Outside the Box: The Wide World Beyond Appraisal Opinions
Why You Should Think About This

• “Appraiser/Valuer” v “Expert”

• We may be turning down our most interesting and lucrative litigation engagements

• We are often the best professionals to do the work

• Richard and Jeff will address the scope of possibilities and share examples

• I’ll wrap up by talking about how our opinions can be reported that might be different from what you are used to
What was lost?

Value or Costs or Something Else?

Jeff Sherman, MAI, AI-GRS
SCENARIO:

- Developer buys 10 acre mixed use site in a desirable, growth city in 2014.
- Site is approved for 15,000 sf of street retail and 80 multi family units.
- Citizenry becomes concerned about the “quality” of the future residents and passes an ordinance revoking the prior zoning approval and downzoning the property. It doesn’t permit his original plan.
- Original zoning restored in 2016.
- Developer alleges that the change caused a loss.
What was lost?

• Did the change in zoning cause a loss?
• If so, how should the loss be measured?
What was Lost?

- **Developer’s Appraiser:**

<table>
<thead>
<tr>
<th>LOSS Categories</th>
<th>Amounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Temporary Damages</td>
<td>$834,288</td>
</tr>
<tr>
<td>Permanent Damages</td>
<td></td>
</tr>
<tr>
<td>Lost Rent</td>
<td>$23,791</td>
</tr>
<tr>
<td>Loss From Increased Construction Costs:</td>
<td>$2,230,000</td>
</tr>
</tbody>
</table>

**Total Value Lost:** $3,087,989
What was lost?

• What indeed did the Developer lose between time point A and time point B?

• Fundamental underlying issues of loss are based in case law, e.g.:

  • can a loss be attributable to non-existing improvements?
What was lost?

• Counsel advised me that they were uncertain about Ohio case law.

• After discussions about methods with them, it was decided to pursue two paths to measure loss.
What was lost?

• **First scenario:** Vacant land from 2014 to 2016.

Very Complex Answer due to mixed use nature of the site:

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2016</th>
<th>Difference (507 days) Appreciation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land Value</td>
<td>$2,020,000</td>
<td>$2,095,000</td>
<td>$75,000</td>
</tr>
</tbody>
</table>
BUT, because the land appreciated, there is no loss, right?

NO! Income attributable to the land over the intervening time period has been lost. However, there is some offset.

Therefore, $2,020,000 \times R_L \text{ of } 0.08915 = -$180,089, less appreciation of $75,000 equals a net loss of:

\[-$105,089.\]

NOTE: In this case, I also prepared an analysis using the price that the developer paid for the land as an alternate scenario.
**Second Scenario:** What if the buildings had been built?

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2016</th>
<th>Difference (Days 792)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market Value:</td>
<td>$9,450,000</td>
<td>$9,900,000</td>
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<tr>
<td>Less Land @ MV:</td>
<td>-$2,020,000</td>
<td>-$2,135,000</td>
<td></td>
</tr>
<tr>
<td>Less Const. Costs:</td>
<td>-$6,477,758</td>
<td>-$6,811,050</td>
<td></td>
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<tr>
<td>Residual to Entrepreneurial Incentive:</td>
<td>$952,242</td>
<td>$953,950</td>
<td>+$1,709</td>
</tr>
<tr>
<td>Plus lost NOI For 792 Days:</td>
<td></td>
<td></td>
<td>-$1,454,244</td>
</tr>
<tr>
<td>Net Loss to Developer:</td>
<td></td>
<td></td>
<td>$1,452,536</td>
</tr>
</tbody>
</table>
What was lost?

• In summary………………..

• Who is best equipped to assist counsel with the answers to this type of loss questions? WE ARE.

• What theory should be applied to measure loss? Lost profit and Income, in my opinion.

• Does anyone here believe that an increase in costs are a true measure of what the developer lost?
Think back to the fundamentals of “The Nature of Value” and the four “Agents of Production”.....

Land,
Labor,
Capital and
Entrepreneurial Coordination (profit).
What was lost?

• Are there any questions?

(By the way, the case settled before I could testify. Many times, there are other objectives and that was true in this case). Counsel was difficult to work with. But, it was a professionally challenging situation and I was well compensated.

Thank you.
Good News

The strengths of real property appraisers include

- Highly defined body of knowledge
  - Texts
  - Courses
  - Literature
- Education
- Training
- Extraordinarily valuable experience
- These assets provide appraisers with a powerful competitive advantage (that is seldom used) compared to other real estate service providers.
Litigation Support Service Providers

Competition consists of

• Litigation consulting firms
• Accounting firms
• Boutique appraisal firms
• Other appraiser firms

Real property appraisers are abdicating their rightful role as litigation support service providers. We are punting on second down.

Economists, litigation support and accounting firms are developing natural monopolies while appraisers remain complacent and are slow to react, if at all.
What is Commercial Litigation

Examples of real estate-related litigation include

- Breach of contract, lease, fiduciary duty
- Partnership disputes
- Construction defects and construction delays
- Contamination and detrimental conditions (groundwater and soil contamination, mold, cement dust, etc.)
- Lender liability cases
- Industry customs and practices
- Others
Requirements

We need to understand

- Damages theory (separate body of knowledge)
- Fundamental understanding of the legal process
- How to write expert reports for use in litigation

Unless you have full command of the subject matter and expertise needed, walk away from the engagement.

Lawyers, more than any other clients, are quick to understand an expert’s weaknesses.
Send in the Clowns
Send in the Clowns
Advice

Stay within your area(s) of expertise.

No matter how much it hurts your ego, you cannot be an expert in all things.

What you say can and will be used in an attempt to impeach your credibility. The litigation community is a small space in which experts play whether locally, regionally, or nationally.

Opposing lawyers and experts will routinely research and share information regarding witnesses, their prior reports and testimony, their demeanor and weaknesses.
The use of ex ante and ex post is one of the most relevant questions in calculating damages.

It is an issue of expectancy vs. outcome.

Selection of one method over the other depends on case law in a particular jurisdiction and circumstances of the case.

Often, the decision rests with the expert regarding selection and justification for use of the most appropriate method.
Ex Ante Method


- Relies on information known or knowable on the trigger date.

- Because the outcome is uncertain, the risk is greater.

- Eliminates “mitigation” issues.
Ex Post Method

- “Damages Assessment, Janis Joplin’s Yearbook and the Pie-Power Court,” Konrad Bonsack, George Mason University Law Review, Fall 1990
- Normally uses current date as measurement date. Measure of damages begins on trigger date and ends when study period is over.
- Outcomes and historical performance are known.
- All information is usable.
- Considers mitigation.
- Less risk than ex ante because already known.
Difficulties

Ex Ante Method

• Complex reconstruction and forecasting often involved
• Risk-adjusted rate required
• Results often run counter to real world results

Ex Post Method

• Determining available information to use
• Appropriately filtering noise in data
• Selection of discount rate (risk free?) given that outcomes are known
Key Facts --

• A factory was being converted to luxury condominiums in 2006/2007 in a major city in the Southeast

• Substantial sums were spent for architectural and pre-sales costs and other expenses

• A bank agreed to provide construction financing

• Pre-sales were strong and were at or near asking prices

• Some of the choicest models were intentionally being held off the market by the developer
Case Study No. 1

- A substantial number of units were pre-sold with soft deposits.
- The FDIC took over the bank, which was failing.
- FDIC notified the developer that, despite the contractual obligation of the bank to provide construction financing, such funding would cease immediately.
- The economy unraveled in 2008.
- All deposits were returned and the building, which was only partially completed, remained vacant.
Case Study No. 1

Issues--

• Has the developer sustained damages?
• If so, what were they?
• Does this situation lend itself to an ex ante or ex post analysis?
• Why?
Case Study No. 2

Key Facts--

• Area serviced by public water. Few, if any, residents have wells

Allegations--

• Contaminated groundwater
• Homeowners in impacted area cannot sell their homes at other than prices lower than market value
• Homeowners in impacted area cannot obtain financing
• Property values of Plaintiff class properties suffer from stigma
Case Study No. 2

Scope of Work

• Define impacted area based on plume maps and other factors

• Investigate history of mortgages obtained in impacted area

• Research history of sales of homes in the impacted or subject area and compare those prices to prices achieved in control areas.

• In addition, we compared prices in the affected area to home prices in the school district, county, and MLS zone. These additional comparisons were not presented in our report but were retained in our workfile.
Case Study No. 2
## Impacted Area

<table>
<thead>
<tr>
<th>Year</th>
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<th>Median</th>
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<td>$280,111</td>
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<tr>
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<td>2006</td>
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<td>$411,677</td>
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<td>2007</td>
<td>8</td>
<td>$357,000</td>
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*Index: 2003 = 100*
## Control Group 1

<table>
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<td>160.00</td>
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<td>$430,000</td>
<td>111.17</td>
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<td>112.00</td>
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<td>$392,500</td>
<td>114.73</td>
<td>104.67</td>
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*Index: 2003 = 100*
Summary of Opinions

• Property owners and purchasers of properties in the impacted area have been able to routinely obtain mortgage financing and equity lines of credit – we were able to name owners and lenders and had copies of mortgages.

• There was a close correlation between the mean and median prices of homes sold in the impacted and control areas as well as the county, school district, and MLS zone.

• Prices of homes in the impacted area were higher in some years than mean and median prices of homes in some of the control areas.
Case Study No. 3

Key Facts--

- Upscale hotel brand developed a condominium building adjacent but connected to a same brand hotel

- After construction, sale, and occupancy, serious plumbing defects throughout the building resulted in a significant, widespread property damage and extensive mold throughout the building

- The events were widely chronicled in local media

- Plaintiff-Developer brought suit against Defendant-Insurance Company which denied coverage.
Case Study No. 3

Issues--

• Plaintiff alleged economic harm (damages) due to significant repair costs incurred as a result of the defects and consequential damages due to reduced prices and absorption and the adverse affect on the reputation of the property (temporary stigma).

• Discuss stigma.
Scope of Work

- Two scenarios were developed – Scenario A and B
- Scenario A represents the most likely financial performance of the property “but for” the construction issues. Projections are predicated on actual experience from completion of construction and commencement of sales to April 2002 (“trigger date”) when extent of construction problems became known.
Case Study No. 3

Scope of Work

• Scenario B is the combination of the actual experience of the property through September 30, 2004, and forecasts thereafter of absorption and likely selling prices based on market data, analysis of supply/demand fundamentals, and the reputation of the property.

• Scenario A was used as the “base line” to which Scenario B (ex post) was compared.
Case Study No. 3

- Damages premise - the difference between the property’s most likely performance “but for” the construction problems (Scenario A) and the property’s actual performance, which reflected the problems, represents the consequential damages sustained by the property.

- Study the larger local market for luxury condominium sales

- Study sales and absorption at subject property

- Research local media
## PRICE APPRECIATION

<table>
<thead>
<tr>
<th>Year</th>
<th>Historical</th>
<th>Scenario A</th>
<th>Scenario B</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>$531.95</td>
<td>$531.95</td>
<td>$531.95</td>
</tr>
<tr>
<td>2000</td>
<td>$620.67</td>
<td>$620.67</td>
<td>$620.67</td>
</tr>
<tr>
<td>2001</td>
<td>$729.59</td>
<td>$729.59</td>
<td>$729.59</td>
</tr>
<tr>
<td>2002</td>
<td>$633.59</td>
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<tr>
<td>2003</td>
<td>$594.48</td>
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<tr>
<td>2004</td>
<td>$602.03</td>
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<tr>
<td>2005</td>
<td>---</td>
<td>$821.16</td>
<td>$611.06</td>
</tr>
<tr>
<td>2006</td>
<td>---</td>
<td>$845.80</td>
<td>$620.23</td>
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</table>

## ABSORPTION

<table>
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<tr>
<th>Year</th>
<th>Historical</th>
<th>Scenario A</th>
<th>Scenario B</th>
</tr>
</thead>
<tbody>
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</tr>
<tr>
<td>2005</td>
<td>---</td>
<td>8</td>
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</tr>
<tr>
<td>2006</td>
<td>---</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>
Observations--

- Subject had strong absorption between 2000 and 2002
- In 2002, there was precipitous decline in number of sales but prices increased.
- The forecasted decline in 2002 reflects the effects of 9/11
- In Scenario B, absorption in 2005 was estimated at 30 units, which is consistent with year-to-date (figures annualized). Two units were forecast to sell in 2006
- Ex post discount rate reflects less risk because it is what actually happened
Case Study No. 4

Background--

• Plaintiff-Client had JV agreement with another large real estate investment and development company to acquire several properties, including partially developed malls, as well as a portfolio of a failed retail store consisting mostly of free-standing buildings.

• The plan was to redevelop some of the malls and complete construction of others. Upon completion of construction the redeveloped/completed properties were to be sold. Separately, the portfolio of free-standing stores were to be sold individually or in small group and leased if becoming vacant.
Case Study No. 4

Issues--

• Not a single property sold.
• Every construction project was over budget
• Plaintiff accused Defendant of overcharging for
  ▪ Excessive insurance
  ▪ Alleged secret agreement with maintenance contractor. That company provided a variety of billing services and contracted with vendors and was paid 3% of amount of contracted fees by the vendors in exchange for award of the contracts. The company “kicked back” 75% of what it was paid to the Defendant which the Defendant did not share with the Plaintiff.
Case Study No. 4

- Excess employee benefit payments
- Unearned development fees

Allegations--

- Breach of contract
- Breach of fiduciary duty
- Fraud
- Damages resulting from all of the above
“Unearned development fees” were interesting. The parties agreed to pay the Defendant 5% of specified costs related to six properties.

Agreements stated that the Defendants would be paid a monthly fee based on the budgeted annual costs but that the fee would be recalculated based on the difference between the budgeted development costs paid compared to the work actually completed.

Simply stated damages calculated in this category were for construction work that was not performed.
Reporting Your Expert Opinion
When it’s a Value Opinion and When it’s Not

Paula K. Konikoff, JD, MAI, AI-GRS
STEP 1

DO NOT OPEN A TEMPLATE

(This is scary, but you can do it)
Open a blank Word document

WHY?

   Not for every intended use

2) You are forced to choose every word in that report
   Keep control of the pencil!
Federal Rules of Civil Procedure, Rule 26

• (i) a complete statement of all opinions the witness will express and the basis and reasons for them;

• (ii) the facts or data considered by the witness in forming them;

• (iii) any exhibits that will be used to summarize or support them;

• (iv) the witness's qualifications, including a list of all publications authored in the previous 10 years;

• (v) a list of all other cases in which, during the previous 4 years, the witness testified as an expert at trial or by deposition; and

• (vi) a statement of the compensation to be paid for the study and testimony in the case.
What Must an Expert Report Include?

All information required by applicable valuation Standards

If USPAP:

✓ STANDARD 2
✓ STANDARD 4
✓ STANDARD 6

If SVP:

STANDARD C

One Standard for reporting both appraisal and review opinions.
UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

ORACLE HOLDINGS I LLC,

Plaintiff,

v.

ADRIAN HOLDINGS COMPANY I LLC,
ADRIAN HOLDINGS COMPANY II LLC
& PETER J. ADRIAN,

Defendants

CIVIL NO. 08 Civ 7882

EXPERT REPORT OF PAULA K. KONIKOFF
I. Professional Qualifications

II. Assignment

III. Additional Disclosures Required by USPAP

IV. Summary of Opinions

V. Then tell your story, what the property is worth, what the damages amounts are, reply to opinions presented by opposing expert(s) and so forth.

VI. Conclusion

VII. Certification
Templates, even proprietary templates, are designed to increase efficiency when producing similar work products, typically appraisal reports for lending purposes. Expert reports in litigation are seldom so similar, and the intended use of the report is not for or related to lending.

Potential dangers lurking in templates:
- Unnecessary repetition of opinions
  - Letter of transmittal
  - Executive Summary
- Statements that report complies with what it might not be intended to comply with (FIRREA is a frequent example)
- Boilerplate
- Jargon
- “Stock” scope of work and other sections
- Definitions of terms not used in the report
- General assumptions and limiting conditions inconsistent with the report
The Expert Report Should

- Be specific
- Be succinct
- Avoid jargon
  - Affirmatively present your expert opinions
    - Just say what you mean
  - Allow the trier of fact to understand your opinions
Questions and Comments