

Market Price vs. Market Value

The Impact of Unique Buyers and Sellers
and Unique Property Types

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Definitions of Market Value

NRAAO has 18 membership jurisdictions:

- 11 northeastern US States plus the District of Columbia
- The six easternmost Canadian Provinces

All rely on Market Value as the basis for property assessment with some nuances in definition and application.

See *MV and NRAAO Jurisdictions* (download from the NRAAO website or leave a business card and we will email it to you).

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Definitions of Market Value

Market value is defined in the appraisal rules of the U.S. Federal Financial Institution Regulatory Agencies as:

The most probable price a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably and assuming the price is not affected by undue stimulus.

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Definitions of Market Value

Market value is defined in *The Appraisal of Real Estate* (Appraisal Institute, 14th Edition, 2013, Page 58) as:

The most probable price, as of a specified date, in cash, or in terms equivalent to cash, or in other precisely revealed terms, for which the specified property rights should sell after reasonable exposure in a competitive market under all conditions requisite to fair sale, with the buyer and seller each acting prudently, knowledgeably, and for self-interest, and assuming that neither is under undue duress.

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Definitions of Market Value

Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

- Buyer and seller are typically motivated.
- Both parties are well informed or well advised and are acting in what they consider their best interests.
- A reasonable time is allowed for exposure in the open market.
- Payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto.
- The price represents the normal consideration for the property sold, unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

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Definitions of Market Value

The previous definition of market value is an extension of the term *fair market value* as referenced in early appraisal literature and as still referenced in some statutes.

The Dictionary of Real Estate Appraisal (Sixth Edition, 2015, Page 85) stated under the term *fair market value*: In nontechnical usage, a term that is equivalent to the contemporary usage of market value.

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Definitions of Market Value

The previous definitions of market value are also consistent with the accounting term *fair value*.

The Financial Accounting Standards Board in Statement of Financial Accounting Standards No. 157 (September 2006, effective for fiscal years beginning after November 15, 2007) defines *fair value* as:

...the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

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Definitions of Market Value

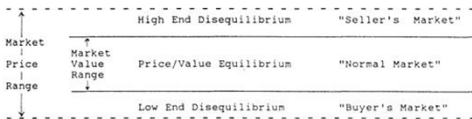
Note: *The Uniform Standards of Professional Appraisal Practice (USPAP)* Has No Specific Market Value Definition

Market Value: a type of value, stated as an opinion, that presumes the transfer of a property...as of a certain date, under specific conditions set forth in the definition of the term identified by the appraiser as applicable in an appraisal....(comment omitted)...

Appraisers are cautioned to identify the exact definition of market value, and its authority, applicable in each appraisal completed for the purpose of market value.

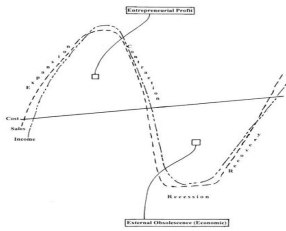
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The Price/Value Relationship



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The Real Estate Market Cycle



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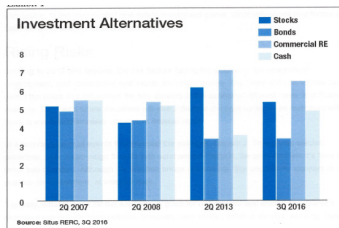
Market Observations

- Prosperity continues in 2017 but the cycle is heading toward a fall (CIRE Magazine, Jan-Feb 2017).
- Poll of professionals at 10th Annual University of Chicago Booth School of Business RE Conference:
 - Commercial RE was at the bottom of the 8th inning at end of 2016 and will enter the 9th inning in 2017.
 - 2017 is expected to be much like 2016 with commercial RE prices and values increasing sluggishly and cap rate compression stalling.
 - The RE industry will likely go into extra innings, but it is difficult to tell how many extra innings will be played to usher in the next phase of the cycle (i.e., next downturn likely in 2018 or 2019).

Source: Ken Riggs, President, Situs RERC

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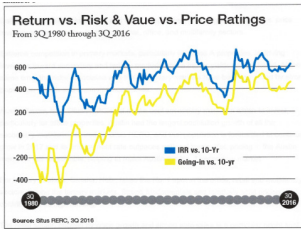
Market Observations



Source: Situs RERC, 3Q 2016

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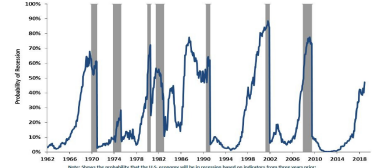
Market Observations



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Market Observations

Near Term Recession Probability Remains Low, More Elevated For 2018



NOTE: Areas shaded in gray represent the time the U.S. economy will be in recession based on historical performance from 1962 to 2017. The length of shaded bars shows the intensity of the recession in the economy. The likelihood of a recession is based on the historical performance of the U.S. economy from 1962 to 2017.



State of the U.S. Market - January 2017
Source: Doug Poutasse, Head of Strategy, Bentall Kennedy

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Market Observations

- These are broad perspectives on the overall US real estate market.
- From these and the various other sources out there, it is reasonable to project that the next downturn will take place in late 2018 or in 2019 (barring a catastrophe).
- Keep an eye on the multifamily sub-market. The poster child of the most recent recovery often becomes the problem child of the next recession.
- Bottom line: You must follow trends in your market to determine the stage of the cycle for the various types of real estate in your jurisdiction and act accordingly.

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Real Estate Investment Trusts (REITs)

- Legislation established REITs in 1960 to make investment in large-scale income-producing real estate accessible to all investors the same way they typically invested through purchase and sale of liquid securities.
- History-the Mortgage REITs of the 1970s.
- Tax Reform Act of 1986 permitted REITs to both own and manage assets, paving the way for today's equity REITs.
- Many REIT IPOs occurred in the mid-1990s in response to the 1988-1992 downturn.

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REITs

Rules for U.S. REITs:

- At least 75% of total assets invested in real estate.
- At least 75% of gross income from real property or interest from mortgages on real property.
- Distribute 90% of taxable income to shareholders each year.
- Be taxable as a corporation.
- Be managed by a Board of Directors or Trustees.
- Have a minimum of 100 shareholders.
- Have no more than 50% of its shares held by five or fewer individuals.

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REITs

- Equity REITs are the bulk (90%±) of the REIT market.
- Stock exchange listed Equity REITs (about 170) represent 70% of all U.S. listed REIT assets.
- Listed Equity REITs own more than \$1 trillion of real estate assets in U.S. (more than 50,000 properties in all 50 states plus the District of Columbia).
- The assets of Equity REITs represent about 15% of total U.S. commercial real estate assets.
- Over the 20-year period ending 30-Nov-2016, U.S. listed Equity REITs delivered compound total annual returns of 9.97% compared with 7.47% for S&P 500 Index.

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REITs

- As purchasers and managers of real estate, REITs are cash flow investors.
- The success of the modern equity REIT stems in part from buying or converting at the right time (the end of the 1988-1992 downturn).
- Most REIT transactions are market transactions.
- You may not recognize that the corporate entity purchasing a property is a REIT.

Source: National Association of Real Estate Investment Trusts (NAREIT) (www.reit.com)

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The Legal Drug Business

- The underlying issue: an aging population takes more pills.
- The modern drug store: 10,000-15,000 sq.ft. standalone building on a signalized corner site (when possible).
- 65-70% of gross sales derived from 5-10% of space.
- Site selection: pointing a finger at a specific location regardless of price or site development costs (value a non-issue).
- Turn-key lease-build program with Single-Tenant Net Lease Sale (or 1031 Exchange) at the end.

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The Legal Drug Business

- Lease based on base NNN rent with percentage of sales increase only...expecting us to buy more drugs going forward.
- Companies claim that Single-Tenant Net Lease Sale is based on value of the company rather than value of the real estate.
- Assessors claim that prices represent value in a national sub-market.
- Case law is mixed with regard to valuation based on existence of a national sub-market vs. local retail market.

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All Big Boxes Are Not the Same

- Big Box is a generic name for standalone retail units that range in size from 50,000 sq.ft. to 150,000 sq.ft.
- Stratification is critical when comparing Big Boxes:
 - Size stratification
 - Interior finish stratification
 - Dick's Sporting Goods is not a comp for Home Depot
 - A Supermarket Chain is not a comp for Target
- Ground leases and built-to-suit leases may often contain more than just the right to use land and/or buildings.

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All Big Boxes...

- Consider the competition when looking for comps:
 - Home Depot v. Lowe's
 - BJ's v. Costco v. Sam's Club
 - Kohl's v. Target v. Wal-Mart
 - Dick's v. Modell's
- Get the replacement cost right:
 - A warehouse store is at it's heart a warehouse.

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All Big Boxes...

- Store sales drive retail value:
 - *Dollars and Cents of Shopping Centers/The SCORE* (ULI and ICSC)
 - Base rent v. percentage rent
- Department Stores v. Discount Department Stores
 - Nordstrom, Lord & Taylor, Macy's, Sears, J.C. Penney are Department Stores
 - Kohl's, Target and Wal-Mart are Discount Department Stores

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All Big Boxes...

- Get the replacement cost right.
 - Construction type: Department Stores v. Discount Department Stores
 - Construction quality = level of interior finish
- All large retail has built-in functional obsolescence.
 - Finish details vary from one store to another
- Mall Department Stores...dealing with the shrinking population of anchors:
 - Anchor stores separated into two floors.
 - Anchor stores demolished for reuse such as exterior-facing restaurant rows.
 - Vacant anchor stores seeking an alternative user.

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All Big Boxes...

- Changes in demand and design criteria:
 - Oh Blockbuster (and lots of other store concepts), where art thou?
 - The 45,000 sq.ft. Neighborhood Supermarket returns.
 - Bricks and clicks marketing alternatives.

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A Few Words About Residential

Price versus Value

1. The amount paid in exchange for a good or commodity. Price is distinguished from value because price becomes a fact when the transaction is consummated as opposed to value, which is an estimate.
2. The amount asked, offered or paid for a property. Once stated, price is a fact, whether it is publicly disclosed or retained in private. Because of the financial capabilities, motivations, or special interests of a given buyer or seller, the price paid for a property may or may not have any relation to the value that might be ascribed to that property by others.

Source: The Dictionary of Real Estate, 6th Edition, Page 175

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A Few Words About Residential

Some Unique Property Types and Issues

Celebrity Properties: Is a premium paid for a celebrity's current or former residence? Value impact, if any, will depend on the notoriety of the owner or former occupant. Will the typical purchaser in this market stratum recognize the celebrity? Is the person famous or infamous? Is it possible the value might be impacted negatively? Originality and condition are important factors. Any impact, positive or negative, tends to dissipate over time.



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A Few Words About Residential

Some Unique Property Types and Issues

Historical Properties: Of course, the level of historical significance will affect any value premium. There is a very unique pool of buyers for this type of property, which will influence price and marketing time.



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A Few Words About Residential

Some Unique Property Types and Issues

Psychologically Impacted / Impaired Properties: Was the property the scene of a gruesome murder that was well publicized, for example? This is a market perception issue. Any stigma is usually temporary and dissipates over time. Impact, if any, is very difficult to remember. The former DeFeo property at 112 Ocean Avenue in Amityville, Long Island came on the market last year for \$850,000. It last sold in 2010 for \$950,000.



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A Few Words About Residential



Some Unique Property Types and Issues

HVTL Corridor Properties: Also a market perception issue. Main drivers tend to be proximity to and view of HVTL structures and power lines. Impact, if any, may be measured by valuing corridor property sales using non-corridor sales. The difference between the appraised value (on the date of sale and under the hypothetical condition that the property was not located along a corridor) and its actual sale price is the impact of the HVTL corridor. Other regression analysis techniques are available measurement tools as are buyer/seller/agent interviews.

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A Few Words About Residential

Some Unique Property Types and Issues

High-Value and Other Unique Property Types: Usually involves expanding the market area for research of comparable data. Remember that functional obsolescence may be built in on the drawing board. All new houses may not be without depreciation of some form.



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A Few Words About Residential



Other Fun Properties

Residential Cooperatives (Co-ops): Corporation owns the real estate and individuals own shares of stock in the corporation, entitling them to a proprietary lease on a unit. In terms of analysis, look for sale price per share. Often not recorded, making data difficult to obtain. Underlying debt of the corporation is an important factor to consider...best to stay within the same complex.

A Few Words About Residential

Other Fun Properties

Dockminiums: Space owned typically extends from the center of the earth to the heavens and is the rectangular slip area on the surface of the water. Appropriate unit values for analysis are sale price per square foot of surface area and sale price per linear foot of surface area (length). Example: A 40-foot long slip sells for \$88,000 or \$2,200 per lin. foot. Important factors to consider...access to and from open water, water depth at low tide, amenities (electricity, water, cable television), additional fees, management, etc. (stay within the same marina for sales, if possible).



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A Few Words About Residential

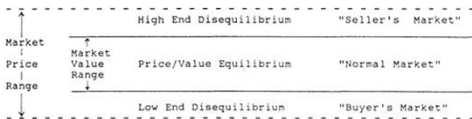
Other Fun Properties

Tear-Downs: Usually signifies that the improvement has ceased to contribute to value. The value of the vacant land is more than the value of the property as improved. Be wary of the single tear-down in your market and, as in any other case, look for a trend. May signal a highest and best use change. In appraisal theory, the sale price paid for the property, plus demolition and removal costs, are equivalent to the land value. Did the purchaser intend to tear the house down? If so, you have a land sale.

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Review and Wrap-Up

Price/Value Relationship Revisited



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Review and Wrap-Up

- Not every price is an indicator of market value.
- Beware of and take a hard look at the outliers when analyzing your market.
- The high-end or low-end land sale may not reflect the actions of the typical purchaser.
- The same goes for the high-end or low-end property sale.
- Appraisal Basics: One sale does not make a market.

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Questions and Comments?

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