

**W**hy is the public resistance to eminent domain takings so strong when property owners are compensated at market value for their properties? The answer lies partly in the endowment effect.

The endowment effect is the term used to describe the tendency of people to assign greater value to what they own than they would the same item that they don't own. The effect was first observed in the 1960's by psychologists, but the term itself was coined by the economist Richard Thaler in 1980 and has been observed in people valuing everything from real estate to chocolate bars.

Assigning high value to one's own property is not unique to one culture or time period. Supreme Court Justice Oliver Wendell Holmes wrote, "It is the nature of man's mind. A thing which you have enjoyed and used as your own for a long time, whether property or an opinion, takes root in your being and cannot be torn away without your resenting the act and trying to defend yourself, however you came by it." Taking a property from an unwilling seller, even with compensation, exacts an emotional toll. Unsurprisingly, the effect is more pronounced the longer a property has been in the owner's possession and the more "endowed" the property is with the owner's labor (such as the work that has been performed on the site, the type of improvements and the history is tied up with the property). We naturally sympathize more with the farmer whose land has been in his family over decades than with a recent buyer of vacant land along a new highway.

### **A Disconnect**

Eminent domain is not well understood by ordinary citizens. Many are unaware that the government has this power at all. It is no wonder then that the outcry is so pronounced in situations such as the *Kelo v. City of New London* case, wherein a public development council exercised eminent domain power to acquire residential property in order to redevelop the area with a corporate headquarters and other commercial



# THE ENDOWMENT

BY MICHELE WOOD

# EFFECT

How to approach eminent domain valuations



uses. Add to this the patchy history of minority communities' property rights and forced removals at the hands of economic progress, and we get fertile ground for resentment, anger and conflict.

Another explanation for the disconnect between governmental bodies with eminent domain power and the citizenry is the way in which the two groups view the legal concepts of ownership. Most citizens think of property as a "discrete asset," that is, as a single thing over which one can exercise dominion. In contrast, the law treats property in terms of the "bundle of sticks" paradigm, which looks at property not as a single thing, but as a collection of rights associated with the thing. In real estate, this collection or "bundle" of rights may include the right to occupy, the right to exclude others, the right to lease, etc. In psychology, the phenomenon of seeing one issue in two distinct ways is called framing. One group is seeing the issue through the discrete asset frame, the other through the bundle of rights frame, yet neither group understands that their frames are not the same. This becomes fertile ground for conflict.

### Why Should Condemning Authorities Care?

When conflicts appear in communities, the community suffers. Conflicts arising from eminent domain situations are no exception. When the taking or the compensation is contested, the ensuing legal battles are expensive to the condemning authority and the taxpayers, which includes the property owner bringing the lawsuit. The delays in construction cause further harm through disruption and uncertainty, often causing very real and significant economic loss. Ultimately, public officials (including planners) are held accountable by their superiors and at the ballot box. What can be done to ensure a minimum of conflict?

First, condemning authorities should recognize that the public reactions to the idea of eminent domain are often not based on unemotional, rational responses to market value compensation. The endowment effect demonstrates that people perceive their own possessions with more value than the "market" does and therefore, they do not feel adequately compensated by market value when they are not willing sellers. In fact, the IRS definition of fair market value is "the price that property would sell for on the open market. It is the price that would be agreed on between a willing buyer and a willing seller, with neither being required to act, and both having reasonable knowledge of the relevant facts." If there is no willing seller, it is reasonable that the condemnee would feel undercompensated.

Second, the condemning authorities should take care to handle the eminent domain process with these sensitivities in mind. The framing of property rights as discrete assets should be understood as authorities approach property owners and engage in negotiations for the properties. For example, it should not be assumed that the power of eminent domain is well understood by the property owner and that they likely have been thinking of their property as the actual dirt and improvements, not as a collection of legal rights to that dirt.

The language used by the condemning authority when approaching an owner and negotiating can have a big impact on the outcome. Specifically, care should be taken to emphasize gain over loss. Examples of phrasing might include the gain of monetary compensation, the potential gain of improved transportation in the area, the gain of economic success in the community and the gain of infrastructure to serve the affected home or business. These are all ways in which to reframe the idea of "taking" into a frame of "building" and bridge the gap between the property owner and the condemnor. Lastly, the condemning authority, in conjunction with the municipality,

may want to consider elements of symbolic compensation in addition to monetary compensation. The emotional loss of property could potentially be mitigated by the addition of a sign or plaque in public areas, the planting of a tree with a plaque naming the former owner of the site, or other ways to memorialize former ownership. This echoes our tradition of honoring charitable gifts to the community by publicly recognizing the benefactor by name. Again, this helps reframe a "taking" to a contribution to the community.

### In Summary

The endowment effect tells us that how we value the property of someone else is not the same as how we value our own property. This presents challenges for a framework that assumes a buyer and seller use the same method to determine a price. While eminent domain procedures and compensation cannot be tailored to the subjective experience of each property owner, certain aspects of the psychology of ownership can be used to help smooth the process and better pave the way for more harmonious communities with great infrastructure projects. ★



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