



Office of the Attorney General
State of Texas

DAN MORALES
ATTORNEY GENERAL

September 28, 1998

The Honorable Robert Junell
Chair, Appropriations Committee
Texas House of Representatives
P.O. Box 2910
Austin, Texas 78768-2910

Letter Opinion No. 98-082

Re: The meaning of the phrase "fair market value of the land" in Local Government Code section 272.001(h), and related question (RQ-1051)

Dear Representative Junell:

Local Government Code section 272.001(h) authorizes a municipality of a certain size owning lakeshore land to sell the land to a person currently leasing the land for a price equal to the land's fair market value. On behalf of the City of San Angelo (the "city"), you ask us to define the phrase "fair market value of the land" as used in section 272.001(h). You further ask whether section 272.001(h) requires or allows the city "to instruct the appraiser as to what it wants appraised."

Your questions arise from a situation in San Angelo. We understand that the City of San Angelo owns Lake Nasworthy and approximately six hundred lots adjacent to the lake. Most of the lots, the city informs us, are leased for residential use for terms of up to forty years. The city further states that many of the lessees have constructed residences and made other improvements to the properties; under a lease, a lessee may remove most of the improvements when the lease is terminated if the improvements may be removed without injuring the land.¹ In preparation for the sale of the lots under Local Government Code section 272.001(h), the city has had some lots appraised on the basis of what the city describes as the underlying fee and reversionary interest, but, the city says, lessees assert that the appraisal should consider the fact that the land is burdened for some period of time by the lease.

¹See Lake Nasworthy Residential Lot Lease, attached to Letter from The Honorable Robert Junell, Chair, House Appropriations Committee, to The Honorable Dan Morales, Attorney General (Dec. 9, 1997) (on file with Office of the Attorney General Opinion Committee).

Local Government Code section 272.001(h), about which you ask, permits a municipality of a certain size to sell a lakeshore lot to the current lessee for a price equal to the fair market value of the land:

A municipality having a population of 250,000 or less and owning land within 5,000 feet of where the shoreline of a lake² would be if the lake were filled to its storage capacity may, without notice or the solicitation of bids, sell the land to the person leasing the land for the *fair market value of the land* as determined by a certified appraiser. While land described by this subsection is under lease, the municipality owning the land may not sell the land to any person other than the person leasing the land. [Emphasis and footnote added.]

Without subsection (h), a municipality with a population of 250,000 or less that desires to sell lakefront property would have to comply with subsection (a) of section 272.001, which requires a political subdivision that wishes to sell or exchange its land to notify the public of the offer and the procedure by which interested persons may bid to purchase or exchange the property.

Before we consider your questions, we believe a short discussion of relevant real-property law may be helpful. The city, as owner of a lot adjacent to Lake Nasworthy, held the lot as an estate in fee simple until the city leased the lot. By definition, the owner of a fee simple estate owns the estate absolutely, unencumbered by any other interest or estate.³ When the city leased the lot, it divided its estate between itself, as lessor, and the lessee: The city now holds a leased fee estate, which includes the right to be paid rent for the term of the lease and a reversionary interest, and the tenant holds a leasehold estate, which includes a right to possess the property and an obligation to pay rent for the lease term.⁴

The meaning of the phrase “fair market value of the land does not appear to be controversial. We have previously defined the phrase “fair market value of property” to denote the amount that a willing buyer, who desires but is not obligated to buy, would pay a willing seller, who desires but is not obligated to sell.⁵ This definition is in accord with numerous Texas court decisions.⁶ In our

²Local Government Code section 272.001(h) defines the term “lake” to mean “an inland body of standing water, including a reservoir formed by impounding the water of a river or creek but not including an impoundment of salt water or brackish water, that has a storage capacity of more than 10,000 acre-feet.”

³See APPRAISAL INSTITUTE, *THE APPRAISAL OF REAL ESTATE* 137 (11th ed. 1996).

⁴See *id.* at 138, 534.

⁵See Attorney General Opinion DM-441 (1997) at 4; *cf. Atterbury v. Brison*, 871 S.W.2d 824, 827 (Tex. App.--Texarkana 1994, writ denied); *Keeton v. State*, 803 S.W.2d 304, 305 (Tex. Crim. App. 1991) (en banc) (interpreting Penal Code § 31.08(a)(1)); APPRAISAL STANDARDS BOARD, *UNIFORM STANDARDS OF PROFESSIONAL APPRAISAL PRACTICE* 163 (1998 ed.) [hereinafter USPAP] (defining “market value”). See *generally* 16 WORDS & PHRASES *Fair Market Value* (1959 & Supp. 1997) (and cases cited therein). The Texas Appraiser Licensing and Certification Board
(continued...)

opinion, the phrase “fair market value of the land” in section 272.001(h) has the same meaning. Typically, the fair market value of property free and clear of a lease is the value of the leased fee estate plus the value of the leasehold estate.⁷ The method used to calculate the fair market value of a particular property and the factors that must be considered in arriving at the fair market value of a particular piece of property are for a qualified appraiser to determine in accordance with accepted standards of appraisal;⁸ they are not questions of law that are susceptible to the opinion process.⁹

In our view, the dispositive issue is not the meaning of “fair market value of the land,” but whether a lessee’s estate will merge with the city’s upon the lessee’s purchase of the land. As the city states in its brief, “The lessees . . . assert that the appraisal should take into account the fact that the land is burdened for some period of time by the lease.” Thus, we understand the lessees to contend that their leasehold estate will not merge with the leased fee estate when they purchase the land. (If this is so, of course, the lessees will continue to pay rent for the life of the lease.)

We conclude that, unless there is evidence that the parties do not intend the leased fee estate and the leasehold estate to merge upon the lessee’s purchase, the two estates merge and the leasehold estate is extinguished.¹⁰ Significantly, the situation about which you ask involves a lessee purchasing the lot he or she currently leases; consequently, it is distinguishable from a situation in which a third party purchases real property that is subject to a lease. Thus, the leased property at issue here must be valued just as leased property that a lessee opts to purchase before the end of the lease term. Cases we have found addressing valuation in that context suggest that the property should be valued as though it is unencumbered unless the lessor and lessee intend that the leased fee

⁵(...continued)

points out that the term “fair market value” is not an appraisal term, but rather an accounting term. See Brief from Renil Linér, Commissioner, Texas Appraiser Licensing & Certification Board, to Ms. Kymberly K. Oltrogge, Assistant Attorney General, Opinion Committee, Office of the Attorney General (Mar. 6, 1998) (on file with Office of the Attorney General Opinion Committee); Appraisal Standards Board Advisory Opinion AO-8, *reprinted in* USPAP, *supra*, at 111-12.

⁶See *Travis Cent. App. Dist. v. FM Properties Operating Co.*, 947 S.W.2d 724, 727 (Tex. App.--Austin 1997, pet. denied) (citing *State v. Windham*, 837 S.W.2d 73, 77 (Tex. 1992); *Polk County v. Tenneco, Inc.*, 554 S.W.2d 918, 921 (Tex. 1977); *City of Pearland v. Alexander*, 483 S.W.2d 244, 247 (Tex. 1972); *Humes v. Hallmark*, 895 S.W.2d 475, 480 (Tex. App.--Austin 1995, no writ)); see also Tax Code § 1.04(7) (defining “market value”).

⁷See APPRAISAL INSTITUTE, REAL ESTATE VALUATION IN LITIGATION 389-90 (2d ed. 1995).

⁸See generally *Travis Cent. Appraisal Dist.*, 947 S.W.2d at 730 (listing three general approaches to determining market value and acknowledging alternatives); USPAP, *supra* note 5; REAL ESTATE VALUATION IN LITIGATION, *supra* note 7; THE APPRAISAL OF REAL ESTATE, *supra* note 3.

⁹See, e.g., Attorney General Opinions DM-98 (1992) at 3, H-56 (1973) at 3, M-187 (1968) at 3, O-2911 (1940) at 2.

¹⁰See *State v. Moak*, 207 S.W.2d 894, 896 (Tex. 1948) (quoting *Childress County v. Schultz*, 199 S.W.2d 860, 863 (Tex. Civ. App.--Amarillo 1946, no writ)).

and leasehold estates will not merge.¹¹ Given that merger will eliminate a lessee's obligation to pay rent as well as the cloud on the lessee's title, we can think of no reason the parties to the transaction would not want the estates to merge.

Moreover, we believe that a lessee who purchases the whole of the city's estate, which includes the right to receive rents for the term of the lease and the city's reversionary interest, must pay for the whole of the estate. The purchase price cannot be discounted by subtracting the value of future rents, as the lessees appear to argue, because nothing in section 272.001(h) authorizes the city to give to the lessees the value of future rental payments. Indeed, article III, section 52(a) of the Texas Constitution forbids a political subdivision to grant a "thing of value . . . to any individual" unless the grant serves a legitimate public purpose or the political subdivision obtains adequate consideration for the grant.¹² Accordingly, the land must be appraised at, and the lessee must pay, both for the right to be free of rent obligations as well as for the reversionary interest.¹³

The appraisal should not, of course, include the value of the improvements a lessee has made to the leased property. You indicate that, under the terms of the leases, lessees may build residences and other improvements on the property and may, at the end of the lease term, remove the improvements. The city may not require a lessee to pay twice for the improvements he or she has made.¹⁴

You finally ask whether the city may or must instruct an appraiser as to whether the land should be valued as encumbered or unencumbered. In our opinion, the city may and must not. The Uniform Standards of Professional Appraisal Practice require an appraiser appraising real property to consider and analyze an applicable lease's effect on the value of the real property.¹⁵ Consequently, a competent appraiser will analyze whether the existing leasehold estate will merge with the leased fee estate upon the lessee's purchase. Any city instructions to the appraiser may taint or appear to taint the appraisal process. The purpose of an appraisal is to have the subject property valued by a disinterested third person.¹⁶

¹¹See *Moak*, 207 S.W.2d at 896 (quoting *Childress County*, 199 S.W.2d at 863); *Bates v. Lefforge*, 63 S.W.2d 360, 363 (Tex. Comm'n App. 1933, judgment adopted); see also *Summit Indus. Equip., Inc. v. Koll/Wells Bay Area*, 186 Cal. App. 3d 309, 318-19 (Cal. Ct. App. 1986, review denied); *Moxley v. Adams*, 8 S.E.2d 525, 525 (Ga. 1940).

¹²See Attorney General Opinion DM-441 (1997) at 3. It is possible, in the alternative, that the city and the lessees disagree as to whether a lessee is buying the whole of the city's estate or simply the city's reversionary interest.

¹³See THE APPRAISAL OF REAL ESTATE, *supra* note 3, at 534. This formula is an approximation; the fair market value will also reflect whether the rent payments are above or below market rents. See *id.* at 142.

¹⁴See *Texas Pig Stands, Inc. v. Krueger*, 441 S.W.2d 940, 946 (Tex. Civ. App.--San Antonio 1969, writ refused n.r.e.).

¹⁵See USPAP, *supra* note 5, rules 1-2(c), 1-4(d).

¹⁶See *Cherokee Water Co. v. Gregg County Appraisal Dist.*, 801 S.W.2d 872, 879 (Tex. 1990) (Ray, J., dissenting).

S U M M A R Y

Under Local Government Code section 272.001(h), the fair market value of a municipality's interest in land is the amount that a willing buyer, who desires but is not obligated to buy, would pay a willing seller, who desires but is not obligated to sell. Unless evidence to the contrary is produced, the leasehold estate merges into the fee simple estate when the lessee purchases the land he or she currently leases. A lessee who purchases the whole of the city's interest in a lakeside lot under section 272.001(h) must pay for both the city's right to future rent payments and the city's reversionary interest.

A municipality may not instruct an appraiser as to whether to value the land as encumbered or unencumbered.

Yours very truly,

A handwritten signature in black ink, reading "Kymberly K. Oltrogge". The signature is written in a cursive style with a long horizontal flourish at the end.

Kymberly K. Oltrogge
Assistant Attorney General
Opinion Committee