

Remediation and Property Values

Issue 2-2, April, 2006

There is an on-going debate in valuation circles about the effect of *promised* remediation on property values. Pre-remediation, the value of contaminated property is affected by both the anticipated cost of remediation *and* stigma. Post-remediation, there is often continued stigma, which may remain for a significant time period.

However, there has been little research on the *promise* of remediation. We know that in some jurisdictions, such as California and New York, the *promise* of no-further-action by a jurisdiction may be an empty one, and hence the issuance of a no-further-action letter may have only marginal impact on the value of a contaminate site. But, what about an indemnity?

To date, there have been few studies or court case on the value impacts of an indemnification. However, there was an interesting ruling out of Indiana in the condemnation process which gives some insight. In *Southtown Properties v. City of Fort Wayne (Ind. Ct. App. 5th Dist. 1/13/06)*, the Court ruled that the promise of environmental remediation by the condemner did not affect the value of the property in a taking. The case hinged on a 37-year-old state supreme court ruling, in which it was determined that changes in property value brought about by the condemnation itself is irrelevant to the valuation for condemnation purposes.

While *Southtown* doesn't specifically speak to third-party indemnification, it is important to recognize that contamination valuation methodology derives heavily from condemnation methodology. Thus, the implication from *Southtown* is that the promise of remediation would have little impact on the value of a contaminated site. This is consistent with our findings here at Greenfield from market evidence, such as our survey research into contamination impacts.

Dr. John Kilpatrick and Dr. Ron Throupe will be presenters at the annual American Real Estate Society meetings in Key West, Florida, April 19-22.

Market Cycle Monitor

In past issues of *The Greenfield Advisor* and our predecessor publication, *Monday@Mundy*, we frequently mentioned the Real Estate Market Cycle Monitor published by Legg Mason. The 3rd quarter, 2005, issue just hit our desks, with a change in ownership. Substantially all of Legg Mason's Capital Market's business has been acquired by Stifel Nicolaus. However, we're pleased to report that Dr. Glenn Mueller continues to author this valuable report.

The monitor essentially tracks long-term occupancy averages both by sub-sector (office, etc.) and by geographic market. Property types or markets may be in one of four phases (recovery, expansion, hypersupply, or recession) or may be on the cusp between cycles. As of this report, all of the office markets in the country are in recovery, with only a few nearing expansion – Orange County being the closest to the cusp. The same is true for industrial markets, with Los Angeles, Las Vegas, Orange County, Riverside, and West Palm Beach being near expansion.

Multi-family markets are marginally more advanced along the cycle. According to the report, eight markets are in expansion (Ft. Lauderdale, Las Vegas, Orange County, Orlando, Tampa, Los Angeles, Riverside, and San Diego). Retail is also distributed between recovery and expansion, with Ft. Lauderdale, New York, Dan Diego, and Washington, DC, leading the pack. Hotel follows the same pattern as retail, but with Honolulu, Los Angeles, New York, DC, and West Palm Beach in the lead. None of the multifamily, retail, or hotel sub-markets coming close to hypersupply.

According to the study, recovery is characterized by new demand in the market. Markets in expansion evidence space which is difficult to find and rents rising rapidly. New construction begins near the top of the cycle. Hypersupply is evidenced by supply growing more rapidly than demand. During recessions, there is low or negative demand growth, a slowing of construction, and completions pushing vacancy higher.

For more information, contact Stifel Nicolaus at www.stifel.com.

To remove your name from our mailing list, please [click here](#).

Questions or comments? E-mail us at info@greenfieldadvisors.com or call Greenfield Advisors at 800-755-0966 and ask for *Client Services*.

Prudential's Market Perspective

Prudential's real estate research is excellent, and among their regular reports is the quarterly *Market Perspective*, which just hit our desks. According to them, conditions in the real estate debt markets changed little in the first quarter, 2006, with the 10-year T-Bond spending much of the quarter around 4.5% and 4.6% before climbing above 4.8% in late March. The FED gave no indication that its job of raising short-term rates was over. At the end of the quarter, the 10-year T-bond pushed above 5% for the first time in three years, as the global economy seemed to expand faster than expected. Consistent with this, global CMBS issuance hit \$57 Billion in the first quarter, substantially higher than the \$41.3 Billion volume of the same period last year.

Prudential's overall view for real estate equities is for slower but continuing appreciation. Capital flows may slow, particularly if the broader stock market continues to strengthen. However, limited new supply, coupled with strengthening tenant demand, improved property income, and demand by investors for stable yield should continue to support prices through the year.

Mass Appraisal in Litigation

Mass appraisal models, sometimes called Automated Valuation Models, are provided for under the Uniform Standards of Professional Appraisal Practice (USPAP Rule 6) and are used throughout the U.S. and elsewhere for property tax assessment and other common large-scale appraisal problems. Common methodology is outlined in the text *Mass Appraisal*, published by the [International Association of Assessing Officers](#), the governing body for county tax assessors.

In recent years, mass appraisal has proven useful in large-scale litigation, particularly class action. Greenfield Advisors has published guidance on this in *Class Action Litigation Report* (2004), *Toxic Law Reporter* (2005), and the forthcoming text s *Brownfield Law and Practice* and *When Bad Things Happen to Good Property*.

Thus, we take note when a court allows mass appraisal testimony or finds such to be a superior indication of value in a litigation situation. Such came out of the Nebraska Court of Appeals this month in *SFI Ltd. Partnership II, appellant, v. Sarpy County Board of Equalization, appellee* (2006 Neb. App. LEXIS 63, April 11, 2006). This case came out of a simple tax appeal. Sarpy County relied on a mass appraisal model to value SFI's property, and SFI used a single-property appraisal model. The Nebraska Tax Equalization and Review Commission found for Sarpy County, and SFI appealed. In ruling on the usefulness of the mass appraisal model in this case, the Appeals Court found that the Commission's ruling was "...supported by competent evidence, and is neither arbitrary, capricious, nor unreasonable."

Journal of Housing Research

Congratulations to the American Real Estate Society for reviving this valuable journal, and to Prof's. Leonard Zumpano (U. Alabama) and Shelton Weeks (Florida Gulf Coast U.) for taking on the editorial roles. The current issue – which just hit our desks – has some great peer-reviewed articles. One of our favorites is "Real Estate Appraisal and Transactions Price: An Empirical Evaluation of Alternative Theories" by Professors Carl Gwin (Baylor U.), Seow Ong (U. Signapore) and Andrew Spieler (Hofstra U.). This article also won the award for Best Paper on Real Estate Valuation at the 2005 ARES meetings, sponsored by the Appraisal Institute.

The article explores, among other things, the error rates in appraisals. It specifically explores why appraisal accuracy seems to improve only during "down" markets. They use a mass multiple regression model and find that typical appraisals are correct only 59.9% of the time during "normal" markets but this improves to about 81.5% of the time during down markets. They examine both a moral hazard hypothesis and a signaling hypothesis to explain this phenomenon.

To remove your name from our mailing list, please [click here](#).

Questions or comments? E-mail us at info@greenfieldadvisors.com or call Greenfield Advisors at 800-755-0966 and ask for *Client Services*.