



Determining the Viability of the Remainder

The impact of a partial taking on utility and value

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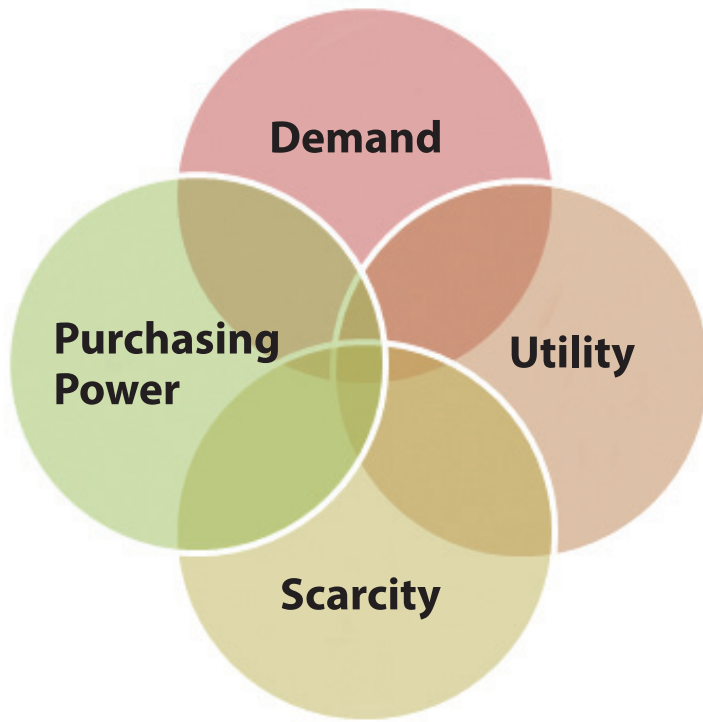
Public works projects frequently result in property expropriations, and appraisals work to determine the fair compensation to which an affected property owner is entitled. An expropriated property owner is entitled to the market value of the land taken, plus any diminution in value sustained by land not taken.

Appraisers are called upon by expropriating authorities and by impacted property owners to prepare appraisals within a statutory framework. The appraiser must conduct a broad enquiry into relevant economic factors and develop well-supported opinions of value within that framework. This necessitates an understanding of valuation procedures unique to expropriation.

Type of Remainder

Depending on the nature and extent of a taking, the land not taken can have its value impacted. The extent of the impact is a function of whether it is a viable or non-viable remainder. After a partial taking, the remainder constitutes an entirely new property, which requires preparation of a separate standalone appraisal, independent of the appraisal of the original property.

The land not taken is known as the remainder, and it can possess varying degrees of utility, depending on the nature and characteristics of the land, the presence and type of any improvements, and the spatial relationship of the land to abutting property, including the part taken. A partial taking that causes a natural severance will always have more than one remainder. A closely related term is remnant, and is considered to have negligible economic utility or value due to its size, shape, location or other detrimental characteristics. It is also referred to as an uneconomic remainder or uneconomic remnant.



For a remainder to have value, it must have these four key components.

Every remainder should be viewed as a new property requiring an appraisal, prepared independently of the before-taking appraisal. The valuation principles used in the initial appraisal should also be applied in appraising the remainder, including identifying the larger parcel as part of highest and best use analysis of the remainder. Both appraisals, however, must comply with the relevant provisions of the applicable expropriation act, ignoring the scheme when it is appropriate to do so.

There are two types of remainders in a property expropriation: viable remainders and non-viable remainders. A viable remainder is one that is marketable as a standalone entity. A non-viable remainder is essentially a remnant or uneconomic remainder or uneconomic remnant, terms that are in common usage in jurisdictions throughout the United States.

Economic Factors

Market value is the principal focus of most appraisal assignments. An opinion of market value predicated on highest and best use must be answered before an appraiser can offer an opinion as to the property's market value. All relevant aspects of highest and best use analysis

applicable to the expropriated property must be explored and sufficiently documented to support the opinion of market value.

For a remainder to have value, it must have four economic factors. First, demand is required. Second, there needs to be a utility value so that buyers will find it of use. Third is scarcity, as too much supply will depress the price. And the fourth requirement is purchasing power. There must be a financial capability to buy, although fewer buyers will depress the price.

While an appraiser's primary objective is to develop fact-based opinions, market value does not apply in a bilateral market where there is single seller and a single buyer. In this situation, the value of a non-viable remainder is affected by the interdependence of the non-viable remainder and an adjoining property under different ownership, combined to form a single larger parcel. Conveyance of a property under this condition does not meet the test of market value, which assumes an active market of many buyers and sellers, and a choice of available properties.

Market value does not apply to a non-viable remainder, as it has no

independent highest and best use. Instead, the value of a non-viable remainder is tied to the market value of a larger parcel by way of "value in contribution." Contributory value is measured in terms of the amount the non-viable remainder adds to the value of the larger parcel or as the amount that its absence detracts from the value of the larger parcel.

Injurious Affection

Injurious affection represents the loss in value sustained by a remainder in a property expropriation, sometimes referred to as remainder damages. According to Section 1 of the Ontario Expropriations Act, injurious affection is "where a statutory authority acquires part of the land of an owner; the reduction in market value thereby caused to the remaining land of the owner by the acquisition or by the construction of the works thereon or by the use of the works thereon or any combination of them."

For a property owner to sustain a claim for injurious affection arising out of a property expropriation, it must be demonstrated that the partial taking caused the remainder's value to change. Generally, the following criteria must be satisfied for a valid injurious affection:

- The remainder must be "held with" the expropriated land;
- The potential loss in value of the remainder must be occasioned by the use or construction of the anticipated public works of the expropriating authority upon the expropriated land;
- The potential loss in value of the remainder must not be too remote; and
- The potential loss in value of the remainder must be permanent rather than temporary.

As long as the expropriated land is part of one holding and is so inextricably linked to the remainder as to diminish the existing or potential

use or marketability thereof, the property owner is entitled to compensation for the consequential injury to the part not taken.

An after-taking market value that is less than the before-taking market value, minus the contributory value of the part expropriated, suggests that the remainder has been injuriously affected. However, injurious affection must be proven through independent, mutually exclusive, and objective valuation exercises without being tainted by a presumption of damages.

Countless legal, physical and economic factors have the potential to affect the market value of a remainder. The factors and their importance differ depending on the type of property, its use or potential use, and the presence of improvements. Factors affecting rural properties often differ from those that affect urban properties. Some of the potential factors that can impact the value of a remainder include title restrictions, easements, exposure, accessibility, lot configuration, dimensions and size, topography, drainage, crop production, diminished utility of existing improvements, increased fixed costs, non-compliance with zoning provisions, and change in highest and best use.

The timing and nature of the public works for which a property expropriation is undertaken can also influence the value of the remainder, due to the time value of money and whether the public works restrict or enhance the utility of the remainder.

Viable vs. Non-Viable

A viable remainder is a standalone larger parcel with an independent market value and highest and best use. However, if the part taken has a greater value as part of the whole property in its highest and best use prior to expropriation, the property owner is entitled to the contributory value of the part taken and there is no injurious affection.

A non-viable remainder has no independent highest and best use, along with limited marketability. Unless it can be tied to an adjoining property as part of a larger parcel for which a highest and best use can be established, a non-viable remainder will have nominal

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or no market value. Only land from an adjoining property that is not part of any other land expropriated can be considered in defining the larger parcel.

In all jurisdictions in Canada, no expropriating authority can compel a property owner to relinquish more land than is necessary to achieve the public purpose underlying an expropriation. Therefore, when a partial taking results in a non-viable remainder, a separate and independent estimate of value is required of the non-viable remainder.

Cost-to-Cure Remedy

In some instances, it might be possible to initiate a “cost-to-cure” that will transform a non-viable remainder into a viable remainder. For example, if legal access can be re-established for a remainder that is landlocked, it may prove cost-effective to remedy the deficiency. This remedy is only beneficial if the cost-to-cure as a measure of injurious affection does not exceed the diminution in market value sustained by the remainder without curing the deficiency.

In addition to the estimated cost of curing the deficiency, determining if a cost-to-cure is appropriate should consider the following:

- Whether a purchaser of the remainder could obtain all approvals necessary to implement the cure;
- The cure can be implemented for a fixed price;
- A purchaser would expect to be compensated for risk and entrepreneurial incentive in undertaking the cure; and
- The cure can be achieved within a reasonable time frame.

The overriding consideration is to ensure that the contemplated cure is both practical and warranted.

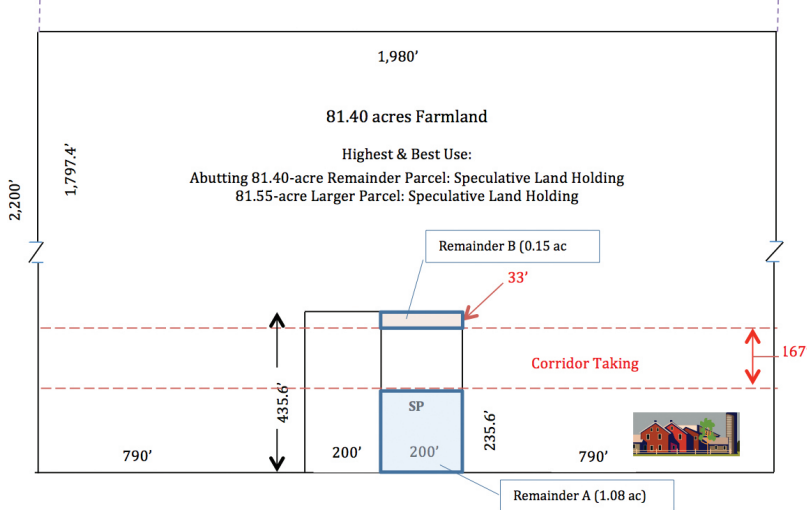
Applying the Concept

As an example, there might be three properties abutting an interior non-viable remainder, one on each side and another at the rear. Depending on the size and utility of each adjoining property, and whether any of these are part of the same expropriation as the subject property, the analyses involved in identifying a larger parcel can be overwhelming, and lead to a finding of more than one larger parcel or none at all. In this example, some of the possible permutations are as follows:

- Two abutting properties taken as a whole, leaving one adjoining property and the non-viable remainder to be potentially combined as one larger parcel.
- One abutting property taken as a whole leaving two adjoining properties and the non-viable remainder to be potentially combined as two larger parcels.
- Only part of each abutting property taken, with the three remainders to be potentially combined with the non-viable remainder to create one larger parcel.
- Only part of two abutting properties taken, with the two remainders to be potentially combined with the non-viable remainder to create one larger parcel.
- Only part of one abutting property taken, with the one remainder to be potentially combined with the non-viable remainder to create one larger parcel.

These permutations are by no means exhaustive, especially if there is more than one non-viable remainder, but the challenge of identifying the larger parcel is a prerequisite in assessing the prospects of a non-viable remainder, and estimating its

Sketch 1



Non-Viable Remainder A

Zoning - Permitted Use	: Single Family Dwelling
Minimum Lot Frontage	: 200'
Minimum Lot Area	: 2 acres
Non-Viable Remainder A	: 47,120 sf (200' x 235.6')
Plus: Abutting Non-Viable Remainder	: 47,120 sf (200' x 235.6')
Combined Site Area (Larger Parcel)	: 94,240 sf (2.16 acres)
Value of 2.16-acre Residential Lot	: \$180,000
Pro-Rata Allocation to Subject Remainder A	: \$180,000 x 0.50
Remainder A Value	: \$90,000

Non-Viable Remainder B

Non-Viable Remainder B	: 00.15 ac
Plus: Abutting Remainder	: 81.40 ac
Combined Site Area (Larger Parcel)	: 81.55 ac
Value of Abutting Parcel (81.40 ac)	: \$4,070,000 (@ \$50,000 per acre)
Value of Larger Parcel (81.55 ac)	: \$4,077,500 (@ \$50,000 per acre)
Maximum Contributory Value of 0.15 acres	: \$7,500
Less: Discount for Trading in Bilateral Market	: \$3,750 (50%)
Discounted Contributory Value of 0.15 acres	: \$3,750

A 200' by 33' (0.15-acre) strip, landlocked as a consequence of the corridor Taking (200' by 167'), can only be added to the abutting 81.40-acre remainder parcel, with frontage to two roads. Adding the non-viable remainder to the abutting remainder parcel, results in a Larger Parcel of 81.55 acres (0.18% increase in parcel area). The abutting 81.40-acre remainder parcel is zoned Agricultural, and, as a standalone parcel, the highest and best use is as a long-term speculative land holding for future urban development, with continuation of the existing agricultural use in the foreseeable future. The addition of the non-viable 0.15-acre remainder as part of a Larger Parcel, at best, provides marginal enhancement in the utility of the 81.40-acre parcel, and no change in highest and best use. The market value of the abutting 81.40 acres is \$4,070,000, based on a unit rate of \$50,000 per acre. On a pro rata basis, the maximum contributory value of Remainder B is \$7,500 (\$50,000 per acre). Further, there is only one potential buyer for Remainder B, which would necessitate a discount of, say, 50%, for trading in a bilateral market. Accordingly, Remainder B has a contributory value of \$3,750.

contributory value. The contributory value on a non-viable remainder will also be influenced by the size of the larger parcel to the extent that the unit rate attributable to the size variable will decrease as parcel size increases, and vice versa, all other elements of value remaining constant.

Highest and Best Use

In the U.S., according to the Appraisal Institute's Uniform Appraisal Standards for Federal Land Acquisitions, "...appraisers must bear in mind that the determination of the larger parcel is required in every appraisal assignment; irrespective of whether the agency has designated an acquisition on a total acquisition or a partial acquisition. This is so because, from a practical standpoint, whether an acquisition is a total or partial acquisition cannot be determined until such time as the appraiser has made a determination of the highest and best use, and the larger parcel."

In Canada, there is no corresponding appraisal instruction at either the federal or provincial level to identify the larger parcel. Instead, most expropriation statutes make indirect references to the larger parcel. For example, Public Works and Government Services Canada's March 2007 Valuation Guidelines on Expropriation under Section 2.12 in respect of "a limited interest or a partial taking," the value assigned to the security interest must be "in the same proportion that the value of the land taken bears to the whole of the land." Further, Section 26(3) states that the part taken "if not marketable on its own, then it is valued at the greater of, the value it contributes to the whole property, or the value of equivalent land," factors that are considered in defining the larger parcel.

The underlying foundational requirements established by the courts in defining the larger parcel are unity of ownership, unity of contiguity and unity of use (highest and best use). The courts have ruled that the unities need not be simultaneously present as of the date of valuation, as would be likely when dealing with a non-viable remainder.

Every partial taking differs in its impact on highest and best use analysis. If there is some doubt or uncertainty as to the physical or legal viability of a remainder for any economic use, independent advice from a qualified third party should be sought. Of course, as the appraiser is ultimately responsible for the opinion of highest and best use and the corresponding market value estimate, the appraiser must be satisfied that the conclusions of any third party are reasonable and appropriate before relying on them.

Contributory Value

When confronted with a non-viable remainder, it may be possible to mitigate damages. This outcome can sometimes be achieved by estimating the remainder's

contributory value to an adjoining property by combining the two to create a larger parcel, akin to an assembly involving separate rights of ownership. In this case, the larger parcel does not necessarily have, or require, unity of ownership.

A larger parcel that combines an abutting non-viable property (often the result of a partial taking involving the same expropriation) and a non-viable remainder of the subject property only requires an estimate of the market value of the larger parcel. In this scenario, both property owners are likely to enjoy equal bargaining power. Prorating the market value of the larger parcel, in its highest and best use, on the basis of an overall unit rate and applying the unit rate to the area of land in each ownership may be an appropriate method of determining the contributory value of each property, provided no improvements are involved.

The concept of the larger parcel is an integral part of highest and best use analysis. This analysis must reflect the most probable and financially feasible economic use. It establishes the basis for estimating both the market value of the larger parcel and the contributory value of the non-viable remainder. The maximum contributory value of a non-viable remainder as part of a larger parcel, before considering the appropriateness of a potential discount associated with a bilateral market, can be estimated by deducting all anticipated costs, including an allowance for entrepreneurial incentive, associated with consolidating title to both properties and achieving the highest and best use of the larger parcel.

In effect, the maximum contributory value of a non-viable remainder, pursuant to any adjustment for trading in a bilateral market, as part of a larger parcel represents the after-taking value of the remainder for inclusion in the before- and after-taking test applied in the appraisal of a partial taking. Depending on the interrelationship of the larger parcel and the non-viable remainder, it is possible to have a highest and best use for the larger parcel that differs from the highest and best use of the abutting property. A hypothetical example of the before and after test involving two non-viable remainders, including the presence of a bilateral market, is illustrated in Sketch 1, and summarized in the table below it.

As long as an adjoining property owner can benefit financially from acquiring a non-viable remainder, it is assumed that the adjoining property owner is a willing buyer. Typically, an adjoining property owner will pay something less than the maximum contributory value for a non-viable remainder to achieve financial benefit.

The discount associated with conveyance of a non-viable remainder in a bilateral market depends largely on the extent the non-viable remainder enhances the value of the adjoining property. Where a non-viable remainder only marginally enhances the utility of an adjoining property, the value in contribution may be virtually non-existent relative to the maximum contributory value to the larger parcel. Conversely, if an addition of a non-viable remainder changes the highest

and best use of an abutting property from residential to commercial as part of the larger parcel, it is likely that no discount to the maximum contributory value on a proportionate basis would be warranted.

Conclusion

The value of a remainder, whether viable or not, is always established as an exercise independent of the before-taking valuation. This means that every remainder is treated as a newly created property and all of the investigations and analyses that are involved in the appraisal process must be undertaken anew, and in compliance with the relevant expropriation act.

A partial taking appraisal prepared in compliance with the provisions of the relevant expropriation act and in compliance with recognized appraisal standards, with appropriately supported opinions of value presented in an unbiased, clear and convincing manner will assist the trier of fact in fixing the amount of compensation to which an affected property owner is entitled. ✪

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