

Current Appraisal Issues

May 26, 2010

- Market Conditions
- TLE's
- Assessed Value of Improvements \neq Value
- Mandatory Appraiser Licensing Update
- Other

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Market Conditions in an Inactive, Down Market

- Market Evidence
 - Lack of sales \neq no market evidence
 - Market evidence from economic evidence
 - The Great Recession
 - Officially began in December 2007
 - Real estate market began feeling in the summer of 2008
 - residential lot sales were very slow
 - commercial sales slowed down
 - leasing activity slow
 - Job losses
 - Unemployment rate doubled

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Market Conditions

- Banking industry crisis
- Government bailouts across numerous business sectors
- Bankruptcy levels increasing
- Foreclosure levels increasing
- Newspaper Articles

Housing market won't recover until 2011

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The worst is not over for home prices in metropolitan Milwaukee, as real estate agents see continued weakness and a national index predicts prices won't start recovering until late 2011.

Prices are probably at or near bottom, but it's uncertain when they will begin appreciating, local experts said. The federal tax credit for first-time home buyers provided a boost to the lower end of the market but that ended April 30, and the post-credit reality is prices aren't getting better.

The home-price news is sobering for sellers hoping to cash in on what is often their largest single investment. It's positive for buyers—if those buyers can sell their existing homes. The staid price environment also shows that the broader metro area economy is still slumbering despite some signs of improvement.

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Market Conditions

- Cap rates have increased significantly from record lows!
- Cap rate increases = value decreases
- Examples

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Shopping Center Cap Rates

Overall Capitalization Rate Comparisons				
National Strip Shopping Center Market, Non-Institutional Grade				
Time Period	Indicated OAR	Change in BPS ⁽¹⁾	Value of \$1 NOI	% Change in Value ⁽¹⁾
Q4, 2009	11.31%	169	\$8.84	-15.00%
Q2, 2009	9.62%	26	\$10.40	-2.60%
Q4, 2008	9.36%	59	\$10.68	-6.30%
Q2, 2008	8.77%	12	\$11.40	-1.40%
Q4, 2007	8.65%	15	\$11.56	-1.70%
Q2, 2007	8.50%	-	\$11.76	-
Total Change in Value Q4, 2008 vs. Q4, 2009				-17.60%
Total Change in Value Q4, 2007 vs. Q4, 2009				-25.30%

(1) Over previously listed time period
Source: PriceWaterhouseCoopers

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Office Cap Rates

Overall Capitalization Rate Comparisons				
National Office Market				
Time Period	OAR, Institutional	% Change in Value ⁽¹⁾	OAR, Non-Institutional	% Change in Value ⁽¹⁾
Q3, 2009	8.72%	-5.50%	10.15%	-5.90%
Q2, 2009	8.24%	-0.80%	9.55%	-0.30%
Q1, 2009	8.17%	-10.10%	9.52%	-10.60%
Q3, 2008	7.34%	-2.90%	8.51%	-1.50%
Q1, 2008	7.13%	1.60%	8.38%	4.70%
Q3, 2007	7.24%	N/Ap	8.78%	N/Ap
Total Change in Value Q3, 2008 vs. Q3, 2009				-16.80%
Total Change in Value Q3, 2007 vs. Q3, 2009				-13.60%

(1) Over previously listed time period
Source: PriceWaterhouseCoopers

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Industrial Flex/R&D Market Cap Rates

Overall Cap Rate Comparisons National Flex/R&D Market			
Time Period	Institutional	Change in BPS ⁽¹⁾	% Change in Value ⁽¹⁾
Q1, 2010	9.36%	22	-2.40%
Q4, 2009	9.14%	78	-8.50%
Q2, 2009	8.36%	60	-7.20%
Q4, 2008	7.76%	8	-1.00%
Q2, 2008	7.68%	-	-
Total Change in Value Q2, 2009 vs. Q1, 2010			-18.10%
Q2, 2008 vs. Q1, 2010			-19.10%

(1) Over previously listed time period
Source: PriceWaterhouseCoopers

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Land Market

- Lack of Recent Sales, What to do?
 - Development Feasibility Horizon
 - When will it become economically to develop again?
 - Application of the principles of opportunity cost and the time value of money
 - Adjustment Matrix
 - 8% to 12% annual rate of return
 - 2- to 4-year development time horizon
 - Indicated Adjustment = -14% to -36%

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Land Market

Market Conditions Adjustment Calculation

		Projected Years to Development		
		2 yrs	3 yrs	4 yrs
Rate of Return	8.0%	-14%	-21%	-26%
	9.0%	-16%	-23%	-29%
	10.0%	-17%	-25%	-32%
	11.0%	-19%	-27%	-34%
	12.0%	-20%	-29%	-36%

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Market Conditions Paired Sales, Residential Acreage

Paired Sales Analysis, Residential/Agricultural Land				
	Comp 1	Comp 2	Comp 3	Comp 4
Sale Comparable Address	Vacant Land - Future Res. Subdivision	Vacant Land - Future Res. Subdivision	Prestige Estates Expansion Land	Vacant Land - Future Res. Subdivision
Municipality	Howards Grove	Herman	Herman	Herman
Sale Price	\$145,000	\$311,700	\$78,785	\$597,000
Acres	10.85	16.56	6.31	45.91
Sale Price/ Acre	\$13,364	\$18,822	\$12,486	\$13,004
Sale Date	Oct-09	Apr-08	Jun-07	Apr-07
Years Between Sales		1.50	2.30	2.50
Adjustments ⁽¹⁾				
Property Rights Conveyed				
Overall Location				
Zoning/Density/H&BU		10%	10%	10%
Development Timeframe				
Size				15%
Shape/Topography				
%Wetlands/Floodplain				
Utilities				
Adjusted Sale Price/Acre	\$13,364	\$20,704	\$13,735	\$16,255
Indicated Market Conditions Adjustment		-35%	-3%	-18%

(1) As compared to Comparable 1

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Market Conditions Paired Sales, Grocery Stores #1

Paired Sales Analysis - Market Conditions					
Sales Pair #1	Comp 1	Comp 3	Sales Pair #2	Comp 1	Comp 4
	Madison Copps	Appleton Piggly Wiggly		Madison Copps	Waterford Pick 'n Save
Sale Price	\$5,238,000	\$3,937,000	Sale Price	\$5,238,000	\$3,800,000
Transactional Adjustments	\$0	\$0	Transactional Adjustments ⁽¹⁾	\$0	\$190,000
Adjusted Sale Price	\$5,238,000	\$3,937,000	Adjusted Sale Price	\$5,238,000	\$3,990,000
Store Sq. Ft.	72,743	30,897	Store Sq. Ft.	72,743	42,856
Sale Price/ Sq. Ft.	\$72.01	\$127.42	Sale Price/ Sq. Ft.	\$72.01	\$93.10
Sale Date	Nov-09	May-08	Sale Date	Nov-09	Apr-08
Years Between Sales	1.50		Years Between Sales	1.60	
<u>Adjustments</u>			<u>Adjustments</u>		
Overall Location			Overall Location		15%
Building Age/Condition			Building Age/Condition		
Building Size		-20%	Building Size		-10%
Adjusted Sale Price/Sq. Ft.	\$72.01	\$101.94	Adjusted Sale Price/Sq. Ft.	\$72.01	\$97.76
Indicated Downward Adjustment			Indicated Downward Adjustment		
			-26%		

(1) Comp 4 adjusted upward 5% for flat-rate lease

Market Conditions Paired Sales, Grocery Stores #2

Paired Sales Analysis - Market Conditions					
Sales Pair #3	Comp 2	Comp 3	Sales Pair #4	Comp 2	Comp 4
	Menasha Piggly Wiggly	Appleton Piggly Wiggly		Menasha Piggly Wiggly	Waterford Pick 'n Save
Location	\$5,400,000	\$3,937,000	Location	\$5,400,000	\$3,800,000
Transactional Adjustments	\$0	\$0	Transactional Adjustments ⁽¹⁾	\$0	\$190,000
Adjusted Sale Price	\$5,400,000	\$3,937,000	Adjusted Sale Price	\$5,400,000	\$3,990,000
Size (Acres)	68,530	30,897	Size (Acres)	68,530	42,856
Sale Price/ Sq. Ft.	\$78.80	\$127.42	Sale Price/ Sq. Ft.	\$78.80	\$93.10
Sale Date	Oct-09	May-08	Sale Date	Oct-09	Apr-08
Years Between Sales	1.50		Years Between Sales	1.50	
<u>Adjustments</u>			<u>Adjustments</u>		
Overall Location			Overall Location		15%
Building Age/Condition			Building Age/Condition		
Building Size		-20%	Building Size		-10%
Adjusted Sale Price/Sq. Ft.	\$78.80	\$101.94	Adjusted Sale Price/Sq. Ft.	\$78.80	\$97.76
Indicated Downward Adjustment			Indicated Downward Adjustment		
			-19%		

(1) Comp 4 adjusted upward 5% for flat-rate lease

Market Conditions

- Conclusions
 - Values have decreased
 - Ample market evidence exists
 - Lack of sales ≠ no market evidence

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Temporary Limited Easement (“TLE”) Revisited

- WI Statute, 32.09(6g)
 - “In the case of the taking of an **easement**, the compensation to be paid by the condemnor shall be determined by deducting from the fair market value of the whole property immediately before the date of evaluation, the fair market value of the remainder immediately after the date of evaluation, assuming the completion of the public improvement ...”
 - What does this mean for the appraiser?
 - Diminution in value using the before & after technique

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TLE's

- Shortcut method
 - Appropriate for relatively nominal amounts
 - Keeps appraisal time/fee down
 - Rental comparables
 - Rent factor

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TLE Shortcut Method

Diminution in Value, TLE Taking (Short Cut Method)	
TLE Area - Sq. Ft.	6,500
Value per Sq. Ft.	\$3.08
Annual Land Rental Factor	8.5%
Annual Land Rent	\$1,702
TLE Lease Term	1 year
Diminution in Value, TLE	\$1,702
Rounded	\$1,700

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Rental Factor

Rent Factor Calculation			
Market Rent		\$1,700	0.085 Rent Factor
Less: Vacancy @	0%	\$0	
Effective Gross Income		\$1,700	0.085 Rent Factor
Operating Expenses			
Real Estate Taxes		-\$400	owner pays
Net Operating Income		\$1,300	0.065 Cap Rate
Cap Rate, Land	÷	6.5%	Rate of Return
Indicated Value		\$20,000	
Land Area, Sq. Ft. 6,500			
Value, \$/Sq. Ft. \$3.08			
Indicated Value \$20,000			
Real Estate Tax Rate 2.0%			

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TLE Rent Factor Considerations

- Length of land lease comps vs. length of TLE
- Rights acquired in a TLE vs. land lease

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TLE Term Length

Land Lease Term Analysis			
US Treasury Bonds			
<u>Maturity</u>	<u>Yield</u>		
3 Month	0.13%		
6 Month	0.20%		
1 Year	0.48%		
2 Year	0.75%		
3 Year	1.20%		
5 Year	2.02%		
10 Year	3.23%		
		<u>Land Lease Rent Factor</u>	
30 Year	4.10%	8.50%	Spread 4.40%
		1 Year Bond	+ 0.48%
		Rent Factor, 1 Year Land Lease	4.88%
		Rent Factor, 3 Year Land Lease	5.60%

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TLE Rights Acquired

- Bundle of Rights
 - Use
 - surface, subsurface, air
 - exclusive use vs. shared use
 - Lease
 - Sell
 - Mortgage
 - Give it away

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TLE Rights Impacted vs. Rights Retained

Land Lease	TLE
Use <ul style="list-style-type: none"> ▪ Surface, subsurface & air rights ▪ Exclusive use 	Use <ul style="list-style-type: none"> ▪ Surface (typically) ▪ Shared use

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TLE Rent Factor

- Surface rights vs. surface, subsurface & air
 - -5%, -10% or -50%?
- Shared use vs. exclusive use
 - -10, -25% or -50%
- Rent factor of 8.5% adjusted down:
 - 1-year TLE term = rent factor of 5.0%
 - Surface rights -5%
 - Shared use -50%
 - = -55% or adjusted rent factor of 2.25%

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TLE Conclusions

- What is the impact on the rights of ownership or the bundle of rights
 - sell, lease, use, mortgage, gift
- The appraiser should use sound reasoning and logic to determine what percentage of the total ownership interest is affected (WisDOT, Real Estate Program Manual)

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Assessed Value of Improvements \neq Value

- Issue: H&BU is for demolition of improvements

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Problem: Improvements at Equalized Value

Real Estate Assessment Summary				
Tax Parcel #	Assessed Value			Equalized Value
	Land	Improvements	Total	
	\$	\$	\$	\$
-001	700,000	1,500,000	2,200,000	2,200,000

Property Value, Before Taking	
Land Value if Vacant	\$2,500,000
Less: Demolition Costs	<u>-\$500,000</u>
Land Value, As-Is	\$2,000,000
 Add: Equalized Value of Improvements	 \$1,500,000
Concluded Value, Before Taking	<u>\$3,500,000</u>
 Versus:	
Land Value, As-Is	\$2,000,000

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Improvements with Extraordinary Assumption

Value, Before Taking (with Extraordinary Assumption)	
Land Value if Vacant	\$2,500,000
Less: Demolition Costs	<u>-\$500,000</u>
Land Value, As-Is	\$2,000,000
 Add: Improvements (Extraordinary Assumption)	 Not Impacted
Concluded Value, Before Taking	<u>\$2,000,000</u>

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Extraordinary Assumption Language

There are no improvements to be taken as part of the planned acquisition nor are the improvements negatively impacted. The contributory value of the improvements is the same both before and after the planned taking as the taking does not impact the existing improvements. Therefore, this appraisal consists only of a land valuation analysis with the contributory value of the improvements intentionally omitted from the before and after conclusions; we have not independently appraised the subject improvements. This appraisal is conditioned upon the extraordinary assumption that the omission of the improvements' contributory value both before and after the taking does not impact the total loss in market value.

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Mandatory Appraiser Licensing, Update

- Assembly Bill 472; Senate Bill 339
- Passed in Assembly with WRA amendment
 - Allows “Broker Market Analysis” for:
 - Establish listing price or to set a purchase price
 - Establish a value for purposes other than a real estate transaction or mortgage
- Stalled in Senate
- It will come back
- Need to pass Mandatory Licensing
 - without broad BMA's

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Mandatory Appraiser Licensing, Update

- Currently, appraiser does not have to be licensed/certified for:
 - Condemnation
 - Tax appeal
 - Any non-federally related transaction
- But if licensed or certified, the appraiser must follow USPAP including de minimis levels
 - DRL Rule RL 81.05

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Mandatory Appraiser Licensing, Update

- RL 81.05, DRL Real Estate Appraisers Code Book: Scope of Appraisal Practice
 - Except as permitted by state or federal law, licensed and certified appraisers are authorized to conduct appraisals in conjunction with federally related and non-federally related transactions as follows:
 - Certified General - without regard to transaction value
 - Certified Residential
 - Residential: without regard to transaction value
 - Commercial: transaction value of not more than \$250,000
 - Licensed Appraiser
 - Complex 1- to- 4-unit residential TV of not more than \$250,000
 - Non-complex 1- to- 4-unit residential TV of not more than \$1,000,000
 - Commercial - transaction value of not more than \$250,000

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Dept. of Regulation & Licensing

- DRL is looking for:
 - 2 CGA members of Application Review Committee
 - Review appraisers for Real Estate Appraisers Board
 - Paid for each USPAP Standard 3 review

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Thank you!!

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