

## Local Government & Public Finance Law

### In Condemnation Actions, Trial Court Is Gatekeeper to Expert Valuation Testimony

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In a condemnation valuation trial, the court exercises a gatekeeping function to screen out potentially unreliable evidence. Where a trial court is confronted with a motion in limine to bar expert valuation testimony, it steps into this “gatekeeper” role established in *State v. Caoili*, 135 N.J. 252 (1994). Based upon a recent review by the Appellate Division of a trial court’s exercise of the gatekeeping function in *State Comm’r of Transp. v. 200 Route 17, L.L.C.*, 421 N.J. Super 168 (App. Div. 2011), and the reversal of a jury verdict based on the admission of expert testimony, attorneys who rely upon expert testimony may now need to take extra care to ensure that their proffer of expert testimony satisfies this reliability prong.

The case involved a partial taking of private property formerly improved with a Sears store located on Route 17 southbound, in Maywood and Rochelle Park. At the time of the taking, the property con-

sisted of a one-story, 31,775-square-foot building on 2.86 acres, with direct access to Route 17. The building contained a merchandise and service center, parts counter, warehouse and offices, and was supported by a 112-car paved parking lot. On May 23, 2005, the New Jersey Department of Transportation filed its condemnation complaint and declaration of taking, which transferred ownership of a 1.65-acre piece (more than half) of defendant’s 2.86-acre property. The taking required removal of all improvements on the property, and the property owner was left with 1.21 acres of vacant land without direct access to Route 17. The case proceeded to a valuation trial after the parties exchanged expert engineering and appraisal reports.

Both parties’ experts suggested the highest and best use of the remaining property was for continued commercial use, and both sides recognized that it was reasonably probable that a property owner would be able to obtain whatever land-use approvals would be necessary to use the property for a commercial use. In this case, the property owner would have had to obtain municipal permits to demolish and rebuild the buildings to function on the substantially altered property.

Both parties’ experts employed the

“cost approach” in valuing the property, whereby the vacant land and reproduction cost of the depreciated building are valued separately. However, whereas the State’s appraiser relied solely on the cost approach, the property owner’s appraiser employed all three approaches to value (cost, income and sales comparison), and testified that the highest and best use of the property was for commercial development consistent with zoning. In order to achieve said highest and best use, the property owner’s appraiser opined that the developer/owner would have to incur \$1,589,000 in expenses to renovate the portion of the existing building, which cost was deducted from his value conclusions.

The state moved at trial to exclude the proffered testimony, arguing that valuing the property as a renovated retail property was speculative given the permits were not in hand at the time of the trial, and the property owner had not committed to actually redeveloping the property. The state’s motion was denied by the trial judge, who found that the future use was reasonably probable based on the facts and testimony presented. After hearing the valuation testimony from both parties, the jury returned a verdict in favor of the property owner for \$8,096,140.

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The state appealed, arguing that the trial judge abused his discretion by permitting the property owner's appraiser to testify. The Appellate Division agreed, and reversed and remanded for a new trial holding that:

[T]he State is required to compensate a property owner for the land and improvements in their present condition, and the trier of fact may consider the reasonable probability of future renovations and approvals required to improve the property to its highest and best use, discounted by the value of the risks and costs of making such improvements.

The holding inexorably resulted from the Appellate Division's narrow framing of the issue: "What would a willing buyer pay a willing seller, without compulsion, for a substandard building, knowing that the buyer would be obligated to obtain appropriate land use and building approvals, as well as spend \$1.5 million for the property to achieve its highest and best use?" This is different from the approach taken by the property owner's appraiser that the existing mixed-use building could be valued by hypothesizing the costs of renovation for a commercial use, deducting those costs from the value of the renovated building, and calling the residue the value of the existing building.

The Appellate Division found "[t]his approach is too simplistic," and noted that "[s]peculative improvements to the property, that do not exist on the valuation date, cannot be considered in valuing this property. ... This provides a windfall to the owner, who has not improved the property, but would be paid as if he had." (Emphasis added.)

The focus of the reviewing court's analysis was on the legal requirements for admitting testimony in a condemnation proceeding where an appraiser opines that the highest and best use is different

than the existing use. Following the New Jersey Supreme Court's holdings in *State v. Gorga*, 26 N.J. 113 (1958), and *Caoili*, the Appellate Division noted that where an appraiser opines that the highest and best use is *different* from the existing use, the courts will look at whether such a use was "reasonably probable" as of the date of taking to determine its legal permissibility. When a reasonable probability of a change in the near future exists, "the influence of that circumstance upon the market value as of that date may be shown."

The Appellate Division's decision in this case indicates it was clearly looking for some recognition of what value a buyer and seller would arrive at during negotiations in an arms-length transaction. However, when a potential change in use is proffered, as stated in *Gorga* and its progeny, an expert may opine to the value employing the future use, "but only by way of explaining his opinion of the existing market value." The goal of course is to arrive at a current value for the property based on a potential reasonably probable future use.

NJDOT's expert valued the property under the cost approach at \$5,637,000 as of the date of taking. The property owner's expert used all three traditional approaches, and opined a value of \$9,133,000, after subtracting \$1,589,000 for the cost of renovations necessary to achieve the purported highest and best use. This approach resulted in the highest value for the property owner and was \$400,000 more than the appraiser's final value conclusion.

The Appellate Division was clearly troubled that the property owner's expert failed to explain why \$9,133,000 was the current value without an adjustment for the probability that the use would not be achieved. However, according to *Caoili*, even if a defendant's expert stated that he made a zero percent adjustment, this is an issue of weight for the jury to consider and not a matter of law for a court's review. This

proposition that an expert's adjustments are a question of weight was also upheld in *Casino Reinvest. Dev. Auth. v. Lustgarten*, 332 N.J. Super. 472, 485 (App. Div.), *certif. den.*, 165 N.J. 607 (2000), a case litigated by this firm and involving the same expert at issue here.

Although the Supreme Court's opinion in *Caoili* is still the law in New Jersey on the admission of expert testimony and the existence of a reasonable probability, the Appellate Division served notice that it is willing to throw out a jury verdict if a party does not discuss the probabilities of achieving a hypothetical highest and best use and how it relates to the property's current value. To protect a client's interests, attorneys and appraisers should be prepared to establish a record with the trial court that a highest and best use suggesting a future hypothetical use is "reasonably probable," and follow that up with making an adjustment based on the probability of the event happening. Even then, it is uncertain based on the Appellate Division's opinion in *200 Route 17* that a jury verdict will stand up on appeal.

The reasonable probability standard limits a trial court's review of the evidence to ensuring that sufficient proofs have been presented on the possible occurrence of an event. Once a reasonable probability has been established, the cases are clear that a trial court's decision on whether an expert should be permitted to testify should only be reversed for an abuse of discretion, and that it is within the jury's province to determine what weight (if any) should be accorded such testimony. As seen in *200 Route 17*, an appraiser must take into consideration that the future hypothetical highest and best use is not an accomplished fact, and any person negotiating for the purchase or sale of such a property would recognize that fact. It is a definite probability that failing to provide some adjustment for a proposed change will be scrutinized more closely by the appellate courts in the future. ■