& CONDEMNATION ZONING LAND USE

2009 ANNUAL REVIEW
FROM THE ABA SECTION OF LITIGATION'S
COMMITTEE ON CONDEMNATION, ZONING, & LAND USE

ABA Section of Litigation
AMERICAN BAR ASSOCIATION

FAIR MARKET VALUE IN A DOWN MARKET

By Alan Ackerman

These are difficult times to ascertain values. Residential values have fallen from 30 to 60 percent of the "abnormal" peaks seen a few years ago. In the past six months, previously flat retail/commercial rental rates have fallen as much as 35 percent in many areas. The decrease leads to even more substantial losses in value, given the retention of fixed costs in the face of decreasing variable rents.

In the condemnation setting, most jurisdictions utilize a date of taking premised upon the date in which title vests. Jury instructions contemplate the valuation as of a specific date. This presents a situation in which the potential for a much lower value, premised upon the value of a specific property on a specific date, exists. Yet, for the parties, precise relocation as of the date does not occur.

Following the definition of market value utilized by the American Institute of Appraisers, federal agencies require lending institutions in the United States to follow a standard premised upon

> [t]he most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:
>
> 1. Buyer and seller are typically motivated;
> 2. Both parties are well-informed or well-advised, and acting in what they consider their best interests;
> 3. A reasonable time is allowed for exposure in the open market;
> 4. Payment is made in terms of cash in U.S dollars or in terms of financial arrangements comparable thereto; and
> 5. The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

The definition, and similar definitions in most states, contemplates fair market value in something other than the artificial conditions of a compulsory eminent domain process. The definition itself contemplates numerous factors that may well apply in what is a stable economic environment but offer uncertain economic dislocations to the owner in a recession or depression. It should be noted that eminent domain is perceived to be a harsh remedy in many jurisdictions and that protections are to be afforded to the owner who is dispossessed of his property. Each part of the definition gives rise to a claim that careful review of the circumstances should be provided that assures market dislocations, be they market spikes or troughs. As an example, for a residential property condemned in Florida in 2005, when dollars followed each other in speculative investment, was that indeed the market? Or would the fact that a number of properties sold for extravagant prices compared with the price for the same properties only 12 months before or after this date, give rise to a consideration of "the undue stimulus" as described in the market price definition? Were the buyers effectively acting imprudently? Was the fact that irrational credit was available an undue stimulus under the definition?

Reviewing each of the definitions reveals the need for concern with how the market dislocation affects value.

1. *Buyer and seller are typically motivated.* In our current market circumstances, many sellers are other than "typically motivated." In many communities, the market value approximates foreclosure sales price at the auction. By definition, the market dislocation during this recession may place a seller in a position where the short-term nature of the auction atmosphere

CONTINUED ON PAGE 4

HIGHLIGHTS

FAIR MARKET VALUE IN A DOWN MARKET

(Continued from page 1)

greatly modifies the value.

2. *Both parties are well-informed or well-advised, and acting in what they consider their best interests*. The reality of the market process during this recession is one in which a well-informed seller simply holds the property rather than sell at a greatly diminished price. The notion of compulsory sale has the effect of modifying the market valuation process.
3. *A reasonable time is allowed for exposure in the open market*. Whether or not a reasonable time is allowed, would one reasonably sell in a market that is truly dislocated and in which buyers and sellers are not openly buying or selling property? The events of the past eight months are little different from the 1991 savings and loan fiasco, in which ready financing was not available for developments and the effective market of the buyer and seller was dislocated. Within 18 months, however, the market had retrenched, and the opportunity to buy and sell at the deflated amounts was no longer available. This is corollary to the *Black's Law Dictionary* definition, which includes the language "with the reasonable time allowed to find a purchaser."
4. *Payment is made in terms of cash in U.S dollars or in terms of financial arrangements comparable thereto*. In the current market, bank financing may not be available (hopefully an interim problem rectified in the coming months). Otherwise, what is now a dislocated market of a recession may end up being the high end of the depression market. One must assume that the funding for reasonable purchases is available because the definition itself is being utilized.
5. *The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale*. Implicit in this definition is the premise that individuals in the transaction themselves are not associated with the "sales concessions." One must ask whether the bank activity is so limited that only "creative financing" is available for many transactions.

Of paramount import to these transactions is "market timing." The standard of the process is that something will occur within a reasonable time. But the desire to sell within a reasonable time in a dramatically down market, which affects reasonable time parameters, runs counter to the notion of the noncoercive conduct contemplated in the definition of fair market value.

The definitions must be applied within an "abnormal" situation, where buyer and seller consider a deflated property value in the context of a likely return of value in the foreseeable future. Discounting the future increase in value that may well be available to a speculative purchaser in a recession creates a market imbalance in an eminent domain proceeding, where the transaction is compulsory as of the date of valuation. These factors make for very difficult times in the valuation process.

This approach contemplates a buyer and seller valuing deflated property in the context of a likely return to a pre-recession value, based upon some type of time and risk/rate of return analysis. This is not available in a condemnation setting because the owner of the property may not have fair market options. Is the market in 2009 any more "normal" than the hyperactive markets that existed only a few years ago?

We now face the possibility of serious dislocations in the supply/demand markets created by liquidity uncertainties. Many of the 15- and 30-year amortization notes on a ten, five, or even shorter terms will come due during the next few years. As the massive demand for recapitalization occurs, will far lower loan-to-value ratios be required? Under such a circumstance, borrowers will be required to invest a far greater proportion of total value. This will diminish the risk of a loss to the lender but will create a further dislocation in the ability to purchase. None of us can foresee the market perfectly, but the short-term concerns are dramatic.

The concerns regarding this process expressed here could be easily resolved. Legislation could limit restrictions on loans or offer prospective lenders some type of "guarantee." The government may become more involved in the lending process, which gives rise to other serious concerns. The notion of market value still must be based upon a pricing system of demand and supply. Even changes in the loan-to-value percentages of what will be lent may have a serious short-term effect but a diminished long-term effect, because supply and demand will always balance out over the longer term. Given this, the concerns set forth in this article, in the current economic environment, present the greatest risk to properties being acquired by eminent domain, simply because owners are less concerned about an abnormal market when they can hold onto property and contemplate that its value shall return.

The premise of fair market value is that one looks to sell property without compulsion. To conclude that the sale must be made on a date certain could, for many owners, severely endanger the opportunity to receive just compensation, simply because they are not willing sellers in the marketplace.

Alan Ackerman is with Ackerman Ackerman & Dynkowski.