

**FINDING THE DEVELOPMENT VALUE OF
WETLANDS AND OTHER ENVIRONMENTALLY
SENSITIVE LANDS UNDER THE EXTENT OF
INTERFERENCE WITH REASONABLE
INVESTMENT-BACKED EXPECTATIONS**

DONALD C. GUY*
JAMES E. HOLLOWAY**

Table of Contents

I.	INTRODUCTION	298
	A. <i>Palazzolo’s Effects on Liability and Remedy</i>	300
	B. <i>Palazzolo’s Impact on Evidence of Liability and Just Compensation</i>	301
	C. <i>Examining the Nature of Palazzolo’s Impact on Liability and Compensation</i>	302
II.	TAKINGS JURISPRUDENCE AND REAL ESTATE DEVELOPMENT	303
	A. <i>Federal Takings Law and Liability</i>	304
	B. <i>Real Estate Development Interests and Market Risks</i>	307
	C. <i>Just Compensation and Appraisal Valuation</i>	309
III.	PALAZZOLO AND WETLANDS IN REGULATORY TAKINGS JURISPRUDENCE	311
	A. <i>The Nature of Development Efforts by the Petitioner in Palazzolo</i>	312
	B. <i>The Impact of Development on Beneficial Use and Acquisition</i>	314
	C. <i>Restricting Per Se Takings Liability but Permitting Development Value as a</i> 315 <i>Beneficial Use</i>	315
IV.	LIABILITY AND COMPENSATION FOR INTERFERENCE WITH ECONOMIC EXPECTATIONS	316
	A. <i>Justice Scalia and Justice O’Connor’s Differences on Liability and Compensation</i>	318
	B. <i>The Existence of Expectations and the Extent of Interference</i>	321
	C. <i>Developing an Expectations Analysis on Fairness and Economics</i>	325
V.	VALUATION UNDER EMERGING LINES OF INVESTMENT-BACKED EXPECTATIONS ANALYSIS	328
	A. <i>Weighing Past Regulatory Conditions in Takings Jurisprudence</i>	329

<i>B. Land Development Approach to Valuation of Land with Investment-Backed Expectations</i>	337
<i>C. Issues in Determining Liability and Compensation for Land with Loss Expectations or Missed Opportunities</i>	339
VI. CONCLUSION	343

I. INTRODUCTION

*Palazzolo v. Rhode Island*¹ raises subtle analytical questions regarding the determinations of liability and a remedy for an unconstitutional interference with reasonable investment-backed expectations² under the Takings Clause.³ Regulatory takings disputes involving sensitive and non-sensitive lands will require lawyers to prove that both the existence of reasonable investment-backed expectations and the extent of interference with these expectations⁴ by land use and environmental regulations amount to a regulatory taking.⁵ If they are successful in establishing a regulatory taking based on the extent of interference by a particular regulation, they must also offer proof of the amount of just compensation for depriving landowners of reasonable investment-backed expectations in the development of the land.⁶ Establishing

* Donald C. Guy, Professor, Finance and Real Estate, Department of Finance, College of Business, East Carolina University, Greenville, North Carolina, 27858. B.A., University of Illinois at Champaign-Urbana, 1962; M.A., University of Illinois at Champaign-Urbana, 1969; Ph.D., University of Illinois at Champaign-Urbana, 1970.

** James E. Holloway, Associate Professor, Business Law, Department of Finance, College of Business, East Carolina University, Greenville, North Carolina, 27858. B.S., North Carolina Agricultural & Technical State University, 1972; M.B.A., East Carolina University, 1984; J.D., University of North Carolina at Chapel Hill, 1983.

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1. 533 U.S. 606 (2001).

2. *Id.* at 632 (“The claims under the *Penn Central* analysis were not examined, and for this purpose the case should be remanded.”).

3. U.S. CONST. amend. V.

4. *See Palazzolo*, 533 U.S. at 632-37 (Scalia, J. and O’Connor, J., concurring).

5. *See id.* at 632. *See also* *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986 (1984) (holding that reasonable investment-backed expectations did not exist under the circumstances); *Penn Cent. Transp. Co. v. City of New York*, 438 U.S. 104 (1978) (holding that investment-backed expectations existed, but there was no unreasonable interference under the circumstances).

6. *See Palazzolo*, 533 U.S. at 636-37 (Scalia, J., concurring); *id.* at 632-36 (O’Connor, J., concurring) (finding the *value* of sensitive and other lands to the public or community is not a settled land valuation task). *See, e.g.*, Donald C. Guy & James E. Holloway, *The Recapture of Public Value on the Termination of the Use of Commercial Land Under Takings Jurisprudence and Economic Analysis*, 15 BYU J. PUB. L. 183 (2001); William N. Kinnard, Jr.,

the development value⁷ of sensitive and other lands may be a challenging task under a confusing takings analysis.⁸ The underlying nature of this analysis presently weighs different regulatory and economic circumstances that eventually affect land valuation.⁹ Lawyers and judges need to understand social, business, and market principles¹⁰ in proving land values resulting from an unreasonable deprivation of economic and financial expectations in holding or using land.¹¹

Palazzolo's most contentious effects on takings liability and just compensation arise from the competing social equity and economic concerns within the takings analysis of Justices Scalia and O'Connor. *Palazzolo's* analytical impact on the extent of interference with reasonable investment-based expectations includes an examination of takings liability and just compensation. Moreover, the analytical impact implicates the movement towards a two-prong test: the circumstantial existence of constitutionally protected *return on investment* interest, and the extensiveness of the government interference with this interest. Part I of this article discusses the purpose, analytical issue, and constitutional scope of *Palazzolo's* impact on litigation and negotiation involving the extent of interference with reasonable investment-backed expectations. Part II explains takings analysis, real estate concerns, and land valuation affected by the development of sensitive lands. Part III examines *Palazzolo's* effects on takings liability and focuses on the Court's findings regarding sensitive land development, beneficial use of sensitive land, and the financial expectations of landowners. It discusses the economic effects of the regulation and the takings

The New Noneconomics: Public Interest Value, Market Value, and Economic Use, 66 APPRAISAL J. 207 (April 1998).

7. We assume that the landowners of sensitive land lost the opportunity to develop the land or that the government chose to take the land for public use, and thus the landowner seeks just compensation for the taking of the land. See *Palazzolo*, 533 U.S. at 625. The landowner can petition state and federal courts to declare the regulation unconstitutional and thus unenforceable by federal, state, and local governments. See *First English Evangelical Lutheran Church of Glendale v. County of L.A.*, 482 U.S. 304, 321 (1987).

8. See *Palazzolo*, 533 U.S. at 636-37 (Scalia, J., concurring); *id.* at 632-36 (O'Connor, J., concurring).

9. Compare *id.* at 636-37 (Scalia, J., concurring) (giving landowner a windfall under the present circumstances), with *id.* at 632-36 (O'Connor, J., concurring) (seeking fairness and justice by including past circumstances).

10. See JAMES H. BOYKIN & ALFRED A. RING, *THE VALUATION OF REAL ESTATE* 40-57 (4th ed. 1993). "An Appraiser must not only be conscious of the forces of changes, but must also learn to evaluate their impact." *Id.* at 57.

11. See *Palazzolo*, 533 U.S. at 636-37 (Scalia, J., concurring) (relying heavily on economic and financial theories in determining the effects of government regulation on the loss of land value and investment expectations); *id.* at 632-37 (O'Connor, J., concurring) (relying heavily on past policy, regulatory schemes, and individual financial decisions in determining the effects of government regulation on land value and investment expectations).

analysis applied to address these effects. Part IV examines just compensation for interference with reasonable investment-backed expectations, and focuses on the use of land valuation and appraisal methods to value sensitive land. It discusses how the duration of the regulation, use restrictions, and other considerations might affect the value of land when the takings dispute involves the extent of interference with reasonable investment-backed expectations. Part V discusses land valuation methods that courts can use to determine the amount of just compensation for a regulatory taking. It also discusses considerations that should be weighed by judges and lawyers in a takings analysis to determine the extent of interference with reasonable investment-based expectations. Part VI notes that the analytical nature of the extent of interference with reasonable investment-based expectations will necessarily involve takings liability and just compensation in the Court's effort to ensure fairness and protect market value in regulatory takings jurisprudence. Thus, the conclusion of this article demands the use of real estate appraisal and investment expertise to determine market value.

A. *Palazzolo's Effects on Liability and Remedy*

The differences in the takings analysis put forth by Justices Scalia and O'Connor directly explicate takings liability and strongly implicate just compensation in regulatory takings jurisprudence. Both Justices share the same takings jurisprudence, but are at different points in the same line of analysis. Specifically, Justices Scalia and O'Connor do not agree on the *circumstances* that should be examined to determine the extensiveness of interference and existence of reasonable investment-backed expectations in the determination of takings liability.¹² In fact, their differences suggest a more subtle but important question — whether they would agree on the *method to determine the amount of just compensation* if they were to find the existence of investment-backed expectations and an unconstitutional interference with these expectations.¹³ Justice O'Connor wants fairness and justice for the

12. See *id.* at 636-37 (Scalia, J., concurring); *id.* at 632-36 (O'Connor, J., concurring).

13. See *id.* at 635-37 (Scalia, J., concurring); *id.* at 632-36 (O'Connor, J., concurring). Our focus on just compensation, U.S. CONST. amend. V., is on the recovery of the value of land, though an interference with reasonable investment-backed expectations may leave the landowner with less beneficial uses of the land. See *A. A. Profiles, Inc. v. City of Fort Lauderdale*, 253 F.3d 576 (11th Cir. 2001). Just compensation can include the fair market value for taking ownership of the land. See *Palazzolo*, 533 U.S. at 611. In some circumstances, courts cannot award fair market value and must award a modified market value (MMV) for an unreasonable economic impact. See *A. A. Profiles*, 253 F.3d at 576. Finally, courts can award injunctive relief to halt government interference, occupation, or use.

public¹⁴ when the landowner would not or could not have developed the property, and thus the landowner's inability to develop may affect takings liability and just compensation under particular circumstances.¹⁵ Justice Scalia, on the other hand, would not apply a broad factual analysis to determine takings liability¹⁶ and would permit a windfall for land unsuitable for development in its natural state.¹⁷ Plaintiffs' lawyers cannot ignore a broader takings analysis because the amount of any windfall may be greatly reduced if Justice O'Connor's factual analysis is used in determining this extent of interference. Under a broader takings analysis, courts may avoid finding any takings liability on the part of government, or use an appraisal method to give less compensation for an unconstitutional interference. Obviously, a regulatory taking of a speculative investment that is not financially feasible should not turn a sow's ear into a silk purse.

B. Palazzolo's Impact on Evidence of Liability and Just Compensation

Lawyers and judges need to understand how *Palazzolo* could affect takings analysis in the determination of the existence and extensiveness of a regulatory interference with reasonable investment-backed expectations and the appraisal methodology¹⁸ applied to determine just compensation.¹⁹ Negotiation and litigation will involve takings analysis in determining the extent of interference²⁰ and rely on appraisal methodology to determine the value of land when the extent of the interference amounts to a regulatory taking.²¹ *Palazzolo* creates two evidentiary hurdles for lawyers and judges. First, judges and plaintiffs' lawyers face uncertainty regarding the breadth of the investment-backed

See First English Evangelical Lutheran Church of Glendale, 482 U.S. at 321.

14. *See Palazzolo*, 533 U.S. at 633 (O'Connor, J., concurring) (noting that fairness and justice are not definite or fixed under the Takings Clause).

15. *See id.* (O'Connor, J., concurring).

16. *See id.* at 637 (Scalia, J., concurring) (arguing that use restrictions in existence at the time the petitioner took title should not be considered in a determination of takings liability).

17. *Id.* at 636-37 (Scalia, J., concurring).

18. *See id.* at 625 (citing *Olson v. United States*, 292 U.S. 246, 255 (1934)). The most common real estate valuation approach may not cover the political and regulatory circumstances Justice O'Connor weighs in the determination of a taking and just compensation under her approach to the *Penn Central* inquiry. *Id.*

19. *See id.* at 636-37 (Scalia, J. and O'Connor, J., concurring) (offering different but arguably reconcilable approaches to an underdeveloped *Penn Central* analysis for the determination of the existence of investment-backed expectations and the extent of interference with these expectations).

20. *See Palazzolo*, 533 U.S. at 632.

21. *See id.* at 625 (citing *Olson*, 292 U.S. at 255; 4 JULIUS L. SACKMAN, NICHOLS ON EMINENT DOMAIN § 12.01 (rev. 3d ed. 2000)).

expectations analysis in determining the extent of interference under past regulation of sensitive lands. Although the time of the imposition of the regulation was not necessarily the time of the regulatory taking,²² Justice O'Connor's broad factual analysis would include policy and regulatory circumstances in the maturation of a takings claim.²³ Second, judges and defendants' lawyers face more confusion regarding an investment-backed expectations analysis which leaves doubts about the choice of appraisal methods²⁴ to determine just compensation for the sake of fairness to the public or government. Weighing the past effects of the regulation to determine a regulatory taking may create confusion in fashioning a remedy that considers missed opportunities to develop the land. Both appraisal methodology and takings analysis may weigh: the level and kind of interference; the quality and suitability of the land; the nature and feasibility of the development; and the timing and severity of the regulation. *Palazzolo's* takings and compensation questions that directly involve the extent of interference with reasonable investment-backed expectations on sensitive lands require greater emphasis on land development and appraisal expertise in negotiation and litigation to establish takings liability and fashion appropriate compensation.

C. Examining the Nature of Palazzolo's Impact on Liability and Compensation

Palazzolo's analytical question strongly suggests internal tension within the dominant line of analysis of the Rehnquist Court's takings jurisprudence.²⁵ This conflict involves the tenuous relationship between public fairness and financial expectations surrounding government regulation of environmentally sensitive land that had previously been mostly off limits for development, and still could be. But *Palazzolo* may extend to non-sensitive lands that have been subject to government regulation that were used by landowners with little financial expectations who chose not to

22. *See id.* at 623. The existence of a regulation does not put a purchaser on notice of regulatory requirements or conditions that would constitute a taking or permit the government to take property without just compensation. *See id.* at 639. Justice Stevens finds that a taking is a discrete acquisition of private property that requires the payment of just compensation. *Id.* at 638-39 (Stevens, J., dissenting) ("It occurs . . . when the relevant property interest is alienated from its owner.").

23. *See id.* at 635 (O'Connor, J., concurring).

24. *See id.* at 632-37 (Scalia, J. and O'Connor, J., concurring).

25. *See id.* at 632. On remand, either the approach of Justice O'Connor or Justice Scalia will be applied to the circumstances under the *Penn Central* inquiry. *Id.* If the protection of property rights receives less protection under the Takings Clause, the direction of the takings jurisprudence of the Rehnquist Court may be affected. *Id.*

challenge the regulation as an unconstitutional taking.²⁶ Both obvious and subtle differences in the circumstances of Justices Scalia and O'Connor's approaches, which consider only one factor of the Court's takings analysis, address regulatory takings and just compensation issues.²⁷ Justices Scalia and O'Connor played pivotal roles in the development of the takings jurisprudence of the Rehnquist Court.²⁸ Therefore, their differences affect the Rehnquist Court's development of takings jurisprudence, and create uncertainty regarding the breadth of analysis the Court will apply to address competing financial expectations and public fairness issues when land use and other regulations do not permit landowners and developers to reap the economic and financial benefits of investments in land.²⁹ Consequently, *Palazzolo's* analytical impact on the extent of interference with reasonable investment-backed expectations involves an obvious takings liability question and a more subtle just compensation concern.

II. TAKINGS JURISPRUDENCE AND REAL ESTATE DEVELOPMENT

Obviously, Justice Holmes' simplistic observation that regulation can go too far³⁰ in burdening property rights of landowners for the benefit of the public has not been simple for the courts to define, including the United States Supreme Court.³¹ The Court has used an ad hoc approach that depends heavily on the facts and circumstances of each case.³² Under its ad hoc approach, the Court develops an analytical framework for each factor, but it

26. *See id.* at 628. The Court is most explicit when it states that a regulation will not be permitted to place an expiration date on the Takings Clause and that future generations should be given the right to challenge unreasonable regulations. *Id.*

27. *Compare id.* at 636-37 (Scalia, J., concurring) (noting that "[t]he 'investment-backed expectations' that the law will take into account do not include the assumed validity of a restriction that in fact deprives property of so much of its value as to be unconstitutional."), *with id.* at 632-36 (O'Connor, J., concurring) (noting that "[f]urther, the state of regulatory affairs at the time of acquisition is not the only factor that may determine the extent of investment-backed expectations.>").

28. *See, e.g.,* *Dolan v. City of Tigard*, 512 U.S. 374 (1994) (developing a means-ends analysis to scrutinize the nature of government action); *Lucas v. S.C. Coastal Council*, 505 U.S. 1003 (1992) (developing a per se test to prohibit a taking of all development use); *Nollan v. Cal. Coastal Comm'n*, 483 U.S. 825 (1987) (developing a means-ends analysis to scrutinize the nature of government action).

29. *See Tahoe-Sierra Pres. Council v. Tahoe Reg'l Planning Agency*, 535 U.S. 302, 339 (2002). Justice Stevens, writing for the majority, adopts Justice O'Connor's comments in *Palazzolo* on "fairness and justice" to reject a per se rule for moratoria on the development of land. *Id.* at 335. Justice O'Connor joined the majority, which did not include Justice Scalia. *Id.* at 344.

30. *Pennsylvania Coal v. Mahon*, 260 U.S. 393, 415 (1922).

31. *See Palazzolo*, 533 U.S. at 606.

32. *Penn Central*, 438 U.S. at 137.

has been slow to develop an analytical framework for economic impact and interference with expected return on investment.³³ However, *Lucas v. South Carolina Coastal Council*³⁴ establishes an all or nothing rule for economic effects that deprive the land of all development value and use, where such use restrictions were not placed on landownership at common law.³⁵ Federal takings law has developed much during the Rehnquist Court, but still remains both confusing and under-developed on the issue of the economic effects of regulation on the exercise of property rights.³⁶

A. Federal Takings Law and Liability

The Court has concluded that the purpose of the Takings Clause is to prevent some citizens from shouldering a burden that should be borne by the public or community as a whole, such as using taxes to buy land and property rights.³⁷ In *Penn Central Transportation Co. v. City of New York*,³⁸ the Court establishes three factors to determine the constitutionality of land use, environmental, and other regulations challenged as a regulatory taking.³⁹ The Court's ad hoc approach requires scrutiny of the nature of the government action,⁴⁰ an analysis of the economic impact of the regulation,⁴¹ and the determination of the extent of interference with reasonable investment-backed expectations⁴² to determine if the regulation

33. See *Monsanto*, 467 U.S. at 986 (holding a lack of reasonable investment-backed expectations); *Penn Central*, 438 U.S. at 104 (holding a lack of unreasonable interference with reasonable investment-backed expectations).

34. 505 U.S. 1003 (1992).

35. See *id.* at 1020, 1031. *Palazzolo* applies *Lucas* to land that had monetary value but a greatly diminished development use based on natural conditions. *Palazzolo*, 533 U.S. at 631.

36. See *Palazzolo*, 533 U.S. at 631-37 (Scalia, J. and O'Connor, J., concurring) (joining the majority in *Palazzolo* but disagreeing on issues of timing, regulatory, and other circumstances to be weighed in the *Penn Central* inquiry on remand).

37. *Armstrong v. United States*, 364 U.S. 40, 49 (1960). *Armstrong* takes on great importance in Justice O'Connor's concurring opinion and continues to do so in *Tahoe-Sierra Pres. Council* where Justice Stevens uses *Armstrong* as a doctrine to underpin *Penn Central*'s deferential means-ends analysis. *Id.*

38. 438 U.S. 104 (1978).

39. See *id.* at 137.

40. See, e.g., *Dolan*, 512 U.S. at 374.

41. See *Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365 (1926) (permitting substantial diminution in value); *Penn Central*, 438 U.S. at 104 (permitting reasonable economic impact). The Takings Clause has a social impact through regulations that limits the use of land and regulations that establish social welfare programs, such as recreation, job training, and transportation. See generally James E. Holloway & Donald C. Guy, *A Limitation on Development Impact Exactions to Limit Social Policy-Making: Interpreting the Takings Clause to Limit Land Use Policy-Making for Social Welfare Goals of Urban Communities*, 9 DICK. J. ENVTL. L. & POL'Y 1 (2000) (discussing the impact of the Court's interpretation of the Takings Clause on the development of social welfare programs).

42. See *Penn Central*, 438 U.S. at 136; *Monsanto*, 467 U.S. at 986. *Penn Central* and *Monsanto* are the Court's analysis of the existence and extent of interference with reasonable

effects a taking of private property for public use.⁴³ The development of takings doctrine to determine whether government regulation imposes a burden on landowners tantamount to an exercise of eminent domain has proven confusing under the *Penn Central* analysis.⁴⁴ In *Penn Central*, the Court concluded that New York City's historic preservation regulations were not a regulatory taking, though their restrictions on development of a local historic site limited the financial expectations of the landowner.⁴⁵ Yet, the Court's progress toward a development of a line of analysis to address investment-backed expectations, except for a total deprivation of developmental use,⁴⁶ has been slow.⁴⁷

The factor in the *Penn Central* analysis that has received most of the Court's attention has been the nature of government action.⁴⁸ The Court has developed means-ends analyses to examine the connection between a regulation and its purposes and justifications.⁴⁹ The Court has limited its attention mostly to land dedication conditions and other development impact exactions.⁵⁰ It has developed an "essential nexus" test to scrutinize the relationship between a land dedication condition and its declared public purposes⁵¹ and a rough proportionality test to scrutinize the relationship between a land dedication condition and the impact of development.⁵² The essential nexus and rough proportionality tests closely scrutinize the relationship between conditional demands and public needs, but the Court has refused to apply these tests to other

investment-backed expectations. See *infra* Part IV.B and accompanying notes.

43. See *Penn Central*, 438 U.S. at 124.

44. See *Palazzolo*, 533 U.S. at 631-37 (Scalia, J. and O'Connor, J., concurring) (typifying the confusion surrounding the Court's takings analysis in their disagreement on the presence and weight of time, regulatory, and other circumstances in the *Penn Central* inquiry).

45. See *Penn Central*, 438 U.S. at 138.

46. See *Lucas*, 505 U.S. at 1003 (denying all economically viable use).

47. See, e.g., Steven J. Eagle, *The Rise and Rise of "Investment-Backed Expectations,"* 32 URB. LAW. 437, 437 (2000); Daniel R. Mandelker, *Investment-Backed Expectations in Taking Law*, 27 URB. LAW. 215, 225-26 (1995); Lynda J. Oswald, *Cornering the Quark: Investment-Backed Expectations and Economically Viable Uses in Takings Analysis*, 70 WASH. L. REV. 91, 116 (1995). Commentators generally do not understand what the Court meant by investment-backed expectations. Eagle, *supra* at 437-40; Mandelker, *supra* at 225-27; Oswald, *supra* at 115-17. *Palazzolo* continues the Court's expansion of the concept of investment-backed expectations without establishing a discrete analysis in takings jurisprudence. *Palazzolo*, 533 U.S. at 606.

48. See, e.g., *Dolan*, 512 U.S. at 374 (scrutinizing the justification for regulation); *Nollan*, 483 U.S. at 825 (scrutinizing the ability of the regulation to further its declared purpose).

49. See also James E. Holloway & Donald C. Guy, *Land Dedication Conditions and Beyond the Essential Nexus: Determining "Reasonably Related" Impacts of Real Estate Development under the Takings Clause*, 27 TEX. TECH. L. REV. 73 (1996) (examining the impact of *Dolan* and *Nollan* on the scrutiny of the nature of government action).

50. See, e.g., *Dolan*, 512 U.S. at 374; *Nollan*, 483 U.S. at 825.

51. See *Nollan*, 483 U.S. at 837.

52. See *Dolan*, 512 U.S. at 391.

government regulations, such as land use, environmental, or coastal zone management regulations, that broadly affect the community as a whole.⁵³

The Court has not found much need to develop a line of analysis for the economic impact and return on investment factors of the *Penn Central* analysis. It earlier concluded in *Village of Euclid v. Ambler Realty Co.*⁵⁴ and other cases that a diminution in market value would not constitute a taking of private property for public use.⁵⁵ However, in *Lucas*, the Court concluded that the denial of all economically viable use is a taking, but it did not develop a precise test to determine when all economically beneficial use has been denied by government regulation.⁵⁶ Likewise, it has not developed a workable, definitive analysis to determine the extent of interference with reasonable investment-backed expectations.⁵⁷ The Court has not concluded that a government regulation unconstitutionally interferes with reasonable investment-backed expectations.⁵⁸ The Court is slowly developing an analytical framework for economic effects beyond a diminution in value,⁵⁹ preserving much government discretion to affect the operation of land markets⁶⁰ and expectations of landowners.⁶¹ The Court's reticence to check government discretion still would not justify the making of financially unsound real estate investments.

53. See *City of Monterey v. Del Monte Dunes of Monterey, Ltd.*, 526 U.S. 687, 702-03 (1999).

54. 272 U.S. 365 (1926).

55. See *Penn Central*, 438 U.S. at 131 (citing *Village of Euclid*, 272 U.S. at 365 (noting 75% diminution in value); *Hadacheck v. Sebastian*, 239 U.S. 394 (1915) (noting 87% diminution in value)).

56. See *Lucas*, 505 U.S. at 1015.

57. See *Monsanto*, 467 U.S. at 986 (finding no reasonable investment-backed expectations); *Penn Central*, 438 U.S. at 104 (finding no unreasonable interference with reasonable investment-backed expectations).

58. See *Monsanto*, 467 U.S. at 1066 (holding there is no reasonable investment-backed expectation in trade secrets of its product if it knew government would disclose secrets); *Penn Central*, 438 U.S. at 136 (denying the owners of the Grand Central Terminal the right to expansion that would generate greater profits did not interfere with the owner's investment-backed expectation).

59. See *Lucas*, 505 U.S. at 1003 (developing a narrowly designed per se test to prohibit the taking of all beneficial or development use).

60. See *Suitum v. Tahoe Reg'l Planning Agency*, 520 U.S. 725 (1997) (examining transferable development rights (TDRs) that may not have been salable or may have possessed limited economic value). For analysis of *Suitum*, see James E. Holloway & Donald C. Guy, *The Utility and Validity of TDRs under the Takings Clause and the Role of TDRs in the Takings Equation under Legal Theory*, 11 PENN STATE ENVTL. L. REV. 45 (2002).

61. See *City of Monterey*, 526 U.S. at 702-03 (delaying a development application that eventually ended with the state purchasing the property).

B. Real Estate Development Interests and Market Risks

Obviously, land and real estate development include financial, legal, and policy risks, and thus a market analysis is necessary to examine these attributes and forces.⁶² Real estate developers, landowners, and business organizations acquire and hold private property for institutional, residential, commercial, and industrial development.⁶³ They own or purchase land for investment, speculation, or both, and eventually plan to develop the land for a return on invested capital.⁶⁴

Land development is not risk-free. Real estate developers must assess and respond to local, state, and national land markets where sufficient supply and demand must exist for real estate products, such as housing and office space.⁶⁵ Economic conditions are not the only factors that affect local real estate markets.⁶⁶ Social conditions, government regulations, and public policy will have both negative and positive effects on residential and commercial development.⁶⁷ Public needs affect development by causing governments to impose responsibility on landowners and developers for social welfare needs, such as affordable housing, education, and recreation.⁶⁸ Population growth and other social changes affect the demand for real estate products.⁶⁹ The provision of real estate products may alleviate some social problems, such as a housing shortage, but may create other public needs, such as schools and other public facilities.⁷⁰ Finally, political or public policy concerns will affect residential, commercial, and other development when cities and communities control use and manage growth, including the imposition of limits on the expansion of public services.⁷¹ Public policy concerns include environmental protection, land use, urban redevelopment, and growth management.⁷² The provision of some

62. See BOYKIN & RING, *supra* note 10, at 60-95; TERRY VAUGHN GRISSOM & JULIAN DIAZ III, REAL ESTATE VALUATION: GUIDE TO INVESTMENT STRATEGIES 66-93 (1st ed. 1991); C. F. SIRMANS & AUSTIN J. JAFFE, THE COMPLETE REAL ESTATE INVESTMENT HANDBOOK 45-98 (2d ed. 1984). Real estate market analysis is not a layman's tool; the stakes are too high. The real estate investors must analyze business risks that are related to legal restrictions, economic conditions, social forces, and other factors. See SIRMANS & JAFFE, *supra* at 46-45.

63. See BOYKIN & RING, *supra* note 10, at 294-95.

64. See *id.*

65. See GRISSOM & DIAZ, *supra* note 62, at 111-12.

66. See BOYKIN & RING, *supra* note 10, at 60-72.

67. See *id.*

68. See *id.* at 62-64.

69. See *id.* at 65.

70. See *id.*; Holloway & Guy, *supra* note 41, at 31-35.

71. See BOYKIN & RING, *supra* note 10, at 61-64.

72. See *id.* at 62-63; James E. Holloway & Donald C. Guy, *Smart Growth and Limits on Government Powers: Effecting Nature, Markets and the Quality of Life under the Takings and*

public needs may enhance the marketability and utility of residential and commercial development, but the timing and costs of these needs create political and legal risks that still make development more risky in some communities.⁷³ Real estate development is a business enterprise that must assess through market analysis business, legal, political, and social risks in financial, marketing, and other components of development plan. Hopefully, this enterprise operates on carefully designed plans, and not solely on intuition or speculation.

The availability of capital and accessibility to capital markets is also an investment need associated with residential, commercial, and other development.⁷⁴ Unless the land developer has its own capital, which is often not the case, it must find financing for its development project, and thus it must develop a financial analysis.⁷⁵ Although land development involves the local use of real estate products, the real estate industry may need capital from other locations, sources, and investors, such as banks and Real Estate Investment Trusts (REIT).⁷⁶ Governments may also use taxes and other revenues to fund real estate development and redevelopment.⁷⁷ In short, real estate development depends heavily on the availability of financing and thus cannot avoid weighing the results of a risk-return analysis.

Obviously, finding and holding land with the hope of future financial benefits or expectations from its development are not enough. Assuming there is actual demand for a particular real estate product, landowners and developers must acquire capital, overcome legal restraints, and anticipate political risks. In an investment-backed expectations analysis, the Court's confusion over the use of financial, social, and economic circumstances in the *Penn Central* analysis that consider the developer's planning for legal risks and political uncertainty places an added burden on real estate investment decisions. Under a confusing regulatory takings analysis, lawyers are left to make arguments while judges are left to fashion rationales that implicate finance, social equity, and economic principles, such as fairness and windfall, but takings analysis leaves the eventual weight of these principles unresolved

Other Provisions, 9 DICK. J. ENVTL. L. & POL'Y 421, 423-26 (2001).

73. See Holloway & Guy, *supra* note 41, at 28-30. Municipalities are shifting part of the cost of providing new public facilities and expanding infrastructure to land developers. *Id.*

74. See SIRMANS & JAFFE, *supra* note 62, at 5-6.

75. See *id.*

76. See *id.* at 5-7. Investors may include equity investors, mortgagors, users, and government. *Id.* at 5; Holloway & Guy, *supra* note 72, at 440 & n.64.

77. See SIRMANS & JAFFE, *supra* note 62, at 5-6.

or unknown.⁷⁸ However, other well-established principles of finance, real estate, and real estate appraisal are applied to determine the measure of damages for a taking or condemnation under the exercise of eminent domain power.

C. Just Compensation and Appraisal Valuation

Justices Scalia and O'Connor's obvious differences regarding takings liability affect the determination of just compensation for an interference with reasonable investment-backed expectations, where courts may need to insure justice and fairness through the consideration of more circumstances, in finding a compensable taking.⁷⁹ The Court states that the value of the land in condemnation proceedings is its fair market value,⁸⁰ including use restrictions, zoning limitations, and other regulatory requirements.⁸¹ The market value of condemned property is fair market value⁸² which is also the measure of damages in condemnation actions.⁸³ Generally, fair market value is "the price

78. See *Palazzolo*, 533 U.S. at 632-37 (Scalia, J. and O'Connor, J., concurring) (regarding the presence and weight of time, regulatory, financial, and other circumstances in the determination of the extent of interference with reasonable investment-backed expectations under the *Penn Central* inquiry Justices Scalia and O'Connor disagree).

79. See *id.* In *Brown v. Legal Found. of Wash.*, 538 U.S. 216 (2003), the Court addresses a just compensation issue and reaffirms that fair market value is the measure of damages. It creates an exception to, or new principle on, the payment of just compensation. When the net earnings taken by the government are less than the transaction costs of returning these earnings to property owners, the government need not pay just compensation. *Id.* at 238-39. In this transaction, the net loss to the property owners would be zero, though the government has a net gain on keeping these earnings that were too costly to return to the property owners. *Id.* at 220.

80. See *Palazzolo*, 533 U.S. at 625 (citing *Olson*, 292 U.S. at 255; SACKMAN, *supra* note 21).

81. See *id.*

82. See *United States v. 50 Acres of Land*, 469 U.S. 24, 29 (1984). The Court noted in *Tahoe-Sierra Pres. Council*, 535 U.S. at 321, that the "Fifth Amendment [U.S. CONST. amend. V.] itself provides the basis for drawing a distinction between physical takings and regulatory takings," and thus it is not unthinkable that the measure of damages in some regulatory takings may consider factors that greatly reduced or increased the economic value of the property. The Court was most adamant about the *wholesale use* of physical takings principles to decide regulatory taking issues. *Id.* at 1479 ("Our regulatory takings jurisprudence . . . is . . . designed to allow 'careful examination and weighing of all the relevant circumstances.'" *Palazzolo*, 533 U.S. at 636 (O'Connor, J., concurring)). Yet, Justice Stevens reasons that the Court in *Palazzolo* refuses to use rules from its physical takings jurisprudence to determine the time of the taking. *Id.* at 637 (Stevens, J., dissenting). It seems as though what goes around comes around.

83. See *City of Harlingen v. Sharboneau*, 1 S.W.3d 282 (Tex. App. 1999), *rev'd*, 48 S.W.3d 177, 182 (Tex. 2001). See also *Brown*, 538 U.S. at 238-39 (finding a physical taking of interest earned on the principal but no loss of value to support an award of just compensation). The Court reaffirms what it and other federal courts have concluded in prior cases when it states that "[t]he 'just compensation' required by the Fifth Amendment is measured by the property owner's loss rather than the government's gain." *Id.* at 237. It also states that an owner "is entitled to be put in as good a position pecuniarily as if his property had not been taken. He

the property will bring when offered for sale by one who desires to sell, but is not obliged to sell and is bought by one who desires to buy, but is under no necessity of buying.”⁸⁴ Fair market value is not self-evident and thus courts may have to use other methods.⁸⁵

Normally courts have determined fair market value in condemnation proceedings by using one of three appraisal methods: comparable sales method, cost method, or income method.⁸⁶ Many courts apply the comparable sales method to determine damages in condemnation proceedings.⁸⁷ Under this method, the appraiser finds the value of similar property and makes adjustments up or down in the sales price depending on the differences in the property.⁸⁸ Courts apply the cost and income methods when “comparable sales figures are lacking or the method is otherwise inadequate.”⁸⁹ The use of cost and income methods depends on the nature and use of the land and other circumstances, such as the cost of producing similar properties and income producing capacity.⁹⁰ Courts apply the cost approach to unique property to determine the cost of replacing it,⁹¹ and they apply the income approach to income-producing property to determine the value of a stream of income.⁹² Using one or more of the three approaches under applicable circumstances should yield the fair market value as a measure of damages in condemnation proceedings.⁹³

Although courts usually apply one of the three approaches just mentioned, other appraisal methodology may be applied in particular circumstances.⁹⁴ When government regulation

must be made whole but is not entitled to more.” *Id.* (quoting *Olson*, 292 U.S. at 255 (1934)).

84. *City of Harlingen*, 48 S.W.3d at 182 (citing *State v. Carpenter*, 89 S.W.2d 979 (Tex. App. 1936)).

85. *See id.* at 183 (examining the use of the subdivision development method as a land valuation technique in condemnation proceedings).

86. *See id.* at 182 (citing *Religious Order of the Sacred Heart v. City of Houston*, 836 S.W.2d 606, 615-17 & n.14 (Tex. 1992)).

87. *Id.* (citing *Bauer v. Lauaca-Navidad River Auth.*, 704 S.W.2d 107, 110 (Tex. App. 1985); *County of Bexar v. Cooper*, 351 S.W.2d 956, 958 (Tex. App. 1961). Land appraiser will make adjustments to the value of the land to adjust for differences in the lots or tracts under the comparable sales approach. *See* BOYKIN & RING, *supra* note 10, at 179.

88. *City of Harlingen*, 48 S.W.3d at 182; *see* BOYKIN & RING, *supra* note 10, at 149-50.

89. *City of Harlingen*, 48 S.W.3d at 182.

90. *Id.*; SIRMANS & JAFFE, *supra* note 62, at 17-18.

91. *City of Harlingen*, 48 S.W.3d at 183; SIRMANS & JAFFE, *supra* note 62, at 17.

92. *City of Harlingen*, 48 S.W.3d at 183; SIRMANS & JAFFE, *supra* note 62, at 17-18.

93. *City of Harlingen*, 48 S.W.3d at 183. If we consider wetlands and other sensitive land to be truly unique lands, then Justices Scalia and O'Connor's differences call for more than the traditional land valuation approach to determine just compensation for a taking. *See A. A. Profiles*, 253 F.3d at 583-84 (applying a modified market value test when the economic impact of the regulation greatly affects land value and the traditional use is no longer available).

94. *See, e.g., City of Harlingen*, 48 S.W.3d at 183 (discussing application of the subdivision

constitutes a regulatory taking by interfering with investment-backed expectations on a tract of developable land (assume filling of land) Justice Scalia's economic analysis (windfall) and Justice O'Connor's regulatory effects analysis (broadly examining past circumstances) may support the modification of one of these land valuation methods or the use of another method that would permit the consideration of circumstances affecting a higher economic use.⁹⁵ Before pursuing that line of analysis in Parts IV and V, we must first examine *Palazzolo* and its impact on takings jurisprudence.

III. PALAZZOLO AND WETLANDS IN REGULATORY TAKINGS JURISPRUDENCE

Palazzolo illustrates that Justices Scalia and O'Connor do not agree on the issue of justice and fairness⁹⁶ in the determination of takings liability and just compensation for long held and uncertain financial expectations on sensitive and unique lands, such as wetlands and prime farmlands. Although the primary issues in *Palazzolo* were ripeness and postregulation acquisition, our focus is on the liability and compensation issues regarding the extent of interference with reasonable investment-backed expectations. These liability and compensation issues show a fundamental difference in fairness and economics in the regulatory takings jurisprudence of the conservative wing of the Rehnquist Court.⁹⁷

or land development method to ready-to-develop land); BOYKIN & RING, *supra* note 10, at 157-58 (discussing the application of the land development method to land easily converted to a higher economic use, such as converting farmland to urban land).

95. See *A. A. Profiles*, 253 F.3d at 576. Courts have applied a modified market value test when the impact of the regulation is a taking but circumstances do not permit compensation for the value. One commentator states that: "[i]n choosing the modified market value test over the lost income measure, which the court generally uses when a regulation only temporarily burdens an owner's land, the court emphasized that Profiles neither possessed nor retained the ability to derive economic value from the property at the point [the court] declared that a taking had occurred." *Constitutional Law – Regulatory Takings – Eleventh Circuit Finds Public Purpose Determination Irrelevant to Damages Calculation – A.A. Profiles, Inc. v. City of Fort Lauderdale*, 253 F.2d 576 (11th Cir. 2001), 115 HARV. L. REV. 899, 902 n.31 (2002) (quoting *A.A. Profiles*, 253 F.3d at 584). Justices Scalia and O'Connor's differences are caused by a temporary situation that did not, and may still not, permit the landowner to develop the land. However, past circumstances may indicate that the landowner could not have used his property for development or any other beneficial use, and thus the measure of damages must weigh these circumstances, which would permit a higher discount rate or a lower capitalization rate in determining the income producing value of the property.

96. Compare *Palazzolo*, 533 U.S. at 635-36 (Scalia, J., concurring) (giving landowner a windfall under present circumstances), with *Palazzolo*, 533 U.S. at 632-33 (O'Connor, J., concurring) (permitting government to seek some constitutional relief under past circumstances).

97. See also *Tahoe-Sierra Pres. Council*, 535 U.S. at 302. Economics and fairness clash again, but Justices Scalia and O'Connor are on different sides of the opinion. Justice O'Connor joins the majority written by Justice Stevens, but Justice Scalia does not. *Id.* at

Both Justice Scalia and Justice O'Connor's approaches to takings analysis are incomplete, though they contain elements necessary to initiate an economic analysis and provide justice and fairness to all parties.

In *Palazzolo*,⁹⁸ the petitioner owned waterfront property that was designated as wetlands under the Coastal Zone Management Regulation of the State of Rhode Island. The property was located in Westerly, Rhode Island.⁹⁹ In 1959, the petitioner invested in three undeveloped, adjoining parcels on the eastern stretch of Atlantic Avenue.¹⁰⁰ Petitioner's parcels faced and bordered Winnapaug Pond, north of the parcel.¹⁰¹ To the south, the parcels faced the eastern end of Atlantic Avenue, the beachfront houses on the other side of the Avenue, and the dunes and ocean beyond the houses.¹⁰² Petitioner and associates formed Shore Gardens, Inc., (SGI) to purchase and hold the property.¹⁰³ Later, petitioner bought his associates' interest and became the sole shareholder.¹⁰⁴ In 1971, while petitioner was submitting applications, Rhode Island enacted legislation establishing the Coastal Resources Management Council (Council) and granted it authority to protect the State's coastal properties.¹⁰⁵ The salt marshes were designated as "protected 'coastal wetlands.'"¹⁰⁶ In 1978, the petitioner became the sole owner of the property when SGI's corporate charter was revoked for a failure to pay taxes.¹⁰⁷ SGI and petitioner made several unsuccessful efforts to acquire a permit to develop the land.¹⁰⁸

A. The Nature of Development Efforts by the Petitioner in Palazzolo

Petitioner's efforts to develop the land were demonstrated primarily by the submission of applications.¹⁰⁹ During the first decade, petitioner submitted a plat subdividing the property into 80 lots and engaged in transactions that left 74 lots.¹¹⁰ The remaining

305.

98. *Palazzolo*, 533 U.S. at 606.

99. *Id.* at 610.

100. *Id.* at 613.

101. *Id.*

102. *Id.*

103. *Palazzolo*, 533 U.S. at 613.

104. *Id.*

105. *Id.* at 615 (citing 1971 R.I. Pub. Laws, ch. 279, § 1).

106. *Id.* (citing Rhode Island Coastal Zone Mgmt. Program § 210.3 (as amended June 28, 1983)).

107. *Palazzolo*, 533 U.S. at 615.

108. *Id.* at 614.

109. *Id.*

110. *Id.*

74 lots consisted of approximately 20 acres. At the same time, petitioner submitted intermittent applications to state agencies to develop the property by filling it.¹¹¹ The property consisted of “salt marsh subject to tidal flooding,” and “would require considerable fill – as much as six feet in some places – before significant structures could be built.”¹¹² The petitioner’s first application in 1962 was denied for a lack of essential information.¹¹³ The next two applications were submitted in 1963 and 1966, and were referred to the Rhode Island Department of Natural Resources, which gave initial approval but later withdrew it.¹¹⁴ SGI did not contest the refusal to approve either application.¹¹⁵

In 1983, almost two decades later, petitioner submitted another application, similar to the 1962 application, “to construct a wooden bulkhead along the shore of Winnapaug Pond and to fill the entire marshland area.”¹¹⁶ “The Council rejected the application, noting it was ‘vague and inadequate for a project of this size and nature.’”¹¹⁷ The Council concluded that the project would have a significant impact on water and wetlands and would conflict with the existing Coastal Resource Management Plan.¹¹⁸ Petitioner did not appeal the Council’s decision.¹¹⁹ In 1985, petitioner submitted another application “to fill 11 acres of the property with gravel to accommodate 50 cars with boat trailers, a dumpster, port-a-johns, picnic tables, barbecue pits of concrete, and other trash receptacles.”¹²⁰ The Council’s regulations required the landowner to have a “special exception” to fill a salt marsh.¹²¹ Such an exception required “a compelling public purpose which provides benefits to the public as a whole as opposed to individual or private interests.”¹²² The Council rejected the application, finding a conflict with regulatory standards for a special exception.¹²³

111. *Id.*

112. *Palazzolo*, 533 U.S. at 614.

113. *Id.*

114. *Id.* at 612-15.

115. *Id.* at 615.

116. *Id.*

117. *Palazzolo*, 533 U.S. at 615.

118. *Id.*

119. *Id.*

120. *Id.* (quoting the petitioner’s 1985 application).

121. *Id.*

122. *Palazzolo*, 533 U.S. at 615.

123. *Id.*

B. The Impact of Development on Beneficial Use and Acquisition

After the last application in 1985, petitioner turned to the courts to acquire compensation for a compensable taking.¹²⁴ Petitioner filed an inverse condemnation claim in the Rhode Island Superior Court claiming a taking of private property without just compensation in violation of the Fifth and Fourteenth Amendments.¹²⁵ Specifically, the petitioner claimed that he had been deprived of all “economically beneficial’ use of his property.”¹²⁶ The Superior Court held for the State of Rhode Island, and the Supreme Court of Rhode Island affirmed its judgment.¹²⁷ The Supreme Court held that the takings claim was not ripe,¹²⁸ and that petitioner “had no right to challenge regulations predating 1978, when he succeeded to legal ownership of the property from SGI.”¹²⁹ The United States Supreme Court granted a writ of certiorari¹³⁰ and reversed the Rhode Island Supreme Court on the ripeness and postregulation acquisition claims.¹³¹

The Court did not agree with the Rhode Island Supreme Court’s conclusion that “notwithstanding the Council’s denials of the applications, doubt remained as to the extent of development the Council would allow on petitioner’s parcel.”¹³² The Court also found that the nature of coastal resource management regulation prohibited “filling or building residential structures on wetlands adjacent to Type 2 waters.”¹³³ The Court also found that the Council rejected the application and refused to grant a special exception.¹³⁴ It found no indication that the Council would ever grant permission to develop a smaller surface area.¹³⁵ Further, the Court found that the Council’s interpretation of the regulation barred all development of land, and thus petitioner could not fill the wetlands.¹³⁶ Therefore, the Court concluded that additional permit applications were unnecessary to establish this point.¹³⁷ The Court explicitly states that the “federal ripeness rules do not require the submission of

124. *Id.*

125. *Id.*

126. *Id.*

127. *Palazzolo*, 533 U.S. at 615-16.

128. *Id.* at 616.

129. *Id.*

130. *Palazzolo v. Rhode Island*, 531 U.S. 923 (2000).

131. *See Palazzolo*, 533 U.S. at 618.

132. *Id.*

133. *Id.*

134. *Id.* at 620.

135. *Id.*

136. *Palazzolo*, 533 U.S. at 620.

137. *Id.*

further and futile applications with other agencies,”¹³⁸ and thus the extent of restrictions on the development property can be determined from the facts and circumstances.¹³⁹ The Court held that petitioner’s taking claims were ripe for review.¹⁴⁰

*C. Restricting Per Se Takings Liability but Permitting
Development Value as a Beneficial Use*

The Court refused to create another *Lucas*-type rule in regulatory takings jurisprudence, but it extended *Lucas* to include development value as a beneficial use. The Court reversed the Supreme Court of Rhode Island’s holding that the postregulation acquisition of title did not permit petitioner to bring taking claims for “deprivation of all economic use” under *Lucas*¹⁴¹ and its background principles of state law¹⁴² for a regulatory taking under the *Penn Central* analysis,¹⁴³ especially the extent of interference with reasonable investment-backed expectations.¹⁴⁴ The Court reasoned that a passage of time and transfer of title do not make a regulatory taking any less onerous or unreasonable and thus does not justify cutting off the state obligation to defend against unreasonable or onerous regulation.¹⁴⁵ The Court concluded that “[a] State would be allowed, in effect, to put an expiration date on the Takings Clause. This ought not to be the rule.”¹⁴⁶ The Court rejected the argument that notice of the enactment of a regulation restricting use at the time the owner acquired the property should prohibit the owner from bringing a takings claim.¹⁴⁷ The Court reasoned that a rule based on such an argument would prejudice the owner and his or her heir and successor, and it would deny the new owner the right to transfer an interest possessed prior to the enactment of the regulation if the original owner had failed to survive the ripening of his or her taking claim.¹⁴⁸ The Court held that a postregulation acquisition takings claim is not barred.¹⁴⁹ Finally, the Court held that petitioner’s *Penn Central* claims must

138. *Id.* at 626.

139. *See id.*

140. *Id.* at 631.

141. *Palazzolo*, 533 U.S. at 626 (citing *Lucas*, 505 U.S. at 1015).

142. *Id.* (citing *Palazzolo v. State ex rel. Tavares*, 746 A.2d 707, 716 (2000)).

143. *Id.* (citing *Penn Central*, 438 U.S. at 174).

144. *See id.* at 630. The Court concluded that the Supreme Court of Rhode Island will not address the *Lucas* claim on remand, but the Court states that the Supreme Court “must address, however, the merits of petitioner’s claim under *Penn Central*.” *Id.*

145. *Id.* at 625.

146. *Palazzolo*, 533 U.S. at 628.

147. *Id.*

148. *Id.*

149. *Id.* at 630.

be examined by the state court, including the interference with reasonable investment-backed expectations.¹⁵⁰

The Court agreed with the Supreme Court of Rhode Island's decision that the petitioner was not denied all "economically beneficial use" of the parcel because "the uplands portion of the property can still be improved."¹⁵¹ The Court noted that the upland portion had a development value of \$200,000, according to the Council and trial court findings, under the state wetland regulations.¹⁵² Yet the Court found that the petitioner did not assert a takings claim based on the premise that the Council sidestepped *Lucas* by leaving him a "token interest" of development value.¹⁵³ The Court concluded that *Lucas* cannot be evaded so easily under just compensation when a taking occurs and that petitioner's right to develop "a two-acre tract" (build a substantial residence) of an eighteen acre parcel "does not leave the property 'economically idle.'"¹⁵⁴ The Court also held that petitioner's *Lucas* claim fails because the upland portion had a development value of \$200,000.¹⁵⁵

IV. LIABILITY AND COMPENSATION FOR INTERFERENCE WITH ECONOMIC EXPECTATIONS

Justice Scalia and Justice O'Connor's differences regarding takings liability affect the issue of just compensation for an interference with reasonable investment-backed expectations.¹⁵⁶ If courts find that the government unreasonably interferes with reasonable investment-backed expectations, they must determine just compensation under conditions and circumstances that affect

150. *Id.*

151. *Palazzolo*, 533 U.S. at 630.

152. *Id.*

153. *Id.*; see also *Suitum*, 520 U.S. at 725 (noting use of transferable development rights to mitigate the impact of environmental regulation).

154. *Palazzolo*, 533 U.S. at 630-32 (citing *Lucas*, 505 U.S. at 1019).

155. *Id.*

156. The issue of just compensation was of interest to one or more Justices during the oral arguments of *Palazzolo*. Several questions lead one to believe that one or more Justices were considering just compensation if the extent of the interference amounted to a taking. One Justice's question posited:

And so I wondered, on your opinion, would it work to say it [takings claim] does run with the land but no one can recover more than his investment back expectation, that is to say if somebody goes and buys cheap, land with an already existing taking claims, they will not benefit from that because they could not recover more in fairness than what they paid for the land minus the value of the land for all other purposes.

Petitioner's Oral Arguments, *Palazzolo v. Rhode Island*, 121 S. Ct. 2448 (2001) (No. 99-2047) (Feb. 26, 2001) (reported by Alderson Reporting Co., Inc., Washington, D. C. 20005, available at http://a257.g.akamaitech.net/7/257/2422/14mar20010800/www.supremecourtus.gov/oral_arguments/argument_transcripts/99-2047.pdf) [hereinafter Oral Argument].

the financial, regulatory, and other feasibility of the real estate investment. Moreover, where the exercise of investment-backed expectations requires an extensive public investment in social welfare, public facilities, and local infrastructure, the courts will have a perplexing issue.¹⁵⁷ The question raised by these circumstances is whether courts can determine just compensation by using appraisal methods that take into account the public and private costs and risks of development. On one hand, Justice O'Connor's concerns raise such a question because she is willing to begin her investment-backed expectations analysis by weighing the impact of past regulations on an owner's economic motives and abilities during ownership, and she may strongly imply a discounted cash-flow method with an extremely high discount rate to determine just compensation to insure fairness.¹⁵⁸ Clearly, the cost of development greatly affects its feasibility. On the other hand, Justice Scalia's concerns point out such a question because he is willing to begin his analysis in the present by weighing only the financial returns (windfall) that may greatly exceed the original investment expectations.¹⁵⁹ The landowner's economic intent and expected returns are not necessarily synonymous with the fair market value of just compensation. Consequently, the ultimate issue is what past regulatory circumstances should be included in both the determination of a compensable taking and the measure of damages. Obviously, bonafide expectations of returns would exist in the past.

157. See *Dolan*, 512 U.S. at 374; *Nollan*, 483 U.S. at 825 (permitting municipalities to impose land dedication conditions and perhaps impact fees to offset public costs or burdens of providing public facilities and infrastructure for private development).

158. See *Palazzolo*, 533 U.S. at 632-35 (O'Connor, J., concurring). A modified market value test may permit the recovery of just compensation for politically degraded land, such as wetlands. Politically degraded land is subject to regulation and suffers a loss of investment potential through market selection for a lesser investment use or class. *Unlike a mere diminution in value in the same land use or investment class*, the remaining productive use could have never been contemplated by landowners at common law, such as infrastructure for natural-based or ecotourism. The question is not whether common law would have permitted this use but whether the landowner would have contemplated such an investment use or class under *past circumstances, such as an abundance of trees and wildlife*. An unexpected but lesser productive use that reasonably indicates a lesser investment return and greater investment risk, preferably during the long-term, justifies a *payment of just compensation under present circumstances*. See *A. A. Profiles*, 253 F.3d at 576 (applying a modified market value test to compensate for land that was no longer in the owner's possession).

159. See *Palazzolo*, 533 U.S. at 635-37 (Scalia, J., concurring).

A. *Justice Scalia and Justice O'Connor's Differences on Liability and Compensation*

Justice O'Connor wants courts to consider the regulatory circumstances in existence when an owner takes title and makes an effort to develop the property under the *Penn Central* analysis when determining the extent of interference with reasonable investment-backed expectations.¹⁶⁰ Justice Scalia takes an entirely different approach that emphasizes the timing of the regulation and recognizes the economics of the land investment.¹⁶¹ Justices Scalia and O'Connor offer contrasting approaches, but they show a reconcilable difference on one or more issues in regulatory takings jurisprudence.¹⁶²

Justice O'Connor broadens the *Penn Central* analysis to include the "timing of the regulation's enactment relative to the acquisition of title" and thus accords it importance but not exclusive consideration in the *Penn Central* analysis.¹⁶³ Her approach recognizes that the interference with reasonable investment-backed expectations is affected by the regulatory regime in place at the time the claimant acquired the property.¹⁶⁴ Justice O'Connor's approach recognizes the "concept of fairness and justice" that is best achieved by examining "the particular circumstances [in that] case."¹⁶⁵ Consequently, the *Penn Central* analysis is primarily a factual assessment with its factors serving as guideposts.

Justice O'Connor lists a few analytical guideposts in determining a regulatory taking involving the extent of interference with reasonable investment-backed expectations. Justice O'Connor states that the Supreme Court of Rhode Island erred in rejecting petitioner's claim for interference with reasonable investment-backed expectations based solely on acquisition of the title after enactment of the regulation.¹⁶⁶ Justice O'Connor notes that the extent of interference with reasonable investment-backed

160. *Id.* at 633-35 (O'Connor, J., concurring). *See also* Dist. Intown Prop. Ltd. P'ship v. Dist. of Columbia, 198 F.3d 874, 877-80 (D.C. Cir. 1998), *cert. denied*, 531 U.S. 812 (2000) (concluding the landowners had no reasonable investment-backed expectation under the regulatory structure at the time of subdivision because mere purchase does not establish reasonable investment-backed expectations if intended use is greatly inconsistent with past use of the property).

161. *Palazzolo*, 533 U.S. at 635-37 (Scalia, J., concurring).

162. *See id.* at 632-35 (O'Connor, J., concurring); *see also infra* Part V.A. and accompanying notes (identifying reconcilable circumstances in Justices Scalia and O'Connor's approaches to an inert *Penn Central* inquiry).

163. *Palazzolo*, 533 U.S. at 632 (O'Connor, J., concurring).

164. *Id.* at 633 (O'Connor, J., concurring).

165. *Id.* (citing *Penn Central*, 438 U.S. at 121 (quoting *United States v. Central Eureka Mining Co.*, 357 U.S. 155, 168 (1958))).

166. *Id.* (O'Connor, J., concurring).

expectations is only one factor and is not determinative of the outcome of the *Penn Central* analysis.¹⁶⁷ Justice O'Connor's approach for an analysis of the existence and extensiveness of a regulatory interference would include circumstances relying more on the policy environment and less on the finance and real estate environments.¹⁶⁸ The first of these circumstances is the "state of regulatory affairs at the time of acquisition."¹⁶⁹ The second is the "nature and extent of permitted development under the regulatory regime."¹⁷⁰ She recognizes that the actions of landowners under some regulatory schemes may create vested rights in development property and thus may preclude government interference.¹⁷¹ The third circumstance is that the Takings Clause does not require a financial investment in development property by post-enactment acquirers of the property, such as a donee, heir, or devisee.¹⁷² These circumstances require that courts "must attend to those circumstances which are probative of what fairness requires in a given case."¹⁷³

Although Justice O'Connor's policy-based approach does not permit investment-backed expectations to be the determinative factor in the *Penn Central* analysis and does not permit the state to define property rights on passage of title, it uses the past regulatory regime to determine the existence and interference with a landowner's expectations.¹⁷⁴ This approach provides more fairness by requiring broader consideration of past regulation in the *Penn Central* analysis. Her approach imposes limits on states' powers, but may not permit land owners to acquire large returns at the government's expense, and thus it curtails the existence or extensiveness of interference with expectations of land investors.¹⁷⁵ Justice O'Connor concludes that the Court maintains and adds balance to the "regulatory backdrop against which an owner takes title"¹⁷⁶ under the *Penn Central* analysis¹⁷⁷ by examining the "effect[s] of existing regulations under the rubric of investment-

167. *Id.*

168. *Palazzolo*, 533 U.S. at 632.

169. *Id.*

170. *Id.* at 633-36 (O'Connor, J., concurring).

171. *Id.* at 636 (O'Connor, J., concurring).

172. *Id.* (O'Connor, J., concurring) (citing *Hodel v. Irving*, 481 U.S. 704, 714-18 (1987)).

173. *Palazzolo*, 533 U.S. at 636 (O'Connor, J., concurring).

174. *Id.* (O'Connor, J., concurring).

175. *Id.* (O'Connor, J., concurring). On this issue, Justice O'Connor disagrees with Justice Scalia, who would not permit past regulation to affect the determination of a diminution in value or interference with investment-backed expectations, and thus would permit a windfall by the landowner for a *post-regulation taking*. *Id.*

176. *Id.*

177. *Palazzolo*, 533 U.S. at 636.

backed expectations in determining whether a compensable taking has occurred.”¹⁷⁸

Justice Scalia states that, based on his understanding, the Court’s opinion that must be considered on remand is not Justice O’Connor’s.¹⁷⁹ He notes that she finds it unfair to acquire a windfall under some circumstances if a later purchaser establishes a partial taking by the government.¹⁸⁰ Justice Scalia’s economic-based approach to the *Penn Central* analysis does not consider past policy, regulatory, or economic circumstances. His approach analyzes the existing regulatory scheme to determine whether it amounts to a taking, validating circumstances that Justice O’Connor would most likely find unfair. He illustrates this validation by stating that a real estate developer could acquire a piece of property that is subject to use and other restrictions and successfully challenge these restrictions and develop the property.¹⁸¹ Justice Scalia refers to the developer’s success as a windfall. His approach recognizes an economic reality: windfalls can be everyday occurrences in American markets.¹⁸² He states that fairness does not require the return of the windfall to the “naïve original owner” and thus, in a transaction involving land that was subject to an unconstitutional taking wrongfully committed by the government, the windfall should not be returned to the government.¹⁸³ Justice Scalia considers the government’s role to be analogous to “a thief clothed with the indicia of title,”¹⁸⁴ where the thief was to receive from the purchaser any windfall accrued from the purchase of property.¹⁸⁵ Justice Scalia points out that the existence of a regulation at the time the purchaser took title has no effect on whether this regulation is a compensable taking.¹⁸⁶ Specifically, he notes that the extent of interference with reasonable investment-backed expectations does not take into consideration the existence of a regulation that reduces the value of the property so much that it

178. *Id.* Justice O’Connor’s policy-based approach focuses primarily on takings liability, but she strongly implicates an unusual just compensation concern where takings liability exists and unrealized compensable expectations may have been highly risky or just not foreseeable. Such risky development could include a physically or financially infeasible development project or a lack of real estate product demand. She recognizes that the present market value of an earlier investment could be affected by recent changes in local real estate markets or could have resulted from newly created government policies and programs. *Id.*

179. *Id.* (Scalia, J., concurring).

180. *Id.* (Scalia, J., concurring).

181. *Id.* (Scalia, J., concurring).

182. *Palazzolo*, 533 U.S. at 636.

183. *Id.* at 635-36 (Scalia, J., concurring).

184. *Id.* at 637 (Scalia, J., concurring).

185. *Id.* (Scalia, J., concurring).

186. *Id.* (Scalia, J., concurring).

amounts to a taking.¹⁸⁷ Finally, Justice Scalia states that since a regulatory taking is not absolved by the transfer of title, the economic effects must be considered under the *Penn Central* analysis, but that does not include weighing the circumstances surrounding an unconstitutional regulation.¹⁸⁸

Justice Scalia and Justice O'Connor's differences on the weight of the regulatory backdrop in the determination of the existence of expectations and the extensiveness of the regulatory interference with expectations are a two-pronged question that the Court has not resolved with any analytical certainty. Obviously, Justice Scalia's economic-based approach implies the more immediate existence of expectations and leaves markets and investors to recognize investment expectations that are questions of risk and return analysis.¹⁸⁹ Looking at the present point to determine expectations is looking at the future and may not address the risk of long term land investors whose expectations were limited by past political uncertainty, legal restraints, and financial market risk in a highly regulated society. Finding the existence of expectations under the circumstances at the time of the taking increases the likelihood of shifting investment risk to the government when a regulation is declared an unconstitutional taking in a well-regulated field, such as wetlands or prime farmland. Ignoring investment risk for the sake of a policy that permits the consideration of past circumstances with no relevance to any risk-return analysis under Justice O'Connor's *Penn Central* analysis may be as flawed as an approach that only considers the most immediate expectations or value, without regard to any risk. The Court is unable to define either reasonable investment-backed expectations or an extensive interference to be a taking; and thus leaves the Takings Clause's impact on risk and return in land investments at the mercy of shifting policies.¹⁹⁰

B. The Existence of Expectations and the Extent of Interference

Shifts in local and state policies that result in land use, environmental, and other regulations make financial returns on real

187. *Palazzolo*, 533 U.S. at 637 (Scalia, J., concurring).

188. *Id.* (Scalia, J., concurring).

189. *Id.* at 635-37 (Scalia, J., concurring).

190. *See Monsanto*, 467 U.S. at 986; *Penn Central*, 438 U.S. at 104. *See also* Meriden Trust & Safe Deposit Co. v. FDIC, 62 F.3d 449 (2d Cir. 1995) (“[W]ithdrawal liability provisions ... was not out of line with owner’s investment-backed expectations.”); Rith Energy, Inc. v. United States, 247 F.3d 1355 (Fed. Cir. 2001) (asserting a “notice requirement” based on the acquisition of the property after the enactment of environmental regulations to cutoff reasonable-investment-backed expectations).

estate investments uncertain or risky, and thus some landowners and real estate investors find that these regulations greatly interfere with their financial incentives and economic expectations for development. The Court has yet to share their concerns on economic expectations, and the extent of interference with investment-backed expectations in cases reaching the Court has not amounted to regulatory takings.¹⁹¹ In *Penn Central*,¹⁹² the Court concluded that denying the owners of the Grand Central Terminal (Terminal) the right to an expansion that would generate greater profits did not interfere with the owner's reasonable investment-backed expectations.¹⁹³ The Court concluded that takings jurisprudence would not permit the severance of air rights from the parcel of land on which the Terminal is located.¹⁹⁴ The Court took into consideration that the owners of the Terminal had anticipated future expansion when it initially constructed the Terminal by building a foundation to support a twenty-story structure.¹⁹⁵ Although *Penn Central* clearly planned for a more profitable use of its site, the Court did not find that the extent of interference with

191. See *Monsanto*, 467 U.S. at 986; *Penn Central*, 438 U.S. at 104. The Court has not defined investment-backed expectations, and commentators and scholars have yet to settle on whether the Court means property interests, financial interests, or both. See Mandelker, *supra* note 47, at 249. In *Palazzolo*, Justices O'Connor and Scalia agree that investment-backed expectations are an essential factor of the *Penn Central* analysis. *Palazzolo*, 533 U.S. at 606. Assuming they can ever find the existence of reasonable investment-backed expectations, they still may disagree on the determination of the *extent of interference* and *measure of damages*. Both Justices appear to be beyond any conceptual questions about the nature and existence of investment-backed expectations in the American private property regime. *Id.* They are clearly engaged in finding the extent of interference, though they are not close. *Id.* at 631-37. (Scalia, J. and O'Connor, J., concurring). They appear to agree not to permit constructive notice created by regulatory programs to invalidate investment-backed expectations. See *id.* at 627. However, Justice O'Connor appears willing to use past regulatory programs to affect a taking in other ways, such as to affect the finding of the existence or interference with investment-backed expectations or their valuation. See *id.* at 633 (O'Connor, J., concurring).

Justices O'Connor and Scalia appear to be arguing about growth or maturity of investment-backed expectations under a regulatory program that has been valid for a number of years, but now could be held to be a taking. See *id.* at 631-37 (Scalia, J. and O'Connor, J., concurring). Justice Scalia's market-sensitive approach under the *Penn Central* analysis simply does not weigh the past impact of invalid regulations on the value of the land or present harm to investment-backed expectations. See *id.* at 637 (Scalia, J., concurring). Justice O'Connor's policy-based approach under the *Penn Central* analysis would weigh the impact of past circumstances on the ability to meet investment-backed expectations. See *id.* at 633 (O'Connor, J., concurring). Justice O'Connor seems willing to weigh risks and uncertainty affecting the decision to develop the land, though her approach may include past market risks and political uncertainties that are no longer relevant in any present risk-return analysis. In fact, Professor Mandelker proposes a regulatory risk theory that would not reward landowners for taking unnecessary risk. Mandelker, *supra* note 47, at 249.

192. 438 U.S. 104 (1978).

193. *Id.* at 136.

194. *Id.* at 136-37.

195. *Id.* at 115, n.15.

investment-backed expectations on the site amounted to a regulatory taking.¹⁹⁶ Even if investment-backed expectations exist, an unreasonable interference with these expectations requires more than an interference with the profit-making potential of the property.

In another case, the Court took a step back by not finding the existence of reasonable investment-backed expectations in proprietary information. In *Ruckelshaus v. Monsanto Co.*,¹⁹⁷ the Court concluded that Monsanto did not have a reasonable investment-backed expectation in the trade secrets of its pesticide product if it knew that the Environmental Protection Agency (EPA) required disclosure of its formula for approval of this pesticide.¹⁹⁸ Again, it is safe to assume that Monsanto had a strategic market plan for the most profitable use of its trade secret, which could have easily included licensing to other manufacturers.¹⁹⁹ The Court has yet to conclude that a government regulation unconstitutionally interferes with reasonable investment-backed expectations, though *Penn Central* recognizes the existence of a reasonable investment-backed expectation in real estate development.²⁰⁰

Although landowners and developers have expectations of greater returns from land investments, they should expect some regulatory and political risks in owning or acquiring property for development.²⁰¹ The impact of these risks on financial returns from development is affected by local, state, and federal policy-making, such as land use planning. Imposing more planning requirements interferes with investments in land already subject to use restrictions and other requirements. These interferences do not

196. *Id.* at 136-37. The Court notes the law does not interfere with the present use, which has been the use for 65 years. *Id.* at 136. It states that “the law does not interfere with what must be regarded as *Penn Central*’s primary expectation concerning the use of the parcel.” *Id.* Finally, the Court notes that the landowner may be able to make some economic use of the land. *Id.* at 137.

197. *Monsanto*, 467 U.S. at 986.

198. *Id.* at 1006. *But see* Phillip Morris v. Harshbarger, 159 F.3d 670 (1st Cir. 1998) (disclosing ingredient information could affect a taking of private property by interfering with investment-backed expectations, and thus the district court did not abuse its discretion by issuing a preliminary injunction to enjoin the state from disclosing this information).

199. *See Monsanto*, 467 U.S. at 997-98. “Monsanto Company (Monsanto) is an inventor, developer, and producer of various kinds of chemical products, including pesticides. Monsanto, headquartered in St. Louis County, Mo., sells [its products] in both domestic and foreign markets. It is one of a relatively small group of companies that invent and develop new active ingredients and conduct most of the research and testing with respect to those ingredients.” *Id.*

200. *See Penn Central*, 438 U.S. at 136-37.

201. In *Concrete Pipe and Products of Cal., Inc. v. Construction Laborers Pension Trust for S. Cal.*, 508 U.S. 606, 646 (1993), Justice Souter, writing for the majority, states that “legislation readjusting rights and burdens is not unlawful solely because it upsets otherwise settled expectations”

mean that the greater extent of interference with expected returns on investments violates the Takings Clause.²⁰² Developers and landowners often need to comply with new planning elements and regulatory requirements, such as zoning and growth management regulations, that may affect takings claims involving the extent of interference with reasonable investment-backed expectations.²⁰³ These regulations are often necessary to provide orderly growth and development, conserve natural resources, and improve the quality of life.²⁰⁴ Protecting the public interests necessarily requires a reasonable interference with financial expectations or returns, which can be offset with transferable development rights (TDRs) and other financial incentives.²⁰⁵

In both *Penn Central* and *Monsanto*, the Court weighed well-settled financial expectations but was not persuaded by plans, strategies, or markets as evidence of the existence of, or extensive interference with, reasonable investment-backed expectations.²⁰⁶ The model for market analysis in real estate and other businesses includes a political, legal, and regulatory assessment of the business environment and markets,²⁰⁷ so *windfalls and wipeouts* that occur as a result of regulation and deregulation should not be surprising to students of real estate.²⁰⁸ *Monsanto* and *Penn Central* represent business life in a regulated society: long-term corporate plans need to include the political uncertainty and legal risk that governments might eventually restrict or prohibit the implementation of future strategies.²⁰⁹ It is safe to assume that the Court knows the

202. See *Penn Central*, 438 U.S. at 136-37.

203. See Holloway & Guy, *supra* note 72, at 246-51. Land use, growth management, and other smart growth regulations may raise takings claims involving the extent of interference with reasonable investment-backed expectations. *Id.*

204. See AMERICAN PLANNING ASSOCIATION, PLANNING COMMUNITIES FOR THE 21ST CENTURY 5-6 (Dec. 1999).

205. See generally James E. Holloway & Donald C. Guy, *Suitum v. Tahoe Reg'l Planning Agency: Its Impact on the Final Decision Requirement and Its Potential Implications for Lucas' Per Se Rule and The Role of TDRs in Taking Analysis*, 20 ZONING AND PLANNING L. REP. 65, 70-71 (Oct. 1997) (discussing the impact of the use of TDRs as an economic incentive under *Lucas*).

206. See *Monsanto*, 467 U.S. at 1006-07; *Penn Central*, 438 U.S. at 136.

207. See BOYKIN & RING, *supra* note 10, at 60-95; GRISSOM & DIAZ, *supra* note 62, at 66-93; SIRMANS & JAFFE, *supra* note 62, at 45-98.

208. See BOYKIN & RING, *supra* note 10, at 60-95; GRISSOM & DIAZ, *supra* note 62, at 66-93; SIRMANS & JAFFE, *supra* note 62, at 45-98.

209. See, e.g., BOYKIN & RING, *supra* note 10, at 61-62. The Court concluded that *Monsanto* was aware of the long-term investment risk to its trade secrets. *Monsanto*, 467 U.S. at 1006-07. It states that:

If, despite the data-consideration and data-disclosure provisions in the statute, *Monsanto* chose to submit the requisite data in order to receive a registration, it can hardly argue that its reasonable investment-backed expectations are disturbed when EPA acts to use or disclose the data in

difference between market risks and political uncertainty. In *Monsanto* and *Penn Central*, the Court gave shifts in politics and public policy the same effect as market risks, and thus the Court concluded the resulting regulation did not rise to the level of an unreasonable interference with investment-backed expectations. *Penn Central* and *Monsanto* can, and often may, frustrate land developers who do not properly weigh political uncertainty, such as regulations, on the amount of growth in a community.²¹⁰ Political uncertainty that eventually results in land use or other regulations can totally annihilate future plans and strategies for market growth and expansion. Simply, the Court seems to be looking for more than future preparation, market potential, and strategic vision to establish the existence of constitutionally protected financial expectations of regulated industries and markets.²¹¹

C. Developing an Expectations Analysis on Fairness and Economics

Justice O'Connor's expectations analysis to determine "the extent to which the regulation has interfered with distinct investment-backed expectations"²¹² would "entail complex factual assessments of the purposes and economic effects of government actions"²¹³ under the *Penn Central* analysis which "provides important guideposts" to determine a regulatory taking.²¹⁴ Her analysis does not reveal the weight given to financial and economic

a manner that was authorized by law at the time of the submission.
Id. at 1006-07.

210. See *Palazollo*, 533 U.S. at 606. One does not need to look far to find an example of limits placed on development. In *Palazollo*, the landowner wanted to develop but was denied because there were changes to public policy and thus new regulation. *Id.*

211. See, e.g., *Price v. City of Junction*, 711 F.2d 582, 591 (5th Cir. 1983) ("[I]noperable junk vehicles do not embody reasonable, investment-backed expectations."); *Western Fuels-Utah, Inc. v. Lujan*, 895 F.2d 780, 788-89 (D.C. Cir. 1990) (A "12.5% royalty on all leases [does not] substantially interfere with their investment-backed expectation in an individualized determination by the Secretary."); *Meriden Trust*, 62 F.3d at 454-55 ("[W]ithdrawal liability provisions . . . was not out of line with owner's investment-backed expectations."); *Rith Energy v. U.S.*, 247 F.3d 1355 (Fed. Cir. 2001) (asserting a "notice requirement" based on the acquisition of the property after the enactment of environmental regulations to cutoff reasonable-investment-backed expectations); *Carolina Water Serv. v. City of Winston-Salem*, 161 F.3d 1 (4th Cir. 1998) ("A party with . . . [non-exclusive franchise] rights does not enjoy a reasonable investment-backed expectation that government will not disturb them."); *Dist. Intown Prop. v. Dist. of Columbia*, 198 F.3d 874 (D.C. Cir. 1999) (concluding that the landowners had no reasonable investment-backed expectation under the regulatory structure at the time of subdivision because mere purchase does not establish a reasonable investment-backed expectations if the intended use is greatly inconsistent with past use of the land).

212. *Palazollo*, 533 U.S. at 633 (citing *Penn Central*, 438 U.S. at 124) (O'Connor, J., concurring).

213. *Id.* (citing *Yee v. City of Escondido*, 503 U.S. 519, 523 (1992)) (O'Connor, J., concurring).

214. *Id.* (O'Connor, J., concurring).

investments, but only provides that the lack of financial investment does not defeat a takings claim.²¹⁵ Justice O'Connor concludes that courts must provide fairness in each situation.²¹⁶

Justice O'Connor wants courts to provide justice and fairness to the public in an investment-backed expectations analysis under *Penn Central*. Regulatory takings doctrine includes two economic effects factors: the economic impact of the regulation, and the extent of interference with reasonable investment-backed expectations. The Court seems unwilling to define economic effects beyond diminution in value and total economic deprivation.²¹⁷ Justice O'Connor's efforts to broaden the *Penn Central* analysis increase its inquiry of political and policy circumstances, but weighs few market or economic circumstances that show economic effects. Moreover, it may actually encourage landowners to give less weight to political and social environments in considering future investment expectations, and consequently engage in risky real estate transactions.²¹⁸ If real estate analysis means little in determining an unconstitutional economic effect or interference with financial expectations, then land developers might not weigh its significance in assessing legal risks and political uncertainty in making real estate investments. Instead, Justice O'Connor's expectations analysis includes the "state of regulatory affairs at the time of acquisition,"²¹⁹ "the nature and extent of permitted development,"²²⁰ and the "development sought by the claimant... [under the lack of] vesting [of] any kind of development right...."²²¹ She recognizes that an actual investment in the land is not required by the Takings Clause.²²² Her reliance on past regulatory affairs

215. See *Palazzolo*, 533 U.S. at 633 (O'Connor, J., concurring).

216. See *id.* (O'Connor, J., concurring).

217. See *Village of Euclid*, 272 U.S. at 365 (holding that diminution in value by land use and other regulation is not regulatory takings); *Lucas*, 505 U.S. at 1003 (Denying all economically viable or beneficial use by land use or other regulation is a regulatory taking).

218. See *Palazzolo*, 533 U.S. at 635 (O'Connor, J., concurring) (finding a role for past regulatory circumstances in an investment-backed expectations analysis). Expectation means looking to the future; thus, any determination of an expectation would necessitate a degree of looking backward. Logically, you could not find a taking for a future investment-backed expectation that had yet to come into existence. Declaring a regulation to be a regulatory taking does not guarantee a reasonable investment-backed expectation that would necessarily permit development of the land under present market conditions, regulatory circumstances, and political conditions. The *Penn Central* inquiry for the extent of interference with investment-backed expectations *should include enough* circumstances to test the validity of past expectations.

219. *Id.* at 633 (O'Connor, J., concurring).

220. *Id.* (O'Connor, J., concurring).

221. *Id.* at 633-36 (O'Connor, J., concurring).

222. *Id.* (O'Connor, J., concurring).

and the state of development may run counter to real estate and other business theories in determining just compensation.²²³

The Court should not impose an expanded factual assessment to insure justice and fairness where the government should have weighed market and economic circumstances resulting in just compensation. It cannot completely save the government from maturing expectations where it imposed unconstitutional land use, growth management, and other regulations.²²⁴ Justice Scalia's economic-based approach begs for the consideration of only economic value when government regulation imposes an unreasonable interference with investment-backed expectations.²²⁵ Justice

223. See generally SIRMANS & JAFFE, *supra* note 62, at 208-09. Real estate investment analysis can affect the value of a real estate development project by assigning a high market risk to the investment and consequently produces a low value for the land development project. *Id.* at 209. One could argue that Justice O'Connor's regulatory, policy, timing, and other circumstances may create a high risk over the duration of the investment, and thus the expected value of the investment would be low — perhaps closer to original price at the time of taking title. Riskreturn analysis and other real estate and finance theories show how time, price, interest rate, and other factors affect the value of an investment and thus cannot be ignored in determining the value of an investment under the *Penn Central* inquiry. See William W. Wade, *Economic Backbone of the Penn Central Test Post Florida Rock V, K&K and Palazzolo*, 32 ENVTL. L. REP. 11, 221 (2002); William W. Wade, *Penn Central's Economic Failings Confounded Takings Jurisprudence*, 31 URB. LAW. 2, 277-308 (1999).

The *Penn Central* inquiry can ill afford neither too little nor too much weight on market risks and investment returns or cash-flows from real estate investment projects when the force of land use and other government regulation relies heavily on balancing competing public and private interests. Whether capitalizing a future stream of income to determine value or discounting the future value of an asset to determine return on capital, the common factor is the time period or time-related circumstances used in the *Penn Central* analysis to determine relevant risks and returns in legal and political environments and real estate and capital markets. Including circumstances of too long a duration makes the *Penn Central* analysis overinclusive. The *Penn Central* analysis need not include unnecessary circumstances that would render the *risk-return analysis* of finance and real estate ineffective or useless in assessing the investments potential of real estate development. Yet, making the *Penn Central* analysis *underinclusive* has some serious consequences. Ignoring market or legal risks may allow an infeasible development project to rise to the level of a highly leveraged takings claim where local communities may have only marginal use for the product of this development. Next, ignoring political uncertainty is tantamount to expanding background principles of common law by making public policy and regulation a constant with little impact on development near the time of the taking. Therefore, although the *Penn Central* inquiry is an ad hoc test based on the circumstances, the beginning point to examine the regulatory structure, market risk, legal restraints, and political uncertainty should be within a few years of the time of the taking and then move either forward or backward, depending on the past changes in ownership, legality of restrictions, level of enforcement, and constitutional pervasiveness of the regulation in a field or industry. Obviously, a family of prohibitive and pervasive regulation whose regulatory structure had survived constitutional scrutiny under the Takings Clause would create less risk and uncertainty, *and if there ever was a taking under this regulatory regime, there would only be a need for a risk-return analysis at the time of the taking.*

224. See *Suitum*, 520 U.S. at 742 (providing that the risk of regulatory pioneering remains with government under some circumstances).

225. See *Palazzolo*, 533 U.S. at 637 (Scalia, J., concurring).

Scalia's approach may entice landowners and developers to avoid understanding constitutional, scientific, and political thinking and thus takes unnecessary political, social, and policy risks where societal, environmental and other conditions indicate a change may likely take place, albeit slowly, in regulation and public policy.²²⁶ His reliance on common law and economics includes circumstances that may not fit our notions of public justice and fairness. Justice Scalia's reliance on background principles to stay the total deprivation of development rights is no better than Justice O'Connor's reliance on past regulatory conditions to determine the extensiveness of interference with investment-backed expectations. Both Justices are relying on past facts rather than financial, scientific, or economic principles to define the circumstances and conditions of economic effects of regulation on sensitive lands. The science and economics of wetlands inform the circumstances of the *Penn Central* inquiry. Justice Scalia's economic approach points to an analytical deficit in takings jurisprudence regarding liability and compensation. This analytical deficit permits past regulatory regimes and states of development to affect the existence of reasonable investment-backed expectations in the determination of an unconstitutional interference under present regulations. Fairness and justice cannot ignore the fact that the maturation of financial expectations includes financial risks and political uncertainty for both government and landowners, and the government must share the risk of an unconstitutional regulation imposed on land development.

V. VALUATION UNDER EMERGING LINES OF INVESTMENT-BACKED EXPECTATIONS ANALYSIS

Obviously, fair market value looks to the present and does not involve consideration of past events which no longer affect the use or condition of the land.²²⁷ The Court has concluded that an owner of a parcel of land is not entitled to the highest and best use under government regulation.²²⁸ Moreover, the Court has concluded that "[w]hen a taking has occurred, under accepted condemnation

226. *Id.* (Scalia, J., concurring).

227. *But see* Oral Argument, *supra* note 156, at 50, lines 11-16. At the oral arguments for *Palazzolo*, one Justice asked a question that leads us to think that the Court would consider the historical or original value of a land investment in measuring just compensation. One Justice asked the following: "[S]upposing I bought an acre of land out in Tysons Corner for \$15,000 in 1959. Now it's appraised at a million dollars and the Government comes on and says, well, look, you only paid [\$]15,000 for that, we ought to take that into consideration deciding whether it's been what's been taken." *Id.*

228. *See, e.g., Village of Euclid*, 272 U.S. at 365; *Penn Central*, 438 U.S. at 104.

principles the owner's damages will be based upon the property's fair market value."²²⁹ The Court has recognized that a state cannot create regulations, such as limiting challenges to regulation, that would "secure a windfall for itself."²³⁰ Finally, the Court has acknowledged that states bear economic risks in imposing regulations, such as use restrictions, in conjunction with TDR programs that could effect a taking of private property and payment of just compensation.²³¹ Yet, the determination of fair market value, which may be an unintended windfall,²³² is a fact-based question that is greatly affected by real estate, finance, and perhaps accounting theories.

A. *Weighing Past Regulatory Conditions in Takings Jurisprudence*

Justice O'Connor's policy-based approach complicates the determination of fair market value by using regulatory and other historical circumstances to determine liability and compensation for a regulatory taking. Assuming in *Palazzolo* that \$3.1 million is the fair market value of the petitioner's tract of land in a developable state, a historical element of an investment-backed expectations analysis that considers past regulatory restrictions may actually take the fair market value at some point in the past and therefore apply a discount rate to reduce the market value for the lack of marketability under past regulation.²³³ Normally, appraisal

229. *Palazzolo*, 533 U.S. at 626 (citing *Olson*, 292 U.S. at 255; SACKMAN, *supra* note 21).

230. *Palazzolo*, 533 U.S. at 628 (citing *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 164 (1980) ("[A] State, by *ipse dixit*, may not transform private property into public property without compensation."). Cf. Robert C. Ellickson, *Property in Land*, 102 YALE L. J. 1315, 1368-69 (1993) (defining characteristic of the fee simple estate is right to transfer interest in land).

231. *See Suitum*, 520 U.S. at 742 ("In fact, the reason for the agency's objection is probably a concern that without much market experience in sales of TDR's, their market values will get low estimates. But this is simply one of the risks of regulation pioneering, and the pioneer here is the agency, not Suitum.").

232. *Palazzolo*, 533 U.S. at 626-28 (citing SACKMAN, *supra* note 21) ("[A]n inquiry will turn, in part, on restrictions on use imposed by legitimate zoning or other regulatory limitations.").

233. *See generally*, AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, *THE APPRAISAL OF REAL ESTATE* 414 (9th ed. 1987) (explaining the use of discount rate in real estate appraisal and investment). "A discount rate is a rate of return on capital used to convert future payments or receipts into present value." *Id.*

Brown does not affect our arguments on just compensation or damages. 538 U.S. at 216. *Brown* involved a just compensation issue regarding the availability of just compensation for interest earned and then taken for public use by government for the purpose of providing legal services. Both the majority and dissent agree that fair market value is the measure of damages for losses to property owners under just compensation. *See id.* at 238 ("The fair market value of a right to receive \$.55 by spending perhaps \$ 5.00 to receive it would be nothing."); *Id.* at 242 (Scalia, J., dissenting) ("In so holding the Court creates a novel exception to our oft-repeated rule that the just compensation owed to former owners of confiscated

methodology does not discount the market value for past regulatory conditions affecting the landowners' motivation to invest if such conditions are not present restrictions or conditions on the land.²³⁴

When regulatory takings liability involves an interference with investment-backed expectations arising from the invalidation of a regulation that totally prohibits land development, incorporating a policy approach into measuring damages for a taking creates an entirely new remedial analysis for just compensation. Thus, a policy-based analysis raises valuation or compensation questions.

One question raised by Justice O'Connor's policy-based analysis is whether the acquisition value of the property could ever be considered the fair market value.²³⁵ When one or more policy or

property is the fair market value of the property taken.”). Our article relies on fair market value as a measure of damages for a regulatory taking under the Takings Clause, and thus *Brown* would not be fatal or undermine the article's arguments on just compensation. The article seeks only to bridge the gap between Justices Scalia and O'Connor's approaches to the *Penn Central* analysis and their effects on just compensation for the taking of wetlands and other sensitive lands. It relies on real estate finance principles, such as discount rate, capitalization rate, risk-return analysis, and other concepts. Yet, we do not assign risks to policy and regulatory circumstances that would justify giving a zero return or giving a huge return when these risks are associated with past circumstances that do not affect present fair market value.

234. See generally BOYKIN & RING, *supra* note 10, at 44-57 (discussing the principles of real estate valuation). But see *id.* at 70-2 (recognizing limitations imposed by government).

235. See Oral Argument, *supra* note 156, at 42 lines 19-23. In the oral arguments of *Palazzolo*, one Justice asked a question showing some concern about just compensation. One Justice asked “if somebody goes and buys cheap land with an already existing takings claim, they will not benefit from that because they could not recover more in fairness than what they paid for the land minus the value of the land for all other purposes.” *Id.* See also *Dist. Intown Prop.*, 198 F.3d at 874 (providing that a mere purchase does not establish reasonable investment-backed expectations if intended use is greatly inconsistent with past use of the property).

Using the windfall value or acquisition cost entails “[d]etermining the value of a single sum either at beginning or at the end of a given period.” BOYKIN & RING, *supra* note 10, at 315. Determining the value of the land using its acquisition cost and other regulatory circumstances is the determination of the value of the original investment over a number of decades. See *id.* It is determining the value at the beginning of the period. *Id.* The *limited* treatment of a few regulatory circumstances in the *Penn Central* analysis may be enough to affect land value by incorporating a discount effect that weighs the risk to the investment by legal and political conditions occurring a few years before the regulatory taking. See SIRMANS & JAFFE, *supra* note 62, at 209 (“[T]he measurement of expected changes in [expected] risk is best handled [through a] discounted cash flow approach.”). It is noted that “the higher the discount rate, the lower the present value.” *Id.* at 219.

In contrast, determining the value of land based on its ability to generate a stream of income may be closer to the windfall value. This value would include the ability of the land to produce a marketable product, such as residential dwellings. Here, the determination of the value is anticipated or expected at the end of the period. This determination may be closer to the capitalization approach, assuming that an estimate of operating or other income is used as an income stream. The *limited* treatment of a few regulatory circumstances in the *Penn Central* analysis may be enough to effect land value by incorporating an income capitalizing effect that takes into account the risk to the investment under legal and political conditions immediately preceding the regulatory takings. See SIRMANS & JAFFE, *supra* note

regulatory circumstances includes past regulatory actions that limit the level of development, just compensation begs to apply an appraisal or investment technique that yields a fair market value with the least modest return on the acquisition cost²³⁶ at the time of imposition of regulation.²³⁷ Land is recorded on the balance sheet at its acquisition or historical cost if the owner planned to develop the property in its own operations.²³⁸ If the petitioner was holding the property for an investment, it would not be treated as a tangible asset under accounting principles, and thus the treatment of the costs for taxes, insurance, and interest would be different.²³⁹ Assuming that the petitioner was engaged in the business of land development, the wetlands would be tangible assets recorded at historical cost.²⁴⁰ The acquisition or historical cost is not the current fair market value of the property.²⁴¹ Yet, corporations rarely sell land for its historical or acquisition value and may use the current fair market value in selling the property.²⁴² In *Palazzolo*, the SGI would have recorded the tract of land at its historical or acquisition value, and thus the transfer value to the petitioner would, we assume, have been at the fair market value of the tract in 1978.²⁴³

62, at 209.

236. See LOREN V. NIKOLAI & JOHN D. BAZLEY, INTERMEDIATE ACCOUNTING 342-43 (6th ed. 1994). Petitioner and associates formed the Shore Gardens, Inc. (SGI) to purchase and hold the property. Later, petitioner bought his associates' interest and became the sole shareholder. Petitioner acquired the property from SGI when the state revoked the corporate character of SGI for a failure to pay taxes. *Palazzolo*, 533 U.S. at 612. We assume that the cost of the land at the transfer was its historical or acquisition cost.

Another issue is whether petitioner held the land as a personal investment or as tangible asset for a land development business. The resolution of this issue affects the intent to develop. If petitioner was engaged in the business of developing this tract of land, then clearly his application for permits to fill and improve the property shows an intent to develop. However, the extent of development beyond the application for a permit are greatly limited, perhaps inquiries about financing and construction would be permissible.

237. Real estate investments consider both risks and returns. See SIRMANS & JAFFE, *supra* note 62, at 208. In purchasing land or investment, Professors Sirmans and Jaffe state that "[r]eal estate investment is basically a capitalization process: investors give up a known, certain amount in exchange for an expected, but uncertain, stream of future cash flows." *Id.*

238. NIKOLAI & BAZLEY, *supra* note 236, at 342-43.

239. *Id.* at 344.

240. See *id.* (assuming that petitioner is engaged in the business of developing land for sale as residential products).

241. See *id.* at 342-43.

242. *Id.* at 343. See *Palazzolo*, 533 U.S. at 614 ("He sought damages in the amount of \$3,150,000, a figure derived from an appraiser's estimate as to the value of a 74-lot residential subdivision."). There is appraisal methodology for valuing developable land converted to a new use, such as residential. *Id.*

243. EPHRAIM P. SMITH ET AL., 2001 CCH FEDERAL TAXATION: COMPREHENSIVE TOPICS ¶ 16,061, 769 (2000); PRENTICE HALL'S FEDERAL TAXATION 2003: CORPORATIONS, PARTNERSHIPS, ESTATES, AND TRUSTS 6-5 (Kenneth E. Anderson et al. eds., 2002) (IRS Code Section 331(a) provides that a shareholder treats the property received in liquidation of a corporation as proceeds obtained from the exchange of stock. The shareholder's gain or loss is determined

Using the most recent historical or acquisition cost as the measure of damages for just compensation discounts the future value due over some future period, which could be 30 years.²⁴⁴ On prime farmland or other highly suitable land, such a discount would be hard to justify because these lands are most suitable for residential, commercial, and other development under many regulatory requirements and real estate needs.²⁴⁵ Discounting the present value to account for past regulatory restraints, but still providing an equitable return on invested capital is more supportable when past regulations severely limited development, the landowner never sought to develop, or a modified market value representing lesser return on invested capital may have been anticipated on any investment. Discounting the present value of a sum due in the future recognizes that executable investment-backed expectations would have been difficult to foresee under environmental, land use, and other regulatory programs.²⁴⁶ Thus,

by deducting the adjusted basis of the shareholder's stock from the fair market value of the property received).

244. See AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, *supra* note 233, at 482. An approach used to determine the value of land for investment is to determine financial and market risks and other circumstances affecting future receipts or returns on the use of wetlands, assuming that wetlands will produce periodic income. *Id.* "A discount rate is a rate of return on capital used to convert future payments or receipts into present value." *Id.* at 414. The discount rate is a yield rate that "is applied to a series of individual incomes to obtain the present value of each." *Id.* at 412. The yield or discount rate is "influenced by many factors, including the degree of apparent risk, market attitudes toward future inflation, the prospective rates of return for alternative investments, the rates of return earned by comparable properties in the past, the supply and demand of mortgage funds, and the availability of tax shelters." *Id.* at 415.

"Periodic income or reversions are converted into present value through discounting, a procedure based on the assumption that benefits received in the future are worth less than the same benefits received today." *Id.* at 489. "Moreover [b]ecause an investor seeks a total return that exceeds the amount invested, the present value of a prospective benefit must be less than its expected future value. . . . The standard formula for discounting future value to present value is Present Value [equals] Future Value/(1+i)ⁿ where *i* is the rate of return on capital per period that will satisfy the investor and *n* is the number of periods that the payment will be deferred." *Id.* The present value of \$1,000.00 due in three years discounted at 10% per year equals \$1,000/1.103 or \$715.31 today. *Id.* Note that the present value due increases as the discount rate decreases, and thus a high discount rate means the present value due is equal or close to the acquisition or original cost, and the investment was extremely risky or not expected to generate much of a return. If Justice O'Connor's approach affects a factor that causes the discount rate to increase, then the value of the property subject to wetland regulation might decrease significantly.

245. See generally BOYKIN & RING, *supra* note 10, at 135 (discussing factors that influence the value of wetlands).

246. See AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, *supra* note 233, at 412. Another approach used to determine the value of land for investment is to capitalize the political and regulatory circumstances by using capitalization to determine the value of wetlands, assuming that wetlands will produce periodic income. Capitalization is the "[t]he procedure for the determination of a market rate of capitalization through which estimated future net operating income is converted into an estimate of present value. The capitalization rate acts

fair market value that does not consider financial risks and other influences on investment may not be full and fair compensation under a few natural conditions and regulatory circumstances.²⁴⁷

Using the present value of a future stream of cash-flow from a tract of wetlands to determine just compensation is more defensible when courts find the regulatory takings was caused by an extensive interference with reasonable investment-backed expectations, and thus a yield or income from the investment in the land is appropriate as just compensation.²⁴⁸ The legal and political risks associated with developing wetlands are great, and the costs of preparation of wetlands for development are greater than costs for the most suitable land, such as prime farmland.²⁴⁹ Actually,

as a conversion mechanism to convert periodic income into an estimate of present value.” BOYKIN & RING, *supra* note 10, at 292. The capitalization rate is an income rate that “is the ratio of one year’s income, or an annual average of several years’ income” AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, *supra* note 233, at 413. The discount and capitalization rates may yield the same result under some circumstances but they are not the same. *See id.* at 412-13; SIRMANS & JAFFE, *supra* note 62, at 208.

The income or capitalization rate is “influenced by many factors, including the degree of apparent risk, market attitudes toward future inflation, the prospective rates of return for alternative investments, the rates of return earned by comparable properties in the past, the supply and demand of mortgage funds, and the availability of tax shelters.” AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, *supra* note 233, at 415.

There are several ways of computing the value using a capitalization approach. *Id.* at 414. The direct capitalization approach does not distinguish between the return on and return of an investor’s capital. *Id.* at 471. “The direct capitalization formula is Value [V] equals Net Operating Income [NOI] divided by the Overall Capitalization Rate [R].” *Id.* at 472. Real estate appraisers can use comparable sales and other techniques to determine the overall capitalization rate. To illustrate, if the NOI is \$85,000 and *R* is 0.0850 (which is 8.5%), the *V* equals \$85,000/0.850 or \$1,000,000. *Id.* at 473. The capitalization approach uses an income stream to determine the present value of the property. *Note that the Value increases as the Overall Capitalization Rate decreases, and thus a windfall value would mean that the capitalization rate was relatively low and thus the investment was not risky and the landowner would expect a high value.* Justice Scalia’s approach that willingly pays a windfall as just compensation recognizes a high capitalization rate.

247. *See generally* AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, *supra* note 233, at 415 (noting the discount and capitalization rates are “influenced by many factors, including the degree of apparent risk, market attitudes toward future inflation, the prospective rates of return for alternative investments, the rates of return earned by comparable properties in the past, the supply and demand of mortgage funds, and the availability of tax shelters.”).

Brown offers new insight into how a costly economic or administrative transaction by government affects fair market value under just compensation. 538 U.S. at 216. The Court concluded that property owners were not entitled to just compensation for a taking because earnings or interest-earned was less than administrative expenses of returning the earnings to the property owners. *Id.* at 239. Thus, the transaction cost of returning any earnings to the owners reduced the fair market value to zero or a net loss of zero. *Id.* at 235-37.

248. *See* AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, *supra* note 233, at 412 (discussing investment or appraisal methods for determining the value of the income and yield from an investment in land).

249. *See generally* BOYKIN & RING, *supra* note 10, at 135 (discussing factors that influence the value of wetlands). Boykin and Ring state that “[t]he best appraisal method of appraising wetlands is the comparable sales analysis.” *Id.* “Other factors that might be considered are

unsuitable land increases costs of development and includes special legal and political risks, such as regulatory permits and conditions.²⁵⁰ Applying a capitalization or discount rate to the future value takes into consideration the inherent political risks and uncertain financial returns of using wetlands and other unsuitable land for development during the last three decades.²⁵¹ Under present environmental regulation of wetlands, new wetland owners should not be disappointed at receiving returns that may be less than the fair market value and exceed the rate of inflation, as long as the returns are reasonable.²⁵²

Numerous circumstances may influence the valuation of wetlands in the determination of just compensation. If courts find that a regulatory interference with investment-backed expectations amounts to a taking, they must consider several circumstances in determining both liability and compensation. These circumstances include the feasibility of financing, cost of development, expected cost of capital, availability of product markets, severity of zoning and use restrictions, costs to the community, current economic conditions, and potential impact on investment quality for holding the land.²⁵³ In addition, the remedy or compensation for takings of wetlands may need to consider the burdensome involuntary allocation of public funds by communities for new or improved public facilities, services, and infrastructure to support

the cost of mitigation, extension of the development period by an owner having to deal with government agencies, and the risk of whether any development will be permitted by governmental bodies." *Id.* at 135 (citing Richard S. Hawrylak, *What You Should Know About Wetlands*, THE PRAC. REAL ESTATE LAW 60, 60-61 (Jan. 1991).

250. *See id.*

251. *See* AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, *supra* note 233, at 415. The discount rate is "influenced by many factors, including the degree of apparent risk, market attitudes toward future inflation, the prospective rates of return for alternative investments, the rates of return earned by comparable properties in the past, the supply and demand of mortgage funds, and the availability of tax shelters." *Id.* at 415.

252. Moreover, courts have not found that investment-backed expectations are greatly reduced in highly regulated fields. *See* Branch *ex rel.* Maine Nat'l Bank v. United States, 69 F.3d 1571, 1581 (Fed. Cir. 1995). "The Court's third point in *Connolly* [v. Pension Benefit Guaranty Corp., 475 U.S. 211 (1986)] and *Concrete Pipe* [v. *Construction Laborers Pension Trust*, 508 U.S. 602, 606 (1993)] — that reasonable investment-backed expectations are greatly reduced in a highly regulated field — applies with special force to rules governing the liability of national banks." Whether wetland conservation is a highly regulated field of natural resource conservation after forty years of regulation is a debatable issue.

In some instances, the landowner may not be entitled to any returns. *See Rith Energy*, 247 F.3d at 1355 (asserting a "notice requirement" based on the acquisition of the property after the enactment of environmental regulations to cutoff reasonable investment-backed expectations). At such a disadvantage, some landowners should consider working with the local, state, or federal government to preserve the use of natural resources but still seek some compensation and limited use where it is possible.

253. *See* AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, *supra* note 233, at 415.

development.²⁵⁴ The Takings Clause must not permit a few profit-driven landowners to allocate more than a fair share of the burden of development onto the public.²⁵⁵ Still, the government cannot use these circumstances to acquire wetlands without consideration of the financial expectations of landowners holding wetlands with distinct expectations of a return under judicial and legislative decisions. Consequently, courts will look to real estate and finance methodologies to weigh circumstances that affect valuation and return on capital issues that are directly related to Justice O'Connor's fairness and Justice Scalia's windfall concerns.²⁵⁶

Finance and real estate principles that apply to Justices Scalia and O'Connor's analytical differences shed much light on the nature of the differences. Both Justices appear willing to find the existence of reasonable investment-backed expectations. They must also agree to apply only past regulatory circumstances of a reasonable duration before, and at the time of, the taking under the *Penn Central* inquiry. If they find this existence and use a short duration, Justices Scalia and O'Connor may differ only on the value of a capitalization rate²⁵⁷ or discount rate²⁵⁸ in the takings equation.²⁵⁹

254. See *Dolan*, 512 U.S. at 374.

255. See *id.* (scrutinizing the relationship between the regulation and the justification for regulation); *Nollan*, 483 U.S. at 825 (scrutinizing the relationship between the regulation and its ability to further its declared purpose).

256. See AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, *supra* note 233, at 415. The discount and capitalization rates are influenced by economic conditions, market risks, and other forces. *Id.*

257. See *id.* at 412; SIRMANS & JAFFE, *supra* note 62, at 203-04. The capitalization rate is an income rate that converts an expected income stream to a present value of the land. See SIRMANS & JAFFE, *supra* note 62, at 203-04. The capitalization or cap rate will determine the value that the investor is willing to pay for the land. *Id.* The higher the cap rate, the lower the value. *Id.* at 203.

258. See AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, *supra* note 233, at 414; SIRMANS & JAFFE, *supra* note 62, at 205-06. The discounted cash flow approach uses a discount rate to determine the return on capital by converting future cash-flow(s) into the present value. See AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, *supra* note 233, at 414. This approach relies on the time value of money and recognizes that "a future amount of money is worth less than the same amount to be received in the present." SIRMANS & JAFFE, *supra* note 62, at 214. This approach also accounts for the market risk of investing in the land and investment effects of an increasing risk of receiving the return on the investment during the holding period. *Id.* at 209.

259. See SIRMANS & JAFFE, *supra* note 62, at 208-09. Real estate investment analysis can be applied to determine the value of an investment under market risk, political uncertainty, and numerous other circumstances over the duration of the investment. Increases in market risk and changes in other circumstances affect future income from, and return on, the investment. *Id.* at 209. Professors Sirmans and Jaffe state that the discounted-cash flow approach is better for handling changes in market risk brought on by circumstances surrounding the investment. *Id.* However, these professors recognize that others find that adjustments to the cap rate can reflect changes in risk. *Id.* In short, Justices O'Connor and Scalia are weighing circumstances that are evidence of a risk return or income analysis of land valuation, though the underdeveloped state of the *Penn Central* inquiry lacks any real

A few past regulatory circumstances improve the likelihood of a court not finding an extensive interference or takings liability, and operate similar to a high discount rate that causes compensation to be extremely low.²⁶⁰ Therefore, when a court finds takings liability and uses a modified market value based on a high discount rate or low capitalization rate based primarily on past regulatory risks or circumstances, the court must make certain that full and fair compensation is not based entirely on a few past regulatory circumstances.²⁶¹ It does not seem fair to discount (mitigate) liability and compensation in the application of the same takings equation by including the same or similar regulatory circumstances on both sides of the equation. Notwithstanding a strong public desire, just compensation may need to take into account economic and other forces that increase the likelihood of a recession or prosperity.²⁶² Courts must recognize that the existence of a few circumstances in finding takings liability could cause the remedy or compensation to be a modified market value determined by applying a capitalization or discount rate to take into consideration the extreme risk of a profitable use.²⁶³ For example, severe use restrictions on flood-prone land without access to public water, sewer, and roads would be subject to a rate that includes the public costs of health and safety. Justices Scalia and O'Connor may find it as difficult to effect liability and compensation based on past regulatory circumstances as land developers and investors find it to use regulatory, legal, market, and other risks to select discount and capitalization rates for real estate projects and investments.²⁶⁴ Moreover, in some instances, the comparable sales approach may not capture the risks and other influences that affect the value of developable land under some natural and business circumstances.

estate investment analysis.

260. See generally *id.* at 209 (providing that a high discount rate means the present value of income or cash flows will be low, and the investment would be extremely risky with little return).

261. See generally AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, *supra* note 233, at 415 (listing a few factors affecting the level of the discount and capitalization rates).

262. See *Suitum*, 520 U.S. at 742 (recognizing and assigning the risk of regulatory pioneering and its affect on land markets to government).

263. See AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, *supra* note 233, at 415. A few factors affecting the level of the discount and capitalization rates are as follows: "degree of apparent risk, . . . the prospective rates of return for alternative investments, the rates of return earned by comparable properties in the past, [and] the supply and demand of mortgage funds." *Id.* These factors determine the income or return on the investment. *Id.*

264. See generally SIRMANS & JAFFE, *supra* note 62, at 46-45 (stating that real estate investors must analyze business risks that are related to legal restrictions, economic conditions, social forces, and other factors).

*B. Land Development Approach to Valuation of Land with
Investment-Backed Expectations*

Other appraisal methods are available to value wetlands and other undeveloped land held for residential and commercial development.²⁶⁵ One method, the land or subdivision development method, considers risk and return by discounting future revenues. Some courts apply this method to value land held for development by landowners.²⁶⁶ In *City of Harlingen v. Sharboneau*,²⁶⁷ the Supreme Court of Texas (Supreme Court) examined the use of the land or subdivision development method to determine the value of land in a condemnation proceeding.²⁶⁸ The City of Harlingen (City) condemned a tract of land to expand its local park.²⁶⁹ Both parties agreed that the highest and best use of the land was a residential subdivision.²⁷⁰ The landowner's appraiser used the subdivision development method to value the condemned property²⁷¹ and found a fair market value of \$413,770.²⁷² The City's appraiser used the comparison sales approach and found a value of \$98,500.²⁷³ The trial court permitted evidence of value based on the subdivision development method, and the intermediate appellate court affirmed the trial court's decision.²⁷⁴ The Supreme Court reversed the appellate court.²⁷⁵

In the *City of Harlingen*, the Supreme Court stated that "[the subdivision development] method values an undeveloped tract by calculating what a developer could expect to realize from sales of individual lots, taking into account the costs of development and discounting future revenues to present value."²⁷⁶ The trial court awarded Sharboneau \$232,000, concluding that the subdivision development method of appraising the value of land reflects the

265. See *City of Harlingen v. Sharboneau*, 48 S.W.3d 177, 181-82 (Tex. 2001); BOYKIN & RING, *supra* note 10, at 157-58.

266. See *id.* (citing *City of Wichita v. Eisenring*, 7 P.2d 1248, 1255 (Kan. 2000); *County of Ramsey v. Miller*, 316 N.W.2d 917, 921-22 (Minn. 1982)) (permitting the admission of evidence of the subdivision development method). But see *id.* at 186-87 (citing *Contra Costa Water Dist. v. Bar-C Prop.*, 7 Cal. Rptr. 2d 91, 93-95 (1992); *Dept. of Transp. v. Benton*, 447 S.E.2d 161 (Ga. App. 1994)) (not permitting the admission of evidence of the subdivision development method).

267. 48 S.W.3d 177 (Tex. 2001).

268. *Id.* at 180-86; see BOYKIN & RING, *supra* note 10, at 157-58.

269. *Id.*

270. *City of Harlingen*, 48 S.W.3d at 180.

271. *Id.* at 180-81.

272. *Id.* at 180.

273. *Id.* at 180-81.

274. See *City of Harlingen v. Estate of Sharboneau*, 1 S.W.3d 282 (Tex. App. 1999), *rev'd*, 48 S.W.3d 177 (Tex. 2001).

275. *City of Harlingen*, 48 S.W.3d at 180.

276. *Id.* at 180.

highest and best use.²⁷⁷ The Supreme Court rejected the subdivision development method because under these circumstances it did not provide “relevant and reliable evidence of market value.”²⁷⁸ The Supreme Court found that this method involved several steps that required assumptions and estimates that could affect the accuracy of the appraisal.²⁷⁹ Further, the Supreme Court found it is not a valid method under ordinary circumstances for valuing undeveloped land, and according to other courts, it may be “speculative and conjectural.”²⁸⁰ Specifically, the Supreme Court found that the subdivision development method failed to “account [for] ... characteristics of the relevant marketplace that would affect what price a willing buyer would pay to a willing seller.”²⁸¹ Moreover, the Supreme Court noted that this method did not consider the failure of the subdivision and it “oversimplifies the problem of finding market value in one crucial respect: it assumes that a willing buyer will value the land at the highest price that still allows a reasonable return on the investment.”²⁸² The Supreme Court noted that the market value includes all factors, conditions, and circumstances that a buyer and seller would consider and that could also increase or decrease the value of property.²⁸³ The Supreme Court observed that the subdivision development and other appraisal methods must

277. *Id.* at 182.

278. *Id.* at 183.

279. *Id.* at 184. See also BOYKIN & RING, *supra* note 10, at 158. This method can produce unrealistic value estimates when a particular analysis, estimate or forecast is inaccurate or incorrect. *Id.* (citing James H. Boykin, *Developmental Method of Land Appraisal*, APPRAISAL J. 181 (April 1976)).

280. *City of Harlingen*, 48 S.W.3d at 184. But see BOYKIN & RING, *supra* note 10, at 157. The subdivision development method recognizes the “ability to modify land and thereby produce land values.” BOYKIN & RING, *supra* note 10, at 157. It can be used to appraise the value of any land that has subdivision potential. *Id.* Specifically, this method is applicable where there is an anticipation of converting or the conversion of land to higher economic use, such as conversion from farmland to urban land. *Id.*

Boykin and Ring state that the subdivision development method consists of the following suggested steps:

1. Create a sound development plan
2. Forecast a realistic pricing schedule
3. Forecast accurately the absorption rate and mix of sites to be sold
4. Accurately estimate the staging and expense of land development and related expenses
5. Forecast marketing and related expenditures
6. Estimate the annual real property taxes during the development and marketing periods
7. Estimate a reasonable overhead and profit allowance
8. Analyze the market to determine the appropriate discount rate expected by investors for this of investment [and]
9. Select a discount rate that properly reflects the timing of the site sales.

BOYKIN & RING, *supra* note 10, at 158-59 (citing James H. Boykin, *Developmental Method of Land Appraisal*, APPRAISAL J. 181 (April 1976)).

281. *City of Harlingen*, 48 S.W.3d at 184.

282. *Id.* at 185.

283. *Id.*

account for the “competitive, risk-filled marketplace of the real world” in determining market value.²⁸⁴

In *City of Harlingen*, the Supreme Court recognized that just compensation should not eliminate the risks that landowners would have encountered in the marketplace.²⁸⁵ It concluded that the subdivision development method would eliminate marketplace risk by determining “the value of ready-to-build lots in successfully completed subdivisions.”²⁸⁶ The Supreme Court also concluded that the subdivision development method could be applied to undeveloped land, but it could not make that determination on the record before it in *City of Harlingen*.²⁸⁷ The subdivision development method could be applied to undeveloped land where courts find that the extent of interference with reasonable investment-backed expectations amounts to a taking, the comparable sales approach is not available, and the land is unique.²⁸⁸ Arguably, isolated wetlands that are developable (filled and marketable land) could be appraised under the subdivision development method.²⁸⁹

*C. Issues in Determining Liability and Compensation for Land
with Loss Expectations or Missed Opportunities*

Weighing past regulatory circumstances to determine the extent of interference with investment-backed expectations is determining government liability and the remedy for loss expectations or missed opportunities.²⁹⁰ *Penn Central* and *Monsanto* make the plaintiff's case difficult because the Court has not been willing to find takings liability for any extent of interference with reasonable investment-backed expectations.²⁹¹ Because the Court has yet to find takings liability for any extent of interference, the issue of just compensation is novel. *Palazzolo* leaves serious doubt regarding how the Court will use the *Penn Central* inquiry in the determination of takings liability and just compensation issues.²⁹²

284. *Id.* at 186.

285. *Id.* at 185.

286. *City of Harlingen*, 48 S.W.3d at 185.

287. *Id.* at 186.

288. *See id.*; GRISSOM & DIAZ, *supra* note 62, at 68 (noting down markets and isolated tracks); BOYKIN & RING, *supra* note 10, at 157 (exploring conversion to a higher economic use).

289. BOYKIN & RING, *supra* note 10, at 157 (discussing particular lands that would be suitable for the application of the subdivision development method).

290. *See Palazzolo*, 533 U.S. at 625; *First English Evangelical Lutheran Church*, 482 U.S. at 321 (stating that landowners might not seek one of three remedies: the value of the land, the value of loss investment-backed expectations, or the invalidation of the regulation and its enforcement).

291. *See Monsanto*, 467 U.S. at 1006; *Penn Central*, 438 U.S. at 139.

292. *See Palazzolo*, 533 U.S. at 632-37 (Scalia, J. and O'Connor, J., concurring).

Plaintiffs' lawyers must find evidence that establishes an intent by the owner to develop the land. Thus, the plaintiffs' lawyer must overcome *Penn Central* and *Monsanto's* reticence to find liability for interference with, or the existence of, a landowner's reasonable expectations to earn investment income or receive the investment value, where the remaining use does not deny all beneficial use under *Lucas*,²⁹³ but provides little opportunity to make profits under *Penn Central*.²⁹⁴ *Palazzolo* defines the parameters by adding qualifications to the extensiveness of interference and existence of investment-backed expectations. *Palazzolo* notes that the Takings Clause does not require any financial investment to establish investment-backed expectations.²⁹⁵ *Palazzolo* adds that past regulation does not create notice of restrictions or prohibitions on development.²⁹⁶ Yet, *Palazzolo* does not give plaintiff's lawyers much guidance on the essential economic or investment circumstances of the takings analysis that would show an extensive interference with investment-backed expectations. Such a claim is between *Lucas* and *Penn Central*, finding the total loss of productive use and the denial of an opportunity to make reasonable profits or returns.

Presently, weighing past regulatory circumstances to determine the extent of interference with reasonable investment-backed expectations would affect compensation when takings liability is determined under the *Penn Central* inquiry.²⁹⁷ On the issue of just compensation, defendants' lawyers must consider appraisal methodology that takes into account circumstances affecting the existence of and interference with reasonable investment-backed expectations in developable land. Justice O'Connor's extension of the *Penn Central* analysis is the starting point.²⁹⁸ Justice O'Connor

293. See *Lucas*, 505 U.S. at 1015 ("When, however, a regulation that declares 'off-limits' all economically productive or beneficial uses of land goes beyond what the relevant background principles would dictate, compensation must be paid.").

294. See *Penn Central*, 438 U.S. at 139 ("The restrictions imposed . . . also afford appellants opportunities further to enhance not only the Terminal site proper but also other properties.").

295. See *Palazzolo*, 533 U.S. at 632 (O'Connor, J., concurring) (citing *Hodel*, 481 U.S. at 714-18).

296. See *id.* at 629.

297. See Oral Arguments, *supra* note 156, at 50, lines 11-16. At least one Justice would consider the value or purchase price at the time of acquiring title as one of the circumstances in determining just compensation. See *id.*

298. See *Palazzolo*, 533 U.S. at 632 (O'Connor, J., concurring). In *Palazzolo*, Justice O'Connor states that:

On the other hand, if existing regulations do nothing to inform the analysis, then some property owners may reap windfalls and an important indicium of fairness is lost. As I understand it, our decision today does not remove the regulatory backdrop against which an owner takes title to property from the purview of the *Penn Central* inquiry. It

seems willing to discount the present value where landowners did not or could not develop unsuitable land for development.²⁹⁹ Her strong suggestion would permit defendants' lawyers to argue that just compensation is a modified market value even when the landowner did not try or could not have used the land for development or other economic benefits while the regulation was assumed valid under the Takings Clause.³⁰⁰ Justice Scalia's approach to finding takings liability for an interference with investment-backed expectations would require defendants' lawyers to focus on the time of the taking and if he or she is successful, then focus on just compensation, which appears to be the fair market value under the present circumstances.³⁰¹

On the issue of takings liability, the differences between Justices Scalia and O'Connor should not be confused with the fact that the

simply restores balance to that inquiry. Courts properly consider the effect of existing regulations under the rubric of investment-backed expectations in determining whether a compensable taking has occurred. As before, the salience of these facts cannot be reduced to any 'set formula.'

Penn Central, 438 U.S. at 124 (internal quotation marks omitted).

The temptation to adopt what amount to per se rules in either direction must be resisted. The Takings Clause requires careful examination and weighing of all the relevant circumstances in this context. The court below therefore must consider on remand the array of relevant factors under *Penn Central* before deciding whether any compensation is due.

299. *See id.* at 632-35 (O'Connor, J., concurring). Justice O'Connor is willing to consider past circumstances that could eventually avoid finding a taking or reducing compensation. *Id.* She would weigh the "state of regulatory affairs" at the time of the acquisition. *Id.* She would also weigh the "nature and extent of development permitted under the regulatory regime." *Id.* at 632-35. Justice O'Connor's approach would not be a traditional fair market value and thus a modified market value (MMV) would be the measure of damages.

300. *See Palazzolo*, 533 U.S. at 632-35 (O'Connor, J., concurring) ("The court below therefore must consider on remand the array of relevant factors under *Penn Central* before deciding whether any compensation is due.").

301. *See id.* at 636 (Scalia, J., concurring). In *Palazzolo*, Justice Scalia states that:

The polar horrible, presumably, is the situation in which a sharp real estate developer, realizing (or indeed, simply gambling on) the unconstitutional excessiveness of a development restriction that a naive landowner assumes to be valid, purchases property at what it would be worth subject to the restriction, and then develops it to its full value (or resells it at its full value) after getting the unconstitutional restriction invalidated.

Id.

In my view, the fact that a restriction existed at the time the purchaser took title (other than a restriction forming part of the "background principles of the State's law of property and nuisance," *Lucas*, 505 U.S. at 1029) should have no bearing upon the determination of whether the restriction is so substantial as to constitute a taking. The "investment-backed expectations" that the law will take into account do not include the assumed validity of a restriction that in fact deprives property of so much of its value as to be unconstitutional.

Id. at 636-38.

Court has only once found the existence of reasonable investment-backed expectations. Justice O'Connor's fairness to the public³⁰² and Justice Scalia's windfall to private landowners³⁰³ can be reconciled by understanding their major constitutional concerns. Plaintiffs' lawyers must address Justice O'Connor's broad *Penn Central* analysis in determining this extent of interference. Foremost, the plaintiffs' lawyers must recognize that the lack of development activity or economic feasibility of the project may indicate the lack of the existence of reasonable investment-backed expectations or cause less extensive interference with these expectations. Other circumstances may also affect the existence of these expectations. Plaintiff and defendants' lawyers must address the financial, legal, political, and market risks in land development where courts must find the existence of distinct, reasonable investment-backed expectations. Plaintiffs' lawyers must remember that the expectation of profits or returns on trade secrets in *Monsanto* was not a reasonable investment-backed expectation.³⁰⁴

On the second part of the issue of takings liability, the differences between Justices Scalia and O'Connor should not be confused with the fact that the Court has never found an unconstitutional interference with reasonable investment-backed expectations. Under the *Penn Central* analysis, plaintiffs' lawyers have an uphill battle to establish an extensive interference. They must establish that the government deprived the landowner of at least a minimum profit on the development or use of the land, where the landowner was deprived of all use of the land and could not expect any profit from the land or nearby properties owned by him or her. Weighing past regulatory circumstances to determine the extensiveness of a regulatory interference with reasonable investment-backed expectations may turn on whether these restrictions and other regulatory circumstances are closer to *Lucas* or *Penn Central*.

If a court finds a regulatory taking based on an extensive interference by government regulation, plaintiffs' lawyers should be prepared to defend against the discounting of just compensation where regulatory and natural circumstances precluded or greatly restricted development, such as wetlands. Both plaintiff and defendants' lawyers may need to consider the utility and investment potential of the land, and thus may need to examine financial, political, and business risks. They need to understand how selecting a discount or capitalization rate will affect the value of the

302. *See id.* at 632-35 (O'Connor, J., concurring).

303. *Id.* at 636 (Scalia, J., concurring).

304. *See Monsanto*, 467 U.S. at 998.

land.³⁰⁵ They need evidence of the cost of the development, feasibility of financing the development, expected cost of capital, availability of product markets, severity of zoning and use restrictions, costs to the community of this development, and existing economic and social conditions restraining development. Plaintiffs' lawyers must understand that the recovery of just compensation for the interference with reasonable investment-backed expectations rests between the Court's conclusions in *Lucas* and *Penn Central*. *Lucas* demands less than total deprivation of beneficial use of developable land,³⁰⁶ while *Penn Central* demands more than a partial loss of the profit-making potential of developable land.³⁰⁷ The Court has not clearly defined the existence of an investment-backed expectation and extensiveness of government's interference with this expectation in land markets.³⁰⁸

VI. CONCLUSION

Justices Scalia and O'Connor play pivotal roles in the development of regulatory takings jurisprudence in the Rehnquist Court.³⁰⁹ Their differences on fairness and economics in regulatory

305. See generally AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, *supra* note 233, at 412-14; BOYKIN & RING, *supra* note 10, at 292; SIRMANS & JAFFE, *supra* note 62, at 208-09 (discussing the use of real estate investment analysis to determine the value of a land investment based on future income or a return).

306. See *Lucas*, 505 U.S. at 1003.

307. *Penn Central*, 438 U.S. at 104.

308. The Court is not alone in reaching such a conclusion. See, e.g., *Price v. City of Johnson*, 711 F.2d 582 (5th Cir. 1983) ("[I]noperable junk vehicle do not embody reasonable, investment-backed expectations."); *Western Fuels-Utah, Inc. v. Lujon*, 895 F.2d 780 (D.C. Cir. 1990) (A "12.5% royalty on all leases [does not] substantially interfere with their investment-backed expectation in an individualized determination by the Secretary."); *Meriden Trust*, 62 F.3d at 449 ("[W]ithdrawal liability provisions . . . [were] not out of line with owner's investment-backed expectations."); *Rith Energy*, 247 F.3d at 1355 (asserting a "notice requirement" based on the acquisition of the property after the enactment of environmental regulations to cutoff reasonable-investment-backed expectations.); *Carolina Water Serv.*, 161 F.3d at 1 ("A party with . . . [non-exclusive franchise] rights does not enjoy a reasonable investment-backed expectation that government will not disturb them."); *Dist. Intown Prop.*, 198 F.3d at 874 (concluding that the landowners had no reasonable investment-backed expectation under the regulatory structure at the time of subdivision; mere purchase does not establish a reasonable investment-backed expectations if the intended use is greatly inconsistent with past use of the property).

At least one federal court of appeals has found the existence of investment-backed expectations. See *Phillip Morris, Inc. v. Harshbarger*, 159 F.3d 670 (1st Cir. 1998) (finding a disclosure of ingredient information could affect a taking of private property by interfering with investment-backed expectations, and thus district court did not abuse its discretion by issuing a preliminary injunction to enjoin the state from disclosing this information).

309. See, e.g., *Dolan*, 512 U.S. at 374 (developing a means-ends analysis to scrutinize the nature of government action); *Lucas*, 505 U.S. at 1003 (developing a per se test the prohibit to taking of all developmental use); *Nollan*, 483 U.S. at 825 (developing a means-ends analysis to scrutinize the nature of government action).

takings jurisprudence complicate an already confusing and underdeveloped *Penn Central* analysis. We are left with a plausible doctrine and unworkable rules that further neither fairness nor economics. Lawyers and judges do not need more confusion. The public cannot be trusted to use degradable resources wisely, and the government cannot be trusted to equitably allocate the burden of conservation. Thus, the Court must develop a workable, objective approach to balancing the fairness of government protection and the economics of land use under the *Penn Central* inquiry.

Palazzolo's impact on the extent of interference with reasonable investment-backed expectations eventually may affect both takings liability and just compensation under the *Penn Central* inquiry. This impact touches the use of evidence in litigation and negotiation involving the extent of interference with reasonable investment-backed expectations, namely profits and returns.³¹⁰ Resolving issues raised by this impact is complicated by the protection of wetlands and sensitive lands from development and valuation for development.³¹¹ Takings liability must address the level of use and

310. See *Palazzolo*, 533 U.S. at 631. In *Palazzolo*, the Court did not address the takings liability or remedy issue and remanded the case to the Supreme Court of Rhode Island with explicit instructions to apply the *Penn Central* inquiry. Justice Kennedy, writing for the majority, states that "[t]he claims under the *Penn Central* analysis were not examined, and for this purpose the case should be remanded." *Id.* at 632.

311. 16 U.S.C. § 1452 (2003); 16 U.S.C. § 3901 (2003). The Coastal Zone Management Act of 1972, Pub. L. No. 89-454, 86 Stat. 1280 (codified as 16 U.S.C. §§ 1451-65 (2003)), sets forth national policy on the protection of wetlands and other coastal resources. It states that:

The Congress finds and declares that it is the national policy:

...

(2) to encourage and assist the states to exercise effectively their responsibilities in the coastal zone through the development and implementation of management programs to achieve wise use of the land and water resources of the coastal zone, giving full consideration to ecological, cultural, historic, and esthetic values as well as the needs for compatible economic development, which programs should at least provide for:

(A) the protection of natural resources, including wetlands, floodplains, estuaries, beaches, dunes, barrier islands, coral reefs, and fish and wildlife and their habitat, within the coastal zone . . .

...

16 U.S.C. § 1452 (2003). Later, the Emergency Wetlands Resources Act of 1986, Pub. L. No. 99-645, 100 Stat. 3582 (codified as 16 U.S.C. §§ 3901-32 (2003)) gave more explicit protection to wetlands resources. The national policy on wetlands preservation and protection set forth:

Sec. 3901. Congressional Findings and statement of purpose

(a) Findings. The Congress finds that —

(1) wetlands play an integral role in maintaining the quality of life through material contributions to our national economy, food supply, water supply and quality, flood control, and fish, wildlife, and plant resources, and thus to the health, safety, recreation, and economic well-being of all our citizens of the Nation;

...

(b) Purpose. It is the purpose of this Act to promote, in concert with other

profitability of sensitive land, which includes a determination of the extensiveness of the effects of regulation on profits and returns. Just compensation must address the valuation of sensitive land, including how the timing, legality, and other factors of the regulation affect the value of the land. Obviously, Justices Scalia and O'Connor must reconcile fairness and economics in determining the extent of interference with reasonable investment-based expectations.

We are certain that an examination of the extent of interference with reasonable investment-backed expectations on sensitive lands demands financial and appraisal expertise. The complexity of the determination of how *extensive* may a regulation interfere requires expertise during litigation, negotiation, and compliance. Both appraisal methodology and takings analysis must weigh, among others, the level and kind of interference, quality and suitability of the land, nature and feasibility of the development, timing and severity of the regulation, and costs to the community. These circumstances address the extensiveness, including the nature and level, of interference by regulation. In addition, appraisal methodology and takings analysis will need to determine and weigh the findings of an earlier market analysis and the nature of expectations under real estate investment principles. These market and investment circumstances affect the validity of reasonable investment-backed expectations. These circumstances determine both the existence of distinct investment-backed expectations and the extensiveness of government interference with these expectations. Such circumstances show the need for financial and appraisal expertise to establish takings liability and fashion a remedy that equitably allocates the public burden in risk-filled land markets and an uncertain political system.

Federal and State statutes and programs, the conservation of the wetlands of the Nation in order to maintain the public benefits they provide and . . .

. . . .

16 U.S.C. § 3901 (2003). The Wetlands Resources Act imposes restrictions on the use of eminent domain power to acquire wetlands for conservation and protection. The pertinent section states that:

Sec. 3923. Restriction on use of eminent domain in acquisitions

The powers of condemnation or eminent domain shall not be used in the acquisition of wetlands under any provision of this chapter where such wetlands have been constructed for the purpose of farming or ranching, or result from conservation activities associated with farming or ranching.

Id. at 3923. However, this provision does not limit the use of eminent domain or police power to protect wetlands from industrial, commercial, or residential development.