

Estimating Commercial Severance Damages



By David Champagne, SR/WA



Severance damages may occur when only a portion of a property is acquired under an eminent domain action. Severance damages are generally defined as a loss in value to the remainder property caused by the acquisition of the portion taken. Such damages commonly are shown as a decrease in the unit value of the remaining land from its unit value before the taking, a decrease in the value of the remaining improvements or some combination of those elements.

Severance damages represent a major component of the real estate expenditures for many agencies involved in the acquisition of right-of-way corridors. In partial takings of commercial properties, credible techniques for estimating the contributory value of the part to be acquired are extremely important. Yet, traditional appraisal courses rarely address the topic of severance damage estimation and documentation with more than a passing mention.

This article presents some typical situations that may arise from partial takings of commercial property and offers some basic insights to assist in appraising the economic impacts of such takings. In particular, the author focuses on marginal situations, where a

major change in highest and best use is unlikely and the major improvements are not in the acquisition area.

Typical Appraisal Concerns

When a right-of-way corridor is widened to allow additional highway lanes, a strip of property is commonly acquired from some of the properties abutting the existing highway. If those properties are already developed to conform to the preexisting conditions, the layout may reflect some optimum use or configuration of the property. An appraiser of such partial takings needs a credible system to discern whether that is the case, and a means of evaluating the factors most pertinent to the potential impact of the acquisition.

Sometimes the most relevant factor for analysis will be simply the overall setback of the improvements, in terms of contribution to basic aesthetic qualities. On other occasions, perhaps when evaluating office or general retail properties, parking spaces may be a major factor of comparison, since the functionality of the improvements may be affected.

Another area of possible concern involves the effect on a display area when exposure of merchandise to

traffic may be important to market value, as with an auto or machinery dealership. With gas stations, specifically, the traffic pattern around the pump islands may be the focus of concern. Such situations generally involve studying the immediate relationship between the improvements and the site layout.

Careful selection and analysis of the most pertinent factors of comparison is a formidable aspect in the development of credible appraisal estimates for severance damages. While the examples noted are among the more common situations encountered, the appraiser needs to assess the particular problems of an individual assignment and determine the most appropriate comparison factors.

Using Factors of Comparison

Consider a small commercial property that loses five out of 40 parking spaces total to a highway-widening project, in which it is suspected that the loss will adversely affect the market value of the property. Appraisals have been prepared for such situations, which have not considered parking in the "before" portion of the appraisal, and where no analysis has been

included (of either the sales or the rentals) concerning that particular attribute.

However, an adjustment line typically appears in the "after" grid labeled "loss of parking," or "loss of marketability," or something similar. An adjustment is then made representing a uniform lump sum to all the comparables reflecting how much the appraiser thinks the lost parking has detracted from the property. That is not a true before and after appraisal, but a comparison of the "before" subject to the "after" subject.

No information about parking from the comparable data (either sales or rentals) has been incorporated into the analysis and the adjustment line does not represent a legitimate application of a comparison factor. It is merely a manipulation of the grid to give the appearance of analysis, while an unsupported lump sum (at least in terms of the appraisal report) is recommended for just compensation.

Occasionally, the appraiser has supplemented the primary appraisal report with a "study" from a third party specializing in physical cost-to-cure work, such as

the replacement of parking areas including paving, striping, curbing and the layout of acceptable traffic patterns. Often, the appraiser adopts the figures from such studies as a part of the overall recommended just compensation. Unfortunately, such studies are generally not well integrated into the appraisal process, and basic appraisal concerns such as contribution, functionality and enhancement are not addressed. Such supplemental studies often do not add convincingly to the solution of a partial taking valuation problem.

To properly employ parking as a factor of comparison requires that each sale be individually compared (adjusted) to the subject regarding the contribution of parking attributes to value. The procedure is similar to the analysis and adjustment of other comparison factors. The actual physical attributes for the factor under analysis needs to be verified and described for the comparables as well as the subject.

For instance, how many parking spaces are there and how are they arranged relative to each property's needs? The information

then may be processed into ratios relating spaces to building areas, or qualitative rating factors or some other system the appraiser deems is appropriate. It may be further necessary to analyze the parking adequacy for both the subject and the comparables, in terms of zoning requirements, general standards for the particular property usage and any other particular areas that the appraiser determines to be important.

In addition to physical inspections and research of published material, some helpful opinions can be obtained from market participants during the verification process. When gathering data for eminent domain appraisals, it is often appropriate to attune the verification information sought, as well as physical observations, to the special concerns that can be anticipated in partial take situations.

The emphasis of analysis often may be quite different from that which is normal in the routine appraising of entire properties. It is noted in USPAP that, "each item must be addressed in the depth and detail required by its significance to the ap-

praisal" (USPAP, Standard 2-2a-viii, 1996). When the severance damage has the potential to be the major component of just compensation, and estimating just compensation is the primary purpose of the appraisal, then the factors that relate to such damage merit a commensurately high level of investigation and analysis.

For illustration, Figures #1 and #2 represent data information grids, for the improved property section of the appraisal. Such grids are sometimes developed before the final value development grids and can be very useful aids in clarifying the importance and potential magnitude of various factors. The parking attributes of three comparables are outlined, to assist in determining a reasonable and consistent pattern for the quantitative parking adjustments to be subsequently developed (the complete final grid would typically contain several other factors, as well).

An indication of the direction and possibly the relative magnitude of the adjustments can be generally postulated from such information. Note that three signs, plus (+) or minus (-),

FIGURE 1: Attribute Grid Before The Taking

NOTE: ONLY PARKING CONSIDERED IN THIS GRID				
FACTORS OF COMPARISON	SUBJECT CHARACTERISTICS	COMP 1	COMP 2	COMP 3
BUILDING SIZE	5000 FT	6000 SQ FT	5500 SQ FT	4500 SQ FT
NUMBER OF PARKING SPACES	40	52	30	36
RATIO OF SPACE 100 SQ FT OF BLDG	0.80	0.87 -ADJ. (sale is superior)	0.55 +++ ADJ. (sale is inferior)	0.80 NO ADJ. (similar)
ZONING AND OR INDUSTRY STANDARDS	CONFORMS	CONFORMS (sale is similar)	NON-CONFORMING + adj. (sale is inferior)	NON-CONFORMING + adj. (sale is inferior)
INDICATED PRICE OF SUBJECT		less than comp, based on parking (-)	significantly more than comp, based on parking (++++)	moderately more than comp, based on parking (+)

FIGURE 2: Attribute Grid After The Taking

NOTE: ONLY PARKING CONSIDERED IN THIS GRID				
FACTORS OF COMPARISON	SUBJECT CHARACTERISTICS	COMP 1	COMP 2	COMP 3
BUILDING SIZE	5000 FT	6000 SQ FT	5500 SQ FT	4500 SQ FT
NUMBER OF PARKING SPACES	35	52	30	36
RATIO OF SPACE 100 SQ FT OF BLDG	0.70	0.87 - ADJ. (sale is superior)	0.55 ++ ADJ. (sale is inferior)	0.80 NO ADJ. (sale is superior)
ZONING AND OR INDUSTRY STANDARDS	CONFORMS	CONFORMS (sale is similar)	NON-CONFORMING + adj. (sale is inferior)	NON-CONFORMING + adj. (sale is inferior)
INDICATED PRICE OF SUBJECT		moderately less than comp, based on parking (-)	more than comp, based on parking (++++)	probably similar to comp, based on parking (+'s and -'s cancel)

indicate a larger adjustment than two signs, and so on. In Figure #1, for instance, comparable #1 would appear to require a modest downward adjustment, to bring it in line with the subject. Comparable #2, on the other hand, is inferior to the subject's parking both in terms of numbers (ratio) and in regard to zoning or industry standards, and will likely merit a significant upward adjustment. Comparable #3 is similar in physical features, but inferior when

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considering its zoning/industry standards specifications, probably leading to an upward adjustment somewhat smaller than that for Comparable #2. The procedures illustrated in that discussion could apply to either sales or income comparables.

After spaces are eliminated by an eminent domain acquisition, the subject's parking ratio will change, and it no longer may comply with zoning or industry standards. It would be expected that a new grid analysis would probably show a modified pattern, such as indicated by the grid in Figure #2. However, the pattern should still be consistent with the comparisons made in the before situation, and consistent with the new characteristics of the subject relative to the comparables.

The combination of the two grids (one before and one after) will then provide a logical guide to the appraiser

in concluding whether or not severance damages have accrued, and the likely magnitude will also be indicated by the comparison to the comparables' characteristics. That will be true in both the sales comparison approach and the income approach (via the market rent grid). If a cost approach were fully developed, it would be expected that the depreciation, particularly functional obsolescence due to layout and site contribution, would be thoroughly analyzed in a similar consistent fashion. That could require the breakdown method to be applied to each comparable, in order to investigate the importance and impact of the factor under study.

Refining the Estimate

Once the appraiser has decided on the most appropriate factors of comparison, and has possibly developed a rating or relative value grid such as discussed above, the final task of working out the actual numbers remains. In that, the same general procedures employed for substantiating and supporting any other adjustment must guide the appraiser. Ideally, the appraiser's tools will include paired sales or regression results to study the marginal value of parking spaces, setback from the highway or whatever factors are considered important.

It may be possible to study a group of sales that differ primarily in the feature under scrutiny to isolate clues about value. When a factor has a significant impact on value, some trending is often discernable, although an extensive study could be required to illuminate it. Simple graphical analysis will sometimes reveal such trends, as will simple sorts of the data. A sort typically involves arranging the price and the factor under study in columns, in ascending or descending order, and then looking for correlating trends. Most standard software packages will handle such chores quite easily.

For instance, an appraiser might be studying a group of sales that differ substantially in a potential feature of interest, such as a display area for an

auto dealership, or parking for a motel. The comparables could be sorted on the factor of setback or number of parking spaces to see if the resulting order of the comparables corresponds to the ascending or descending order of the prices. Additionally, a graph comparing the factor under analysis with the sale prices or rental incomes could be prepared. If such a graph of a factor versus the prices or rentals indicates a trend (such as a straight line, or some other definite pattern), as opposed to random scattering, then it is a clue that the factor is relevant to the value.

It may even be possible to estimate a range of the likely value of incremental units of setback or parking spaces or display area from such a graph. If so, that information can be translated into adjustments for the market value or rental grids. It could also be the point in the appraisal process where consideration is given to cost data, provided either by third party specialists or developed by the primary appraiser. While it may be inappropriate to merely insert a cost figure as a lump sum "adjustment," such data still may be useful, in conjunction with other information, in analyzing the differences between the subject and the various comparables.

Whenever applying analytical techniques, or incorporating information from other sources, the appraiser should consider whether the indicated conclusions are leading to reasonable or expected results. The basis for such a consideration may come from discussions with parties to the transactions during the verification process, from available research literature, or even from experience with similar properties or situations. That does not mean results contrary to preliminary expectations are necessarily wrong. However, if experience with the particular "sub-market" leads to expectations inconsistent with the research indications, some caution and further investigation is advisable. Analytical techniques are useful and necessary tools, but they should not supersede good, reasoned judgment.

The verification process can be especially useful in analyzing such questions and considerable planning should go into preparing for discussions with owners and investors. Although an appraiser might not spend much time probing an investor in an auto dealership about display area for a standard "full property" appraisal, such a topic should receive special emphasis when the primary objective is an estimate of potential severance damages caused by a partial taking.

Summary

In preparing eminent domain appraisals, a critical step is the ascertainment and analysis of the most important factors of comparison. Procedures such as those discussed should facilitate the detection and quantification, of any patterns of contributory value for the particular factors of comparison. That in turn will facilitate a logical adjustment to each sale for each of the subject appraisals (one subject "before," and another subject "after"). Most importantly, in terms of the before and after appraisal process, the values for the subject before and after the acquisition will be derived from comparisons between the subjects and the sales or rentals, rather than from directly comparing the before subject to the after subject.

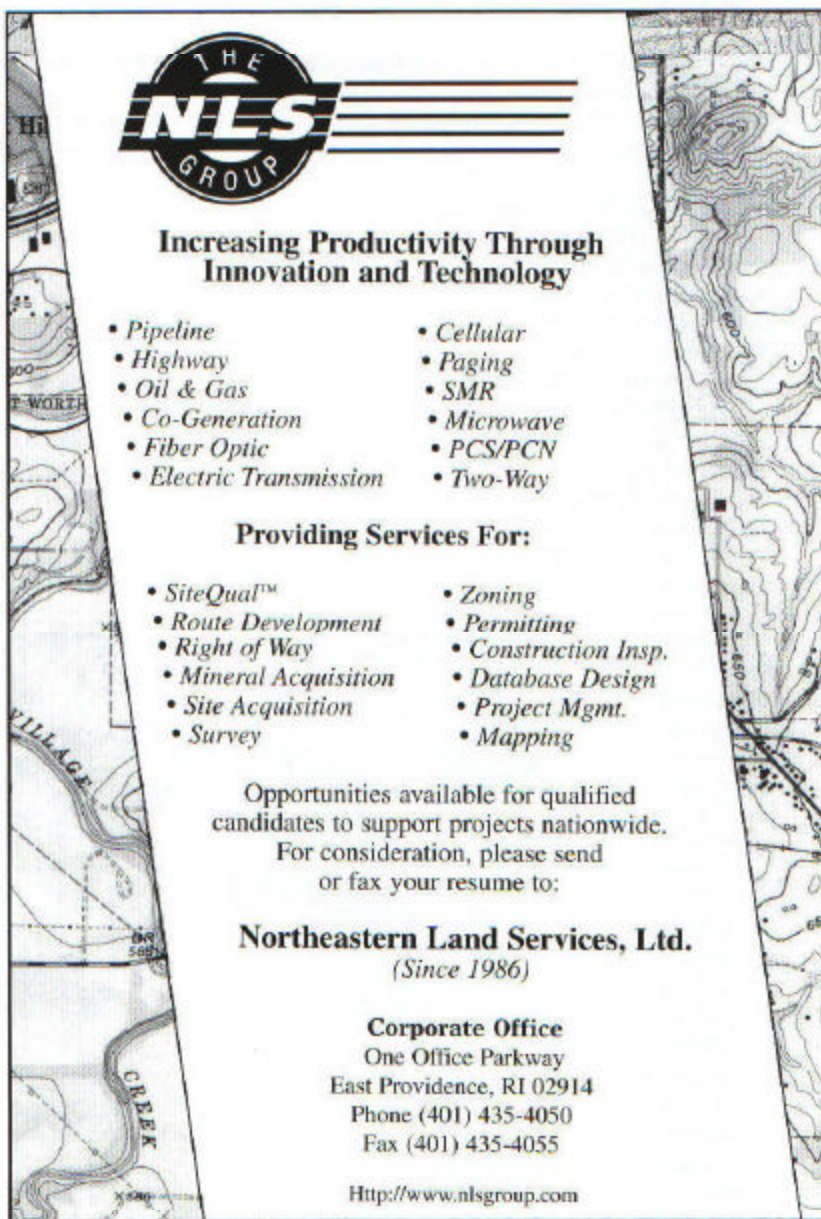
In many eminent domain appraisals, such analysis is crucial to the process of producing reasonably supported offers for properties subjected to partial takings for public purposes. Without thorough and market based, factual analysis, an agency and an affected property owner often end up on opposite sides of the bargaining table, or in court. Each party will have their own unsupported position based, from an appraisal perspective, on a lump sum "adjustment" which is not related in any observable way to market evidence.

In essence, they will each have, at least in appearance, advocacy appraisals. Under such circumstances, just compensation will be determined largely by subjective arguments, bargaining ability

and ultimately a court's biases, rather than market evidence. That cannot be expected to convey a positive impression of the appraisal profession or of the eminent domain acquisition process. ■

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