

## PERSPECTIVE

### What's "Still" Special About Special Purpose Property

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#### Introduction

After fielding comments and inquiries on special purpose property definitions and refinements based on the original article "What's so Special About Special Purpose Property?"<sup>1</sup> It is clear that further explanation is warranted. Some of the terminology is in need of further commentary, in combination with the refined issues that unfold from valuation in litigation. This paper expands on the concept of special purpose property by evaluating the base definitions, expands on the role of land, and addresses the issues that may arise in litigation.

We start with a review of terminology and definitions, followed by an analysis of what "special purpose" means and what properties might be considered special purpose. Next is a discussion of whether land or improvements are special, followed by a discussion of searching for comparable properties with the caveat of focusing on the likely buyer, and then comments on litigation practices.

#### Terminology Overview

*A Review of "special," "purpose," and "special purpose"*

Before one can discuss any specific valuation issues and nuances, it makes sense to start at a fundamental level and evaluate the words "special purpose" themselves.



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First, let's examine the term "special." At a fundamental level, what does the term "special" mean? The Merriam-Webster Dictionary defines it as: **"Uncommon, noteworthy, individual, unique, particularly..."**<sup>2</sup>

Thus, is something special in the eyes of the beholder, or is it agreed upon by a group? There are those who may say a property is special because it is rare or important to them or in the valuation world, scarce with few comparables. But what decides when something is special: Man, Law, or Others?

Next, the word "purpose." What is the purpose, and how is it decided upon? The Merriam-Webster Dictionary defines "purpose" as **"An object or result aimed at, intention, resolution, determination."**<sup>3</sup> In essence, purpose is an intentional act to create a particular result or use. In a real estate context, this implies that the creation of a purpose is not by accident, and any future use other than the original purpose is a modification and likely not of similar utility.

Taking these two definitions into account, what is the meaning of the combined words "special purpose"? The combined phrase implies that the use of the improvements is intentional, but unique or rare. This definition results in a limited set of possible uses that will comply with the definition of the term. The combined phrase also aligns with the special purpose definition previously offered by Throupe et al.

*"A special-purpose property is defined as a property that has limited utility and marketability other than for its original use. These properties may include a hazardous waste facility, an oil refinery, or a specialized manufacturer. Often these properties are "build to suit," which generate a very limited set of alternative users. In fact, most of the time a special-purpose property needs significant investment to be converted to an alternative use, making most conversions financially infeasible. To be special purpose, the property itself, not the use, needs to be unique."*<sup>4</sup>

#### Does "Special Purpose" Land Exist?

A debate has arisen in recent years as to whether land by itself can be a special purpose property. This debate centers on whether land with a unique view or site to build is considered "special purpose" because of the

location. There are several considerations to take into account when it comes to land. How does the word "purpose" affect any categorizing of land as Special Purpose? Is the purpose for the land's existence related to a current use or any use? What came first, the land or the purpose? Land has been around since the creation of the earth, but was the purpose for that land already in existence? Or did the purpose come later?

In contrast examining a property with improvements, one might judge whether the improvements are special, scarce, or have few comparables. So is it the combination of improvements and land that make a property special or special purpose? A particular use may be better suited to certain locations, but is the location so unique that the improvements could not be built in other locations, whether that is nearby, or in a different area of the country? Which came first, the improvements built for a purpose or the purpose of the land?

This debate on land is not as simple as it initially appears. As an example, there is a place that is the highest point on earth. Thus, wherever that area is, it has a purpose to be that particular spot. Can the summit of Mount Everest in and of itself be "special purpose" because it is the highest point on earth? Or is it man who created the purpose as a place to explore because of its uniqueness? That is man creating a purpose for the land. One may argue that other locations are special or have a purpose, in and of themselves. These distinct parcels of land tend to be historical sites that are special because of a historic event that occurred at that location or because of a special attribute of the land. But one needs to ask, did this land always have a purpose related to these events, even before they happened? Or was it over time that a use or several uses for this land evolved?

A review of the article "What's so Special About Special Purpose Property"<sup>5</sup> concludes that what is "special" is an inability to economically convert the property to a different use. The authors were referring to the conversion of the improvements assuming the land exists in a similar condition regardless of the use. It is land use and permissible uses in current society that may change through history. The value of this land may change through time, as a location's desirability changes, based

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on what is of value in society. With the aforementioned in mind, we contend that a parcel of land can be viewed as serving a special use but there are very few places that can even be debated to be a special purpose based solely on location. It's hard to claim any land as special purpose if it is economically convertible. So, land in and of itself with few exceptions is not special purpose, it can have a special use at the time of discernment with potential special purpose improvements placed on it. But in order for a property to be considered special purpose, with few exceptions, it must have improvements intentionally placed upon it. Furthermore, if there is land adjacent to or integrated with the special purpose property, that parcel may also be serving the special purpose property and thus, may be special use land. Thus special use land can domicile a special purpose property.

What is "still" special about special purpose property is that the conversion cost makes it financially infeasible to convert to a higher or equal use? That does not mean conversion is not possible, but the prior improvements are not likely to be assigned much value by a buyer, because of the conversion costs required. Thus the property may be used at an alternate utility in a 2<sup>nd</sup> generation use.<sup>6</sup>

To summarize, excluding extraordinary sites such as the highest point on earth and the lowest, it would be nearly impossible for a location to be special purpose property only due to the land. Even historical and religious sites may be excluded from this categorization considering that the land underneath them is many times is adaptable to other uses (Albeit one can argue that certain religious sites can be argued to be irreplaceable). In general special use land is serving special purpose improvements. Improvements can be either special use (by zoning) or special purpose, however land without improvements or modification is special use since the definition of purpose denotes intention, and natural land formations don't have man-made intention.

### Special Land: "Area 51"

There is a recent special purpose dispute pertaining to private lands with a view of the military base known as "Area 51" in the Nevada desert.<sup>7,8</sup> Area 51 is formerly

known as the Nevada Test and Training center. However, this private land is unique and serves as the sole viewing location of Area 51. The property is irreplaceable for its continued special use with no comparable properties available. In fact, it is the only private property in the world with an unobstructed view of Area 51.

The Sheahan family had owned this 400-acre parcel of property in the Groom Lake valley since the late 1800s. Of course, there are adjacent properties that make up the current perimeter to Area 51, but this particular perimeter property is the only remaining privately held property with a view. The uniqueness (that's the "special" claim) of the view location was previously created as a result of a taking of other view properties and not part of a new project for any eminent domain action. But does it create a special purpose property? What came first, the purpose (in this case, a view claim) or the land? As said earlier, the land now serves in a special use. But the purpose of that land was not to wait for the creation of Area 51. It was a mining site prior. Thus, in general, a "purpose" is intentional and manmade. It may be argued that a resulting purpose (view of Area 51) was manmade because man created the facilities known as Area 51. But creating a viewing site was likely not intentional.

### "Special Use" vs. "Special Purpose" Property or Land?

To summarize, Throupe et al. note that special use is a zoning designation and not a property type or synonym for special purpose. Unfortunately, some courts have made it more difficult for the valuation profession by muddling the words and loosely interchanging special use, special purpose and limited market properties.<sup>9,10,11</sup> A land's special use comes from a man-made decision to produce special purpose improvements on it. A special use land is formed by either having a special purpose on or adjacent to it. Either way the land is integrated with the special purpose improvements. That is not to imply that the only special use land is land integrated into a special purpose improvement. Land without a special purpose integration can serve as special use, such as land with a unique or one of a kind view of a unique or one of a kind property. Also, special purpose property

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doesn't necessarily have to sit on special use zoned land.

### Sales Approach Misuse

The sales approach does need consideration even if there appears to be few local comparables. This approach may become more of a "test of reasonableness" to the cost approach because of the difficulty to make utility adjustments between selected comparables.<sup>12</sup>

For whatever industry the subject property is associated with a review of industry competitors, their property sales, purchases of similar assets, and their likelihood of being a buyer of the subject facility needs to be analyzed. This industry group of competitors or similar industries are the likely buyers and this industry's market may be national in locations, refuting the concept that "local market" comparables are required or the subject is special purpose. It is a limited property to that particular local market, but there may be suitable comparables elsewhere. The idea that no local comparables means to conclude a special purpose property and default to a cost approach is a leap of logic.

### Litigation Strategies

Too often it appears that coining a property as "special purpose" is a strategy for compensation in eminent domain takings. The idea is that if local comparables are not supposedly available, it must be special purpose. Or, one might rely on some specific property improvement that is deemed special or rare and then extend a claim that the whole property is "special purpose". This causes a default reliance on the cost approach and subjective reasoning as to depreciation allowances, with limited analysis to determine if there is any remaining economic life. To put it simply, in cases involving special purpose, there have been repeated cases of confusing remaining economic life with remaining physical life (physical life is typically longer) and using physical life to determine depreciation allowances which results in lower depreciation, resulting in greater remaining value.<sup>13, 14</sup> Another common misuse is to estimate a value that is based on business enterprise value, not real estate value, thus again resulting in a higher value for compensation. An astute valuation expert will be able to refute these claims.

### Conclusion

Starting from elaborating on the terms "special" and "purpose" and the combined terminology of "special purpose," and "special use", this paper reviews what makes a special purpose property and how land is portrayed. Guidance is then given on valuation issues that frequently emerge when the analyst's assignment includes a special purpose property.

We remind the readers that "what is still special" is the difficulty to convert special purpose properties to alternative uses because of the costs associated. Furthermore, the analyst needs to judge who is the likely buyer in order to determine the geographic search for buyers and competitors within the industry or related industry of the current use. It is only then that the analyst can judge if any buyers/users are likely or if conversion is probable. A study to determine if a special purpose property exists requires the proper and complete research of the subject, industry economics, competitors, potential comparables, likely buyers, and a review of economic vs. physical life. Most importantly, there is a need to resist quick conclusions of special purpose without such research. •

### Endnotes

1. Ron Throupe, Kay Zhang and Xue Mao, "What's so Special About Special Purpose Property" *Appraisal Journal* Summer 2015: 226-236.
2. The Merriam-Webster Dictionary, Pocket Books, New York NY, 1974, pg. 659.
3. The Merriam-Webster Dictionary, Pocket Books, New York NY, 1974, pg. 565.
4. Ron Throupe, Kay Zhang and Xue Mao, "What's so Special About Special Purpose Property" *Appraisal Journal* Summer 2015: 229.
5. What's so Special About Special Purpose Property? *The Appraisal Journal*, Summer 2015: 226-236.
6. John Lipscomb, "Second-Generation Industrial Buildings: Value Determinants," *The Appraisal Journal* (July 2002): 298-303.

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7. Family Loses Land Battle With The Federal Government, <http://www.aero-news.net/index.cfm?do=main.textpost&id=15931408-31cd-489f-a996-1fd0c5aa751e>. Oct 22, 2015.
8. A battle is on for Area 51 in Nevada, but not the kind you might think. Jason Kravarik, CNN, and Dan Simon, CNN, Updated 1:32 PM ET, Sat September 12, 2015. <https://www.cnn.com/2015/09/11/us/area-51-nevada-legal-battle/index.html>.
9. Special Use: special use permit. Permission granted by a local zoning agency that authorizes a use as a special exception to the applicable zoning. A special use permit in a residentially zoned area might allow for construction of a church or hospital. Such uses are considered conditional uses, only permitted upon the approval of the zoning authority. Sometimes referred to as a conditional use permit. See also legally nonconforming use; zoning variance.
10. Dictionary of Appraisal, Appraisal Institute, 6<sup>th</sup> Edition, 2016, pg. 218.
11. Special-purpose property. A property with a unique physical design, special construction materials, or a layout that particularly adapts its utility to the use for which it was built; also called a special-design property.
12. The income approach is rarely used because of the entanglement of real estate, personal property and intangibles. See Chapter 35 of the 14<sup>th</sup> Edition, Appraisal of Real Estate.
13. The period over which improvements to real estate contribute to property value. Dictionary of Appraisal, Appraisal Institute, 6<sup>th</sup> Edition, 2016: 72.
14. An estimate of how old a building or improvement will be when it is worn out. 2. The total period a building lasts or is expected to last as opposed to its economic life. Dictionary of Appraisal, Appraisal Institute, 6<sup>th</sup> Edition, 2016: 171.



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