

Is Across-the-Fence Value Equal to Market Value?

**IRWA Educational Conference
San Diego, California
June 16, 2015**

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BUSINESS & REAL ESTATE VALUATIONS

What is the goal of valuation assignments?

Market Value

Implied value “as is”

- USPAP requirement for hypothetical conditions and extraordinary assumptions



What is Across the Fence (ATF)?

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

Why are we asking this question?

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



Background:

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



Background (continued):

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



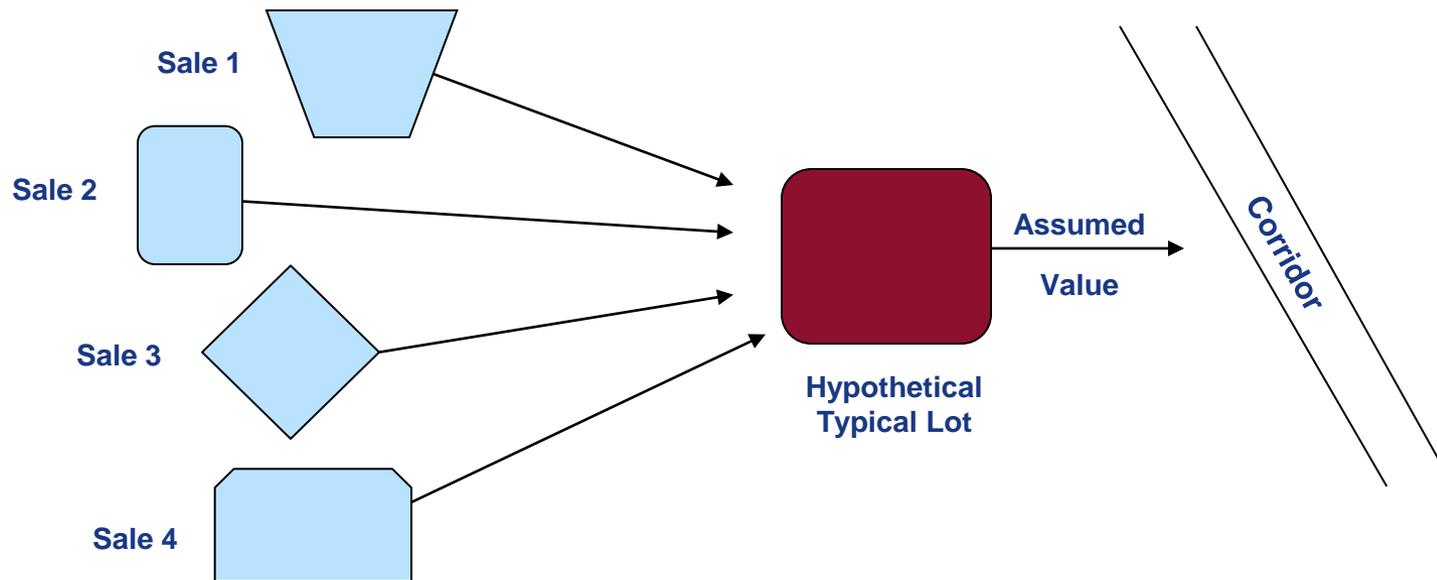
ATF Process

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

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

ATF Process (continued)

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



ATF Process (continued)

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



ATF Process (continued)

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

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

ATF Process (continued)

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

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



Issues with the ATF Process

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

Presumed + at least + is worth

Assumed Minimum Value = AMV

Extraordinary Assumption = USPAP Disclosure Requirement



Issues with ATF Process (continued)

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



USPAP Definition

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



Extraordinary Assumption (continued)

- **Comment:**

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



USPAP Definition

- Hypothetical condition:

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



Hypothetical Condition (continued)

- **Comment:**

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



Definition (Dictionary of Real Estate Appraisal)

- Excess land:

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



Surface Transportation Board

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



STB Questions and Responses

- Question 1:

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



STB Questions and Responses

- Response to Question 1

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



STB Questions and Responses

- Question 2:

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



STB Questions and Responses

- Question 3:

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



STB Questions and Responses

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



STB Questions and Responses

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



Rail Corridor Economics

- ATF fails to consider economic profile of the corridor
 - STB created primary and secondary legal units
 - Economic profile different between active rails and excess land



Rail Corridor Economics (continued)

- **Facts:**
 - Active rail tracks: 100% demand for center portion of the corridor
 - Excess land: Generally less than 100% demand for excess land



Rail Corridor Economics (continued)

- Active rail tracks
 - Center 17 feet to 25 feet (no standard)
 - Land residual method
 - Railroad operating income attributed to land (miles of road)
 - residual operating income per rail car per mile of road



Rail Corridor Economics (continued)

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

Rail Corridor Economics (continued)

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

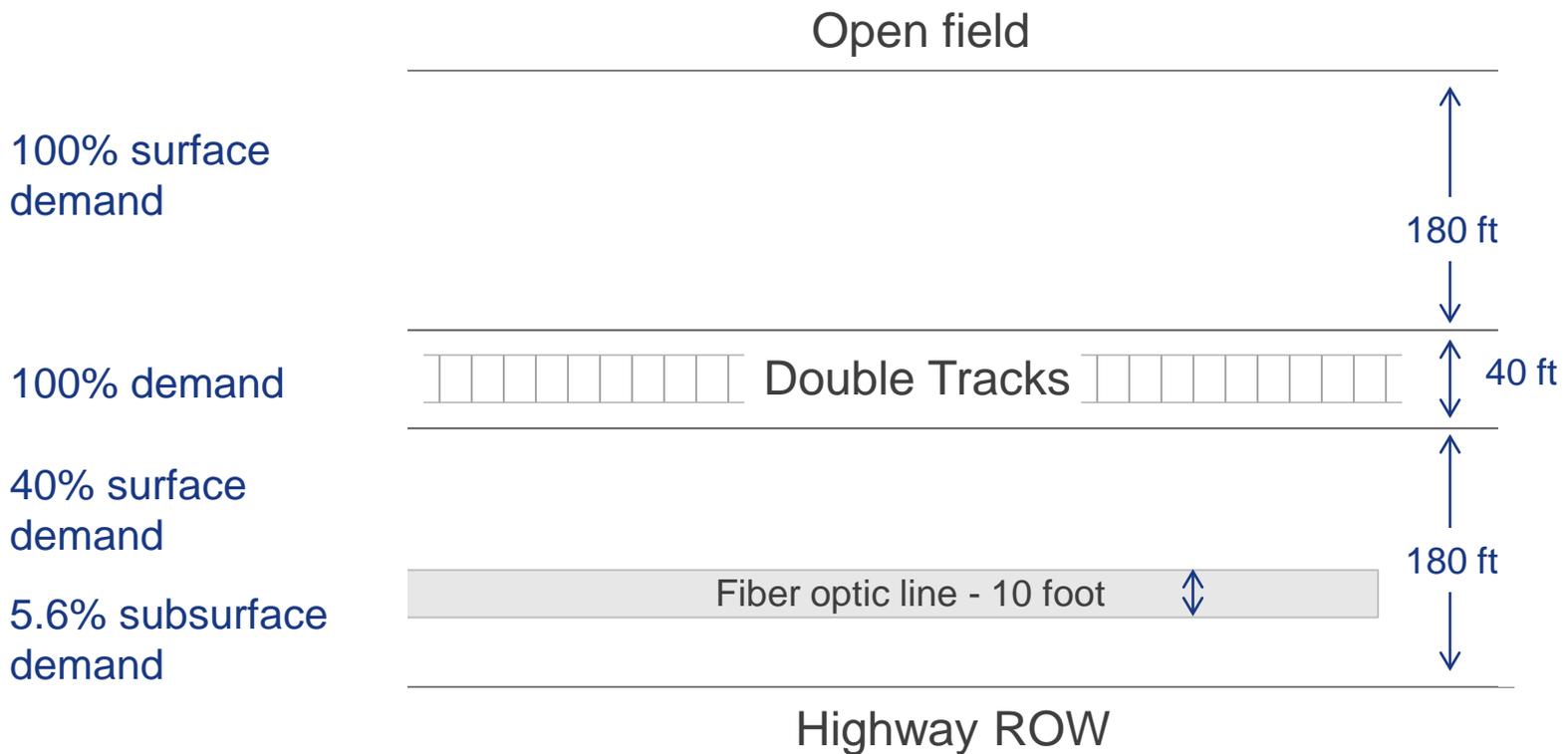


Example 1

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



Exhibit 1

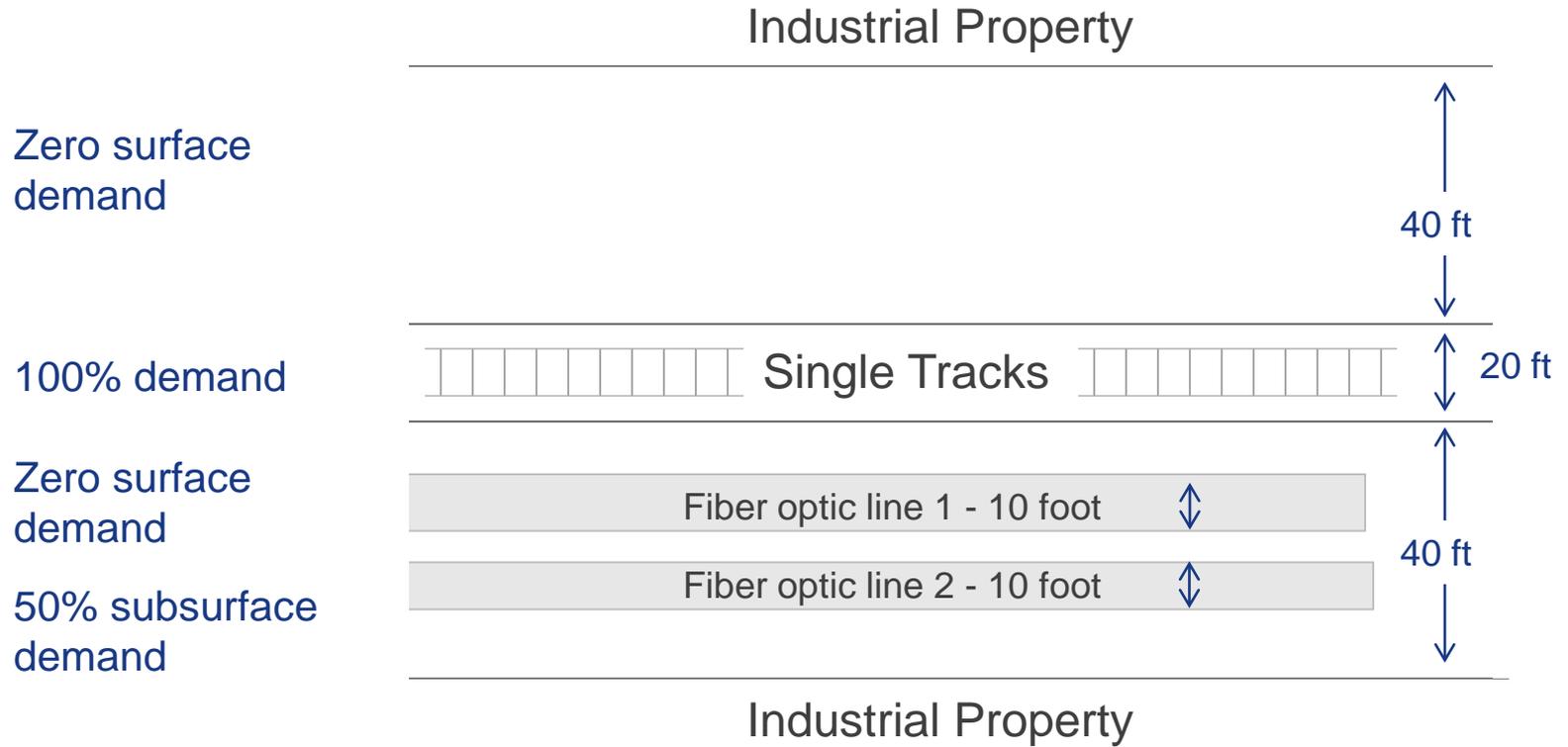


Example 2

- 100-foot wide corridor with one track and two easements
 - Active tracks: Center 20 feet
 - Industrial property one side: 40 feet excess land – zero surface demand
 - Industrial property on other side with two 10-foot wide pipeline easements – zero surface demand



Exhibit 2



AMV Implied Assumptions

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



Central Flaws in ATF Methodology

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



Is Across-the-Fence Methodology Equal to Market Value?

NO

The ATF methodology, as currently used, is
MISLEADING



Is There an Alternative?

- How to avoid the flaws of the ATF methodology
- Market-based appraisal methodology
 - Recognize the primary and secondary use of the land (active tracks)
 - Eliminate the AMV (Extraordinary Assumption)
 - Recognize all physical, legal and financial differences and make appropriate adjustments



For more information

Please see the article:

Is Across the Fence Methodology Consistent with Professional Standards?

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



About John Schmick

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



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