

Special Master Bias in Eminent Domain Cases

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OVERVIEW OF EMINENT DOMAIN VALUATION

The various state laws in the United States are consistent on eminent domain valuation: the stated goal is the difference between the total value of the property before the taking and the total value after the taking. Various states break the valuation into two portions: (1) the value of the actual property taken; and (2) the reduction in value of the remaining property due to the taking. This reduction in value of the remaining property is also known as consequential damages.

To attempt to speed up the resolution of eminent domain cases, the various states employ arbitrators or arbitration panels to hear these cases and render a decision on property value. Eighteen states appoint attorneys—special masters—to hear these cases.¹ These states require a special master proceeding to be completed before an appeal to a higher court can be filed. The special masters are limited to deciding the amount due the property owner for the property taken, and they generally have broad discretion on admissibility of evidence. The decision of the special master can be appealed to a court of general jurisdiction and a jury trial.

The study in question concerns eminent domain cases in Georgia, where the special master is appointed by the judge or judges of the Superior Courts (the courts of general jurisdiction).² It is common for the condemnor to request the appointment of a specific individual as special master at the time the eminent domain action is filed in court; generally, the court agrees with the suggestion and makes the appointment. Hence, the condemnor is in effect appointing the arbitrator. Evidence from the actual

cases analyzed suggests that there may be profound and persistent systematic bias by special masters toward the condemning authority.

Bias in valuations favoring the condemnor could have several possible causes:

- Direct appointment of the special master by the condemnor, or at least great influence by the condemnor in the selection process;



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- A perception by the special master that awards favoring the condemnee will result in fewer appointments in the future; or
- A conservative bias resulting from a lack of valuation training that favors erring on the low side.

The problem in dealing with bias in special master cases is that the law tends to contemplate, and be oriented toward, *individual* bias but not *systematic* bias. The Georgia law is illustrative. In Georgia, the responsibility of the special master is to establish the value of the property condemned, and nothing else.³ Georgia case law characterizes the special master's decision as judicial, or at least quasi-judicial.⁴ Thus, the special master is a judicial officer within the contemplation of the immunity doctrine.⁵ A complaint could be filed against a special master for bias, but it would be decided under the rules applicable for judicial misconduct. Such rules contemplate discipline for bias against an individual, but systematic bias in the form of consistently low or high awards would have no remedy.

The states require a special master proceeding to be completed before an appeal may be filed. Counsel for the condemnee may find it difficult to ascertain the pattern of rulings for any particular special master, since special masters often are only required to award an amount for the taking, and not issue a formal ruling that may be analyzed. Attorneys appointed as special masters may work in several different jurisdictions as well, making such research difficult. The states make removal of a special master difficult, and the removal requires a ruling from a superior court judge.

The sole remedy (other than judicial misconduct) for correcting special master errors is an appeal in Superior Court, the trial court of general jurisdiction in Georgia. However, the special master's finding of value will not be set aside if it is within the range of the evidence presented at the hearing.⁶ It would appear, then, that an attempt to appeal a special master's award who is systematically high or low will be unsuccessful. If moral hazard is present in the selection of the special master by the condemnor, the awards will tend to be systematically low. Awards that are systematically low will not be successfully attacked if they are within the range of the evidence, and the special master is shielded by judicial immunity and subject to attack only for the extraordinary grounds of bias that are

addressed in judicial misconduct cases. This study will show that special master awards exhibit systematic bias toward lower valuations.

RESEARCH HYPOTHESES AND METHODS

The test hypothesis will be that final awards to property owners—whether settlements or jury awards—vary dramatically both from the condemnor appraisal and from the special master award. These jury awards/settlements tend to be statistically much closer to the value ascertained by the appraiser for the property owner. This will be the first study using data from a number of individual condemnation cases, with the research goal being to show quantitatively that this bias exists.

The research will look at 16 actual eminent domain cases. It will compare the initial appraisal value proposed by the condemnor with: (1) the appraisal obtained by the property owner; (2) the award granted by an arbitrator; and (3) the final settlement amount. Most of the cases studied are partial takings.

The proposed study will use actual individual eminent domain appraisals performed by two different appraisers, one each for the condemnor and the property owner, and use actual settlement amounts to determine if bias may exist. The importance of this study is that prior research has not quantitatively examined actual appraisals and settlements to determine if appraisal bias might exist. The data was generated from cases supplied by two Atlanta law firms.

A thorough search of the major real estate journals dealing with appraisal issues—*The Appraisal Journal*, *The Journal of Real Estate Research* and *The Journal of Housing Research*—does not yield any articles on this specific topic of appraisal bias and eminent domain. While a review of appraisal behavioral research articles did not find a study specifically related to the issues involved in eminent domain valuation, this prior research does identify appraisal behavioral patterns that could have an impact on the appraisal results in an eminent domain case.

EMINENT DOMAIN LITERATURE

A recent study by Clauretje, Kuhn and Schwer⁷ examined mass residential condemnation appraisals due to a major airport expansion. The government appraisers used a few discrete attributes for each house—such as number of bedrooms, lot size, number of bathrooms—to estimate

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value. Individual appraisals were not performed. The properties were all complete takings. The researchers found that:

- the appraisers tended to undervalue properties with lower market values and overvalue those with higher market values;
- within the overall study, government appraisers overvalued the properties by an average of 17 percent; and
- these variations were perhaps caused by the appraisers using models with fewer variables than might be used in a typical appraisal.

The researchers did not address the possibility of bias in the government appraisers, nor did they address the possibility that individual appraisals of the properties being taken may have yielded different results than those achieved using a generic model.

Another earlier study by Kowalski and Colwell⁸ compared market values with assessed values for property tax purposes. The authors found an underassessment (undervaluation) of properties as a result of the failure of government appraisers to include evidence of incremental value—such as frontage or ability to subdivide—into the assessed value. The study did not address the possibility of bias, nor was it focused on eminent domain actions.

Guidy and Do⁹ compared eminent domain valuations for single-family homes in San Diego, California, to market transactions. The study does not explain the methodology of the government valuations nor does it explain the purpose of the takings. The study did not review individual appraisals; instead, the researchers used market sales from the local residential multiple listing service in the same areas as houses taken for eminent domain purposes. The study used seven standard attributes of housing (views, size, bathrooms, etc.), then compared mean sales prices of the market transactions with the mean prices of those taken via condemnation. The authors found that the properties taken by the government averaged 4.7 percent more in price than comparable market transactions. The authors did not attempt to explain why this variation might occur. This study also did not examine if the price paid by the condemnor was more or less than the condemnor's appraisal.

Fennell¹⁰ in a law review article studied the undervaluation of properties in eminent domain from a legal perspective. The article indicated that regulatory takings persistently undervalued property because the condemnor did not place value on the real options—“surplus value”—enjoyed by the property owner, nor on the ability of the owner to rebuild or replace the property in question for the value received. This article is a needed and thorough review of legal issues and alternatives, but does not address specific appraisal concerns, nor does it contain any quantitative analysis.

MORAL HAZARD LITERATURE

Gwin and Maxam¹¹ questioned why appraisals so often equal the offer price and whether moral hazard exists when a lender can award an appraiser more work for generating appraisals that help close a loan transaction. The appraiser may tend to overstate the property value if he feels the lender wants him to do so; however, the point of the research is whether this moral hazard problem actually creates any problems for the participants in the transaction. Gwin, Ong and Spieler¹² found an increased incentive for the appraiser to set value equal to the purchase price in a bear market, and found that the likelihood that the appraised price would equal the purchase price increased as loan-to-value (LTV) increased.

Devaney¹³ argued that moral hazard in appraisal was directly related to how much risk was retained by the lender. His study of residential loans indicated that, when mortgages are primarily originated and sold immediately, the appraisals were equal or higher than the contract price over 98 percent of the time. Commercial real estate loans are primarily held by the loan originator and not sold, because of the uniqueness and complexity of the transaction, hence, moral hazard was much less apparent. These findings are consistent with Enstrom,¹⁴ who studied commercial property loans and appraisals in Sweden. Ferguson,¹⁵ and suggests that appraisers test themselves using statistical measures like standard deviation to determine if bias has crept into their work.

Cook and Roth¹⁶ studied appraisal bias in institutional investments and found two basic problems: (1) appraisers relied more on historical information and much less on definitive market studies; and (2) real estate advisors earned fees based on the appraised value of the portfolio, creating incentives for bias.

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BEHAVIORAL LITERATURE

Client feedback has been shown in numerous studies to influence the appraisal result. Value adjustments under client pressure were found by Kinnard, Lenk and Worzala,¹⁷ Wolverton and Gallimore¹⁸ and Levy and Schuck.¹⁹ Hansz and Diaz²⁰ found that transaction feedback on commercial property values indicating that the appraisal was “too low” caused appraisers to adjust subsequent valuations by a significantly higher amount. Diaz²¹ found that appraisers were not influenced by previous value opinions of other experts. Wolverton²¹ noted that appraisers were subject to greater coercive feedback when a higher percentage of their work was for mortgage brokers or for specific attorney/client groups. Wolverton also found that private-party clients had less influence on the appraiser.

THE STUDY—RESEARCH HYPOTHESES

The purpose of this study is to determine if bias is exhibited by court-appointed special masters in eminent domain cases. This study uses actual Georgia court cases, most of which were partial takings.

RESEARCH QUESTIONS:

1. Are pre-trial arbitration (“special master”) awards for the property taken far more likely to agree or be near the number offered by the condemnor appraisal, indicating persistent bias from the appointed special masters?
2. Are appraisals for condemning authorities consistently and repeatedly far below appraisals for property owners? *Test statistic:* Compare mean of condemnor appraisals to mean of appraisals for owners.
3. Are special master awards statistically similar to condemnor appraisal amounts?
4. Are jury awards or pre-trial settlements more likely to be near the appraisal amount offered by the owner’s appraiser and differ significantly from the award of the special master?

RESULTS (TEST STATISTICS): N = 16

The statistical tests employed were a difference in means test, t-test, and paired-samples analysis. The statistics indicate a strong correlation between the condemnor appraisal and the special master award (73.3 percent). All tests showed a decided statistical difference between both the condemnor appraisal and the special master award

when compared to the final award received by the property owner, whether by jury or settlement.

| | MEAN | STANDARD DEVIATION |
|----------------------|-----------|--------------------|
| Condemnor appraisal | \$32,722 | \$40,459 |
| Special master award | \$51,304 | \$14,328 |
| Final award to owner | \$177,758 | \$275,427 |

The average final award to the property owner was \$177,758 compared to the average special master award of \$51,304. The average final settlement amount was 3.4 times the amount of the special master award and 5.4 times the amount of the condemnor appraiser. In 57 percent of the cases in this sample, the special master award either was identical to the condemnor appraisal amount or within 5 percent.

The results indicate that:

- The special master award is statistically consistent with the appraisal for the condemnor, and statistically different from the final award from a jury or settlement.
- The condemnor appraisal, when compared either with the award, with property appraisal with damages, or with property-taken only, does consistently, significantly vary (t values of -3.9, -2.6, -3.5; p-values of .000, .012, .001).
- When reviewing the data, condemnor appraisals are consistently lower than either the property owner appraisal or the final award.
- The property-taken appraisal amount is statistically comparable to the final award (t value of .768, p-value: .448).
- None of the condemnor appraisals gave any value for consequential damages to the remaining property, even though virtually all of the cases were partial takings.

CONCLUSION AND FUTURE RESEARCH

This study supports the premise that special master bias exists in eminent domain cases. The cause is likely because of client pressure from the condemnor, since in Georgia the special master is, in effect, appointed by the condemnor. Prior studies (Kinnard et al.; Levy and

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Schuck; Wolverton and Gallimore) all found that client feedback influenced the appraisal result. Wolverton (2000) noted that pressure on the appraiser increased when the appraiser performed a volume of work for one entity, which is often the case for appraisers representing condemnors. Wolverton also found that client pressure was lessened when appraisers worked for multiple clients, which is more often the case for appraisers representing property owners. None of the cases in this study showed any finding of consequential damages by the condemnor appraiser, even though virtually all the cases were partial takings. This is consistent with the moral hazard work of Gwin and Maxam (2002), who found that appraisers can be influenced by the offer of more work in the future.

The problem is threefold. First, moral hazard is present in the system of appointing special masters. In any state in which the condemnor has influence in the appointment of the special master, the special masters have an incentive to systematically value properties lower, thus raising the probability that they will be favorably considered for future assignments by the condemnor, who benefits from low awards. Second, the system of appeal is limited to accuracy of value, and if statutory or case law provides latitude in individual cases to anything justified by the evidence, then only the individual award is in question, not the special master's tendencies and patterns. It should be noted that this scope of review does not necessarily encourage systematically low or high results. Awards should vary randomly, not systematically. This limitation correctly shields the special master from attack if the award is justified by the evidence. However, no avenue for exploring systematic bias is available within the special master system in states with this limitation. Third, there is no monitoring system to ensure that awards are fair in the aggregate, not just in the individual case.

The solution cannot be found, at least in Georgia and states with similar laws, by resort to the judicial system. Legislative intervention is necessary. A revised statute could address the moral hazard issue inherent in the nomination of special masters. Educational intervention could take the form of training and certification for special masters, along the lines of arbitrators or other practice specialties. A monitoring system could be set up, randomly pulling cases and subjecting them to a similar analysis as used in this paper. Only then will condemnees have the benefit of protection against both individual and systematic bias in special master awards.

This study is limited by a small database from one locality, hence generalization is cautioned. Future research could focus on a larger data base from a different locale to see if the results are replicable. Other research opportunities lie in the area of performing this type of analysis on other types of arbitration panels. Future research could also study bias on behalf of appraisals for property owners, particularly in the area of assessing consequential damages. ■

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