

Expropriation appraisal review.

<http://www.entrepreneur.com/tradejournals/article/179535027.html>

by Sevelka, Tony

Appraisal Journal • Spring, 2008 •

ABSTRACT

This article discusses appraisal review in general and as it relates to expropriation or condemnation appraisals. Scope of work obligates an appraiser to fashion a solution and plan of action consistent with the intended use of the appraisal and to produce credible results. This flexibility makes appraisal format problem specific, and more narrowly defines the review appraiser's task. However, in the area of expropriation, there are statutory requirements that form an integral part of the appraisal development process, and these must be considered in the review of an expropriation-related appraisal. Like the initial appraiser, the expropriation appraisal reviewer is obligated to prepare a scope of work as an integral part of the review process.

Appraisal review is an important auditing and quality control function. Appraisal review procedures vary with the nature of the assignment, the requirements of the client, and the complexity of the issues surrounding the property appraised. Appraisal review in the area of expropriation or condemnation presents unique challenges due to the legislative requirements surrounding valuation and the potential for divergent opinions of value.

Expropriation is a specialized field, where both the initial appraiser whose appraisal is under review and the review appraiser have a professional obligation to understand the regulatory and statutory requirements that may apply within the specific jurisdiction. Expropriation can be defined as the right of an authorized agency to take an interest in property in return for compensation. Usually it is found in the right of government to take private property for public use, without the consent of the owner, subject to reimbursement. In the United States, this right is known as condemnation. (1)

Appraisal review requirements under the Canadian Uniform Standards of Professional Appraisal Practice (CUSPAP) (2) apply to members of the Appraisal Institute of Canada, a self-regulating body. Although CUSPAP is not enshrined in federal legislation, it is the de facto standard in Canada.

While the primary focus of this article is review appraisal in the specialized area of expropriation, many of the issues addressed are common to appraisal review in general.

Appraisal Review Standard Rules

As defined in the 2008 edition of the Canadian Uniform Standards of Professional Appraisal Practice (CUSPAP), there are essentially two types of appraisal reviews: technical reviews and administrative reviews. (3) The Review Standard Rules of CUSPAP define technical review as work prepared by an independent third party appraiser in accordance with [the] Review Standard, of an appraisal report prepared by another appraiser for the purpose of forming an opinion as to whether the analysis, opinions and conclusions in the report under review are appropriate and reasonable. (4)

In conducting a technical review, the review appraiser must develop and report a credible opinion as to the quality of another appraiser's work and clearly disclose the scope of work performed in the review assignment. (5)

In presenting the findings of the technical review, the review appraiser must, at a minimum,

- * identify the client and other intended user(s) of the review report by name;
- * identify the intended use of the review appraiser's opinions and conclusions;
- * identify the purpose of the appraisal review;
- * identify the report under review, the appraiser(s) that completed the report under review, the real estate and real property interest appraised, and the effective date of the opinion in the report under review;
- * identify the date of the review;
- * identify the scope of work of the review process; (6)
- * identify all assumptions and limiting conditions;
- * provide an opinion as to the completeness of the report under review within the scope of work applicable in the review assignment;

- * provide an opinion as to the apparent adequacy and relevance of the data and the propriety of any adjustments to the data;
- * provide an opinion as to the appropriateness and proper application of the appraisal methods and techniques used;
- * provide an opinion as to whether the analyses, opinions, and conclusions in the report under review are appropriate and reasonable;
- * provide the reasons developed for any disagreement or agreement with the appraisal report being reviewed;
- * include all known pertinent information; and
- * include a signed Certification, which is an acknowledgement that the review appraiser accepts responsibility for the review and the contents of the review report. (7)

In addition to reviewing for compliance with CUSPAP, consistent with an appropriate scope of work, the appraisal report should be reviewed for compliance with the regulatory and statutory requirements of the jurisdiction. (8)

If the review appraiser is required to develop and report an independent estimate of value, the assignment becomes a two-stage assignment consisting of an appraisal review plus a value estimate by the review appraiser, and requires the review appraiser to expand the scope of work. The CUSPAP Review Standard Comments on scope of work state,

Those items in the appraisal under review that the review appraiser concludes are credible and in compliance with the appraisal standard can be extended to the review appraiser's value opinion development process on the basis of an extraordinary assumption by the review appraiser. Those items not deemed to be in compliance must be replaced with information or analysis by the review appraiser, developed in conformance with the appraisal standard to produce a credible value opinion.

When the purpose of an appraisal review includes the review appraiser developing an opinion of value, in addition to developing an opinion as to the quality of the appraisal under review, the review appraiser's scope of work must be in compliance with the requirements of this standard in developing the opinion as to the quality of the appraisal under review and the appraisal standard involved in the appraisal under review. (9)

Considerations in Expropriation Appraisal Assignments In both an initial expropriation appraisal assignment and an appraisal review assignment, the appraiser will take into consideration the scope of work, the history of the subject, the nature of the scheme (project), highest and best use of the property, and the information from graphic aids.

Scope of Work Scope of work is one of the most important aspects of any appraisal assignment, as it addresses the issue of problem identification. (10) An appropriate scope of work should answer the following questions:

- * Who is the intended user or user group of the appraisal?
- * What is the intended use of the appraisal?
- * What property rights are being appraised, including the source of the definition(s) of the property rights appraised?
- * What are the salient physical and/or economic characteristics of the property?
- * What is the extent of inspection of the subject property? (If the property is not inspected, a declaration and reason for noninspection should be provided.)
- * What is the level of investigation in respect of property-specific issues?
- * What is the level of macroeconomic analysis, if applicable?
- * What type of opinion or value is being sought, including the source of the definition of value? (11)
- * What third-party consultants (i.e., planner, engineer, etc.) and/or reports, if any, are relied upon in the preparation of the appraisal?
- * What is the method of valuation deemed appropriate for the type of property being appraised? * What type of market/transactional data is to be investigated?
- * What data sources are to be relied upon in searching for market and transactional data?
- * What are the geographic parameters and time frame for collection of the market and transactional data?

- * What methods of data verification are to be employed in confirming market/transactional data?
- * Are the comparables physically inspected? (If the comparables are not physically inspected, the report should include a declaration to that effect.)
- * Are there any hypothetical conditions or extraordinary assumptions underlying the opinion or value being sought?

History of the Subject Property The appraisal under review should provide a history of the subject property and rifle, including an abstract of title, disclosing the following:

- * Acquisition particulars
- * Outstanding mortgages, including terms and conditions
- * Liens
- * Easements or rights-of-way that may impact highest and best use analysis
- * Restrictive covenants that run with the land that may impact highest and best use analysis
- * Leases, including terms and conditions that may impact highest and best use analysis
- * Outstanding work orders applicable for improved properties that may impact market value and market rent
- * Use of the property, which may disclose concern for environmental contamination that could impact highest and best use, market value, and market rent
- * Pending and past applications for rezoning and official plan (master plan) amendment that may impact highest and best use analysis
- * Pending and expired listings for sale and lease within three years of the date of the appraisal that may provide evidence of market value and market rent

In an expropriation appraisal, the scheme (12) or project, its imminence, and everything flowing from the scheme must be ignored in ascertaining highest and best use before the taking, and an estimate of market value. (13) This approach should be followed whether the taking consists of the entire property or only a portion of the property.

The date of significance in screening out the scheme's impact is the date on which the imminence of the scheme became public knowledge. (14) To screen out the impact of the scheme, the appraisal report under review should (1) identify any planning initiatives directly related to, or flowing from the scheme; (2) ignore any existing zoning enacted or proposed rezoning contemplated in anticipation of the scheme; (3) identify any public works proposed or completed in contemplation of the scheme; (15) (4) identify the geographic extent of the influence of the scheme; and (5) ignore market and transactional data that has been influenced by the scheme (applicable in estimating the market value of the property before the taking).

Highest and Best Use

Highest and best use underlies every estimate of market value. However, in no area of appraisal practice is the issue of highest and best use more contentious than in the field of expropriation and condemnation. The amount of compensation in an expropriation or condemnation case can vary considerably depending upon the highest and best use of the subject property.

In a partial taking it is possible for the highest and best use after the taking to differ from the highest and best use before the taking, depending on the nature of the scheme or project and its impact on the remainder.

When reviewing an appraisal report prepared in contemplation of expropriation or condemnation, the review should ensure that only existing or potential economic uses have been considered in the analysis of highest and best use (16) when the stated objective of the appraisal is to estimate market value, as defined in the governing legislation. The reviewer should seek information as to the following.

Impact of the Scheme. If there is a partial physical taking or partial interest taking, has the impact of the scheme or project been appropriately ignored in the highest and best use analysis of the subject property before the taking, and brought back into the highest and best use analysis after the taking?

Physically Possible Use. If there is a partial physical taking or partial interest taking, is the stated economic use physically possible in the context of site/parcel and locational characteristics before the taking and after the taking?

Legally Permissible Use. If there is a partial physical taking or partial interest taking, is the stated economic use legally permissible or within the realm of probability before the taking and after the taking?

Restrictive Covenants. Is the stated economic use precluded by any restrictive covenants registered against title that runs with the land?

Achievable Time Frame. If there is a partial physical taking or partial interest taking, is the stated economic use achievable within a reasonable time frame of the effective date of appraisal before the taking and after the taking? (17)

Financial Feasibility. If there is a partial physical taking or partial interest taking, is the stated economic use financially feasible within a reasonable time frame of the effective date of appraisal before the taking and after the taking?

Sufficient Demand. If there is a partial physical taking or partial interest taking, is there sufficient demand for the stated economic use within a reasonable time frame of the effective date of appraisal before the taking and after the taking?

Larger Parcel. If there is a partial physical taking or partial interest taking, is the stated economic use reflective of the larger parcel, which may encompass an area of land equal to, less than, or greater than the boundary limits of the subject property either before or after the taking? (18)

Rezoning Contingencies. If the stated economic use is contingent upon rezoning or amendment of the official plan or master plan, does the highest and best use analysis reflect the time and time value of money and the costs-including an allowance for the risk and entrepreneurial profit associated with achieving the highest and best use?

Infrastructure Contingencies. If achieving the stated economic use is contingent upon servicing, infrastructure, development charges, etc., are the necessary expenditures reflected in the highest and best use analysis? (19)

Graphic Aids

Surveys, sketches, cross-sectional drawings and aerial photos are important in the preparation of appraisals for expropriation, and should be expected in the appraisal report under review. These graphic aids assist the review appraiser's understanding of the location, boundaries, and configuration of the subject property. Graphics also help the review appraiser in identifying and visualizing the nature of the public works and the spatiotemporal relationship of the subject property to the surrounding area.

Graphics help the reviewer identify the location and boundaries of the partial taking in relation to the subject property and improvements as well as the location, boundaries, and configuration of the remainder and its relationship to any improvements. The graphics also aid in identifying any potential problems of access, grade separation, topography, or utilization of improvements related to the partial taking.

Special Issues in Partial Takings

Partial takings present unique valuation issues that must be addressed in an appraisal. Identifying the larger parcel is the initial step in the valuation process. (20) If the taking is a stand-alone parcel with an independent highest and best use, the taking is considered the larger parcel, and there is no remainder.

The taking can only be considered the larger parcel if it satisfies all of the requirements of highest and best use (i.e., physical possibility, legal permissibility, financial feasibility, and maximum profitability). (21) In determining whether a taking constitutes the larger parcel, questions such as the following should be addressed in the appraisal report under review:

- * Does the taking have legal access (not landlocked) and is it physically accessible?
- * Is the taking of a size and configuration that complies with the prevailing land use controls for permitted or probable economic uses attributed to the taking?
- * Are soil conditions and topographical characteristics of the property capable of supporting any economic use even if the taking as a stand-alone parcel complies with the prevailing land use controls?
- * Is there any demand for the use attributed to the taking as a stand-alone parcel even if it complies with the prevailing land use controls?
- * Is the use attributed to the taking as a standalone parcel financially feasible?

Note that partial takings of property interests of easements (surface rights, air rights, subsurface rights, rights-of-way, etc.) convey use but not ownership. The partial takings of easement interests are unlikely to have an independent highest and best use, which renders them unmarketable as standalone entities. In reviewing appraisals pertaining to property rights associated with easements, the appraisal under review should describe (1) the nature and stated use of the interest being expropriated and its impact on the analysis of highest and best use of the remainder; and (2) the location, configuration, and/or extent of the interest being expropriated in relation to the subject property, and its impact on the analysis of highest and best use of the remainder.

Impact of the Taking

When the expropriation involves a partial taking that has no independent highest and best use as a stand-alone parcel, the appraisal report under review should provide a detailed description of the impact of the taking by addressing the following issues:

- * What are the purpose of the taking and the nature of the public works?
- * What property rights are involved in the taking?
- * Will the taking change the configuration of the parcel?
- * Will the taking reduce the size of the property and to what extent?
- * Will access to the remainder be affected by the taking?
- * Will the taking impact the physical or economic utility of the property?
- * Will the taking cause a change in the highest and best use of the property?
- * Will the taking alter the timing of development or redevelopment if the property has development or redevelopment potential?
- * Will the taking alter the rate of absorption if the property has subdivision potential?

Answers to the preceding questions set the stage for determining the appropriate appraisal methodology(s) in valuing the remainder; the type of market and transactional data to be collected; and the quantum of compensation to which the property owner is entitled as a consequence of the taking, applying the before and after test.

Market Value Estimates

In a partial taking of land that is not a viable standalone parcel, the appraisal report under review should typically contain market value estimates based on the before and after test, (22) with each estimate prepared as an independent exercise applying recognized market value principles based on a proper foundation. (23)

Only after each indication of value is prepared (one estimate prior to the taking and the other an estimate of the remainder) is it appropriate to compare the quantitative results to ascertain the diminution in market value attributable to the taking. The diminution in the market value should be presented in a format that separately reflects the market value of the land taken and, if applicable, any injurious affection or damages and any betterment or benefits attributable to the remainder. Injurious affection can be defined as

a reduction in the market value of the remaining land
where only part of the owners land [and interest in land]
is taken, or a reduction in value where no land is taken]
analogous to an inverse condemnation]. (24)

Betterment is the converse of injurious affection (damages) and pertains to benefits or advantages, which occur when, as a result of the use made of the expropriated land, the remaining land is increased in value. (25) Benefits that enhance the value of the remaining land are often characterized as either general or special.

General benefits can be defined as those benefits that "accrue to the community at large as a result of the new public work and the increased general prosperity that accompanies development," while special benefits are benefits that "arise from the peculiar relation of the land in question to the public improvement, usually resulting from a change in its highest and best use." (26) Note that special benefits "may accrue to multiple parcels (such as all four quadrants of a newly constructed freeway interchange) because the parcels are directly benefitted in a similar manner, if not to the same degree." (27)

In presenting an estimate of market value, the appraisal should include the following items that are directly related to the definition of market value:

- * Identification of the specific property rights appraised
- * A statement of the effective date of the value opinion
- * Specification as to whether cash, terms equivalent to cash, or other precisely described financing terms are assumed as the basis of the appraisal

Before and After Test Format for Partial Takings

The following two examples-the first with one remainder and the second with two remainders-illustrate the typical format of the before and after test expected to be contained in an appraisal report of a partial taking. This format ensures that the market value of the taking is readily apparent, and any injurious affection or damages and betterment or benefits are quantified separately.

Before and After Test--One Remainder

In Example 1 there is a partial taking of an interior parcel for roadway development and the taking results in a remainder that is a corner parcel (Figure 1). The before and after test is applied, as demonstrated in

Table 1, and the results show that the remainder experienced an enhancement in value of \$974,750 (38.990 acres at \$25,000 per acre).

In the before and after method, the value of the remainder as part of the whole (larger parcel) before the taking is not a separate estimate of value, but simply a mathematical benchmark calculation: the value of the taking ignoring the scheme (Step 1) minus the contributory value of the part taken (Step 2). The resulting amount (Step 3) is used to gauge the quantum of injurious affection or betterment, if any, based on the estimated market value of the remainder (Step 4).

Step 4 constitutes a second appraisal of the property reflecting the market value of the property after the taking (the remainder) considering the impact of the taking and the scheme (expropriation).

Step 5 is simply the difference between Steps 3 and 4 (Step 3 minus Step 4). If the difference is a positive amount, the landowner is entitled to receive the amount indicated in Step 2, the market value of the land taken plus the amount attributed to injurious affection, indicated in Step 5.

If the difference in Step 5 (Step 3 minus Step 4) is a negative amount, this is an indication of betterment, and the landowner is simply entitled to receive the amount indicated in Step 2, the market value of the land taken.

In Step 2, the contributory value of part taken (before the taking) allows consideration of takings where the quality (soil capacity, topography), use, or interest (property rights) of the property taken differs from that inherent in the larger parcel so as to warrant a disproportionate unit rate. (28) If the contributory value of the part taken is disproportionate, it is important to ensure that the disparity is not the result of a violation of the unit rule in the context of having improperly defined the larger parcel. (29)

Before and After Test--Two Remainders

in Example 2 there is a partial taking of an interior parcel for roadway development, and the taking results in two remainders, both corner parcels (Figure 2). In this second example of the before and after test (Table 2), Remainder A has suffered a diminution in value at a unit rate of \$75,000 per acre (\$275,000 minus \$200,000), equal to injurious affection of \$300,000 (4.00 acres at \$75,000 per acre), while Remainder B has experienced an enhancement in value at a unit rate of \$25,000 (\$275,000 minus \$500,000), equal to betterment of \$874,750 (54.99 acres at \$25,000 per acre). As the betterment of \$874,750 for Remainder B exceeds the injurious affection of \$300,000 for Remainder A, the impact of the taking and scheme (expropriation) is an overall benefit of \$574,750. Since betterment can be set off only against the value of the remainders, (30) the landowner is entitled to the amount in Step 2, the market value of the land taken.

Market Value and Costs

Estimates of market value and injurious affection (damages) or betterment (benefits) that rely on costs without reference to market value should be viewed with skepticism. Costs have no relevance to market value unless they are related to expenditures that a knowledgeable and prudent purchaser would be expected to incur to remedy a deficiency within a short period following acquisition of the subject property. Such expenditures are often quantified in price negotiations between the vendor and purchaser, and may include costs to cure deferred maintenance; demolish and remove any portion of the improvements; and remediate environmental contamination.

A cost to cure damages to a remainder is an appropriate remedy when the deficiency suffered can be physically and economically corrected. However, in no event can the cost to cure exceed the diminution in the value of the remainder (injurious affection) that would result if the cure were not undertaken. (31) Likewise, the cost to cure cannot exceed the enhancement in value of the remainder as a measure of betterment.

Unacceptable Practices in Expropriation Appraisals

Appraisals that deviate from recognized appraisal principles and practices are especially troublesome. Examples of unacceptable appraisal practices that may be identified in an expropriation appraisal review include the following:

- * Failure to apply the theory of consistent use in highest and best use analysis of improved property, where the land is valued on the basis of one use while the improvements are valued on the basis of another (32)
- * Use of the cost approach as a measure of market value (33)
- * Failure to estimate the market value of the remainder in a partial taking, while relying solely on costs as a measure of damages (injurious affection) (34)
- * Inconsistency in the approaches to value used in analysis of comparables and the subject property
- * Reliance on transactional data that is inconsistent with the stated highest and best use of the subject property in estimating market value. When the partial taking changes the highest and best use, the parcel

size, or the property rights, the transactional data relied upon in estimating market value after the taking might differ from that relied upon in estimating market value before the taking.

- * Failure to support quantitative adjustments and qualitative rating/ranking of elements of comparison in the approaches to value

- * Failure to employ the before and after test when valuing a partial taking that has no independent highest and best use as a stand-alone parcel (35)

- * Calculating injurious affection in isolation from and without reference to market value, i.e., value in exchange

- * Presenting as injurious affection any anticipated development costs that have not been incurred (and may never be incurred) and without reference to market value (36)

- * Adding development costs to the estimate of market value for land that has potential for development or redevelopment, where the market value estimate is based on comparable sales with similar development potential and implied development costs, resulting in double compensation (37)

- * Claiming damages or injurious affection for unearned developer's profit--a component that is implied in every estimate of market value of land with potential for development or redevelopment--resulting in double compensation. (Potential profit is already implied in the price of every comparable land sale with similar development or redevelopment potential.) (38)

- * Failure to adjust the purchase prices of comparable sales that have atypical financing terms or conditions to their cash-equivalent price (39)

- * Failure to take into account undevelopable land in computing an appropriate unit rate for comparable land sales with development potential, and applying the unit rate in the same manner in the valuation of the subject property (40)

Unacceptable Review Appraisal Practices

Appraisal reviewers also are expected to conduct their reviews within recognized appraisal principles and practices. Examples of practices that are considered inappropriate in conducting an appraisal review include the following:

- * Applying a scope of work that cannot yield a meaningful comparison of the opinions and conclusions founded upon the scope of work in the appraisal under review, unless the scope of work in the appraisal report is consistent with the expectations of participants in the market for the same or similar appraisal services, and what the appraiser's peers' actions would be in performing the same or similar assignment in compliance with CUSPAP, and regulatory and statutory requirements

- * Relying solely on a checklist emphasizing form over substance (such an exercise does not constitute analysis, which is an essential component of an effective appraisal review)

- * Adopting a definition of value and incorporating property rights that differ from those contained in the appraisal report, unless it is appropriate within the stated valuation parameters (scope of work) in the report, or unless a definition of value and/or property rights has been omitted

- * Ignoring or altering legitimate extraordinary assumptions/hypothetical conditions (i.e., an expropriation scheme is disregarded) and ordinary assumptions and limiting conditions, consistent with the appraiser's scope of work, that form an integral part of the analysis and impact the opinions and conclusions

- * Overemphasizing typographical errors, minor mathematical miscalculations, minor inconsistencies and insignificant omissions

- * Refuting property-specific documentation and value-supporting market or transactional data without ascertaining its accuracy

- * Criticizing the inclusion or exclusion of specific valuation methods (i.e., cost, income and direct comparison approaches, and subdivision development method) without providing a reasoned explanation

- * Criticizing the technical execution of any valuation methodology without providing a reasoned explanation

- * Considering unanticipated events, market data, or transactional data that occurred subsequent to the effective date of the appraisal, unless it is apparent that the appraiser has relied upon hindsight in formulating opinions and conclusions, as might occur in the preparation of a retrospective appraisal

- * Using inflammatory language or engaging in character assassination, as this type of conduct is inappropriate, prejudicial, and unprofessional, and has the appearance of bias.

Conclusion

The review of an appraisal prepared for expropriation or in anticipation of expropriation requires the review appraiser to possess an understanding of the statutory appraisal requirements in the jurisdiction in which the subject property is located. The reviewer must ensure that the scope of work used as the reference point for the appraisal review parallels the scope of work contained in the appraisal report under

review, so as to generate a meaningful comparative analysis of findings and conclusions, provided that the scope of work in the appraisal report is an accurate representation of the problem to be solved (problem identification).

In expropriations, partial takings present unique valuation challenges especially when the taking has no independent highest and best use as a stand-alone parcel, and inclusion of a before and after test is essential in ascertaining whether the remainder has sustained any injurious affection (damages) or betterment (benefits).

The ultimate objective of the technical review is to test the reasonableness of the logic, assumptions, and the value conclusions as well as compliance with CUSPAP, and regulatory and statutory requirements.

(41) While this article addresses important review appraisal issues relating to market value as the principal form of compensation in an expropriation, an expropriated landowner may be entitled to additional compensation under statutory requirements, which is not specifically a function of market value and the appraisal process.

Additional Reading

Boyd, Kenneth J. *Expropriation in Canada*. Canada Law Book Inc., 1988.

Coates, John A., and Stephen F. Waque. *New Law of Expropriation*. Release No. 2. Carswell Thomson Professional Publishing, 1994.

Coleman, Stephanie. *Scope of Work*. Chicago: Appraisal Institute, 2006.

Eaton, James D. *Real Estate Valuation in Litigation*. 2nd ed. Chicago: Appraisal Institute, 1995.

International Right of Way Association. *Principles of Right of Way*. BBW Communications Inc., 1995.

Kummerow, Max. "Logical Steps in Property Valuation" *The Appraisal Journal* (January 1997): 25-31.

Law Reform Commission of British Columbia. *Law Reform Commission of British Columbia Report on Expropriation*. Victoria, 1971.

Ontario Law Reform Commission. *Report of the Ontario Reform Commission on the Basis for Compensation on Expropriation*. Toronto: Department of Attorney General, 1967.

Public Works and Government Services Canada. "Special Requirements: Expropriation" In *Real Property Valuation Guidelines Federal Expropriation Act*. http://www.pwgsc.gc.ca/realproperty/text/pubs_valuation/chap_1c1-e.html.

Sevelka, Tony. "Appraisal Standards and Professional Negligence Claims" *The Appraisal Journal* (Fall 2004): 339-354.

Sevelka, Tony. "Expropriation Claims for Increased Development Costs and Loss of Profit" *The Appraisal Journal* (Fall 2005): 384-390.

Sevelka, Tony. "Appraisal Review: An Emerging Discipline." Pts. 1 and 2. *The Canadian Appraiser* 40, no. 4 (Winter 1996): 38-40; 41, no. 1 (Spring 1997): 42-46.

Sevelka, Tony. "A Review of the Subdivision Development Method" Pts. 1 and 2. *The Canadian Appraiser* 49, no. 3 (Summer 2005): A Review of the Subdivision Development Method 38-41; 49, no. 4 (Fall 2005): 43-45.

(1.) "Expropriation and Appraisal Review," Lesson No. 11 in *BUSI 442 Case Studies in Appraisal I, Course Workbook* (UBC Real Estate Division and Appraisal Institute of Canada, 2006), 11.3.

(2.) Standards Committee, *Canadian Uniform Standards of Professional Appraisal Practice* (Ottawa, Ontario: Appraisal Institute of Canada, 2008). CUSPAP is similar in substance to the Uniform Standards of Professional Appraisal Practice (USPAP) of The Appraisal Foundation, and the CUSPAP standards meet the sponsor criteria of the Foundation in its international membership category. 3. The Review Standard Rules (CUSPAR Section 8) are not applicable to administrative review, supervisory cosigning, and professional practice peer review. An administrative review is work performed by clients and users of appraisal services as a due diligence function in the context of making a business decision.

(4.) CUSPAP, 8.1.4.

(5.) CUSPAP Review Standard Rules 8.1.1. The Uniform Standards of Professional Appraisal Practice (USPAP) contain similar development and reporting requirements, which are outlined in USPAP Standard 3: Appraisal Review, Development and Reporting.

(6.) The reviewer's scope of work could differ from that of the appraisal under review in a number of respects, depending on whether the reviewer chooses to conduct a site visit of the subject property, confirm property-specific data, independently verify the transactional data in the report, research additional transactional data, etc.

(7.) CUSPAP, 8.2.1-8.2.14.

(8.) A landowner whose land is expropriated is entitled to receive from the expropriating authority a "proper appraisal" according to the Ontario Court of Appeal in *Bambrough et al. v. Ministry of Housing*

for the Province of Ontario et al. [1974] O.J. No. 2072. The court held, without defining what constitutes an appraisal report, that "the Expropriations Act contemplates that the person whose property is being expropriated should be given more than a mere mimeographed two-page statement such as was furnished to the applicants. The person whose property is being expropriated should be able to determine from the appraisal report if he should proceed to arbitration or should accept the offer which has been made."

(9.) CUSPAP, 9.5.3.

(10.) "An appraiser must gather and analyze information about those assignment elements that are necessary to properly identify the appraisal, appraisal review or appraisal-consulting problem to be solved." Stephanie Coleman, "Scope of Work and Problem Identification: The Significant Seven," *The Appraisal Journal* (Summer 2006): 232, quoting USPAP's Scope of Work Rule.

(11.) The statutory definition of market value differs from jurisdiction to jurisdiction in Canada as well as in the United States. In *The King v. W.D. Morris Realty* [1943] Ex. C.R. 140, the court in Canada enunciated the general principles for determining the value of expropriated property stating, "[t]he owner of expropriated property is to be compensated for the loss of the value of such property resulting from its expropriation by receiving its equivalent value in money, such equivalent value to be estimated on the value of the property to him and not on its value to the expropriating party, subject to the rule that the value of the property to the owner must be measured by its fair market value as it stood at the date of expropriation." The court also stated that market value "assumes a price that a purchaser, having carefully considered the advantages and possible uses of the property, would be willing to pay in order to obtain it. It must not be forgotten, however that, while consideration may be given not only to the present use of the property but also to its prospective advantages, it is only the present value, as at the date of expropriation, of such prospective advantages, that falls to be determined: vide *The King v. Elgin Realty Company Limited* [1943] S.C.R. 49."

(12.) In the United States the scheme is referred to as the project.

(13.) This includes any increase or decrease in market value flowing from the scheme or project.

(14.) In *Torvalley Development Ltd. v. Metropolitan Toronto and Region Conservation Authority* [1989] 69 O.R (2d) 508, O.J. No. 1298, involving the expropriation of a former brickyard, the court upheld the finding of the Ontario Municipal Board that "even though the first statement of acquisition intent is clearly made public approximately 28 years prior to the expropriation, that intent is continued and has been supported by ongoing statements of the respondent in published documents. That clearly brings it within the wording 'imminent prospect of expropriation' in the Act and is therefore not to be taken into account in determining market value."

(15.) In *Doll v. Manitoba (Minister of Tourism, Recreation and Cultural Affairs)* [1977] M.J. No. 311, property on Hecla Island was expropriated to provide for a provincial park. As part of the development plan a causeway was being built between the mainland and the island. The property owners argued that there should be an increased value to their properties because the causeway made their properties more accessible. In denying the owners a higher value, the court ruled that "[t]he construction of the causeway was an integral part of the development of Hecla Provincial Park and it is significant that its announcement was included in the announcement of the development of the Park and of the purchase of private property on the island."

(16.) Highest and best use is an economic concept intended to reflect "the highest economic value on the open market." John A. Coates and Stephen E Waque, *New Law of Expropriation*, vol. 1 (Toronto: Carswell, 1998), 5-18. Where a taking pertains to a noneconomic use such as a place of worship, hospital, school, fire hall, community center, etc., the expropriated party in Canada is entitled to the cost of equivalent reinstatement. In this circumstance the cost approach would be applicable.

(17.) Nonurban rural and agricultural land on the urban fringe may not have an ascertainable time frame for achieving a higher and better use, but an expectation of urbanization as a higher and better use should be reflected in the prices of similarly Located comparable land sales. Nonurban or agricultural land with market-recognized, long-term urban development potential may be characterized as a speculative landholding for anticipated urban development, with the existing use continuing into the foreseeable future.

(18.) In jurisdictions that subscribe to block development planning principles (applied primarily in greenfield environments), severance damages stemming from a landlocked remainder are likely to be mitigated if the remainder must be developed simultaneously and in conjunction with adjoining property as a single economic unit to achieve the highest and best use.

(19.) In *Gillespie v. Ontario (Minister of Transportation)*, 2007 ONCA 441 (CanLII), the Ontario Court of Appeal noted that "market value of the expropriated lands ... premised on the assumption that the lands

are properly serviced [for their highest and best use as] commercial land ... ignores the development costs necessary to bring the expropriated property to that market value." In Gillespie, the lower court had misapprehended the appraisal evidence by arriving at an "as if" market value contingent on the property being properly serviced rather than an "as is" market value reflecting the property in its actual unserviced condition.

(20.) In expropriation, the larger parcel is defined by the three unities: unity of ownership, unity of contiguity, and unity of use (i.e., highest and best use), see Tony Sevelka, "Expropriation and Condemnation: The Larger Parcel," *The Appraisal Journal* (January 2003): 76. In *Alberta (Minister of Transportation) v. Bonaventure Sales Ltd.* [1980] A.J. No. 114, the appeals court ruled that the Land Compensation Board proceeded on a wrong principle in (a) treating the land taken from two adjoining parcels as one; and (b) equating strips of land taken for a road widening with saleable acreage and treating it as saleable acreage valued by itself. There were, in effect, two larger parcels: a 127.93-acre industrially designated parcel from which a 3.43-acre strip was taken, and a 1.51-acre industrially zoned parcel from which a 0.30-acre strip was taken.

(21.) Any use that cannot satisfy the preliminary test of legal permissibility or physical possibility is eliminated from further consideration in highest and best use analysis. However, a nonpermitted use that is within the realm of probability may be considered. Further, as noted by the Ontario Court of Appeal in *Farlinger Developments Ltd. v. East York (Borough)* [1975] O.J. No. 609 (Ont. C.A), highest and best use is an economic concept. The Farlinger court, in considering the prospect of rezoning, ruled that "highest and best use must be based on something more than a possibility of rezoning. There must be a probability or a reasonable expectation that such rezoning will take place. It is not enough that the lands have the capability of rezoning." In *Guido v. Ontario (Ministry of Transportation)* [1977] O.J. No. 1008 (Ont. Div. Ct.), the court upheld the board's rejection of motel use as the highest and best use of the legally permitted uses, as the use was considered physically impossible, financially imprudent, and lacking demand. In its analysis of highest and best use, the board considered the likelihood of commercial access from the highway "so remote as to be non-existent" and that the provincial and municipal setback requirements were "so severe as to render [the buildable area of the parcel] virtually useless for all practical purposes as a site for a motel." The board also found it "exceedingly difficult to believe that a prospective and prudent purchaser of land for a motel site, knowledgeable in motel management and operation, would risk an investment in the claimants' land and construction of a motel thereon."

(22.) Strict application of the before and after method, without a separate line item estimating the contributory value of the land taken to the market value of the property as a whole prior to the taking, would deprive the property owner of the full value of the land taken if the market value of the remainder were enhanced as a result of the expropriation.

(23.) In *Vyricherla Naravana Gajapatiraju (Raja) v. Revenue Divisional Officer, Vizagapatam* [1939] A.C. 302 (P.C.), the provincial court characterized quantum of market value as an "as is" premise: "No one can suppose in the case of land which is certain, or even likely, to be used in the immediate or reasonably near future for building purposes, but which at the valuation date is waste land or is being used for agricultural purposes, that the owner, however willing a vendor, will be content to sell the land for its value as waste or agricultural land ... It is plain that in ascertaining its value the possibility of its being used for building purposes will have to be taken into account. It is equally plain, however, that the land must not be valued as though it had already been built upon ... it is the possibilities of the land and not its realized possibilities that must be taken into consideration."

(24.) "Expropriation and Appraisal Review," *Case Studies in Appraisal I, Course Workbook*, 11.15. Injurious affection is similar to severance damages in condemnation, which are defined as "the diminution of the market value of the remainder area, in the case of a partial taking, which arises (a) by reason of the taking (severance), and/or (b) the construction of the improvement in the manner proposed." American Institute of Real Estate Appraisers and the Society of Real Estate Appraisers, *Real Estate Appraisal Terminology*, rev. ed., Byrl N. Boyce, ed. (Cambridge, Mass.: Ballinger Publishing Company, 1981), 69.

(25.) Eric C.E. Todd, *The Law of Expropriation and Compensation in Canada*, 2nd ed. (Scarborough: Carswell Thomson Professional Publishing, 1992). Betterment here does not refer to physical improvements or renovation.

(26.) *The Dictionary of Real Estate Appraisal*, 4th ed. (Chicago: Appraisal Institute, 2002), 29.

(27.) *Ibid.* In many partial taking cases there is not a bright-line distinction to ascertain whether the betterment is special or general. Section 29(1)(g) of the Province of Newfoundland and Labrador Expropriation Act states that "in all cases an advantage that the owner may derive or be likely to derive

directly or indirectly from the contemplated work and operations for which the land is expropriated shall be taken into account in reduction of the amount of the compensation." The dicta in *Roberts v. Newfoundland and Labrador (Minister of Transportation and Works)* [2005] N.J. No. 156 suggests that the question of whether the type of benefit contemplated under Section 29(1)(g) for a setoff against compensation must be "as a result of an advantage over and above that generally accruing to all the neighbours ... and the question of whether any setoff can be made against compensation generally or only against injurious affection to the remaining land" remain unsettled. Section 44(1.1) of the British Columbia Expropriation Act states that "[i]f part of the land of an owner is expropriated, and the expropriation or the construction or use of the works for which the expropriated land was acquired are of any benefit to that owner, the estimated value of the benefit must be deducted from the amount of compensation otherwise payable to that owner ... for the reduction in the market value of the remaining land, whether or not any other owner is benefited by the expropriation of the expropriated land or by the construction or use of the works." Only special benefits can be deducted from the total compensation. In most provincial jurisdictions only special benefits can be set off against a claim for injurious affection.

(28.) Contribution is defined as "the concept that the value of a particular component is measured in terms of its contribution to the value of the whole property, or as the amount that its absence would detract from the value of the whole." *The Dictionary of Real Estate Appraisal*, 63.

(29.) In *Kerr v. The Queen in Right of Alberta* [1981] 119 D.L.R. (3d) 386, a strip consisting of 7.71 acres was taken from the frontage of a 147-acre parcel. The appeals court upheld the finding of the Land Compensation Board that the highest and best use of the land was highway commercial adjacent to the existing highway, achievable in three years and encompassing approximately 37 acres, and recreational as to the remainder. The Land Compensation Board determined that the proper approach was to establish the unit value of the 37 acres having commercial potential (the larger parcel) and attribute the unit value to the 7.71-acre taking, with "the remaining land found to be of use for recreational purposes ...[considered] extraneous to determination of the market value of the subject land." The court rejected the expropriating authority's argument that the land taken should have been valued as recreational land on the basis that the effect of the taking was to move the strip suitable for highway commercial back on to the remainder. The court held that "[a]s different portions of the land were capable of different uses, a valuation of the entire parcel and an attribution of a pro rata value to the acquired land is inappropriate." Further, the court stated that "where only part of an owner's land is taken and as a result the value of the remainder is increased, the owner is nevertheless entitled to the market value of the land taken."

(30.) Betterment can also be set off against any other claim for injurious affection. In *Green Life Proteins Ltd. v. Ontario (Ministry of Transportation)* [2002] O.M.B.D. No. 505, business losses occurred after the Ministry of Transportation expropriated 10 acres for a highway extension that divided the property into two rural residential lots and resulted in betterment of \$60,000 to the two remainders. Green Life successfully established a claim for injurious affection for the loss of its alfalfa crop in the amount of \$36,907, which was wiped out entirely by the betterment of \$60,000 attributed to the two remainders.

(31.) Cost to cure is the cost of an attempt to ameliorate the diminished value from a partial taking. The theory is that it is more economical to spend money on a cure to restore value to the remaining property than to pay compensation for the reduced value. While the cost to cure may be relevant on the issue of damages, it is not a measure of damages (injurious affection) to be separately assessed without reference to the market value of the remainder.

(32.) In *Saint John Harbour Bridge Authority v. J.M. Driscoll Ltd.* [1968] S.C.R. 633, the Supreme Court of Canada held that "[t]here was no error in the conclusion of the Appeal Division that the value of the land in question should be fixed at \$1 per square foot. That figure represented the ... value of the land when put to its highest and best use ..." for a large warehousing or manufacturing enterprise and did not represent "the value of the land when used by a small business supplying lumber items to ships. Before any purchaser could utilize the land for that highest and best use, the purchaser would have to remove from the site the considerable number of frame buildings which existed at the time of the expropriation and which had been valuable and efficient for the use for which the owner was putting them ... Having adopted the rate of \$1 per square foot as the value of the lands, it was an error in principle to add to that amount any valuation of the buildings." Accordingly, the award was reduced by a sum representing the value of the buildings included in the amount awarded.

(33.) *Appraisal Institute of Canada, Claim Prevention Bulletin CP-6*, revised October 1995, states that "for market value purposes, there is absolutely no justification for using the cost approach as 'one of the three methods of appraisal'. Acceptance of the cost approach is for the most part limited to North America, and there is limited rational reason for its use other than for new construction. The only

exception would be for special use properties in which the end result is in realty a 'value in use' and not 'market value'. As such, the appraiser should make it abundantly clear in the report that the value is based on something other than market value and give an explanation as to the impact on the value reported, if any, between 'market value' and 'value in use.'" Canada v. Edwards [1946] Ex. C.R. 311, states "[t]hat the court should not estimate the value of the land and buildings separately but must estimate the market value of the property as a whole. The King v. Manuel [1915] 15 Ex. C.R. 381 followed. The Court is not directed to estimate the value of the component parts of the property separately, 'although all these elements must be taken into consideration'... And, while the estimate of value must be on the basis of value to the owner, such value ... cannot be disassociated from the price which a possible purchaser would be willing to pay for it, or exceed the amount which a prudent man, in a position similar to that of the owner, 'would have been willing to give for the land sooner than fail to obtain it', as Lord Moulton expressed it in Pastoral Finance Association, Limited v. The Minister [1914] A.C. 1083." The valuation principles set out in the Edwards ruling were subsequently followed in Waby Brook Farms Ltd. v. British Columbia Hydro and Power Authority [1984] B.C.J. No. 149.

(34.) In *Accurate Fasteners Ltd. v. Gray* (2005) CanLII 35479 (ON S.C.), the superior court dismissed a damages claim of solicitor negligence for the cost of fill required to permit development of raw land: "The plaintiff's expert witness on value was specifically instructed not to consider market value, but rather to base his estimate of value on the cost to cure the landfill problem or the amount by which the purchaser might have been able to negotiate a lower price for the property. The court of appeal has held that ... the clients are entitled to recover 'the difference between the price actually paid for the property and the market value of the property with [the problem that was not disclosed to the client because of the lawyer's negligence]": *Toronto Industrial Leaseholds Limited v. Posorski* [1995] 21 O.R. (2d) 1 (C.A.) at 23; *Messineo v. Beale* [1978], 20 O.R. (2d) 40 (C.A.). In my view, this is the normal measure of damages and the one which most effectively puts the client back in the position he would have been but for the solicitor's negligence." This approach to estimating damages is consistent with the before and after test, with the measure of damages akin to injurious affection.

(35.) In *Winnipeg Supply & Fuel Co. v. Greater Winnipeg (Metropolitan)* [1966] S.C.J. No. 13, the Supreme Court of Canada ruled that the before and after approach employed by the experts was the only possible approach in this case. "Metro took an irregular piece of land which, had it stood alone, would have been close to being unmarketable. No one would have paid \$280,000 for this parcel of land and there was no suggestion in the evidence that it could have been sold separately."

(36.) In *Ridgeway Associates, Inc. v. State*, 40 A.D.2d 1051; 339 N.Y.S.2d 160; 1972 N.Y. App. Div. LEXIS 3039, the Supreme Court of New York commented, "One drawback of ...[the appraiser's] testimony is his calculation of the subject property's value after the appropriation. This figure was arrived at primarily by deducting from the before value of the property as consequential damages the actual or, in some instances, the anticipated increased costs of developing the remainder area. While these costs are certainly valid factors to be considered in determining the subject property's post-taking value and the damages sustained, they are not, in and by themselves, solely determinative of the issues ... While evidence of the cost to cure a condition resulting from an appropriation is admissible such cost cannot be allowed in an amount greater than the amount of consequential damages otherwise supported by the record.... Such prospective expenditures are not the measure of damages but are only an aid in determining the difference in the before and after value of the property ... and cannot operate to increase the damages above what they could be without the expenditure."

(37.) The court in *Ridgeway Associates, Inc.*, concluded that the comparable sales had similar development potential as the property being appraised noting that the comparable sales "involved properties purchased by developers for development purposes and accordingly were sales in which development costs have been considered and were reflected in the sales price ... To add an increment to the value established on the basis of these sales is to inflate and distort the market value of the subject property."

(38.) In *747926 Ontario Ltd. v. Upper Grand District School Board* [2001] O.J. No. 3909, the Ontario Court of Appeal noted "there is no evidence ... that the claimants suffered actual damages as a result of the expropriation ... Rather, the lost developer's profit claimed is the prospective profit that the claimants anticipate they would have received sometime after the valuation date upon the sale of the expropriated lands ... the Act is clear that the compensation payable to the owner for a compulsory taking shall be the market value of the land ... Market value [as defined in Section 14(1)] does not include damages ...[and] makes no reference to any concept of profit because the market adjusts for the potential of the land for future development. A willing seller does not refuse to sell unless he gets the profit he anticipates will

result when the land is subdivided into serviced lots. Rather, a willing seller takes what the market, in the form of a willing buyer, is prepared to pay." In *Gedalia Properties Ltd. v. Ministry of Government Services* [1981] 32 O.R. (2d) 449, 122 D.L.R. (3d) 298, the court denied a claim for injurious affection based on a notional increase in the cost of construction for the remainder, stating, "There was no evidence to show any 'reduction in market value'... What the appellant has lost, if anything, is prospective profit."

(39.) In *Harris v. Minister of Lands and Forests* [1975] N.S.J. No. 33711 N.S.R.(2d) 361, the Nova Scotia Supreme Court in reference to cash-equivalency observed that "[i]f the land had been expropriated the day after Kenman agreed to buy it from Harris, the market value of the land would have been the original \$93,000.00 specified by the agreement, discounted to \$87,015.00 as cash value to allow for the estimated eight months which it would take Harris to get his money."

(40.) In *Mannix v. Alberta, Province of* [1983] A.J. No. 961 47 A.R. 81, a parcel in the city of Calgary was expropriated for a provincial park. The court found that residential subdivision was the highest and best use, but to achieve the highest and best use the undevelopable acreage would have to be dedicated as an environmental reserve as a condition of development under the Planning Act. Only the developable acreage was taken into account in determining the market value of the property based on the rate per "gross developable acre" as the unit of comparison in the market approach (direct comparison approach).

(41.) Richard C. Sorenson, *Appraising the Appraisal: The Art of Appraisal Review* (Chicago: Appraisal Institute, 1998), 159.

by Tony Sevelka, MAI

Tony Sevelka, MAI, is president of International Forensic & Litigation Appraisal Services Inc. and international Valuation Consultants Inc. (InterVal), an appraisal and consulting firm in the Toronto area. Sevelka has been appraising since 1972 and specializes in forensic and litigation work. Contact: T 905-602-4350; E-mail: tonysevelka@intval.com; Web site: www.intval.com

Table 1 Before and After Test, One Remainder

1. Value before taking (larger 50.000 acres @ parcel) ignoring the scheme \$275,000 per acre \$13,750,000

2. Less: Contributory value of 11.010 acres @ part taken (as part of the \$275,000 per acre \$3,027,750 whole)

3. Remainder value before the 38.990 acres @ taking (as part of the whole) \$275,000 per acre \$10,722,250

4. Less: Remainder value after 38.990 acres @ the taking \$300,000 per acre \$11,697,000

5. Equals: Injurious affection (betterment) \$(974,750)

Table 2 Before and After Test, Two Remainders

1. Value before the taking 50.000 acres @ \$13,750,000 (larger parcel) ignoring \$275,000 per acre the scheme

2. Less: Contributory value 11.010 acres @ \$3,027,750 of part taken (as part of \$275,000 per acre the whole)

3. Remainder value before 38.990 acres @ \$10,722,250 the taking (as part of \$275,000 per acre the whole)

4. Less: Market value of 4.000 acres @ \$800,000 Remainder A after taking \$200,000 per acre Market value of Remainder \$10,497,000 B after taking \$11,297,000

5. Equals: Injurious 34.990 acres @ \$(574,750) affection (betterment) \$300,000 per acre

Figure 1 Example 1-Partial Taking with One Remainder

Before the Taking After the Taking Location: Interior Parcel Corner Parcel

Greenfield Environment Greenfield Environment Topography: Level and at Grade Level and at Grade

Size: 50.000 acres 38.990 acres Configuration: Rectangular Rectangular with

Daylighting Zoning: Agricultural Agricultural Official Plan: Low-Density Residential Low-Density

Residential Highest & Best Future Urban

Use: Residential Future Urban Residential Value Per Acre: \$275,000 \$300,000 Figure 2 Example 2--

Partial Taking with Two Remainders

Before the After the After the

Taking Taking Taking

Remainder A Remainder B Location: Interior Parcel Corner Parcel Corner Parcel

Greenfield Greenfield Greenfield

Environment Environment Environment Topography: Level and at Level and at Level and at

Grade Grade Grade Size: 50.000 acres 4.000 acres 34.990 acres Configuration: Rectangular Triangular

Quasi-

rectangular Zoning: Agricultural Agricultural Agricultural Official Plan: Low-Density Low-Density Low-

Density

Residential Residential Residential Highest & Best Future Urban Future Urban Future Urban Use:

Residential Residential Residential Value Per Acre: \$275,000 \$200,000 \$300,000