DIMINUTION VALUATION ASSIGNMENTS
ENHANCE THE IMPORTANCE OF HIGHEST AND BEST USE

Ben Sellers, MAI
Scott Robinson, MAI, SRA, AI-GRS, AI-RRS
“The **difference** between the **unimpaired** and **impaired** values of the property being appraised.”

POTENTIAL DIMINUTION VALUATION ASSIGNMENTS

**Physical Change (Real Estate)**

Eminent Domain Proceedings

Damages due to a property created by a taking

Partial or full
POTENTIAL DIMINUTION VALUATION ASSIGNMENTS

Real Estate Litigation

Damages due to defects
  • Construction defects
  • Defects in title

Damages created by an event
  • Flood
  • Environmental accidents
  • Viewshed change
POTENTIAL DIMINUTION VALUATION ASSIGNMENTS

**Tax Matters**

Legal Change (Real Property Rights)

Voluntary or involuntary?

Develop an opinion of value of easements

Conservation Easements

Façade Easements
“In eminent domain valuation, a procedure in which just compensation is measured as the difference between the value of the entire property before the taking and the value of the remainder after the taking.”

"The before and after method of valuation for partial acquisitions is accepted in all federal courts. It is often called the federal rule, although it also applies in many (but not all) state jurisdictions. A before and after valuation requires careful determination of the larger parcel (or parent tract) at issue—which may differ before and after the acquisition—and proper consideration of damages and benefits to the remainder property due to the government acquisition. Each of these issues will be addressed below, along with limited exceptions to the before and after method."

UASFLA (Yellowbook) 2017 Page 150
BASIC PREMISE

HBU Before

Value Before

HBU After

Value After
BASIC PREMISE

HBU Before

Value Before

HBU After

Value After

Diminution Value
BASIC PREMISE

HBU Before = HBU After

Value Before = Value After

Potential Diminution in Value
BASIC PREMISE

HBU Before

Value Before

HBU After

Value After

Potential Diminution in Value
HIGHEST AND BEST USE DRIVES EVERYTHING

**HBU establishes the key premise for which the measure of value is based**

Before Value - Value of ownership rights existing before

After Value - Value of ownership rights existing after

- Remaining rights define the market
- HBU based on defined market
- Value based on HBU after
Why HBU is Critical

“The highest and best use is established in the first part of an appraisal, and value itself is measured in the second part. The value of a property can be measured with accuracy only when the factors that establish the basis for its value are properly analyzed.”

OVERVIEW

Potential Diminution Value Assignments

• Many times complex in nature
  • Physical change
  • Legal change
• Does this change the market for the property?
• Before and after method?
• HBU plays critical role
• MUST follow logical stepped process
• MUST have appropriate support for conclusions (emphasis added)
• But first we must identify the problem.....
IDENTIFICATION OF THE PROBLEM IS CRUCIAL

INTENDED USE AND USER(S) IMPLICATIONS
- Professional standards may vary
- Market Value definition may vary
- Subject property definition may vary

RELEVANT PROPERTY CHARACTERISTICS
- MUST have a clear understanding of what you are appraising
- Often requires significant research
- Legal and physical attributes shape property utility

ASSIGNMENT CONDITIONS?

SOLVE THE PROBLEM
- Develop appropriate scope of work
WHAT ARE YOU VALUING?

The distinction between real estate and real property is fundamental to appraisal:

real estate
An identified parcel or tract of land, including improvements, if any.

real property
The interests, benefits, and rights inherent in the ownership of real estate.


Changes to the physical real estate and or the legal ownership interest(s) **may potentially** diminsh property value.
REAL PROPERTY INTERESTS

“BUNDLE OF RIGHTS”
- Includes numerous rights that create a property’s value
- Each right may or may not have value
- Individually rights not all equivalent
- Some more significant (or valuable) than others
- “Each individual right in the bundle may have potential value.” TARE 14th page 5

PROPERTY RIGHTS THAT MAY IMPACT VALUE
- Easements
- Sub surface rights
- Air rights
- Some property rights don’t have (measurable) impact on value
- New highway may enhance remainder value, rather than diminish value
Step 1 – Identify the Problem

- You must know who the client is, how they want the appraisal (standards) to understand what you are appraising (identify the problem) and develop the appropriate solution (scope of work)
Step 1 – Identify the Problem (Simplified)

- What Value?
- What Interest?
- As of What Date?
If I had an hour to solve a problem and my life depended on it, I would use the first 55 minutes determining the proper questions to ask.

Albert Einstein
What is Market Value?

**USPAP 2018-2019 page 5**

- “Appraisers are cautioned to identify the exact definition of market value, and its authority, applicable in each appraisal completed for the purpose of market value.”

**The Appraisal of Real Estate, 14th Edition, page 59**

- It is important to note that USPAP does not provide a citable definition of market value. Indeed, USPAP states that “appraisers are cautioned to identify the exact definition of market value, and its authority, applicable in each appraisal completed for the purpose of market value.” Therefore, an appraiser may not cite USPAP as the source for a definition of market value.

- Citable definitions of market value can be found in state and federal regulations, laws, or publications.
What is Market Value?

The intended use of an appraisal dictates which definition of market value is applicable to a specific assignment. Client wishes or instructions do not change the basic requirement that the appraiser must identify an appraisal’s intended use and cite an appropriate definition of market value for that use. Appraisers must understand why a particular definition of market value should be used, apply that definition according to established standards, and communicate these requirements clearly to the clients they serve. Government and regulatory agencies may redefine or reinterpret market value for specific types of assignments, so individuals performing appraisal services for these agencies or for institutions under their control must be sure to use the applicable definition.
What is Market Value?

Treasury Regulations §§ 1.170A-1(c)(2), 25.2512-1, & 20.2031-1(b)

• **Fair market value is defined as:**
  
  • “the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts.”
What is Market Value?

The Dictionary of Real Estate Appraisal 6th Edition Page 141

- **market value.** The most widely accepted components of market value are incorporated in the following definition:

  The most probable price, as of a specified date, in cash, or in terms equivalent to cash, or in other precisely revealed terms, for which the specified property rights should sell after reasonable exposure in a competitive market under all conditions requisite to a fair sale, with the buyer and seller each acting prudently, knowledgeably, and for self-interest, and assuming that neither is under undue duress.

The Appraisal of Real Estate, 14th Edition, Page 59

“[A] type of value, stated as an opinion, that presumes the transfer of a property (i.e., a right of ownership or a bundle of such rights), as of a certain date, under specific conditions set forth in the definition of the term identified by the appraiser as applicable in an appraisal.”
What is Market Value?

UASFLA (Yellowbook) 2017 Page 10

• Definition of Market Value

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

• Note: does not link exposure time
What is HBU?

UASFLA (Yellowbook) 2017

**Definition of Highest and Best Use (page 102)**

• “The highest and most profitable use for which the property is adaptable and needed or likely to be needed in the reasonably near future.”

**Market Demand (page 104)**

• “Any highest and best use requires a showing of market demand.”
• “it is generally accepted that there must be demonstrated an actual profitable use or a market demand for the prospective use.”
• To meet this standard, “objective evidence substantiating [the appraiser’s] market demand analysis” is required.
• “Value implies demand and a buyer”—and each must be proven, never assumed.

**Economic Use (page 105)**

• For just compensation purposes, market value must be based on a property’s highest and most profitable use—that is, an economic use.
• noneconomic uses cannot be considered in determining market value for federal acquisitions.
• Federal courts have also rejected valuations that improperly fail to consider an economic use.
What is HBU?


1) The reasonably probable use of property that results in the highest value. The four criteria that the highest and best use must meet are legal permissibility, physical possibility, financial feasibility, and maximum productivity.

2) The use of an asset that maximizes its potential and that is possible, legally permissible, and financially feasible. The highest and best use may be for continuation of an asset’s existing use or for some alternative use. This is determined by the use that a market participant would have in mind for the asset when formulating the price that it would be willing to bid. *(IVS)*

3) [The] highest and most profitable use for which the property is adaptable and needed or likely to be needed in the reasonably near future. *(Uniform Appraisal Standards for Federal Land Acquisitions)*
Scope of Work

• The Appraisal of Real Estate, 14th Edition, page 39
  • “The scope of work decision is appropriate when it allows the appraiser to arrive at credible assignment results and is consistent with the expectations of similar clients and the work that would be performed by the appraiser’s peers in a similar situation.”
  • Accepted methods and techniques?

• Definition of Credible – USPAP 2018-2019 page 4
  • CREDIBLE: worthy of belief.
  • Comment: Credible assignment results require support, by relevant evidence and logic, to the degree necessary for the intended use.
Goal of Appraisal?

- **The Appraisal of Real Estate, 14th Edition, page 36**
  - “In assignments to develop an opinion of market value, the ultimate goal of the valuation process is a well-supported value conclusion that reflects all of the pertinent factors that influence the market value of the property being appraised.”

- Some appraisers simply state they do not need all that study and data after all it is – *just my opinion*

- **An appraisal is more than just an opinion**
  - Thus an appraisal cannot be just an opinion but must be an opinion based on well-supported facts, data and analysis.
  - Credible includes following recognized methods and techniques.
The Valuation Process

The Value Cannot Be Right if the HBU is Wrong
The Eight Step Process

Highest and Best Use Analysis Process

Alternative Use Scoping (Determine Reasonably Probable Alternatives to Study)

Market/Marketability Analysis of Most Probable Alternatives

Property Analysis

Step 1 - Property Productivity Analysis (Define the Product)
- Legal determinants of use
- Site & improvements determinants of use
- Location determinants of use and timing

Market Analysis

Step 2 - Delineate the Market (Identify Demand Sources of Property Users)

Step 3 - Demand Analysis (Current and Forecasted User Demand)

Step 4 - Supply Analysis (Measure Current & Forecasted Competition for Demand)

Step 5 - Market Condition Analysis (Market Cycle Analysis)

Marketability Analysis

Step 6 - Subject Marketability Analysis (Determine Market Capture)

Testing Highest and Best Use Alternatives

Step 7 - Financial Analysis of Alternative Uses (Present Value of Future Benefits)

Step 8 - Highest and Best Use Conclusions (Most Profitable Alternative at Least Risk)

Six-Step M/M Process Questions

1. What attributes does the subject property offer the market?
2. Who are the most likely users of these attributes?
3. Is the property use needed?
4. What is the competition?
5. What is the condition of the market?
6. How much of the market can the subject property capture?
Property Productivity Analysis

• **Legal determinants of use**
  • MUST clearly identify and understand what legal constraints exist on the property in BOTH the before and after scenario
  • MUST explain and analyze their impact on use in BOTH the before and after scenario

• **Legal changes?**
  • Limitations on Use
  • Temporary Loss of Use
  • Permanent Loss of Use
  • Intensity of Use
  • Access
  • Development rights/density/subdivision
  • Deed restrictions
Property Productivity Analysis

- **Physical determinants of use**
  - MUST clearly identify and understand what physical constraints exist on the property in BOTH the before and after scenario
  - MUST explain and analyze their impact on use in BOTH the before and after scenario

- **Physical changes?**
  - Less land to support the existing improvement
  - Change in the Ideal Improvement
  - Limited Parking
  - Inadequate setbacks
  - Changes in Elevation
  - Access
  - Change in market perception on acceptability (General)
Property Productivity Analysis

- **USPAP 2018-2019 Standard 1-2(e)**
- “In developing a real property appraisal, an appraiser must identify the characteristics of the property that are relevant to the type and definition of value and intended use of the appraisal including:
  1. its location and physical, legal, and economic attributes;
  2. the real property interest to be valued;
  3. any personal property, trade fixtures, or intangible items that are not real property but are included in the appraisal
Property Productivity Analysis

Highest and Best Use Legal Test

• It may be allowed, but where is market??
Property Productivity Analysis

Highest and Best Use Physical Test

• Without economic demand what do we have??
COMMON PITFALLS IN HBU

• Inadequate Productivity Analysis
  • Property Characteristics
  • Omission of key legal constraints

• Inadequate Market Analysis
  • Lack of support for economic demand
  • Lack of support for feasibility analysis & conclusions (timing)

• Inconsistency Between HBU and Valuation Approaches
  • Utilizing sales with inconsistent HBU as the subject
Case Studies
CASE STUDY 1
TITLE DEFECT ON RESIDENTIAL SUBDIVISION DEVELOPMENT

2017 – Purchase of 16.73 Acres for residential development

2018 – Received approval for 51 lot development plan from City Zoning & Planning

2018 – Underground gas line easement discovered prior to starting site excavation

**Problem to be solved:**
Does the missed utility easement, which reduces development potential by 50%, result in a diminution of value? If so, how much?
CASE STUDY 1
TITLE DEFECT ON RESIDENTIAL SUBDIVISION DEVELOPMENT
OVERVIEW

• Street view visual
“BEFORE” HBU

LEGAL/PHYSICAL CONSTRAINTS?
• Recently rezoned to R-6 High Density Residential District
• Flood hazard area at west of site hinders potential development

FEASIBILITY?
• Development now or in future?
  • If future – how long in future?
• Does economic demand exist?
INDICATORS OF ECONOMIC DEMAND?

1. Economic base
   • Population, income, employment

<table>
<thead>
<tr>
<th>Subject Market Area</th>
<th>Annual Change (%) Past 10 Years</th>
<th>Annual Change (%) Past 5 Years</th>
<th>Trend</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population</td>
<td>2.0%</td>
<td>3.5%</td>
<td>↑</td>
</tr>
<tr>
<td>Income</td>
<td>1.5%</td>
<td>3.5%</td>
<td>↑</td>
</tr>
<tr>
<td>Employment</td>
<td>1.0%</td>
<td>2.5%</td>
<td>↑</td>
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</table>
## Indicators of Economic Demand?

### Suburban Market Area

<table>
<thead>
<tr>
<th>Subject Market Area - A</th>
<th>5 Yrs Ago</th>
<th>4 Yrs Ago</th>
<th>3 Yrs Ago</th>
<th>2 Yrs Ago</th>
<th>1 Yr Ago</th>
<th>Current Yr</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Home Sales</td>
<td>99</td>
<td>132</td>
<td>178</td>
<td>406</td>
<td>525</td>
<td>746</td>
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<tr>
<td>Median New Home Price</td>
<td>$172,350</td>
<td>$180,000</td>
<td>$204,202</td>
<td>$208,105</td>
<td>$232,753</td>
<td>$260,500</td>
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<tr>
<td>SF Building Permits</td>
<td>539</td>
<td>676</td>
<td>777</td>
<td>537</td>
<td>708</td>
<td>813</td>
</tr>
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</table>

Demand is Well Supported
# INDICATORS OF ECONOMIC DEMAND?

## Rural Market Area

<table>
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<tr>
<th>Subject Market Area - B</th>
<th>5 Yrs Ago</th>
<th>4 Yrs Ago</th>
<th>3 Yrs Ago</th>
<th>2 Yrs Ago</th>
<th>1 Yr Ago</th>
<th>Current Yr</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Home Sales</td>
<td>152</td>
<td>72</td>
<td>59</td>
<td>43</td>
<td>21</td>
<td>10</td>
</tr>
<tr>
<td>Foreclosures</td>
<td>101</td>
<td>128</td>
<td>167</td>
<td>251</td>
<td>215</td>
<td>182</td>
</tr>
<tr>
<td>Median New Home Price</td>
<td>$135,750</td>
<td>$144,600</td>
<td>$285,000</td>
<td>$215,000</td>
<td>$154,900</td>
<td>$148,300</td>
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<tr>
<td>SF Building Permits</td>
<td>35</td>
<td>40</td>
<td>10</td>
<td>228</td>
<td>19</td>
<td>14</td>
</tr>
</tbody>
</table>

Demand is **NOT** Well Supported
HBU Conclusion is More than Use

• **Use**

• **Timing for Use**
  Probable construction date and/or future occupancy

• **Market Participants**
  Most Probable Buyer
  Most Probable Users of Space

“the land must support a highest and best use for immediate development at the time of the appraisal”  
The Appraisal of Real Estate, 14th Edition
HBU Conclusion on Timing

“One day there may be houses close by”

“One day people may want retail”

But we are not valuing what it might be worth **ONE DAY**, we are valuing what it is worth **TODAY!**
"AFTER" HBU

LEGAL/PHYSICAL CONSTRAINTS?
• 10’ high pressure gas utility line easement
• High pressure gas lines cannot be crossed with streets or driveways
• Limits development to 29 lots (not 51)

FEASIBILITY?
• Economic demand currently strong based on “before” and “after” market analysis

WHAT IS VALUE DIMINUTION?
• Cost to cure $460,000
• Diminution value at lower density is $300,000
CASE STUDY 2
Partial Acquisition

Subject Office Building:
Location: Established suburban office
Site: 0.70 acres
Improvements: 1 story; 6,200 SF
Age/Condition: 20 years/Good
Occupancy: 100% (2 medical office suites)
Rental Rates: Typical medical office
Tenants: Dentist & Orthodontist
Parking Spaces:
• “Before” 22
• “After” 13

Problem to be solved:
Does the partial acquisition result in a diminution in value to the remainder? If so, how much?
Partial Acquisition Assignments

RE Valuation in Litigation, 2nd Ed, page 104

• “When an appraisal involves a partial acquisition, the appraiser must make two separate and distinct highest and best use estimates.”

• “If the appraiser does not estimate the property’s highest and best use correctly in both the before and after situations, it will be impossible to estimate the property’s value correctly.”
Identify & Apply

Why is Market Analysis important?

“The data and conclusions generated through market analysis are essential components in other portions of the valuation process.”

The Appraisal of Real Estate, 14th Ed. Page 42

Loss of parking does not necessarily mean damages to the remainder.

Zoning regulations do not set Parking Standards...the Market Does!

Depends on economic demand for the parking improvements in the before compared to the competition.
Identifying Depreciation

Comparison to ideal improvement

“Any difference in value between the existing improvement and the ideal improvement would be attributable to depreciation...”

The Appraisal of Real Estate, 14th Ed. Page 345
Productivity Analysis

Step 1: Identification of the subject attributes

• What are market expectations?

• How does each factor affect potential tenants?
  • Legal – What is required by zoning?
  • Physical – What is required by market?
Legal Analysis

• **Step 1: Identify**

<table>
<thead>
<tr>
<th>Subject</th>
<th>Parking Spaces</th>
<th>GBA</th>
<th>Spaces per 300 SF</th>
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</thead>
<tbody>
<tr>
<td>“Before”</td>
<td>22</td>
<td>6,200 SF</td>
<td>1.20</td>
</tr>
<tr>
<td>“After”</td>
<td>13</td>
<td>6,200 SF</td>
<td>0.71</td>
</tr>
<tr>
<td>Zoning</td>
<td></td>
<td></td>
<td>1.00</td>
</tr>
</tbody>
</table>

• **Subject “After” – Over improvement to site**
Physical Analysis

Market Demands:

- What are the characteristics of the expected end users?

<table>
<thead>
<tr>
<th>Comp</th>
<th>Parking Spaces</th>
<th>GBA (SF)</th>
<th>Spaces per 300 SF</th>
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</thead>
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<tr>
<td>1</td>
<td>24</td>
<td>5,017</td>
<td>1.44</td>
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<td>2</td>
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<td>8,000</td>
<td>1.13</td>
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<td>4</td>
<td>40</td>
<td>9,672</td>
<td>1.24</td>
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<tr>
<td>5</td>
<td>30</td>
<td>8,000</td>
<td>1.13</td>
</tr>
<tr>
<td>6</td>
<td>11</td>
<td>2,800</td>
<td>1.18</td>
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<table>
<thead>
<tr>
<th></th>
<th>Average</th>
<th>Median</th>
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</thead>
<tbody>
<tr>
<td>Subjects Before</td>
<td>1.20</td>
<td>1.20</td>
</tr>
<tr>
<td>Subject “After”</td>
<td>0.71</td>
<td></td>
</tr>
</tbody>
</table>
Before HBU “As Vacant”

Current Improvement = Ideal Improvement
After HBU “As Vacant”

Ideal Improvement
After HBU “As Improved”

Current Improvement ≠ Ideal Improvement
Productivity Conclusions

Step 1 Conclusion: Identify the problem

<table>
<thead>
<tr>
<th></th>
<th>Subject After</th>
<th>Zoning (Required)</th>
<th>Market (Demanded)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spaces per 300 SF</td>
<td>0.71</td>
<td>1.00</td>
<td>1.20</td>
</tr>
<tr>
<td>% Deficiency</td>
<td>30%</td>
<td></td>
<td>40%</td>
</tr>
</tbody>
</table>
After HBU “As Improved”

After HBU Improved – Maximally Productive

• Existing improvements represent over improvement
• Larger building existing in proportion to market demanded parking
• Efficiency of improvements are negatively affected by insufficient parking
• Functional depreciation is applied to the subject improvement
• Insufficient parking has a negative effect on the productivity of the existing improvements for their intended use
Methodology Solution

Capture loss in value attributed by the capitalized difference in rent loss.

Market evidence suggests:

- Deficiency property rents range 50% lower
- Deficiency property vacancy levels range 25% higher
Application

Application Solution

• A discounted cash flow analysis to measure loss before and after
• “After” rental rate reduced from $15.00 to $10.00 per SF for half of space to account for the parking deficiency.
• “After” vacancy increased to weighted average 11% to account for parking deficiency
• “After” has longer marketing period in acquiring tenants due to the parking deficiency.
Calculation of Diminution in Value

“Before Value” without parking deficiency  $353,000
Less “After Value” with parking deficiency  $261,000
Equals Diminution in Value  $92,000
CASE STUDY 3
Density—things are not always as they seem
Impact of impairment

The issue in the condemnation case was the fact that the property had subterranean contamination by burn dump ash. Absent the contamination, the highest and best of the property was to build mid-rise residential, which would have required two or three levels of subterranean parking.

Problem to be solved:
Is there an important “underlying” assumption that if missed will produce incorrect results?
"BEFORE" HBU

LEGAL/PHYSICAL CONSTRAINTS?

FEASIBILITY?
• Near term economic demand

HIGHEST & BEST USE?
• development of mid-rise residential, which would have required two or three levels of subterranean parking.

The unimpaired value was $200.00 per SF, or $4,000,000
“AFTER” HBU

LEGAL/PHYSICAL CONSTRAINTS?
• Remediation required for development to highest use

FEASIBILITY?
• ??---it depends...

WHAT IS DIMINUTION VALUE?
1. value the property based on its HBU (mid-rise residential), then deduct the engineer’s cost to fully remediate the site.

   The unimpaired value was $200.00 per SF, or $4,000,000.

   The estimated costs to fully remediate were $3,500,000.

   .Leaving an indicated land value of $500,000.

   Diminution of $3,500,000
2. value based on less intense development (only two or three stories)
   
   Only one level of below-grade parking needed
   Remediation cost estimated to be $1,000,000.
   The conclusion for the value per square foot for this less intense use was $125.

   With those assumptions, the land value is actually $1,500,000 ($2,500,000 - $1,000,000).
As a result of the contamination, the maximally productive use of the site (the highest residual land value) is to do the residential development, but at far less than the maximum FAR permitted.

So, the HBU didn’t change in terms of use, but the HBU intensity of use changed.

**Diminution $2,500,000**
CASE STUDY 4

Case 3—Highest and best use—missed—aka everything is not a development in its next life...
Background
In 2002, PBBM-Rose Hill, Ltd., a partnership (PBBM), purchased a 241-acre, 27-hole golf course located in Beaufort County, South Carolina, from Rose Hill Country Club, Inc., for $2.4 million. The golf course was largely interspersed among the houses of a gated community.

PBBM ceased all business operations on the golf course in January 2006, and two months later filed a voluntary Chapter 11 bankruptcy petition.

On December 28, 2007, PBBM contributed a conservation easement to the North American Land Trust (NALT) with respect to 234 acres of the golf-course property (7 acres were excluded from the easement for golf course maintenance and clubhouse areas). Three days later, on December 31, 2007, PBBM sold the golf course to a subsidiary of the Rose Hill Plantation Property Owners Association (a homeowners association) for $2.3 million. The appraisal that PBBM submitted with its tax return valued the easement at $15,610,000. PBBM hired the same appraiser to serve as its expert valuation witness at trial.
The IRS challenged the deduction claimed for the conservation easement donation on numerous grounds. The IRS’s expert witness concluded that the easement had a value of only $100,000. He maintained that the highest and best use of the property before the easement was a golf course. He assumed that current zoning restrictions allowed the property to be used only for open space or recreational use that it was highly unlikely the property could be rezoned for development, and that the owners of adjoining houses would likely oppose development.
Valuation
Under the before and after valuation approach, the value of an easement is equal to the (fair) market value of the property it encumbers before and after granting the restriction. In the tax court proceedings, both parties’ appraiser agreed that the after value was $2.3 million. The dispute centered on the before value specifically debating whether the property could be developed.
The PBBM appraisal supported its claim resting on an extraordinary assumption that the property could be rezoned to permit commercial uses, which in turn was based on a letter from an attorney who opined that the neighborhood master plan would have allowed the property to be used as a residential or commercial site. PBBM’s appraiser opined that the highest and best before-use was to develop the land described in a conceptual plan presented by a land planned offered up by PBBM. The plan proposed developing the property into commercial businesses, single family houses, and multifamily residences.
The commissioner’s appraiser opined that the highest and best use was the same before as it was after...a golf course or other recreational purpose. Because the zoning permitted only recreational uses, “any other uses would be speculative at best.” The appraiser spoke with the county zoning administrator and neighboring residents who opposed development.
**In conclusion**, the court of appeals held that the tax court did not err in finding that development was unlikely. Accordingly, the highest and best use of the property before the taking of the easement was the same as after. The easement was valued at $100,000.
CASE STUDY 4

Unreasonable assumptions....
According to the appraiser 1 report, the highest and best use conclusion for the parcel is for development of a retail/commercial building.

Several statements made in the highest and best use section of this report were incorrect including:

- “…access to the subject site from transportation linkages is good and exposure is excellent.”
- “Utilities are available to the site…”
- “…access is available from nameless road”
The expressed analysis does not address aspects of alternative use options such as financial feasibility, maximally productive use, timing, or market participants. These are important aspects of highest and best use analysis, given the potential cost of obtaining legal access and serving this property with the necessary utilities and other infrastructure for development. Utilities, roads, and other improvements impact financially feasible alternative uses as well as development timing. Thus, the present value is an investor value, not a user value.
This observation speaks directly to the comparability of the sales relied upon for sale comparison purposes. The highest and best use analysis does not mention or address the limitations outlined previously and, as a result, does not accurately assess the impact of these factors on the potential use of the parcel.

An accurate study would have concluded that the optimum use of the property, at least for the foreseeable future and without significant capital outlay, is to continue in agricultural production or to serve as open space.

The adjustments generally were not supported from market data, were inconsistent and unreasonable. More important, however, is the fact that this group of sales is not an appropriate database upon which to rely in valuation of the subject property.

<table>
<thead>
<tr>
<th>Factor</th>
<th>Sales</th>
<th>Subject</th>
</tr>
</thead>
<tbody>
<tr>
<td>Development Potential</td>
<td>Stand-alone independent parcels</td>
<td>Must be developed in conjunction with additional adjacent land.</td>
</tr>
<tr>
<td>Highest and Best Use</td>
<td>Near-term development</td>
<td>Investment; holding period unknown.</td>
</tr>
<tr>
<td>Access</td>
<td>Available to all; some with benefit of corner configuration</td>
<td>None</td>
</tr>
<tr>
<td>Utilities</td>
<td>At or very near lot lines</td>
<td>None; available only with extensive capital investment</td>
</tr>
<tr>
<td>Location</td>
<td>Developed or developing commercial areas</td>
<td>Near interchange but surrounded by undeveloped land. Future potential with extension of utilities.</td>
</tr>
</tbody>
</table>
These are such fundamental differences that the adjustment process relying upon the presented sales is incapable of resulting in credible value indications. In summary, the relevant property characteristics were not properly or correctly identified. This led the appraiser to an unsupported and incorrect highest and best use analysis and conclusion. In turn, this led to reliance upon data which were not representative of the subject property and the resultant issues cannot be adequately addressed by adjustments; the sales comprise the wrong dataset.
Questions?