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Response:

Testing the Value of Eminent Domain

Christopher Serkin*

In their new article, Sebastien Gay and Nadia Nasser-Ghodsí add some empirical evidence to the ongoing debate over compensation for eminent domain.¹ Their model raises a number of interesting questions, some of which are identified below, but their principal contribution is actually conceptual. They identify countervailing pressures on property values resulting from the possibility of eminent domain. On the one hand, they hypothesize that property buyers will discount the value of property at risk of eminent domain. On the other, they identify the offsetting premium that buyers should pay for a community's economically beneficial use of eminent domain, an effect too often ignored by courts, scholars, and politicians. Gay and Nasser-Ghodsí perform an important service by drawing attention to these potential benefits of eminent domain.

Theirs is not casual speculation, however. They actually set out to test their thesis. Their model is straightforward but insightful. They hypothesize that the risks and rewards of eminent domain should be reflected in property values in ways that can be detected and empirically tested. Consider the risks first.

It is, by now, well known that the fair market value standard for just compensation under the Takings Clause excludes at least some aspects of subjective value.² Professor Lee Fennell, in an excellent article, referred to this as part of an "uncompensated increment" in just compensation.³ However characterized, there is little doubt that the fair

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1. Sebastien Gay & Nadia Nasser-Ghodsí, *Guarding the Subjective Premium: Condemnation Risk Discounts in the Housing Market*, 89 TUL. L. REV. 79 (2014).

2. See, e.g., Thomas W. Merrill, *The Economics of Public Use*, 72 CORNELL L. REV. 61, 83 (1986) (identifying subjective premium); see also James E. Krier & Christopher Serkin, *Public Ruses*, 2004 MICH. ST. L. REV. 859, 866 (identifying absence of compensation for different costs of eminent domain). But see Brian Angelo Lee, *Just Undercompensation: The Idiosyncratic Premium in Eminent Domain*, 113 COLUM. L. REV. 593, 615-16 (2013) ("With the exception of compensation for lost autonomy, fair market value compensation will fail to provide full compensation for a property owner's value in the taken property only to the extent that the owner has idiosyncratically large amounts of 'subjective value.'").

3. Lee Anne Fennell, *Taking Eminent Domain Apart*, 2004 MICH. ST. L. REV. 957, 962.

market value standard frequently fails to make property owners truly indifferent to the government's exercise of eminent domain. This is not to suggest that an "indifference" standard is the necessary or even appropriate goal. Indeed, there are good reasons to think that fair market value compensation is normatively preferable.⁴ Nevertheless, the fact of the uncompensated increment means that eminent domain will predictably impose a burden on the condemnee relative to a voluntary transaction.⁵ Therefore, according to Gay and Nasser-Ghodsi, the risk of eminent domain should be reflected in property values.

The basic intuition is simply this: someone buying property at risk of condemnation should impose a discount measured by the expected value of the uncompensated increment. In other words, the risk of eminent domain requires a discount in property values equal to the magnitude of the uncompensated harm multiplied by the probability of the condemnation. To put stylized numbers on it, imagine someone is considering buying property (or not selling, which is conceptually identical for these purposes) worth \$100 to them. However, they perceive a 25% risk that the government may take the property by eminent domain, in which case it will pay "only" the property's fair market value, say \$80. In this example, the uncompensated increment is \$20. The discount demanded for the risk of eminent domain will then be the expected value of the uncompensated increment: a 25% chance of a \$20 loss, or \$5. In this example, the buyer can be expected to offer only \$95.

In theory, this "risk premium" should be observable in property values when information about the likelihood of eminent domain changes people's assessment of risk. Gay and Nasser-Ghodsi identify the United States Supreme Court's decision in *Kelo v. City of New London*⁶ as a moment at which the salience of eminent domain increased for the general public and, so, might have been detectable in changing property values immediately following the opinion.

4. See Lee, *supra* note 2, at 633-34; Katrina Miriam Wyman, *The Measure of Just Compensation*, 41 U.C. DAVIS L. REV. 239, 266-73 (2007); see also Christopher Serkin, *The Meaning of Value: Assessing Just Compensation for Regulatory Takings*, 99 NW. U. L. REV. 677 (2005) (identifying approaches to compensation that are consistent with different substantive views of property protection).

5. See Yun-chien Chang, *An Empirical Study of Compensation Paid in Eminent Domain Settlements: New York City, 1990-2002*, 39 J. LEGAL STUD. 201 (2010) (demonstrating inadequacy of compensation relative to voluntary market transactions).

6. 545 U.S. 469 (2005).

Kelo itself was not the end of the story, however. In response to the public backlash against the opinion, the vast majority of states adopted eminent domain reform, restricting eminent domain to a greater or lesser degree. And, here, the authors make an insightful move. They point out that eminent domain is often used to promote projects that provide a substantial benefit to the community. True, the stories that grab headlines generally involve foolish or ultimately misguided condemn-and-retransfer plans, but there are many examples where eminent domain generates significant net-positive value for the community and therefore drives increases in local property values.⁷ If eminent domain reform prohibits these beneficial government actions, then this should reduce property values. Of course, if eminent domain reform prevents the government from undertaking foolhardy projects that are likely to be net losers, then the reform will exert positive pressure on market value. These pressures, too, should be detectable in property values.

To illustrate this dynamic in action, imagine someone choosing to buy into a community that is considering an economic redevelopment plan to bring a new sports franchise to the town (a plan that is perceived as valuable). As Gay and Nasser-Ghodsi imagine it, the risk of eminent domain is “like a tornado with an uncertain path that could hit anyone.”⁸ The benefits of the sports franchise will also redound to the community as a whole. Someone buying into the town will therefore discount the value of property to reflect the risk that it may ultimately be taken for the project, but will pay a premium for the economic benefit that the sports team will generate. The net impact on property values will reveal the market’s judgment about whether eminent domain will impose more uncompensated costs than benefits.

Gay and Nasser-Ghodsi ultimately put their model to the test by examining the effect of post-*Kelo* eminent domain reform on property values. They measured a downturn in housing prices following *Kelo*, reflecting, in their view, the increased salience of eminent domain risks

7. For a controversial example, implicating both possibilities, consider Atlantic Yards. Charles V. Bagli, *Ruling Lets Atlantic Yards Seize Land*, N.Y. TIMES (Nov. 24, 2009), <http://www.nytimes.com/2009/11/25/nyregion/25yards.html> (describing the Atlantic Yards project). Although the redevelopment plan met with significant skepticism about its benefits, it is hard to deny that the area around the stadium is flourishing. See, e.g., Phyllis Furman, *Barclays Center at 1 Year: A ‘True Brooklyn Success Story’*, N.Y. DAILY NEWS (Sept. 22, 2013, 12:01 AM), <http://www.nydailynews.com/new-york/brooklyn/barclays-1-year-article-1.1460150>; cf. Krier & Serkin, *supra* note 2, at 869 (proposing compensation based on government assumptions about increased economic activity and resulting positive impact on property values).

8. Gay & Nasser-Ghodsi, *supra* note 1, at 89.

to prospective home buyers following the notoriety of the decision. But most impressively, they then code different states' responses to *Kelo* and find that the states that adopted the most restrictive eminent domain reforms experienced a negative impact on property values. As they explain the findings, "Strong anti-*Kelo* legislation constrained local governments from making improvements to the relevant real estate market in the face of holdouts or other impediments to organic economic development."⁹

The claim is an insightful one. In the aftermath of *Kelo*, many state legislatures committed to greatly restricting the use of eminent domain.¹⁰ While property owners often felt reassured, many missed the trade-off that the government was making. Eminent domain, after all, is a powerful tool for the government, and while it can undoubtedly be used for foolish and ill-advised purposes, it can also be an important driver for economic development. Gay and Nasser-Ghodsi's findings highlight that trade-off.

The empirical aspect of their work, while sophisticated and carefully done, raises some additional questions and concerns, however. For one, eminent domain reform may well be correlated with other political values that may account for the effects they detect.

The responses to *Kelo* immediately following the decision cut across political lines.¹¹ Conservatives decried the invasion of property rights. Liberals objected to the coercive transfer of property from individuals to corporations like Pfizer; they saw economic redevelopment being used to benefit the economically powerful at the expense of the politically powerless. And, indeed, these are at least some of the stakes in the fight over eminent domain. But there are other stakes, too, that hew more closely to familiar political divisions.

Stepping back from the details of *Kelo* and the context of economic development, eminent domain broadly implicates the balance between private property rights and governmental power. It is no coincidence that the conservative property rights movement focused on *Kelo* as a kind of wedge issue. It saw in the public's response the opportunity to argue for more expansive protection of

9. *Id.* at 113.

10. Ilya Somin, *The Limits of Backlash: Assessing the Political Response to Kelo*, 93 MINN. L. REV. 2100, 2102 (2009).

11. *Id.* at 2109 ("In addition to expected denunciations from conservatives and libertarians, *Kelo* was condemned by numerous liberal political leaders including former President Bill Clinton, then-Democratic National Committee Chair Howard Dean, and prominent African-American politician and California Representative Maxine Waters." (footnotes omitted)).

private property, and a concomitant reduction in governmental power. Eminent domain reform therefore implicates the extent of the government's ability to exercise power despite the objection of property owners. Liberals, of course, tend to favor broad regulatory powers, while conservatives tend to favor strong property rights. The government's ability to adopt regulatory responses to society's problems is constrained by the strength of private property rights. This conflict between public power and private rights is at the heart of conflicts over environmental regulations and land use controls, for example.

When the issue is viewed through this lens, the states that rejected the strongest eminent domain reforms may also have been the states that are most concerned about preserving governmental power over private property. And it is at least plausible that those are also the states that more often pursue public responses to social problems, whether economic or otherwise. If so, those may also be the states that tend to invest more in public infrastructure, in the environment, and in the social safety net. Those latter concerns may have little or nothing to do with eminent domain itself but may nevertheless correlate to attitudes about eminent domain, and they may have significant independent effects on property values. It is therefore important to tease out which is having the positive impact on property values that Gay and Nasser-Ghodsi identify: the content of the eminent domain reform or the other public expenditures that may be higher in states rejecting strong eminent domain reform.

To be clear, I have no data suggesting that this collinearity hypothesis is correct, nor do I presuppose that these different political attitudes would generally drive positive as opposed to negative pressures on property values. Rather, I suggest that eminent domain reform should be viewed as a salient political issue that may well track other political attitudes and that it is therefore difficult to determine the impact of eminent domain reform in isolation.

It is also important to recognize that the impact of eminent domain reform is not going to be evenly distributed within a state. I have previously argued that eminent domain is much more important in the dense urban core, where land assembly is difficult, than in suburbs and rural areas, where land assembly is much easier.¹² The intuition is straightforward but important: a one-size-fits-all response

12. Christopher Serkin, *Local Property Law: Adjusting the Scale of Property Protection*, 107 COLUM. L. REV. 883, 897 (2007).

to *Kelo* will have a much more significant impact on cities than on rural areas. Testing the impact of eminent domain reform on a statewide level appears to miss profound differences between municipalities when it comes to the benefits of eminent domain.

This is more than just a concern about the spatial scale of the model, however. Property values in those urban centers may dramatically drive the housing price index for the entire state. Impacts on urban property values will also have an outsized impact on statewide measures of property values. More problematically, some state eminent domain reform efforts have explicitly exempted their largest cities for precisely this reason. Pennsylvania, for example, limited the use of eminent domain after *Kelo*, but did not apply the new restrictions to Philadelphia or Pittsburgh.¹³ It is not clear how Gay and Nasser-Ghodsí scored this kind of legislative response to *Kelo*, and it is not clear how they should have. The bottom line is that the impact of reform is likely to be widely divergent within a state and that the statewide focus of their model obscures important dynamics.

The heterogeneous impact of eminent domain reform on the urban core may be exacerbated by macro trends in housing markets and by the regional impact of cities. For a concrete example, consider New York City—in some ways the 600-pound gorilla in the model. The density of New York City means that land assembly often occurs through eminent domain. From the enormous new facility for the Brooklyn Nets basketball team, to the headquarters for the *New York Times*, much private development relies upon the exercise of eminent domain.¹⁴ Importantly, New York State has stoically refused to adopt eminent domain reform. It therefore scores a zero in its post-*Kelo* response. And the city has indeed flourished during the years that Gay and Nasser-Ghodsí have studied.

The increase in property values in New York City is, however, attributable to macro trends that appear to have little or nothing to do with eminent domain. Yes, the ability of the city to pursue certain economic development strategies may have contributed to its astonishing success during the study period, but more than anything, the principal drivers appear to have been a newfound taste for urban

13. See 26 PA. CONS. STAT. § 203(b)(4) (2014); *Pennsylvania Senate Passes Eminent Domain Reform*, HEARTLAND INST. (Feb. 1, 2006), <http://news.heartland.org/newspaper-article/2006/02/01/pennsylvania-senate-passes-eminent-domain-reform>.

14. See Bagli, *supra* note 7 (discussing the Atlantic Yards taking and the construction of the Barclays Center in Brooklyn); Michael Heller & Rick Hills, *Land Assembly Districts*, 121 HARV. L. REV. 1465, 1468-69 (2008) (discussing land assembly for the New York Times Company's headquarters).

living by the affluent and, at the high end, foreign investment in New York City real estate. In addition, land use policies have restricted supply in the city's most desirable neighborhoods, which has caused tremendous price pressure.¹⁵ New York City strongly reinforces the correlation between broad powers of eminent domain and high property values, but it is not clear how much Gay and Nasser-Ghodsi's statistical model actually captures the dynamics of price increases there.

But there is another problem, too. The success of New York City has not been confined to New York State. The city spans a three-state metro region that includes New York, New Jersey, and Connecticut (the state where *Kelo* occurred). Because housing outside of the city is, in a general sense, substitutable for housing in the city, the run-up in New York City real estate markets has had a tremendous effect on the markets in nearby communities across state lines. That dynamic, however, cannot be caught by Gay and Nasser-Ghodsi's state-by-state measure of property values. That kind of regional impact is not confined to the New York City metro region, either. One state's eminent domain reforms will affect cities within its borders, but will also generate significant spillovers to nearby communities across state lines. All of this is simply to say that one state's eminent domain reforms (or lack thereof) will apply unevenly within the state and may also have impacts outside the state, at least where it has an urban center near the state border.

Finally, and perhaps most importantly, one of Gay and Nasser-Ghodsi's simplifying assumptions is that eminent domain is, in effect, a random event. In fact, eminent domain does not work like a tornado, unless it is a kind of poor-seeking tornado that happens to target low-income communities. The reality, of course, is that eminent domain does not fall randomly, especially when used for economic redevelopment (which is the exclusive subject of most eminent domain reform). Even as the most pernicious aspects of the history of urban renewal fade into the past, there is no doubt that racial minorities and the poor are subject to an increased risk of eminent domain because of their relative lack of political power.¹⁶

15. Amy Armstrong et al., *How Have Recent Rezoning Affected the City's Ability To Grow?*, FURMAN CENTER FOR REAL EST. & URB. POL'Y (Mar. 2010), http://furmancenter.org/files/publications/Rezoning_Furman_Center_Policy_Brief_March_2010.pdf.

16. For a history of eminent domain, see, for example, Wendell E. Pritchett, *The "Public Menace" of Blight: Urban Renewal and the Private Uses of Eminent Domain*, 21 YALE L. & POL'Y REV. 1 (2003).

Instead of a potential home buyer considering buying into a market and being subject to both the risks and benefits of eminent domain, the more realistic example involves two different potential home buyers. The first is a relatively poor African American, whose purchasing options are limited to a small lower-income development in an underperforming area near the urban core. The second is an affluent white worker looking in an upscale urban or suburban neighborhood. If eminent domain is unrestricted in the state, the first buyer may well impose a discount to reflect the risk of condemnation, but the second will pay a premium for the prospect of economic redevelopment. He knows that his property will not be subject to eminent domain, and, so, he can secure the benefits of economic redevelopment without bearing the risk of eminent domain.

The costs of eminent domain will predominantly affect lower-valued properties, while the benefits will tend to flow to higher-valued properties. The effect of eminent domain risk will therefore be muted because the low-valued property most affected by the risk is a relatively small driver of the state's housing price index. Think of it this way: the risk of eminent domain will be primarily borne by low-valued properties that do not have far to fall. Even a 10% drop in the value of property reasonably at risk of eminent domain may be quite small in absolute terms. A similar or even smaller percentage impact on high-valued properties, reflecting the benefits of increased economic activity, may be much higher in absolute terms and, so, overwhelm the costs associated with eminent domain risk.

This is not a direct challenge to Gay and Nasser-Ghodsi. After all, their findings do not purport to address the distributional aspects of eminent domain. And their measure of property values is entirely consistent with economic redevelopment that benefits the rich more than it harms the poor. But to the extent that their model implies a normative evaluation of the costs and benefits of eminent domain reform, it is important to be aware of the distributional consequences.

Ultimately, then, Gay and Nasser-Ghodsi's article makes an important contribution by identifying the competing pressures that eminent domain will have on property values and suggesting a way of thinking about the optimal level of eminent domain. Indeed, they conclude that onerous restrictions on eminent domain may well have negative impacts on property values within the state. But their model raises additional questions and challenges, some of which would require very different and difficult data collection to address. We can hope that they or others will continue the work and refine the empirical

results, perhaps testing their theory at the county instead of the state level. But already they have posed a serious challenge to the strictest eminent domain reforms.
