CONDEMNATION ZONING & LAND USE

2009 ANNUAL REVIEW
FROM THE ABA SECTION OF LITIGATION'S
COMMITTEE ON CONDEMNATION, ZONING, & LAND USE

ABA Section of Litigation
AMERICAN BAR ASSOCIATION

FAIR MARKET VALUE IN A DOWN MARKET

By Alan Ackerman

These are difficult times to ascertain values. Residential values have fallen from 30 to 60 percent of the "abnormal" peaks seen a few years ago. In the past six months, previously flat retail/commercial rental rates have fallen as much as 35 percent in many areas. The decrease leads to even more substantial losses in value, given the retention of fixed costs in the face of decreasing variable rents.

In the condemnation setting, most jurisdictions utilize a date of taking premised upon the date in which title vests. Jury instructions contemplate the valuation as of a specific date. This presents a situation in which the potential for a much lower value, premised upon the value of a specific property on a specific date, exists. Yet, for the parties, precise relocation as of the date does not occur.

Following the definition of market value utilized by the American Institute of Appraisers, federal agencies require lending institutions in the United States to follow a standard premised upon

> [t]he most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:
>
> 1. Buyer and seller are typically motivated;
> 2. Both parties are well-informed or well-advised, and acting in what they consider their best interests;
> 3. A reasonable time is allowed for exposure in the open market;
> 4. Payment is made in terms of cash in U.S dollars or in terms of financial arrangements comparable thereto; and
> 5. The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

The definition, and similar definitions in most states, contemplates fair market value in something other than the artificial conditions of a compulsory eminent domain process. The definition itself contemplates numerous factors that may well apply in what is a stable economic environment but offer uncertain economic dislocations to the owner in a recession or depression. It should be noted that eminent domain is perceived to be a harsh remedy in many jurisdictions and that protections are to be afforded to the owner who is dispossessed of his property. Each part of the definition gives rise to a claim that careful review of the circumstances should be provided that assures market dislocations, be they market spikes or troughs. As an example, for a residential property condemned in Florida in 2005, when dollars followed each other in speculative investment, was that indeed the market? Or would the fact that a number of properties sold for extravagant prices compared with the price for the same properties only 12 months before or after this date, give rise to a consideration of "the undue stimulus" as described in the market price definition? Were the buyers effectively acting imprudently? Was the fact that irrational credit was available an undue stimulus under the definition?

Reviewing each of the definitions reveals the need for concern with how the market dislocation affects value.

1. *Buyer and seller are typically motivated.* In our current market circumstances, many sellers are other than "typically motivated." In many communities, the market value approximates foreclosure sales price at the auction. By definition, the market dislocation during this recession may place a seller in a position where the short-term nature of the auction atmosphere

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HIGHLIGHTS

MESSAGE FROM THE CHAIRS

Greetings! Welcome to the inaugural edition of the Annual Review from the Condemnation, Zoning, & Land Use Committee of the ABA Section of Litigation. Our cochairs are Jeffrey A. Beaver from the Graham & Dunn law firm in Seattle, jbeaver@grahamdunn.com, and Jill S. Gelineau from the Schwabe Williamson & Wyatt law firm in Portland, Oregon, jgelineau@schwabe.com. If you are not already a member of the committee, we would love to have you join us. Join at www.abanet.org/litigation/committees. If you are a member already, we would love to see you become more involved.

Property rights and various land use initiatives continue to be a source of political and legal wrangling. *Kelo* has caused a renewed interest in this issue.

Our major objective is to make the committee the premiere source of information for networking for the litigators in our field. We want to make membership an important credential for litigators engaged in the practice of condemnation, zoning, and land use. We are working to enlarge and deepen our committee membership base. We want our members to be able to find a network with other members in their state and those in other states. We continue to improve our website and our subcommittee structure to encourage new leadership in our committee in the Section. We also monitor important issues as they arise federally and on a state-by-state basis by continually asking members to forward information on late-breaking developments to our website and annual review editors.

Readers who would like to get involved have several opportunities. For more information please contact one of the cochairs.

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The Fifty-State Compendium

First, the committee continues to work on its Fifty-State Compendium through the hard work of its editor, William Blake, of Baylor, Evnen, Curtiss, Grimit & Witt, LLP, in Lincoln, NE. We now have state summaries online in states where 70 percent of our membership resides. We are looking for additional authors/editors to complete this compendium, so please let us know if you have a desire to contribute to this effort. Email William Blake at wblake@baylorevnen.com.

Website Articles

In addition, our website editor, Robert J. Will, of Lewis Rice Fingersh, L.C., in St. Louis, MO, is always interested in obtaining additional articles or stories regarding new cases and cutting-edge issues in our field. If you have an idea for an article or a story, email Robert J. Will at rwill@lewisrice.com, and he will be happy to post your submission.

Annual Review

Because you are reading this, you know our Committee now provides an Annual Review under the editorship of Charles McFarland, of the Houston, Texas, firm of Joyce, McFarland & McFarland, LLP. Charles is looking to recruit more great authors for the content of the Annual Review. Contact him at cmcfarland@jmmllp.com. He would appreciate your comments, ideas, and thoughts as well.

Recent Events

The Condemnation, Zoning, & Land Use Committee meets at the Spring Section Annual Conference and at the Annual Meeting. This year the Section Annual Conference was in Atlanta. During that meeting, the Condemnation, Zoning, & Land Use Committee cochaired a committee networking lunch with the Energy Litigation Committee. Our thanks to Marty Truss, cochair of the Energy Litigation Committee, from Cox and Smith in San Antonio, TX, for joining us during the networking lunch in Atlanta. Our committee also cochaired a program called "Setting the Table: Trial Proof and Strategy in Condemnation and *de Facto* Takings Claims." Thanks to our speakers for that program: Organizer and moderator Jeffrey M. Pollock from Fox Rothschild in Princeton, NJ; Christian Torgimson and Charles N. Pursley Jr., both of Pursley, Lowery Meeks in Atlanta; Judge William A. Fletcher from the U. S. Court of Appeals, Ninth Judicial Circuit; and Orell C. Anderson, real estate appraiser from Bells Anderson & Sanders LLC in Laguna Beach, CA. Thanks also to Casey Pipes from Helmsing, Leach, Herlong, Newman & Rouse, PC in Mobile, AL, the committee's program cochair, for his ongoing good work organizing great programs for the committee. We also held a very interesting committee expo at the meeting, and it was great to see both familiar and new faces. Our appreciation goes to Paul Nettleton, our director in the Section of Litigation, for his support and encouragement this year.

So—get involved. We hope to hear from you.

Jill S. Gelineau & Jeffrey Beaver
Cochairs, Condemnation, Zoning, & Land Use Litigation Committee

LETTER FROM THE EDITOR

Welcome to the first Annual Review from the Committee on Condemnation, Zoning, & Land Use Litigation. These are interesting times for all practice areas, but perhaps for none as much as condemnation, land use, and zoning litigation. As a practice area, we were still in the afterglow of the Supreme Court's decision in *Kelo v. City of New London*, and the elevated interest and attention that came with it (whether or not warranted), when the nation was hit with this recession. An integral part of this financial crisis has been the market value of real property. With this background, this newsletter turns its focus away from the overexposed issue of public use, or the lack thereof, and back to the compensation question.

We are pleased to present four articles covering a wide array of valuation issues, starting with a submission by Alan Ackerman, a longtime advocate for property owners in condemnation cases in Michigan, addressing the effects the financial crisis could have on the presentation of market value in condemnation cases. This submission is short enough, and important enough, to be read twice. Carol Lansing, a former Assistant City Attorney in Minneapolis with extensive experience in zoning and land use issues, and Mark Savin, a preeminent condemnation lawyer from Minnesota with experience representing condemning authorities and property owners, analyze the interplay between partial takings and zoning compliance. Drew Kapur, a former New Jersey Deputy Attorney General in condemnation matters who represents both condemning authorities and property owners, discusses ways property owners can take advantage of the disparate valuation principles in condemnation proceedings and tax assessment appeals to achieve lower assessed values. Finally, Gideon Kanner, a leading appellate lawyer in eminent domain and inverse condemnation for more than 40 years, provides an intriguing evaluation of the undivided-fee rule of valuation.

I am grateful to these authors for their contributions to our first Annual Review. I invite you, after reading it, to submit your thoughts on topics you would like to see addressed in this publication or on the committee's website, www.abanet.org/litigation/committees/condemnation. Please feel free to contact me directly with any proposed topics you may have. Also, we are already looking for articles for publication in next year's Annual Review, so do contact me if you have any questions or comments or would like to submit an article for the Annual Review. And, as Nicole Fagerberg, one of our Assistant Attorneys General in Texas is fond of saying, Happy Litigating.

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(Continued from page 1)

greatly modifies the value.

2. *Both parties are well-informed or well-advised, and acting in what they consider their best interests.* The reality of the market process during this recession is one in which a well-informed seller simply holds the property rather than sell at a greatly diminished price. The notion of compulsory sale has the effect of modifying the market valuation process.
3. *A reasonable time is allowed for exposure in the open market.* Whether or not a reasonable time is allowed, would one reasonably sell in a market that is truly dislocated and in which buyers and sellers are not openly buying or selling property? The events of the past eight months are little different from the 1991 savings and loan fiasco, in which ready financing was not available for developments and the effective market of the buyer and seller was dislocated. Within 18 months, however, the market had retrenched, and the opportunity to buy and sell at the deflated amounts was no longer available. This is corollary to the *Black's Law Dictionary* definition, which includes the language "with the reasonable time allowed to find a purchaser."
4. *Payment is made in terms of cash in U.S dollars or in terms of financial arrangements comparable thereto.* In the current market, bank financing may not be available (hopefully an interim problem rectified in the coming months). Otherwise, what is now a dislocated market of a recession may end up being the high end of the depression market. One must assume that the funding for reasonable purchases is available because the definition itself is being utilized.
5. *The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.* Implicit in this definition is the premise that individuals in the transaction themselves are not associated with the "sales concessions." One must ask whether the bank activity is so limited that only "creative financing" is available for many transactions.

Of paramount import to these transactions is "market timing." The standard of the process is that something will occur within a reasonable time. But the desire to sell within a reasonable time in a dramatically down market, which affects reasonable time parameters, runs counter to the notion of the noncoercive conduct contemplated in the definition of fair market value.

The definitions must be applied within an "abnormal" situation, where buyer and seller consider a deflated property value in the context of a likely return of value in the foreseeable future. Discounting the future increase in value that may well be available to a speculative purchaser in a recession creates a market imbalance in an eminent domain proceeding, where the transaction is compulsory as of the date of valuation. These factors make for very difficult times in the valuation process.

This approach contemplates a buyer and seller valuing deflated property in the context of a likely return to a prerecession value, based upon some type of time and risk/rate of return analysis. This is not available in a condemnation setting because the owner of the property may not have fair market options. Is the market in 2009 any more "normal" than the hyperactive markets that existed only a few years ago?

We now face the possibility of serious dislocations in the supply/demand markets created by liquidity uncertainties. Many of the 15- and 30-year amortization notes on a ten, five, or even shorter terms will come due during the next few years. As the massive demand for recapitalization occurs, will far lower loan-to-value ratios be required? Under such a circumstance, borrowers will be required to invest a far greater proportion of total value. This will diminish the risk of a loss to the lender but will create a further dislocation in the ability to purchase. None of us can foresee the market perfectly, but the short-term concerns are dramatic.

The concerns regarding this process expressed here could be easily resolved. Legislation could limit restrictions on loans or offer prospective lenders some type of "guarantee." The government may become more involved in the lending process, which gives rise to other serious concerns. The notion of market value still must be based upon a pricing system of demand and supply. Even changes in the loan-to-value percentages of what will be lent may have a serious short-term effect but a diminished long-term effect, because supply and demand will always balance out over the longer term. Given this, the concerns set forth in this article, in the current economic environment, present the greatest risk to properties being acquired by eminent domain, simply because owners are less concerned about an abnormal market when they can hold onto property and contemplate that its value shall return.

The premise of fair market value is that one looks to sell property without compulsion. To conclude that the sale must be made on a date certain could, for many owners, severely endanger the opportunity to receive just compensation, simply because they are not willing sellers in the marketplace.

Alan Ackerman is with Ackerman Ackerman & Dynkowski.

ASSESSING AND MITIGATING THE ZONING IMPACTS OF A PARTIAL TAKING

By Carol Lansing and Mark Savin

Condemnation for transportation projects is increasingly utilized for the expansion and improvement of existing highway systems within developed urban and metropolitan areas. Often, the need for these improvement projects is related in part to the growth of commercial development along urban corridors and the concomitant increase in traffic congestion. At the same time, many cities have enacted increasingly extensive and prescriptive zoning regulations that seek to control highway commercial development and manage its environmental and traffic impacts. Additionally, cities with such controls have become increasingly stringent about compliance with these ordinances. As a result, zoning noncompliance has become an increasingly significant issue, impacting properties subject to partial taking for roadway projects. This noncompliance may be a direct result of the physical taking (e.g., parking stalls that are actually taken for right-of-way) or may be triggered by the physical taking because of the need to reconfigure site features on the property to comply with local zoning regulations (e.g., taking of required setback areas that cause adjacent parking to become nonconforming).

Lawyers, for both the condemnor and the landowner who are not well-versed in land use law may overlook or substantially underestimate the impact of zoning noncompliance on the property. They should carefully analyze the interplay between the taking and existing land use controls; understand the differing interests of the condemning authority and the land use authority; and recognize and consider the substantial impact on value that may result from such nonconformance.

Impacts of Nonconformities Created by a Taking

A property is nonconforming if the uses, structures, or lots do not comply with the requirements of the zoning ordinances of the governing jurisdiction. Uses, structures, and lots that were in compliance with the zoning ordinances in effect at the time they were established but that became nonconforming due to a change in the zoning ordinance itself, are considered "legal" nonconformities. Legal nonconformities are protected as vested property rights and may be continued (often referred to as having "grandfather" rights). Generally, however, nonconformities that are created by circumstances other than ordinance amendments, including partial takings, do not have legal nonconforming status; municipalities can require that the property be brought into compliance with current ordinances.[1] As noted in *Rathkopf's The Law of Zoning and Planning*, some jurisdictions depart from this general rule, but departure is less common than generally thought.[2] It is a mistake to merely assume that a taking creating nonconformance will be grandfathered. Thus, it is critical to determine what legal status the local zoning authority will assign to any nonconformities created by the taking.

Even if nonconformities created by a taking are deemed by a particular municipality to have legal status, nonconforming status can have several practical impacts on the property, as the following points illustrate:

- Although legal nonconformities can continue, they are subject to significant restrictions on whether or how they may be expanded or otherwise altered. Further, a nonconformity that is damaged or destroyed to a substantial degree generally loses its nonconforming rights and must be rebuilt in compliance with current ordinances. These restrictions may limit the useful life or development potential of the property. And, in the case of property impacted by eminent domain, if reconfiguration or reconstruction on the site is required, the regulations may prohibit such work unless the post-taking property is brought into conformance with current ordinances.
- Nonconformities may reduce the marketability and hence the value of the property compared to its pre-take conforming condition.
- The ability to obtain financing may be impaired because lenders may not accept a nonconforming property as security due to the development restrictions and the risk that nonconforming rights may be lost. The importance of this issue in the current economic climate is obvious.

Thus, even in a jurisdiction where there is no immediate legal obligation to bring the property into zoning conformance, the owner may conclude it is in its best interest as an economic matter to attempt to do so. Further, because an owner in some jurisdictions may be required to mitigate the damages of the taking, whether any land use remedies for the nonconformity exist, and whether such remedies are cost efficient, must be determined. For example, a variance, if obtainable, for a nonconforming setback would make the condition fully legal and "conforming" (as opposed to "legally nonconforming") and would free it from the development restrictions imposed upon nonconformities.

Evaluate Pre- and Post-Taking Conditions for Compliance with Zoning Requirements

In order to assess the zoning impacts of a partial taking, the first step is to determine how the property before the taking complied with zoning regulations in effect at the date of taking. If the property was fully conforming at the date of taking, the analysis of its pre-take zoning status will be relatively straightforward. Changes in zoning ordinances since the property was developed, however, may have made

the property nonconforming prior to the taking. If the pre-take property was nonconforming, the ability to alter site features to mitigate the effects of the taking may be limited or even prohibited, depending upon how the zoning authority regulates nonconforming uses and structures. Information about the pre-take zoning status of the property is, of course, also relevant to valuation.

How an existing nonconformity will impact value depends upon the particular facts of the case. A right to continued operation of a nonconforming use in a particular location may be a benefit to a property that increases value. The nonconforming use may generate higher value than uses allowed under current ordinances or may have a competitive advantage because similar uses could not be established in the same zoning district.[3] However, structural and dimensional nonconformities existing before or created by partial takings are unlikely to have a beneficial effect on value.

The second step is to determine the physical impacts of the taking on the property and its zoning status, and require the following actions:

- Obtain records of prior zoning approvals for the property. For many large commercial properties, regulation will occur under "planned use development" concepts that create controls specific to that property. These records will identify what site features were the basis for or conditions of zoning compliance for the pre-take property development. For example, a variance may have been granted to allow a sign that is taller than the general standard or to reduce the amount of parking required on the zoning lot. A certain percentage and location of landscaped areas and specific types of vegetation will frequently be specified conditions for site plan approval.
- Determine whether the taking may impact contiguous or noncontiguous parcels that relied on the take parcel for zoning compliance. For example, did the take parcel provide off-site parking to fulfill zoning requirements for another parcel or fulfill open-space set-aside requirements?
- Obtain copies of relevant portions of the current zoning code. These codes outline what zoning requirements apply to the property and help determine whether the taking will result in any areas of noncompliance or whether changes in zoning ordinances since the property was originally developed have resulted in some legal nonconformity that is not a result of the taking. Further, consulting current zoning ordinances will identify the zoning permits and reviews that will be required to make changes to the site to mitigate the impacts of the taking (e.g., conditional use permits, variances, site plan review).
- Obtain or prepare scaled and dimensioned site plans that show the pre- and post-take conditions, depicting building footprints, driveways and parking areas, yards, impervious areas, landscape features, sign locations, fences, stormwater management features, utilities, and adjacent rights-of-way. The property owner or the zoning authority may already have these records for the pre-take condition. Surveys and right-of-way plats created to document the taking will provide information about the post-take condition.
- Compare the site plans to the zoning code requirements to identify areas of noncompliance in both the pre-take and post-take conditions.

In a number of recent cases, we have seen condemning authorities fail to do the necessary analysis of how the highway project would impact land use controls governing properties taken for the project. In one instance, this failure caused the suspension of the project for more than six months. The condemnor's error was assuming that the local municipality that controlled zoning would grant a variance from its ordinances so that no setback would be required between the new post-taking property line and the adjacent parking field. The city, however, had no intention of permitting such a deviation from its ordinance requirements. The condemnor apparently was accustomed to assuming that variances would be granted or local controls otherwise be disregarded in light of a significant highway project by a superior government entity. It was unprepared for the city's refusal to disregard its own ordinances, which did not allow for setback variances of the extent required for the post-take conditions.

Only when the controlling city, at the urging of both the landowner and the condemnor, modified its ordinance was the project able to go forward. The property owner's interest in modifying the ordinance was in protecting its ability to modify the post-taking site so as to retain its ability to operate a large retail center; the condemnor's interest was in allowing such mitigation so as to reduce its economic damages. Put simply, by persuading the local municipality to change its ordinance, the property owner was able to protect its business, and the condemnor was able to reduce what it would have to pay in damages. Nonetheless, had the condemnor recognized the nonconformance issue in its original design analysis, the entire problem might have been avoided.

Determine How the Proposed Site Plan Complies with Land Use Regulations and Identify Required Land Use Approvals

At this stage, it is important to consult with the planning and zoning staff for the municipality that has zoning authority over the property. Municipalities have considerable discretion in how they implement their zoning authority. It is important to learn the policies, principles, practices, and preferences that planning staff, commissioners, and council members will apply to determine what site improvements or alterations, if any, will be required or allowed by the zoning authority. Some jurisdictions may be particularly rigid in requiring full compliance with current zoning regulations. Others may be more sensitive to adverse operational impacts that can result from a partial taking and will make accommodations in order to support their local businesses. The municipality may also be willing to be flexible in how it applies its zoning authority where its decisions will impact

the costs of condemnation to the road authority exercising eminent domain. The following steps should be followed:

- Request that the zoning authority staff review the post-taking site plans to confirm or revise the analysis regarding areas of noncompliance.
- Determine whether and how state statutes and municipal ordinances and policies address noncompliance resulting from eminent domain. Will the local jurisdiction require compliance with current zoning requirements?
- Identify what site modifications, variances, or other zoning and regulatory approvals will be required by the municipality. Ask staff for a preliminary assessment of their position regarding the required zoning approvals.

Site Planning to Mitigate the Taking and Respond to Other Project Impacts

Reconstruction of and changes to site features of the property may be required to restore areas disturbed by the road project, to reconfigure the site to maximize post-taking parking, to realign site features in response to changes in access points, or to bring the post-take property into compliance with zoning requirements. Site revisions may also be desired to mitigate the adverse impacts of the taking on business operations and property value. Further, the property owner may want to take advantage of the mobilization for site work required in response to the taking (often involving professional site planners, surveyors, engineers, or landscape architects) to implement additional, non-taking-related improvements to the property in a cost-effective manner.

- Determine the work necessary to maintain the basic functionality of the site. Examples include reconstructing curbs, pavements, and landscaping to restore areas of the site disturbed during the road construction; reconfiguring and re-striping drive aisles and parking lanes to accommodate changes in driveway locations; relocating signs from the take area; and reconstructing lost building area on another part of the property.
- Evaluate whether additional site modifications could mitigate the adverse impacts of the taking on business operations or property value. For example, can the net loss of parking spaces be reduced by re-striping the parking lot or converting landscaped setback areas to parking spots? Would remodeling the building to change entrance locations improve visibility lost due to road reconfigurations?
- Evaluate the changes and improvements that would be necessary to achieve compliance with current zoning ordinances or other regulatory requirements. For example, what would full compliance mean with respect to parking setbacks and number of spaces, building setbacks and materials, sign setbacks and design, landscaping and screening, or stormwater treatment?
- Prepare one or more site plans depicting the site with the mitigation options.

Consult with and Advise the Client

Before deciding which zoning approvals to seek from the municipality, if any, review the options for mitigation and assess the costs and benefits of each with the client. An analysis of damages will typically look like this:

Value of the property before taking	$20 million
Value of the property after taking (without mitigation)	$14 million
Damages (without mitigation)	$6 million
Value of the property before taking	$20 million
Value of property after taking (with mitigation)	$18 million
Cost of mitigation ("cost to cure")	$1.5 million
Damages including cost to cure	$3.5 million

In this instance, an expenditure of $1.5 million on cost to cure mitigation will reduce the overall damages from $6 million to $3.5 million. This is obviously advantageous to the condemnor; it is also, however, advantageous to the owner who is interested in protecting the business operated on the real property. If the property owner attempts to mitigate damages in this way, not all costs to cure may be compensable. The cost to mitigate damages cannot exceed the severance damages that would be incurred without mitigation. By way of example, if the loss in value to a property resulting from the loss of five parking spaces is $100,000 but the cost to mitigate that loss by reconfiguring the site is $150,000, only $100,000 will be compensable in the condemnation.

To recap, the options for site restoration or reconfiguration will generally fall into the following categories:

- Site restoration required to maintain basic functionality of the site for the business.
- Site work required by the zoning authority in order to legally continue the present use of the property.
- Site work that will mitigate the impacts of the condemnation on property value.
- Variances or other land use approvals that grant conforming status to nonconformities created by the taking.
- Site improvements that are not legally required or necessary to mitigate the taking but are desirable from a business perspective. The cost of these improvements will not be compensable in the condemnation, but the owner may want to seek the requisite zoning approval for them concurrent with proposed land use approvals required to address the taking.

Submit Land Use Applications and Advocate for Approvals Before Decision-Making Bodies

If the site impacts of the taking are not extensive, planning staff may be able to approve the site modifications administratively. Modifications that require conditional use permits, variances, and, sometimes, site plan approval, however, will involve public hearings and decisions by a board of adjustment, planning commission, and/or city council.

In some cases, mitigation may involve an application for rezoning to make a nonconforming use conforming. If a municipality's ordinances do not provide the authority to approve the site plan as proposed (e.g., where the extent of setback variance that may be granted is limited or where the ordinance prohibits the relocation on the zoning lot of structures housing nonconforming uses), amendment to the zoning ordinances may be necessary.

- The narrative statements submitted in support of the zoning applications should include an explanation of the impact of the taking on business viability—the "business case" for the requests—to appeal to the interest of the local jurisdiction in maintaining commercial vitality in the community.
- Critical to the application is the explanation that the need for a modification results from the actions of the condemning authority. Throughout the process, and particularly in documents and presentations that become part of the public record, take care to document how the need for the site changes for which approval is being sought is a result of the taking and how the proposed actions mitigate the adverse impacts of the condemnation.
- Evaluate whether it is appropriate and beneficial to contact other local officials, such as the city manager or the city's elected officials, to inform them about the issues and impacts and seek their support.

Conclusion

An analysis of the impact of a partial taking on zoning compliance and zoning approvals needed for site mitigation should be initiated as early as possible in the eminent domain process. The site planning, administrative, and public zoning review processes that may be required can take several months. Early and expeditious efforts to address the zoning and other land use impacts is necessary to maintain a functioning site that is accessible to and convenient for customers. It is also important to have resolved the land use issues with the municipality before concluding a settlement or beginning the hearings in the condemnation case so that the costs of mitigation can be fully and accurately addressed. Although the focus of this article is the zoning analysis required for mitigation, similar analyses should be conducted to determine the impact of a partial taking on the potential for expanded development, options for redevelopment, and the reasonable probability of a zoning change to establish and maintain the site's highest and best use.

Carol Lansing is special counsel and Mark Savin is a partner at Faegre & Benson LLP in Minneapolis, MN.

1. *See generally* 4 Edward H. Ziegler Jr., *Rathkopf's The Law of Zoning and Planning*, § 75:10 (2008).
2. *Id.* note 2; *cf* 4A Julius L. Sackman, *Nichols on Eminent Domain*, § 14.02[2][b][iv] (3d ed.) (*Nichols* asserts that the majority of zoning jurisdictions treat nonconformities created as a result of condemnation as legal nonconformities).
3. See supra note 1, §75:9.

NONCOMPENSABLE DAMAGES IN A TAX ASSESSMENT APPEAL

By Drew Kapur

Damnum Asbque Injuria: Loss Without Injury

As we all know, the right of the government to take private property under its power of eminent domain is subject to the requirement of the Fifth Amendment to the Constitution, as applied to the states by the Fourteenth Amendment, that private property shall not be taken for public use without just compensation. Just compensation is normally measured by the fair market value of the property at the time of the taking. Further, courts have directed that the compensation award should put the owner of the condemned property "in as good a position pecuniarily as if [the] property had not been taken."[1] In this regard, the concept of just compensation is meant to imply full indemnification for the loss sustained by the owner.

We are frequently told the constitutionally mandated just compensation to be paid to property owners whose property is taken is meant to make property owners whole; however, it rarely does. Condemnation actions often involve certain losses for which the law provides no right to recover. For those familiar with condemnation practice, particularly those who represent property owners, this maxim of *damnum absque injuria*, a loss or damage without injury in the legal sense, can be a very frustrating refrain.

A host of damages that are not compensable may result from a condemnation; however, these damages are generally fair game in an assessment appeal. Condemnees as well as any property owner subject to or threatened by a condemnation should conduct a careful analysis to determine whether an assessment appeal is appropriate. Although a property owner may not be able to recoup all damages in a condemnation action, there is no reason why he or she should have to pay real estate taxes based upon an artificial property value.

Assessment Process

Typically, a local assessor establishes the market (assessed) value of a property by appraising the value of that property under applicable state laws. As in condemnation, the local property tax on real property is to be assessed at its fair market value. State law usually governs the date on which the property is to be valued. If on this date a condemnation has taken place or a public construction project has been announced that might impact the subject property, the assessed value should reflect all impacts of the project. Chances are, however, the assessor has not fully analyzed the impacts various takings or governmental action have on the property.

Using Noncompensable Condemnation Damages in Assessment Appeals

Because evidence of certain damages admissible in an assessment appeal would be otherwise excluded in a condemnation case, it will likely be necessary for a property owner to obtain a separate appraisal for assessment-appeal purposes. Nevertheless, the tax savings could be worth the additional cost of a second appraisal. Below is an analysis of a list of damages that can result from a condemnation or governmental regulation which are typically noncompensable in a condemnation action but may offer a significant opportunity for property owners to reduce their tax burden.

Regulation of Access

The owner of land abutting on a street or highway enjoys a general right of access. The right is considered a natural easement and an incident of land ownership. It is a property right, and its deprivation therefore requires just compensation. It is generally accepted, however, that pursuant to the police power, a government may regulate access to and from the road for the public safety and welfare. Consequently, the rights of an abutting owner may be subordinated to the right of the public to the proper use of the highway and the right of governmental agencies to enforce proper police regulation.

Unless the regulation of access fails to provide the property owner with "reasonable alternative access," it is not compensable in many jurisdictions. Nevertheless, the impact of regulation of access on a property, particularly a property commercial in nature, is significant. A commercial site is often only as good as its access—the ability of its consumers to get to it. Consequently, good access can add value to a site, and poor access can strip it of value.

Under proper exercise of its police power in the regulation of traffic, a state entity or transportation authority may

- reduce the number of existing access points;
- change the width of an access point;
- change the location of an access point;
- re-route or divert traffic;
- construct a traffic island;
- install a median strip prohibiting or limiting crossovers from one lane to another;
- use or install traffic-control devices;
- prescribe one-way traffic;
- place restrictions on U-turns and left and right turns;
- install guardrails or curbing;
- restrict the weight, size, and speed of traffic on the street;
- construct a fly-over past a property;
- replace access on a highway with access on a local roadway.

From a condemnation perspective, the inconvenience, reduction in profits, or depreciation in the value of property that occurs as a result of a legitimate exercise of the state's police power is considered *damnum absque injuria*: there is no damage recognized under the law, and therefore the losses are not compensable.

Thus, the right of access is more properly regarded as the right to *reasonable but not unlimited* access to existing

and adjacent public roads; that is, "the property owner is not entitled to access to his land at every point between it and the highway but only to 'free and convenient access to his property and the improvements on it.'"[2] It is often stated that a property owner has no vested right in the continued flow of traffic past a property. Therefore, where, by virtue of state action, access is limited but remains reasonable, no such denial of access entitles the landowner to compensation.

A change in access or similar exercise of police power as described above can have a myriad of effects. A change in access may reverse traffic flows through drive aisles or around improvements, disrupt the ability of delivery vehicles to safely enter or exit the site, cause internal circulation problems such as mixing of commercial vehicles with customer traffic, cause traffic to flow by a competitor's business before reaching an entry point on the subject property, create a circuitous access route, shift a primary access point from the front of a building to the back, shift a primary access point from a highly traveled highway to a local roadway or connector road, make access more difficult by creating the need to cross a newly constructed feeder lane, limit movements entering or exiting the subject property, and reduce visibility.

Access is a key component of property value, and the impairment of access that results from a partial taking of property often has significant real-world effects on value. The availability of safe and convenient access to a property is vital to certain commercial operations. For example, many retail establishments depend upon pass-by customers who, while driving by, choose to stop and purchase goods or services. These businesses require a certain degree of traffic flow and easy access. If entry onto the business establishment becomes difficult, customers will likely patronize other competing businesses that have easier or more convenient access. In the real world, an ordinary purchaser of this type of property would consider access in negotiating a price for the property.

Simply stated, the regulation of access can turn a good location into a bad location. Although the above-described regulatory actions and their associated effects upon a property owner may not rise to the level of a compensable taking, the diminution in value they may cause should be noted in the local tax assessment. It is largely acknowledged that all of the above-referenced access-related modifications can have a substantial impact on the market value of a property. Consequently, a change in access can provide a prime basis to file an assessment appeal.

Loss of Visibility

A public work can substantially impact the view and/or visibility of a property. Generally, however, only a property owner who has had a part of his land taken has the right to have the interference with his view considered when determining damages caused by the taking. Generally, adjoining property owners who have suffered a diminution in the value of their property but have not suffered a physical invasion or actual appropriation are not entitled to compensation because there has been no taking.

Nevertheless, visibility plays a major role in the fair market value of a commercial property. A prospective buyer looking for a site for a retail use prefers a site with high visibility as opposed to one that cannot be seen from the road. The landowner whose retail site had excellent visibility, however, may now be faced with a site partially or fully obscured from the view of travelers as a result of the public improvement. This site no longer has the same value it had prior to the improvement project. This diminution in value should be reflected in the tax assessment. If the assessment has not been reduced and the loss of visibility has caused a significant reduction in value, an assessment appeal might be appropriate.

Imminence of Condemnation

In a condemnation action, the estimate of value for the property taken must exclude any increase or decrease in value caused by the announcement of a project. This effect upon a property's value is often referred to as *project influence*. The concept recognizes that an announcement of a project can impact the value of a property and that, for compensation to be just, the impact of the project announcement on value should be excluded from valuation in a condemnation action.

The losses that can result from the announcement of a public improvement project could include loss of rental income. For example, if a property is slotted for acquisition due to a governmental project, tenants may begin to move out prior to the taking rather than wait until the last minute to relocate. Moreover, the owner may be unable to find new market-rate tenants. Thus, the cloud of condemnation depreciates the value of the property.

The announcement of a project might also cause deterioration of the surrounding area as other property owners under the cloud of condemnation fail to perform appropriate maintenance and upkeep. This, too, will cause a property's value to drop.

An announcement of a large infrastructure project could severely diminish the value of certain commercial properties anticipated to be impacted by the taking. A seller who is aware of an upcoming project is likely responsible for informing the purchaser about that project. If there is any potential that the project will impact the site, the buyer is going to request certain concessions or simply look for another property unaffected by the project, due to the diminished market perception.

In an assessment-appeal situation, any impact to the value of a property caused by the announcement of a project should be recognized. As opposed to excluding it from the valuation analysis, as required in a condemnation action, a property owner should look to demonstrate how the announcement of the project has diminished the value of the property in an assessment appeal. As long as information regarding the project is in the public domain on the assessment date and is information a reasonable buyer would consider in purchasing the property, the local assessor should consider it in the assessment. Moreover, a property owner need not wait until a taking manifests itself

in order to demonstrate an impact on value for assessment purposes.

Construction Upset

Construction projects can be noisy and dirty and wreak havoc on local roadways. Often, customers/drivers will seek to avoid an area currently undergoing construction. Consequently, businesses within or near a construction area may realize a significant impact, particularly if they depend on drive-by traffic. The inconvenience caused by the construction will last for the duration of the public improvement project. For large-scale infrastructure improvements, projects can last several years.

During the period of construction, a property owner seeking to sell a property may have a more difficult time than property owners outside the scope of the project. The area surrounding the project may have become less convenient and therefore less desirable. Potential buyers who witness the construction taking place appreciate the impact it can have on business traffic. Additionally, even if these buyers are presented with plans of what the roadway will look like once construction is completed, they are likely to walk or to wait until the project is finished before pursuing a purchase. Consequently, what may have been a good location prior to the project and might be a good location once the project is done has diminished value during the period of construction.

In condemnation cases, courts are generally unwilling to recognize noise-, vibration-, or dust-only takings; that is, in the absence of any actual appropriation of land, the owner of property adjacent to a roadway project generally has no right to compensation under the law of eminent domain for noise, dust, or similar interferences with beneficial use of the property.[3] The damages are viewed as a general inconvenience, caused by the temporary construction process, which is shared by the community.

In an assessment appeal, the view that inconveniences caused by a construction project are shared generally by the community is of no concern. As long as a property owner can demonstrate that the construction upset or inconvenience has a real effect on market value that would be considered by a reasonable buyer and seller on the assessment date, that fact should be reflected in the assessment.

Conclusion

A public-improvement project can impact the value of surrounding properties in a number of ways, even without the use of eminent domain. Often, a property owner impacted by a project can be frustrated that the damages cannot be recovered in a condemnation action, especially where the damages have a significant impact of the value of the subject property. Due to the differences in valuation concepts in tax assessment appeals as opposed to condemnation actions, however, a property owner who is subject to a condemnation or otherwise impacted by a public improvement project may be able to recoup some of the damages through an assessment appeal.

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1. United States v. 564.54 Acres of Monroe and Pike County Land, 441 U.S. 506, 510 (1979) (quoting Olson v. United States, 292 U.S. 246, 255 (1934).
2. *See* High Horizons Development Co. v. State of New Jersey, Dep't of Transp., 120 N.J. 40, 48 (1990) (citations omitted).
3. 2A *Nichols* § 6.01[14][e][i].

AN EVALUATION OF THE "UNDIVIDED FEE RULE" OF VALUATION

By Gideon Kanner

The "undivided fee rule" presupposes that in valuing the subject property, the appraiser must assume that it is owned by one person who holds an "undivided" fee simple title to it.[1] Once the value of the property is so determined, the lump sum awarded as fair market value is apportioned in a second-stage hearing in which the owners of the various interests present evidence of value of their respective interests. By then, the condemnor's liability has been determined by a fact finder's first-stage valuation verdict, so the condemnor no longer has an interest in such an apportionment proceeding. The competing rule is the "aggregate of interests" rule, in which the value of each compensable property interest in the subject property (e.g., leasehold or easement) is determined separately and the respective awards are added up to produce the aggregate, total sum that the condemnor is required to pay.

In most cases, these two approaches produce similar results. But in some cases, consideration of the separate interests in the subject property does have an impact on total compensation, and this is where the fun begins. Condemnors typically prefer the undivided-fee rule, arguing that they are taking the fee simple title to the subject property and, therefore, should be required to pay only for it. This argument is often embellished by assertions that the sum of the parts cannot exceed the value of the whole, which is what is being taken. Though frequently repeated, the latter assertion is nonsense because mathematics tells us that although the whole cannot be more than the sum of its parts, it also cannot be *less than* the sum of its parts. So to the extent mathematics is pertinent here, it tells us that the whole can be neither more nor less than the sum of its parts. Mathematics thus contradicts the undivided fee rule, which insists that the whole can be something other than the sum of its parts. As far as legal doctrine goes, the undivided-fee rule is conceptually wrong because it runs contrary to the basic principle that compensation is payable for what the owner has lost, not what the taker has gained. Arguing that the condemnor condemns only the fee simple interest is thus beside the point, because the fee simple title includes all interests in the subject property, and each owner of each compensable property interest is entitled to just compensation for its taking.

There are other reasons why the undivided-fee rule is wrong. First, to say that the condemnor acquires the fee simple title is true but misleading. The fee simple title includes all the "sticks" in the conceptual "bundle of sticks" that comprise property, and each owner of each stick is entitled to just compensation when the stick is taken for public use. By condemning the fee simple title, the condemnor extinguishes each privately held stick in the bundle, that is., each property right and interest in the subject property. Thus, for example, tenants are entitled to compensation for what is taken *from them*, not for what may have been taken from their landlord or from anyone else with a compensable interest in the subject property.

Second, the right to receive just compensation is a personal one, as are other rights protected by the Bill of Rights. Just compensation is payable to the person or entity that holds title at the time of taking. As Justice Holmes put it, "The Constitution deals with people, not with tracts of land"; therefore, "The question is what has the owner lost, not what has the taker gained."[2] Each owner of each taken interest is entitled to constitutional protection in the form of the just compensation for what he or she lost—no more but certainly no less. The fact that there are other owners of other property interests who claim just compensation is irrelevant to the question of how much the condemnor must pay to an individual owner of a compensable property interest that the condemnor takes.

Third, before talking about valuation of the whole, one must determine what comprises the "whole." If consideration of the component parts of the whole results in a higher market value, the valuation process must reflect that if it is to be rational.

Fourth, as the U.S. Supreme Court put it, "The courts have held that the deprivation of the former owner rather than the accretion of a right or interest to the sovereign constitutes the taking."[3] This follows from the principle that the Fifth Amendment is a part of the Bill of Rights that secures individual rights. Thus, if we say with Justice Holmes that the Constitution deals with people, not with tracts of land, each individual's rights secured by the Constitution must be observed, and none of them can be made to disappear by lumping owners of the various property rights with others.

Finally, the undivided fee rule is fundamentally at odds with the basic tenet of valuation law that makes fair market value the usual measure of just compensation. In turn, fair market value is defined as follows:

> The fair market value of the property taken is the highest price in the date of valuation that would be agreed to by a seller, being willing but under no particular or urgent necessity for so doing, nor obliged to sell, and a buyer, being ready, willing and able to buy but under no particular necessity for so doing, each dealing with the other with full knowledge of all the uses and purposes for which the property is reasonably adaptable and available.

No rational, informed seller of a property in a voluntary market transaction would agree to a price derived from the assumption that a valuable attribute of the subject property, which makes its ownership profitable, does not exist.

To take a common example, when the interest of an owner of a leasehold is taken (whether alone or as part of a fee simple title-taking), the lessee loses that interest and is just as entitled to compensation as the landlord is.[4] The leasehold value is the difference between capitalized actual rents paid over the remaining life of the lease and capitalized comparable

market rents. Thus, actual rents cannot be ignored if the interest of the tenant is to be rationally determined, because ignoring them deprives the appraiser of an essential datum that must be used in the leasehold valuation process. Once the property is taken, entitlement to compensation follows, and it does not matter whether the condemnee is the lessor or lessee, or the owner of another property interest—the condemnor must pay for what it takes *from each owner of each property interest*. There is no doctrinal or logical basis for assuming that, for purposes of valuation, the actual state of title to the subject property is to be treated as if it were other than what it is. When title is divided among owners of separate interests in the subject property, the law has to deal with that reality, not with a fiction that an individual who owns a valuable interest in the taken property (such as an easement or leasehold) does not own it. As Justice Holmes put it:

> "[T]he Constitution does not require a disregard of the mode of ownership—of the state of the title. It does not require a parcel of land to be valued as an unencumbered whole when it is not held as an unencumbered whole. It merely requires that an owner of property taken should be paid for what is taken from him."[5]

The proof is found in a situation in which application of the undivided-fee rule would result in a significantly higher, not lower, value than use of the aggregate of interests rule would produce. I have never heard of a condemnor or a court insisting on payment of compensation that is *higher than what the property would bring in the market* by disregarding the actual state of title. For example, suppose that a valuable vacant property is bisected by an existing easement that precludes or severely limits the use of the property. Under these circumstances, can you visualize a condemnor (or a court) insisting that the condemnor must pay for the property what it would be worth without the easement—a sum that would be more than what the parcel would sell for in the open market in its actual condition?

There are also appraisal practicalities to consider. Suppose that the subject property is a leased commercial building. Although several valuation approaches can be used, the capitalization-of-rentals approach is the best way to value income-producing property. This makes sense because people who make up the market for such properties usually buy rental properties for the income they produce; capitalization of that income reliably establishes what other potential buyers would be willing to pay. Enter the undivided fee rule. If we apply it to this common situation, an absurdity immediately results. If we say that the property must be valued as if owned by one owner, must we now also assume that there are no leasehold interests? And if we do that, what are we to capitalize? Must we now also assume that the landlord occupies the entire building when he doesn't, or pretend that he pays rent to himself? And what might such a rent be?

The response of proponents of the undivided fee rule in such cases is that we should assume a reasonable market rent derived from rents prevailing in the area, and capitalize that. But if we do that, we would be using the capitalization method to value not the subject building but rather some other hypothetical building occupied by fictitious tenants paying fictitious rents. By disregarding objective reality and choosing what hypothetical market rents to capitalize (as opposed to the actual rents), we would be assuming the answer to the valuation question that has to be answered.

Typically, application of the undivided fee rule becomes a problem when the rent diverges substantially from rents paid in the local market. The leading case is *People ex rel. Department of Public Works v. Lynbar, Inc.*[6] In *Lynbar,* the condemnee owned a string of service stations. When his leases with Mobil came to an end, Lynbar was offered higher rents by Tidewater Oil. Lynbar accepted. When the condemnation action was filed, the condemnor contended that under the undivided fee rule, Lynbar's appraiser should not be permitted to capitalize the actual rent and should have to capitalize prevailing service station-market rents. This made a significant difference—the value would be $50,000 under the condemnor's approach, and no less than $125,000 under Lynbar's. Lynbar contended that each side should present its preferred valuation approach and let the jury decide on the basis of respective appraisal testimony which represented the better view on these facts. The trial court allowed both approaches, and the condemnor appealed. Held: affirmed.

The *Lynbar* court cited *Boston Chamber of Commerce* and took the position that the owner was constitutionally entitled to just compensation for the property taken from him and that therefore it was no error to permit the use of capitalization of rents generated by the actual rents generated by that property. It responded to the "whole versus the sum of the parts" argument by saying:

> The question to be answered in this case is, of what does the whole really consist, for which payment is to be made by the condemnor in one lump sum . . . ? It seems to us that this whole must be the total of what the various involuntary sellers have to sell and not the undivided fee which the condemnor is seeking to acquire.

The sensible conclusion that emerges from such cases is that the undivided fee rule is a rule of convenience that works in most cases but not in unusual cases where its invocation would deprive an owner of a compensable property interest—of his just compensation. The commissioners' comment to Uniform Eminent Domain Code § 905 recognizes that

> in some cases, the amount of compensation that would be awarded if the property were valued on the assumption that it is under a single and undivided ownership may be insufficient to provide adequate compensation for each of the divided interests. In these cases, a separate determination of the compensation required for each interest may be advisable; the aggregate of the amounts separately assessed for each of the interests will then constitute the amount to be subsequently apportioned.

The *Lynbar* problem represented the more common case, where the rent reserved in the lease is higher than rents paid by tenants occupying other similar properties. But the opposite is sometimes true—the rents actually paid can be lower than prevailing market rents. What then? In a brief statement added to the *Lynbar* opinion upon denial of rehearing, the court stated that in the case of rents that are lower than prevailing rents, the value (derived by the capitalization method) would be lower. Because that statement was made as dictum, without qualification and without assistance from the parties' briefing, it does not necessarily represent good law. Why? Because capitalization of actual rents is only one valuation method, and the *Lynbar* rule allows the capitalization of both actual rents and rents paid by lessees in the local market for occupancy of comparable properties. In other words, if the landlord decides to charge his tenants less than what the traffic would bear, why should the courts be required to punish him for not being greedy? Why, under these circumstances, should he be required to accept less than what his property would actually bring in the market?[7]

This is in principle no different from the situation where a landowner puts his land to less than its highest and best use. The fact that the land is not being put to its highest and best (most profitable) use at the time of taking does not justify allowing the condemnor to pay less than fair market value, because the market does consider the actual highest and best use. In any event, the fair market value that is the usual measure of just compensation is the *highest* price the subject property would bring in the market in a voluntary transaction between knowledgeable parties. It follows that where there are two appropriate valuation methods, the one yielding the higher value is preferred.

But the postscript to the *Lynbar* opinion implicitly raised a fascinating problem. Suppose that the rents actually paid are substantially below prevailing market rents, thus indicating a low market value of the landlord's interest arrived at by the capitalization approach. Is that the end of the matter? No. The tenant may now say, "Wait a minute. What about my bonus value?" He has a point—the measure of compensation payable to the tenant *is* the bonus value, the difference between market rent and the actual rent, calculated over the remaining term of the lease and then reduced to its present value.

I was once involved in such a case. The subject property was an attractive older brick building that for many years had been leased as a post office. As the community grew, the post office moved to larger quarters, leaving the building vacant. It would have been premature at that time to demolish the building and reuse the land, so the owner leased it to a restaurant owner. The restaurant proved to be a huge success. When the city filed a condemnation action to take that property for a street-widening, the appraisers investigating the local leasehold market discovered that all nearby commercial leases to which they would normally look for comparable rents were gross-income-percentage leases, and when the lessee's gross income was considered, his bonus value was huge. The case settled.

A case illustrating the potential absurdity of the "undivided fee rule, *City of Milwaukee Post No. 2874 Veterans of Foreign Wars v. Redevelopment Authority of the City of Milwaukee*,[8] 746 N.W.2d 536 (Wisc.App. 2008), was recently decided by the Wisconsin Court of Appeals. The Veterans of Foreign Wars (VFW) had a long-term lease in the subject office building, which it had prepaid, and its monthly rental payments were one dollar. This gave rise to a large six-figure bonus value. But the jury valued the property at zero.[9] The VFW then sought to put on evidence of the value of its leasehold interest, but the trial court invoked the undivided fee rule and refused to permit it. The Wisconsin Court of Appeals was now facing an absurdity: the VFW's admittedly valuable leasehold interest, indisputably a property right, was being taken without any compensation, supposedly because "the law" of just compensation, no less, so required. The court responded by carving out an exception to the undivided fee rule, reasoning that because the Constitution required payment of just compensation for takings of property, and the VFW's valuable property interest was taken, the VFW would have to be afforded an opportunity to present its valuation case to a jury. Reversed.

A divided Wisconsin Supreme Court reversed that decision on July 17, 2009, and in a lengthy opinion, held that the undivided fee rule had to be applied in spite of the absurd result whereby the VFW's concededly valuable leasehold interest was taken without any compensation.

The Nevada Supreme Court in *County of Clark v. Sun State Properties*,[10] also applied the undivided fee rule. The *Sun State* opinion is frustrating to an informed reader because the court never discussed the exact factual context in which the undivided fee rule and the aggregate-of-interests rules came into conflict. It discussed only the law. The owner in *Sun State* relied on the *Lynbar* case, so the case turned on its interpretation. Unfortunately, the Nevada court misunderstood *Lynbar* and thought that *Lynbar* required that under California law, only the undivided fee rule should be used, whereas *Lynbar* actually permitted the use of both valuation rules, leaving it to the trier of fact to decide which was more appropriate under the circumstances.[11] The Nevada court thought that *Lynbar* was not finally decisive of California law and, therefore, decided not to follow it. Actually, the *Lynbar* rule is firmly a part of California law because, among other reasons, the legislature has codified its rule in California Code of Civil Procedure § 1260.220(b), which allows the owner of any interest in the subject property to present evidence of value of its interest in the first-phase valuation trial, thus avoiding the problem of being deprived of an opportunity to present its valuation case before the lump sum award is determined.

A Problem to Solve Based on an Actual Case

A successful physician decided to invest money for his old age by buying income property, reasoning that this would provide him with a tax-advantaged income stream and long-term appreciation. But he wanted to avoid involvement in building management and to devote himself to the practice of medicine full time.

He found a small commercial office building for which he paid $250,000.[12] He paid $50,000 down and took title subject

to an existing $150,000 deed of trust securing a loan from an insurance company. There was also an outstanding $50,000 second deed of trust held by an individual who had bought it from a trustee in bankruptcy at a substantial discount, paying only $35,000 for it.

The doctor then found a financially responsible tenant willing to sign a long-term lease and pay triple net rent (taking on all maintenance responsibilities as well as payment of taxes and insurance). He found an AA-rated high-tech engineering company that was looking for space in the area. In order to achieve his investment objectives and to make it worthwhile to the tenant to sign a long-term lease, the doctor agreed to a lease at below-market rent. The tenant took possession. Shortly thereafter, a condemnation action was filed to take the subject property for a new government building site.

The condemnor, relying on the doctor's recent purchase price, offered $250,000. The first trust deed holder demanded its $150,000 loan balance and the second trust deed holder, his $50,000 note balance. The tenant now dropped his bombshell. It pointed to the low rent that, combined with the long term of the lease, gave it a large bonus value, calculated to be nearly $100,000. Also, the tenant had installed extensive (and expensive) fixtures for which he claimed compensation.[13] Those were worth, conservatively, $50,000.

You represent the doctor, who wants to know what to expect by way of compensation. The government invokes the undivided fee rule and offers $250,000 for the property (based on its recent sale to the doctor). The two lenders claim a total of $200,000, and the tenant claims $150,000, for a grand total of $350,000. Thus, the condemnor's offer is inadequate to compensate even the lenders and the tenant, much less your client. Your client is now faced with the prospect of getting nothing for a valuable building conceded to be worth more than $250,000, and losing his entire $50,000 equity to boot. With one exception, everybody involved concedes that everyone else's claims are not unreasonable.[14]

Your client, the doctor, is furious at the thought that, for being reasonable and not squeezing the maximum rent from his tenant, he is to be punished by receiving nothing at all. What do you tell him?

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1. There is no doctrinal basis for this assumption, although efforts have been made to justify it on the grounds that a condemnation is a proceeding *in rem*—against the property rather than against the owner. But the classification of a proceeding as *in rem* means only that the judgment of the court determines title or the status of property as against the entire world, not just among the parties to the lawsuit. Black's Law Dictionary (Bryan A. Garner, ed., 1999) at 797. That has nothing to do with how one arrives at the value of the *res*. Property does not have rights—people do, and it is those rights that are being enforced in a condemnation action. The *in rem* approach thus substitutes label affixation for legal analysis. Finally, owners of all property rights in the subject property must be given notice and an opportunity to be heard on the issue of just compensation to which they are entitled, and to present their valuation evidence. Thus, assuming that neither they nor their property interest(s) exist makes no sense.
2. Boston Chamber of Commerce v. Boston, 217 U.S. 189, 195 (1910).
3. United States v. General Motors Corp. 323 U.S. 373, 378 (1945).
4. See Cal. Code Civ. Proc. § 1265.110 (taking of leased property terminates the lease).
5. *Boston Chamber of Commerce*, 217 U.S. at 195.
6. 253 Cal. App. 2d 870, 62 Cal. Rptr. 320 (1967).
7. It is not necessarily true that a below-wmarket rent would cause the property to sell for less. There are situations where the landlord would gladly accept seemingly below-market rent because of the stability or prominence of the tenant, the length of the lease, the extent to which the tenant may be willing to assume operational burdens, or other factors. Conversely, there are situations in which the tenant may be pleased to pay above-market rent, as in the *Lynbar* case.
8. 746 N.W.2d 536 (Wisc.App. 2008).
9. To achieve the highest and best use, the existing building would have to be demolished and its site subjected to an environmental cleanup. Because of these costs, the building had no market value.
10. 72 P.3d 954 (Nev. 2003).
11. For an interpretation of the *Lynbar* case by a California court, which the Nevada Supreme Court missed, see Clayton v. County of Los Angeles, 26 Cal. App. 3d 390, 394, n. 5, 6 (1972), characterizing an outcome such as that in the VFW case an absurdity.
12. This was in the "good old days," a fact reflected in the numbers.
13. The tenant relies on the U.S. Supreme Court's holding that "For fixtures and permanent equipment destroyed or depreciated in value by the taking, the [tenant] is entitled to compensation. An owner's rights in these are no less property within the meaning of the Fifth Amendment than his rights in land and the structures thereon erected. And it matters not whether they were taken over by the Government or destroyed, since, as has been said, destruction is tantamount to taking. This is true whether the fixtures and equipment would be considered such as between vendor and vendee, or as a tenant's trade fixtures. In respect of them, the tenant whose occupancy is taken is entitled to compensation for destruction, damage or depreciation in value. And since they are property distinct from the right of occupancy such compensation should be awarded not as part of but in addition to the value of the occupancy as such." United States v. General Motors Corp., 323 U.S. 373, 383-84 (1945), footnotes omitted.
14. Because interest rates had gone up shortly before this condemnation was filed and the note securing the second deed of trust was sold in a distress sale, the second trust deed holder bought his $50,000 note at a discount from a trustee in bankruptcy for only $35,000. The doctor is upset that he could lose his $50,000 equity/down payment and get nothing, while the second trust deed holder—a hardboiled speculator dealing in distressed properties—stands to receive a windfall by getting the full $50,000 for his interest-securing note for which he paid only $35,000. But the second trust deed holder argues that the price a condemnee paid for property interest is not decisive (*see* Vogelstein & Co. v. United States, 262 U.S. 337 (1923)), and besides, he is entitled to fair market value of his interest irrespective of what he paid for it (see D.O.T. v. Mendel, 517 S.E.2d 365 (Ga. App. 1999)). In other words, the condemnor is not required to make good an owner's or a lender's investment in the subject property whose fair market value at the time of taking may be more or less than what the owner or lender paid.