Appraisal: Special financing and creative equity contributions: Value, value and more value

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When I first entered the appraisal field forty years ago there was a lot to learn. Nothing has changed forty years later, because I continue to learn something new everyday. In the early 1970s appraisers were concerned with general fee simple market value or leased fee interest value. Leased fee interest value is defined as fee simple interest value subject to lease(s). Occasionally, leasehold interest value or value-in-use would be estimated. Leasehold interest valuation has long been common when a ground tenant's interest has to be estimated such as a fast food restaurant building subject to a ground lease. Value-in-use has long been estimated for special purpose properties such as sewage treatment plants, etc. Fee simple interest, leased fee interest, leasehold interest value and value-in-use have definitely stood the test of time.

Beginning in the 1970s state, local and regional economies especially in the Northeast began to sputter because of high taxes, non competitive union contracts, infrastructure deterioration, foreign manufacturing competition, political corruption, etc. As an example, New York City practically became insolvent in the early 1970s. This created tremendous opportunity for entrepreneurs like Donald Trump who took advantage of low real estate prices and created tremendous capital gains. In Upstate New York and other regions of the Northeast there was a lack of conventional financing due to some lack of willing lenders and equity investors because of various time periods of recession. Lenders were very cautious due to the lack of feasibility of many real estate projects because of lack of demand. In spite of a lack of feasibility; local, state and federal governments started to expand various real estate incentives such as real estate tax abatements, industrial revenue bonds (taxable and tax exempt), grants, etc. Other quasi governmental agencies were expanded or newly formed received funding from counties, states and the federal government. These incentives have been applied to many segments of the real estate spectrum since the 1970s.

A good example of this is low income and other subsidized housing becoming a growing dynamic for seniors, the general population and the handicapped. As an example, the Housing Trust Fund Corp. (HTFC), Tax Credit Assistance Program (TCAP), FHA, Rural Housing Subsidy Loans (RHS), tax credits, Homeless Housing Assistance Program (HHAP), etc. all play roles in this market. So lenders need many different values reported besides the traditional top 4 of fee simple interest, leased fee interest, leasehold interest and value-in-use. Over the past 10 years these types of programs have become more frequent due to increased local, state and federal government spending targeting these sectors. However, there is a price to pay when using these programs in that direct union labor for the full or part of the project is needed or a prevailing wage requirement is instituted which inflates the cost of the project relative to open bidding in the non union market. As a hypothetical example, an outlying Upstate New York senior apartment project of 56 one-bedroom units is considered. The lender requires the reporting of some unique value estimates. The conclusion of

the appraiser is the following: 1) Fee simple interest market value based upon market rents is $3.4 million or $60,714 per unit. 2) Fee simple interest market value subject to restricted rents is $2.4 million or $42,857 per unit 3)Value with special financing but without the tax credits $4.465 million or $79,732 per unit 4)Value with tax credits and special financing is $10 million or $178,571 per unit.

The financing of the project is from a number of different sources including a $865,000, 1%, 50-year amortized, 30-year term loan; a $2.125 million, 1% interest only 30-year loan and a $110,000, 0%, 30 year loan. These below market loans creates value relative to conventional financing which is at a much more debt service burdensome level. In addition, the tax credits encourage investors to supply substantial equity to the project. All this helps compensate for the higher labor and other costs.

In summary, special financing, creative equity contributions and the appraisal professional certainly has come a long way in handling these complex current day appraisal issues and have adapted well. Who knows what the next 40 years or for that matter what next week will bring?

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