



BACK TO THE BASICS

INCREASING CONFIDENCE IN CRE APPRAISALS THROUGH FUNDAMENTAL MARKET ANALYSES

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LOAN MONITORING

- Banks closely monitor loans secured by investment grade income-producing properties.
 - Most lenders must provide quarterly status reports; such is essential when properties are in lease-up or present a subdivision or condo scenario when lots or units are being sold.
- Loan agreements often dictate when a new appraisal is needed.
 - New appraisal as of a specific date.
 - Occupancy falls below a certain level.
 - Internal valuation analyses reflect the loan to value ratio is increasing, suggesting a re-margining may be on the horizon.
- New appraisals are obviously triggered by signs of default looming / increasing probability of the property heading into foreclosure.



THERE IS NO “MAGIC BULLET”

- During a boom period, increasing property values are supported with relative ease because comparable sales and rentals tend to be readily available. In short, increasing values have been expected to be well supported by the most recent comparable sales and rentals.
- When markets / properties are in a period of decline, the diminished availability of comparable data does not justify a diminished level of due diligence; **decreasing values are expected to be supported equally as well.** In short, producing an quality appraisal during difficult market conditions usually require further due diligence than that usually provided during boom periods.



IMPACT ON APPRAISAL FEES

- Given financial institutions face a strongly increased probability of loss in a down market, appraisers should assume declining value conclusions typically require more due diligence, and appraisal fees should be reflective of such.
- Financial institution clients should be skeptical when low bids are received on challenging appraisal assignments.



BACK TO THE BASICS...

- Become reacquainted with market value
 - Meeting of the minds
 - Sales price is not market value
- Sellers of investment grade income-producing real estate in 2009:
 - wanted to sell assets as a part of regular portfolio maintenance / balancing regardless of the market (**very few**).
 - Owned high quality assets that were not as significantly impacted by the declining market conditions (**very few – see 1999 K St. NW**). **Highest quality real estate recovers the fastest.**
 - Sellers being forced to sell (**most**).
- During the first through third quarters of 2009, there were roughly 7-8 investment grade office building sales in DC; **usually we average 40-45 sales**. There were only three sales in Northern Virginia, and two sales in suburban Maryland.





Property	1999 K St., NW Washington, DC
RBA	249,000
Year Built	2009
Buyer	Deka Immobilien Investment
Seller	Vornado Realty Trust
Sale Date	Sep 2009
Sale Price	\$207,800,000
Price PSF	\$835
Cap Rate	6.3%



SERIES OF EVENTS: IT STARTED 12/2007

- December 2007 is widely accepted as the beginning of the recession.
- March, 2008: Fall of Bear Stearns
- September 2008: Fall of Lehman Brothers
- October 2008: Emergency Economic Stabilization Act (EESA)
 - \$700 billion Troubled Asset Relief Program (TARP)
- February 2009: American Recovery and Reinvestment Act of 2009 (AARA).



INVESTOR ACTIVITY FROM MID 2008

- Many users of appraisal services consider two types of comparable sales:
 - Pre-September 2008
 - After September 2008
- Many appraisals we review still make strong use of pre-September 2008 comparable sale and rental data.
- Many appraisers have no issue using sales from 2006 through 2008 (especially when there are few 2009-10 comparables), and adjusting making large, unsupported downward adjustments.



SUGGESTIONS - CHECK RATES, RATIOS, ETC. AS A GUIDE (*LAGGING INDICATORS*)

National Markets	Average 1 st Qtr. 2008	Average 1 st Qtr. 2009	Average 1 st Qtr. 2010	Average 2nd Qtr. 2010
Apartment	5.79%	6.88%	7.85%	7.68%
Warehouse	6.47%	7.13%	8.73%	8.60%
CBD Office	6.63%	7.52%	8.35%	8.15%
Regional Mall	6.68%	6.99%	8.34%	7.93%
Power Center	7.13%	7.98%	8.55%	8.70%
Suburban Office	7.13%	8.17%	8.79%	8.60%
Strip Shopping Center	7.28%	7.63%	8.49%	8.38%
Flex/R&D	7.47%	8.20%	9.36%	9.38%



SUGGESTIONS – RECONSIDER HIGHEST & BEST USE / MARKET ANALYSIS

- What were pricing / rents indicating in 2003, 2004, 2005, etc. relative to vacancy rates.
- Real estate appraisals are considered by many to be lagging indicator, when detailed demand analysis requires forward thinking.
- Employment growth forecast – employment does return to most markets.
 - Office demand generator
 - Housing demand generator
 - Retail demand generator



CONTRACT RENT VS. MARKET RENT

- Stabilized properties with an average contract rent higher than the current average market rent.
 - Should not assume significantly higher probability of default with quality tenants (maybe not in retail).
 - Could market rent increase back to contract rent before major rollovers?
 - Rental rates and property feasibility / rent spikes occur after an economic recovery / market stabilization. A “flight to quality” occurs in down markets.



YOUR VOICE IS YOUR MOST VALUABLE ASSET...FROM A WFB ENGAGEMENT.

- Due to concerns with changing market trends and conditions, we are requiring your analyses to consider:
 - Market Participant Interviews: Discussions with real estate market participants (buyers, sellers, property managers, real estate agents/brokers). Reference these interviews in a dedicated section, and report and analyze the most pertinent comments and how they impact the subject value.



YOUR VOICE IS YOUR MOST VALUABLE ASSET...

- Lender conversations:
 - Lenders usually have more information than what we assume.
 - Appraisers should have access to lenders, those involved in work out situations, etc.
 - Make sure the bank's appraisal group is a part of the conversation to insure no bias, lender pressure, etc.



DO NOT ALWAYS ASSUME COMPETENT MANAGEMENT...

- Small office example – losing all tenants.
- Large office example – expecting to land that prime single GSA tenant, and not having a back-up plan.
- Partial redevelopment / value added situation, where property owners were too greedy when deals could have been made.
- Certain borrowers may not be the best at managing various property types (especially mixed-use properties).



THOROUGH ANALYSIS OF COMPARABLE DATA

- Economic principles that impact one comparable, may / may not impact the subject in a similar fashion (location, occupancy, leases).
- Real Capital Analytic's most recent article *Good Comp, Bad Comp*.



GOOD COMP / BAD COMP: NYC OFFICE

Good Comp: \$382/SF

HSBC HQ

452 Fifth Avenue

New York, NY

Buyer: IDB Group

Seller: Midtown Equities

Date: April 2010, Closed

SF/Year Built: 865,000 SF/1902

Price/PSF/Cap Rate: \$330.0 Mil / \$382 PSF / 8.0%



Bad Comp: \$89/SF

Four New York Plaza

4 New York Plaza

New York, NY

**Buyer: Harbor Group
International/Capstone Equities**

Seller: JP Morgan Chase

Date: January 2010, Closed

SF/ Year Built: 1,200,000 SF/1969

Price/ PSF/Cap Rate: \$107.0 Mil / \$89 PSF / 6.9%



GOOD COMP / BAD COMP: CHICAGO OFFICE

Good Comp: \$503/SF

300 North LaSalle Street

Chicago, IL

Buyer: KBS REIT

Seller: Hines Interests LP

Date: June 2010, Contract

SF/Year Built: 1,302,901 SF/2009

Price/PSF/Cap Rate: \$655.0 Mil / \$503 PSF / 6.2%

Bad Comp: \$94/SF

180 North LaSalle Street

Chicago, IL

Buyer: Berkley Properties

Seller: Lightstone Group

Date: May 2010, Closed

SF/Year Built: 767,605 SF/1972

Price/PSF: \$72.3 Mil / \$94 PSF





END OF PRESENTATION

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