Valuing the Probability of Rezoning

In this article, the problem of valuing the probability of rezoning is discussed. The discussion is based on an actual appraisal problem. The probability that rezoning will occur is not an assumption that can be easily made, and the reasonableness of such a conclusion is more often than not the subject of considerable debate.

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A unique appraisal problem exists when valuing a property that has a reasonable probability of being rezoned. Under circumstances such as eminent domain, the value estimate must be based on a specific date, reflect the value of the property as currently zoned, and consider the probability of rezoning. The value estimate must also consider the cost, delays, and time involved in obtaining a rezoning, while allowing for the uncertainty of rezoning based on the market's perspective. A potential pitfall awaits the appraiser who might try to solve this problem by making the value estimate "subject to" rezoning taking place, or who makes the speculative assumption that a reasonable probability exists for the rezoning to occur and, thus, values the property as if rezoning were an established fact. In this article, it is asserted that such an assumption is a serious mistake and one that might be difficult to justify in a court of law under cross-examination. To illustrate the complexities of this problem, an actual appraisal will be discussed.

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The Appraisal Problem

The subject property, located in the municipality of Anchorage, Alaska, was the focal point of a major highway project that was completed in the fall of 1985. The appraisal problem begins with a retrospective valuation date—the effective date of the declaration of the right of way taking under eminent domain. In this instance, the actual data of the appraisal report was three years after the effective date of the right of way taking (1 year after the actual completion of the highway project), making the circumstances relative to the impact of the right of way project on the subject property quite obvious. Consequently, the "after" valuation problem was more readily understood and analyzed than it may have been before completion of the highway project; while the "before" valuation problem was less discernible and required the appraiser to view the property as if the highway project did not exist. Great care must be exercised throughout the appraisal process in the "before" condition so that market data are not affected by project enhancement. This is sometimes difficult, as in the case of the subject; the project had been under consideration by the state for a 10-year period prior to the effective date of the taking and, therefore, sales affected by market speculation in anticipation of the project had to be avoided.

> **The appraisal problem stems from the subject property's residential zoning having been designated commercial in the municipality's overall development plan.**

The crux of the appraisal problem centered on the subject property's multifamily residential zoning at the time of the right of way taking, notwithstanding the fact that it was designated as commercial property within the municipality's comprehensive development plan. But most important, the highest and best use was clearly commercial as of the date of taking. After analyzing all of the pertinent data, it was concluded that a reasonable probability existed prior to the date of taking for a zoning change in the near future to a more intense commercial utilization of the land.

Description of the Property

In the before conditions, the subject property consisted of an undeveloped rectangular-shaped 7.16-acre parcel. The state of Alaska, under the power of eminent domain, acquired approximately 42.7% of this property for the A-C Couplet Highway Project, which left a remainder of four separate and distinct parcels of varying size and shape.

The C Street corridor, a major commercial district arterial, fronted the subject property along its western boundary. Although the subject property did not have direct access to this arterial, it had good exposure and indirect access from developed and undeveloped rights of way. Overall, access and exposure were considered to have been adequate to feasibly support a commercial development.

Properties along the C Street corridor for one half mile on either side of the subject parcel were commercially zoned before the taking, with the exception of a mobile home park directly across the corridor that was zoned multifamily residential. Consequently, neighborhood development was primarily commercial, especially along the

Significant rezoning had already occurred in close proximity to the subject.

major traffic arterials. Furthermore, significant rezoning had taken place in close proximity to the subject property both before and after the effective data of taking. To the north and adjoining the subject property was a recently completed 14-story glass and steel office tower; a small business park developed with primarily two- to eight-story office structures buffered the property to the south. To the east and adjoining the subject prior to the date of taking was a large tract of undeveloped land-zoned multifamily residential. This tract was clearly at the center of commercial development with no major road frontage or exposure. Its existence, however, increased the risk of rezoning the subject parcel to commercial because of its immediate proximity to the subject. The municipal planning staff had previously expressed the opinion that high density residentially zoned land in close proximity to a commercial district was in keeping with the goals of the community. In addition, there were several tracts of undeveloped commercially zoned land in the district that had attributes equally desirable as those of the subject site. Therefore, although significant data and support existed in favor of the rezoning effort contemplated, an element of uncertainty and risk would have been perceived by the market.

Highest and Best Use Before the Taking

The appraisal reasonably established that a rezoning effort to commercial utilization would be successful and, therefore, the legal limitations of zoning were not considered to be significant in the development planning process.

Before the right of way taking, the subject

Although significant data supported a rezoning, a certain amount of risk could be perceived by the market due to particular community goals.

property was physically capable of being developed for a variety of uses. No particular physical limitations were apparent with respect to any of the feasible uses. After completing a thorough analysis, market dynamics indicated only two feasible uses as of the date of taking. The alternatives were a retail mall type of development or a subdivision into a small-lot commercial business park similar to the adjoining property to the south. A hypothetical subdivision analysis was performed which included a comparative sales analysis of similarly sized, commercially zoned subdivision lots to form a residual value estimate for the land. The indicated land value developed from this analysis was $6.50 per square foot, which was nearly equal to the value as currently zoned.

A land residual analysis using current market data was performed on a hypothetical retail mall development. This was supported with cost data obtained from a similarly sized retail mall project and other relevant market data. This analysis revealed a substantial difference as compared with the hypothetical subdivision analysis, indicating a residual value to the land of $11.50 per square foot.

The Valuation Problem

With the highest and best use of the property established, the task of valuing the property before the right of way taking became the next step in the valuation process. The best comparisons to the subject property would have been properties with similar characteristics that had sold prior to rezoning and were in transition from multifamily residential to commercial zoning. Market investigation, however, revealed that no truly comparable properties with similar characteristics had sold under these circumstances.

Typically, buyers are averse to closing at a price reflecting a value as rezoned when

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