THE REAL VALUE OF BUSINESS PROPERTY

New Minnesota law gives appraisers a way to establish minimum compensation in eminent domain cases

BY JOHN SCHMICK

Real estate markets are dynamic in nature, constantly shifting as market parameters change. To reflect these changing market realities, the laws impacting real estate have evolved. Eminent domain law is one example.

The use of eminent domain is intended as a last resort for acquiring land needed for a public use like highways, railroads and public utilities. In some instances, it has been used for economic development purposes or as a tool for redeveloping blighted areas, reasoning that it would be economically beneficial to the community, even if the development is privately funded.

The issue of whether such public benefits can be considered a public use under the federal Takings Clause was at the center of the *Kelo v. City of New London* U.S. Supreme Court decision in June 2005. The court ruled that the city of New London's economic development plan did qualify as a public use, even though it was privately funded. As the public's outrage reached national proportions, concern over the ruling and the interpretation of public use led the Minnesota Legislature to pass new laws regarding compensation for impacted businesses.

Protection for Businesses

Historically, a business owner who lost their property through the eminent domain process was compensated for the property taken based on fair market value. However, if the amount was not sufficient to acquire another property, that business and the related jobs were lost. There was simply no compensation given for the value of the business. As a matter of public policy, Minnesota determined that preserving those businesses and jobs is beneficial to the community. However, because that original minimum compensation law was poorly written, it generated confusion and required further clarification.

In 2006, Minnesota lawmakers enacted what is believed to be the nation's first eminent domain law provision intended to protect business owners who experience a forced closure. Statute 117.187 Minimum Compensation is the most significant change to the eminent domain laws in recent years.

Under the statute, the intent is to put the property owner in the same position regardless of whether the minimum compensation is greater than the fair market value of the property taken. The statute states: "When an owner must

THE REAL VALUE OF BUSINESS PROPERTY

New Minnesota law gives appraisers a way to establish minimum compensation in eminent domain cases

BY JOHN SCHMICK

Real estate markets are dynamic in nature, constantly shifting as market parameters change. To reflect these changing market realities, the laws impacting real estate have evolved. Eminent domain law is one example.

The use of eminent domain is intended as a last resort for acquiring land needed for a public use like highways, railroads and public utilities. In some instances, it has been used for economic development purposes or as a tool for redeveloping blighted areas, reasoning that it would be economically beneficial to the community, even if the development is privately funded.

The issue of whether such public benefits can be considered a public use under the federal Takings Clause was at the center of the *Kelo v. City of New London* U.S. Supreme Court decision in June 2005. The court ruled that the city of New London's economic development plan did qualify as a public use, even though it was privately funded. As the public's outrage reached national proportions, concern over the ruling and the interpretation of public use led the Minnesota Legislature to pass new laws regarding compensation for impacted businesses.

Protection for Businesses

Historically, a business owner who lost their property through the eminent domain process was compensated for the property taken based on fair market value. However, if the amount was not sufficient to acquire another property, that business and the related jobs were lost. There was simply no compensation given for the value of the business. As a matter of public policy, Minnesota determined that preserving those businesses and jobs is beneficial to the community. However, because that original minimum compensation law was poorly written, it generated confusion and required further clarification.

In 2006, Minnesota lawmakers enacted what is believed to be the nation's first eminent domain law provision intended to protect business owners who experience a forced closure. Statute 117.187 Minimum Compensation is the most significant change to the eminent domain laws in recent years.

Under the statute, the intent is to put the property owner in the same position regardless of whether the minimum compensation is greater than the fair market value of the property taken. The statute states: "When an owner must

relocate, the amount of damages payable, at a minimum, must be sufficient for an owner to purchase a comparable property in the community and not less than the condemning authority's payment of deposit under section 117.042, to the extent that damages will not be duplicated in the compensation otherwise awarded to the owner of the property."

In a test case, *County of Dakota v. George W. Cameron*, the property owner claimed he could not find a suitable replacement property for his liquor store after his land was taken for a public project. As a result, he purchased some property and built a new store within a few blocks of the original location, and requested compensation based on full replacement cost. The District Court ruled that the trade area identified by Cameron did not qualify as a community. It recognized a different commercial property that had sold (but was not available) and was located within a few blocks of another liquor store, as a comparable property. In determining the compensation, the Court adjusted the sale price for property size only. In March 2012 the Court of Appeals of Minnesota affirmed the District Court decision but expanded the price adjustments based on the characteristics of the subject property. The case then moved to the Supreme Court of Minnesota, which published a decision in November 2013, clarifying the Minimum Compensation (min-comp) Statute and affirming the lower court's ruling.

And so, almost five and a half years after the case started, both the appraisal and legal communities finally have some guidelines on how to interpret Minnesota's min-comp statute. The new guidelines outline exactly what the statute provides, and clearly defines community and comparable property.

New Guidelines for Appraisers

While many property owners believe that the min-comp statute will provide them with a replacement property, the Minnesota Supreme Court actually ruled otherwise, stating that "the remedy afforded by the minimum-compensation statute is not a replacement property. Rather, the minimum-compensation statute provided for *monetary* compensation, the amount of which is equivalent to the sum necessary to purchase a comparable property." The Court goes on to define, in part, a comparable property as "an existing property – regardless of its availability for purchase."

As a result, from an appraisal viewpoint, the Court has created a hypothetical condition in which any comparable property may be considered, even if there isn't one available for purchase. This hypothetical condition must be disclosed by an appraiser in the report. In addition, the appraiser must now consider a wider range of property as comparable and establish a hierarchy of property categories to ensure a property search results in a reasonable and supportable conclusion.

Defining the Community

The min-comp statute seems innocuous in its reference to the "community" but the *Cameron* case elevated the issue sufficiently that the Court eventually saw fit to provide a definition. The Court defined community as: "an identifiable locality that has a socially or governmentally recognized identity, or group of such localities." The Court suggests that, depending on the facts of a particular case, a community "could be a neighborhood, district, town, village, city, county, region or other similar localities." Noticeably missing from this list is the concept of a trade area, which is neither a socially or governmentally recognized identity. Rejection of this concept at the lower court level was affirmed.

However, the Court's definition of community gives appraisers the opportunity to consider many sources of information in the search to define a specific geographic area as the relevant community. Geographic locality with a governmental identity certainly includes those categories listed by the Court, but it is not limited to those categories. For example, census tracts and school district boundaries are also forms of government-identified localities. Government identity may include water districts, postal zip codes, park districts, zoning districts, environmental districts, or any other form of government identity as ascribed by

George Cameron's case was the first test case after Minnesota lawmakers, in 2006, passed legislation to enact a minimum compensation statute to protect business owners.

any governmental entity. In terms of social identity, an appraiser may now consider such categories as demographics based on ethnic or religious composition, social gathering points, school district demographics and any other social characteristic relevant to the owner's business.

In a recent case, appraisers overlaid census tract data, zip code data, city council neighborhood districts, school enrollment demographic data and ethnic business location data to define an "Asian Community" that met the Court's requirement for an identifiable locality with socially or governmentally recognized identity. Specific boundaries were defined that were much smaller than the whole city and the subject's wider trade area, but that contained specific social and governmental identity characteristics. By focusing on the owner, the business and social/business relationships to a geographic area, a definition of the relevant community was identified. It is then within this defined community that an appraiser searches for comparable properties in the next step of the minimum-compensation analysis.

Purchasing a Comparable Property

The Court concluded that for the purpose of the min-comp statute, a comparable property is "an existing property – regardless of its availability for purchase – that has enough like characteristics or qualities to another property that the value of one can be used to determine the value of the other." This definition creates a hypothetical condition for an appraiser because the emphasis is not on a replacement property but any property with enough like characteristics to be considered comparable. As a result, an appraiser searches for properties within the defined community that have sold in a time period relevant to the date of taking, properties listed for sale at the time of the taking, and finally, any existing property that could be considered comparable regardless of whether it recently sold or was listed for sale.

It is important to note that the Court's emphasis is on a monetary amount sufficient to purchase a comparable property. As such, each of these categories of property may yield one or more comparable properties that are useful in measuring that monetary amount. Asking prices for a property for sale is just as valid as the sale price of the traditional sold comparable property. The more difficult comparable property is the last category of any existing property within the defined community. Within this category, it is necessary for an appraiser to determine if the owner has an opinion of value for their property, or a price at which they are willing to sell, or a price at which they can be induced to sell. If the owner declines to comment, an appraiser must estimate its value from any available information about the property. This is consistent with the hypothetical condition created by the Court's definition of a comparable property, regardless of availability or other factors.

Finally, an appraiser must consider the scenario where no comparable property is identified. The District Court rejected the approach of just buying land and constructing a building in the original Cameron trial. But that case was based on the trade area, not a defined community, and in hindsight, that significantly limited the analysis. Based on the new Court guidelines, when there are no comparable properties, it is not known whether the Court would consider a depreciated replacement cost approach as a last attempt to estimate the monetary compensation amount described in the statute. Some attorneys believe that if there are no comparable properties, the business is lost and the appropriate compensation should be based on loss-of-going-concern value. Ultimately, this is one of many questions that may require a return trip to the Court.

Making Necessary Adjustments

Lastly, there must be adjustments to the comparable properties. In the original Cameron case, the District Court recognized the difference in size between the comparable property and the subject property. The Appellate Court recognized a typical range of adjustment categories and the need for adjustments as well.

The State Supreme Court's definition of a comparable property includes the phrase "has enough like characteristics or qualities to another property," but determining what those are is subjective to each property and each appraisal assignment. Understanding the subject property so that those characteristics can be identified is essential to the process of measuring minimum compensation under the statute.

Appraisers commonly make adjustments to properties for a variety of reasons and use a variety of methods or techniques, including both qualitative and quantitative adjustments. But the Court offers no guidelines or restrictions on what adjustments can be made, or how those adjustments are made to the comparable sales, instead, deferring to the appraiser's judgment. Ultimately, for an appraiser's minimum compensation analysis to be considered credible, adjustments for difference between the subject and the comparable property are necessary.

Conclusion

Minnesota Statute 117.187 Minimum Compensation was intended to prevent the unnecessary loss of businesses and jobs when private property is taken through eminent domain. It is a statute that is unique to Minnesota but has relevance to all states where property can be taken by eminent domain law.

With the review by the Minnesota Supreme Court to clarify specific terms and interpret the meaning of its language, this new statute is already influencing individual judgment on property to be taken and the compensation offered. In providing guidance on the meaning of the statute, the Court has identified a hypothetical condition that appraisers must disclose in their appraisal reports. Ultimately, this is a law with numerous public policy benefits and should be considered in other states. ✪

John is Vice President, Director of Special Projects for the Shenehon Company where he specializes in complex valuation projects for rights of way, pipelines, fiber optic and high-voltage transmission lines.

relocate, the amount of damages payable, at a minimum, must be sufficient for an owner to purchase a comparable property in the community and not less than the condemning authority's payment of deposit under section 117.042, to the extent that damages will not be duplicated in the compensation otherwise awarded to the owner of the property."

In a test case, *County of Dakota v. George W. Cameron*, the property owner claimed he could not find a suitable replacement property for his liquor store after his land was taken for a public project. As a result, he purchased some property and built a new store within a few blocks of the original location, and requested compensation based on full replacement cost. The District Court ruled that the trade area identified by Cameron did not qualify as a community. It recognized a different commercial property that had sold (but was not available) and was located within a few blocks of another liquor store, as a comparable property. In determining the compensation, the Court adjusted the sale price for property size only. In March 2012 the Court of Appeals of Minnesota affirmed the District Court decision but expanded the price adjustments based on the characteristics of the subject property. The case then moved to the Supreme Court of Minnesota, which published a decision in November 2013, clarifying the Minimum Compensation (min-comp) Statute and affirming the lower court's ruling.

And so, almost five and a half years after the case started, both the appraisal and legal communities finally have some guidelines on how to interpret Minnesota's min-comp statute. The new guidelines outline exactly what the statute provides, and clearly defines community and comparable property.

New Guidelines for Appraisers

While many property owners believe that the min-comp statute will provide them with a replacement property, the Minnesota Supreme Court actually ruled otherwise, stating that "the remedy afforded by the minimum-compensation statute is not a replacement property. Rather, the minimum-compensation statute provided for *monetary* compensation, the amount of which is equivalent to the sum necessary to purchase a comparable property." The Court goes on to define, in part, a comparable property as "an existing property – regardless of its availability for purchase."

As a result, from an appraisal viewpoint, the Court has created a hypothetical condition in which any comparable property may be considered, even if there isn't one available for purchase. This hypothetical condition must be disclosed by an appraiser in the report. In addition, the appraiser must now consider a wider range of property as comparable and establish a hierarchy of property categories to ensure a property search results in a reasonable and supportable conclusion.

Defining the Community

The min-comp statute seems innocuous in its reference to the "community" but the *Cameron* case elevated the issue sufficiently that the Court eventually saw fit to provide a definition. The Court defined community as: "an identifiable locality that has a socially or governmentally recognized identity, or group of such localities." The Court suggests that, depending on the facts of a particular case, a community "could be a neighborhood, district, town, village, city, county, region or other similar localities." Noticeably missing from this list is the concept of a trade area, which is neither a socially or governmentally recognized identity. Rejection of this concept at the lower court level was affirmed.

However, the Court's definition of community gives appraisers the opportunity to consider many sources of information in the search to define a specific geographic area as the relevant community. Geographic locality with a governmental identity certainly includes those categories listed by the Court, but it is not limited to those categories. For example, census tracts and school district boundaries are also forms of government-identified localities. Government identity may include water districts, postal zip codes, park districts, zoning districts, environmental districts, or any other form of government identity as ascribed by

George Cameron's case was the first test case after Minnesota lawmakers, in 2006, passed legislation to enact a minimum compensation statute to protect business owners.

any governmental entity. In terms of social identity, an appraiser may now consider such categories as demographics based on ethnic or religious composition, social gathering points, school district demographics and any other social characteristic relevant to the owner's business.

In a recent case, appraisers overlaid census tract data, zip code data, city council neighborhood districts, school enrollment demographic data and ethnic business location data to define an "Asian Community" that met the Court's requirement for an identifiable locality with socially or governmentally recognized identity. Specific boundaries were defined that were much smaller than the whole city and the subject's wider trade area, but that contained specific social and governmental identity characteristics. By focusing on the owner, the business and social/business relationships to a geographic area, a definition of the relevant community was identified. It is then within this defined community that an appraiser searches for comparable properties in the next step of the minimum-compensation analysis.

Purchasing a Comparable Property

The Court concluded that for the purpose of the min-comp statute, a comparable property is "an existing property – regardless of its availability for purchase – that has enough like characteristics or qualities to another property that the value of one can be used to determine the value of the other." This definition creates a hypothetical condition for an appraiser because the emphasis is not on a replacement property but any property with enough like characteristics to be considered comparable. As a result, an appraiser searches for properties within the defined community that have sold in a time period relevant to the date of taking, properties listed for sale at the time of the taking, and finally, any existing property that could be considered comparable regardless of whether it recently sold or was listed for sale.

It is important to note that the Court's emphasis is on a monetary amount sufficient to purchase a comparable property. As such, each of these categories of property may yield one or more comparable properties that are useful in measuring that monetary amount. Asking prices for a property for sale is just as valid as the sale price of the traditional sold comparable property. The more difficult comparable property is the last category of any existing property within the defined community. Within this category, it is necessary for an appraiser to determine if the owner has an opinion of value for their property, or a price at which they are willing to sell, or a price at which they can be induced to sell. If the owner declines to comment, an appraiser must estimate its value from any available information about the property. This is consistent with the hypothetical condition created by the Court's definition of a comparable property, regardless of availability or other factors.

Finally, an appraiser must consider the scenario where no comparable property is identified. The District Court rejected the approach of just buying land and constructing a building in the original Cameron trial. But that case was based on the trade area, not a defined community, and in hindsight, that significantly limited the analysis. Based on the new Court guidelines, when there are no comparable properties, it is not known whether the Court would consider a depreciated replacement cost approach as a last attempt to estimate the monetary compensation amount described in the statute. Some attorneys believe that if there are no comparable properties, the business is lost and the appropriate compensation should be based on loss-of-going-concern value. Ultimately, this is one of many questions that may require a return trip to the Court.

Making Necessary Adjustments

Lastly, there must be adjustments to the comparable properties. In the original Cameron case, the District Court recognized the difference in size between the comparable property and the subject property. The Appellate Court recognized a typical range of adjustment categories and the need for adjustments as well.

The State Supreme Court's definition of a comparable property includes the phrase "has enough like characteristics or qualities to another property," but determining what those are is subjective to each property and each appraisal assignment. Understanding the subject property so that those characteristics can be identified is essential to the process of measuring minimum compensation under the statute.

Appraisers commonly make adjustments to properties for a variety of reasons and use a variety of methods or techniques, including both qualitative and quantitative adjustments. But the Court offers no guidelines or restrictions on what adjustments can be made, or how those adjustments are made to the comparable sales, instead, deferring to the appraiser's judgment. Ultimately, for an appraiser's minimum compensation analysis to be considered credible, adjustments for difference between the subject and the comparable property are necessary.

Conclusion

Minnesota Statute 117.187 Minimum Compensation was intended to prevent the unnecessary loss of businesses and jobs when private property is taken through eminent domain. It is a statute that is unique to Minnesota but has relevance to all states where property can be taken by eminent domain law.

With the review by the Minnesota Supreme Court to clarify specific terms and interpret the meaning of its language, this new statute is already influencing individual judgment on property to be taken and the compensation offered. In providing guidance on the meaning of the statute, the Court has identified a hypothetical condition that appraisers must disclose in their appraisal reports. Ultimately, this is a law with numerous public policy benefits and should be considered in other states. ✪

John is Vice President, Director of Special Projects for the Shenehon Company where he specializes in complex valuation projects for rights of way, pipelines, fiber optic and high-voltage transmission lines.