Exposure Draft

Setting the Record Straight on Fee Simple

by the IAAO Fee Simple Task Force

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I. Introduction

The purpose of this paper is to address issues surrounding the definition of the term *fee simple*. The fee simple estate definition is the foundation of what assessors are often asked to examine. It is evident, particularly in property tax appeals, that it is necessary to clarify this concept for assessors, appraisers, the courts, and others in the appraisal community.

Misunderstandings about the term fee simple, more appropriately, *fee simple absolute*, have led to uncertainty in the appraisal of a fee simple absolute estate.

Issues arising from the term *fee simple absolute* include whether the property should be valued as if vacant, whether the term assumes any encumbrances on the property, and whether the term assumes market rent. An investigation of the evolution of the term reveals that the appraisal industry definition has diverged from the legal definition, leading to confusion in the appraisal community, particularly in the field of property taxation. Therefore, it is essential to clarify fee simple in order to maintain accuracy, consistency, and uniformity in assessment practices and to retain credibility in the assessment profession.

This paper explains these issues and sets the record straight about what fee simple is and what fee simple is not.
II. Definition of Fee Simple

A. Legal Definition

1. History of the Term

The term *fee simple absolute* dates back to the early 1300s in England (Garner 2014, 733–734; Wolf 2009, 13–1). The legal definition remained constant over the years and is generally defined as an estate that has a potentially infinite duration and, if limited in favor of a person, would be inheritable by his heirs (Wolf 2009, *First Restatement of Property*, section 14; section 13.02). The history of fee simple absolute, and the other estates traditionally recognized in the United States, is long. Estates arose from feudal law in England centuries ago and were carried over to the United States.\(^2\) The definition in the legal arena has not changed in meaning over time; however, the concept of fee simple within the appraisal community has changed significantly.

2. Definition

The definition of *fee simple* in the *First Restatement of Property* is as follows:

*An estate in fee simple absolute is an estate which has a duration potentially infinite, or if limited in favor of a natural person, would be inheritable by his collateral as well as by his lineal heirs* (Wolf 2009, section 13).

Similarly, *Black’s Law Dictionary* defines fee simple as follows:

*An interest in land that, being the broadest property interest allowed by law, endures until the current holder dies without heirs; esp., a fee simple absolute* (Garner 2014, 733).

*Introduction to The Law of Real Property* describes fee simple as,

*... the largest estate known to law. It denotes the maximum of legal ownership, the greatest possible aggregate of rights, powers, privileges, and immunities*

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\(^2\) The likely first reference to *fee simple* in the courts in the United States was in a Maryland court in the case of *Smith’s Lessee v. Broughton* in the year 1714.
which a person may have in land. It is an estate of potentially infinite duration in the holder’s successors who acquire the holder’s interest in the property either by conveyance, devise, or inheritance. The three hallmarks of the estate are that it is alienable, devisable, and descendible. (Moynihan and Kurtz 2002, 34)

Although these legal texts do not use identical terminology, the definitions have similar meanings that emphasize absolute control, duration, and inheritability.

3. Distinguishing Fee Simple from Other Estates in Real Estate

As noted above, the fee simple absolute estate implies nothing more than an ownership interest in property in which the owner has complete control of the disposition of the property. Fee simple is one of six freehold estates in real property:

(1) Fee simple absolute
(2) Life estate
(3) Fee simple determinable
(4) Fee simple on condition subsequent
(5) Estate for years
(6) Estate at will.

These estates essentially determine the disposition of the property. For example, a life estate terminates upon the death of the holder of that estate, with the property predetermined to go to another person, the remainderman. With a fee simple determinable or fee simple on condition subsequent estate, the owner of these estates loses title upon the occurrence of some event specified in the deed, say, marriage, or the use of the property for other than a public use. With an estate for years, the owner of the estate is simply divested of title after the expiration of a certain time frame, say, 10 years. Finally, the owner of an estate at will can lose title at the will of the grantor.
However, with a fee simple absolute estate, there is no event that triggers a loss of ownership of the property. The holder of the fee simple absolute estate can sell the full unrestricted estate in the property or put it in a will so that the owner can determine the disposition of the property upon death.

B. Appraisal Definition of Fee Simple

1. History

The appraisal definition of the term fee simple differs from the legal definition, and the distinction becomes evident upon tracing the definition’s evolution in appraisal industry.

Initially, the appraisal definition aligned perfectly with the legal definition of fee simple absolute; however, in the 1980s the term unencumbered was appended to the definition. It is that divergence from the legal term that has caused the issues addressed by this paper. The following chronology describes the transformation of the definition in the appraisal industry.

- *Appraisal Terminology*, 1938, **absolute fee simple**. The largest possible interest or estate in property, subject, however, to the limitations of Eminent Domain, Escheat, Police Power, and Taxation; an inheritable estate. (American Institute of Real Estate Appraisers 1938)
- *The Appraisal of Real Estate*, 1983. A person owning all of the rights is said to have fee simple title. Fee simple title is regarded as an estate without limitations or restrictions. (Appraisal Institute 1983)
- *The Dictionary of Real Estate Appraisal*, 1984. fee simple estate. Absolute ownership unencumbered by any other interest or estate; subject only to the limitations of eminent domain, escheat, police power, and taxation. (Appraisal Institute 1984)
A person who owns all the property rights is said to have fee simple title. A fee simple estate implies absolute ownership unencumbered by any other interest or estate. (Appraisal Institute 1987, 1992, 1996)

Absolute ownership unencumbered by any other interest or estate; subject only to the limitations imposed by the governmental powers of taxation, eminent domain, police power, and escheat. (Appraisal Institute 1989)

Absolute ownership unencumbered by any other interest or estate; subject only to the limitations imposed by the governmental powers of taxation, eminent domain, police power, and escheat. (Appraisal Institute 1993, 2002, 2010, 2015)

Absolute ownership unencumbered by any other interest or estate, subject only to the limitations imposed by the governmental powers of taxation, eminent domain, police power, and escheat. (Appraisal Institute 2001)

Absolute ownership unencumbered by any other interest or estate, subject only to the limitations imposed by the governmental powers of taxation, eminent domain, police power, and escheat. (Appraisal Institute 2008, 2013)

Note that the 1984 version of The Dictionary of Real Estate and the 1987 version of The Appraisal of Real Estate were the first publications to diverge from the established definition of fee simple.

2. Appraisal Industry Definition

The current definition in The Dictionary of Real Estate Appraisal defines fee simple estate as,

Absolute ownership unencumbered by any other interest or estate, subject only to the limitations imposed by the governmental powers of taxation, eminent domain, police power, and escheat (Appraisal Institute 2015).

The concept that fee simple means the property is “unencumbered by any other interest or estate” is the point at which the appraisal definition digresses from the legal definition. The Dictionary of Real Estate definition emphasizes absolute ownership, but the “unencumbered by any other interest or estate” phrase implies that the existence of an encumbrance results in
something other than fee simple absolute ownership. That premise is inaccurate. In particular, the word *unencumbered* has led some to mistakenly interpret fee simple to mean that any property with a lease is no longer a fee simple estate.\(^3\)

The courts have also noted the discrepancy between the legal and appraisal definitions of fee simple:

\[\text{The distinction between ‘fee simple’ and ‘leased fee’ is one drawn in the context of appraisal practice. The appraisal industry uses the term ‘fee simple’ to refer to unencumbered property – or to property appraised as if it were unencumbered. This distinction is not one recognized by the law, however. A ‘fee simple’ may be absolute, conditional, or subject to defeasance, but the mere existence of encumbrances does not affect its status as fee simple. (Meijer Stores Ltd. Partnership v. Franklin Cty. Bd. of Revision 2009; HIN, L.L.C. v. Cuyahoga Cnty. Bd. of Revision 2014)}\]

In addition, the United States 9th Circuit Court of Appeals notes that a leaseholder is not “seised of land” and that a “lease-hold is not an ownership interest” (*City of L.A. v. San Pedro Boat Works* 2011). If the tenant has no ownership interest in real estate, then the fee owner has not given up any ownership rights.

The final clause in the definition, which references the four powers of government (powers of taxation, eminent domain, police power, and escheat), is simply an acknowledgment that all privately owned real estate, regardless of the estate in which it is held, is subject to those governmental limitations.

**3. Implications of the Word ‘Unencumbered’**

The appraisal industry definition of fee simple does not identify any specific encumbrances that would allegedly destroy the fee simple estate, but instead uses the all-

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\(^3\) The phrase “unencumbered by any other interest or estate” also raises another issue. As already established, fee simple absolute is an estate. An estate is not an encumbrance. A fee simple estate cannot be encumbered with another “estate”—the existence of another estate simply means the estate is not fee simple.
The definition states that the existence of an encumbrance results in something other than fee simple absolute. This is incorrect; moreover, it is rare, if ever, that an appraisal assignment, for property tax purposes or otherwise, would request a value of an unencumbered estate. Valuing an unencumbered estate would mean ignoring utility easements (i.e., gas, electric, water, and the like), access easements, and restrictive covenants (i.e., deed restrictions). Whereas many appraisal assignments request a value of the fee simple estate, it is unlikely that the purpose of the appraisal is to value the property ignoring easements and restrictive covenants, among other encumbrances. Thus, the appraiser is caught between conforming to the appraisal industry definition of fee simple (ignoring all encumbrances) and to the actual goal of the appraisal, which likely seeks a value considering utility and access easements and any restrictive covenants.

This illogical result arising from the erroneous definition is pointed out in The Appraisal of Real Estate:

The complexity of real property ownership in the United States today suggests that a true fee simple interest seldom exists because nearly all properties are encumbered to some degree by easements, reservations, or private restrictions. ... Even so, many assignments call for the valuation of the fee simple interest.

(Appraisal Institute 2013, 111).

In sum, the important aspect to note is that fee simple has absolutely nothing to do with leases/mortgages/liens/deed restrictions/easements or any other encumbrance or distribution of property rights to others. The typical homeowner likely owns the home in fee simple absolute, and the deed reflects that estate. The existence of a mortgage does not mean the owner has less than a fee simple absolute estate. The home also has utility easements for water, power, and cable; however, the owner still holds the property in fee simple absolute. More specifically, the property is owned in fee simple absolute subject to the mortgage and the utility easements. And
if the home is leased, then the property is owned in fee simple absolute *subject to* the lease.\(^4\) A fee simple estate or any other estate is not defeated by the existence of encumbrances.

**C. Interests, Estates, Encumbrances, and Real Estate**

Much of the confusion in this area is the result of the intermingling of terms that do not carry the same meaning. The general term *real estate* (i.e., land and all things permanently attached thereto) represents the physical asset to which the interests held by an owner of real property (i.e., the bundle of rights or sticks) pertain. The term *interest* as used in both the legal and real estate industries is a broad generic term representing any of the rights in real estate and can refer to estates, encumbrances, leases, possessory interests, mortgages, and so forth. The term *estate*, as discussed above, specifically identifies the category of ownership interests that define the length of the ownership along with any events affecting the duration of that ownership term.

The universal term *interests* encompasses any of the various rights in real estate; however, the various subcategories of interests do not overlap. Thus, while estates, possessory interests, leasehold and leased fee interests, encumbrances, and so on can all be considered interests, they are still separate from each other.

**III. Problems Arising from the Appraisal Industry Definition**

**A. Fee Simple and Vacancy**

One of the main controversies that has emerged as a result of the word *unencumbered* is the interpretation that a property encumbered by a lease is not fee simple, and that appraising a property in fee simple means one must assume the property is unencumbered by a lease, that is,

\(^4\) A lease fulfills the basic wish of an owner to receive rent. It is a contract for the use of the property to provide rental income to the owner.
vacant. Fee simple does not mean the property is vacant. Fee simple defines an estate. It is not synonymous with dark value or liquidation value. Under this misguided theory of the fee simple estate, multitenant office buildings and apartment buildings would be appraised as vacant properties even if fully occupied—something contrary to what exists, otherwise known as a hypothetical condition. If the appraisal industry definition of fee simple were accurate, then according to USPAP, every appraisal of the fee simple interest of a leased property would require the application of a hypothetical condition valuing the property as vacant, which is not likely to be the intended result of the appraisal of a fee simple estate.

The Uniform Standards of Appraisal Practice (USPAP) (TAF 2018) defines hypothetical condition as,

A condition directly related to a specific assignment, which is contrary to what is known by the appraiser to exist on the effective date of the assignment results, but is used for the purpose of analysis.

Comment: Hypothetical conditions are contrary to known facts about physical, legal, or economic characteristics of the subject property; or about conditions external to the property, such as market conditions or trends, or about the integrity of data used in an analysis. (TAF 2018, 4)

Of course, an appraisal assignment may specify that the property be appraised as vacant; however, unless this is part of the defined scope of work, the phrase fee simple absolute should not imply vacant when the subject property is occupied.

What also emanates from this faulty presumption is the theory that a fee simple valuation assumes the property is vacant and available for lease or for sale to some other prospective user, a hypothetical user. Some then go further and eliminate the current use and user from the pool of prospective uses and users. This perspective ignores the current use of the property even if that is the highest and best use. In other words, it ignores the fact that the continuation of the current use of the property could be the highest and best use and biases the appraisal development process.
B. Fee Simple Absolute and Leased Fee Interest

Another issue arising from the erroneous fee simple definition is whether a fee simple estate and leased fee interest are mutually exclusive of one another. *Leased fee* is a term defined by *The Dictionary of Real Estate Appraisal* as

> The ownership interest held by the lessor, which includes the right to receive the contract rent specified in a lease plus the reversionary right when the lease expires. The term is used by appraisers as a basis to estimate the lessor’s value subject to a lease. It is based usually on the capitalization of net operating income (NOI) or the sum of the present value of the forecast NOI over a holding period and the present value of the reversion. In reality, leased fee is synonymous with fee simple, subject to a lease when possession but not the ownership is temporarily transferred to another. (Appraisal Institute 2015, 128)

As noted, leased fee is merely an *interest*, not an estate. As the definition also notes, leased fee is actually a fee simple interest subject to a lease. (Obviously any estate may be subject to a lease—life estate, fee simple on condition subsequent, and so on). Therefore, an appraiser may use leased fee properties as comparable sales when estimating the market value of a fee simple estate, provided that necessary adjustments are applied to account for above- or below-market characteristics.

C. Bundle of Sticks

Another common but inaccurate description of the fee simple estate is that it represents the whole *bundle or rights or bundle of sticks*. The bundle of rights or bundle of sticks metaphor originated as a description of real estate, not a fee simple absolute estate. Fee simple absolute is not synonymous with the term *real estate*.

The problem with this description of fee simple is that the metaphor implies that fee simple represents the entire set of rights and that each stick represents one piece of the whole. When any stick is removed, what remains is something less than fee simple. Any of the estates in real property contains that same bundle of rights. When the fee simple estate owner exercises the
right to lease the real estate, he/she receives a benefit of ownership for a finite period of time
after which the real estate can be owner-occupied, leased, or left vacant. Thus, the transfer of one
or more sticks from the bundle of rights does not diminish the *estate*. The owner of a property
that has a fee simple absolute estate can still lease the property, encumber it with a mortgage or
other lien, and transfer easement rights to another, without diminishing or changing the fee
simple absolute estate.

**D. Fee Simple Is Not a Value Concept**

Another point of confusion is equating fee simple with market value. Fee simple is an
ownership concept, not a value concept, although some appraisers have mistakenly used fee
simple to imply *at market*. Market rent or market value is precisely that, and fee simple should
not be used interchangeably with those terms.

**IV. The Definition of Fee Simple Should Not Differ among the Appraisal, Legal, or Real Estate Industries**

The appraisal industry is too closely associated with the legal industry and the
general real estate industry for different definitions to exist among the three. Review of
the real estate industry shows that brokers and real estate salespersons, real estate
financing persons, real estate attorneys, and the courts all understand fee simple to have
the meaning set forth by the legal definition, which has remained constant throughout the
years. Statutes governing property tax can be also assumed to follow the legal definition.

There is no rationale for the appraisal industry to apply its own definition to a term
universally understood by the other participants in the real estate industry.
V. Conclusions

Once the definition of fee simple absolute is clarified, it is evident that fee simple is a property rights concept that does not mean vacant or unencumbered by a lease and is not a value concept to be used interchangeably with market value. It is important to understand these distinctions so that the appraiser or assessor can properly define the appraisal problem. An appraiser can value the fee simple ownership of an occupied apartment building assuming leases in-place, market rents, or a lease-up period. The mere fact that there are renters in a commercial property does not detract from fee simple ownership. In other words, if that apartment building, whether occupied or vacant, were to convey in a sale, the deed would state that the property transferred in fee simple. What is being valued is based on the scope of work of the assignment. Whether the appraiser or assessor considers an easement or above- or below-market leases is defined by the appraisal assignment and, in the case of property taxation, by the jurisdictional requirements mandated by statutes and the courts.

VI. References


*City of L.A. v. San Pedro Boat Works*, 635 F. 3d 440 (9th Cir. 2011) (quoting *Auerbach v. Assessment Appeals Bd. No. 1.*, 137 P.3d 951, 956 (Cal. 2006)).


*Smith’s Lessee v. Broughton*, 1 H & McH. 33, 1714.
