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Eminent domain

What commercial landlords, tenants and lenders need to know

If you own or lease commercial real estate, or if you lend money to commercial landlords, you need to know your rights when it comes to eminent domain. This article addresses some of the basics on how to protect the value of your property and ensure that you are fully compensated when the government takes all or a portion of your property.

Eminent domain is the government's power to take private property for a public use. There are many reasons for a taking authority to exercise its eminent domain power, including the construction of utilities, greenways, railways,

compensation is generally measured by the difference between the value of your property as it existed on the day of the taking and the value of your property as it exists immediately after the taking. For example, suppose you own a parcel that is 50,000 square feet - or a little more than an acre of land - and the government permanently acquires 20 feet across the length of your property's 200 feet of road frontage to widen the road and install a sidewalk. That would be 4,000 square feet of land taken from you. If the fair market value of your land (not counting the building and other improvements) is \$50 a square foot,

and future retail use. If that were to happen, then you will have suffered damages to the remainder of your entire parcel. Those damages must be taken into account when you calculate just compensation. With the help of an appraiser, your attorney explains that now your \$2.5 million parcel, with an improved value of \$4.5 million as of the date of the taking, may only be worth \$2 million because you can no longer use the property in the same manner as before. So while the taking authority's offer was \$200,000, your just compensation should be more like \$2.5 million. Alternately, your attorney might work with a traffic engineer to have the taking authority change the location of the sidewalk or negotiate relief on the setbacks, saving your parking and greatly reducing your damages. It has been our experience that the N.C. Department of Transportation and local municipalities welcome such conversations early in the process to develop a win-win solution whenever possible.

At the same time, if you are the landlord, you will need for your attorney to review the title records to determine who else has a legal interest in your property. For example, is there a mortgage on your property? If so, you have probably assigned the condemnation proceeds to your lender in the fine print of your deed of trust. Your attorney will need to work with your lender to be sure that the lender is satisfied with the plan to settle or litigate the issue of just compensation.

Similarly, if you have a tenant on the premises, your attorney will need to review the lease to determine what

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schools and airports. But by far, the most common reason is widening an existing roadway. If the value and appeal of your commercial property depends upon the adjacent roadway for customer access and exposure, then there will usually be some degree of negative impact on your property and your financial and business interests when the roadway is altered.

Fortunately, the drafters of the Bill of Rights wrote the Fifth Amendment with you in mind: "... nor shall private property be taken for public use, without just compensation." Just

then the government will have taken \$200,000 worth of your property. If the government offers you \$200,000 for your property, should you take it? Not without some careful consideration of what the taking really means to your commercial property and who else may have an interest.

First, you will need to investigate the legal interests that are being taken from you and determine the impact on your property. Suppose your attorney discovers that the taking destroys your setbacks and cuts into 10 parking spaces that you need for your current

rights your tenant may have to terminate the lease or share in the proceeds of the just compensation. If your tenant has a right to terminate for loss of parking, and your attorney is able to work a deal to preserve your parking spaces, then you just saved your income stream from the property for years to come. However, your tenant is probably entitled to a portion of the condemnation proceeds. Here's a tip that most landlords don't know: A tenant is entitled to share in the condemnation proceeds and to recover the loss or damage to its leasehold interest in the property unless the lease expressly provides otherwise, and a long-term tenant may be entitled to the lion's share.

If you are the tenant, you also will want to have an attorney review the title to determine your rights. Your lease may give you the right to terminate, but it may have very short, even onerous, time deadlines for you to exercise that right of termination. I have seen notice requirements that are as short as 10 or 20 days from the taking. You may have a problem if you have assigned your right in the condemnation to your landlord, if you have subordinated your rights to the landlord's lender or if your lease is unrecorded. Here's a tip that many tenants don't know: The taking authority is required to give notice to everyone with a "recorded" interest in the property, and leases for more than three years must be recorded to be valid against purchasers for value in North Carolina.

The former example for a taking 4,000 square feet of property was on the surface pretty straight-forward, but as you probably already know, most roadway projects are not that simple. Nearly every major roadway widening requires that multiple legal interests be acquired. For example, in addition to acquiring the new right-of-way over

your property, NCDOT will likely need to relocate utilities, deal with moving storm drains and gain access for its construction crews before it can widen the road adjacent to your property. To accomplish this, NCDOT may take a new right-of-way (which is a permanent taking of your property) where the road is to be widened for new travel lanes, curb and gutter, and usually some additional land for sight lines and buffers. NCDOT also will take permanent utility easements, drainage easements, slope easements and temporary construction easements to facilitate the project.

I have experience with tenants who have terminated their leases because of a slope easement. I also have seen temporary easements that last for many years and add up to hundreds of thousands of dollars in damages, so you will want to be sure to understand what the taking entails before you determine your course of action.

Finally, if you are a lender, you also should have your attorney investigate the impact to the property and determine who else has an interest in the land that that serves as your collateral for your loan. For example, if the ability to repay the loan was based on the rental income from the property, and the tenant has a right to terminate the lease, you could wind up with a defaulted loan, a credit bid at foreclosure and a distressed property in your real-

estate-owned department. If the tenant does not terminate, you can protect your income stream from the property, but the tenant may be entitled to a large portion of the condemnation proceeds. Here's a tip that many lenders don't know: Almost all subordination agreements with long-term tenants also are non-disturbance and attornment agreements. Rather than subordinate the tenant's interest in condemnation proceeds, such agreements allow the tenant to be compensated for any loss to its leasehold interest. Determination of these issues is critical to determining if the property has adequate collateral value as security for the loan and the ability to generate cash flow for debt service.

Navigating the eminent domain process can be challenging, even for sophisticated landlords, tenants and lenders. Make sure that you are prepared for the twists and turns that a project might take and even some unexpected bumps in the road, such as a lease termination or a defaulted loan. Knowing your legal rights and understanding the impact of a proposed project at the outset usually is the key to a successful outcome. In some instances, you can protect your rights and maintain your property value by working with the taking authority to minimize the impact. If that fails, make sure that you are fully compensated for the rights that are taken from you.

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