

Property Rights Symposium Discussion Paper

December 21, 2017

1 **Introduction**

2 The Appraisal Institute held a Property Rights Symposium at its headquarters office in September 2017.
3 The event was attended by approximately fifty valuers, attorneys, and other interested parties with prior
4 involvement relating to the specific questions posed, along with Appraisal Institute officers, committee
5 chairs, and staff. It was facilitated by Dr. Lowell “Duke” Kuehn, a professional facilitator and strategic
6 planner.
7

8 The purpose of the symposium was to consider differences of opinion relating to the valuation of fee
9 simple estates. This Discussion Paper summarizes the issues discussed at the symposium, describes
10 the proceedings at the symposium, sets forth ideas emanating from symposium attendees, explores
11 some possible implications of these ideas and identifies a number of questions for individuals reading the
12 Discussion Paper.
13

14 The purpose of the Discussion Paper is to stimulate broader discussion, thought and feedback. The
15 ideas, views and opinions expressed in the Discussion Paper are not endorsed or approved by the
16 Appraisal Institute. The Appraisal Institute has not taken a position on the matters discussed, made any
17 revisions to *The Dictionary of Real Estate Appraisal, 6th edition* or *The Appraisal of Real Estate, 14th*
18 *edition*, or even made a proposal to do so. Numerous steps would need to occur to get to that point. The
19 Appraisal Institute hopes that the Discussion Paper results in constructive dialogue around important
20 issues to help advance the appraisal profession and public trust.
21

22 To these ends, the Appraisal Institute Board of Directors directed exposure of the Discussion Paper to
23 Appraisal Institute Professionals and other appropriate parties. The Board of Directors and the Body of
24 Knowledge Committee will review the feedback and consider what, if any additional steps, to recommend
25 or take.
26

27 If you have any comments on the Discussion Paper, please send your comments via e-mail to
28 comments@appraisalinstitute.org within sixty (60) days of the date of this Discussion Paper. Comments
29 sent to this e-mail address will be compiled for distribution to the Body of Knowledge Committee and
30 Appraisal Institute Board of Directors.
31

32 **The Issue**

33 Long-standing valuation theory has held that the interests or rights in real estate are valued rather than
34 the physical land and buildings themselves. Valuation standards require that the interests or rights be
35 identified and reported in the valuation report. Valuers have traditionally accomplished this task using
36 terms such as *fee simple*, *leased fee*, or *leasehold*. When a property is leased and the value of a lease
37 interest is sought, the valuation process will reflect the lease and account for any loss or benefit due to
38 the rent being above or below market or loss due to the time and cost to lease vacant space. But when
39 the assignment is to value the fee simple estate in property that is typically leased and sold as leased, the
40 question arises as to whether it should be valued as though occupied or as though vacant.

41 This question is critical in eminent domain and property taxation where law or regulation generally
42 requires the valuation of the fee simple estate, even if a lease exists. It is also an important question in
43 mortgage lending when lease income is needed to repay the loan but there is risk of unexpected vacancy.
44 In recent years, there have been numerous property tax appeal cases where the appropriate
45 methodology for valuing the fee simple estate has been at issue; several states have adopted or
46 proposed legislation that dictates methodology for assessment purposes. One property type involved is

47 big-box retail—buildings designed for a single user, either (a) subject to sale-leaseback or bondable lease
48 arrangements or (b) owner-occupied. Other property types have been involved also.
49

50 Related questions include the following:
51

- 52 • Does *fee simple* mean vacant and available for lease or occupancy? If so, should deductions be
53 taken for lease-up time and cost? Does *fee simple* imply a “go dark” scenario?
54
- 55 • The definition of *market value* presumes a sale. *The Appraisal of Real Estate*, 14th edition, states
56 that the best comparables will have the same highest and best use as the subject property. What
57 are the considerations for market analysis and highest and best use analysis? To what level must
58 the appraiser investigate effective demand, physical adaptability of the real estate, the typical
59 buyer, and timing of use?
60
- 61 • What are the considerations for the selection of comparable sales and the derivation of
62 capitalization rates? Are sales of fee simple estates involving vacant properties the best
63 comparable sales? Is it appropriate to derive capitalization rates from sale-leasebacks?
64

65 In late 2016, the issue and related questions were brought to the attention of the Appraisal Institute’s
66 Body of Knowledge Committee, which proposed a symposium to the Board of Directors to help explore
67 the issue and advance the profession towards generally agreed-upon theory and practice relating to the
68 matter.
69

70 **Proceedings and Issues Addressed**

71 After President and acting CEO Jim Amorin, MAI, SRA, AI-GRS, gave opening remarks, Dr. Kuehn
72 introduced the process to be followed for the two-day session. Three brief presentations were then
73 delivered on why the issue is critical to the valuation profession. For the remainder of the first day, four
74 panels, each with three to four valuers working in different areas of practice, presented concerns and
75 questions about how the issue affects condemnation, property taxation, and lending. After each of these
76 panels’ presentations, symposium participants were divided into four work groups, and each of these
77 groups convened to brainstorm ideas and identify possible resolutions. After each discussion, the entire
78 group of symposium participants reconvened as a whole to share their findings.
79

80 The four work groups raised and deliberated over many issues, including the following:
81

82 Theory issues:

83 Value definitions: Do the definitions of *market value* and *value in use* need to be
84 revisited? Do the definitions contribute to the issue?
85

86 Possible deficiencies in market analysis and highest and best use analysis: Do these
87 types of deficiencies exist and if so, can they lead to value opinions that are not credible?
88

89 Data verification: Are valuers obtaining adequate information about what interests are
90 included in a sale transaction?
91

92 Ethics issues:

93 Are there instances where valuers take positions that are not reasonably supported but
94 that advocate the cause of their clients? If so, how pervasive is this problem?
95

96 Has the profession lost the confidence of some whom it serves (public trust) because of a
97 perception that valuers can provide differing values on the fee simple estate in the same
98 property, and, if so, what can be done about it?
99

100 Are valuers making assumptions relating to occupancy and vacancy that aren't
101 appropriate for the intended use or aren't properly disclosed in the valuation report? If so,
102 what can be done to resolve these problems?
103

104 Client relations issues:

105 Many clients may not understand what estates/interests are and which needs to be
106 valued when. This can make it difficult for the valuer to frame the assignment properly.
107 What can be done to ameliorate this?
108

109 Valuers need to learn to help clients "get the question right." What kind of assistance can
110 be provided to valuers to help them achieve this?
111

112 Other issues:

113 There is a need for the valuation profession to take the lead in establishing valuation
114 theory and practice, rather than the courts, regulators, or others. How can we ensure this
115 happens?
116

117 There is a need to expand on valuation education, especially if a change is made to
118 established definitions or theory. How can we ensure this happens?
119

120 The valuation profession's terminology relating to "fee simple" may be out of sync with
121 others in the real estate world. Is this a real concern, and, if so, how do we resolve it?
122

123 By the second day of the symposium, there was a common thread running through all the discussions
124 related to the definition of *fee simple estate*. Many participants thought that the definition currently used
125 by the valuation profession should be re-examined and probably revised.
126

127 Twelve individuals were nominated to a work group to draft a potential new definition of *fee simple estate*.
128 While this Fee Simple Definition Work Group met, the remaining participants split into smaller groups to
129 discuss methodology issues relating to the "fee simple" question.
130

131 **Proposal**

132 After deliberating, the Fee Simple Definition Work Group presented a proposed new definition, as follows:
133

134 *Fee simple estate. The highest estate allowed by law. An inheritable ownership interest of*
135 *indefinite duration.*
136

137 In addition, it was suggested that the valuation profession discontinue use of the terms *leased fee* and
138 *leased fee estate*.
139

140 The group as a whole debated these proposals for the remainder of the second day in conjunction with
141 the issues deliberated by the Methodology Work Groups. By the end of the symposium, there was
142 general agreement that the proposed new definition should be exposed for comment in a Discussion
143 Paper that provides an explanation of the rationale for the proposed change and its potential implications.
144

145 **Rationale for Proposed New Definition of *Fee Simple Estate***

146 The definition of fee simple estate currently used by the valuation profession and published by the
147 Appraisal Institute in *The Dictionary of Real Estate Appraisal*, 6th edition, is

148
149 Fee simple estate. Absolute ownership unencumbered by any other interest or estate, subject
150 only to the limitations imposed by the governmental powers of taxation, eminent domain,
151 police power, and escheat.
152

153 Symposium participants identified the phrase “unencumbered by any other interest or estate” to be a
154 source of potential confusion in the profession because some practitioners have interpreted that language
155 to mean that the property is to be valued as though vacant and available to be leased or occupied while
156 others have interpreted the phrase differently. Another potential source of confusion arises because the
157 definition of *fee simple estate* may differ with how the term is defined in *Black’s Law Dictionary* and often
158 used in other areas of real estate. For example, real estate agents typically list a property to be sold with
159 a lease (or leases) in place as “fee simple,” not “leased fee.”
160

161 The term *fee simple* has its roots in feudal England, when title to all of the land in the kingdom ultimately
162 resided in the king. At first, only the king had a permanent ownership interest in land. Over time,
163 individuals secured the right to acquire and pass on title without limitation. The name of this estate,
164 unrestricted in terms of duration, disposition, and inheritance, was “fee simple.” The terms *fee*, *fee simple*,
165 and *fee simple absolute* had to do solely with whether the estate was perpetual and freely inheritable.
166 They did not have anything to do with which “sticks in the bundle of rights” were being conveyed or
167 whether there were other claims encumbering the estate.
168

169 Other estates—leasehold, life estate, fee tail—had finite durations and restrictions on disposition. The
170 land reverted to the sovereign (lessor) at the end of the lease in the case of a leasehold, the end of the
171 person’s life in the case of a life estate, or after all specified descendants passed on without issue in the
172 case of a fee tail. Only the fee simple estate was, in essence, infinite in duration.
173

174 *Black’s Law Dictionary* defines *fee simple* as “An interest in land that, being the broadest property interest
175 allowed by law, endures until the current holder dies without heirs, esp. a fee simple absolute. Often
176 shortened to fee.”¹ This definition contains two key concepts:

- 177
- 178 1. the concept that fee simple includes a possessory interest in the land (it is the “broadest” form of
179 ownership)
 - 180
 - 181 2. the concept of inheritability (i.e., permanence)
 - 182

183 Both of these concepts reflect the term’s feudal origins.
184

¹ *Black’s Law Dictionary*, 10th ed. (Thomson Reuters, St. Paul, MN, 2014), 733-734.

185 In valuation literature, earlier versions of the definitions of *fee simple* and *fee simple estate* were more
186 consistent with the definition in *Black’s Law Dictionary*, and those earlier versions referenced inheritability.
187 But over time the valuation profession began to define the terms with respect to the *types of interests*
188 associated with the estate, not the character of the estate itself. *Real Estate Appraisal Terminology*, jointly
189 published in 1981 by the American Institute of Real Estate Appraisers and the Society of Real Estate
190 Appraisers, included this definition:

191
192 *Fee simple. An absolute fee; a fee without limitations to any particular class of heirs or*
193 *restrictions, but subject to the limitations of eminent domain, escheat, police power, and taxation.*
194 *An inheritable estate.*²
195

196 The first edition of *The Dictionary of Real Estate Appraisal*, published by the American Institute of Real
197 Estate Appraisers in 1984, included this definition:

198
199 *Fee simple estate. Absolute ownership unencumbered by any other interest or estate; subject*
200 *only to the limitations of eminent domain, escheat, police power, and taxation.*³
201

202 The earlier *Real Estate Appraisal Terminology* focused on the issue of inheritability, whereas the
203 definition in *The Dictionary of Real Estate Appraisal* introduced the phrase “unencumbered by any other
204 interest or estate.” This phrase has remained in all subsequent editions of *The Dictionary of Real Estate*
205 *Appraisal* published by the American Institute of Real Estate Appraisers and then by the Appraisal
206 Institute. Yet considering the *Black’s Law Dictionary* definition, the notion that the fee simple interest
207 implies a lack of encumbrances apparently is not used in the legal profession.
208

209 Once the definition became focused on encumbrances (or absence of encumbrances) rather than on
210 duration, some may have perceived potential ambiguity with regard to *what* was being valued—the
211 property as though occupied, as though leased at market rents, or as though vacant and available to be
212 leased or occupied. If the interpretation were the latter—that when valued in fee simple the property
213 would be valued as though vacant, or “dark”—then a deduction would be required to reflect any loss in
214 income over the lease-up period. Further, an occupied, performing property would need to be compared
215 to supposedly “comparable” sales of vacant, potentially functionally obsolete properties because those
216 would be the only sales in the market without leases in place. If this stance is taken, the resultant value
217 opinion could be significantly lower than if the interpretation were that fee simple did not mean “vacant.”
218

219 **Implications for Valuations**

220 The proposed revision of the definition would make it more consistent with the definition in *Black’s Law*
221 *Dictionary* and with its general use in other areas of real estate practice. Under the proposed definition,
222 *fee simple estate* would refer to the duration of a possessory right, not to which interests may or may not
223 encumber that estate. The interests associated with the real estate are of course highly relevant to the
224 appraisal assignment. But merely identifying the rights appraised as the “fee simple estate” does not
225 settle the appraiser’s question about whether any actual or hypothetical interests, such as leases or

2 Byrl N. Boyce, *Real Estate Appraisal Terminology* (American Institute of Real Estate Appraisers and Society of Real Estate Appraisers, Chicago, 1981), 102.

3 *The Dictionary of Real Estate Appraisal* (American Institute of Real Estate Appraisers, Chicago, 1984), 123.

226 easements, are to be included. A significant implication of this proposed definition is that the valuer likely
227 would need to identify not only the ownership estate (fee simple, leasehold, life estate) but also the
228 interests associated with the property to be valued.

229

230 *Title* is ownership or evidence of ownership. An *estate* is what is owned; it carries with it the hallmark of
231 ownership, which is the right of possession and the power to exclude others.⁴ *Interests* are rights in real
232 property; they can burden the land and affect the value of the estate. **What is valued is the estate
233 subject to specified interests.**

234

235 In the overwhelming majority of valuation assignments, the estate to be valued will be the fee simple
236 estate. Less frequently, the estate will be a leasehold, and on occasion a valuation assignment will
237 involve a life estate.⁵

238

239 Interests that may be associated with the real estate include all of the claims on the real property by third
240 parties, such as easements, restrictions, encumbrances, leases, reservations, covenants, contracts,
241 declarations, special assessments, ordinances, or other items of a similar nature.⁶

242

243 Another potential implication of the proposed revision to the definition of *fee simple estate* is that the
244 terms *leased fee* and *leased fee estate* would not be needed; in fact, such terms would be inappropriate
245 and would not be used. A lease is simply an interest in property, albeit a possessory interest. When a
246 property is leased, the lessor retains the fee simple estate, though the rights (interests) to use and occupy
247 the property are transferred to the lessee. The lessee now has a leasehold estate, but it lasts only until
248 the end of the lease, at which point the rights of use and occupancy revert to the lessor. “Leased fee”
249 would be presented instead as a fee simple estate subject to a lease.

250

251 The first step in the valuation process, problem identification, includes identifying “what is to be valued”,
252 or which estate subject to which interests. This information generally comes from the client; the valuer
253 must consult with the client to ensure that the valuation will address the correct estate and interests.

254

255 From a practical standpoint, the valuer can usually identify the interests to be reflected in the valuation by
256 referring to a title report that details the interests or rights associated with the real estate. The valuer
257 should consult with the client to identify any specifically included or specifically excluded interests, as well

⁴ Possession is the power to exclude others, and it is what makes an estate different from a mere interest in property. Possession (the power to exclude) is not identical to occupancy (the actual physical use of the property), and more than one party may have possessory rights at any given time. For example, a landlord and a tenant both have possessory rights to exclude others; because each has a possessory right, each has an estate (landlord: fee simple; tenant: leasehold). By contrast, the holders of mere interests in a property (such as a mortgagee or the beneficiary of an easement) has no possessory right and hence no power to exclude others.

⁵ Fractional interests in the fee simple estate may also be valued, such as mineral rights, development rights, and air rights.

⁶ *Uniform Standards of Professional Appraisal Practice*, 2016-2017 ed. (The Appraisal Foundation, Washington D.C., 2016: Standards Rule 1-2(e)(iv)), 18. Certain claims may grant rights to use the property for a specific purpose, such as to harvest timber, graze livestock, farm, or hunt.

258 as any presumed conditions of the property as of the date of value.⁷ For example, if the estate to be
259 valued is the fee simple estate, it may be valued

260

261 • subject to an existing lease,

262

263 • subject to hypothesized leases at market rates and terms, or

264

265 • as though vacant and available to be occupied or leased at market rates and terms.

266

267 Any presumed condition regarding occupancy must be clearly stated in the valuation report. The
268 methodology applied to arrive at the value opinion must reflect the presumed condition. That is, if the
269 assignment is to value the fee simple estate subject to the existing leases, the value will reflect any
270 nonmarket leases as well as time and cost to lease up unleased space. Or, if the assignment is to value
271 the fee simple estate as though subject to leases at market rates and terms, the value will reflect the
272 property as if fully leased to stabilized occupancy at market rates and terms. Finally, if the assignment is
273 to value the fee simple estate as though unencumbered by leases (“dark”), the value would reflect any
274 lease-up costs and loss in income over the lease-up period, if appropriate.

275

276 **Examples of Possible Statements in Valuation Reports**

277 As noted above, using the proposed revised definition of *fee simple estate* would require the valuer to
278 determine and clearly state in the valuation report (1) the estate (fee simple, leasehold, or life estate) as
279 well as (2) the interests associated with the real estate that are reflected in the valuation. The following
280 are examples of language that might appear in valuation reports:

281 Example 1

282 The purpose of this appraisal is to provide an opinion of the market value as of January 2, 2018
283 of the fee simple estate in 123 Main St., Anytown, USA, subject to the easements described in
284 the title report provided by XYZ Title Company, dated mm/dd/yyyy. A copy of this title report is
285 included in the addenda.

286 Example 2

287 The purpose of this appraisal is to provide an opinion of the market value as of January 3, 2018
288 of the fee simple estate in 456 Main St., Anytown, USA, subject to a lease between ABC
289 Investment Partners Ltd. and Goodpills Drug Store, dated mm/dd/yyyy. The lease terms and
290 conditions are more fully described on p. xx of this appraisal report.

291

292 Example 3

293 The purpose of this appraisal is to provide an opinion of the market value as of January 4, 2018
294 of the fee simple estate in 789 Main St., Anytown, USA. The value opinion is based on the
295 premise that the property is leased at market rates and terms and is at stabilized occupancy on
296 the date of value.

297

⁷ The definition of *market value* presumes a hypothetical sale of the property on the date of value. The question is, what rights or interests would affect the estate on the date of value?

298 Example 4
299 The purpose of this appraisal is to provide an opinion of the market value as of January 5, 2018
300 of the fee simple estate in 1011 Main St., Anytown, USA. The value opinion is based on the
301 premise that the subject is vacant and available for occupancy or lease on the date of value.
302

303 **Conclusions**

304 Based on discussions by participants in the symposium, this Discussion Paper explores the following
305 proposals:
306

- 307 1. Whether the definition of fee simple estate currently in *The Dictionary of Real Estate Appraisal*,
308 6th edition, and used throughout the Appraisal Institute's educational materials should be revised
309 to delete reference to "encumbrances," and to be more consistent with the definition in *Black's*
310 *Law Dictionary*, such as the following: *The highest estate allowed by law. An inheritable*
311 *ownership interest of indefinite duration.*
- 312
- 313 2. Whether the terms *leased fee* and *leased fee estate* should no longer be used in valuation
314 practice.
315

316 Potential implications of these proposals are that valuers would need to determine, and valuation reports
317 clearly state, the estate (fee simple, leasehold, or life estate) as well as the actual or assumed interests
318 associated with the real estate that are reflected in the valuation. Depending on the question to be
319 answered by the valuation (i.e., the problem to be solved) for a property that is leased, or would likely be
320 leased, the valuation could be subject to the existing lease, subject to leases at market rates and terms,
321 or as though vacant and available to be leased at market rates and terms. The valuer generally must
322 consult with the client for the service to clarify which interests to value.
323

324 **QUESTIONS FOR DISCUSSION PAPER RECIPIENTS:**

- 325 1. Do you agree with the definition of *fee simple estate* proposed in the Discussion Paper? If not,
326 why not?
327
- 328 2. If you agree with the proposed definition of *fee simple estate*, does the Discussion Paper
329 adequately explain the definition and its implications so that valuers as well as users of valuation
330 services can understand them?
331
- 332 3. What questions related to the issue remain outstanding? What is the best way for the Appraisal
333 Institute to assist in ensuring that these questions are resolved?