

# Property Valuation in Condemnation Law

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Article 10, §2 of the Michigan Constitution provides that “[p]rivate property shall not be taken for public use without just compensation therefore

being first made or secured in a manner prescribed by law.” When natural market forces define the price of real estate, the determination of “just compensation” or fair payment is self-evident: It is simply the amount of money that you can get for your property. When property is taken through the power of eminent domain, the determination of just compensation becomes more complicated. The purpose of this article is to highlight basic issues that arise in the valuation of condemned property. This article should not be viewed as an endorsement of any particular legal theory. Any meaningful application of valuation principles must be conducted on a case-by-case basis.

## ***Just Compensation – Fundamental Principles***

Pursuant to Uniform Condemnation Procedures Act<sup>1</sup> (UCPA), the date that the complaint is filed is generally the “date of valuation,” as well as the date that title to the property vests in the condemnor.<sup>2</sup> Generally, professional real estate appraisers for the condemning authority and property owner seek to recreate the market conditions that existed on the date of valuation and render an opinion as to the price that an arm’s-length sale would have brought if natural market forces defined the value. Accordingly, Standard Jury Instruction 90.05 defines just compensation as:

“... the amount of money which will put the person whose property has been taken in as good a position as the person would have been in had the taking not occurred. The owner must not be forced to sacrifice or suffer by receiving less than full and fair value for the property. Just compensation should enrich neither the individual at the expense of the public nor the public at the expense of the individual.”

A fundamental principle of condemnation law dictates that the property must be valued as if the condemnation project had not been contemplated.<sup>3</sup> This precept precludes appraisers from considering any increment of value, whether positive or negative, that is attributable to the project for which the property is being condemned. For example, if the announcement of an urban renewal project exacerbates the deterioration of a blighted area, a condemnee will not be expected to suffer the loss of value attributed to the project. Similarly, if awareness of a condem-

nation project enhances the value of property, the landowner is not entitled to the increase in value due to the project.<sup>4</sup>

## ***Highest and Best Use***

Just compensation is based upon the “fair market value” of the property. Fair market value is defined as:

“... the highest price estimated in terms of money that the property will bring if exposed for sale in the open market with a reasonable time allowed to find a purchaser buying with knowledge of all of the uses and purposes to which it is adapted and for which it is capable of being used.”<sup>5</sup>

Because fair market value is defined as the highest price for which the property would have been sold, a key determining factor in the valuation of property is the appraiser’s opinion of the “highest and best use” of the property. Highest and best use is defined as “the most profitable and advantageous use the 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.”<sup>6</sup> The contrast between property values based upon differing opinions of highest and best use (e.g., residential versus commercial) can be substantial and is often the reason for great disparity between the condemning agency’s and property owner’s positions.

In determining highest and best use, appraisers are permitted to consider the reasonable possibility that issues affecting the development of property would have been successfully addressed (e.g., rezoning, variances, assemblage, site plan approvals, extension of utilities).<sup>7</sup> Ideally, appraisal opinions concerning the reasonable possibility that certain events would have occurred absent the condemnation will be grounded in reality. The ultimate issue is whether market participants would have recognized the reasonable possibility that issues affecting property development would have been successfully dealt with. In *State Hwy Comm’r v Eilender*,<sup>8</sup> the court stated that evidence of the reasonable possibility of rezoning “must be considered in terms of the extent to which the ‘possibility’ would have affected the price which a willing buyer would have offered for the property just prior to the taking.”<sup>9</sup>

In *Hartland Township v Kucykowicz*,<sup>10</sup> the Michigan Court of Appeals affirmed the trial court’s ruling that a highest and best use of multiple residential was inadmissibly speculative where the proposed use of the property was

predicated on rezoning as well as the development of a sewage treatment facility. The court noted that:

"... the landowner would have to secure a permit [for building the plant] from the Department of Natural Resources [and] obtain the township's agreement that it would take over and operate the system should the private owner fail."<sup>11</sup>

### ***Damages To The Remainder – Severance Damages***

Where only part of a parcel has been condemned, damages to the remainder or "severance damages" are measured by calculating the difference between the market value of the entire parcel before the taking and the value of the remainder after the taking.<sup>12</sup> This method is commonly called the "before and after method."<sup>13</sup> Factors that may have an effect on the value of the remainder include:

"(1) reduced access; (2) any change in utility or desirability of what is left after the taking; (3) change in size or shape; (4) certainty of the project and the timing of the project and the road work; and (5) the use which the [condemning agency] intends to make of the property it is acquiring and the effect of that use upon the owner's remaining property."<sup>14</sup>

The application of any one of these factors only can be assessed on a case-by-case basis. Some damage claims have been held to be non-compensable.<sup>15</sup>

In the recent Michigan Supreme Court decision, *Spiek v Michigan Dept of Transportation*,<sup>16</sup> property owners adjacent to I-696 filed an inverse condemnation action,<sup>17</sup> alleging that the effect of noise, dust, vibration, and fumes emanating from the expressway constituted a taking of their property. In rejecting this argument, the court held that damages must be "unique, special, or peculiar, or in some way different in kind or character from the effects incurred by all property owners who reside adjacent to freeways or other busy highways"<sup>18</sup> in order to be compensable. The applicability of this case to actions brought under the UCPA has not been specifically addressed by Michigan appellate courts.

MCL 213.51(g) defines "parcel" as "an identifiable unit of land, whether physically contiguous or not, having substantially common beneficial ownership, all or part of which is being acquired, and treated as separate for valuation purposes (*emphasis added*)."<sup>19</sup> In certain cases, where a discrete parcel is an integral part of a unified farm or business, the possibility exists that what appears to be a total taking might actually be a partial taking of a large parcel. In such cases, a property owner may argue that the taking has caused substantial damage to the larger parcel.

### ***Business-Related Claims***

In cases where an ongoing business is located on the condemned property, business-related claims may arise. The condemnation may result in modification or termination of a lease or other contractual arrangements (e.g., franchise agreements, lender obligations). Displaced business owners may also claim business interruption damages or a total taking of the going concern of the business.

### ***Loss of Going Concern***

A claim for loss of going concern depends upon whether the unique location of a business forecloses its transfer to another location. In *City of Detroit v Michael's Prescriptions*,<sup>19</sup> the Court of Appeals found that the lower court did not abuse its discretion in admitting evidence of loss of going concern, where the relocation of a pharmacy was arguably foreclosed because the condemnation project scattered established customers and eliminated sources of businesses, including the pharmacy's monopoly over a nearby emergency room's prescription business. The Court of Appeals stated that "it is clear that recovery of the going concern value of a business lost to condemnation will depend on the transferability of that business to another location. If the business can be transferred, nothing is taken and compensation is therefore not required."<sup>20</sup>

### ***Business Interruption Damages***

If a business can be moved, as is commonly the case, business interruption damages may be applicable. Business interruption damages are costs associated with the relocation of the business and may include such items as rental expenses, advertising expenses, labor costs, or duplicate expenses incurred in the relocation process. However, because of their speculative nature, damages for lost profits are not recoverable in a business-interruption case.<sup>21</sup> A business cannot recover for both business interruption and loss of going concern, because the "two theories are mutually exclusive."<sup>22</sup>

### ***Value of the Lease***

The lease itself may also have value. The basic formula for determining the value of a leasehold is the difference between the fair market rental value of the remainder of the term and the rent reserved in the lease.<sup>23</sup> If the fair market value of the lease exceeds the contract rent, the lease has value to the lessee and vice versa. When valuing a leasehold, it is possible that the term of the lease can exceed the contract term of the lease. The United States Supreme Court succinctly explained that:

"... a [willing] buyer would expect to have the lease renewed and to continue to use the improvements in place. The value of the buildings, machinery, and equipment in place would be substantially greater than their salvage value at the end of the lease term, and a purchaser in an open market would pay for the anticipated use of the buildings and for the savings he would realize from not having to construct new improvements himself."<sup>24</sup>

### ***Methods of Valuation***

Expert real estate appraisers are required to comply with the Uniform Standards of Professional Appraisal Practice (USPAP) as well as other licensing requirements.<sup>25</sup> Real estate appraisers generally use one or more of the following three valuation methods.<sup>26</sup>

**Sales Comparison, Comparative Market or Market Data Approach:** In this method, the appraiser analyzes

“comparable” arm’s-length market transactions (e.g., sales, listings, offers, options) which are chosen based upon the appraiser’s opinion that the properties involved possess characteristics similar to the property being appraised. Consideration is given to factoring out the effect of unusual financing terms or other atypical conditions surrounding the transaction.

“Adjustments” are then made to the values of the comparable sales based upon such factors as the date of sale, size of the parcel, zoning, etc. If a particular attribute is inferior to the parcel being appraised, the appraiser will make a “positive adjustment,” and raise the price of the comparable property to reflect what it hypothetically would have sold for if it possessed the same attribute as the subject property. Similarly, where the comparable property possesses a superior attribute, a negative adjustment will be made. Any disparities between the comparable property are germane to this approach.<sup>27</sup> Ultimately, the appraiser will review and analyze the adjusted values and arrive at a final conclusion for the property being appraised.

**Income or Capitalization Approach:** This approach is generally used when the subject property produces income. This method requires the appraiser to consider the net income generated by the property and to determine the capitalized value of the property.<sup>28</sup> In other words, the goal is to determine what a willing buyer would pay for the property on the date of taking, based upon the present value of the projected future income stream generated by the property.

**Cost Approach:** In cases where the improvements on the property create substantial value, it is often difficult or impossible to locate comparable properties with similar improvements. In such cases, an appraiser may determine the depreciated cost of replacing the improvements and add the value of the vacant real estate (determined through the sales comparison approach) to arrive at a final conclusion of value.

### Reconciliation of Values

Where more than one appraisal technique is used, the appraiser will analyze the final conclusions indicated by each method and determine which approach generated a more reliable indication of value, or whether a combination provides the more reliable conclusion.<sup>29</sup>

### Conclusion

When valuing property that has been taken by the power of eminent domain, an appraiser seeks to determine the fair market value of the property on the date that the condemnation complaint was filed. The valuation process involves consideration of all of the uses and purposes to which the property is adapted and capable of being used.<sup>30</sup> Consideration also should be given to any factors that hypothetically would influence “the amount which the property would bring if it were offered for sale by one who desired, but was not obliged, to sell, and was bought by

one who was willing, but not obliged, to buy.”<sup>31</sup> This article has highlighted some of the fundamental principles and methods which are involved in the valuation process.

### Footnotes

- 1 MCL 213.51 *et seq* (Public Act 1980, No. 87, as amended) provides “procedures for the condemnation, acquisition, or exercise of eminent domain of real or personal property by public agencies or private agencies.” Significant amendments were made to the UCPA, (1980 PA 87), which became effective on January 1, 1997. Although nominally a procedural act, the UCPA contains many substantive provisions relative to the valuation process.
- 2 MCL 213.57; MCL 213.70; SJI2d 90.13. Generally interest is due from the date of the filing of the complaint until the judgment is paid for any difference between the judgment and any portion of just compensation that has already been paid. See MCLA 213.65.
- 3 MCL 213.70; SJI2d 90.15.
- 4 See *In re Urban Renewal, Elmwood Park Project (Cassese)* 376 Mich 311, 319; 136 NW2d 896 (1965). In *Consumers Power Co v Allegan State Bank*, 20 Mich App 720, 744-745; 174 NW2d 578, 591 (1969), the court recognized a limited exception to this general rule, permitting the property owner to value the property with a highest and best use of gas storage; the same purpose for which the property was being condemned. In reaching its decision, the court found that the property was exceptionally adapted and available for this use and the necessity for such use was “so imminent as to add something to the present value in the minds of possible buyers.” *Id* at 737 (citation omitted).
- 5 SJI2d 90.06 (citing *Consumers Power Co v Allegan State Bank*, supra). See SJI2d 90.06 for alternate definitions of fair market value.
- 6 SJI2d 90.09
- 7 See *State Highway Commissioner v Eilender*, 373 Mich 46; 127 NW2d 890 (1964); *Consumers Power Co v Allegan State Bank*, supra; SJI2d 90.10.
- 8 362 Mich 697; 108 NW2d 755 (1961).
- 9 *Id* at 699 (citation omitted); SJI2d 90.10.
- 10 189 Mich App 591, 474 NW2d 306 (1991).
- 11 *Id* at 597.
- 12 *Department of Transp. v Sherburn*, 196 Mich App 301, 304-05; 492 NW2d 517 (1992); SJI2d 90.12.
- 13 *Petition of Mackie*, 5 Mich App 572; 147 NW2d 441 (1967).
- 14 SJI2d 90.12.
- 15 *Mackie v Watt*, 374 Mich 300; 132 NW2d 113 (1965); *Tomaszewski v Palmer Bee Co*, 223 Mich 565, 570 (1923). Property owners who have property abutting a vacated street or alley may have cognizable damage claims. See *Roberts v Detroit*, 241 Mich 71, 77-78 (1927).
- 16 456 Mich 331; 572 NW2d 201 (1998).
- 17 In an inverse condemnation action, no formal condemnation action has been filed. The property owner files suit, as opposed to the condemnor, alleging that certain acts constitute a de facto taking. In such cases, the designations of plaintiff and defendant are reversed, hence the term “inverse condemnation.”
- 18 *Id* at 333.
- 19 143 Mich App 808, 819 (1975).
- 20 *Id* at 819. See also *Detroit v Whalings*, 43 Mich App 1 (1972).
- 21 *City of Detroit v Larned Associates*, 199 Mich App 36, 42; 501 NW2d 189 (1993) (citing *In re Slum Clearance*, 332 Mich. 485, 496, 52 NW2d 195 (1952)).
- 22 *Larned Associates*, 199 Mich App at 42 (citing *Detroit v Michael’s Prescriptions*, 143 Mich App 808, 819, n2, 373 NW2d 219 (1985)).
- 23 *Pierson v H.R. Leonard Furniture Co*, 268 Mich 507, 522 (1934).
- 24 *Almota Farmers Elevator and Warehouse Co v US*, 409 US 470 (1973).
- 25 See MCL 213.61 and citations contained therein.
- 26 Other valuation methods, as well as nuances on the methods presented below are beyond the scope of this article.
- 27 See SJI2d 90.16 which contains an extensive list of factors that the jury may consider in assessing the weighing the appraisers’ use of comparable properties.
- 28 See *In re Acquisition of Billboard Leases and Easements*, 205 Mich App 659; 517 NW2d 872 (1994) (court reversing lower court’s exclusion of capitalization method). See also, *Mackie v Hessel*, 5 Mich App 559; 147 NW2d 464 (1967).
- 29 E.g., of *Muskegon v Berglund Food Stores, Inc*, 50 Mich App 305; 213 NW2d 195 (1973), where appraiser used all three approaches of value.
- 30 SJI2d 90.06 (citing *Consumers Power Co v Allegan State Bank*, supra). See SJI2d 90.06 for alternate definitions of fair market value.
- 31 SJI2d 90.06.