

VALUING REAL PROPERTY IN EMINENT DOMAIN

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It is a truism that the 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 its value 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 eminent domain.

EMINENT DOMAIN

In no other field of litigation is value so keenly put in issue as 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 creates 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, §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. *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). 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. *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), 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. *Keator v. State of New York*, 23 N.Y.2d 337, 339 (1968).

The fundamental question, then, to be answered by the court in valuing damages is, “What has the owner lost?” and not “What has the taken gained?” *Boston Chamber of Commerce v. Boston*, 217 U.S. 189, 195. This is so because the owner is to be put in as good a position pecuniarily as he would have occupied if the property had not been taken. *United States v. Miller*, 317 U.S. 369, 373.

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.

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. *Matter of Town of Islip (Mascioli)*, 49 N.Y.2d 354; *Spriggs v. State of New York*, 54 A.D.2d 1080.

HOW PROPERTY IS VALUED

Appraisers estimate property value by utilizing three approaches to analyze real estate data. The three classic methods are (a) market data or comparable sales approach, (b) income capitalization approach, and (c) the cost approach.

This last one is rarely used in condemnation cases, as 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. *People ex rel. New York Stock Exchange Building v. Cantor*, 248 N.Y. 533. 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. *Matter of City of New York (Salvation Army)*, 43 N.Y.2d 512. While the cost approach is rarely used in a condemnation real property case, it is always used in a trade fixture case. *Matter of City of New York (Fulton Park U.R. – Kerievsky)*, 57 A.D.2d 954, aff'd. 44 N.Y.2d 974.

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. *Plaza Hotel Assoc. v. Wellington Assoc.*, 37 N.Y.2d 277.

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, (*Matter of Allied Corp. v. Town of Camillus*, 80 N.Y.2d 351, 356) 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. *Gold-Mark 35 Associates v. State of New York*, 210 A.D.2d 377.

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 has not intervened ...” *Levin v. State of New York*, 13 N.Y.2d 87.

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. *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.

The appraiser makes an extensive market study and estimates the economic rent of the property. Actual rents must be considered. *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. 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. *Matter of City of Albany (A.D. Johnson)*, 136 A.D.2d 818.

The appraiser then estimates the expenses of the property. The net income is then applied to 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. *Matter of City of New York (Shore Front High School – Rudnick)*, 25 N.Y.2d 146. 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. *Sparkill Realty Corp. v. State of New York*, 254 App. Div. 78, aff'd 279 N.Y. 656.

PARTIAL TAKINGS

Sometimes a condemner does not take all of the owner's 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. *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.

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 condemner. *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).

One of the surest guides in measuring damages occasioned by a partial taking is the diminution in rental value resulting therefrom. *Humble Oil Refining*

Co. v. State of New York, 12 N.Y.2d 861. Further, a deterioration of the quality of the income in the after situation merits the award of substantial consequential damages. *Star Plaza, Inc. v. State of New York*, 79 A.D.2d 746.

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, the court 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.”