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AN ECONOMIC APPRAISAL OF LEASEHOLD VALUATION IN CONDEMNATION PROCEEDINGS

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I. INTRODUCTION

Recent years have witnessed a tremendous increase in eminent domain proceedings. This activity is reflected at all levels of government—local, state and federal—and the trend is not likely to be reversed in the near future. The phenomenal growth in population, the changing philosophy as to the proper sphere of public activity, the concentrations of population in cities, suburbs, and "slurbs,"[1] the depreciation and obsolescence of roads, schools and other public buildings to the point where they are inadequate, and the technological developments resulting in the demand for new and better facilities, are simply a few of the obvious reasons for increased land acquisitions by governmental units.

The need and likelihood of increased activity in just one area of

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1. "The resulting urban sprawl has led to the development of 'sloppy, sleazy, slovenly, slip-shod, semi-cities' called 'slurbs.'" Comment, *Community Apartments: Condominium Or Stock Cooperative?*, 50 CALIF. L. REV. 299 (1962), citing WOOD & HELLER, CALIFORNIA GOING, GOING . . . 10 (1962).

public land acquisitions, and an area comparatively new to governmental activity at that, has been aptly expressed by President Kennedy:[2]

> [O]ur national household is cluttered with unfinished and neglected tasks. Our cities are being engulfed in squalor. Twelve long years after Congress declared our goal to be a decent home and a suitable environment for every American family, we still have 25 million Americans living in substandard homes. A new housing program under a new Housing and Urban Affairs Department will be needed this year.

The need for slum clearance, urban renewal projects, more schools, better streets and highways, additional parks and playgrounds is practically everywhere self-evident. The completion and further development of the inter-state highway program,[3] new and improved tollways, urban expressways, jet airports, and similar projects indicate to a slight extent the degree to which governmental units are and will be acquiring land for many years to come. Many of these acquisitions will result in condemnation litigation.

Perhaps the chief points of controversy in eminent domain proceedings are the determinations of the value of the land taken and of the estates or other property rights of the respective parties claiming an interest therein. It is at this point, the determination of values, that the fields of law and economics become of equal importance. Indeed, the economic questions may be the dominant ones, but the rules and procedures circumscribing the methods of determination are predominantly legal.

In condemnation proceedings the "customs of the trade" of real estate appraisers have tended to influence the law. These customs are at times in accord with sound economic principles,[4] but at other times, yielding to expediency and a desire for simplicity, they have thwarted

2. State of Union Message, Jan. 30, 1961, 1 U.S. Code Cong. & Ad. News 25, 29 (1961).

3. "The federal government has three basic highway programs. One provides for the construction of an interstate highway system, authorized in 1956, to consist of 41,000 miles of super-highways connecting all major cities in the country. It is scheduled for completion in 1972. In 1961, the First Session of the 87th Congress authorized an increase in the Federal share of the cost by $11.56 billion to $37 billion. See Public Law 87-61, U.S. Code Cong. and Ad. News (1961), at 141. The states are building the interstate super-highways system, and the federal government pays 90% of the cost on a pay-as-you-go basis from the Federal Highway Trust Fund, which receives federal gasoline and other user taxes for the purpose.

"The other two federal-aid highway programs constitute the so-called A-B-C program, established in 1916, in which the federal government pays 50% of the costs of primary, secondary, and urban roads constructed by the states. The bill that authorizes appropriations for the A-B-C program usually adds authorizations for road construction on federal lands and Indian reservations. The federal government builds these roads and pays the entire costs." U.S. CODE CONG. AD. & NEWS (1962), No. 11, at XV of *Congressional and Administrative Highlights.*

4. See, *e.g.*, text following note 29 *infra.*

basic economic philosophy.[5] It is the purpose of this paper to examine these "customs of the trade" of appraisers, and to examine also the various rules for ascertaining valuations and for apportioning awards between a landlord and tenant when the condemned property is encumbered with a lease. The soundness of these procedures from an economic viewpoint will then be appraised.

II. The Theory and Problem of Just Compensation: The Unencumbered Fee

A. *General Considerations*

Federal[6] and state constitutions[7] impose general standards on the measure of compensation to be awarded when private property is taken under eminent domain proceedings. Although there are some variations in phrasing, the limitation set in the Federal Constitution, and the one most customarily applied, is that of "just compensation."[8] The charters of government rarely elaborate as to what is meant by words like "just" or "full"; hence the details must be supplied by the courts.

Ownership of land, of course, may be divided in many different ways among many different people. Untold variables as to cotenancies, present estates, future interests, marital rights, landlord-tenant relationships, easements, covenants, mortgages, liens, and related security interests and encumbrances may exist as to any one piece of realty. Most, if not all, of the holders of these interests are entitled to a share in the proceeds. The result depends somewhat on constitutional and statutory provisions and on the substantiality of the claimant's interest.[9]

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5. See, *e.g.*, text following note 82 *infra*.

6. The fifth amendment to the U.S. Constitution prohibits the taking of private property without just compensation. The fourteenth amendment prohibits states from depriving a person of his property without due process of law.

7. Cal. Const. art. I, § 14, for example, uses the standard of "just compensation," as do Colo. Const. art. II, § 15; Conn. Const. art. I, § 11; Ga. Const. § 2-301 (1945); Idaho Const. art. I, § 14; Ill. Const. art. II, § 13; Mo. Const. art. I, § 26. La. Const. art. I, § 2, uses "just and adequate compensation"; Mass. Const. Pt. I, art. X, "reasonable compensation"; Ohio Const. art. I, § 17, simply "compensation . . . in money"; and Tex. Const. art. I, § 17, "adequate compensation."

Fla. Const. Decl. of Rights § 12, uses the phrase "just compensation," whereas art. XVI, § 29 of the same constitution uses the phrase "full compensation." In a dissenting opinion of Mr. Justice Thornal in Jacksonville Expressway Authority v. Henry G. DuPree Co., 108 So.2d 289, 293 (Fla. 1958), the suggestion is made that the requirement of just compensation applies to governmental agencies, and that full compensation applies to condemnations by corporations or individuals.

8. See notes 6 and 7 *supra*.

9. An option to purchase which has not ripened into a mutually binding contract is not such a property interest as to entitle the optionee to a share in the award. Cravero v. Florida State Turnpike Authority, 91 So.2d 312 (Fla. 1956); 4 Nichols, Eminent Domain 28 (1962).

The owner of riparian rights is entitled to compensation. Brickell v. Trammell, 77 Fla. 544, 82 So. 221 (1919); Broward v. Mabry, 58 Fla. 398, 50 So. 826 (1909); Monmouth

The usual method of procedure in condemnation of land burdened with split ownership or encumbrances is to determine first the whole value of the land or property as if it were unencumbered, and then to apportion the award among the various claimants.[10] The following paragraphs list and appraise the methods of valuation commonly employed in arriving at the total value of the property taken. Afterwards, the

Consol. Water Co. v. Blackburn, 72 N.J. Super. 377, 178 A.2d 377 (1962); JAHR, EMINENT DOMAIN 64 (1962).

An owner of an easement is entitled to compensation when it is condemned. City of Jacksonville v. Shaffer, 107 Fla. 367, 144 So. 888 (1932).

There is a conflict of authority as to whether the right to enforce a restrictive covenant or equitable servitude is property, requiring compensation when a parcel of restricted land is condemned for public purposes contrary to the restricted uses. See Britton v. School Dist. of Univ. City, 328 Mo. 1185, 44 S.W.2d 33 (1931), requiring compensation, and Board of Pub. Instruction v. Town of Bay Harbor Islands, 81 So.2d 637 (Fla. 1955), not requiring compensation. Additional cases are collected in Annots., 17 A.L.R. 554 (1922), 67 A.L.R. 385 (1930), and 122 A.L.R. 1464 (1939). See also Comment, 38 MICH. L. REV. 357 (1940).

The majority view is that a wife's inchoate dower is extinguished by eminent domain and that she is not entitled to a lien on the proceeds; but a minority of jurisdictions estimate the value of the dower interest and apportion the award. Cases can be found in 4 NICHOLS, EMINENT DOMAIN § 5.71(1) (1962); and 1 ORGEL, VALUATION UNDER EMINENT DOMAIN 507-08 (2d ed. 1953).

A mortgagee is entitled to protection whenever the entire mortgaged estate is condemned, but the nature of the remedy depends upon the jurisdiction. In some jurisdictions, the mortgagor is assigned the entire award, but the mortgagee may in equity have the award applied to the payment of the debt. In other jurisdictions the mortgagee participates in the condemnation proceedings, and the award takes the place of the condemned land with the various liens formerly applicable to the land now attaching to the award. The liens are then paid according to their priorities, with any residue representing the mortgagor's share. In the case of partial takings, various solutions have been reached. See generally 1 ORGEL, *op. cit. supra* at 485-502.

A mortgagee is not an "owner" within the meaning of FLA. STAT. §§ 73.11, 73.12 (1961), so as to be entitled to an attorney's fee when the property is condemned. Shavers v. Duval County, 73 So.2d 684 (Fla. 1954). When all of the mortgaged land is taken, the mortgagee is entitled to so much of the award as is necessary to satisfy the mortgage debt. Seaboard All-Florida Ry. v. Leavitt, 105 Fla. 600, 141 So. 886 (1932) (dictum).

The holders of security interests other than mortgages are treated substantially the same as mortgage holders, but some procedural differences may arise. 1 ORGEL, *op. cit. supra* at 502-06.

The holder of a possibility of reverter or right of re-entry is generally not entitled to a portion of the award if the fee simple defeasible were not likely to terminate within a reasonably short period without regard to the condemnation. United Baptist Convention v. East Weare Baptist Church, 103 N.H. 521, 176 A.2d 325 (1961); RESTATEMENT, PROPERTY § 53, comment b (1936). *But see* Stoyles, *Condemnation of Future Interests,* 43 IOWA L. REV. 241 (1958); Note, 46 CORNELL L.Q. 631 (1961).

An advertising company was held not entitled to compensation for the loss of its right to place billboards on the condemned land since it had only a contract right and not a property right. Ohio Valley Advertising Corp. v. Linzell, 168 Ohio St. 259, 153 N.E.2d 773 (1958), *affirming* 107 Ohio App. 351, 152 N.E.2d 380 (1958), which categorized the relationship as licensor-licensee rather than lessor-lessee.

The holders of an executory interest were held entitled to compensation in Hemphill v. Mississippi State Highway Comm'n, 145 So.2d 455 (Miss. 1962).

10. Carlock v. United States, 53 F.2d 926 (D.C. Cir. 1931); American Oil Co. v. State Highway Bd., 122 Vt. 496, 177 A.2d 358 (1962); 4 NICHOLS, EMINENT DOMAIN § 12.36 [1] (1962); 1 ORGEL, VALUATION UNDER EMINENT DOMAIN § 109 (2d ed. 1953), both citing many cases; Part III *infra.*

methods commonly used to apportion the award in one situation of divided ownership, namely that of landlord and tenant, are delineated and appraised.

The ideal of just compensation has been aptly expressed by the United States Supreme Court as:

> the full and perfect equivalent in money of the property taken [whereby the owner is put] in as good a position pecuniarily as he would have occupied if his property had not been taken.[11]

Although the concept of just compensation is necessarily a flexible one, there is almost unanimous agreement that "fair market value" is an acceptable criterion in those cases where the property has a market value.[12] "Market value" as used by most courts means a competitive price established in a free market:

> It is nothing more or less than what the subject would sell for in the open market, exposed to all bidders in the regular course of trade and competition which ordinarily obtain with respect to their particular class of subject. Nothing short of an actual sale of a tract of land in the open market can fix definitely and certainly its market value. Until so sold, what it will bring in a fair and open market, is mere matter of opinion, and while divergence in view is in most cases to be expected, rarely, however, so marked as in the present case. Nevertheless, it is from these opinions, based upon the general selling price of land, however divergent, that the law seeks to arrive at an estimate that will serve the ends of practical justice.[13]

This criterion of market value is in general accord with the economic concept of a market price determined in a highly competitive market.

> Any price determined on a market is the necessary outgrowth of the interplay of the forces operating, that is, demand and supply. Whatever the market situation which generated this

11. United States v. Miller, 317 U.S. 369, 373 (1943).

12. State v. Richard, 135 So.2d 319 (La. App. 1961); 4 NICHOLS, *op. cit. supra* note 10, § 12.2 and cases cited therein.

13. Savings & Trust Co. v. Pennsylvania R.R., 229 Pa. 484, 487, 78 Atl. 1039 (1911).

Cf. the following definitions: "It is 'the highest price established in terms of money which the land would bring . . . in the open market, with reasonable time allowed in which to find a purchaser . . . .'" Buena Park School Dist. v. Metrin Corp., 176 Cal. App. 2d 255, 258, 1 Cal. Rptr. 250, 252 (1959), quoting Sacramento So. R.R. v. Helibron, 156 Cal. 408, 104 Pac. 979, 980 (1909).

"The market value means the fair value of the property as between one who wants to purchase and one who wants to sell, not what could be obtained for it under peculiar circumstances when a greater than its fair price could be obtained, nor its speculative value; not a value obtained from the necessities of another; nor, on the other hand, is it to be limited to that price which the property would bring when forced off at auction under the hammer. It is what it would bring at a fair public sale when one party wanted to sell and the other to buy." Kansas City, W. & N.W.R.R. v. Fisher, 49 Kan. 17, 18, 30 Pac. 111 (1892).

> price may be, with regard to it the price is always adequate, genuine, and real. It cannot be higher if no bidder ready to offer a higher price turns up, and it cannot be lower if no seller ready to deliver at a lower price turns up. Only the appearance of such people ready to buy or sell can alter prices.[14]

Further, the requirement that the "perfect equivalent in money" is market value has solved the enigma arising from the fact that value is a word of many meanings.[15] The truth of this statement has long been recognized by economists who have written extensively on such subjects as "value in use and value in exchange." In declaring "value in exchange," *i.e.*, market value, to be the desirable standard for computing a condemnation award, the courts have given legal sanction to two basic economic precepts: (1) Since money functions as a common denominator of all values, it is the only acceptable standard by which value can be objectively measured; (2) All values, other than market value, are subjective values and hence are not conducive to objective measurement.[16]

A court that utilizes the criterion of market value and recognizes that "nothing short of an actual sale of a tract of land in the open market can fix definitely and certainly its market value,"[17] demonstrates a remarkable insight into the phenomenon of market prices. Confirmation of this principle is readily found in the literature of the economist:

> Prices are a market phenomenon. They are generated by the market process and are the pith of the market economy. There is no such thing as prices outside the market. Prices cannot be constructed synthetically, as it were. They are the result of a certain constellation of market data, of actions and reactions of the members of society.[18]

B. *Criteria of Value*

Logically, there are three standards of valuation which might be applied to property taken under eminent domain:[19] (1) value to the condemnor; (2) value to the condemnee; and, (3) value to other persons as evidenced by market value. The courts have been almost unanimous in refusing as a test of damages the value to the condemnor,[20] but evi-

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14. VON MISES, HUMAN ACTION, A TREATISE ON ECONOMICS 393 (1949).

15. See generally JAHR, EMINENT DOMAIN 94-101 (1953).

16. MARSHALL, PRINCIPLES OF ECONOMICS 62-63 (8th ed. 1946). See also VON MISES, *op. cit. supra* note 14, at 215-18, DODD & HAILSTONES, ECONOMICS, PRINCIPLES AND APPLICATIONS 360-62 (4th ed. 1961); 19 ENCYCLOPEDIA AMERICANA 347 (1957 ed.).

17. See the quotation from Savings & Trust Co. v. Pennsylvania R.R., note 13 *supra*.

18. VON MISES, *op. cit. supra* note 14, at 392.

19. 4 NICHOLS, EMINENT DOMAIN § 12.1[5] (1962); 1 ORGEL, *op. cit. supra* note 10, at 73.

20. United States v. Chandler-Dunbar Water Power Co., 229 U.S. 53, 81 (1913); 4 NICHOLS, *op. cit. supra* note 19, § 12.21.

> Indeed the primary object of the power to condemn property for a public purpose would be defeated if this measure of compensation were adopted. . . . [This] is so

dence of this value may at times come in the "back door" and be considered as an element of fair market value.[21]

In ordinary situations, a value-to-the-taker standard would severely penalize the property owner, since, generally, the use of the property by the condemning authority would not be for its highest and best use. For example, when a home or business is taken for highway purposes, the condemning authority is interested only in the land, and the building improvement to the authority is not only worth very little, but may actually be a liability since it must be destroyed or moved. This theory of value to the taker has been advanced in only a few cases by property owners who hold barren or unproductive land.[22]

The "value to the owner" test has generally, at least until recent years, been rejected with few exceptions. The exceptions have included structures especially adapted to the use of the present owner—situations where the court has said that the properties had no market value. The best examples are churches, private schools and colleges, and unusually expensive residences.[23]

The fair market value standard, as previously stated,[24] is the basic and generally applied criterion of value in eminent domain proceedings. This has been variously defined, but generally may be stated as the willing buyer-willing seller test. This standard assumes that neither party is under compulsion to buy or sell, and that both are fully advised as to all relevant and material facts. The explanation of a California appellate court is more or less typical. Market value is:

> the highest price estimated in terms of money . . . which the land would bring if exposed for sale in the open market with reasonable time allowed in which to find a purchaser, buying with the knowledge of all the uses and purposes to which it was adapted and for which it is capable.[25]

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generally recognized that it cannot be considered open to argument. 1 ORGEL, *op. cit. supra* note 10, at 74.

21. "What is open to argument, however, is the contention that the owner of condemned property should be allowed some 'fair share' of its special value to the taker. . . ." 1 ORGEL, *op. cit. supra* note 10, at 74.

22. See Black, *Fair Market Value and Just Compensation,* TECHNICAL VALUATION 37 (Oct. 1960); 1 ORGEL, *op. cit. supra* note 10, at 355-59.

23. In Idaho-W. Ry. v. Columbia Synod, 20 Idaho, 568, 583, 119 Pac. 60, 65 (1911), the court stated: "Whenever the property is of such value and nature that it has no market value, its value 'for the uses and purposes to which it is devoted, and to which it is peculiarly adaptable,' may be shown."

The premise that churches or church property have no market value may be questioned. Certainly, a church would have some market value, even if only for use as a warehouse or, to be extreme, for the value of the land on which it is located. However, what the court probably had in mind was the fact that churches are not bought and sold often enough to set a fair market value standard, and that the market value for other uses would be so much less than its value for use as a church as to be shocking to the court's sense of justice. Thus, under such circumstances, the court will engraft an exception to the general rule without otherwise abandoning or overruling it. See also notes 34 and 100 *infra.*

24. See note 12 *supra* and accompanying text.

25. City of Los Angeles v. Deacon, 119 Cal. App. 491, 492-93, 7 P.2d 378 (1932).

The fair market value test has been modified in favor of the landowner by application of the "highest and best use" test, a typical explanation of which is:

> Just compensation includes all elements of value that inhere in the property, but it does not exceed market value fairly determined. The sum required to be paid to the owner does not depend upon the uses to which he has devoted his land but it is to be arrived at upon just consideration of all uses for which it is suitable. The highest and most profitable use for which the property is adaptable and needed or likely to be needed in the reasonably near future is to be considered not necessarily as the measure of value, but to the full extent that the prospect of demand for such use affects the market value while the property is privately held.[26]

Evidence of the highest and best use for which the property is situated necessarily means that the fair market value of the land condemned will not be determined solely in reference to the uses to which the land is currently applied. Consideration is to be given to all uses for which the land is available, including uses for which it is likely to be needed in the reasonably near future.[27] However, the courts have not as yet opened the door *carte blanche* to evidence of other uses to which the property might be put. Restrictions on the use of this kind of evidence are common.[28]

C. *Experts and Their Appraisal Techniques*

Expert witnesses as to the value of the land taken are either professional appraisers or dealers in real estate. These appraisers value real estate by three basic methods: (1) the market data approach, (2) the

26. Olson v. United States, 292 U.S. 246, 255 (1934).

27. McCandless v. United States, 298 U.S. 342 (1936); Olson v. United States, 292 U.S. 246 (1934); Karlson v. United States, 292 U.S. 246 (1934); Brewster v. United States, 292 U.S. 246 (1934); Cameron Dev. Co. v. United States, 145 F.2d 209 (5th Cir. 1944); Atlantic Coast Line R.R. v. United States, 132 F.2d 959 (5th Cir. 1943); Swift & Co. v. Housing Authority, 106 So.2d 616 (Fla. 2d Dist. 1958); Rothman v. Commonwealth, 406 Pa. 579, 178 A.2d 605 (Pa. 1962).

28. "To warrant admission of testimony as to the value for purposes other than that to which the land is being put, or to which its use is limited by ordinance at the time of the taking, the landowner must first show: (1) that the property is adaptable to the other use, (2) that it is reasonably probable that it will be put to the other use within the immediate future, or within a reasonable time, (3) that the market value of the land had been enhanced by the other use for which it is adaptable." Board of Comm'rs v. Tallahassee Bank & Trust Co., 100 So.2d 67, 69 (Fla. 1st Dist. 1958). See also City of Austin v. Cannizzo, 153 Tex. 324, 267 S.W.2d 808 (1954); Boom Co. v. Patterson, 98 U.S. 403 (1878); School Dist. No. 13 of Town of Huntington v. Wicks, 227 N.Y.S.2d 768 (Sup. Ct. 1962). See notes 41 and 43 *infra* and accompanying text.

Under the above limitations, evidence of increased value has been allowed to show what the property would be worth if it were zoned more realistically, or more in accordance with surrounding land and development. Board of Comm'rs v. Tallahassee Bank & Trust Co., *supra;* Swift & Co. v. Housing Authority, 106 So.2d 616 (Fla. 2d Dist. 1958); Long Beach City High School Dist. v. Stewart, 30 Cal. 2d 763, 185 P.2d 585 (1947); City of Austin v.

income approach and (3) the cost approach.[29] The market data approach is the one most frequently used, and the one given the greatest weight by both appraisers and the courts. Its preference is undoubtedly due to the fact that it most nearly corresponds to the legal concept of fair market value.

The market data approach is founded upon the economic principle of substitution, *i.e.*, "the value of a property tends to be set by the cost of acquisition of an equally desirable substitute property, assuming no costly delay is encountered in making the substitution."[30] Perhaps the simplest form of comparison in the valuation process is the substitution of one vacant lot for another. If, for example, a vacant lot recently sold for $5,000, and this lot is identical in all respects except location to the one being taken, and the location is similar, then a fair value for the condemned lot is $5,000.

The market data approach, however, does not have complete validity when it is applied to a combination of land and buildings, or what is otherwise described as improved property. Improved properties raise many problems in determining market price since seldom can two buildings be found that are of like construction, similarly environed, and perfect substitutes for each other.

In the absence of an absolute comparison the expert witnesses must state an opinion based upon market data. The principal weakness of this approach lies not in its theory but in its practice. It is the unfortunate tendency of the condemnee's witnesses to stretch high while the condemnor's equally competent experts stoop low as they state their opinions of market value.[31]

Cannizzo, *supra;* Hall v. City of West Des Moines, 245 Iowa 458, 62 N.W.2d 734 (1954); People v. Donovan, 57 Cal. 2d 346, 19 Cal. Rptr. 473, 369 P.2d 1 (1962).

Other probable changes which may increase value include the filling of unfilled land and the transformation of raw acreage into a subdivision. City of Los Angeles v. Hughes, 202 Cal. 731, 262 Pac. 737 (1927); Barnes v. North Carolina State Highway Comm'n, 250 N.C. 378, 109 S.E.2d 219 (1959); Rothman v. Commonwealth, 406 Pa. 579, 178 A.2d 605 (1962); Lower Nueces River Water Supply Dist. v. Collins, 357 S.W.2d 449 (Tex. Civ. App. 1962); State v. Barrilleaux, 139 So.2d 242 (La. App. 1962).

29. A discussion of each method combined with a typical example can be found in NORTH & RING, REAL ESTATE PRINCIPLES AND PRACTICES 374-75 (1961); Condist, *The Appraiser's Yardsticks*, AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, SELECTED READING IN REAL ESTATE APPRAISAL 215 (1953); Allison, *The Three Approaches To Value*, SOUTHWESTERN LEGAL FOUNDATION, THIRD ANNUAL INSTITUTE ON EMINENT DOMAIN 181 (1961).

A comparison of results using the three methods in the appraisal of residential property can be found in State v. Fridge, 135 So.2d 325 (La. App. 1961).

30. Schmutz, *Evolution of the Interpretation of Appraisal Principles*, AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, SELECTED READINGS IN REAL ESTATE APPRAISAL 169, 175 (1953). That a comparison of recent sales in the same area is the best method of determining value, see Mississippi River Bridge Authority v. Gwin, 138 So.2d 175 (La. App. 1962).

31. See the excerpt from Savings & Trust Co. v. Pennsylvania R.R. reprinted in text accompanying note 13 *supra*. Many examples of extremely wide divergencies in the estimates of the appraisers can be found in Note, *Eminent Domain Valuations in An Age of Redevelopment: Incidental Losses*, 67 YALE L.J. 61, 73 (1957).

The income approach as a theory of appraising value utilizes the concept of capitalized income as the value of the property. It emerges from the theory that buyers and sellers of income-producing assets consider income a yardstick by which value is measured. The process is sometimes referred to as "capitalizing expected future income," which is in effect simply a process of determining the current value on the basis of a going rate of interest. An income of $5,000 per year is worth $100,000 when the normal going rate of interest is five per cent. A more detailed analysis of this approach is discussed later in connection with the valuation of leasehold estates.

The cost approach is computed in three stages: (1) estimating the value of the land as if vacant; (2) estimating the current reproduction cost of the existing improvements and deducting any accrued depreciation; (3) then adding the value of the land to the depreciated cost of the improvement.[32]

Three types of costs may have significance: original cost, reproduction cost and replacement cost. The original cost in this context probably means the amounts spent by the present owner. It is rarely if ever used as a test of value. Reproduction cost is the cost of reproducing the exact improvement that is on the land; while replacement cost is the cost of replacing the improvement with one of a similar but not identical structure. As a practical matter, replacement rather than reproduction would be the more likely procedure in the event of a fortuitous loss of a building except in those rare instances where the building was very new and extremely functional. Where the issue arises, the courts are more likely to talk in terms of reproduction cost, although replacement ideas are also present in that allowances are made for depreciation and obsolescence.[33]

It is fundamental, from a standpoint of law as well as economics, that improvements are valuable only when they enhance the market value of the property. For example, a motion picture theatre of a highly ornate

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32. Allison, *The Three Approaches To Value, op. cit. supra note* 29, at 183.

33. 4 NICHOLS, *op. cit. supra* note 19, § 12.313[1]; JAHR, EMINENT DOMAIN 241-43 (2d ed. 1953).

The secondary role of cost as an element of value in condemnation cases is illustrated by the following:

> They [meaning the appraisers] relied largely upon reproduction costs calculated on a rule of thumb cubic footage basis, less depreciation. The testimony of one appraiser, especially, would have led the jury to believe this is a formula for arriving at the fair market value. This is not so. While the jury could be informed by the witness of these calculations in explanation of the process by which he arrived at his opinion of fair market value, the calculations are not themselves evidence of fair market value for this type of property. There is no necessary relationship between reproduction cost and market value. Cost of reproduction is a method of valuation usually resorted to "where the character of the property is such as not to be susceptible to the application of the market value doctrine."

Riley v. District of Columbia Redevelopment Land Agency, 246 F.2d 641, 644 (D.C. Cir. 1957). See also note 34 *infra*.

design built in 1920 would cost a tremendous amount of money to reproduce in 1963, but the market value of the property would hardly be enhanced by such a structure. If such a building were duplicated in 1962, the owner would be incorporating into the improvement a considerable amount of functional obsolescence which could never be recovered in a current market.

Thus costs, including each type of costs mentioned above, are not as a rule either singularly or collectively used to determine value. The test is market value and evidence of costs where applicable is used only as an aid to that determination. The award must be based on the value of the land as affected or enhanced by the improvement.[34] Thus, obsolescence and the utility of the building must be considered in arriving at value of the improved land. One of the objections to using reproduction costs as a basis for the award is that the technique invariably leads to an excessive award unless it is adequately discounted for obsolescence, inadequacy and physical depreciation.[35]

D. *Excluded Elements of Value*

Although the courts are solicitous of the landowner, they normally exclude certain elements of value. These exclusions are based on sound economic reasons in that the proffered elements have only remote, speculative or inconsequential probative utility in reaching the standard of fair market value. Five of the elements which are excluded, except in unique cases, are business profits, assessed valuation, special value to the owner, speculative uses of the property, and inability to find a new business location.

The courts have made a distinction between income from rent and income from conducting a business on the property. While income from rentals is accepted[36] as evidence of market value, profits are normally rejected.[37] The reason for excluding profits is that the amount of profits

34. 4 NICHOLS, *op. cit. supra* note 19, § 13.313. Of course, where the land is not regarded as having a market value, then reproduction costs or other criteria may be employed to determine its value. See Good Shepherd Lutheran Church v. State Road Dep't, 138 So.2d 358 (Fla. 3d Dist. 1962), allowing reproduction cost in the valuation of a church. Additional cases may be found in note 100 *infra*.

35. A suggestion has been advanced that evidence of reproduction cost should be admitted, but that it should be regarded as setting the upper limit upon a valuation derived by any other method, save in those rare instances where the owner of the property can produce satisfactory proof that a higher value of combined land and structure is warranted. It has also been suggested that structural cost should be recognized as an inferior measure of value, to be given weight only where more satisfactory evidence based on actual sales or earning power is not available, and whenever reproduction cost is offered as evidence, the court should make every effort to assure a full deduction for those elusive forms of depreciation, obsolescence and inadequacy that are so often disregarded by all but the most careful appraisers. 2 ORGEL, VALUATION UNDER EMINENT DOMAIN 57 (2d ed. 1953).

36. Armory v. Commonwealth, 321 Mass. 240, 72 N.E.2d 549 (1947); State v. Cerruti, 188 Ore. 103, 214 P.2d 346 (1950).

37. Assessors of Quincy v. Boston Consol. Gas Co., 309 Mass. 60, 34 N.E.2d 623

depends on many intangibles such as the general level of business activity and the skill and ability of the management.

Because undervaluation of property by tax assessors is rather common, it is generally the condemnor who attempts to present assessed valuation as a criteria of value. The courts have been almost unanimous in rejecting this evidence[38] because assessed values are fixed by tax agents whose function is purely administrative and whose evidence is assembled without a hearing.

Sentimental value or special value to the owner is intrinsic value, which is not an acceptable basis for the determination of market value.[39] The courts have accepted the economic doctrine that it is impossible to determine an objective market price based on purely subjective reasoning such as sentimental value.[40]

Evidence of speculative or imaginative use of the property is normally excluded.[41] A federal district court in Alabama is more or less typical in its statement of the reason for rejecting this evidence.

> In considering the measure of damages or compensation to be paid for said lands, possible, probable or imaginary uses are not to be considered. Such uses would be remote and speculative.[42]

It may be noted, however, that although evidence of imaginative or speculative use is not admitted, evidence of the property's suitability and

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(1941); Mississippi State Highway Comm'n v. Ladner, 137 So.2d 791 (Miss. 1962). Sparkhill Realty Corp. v. State, 268 N.Y. 192, 197 N.E. 192 (1935).

In Meyers v. City of Daytona Beach, 158 Fla. 859, 30 So.2d 354 (1947), however, the operator of a service station was allowed his business profits of $600 per month while his station was being reconstructed and returned to operation.

38. Bergen County Sewer Authority v. Borough of Little Ferry, 15 N.J. Super. 43, 83 A.2d 4 (1951); Myers v. Daytona Beach, *supra* note 37; United States v. Certain Parcels of Land, 261 F.2d 287 (4th Cir. 1958). *Contra*, Garabedian v. City of Worcester, 338 Mass. 48, 153 N.E.2d 622 (1958).

39. *In re* Edward J. Jeffries Homes Housing Project, 306 Mich. 638, 11 N.W.2d 272 (1943); *In re* Condemnation by City of Greensboro, 252 N.C. 765, 114 S.E.2d 635 (1960); Cane Belt Ry. v. Hughes, 31 Tex. Civ. App. 565, 72 S.W. 1020 (1903).

See, however, note 23 *supra* as to property which has no established market value.

40. See text accompanying notes 16 *supra*; State v. Schlick, 142 Tex. 410, 179 S.W.2d 246 (1944).

41. Coral-Glade Co. v. Board of Public Instruction, 122 So.2d 587 (Fla. 3d Dist. 1960); Tigar v. Mystic River Bridge Authority, 329 Mass. 514, 109 N.E.2d 148 (1952); Northern Natural Gas Co. v. Johnson, 278 S.W.2d 410 (Tex. Civ. App. 1954); Santa Clara County Flood Control & Water Conservation Dist. v. Freitas, 177 Cal. App. 2d 264, 2 Cal. Rptr. 129 (1960); School Dist. No. 13 v. Wicks, 227 N.Y.S.2d 768 (Sup. Ct. 1962) (value based on possible zoning change too remote or speculative but value based on special exception to permit partial business use admissible); Peoples Gas Light & Coke Co. v. Buckles, 24 Ill. 2d 520, 182 N.E.2d 169 (1962); People v. Johnson, 22 Cal. Rptr. 149 (Cal. App. 1962); People *ex rel.* State Park Comm'n v. Johnson, ——— Cal. App. 2d ———, 22 Cal. Rptr. 149 (1962).

42. United States v. First Nat'l Bank, 250 Fed. 299, 302 (M.D. Ala. 1918).

potential for more valuable utilization is allowable on the question of the highest and best use.[43]

The inability to find a new business location is not acceptable as a measure of damages.[44] Market value implies as a necessary concomitant the value of a similar property in the market. If the owner receives the market value of the property taken, he can theoretically, at any rate, replace that property with a similar piece of property at the same price.

E. *Fair Market Value; Appraisal*

The fair market value standard works well in many, perhaps in most cases. It is flexible, functional, very easy to comprehend, and generally fair. However, there is no reason to believe that it will always be applied in the same manner, or that changing circumstances may not warrant modifications.

Already fair market value has been enlarged to include evidence of the highest and best use, even to the extent, in some circumstances, of permitting evidence of increased value were a change in zoning to take place. Cases of particular hardship may result in making fair market value the sole criterion inadequate.[45]

Occasionally, particular statutes provide for additional items of compensation. For example, under the Federal Urban Renewal Law,[46] moving costs up to a certain amount are allowed owners of both condemned houses and businesses. New York allows moving costs for displaced tenants up to a maximum of $500 for businesses when land is condemned for Public Housing projects.[47] Florida has a damage-to-business statute,[48] but it is of limited application. The courts also occa-

43. See notes 26 and 28 *supra*.

44. Mitchell v. United States, 267 U.S. 341 (1925).

45. In LIFE, June 20, 1960, at 49, there appeared a story concerning a valley to be flooded as part of a reservoir for a flood control dam. A town of 3,000 people was to be destroyed, and those people had to be moved and relocated. Included in the article was the following: "The cost of resettling and the beginning of new lives came high. New property usually costs more than the fees awarded for the old. It was a sad wrench, especially for the old people." Allowance for resettlement costs in many instances might be warranted.

See Note, *Eminent Domain Valuations in an Age of Redevelopment: Incidental Losses*, 67 YALE L.J. 61, 74 (1957) for a pointed criticism of the market value approach. "Despite this black-letter approach, courts, either by stretching the market value standard or by frankly admitting that its strict application would be unjust, have often granted compensation for incidentals to avoid an otherwise unconscionable award. As a result, the standard in practice operates unequally, with some condemnees fully indemnified while many others are forced to bear considerable losses. Thus, although these judicial techniques may produce desirable results when utilized, they do not operate to effect a uniform system for compensation of incidential losses. Rather, as instances of departure from the market value standard, they cast further doubt on the wisdom of maintaining that formula as a barrier to compensating such losses."

46. 42 U.S.C.A. § 1456(f)(2) (1962 Supp.).

47. N.Y. PUB. HOUSING LAW § 153, para. 1 (McKinney's 1962 Supp.). This statute limits the amount in the case of families to a maximum of $200.00.

48. FLA. STAT. § 73.10(4) (1961):

sionally step beyond the bounds of fair market value and permit the consideration of other elements.[49]

Thus it may be expected that the concept of fair market value will expand or contract as the equities of the situation demand in the light of evolving moral and ethical standards. The concept is in itself a satisfactory standard in many cases, and it serves as a focal point in others where deviations may be justified because of particular fact situations. It generally conforms to sound economic principles, and the courts have achieved a pragmatic harmony of economic and legal theory in the administration of condemnation litigation.

III. THE ENCUMBERED OR DIVIDED FEE: APPORTIONMENT

A. *General Considerations*

When the ownership of condemned land is split or fractionalized among two or more persons, the undivided fee rule is generally followed

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A condemnation suit being an action in rem, in such a suit by the state road department, county, municipality, board, district, or other public body for the condemnation of a road rights-of-way, borrow pits or drainage easements or other rights-of-way the condemnation jury shall determine solely the amount of compensation to be awarded for the property taken and damages to the remaining property, if any. Provided, however, that when the suit is by the state road department, county, municipality, board, district or other public body for the condemnation of a right-of-way, and the effect of the taking of the property involved may damage or destroy an established business of more than five years standing, owned by the party whose lands being so taken, located upon adjoining lands owned or held by such party, the jury shall consider the probable effect the denial of the use of the property so taken may have upon the said business, and assess in addition to the amount to be awarded for the taking, the probable damages to such business which the denial of the use of the property so taken may reasonably cause; any person claiming the right to recover such special damages shall set forth in his answer the nature and extent of such damages.

The statute was applied in Guarria v. State Road Dep't, 117 So.2d 5 (Fla. 3d Dist. 1960), and in Hooper v. State Road Dep't, 105 So.2d 515 (Fla. 2d Dist. 1958), the former denying recovery for damage to business where the business property was taken in its entirety, and the latter permitting such recovery where the business had been in existence for more than five years but the then owner had operated it only for about a year at the time of condemnation.

49. *I further charge you gentlemen, that the constitutional provision as to just and adequate compensation does not necessarily restrict the lessee's recovery to market value. The lessee is entitled to just and adequate compensation for his property; that is, the value of the property to him, not its value to the Housing Authority.* The measure of damages for property taken by eminent domain, being compensatory in its nature, is the loss sustained by the owner, taking into consideration all the relevant factors.

Housing Authority v. Savannah Iron & Wire Works, Inc., 91 Ga. App. 881, 884, 87 S.E.2d 671, 675 (1955).

We feel our constitutional provision for full compensation requires that the courts determine the value of the property by taking into account all facts and circumstances which bear a reasonable relationship to the loss occasioned the owner by virtue of the taking of his property under the right of eminent domain. . . . Although fair market value is an important element in the compensation formula, it is not an exclusive standard in this jurisdiction. Fair market value is merely a tool to assist us in determining what is full or just compensation within the purview of our constitutional requirement.

Jacksonville Expressway Authority v. Henry G. Du Pree Co., 108 So.2d 289, 291 (Fla. 1959), allowing moving costs to the owner.

in determining the value of the land taken.[50] The theory behind this rule is that the land itself is taken and not the separate interests of different persons in the land. Compensation is thus awarded for the land itself, not for the sum of the different interests therein.[51] This procedure makes for speedy condemnation and precision in forecasting the probable cost of acquisition.

To the undivided fee rule, however, there are exceptions. The most common exception is the case of land burdened with easements. In many cases land burdened with easements, as for light, air, ingress and egress, is worth considerably less than the same land if unencumbered.[52] Freedom of use is greatly restricted by the presence of the easements and the market value greatly lessened. Further, the easements themselves generally have no market apart from the dominant tenement to which they are attached, and if the land is taken for highway or similar purposes, the former easement holder is often damaged in no way whatsoever. Thus, in these and similar cases, the courts have refused to follow the usual formula and have held that account must be taken of the state of title, and the compensation must be assessed on the basis of the valuation of the separate interests in the property.[53] This means that the amount that must be paid by the condemning authority is usually considerably less than what would have to be paid if the land were valued as an unencumbered fee.

Initially and as an abstract proposition, the question as to whether the sum of the values of the separate interests must be equivalent to the value of the unencumbered fee is interesting and complex. Prima facie, it might seem that the answer should be a resounding yes, that the total of the separate interests must equal the value of the whole. The case of

50. *In re* Mackie's Petition, 115 N.W.2d 90 (Mich. 1962); State *ex rel.* Kafka v. District Court, 128 Minn. 432, 151 N.W. 144 (1915); 4 NICHOLS, EMINENT DOMAIN § 12.36[1] (1962), and cases cited therein.

51. People v. S. & E. Homebuilders, Inc., 142 Cal. App. 2d 105, 298 P.2d 53 (1956); Cravero v. Florida State Turnpike Authority, 91 So.2d 312 (Fla. 1956); City of Ashland v. Price, 318 S.W.2d 861 (Ky. 1958); State v. Anderson, 176 Minn. 525, 223 N.W. 923 (1929); St. Louis v. Rossi, 333 Mo. 1092,, 64 S.W.2d 600 (1933); Reckson, *Lessee's Right To Jury Trial In Eminent Domain*, 16 U. MIAMI L. REV. 102, 106 (1961).

52. JAHR, EMINENT DOMAIN 169 (1953); 1 ORGEL, VALUATION UNDER EMINENT DOMAIN § 107 (2d ed. 1953).

53. First Parish in Woburn v. Middlesex County, 73 Mass. (7 Gray) 106 (1856) (condemnation for highway purposes of land held by town for only parochial purposes and which was used for a meeting house); Boston Chamber of Commerce v. Boston, 217 U.S. 189 (1910), *affirming* 195 Mass. 338, 81 N.E. 244 (1907) (taking of a fee, a private way, subject to easements of light, air and way for use as a public street); United States v. Gould, 301 F.2d 353 (5th Cir. 1962) (indicating that owner of fee underlying dedicated streets or "streets" burdened with private easements of access if dedication not complete would be entitled to only nominal damages); *In re* 106th Ave. N.E., 370 P.2d 861 (Wash. 1962) (landowner entitled to only nominal damages when private street transformed into public street); Rogers v. State Roads Comm'n, 177 A.2d 850 (Md. 1962) (restrictive covenant against commercial purposes considered in valuation). See also 1 ORGEL, *op. cit. supra* note 52, § 111.

the land encumbered with easements has already been noted. Obviously, the land free of easements may be worth considerably more than the land so burdened. And it does not follow that the value of the easements to their respective holders is necessarily equivalent to the loss in value of the encumbered land. Many instances may be conceived where the value to an easement holder may be relatively light, but at the same time the easement may lessen considerably the value of the burdened fee.[54]

Likewise, in the condemnation of real estate to which there is an appurtenant easement, the land and the easement should be valued separately and the results added.[55] The appurtenant easement is a separate property right which is being taken in addition to the fee. The fee is enhanced by the existence of the easement, and the owner should be compensated for both interests when the two are taken from him. In case the various ownership interests in the land are other than easements, the general effect on market value is not so clear. For example, a lessor's interest might be either enhanced or diminished by the existence of a particularly favorable or unfavorable lease, or by the lessee being either a very valuable tenant with considerable know-how and resources or by being just the opposite.

The general use of the undivided fee rule may be easily misunderstood. At first glance it lends some credence to the criticism:

> Courts have frequently displayed a keen desire to oversimplify the process of valuation in eminent domain. It is far easier, and makes for greater expedition of a case to value property as unencumbered. If ownership is divided, it is simpler to consider the fee value and then appropriate that value according to the respective interests in the entire property.[56]

In practice the undivided fee rule often works to the advantage of the landowner. The rule is sound from an economic viewpoint in that it permits consideration of all relevant factors contributing to the value of the realty. Conversely, however, it disregards many existing factors which tend to diminish the value of the property taken.[57] Thus, in many

54. This would be particularly true in the case of private "street easements" if the condemnation were for the purpose of converting them into public streets. See note 53 *supra.* Also an easement of way, for example, could have been created across one parcel for the benefit of another at a time when it was the only practical way of access, but the construction of a new public road on the other side of the dominant tenement could render the easement of slight value to the dominant estate but at the same time lessen considerably the value of the servient estate.

55. United States v. Welch, 217 U.S. 333 (1910); Town of Stamford v. Vuono, 108 Conn. 359, 143 Atl. 245 (1928); *In re* West Tenth St., 267 N.Y. 212, 196 N.E. 30 (1935).

56. JAHR, *op. cit. supra* note 52, at 172.

57. For example, consideration of the highest and best use tends to minimize the present use being made of the land. It also tends to minimize the effect of restrictive covenants or present zoning regulations which may preclude or impede further development of the land. See notes 27, 28 *supra.* See also text immediately following this footnote for an example of how an outstanding lease may adversely effect present values.

cases it will be found that the value of the unencumbered fee will be greater than the total value of the separate interests. This may be illustrated by consideration of a hypothetical case of realty subject to a leasehold.

We may assume, for purposes of illustration, that a lease has a long period before expiration, and that it contains many restrictive clauses. Under these circumstances the lessee has little opportunity to exploit fully the potential productivity of the land, and the value of the leasehold interest is therefore relatively low. Similarly, the landlord can not utilize the land for the highest and best use because the privilege of user, although restricted by the lease, belongs to the tenant. While the landlord may enjoy the rental income, this income may be substantially less than the property is capable of earning. Thus, both the lessor and the lessee suffer.

In such a situation, it seems obvious that the sum total of the two separate interests will be less than the "fair market value" as an unencumbered fee. The determination of a condemnation award by ascertaining the value of the lease, as evidenced by what it would sell for in the open market, and then adding the value of the lessor's interest similarly determined, would result in a relatively low total value. On the other hand, valuation based on the highest and most profitable use for which the land might reasonably be suitable if it were free from all encumbrances, would result in a considerably higher award. It thus appears that at this state of the condemnation proceedings there frequently is a certain amount of surplus awarded above the actual market value of the respective interests in the land. It is the division of this award, and hence of the surplus, among the holders of the respective interests that creates an economic and legal problem of considerable magnitude which has not been fully realized by the courts.

Most courts, in applying the unencumbered fee rule, consider that the award is substituted for the land, and that the various claimants should share in proportion to the damage suffered by them.[58] Most courts disregard the possibility that the award might be more or less than the sum total of the respective interests. Insofar as the award is more or less than the total of the interests, it would appear that the overage or shortage should be shared by the respective owners in proportion to the value of their respective interests.

B. *"Contract Rent" and "Economic Rent"*

In determining the value of the respective interests of the landlord and tenant, a brief consideration of "rent" is desirable. The word "rent"

58. Cravero v. Florida State Turnpike Authority, 91 So.2d 312 (Fla. 1956); Kafka v. Davidson, 135 Minn. 389, 160 N.W. 1021 (1917); Wilkins v. Oken, 157 Cal. App. 2d 603, 321 P.2d 876 (1958).

as ordinarily used refers to the payment of a stipulated sum of money at stated intervals of time for the use of some form of property. Since this form of payment is usually arranged by contract it is more accurate to refer to it as "contract rent." This use, however, is not sufficiently precise for the purpose of economic analysis. Economists have, therefore, refined the term "rent" to have a more specific meaning. "Economic rent" is a form of income distinct from wages, interest and profits. It may be defined as that share of the productivity, or its monetary value, which may be attributed to the land because of its contribution when land, labor, capital and management are combined in a productive effort.[59]

The over-all supply of land is fixed; consequently, rent depends on the demand for land. The demand for land is influenced in turn by the productivity of a particular plot of land. This productivity is determined by both fertility and location. In agricultural areas both fertility and location determine rent. If two equal size plots of land will produce different yields of grain with the same costs of production, and are so situated that they have equal costs of transportation to the market, all other things being equal, the land with the highest yield will have a higher economic rent. This is measured by the differences in net income produced by the two plots of land.

In urban areas, land rent arises because of location. Desirable offices in the heart of a financial district or apartments overlooking a river are examples of locations which may allow high prices. However, high rents do not necessarily result because the user may attempt to charge high prices. They are the result of the ability of the land, due to its location, to do a greater volume of business at a given price. A package of cigarettes costs no more at high rent spots in a large city than at low rent locations in a rural area. The high rent is caused by the productivity of the land due to its particular location.[60]

A potential buyer or a lessee of a piece of real estate attempts to estimate the economic rent of the land the use of which he is contemplating. It is upon the basis of this estimate that he offers a bid for either a lease or outright purchase of the property.

Hence, it is the economic rent that causes one location to command a high contract rent and another a low contract rent. It is axiomatic that a tenant will wish to pay as low a contract rent as possible, while the landlord will seek a high rent. If at the execution of the lease, both the lessor and the lessee have adequate knowledge of the potential produc-

59. See generally DODD & HAILSTONES, ECONOMICS, PRINCIPLES AND APPLICATIONS 279-280 (4th ed. 1961); AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, SELECTED READINGS IN REAL ESTATE APPRAISAL 55, 88-90, 253 (1953).

60. DODD & HAILSTONES, *op. cit. supra* note 59, at 281-89; AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, *op. cit. supra* note 59, at 159.

tivity of the site, the equitable "contract" rent should be identical or in close approximation to the "economic" rent![61]

However, circumstances change, and over the life of a long-term lease there is likely to be a difference between economic rent and contract rent. If the contract rent is greater than the monetary value of the productivity of the land—economic rent—the landlord gains an unearned income. Conversely, if the economic rent increases the tenant enjoys the surplus. This difference between the contract rent and the economic rent is frequently referred to by appraisers of real estate as the lessee's "bonus value" in the lease.[62]

Both the economic and contractual nature of rent have been recognized by the courts. The following are illustrations:

> [The word] "rent" as a noun is defined: "A profit out of land and tenements;" . . . as a verb, "to grant the right to occupy lands, paying a certain sum therefor," [and also means] "A certain profit in money, provisions, chattels or labor issuing out of lands and tenements, in retribution for use," . . . rent somewhat resembles an annuity. Their difference consists in the fact that the former issues out of land and the latter is a mere personal charge.[63]
>
> Rent is an incorporeal hereditament. It is a certain profit issuing yearly out of lands and tenements.[64]
>
> The term "rent" is used in different senses. In its largest signification it may mean all the profit issuing yearly out of lands, in return for their use.[65]
>
> Rent is a sum stipulated to be paid for the actual use and enjoyment of another's land . . . the occupation of the land is consideration for the rent.[66]

Thus, generally, the legal and economic concepts of rent harmonize. Contract rent, from both the legal and economic viewpoints, represents a payment which arises ultimately out of productivity of the land.

C. *Effect of Condemnation*

The effect of condemnation on the leasehold estate, in the absence of an express provision in the lease, varies accordingly as to whether

61. See generally Thorson, *Contract vs. Economic Rent*, I & II, AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, *op. cit. supra* note 59, at 1197-1228.

62. Sando, *Appraisal of Leasehold Interests*, SOUTHWESTERN LEGAL FOUNDATION, THIRD ANNUAL INSTITUTE ON EMINENT DOMAIN 79, 85, 92-94 (1961); McMichael, *Appraising Leasehold Estates*, AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, SELECTED READINGS IN REAL ESTATE APPRAISAL 1188, 1192 (1953); Continuing Education of the Bar, *California Condemnation Practice* 84 (1960).

63. Cox v. Snyder, 241 Ill. App. 471, 474 (1926).

64. Brown v. Brown, 33 N.J. Eq. (6 Stew.) 650, 659 (1881).

65. Schuricht v. Broadwell, 4 Mo. App. 160, 161 (1877).

66. Cooper v. Cesco Mercantile Trust Co., 134 Me. 372, 378, 186 Atl. 885, 888 (1936).

there is an entire or partial taking of the land subject to the leasehold. When there is an entire taking, the lessee's estate is terminated and his obligation to pay rent ceases.[67] When there is a partial taking, the lease is not cancelled under the majority rule, and the lessee's obligation to pay rent continues.[68] When this latter situation results, the lessee is compensated by an award of the present value of the rent with respect to the part of the real estate taken for the remainder of the term. He is thus compensated for his loss of the use of a part of the property; hence he has been made whole, and his obligation under the contract remains in force.

In this paper attention is confined to the rights of the landlord and tenant where there has been a complete taking of the leased property. The rights of the parties to the award are frequently complicated by the existence of improvements, which may have been erected by the lessee, and which may or may not by contract belong to the lessee at the termination of the lease. If the improvements are substantial, they normally inure to the landlord at the termination of the lease. Apportionment must be made between the landlord and tenant according to their respective interests in both the land and the improvements.[69]

D. *Theory of Apportionment*

The theory of a fair apportionment of the condemnation award between landlord and tenant, when there has been a taking of the entire property, will be considered in the remaining sections of this paper. Disregarding the amount representing the value of the improvements,[70] there still remains a difficult problem of apportioning the award. As previously noted,[71] the condemnation of the whole parcel terminates the lease and relieves the tenant from the further obligation of paying rent. Thus, theoretically, if the fair rental value of the premises is equivalent to the contract rental which the lessee was obligated to pay the landlord, the lessee should receive no part of the award. The market value of his lease was equivalent to his rental obligations, which have been cancelled, and therefore he is amply compensated for the loss of his leasehold.[72]

If, however, the use of the land which the lessee has purchased is

67. 2 POWELL, REAL PROPERTY, 287 (1950).

68. *Id.* at 288. The author criticizes this majority rule and contends that proportionate reduction in rent would be more businesslike. Condemnation clauses are now rather common, providing that upon a taking by eminent domain, whether partial or complete, the term shall come to an end. 4 NICHOLS, *op. cit. supra* note 50, at 300.

69. See generally JAHR, *op. cit. supra* note 52, at 190-98; note 70 *infra*.

70. See generally Hitchings, *The Valuation of Leasehold Interests and Some Elements of Damage Thereto,* SOUTHWESTERN LEGAL FOUNDATION, SECOND ANNUAL INSTITUTE ON EMINENT DOMAIN 61, 66 (1960); Note, *Methods of Establishing "Just Compensation" In Eminent Domain Proceedings in Illinois,* LAW FORUM 289, 304-05 (1957); 2 ORGEL, VALUATION UNDER EMINENT DOMAIN 6, 7 (1953); JAHR, *op. cit. supra* note 52, at 195-98.

71. See text accompanying note 67 *supra*.

72. Sando, *supra* note 62, at 84, 85; 4 NICHOLS, *op. cit. supra* note 50, at 316.

contributing a surplus to his enterprise over and above its cost to him, he has not been made whole by simply removing his obligation to pay rent. In terms of economic analysis, if his "contract" rent is less than the "economic" rent of the land, he has incurred an actual loss. The loss is equal to the difference between the two.[73] Legal and economic concepts are in general agreement on this point. The measure of damages suffered by a lessee when a leasehold estate is terminated under the law of eminent domain is the difference in value between the market value of the leasehold and the amount (contract rent) which the lessee is obligated to pay. The following excerpts are typical:

> The measure of damages, in determining just compensation to which the lessor is entitled upon condemnation of leasehold, is the difference between value of the use and occupancy of the leasehold for the remainder of the tenant's term . . . less the agreed rent which the tenant would pay for such use and occupancy.[74]
>
> The correct measure of damages to a tenant on the taking of his leasehold interest by condemnation is the market value of the use and occupancy of the leasehold for the remainder of the tenant's term minus the agreed rent which the tenant would pay for such use and occupancy.[75]
>
> The measure of a lessee's damages for the condemnation of his leasehold interest is said to be the market value of the leasehold condemned, that is, the difference between the rental value of the remainder of the term and the rent reserved in the lease or the actual value of the leasehold when there is no market value.[76]

The concept of economic rent is readily found in the literature describing the philosophy and content of the law relative to eminent domain in such sources as appraisal journals and accepted textbooks on appraisal of real estate.[77] The concept, however, generally lacks a basis in statute law and judicial decisions. Although the implications of the term are abundant, the actual reference to economic rent is seldom found in strictly legal pronouncements.[78]

The avoidance of the term "economic" rent in statutory and judicial pronouncements is not surprising. The precise measurement of economic

73. *In re* Mott Haven Houses, Borough of Bronx, 33 Misc. 2d 808, 227 N.Y.S.2d 858 (Sup. Ct. 1960); 4 NICHOLS, *op. cit. supra* note 50, at 417; Sando, *supra* note 62, at 84, 85; 2 POWELL, *op. cit. supra* note 67, at 287.

74. John Hancock Mut. Life Ins. Co. v. United States, 155 F.2d 977, 978 (1st Cir. 1946).

75. United States v. Advertising Checking Bureau, 204 F.2d 770, 772 (7th Cir. 1953).

76. Pierson v. H. R. Leonard Furniture Co., 268 Mich. 507, 521, 256 N.W. 529, 533 (1934).

77. See, *e.g.*, references in notes 59-61 *supra;* Hitchings, *supra* note 70, at 66.

78. The term is used in Rossi v. State, 31 Misc. 2d 205, 223 N.Y.S.2d 139 (Ct. Cl. 1961); Ballantyne Co. v. City of Omaha, 173 Neb. 229, 113 N.W.2d 486 (1962).

rent has long perplexed the academic economist. Within a classroom, using a hypothetical model and carefully defining each and every assumption, it is theoretically possible. To measure economic rent as it contributes to the profit of an actual business concern is much more difficult. There is no practical way of isolating the actual productivity which is directly attributable to the land separately from the other elements of production.

The legal profession, and largely without the aid of academic economists, has arrived at a practical solution for the determination of economic rent. Further, the determination is in accord with sound economic theory. The solution of the law is the concept of fair rental value as an imputed measure of economic rent. By adjudication, fair rental value has become the market value of the lease.[79] This in turn becomes the price determined by a willing buyer and a willing seller through the impartial workings of a free and competitive market.

The legal concept of "fair market value" is economically sound. It is based on the valid assumption that in a competitive market the true value of a piece of property can be accurately determined. This value will be the amount of money prudent business men will pay for the use of a piece of land. While there will be a range of prices offered for the use of a particular piece of property, no prudent and competent businessman will offer to pay a greater rent for property than "the land will support." If these offers are the result of competitive bidding by business men who are willing to risk their capital and productive ventures of varied types, there should be a close approximation of their bids to economic rent based upon the "highest and best use" of the land. The lower amounts will be offered by enterprises which are not as suitable for this location as are those which offer the higher rents.

Sales of leases on comparable plots of ground in the past, and new leases which have been negotiated on land of similar location, are a consensus of many businessmen regarding the value of the inherent qualities of the land. If the contract were negotiated by buyers and sellers of equal ability and bargaining power, then the selling price of the leases, the "contract" rent, will be a close approximation of the "economic" rent. When the current "contract" rent on a similar piece of property is higher than the "contract" rent stipulated in the lease on the condemned property, the difference in the two amounts can be measured. The magnitude

79. See Orange State Oil Co. v. Jacksonville Expressway Authority, 110 So.2d 687 (Fla. 1st Dist. 1959), recognizing the validity of the text statement but reversing the trial court because fair market value is not an exclusive standard in Florida, and approving the "summation" [see note 84 *infra*] method of leasehold valuation in the instant case; State v. Levy, 136 So.2d 35 (La. 1961); Ballantyne v. City of Omaha, 173 Neb. 229, 113 N.W.2d 486 (1962); *In re* Appropriation For Highway Purposes, 169 Ohio St. 309, 159 N.E.2d 456 (1959); Sackman, *Compensation Upon the Partial Taking of A Leasehold Interest,* SOUTHWESTERN LEGAL FOUNDATION, THIRD ANNUAL INSTITUTE ON EMINENT DOMAIN 39, 49 (1961).

of this difference is the amount which prudent business men have collectively agreed and given as the measure of the "bonus value" of the lease to the lessee. They have simultaneously determined the measure of damages to the leasehold estate. This measure of damages, of "just compensation," should be the difference between the rent stipulated in the lease and the market price at which the new lease could be negotiated.[80] If the current offer is less than the rent agreed in the contract, the lessee is freed from his unprofitable position. Since he has suffered no damage, he is not entitled to share in the award which stands in lieu of the property.[81]

E. *Divergence between Theory and Practice*

Theoretically the approach to valuation is the same whether the entire fee or a fragmented interest is being appraised, and the standard in both instances is that of fair market value. In the case of leaseholds, however, the concept is somewhat illusory. Since there is no common trading place for real estate, the estimation of market value is not as simple as is the case with listed stocks and fungible goods. The determination of market value is even more complex with leases. If there are sufficient sales of comparable leases in the vicinity, there is little or no problem. However, this is rarely true[82] since leases are never exactly alike. Each leasehold is sui generis. Each term and covenant of each lease contributes to the basic value of the lease.

Because of the great difficulty in attempting an intrinsic appraisal and obtaining suitable market data, most textbooks and appraisal manuals tend to seek a more direct and less debatable method of computing the value of a leasehold. Many appraisers, therefore, tend to follow the suggestions found in their manuals.

> In most appraisal problems the estimation of the value of the lessor's interest is relatively simple when compared with the problem of estimating the lessee's interest. This is particularly true when the property has been improved with the structure at the expense of the lessee. Because of this many appraisers first value the property as a freehold, then estimate the lessor's interest and, by subtraction, reach an opinion of the value of the lessee's interest.[83]
>
> When property has been leased, the lessor's interest consists of the right of collection of the agreed rentals and the right of repossession of the property at the end of the lease term. The value of the lessor's interest is thus (1) the present worth of the net rents that he is to receive in addition to (2) the

80. See generally notes 74-76, 79 *supra;* 4 NICHOLS, *op. cit. supra* note 50 at 314-315.

81. Ballantyne Co. v. City of Omaha, 173 Neb. 229, 113 N.W.2d 486 (1962); State v. Levy, 126 So.2d 35 (La. 1961); Sackman, *supra* note 79, at 49.

82. JAHR, *op. cit. supra* note 52, at 194.

83. McMichael, *supra* note 62, at 1191.

> present worth of the value of the property to be repossessed at the time of the termination of the lease.[84]
>
> The appraisal of a lessor's interest in a well secured ground lease is a comparatively simple performance as it involves merely finding a present worth of the various periodic rent contributions called for under the terms of the lease contract.[85]

The result of this procedure might be illustrated by the following hypothetical case. A 60-year lease was executed on January 15, 1940, for a piece of property upon which the lessee erected a building. The lease called for a rental payment of $10,000 and the lessee agreed to pay all taxes and assessments. On January 15, 1960, the property was condemned and the court awarded a sum of $500,000 based upon the market value of the entire property. In attempting an apportionment of the award, the attorneys sought the aid of several appraisers, a composite statement of whom might read as follows:

> Based on the award made by the jury resulting from the taking of the above property by the Board of Public Instruction, I have reviewed the property including the provisions of the existing lease.
>
> In appraising the lessor's interest I have used the annual annuity method and have used a rate of 7%. I have selected this rate because the risk is not great and the property has been improved.
>
> In my opinion the interest of the lessor in this leased fee is $10,000 annually for a period of 40 years, or on a 7 per cent basis, the value of the existing income flow is $133,320.00 plus the value of the reversion, which at 7 per cent 40 years hence based on the total award, is $1,695.00, or the total value of the fee, subject to the existing lease is $135,015, say $135,000.
>
> The value of the lessee's interest is, in my opinion, $364,985, say $365,000.

It is obvious that the appraiser treated the landlord's rental income as an annuity and converted this future income into a present day capital value. To this current value of the future income he added the reversionary interest to arrive at the lessor's share. The value of the lessee's interest was then determined by simply subtracting this figure from the

84. SCHMUTZ, THE APPRAISAL PROCESS 169 (1948). A Florida court gave this definition: This method [summation] consists of first determining the fair market value of the property being condemned, free of the leasehold estate. The next step in the process consisted of adding to the reversionary value of the fee at the termination of the lease the reserved rent payable during the remainder of the term, and reducing the total to its present worth by application of the appropriate annuity tables. The last figure thus reached represented the witness' opinion as to what constituted the present value of the fee subject to the lease which, when deducted from the present market value of the unencumbered fee, left a remainder which represented the value of the leasehold. Orange State Oil Co. v. Jacksonville Expressway Authority, 110 So.2d 687, 689 (Fla. 1st Dist. 1959).

85. Thorson, *supra* note 61, at 1202.

total award.[86] An arbitrary method of apportionment such as this must be examined in the light of the philosophy of capitalization. The basic premise is the assumption that the position of the lessor is analogous to that of the holder of a bond.[87] He expects to receive a fixed income from his property for the life of the lease. Rental income is therefore like an annuity and the problem is resolved simply by transforming these annuity payments into the present value of future net incomes.

Since present money commands a premium over future money, one is disposed to pay less for that which is to be enjoyed in the future than that which is to be enjoyed in the present. Stated differently, future amounts have a present day value which is less than face value. The difference is an amount equal to the loss of interest during the time until the future collection period. By this reasoning, the present worth of an annuity of $10,000 annually, payable at the end of the year, for a term of 50 years, when discounted at 6% interest, is $157,618.60. The same method and philosophy is used in determining the value of the reversion. A sum of $400,000 to be received in 50 years is at six per cent interest worth $21,600 today.[88]

When the value of any property right is computed in this manner, the most important element in determining the value of that right is the capitalization rate. Yet little, if any, consideration is ever given to a scientific analysis of the reasons for the selection of a particular rate. Appraisers' reports are likely to indicate that the particular capitalization rate was selected because "it is the prevalent return in investments of this character," or "my 20 years of experience indicates this to be the current market rate."[89] In most cases the court is faced with evidence

86. As to valuation procedures, including discussions on such methods as capitalization, Inwood and discount, see generally Sando, *supra* note 62, at 85; Hitchings, *supra* note 70, at 66; Thorson, *supra* note 61, at 1197-1228; McMichael, *supra* note 62, at 1192.

87. Thorson, *supra* note 61, at 1200, 1201.

88. When the rental income is treated as an annuity the present value is the sum of the present values of all the payments. The present value of the first payment per dollar is $(1+r)^{-1}$; the present value of subsequent payments is $(1+r)^{-n}$ per dollar of the annual rent. Hence by the application of a formula for the sum of the terms of a geometric series, we have the present values of all the annual payments.

Because these values are so often computed and to simplify the work involved, tables of the value of $1 per period (n) are published for the convenience of determining the present value of future incomes. Thus, the present value of a rental income of $10,000 a year for a period of 50 years is computed by referring to a table such as that given below:

PRESENT VALUE OF AN ANNUITY

n	1%	5%	6%	7%
1	0.99009	0.97087	0.94339	0.93457
5	4.85343	4.32947	4.21236	4.10019
10	9.47130	7.72173	7.36008	7.02358
20	18.04555	12.46221	11.46992	10.59401
50	39.19611	18.25592	15.76186	13.80074

$10,000 \times 15.76186 = \$157,618.60$

89. Under the prevalent practice of the undivided fee rule, the apportionment of the

indicating several prevailing "current market rates."[90] It is axiomatic that the witnesses employed by the landlord will view the current market rate at several percentage points lower than those of the tenant. Yet all the witnesses base their valuation on the "current market rate." The following table shows the results of a varying rate of interest in the value of an annuity income.

TABLE

Present Worth of An Annuity (Rental Income) of $1,000 per annum at Various Rates of Interest for a Period of 50 years.

3%	$25,730.00
4%	21,482.00
5%	18,256.00
6%	15,762.00
7%	13,801.00
8%	12,233.00
9%	10,961.00
10%	9,915.00
12%	8,305.00
15%	6,661.00

It is not the purpose of this paper to conduct a study of capitalization rates. The table is sufficient to indicate the inherent weakness of this method. *The point to be emphasised is that this is the method by which expert witnesses commonly attempt to determine the value of a leasehold interest.* The lessor's interest is determined by treating his rental income as an annuity. The remainder of the award, less the pittance of the reversion,[91] is by inference the lessee's interest.

F. *Criticism of the Capitalization Method in Apportionment Cases*

It is obviously a simple and routine task to determine the lessor's

award takes place in an ancillary proceeding, usually before a judge alone. The distribution of the award is likely to become somewhat anti-climatic with the parties discouraged from the delays of litigation and amenable to compromise. Because of these factors the actual mechanics of apportionment are only infrequently revealed in published appellate reports. Occasional reference to divergent capitalization rates, or to the fact that the rate selected was within the range of those suggested, can be found. It is because of this lack of judicial scrutiny, because of the difficulty of determining valuations, and because also of the natural tendency to seek security in mathematical computations, that a proper understanding of the philosophy of capitalization is important.

In United States v. Certain Interests in Property, 296 F.2d 264, 267 (4th Cir. 1961), the court referred to an appraiser who based his opinion on "his market information," and then remarked that at no point did the appraiser reveal the source of his market information.

In Orange State Oil Co. v. Jacksonville Expressway Authority, 110 So.2d 687, 689 (Fla. 1st. Dist. 1959), the use of the summation method was justified by the witness on the basis that it was the accepted method of appraising. See note 84 *supra* for an explanation of the summation method.

90. In United States v. Certain Interests in Property, 296 F.2d 264 (4th Cir. 1961), seven experts estimated the remaining economic life of the buildings from a low of 30 to a high of 50 years and the capitalization rate variously at 5½, 6, 6½ and 7%.

91. For example, a sum of $1,000, discounted at a rate of 6% for 50 years, has a current value of $54.30.

interest in a leasehold estate by merely capitalizing the rental income of the property. To many appraisers this method has the advantage of limiting the scope of professional and expert opinion to a single point which might be open to dispute, namely, the rate of capitalization. This method frees appraisers of the difficult task of determining the fair market value of the lease. The economists' criticism of this approach lies neither with the philosophy nor the mechanics of discounting the future rental income into a current cash value. It is far more fundamental than merely objecting to the methodology of an average appraiser. The criticism of the economist is directed to three major areas in which he disputes both the logic and the validity of the *assumptions* underlying the appraiser's technique.

First, a fundamental error is made when the appraiser considers the lessee's interest to be the total award less the value of the discounted rental income. Such reasoning ignores the fact that the sum total of the separate interests is usually less than the value of the undivided fee. Because of consideration of the highest and best use, and other dispensations made to the property owner, the total award is frequently greater than the sum of the separate interests.[92] Provision should be made for apportioning this surplus.

The error of the method above described lies in the fact that the lessee's property right, the privilege or liberty of use for a limited time, becomes more valuable than the sum total of all the remaining rights and privileges. The method ignores the fact that the lessor's interest consists of the entire multitude of property rights less those given to the tenant. The lessee does not have the ultimate right of disposal of his property right, for in most leases the obligations of the lessee do not terminate when he subleases. His is only a restricted right which is subject to termination on default of his obligation. At the end of the term, the whole estate reverts to the landlord.

Thus, it would seem as a matter of logic, that if the total award is greater than the sum of the individual interests, as it often is, all the surplus should not go to the tenant, the holder of the lesser interest. It would be more just that the surplus (1) be returned to the public treasury, (2) go to the holder of the major interest in the property, the landlord, or (3) be apportioned between the landlord and tenant. Nevertheless, the method described above ignores this question and gives all the surplus to the tenant.

A second criticism of the capitalization technique is the contrasting fashion in which the interests of the lessor and lessee are treated in the distribution of the award. The lessor's interest is treated as an annuity

92. See text following note 53 *supra*.

to be discounted to a present day value, while the lessee's interest is considered a windfall profit and is not subject to discounting. With this in mind, the economist asks "why is not sauce for the goose sauce for the gander?" If it is to be assumed that the contract rent would be forthcoming in the future, is it not equal justice to assume that the "bonus" value of the lease, *i.e.*, the difference between the economic rent and the contract rent,[93] will accrue to the lessee in annual installments rather than in a lump sum? If justice is to be uniform it would seem that both parties to the distribution should be treated in a like manner. If the lessor is to pay a penalty for acquiring the value of his rental annuity in a single payment, should not the lessee pay an equal penalty?

This entire discussion becomes somewhat pedantic when one realizes the faulty logic involved in treating the potential future contract rent as an integral part of the condemnation award. It is a universal rule that the taking of an entire property terminates the lease.[94] There is therefore no guaranteed future income to be discounted. This is self-evident when one realizes that the termination of the contract frees the lessee of his obligation to pay rent.

A court or jury in arriving at the total value of the condemnation award does not consider that there is in the award a discounted present-day value of future income. The award is determined by the current market value of the unencumbered property. There is no implication that any property right is to be treated differently from any other. Since the award stands in lieu of the property, all future interests in the property are cancelled and transferred into the award. If the future claims on the property are cancelled, and the lease itself is voided, it is only logical to assume that future incomes generated by this property will also terminate. The appraiser, however, chooses to ignore this fact. Hence, appraisers using the capitalization method submit to the court a current or present day value of an nonexistent future income.

The third criticism of the capitalization method as a basis for apportioning the award is the most important. This criticism is simply that the method used by many appraisers and expounded in their manuals, as delineated above, does not coincide with legal standards. It is axiomatic, for example, that the burden of proof is upon the plaintiff. Thus, when a lessee lays claim to a share of the condemnation award, the burden of proof is on him as to the value of his leasehold. He must show that he has suffered a detriment by the loss of his leasehold.

> [Where tenants sought part of the award in a condemnation proceeding, it was held that] to recover, they must show

93. See text following note 71 *supra*.
94. See text accompanying note 67 *supra*.

> by the weight of the evidence that the market value of the leases was greater than the rent reserved . . . .[95]

The measure of damages of a tenant is, as indicated above,[96] the market value of what he has lost.

> The measure of damages is the fair market value of the estate so taken; or if only a part thereof be taken, the measure of damages is the difference between the fair market value of the entire leasehold estate and the fair market value of the portion thereof not taken.[97]

The general theory of apportionment has been stated as follows:

> In such cases [condemnation of the whole fee] the awards of compensation should be for the market value of the property as a whole with apportionment as between the lessor and lessee according to the respective interests.[98]

> [The] guiding principle of just compensation is reimbursement to the owner for the property interest taken. . . . [The owner] is entitled to be put in as good a position pecuniarily as if his property had not been taken. He must be made whole but he is not entitled to more.[99]

These principles as enunciated by the courts are generally absent from the methodology of the appraisers' manuals, and the technique of apportionment as set out above. The determination of the lessor's and lessee's interests under common practice is often confined to the mechanical computation of the present value of annuity income. The difference between the value of the annuity and the total award is arbitrarily concluded to be the value of the leasehold estate. It is neither a measure of the damages suffered by the lessee nor an approximation of the market value of the lease. Therefore, it is not in accord with either the spirit or the letter of the law. It is merely a convenient way of refusing to admit a lack of knowledge of current real estate values.[100]

95. City of Newark v. Eisner, 100 N.J. Eq. 101, 102, 135 Atl. 86, 87 (1926). *Accord* (as to burden of proof on tenant), State v. Levy, 136 So.2d 35 (La. 1961).

96. See text following note 73 *supra*.

97. Kafka v. Davidson, 135 Minn. 389, 160 N.W. 1021, 1023 (1917).

98. Minneapolis-St. Paul Metropolitan Airports Comm'n v. Hedberg-Freidheim Co., 226 Minn. 282, 287, 32 N.W.2d 569, 572 (1948).

99. United States v. Virginia Elec. & Power Co., 365 U.S. 624, 633 (1960). See also *Theory of Apportionment*, Part II D., *supra*.

100. The authors acknowledge that market value is not the sole technique in appraising real estate under eminent domain, and have attempted to point this out at various places. See, *e.g.*, notes 29, 45-49 *supra* and accompanying text. The fact, however, that comparable sales or market data is not the exclusive approach to valuation does not detract from the validity of the criticisms herein discussed in those cases where market value is the basis of the award to be apportioned. For examples of instances where other than market data were used to determine the value of the condemned land, see State v. Gras, 141 So.2d 35 (La. 1962), using capitalization of income method; State v. Frellsen, 135 So.2d 378 (La. 1961), using reproduction or replacement cost method.

IV. CONCLUSION

The law of eminent domain, as formulated by the courts, in general shows a remarkable adherence to the principles of orthodox economics. The principle of economics involved is the substitution of a sum of money for the value of property rights which have been taken. In case of the valuation of an unencumbered fee, the solution is generally within the framework of orthodox economic price theory, and the results are good.[101]

In the distribution of a condemnation award between divergent interests, however, particularly in a case of lessor and lessee, the results are less satisfactory. These unsatisfactory results arise from the practice of valuing the fee as if it were unencumbered, and then apportioning the award without a thorough understanding of the *philosophy* of the capitalization method of valuation. When the apportionment is based solely on the capitalization of the lessor's interest, a different philosophy is used in computing the award than is used in distributing it. This change of philosophy arises not from a conscious desire of the courts; indeed, just the opposite is reflected in the decisions, but because of the difficulties in ascertaining independently the market value of a lease, and because the mathematical computations of the expert witness have an illusion of certainty which lulls the participants into overlooking the underlying philosophy behind the capitalization method.

The courts have in general proclaimed that the same standard of fair market value shall be used in determining the value of all property interests taken. It is not too much to impose upon them the further

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In condemnation of leasehold interests in Wherry Housing Projects, methods other than market data are commonly employed because of the lack of comparable sales. The problem there, however, is similar to the problem of determining the value of a fee where there is "no market value" since the only estate being taken is the leasehold and there is no apportionment problem. See United States v. 190.71 Acres of Land in Lake County, Ill., 300 F.2d 52 (7th Cir. 1962), using capitalization of income and evidence of original cost; United States v. Certain Interests In Property, 296 F.2d 264 (4th Cir. 1961), and United States v. Tampa Bay Garden Apartments, 294 F.2d 598 (5th Cir. 1961), both using capitalization of income method.

101. This, of course, is a matter of opinion. See, for example, Note, 67 YALE L.J. 61 (1957). The fact that different experts may have widely varying opinions as to the market value of a particular parcel does not per se indict the standard. It is the function of the jury to weigh the evidence and to determine credibility. It is doubtful that any other standard would result in mathematical certainty. The difficulty of determining damages in other areas, as for example, in personal injury cases, is at least equally as great. Consider also, the problem of determining a dollar value for pain and suffering, the estimation of future medical expenses and loss of earnings for many years in the future, and the computation of a monetary value for loss of consortium. It should also be pointed out that allowance for additional damages, for example, moving expenses, loss of profits or similar items, will not necessarily obviate the necessity of determining market value, or constructing some other standard, representing the worth of the land (property) taken. Compensation will have to be awarded on some basis for the value of the land (property) itself irrespective of any additional damages that may be authorized.

duty of seeing that the same standard is in fact applied. Further, it is not too much to impose upon the professional appraisers the duty of securing adequate training in the underlying philosophies behind their methods of appraisal. Only with a thorough understanding of the philosophy behind appraisal techniques, and with an understanding of the purpose for which the valuation is sought, can a really intelligent appraisal be made in each instance. A full appreciation of these fundamental concepts on the part of all parties, the attorneys, the appraisers, and the judges, will result in sound appraisal and apportionment, and will also prevent wide divergences between the actual practices and standards set by the courts.