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The Abutter Approach

Frequently a particular party, usually an individual owning abutting property, has a special interest in purchasing property being appraised. Under such conditions, the appraiser's client will often request an estimate of the value of the property to the abutter. Value to the abutter may greatly exceed that in the general market. This article describes the "abutter approach," a method for estimating such value.

To estimate market value, appraisers make certain assumptions about what constitutes the market. We assume a hypothetical willing buyer and a willing seller, both motivated as described in the numerous definitions of market value. When we inform our clients that their property is worth $2 million because it can be subdivided into 20 lots and they object that they have no intention of subdividing and, in fact, have promised a relative on his or her death bed that they would never subdivide the property in question, we are quick to answer that the value we are estimating is not the value to them but to a more general market, under the property's highest and best use. We properly blind ourselves to the circumstances of individuals who may be closely associated with a property and train ourselves to look from the perspective of a larger outside market. In many situations, however, we are able to identify a particular party with a special interest in purchasing a property being appraised, and here the usefulness of our assumption of a general market breaks down. To serve our clients properly in such cases, we must temporarily unblind ourselves to the motives of particular individuals whose intentions can have a substantial impact on the probability of achieving one price or another.

In many situations, a particular party, an "abutter," has special motivations for purchasing a property being appraised.

In this article, certain situations in which it is necessary to consider the special motivations of identifiable potential buyers, usually "abutters," are described; a formal methodology for valuation is described; methods of reporting to the clients the value conclusions reached in such analyses are discussed; and finally, obstacles that make identification, analysis, and

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reporting more difficult in these instances than in others are considered.

CLIENTS' NEEDS

Several years ago, a major oil company with which our appraisal office has had a long-standing relationship requested that we begin including in our reports analysis of certain factors that we had previously not included. When this client was about to dispose of surplus holdings in other cities, it contracted for appraisal services and sold properties at their appraised values. It then sometimes found that the buyer might be an assembler paying far higher prices per square foot for other parcels on the same block because through the process of assemblage, a new use was possible. The client wanted to know the potential for such change in local properties and whether it might be to its advantage to attempt to act as an assembler rather than as a contributor to another party's assemblage.

Another client in a similar situation was the operator of a large network of rail corridors. Occasionally this client would be approached by a party interested in acquiring a short stretch of unused surplus track. The client asked that we estimate "enhancement value." Although we could not find a definition for the term, we were well aware of what the client was after—not the value of the surplus parcel in the general market but the increase in value of the property to the party seeking the acquisition, usually an abutter. The client was aware that the value would be higher due to the proposed acquisition. At times, we did our best to satisfy the client's request. At other times, not being told even the identity of the party who wanted to acquire the property, we ignored the request, delivered the usual market value appraisal, and were left wondering whether we had provided a useful service.

In both instances, we were asked for an analysis distinct from the usual market valuation. In both instances, we were at a loss for a comprehensive means to meet the request. We were asked for a value that seemed to have no definition, to be reached through an analysis that we had not been taught. The advantage in each instance was that the client was relatively sophisticated and capable of leading us, albeit vaguely, in sophisticated directions. In other cases, the client was not so sophisticated at all, and then neither the client nor the appraiser asked or answered important questions when an obvious, substantial source of value distinct from market value lay waiting to be discovered.

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THE ABUTTER APPROACH

"Enhancement value" is the amount by which the value of a property is increased through assemblage of another property into the same ownership. Although our clients used an unfamiliar, undefined term, in fact, they were asking for an estimate of value that recognized plottage. The method we used is the reverse of the procedure for estimating loss in value due to a partial taking. The value of the parcel into which the subject is to be assembled is estimated before and after the assemblage, and the difference between the two values is the enhancement value. The method, for lack of a better term, may be called the "abutter approach" because it usually, though not necessarily only, involves analysis of the interest of abutters.

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Estimating enhancement value through the abutter approach involves several steps: identification of abutters, before-and-after analysis of the potential for enhancement to each, and reporting of the conclusion to the client.

IDENTIFICATION

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A complete list of the parties for whom there may be a special enhancement through acquisition of a property being appraised would certainly include all those whose property shares a boundary with the subject. Other abutters may be those whose property is separated from the subject by a physical barrier such as a street but who may be in sufficient proximity to the subject to make the subject especially attractive. Sometimes, even though the physical separation between properties may be great, the potential enhancement value through new use is so large that distant properties should be included. For instance, a small undevelopable beach may afford inland hotels the opportunity to offer their clientele private beach use, thereby substantially increasing revenues and yielding an enhancement value equal to what would be lost if the hotel had originally been owned together with the beach and the beach taken by eminent domain. When the interest being appraised is a fractional interest (leasehold, leased fee, interest of the holder of a mortgage, easement, timeshare interest), it would be advantageous to list the holders of other fractional interests in the same property. For example, a tenant might be especially motivated to acquire the fee interest in a leased property at a price above its value on the more general market. For commercial property, the list might also include those whose business interests other than in real estate might especially be enhanced through acquisition. There are those whose motives might be personal—a wealthy former president, for instance, wanting to acquire his or her birthplace for preservation as a national landmark, particularly if a developer threatens demolition. Often, the identity of potential buyers with special motivations is readily apparent. At other times, compiling a complete list may be extremely difficult because the business interests of some potential buyers are well hidden. Completeness will likely require the cooperation of numerous parties who may question why the appraiser is delving into areas of unorthodox inquiry.

ANALYSIS

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For each abutter, the method of analysis is the same. The abutter's property is valued with and without the subject, and the difference between the two is the enhancement value to that particular abutter. This analysis is performed for each abutter. When the highest and best use of both the subject and an abutting property is for the same type of development, measuring enhancement value may require no additional sales research beyond that required for the market valuation of the subject. In such an instance, the value of the abutting parcel in both the "before" and "after" situations can be readily calculated. When the highest and best uses differ, measuring enhancement value may require considerable additional market research. In many cases, information required for a thorough analysis of enhancement simply cannot be obtained. Most likely the appraiser has the cooperation of the owner of the property being appraised but not of abutters. The appraiser may have difficulty gaining access to a building, to lease information, or to business records of abutters who may well recognize their role as potential bidders for the subject property and for that reason be especially unwilling to make disclosures to an agent of the other party in negotiation. The abutter's interest valued is usually a real property interest and is therefore within the expertise of the real estate appraiser. However, in some situations it may be an abutter's business interest other than real estate that is enhanced, and proper analysis requires an expert in business valuation. When the abutter's motivation is noneconomic and personal, as in the example of the former president's home, analysis (presuming that a dollars-and-cents analysis can be made at all) may require a personal interview to determine the strength of the abutter's motives and means.

REPORTING

One or more values calculated in the abutter approach are reported to the client as enhancement values. Enhancement value is distinct from market value in that it is an additional amount that may be fully achieved in the event that the advantage in negotiation goes entirely to the owner of the subject. It is a component of market value in the delivery of the final value estimate to the client.

Presumably, several analyses have been performed: a sales comparison approach, in which the market value of the subject in the general market of nonabutters is estimated; perhaps an income capitalization approach; perhaps a cost approach; and an abutter approach, in which one or more estimates of enhancement value are provided. An explanation and calculation of each of these approaches is set forth in a separate section of the report. The task of reaching conclusions regarding the relative significance of each approach is handled in the reconciliation and final value estimate.

An appraiser would probably begin by reconciling the estimates from the sales comparison, income capitalization, and cost approaches as the market value to nonabutters and reporting this value to the client as a point estimate, range, or probability curve.[1] The separate enhancement values to different abutters are then set forth. Because the presentation can become complicated, it is often helpful to use a simple line graph identifying different values on the spectrum. It is important that the client understand the meaning of the different points, the enhancement values being amounts that may potentially, though not necessarily, be achieved.

The abutter's interest that is valued is usually a real property interest and is, therefore, within the expertise of the real estate appraiser.

In some assignments the above process may represent adequate reporting, leaving the client with the appraiser's estimates of market value to the market of nonabutters and enhancement value as the ends of a negotiating range, with a conclusion regarding the outcome beyond the scope of appraisal.[2] When the function of the appraisal is for eminent domain, taxation, or mortgage lending and a one-number conclusion is required, the appraiser must take the analysis a step further.

Enhancement value is distinct from market value in that it is an additional amount that may be fully achieved in the event that the advantage in negotiation goes entirely to the owner of the subject.

In all cases, the market value to nonabutters will represent the low end of the value range. Whether the high end, represented by the enhancement values, can be achieved depends on whether a particular abutter recognizes the potential for enhancement, has the financial means for acquisition, and is willing to pay an amount above the market value to nonabutters. If an abutter has been active in ac-

1. Eric T. Reenstierna, "Alternatives to Point Estimates," *The Appraisal Journal* (January 1985): 115–126.
2. Joseph D. Albert, H. Stan Banton, and Thomas D. Pearson, "Valuing Real Estate Under Conditions of Bilateral Monopoly," *The Appraisal Journal* (October 1982): 532–536.

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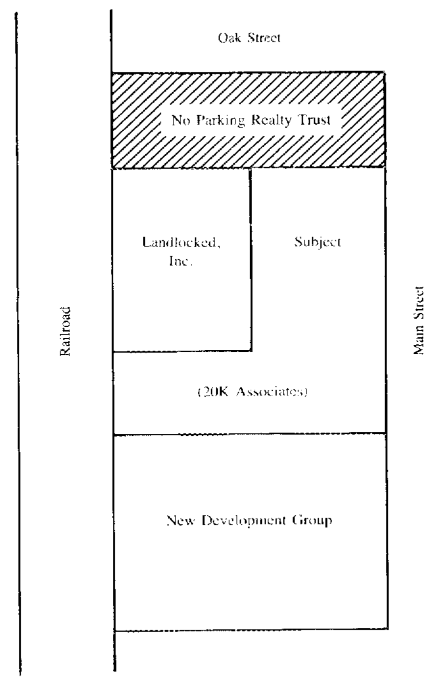
quisitions and has demonstrated a willingness to pay prices at enhancement value levels, then the enhancement value for that abutter may be judged the most probable selling price and the market value. If the abutter's awareness, means, or willingness are less clearly demonstrated, then the final estimate of market value may be a weighted average of the indications of value; the weighting depending on the appraiser's judgment of the relative probability of occurrence of the various scenarios. Suppose you have been asked to appraise a vacant, 20,000 square foot business-zoned site. In your research you find several comparable sales, make adjustments for differences, and arrive at value indications for the subject in a range of $12 to $18 per square foot, with several at about $15. You conclude that the value of the subject in the market of nonabutters is $300,000 ($15 per square foot, or a range of $12 to $18).

In the abutter approach, the layout of the block in which the subject is located must be considered (see Figure 1). The subject, 20K Associates, has three abutters: No Parking Realty Trust, which owns a 20,000 square foot, two-story office building without parking on a 10,000 square foot site; Landlocked, Inc., owner of a vacant, rear, 10,000 square foot site without access; and New Development Group, the owner of a 40,000 square foot assembled site with minor, older improvements.

No Parking Realty Trust's office space could operate more efficiently with 20,000 square feet of parking. Because it lacks parking, the building suffers a rent loss of $3 per square foot, which could be recouped through acquisition of the subject. The enhancement value of the subject for No Parking Realty Trust can be measured as the additional rent capitalized at the market rate, or $600,000 (20,000

FIGURE 1 Layout of Block in Which Subject is Located



square feet of building times $3 per square foot, capitalized at 10%).

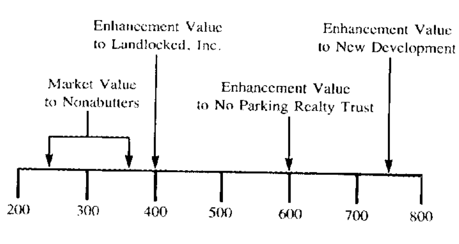
Landlocked, Inc.'s parcel is of nominal value because No Parking Realty Trust, though an abutter, is blocked from access by its own building and there is no access except through the property of others. If access were available, Landlocked, Inc.'s parcel, which has no street exposure, would be worth $10 per square foot. Landlocked, Inc. has a special motive for acquiring the subject in that the subject can provide access, thereby unlocking Landlocked's value. The estimate of the enhancement value for Landlocked, Inc. is the difference between the value of its holding before acquisition ($0) and after (20K Associates' 20,000 square feet at $15 per square foot plus Landlocked, Inc.'s 10,000 square feet at $10), or $400,000.

New Development Group's 40,000 square feet are also worth $15 per square foot without assemblage of the subject, or $600,000. A provision of the zoning bylaw states that a floor-area ratio bonus to 1.5 (from the standard 1.0) is available for parcels that exceed 50,000 square feet. Assemblage of the subject would put New Development Group's holding over the limit, thus qualifying it for the bonus. Because acquisition of the subject more than doubles the amount of building New Development Group can undertake (40,000 square feet of building possible before assemblage versus 60,000 square feet of land times 1.5 floor-area ratio, or 90,000 square feet of building possible after assemblage, an increase of 125%), the enhancement value of the subject for New Development Group is $750,000 (125% of $600,000).

The several value conclusions for the subject can be displayed graphically (see Figure 2).

Landlocked, Inc. is owned by a cocaine addict who has spent his inheritance and faces bankruptcy. Consequently, realizing the potential for enhancement value from this source in the near future appears low. However, both No Parking Realty Trust and New Development Group are competently managed by owners who are aware of the enhancement available through the subject, have substantial financial resources, and can obtain the same benefits from no other source. Up to a price of $600,000, then, it would appear that there is a competitive market of two bidders. Between $600,000 and $750,000, there is one bidder who can justify a price in that range. It can be concluded then, that the market value of the subject property ranges from $600,000 to $750,000, a level well above the $300,000 value to nonabutters. As appraisers, we can additionally serve the client by pointing out the possibility of selling No Parking Realty Trust the surface rights to the site, Landlocked, Inc. an access easement, and New Development Group the fee simple rights encumbered by the two easements, thereby meeting each of the abutter's needs and realizing a gross sellout well in excess of the amount available from any one purchaser.

FIGURE 2 Value Conclusions for Subject (20K Associates)



OBSTACLES

There are a number of reasons why few of the methods outlined here have found their way into the everyday appraisal process, most having to do with obstacles to practical application. First, it may be difficult to identify all abutters when some may be parties with hidden business interests. Determining whether a particular abutter is aware of the potential for enhancement and has the financial means to take advantage of that potential and calculating the amount of the enhancement when the calculation may require information regarding lease terms or business operations all require information that may well not be available to the appraiser, making the inquiry seem fruitless. Often, specially motivated abutters become known to the appraiser only during the course of the appraisal, after the client and the appraiser have agreed on a fee. Because the abutter approach requires a before-and-after appraisal of the interest of at least one abutter in addition to the scope of work originally envisioned, extra work is created for the appraiser. Finally, the necessity to

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report the conclusion of enhancement value as a potential amount that may or not be achieved can make the final value conclusion appear less reliable when an unspoken goal of the appraisal is to deliver an uncluttered conclusion with certainty. Of course, all of these are reasons why the abutter approach is not undertaken, not why it should not be.

The value of a particular parcel may be affected greatly when it offers unique enhancement to its abutters.

When the need for abutter analysis only becomes apparent during the course of an assignment, it is appropriate to complete the assignment as originally envisioned and inform the client that a before-and-after analysis of the abutters' property is required. The client is then fully informed, and it is the client's decision whether to proceed with the additional analysis.

CONCLUSION

Because parcels of real estate are locationally unique, with no two being identical and few sharing the same abutters, the value of a particular parcel may be affected greatly when it offers unique enhancement to its abutters. Such situations are infrequent for developed residential property or substantial office buildings, shopping centers, and industrial facilities. They are more common, however, for relatively smaller commercial properties and development land, when enhancement value may represent the bulk of the market value. In any appraisal assignment, the appraiser should be aware of the potential for enhancement. Properly applying the abutter approach means identifying abutters, performing a before-and-after analysis of each, and reaching conclusions regarding the likelihood of realizing enhancement value. In addition, it means taking an approach to value that is somewhat at odds with other appraisal methods. It means looking for value not in the thing valued but in the change in value of the things with which it may be combined. It means looking not at a general market of hypothetical buyers but at specific, identifiable individuals, whose peculiar motives and financial means directly affect the likelihood of realizing enhancement value. It means attempting to work with information that may be less than adequate and delivering the value conclusion perhaps as a broad range in a form that we might wish could be more certain. It also means more work. And, certainly, it means giving the client a more complete answer than could be delivered otherwise, as complete an answer as is possible within our current data-gathering and analytical capabilities.