

PRINCIPLES OF COMPENSATION

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This is the first of a two part series dealing with parking lots and the just compensation process for parking lots acquired through a governmental agency's use of eminent domain. Principles of "just compensation" and basic valuation are discussed in the first of these articles. The second article will include discussions of the concepts of "highest and best use" and the valuation determination for "partial takings".

The ability of the government to acquire property for public use by condemning it through the power of eminent domain is a Constitutional delegation provided under both the Federal and State Constitutions that allow private property to be taken for a public use upon the payment of just compensation. This article will assume that "public use" exists for the project necessitating the acquisition and will focus on the valuation aspects of an eminent domain acquisition.

The question the judicial system is called upon to determine in eminent domain proceedings usually pertains to the issue of what constitutes just compensation for a taking of an individual parcel of property, including the value of structures, easements, and property rights. The basic principle followed by virtually every jurisdiction is that the owner of property should be placed in the same position as if the condemnation had not occurred.

Many jurisdictions utilize the American Institute of

Appraisers' (AIA) definitions as the foundation for the appraisals, including condemnation appraisals. However, some jurisdictions apply different standards than the American Institute standards, which usually results in a more favorable result for the owner.

The AIA defines just compensation as "the payment of market value of the real estate which was taken."

Most AIA definitions, as applied to condemnation settings, create a conservative approach to the valuation process. This is due to the intent of the AIA standards to protect lending institutions by requiring appraisers to go through the most conservative approach in their appraisal analysis. By example, the AIA definition requires only the "most probable price in terms of money. . ." as opposed to the "highest price estimate in terms of money" utilized for condemnation actions in many states. Nor does the AIA standard discuss possible uses or adaptability to uses other than the existing uses. Almost every State is much more expansive in the application of how a fair market value determination is to be presented in a condemnation proceeding.

The Comparable Approach

The fact finder may look to the value of properties similar to the property at issue in determining fair market value. Whether the properties are sufficiently similar to have some bearing on value rests in the sound discretion of the trial court.

The standard has traditionally been broad in allowing evidence to be admitted and relied upon in determining what is a comparable

property. For example, similar property of different size and an entirely different locality may be admissible. It is sufficient if the property referred to has a resemblance to the property being acquired.

It is within the discretion of the trial court to determine whether a sale used for comparison took place within a reasonable time of the proposed taking. Any objection to the sale as remote in time must be made at the trial level and not for the first time on appeal.

Admissibility of Recent Sales

Recent sales of the subject property are nearly always admissible. A sales price is considered competent evidence to show fair market value as long as the sale otherwise fulfills the fair market value standard and is "voluntary, not too remote in time, and not otherwise shown to have no probative value."

The burden is on the party challenging presentation of the recent purchase to show that the sale is too remote in time or that there are other factors that make the transaction something other than arms length. It is within the discretion of the trial court to determine admissibility of recent sales evidence, and a trial court's ruling on such evidence will typically not be disturbed on appeal absent an abuse of discretion by the trial court.

Generally, a sale may not be allowed if the physical and economic conditions are not similar because the price will not be relevant to the fair market value of the property being taken.

Further, where property is completely changed in use or totally remodeled after purchase, the proposed sale price of a comparable may not be comparable and, therefore, will likely be excluded from consideration. Simply by example, if a parking lot was purchased a few years earlier than a taking by the governmental agency, it was not necessarily relevant to value when it is clear that the area has undergone substantial changes in the market demographics which would provide a far different value.

An example of a substantial fluctuation would be a situation in which the condemnor's appraisal recognizes that the fair market value of the property is different than a recent purchase price. Where there has been tremendous movement in value, even over a short period of time, the subject property's purchase price will be inadmissible.

Utilization of Capitalization of Income

Capitalization of income as a method of valuation generally may properly be introduced as evidence and considered competent before the fact finder.

The reality of the parking lot business inhibits utilization of the income approach. The present income for parking lots is often far less than the value of the parcel premised upon a capitalized rate of return because individual owners fully contemplate that the property in its utilization as parking is a transitional (interim) use, awaiting further intensive development. As such, utilization of an income approach should rationally

require a capitalization rate far below the type of rate which would be utilized for properties readily bought and sold premised upon their present income producing ability. Examples of income properties would be apartment or office buildings.

The fair market value allows that the property should be considered as to what it is worth on the market, allowing a reasonable time within which to effect a sale. This means that the government cannot simply condemn a parking lot which may maintain a different purpose simply because it is not ready on the specific date of taking for the alternative purpose.

GOVERNMENTAL ACTIVITIES

There are areas of governmental activities which may be of interest to a National Parking Association member. First, almost every jurisdiction premises just compensation upon a theory that an owner should be placed in a position as if the taking had not occurred. As such, almost every jurisdiction requires the fact finder to ignore any refusal to rezone the property unless one could reasonably believe that the request to rezone would have been denied even in the absence of the contemplated condemnation and planned public improvement. Courts have consistently held that it is improper for one agency of the government to artificially depress the value of the property by unreasonably restrictive zoning so that another agency of the government can obtain it by condemnation at a lower price.

Probability of Rezoning.

Almost all jurisdictions have maintained that a jury or fact finding court may determine that as part of the highest and best use of the property one of the things that must be considered is whether the zoning classification at the time of the taking was reasonable. If there was a reasonable probability, absent the threat of the condemnation case, that the zoning classification would have been changed, the fact finder should consider this probability in arriving at the value of the property on the date of taking. In order to affect the value of the property, this probability of rezoning must be real enough to have caused a prudent prospective buyer to pay more for the property than he or she would otherwise pay.

Effect of the Proposed Public Improvement.

The process of determining the value on the date of taking may be complicated by the government's actions leading up to the taking, if those actions have had an effect on the market value of the property. If there is such an effect, it must be disregarded.

While the project is not to be considered as part of the valuation process, clearly the announcement of the project should not be considered to insulate the property from normal economic forces. As such, only changes directly traceable to the prospect of the condemnation should be considered so as not to penalize either the owner or the public.

Become Familiar with Valuation Principles in Your Jurisdiction.

In order to properly protect your rights as an owner in a condemnation or eminent domain action, it is vitally important that you become familiar with the principles of compensation available in your jurisdiction. From the market value standard utilized by the jurisdiction to the various nuances associated with the definitions, any number of factors may have a significant impact on the compensation finally realized for the acquisition. The second part of this article will focus on highest and best use and partial taking issues for a parking lot subject to condemnation or eminent domain actions.

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HIGHEST AND BEST USE AND PARTIAL TAKINGS ISSUES

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This is the second part of a two-part series dealing with the valuation of surface parking lots acquired through a governmental agency's power of eminent domain.

Parking lots acquired through eminent domain involve other than a voluntary negotiation and valuation process. All of us expect to be treated fairly, especially if we are not voluntarily selling our property.

Frequently, the use for parking is only an interim use. Parking serves as a profit center until such time as a more intensive utilization of the property occurs. In facing a governmental agency seeking to involuntarily acquire the owner's property, one should remember that the basic requirement remains that common sense must apply. Valuation of the property as part of an eminent domain proceeding should be treated in a manner similar to what would occur in a voluntary transaction.

The basic tenet of market value is that the "highest and best use" of the property be considered in the valuation process. This offers a special problem in parking lots because the government will frequently try to treat the parking lot as an income-producing facility and nothing more than a parking lot, with no consideration given to what may be the highest and best use of the property in

the reasonably near future. The standard for highest and best use frequently is premised upon federal precedent maintaining that the most profitable use which the land can be placed in the reasonably near future, and consideration of this potential is to be provided as part of the valuation.

As noted in the seminal U.S. Supreme Court case of *Olson v. United States*, 292 U.S. 246, 255, "the fact that such use can be made only in connection with other lands does not necessarily exclude it from consideration if the possibility of such connection is reasonably sufficient to affect the market value." The highest and best use of the property may be different than the existing use, and the potential for assembly may create an even higher value to property. Under such circumstances, if there is a realistic potential for the different use or an opportunity to assemble to create a higher value, such may be considered in the process so long as it is contemplated that the event of the different use or assemblage will be within the reasonably near future.

HIGHEST AND BEST USE: DEFINITIONS AND RELEVANCE

In making a determination of fair market value, the fact finder is not limited to placing a value on the land and its existing use, but can also consider other legal potential uses of the property. This is commonly referred to as highest and best use.

The AIA definition of highest and best use is:

That reasonable and probable use that supports the highest present value, as of the effective date of the appraisal.

Many jurisdictions also include in the highest and best use definition, "the most profitable and advantageous use an owner may make of the property, even if the property is presently used for a different purpose or is vacant, so long as there is a market demand for such use."

The notion that the property should not be limited in value to its existing use and that consideration should be given to all possible uses to which it may be adapted, with compensation based upon the most advantageous use, arises out of situations in which courts have applied the "indemnification" standard, requiring payment for what the owner has lost.

Of great importance is the recognition that even in the most liberal states which allow compensation for the most profitable and advantageous use, there is a limitation to a prospective use that has a reasonable basis, but cannot rest upon mere speculation.

Concern regarding "speculation" has been a constant problem for parking lot owners who fully understand that there is always the potential of a substantial incremental value created by demand for the vacant land assembled with surrounding vacant land in order to build an intensive urban project. The best procedure to attack this government "speculation" argument is to show past assemblages that required payment of the incremental amounts far above what a use only for parking lot purposes could be.

Any evidence relating to the question of the highest and best use of property is material and therefore admissible regarding value, and the jury may consider every legitimate use of the property.

All Uses to Which Property May Reasonably Be Adapted.

The requirement that the highest and best use is to include those uses to which the property may be reasonably adapted includes two very important considerations:

Potential to Expand. Included in the highest and best use of property is the potential to expand on the property. Payments for a diminution in this potential is properly considered in the determination of just compensation.

Assemblage. A difficult problem in ascertaining the highest and best use of property occurs when there is a claim that assemblage may be possible. Frequently, the highest and best use of property involves assemblage with other parcels.

So long as the trial court determines that the potential to assemble properties together is not totally speculative, the issue of whether value attributable to a particular use realizable only through an assembly of multiple tracts must be considered in determining the value if the land is enhanced in its value from the probability of its coming to the market for such use.

Generally, the probability of assembly without eminent domain is a question of fact to be determined with the evidence presented. The issue is one of whether there is a probability of assemblage within a reasonable time at a reasonable price. As one court noted, "If such assemblage is found to be practical without exercising eminent domain, the increment in value due to the particular use should be apportioned among the parcels comprising the entire tract."

Where the highest and best use of separate parcels involves their integrated use with the lands of another, such prospective use may be properly considered in determining the value of the property if the potential for assemblage was reasonably sufficient to affect market value.

Incompatible Uses.

One of the frequent errors in litigating parking lot valuation cases has been the position of owners that they have a right to the income on the property capitalized into future years while at the same time seeking a substantial value for something other than a

parking lot use. The recognition that the property value should be premised upon its income as presently calculated directly contradicts the potential for an alternative higher and better use.

It is error to consider the value of two incompatible uses together on the same land when determining damages. "It is not a combination of all mutually exclusive uses, but, rather the highest and best use which is the standard to be applied." However, the interim use of a parking lot may add value when compared to interim uses which have no income for the interim period.

**THE TAKING OF ONE PARKING LOT OUT
OF A MULTI-LOCATION OPERATION**

When a multi-location operation loses one of its lots, the loss of a single lot may have a devastating effect on the viability of the total operation. Traditionally, compensation was limited to the taking of the one lot and the value of that particular lot. On a regular basis, the going-concern value of the lot would be diminished because of its inseparability from the total operation or because of local jurisdictional limitations upon the right to be paid Just Compensation for the property.

A parking lot operator who loses one lot in a condemnation proceeding may no longer have to endure the paradox of finding themselves worse off than if the entire operation had been taken. Thanks to a trend pioneered by the federal court system,

determination of just compensation in partial taking cases has been liberalized in many states.

Effect on Parking Lot Systems.

Frequently, specific locational distances between parking lots is a requirement for a chain. The loss of the location, if proven irreplaceable, can have a substantial effect on continued profitability for the remainder of the operation. This effect is a consideration which must be determined as part of the just compensation process.

Underlying the notion that indemnification should be made to the chain is the availability of compensation under the terms of the lease between the chain and its landlord. Even in the most pro-landlord leases, the business damages or losses outside of the difference between the fair rental value and contract rent will be considered part of the indemnification to the chain. The issue, in all likelihood, should be the factual issue on a case-by-case analysis of whether the loss of one of the lots affects the chain as a whole.

The true effect on a specific location can only be determined by the market needs of the location to the overall operation and the potential for obtaining a replacement site. Clearly a multi-location operator can seek a new community or market area to replace what is lost. At the same time, market areas are sought for specifically that reason; i.e. the market area is desirous for

the continued profitability of the organization. The determination of those losses is certainly one which must be determined on a case-by-case process.

Conclusion

If faced with an involuntary acquisition through the government's eminent domain process, parking lot owners should be vigilant in their quest for "just compensation". The best way for a parking lot owner to receive full and fair compensation is to be completely aware of all factors to be considered in determining full and fair compensation in the jurisdiction at issue. Competent, knowledgeable representation is required to insure that no element of compensation is lost in the process.

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