

Learning Objectives

- Identify key concepts associated with the valuation of property
- Define fair market value
- Review the appraisal process
- Describe the approaches to value in appraisals



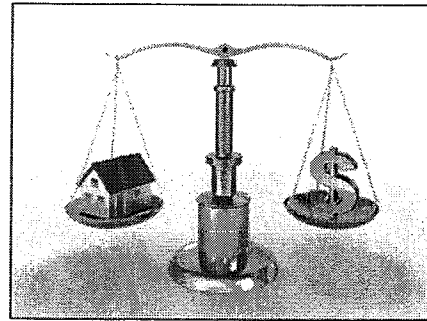
Key Message: We have four objectives to discuss in this module

The concepts will address:

1. What is valuation and the valuation process
2. What is fair market value; its origins, and use
3. What is an appraisal, how is it related to valuation and fair market value
4. How do appraisers derive a value for a given property

Concepts

- Just Compensation
- Fair Market Value
- Appraisal
- Willing Buyer and Willing Seller



Key Message: These are the critical elements of valuation and reflect the foundation of the work we do in acquiring property for capital projects.

Notes:

Just Compensation- The payment required by the US constitution and many state constitutions; this will be further addressed in a later slide. It is the terminology used in the constitution. It is the goal of the valuation process.

Fair Market Value- An appraisal concept that often the equivalent of Just Compensation. Early court decisions indicated that Just Compensation could be best approximated by determining fair market value. This will be defined in detail in a latter slide

Appraisal- The document and process used to determine fair market value. This term has an exact meaning within the scope of the Uniform Act. It is defined in 49 CFR Part 24. The definition and citation are indicated on latter slides.

Willing buyer and seller- The parties that determine “value”; and ultimately our estimate of value. The action of these parties is the foundation of the concept of fair market value. This will be further explored in a later slide.



Fair Market Value

- Willing buyers and sellers – not compelled
- Each with full knowledge
- Arrive at mutually agreeable price



Key Message: Fair Market Value is what we measure by the appraisal.

Notes:

In the private market, buyers and sellers acting without coercion make decisions that reflect the value of a parcel of real estate. When those parties reach an agreed price based on reasonable knowledge of the market, they have established the value of a particular parcel. Looking at the cumulative effect of many such transactions, can gauge how much something is “worth.”

It might be helpful to relate this concept to non-real estate matters, such as buying a used car. Seeing what others pay for something may provide guidance in determining what someone else is likely to pay.



Fair Market Value

- Estimated through appraisal
- 49 CFR 24.2(a)(3) :
 - "... a written statement independently and impartially prepared by a qualified appraiser setting forth an opinion of defined value of an adequately described property as of a specific date, supported by the presentation and analysis of relevant market information."



Key Message: Part 24 defines an appraisal. An appraisal is only an estimate of FMV.

Notes:

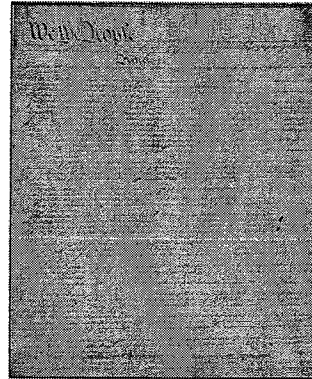
We estimate the value of a real estate parcel with an appraisal since we do not have a true situation involving willing buyers and sellers. The appraisal is our method to estimate the actions of such parties. We try to get close to the value through appraisals and usually the result is accurate. However, it is only an opinion of value.

Refer to the referenced citation for the location of the definition of an appraisal. Note that the definition contains the language "the presentation and analysis of ..." this is the aspect that is often missing from appraisal obtained by transit agencies. The appraisal must explain its assumptions and calculations.

Just Compensation

5th Amendment to the US Constitution:

"...nor shall private property be taken for public use, without Just Compensation..."



Key Message: The Fifth Amendment is basis of the valuation of real estate in eminent domain actions.

Notes:

This short phrase has been the subject of thousands of cases over the two hundred plus years of US history. Determining Just Compensation is the critical step in the process of acquiring property.

The Amendment is generally not limiting on a governments right to acquire, but does set out that the property must be paid for and that the standard for payment is Just Compensation.

The most recent significant legal reference is the "Kelo Case" 2005 (Kelo versus the City of New London). In this case, which took place in Connecticut, the US Supreme Court ruled that legislative body can determine what is the "public use" mentioned in the Fifth Amendment. The case was a redevelopment case, but the principle applies to all eminent domain cases. Many States used this opportunity to update their eminent domain statutes.

When Federal and State law do not mesh perfectly, then the grantee must adopt the more stringent requirement. A grantee must meet both levels of requirements. For example, if a grantee is permitted under State law to make a verbal offer, while the Uniform Act (Federal Law) requires a written offer, then the grantee must make a written offer to comply with the more stringent of the two permitted methods.

Just Compensation Process

- Appraisers estimate Fair Market Value
- Review Appraiser recommends Just Compensation
- The Agency sets the Just Compensation



Key Message: This is the model process which should be followed for Uniform Act work.

Notes:

This is a sequential process and there are intermediate FTA approvals required (e.g. appraisals over \$500,000). These approvals must precede offer or settlement.

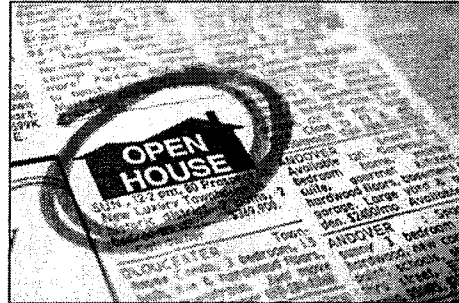
An Agency must have a process to value property through an appraisal; review that appraisal; and use the appraisal and review to establish the offer to be made to the property owner which is the Agency's offer of Just Compensation. The offer cannot be less than the approved appraisal.

The Review Appraiser has a critical role in the process of formulating an offer. This will be discussed further in Module 4.

Best Approach in Appraisals

Sales Comparison Approach

- Regarded as the best and legally most secure approach for Eminent Domain situations



Key Message: The courts have repeatedly emphasized that the best measure of fair market value is a direct comparison with other similar sales. No other approach is needed if adequate market sales exist.

Notes:

The Sales Comparison Approach is simple and direct. For example, if a vacant lot next to a subject property sells for \$10,000, then it is reasonable to assume that the subject property will also sell for about \$10,000, if all other factors are equal. The approach makes sense, is easy to explain, and is very logical.

The following Learning Activity will provide examples and simple applications.

Other Approaches to Value in Appraisals

- Income Approach
 - Valued by income production
- Cost Approach
 - Value by cost to construct less depreciation



Key Message: These are the “second string” in terms of valuation in eminent domain work.

Notes:

The Income Approach uses the concept of a stream of revenue converted to a lump sum to develop an indication of the value of a parcel. This can be easily demonstrated by posing the question, “how much would you pay me in a lump sum today for the right to receive a specific annual payment of \$1,000?” The lump sum figure is an estimate of the value of the future stream of income.

The Cost Approach uses the depreciated cost of new improvements to estimate their value. It does not provide a land value, since land is not depreciated. So land must be added to the determined value of the improvements to indicate a value of the entire parcel. However, cost does not always equal value and that is a weakness of the approach. The Cost Approach is often used with special purpose properties—hospitals, elaborate churches, etc. It may also be used in improved partial takes.

Grantee Pre-Appraisal Activity

Scope of Work

- Grantee and appraiser must develop a Scope of Work, § 24.103 (a)(1)



Key Message: The scope of work is a new point of emphasis. FTA grantees typically have not completed this step. Appendix C, USPAP Q & A.

Notes:

The parcel appraisal Scope of Work should be developed for each parcel. It is best developed mutually with the parcel appraiser. The idea is that the grantee should set expectations of the content of the appraisal in writing with the appraiser.

Review with the class the 5010.1D, Appendix C; and USPAP Standards material in the Appendix. The Standards material addresses whether it is proper for an appraiser to develop the Scope with the client. The short answer is that it is permissible.



FTA Experience

- Appraisals lack substance and do not meet requirements
- Realty / personalty reports not complete
- Appraisal missing or obtained "post-agreement"



Key Message: FTA review of grantee appraisals indicate that there are significant problems.

Notes:

Issues with appraisals include:

- Not showing adjustments when these are significant
- Poor description of realty
- Inadequate approaches (e.g., income approach but no comparable sales approach)
- Realty/personalty reports –Now are a requirement of an appraisal if taking includes any improvements. There must be a clear delineation of realty (which is acquired by the Agency) and personalty (which is moved by the Agency under the relocation program.)

Some agencies appear to reach a settlement or begin negotiations prior to obtaining an appraisal. They may also fail to complete the review until after settlement. These are not acceptable practices.