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How Do I Appraise Temporary Construction Easements?

Part One

Brian's Answer:

This is a technical topic. The appraisal of temporary construction easements (TCEs) could be its own IRWA course. We are taking a bite of this now and will be following up later with more analysis. Also, any feedback or edifying information is greatly appreciated — PLEASE SEND — and if you want to be cited in a future column, let us know.

A Temporary Construction Easement (TCE) is an easement that expires. TCEs are often used for construction or temporary workspace and commonly are only for a year or two, expiring upon completion of construction. They are not permanent and are typically used by the project for only a year or two but may last for years. We occasionally see terms of much longer than a year or two in very large projects that may persevere over decades.

The correct answer is typically either Method A: Area x Rental Rate* x Term of TCE or Method B: Area x Fee Unit Land Rate* x Term of TCE x Market-based Rate of Return, where Method A is the preferred method (*use the After Value, not the Before). Yes, we see some hybrid analyses when an agency only needs to be on the subject property for a short period of time but are not certain when they will be starting the project near that subject. These instances are almost always based on academic rationale with very little (or no) market evidence in support or refutation of the hybrid method. If you know of some sales of parcels impacted by these long-term active and/or inactive TCEs, please let us know at Ask@NRWRA.com. We will compile the data and release it at a later date. As this is an important and complicated subject, we intend on publishing Part 2 in the future.

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Together, they are the authors behind *Ask an Appraisal Reviewer.*

David's Answer:

TCEs are commonly appraised by simply paying the property owner a reasonable return on the value of that portion of a site that is being encumbered by the TCE (Method B above). A reasonable return is market based and often gleaned from published sources (such as CoStar or Realty Rates). For example, if a TCE encumbers one acre of a property worth $100,000 per acre, and a reasonable rate of return is 8.0%, an annual rental would be $8,000 per acre (8% of $100,000). If the term of the TCE is six months, compensation would be $4,000, and if it were two years, compensation would be $16,000. However, this method is a commonly used shortcut, often applied to nominal TCEs that involve limited compensation and is not truly accurate. The Uniform Appraisal Standards for Federal Land Acquisition (UASFLA/Yellow Book) states on Page 42: "even though technically incorrect, this shortcut is generally acceptable to agencies because of the nominal nature of TCE acquisition and the cost/time savings associated with the shortcut. However, appraisers must recognize that the shortcut methodology will be found unacceptable under these Standards if the indicated compensation is more than nominal."

The correct method for valuing TCEs is generally using rental concepts (Method A above), although we recognize that this method is less often applied. One needs to apply market rental to the land being encumbered by the TCE, which differs from a simple percentage return on land value. Again, from UASFLA on Page 42, "Damages that revolve from TCEs are usually based on the economic or market rent of the affected area for the term of the temporary easement." For example, if a TCE involves 10 acres of agricultural land for a period of one year, and market rentals are available that indicate farmland rents for $300 per acre, then the annual compensation for the use of these ten acres would be $3,000 based on 10 acres at $300 per acre is regardless of the market value of the land and based on market rental rates only. Of course, market rental and market value of land are not independent variables, but they are also not the same.

However, one must also realize that simply determining a fair market rental for the land is sometimes not adequate. A TCE is part of and may impact the after value of the entire property (and not just the area within the TCE). An appraiser must also contemplate whether a TCE will restrict the use of the unencumbered portion of the property for its highest and best use during the term of the TCE. In these cases, it may be necessary to apply a rent loss to all lands so affected whether within or without the TCE. Furthermore, TCEs are not independent acquisitions so the rent loss should be applied as an adjustment to the value of the remainder after the taking and not as something added to the difference between the before and after values.

Remember that for an appraisal where the highest and best use of the property after the taking is different than before the taking, or simply that the remainder has been damaged by the permanent taking, it is important to apply these rental concepts to the property after the taking. If the TCE occurs after the taking, the TCE impacts (and rents) after-taking property, not the property before the taking.

Recently, Orell Anderson, MAI, brought a memorandum entitled "Temporary Construction Easements – Payment of Compensation" to my attention, which was published on July 6, 2015. This memo lays out a few important considerations. For example, "TCEs are valued by the owner's loss in utility and enjoyment of the encumbered area for the entire TCE term/duration. This loss may be expressed as a discounted land rental rate."

There are also issues with the timing of TCEs, which will be dealt with in the future incarnation of this column ("How do I Appraise Temporary Construction Easements? Part Two"). One issue is whether it is necessary to discount the rental payments when the TCE last for more than a year or two. That is, using a present value (PV) for what should be a series of annual payments.

Additionally, there is the circumstance when a TCE is in place for a period of years, but the use of said TCE is restricted to a more limited period, perhaps only a few months. In this case, there is an argument that the market rental-based compensation for the entire two years would be less for those periods of time that the TCE is not actually being used. However, the 2015 Caltrans memo states "TCEs cannot 'float.' A TCE for a 12-month anticipated duration to be used within the 36-month timeframe is not permitted. Both Caltrans and FHWA agree that this constitutes a 'taking' (encumbrance) even if actual/physical possession is only anticipated for 12 months. The property must be compensated for the entire TCE term (in this case, for the entire 36 months duration."

Again, any feedback or edifying information regarding TCEs will be greatly appreciated — PLEASE SEND! And stay tuned! ✪

Have a burning question about appraisal review or appraisal? Ask an Appraisal Reviewer is open for questions or topics to tackle! Reach out to **ask@NRWRA.com** to submit your question today.