

# Landlord and Tenant and Severance Damages in Street Widening Cases

THE valuation of improved properties in recent street widening cases when only a part of the property is taken has presented novel and difficult problems. The solution of problems of severance damage allowance particularly has caused courts and counsel a great deal of trouble and it is hoped that the ensuing discussion may be of assistance in typical cases of frequent occurrence, *i.e.* when there are subsisting leases and both landlord and tenant claim compensation.

Severance damages must be allowed under the plain mandate of article I, section 14, of the California constitution providing that property shall not be taken or damaged without just compensation. The legislature has required that this item of damages be fixed separately.<sup>1</sup>

The key rule as to severance damages is simple of statement but often difficult of application. It is this: assuming that the part of the property taken is paid for, how much less in proportion will the remainder be worth because it is no longer part of the original parcel?<sup>2</sup> To restate the matter: first inquire how much the property (land and building) is worth before the taking. From that sum deduct the value of the remainder as it will exist after the taking. From such difference, deduct the value of the part taken, and the result will be the severance damage. In any case, market value is of course the criterion.<sup>3</sup>

But what is the larger parcel? The solution to this question is a preliminary question of fact for determination by the court.<sup>4</sup> In general, it may be said that the larger parcel is so much property as belongs to the same proprietor as the part taken, is continuous with it,

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<sup>1</sup> CAL. CODE CIV. PROC. § 1248; STREET OPENING ACT OF 1903, Cal. Stat. 1903, 376; ACQUISITION AND IMPROVEMENT ACT OF 1925, Cal. Stat. 1925, 451.

<sup>2</sup> Sacramento R. Co. v. Heilbron (1909) 156 Cal. 408, 414, 104 Pac. 979, 982; Oakland v. Pacific, etc. Co. (1915) 171 Cal. 392, 400, 153 Pac. 705, 708; County of Los Angeles v. Signal R. Co. (1927) 86 Cal. App. 704, 709, 261 Pac. 536, 538 (Note that market value means market, not what a particular land owner might be willing to pay for the residue.) Chicago, etc. R. Co. v. Kelley (1906) 221 Ill. 498, 506, 77 N. E. 916, 919.

<sup>3</sup> Note that reconstruction costs, *i.e.* costs allowed to a property owner in order to enable him to restore a front wall or revamp a building are allowed as part as severance damage allowance on the theory of minimizing damages. Pasadena v. Porter (1927) 201 Cal. 381, 257 Pac. 526; Detroit v. Loula (1924) 227 Mich. 189, 198 N. W. 837; St. Louis v. Brown (1900) 155 Mo. 545, 56 S. W. 298.

<sup>4</sup> LEWIS, EMINENT DOMAIN (3d ed. 1909) 1213; Oakland v. Pacific, etc. Co., *supra* n. 2.

and is used for a common purpose.<sup>5</sup> Ownership connotes not only power to control, but also identity of tenure.<sup>6</sup> If A owns the fee of Blackacre and leases adjoining Whiteacre and part of Blackacre is condemned, the authorities indicate that the larger parcel is Blackacre, even though Blackacre and Whiteacre are used in common and as part of a single enterprise. The requirement that the property be "continuous" contemplates a decision in the light of all existing circumstances. The existence of mere paper subdivisions, alleys, highways, and even a river does not *per se* invalidate the claim of the owner that the properties so separated constitute one parcel for purposes of condemnation of a part.<sup>7</sup> It is actual joint use at the time when the valuation is to be made, or reasonably practicable future joint use considering all surrounding circumstances, but not a fanciful or speculative possible joint use, which determines what is the larger parcel.<sup>8</sup>

The reported cases deal mostly with severance damages in cases of the taking of unimproved land and there is a surprising dearth of decisions considering the more complicated question of urban business properties. If an entire property is improved with a single building, the larger parcel is, in the normal case, the building and the land on which the same is situated. But complications arise when a part of the building is leased. A lessee is an "owner" and as such entitled to compensation.<sup>9</sup> In fact, the California statutes already referred to require a valuation of the various "estates." When the entire premises are taken, the obligation to pay rent ceases<sup>10</sup> and the lessee is entitled to the "bonus value" of his lease, *i.e.* its value in the open market.<sup>11</sup> This situation presents no question of severance damages as far as the tenant is concerned, although it may in connection with the landlord's claim. But assume, as is frequently the case, that only a portion of the leased premises are taken and that the lease covers only a part of the building

<sup>5</sup> LEWIS, EMINENT DOMAIN (3d ed. 1909) 1208; Sultan Water & Power Co. v. Weyerhaeuser Timber Co. (1903) 31 Wash. 558, 72 Pac. 114.

<sup>6</sup> Conness v. I. I. & I. R. Co. (1901) 193 Ill. 464, 470, 62 N. E. 221, 223; Glendenning v. Stahley (1910) 173 Ind. 674, 683, 91 N. E. 234, 238. *Contra*: Kansas City So. R. Co. v. Boles (1908) 88 Ark. 533, 115 S. W. 375; Chicago, etc. R. Co. v. Dresel (1884) 110 Ill. 89, and see Westbrook v. Muscatine R. Co. (1901) 115 Iowa 106, 88 N. W. 202; Smith County v. Lahore (1887) 37 Kan. 480, 15 Pac. 577.

<sup>7</sup> St. Louis, etc. R. Co. v. Aubuchon (1906) 199 Mo. 352, 97 S. W. 867, 9 L. R. A. (N. S.) 426.

<sup>8</sup> Southern Pacific Co. v. Hart (1906) 3 Cal. App. 11, 84 Pac. 218, and see Sultan Power & Water Co. v. Weyerhaeuser, *supra* n. 5.

<sup>9</sup> Pasadena v. Porter (1927) 201 Cal. 381, 386, 257 Pac. 526, 528.

<sup>10</sup> *Ibid.*

<sup>11</sup> Matter of Commissioners of Central Park (1873) 54 How. Pr. (N. Y.) 313, 316.

and that the lease makes no provision for the disposition of awards in condemnation. We shall treat the questions raised in such a case in the following order:

- I. Valuation of the lessee's estate.
- II. Interrelation of the lessee's and landlord's award.
- III. The award to the landlord.

Some collateral questions will necessarily be mentioned, but the main purpose of this discussion is confined to severance damage allowances.

#### I. VALUATION OF LESSEE'S ESTATE

Is the tenant's larger parcel merely the store held by him under lease, or is his severance allowance to be computed on the theory that the whole building constitutes the larger parcel? The general principle above set forth (single ownership, continuity, and joint use) clearly indicates that the larger parcel in the case of the tenant is his store, for he has no control over the remainder of the building and the landlord cannot be forced to relinquish any space additional to that called for by the lease. As to the larger parcel in the case of the landlord, see *infra*.

In *Pasadena v. Porter* there was a controversy as to the distribution of an award between landlord and tenant. Neither party objected to the total allowance, but the landlord claimed the entire award and offered to reduce the future rentals from \$700.00 per month to \$533.33 per month, the condemning authority having taken 8-33 feet from a 20 foot store. The court refused to modify the lease, holding that the tenant would continue liable for the full reserved rent, and awarded to the tenant a sum of money which, placed at interest at 6% per annum, would permit him to draw out \$166.66 per month and have nothing left at the end of the 7 year term, *i.e.* the "present worth" of the excess rental obligation. In addition the tenant was awarded the bonus value of the lease on the part taken. Thus the tenant was allowed \$19,380.22 and the landlord \$16,682.68.

It is a long step from the general statement that the measure of damages in condemnation cases is "market value"<sup>12</sup> to this result. The tenant in the *Pasadena* case got more than market value, for bonus value is market value in the case of a lease, and the tenant here also got the "present worth" figure above referred to. His bonus value arose by reason of the fact that he had made a favorable lease and that the evidence showed that a ready, able, and willing purchaser would pay this tenant for the privilege of conducting a business in that location at a rental of \$700.00 per month, *i.e.* for an assignment of the

<sup>12</sup> *Kishlar v. S. P. R. Co.* (1901) 134 Cal. 636, 639, 66 Pac. 848, 849.

lease.<sup>13</sup> This is not always true, and then (subject to the remarks hereinafter made concerning fixtures) there would be no bonus value. The *Pasadena* case does not discuss severance damages.

On analysis, a tribunal fixing such damages would, in the case of a tenant, inquire:

1. Is there a market or bonus value to the lease as it stands? If so, a proportionate part of such figure should be assigned to the value of the part taken and paid for as such, as was done in the *Pasadena* case (i.e. if  $\frac{1}{4}$  of the space is condemned,  $\frac{1}{4}$  of the bonus value should be paid to the tenant). This, however, is not severance damage at all.

2. Is there a bonus value to a lease on the remaining part of the property on the assumption that the rent will be proportionately reduced (it should, of course, be remembered that the tenant has a fund on which he can draw for the excess rentals, and a "purchaser" from the lessee would naturally expect to have the fund turned over to him or he would demand a reduction in the bonus price measured by that amount if he purchased)?<sup>14</sup> If this bonus value is equal in proportion to the bonus value of the lease as it now stands, there is no severance damage on any market value or bonus theory; if it is less, or has disappeared, such difference is the tenant's severance damage.<sup>15</sup>

3. If the lease has no bonus value, and if the tenant is therefore paying exactly the fair rental for his premises or if he is paying too much rent, he may still suffer a severance damage. The inquiry in this connection should be: "How much is the present reasonable rental value and whether or not the future rental value of the remainder will be less in proportion?"<sup>16</sup> If so, there is a severance damage, and it would seem that the actuarial method adopted in the *Pasadena* case should be applied here also.<sup>17</sup>

*Gluck v. Baltimore*<sup>18</sup> is frequently cited in this connection. It is there said:

"The appropriation of part of the property for a public use leaves the tenant in the position of being deprived of a part of his property while he still remains liable to pay rent for the whole of it, and to that extent obviously does him an appreciable injury, which should be considered by the jury in estimating the decreased market value of the remaining portion of the demised premises."

<sup>13</sup> "But market value is an unsatisfactory test of the value to a tenant of a leasehold interest . . . a lease rarely has any market value." *McMillan Co. v. Pittsburg R. Co.* (1907) 216 Pa. 504, 511, 65 Atl. 1091, 1094.

<sup>14</sup> The courts recognize existing business practice in similar situations. *Lane Mortgage Co. v. Crenshaw* (1928) 56 Cal. App. Dec. 1163, 269 Pac. 672.

<sup>15</sup> *Matter of N. Y. W. S. & B. R. Co. v. Bell* (1882) 28 Hun. (N. Y.) 426.

<sup>16</sup> That such testimony is proper. *Renwick v. D. & N. W. R. Co.* (1878) 49 Iowa 664, 674; *Matter of N. Y. W. S. & B. R. Co. v. Bell*, *supra* n. 15.

<sup>17</sup> For example, a seven hundred and fifty square foot drug store rents for twenty cents per square foot. One hundred and fifty feet are taken. If the remaining part is only worth fifteen cents per square foot, the tenant should receive "present worth" of \$30.00 per month for the balance of the term as severance damages; and note discussion of the *McCarty* lease in *Corrigan v. Chicago* (1893) 144 Ill. 537, 549, 33 N. E. 746, 749, 21 L. R. A. 212, 224.

<sup>18</sup> (1895) 81 Md. 315, 324, 32 Atl. 515, 516.

It is submitted that this is muddled thinking. If the lease has no market value or bonus value at the outset, and most leases are of that character, obviously it will have no market value after the taking of a part. If the remaining portion is worth as much per square foot as the entire leased premises are worth per square foot, there is no severance damage, but there is and must be an allowance for excess rentals to be paid in the future. In reality, this is an awarding of something that belongs to the landlord to the tenant, and is done for the very good reason that the court or referees or jury cannot reform the lease. The landlord is "paid" because he will receive his money month by month or year by year in the form of rental for which the tenant receives no equivalent during those months and years.<sup>19</sup>

Before leaving the valuation of the tenant's estate, it should be noted that losses to business cannot be considered;<sup>20</sup> nor can the tenant, or for that matter anyone else, recover as damages the original cost of installation, or the cost of removal of fixtures unless they be part of the realty as distinguished from readily removable installations. Normally, of course, the landlord would be the one entitled to compensation for the taking of the realty, including the improvements and permanent fixtures.<sup>21</sup> It is suggested that the sole bearing of evidence concerning fixtures would be to shed light on the bonus value of the lease.<sup>22</sup> If good judgment has been used in installing fixtures, the lease (otherwise without bonus value) might have a bonus value equal to, greater than, or less than the cost of the fixtures.<sup>23</sup> If poor judgment has been used in such installation, the cost might not have added to an existing bonus value or created any bonus value at all. It should also be noted that testimony of rental value should cover rental value for any and all purposes, just as market value means market value for any and all purposes, including particularly the highest available use.<sup>24</sup> But

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<sup>19</sup> *Corrigan v. Chicago* (1893) 144 Ill. 537, 546, 33 N. E. 746, 748, 21 L. R. A. 212, 219.

<sup>20</sup> *San Francisco v. Kiernan* (1893) 98 Cal. 614, 33 Pac. 720; *Oakland v. Pacific Coast Lumber, etc. Co.* (1915) 171 Cal. 392, 398, 153 Pac. 705, 707; *Los Angeles v. Pedersen* (1927) 53 Cal. App. Dec. 6, 255 Pac. 889; 10 R. C. L. 137; Note: L. R. A. 1916C 1094.

<sup>21</sup> *County of L. A. v. Signal R. Co.* (1927) 86 Cal. App. 704, 711, 261 Pac. 536, 539 and cases cited. But see *In re City of New York* (1908) 192 N. Y. 295, 84 N. E. 1105, 18 L. R. A. (n. s.) 423; and see as to proper party to receive award, *Los Angeles v. Pedersen*, *supra* n. 20.

<sup>22</sup> But see *Kafka v. Davidson* (1917) 135 Minn. 389, 395, 160 N. W. 1021, 1023; *Seattle, etc. R. Co. v. Scheike* (1892) 3 Wash. 625, 29 Pac. 217.

<sup>23</sup> *Bales v. Wichita, etc. R. Co.* (1914) 92 Kan. 771, 773, 141 Pac. 1009, 1010, L. R. A. 1916C 1090, 1092.

<sup>24</sup> *Santa Ana v. Harlin* (1893) 99 Cal. 538, 34 Pac. 224; *Freiberg v. R. Co.* (1906) 221 Ill. 508, 516, 77 N. E. 920, 923.

if the lease provides for a specific or limited use only, rental value for that use is the test.<sup>25</sup>

As to the tenant's estate therefore, severance damages mean merely this: how much bonus value on the remainder is lost, or how much less in proportion is the remaining portion reasonably worth than it is reasonably worth as part of the existing leased premises. The first item is a flat figure and the second is a "present worth" figure.

## II. INTERRELATION OF THE LESSEE'S AND LANDLORD'S AWARD

The question of the interrelation of compensation to landlord and compensation to tenant must still be considered. The normal reaction of any first consideration of this relation is that a condemning party should pay the market value of the part taken plus severance damages, and that the owners of various interests or estates in said property should then be awarded their proportionate share of the total sum. In other words, it appears to the casual observer that "the sum of the parts cannot be greater than the whole." But is there a "whole"? The method of "carving out" is the usual rule and has been followed in all but two cases known to the writers.<sup>26</sup> One of the dissenting courts, however, is the Supreme Court of the United States,<sup>27</sup> and it has been suggested that the "majority" method is incorrect under special circumstances.<sup>28</sup> The supreme court of California in the *Pasadena* case says nothing about the question, but it cites an Illinois decision where it was held that when landlord's and tenant's cases were tried together and there was a separate verdict as to each, the tenant might have a new trial while the verdict as to the landlord remained undisturbed.<sup>29</sup> The Supreme Court of the United States in *Boston Chamber of Commerce v. Boston*<sup>30</sup> said: "And the question is what has the owner lost, not what has the taker gained?" If, therefore, the value of

<sup>25</sup> *North Coast R. Co. v. Kraft Co.* (1911) 63 Wash. 250, 115 Pac. 97; *Allen v. Boston* (1884) 137 Mass. 319. And see *Kafka v. Davidson*, *supra* n. 22, holding that where the landlord may terminate the lease on payment of \$1,500.00 that amount is the maximum value of the lease.

<sup>26</sup> 10 R. C. L. 134.

<sup>27</sup> *Boston Chamber of Commerce v. Boston* (1910) 217 U. S. 189, 30 Sup. Ct. 459. Note that the actual title situation should be considered in fixing the value, *Allen v. Boston*, *supra* n. 25 (covenant restricting property to residence use). *Los Angeles v. Zeller* (1917) 176 Cal. 194, 167 Pac. 849 (restriction created by law). *Semble contra*: *San Diego Land, etc. Co. v. Neale* (1888) 78 Cal. 63, 72, 20 Pac. 372, 376: "The question of value is distinct from the question of ownership."

<sup>28</sup> *Baltimore v. Latrobe* (1905) 101 Md. 621, 61 Atl. 203; 10 R. C. L. 134.

<sup>29</sup> *Stubbings v. Evanston* (1891) 136 Ill. 37, 26 N. E. 577. And *cf.* *San Diego v. Neale*, *supra* n. 27, applying the doctrine that there may be a new trial as to part of the issues in a case.

<sup>30</sup> *Supra* n. 27, 217 U. S. at 195, 30 Sup. Ct. at 460.

the tenant's estate added to the value of the landlord's estate is either greater or less than the market value of the property would be if there were but one estate or ownership, the condemning party should be entitled to the benefit or should pay the excess, as the case may be.<sup>31</sup>

There is no difficulty as to the part taken. The tenant is allowed the "present worth of his excess rentals" computed on the basis of actual rents, which may equal, exceed, or be less than market or reasonable rentals. This figure is payment to the landlord and should be deducted from his award because he will get it back month by month or year by year until the end of the lease. The sum of the two awards here equals the market value of the part taken. But severance damages to the landlord present a different question. If the lease has a bonus value, obviously the landlord will not receive any part of the award to the tenant in such a situation. If the tenant is awarded a present worth figure, based upon testimony that the remaining space is worth less than its proportion of the reserved rental, the landlord will get no part of that back from month to month, or at least not in the same sense in which he is "paid" by receiving rent for property which he no longer owns. It is submitted that the landlord's "larger parcel" may be different from the tenant's larger parcel; therefore entirely different considerations may apply to the fixing of his severance damages than apply in the case of the tenant (see *infra*).

In California there is no definite requirement as to the method of trial. The cases of landlord and tenant may be tried separately or together.

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<sup>31</sup> Assume an inside lot improved with a building containing four thirty-five foot stores rented for seven years each at a monthly rental of \$700.00 per month. Eight and thirty-three hundredths feet are taken as in the Pasadena case. The annual rental is approximately \$33,000.00 per year. If twelve per cent gross be regarded as a fair return, and many leases are made on such a basis, the property has a value of somewhere in the vicinity of \$264,000.00. The award to the tenants would be four times \$14,000.00 or \$56,000.00 in diminution of rent if there were no severance. The landlord has permanently lost one-fourth of his property, or \$66,000.00, yet he only receives \$10,000.00. If severance damages are computed to the lessee on the basis of his store, his proportion increases, leaving less for the landlord. Of course, the landlord would also be entitled to severance damages, and it is hereinafter suggested that he should be compensated on the basis of the entire building constituting the larger parcel. His severance would be correspondingly less. Hence, even in the case supposed, the "total" award might not equal the sum of the awards to the tenants. It is no answer to say, as was said in *Pasadena v. Porter*, that he is paid because he will continue to receive rent for something he no longer owns, for if that be carried to its logical conclusion, the landlord might be compelled to pay money into court in order that there should be enough for the tenant. It is submitted that the principle of *Norwood v. Baker* (1898) 172 U. S. 269, 19 Sup. Ct. 187 would operate to prevent such result.

## III. THE AWARD TO THE LANDLORD

Applying the test of same ownership, continuity, and common use to the landlord's estate, the result follows in the normal case that the entire building is the larger parcel. Most store buildings are so arranged that changes can be economically made to suit individual tenants, and the moving of a wall is not usually a costly matter. In such case, the court should determine upon the most feasible plan of reconstruction<sup>32</sup> and the cost of that reconstruction should be allowed. In the normal case it would probably be found that the most feasible plan would coincide with the most feasible plan for the tenant, *i.e.* the mere reconstruction of the front wall. In cases of corner property, it might be found to require the joining of the corner store with the store next behind it, thus eliminating one store. The landlord normally has control of the outside of his building and he therefore receives the cost of rebuilding the front wall.<sup>33</sup> The condemning party normally would not object to an allowance of a sum of money which, placed at interest now, would produce by the end of the lease enough money to make one store out of two, or similar tenant's changes. To this point, therefore, we may assume that the building has been reconstructed in the most feasible manner and the tenant is paid.

The larger parcel on principle, therefore, in the case of the landlord, is the entire building—he owns it, it is certainly continuous, and he uses it for a "common purpose," *i.e.* renting out portions to produce as much income as he can get from the whole. First we must find the value of the part taken. The value of the part taken is the value of the land subject to the lease, or as before stated, the award to the landlord for the part taken is the reasonable market value of the land as improved less the reserved rent which the tenant continues to pay. Therefore, the "present worth figure" paid to the tenant should be deducted from the award to the landlord.<sup>34</sup>

It is submitted that the foregoing remarks, together with the illustration given, constitute the most reasonable construction available of the language used in *Pasadena v. Porter* to the effect that the lessor is entitled to the "present value of his reversion."

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<sup>32</sup> See *supra* n. 3.

<sup>33</sup> See CAL. CIV. CODE § 1932.

<sup>34</sup> If a building contains four stories, two of which are affected, let us say, by the taking of one-fourth of the area of each store, and the rentals are \$200.00 per month each, the tenant would receive the present worth of \$50.00 per month for the balance of the term. The landlord has a \$100,000.00 property and loses one-eighth of the land and building. His award for the part taken, therefore, should be \$12,500.00, but he gets part of his pay by continuing to receive excess rent. If the leases have ten years to run at \$100.00 per month excess rent, in the case supposed, his award should be \$500.00.



If, as herein contended, the larger parcel is the entire building, the damage to the remainder must be figured on that larger parcel. If the amount paid for the part taken (and in this is included the amount paid "via" excess rentals in the future), plus the value of the reconstructed remainder equals the present day market value of the property before the taking, there are no severance damages. But if the remainder so constructed will be worth less in proportion because it is no longer part of the whole, that difference is severance damages.

This suggests that the most important element in determining this value of the remainder, but by no means the only element, is an inquiry as to how much the remainder can be rented for after reconstruction in the most feasible manner. This is one of the principal inquiries a prospective purchaser would make. If it be assumed that  $\frac{1}{8}$  of the property is taken and the remainder would rent for  $\frac{1}{4}$  less than the present structure, there would be strong reasons for contending for a severance allowance of  $\frac{1}{8}$  of the value of the land and building.<sup>35</sup>

There should not be deducted from the figure so arrived at, however, the amounts, if any, given to the tenant because of loss of bonus value in the remainder of his estate or severance damage allowance on the actuarial basis, if such was made, because the landlord will not receive these sums in the same sense that he will receive the present worth figure on the part taken.

Note here again the net result is to give to the lessor the present day value of his reversion, for that is what a prospective purchaser buys from the lessor for the simple reason that that is what he has to sell. There is a plausible theory that if a lessor has a \$100,000 building subject to 10 year leases, and if the value of the part taken plus severance damages figured in the abstract would amount to \$20,000, the lessor should receive only \$10,000 because that sum placed at compound interest at 6% per annum would double in 10 years. That theory has been carefully considered and rejected because the thoughts of persons buying and selling real estate do not run in such channels and concrete examples based on the theory produce results which are shocking to any sense of fair dealing; nor would such a theory assist the trier of the fact in ascertaining what it must ascertain, to-wit: "the damages which will accrue to the portion not sought to be condemned by reason of its severance," a finding necessarily to be made on the basis of present day market value.

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<sup>35</sup> Note that the actuarial basis as to "loss of rents" can hardly be claimed as a proper method of computation in the light of *County of L. A. v. Signal R. Co.*, *supra* n. 21.