

**SPECIAL ASSETS:
UNDERSTANDING THE VALUATION NEEDS OF
ASSET MANAGERS AND SPECIAL SERVICERS**

STEPHEN T. CROSSON, MAI, SRA

**APPRAISAL INSTITUTE CONFERENCE
2011**

- MY PERSPECTIVE-BASED UPON MORE THAN 13 YEARS OF DEALING WITH DISTRESSED ASSETS HELD BY SPECIAL SERVICERS

- SPECIAL ASSETS
 - REAL ESTATE LOAN THAT IS NOT PERFORMING AS FORECAST DUE TO:
 - COLLATERAL INSTABILITY (E.G., LOSS OF TENANTS, INABILITY TO RE-LEASE)

- INSUPPORTABLE LEVEL OF DEBT
- BORROWER LIQUIDITY PROBLEMS (E.G., CANNOT FUND TI ALLOWANCES)
- BORROWER REALIZATION THAT NO EQUITY EXISTS OR WILL LIKELY EXIST FOR FORESEEABLE FUTURE-“HERE’S THE KEYS”
- SOME COMBINATION OF 2 OR MORE OF THE ABOVE

- A DISTRESSED PROPERTY MAY BE IN A NON-DISTRESSED MARKET; HOWEVER, MOST PROPERTIES ARE DISTRESSED IN DISTRESSED MARKETS

- NEEDS OF SPECIAL SERVICERS (THOSE DEAL WITH PROPERTIES IN SECURITIZATIONS)
 - ACCURATE VALUATIONS
 - NOT HELPED BY ABOVE-OR BELOW-MARKET VALUES

- JUST NEED REALISTIC VALUE

- o A HIGH VALUE MAKES IT DIFFICULT TO GET APPROVAL TO ACCEPT CONTRACT AT MARKET VALUE
- o A LOW VALUE UNDERMINDS CREDIBILITY OF APPRAISER WHEN PROPERTY SELLS FOR A SIGNIFICANLTLY HIGHER AMOUNT

- ASSET MANAGERS THAT WE DEAL WITH ARE DISCERNING READERS OF VALUATION REPORTS. THEY EXPECT GOOD QUALITY
 - “COMMODITY” QUALITY NOT ACCEPTABLE
- BECAUSE OF DISTRESSED NATURE OF THE ASSET, AVAILABLE INFORMATION IS OFTEN INCOMPLETE
 - APPRAISER MUST SIMPLY DO THE BEST THAT HE/SHE CAN; COMPLAINING DOESN'T HELP

- MANDATE PER REMIC RULES
 - RECOVER AS MUCH AS POSSIBLE FOR CERTIFICATE HOLDERS WITHIN A REASONABLE PERIOD OF TIME

 - REPOSITIONING, RECONFIGURATION, REDEVELOPMENT NOT PERMITTED
 - VALUATION ON “AS IS” BASIS, REFLECTIVE OF POTENTIAL OF PROPERTY

- AREAS OF PARTICULAR IMPORTANCE
 - ASSUMPTIONS REGARDING ABSORPTION
 - “HOCKEY STICK” IMPROVEMENT? WHY?

 - NEED FOR REAL-TIME METRICS
 - BROKER INTERVIEWS

 - LEASE PROPOSALS **NOT ACCEPTED** ARE VERY VALUABLE DATA

- ADEQUATE PROFIT INCENTIVE FOR PROSPECTIVE INVESTOR
 - BUYERS OF DISTRESSED PROPERTIES ARE TYPICALLY ENTREPRENEURS RATHER THAN INSTITUTIONAL INVESTORS. RETURNS MUST BE ADEQUATE.
 - SUCH BUYERS EXPECT TO ACHIEVE RETURNS **PRIMARILY ON ASSET APPRECIATION**
 - MANY APPLY 15-25% PROFIT TO LEASE-UP COSTS
 - RESULT-RIDICULOUSLY LOW PROFIT IN ABSOLUTE DOLLARS

- TREATMENT OF ABOVE-MARKET LEASE RATES
 - MUCH HIGHER RISK OF DEFAULT OR TENANT-DRIVEN MODIFICATION
 - WILL LIKELY BUYER ASCRIBE **ANY** VALUE TO EXCESS RENT? TENANT CREDIT IS OBVIOUSLY IMPORTANT CONSIDERATION
 - IN ANALYZING THE SUBJECT'S RENT ROLL, CAREFUL CONSIDERATION SHOULD BE GIVEN TO THE DEGREE BY WHICH CONTRACT RENT EXCEEDS MARKET RENT, SINCE RISK IS POSITIVELY CORRELATED WITH EXCESS RENT.

Suite No.	Size (SF)	Contract Rent	Market Rent	Excess Rent
100	3,500	\$112,000	\$70,000	\$42,000
101	11,500	382,000	230,000	152,000
102	7,000	112,000	140,000	-28,000
103	15,000	150,000	300,000	-150,000
104	12,500	372,500	250,000	122,500
Totals		\$1,128,500	\$990,000	\$138,500

- A CURSORY VIEW OF THE ABOVE REVEALS AGGREGATE EXCESS RENT THAT IS 14.0% GREATER THAN MARKET RENT.
- WHILE NOMINALLY TRUE, THE CALCULATION OF EXCESS RENT SHOULD NOT BE BASED UPON OFFSETTING BELOW-MARKET RENT AGAINST EXCESS RENT.

- IN SUCH INSTANCES, RISK IS NOT LINEAR. THE RISK OF DEFAULT OR TENANT-DRIVEN LEASE MODIFICATION IS SIGNIFICANTLY GREATER THAN THE REDUCTION IN RISK INHERENT IN BELOW-MARKET LEASES.

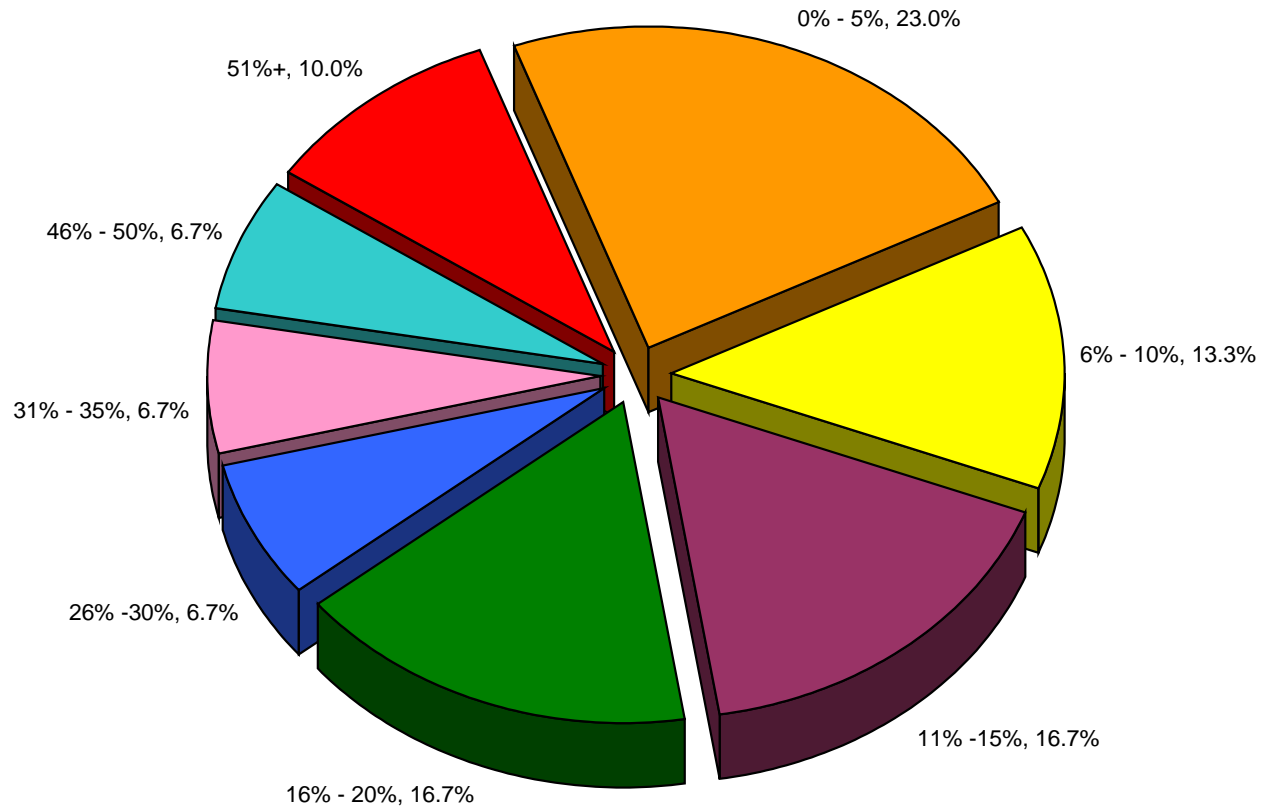
- BASED UPON THIS REASONING, EFFECTIVE EXCESS RENT IS \$316,500 PER ANNUM OR 32.0% GREATER THAN MARKET.

ACTUAL CASE COMPARISON

Sale Price, Appraised Value, BOVS

Broker #7	\$5.678 million
Broker #5	\$4.920 million
Broker #6	\$3.00 million
Broker #1	\$2.996 million
Sale Price	\$2.90 million
Appraisal	\$2.84 million
Broker #2	\$2.258 million
Broker #4	\$2.072 million
Broker #3	\$1.129 million

VARIATION IN BOVS



Sample	30 Properties, 60 BOVs
Median Variance	14.7%
Mean Variance	21.4%
Percentage with 15% or Less	53.0%
Percentage over 15%	47.0%