

Preventing A Down Real Estate Market From Affecting Valuation In Condemnation Cases



Joseph T. Waldo has practiced law since graduating from William & Mary Law School in 1978. Over the course of a decade, Joe found himself having to defend his own property from being taken as part of a condemnor's eminent domain plan. In 1998 he founded

Waldo & Lyle, P.C., thus starting the only law firm in Virginia dedicated to representing only property owners in condemnation proceedings. Joe has tried over 100 cases on behalf of property owners facing an eminent domain condemnation. Believing that public education is as valuable to protecting property rights as succeeding in the courtroom, Joe lectures nationally, writes, and frequently makes media appearances to advocate for the defense of individual property rights. He can be reached at jtw@emdomain.com.



Stephen J. Clarke grew up in New Jersey, and came to Virginia to attend William & Mary Law School, graduating in 2006. While in law school, Steve served as the Senior Notes Editor of Volume 14 of the William & Mary Bill of Rights

Journal, where his appreciation for the fundamental right of private property ownership grew. Following law school, Steve completed a two-year term as law clerk to the Honorable Jerome B. Friedman of the U.S. District Court for the Eastern District of Virginia, Norfolk Division. Steve joined Waldo & Lyle after completing his clerkship in the fall of 2008. This article is based on a paper the authors prepared for a seminar sponsored by the ABA's Section Real Property, Probate and Trust Law. He can be reached at sjc@emdomain.com.

Joseph T. Waldo and Stephen J. Clarke

Even if it's a tough market, you can minimize the fear factor.

WHATEVER THE economic circumstances, everyone knows the basis for just compensation in eminent domain cases, from the Fifth Amendment of the U.S. Constitution: "nor shall private property be taken for public use, without just compensation." State Constitutions echo the U.S. Constitution. Here are some examples:

- Virginia, Article I, Section 11 — "That no person shall be deprived of his life, liberty, or property without due process of law; that the General Assembly shall not pass...any law whereby private property shall be taken or damaged for public uses, without just compensation, the term 'public uses' to be defined by the General Assembly";
- Maryland, Article 3, Section 40 — "The General Assembly shall enact no Law authorizing private property to be taken for public use without just compensation, as agreed upon between the parties, or awarded by a jury, being first paid or tendered to the party entitled to such compensation";
- Florida, Article X, Section 6 — "No private property shall be taken except for a public purpose and with full compensation therefor paid to each owner or secured by deposit in the registry of the court and available to the owner."

This outline will overview the basics of how just compensation works, and how to make the best of it in a tough real estate market.

1. Just Compensation Defined By Fair Market Value

- a. “The guiding principle of just compensation is reimbursement to the owner for the property interest taken.... He must be made whole but is not entitled to more.” *United States v. Virginia Elec. & Power Co.*, 365 U.S. 624, 633 (1961).
- b. “[J]ust compensation means the full and perfect equivalent in money of the property taken.” *United States v. Miller*, 317 U.S. 369, 373 (1943).
- c. “The word ‘just’ in the Fifth Amendment evokes ideas of ‘fairness’ and ‘equity.’” *United States v. Commodities Trading Corp.*, 339 U.S. 121, 124 (1950).
- d. “The constitutional requirement of just compensation derives as much content from the basic equitable principles of fairness...as it does from technical concepts of property law.” *United States v. Fuller*, 409 U.S. 488, 490 (1973).
- e. The role of just compensation is to put the landowner in the same pecuniary position as he or she would be had the taking not occurred. See *Almota Elevator & Warehouse Co. v. United States*, 409 U.S. 470, 473-74 (1973); *Virginia Elec. & Power Co.*, supra, 365 U.S. at 633.
- f. Payment of just compensation is based on the equitable notion that an individual should not be forced to bear a cost that should be borne by society in general. See *Lingle v. Chevron U.S.A., Inc.*, 544 U.S. 528, 537 (2005); *Tahoe-Sierra Preserv. Council, Inc. v. Tahoe Reg’l Planning Agency*, 535, U.S. 302, 336 (2002).

2. Courts Have Determined That Fair Market Value Is The Typical Measurement Of Just Compensation, But Not The Exclusive Measure

- a. “In determining the value of land appropriated for public purposes, the same considerations are to be regarded as in a sale of property between private parties. The inquiry...must be what is the property worth in the market.” *Boom Co. v. Patterson*, 98 U.S. 403, 407-08 (1879).
- b. The Supreme Court later explained that “[i]t is conceivable that an owner’s indemnity should be measured in various ways depending upon the circumstances of each case and that no general formula should be used for the purpose. In an effort, however, to find some practical standard, the courts early adopted, and have retained, the concept of market value [as the normal measure for just compensation.]” *United States v. Miller*, 317 U.S. 369, 373-74 (1943).
- c. Fair Market Value is “the amount a willing buyer would have paid a willing seller in an arms-length transaction with both parties being fully informed concerning all of the advantages and disadvantages of the property, and with neither acting under any compulsion to buy or sell.” See 3A Kevin O’Malley, Jay Grenig & William Lee, *Federal Jury Practice and Instructions* §154.31 (5th ed.). The Court has defined it as “what a willing buyer would pay in cash to a willing seller at the time of the taking.” *United States v. 564.54*

Acres of Land, 441 U.S. 506, 511 (1979). Every state has a similar definition. *See, e.g., Fruit Growers Express Co. v. City of Alexandria*, 216 Va. 602, 606 (Va. 1976) (defining fair market value as the price the property would bring if it were offered for sale by one who wanted to sell but was under no necessity and was bought by one who wanted to buy but was under no necessity).

d. Fair market value cannot be the standard of valuation when it produces less than the constitutional guarantee or when the market value cannot be ascertained. Fair market value is generally not used to value special purpose properties or public service facilities because properties of this type are not typically bought and sold on the open market. *See State Road Comm'n v. Bd. of Park Comm'rs*, 173 S.E.2d 919, 925 (W.Va. 1970) (use of other valuation methods for public service facilities). *But see United States v. 50 Acres of Land*, 469 U.S. 24 (1984) (fair market value should still be used when market value is ascertainable).

3. Date Of Valuation

a. Most states have laws governing the date on which property taken by eminent domain is to be valued, and often this is the date the case is filed, the date the condemnor takes possession or title of the property, or the date of the trial on just compensation.

b. Frequently, a state statute will point to the property's value as of the time when the condemnor files its initial pleadings to take the property. However, an actual taking does not occur until the condemnor has taken additional steps; usually this requires the posting with the court for the benefit of the property owner a sum of money at least equal to the condemnor's own estimate of just compensation. Often the condemnor will take these additional steps at or near the statutory date of valuation, but that is not always the case. Condemnors may delay for months or even years the tender or posting of the deposit required to take title — this may be because the condemnor is speculating on the outcome of the case. In fact, many states permit the condemning authority to abandon the condemnation within a short period after its liability for the taking has been established.

c. Whenever there is a delay between the date of valuation and the date on which just compensation is actually determined, there is a potential for a declining or rising real estate market to affect the value of the property being acquired and the ability of the property owner to reinvest the proceeds of the condemnation in equivalent property.

d. Thus, the attorneys involved must know the date of valuation that is applicable in their jurisdiction, and be focused on determining fair market value of the property on the date of valuation. The longer the delay between the date of valuation and the date on which just compensation is actually determined, the more difficult it may be to demonstrate to a judge or jury what just compensation actually is.

e. In particular where real estate prices have fallen since the date of valuation, the property owner's attorney must be able to convince jurors to understand that fair market values might have been established on an earlier date, especially when some jurors may perceive that they have lost value in their own properties in recent times.

4. Determining Whether A Fair Market Exists

a. It is important to remember that what is being valued is the fair market value of the property, and not the current market value. Thus, when a property is acquired by eminent domain in a depressed real estate market, to be compensated with fair market value may require more than valuing the property in the current market.

b. Before this is done, however, it must be demonstrated that the current market is not a fair one. From the property owner's perspective, this will often involve demonstrating that the real estate market has become unnaturally depressed, volatile, or erratic, and that the market value of a property at some previous point in time is more representative of fair market value than the current market. The property owner's attorney must be creative in demonstrating unnatural market conditions as opposed to unfair market conditions. Government intervention and sell-offs by large institutional investors are examples of abnormal and non arm's-length transactions. Conversely, the condemnor will attempt to demonstrate that real estate prices in recent years were artificially and unfairly inflated, and therefore that the current market value of a property is actually its fair market value.

c. In making this determination, both sides would be wise to at least consider hiring or retaining the services of an economist, real estate broker, land planner, or other expert who is skilled in evaluating the market for real estate and can opine as to whether the current market (or the market on the date of valuation) is reflective of fair market conditions.

d. Perhaps one of the greatest indicators that current market conditions are not normal or natural indications of true market value is the influence of fear in the market. *See* Laurence H. Summers, *Responding to an Historic Economic Crisis: The Obama Program*, Remarks delivered at the Brookings Institution, Washington, D.C., March 13, 2009, available at <http://blogs.wsj.com/economics/2009/03/13/summers-on-how-to-deal-with-a-rarer-kind-of-recession/>. Many economists have attributed fear in the market to driving real estate prices downward.

5. Is The Current Market A Fair Market?

a. Although most property owners have seen the value of their property investments fall in recent times, there remains a dispute as to whether this is reflective of an unnatural decline in the real estate market or a "market correction," after a period of unfairly and unnaturally inflated real estate prices. The Wall Street Journal reports that "[h]ome prices continued their multiyear slide in January [2009], according to the S&P/Case-Shiller home-price indexes, as 14 of 20 major metropolitan areas posted price declines of more than 10% from a year earlier." Kerry E. Grace, *No Relief from Home Price Drops*, Wall St. J., March 31, 2009, available at <http://online.wsj.com/article/SB123850357559373519.html>. More recently, the Journal reports that "[h]ome prices have pulled out of their recession free fall but remain weak as concerns linger about the strength of the economic recovery." Sara Murray, *Housing Prices Remain Weak*, Wall St. J., May 26, 2010.

b. The recent economic recession, and the resulting rise in the sale of foreclosed homes, further muddies the waters, as foreclosure sales are usually far below fair market value and are rarely considered arms-length, but are so dominating the market in some areas that it is difficult for real estate appraisers to find legitimate comparable sales. Worse, these foreclosures drive down arm's length sales. For example, in the Ft. Myers, Florida, area, only about 19 percent of home sales in February 2009 were traditional (non-foreclosure, non-short) sales. *See* Thomas A. Lawler, *Home Prices Nearing Bottom? Well, That Depends* —, WSJ Developments Weblog, March 20, 2009, available at <http://blogs.wsj.com/developments/2009/03/20/home-prices-nearing-bottom-well-that-depends/>. The glut of foreclosed homes being sold for below-market value also drives down the values of other homes involved in traditional sales.

c. Thus, the attorney representing the property owner in an eminent domain case if called upon should place the burden on the condemnor to prove that the current real estate market as well as market conditions are in fact a fair market, and that market information, such as that provided by comparable sales, is reflective of the fair market value of the property being condemned.

6. Valuing The Property Under No Compulsion To Sell

a. Although the definition of fair market value used by almost every jurisdiction in the United States includes language relating to the property owner being under no compulsion to sell, it is impossible to ignore the fact that, in a condemnation, the property owner is in fact an unwilling seller. Many jurisdictions require that, before a condemnor may initiate eminent domain proceedings, it make a bona fide offer to purchase the property from the owner, and only after such offer is rejected may it take action to condemn the property.

b. Thus, in considering the price that a property owner would accept were the owner under no compulsion to sell the property, it is both inappropriate and unlawful to consider the value of the property in a depressed real estate market, for the simple fact that the property owner would not have voluntarily sold the property in such a market. In a down real estate market, a property owner who had no compulsion to sell would simply retain the property until real estate prices leveled out or increased, or the owner might borrow against the property if in need of liquid assets (i.e. cash).

c. An attorney representing a property owner whose property has been taken in a down real estate market must demonstrate that, because his or her client (or any reasonable person) would not have voluntarily sold the property in such a market, it is inappropriate to calculate the property's fair market value (and therefore the just compensation owed for the taking) based on the value in the down market.

d. The benefit to the property owner from demonstrating that current market value may not always be fair market value is obvious, and it helps eliminate one of the natural advantages that the condemnor has — the ability to determine when to take the property (and therefore to determine the date of valuation). Because a condemnor has a vested interest in reducing the amount it pays as just compensation, if the condemnor suspects that real estate prices will fall in the short-term, it may hold off on exercising the power of eminent domain while prices fall. If, however, the property owner can demonstrate that current

market value is not an appropriate means of calculating fair market value, the property owner should be able to recover the same value as just compensation as he or she would have recovered had the property been taken when the market reflected more normal conditions.

e. The condemnor may rightly attempt to demonstrate that, were the property owner compensated with the current market value of the property, he or she could simply reinvest that amount in a similarly-valued property, and in a few years, if the real estate market picks up again, the new property will have appreciated in the same manner as the old property would have. Although this presents a compelling argument for using current market value as the standard for just compensation, it ignores the basic principle that real estate is not fungible. Indeed, if a property owner could purchase a parcel of real estate that is exactly the same as the parcel that is being taken by the power of eminent domain, a reasonable property owner would be agreeable to accepting as compensation the price for which he or she could purchase the duplicate parcel. However, because all real estate is unique, exact duplicates do not exist, and the property owner would be forced to risk that the property he or she winds up purchasing would appreciate similarly to the property he or she presently owns. In addition forced sales or compulsory sales inflict hardship including but not limited to tax consequences, moving expenses, disruption to work or business losses. (Most of these costs are non-compensable losses as a result of a forced taking.) Essentially, the condemnor is attempting to avoid paying all of the just compensation that is owed to a property owner in that circumstance, and instead have the real estate market (and more specifically, some unknown future buyer), bear a portion of the just compensation. This is not only improper, it is an unconstitutional abdication of the responsibility of paying just compensation.

7. Jury Psychology

a. As indicated above, even when there is no dispute that the real estate market as of the date of valuation is a fair market, a falling real estate market between the date of valuation and the date on which just compensation is actually determined (e.g., the trial date), can influence how jurors respond to valuation evidence. Beyond the mere difficulty of getting jurors to remember how much higher the real estate market may have been a year or more before the trial date, the property owner may often face a condemnor that is eager to exploit juror psychology to decrease the amount of compensation that a jury will determine is just.

b. Consider a hypothetical example that is not too factually different from a recent case in Virginia: a condemnor is relocating a road and building an overpass in Northern Virginia. As part of the project, the condemnor required a portion of a large piece of property held by a private corporation. Virginia law requires that the condemnor obtain an appraisal and then make an offer to purchase the property based on the appraisal prior to initiating condemnation proceedings. The condemnor obtained an appraisal of the property for \$2.9 million, and offered the property owner to purchase the portion of its property needed for the road project for that amount. The property owner declined to sell and the condemnor initiated condemnation proceedings by filing a Certificate of Take and depositing \$2.9 million with the court. The property owner had drawn down the funds on deposit during the pretrial stage of the litigation, but shortly before trial, the condemnor obtained a second appraisal for approximately \$650,000 less than its

original appraisal. Because jurors have been known to fix just compensation to be at or near the midpoint of the evidence presented by the opposing parties, the clear benefit of such a reduced valuation for the condemnor is that, even if the jury returned a verdict for \$500,000 more than the condemnor contended was just, the property owner would still end up with \$150,000 less than it would have received had it taken the condemnor's original offer. In this hypothetical, the property owner would have been required to write a \$150,000 check to the condemnor, to compensate for the funds it had drawn down.

c. Clearly, a falling real estate market only exacerbates the effect of abusive tactics like those taken by the condemnor in the above-referenced case, making it more likely that condemnors will attempt to utilize such tactics on an ongoing basis. To counter them, attorneys representing property owners may attempt to have the initial determination of just compensation introduced at trial as a party admission (although this technique may face challenges on the basis that such initial determinations are merely statements of opinion), or otherwise attempt to limit the condemnor's drastically reduced appraisal by demonstrating that, at one point, the condemnor had offered the property owner a significantly higher amount.

8. Conclusion

A down market for real estate presents significant hurdles to the representative of a property owner whose land is being taken by eminent domain, both in the form of ensuring that the property is fairly valued and in ensuring that jurors are not swayed by their own worries about the value of their own properties. The landowner's attorney must therefore ensure that the court applies the definition of fair market value, and may require the services of various predicate witnesses — such as economists, real estate brokers, and land planners — in addition to real estate appraisers, in order to demonstrate to the court and jury that the current real estate market is not a “fair” one. The landowner's attorney must also show that the landowner would never voluntarily sell his or her property in a down real estate market, and therefore that he or she should not be compensated as if he or she were doing so — instead, he or she should receive just compensation, the amount that he or she would receive were he or she selling his or her property in a fair market, under no compulsion to do so. Finally, the landowner's attorney must ensure that the condemnor does not exploit jury psychology and juror fears in order to prevent the landowner from fully recovering the compensation that is owed for the taking of the land. (This is the place that a Motion in Limine is helpful. A prudent takings practitioner will prepare in limine to exclude sales that are flawed or other evidence from being introduced that does not reflect fair market conditions.) If the landowner's attorney can succeed in achieving these goals, the down real estate market will not have a significant negative impact on the valuation of real estate and the determination of just compensation in eminent domain cases.

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