CHAPTER 9

PRETRIAL MOTIONS, DISCOVERY, AND EXPERT WITNESSES

I. Introduction

This chapter offers strategic advice on preparing a regulatory takings case for trial. First, it discuss the motions government counsel should consider bringing based solely on the pleadings and the administrative record. Insofar as discovery is necessary to defend a takings case, it then outlines critical issues the government should cover in depositions and requests for documents from the property owner in order to develop a defense based on the substantive issues reviewed in the previous chapters. Finally, the chapter explores the effective use of expert witnesses to gain maximum advantage in defending takings cases.

II. Motions Attacking the Pleadings

Chapter 3 discusses preliminary steps — ranging from assembling and reviewing the administrative record, to interviewing responsible officials, to conducting a title search — that government counsel should take at the outset of every takings case. Unlike most civil actions, a regulatory takings case usually arises from a legislative or administrative proceeding for which there is a written public record. By the time a takings case is filed, many critical facts will be undisputed. As a result, the preliminary investigation outlined in Chapter 3 will frequently produce all the factual information necessary for the government to prevail in a takings challenge.

In most regulatory takings cases, therefore, the government can file motions attacking the pleadings or for summary judgment. Indeed, takings cases are frequently resolved by such motions. *See* Text Block 9.1. These pretrial motions, when successful, can reduce or completely relieve the government of the burden of discovery.

A motion attacking the pleadings[121] is appropriate when government counsel can demonstrate that, even assuming every fact asserted by the plaintiff in its complaint is true, no relief can be granted. A motion for summary judgment should be brought where undisputed facts from outside the pleadings demonstrate that the court can rule for the government as a matter of law. *See* FED. R. CIV. PRO. 56. The two motions are not exclusive of one another; government counsel is free to renew a procedural or substantive defense on summary judgment even if the court rejects a motion attacking the pleadings on the same issue.[122]

Such motions generally proceed from the procedural to the substantive defenses. The following outline of defenses may be useful in guiding motions practice in state court takings cases:[123]

(1) Procedural defenses
    (a) final decision ripeness
    (b) failure to exhaust administrative remedies
    (c) statute of limitations
    (d) standing
(2) Substantive defenses
    (a) background principles
    (b) no categorical taking
    (c) no taking under *Penn Central* factors

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[121] Federal courts call this a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6). In some states, this motion is called a demurrer, based on the plaintiff's failure to state facts on which relief can be granted. *E.g.,* CAL. CODE CIV. PRO. § 430.10(e) ("The pleading does not state facts sufficient to constitute a cause of action.")

[122] *See, e.g.*, De La Beckwith v. Superior Ct., 80 P. 717, 718 (Cal. 1905) (overruling of demurrer not *res judicata* as to any issue raised in motion for summary judgment); Frisco Land & Min. Co. v. State, 141 Cal. Rptr. 820, 822 (Ct. App. 1977) (same).

[123] For actions filed initially in federal court, government counsel should seek dismissal for failure to comply with the state compensation requirement. *See* Chapter 4. For actions in federal court after litigation in state court, dismissal may be appropriate under claim preclusion, issue preclusion, and the *Rooker/Feldman* doctrine. *Id.*

Text Block 9.1

Winning Takings Cases by Dispositive Motions

In order to dodge agencies' dispositive pre-trial motions, takings claimants frequently contend that no regulatory takings claim can be resolved short of a trial. In advancing this argument, claimants usually cite out-of-context language from *Penn Central Transportation Co. v. New York City*, 438 U.S. 104, 124 (1978), that takings cases involve "essentially ad hoc, factual inquiries," or quote from *Pennsylvania Coal Co. Mahon*, 260 U.S. 393, 413 (1922), that takings claims can be decided only after examination of "the particular facts." Placed in proper context, these statements indicate merely that the Supreme Court recognized the difficulty of devising takings tests that would apply across-the-board to every land use regulation.

However, as demonstrated in Chapters 5 through 7, the courts have established a host of specific tests and factors to guide the courts in their assessment of regulatory takings claims. Because most takings cases arise from administrative proceedings where the facts are undisputed, the evaluation of a procedural defense and determination of the government's liability for a taking in any individual case involve the court's application of these established tests to undisputed facts. As a result, courts routinely dismiss taking claims on the pleadings or on summary judgment. *See, e.g., Yee v. City of Escondido*, 503 U.S. 519, 525, 539 (1992) (demurrer sustained); *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470. 473-74 (1987) (summary judgment granted); *MacDonald, Sommer & Frates v. County of Yolo*, 477 U.S. 340, 344-6, 353 (1986) (demurrer sustained); *Agins v. City of Tiburon* 477 U.S. 255, 261 (1980) (demurrer sustained); *Dodd v. Hood River County*, 136 F.3d 1219, 1224, 1230 (9th Cir. 1998) (summary judgment granted), *cert. denied*, 525 U.S. 923 (1998); *Carson Harbor Village Ltd. v. City of Carson*, 37 F.3d 468, 471, 477 (9th Cir. 1994) (motion to dismiss granted); *Hensler v. City of Glendale*, 876 P.2d 1043, 1047 (Cal. 1994) (demurrer granted), *modified*, 8 Cal. 4th 440b (Cal. 1994).

When filing pre-trial dispositive motions, government counsel should argue that (1) all facts material to the takings claim are undisputed, (2) the court should apply established takings standards to those facts, and (3) the government is entitled to judgment as a matter of law.

(i) economic impact
(ii) investment-backed expectations
(iii) character of government action

III. Discovery

A. The Need for Discovery

Discovery typically is not necessary to support dispositive motions based on procedural defenses such as ripeness, standing, or the statute of limitations. Similarly, discovery may be unnecessary for motions addressing the merits of a takings claim in facial challenges to legislation, or where the pleadings and the administrative record make clear that the plaintiff cannot assert facts satisfying any of the substantive tests for a taking.

However, where preliminary and procedural motions fail, discovery often becomes essential. To prepare for a trial on the merits of a regulatory takings claim, government counsel will need to establish facts sufficient to negate each of the plaintiff's theories of liability for a taking. For example, the government should be prepared to show that the regulation does not effect a categorical taking because it does not deny all economically viable use or require a permanent physical occupation of the property. Having established that the regulation does not cause a categorical taking, the government should present evidence that the regulation does not satisfy the *Penn Central* multi-factored test for a taking. In particular, the government should demonstrate that the regulation did not dramatically diminish the value of the property or defeat the owner's reasonable investment-backed expectations. *See Penn Central*, 438 U.S. at 124.

Discovery may yield critical facts about the plaintiff's development plans for adjacent properties also owned or controlled by the plaintiff that will help government counsel define the relevant parcel. Discovery may also be useful in determining the timing of the plaintiff's purchase of the property in order to develop the argument

that background principles of law preclude the takings claim or deprive the claimant of reasonable, investment-backed expectations to pursue the proposed land use. Finally, discovery is usually required to prepare a defense to the plaintiff's claims for damages.

B. Internet Discovery

The internet is an increasingly useful tool for informal discovery. Before initiating formal discovery, search the internet for information on the plaintiff and the subject property. Many developers maintain web sites and other information that may be downloaded from the internet. This information can include the legal structure of the plaintiff and its affiliates, parents, and subsidiaries; key dates relating to the property in question; the plaintiff's expectations for development of the property at issue; and financial data. This information can be introduced in evidence as an admission of a party against its interest, *see* FED. R. EVID. 804(b)(3), or confirmed by deposition testimony or responses to requests for admissions. The advantages of obtaining information from the internet are three-fold: (1) the evidence can be obtained immediately; (2) the evidence costs nothing; and (3) the government avoids the game playing that often accompanies formal discovery.

C. Formal Discovery

In Appendix A to this chapter, we have prepared a list of discovery questions and document requests for formal discovery that should elicit useful evidence for a defense on the merits of a regulatory takings case. The questions are categorized by issue, but many of the questions are relevant to more than one issue. Government counsel should, therefore, scan the entire list of questions, even if every issue is not present in the case.

These questions are most effective if incorporated into a request for documents and asked at deposition rather than by interrogatory. Given that the plaintiff generally has at least 30 days to respond to written interrogatories and requests for admissions, the plaintiff too

easily can supply evasive answers to written questions. Moreover, depositions have the advantage of allowing the government lawyer to ask follow-up questions.

D. Post-Discovery Motions for Summary Judgment

Some trial courts, particularly those unfamiliar with regulatory takings, may be reluctant to grant dispositive motions before the parties have had an opportunity for discovery. A denial of an early dispositive motion should not discourage government counsel from filing or renewing a motion for summary judgment if facts gathered through discovery demonstrate that there is no disputed material fact that prevents judgment on the law for the government.

IV. Expert Witnesses

Expert witnesses can be essential for the defense of a takings case on the issues of liability for the taking, and, if the government is found liable, the amount of just compensation.

A. Using Experts to Prove that the Plaintiff's Development Request Was Not Reasonable

Expert witnesses may help government counsel in several aspects of proving that a claimant's development request was not reasonable. For example, where the reasonableness of expectations are an issue, government counsel should consult with an expert in zoning, planning, or real estate development who has recent experience with the local planning commission, city council, or county board in obtaining land use permits. This witness should be equipped to testify as to the reasonable development potential of the property.[124] This expert is often an architect, land use planner, or

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[124] The test for reasonable investment-backed expectations is intertwined with the test for the market value of property that has development potential, but no permits. In the latter case, an opinion of market value can be based on a development

even a lawyer. If a consultant is willing to opine that he would have advised against investment of resources in the proposal or that it was unreasonable for the developer to have expected permission to develop, government counsel should consider retaining the consultant as an expert for trial.

In cases where the developer could not have reasonably expected government approval of the project because the project would produce severe adverse impacts on an ecosystem or other natural resource, the government should present expert scientific testimony of the potential impacts of the proposed project. These experts are usually academics or government-employed scientists.

Government counsel should also consider retaining an expert to show that the proposed development was not economically viable. Development of sensitive parcels like floodplains, wetlands, and hillsides is often prohibitively expensive. The developer may be a speculator that is taking risks few other developers in the area would take. He also may be using the request simply to establish the predicate for a takings claim.

In cases in which the economic feasibility of the proposed development project is questionable, the government lawyer should retain a real estate economist with expertise in developing operating projections of real estate development projects. This economist should project the expenses and revenue for the proposed development to determine how much profit the owner would make. The projection should inform the trier of fact as to whether the proposed development would have been profitable or could attract financing. If the government can establish that the development would not have been profitable, then it can argue that it took nothing from the developer by denying a permit for the project. These experts can be found in economic consulting firms, accounting firms, real estate development firms, and academia.

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scenario only if that development has a "reasonable probability" of approval. *See* City of Los Angeles v. Decker, 558 P.2d 545, 549 (Cal. 1977); Redevelopment Agency v. Contra Costa Theatre, Inc., 185 Cal. Rptr. 159, 162-66 (Ct. App. 1982).

B. Using Experts to Prove the Economic Impact Was Not Unduly Harsh

To defend a takings claim on the crucial issue of the diminution in value caused by the regulation, the government must often present evidence of the fair market value of the property both before and after the regulation went into effect. A professional real estate appraiser with experience in the relevant market is most qualified to express an opinion on the value of the property.[125] The government should select an appraiser who has accumulated the training and experience to qualify as a Member of the Appraisal Institute (MAI).[126] Experience defending appraisals in depositions and in court is also desirable.

The appraiser is usually the focal point of the government's proof that the property has retained substantial market value despite the challenged regulation. The government, however, may still need other experts to support the appraiser's opinion of value. The appraiser may rely on the opinion of a planning or real estate expert as to the reasonable development potential of the property.

The fair market value of vacant land is ordinarily a function of the potential uses of the property, referred to as the "highest and best use." The appraiser must assess the potential for development of the property for a use that will yield a profit to the owner. The development potential of property depends on the property's physical features, location, and the applicable zoning. In addition, whether

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[125] *See* discussion of real estate valuation, below in Chapter 13.

[126] The Appraisal Institute, based in Chicago, Illinois, is an association of professional fee appraisers that establishes criteria for competency and ethics, offers training programs for new and experienced appraisers, and formulates a code of ethics and standards of professional conduct. The Institute awards the MAI designation to those appraisers who have successfully completed the Institute's coursework and submitted appraisals that meet the Institute's standards. The MAI designation is the highest certification in the appraisal profession. The Institute has also developed a Code of Professional Ethics, containing six canons, and the Standards of Professional Appraisal Practice, which incorporates the Uniform Standards of Professional Appraisal Practice (USPAP), Supplemental Standards, and Guide Notes. *See* THE APPRAISAL INSTITUTE, THE APPRAISAL OF REAL ESTATE 705 (11th ed. 1996) ("*Appraisal*").

there is a reasonable probability that the zoning would be changed to expand the possibilities for development of the property turns on local politics and the history of similar development proposals in the jurisdiction. The planning/development expert should be qualified to advise the appraiser as to the reasonable development potential of the property.

Where the development potential of the property is complicated by topography, difficult access, or other physical features of the subject property and the surrounding land, a civil engineer qualified to design roads and infrastructure, and an architect may also be necessary to advise the appraiser as to the economic feasibility of a particular development. In some cases, a land surveyor is also needed to delineate the boundaries and dimensions of the property.

The government lawyer should be careful to limit her instructions to the experts to avoid the appearance of undue influence. The appraiser should be instructed simply to determine the fair market value of the subject property, assuming that the challenged regulation is in place. The supporting experts should be instructed to advise the appraiser as to the economically viable uses of the property, assuming that the regulation alleged to be a taking is imposed.

In Appendix B to this chapter, we have outlined a four-step process for supervising a fair and accurate appraisal. Appendix C suggests questions government counsel may want to use when deposing a developer's appraiser or cross-examining an appraiser at trial.

APPENDIX A

SAMPLE QUESTIONS FOR FORMAL DISCOVERY[127]

I. Background Principles and Expectations

A. Timing of Acquisition and Purchase Price

1. When did the plaintiff acquire the property? From whom?

2. Did the plaintiff acquire fee title, an option, or some other interest?

3. Did the plaintiff buy the property? What were the purchase price and the other terms of the purchase? Was the purchase of the property contingent on the plaintiff obtaining permits or financing, or on other events?

4. Was the purchase of the property financed? What was the source of all financing? What were the terms?

5. If the plaintiff acquired the property by means other than purchase, did the plaintiff give consideration of any kind for the property?

6. Is the property security for a loan? What was the original principle and what is the current amount of the debt secured by the property? When was the property first encumbered with the mortgage lien?

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[127] Some of the following questions were suggested by the interrogatories and document requests filed by Rhode Island in *Rhode Island v. Durfee*, No. 89-6141 (R.I. Super. Ct.) (on file with Community Rights Counsel).

7. Before acquiring the property, did the plaintiff have the property appraised? After acquiring the property?

8. Did the plaintiff acquire the property in a bulk sale, *i.e.*, did the plaintiff acquire other property along with the subject property in the same transaction? If so, how did the plaintiff determine the purchase price allocated to the subject property?

9. How did the plaintiff determine how much to pay for the property? What "due diligence" measures did the plaintiff take prior to purchase?

10. Did the plaintiff discount the purchase price to account for the risk of obtaining necessary permits?

11. Before purchasing the property, did the plaintiff consider the risk of obtaining necessary permits?

B. Investment-Backed Expectations

1. Before acquiring the property, did the plaintiff project the anticipated income and rate of return from development of the property? After acquiring the property?

2. What were the tax considerations to the plaintiff in purchasing the property? After purchasing the property?

3. What were the actual tax effects on the plaintiff from purchasing and owning the property?

4. Does the plaintiff own other investment properties? What income and rate of return on investment does the plaintiff realize from these properties?

5. Before acquiring the property, did the plaintiff investigate the development potential of the property? Did the plaintiff attempt to identify the regulations applicable to the property? After acquiring the property?

6. Before acquiring the property, did the plaintiff discuss the development potential of the property with any government agency? After acquiring the property?

7. Before acquiring the property, did the plaintiff discuss the development potential of the property with any other person, including the seller? After acquiring the property?

8. If the plaintiff is a corporation, did the corporation discuss the subject property or the proposed development in an annual report? In a prospectus or other information supplied to shareholders? In information filed with the SEC, including a Form 10-K or 10-Q? In any other filing with any government agency, including the Internal Revenue Service? In any other publication?

9. If the plaintiff is a partnership, did the partnership discuss the subject property or the proposed development in an offering memorandum or other document supplied to partners or prospective partners?

10. At the time the plaintiff acquired the property, did the property have any necessary permits? Has the plaintiff obtained any permits since?

11. Before acquiring the property, did the plaintiff attempt to obtain any permits necessary for development of the property? After acquiring the property?

12. At the time the plaintiff acquired the property, did the seller indicate that the property had any necessary permits?

13. What was the zoning of the property at the time the plaintiff acquired it? Has the zoning changed since that date?

14. What are the uses of the property allowed by its current zoning?

15. What do the general plan and any specific plans of the local government state with respect to the property?

16. What is the basis for the plaintiff's expectations that the property could be developed in the manner for which the plaintiff applied?

17. Did the plaintiff's proposed development of the property require a change in the zoning of the property? A variance? Amendment of a general plan or other special plan? Approval of a special plan or its equivalent?

18. What is the basis for the plaintiff's expectation that such change, variance, amendment, or approval would be forthcoming?

19. What is the plaintiff's experience with real estate development?

20. What is the plaintiff's experience developing real estate in the relevant jurisdiction?

21. When did the plaintiff formulate its plans to develop the property?

22. Before acquiring the property, was the plaintiff aware that approval of development on the property was subject to the discretion of the government? After acquiring the property?

23. Is the plaintiff aware of any similar development proposals to the same government agency? What was the government's action on those proposals? Have any conditions changed since the government's action on those similar development proposals? Has the law changed since?

24. Before the plaintiff acquired the property, was the plaintiff aware of any opposition to the proposed development of the property? From whom? Did the plaintiff consider or anticipate future opposition? From whom?

25. Did the plaintiff expect to prevail in the administrative process in the face of this opposition? For what reasons?

26. During the administrative process, did the plaintiff attempt to compromise with the opposition to the project? What measures did the plaintiff take to counter the opposition?

27. What additional permits would be necessary to complete the proposed development disapproved by the defendant? Is the property subject to regulation

by any government agency other than the defendant? What are the permits that these agencies must issue to permit the proposed development? Are such permits discretionary or mandatory? Are these permits linked to the permit denied by the defendant? Has the plaintiff obtained any permits or approvals from these other government agencies? What is the risk that the plaintiff could not obtain these permits?

28. Has the plaintiff filed suit to challenge regulation of the plaintiff's property by any other governmental agency?

C. Timing of Challenged Regulation

1. When was the regulation at issue enacted or imposed on the property?

2. If the regulation is legislative, when was the regulation enacted? When did the plaintiff first become aware of its enactment?

3. If the challenged regulation is an action of an adjudicatory body, when was the regulation imposed on the property? When did the plaintiff first become aware that the regulation had been imposed?

4. Since the date the plaintiff first acquired an interest in the land allegedly taken, identify (1) each use to which such land has been put, (2) the inclusive dates of each use, (3) the gross and net profit for each use, (4) the land involved in such use.

5. For the period of three years prior to the plaintiff's acquisition of an interest in the land allegedly taken, identify (1) each use to which such land was put,

(2) the inclusive dates of each use, (3) the gross and net profit for each use, (4) the land involved in each such use.

6. Did the plaintiff apply to develop the property before the application in question? What action did the local government take on this earlier application?

7. For the three years prior to the plaintiff's acquisition of an interest in the land allegedly taken, did the former owner apply to develop the property? What action did the local government take on this earlier application?

8. What action did the local government take on the application at issue in the lawsuit?

9. Did the plaintiff file a second application to develop the property? A variance application? Any other type of application?

10. Did the plaintiff file any administrative appeals of the government decision challenged? Did the plaintiff fail to pursue any available administrative remedy or appeal? If so, why?

III. Relevant Parcel and Economic Impact

A. Relevant Parcel

1. Is the plaintiff an individual, partnership, corporation, or unincorporated association?

2. Does the plaintiff own any property adjacent to the subject property? In the general vicinity of the subject property?

3. Is the plaintiff owned or controlled by any other entity?

4. Is the plaintiff a subsidiary of another corporation? Does the parent corporation own any property adjacent to the subject property? In the general vicinity?

5. Does the plaintiff own or control any other entity that owns property adjacent to the subject property? In the general vicinity?

6. Does the plaintiff intend to develop the subject property in conjunction with adjacent or nearby property?

7. Since the date the plaintiff first acquired an interest in the adjacent or nearby property, identify (1) each use to which such land has been put, (2) the inclusive dates of each use, (3) the gross and net profit for each use, (4) the land involved in such use.

8. For the period of three years before the plaintiff's acquisition of an interest in the adjacent or nearby property, identify (1) each use to which such land was put, (2) the inclusive dates of each use, (3) the gross and net profit for each use, (4) the land involved in each such use.

9. Is the development of the subject property denied by the defendant related in any way to the development of adjacent or nearby property in which the plaintiff also owns an interest? When does the plaintiff intend to develop the adjacent or nearby property? Does it intend to develop the subject property and the

adjacent or nearby property at the same or near the same time?

10. Has the plaintiff ever treated the subject property and adjacent or nearby property as a single unit for purposes of financing? For purposes of obtaining necessary permits?

B. Economic Impact

1. Did the plaintiff attempt to finance construction on the property, either through an equity partner or a lender? What is the status of such financing? If refused financing, what were the reasons given by prospective partners or lenders for refusing to provide financing for the project?

2. Has the plaintiff tried to sell the property? When? What were the listing price and other terms of the proposed sale?

3. Has the plaintiff sold the property? When? For what price and terms? To whom?

4. Before the denial at issue in the litigation, did the plaintiff intend to sell the property?

5. Before the denial at issue in the litigation, did the plaintiff intend to build on the property?

6. How has the property been used since the alleged taking? Has the plaintiff received any revenue from the property since the date of the alleged taking?

7. Does the plaintiff have an opinion as to what the fair market value of the property would be? If so, the

value as of what date? What did the plaintiff assume is the development potential of the property on the date of value? What is the basis for the opinion of value?

8. Has the plaintiff ever consulted with any real estate professionals to determine the market value of the property? When? What advice or estimates did these professionals give regarding the market value of the property?

9. Has the plaintiff had the property appraised? What is the date of value of the appraisal? What is the basis for the appraiser's opinion of value? What did the appraiser assume is the development potential of the property on the date of value?

10. What was the market value of the property when the plaintiff acquired it? What was the value of the property when the challenged regulation was imposed? What is the basis for these opinions of value?

11. What have been the trends in prices of comparable property since the plaintiff acquired the property? Of the commercial (residential) real estate market generally during that period?

12. Since the plaintiff acquired the property, what events other than the enactment or adoption of the challenged regulation have affected its market value?

13. If the plaintiff proposed a commercial development for the property, what was the market demand for such development on the date of value? Have any similar developments failed within three years before or after

the date of value? Why would the plaintiff's development have been profitable?

14. Is the challenged regulation the sole cause of the plaintiff's inability to develop the property? Would development of the property require the provision of new utility lines or facilities, construction of roads, or the provision of other public services? Was the failure of the plaintiff to obtain utilities or vehicular access to the property one of the causes of the plaintiff's inability to develop the property?

15. Does the plaintiff contend that the market value of the property will increase, stay the same, or decrease in the near future? Why? What events are likely to affect the market value of the property?

16. What is the total amount of just compensation the plaintiff claims is due for the alleged taking? How does the plaintiff calculate this proposed just compensation?

17. Is the plaintiff seeking money damages in addition to the fair market value of the real property allegedly taken in this action? If so, itemize and explain.

18. Does the plaintiff have an opinion of the market value of the property if the government had approved a development less intensive than that proposed by the plaintiff (to be described by government counsel based on the facts; *e.g.*, a development of 100 units instead of 200 proposed by the plaintiff)?

19. Is there any development of the property that the government indicated would have a greater chance

of approval than the project the government had rejected?

20. Did the government ever indicate that it might approve the plaintiff's project with conditions?

21. Did the plaintiff estimate the market value, rate of return and/or income generated from the project if approved with those conditions?

22. Does the plaintiff claim that the challenged regulation impairs the owner's use of the entire property, or only a portion or partial interest, such as an easement? If so, what property interest was injured by the regulation?

23. Demand production of the plaintiff's income and expense statements, profit and loss statements (if different), balance sheets, audited financial statements, unaudited financial statements, and state income tax returns (if discoverable under applicable law) for three years before the alleged taking.

III. Physical Occupation and Invasions

1. Does the plaintiff contend that the challenged regulation deprived it of the ability to exclude others or others' property from the property? If so, why?

2. Did the plaintiff voluntarily permit the persons or property to occupy her property initially, before the regulation compelled the plaintiff to allow their continued occupation?

3. Does the plaintiff have the legal right to remove persons or property occupying her property pursuant to the challenged regulation?

4. What steps has the plaintiff taken to remove persons or property occupying her property pursuant to the challenged regulation?

5. Does the plaintiff have the legal right to change the use of the property to avoid a physical occupation of the property compelled by the challenged regulation?

APPENDIX B
THE FOUR STEP METHOD TO GETTING A FAIR AND ACCURATE APPRAISAL

Defending a regulatory takings claim will frequently require a fair and accurate determination of the fair market value of the subject parcel. This determination typically is based on an appraisal. An appraisal is a subjective "opinion of value," not a mechanical or scientific process. Thus, the government's case might well stand or fall with the credibility of its appraisal. The government should therefore take great care in the selection of an appraiser and supporting experts. Government counsel must strive to produce an appraisal that is both fair from the government's perspective and more credible than the developer's appraisal. We recommend the following four-step method for producing a fair and accurate appraisal.[128]

The first step is for the lawyer to instruct the appraiser on the "date of value" and the appropriate law to be applied. Assigning a date of value is generally straightforward. For facial takings, the date of value is the date on which the ordinance went into effect. For as-applied takings, the date of value is the date on which the administrative decision applying a regulation was final. The government lawyer should also instruct the appraiser as to the definition of fair market value. The legal definition of fair market value varies slightly from state to state.[129] Government counsel should make sure that the appraiser is using the precise statutory definition of fair market value applicable to eminent domain actions for the state

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[128] For a helpful overview of appraisal standards that is available on the internet, *see* Interagency Land Acquisition Conference, *Uniform Appraisal Standards for Federal Land Acquisitions* (last modified April 13, 1998) (available at www.usdoj.gov/enrd/land-ack/).

[129] A commonly used definition of fair market value is that established by the Office of the Controller of the Currency, which states in part: "Market value means the most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently, knowledgeably, and assuming the price is not affected by undue stimulus." 12 C.F.R. § 34.42(g).

Text Block 9.2

Traps to Avoid in the Appraisal Process

Government counsel are advised to beware of valuation techniques that may inflate the value of the property and hence the claimant's damages. The most notorious of these techniques is the land residual technique (also known as the development approach or the lot method) for valuing large acreage suitable for subdivision. Some jurisdictions permit evidence based on this method of valuation in certain circumstances.[130] In other jurisdictions, the residual land technique is viewed as so unreliable that it is not admissible as evidence under any circumstances. *See Oklahoma v. Panell*, 853 P.2d 244 (Okla. Ct. App. 1993).

The land residual technique is used to value vacant land or land on which the improvements are not the highest and best use. The appraiser first determines the highest and best use of the land and makes an assumption as to the number of lots that would be approved for subdivision. Then she estimates the cost to build infrastructure necessary to market the subdivided lots at retail, and adds marketing costs and a reasonable profit to the developer. Then the appraiser estimates the retail income that would be derived from sales of the hypothetical lots. Finally, the appraiser

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[130] *See* United States v. 47.3096 Acres of Land, 583 F.2d 270, 272 (6th Cir. 1978) (allowing the land residual method of appraisal where the "proponent offers credible evidence of the costs of subdivision"); United States v. 100 Acres of Land, More or Less, 468 F.2d 1261, 1266 (9th Cir. 1972) (admitting the land residual technique where the property was partially under development at the time it was taken); Drakes Bay Land Co. v. United States, 459 F.2d 504, 506, 519 (Ct. Cl. 1972) (permitting land residual analysis where the claimant already began constructing roads in the proposed subdivision); Algonquin Gas Transmission Co. v. 60 Acres of Land, More or Less, 855 F. Supp. 449 (D. Mass. 1994) (the land residual technique "is too inherently speculative to be used except in those cases where development of the subdivision is relatively far along.") (*citing* Clifford v. Algonquin Gas Transmission Co., 604 N.E.2d 697, 702-04 (Mass. 1992) (approving land residual analysis where the claimants had already received approval from the planning board and the necessary permits for Phase I of a two-phase development project)); 4 Nichols, eminent domain § 12B.14 [1] (rev. 3d ed. 1990) (Whether jurisdictions accept the valuation into evidence usually "turns on the particular facts and the extent to which the developments had progressed toward completion.").

subtracts the costs from the income to arrive at a value that the developer would pay for the land. *See Appraisal,* footnote 126, at 328-29. Because the permits and improvements in this scenario do not actually exist, most courts view these density, cost, and revenue estimates as altogether too speculative. We recommend that the government discourage use of this technique by its appraiser, and further, that the government move to exclude from evidence any land residual appraisal offered by the plaintiff.

For similar reasons, we recommend that the government lawyer move to exclude an appraisal using the discounted cash flow ("DCF") methodology. Under the DCF approach, the appraiser computes the net present value of future cash flows from the development or use of the property. This approach requires the appraiser to make assumptions as to (1) the future construction of hypothetical improvements or a use of the property; (2) the future costs of construction or operation of the asset; (3) the future income from sale of the development or operation of the property; (4) the length of time for construction of the project or productive use of the property; and (5) an appropriate discount rate. Because use of the DCF method requires speculation and conjecture, it should not be admitted into evidence in a regulatory takings case.

in which the property is located. *See, e.g.*, CAL. CODE CIV. PRO. § 1263.320.

The second, and perhaps most important, step for the appraiser is to determine the highest and best use of the property. The highest and best use is "the property's optimum use in light of market conditions on a specific date." *Appraisal,* footnote 126, at 50. Simply put, it is the most profitable use of the property. The Appraisal Institute defines highest and best use as: "The reasonably probable and legal use of vacant land or improved property, which is physically possible, appropriately supported, financially feasible, and that results in the highest value." *Id.* In determining the highest and best use, the appraiser assumes that the land is vacant. The appraiser ultimately compares the subject property with similar vacant properties. If the existing improvements on the property are not the highest and best use, and the appraiser is comparing the subject property to other

vacant properties, the cost of demolition of the improvements must be subtracted from the market value of the land as if vacant.

To determine the most profitable use of the property that is reasonably probable and physically possible, the appraiser may need to rely on the opinions of other experts, such as planners, engineers, and architects. For example, a planning consultant can advise the appraiser that the zoning does not permit a hotel on the site, or that the zoning limits the height or bulk of a hotel such that a hotel would not be the most economic use. An office building, on the other hand, might produce the greatest revenue. Similarly, an architect may advise that a hotel is not feasible because poor access to the site would not allow for adequate loading docks, or the shape of the lot would not permit efficient use of space for a hotel. The appraiser must incorporate this information with his or her knowledge of the market to arrive at a determination of the highest and best use. This process obviously demands a sophisticated appraiser. It bears emphasis that the government lawyer should carefully select an appraiser for this task that has extensive experience in the market for the subject property.

Once the appraiser has reached a conclusion as to the highest and best use of the property, the third major step in the appraisal is to research the market for transactions of comparable properties. Appraisers sometimes rely on on-line services that provide information on real estate transactions to identify sales potentially comparable to the subject property. An appraiser experienced in the geographic market for the property will often be familiar with the salient transactions in that market. Appraisers also obtain market data by interviewing real estate brokers and developers.

The fourth step in the appraisal is the actual valuation of the real estate. There are three commonly accepted techniques or approaches to valuation admissible in most courts: sales comparison, income capitalization, and replacement cost. *See, e.g.*, CAL. EVID. CODE §§ 816, 819, 820 (West 1999); *Appraisal,* footnote 126, at 335-446.

The generally accepted and applicable valuation method for regulatory takings is the sales comparison approach.[131] The sales comparison method of value involves a comparison between the subject property and similar properties in terms of location, quality, character, condition, highest and best use, and size that have transferred in open market transactions within a reasonable time before or after the date of value. The appraiser extracts from each comparable sale a unit of comparison, such as dollars per square foot or per developable housing unit. Next, the appraiser compares this data to the subject property by adjusting the unit of comparison between the subject property and the sale for differences in location, quality, etc.

In the income capitalization approach, the appraiser estimates the net return on income property, such as an office building, by calculating the annual net income the property would generate at stabilized occupancy, deducting the annual expenses, and dividing by a fraction derived from the market, called a capitalization rate. The capitalization rate processes the net income to arrive at a value that buyers would pay for the building and its income-earning potential. The capitalization rate takes into account the risk that the asset will maintain the same net revenue stream. *See* CAL. EVID. CODE § 819 (West 1999); *Appraisal,* footnote 126, at 449-68.

In the cost approach, the appraiser estimates the cost to construct the existing improvements on the property as if new, and then deducts an amount to account for the depreciation of the improvements to derive a value of the improvements in their existing condition. Then the appraiser adds to that cost the land value to arrive at a composite value for the real estate. *See Appraisal,* footnote 126, at 335-95.

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[131] *See* United States v. 179.26 Acres of Land, 644 F.2d 367, 371 (10th Cir. 1981); Houser v. United States, 12 Cl. Ct. 454, 472-73 (1987); Nemmers v. City of Dubuque, 764 F.2d 502, 505 (8th Cir. 1985).

The income capitalization and replacement cost methods apply only to improved property.[132] Because a taking is almost never found where a regulation permits the continuation of the historic use of an improved parcel of land, these two methods are rarely applicable in regulatory takings cases.

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[132] *See Penn Central*, 438 U.S. at 136 (designation of Grand Central Terminal as historic landmark not a taking because it "contemplates that appellants may continue to use the property precisely as it has been used for the past 65 years . . . . More importantly, . . . we must regard the [challenged regulation] as permitting Penn Central not only to profit from the Terminal but also to obtain a 'reasonable return' on its investment.").

APPENDIX C
EXAMINING THE DEVELOPER'S APPRAISER

The following are suggested issues for examination of a developer's appraiser:

I. Qualifications

1. The appraiser was unduly influenced by the developer or her attorney.

2. The appraiser is not an MAI.

3. The appraiser has insufficient appraisal experience in the relevant market.

4. The appraiser has insufficient experience with condemnation appraisal principles.

5. The appraiser has insufficient experience appraising the type of property at issue.

6. The appraiser has a conflict of interest, *e.g.*, by attempting to negotiate a settlement of the dispute on behalf of the developer, the appraiser is not independent and disinterested.

7. The appraiser works only for private property owners rather than a mixture of public and private clients.

II. Highest and Best Use

1. The applicable zoning does not permit the use, and there is no reasonable probability that the zoning will be changed.

2. The use is not physically possible.

3. The use is not economically feasible.

4. The use cannot attract the necessary financing.

5. Approval of the use is discretionary, and such approval is not reasonably probable.

III. Market Research

1. Comparable sales are inconsistent with the appraiser's conclusion of value.

2. The appraiser failed to confirm sales data with the parties.

3. The terms of comparable sales are other than that assumed by the appraiser.

IV. Valuation

1. The appraiser failed to make consistent adjustments of comparable sales.

2. The appraiser failed to quantify elements of comparison that are readily quantifiable, and/or has improperly quantified qualitative items.

3. In adjusting comparable sales, the appraiser placed greater emphasis on certain factors than is warranted by the market, such as making significant adjustments for the time of the sale, when the market for the subject property was flat.

4. The appraiser used improved property as a comparable sale.

5. The appraiser used as a comparable sale property with different zoning and different use restrictions than the subject.

6. The appraiser used sales as comparables that were not open market, arms-length transactions.

7. The appraiser used listings as comparables, rather than sales or contracts to sell.

8. The appraiser gave greater weight to less comparable sales.