Rob Cassam
MBA, CCIM
Owner-Broker (NC,SC)
704-533-3074

CAROLINA
REALTY ADVISORS
1001 East Blvd. Suite B • Charlotte NC 28203
Phone: 704-442-1774 Ext.100
Efax: 800-571-7536
rob@charlotteNCproperty.com
www.charlottencproperty.com/commercial

Determine Market Value With Appraisal

The purpose of any real estate appraisal is to determine the market value of the property being appraised. The handbook of the Appraisal Institute defines market value as;

"The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller, each acting prudently, knowledgeably and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby: (a) buyer and seller are typically motivated: (b) both parties are well informed or well advised, and each acting in what he considers his own best interest; (c) a reasonable time is allowed for exposure in the open market; (d) payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and (e) the price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale."

If we put this another way, the value of a particular property is made up of the future benefits that the owner of the property can expect to receive from rental or other income. In determining the future benefits that an owner can receive from a property, the current use of the property is considered, and all other uses that it may be capable of in the foreseeable future. As an example, a property that is being used as farmland could be usable for a residential subdivision in a few years, but later might be usable as commercial or industrial sites.

Decision Making

Knowing the value of property is a vital part of the decision-making process of all buyers, sellers and users of real estate. Therefore, valuation is an integral part of all real estate activity. It is needed for your personal planning. Also, zoning, community planning, taxation require a knowledge and use of appraisal.

If the property is held, or will be held for investment purposes

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This publication is not a solicitation but is an information service from this office.

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(and most are, even small residential properties) an additional question might be, "What will it be worth in the future?"

There can never be perfectly sure answers, but the closest that anyone can come to it is by the appraisal from a professional appraiser. This trained specialist can give a good accurate estimate of a property's value.

When an Appraisal is Needed

When we refer to "Market Value" we have to remember that it is not necessarily the same as market price. Market price represents the actual dollar amount put on a property by a buyer and a seller at the time of a negotiated transaction. This might be higher or lower than the value an individual appraiser might place on the property. This difference might be due to differences of opinion, or it may be that the property, to this particular buyer or seller, has a greater or lesser value because of some special consideration, such as financing that the buyer can obtain or the need of a seller to raise cash quickly.

While the owner or a prospective buyer can order an appraisal at any time, there are times when it is almost always required. Here are some of the recommended times to get an appraisal;

1. Purchase and sale
To determine whether a proposed purchase or sale is at a fair price or competitive price. The value fixed by the appraiser may strongly affect the final price, but the financing and tax aspects of the overall transaction may be such that a buyer might offer more or a seller could be willing to take less for the property.

2. Exchange
Appraisals of each of the properties in a planned exchange should be made if the exchange will have prices on the properties (rather than just equity for equity). A good estimate of value on each will assist everyone involved to establish equities in the priced exchange.

3. Finance
Always when a new loan is required for a new buyer. Often, the lender will appraise the property conservatively and slightly lower than the new buyer. This can be understandable when the buyer may be prepared to put up as little as 10% of the value, and the lender is being asked to put up all or most of the balance of the purchase price.

4. Lease
Before entering into a long-term lease, both the lessor and lessee each may need a very accurate idea of the value. This might be a basis for negotiation by either person, to determine if the proposed lease is for a fair rental amount.

5. Remodel
What if a renovation or modernization of an older building is being planned? The appraisal may be requested to be made on the basis of the property as it is now and as it will be when the renovation is completed. The purpose of the appraisal would be to determine if the additional income would be sufficient to amortize the capital investment and also return a profit to the owner.

6. For insurance purposes
It may be important to establish replacement costs, less the physical depreciation, to determine how much fire and casualty insurance should be purchased to adequately cover the property. An appraisal, updated on a regular basis, may also be needed to establish proof of loss or to establish the basis for settlement in cases of partial or total loss under insurance contracts.

7. For condemnation purposes
To estimate damages that are adequate, but not in excess of fair compensation, when negotiating a condemnation award, or seeking the determination of fair compensation for a condemned property in court.

8. For property tax purposes
To make a proper assessment for local real estate taxes, or to review and contest an assessment to reduce real estate taxes.

9. Income tax liability
It may be necessary to appraise a property to determine the liability for income taxes in a taxable exchange, or in a liquidation of a corporation owning real estate.

10. For estate tax purposes.
To determine inheritance and estate tax liability when real estate was owned by a decedent at the time of his or her death.

11. For gift tax purposes
To determine the tax liability when real estate is the taxable gift.

12. Syndication
As a basis for offering investors an interest in real estate through syndication or participation in a corporation or real estate investment trust. ❏

Rising Rental Rates Make Apartments Most Popular

In the world of investment real estate, multifamily housing is still the most popular type of real estate investment. Currently, it continues to account for nearly one third of real estate investment transactions. This has been the most popular type of investment because of rising rental rates.

Investments in these properties are based on economic fundamentals. Lenders and investors closely scrutinize the financing of multifamily housing projects to be sure that the cash flows will cover expenses.

The recession and the poor housing market has changed markets for new homes. But lower interest rates and lower prices have increased demand for new home purchases in some key areas.

There have been some changes in the types of households and tenants who will be the users of apartments. Some were owners who lost a home through foreclosure.

The New Tenants

The recession took some previous homeowners out of their homes and into apartments. The traditional type of family group buying or renting apartments and houses has been the married couple with children. These will certainly remain as a large part of the market for apartment units. Recently however, there have been more single-person tenants and non-traditional families than in any previous time. The average household size has shrunk to 1.5 persons during the past ten years. In the next decade, the figure may be smaller.

Older citizens in the age group of 65 to 75 are also in the apartment market. While about 70% of this group own their homes, the remainder need rental housing. There also are a large number of single-person households in this age group.

With the increased prices and values of single-family homes, there should be an increase in the demand for apartment units. These changes should affect the plans of developers for the sizes of units and their locations.

An Urban Location

In previous decades, a high percentage of the apartments that were built were in the suburbs. The new tenants, non-traditional families and single person households, are choosing more urban locations. The choices for developers may be high-rise structures back closer to the urban areas, on the periphery of downtown rather than in the suburbs. ❑

Filling Vacancies In Office Buildings

Office buildings are excellent commercial properties to own. In certain areas, however, there are still a number of vacancies reported. One of the most important jobs of a leasing agent for a building with available space is to analyze other buildings to see if any tenant could be induced to move.

Newer buildings may fill up at the expense of older buildings. Since new buildings cost more to build than the older ones, rents may be higher. The actual dollars-per-square-foot costs must be compared, along with other benefits that the tenant may receive, before a final decision is made by the tenant on staying or moving. Here are some of the items for comparison;

- What is the time factor for employees at the old location? In a business' expansion at the old location, they may have expanded to different floors or to different buildings as more space was needed. There may be a big loss in employee time due to the inconvenient layout.
- In a similar idea, the tenant may be planning an expansion in the next few years, which will make it necessary to rent space in the old location at then-current rentals, raising the average rental per square foot for the tenant's entire space, in a less than adequate location.
- Don't assume that the new space rentals are not competitive. Cost-of-living clauses in the tenant's existing lease may have escalated the rent level up to the costs in the newer, more modern building.
- The newer building represents more efficient design, better and newer lighting, modern in every way. The intangible improvements in employee morale and efficiency might overcome any slight difference in dollar-costs per month.
- Finally, a change in location to a more, prestigious building in a better part of the community can contribute to the reputation of the tenant–and ultimately to the profitability of the business.

The tenants who could be good new tenants at the new location will usually not be aware of all of the benefits of a move until they are contacted and are given the opportunity to make the comparison. ❑

Creative Management Ideas

Space Sharing Executive Suites

With the revolution in communications, building owners must keep up with the changing needs of the corporate tenant. Often the larger, well-organized businesses do not need the space that was necessary just a few years ago. Computers, faxes and e-mail have substituted for leased office space. Office personal are working from home or a small office near their home and coming into the office once in a while for a meeting. Managers are more willing to grant favorable lease terms to operators of shared space. The operator sometimes receives a monthly management fee for operating the shared space plus a portion of rent revenues over a certain amount.

Tenants in an office suite are offered a private office within the suite that has a receptionist, secretarial help, conference rooms and other amenities. This can be a big saving for small space users or users who need a small office for only a short period of time.

Another user is from the large corporation that needs small branch offices in different parts of the country. Other users might be individuals who need a private space for investment or other work activities as well as professionals such as attorneys or accountants who work primarily away from their offices.

The concept of shared space can be used by companies that have excess space that cannot be leased in its entirety. The company's existing facilities such as copier rooms, computer rooms, cafeterias already are available. Any income from this type of shared space can be nearly 100% profit.

If this is space that is leased by the company rather than owned space, the lease must be reviewed carefully to see if a sublease could violate the sublease/assignment clause of the lease.

Renting To The Right Tenant

Property managers must always think about the type of tenant that is most likely to reside in that particular building. For example, when apartments in a project rent for $11,000 to $15,000 per year, tenants will be concerned primarily with shelter. This means a safe, clean, efficient building but without frills and amenities.

On the other hand, if the apartments will rent for $30,000 to $35,000 per year, or more, tenants typically expect and demand much more than just shelter. These tenants want a luxurious life-style, and that means the building should contain a health club, a swimming pool, a private park, and similar conveniences.

In the lower priced units, investors will concentrate more on the basic design and layout of each apartment and on the reliability of such things as the elevator service and the garbage disposal. For common areas, the workings of the lobby intercom system, the location of the mailboxes, and safety, for example, are prime considerations.

However, at the more fully equipped building, the investor faces increased costs of construction and maintenance of areas that produce not direct rental income. If these life-style areas become the slightest bit shabby, it can lead to tenant dissatisfaction and vacancy. The well-equipped, well maintained building usually has a very low vacancy rate. In fact, it often has a waiting list of prospective tenants that assures full occupancy for a long time in the future–a good sign for investors.

The Upkeep On Your Rental Property

Keeping your property in top condition is not difficult if it is a continuing effort. There will be a plan in place for making ongoing improvements by investing a portion of each year's income. Failure to do this will result in a neglected property.

Many investment properties suffer from improper care and neglect. Getting started on the program of enhancing the value should focus first on three areas. These three will immediately make an office or apartment building begin to stand out:

- The lobby and interiors of the building must be perceived by tenants and visitors as something unique.
- The outside appearance from the street must give a favorable impression to passers-by, both pedestrians and those in vehicles.

The Improvements

Here are a few improvements that usually will change the appearance of an office or apartment building quickly:

- A new lighting system outside, will enhance the nighttime visibility and take advantage of any night-time traffic. The building will be more visible from a distance.
- In older buildings, the elevators often are slow and reflect the age. Without changing the entire elevators, an electronic control system might be added, producing a swifter and more consistent service.
- Replace the wall and floor coverings on each of the floors to produce a lighter, cleaner image. It is seldom necessary to "do" an entire building all at one time, disrupting tenants and running up big costs. Try an improvement on one floor to see how it works and how cost effective it is. If it makes sense, phase in the improvement over a period of months or years. ❑