

Committee on Resources

Subcommittee on Forests & Forest Health

Witness Statement

Testimony of

Richard M. Betts, MAI, ASA, SRA

California State-Certified General Appraiser

Betts & Associates

on

H.R. 3327, the Cabin User Fee Fairness Act of 1999

before the

Subcommittee on Forests and Forest Health

of the

House Committee on Resources

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Madam Chairman, my name is Richard M. Betts, and I am a California State-Certified General Appraiser and the principle partner in Betts & Associates, Berkeley, California. I appreciate the opportunity this afternoon to present to the subcommittee my analysis of the difficulties that have arisen with respect to the determination of appropriate fees for occupancy of cabin lots in the National Forest System.

I was retained in 1998 to assist a coalition of cabin owners with the analysis of the appraisal methodology and instructions employed by the USDA Forest Service in determining special use fees for the use and occupancy of these cabin lots, and to make recommendation to the coalition about possible solutions that meet any statutory or political requirements for capturing fair market value for the federal government. Their coalition consisted of representatives of the National Forest Homeowners, American Land Rights Association, California Forest Homeowners Association, Oregon Forest Homeowners Association, and Sawtooth Forest Cabin Owners Association in Idaho. I am being compensated by the coalition for my appearance today, but the coalition has exercised no control over my statement nor whatever replies I might offer in response to questions from the subcommittee.

Qualifications

I would describe myself as a very active appraiser, specializing in complex properties and complex situations. I'm the holder of the MAI, ASA (Real Estate), and SRA professional designations, with more than 35 years of experience in appraisal and real estate economics consulting.

I hold Bachelor of Science and Master of Business Administration degrees from the University of California, Berkeley, with a major in Real Estate and Urban Economics, and a minor in Economics. I've since received substantial postgraduate education from colleges and professional groups. I have also taught extensively, including courses for the University of California, Berkeley, School of Business, University of California, Berkeley, Extension Division, University of Southern California, Merritt Community College, American Institute of Real Estate Appraisers, Society of Real Estate Appraisers, Appraisal Institute, American Society of Appraisers, International Association of Assessing Officers, and others. And I have also lectured extensively, giving speeches, workshops and seminars for professional groups, community colleges, and community organizations.

I am the author of a number of books and articles, receiving the Robert H. Armstrong Award from the American Institute of Real Estate Appraiser in 1986 for my article, "The Impact of Securitization on Real Estate Appraisal." I was the author, in 1979, of The Instructor's Guide for Real Estate Appraisal, published by the State of California Department of Real Estate. I am the coauthor, with Silas Ely, of Basic Real Estate Appraisal, now in Fourth Edition, published by Prentice Hall, 1998. I am also the coauthor, with Dennis McKenzie, of The Essentials of Real Estate Economics, also published by Prentice Hall and now in Fourth Edition, 1994.

I have been accepted as an Expert in more than ten Superior Courts, in the District Courts, in Federal Bankruptcy Courts, and in Assessment Appeal Boards of six counties in California. I also have extensive arbitration experience, both as a "party" arbitrator, and as a neutral third, in numerous private arbitrations. I am on the Panel of Arbitrators for the American Arbitration Association and have served as an arbitrator on AAA cases, as well as a lecturer at AAA training sessions in California and Hawaii. I have also performed assignments for the U.S. General Accounting Office, the U.S. Department of Justice, the National Park Service, the U.S. Fish and Wildlife Service, the California Auditor General, and numerous other agencies, large and small corporations, organizations, and private individuals.

Certification

I don't mean to belabor my credentials, Madam Chairman, but I think it is important that my recommendations to the coalition of cabin owners be evaluated by this subcommittee within the context of the extensive training and experience I brought to the task. I also want to certify to this subcommittee the same statement I signed in conveying to the coalition my report dated June 4, 1999, containing my analysis and recommendations; that--

The statements of fact contained in the report (and my testimony today) are true and correct.

The reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions, and are my personal, unbiased professional analyses, opinions, and conclusions.

I have no present or prospective interest in the property (if any) that is the subject of this report, and I have no personal interest with respect to the parties involved.

I have no bias with respect to any property that is the subject of the report or to the parties involved with this assignment.

My compensation from the cabin coalition was not contingent upon an action or event resulting from the analyses, opinions, or conclusions in, or the use of, the report.

My analyses, opinions, and conclusions were developed, and the report was prepared, in conformity with the Uniform Standards of Professional Appraisal Practice.

I have not made a personal inspection of the property that is the subject of the report.

No one provided significant professional assistance in my preparation of the report.

Documentation

In conducting my analysis for the cabin coalition, I reviewed 16 key documents. These included the Forest Service Recreation Residence Authorization Policy (59 FR 28714), relevant sections of the Forest Service Handbook, various government memorandums and correspondence, and testimony offered in earlier congressional hearings. I also examined in detail the initial appraisal reports and several second appraisal reports from cabin tracts on National Forests in Idaho, Oregon and California. Congressional staff and members would find at least some of these materials essential to the understanding of the problem and potential solutions. If so, I have made the full bibliography available to the subcommittee staff.

The Problem

The United States Forest Service has, for many years, maintained a program of providing sites for cabins in the national Forests. Nearly all of the cabin sites are grouped into clusters, called a Tract. Each cabin site consists of a dimensioned parcel, drawn on a map. No subdivision process is followed, and no local approvals are involved. Holders of a Permit to use a lot are allowed to build a small cabin, for occasional use only, subject to many restrictions. Usually, the Forest Service provides only raw native land, and the permittee must pay the expense, and bear the risk, to provide and maintain any access road or trail, as well as any desired water, sewer, electrical, or other utility system. The permit is only valid for 20 years, and the permittee may have to remove all improvements at the end of the term. However, the permit can be renewed, and they usually are. The permit can also be canceled, with 10 year's notice, and they sometimes are.

The permittee pays a fee for the permitted limited rights of use to the lot. Currently, this fee is set at 5% of the market value of the raw land at the start of the permit term, updated annually by the Implicit Price Deflator - Gross Domestic Product, (IPD). The market value is set by an appraisal of a sample lot, or lots, in the Tract. Currently, the Forest Service has started the first reappraisal sequence in some years, as the policy had been under administrative review for some time. I examined the early results of that process, to determine if corrective action is needed.

The Conclusions

It is clear that corrective action is needed, that the early results of the process indicate a number of problems, of a

systematic nature. As somewhat of an aside, there appear to be several significant public policy questions with the policy as conceptualized. For instance, the IPD index does not match the changes in local land values around the country, leading to substantial under- and over-indexing, and abrupt changes in permit fee upon reappraisal. I am also concerned about the lack of support for the 5% return, given the unusually large number of negative influences that are hidden within it, rather than being enumerated in the appraisal process.

The primary focus of my analysis was upon the appraisal process itself, including the instructions and their implementation. Unquestionably, major work is needed, to clarify the instructions, remove material that is contrary to the adopted Policy, and guide appraisers to proper practice in this very complex and unusual setting. A set of those instructions is attached to my testimony.

The major problem area I noted is especially in the definition of the property being appraised. Policy clearly states that the Forest Service is providing raw acreage, but most appraisals are of subdivided lots. A second major problem is with adjustments for access and utilities, usually provided by the permittees, but often incorrectly handled in instructions and appraisals. Added problems are noted with the selection of market data upon which to base the valuation, and the adjustment of the market data for relevant differences.

Based on my analysis, I have made recommendations to the cabin owners' coalition for appraisal guideline language, intended to provide clearer direction to appraisers, based upon the problems noted as of June 4, 1999.

Summary of Findings

The four elements of the current Forest Service Recreation Residence Permit Fee program are 1) the selection of representative sample lots to appraise, 2) the appraisal of the market value of the Forest Service land, 3) the percentage of value charged as the fee, and 4) the annual fee indexing procedure. In my opinion, there is strong reason to be concerned about the probable consequences of the policy as presently envisioned. With respect to the policy as implemented, it appears that the process for selecting sample lots is working satisfactorily. However, the evidence clearly shows that the current appraisal process and the annual indexing procedure are not working satisfactorily. And it is highly unlikely that the current fee percentage, 5%, correctly reflects the positive and negative elements that it is supposed to capture.

Issues Regarding Policy Consequences

To examine the underlying philosophical goals of the policy is not at all a primary goal of my work in this matter. Nevertheless, the context of my work would be remiss if it did not, at the least, point out some of the more obvious anomalies I've observed.

One public policy question involves giving the public a reasonable planning horizon, for investing in constructing and recovering benefits from a cabin. The policy appears to call for an annual fee that represents a 5% return on the then-market value of the native undeveloped land, but with permission to build a cabin, for recreational residential use only. In areas of the country where there are larger increases in population, income, or other factors that increase demand, the result will be that cabin fees will certainly escalate faster than the normal increases in income of many cabin owners. This forces out those who are less well off, in favor of those better able to pay the new higher rent. It might be better public policy to give a cabin-building family some better assurance of being able to stay there through a generation cycle, perhaps 30 years, or until the title transfers. Such an improved policy might, for example, cap the permit fee increases arising from market value increases to no more than the CPI, with recovery of the excess upon transfer.

A second public policy question arises when the government creates a monopoly by artificially restricting the supply of cabin sites, and then seeks to be paid rent based on the high prices arising from its artificially contrived

shortage. In some parts of the country, it seems very likely that the Forest Service has so completely eliminated private land holdings and cabin sites that there is no private competition for the Forest Service cabin lots. In turn, the current Forest Service policy of allowing no new lots, and of selectively eliminating existing ones, further eliminates supply. Here, then, the Forest Service almost certainly has so constrained supply as to artificially drive up values, and the rents to be paid. To profit from such a system does not appear either fair or good public policy.

Annual Fee Indexing Procedure

It was not part of the scope of my work to analyze this issue in detail. However, it is clear that the current fee indexing methods are not working at all well. Some lots appear to have been indexed well over what is probably about their correct amount, while others may be well under. Forest Service staff has explored ideas for alternate indexes, and I believe that these ideas, and others, should be investigated. It is possible, too, that a review of this topic should also address the public policy question of a reasonable planning horizon, which I have raised above.

Fee Percent of Value

It also was not part of the scope of work to analyze this issue in detail, but what the percentage represents is nonetheless closely tied to adjustments in values addressed in Section 6 of H.R. 3327. The percentage of market value that is charged as a fee is set at 5%. This number has been in use for many years, and there does not appear to be any evidence to establish its basis or appropriateness. I have assumed that this rate is to be left in place, but I have grave doubts that it fully reflects all of the permit limitations that it is supposed to reflect.

It is alleged by the Forest Service that this rate is discounted from the land return rates found in the market, in order to reflect a number of restrictions imposed upon permit holders that are not found in private market land transactions. Thus, there is supposed to be a good relationship between the amount of the reduction in the rate and the reduction in desirability resulting from the restrictions.

Land rates of return, (as a percent of the first year's value, as is the case here), are influenced by numerous factors, including the length of the contract, (longer increases the rate), if the rent is periodically indexed for inflation, (which lowers the rate), if the land is subordinated to a construction loan, (increased rate), and if performance on the contract is guaranteed by tenant expenditures on buildings (which lowers the rate). Location also influences land return rates, as urban rates are considered higher than rural rates.

Forest Service staff has written of market rates that range from 10 to 17%, in justifying the amount of discount produced by the 5% rate. However, it is likely that rural rates for 20 year leases with annual indexing, secured by development of cabins, often also secured by the expense of developing water, septic, electricity and roads, are more in the 7 to 10% range, leaving a relatively slim discount for the substantial ownership and use restrictions, so well documented in prior hearings on this topic.

The Appraisal Process

The problems with the appraisal process are numerous, but appear to be interrelated, and may be summarized as follows.

One: The implementation of the appraisal process is producing a wide variation in results across the country, and a general bias toward excessively high values. Anecdotal evidence indicated that relatively few lots are being undervalued, but many are being substantially overvalued.

Two: Review of actual appraisal reports indicates widespread misunderstanding of the assignment by appraisers.

Example: Appraisals are typically being performed by relying solely on sales of privately subdivided lots, usually

with some lot improvements, utilities, and road access, often accessible and useable year-round. However, the Specifications make clear that the Forest Service is only providing unsubdivided raw acreage, ["in a natural, native state," C-2.1(f)(3)], usually without lot improvements, utilities or road access.

Example: Some appraisals are performed apparently assuming that permit holders should be charged for the value contribution of access roads and utility systems, without any investigation or documentation as to whether the access roads and utility systems were provided by the permittees or the Forest Service, despite the direction set forth in the Specifications.

Three: Appraisal Guidelines provided by the Forest Service are giving incorrect, biased or inadequate definition of the assignment, providing incorrect, biased or inadequate direction to both regional staff and contract appraisers.

Example: Appraisers are given explicit factors that they must consider, in some cases without adequate instruction that other relevant value factors must also be considered, leading to appraisals that ignore, for example, significant locational differences. See also the examples, above, of apparent appraiser misunderstanding.

Example: Forest Service materials indicate that appraisers should reflect the value increment resulting from power, water, or telephone systems or public roads owned by other public agencies. However, under the clear language of the Specifications, this is not correct whenever these systems 1) were not present at the time of the first cabin permit at that location, or 2) were installed at the expense of the cabin holders. In addition, there are undoubtedly cases where the system was indirectly paid for by the permittees, through monthly bills or annual property tax assessments, for example, and it is unquestionably the intent of the policy not to reward the Forest Service for those features.

Four: Review of actual appraisal reports indicates widespread problems with application of the particular appraisal skills needed to accurately perform these assignments.

Example: Appraisers are adjusting for the existence of lot access, utility systems, or building improvements, correctly using the depreciated current replacement cost of the improvements, but apparently without adjustment for the extra costs involved in construction in the more remote locations, without allowance for the non-contractor cost elements that impact value, and using depreciation procedures that do not reflect the real economic lives of such improvements. See also the earlier examples.

Five: Statements by Forest Service staff indicate a lack of understanding of appraisal theory, as applied to these assignments.

Example: Staff has indicated that the historical cost of cabin permittee-provided roads, utility system, and lot improvements is to be deducted from the value conclusion, when using comparable sales that have such amenities and lot improvements. In fact, to estimate the market value of the lot, the market value of those improvements must be deducted. There is no debate about this issue among appraisal theoreticians.

Example: Staff has indicated that only the depreciated cost of access, utilities, and/or improvements should be deducted, and has indicated that any deduction for the risks faced in installing these items must be ignored, along with any allowance for overhead and profit. There is no debate among appraisal theoreticians about including these items in cost-based value analyses of the type indicated here.

RECOMMENDATIONS

General Policy Statements

One: The policy probably should seek to base the fee on the Market Value of the "fee simple estate of the

National Forest land underlying the lot," (#33.3), for use as a seasonal recreation residence site only.

Comment: However, it is very likely that an alternative system could be developed that would be equitable, much less expensive, less controversial, and less error-prone.

Two: The fee should be based on a percentage return on the estimated market value. The percentage return will be 5%, said number being understood as reflecting a Market rate of return, adjusted downward for the 1) short term of the permit, 2) the substantial limitations placed by the permit upon the use of the lot and the term of the permit, and 3) the public rights of use to the lot. The limitation of the use to seasonal, non-permanent use is understood not to be reflected in the rate, but rather in the value process.

Comment: I am simply assuming that this part of the process will be continued. It bears repeating that there does not appear to be any documentation to support this figure, nor does it appear likely that it correctly represents the correct discount from market rates of return for the many restrictions imposed on the permittees.

Three: The market value should be determined by appraisals of representative lots, selected in the same manner as now established.

Four: The appraisals should be performed by a "state-certified general real estate appraiser," licensed to practice in the state where the lot(s) are located.

Five: Each appraiser should be required to perform the appraisal in compliance with the Uniform Standards of Professional Appraisal Practice (USPAP), then-current edition, and the Uniform Appraisal Standards for Federal Land Acquisitions (UASFLA), then-current edition, and with the Specifications, as amended to reflect policies and guidelines established by the Congress.

Six: The appraisal report should be a "self-contained report," as that term is defined by USPAP, and the report should be compliant with the reporting guidelines established in UASFLA.

Specific Appraisal Guidelines

One: The appraisal should estimate the market value of the raw land provided by the Forest Service, available for use as a seasonal cabin site. The appraisal should not appraise the lot as if a legally subdivided lot.

Comment: The Forest Service is indeed only providing raw land, without the burden of the expensive mapping and approval process faced by private parties. The costs and risks of this process are reflected in the sale prices of all private subdivided lots, (whether the specific lot predated the current expensive process or not). It is unfair to ask cabin permittees to pay rent on something that the Forest Service did not provide.

Two: Where the sold parcels that are identified in the marketplace are small parcels, whether within a subdivision or not, the adjustments must reflect the market difference between such small legally divided parcels and lots such as the subject, which are legally undivided portions of a large acreage. Where the sold parcels are relatively large parcels, the adjustments must reflect the market difference between the sales and the subject lots, due to the greater land area that the buyer will control in the sale, on the one hand, and the possibility of more than one cabin lot, if allowable, on the sale parcel. It may be desirable to obtain both types of comparable sales, if possible, in order to better bracket this adjustment.

Comment: The Forest Service cabin lots do not have an exact equivalent in the private marketplace. The lots have the same "cabin site benefit" that gives value to a privately held parcel, but they lack the feature of being a separate legal parcel. On the other hand, they are more valuable than a "pro-rata" allocation of bulk acreage, as each has its own cabin approval, while the bulk acreage often only has permission for one cabin. The cabin sites

are, on a price per acre basis, inferior to a privately divided lot of similar size, but superior to a larger parcel with zoning capability for only one cabin. However, on a parcel price basis, the Forest Service cabin lots are inferior to both privately divided parcels of similar size and larger parcels limited by zoning to only one cabin site. It is necessary to spell out this unique aspect of the appraisal assignment.

Three: The appraisal should reflect the market value contribution of any utilities, (such as water, sewer, electricity, or telephone), or access roads or trails, etc., that can be clearly established as having been provided and maintained by the Forest Service. Utilities and access provided from the general funds of any other government agency, as opposed to a special district or other user funding source, shall also be reflected. All other utilities and access should be presumed to have been provided by or funded by the permittee.

Comment: Some Forest Service lots were developed many years ago. Policies at that time did not require that the permittee maintain permanent records of work performed or expenditures. The burden of proof as to the original funding for utilities and access within the Forest should now be on the Forest Service. Further, where the original facilities were funded by the Forest Service, but have been maintained for many years at permittee expense, these should be treated as if provided by the permittees. However, some facilities will have been paid for by local government funds not generated for that purpose by the permittees. It is not practical to separate those predating the Forest Service Tract from those installed since, and it is more equitable that the permittee's rent reflect both than neither.

Four: The appraisal should be based upon analysis of one or more of the following categories of market data:

Sales of larger privately-owned acreage parcels of land, generally somewhat similar in size to the Forest Tract being examined,

Sales of privately-owned individual smaller parcels of land, not part of an established subdivision,

Sales of privately-owned lots in a mapped and recorded subdivision,

Sales of cabins in the Forest Service tract in question, or other nearby similar Forest Service tracts.

Comment: It is desirable to give the appraiser the ability to rely on all possible sources of market information. Available data in some locations may be much more limited than in other locations. However, it is clear that appraisers need some guidance ranking the relevance of the data that might be available.

Five: The relative weight to be given by the appraiser to the market data that has been collected should be in the same order as set forth in guideline **Four**, above, (sales of larger privately-owned acreage parcels of land, generally somewhat similar in size to the Forest Tract being examined being given the most weight). This weighting reflects the relative similarity with the land provided by the Forest Service, and the inherent problems with adjusting evidence of a less similar nature to accurately reflect the differences. Sales of cabins in the Forest Service tract in question (or nearby) should not be used, unless there is no other relevant data, lest the appraisal reflect local artificial scarcity factors caused by Forest Service policies.

Comment: It is important to stress to appraisers that the potential evidence varies in its usability, lest they select data on the basis of its ease of access, for example, or other, less relevant factors. It is also important to limit appraisers use of less reliable information to those times when it is the only data available. Please note that the results of such an appraisal may be artificially inflated.

Six: The appraiser should consider, and adjust prices of the sold parcels for, all factors likely to materially influence market value, in estimating the market value of the specific parcel. These factors would include, but are not limited to, all typical value influences set forth in standard appraisal literature. Particular attention should be

paid to differences in the locations of the parcels, in seasonal accessibility, and in the physical ease or relative cost of cabin construction.

Comment: I have not tried to provide a "shopping list" of possible factors. Instead, I have tried to use standard appraisal language, pointing to the sources that appraisers know from their training. However, I have added a sentence here to stress those issues that I believe are most likely to cause problems in this circumstance.

Seven: Where the sold parcels, (market data), have cabin improvements, or lot improvements, (such as utilities, access road, or lot grading), and the Forest Service lots being appraised did not have these amenities provided by the Forest Service, the appraiser should adjust the sales prices of the sold parcels by the market value contribution of any such amenity. The adjustment process also needs to reflect the construction difficulties for such amenities at the subject lot, and must include an appropriate allowance for entrepreneurial profit and overhead.

Comment: It clearly is important to remind appraisers that it is the market value impact of these amenities that must be adjusted for, including all typical cost elements, and using costs applicable to the subject lot, not those at the location of the sale. Please note that these lots have the normal risks associated with development, reflected in the profit and risk allowance noted above. There also are abnormal risks associated with these sites, which are discussed in guideline **Eight**, below.

Eight: Where the sold parcels have wells, (or water systems), and/or septic systems, and the lots being appraised do not have these facilities provided by the Forest Service, the adjustment must reflect not only the depreciated current replacement costs of installing such facilities at the lots being appraised, as set forth in guideline **Seven**, above, but also must reflect the risk deduction that is taken in the market when such facilities are absent and the buyer cannot know at sale whether it will be routine or highly difficult to install them. This risk allowance might be the cost of drilling for water at several locations, or drilling deeper, or the cost of an alternate, more expensive method of proceeding.

Comment: Appraisers clearly need to be reminded that the adjustment amount must reflect the thinking in the market. Where no well or septic is in place, and the buyer is to bear all of the risk regarding cost overruns, or complete failure, to complete them, it is clear that the discount in the market value is greater than just the cost of a well, or successful system. That discount belongs to the party who bore that risk, usually the permittee.

These recommendations will sound familiar to those who have already read H.R. 3327. The cabin coalition has made available to the Chairman's staff, and to Representative Nethercutt's staff, over the past two years as much information as was available to the coalition about various alternatives worth examining. A number of alternatives were discarded as unworkable and unlikely to produce a reliable, fair process of determining fees over time.

There are a number of methodologies available to the subcommittee for setting fees in a manner that returns fair market value. For example, you can mandate an entrance or user day fee, to be paid every time the cabin owner visits the cabin. Or, you can determine the average cost of renting and divide this number by days or value. You can establish "market value," or what the use (amenity) would be worth for rent or sale in the general market, exposed to a large number of people. A more nebulous measure of fair market value is "use value," the value to a specific user for a specific use.

It was clear to me in discussions with the cabin owners and the Forest Service that capturing fair market value is both a consideration in setting policy and a consideration in compliance with statute. In making new law, it is the choice of the Congress whether to further the practice of capturing fair market value, or to set some new course.

The recommendations I have offered further the policy and practice of capturing fair market value for the occupancy and use of forest cabin lots.

I believe that, if adopted, these recommendations will do the job without the inconsistencies, errors and ambiguities contained in the current Forest Service policies, procedures and instructions for determining the market value of cabin lots. The current fee determination process leads to errors, misapprehensions and misunderstandings on the part of appraisers in the field, who are being asked, without sufficient and clear direction, to examine a very complex and unusual setting.

I also believe it is unlikely we will see the appropriate changes occur, absent clear guidance from Congress and one or more of our professional appraisal organizations about how to do it.

I very much appreciate this opportunity to testify. As the subcommittee continues its work on H.R. 3327, I will be available and pleased to assist as needed.

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