



# State of the Market (WDC/MD/VA) – From the Appraiser's Perspective

Commercial Real Estate Women  
(CREW)

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Presented by the Valuation and Transaction Advisory Group (VTAG)



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## VALUATION GROUP – REAL ESTATE RELATED

- APPRAISALS
- MARKET FEASIBILITY STUDIES
- REVIEWS OF APPRAISALS/VALUATIONS FOR FINANCIAL REPORTING PURPOSES (FAIR VALUE)
- FRACTIONAL INTERESTS IN PARTNERSHIPS
- PARTNERS' EXIT STRATEGY ANALYSES
- LOW INCOME HOUSING, NEW MARKET, HISTORIC TAX CREDITS
- PURCHASE PRICE ALLOCATION (FAS 141R)
- COMPLEX INSTRUMENTS - DEBT AND EQUITY
- LITIGATION SUPPORT



## Valuation and Transaction Advisory Group



*Our Services at a Glance:*

Financial Reporting and Tax-Related Valuation Services	Transaction and Strategic Advisory	Real Estate Valuation and Transaction Advisory	Dispute and Litigation Consulting
<ul style="list-style-type: none"> <li>■ Purchase Price Allocations in accordance with SFAS 141</li> <li>■ Goodwill Impairment studies in accordance with SFAS 142</li> <li>■ Valuing stock-based compensation and options 409A and 123 (R)</li> <li>■ Valuation of Derivatives and Embedded Derivatives (SFAS 133 and SFAS 155)</li> <li>■ Charitable Contributions</li> <li>■ Estate and Gift Tax</li> <li>■ Net Operating Loss Limitations</li> <li>■ Corporate Reorganizations and Restructurings</li> <li>■ Transfer Pricing</li> <li>■ Arbitrage Rebate</li> </ul>	<ul style="list-style-type: none"> <li>■ Compensation Studies</li> <li>■ Fairness Opinion</li> <li>■ Merger / Acquisition Advisory</li> <li>■ Buy / Sell agreements</li> <li>■ Deal Structuring</li> <li>■ Financial / Tax Due Diligence</li> <li>■ Capital Raising</li> <li>■ Business Succession Planning</li> <li>■ Establishment of reasonable royalty rates for the licensing of intellectual property</li> <li>■ Valuations for employee stock ownership plans (ESOP)</li> <li>■ ESOP feasibility studies and advisory</li> <li>■ Business Plans / Projections; Profit / Value Enhancement</li> <li>■ Forecasting, Optimization, and real options analysis by Monte Carlo simulation</li> </ul>	<ul style="list-style-type: none"> <li>■ Valuation and appraisal for all property types nationally</li> <li>■ Valuation studies of fractional interests in real estate holdings, including limited and general partner interests</li> <li>■ Debt or equity financing</li> <li>■ Acquisition or sale of a property or ownership interest</li> <li>■ Market feasibility studies</li> <li>■ Portfolio analysis</li> <li>■ Valuation of mortgages, mortgage-backed securities, and mortgage servicing rights</li> </ul>	<ul style="list-style-type: none"> <li>■ Shareholder and partner disputes</li> <li>■ Divorce</li> <li>■ Bankruptcy and liquidation</li> <li>■ Corporate damage calculations</li> <li>■ Expert testimony</li> <li>■ Forensic accounting and analysis</li> </ul>



## AGENDA - State of the Market (WDC/MD/VA) –

- **MARKET SITUATION**
- **SALES APPROACH CHALLENGES**
- **INCOME APPROACH CHALLENGES**
- **SUMMARY OF APPRAISAL CHALLENGES AND OPPORTUNITIES**





## MARKET SITUATION (EXTRACT)

1. LACK OF LIQUIDITY

2. INCREASED OFFICE VACANCY AND  
COLLECTION LOSS, LOWER RENTS

3. INCREASED MULTIFAMILY  
VACANCY AND COLLECTION LOSS,



# 1. LIQUIDITY CRISIS

I. US: \$6 TRILLION COMMERCIAL RE MARKET

II. FINANCED THROUGH >\$3 TRILLION DEBT

III. BANKS AND CMBS REPRESENT 75% OF ALL OUTSTANDING LOANS



# 1. LIQUIDITY CRISIS – SLIDE TWO

IV. HUNDREDS OF BILLIONS OF  
COMMERCIAL RE LOANS EXPECTED

V. OVER \$1 TRILLION EXPECTED TO  
MATURE 2010+

VI. GROWING CHALLENGE FOR RE-  
FINANCING



# 1. LIQUIDITY CRISIS – SLIDE THREE

VII. LOAN-TO-VALUE RATIOS  
DECREASE

VIII. THIS LEADS TO HIGHER EQUITY  
REQUIREMENT

IX. TOGETHER WITH HIGHER  
INTEREST RATES AND EQUITY RATES,



## 1. LIQUIDITY CRISIS – CONCLUSION

LACK OF AVAILABLE FINANCING  
LEADS TO INABILITY TO REFINANCE  
MORTGAGES THAT COME DUE ---

OWNERS OF “GOOD” PROPERTIES  
NOT WILLING TO SELL UNLESS NEED  
TO LIQUIDATE

## 2. INCREASED OFFICE VACANCY AND COLLECTION LOSS, LOWER RENTS

- DOWNSIZING AND BANKRUPTCIES OF COMPANIES = LESS OFFICE SPACE DEMAND
- IN DC, 4Q 2008 VACANCY AT 7.4% (UP FROM 6.6% A YEAR AGO); MD 12.0% (UP FROM 11.0% A YEAR AGO)
- IN DC, 1.1 M VACANT SPACE FROM NEW CONSTRUCTION DELIVERED IN 2008, INCREASE IN SUBLET SPACE AS TENANTS CONTRACTED OR DISSOLVED IN 4Q OF 2008
- DC AND MD: LACK OF PRELEASING ACTIVITY IN NEW CONSTRUCTION LIKELY TO INCREASE VACANCY DURING 1Q 2009



## 2. INCREASED OFFICE VACANCY AND COLLECTION LOSS, LOWER RENTS –

- IN DC, THERE IS CURRENTLY 9.5 MILLION SQUARE FEET IN THE DEVELOPMENT PIPELINE, OF WHICH 25% IS PRELEASED
- IN MD, A TOTAL OF 2.2 MILLION SQUARE FEET WILL DELIVER IN 2009 WITH 33.8% PRELEASED
- IN DC, OFFICE USING EMPLOYMENT GREW LESS THAN IN PREVIOUS YEARS, EVEN GOVERNMENT
- IN MD, THERE WAS A NET INCREASE IN OFFICE JOBS OF 2,300 DURING THE YEAR ENDED OCTOBER 2008

## 2. INCREASED OFFICE VACANCY AND COLLECTION LOSS, LOWER RENTS – SLIDE THREE

- IN DC, DIRECT ASKING RENTAL RATES DROPPED BY ALMOST \$3.00/SF BETWEEN THIRD AND FOURTH QUARTER 2008
- IN MD, OVERALL ASKING RENTS IN THE I-270 CORRIDOR DECREASED BY 4.8% BETWEEN THIRD AND FOURTH QUARTER
- **COMBINED, HIGHER VACANCY AND COLLECTION LOSS, LESS DEMAND VERSUS SUPPLY AND LOWER RENTS LEAD TO LOWER VALUES**



### 3. INCREASED MULTIFAMILY VACANCY AND COLLECTION LOSS, LOWER RENTS

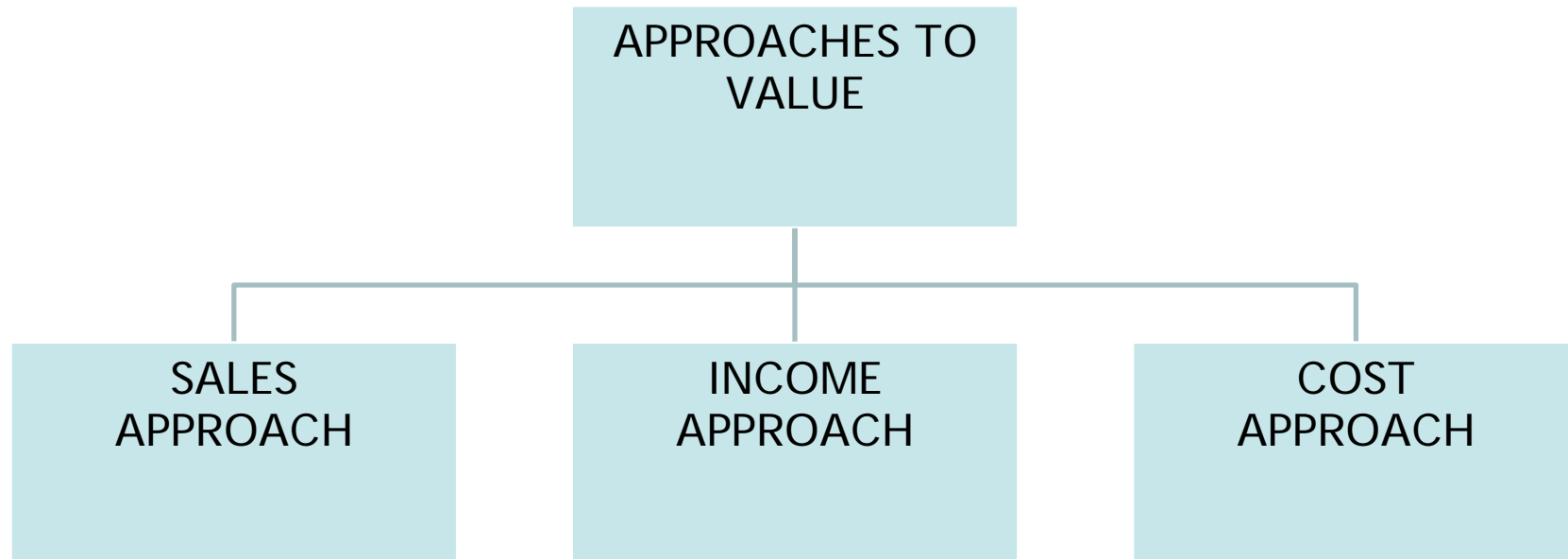
- THE WASHINGTON AREA UNEMPLOYMENT RATE INCREASED BY 110 BASIS POINTS DURING THE PAST YEAR TO 4.1% IN OCTOBER 2008.
- THE WASHINGTON METRO AREA HAS THE LOWEST UNEMPLOYMENT RATE AMONG COMPARABLE METROS AND COMPARES FAVORABLY TO THE NATIONAL RATE OF 6.5% IN OCTOBER 2008.

### 3. INCREASED MULTIFAMILY VACANCY AND COLLECTION LOSS, LOWER RENTS -SLIDE TWO

- VACANCY OF CLASS A AND B APARTMENTS INCREASED TO 4.3% IN WDC METRO AREA (12/08) FROM 3.7% IN 12/07
- NO OR NOMINAL RENT GROWTH LAST YEAR
- 51 PROJECTS ARE IN LEASE-UP, ABSORPTION ON AVERAGE 15 UNITS A MONTH
- CONCESSIONS AT 5.7% OF FACE RENT (CLASS A)
- CONSTRUCTION PIPELINE: 27,000 AS OF 12/08, DOWN FROM 37,000 UNITS AS OF 1/08
- LESS SALES TRANSACTIONS (23 IN '07; 12 IN '08)



## APPRAISAL – APPROACHES TO VALUE

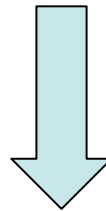


## SALES APPROACH

- LACK OF LIQUIDITY, HIGHER INTEREST AND EQUITY YIELD RATES COMBINED WITH HIGHER EQUITY PORTIONS OF FUNDING ---→ LEADS TO HIGHER DISCOUNT AND CAP RATES --→ LEADS TO LOWER PRICES
- SOME PROPERTIES NEED TO BE SOLD IF MORTGAGE LOAN COMES DUE AND LENDER WILL NOT EXTEND LOAN AND DEMANDS REPAYMENT --→ LOWER/DISTRESSED SALE PRICE
- OWNERS DO NOT SELL UNLESS NEED FOR LIQUIDATION

## SALES APPROACH

- **INVESTORS HAVE LITTLE INTEREST IN PURCHASING A FULLY PRICED PROPERTY WHEN DISCOUNTED PROPERTIES ARE AVAILABLE**



- **LACK OF “MARKET” SALES AND CAP RATE DATA**
- **PRICE MAY NOT EQUAL VALUE: APPRAISERS HAVE TO THOROUGHLY INVESTIGATE THE CONDITIONS/MOTIVATIONS BEHIND EACH SALE**



## INCOME APPROACH – A TRADITIONAL APPROACH

### GOAL:

**CONVERTING ANTICIPATED BENEFITS (CASH FLOW AND REVERSIONARY SALE) INTO PROPERTY VALUE.**

### STABILIZED PROPERTY:

**ONE YEAR'S INCOME EXPECTANCY CAN BE CAPITALIZED AT A MARKET-DERIVED CAPITALIZATION RATE**

### UN-STABILIZED PROPERTY:

**ANNUAL CASH FLOWS FOR THE HOLDING PERIOD AND THE REVERSION DISCOUNTED AT A SPECIFIED YIELD RATE.**



## INCOME APPROACH CHALLENGES

- INCOME STREAMS LESS CERTAIN
- RISK OF DEFAULTS INCREASES
- INCOME OVER FIRST COUPLE YEARS  
FLAT OR DECREASING DUE TO  
IN VACANCIES AND CONCESSIONS

# INCOME APPROACH – EXAMPLE

Subject Property	
<b>DIRECT CAPITALIZATION - STABILIZED (SHORTENED VERSION)</b>	
	Year 1
For the Years Ending	Feb-2002
Scheduled Base Rental Revenue	\$1,995,540
Parking	\$80,000
<b>TOTAL POTENTIAL GROSS INCOME</b>	<b>\$2,075,540</b>
General Vacancy	-\$99,777
Collection Loss	-\$39,911
<b>EFFECTIVE GROSS INCOME</b>	<b>\$1,935,852</b>
<b>TOTAL OPERATING EXPENSES</b>	<b>\$484,730</b>
<b>NET OPERATING INCOME</b>	<b>\$1,451,122</b>
<b>TOTAL LEASING &amp; CAPITAL COSTS</b>	<b>\$28,754</b>
<b>CASH FLOW BEFORE DEBT SERVICE</b>	<b>\$1,422,368</b>
	=====
PV at cap rate of 8.5%	\$16,733,741
<b>PV at cap rate of 8.5% (rounded)</b>	<b>\$16,700,000</b>

- FEW CAP RATE DATA
- CAP RATES INCREASING
- INVESTORS CONSIDER MORTGAGE CONSTANT AS BENCHMARK

## SUMMARY OF APPRAISAL CHALLENGES AND OPPORTUNITIES

- UNCERTAINTIES ABOUT FUTURE CASH FLOWS (I.E. VACANCY, COLLECTION LOSSES, RE-LEASE RATES, TENANT IMPROVEMENT ALLOWANCES)
- LACK OF DATA FROM “MARKET” (NOT DISTRESSED) TRANSACTIONS
- APPRAISING IS A REFLECTION OF HOW INVESTORS ANALYZE PROPERTIES

## SUMMARY OF APPRAISAL CHALLENGES AND OPPORTUNITIES – SLIDE TWO

### THOUGHTS ON APPRAISAL PRACTICE:

- APPRAISING IS DONE AS OF A CERTAIN VALUATION DATE AND CONSIDERS HOW TYPICAL INVESTORS/ BUYERS WOULD ANALYZE THE PROPERTY
- IF INVESTORS DO NOT CONSIDER CERTAIN ISSUES, APPRAISING DOES NOT CONSIDER IT EITHER
- THIS HOLDS FOR EXAMPLE FOR THE RECENT IMPACT OF CREATIVE FINANCING WHICH LOWERED CAP RATES AND LEAD TO OVERHEATED PRICES THAT WERE NOT SUSTAINABLE

## SUMMARY OF APPRAISAL CHALLENGES AND OPPORTUNITIES – SLIDE THREE

- CURRENT RISKS: RISK OF COMMERCIAL REAL ESTATE OWNERS WALKING AWAY FROM THEIR PROPERTIES/LOAN OBLIGATIONS IF INABILITY TO REFINANCE AND/OR INCREASE IN “DISTRESSED SALES”
- APPRAISERS SHOULD OFFER AN OUTLOOK AND ANALYSIS OF RISKS IN THE MARKET PLACE AND BANKS AND INVESTORS SHOULD CONSIDER THOSE RISKS