

Creating a marketplace for large trees

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Introduction

One of the greatest challenges to appraising large trees is their illiquidity. Large trees cannot be moved without spending large sums of money and causing harm to tree health. Because large trees cannot be easily and readily moved, there is a limited market for them as standing trees. The typical buyer of an urban real estate parcel on which large trees are located purchases them as fixtures to the land, not as the primary subject of the real estate transaction. Therefore, a necessity has emerged to appraise trees by a proxy method such as the CTLA trunk formula method.

But what if there were a way to buy and sell trees *without moving them*?

Real property ownership is defined by a set of rights conferred by a governing body. Among these rights are the right to buy and sell the property and the right to modify the property within the limitations of the governing law. Transfer of ownership does not necessarily require physical movement of the property. The most common transactions that exemplify this are real estate transactions. Developed land is commonly bought and sold, but owners do not commonly transfer the location of the structures that reside on the land. Undeveloped land is bought and sold, but with few exceptions, buyers do not (and typically cannot) remove the soil and move it elsewhere. Such ideas are ludicrous because the rights conferred upon the property owner are defined by the geographic boundaries of the land parcel, and these boundaries cannot be picked up and moved.

Because real property cannot be moved when it is bought and sold, the principle of a real estate transaction is an agreement made between parties to transfer the underlying

property rights, and the agreement is documented at the local government's recording office. To represent the confirmation of rights, a deed of trust is transferred from one party to another. Essentially, a real estate transaction is a transfer of one piece of paper to another.

What if this same idea could be applied to trees?

In this article, I will propose a practical method that will allow trees to transfer ownership without being moved. It will motivate property owners to grow and maintain beautiful trees, and it will place the burden of cost with those who value them most. Those who place the most economic or amenity value on trees

will be able to control them; those who would otherwise be indifferent would have more of a reason to grow and maintain their trees; and local governments would see an increase in property tax revenues from an increase in property values.

ments to install power lines, water lines, gas lines, and sewer lines across privately owned property. Property owners must honor the rights of access conferred by easements because they are enforceable by the governing body of law.

All easements are grouped into a larger category of burdens placed on a property owner—called **covenants**. Simply put, a covenant is a promise that must be honored by the owner of that parcel of real estate. It is different from a **contract** in one important way: whereas contracts are between two parties and expire when the relationship between those parties is terminated, covenants “**run with the land.**” Promises conferred

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Easements and covenants

Within the body of rights conferred upon a property owner, there are limitations also connected with the ownership of the land. An example of one of these limitations is an easement, which grants rights of access to specified people who do not own the land. Landlocked property owners commonly get easements to cross their neighbors' land and access their own land. Utility companies use ease-

by covenants do not disappear when a property is bought and sold. Rather, they become a continuing obligation on subsequent owners of the land.

The concept of a covenant can be applied to a tree. A third-party entity agrees to assume the cost of maintaining the tree, and in exchange, the property owner agrees to give up his right to modify or remove the tree. If the property owner ever sells his real estate to another party, the new owner will purchase a parcel of land encumbered by this agreement, and he too will be required to honor it. The other party to the covenant will continue to hold the obligation to service the tree until the tree dies or the covenant is released from the land. The exact terms of the agreement can

be specifically negotiated by the originating parties. Some key deal points are discussed later in this article.

Tree sellers

The mere presence of trees is often an encumbrance on a property owner. Even if they do not pose significant hazards to the landscape, they can still be liabilities. Trees hinder building additions, their roots can damage structures, and their canopies can obstruct views for residential property or signage on commercial property. It is a common occurrence to see a large tree removed to solve one of these issues. Usually the rationale behind removing a tree is financial: a new addition increases the value of a property, and better exposure of a sign leads to an increase in business. Another common reason property owners remove trees is so they do not have to pay for their maintenance.

The owners of property with large, important trees could be potential tree sellers. Those who would ordinarily have removed their trees may be convinced to keep them by exchanging a promise that another party will care for the maintenance of the tree. If the primary reason to remove a tree is to remove a financial liability, then a rational property owner may be convinced to receive financial compensation equal to that liability in lieu of removing the tree.

Tree buyers

There are many organizations and many more individuals who are actively involved in their communities, trying to preserve historic trees from being removed for short-sighted gains. Historical societies work to-

wards preserving trees with historical significance, environmental groups try to preserve habitats, and local community activist organizations try to preserve the appearance and character of their neighborhoods. They argue that because trees are irreplaceable due to the long time it takes them to grow, property owners should not have the right to remove them on a whim without concern for the greater community. These tree



activists are not likely to be able to afford large-scale purchases of tree liabilities, but they would make good **donors** to a larger organization. This demographic will serve as a source of capital. When the capital is sufficiently concentrated, broader swaths of transactions can be undertaken, reducing costs and achieving what is known as **economy of scale**. The unit (per tree) transactional costs will be smaller, making other transactions more economically feasible.

For purposes of starting a primary market for these trees, one or more new nonprofit organizations will need to be formed. Their stated mission would be to preserve trees and beautify communities. These nonprofits will receive startup funding from tree activists to begin operations, and they will be the **underwriters** of the proposed tree covenants.

In a typical transaction, a nonprofit buyer and a potential seller would connect and formulate an agreement to be recorded as a covenant to the deed. The seller will receive some compensation and a piece of paper that confers the right to receive maintenance and care of the tree by the underwriting nonprofit organization. The nonprofit buyer will receive a piece of paper stating the guarantee that the tree will not be removed by the property owner and some additional rights. (See inset on next page "Specifics of the Covenant Agreement")

Qualified arborists are necessary for facilitating these transactions. They would help with appraisals, recommendations, and identification of any potential problems with the tree's health, location, and other attributes. These arborists would be employed by the nonprofit underwriter because they would be acting in the best interest of the trees. Their observations and recommendations could either be suggestive or binding, depending on the negotiations between the buyer and the seller.

Insurance

The tree buyers will want to obtain some form of protection for their new investment. If some unprecedented weather event were to damage or destroy a tree, they would want to receive some form of monetary com-

Specifics of the covenant agreement

➤ *Term of the Agreement*

Trees have a finite lifespan, and therefore this should be reflected in the agreement. When a tree is determined to be dead, the agreement would be terminated and no longer “run” with the land. The right to determine whether the tree is dead would be granted to the tree buyer to prevent the property owner from arbitrarily deciding that the tree is dead and destroying the buyer’s investment.

➤ *Liability for Damages*

Buyers would also be assuming the liability of damages caused by the tree. As part of the covenant, in addition to paying the costs of maintaining the tree, the buyer will also assume the liability of any damages caused by the tree. If the tree drops a limb and injures a person or causes property damage, the buyer will be held responsible.

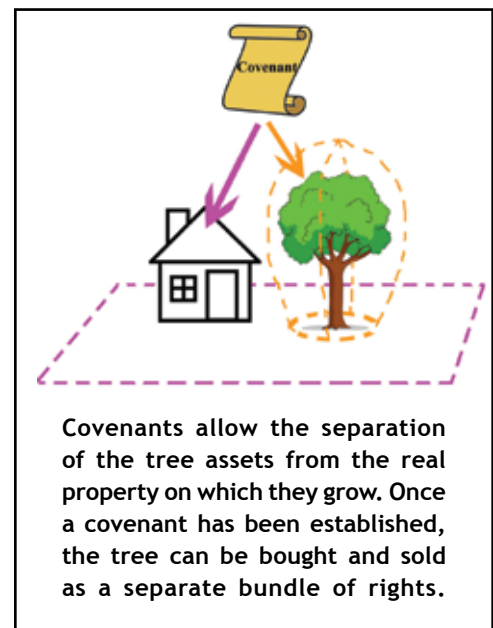
Because of this additional responsibility, it is likely that all recently-dead trees will be removed by their purchasers to prevent the extension of any liability to them from the recently-deceased tree falling and causing damage.

➤ *Additional Rights*

In addition to the guarantee not to cut the tree down, tree buyers can receive other rights from the transaction. One example from an existing agreement is a tree owner receives a monthly royalty in exchange for the contract holder’s right to hold photography shoots under the tree, using it as a beautiful backdrop. Another right could be the right to install a tree house, provided that it conforms to the local planning ordinances. These could be decided on a case-by-case basis, but would require assistance of a licensed real estate attorney.

Because the tree buyer is interested in the health of the tree, it will need to be inspected periodically by a qualified arborist. Such a right will be conferred in the covenant.

Because the condition of the tree would be impacted by management of the surrounding land and future site development, there would need to be some language in the covenant that places restrictions on these activities by the landowner, allowing them only if there is mutual consent or if there is no impact to the subject tree. If the loss of the tree were attributable to the actions of the landowner without the consent of the tree buyer, then the landowner could potentially be held responsible.



pensation. They would also want to be protected from the liability to other parties such as the land owner. Therefore, a new market for tree insurance will suddenly exist.

Insurance companies will need to rely on the actuarial data gathered by field arborists to determine fair premiums accurately. Arborists will need to be recruited to quantify tree loss probabilities given species, location, form, and age. With this data in place, many policies could be sold at a marginal cost. A sufficient market

would have to exist for the insurance to overcome the critical mass necessary to justify the upfront expense of amassing the data.

Policies would have two parts: liability and comprehensive. Much like a car insurance policy, the liability portion would cover damage that the tree causes to another party, such as a branch dropping on a person or a root system damaging a piece of pavement. The comprehensive portion of the policy would cover the appraised value of the tree in the event of a loss

of the tree. The appraised value and the premiums would change over time as the tree ages and would be determined by one or more appraisals.

The secondary market

Once the insurance is in place, a level of security would accompany the purchase of a tree asset. The combination of the covenant and the insurance policy could be packed as a single “tree asset” that could then subsequently be bought and sold on a secondary market. The secondary

market would consist of any outside investors that would not have the capability to service broad portfolios of trees but would still wish to participate in the marketplace.

Asset servicing is a commonplace agreement in real-estate financing. A mortgage originator will first loan money to a property buyer. Then the originator will subsequently sell that mortgage note on the secondary market to another buyer while retaining the responsibility of receiving the cash flows generated by the note and sending a portion of them to the purchaser of the note. In the aforementioned tree transaction, the originator (former buyer) would sell the tree asset to the secondary buyer with the agreement that they would continue to “service” the asset. In this case, servicing would entail maintenance pruning, inspections, and payment of insurance premiums.

Financing and banks

Once the tree asset is defined as a transferrable note with a defined value, a new potential market for tree mortgages could be created. These loans would be secured by the tree asset and would allow investors to purchase trees with limited capital resources. Because the trees would be protected by the insurance policy, the banks would be protected in the event of a loss. Loan underwriters could determine the likelihood of default and the likely price they would receive on the secondary market if they had to seize the tree asset due to default.

When tree assets can be used as loan collateral, tree activists will be able to leverage their capital resources to purchase and preserve even more trees.

Tax benefits

For tax purposes, trees would serve as an excellent tax shelter. First, the tree would be carried as an asset on the owner’s balance sheet as the book value at the time of purchase. Then, the cash flow (presumably negative) would be recorded as a financial loss that would offset capital gains

in another part of the owner’s portfolio. If the market for the tree were to increase in value, the return on investment would be deferred until the time of sale, much like any other financial asset. Therefore, any gains on the sale of the tree-asset would not be realized until the sale, creating an advantageous tax position for the asset holder.

Donors to the initial nonprofit underwriter would be able to write off the value of the donated trees. These donations would be important to gain the sufficient initial critical mass to establish a marketplace, and are discussed in a later section.

Secondary market and tree appraisals

The larger the secondary marketplace, the more accurately the sale prices will reflect their true market values. Small marketplaces are dominated by inefficiencies: sellers compromise on asking price because they need to liquidate quickly, and buyers are able to offer lower prices when there is no competition. If more buyers were to exist to bid on the same trees, it would drive prices up, and property owners would be more motivated to preserve their trees in the hopes of a big payout at the closing table.

When the secondary market is sufficiently large, recent sale prices could be used as accurate reflections of true market value, and there would be no need for proxy appraisals such as the trunk formula. A tree would be valued by what someone would be willing to pay for it.

Implementing this proposal

Two key elements of this proposal are highly scalable: insurance and financing; they require high critical mass to overcome the high upfront costs of opening a new marketplace for insurance products and tree-secured loans, but once the infrastructure is in place, it can service many new trees at a relatively low marginal cost. Therefore, in order to implement this proposal in its early stages, trees will have to be purchased initially without insurance

or financing, which will require committed and enthusiastic investors who are willing to risk their capital for an opportunity at being the first to step into a brand new marketplace.

One way to overcome this initial hurdle is by quickly creating a critical mass of tree assets by encouraging tree activists to donate their own trees to the nonprofit. A purchase agreement could be written up, and the donor could agree to donate 100% of the proceeds of the sale back to the organization. These donations would make up the initial asset base for the nonprofit. Once a sufficient inventory can be established, an efficient program for care and maintenance can be established.

After an inventory can be established, the nonprofit underwriter can begin to market selling the trees to secondary market investors. The sales pitch for investors would be:

- Help save the environment by buying and preserving a tree.
- Get a tax write-off for the negative cash flow generated by the tree asset.
- Profit from the future sale of the tree asset.
- Borrow against the tree asset to access the appreciated value of the tree asset without realizing any of the taxable gains.

The population of investors that wishes to purchase trees simply for the public good is limited in size. The only way to get a sufficient size marketplace is to create a system that motivates investors who are typically indifferent to tree health to still make decisions that are in the best interest of preserving trees. This proposed system of financial value and tax write-offs will serve as that additional motivation.

Once the critical mass has been achieved, a public marketplace can be created. This marketplace would be a construction similar to the existing Multiple Listing Service (MLS) for real properties. In its early stages, the marketplace might be imagined as more of a centralized classified

advertising section. This would be where buyers and sellers could find each other.

Limitations

There is potential for some abuse, but market forces should correct these problems organically:

- A seller could present a sales pitch to a buyer: “We’re going to cut this tree down unless you buy it from us.” This scenario could occur early on, but if the secondary market were to grow sufficiently enough, then the buyers would be able to call the seller’s bluff. The potential seller can go ahead and cut down his own tree, but he won’t be able to sell it later.
- A property owner could sell his tree and then deliberately poison it. This would not benefit him because he would lose the protections conferred by the covenant: if the tree is alive, he gets to enjoy the tree for free. If he still

wanted to poison it, then the tree-asset owner could sue for damages. Many municipal codes have punitive damage clauses that magnify the awarded damages by a factor of two or three.

Municipal ordinances

Currently, the commonly used method for legally protecting trees is the municipal ordinance. Cities or local governments can pass ordinances that affect large swaths of trees (usually, but not always, the entire municipality), specifying who is responsible for maintaining them. These ordinances restrict the property owners’ rights to remove trees, but they do not provide financial motivation for landowners to plant and care for trees. The restrictions of these city ordinances are strictly a liability for the landowner and do not catalyze the installation of new privately-owned trees.

Encouraging this new tree ownership model helps municipalities accomplish their goals of preserv-

ing and growing tree canopy. They could potentially be big supporters by promoting the model to constituents who could then subsequently sell or donate their trees and add to the size of the marketplace. Although it would be possible for municipalities to be buyers of trees themselves, it is unlikely that they would be the best source of funds. The most effective utilization of their power would be their continued enforcement of tree protection ordinances and their promotion of this new model of tree ownership.

Conclusion

Trees can be preserved when there is a mutually beneficial exchange that places assets with those who value them the most. Tree activists and other entities can own trees, indifferent property owners can be relieved of their financial obligations to maintain them, and investors can contribute capital to the system to benefit their own income statements. Non-activist tree owners would have a motivation to farm new trees for future sale, and ultimately, the urban forest will be preserved and expanded for the benefit of all.

Author’s Note: This model is offered as a theoretical proposal, but I am not currently aware of any existing tree-covenant transactions already in existence. I hope that this article will encourage discussion of this topic and catalyze the early transactions necessary to create the proposed marketplace.

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