JAMES A. GRAASKAMP COLLECTION OF TEACHING MATERIALS

II. CLASSES AT THE UNIVERSITY OF WISCONSIN--MADISON

U. Student Coursework Collections (Arranged in Chronological Order)

3. Steve Luettgen's Lecture Notes from Business 856 (Advanced Appraisal Theory and Practice): Fall 1986

856 Notes
Fall-1986
Steve Luettgen
Pg 1

Sept 3 1986
Thurs 2:25 3:40 Rm 22 Writing Lab Sept 10-we
Following week - writing sessions on Thurs Rm 22

Goal of course is to produce an appraisal for our portfolios

Appraisal process taught in 556 is highly stylized process which depended largely on form for its communication of credibility. It grew out of the colapse of the 1930's when the major survivors of the depression in R/E got togeather and recognized that you could not define malfeasance w/o first defining what is appropriate procedure.

Intent of 3 major ~~association~~ institution -
1) National Assoc of Realator
2) Federal Housing administration
3) life insurance industry

to arrive at some standard of performance in an appraisal But they each had some biases:

the realator - the value of property is the price it will bring. Only the market approach would provide a legitimate estimate of what property is worth. Cost was irrelevant - income was irrelevant

life insurance ind. - insisted that cost was more benefit to their industry because it would assure them on a new project, that if they lent 75% of cost, the borrower had to put out the other 25% in hard dollars. They had gotten themselves in trouble by allowing developers to capitalize income and finance project for more than cost.

Federal Housing admin - led by professor Babcock from U. of Michigan. Radcliff + Babcock set up the appraisal system for the FHA. R/E is essentially a capital asset and a capital asset is only worth the present value of the future benefits to be enjoyed. ie single family home is valued at the rental value of the home.

In order to get the American institute of R/E appraisers under way, with some standard of performance, they arrived at the traditional american synthesis of view points which said there are 3 approaches to value. all 3 must be executed as a check on the others and then evaluate the quality of data underlying each approach and sythesize the results to a final conclusion.

It was done to accomodate getting on with appraisals as a professional process.

Modeling - 3 element to the theory of models

1) What is the question? - FMV of the entire bundle of rights - (fee simple title).

2) Data could be collected from several sources. - What Kind

3) Hypothesis that relates the data to the question. principal of substitution was one of the major hypothesis. that a buyer would pay no more for a property than he would have to pay in the market or build one from start or find an investment of comparable return.

~~Any decision~~ Every appraisal model or any decision model always with these 3 elements.

The ultimat test of whatever model we chose is; how well does it predict what people actually do.

If G.R.M consistently provides the best answer consistently then it is the best method.

3 practical constraint on the model:
1) the ability of the user
2) what was the creability of the method with the client
3) was the method cost effective.

There was never an inference that the 3 approaches had to come out at the same number. original litature implied that they would always be diffrent numbers, Partly because the data was of uneven quality, and partly because the approaches came in at diffrent time perspectives.

properties tended to approach cost to replace over the long run because there was a long period of time necessary to go about the search & development process.

Income approach is limited by ability to forecast income which in those days was 2-5 years.

Market's tended to be very short term

Once the process was developed - the oldguard was against changing it for fear of making their previous work look bad.

It is useful to put the appraisal process into the context of a decision - therefore Hayes is introduced!

1) What is the question for which the appraisal is required? Value as going concern - R/E taxes - monitor perf. of property?

appraisal process needs to be able to:
1) Replicate
2) Validate
3) be sensitive to short term changes.

fundamental weakness in the appraisal process is the buyer of the service - has no idea of what to ask or what is available. The appraiser must understand the issue for which the appraisal is sought and what are the implications of the results.

Ackoff: Problems can be divided into 5 elements
1) The decision maker
2) the controllable variables - element that decision maker can control ie: the assumptions he can make.

3) Uncontrolable variables - the exogenous factors

4) Constraints imposed from within or without

5) Possible outcomes

Problem is solved when solution maximizes the outcome. Resolved when solution is good enough. Most appraisals are resolved. (good enough)

Dissolve the problem - change the parameter or assumptions and the appraisal isn't needed. ie: liability of driving auto - Don't drive.

appraisals resolve problems. Other problem of appraisers is that they are reactive - they respond to problems by walking into the future facing backwards.

Problem should always be specified in a Pro active way what would be the ideal solution and then can we implement that solution. ie: 25000 acres of slopes of cascades - value of wilderness is $50 /acre. Grasshopp - value of land taken and damage to value of land ~~tak~~ not taken. Located all the buyers of wilderness to establish a value

* eminent domain sales can't be used as comparable sales of land for market value.

Once the problem is understood, the hypothesis of the problem becomes more obvious and it begins to control the editorial of the appraisal

Planning is dealing with interacting sets of problems. Problem solving is finding alternative routes to solve an ~~anc~~ individual problem.

Feasibility analysis is testing a specific alternative solution so as to measure how well it satisfies the objectives.

An appraisal is a fictious feasibility study in which certain constraints are assumed.

9-3-1986

2nd technique of problem solving has to do with Hayes. - Title of book is alarming!

Problems should be represented by simple pictures and graphs. - chief wants simple graphs in our appraisals showing where we're at - where we're going and how we're going to get there. - (here's my logic!)

Main problem is to define the goal of the report! Then correctly specifying the initial state of affairs. Specify the difference between the two and what kind of restrictions are there toward moving to the goal. + what kind of operators (assumptions) can be available to advance you toward the goal.

Translate the Hayes reading into R/E problem solving.

Decision making Techniques:
1) those under certainty
2) those under uncertainty
3) Risk
4) competitive conflict

R/E has traditionally operated under certainty for the appraisal process - we are beginning to realize that this is not true - we need to look at what happens under competitive uncertainty. Can we handle that the conclusion will be a range of numbers.

Because of conflict, there is a difference between the most probable price at which a property will sell and the fair mkt value of the property.

assemblage of property will also change the value of properties.

~~lex~~ lexographic method - set up alternative screens by which to select an appropriate comp.

additive weighting - different attributes are worth different amts of weight - add up total then develope price per point

effectiveness index - look at index to measure operating results of different property + compare results

profitability index - NPV divided by cost gives index.

these methods move appraisal methods back into the main stream of decision theory + data mgnt. as long as they improve the reliability of our estimate, the method is cost effective and the user can understand the method + its flaws - and that it has credibility. (Ellwood failed because of lack of credibility)

856
9-8-1986

Cushman + Wakefield - recently opened up appraisal + feasibility services division - Chief "- they are the best in terms of detail + care." Will be interviewing the 17th - Wed. even wine + cheese. In most of major cities.

R/E Club meeting the 17th - 7:00 Rm 19
ULI - trip discussed.

Dillmore - 3 approaches to value
1) truth
2) beauty
3) chance

1) Truth the presumption that if the irrelevancies could be taken away we ultimately would come to the truth of the matter. - There are patterns of truth that come to light if you take away the extraneous data. There is a rational mkt out there that does work.

2) Chance - there is nothing wrong with error appraisal is a social science and as such it is prone to error. It shouldn't be disguised but let the client know the probability of error in the final conclusion.

3) Beauty - intuition + the elegance of the solution needs to be considered. The honest appraiser can have intuitions that will provide elegant solutions that can't be proved.

Traditional view of 3 approaches
1) market
2) cost
3) income

cost + income models have no prediction power of the way people will be behave in a given context. ~~Therefore~~ Therefore FMV is a normative statement about a transaction price which predicts what people would do if they thought like appraisers. Appraiser should anticipate that - not determine that.

Ratcliff would also argue that there are 3 approaches
~~I~~ I inference from actual transactions for properties of similar potential for buyers of similar motivation. Notice the double constraint on comparability.
A) properties of similar potential
B) buyers of similar motivation.

there are occasions when ~~them~~ there isn't sufficient data to give patterns of data tight enough to resolve the issue of price.
II We would then use a second method - "simulation of the buyer calculus" - tends to ignore the supply side of the mkt - the emphasis is on the demand side - what is the buyers calculus. In order for there to be a transaction, buyer + seller must have some overlapping expectation.

Simulation of the buyers calculus could be as simple as the gross rent multiplier in some market - if that's all that is required. - or rules of thumb might be used as the calculus.

If you are going to infer what people will pay - you have to go and ask them how they arrived at that price. If you can't find a property as a comparable find a buyer that is a comparable. and ask the pricing technique used.

Failing to infer from transaction or failing to reproduce the buyers calculus - you fall
III to the third level which is normative approaches. "What would people do if they were as smart as me, the appraiser?" The same method could fall into any of the 3 approaches, depending on how people really behave.

After Tax cash flow is the normative method for duplex owners - because they don't think that way - they use GRM or NIM or other normative parameters.

The contemporary approach says the fundamental job is to anticipate a future transaction. That's a forecast under conditions of uncertainty.

Summary for Radcliffs 3 approachs
I Inference
II Simulation
III Normative - Cost, Income, etc.

Process for appraisal according to Ratcliff
1) ~~to~~ Determine what the issue is for which the appraisal is sought. Careful definition of this issue structures the entire appraisal report, and determines the choice of valuation methods.

2) What property rights are relevant to that issue which is being appraised and should be included in the valuation.
ie: land + building w/w/o furnishings, books of business licences etc.

3) What is the most probable use of that set of rights? This brings about the classic question - who needs it and who needs it the most. This decision would be set up as a series of alternative decision; "this building could be a warehouse, commercial building, apt building or it could be torn down. Each course must be analyzed before the use is decided on. The decision will reflect mkt demand, capital costs, political acceptability.

Once most probable use has been determined, it automatically determines who the most probable buyer is.

Here is where the traditional + contemporary appraisal differs. - FMV is a statistical market concept in which it is always presumed in which the buyer + seller each have alternatives. The difference between first + second buyer/seller is relatively small. This theory underlies all of traditional appraisals.

To destroy a traditional appraisal: you choose one comparable because it was the only one in the mkt. place. - it is then a forced purchase. a captive buyer is disguarded as a Fair Mkt. transaction.

Contemporary approach - (Ratcliff's) whole it is possible + legitimate to say that the most probable buyer is the guy next door. Because if he doesn't get it, he doesn't have an opportunity for parking for his building. At this point, buyer's calculus would determine the price.

Chief gives the example of the pipeline being laid across the Indian reservation.

A traditional appraisal wouldn't be able to explain the higher than normal price pd. for the property because of the monopolistic mkt.

Traditional approach says that the move from most probable use to most probable buyer must be in a statistical market place in which there are multiple buyers/sellers.

Ratcliff says the market doesn't need to be statistical. When a monopolistic situation occurs, the most probable price will be different from FMV.

The traditional approach recognizes that the most probable price includes a zone of prices where the transaction may take place. They do not recognize a monopolistic market however where one party had to buy or sell and there was no statistical mkt. place.

Note: Eminent Domain operates under traditional def of FMV. Lesson: Take a monopolistic price offered rather than ~~wait for~~ take chance and have eminent domain take property at a lower price.

Mkt Price and Probable price are **Not** the same! They may be, but only if all of the other conditions are met!

Once most probable use + buyer are determined, look at three alternative methods to value and choose one.
1) Inference
2) Simulation
3) Normative (Cost, Income etc.)

The Ellwood method would fall into the normative method. Chief says he doesn't think you would ever find a buyer who used Ellwood to buy a building. It will not predict what people will pay.

"also ~~[illegible]~~ buyers don't use normative methods.

Ellwood is elegant + beautiful, but it never had credibility. Too elegant for the data available at the time.

Once we have the inferential method of valuation, we arrive at a conclusion. But Ratcliff says, that conclusion must be subject to two qualification

1) have conditions changed materially since the sales data collected were available. Are there externalities now that weren't included in the data.

2) Does the value determined, in fact, do for the investors what the investors objectives were stated as. (The investor being the most probable buyer)

Ratcliff approach - there is one method to valuation that is always better than the others.
Traditional approach - run through all three approaches and disregard one if the answer or data are crazy off.

Ratcliff - go with the one method and then look for externalities that have been overlooked.

Once tested value is arrived at, we can then arrive at a statement of the most probable price.

Most probable price is a central tendancy. the transaction zone is not a statistically measurable amount. It is reliant upon human behavior.

If seller does the financing, students usually assume a higher sales price. When dealing with older existing buildings that is seldom the case, because if the building requires extensive renovation the buyer will need financing. and that financing will require a first lien situation. If seller financed, the buyer wouldn't have any collateral to work with. I must simulate both sides of the equation.

Summary for Ratcliff Approach

1) What is the issue.
2) What Rights are to be appraised relative to that issue
3) What is the most probable use of those rights.
4) Who is the most probable buyer for those Rights.
5) Given the buyer + those rights - What is the best method for inferring the price at which they will sell
   1) Inferential
   2) Buyer simulation
   3) Normative
6) Are there any extenuating that haven't been considered and should be factored in to the conclusion.
7) Is there a test to show the plausibility of the conclusion.
8) What is the final statement as to the central tendancy and possibly transaction range around that central tendancy. Or it can just be a statement about the reliability of the pattern in the data.

856
9/8/1984

What is the issue to be appraised?

	What Value is Relevant?	What Property Interest are Relevant?
1) Appealing the R/E tax	FMV of fee simple title of land + building (Sentry Building example) (city had to sue the state) what will the land + building sell for to the next buyer:	
2) Emminent Domain	FMV as of a certain date of taking and neither buyer or seller knew that it would be taken	compute two value - B4 + after taking - pay no less than the value of piece taken. (FMV of Land + Building)
3) Collateral to secure a fixed interest Loan	Efit value of the property. What can you sell it for if it fails?	
4) Collateral to secure a participaty Loan	1) Vested collectable rights. 2) Contingent future rights.	
5) Purchase of a Going Concern	all of related benefit of the property. Mgmt fees, ins. commision. Mgmt values.	

factor out the income created by mgmt to come up with a value for building + land only.

856
9-8-1986

Appraiser must understand the issue for which the appraisal is sought. If it is used for a securities prospectus - appraiser is liable for triple damages for omission or comission which may have affected the investment decision -

if used for purchase of property for a pension fund - subject to ERISA + corporate fiduciary responsibility

Statement of limiting conditions should state any ~~conditions~~ standards that the appraiser doesn't want to meet, ie "Can't use appraisal in court w/o permission w/o additional compensation to cover the liability.

The cost of the report + the compensation to the appraiser is also controlled by the issue of the report.

Weakness of the appraisal profession is the customer of the appraisal - for not specifying more accurately what the issue is.

The customer controls the rate of innovation in appraising

Course is designed to teach us to be intelligent consumers of appraisal services.

I. What is the issue? → defines the rules of the game for the balance of the appraisal. Need to define the correct premise from which you are moving.

If the issue is statatory - ie; what shall we pay under emminent domain. there are specific rules as to what is admissable as evidence.

There are also defenses for such - don't volunteer any additional information as an appraiser. Don't make statements that are not defensable in court.

Dont tell all you know in court - hold back info so you can unload with a series of fact.

Chief tells the story about the micro photographer who qualifies himself as a microphotographer.

The issue of the appraisal acts as an editorial constraint for everything from the report and to whom you write it for, what the appropriate approach + style are.

Broad catagory of issues:

1) statatory - emminent domain - appeal of R/E tax appraising for any guaranteed S+L which is now subject to R-41B (defines what the appraisal product should be, the format + the subjects covered.

2) What damages occured from ~~most~~ not being able to go forward in deal - direct + consequential losses are then measured. Most Probable price may be more relevant than FMV.

II What are the legal Rights that are relevant to that issue. No greater area of misdirection. - Fee Simple title no longer exist today. Titles are modified by covenants, leases that encumber them, ordinances that affect different classes of property, district lines, etc

ie: R/E tax - we would be concerned with entire bundle of rights. Doesn't matter where the benefits fall.

Sell the building with a lease - appraise the encumbered title subject to the lease. Makes for a dramatic difference in value.

ie: chief tells story about client who owned a warehouse that was rented to Sears on a long term lease. Client had a \$1m building with only \$75,000 equitable interest, Sears had \$925,000. Sears had to pay client to go away. If there had been an eminent domain taking of the property - the client would only have received \$75,000. Client sold Sears their interest for half of Sears leasehold interest 475,000 + clients interest of 75000 for a total of \$550,000. Sears then could sell the property for \$1 m. because it then had title.

ie: chiefs next story is about recreational land bought by client. - State wanted to take it by ~~for~~ eminent domain appraisal of property should include: ~~EMV of~~ fee simple title to the land plus; a transferable entitlement to build a lake + an entitlement to hook up to the sewer + entitlement for on/off ramp on hwy 70. That changes the character of the probable use of the property.

~~it~~ critical to assess what the nature of the entitlements are that are moving with the title.

Value in R/E is more in the permits that have already been granted and vested which are assignable.

Title has to be defined in a number of ways:
1) legal description
2) statement of transfer in the deed itself.
3) quit claim deeds
4) warranty deeds
5) qualified warranty deeds

title transfered must be carefully research as to the authenticity and the rights that the title actually have. Check to see if there are any limitations or encumbrances on the title.

Chief goes through the example of the Tejon ranch where the ranch was syndicated and the title sold w/o any of ~~the~~ rights of ownership. syndicate bought the rights to the depreciation only.
When the ranch was bought back from the syndication, an appraiser was to establish the buyback value. ~~title~~ The title which was bought back only included the right to depreciation, which had been used up, the result was that the property was worth $1.

Thus the appraiser must understand the rights that he is supposed to appraise and are included in the property. - This leads to the definition of value.

FMV - Knolegable buyer - Knolegable seller - aware of potential uses that the property could be put. neither under duress. - property has been on the mkt. for a reasonable period of time.

FMV says cash to the seller - how much.
Do not include the value of any financing included by the seller.

Radcliff's most probable price - that price at which two parties would strike a transaction if the property was on the market for a reasonable period of time at terms available in the market place. (If everyone is selling on land contract, then the most probable price will involve a land contract sale.

* Ratcliff's definition includes the right to assume financing at a favorable rate - traditional approach doesn't.

Terms of sale have to do with the horizon of the investment
ie: Going concern investment - everything is included - goodwill, working capital, book of business. - all property interests

Exit value to English - what if things go to hell and you have to dump property w/o having it on the market for a reasonable period. The ultimate value of the property less what costs it will take to get the project completed = exit value. It doesn't matter what you have already invested in the project

Lenders don't consider the exit value of a property when lending. In order to have an enforceable loan, you must understand the value of what you are trying to enforce it on. You always want to know how much the property is worth on the backside in case of an abrupt termination of the project.

The difference between the loan amount + the exit value needs to be collateralized by something other than the R/E.

construction lender attempt to do that by what is called hold backs. The hold back typically doesn't cover the diffrence between exit value + loan value

Understand the exact set of rights that is being appraised + be able to reassemble those to match the issue for which the appraisal is sought.

R 41B is designed to put the liability on the loan officer who asked for the appraisal to ask for the appraisal that entails the correct rights to be appraised.

Lender must determine what they can put their hands on as collateral and sell off to avoid foreclosure. ie: take assignment of the borrowers general partnership instead of foreclosing on R/E (no hassles).

emminent domain - 3 criteria to determine what is in a piece of ground. (the larger piece) - the three unities
1) contiguous ownership - (identical)
2) must be touching (continuity)
3) must be in same use

#2 has been somewhat struck down, because it is conceivable that two properties that don't touch are ancillary. ie: shopping district with parking across the street - of parking is taken away for emminent domain - courts will rule that the larger parcel was ~~the to~~ part of the total complex removed.

#3 if two parcels are zoned diffrently (ie: C1-R; if just one parcel is taken - you can only consider the value of the parcel taken.

#1 (same ownership) parcel A in developers name, parcel B in corporate name, but he is the sole owner of stock. If stock is assigned to someone as collateral, it can be argued that the stock is not in the same ownership.

If two parcels touch only at the survey point - it is not continuous ownership because the survey is an abstract point and therefore it is not physically contiguous

In defining the bundle of rights - we are interested in the legal statement of rights and the map of the property.

The plat of a ~~po~~ subdivision may show a proposed city park - in the absence of anything else - that will control the future use. Those who buy lots will buy lots with that expectation - need to understand the way in which rights arise in R/E. and the way in which rights are extinguished.

ie: highwater mark controls the ownership of a marsh. if there is a highwater mark - the DNR owns the land.

if rights are undefined - what kind of discount should the appraiser supply for the uncertainty.

Summary

1) Define what is it is that the appraiser is valuing. until the rights are defined - there is no way to satisfy the Ratcliffean requirement of determining the alternative uses given the existing rights. + alternatives.
2) Form the physical description of the property
   1) physical attributes
   2) legal / political
   3) linkages

4) Dynamic attributes
5) Environmental attribute

There are always four possibilities to be explored
1) continued use of property as is:
2) Modified use of property as is: (Retail Bld cut up into sma
3) a change in use (store to office Bld.
4) Removal of improvements + start with a vacant site.

appraiser must always go through these 4 scenarios

Set up a matrix for each scenario that checks:
1) the cash generated by the property.
2) Is it political/legal to do that
3) Is there a market for that use.
4) Does the public have a particular bias
(public favors uses that produce more R/E taxes)

Once the most probable use has been established - the appraiser needs to determine who is the most probable buyer. This will require a number of steps of investigation in order to profile motivation.

The use may suggest the buyer - ie: large renovation project calls for a professional renovator. or map the ownership in the block to notice any assemblage trends. or a buyer for use to house their own activities in.

Once you have the most probable buyer determined - you have set up the parameters for the search for comparables. If it is an assemblage - need to know what people have paid for assemblage + what they think they are going to do with it.

If building is the type bought by renovators - you must go out + find other building bought by renovators, extensively remodeled + successfully marketed.

Radcliff is radical in saying that there is only one method of value which will give the most reliable prediction as to what price will be paid.

Conventional appraisal - run all 3 approaches as a check + balance on other two. Radcliff says consistency of estimate is not only unlikely but also irrelevant - the real test of value derived is "would it allow the buyer to achieve whatever he was trying to achieve.

If the value doesn't meet tests - something is wrong with the profile of the investor + your presumptions about his motivations or something is wrong with the value conclusion.

So if your sure about the investor profile, then you must be suspect about your value conclusion that doesn't allow tests to be met.

class at 3:15 Sept 22nd
14 W Mifflin St.

Description of the Property:
should be done in an outline form as opposed to a prose form.

Outline should be broken up into catagories
1) site
2) site improvements - parking lots - retaining wall, wells
3) above ground structure include the basement.

I with in each of the above catagories
1) site
A) Address
B) Further refinement in tax parcel #
C) legal description + source of description
(legal descriptions and tax parcel # must match - conflicts must be resolved.)

2) identify all of the legal constraints of the property
A) start at the federal level - corp of engineers - EPA - HUD - FAA ie: (EPA - scale + nature of facility)
B) State level
state Highway - state dept of aeronotics controls hight, use, construction materials,
C) Local level + county level
* all of these restrictions are incumbrances on the property

The appraiser should identify what the critical limiting constraint is. - ie: parking ratios, # of dwelling units limitations.

all of these elements have to be imposed onto the site map. Site map should show borders, points of egress + access to site and all easements on the site. So that when done, the appraiser has defined the permissable building on the site.

It is usefull for the ~~ao~~ appraiser to use a check list for all of these restrictions.

Go through all the jurisdictional levels to arrive at ~~a~~ the permissable uses and the building envelope. (usually won't have any complications except the local zoning itself)

The final constraints are the legal covenants that run with the land. On the deed or the plat, there may be a reference to the covenants filed under the misc. catagory at the register of deeds or Home owners association

The statutory length of a covenant is 30 yrs in WIS. at that time it is renewed automatically or it must be renewed by someone - depends on how it was drafted.

Common law presedence says that covenants last as long as 60 yrs.

The appraiser may request the client to have a title search done on the property, where the appraiser feels that there is reason to suspect a flaw in the title.

The title co. can also help the appraiser find all of the comparable sales in the area

The appraiser should describe what are the possible options for the property, given all of the constraints put upon the land.

3) identify the availability of public services. - The proximity of the services is not enough. - Capacity of service is not enough. The appraiser should check with the utility for additional capacity, moratorium on sewer connections and if there is a constraint on the kinds of connections. ie(industrial user that can't use a residential sewer line.)

check private sources for utility hook ups

4) Define the building envelope for the various uses. given any code there are several alternatives. The appraiser must test each one. (Front + side yard constraints, use proposed, hight proposed, is the code negotiable in the area. Need to know the maximum building potential on that site.

(II) Site Improvements
critical from two standpoints -
1) existing improvement often control the land use.
ie(existing improvement line controls any new improvement line) or (leave existing exterior walls intact, the down zoning doesnt control).

Bulkhead lines are critical for property located next to water. Bulkhead lines are set by the corp of engineers and define the navigatable water + the jurisdictional zone of the corp of engineers. Represents the furthest point to which you can build. It is possible to alter a bulkhead line if you can file evidence that it is not the proper definition of the stream. If you dont know where the line is, you dont know how much land is in the site.

If you can't determine the bulk head line - be sure to identify where the ordinary high water mark is, - that will require a professional engineer. Where that line is - is the beginning of public ownership.

d) Unrecorded easement for public utilities
useful to cruise the site to look for settlements or earthmovement that suggest improvements.

the question to ask is; what will it cost to get the site in buildable order? - Remove peat moss, old gasoline tanks etc..

III Description of the Building
appraiser is expected to be able to describe the building in such a way that it can be properly classified.
Not expected to be a structural engineer nor a high tech mechanical engineer.

* No such thing as a fire proof building - only fire resistant bldg

be able to describe the foundation system, structural support sys. floor, ceiling, exterior wall, interior walls, horizontal + vertical circulation system, life safety system, HVAC. Site circulation system (how cars get in + out - where truck come in for deliveries) approach zone to the property

The appraiser should be able to identify the critical element of the building (ie: floor load restricts the use)

Books to help describe the physical property:
Building Standards
Site Planning Standards by Harris $79.^{00}

use a bullet form of writing to communicate this kind of stuff.

appraiser is allowed to state in the limiting conditions that he is not responsible for structural problems. This allows the appraiser to get off the hook for a # of things that make the building profitable / nonprofitable.

If he allows too many hold harmless clauses - the report is useless.

The appraiser of tomorrow will operate in a clinic with the other necessary professionals. Other options is to have an allowance in the appraisal budget for needed professional service.

The appraiser must have adequate information on what it will cost to make the changes or repairs to the building or else the market will attempt to depress the value of the building more than is actually warranted.

Major issues that appraisers must deal with today:
1) toxic waste problems, (asbestos, PCV, toxic wastes) the new owner is liable for the cost of cleaning up a site. The value of the property must be discounted for risk if the owner won't provide the necessary information.

2) Storm water mgmt. - shifts as the surface of land becomes more waterproof. If adjacent storm water removal facilities aren't capable of handling water - the burden is put on the land owner to have retention systems on site. ie (shopping center with lake on parking lot + 1 ft of storage on roof.) - alternate solution for a site is to pitch a site in a different direction.

3) Arrive at the net usable area. Before comparing sites, you must establish the net usable area.

if your looking at agricultural land - no longer concerned with land area, but concerned with units of production, acre feet of timber, bushels of corn, # of live stock that land can sustain etc..

when looking at comparables in a mountain area - must look at comps on the same side of the mountain. North slopes are more productive for vegetation. also true for open slopes - which way does the land slope

In an urban area - the measure is usuable area - must deduct for easements + irregular shapes. that are unusable.

Be aware of former foundations that are still in place. In particular - urban areas that are being redeveloped. - Look to the demolition companies specifications as to what he was supposed to do with the foundations.

In looking at filled land - look at what is below the filled land. - look in the public sources to find information. If your property is next to a state highway - use the states borings to determine what your soil is like. Use utilities companies to find out what soil was underneath the utility tower.

Caution in using soil maps - soil map are only good for about 18 inches. Surface + Subsurface geology is more important. this tells how the land areas were formed

Once all descriptions are complete - you want to propose no less than four alternative uses.

1) current use continued
2) current use modified (large retail → small retail)
3) change in use
4) demolition of existing

chief tells story about the office developer who started buying residential lots for development into commercial. Lawyers recognized what he was doing + encourage their neighbors to sell. They themselves held out till the end + received the most money.

(Moral) Just because something is zoned one way - don't limit the appraisal to that existing use.

Appraiser must be aware when an assemblage is going on - MAI must go back 5 yrs on the the parcel appraised - look at other properties.

Appraisal requires military intelligence

* Use the back door approach to rank the alternatives approved - this won't produce a value - just allows a ranking.

Back door approach doesn't take into acct. the reversion values or other project profit centers.

Then go back + determine which alternative has the greatest market demand, favorable risk payoff matrix and legal feasibility. Filter through the matrix + determine the most probable use

If building is presently occupied - current use is probably the best use.

If called on the carpet, the appraiser must be able to show computations used in determining the highest + best use.

Manchester Building
(14 W. Mifflin Street.)
Marty Rifkin → General Partner
Wayne Sweeney → Remodeled by
will answer questions about the structure Wednesday.

In 1985 building was acquired. Property was on the market for $1½ million. Didn't see opportunity for much restoration. It was having problems in terms of vacancy. Building was selected because of the location - he felt downtown would come back, acquired the building at a price that made economic sense. They felt they could lease the building. actual price paid was around $750,000 and seller took back some paper.

(appraiser must report all transactions up to 5 yrs before the appraisal date) -

there was a master lease on the property that they had to assume. The seller wouldn't terminate the lease. The lease lasted another year. Purchase price with the lease was around $180,000.

Primary concern when purchasing building:
1) What kind or return is cap rate.
2) cost per square ft. - concerned about cost of restoration and still be marketable.

Discovered Mechanical Problems after bought building problems stemmed from a maintenance failure.
HVAC not operating properly. - Decided not to replace HVAC system.

Cooling tank on roof requires alot of work.

The building is fairly expensive to operate

Manchester Bldg.

The leases are full service leases.

Can't seperate any of utilities in the building. Utility costs are more than they expected (electric).

They also had to inherit unfavorable leases - attornies upstairs - (Cowens + Bode) - landlord has to pay for 5 parking stalls in the downtown area for them. Legal firm will be moving out soon and they expect it will improve their bottom line.

They were aware of the leases when they bought the building - thats why it was priced favorably.

When they bought the building - the whole lower level was open area - except for the tanning area.

There was a restaurant built by the previous owners called ("P.J. Ogobby's"), went out of business within 1 year, so they inherited alot of empty space.

New owners chose to create a hallway surrounding the stairway. (Done for purpose of code). Created offices created around the hallway. Space leased up very quickly. Started at $6-7/sqft ended up at $8-9/sq.ft.

Discovered that R/E on the square was easy to lease to smaller tenants. Another advantage was that the elevator is handicap accessible (opens it up to many of the nonprofit clients)

Chief

This was initially 3 building. (Manchester Home Furnishe...

The conversion to an office building began with the liability of having an elevator system at the side + rear of the building.

Location of the elevator results in alot of lost space because of the needed corridor system. Plus there is a security problem of having the elevators back of bldg - s/b visible from the street.

Certain walls were immovable, so options were limited.

Atrium on 2nd + 3rd floor was main concept brought in. created a little more light + air.

Facade of bldg on Mifflin conceals existence of several different buildings.

Marty
Utilities to a new tenant would be brought in through the ceiling. - The building has plenty of electric power. Impossible to separate power

Security has been a problem - always is with former dept. stores - because of location of the elevator. Creates a problem trying to redesign a floor for a tenant.

Problems with people breaking in through the alley in the back - problem with tenants that want to stay open late (Nunton spa - require a student at front door to direct traffic away from rest of building)

There is no way to close the elevators down for the evening - too costly. Have rekey the building recently - tenant awareness of problem has helped. Overall problem has been controled. If the building was bigger - they would have problems.

Atrium is a problem - much to big - wasted space.
Have considered closing it + giving it to the first floor.

There are codes for a two story atrium that say it must be enclosed - in case of fire 4 hour fire wall or a sprinkler system + certain vents on roof -(chief)- reason windows are sealed is so the fan can exhaust topic waste.

Marty - Also if the area was open, it would throw off the HVAC system. Atrium has access from only one office - they have options for several more yrs.

Chief: - concept of atrium is to remove the clostrophobic feeling of a building ~~with inside space~~ that is as deep as this building. allows smaller tenants the allusion of outdoors

The existing fire walls probably dictated how large ~~it~~ the atrium would be.

Marty - A lot of common areas in the building - so cleaning service (60¢-75¢ sq ft) for hallway is a big expense. Plants have to be maintained.

With the kind of tenants you have to lease to in these buildings - you have to provide those kinds of services.

Operating expenses are probably running $4-5 sq ft. net rentable other buildings are in $3-4 sq ft.

Chief: Notice how the alley is greatly constucted.

Also detect the relationship between this building + the Concourse, next door.

This building lines up pretty well with the lobby + entrance in the concourse.

The building on the corner is "30 on the Square", owned by Gordon Rice ______ which spun out of a REIT a year ago and is really hurting for a lack of parking. At one time there was adequate parking in the basement of the concourse but the concourse expanded rooms + pushed most of the tenant parking out. (Primarily for Hotel guests now)

They also own the woolworth building on the other corner which is on a short time fuse with the woolworth people.

The building in the middle (Brat + Brau) is under option to Gerald Wild of the concourse. Wild has always felt that the concourse has to break out to the square.

The Rifz people + Wild have talked in some detail with the city about taking the very heavy $5 m. TIF benefits that have spun off of the development of the concourse, and tearing the whole block down except for "30 on the square" putting two layers of parking underneath for 400-600 cars, putting retail on top of that, and the exhibition center on top of that - which would be level with the ball room + meeting room of the concourse.

Wild has a model in the lobby of the Concourse showing an embassy ~~sweet~~ suite atrium hotel ontop ~~of~~ of this site. So the grand sweep is to redevelope the entire block, provide parking which would overnight change "30 on the square" from a "BC" building to an "A" class building.

Issue is: Is this building too expensive to acquire for its land value. - Would you just redevelope Woolworths + the Brat+Brau Bldg (currently vacant - may have new tenant signed up).

The city + tenants are the owners of the building in which McDonalds is located. Original lease had clause in it requiring MacDonalds to vacate in case of redevelopment of the entire block. Somehow the clause was lost 84 the final drafting.

What is the most probable price you would have to pay to get Morty out of there - question #1

2nd question - what is FMV under WIS emminent domain standards - The city could take it by emminent domain, but now that it is in the TIF and redevelopment district, the city could take it by emminent domain, assemble the whole block, other than "30 on the square" + go forward with redevelopment. this would include parking, and other uses.

Other feasibility studies on subject will be available with different views.

Would this building sell as a part of an assemblage - if so how much. Would it sell as a free standing investment - if so, how much.

Would this building sell on a most probable buyer basis

Manchester Bldg.

a lot of parties are interest in the block because of the tremendous overhanging TIF.

Other arguement are that we dont need an exhibition center - we need a continuing education ~~room~~ space. Need an economy hotel then in the $30-40 range.

The TIF would be available for public participation in the project for financing the parking, financing the write down of the site. The city could buy the site under emmint domain and resell it to a developer at a price that would make the rest of the redevelopment work.

WALK The Neighborhood -

9-24-86 856 Pg 1

(Handouts for Appraisal)

Dimensions (79' 6" wide x 132' ft deep) of building

5 yr. chronology and any transactions that affect the property are needed for any appraisal of property. Purpose is to expose any kiting of value, that may be going on.

Fire Rating Bureau - rates on following criteria
1) combustibility of the construction itself
2) ignitability of the contents within
3) Housekeeping
4) Nature of ajacent properties.

will provide a base property insurance rate against which all other rates are judged. - When you buy an old existing building, one of the cheapest sources of data about building is the the fire rating bureau. Need consent of the owner - as it is privileged info.

Sanford Map Book - analyzes structural characteristics of all buildings on the block - desk of Building permit dept or city engineering dept.

Fire Rating Bureau - function is to analyze each custom building in terms of fire characteristics. Building over 50,000 cu. ft.
1) Structural characteristics - rates carry penalties for parts that are more combustible than others. Steel is one of the worst things to have as structure of building - w/o expansion joint it will heat up and expand so much that it will knock itself down.

Brick mill construction (subject property) - outer walls are 4 hour masonry with 4 courses of brick (16" thick) - interior supports are light steel lally columns + probably support 6x16 wood girders.

2) Occupancy - dry cleaning establishment is more dangerous than financial service business. Auto body shops are the highest - acetylene torches. Keep TBA building away from the main shopping center.

3) Housekeeping - are all the sprinkler heads working - garbage piled up - stairways blocked.

4) Environment in which it is located
   1) fire dept efficiency
   2) position of closest fire hydrants or water reservoi
   3) contiguous occupancy. - (neighbor is fire hazard)

This determines the base of the assessment - other endorsements might be added or subtracted for additional features in the policy. Nature of the companies registration in the state will affect what discount can be taken from the base. Discounts are granted based on the insurance co's. record.

Preferred Mutual std of construction + mgmt - rigorous std of fire code that must be met to qualify for second level of discount - up to 50% of off the bureau rate.

If there is a large enough pool of properties - you can have an underwriting discount of scale - experience rate the pool of properties by themselves.

If you buy a building from Prudential - don't expect to get the same insurance premiums.

9-24-86 856

If there is any hint that a building is owned in a partnership, then you must go to the miscellaneous records where limited ptnship material is also on file to find out; who the ptns were, any modification of the ptnship + any pmt to extinguish the ptnship.

Start to follow the outline in 25 N. Pickney + begin to write sec I

The issue for which the appraisal is sought is going to be 2 number:

1) FMV as of Oct 1, 1986 assuming the city was acquiring the building by emmint domain. Total value of all interests including the lease hold rents (Review for mkt. Rents)

2) MPP as of Oct 1 1986, at which Marty R's general ptnship could sell the property to a private party.

If there is an assemblage going on - the owners may be able to get more than Market Value. But if you look at other situations on the square, developers are refusing to pay the hold out price and have told the city that if they want the development to proceed - take the property by emmint domain.

Emmint Domain can be more expensive when considering the time delay + unpredictability of the jury + the relocation costs in finding suitable alternatives for the tenants.

It is conceivable that if the present partnership pushed too hard so that it delay a much desired public project its conceivable that community development assoc. (C.D. would revert to emmint domain.

Theres been a big battle down there - The TIF got passed immediately - everyone likes TIF financing. But the State street group held out to have ~~#~~ State street excluded from the redevelopment district, because once it is labeled a redevelopment district, CDA has powers of eminent domain.

this will put a bargaining limit on the M.P.P.

the CDA has extremely broad powers to move forward with redevelopment

FMV will be a single number - we are advised to read in advance that have to do with Wisconsins Eminent Domain Law and definitions of value + interest that are ~~pert~~ applicable

MPP will be a transaction zone in which there will be a central tendancy. (a range of alternatives) It may be possible that the deal won't be cash to the seller (but it probably will) or it could be an assumption of primary financing. We will have to arrive at that pattern from the existing transactions.

(Building is not formally for Sale at this time!)

For the market comparison approach - we must use the Ratcliffian market comparison approach.

2) evaluate the comps. we have chosen using a single linear regression run to identify a common unit of comparison. Chances are the unit will be gross building area or frontage

1) ~~2)~~ Convert the prices to a cash equivalent, time adjusted price.

then regress the time adjusted price against the single factors. Also try the unadjusted price against the common factor - see which gives the best fit (r^2). (45-65%) expected

3) Then set up a grid that defines from 5-7 attributes which we think become submerged when we talk about an average price per sq. ft. of building. Establish a score (1, 3, 5) then establish a weight for the factors. Program called "QP" (in the infirmary) does it automatically - First do it by hand, then use the program. Use program in Report.

4) For the income approach - use both - Overall Rate applied to a normalized income and a discounted cash flow. Use Mr GIB or Val Test or ATV. Notice that the overall rate system applies to net Income on an accrual basis, where discounted cash flow applies to hard dollars when received.

5) Cost approach - because it is not reasonable - write a paragraph as to why the singular requirements + conditions of a reliable cost approach do not fit the current situation and therefore not provided.

* Brant house two was purchased by Doyl Wild
We are expected to do a lot of editing of materials.

The concourse was owned by a ptnship - ptnship was in chapter 11 at the time it came on the market (Spendlater Bldg - was effectively out of mkt - otherwise he would have been one of the players.

North square plaza - demolish everything on the block except 30 on the square + put 2 levels of parking below grade and then allow retail/hotel/office structure to be built on top of parking.

Laws of Eminent Domain -
1) Replace all tenant in equal facilities
2) Pay the spread for 5 yrs of difference in rents
3) Pay all of the moving cost

Most communities try to avoid major eminent domain acquisition of multiple tenant facilites because the relocation problem is a blank check. Not sure when tenants will be done, @ what the total cost will be. - chances are good that it will cost more than the actual building - City would prefer a negotiation with the buyer of the building. *

* If the city purchases a building in a friendly purchase - the city of Madison has taken the view that the laws of eminent domain still apply.

Chief gave the example of the city trying to buy the Rail yard - structured a group of private non-profit citizens to buy it, so the city wouldn't be liable for relocation.

Emmit Donavan has lost a lot of flexibility + finality that it once had.

Most Probable buyer Profile:
1) Grow out of the attributes of the property + the use to which it could be put.
2) Grows out of the pattern of ownership which is appearing contiguous to the property.
3) Grows out of the tenancy of both the subject property and those contiguous to the property.

1) if the building is large enough + suitable for renovation, enjoys tax credits, it would be reasonable to determine that it probably would be bought by a professional developer.
2) A) may see an assemblage going on.
B) or it may be that an assemblage would be desireable (30 on the square falls into that catagory - it's landlock, has no parking, difficult to compete for tenants because of this). Presently in the $8-9 market + significant vacancies, → parking would move it into the $12-14 market with a significant drop in vacancies. That will have a multiplier effect on its value.
C) must look at who the possible players are and what they're purchasing power is.
3) Looks at a building in the way a R/E broker might look at the building. Chief tells the story of a HMO building being occupied ~~by a~~ mostly by the HMO (55%). Normally they would be the most likely purchaser. Can't purchase however because they are federally financed + gov. has to approve all capital expenditures - policy of gov. is to disallow HMO's from becoming landlords & want to remain liquid.

The tenant may not be from the building - may be a tenant that is being dislocated from an adjoining property and wants to maintain the linkages. or has expanded beyond a property. Or a tenant that wants to invest in an area that he is familiar.
In any event - must look at contiguous occupancies + identify a probable buyer or ~~most~~ none of them at all would be interested.

Typically the appraiser must find 2-3 different source of interest in buying the property - (from the immediate area.) and then use investigation or judgement to choose the one that is the most probable. then indicate the critical criteria of that most probable buyer.

Must be careful in specifying the criteria that will bring out the property into the interest of the most probable buyer.
Must also indicate the investment elements that attracted the investor are in fact present at the proposed price.
ie: Major Insurance co -> $10 m minimum + 120,000 sq. ft.

Don't have to be too specific when specifying the MPB.
You can presume that the MPB has the finances to make the acquisition - we're not expected to qualify the MPB.

(Concourse is out of trouble financially - however the last thing that they need is more competition at, since downtown hotels are running at about 56% occupancy.

Price Comparison Methods:
Fundamental premise of the market comparison approach is that there are least adequate substitutes for the subject property.

the appraiser is forced to deal with abstract concept of ① "sameness" + ② "critical difference"

~~For~~ To fall in the set of comparables, there must be a common denominator of "sameness." (ie: 4 bdrm, 1½ baths has sameness as another 4 bdrm 1½ baths) Probably are comparable even though different style.
Most people are more concerned with functionality + location of house.

Appraiser must decide if the differences are of such significance that the price should be adjusted to represent the disutility of difference in layout.

Need to find ways to measure "sameness", to define what is in the set of comparables, and then adjust prices for distinct differences.

The initial decision of sameness is highly subjective

★ Which comps, we use for appraisal is highly subjective! probably have 5 comps when done.

Need to treat differences as objectively as possible, consistency at this point is very important.

In 556 course; process was as follows:
1) Select comps.,
2) adjust for terms of sale if any, and inclusions
3) the time of sale - change in value of $
4) adjust for location
5) quantity of features
6) quality of features
7) Market attitude

the appraiser is reluctant to make any adjustments at all.

One way to avoid subjectivity is to make a decision rule (ie: only accept comps located in Maple Bluff + within 1000 ft of the subject property.) (In 1000 feet in commercial appraisal, there is a hell of a difference between State + Mifflin + Carol)

Maybe 1 block or 2 blocks for our appraisal. But must define a mkt location from which comps can be drawn, tightly enough so that no adjustment is necessary in the majority of cases.

Keep in mind that a comp. must be an acceptable substitute for the subject property. Appraisers sometime assume that the substitutability is there when it isn't.

* Appraiser should keep his area of comps as tight + small as possible.

Quantity has to do with sq ft of building - size of lot, - number of bedrooms. The appraiser would like to identify one or two elements of quantity that we can call a continuous variable from 0 to 100,000 sq. ft. Shore line is a continous variable; frontage is a continuous variable, square ft of land is a continuous variable.

Obviously the price per sq ft will start to decline as it reaches a point where there is no longer the same ~~#~~ increment of attractiveness.

When making comparisons - must deal with relatively small ranges in putting together a set of continous variables.

(ie one or two fireplaces is nice - sixteen is a pain in the ass.)

The same is true of quality - difficult variable because ① - it comes in 2nd in terms of buyer desirability.

Note) Maps + drawings aren't expected in 1st draft of appraisal - just leave page blank + note what it is.

Quality is much more subjective and difficult to detect. Appraiser must be able to explain how he made the call. Avoid if possible - may be a variable such as accessibility - could quantify by counting driveway entrances + # of streets fronting property.

When dealing with quality - make sure you pick an abstract concept such as; accessibility, attractiveness,
* where you can make a subjective call which the majority of persons would agree.

Be carefull not to make a scale of judgement that is so fussy that it becomes difficult to distinguish what the difference between an 8 - 9 is.

* Attitude of the Market place - not relative to the property but rather to the area. It is more of a locational factor.

Traditionally - appraisers have adjusted the price of comps to account for the difference between the property + the subject. One of the problems with that is that appraisers tended to add features that were desired by them, but not expected in the market place. (Ie: 950 sq ft home is penalized because it doesn't have a vestabule)

This process is highly subjective, therefore a number of other methods have been tried - but each has a certain weak points:

1) Regression analysis
2) Market Comp.
3) QP (Quality Point)

1) Regression - expected to identify the weights to be attached to the difference of the element of a set (houses that are comparable to the subject)
formula: $a+bx=y$

by taking the weighted mean price per sq ft of all houses in set would give a means of adjustment. But if we recognize the diminishing return of increasing sq.ft., then you realize that regression is a way of measuring the slope away from the mean (a horizontal line).

The point of regression analysis is to find the slope that produces the smallest residual error.

The computer will find the set of attributes + coefficients which will produce the smallest residual error.

We don't care what the coefficients are; they may/may not represent what consumers think. We simply know that the total estimated price is closer than any other combination of facts. The coefficient are not the adjustments for different attributes. We can only look at the final results of the the regression.

In a step wise regression the first coefficient probably does represent the thinking of the market.

In a single family home, 99% of the time, the first attribute picked will be ~~sto~~ sq ft as a predictor

60-70% of the price is explained by the first attribute.

As soon as you move to the second attribute, you are no longer trying to correlate the attribute to the price, stepwise regression, correlate that to the unexplained residual error.

Regression has been ruled out as a legitimate appraisal technique by the Home Loan Bank + other who feel it violates presumption of the appraisal process;
1) the appraiser sets the weights for adjusting to difference.
2) the appraiser is expected to edit the data base to a specific set. The mkt is not so statistical that you can use a whole set of transaction. Comparability means that there are only 3-5 legitimate substitutes for the subject.

In regression, you are no longer comparing it to a subject property; you are comparing a subject property to the mean of all the properties in the set.

As a result, the distance has destroyed the effectiveness of being able to represent the element of substitutability.
~~that~~
Regression is useful for ~~predicting~~ identifying key variables ($1^{st}+2^{nd}$) variable are very meaningful in ~~prco~~ identifying the production power ~~of~~ as perceived by the consumer.

But you are never sure if the proper variable has been identified or something related to the variable. (ie cedar roofs are related to quality of other appointments of the house.)

Regression has fallen from a method of predicting the total value of the home to a method of identifying the which of the variable provide the most predictive power.

2) Market Comp.

Mkt comp take the view that it doesnt matter how much we know about the differents values to be attached to attributes. We can come up with some crude weight attached to attributes + still come up with a reliable estimate of value as long as our comp. tend to bracket the subject property. If we have 5-6 comps and the subject property is in the middle, ~~the~~ we will have overestimated as much in either direction and the result will be a central tendancy that is fairly close.

this will work will in residential appraising because there are a sufficient # of comps that have similar attributes. Where that opportunity exists, attribute matching is probably the best way of identifying substitability + therfore eligibility as a comp.

3) Quality Point

Recognizes that some markets (commercial properties), the elements of sameness is very hard to find; But in the semi rationality of the market, even if we discover that investors buy gross leasable area, that that mean will be distored by 5-6 other variables

If We can identify a point scale for each of those attributes which represent ~~ob~~ in objective form the differnce in each catagory. We can then solve for what weight the buyer may be placing on the differnces, and come up with a weighted point score for the differnces between the comprable properties.

If we devide the weighted differnce score into the common unit price per sq. ft of GLA, we end up with a price per unit. Our test on a price per point unit in a quality point situation is to first price each of the comps., if we come up with a pricing algorythm that anticipates the price paid for the comps., we then make the assumption that we can apply the same algorythm to the subject property and anticipate what it might sell for if graded for differnces in the same way.

The one thing the QP. system does better than the others, is: 1) make the process of adjustments between comps. most objective.

2) makes the choice of comps. more objective
The failure of con regression is that while the choice of comp is subjective, the choice factor of adjustment for differences is irrelevant to the R/E or the buyers behavior. - Not only is it not objective, but it is irrelevant.

10/1/86 856 Pg 1

To be reviewed while looking at: "Program B"

Pg 24 Feasibility of Alternative Uses (Matrix)
it is necessary for the appraiser to begin with the premise that there is at least 4 alternative courses of action at any time:
1) Continue present use as is.
2) Modify current use so it better fits the current mkt. for that kind of space.
3) change the use
4) Demolish the building + start over with the site.

* Under tax laws, if you restore property under involuntary conversion (fire), you retain the old basis - doesn't increase the R/E tax to the city.

The appraiser picked scenario as the most probable use even though it wasn't the most fitting use

The investment "Power number derived" is not an indication of value - used only for ranking.

* Set up a statement of possibilities for our appraisal in the same way. Potentially the same attributes. First look at the five attributes that properties may have;
1) physical
2) legal
3) Dynamic
4) linkage
5) environmental
then be sure to look at "market demand," then look at what the interest of the community in the property.

Some of these may drop out. - If environmental impact isn't clear, or picked up in the legal special catagory.

Finally look at the collective demand (the community + local citizens) for that kind of property.

* The subject property has just been remodeled, won't need any more fixing up - Demolition cost is 15¢ per cubic ft.

* Don't pursue changing the zoning of the building to remodeling for apts.

The appraiser should only consider what the realistic possibilities are: What is the least you can do with the investment + still make it work?

Don't need to explore each alternative - point out that it is a specialized building that can't have the use changed.

Could change the management of the building!

At this time we are evaluating "Fee Simple title encumbered by its lease + mortgage".

Must indicate that you looked at each of the scenarios and why you dismissed them.

Pg 37-39 Economic concept of Bounded Rationality
(look this over)

Pg 44 Correlation Coefficient and R^2 of Sales Prices
look at: what price is related to.
Ran the total price against the total factors involved.
(ie: first floor frontage)

all of these were run on a simple linear regression,
(total price to total quantity.) Gross building
area became the unit of comparison. Then
the price of each of the comparables was adjusted
down to that base.

Regression analysis can also be used to identify "outlier"
sales - more than 3 std deviations away

Comparables are picked subjectively by some
set of decision rules ie/ 1) everything on the square,
2) Buildings bought for renovation, 3) former retail +
then converted

then come back + say, "I picked these comps. because
I thought they had a lot of sameness in them," now
when you run the regression - you can show
that there is a common denominator running
through them.

If the correlation is only 25%, there may be
one bad comp in there that needs to be rooted
out.

All this test does is show the sameness of the comps.,
we haven't made any adjustments relative to the
subject property.

At this point you are dealing with the average price per square ft of gross building area and that is the "A" in the equation $A+BX=Y$. We need to improve on that to get a weighted average for other attributes which are important to our most probable use.

Our Most probable use has already been determined to be (ie restoration + conversion), so we develope a set of attributes that we think may be relevant to expose differences among the property. The selection of attributes is somewhat subjective.

(Ignore %'s assigned at this point - just pick attributes)

Look for the difference in these attributes ie (high visibility - low visibility)

* It is OK to use the subject property in the comparable. But must use the conditions (weights) at that time of sale. Divide total adjusted price by the total weighted point score

* Any lease on a building in the Madison market goes to the seller benefit.

* Where the weights come from:
Pg 49 1) can work the weights out by hand - start by giving them all equal weights and then calc. the sq std. dev.
2) Re work the problem until you get a small std dev. (eyeball to see which attribute is throwing you off the most and then change weighting)

alternate solution is to use the "Powers Rule from Set theory" - finds the combination of weights that produces the lowest Standard Deviation. that's what the Program "QP" does.

* Chief wants us to do this by hand first!

Pg 47 → Shows the "Q.P." program in action
Again - run iterations until the smallest deviation is produced.

We don't know if thats the best answer because we put cap limit on the weights that could be assigned.

Pg 48 → ~~So Rerate~~ So rerun again.

Use a scale of 1-3-5 because it is more definable in count and the std of difference can be easily interpreted.

If you can make very clear distinctions between catagories - you can use a scale of 1-5.

Pg 51 "Guts of the system" - when net variance of disappears, the skewing has disappeared.

You can't say for sure that the attributes use are predictive of the price, the attribute may be highly correlated with another variable that the market did use.

An ordinal measure is a "5-3-1" it is consistent within the variable, but the "5" has no relevance to the "5" in the next attribute.

This procedure converts an ordinal score to a cardinal net score. We are creating a common denominator for that rules of conversion of 100%.

Were saying these 5 variables all add up to 100% when the appropriate weights are attached.

Statistics will tell you that once you have converted an ordinal score to a cardinal score, the only legitimate statistical technique is to determine the mean and the std. error of the mean. One other statistic you can apply - the std error of the forecast - recognizes that as you move outside the set, the error will be larger than simply measuring the std. dev. within the set.

Pg 50 Final Result:
Low, central, High tendancy -
Round to ~~the~~ two signifigant numbers -
* can round 2% of a number.

Pg 52-54 - Other weighted score high score is only 2.6 x's the low score. ~~It~~ Was arrived at by using the Marshall + Swift expensive + lousy construction.

leave at 5:30 from union for ULI!

Floor plan handed out in class is of how the building used to be!

Major life insurance cos. will no longer lend or acquire buildings in which there are aspestos. (this note came from chiefs story about a present appraisal he is doing)

More + more the appraiser is going to have to be the economic interpreter of the other elements of expertise, (i.e. traffic, civil engineering, mechanical engineering, or chemical engineer to check for contamination) all of the reports will have to be in and the appraiser will have to interpret them.

Fair market appraisal attempts to ignore problem, by hold harmless clauses.

Due diligence is a sliding scale that moves with the level of expertise that is being developed in the market.

Corporate fiduciary - held to a much higher std of trusteeship than the individual fiduciary. You are not expected to pick a winning investment all the time, but you are expected to have a highly systematic selection procedure which you observe. that you do everything to protect the corpus.

Notes apply to pg 113 of "Program B - contemporary income property appraising"

Def: Normalized net income - an accrued accty income. accrual accty. means you will level certain periodic expenses. (ie.. space lease for 5 yrs for $100, but dont pay until 5th yr - report income of $20/yr on an accrual basis.). Likewise expenditure (tenant improvement) are normalized over the period of the lease in accrual accty.

Accountants feel accrual accty is the best measure of economic productivity of the asset. (Match Revenue to Expenses per time period.)

Normalized income is the basis for direct capitalization. Overall Rate = normalized income of comparable sale divide by cash equivalent sales price. This is a market derived overall rate and one basis for direct capitalization.

Alternative way is to construct an overall rate by use of Ellwood or a build up method.

There is some return to a pseudo build up method that looks at a AA bond for the same term as the investment period as representing the term for long term capital + then adding basis pts for lack of liquidity.

The "AA" bond or "B" bond has a risk that not all of your capital will be recovered + therefore its representative of R/E.

There is an increased effort to come up with a Moody's or Standards + Poor's rating on many of the major R/E investment products.

If project is rated, can go to central tendancy of yield in then that rate and adjust for liquidity (or mgmt. problems and come up with a direct cap. rate from the market.

* When you shift to discounted cash flow (research shows that this is the predominant method relied on today), you move to cash acctg. Therefore the normalized or accrual stmt is not the same net income figure.

When you move to DCF, you're back to basic finance, (Receipts + Outlays). Doesn't matter what the acctg classification is as much as the timing of cash flows. Traditionally at the end of the year.

A way to hype the value in an appraisal is to use 6 month period for receipts.

Now we are beginning to look at revenue from all sources to the enterprise, expenses of all forms and driving for net cash distributable.

Ultimately the investor buys cash for distribution.
"People buy stocks primarily on the dividends that are paid, and discount for earnings that are retained", Graham + Dodd

"Cash is King", "Cash going in + Cash coming out" - James A Graaskamp

Cash can be significantly altered by the lease package, nature of deferred expenditures, or nature of expenditures made just prior to the purchase.

Traditional features in leases of 5-10 yrs. ago are disappearing - new types of adjustments, indexes + allocations of risk are creeping in.

Begin with:

Base Rent: (monthly basis) generally done by catagory of size of tenant space. Usually less $ per sq ft as the size of space increases. Different mkts have different adjustments for each floor in height (view of city).

Index to Base Rent: adjust for 1) position in the building, 2) amenities like view, 3) time, stage the increases in rent ~~6 mos for the first~~ 10% in 1 yr., 12% second year.

Problems with formulas: 1) got to be too complex 2) acctg detail + audit procedures got tough, 3) as mkt soften, tenant dares you to try + collect it.

Shift is to a step index, easy + automatic, collect at end of 1st yr. and now applies to the second yr. (ie 1st yr at base, then 2nd yr automatic at 103% of Base.

Rents are moving away from the CPI adjustment as it doesn't accurately reflect increases in expense.

% or Overage Rents - popular in retail leases (ie: 5% of gross sales ~~minus~~ plus the base rent) works well with large retailers good acctg systems in place - not so good for small retailers.

Auditing + right of landlord became too cumbersome for small retailers.

Landlords are moving away from % rents and going for relatively short lease spans and then using a step lease.

Also found that you make more money by throwing out the weak tenant than milking the strong tenant. Rent enhancement comes from short term leases with reviews.

10 yr leases are as long as you'll get ~~note~~ now.

Trend today is toward separation of business for rental of real estate and tenant finishes. Rouse + Hines both have finance cos. which they use to support their own tenants + make loan for tenant improvement. Stabilizes the rent + the debt service on their buildings.

Typically a construction loan carries a balance to finance tenant improvements, but that only finances the first round of improvements.

Traditional method of passing through increased operating cost was through a series of reimbursables. Reimbursable was an escalator of some form - at end of yr., compare actual to previous yr. base costs, and then prorate difference among space in building. This required a lot of acctg + auditing problems.

There was also a time delay with this and in a soft market, not all of it was collectable.

Reimbursables took several forms:
1) Stop clause - landlord pays everything up to

a certain amount + then tenant kicks in. This is a favorite in neighborhood centers where there is a dominant tenant that can drive the stop very high - little guy gets a low stop to compensate.

Sometimes a big tenant will put a cap on the escalator.

More of a move now towards CAM (common area maintenance). Originally began with exterior maintenance charges. Charges were shared by all tenants in occupancy (100 reimbursed to landlord). Payable in advance monthly. 13th month reconcile shortage/overage. There is also an additional charge for the mgmt co to do all the accty. Trend to put everything into CAM now; R/E taxes - air conditioning etc..

Sophisticated tenants put caps on the vacancy rate, where landlord will have to start kicking in.

Rates on the landlords mtg can be lowered by maintaining a large offsetting balance from CAM at landlords bank. Or lower his construction loan rate on the next project.

The ability to do favors for people is the essence of R/E. (leave money in bank 1 as opposed to bank 2).

Read Robert Moses's book "Power Broker"

Interest on reserves - several kinds of reserves - anything financed with IRB, FHA insured or credit enhanced loans, will have a fund for replacement of short lived replacements. Generally be a cap on the reserve. If property is sold, the reserve goes to the new owner. (Care in calculating cash equivalency). Income from reserve is available to the project and goes into the project. Income from reserve is substantial, capped into the income of the project.

2nd kind of reserve - pmnt to Bond trustee for a bond issue secured by a mtg. is a preferred distribution. Should you go into Chapter 11, all distributions to bond trustee are halted while claims are sorted out. Bond trustee will want to continue making pmnts on the bond to bondholders, so tries to anticipate this by creating a cash reserve from initial funding of bond. ($3 m. mortgage to prop. - sell $3.5 m worth of bonds, then take the total interest rate required on $3.5 m and load it against the $3 m. being lent on the mtg.

That $.5 m stays behind with the bond trustee - was never in the project and therefore out of the control of the receivership of the project should it go sour.

Interest on the acct ~~for~~ at the trustee goes to the project and can be swept monthly or quarterly.

This income is bought when the project is bought and must be accounted for by the appraiser.

Gov. Transfer Pmnts. - represent rent subsidy to the project. 236 projects - rent subsidy is differnc between 1% interest + gov whatever rate you pay.

Sec 8 project - differnc between mkt rents and less what tenants can pay with 30% of their income.

SBA grants to fund differnc between what the business can pay + mkt rent for the space.

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UDAG grants - difference between mkt rents & what the tenant can afford - sufficient money is put in escrow to generate income to cover the difference. UDAG grant would then return to the city once the subsidized period passed.

If the developer would have gotten the loan itself, he could have hyped the value of the project!

II Loss of Potential Receipts:
1) Vacancy losses
2) Rent collection loss - highest on the high income properties.
3) Reimbursement of collection losses - landlord can hire any attorney in town.
4) Receivables - loss rent that was being accrued to the tenant.
5) Concessions - if you give them in the 3rd & 4th yr. of the lease - probably hold tenant for a longer period. They also won't show up in the appraisal

Gross Outlays from Operations - used to be organized by variable & fixed expenses, today it is done by the nature of the reimbursement. (See pg 113 for a list!)

Subtract from total cash from operations, the interest part, principle part and capital improvements. This gives net cash distributable before taxes. Add back, transfers from cash reserves from previous periods. then add the net increase in loan balances outstanding (earn out for improved vacancy)

o

this equals cash available for distr. or taxes, less the distributions + taxes equals the net addition to cash reserves.

This was the formula for a cash acctg. model!

In back of this book - read the exhibit from Cushman & Wakefield Appraisal. Notice that the market approach is quoted as a range of values also notice the analysis of the market rent schedule, analysis of leases. They provide both DCF and then as a test, do a direct capitalization of value and then arrive at a value. Good example

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FMV addresses a statutory issue
MPP is for financial issues
Both can coexist with each other. Not designed to replace each other.

The ~~value at~~ issue which defines what value is sought defines which value is required.

Write crisply by using strong introductory line in paragraphs. Telegraph what you will say in the rest of the paragraph.

ie: contemporary appraisal differs from traditional appraisals in 3 regards: 1) Definition of the question underlying the appraisal; 2) Choice of value definition; 3) choice in appraisal methodology.

Bullet as much information as you can!

Several misunderstanding with the appraisal
✱ 1) use the term "Market Value" - not "Fair Mkt Value" use the definition that is in the 8th edition not the "highest price definition"

Be sure to learn the Market Value definition in the 8th edition + be able to recite it with the 6 limitations. (It in the tan outline Book)

2) Be sure to indicate that the Ratcliff + MV. approach will probably produce the same conclusions in a competitive market, where they differ is that contemporary approach doesn't presume a competitive mkt. That is something that must be established by the researcher.

o

If seller is in a monopoly situation, then it will affect the MPP. If there are no options, then you reach the opportunity cost theory of pricing.

Opportunity cost theory of pricing - get at least 50% of what it would cost you to do it with the next best opportunity. If no opportunity then within a dollar of not doing it at all.

Mkt Value always presumes an almost equally acceptable alternative - never gets to monopoly prices.

4. Contemporary appraisal says that competitive conditions is something to be proven by the appraiser. But if competition exists, then a good appraisal will produce the same values for MV + MPP in a competitive mkt.

Do a contemporary appraisal on 14 W Mifflin - In letter of transmittal - indicate to chief if the MPP is in fact MV and if not, what adjustment would we make to arrive at M.V.

Client needs to know if there is a difference in value, so that he knows how far he can push the issue, before he is better off to wait for condemnation or better off selling to someone who is putting together the assemblage at a premium.

Ch. 32 Statutes for Eminent Domain - takes all of the rights. ie: if rents are less than market, you would have a fee encumbered by nonmarket rents which is what would sell in the market.

Some leases state that the tenant will participate in eminent domain awards at a rate that will allow recovery of 10% of tenant improvements for each year remaining on the lease

Eminent domain award is for the fall fee because everyone gets extinguished. Relocation benefits + awards are seperate from the R/E award.

turn to:
Income approach - pg 151 of "Program B"

set up each item in a pro forma stmt - each item must have a footnote explaining where that information came from and how it was treated. (Footnote should be in bullet form)
Must develope these sections:
1) Revenue
2) Expense
3) Finance PKg
4) Method of converting residual income to a resale price

this appraisal was done for a S+L doing the credit enhancement on the tax exempt. that brings it under R41B.
When doing R41B, you dont assume an inflation rate, you have to prove one. Put the data for supporting the rate of inflation in the appendix. Use "paired" comparisons - (same apartment different years). Base the future on the past - what else could you use as indication.

The expenses are done the same way - itemized, footnoted and substantiated.

Should use a third exhibit to tie the expenses + revenues togeather. Then work down to distributable cash.

Pg 160 + 161 Table "M" from American council of Life Insurance Co. Report quarterly on terms of financing provided by those companies. this is used by appraisers to determine what would have been available in the terms of interest rate, constants, debt coverage ratios, for property classes or type of property. commercial, retail industrial, etc. then it is broken down by size within class.

the company is based in Washington D.C.
$35 charge to join - 10 pg qtrly report.

Net income from operations is modified until you get to distributable cash before taxes. The charges against NOI will be any cash hits for commission, tenant improvements and deferred maintance.

capital asset is anything that extends the useful life of a property.

Most property mgrs try to bury as much in maintenance acct as possible.

The appraiser should at least be aware of when the operating stmts are being loaded with capital improvements in the expense catagory.

Before a property goes on the market
1) landlord probably postpones certain expenditures to make operating ratio look better.
2) postpone rental increases so that they don't have to pay the limited ptnrs what the asset was worth.

appraiser may have to read the general ledger to get a flavor for what is going into the various accts. When you have an owner occuppied building, it is very important because, the owner will allocate things to the building which should be allocated to the business. (ie: Bank guards at a bank)

Distributable cash is adjusted downward for any capital expenditure that need to be made, that might otherwise be handle by a reserve or an accrual adjustment.

ie deferred capital. S/B a deferred accrual item in the year of repair.

The pluses for distributable cash are:
1) funds released from reserves that are released for improvements
3)

If you assume that all revenues come in at the end of the period, you also assume that all expenditures occur at the beginning of the period. It is unclear when to time the reimbursement for capital expenditures.

2) Release of additional escrow or loan funds. (release more money as tenant improvements are in and occupied) (or achieved certain occupancy levels)

If there are non recurring inflows - the lender will disregard those for purposes of making his loan + establish a debt cover ratio or break even pt for his loan losses.

The debt coverage ratio is more common. May take 1st yr of normal operations - establish amount of debt they can carry given available terms. Having established how much you can borrow, the cash available to the equity position less earnings to be retained is capitalized at a cash on cash rate.

Cash on cash rate is steadily moving up as people are becoming less certain about the inflation factor in the resale price. Probably between 9-10½% right now base - higher for riskier properties.

People are buying 10¼, 10½ presently.

Cash on cash rate is more easily ascertainable than the overall rate is in any situation.

(1) this was one way of arriving at value

(2) 2nd way to arrive at the value is to apply an equity discount rate to all of the distributable $'s. and to the estimated reversion price of the property. there are several methods of determining what the discount rate might be when applied to nonleveraged R/E.

A) Relate to the Frank Russell Index (FRI) represents over 1000 nonleveraged properties held by pension funds. Report quarterly the mean cash on cash dividend and the increment in value of any. The content of the Russell index is published by NACREF (national council of R/E fiduciaries). NACREF + ULI are allied and run out of the same office.

3) third method of capitalizing on a nonleveraged property that is appearing more frequently in appraisals is the to look at the upper end of the "B" bond rates and load it for lack of liquidity. "B" bond rate says the investor has some probability of losing his capital. "B" bonds are said to be analogous to R/E in that you may not get all your capital back. 75-125 basis pts for lack of liquidity.

4 fourth method is simply to ask the institutional investor to find out what the threashold rate is. This is the the minimum rate of return that you would hope to make. Currently the threashold seems to be around 13% on the equity.

another alternative would be to look at the return on the hybrid trusts - (presently 10 1/2 mtg trust)

The appropriate method as to whether to use an all equity rate or a split rate is going to reflect the most probable buyer. If dealing with an institutional grade property - may be an all equity basis, chances of all cash for appraisal building are remote.

Seller can't ~~often~~ finance a rehab building as the buyer would be left without equity to pledge to secure a renovation loan.

We haven't discussed yet, the capitalization rate "from the market" yet. From the market presumes you can look at several income properties and discover; A) the price they sold for, B) the net income of the properties on the date of sale. Both premises are rediculous. 1st of all, the sale price on most significant income properties is an engineered price. Buyer/seller allocate the purchase price to ~~whole~~ whatever assets will provide the fastest write off. ~~for~~

Another ploy by corporation who lost money on their headquarters and want to hide it will do the following: Sell the building at a nominal price (fake) and then lease it back at a rate over the market rate and charge off the excess over the term of the lease. As a result, the price reported to market doesn't show the loss, but the cash equivalent price would.

Another trick is when you buy out another company, load most of the $ into the inventory + shortlived assets. In order to write them off as quickly as possible and understate the price of R/E.

Problem 1 It is unlikely that the appraiser will get the real story to reveal the truth about the price of a property.

Problem 2 What was the income that the buyer had in mind when he bought it?

Was it the income at time of acquisition or ~~do~~ is it the anticipated income!

Do we know if the seller was knowlegable as to the rent he should have been charging. Are present rents at market rates.

Gross Rent Multiplier is also suspect! When you do use a GRM, you must be able to show that thats how buyers think. Purchase of duplex would be influenced by GRM. If it is a stronger indicator, then use it.

Can't use is the overall rate derived from the traditional net income divided by sales price, even after sales price is adjusted for cash equivalency.

It is not unusual today for the buyer and seller to negotiate on the cap rate rather than the price. Having arrived at a cap rate then set up the price based on the average net income for the last 2-3 years.

Many institutional buyers require 3 yrs of financial stmts on an existing building. This is just backward of what is presumed by the direct/overall cap rate from mkt.

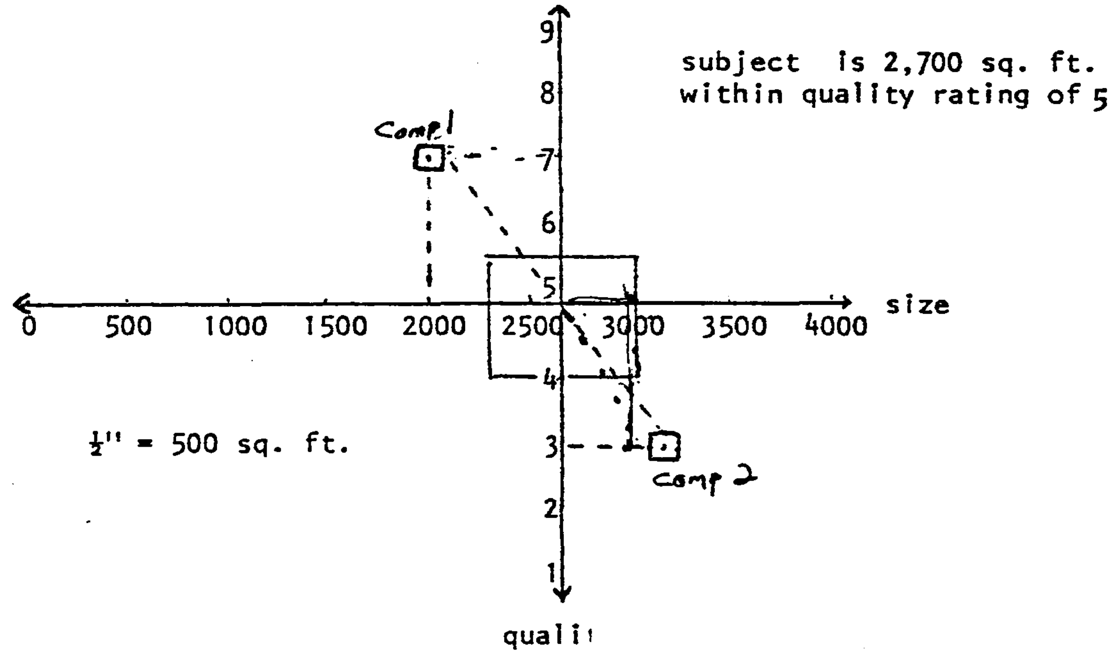
Strong seller would want to look at next years income.

Tax assessors + mtg lenders are the most flagrant abusers of using a mkt cap rate. By choosing the comps selectively, you can create a cap rate.

EXHIBIT 11

Demonstration of Euclidian Distance For Selection of Best Comparable

Comparable 1 = 2,000 sq. ft. and quality 7 sold for \$80,000
Comparable 2 = 3,000 sq. ft. and quality 3 sold for \$110,000
Adjustment for difference in size is \$20 per sq. ft.
Adjustment for difference in quality is 2% of sales price per point.



Comp. 1 Euclidian distance dollars $= [(2{,}700-2{,}000)\ \$20]^2 + [(5-7).02 \times \overset{\text{comp \#1}}{80{,}000}]^2$
$= 14{,}000^2 + 3200^2$ or $196{,}000{,}000 + 10{,}240{,}000$
$= \sqrt{206{,}240{,}000}$
$= 14{,}361$

Comp. 2 Euclidian distance in dollars $= [(2{,}700-3{,}000)\ \$20]^2 + [(5-3).02 \times \overset{\text{comp \#2}}{110{,}000}]^2$
$= 300 \times 20$ or $6000^2 + 4400^2$
$= 36{,}000{,}000 + 19{,}360{,}000 = \sqrt{55{,}360{,}000} = 7440$

Therefore, Comparable 2 is most comparable to the subject property, because hypotenuse $\sqrt{55{,}360{,}000}$ is shorter than hypotenuse $\sqrt{206{,}240{,}000}$

fixtures to be included in appraisal of the building - ceiling, lighting, finished walls, floors provided by landlord

soils are irrelevant in an existing building - geology is what counts. Capitol hill is a glacial moraine. recent building built found nothing but fine sand. Ideal conditions for high rise. Soils are low corrosive. Soil surface maps are irrelevant to existing areas.

Executive Management - Gordy Rice + trust owns 30 on the square, Woolworth, Manchester - trust was broken up. Gordy Rice still owns Woolworth.

* How much of the block is going to be redeveloped - (the issue,

assume all leases will be rolled over at the existing rates.

An appraisal must be a stand alone document today - can't just reference other documents.

Introduction to MKT Comp Model: Models on mkt will;
1) allow adjustments between comps in an objective fash
2) select comps in an objective fashion

mkt comp: specifically allow:
1) selection of comps is selection is objective
2) adjustment between comps is subjective.

Euclidean distance is a way of ranking the sameness (see handout 1 page)

Problem is to put the two sides of the triangle on a common denominator - that denominator will be dollars.

comp #2 is the best comp; - comps are ranked to find which ones are more like.

If you had 200 properties in data base + you wanted the best 5 - repeat process + find the 5 shortest hypothesis. (This can be based on more than 2 variables)

comparability of coefficient - sq rt of Σ of squares - the smaller the coefficient - the more comparable it is to the subject prop.

Eucledian distance allows the selection of a set from a data base most like the subject property.

Once a set has been selected and the set "brackets" the subject property - when you start adjusting toward the comparable from the subject, if you bracket the subject well enough, you overreach equally and the mean doesn't shift much at all. ie (you could have used $24/□ft instead of 20 and still ended ~~up~~ up with the same comps. Should have an equal # of comps on each side of the bracket.

This process creates a soft set; (in regression, if there are 50 sales - all 50 would be included in final determination of mean value) allows us to set up certain preferred criteria for the set, but if a comp. falls out in only one attribute, this method can use that comp..

If you want to create a hard set - create an unreasonable adjustment. ie ($100,000 per front foot on a lake - Knocks nonlake properties out.

2nd step involves what the Home Loan Bank says the market comparison should be all about.

if the appraiser should control whats in or out of the set.

2) appraiser should control the amount of the adjustment.

Notice in the QP approach, the appraiser sets the score, (5, 3, 1) based on property, the weight attached to adjustments are set by factor theory. In market comp., the appraiser sets the weights or $ for the differences.

In assessment, there are only about 10 factors that account for a real difference in value. People think there is about 50 different factors.

One of the items that really market a house is the living room - layout is very important - size proportion, can't be located so that front door opens immediately into it.

Kitchen is very sensitive area - size + type + work area + eating space

In WIS - tax assessment information is private - only aggregate land + total value is public knowledge

MKt comp - enter the selection factor weights to make the comps jump out of the data base as comparables. then use the adjustment factor entered to distinguish between them

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5:20 - Memorial Union Weds

Be in council meeting by 9:00

Ask for the bus tour when we register

appraisal issues:

New tax law is irrelevant to our appraisal:
1) consensus is, change in tax law should have depressed R/E prices, it has not occurred because interest rate has dropped 300-400 basis pts, + prices didn't go anywhere - so real estate took a hit in price deflation - because it didn't go up when interest rate fell. So whatever impact the tax law has had - has already been washed through the market.

vacancies in markets has alot more to do with controlling values of price.

Forget the tax law for the appraisal!

The appraisal building has already been renovated - there are no further Investment tax credit.

The long term trend of what will happen on the block is clearly not influenced by the tax law - it may be influenced by what the public is willing to subsidize, or other decisions as to what is going on, on the North side of the square, the ownership patterns of the block. etc.
* This should be mentioned in the "dynamic" ~~select~~ section of the report

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appraisal is in state of transition. Now appraiser must be concerned with the dynamics of demand.

Chief believes that the partnership format will continue. Will see General Ptnship used much more extensively - particularly on renovation projects, because gen. ptnship is not limited by the "at Risk rule, where limited ptnships are; Gen. Ptnship can put in mixed kinds of financing (equity + debt) where a limited ptnr can't.

* Building is a General Ptnship set up 14 W Mifflin

Leases will roll at current rate - this is a setback as those rates were set 2-3 yrs ago. Make this assumption in the letter of transmittal

* Letters indicate that the building is a "chilled water, low pressure boiler system - distribution center on each floor - some don't work well etc - that's good enough at this pt. - Indicate that current owners have attempted to upgrade the system. (that will be good enough)

Chief is concerned about question "How much money does it cost to build a hotel" - that's not our concern - can't use the land residual value when you're going into new construction. Land residual model is too volatile to assumptions made for the construction - Have to look at land prices on the square - and there ain't many. those that are there are irrelevant - Chief will try to get a value from the Manchester building '84 financing - probably won't exceed $40/□ft.

o

chief – "You're not going to tear the building down to get to the land value"! anybody that tears it down, decides they want to use the land, is going to pay for the building as they find it, tenants + all + presume that they can create excess value for it otherwise they won't tear it down. So we don't have to go through a whole sequence of "what will I build on the land!"

Kitty Rankins history of the build is in packet handed out today – originally 2 - 2 story bldg on front part of the lot + in remodeling made it three stories + put addition on the back.

Robert Kohls Report on Doyl Weill

He needs the convention center right there – or our addition would make no sense. Anywhere else – forget it. – makes mention to 4 month convention season – don't want to walk. 300+ rooms – his average cost per room is low now – so he can cut his price to stay alive. Doesn't want to raise ove. cost per unit w/o being able to raise revenue

Currently 55% occupancy for hotels in this town
He feels addition was a little ahead of himself

Other hotels have higher vacancies than his.

Conversion of subject site to Hotel rooms would be at \$60-70/□ ft, fixtures would be an additional 25% of cost.

15¢ per cubic foot for cost of demolition - assuming no asbestos removal

cost is $100,000 per room to build a new hotel room
top of the line rooms - $105-110 / per night

Rule of thumb - Room rate is 1% of cost of room
that includes everything - but note - he wouldn't have to
build common areas. Problem with site - inside
lot - not much window area - unless an atrium.
Model - figured on additional 200 rooms at 350 sq ft/room.

Model in lobby has no facts or figures behind it.

Model includes 3 levels of parking underneath subject
cost $9000 / stall - 100 stalls per level
lease about 125 of them for $70-75 per stall/month

His Restaurant (present) $5000-8000 per day gross
expenses 75% total
35% food
40% labor

Appraiser would only care what the rent on the restaurant
space would be: anything other is a return to mgmt.
always convert public spaces to rental value -
currently $10 a sq ft triple net
$15-18 for landlord to put in decor

Doyle didn't feel a need to purchase air rights!
"He didn't feel there were any"

He bought the Brauthaus just so he would have
a vested interest in what happens to the redevelopment
of the block - they will have to deal with him
one way or another.

 10-20-86

That's all that was available to buy. If they ever want to expand or do something with Woolworths, they will have to buy his site too. Which means he would be able to trade for additional parking. He is in an ideal situation, his parking ramp comes right down that side, if anyone wanted to redevelope the Woolworth block + Branthaus block, ~~if~~ it would be cheapest for them to have entry to their parking through his gate + just give him parking.

Notice the contract to buy the Branthaus is a nonrecourse - nickel down, dollar when you catch me - not a big committment - as long as he can cover the rent - it is a no charge option.

Difference between class A-B-C office space

Class A

1) ~~[illegible]~~ newer - built within last 20 yrs.
2) integrated parking ~~system~~ system (its own)
3) functional + good appearing lobby + elevator system
4) Image as its own ie First WIS.

Class B

1) Older stace - more than 20 yrs ago + refurbished
2) doesn't have complete parking support.
3)

Class C

1) No parking
2) Doesnt have an adequate lobby + elevator service
3) Public spaces are dated (corridors + bathrooms)
(30 on the square) is "C"

No present plans to build the convention center - planned on building it on portion of city hall & Tenney bldg site. They are now trying to rationalize a larger center. ~~The south side of the square seems like a likely site~~ - we can assume it won't go on the MATC site. Can't assume it will be built on the south side. It may not be built at all.

TIF money is considered "spent" when it is granted to the CDA for the purpose. CDA can use more than 5 yrs to spend the money.

Only special assessment is the ongoing one for maintenance of the mall + the one inherited from original construction of the mall.

* Rent that we have are considered current.

Clif: Sale prices on the square have been stagnant - would expect them to go up, but they haven't.

Assume that city utilities are present & adequate

Atrium was added in 1981-82

No matter who builds on the site (hotel rooms) we are not concerned with the cost of those rooms, just the cost of the vacant land. We don't have to hypothesis the cost of constructing a hotel -

assume $40 □ ft. less the cost of demolition

Use the leases for the building to determine what the retail rents are ~~could~~ going for

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MKt Comp: ~~factors~~

Original regression was ruled out because;*
1) appraiser wasn't selecting specific comps. - he related subject property to the mean of a set.

2) appraiser has no control over adjustments made between subject property + comps.

3) ~~While~~ ~~when~~ ~~regr~~ Reliability of regression fall off drastically when applied to a property outside of set. The degree of error will be multiplied by a degree of about three.

If you took regression to courtroom - lawyer would ask 4 fundamental assumptions of regression:
1) each variable is independent of the others. (variables are usually highly related)
2) Residual error is randomly distributed. (In R/E, best clue as to what is happening, is shown by plotting the error to find pattern of skewed because of curvilinear relationship.
3) All relationship are linear - each incremental unit increases at same rate.
4) Size of sample calls for at least 30 more observations than the number of attributes that you want to examine.

Advantages or what Regression can do:
1) arrive at a general range of prices at the very center of a set of comparables

MKT Comp: 1) matches attributes to create a small subset which brackets the subject property: means that we are dealing with a "chord on the curve" (curve of regression) so that many of the adjustments can be linear, because they are over a short distance.

② choice of attributes by which you define the set and adjust among the set is under the control of the appraiser.

③ adjustment factor for attribute is within the control of the appraiser and if ~~it~~ there is still a curvilinear effect for the attribute (interval between attributes are not equal), we can adjust the nominal quantity to equivalency.

④ Mkt comp is stable despite errors in the adjustment factors entered. It chooses the same comps, if subject property is properly bracketed, no matter what ~~size of an~~ amount is entered for the adjustment.

Use of mkt comp. will make the selection of comparables objective rather than subjective.
\+
By using the adjustment system, ~~the~~ it will be more comprehensive the differences in property, at a lower cost, than a traditional Fannie May Form. (More reliable at a lower cost)

Mkt comp will be used commercially to value properties and to determine "market rents" for space. This will then drive the income models.

Legislation coming out now will require:
1) lending institution to purchase their own appraisal of the property and not accept one from borrower

2) That it will be done to federal std. (R-41-C)

3) Loan officer + appraiser can be sued directly by the fed gov. when there is evidence of gross

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negligence or fraud.

4) agencies to establish a list of acceptable appraisers + blacklist some appraisers from any work for any agency.

after arriving at MPP - two remaining steps
1) any external circumstances that will affect
- change in conditions since comp sales
- change in assumptions for income stream
- ie: interest rate change
+ tax law changes
+ prevelance of seller financing on comps.

seller financing will have been address in adjusted comp price - must decide if properties move w/o seller financing - buyers are better off with 3rd party financing - must show why seller financing isnt the predominant form of financing

* convention center
* city dreams of redevelopment
* does speculation happen
* assemblage interest - is it significant
* anything that needs to be considered.

can have an adjustment or a range around the MPP
* just recognize the issues!

Test the MPP for its reasonableness & plausibility.
the tests are a reflection of method of valuation
- if market valuation then test by financial returns
- what kind of unit price do I end up with - $/□ft.

Look for pattens - look for consistency in patterns.

If do an income approach - must look at the degree of assumptions that your relying on. - must underscore the chance for risk.

Talk on a Pretax basis - break out present value of property & allocate how much is due to

1) income under contract
2) PV of income due to releasing of space
3) PV of reduction of debt

4) Present value of the equity if resell at same purchase price
5) Present value of Gain or loss on Resale from purchase price

May want to apply different Risk rates levels to the various components.

English traddition is to apply take each lease separately - American method lumps it all together.

This provides a method of measuring the objectivity of income

Test of resale assumption - given 10th yr income - can the buyer finance that at todays standards - what kind of cash on cash will return will the buyer get.

Can't assume that Resale pricing will be different

Make your money when you buy - not when you sell

Significant upside on the property will be in the leasehold interest

as leased - encumbered by present leases - if all leases were at current rate what would the property be worth - difference between the two is the leasehold interest.

Asset enhancement would be to buy out the leasehold interest

American tradition has been parsimonious towards leasehold interest

Be sure to report the difference in value of property

R/E tax appeals - based on total interest in the property - landlord + leasehold interest - the same applies to eminent domain. Must divide the interest between two parties (if in the contract)

Include a lease expiration table - can be a bonus or a negative influence on future rents.

If you know lease expirations of comps. - you can compute the

Value as leases vs available for lease
be careful in defining the purpose ~~of~~ on the appraisal.

Look at proportion of Net Income that can be allocated to the various sources - basic rents, overages, amortization of costs etc...
- should reallocate purchase price among the various sources - bldg, tenant finishes

ie: source of revenue - sale of electricity to tenants what % of the income is assured - (tenants needs electricity) Reveals the vulnerability of income + to reveal that R/E is a combination of business.

interest rate would be higher on business start ups

Purchase price must be allocated among (1) Land (2) Bldg (3) fixtures (4) Intangibles (* license + business)

State final value conclusion - always must be qualified as to;

1) Date of valuation

2) Terms of sale under central tendancy

FMV - always cash to seller

MPP - typical to assignment

3) Transaction zone - be aware that zone need not be a std. deviation - central tendancy doesn't have to be in center of range.

4) certification of value

A) No interest in property

B) fee isn't contingent

C) saw subject property

D) visited my comps.

E) Signed separately from Report

(can use the one out of book)

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10-25-85 - Test-midterm

Once a conclusion has been reached for Most probable Price - two remaining steps:

1) indicate any external factors that would affect value of property. Most will have to do with changes in conditions since the comparables were transacted or conditions that would affect the projections for income simulation. - Indicate what adjustment is appropriate. * interest rate changes * tax law chances + prevelance of seller financing.

must decide if there is a market if seller doesn't provide financing or whether there is further need for financing

Under new tax law, buyer's are better off with institutional financing. If comps had seller financing, must explain why that isn't common today.

Other externalities
1) Convention center - north/south
2) Concourse - Redevelopment.

~~this brings about the~~ As a result of adjustment - arrive at the most probable price.

2) Test most probable price for reasonablness + plausibility. the test will reflect the primary method of valuation. If used market approach the test with financial tests. What does the overall rate look like - is it consistent with investors expectations.
Hotels - price per room
Houses - price per room
Office - price per sq ft.

Look at the patterns for reasonableness.

If you had used an income approach - must look at to what degree are you dependant on the assumptions for values. Dilmores article about unbundling the yield into 7 components gets at this problem.

For appraisals - you want to talk on a pre tax basis.

So allocate value of property among 5 sources of values.

1) How much of present value is income under present contract (1A) How much depends on value of leases rolling over at anticipated rate
2) How much to the reduction in debt. (PV of debt reduction over forecast period)
3) Balance of value is then attributable to resale.
   A) What's the value of the equity is I resell at the same purchase price.
   B) What is the P.V. of GAIN (LOSS) relative to original purchase price.

May apply different discount factors to each element to reflect the risk. An effective compromise is to assume that NOI of yr. "1" is under contract and all changes after that are a matter of assumption

The English tradition is: value each lease seperately + apply different discount rates to different leases with different expiration dates or different tenant quality. Building value is the sum of each lease

American tradition: aggregate all leases together + then take the value of income.

offsetting errors support the American view.

English pick up differences in discount rates.

If you have 5 shopping centers, and all have "GRANT" store, there is significant exposure to health of store.

Another test of DCF approach - Gilmore - measure net annual rate of change implied by Gross rent figure expense figure & net income figure for first & last year of ~~the~~ your forecast. Look at expected changes between yr. 1 & 10 and decide if it is reasonable.

Resale Price assumption is also a critical assumption. Test of resale price has to be, given the 11th yr income or 10th, that the buyer could finance it and go in on a reasonable basis. What kind of mtg would it take - cash on cash for needed equity.

Must assume that investments in R/E are reasonably std. Can't assume there will always be a bigger fool.

Prudent investors make their money when they "buy," not when they sell.

If you use the income approach & have a resale price - see if it makes sense to the next buyer. If you use mkt. comparison - ask what your resale price must be to meet your return on investment criteria.

Upside on a property will be in the proportion to value that is the leasehold (tenants) interest. Often see two values - 1) as leased value
2) available for lease value

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As leased - encumbered by existing leases. - Not the full mkt value of the property - mkt value of encumbered leases

available for lease - if you could lease it all today at current rates.

Difference between two #'s is the leasehold interest of the tenant.

Most opportunity for asset enhancement depends on how quickly those leases expire. or asset mgr. can encourage tenants to leave by buying them out. - This is the real upside potential in a property.

American tradition has been very passive about leasehold values. "Pan American example" tore up own leases to come back at current mkt rate to kick up the value of the property. Take a capital gain or increase and refinance airline with the proceeds, - pay for it by increased rent.

Real Estate tax appeals are always based on the "available for lease value" - fact that you have a bad tenant doesn't matter to assessor - he taxes all of the interests in the property.

This is same for eminent domain - "as available for lease" - landlord has problem of allocating the proceeds. Tenants should protect their leases and the tenant improvements with a clause to right of proceeds upon eminent domain.

Lease expiration data should be included in every appraisal. If property is at market or more - it is a ticking time bomb.

If your in a strong mkt. + mkt value of rent are higher than the contract rent - expiration date is important to realize upside of the property.

If you know lease expiration for comps. you can understand why building sold for different cap rates.

In defining the purpose of the appraisal define which number your interested in - chief tells the Warehouse + Sears story.

Mkt. value is what you want if your paying taxes on property. (As leased)

Look at proportion of Net Income that can be contributed to the various elements. How much of return comes from different sources - Basic rent; overages, sale of services, amortization of some costs.

Total purchase price of a building is not R/E alone - ~~of~~ price is a refund to seller the cost of tenant improvements, leasing commissions; part of income is therefore the amortization of earlier costs. (Seller got to expense them, buyer will amortize them.)

Income in shopping center could be sale of electricity to tenants. Retail the electricity to tenants at outside rates. Landlord can evict a tenant for non-pmt of electric bill - electric co. can't. - additional leverage on tenant! - How much did you pay (cost of property) for the right to sell electricity.

Service income is another profit center that is purchased. Maid; car, etc... Must figure out how much you would lose by not providing the service.

R/E is a combination of business. Game of the past has been to apply the low cap rates of R/E to income from other business that would have had higher cap rate if purchased separately.

(R/E Gets longer + cheaper money than a traditional business start up would) - useful to obscure the income when it come to borrowing, + the income attributable to different sources.

Fiduciary should want to see the different sources of income and apply appropriate rate to each

Once a value has been arrived at that tests out, you state final value conclusion: must always qualify it as to:

1) Date of valuation - protects against unknown future events to property
* 2) Terms of Sale under which central tendency is so. Under FMV - always is cash to the seller. Under MPP it will be what ever terms discussed in the report.
3) Transaction zone is not the same thing as a standard deviation. Low side may be lower than the high side. MPP may be the high side. Don't have to be in the center of the range.
4) Certification of value - can be an affidavit
   1) No interest in property now or in future
   2) fee isn't contingent on conclusion.
   3) Saw the subject property
   4) Visited the comps.

Sign the letter of transmittal + certification of value. If report is mailed - you are guilty of fraud through mail - if hiring appraiser - require that he mail the ~~letter~~ appraisal

Cost approach - classic nomative process - grew out of life insurance industry's mtg. lending of 1930's + 1940's wanted to be sure borrower had real money ahead of their loan. Preferred to have contractors bids + break-downs Used masonry bid as key bids because it was a constant percentage of project, - used to estimate total cost.

Services - each have own ~~capabilities~~ strengths
1) Marshall + Swift
2) Beck
3) Means
4) Dow system

In looking at a cost approach - it is critical to define which cost you are talking about.

1) Reproduction Cost - photo reproduction of bldg as you see it. (classic stone cuttings + material) relevant for replacement cost insurance for landmark buildings.

2) Replacement cost - more common - produce same amount of space and functional utility, using the most current building methods. (A) - Costs will vary by region because of local building standards.

(B) ~~So~~ 2nd problem - determing what function you want it to serve. Is clear span important? this requirement will change from year to year. (ie: light warehouse s/b 5 pallets high - now industry doesn't store as much on site and height isn't being used.) (or but height can be subdivided into 2 floors).

(C) Floor load capacity

(D) #. of docks that ~~store~~ serve the space. (too many are disfunctional) appraiser must decide what are they building today that matches the function of old building. The new building (hypothetical) becomes the basis for building costs. He then compares that to what is on the site. Your not comparing to a real building - the new building may have characteristic that are not present in appraised building. Even though the hypothetical building is better than subject property (new building methods + materials) you charge it with functional obsolence relative to the subject property which doesn't have that feature. (Reverse Logic)

Other element is "Wear + Tear".
1) curable
2) incurable

appraiser establish credibility by doing detail on property. (takes a number of facts to make a good lie stick) cost approach lends itself to detail.

3) Burnable or insurable value - what insurance company's talk about in cost to replace. Subtract from total cost to replace those items that wouldn't be affected by a holocost. ie.. wiring to site, sewer + water interceptor, pavement etc.. also engineering drawing costs and other soft costs of construction pts of new mtg.. included would be construction mgmt to repair.

4) Feasability Budget done by a cost service
ie: Marshall + Swift.
Marshall + Stevens have 3 levels of detail.
1) average cost to construct / unit
all inclusive cost ie: $27.40 / ft for reside
* includes <u>all</u> soft costs

2) unit in place cost - partially disaggregated.
"a square foot of wall" - includes all components that make up the wall.
3) estimating approach - take a quantity approach - ie: yds of concrete - board feet of lumber.
~~Isn't related to local area labor ra~~

Ave. cost to construct isn't related to local area conditions and costs for material + lumber

Unit in place + estimating method - don't include soft costs - add these back.

Marshall + Stevens, ~~and~~ Beck have developed local indices for labor + material rates.

The cost services also have ranges of quality for building stds.

"Means" is more popular for site development costs.
Marshall + ~~Swift~~ Stevens + Beck is popular for buildings.

"Means" has no loading in so ave. or unit cost to account for soft costs.

Simplest method, used primarily for insurance purposes is the DOW system. Unit in place + Quantity methods are loaded for the "burnable" factor. (Doesn't include soft costs.)

Cost systems work best with buildings that are new + free of functional obsolescence. Appraiser that omit the approach must state "building no longer represents highest + best use, current bldg technology + therefore obsolescence makes the cost approach unreliable.

Regulatory rules still require three approaches to value. If appropriate - must explain why an approach isn't used.

Land must be appraised as if vacant, presumption that R/E is the sum of the land + depreciated value of building. Presumption is that land never depreciates! That is doubtful - a new house in poor neighborhood is instantly depreciated. Land itself has a negative value.

Economic obsolecence is sometimes referred to as "locational obsolence". However chief defines economic obsolence as when you have a new buggy whip factory with no demand for buggy whips. Characteristic of the economic environment, Locational obsolence reflects that some sites have a negative value which erodes the value of physical improvement.

Cost approach is based on "Nobody will pay more than the cost to replace" + detail itself creates an aura of credibility. There is no evidence to back up that investors follow this logic.

Estimating depreciation is highly subjective - no way to measure it except by using the other approaches. ie (Sentry building in Stevens Point)

Recently became apparent to FDIC + FHLIC
that the appraisal product

R41B developed from initial flaws found in appraisals.
R41C replaces, and with fewer ambiguities. - control
S+L lending. Had never established what constitutes
a good appraisal. Results were that value could
be defined any way appraiser wanted. - as long
as consistent in hold harmless clauses and in report.

Appraiser was only liable to individual that hired him.
So no way for FDIC or FHLI to get back at the appraiser
+ lending officer had an appraisal in the file so he was
free of liability.

R41C makes lending officer equally responsible ~~of~~ as the
appraiser in securing a proper appraisal. He has
corporate fiduciary responsibility.

Regardless of privity of contract, if appraiser deals with
federal agency, he will be personally acctable to
agency or designed.

To make liability stick, there must be a defined standard,
hence R41C.

R41C is important to us because of the letter of engagement
should state that appraisal should meet R41C Stds.
and we should know if it does. So it important for
other transactions other than loans.

Requirements of R41C that are not necessary for the situation
should be waived and appropiately noted in the report.

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First thing that should be noted from R41C handout is:

Mgnt. Policy:

1) investment board must have specific written stmt of investment policy. Most pension funds didn't have a stmt to define how to procure appraisal.

Members of the appraisal profession can be marked as having ~~completed~~ continued their education. Without "star," don't meet the criteria. Society is trying to police membership into continued education. - cost of yanking license is $25,000 - so tough to do. Refusal lists can now be published for gov. work

Appraisal Mgnt.

burden of appraisal is upon mgnt - not the appraiser to obtain all the necessary information & fullfill Report requirements.

Information used must be current - within 6 mo. of appraisal.

Reflect right of security must be defined and stated seperately.

Contain info suffient to tell how much to lend.

Officers of institutions are now personally accountable to the shareholders and can be sued.

Must project future market conditions not just the status quo. Need for demographic forecasts.

Style of report is in an acceptable format

Specifically defined the value of "Market Value" defines what properties can be used as comparable (can't use land contracts & unless equalized)

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Sales of property that weren't on the market long enough would be knocked out.

Sales price unaffected by special or creative financing - must investigate all sales - must be cash to the seller.

Must be use all recognized appraisal methods.

Must pay special attention to older sales - defined by ~~no~~ dates (specific) Designed to avoid kiting of values between related parties.

contain info on absortion rates, mkt conditions in the future for development projects. Occupancy rates, etc.

Information to support all estimates and reasonableness of such.

Must show you considered all alternatives

Institution must take steps to assure validity of appraisal before disbursement of funds.

Whenever change of conditions occurs after a loan is made, the lender will take any appropriate step to protect investment.

1) Recertify value of property or reappraise

2) feasibility study + appraisal must concurr on the results. If you use someone elses input - you must concur w/conclusio

Report a single mkt value of property not a sum of individual price if sold seperately.

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Valuation should reflect all appropriate discount

Properties shall reflect absorbtion rate for properties under construction - (include lease up costs)

Appraisal must recognize value of fractional interest
Can't ~~only~~ add up seperate interest - must recognize non real estate components

You can now do a good job + charge client appropriate for it!

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Arthur Anderson - appraisal candidates in Chicago

Most significant influence on appraisal reform other than congress is Financial Accty Std Board. Proceeding ~~into~~ in 2 areas:

1) discussion paper that all business accty should be on an accrual basis - devastating to R/E (appraiser will have to learn accty.)
2) FASB acceptance of Town? + Market accty standards developed in Europe. Different countries had different methods of valuation; so they finally got togeather and developed a method of standarzation

Produced a series of document that address a series of appraisal problems:
1) which definition in value is appropriate to which use.
2) which type of properties will be appraised by which metho.
3) when values shall be allocated between fixed + personal assets and when not.

British tradition is to look at hotel values as a going concern + include all of the assets. (Hotel won't work w/o any factor

In U.S. you would expect to allocate out the value.

Standard are addressing the problem of procurement - to what degree does the client control the product in order that it be suitable for the purpose intended.

British system is under study by FASB in antipaction of adoption to the U.S. . Ultimately accty profession will define parameters in which appraisal will operate.

Some groups feel that they can control the product through a std. letter of engagement. (NACREF + PREA)

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Letter of engagement will be concerned with -
1) what kind of search of the mkt.
2) who will do the work
3) what methods will they follow

Letters of engagement will be concerned w/ 4 issues:
1) What is the question for which the appraisal is required, What constraints does that impose on the product? (What assets + interest, what def of value)

2) What protocols are to be observed in the collection of data so as to maintain independance of appraiser and reduce probability of systematic bias.

~~First~~ Problems with a generalist (appraiser) doing all the work
1) what value is, given encumbrances on property.
-presumption is to read all the leases. + create an abstract saying he has done so. - Many firms have leases on floppy disks - can the appraiser accept this information for appraisal. - Is the appraiser an auditor of internal data, or is he limited to external conditions. Cost/Benefit analysis ~~can~~ should be looked at in deciding to read all the leases. - there is no established procedure for sampling leases, thats what the protocols are.

Information explosion - data on floppies - has created a problem for the appraiser - what information is he allowed to accept w/o challange and in what form can he accept it.

2) Sequencing of the appraisal - it makes more sense that the appraiser should be the interpreter of the of the physical, legal facts of property.
Civil engineer should sign off on structure

all of the reports would be available for the appraiser as to constraints on his determination.

3) Who's property mgmt program controls making forecasts for the property for next 10 yrs.
(Chief tells story about Kleunker shopping center that has potential by kicking out tenants + expanding)
Problem is; what does the appraiser follow for projection. Does he appraise as he sees it or as the given forecast for the property. Where does the right to forecast end. - To what degree does the appraiser establish his own forecast + to what degree does he use the forecast given him by mgmt.

British treat it follows: 4 catagories of appraisal assign.
1) Investment properties - 80% rented or more
2) Development properties - under construction - less than 80% rented
3) Speculative properties for which only ideas exist nonproductive
4) Properties for use - British say they should be valued at cost to replace less depreciation.
~~British~~ Not bought for speculation or investment - it will be consumed by the enterprise.

* Investment properties are valued by D.C.F.
* Development properties are valued at cost in place or market, whichever is less.
* Speculative properties go on and stay on the books at cost or market if market is less - No adjusting of price until it is actually sold.

Protocols are: how do we catagorize property we are appraising and what are the legitimate methods of valuation.

American method attempts to determine what can you sell it for at the date of the appraisal as it stands. - It may include a speculative upside, but it would be discounted sharply. This is what R4IC aims at.

Other element of protocols is related to the degree to which appraiser can accept data w/o validation from fellow professionals. - Is it cost effective to visit all comps if he has all the relevant data from another appraiser. Some appraiser don't certify that they saw all the comps.

If there is a time sharing slystem of comps. - must the appraiser tour each one - it depends on what your doing. If it is a quarterly evaluation - probably not! If your going into court - make sure you know everything there is to know. As different levels of responsibility emerge - it need to be spelled out in the letter of engagement. So It is a sliding standard! Overall the flexibility in reporting is increasing. But the objective is more information so that the readers can go through the report and arrive at the same conclusion or if reader alters an assumption, should be able to determine the consequences of that.

"Barnard report" itemizes a number of deficiencies in appraisal Pg 45 of handout - National regulation.
Much of the appraisal problem is inherent in the regulators rather than the appraisers.

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List of requirements for all gov. agencies involved in securing or guaranteeing various pools of capital.

1) any loan will require an independent appraisal by appraiser hired + supervised by lender himself.

~~2~~ Lender will pay the appraiser when he delivers the report. Chief says this was the number #1 element distorting the appraiser view point.

2) Federal gov. will have direct sanctions against any appraiser serving a federally regulated institution. Allow gov. to sue for damages on the civil side + fraud from the criminal side.

3) Gov. will also have sanctions against loan officers who accept an appraisal that doesn't meet minimum standards.

4) Minimum federal stds will be developed by joint committee representing financial industry + pension industry. In absence of this, R41C will control

5) Agencies will pool their data.

1) transaction data that is screened + qualified

2) both sellers + buyers must file details with IRS. all lenders that are gov. supervised must also pool data. Pool will be accessible to anyone in gov network + the employed appraiser.

3) Which appraisers are qualified by past performance by the lenders or the auditors. Can create a black list. Presently the IRS has such a list and there hasn't been any challenge to it. any appraiser that missed market by 200% was blacklisted.

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Federal constraints then go further in stating that;
1) appraisal is a dynamic field and that certified appraisers must provide certified evidence of continued education. (technique + methodology) Examinations will not be required - not just attendance at meeting. If any of this is passed into legislation remains to be seen.

All of this reflects that congress has lost patience with appraisers + the lending industry.

Last item of Protocol:
control of unwitting bias in a series of appraisal for a number of reasons;
1) amount of the fee + $ volume of business with the client. (No interest in property + fee isnt contingent)
A) Possible that appraisal firm can't get more than 10% of revenue from any one client
B) No appraiser can appraise the same property for more than 3 yrs in a row.
C) Unethical for new appraiser to read the previous appraisal report.

3RD element of a letter of engagement has to do with the product.
1) what is it that the client wants: ie pension fund would want a series of #'s that would allow you to be analytical about property.
A) MKT Value as encumbered
B) leasehold interest.
C) Report on the mgmt of the property.

Product should expand the array of services that can be delivered as a result of the appraisal process. appraisers opinion is important - should be expanded

D) Business relationship between appraiser and his client.

1) his fees + how he will be paid. - upon delivery he must be paid. If they don't like the report, they can sue him but can't hold his fee.
2) who do you get for the appraisal - if you pay top rates - you get to name who will do the report. (ie: ask for Pattie Luttgin
3) schedules - when do you start, when do I finish - where are there interim check points.
4) Who provides the data and where will they provide it - when will be provided - S/B just one person who deals with getting info for appraiser.
5) Traditional business problems of insurance, degree of latitude in discussion of the assignment with outsiders.

Points of todays discussion:
1) Protocols of information processing
2) Kinds of products + service you are expected to offer
3) Newly emerging area of ethics of communication.
A) when is data truly independent data.
B) when do you qualify information.

Land Valuation - vacant land should be subdivided into 3 catagories:
1) agricultural
2) developmental
3) wilderness or open land.

Agricultural appraisal is well developed - textbook authority is Robert Sutter of Purdue. Agric. land illustrates the principle of balance seldom seen in urban appraisal. Critical in agric. land - stanchions in barn must meet with grazing land available - a taking of ten acres affect the balance between barn + land. Other considerations are soil types + slopes to certain crop mixture - if not proper - entire property sells at a discount. Water to support land - is it sufficient.

Developmental land - large acreage - this kind of land has only recently gotten attention because of the Irving case. Classic case of litigation growing out of fact that there was no appraisal doctrine on how to handle developmental land.

Irving case involved 120 000 acres - 25% of Orange county, South of Los Angeles - put togeother in late 1800's by ~~Senior~~ Irving.

Irving places closest friends on various political boards that affected the public infrastructure of southern Calif. Within 15-20 yrs. - public infrastructure became supportable for Irving ranch. As land was acquired at low prices - land could substain itself indefinately - provided for slow patient approach. When Irving died he left all the stock to the Irving Co. in a trust - trust was represented by seven major political figures. Trust proceed to develope the land - Policy was to create large parcels of land that represented a neighborhood unit.

Then selling the tract to a single developer who then determined how to develope + to what market group. Irving Trust got sales proceeds + % of the developer sales of house + lot. They started by selling to upper income groups first. Then sold down from that.

Irving daughter Joan was pissed that she didn't have control of the company. She went to congress + argued that it was unfair under the Estate tax law to allow major corps. to immunize control of corp., by putting all the voting stock in hands of trustee., and then allow a small block of control stock to remain with the family. (as did the Fords, + Rockefellers)

1st victory was that in order to retain tax exempt status you must pay out at least 5% of asset values each year. - therefore needed an appraised value of assets.

2nd - strategy of immunizing large capital wealth + maintaining control in the hands of a few was itself undesirable public policy. Those types of foundations were given 10 yrs to dispose of their control interest.

Must decide on a price for the land and who can buy it. Initial premise was that life insurance co's would be logical buyer ~~that~~ Prudential + New England Life looked at it but State of N.Y. insurance commission looked at it + ruled that any piece of land with absorbtion longer than 5 yrs was a speculative investment + therefore unsuitable for life Insurance co. doing business in N.Y.

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Irvine foundation wanted to meet objective of law but sidestep the objective of getting Irvine ranch back in public control.

Brooks Harvey Corp (division of Morgan Stanley) representing Mobile Oil offered $200,000 for property. But there was a conflict of interest, Joan then blocked it with a suit. Suit brought in W. Virginia.

Then problem is how to value land of 110,000 acres expected to take 25-40 yrs. for completion.

Brooks Harvey presented their 1st appraisal - they used Gran + Dod security analysis + said the Irvine Co. stock is what is being sold. It would be valued as a security (preference for distributable earnings. (2 x's dividend + 1/3 earnings) Value shows on basis on Gran + Dod. - but hadn't been paying dividends at all. In creating downtown Irvine, (Newport center was created - largest + best commercial properties) built on a land leasehold so Irvine continued to own land with step leases. Method of valuation didn't anticipate the step up of the leases.

Appraisal #2

appraise all of the different assets in the Irvine ranch. Broke them into small groups + then assumed that all of them could be sold instantly. $1.5 billion value. State attorney general then invoked the statue saying that if the trustees sold the land for less than it was worth, the trustees were personally liable for difference.

APPRAISAL #3

Attorney general then called for an appraisal - appraiser came up with a # of each class of acreage. - establish a price for each class - $880 million value. A collection of land opportunities that will sell at an average price per acre over 5 yrs.

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Appraisal #4

what we have is a series of developmental opportunities in which costs are uncertain, therefore we want to do a density model. Chief + Givins were hired to build a density model with a central tendancy of value. This would addressed the fact that whether the mgmt would be able to get the master plan through the costal commissions. Rethink which lands would be developed + which lands preserved. TO what degree are parcels developable + what infrastructure would be available. Established a range of price, capital costs + absorbtion rates, tied to a demographic model to the area.

Produce 500 computer runs, take central tendancy and if sale price is within 1 STD deviation, price is reasonable.

Judge said - what your trying to do is predict behavior - lets have a bidding contest with all cash price. Bidding process then became the appraisal process. Ultimately 3 players.

1) Syndicate by the Taubman group - included Town hei
2) Cadillac Fairview representing Canadian money
3) Mobile oil.

Top 3 bids taken + then allowed to refine bid. Mobile Oil went from $300,000 to 400,000

Third bid then allowed - found out finance committee for mobile oil had authorized $480,000,000 - Taubman group bid $481 m.; mobile authority couldn't meet it. Cadillac Fairview came in at $465 m.

Taubman group got the project. They then leveraged out of the buyout. Asset values allowed 100% financing.

R/E had matured during this time of fighting.

Question still remains if it was Market Value as value was financed 100% on value of assets acquired.

Lesson to be learned from this:
1) Development land values are set partly by absorbtion rate potentials and of course allowed density.
2) What financing is available - since life insurance companies weren't allowed to play. So must find a way of avoiding the tag of development land. - Fragment the enterprise.

Once the bidding was complete at $481m., the mgmt of Irvine co. said that value depends on achieving densities we have negotiated with all the regulatory authorities that control land development. If we weren't here, you would have to renegotiate again because they wouldn't trust the new mgmt. This is a significant part of the value of the enterprise.

To what degree is value of development land inherent in the mgmt and to what degree is it inherent in the effective demand.

Most appraisers recognize this problem by using high discount rate on the property. Land development w/o debt typically carries a rate of 35%, with debt - 75% to 100% annual rate of return on equity.

Which land should be discounted as development land & which land should be discounted as agriculture land.

Developmental value for large acreages will be on a density model basis in the future. Begin with a simplistic model and move forward with different density factors. The discount rate then becomes the basic cost of capital plus the 3RD power root of the variance. Then do a new P.V. of property with that cap rate.

General Electric was the first to complete a density model, who developed it for new town ~~building~~ building.

Tyron Oliver - land brokers in Philli - had Harvard build a density model for them 15 yrs ago.

HUD developed a density model - Edward Ram - picked up on Chiefs + Gruns model.
1) federal program for new towns died.
2) Ed. RAM died + program was put in LIMBO.

Wilderness or Open land - several alternative method:
1) partial sales are made on opportunity basis to the buyer. Classic MPP situation. (power lines going around land)
2) simplistic category value. ie: digitized air photos of types of land (marsh, timber, scrub, and add up acres of each. MKt price for each type.

Shoreline creates additional values, so there is a loading for feet of shoreline.

3) amount of site improvements in place - roads, golf course etc on a depreciated cost basis.

Scale of attributes comes into play - 1 acre of trees isnt worth anything as wilderness or recreation. Wilderness is a minimum of 25,000 acres in a single piece. Increase % in value as size increases.

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4) Look at what comps are selling for with similar use characteristic. ie (Bird refuge land) -must match ecological system + environmental characteristics -

Chief tells the story about S/E quadrant of FLA being reacquired by gov. to protect the shrimp industry. Gov is using MKt comp to value land reacquired. ~~in~~ + attributes used are elevation, % of water, vegetation etc.. They are now tearing up both highways + rebuilding them on an elevated system of pilings

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Dr. David Scripner - University of Connecticut - now at Landauer
Senior Vice president - in charge of recruitment.
Consulting work. Seven offices - largest in NY.

1) Value all of Rouse Properties
2) EtNA holdings - analyze the value - 4 x's ago.
3) Olympia New York.

1) Looking for bright people
2) Graduate degrees
3) 1-2 yrs. experience
4) Good writing + technical (Lotus) skill
5) some math aptitude
6) wing it - good interpersonal skills
7) attitude - receive information objectively as it comes in.
8) Pay is less than you think your worth.
9) Task orientated work ethic - Know when to stop/cut details

Consulting - buy + dispose of properties for pension funds leasing. Most of work is consultant.

Offices in Chicago
Houston
San Jose + 30 miles away in Los Angeles
West Palm Beach
Atlanta
New York

Lowell Hall rest of this week + next week in room 605

Real Estate tax assessment + Valuation techniques

tax assessor has a problem in establish a value for each parcel in the district, which is a pseudo market value with certain constraints on it.

Constraints:

1) only a limited amount of time to value a property. needs a cost effective technique
2) he is judged on consistency far more than accuracy. - primary defense is that everyone was treated the same. Differences are treated in the same way. Consistency more than accuracy.

3) Objectivity rather than subjectivity - wants a method for mass appraisal because it is the most defensible in terms of potential distortion + graft. System should be designed so that it can be replicated and validated

4) Simple enough so that it can be explained to the tax payer. R/E tax is the only tax that tax payer doesn't compute himself. Tax itself is computed by a seperate budgeting board that determines how many $'s will be raised from R/E assessment base and what mill rate will be applied.

5) always a suspicion that someone else is treated more favorably than he did.

6) next problem is that it is multi-districted. creates 2 problems in equalization
   1) Not everyone is assessed in the same year. 5 year spread: assessments always lag presumed mkt value of the property. Therefore the equalization rate was developed within the community.

2) many taxing districts cover more than 1 assessment district (ie school board of Madison covers Shorewood + maple bluff), so there is a state board of equalization which analyzes the ratio of assessed value to sales in each community. Take total assessed value and divide by 70% (assumed ratio) to come up with adjusted equalized value for the community in the aggregate. That base is used against other adjusted basis to determine what share of the school board tax needs to be allocated to that particular community.

Equalization ratio gets screwed up by how well the state board screens the sale. Review maple bluff assessment form to see how elimination of one sale can drop the equalization rate

So there is high sensitivity ~~to~~ and misunderstanding about
1) how the total $'s to be collected from assessment base is to be determined (this is the numerator)
2) what the aggregate value is for the district - (this is the denominator)

Skill level applied to assessment is a function of the pay for the position - so skill is relatively low.

Total system doesn't lend itself to standardization + sense of control that characterizes federal income system.

Where the assessors became best at being right is California which has a superior system - they kept the assessments moving with the market. Then Proposition 13 - 2% limit purchase price is the assessment

Best Journal of Appraisal is still the Quarterly Tax assessment Journal -

Appraiser function as appraiser / consultant.

1) Define the issue for the appraisal assignment

* Issue for assessment is to identify the productivity directly assignable to land + the improvements.

used to be measured by how much grain farm land could produce - how much wood - cattle capacity.

In an Urban enviroment - what you paid for property was a measure of the P.V. of future benefit. Market Value was assumed to be the basis for assessment.

Key concept is segregation of benefits so that you value only the contribution of land + building. This is getting hard to determine in going concerns. Chief tells about Boca Raton club example.

Hotels are a good example of multiple business contained in a single operation.

Value is what it will sell for to another user, it doesn't matter what you paid for it. What would ~~it~~ sell for to another user. ie (Sentry insurance building in Steven Point) Building was worth $42 m, but state board of equalization had set it at $90 m., as a result, aggregate assessed value of Stevens Point was higher than should be + therefore city was paying a higher portion of county school taxes than they thought they should be. so city sued the state and won.

Productivity of the real estate need not be reflected in the rental value, the test of value is in the market value (what you paid for it). Productivity can be in corporate image. ie (Lever brothers building) So fun to be in building that absention dropped + productivity increased.

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Supreme ct. of N.Y. rules that what a company pays for a building sets the assessed value. (Segrams Ru

architects disliked this ruling - discouraged urban aesthetics

Most of the other states are less severe than this ruling and they tend to have a double std.

Relation to single family homes where it is easy to trace the value through the volume of sales, and sales are current. They all seem to be following the Segrams rule - what you paid is what you got.

When you move to commercial property and agricultural properties, we have a real problem. In agricultural properties, once you factor out other elements of produc (labor capital, mgmt.) there is no income to the lan If you assess the land at what it would sell to a devel at, an acres worth 4,000 an acre, with no attempt to adjus for the absorbtion rate, the result is punitive to farms. So you have to make an exception - value placed on "use value" for ~~desired~~ socially desired uses. It should be assessed on current use and not the best use or what it will sell for at some future tim

2nd problem is that jobs are highly desireable, jobs depend on being competitive for industry. If you a high silotte in the wrong township - you get assesse at full value. Why go to WIS., when you can go to Tennessee + make a deal with the assessor.

State says, "we can't have all the industry bleeding away so we will do all industrial appraisals out of a state office - we will base our assessment on a cost to replace less depreciation. American appraisal Beck system is used - guaranteed to produce a low ~~number~~.

Special catagories are being developed in which the perspective of the values shifts.
Wet lands + agricultural lands valued on a "use basis"
Industrial basis valued on a cost to replace less depreciation basis.
Everyone else on a market basis.

The result is a shift in the incidence of taxation away from industrial to commercial + residential. But residential people vote, so they lean harder on shopping centers + hotels. An inherent bias is built into the appraisal process.

Assessor isn't given much time or money to come up with a number - the numbers that are too high, he gets challenged on. Appraiser must understand the logic of the state in which he is operating, what is the value they are trying to create.

TAXPAYER First thing he must establish is that the (taxpayer) ~~is~~
1) assessed value is off by more than 10% of true market value or you can't appeal the assessment.

2) must prove that you are being treated unequally relative to similiar properties.

If you can prove both, then you can go into the valuation ~~proceedings~~ procedure. Procedure is difficult because it is a fair market value - cash to the seller measure and can only relate to benefits of land ~~and~~ and building. Must be able to demonstrate that you have correctly factored out the value attributable to personal property, mgmt., franchises and goodwill.

Trying to explain all this to the assessor + the appeals board is difficult - the distrust you and have or interest in keeping the mill rate down.

Once able to establish what productivity is in land + blding: then tax system has the same hierarchy of preference that the contemporary appraisal does.

1) can you support value from market data
2) failing that, can the ~~more~~ decision process be simulated from the would be buyer.
3) more must be able to communicate the method of appraisal to a ~~fair~~ simple minded board.

Back door approach is easy to explain - DCF is difficult to explain.

In tax assessment process - if unsatisfied with board of assessors or board of appeals - you have a number of avenues of appeal. Assessors are slowly cutting off the avenues of appeal. In WIS, there are three methods for appealing.

1) appeal in certiori - circuit judge will review the record made at the appeal board - (most common method) - not a full trial - he may read the appraisal - only permitted to search for an illegal methodology, either omission or comission. He can remand the conclusion back to the appeal board for reconsideration. The only way to get information into the appeal board record is to read it into record. Presumption is that neither judge nor board will read the appraisal.

2) Trial de Novo - both sides come to Dane County court for trial - both sides go through a full court procedure presenting evidence before a judge + jury. Judy + jury set the value.

3) Appeal directly to State dept of revenue who had an appeal commission that they felt would set presedence for other cases.

chief tells example of the Xerox machine case.
(personal property tax on leased equipment)

assessors got beaten by the appeal board so often that they were able to get legislation that ~~allowed~~ ~~prope~~ said a property could not be brought before the appeal board unless it was less than $1 m. in value.

The appeal process begins to control the kind of product that the appraiser will provide. Have to assume that appraisal will go to appeals - Don't get a second chance unless you go "De Novo" and thats expensive.

Precedence becomes the overriding control on what the assessor may/may not do. In WIS, one other issue, the assessor have decided that it is too expensive to investigate sales with creative financing.
While law says FMV, they are studying value of sales that are not adjusted for noncash transactions. Finally got court to rule that ~~asso~~ assessor, appraiser and equalization board must recognize cash equivalency.

The more commercial properties use pass through for taxes, the less likely that over assessments will have the necessary constituents to fight the unfairness.

The impact of the federal income tax change will be felt primarily at the local R/E tax level. The mill rate can be expected to double over next five to ten yrs.

There is likely to be a restructuring of R/E tax system. In Minnesota they value everyone at market value. But the equalization ratio that is applied differs by class. Single family is assessed at 50% of MV.; Tenant occupied at 90%; Mult family tenant at 100%; commercial at 150%; Mining and forestry at 200%

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Most states will likely come up with a formula which will shift tax burden to high silhouette immovable R/E investment (big industry) in favor of resident owners.

Exam Returned

I 1) institutional economics vs traditional economics

1) Mr. Witts list - Readings

2) FMV vs MPP

1) provid a full def of FMV

2) only in perfect market - all 6 conditions met MPP = FMV

3) Truth Chance + beauty vs Inference, Simulation Normative

Chance - chance for error

Order - Simulation - presumed rational process

Normative - beauty - chosen because they're elegant

4) Best use vs Most probable use

Best use - publ/private intent

MPU - public + private use

5) Rent Roll over vs Revenue

Rent roll is contract rent

6) Cash Equalency

Theory - take PV of difference between pmts due + what they should have been at current mkt interest rates

Practice - Most people don't recognize this - they say actual discount is about ½ of total cash equalency.

7) Mkt comp vs Mulvar -

Mkt Comp - attribute matching where adjustments are provided by the appraiser + is designed to choose a specific # of comps.

Mul Var is a regression system in which total data set is determined by geographic area - adjustments are coefficients.

II Problem solving approach of Ackoff + Hayes to Ratgram

Ratcliffia process - define the issue & determine the perspective of the problem - defining the resource

Resolve - where do I want to go - how to get there

Recognition that answer will be stated as a central tendency in the transaction zone.
Risk can be recognized by discount rates applied to revenues

III Block out tabs of Income statement Normalized stmt.
must organize revenues by character
expenses by pass throughts
Net Income
less Interest + principle
= Cash throw off
- Subtract capital for tenant improvement
= Distributable cash (Basis for DCF)

IV Ratgran - identify ratcliffian approach
purpose of appraisal is to come up with a measure of value that relevant to the issue
Then define the issue. Contemporary identifies issue first + then determine what value is relevant.
Substance is more important than reconciliation of 3 appro

V Discuss mkt Value article
concerned with cash to seller
partial interests
what is a reasonable period of time

Real estate Tax Assessment:
for assessment - requires careful assessment as to what is the contribution of land + building to the total basis for assessment.

Basic issues in litigation
~~A)~~ assessment of subsidized housing.
221D4 - 7½% loan package for 90% of the nominal value of R/E. Intended for people dislocated as a result of urban renewal or highway programs. Became part of program called the "tandem plan" in which loan was purchased at par by Ginnie May + sold at a discount to the market. Developer of project enjoyed a low rate 7½% - 40yr. loan. FHA process was to establish a "fair market rent" for the project. FMR was at upper end of market in order to justify construction at current costs. The assessors used construction cost as indicative of the assessed value even though more money was spent on the project because the loan constant was lower than conventional mtg, also because construction costs were designed to meet FHA multifamily housing std which are typically in excess of conventional building.
Any project built as FHA project had to be built according to the Davis-Bacon act - the wages paid had to meet local standard + certain % of workers had to go to minority contractors. Both of these elements probably inflated costs by 10% or more. Before closing on FHA loan - had to go through an intensive audit to validate costs.
Soft costs - highly stylized - architecture + inspection - letter of credits - additional 15% of project costs - allowed whether or not you spent them. Became basis of cost factor to which loan value is applied.

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To build FHA project resulted in 10-20% more than conventional project. Assesors use cost as basis for assessment.

The only way to fight this assessment: cost may represent the total interest in the property, but the public has a possessory interest for the term of the project - FHA sets rules for occupancy + rents of the project. Must file appropriate reports to continue qualification. Public ~~[illegible]~~ interest should not be taxed.

2) Section 8 ~~was primary new~~ - FHA would establish fair market rent. Legislators wanted it to be a "real fair market rent derived from the market place. Because of length of time to construct projects - FMV didn't have any relationship as to what it would cost to build, so FHA established artificial FMR - set high enough so project was affordable - then they supplied all the rent in excess of 30% of occupant income. Artificial amount used to justify feasibility of the project + amount of the loan. Sec 8 rents are usually at least 15% above market rents. Assessors used the FMR x's their gross rent multiplier to establish value - there is a full pass through of taxes to ~~government~~ next yrs rent (gov. paid) Cities gouged the gov. for R/E taxes. Sec 8 owners can no longer put through an increase in R/E taxes unless they can show that they have made a bona fide ~~[illegible]~~ appeal + lost the case.

Arguments that have prevailed:

1) Income approach should be the predominant approach for the valuation of the sale to another user. To do that, you need Real Market Rents - not what FHA says they are - Real Operating Expenses - take out some of things FHA requires + arrive at new NOI + discount to arrive at value of project

if it was subject to FHA.
1) Real Rents
2) Real Expenses
3) Real Financing

1) In Wisconsin, courts have ruled that you can't compare a Sec 8 project to a conventional project.
2) Cost approach isn't relevant.
3) Preferred method is DCF method.
4) Don't have a decision on possessory interest yet.

II All of the financing is done by Industrial tax exempt bonds or other forms of grants (UDAG)
1) ~~Dollar~~ cost to build project will be the increment in tax basis - once it is up + running, market value is something different. What starts out to be a tax increment of $25 m ends up to a market value of $15 m. if the advantage of financing is removed.
As a result: as a condition of getting community support in form of tax exempt financing or UDAG's or anything else., the developer must concede to a predetermined assessed value, (typically negotiated + falls between real cost of the project and the usable value of the project)

III Development of stylized methodologies for one of a kind resources (ie: how do you appraise a railroad, how much value is assignable to the land. land takes on value of land immediately adjacent to it. Take total value of R.R. book value of assets + other such value + then break it down + assign it to the various components.

Second example is a power generating plant. State has formulas where value is allocated among assets. Chief tells story about Castle Rock power - power companies selling electricity to larger power companies.

Up until 1978, there was no market sale of hydro electric plants on which to base value. Then when energy crisis hit, gov passed law that compelled power companies to purchase all excess power from hydro electric plants at highest marginal cost of production.

Value the system - water, dykes, land around, then take total value of system + allocate it to the components based on the original proportion to total cost.

If you have to appraise the dam, if the dam was the sole source of power, you would have to buy the generating equipment + therefore would be eligible for the government sponsored 5% money. Then the cheap money must be included in the valuation of the power generating plant.

Appraiser has to begin researching the property to determine what are the economics involved for this kind of resource.

Another example is the value of the land in ~~Michigan~~ Minnesota that US Steel owns with taconite on it.

1) Must establish value of delivered taconite in Cleveland
2) Then work out cost of shipment
3) Rate of production of taconite
4) absorption rate for taconite.

As price of Taconite changes in Cleveland, so does the assessment of the land in Minnesota. Price is also tied to price of rich iron ore from Brazil.

Driving force of the appraisal model then becomes an economic model or legislation that control the service.

Another area of tax appeal that is occurring more frequently is in the area of syndications. Assessor is taking the position that the value of partial interest is indicative of the total interest. ie (50% interest for \$1m = 100% for \$2m) This gives no recognition to different preferred positions of the partners, or that original developer retains many of the profit centers in mgmt of center. 50% is probably closer to 35% of the real value of the project.

For partnerships where a partner buys the tax shelter (depreciation), is the tax shelter a R/E interest or not. Some jurisdiction will allow this kind of valuation to stand because the investors are from out of town.

Many people confuse the R/E tax with the income tax. The more income you have, the less likely you are to win your appeal.

Allocation between tangible + intangible property: intangible property is goodwill, mgmt finesse, franchise name value etc. Any one of the franchises can take the name away - this would damage the value of the property. How do you assign a value to what the intangible asset does for the property. Assessor would like all the intangible value wrapped into the property. The appraiser will have to extrapolate the value - must find an old franchise that is sold without the franchise name attached. This would give the value of franchise name.

Future appreciation in R/E will come from reduction in expenses. R/E taxes offer the easiest way to cut costs!

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R41C - will be controlling on appraisal reports in the coming yr. - should know rather well! (on test)

For final exam - be aware of recomendations Barnard Report (Summaryed on pg 13)

Hand in comments + original copy + final copy of appraisal.
1 copy will be sufficient.

Balance of Semester:
1) Appraisal in litigation
2) Appraisal as a profession + opportunities + economics of.

Litigation best defined by emminent domain issues, damages, breach of contract, R/E tax appeals, IRS tax appeals, division of partnership, dislocation of general ptnrs possible negligence of those who led to collapse of R/E project.

Emmint domain: special attributes of appraisal for litigation (E/D) in particular;
1) there is a specific concept of damage that will apply + therefore a specific of which rights are legitimately considered for appraisal. Each state has own rules relating to condemnation, whats included;
(ie to run a road through middle of farm + now farmer has to travel a mile to other field - no compensation. ~~to~~ extra travel is not considered a compensable damage in appraisal process in WIS.
(clear example of Ratcliff doctrine - figure out the problem before you jump in)

2). The report format has to be consistent with court room strategy. ie (if in R/E tax appeal case - not permitted to submit report - ~~can~~ put everything into record orally)
If I can present models - then reports can reference other materials. Give just enough information so

that they can follow your logic, but hold each information to surprise the cross examiner.
Dig some pits for the opposition to stumble into in the cross examination

3) What is the definition of value that is relevant to the case?

4) Whose definition is going to be required for the interest taken. chief uses example of nation in Alaska - 250,000 acres of goose breeding land ~~that~~ for some select land that may/may not have oil on it. Fed gov says that because they don't have right of (E/D) they are willing to pay for preservation value of goose lands. The indians only own the surface rights to the land. Therefore they have substance rights for the land. Gov wants to buy fee simple to surface rights + then give indians a license to the subsistence rights. The only thing they lost is the right to include 1 fed federal gov controls of a conservation area. That value must be defined for the trade with the fed gov for other lands.

5) Must understand that in any litigation work, there is a highly stylized review process. The review appraiser may be more concerned with uniformity than with applicability. Imagine how state highway dept felt the first time they saw QP method

6) In most litigation, the E/E is only a component of the total indemnity issue. There is more than just the property taken - there is consequential damages. there a cost to a person to find another place to locate a business. (Business lost) Eminent Domain doesn't recognize this. The government has their own method to compute damages. ~~to~~ Determination of damages isn't the appraisers function. He should only be looking for cost to the seller. Other elements may be compensated from other procedures

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Emint Domain process in WIS (chap 32):

1) delineation of which public + private agencies have the power of E/D. (Railroads, public utilities gov. etc.) there are different level of ranking of power. Railroads are equal to those of cities. Madison couldn't condemn rail corridor from the railroad Beltline through arboretum - state + university were equal.

2) Power can come + go, particularily in federal jurisdiction. Most gov. agencies have latent power of E/D, but power isn't operational until: 1) actual purchase has been funded and agencies have received cabinet level approval for the takings. Why important: 1) Most of sales that are relevant in E/D situation may have been to gov. - courts have said sales aren't legitimate comps. to be used by the appraiser. Must research sales carefully to determine if the power of E/D was operational at that time, because acquisition was not funded or not approved by cabinet officer. If these two things weren't in place - it was a legitimate negotiated sale. Can be then used as a comp even though it was a purchase by the condemnor. Various communities have policies about E/D - they rarely use E/D. Consequential costs of the taking are generally more expensive than the taking itself. ~~If~~ appraiser can show that any purchase that gov makes is an acceptable comp because gov never exercises E/D. It must be more than just a right - must be a real factor in sale

3) General Procedure:

A) condemnor to go into county court in which property is located and file a description of the proposed taking. (identify by survey land taken - land affected, owners of record + information about public purpose for which it is taken)

B) They are petitioning the equity court at this point to do the following -

i) they want a hearing to show public purpose is a legitimate ~~purpose~~ use for E/D. Used to be a presumption that public would have to have access it. Eventually public purpose has become very broad. It is extremely difficult to defeat "public purpose" question in court.

ii) TO appoint a commission for the valuation of property taken. may be a pemanent or special commission.
1) must be a landowner + resident of the community to be on the board. Usually staffed with retired business people. When sets up a commission, date is also set for valuation hearing (semi formal presentation by each party.) For more complex property - each side can have two appraisal presented. Chief commissioner will determine what is admissible, what procedures will be followed - more lax than a courtroom as to what is admissible
Commission has typically 60 days (set by judge) to establish their award. They make an award. In WIS, prior to the commission meeting the condemnor meets with property ~~owner~~ + present all of the appraisal + then hold a negotiation session to arrive at a price. Failing that, they ~~go to court~~ make a jurisdictional offer. The offer says we will pay "x" dollars - take it or leave it - then if they don't take it they go before the commission. Commission may meet B4 or after taking. Under a quick taking, condemnor has immediate possession of property (put money on deposit) (within 10 days of jurisdictional offering)

Quick taking is designed to seperate progress of public project from progress of negotiations. Once jurisdictional offer is made - typically a limited # of days before possession is transfered to condemnor who has deposited with clerk of courts

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any money that represents the difference between his jurisdictional offer and the price property is asking. Property owner gets jurisdictional offer price + is assured of difference on deposit.
At that point, go back to court + explain to judge. Either side can fight the jurisdictional offer. Judge says - Do you want a trial by jury. Judge then sets pretrial date for resolution of the issues + the actual date of trial.

Again - each party may present no more than 3 appraisals and the state is required to provide property owner with all of the appraisals done by condemnor for the cost of xeroxing.

Used to be that E/D awards were for the R/E interest only - no award for loss of business etc. Chief talks uses example of Italian butcher shop being displaced. Resulted in bogus values by jurors, attorneys to subvert the appraisal process to provide adequate compensation - cause law wasn't doing it.

Muskie act said any project in which there are federal monies involved will require following ethical + procedural control.

1) illegal to make a jurisdictional offer below market value
2) have to show all appraisal done for property and only cost to landowner is cost of xeroxing. (specified what cost per sheet was to be)
Highway dept tried to present only the summary pgs.
3) once notice is given - property owner has 60 days to go out + hire an appraiser who will be paid ultimately by the condemnor.

Judge tries to determine where the issues are that are in disagreement. Judge will try to restrain the ct. room procedure to focus on those elements.

Plantiff (propertyowner) ~~typically~~ gets to go first. Then defendant makes his case and then other party gets a crossexamination, then summary of position of each party

What is the theory of damages:
WIS + MICH. were only state that defined damages as difference between the property value before the taking and the value after the taking. Only one problem - corn field that increases in value because of interstate. In 1978 - WI changed law to say that appraiser must solve for two values - value of property taken as a stand alone piece of R/E and also before + after value. Property owner gets the higher value.
Other states require value property as a stand alone and then if it is a partial taking, then you are entitled to severance damages to the remainder. Severance damages are the decrease in value for loss of economy in scale or efficiency. Recognize principle of balance between components of farmland.

May be a total taking or a partial taking: to decide, must define - what is the total property.
Principle of the three unities.
1) same ownership.
2) same use or potential use
3) all parts must be contiguous to one another - this is the weakest of the three - properties that are synergistic. (factory + parking lot example)

Chief gives the example of state highway commission trying to take backside of Southtown and call it an industrial lot.

Next example is wilderness - need "x" amount of continuous land to be considered wilderness - if land is reduced it affects the entire parcel of land.

Special situations in which property owner can counter attack:

1) excess condemnation - leaving property owner with unusable piece, demand that you take the remainder land also.
(chief give gas station example)

2) inverse condemnation - when property owner petitions the court when a property right has been taken without compensation. (ie Private property taken for green space) land taken + owner fights and wins suit - property is returned + the state become liable for the loss ~~xxxxx~~ to owner for period of time which state had the land.
Can occur in a variety of ways:
Planes landing at airport next to residential subdivision - property owners sued and it was ruling that the planes had "taken" privacy + security inherent in subdivision.

Must be careful - distinct difference between taking of a property right which public never had and the exercise of a police power (which the public always has in terms of a right). The sequencing of that is critical. chief uses example of when building new - interstate to Chicago, there was a garage/restaurant on the border (Smuggled olio into state) Very lucrative station with a farm of 120 acres. Interstate missed the row of the farm. They claimed damaged H/E development. The Police power determined where the highway would be located. At that point, their business was doomed. (The B 4 value was set after the decision to relocate the highway - the after value then shows that you lost an acre of cornfield.)

A taking only occurs when the public acquires something they didn't have already. The police power is something they always had in terms of setting their route for the highway.

ie: So if you put a median strip down the middle of the road and it prevents making left turns onto the property - there is no taking - the community always had a right to have a median strip. The latent right was always there, therefore there is no taking.

Business risk is that highway will always run in front of your store, there is no guarantee from the public that that is so.

Any land use decision that can be made in the name of Police power means there is no compensation to those adversely affected (No taking has occurred)

14 W Mifflin
with 800,000 debt - cash flow - probable sale price
of won't be less than

FMV - is reflection of the market
MPP will be where the transaction would take place
3 possibilities
30 on the square
no parking
can woolworth

Outline 10 rules for cross examination
Rewrite due on the 17th

Cross Examination
communication problem in court room
1) has to put economic concepts across at a basic level
2) anticipate that he will have to defend most critical or damaging criteria hold something back
3) Judge will determine what is submittable evidence
4) 3-D model may not be ~~submittable~~ admissable
can jury go to site.
some judges require specific answers each
some judges allow only 3 questions.
critical that appraiser + attorney work together
B) cross examination attorney job is to discredit you. they will zero in on minor elements that will taint the jurors information recollection.
state things firmly
c) It is important who is communicating the information + how well it is communicated.
The court room is a teaching process for the appraiser

D) Don't want to provide extraneous facts that will give the attorney something to argue about.
Knock about anything that isn't concrete + flowed.

The Art of Cross Examination for lawyers. 12-3-86

Does not pertain to positive crossexamination
Pertains to Destructive cross examination - discredit the witness.

I Technology - what to do.
II Art of Cross exam - How to do it

I) must look at the evidence. -
9 thing to remember

4 requirements of ~~assessment~~ competence
~~3) competence in taking the witness stand~~ ~~competence~~

1) must take the oath - must understand significance - judge decides
2) witness must have perceived evidence
3) memory of perception
4) communicate in a rational form

(2–4:) jury decides on credibility

lawyer should use these 4 elements to impeach the witness
* must Know when to stop questions *
Reverse elements of competence (above 4)

Characteristic of next four - never want to repeat on cross examine what the witness said under direct examine.

II) Ask a question that can introduce a different issue collateral vs noncollateral. If question fits one of the pigeon holes it can be asked.
noncollateral - can call witnesses that will disprove answer
collateral - can't call witness

Poison the jury - question must have a good faith basis for the question.

1) bias, prejudice, interest, corruption - impeaches witness

2) impeachment by showing that witness was convicted of a crime.

3) Prior bad acts that aren't convictions
ie (wife beating)
collateral (if denied)

4) prior inconsistent statements - from previous stmts taken.
preliminary requirement for this is by asking foundation questions that lead to the consistency.
Don't need to lay foundation in federal court.

Rule for collateral / important vs non important

1) Impeach witness by calling a different witness.
Reputation witness (1st witness has a bad reputation.