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Unadjusted sales of leased properties are not comparables in property tax valuation of grocery store

Kroger is a grocery store chain that owns, in fee simple, a parcel of land and improvements in Georgetown, Kentucky. The property consists of 12 acres of land and a 130,000-square-foot retail building primarily occupied by a Kroger grocery store.

For the 2015 tax year, the Scott County Property Valuation Administrator (PVA) valued the property at $15.2 million. Kroger disputed this valuation, initially seeking review with the County Board of Assessment Appeals, then with the state Board of Tax Appeals (Board). Kroger asserted that the PVA's valuation was arbitrary, because it was not based on admissible evidence of value and was improperly based on a value-in-use methodology. In opposition, Kroger offered an appraisal opinion of fair cash value of $6.7 million—$4.1 million for the improvement and $2.6 million for the land. Kroger's appraiser used the sales comparison and income approaches to value the property.

Before the Board, Kroger's appraiser explained that he valued the property at its fair market value for the fee simple title because no lease was in place. Therefore, he searched for sales of properties being sold in fee simple and large enough to be comparable to the grocery store. Although those properties were primarily outside the local area, they were all sales of large single-occupant properties.

Kroger's appraiser also addressed the comparable properties provided by the PVA. Those properties, according to the appraiser, were purchased subject to a lease, rather than in fee simple. Also, the PVA's comparables included properties sold as part of a portfolio and a Section 1031 exchange, which the appraiser explained would affect the parties' motivations in negotiating a sale price.

In response, the PVA's chief deputy explained that he relied on Kroger's actual construction costs in setting the assessment, but that he also identified sales of purportedly comparable properties. He did not make adjustments to account for vacancy or occupancy at the time of the sale, because, in the chief deputy's opinion, the sale price represents each property's fair market value and thus no adjustment was needed.

The Board entered a final order upholding the PVA's assessment, because the PVA's sales were transactions of occupied properties, which the Board found to be more comparable to the subject property than Kroger's vacant property sales from outside Kentucky. Kroger appealed to the county circuit court, which denied the appeal, and then to the court of appeals.

On appeal, Kroger argued that there was insufficient evidence to support the Board's final order. Kroger contended that the PVA's use of unadjusted sales of leased properties and original construction costs did not constitute substantial evidence, and that Kroger's appraiser had explained why each sale was not a reliable indicator of the property's value. The court of appeals agreed with Kroger.

The court observed that all of the PVA's comparable sales were subject to leases. A lease has its own value. Under prior case law, the fair market value of a leasehold could be ascertained by subtracting the fair market value of the land if sold subject to the lease from the fair market value of the land as if sold free and clear of the lease. Furthermore, additional information is needed to value properties with leases, including the terms of the lease, requirements for mainte-
nance and improvements, fixed or percentage rent, length and duration of the lease, options for increases or decreases, and “the type of tenants and his financial stability.”

Because the PVA did not introduce any evidence to apply the necessary adjustments to the sales of leased properties, the court agreed with Kroger that the evidence it presented to counter the PVA’s assessment compels a finding that the property was overvalued. As Kroger’s appraiser explained, each of the sales the PVA relied on was not truly comparable to the subject property. Therefore, those sales could not provide a basis for the PVA’s assessment, and the circuit court erred in affirming the Board’s final order.

The court of appeals reversed the Board’s decision and remanded the case for reconsideration of the proper assessment using proper evidence.

Kroger Ltd. P’ship I v. Jenkins
Kentucky Court of Appeals
July 17, 2020
No. 2019-CA-001133-MR

Approved final development plan not subject to ordinances that have the effect of a zoning change

Shipyard Associates LP (Shipyard) owns several pieces of waterfront property abutting the Hudson River in Hoboken, New Jersey (City). In 1997, the City Planning Board approved Shipyard’s proposal to develop several luxury high-rise apartment buildings, commercial retail units, parking garages, a park, and a waterfront promenade on the property. The proposal also included three tennis courts and a tennis pavilion available to the fee-paying public, which would be built on a platform extending into the river. Shipyard developed most of the property in substantial accordance with the agreement. But in August 2011, Shipyard filed an application with the planning board seeking to amend the site plan approval and replace the tennis facilities with two eleven-story residential buildings. The City was dissatisfied with the proposed changes and attempted to block Shipyard from moving forward. Notwithstanding the City’s opposition, the state Department of Environmental Protection issued a waterfront development permit to Shipyard.

Following several lawsuits and administrative proceedings, the planning board voted to deny Shipyard’s new application without holding a hearing. Shipyard filed suit seeking automatic approval of its application under the Municipal Land Use Law (MLUL), and a trial court agreed with Shipyard that the failure of the board to hold a hearing compelled automatic approval of the plans. This decision was upheld on appeal.

In late 2013, while these proceedings were pending, the City passed two ordinances affecting Shipyard’s proposed plans. The first was a zoning ordinance that prohibited new construction or substantial improvement of existing structures on piers or platforms projecting into the river. The second, passed under the City’s police powers, required all construction to be “landward of the mean high tide” except for port and shipbuilding facilities and “open space and outdoor passive and active recreational uses.” Shipyard’s pier was seaward of the mean high tide, and its proposal would not satisfy either of these permitted uses.

Shipyard filed suit challenging the City’s proposed application of the ordinances to its approved plans. Shipyard argued that the prior appellate decision finalized its application, thereby insulating it from any zoning ordinances passed within two years of its final approval, by operation of the MLUL. The City, in response, argued that the second ordinance was a general environmental regulation, not a zoning ordinance, and therefore not subject to the two-year protection. In 2017, the trial court agreed with Shipyard, finding that the ordinance was functionally a zoning ordinance because it fundamentally changed the zoning of the land where
the project was to be built. The City appealed. On appeal, the City emphasized that it had enacted the ordinance under its police power to amend the City's flood-damage-prevention requirements, not the zoning requirements, and that therefore the two-year protection did not apply. In response, Shipyard emphasized that the ordinance established a new permit requirement and contained provisions regulating construction, utilities, subdivisions, and new development, and thus, no matter what the City called it, the ordinance operated as a zoning ordinance and subverted the two-year protection.

The court agreed that zoning is a police power vested in the legislative branch, but that the MLUL assigned zoning powers to municipalities so they could regulate land development in a manner that promotes public health, safety, and welfare. But in evaluating an ordinance, the court considers not only how the city characterizes it, but also how the ordinance functions in practice. Here, the court agreed with Shipyard that the ordinance was a zoning ordinance.

Before the enactment, Shipyard could build residential high-rises on the pier, but the ordinance eliminated any possibility of moving forward with the project. It was thus a fundamental change to the zoning of the land.

The City also argued, in the alternative, that the MLUL contains various exceptions for the application of regulations pertaining to public health and safety. The City thus suggested that the court read the public health and safety exceptions into the two-year protection, which was in a different section of the statute. The court declined such a reading. Because the legislature included public health and safety exceptions only in the sections applying to preliminary approvals, not final approvals, the court interpreted the plain language of the statute as contemplating greater protections for developers at successive stages of the approval process.

Having determined that the MLUL provided the holder of a final approval with vested rights for two years against even those changes in zoning pertaining to public health and safety, the court concluded that the two-year period of protection had been tolled while the litigation progressed. Therefore, the court concluded that the City could not use either of the ordinances to amend the zoning requirements for Shipyard's project.

**Shipyard Associates LP v. City of Hoboken**  
New Jersey Supreme Court  
May 5, 2020  
230 A.3d 278

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**Home renovation breach of contract award may include both out-of-pocket and benefit-of-the-bargain damages**

Justin Moore could not afford a home in the San Francisco neighborhoods he preferred. He contacted Richard Teed, a real estate agent who promoted himself as a building contractor with an extensive background in historic renovations and quality construction. Teed told Moore that he could locate a lower-priced fixer-upper home in a choice neighborhood and renovate it in a cost-effective manner. After touring examples of other homes Teed had renovated, Moore retained Teed as his real estate agent.

In May 2011, Moore bought a large fixer-upper for $4.8 million. Moore borrowed significantly from his father and a bank to purchase the house, and Teed received a commission on the sale. Teed proposed renovating the basement to create a "below-ground floor Grade A living space," as well as modernizing and expanding other rooms in the house. Teed and Moore had in-depth discussions about the costs of construction. Moore expected that for $900,000, Teed would deliver the home renovated to the same high-end standard as the other projects they had toured. The parties did not sign a written contract, but Moore nonetheless believed the parties had an oral agreement.
Based on his interactions with Teed and Teed's promotional materials, Moore believed Teed was a general contractor in addition to a real estate agent. In fact, Teed was not a licensed contractor. Teed's team gutted large parts of the house and built a defective foundation that lacked waterproofing despite the property's high water table. After Moore became aware of the defects, he halted all work on the project, and his father engaged consultants who concluded that the foundation had to be torn out and replaced. Moore hired a new architect and contractor who completed the promised work at a much higher cost than Teed had estimated.

In August 2013, Moore filed suit against Teed. Moore alleged that he was fraudulently induced to purchase and renovate the property based on false representations. Moore eventually expanded the renovation beyond what Teed had originally proposed at a cost of $9 million, but Moore did not seek damages for those additions.

At trial, Moore offered the testimony of a construction cost estimator who opined that Teed's estimates had been unrealistically low and that construction costs had increased in the time it took to replace the foundation. Moore sought damages in the amount of the difference between Teed's promised renovation cost of $900,000 and the estimated $4.47 million cost to do that work. Teed argued that there was no promised remodel, and that Moore’s alleged damages did not represent any loss that was actually sustained by Moore. The jury found for Moore on most of his claims, awarding “benefit-of-the-bargain” damages of $900,000 and out-of-pocket damages of $822,904 for the actual cost to replace the foundation, plus additional damages for delay and attorney fees. Teed appealed.

Teed challenged the damages award on several grounds. First, he claimed that benefit-of-the-bargain damages cannot be awarded alongside out-of-pocket damages as a matter of law and that benefit-of-the-bargain damages are not a permissible form of recovery for fraud actions involving purchases of real estate. The court of appeal found no merit to these contentions.

There are two measures of damages for fraud: out-of-pocket and benefit-of-the-bargain. Out-of-pocket damages are intended to restore the plaintiff to the financial position enjoyed prior to the fraudulent transaction, awarding the difference in actual value at the time of the transaction between what the plaintiff gave and what he received. Benefit-of-the-bargain damages are concerned with putting the plaintiff in the position he would have enjoyed if the false representation relied upon had been true. Teed contended that these two types of damages cannot both be awarded on a tort claim, but the court concluded that where the defrauding party has a fiduciary duty to the victim of fraud, a broader measure of damages than just out-of-pocket losses may be awarded.

Teed also argued that the benefit-of-the-bargain damages award was improper because the scope of the promised work and the actual value received were not definite and concrete. According to Teed, Moore’s damages were too speculative because the project that Teed said would cost $900,000 was never built due to extensive revisions Moore made to the plans over time. Teed also argued that the cost estimation expert could not re-create the cost of building such a project under 2011–2012 rates, and the estimator had not relied on the actual costs to complete the project. On both arguments, the court disagreed with Teed. The court concluded that the estimator’s testimony established the projected costs with reasonable certainty, based on floor plans and specifications directly tied to Teed’s original proposal. The jury’s award was thus not improperly speculative, and the court affirmed the jury’s award of damages.

Moore v. Teed
California Court of Appeal, First District
April 24, 2020
48 Cal. App. 5th 280
Property appurtenant to golf course qualifies for conservation easement deduction

Pollard Land Company bought over 2,000 undeveloped acres along the Savannah River north of Augusta, Georgia. In 2002, Pollard conveyed 463 acres of the land to Champions Retreat Golf Founders LLC (Champions). On the land, Champions built a golf course consisting of three nine-hole courses, each designed by a celebrated professional golfer. The course opened in 2005 and remains a private course open only to club members and their guests.

The golf course occupies roughly two-thirds of the 463 acres. Champions also sold 66 homesites on 95 acres on the west side of the course, away from the Savannah River. Thus, roughly 57 acres, consisting of bottomland forests and wetlands, remains undeveloped. This includes land on an island in the river that consists of both undeveloped land and six holes of the golf course.

The property is home to several species of birds, some of which are rare, and to the regionally declining southern fox squirrel, and to rare plant species. Although the land is not accessible to the public, the property is observable to members of the public who kayak or canoe on the river.

In 2009, the Champions golf course was struggling financially. After hearing of another case involving a deduction for conservation easements over golf course property, Champions contributed a conservation easement to the North American Land Trust (Trust). The easement covers 348 acres, including both the undeveloped land and the golf course and driving range, but not the golf course buildings or homesites. The Champions easement runs to the bank of the Savannah River; on the other side, 700 feet away, is a large national forest. Champions claimed a charitable deduction for the contribution, but the Internal Revenue Service (IRS) disallowed the deduction. The tax court upheld the IRS’s decision, and Champions appealed.

The parties agreed that the easement met the requirement that the restriction be granted in perpetuity, and they agreed that the Trust was a qualified organization. There also was no question that the protection of “a relatively natural habitat of fish, wildlife, or plants” and the “preservation of open space… for the scenic enjoyment of the general public” constitute conservation purposes. The parties disagreed, however, about whether the contribution was made exclusively for those conservation purposes.

The Internal Revenue Code allows a deduction for an easement contributed for the protection of a habitat for rare, endangered, or threatened species or if the easement contributes to the ecological viability of a nearby national forest. These standards apply despite the presence of a golf course on part of the property.

The IRS’s expert agreed that many birds use the property but explained that the habitat itself is not “relatively natural” on account of the fairways and greens, which consist of non-native grasses. But the court observed that the birds do, in fact, live on the property and “apparently find the habitat quite suitable.” Furthermore, while the golf course itself is comprised of non-native grasses, the remainder of the easement property is natural and includes a rare species of plant. The court held that the IRS offered no theory why protecting that plant is not an appropriate conservation purpose. In total, the court agreed with Champions that the easement protected “a relatively natural habitat of fish, wildlife, or plants” consistent with the statutory requirements.

The IRS also argued that the land was not open to the general public, and thus could not be used for the scenic enjoyment of the property. The relevant regulation explains that preservation of land may be for the scenic enjoyment of the public if development of the property would impair the scenic character of the land or would interfere with a scenic panorama that can be enjoyed from a park, nature preserve, road, or waterbody that is open to or used by the public.
Indisputably, members of the public canoe and kayak alongside and through the easement. And while the golf course itself might not provide scenic enjoyment, the natural areas covered by the easement do, and the golf course detracts little, if at all, from that visibility. Ultimately, therefore, the court concluded that the record established that Champions was entitled to a deduction in the proper amount. Because the tax court upheld the IRS’s disallowance of the deduction, the tax court did not address the amount of the deduction, so the court remanded the case for the tax court to address that issue.

Champions Retreat Golf Founders LLC v. Commissioner of IRS
Eleventh Circuit Court of Appeals
May 13, 2020
959 F.3d 1033

Assessment of taxes on lessee-owned improvements is proper regardless of exempt lessor’s revisionary interest

Yavapai County, Arizona, (County) owns and leases land to the Sedona Oak Creek Airport Authority (Airport Authority) to operate the Sedona Airport. In 1982, the Airport Authority subleased several acres to Sky Ranch Operations LLC (Sky Ranch), on which Sky Ranch would build and operate a lodge and resort. The sublease has been extended through 2050.

The Sky Ranch sublease provides that all buildings installed by the lessee “shall be and remain the property of Lessee during the term of this lease” but that upon termination of the lease, all buildings would become the property of the Airport Authority and the County.

For the 2016 and 2017 tax years, the County assessed and taxed Sky Ranch for the resort buildings as improvements on possessory rights. Sky Ranch sought a refund of the taxes paid, arguing that the taxes were illegal because the County actually owned the improvements. Following briefing, the state tax court concluded that Sky Ranch owned the improvements and upheld the tax. Sky Ranch appealed.

In Arizona, the general rule is that a permanent structure placed upon and attached to the realty by a tenant is real property belonging to the lessee. Parties may alter this rule, however, by specifically agreeing to treat the improvements as owned by the lessee. The question was whether Sky Ranch’s ownership of the improvements during the term of the lease qualified as ownership of the improvements for assessment purposes.

Sky Ranch cited several cases which held that lessors owned improvements built by the lessees, but the court observed that the lease agreements in those cases did not expressly recognize that the lessee would own the improvements for the term of the lease.

Beyond that “plain term” in the lease, the lease confirmed that Sky Ranch enjoyed the traditional rights of control and disposition of improvements, for example by preserving Sky Ranch’s right to convey or encumber its interest in all buildings situated on the leased premises. And Sky Ranch had relied on that language to offer the improvements as collateral under a loan agreement. To the court, this supported the conclusion that the parties intended the lease to abrogate the general ownership rule and provide that Sky Ranch owns the improvements.

As further evidence that Sky Ranch owns the improvements, the County noted that the lease extended to the “premises,” which is described as only the raw land. Although a lease extending only to land is “unremarkable” when no improvements had been built, the present lease had been amended three times since the improvements were constructed, yet the lease description remained the same.

Finally, Sky Ranch argued that its interest was merely a leasehold interest in the improvements because the County owns the improvements when the lease terminates. But the court con-
cluded that a lessor's reversionary interest in improvements did not determine who presently owned the improvements. And since the lease here expressly granted a present ownership interest in the improvements to Sky Ranch, the reversion provision does not control.

Because the court agreed that Sky Ranch owned the improvements on leased ground, it affirmed the tax court's decision. Accordingly, because Sky Ranch owned the improvements, the assessment of taxes on those improvements was proper.

Sky Ranch Operations LLC v. Yavapai County
Arizona Court of Appeals
May 12, 2020
2020 WL 2393785

For qualified tax deduction, donation must be for conservation purposes in perpetuity

Hoffman Properties owns the historic Tremaine Building in Cleveland, Ohio. In the mid-2000s, Hoffman donated an easement in the facade of the building, as well as certain airspace restrictions, to the American Association of Historic Preservation (AAHP). Through a written donation agreement, Hoffman agreed not to alter the historic character of the facade or to build in the airspace. Hoffman treated the donation as a qualified conservation contribution, and claimed a $15 million tax deduction for its donation.

The donation agreement described certain actions that Hoffman could take as long as AAHP approved, which the parties referred to as "conditional rights." Hoffman reserved the right to alter, reconstruct, or change the appearance of the facade contrary to the regulations of the Secretary of the Interior on the rehabilitation of historic buildings. Under the agreement, if Hoffman sought to act upon this right, it was required to submit the proposed changes to AAHP, which would review them and either approve or reject them. But AAHP's failure to act within 45 days of receipt of a proposed change would be deemed an approval of the change, and Hoffman would be permitted to undertake the proposed activity.

Based on the language of the donation agreement, the Internal Revenue Service concluded that Hoffman was not entitled to a deduction. The tax court agreed, holding that Hoffman's donation did not qualify for a deduction because it was not "exclusively for conservation purposes." Hoffman appealed.

As a general rule, the Internal Revenue Code does not allow taxpayers to take a charitable deduction for a donation of a partial interest in property, like an easement. But qualified conservation contributions are an exception to that general rule. To qualify, the donation must be "exclusively for conservation purposes," a term which includes the preservation of historic buildings.

Among the requirements for a donation to be considered exclusively for conservation purposes is that the donation must protect the conservation purposes in perpetuity. To satisfy this requirement, the donation must be enforceable in perpetuity, meaning that it must include legally enforceable restrictions that will prevent the donor from using its retained interest in the property in a way that is inconsistent with the donation's conservation purposes.

The court of appeals observed that the donation agreement gives AAHP a 45-day window in which to prevent certain changes to the facade or airspace. If AAHP were to miss that window for any reason, it would lose the ability to stop Hoffman from making the change. The court further noted the "world of difference" between restrictions that are enforceable in perpetuity and those that are enforceable for only 45 days.

Hoffman offered an alternative theory of the perpetuity requirement, namely that the restrictions are perpetual because the restrictions themselves will always be a part of the agreement. The court dismissed this theory because the Internal Revenue Code is not concerned about the mere
existence of restrictions; rather, it requires that the donation protect the conservation purposes in perpetuity. Once the 45-day provision is triggered, Hoffman’s donation no longer protects the historical character of the building.

The court also distinguished Hoffman’s donation agreement from other cases where courts have upheld tax deductions for similar donations. In those cases, the parties included clauses that allowed the donee to give its consent to changes in the facade or to abandon some or all of its rights in the donation. Those terms are consistent with the perpetuity requirement because “any donee might fail to enforce a conservation easement, with or without such a clause.” But the court noted that Hoffman’s 45-day clause goes much further. It does not simply allow AAHP to abandon the protections in the agreement; it divests AAHP of the power to enforce the protections if it fails to act within a limited window of time. Accordingly, the donation was not considered to be exclusively for conservation purposes in perpetuity, and the court of appeals affirmed the tax court’s denial of the deduction.

**Hoffman Properties II, LP v. Commissioner of Internal Revenue**
Sixth Circuit Court of Appeals
April 14, 2020
956 F.3d 832

Deed restriction for below-market rent should be considered in market value appraisals

Poplar Bluff Associates LP (Poplar Bluff) developed two housing complexes funded by low-income tax credits in Butler County, Missouri. The first project, developed in 1999, included 48 units, while the second project, developed in 2005, included 40 units. Both developments are subject to low-income housing tax credit land use restriction agreements (LURA) made between Poplar Bluff and the Missouri Housing Development Commission (MHDC). The terms of the LURA state that restrictive covenants governing use and occupancy run with the land and bind subsequent owners of the properties for the terms of the agreements. The mandatory compliance period for both properties was fifteen years, plus an extended low-income use period of fifteen years.

Under the terms of the LURA, the properties had to be rented to qualified low-income tenants, and rent could not be increased without prior approval of MHDC and subject to limitations. The properties could also not be sold without the consent of MHDC.

The county assessor assessed the properties at values between $2.4 million and $3.6 million for the 2009, 2011, and 2013 tax years. Poplar Bluff appealed and requested review by the State Tax Commission. At trial, two appraisers testified on behalf of the assessor and two appraisers testified on behalf of Poplar Bluff. The main distinction between the appraisers’ methodologies was whether or not they considered the LURA while preparing their appraisals. The assessor rejected a valuation approach that relied on actual income and expenses. To the assessor, the owner’s decision to enter into LURA was a choice made when deciding to own low-income housing, and assessors are to value the property, not the business of the owner.

Both of the assessor’s appraisal witnesses testified that they looked at market income levels and did not consider the restrictions on the property. The first appraiser evaluated Poplar Bluff’s property rights as an owner of the fee simple title under the hypothetical condition that no government contracts were in place. The second appraiser did not consider the deed restrictions associated with the properties, instead choosing to look at the rents on four comparable properties.

Both of Poplar Bluff’s appraisal witnesses, on the other hand, testified that they valued the properties with restrictions in place. The first
appraiser stated that he had to value the property with the deed restriction in place and using the current low-income housing tax credit rents established by MHDC. The second appraiser compared the market rents from other rent-restricted properties, inherently valuing the property as rent-restricted.

After the trial, the Commission’s hearing officer found that Poplar Bluff had presented persuasive evidence that the true market value of the properties was significantly lower than the assessor’s valuations. The hearing officer agreed that properties funded by low-income tax credits are unique in that their owners have willingly accepted various restrictions in exchange for economically desirable benefits. The assessor appealed, eventually to the state court of appeals.

On appeal, the assessor argued that the Commission erred by ruling that low-income housing should be valued using its actual income and expenses rather than market income and expenses, because this method failed to value the fee simple estate and otherwise undervalued the property. The court, however, noted that prior case law held that the “better reasoned approach” is to consider actual as well as potential income in determining true value. It said that this approach was more realistic with regard to economic conditions that cause property to have lower actual rents than could be obtained if the property was unrestricted.

The court agreed that prior case law held that low-income housing tax credits themselves are intangible property, and thus they could not be considered in the valuation of a rent-restricted apartment complex. Here, however, it was not clear that the credits themselves were at issue. Rather, both properties were covered by LURA that restrict the amounts the owner could charge for rent, and a well-informed buyer would consider the existence of a deed restriction associated with a property when making a decision on whether to buy the property. To calculate the value of the properties without considering the restrictions imposed by virtue of the LURA would hypothesize an unrealistic market and assume facts that do not exist.

Therefore, the court held that unlike tax credits, which have no direct contribution to the market value of subsidized housing, below-market leases have a direct effect on the income of the property, and thus its market value. Therefore, the Commission’s adoption of Poplar Bluff’s appraiser’s opinion was both reasonable and lawful, and the decision was affirmed.

Tibbs v. Poplar Bluff Associates I, LP
Missouri Court of Appeals
April 14, 2020
599 S.W.3d 1

Tax assessment valuation not valid where methodology did not remove all intangible business value

In 1990, Walt Disney Parks & Resorts (Disney) constructed the Disney Yacht & Beach Club Resort on 65 acres adjacent to Epcot near several other hotels. The resort features 1,197 guest rooms, a 70,000-square-foot conference center, dining and retail outlets, a spa, and other recreational amenities.

In 2015, the County Property Appraiser (County Appraiser) assessed the value of the property at $336.9 million, an increase of 118% over the prior year’s assessment. Disney filed a complaint against the County Appraiser, arguing that the County Appraiser’s assessment failed to comply with Florida law and accepted appraisal practices because it exceeded market value and included the value of certain intangible property.

At trial, Disney offered first the testimony of a business appraiser who valued the intangible assets on the property as if a hypothetical investor was buying the property. He specifically identified cash, favorable operating licenses, assembled workforce, brand, and goodwill as...
intangible assets implicated. He determined that the business enterprise value of the property was $341.9 million.

Disney also presented the testimony of a real estate appraiser. For his analysis, the Disney appraiser used the income capitalization approach. He started with the actual average daily rate achieved by the resort, then made adjustments to account for nontaxable items that were part of the value of the rooms. He also adopted hypothetical conditions and calculated the hypothetical lease income for the property’s retail, restaurant, and spa spaces that were leased to third parties, which he explained had the effect of extracting business value. After capitalizing the net operating income, he deducted tangible personal property value, ultimately arriving at a real estate value of $180.9 million.

The County Appraiser presented a valuation expert from the County Appraiser’s office. As operating expenses, he deducted management fees and franchise fees but made no other adjustments to revenue for any amenities or for the fact that the property is Disney-branded. He explained that the operating expense deductions removed all business-related income from the gross figure. The result was the final assessed value of $336.9 million.

In rebuttal, Disney presented the testimony of an economist who opined that the County Appraiser’s methodology was inconsistent with economic theory and market behavior, underestimated business value, and failed to account for a return on the investment in furniture, fixtures, and equipment. Overall, he opined that there was “no scenario” in which simply deducting franchise and management fees would remove all intangible value.

The trial court found that the County Appraiser improperly considered income from the business activities conducted on the property in establishing the just value of the property, and rejected the County Appraiser’s contention that the intangibles identified by Disney’s experts did not qualify for removal. The trial court ruled that, even if the methodology used by the County Appraiser was accepted in the appraisal profession, it could not be used in a manner that violated Florida law by assessing more than real property value. After adjusting Disney’s appraised values, the court concluded to a value of $209.2 million. The County Appraiser appealed.

On appeal, the County Appraiser argued that the trial court should not have rejected its method of removing intangible value and should not have performed its own assessment rather than remanding the case for reassessment.

The court of appeal began by noting that the Florida Constitution specifically prohibits counties from taxing intangible property. Real property, which is subject to tax, includes only land, buildings, fixtures, and improvements to land. The court agreed with the trial court that the method used by the County Appraiser impermissibly included Disney’s intangible business value in its assessment.

The court concluded that, because the County Appraiser’s method does not provide for adjustments to the gross income for intangible business value prior to making management and franchise fee expense deductions, the method “does not remove all business value from an assessment.” To the contrary, the court concluded that the method “ignores the fact that an intangible business value may be directly benefiting a business’s income stream.” Therefore, the court held that the method itself “violates Florida law because it does not remove the non-taxable, intangible business value from an assessment.” The court did, however, order the trial court to remand the dispute to the County Appraiser for a reassessment.

Following the first court of appeal decision in this case, the County Appraiser moved for a rehearing by the court of appeal, arguing that the court’s first decision was overextended by rejecting the method used by the County Appraiser in itself, rather than as applied by the County Appraiser in this case. The court granted the
motion for rehearing, withdrew its first decision, and issued a substitute opinion. In the substitute opinion, instead of using sweeping language rejecting the method used by the County Appraiser, the court concluded that the manner in which the County Appraiser applied the method impermissibly included intangible business value. The outcome of the decision was the same, but the substitute opinion gave counties leeway to properly apply the method used by the County Appraiser here.


Highest and best use analysis supports valuation in taking of landfill

The New Jersey Sports and Exposition Authority (NJSEA) is the zoning and planning agency for the Hackensack region. NJSEA is authorized to acquire any real property in its jurisdiction if it is necessary or convenient to do so for any authorized purposes, including the provision of solid waste disposal and recycling facilities.

The Keegan Landfill consists of approximately 110 acres located in Kearny, New Jersey (Kearny). The majority of the disposal activity occurred at the site in the 1960s and 1970s, and the landfill was not properly remediated. NJSEA or its affiliates leased the landfill from Kearny. According to a 2016 appraisal report, the estimated market value of the fee simple interest in the landfill was $1.88 million. By letter NJSEA offered to purchase the landfill from Kearny precondemnation at market value, which Kearny declined. NJSEA therefore filed a condemnation complaint in the trial court. Following a challenge and appeals, the courts authorized NJSEA to exercise its eminent domain powers.

Proceeding to trial, both parties offered expert opinions of value. Kearny's appraiser estimated the value of the entire landfill, not just the subject property, at $23.4 million. He assumed assemblage, i.e., that a new buyer would also buy the portion of the property already owned by NJSEA. Because zone landfills are legally permissible and because the property is an operating landfill, the appraiser opined that its current use was its highest and best use. Further, based on his review, the appraiser testified that the property will generate $14 million to $16 million per year for the next seven years, so the landfill was the maximally productive use.

NJSEA's appraiser, in contrast, based his appraised values on the property's highest and best use at the termination of the lease between NJSEA and Kearny, at which time the landfill operations would cease. Thus, he calculated the property's value under the assumption that the landfill operations would cease. Further, in his highest and best use analysis, he emphasized that due to the large mound of garbage sitting in the middle of the landfill, in a tidal marsh, with steeply sloped sides, the landfill had virtually no practical utility. Thus, given the limited potential uses, he concluded recreational use was the property's highest and best use.

In October 2018, the trial court held a bench trial, hearing from eight witnesses, including appraisers and other experts. The court found that NJSEA's expert's valuation of the property was correct and held that the fair market value at the time of the taking was $1.818 million. The preponderance of the evidence supported NJSEA's appraiser's assumption, while Kearny provided no reason to assume cooperation between NJSEA and a new purchaser. Because a landfill could not be operated solely on the Kearny portion without significant alterations, the court agreed that the property was best suited for passive recreation.

Kearny appealed, arguing that the trial court erred in finding its appraiser's use of assemblage was speculative. Considering the history of coop-
eration and the lease agreement between the parties, Kearny argued it reasonably incorporated the value of the property already owned by NJSEA into its just compensation calculation. The appellate division rejected this argument summarily.

Kearny also argued that two of NJSEA’s non-appraisal expert reports set forth inadmissible “net opinions” that failed to explain the reasons or calculations that led to their conclusions. The net opinion rule forbids the admission of an expert’s conclusions that are not supported by factual evidence or other data. Thus, the expert must “give the why and wherefore” that supports the opinion, rather than a mere conclusion.

Contrary to Kearny’s assertions, though, the appellate division noted that the expert reports in question were not appraisals or opinions of value. Rather, one expert simply discussed New Jersey’s regulations and the permitting process for solid waste landfills. Any reference to the sale of the property was within the context of describing the process of transferring the permit. In addition, the second expert discussed the factors a buyer would consider in purchasing the property and why a hypothetical buyer would not be interested in doing so. Both experts sufficiently supported their conclusions. Accordingly, the appellate division affirmed the trial court’s judgment.

New Jersey Sports and Exposition Authority v. Town of Kearny
Superior Ct. of New Jersey, Appellate Division
April 9, 2020
Docket No. A-2487-18T2

Change in specifics of city redevelopment plan did not negate public taking

Fred Eychaner owned vacant land in the River West area of Chicago. In 1999, the City of Chicago (City) proposed creating a planned manufacturing district (PMD) there, aimed at protecting industrial jobs and preventing residential encroachment on existing manufacturing facilities. Residential uses were thus not permitted within PMDs.

A large chocolate factory was located two blocks south of Eychaner’s property. The factory’s owner initially opposed its factory’s inclusion in the PMD, but eventually the owner dropped its opposition in exchange for the City’s willingness to help it expand its industrial campus by acquiring nearby property to create a buffer between its operations and proposed residential development. The City intended to fund the project through a tax increment financing (TIF) plan.

Although Eychaner’s property was not deemed blighted, a study commissioned by the City stated that it met the requirements of a conservation area, which may become a blighted area. The factory’s owner submitted a redevelopment proposal seeking to acquire 4.2 acres surrounding its factory, including Eychaner’s land. Initially the factory offered to buy Eychaner’s land, but he refused to sell, so the City notified Eychaner of its possible taking of his property with the intent of conveying it to the chocolate factory. The city council passed an ordinance authorizing the taking to achieve the objectives of the TIF.

In 2005, the City filed a complaint to condemn Eychaner’s property. The case eventually proceeded to a jury trial on just compensation, which resulted in an award of $2.5 million. Eychaner appealed, and the courts ultimately concluded that the use of eminent domain to expand the chocolate factory’s campus passed constitutional muster, but the case was remanded for a new trial on just compensation.

Meanwhile, the City was undertaking a comprehensive review of the industrial corridors in the City, to address the modern realities of the industrial marketplace and its evolving role in the economy. The first corridor to be reviewed included Eychaner’s property and the chocolate factory. A mix of uses, including high-density, mixed-use development, was proposed as the best use of the area.
At the second just compensation trial, the City and Eychaner presented experts who agreed that the highest and best use of the property would be high-rise residential development with ancillary commercial use. Although the property would have to be rezoned, the experts agreed that approval of the zoning change was reasonably probable. The jury returned an award of $7.1 million to Eychaner. Eychaner filed a post-trial motion not challenging the compensation award, but renewing his argument that the City’s exercise of eminent domain was unconstitutional. He also asserted that the taking no longer served a permissible public use since the City had changed its plans for the area surrounding Eychaner’s property. The trial court denied the motion, and Eychaner appealed.

On appeal, Eychaner argued that the TIF and the City’s plans for the area were inconsistent. He asserted that the City no longer intended to preserve industrial uses in the area; Eychaner argued that the City would relocate the chocolate factory rather than expand its campus, and therefore the taking was for private, not public, use and “nothing more than a naked transfer from Eychaner to the factory owner in the name of economic development.” Because the trial court did not reconsider the judgment, Eychaner argued that the judgment should be reversed.

The court found that Eychaner failed to demonstrate that the purported new evidence would change the outcome. While it was true that the earlier decisions relied on the City’s TIF, the court disagreed that the City’s review proposal was the “sole expression” of the City’s plans for the area, and that it did not supersede the TIF, which continued to remain in effect. Further, the City’s current plan to redevelop the area around Eychaner’s property seeks to preserve the industrial character of the corridor while also attracting innovation and technology-oriented businesses, a valid public use.

Finally, the court held that Eychaner presented no evidence of changes to the plan for the area, and that his assertion that the current plan no longer supports the taking was false. Residential uses remain prohibited under the current zoning, and Eychaner cited no evidence that the factory’s owners intend to use the property for a residential purpose or a use otherwise inconsistent with the TIF’s goals. Rather, the acquisition of Eychaner’s property would allow the factory to expand into a self-contained campus, thereby maintaining its workforce in the City while reducing conflicts with neighboring uses. Because these are all legitimate goals and part of the City’s larger plans for the area, the court held that the trial court did not err in denying Eychaner’s post-trial motion to reconsider.

City of Chicago v. Eychaner
Illinois Appellate Court, First District
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Perspectives on the Assembled Workforce in Real Property Valuation

by Kimberly K. Merriman, PhD, and Leonard J. Patcella, MAI

Abstract
A valuation assignment, such as an appraisal for ad valorem tax purposes, may require appraisers to remove the value of identified non–real property elements from the real property value. This article examines theory and practice surrounding one recognized yet debated non–real property element: the trained and assembled workforce. The article describes the appraisal context where an assembled workforce is likely relevant, the theoretical footings of this intangible asset, and a step-by-step conceptual treatment of the assembled workforce in real property valuations. Then, a case study is presented that demonstrates a unique market test of basic concepts. The article concludes with key practical insights for real property appraisers and related practitioners.

Introduction
The Uniform Standards of Professional Appraisal Practice (USPAP) requires appraisers to identify “any personal property, trade fixtures, or intangible assets that are not real property but are included in the appraisal” for the development of real property appraisals. This is most relevant to appraisals of real properties that are intertwined with operating businesses, such as hotels and nursing homes. Appraisers are at times tasked with more than simply identifying the non–real property elements. When the scope of appraisal calls for it, such as with ad valorem tax purposes, the appraiser must remove the value of identified non–real property elements from real property value. This article examines theory and practice surrounding one recognized non–real property element: the trained and assembled workforce.

There are differing views on the removal of the value of a trained and assembled workforce from real property value. Before delving into these perspectives, the discussion will first describe the real property appraisal context where an assembled workforce is likely relevant at all. This is followed by a discussion of the theory and precedent regarding how an assembled workforce is treated in real property valuations, and a road map of potential steps entailed. A case study will then be presented that demonstrates a unique market test of basic concepts. The case study property is an owner-occupied juvenile detention center. Importantly, recent comparable sales had occurred of facilities that were no longer in operation but still reflected a similar highest and best use, providing a reasonableness check for assumptions applied in the income approach to address the assembled workforce.

Assembled Workforce in Real Estate Contexts

The issue of an assembled workforce is irrelevant when a market lease rate for real property is ascribable to a subject property based on its high-

est and best use. The lease rate can then form the basis for the income approach to value. Certain property types, however, are an integral part of the business that occupies the property. Hotels, nursing homes, hospitals, and correctional facilities are good examples of this situation. The real estate and business are intertwined, and typically occupied and operated by the same entity rather than through an arm’s-length lease. In this article, this type of real property will be referred to as “real property going concerns.”

Without market support for a real property lease rate, appraisers rely on the financials of real property going concerns for the income approach analysis. The financials of real property going concerns reflect income from more than the real property alone. As noted, real estate appraisers must disclose, and at times separate, any non-real property elements that are part of the real property appraisal. It is at these times that the question of potential value attributable to the assembled workforce is relevant—when appraising a real property going concern and when required to isolate real property value.

The sales comparison approach and cost approach each present their own difficulties in separating real property value for real property going concerns. These property types are commonly sold while still operating as real property going concerns, and the reported allocation of the purchase price among the acquired components is often arbitrary or in keeping with a purpose other than market value, and sometimes overlooked altogether. When these property types sell after the business operation has closed, the closed operation may indicate that the highest and best use of the property has changed. In that instance, the sale of a closed hotel that is no longer economically viable and is purchased for redevelopment to an alternative use does not inform the analysis of the value of an operating hotel for which the highest and best use remains a hotel. The cost approach is also limited in this context because of the difficulty in determining accrued depreciation without market data on real property sales and rentals. By default, the income approach often represents the most reliable way to isolate real property value when appraising a real property going concern.

**Theory and Precedent**

The concept that an assembled workforce has an identifiable economic value is nothing new. For instance, almost a half century ago scholars noted the following:

> Suppose that tomorrow your firm had all of its present facilities—everything, but no personnel except the president; and he had to rebuild the human organization back to its present effectiveness. How much would this cost?3

This broad concept is also recognized with specific regards to real property going concerns by the Appraisal Institute, which states that “attributes of an assembly of people with special skills, team-working ability, pride of workmanship, or loyalty can be a valuable intangible business asset.”5

The notion that an assembled workforce is a conceptually separable—though difficult to measure—intangible business asset was explicated in the 1994 US Court of Appeals decision *Ithaca Industries Inc. v. Commissioner of Internal Revenue.*6

Ithaca Industries Inc. was a manufacturing company that transferred ownership in October 1983 for an amount of $110 million. It was appraised at the time of transfer in order to allocate the purchase price among the acquired assets for income tax purposes—or in accounting terms, to determine the basis for depreciable and amortizable assets. The value ascribed to the assembled workforce, comprised of 5,153 line workers and 212 non-line employees, was $7.7 million. The decision ultimately granted on February 23, 1994, recognized the value of the assembled workforce as a separable intangible asset. While this decision was not specific to the realm of real

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property appraisals, it did clarify that the assembled workforce is a separable intangible asset and that there is a need for ongoing investment in an assembled workforce to maintain its value.

While the *Ithaca Industries* case clarified important concepts related to the assembled workforce, two cases more central to real property appraisal demonstrate implications for appraisers. In 1995, the US Court of Appeals supported a decision on separating the value of the assembled workforce from real property value. In that case involving the Burlington Northern Railroad Company and the Iowa Department of Revenue, the Department of Revenue appealed a decision by the district court that prohibited the state from collecting property taxes on the value attributable to intangible personal property, specifically including the assembled workforce. The appeals court upheld the favorable decision for Burlington Northern Railroad.7

A 2014 US Court of Appeals case involved the Ritz-Carlton Half Moon Bay hotel and the County of San Mateo, California. That dispute was in regard to real estate taxes on the property value assessed by the County of San Mateo. The operating hotel was acquired in 2004 for $124.35 million in total, and the assessed value was determined to be $116.98 million based on the county removing some intangible business assets from the real property value. The hotel argued that additional intangible business assets—including specifically the assembled workforce—should be excluded from the real property value. This argument was supported by the court of appeals.8

In sum, there is conceptual support and precedent for the broad point that an assembled workforce has separable value. However, the court decisions cited do not attempt to determine how this value should be quantified. This is where the issue becomes much more complicated as debate surrounds the degree of value when addressing the separation of assembled workforce value in real property appraisals. The following discussion summarizes known views on quantifying workforce separable value, ranging from the least speculative to most speculative.

### Removing Workforce Value from Total Real Property Value of a Going Concern

#### Quantifying Assembled Workforce Value

There are different perspectives regarding how to separate the assembled workforce value from real property value when appraising real property that is intertwined with a going concern. For instance, a 2017 publication by a special committee of the International Association of Assessing Officers (IAAO) seeks to guide real estate appraisers and assessors on how to address intangible assets in valuing properties that are part of a going concern.9 The IAAO special committee’s view on the assembled workforce is that its value is removed through the deduction of salaries and wages as an operating expense in the income approach to value, and assembled workforce value is otherwise inextricably intertwined with real property value. This view has received varied levels of support in adjudicated disputes, as summarized within IAAO’s intangible assets guide; it is also in keeping with an established method known as “the Rushmore Approach.” The Rushmore Approach was developed specifically in relation to hotels, but its fundamental treatment of the assembled workforce is generalizable. The Rushmore Approach states that a hotel’s stabilized net income contains all workforce expenses incurred in carrying out its ongoing functions—specifically, salaries and wages along with any recurring expenses associated with employee turnover and replacement.10 Contrary to the IAAO guide, others maintain that the value of the assembled workforce is not fully

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removed through the deduction of these ongoing expenses, and the workforce value must be further considered despite its embeddedness.\textsuperscript{11}

The potential areas for removing the value of the trained and assembled workforce from a real property going concern are detailed below—shown from least to most debated deduction—and are summarized in Exhibit 1. The potential deductions for workforce value are ordered so that costs are recognized before return or loss are considered. The information is presented in the language of the income approach to value, specifically when the income approach is based on revenue from a real property going concern. The same concepts apply, however, to the sales comparison approach. That is, the costs and returns associated with the assembled workforce can also be used to quantify its “replacement cost,” which can then serve as the basis for an allocation of the value derived via the sales comparison approach.\textsuperscript{12}

**Potential Step 1: Deduction of Direct and Indirect Labor Costs (Salary, Wages, and Benefits)**

The deduction of labor costs, which are an expense required to generate the revenue, is largely accepted as a necessary step in deriving a net income attributable to the real property. This includes the direct compensation costs of salary and wages, and the indirect compensation costs of employee benefits. The actual compensation of the assembled workforce is a reasonable reference point. However, actual compensation rates of existing employees may vary from the current market rate required to replace the workforce with employees of comparable utility. A market survey of compensation rates provides a benchmark. The underlying logic of adjusting below- or above-market labor costs to within market range is that a rational investor would do so to support employee retention and return on investment, respectively. Alternatively, the appraisal may disclose rather than adjust above-market pay, particularly when these obligations are inflexible. A workforce can represent a liability if it comes with significant obligations such as an onerous labor contract.\textsuperscript{13}

Market surveys of compensation rates are most commonly conducted based on job category. Various free sources of market compensation data exist, including government agencies such as the US Bureau of Labor and Statistics and online job sites such as Indeed and Salary.com.\textsuperscript{14} These sources also provide information on the employer-provided benefits for the calculation of total compensation. A 2019 report by the Bureau of Labor Statistics indicates that benefits, on average, comprise over 37% of the total compensation cost.\textsuperscript{15}

**Potential Step 2: Deduction of Cost to Maintain Workforce (Ongoing Recruiting, Hiring, and Training Costs)**

A subtle but important point in the previously noted *Ithaca Industries* court decision is that the assembled workforce at any given time requires ongoing investments in recruiting and hiring to address turnover as well as training to maintain the utility of the assembled workforce as a collective. In other words, the ongoing regeneration of the assembled workforce requires substantial effort on the part of the business. It is this point, that the assembled workforce is not a self-regenerating asset, that laid the groundwork for its treatment as a depreciable asset in the *Ithaca Industries* case. For the purpose of appraising real property going concerns, this points to the need to deduct workforce maintenance costs from income when using the income approach to value.

Costs associated with ongoing recruiting and hiring include advertising fees; fees to consultants for external support in recruiting; costs associated with screening, testing, and hosting candidates; relocation costs; hiring bonuses; and more. These costs correlate to some degree with


\textsuperscript{13} IAAO Special Committee on Intangibles, “Understanding Intangible Assets.”


employee skill and ability levels since higher-level employees tend to require more extensive recruiting and screening efforts. As a benchmark of ongoing recruiting and hiring costs, one study analyzing case studies of turnover over a fifteen-year period through 2007 found that recruiting and hiring costs for jobs paying $30,000 or less per year averaged just over 16% of compensation while jobs up to $75,000 per year were in the average range of 20%; highly specialized jobs and executive-level positions could have recruiting and hiring costs that range much higher. However, care must be taken to understand what is and is not included when referencing benchmarks. For instance, the above-cited percentages include initial training costs in some cases and are based on salary only rather than total compensation (salary plus benefits).

Costs associated with training may include compensation for those involved in administering training; costs of overhead, course materials, software, or licensing fees for online training modules; and course fees for external training. As a benchmarking source, Training magazine provides an annual industry report that analyzes training costs across a wide range of industries and positions.

Potential Step 3: Deduction of Entrepreneurial Return

A return on the assembled workforce is theoretically necessary and distinct from income attributed to the real property—otherwise a rational person would have little reason to pursue an assembled workforce when their expertise and capital could be invested elsewhere for a return. Framed in economic terms, the analysis must account for the opportunity costs associated with the factors of production. Classical economics recognizes three basic factors of production: land, labor, and capital. The latter two, labor and capital, are relevant factors of production in creating an assembled workforce. These can be labeled as the opportunity cost to the developer and the opportunity cost to capital. Unlike the workforce expenses described in potential Steps 1 and 2 above, these two opportunity costs are not recurring costs and therefore can be deducted as a lump sum from the capitalized income value. The opportunity costs can be treated in the following ways.

- When valuing intangible assets, “a developer can be thought of as a special class of labor, making the development fee a special class of wage” and is therefore entitled to receive opportunity costs in exchange for the developer’s contribution to creating the asset. The opportunity cost to the developer, or developer’s fee, is typically calculated as a percentage rate of return of total direct and indirect costs, at a rate in keeping with industry norms. Therefore, in valuing a firm’s human capital, the developer fee is calculated as a percentage rate of return on the total costs associated with the assembled workforce, at a rate in line with the prevailing terms of the market for a development initiative of equivalent effort and risk.

- The opportunity cost of capital is the return required to persuade an individual to pursue the investment. The underlying logic is that a return on capital invested to build the workforce is only gradually realized as the workforce becomes assembled and trained. A buyer of a real property going concern with a trained workforce already in place earns a return from day one, and the buyer, therefore, would theoretically place a higher value on such an investment. This opportunity cost can be calculated by applying an appropriate rate of return to the average workforce cost over the assemblage period. For instance, if the full workforce assemblage takes one year to complete, then the average cost throughout the year equates to half the total workforce compensation cost. Not all costs are incurred at once, and returns are gradually experienced leading up to stabilization at year-end. The rate of return applied should be based on the cost of capital, that is, the rate of return that could be earned by placing the money in a different investment of equivalent risk.

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Conceptually, not all assembled workforces may warrant a return on investment. The likelihood that employees may not remain in place and the possibility that a buyer will not want to retain the workforce are both factors to consider. This point will be considered more closely in the case study that follows later. It should also be noted that this return is theoretically distinct from residual economic profit, the speculative return realized after the sale after all other costs, including the return to labor and capital, are satisfied. With economic profit, the entrepreneur receives what is left over, if anything.

**Potential Step 4: Deduction of Lost Productivity during Assemblage of Workforce**

Removal of the expenses associated with the assembled workforce (Steps 1 and 2 above) before converting income to value can be seen as removing its value, or in other words the return of this intangible asset. Step 3 above then represents a return on the intangible asset by acknowledging a return to developer labor and capital invested to form the intangible asset. A debated point is whether or not this fully accounts for the intangible asset value of the assembled workforce.

Lost productivity is a potential additional opportunity cost over and above the opportunity costs considered in Step 3, though it has also been cast as representing the total opportunity cost. Lost productivity occurs most significantly at the initial assemblage of the workforce, until all positions are filled and new hires reach full productivity. Due to the integral nature of the workforce to the revenue of the real property going concern, this lost productivity equates to a period of foregone or non-stabilized income. This is a cost that a new owner of the real property going concern would not have to incur (by acquiring rather than assembling a workforce), and therefore theoretically enhances the value of the real property going concern by a commensurate amount.

A relatively precise estimate of lost productivity related to training requires consideration of the varied learning curves of employees. The amount of time entailed in hiring, employee learning, and the pace of productivity improvements commonly varies across job categories and seniority of the position. Estimates can be derived from actual company experience and market data to allow for an average by employee segments. The rate would be expressed as a percentage of the total compensation with the implicit assumption that employees are paid their marginal product (i.e., pay equals what employees contribute in value to the organization). For example, engineers may take on average a year to hire and reach full productivity. Productivity is at 0% while the position is vacant. The new hire may start at 60% productivity and then gradually increase to full productivity.

While a discounted cash analysis could determine the present value of the precise loss to productivity as it incrementally changes over the total period in question, the assumptions underlying this degree of precision would be difficult to defend. Alternatively, an average rate of loss by a workforce segment or the workforce overall is a more practical approach. For example, if employees take three months on average to hire and nine months to reach full productivity after hire, lost productivity would equate to 40% of total compensation: a 100% productivity loss for 25% of the year plus a 20% average productivity loss for 75% of the year.

**Summation**

In sum, even though there is general agreement that real property going concerns include some degree of intangible asset value related to the assembled workforce, the extent of this amount is far from settled. The following case study offers some central insights to inform this question.

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20. IAAO Special Committee on Intangibles, “Understanding Intangible Assets.”


Case Study

The following is a case study of a hypothetical real property going concern in which the scope of the assignment requires isolation of real property, and thus removal of any value attributed to the assembled workforce. The case study is based on a composite of actual appraisal assignments and market information. Information has been altered for demonstration purposes and to maintain client confidentiality, but the pattern of findings remains unchanged. Market support for the value allocation of the assembled workforce is generally difficult to attain. However, the case depicts a somewhat rare instance in which financial statements for the real property going concern are available for the income approach and, importantly, non-operating comparable sales are available for the sales comparison approach.

An abbreviated version of the actual valuation steps is presented in order to highlight issues pertinent to the assembled workforce. The analysis supports a key point with regard to the return of the assembled workforce: both the deduction of payroll costs and the deduction of ongoing hiring costs from revenue were justified by the market. The analysis also provides insight for the return on the assembled workforce, which was not deemed theoretically present in this case and accordingly not supported through the reconciliation of value between the sales comparison and income approaches.

Subject Description

The subject of the case is a hypothetical, owner-occupied juvenile correctional and treatment facility with 150 beds (150 single-bed rooms) and 150,000 square feet of gross building area. The subject contracts to securely house juvenile offenders and provide rehabilitation services, education, and treatment to these residents. As such, the revenue-generating contracts require substantial professional services and are not simply contracts to house individuals.
The importance of a trained workforce is often evident at the pre-inspection research stage and inspection of a subject property. The extensive services included in the subject revenues signal a clear impact of the assembled workforce on the value of the real property going concern since these programs could not operate without the staffing in place. Research into the for-profit correctional industry shows many properties built in the 1990s and early 2000s were initially fully occupied but closed rather quickly because of inability to maintain the contract requirements and sufficiently provide for the desired educational and counseling services, and safety, of the incarcerated population. History shows that many of these facilities now operate at a much lower occupancy due to the workforce constraints.

In short, this type of real property going concern shows the impact of a workforce on the real property value. Without a trained and adequate workforce, these properties cannot meet the contractual requirements and may be forced to operate at lower occupancy. This is an important point to bear in mind as the analysis proceeds with the otherwise standard steps in conducting the appraisal.

### Highest and Best Use

The issue of an assembled workforce has little direct bearing on the initial aspects of the appraisal—including the scope of work, intended user, and market conditions. Nor is the assembled workforce a substantive element in the description of the site, building improvements, zoning, and assessment. The highest and best use analysis is typically the first pivotal step in the valuation process that determines whether the assembled workforce is relevant to the appraisal. For the case study example, it must be established whether the highest and best use of the subject is the current use in order to justify valuing the subject as a real property going concern. A different highest and best use would likely require setting aside the subject financials and turning to market lease rates.

To evaluate the highest and best use as vacant and as improved, the subject is sequentially viewed in terms of what is physically possible, legally permissible, financially feasible, and maximally productive. Correctional facilities such as the subject are generally located remote from population centers in terms of access and visibility, features that detract from a site’s desirability for most other uses. So, while a variety of uses are physically and legally possible for the subject site, the fettered visibility and access will limit financial feasibility for most permitted uses. At the same time, not all remote sites are financially feasible for correctional facility use since, in addition to navigating public concerns, reasonable proximity to a labor force, courthouse, and other supporting elements is also a factor. The subject site meets these conditions. The highest and best use is that use among financially feasible uses that produces the maximum value relative to risk. The highest and best use of the subject as vacant is for development of a permitted institutional use, such as a correctional facility or drug rehabilitation facility, that would benefit from the described locational characteristics. Therefore, the highest and best use of the case study improved property is continued use as a correctional facility.

### Approaches to Value

The highest and best use analysis supports valuing the subject property based on continued use as a correctional type facility, thus valuing it as a real property going concern. This justifies consideration of the subject financials in developing the income approach to value. Sales considered comparable to the subject have occurred, justifying development of the sales comparison approach to value. The cost approach is theoretically a good way to determine real property value without the intertwined elements of value related to intangibles and personal property. However, industry changes since the construction of the subject improvements, and the reduction in occupancy due to the workforce considerations, contribute to issues of functional and external obsolescence that are significant and difficult to estimate. Therefore, the cost approach is not developed.

Income Approach
Development of the income approach involves estimating the property's potential annual gross income, and then deducting a vacancy and collection loss allowance as well as the ownership expenses from annual gross income to obtain net operating income. The net operating income is then converted into a market value estimate with the use of an appropriate technique. The subject's market value was estimated by employing direct capitalization. A summary of each step of the income approach follows, and results are detailed in Exhibit 2.

Annual Gross Revenue. As noted earlier, the subject's revenue generation requires substantial professional services. The sources of income for the subject property are a per diem rate per occupant for housing and treatment, and the program revenue generated from providing academic education to occupants. To estimate these revenues, it is customary to rely on the normalized income and occupancy of the subject property in conjunction with market benchmarks. For this example, the subject's annual gross revenue is estimated based on an average per diem rate of $400, average occupancy of 100 beds per day for a 365-day year, and program revenue of 3% of occupancy revenue. This results in total gross revenue of $15,038,000.

Departmental Expense. Again, it is customary to rely on the normalized financials for a stabilized subject operation and market benchmarks. Expenses associated directly with gross revenue for the subject property type include labor costs; services and supplies including medical, clothing, and food; program expenses; and other miscellaneous operating costs. Labor costs include compensation and employee benefits, which can range from 70% to 80% of gross revenue for this type of labor-intensive going concern. For this case study example, the subject's annual departmental expenses are estimated at an average per diem cost of $340 per occupied bed, or approximately 83% of gross revenue. This step removes a significant portion, but not all, of the expense associated with the assembled workforce necessary to generate the revenue; additional workforce-related expenses are accounted for in the next step.

Undistributed and Fixed Expenses. Undistributed operating expenses for the subject property type generally consist of administrative and general expenses, utilities, repair and maintenance expenses, miscellaneous operating expenses, and importantly, ongoing recruiting and hiring expenses to maintain staffing. A review of actual financials across the subject property type indicates an average stabilized expense to maintain staffing that is equivalent to 0.6% of gross revenue. Absent reliable actual expenses, this expense would be estimated based on market benchmarks for turnover and staffing costs, as described earlier. Fixed expenses consist of insurance and real estate taxes. Real estate taxes for the subject property are loaded in the capitalization rate by adding real estate taxes expressed as a percentage of property value (commonly referred to as the effective or ad valorem tax rate). This has the same effect on value as deducting real estate taxes as an expense and is used instead of actual taxes when seeking to align taxes with the value estimate. Normalized subject expenses are checked against market standards for reasonableness. Ongoing recruiting and hiring expenses for the case study example equated to approximately 1% of gross revenue. Including consideration of the ongoing expense to maintain the trained and assembled workforce is consistent with the theoretical and judicial concept that an assembled workforce is a depreciable asset, as discussed earlier.

An overall management fee of 6% is estimated to allow for professional management distinct from the included administrative expense that addresses operational management. Ownership expenses must also include a reserve to replace building structures, mechanical systems, and site improvements that have a shorter life than the overall facility. An amount of $0.40 per square foot of gross building area was estimated in total. It should be noted that market participants often do not reflect a deduction for replacement reserves in net income, thus adjustments may be necessary in translating market-derived overall rates to the property being valued. For example, a market-extracted capitalization rate that ignores reserves would be adjusted downward to reflect a riskier income profile relative to a subject property with reserves considered in net income.24

### Exhibit 2  Income Approach Summary

**Gross Revenue**

Occupancy Revenue (per diem = average daily rate per occupied bed)

<table>
<thead>
<tr>
<th>Daily Occupied Beds</th>
<th>Per Diem</th>
<th>Total Gross Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>100</td>
<td>$400 x 365 days</td>
<td>$14,600,000</td>
</tr>
</tbody>
</table>

Program Revenue @ 3% of occupancy revenue  
Total Gross Revenue  

| Departmental Expense* | $340 x 365 days | (12,410,000) |

| Departmental Income | $2,628,000 |

**Undistributed and Fixed Expenses**

| Management | 6% Revenue | 902,280 |
| Operating Expenses and Insurance† | 1,443,648 |
| Real Estate Taxes | in cap rate | – |
| Building/Site Reserve (including 2.4-mile private road) | $0.40 SF | 60,000 |

Total Undistributed and Fixed Expenses  
Net Operating Income before real estate taxes and FF&E  
Less Return on and of FF&E ($4,500/room x 150 rooms, 5% yield, 8 years)  

| Net Operating Income before real estate taxes | $119,527 |

Capitalization Rate loaded for real estate taxes = 11%

**Capitalized Value before return on assembled workforce (rounded)**  

| Capitalized Value before return on assembled workforce (rounded)† | $1,100,000 |

**Potential Return on Assembled Workforce**

Opportunity Cost to Developer (total labor costs @ 7% return)  
Opportunity Cost to Capital (6 months of labor costs @ 5% cost of capital)  
Total Return on Assembled Workforce  

| Total Return on Assembled Workforce | (1,071,458) |

**Capitalized Value after return on assembled workforce (rounded)**  

| Capitalized Value after return on assembled workforce (rounded) | $100,000 |

* Labor costs (salaries, wages, and benefits) included in this expense  
† Ongoing cost of recruitment and hiring included in this expense  
‡ Reflects value after return of assembled workforce
Finally, a return on and return of the furniture, fixtures, and equipment (FF&E) was deducted from income in order to remove these elements of personal property value. An annual amortized amount is calculated based on an average cost of $4,500 per room at a 5% yield and 8-year life. This includes the furnishings for each of the 150 single-bed rooms and all miscellaneous FF&E throughout support areas. While this amount is low compared to hotel properties, furnishings for correctional facilities are relatively sparse in comparison to typical hotel properties. Removing income associated with FF&E from net income avoids erroneously applying the real estate tax load factor to personal property. However, as noted above, market-derived capitalization rates may require adjustment to reflect an equivalent income profile.

Capitalization to Value. Deducting ownership expenses and the return on and of FF&E from departmental income results in a net operating income of $119,527 before real estate taxes. Assumptions are applied in keeping with the subject’s risk level and income profile to conclude an 8% overall rate. For example, the CBRE North America Cap Rate Survey for the second half of 2019 reports an average capitalization rate of 8.55% for suburban hotel properties based on net operating income of the real property going concern and including deductions for management and replacement reserves, but excluding a return on FF&E and reflecting somewhat higher risk relative to the subject’s longer-term contracted occupancies. The rate was then loaded for real estate taxes as described earlier: adding the effective tax of 3%. Capitalizing the net income at the loaded capitalization rate of 11% resulted in a value by the income approach rounded to $1,100,000, before consideration of a return on the assembled workforce.

Return On Assembled Workforce. As described earlier, a return on the assembled workforce is theoretically necessary since a rational business owner would have little reason to pursue the assemblage when they could instead invest their expertise and capital elsewhere for a return. The return is labeled as the opportunity cost to the developer and the opportunity cost to the capital. Following the format explained earlier, the opportunity cost to the developer (opportunity cost for creating the asset) was calculated as a percentage rate of return of total compensation costs at a 7% rate of return. For the opportunity cost of capital (return required to persuade pursuit of the investment), there is assumed a 5% rate of return and average costs equal to half the total compensation cost throughout the year leading to a stabilized workforce. Together, the opportunity costs to the developer and capital total just over $1,000,000. Deducting this amount from the value determined by the income approach results in a $100,000 rounded value remaining for allocation to real property value.

However, recall that returns on an assembled workforce are conceptually realized because a buyer of a real property going concern would not incur these opportunity costs. If a going concern ceases prior to sale, a buyer would instead need to assemble a new workforce and would not avoid incurring the noted opportunity costs. Thus the conceptual rationale for a return on the assembled workforce is no longer met. Nonetheless, this remains an empirical question to examine. The sales comparison approach in this case, which involves comparable sales in which the going concern had ceased operation, provides a unique opportunity to probe this point.

Sales Comparison Approach
The sales comparison approach is particularly useful in this instance to establish real property value. Because of the changing market for correctional facilities, sales of vacant correctional facilities are available for comparison. Privately operated juvenile correctional and treatment facilities house youths and provide significant rehabilitation, education, and treatment services for these individuals while housed. Two sales in particular reflected the closest match—both were vacant at the time of sale with no workforce in place, but purchased for the similar purpose of housing individuals for treatment and education, showing a continued highest and best use comparable to the subject’s concluded highest and best use. The sales comparison also demonstrates that properties similar to the subject tend to sell vacant rather than while operating, even when the highest and best use remains the same. This had important implications for how the return on the assembled workforce is conceived for the income approach, as discussed earlier.
Each of the sales was compared to the subject, and adjustments were made in the following sequence:

- first, property rights conveyed, cash equivalency, and conditions of sale;
- next, market condition changes since the date of sale; and
- finally, location; site characteristics; relative building size; improvement age, quality, finish, and physical condition; functional utility; and land-to-building ratio.

The adjusted unit prices range from $1.96 to $10.70 per square foot, or $5,524 to $16,923 per bed. Given the likely reconfiguration of room use by each buyer of the non-operating comparable sales and the extensive support building area associated with each sale and the subject, the unit rate per bed is deemed less reliable than unit rate per square foot of gross building area as an indication of value. For instance, in response to market trends, it is common to see rooms converted to clinician offices and double-bed rooms converted to single-bed rooms. The subject and comparable sale properties commonly included classrooms, recreational areas, offices, and cafeteria facilities. After considering the comparable sales used in the analysis and all factors affecting market value, the market value of the subject’s fee simple interest by the sales comparison approach is estimated to be $7.00 per square foot of gross building area including land, resulting in a market value rounded to $1,100,000 or $11,000 per bed as a non-operating facility with no workforce in place.

Reconciling the Income and Sales Comparison Approaches to Value

Recall that the income approach indicated a value after return of, but before return on, the assembled workforce of $1,100,000. Further deducting an allowance for return on the assembled workforce reduced the value to $100,000. The sales comparison approach indicated a value for real property (as a non-operating facility with no workforce in place) of $1,100,000. Thus, as expected for this example, the value derived through the sales comparison approach does not support allowance for a return on the assembled workforce in the income approach. However, the value derived through the sales comparison approach does align with allowance of a return of the assembled workforce in the income approach through deduction of labor costs and the ongoing costs to maintain the workforce through continuous recruitment, hiring, and training.

Conclusion

This article has provided a conceptual review and case study on when and how to consider the removal of intangible asset value associated with the assembled workforce in the valuation of real property going concerns. The discussion began with the fundamental point that when appraising a real property going concern, the intangible asset value of the assembled workforce is inherent in the financials of the going concern and must be noted and, in some cases, removed. Next, the discussion addressed the varying degrees of value that appraisers and related practitioners might ascribe to the assembled workforce. The expenses associated with the return of the assembled workforce includes the labor costs in the form of payroll expenses (salaries, wages, and employer-provided benefits). Importantly, it also includes the ongoing cost to maintain the skilled assembled workforce, which typically encompasses recruitment and hiring expenses to address turnover and ongoing training costs.

The more complex and speculative topic of “return on” was also examined. A return on the assembled workforce is theoretically necessary since a buyer of the real property going concern would not incur these opportunity costs and would thus pay for the privilege of an assembled workforce. However, as the case study demonstrated, a return on the assembled workforce is not supported when the going concern is likely to cease operation prior to sale. Whether this market finding extends to real property going concerns such as hotels that tend to operate continuously from one owner to the next remains an empirical question. We encourage the continued development of market-derived insights on this point and offer this research as an instrumental contribution in the ongoing discussion among appraisers and related practitioners.
About the Authors

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Additional Resources

Suggested by the Y. T. and Louise Lee Lum Library

American Bankruptcy Institute—“A Guide to Valuation of the Assembled Workforce Intangible Asset”

Appraisal Institute

- **AI Guide Note 5—“Appraisals of Real Estate with Related Personal Property, Business Property or Intangibles”**
  https://www.appraisalinstitute.org/assets/1/7/guide-note-5.pdf
- **Fundamentals of Separating Real Property, Personal Property, and Intangible Business Assets**
- **Lum Library External Resources Knowledge Base [Login required]**
  Information Files—Business valuation; Special use properties

*The CPA Journal*—“The Tangle of Intangible Assets and Business Combinations”
https://www.cpajournal.com/2016/01/13/tangle-intangible-assets-business-combinations/
Is the Eiffel Tower Worth More Than the Statue of Liberty? Techniques for Determining the Value of Iconic National Landmarks—Part II

by Richard J. Roddewig, JD, MAI, Anne S. Baxendale, and J. Andrew Stables

Abstract
This article is the second in a two-part series on the valuation of iconic national landmarks. The discussion explores the difference between market value and “public interest value” through analysis of the Statue of Liberty and the Eiffel Tower. Part 1 of this article defined the relevant terms and set forth alternative reproduction cost techniques and income approach elements that can be used to estimate the value of these two iconic symbols. Part 2 analyzes the land value of each landmark site. It also presents tools for estimating the impact of additional sources of revenue that might be generated under private ownership and branding arrangements, and it discusses the concept of “public interest value” by reference to the public tax revenues generated by these iconic symbols.

Introduction
Part 1 of this two-part article demonstrates the valuation of two iconic landmarks—the Statue of Liberty and the Eiffel Tower—based on income generated and a depreciated reproduction cost. In Part 2, the discussion will explore techniques for estimating the value of the land under each landmark and the additional contribution to their “public interest value” resulting from the economic benefits they generate in tax revenues. Potential sources of additional income through arrangements with third-party entities are also discussed.

Summary of the Depreciated Cost and Income Approach Result
The first part of this article concluded with the following table summarizing the results of the reproduction cost calculation and the income approach to value.

| Eiffel Tower and Statue of Liberty: Cost and Income Approaches to Value (US$) |
|---------------------------------|---------|---------|
| Eiffel Tower                    | Statue of Liberty |
| Cost Approach: Improvements Only | 436,500,000 | 215,000,000 |
| Income Approach                 | 380,800,000 | 350,000,000 |

The results from the two approaches to value for the Eiffel Tower are relatively closer than the results from the two approaches for the Statue of Liberty. One reason for the difference in the Statue of Liberty results is the disregard of the National Park Service (NPS) operating costs. Another reason for the difference in the results of the cost and income approaches for the Statue of Liberty is that land value had not yet been estimated and included in the cost approach estimate.
The iconic Statue of Liberty and the Eiffel Tower encompass more than merely structures; each comprises land that must be considered in a valuation. The relationship of the land to the ownership interest in the landmarks differs, however. The Statue of Liberty concessioners do not operate any portion of the icon’s land other than the square footage directly under the retail and food concession areas. In contrast, the Eiffel Tower’s Société d’Exploitation de la Tour Eiffel (SETE) appears to have the rights to use the land under the tower itself.

Statue of Liberty—Liberty Island Land Value
What technique can be used to determine the value of the land on Liberty Island where the Statue of Liberty is located? Land value in the cost approach is typically derived by analyzing sales of land sold for similar uses in the same competitive market. For iconic special-purpose properties such as the Statue of Liberty, there are no such comparable land sales; therefore, an alternative approach to land value must be considered.

One alternative method for estimating land value is an analysis of prices paid for waterfront sites in nearby New Jersey and New York, with adjustments for size and other factors. The NPS map in Exhibit 1 shows the ferry routes between Manhattan, Liberty Island, Ellis Island, and New Jersey waterfronts. However, analyzing only New York and New Jersey waterfront land prices would not reflect the unique value of Liberty Island on which the statue was constructed. In addition, nearby waterfront land prices would be difficult to translate based on differences in the development allowed by zoning. Liberty Island, as a national historic landmark, has very limited, if any, development potential other than as it relates to the statue itself and its museum.

The map also shows Governors Island, which contains 172 acres and is substantially larger than the 14.717-acre Liberty Island. The long-running controversy over the development of Governors Island and its value illustrate the difficulty of using any prices paid for it as evidence of the market value of Liberty Island land. However, applying a weighting between recent prices for Lower Manhattan, Brooklyn waterfront, Governors Island, and New Jersey shoreline land and Liberty Island suggests that the 14.717 acres of Liberty Island could easily command a value of $500 per square foot. That would indicate a value of about $320.5 million for Liberty Island land.

A more promising approach to determining the value of the land on Liberty Island is to analyze land leases structured as a percentage of revenues generated by a business or development on a publicly owned (or privately owned) land parcel. This arrangement has been common in many

1. Although Liberty Island is owned by the federal government, there have been disputes between New Jersey and New York as to which state has jurisdiction. Both states currently share jurisdiction of the entire island. For additional discussion see “Liberty Island,” Wikipedia, https://en.wikipedia.org/wiki/Liberty_Island.
2. For discussion of the island’s redevelopment, see “State of #OurCity: Mayor de Blasio Announces Transformation of Governors Island into a Year-Round Destination,” February 4, 2016, City of New York website, https://on.nyc.gov/3guGZSi.
3. In 2016, the City of New York purchased an 11-acre Citistorage site on the Brooklyn waterfront for $160 million (approximately $334 per square foot) as part of an assemblage effort for a park. Emma Whitford, “City Finally Acquires Citistorage Site to Complete Long-Delayed Bushwick Inlet Park,” Gothamist, November 22, 2016, https://bit.ly/2BWhYjV. Record land prices on the Jersey City waterfront were reported in 2016. A Chinese firm reportedly agreed to pay $55 million for a parcel at 75 Park Lane on the Jersey City waterfront in 2015. That price equaled to $1,070 per square foot for the small 1.18-acre land parcel located about 1.6 miles from the New Jersey ferry terminal for the Statue of Liberty. Miriam Kreinin Souccar, “Land Ho!” The Real Deal, June 1, 2016, https://trd.media/ny/LxpIr5.
parts of the United States, including Chicago, San Diego, and New York City. For example, the City of New York and the Port Authority of New York and New Jersey in 2004 entered into a 49-year lease agreement for the land and structures at both LaGuardia and John F. Kennedy Airports. That deal amended an existing lease that was part of a succession of leases between the city and the Port Authority extending back to 1947. The 2004 lease set the base rent at 8% of “annual gross revenue from various sources such as scheduled airline terminal rentals, flight fees, tenant parking, retail vendor percentage fees, and fixed rentals and fuel farm fees.”

The provisions also included an upfront lump-sum payment as well as a scheduled increase to 10% of gross revenues after the first five years. A search of CoStar’s online real estate database in early 2020 revealed 143 active sale listings of single-tenant properties with a ground lease in the United States. The average capitalization rate based on the asking rent was 6.34%, and the median capitalization rate was 5.69%. For the 125 properties involving either hospitality or retail ground leases, the average capitalization rate was 5.54%, and the median rate was 5.50%. Based on that, a land lease rate equal to 6% of the gross revenues generated by the concession contracts at the Statue of Liberty is supportable. Given the stabilized gross concession revenues of $102.517 million and a 6% land lease rate, the appropriate land lease at Liberty Island would generate $6.151 million per year in revenue, which, after deducting a government rate lease management expense of 7.5%, would leave a net lease income to the NPS of approximately $5.690 million. If capitalized at the government bond rate of 1.695% in early 2020 (before the effect of COVID-19 impacted bond markets), the land value would add $335.695 million to the value of the Statue of Liberty by the cost approach, reasonably close to the estimate of the land value of Liberty Island based on Manhattan, Brooklyn, Governors Island, and New Jersey waterfront land sales.

**Eiffel Tower—Champ de Mars Land Value**

The Eiffel Tower sits in the Champ de Mars, which is a public park. The base of the tower measures 410 feet on each side, indicating an area directly under the tower of 3.86 acres. If 10% is added for foundations and an access walkway around the base, the approximate area needed for operation of the tower would be 4.25 acres. If a 6% land rent rate similar to that for Liberty Island land is applied to SETE royalty payments to the City of Paris, the annual return to the land under the Eiffel Tower would be about €5,245 million. After deducting a 7.5% management fee, the land value of the approximately 4.25 acres on which the tower sits would be about €390.7 million at the French bond rate of 1.242%, which was previously used in the income approach to value. Using an exchange rate of one euro equals $1,09, this equates to about $425.9 million.

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5. A separate February 2020 lease involved 65,000 square feet of land for a Hudson River commuter boat service at the Port Jersey–Port Authority Marine Terminal in Bayonne, New Jersey. John Heineis, “Port Authority Approves 10-Year, $2.6M Land Lease for Bayonne Ferry Service to Manhattan,” Hudson County View, February 15, 2020, https://bit.ly/3l0Q4uT. Due to the complications of the lease deal, it is difficult to derive a land rent as a percentage of revenues to be generated. One article reported that the ferry service lease will cost the City of Bayonne approximately $220,000 per year, with Bayonne paying the terminal lease until the ferry service breaks even. After that, the city is to split the profits with the ferry service. Daniel Israel, “Bayonne Ferry Terminal Lease Approved,” Hudson Reporter, February 20, 2020, https://bit.ly/30QqLIf. Further complicating an analysis of the lease is the fact that the city would be responsible for financing infrastructure improvements and the cost of building a ferry terminal would be partially offset by a federal grant. Chris Fry, “Bayonne Ferry Service One Step Closer to Reality,” Jersey Digs, January 21, 2010, https://bit.ly/3fjjgNF.

6. Data source, CoStar database search, “2020 active property sale listings of single-tenant properties, including a ground lease in the United States.”


9. The *Pricing the Priceless* television production on the Eiffel Tower estimated the value of land under the Eiffel Tower at $20,000 per square meter, equivalent to a value of $344 million. Kevin Cook, “The Eiffel Tower,” *Pricing the Priceless*, November 21, 2016, available at https://bit.ly/2C2oEL5. To provide consistency in the comparison analysis for the land value of both icons, the result of the land rent analysis in this article is used for the Eiffel Tower rather than the estimate from *Pricing the Priceless*. 
Final Cost and Income Approach Results
The final comparison between the Eiffel Tower and Statue of Liberty approaches to value would be as follows:

<table>
<thead>
<tr>
<th>Eiffel Tower and Statue of Liberty: Final Cost and Income Approaches to Value (USS)</th>
<th>Eiffel Tower</th>
<th>Statue of Liberty</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost Approach:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land &amp; Improvements</td>
<td>862,400,000</td>
<td>550,695,000</td>
</tr>
<tr>
<td>Income Approach</td>
<td>380,800,000</td>
<td>350,000,000</td>
</tr>
</tbody>
</table>

Reconciling each of the approaches and giving equal weight to each, the indications of value by the traditional approaches to value would be as follows:

<table>
<thead>
<tr>
<th>Eiffel Tower and Statue of Liberty: Final Reconciliation of Approaches to Value (USS)</th>
<th>Eiffel Tower</th>
<th>Statue of Liberty</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reconciled Value</td>
<td>621,600,000</td>
<td>450,347,500</td>
</tr>
</tbody>
</table>

Consideration of Other Sources of Government Revenues and Additional Components of “Public Interest Value”

Iconic landmarks such as the Eiffel Tower and the Statue of Liberty may generate public sector revenues in a number of ways, including the following:

- **Income tax.** Employees of the concessioners and the NPS at the Statue of Liberty and employees of SETE at the Eiffel Tower pay federal income taxes.
- **Sales tax.** Visitors to the Statue of Liberty pay sales taxes to New York or New Jersey on their cruise and retail purchases.
- **VAT.** Eiffel Tower visitors pay a value-added tax (VAT) on their expenditures at the tower. Unlike sales taxes in the United States, which accrue to state and local government, the VAT in France accrues to the French national government. The standard VAT rate in France is 20%, but there are exceptions that can reduce the rate for various types of purchases.11
- **View premiums.** Hotels charge a premium for rooms with a view of the Eiffel Tower or for eating at rooftop restaurants or terraces with views. Similarly, residential and commercial properties in New York and New Jersey with views of New York harbor and the Statue of Liberty generate premium rents, which could translate into direct and indirect sources of federal, state, and local taxes.
- **Increased tourism.** Some portions of the total expenditures of tourists in Paris or visitors to New York City are directly attributable to their desire to visit the iconic Eiffel Tower and Statue of Liberty. In this way, if these landmarks did not exist the total amount of visitors and tourism expenditures in Paris and New York City would be significantly less.
- **Branding and licensing.** Creative marketing and branding of iconic landmarks could significantly increase revenues to the government owners of both landmarks.

The following estimates the public revenue for some of these categories.

**Income Tax**
In 2019, the NPS employed 100 permanent employees and 32 seasonal workers.12 Permanent employees at the NPS were reported to earn an average salary of $66,251 per year in 2018.13 Inflating the 2018 average to 2021 at a 2.5% rate

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10. According to The Appraisal of Real Estate, fourteenth edition, final value “reconciliation requires appraisal judgment and a careful, logical analysis of the procedures that lead to each value indication. Appropriateness, accuracy, and quantity of evidence are the criteria with which an appraiser forms a meaningful, defensible final opinion of value.” Appraisal Institute, The Appraisal of Real Estate, 14th ed. (Chicago: Appraisal Institute, 2013), 646–647. Depending on how these criteria apply to the approaches to value used, equal weighting may or may not be appropriate. For simplicity in this article it is assumed an equal weighting is appropriate.


of inflation would indicate 2021 stabilized annual full-time salary of $71,345. The seasonal employment salary, estimated at 40% of an average full year salary, would be approximately $28,538 in 2021; total 2021 stabilized salaries would be $8.050 million. At a 24.22% and 16.15% income tax rate, respectively, total federal income taxes could be $1.875 million annually, without consideration of any deductions. The concessioners at the Statue of Liberty reportedly temporarily laid off 400 workers following Hurricane Sandy in 2012 due to the shutdown of the island and ferry service. Assuming the same mix of full-time and seasonal workers and the same full-time average annual salary of $71,345 in 2021, total salaries would be approximately $24.385 million and federal income taxes generated would be $5.682 million. The combined NPS and concession employee-generated annual federal income tax would be about $7.557 million. Capitalized at 1.695%, the value contribution of federal income taxes generated by employees alone would be $445.8 million.

Payroll taxes paid to the federal government to fund Social Security and Medicare (both part of FICA) and federal unemployment insurance can also be calculated. The combined FICA rate is 15.3% for the average salary of Liberty workers. The $24.385 million in salaries would generate $3,730,905, which capitalized at 1.695% would have a value of approximately $220.110 million. The $42 per employee per year unemployment insurance tax weighted between full-time and seasonal employees would generate about $34.30 per employee, or an additional $18,240, which when capitalized provides an additional value of about $1.075 million. The combined capitalized value of the FICA and unemployment insurance revenue would be about $221.185 million.

Employees of the Eiffel Tower also pay income taxes. SETE has 340 employees and their average salary in 2016 was reportedly €61,000. Inflating that salary at the average French rate of inflation of 1.48% per year between 2017 and 2019, the salary would be about €64,700 in 2020. At the early 2020 conversion rate of 1.09 euros to the dollar, this would equate to $70,523. Based on French income tax rates, the income tax paid on €64,700 in 2020 could be as high as approximately €13,554, or 20.95% per person. The capitalized value at a 1.242% capitalization rate of annual income taxes paid by employees at the Eiffel Tower would be about $404.5 million. There is also a payroll tax in France, which funds its universal health care system and other government benefits. The rate averages about 20% of income, and using average Eiffel Tower employee salaries this would generate an additional $386.1 million in government revenue.

Sales Tax
As indicated below, total stabilized gross receipts generated by concessions at the Statue of Liberty are forecasted to be in excess of $102.5 million in 2021.

<table>
<thead>
<tr>
<th>Statue of Liberty: Forecasted 2021 Gross Receipts from Concessions (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ferry Service and Tour Tickets</td>
</tr>
<tr>
<td>Food Service and Retail Sales</td>
</tr>
<tr>
<td><strong>Total Gross Receipts</strong></td>
</tr>
</tbody>
</table>

Based on the respective number of passengers embarking from New Jersey compared to New York City and respective sales tax rates, the sales taxes generated by concession purchases are as shown in the following table.

15. This forecast may be high; employment ads for the ferry concession operator indicate the hourly wage for its employees is $15.00 per hour; for example, see https://bit.ly/3hTNYEB.
19. This is based on the French tax rates for single individuals exempting the first €10,064 from tax, then a 14% rate on €10,065 to €27,794, and a 30% rate on €27,795 to €74,517, indicating an effective rate of 20.95% (assuming no deductions). “Guide to French Income Tax,” French-Property.com, https://bit.ly/316klf5.
Statue of Liberty: Sales Tax Generated by Point of Embarkation (US$)

<table>
<thead>
<tr>
<th>Gross Receipts</th>
<th>Sales Tax Generated</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Ferry Service and Tour Ticket</td>
<td></td>
</tr>
<tr>
<td>Gross Receipts</td>
<td>$66,667,000</td>
</tr>
<tr>
<td>Attributable to NJ (21% of passengers;* 6.625% sales tax†)</td>
<td>13,825,107</td>
</tr>
<tr>
<td>Attributable to NY (79% of passengers; 8.875% sales tax‡)</td>
<td>52,841,893</td>
</tr>
<tr>
<td>Total Food Service and Retail Sales</td>
<td></td>
</tr>
<tr>
<td>Gross Receipts</td>
<td>$35,850,000</td>
</tr>
<tr>
<td>Attributable to NJ (21% of passengers; 6.625% sales tax)</td>
<td>7,434,414</td>
</tr>
<tr>
<td>Attributable to NY (79% of passengers; 8.875% sales tax)</td>
<td>28,415,586</td>
</tr>
<tr>
<td>Total Receipts</td>
<td>$102,517,000</td>
</tr>
</tbody>
</table>


Capitalized at 1.695%, the value contribution of state sales taxes generated by concession sales would be $619.62 million.

VAT
Calculating VAT revenue generated by the Eiffel Tower is more difficult than calculating sales taxes generated by the Statue of Liberty because the VAT is included in the price of admission for the Eiffel Tower. As a result, the gross revenues reported by SETE include the portion of gross revenues attributable to the VAT.

At the standard VAT rate of 20%—and given the Eiffel Tower’s €87.425 million in stabilized operating income—the potential maximum VAT would be about €17.485 million. Capitalized at 1.242%, the value contribution of VAT generated by the Eiffel Tower would be €1.41 billion, equivalent to $1.54 billion. However, the VAT revenues generated at the Eiffel Tower are likely much lower because the VAT on food and non-alcoholic beverage sales is only 5.5%, the French VAT rules allow for a substantially lower rate on admissions to cultural sites, and international travelers can receive a rebate on some purchases during their stay in France. Although a precise estimate of net VAT after the international rebate is difficult to determine, the overall rate after considering food and beverage sales as a percentage of SETE annual revenues and rebates to international travelers is likely closer to 10% than 20%. Applying a 10% rate to the €87.425 million in stabilized operating income indicates a capitalized value of $770 million.

However, this likely overstates capitalized VAT revenues. If the concession fee paid by SETE is based on total revenues from prices that include the VAT, then a deduction must be made to account for VAT payments transferred to the City of Paris as part of the royalty payment made by SETE. A 10% VAT included in the 23% royalty payment would leave about €67.315 million against which an additional VAT of 10% would need to be capitalized, indicating a VAT value of $590.9 million.

View Premiums
Hotels with a view of the Eiffel Tower can command a premium in room rates (Exhibit 2). While the number of such rooms cannot be accurately estimated from online data, a Google map search found dozens of hotels within one-half mile of the Eiffel Tower. The twenty hotels located closest to the Eiffel Tower contained a total of 1,607 rooms; Exhibit 3 lists these hotels and their approximate direct-line distance from the Eiffel Tower.

Of the twenty hotels studied, nine hotels had comparable room types with and without direct views of the Eiffel Tower. For this comparison,

21. The European Commission lists “admission to cultural services” as a category where application of reduced VAT rates can be applied; France applies a wide range of rates to these activities, ranging from 2.1% up to the standard 20%. European Commission, “VAT Rates Applied in the Member States of the European Union,” January 1, 2020, https://bit.ly/3fTEicD.
the Eiffel Tower view price premium ranged from 0% to 61%, with a median of 18%.\textsuperscript{23} If we assume that at least 10% of the rooms at the nine hotels had rooms with tower views, then approximately 110 hotel rooms could be expected to generate an 18% premium due to the presence of the Eiffel Tower. Given an average cost differential in comparable rooms of $123, this equals up to $13,530 per night, or approximately $4.94 million annually. At the average room rate differential, with a 75% occupancy rate, the 10% VAT for hotel stays\textsuperscript{24} would generate approximately $370,000 per year, which when capitalized at the 1.242% rate used in the income approach indicates a capitalized value of $29.8 million for the view premium. Many other hotels farther than one-half mile from the Eiffel Tower also have rooms with a view of the tower that can command a premium.\textsuperscript{25}

Exhibit 2 Hotel Room with View of Eiffel Tower

Source: Shangri-La Hotel, Paris

Exhibit 3 20 Paris Hotels Closest to Eiffel Tower

<table>
<thead>
<tr>
<th>Hotel Name</th>
<th>Hotel Class</th>
<th>Distance from Eiffel Tower (Mi.)</th>
<th>Total Rooms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hotel Pullman Paris Tour Eiffel</td>
<td>4-Star</td>
<td>0.2</td>
<td>430</td>
</tr>
<tr>
<td>Hotel Mercure Paris Centre Tour Eiffel</td>
<td>4-Star</td>
<td>0.2</td>
<td>405</td>
</tr>
<tr>
<td>Hotel Le Derby Alma Paris</td>
<td>4-Star</td>
<td>0.3</td>
<td>33</td>
</tr>
<tr>
<td>Hotel de Londres Eiffel</td>
<td>3-Star</td>
<td>0.3</td>
<td>30</td>
</tr>
<tr>
<td>Hotel Eiffel Seine</td>
<td>3-Star</td>
<td>0.4</td>
<td>45</td>
</tr>
<tr>
<td>Hotel Eiffel Kensington</td>
<td>2-Star</td>
<td>0.4</td>
<td>25</td>
</tr>
<tr>
<td>Shangri-La Hotel</td>
<td>5-Star</td>
<td>0.4</td>
<td>100</td>
</tr>
<tr>
<td>Hotel de la Tour Eiffel</td>
<td>2-Star</td>
<td>0.4</td>
<td>22</td>
</tr>
<tr>
<td>Hotel de la Paix Tour Eiffel</td>
<td>3-Star</td>
<td>0.4</td>
<td>23</td>
</tr>
<tr>
<td>Hotel De L’Alma</td>
<td>3-Star</td>
<td>0.4</td>
<td>32</td>
</tr>
<tr>
<td>Hotel Eiffel Trocadéro</td>
<td>4-Star</td>
<td>0.4</td>
<td>17</td>
</tr>
<tr>
<td>Hotel Maison FL</td>
<td>4-Star</td>
<td>0.5</td>
<td>62</td>
</tr>
<tr>
<td>Hotel Le Marquis Eiffel Paris</td>
<td>4-Star</td>
<td>0.5</td>
<td>36</td>
</tr>
<tr>
<td>Hotel Passy Eiffel</td>
<td>3-Star</td>
<td>0.5</td>
<td>49</td>
</tr>
<tr>
<td>Hotel Juliana</td>
<td>5-Star</td>
<td>0.5</td>
<td>40</td>
</tr>
<tr>
<td>La Clef Tour Eiffel Paris</td>
<td>5-Star</td>
<td>0.5</td>
<td>112</td>
</tr>
<tr>
<td>Hotel Relais Bosquet</td>
<td>3-Star</td>
<td>0.5</td>
<td>40</td>
</tr>
<tr>
<td>Hotel La Bourdonnais Paris</td>
<td>4-Star</td>
<td>0.5</td>
<td>53</td>
</tr>
<tr>
<td>Best Western Hotel Au Trocadéro</td>
<td>3-Star</td>
<td>0.5</td>
<td>27</td>
</tr>
</tbody>
</table>

Source: Tripadvisor

23. Rate premiums are derived from nightly hotel rates between June 11, 2020, and July 26, 2020. Comparable rooms at a given hotel used rates from the same night. Variation in nights used was based on availability of data for particular room rates during this peak tourism season in Paris.


25. Estimating the contribution of a view of the Statue of Liberty to rents in New Jersey and New York is difficult given the location of the statue offshore and the immensity of the vista of New York harbor compared to the size of the Statue of Liberty in those views.
**Increased Tourism**

For both the Statue of Liberty and the Eiffel Tower there have been studies to determine the contribution of these respective iconic landmarks to the regional and national economies. According to the NPS, in 2018 4.34 million visitors “spent an estimated $256 million in local gateway regions while visiting Statue of Liberty National Monument.” That $256 million in regional expenditures equates to $58.99 per visitor to the monument. In addition, the NPS estimates the monument supported a total of 2,989 jobs, $141.4 million in labor income, $238.7 million in value added, and $355.7 million in economic output in local gateway economies surrounding Statue of Liberty National Monument.\(^{26}\)

**Branding and Licensing**

A study released in August 2012 by the Chamber of Commerce of Monza and Brianza (an Italian province near Milan) estimated the Eiffel Tower to be worth about €435 billion to the French economy.\(^{27}\) Critics of the study have said this figure is implausibly high since, at the time, it equated to almost 20% of France’s entire annual gross domestic product.\(^{28}\) The study also ranked the Eiffel Tower as the “most valuable” heritage site in Europe and placed its worth at more than 4.5 times the €91 billion value estimate for the Colosseum in Rome—the second most valuable heritage site in Europe.\(^{29}\) The study was reportedly based “not on the material value of the monuments, but on their image, branding and attractiveness to visitors.” It “reportedly used figures from the European statistics bodies Eurostat and Istat and from the Urban Audit, a study of cities carried out for the European Commission.”\(^{30}\)

One element of the Monza and Brianza study was an analysis of the branding of the Eiffel Tower.\(^{31}\) While all of the assumptions underlying the Monza and Brianza analysis of the value of branding of the Eiffel Tower are not clear, there are past and present branding rights associated with the Eiffel Tower. Between 1925 and 1934, the French auto manufacturer Citroën paid to use the Eiffel Tower as a billboard and installed 250,000 lights spelling out its corporate name on the tower (Exhibit 4).\(^{32}\)

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\(^{31}\) When real estate valuers refer to “branding,” they typically mean attaching the name of an entity to the public image of a real estate development—for example, by naming the building after the largest tenant or the developer and attaching prominent signage with that name to the exterior of the building. “Branding” can also go further and provide a person or entity with the exclusive or semi-exclusive right to use the image or photo of the building in various ways that associate the building with the person or entity. For example, see W. K. S. Christiansen, “The Naming of Office Buildings: A New Rental Component?” The Appraisal Journal (April 1984): 230–236.

Nighttime photographs of the Eiffel Tower continue to be controlled by the French government and SETE. Nighttime photos of the tower are technically illegal in France because SETE controls the copyright to all images of the illuminated Eiffel Tower. SETE considers the lighting to be an artistic work and requires prior permission to take nighttime photos.\(^{33}\) Financial reporting by SETE indicates that it does collect some copyright and licensing fees. The 2015 annual report for SETE reports €582,361 in copyright fees from a combination of filming (€175,010), image reproduction rights (€318,265), and “by-product activity” (€89,086).\(^{34}\) That included revenues from allowing the illuminated Eiffel Tower to appear in some feature films and also included advertising revenues from licensing to companies such as Cartier, Givenchy, and Schwarzkopf.\(^{35}\)

Unlike the Eiffel Tower, there is no current specific trademark or copyright restriction on use of images of the Statue of Liberty.\(^{36}\) The statue is considered to be in the public domain. As a result, the Statue of Liberty has been featured in hundreds of advertising campaigns, including those for airlines, New York City, and even cigarette companies. Recently, the Statue of Liberty has been featured in well-known ads by Liberty Mutual Insurance Company. The National Park Service describes the statue’s historic use in advertising as follows:

The image of the Statue of Liberty has been used for every conceivable commercial purpose. Bartholdi [the sculptor] himself began it all by licensing her image in 1875 and urging French advertisers to use it. The Statue began appearing on the products and trade cards of American companies by 1877, nine years before it was unveiled. Since then, manufacturers around the world have not hesitated to use the Statue to sell everything from cigars to soap.

The use of the Statue to sell products has been a source of discomfort and dissonance when Americans perceive the Statue of Liberty as being used inappropriately by advertisers. When advertising using the Statue contradicts the ideals of the Statue, or insults an important meaning of the Statue, the ad can come under fire from people trying to prevent the Statue’s meaning from being diminished or diluted.

An early example of this critique of product ads obscuring the noble ideals of the Statue of Liberty is an editorial cartoon that appeared in Puck magazine [Exhibit 5] during the funding campaign for the pedestal in the 1880s. The cartoon lampooned the way that

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33. France has reportedly opted out of the EU directive that all photos of public buildings can be published or distributed without prior governmental permission. Steve Schlackman, “Do Night Photos of the Eiffel Tower Violate Copyright?” Artrepreneur Art Law Journal, November 16, 2014, https://bit.ly/3fV5h7Z. According to this source, French courts have not ruled on the legality or enforceability of the copyright and SETE does not typically enforce its right.


35. SETE, Annual Report for 2015.

36. A copyright registration was issued in 1876 to Frederic-Auguste Bartholdi, the French sculptor of the statue; the patent expired after fourteen years. In 1879, Bartholdi obtained a design patent that covered replicating the design as a statue, in pictures, and in “metal, stone, terracotta, plaster-of-paris, or other plastic composition.” Kat Eschner, “The Statue of Liberty Was Once Patented,” Smithsonian (February 17, 2017), https://bit.ly/3fqzr27. Under US law, works registered before 1923 are in the public domain so the copyright technically is expired. “Is It a Violation of Copyright to Sell Photos of the Statue of Liberty?” IPNexus, https://secure.ipnexus.com/en/articles/42.
advertising exploited any opportunity and symbol to sell its wares. It shows the Statue covered in advertisements [from] her top—wearing a “Silker the Hatter” top hat and holding a “Gamp & Co. Umbrella”—to her bare feet, which were flanked by competing ads for corn cures.37

Because the image of the Statue of Liberty is in the public domain, the NPS does not receive any revenue from its use. However, the NPS—at times in cooperation with nonprofits such as the National Park Foundation and the Statue of Liberty-Ellis Island Foundation—has used the statue to raise funds to support its maintenance and restoration. The Statue of Liberty-Ellis Island Foundation centennial restoration funding campaign included corporate sponsorships sold for $3 million to $5 million, which raised $66 million of the total $305 million raised.38 The sponsorships gave the corporate donors the right to use the fundraising campaign logo, which had been trademarked.

For their contributions, sponsors were permitted to advertise their association with the project and to devise products that reflected that affiliation. Some of the items were... imprinted with images of the statue, the [campaign] logo, the campaign slogan (“Keep the Torch Lit”), and the company’s name. ... The foundation not only benefitted from the monetary contributions but also received considerable publicity from these products and other advertising the company developed.39

In 2015, Budweiser started an advertising campaign featuring images of the Statue of Liberty on its cans and bottles and gave $2.5 million to the National Park Foundation40 for its “Find Your Park” campaign; as part of the campaign, Budweiser also sponsored a “Made in America” concert on Liberty Island.41 In March 2016, the NPS issued a new directive about corporate donations to support the national parks.

The Park Service still won’t recognize donors with advertising or marketing slogans. But for the first time, their logos will get prominent display. Companies will be able to earmark gifts for recurring park expenses, which was prohibited before. ... Bricks or paving stones on the steps to a visitor center, video screens inside, educational, interpretive, research, recreation and youth programs, positions or endowments — these also will get naming rights, according to the proposed policy. There could be walls in visitor centers dedicated to donors, or digital ones, as fundraising is beefed up through crowdsourcing and other online strategies to reach the public. And a donor will now be allowed to design and build a park building and even operate it long term.42

If the statue were privately owned, how much revenue could be generated by selling the branding or naming rights for the Statue of Liberty, Liberty Island, or “Lady Liberty”? Licensing corporate sponsors or selling naming rights is a common part of the operation of sports stadiums, music venues, and various public facilities. In 2019, sponsorships were responsible for $1.1 billion in MLB revenue.43 For example, the New York Yankees and Yankee Stadium have had licensing deals with PepsiCo, Delta Airlines, Audi, Canon, Mastercard, and Bank of America.44 New York City has the two highest-grossing naming rights sports facilities in the United States—Citi Field (home of the MLB Mets) and the Barclays Center.

40. Gina Pace, “Budweiser Embraces Statue of Liberty in New Campaign,” NY Daily News, April 22, 2015, https://bit.ly/2ZDs2AfY. According to its website, the National Park Foundation is “the official charitable partner of the National Park Service.” The Foundation is private and not a part of the federal government but assists the National Park Service in funding acquisition and maintenance projects when public funding is not available. https://www.nationalparks.org/about-foundation.
(home of the NBA Nets and the NHL Islanders); both naming rights agreements are reported to include payments of over $20 million annually during the twenty-year deals.\textsuperscript{45} Naming rights have also been sold/leased for publicly owned transit stations in Philadelphia and Las Vegas and have been considered for transit facilities in New York, Boston, and San Francisco.\textsuperscript{46}

In 2016, it was estimated that the Barclays Center drew two million visitors annually to its various professional sports contests, concerts, and other special events.\textsuperscript{47} Compare that to the Statue of Liberty stabilized attendance estimate of 4.35 million visitors, and it is clear that any “naming” or branding rights for the Statue of Liberty could command substantially more than the $20 million per year Barclays paid for the naming rights to the Barclays Center.\textsuperscript{48} A naming rights value of $40 million per year for the Statue of Liberty would be comparable to the largest naming rights deal ever signed, in which the Scotiabank paid $800 million as part of a twenty-year deal for the naming rights to the Toronto venue where the Toronto Maple Leafs and Toronto Raptors play.\textsuperscript{49} Deducting a 7\% management fee and capitalizing the net ($38.8 million) at the 2.21\% rate for twenty-year Treasuries,\textsuperscript{50} the value of the naming rights for the Statue of Liberty would be $1.75 billion.

These types of branding and sponsorship partnerships of national parks have come under some criticism.\textsuperscript{51} A US General Accountability Office (GAO) report discussed concerns by some members of Congress that potential corporate donors would have “undue influence over agency priorities” and the prospect of too much commercialization of the national parks.\textsuperscript{52} Another concern was ensuring sufficient ongoing maintenance and operational funding for any major construction initiatives that might be part of corporate partnering. Because of these types of concerns, it is likely that the only politically possible branding of the Statue of Liberty would be a cooperative partnership of limited scope and through an organization, similar to the sponsorship the National Park Foundation used in the Budweiser concert promotion.\textsuperscript{53} An ongoing program with an annual average sponsorship cost of $2.5 million might be more politically possible. Again, after deducting a 7\% management fee, the net annual income of such a twenty-year commitment at
the 2.21% rate for twenty-year Treasuries would have a “value” of $105.2 million.

The types of studies done by the NPS and the Chamber of Commerce of Monza and Brianza concerning the broader economic value of iconic landmarks can be analyzed in detail to determine the additional components of “historic value” or “public interest value.” For example, if the NPS is correct that visitors to the Statue of Liberty supported an additional indirect expenditure of $155.4 million in regional labor income, then the average salary and federal, state, and local income taxes generated by that indirect labor expenditure could be capitalized and added to create a larger picture of the total “public interest value” of the Statue of Liberty.

Final Analysis

This article has explored the concepts of “historic value” and “public interest value” as they might be used to understand the “value” of iconic landmarks such as the Eiffel Tower, the Statue of Liberty, and other similar national symbols around the globe. The question of whether there is such a thing as “historic value” or “public interest value” has caused significant debate within the real estate appraisal and valuation profession for decades. One consensus is that such values need to be measured for such national symbols in terms of their economic rather than noneconomic use.

In addressing those issues, this two-part article addressed the following questions:

• What is the difference between “public value” and market value, and how does that difference affect the valuation assignment and the resulting value conclusion?

• What are the appropriate techniques for analyzing the value of iconic special-purpose properties such as publicly owned landmarks?

• How can the real estate value be extrapolated from the business value or investment value of iconic properties?

Both the Statue of Liberty and the Eiffel Tower are special-purpose properties given their specialized design, construction for a specialized use, and uniqueness. There are no comparable sales that can provide insight into their value, and they have limited utility for conversion to alternative uses.

For special-purpose properties, some variation of the cost approach is typically used. But how can cost approach techniques reliably be undertaken for these two iconic landmarks originally constructed in the 1870s and 1880s? Inflating the original construction cost and using that as the basis for calculating undepreciated reproduction cost today are techniques that can be applied to both the Statue of Liberty and the Eiffel Tower. The cost of construction of replicas of the Eiffel Tower can also be consulted, but none of the replicas is true to the original scale or construction materials and techniques used in the nineteenth century.

Another difficulty in applying the cost approach appropriately is estimating the value of the land underlying the landmarks. In the analysis presented, the appropriate percentage of gross revenues that could be viewed as land rent was capitalized and the result added to the depreciated value of the improvements to arrive at a final cost approach to value for both iconic landmarks.

Variations on the income approach to value can also be attempted. The revenues to the City of Paris from its operating agreement with SETE were analyzed, and the concession revenues to the NPS from the latest concession agreements for the Statue of Liberty were also analyzed. Analysis of SETE’s operating agreement with the City of Paris seems to arrive at a net operating income (after deducting a reasonable annual maintenance cost, management fee, and reserve for replacement) for the Eiffel Tower.

Deriving a net operating income to the NPS from the Statue of Liberty is problematic, however. According to one measure, the additional operating costs to the NPS for National Park Service Rangers and other employees equal or exceed annual concession revenues. Based on operating margins at other heritage sites and in the hospitality industry, it is possible to estimate a more appropriate operating expense ratio for the Statue of Liberty. Also to be considered in an income approach, however, are the annualized revenues that the NPS indirectly receives through its affiliated nonprofit support groups such as the National Park Foundation, which raises additional funds for the Statue of Liberty through activities such as sponsored concerts or other branded events.

Based on these considerations, the final comparison of the results of the cost approaches and income approaches for the two iconic properties can be summarized as follows.
Reconciling each of the approaches by giving equal weight to each, the indications of “investment value” by those approaches to value would be as follows:

<table>
<thead>
<tr>
<th>Eiffel Tower and Statue of Liberty: Investment Value (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Statue of Liberty</strong></td>
</tr>
<tr>
<td>Cost Approach: Land &amp; Improvements</td>
</tr>
<tr>
<td>Income Approach: Concession Revenue</td>
</tr>
<tr>
<td>Plus: Value of Additional Branding &amp; Marketing Opportunity</td>
</tr>
<tr>
<td><strong>Income Approach Total</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Eiffel Tower</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost Approach: Land &amp; Improvements</td>
</tr>
<tr>
<td>Income Approach</td>
</tr>
<tr>
<td>Plus: Additional Branding &amp; Marketing Opportunity</td>
</tr>
<tr>
<td><strong>Income Approach Total</strong></td>
</tr>
</tbody>
</table>

But can we arrive at an estimate of market value as conventionally defined for each of those icons? To do so would require us first to determine if the various admission prices and food, beverage and retail prices at each site are based on a market rate. At the Eiffel Tower, it appears SETE has the freedom to set its prices at a market-supported rate so its charges may already reflect market rates. The same is not true at the Statue of Liberty. The NPS reviews and approves prices charged by its concessioners and only allows price increases based on inflation rates. Its goal is not to set prices to market but to establish prices that are fair to both the concessioner and to the general public. As a result, the ferry ticket/admission prices in the 2019 concession prospectuses were not set at a level that would maximize gross revenue. The Statue of Liberty admission price established for 2021 is significantly lower than admission prices at many other New York City tourism attractions as indicated in Exhibit 6.

Based on the fee comparison in Exhibit 6, Statue of Liberty admission prices are substantially below market, especially given the daily limit on the number of admissions imposed by the Park Service. The NPS 2019 prospectus forecasts the average “transportation revenue” per passenger in 2021 to be $13.50 to $14.00 per visitor. Given the competition, 2021 rates free from NPS price control could be set at $40.00 for adults,
### Exhibit 6  Admission Fees for New York City Attractions

<table>
<thead>
<tr>
<th>New York City Attraction</th>
<th>Type of Ticket</th>
<th>Admission Fee (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Statue of Liberty</strong></td>
<td>Reserve/Pedestal/Crown 2021</td>
<td>Adult: 16.00 Senior: 10.00 Child: 5.00</td>
</tr>
<tr>
<td></td>
<td>Reserve/Pedestal/Crown 2022</td>
<td>Adult: 17.00 Senior: 10.00 Child: 5.00</td>
</tr>
<tr>
<td></td>
<td>Reserve/Pedestal/Crown 2023</td>
<td>Adult: 18.00 Senior: 10.00 Child: 5.00</td>
</tr>
<tr>
<td></td>
<td>Reserve/Pedestal/Crown 2024</td>
<td>Adult: 19.00 Senior: 10.00 Child: 5.00</td>
</tr>
<tr>
<td></td>
<td>Reserve/Pedestal/Crown 2025 to 2027</td>
<td>Adult: 20.00 Senior: 10.00 Child: 5.00</td>
</tr>
<tr>
<td></td>
<td>Reserve/Pedestal/Crown Post-2027</td>
<td>Increased at NYC CPI every 3 years</td>
</tr>
<tr>
<td><strong>September 11 Memorial</strong></td>
<td>Standard</td>
<td>Adult: 24.00 Senior: 18.00 Child: 15.00</td>
</tr>
<tr>
<td><strong>Metropolitan Museum of Art</strong></td>
<td>Standard</td>
<td>Adult: 25.00 Senior: 17.00 Student: 12.00 Child: Free Patron: Free</td>
</tr>
<tr>
<td><strong>Museum of Modern Art</strong></td>
<td>Standard</td>
<td>Adult: 25.00 Senior: 18.00 Student: 14.00 Child: Free Member: Free</td>
</tr>
<tr>
<td><strong>NBC Rockefeller Center</strong></td>
<td>Standard Tour</td>
<td>Adult: 33.00 Senior: 29.00 Child: 29.00</td>
</tr>
<tr>
<td></td>
<td>Top of the Rock Observatory</td>
<td>Adult: 38.00 Senior: 36.00 Child: 32.00</td>
</tr>
<tr>
<td></td>
<td>VIP Access to Observatory (No Line &amp; 20% Off Merchandise)</td>
<td>75.00</td>
</tr>
<tr>
<td><strong>Empire State Building</strong></td>
<td>Standard (86th Floor Observation Deck plus 2nd Floor Museum)</td>
<td>Adult: 42.00 Senior: 40.00 Child: 36.00</td>
</tr>
<tr>
<td></td>
<td>Skip-the-Lines</td>
<td>78.00</td>
</tr>
<tr>
<td></td>
<td>Guided Tour (90 minutes)</td>
<td>161.55</td>
</tr>
<tr>
<td></td>
<td>All Access Tour</td>
<td>460.00</td>
</tr>
<tr>
<td><strong>Yankee Stadium</strong>*</td>
<td>Non-Premium Ticket</td>
<td>47.62</td>
</tr>
<tr>
<td></td>
<td>Premium Ticket</td>
<td>Up to 350.00 average</td>
</tr>
</tbody>
</table>

$30.00 for seniors, and $25.00 for children without significantly affecting total visitor numbers. That could result in an increase in stabilized revenues of 80%, indicating an average revenue of $24.75 per visitor. If there was no increase in the forecasted food service and retail sales prices, the market value based on an income approach with market rates would be calculated as follows:

<table>
<thead>
<tr>
<th>Statue of Liberty Market Rate: Outsourced Stabilized Annual Income &amp; Capitalized Value (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>2021 Gross Receipts: ferry service, tour tickets</strong></td>
</tr>
<tr>
<td>Annual Franchise Fee (32.9%) (rounded)</td>
</tr>
<tr>
<td><strong>2021 Gross Receipts: food service, retail sales</strong></td>
</tr>
<tr>
<td>Annual Franchise Fee (22.0%) (rounded)</td>
</tr>
<tr>
<td><strong>Total 2021 Franchise Fees</strong></td>
</tr>
<tr>
<td>Less: Operating Costs, Management Fee, Reserve for Replacement (80%)</td>
</tr>
<tr>
<td><strong>Net Income to National Park Service from Concessions</strong></td>
</tr>
<tr>
<td>Capitalization Rate</td>
</tr>
<tr>
<td>Capitalized Value: Concession Opportunity</td>
</tr>
<tr>
<td>Rounded to</td>
</tr>
<tr>
<td>Plus: Capitalized Value of Branding &amp; Marketing Opportunity</td>
</tr>
<tr>
<td><strong>Total Capitalized Value</strong></td>
</tr>
<tr>
<td>Rounded to</td>
</tr>
</tbody>
</table>

But even that is not truly the “market value” because the Statue of Liberty value is still being measured as in the hands of the NPS rather than if sold and in the hands of a private operator. Such a sale would be based on what a private operator could generate in total revenues, less operating expenses. There would be no concession payments to the NPS after the sale, but the owner would have to operate the ferry service, food, beverage, and retail facilities, and pay all operating expenses. It can be assumed, however, that the government would impose some type of deed restriction on the branding/marketing of the Statue of Liberty to avoid the political and popular criticism that greeted the NPS’s proposal to significantly expand corporate branding at national parks. Perhaps a doubling of the annual marketing/corporate sponsorship revenue to $5 million could be accomplished without seriously commercializing the image of the Statue of Liberty. The operating expense ratio and net operating income ratio would be more in line with those from the hospitality and theme park industry. The management expense for the marketing/corporate sponsorship program could be reduced to 3.5%, which is more in line with private management expense ratios and could reduce the overall operating expense ratio to about 75%. However, the capitalization rate would be based on private-sector rates of return rather than government bond rates.

Based on the market-supported revenues, a 75% operating expense ratio, and an 8% capitalization rate, the market value of the Statue of Liberty would be as indicated below.

<table>
<thead>
<tr>
<th>Statue of Liberty Market Value: Stabilized Annual Income &amp; Capitalized Value (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>2021 Gross Receipts: ferry service, tour tickets</strong></td>
</tr>
<tr>
<td>Plus: <strong>2021 Gross Receipts: food service, retail sales</strong></td>
</tr>
<tr>
<td><strong>Total 2021 Admission &amp; Retail Revenues</strong></td>
</tr>
<tr>
<td>Less: Operating Costs, Management Fee, Reserve for Replacement (75%)</td>
</tr>
<tr>
<td><strong>Net Income from Operations</strong></td>
</tr>
<tr>
<td>Capitalization Rate</td>
</tr>
<tr>
<td><strong>Total Capitalized Value of Operations</strong></td>
</tr>
<tr>
<td>Plus: Capitalized Value of Branding &amp; Marketing Revenues</td>
</tr>
<tr>
<td><strong>Total Capitalized Value</strong></td>
</tr>
<tr>
<td>Rounded to</td>
</tr>
</tbody>
</table>

A supported market value of $545,000,000,000 for the Statue of Liberty is very close to the cost approach result of $550,695,000.

A similar analysis can be undertaken for the Eiffel Tower. SETE has more freedom than the concessioners at the Statue of Liberty to set admission and food and beverage prices, and it also has the ability to market the Eiffel Tower “brand” and image. However, as a quasi-government entity, it appears to have operating expenses that are out of line with private hospitality industry norms. An estimate of market value can be developed if the royalty payments are eliminated in the analysis, and the revenues and the stabilized visitor numbers are accepted as market supported. Operating expenses would need to be adjusted to be more in line with industry standards. Applying a private market capitalization rate, the market value of the Eiffel Tower would be calculated as shown below.

<table>
<thead>
<tr>
<th>Eiffel Tower Market Value:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Stabilized Annual Income &amp; Capitalized Value (US$)</strong></td>
<td></td>
</tr>
<tr>
<td>2020 Gross Receipts</td>
<td>95,293,000</td>
</tr>
<tr>
<td>Less: Operating Costs, Management Fee, &amp; Reserve for Replacement (75%)</td>
<td>71,470,000</td>
</tr>
<tr>
<td>Net Income from Operations</td>
<td>23,823,000</td>
</tr>
<tr>
<td>Capitalization Rate</td>
<td>8.0%</td>
</tr>
<tr>
<td><strong>Total Capitalized Value</strong></td>
<td><strong>$297,787,500</strong></td>
</tr>
<tr>
<td>Rounded to</td>
<td><strong>$300,000,000</strong></td>
</tr>
</tbody>
</table>

The comparison indicates that the market value of the Statue of Liberty by the income approach is significantly higher than the market value of the Eiffel Tower despite the fact that the tower draws substantially more visitors than the Statue of Liberty. But the results of the cost approach to value—another indication of market value—must also be considered. Including both the cost and income approaches to market value and giving equal weight to each, the comparative results would be as follows:

<table>
<thead>
<tr>
<th>Eiffel Tower and Statue of Liberty: Cost and Income Approaches to Market Value (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Eiffel Tower</strong></td>
</tr>
<tr>
<td>Cost Approach: Land &amp; Improvements</td>
</tr>
<tr>
<td>Income Approach: Market Rates on Expenses &amp; Capitalization</td>
</tr>
<tr>
<td><strong>Weighted Market Value</strong></td>
</tr>
<tr>
<td><strong>Statue of Liberty</strong></td>
</tr>
<tr>
<td>Cost Approach: Land &amp; Improvements</td>
</tr>
<tr>
<td>Income Approach: Market Rates on Revenues, Expenses &amp; Capitalization</td>
</tr>
<tr>
<td><strong>Weighted Market Value</strong></td>
</tr>
</tbody>
</table>

The final indicated market values are remarkably close.

The rest of the analysis focuses on additional sources of revenue to the units of government that own the Eiffel Tower and the Statue of Liberty. That analysis could be considered part of a calculation of the total “public interest value” of each landmark.

The various sources of revenue and their capitalized annual values at the government bond rates used in this analysis are summarized below.

<table>
<thead>
<tr>
<th>Statue of Liberty Public Interest Value (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capitalized Direct Investment Value</td>
</tr>
<tr>
<td>Capitalized Value of Employee Federal Income Taxes</td>
</tr>
<tr>
<td>Capitalized Value of New York &amp; New Jersey Sales Taxes</td>
</tr>
<tr>
<td>Capitalized Value of FICA &amp; Federal Unemployment Insurance Taxes</td>
</tr>
<tr>
<td><strong>Total Capitalized Public Interest Value from Operations</strong></td>
</tr>
<tr>
<td>Rounded to</td>
</tr>
</tbody>
</table>

The above estimate does not include all aspects of “public interest value,” such as the capitalized value of state income tax payments in New York and New Jersey by employees or the indirect income and sales taxes by goods and services supplied to the NPS and the concession operators. It
also does not take into account the various indirect tax revenues generated by visitors who come to New York City for the sole purpose of visiting the Statue of Liberty and the tourists’ expenditures (in sales and other taxes) on hotel stays, food and beverage, and souvenirs.

A similar partial picture of the public interest value of the Eiffel Tower can be constructed based on directly generated revenues and taxes as shown below.

<table>
<thead>
<tr>
<th>Eiffel Tower Public Interest Value (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capitalized Direct Investment Value</td>
</tr>
<tr>
<td>Capitalized Value of SETE French Income Taxes</td>
</tr>
<tr>
<td>Capitalized Value of Value Added Tax (VAT)</td>
</tr>
<tr>
<td>Capitalized Value of French Payroll Tax</td>
</tr>
<tr>
<td>Total Capitalized Public Interest Value from Operations</td>
</tr>
<tr>
<td>Rounded to</td>
</tr>
</tbody>
</table>

But as indicated in the analysis of the VAT at the Eiffel Tower, that tax is included in the cost of admission, food and beverage, and retail sales. If the concession fee paid by SETE is based on total revenues including the VAT, then a deduction must be made since some of the capitalized value of the VAT has already been incorporated in the capitalized value of the concession revenues paid to the City of Paris.

Is it appropriate to deduct operating expenses from revenues generated at the Eiffel Tower and the Statue of Liberty? Since the entities operating both icons are essentially government agencies, all of the revenues generated accrue to the public treasury even if the revenues are then spent on government employees and operating costs. The capitalized value of the $102.517 million stabilized gross receipts at the Statue of Liberty would be $6.05 billion. At the Eiffel Tower, the capitalized value of the €87,425,000 annual receipts would be €7.04 billion, equivalent to $7.67 billion.

Based on this analysis, the final calculation of the public interest value of each icon would be as follows:

<table>
<thead>
<tr>
<th>Statue of Liberty Final Public Interest Value Calculation (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capitalized Value of Gross Receipts</td>
</tr>
<tr>
<td>Capitalized Value of Employee Federal Income Taxes</td>
</tr>
<tr>
<td>Capitalized Value of New York &amp; New Jersey Sales Taxes</td>
</tr>
<tr>
<td>Capitalized Value of FICA &amp; Federal Unemployment Insurance Taxes</td>
</tr>
<tr>
<td>Total Capitalized Public Interest Value from Operations</td>
</tr>
<tr>
<td>Rounded to</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Eiffel Tower Final Public Interest Value Calculation (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capitalized Value of Gross Receipts</td>
</tr>
<tr>
<td>Capitalized Value of SETE French Income Taxes</td>
</tr>
<tr>
<td>Capitalized Value of Value Added Tax (VAT)</td>
</tr>
<tr>
<td>Capitalized Value of French Payroll Tax</td>
</tr>
<tr>
<td>Total Capitalized Public Interest Value from Operations</td>
</tr>
<tr>
<td>Rounded to</td>
</tr>
</tbody>
</table>

The public interest value of the Eiffel Tower is approximately 23.4% higher than that of the Statue of Liberty.

Finally, in an age of tourism uncertainties caused by terrorism, pandemics, and other factors, one consideration is whether a stabilized amount should be deducted for external obsolescence, also referred to as economic obsolescence. The Dictionary of Real Estate Appraisal defines external obsolescence as “a type of depreciation; a diminution in value caused by negative external influences and generally incurable on the part of the owner, landlord, or tenant. The external influence may

59. As indicated in Part 1, SETE is a public company owned 99% by the City of Paris, with the remaining 1% owned by the Métropole du Grand Paris.
be either temporary or permanent.”\footnote{The Dictionary of Real Estate Appraisal, 6th ed., s.v. “external obsolescence.”} The cost of the extra security to guard against terror attacks is an example of such an external factor, as is the loss in revenues due to temporary closings.\footnote{For example, both landmarks experienced closures due to COVID-19. The Eiffel Tower closed following the “yellow vest” protests in 2018 and 2019. The Statue of Liberty closed in the wake of the 9/11 terrorist attacks.}

In an age when terrorists target national cultural heritage sites, there are extra security costs that create external obsolescence. These costs need to be considered before arriving at an accurate picture of the net public interest value. Approximately $40 million of the $321 million improvement project at the Eiffel Tower was devoted to improving security by constructing a ten-foot high, two-inch thick bulletproof glass wall around the Eiffel Tower.\footnote{Sasha Ingber, “Eiffel Tower Now Has Bulletproof Glass Walls to Protect against Terror Attacks,” NPR, June 15, 2018, https://n.pr/2ZeddKk.}

In the wake of the 2015 terrorist attacks in France, regular French troops were called in to provide security at many iconic tourism sites in Paris, including the Louvre and the Eiffel Tower, at an estimated cost of about one million euros per day.\footnote{James McAuley, “In France, Are Soldiers Outside the Louvre and the Eiffel Tower Really Worth It?” Washington Post, June 4, 2016.}

One potential approach could be to calculate an external obsolescence factor after consideration of the decrease in visitors and revenues during years when terrorist attacks occur to arrive at an average visitor and revenue number over a ten-year period. This might be the equivalent of a “vacancy rate” applied to the typical income-producing property. An additional amount could be added to the appropriate Eiffel Tower average visitor number to account for the effect of strikes and protests on revenues. To some extent, this has already been done in the calculation of stabilized visitor levels at the Eiffel Tower. As an alternative, the capitalization rate could be adjusted to reflect the additional risk associated with public revenues generated by cultural icon tourism. Terrorism and public protests will continue to affect the revenues and value of iconic landmarks and merit additional attention in addressing appropriate rates of return on publicly owned landmarks.

It is more difficult to account for the impact of pandemic-type events on international tourism. The effect of COVID-19 on the world economy is unprecedented. The length of time it will take for the tourism industry and visitor numbers at iconic sites to return to their previous levels is unknown. Travel-related risks and the risk that governments in the future will close borders cannot be forecasted. As a result, adding a “vacancy factor” or a “risk factor” to capitalization rates based on consideration of health issues is not yet supportable based on past economic behavior.

### Conclusion

This article has been designed only as an exercise in analyzing various approaches to the value or “worth” of two iconic landmarks—the Eiffel Tower and the Statue of Liberty. The discussion presents just one process for understanding the difference between market value and “public interest value” using traditional economic and real estate valuation tools and measuring those amounts. As a result, the article only partially answers the questions raised in its introduction. Some would argue that the true cultural “worth” to France and the United States, respectively, of the Eiffel Tower and the Statue of Liberty can only be measured in noneconomic terms.
About the Authors

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Additional Resources

Suggested by the Y. T. and Louise Lee Lum Library

Appraisal Institute

• Lum Library, Knowledge Base [Login required]
  • Business Valuation
  • Public lands
  • Special use properties/sports, recreation, and entertainment/parks

• Publications
  • Valuing Conservation and Historic Preservation Easements

Federal Reserve Bank of St. Louis Economic Research (FRED)—COVID-19 Research Resources

https://research.stlouisfed.org/resources/covid-19/
Timing Is Everything: The Role of Interim Use in the Highest and Best Use Conclusion

by David C. Lennhoff, MAI, SRA, AI-GRS, and Richard L. Parli, MAI

Abstract
The purpose of this article is to propose the formal incorporation of the concept of **interim use** into the definition of **highest and best use**. It seems like an unnecessary task, but nowhere in the body of knowledge is the relationship expressed explicitly. This article discusses the reasons in support of the incorporation.

In the valuation of real estate, it is axiomatic that “you can’t get the value right if you get the highest and best use wrong.” This is true because it is the use that is valued. However, as the discussion will reveal, there is a lot more to highest and best use than the use.

Consider the following from an actual court case concerning an older, low-density retail center. The location was quasi-urban, in the path of high-density redevelopment spawned by recently improved rapid rail transportation. It was forecasted that it would be five years before redevelopment of the retail center would be feasible. The issue was the land’s highest and best use. The plaintiff claimed that the land’s highest and best use was its interim use, and the interim use should be the basis of the land’s market value. The defendant’s appraiser concluded that the land’s highest and best use was its use in five years—not the interim use. Who was right?

The answer to that question centers on the relationship of interim use to a property’s highest and best use and resolve any confusion about that relationship. In addition, two new definitions are proposed with the intent of clarifying the role of interim use in the valuation process.

Relationships of Interim Use and Highest and Best Use

Interim use is only an issue when development or redevelopment of a property is delayed due to legal, physical, or financial reasons. As with the opening anecdote, confusion can occur as to when a property’s highest and best use begins. Is it on the date of value, or is it on a future date when the actual development will occur?

The basic template for the definition of **highest and best use**, developed in the mid-1970s,\(^1\) is as follows:

The reasonably probable and legal use of vacant land or an improved property, which is physically possible, appropriately supported, financially feasible, and that results in the highest value. The four criteria the highest

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and best use must meet are legal permissibility, physical possibility, financial feasibility, and maximum productivity. Alternatively, the probable use of land or improved property—specific with respect to the user and timing of the use—that is adequately supported and results in the highest present value.² [Emphasis added.]

The definition requires three conclusions from a highest and best use analysis: the use, the timing of the use, and the most likely users of the property. The three requirements are interwoven and necessary for a clear understanding of the future use of a property. Together, the three conclusions define how a property achieves its maximum productivity. A specific use can be now or in the future and should be targeted to a particular segment of the market. Change one of these elements in a highest and best use conclusion and the productivity of a property necessarily changes. It is the analyst’s challenge to determine the combination that results in the highest property value as of the effective date of the appraisal.

Timing Is the Key Ingredient

Of the three highest and best use conclusions, timing of the use is arguably the most critical. No matter how productive a specific use is, if market characteristics dictate an extended delay in implementing that use, the use can become secondary in productivity. As The Appraisal of Real Estate states, “The timing of alternative uses is a key consideration in highest and best use analysis because highest and best use is subject to change.”³

The diagram in Exhibit 1 delineates the eight-step process for determining which use is a property’s highest and best use.⁴ The first six steps are a recitation of the six-step process of market analysis. Step 1 is a blend of the filtering necessary to determine those uses that qualify to be tested for financial feasibility. It is Steps 2–6 that determine if a use is currently financially feasible or can be forecast to become financially feasible in the predictable future. These uses are candidates for satisfying the maximally productive requirement of the analysis. The alternative use with the highest residual land value is deemed the property’s highest and best use.

In the eight-step highest and best use process, it is clear that the highest value of a property can be currently not legally permissible, not physically possible, and not financially feasible. The Appraisal of Real Estate notes that “holding a property for future use may produce a higher present value than current development of a different use on the property.”⁵

An example of a physical requirement preventing immediate development is the delayed arrival of public sewer; examples of a legal requirement include an expected change in zoning, subdivision approval, or the expiration of a lease. Once the delay is confirmed, the length of the delay is determined in Step 7 and the residual land value is treated as a reversion, discounted to present value over the holding period at an appropriate rate. This value becomes a candidate for satisfying the maximum productivity requirement. Alternative uses that are not currently ripe can be compared to those that are currently ripe using discounted cash flow analysis. The probable use with the highest present value becomes the highest and best use.

As such, a use that is delayed many years in the future can be a property’s highest and best use even though an alternative use is currently ripe for development. If this is the case—i.e., the maximally productive use is a delayed use—there is necessarily an interim use of the property, although that “use” may be simply to wait. Interim use is defined as “the temporary use to which a site or improved property is put until a different use becomes maximally productive.”⁶ An interim use always influences property value. That influence is not necessarily positive, however, as there can be carrying expenses associated with the property that may not be offset by actual income.

2. See discussion in The Appraisal of Real Estate, 15th ed., 306. The emphasized portion of the definition was added in 2004.
4. The Appraisal of Real Estate, 15th ed., 318. The eight-step process has long been taught in Appraisal Institute courses, but it has been clarified and emphasized in the fifteenth edition of The Appraisal of Real Estate.
Application of the Current Methodology

In a highest and best use analysis there is usually at least one use that is not subject to an unusual delay in development. If there is also a competitive, reasonably probable use that is forecasted to be delayed, its net income (income less expenses) would be discounted to present value. Again, the use that produces the highest value, regardless of timing, wins the honor of being the highest and best use. A simple example, paraphrased from the Appraisal Institute’s Advanced Market Analysis and Highest and Best Use course, is helpful in illustrating this concept. Suppose a site has two possible uses that meet the physically possible and legally permissible requirements. The first, a single-family parcel, is currently feasible and has a value to an end user of $3.50 per square foot. The second use, townhouses, is not yet financially feasible but is forecast to be in three years, at which time it will have an end-user value of $6.00 per square foot. If the discount rate that properly reflects the speculative investor’s perception of risk and reward is 13%, what is the highest and best use? The answer is townhouses...even though they are not currently financially feasible. This is because the present value of waiting three years for the $6.00 price, at 13%, is still higher than the currently feasible single-family unit price at $3.50. To reiterate, this conclusion holds regardless of the cause of the delay.

A highest and best use determination is nearly always a math problem—implicit for non-income-producing properties and explicit for income-producing properties (simply by the nature of comparison of relative values). If a use is delayed, the problems become more mathematical since it necessarily includes discounted cash flow analysis. The Appraisal of Real Estate states, “Alternative uses that are

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7. An end-user sale is differentiated from a sale to a speculative investor in that the former involves a buyer who intends to occupy and use the land for his or her own purposes, while the latter involves the purchase of the real property as an investment to be held with the hope of selling it at a profit in the future; see Appraisal Institute course Advanced Market Analysis and Highest and Best Use, Part 2-50.
currently financially feasible and those that are forecast to be financially feasible can be compared with discounted cash flow analysis.\(^8\) The discounted cash flow process applied in the highest and best use analysis is similar to that applied in the valuation of a property whose development is delayed.

**Problems with Current Methodology**

The current methodology is clear in two main areas: highest and best use is based on market analysis, and market value is based on highest and best use. An interim use is just one of many uses considered in the eight steps. The resulting highest and best use could be an interim use for a certain number of years, and it could change to a higher use at the end of that period.\(^9\)

The concept of interim use rests on the definition of temporary. An interim use is often referred to as a *transitional use*,\(^10\) but the meaning is the same—a use that will eventually be supplanted by a higher and better use. When this change will occur is left for the analyst to discern—almost always by using marketability analysis (recommended but not required). The problem with this is the arbitrary nature of the decision; the future highest and best use must “be predictable with a reasonable degree of reliability.”\(^11\) This has persisted as a bone of contention in the concept of interim use for many years. For example, in 1973, Sando opined that “transitional use has a foreseeable termination, usually in from one to five years, and certainly not more than 10 years. A highest and best use concept deferred beyond that period might bring too speculative and remote uses into consideration.”\(^12\) Eaton, to a certain extent, agreed. He states,

> to estimate an interim use period longer than five years can be considered speculation and conjecture…If the amount of time between the effective date of the appraisal and the time when the property is expected to reach its ultimate highest and best use is too great, the appraiser’s conclusion of highest and best use becomes remote and speculative and will be rejected by the courts.”\(^13\)

The obvious question then is, what is magical about five years and where does that length of time come from?

The definition of *interim* use provides no guidance in determining whether an existing use is interim or the actual highest and best use. For example, one classic interim use of vacant land is as a surface parking lot within a central business district. This use can provide significant income and is typically seen as a placeholder or “taxpayer” until the land can be put to a more productive use. In fact, a well-managed central business district parking lot is an income-producing property that provides a return to the land that can be greater than any other use at that time.

The problem is in determining the “if and when” a more productive use will become available. If that time is forecast to be ten years, is a parking lot really an interim use? What about fifteen years? What about an uncertain time period caused by a national financial collapse or an economic collapse caused by a pandemic? The point is that any of those situations can cause a use to qualify for an interim or a highest and best use. The answer is found in market expectations. Would the typical market participant purchase a property with a ten-year hold based on its current condition, or would that purchaser base a purchase decision on the value of the property ten years in the future? Stated differently, if the buyer is willing to pay more for the property than its current use alone can support because of its upside potential, then the current use is best classified as interim.

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9. Appraisal Institute course Advanced Market Analysis and Highest and Best Use.
Complicating acceptance of the current definition is the fact that virtually all uses are temporary. All land that legally and physically can be developed may eventually be developed; nearly all improved property is destined to be redeveloped. The question essentially comes down to how to determine the demarcation between an interim use and a highest and best use. In other words, when does an interim use become the highest and best use, and when is the current use simply interim? The questions go to the heart of the timing issue, and the answers are found in market data and market analysis. Financial feasibility of an alternative use can be sensitive to market acceptance of the alternative use. The Appraisal of Real Estate notes that “the timing of alternative uses is a consideration in the conclusion of highest and best use because highest and best use is subject to change.”14

An interim use “may have value to the property user” because the interim use generates income that covers costs related to the property.15 This value to the property user is investment value and must be distinguished from the property’s market value.16 Would a typical market participant credit the benefits/expenses to the real estate, and would those market participants limit the benefits to only offsetting carrying costs and demolition expenses? This may be a point of price negotiation, but it seems unlikely that a typical seller would discount such a benefit, no matter how much involvement is required of the user.

An example can demonstrate the dilemma. Suppose two uses for an urban parcel of land have been determined to be reasonably probable and both are legally permissible and physically possible. Market analysis has determined that apartment development is currently financially feasible; office development is forecast not to be financially feasible for five years. The current use of the property is for surface commercial parking.17 The following table shows the various inputs in the use analysis.

<table>
<thead>
<tr>
<th>Category</th>
<th>Apartment Use</th>
<th>Office Use</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property land size (sf)</td>
<td>100,000</td>
<td>100,000</td>
</tr>
<tr>
<td>Most recent user price per sq. ft.</td>
<td>$20</td>
<td>$45</td>
</tr>
<tr>
<td>Indicated user value</td>
<td>$2,000,000</td>
<td>$4,500,000</td>
</tr>
<tr>
<td>Holding period (yrs)</td>
<td>0</td>
<td>5</td>
</tr>
<tr>
<td>Discount rate</td>
<td>—</td>
<td>20%</td>
</tr>
<tr>
<td>Indicated value disregarding interim use</td>
<td>$2,000,000</td>
<td>$1,808,449</td>
</tr>
<tr>
<td>Interim use NOI/Yr</td>
<td>0</td>
<td>$100,000</td>
</tr>
<tr>
<td>Present value of interim use</td>
<td>0</td>
<td>$299,061</td>
</tr>
<tr>
<td>Indicated value including interim use</td>
<td>$2,000,000</td>
<td>$2,107,510</td>
</tr>
</tbody>
</table>

Without consideration of the present value of the interim use ($299,061), the analyst would conclude the land’s highest and best use to be apartment use: $2,000,000 compared to $1,808,449 for future office use. But with consideration of the contributory value of the interim use, the highest and best use is office use ($2,107,510). This would indicate that the land should be valued as office land with a five-year delay in development, with a future value of $4,500,000. Limiting the contribution of the interim use would yield an erroneous result. That is, by restricting the utility of the interim use, the current value of the property would be $1,808,449, which is less than the current value of the land as an apartment site. The use in highest and best use is the use that creates the highest land value. The principle of consistency dictates that land cannot be valued for one use while the improvements are valued for another. By extension, it is inconsistent to identify interim use as a contribution to property value in one section of an appraisal and dismiss it in another.

16. There are numerous references in the literature related to defray-the-costs conditions, but these predate the publication of the 15th edition of The Appraisal of Real Estate. See, for example, David M. Champagne, “Interim Highest and Best Use: Condemnation Appraising,” The Appraisal Journal (January 2001): 19–25; and Galleshaw, “Evaluating Interim Uses.”
17. Parking lots can present issues relative to business versus real estate income. See, for example, Barry A. Diskin and David C. Lennhoff, “They Paved Paradise: Appraising a Parking Lot,” The Appraisal Journal (Spring 2020): 126–139.
Timing Is Everything: The Role of Interim Use in the Highest and Best Use Conclusion

Solutions to the Current Methodology

In the example, the confusion extends to the application of the methodology. Who would be the knowledgeable buyer of this land, and how would the land be priced? If the land is marketed to an office user, then a prudent and knowledgeable seller would demand compensation for the potential income of the interim use. The interim use should be integral to both the determination of the land's highest and best use and to the determination of the land's value. This would rectify any consistency problem as well as recognize that what is being concluded and what is being valued is a property with mixed uses.

There is no controversy regarding a highest and best use conclusion that is mixed-use. “Highest and best use often comprises more than one use for a parcel of land or an improved property.” There also is no controversy on how to value a mixed-use property. “If the highest and best use of a property is for more than one use on the same parcel or in the same building, the appraiser must analyze the contributory value of each use.”

Continuing with the apartment/office example, if it is accepted that the highest and best use of the land is for future office development, which requires the consideration of the interim use, the interim use value is de facto contributory value. Consequently, interim use converts a single-use conclusion to a mixed-use highest and best use conclusion—one that is based entirely on the timing of the mixed uses.

Most mixed-use conclusions are not only a mix of uses but also a mix of timing for the uses. Although not occupying the same space, the uses often occupy different points in time. For example, a mixed-use highest and best use conclusion might be expressed as follows: the front two acres developed immediately with retail, the rear two acres with office sometime in the identifiable future. In this example, there could be a third use, an interim use, associated with the land identified for future office development. Highest and best use is one conclusion, but that conclusion can incorporate more than one use and more than one timing. This is not a novel viewpoint. Eaton noted that “one property may, in effect, have two highest and best uses—one for a relatively short period and one as a deferred highest and best use.” Eaton’s position is consistent with an earlier understanding of interim use, which held that “interim uses are current highest and best uses that are likely to change in a relatively short time.” The Appraisal Institute text Real Property Valuation in Condemnation takes another view. It states, “A complete highest and best use conclusion must include an opinion as to the proper timing of the use. There are not two highest and best use conclusions. An interim use is not itself a highest and best use. Rather, an interim use is part of a highest and best use.” No explanation is given on how an interim use is integrated into a property’s highest and best use. However, this article proposes that the integration is so complete that interim use is equivalent to any other use identified in a highest and best use conclusion.

New Definitions Proposed

The relationship of interim use to highest and best use needs to be clarified. To help improve understanding of the relationship, the following definitions are proposed for interim use and mixed-use development.

Interim Use. A temporary use to which a property or portion of a property is put until a more intense future use of the same property is identified and supported by market data and market analysis. Interim uses contribute to highest and best use decisions as well as property value for a finite period of time.

The proposed definition is more flexible in describing what really constitutes an interim use. It retains the concept of the temporary nature of the use but also requires the timing of the use to be supported with a reasonable degree of certainty.

22. Appraisal Institute, Real Property Valuation in Condemnation (Chicago: Appraisal Institute, 2018), 83–84.
The acceptance of the above definition of interim use would not be that radical. The definition would simply dismiss the possibility that a highest and best use determination is fluid. If the uses of a site change over time, then the highest and best use is a mixture of uses, not a complete change of use. This recognition requires a new definition of mixed-use development.

**Mixed-Use Development.** A property that comprises multiple uses within a single site, characterized by the physical, function, and timing integration of its components.

Interim use should be treated the same as any other part of a mixed-use conclusion is treated—a different use with a different timing. The determination of the balance and contribution of the various uses in a project can be discovered through discounted cash flow analysis. The only twist is that there is a limited life to an interim use. But this is no different from the conclusion of a residential subdivision, which also has a limited life.

**Conclusions**

In practice, how would the new definitions be applied? Let's revisit the introductory courtroom drama. Although this case was settled with both sides claiming “satisfaction,” the issue would never have materialized had it not been for the ambiguity of the methodology. If the methodology had employed the two proposed definitions, the land rent at issue would be based on the total property value since the highest and best use would be a mixed-use development. The interim use would just be one of the two uses that combined to create a mixed-use project. Land value should not be based on the interim use alone nor the ultimate use alone. It is the combination of those uses that results in the property's highest and best use and the basis of value.

Under the two proposed definitions, the highest and best use conclusion of the introductory property could be expressed as follows:

Based on the marketability study conclusions, in our opinion, the highest and best use of the site is for development of a Class A, mid-rise apartment building by an end user, with development in five years following the operation and then demolition of the existing shopping center improvements.

A statement of this nature accepts that highest and best use can be dependent on the passage of time and the change of use over time. All appropriate uses are integrated into the conclusion, leaving no use as secondary and leaving no use as incidental.

When any use of a property is delayed, interim use becomes an issue. Interim use is a property characteristic that must be considered directly in a highest and best use conclusion when a use is delayed. Incorporating interim use into a highest and best use conclusion is no different than arriving at any other mixed-use conclusion. Consistency dictates that interim use be treated the same in the highest and best use conclusion and the valuation of a property. Recognizing that interim use is a component of a mixed-use development would result in such consistency.

SEE NEXT PAGE FOR ADDITIONAL RESOURCES >

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23. The process is demonstrated in the Appraisal Institute course *Advanced Market Analysis and Highest and Best Use*, Section 7.
Timing Is Everything: The Role of Interim Use in the Highest and Best Use Conclusion

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Additional Resources

Suggested by the Y. T. and Louise Lee Lum Library

Appraisal Institute

- Education
  http://www.appraisalinstitute.org/assets/1/7/aiedcat.pdf

- Guide Notes to the Standards of Professional Appraisal Practice
  https://www.appraisalinstitute.org/assets/1/7/AI_Guide_Notes.pdf

- Lum Library, Knowledge Base [Login required]
  Information Files—Value

- Property Rights Symposium Discussion Paper
Exploring Residential Property Dynamics: Commentary on Residential Property Appraisal

About This Column

Appraisers who value residential properties complete assignments in dynamic markets. This edition of Resource Center looks at Residential Property Appraisal, a resource that offers appraisers information and guidance on application of real property concepts in both typical and atypical residential assignments.

The newly published Residential Property Appraisal is an essential text for the residential appraiser, whether seasoned or novice. This is the most recent in the Appraisal Institute’s books of particular interest to residential appraisers. Its sixteen chapters cover the basics—addressing timeless topics with current applications. In addition, it covers subtopics such as specialty residential property types, green and high-performance houses, and specialty residential markets. The reader will find helpful supplementary information in a section on financial calculator basics and a bibliography for those interested in digging deeper.

The author, Mark R. Ratterman, MAI, SRA, is an outstanding communicator. He offers clear explanations of basics that even experienced appraisers can use for a refresher and that novices need for in-depth understanding and clarity. The writing is clear and to the point, with ample examples, illustrations, and resource citations. In addition, Sandra K. Adomatis, SRA, LEED Green Associate, and Maureen Sweeney, SRA, AI-RRS, contribute chapters on residential specialty segments as described below.

Residential Property Appraisal by Mark R. Ratterman, MAI, SRA

Price: $85 softcover or PDF
AI Price: $75

1. Other books include, but are not limited to, The Valuation of Condominiums, Cooperatives, and PUDs; Residential Green Valuation Tools; Appraising the Tough Ones: Creative Ways to Value Complex Residential Properties; Valuation by Comparison: Residential Analysis and Logic, 2nd ed.; Identifying Residential Architectural Styles; Using Residential Appraisal Report Forms: URAR, Form 2055, and the Market Conditions Form, 2nd ed.; and An Introduction to Green Homes. Of course, residential appraisers also rely on the Appraisal Institute’s texts The Appraisal of Real Estate and The Dictionary of Real Estate Appraisal.
**Chapter 1, “Real Property Ownership and Appraisals,”** introduces foundational concepts in real estate including the following:

- Forms of ownership
- Distinction between real property and real estate
- Personal property
- Tangible and intangible property
- Fixtures and trade fixtures
- Types of estates
- Eminent domain
- Powers of government
- Leasehold and leased fee interests
- Identification of property rights
- Condominiums and cooperatives
- Planned unit developments (PUDs)

The chapter also has excellent to-the-point discussions about contracts, leases, types of deeds, and options.

The second part of the chapter provides an overview of appraisal and appraisers. It explains what an appraisal is, why appraisals are needed, the valuation process and related services, and residential appraiser qualifications, including licensing, certification, designations, credentials, and competency.

**Chapter 2, “Principles of Value, Real Estate Economics, and Finance,”** takes a look at the concept of value and types of value; gross and net pricing; insurable value; and assessed value. Principles of real estate economics are clearly explained. Real estate markets are examined by property type, including their key characteristics, and the differences between neighborhoods, districts, and market areas are explained. The classic “four forces that influence value” are presented along with the significance of changes, trends, and cycles in real estate markets.

The second portion of the chapter gets into the financing side of residential real estate, with a look at the sources of mortgage money, the secondary mortgage market, and influences on the mortgage market. This discussion covers the federal reserve system, credit regulation, and the US Department of the Treasury. The chapter is rounded out with a discussion of the particulars of loan risk, points, financial trends, financing fraud, and financing plans and trends.

**Chapter 3, “The Valuation Process, Beginning the Appraisal, and Data Collection,”** offers a good in-depth overview of the approaches to value, which are more specifically addressed in later chapters. The text here starts with an effective discussion of the valuation process and a diagram of the steps involved. The author presents a thorough treatment of the important topics of scope of work, data collection, property description, site value, and data analysis. The text provides a practical look at elements of data analysis in the appraisal process—including market and neighborhood analysis and highest and best use analysis—with illustrative examples.

Chapter 3 concludes with a brief discussion of reconciliation and reporting the defined value, with more thorough examples left for later in the book. The real-world topics of scheduling and planning, collection of data on the subject property, property inspection, and collection of data on comparable properties also are discussed.

**Chapter 4, “Neighborhood and Market Area Analysis and Highest and Best Use,”** provides information about analysis of location. The distinction is made between a market study and a marketability study, and an explanation is given as to the questions each answers, the items included, and the use of each. The distinctions between neighborhood and market area are explained, and critical market area influences and trends are presented. The discussion addresses the following topics related to these concepts:
• **Social influences**, including population trends and characteristics, community and neighborhood organizations, and the need for understanding the quality of services, establishments, and neighborhood associations.

• **Economic influences**, including demographics about income and purchasing power, financing availability, real estate prices, rent levels, new construction, government services and tax influences, public and private restrictions, schools, and owner-occupancy rates.

• **Environmental influences (physical and geographic)**, including siting factors, flood zones, location as it relates to the overall community, transportation systems and linkages, recreation, amenities, soils, views, characteristics and conditions of residences, and adequacy of utilities. There is also discussion of the importance of consistency in markets and reporting neighborhood conclusions.

Highest and best use is the next main section of the chapter. Several commonly used highest and best use definitions are presented and discussed. This chapter offers a well-explained section on highest and best use of a site as though vacant and highest and best use of a property as improved. The concept of consistent use is addressed and analyzed. There is also a useful discussion of special situations in highest and best use analysis; it tackles the concepts of interim uses, legally non-conforming uses, excess and surplus land, and neighborhoods in transition. Examples are included throughout the discussion to augment definitions and concepts.

**Chapter 5, “Site Description,”** addresses what is needed for understanding of a site before its valuation. Topics covered here include

- legal and other descriptions;
- property rights involved;
- public and private limitations on ownership rights of the site (zoning, covenants and use restrictions, party-wall agreements);
- understanding physical characteristics of the site (immediate location characteristics, physical and economic linkages, environmental influences);
- tax and assessment information;
- real estate tax status (especially compared to similar properties);
- special assessments;
- government and private services and costs;
- explanations of the types of legal descriptions; and
- data sources for site information.

The chapter has a thorough discussion of each item, with illustrations, exhibits, and examples.

**Chapter 6, “Improvements Description,”** addresses the description of building improvements, from site placement and utility to construction materials and building systems features. The chapter discussion covers Fannie Mae quality of construction ratings and property condition ratings. Residential architecture and trends, types of houses, house living zones and condition are all in this chapter.

**Chapter 7, “Land and Site Valuation,”** delves into the difference between land and site. The text explores the notion of valuation of property rights to or in the physically described real estate; the principles of progression and regression; and the market forces that influence land value. The chapter allocates significant discussion to the valuation of land and site in the residential context. The major land and site valuation techniques are thoroughly discussed with clear explanations and examples of each. Emphasis is on the sales comparison method, with seventeen pages describing the technique and thor-
ough examples of research, comparison, and adjustments (both qualitative and quantitative), and applied conclusion.

Other land or site valuation techniques discussed include the allocation technique, extraction technique, income capitalization techniques (land residual and ground rent capitalization), and subdivision development analysis. When to use each of these land or site valuation methods is covered and examples are provided.

In Chapter 8, “The Cost Approach,” the application of this approach and its pros and cons are examined. The author breaks the cost approach into the following useful steps:

1. Develop an opinion of the market value of the site as though vacant.
2. Estimate direct and indirect construction costs of the improvements.
3. Estimate the entrepreneurial incentive required to bring the improvements into production.
4. Add direct costs, indirect costs, and entrepreneurial incentives.
5. Estimate improvements’ applicable depreciation from any cause.
6. Deduct the depreciation from all causes from the improvement cost estimate.
7. Estimate the contributory (net) value of the site improvements.
8. Add the site value to the depreciated cost of all improvements.

Other sections of interest examine the relationship of the cost approach to appraisal principles, the challenges of overimprovement and underimprovement, and the applicability of the cost approach. Cost-estimating methods are introduced with examples. The comparative unit method, unit-in-place method, and quantity survey method are also covered. Finally, this chapter offers a good introduction to depreciation, with details left to the next chapter.

Chapter 9, “Estimating Depreciation,” introduces the three types of depreciation—the market extraction method, age-life method, and breakdown method. There is a thorough explanation of each depreciation type, with helpful diagrams illustrating the relationship and major items in each method. The examples help improve the reader’s understanding and are valuable for both the student and experienced appraiser as a reference.

Chapter 10, “The Sales Comparison Approach,” gets into the basic steps of this approach and includes an example of a sales comparison adjustment grid. The discussion addresses real-world topics such as errors in data searches, strengths and limitations of the approach, and the research and selection of comparable sales. The latter section discusses how to identify comparable properties, the importance of field inspection (particularly when database information is insufficient), the importance of highest and best use, and verification of data—with key items to cover in the verification process. A brief section on “thinking of comparables as competitive properties” contains some particularly valuable practical points.

The process of making comparison adjustments is a significant part of this chapter. It addresses units of comparison, dollar versus percentage adjustments, sequence of adjustments, and paired-data analysis and its limitations. Qualitative analysis is also covered, including ranking. The chapter concludes with considerations in the final reconciliation of data, findings, and analysis in the sales comparison approach.

Chapter 11, “Adjusting Comparable Sales,” continues the discussion of the sales comparison approach and process. There is an overview of the concept of comparison adjustments and elements of comparison followed by a discussion of each of the following examples of elements of comparison:
• Real property rights conveyed
• Financing terms, concessions
• Conditions of sale
• Expenditures immediately after purchase
• Market conditions, date of sale
• Location
• Property interests
• Site size
• View amenity
• Improvement age
• Improvement condition
• Above-grade room count
• Above-grade gross living area
• Basement, finished area below grade
• Heating, cooling, energy-efficient items
• Garage, car storage
• Porches, patios, decks
• Intangible property, economic characteristics
• Zoning
• Personal property, nonrealty components

Of course, there may be subitems and other points for consideration depending on the comparable and appraised property characteristics. For example, in the section on rights conveyed, long-term leased land is addressed as well as differences in rights such as mineral rights, life estates, and negative easements. Under the section on financing terms and concessions, nonstandard or creative financing is discussed along with the possible impact on price of the comparable and need for comparison adjustments. Other financing arrangements, such as seller financing, non-cash considerations in a comparable transaction, and below-market rate financing, are covered with valuable examples.

The condition of sale element of comparison has good coverage in the chapter along with an example. The consideration of expenditures made immediately after purchase and market conditions/date of sale elements of comparison are discussed effectively. The location adjustment is well covered and addresses key practical points. For example, the discussion looks at whether location is in the site value or a separate adjustment for the total property sales comparison process. Ample examples are provided in this section and throughout the chapter.

Comparisons of improvement condition brings up some practical points useful to the practitioner, as does the discussion of above-grade and below-grade footage. As with other topics, the examples make the discussion practical and useful for understanding and reference.

Chapter 12, “The Income Capitalization Approach,” provides a good overview of the income capitalization approach for the residential appraiser, its research and data requirements, and applicability. This section includes the use of multipliers and the direct capitalization process as relates to the single-family residential property. This chapter has excellent discussions, and many examples, involving:
• the data collection and rent survey process,
• analysis of lease provisions,
• derivation of multipliers from the market (including the adjusting of comparable sales),
• reconciliation of the multiplier indications,
• estimating monthly rent (including adjusting market data),
• reconstructed operating statements,
• estimating operating expenses, and
• direct capitalization of a single year’s net income.

This chapter is a significant aid to understanding the income approach for single-unit residential property because of its clear writing, practicality, and helpful examples.

Chapter 13, “Final Reconciliation and the Appraisal Report,” covers a topic of importance for appraisal reports. The discussion in this chapter will help appraisers—even experienced practitioners—understand reconciliation and improve the appraisal process and their writing of the reconciliation part of their appraisal reports. Part
of reconciliation includes a self-review of the work done in the appraisal process through the approaches; to enhance this step the text includes a good self-review checklist. (Page 407)

The importance of addressing the appraisal question and any special situations is part of the self-review and reconciliation process. For example, the client may need a defined value for the property “as is” or “as if repaired,” or may want a list of needed repairs and estimated cost to complete, or may have stipulated specific requirements for the report’s content.

The chapter has a good discussion about the importance of reviewing for adequacy of data and analysis, consistency, math, and other such items. The author notes that discussion in the reconciliation section of the appraisal report should address the applicable approaches, quality and quantity of data available and used, the value indications, and the supported final value indication. As the author says, “Reconciliation is a process that is required in all appraisals. Reconcilation is necessary because value opinions are often based on imperfect data” and multiple value indications as well as special conditions or assumptions. (Page 422)

Examples of various commonly used form reports are included in the text, but the reader must remember that these change from time to time, so it is important to check current requirements of the client, regulators, and the secondary mortgage market.

Chapter 14, “Specialty Residential Property Types,” drills down into concerns regarding certain types of residential properties. This section, contributed by Maureen Sweeney, SRA, AI-RRS, addresses the specific situations and considerations for specialty property types, including condominiums, site condominiums, condo-hotels, cooperatives, planned unit developments (PUDs), and small income-producing residential properties.

The author points out several important details to keep in mind in valuing these special types of residential property. Awareness of the following basics will help keep the appraiser’s thinking and analysis process on track in these assignments:

- Buyers and sellers buy and sell real property (i.e., rights), not real estate.
- The address of a property is merely directions to the mail carrier—it does not describe the bundle of rights involved.
- *Condominium* is a generic term used to describe a property that is or is not attached to another unit and normally has a level of maintenance performed by a homeowners association (HOA).
- Condominium is also a legal term, specifically defined by the state jurisdiction in which it is located.
- PUDs are properties with ownership normally like most other types of real estate, with interests spatially defined by the legal description. PUDs normally have HOAs (community associations), and individual ownership carries both individual and joint property rights. (Pages 423–424)

The chapter has a thorough five-page overview of condominiums, condominium ownership, common elements, limited common elements (LCEs), site condominiums, and condo-hotels.

Cooperatives, their characteristics, valuation considerations, and a comparison of condominiums and cooperatives make up the next section. It addresses cooperative ownership and proprietary leases. The balance of the first part of the chapter is a discussion of PUDs, leasehold estates and ground (land) leases. Examples are included to increase the reader’s understanding.

The last ten pages of the chapter address the valuation of “small income-producing properties.” These include duplexes, triplexes, quads, two-flats, and three-flats. The author notes the importance of understanding the bundle of rights, and characteristics of the lease(s) in place for such properties. Also important is an understanding of the market norm for occupancy period; rent
amount; payment of utilities, insurance, and taxes; parking; concessions; termination terms; and tenant restrictions. The landlord and tenant obligations are among the points for appraisers to investigate—for the subject and comparable rentals alike. The distinction between market rent and contract rent is explained as well.

As the text explains, the capitalization technique most often used in the appraisal of small income-producing properties is direct capitalization. This topic is well covered and explained with good examples.

Chapter 15, “Green and High-Performance Homes,” was contributed by Sandra K. Adomatis, SRA, LEED Green Associate. The meaning of “green” and “high-performance” are discussed so the reader has an immediate basic understanding of the terms. The six elements of green building are listed and discussed individually:

- Site
- Water efficiency
- Energy efficiency
- Indoor air quality
- Materials
- Operations and maintenance

The energy efficiency section of this chapter explains energy ratings and rating systems and solar photovoltaics. The indoor air quality section addresses indoor pollutants. The materials section discusses quality and quantity of materials and the effect on the construction budget and building performance. Finally, the operations and maintenance section examines the importance of the truly green building ideally costing less to operate than a non-green building.

The chapter goes on to explain the “Residential Green and Energy Efficient Addendum” report form, and green verification programs, including:

- Energy Star,
- LEED,
- Living Building Challenge,
- National Green Building Standard,
- Pearl Certification, and
- Passive House.

Several green residential studies are shown for additional resources of information for appraisers. (Pages 459–460)

Chapter 16, “Specialty Residential Markets,” also contributed by Maureen Sweeney, SRA, AI-RRS, covers a number of useful topics:

- Senior housing
- Investor markets
- Bulk sales, which may involve a few residences or a portfolio of residences
- Multiple sales of similar units, such as developed residential lots, houses, and condominiums
- Foreclosure properties, including a financial institution’s real estate owned properties
- Homes in poor condition
- Relocation appraisals
- Rural markets

2. It is important for the appraiser to understand state landlord-tenant laws for residential property, especially for reported month-to-month rentals.

3. Gross rent multiplier analysis is also explained, with examples.

4. The Employee Relocation Real Estate Advisory Council uses the term anticipated sales price; its definition and components are explained in the text. The client for relocation appraisals has particular needs, one of which is a prospective opinion of value considering the client’s specified marketing period. Forecasting is in the definition of anticipated sales price, and thus involved in the appraisal process and appraisal report.
The discussion on specialty markets is significant. In these assignments, the appraiser needs to consider items, and even valuation techniques, that may differ considerably from the typical residential property appraisal. The author alerts appraisers to the special items calling for particular attention in each specialty category. Examples further enhance readers’ understanding.

The book’s regular chapters are supplemented by a five-page special section on Financial Calculator Basics, with emphasis on the classic workhorse, HP-12C calculator. This part of the book addresses the calculator’s mortgage and other financial functions and offers helpful hands-on examples. Also included are citations for additional resources.

Another helpful supplement follows: the Bibliography, which includes citations for a number of books on residential appraisal, including many with advice on completing residential forms and on valuing specialty residential property types and markets. The section “Publications about Appraisal Forms” points the residential appraiser to good online resources, including some resources for appraising green properties. The text concludes with a twelve-page Index to help the reader find specific topics and terms.

Recommendation. Valuers will find the Appraisal Institute’s new Residential Property Appraisal a helpful reference and guide. The text covers the basics and more. Written by residential experts, it provides a thorough overview of all aspects of residential appraisal as well as the issues that may be encountered. The general discussion leads the reader through the various steps in a valuation of residential property. This is supplemented by chapters on the specific considerations in valuation of green residential properties and specialty residential property types, such as condominiums. The clear writing and exhibits throughout aid in the reader’s understanding. Residential Property Appraisal is an essential text for residential appraisers, no matter what the level of experience.

About the Author

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If you know of additional resources of interest to real estate analysts and valuers—or would like to suggest topics for this column—please contact the author.
### Appendix  Terms and Concepts Defined in *Residential Property Appraisal*

| Actual age | Earnest money | Highest and best use |
| Ad valorem tax | Easement | Homeowners association |
| Anticipated sales price | Economic base | Improvements |
| Anticipation | Economic base analysis | Income capitalization approach |
| Appraisal | Economic life | Indirect costs |
| Approaches to value | Effective age | Inspection |
| Assessed value | Effective date | Installment contract |
| Assignment condition | Effective gross income multiplier | Insurable value |
| Assumption of mortgage | Effective purchasing power | Intended use |
| Automated valuation model | Elements of comparison | Intended user |
| Balloon payment | Eminent domain | Interim use |
| Bargain and sale deed | Entrepreneurial incentive | Jurisdictional exception |
| Basic industries | Entrepreneurial profit | Land |
| Bundle of rights theory | Equity | Lease |
| Buydown | Escheat | Leased fee interest |
| Capitalize, capitalization | Estate | Leasehold interest |
| Cash equivalency analysis | Excess land | Legal permissibility |
| Common elements | External obsolescence | Legally nonconforming use |
| Community associations | Fair housing laws | Limited common elements |
| Competition | Fannie Mae | Linkage |
| Conditional sales contract | Federal discount rate | Littoral rights |
| Condo hotel | Fee simple estate | Location |
| Condominium | Final reconciliation | Market area |
| Condominium ownership | Financial feasibility | Market rent |
| Consistent use | First mortgage | Market study |
| Contract | Fixture | Market value |
| Contract for deed | Forecasting | Marketability |
| Cooperative ownership | Form report | Master plan |
| Cost approach | Fraud | Maximum productivity |
| Creative financing | Freddie Mac | Mortgage |
| | Fully amortizing mortgage | Mortgage-backed securities |
| | Functional obsolescence | Mortgagor |
| | | Multiple listing |
| Date of opinion of value | General data | Neighborhood |
| Decline | General warranty deed | Neighborhood life cycle |
| Deed | Gentrification | |
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To the Editor

David Lennhoff, MAI, SRA, AI-GRS, and Richard Parli, MAI, address an important subject in “Revisiting Market Value and Market Rent” (Winter 2020), recognizing that the definitions we use are often taken for granted, and the importance of definitions is not sufficiently appreciated. Their article is directly related to my previous article on this topic, “Market Value: What Does It Really Mean?” published in the Summer 2018 edition of The Appraisal Journal.

While the article by Lennhoff and Parli addresses definitions of both market value and market rent, it focuses primarily on market value, which has a rich definitional history and has been the subject of debate for decades. Market rent, on the other hand, has had fairly superfluous treatment, with cursory one-sentence definitions in the 1975 and 1982 editions of Real Estate Appraisal Terminology, and similar treatment (using the alternative term economic rent) in the 1950 and 1962 editions of the American Institute of Real Estate Appraisers (AIREA) text Appraisal Terminology and Handbook. The current definition of market rent in the sixth edition of The Dictionary of Real Estate Appraisal is still one sentence, but with slightly more detail. The article’s authors note that the Appraisal Institute board of directors in February 2020 approved a new definition of market rent that more closely parallels the current lending definition of market value, and this definition has been incorporated in The Appraisal of Real Estate, fifteenth edition.

It is important to note that the article focuses primarily on the market value definition used for mortgage lending, formalized with the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, presently codified in Title 12 of the Code of Federal Regulations. This is readily acknowledged by the authors, who state, “While there are alternative definitions that are applicable to different situations [for example the Uniform Appraisal Standards for Federal Land Acquisitions definition], the discussion … focuses only on the one that incorporates ‘the most widely accepted components of market value.’” The problem, as addressed in my own article, is that there are a multitude of definitions of market value and fair market value, creating needless subjectivity and clear conflicts among the different definitions of this important term. Any effort to clarify the market value concept so it can be universally applied cannot ignore these other definitions that are used for a variety of purposes, including civil litigation, eminent domain, marital dissolution, property taxation and appeals, federal estate taxation, casualty losses, and financial reporting. While acknowledging that mortgage lending (and its corresponding value definition) comprises the lion’s share of appraisal assignments, the discussion at hand is incomplete without considering the sheer number of and significant differences among competing definitions of market value and fair market value, particularly if the authors wish to propose a single new definition to replace those in current use.

The historical perspective on the current market value definition is useful, but not complete, nor completely accurate. It is important to understand that our conceptual understanding of market value dates to the late 1800s, with the neoclassical economists (particularly Alfred Marshall) finally proposing a unified theory of value encompassing both the cost/supply side and the price/demand side (the supply/demand curve, equilibrium price, and perfectly competitive market). One of the first articulated definitions of market value is found in an early 1900s eminent domain case in California (Sacramento Southern Railroad v. Heilbron), and it is this defi-
nition that survived for decades, appearing with little change in the 1950 and 1962 editions of AIREA's Appraisal Terminology and Handbook.

In referencing the definition proposed by William Kinnard, in 1971 (which I wish I'd known of so I could have included it in my own article), the authors note that the contemporaneous sixth edition of The Appraisal of Real Estate did not offer a formal definition, but merely three ambiguous alternatives. The three alternatives are identical to those in the 1950 and 1962 editions of the Appraisal Terminology and Handbook, and treat the topic of market value in much the same fashion as the current sixth edition of The Dictionary of Real Estate Appraisal, presenting alternative definitions in contemporaneous use, without advocating for a single definition that would be appropriate in all circumstances.

The article states that the definition of market value in the 1975 edition of Real Estate Appraisal Terminology “has been carried forward, virtually untouched, as the current definition in The Dictionary of Real Estate Appraisal, sixth edition,” noting also that “although there are many current definitions of market value, most are quite similar [emphasis added].” Both statements are incorrect. The 1975 edition of Real Estate Appraisal Terminology defines market value as “the highest price,” while the referenced definition in the sixth edition of The Dictionary of Real Estate Appraisal defines market value as “the most probable price.”

This term makes the two definitions significantly different. It represents one of the key differences among current definitions of market value and fair market value—the value standard—whether it be highest price, most probable price, or price with no qualifier. The notion that current definitions of market value are quite similar is also dubious. The value standard regarding price (highest versus most probable versus no standard) is obviously one where current definitions diverge. The other concerns assumptions about the market where a hypothetical transaction is to take place:

- the relationship, knowledge, and motivation of the parties (buyer and seller);
- the terms of sale (cash, cash equivalent, or other terms); and
- the conditions of sale (exposure in a competitive market for a reasonable time prior to sale).

Examination of a sample of common market value definitions in current use illustrates the wide variation in normative conditions that attach to various market value definitions (see Exhibit 1 in “Market Value: What Does It Really Mean?”).

It is noteworthy that Kinnard's proposed definition as well as the one published in the 1975 edition of Real Estate Appraisal Terminology represents attempts to clarify a definition that has mutated and replicated numerous times over the years, much as the authors are attempting to bring clarity and consistency with their own proposed definition of market value. Richard Marchitelli and Peter Korpacz attempted to do the same with their proposed 1992 definition that used “likely” instead of “most probable,” and made few explicit assumptions about the market:

“The notion that current definitions of market value are quite similar is also dubious. The value standard regarding price (highest versus most probable versus no standard) is obviously one where current definitions diverge.”

The price in cash and/or other identified terms for which the specified real property interest is likely to sell as of the effective date of appraisal in the real estate marketplace under all conditions requisite to a fair sale.
The article by Lennhoff and Parli identifies additional deficiencies in the current definition of *market value* relative to timing, financing, exposure time, and undue duress. With respect to financing and exposure time, one or both of these elements are not even included in many common definitions (for example provisions related to California eminent domain, civil litigation, marital dissolution, federal estate tax, casualty losses, financial reporting, and global valuation); this again illustrates the incomplete treatment of the topic of market value without considering the range of definitions in common use.

The authors’ issue with timing has to do with the word “should” in connection with “the most probable price which a property should bring,” suggesting this somehow relates to a future time period as opposed to the time period immediately preceding the effective date. While it is true that “should” is sometimes used to express futurity, this is not the only way an auxiliary verb can be used, and it is not hard to conjure up the intended meaning of “should,” in this context, as simply indicating probability or expectation—if all the conditions of the definition are satisfied, the most probable price is what should be expected at the effective date (not a prospective future date).

The discussion of undue duress is especially problematic, because this term is not actually part of the *market value* definition in the 1984 edition of *Real Estate Appraisal Terminology* cited in footnote 8, or the definition in the August 22, 1990, edition of the *Federal Register* cited in footnote 9. Moreover, the definition in the 1984 edition of *Real Estate Appraisal Terminology* differs in other respects from that reproduced on page 43 of the article and referenced in footnote 8. The term actually used in all known editions of *Real Estate Appraisal Terminology* is “undue stimulus” rather than “undue duress,” which negates much of the authors’ discussion of the word *duress*. (“Undue duress” appears in a generic definition of market value in *The Dictionary of Real Estate Appraisal*, sixth edition, and *The Appraisal of Real Estate*, fifteenth edition, but this definition is not citable for any standard purpose.) The term “undue duress” does not appear in any current definitions of *market value* used for financing and credit, published in multiple sections of Title 12 of the Code of Federal Regulations, all of which use the term “undue stimulus.” The word *stimulus* is generally more applicable, since it can reasonably apply to anything that causes a response, either positive or negative.

“The simplicity of a single definition of *market value* is appealing, but *market value* and *fair market value* definitions are embedded in a plethora of codes, regulations, and court decisions across the country (and around the globe).”

The authors’ proposed new universal definition of *market value* is certainly a worthwhile contribution to the continuing discussion of this issue, using “most probable price,” and adding a number of normative conditions, including financing, exposure, competitive market, and prudent, knowledgeable and self-interested parties. And there can be no disagreement that appraisers valuing the same asset at the same effective date, and with the same assumptions and conditions, can indeed come up with different numbers (“or answering completely different questions,” as stated in the article). I would not necessarily agree, however, that “cleaning up the definitions of *market value* and *market rent* is not that difficult.” The simplicity of a single definition of *market value* is appealing, but *market value* and *fair market value* definitions are embedded in
Letters to the Editor

a plethora of codes, regulations, and court decisions across the country (and around the globe). The role of the appraiser in this discussion has been usurped by the courts, regulators, and others, and it is not realistic to think that these definitions could be easily changed to conform to a new universal definition of market value. However, what the appraisal profession can do is provide guidance on what the market value concept really means, and how the various definitions can be interpreted, reconciled, and applied to provide consistent results. One might hope that the Appraisal Institute could take the lead with respect to this important issue.

Michael V. Sanders, MAI, SRA
Seal Beach, California

Authors’ Response

We appreciate the careful reading of our article by Mr. Sanders and his contributions to the history of both the market value and market rent terms. Furthermore, he has highlighted the “plethora of codes, regulations, and court decisions across the country (and around the globe)” that define market value. The appraisal profession, of course, is not responsible for this plethora, but it is responsible for consistency and clarity in applying definitions. Like Mr. Sanders, we hope the Appraisal Institute will continue to take the lead.

David C. Lennhoff
Gaithersburg, Maryland

Richard L. Parli
Fairfax, Virginia

To the Editor

In “Revisiting Market Value and Market Rent” (Winter 2020), the following two statements are made: “Public trust is diminished,” and “In an improving market it is likely the most probable selling price (the prospective value) will exceed market value.”

There is no question that public trust is diminished when appraisals are driven by a results-oriented conclusion. Too often appraisers confuse what their role is. Rather than reporting what the market did, they seem more interested in what they think the market should do or should have done. Suggesting that the selling price will exceed the market value is but one example of this. The mistake is largely the result of the abandonment of the legal and traditional definition of fee simple absolute. Also, there has been a hijacking of the leased fee definition in recent years along with a misapprehension of what market rents are. Market rents are rents freely negotiated between two knowledgeable parties in the open market. There can be no such thing as a current, freely negotiated, rent that is above market. While the rent may be higher than other current rents and more than what the appraiser thinks should have been paid, it is still a market rent. This appraisal fallacy leads to the results often seen in taxation litigation where an appraiser will value a property at significantly less than its actual sale price. In a freely negotiated sale, to use an actual case as an example, a $100 million office building appraised at $70 million because the rents were allegedly “above market.” It is further argued that the most creditworthy companies pay above market rent. The public trust is diminished when faced with such arguments that the best companies pay more for their products or rents than non-creditworthy companies.

The misuse of business enterprise value (BEV) is another example of appraisals deliberately undervaluing real estate for taxation purposes. When markets are good, a huge portion of the value is called BEV. Will these appraisers be consistent in this COVID-19 era and say huge declines in occupancy and rents is a result of a business value decline? Is consistency too much to ask?

When appraisers substitute their opinion of what rents should be for what they actually are, appraisers have lost their way and forgotten
their role. Tortured explanations of why these things are done represent sophistry masquerading as erudition.

In my view, to restore public trust in its profession, the appraisal industry needs as a start to arrive at or return to a sensible definition of leased fee.

Thomas J. Scheve, JD
Cincinnati, Ohio

Authors’ Response

We appreciate the reading of our article by Mr. Scheve. His primary point seems to be, with respect to both rent and sales, if “freely negotiated between two knowledgeable parties in the open market,” they are equal to market rent and market value. Furthermore, he asserts, appraisers should not substitute their own opinions “of what rents should be for what they actually are…” These statements, however, reflect a fundamental misunderstanding of exactly what an appraisal is: “the act or process of developing an opinion of value; an opinion of value.” Although we would agree that current rent/sale prices can be good indicators of market, they do not always equal it. They should be adjusted just as you would adjust a comparable sale/rental. If every freely negotiated rent or value were market, there would probably be no need for a real estate appraiser. Furthermore, if “there can be no such thing as a current, freely negotiated rent that is above market,” then it follows that there can be no above-market rent. Appraisers encounter above-market rent (and below-market rent) every day, all freely negotiated, and account for such in the appraisal process, either through adjustment or elimination. This is no fallacy.

Realty often involves many transactions—both rents and sale prices—that are freely negotiated, in both parties’ best interests, but not at market, as that term is defined in appraisal. A good example would be a sale/leaseback. Although these transactions are freely negotiated and in the interest of both parties, they are often not at market. Build-to-suits are equally vulnerable to not being at market. Both parties may be fine with what is being paid, but it is unlikely the market would feel the same. It is certainly not our argument that “the best companies pay more for their products or rents than non-creditworthy companies.” Rather, often the rent paid by the best companies fits their business model, regardless of the rent’s relationship to market rent. The whole concept of investment value bears this out. Investment value is defined as “the value of a property to a particular investor or class of investors based on the investor’s specific requirements. Investment value may be different from market value because it depends on a set of investment criteria that are not necessarily typical of the market.” We suggest Mr. Scheve look carefully at his statement, as its most important component—“the open market”—seems to be lost in his interpretation. Two parties freely negotiating a rent or a value may have very legitimate reasons for agreeing to something that does not represent what would be negotiated on the open market.

David C. Lennhoff
Gaithersburg, Maryland

Richard L. Parli
Fairfax, Virginia


To the Editor

Thank you to David C. Lennhoff, MAI, SRA, AI-GRS, and Richard L. Parli, MAI, for their article “Revisiting Market Value and Market Rent,” (Winter 2020), in which they identify some problems inherent in various iterations of value definitions. Since market value and market rent are opinions of applicable markets and appraisers develop opinions of those opinions, the authors have actually addressed standards for appraising.

“A market value appraisal assumes that the exposure time of the hypothetical sale was sufficient to have produced a sale at market value; the assumption of any exposure time beyond sufficient is irrelevant.”

Every appraisal is based on a hypothetical sale of the property appraised that is assumed to have occurred as of the effective date (moment) of the appraisal. A market value appraisal assumes that the exposure time of the hypothetical sale was sufficient to have produced a sale at market value; the assumption of any exposure time beyond sufficient is irrelevant. The article’s suggestion for the hypothetical sale includes “assuming a specified exposure period,” a requirement that admittedly conforms to the current Uniform Standards of Professional Appraisal Practice (USPAP).

Logic allows only three types of exposure time: excessive, insufficient, and sufficient; the last is explained above. Excessive exposure time might cause long-marketed properties to be considered old news and to face market nonchalance that can result in less than market value prices; such prices are casually described as “getting a deal.” Excessive exposure time may affect price but has no effect on market value.

Insufficient exposure time is another matter. Simply put, assuming an insufficient exposure time in the hypothetical sale usually results in an appraised value that is less than that which would have been a traditional market value based on a sufficient exposure time.

Ergo, if the hypothetical sale was based on exposure time that was assumed sufficient to have resulted in a sale at market value, there is no practical or functional need to estimate a specified exposure time other than the current USPAP pronouncement. For market value appraisals, developing or reporting estimates of exposure time are of no value to the appraisal process or to intended users (although the absence of such estimates in appraisal reports are viewed by some reviewers as USPAP violations).

With the exception of exposure time, the authors’ standards are excellent for sophisticated users and for withstanding legal scrutiny. However, another group of intended users, i.e., less-experienced individuals and employees of smaller businesses and smaller governments, often have little understanding of the appraisal process or the reasoning that reports of appraisal are intended to convey. The following is intended to address the needs of the latter.

Changes in market conditions can affect the value of properties in that market. Abrupt changes in markets (December 7, 1941; September 11, 2001; the COVID-19 pandemic) can cause abrupt value changes, so the moment of the appraisal should always be considered in value conclusions.

In actuality, any appraisal can only be retrospective—i.e., a value conclusion as of a stated point in time that is before the moment of the report, or prospective—i.e., a value conclusion as of a stated point in time that is after the moment of the report, albeit our industry seems to use a “recent point-in-time” option.
The following, based somewhat on Lennhoff and Parli’s suggestions, are intended to contribute to a broader user understanding of reports of appraisals. These standards are captioned to clearly state the value that has been appraised.

**Appraised Retrospective Market Value.** Appraised retrospective market value is the most probable price for which identified property rights were assumed to have sold in a hypothetical sale that occurred in a competitive market as of a specified date under all conditions requisite to a fair sale, including the following:

1. Both the hypothetical buyer and the hypothetical seller were assumed to have been typically motivated and to have acted prudently, knowledgeably, and for self-interest;
2. The exposure time of the hypothetical sale was assumed sufficient to have achieved a sale at market value;
3. Payment in the hypothetical sale was made in cash in US dollars or in the local currency, or in precisely revealed terms equivalent to cash; and
4. The price of the hypothetical sale was subject to actual market conditions prevailing as of the date of valuation and was unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

When an appraisal is based on “special or creative financing or sales concessions granted by anyone associated with the sale,” such terms should be defined. Prospective valuations (i.e., valuations as of future dates) require separate standards, which are somewhat based on the four elements mentioned above for appraising retrospective market value.

**Appraised Prospective Market Value.** Appraised prospective market value is the most probable price for which identified property rights are projected to sell at some time in the future in a hypothetical sale that is assumed to occur in a competitive market as of a specified date under all conditions requisite to a fair sale, including the following:

1. Both the hypothetical buyer and the hypothetical seller are assumed to be typically motivated and to act prudently, knowledgeably, and for self-interest;
2. The market-exposure time of the hypothetical sale was assumed sufficient to have achieved a sale at market value;
3. Payment in the hypothetical sale is to be made in cash in US dollars or in the local currency, or in precisely revealed terms equivalent to cash; and
4. The price of the hypothetical sale will be subject to market conditions projected as prevailing as of the date of valuation and will be unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

Retrospective market value and prospective market value both require an explanation that any changes in market conditions between the moment of the appraisal and the moment of the report may call for a market conditions adjustment.

Valuation standards for other situations exist. Since there is a conflict between the highly similar liquidation value and disposition value standards as currently defined in *The Dictionary of Real Estate Appraisal*, the following proposal combines those standards and removes the conflict.
Appraised Retrospective Quick-Sale Value.

Appraised retrospective quick-sale value is the most probable price that a specified interest in a property should have brought in a hypothetical sale in a competitive and open market as of the effective date of the appraisal under the following conditions:

1. Both the buyer and the seller were assumed to have acted prudently, knowledgeably, and for self-interest;
2. The buyer was typically motivated;
3. The client-specified exposure time in the hypothetical sale defined the hypothetical seller’s motivation and was insufficient to have allowed an adequate marketing effort that would have resulted in a sale at market value;
4. Payment in the hypothetical sale was made in cash in US dollars or in the local currency, or in precisely revealed terms equivalent to cash; and
5. The price of the hypothetical sale was subject to market conditions prevailing as of the date of valuation and was unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

Should a prospective appraised quick-sale value be needed, adapting the standards should be self-evident. In conclusion, a few additional words of explanation are of no consequence to the cost or effort of report preparation and would provide additional clarity in the opinion of value. I hope this further stimulates thinking on value standards.

Neill F. McDonald, MAI, AI-GRS
Savannah, Georgia

Authors’ Response

We appreciate the careful reading of our article by Mr. McDonald, and we thank him for the insights he offers in his Letter to the Editor. Our goal in writing the article was to clear up the definitions of market rent and market value in hopes of reducing the differences between otherwise well-prepared appraisals by equally qualified appraisers. Mr. McDonald sought to contribute to our objective by targeting a “broader user understanding of reports of appraisals.” He has, in our opinion, achieved that goal.

David C. Lennhoff
Gaithersburg, Maryland

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