CAN ONE HAVE THEIR GRAPES AND EAT THEM TOO?

A case study on contributory value

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An appraiser's general role is to determine the fair market value of property being acquired. This can be done, in part, by analyzing various property components that contribute to its overall value. A recent acquisition involving the authors highlights the importance of understanding the concept of contributory value and how failure to do so can result in unreliable value conclusions.

An Introduction to Contributory Value

According to "The Dictionary of Real Estate Appraisal, 7th Edition," contributory value reflects the amount a property or property component contributes to the value of another asset or to the property as a whole. A second included definition is: "The change in the value of a property as a whole, whether positive or negative, resulting from the addition or deletion of a property component. Also called *deprival value* in some countries." The Appraisal of Real Estate, 15th Edition, provides a good explanation as well; in essence, contributory value answers the question: "How much does a specific component add to the value of the property as a whole?"

Contributory value is the change in value to the overall property from either the *addition* or *deletion* of a property component. Additionally, the existence or nonexistence of a component can have a *positive* or *negative* effect on value. Take, for example, an older single-family home located on a busy street where the highest and best use is for mid-rise

office redevelopment because the land value as if vacant is higher than the value of the property as improved. Even though the home is functional and livable, greater value can be "unlocked" by demolishing the improvements. In this case, the residence does not contribute to market value at all; in fact, the cost of demolishing the improvements for redevelopment negatively impacts value and a perfectly functional improvement has no contributory value because it is inconsistent with the property's highest and best use.

Standards and Case Law on Contributory Value

An appraiser's professional standards and applicable case law can also provide context on contributory value. As noted in the 2020-2021 Uniform Standards of Professional Appraisal Practice, an appraiser must refrain from valuing the whole solely by adding together the individual values of various estates or component parts. While a property component (such as a functional home) might appear to have a "market value" of a certain amount, appraisers need to analyze how that component contributes to the market value of the whole property. The 2002 California case *Emeryville Redevelopment Agency v. Harcros Pigments, Inc.* provides further insight on this issue; if the improvements are consistent with the highest and best use as improved, then the improvements can contribute value. On the other hand, the highest and best use may be to remove the improvements, which results in additional costs and detracts from the overall value.

A related concept to contributory value is the cost to cure an item versus the diminution in value if that item is not cured. In many instances, an acquisition involves altering a component of the property, which could reduce value. For example, if an apartment complex had a swimming pool located in an area being condemned, the apartment property owner could be entitled to compensation for loss of the pool. While this loss is sometimes measured as the cost to replace the pool on the remainder, if the cost to build a new pool exceeds the value reduction without the pool, then the owner could be entitled to the lesser figure (in this case, the value loss to the remainder).

In this example, the cost to cure an impact to the property's value cannot typically be used as a measure of loss if it exceeds the value loss without the cure. This issue of cost to cure versus diminution in value, set forth in the 1963 case *People ex rel. Department of Public Works v. Hayward Building Materials Co.,* illustrates how the contributory value of a component should be considered. Aside from the litigation context, such a cost/value analysis would also be considered by market participants in general; as noted in the Appraisal Institute's "Real Estate Valuation in Litigation," both the seller and the potential buyer would consider the cost to cure a deficiency if it was physically and economically curable. To not consider this test would be inconsistent with California law and with market participant behaviors.

Case Study

The case study involves a partial acquisition impacting a table grape vineyard in southern California. Various rights were being acquired, including a road easement that required removal of the property's only well and a portion of the existing vines.

Several components were considered as possible contributions to value, one of which was a well in the acquired road easement area. It was concluded that the cost to build a well on the remainder was less than the reduction in value as a result of the remainder not having a well in the after condition. Therefore, the severance damage analysis included a cost to cure (replacing the well) because that was the proper measure of the damages.

A change in crop values in the market area (unrelated to the project) provided another interesting aspect of the case. Around the date of value, table grape crop values had decreased to a point where local properties planted with grapes were being purchased and replanted with a different crop. Research indicated that buyers were essentially paying bare ground prices for vineyard properties similar to the subject. In other words, the vine improvements provided no contributory value because they did not contribute to the highest and best use for replanting, just as the house in the earlier example did not contribute to value because it was inconsistent with office use.

In this case, it was not appropriate to directly value the vines and add the result to bare ground value; the fact that vineyard properties and vacant properties alike were selling around the same price indicated that the vines had little to no contributory value. Similarly, it would be inappropriate to value a property with a well using sales of land without water and then adding the cost to install a well, nor would it have been appropriate to only use properties lacking a well to value the remainder, because market participants would have considered the cost to cure the deficiency.

The other side's exchange of valuation data revealed several issues related to that appraiser's analysis. First, their larger parcel value was based partly on adding what they believed to be the contributory value of the vineyard improvements (independently valued using a discounted cash flow analysis) to the value of the land, resulting in a value per acre that was over twice the amount of any vineyard property sale in the submarket. While the appraiser researched bare ground sales, no vineyard sales were included in the exchange of data to support their conclusion. Essentially, this discounted cash flow analysis "double-counted" the value of land; the vines cannot produce grapes without being planted into the ground, and so the present value of the income associated with the vines was reflected already as part of the land value.

The appraiser also did not consider the cost to replace the well in the roadway easement area, only the much higher diminution in value based on remote sales of land with no well. Compounding this issue was that the appraiser had a cost to cure analysis from their own well expert, who provided a replacement cost of about $500,000, far less than the opined diminution in value. Based on these figures, the appraiser's estimate of severance damages was over $1.2 million above their own well expert's estimated cost to cure.

These issues were the reasons that the difference in the parties' estimated value of the rights acquired was over $2 million. The parties were able to settle the case in mediation, but had the case moved forward, the other appraiser would have had to explain why they did not consider vineyard sales in support of their larger parcel value, or why they did not consider their own expert's well cost in valuing the remainder in lieu of the much higher diminution in value figure.

Conclusion

Contributory value can be a complicated concept to understand, let alone apply in practice. This is why having the right experts and legal counsel that understand complex valuation issues is paramount when acquiring property for any given project. No matter the party being represented, an appropriate valuation that considers how much a component of the property contributes to the value of the whole will ensure that the property owner is adequately compensated and that the public agency has responsibly expended public funds. ✪

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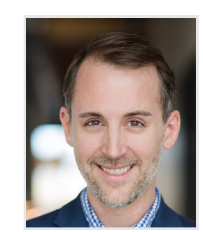

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