

Across-the-Fence Value and Hostage Occupancy Agreements



**EUCI Conference: Electric
Transmission Projects
San Diego, California
September 19, 2016**

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What is the goal of valuation assignments?

Market Value

Implied value “as is”

- USPAP requirement for hypothetical conditions and extraordinary assumptions



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What is Across the Fence (ATF)?

- Valuation methodology used in valuing corridors
- Commonly used in negotiations for leasing or sale of corridor property

Why are we asking this question?

- For years there have been questions about the reliability of ATF
- Many users or buyers of corridor property complain that it does not make sense



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Background:

- Hunsperger, McGuire and Throupe, “*Transit Corridor Valuation: Issues and Methods*,” The Appraisal Journal, Summer 2012
- Good article on the history and current application of ATF Methodology



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Background (continued):

- ATF was adopted by the Interstate Commerce Commission in 1887
- Has been in some form of use for over 100 years
- Millions of dollars of transactions have been based on the current use of ATF



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ATF Process

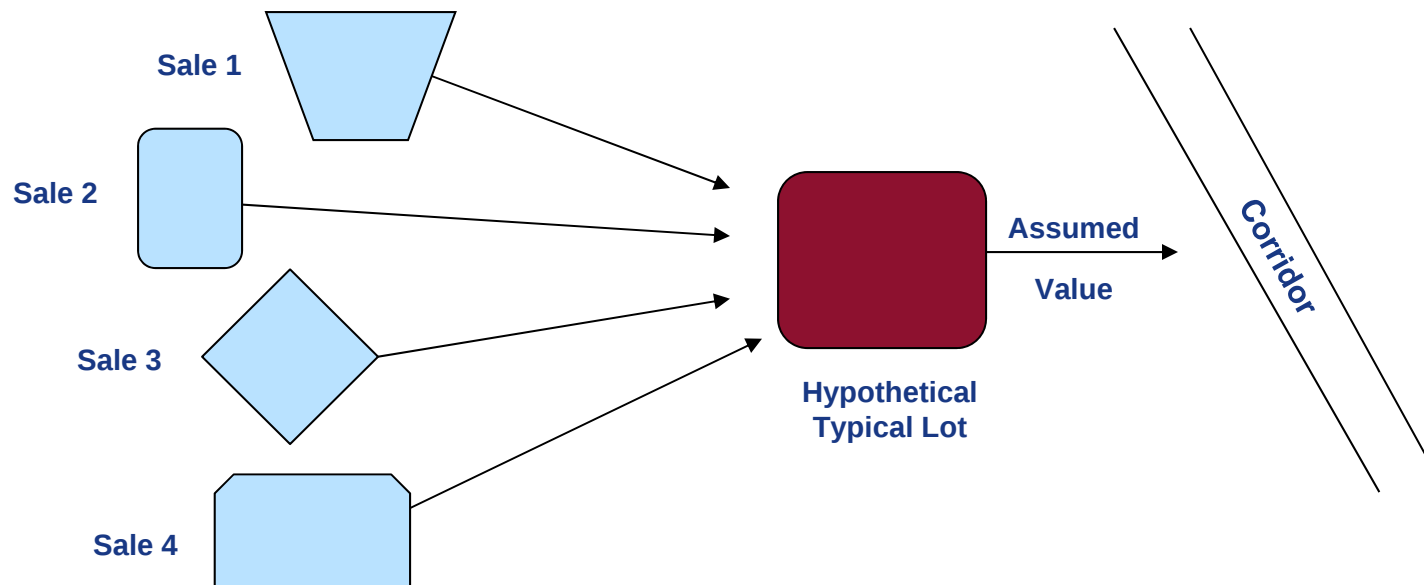
- ATF methodology studies land values in the area of a corridor to determine the value of the corridor
- ATF “presumes the corridor is worth at least as much as the lands through which it passes”¹
- Essentially the ATF methodology is a sales comparison approach to value

¹ Hunsperger, McGuire and Throupe, “*Transit Corridor Valuation: Issues and Methods*,” The Appraisal Journal, Summer 2012.



ATF Process (continued)

- Land sales in the area are compared to a hypothetical typical lot



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ATF Process (continued)

- Adjustments for time, location and condition of sale
- ATF then assumes the value of the corridor is equal to the value of the hypothetical typical lot
- No direct comparison between the land sales and the corridor



ATF Process (continued)

- No adjustment for size, shape, topography or access
 - Why?
 - Rahn:² “The rationale for this is that, absent the corridor, the land beneath the corridor would be part of the adjacent parcels and share their access, shape, and topography.”

2 Arthur G. Rahn, *Corridor Valuation—An Appraiser’s Overview* (Fairfield, CA: Arthur G. Rahn, October 2005), 18.



ATF Process (continued)

- Dolman and Seymour:³ “Each segment of the corridor is considered to be either part of, or made up of, one or more such typical parcels, thereby disregarding the size, shape, and access characteristics of the segment.”

3 Dolman and Seymour, “Valuation of Transportation/Communication Corridors,” The Appraisal Journal (October 1978) 518.



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Issues with the ATF Process

- ATF “presumes the corridor is worth at least as much as the lands through which it passes”

Presumed + at least + is worth

Assumed Minimum Value = AMV

Extraordinary Assumption = USPAP Disclosure Requirement



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AMV Implied Assumptions

- Equal market demand:
 - Excess/Surplus land and local land sales data has equal demand
- Equal function:
 - Excess/surplus land and local land sales data has equal functional use
- Equal HBU:
 - Excess/surplus land and local sales data has equal HBU



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Issues with ATF Process (continued)

- Uniform Standards of Professional Appraisal Practice USPAP
- Adopted January 30, 1989 by the Appraisal Standards Board
- ATF methodology continues to be used without modification to meet USPAP Standards



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USPAP Definition

- **Extraordinary assumption:**

“An assumption, directly related to a specific assignment, as of the effective date of the assignment results, which if found to be false, could alter the appraiser’s opinions or conclusions”

- **Comment:**

“Presume as fact otherwise uncertain information about the physical, legal or economic characteristics of the subject property; or about the conditions external to the property, such as market conditions or trends; or about the integrity of data used in the analysis”



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USPAP Definition

- **Hypothetical condition:**

“A condition, directly related to a specific assignment, which is contrary to what is known by the appraiser to exist on the effective date of the assignment results, but is used for the purpose of the analysis”

- **Comment:**

“Hypothetical conditions are contrary to known facts about physical, legal or economic characteristics of the subject property; or about the conditions external to the property, such as market conditions or trends; or about the integrity of data used in the analysis.”



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Definition (Dictionary of Real Estate Appraisal)

- Excess land:

“In regard to an improved site, the land not needed to serve or support the existing improvement. In regard to a vacant site or a site considered as though vacant, the land not needed to accommodate the site’s primary highest and best use. Such land may be separated from the larger parcel and have its own highest and best use, or it may allow future expansion of the existing or anticipated improvement.”



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Definition (Dictionary of Real Estate Appraisal)

- Surplus land:

“Land that is not currently needed but cannot be separated from the property and sold off. Surplus land does not have an independent highest and best use and may or may not contribute value to the improved parcel.”



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Surface Transportation Board

- *City of Creede, CO v. Denver & Rio Grande Railway Historical Foundation, STB No. 35239 EB, May 3, 2005.*
 - Three questions from district court to the STB



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STB Questions and Responses

- Question 1:

Is the land on the outer portions of railroad's ROW "necessary for the safe and convenient use of the central portion of the ROW, which is 25 feet wide and which accommodates the tracks and side clearance on both sides of the tracks?"



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STB Questions and Responses

- Response to Question 1

“It cannot be said that property at the edge of the railroad’s ROW is “not needed for railroad transportation” just because tracks or facilities are not physically located there now.”



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STB Questions and Responses

- Questions 2 and 3:

If the answer to Question 1 is negative (2) /positive (3), are the City of Creede's zoning ordinances applicable to the outer portions of the ROW or are these zoning ordinances preempted by federal law or invalidated because they conflict with the Commerce Clause of the U.S. Constitution?



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STB Questions and Responses

- Response to Questions 2 and 3
 - “To come within the Board’s jurisdiction and the federal preemption provision, an activity must be both ‘transportation’ and offered by a ‘rail carrier.’”
 - “Conversely, state and local laws are not preempted where the activity is not ‘transportation’ and is not offered by a ‘rail carrier.’”



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STB Questions and Responses

- Response to Questions 2 and 3 (continued)
 - Example given is a hotel or restaurant on rail corridor land.
 - “Similarly, even if the property is being used for transportation purposes, the activity must be performed by a duly authorized rail carrier.”



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Corridor Economics

- ATF fails to consider economic profile of the corridor
 - STB created primary and secondary legal units
 - Economic profile different between active rails and excess land
 - The same concept applies to electric power line corridors.



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Corridor Economics (continued)

- Facts:
 - Active rail tracks: 100% demand for center portion of the corridor
 - Excess/surplus land: Generally less than 100% demand
 - Power Line corridors:
 - Some percentage demand for physical occupancy
 - Some percentage of excess/surplus land
 - Is there market demand for excess/surplus land?



Corridor Economics (continued)

- Excess/Surplus Land - Demand
 - Actual Demand: What is there now?
 - Reasonable potential demand – new demand
 - Survey potential users



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Corridor Economics (continued)

- Occupancy Issue: Railroad Corridors
 - Center 20 feet – 100% demand
 - Excess/Surplus:
 - Actual
 - Reasonable potential – new demand



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Corridor Economics (continued)

- Occupancy Issue: Power Line Corridors
 - Poles and reasonable work space – 100% demand
 - Excess/Surplus:
 - Actual
 - Reasonable potential – new demand



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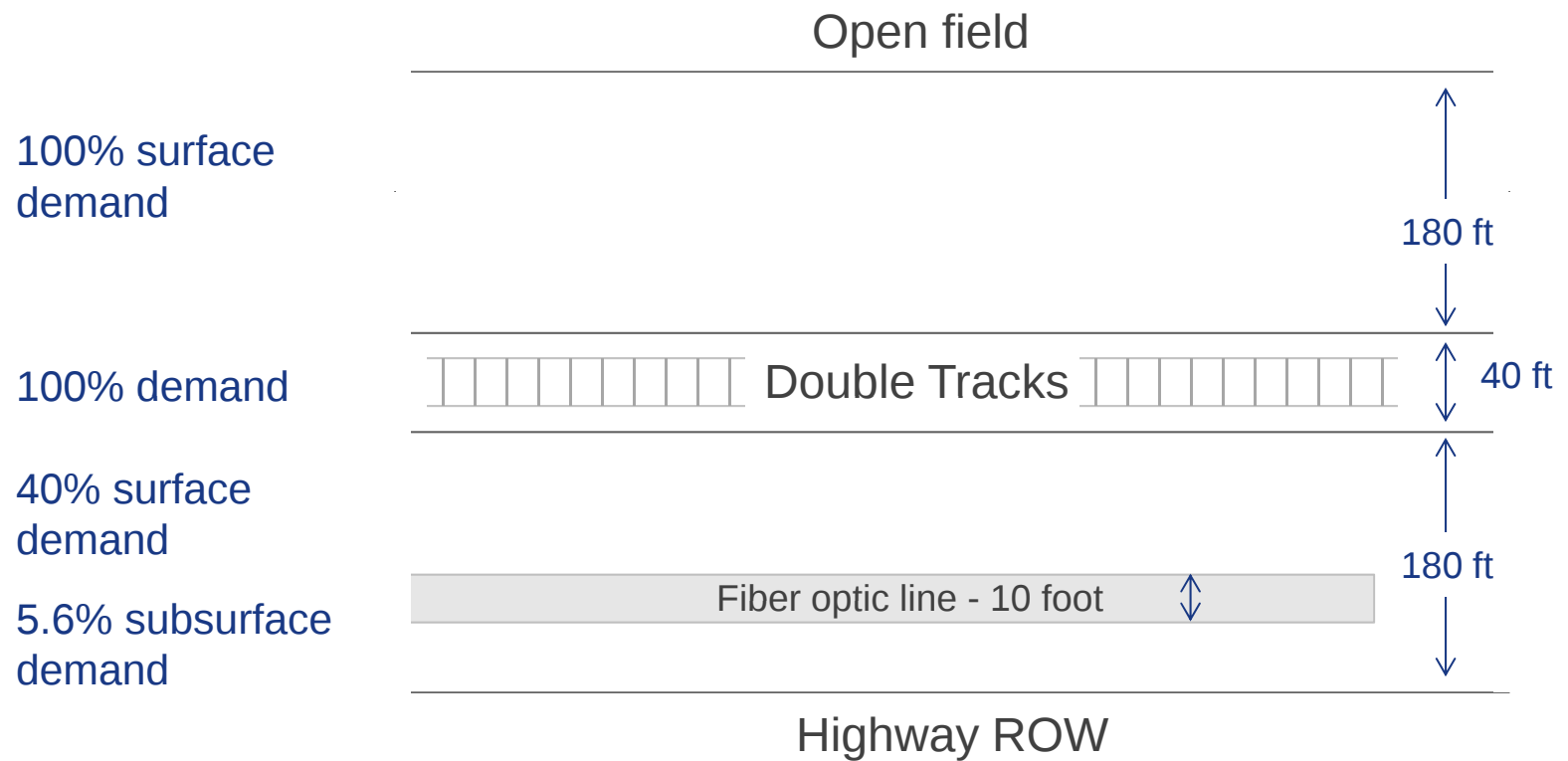
Example 1

- 400-foot wide corridor with two tracks and one easement
 - Active tracks: Center 40 feet
 - Open fields on one side (180-foot excess) – ranch land or crops – 100% surface demand
 - State highway on other side (180-foot excess) with 40% surface demand + one 10-foot wide fiber optic easement



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Exhibit 1



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Example 2

- 150-foot wide power line corridor with four poles supporting 345Kv power line and one easements
 - 25-foot work space around poles and 15-foot wide service access road (combined 40 feet)
 - Open fields on one side (60-foot surplus) – ranch land or crops – 100% surface demand
 - property one side: 40 feet excess land – zero surface demand
 - Other side: 50 feet with 10-foot subsurface fiber line. Little to no surface demand



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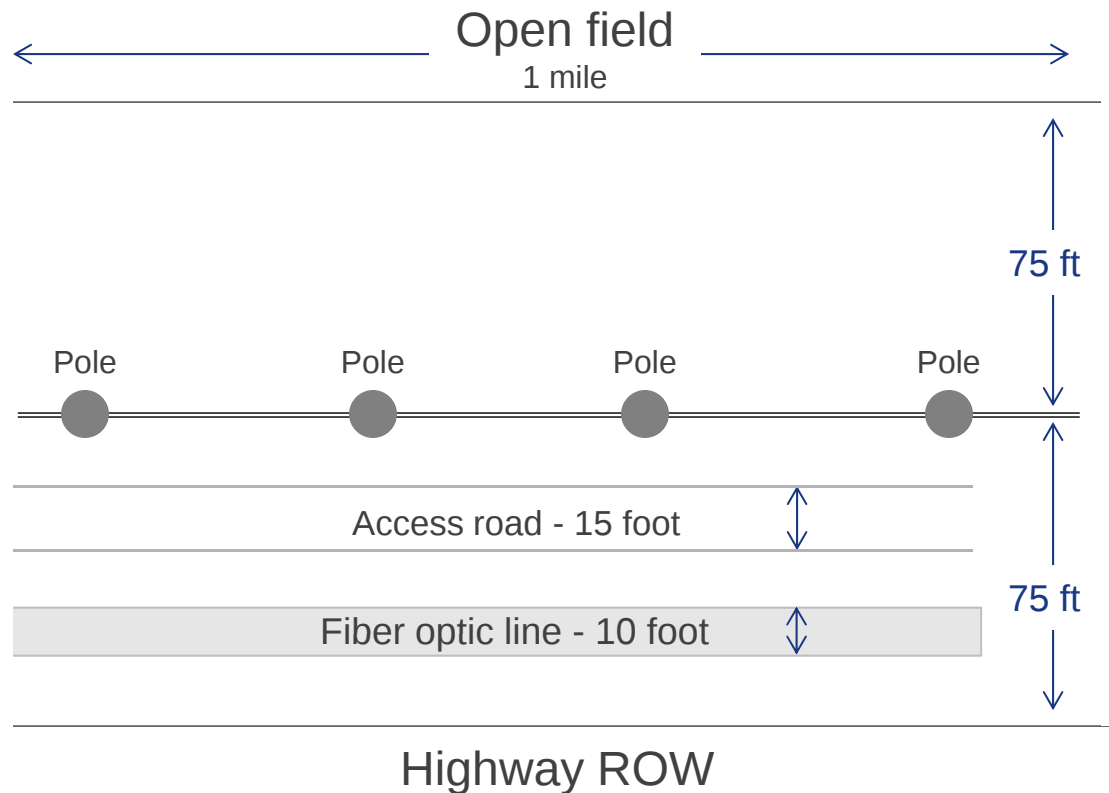
Exhibit 2

60 feet: 100%
surface demand
(40%)

40 feet: 100%
surface demand
(26.7%)

50 feet: limited to
no surface
demand (33.3%)

10 feet:
subsurface
demand (6.7%)



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Central Flaws in ATF Methodology

- ATF does not identify the actual or “as is” value of the excess land in the corridor
- ATF produces an assumed minimum value based on hypothetical conditions
- ATF fails to disclose extraordinary assumptions and hypothetical conditions



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Hostage Occupancy Agreements

- Occupancy by lease, license, easement or other form
- Terms that are detrimental or disadvantageous to tenant that can lead to non-market transactions



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Definitions

- Arms-Length Transaction:
 - “A transaction between unrelated parties who are each acting in his or her best interest.”
- Forced Sale:
 - “Offering and transferring property for a valuable consideration under conditions of compulsion.”
- Forced-Sale Price:
 - “A price paid in a forced sale or purchase, i.e., a sale in which a reasonable time was not allowed to find a purchaser or the purchaser was forced to buy.”



Definitions (continued)

- Tenancy at Will:
 - “An estate that has no fixed term and may be cancelled at will by either the landlord or the tenant.”

Market Value (1)

- “The most widely accepted components of market value are incorporated in the following definition: The most probable price that the specific property interest should sell for in a competitive market after a reasonable exposure time, as of a specific date, in cash, or in terms equivalent to cash, under all conditions requisite to a fair-sale, with the buyer and seller each acting prudently, knowledgeably, for self-interest, and assuming that neither is under duress.”



Definitions (continued)

- Market Value (2):
 - “Market value is the amount in cash, or on terms reasonably equivalent to cash, for which in all probability the property would have sold on the effective date of the appraisal, after a reasonable exposure time on the open competitive market, from a willing and reasonably knowledgeable seller to a willing and reasonably knowledgeable buyer, with neither acting under any compulsion to buy or sell, giving due consideration to all available economic uses of the property at the time of the appraisal.”



Characteristics of Power Lines

- Costly to build
- Difficult to relocate
- Long-term facility
- Can be upgraded or replaced



Hostage Conditions

- Easily Terminated
 - Tenants at Will – Cancellable at Will
 - Short-term notice
 - Termination for any reason
 - End of fixed term
 - Not renewed or extended



Hostage Conditions (continued)

- Movable at will
 - Landlord may require tenant to relocate their facility on the property for any reason
 - Tenant pays full cost to relocate their facility
 - Most secondary users have non-exclusive agreements
 - Allows landlord to attract other additional secondary users and require existing tenants to move to accommodate new user



Hostage Conditions (continued)

- No protection for tenants
 - No dispute resolution option
 - No procedure for mediation or arbitration
 - **“Pay up or get off”**



Hostage Conditions (continued)

- No criteria for rent increases
 - Rents can be raised at any time for any reason for any amount



Hostage Conditions

- Results:
 - Financial Duress on Tenant
 - Options to tenant
 - Relocate facility off the corridor
 - Highest cost option
 - Pay the asking price
 - Next highest cost option
 - Try to negotiate – possible litigation
 - Next highest cost option
 - Start eminent domain litigation to protect assets (facilities in place)
 - Likely lowest cost option



Hostage Conditions

- Results:

In every hostage occupancy agreement the tenant is faced with a “pay or fight” decision. Most tenants pay the asking price. The result is a data base of transactions that are tainted by a flawed methodology and financial duress on the buyer/tenant.

Definition of a Forced Sale:

“Offering and transferring property for a valuable consideration under conditions of compulsion.”



For more information

Please see the article:

Is Across the Fence Methodology Consistent with Professional Standards?

- By John T. Schmick and Jeffrey K Jones, MAI
- Appraisal Journal, Fall Issue, 2014



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About John Schmick

John is a highly respected and experienced appraiser who has prepared over 500 appraisals of commercial properties, special use properties, and easements. John's specialty area is corridor valuation. In particular, he values right of ways, pipelines, fiber optic lines, and high-voltage transmission lines. He is frequently called upon to provide litigation support for matters relating to these types of properties. John has published numerous articles in national journals describing valuation methodologies and is adjunct faculty at the University of St. Thomas.



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