

A condemnation concept that applies to market analysis.

Larger Parcel Theory

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JUST AS SMALL BUSINESSES may be combined to form larger corporations, small parcels of land may be combined into larger parcels, which can then be developed for a variety of uses. Large corporations often sell segments or divisions of themselves. Similarly, small parcels may be separated from larger land parcels, as, for example, in the subdivision of land for a housing project. Whether business entities or land, the grouping of several separate parts may produce a value that is greater than the sum of the individual parts, and the loss of one part of a grouping may affect the value of the remaining parts. In the practice of real estate valuation, it is necessary for the appraiser to recognize when the individual parcel is part of a larger parcel and, if it is part of a larger parcel, to take account of that fact in making

his value estimate. The following discussion examines principles of the larger parcel theory in real estate and focuses on the application of the theory outside the area of eminent domain.

The application of the larger parcel theory outside of the eminent domain area is illustrated by a recent transaction involving a land lease under a downtown office building. The land area under the building totaled approximately 100,000 square feet. The building owner owned 60 percent of the area in fee and had a leasehold interest on the other 40 percent. The land lease called for a reevaluation of

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land every ten years that would establish its current market value under its highest and best use. After the parties had agreed on a new market value, the rent was adjusted to be 5 percent of the new value. In the last negotiation, the leasehold interest took the position that the highest and best use of the land under lease was not that of a high-rise office building. He argued that the highest and best use of the small parcel (40 percent of the total property) was that of a low-rise commercial, a use that would support a land value significantly less than that typical for downtown office property. Of course, the leased-fee interest argued for a reevaluation consistent with surrounding land values in high-rise office building uses.

The authors believe that the larger parcel theory should be used to establish the land valuation. Under that theory, the highest and best use of the leased land is for a high-rise office building, and the land should be valued consistently with its current use and other surrounding office properties. This article explains our position.

DEFINITION

The term "larger parcel" is sometimes used interchangeably with the words "plottage," "assemblage," and the legal word "joinder." Basically, they all mean about the same thing—a union or combination of several individual parcels into a larger single unit. The joining together may have been accomplished by the private market or as the result of the action of a government agency such as a community development agency.

However, the larger parcel is not necessarily a group of separate parcels with legally defined boundaries that have been combined into a unit. Rather, it is an area of land that is being put to a homogeneous or single use. Part of the definition of "larger parcel" in *The Dictionary of Real Estate Appraisal* reads, "[T]he portion of a property that has unity of ownership, contiguity, and unity of use. . . ."¹

BACKGROUND

Larger parcel theory is most commonly used in eminent domain and condemnation proceedings. Eminent domain is the only area of real estate in which one *does not* find willing sellers and willing buyers. In open, efficient markets, willing buyers

and willing sellers determine value through the process of negotiation. Generally speaking, the open market establishes value based on the highest and best use of the property. When the government takes property, however, the courts must determine value and just compensation.

In a condemnation of land, the condemning authority has no need to acquire more land than it actually requires for the proposed project. Consequently, the condemning authority tends to ignore the larger parcel and to pay compensation only for what is taken. In most cases, land taken for the public good is put to a use other than what the open market would perceive as its highest and best use. Furthermore, the condemning authorities are usually subject to budget constraints. All these factors provide incentives for the governmental body to try to pay as little as possible for appropriated land.

On the other side of the condemnation proceedings is the unwilling seller who is entitled to receive compensation for his loss. In the open market, a willing seller would not knowingly damage the value of his property by selling an individual parcel if that parcel was necessary for the continued use of the remaining land. Consequently, the landowner wants compensation that includes damages to the remaining land after the individual parcel is taken. Of course, he must demonstrate that the individual parcel being taken is part of a larger parcel and that its value is based on the larger parcel.

The result of this conflict is the formalization of open-market principles and actions into written condemnation theory and guidelines for establishing value and just compensation by courts. The larger parcel concept in condemnation protects the unwilling seller by reflecting how the open market actually functions.

KEY ELEMENTS

All formal definitions of larger parcel list three elements that must be present to establish the presence of the larger parcel, as follows:

- Contiguity of land
- Unity of ownership
- Unity of use

The common perception is that all three elements must be present to have a larger parcel. It is often thought that the land must be contiguous, that it must be put to a single use, and that the same party must own all the land in fee simple. However, judges in various courts around the country have

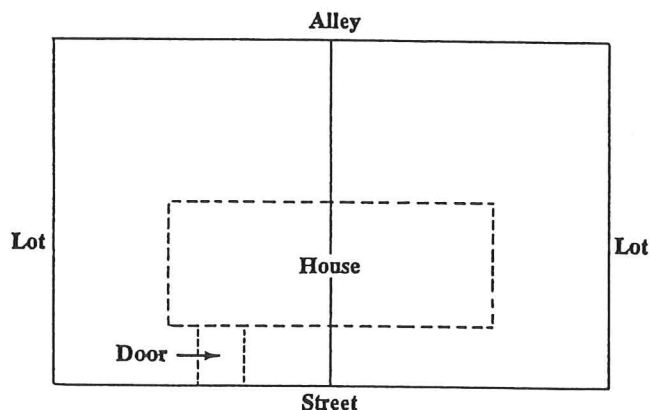
¹ American Institute of Real Estate Appraisers, *The Dictionary of Real Estate Appraisal* 178 (1984).

established that all three elements need not be present and that they may be present in different forms.² In these decisions, the courts appear to have tried to make awards that reflected the prudent expectations of the open market.

Contiguity of Land

Of the three elements, contiguity of land is probably the easiest to understand. Quite simply, if two or more tracts of land are related and put to a single use, they are seen as a single parcel. For example, as illustrated in Exhibit 1, two adjoining lots with a single-story residential dwelling unit built across the common boundary would be viewed as a single parcel. Obviously, one lot cannot be separated from the other without damage to the common improvements.

EXHIBIT 1
CONTIGUITY OF LAND
(SINGLE USE)

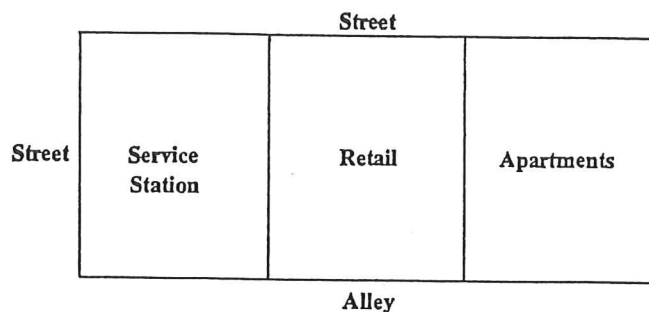


Interestingly, the controlling factor in viewing a contiguous land area (the first element) as a larger parcel is the use of the land (the third element). The controlling role of use in determining whether contiguous lots are part of a larger parcel is demonstrated by Exhibit 2.

Exhibit 2 shows three lots in a prime suburban location contiguous to each other and owned by the same individual. The corner lot is occupied by a service station, the second lot by a small retail building, and the third lot by an apartment building. Although the lots are contiguous and owned by the same person, they are not a larger parcel because

their uses differ. Any one of the three lots could be separated, or taken, from the others without damage to the remaining lots. Thus, contiguity of land does not guarantee the determination of a larger parcel because contiguity is controlled by present use.

EXHIBIT 2
CONTIGUITY OF LAND
(MULTIPLE USES)



If contiguous lots are not necessarily part of a larger parcel, can physically separate parcels of land be considered to be a larger parcel? Several court decisions have established that physically separate parcels of land when occupied and used for a single purpose are in fact a larger parcel.³ Obviously, the farther apart the individual parcels are, the harder it is to demonstrate an integrated or unified use. Exhibit 3 shows two tracts of land separated by a road, both owned by ABC Road Material Co. On tract A, the company has a rock crushing plant, and on tract B the company has its gravel quarry pit. The company mines the rock in tract B and carries it across the road to tract A for processing. The courts have treated both tracts as part of a larger parcel. Both parcels are occupied and used for the single purpose of producing road-building material. If one parcel were taken away, the value of the other parcel would be greatly diminished because the one cannot function without the other.

If a tract of land, no part of which is taken, is used in connection with the same farm, or the same manufacturing establishment, or the same enterprise of any other character as the tract, part of which was taken, it is not considered a separate and independent parcel merely because it was bought at a different time, and separated by an imaginary line, or even if the two tracts are separated by a highway, railroad, or canal.⁴

² Barnes v. North Carolina State Highway Comm'n, 109 S.E.2d 219 (N.C. June 12, 1959).

³ State v. Nelson Sand & Gravel, 468 P.2d 306 (Idaho 1970); Peck v. Superior Short Line R.R. Co. 31 N.W. 217-218 (Minn. 1887);—Nichols on Eminent Domain § 14 (3d ed.); Ives v. Kansas Turnpike Auth., 334 P.2d 399 (Kan. 1959).

⁴ 18 Am. Jur., "Eminent Domain" § 270, at 910.

Thus, although the courts and the marketplace view contiguity of land as one of the three elements normally needed to establish the larger parcel, its importance and necessity are completely dominated by the issue of the land's present use.

Unity of Ownership

The principle of unity of ownership has given the courts and the marketplace the most trouble when they try to determine whether a larger parcel exists. Many years ago, it was generally thought that unity of ownership meant ownership in fee simple. Consequently, if a husband owned one lot and his wife owned the adjacent lot, the lots were not considered a larger parcel because each lot had a different, though related, fee owner. The courts have moved away from this position, however. The majority of court decisions on this issue now make unity of ownership subordinate to unity of use.

The first modern case was decided on May 19, 1884, by the Supreme Court of Illinois in *Chicago & Evanston Railroad Co. v. August Dresel*.⁵ The facts of the *Dresel* case, briefly summarized, are as follows:

Dresel owned ten lots and leased four other lots on the same block. All 14 lots were used in his business and were viewed by the public as one property. The railroad company proposed to take about 20 percent of the leased property for its use. Dresel claimed damages to the entire property by the taking since it was used as one property, even though he did not own the leased land.⁶

The railroad claimed value based on the fee simple ownership of the four leased lots, presumably at a lower value than Dresel claimed. Dresel claimed value based on the larger parcel of all fourteen lots. The court favored Dresel and awarded damages to the whole property.

Dresel and many cases that followed it established that unity of ownership does not mean ownership in fee simple. Unity between two tracts exists even if the owner does not have the same quantity or quality of interest or estate in each tract. Furthermore, all these cases look at the present use of the entire property as being a controlling factor over a strict interpretation of unity of title.

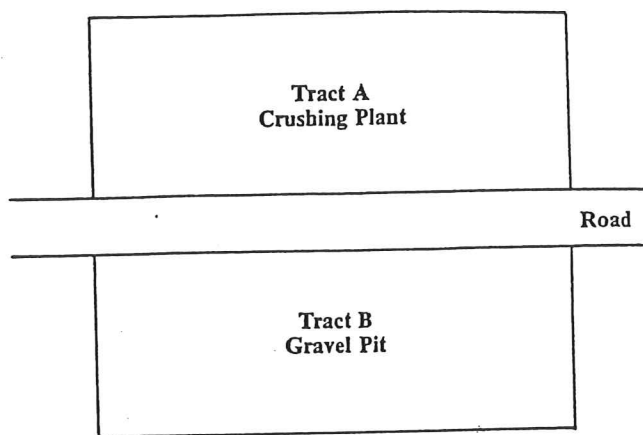
Furthermore, *Dresel* established that the current use of the property was the controlling factor. It

⁵ 110 Ill. 89.

⁶ *Id.*

EXHIBIT 3

NONCONTIGUOUS LOTS IN A LARGER PARCEL



clearly ranked the three elements of a larger parcel in the following order: unity of use (most important), unity of ownership (next important), and contiguity of land (least important). Indeed, *Dresel* and its successors are a prudent reflection of the way willing buyers and willing sellers function in the open marketplace.

Unity of Use

Because of its importance, the unity-of-use element in determining the larger parcel has already been discussed. However, some further examples will clarify current legal thinking.

As implied previously, the unity-of-use principle relates to an integrated, current use on two parcels between which "there must be such a connection, or relation of adaptation, convenience, and actual and permanent use between them, as to make the enjoyment of the parcel taken, reasonably and substantially necessary to the enjoyment of the parcel left, in the most advantageous and profitable manner in the business for which it is used."⁷ In part, this definition is similar to the definition of highest and best use in that it sees the current use of the larger parcel as the reasonable use that supports the highest present land value."

Returning to Exhibit 2, which shows three lots in a prime neighborhood, assume that the three lots are owned in fee simple by three separate individuals and that the buildings are fully depreciated and in a poor state of repair.

The owners agree to a long-term lease of their lots to a fourth individual, who wishes to construct a

⁷ *Peck v. Superior Short Line R.R. Co.*, 31 N.W. 217 (Minn. 1887).

high-rise office building. Once the leases are signed, the larger parcel was established by recognizing a highest and best use of the assembled property as an office building in a single development. This becomes obvious once the building has been constructed. To the general public, this quarter block is now one property with one building on it. The three elements of larger parcel are present: The land is contiguous, unity of ownership is created by the common leasehold interest in the three lots, and there is unity of use for a single purpose. Although the leasehold interest is less than fee simple ownership, it is an ownership interest. The taking of one of the lots would damage the other two lots because the remaining lots could not support the high-rise building. Therefore, the value of each of the lots is based on the value of the quarter block assemblage, not the value of the individual lots.

THE CONSEQUENCES OF IGNORING THE LARGER PARCEL

We stated earlier that courtroom decisions involving larger parcel theory are merely a reflection and recognition of the way a free, open market functions. In order to demonstrate the illogical consequences of ignoring the larger parcel, look at what would happen if either the market or the courts ignored the larger parcel.

Ignoring the Larger Parcel to Reduce Taxes

Assume there is an office building on a quarter block section downtown. If the landowner could ignore unity of use and unity of title, and if he wished to reduce his property taxes, he would have a strong incentive to own many small pieces of land rather than a large piece of land. All property owners would replat their large parcels of land into many small pieces of land, knowing that the value of each individual piece would not extend beyond its legal boundaries to a larger parcel. Consequently, the value of the individual pieces would be very small or almost nothing, and the owners' property taxes would be reduced.

It would not be necessary to divide the entire larger parcel into many small pieces; it would be sufficient to carve several small pieces in key locations out of the larger tract, creating a parcel that looks like Swiss cheese and is thereby unusable by itself. Two enormous problems would prevent this from happening in the marketplace. The first and the most obvious problem is that the taxing authorities would argue strenuously that the value of

the property should be as a larger parcel, not as smaller parcels; they would probably win in court. The second problem is that although the landowner wishes to reduce his taxes, he wishes to maximize property value when he thinks of selling or leasing the property. The property owner would, on the one hand, value the property as a single unit for the purposes of resale or rental and then, on the other hand, value the property in small pieces for real estate taxation. The grossly inconsistent range of values on the same property, both defined as fair market value, could not be accepted by the courts.

Ignoring the Larger Parcel in Condemnation

It is quite common in the marketplace to find that several small pieces of land have been assembled into a larger parcel to develop, say, a shopping center for an office building. Often, the landowner does not go to the expense of replatting the land into a single larger parcel. Let's now suppose that a condemning authority wished to acquire a portion of that assemblage. If the condemning authority could ignore the unity-of-use and unity-of-title principles, it would be to its advantage to acquire a small part of the smallest and least valuable piece in the assemblage. The taking in the first part thereby reduces the value of the remaining part. Having reduced the value of the parcel, the condemning authority could then proceed to take another small part of that parcel at a reduced value, further reducing the value of the remaining parcel. The condemning authority could continue to take small pieces, reducing the value of the future parcels, until it had acquired sufficient individual pieces in strategic locations to render the remaining larger parcel worthless. Landowners everywhere would challenge such a practice as an abuse of power by the condemning authority. This is precisely the scenario that the larger parcel theory was established to prevent.

CONCLUSION

The larger parcel is more than an abstract theory developed for use in condemnation cases; it is the reflection of open market activities between willing buyers and willing sellers that the courts use to settle disputes between unwilling buyers and unwilling sellers. Appraisers and others should consciously use larger parcel theory outside of the condemnation framework. The larger parcel concept also applies to land lease negotiation and should be a part of the routine highest and best use analysis in every appraisal assignment.