A Culminating Project Presented to the Faculty of the
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1995

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Santa Rosa, California**

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Chapter 1

INTRODUCTION

The Field of Valuation

In the field of Valuation concepts are developed that impact the traditional approaches of value to the appraiser. The appraisal report as we know it today did not exist 100 years ago. In fact the sophistication we see today has developed within the last 20 years. Certainly the advent of the computer and the fast data analysis it accomplishes has impacted valuation science. But the professional appraiser by his research, analysis, and innovations has been the main motivating factor.

Today there is the Uniform Standards of Professional Appraisal Practice¹ (USPAP) setting national standards for appraisers and valuation reports. These standards are enforced at the state level by specific state laws. The traditional valuation usage of Cost Approach, Income Approach, and the Sales Market Approach have now been legalized by government legislation.

The research for this thesis will show that consideration was given to the taking of private property

in the United States Constitution by the Fifth Amendment². It states "...nor shall private property be taken for public use, without just compensation..." The Fourteenth Amendment of the Constitution³ also speaks to the "due process" of a taking and requirement for just compensation.

The Fourteenth Amendment states, "...No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any state deprive any person of life, liberty, or property without due process of law; nor deny to any within its jurisdiction the equal protection of the law."

The Federal Approach to Value has developed into a field of law under this provision of the Fifth Amendment and the constitutional provisions of the Fourteenth Amendment. These constitutional amendments create an arena for Eminent Domain and Just Compensation legislation and case law.

The concept states that a sovereign government may acquire private property for public or quasi-public use without the consent of the property owner upon payment of just compensation. The courts stated in the 1890 case of *Searl versus School District, Lake County*⁴ that "...it is

the duty of the State, in the conduct of the inquest by which compensation is ascertained, to see that it is just, not merely to the individual whose property is taken, but to the public which is to pay for it." In the 1897 case of *Chicago, Burlington and Quincy R.R. versus Chicago*,⁵ in reference to the due process clause of Fourteenth Amendment, the court required due process for the just compensation of private property taken.

The right of the sovereign to take the property is sometimes questioned. The question is resolved based upon the need of the sovereign. Historically this need has not often been challenged. Today, the authority of the sovereign on "Regulatory Takings" of private property is a legal question.

The "Just Compensation" or, value of the property taken, is most often challenged in the courts. This continual challenge on the just compensation issue has created a vast amount of court decisions. These court decisions, Federal administrative regulations, and government legislations have impacted the valuation science field. A federal uniform standard has developed from these challenges. This standard is not in conflict with the methodology used by the private sector appraiser.

The private sector appraiser becomes the contract appraiser for government appraisals. By contract, he is required to comply with the federal requirements of the Uniform Appraisal Standards for Federal Land Acquisitions⁶ and the Uniform Standards of Professional Appraisal Practice⁷. This federal requirement is not unique to government appraisals, but is the standard of most private sector appraisals as well.

Perhaps the one exception might be a valuation technique known as the "Before and After" approach. This methodology is required in all Federal acquisitions that are for less than full fee value. The term full fee value used here represents the 100% right of ownership. This technique is not common in the appraisal field.

Thesis Research and Methodology

This thesis will develop the technique of the "Before and After" concept as it can relate to unique and special purpose analysis and valuation. The thesis will take the broad base of valuation under the federal requirements and develop the "Before and After" concept from that base. From this conception a methodology will be developed. The methodology will then be applied to a

classic type case study. Finally the conception will be applied to a unique and special purpose analysis and valuation of a case study. The case study will demonstrate that the application of the "Before and After" concept is the proper and best approach to use.

Thesis Statement

The concept of valuation is legally supported in the Constitution of the United States. The federal area of Eminent Domain has created a field of use through case law and federal administrative policies and requirements. The federal case law and court decisions have created a whole field of legal terminology. The areas of Eminent Domain and its Just Compensation requirements have developed legally accepted methodology. One of the required methodologies for partial federal takings is the "Before and After" concept. The "Before and After" methodology is used to measure the difference between two sets of valuation facts. This concept when used properly can be used to measure changes in use and rights.

1 Uniform Standards of Professional Appraisal Practice

2 United States Constitution, the Fifth Amendment

3 United States Constitution, the Fourteenth Amendment

4 Searl v. School District, Lake County, 133 U.S. 553,562 1890

5 Chicago, Burlington & Quincy R.R. v. Chicago, 166 U.S. 226, 235 1897

6 Uniform Appraisal Standards for Federal Land Acquisitions

7 Uniform Standards of Professional Appraisal Practices

Chapter 2

KEY TERMS AND THEIR LEGAL USAGE

It was stated in Chapter 1 that the federal concept to valuation will form the base for the analysis and application of the "Before and After" methodology. The decision to use the federal concept is based upon the vast amount of case law, federal administrative procedure and government legislation data that is available. The source of this data is generated by the United States Constitution. These key terms for federal acquisition have been court tested. From this evolution of court testing there has been a development of specific key terms and their legal usage.

Federal agencies, using this case law as their base, have set the administrative standards and requirements for their government valuations. Because the "Before and After" concept is required in all federal partial takings, the methodology is specifically defined. In the development and application of the "Before and After" federal concept it becomes necessary to deal with terminology as specified in the court tested definitions. No attempt will be made at this point to explain the application of these key terms and

their legal usage but when applicable a brief rationale shall be given.

Key Terms

Fair Market Value: In the Kerr versus South Park Commissioner¹, it was stated that this is the amount in cash, or on terms reasonably equivalent to cash, for which in all probability the property would be sold by a knowledgeable owner willing but not obligated to sell to a knowledgeable purchaser who desired but is not obligated to buy.

Rationale: The cases on Fair Market Value over a long period of time started to mean "market." In the 1951 case of Anderson-Tulley versus United States² it was stated in effect that the court would not deal with a theoretical or hypothetical value. It also stated that the market price is the just compensation.

Highest and Best Use: In the 1934 landmark case of Olson versus United States³ it was stated, "...the highest and most profitable use for which the property is adaptable and needed or likely to be needed in the near future." This case further states, "...elements affecting value that depend upon events or combinations of

occurrences which, while within the realm of possibility, are not fairly shown to be reasonably probable should be excluded from consideration, for that would be to allow mere speculation and conjecture to become a guide for the ascertainment of value...”

Rationale: This is the use which, at the time of appraisal, is most likely to produce the greatest net return to the land and/or improvements over a given period of time. It is that legal use which will yield to the land the highest present value. The importance of this principal cannot be over emphasized. The Highest and Best Use of a subject must be determined both before and after. This analysis of Highest and Best Use in its before and after condition impacts value.

Bundle of Rights Theory: The Appraisal Terminology and Handbook of the American Institute of Real Estate Appraisers⁴ defines this theory as, “..An undivided ownership grants certain rights. Each of the following rights are measured in the market place. Some of these rights are the right to occupy and use, the right to sell and/or rent, the right to receive rents and the right to obtain occupancy of the property at the end of the lease period.”

Rationale: This is a property term that has evolved with use. The old common law term “fee” was meant to be a 100% ownership of absolute use. Today, these rights and privileges of property ownership, the sticks of the bundle, are limited by the four powers of government: taxation; eminent domain; police power; escheat. In our study it will be necessary to identify each right and measure it to find out what has really been taken and what is left.

Partial Taking: Uniform Appraisal Standards for Federal Land Acquisition, page 28⁵, states, “...When the United States acquires only part of a unitary holding, Federal law requires that compensation be made not only for the part taken, but also for the diminution, if any, in the value of the remainder directly caused by the taking and /or by the use to which the part taken will be put...” It is further stated “...Essential to a ‘partial taking’ and the application of the rules as to severance damages and special benefits is that the land taken be a part of a unitary holding (a ‘whole’)...”

Rationale: In the partial taking concept of federal acquisition, the identification of the unitary holding is of primary importance. In the 1943 *Miller versus United States*⁶ case, the court uses the term “unitary holding” to

define the "whole." The whole becomes very important when there is a partial acquisition of say 10 acres leaving a remainder of 5 acres in one instance or 500 acres in another. It is realized that a partial taking can place economic damage on the remainder that is referred to as "severance damage."

The determination of the whole can so impact valuation and severance damages that the courts have set out a unitary holding test. There are many case decisions in this area. In the 1950 decision of *Honolulu Plantation Co. versus United States*⁷ it was stated that the test must meet two requirements. These two test requirements are the "unity of ownership" and the "unity of use." The application of these tests will be further discussed in a later chapter.

Severance Damages: In the *Miller versus United States*⁸ decision, the court stated in effect that Federal law requires that if there is any diminution in value of the remainder as a direct result of the original taking just compensation must be considered. This diminution of value must be to the remainder as part of the whole.

Rationale: Federal courts are reluctant to recognize severance damages as such. State courts often consider

severance damages separately and therefore there is a conflict in this area of eminent domain. The process of this analysis is very important to our study.

Other Terms: During the analysis and valuation development of this report, certain other terms will be used. It should be noted at this point in our study and analysis that certain terms are used in specific ways. These terms are specific to federal partial taking. Reference is made to the subject parcel. When this term is used it is meant to be the whole parcel or larger parcel before there is any taking away from it. The next term of equal importance is the use of the term, take. The "take" is the portion acquired and it is identified but seldom valued separately. The term remainder is used to identify the balance of acreage left after a portion of the land is taken for use. Therefore, in use, the whole will be valued before the take and the remainder will be valued after the take. It is assumed that the difference from the value of the whole and the remainder is the take.⁹

Summary

Terms are used in federal acquisition and in the field of eminent domain in a specific legal sense. The courts

have placed specific legal meaning to them. If any transition of this appraisal concept of "Before and After" is to be made to other appraisal problems, the terminology must be known and understood.

¹ Kerr v. South Park Commissioner, 117 U.S. 376, 386, 1886

² Anderson-Tulley v. United States, 189 F.2d 192, 195 5th Cir. 1951

³ Olson v. United States, 292 U.S. 246, 255 1934

⁴ Appraisal Terminology and Handbook of the American Institute of Real Estate Appraisers

⁵ Uniform Appraisal Standards for Federal Land Acquisition, page 28

⁶ Miller v. United States, 317 U.S. 369, 376, 377 1943

⁷ Honolulu Plantation Co. v. United States, 182 F.2d 172, 179 9th Cir. 1950

⁸ Miller v. United States, 317 U.S. 369, 376, 377 1943

⁹ Uniform Appraisal Standards for Federal Land Acquisition, pgs. 28-35

Chapter 3

APPLICATION OF KEY TERMS

The definition of the legal area of eminent domain from the U.S. Constitution is in Chapter 1 of this thesis. Early case law by court decisions starts to form specific terms and their uses. Through this legal process these terms began to become legal definitions.

In Chapter 2 actual key terms and their legal usage were given for a specific action or use. An entire concept of legal term uses starts to take place. The intention when using a specific term is to mean that specific use.

It has been established that there is a legal basis for the "Before and After" concept. This concept is formed from case law and by the development and use of administrative standards and the requirements of federal agencies. This process is important to this thesis because it forms a strong legal basis for its use.

Specific terminology is developed from this base. When this terminology is used in the "Before and After" concept, a methodology of use begins to take place. In this chapter, the legal terms will be applied and a "how to" analysis will be made.

This "how to" methodology requires analysis of a certain sequence. This sequence in effect sets up a check list of what to do and when to do it. While the order of analysis may change from time to time, certain facts must be determined before the next step can be started. This order can be determined on a case to case use.

Bundle of Rights Theory: In most of the text books on valuation, the first step is to define the appraisal problem. In the "Before and After" methodology the first step is to analyse the subject property. This is an in depth analysis of all the present rights and all the present burdens on the subject property.

What rights does the owner have or does he not have? The old common law concept of absolute fee simple title and unrestricted use became limited with the powers of government. **The Appraisal Terminology and Handbook** of the American Institute of Real Estate Appraisers¹, cited in Chapter 2 of this thesis, presents the following four specific powers of government that burden most properties: power of taxation; power of eminent domain; police power; escheat. Each one of these powers of the government can and does impact value.

This thesis will not endeavor to make an in depth analysis of each of these governmental powers. The main point here is that there is not absolute use of property in the market place today. Once this concept is accepted then there is the possibility that other sticks, the rights and the privileges of ownership, might have been taken or transferred from the bundle of sticks.

Looking for the "Before" value of the subject property, the present bundle of rights must be determined and identified. How does the research start?

The owner may be a good source for property data but third party information may be necessary for this type of analysis. The best research data to start with is the Preliminary Title Report and/or Abstract of Title obtained from a Title Insurance Company or an attorney. One of the most important pieces of title data to look for is the "subject to" portion of any report. These types of reports, in most cases, will recite what the status of ownership was and what the buyer acquired when he purchased the property. If these sources are not available then actual public records should be checked. In fact, the subject property analysis is such an important element of the "Before and After" concept that actual document copies

are usually obtained. These document copies are often placed in the addenda of the appraisal report and they become a part of the valuation.

What will these records tell? They will tell what the property rights were at the time the present owners acquired the property. They will also show any rights on or to the property that the owner may have conveyed to others or those rights which he is legally bound to honor such as an easement that is appurtenant to the land.

This could be called a "before status" of the subject property or an inventory of ownership rights. A property owner cannot sell or transfer any property rights he does not have. If the property owner conveys a right or there is a partial taking of some of the property rights inventory, the remainder of the inventory rights would represent the "after status" of the subject property.

The following examples will be given to illustrate the concept of the bundle of rights analysis.

Long Term Lease: The most obvious example might be a long term lease of the property. The fee owner retains the property rights of receiving rents (income) and getting the property back at the end of the lease term (reversion). There may be an additional property interest which is

known as a Leasehold Estate². The Leasehold Estate would reflect any interest that the lessee might have in the property that is market generated. This could be measured by a Present Value (PV), the difference of the economic rent over the base rent of the lease. The property owner may only sell and convey that interest to which he has a legal right such as the right to rents and the reversion of the property at the end of the lease term. The leasehold interest would remain with the lessee during the term of the lease and it could be sold or assigned if the lease conditions allow it.

Appraisers will often make the statement in their Assumptions and Limiting Conditions that they are valuing the subject property as if it was free and clear. This is not the real world of valuation. While this appears to be a simple concept, the full market impact may not be realized by some appraisers.

During the 1950s, the United States Postal Service (USPS) acquired small rural post offices throughout the western states. These were on a build/lease-back arrangement. The owner, lessor, would build a small post office to the United States Postal Service specifications and then lease it back to the United States Postal Service on a

long term lease. The United States Postal Service awarded long term leases on these post offices based upon the best competitive rents offered by the potential lessor. The lessor would usually pay all operating expenses during the lease term.

A post office may be considered a special purpose property. The market or comparison approach to rents is usually not considered indicative of the market for these properties because of the lack of comparable data. Other comparative post office rents are not acceptable to the United States Postal Service for valuation purposes.

Because of the special use and construction requirements, post offices are not what could be considered an open market item. They are created for one user and for only one use. Certain items cannot be used by anyone other than the United States Postal Service. An example of this is the inspector's gallery which is a long corridor built into the ceiling. The inspector's gallery is sound proof and has a one way observation window along the corridor. This expensive item has a specific use to only one user.

As a special purpose property, an income formula is used to establish an investor's net income on the property.

The "Return On Investment" (ROI) is the basic approach used. This approach takes the cost of the investment and applies a percentage to it to determine the net profit to the investment. The net profit to the property is composed of the Return On (a percentage rate of return on the investment) and Return Of (a percentage recapture rate of return on the total investment).³

At the time these small rural post offices were acquired by competitive bid, the Return On Investment approach was used for bid rating purposes and awarding. The United States Postal Service took into consideration certain short life assets and a composite weighted recapture rate was established. In the 1950s, the time of the awards, the rents were considered a fair and reasonable market return on investment property for the investor.

It should be noted at this point that all the leases required the lessor to pay fuel and utilities expenses. The United States Postal Service was to be held responsible for the payment of property taxes only. These lease conditions were common to the market at the time of these lease contracts.

By the mid 1970s, the United States found itself in a fuel crisis and the price of fuel skyrocketed. Along with this dramatic increase in fuel prices, all costs and prices increased and inflation became a fact of life. Real estate responded to the cost and price increases of the market. Inflation formed a partnership with the real estate market and real estate prices spiraled upward.

At this time, the expenses of fuel and utilities were exceeding the gross rents received by the lessors. The owners/lessors were being placed into a negative cash flow position. Most of the market value of the property was in the Leasehold Estate. In fact the lease fee ownership was considered a liability.

The United States Postal Service realized that the leasehold estate that they enjoyed was an unreal market condition. The landlord could and would refuse to complete any maintenance and repairs under these market conditions. Property owners were walking away from their mortgages and the public image of the United States Postal Service was at an all time low in these small rural communities. The United States Postal Service, in the 1980s, went out and renegotiated most of these leases to the then fair rental value. The fuel and utilities expenses in

the new leases became a variable cost. An example follows.

The replacement cost, less depreciation plus land, of a subject rural post office is \$150,000. It is determined from the market that a good ROI is a 10% rate of return. This rate of return would allow a 6% return on the investment and a recapture rate of 4%. When the 10% rate of return is taken on the depreciated replacement cost of \$150,000, the net income to the property is \$15,000 per annum. Note that this is net income.

In reality, the facts show that there was not any net income to the property owner. In fact there was a negative cash flow to him. If the property was worth \$150,000 by the cost approach, then it might be assumed that a good part of that value was Leasehold Estate. The Leased Fee could be worth \$0.00 or even a negative figure. The day that the United States Postal Service renegotiated the lease contract, Lease Fee and Leasehold Estate values changed.

It might be noted that in a federal condemnation action under eminent domain, the government would have to condemn all property interest. This would include the

lease fee and any leasehold estate and any other possible property interest.

Mineral Rights: This includes mining, oil rights and other subsurface rights. It is not uncommon to find a deed reserving out mineral rights. Sometimes these reserved rights have already been granted to a third party. When mineral rights show up on a subject property analysis, it is important for the appraiser to determine if these rights have value. Mineral rights are part of the total fee value and if they are identified, they should be measured.

The first approach might be to analyse the geographical market for producing mines or oil wells. If there are not any producing mines or oil wells, it should be determined if there are any future planned operations. Is anyone buying or selling mineral rights in the market area of the subject property? It is important to analyse the document conveying the interest of the mineral rights. This instrument can limit any future use of the land by its conditions. It has been shown that the analysis of this granting document is important because a single clause of a condition can impact value within the market place.

A case in point was a large parcel of land in Southern California which was to be valued. This parcel was located

on the ocean highway in the Huntington Beach area of California. Property on both sides of it was commercially zoned and the demand was great for commercial ocean front land. The market was paying from \$60 a square foot to \$70 a square foot at that time.

When the preliminary title report was analysed, it was determined that there was an oil grant recorded on the property. The grant was to a large national oil company. A copy of the document was obtained. The oil grant called for the payment of royalties based upon oil production. The oil company did not intend to start any drilling on the land in the near future. A condition in the grant stated that the oil company had the right to surface drill anywhere on the parcel.

It was determined that the right to surface drill anywhere on the parcel could preclude any possible commercial development. The grantee had the legal right to start drilling a well in the middle of a shopping mall. A \$5 a square foot value was indicated from the market based upon this mineral right. Without this right of surface drilling anywhere on the land parcel the market indicated a \$60 square foot \$70 square foot value. This

would represent an almost 1,000% increase in value if the right to drill was modified.

It is my understanding the fee owner and the oil company renegotiated the contract. Under the new contract the oil company could only surface drill at the boundary lines. This allowed full surface development for the rest of the parcel. It is understood that the price was negotiated by splitting the difference between the values of the square foot before the contract change and the fair market value per square foot after the contract change.

Air Rights: When one thinks of air rights, airport and plane operation comes to mind. Certainly there are safety requirements in an identified crash zone. Sound, based upon environmental concerns, has become a major factor today. The sound problem has been a negative factor in airport expansion. National and international airports originally were located outside of urban areas. Urban "encroachment" today has made these locations the subject of environmental and politically sensitive issues.

The environmental sound requirements are quite simple. The higher the engine noise, the lower the density and use. This type of restriction usually takes the form of zoning restrictions. The courts today are considering that

the non-granting of development zoning as a possible taking and this action as an "inverse condemnation." This whole field of airports and aircraft has become such a intense environmental and politically sensitive problem that it could be a thesis subject of its own. The appraiser must be aware of the potential impact on market value.

Perhaps less known are air rights in the big city. These types of air rights control the density and use of large buildings sometimes called skyscrapers. These air rights are measured as the cost of land and they may sometimes have a high unit value. They are often buried in deed transfers and they must be researched from third party data.

A specific case example on this problem will be used to illustrate this point. A large international corporation was quietly acquiring a city block in the financial district of San Francisco, California. There were over 40 small, older buildings and ownerships to acquire. Possibly 60% of the property was acquired under various names when the remaining property owners realized what was happening. At that point the average acquisition cost of \$100 a square foot jumped to an average cost of \$300 a square foot. Most of the older 5 to 10 story buildings were torn down

for the construction of the 40 plus story corporate headquarters. A few of the older buildings were retained when the ground area was not needed for the new skyscraper.

A government agency came into the project to determine for tax purposes the allocation of the acquisition cost to land and improvements. The subject was a 40 year old office building with a plot of land about equal to its footprint. The appraisal problem was to allocate the acquisition cost to the land and to the building.

The new corporate owners had allocated over 70% to the building and 30% to land. A land residual approach and a building residual approach was made on the property. Then a comparative analysis was made and it indicated that the conclusion reached by the corporate owners was not supported by the market. The parts did not equal the whole. Replacement cost of the building new before depreciation, was less than 40% of the total acquisition cost.

The San Francisco County Planning Department was contacted. It was discovered that the zoning on the land of the subject building was office space use at a 20 to 1 building to land ratio. The San Francisco Building Code

would allow 20 gross square feet of building for each square foot of land. This would transfer to an allowable building density of a 20 story building while the subject building was a 40 year old 10 story building.

The San Francisco Assessor's Office was contacted to see if the additional air rights, the density, had been assessed. The property record files were checked. These record files showed that at the time of the acquisition the air rights from the subject parcel had been transferred to the corporate headquarters height use density. The air rights from the subject parcel, when transferred to the corporate skyscraper became part of the 40 plus stories of the headquarters building. Further research indicated that it was quite common in the San Francisco city market to sell and/or purchase these air rights/density for use on another parcel of land.

This pattern was found in the other old buildings of the block that had not been torn down. Here the motivation of the corporate owners was to allocate as much acquisition cost to the depreciable building assets as possible. They had absorbed the air rights acquisition cost for the headquarters building into building costs for

depreciation purposes. Actually the air rights acquisition cost was a land allocation and not a depreciable asset.

Each of the older buildings had been appraised by different appraisers. Each had considered the acquisition cost as market value and they made an allocation of the acquisition cost. They did not consider the air rights as a separate property interest and a stick from the Bundle of Rights.

Summary: This study has devoted a great deal of time and space to the Bundle of Rights Theory. It is that important to the use of the "Before and After" concept. Each stick of that bundle of rights "Before" must be identified and often measured in dollars. You cannot take what is not there.

The bundle of rights of the "Before" condition of the subject property is the 100% fee ownership at the time of valuation. The "After" will be the remainder or what is left of the original rights after the partial take or sale. The remainder can be measured in dollars. The value before the partial taking is compared to the value after the partial taking. The remaining rights form the base for the fair market value of the property in its "After" condition.

Highest and Best Use: The 1934 landmark case of Olson versus United States⁴ is still the preferred definition of most federal agencies for Highest and Best Use. This case defined it as, "...the highest and most profitable use for which the property is adaptable and needed or likely to be needed in the near future..."

A Highest and Best Use Analysis must be made to the subject property in the "Before" and in the "After" conditions. This means that a separate analysis must be made in both valuations. The appraisal reports have a specific section identified that deals in depth with an analysis of the Highest and Best Use of the subject property. A recent project with the United States Park Service required a complete and separate Highest and Best Use volume for a 500 acre resort parcel on the Big Island of Hawaii.

It should be noted that in a "Before" and an "After" valuation there are two separate appraisals. After there has been a partial acquisition of the whole or larger parcel the remainder can have a different Highest and Best Use in the "After" condition. Today environmental groups are acquiring a partial interest in land which is called "Land Conservation Easement." The Land Trust Alliance and the

National Trust for Historic Preservation in the United States published Appraising Easements: Guidelines for Valuation of Historic Preservation and Land Conservation Easements.⁵

In this publication an outline is presented to show a procedure to acquire the future development rights of land in its present condition. In this outline it is assumed that there will be a difference between the "Before" and "After" condition of the land after the development rights are acquired.

The Highest and Best Use analysis is important to the entire concept of fair market value. There cannot be any short cut in doing this analysis. Because of the importance an element by element breakdown of the Highest and Best Use Analysis has been developed for analysis purposes. Taking the Highest and Best Use concept as a base, the elements of physical adaptability, possibility of use and demand for use were extracted for analysis purposes.

The three elements are as follows. First, the highest and most profitable use must be available and the property must be adaptable to that use. This would mean a physical adaptability to that use. Second, there must be a reasonable possibility that the property can be used in the near future for this particular use. Third, the use must be

needed or likely to be needed. There must be a demand within the market for this particular use.

This Highest and Best Use analysis cannot be a hypothetical analysis but it must be an comparative analyses of these elements into the real market as was cited in the Olson versus United State.⁶ For demonstration purposes, examples of this analysis are made from actual cases from the market place based upon experience.

Element 1 speaks of physical adaptability. This can mean if the property can be used where it is and how it is. In this specific case there was a huge underground electric rail system under a big city. The electric rail system had been purchased by a large national transportation company. The electric rail system was discontinued to allow the company's gas buses to operate at a profit by not having the electric rail as a competitor. After a few years it was determined by the company's tax manager that a tax deductible contribution might be possible if the rail and tunnel system were donated to the city. The city would accept the offer in view of the no cost factor because they really had nothing to lose. The company contracted an appraiser to value the rail and tunnel system. The appraiser used the Cost approach. They used

the Replacement Cost new less depreciation. The appraised value for the system and tunnels was \$10 million dollars. There was also the assumption that there would be continued use, their Highest and Best Use.

The continued use was an assumption that was not physically possible. The tunnel system had been breached by the intrusion of a redevelopment project. This project closed off a major portion of the tunnel system. The license to operate had been revoked after a certain period of time for non use. The stations no longer could service the rail system operations. In fact the rail and tunnel system could no longer operate as such. Future cost of filling these tunnels was the responsibility of the company. The appraiser for the owner had made a Highest and Best Use assumption on the system and tunnels that was not feasible. They were no longer physically adaptable for continued use. The value of the contribution was reduced to a liability position because of the redevelopment projects in the city.

Element 2 speaks of a reasonable possibility that the property can be used in the near future for this particular use. This reasonable possibility must be a market place reality.

A value of the 350 acres of land in the San Francisco Bay area of Northern California was made. The client, a government agency, wanted to acquire the land for environmental purposes. A portion of land was classified as wetlands. Vernal pools had been identified throughout the parcel. The wetlands and vernal pools had given the land a high visibility. This land became an environmentally and politically sensitive parcel.

The parcel was zoned for industrial use. It was located in the East Bay Area of the San Francisco Bay Area. It was adjacent to a developing Research and Development (R&D) park at the upper end of San Jose's "Silicone Valley." The subject land was situated within the city limits of the City of Fremont and it was under their planning and zoning jurisdiction. Research showed that the city of Fremont had been attempting to place a small feeder airport on this parcel for the past 12 years. Each time the city held a hearing on the parcel, it received negative public reaction because of the environmental concerns. Then the city would retreat to a new Environmental Impact Statement. Over the years this highly visible and politically sensitive parcel was subject to negative public reaction.

Also during this period, the owners had attempted to develop the land. Any development had met with the same set of circumstances as the city had encountered. The owners had finally defaulted on a six million dollar loan and the bank was attempting to market the property. Each time this parcel was appraised, the Highest and Best Use was for Research and Development. The appraisers stated this use in the face of all the historical data on the parcel. The fact that the loan had defaulted because of the inability of the owners to develop the parcel was ignored. Even with the Research and Development zoning there was not a reasonable possibility that it could be developed within the near future. Our firm's analysis determined that the parcel was a high risk investment, subject to a long period of time before it could be developed within its market. Our estimate of value was approximately three million dollars.

Element 3 is perhaps the hardest to analyse. Market demand is often assumed by the appraiser. This element requires that the use must be needed or likely to be needed and that there must be a demand within the market for this particular use. If elements 1 and 2 are positive to the analysis, it is often assumed that the

market demand is there if the supply can be met. That situation is not a market reality.

An appraisal was completed for a governmental agency for the partial taking of beach front land on the Big Island of Hawaii in the State of Hawaii. The larger parcel was approximately 500 acres of land on the Kona side of the Big Island. The take from this larger parcel was 25 acres of beach land. A "Before and After" valuation was required. This meant that the whole 500 acres must be valued in its "Before" condition. The approximately 475 acre remainder would be valued in the "After" condition. This area had been under intense new development for hotel/resort use. Most of the hotels/resorts on the Kona side have been developed within the last 20 years. Just north of the subject land and the town of Kailua-Kona is the internationally famous "Kona Gold Coast." This area has a number of five star resorts with golf and beach front locations.

In the 1980s the demand from Japanese investors for resort and golf course development in the Kona Coast area was at its highest. Land was acquired and hotel/resort development approval was being processed. At the time there appeared to be an unlimited demand for this use

within the market. In the late 1980s and early 1990s, the international tourist market went into deep recession along with the rest of the world's economy. The Japanese investment monies for hotel/resort development dried up and there was little local money available for what had become a high risk market.

The market from 1985 to 1990 assumed that if you could obtain the land and proper approvals, you would have a viable investment. The analysis of the Kona Coast market found an over supply of rooms and hotels and a downward demand for them.

The market analysis showed that the number of hotel rooms far exceeded the demand. This was based upon the present market inventory of rooms. The occupancy factor for these rooms was at 52%. The break even point for these high cost rooms was at 72%. An analysis was made of the hotel/resorts under construction and it was estimated that there would be an average yearly increase of the room inventories of 20% to 25%.

The large five star Waikoloan Resort Hotel on the Kona Gold Coast had just been sold under distress sale conditions. Based upon the known original cost of the project, it was sold at 30 cents on the dollar cost.

Construction had stopped on other planned hotel/resort projects on the island. The analysis of present inventory and on line construction showed a projected 10 year potential occupancy of 68%. It was estimated that a developed project on the subject property would take from 15 years to 20 years after its completion to reach a break even point within this market.

But The subject resort development was under a law suit filed by a Native Hawaiian sovereignty group. While the developers of the subject property had received Planned Unit Development (PUD) approval from the State Land Use Commission, specific approval was being withheld under the coastal act permit requirements. Suits were pending on the use of the beach area by the public and also on the environmental concerns of a proposed resort marina development. It was estimated that it would be at least 3 years before actual construction could start even if these legal problems could be resolved. It would take 5 years to 8 years to complete the phased development of a resort type hotel of 1,100 rooms, 600 condominiums, 200 residential golf course units and the commercial/marina complex. These are impressive numbers for the State of Hawaii and the Big Island of Hawaii. The problem, based

upon our analysis, was that there did not appear to be a market for these numbers.

While the Kona project could meet elements 1 and 2, it appeared that element 3, demand within the market, was not a market reality. The Highest and Best Use was for a future holding investment of the land.

Considerable time and space has been spent upon the Bundle of Rights Theory and the Highest and Best Use Analysis. These two valuation concepts are important in all appraisals. In the "Before and After" methodology of valuation, they become two of the most important concepts in the entire process.

Other Terms Specific to Eminent Domain: In Chapter 2, under the heading of Other Terms, certain specific terms are discussed. The use of these terms has developed over the years by court decisions on these specific legal issues. The use of the term, subject parcel, specifically means the whole parcel or larger parcel at the time of the "Before" value. This is the starting point and the 100% base of all considered rights. Is there a difference if the subject parcel is 10 acres or 1,000 acres? If the land to be taken is 9 acres, the impact to the 10 acre parcel with one acre remaining might have more economic impact than if the

remainder after the take was 991 acres. The remainder or what is left now becomes the subject parcel for the after value. What is the Highest and Best Use of the remainder? Does the remainder have an economic use or has the future use been economically damaged? This larger parcel issue is a question that will always be challenged in the courts because of its variable dollar potential on fair market value.

The prime issue in the field of eminent domain today is the question of "inverse condemnation" and/or "regulatory taking." The United States Supreme Court has been reluctant to rule on this issue. The last 15 years has seen "property rights people" give morale and monetary support to these challenges throughout the court system.

A recent symposium on this issue was held on January 12 and 13, 1995, in Honolulu, Hawaii. The symposium was entitled "Native Hawaiian Land Rights, Eminent Domain and Regulatory Takings." The sponsors of this symposium were: Native Hawaiian Bar Association; University of Hawaii, William S. Richardson School of Law; Pacific Law Institute; Kamehameha Schools, Bernice Pauahi Bishop Estate. The faculty was obtained from local and national experts in the eminent domain field. There was an emphasis placed on

the land historically obtained from the original native Hawaiian.

Out of the twelve speakers at the symposium three of them spoke to federal and national condemnation issues. These three men were: Richard A. Epstein,⁷ Alex Kozinski,⁸ and Mark L. Pollot.⁹

The subject of the taking of property by the government was the theme of this symposium. Part of the symposium dealt with the Hawaiian Rights question but the base that was used was the United States Constitution and the decisions of the Federal and United States Supreme Courts. Mr. Pollot, a constitutional lawyer, used the Constitution to develop his points of the taking of property by government without the payment of just compensation. Professor Epstein hit the point of a regulatory agency denying zoning that is the Dolan versus City of Tigard,¹⁰ case. Judge Kozinski gave some insight into workings of the court and how the United States Supreme Court will only entertain such cases that they want to have before them.

All three of the speakers spoke in great depth about the Lucas versus South Carolina Coastal Council.¹¹ In the Lucas case, the petitioner in 1986 purchased two

residential lots on the Isle of Palms in Charleston County, South Carolina for \$975,000. In 1987, the State of South Carolina enacted a Beachfront Management Act, SC Code @48-39-250 et seq. (Supp 1990 Act) which barred the petitioner from erecting any permanent structure on his two lots. The Supreme Court did not dodge the issue of the taking clause of the United States Constitution. Justice Scalia delivered the opinion of the Court. The Court held that the State of South Carolina did effect a taking under the Fifth Amendment of the Constitution.

In the more recent Dolan versus City of Tigard,¹² the city withheld a zoning permit to enlarge an existing store pending the granting of a flood easement and a bike path by the petitioners. Neither need, the flood nor the bike path, was caused by the expansion of the existing business. This case advances one step more in the arena of eminent domain, takings and just compensation.

¹ The Appraisal Terminology and Handbook of the American Institute of Real Estate Appraisers

² Income Property Appraisal and Analysis

³ Income Property Appraisal and Analysis

⁴ Olson v. United States, 292 U.S. 246,255 1934

⁵ Appraising Easements: Guidelines for Valuation of Historic Preservation and Land Conservation Easements.

⁶ **Olson v. United States, 292 U.S. 246,255 1934**

⁷ **Richard A. Epstein, Esquire, Distinguished Service Professor of Law at the University of Chicago since 1972. Mr. Epstein has taught law at the University of Southern California from 1968 to 1972. He is a member of the American Academy of Arts and Sciences and a Senior Fellow of the Center for Clinical Medical Ethics at the University of Chicago Medical School. He served as editor of the Journal of Legal Studies and editor of the Journal of Law and Economics. He has written over six books in the field of property and economics including Takings: Private Property and the Power of Eminent Domain (Harvard, 1985) Professor Epstein participated in the recent Dolan versus City of Tigard, 854 P.2d 437 (Ore.1993), rev'd, 114 S. 2309,62 U.S.L.W. 4576 (U.S. June 24, 1994)**

⁸ **The Honorable Alex Kozinski, Judge, United States Circuit of Appeals for the Ninth Circuit. Judge Kozinski graduated from the University of Southern California. He served as law clerk to Circuit Judge Anthony M. Kennedy. He is a former law clerk to Chief Justice Warren E. Burger of the United States Supreme Court. Judge Kozinski is involved in many of the cases dealing with this issue in the eminent domain field.**

⁹ **Mark L. Pollot, Esquire, is Director of the Stewards of the Range Constitutional Law Center, headquarters in Boise, Idaho. He was a member of the University of San Diego Law Review. Mark Pollot also received the United States Attorney General's Special Achievement Award in recognition of his work in the United States Department of Justice. Mr. Pollot, while a Special Assistant to the Assistant Attorney General for Environmental and Natural Resources Division of the United States Department of Justice, authored Executive Order 12630 (the taking order) which was signed by President Reagan on March 15, 1988. He was the author of Grand Theft and Petit Larceny: Property Rights In America, which has been used as resource data for this thesis.**

¹⁰ **Dolan v. City of Tigard, 854 P.2d 437 Ore. 1993, rev'd, 114S.2309,62 U.S.L.W. 4576 U.S. June 24, 1994**

¹¹ **Lucas v. South Carolina Coastal Council**

¹² **Dolan v. City of Tigard, 854 P.2d 437 Ore. 1993, rev'd, 114S.2309,62 U.S.L.W. 4576 U.S. June 24, 1994**

Chapter 4

IN SEARCH OF USE

The “Before and After” method is identified in Chapter 1 of this thesis. In Chapter 2 which is titled, Key Terms and Their Legal Usage, this method is defined and a rationale given. With this definition comes the concept of looking to the whole or larger parcel for a before value that considers all the property. This before value is a complete appraisal with all the required methodology of Uniform Appraisal Standards for Federal Land Acquisitions.¹ In the *Grizzard versus United States*² and in the *Honolulu Plantation Company versus United States*³ cases this concept has been supported by court decisions.

The above cases also deal with the after value of the whole property. In the after condition the balance or remainder of the whole or larger parcel is valued. This value of the remainder is considered a new appraisal. A new Highest and Best Analysis is made and an after use is determined. If the after use is different than the before use the appraiser would obtain new market data.

While the difference between the before and the after value is the part taken, it is not appraised as a

separate property interest. If the unit value of the remainder has decreased it is assumed in this concept that any severance damages are included in the take amount.

The "Before and After" concept is simple and easy to understand. It is in its use that problems are created. An example in its simplest form follows.

The larger parcel is 100 acres of prime farm land. The market value of the 100 acres is \$1,000 per acre or \$100,000 for the whole. The government needs 50 acres for a dam. The value of the remainder after the taking of the 50 acres is \$50,000.

Before Value	\$100,000
After Value	<u>\$ 50,000</u>
Value of the Take	\$ 50,000

This is the simplest form of the concept. This concept is logical and it makes sense. The concept will not change but the facts will change on a case by case basis. The facts of the example are slightly changed. The prime farm operation needed water and the only water wells were on the 50 acres taken. When the 50 acres are taken, the remainder will not have any water for agricultural production. An after value is made of the remaining 50

acres. It is found to be worth \$100 per acre or \$5,000 for the entire 50 acres. Now the example changes to:

Before Value	\$100,000
After Value	<u>\$ 5,000</u>
Value of the Take	\$ 95,000

The facts in the second example were changed but the "Before and After" methodology has not changed. As stated in Chapter 3, the property must be analysed and the Bundle of Rights of that property must be defined. What has changed between example 1 and example 2? The needed water for the farm operation in the form of water wells is on the take property leaving the remainder with no water. The larger parcel had a Highest and Best Use of a prime farm operation. After the take the remainder had little or no prime farm use. This decrease in the unit value of the remainder is reflected by market sales.

In the above examples there is a physical taking or shifting of value. The water wells were taken from the whole. As this concept became more refined the legal rights to do or not do something began to be measured for value.

When rights are defined and considered for possible acquisition they must be measured. The "Before and After"

concept could create a framework for this type of measurement. The use of this methodology is a logical transition. This transition is recognized by the federal government in their Justice Department's comments in the previously cited Uniform Appraisal Standards for Federal Land Acquisitions.⁴ On page 56 of these federal standards, easements are defined and discussed. Their definition of an easement is "...an interest in land of another entitling the owner of that interest to a limited use of the land in which it exists. An easement is a less than the fee estate... An easement can also subject the underlying property to specific restrictions on the use that the owner may make of the property. Federal acquisitions involve a wide variety of easement types ranging from the traditional to the exotic and include road, pipe line, electric transmission line, levee, flowage, clearance, navigation, scenic, conservation, tunnel, sewer line, and safety zone easements."

The federal uniform standards further state in effect that the appraiser have a clear understanding of the exact terms of the easement and impact of the burden on the land that the easement imposes. *Virginia Electric and Power Company versus United States (1961)*⁵ is also cited.

This case states in effect that the easement is valued based upon the destructive impact upon other uses of the land owners.

There is considerable other discussion and case citing on pages 56 to 58 of the Uniform Appraisal Standards for Federal Land Acquisitions⁶ on easements. The major issue is the need to measure the value before the easement and the need to value the property after the easement burdens it. Which is the "Before and After" concept.

The easement approach to property rights and uses has really been accepted and used for environmental purposes and by environmental groups. A book has been published by the Land Trust Alliance and the Trust for Public Land entitled "The Conservation Easement Handbook."⁷ This book was published for groups who are managing land conservation and historical preservation easement programs. It includes model easements with commentaries.

The use of the easement methodology for partial acquisition of a property right by conservation groups and some federal agencies is growing. This methodology is based upon the "Before and After" concept. The previously cited "Appraising Easements: Guidelines for Valuation of

Historic Preservation and Land Conservation Easements”⁸ published by the Land Trust Alliance and the National Trust for Historic Preservation in the United States defines the value before the easement and the value after the easement concept. The above provides guidelines for further refining and identifying specific types and sub-types of easements. The Historic Preservation Easement identifies: Historic Preservation Easements on Urban Properties; Historic Preservation Easements on Open Lands. Under Open Space Easements the guideline identifies: Scenic Easements; Farmland Easements; Timberland Easements. Two other types of easements are listed and they are: Natural Habitat Easements; Easements to Protect Land Areas for Public Outdoor Recreation and Education.

While there appears to be unlimited number of easements possible, the basic concept of the value of the land before the easement and the value after the easement is used in each of the easement valuations. This is a logical extension of the partial taking of a property interest. Once that property interest is identified it can be measured in dollars.

Case Study: A recent appraisal completed was based upon the acquisition of water rights. In the previous

example a 100 acre farm was used and there was a physical taking of 50 acres which included the water wells.

In this valuation water rights were to be acquired by a federal agency from the land owners. It was a large tract acquisition of many land owners. A master appraisal was prepared that dealt with the areas in common. These common areas were: state location and data; state and county economics; county land market and the supply and demand for it; land inventory and use. The water rights to be acquired were based upon an acre allocation of water to the whole parcel.

For the purposes of this report an actual tract appraisal report is used. In accordance with Uniform Appraisal Standards for Federal Land Acquisitions⁹ requirements identification and ownership have been altered for thesis purposes. Selected parts of the appraisal report will be used to demonstrate and support certain valuation issues and concepts. These selections are taken from the report in their entirety and comments are interjected through out the report to illustrate specific concepts and issues.

Comment: The appraisal date is a must in any appraisal and it can never be excluded from the report. It

sets the time of valuation. The date of appraisal may be different from the date the appraisal was signed but this does not impact the valuation date.

Case Study Exhibit 1.0

"INTRODUCTION

Date of Appraisal: July 13, 1994"

Comment: In a partial interest taking, to define Purpose and Function is very important. The Purpose alerts the reader that there will be less than a full taking. The Function will tell the reader why this is being done.

Case Study Exhibit 1.1

"Purpose of the Appraisal

The purpose of the appraisal is to value the Fair Market Value of the subject parcel's water rights. The Fair Market Value defined in the project appraisal report is used.

Function

The function of the estimated Fair Market Value is for the Federal Government to use this value to negotiate the acquisition of the subject tract's water rights for a Wildlife Management Area."

Comment: The Scope sets the methodology that the appraiser will use. It takes the reader step by step through the report. It states the depth of the report and how the appraiser will arrive at his valuation.

Case Study Exhibit 1.2

"Scope

The scope of this appraisal is within the provisions of Uniform Standard of Professional Appraisal Practice and the Uniform Appraisal Standards of Federal Land Acquisitions. Our assignment is to value multiple tracts of land that are located in the County of Up in the State of Nevada, for acquisition by the federal government. We will use the 'Project Appraisal Report' concept set out in the Federal Land Acquisition Standards.

In the Property Description section the subject tract will be fully described and developed. A Highest and Best Use Analysis will be made of the subject tract.

In the Valuation section of our report a complete valuation analysis of the subject will be made. This analysis will consider the three approaches to value of Cost, Income and Market. While it may not be possible to use all three of

these approaches on this type of property, each approach will be discussed and evaluated in this analysis.

An estimate of value shall be determined based upon this analysis. There will be a Before and After valuation made of the subject tract. This value will include all property interest that is not otherwise restricted by law. The After valuation will consider the removal of the water rights from the tract. This value will only be subject to those restrictions and any others that are specifically set out in this report and our Assumptions and Limitations. ”

Comment: The TRACT DATA AND ANALYSIS part of the appraisal is often termed as the section where the appraiser does his “homework”. The property is reviewed and analysed. The Bundle of Rights Theory is applied to the property in its present condition. Here is where all the owners rights and burdens on the subject property are identified. They must be included and identified here. This section sets the stage for the application of the before and after concept. All the rights in the bundle must be known and identified before any taking can take place.

Case Study Exhibit 1.3

“TRACT DATA AND ANALYSIS

Location

This parcel is located in the southwest area of the City of Desert. It might be considered the suburb of the Desert area. It is located within a couple of miles of the Reno Highway, Highway 50. The Carson River cuts across the southern portion of the original parcel.

Legal Ownership

We have been furnished a Preliminary Title Report by the federal government. It is assumed that there is not a problem with the transferring and sale of water rights by the owners. Property matters were discussed with the owner. He stated that he did not think that there was any legal problem in the recent past on the transfer of land and/or in water righted acres.

Legal Description: Section 28-Township 19N-Range 28E

Date of Inspection: April 20, 1994

Legal Owner: Doe, John and Mary

Last Sale: Doe, John and Mary owners since 1984, verified by Assessor's Records and County records. No prior sale of record during this period. Mr. Doe stated that the property had been a family dairy operation.

Assessor's Parcel Number: 08-493-21 - this parcel had been a larger parcel and it is now subdivided into the subject 28.30 acres and into 20 one plus acres lots.

Size: 28.30 acres

Water Rights: 26.68 acres

Percentage Water Rights to Land: 94 %

TCID Number: #565-44 (the print-out from Truckee Carson Irrigation District has been included because of the question of allocation from the previous parcel splits)

Present Use: The subdivision of a portion of the original parcel appears to be a very successful venture. The owners stated that they are holding the subject parcel for additional future development. Marginal and interim alfalfa use by leasing arrangement with large farm owner percent operation.

Improvements: No improvements were noted during the inspection of the property. There are some old dairy type buildings on the 5 acres fronting McLean Road which was split out from the original subject tract.

Zoning: E1 (First Estate District) - this zoning was established in Up County on 9/92. A copy of this zoning is included in our Addenda. This zoning allows single family development of one acre with water rights requirements

and one-half acre development without water rights requirements.

Assessment and Taxes: 1993 to 1994 year taxes of \$995.59

Access: Access is available from a good road county road.

Remarks: Appraisal of water rights only but the Before and After concept will be used to value such water rights.”

Comment: The Highest and Best Use is of equal importance to the Bundle of Rights Theory in the partial taking of a property interest. As stated in Chapter 3 of this thesis, use must be established both before and after the taking of the property interest.

Case Study Exhibit 1.4

“Highest and Best Use Analysis

In the Project Appraisal Report a definition is given of the Highest and Best Use. In that definition the following three key elements are stated.

1. The highest and most profitable use must be available and the property must be adaptable to that use. This would mean a physical adaptability to that use.
2. There must be a reasonable possibility that the property can be used in the near future for this particular use.

3. The use must be needed or likely to be needed. There must be a demand within the market for this particular use.”

Comment: The economic analysis discussed in the Project Appraisal Report is considered a part of this tract analysis. In the report it was determined that two potential uses exist in the subjects' economic market. These are agricultural and subdivision uses. Often the agricultural use is of an interim nature until the land can be absorbed into the subdivision market.

Case Study Exhibit 1.5

“Highest and Best Use

The subject parcel was part of a larger parcel of land. The land was split for subdivision purposes. There are presently approximately 15 finished lots of one acre or more on the land that was split out from the original parcel. The finished lots have been selling and they are listed at \$20,000 to \$25,000 per lot.

The owner, Mr. Doe, stated that it is his intent to subdivide the subject tract in the future. They will be developed into one acre plus lots. He could not predict the time frame for the future development because it would be based upon

market demand. His present lot inventory would also impact future development of the subject land.

It is our opinion that the subject tract Highest and Best Use in the 'Before' condition is interim farm use, until the potential future subdivision.

It is also our opinion that the Highest and Best Use in the 'After' condition is future subdivision use. Other market data indicates that when there is not any future subdivision use there is little other use. Once the water is stripped from the land it reverts back to a sandy desert condition."

Comment: A reader may ask why the definitive analysis of the Bundle of Rights Theory and The Highest and Best Use analysis are used to get to the valuation section that follows. These two elements are identified and analysed, then the market is researched for data. The market data must be compared to these two elements.

Case Study Exhibit 1.6

"VALUATION

General: In this valuation section we will consider all of the indicators of values. To estimate the value of the

tract, we will consider, as applicable, the Cost Approach, Income Approach, and Market Approach.

Methodology: We have researched the market for sales data. Water Rights are a factor and they are weighted in our comparative analysis. Because this is a water rights acquisition, the water rights will be identified and valued. In our Book of Sales we have our sales map and the sales data. Each sale will have a summary sheet of the sale. Each of the sales have that sales summary information sheet, a plat map, and photographs. We have included the narrative sales analysis for each of the sales with the other sales data in the Book of Sales. A sales map is included for identification purposes.

Adjustments to Sales

Time: We do not feel that there has been a great time appreciation. Some of our sales and resales show little or no increases. Sales 4 and 4A which were sold in 1989 and 1990 show an annual increase for time of 5% per year. We are inclined to think that this is most representative of an inflation factor and is not an appreciation factor. The CPI showed an increase of 4.1% from 1991 to 1992 and a 4.2% from 1992 to 1993. Based upon these factors, we will use 5% as reasonable annual time adjustment.

Size: We could find very little difference in market price for size. Most of the sales were not farmed by the owners. Our study on farming of hay/alfalfa shows an economic unit size of 300 acres to 500 acres as a minimum. A cattle operation appears to need a ranch of 400 acres or more to form an economic unit. This is the full time farmer who makes his living from farming. He must pay for his time, labor, and receive a return on his assets.

The market does show from the sales data that the splitting of the larger parcel into smaller parcels creates a different market. This is the 1 acre to 10 acre mini-ranch home sites. It will be noted from the 'dry land' sales that location of the land in the county is a major factor for future and/or potential subdivision use.

Project Influence: There is a historical project influence of lands acquired by government and The Nature Conservancy. During our field investigation, we heard that the "project" people were paying top dollar for water. In fact many land owners who could not sell their lands on the market are looking to the government to buy it. We did not use any sales made to the government. In a limited sales market as there is presently in the Desert area, project influence is adjusted within the market.

There is so much land available on the market that under the principle of substitution, project influence is self adjusted. We used sales with and without water allocation made by The Nature Conservancy group because they, in most cases, appear to be open market transaction.

Water Righted Acre Adjustment: This will be our main adjustment to the sales data. We have formed the opinion from all the market data that an acre of land with a water allocation is worth more than an acre of land without a water allocation. This adjustment will be on sales used as a comparative that do not have the exact percentage of water to land as has the subject tract. An example of this adjustment follows.

Sales A @ 100 acres has an 85 acre water allocation. The ratio of water to land is 85%. The unit price per acre is \$2,000. Subject Tract @ 100 acres with a 90 acre water allocation at 90%. All others factors are equal. The comparable sale must be adjusted upward to make it equal to the Subject Tract.

Subject Tract water allocation is: 90%

Sale A water allocation is: 85%

Ratio is: $90/85 = 1.059$

Adjustment Indicated: $\$2,000 \times 1.059 = \$2,118$ per acre"

Comment: At this point the report again states the importance of the 'Bundle of Rights' theory. The reader is again made aware of the "Before and After" concept and the rationale behind it.

Case Study Exhibit 1.7

Summary: In the acquisition of water rights only, there is a taking of one property interest in the 'Bundle of Rights Theory.' This in effect becomes a 'partial taking.' The whole parcel is the before condition of the tract prior to the taking. The remainder is the parcel after the taking of the water rights.

The subject tract will be valued in fee including the water rights. This is considered the 'Before' value. The second valuation will consider the subject tract without the water rights. This will be the 'After' value. The difference between the two values will be the just compensation or value of the water rights.

Valuation Analysis

The subject tract is located in an area of growth for rural type home sites. The southwest area of Desert is being subdivided into 1 acre to 20 acres home sites. The market

responding to this demand has created a large inventory of these rural lots.

The market approach will be used. Our Book of Sales contains our Up County sales data. In our analysis of the subject tract, we determined that size, percentage of water righted acres, and topography should be the points of comparability.

<u>COMPARABLE SALES</u>	<u>Page</u>
Sale 1	13
Sale 2	18
Sale 2A	21
Sale 3	24
Sale 4	27
Sale 4A	30
Sale 5	32
Sale 6	35
Sale 6A	38
Sale 7	41
Sale 8	44
Sale 8A	47
Sale 8B	49
Sale 8C	51
Sale 9	53

Sale 10	56
Sale 11	59
Sale 12	62
Sale 13	65
Sale 14	68
Sale 15	70
Sale 16	73
Sale 17	79
Sale 18	82
Sale 19	86
Sale 20	89
Sale 21 a,b,c	92
Sale 22	97
Sale 23	99
Sale 24	102
Sale 25	105
Sale 26	107
Sale 27	109
Sale 28	112
Sale 29	115
Sale 30	118
Sale 31	121
Sale 32	123"

Comment: At this point in the valuation the before valuation will be determined.

Case Study Exhibit 1.8

"Before Value

This value will consider the subject tract in its present condition and within in its present market. In reviewing the approximately 32 plus sales, it is our opinion that the following sales are the most comparable:

<u>Sale No.</u>	<u>Date</u>	<u>Water Acres</u>	<u>Percentage</u>	<u>Unit Price Per Acre</u>
7	02/21/92	80.00	88%	\$1,204
15	08/27/91	87.68	97%	\$1,836
20	07/06/92	107.55	84%	\$1,381
22	05/05/92	86.80	72%	\$1,333
30	02/18/93	80.00	100%	\$1,550
31	06/07/93	245.00	97%	\$1,525

Time Adjustment:

<u>Sale No.</u>	<u>Date</u>	<u>Months</u>	<u>Percentage Increase</u>	<u>Unit Price</u>	<u>Adjusted Unit Price</u>
7	02/21/92	29	11.6	\$1,204	\$1,344
15	08/27/91	35	14.0	\$1,836	\$2,093
20	07/06/92	24	9.6	\$1,381	\$1,514

						66
22	05/05/92	26	10.4	\$1,333	\$1,472	
30	02/18/93	17	6.8	\$1,550	\$1,655	
31	06/07/93	13	5.2	\$1,525	\$1,604	

Water to Land Adjustment:

<u>Sale No.</u>	<u>Total Acre</u>	<u>Percentage Water Acre</u>	<u>Ratio</u>	<u>Adjusted Unit Price</u>	<u>Adjusted Acre Value</u>
7	80.00	88%	1.07	\$1,344	\$1,438
15	87.68	97%	.97	\$2,093	\$2,030
20	107.55	84%	1.12	\$1,514	\$1,696
22	86.89	72%	1.32	\$1,472	\$1,943
30	80.00	100%	.94	\$1,655	\$1,556
31	252.50	97%	.97	\$1,604	\$1,556

The sales range from \$1,438 per acre to \$2,030 per acre.

The location of the subject tract is within the area of an existing subdivision. In fact it could be considered as part of the present subdivision with some development in the near future.

In our analysis of the sales, after adjustments have been made for time and water rights allocation, Sales Numbers 15, 30, and 31 are considered the most comparable. These sales will be adjusted to the subject tract. With the exception of location and time to develop for subdivision purposes they are comparable to the subject tract.

Sale Number 15 is located west of Highway 95 and south of Desert. It is in an area of developing rural home sites. Some of the original 87.68 acres have been developed by home buyers into 10 acre to 20 acre home sites. There are some prefab homes with horse corrals for pleasure use. The subject tract would need subdivision map approval and market absorption within its own market area. It is our opinion that the sale parcel is an equal location to the subject for lot marketing purposes. The subdivision potential of the sale is superior to the subject tract with some land already under subdivision and a downward adjustment of 20% is made. The downward adjustment of 20% is made and the adjusted unit value is \$1,624 per acre. Sale Number 30 is a February of 1993 sale which is reflective of the current market. It was a 80 acre parcel with 100% water rights. It has an adjusted unit value of \$1,556 per acre. The sale has considerable frontage on Highway 95 south. This is considered ideal frontage for subdivision development road access. The subject tract has no road access with the exception of its own subdivision development. A downward adjustment of 10% is made for better subdivision potential because of the better access. The subject tract has better location

because it is close to Desert and it is in an area of large custom homes. An upward adjustment of 20% is made for location. This is a net plus 10% adjustment which gives the sale an adjusted value of \$1,712 per acre.

Sale Number 31 is a June of 1993 sale. There were 252.5 acres in the sale parcel. It had a 97% water to land ratio of water rights. The adjusted unit value of this sale is \$1,556 per acre. This sale parcel is contiguous to Sale Number 30. It has the same comparability in location and subdivision potential. The same adjustments are made and there gives a net plus 10% for an adjusted value of \$1,712 per acre.

Summary of Adjustments

<u>Sale</u>	<u>Total Acres</u>	<u>Value Per Acre</u>	<u>Percent Adjust.</u>	<u>Adjusted Per Acre</u>
15	87.68	\$2,030	- 20%	\$1,624
30	80.00	\$1,556	+ 10%	\$1,712
31	252.50	\$1,556	+ 10%	\$1,712

The adjusted range of sales after all adjustments is \$1,624 to \$1,712 per acre. Sale Number 30 is considered the most comparable to the subject tract. It is our opinion that the

unit market value of the 'Before Value' of the subject tract is \$1,712 per acre - rounded to \$1,700 per acre."

Comment: A valuation will be completed for the **Before** condition of the subject land. It should be noted that the before value is not the purpose of the appraisal but it must be determined to find the value of the part taken, i.e., water rights.

Case Study Exhibit 1.9

"Before Valuation Conclusion: It is our opinion that the Market value of the subject tract land and improvements is the following.

28.30 acres @ \$1,700 per acre = **\$48,110"**

Comment: A **second** valuation must be made of the subject after the water rights have been taken from it. Now this considers the parcel in its present condition without the right of water use.

Case Study Exhibit 1.10

"After Valuation

In the after valuation we will value the subject tract as if it did not have any water righted acres.

Time Adjustment: We did not find any time impact in values on dry land sales. As stated in our time adjustment in our Book of Sales, the entire market has been flat and our time adjustment considers the inflation factor. Our market analysis has indicated any increase in price for this type of land would be based upon other uses for it. These would be either subdivision or potential subdivision. This higher use would place the land into another classification. Based upon this factor we will not adjust dry land sales for time. Any inflation factor would be built into the higher use.”

Comment: The dry land sales are sales that do not have any water rights. Some of the sales had water rights that were stripped from the land and sold separately. Some of the sales were later developed into subdivision lots of 1 acre to 20 acres with their own wells.

Case Study Exhibit 1.11

“The following chart is our analysis of the ‘dry’ land sales which are a part of our Up County Book of Sales. SUMMARY OF DRY LAND SALES OF UP COUNTY chart shows the acres, dry land price, date of sale and the unit price per acre.

SUMMARY OF DRY LAND SALES OF UP COUNTY

<u>Sale</u>				<u>Dry Land</u>	<u>Unit</u>
<u>No.</u>	<u>Date</u>	<u>APN</u>	<u>Acres</u>	<u>Price</u>	<u>Price</u>
10	03/24/92	06-671-08	117.50	\$85,000	\$375
11	01/31/92	06-081-01	191.04	\$55,000	\$287
12	01/31/92	06-081-06	80.00	\$30,000	\$375
14	06/04/91	09-011-13	160.00	\$16,000	\$160
18	09/11/91	07-091-01	1,030.10	\$154,50	\$150
		09-371-56			
19	05/04/92	07-121-28	80.00	\$45,000	\$562
21C	03/11/91	06-091-32	169.17	\$75,000	\$443
27	07/29/93	06-051-07	40.00	\$13,000	\$325
32	06/07/93	06-111-15	60.00	\$30,000	\$500
		06-111-16			

Based upon this analysis we consider that Sale Numbers 21C, 27, and 32 are comparable to the subject tract. We made a comparative analysis of these three sales to the subject.

Sale Number 21C is a dry land sale where the water rights had been stripped by The Nature Conservancy and the dry land had been sold. Sale Number 21B sold with 100% water rights for \$1,545 per acre. The unit value for Sale Number 21C was \$443. These sales show:

Per acre with water rights	\$1,545
Per acre without water rights	<u>443</u>
Value of water rights per acre	\$1,102

Sale Number 21C is comparable with the subject tract with the exception of location. The subject has a better location and we will adjust the sale upward by 20%. This gives an adjusted unit value of \$532 per acre.

Sale Number 27 is located south of the subject tract and west of Highway 95 south. It is a 40 acre parcel that is set off the road. At the time of inspection we could not find any public access. This sale was listed in August of 1992 for \$24,500. It was later reduced to \$15,000 and finally sold for \$13,000 in December of 1993. This gives a sales price of \$325 per acre. The buyer paid \$1,500 down and the seller carried the balance as a first.

The subject tract is superior to the sale in access and there is an upward adjustment of 20% made. The subject tract is superior in location for subdivision use and a 20% upward adjustment is made. This is a total upward adjustment of 40% for an adjusted value of \$455 per acre.

Sale Number 32 is a 'dry land' of a portion of Sale Number 31 after the water was stripped from the land. Sale Number 31 was a 252.5 acre sale that had over 97% of the

total acres with water rights. On the day of the sale a portion of 60 acres, which is Sale Number 32, was sold stripped of the water rights.

Sale Number 31 sold for \$1,525 per acre. The unit value for Sale Number 32 is \$500. These sales now show:

Per acre with water rights	\$1,525
Per acre without water rights	<u>500</u>
Value of water rights per acre	\$1,025

Sale Number 32 is equal to the subject tract with the exception of location which also influences time to develop. We have made a 20% upward adjustment for these factors for an adjusted unit value of \$600 per acre.

Summary of Adjustments

<u>Sale</u>	<u>Total</u> <u>Acres</u>	<u>Value</u> <u>Per Acre</u>	<u>Percent</u> <u>Adjust.</u>	<u>Adjusted</u> <u>Per Acre</u>
21C	169.17	\$443	+ 20	\$532
27	40.00	\$325	+ 40	\$455
32	60.00	\$500	+ 20	\$600

The adjusted range per acre is from \$455 to \$600. Sale Number 32 is the most comparable of all the sales. It is only 60 acres and the subject is 28.3 acres. It is also a resale of land that has been stripped of the water rights as

is the subject tract's after condition. Based upon this analysis it is our opinion that the unit market value of the 'After' is \$600 per acre."

Comment: Now the value of the after condition is to be determined. When the after value is determined the second element of concept will be completed.

Case Study Exhibit 1.12

"After Valuation Conclusion

It is our opinion that the Market After value of the subject tract land and improvements is:

28.30 acres @ \$600 per acre = \$16,980"

Comment: Two separate valuations have been completed to get to this point. It is important to note that these two values must be determined before the purpose of our appraisal, the water rights, can be estimated.

Case Study Exhibit 1.13

"Valuation Summary - Market Value

Before Value (before the Take)	\$48,110
After Value (Remainder after the Take)	<u>\$16,980</u>
Value of the Take	\$31,130
Severance Damages	-0-

The summary of Chapter 4 is needed because the presentation was long and detailed. Perhaps it is fitting that it is long and detailed. The 'Before and After' concept is a detailed process. An easier, faster way has not been found today. The appraiser finds himself doing research and analysis in-depth. There are very few assumptions that can be made in this concept. The bundle of rights must be as correctly identified as possible. The Highest and Best Use of the 'Before and After' must be real market. It cannot be just theory. It must be based upon reality.

At this point in this thesis, it can be assumed that the reader is starting to understand the concepts and theory of the 'Before and After' methodology. In Chapter 5 this methodology will be taken beyond the limited field of pure valuation and into the areas of feasibility studies and economic analysis.

¹ Uniform Appraisal Standards for Federal Land Acquisitions

² Grizzard v. United States, 219 U.S. 180. 185-186 1911

³ Honolulu Plantation Company v. United States, 182 F.2d 172, 179 9th Cir. 1950

⁴ Uniform Appraisal Standards for Federal Land Acquisitions

⁵ Virginia Electric & Power Company v. United States

⁶ Uniform Appraisal Standards for Federal Land Acquisitions

7 The Conservation Easement Handbook, by the Land Trust Alliance and the Trust for Public Land

8 Appraising Easements: Guidelines for Valuation of Historic Preservation and Land Conservation Easements

9 Uniform Appraisal Standards for Federal Land Acquisitions

Chapter 5

THESIS EVOLUTION

In Chapter 1 a broad analysis is made of the entire field of valuation. The Constitution of the United States is researched and it is determined that the Fifth and Fourteenth Amendments¹ have a direct impact on the field of valuation. The federal courts have reacted to the challenges of the sovereign rights of Eminent Domain. Landmark cases dealing with fair market value and just compensation began to develop from the cases and decisions of the federal court. A federal approach to value develops as these decisions arise from the federal courts.

From this field of federal law, certain concepts and appraisal methodology have developed. National standards have been set by the Uniform Standards of Professional Appraisal Practice² (USPAP) which has in effect legalized the field of valuation. Government agencies, based upon these federal court decisions, have developed federal administrative standards on their appraisal requirements. These standards are set out in the federal publication of Uniform Appraisal Standards for Federal Land Acquisitions³ and the Uniform Standards of Professional Appraisal

Practice⁴. These standards have become requirements of most of the federal agencies. Stated in these standards is the requirement that all federal acquisitions that are less than full fee value must use the "Before and After" concept and methodology.

The federal courts continue to decide cases in the valuation field. From these court decisions based upon case law, specific terminology began to develop. This process is important because of its strong legal basis. In Chapter 2 the specific legal terms and their usage developed by the federal courts is analysed. It is determined in Chapter 2 that the use of the "Before and After" concept and methodology requires the use of specific key terms or terminology based upon its legal usage. This specific legal terminology is now court "tested."

In Chapter 2 the term is defined and the source of the definition is stated. Each of the terms is analysed under the heading of the rationale section. The following terms that are specifically identified are: Fair Market Value; Highest and Best Use; Bundle of Rights Theory; Partial Takings; Severance Damages; and Other Terms. Under Other Terms, the following are set out: subject parcel;

whole or larger parcel; take; and remainder. It is important that these terms be understood because they are part of the “Before and After” concept and methodology.

In Chapter 2 it was demonstrated that terms are used in a specific legal sense in federal acquisition and in the field of eminent domain. The courts in their decisions have placed this specific legal meaning to the terms. If the conception and methodology of the appraisal concept of “Before and After” is to be made to unique and special purpose analysis and valuation, the key terms and their legal terminology should be known and understood.

In Chapter 3, the key terms and their legal usage is taken to the market place. In this chapter, a direct application of the terms is applied to the “Before and After” concept. The “How to” is developed. Because of its importance, the chapter analyses the Bundle of Rights Theory. The importance of developing all the rights and burdens of the subject property are demonstrated by direct application. Actual valuation appraisals taken from personal experience are used for this demonstration. Some of the examples used would not be considered common types because of their differences from the norm. These

examples are of long term leases, mineral rights and air rights.

Chapter 3 develops in detail the Highest and Best Use Analysis. A great deal of in-depth analysis was made on the Highest and Best Use Analysis because of its importance to the methodology of the "Before and After" concept. The Highest and Best Use definition is broken down into three elements for analysis purposes. An application of each of the three elements is made from actual valuation appraisals taken from personal experience. These examples are given in detail because of the importance of this appraisal concept to the process of the "Before and After" concept. There was also a brief analysis of the inverse condemnation or regulatory taking. This issue has fueled the court on the eminent domain and regulatory taking questions.

Chapter 3 demonstrated how vital the need was for a complete determination of the concept of the Bundle of Rights Theory and the Highest and Best Analysis to the use of the "Before and After" methodology. The methodology requires an in-depth analysis of all the rights and burdens of the subject parcel. One cannot sell or have taken by eminent domain something they do not have. One can only

acquire the rights and burdens that are left after a selling or a taking. The Highest and Best Use may or may not be the same in the before and after condition. The Highest and Best Use must be analysed in the before condition and in the after condition.

In Chapter 4 all the concepts and methodology that have been developed in the first three chapters are brought into use. A straight forward example of the 100 acre farm with a 50 acre take is used. The same facts with the exception of the additional taking of all the water in the 50 acre take is used. The value of the take goes from \$50,000 to \$95,000 with the inclusion of the water in the take area.

Examples are given in the easement area both by the federal government and the private sector. Some of the examples used for federal easements are: roads; pipe lines; electric transmission lines; levees; flowage; clearance; navigation; scenic; conservation; tunnel; sewer line; and safety zones. In the private sector there are: Historic Preservation Easement On Urban Properties; Historic Preservation Easements on Open Lands; Scenic Easements; Farmland Easements; Timberland Easements; Natural Habitat Easements; Easements to Protect Land; and Areas

for Public Outdoor /Recreation and Education. All of these easements use the "Before and After" concept and methodology.

Chapter 4 presented a case study of an appraisal on the use of the "Before and After" concept. Actual pages from an appraisal report have been used when they have direct demonstration value. Case study comments are interjected at strategic points in the appraisal report. The "Before and After" methodology is used on the case study and the take is the same as the 100 acres with a 50 acre take example. In the case study a right is taken from the subject property. The take is a water right that is stripped from the land after acquisition. The remainder of the land is left without water. This case study has used all the major points of Chapters 1, 2, and 3. It becomes a classic example of the "Before and After" concept at work. At this point in the thesis evolution the following has been demonstrated. The concept of valuation is legally supported in the Constitution of the United States. The federal area of Eminent Domain has created a field of use through case law and federal administrative policies and requirements. The federal case law and court decisions have created a whole field of legal terminology. The areas

of Eminent Domain and its Just Compensation requirements have developed legally accepted methodology. One of the required methodologies for partial federal takings is the "Before and After" concept. The "Before and After" methodology is used to measure the difference between two sets of valuation facts. To complete the thesis evolution this concept will be used to measure changes in uses and rights.

A case study will be presented that will illustrate the "Before and After" concept and methodology as they can relate to unique and special purpose uses and rights. The case study will be taken from an actual project that was performed in Guam for a private sector client. I was contracted by a Japanese national company to prepare a report for their proposal on the privatization of a government owned marina in Agana, Guam. The report was entitled, "Economic Analysis and Valuation for the Privatization of Agana Marina."⁵ That report will be used as this case study.

Case Study

Facts: The subject project was known as the Agana Boat Basin. It is still being used as a marina by the

Territory of Guam's Port Authority. The marina operation had been offered, under Request for Proposal (RFP) Number 88-001, for management and development. The Request for Proposal was issued on September 16, 1988 with proposals due by December 9, 1988. It was because of this Request for Proposal and at the request of our client that the study was prepared.

It was our opinion and our recommendation to our client that an economic study be made within the requirements of the Request for Proposal and within the private sector market. In view of the fact that this was a privatization of a public resource, the public would be sensitive to: public land use; land utilization; economic benefits to the government; reasonable profits to the developer.

Economic Problem: The question asked is what must the study show? We could not just deal with intangibles. If there were any actual and concrete benefits, they would have to be measured. The most understandable measure of comparison is a measure of benefits in dollars and any percentage of change in the actual use. Our study took the dollar benefits obtained from our analysis and placed a time and interest factor to them. It was determined that

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the study could show the following: utilization of the land to more than its present use; exceed the existing level of service; create a positive cash flow into the Government of Guam treasury; stop a negative cash flow from the Government of Guam treasury; and create full use of a natural resource.

The sensitive issue of privatization demanded that the interests of the public, government, and developer be identified and determined. All positive and negative impacts had to be identified. If one party received a greater benefit than the other, the balance would change and the privatization might not be viable.

The question asked was if the interests of the public, the government, and the developer could be met in a reasonable and acceptable manner by this project. Would there be sufficient benefits to all parties to have a viable project?

We felt that it was important that these questions and items should be addressed and analysed. Could the land be fully developed to its "Highest and Best Use" under the present Request for Proposal? What is the present use and public access? Would the present use increase or decrease? Was the future public use and access

considered in the proposed plan? What is the future public use and public access? What are the considerations of infrastructure (water, sewer, and roads)? What are the improvements of the harbor? Who pays the cost of development and improvements? Will there be reversion and the possible value of these reversions? Who receives it? Who pays this expense? Are there benefits (Monetary and Public use)?

The Request for Proposal was issued by GovGuam requesting proposals to improve and operate the marina. This Request for Proposal was issued on September 16, 1988 in accordance with Executive Order (EO) #87-19 of the Territory of Guam. The executive order gives the legal authority, terms, and conditions of leasing commercial government property. Some of the requirements: conveying property by lease for a term not to exceed 50 years; not selling or assigning property without approval of GovGuam; and renting must be for Fair Rental Value.

To our knowledge, this was the first effort to privatize a marina and harbor operation in the Pacific Basin. In fact, to our knowledge, this was the first public privatization effort of any kind for the Pacific area.

Case Study Exhibit 1.0

"AREA and ISLAND DATA in 1989

Guam Island: The island of Guam is an unincorporated territory of the United States. It is the largest island in the Marianas Archipelago. The island is 30 miles long and the width is from 5 miles to 8.5 miles. It has a total land area of 209 square miles. It is located 3,700 miles southwest of Honolulu, 1,500 miles east of Manila, 3,100 miles northwest of Sydney, and 1,500 miles south of Tokyo.

Area Data: Guam is the center or "hub" of the Pacific Rim. It has a military, economic, and tourist demand that has impacted this side of the world. At this time the island had certain set patterns of use. The military was located in the north at Andersen Air Force Base and in the south-central at the Naval Station. Tourism is centered in Tumon Bay. Agana is the commercial and government center.

Guam's Apra Harbor is one of the finest deep water harbors between Hawaii and the Philippines. This harbor has been one of the most important factors in the island's economic growth. Cargo revenue tons from harbor operations have shown a continual increase from previous periods. Full utilization of the harbor land and facilities is

a reasonable assumption in the near future. Small boat marina use does not appear to be feasible and compatible in Apra Harbor.

Neighborhood Data: The city of Agana is on the west side and in the middle of the island. Agana has always been the commercial center for the island. Most of the city buildings were destroyed during the World War II invasion of 1945. There are now large modern commercial buildings and shopping centers. There are office and government buildings and more are in the process of being built.

On the ocean side of the city across Marine Drive are the Agana Marina, a baseball stadium, and park and recreation areas. Most of the strip commercial is on the south side of Marine Drive. Originally, there was only one first class hotel in Agana. This is the Cliff Hotel which is on the hill across from the Governor's House. There are no new first class hotels in the Agana area. In fact there are no new first class hotels outside of the Tumon Bay area. Investors, at the time, felt that there could a shortfall of over 2,000 rooms on the island."

Comment: The Agana Marina was well used by local and visiting boaters. There were 42 slips which were fully rented with a supposed waiting list. Some early studies

showed a need for 300 to 400 more slips. At the time of the RFP, GovGuam's Agate Marina was coming on line with 156 more slips.

Case Study Exhibit 1.1

"ECONOMY

Historically Guam's economy has relied on the Government of the United States for funds. The United States military has become a big part of the Guam economy. Federal funds support GovGuam and the federal government is the largest employer on the island.

In the 1980s, the Japanese investment and tourist influence began to impact the Pacific Basin. They soon became the major economic motivation on the island.

Japanese influence: The economy was significantly influenced by the United States Federal Government and Japanese investment. Federal funds tended to be more stable and predictable than Japanese investment.

Tourism: The force behind the growth in retail and service employment was tourism. The number of tourists arriving by air had accelerated sharply during the late 1980s to a

total of 769,876 visitors and tourists in 1990. This was a 16.8 percent increase over the 1989 level and over 100 percent increase over the 1985 level of 378,146. Projected growth in tourism had been expected to continue to escalate due to the large number of hotels under construction and the proposed development projects on Guam. Dr. Thomas Iverson, a Labor Economist from the University of Guam, predicted that the number of tourists expected by 1994 would exceed 2,000,000. This estimate had been based on a study prepared for the Guam Economic Development Authority in the Spring of 1991.”

Comment: The time for privatization appeared to be right. From 1987 to 1991 the Island of Guam was riding the top of a high economic wave. No longer was GovGuam completely dependent upon the budget allocation of the United States Department of Interior. Japanese investments on the island in hotels and golf courses had fueled the growth of Japanese tourism. Hotel room taxes were high and the entire economy of the island was being impacted. The local population shared in this economic boom time. Millionaires were made overnight by land sales to the foreign investors. Island employment was high and so were the wages. Land became power and power was

used politically. Political corruption was on the rise with former Governor Ricky Bordello found guilty of fraud and extortion by the federal courts. During this time other department heads of GovGuam were being prosecuted by the U.S. Attorney's Office for political fraud and corruption.

The public advertising of the privatization of the Agana Marina appeared to be a positive act of GovGuam. The appearance of open competition at this time was also considered a positive act of GovGuam. This was a high visibility project and it would be subject to public review. In an objective manner, based upon all of these factors we prepared our analysis and study leading to the economic decisions.

The concept of privatization makes economic sense in an emerging territory such as Guam. There was a lack of capital funds for the development of a public marina. The RFP requested that the harbor and slips be improved at the developer's cost.

As stated earlier, it is necessary to establish and measure certain elements and factors in the analysis methodology. These factors were identified as: utilization by the public of the land to more than its present use; exceeding the existing level of service to the public;

creating a positive cash flow into the Government of Guam treasury that would stop a negative cash flow from the Government of Guam treasury; creating full use of a natural resource.

Based upon our experience with sensitive public issues, it was determined to set out an analysis that could be measured and understood by the general public. The concept of a "Before and After" approach is the basis of the federal concept of partial acquisition and/or easement taking. Using this concept we researched and analysed the "Before" or present use and operation of the marina. Using our client's proposal we demonstrated the "After" or future use and operation of the marina. The following data was obtained in this manner.

Case Study Exhibit 1.2

"BEFORE (PRESENT USE AND OPERATION)

Government operational cost

Profit or Loss: It is not common practice to look at a government operation from a profit or loss analysis. The government usually provides a service regardless of profit or loss. The government offsets any deficit by taxes. To prepare a proper analysis on the privatization of the

marina operation, the cost to operate is a major factor. This factor is not only important to the government but it is a must factor to the private sector.

Expenses: The Operating Expenses are the responsibility of GovGuam and more specifically the Port Authority. Actual expenses obtained from the Port Authority for the years of 1987 and 1988 are:

<u>Expenses</u>	<u>1987</u>	<u>1988</u>
Salaries	\$22,241.24	\$20,449.32
Overtime/etc.	1,730.72	1,161.36
Retr.	2,877.62	2,823.86
AL Earned	2,142.61	1,746.24
Unfunded Ret.	1,782.71	1,246.52
Sick Leave	151.20	270.16
Contract Out	3,103.80	-0-
Gas & Oil usage	223.25	2.37
Misc. (utilities)	7,160.28	10,886.91
Supplies	855.25	294.17
*TOTAL EXPENSE	\$42,268.68	\$38,880.91

*There is not an expense item for indirect overhead.

There is little maintenance of the improvements done because of the lack of budgetary funding. Deferred Maintenance and Repair is determined to be a major item.

An item cost of Reserve for Replacement was discussed with the Port Authority and it was stated by them that there is not a specific reserve account for normal replacement. Any replacement would need to be a one time budget item request. For purposes of this study, the reconstructed estimated expenses for the years of 1987 and 1988 are:

	<u>1987</u>	<u>1988</u>
Total Expenses forward	\$42,268.68	\$38,880.91
Res. for Replacement		
(slips & docks, etc.)*	12,300.00	12,300.00
Overhead-Direct and		
Indirect (@10%)	<u>4,227.00</u>	<u>3,888.00</u>
Total Stated and Reconstructed		
Expenses	<u>\$58,795.68</u>	<u>\$55,068.91</u>

*Based upon a replacement cost of \$184,500 @ 15 year life

Income: There are some minor support and service charges but the majority of the marina income is derived from berthing and mooring charges. These rates are politically determined. Any rate increase or decrease has to be presented by the Port Authority to the legislature for approval. If the legislature does not approve the request, then the increase or decrease cannot be implemented. The

rates are based upon Section 15430, Title 16, Natural Resources and Recreation, which set forth the original approved rate charges. Based upon these charges the actual gross income for the years of 1987 and 1988 was:

	<u>1987</u>	<u>1988</u>
Income	\$11,708.50	\$15,341.50

Profit or Loss: In the private sector, the difference between the cost to operate and the income would be considered either the Profit or Loss of the business and/or operation. This factor is important in the private sector and it often determines if an operation can be continued. However, government is often in the service business and profit is not necessarily the primary objection of their operation.

	<u>1987</u>	<u>1988</u>
Income	\$11,708.50	\$15,341.50
Cost to Operate	<u>58,795.68</u>	<u>55,068.91</u>
Profit/Loss	(\$47,087.18)	(\$39,727.41)
<u>Average Loss for 1987/1988</u>		(\$43,407.30)

Present Value: All income and expenses were increased 10% every 5th year. The loss was discounted at 9% for 50 years and the Present Value is (\$515,473).

Before cost to operate by GovGuam: The 'Before' cost to operate 42 slips by the government resulted in a yearly average loss of \$43,407 or an average cash loss by the government of \$1034 per slip per year.

Monetary benefits measured

Indirect Monetary Benefits: In the analysis of government management and development versus privatization and development by the private sector, monetary benefits have to be considered and measured when possible.

Some of the benefits are created by the project itself. The very act of construction requires local employment and supplies. The fact of the cost of constructing these major improvements over a three to four year period alone would impact the economic base of the island."

Comment: It was projected in the proposal that by the end of the fifth year the marina would employ from 160 to 265 people. Based upon these facts the company would become one of the major employers on the island.

The proposal estimated that the marina would bring into the government treasury, total taxes of over \$1,000,000. These would be in the form of business privilege taxes, individual withholding taxes and corporate income taxes. It was noted that this would be a new source of revenue and that it would be a continual income stream for the next 50 plus years.

Case Study Exhibit 1.3

“Direct Monetary Benefits: Monetary benefits that can be measured are the following.

1. Savings of annual operating loss.
2. Positive cash flow from land rent of marina.
3. Asset reversion at end of lease period for the marina.

The following shows each one of the benefits multiplied by the Present Value (PV) factor and then added together to form the total direct benefits.

Present Value from Savings of Operating Loss	\$ 515,473
Present Value from land rent cash flow:	
Marina at PV of	436,752
Asset Reversion	<u>\$4,000,000</u>
Total Present Value	<u>\$4,952,225</u>

Physical use and asset inventory

Slips: There are 42 slips in the boat basin area. The berthing and moorage fees are set by the Port Authority at the request of GovGuam. The rates for berthing and moorage fees are politically determined and they do not cover the expenses.

Operational Cost: The marina and boat basin is operated by the Port Authority. They had been given jurisdiction by GovGuam. A detailed Income and Expense analysis has been done above. It shows that the Port Authority had an average yearly loss of \$43,407. In our analysis we did a Present Value (PV) at 9% for the 50 year term of the lease and the PV for the loss was \$515,473.

Public Access: At this time the public has access to the marina and slips. It is noted that there is only an 8 (eight) acre parcel that comprises the marina. The seawall road between the marina parcels and the sewage treatment plant is limited to authorized personnel only and not open to the general public. Without this access road, the public cannot reach the breakwater area.

Recreational Use Area: There are no open space recreational areas within the marina boundaries. There is some public recreational space east of the marina area

along the entrance channel within the park boundaries. This is not directly within the marina area and it is also poorly maintained.

Commercial Boat Use: Charter and commercial fishermen operate out of the marina. They use the facilities and services at the rates set by the government. There are not any restaurants, stores, or any other public sales.

Parking: Parking is scattered around the marina. A small portion is located on the frontage area. There is another area in front of the office and another small portion on the L-shaped mole. This totals approximately 60 parking spaces.

Restrooms: There is one restroom of approximately 225 SF (15'x 15').

Utilities: There is water, electricity, and sewer connections to the buildings and dock areas. None of these utilities are available to boats in moorage.

Improvements

All the improvements were inspected and the replacement cost estimated. Depreciation was taken and the present value was determined. The estimated present value of all marina improvements is \$1,625,179.

Reversion

If any improvements are made before or during the lease period, they would revert to the lessor at the end of the lease term. This would be a \$1,000,000 base for the before time.”

Comment: Summary of the before and/or present use

Each item of use and the condition of the original marina had been reviewed and analysed. This is the “status quo” period in time. The RFP stated, in effect, that the proposal that could maintain the existing level of services and provide enhancements would be given the greatest weight. A plan for the use of the submerged land would be a plus factor in the proposal evaluation. It becomes important in our analysis to know the existing level of services and existing improvements. These become the base or starting point for any comparative analysis.

Now we deal with the same items. The items are taken from our client’s proposal. After these items have been identified and analysed, then a comparative study is made.

Case Study Exhibit 1.4

“After or proposal use of asset inventory

Slips: While there are 42 slips, the ‘After’ number proposed is 350 slips. This represents an increase of 308 slips or an increase of 733%.

Operational Cost: The marina, under the proposal, is to be operated by Matuzato Sogyo Company. All management and expenses of operation would be undertaken by them. There would be no cost to the government.

Commercial Facilities: There are no commercial facilities in the Before condition. The proposal would add a boat yard, boat sales, restaurants, and other commercial retail outlets.

Public Access: The public is to have access to the entire expanded marina. This would also include the now inaccessible submerged land. This area was referred to in the Department of Land Management map #E4-88T 703 as the “Agana Marina North” (area = 28.43 acres). The original boat area is identified as “Agana Marina South” (area = 8.32 acres).

Recreational Use: All the restaurants and commercial outlets are to be used by the public. Actual

picnic shelters have been planned. Ten permanent and attractive picnic shelters are to be constructed in locations providing convenient access for the public. The shelters will have facilities for food preparation and for barbecues. Each covered area measures about 10 feet by 6 feet. Their location is to be decided jointly by the Port Authority and the Department of Parks and Recreation.

Commercial Boat Use: Charter and commercial fishermen will continue to operate out of the marina's expanded facilities. The following facilities are to be added under the proposed 'After' plan: restaurants (three restaurants of 2,500 SF each); specialty shops (five shops of 900 SF each); a 5,500 SF yacht club; boat and ship chandlery; fuel and loading dock.

Parking: There will be a total of 260 parking stalls throughout the marina. In addition, about 60 auto-trailer parking stalls will be provided near the public launching ramp. Several parking stalls will be created for buses near the terminal building.

Restrooms: There will be three separate restrooms. One of the facilities will have men's and women's shower areas.

Utilities: There will be water, electricity and sewer connections to all buildings and dock areas. There will be metered connections for water and electricity to the slips. It is our impression that sewage hookups would be available to the slips but this could not be confirmed within the proposal.

Improvements

Juan C. Tenorio, PE, of the firm of Juan C. Tenorio & Associates Incorporated, prepared the proposed costs for the improvement figures. This company is a large engineering, surveying and planning company on Guam and Saipan.

The proposed improvement costs of the new marina and their classification:

Heavy Construction	\$ 3,920,000
Revenue Facilities	\$ 5,950,000
Support Facilities	<u>\$ 1,560,000</u>
Total Cost	\$11,430,000

Reversion

Any improvements made during the term of the lease will revert back to the owner/lessor. The original improvement of \$11,430,000 would revert to the lessor at the end of the lease term. Because of the type of

improvements and the required high degree of maintenance, it is estimated that the value of the reversion would be \$5,000,000.”

Comment: Summary of the after and/or future use

The “After” condition deals with future and not the “status quo” of the marina. The above information had been obtained from our client’s proposal and analysed for use in our study. No effort had been made up to this point to do a comparative analysis. The Matsuzato Sogyo Company retained our services to prepare an economic comparative analysis.

Case Study Exhibit 1.5

“Comparative analysis

Section 1-1 Introduction, of the RFP states: ‘...The Port Authority of Guam is soliciting proposals for the transfer of the Agana Marina management and development to a private entity. Transfer is to include the responsibility for the management and maintenance of all existing facilities, water ways and approximately 26 acres of submerged land in the Agana Boat Basin... The Port Authority is particularly interested in receiving proposals from developers who will expand and improve the existing facilities and services

available at the boat basin. However, development proposals that maintain the existing level of services and provide enhancements to the use of the submerged land will be considered”.

Comment: We were aware of the local concern with the term “privatization” and its impact on the political scene. Any time there is a transfer of control of a public resource to the private sector there is public reaction. It became necessary, to demonstrate in a very factual way, the “Before” (present) and the “After” (proposed) conditions of the marina. If there was to be any loss or gain of services, improvements, and money, it must surface during this type of comparative analysis.

Each item was compared and analysed and the loss or gain would be demonstrated.

Case Study Exhibit 1.6

“Slips

Before (GovGuam)	42	
After (Proposed)	350	
Difference	+308	
%		+733%

Remarks: The minimum requirements set out in the RFP states that the proposal must maintain the existing level of service. The proposal expanded the existing level by 308 slips or an increase of 733%.

Operational Cost

Before (GovGuam)	(\$43,407)
After (Proposed)	(\$-0-)
Difference	+\$43,407
%	+100%

Remarks: The yearly average loss for the years of 1987 and 1988 was (\$43,407) per year. The average loss per slip for the 42 slips was (\$1,034) per slip per year. The Present Value of this loss to the government at 9% for 50 years is (\$515,473). Under the proposal, 350 slips would be operated at no cost to the government.

Public Access

Before (GovGuam)	8.32 acres
After (Proposed)	36.75 acres
Difference	+28.43 acres
%	+342%

Remarks: In the before condition, the original marina operation was limited to 'Agana Marina South.' In the "Agana Marina North" which is approximately 28.43 acres, there is some open moorage between the seawall and the original slips, but there is no access for the nonboating public. In the after condition, this entire northern area would have non-boating access.

Recreational Use

Before (GovGuam)	-0-
After (Proposed)	10 picnic shelters
Difference	+10
%	+1,000%

Remarks: Under the before operation there were not any picnic areas for the public use within the marina boundaries. In the proposal there are 10 picnic areas with covered shelters and they would be accessible to the non-boating public. Also in the proposal, retail outlets and restaurants are planned.

Commercial Boat Use

Before (GovGuam)	*100%
After (Proposal)	*500%

Difference +400%

Remarks: This assumes that the original operational use of some charter and commercial fishermen and their supporting services represent a 100% base. The after increase is based upon the increased commercial use proposed and the additional accessible use of the northern 28 acres. Restaurants, specialty shops, a yacht club, and a boat and ship chandlery are proposed.

Parking

Before (GovGuam)	60	
After (Proposed)	260	
Difference	+200	
%		+333%

Remarks: The +333% increase is a comparison of auto parking spaces only. In addition to the normal auto parking, stalls would be provided for approximately 60 auto-trailers. Also additional parking stalls would be created for buses near a new terminal building.

Restrooms

Before (GovGuam)	1
After (Proposed)	3

Difference	+2
%	+200%

Remarks: The three new restrooms will be large facilities. One of the proposed facilities will have men's and women's shower areas.

Utilities

Before (GovGuam)	*100%
After (Proposal)	*400%
Difference	+300%

Remarks: *The assumption is that the original use formed the 100% base for utilities and their accessibility by the boat users. Water, sewers, and electricity were originally on site to the office and dock facilities. It is our understanding that they could not be connected to the boats in their slips. The proposal states that individually metered power and water hookups would be provided. It was our understanding that sewage hookups would also be provided.

Improvements

Before (GovGuam)	\$ 1,625,179
After (Proposal)	\$11,430,000

Total	\$13,055,179	
Difference	+\$11,430,000	
%		+703%

Remarks: The original improvements on the marina land were valued at \$1,625,179. The proposal intends to build improvements in the amount of \$11,430,000. The Matsuzato Sogyo Company will pay the entire cost of the new improvements and there would not be any cost to the government. This represents a 703% increase in improvements without any cost to the government.

Reversion

Before (GovGuam)	\$1,000,000	
After (Proposal)	\$4,000,000	
Total	\$5,000,000	
Difference	+\$4,000,000	
%		+400%

Remarks: All improvements on the marina land at the end of the lease period will become the property of the lessor/landlord. Because of the type of improvements and the high degree of maintenance needed, some of the improvements would have a market value at the end of the lease term. An example of the types of improvements

considered: seawalls; moles; bulkheads. This does not include the \$20,000,000 reversion from the hotel site.”

Comments: Comparative analysis summary

The comparative analysis shows that all classifications of use and service increase. This increase shall not cost the Port Authority even one dollar in money. Service and use will increase and the monetary cost has gone down to zero to the government. This indicates that there could be a successful privatization of the marina.

Case Study Exhibit 1.7

“A summary review the comparative analysis follows.

Before and After Summary Sheet

<u>Item</u>	<u>Before</u>	<u>After</u>	<u>Percent</u>
Slips	42	350	+733%
Public Access	8.32 ac	36.75 ac	+342%
Recreational Use	-0-shelters	10	+1000%
Commercial Use	100%	500%	+400%
Parking	60	260	+333%
Restrooms	1	3	+200%
Utilities	100%	400%	+300%

			112
Improvements	\$1,625,179	\$13,055,179	+703%
Reversion	\$1,000,000	\$5,000,000	+400%
Operational Cost	(\$43,407) p/a	-0-	+100% ”

Comment: Each area of service, use, cost, and other benefit has been analysed. Not one negative area or factor to the government can be found. In fact there has been substantial percentage increase of use and service, and a decrease to zero in all costs. Improvements will be added without money cost to the government. At the end of the lease period the government receives all the reversion of all improvements in the marina without having made any cash investment of their own.

¹ United States Constitution, Fifth and Fourteenth Amendments

² Uniform Standards of Professional Appraisal Practice

³ Uniform Appraisal Standards for Federal Land Acquisitions

⁴ Uniform Standards of Professional Appraisal Practice

⁵ WESTCO/PAC International Ltd. Economic Analysis and Valuation for the Privatization of Agana Marina

Chapter 6

CASE STUDY SUMMARY AND THESIS CONCLUSION

Case Summary: All the benefits have been identified and when possible measured. In our Economic Analysis portion of the study certain questions were presented that we felt should be answered. If the proposal of Matsuzato Sogyo Company had been accepted by GovGuam, would the privatization of the marina operation have been to the best interest of GovGuam?

These specific questions were asked. Would the proposal utilize the land to more than its present use? Would the proposal have exceeded the existing level of services? Would the proposal stop a negative cash flow from the treasury of GovGuam? Would the proposal create a positive cash flow into the treasury of GovGuam? Would the proposal create full use of a natural resource?

An extensive analysis was made on all the areas of concern of the above questions. A "Before" and "After" methodology was used on the services and uses. The cash flows, both negative and positive, were measured and the present value principle was used for the comparative

analysis. A land economic analysis was made that addressed the full use of the marina as a natural resource. Our analysis identified the present use and services of the marina in the "Before" section. It took those same uses and established a level of use and service from the proposal in the "After" section. A side by side comparison was made of all the uses and services in their "Before" and "After" conditions. These results were found. It was determined that none of the present uses and/or services would cease or be reduced. The proposal created new areas of uses and services. All original uses and services were increased between +100% to +733%. The +733% is the major item of increasing the slips from 42 to 350.

The Port Authority furnished us with actual income and expense information for the years of 1987 and 1988. Direct and indirect overhead had not been included. An account for a reserve for replacement also had not been established. When these expenses were identified, adjustments were made and the expenses for the year of 1987 and 1988 were increased, showing the following. There were Operating Loss for 1987 of \$47,087.18 and Operating Loss for 1988 of \$39,727.41. An average yearly

Operating Loss of \$43,407 was found. Currently, there is a Present Value of Operating Loss of \$515,473.

Once the Matsuzato Sogyo Company had assumed the management and development of the marina under the terms of its proposal, all negative cash flow from the treasury of GovGuam would cease for the operation of the marina. Once land rents were paid by Matsuzato Sogyo Company a positive cash flow into GovGuam's treasury would be created. These rents were appraised for our clients as a part of our analysis and study for them. The rents were \$25,000 per year with 10% increases every 5 years for 50 years at a 9% rate. The Present Value of this income stream for 50 years was \$436,752.

It is the opinion, based upon all the data, market, and analysis facts that the proposal would benefit GovGuam. In summary, the proposal to award the contract and privatize the marina management and operation was to the best interest of the Government of Guam.

Thesis Conclusion: The case study on privatization of a marina in Guam shows the use of the "Before and After" concept in its analysis. The case presentation demonstrated the used of the "Before and After" concept and its methodology. In the case analysis it became

obvious that the economic analysis and the feasibility study required a special and unique approach. A measurement was needed for comparative analysis purposes. It was determined in the case study that the before and after concept could work on all kinds of benefits and liabilities.

Therefore, the thesis shows that the Constitution of the United States legally supported the concept of valuation. The area of Eminent Domain developed by federal case law and federal administrative policies and requirements has created a special field of valuation law. From the federal case law and the court decisions there has been created a whole field of legal terminology. Along with this terminology certain legally accepted concepts and methodology has developed. One of the required methodologies for partial federal takings is the "Before and After" concept. This methodology is used to measure the difference between two sets of valuation facts. The case study on privatization shows that this concept, when used properly, can be used to measure changes in uses and rights. This research paper has addressed the Thesis Statement and it has demonstrated other potential uses of the "Before and After" concept and methodology.

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