

JAMES A. GRAASKAMP COLLECTION OF TEACHING MATERIALS

II. CLASSES AT THE UNIVERSITY OF WISCONSIN--MADISON

U. Student Coursework Collections (Arranged in Chronological Order)

(Following subdivisions include syllabi, exams, lecture notes, and problem sets, but reading packets have been deleted)

2. John Dreier's Complete Set of Coursework

d. Business 856 (Advanced Appraisal Theory and Practice): Fall 1982

Business 856

Appraisal Seminar - Semester I

First Semester 1982

Instructors: J. A. Graaskamp
J. Mittnacht

I. Objectives

The purpose of this course is to provide the student with advanced appraisal techniques and possible reforms of appraisal theory currently prescribed by the professional appraisal organizations. The course assumes the student has successfully completed 556 or two basic professional courses on the standard mechanics of appraisal. The course will stress a complex field problem and English composition for report writing.

II. General Course Format

There will be two lectures and reading assignments each week. It is advised that you read the material in advance of class. There will be two 1-2 hour written exams on this material. On each Friday there will be a 50 min. workshop on English composition and on report techniques. There will be two property appraisal reports: Each student will do a complete first draft appraisal utilizing Ratcliff-Graaskamp approach and outline. The report will be graded on appraisal and on composition and returned to be completely redone as a final report. Final grade will be based on total points scored on the first draft appraisal (30%), the redraft appraisal (20%), and 50% on two exams.

III. Textbooks

Recommended for purchase:

Ratcliff Readings on Appraisal and Its Foundation Economics, R. U. Ratcliff,
Landmark Research, Madison, Wisconsin 1979 (\$9.50)
The Appraisal of 25 N. Pinckney: A Demonstration Case For Contemporary
Appraisal Methods, James A. Graaskamp, 1977 (\$9.00)
A Guide to Appraising for Federal Agencies, (\$4.00)
Packet of mimeos and assorted text materials (\$10.00)
Wisconsin Administrative Code, Building and HVAC (\$4.00)
Techniques For Writing Business Reports, Frances Larson, Landmark Research,
Madison, Wisconsin 1980 (\$8.00)

(Books can be purchased from the UW Real Estate Club in Room 118. (No credit!))

Recommended for purchase at book store:

The Elements of Style, William Strunk, Jr. & E. B. White, McMillan
Publishing Co., Inc., New York 1972.
A Manual For Writers of Term Papers, Theses, and Research Papers,
Kate L. Turabian, 4th Edition, University of Chicago Press.

NOTE: ALL PAPERS AND EXERCISES TO HANDED IN SHOULD BE STAPLED AT
UPPER LEFT HAND CORNER AND GIVEN A TITLE PAGE BUT LEFT WITHOUT
PLASTIC BINDERS OR OTHER SIMILAR COVERS.

ADVANCED REAL ESTATE APPRAISAL - BUS 856
Topic Schedule, Fall 1982

Aug. 30, M	THE APPRAISAL PROCESS - INTRODUCTION
Sept. 1, W	EVOLUTION OF VALUE CONCEPTS
6, M	* * LABOR DAY * *
8, W	RATCLIFF RESTATEMENT OF THE APPRAISAL PROCESS
10, F	FIELD INSPECTION OF PROPERTY TO BE APPRAISED
13, M	OTHER CRITICS OF THE APPRAISAL PROCESS
15, W	(LAB) BASIC ELEMENTS OF THE APPRAISAL PROCESS & THE REPORT 3:45 p.m.
17, F	WRITING LAB #1 - JENNIFER MITTNACHT
20, M	MOST PROBABLE USE MATRIX
22, W	MOST PROBABLE USE (CONTINUED)
24, F	WRITING LAB - JENNIFER MITTNACHT (EXERCISE #1, DUE)
27, M	MOST PROBABLE BUYER PROFILE
29, W	MARKET PRICE COMPARISON
Oct. 1, F	WRITING LAB - JENNIFER MITTNACHT (EXERCISE #2 IS DUE)
4, M	PRESENTATION OF MARKET COMPARABLES AND ADJUSTMENTS
6, W	STATISTICAL APPRAISAL TOOLS (PACK RIVER TECHNIQUES - ROBBINS)
8, F	WRITING LAB - JENNIFER MITTNACHT (EXERCISE #3 IS DUE)
11, M	SIMULATION OF PROBABLE BUYER CALCULUS
13, W	INVESTMENT SIMULATION
15, F	IMPACT OF PUBLIC INVESTMENT
18, M	NORMATIVE METHODS - THE COST APPROACH
20, W	TESTING APPRAISAL PRICE CONCLUSIONS
22, F	APPRAISAL GRAPHICS (GUEST SPEAKER)
25, M	FIRST DRAFT OF APPRAISAL REPORT DUE AT BEGINNING OF CLASS - LATE PAPERS PENALIZED
27, W	REVIEW FOR EXAM
Nov. 1, M	* * MID-SEMESTER EXAM * *
3, W	MULTIPLE REGRESSION AND APPRAISAL
5, F	MULTIPLE REGRESSION AND APPRAISAL (CONTINUED)

BUS 856 - Fall 1982

Topic Schedule

Nov.	8, M	RETURN OF FIRST DRAFT OF APPRAISALS
	10, W	APPRAISAL FOR REAL ESTATE TAX ASSESSMENT
	12, F	APPRAISAL FOR REAL ESTATE TAX ASSESSMENT (CONTINUED)
	15, M	MKTCOMP - AN AUTOMATED ALTERNATIVE
	17, W	DEMONSTRATION OF MKTCOMP PROGRAM
	19, F	VIDEO FILM - ART OF THE CROSS-EXAMINATION
	22, M	LAND VALUATION
	24, W	LAND VALUATION (CONTINUED)
	26, F	* * THANKSGIVING RECESS * *
	29, M	APPRAISAL FOR CONDEMNATION
DEC.	1, W	APPRAISAL FOR CONDEMNATION (CONTINUED)
	6, M	GOVERNMENT STANDARDS FOR APPRAISAL PRODUCTS
	8, W	THE BUSINESS OF APPRAISAL PRACTICE
	10, F	* * <u>FINAL EXAM</u> * *

ADVANCED REAL ESTATE APPRAISAL - BUS 856

Prof. James A. Graaskamp

Fall Semester 1982

<u>Class Period</u>	<u>Readings</u>	<u>Source</u>
Aug. 30, Mon.	THE APPRAISAL PROCESS - INTRODUCTION	
Done	A. "Institutionalism and Urban Land Economics," <u>Recent Perspectives in Urban Land Economics</u> , Vancouver, British Columbia: University of British Columbia, 1976.	R-Text
Done	B. "A Rational Approach to Feasibility Analysis," J. A. Graaskamp, <u>Appraisal Journal</u> , Oct. 1972.	Mimeo
Done	C. Chap. 1, "What is Value?" Chap. 2, "The Development of Appraisal Theory," <u>Real Estate Appraisal: Review and Outlook</u> , Paul Wendt, University of Georgia Press, 1974.	HD 1337 } Bus. Lib. w/46 - Bus. Res.
Sept. 1, Wed.	EVOLUTION OF VALUE CONCEPTS	
Done	A. $Value = f(\text{productivity w/in a RE mkt.})$ <u>Valuation for Real Estate Decisions</u> , R. U. Ratcliff, Chapters 1-3. <u>Old school vs. new school</u>	R-Text
Done	B. "Appraisal: Is It Measurement or Prediction?" <u>The Real Estate Appraiser</u> , Nov.-Dec. 1972. p. 28 See Foreward p. 35	R-Text
Done	C. "A Statistically Oriented Definition of Market Value," Peter F. Colwell, <u>Appraisal Journal</u> , Jan. 1979, pp. 53-58.	Mimeo
Done	D. "Data, The Appraisal Process, and the Market Value Definition," Kenneth M. Lusht, <u>Appraisal Journal</u> , Oct., 1981.	Mimeo
Done	E. "A Critique of the Prevailing Definition of Market Value," Harold Albritton, <u>Appraisal Journal</u> , April, 1980, pp. 199-205.	Mimeo
Sept. 8, Wed.	RATCLIFF RESTATEMENT OF THE APPRAISAL PROCESS	
Done	A. "Is There a 'New School' of Appraisal Thought?" <u>The Appraisal Journal</u> , Oct., 1972. p. 1	R-Text
Done	B. "Appraisal Is Market Analysis," <u>The Appraisal Journal</u> , Oct., 1975. p. 5	R-Text
Done	C. <u>Valuation for Real Estate Decisions</u> , R. U. Ratcliff, Chap. 4. p. 73 stat. inference mkt. simulation	R-Text

Bus. 856 - Fall 1982

Sept. 10, Fri. FIELD INSPECTION

Sept. 13, Mon. OTHER CRITICS OF THE APPRAISAL PROCESS

- | | | |
|------|--|-------|
| Done | A. "Should the Traditional Appraisal Process Be Re-Structured?" H.C. Smith and R.L. Racster, <u>The Real Estate Appraiser</u> , Nov.-Dec. 1970 | Mimeo |
| Done | B. "The Three Approaches," Frederick M. Babcock | Mimeo |
| | C. "Annotated Bibliography for Modernization in Valuation of Investment Classed Real Estate," McCloud B. Hodges, Jr., February 1981. | Mimeo |

Sept. 15, Wed. BASIC ELEMENTS OF THE APPRAISAL PROCESS & THE REPORT

- | | | |
|------|---|-------|
| Done | A. Section One and Two, <u>The Appraisal of 25 N. Pinckney</u> . | Text |
| Done | B. "Guidelines for Understanding and Reviewing Real Estate Appraisal Reports," Edwin Rams, <u>Appraisal Review Journal</u> , pp. 60-67. | Mimeo |
| Done | C. "The Written Appraisal Concept," <u>Real Estate Appraiser</u> , Jan.-Feb. 1977. | Mimeo |
| Done | D. "How to Write a Poor Report," Charles B. Smith, <u>Appraisal Journal</u> , April 1973. | Mimeo |

Sept. 17, Fri. WRITING LAB #1 - JENNIFER MITTNACHT

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| Done | A. <u>The Elements of Style</u> , Strunk & White | Text |
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Sept. 20, Mon. MOST PROBABLE USE MATRIX

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|------|---|-------|
| Done | A. "Highest and Best Use: A New Definition, A New Opportunity," John E. Bohling, <u>The Real Estate Appraiser</u> , Jan.-Feb. 1976, pp. 33-37 | Mimeo |
| Done | B. "Highest and Best Use - Fact or Fancy," Paul F. Wendt, <u>Appraisal Journal</u> , April 1972. | Mimeo |
| Done | C. "Toward Analytically Precise Definitions of Market Value and Highest and Best Use," Kerry D. Vandell, <u>Appraisal Journal</u> , April 1982. | Mimeo |
| Done | D. "Highest and Best Use in the Appraisal Profession," Halbert C. Smith & Mark A. Maurais, <u>The Real Estate Appraiser and Analyst</u> , Mar.-Apr. 1980. | Mimeo |
| Done | E. "The Dynamic Nature of Highest and Best Use," N. Ordway & J. Harris, <u>Appraisal Journal</u> , July 1981. | Mimeo |

Bus. 856 - Fall 1982

Sept. 22, Wed. MOST PROBABLE USE (CONTINUED)

- Done A. The Appraisal of 25 N. Pinckney, pp. 14-62 Text
- B. Wisconsin Administrative Code: Building and Heating Ventilating and Air Conditioning Code, Chapter 50, Administration and Enforcement, Chapter 52, 53, and 54. Text
- Done C. "Highest and Best Use: A Critical Reexamination," James R. Webb, The Appraisal Journal, January, 1980, pp. 57-63. Mimeo

Sept. 24, Fri. WRITING LAB #2 JENNIFER MITTNACHT (EXERCISE #1, DUE)

Sept. 27, Mon. MOST PROBABLE BUYER PROFILE

- Done A. Appraisal of 25 N. Pinckney, pp. 63-71. Text
- Done B. Valuation for Real Estate Decisions, R. U. Ratcliff, Chapters 6 & 7. p.94 R-Text

Sept. 29, Wed. MARKET PRICE COMPARISON

- Done A. Appraisal of 25 N. Pinckney, pp. 71-81, 106-123. Text
- Done B. "Do Not Demean the Mean," Robert C. Mason, The Appraisal Journal, Jan. 1977. Mimeo
- Done C. "Seller Financing and Cash Equivalence," Jack Friedman and Bruce Lindeman, The Real Estate Appraiser and Analyst, May-June, 1979, pp. 46-50. Mimeo
- Done D. "Theory and Methods of Social Measurement," Clyde H. Coombs. Mimeo
- Done E. "The Fourth Method of Valuation: The Weed Tree Test," Jeffrey Jahns, Real Estate Review, pp. 85-87. Mimeo

Oct. 1, Fri. WRITING LAB - JENNIFER MITTNACHT (EXERCISE # 2 DUE)

Oct. 4, Mon. PRESENTATION OF MARKET COMPARABLES & ADJUSTMENTS

A.

B.

C.

Bus. 856 - Fall 1982

Oct. 6, Wed. STATISTICAL APPRAISAL TOOLS

- Done A. "Some Quick and Easy Statistical Procedures for the Real Estate Analyst," Wayne W. Daniel, Appraisal Journal, April 1974. Mimeo
- Done B. Chapters 1 and 4, Quantitative Techniques in Real Estate Counseling, Gene Dilmore, Lexington Books, Lexington, MA 1981. Mimeo
- Done C. "The Application of Correlation Matrix Analysis to Real Estate Appraisal," Walter Chudleigh III, The Appraisal Journal, Oct., 1979, pp. 523-531. Mimeo

Oct. 8, Fri. WRITING LAB - JENNIFER MITTNACHT (EXERCISE #3, DUE)

Oct. 11, Mon. SIMULATION OF PROBABLE BUYER CALCULUS

- Done A. "Don't Underrate the Gross Income Multiplier," p.24
R. U. Ratcliff, Appraisal Journal, Apr., 1971. R-Text
- Done B. "The Behavior of Appraisers in Valuing Income Property: A Status Report," Kenneth M. Lusht, The Real Estate Appraiser and Analyst, July-Aug., 1979. Mimeo

Oct. 13, Wed. INVESTMENT SIMULATION

- Done A. "Babcock Revisited - A Return to Fundamentals," Edited by M. B. Hodges. Mimeo
- Done B. Valuation for Real Estate Decisions, R. U. Ratcliff, Chaps. 8-10. p.169+ R-Text
- Done C. "DCR/R Capitalization Rate Tables For Today's Financing," Robert Steele, Appraisal Journal, Jan., 1981, pp. 15-22. Mimeo
- Done D. "Discount Rates for Cash Equivalent Analysis," Joseph Lipscomb, Appraisal Journal, Jan. 1981. Mimeo
- Done E. "Valuing Real Estate Subject to Tax-Free Financing," Bruce Coin, Appraisal Journal, Apr., 1980, pp. 261-266. Mimeo

Oct. 15, Fri. IMPACT OF PUBLIC INVESTMENT AND INCENTIVES

- Done A. "Historic Properties: Variable Valuations," Sally G. Oldham, The Appraisal Journal, July, 1982. Mimeo
- Done B. "Appraising the Best Tax Shelter in History," R. J. Roddewig & Jared Shlaes, The Appraisal Journal, Jan., 1982. Mimeo

Bus. 856, Fall 1982

Oct. 18, Mon. NORMATIVE METHODS - THE COST APPROACH

- | | | |
|------|--|---------|
| Done | A. <u>Valuation for Real Estate Decisions</u> , R. U. Ratcliff, Chaps. 5, 12, 13.
p. 83, p. 171+ | Text |
| Done | B. "Building Design Trade-Offs: Initial Cost Vs. Operating Cost Vs. Rental Income," Clayform T. Grimm, <u>The Appraisal Journal</u> , April, 1976. | Mimeo |
| Done | C. "Kahn on the Entrepreneur," Sanders A. Kahn, <u>The Appraisal Journal</u> , 1973. | Mimeo |
| Done | D. Marshall & Swift Computerized Cost Estimating System, Case Example | Handout |

Oct. 20, Wed. TESTING APPRAISAL PRICE CONCLUSIONS

- A. BFCF
- B. Front Door Approach - MR CAP

Oct. 22, Fri. APPRAISAL GRAPHICS (GUEST SPEAKER)

- | | |
|------------------------------------|---------|
| A. Real Estate Graphic Aids (SREA) | Handout |
|------------------------------------|---------|

Oct. 25, Mon. RESOLUTION OF APPRAISAL REPORT ISSUES

Oct. 27, Wed. FIRST DRAFT OF APPRAISAL REPORT DUE AT BEGINNING OF CLASS: LATE PAPERS PENALIZED

Nov. 1, Mon. MID-SEMESTER EXAM

Nov. 3, Wed. MULTIPLE REGRESSION AND APPRAISAL

- | | | |
|------|---|-------|
| Done | A. Chapter 5, <u>Quantitative Techniques in Real Estate Counseling</u> , Gene Dilmore, Lexington Books, Lexington, MA. 1981. | Mimeo |
| Done | B. "E.S.P. and the Appraiser," Robert Gustafson. | Mimeo |
| Done | C. "Appraising Houses," Gene Dilmore, <u>Real Estate Appraiser</u> , July-Aug. 1974. | Mimeo |
| Done | D. "Multiple Regression Analysis & The Appraisal Process," Jerome Dasso, <u>The Real Estate Appraiser</u> , March-April 1973. | Mimeo |

Nov. 5, Fri. MULTIPLE REGRESSION AND APPRAISAL (CONTINUED)

- | | | |
|------|---|-------|
| Done | A. "The Use of Multivariate Statistical Methods in Appraisal Analysis," James E. Reinmuth, <u>Assessors Journal</u> , Sept. 1976. | Mimeo |
|------|---|-------|

Nov. 8, Mon.	RETURN OF FIRST DRAFT OF APPRAISALS	
Nov. 10, Wed.	APPRAISALS FOR REAL ESTATE TAX ASSESSMENT	
Done	A. Chap. 19, "Realty Taxes," Kahn & Case, <u>Real Estate Appraisal and Investment</u> .	Mimeo
Done	B. Wild, Inc., VS City of Madison Board of Review	Mimeo
Done	C. "FHA 236 Housing Projects: Some Thoughts on Valuation," William B. Jackson.	Mimeo
	D. Proposed State of Wisconsin Automated Residential System	Mimeo
Nov. 12, Fri.	APPRAISALS FOR REAL ESTATE TAX ASSESSMENT (CONTINUED)	
	A.	
	B.	
Nov. 15, Mon.	MKTCOMP - AN AUTOMATED ALTERNATIVE - THEORY	
Done	A. "Comparable Sales Selection--A Computer Approach," Arnold Tchira, <u>The Appraisal Journal</u> , Jan. 1979	Mimeo
Done	B. MKTCOMP kit for WITS case problem	
Nov. 17, Wed.	MKTCOMP - AN AUTOMATED ALTERNATIVE - PRACTICE	
	A. Sample Duluth assessment output	Mimeo
	B. Sample Maple Bluff output	Mimeo
	C. Sample Mulvar output	Mimeo
Nov. 19, Fri.	VIDEO FILM - ART OF THE CROSS-EXAMINATION	
Nov. 22, Mon.	LAND VALUATION	
	A. <u>Valuation for Real Estate Decisions</u> , R. U. Ratcliff, Chap. 11.	R-Text
Done	B. "Subdivision Analysis: A Case Study," Marvin A. Maes, <u>The Appraisal Journal</u> , Jan. 1982.	Mimeo
Done	C. "A Basic Methodology for Estimating the Market Value of a Subdivision Land Development," Dan Swango, <u>The Real Estate Appraiser</u> , Nov.-Dec., 1971	Mimeo

Bus. 856, Fall 1982

Done D. "Developmental Method of Land Appraisal," James H. Boykin, Appraisal Journal, Apr. 1976. Mimeo

Done E. "Condominium/Developed Lot Discounting Concept...Again," Richard Hewitt, III, The Real Estate Appraiser and Analyst, Jan.-Feb., 1980, pp. 7-12. Mimeo

Nov. 24, Wed. LAND VALUATION (CONTINUED)

Done A. "Lease and Fee-Hold Price Differentials in Hawaii," Richard A. Palfin, The Appraisal Journal, April, 1979, pp. 227-242.

Done B. "Some Economic Implications of Land Use Planning for Real Estate Owners and Investors," Donald R. Levi, The Appraisal Journal, July, '75. Mimeo

Done C. "Water Rights in Relation to the Appraisal of Land," E. J. Skeen, The Appraisal Journal, July, 1975. Mimeo

Nov. 26, Fri. * * THANKSGIVING RECESS * *

Nov. 29, Mon. APPRAISAL FOR CONDEMNATION

A. Valuation for Real Estate Decisions, R. U. Ratcliff, Chap. 14. R - Text

Done B. "Eminent Domain: A Kaleidoscopic View," Sidney Z. Searles, Real Estate Law Journal, Winter, 1973. Mimeo

Done C. Chapter 32, Wisconsin Statutes.

Done D. "Markets, Market Value, and Just Compensation," E.M. Rams, ASA Valuation, Oct-Nov. 1975. Mimeo

Dec. 1, Wed. APPRAISAL FOR CONDEMNATION (CONTINUED)

A. Rules of Compensability and Valuation Evidence for Highway Land Acquisition, Highway Research Program Report, Dean T. Massey, University of Wisconsin, Madison, Wisconsin.

Done Chap. 2: Qualifications of Witnesses Giving Opinion Evidence

Done Chap. 4: Admissibility of Evidence of Sales of Similar Properties

Done Chap. 5: Admissibility of Evidence of Sales of the Subject Property

Done Chap. 6: Admissibility of Evidence of Income

Done Chap. 11: Admissibility of Evidence of Reputation or Sentimental Value

Done Chap. 12: Admissibility of Evidence of Highest and Best Use of Property

Done Chap. 13: Admissibility of Photographs or Other Visual Aids

Bus. 856, Fall 1982

Done B. "The Expert Witness From A Lawyer's Viewpoint,"
Fred M. Winner, Condemnation Appraisal Practice,
pp. 445-452. Mimeo

Done C. "What is Expected of the Expert Witness?"
John D. Cochran, Condemnation Appraisal Practice,
pp. 453-460. Mimeo

Dec. 6, Mon. GOVERNMENT STANDARDS FOR APPRAISAL PRODUCTS

Done A. "The Demand for and Supply of Real Estate
Analyst Reports," Herman Kelting, Real Estate
Appraiser & Analyst, Jan.-Feb., 1979. Mimeo

✓ B. A Guide to Appraising For Federal Agencies Text

Dec. 8, Wed. THE BUSINESS OF APPRAISAL PRACTICE

✓ A. "Real Estate Service Firms Must Sell
Themselves," Park Weaver, Jr., Real Estate
Review. Mimeo

Done B. "Managing An Appraisal Office," Harry Lewman,
published by American Institute of Real Estate
Appraisers. Mimeo

Done C. "Fee Appraiser's Contract Form Developed," The
Real Estate Appraiser, March-April 1976. Mimeo

Done D. "Standards of Professional Practice & Conduct,"
Real Estate Appraiser & Analyst, Jan.-Feb. 1980,
pp. 18-33. Mimeo

Done E. "The Liability of the Appraiser (1933),"
J. George Head, "Appraisal Liability (1982):
Who May Sue?", Morgan D. S. Prickett, The
Appraisal Journal, July 1982. Mimeo

Done F. "The Role of the Professional Appraiser in the
1980's," Carroll Pennell, II, The Appraisal
Journal, Apr. 1981, pp. 205-213. Mimeo

Done G. "Certification of Appraisers: Issues,
Dilemmas, & Prospects," David Nielsen, Appraisal
Journal, Apr. 1981, pp. 259-270. Mimeo

Dec. 10, Fri. * * FINAL EXAM * *

Examination Book

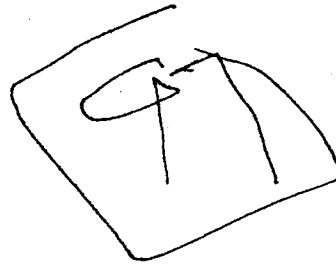
NAME JOHN D. DREIER

SUBJECT BUS. 856

INSTRUCTOR PROF GRAASKAMP

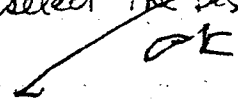
EXAM SEAT NO. _____ SECTION _____

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I.

B. Statistically oriented def'n of value = Colwood used this concept to define different kinds of value ~~like~~ (ie. mean, mode, median). He used a non-linear transformation of a linear method to achieve what he said was a superior method. By using the approach, ~~he~~ ^{he} derives a mean -- which he said was the "best" def'n of value and a mode that he said Ratcliff used for most prob. price, and a median. He said the appraisers should select the best one based on his particular needs. 

D. Entrepreneurial component to cost: Sanders Kahn wrote at least 2 articles about this. His thesis ~~is~~ ^{is} that the cost approach should include an entrepreneurial component in order to be accurate. In effect, Kahn is saying that entrepreneurial mgmt. is inherent in the RE. There is a problem w/ valuation here, because entrepreneurial costs are not inherent in the RE, but are part of the construction process. If you take Kahn's approach, it will lead to over valuation and over lending. Kahn also says that entrepreneurialism applies to the ~~cost~~ ^{residual} approach.

This points up the fact that appraiser has not learned to handle intangibles in valuation; accounting has! 

C. Cash equivalency = a concept or procedure that is necessary to adjust actual real estate prices ^{of comparables} to their cash equivalent basis. When RE is sold with ~~more market~~ below-market financing or if the seller pays, the buyers points, this means that the favorable terms ~~changed~~ the effective price of the RE vs. the market value which wasn't affected. Therefore, the appraiser must adjust the ^{comp} sale to get a cash equivalent price. This methodology is used to comply w/ the FMV def'n of cash to the seller or the most probable price def'n if predominant terms ~~in the contract~~ differ from what was actually paid.

E. Value: this is an eclectic terms that has numerous meanings. The two predominant def'n's of value in our readings were fair mkt. value and most probable price. However, investment value, subjective value and cost to replace value were also discussed. ~~Fair mkt. value~~ Value def'n is the key element in defining ~~the~~ analysis approach and the ultimate value of the property, according to Wandt.

Value definitions were born in economic theory and evolved from Marshall, Babcock and Ratchiff. Value is within a context and it depends on the function of your appraisal (contemporary view). The traditional approach defined FMV first and went on from there with 3 approaches and denial of the client's needs.

Value def's have been influenced by investment people, securities people (P/E ratios) and accountants (depreciation)

Value to traditional appraisers is almost always fair mkt. value; to the contemporary appraiser, value depends on the question to be answered.

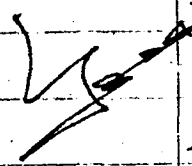
III.

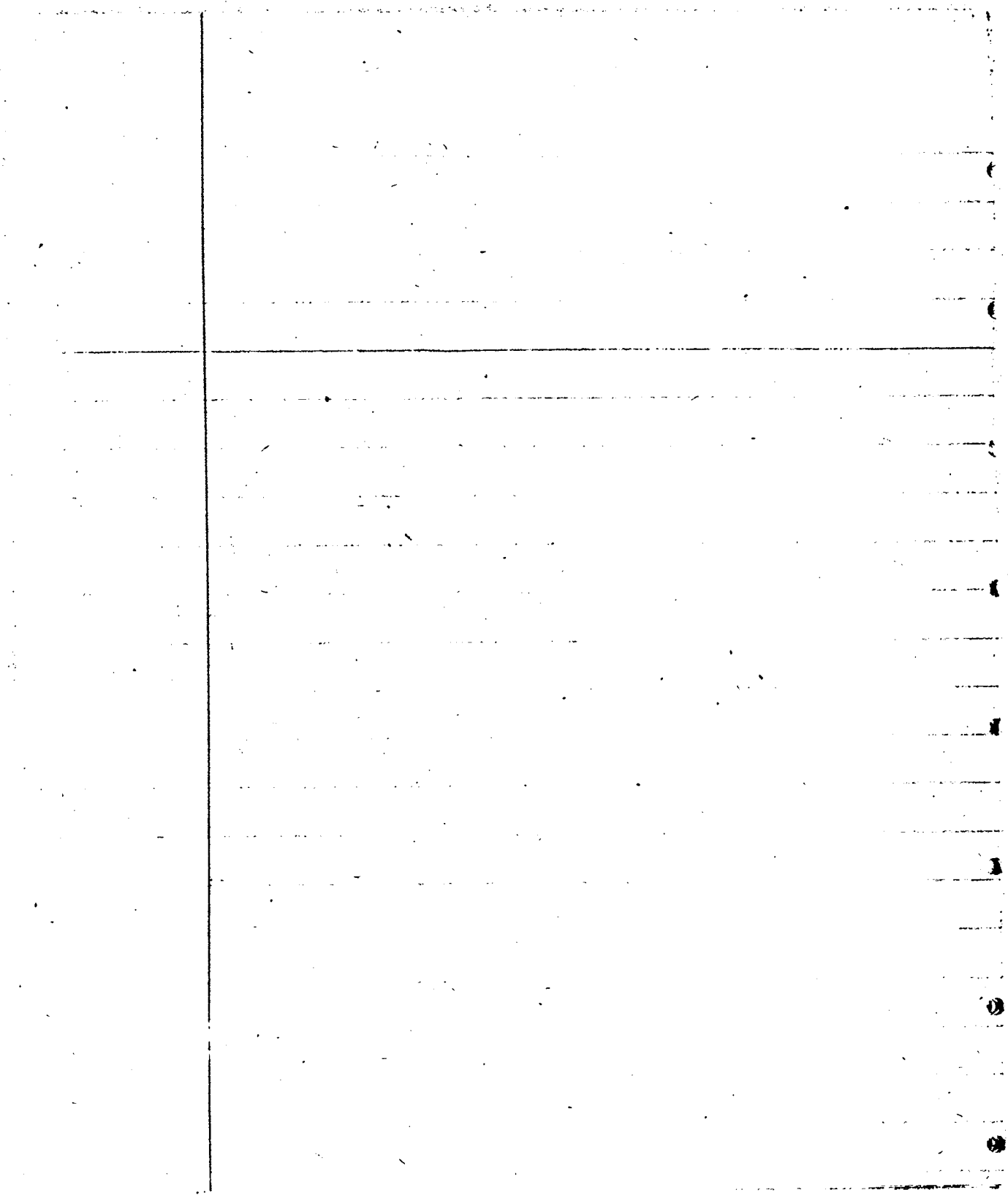
(A) Ratcliff's attack on the cost approach is quite brutal, but useful. He begins his attack by showing how the cost approach is philosophically rooted in economic theory, which equates cost and value. Ratcliff vehemently denies this equation. He says cost and value may be related, but they are almost always not equal. Further, he says that the cost approach implies intrinsic RE value that is therefore ~~exposed~~ capable of measurement. Ratcliff says that RE value is not intrinsic in itself; rather, its value follows from its productivity characteristics in reference to consumer desire for utility and lack of scarcity. Thus, Ratcliff notes that the cost approach implies a specious accuracy that is false. He also disagrees with its implication that value is a single amount.

Ratcliff further destroys the cost approach by pointing out the travesty of separating land value from improvement value. He points out that RE cannot be separated for valuation. To do so, the appraiser develops a fictional situation that is illogical. Therefore, the approach is untenable.

Ritchiff also attacks the notion of depreciation in the cost approach. He asks on what basis the functional, physical and economic/locational depr. is estimated. Clearly, there is no market basis for doing so and depreciation is not accurate.

above all, Mr. Ritchiff is was a behaviorist who said the cost approach - and the income approach - ~~were~~ were not market derived and hence were not statistical inference or investment simulation.

 In contemporary appraisal, however, Ritchiff's comments may not always apply. Cont. appraisal looks at the question to be answered and then defines the approach and value def'n. If sufficient market data are not available to use the empirical approach and investor calculus via the simulation approach are not available, the cont. may elect to use the cost approach. He may be required to do so for a legal battle, etc. The cont. appraiser has flexibility of approach; he may or may not use ~~it~~ the cost approach.



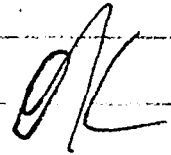
III ③ Hodges' article about Babcock's theories was useful. Hodges quoted Babcock frequently, from which we can glimpse into Babcock's approach to appraisal.

Babcock rejected the cost approach ^{and} disregarded the market approach in favor of what he called the fundamental way... the income approach. Babcock believed that RE value was a function of the "Use and program of future utilization that resulted in the highest land value." If a property has any substantive income that could be quantified, Babcock would use the income approach. His ideas are highly steeped in traditional economics and influenced by investment theories of the 1920's. Whenever possible, Babcock said, the income approach "should be applied."

Babcock rejected the cost approach as being a terrible methodology due to the inaccuracy of ~~separating~~ separating the land and improvements valuation.

Babcock also said that market value should be viewed over the long run as a warranted value and that market price and

market value weren't equal. Hodges also warned the reader to not prostitute himself by using approaches that ~~he~~ cannot be supported (ie. the cost approach); the appraiser must be true to himself and the ~~the~~ client by not adulterating the methodologies available to him.



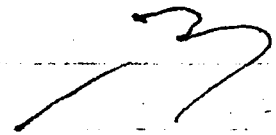
II. the current definition of HABU, as accepted by the appraisal societies, has changed significantly from Babbcock's def'n. the current def'n says that HABU is: "that use, from among those alternative uses that are reasonably probable and legal, that is physically possible, reasonable supported and financially feasible, that results in the highest land value." although this def'n has some strong feasibility overtones, it still says the "highest land value", which is the traditional view of fair market value ... which says "the highest price in terms of money that the property will bring in an open/competitive mkt under all conditions requisite to a fair sale, with the buyer and seller acting prudently, knowledgeably and the price subject to no undue influence." So, while this def'n of HABU is getting closer to feasibility and the contemporary approach, large gaps remain.

Fair mkt. value determines its value under the HABU, most probable price under the contemporary approach values RE based on its most probable use. Most probable use differs from HABU in that it looks to the most fitting and most probable use in terms of the solvency of the

participants and constraints such as ethics and government controls. The contemporary approach is feasibility oriented and it doesn't require that the price paid be the "highest" price, nor does it require that part. be in terms of cash, nor does it require that the parties be knowledgeable and it doesn't require that the buyer and seller has alternatives ~~for~~ on their indifference curve. The contemporary approach ~~is not limited~~ looks to the question of the appraisal first, in contrast to the fair mkt. value appraisal defining value first, and then selects the analysis approach based on what's needed for the job, not necessarily 3 approaches. Finally, the contemporary approach is client oriented, whereas the traditional approach assumes the value applies to anyone.

Thus, the "highest price" component of the HABU def'n leads to a specific set of fictional constraints (motivated, informed, time on mkt. is adequate, cash, available financing, etc) and a hypothetical client that are challenged by the contemporary approach. Contemporary appraisers recognize an actual client and they destroy the artificial market constraints thereby attaining a feasibility context.

Also, HABU implies certainty that Ratcliff rejects. He says that V_p (market value) is behavioristic and economic forecasting under uncertainty. The contemporary approach forecasts an economic event, the sale of the subject, and derives a range of values given the current state of ~~market~~ financial conditions in the market. Ratcliff says you can do this either via statistical induction of the future price from past sales or via simulation of the buyer calculus. Above all, the buyer in the market is the key to appraisal.



ADVANCED APPRAISAL (856)

FALL 1982

No class on Friday, Sept. 3

I. INTRODUCTION

A. Overview of Course —

1. The course is very detailed in orientation.
2. Grading: 50% appraisal, 50% english orientation.
3. Uses the contemporary approach using a range of values.

B. Property for Appraisal —

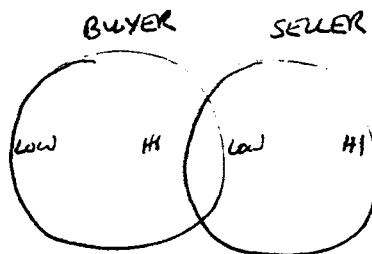
1. P.O. Annex Garage on William St. and Blair St. Has reached its life. St. to be reorganized. Neighborhood usin in the area.
2. Visit - Friday, Sept. 10

C. Traditional Appraisal Techniques —

1. Under fire from many sides today due to changes in the economy.

D. Defn of an Appraisal

- * 1. An appraisal provides a ^{a decision} benchmark for something. It deals w/ transactional behavior, a future event and incomplete info. It is a forecast of sales price and it must be a range of value w/ in which the price will range.



classic appraisal = a single conclusion.

* The appraiser must define what the range is and under what conditions it will overlap. Two keys: ① must have a price range and ② must have credit-
crinal assumptions assoc. w/ the central tendency re: financing and relative bargaining position of the parties. The conditions may be defined by law.

2. First issue = what is the question, what is the issue for this appraisal? There are different answers to different questions. Need a variety of questions.

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Today, the key question is how much to pay for a property or how much to offer on it. Many questions: ins. value, tax value, liquidation value
An appraisal is always intended to provide a benchmark for a decision. Rutcliff deals w/ the most probable price at which it would sell. $\Rightarrow$ what conditions, timing, financing, etc. are included here.

3. Most people involved don't look at the appraisal for decision making anyway. So a lot of doubt about appraisers exists today in industry. We are going to assume appraisals can be done.

E. Decision Making Behavior —

1. Man learns by trial and error. Appraisers have weaved a model of the reality of economic life to base their decisions on. Decision making has moved from deductive to the inductive approach (scientific method).

F. The Appraisal Process — Contemporary Approach

- * 1. The issue involved w/ the appraisal
2. A property in search of a use
3. Who needs it? And who needs it most?
- Inductively infer how others who have needed it (past transactions) to other people w/ similar properties and intentions. ^① Empirical approach
 - Failing this, we can ask people (buyer simulation) who may be in the same situation. Simulating the decision intention of the potential buyer. How people might behave. ^② Simulation Approach
 - Normative methodology - what would people do if they were as smart as me (idealized approach), the appraisers. If people really do use the normative approach, it becomes upgraded to the simulation approach. ^③ Normative Approach
4. Even though inductive, we still need a model to operate from in contemporary appraisal. Use the methodology in appraisal that works. Internal elegance is not key; the reliability of the conclusion is key. However, standardized process $\Rightarrow$ less legal liability.

Inductive
in
Nature
and
Empirical

G. Six Basic Appraisal Questions - Modelling Ideas

- * What app. is all about. {
1. What is the Question?
 2. What kind of relevant data do I have?
 3. What kind of hypothesis do I have that focuses the data on the question?

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Limits on modelling: Constraints

Criteria
in
Models *

1. Talents and tools available to the appraiser. Must choose "doable" models
2. Whatever you do must have credibility w/ the decision maker. Must know who the audience is and what they are looking for. Must know their needs.
3. What is cost effective? At some point you must go w/ what data you have. Most appraisers error of lack of detail.

EX: Use of Ellwood Techniques: Appraisers had great precision but terrible accuracy in many cases because they don't understand it. The Ellwood method has fallen from grace in the industry today. Ellwood suggested that the revision value of the property is not predictable $\Rightarrow$ are all assumptions questionable?

Appraisals rely on the density model: each assumption has a probability assoc. w/ it. Problem here is that appraisers don't know probability/statistics and neither do the readers. Today, we have micro computers that will do much of the job -- if they have confidence in the machine. Micros add greatly to what can be done in appraisal. A drop in data mgmt. costs.

Appraisal = ① data input. to obtain assumptions and to structure the assumptions to forecast sales price. ATT sees a huge market in the area of RE data.

② We are learning more about ^{how} people behave in the mkt. place. We even have a real estate price index now.

*

Every appraisal assignment and problem is an exercise in logic and we bring a group of tools together (sub-system) to create a report. The cost approach is a model and the income appr. is a model. The report is a model also in terms of communications. An appraisal is a series of sub-model systems that arrives at another decision and so on. We move through a logical progression to arrive at the ultimate decision report. Appraisal report = communication model. Cost approach = analytic model. A logic system implies the need to be consistent. Once you have determined a probable use, you must be consistent in discussing it further in terms of deficiencies, etc. Be careful to be consistent w/ in the framework you are operating in. Yet, you can't be too rigid and standard. Be consistent, yet not overly rigid and unrealistic.

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I. THE RELATIONSHIP BETWEEN "THE QUESTION" AND THE DEFINITION OF VALUE

A. Basic Ideas —

- * {
1. The key question in appraisal and the defin of value are related to the rights assoc. w/ the property which in turn affect the outcome of the appraisal.
 2. the function of the appraisal = the question to be answered by the appraisal. These two things are highly related. Question = purpose.

FUNCTION OF APPRAISAL	PROPERTY RIGHTS	RELEVANT DEF'N OF VALUE	ALLOCATION OF PRODUCTIVITY	BUYER MOTIVATION PRESUMED
• Tax Assessment	Fee simple private rights	Fair market value	Income attributable to land or improvements or fixtures there to	Patient man buying econ. productivity (econ. surplus)
• Purchase of an Investment	Encumbered title plus entitlements	Most probable price given alternatives and pinch point	Land, structure, personality, intangible assets less π centers for mgmt.	
• Mortgage loan (Non-partic)				
• Mortgage loan (participating)				
• Sale of Investment				
• Going concern purch. of business				
• Insurance value				

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- * {
3. Note that the traditional appraisal distinguished between function and purpose. Function was fire ins, eminent domain, etc. Purpose was a specific def'n of value. Chief uses the terms interchangeably because the value itself shifts once you know the purpose of the appraisal.
 4. The critical issue is not the purpose of the appraisal (Chief doesn't care about this) but the function of the appraisal ... what is it trying to do? What is it trying to serve as a benchmark for?
 5. Once the function of the appraisal is defined, we then know the property rights to be appraised. Then, once the property rights are known, we can then select the relevant definition of value. Next, given our def'n of value we need an allocation of the productivity of these rights. Finally, we have to assume a buyer motivation involved w/ the transaction. Thus, we see a process of definition falling out from the basic function of the appraisal.
 6. Example functions of an appraisal ...

[1] Tax Assessment - here you want to identify the income attributable to personality so you can subtract this from total income to arrive @ income attributable to land/improv/fixtures. This seems simple, but it is very difficult to separate out the appropriate income items to finally get down to only those attributable to real estate. How much of the income gets allocated to a unique oper. agreement which controls risk? The agreement may only be available on that one site. Next, one party may be getting cheap electric rates through a L.T. prior agreement. What about many personality items involved? How much of a \$1.5 MM of overage rent is due to merchandising vs. the unique synergy of the 2 major stores plus the other shoe stores in the shopping center? How much of the \$1.5 MM is skill of mktg. vs. the shopping ctr. itself. We quickly see that it isn't easy to separate out the income attributable to real estate only; there are many intertwining factors that complicate the issues. Once you set up the artificiality of "fair mkt. value" you are left w/ the question of what is the fee simple bundle of rights that comes w/ the real estate. You must separate out the income attrib to the location (real estate) vs. income attrib to mgmt or contracts, etc. Appraisals assume are. mgmt but what is that?

Point: Given the def'n of value, the real problem is how to reshape the enterprise that is on a piece of ground so we can correctly allocate the income attrib. to land/buildings because that is all we can appraise under the tax assessment case. Where is the value of the real estate ??? Must look carefully for what is RE income only.

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[2] Purchase of an Investment - he won't get fee simple title because there are many things already in place (i.e. leases, mortgages, etc.) Fee simple unencumbered means that all the leases are @ mkt. price, it means the loan is at mkt. rate. His purchase means leases < @ mkt., mtge loan < @ mkt., etc. He is buying an encumbered title; some encumbrances are positive and some are negative to the buyer. He may also be buying entitlements (public permission to do what you want to do). The buyer may have the only permitted use in a certain area. How much is this worth? Must separate this out from the real estate.

* { Peril point = stock mkt. concept that says @ some point the P/E ratio gets so far out of line w/ the cap rate that the rate of growth in income + the reversion are not likely to produce the necessary rate of return. This concept assumes a growth slope in income + reversion necessary to increase your yield to an adequate level. Ex. Pan Am Bldg. The rate of slope is too high to be reasonable.

In this case, for the \$75 MM price, we must allocate something for entitlements, merchandising ability/mgmt. skills, services, joint store benefits (franchise value)

Note: A good deal of appraisal today is working w/ these theoretical concepts vs. a knee jerk 7 times gross income approach. This type of thought merges appraisal and consulting.

Ex: Concourse Hotel. If the Concourse is sold under foreclosure, the owner would get the land and buildings, not the chattels (furniture, book of business, receivables, etc, mgmt.) because they forgot to perfect their lien on the chattels. w/o the chattels the hotel is worth \$4 MM vs. \$16 MM for everything. The judge said that they were entitled to fair mkt. value under the mtge. Once this was defined, strict appl'n of consistent logic was applied and the appraiser must strip out all non real estate items. This is very different than the going concern purchase of a business! The defin of value is at the heart of the appraisal assignment

* { Most appraisers start running and re shape the assignment to fit their preconceived notion of fair mkt. value. Contemporary appraisal, in contrast, applies logic through out the process and lets the question/problem guide his thinking and analysis. What is the issue?

1/1/82 lecture

EXHIBIT I

Critical Issues Which Define Appraisal Process

Function of the Appraisal	Property Rights	Relevant Definition of Value	Allocation of Productivity	Buyer Motivation Presumed
• Tax assessment	Fee simple private rights unencumbered	Fair market value	Income attributable to land and structures only	Purchase of economic productivity
• Mortgage loan (non-participating)	Encumbered fee simple private rights plus additional rights pledged	• Regulations - fair market value • Underwriting - solvency price or liquidating value	Fixed income pledged from all sources <u>less</u> costs of <u>creative management</u>	Share of economic productivity contributed by capital
• Mortgage loan (participatory)	Encumbered title plus non-vested interest in selected future revenues	Present value of all future cash flows	Variable income pledged plus share of reversionary interest	Share of economic productivity contributed by capital plus share in selected management returns plus positioning against devaluation due to changing conditions
• Sale of an Investment	Encumbered title plus vested entitlements plus going concern profit center opportunities	Most probable price above minimum acceptable alternative opportunity (threshold)	Return from land, structures, personality, and selected entitlements	• Increase in spendable cash • Increase in liquidity value of estate • Positioning to maximize probability of survival of benefits despite changing conditions
• Purchase of Investments	Encumbered title plus positioning for access to entitlements	Most probable price within perceived peril point limit	Land, structure, personality, and intangible assets less profit centers for management	Increase in spendable cash Increase in liquidity value of estate Positioning to maximize probability of survival of benefits despite changing conditions
• Going concern purchase of a business	Encumbered title plus positioning for access to entitlements plus reduction in risk for business start-up plus monopolistic market controls	Most probable price within perceived costs of alternative	Land, structure, personality, and intangible assets and good will plus profit centers for management	Increase in spendable cash Increase in liquidity value of estate Positioning to maximize probability of survival of benefits despite changing conditions

I. PURPOSE OF THE APPRAISAL AND DEF'N OF PROPERTY RIGHTS, CONT

A. Discussion of Buyer Motivation Presumed —

1. This is important because in order to have a deal there must be an overlap of buyer and seller perceptions. In general, the buyers perceptions are more keen than the sellers. The buyer is more current and aware of current mkt. conditions, The seller is less current; he's more in the past $\Rightarrow$ a lag in perceptions.
2. When looking at buyer motivation, you are also looking at buyer sophistication. He well informed is the buyer. Also, must look at the profit centers as the buyer perceives them. If you can identify the potential π centers of the buyer it can mean a captive buyer which may give you the high side of your price range. Different motivations lead to different price ranges. EX. Gas station in Middleton. Must look at who's in the neighborhood and the possible needs they may have for your land, etc.

B. Grid Sheet (Exhibit 1) Discussion Continued —

1. Non-participating Mortgage Loan

- | | | |
|---------------------|---|---|
| Prop. Rights | { | • Encumbered because of leases, etc. They won't give a mtge. based on what mkt. rent could be because they are already locked into $<$ mkt. leases. |
| | | • Other rights pledged may be the liquor license, Furn. + Fixtures, etc. You want to know the other rights being pledged. Permits, licenses, etc. |
| Def'n of Value | { | • Liquidating value is usually desired if the bldg. has been mismanaged and is going to be sold. The lender may also be interested in F.M. Value for eq. purposes. A lending officer must be extremely careful about the appraisal under F.M.V. The value may presume leases @ mkt. rates which simply isn't the case right now in the prop. The F.M.V. may not have anything to do w/ the real cash available. Fee simple value is X minus the leasehold int. equals the value of the prop. today $\Rightarrow$ proper way. Must subtract the leasehold int. to get @ the real collateral value of the prop. |
| Allocation of Prod. | | • As a lender you get the fixed income pledged less costs of creative mgmt. Mgmt. comes off above the Net Income line; only N.I. is avail. to the lender for D.S. Must define the income after the creative mgmt. costs. = income avail for D.S.
• He is interested in his share of the deal per his capital contribution; no sharing in equity here. |

2. Participating Mortgage Loan

- | | | |
|--------------|---|--|
| Prop. Rights | { | • He receives an encumbered title plus a non-vested interest (when and if earned) in selected future revenues. It is not an interest obligation. He gets $X\%$ over and above the D.S. It is contingent. |
| | | |

Def'n of 9/8/82 (BS6)

- Value { • Receives the P.V. of all future cash flows. He may use a split cap rate: one rate on the mktg; one rate on the participation.
- Prod. { • Var. income pledged + share of reversionary income
- Motivation { • Shares in capital productivity + shares in mgmt. returns + pos. position against devaluation, etc.

3. Sale of an Investment

- Prop. Rights { • Encumbered title + going concern + other app. + vested entitlements. Ex. sewer interceptors, highways, lakes and other benefits are key valued entitlements so not selling for simple title only. Spec. position in future app.
- Def'n of V. { • Will pay the most probable price above a certain threshold (alt. opportunity)
- Prod { • Productivity from land, structures, personality and entitlements: all sources.
- Motivation { • Increase in cash, liquidity value, positioning to max. Prob. of survival. Ex. Jome: Wilson Plaza: the buyers have a call against the \$26 rental GLA via the land contract so value will ↑ if rents ↑. If not, they have the option to sell it back to the seller. They pd. \$3 MM for positioning in paper money. Positioning means they can take advantage of the situation no matter which way conditions go.

4. Going Concern Purchase of a Business

- How much of it is real estate vs. personality, etc. The appraiser must find out the presumptions (re personality) and see if they rebut the facts. If so, the presumption may mean it isn't a fixture ⇒ change in value!

* C. Six Ways To Decide If Real Estate is Income or Not —

① Is the income from a retailing or wholesaling of space? Ex. ticket sales to the top floor of John Hancock bldg. are these revenues attrib. to RE? The value of income that applies to RE is the total floor rent, not the ticket sales. Tickets are entrepreneurial in nature and must be subtracted out. Ex. Parking ramp. Do you take the gross rent receipts or what it would lease for to a ramp operator? You use what it would lease for wholesale to an operator. Diff = mgmt. Ex. Shopping Ctr. in which tenant fixes up his space a lot. RE value applies to wholesaling the shell. What the store would rent for completely finished is a retailing game. Overage rent = f(mgmt), not the RE because base rent should be @ mkt. rates to begin with. Appraised assumes are mgmt ⇒ base rent, not overage.

② The Income must be attributable to space and services normally provided. Rent for apt. may incl. heat and janitorial but not maid service and doormen. The latter are not attrib. to RE and must be subtracted out of the income.

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- ③ The Income must be attributable to the normal service and utility package of the property. Electricity bought by the bldg. owner and marked up to tenants is not income attrib. to RE. It's a separate π ctr, not RE revenue.
- ④ Is the income attributable to a franchise logo or other intangible property interest?
Ex. Holiday Inns don't own their signs, the corp. HQ does. To get the true income attrib. to a particular hotel you must subtract off the franchise value that the corp. org. gives to the ind. hotel i.e. 10% from national reservation service. It is not a vested franchise because they must meet criteria to remain a Holiday Inn member. Ex. Concourse Hotel. \$3/night of the room bill goes to parking, so this must be subtracted out of the gross income of \$21/day. Must find out what is in the gross!
- ⑤ How much of the income is attributable to contract rents in excess of market rents? Not attrib to RE if you're doing FMV; it is attrib to RE if you're buying the encumbered position. For tax assessment you must go on fair market rents. Is there a contract rent advantage to the land lord that is not attributable to the RE? It may come from ~~amgmt.~~
- ⑥ How much of the income is attributable to financial factors as opposed to the real estate? Ex. ind. bldg. financed w/ an ind. bond. Income may be increased due to the influence of favorable financing at below mkt. levels. You must correct the mkt. rents to the cash equivalency of whatever it would cost to finance it in the conventional mkt.: if doing F.M.V. Under most probable price concept appraising what adj. do you make? Is the most prob. buyer someone else who will qualify for the ind. bond? Ex. Pension Fund. Investors got a \$1.5MM leasehold interest which means auto. rent increases in future. So paid less for the bldg. due to favorable financing. How you keep score makes a tremendous difference in performance. To compare pension fund performance you must know their appraisal rules which aren't disclosed.

Point: You must define what you're measuring, for what purpose of the benchmark, and then set up a set of working rules to guide you.

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PROJECT:

A. Assignment —

1. Estimate the most probable price as of Nov. 1, 1982
2. Estimate the discount, if any, that will apply to fair market value as of Nov. 1, 1982

B. Discussion of Project —

1. Mr. Foreman is the owner of the property. He is a tough bargainer and is currently ill. Price has been transient as a result.
2. We are talking about relating purpose to the definition of value.
3. Steps in developing scenarios for the property

- * {
- (1) physical attributes of the site
 - (2) legal / political attributes of the site as if it were vacant
 - (3) physical attributes of the structure: building code characteristics
 - (4) linkage attributes
 - (5) environment attributes - off site impacts

From an analysis of these 5 items we should be able to identify some alternate uses according to three categories ...

- Use Patterns {
- marketing existing uses
- (1) Existing use - w/o major modifications as an industrial bldg. + garage
 - (2) Modification of existing use - for remarketing; keep structure and Δ use. Renovation of existing property.
 - (3) Remove structure and re use site - change it severely
 - (3) Redirection of existing property to alternate tenancies and use

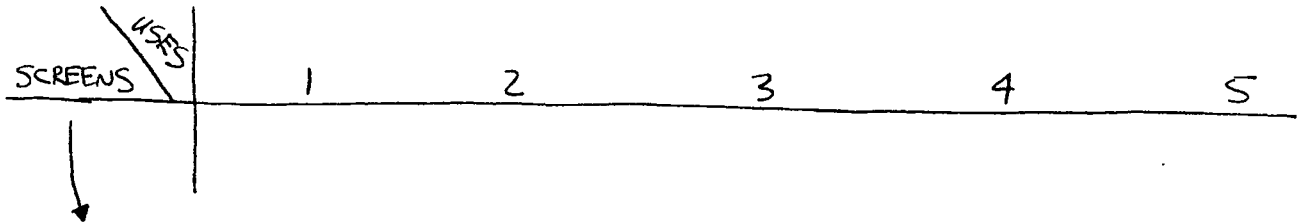
From the above we may want to identify 4-5 alternate uses for the property that fall into the above categories. May want to consider looking at alternatives with + w/o plotage value in influence.

4. Once the basic 4-5 scenarios have been developed, the next step is to apply screens to these alternate uses via a matrix ...

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1. What is physically possible? Many things won't be possible
2. What is legally and politically acceptable?
3. What is environmentally acceptable?

↓
[Eliminate some alternate uses]

Because the market analysis and financial analysis are most difficult you want to eliminate some alternatives via the first 3 screens.

4. Need to determine economic power.

- * Use the backdoor approach to find out how much power is inherent in the income flow.
- * You should only do appraisals on properties w/ current productivity; long term view is speculation which doesn't lend itself to appraisal. Too great a range of prices.
- * Economic power = f(a scenario about rents, oper. expenses, RE taxes, financing, etc. before taxes) Typically before taxes, but our prop. may be subject to a 20% ITC because it is > 20 yrs. old. This will impact tax liability and prop. value. It is a capital benefit, not an operating benefit.
- * Use the backdoor approach on each of the 5 scenarios. Drive down from mkt. rents to oper. expenses and finally arrive at the total investment under the scenario. From this total investment, then subtract some allowance for the cost of the execution of the strategy. The residual value is an index of the economic power that is inherent in the income stream. It has nothing to do w/ appraised price or impact of future appreciation. It's simply an index of the prop's capability to generate out of its own income a justified capital price. It gives an order of magnitude to rank different scenarios in terms of most probable use.
- * Tendency toward too much detail at this point - use the broad brush approach and simply run through the approach to get an idea of how to do it. An appraiser's role is not too get too detailed. Note that cost data about the bldg. may already exist via the owner. Costs of corrective action. Another way to look at costs is to say "OK, \$25/ft² is what the rents will allow us to spend on remodeling, etc. so let's prioritize and see what we can get for the \$25/ft². Set a target and move down.
- * The result here should be a net dollar amt. of the estimated economic power of each scenario.

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Assignment: By Monday, prepare a 1 page matrix that results in a statement of what I consider the alternative uses to be. Incl. uses and screens and discussion.

5. Determine market risk of each scenario.

• How can this be handled?

6. Determine financial risk of each scenario

• How can this be handled. How predictable are rents and expenses? The degree of pickiness of the bldg. code affects this.

7. Is there an Investment Tax Credit of significance?

Q1. WHAT CAN I USE THIS PROPERTY FOR?

* { the result of this matrix analysis is a conclusion stating that the Most Probable Use is ... #2 or #3, because it has the highest economic power and highest legal acceptability and best mkt demand and it has an ITC which the others don't have even though it is environmentally somewhat unsound.

Q2. WHO WILL WANT TO USE IT?

the next step is to identify the Most Probable Buyer via field discussions, etc. Past interested buyers were MG & E, a manufacturing concern and the Reynolds Family. Note that almost all the bldgs in the area are for sale. Assemblage by MG & E and Reynolds Family is possible.

Note: Ultimately, we need some schematic sketch of the alternative use for the property so we know how many ft² are leaseable. Do a rough sketch.

Rents downtown: Class B office = \$8.00 - \$8.50 / ft.²

Apartment = \$5.50 / ft.²

Industrial space = \$2.00 / ft.² + utilities

Note: At one point there was an attempt to put a large portion of land in our site area together and then reroute Williamson St. Object is to get a large parcel of land on the lake. Marty Rifkin.

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c. Discussion of Relationship of alternate uses and Most Probable Buyer —

1. Creativity = $f(\text{ill defined problem})$. A well defined problem doesn't require much creativity. In our case we have many options and can use creativity in how to best use it. Use common sense so you don't get too grandiose.

Arden Kei / Descon Architectural Firm / Inventory for Redevelopment
Comments:

- A deep cord box truss so it can be made w/ light channel irons. Can support the roof only w/ snow load + another 10 lbs/ft.² max for a suspended ceiling or HVAC.
- Roof is an interlocking metal tan w/ light fibre board on top that is disintegrating in the area of the clear story windows in the center portion of the main garage. Roof is pitched inward so const. only required 1 set of down spouts $\Rightarrow$ saves money, but it requires H₂O removal @ center of bldg.
- Deep trusses may mean the possibility of a 2 story structure.
- Walls are brick over block w/ no insulation. Frost problem, cold temps inside. Pipes were insulated inside.
- The 2nd annex trusses run the opposite, so you could share the bldg. off. Each bay is self supporting so a portion could be cut off $\Rightarrow$ important if Williamson St. is Δ ed to a 4 way. May have to share off 1 bay for this.
- City is reluctant to use eminent domain because of cost... pay for prop. + relo exp + lost business expense. Taking is very expensive; more expensive than simply buying the prop.
- \$125,000 price on land and bldg. @ car dealership

- * {
2. With a particular use in mind, you now begin to look at the pattern of surrounding ownership. This begins to suggest the most probable buyer. It may be a speculator, or a buyer for own use.
 3. Once you have identified 2-3 most probable buyers, then you must match this against your most probable use. If your most probable use involves a great deal of marketing expertise, then this will eliminate the little guy as a most probable buyer. So you must consider the necessary characteristics of the most probable user as to how the most probable buyers fit these requirements. What talent level is required?

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- city for
redew. →
- the Reynolds Family is a serious most probable buyer. They own the land to the NE corner of our site, the office bldg. across the street, and machinery row across Williamson St. They have been accreting land in Madison for some time and they are interested in the area $\Rightarrow$ and they are under pressure to sell their other truck operations on E. Washington $\Rightarrow$ serious probable buyer. A match here 'cause they are a warehouse/moving firm.
 - MG & E is also a possible most probable buyer. They have a huge investment in the area, and they are a big anchor to the North. Why did the deal fall down in the first place. MG & E corp. HQ is in the area. \$3MM underground investment in area $\Rightarrow$ they can't move due to high costs.
 - Many local developers are making a specialty of redoing old bldgs. in the area.

Point: a classic Real Estate in transition problem!

4. Between the most probable use and most probable buyer we should define the problem at hand.
 - Is there a consistency in what MG & E has paid for land? The Reynolds Family?

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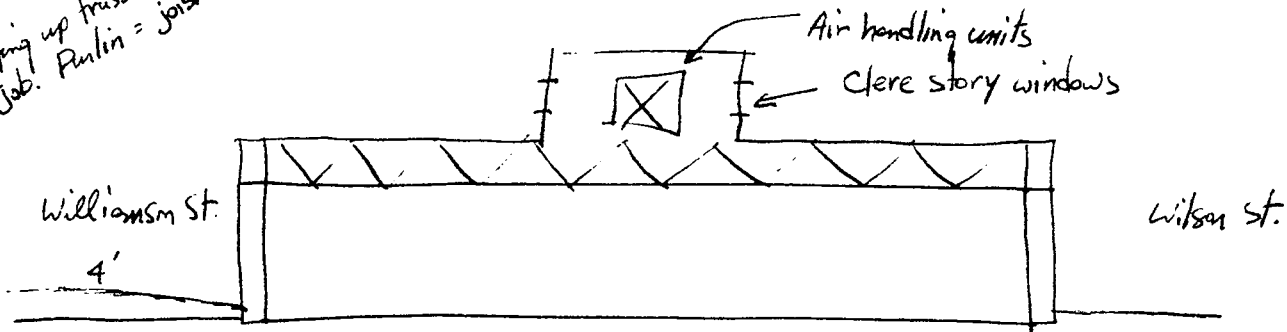
I. DISCUSSION OF MOST PROBABLE USE

A. Architects Discussion of Building —

1. Built in the early 1950's
2. Masonry load bearing w/a girder system; built w/economy in mind.
3. Roof

Trusses are light. May be able to put in m roof - if scattered. Joists are light. Beefing up trusses = big costly job. Pull in = joist.

- Nothing done since original const.
- 1/2" fesco board on roof (cellulose) that keeps the roof from sinking (spacer).
- The upper monitor is a raised roof; it (the edges) are collapsing. If not repaired it will worsen over time. The box = the Monitor. Clerestory windows.



4. Grade Problem

- The Williams St. side has a higher grade which results in water running down the interior ramp and causing problems.
- The grade problem has also caused an exterior masonry problem. The water runs against the bldg. and wicks inside causing eventual masonry deterioration.
- The water is also affecting the base of the steel columns; will cause problems in the future. The site drains into itself $\Rightarrow$ problem. Need to Δ slope @ cost.

5. Bay Sizes, etc.

- Main beams in garage = 22' o.c. 132' deep
- Annex = 132' X 66'
- Slab to truss height: West Annex 9'4" to truss
Garage 12' to truss (constraint)

6. General condition: bldg. shell is in very good shape.

- No columns on edge of clerestory.

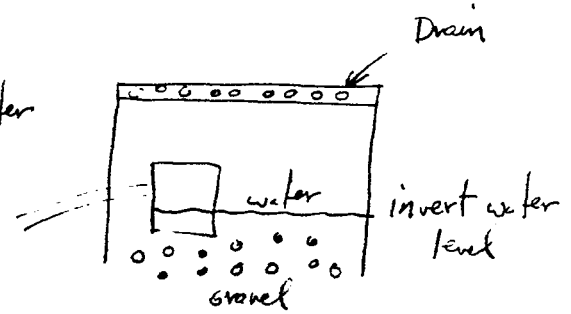
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7. Floor Drainage

- It has a typical system. The standing water inside the drain is no problem.



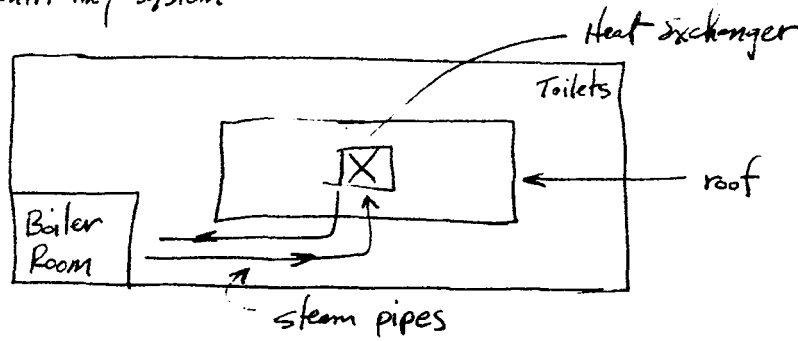
8. Wall structures

No load bearing walls

- There is a steel wall between the garage and annex; it is not load bearing.
- All of the walls are movable, only the columns must be carefully considered.

9. Heating / Ventilating system

Can beef up columns a little w/ st.



- A roof hatch serves to obtain fresh air and blow it into the bldg.
- Space heaters are in the annex and perimeter of garage.
- Current heating system is not acceptable for an occupied space; it can handle a garage type use.
- No Air Conditioning. Boiler = probably oil; it may be able to handle other uses.

10. Floors

- Slab on grade w/ $\approx 3,000 \text{ lbs/ft}^2$ strength. Only constraint on floor may be a heavy machine w/ a heavy point load.

11. Electric System

- Need a new electric system. It is only light warehouse now w/ a 400 amp. panel w/ add ons.

Note: M&E interest in subject site. They have recently purchased 3 bldgs. in the area for storage so they have adequate space and are not interested in the subject on a S.T. basis; maybe L.T. however.

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B. Preliminary Most Probable Use Discussion —

1. Re-use of the existing shell (EX. Parking Garage)

(a) Cars
(b) Trucks

- Demand - who would use parking downtown? Reynolds family is one, the Madison Fire Dept. is another. The Reynolds family owns the bldg. next door and the bldg. across the st.; in addition, Reynolds owns a strip of land adjacent to mkt. square and mkt. st. near E. Washington. The city wants to use this space for an infill residential project, so the city is looking for land to trade Reynolds for the infill land. Reynolds currently uses the strip land for parking trucks, etc. The general city plan for the strip area and our site is to reduce heterogeneity and conflict of uses, and make it a residential area. Either the fire dept. option or the Reynolds option suggests that the city may buy the subject and trade it for advancing city plans in other areas.
- Political acceptability - it may be illegal in view of city rules. Hence marginal at best.
- Economic power - In terms of auto parking, rents run \$25/mo. for covered parking and \$20/mo. for uncovered. \$210,000 backdoor for car garage option. Truck option rents for \$1/ft/yr $\approx$ \$35,000/yr. Net basis.
- Physical / Technical - may have height problem for very large trucks; need smaller trucks, perhaps.
- Environmental - may leave a social vacuum

2. Redirection of Building for Remarketing (EX. Light Manufacturing)

- Market - soft. A rail siding was proposed previously and turned down.
- Economic Power - \$2.10 to \$2.15/ft/yr. net of taxes
- Political - may be unacceptable due to Marquette neighborhood desires. They want employment, but of the clean variety.
- Technically - OK, but must replumb, rewire and relayout.
- Environmental - visually unappealing; may impact the Fauerbach.

3. Significant Change (EX. Specialty Retail)

- Market - Politically, a food mkt. of the small merchant variety is desired in the area. Problem is the mkt. draw on the East side. MG & E's cafeteria overflow may be a mkt. for a spec. restaurant type use. Question is how many employees actually work downtown and what % would use the restaurant.
- Linkage / Access - parking will be a major constraint for a mixed office/retail use. A viable alternative if not enough parking is to remove part of the bldg. and turn it into parking

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- Note that it will cost ~ \$8/ft. to buy land downtown for office space. This is much higher than West side Madison for office space.

4. Vacant Site (Ex. other use)

Note: available "kickers" in the area for a deal

[1] Tax Credit

[2] TIF financing - the city is currently considering a TIF from the Cardinal to Berkeley St.

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I. PROJECT DISCUSSION

A. General Comments on Data, etc. —

1. Traffic patterns - what happens in the block and area will be determined by the citizens committee and the alderperson. Currently in a state of flux. It is likely, however that the street pattern will follow the kinds of uses that the city would like to see on the site. See 6 below.
2. Political analysis - see the Marquette report.
3. Expense data - from B.O.M.A., U.L.I. and # and \$ of shopping centers. Heating costs are unique to individual bldgs.
4. Other data -
 - Renovation costs = 12¢/cu. ft.
 - Equity Dividend rate = retail 6-7%; suburban office = 8-10%; industrial space = 2% w/ DCR near 1, default @ .95 w/ triple net lease.
 - Renovation costs =
 - Major: \$40/ft.² w/ wiring, partitions, w/ HVAC Δ, carpeting, ceiling, floor.
 - Family major: \$30/ft.² w/ drop ceiling, floors but no major Δ's to walls, etc.
 - Superficial: \$15-\$20/ft.² w/ no major HVAC Δ's
 - New costs = use Marshall + Swift
 - HVAC alone costs \$9-\$10/ft.² Need insulation.
 - Default ratios
 - office 85%
 - Retail 75-80% overbuilt in Madison
 - Industrial 95% w/ triple net rent
 - Insurance costs ≈ 1% of capital costs at least
 - Roof cost estimate: (a) redo present roof; (b) allowance for insulation on roof on inside and then drop ceiling ⇒ reducing cu. ft. of heating space.
5. Estimate rents as of the date of appraisal, not into the future. Warehouse rents in Madison = some info. in handout, some in market place. Read sales data from Fred.
6. Traffic changes - must note that the intersection is high on the priority list for redesign and must estimate the implications of this on the linkages and what some of the alternative traffic proposals are and what their implications are. May have to suggest that 4 or 2 scenarios are dependant on a given traffic redesign scenario which leads to the need to est. the prob. of the traffic scenario actually occurring. Must also consider RR tracks.
7. Railroad tracks - the one closest to Wilson St. is Northwestern RR; at the intersection it is the Milw. Road (on the ropes financially). The railroads are unprofitable.

Gut and rebuild
= \$38-\$40/ft.
Cosmetics job on Churchill
Bldg = \$15/ft.

not talking. The city cannot condemn the RR; even if they do the city must re-locate them @ large expense.

II. ALTERNATIVE USE ANALYSIS

A. Continued Refinement of Most Probable Use - 4 Options

1. Building As IS / Existing Use
 - As a garage or light industrial w/ some remedial insulation, etc.
2. Renovation of existing property
 - Multi-tenant operation like Independence Square (Greg Rice) which was formerly industrial space. Break up the space.
3. Redirection of existing property
 - May have subcategories here: (1) retail (2) athletic club
4. Replacement of existing facilities
 - Demolition and redirection according to our perceptions of the linkages in the nea.

*

Note: Chief's model begins w/ existing uses is and then moves on to alternatives for the site (above 4 items). always consider starting over again w/ an empty site in every appraisal $\Rightarrow$ failing to do this will short change the client. Must explore different options up front. The existing use may not be the best use!

Point: Given an analysis of the physical, legal, linkage and environmental/dynamic attributes, the economic power question is next.

B. Economic Power via Backdoor Approach -

1. The appraiser is not a remodeler; he is an estimator and sets up allowances for things. Set up an allowance and then work backwards w/in the budget. We've got \$30 to work w/ what is the 1ST step to attach and solve w/in the budget. "the bldg. costs \$X and I can make it go at \$X/\$ so I know I have \$30/\$ for renovation, etc. What can I get for that?" Allocate the \$30 budget.
2. An appraisal must be sensitive to the deficiency of the bldg. relative to building codes. Ex. # stair wells appropriate?; # exits ok?; does it meet the handi-capped code (if $> 20,000^{\text{gross}}$ it must meet this); does it have enough washrooms?

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3. An appraiser must check energy codes to see what is required. EX. % of exterior wall area that is glass, the R factor of the roof. Our bldg. has glass all over so we may need to brick up a lot of it. However, this will create a lighting problem. The bldg. is very inefficient now so any energy efficiency changes will have a major impact. It is almost an outside possibility now!
 4. Once the codes have been examined, then you must be careful to not get into trouble w/ the uses. Typical problems: if the bldg. use involves >99 people you are subject to a tough part of the code (public assembly). Building code public assembly code. A 1 story bldg. is hard to meet, but a multi story is difficult. The code changes at 4 stories. The cost to comply may be prohibitive!
 5. The backdoor begins w/ rents at a triple net basis, etc. Can use mkt. rent as long as you assume the subject has the same efficiency - in terms of utilities - as the prototype you're relating to. If deficient, you may have to adjust the rents downward. Most industrial bldgs leak like a sieve so may not have to adjust.
 6. After rents and # units, then use a stick drawing to visualize what is rentable. You need a concept for lease to produce an income figure (net rentable area).
 7. After rent and terms, you can adjust expenses (if any) and drive down to NOI; then apply a DCR - which is sensitive to the character of the specific project. Δ the DCR for different scenarios. The more elaborate the remodeling and the better the mkt. for a scenario, then lower the DCR will be.
 8. In addition to the M.C. on the loan, the lender may want a piece of the action. So on the grid, scratch out risk reserve and put in the participation. The lender will get 10-25% of the CTO. A 1.20 DCR $\Rightarrow$ \$1.20 of income, a \$1 in debt and 20¢ left over. If 5¢ vacancy, you then have 15¢ left and the lender will get 25% of this or 3.75¢/¢ in a kick above and beyond the interest you have pd. him. 25% of CTO after D.S.
 9. The object of the backdoor is to arrive at the total value of the project completed minus remodeling equals the economic power of the asset. It is not a residual value; just what you can do from income from the property. Not a mkt. value.
- allowance {
- * Point: If the mkt. comps. show heavy usage of L.C. terms it may cause a problem. Anyone who buys the prop. on L.C. will have major remodeling to do and the buyer won't be able to get financing for rehab w/ the L.C. so he needs the owner to subordinate or he must have fees. Problem is that Foreman is an SOB; he won't subordinate to your venture. So you need another financing arrangement in this case. Most building that are sold on L.C. don't need much remodeling. The owner must do the rehab out of pocket. If we
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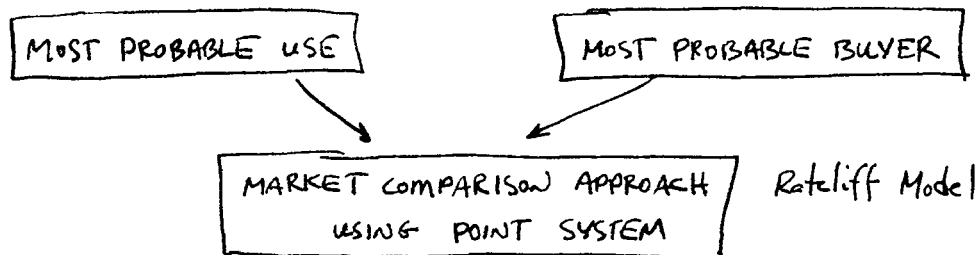
stick w/ an scenario that involves minor rehabing, than a L.C. terms scenario might be plausible. on a S.T. interim basis.

- * { In some senses the economic power calc. may be misleading. What is the highest economic power now may not be the highest residual value in the L.T. You adjust for this difference via the cash-in-cash requirement. Cash in cash is a proxy for three things:
- Cash in Cash Recognizes {
- (1) Tax Shelter Benefits - a low cash in cash may be acceptable due to the large tax benefits
 - (2) Reversion Value - a high, stable reversion value $\Rightarrow$ a low ConC requirement now 'cause you'll get the resale Π .
 - (3) Potential Increment in Land Values - a project may have no cash return in anticipation of an alternative use for the land. The econ. power may be high even though the cash output is very low.

How you select the ConC rate is sensitive to the above three things.

10. The holding costs of our project are largely opp. costs and Mr. Foreman has taken a hard line on the property. He will sell it when someone meets his offer. History of this position, but his position has died due to the medical situation.

Point: We are appraising for: (1) taking and (2) fair mkt. value but you could argue that FMV is irrelevant because it says that neither party is under any duress.



Steps:

- (1) Given the most probable use and most probable buyer, what are the most likely units of comparison? $\#$ of bldg. area? $\#$ of land? Front foot? Pick 3 alternative measures that have some plausibility. $\#$ of land, $\#$ of building and something else.

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- (2) Next, run a linear regression on this: run price against the 3 indexes we picked above. Choose the base of comparison that has the best R^2 . The best R^2 becomes the unit of comparison. You have already explained the R^2 percent of the variance, so the point system only deals w/ the unexplained variance.
- (3) Next, set up 5 or 6 things that I think the buyer will look at: efficiency of the bldg. for heating, A/C; flexibility of the bldg. for layout; access in terms of location, etc. and then grade each bldg. on a 1, 3 or 5 scale, where 5 = above ave., 3 = average and 1 = below average. 0 = doesn't have the attribute. Once you've made the call, don't tinker w/ it - go w/ it.
- (4) The weights are an attempt to explain what factors buyers think are important or at least a way to explain what they pay. Once the weights are defined, you come up w/ a price per point per square foot along w/ its mean and a measure of dispersion around the mean. You may end up w/ \$2.70 per point per $\text{ft}^2 \pm \$2.00 \Rightarrow$ too much variance so go back and change the weights to get a smaller variance. Change the weights so you can arrive at the best fit possible in terms of price/point/ ft^2 or whatever your base of comparison is. You want a very tight dispersion around the mean.
- (5) Finally, you apply the mean to the score of the subject property. You use the price/point/ ft^2 mean of the comps we have selected. You compare the comp. to mean of the comps, not the subject. This is a more-moment away from traditional appraisal.

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I. PROJECT DISCUSSION

A. Ideas —

1. An appraiser would go back and look at title data to see if the property has recently sold. This one has been in Forman's hands for a long time.
2. Roco's title search shows that the past history of the property gives no indications about its value.
3. lease on property - 20 yr. lease w/ renewal option.
4. Paths for scenarios:
 - ① Warehouses - see comp. package
 - ②
5. Appraiser needs a sense of land uses in the area: who is using properties that are like the subject? Reynolds, MG & E, Fire Department.
6. We have city engineering data.
7. Reed has roofing costs
8. Code violations: In 1980, transients were inside the subject property and complaints were filed.
9. No data on operating costs in the property. The holdings costs are RE taxes (\$7,075) and insurance (1%).
10. Most comparable property similar to the subject is independence center.
11. Neighborhood (see usage map)
 - The car dealership used to be a gas station; Forman sold this off.
 - Red Caboose Day day care center is new in the area
 - Reynolds re-habs a nearby bldg. Across Blount St. Light industrial.
 - U.W. Research Lab
 - Miller Horn went out of business
12. Marquette Neighborhood plan
 - Chief said that there "won't be residential on the triangular block".
 - Study by Commonwealth of opinion leaders in area $\Rightarrow$ not fixed opinions of the future of the area.
 - Marquette wants to see residential, but make take retail. They want more consistency in the area; less conflicting uses. Light mfg. may be OK, although heavy mfg. wouldn't be accepted.
 - Local neighbors (Reynolds/Mehlendorf) would be interested in what occurs in the area)

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13. Most probable user: will it be a user or an interim use or a professional investor.
14. Traffic / Access
 - The 4 way either way scenario is purely hypothetical. The city intends to go forward in 1984 w/ the drawn plan that we have. Assume the city will go forward w/ its plan. At least one alderperson doesn't like the plan as drawn. The traffic & plan will not involve eminent domain of current property. It is the path of least cost / least delay.
15. Soils situation - the water table is high in the entire Isthmus area; a creek was in the Blair St. access; a channel was once planned through the area. The soils aren't good, but you still can build most anything. Don't worry too much about the soils: marginal but buildable.
ht. of Lk. Monona.
16. Special financing - the city has never extended a TIF district beyond a single project. TIF is possible; Madison isn't eligible for UDAG. May use IRB's; 10 1/2% now. "Assume that special financing is speculative, but possible." "Int. rate will be 10 1/2 incl. guarantee costs."
17. Olin Place is a pipe dream - no substance behind it. Pennies lease is expiring and they likely won't renew.
18. Anxiety levels - the area has a bad image which may have led to the decline of the dinner theatre. The businesses in the area lead to a bad image: Cardinal Hotel, Wilson Hotel image, Comic bar image. A "tacky" area w/ an image problem.
19. The site is not conditional zoned.
20. Comp adjustments - if a post sale was on a L.C. you use the i rate @ the date of sale; get i rates from Journal of Mktg. banking
21. General market demand
 - Mkt. is soft due to high i rates and bad economy
22. Cost for a retail shell = \$30/ sq ft new less a credit for what is there
23. Plotage Value - for a retail use we will need the corner property. Plotage values runs to the site; not on it.
24. RR - the first track off of Wilson St. may be removed
25. Growth in area - should be concerned w/ which sector of the city is growing and its implications.

BUSINESS 356
FEASIBILITY MATRIX
SEPT. 20, 1982

TO: PROFESSOR JAMES A. CRACKLAND
FROM: JOHN D. DEER
SUBJECT: PRELIMINARY FEASIBILITY MATRIX FOR POST OFFICE ANNEX/GARAGE PROPERTY

IN COMPLIANCE WITH YOUR REQUEST, I HAVE PREPARED A FEASIBILITY MATRIX FOR THE SUBJECT PROPERTY (EXHIBIT 1).

EXHIBIT - 1

Finding tenants for the space?
Rev. that tenant will generate?

PRELIMINARY MATRIX OF FEASIBILITY OF ALTERNATIVE USES

	SCENARIO 1	SCENARIO 2	SCENARIO 3	SCENARIO 4	SCENARIO 5
	PARKING GARAGE	MINI WAREHOUSE	LIGHT INDUSTRIAL	INDUSTRIAL WAREHOUSE	SPECIALTY RETAIL
FEASIBILITY FACTOR	MOST	MORE	LESS		
• PHYSICAL ACCEPTABILITY	ACCEPTABLE	ACCEPTABLE	ACCEPTABLE	ACCEPTABLE	ACCEPTABLE
• POLITICAL ACCEPTABILITY	NEGATIVE	ACCEPTABLE	LESS ACCEPTABLE	ACCEPTABLE	MOST ACCEPTABLE
• ENVIRONMENTAL ACCEPTABILITY	GOOD/LOW	GOOD	WEAK	GOOD	MOST ACCEPTABLE
• JUSTIFIED INVESTMENT IN SUBJECT (ECONOMIC POWER)	+\$242,000	+\$220,000	+\$398,000	+\$273,000	+\$480,000
• MARKET RISK	MODERATE	LOW/MODERATE	LOW/MODERATE	LOW	MODERATE
• IMPACT OF TAX CREDIT	LOW	LOW	MODERATE	LOW	HIGH
• FINANCIAL RISK	MODERATE - DEPENDS ON DEMAND BY REYNOLDS OR MG, E AND COMPET- ITION BY CITY PARKING LOTS	LOW RISK - DEPENDS ON COMPETITIVE PLANS AND DOWN TOWN BYRIAL SPACE IN OTHER MINIWARE- HOUSE BUILDERS	MODERATE - DEPENDS ON DE- MAND FOR INDUST- RIAL SPACE IN DOWN TOWN MAD- ISON	LOW/MODERATE - DEPENDS ON SPEC- IFIC USE AND THE FUTURE OF INDUST- RY IN DOWN TOWN MADISON	MODERATE - DEPENDS ON EAST SIDE MARKET DOWN TOWN PURCH- ASING POWER

THE ALTERNATIVE USES THAT MIGHT BE PLAUSIBLE FOR THE SUBJECT PROPERTY ARE ALL ACCEPTABLE FROM A PHYSICAL/TECHNICAL PERSPECTIVE. POLITICALLY, SCENARIO 1 IS HIGHLY QUESTIONABLE WHILE SCENARIO 5 IS VERY ACCEPTABLE. SCENARIO 5 DISTINGUISHES ITSELF AS THE MOST ACCEPTABLE ALTERNATIVE FROM AN ENVIRONMENTAL VIEWPOINT. EACH OF THE FIVE SCENARIOS HAS A POSITIVE ECONOMIC POWER, RANGING FROM A LOW OF \$220,000 FOR THE MINI WAREHOUSE TO \$480,000 FOR SPECIALTY RETAIL. MARKET RISK LEVELS AMONG THE ALTERNATIVES RANGE FROM LOW TO MODERATE, WITH SCENARIO 4 THE LEAST RISKY. THE MINI WAREHOUSE OPTION HAS THE SMALLEST DEGREE OF FINANCIAL RISK; THE OTHER ALTERNATIVES EXHIBIT AT LEAST MODERATE RISK.

THE PRELIMINARY MOST PROBABLE USE OF THE SUBJECT PROPERTY WOULD BE AS A SPECIALTY RETAIL SHOPPING CENTER. THIS ALTERNATIVE PROVIDES THE LARGEST AMOUNT OF ECONOMIC POWER AND IS THE MOST ACCEPTABLE FROM A POLITICAL AND ENVIRONMENTAL PERSPECTIVE. THESE SUBSTANTIAL BENEFITS MORE THAN OFFSET THE MODERATE RISK LEVELS INHERENT IN THE PROJECT.

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I. PROJECT / GREG RICE DISCUSSION OF INDEPENDENCE CENTER

A. Details of Independence Center —

1. Located at 1245 E. Washington Ave. ; 12 blks. from Square at corner of E. Wash. and Baldwin St. Purch. in 1972 as a vacant machine tool shop.

2. Space components

- 40,000 ft.² office bldg. • 50,000 ft.² available for rent
- 240,000 ft.² industrial bldg.
- 26,000 ft.² garage space ; 6,000 ft.² rented ; 20,000 ft.² empty $\Rightarrow$ soft demand

3. When purchased, they split the bldg. up into smaller leaseable areas and built a loading dock in the rear for trucks and created a corridor inside for trucks.

4. Tenants : retail, warehouse

5. Mkt. is very soft for old bldgs.

6. Rent structures

- Utility costs are very important to tenants (#1 concern). They have a 6 year old radiant heating plant. A good heat system makes it more rentable. Radiant heat plant costs twice as much. Heat loss = f(differential between temp. ext. and interior). This system heats the floor and not the air. A new heat syst. is an alternative to reinsulating to bldg $\Rightarrow$ much cheaper for the new heat syst. No A/C
- \$1.50/ft.² for 15,000-20,000 ft.² area ; \$1.80/ft.² for 6,000 ft.² site. Tenant pays all utilities ; landlord pays maintenance on exterior + insurance + RE taxes.

Costs: insurance = 5.5¢/ft.²

maintenance = ranges from 2¢ to 10¢/ft.²

RE taxes = 22¢/ft.² Reassessed twice in 10 yrs. They chg. the tenant the inc. in RE taxes over the base yr. they move in.

commercial bldg. not industrial so RE taxes assessed by city.

- Lease term runs 1 year to 10 years. Rents are adjusted via the CPI each year ; they want 100% of CPI but will settle for 50%. It increases their rents. CPI has no relationship to oper. costs, however.

7. RE taxes on Class B office should be ~ 50¢/ft.².

8. Ceiling heights are important to tenants $\Rightarrow$ they usually need to go 3 pallets high, which is ~ 18'; they want to reduce their cost per pallet. Need 14' clearance for trucks. Very expensive to do on old roof and put in insulation (\$2/ft.²).

9. Heating system is a "catch 22": w/ it you can't command enough rents at the beginning ; w/o it your vacancy will be high.

10. Market demand:

- Very soft in old bldgs ; better in new bldgs.
- Not much space of this kind in Msn and not much demand $\Rightarrow$ look for special tenant needs.

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- Whether it is an advantage to be down town = $f(\text{access})$
- 11. Mkt. advantages - f independence ctr.
 - Low cost rent to tenants: cost of new bldg. would be \$3/ft² so ureq can cut this down to \$1.50/ft² w/ the old bldg.
 - 50,000 ft² available on mkt.; 14,000 ft² has been available since last fall; 30,000 ft² available since spring. Why not rented? Access to dock area isn't available for this space which reduces demand; Ceiling heights are only 12'.
 - Tenants typically want 90% warehouse space and 10% office for a mfg. facility.
- 12. B class office space in independence rents for \$6/ft² gross w/ land/lord paying all utils, expenses, etc. Spaces range from 150 ft² to 4,000 ft² on the 2ND floor; rents here range from \$6.50 to \$7.50/ft² gross. Allowance for improvements for B class office is ① S.T. lease = 25¢/ft² for paint, etc. ② \$2/ft² on a L.T. lease.
- 13. Mini warehouses
 - 2 story @ U. Haul place on Bedford Must have fire proof steel partitions.
 - They have been fairly successful.
 - Trammel Crow rents for \$3/ft² in Dallas for crafts type people for sales display and specialty retail.
- 14. Parking
 - Plentiful @ independence ctr; a big problem at the subject site. Parking is incl. free at indep. ctr. It is a big draw for office space.
- 15. locational concerns
 - People locate in the area where the bus lines; where they live is very important, so it somewhat limits the mkt. to east side people.
 - People would rather be in their own bldg. than in someone else's facility. Much more specialization among tenants so they want a special site and layout.

II. COMMENTS ON FEASIBILITY MATRIX

A. Chiefs Comments —

1. We need more specification of the feasibility factors; he suggested the following for alternative uses/categories:
 - location
 - Quality of construction
 - fit of the structural format to the proposed use
 - compatibility w/ neighborhood - environmental always has to do w/ physical fit of your use to the neighborhood. Use "environmental" w/ precision. Ex. noise/odors. It goes both ways - site to external and vice versa.

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- Linkages - road ties, visual ties, pedestrian accessibility
- Political acceptability
- 2. In terms of demolition, it would be best to speak of it as demolition and then resale as a clear site. Economic product may be \$2/ft² for vacant land. The vacant land price is an interesting point of comparison for highest and best use.
- 3. Fire Dept. influence
 - They are on a month-to-month lease on Blair St. and they are not actively seeking a new space. They need 12' clearance for trucks.
 - The site is for sale.
- * { 4. Note that the justified investment via the backdoor approach $\neq$ value of the property because you haven't acc'd. for residual value of the asset. Backdoor econ. power says "how much capital can I control with my income stream" $\neq$ purchase price.
- * 5. Financial risk
 - It means the relationship of NOI to DS. Items that relate are: low D.C.R. or less stable income or more unpredictable expenses $\Rightarrow$ more risk.
- * 6. Market risk
 - It says "Will there be a sufficient # of people to accept this."
 - Parking = the # of people who will park
 - Miniwarehouse = will lease it to someone else so you have an initial wholesaling problem and then a retailing problem to move the space.
 - Apts = is it no tenants or price? you can always sell them (rent them) at some price
 - Ind. warehouse = you comment on warehousing

$\Rightarrow$ market risk shifts for different uses. Don't use low, medium or high. What does the risk apply to?

Market risk not necessarily effective demand. Eff. demand is stabilized price, quantity is the only variable. When you speak of market risk he doesn't know if demand is varying or price is changing $\Rightarrow$ must distinguish. Mkt. risk is a comb. of both.
- 7. Use physical fit, not physical acceptability
- 8. Office use on subject site
 - The measure of economic power would be \$X/ft² less the cost of demolition.
 - Office conversion of existing site would be very difficult given ceiling hts, fenestration, depth of bldg relative to width, etc. $\Rightarrow$ a lot of area w/o windows or a lot of unoccupied cubeage. Very simple fit to the site. Office in a new bldg. maybe, but not w/ the existing structure. Need 1 parking space for each 300 ft² of area.

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9. Warehouse option

"the mkt. could be the city, either for its own use or for trading purposes." Or, it could be for a user/occupant. Use this at the initial stage of most probable use either city or private uses.

10. Biggest failure of the exercise = failure to distinguish between linkages of the site as it relates to mkt. for the site.

• Parking - it isn't related to a place w/ high parking demand

• Warehouse - may be excellent. Blair St / John Nolan. Truck linkages are bad.

The key here is the scale of the mkt. you perceive. 300' is very different from 1 mile in terms of acceptability of the linkages.

11. In terms of mkt. demand it is important to distinguish between tenant demand vs. a buyer for the property.

B. Discussion of Comparables / Screens / Weighting —

1. Set up screen characteristics for the comps (ie. M-1 zoning, bldgs. of a certain size, etc.) then screen down. You'll get a price / $\$$. Then must decide whether to adj. the prices for: (a) time ^{sale}, (b) terms/conditions (cash equivalency). You then end up w/ an adjusted price per $\$$. The mkt. for industrial property has been slow for 3 yrs so you may not need any adjustment... just say why. May adjust it for cash equiv. if the terms under which it sold are exceptional, so the guy bought the terms, not the bldg. You may want to subtract out the value of extra land area on the site.

2. You're now down to adj. price / $\$$. You now define the variables that are important.

- location
- condition/quality of bldg.
- visual quality of bldg. (appearance)
- HVAC systems - probably can't get this.

} Choose 4-5 categories.

3. Once you've selected the categories, then you must define what you mean by each of these elements. They may have > 1 sub defn.

• location 40% $\left\{ \begin{array}{l} \text{accessibility to trade area} \quad 15\% \\ \text{neighborhood} \quad 25\% \end{array} \right\} \text{ add to 40\%}$

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Condition of Bldg. 30%	↙ visual appearance 20%
	↘ age 10%

note: Don't be too picky about the subcategories. Legal political may drop out if all comps. are similar by your initial selection. You are looking for the elements that aren't explained directly in the price/space. They are not space related elements. They have to do w/ convenience, access, etc. fire proof vs. wood. You want the significant differences in the properties. You're trying to reduce the dispersion.

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See Tennessee Handout: exhibit 10, 20, 21. See special features in Maple Bluff Mkt. comp. system. ^{Cardinal Hotel}

Note: A group in Madison is trying to put together a 70,000 \$ health club concept.

I. INVESTMENT SIMULATION APPROACH

A. Idea —

- * {
1. It assumes you can simulate the calculus of the buyer, when you don't have comp. sales handy.
 2. Assume multiple tenants w/ multiple leases where you can apply a cash flow modeling system. Requires analysis of each lease for current rent, indexing and pass throughs.
 3. Must be careful of the purpose for the investment: tax assessment $\Rightarrow$ use of mkt. rent, not contract rent. Inv. value uses contract rent, not mkt. rent. The difference between the mkt. rent and contract rent = (leasehold) interest in the property.

B. Categories of Revenue —

1. The revenue elements in the statement are:

- * {
- Base Rent
 - Reimbursements - utilities, escalators
 - Common Area Maintenance Charge (C.A.M.)
 - Inflation Adjustment
 - Amortage
- } Sum = Cash Revenues

2. Each lease must be analyzed for each of those elements (5 above). Each of these items will have its own supporting schedule.
3. Be careful not to net the reimburseables or CAM against expenses. 2 problems: (1) time lag because the reimburseables lag behind; (2) prop. mgmt. firms have a % age for the collection of CAM (they charge) so the CAM amt. is marked up for this fee. CAM may show 110% of actual to allow for the 10% prop. mgmt. fee.
4. It is very deceptive to simply project 4 years lease income out to future years due to the impact of lease rollovers.
5. You must read the lease and you must determine how much they actually collected; there may be a big difference. The CPI increase may not be collected. It may not be enforced. Go to the general ledger.

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6. Appraisals are often used to judge the effectiveness of mgmt. performance in a bldg.

*
Need to est.
reassessed value
and millrate @ time
of appr.

Dean's Analytic
Rating System

C. Simulation of the Expense Forecast —

→ Expenses should be broken down into fixed and variable expenses.

1. Fixed expenses

- RE taxes - will it be reassessed? Mill rate? Fire rate = base rate; other ins. is added on
- Insurance - class properties Ind. rated bldgs. Rating = $\frac{1}{4}$ (occupancy, $\frac{1}{2}$ struct. hazards, $\frac{1}{4}$ hsekeeping, $\frac{1}{4}$ fire syst)
- Fixed mgmt. costs - Ins. rating bureau

2. Variable expenses (must break these down)

- Utilities - it is the major expense. First, get the budget for various items and compare it w/ state energy code data which gives a measure of functional obs. Use a mech. engineer to est. what is usable and what is not. Must decide what is good mgmt. and what is not. EX. N.Y. bldg. w/ lots of elevator oper. that is appraised w/ those excess costs. → \$300,000 over cost which means \$300,000 in value lost to the seller.
- Payroll / Salaries - one that bldg. related or service related beyond the ordinary. Must analyze each payroll component to see if the costs are related to the RE. If not, it must be backed out (don't incl. services or other IT centers like extra janitorial). Big impact on value.
- Custodial costs - best to find out what those costs would be if contracted out vs. the historical cost of custodial services @ the bldg. Get a cost est. from a local firm. Do the current costs listed on the G.L. make sense? Check it against the cost estimate (ie. X \$/sq ft for lobby space, floor maint, etc.).
- Maintenance and Repairs - difficult because the appr. doesn't know how much has been buried as an expense when it should have been a capital item. Categories are: (1) HVAC; (2) elevator syst. maint; (3) floor/roof; (4) exterior shell; (5) all other.
- Supplies and Materials

Appraisal will become
a clinic practice in
the future.

3. Capital Charges

- Tenant Improvements - they are charged in the year incurred and written off over 5 years
- Reserves for Replacement of short lived items that will be replaced during the timeline of the appraisal - only real cash outlays during the 5 year forecast period. On going replacement (ie. carpeting) can be treated as an expense. You must have a track record. Not depr; real outlays.

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- Deferred Maintenance - irregular. Is it periodic? If so he can incl. it as expense. If it is a 1 time thing, then it must be treated as a capital item. Expense items do not extend the useful life of the bldg.

Summary:

$$\frac{\text{Total Revenues from Real Estate}}{\text{(Total Expenses attributable to RE)}} = \text{N.O.I. before taxes, Debt Service or investor return.}$$

* The Appraisal problem = how to "convert" a periodic cash stream into a value, and how to convert the future reversion to a present value. All properties don't necessarily use discounting; hotels use a house profit multiplier that ignores the reversion.

See Handout II-12 p.62.

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Note: RE taxes are sort of a chicken/egg problem. You must only include the RE taxes in RE derived income, so some RE taxes may apply to other things; however, you don't know the value of the property 'till you incl. the RE taxes.

At the N.O.I. point you must make a decision as to how to treat RE taxes. If you are concerned w/ FMV for assessment, you strip out of income all income attributable to non-real est. components. Personal property and intangible property, and any thing else stated in the lease.

R.E. VS.
PERS. PROP.

Rules for determining pers. property: (1) that which can be removed w/o perm. damage to structure; (2) intent of parties; (3) tax intent of property

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Point: Once you reach the N.O.I. land, you must then ask yourself where you are going with the appraisal. Do I want income attrib. to the business? attrib to the investment? or income attrib. to just land and bldgs? This is the point where you strip income off if necessary.

Ex. Appraisal for Pension Fund (inv. value). Given your calc. of NOI, you must ask whether it is based on contract rents or fair mkt. rents. The correct way is to use fair mkt. rents and subtract out the difference between fair mkt. rents and contract rents. For pensions, you must report both the Inv. Value, the FM rents and the difference, which is leasehold value. w/o this full disclosure you can't tell if performance is above or not.

Best to start w/ fair mkt. rents, come down to NOI, and then subtract out the leasehold position to get investment value. Unit Rule = says you tax the entire property and charge RE taxes to owner. Only private side. RE taxes tax the producer surplus: problem is that ownership can be split many ways.

D. Conversion of Net Income into Value —

1. We begin w/ n.o.i. attributable to the enterprise and then adjust for non-RE income (if we are valuing the RE) = the income from the rights we wish to value.
2. Now, we must convert the income stream and the reversion to a pres. value. How to convert?

(1) Some type of discounting ...

- straight line system
- Haskold, Inwood, Ellwood

} Normally, properties aren't valued via a discounting approach.

(2) the Goldwell Banker Approach

- Which says ... how do people normally finance property today? What is avail. from a 3rd party? Are you interested in a cash sale (FMV) or will the seller help finance it? Or must you look to a 3rd party lender? For our case assume the 3rd party.

3. As the measure of risk, the Amer. Council of Life Ins., 1850 K Street Washington DC 20006 (202) 862-4000 gives data on lending ratios for different types bldgs and sizes (Chart F). It gives the Debt Cap Retn at a pt. in time

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4. Some D.C.R.'s are very stable:

- office bldgs $\sim 1.3 \pm .05$
- Shopping ctr ~ 1.15 to 1.20

Some are volatile

- Hotels ~ 1.5 to 2.2

The more stable the DCR's are the better chance you have in court.

$$\left\{ \frac{\left[\frac{NOI}{DCR} \right]}{M.C.} \right\} \text{ this gives the amt. of debt the project will carry w/ 3rd party financing.}$$

5. Next component is the Cash Throw off (NOI minus D.S.). CTO is being capped separately and different types of properties have different cap rates. The CTO (cash in cash) cap rate is a proxy for three things:

*

- (1) tax character of the Real Estate
- (2) general attitude toward appreciation and resale of the property - not actual price of sale but an attitude about where resale price will go
- (3) his perception of the volatility of the income - a risk factor

This is the initial basis for pricing a property, but it doesn't tell you what the investor perceives as his return. A property may be priced at a 10% ConC, but the investor may require a 18% Ret. on Inv. Therefore, he must determine how much appr. is necessary to increase the return up to 18% overall Ret. on Inv. Most use a IRR but many are shifting to a MIRR (flat mon. rate)

There is a difference between knowing an investor's expected RoI Return and his pricing of the property. You don't know their target RoI R given their ConC requirement. How to get anticipated RoI R. You can measure the ConC rate and there are patterns.

Typically ConC is 11-13% today - required and increasing due to less appr.

- Section 8 $\rightarrow DCR = 1.0 \rightarrow ConC = 1\%$ to -3%
- Small office $\rightarrow DCR = 1.25 \rightarrow ConC =$ up to 6% by EOY 2
- Pension Fund
Big Deal $ConC = 10.5\%$ to 13%

The cash in cash rate begins to reflect the investor's anticipation of where future rents will go. Need to consider the potential to roll the leases $\Rightarrow$ cash flow forecast.

The larger the leasehold values and the shorter the term of the leases, the lower the ConC will be. Why? 'Cause the investor is more confident of picking up the increased rents in the short term. Mkt. is moving away from long appr.

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U.S. Economy Summary: 1st Dallas Bank Pres.

- Stagnant economy for 3+ years
- Stagnant RE mkt. w/ little appr; game is prop. mgmt.
- Int. rates won't rise much
- Will be political stalemate for 4 years

I. CONTINUED DISCUSSION OF CONVERSION OF CASH STREAMS AND REVERSIONS TO VALUES

A. Coldwell Banker Method —

- * 1. Consists of formatting in terms of DCR and then adding to that the disc. value of the CTO.
2. No need for consideration of reversion here, because it assumes the Cap Cost rate is a proxy for appreciation. It doesn't require you to guess about reversion values.

B. Secar's Method = PV of Equity Returns before or after tax —

1. You take the orig. mortgage Balance + PV of CTO to Equity position + PV of Equity Reversion after all claims (taxes, etc.) have been paid.
2. This method assumes you'll have a sales price in the future; hence it requires an estimate of what the reversion value will be. Ways to forecast the reversion value?
 - (1) Net Income Multiplier — it is typically set under the mkt. multiplier. If mkt. is 10, they use 9. Cap rate = $1/\text{net income multiplier}$
 - (2) Est. a threshold for buying vs. threshold for return — Ins. Cos. often use this. It assumes the resale price will be some fixed amt. above the mtge. balance. Ex. may be \$500K above the mtge. balance. They want to assure an adequate return from income alone; they aren't depending on resale except a salvage value of say \$500K, like in the example.

C. Third Method for Conversion = Pick a normalized year and apply a Gross Rent Mult. —

1. Once the GRM is defined, you must test the presumed re-sale price to find out what the yield to the next investor would be at that price. You can't just extrapolate a resale price to the future using N. Inc. Mult. or GRM, you must test that price to see how it would apply and appeal to the next investor. Most appraisals fail here because they assume an extrapolation of current trends and don't test it. You must go one step further and assume that someone buys the property @ that price. How would they do? It may be a good deal for you but a bad deal for the buyer. Must test the assumptions.

CONVERSION
METHODS

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2. Most investors view that an investment should be a good return even on a cash basis. Because there is less dependence on investing for tomorrow, the investor will want a respectable ConC return up front.

Note: In the Tenny Bldg. example, landmark used the weighted point system to get a central tendency of \$1,150,000. They then tested the price via MR, AP and also (to their embarrassment) got \$1,150,000. Handout.

D. Discussion of Definition of what We're Appraising / Distinction it Makes in Methodology applied to Income Property Appraising —

1. See Tennessee Handout near end p. 37
2. Section 8 projects are called fair mkt. rents, but they are actually 20% higher than FM rents to justify new construction. 2ND, they are financed w/ gov't help so the rate is less than conv. financing costs.
3. Three ways to view this as an appraisal problem ...
 - 1] S.T. view is a problem in setting mkt. rents and calculating the cash B.E. point for valuation of the project. Problem is inflation.
 - 2] Assume the gov't has a lease hold value in the prop. Prop. mgmt. agreement + mortgage + bond indenture on the state hsg. finance bonds in total represent a lease of the property. As a result, you would value the prop. in fee simple and then subtract the value of the public position.
 - 3] Assume you are buying a set of encumbered private rights

Best Method →

4. Discussion of each of the three views of the Section 8 appraisal problem
 - #2 - as a prop owner under this view, you get the ConC yield + cash expected on resale. You disc. the ConC yield @ same return to equity rate (say 20%). After discounting you have ... the PV of equity position + orig. mtge. bal = value of the project. No reversion here; ConC rate accts. for it.
 - #3 - In the encumbered case you must determine what the rents would be w/o the gov't pgm. Must reset the rents and solve for cash on cash yield. You have an eq. div. + eq. build up in the mtge. PV of cash flow @ mkt. rent + PV of eq. build up in gov't mtge.
 - #1 - Must disc. rents down from FM rents down to mkt. or economic rents. May also adj. expenses to arrive @ a new income stream for the prop. PV of Prop = ConC yield disc. + resale value of prop. in 20 yrs. disc. back. Resale value = f(premises about the property). Residual value in early years is small; it grows fast in the later yrs. ∴ Set rents to mkt → new Net Inc. then disc. the existing mtge by assuming the financing is conventional, cash equivalent. Subject to mtge, no appr/depr.

Looking for Appr. downstream.

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5. Notice that you appraise the Section 8 project differently depending on your view of the problem. Encumbered fee vs. govt. leased vs. mkt. rent makes a big difference in the appraised value.
6. For tax assessment, you must prepare all three methods for the appeal board. The judge may view it in all three ways. #2 tries to simulate where people will be in 20 yrs. and why they bought it. Assessment must be on the vested interest, not future interest.

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I. INVESTMENT SIMULATION, CON'T

A. Ideas —

1. Note that there is a difference in method between whether an Ins. Co. is purchasing an asset for its pension fund vs. its general acct. The pension fund will look to appr., while the general fund will not. Two investment rules w/in the same entity.
2. For businesses such as offices and industrial properties, they typically use a disc. cash flow procedure w/a N.I. Mult. on resale.
3. Specialty properties -- hotels and restaurants -- use an alternative pricing mechanism.
 - Hotels use "house profit" as the measure of multiple for price and resale. So you must keep your books differently. A G.R.M. in the hotel business is not the same as in apts; it is typically less.
 - Hotel growth = $f(\text{ave. room rate, occupancy, relationship of other income to occupancy, and the relationship of these items. Ave. room rate} = f(\text{\# seasons in the city, room mix, and occup. by type of house}))$.
 - You must know something about hotel acctg. procedures in order to simulate its cash flows, and how people buy and sell hotel properties.

B. Other Types of Simulation —

1. Gross Rent Multiplier
2. Net Income Multiplier
3. By hotel room
4. By sq. ft.
5. Gallons per mo/gas st.

The key here is not the elegance, but what people are using and whether it works. These are benchmarks that people use.

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* { Note: If you do not have enough comparable properties or the ones you have cannot be used, only then do you apply the investment simulation; however, buyers may not meet their buying standards (via your asking them), so you may be forced to use the normative approach. The normative approach has no predictive power; however, so investment simulation is preferable when you can use it.

Failing the investment simulation approach, you apply the normative approach.

* { D. Brief Summary of the Normative Approach — "What You Should Do"
1. Cost Approach
2. Capitalized income approaches

Note: Regardless of the approach, you try to validate your assumptions with mkt. data i.e. a lender, etc.

• A problem w/ this approach is that it depends on a single N.O.I./O.A.R. which smooths the income over time to fit the mathematics. Thus, it is important to know the limitations of the various capitalized income approaches.

(1) Straight Capitalization

• Assumes income is declining @ a rate = int. on money times the recapture of money divided by int. on money + recapture on money. $\frac{.08(.02)}{.08 + .02} = \frac{.0016}{.1} = .016$

or a 1.6% decline in income for each year the property is held.

The method selected determines the slope of the future income line.

(2) Haskold Method

• Uses a SF recapture but the same formula applies as in st. capitalization.

$$\frac{.08(SFF)}{.08 + SFF} = \text{rate of } \Delta \text{ forecast in N.I. stream}$$

(3) Inwood Capitalization Rate

• Traditional PV rate. It assumes N.I. is constant; income lost as you recover the capital is being replaced by the reinvestment rate on the capital recovered. Inc. is reinvested @ the same rate you are discounting at.

(4) Ellwood Method

• Assumes income was level but resale price could ↑ or ↓. He only covered a straight lease situation. Adj. w/ the "J factor" table.

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* { Note: the capitalized income approaches treat income as a mathematically predictable quantity. Simulation income can Δ greatly period by period. Hence the methods differ greatly.

- * {
3. The normative approach is the quick models of N.O.I./O.A.R. that carry w/in them implicit assumptions about the slope of future income and implicit assumptions about the future resale price.
 4. Normative is not due to mathematics, they are normative because people who buy and sell don't use them, only appraisers do. If you run into buyers who use Ellwood textbooks, then the normative approach becomes a simulation approach.
 5. Simulation is predictive; normative is not.
 6. Bias = a tilt due to judgment. Error = random and offsetting.
 7. Many normative models are designed to: (1) reduce bias and (2) control error. Unfortunately Ellwood introduced bias in the form of forecasted resale price and error in item 5 & 6 digital places.
- * }

NORMATIVE
VS.
SIMULATION

E. Simulation vs. Normative Approach —

1. Simulation may allow you to utilize more of the available data than the normative approach, but @ the cost of credibility w/ the dec. maker. Simulation may be precise, but if you fail w/ one component of income the whole thing fails. W/normative you have more latitude w/a central tendency that is undefined. Simulation provides the pts. which leaves you vulnerable to attack. The normative approach can be used for defensive purposes once he has used the simulation method to get his value. Normative is good for the courts; it is simple and flexible.

F. Presentation of Appraisal Results —

1. You always want to consider what the purpose of the communication is as well as the function of the appraisal.
2. The purpose of the appraisal may be value for eminent domain; the purpose of the communication may be to protect yourself in terms of cross examination 'cause the other side will have your report in advance.
3. If purpose of the appr. is how much client should pay for a bldg, then you may want to include other analyses and opinions of help to the client. Must keep the purpose in mind: service, defense, education, intimidation, facilitate.

* { Note: There are two hierarchies to consider in choosing one of the three approaches -- market, simulation and normative -- (1) predictive power and (2) purpose of communication and appraisal. For example, in the courtroom the normative approach

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may be best 'cause it's the least controversial.

G. Review of Basic Capitalization Techniques —

*

$$\rightarrow \boxed{NOI = \text{ECON. RENT} - \text{ECON. COSTS}}$$

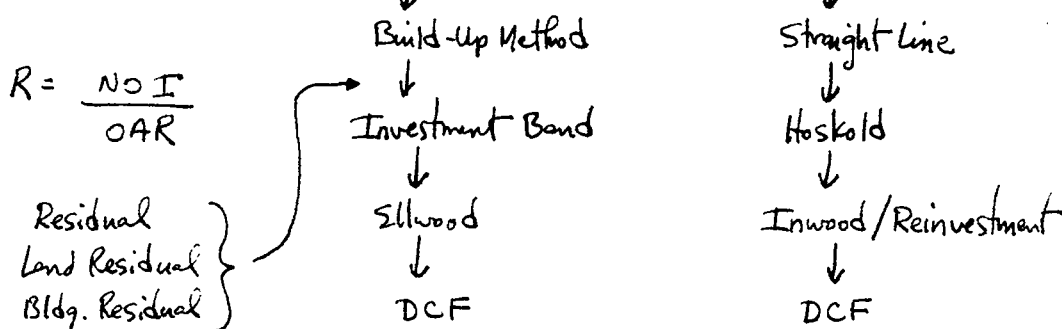
* Economic rent $\neq$ contract rent. With an over supply situation, economic rent will be less than contract rents.

* Trying measure producer surplus -- the net contribution to society of this asset.

* Economic costs are over. costs and assume are. mgmt. and incl. replacement reserves for any thing w/ a life shorter than the life of the total property.

* We end up w/ a normalized net income

$$\boxed{OAR = \underbrace{(i)}_{\text{interest on money}} + \underbrace{(r)}_{\text{recapture of capital}}}$$



1. Build up Method

- the rate is built up from a basic rate via a risk prem, etc. on top of a risk free rate. It reflected the thinking of the 1920's investment mkt. Very hard to measure.
- Interest on the total capital employed.

2. St. line recapture

- It assumed that capital was a wasting asset and hence should be recaptured over its life (say 30 years). % allocation of wasting asset vs. land.
- It assumes income will decline over time

3. Hoskold

- Said we will replace the asset by creating a SF which will be invested @ a conservative rate. Approp. for bonds, not RE $\Rightarrow$ understatement so Inwood is more appropriate.

4. Inwood Method

- Like the hoskold method, except the SF rate = the disc. rate.

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5. Investment Bond

- This says that the int. on money should be a weighted ave. of the various capital comp-
onents.

$$\text{Debt } .75 \times .08 = .06$$

$$\text{Eq. } .25 \times .12 = .03$$

$$\underline{.09}$$

$$.12 - .08 = .04$$

$$Y - MC = OAR$$

$$.12 - .75(.04)$$

$$.12 - .03 = .09$$

$Y - MC$ is a trick for computing a weighted ave. they are identical! Ellwood grows out of this trick.

6. Ellwood

- The inv. bond looks only @ int on money, but the yield to eq. has 2 components, a cash div. and a deferred return as a result of mtge. amort. $\therefore$ we must modify the formula to reflect the postponement of that part of our return that's in the eq. build up.

$$C = \text{portion pd. off over projection period} \times P$$

- A trick for computing the inv. bond w/ an adj. for eq. build up.
- He also added in an appr/depn adjustment.
- He assumed income would fall @ a mathematically predictable rate. He didn't assume NOI could vary.

7. DCF model

- No distinction between int. on money and the recapture of money 'cause the disc. rate itself carries inherent by the recapture component. Every return is a reversion so we simply have a series of reversions over time.
- It doesn't require income to fall along a math line.

Note: As you move from the basic OAR to DCF, you remove the limitations and make it applicable to a broader range of applications.

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I. THE DIFFERENCE BETWEEN FAIR MARKET VALUE AND MOST PROBABLE PRICE

A. Key: An Examination of the Underlying Implicit Assumptions —

1. Fair market value

- MITCFT + IND.
- Buyer and seller are fully informed as to the uses to which the property may be put
 - Neither is under any duress
 - Property on the mkt. for a reasonable time
 - Seller receives cash or its equivalent
 - Financing is readily available in local mkt.
 - It's a statistical mkt: the buyer and seller have other alternatives on an indifference curve that are very similar alternatives; looking for an intersection of these indifference curves.

2. Most probable price

- Doesn't require that the buyer and seller have a point of indifference; one or the other may not have alternatives or a satisfactory alternative
- It is not necessary that cash go to the seller if predominant terms in market are such that sellers provide financing.
- One or the other may not be knowledgeable

Note: MPP is a broader, more realistic statement of the market. Numerous assumptions of FMV don't have to apply for MPP to be operational. What Chief wants is for us to have the ability to argue point by point these differences.

- A range around a central tendency that recognizes the uncertainties inherent in the buyer and seller behavior patterns.

B. Contemporary Appraisal vs. Traditional Appraisal —

- 1. The traditional appraiser sees the purpose of the appraisal as = the function of the appraisal (i.e. to determine FMV). The cont. appraiser begins with the question as the critical element and then asks what purpose the appraisal is to serve as a benchmark. He then fits the def'n of value among a much broader array of alternatives. Different def'n's of value apply in different situations.
- 2. Key difference: ① the traditionalist almost always tries to redefine his problem in terms of FMV. ② FMV then implies a standardized approach, but he doesn't have to use the three approaches to value; he must explain at the outset where he won't use one or more of the approaches. The cont. appraiser doesn't have to explain himself; just explain why he selected the one that he did. ③ the cont. appraiser focuses on the

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client's needs so his format and emphasis shifts relative to the need being addressed. In FMV appraisals, it should be the same for all parties, in contrast to the cont. approach.

II. INVESTMENT SIMULATION, CONTINUED

A. Impact of Non-market financing on Fair Market Value —

Occurrences that distort FMV

1. Appraisers have typically ignored this issue; they say that because law requires the seller to pay for points on a V.A. or FHA loan, it is accepted in the market and hence the price paid is FMV. They have turned their back on this issue.
2. Today, we are @ a pt. where developers must use buydowns or i-rates in order to sell condos. \$100,000 price but builder pays \$9,000/unit to buydown the i rate from 16% to 11.5%, what is the appr. MV of the R.E? If sold on a conv. basis it would sell for \$91,000 or less, if at all. How do you distinguish these two?
3. A comparable situation is industrial facilities financed w/ IRB's at i rates < conv. rates. If you appraised it at conv. rates $\Rightarrow$ big decline in prop. value. Which one is FMV? MPP?
 - Under MPP you have a few options. If you buy the property "subject to" the IRB you are buying the financing too.
 - Under FMV, would have to adjust the value to cash equivalency? FMV would require cash equivalency here. If you elected to treat the IRB as an entitlement, it then becomes personalty, not RE. If you appraised it as conv. financed your value would be < bond issue. In order to let the bond issue pass, appraisers have appraised it as FMV. Bond underwriters distort the appraisal process just like the V.A. did in #1 above.
4. The historic property is another example. How much does the investor pay for the land and bldg. vs. the entitlement under the tax law? Some prem. is pd. for the tax advantage of the ITC on rehab. costs.

* { Point: all of these examples bring us to the inherent conflict between appraisal and accounting. Accounting handles these situations by referring to current exit value or future exit value (in the normal course of business).

B. Accounting vs. Appraisal —

1. the classic case is a new bldg. that comes up for assessment. Assume an office bldg. is 40% complete on May 1. The assessor says it will be worth \$1,000,000 when

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complete; only \$400,000 now 'cause it's 40% complete. The \$1,000,000 future exit value assumes it will be rented up in the normal course of business, $\therefore$ the PV of income $>$ cost to construct.

• If you take the current exit approach, it probably won't sell for \$400 K.

Point: You get a classic debate between the assessor who values property under the cost approach (40% complete) vs. the future exit value (a non-vested interest). No one guarantees the future. The assessor uses current exit value on the home, but future exit value on the commercial income property.

2. Returning to the VA/FHA example.

• Future exit value will be selling it for my cost + points; current exit value for the seller = sale price minus points. What is the appraiser appraising? Lender is interested in future exit value. But for the estate that's selling the home, you appraise on current exit value (net value). Appraisal makes no distinction between current and future exit values, but it's a big deal in acctg.

Point: The buyer of current exit value is looking to the future in terms of how much he'll have to put in, the assessor is looking back @ how much is already in it. Ex. Capitol Centre. Cost w/o fin = \$17 MM; w/ fin = \$12 MM. It will go to current cause assessors are not distinguishing between these values. Assessors must be consistent.

* { Note: FMV can't handle the current vs. future exit problem because it doesn't have a perspective in time. MPP, in contrast, can handle it because it has a perspective from whose viewpoint you're looking at it from; it can handle the time question. The assessor should work on current exit value, because the future is unknown and you can't be taxed on the unknown future (non-vested).

3. There is a fundamental disagreement between appraising and acctg., yet investment simulation is an accounting process. Cash flows over time and charges to assets are acctg. games.

- Accounting views: (1) historical cost; (2) PV views: current exit value and PV of current income stream over time; (3) FV approach: future exit value or disc. value of future returns
- Movement toward cost to replace loss depreciation as a parenthetical item near all fixed assets.

Accounting uses
Current Exit
Value

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- Note that appraising doesn't consider the different possible views, it immediately judges to a FV of income under the inv. sim. technique.

Point: there is a fundamental clash between appraisal, using the income approach, and accty. theory when looking at the valuation of an enterprise.

4. Pension fund valuation is bringing the clash to the foreground.

Appraisal is a large part of the valuation of a co-mingled fund.

- Accty. audit says that non-RE assets are valued on a current exit value and all RE assets will be turned over to the RE appraisers. Problem is that the appraisers aren't proceeding under the same logic base as the accountants. Result is a misleading fin. statement. A reader wants to know if the exit value of the current assets = PV of existing vested liab. Is it fully funded? If not, then the employers must put in more funding. Current exit value.
- From an investors perspective, you want to look at the exit value in the future.

Note: But in most appraisals, no distinction is made and just FMV is given and it is assumed to be equally valid to the regular and those who are monitoring investment performance. But they are not equally relevant.

Appraisal theory has no basis to handle this!

Note: Investment simulation doesn't rely on the historical record; it says we know where future income and resale price are going. We alter the current record, which is unacceptable to accountants.

5. To what degree is the lower i rate or points, etc. a return on mgmt. vs. a return on RE? Our measurements of this are crude. The appraisal societies say nothing about this. Is the ITC inherent in RE? personality? It affects price for sure.

Note: MPP can deal w/ this, but you must specify the entitlements up front in the report (re. tax credits, etc.)

III. NORMATIVE VALUES

A. Cost Approach —

- 1. It takes the L.T. view that any asset — in the L.T. — is priced at its cost to replace.
- 2. Big debate is replacement value vs. reproduction value (photographic done). Replacement value is equal utility $\Rightarrow$ many issues: (1) who decides the amt. of space necessary for equal utility? (2) who decides which structural system you would use?
- 3. What is functional obs.? EX. replacement under a section 8 program requires 2-bdrm. units be $\geq 1,108$ sq. ft. Superadequacy = too much space.
- 4. Economic obs. $\neq$ locational obs.
 - Locational obs. (EX. Voyager in Rdsburg vs. Dells) is measurable.
 - Economic obs. has to do w/ external influences; i rates, etc.
- 5. Kahn argues that the cost approach never recognizes entrepreneurial value, which must be added to the cost to construct in order to reconcile cost to replace w/ income value. Chief disagrees 'cause mgmt. is not in the RE. Mgmt. value is in the const. process, not in the mktg. of the product. No clear statement in acctg. literature about this. Kahn attributes const. entrepreneurship to the RE; Chief disagrees. RE appraisal has no way to recognize the intangibles in valuing an enterprise and $\therefore$ attributes it all to land and bldg., which Chief says leads to misallocations and funding problems if you land 75% or on RE values!

Note: The inability of the approach to ^{integrate} merge w/ acctg. theory leads to distortions in the valuation of businesses, etc.

I. NORMATIVE APPROACH, CON'T

A. Cost Approach, Con't —

1. Functional Obsolescence considerations

- Must consider your def'n. of replacement cost
- You may have functional obs. even w/a new bldg.
- The most typical functional obs. problem is w/a concealed ~~the~~ obs.
- Curable vs. incurable: curable $\Rightarrow$ they are curable w/in an economic constraint. Some-thing that is incurable in a small bldg. may be curable in a large one. It also dep ends on the current state of the art in bldg. tech. An outdated new A/C system may be incurable, but an older A/C syst. near the end of its life may be curable. The pt. on the bldg's lifecycle affects curability vs. incurability.

2. Locational/Economic Obsolescence

- Economic obs = external conditions that affect the utility of the bldg. "offsite forces at work." EX. movie theatre in late 1950's when T.V.'s started at which pt. economic obs. for theatres would have been very large. Most appraisers miss econ. obs. 'cause they aren't willing to do the research in the specific industry for a special use bldg.
- Locational issue = two problems: (1) some locational issues are already compensated for in the price of the land; (2) what is the impact on revenue over and above the difference in land cost? EX. H. Johnson's pd. a prem. price for site - land was worth it for dense res., but not for a hotel - so they pay \$2K/mo. for billboards. MKT. value of site as though vacant is high for another use, we have a hotel in the wrong location so we try to measure locational obs. One way is to cap out the billboard costs; another way is the lower room rate so can cap out the lost revenues - not gross revenues but only the revenues that fall through.
- You can have both an economic obs. loss and a locational obs. loss (i.e. a theatre in the wrong place - locational - and in the wrong configuration relative to the indus-try - economic).

3. Reliability of the Cost Approach

- The cost approach has a specious accuracy that with the introduction of the depr. techniquing it becomes the most subjective of all.
- The least reliable of the methods. Ratchiff rips it apart and says it is hypothetical.

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B. Capitalization of Net Income Approach —

1. Net income is capitalized at an overall rate (NOI/OAR)
2. Most appraisers do not perceive this as a forecast of future income and resale; they see it as a reciprocal of Net Income Multiplier. 8% cap rate = $12\frac{1}{2}$ multiplier; 5% cap rate = 20 times net income multiplier. This is very pervasive. Malpractice vis. for appraisers doesn't cover future projections. Yet, how can you do an income prop. approach w/o forecasting future income? Appraisers don't regard NOI/OAR as an express or implied forecast of future NOI ! They don't understand the mathematics of their own tools such that they realize that NOI implies income over time falling along a straight line or a curve that can be mathematically forecast and that resale price is also being forecast as whatever the reversion is being implied by depreciation. To get around the malpractice vis. problem, they simply say they are estimates, not real #'s.
3. To the extent the industry does use NOI/OAR , it becomes predictive rather than normative. Once a group of people actually use a multiplier, it is no longer normative, but predictive simulation. Those who are in the mkt. "do it this way."
4. Ellwood comments:
 - It is a classic case of an intellectually elegant system w/ no predictive power because no one used in out in the mkt; it was not related to how people acted and it didn't predict how much they would pay. It tended to distort the price paid because it didn't put further checks and constraints on it.
 - It requires $Y - MC \pm \text{depr}/\text{appr}$. No constraint for the max. mtge. It worked fine mathematically, but not in reality.
 - It led to an inability to use the income approach for mtge. lending. The Home Loan Bank said Ellwood could be used for appraisals; you could use the investment bond however. Given this directive, the investment bond now becomes predictive rather than normative. The regulatory agency advances it up from a normative to a simulation approach.

C. Analog Normative Model —

1. They become predictive for the appraiser; they are predictive models used by chains such as McDonald's for site location. The information is available in trade journals. If the appraiser can identify which analog model the firm uses, it becomes a predictive model for the value of the site. It helps you to work backwards. Many types of industry standards (ie. Wis. Law Journal gives $\$/\text{lawyer}$, etc.)
2. They are typically out of date, but the key variables will be there.

I. TESTING THE APPRAISAL

A. Objective of the Test —

1. To provide a checkpoint using an alternative method of analysis. If you use a market approach, you may want to test it with the income test; if you use an income approach, test it with whatever is available to you.
2. Next, it is also important to look at buyer motivations; what did he want from the deal? Capital gain? Income? Assemblage value? The test must serve this motivation by its conclusion.
3. The test also depends on what you were seeking, FMV or MPP. EX. income approach for FMV + shopping around the test, because FMV assumes cash to the seller, you would have to assume institutional financing terms. If your MPP buyer was a syndicator, then you would use other financing terms. You must consider two things: (1) def'n of value and (2) buyer motivation.
4. BFCF tests sensitivity to appreciation.

B. Types of Tests —

1. If you derive MPP or FMV via the market approach, use an income test.
2. If you arrive at your value via the income approach, it may be that your best test is a bracket type approach. Does our number fall into the range of similar properties? It may be the best you can do. Which side of the range does our property sell and why?
3. There is no expectation that the test(s) should converge on a specific # like the 3 approaches to value. The general pattern of DCR's and ATIRR is such and such and our property falls in this range. It may not be a precise confirmation. It only establishes parameters; our value may fall outside the range - if so, just say why.
4. May use a sequence of tests to prove points: (1) first test may be that institutions will finance it @ those terms so you refer to a report by Co. X and your DCR is consistent w/ this; reference the source; expense ratio and NOI are consistent w/ BOMA or ULI for that type of bldg. The ratios that derive from my conclusion are consistent w/ those sources. (2) take my conclusion and relate it to some other benchmark conclusion about similar properties. My value is consistent w/ other value conclusions (3) A sensitivity analysis that says "what if this isn't the right answer." If the answer should be 5% higher, what does that suggest for my ratios?
5. Test selection = f(type of property and appraisal issue (ie. the pt. you're trying to make))
a creative rather than boiler plate thing.

II. STATEMENT OF LIMITING CONDITIONS

A. Key: Limiting Conditions that Affect Assumptions Made by the Appraiser —

1. three kinds of assumptions here:

(1) Verification of historical data assumptions

(2) Assumptions about continued operation of the enterprise in an orderly fashion

• Extrapolation from current operations into the future. May want the corroboration of an expert; reference them and make them liable.

(3) Hypothetical operations of a future non-existent use

• Label it as such. Hypotheses about the mkt, rev/exp, etc. Hypotheses about the future. Opinion, not necessarily facts.

Note: It is important to distinguish between sources of ⁽¹⁾ historical data, ⁽²⁾ extrapolations of original data, and construction ⁽³⁾ of a hypothesis about what the future may be.

ultimate trend is toward a Bayesian model of decision making.

2. Instructions provided by the client

- There is a trend for clients to provide certain pieces of info. EX. 1st Chicago, Contraband Fund F.
- The appraiser wants to get himself off the hook; you can't verify the client's input to your work.

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I. MULTIPLE REGRESSION APPLIED TO APPRAISAL

A. Origins —

1. Began in the 1930's in Nebraska for land evaluations.
2. Cal. Board of Equalization used it for economy of reassessment and developed it into a useful tool. Zach Co. assessment office was audited and found to be unequal. Hence, M. Reg. was used to bring equity into their assessments. Reg. reduced the inequities, which was the basic motivation for it. Robert Gustafson.
3. First experiments were in Orange Co., Cal. It fell apart w/o technical support.
4. San Mateo was the real beginning of M. Reg. for appraisal. The Lincoln Inst. is big in it today.

B. Consideration of its Uses / Faults, etc —

1. Although it is useful, M. Reg. has fallen on disfavor as a legitimate appraisal technique primarily due to its technical problems.
2. It's best use is in an indirect manner vs. direct manner. It is applicable for calc. of adjustment factors for AIKTCOMP and for aggregation values, but not individual values.

$$\text{Value} = a + \overset{\text{slope}}{\beta}x + cy + \dots + \overset{\text{residual error}}{e_r}$$

↑ intercept (mean of the sample if alone) if no other variables.

3. M. Reg. modifies β (the slope of the line) in order to modify the residual error.
4. The key to reliability is the residual error.

C. Four Basic Rules of M. Regression that are violated in Appraisal —

1. all variables are presumed to be independent of one another.
2. It is assumed that residual error is randomly distributed.
3. It is assumed that the relationship of the quantity and the dependant variable is linear. The quan. representing the variable is assumed linear.

Note: all three of these are violated in RE due to cross-correlation. If you have a bigger lot, you tend to have a bigger home, etc. A transformation may be more reliable.

Note: there is no relationship between the variables chosen plus there is a spurious indication that people behave this way. After you get past $a + \beta X$, the next variable is chosen by how it $\downarrow e_r$, not how it affects value.

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Note: the correlation is to the residual error. Hence, the coefficients may deny common sense and have nothing to do w/ consumer behavior! The only conclusion you can make is the value itself, not the variables that generate the value.

4. It is assumed you need a min. of 30 degrees of freedom. A d.f. = # of sample minus # variables. 50 sales - 20 variables = 30 d.f.

D. Problems w/ Mult. Regression —

BASIC VIOLATIONS

- You must distinguish between pragmatic use and elegance.
- 1. It violates the principle of mkt. comparison of the subj. prop. to substitutes in the field. It compares each prop. to the mean of the sample rather than to a particular subj. prop. Even the subj. is compared to a mean.
- 2. It violates the principle that an appraiser must visit his comps. in order to use them. M. Reg. requires so many comps that an appraiser can't physical visit them all. It violates a basic ethic of appraisal.
- 3. It violates the principle that the adjustment factors must be selected by the appraiser. He has personal account ability for these. M. Reg. allows the least squares process to generate adjustments for the residual error, not the comps.

Note: You can't defend M. Reg. in court due to the above problems. The U.S. govt agencies have also rejected it as an acceptable appraisal process.

E. Successes for Mult. Regression —

1. Prediction of aggregate values
 - Quite accurate in predicting the price of a total parcel or an assemblage. Reason: the Σ of the error should equal zero and by combining properties you reduce error.
 - Good for budgeting purposes for eminent domain, highways, U.W. land purchases, etc.
2. Equalization value prediction
 - Total equalized mkt. value is predicted quite accurately.
3. Identification of the Non-market transaction
 - You compare predicted values w/ the actual sales price which means you can identify outliers as non-mkt. They'll be out 2-3 std. errors; high dispersion.
4. Identification of variables that are highly correlated to price
 - High t values

Note: What is needed is something that doesn't violate the tenants of M. Reg. and that keeps its useful aspects $\Rightarrow$ MKTCOMP.

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Note: MKTCOMP uses M. Reg's ability to identify the best variables that predict price, while using specific comparables.

5. Use δ , residual error to identify curvilinear relationships

- At some pt. extra living area doesn't mean as much, you must use a curvilinear transformation. Decreasing utility of something.

6. It can suggest the weights that can be applied for adj. between comps. as long as it is done on a short span of the total curve.

- Reliability for only a portion of the larger curve. This allows us to bracket differences between properties by looking at a straight line on the curve. MKTCOMP does this. No system (M. Reg., cost approach, etc.) can work well at the extremes

Note: Mr. Shankel says the problem in applying M. Reg. to appraisal is that appraisal is not a statistics game, it is set theory. Appraisal defines the set of 3-5 elements (comps) that is most like the subject prop. and can be adj. for small differences.

KEY ISSUE
IN APPRAISAL

The key = how to define the subset so you aren't making comparisons across sets. Too much data means you haven't defined your sets closely enough yet. Can only compare like items, not across sets.

I. MULTIPLE REGRESSION TOPICS AND DATA SUITABILITY

A. Three kinds of Data —

1. Continuous variables - an infinite number of points; the most useful data variables such as sq. ft. of living area.
2. Discrete variables - # bedrooms; either you have it or you don't. It may be binary in the sense that either it's there or not. Coding the # bedrooms causes a problem because it implies that something coded 3 is 3X better than 1 bedroom. The code # implies a weight in M. Reg. More appropriate to set up multiple categories of bedrooms and code it as binary (ie. 1 bedroom house: 0 = no, 1 = yes). This method means many categories but only one coding answer. This eliminates the implicit wt. of the coding #.
3. Qualitative variables - subjective call by the observer; difficult to standardize for mult. observers. Ex. quality. Difficult for > 1 person to judge this, yet it is very important. Ideal is to min. interval differences (ie. 1, 3, 5), which reduces error.

Note: The appraiser looks for continuous variables on which to build his model and codes it on discrete variables for which the code is neutralized and minimize qualitative variables

DATA SELECTION
SCREENS

1ST Variable Screen.

2ND Variable Screen

- (1) Min. the maintenance problem in the data base, so you select the variables that Δ least often. Room counts, sq. ft. of living area are examples.
- (2) Choose a reliable source. Sissy to get reliable lot area from assessors or surveyors. You want the source to be reliable, yet cost effective. MLS is unreliable. Who measured it and how long ago.

B. Other Factors Impacting Data Suitability / Variable Selection —

1. Mult. regression presumes linear data over its full range. This is almost never the case, however, there is almost always a discontinuity assoc. w/ increasing amts. of something. Since many variables are not linear over a long range, you look for variables that are capable of data transformation to recognize their curvilinear relationship. It may be increasing, decreasing. Can use a curve fitting program. The heating system may be a

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- decimal, for example. Another type of transformation is the order of magnitude issue. You may have a score for the aggregate # of some particular attribute (ie. extras).
2. Hence, the effectiveness of M. Reg. depends almost solely on the data selected, coded and then transformed for use in the Reg. formula. Even then the user of regression will be vulnerable to cross-correlation or multi-collinearity. Are bathrooms and its correlated? Have we already accounted for one? If so, you may select a dummy variable you may mult. three variables together to neutralize neg. multi-collinearity.
 3. You should not have > 6 to 7 independent variables in a M. Regression. But in RE, it isn't unusual to have 20 variables. Why? Because many of the variables are inter-related so it becomes unreliable.
 4. Cluster programs are a way to obtain similar groups of factors in sub-sets. It results in min. internal differences and max. external differences. The similarity w/in the cluster is very high. This creates sub-sets that eliminates many of the necessary distinctions, because 2 bdrm. homes could be in the same cluster $\Rightarrow$ you can reduce the amount of your data. You then compute a reg. coef. for each cluster.
 - Problem = you are drawing hard lines around your data clusters. It says that one home is always in cluster A when in fact it may be very similar to cluster B. You may have a problem w/ treating everyone equally.
 5. the maintenance of the data base is the key to M. Reg. It has a high cost for a reliable data base; it is the major cost of automated appraisal and is seldom justified in practice. Its best commercial use is where a public body has the economic incentive to create the huge data base necessary.
 6. MULVAR was a semi-successful M. Reg. application, but it failed. Gov't said it was not acceptable as an appraisal method.

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I. REAL ESTATE TAXES / ASSESSED VALUATIONS

A. Tax Computations —

1. assessed Value $\times$ Mill Rate = Real Estate Taxes
2. Market fluctuations mean that RE taxes vary a good deal.
3. The assessed value is the tax base.

B. Discussion of Market Comp —

1. $Y = \text{sales price}$
 $X = \text{all factors}$ } $\hat{Y} = \text{predicted value for the next sale.}$
2. The comps that yield the smallest differences between the subject property is used to value it.
3. Steps:
 - (1) selects the comps (based on 7 attributes)
 - (2) adjustments

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Map of Our
Comps.

Jobs: MGIC
Ops - Proj. mgmt.
Richard Ellis

outlook for development is slow. More opp. in the
service side (ie. prop. mgmt, etc.)

I. MKTCOMP MODEL

A. Variables and Adjustments —

1. Used 6 variables generated from M. Regression + a number of small adjustments that tend to offset one another.
2. Three types of adjustments: ① from M. Reg. ② large adj. for a fire place, etc. ③ small judgment adjustments.

II. LAND VALUATION

A. Categorizations of Land —

1. Bulk land
 - Recreational land w/ resource potential.
2. Farm land
 - Becoming very sophisticated in determining a tie between soil quality, etc. and the income generated from the land.
3. Rural / Urban transitional
 - Will eventually be urban land.
4. Urban land
 - Surrounding by infrastructure

Note: Each different land type has a different measurement method and hence pricing method.

B. attributes of land for analysis —

1. Pos. attributes
2. Neg. attributes
3. Existing land controls
4. Potential land controls
5. Linkages
6. Potential linkages
7. Dynamic attributes
8. Best use of the land $\Rightarrow$ alternative uses

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9. Weight the uses
10. Set up criteria
11. Select the best use.

Note: Most difficult part is to choose the basis of comparison.

C. Most Probable Buyer considerations —

1.

D. Most Fitting Use —

1.

E. Systems for Appraisal of land —

1. Co-Mark System

- Linear Prog. model that yields the best use of a site given inputs. It allocates the land according to input needs and then assigns a price to it. A land dev. allocation of acreage. It satisfies planning constraints.

2. RE Research Corp.

- Looked around the subject perimeter for comps. that were very similar and then transcribed this to the subject. They looked in a 1 or 2 block area near the subject site. Flip these as a mirror image onto the subject.
- It was popular for appraising large parcels of urban renewal land.

3. Pac River Ideas

- Relate physical aspects to similar properties

4. Land Residual Approach

- Must be careful to get the correct income

5. Abstraction Method

- Ratio of land to bldg. ^{cost} ~~value~~. Suspect and difficult to do. You look for relationships.

Note: Valuation of vacant land is difficult.

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F. LAND VALUATION, CON'T

A. Special Use Units —

1. Urban Renewal
2. Rail Corridors
3. Land as a Negative Value

B. Urban Renewal Tracts —

1. Appraisers must go back to the master plan. A change in a master plan requires approval by all prop. owners and all contiguous prop. owners. Bonuses are often promised for conformance w/ the master plan. How much are these bonuses worth from an appraisal perspective? Master plan becomes a covenant running w/ the land that constrains future uses of the land. Tricky appraisal; covenants must be researched.
2. Comps. were required to be from the suburbs (special instructions: ① urban renewal influence and ② must appraise it by federal stds. i.e. from the suburbs). The govt forced the fees of the project by its appraisal instructions.

C. Land As A Negative Value —

1. There is debate about whether land can have a neg. value. Neg. Value = PV of the inordinate costs of being at a certain location due to carry costs. A seller may have to pay the buyer to get the property sold; it has a neg. value. May result from title flaw or location problem.
2. Neg. land value causes a big problem w/ appraisal theory.

D. Rail Corridor Valuation —

1. Precipitated by the bankruptcy of the 5 major east coast RR's + Milw. Road $\Rightarrow$ led to abandonment of many Acres of rail land in the U.S.
2. There is a ready mkt. for rails and ties from the rails.
3. Valuation: do we have a corridor or a series of parcels in string? These are two differences in appraisal philosophy. If a corridor, where does it start and where does it go and what can it be used for? This is one way of looking at most probable use. Recreation use; local line railroad.
 - ATF (Across the fence) value concept that says that land here is worth what else it is worth across the fence. Use a method of price per sq. ft.
 - Plotage Value is an alternative for valuation. Ex. Railroad office in dtn. Madison.

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Note: Land Valuation brings in a whole series of philosophies about land itself.
Value in use vs. other value.

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I. DISCUSSION OF APPRAISALS

A. Points To Consider —

1. Must decide whether they are cash equiv. sales or L.C. sales and left unad'justed or left unad'justed and I explain why. If the predominant terms in the mkt. are terms and the MPP requires terms, then you adjust. But if FMV (cash to seller) is required, which is not terms predominant in the mkt. place, do you adjust for this? If 20% down is the predominant terms, then you just adjust those w/ terms that vary from the 20% down amt. If the mkt. is flat, then make an argument for little adj-ments. Be careful to not jump from MPP (unadjusted for terms) to FMV (cash to seller) w/o explaining things. Be careful about presuming that the central tendency of MPP is cash to the seller.
2. FMV says neither party is under duress, so you can't argue that the lower range value is the cash value (FMV) and then use the duress argument. Reexamine the logic of arriving @ MPP and then backing down to the FMV. Why is the cash price at the low end of the range? Is this consistent w/ the 6 conditions of FMV?
3. Def'n of value

Part 1: MPP Rutchiff

Part 2: FMV and the 6 conditions

Why? 'Cause at the end you can then say "MPP is \$X, but FMV is \$X because Mr. Foreman's health is no longer an external factor on price, 4 out of 5 were L.C.'s so I can't consider this - must look at cash. Use a pt., counter pt., and include it in the letter of transmittal. Insert a ¶ justifying why mkt. value for eminent domain will be such and such. For eminent domain, any evidence that Mr. Foreman's bargaining position isn't a good one, or evidence that the sale will be on a cold basis is irrelevant... it must be thrown out! You could argue that Mr. Foreman's best way out is to precipitate an eminent domain action. His MPP in terms of when and how much will be < under FMV 'cause FMV can't consider other elements that another trader in the mkt. might consider.

4. ^{Appr.} Issue = he wants to sell the property. Problem: a prop. @ the end of its useful life, on a pivotal block and a transitional neighborhood, so the 1st call is the most prob. use for prop. Three elements of speculation: ① who needs it now ② what's it going to be worth when the neighborhood settles down ③ what's the relationship of this block to the neighborhood when it settles down? It is at the edge of the Marquette neighborhood and the gateway to the neighborhood. You can't go forward w/ the prop. till the 700 block (defunct theatre) settles down. 2 problems: ① demand - it is very limited because the bldg. is near the ^① end of its useful life and the neighborhood

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is in transition (direction and pace) and the prop. is pivotal and doomed to mixed use w/ RR area on 4 side and heavy traffic artery on the other. $\Rightarrow$ very speculative situation from an appraisal viewpoint ... i.e. quite a lot of error.

5. Tests. If an interim use involved reuse of the site, how many units can it support? Vacant land scenario ... consider reuses for the land and how much you could afford to pay for it. X thousand \$ and then speculate what future uses you could justify putting on it.
6. the scenario of demolition and then sit on it for a while requires ~~an~~ assumption about the remainder reversion or sale so you must add in the PV of the reversion. In 5 years it can be used for 40 apt. units, etc. @ \$5,000 / pad, hence \$200,000 residual disc. back. Now you put this scenario on a par of the rest for comparison.
7. Use scenarios ... Chief says the access is so bad to the site that the retail use probably won't work. Can't get the traffic from the Capitol side. An office bldg. may be an alternative ... take off the garage roof, leave the garage floor as the parking area, and convert the annex into an office bldg. 6,000 - 8,000 \$ of Class B office space. Landscape the Williamson St. side and can access the parking lot from either side (Williamson or Williamson). Soft mkt, but professionals may want it. Buy up the Williamson side to Dean's land.

Big vacancy in office bldgs. downtown due to parking problems.

Another alternative is to use the annex as an industrial warehouse and build an office strip on the front of it where the deck is now ... yields loading docks on the back and office on the front. Offices have view of lake. Very soft mkt. however for this.

Housing won't work due to access and depth problems.

8. adjustments ... for time (flat 4%) in general time has been flat so no infatigable increase in the mkt. Excess land adj. (adj. to the mean ground cover) based on bldg. to lot area ratio. \$3/\$ for land in downtown; \$2/\$ for zone outside of sq. and \$1/\$ for suburban land. Improved R^2 . Dangerous linear relationship assumption here.
9. Tests ... BFCF gives a sensitivity to resale price assumptions. Gave no argument for reuse of the site as such and such at \$X/\$. Put it in some unit of comparison. The \$400,000 is an extrapolation unless compared w/ so much per apt or \$X/\$ of land area. Must justify the significant inflation assumptions.
10. Soils Section: the soils are related to the bldg. problems (settlement in the NW corner) so incl. the bldg. problems in the soils section.
11. Traffic ... be systematic in explanation. Start at the Capitol and approach the site and define the problems. Follow the patterns through. Show the interrelationships.
12. Neighborhood ... integrate in the existing studies (1980 census data, consumer preference comments from the Fauerbach study, Maguette study) to a final conclusion about the neighborhood. Facts were left hanging. Not enough hotels, taverns, etc.

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lack of purchasing power, concern for services in the area, but lack of ability to pay for them.

13. Weights... message them to get a lower error factor.

14. Comps... don't throw them out so soon. Chief took issue w/ the SSS Washington prop. 2 story.

Include Chief's and Genny's comments w/ the final draft. Need the final draft by December 18 or 19 at the latest; grades are needed by the 24th.

Final Exam

- the use of MPP in eminent domain, for example.
- MPP and appraisal ethics, for example
- 1 1/2 hours Fri. Dec. 10th

} Not Cumulative in nature.

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Final Exam: MPP and appraisal ethics, etc. 1 1/2 hours Fri. Dec. 10th

II. THE REAL ESTATE TAX APPEAL

A. Def'n of Value —

- 2 problems →
1. Wisc Rule = sale to another user, so value in use doesn't apply in the def'n of value.
 2. N.Y. Rule = what you paid for it (mkt. in 1) is what it is worth.

B. Def'n of the interest to be appraised —

1. Unity rule: look at all rights. Can use mkt. rents and not the actual ~~mkt~~ rents. Inv value ≠ assessment value.

2. Section 8 case

3 ways: ~~test to construct~~

- Valuation Approaches
- Inc. st. + PV of reversion if resale
- ① FMV rents are > mkt. rents by 15-20%. Volatile. Cash Div + reversion.
 - ② Loan does repr. FMV so you disc. to stream of pmts @ an appr. % age.
 - ③ Transfer of the bundle of rights to the public sector. Locked into the cash div.
 - ③ Cash div + eq. build up in the mkt. Fut. RE tax is a non-vested interest, so not subject to taxation. PV (Cash Div.) + PV (Eq. build up) on mkt. You must look @ land and bldg. only.

C. Grounds for Appeal —

1. Presumption of error: has a 10-12% error.
2. Challenge the appraisal methodology itself:
3. Challenge on equity: the neighbor's home is like mine, but his assessment was lower.

D. Appeals Process —

1. Review by appraiser
2. Bd. of Appeals review
3. Either/or appeal to circuit court or State Dept. of Revenue.

E. Comm. Options —

1. Refund taxes to owner.
2. Reduce next years value temporarily next year. Net over 2 years is the same amt.

OVER

F. Problem areas —

1. Can he anticipate inflation in the process?
2. What is the legality of the income approach?
3. Legality of regression analysis's useage
4. Privacy of the data records.

Definition of mkt. area

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③

6. Till recently, e.d. dealt w/ RE only, not the value of the bargain or money in hand, etc.
 ∴ the award incl. damages for consequential damages $\Rightarrow$ many injuries. Wisc. law is not generous.
7. Can have several actions by the condemnee.
 - ① Inverse condemnation - the effect of what you have done effectively took my property.
 - ② Excess condemnation - you took so much that what's left is not worth much more or it may be worth a lot.
8. Appraiser's appearance
 - ① 1st is a consultant to the prop. owner. 1st offer is a jurisdictional offer = bid. if you choose to accept it; it may be higher than the final settlement; it may be 10-15% higher than the appraisal. It must be @ FMV now, but may be a prem.
 - ② After jurisdictional offer you go to a commission for presentations by both sides. Oral presentations, the commission hearing results in an award.
9. Process of litigation leads to process of discovery: lots of info. access to anything in the files. 2 aspects: ① inadvertent discovery of info ② huge cost. Can be used to crush one financially.
10. In the report, you need a sense of the legal strategy to be used.

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I. EMINENT DOMAIN

A. Special Attributes:

1. Each state has a diff. mechanism for determination of awards.
2. WISC = Value before vs. value just after = diff. is the amt. of the award. It is possible for you to receive nothing in theory but not practice. Full takings are fairly es. y.
3. Key: problem w/ partial takings. Before (not taken) vs. after (not taken) = same value. Other states have an arbitrary rule vs. the before and after of the federal and WISC.
4. 2nd problem: the report must anticipate courtroom strategy. Don't give up info. in the report; exercise editorial control in advance.
5. 3rd element: the def'n of value may vary.
6. 4th " : Def'n of the interest taken. Very important to carefully define this. Must be very careful.
7. 5th : highly stylized review process is involved.
8. 6th : the question of indemnity goes beyond the appraisal itself.

Note It is a different environment.

B. Summary of Eminent Domain Process —

1. Chap. 32 delineates the agencies that have the power.
2. 2 schools of thought re: power
 - ① all agencies have the power in latency if \$ is
 - ② agencies have the power once the budget is provided. } Do they have the power? When does it become active? Must be very specific about this.
3. Condemnor files desc. of prop. and proj. w/ ownership and tract interests involved w/ the eq. court in the Co. where the prop. lies. This action begins the process.
4. Next, the judge...
 - ① Sets date for a hearing on public purpose. It is so broad now no one can attack it today. Just need due process. Protest
 - ② Appoints a commission to value the property - political in nature
 - ③ Commission has 60 days to make an award: both parties can appeal it to the circuit court. Condemnor can take the land after the award is determined. Amt. in dispute is held in escrow.
 - ④ Disputes - all appraisals by condemnor must be given to condonee.
5. the dispute...
 - ① Qualifications of the appraiser
 - ② pre-trial hearing to identify differences in assumptions

I. EMINENT DOMAIN

A. Admissibility of Evidence —

- see articles
1. You usually aren't cross-examined by the opposing attorney. They can interrupt your examination, etc.
 2. The cross examination deals w/ discreditation of the witness. So you try to give them nothing to shoot at. Must be very careful about what you say; refer to facts, not opinion.
 3. The attacks must be anticipated.

B. Qualification / Credibility —

1. Depends on ... criteria of the witness
 - (1) Stipulate to expertise by both sides. Strategy here
 - (2) Separate his past experience from the case @ hand; try to imply that the witnesses past history doesn't qualify him for the case @ hand.
 - (3) Vested interest in the result implication: he's expected to be an independent opinion

① Employment ② Past association	} Must establish no vested interest w/ the plaintiff.
--	---

C. Areas of Differences —

- Problems w/ takings
1. Takings vs. Police Power
 - The distinction is difficult to understand today.
 2. Transferrability of entitlements
 - What rights are incl. w/ fee simple title? What is compensable?
 - What do you acquire?

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Exam: 7:45 a.m. Room 120 2 hours

I. THE BUSINESS OF APPRAISAL

A. Ideas —

1. Problem w/ billable time being so low; ~ 60% of time is billable. Overhead is another problem; 2/3 rds of income is overhead. Hence, it is difficult to make money at it.
2. Advantages: can do personal investing that subsidizing the appraisal work.
3. Ways to earn more money:
 - (1) development work
 - (2) brokerage work
4. People's perception of the justifiable billing rate for appraisers is a problem. Hence, a real need to push production work off to less costly people and get bill out at the higher partner rate.
5. Productivity = f(mechanization or specialization of appraisals). Problems w/ this are boredom and loss of employees because they get so good. The vast majority of appraisal firms are subsidized by other elements of their operation.
6. Ethics vs. Economics
 - the appraisal is written for someone other than who pays for it ... this creates a conflict of interest. He's hired to be objective, but not compensatable on that basis.
 - Appraisal is either regarded as an advocate position or as a C.V.A. position.
 - the name of quantity tends to deteriorate quality. Sol'n: inform consumers. The real issue is whether the prop. will rent-up.
7. To make appraisal a profession, you must start w/ the consumer and chg. the parties that make the decision (banks, etc.) then the appraiser can be objective. The appraiser should be a friend of the court; perception of bias.
8. Next, the bid system should be replaced.
9. The decision making calculus of the decision maker should be modified. Is the problem w/ the consumer or the profession. Appraiser is in a trap -- viewed as meretricious -- and on an hourly basis. Professionals are able to chg. for their services and its value.
10. Appraisers haven't been able to convince people that they can really chg. for their services. Roulac believes you can chg. for their services -- their participation creates value for the client.

B. Ethics —

1. Is it etiquette or ethics? Etiquette is protocol; ethics is whether your judgement is trusted by the fee.

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2. Very few cases of malfeasance against appraisers because they can't make it stick. SEC has eliminated the priority of contract issue in appraisals dealing w/ syndications.
Negligence = ordinary care / omission or commission. Malfeasance = failure to do that which the other party had a reasonable expectation that you could do. Failure to do what you could do; you didn't do it.
3. Appraisal liabilities, doesn't cover "forecasts" of the future.
4. Ethics is intellectual integrity vs. behavioral
5. It wants to be a profession in fees, but an art for procedure. It is undefined as of now, so no agreement as how best to do it.
6. Result: appraisal industry is becoming extinct. Losing high vol. low fee $\rightarrow$ extinction and losing low vol. / high fee $\rightarrow$ accts. Appraisers are locked into their procedures, not the product $\Rightarrow$ locked into an obsolete product. Society has recognized this to increase services (analysis) available. MAI's are standing firm; not AIA. The industry is fragmented (MAI, Society, Amer. Appraisers, HWY Appraisers) Movement toward consolidation, but it has broken down. $\therefore$ no one speaks for the appraisal profession. $\Rightarrow$ it will either be a specialization in acctg. or highly down graded. Acctg. has great access to industry and it's a logical addition to their services. Inv. banking.
7. Dim career opportunities in appraisal, but it is a good door opener in a mkt.

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LAB

11

Genny Mittnacht 271-3234

I. WRITING LAB

A. Reasoning For Learning Writing Techniques —

1. Our concern will be with technical writing; concerned with facts only. known as expository writing. Precise expression of meaning in a min. of words.
2. Exposition is reporting of what you have learned.

* Assignment: chaps. 1-4 in Fran's Book for the next class. *

B. Writing Tools —

1. Physical equipment

- Paper - best paper is cotton content and 16# or 20# The draft should be double spaced. Do not use onion skin or corrugable paper.

2. Reference materials

- Dictionary
- Style Book - mechanical rules for consistent use; Terabrian is best
- Elements of Style - Strunk + White
- Grammar - Words into Type book by Skinner

C. Assignments —

1. Must be typed, double spaced, 2 copies, stapled in left corner, name in upper right corner. Margin = 1" on each side.
2. Study Chap. 1-4 in Fran's book.

• Concentrate on p. 14-15 sentence
p. 70-71 Paragraph } Book
p. 74-87

3. Write a TP that describes a building. Research in Sylvain art Lib. History of architecture. About the architectural features of the bldg. 1 footnote and 2 bibliographic entries done properly using Terabrian as a guide. Need to look at 2 books. Include 2 copies; 1 for Genny, 1 for Chief. all on 1 page.

Name of bldg, address and style } left corner. Due Sept. 24, 1982 Friday.

WARF
BUILDING

9/29/82

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2

I. GRAMMER AND PUNCTUATION

A. Parts of Speech —

1. Noun
2. Pronoun
3. adjective
4. Verb
5. Preposition
6. Adverb
7. Interjection
8. Conjunction

B. other ideas —

1. Active voice means that the subject did the action of the verb. the subject is responsible for the action.

Active: The council examined the budget. } Use in business reports.

Passive: The budget was examined by the council.

C. Punctuation —

1. ellipsis = only used in quoted material.

Assignment:

- 1 page business letter to a lawyer who has called me asking me what fair market value and most probable price means. Use Baymans terms.
- Due next Friday.

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3

Note: If you can put a comma in front of it, use a "which". If you can't use a "that". If you can drop all the info. before which then you can use it.
Ratcliff p.23 Value Def'n

Data = plural

I. PARAGRAPHS

Assignment:

Explain the difference in approach.

Explain Difference between the approach of a contemporary approach vs. an older traditional M.A.I. Define the question, choose ^{Explain how you} ~~an~~ approp. def'n of value and ~~choose~~ ^{period} how you ~~choose~~ ^{an} appropriate methodology + a wrap up statement.

4 items that
lead to an
outline

Explain these 4 items and how it differs.

A. Ideas —

1. Have a strong topic sentence that starts w/ a noun.
2. Also, you need a good wrap up sentence.

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4

I. THE APPRAISAL

A. Tips on Writing the Appraisal —

1. Use an outline format; the more detailed the better.

2. Questions to ask...

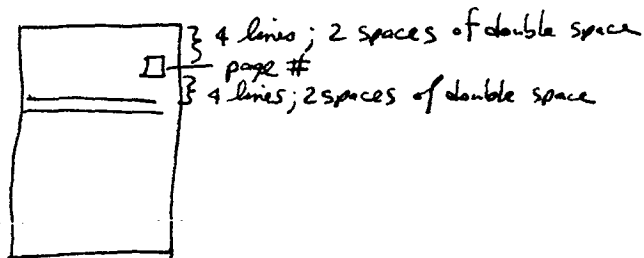
- ① Does each IP fulfill the req. of a IP? Topic sentence? General concluding statement @ end of IP? Logical order of the IP's
- ② Sentences - read each one and make sure each one is grammatically correct.
- ③ Is it in the active voice? The subject does the action.
- ④ Choose appropriate words. A report is no place for opinions or values.
- ⑤ Try to reduce the # of extraneous words. Remove qualifiers: "very"
- ⑥ Tables - use a consistent style
- ⑦ Style - use simple, clear direct writing of facts in a simple way.

B. Triggers / Rules —

1. Very / rather / somewhat = qualifiers, so leave them out.
2. Upon / Within = use "on" and "in" instead of upon and within.
3. The = ask if you need this every time you use it.
4. It = don't start a sentence w/ it. Redo the sentence.
5. This = It should not be sitting alone in the sentence.
6. There are / there is = can usually be eliminated
7. The fact that = always remove this. In fact = always remove this too.

C. Typist Rules —

1. Use elite type
2. 1" margins on top, side and bottom
- 3.



- A. Use arabic numbers (46) in front of a percent.
5. Double space for draft

Dear Mrs. Larson

As per your request, I have located a property in Madison ... The subject property, located at _____, is of the Tudor design and is constructed w/ materials that

Sincerely,

Greek Revival

Gothic "

Art Deco

English Tudor

Norman

So. Colonial

Skidmore, Owings and Merrill
1st Wisc.

One of these styles.

Contemporary modern style

Granite wall cladding (Main)

Curtain wall panels

conc. frame construction

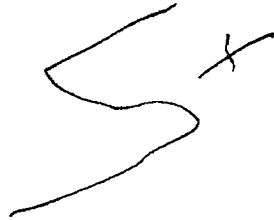
High rise

Tinted glass

Triangle shaped w/ upper two stories w/ cap on column

October 8, 1982

Mr. David James
Certified Public Accountant
1758 Odana Court
Madison, Wisconsin 53705



Dear Mr. James:

In our telephone conversation you asked us to explain the difference between the traditional appraisal method and the newer contemporary approach. Our discussion focuses on three differences: definition of the appraisal question, selection of the value definition, and selection of an appropriate analysis methodology.

A clear definition of the appraisal question is the first issue in a well-written, logical report. Without a succinct statement of the question--the reason for the appraisal--the value definition, the analysis methodology, and the ultimate value conclusion will not meet the client's goals. Different questions lead to different answers, so the appraiser's first task is to determine the client's reason(s) for doing the appraisal. Traditional appraisers frequently ignore this important step; they rapidly proceed to forecast fair market value. In contrast, contemporary appraisers place strong emphasis on definition of the appraisal question (purpose) before planning the rest of the appraisal. The purpose of the appraisal leads the contemporary appraiser directly to the relevant definition of value, which helps determine the appropriate analysis methodology. While traditional appraisers concentrate on forecasting fair market value, contemporary appraisers recognize other purposes for an appraisal: tax assessment, purchase of an investment, sale of an investment, purchase of a going-concern, and valuation for insurance purposes. Each of these five questions may lead to a different definition of value and hence a different value forecast. Thus, traditional appraisers are frequently myopic and unfair to their clients when they immediately focus on fair market value without carefully considering the purpose of the appraisal.

Definition of value is at the heart of the appraisal process. Contemporary appraisers rely on the purpose of the appraisal as the key determinant of the definition of value. Once the client's question is clearly understood, the definition of value is largely determined. As noted above, traditional appraisers often select the value definition first, thereby ignoring the purpose for the appraisal. Some of the common value definitions used by appraisers include: insurance value, tax value, liquidation value, and investment value. The choice of which definition is appropriate depends on the purpose for the appraisal.

Given a purpose and a definition of value, the appraiser must select an appropriate analysis methodology. The traditional appraisal method requires a single value estimate derived from three approaches: cost to replace, market comparison, and income capitalization. Inflexible by design, the traditional approach uses the same analysis methodology regardless of data availability

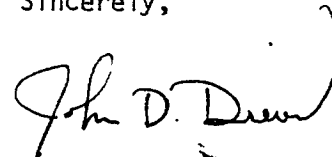
Mr. David James

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or results. In contrast, the contemporary approach allows appraisers to design a relatively flexible feasibility model that maximizes the use of available data consistent with reliable results. Typically, contemporary appraisers utilize one of the following approaches: (1) The empirical method inductively relates past sales transactions to the value of the subject property; (2) If sufficient data are not available for the empirical method, the appraiser may apply a technique that simulates buyer behavior; and (3) Failing number one and number two, the appraiser may use a normative approach that assumes an idealized environment. The selection of analysis method depends on data availability, courtroom precedent, and the historic reliability of the method. Once the method is selected, the appraiser applies the model to the data and derives a range of value estimates. In contrast to the traditional appraiser's single, cash equivalent value, the contemporary appraiser defines a central tendency value that assumes different bargaining positions among the parties and the influence of financing on the ultimate price. The key to the contemporary approach is its flexibility; the approach can be adjusted to the data thereby achieving the best conclusion.

We hope we have answered your questions. If you have any further questions, please call us.

Sincerely,

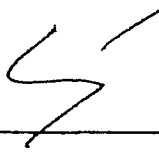
A handwritten signature in black ink, reading "John D. Dreier". The signature is fluid and cursive, with a large, sweeping loop at the end of the last name.

John D. Dreier
Madison Appraisal Associates

Wisconsin Alumni Research Foundation Building (WARF)
610 North Walnut Street
Madison, Wisconsin

Contemporary Office Building

John D. Dreier
September 24, 1982



To: Genny Mittnacht
From: John D. Dreier
Subject: Architectural Characteristics of the WARF Building

The Wisconsin Alumni Research Foundation Building (WARF), located at 610 North Walnut Street, is a fourteen story contemporary office building. Completed in 1971, the triangular shaped structure houses educational, administrative and laboratory personnel within its 130,578 gross square feet.¹ The WARF building is structurally supported by precast, reinforced concrete walls. The exterior of the building is covered by two surfaces: granite cladding on the curved angular edges and porcelain enamel curtain walls on the straight sides. All windows are double-glazed tinted glass, a material infrequently used in office buildings prior to 1973. The top two floors of the building form a unique office penthouse that extends slightly beyond the outer edges of the triangular plane. The penthouse enhances the external features of the structure while it creates more interior space. Although the exterior landscaping is dominated by concrete walkways, it does not detract from the attractive architectural appearance of the building.

¹

"WARF Builds to Share with U.W.," Wisconsin Alumnus, LXX, No. 9, (1969), 19.

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Department of Planning and Construction. The University of Wisconsin - Madison Factbook. Madison: Department of Planning and Construction, 1971.

"WARF Builds to Share with U.W.." Wisconsin Alumnus. 1969. Vol. LXX.

✓
S-
October 1, 1982

Mr. David Smith
Attorney-at-law
Smith, Jones and Davis
1100 Odana Road
Madison, Wisconsin 53705

Dear Mr. Smith:

In our telephone conversation you asked us to provide you with an explanation of fair market value and most probable price. Within the appraisal profession there is disagreement about the exact meaning of these terms. We offer our opinions as guidance, not as a definitive statement.

X Fair market value and most probable price are related but different terms. Both concepts result from real estate value estimation for a specific purpose at a point in time. However, each term uses a different methodology to achieve its goal. As the typical objective of the traditional appraisal process, fair market value uses three approaches to value - replacement cost, market comparisons, and capitalized income. After the three estimation approaches are applied, the appraiser reconciles the numbers into a single price for the subject property. A highly structured set of conditions are inherent in this approach: (1) the buyer and seller are motivated and informed; (2) the price is the highest the property will bring in a competitive and open market under fair sale conditions; (3) the property is on the market for a reasonable time and not unduly influenced by special financing terms; and (4) the payment is in cash, or its equivalent, and financing is generally available in the local market. Given these conditions, the appraiser's task is to estimate a single price for the property based on its highest and best use - generally regarded as the most profitable use.

The most probable price is an alternative to fair market value. It uses a range of prices to recognize that uncertainty exists in real estate markets. Most probable price utilizes a probabilistic transaction zone that overtly acknowledges alternative prices in a transaction affected by many factors. While fair market value requires three separate approaches to value, the contemporary approach allows the appraiser to select the most appropriate method consistent with the most likely use for the site, the most likely buyer group, and the original purpose for the appraisal. Fair market value is much less flexible than most probable price because it implies certainty and it frequently ignores the purpose for the appraisal. The most probable price method is often referred to as the contemporary approach because it solves many of the problems inherent in the traditional approach. For example, fair market value estimates a single price based on highest and best use. The most probable price recognizes that the highest and best use (most profitable) is only one of many factors influencing the transaction. Other constraints, such as legal factors, market trends, and community standards must also be considered. Thus, most probable price goes beyond highest and best use by recognizing other constraints that reduce the highest and best use to its most probable use. Summarizing, the most probable price is the price at which a property would most likely sell if "exposed to the market for a reasonable time and under market conditions prevailing at the time of appraisal."

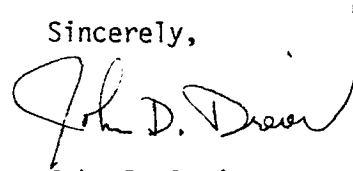
Mr. David Smith

Page 2

You should recognize that courts typically have their own definitions of fair market value and most probable price. If you ever become involved with an eminent domain case, you would be well advised to carefully study all precedent cases in the applicable jurisdiction. You will probably find that the particular court you are dealing with will have its own specific definition of market value. Historically, courts have equated fair market value with actual cash value, fair cash value, reasonable market value, and true cash value.

We hope this information is useful to you. If you have any questions, please do not hesitate to call us.

Sincerely,

A handwritten signature in black ink, appearing to read "John D. Dreier". The signature is fluid and cursive, with a large initial "J" and a long, sweeping underline.

John D. Dreier
Madison Appraisal Associates

John Dreier

Nicely developed discussion, John.

Did you do that last line just to give me something to pick at after all these weeks? Or, better, didn't you realize you had questions repeated so closely together?

October 8, 1982

Mr. David James
Certified Public Accountant
1758 Odana Court
Madison, Wisconsin 53705

Dear Mr. James:

In our telephone conversation you asked us to explain the difference between the traditional appraisal method and the newer contemporary approach. Our discussion focuses on three differences: definition of the appraisal question, selection of the value definition, and selection of an appropriate analysis methodology.

A clear definition of the appraisal question is the first issue in a well-written, logical report. Without a succinct statement of the question--the reason for the appraisal--the value definition, the analysis methodology, and the ultimate value conclusion will not meet the client's goals. Different questions lead to different answers, so the appraiser's first task is to determine the client's reason(s) for doing the appraisal. Traditional appraisers frequently ignore this important step; they rapidly proceed to forecast fair market value. In contrast, contemporary appraisers place strong emphasis on definition of the appraisal question (purpose) before planning the rest of the appraisal. The purpose of the appraisal leads the contemporary appraiser directly to the relevant definition of value, which helps determine the appropriate analysis methodology. While traditional appraisers concentrate on forecasting fair market value, contemporary appraisers recognize other purposes for an appraisal: tax assessment, purchase of an investment, sale of an investment, purchase of a going-concern, and valuation for insurance purposes. Each of these five questions may lead to a different definition of value and hence a different value forecast. Thus, traditional appraisers are frequently myopic and unfair to their clients when they immediately focus on fair market value without carefully considering the purpose of the appraisal.

Definition of value is at the heart of the appraisal process. Contemporary appraisers rely on the purpose of the appraisal as the key determinant of the definition of value. Once the client's question is clearly understood, the definition of value is largely determined. As noted above, traditional appraisers often select the value definition first, thereby ignoring the purpose for the appraisal. Some of the common value definitions used by appraisers include: insurance value, tax value, liquidation value, and investment value. The choice of which definition is appropriate depends on the purpose for the appraisal.

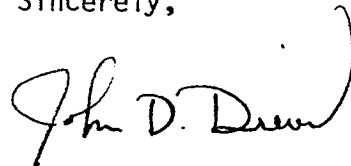
Given a purpose and a definition of value, the appraiser must select an appropriate analysis methodology. The traditional appraisal method requires a single value estimate derived from three approaches: cost to replace, market comparison, and income capitalization. Inflexible by design, the traditional approach uses the same analysis methodology regardless of data availability

Mr. David James
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or results. In contrast, the contemporary approach allows appraisers to design a relatively flexible feasibility model that maximizes the use of available data consistent with reliable results. Typically, contemporary appraisers utilize one of the following approaches: (1) ~~The~~ empirical method inductively relates past sales transactions to the value of the subject property; (2) ~~If~~ sufficient data are not available for the empirical method, the appraiser may apply a technique that simulates buyer behavior; and (3) ~~Failing~~ number one and number two, the appraiser may use a normative approach that assumes an idealized environment. ~~The~~ selection of analysis method depends on data availability, courtroom precedent, and the historic reliability of the method. Once the method is selected, the appraiser applies the model to the data and derives a range of value estimates. In contrast to the traditional appraiser's single, cash equivalent value, the contemporary appraiser defines a central tendency value that assumes different bargaining positions among the parties and the influence of financing on the ultimate price. The key to the contemporary approach is its flexibility; the approach can be adjusted to the data thereby achieving the best conclusion.

We hope we have answered your questions. If you have any further questions, please call us.

Sincerely,

A handwritten signature in dark ink, appearing to read "John D. Dreier". The signature is fluid and cursive, with a large, sweeping loop at the end.

John D. Dreier
Madison Appraisal Associates

John Dreier

'ell, John, your maturity shows.

As does your experience.

Your sentences are nicely articulate
and flow easily right down the page.

Setting out your conditions with
numbers keeps clear what could be
confusing information.

As you see, the only thing I did was
unsplit an infinitive on the second
page.

October 1, 1982

Mr. David Smith
Attorney-at-law
Smith, Jones and Davis
1100 Odana Road
Madison, Wisconsin 53705

Dear Mr. Smith:

In our telephone conversation you asked ^{for} ~~us to provide you with~~ an explanation of fair market value and most probable price. Within the appraisal profession there is disagreement about the exact meaning of these terms. We offer our opinions as guidance, not as a definitive statement.

Fair market value and most probable price are related but different terms. Both concepts result from real estate value estimation for a specific purpose at a point in time. However, each term uses a different methodology to achieve its goal. As the typical objective of the traditional appraisal process, fair market value uses three approaches to value—replacement cost, market comparisons, and capitalized income. After the three estimation approaches are applied, the appraiser reconciles the numbers into a single price for the subject property. A highly structured set of conditions are inherent in this approach: (1) the buyer and seller are motivated and informed; (2) the price is the highest the property will bring in a competitive and open market under fair sale conditions; (3) the property is on the market for a reasonable time and not unduly influenced by special financing terms; and (4) the payment is in cash, or its equivalent, and financing is generally available in the local market. Given these conditions, the appraiser's task is to estimate a single price for the property based on its highest and best use—generally regarded as the most profitable use.

⁹ The most probable price is an alternative to fair market value ^{and} uses a range of prices to recognize that uncertainty exists in real estate markets. Most probable price utilizes a probabilistic transaction zone that overtly acknowledges alternative prices in a transaction affected by many factors. While fair market value requires three separate approaches to value, the contemporary approach allows the appraiser to select the most appropriate method consistent with the most likely use for the site, the most likely buyer group, and the original purpose for the appraisal. Fair market value is much less flexible than most probable price because it implies certainty and it frequently ignores the purpose for the appraisal. The most probable price method is often referred to as the contemporary approach because it solves many of the problems inherent in the traditional approach. For example, fair market value estimates a single price based on highest and best use. The most probable price recognizes that the highest and best use (most profitable) is only one of many factors influencing the transaction. Other constraints, such as legal factors, market trends, and community standards must also be considered. Thus, most probable price goes beyond highest and best use by recognizing other constraints that reduce the highest and best use to its most probable use. Summarizing, the most probable price is the price at which a property would most likely sell if "exposed to the market for a reasonable time and under market conditions prevailing at the time of appraisal."

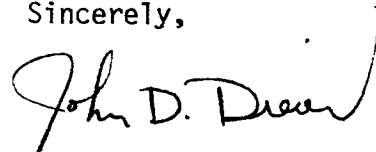
Mr. David Smith

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You should recognize that courts typically have their own definitions of fair market value and most probable price. If you ever become involved with an eminent domain case, you would be well advised to carefully study all precedent cases in the applicable jurisdiction. You will probably find that the particular court you are dealing with will have its own specific definition of market value. Historically, courts have equated fair market value with actual cash value, fair cash value, reasonable market value, and true cash value.

We hope this information is useful to you. If you have any questions, please do not hesitate to call us.

Sincerely,

A handwritten signature in black ink, reading "John D. Dreier". The signature is written in a cursive style with a large, sweeping initial "J" and a long, horizontal flourish extending to the right.

John D. Dreier
Madison Appraisal Associates

October 1, 1982

Mr. David Smith
Attorney-at-law
Smith, Jones and Davis
1100 Odana Road
Madison, Wisconsin 53705

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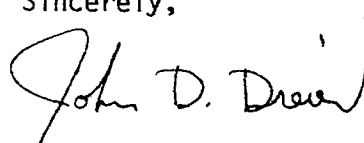
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We hope this information is useful to you. If you have any questions, please do not hesitate to call us.

Sincerely,

A handwritten signature in black ink, reading "John D. Dreier". The signature is fluid and cursive, with a large initial "J" and a stylized "D".

John D. Dreier
Madison Appraisal Associates

John Dreier

WARF Building-610 N. Walnut (contemporary)

Well, John, I don't think we will have much to talk about if we have a conference. A very nice paragraph. Simple, straightforward language, with perhaps only the two sentences about the penthouse sort of choppy. Combine into one?

Wisconsin Alumni Research Foundation Building (WARF)
610 North Walnut Street
Madison, Wisconsin

Contemporary Office Building

John D. Dreier
September 24, 1982

To: Genny Mittnacht
From: John D. Dreier
Subject: Architectural Characteristics of the WARF Building

*red ink
of color*

The Wisconsin Alumni Research Foundation Building (WARF), located at 610 North Walnut Street, is a fourteen-story contemporary office building. Completed in 1971, the triangular-shaped structure houses educational, administrative and laboratory personnel within its 130,578 gross square feet.¹ The WARF building is structurally supported by precast, reinforced concrete walls. The exterior of the building is covered by two surfaces: granite cladding on the curved angular edges and porcelain enamel curtain walls on the straight sides. All windows are double-glazed tinted glass, a material infrequently used in office buildings prior to 1973. The top two floors of the building form a unique office penthouse that extends slightly beyond the outer edges of the triangular plane. ^{At} ~~The~~ penthouse enhances the external features of the structure while it creates more interior space. Although the exterior landscaping is dominated by concrete walkways, it does not detract from the attractive architectural appearance of the building.

¹
"WARF Builds to Share with U.W.," Wisconsin Alumnus, LXX, No. 9, (1969), 19.

*Q. 44
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Department of Planning and Construction. The University of Wisconsin - Madison Factbook. Madison: Department of Planning and Construction, 1971.

"WARF Builds to Share with U.W." Wisconsin Alumnus. 1969. Vol. LXX.