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Is Fair Market Value Fair?

Alternative method for determining just compensation is needed

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Justice Roberto Rivera-Soto's well-reasoned dissent in *Mt. Laurel Tp. v. MiPro Homes, LLC,* (Dec. 7, 2006), contains the seeds of a much needed corrective to the received wisdom that has dominated eminent domain jurisprudence for decades: the thought that fair market value is somehow a perfect equivalent in all cases to the constitutionally mandated "just compensation." Fair market value is usually defined as "the price which would be mutually agreeable to a willing buyer and a willing seller, neither being under compulsion to act," *Village of South Orange v. Alden Corp.*, 71 N.J. 363, 367-68 (1976), or some similar configuration.

In *MiPro,* the issue was whether Mount Laurel had the right to take some 16 acres within the Township, which had been approved only 22 days before for construction of 23 single-family homes. The majority held that the municipality's desire to avoid traffic congestion, pollution and a burden on its school system was consistent with the public purposes that support open-space acquisition generally. Accordingly, the taking would be upheld.

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The majority pointed out that the standard for measurement of compensation before commissioners and on appeal therefrom would be the fair market value of the property, including any enhancement in value associated with the approvals. While the court did not specifically mention *State of New Jersey v. F and J Partnership*, 250 N.J. Super. 19 (App. Div. 1991), it is likely that its emphasis on the need to consider the approvals despite the fact that they had been obtained only a short time before the institution of the condemnation action and almost certainly in full awareness thereof, was meant to dispel any notion that the strictures of that case would apply here. (*F and J Partners* held generally that approvals obtained in contemplation of a condemnation were not "in good faith," and should therefore be disregarded in calculating compensation.)

But Justice Rivera-Soto dissented. He differed with the majority on the "right-to-take" issue and, of primary importance here, on the standard of compensation. He found that even if the recently obtained approvals were to be considered, the fair market value criterion was "woefully inadequate." He suggested that because MiPro Homes' intent was to develop the property and sell the homes for a profit, any reasonable definition of just compensation should include both full restitution for all the costs associated with MiPro's purchase and development of the property, *and* its anticipated profits.

The implications of the dissent are much broader than the facts of this case. While earlier cases frequently articulate the need for flexibility in the determination of "just compensation," there are few, if any, instances in which an alternative method has been suggested. *See e.g Jersey City Redevelopment Agency v. Kugler,* 58 N.J. 374 (1971); *State v. Silver,* 92 N.J. 507 (1983). Justice Rivera-Soto was plainly dissatisfied with the rote application of the "fair market value" standard where that standard would not fully indemnify the property owner.

> [T]he proper quantum of damages arising from the taking is the aggregate of MiPro's restitution damages and expectancy

> damages. Anything less takes from MiPro a property right without just compensation, something prohibited by our Constitution[.]

Justice Rivera-Soto is in good company. At the oral argument in *Kelo v. City of New London*, 545 U.S. 469 (2005), it became apparent that at least one of the justices, Justice Anthony Kennedy, was likewise troubled by the conventional approach to eminent domain compensating. He wondered aloud whether the amount of *compensation* should be "adjusted" — at least in those cases in which a private investor will eventually own and develop the property in question — to permit some sort of "premium."

> JUSTICE KENNEDY: Are there any writings or scholarship that indicates that when you have property being taken from one private person ultimately to go to another private person, that what we ought to do is to adjust the measure of compensation, so that the owner — the condemnee — can receive some sort of a premium for the development?
> MR. BULLOCK: There may be some scholarship about that. This Court has consistently held that the property owner is simply entitled to just compensation of the appraised value of the property. Of course, the property owner –
> JUSTICE KENNEDY: And you have to prescind the project when you fix the value.
> MR. BULLOCK: I'm sorry?
> JUSTICE KENNEDY: You have to prescind the project — you have to — you have to ignore the project when you determine the value. The value is a willing buyer and a willing seller, without reference to the project.
> MR. BULLOCK: Yes, that is right. And so they simply get the —
> JUSTICE KENNEDY: But what I am asking is if there has been any scholarship to indicate that maybe that compensation measure ought to be adjusted when A is losing property for the economic benefit of B.
> [T 2/22/2005 22-4 to 23-6]

Both Justices Kennedy and Rivera-Soto recognized that "fair market value" is at least sometimes an inadequate standard. It is not coincidental that in both cases recognition of this reality was in the context of a case that arguably expanded government's right to take private property. In *MiPro*, the New Jersey Supreme Court tackled an issue that had been before the lower courts for years in a series of unreported cases, but in which no clear consensus had emerged. See, e.g. *Township of Monroe v. Noonan* (A-1443-99T1, Mar. 9, 2001); *Township of Allamuchy v. Progressive Properties* (A-987-02T3, July 16, 2004); *Township of North Brunswick v. U.S. Home Corp.* (A2929-01T2, Mar. 11, 2003).

In *Kelo*, the United States Supreme Court held that private property could be taken for purposes of economic revitalization: a holding at least some commentators viewed as a clear departure from existing law.

But whether either *MiPro* or *Kelo* is seen as a departure from or a logical extension of established precedent, both cases can fairly be said to have placed government's exercise of the power of eminent domain in a new context — one quite different from that in which the fair market value standard had gained its ascendancy. For the first time in a very long time, courts have been encouraged to take a fresh look at doctrines that only a couple of years ago had been routinely applied without much introspection about their fundamental fairness, or whether they were a good fit with the broad constitutional imperative. Indeed *Kelo*, and the unprecedented reaction to it, is responsible for much of the attention that has only recently been given to eminent domain. It would not be surprising if *MiPro* had a similar, but more local, impact.

Among the failures of the fair market value template to square with the full indemnity inherent in the constitutional mandate of "just compensation" is the fact that despite language in the cases to the contrary, all of the considerations that would influence a buyer and a seller in the real estate market place are *not* always placed before the trier of fact in a condemnation trial. Indeed, anybody who has actually tried these cases on behalf of property owners knows to expect at least one, and probably several, motions in limine whose whole purpose is to be sure that the trier of fact never gets to hear about those considerations.

Among the most common subjects of such motions is loss of access. While a location on a major highway — as opposed to, say, a location on a service road — would seem to be a major consideration in the value of any commercial property and certainly of a gasoline service station, loss of just such an attribute of value was held to be noncompensable in *State v. Charles Investment,* 143 N.J. Super. 541 (Law Div. l976), *aff'd,* 157 N.J. Super. 14 (App. Div. 1977), *aff'd o.b.,* 76 N.J. 86 (1978).

Similarly, loss of business is routinely pronounced to be noncompensable. Surely an important factor in setting the price of a commercial establishment is the business it has attracted. In fact, businesses are frequently bought and sold separate and apart from the real estate that houses them. A good example would be oil company franchises that permit operation of gasoline service stations. People routinely buy these franchises and an associated lease on premises suitable for the conduct of such a business. But when that property is taken, the franchisee will find that he is not entitled to reimbursement for the loss of his franchise, even though in practical terms it is irreplaceable. *State v. Hess Realty Corp.,* 226 N.J. Super 256 (App.Div.1988); *Bahrle v. Exxon Corp.*, 279 N.J. Super. 5 (App. Div. 1994), aff'd, 145 N.J. 144 (1996).

Value which can be attributed — sometimes with amazing creativity — to the "project" for which the property is taken is habitually disallowed. *Jersey City Redevelopment Agency v. Kugler*, 58 N.J. 374 (1971); *New Jersey Tpke. Auth. V. Herrontown Woods, Inc*., 145 N.J. Super. 279 (App. Div. 1970). Thus the owner of a property which is taken for a redevelopment project does not benefit from the very economic revitalization that constitutes the "public use" that supports the taking in the first place. Meanwhile, his neighbors who are outside the redevelopment area enjoy the full benefit of that revitalization, even though they have paid no more taxes, and have made no more contribution to the common good than the condemnee. When Justice Kennedy questioned the fair market value paradigm in *Kelo*, suggesting that perhaps the proper measure of compensation should be something greater than the property's value with the effect of the project "prescind[ed]," he was questioning just this doctrine.

Moreover, fair market value is not an abstract presence; it must be measured as of a particular date, and using objective data. By choosing when to take the property, the condemnor can unilaterally set one of the most important parameters in the case: the date of value. And because the appraisal process is necessarily backward looking — the appraiser uses sales and leases that, for the most part, occurred before the date of value — the process is skewed from the outset. Similarly, courts will frequently strike as "speculative" methods of arriving at fair market value that are routinely used in the actual real estate market. See e.g., *State v. Mehlman*, 118 N.J.S. 587 (App. Div. 1972) (striking use of the land residual approach to value), and *State v. Whitehead Bros. Co., Inc.,* 210 N.J. Super 359 (Law Div.1986) (striking an appraisal of mineral-producing land that mirrored the manner in which such land is evaluated in the market).

But while the foregoing are legitimate criticisms of the fair market value standard as it is practically applied, Justice Rivera-Soto's concerns were directed at the use of fair market value *itself* as a proxy for the constitutional imperative.

> [L]imiting the condemnee's recovery to the fair market value of his property, including any increase in the value resulting from the subdivision approval, denies the property owner the basis of his bargain.

In the context of an increasingly expansive judicial view of what constitutes a public use, *Kelo,* and an increasingly restrictive view of the available defenses to a government taking, *MiPro,* the fair market value criterion does indeed require closer scrutiny. While a taking for highway purposes, for example, may not ordinarily imply anything in particular about the various properties within the right-of-way or their economic status, the same cannot necessarily be said for other kinds of acquisitions.

Redevelopers, for example, are business people. They will not be interested in acquiring property unless they anticipate making a profit from developing and "re-using" that property. "Area[s] in need of redevelopment" typically will be (or at least, should be) in rundown areas of older municipalities. Therefore — virtually by definition — a property in which redevelopers are interested will have reached that stage in its economic life where it makes financial sense to use it for a different "highest and best use" from its current utilization.

That change in highest and best use will dramatically increase the value of the property in question. But because of various doctrines of noncompensability, pre-eminently the "project influence" doctrine mentioned earlier, the owner whose property is taken to make way for the project will not participate at all in the property's incremental value; not even the portion that is the result of economic forces which owe nothing to the prospect of redevelopment, such as increasing scarcity of land available for development, or the growing desirability of "gentrified" areas.

Among the reasons the owner will necessarily be under-compensated under traditional notions of fair market value is that there is no way to accurately measure the prospective benefits that flow simply because the property's "time has come," as distinct from the prospective benefits anticipated to flow from the unique efforts of the redeveloper. Usable market data — arm's length, freely negotiated sales between knowledgeable persons who are not under undue pressure — are few and far between; participants in the market will not sell such property except under compulsion for the same reason one does not sell a rising stock: the prospect of even greater future gain.

But the redeveloper whose motivation is to increase his profit margin will try to capture *all* of the property's increased value. And because of unduly restrictive evidentiary rules like the project influence rule, and because of the scarcity of real world market transactions that effectively mirror the true value of the property in question, i.e., a value that recognizes that its time has come, that attempt is usually successful.

While the kinds of properties ordinarily targeted for open space acquisition are typically a world away from those in areas "in need of redevelopment" — open-space acquisitions are usually in suburban or rural municipalities intent on preserving the rustic "character of their communities" — much the same analysis holds there as well.

Such towns and villages have limited resources to effect their land acquisition programs, despite the availability of substantial state funding for the purpose. Accordingly it will frequently make good sense to give priority to those properties within its borders that are most ripe for development. Under *MiPro,* municipalities are given much freer rein to do this than under at least some of the earlier unpublished cases. Again, as Justice Rivera-Soto pointed out, rote application of a fair market standard will not reflect the value the property has in the hands of the developer who has identified it and shepherded it through the approval process — not with the intention to sell it at the end of that process for an artificially determined "fair market value" — but to sell the completed homes at a substantial profit.

As Justice Rivera-Soto also implied, the measure of compensation in noncondemnation matters is often broader and more "just" than that permitted in eminent domain. This is due in substantial measure to the traditional unwillingness of the courts to look beyond fair market value as the standard of compensation, even when the context in which the power of eminent domain may be exercised is enlarged to the point where re-examination of the traditional paradigm is needed. "Just compensation," not "fair market value," is what the Constitution calls for, and persons whose property is taken to serve a public use — especially in light of the expansive meaning that term has come to have — deserve no less. ■