U.S. DEPARTMENT OF STATE: Background

- **275 MISSIONS**
- **12,000 CULTURALLY SIGNIFICANT OBJECTS**
- **70,000,000 SQUARE FEET**
- **5,300 ARTWORKS**
- **$7 BILLION UNDER DESIGN & CONSTRUCTION**
Major Functions

- Develop Fair Market Value (FMV) opinions for all properties bought or sold
- Develop Fair Market Rent Value (FMRV) opinions for all “high cost” leases
- Conduct research and analysis needed to make investment decisions
- Develop transaction guidance on complex and high cost acquisitions (lease vs. buy, lease vs. build, capital or operating lease scoring, PPP financial models, and other tools)
- The Evaluations Division values between 200-300 properties per fiscal year, or $1B - $2B in cumulative value (2015 > $3B)
Not Just an Appraisal Division

- Lease vs. Buy analyses on residences, executive homes, offices, and warehouses
- A-11 Scoring assistance for Major Leases
- Build-to-Lease and PPPs of housing compounds and warehouses

New Embassy Compound Alternative Analyses – What is the most financially feasible path for solving a wide variety of problems when we can’t build new?

Warehouse Business Cases – From a financial perspective, should we build a warehouse on an Embassy site, build one off-site, buy/renovate an existing warehouse property, or lease/upgrade an existing property?

Custom business cases that can answer any number of unique, financially driven decision questions
Appraisal Process

• Commission two independent third-party appraisals that we reconcile for purchases and sales; one appraisal for leasing

• Supported by seven real estate appraisal and consulting contracts:
  - CBRE
  - Jones Lang LaSalle
  - Cushman & Wakefield
  - DTZ
  - Dunkin Valuation Services
  - Knight Frank
  - KPMG

• Ability to contract for appraisal services through an embassy or consulate

• May perform appraisals “in-house” in extremely non-transparent markets utilizing third-party market data or internal research

• Challenging value reconciliation process – reliance may be placed upon both appraisals, a single appraisal, or in-house analysis may be performed utilizing the best data from both reports and/or other sources
The Owner or Tenant Perspective

- Unlike banks that rarely hold their own paper or appraisal firms where the appraisal ends their interaction, State owns and leases many thousand of properties. Property market value and FMRV updates are common.

- The need to be in select secure areas limits purchases and leases to the most prime commercial and residential areas.

- Unique owner/tenant perspectives include:
  - Forefront of the real estate industry in terms of security and international site selection (new Embassies and Consulates)
  - Construction in places where seismic housing does not exist
  - Western style housing in places where there are few or no such homes
  - Very long term ownership positions, typically greater than 30 years
  - Many unique cultural heritage properties, historic properties, and trophy properties

- All the owner/tenant perspectives above are recognized as investment value, though there are very few ways to calculate it.
Additional Services

• Lead planning and analysis to inform major investments and developments

• Decision making vehicles include:
  - Lease vs. Buy
  - Lease vs. Build
  - Custom PPP analyses
  - Operating/Capital lease scoring
  - Multiple Build-to-Lease and Option-to-Lease decision templates
  - Programmatic reporting (data mining metrics & statistics from the portfolio)
  - Negotiation templates for at-the-table financial discussions

• Solve asking-market value differences when appraisals are weak or poor

• Briefings to senior Department of State personnel, Ambassadors, and transactional support; travel to support negotiations is common
How to Get Involved

• Most appraisals are done via IDIQ (Indefinite Delivery, Indefinite Quantity).
  - IDIQ contracts are for a year with yearly options to renew
  - They are advertised on FedBizOpps.gov
  - The next advertisement will be around mid-2017… *watch for announcements!*

• Some appraisals are ordered in the city they’re needed, but you need to be practicing in that city to be considered

• Working or subcontracting for one of the IDIQ firms is an option

• If you want to really get involved doing international appraisals, work directly for State. Watch for advertisement in USAJobs.com for the State Department, Bureau of Overseas Building Operations.
Appraising Land in Baku, Azerbaijan
Where is Baku?

Neighbors:
- Russia and Georgia to the North
- Iran to the South
- Caspian Sea to the East
- Armenia to the west (Nagorno-Karabakh War from late 1980’s to 1994)
Money and the Real Estate Industry

Oil, Oil Everywhere

- Azerbaijan produces approximately 20 percent of the world’s oil.
- Azerbaijan has only been independent from the USSR since 1991.
- Much of the onshore petroleum has been exhausted, so drilling has extended into the sea offshore.
- 94 percent of exports are oil and natural gas.

Totally Non-Transparent (“opaque”) Market

- Sale prices recorded but not accurate due to tax avoidance.
- There is almost no real estate brokerage industry, no appraisers, no MLS, and no data services.
- There is no zoning and no construction code. Construction codes change every few months or so as do the fees.
- Land and buildings are separately titled.
Not the Same Rules You’re Used To

Pervasive Government Corruption
• Costs of doing business are unknown as is profit and return on investment.
• A small elite close to the government controls most of the country’s economic activities, particularly the real estate sector.

Real Estate Markets are Impervious to Supply and Demand
• With so much oil revenue, there is tremendous local wealth to be invested. Real estate is in the hands of billionaires with no compulsion to sell.
• With approximately 20 million Azerbaijani in Iran and 2 million in Russia, substantial wealth funds flow into Baku, which is viewed as safer for investment.
• Turks are major investors in Baku due to its large Turkish population and the view that real estate is less expensive in Baku than the major cities in Turkey.

Real estate is viewed as a status symbol. Real estate is bought to park money; hence, most buildings are sold “core and shell” (unfinished interior units) and not even rented.
The Construction Industry and Title

Self-financed Projects
- A developer can stop construction anytime.
- Lot coverage ratios depend on who comes to ask about plans. No one knows the rules. Every three months or so, the State changes the construction code.

Title
- “Project fees” are expected as a cost of obtaining title. The inability of developers to predict what these costs will be on multiple levels of government make it nearly impossible for developers to do accurate cash flow forecasting, so as a whole they do not.
- Baku is a Two-Tiered Real Estate Market. Six or so major developers can deliver “title” that commands a substantial unit sale price premium.
Developers and Financing

Dealing with Developers

- Demand does not drive building.
- An unscrupulous developer can sell a unit two or three times. With no ownership registration and units sold core and shell, many such sales go undiscovered.
- Developers do not think in terms of ratios or even numbers beyond sale price/m². There is too much uncertainty in everything. If you build it, you will pre-sell it.

Financing

- Financing is rare. When the real estate is owned by billionaires, who needs banks?
- There is a total lack of investment sophistication. Only a few developers do any cash flow modeling. None do discounted cash flows. There’s no need when so much presale money comes in before the units are even constructed. Developers do not think in terms of ratios or even numbers beyond sale price/m².
- You can finance a property that has a property certificate (a.k.a. ownership certificate) but not a purchase contract without one. So the low and middle income projects are paid all cash up-front.
Housing Styles

Trump Hotel & Tower (apt./hotel)

Turkish Style

Soviet Style
Different Value Assumptions = Different Values

<table>
<thead>
<tr>
<th>#</th>
<th>General Inputs</th>
<th>Appraisal Firm 1</th>
<th>Appraisal Firm 2</th>
<th>Difference (Δ)</th>
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<tr>
<td>1</td>
<td>Site Size in m²</td>
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<tr>
<td>2</td>
<td>HBU</td>
<td>Retail/Office/Apartment</td>
<td>Apartment</td>
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<td>Lot Coverage Ratio</td>
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<td>Not Cited</td>
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<td>6</td>
<td>Number of Parking Spaces</td>
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<td>Built-up Area</td>
<td><strong>177,019</strong></td>
<td><strong>263,986</strong></td>
<td><strong>49.1%</strong></td>
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<td>Resulting FAR</td>
<td><strong>6.81</strong></td>
<td><strong>10.15</strong></td>
<td><strong>3.34</strong></td>
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</table>

Note: Numbers changed for confidentiality

No Zoning - a lack of definitive zoning and bulk area requirements makes estimates of the highest and best use subjective, which explains the different appraisal assumptions above. Appraisers didn’t test the HBU mathematically.

Values were far apart; my job was to reconcile them. That could not be done at a desk, hence I went to the market to determine the most likely development on the site.
Further Information - Contact

U. S. Department of State
Bureau of Overseas Buildings Operations
https://overseasbuildings.state.gov
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