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Real Estate Section Feature

History of “Across the Fence” Valuation for Railroad Real Estate

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Having corridor and transportation property valuation methodology questioned is a regular occurrence for those of us working in railroad real estate. Consistent with market based principals of substitution railroad companies use “Across the Fence” methodology and when appropriate apply an “Enhancement Factor” in determining the value of a utility occupancy. Most of us have developed abridged explanations of the “Across the Fence” method. However, not all of us know the historical context. This approach in valuing railroad corridor has been accepted in the marketplace for over a century. Each year, more and more pressure is put on railroads by utility advocates to reduce the costs and processing times in granting utility licenses. These utility advocates pressure state legislators to enact statutes that predetermine those factors and set a flat fee for utility real estate rights, ignoring the marketplace role or the actual costs and needed processing time. Understanding the history of “Across the Fence” valuation for transportation corridors is important for railroad real estate professionals who are defending the corridor and transportation property market based valuation.

Real estate markets are influenced by public and private industry standards, policies and practices. The United States Congress has a significant role in shaping property valuation precepts. The Fifth Amendment of the United States Constitution states, “No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.” State constitutions mirror the US Constitution with respect to just compensation for taking of property.

Transportation corridors are formed by combining multiple properties acquired from multiple owners, an assemblage, the exception being lands conveyed by Congress, a single authority. Union Pacific Railroad and other North American Class I railroads are made up of numerous predecessor companies that were amalgamated by combining a variety of company and real estate interests over decades. Underlying real property interests reflect regional differences in transaction practices, deed construction and laws. Forming a binding opinion of title condition or estate interest requires legal expertise and should not be done speculatively.

Historic studies of transportation corridor valuation do not place emphasis on title condition, likely because there is no dispute that the railroad right of way and plant exists, a presumption being that title condition and construct is sufficient for the property’s use as a railroad right of way. The US Congress Interstate Commerce Act, March 1, 1913 required the Interstate Commerce Commission to “…investigate, ascertain, and report, the value of all property owned or used by every common carrier, subject to the provisions of this part…" (4) …creating a framework for railroad valuation accounting based on the late 1800's-early 1900's rate case valuation studies. The 1913 Act resulted in published instructions in 1918 establishing across the fence land value as the method for estimating value of corridor land described in part "…to find the value of similar land adjoining or adjacent to that of the carrier..." (5, pg 1). The US Interstate Commerce Commission in its 1918 *Instructions Pertaining to Land Appraisals* states "…As to lands within the ordinary right of way or station grounds, the appraiser need not concern himself (sic) with questions of ownership…" (5, pg 16) Today's value standard follows a similar practice, unless directed otherwise, valuations are done assuming title condition is valid and fee equivalent, and sufficient for a property's use as a corridor.

Today's transportation corridor valuation is rooted in the market behavior of transactions when railroad companies created the new routes (rights of way) that crossed the nation during the mid-1800's. Railroads sent land agents across territories to rent or buy town-site grant lands from local emigrates or residents paying prices at negotiated amounts 'based on the merits of the land minus improvements'. (1, pgs 183-196) Today's railroads seeking to acquire additional property continue to pay market based negotiated prices reflecting a property's highest and best use, vacant or improved, including other project amounts. (3)

Today's Across the Fence Land Value technique of the Sale Comparison Approach method (some argue that the appraisal method is the Sales Comparison Approach for the land component of the Cost Approach) is fundamentally based upon the findings of widespread studies of railroad shipping rates undertaken at the beginning of the 20th century to determine if the shipping rates were a fair return on land and property improvements values (investment). In the late 1800's and early 1900's, exhaustive land value studies, called physical valuations, were done by states of Michigan, Wisconsin, Minnesota, Texas, Alabama and Washington. The Midwestern state studies included obtaining all land transfer records within one and one-half mile of either side of the track centerline and extending the study area further outward at places with insufficient transactions, covering a 7 year period before the date of value. In town land was valued based on the expertise of railroad and court sanctioned appraisers with considerable discussion on whether the opined land values were for general purposes or railroad purposes. (1, pgs 37-46)

The Minnesota study was particularly detailed covering 95% of railroads in the state. A focus for land value was to find out what the railroads paid for land intended to be used for railway right of way. The investigation showed it cost in the 1800's an average of three times as much to get land for railroad right of way than it did to buy land for other purposes. The study showed where a railroad bought land by negotiated agreement the price was less than if acquired by condemnation proceedings. (2, pg 9) State taxing boards appraised railway land at 100 percent to 150 percent more than the land's value as for other non-railroad purposes. (2, pg 19) In the early 1900's the Chief Engineer for the Nebraska Railroad Commission added a minimum of 50 percent and maximum of 225 percent for rural located property and 25 percent to 100 percent for town property. (1, pg 35) These are examples of market based and justified application of a 'railroad factor' to land value, today interchangeably known as 'assemblage factor', 'enhancement factor' or 'corridor factor'.

Beginning in the 1850's, federal land grants were made with newly organized railroad companies. It is a misconception that granted rights of way were a 'free giveaway'. In fact, before the land grants accrued ownership, the railroad companies were required (with private investor money) to build a telegraph system, grade a right of way and install tracks. They were also required to provide uncompensated shipping to the Federal Government for decades thereafter. Post World War II studies to determine if railroads should be released from uncompensated federal shipping practices, show railroad investments in right of way infrastructure plus the value of decades of free federal shipments far exceeded the value of the right of way land grants themselves.

The Interstate Commerce Commission (known as 'ICC') was succeeded in the 1990's by today's Surface Transportation Board (STB). Today, the STB promulgates procedures relating to freight transportation common carrier obligations including cessation of railroad shipping by an abandonment proceeding. This process includes public notice, economic justification and opportunity for railroad reinvestment via a proceeding known as Offer of Financial Assistance (known as 'OFA'). The STB 'OFA' process requires a non-market value standard, land and improvements valuation based on a presumed sale of the assets for non-railroad/non-transportation corridor use, often called liquidation value. Additionally, property owned in other than fee title is excluded from the inventory of property appraised. Market based value standards consider the use of the property for continued transportation corridor and other purposes and include an estimate of value for all property interests.

State commissions (often public utility commissions) oversee public-private interests such as road-railroad crossings, utility infrastructure, and operational matters. This oversight and proceedings influence the way real estate market participants view issues and values, generally tempering urges to take extreme positions.

Many large private and public organizations have also established procedures to facilitate business operations. For example, state highway departments often publish internal dictums explaining methods and rates to use in real estate dealings, with some ignorance to market behavior or practices, reflecting an internal acquisition oriented bias. Widely influential is the Uniform Appraisal Standards for Federal Land Acquisitions, originally published 1971 by United States Government Interagency Land Acquisition Conference, updated to 2000 edition by agreement between the Appraisal Institute and US Department of Justice. Known as the 'Yellow Book', this document defines the process used for valuation of property to be acquired by Federal Agencies or with Federal funding, goal being uniformity in the appraisal of real property. (1)

Based on this historic experience, Union Pacific Railroad and other railroads have established business policies and rules, and other guidelines to facilitate the valuation of its corridor and the rents or license fees it charges for occupancy in its corridor. Understanding the Across the Fence appraisal methodology and its origins is important in defending the precedent and established merits of the approach in determining rental or one time fees using the market based principals of substitution which are foundational to business.

(1) *Railroad Valuation* by Homer Bews Vanderblue, PhD., Associate Professor of Transportation, Northwestern University, School of Commerce, Houghton Mifflin Company, The Riverside Press Cambridge, March 1917

(2) *Current Railway Problems* by Samuel O. Dunn, Editorial Director, Railway Age Gazette, 1911

(3) Uniform Appraisal Standards for Federal Land Acquisitions, known as 'the Yellow Book', Appraisal Institute in Cooperation with the United States Department of Justice, April 2001, Chicago, Illinois

(4) *Santa Fe Today (No. 5)*, Santa Fe Railway Valuation Department, Chicago, Illinois, October 15, 1947, pages 53-57

(5) *Instructions Pertaining to Land Appraisals, Field*, Issued by T.P. Artaud, Supervisor Land Appraisals, Revised to April 1, 1918, Cancels All Previous Instructions Pertaining to Land Appraisals, Bureau of Valuation, Interstate Commerce Commission