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**WHAT'S IT WORTH? THE VALUATION OF REAL
PROPERTY IN LITIGATION**

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**“WHAT’S IT WORTH - WHO WANTS TO KNOW?” - THE
VALUATION OF REAL PROPERTY IN LITIGATION**

by: MICHAEL RIKON

INTRODUCTION

The title of this article is, of course, meant to grab the readers attention. It is, however, a truism that value of real property is often not simple to fix. We all recall the study of the legal dilemmas that faced “Black Acre” in law school, but the focus on the value of “Black Acre” is far more illusive. If beauty is in the eye of the beholder, then value of real property lies in the one who has title, but not always.

Real property value is very dependent on the factual circumstances presented. It is also dependent on the reason for the need to value the property.

Real property rarely presents itself in a perfect model of circumstance for valuation. This does not mean that one occasionally does not get lucky. There can be a very recent sale of a condominium unit in the same building, in the same line, and only one floor away. This rarity aside, real property is usually unique in a number of factors including its location. It generally lasts forever and is of limited supply. Its value may be very dependent on its use which could be unique to its present owner. What real property is worth may not be equated to what it cost. Nor does fair market value necessarily mean assessed value. Real property value will often vary depending on subjective factors, legal issues and the very nature of the inquiry. In this article we will address the valuation of real property as it may appear in the context of litigation.

EMINENT DOMAIN

In no other field of litigation is value so keenly put in issue than in a condemnation case. It is the primary inquiry. Condemnation is a harsh remedy. It is the forced sale of property. In many cases, the owner would not part with title no matter the price. Yet, the power of eminent domain is inherent in the sovereign. There is nothing in our constitutions which create the power to condemn and that is because it existed before our constitutions came into existence. What does exist is a limitation on that power. The Fifth Amendment to the United States Constitution and Article 1, Sec. 7(a) of the New York State Constitution provide that in the event that property is taken for a public use, the owner must receive “just compensation.” The search for what exactly constitutes “just compensation” is the paramount issue in any condemnation case.

The constitutional requirement of “just compensation” requires that the property owner be indemnified so that he may be put in the same relative position, insofar as this is possible, as if the taking had not occurred.¹ It is the general rule that “just compensation” is to be determined by reference to the fair market value of the property at the date of the taking,² and fair market value is the price for which the property would sell if there was a willing buyer who was under no compulsion to buy and a willing seller under no compulsion to sell.³ The fundamental question then to be answered by the Court in valuing damages is “what has the owner lost?”, not “what has the taker gained?”⁴ This is so because the owner is to be put in as good a position pecuniarily as it would have occupied if the property had not been taken.⁵

In a condemnation claim, a former owner (at this stage, a claimant) is not limited to a study based on the property’s actual use, for the property must be valued on its highest and best use

regardless of the actual use. As will be discussed below, this differs significantly from tax reduction cases.

Not only is an owner allowed to project a value of the property on a different highest and best use, but that owner may also have the trial court consider the reasonable probability of re-zoning the property.⁶

HOW REAL PROPERTY IS VALUED

Appraisers estimate property value by utilizing three approaches to analyze real estate data. The three classic methods of valuing real property are (a) market data or comparable sales approach, (b) income capitalization approach, and (c) the cost approach. The cost approach is rarely used in condemnation cases for real estate. Real property must constitute a “specialty” for the cost approach to be employed. A “specialty” has been defined as a building designed for a unique purpose.⁷ For a building to be a “specialty,” it must be truly unique so that only the owner would have use for it and the sole way to replace it would be by its reproduction. The cost approach requires the appraiser to find a value of the land and then add the estimated value of the improvements. The value of the improvements is found by finding the current cost of constructing a reproduction of the valuation subject and then subtracting depreciation. All incremental costs are also considered and added to value.⁸ While the cost approach is rarely used in a condemnation real property case, it is always used in a trade fixture case.⁹

The market data, or comparable sale approach is used when the subject property is similar to other properties which have been sold, or perhaps are currently for sale in the subject property

neighborhood. This method works well for residential properties and is always used for vacant land. The appraiser will analyze the sales by making a grid to show the expert's adjustments for location, size, time, zoning, marketing factors, view and other factors that a buyer would consider, all with the idea that the comparable sales, as adjusted, will indicate a value of the subject.

In reviewing an appraiser's adjustment factors, one must be alert for any large adjustment since the greater the adjustment, the less reliable the sale. Sometimes a condemned parcel, often denominated as a "damage parcel," (an archaic description that survives) may have been recently purchased. The Court of Appeals has held that a recent sale, if not explained away as abnormal in any fashion, is evidence of the "highest rank" to determine the true value of the property at that time.¹⁰ However, while the best evidence of value may be a recent sale of the subject property between a seller, under no compulsion to sell, and a buyer, under no compulsion to buy,¹¹ a recent sale of such property is not relevant to the question of value if it is established that such a sale was "abnormal" and, therefore, not reflective of market value.¹²

If the property was purchased for development, the owner is entitled to a far greater return than mere acquisition costs. Since an owner is entitled in condemnation to be fully indemnified, that owner should be entitled to recover not only the fair market value of the land, but all costs expended and an entrepreneurial return on the investment. If the use is specific, for example, the construction and operation of a new funeral parlor or self-storage facility which was well advanced when condemned, that claimant is entitled to receive exactly what the owner would have received in a fair market sale. In other words, the property increased in value substantially because of the owner's money, knowledge and hard work. Every step that was taken to advance the project would provide

an incremental and, perhaps, geometrical increase in value. This is because “a sagacious and experienced prospective purchaser on the day of the taking would undoubtedly have taken into consideration the net rental income which might have been derived from (the) property if the taking had not intervened . . .”¹³

If the subject property is income producing, it should be valued by the income capitalization approach. Simply put, this approach finds the present value of real property based on its future income. In condemnation, the property is valued as if it is free and clear of all liens, encumbrances and leases.¹⁴

The appraiser makes an extensive market study and estimates the economic rent of the property. Actual rents must be considered.¹⁵ Actual rents provide the best indicator of fair market rental, especially if there is no indication that the actual rental is too high or too low.¹⁶

The appraiser then estimates the expenses of the property. The net income is then applied a capitalization rate which, itself, is determined by a study of various economic factors including the returns on other investments, taking into account mortgage, equity components, and risk. The rate of capitalization should be a reflection of the market, i.e., what an investor would require from an investment in a property of similar age, kind and condition. The resulting “cap” rate is then divided into the net income to indicate a value for the property, while care must be taken not to capitalize a speculative or hypothetical income stream from a non-existent structure.¹⁷ However, a property with an existing lease and in development may certainly be valued on a capitalization approach for that is exactly what a buyer would do when purchasing the property.¹⁸

PARTIAL TAKINGS

Sometimes a condemnor does not take all of your property. A partial taking is a frequent occurrence in a street widening. As a general rule, the measure of damages in a partial taking case is the difference between the fair market value of the whole before the taking and the fair market of the remainder after the taking.¹⁹

The damages that result are broken down into direct and consequential. Direct damages represent the value for the property, whether real or trade fixtures, which are within the area condemned or appropriated.

Consequential damages are those which result to the portion of the property remaining (the remainder), not only by reason of the direct taking, but also by virtue of the use to which the appropriated parcel is put by the condemnor.²⁰ One of the surest guides in measuring damages occasioned by a partial taking is the diminution in rental value resulting therefrom.²¹ Further, a deterioration of the quality of the income in the after situation merits the award of substantial consequential damages.²²

A partial taking may consist of a small taking, yet it may cause substantial damage to the remainder, if it leaves the remainder with unsuitable access for its highest and best use. In *Priestly v. State of New York*, 23 N.Y.2d 152, at p. 156, Judge Burke defined “suitable” as meaning “that which is adequate to the requirements of or answers the needs of a particular object. The concepts are not mutually exclusive and, therefore, a finding that a means of access is indeed circuitous does not eliminate the possibility that the same means of access might also be unsuitable in that it is inadequate to the access needs inherent in the highest and best use of the property involved.”

TAX CERTIORARI

The ability of government to tax, similar to its power of eminent domain, is an inherent power of a sovereign. Real property tax laws are complex. Generally the same basic valuation theories will apply for as the Court of Appeals has held, “the ultimate purpose of valuation, whether in eminent domain or tax certiorari proceedings, is to arrive at a fair and realistic value of the property involved . . .”²³

The big difference in condemnation and tax certiorari cases is that the law requires the maximum award based on a parcel’s highest and best use in a just compensation claim, while a tax certiorari inquiry will require an inquiry as to the property’s condition and ownership on the applicable valuation.²⁴

In an excellent decision, Judge Frank Rossetti wrote in *Matter of the New Country Club of Garden City v. Board of Assessors of Nassau County* (Sup. Ct. Nassau Co., Index 12696/88), N.Y.L.J., June 14, 1991, p. 1,

“The general standard of value in assessments is market value, although other tests can be used if market value is not determinable. (See, Matter of Great Atl. & Pac. Tea Co. v. Kiernan, 42 NY2d 236, 239-240; G.R.F. Inc. v. Bd. of Assessors of the County of Nassau, 41 NY2d 512, 515; Matter of Hellerstein v. Assessor of the Town of Islip, 37 NY2d 1, 3, & case quoted.) This is analogous to appropriation, although there is an overriding constitutional standard prevails, to wit, just compensation (see, US Const 5th Amend; NY Const, art 1, § 7[a]). No such more embrasive constitutional standard exists in assessment law, but there are the underlying purposes and goals of assessment to equitably and fairly distribute the tax burden in a nondiscriminatory manner in light of the existing “varied and

multifaceted patterns of land use.” (Matter of Merrick Holding Corp. v. Bd. of Assessors of the County of Nassau, 45 NY2d 538, 541, 544.) In pursuit of its constitutional mandate of just compensation, appropriation law has applied and evolved the concept of highest and best use, whereby a condemnee’s taken property is valued according to its most valuable probable use, whether actually so used or not (see, e.g., Matter of County of Suffolk [Firester], 37 NY2d 649, 652). Thus, where appropriated property has a more valuable use to which it is reasonably probable it could or would be put in the reasonably near future, that is the use under which the property’s value is determined. (Cf., e.g., Matter of City of N.Y. [Broadway Carey Corp.], 34 NY2d 535, 536.) This accords with the basic condemnation principle that a condemnee should be compensated on the basis of what he has lost. (See generally, 3 Nichols on Eminent Domain § 8.61 [3d ed].) In assessment, however, the statutory prescription of valuation according to extant conditions (i.e., RPTL 302[1], a “cardinal principle of valuation” [Matter of Northville Inds. Corp. v. Bd. of Assessors of the Town of Riverhead, 143 AD2d 135, 136]) has been interpreted to require valuation of improved property according to its existing use, not a potential one contemplated in the future. (See, Matter of Gen. Motors Corp. Cent. Foundry Div. v. Assessor of the Town of Massena, 146 AD2d 851, 852, & cases cited; Matter of BCA-White Plains Lanes v. Glaser, 91 AD2d 633, 635.)”

VALUATION OF REAL PROPERTY IN OTHER CONTEXTS

Judges or arbitrators are often shocked at the wide disparity in values found by appraisers for the same property in the same case. In judicial proceedings, the judges who must often hear real estate valuation cases do so without a jury. These jurists have the ability to move a case forward

quickly. We have heard of arbitrations dealing with the valuation of a leasehold for a lease renewal going on for years.

Appraisals are often so subjective that they are not reliable. Appraisals for estate tax may bear no resemblance to appraisals prepared for the same property in a condemnation. A husband's expert's opinion of value of the marital home is often widely different from that of the wife's appraiser's opinion.

Case law has held that appraisers have broad discretion as to their methods and sources of information, and may determine "which of the myriad factors are relevant to a particular valuation and how such factors impact the valuation of the parcel of land without interference or direction" absent an agreement expressly identifying such factors.²⁵

QUALIFICATION OF APPRAISER

The qualifications of a witness as an expert rests in the discretion of the trial judge, subject to review only if the judge has made a serious mistake, committed an error of law or abused the discretion.²⁶ Put another way, the determination of a witness' qualification to testify as an expert in a specific field rests in the broad discretion of the trial court, and such a determination will not be lightly disturbed.²⁷

Since a condemnation or tax certiorari claim is tried without a jury, the Court, as the trier of fact, solely determines the weight of the expert testimony.²⁸

REQUIREMENT OF THE JUDICIAL DECISION

The law is well established that the trial court is obligated to explain the values it finds.²⁹

The trial court is obligated to make its factual findings and underlying mathematical calculations as explicit as possible.³⁰ As the Court of Appeals stated in *Matter of City of New York (College Point)*, 55 N.Y.2d 885, “In determining an award to an owner of real property, the findings must either be within the range of the expert testimony or be supported by other evidence and adequately explained by the Court.”³¹

Conversely, if the Court’s total award, as well as its various components, is within the range of the expert testimony, it should only be upset if the trial court committed legal error.³²

1. *City of Buffalo v. J.W. Clement Co., Inc.*, 28 N.Y.2d 241, 258 (1971); *Rose v. State of New York*, 24 N.Y.2d 80, 87 (1969); *Marraro v. State of New York*, 12 N.Y.2d 285, 292-293 (1963).
2. *Matter of Board of Water Supply of City of New York*, 277 N.Y. 452 (1938), *County of Erie v. Fridenberg*, 221 N.Y. 389 (1917)
3. *Keator v. State of New York*, 23 N.Y.2d 337, 339 (1968).
4. *Boston Chamber of Commerce v. Boston*, 217 U.S. 189, 195.
5. *United States v. Miller*, 317 U.S. 369, 373.
6. *Matter of Town of Islip [Mascioli]*, 49 N.Y.2d 354; *Spriggs v. State of New York*, 54 A.D.2d 1080.
7. *People ex rel. New York Stock Exchange Building v. Cantor*, 248 N.Y. 533.
8. *Matter of City of New York [Salvation Army]*, 43 N.Y.2d 512.
9. *Matter of City of New York [Fulton Park U.R. - Kerievsky]*, 57 A.D.2d 954, aff'd. 44 N.Y.2d 974.
10. *Plaza Hotel Assoc. v. Wellington Assoc.*, 37 N.Y.2d 277.
11. *Matter of Allied Corp. v. Town of Camillus*, 80 N.Y.2d 351, 356
12. *Gold-Mark 35 Associates v. State of New York*, 210 A.D.2d 377.
13. *Levin v. State of New York*, 13 N.Y.2d 87.
14. *41 Kew Gardens Road Associates v. Tyburski*, 70 N.Y.2d 325. *Matter of City of New York [Franklin Record Center, Inc.]*, 59 N.Y.2d 57.
15. *Matter of City of New York [Maxwell]*, 15 A.D.2d 153, aff'd, 12 N.Y.2d 1086; *Marjal Realty Corp. v. State of New York*, 23 A.D.2d 941.
16. *Matter of City of Albany [A.D. Johnson]*, 136 A.D.2d 818.
17. *Matter of City of New York (Shore Front High School - Rudnick)*, 25 N.Y.2d 146.
18. *Sparkill Realty Corp. v. State of New York*, 254 App. Div. 78, aff'd 279 N.Y. 656.

19. *Acme Theatres, Inc. v. State of New York*, 26 N.Y.2d 385, 388; *Diocese of Buffalo v. State of New York*, 24 N.Y.2d 320, 323; *Frank Micali Cadillac-Oldsmobile v. State of New York*, 104 A.D.2d 477
20. *South Buffalo R. Co. v. Kirover*, 176 N.Y. 301 (railroad use); *Dennison v. State of New York*, 28 A.D.2d 28, aff'd. 22 N.Y.2d 409 (damages to remainder caused by loss of view and noise); *Criscuola v. Power Authority of New York*, 81 N.Y.2d 649 (loss of value to remainder caused by high voltage power line).
21. *Humble Oil Refining Co. v. State of New York*, 12 N.Y.2d 861.
22. *Star Plaza, Inc. v. State of New York*, 79 A.D.2d 746.
23. *Matter of Allied Corp. v. Town of Camillus*, 80 N.Y.2d 351.
24. RPTL Sec. 301(1).
25. *Vitale v. Friedman*, 245 A.D.2d 14.
26. *Tarlowe v. Metropolitan Ski Slopes*, 28 N.Y.2d 410, 414, op on remd. 37 A.D.2d 810; *Meiselman v. Crown Height Hosp.*, 285 N.Y. 389, 398-399.
27. *Werner v. Sun Oil Co.*, 65 N.Y.2d 839; *Smith v. City of New York*, 238 A.D.2d 500.
28. *Felt v. Olson*, 51 N.Y.2d 977; *Prince, Richardson on Evidence* (11th ed.) Sec. 7-305.
29. *Ridgeway Associates v. State of New York*, 32 A.D.2d 851.
30. *Lord v. State of New York*, 48 N.Y.2d 711; *County of Suffolk [Firester]*, 37 N.Y.2d 649.
31. *Matter of City of New York [A & W Realty Corp.]*, 1 N.Y.2d 428, 432-433; *Milsap v. State of New York*, 32 A.D.2d 586.
32. *Matter of Alexander's Dept. Store of Valley Stream, Inc. v. Board of Assessors*, 227 A.D.2d 549; *Krebs v. Board of Assessors*, 225 A.D.2d 625.

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