

Green Buildings - Valuation Issues

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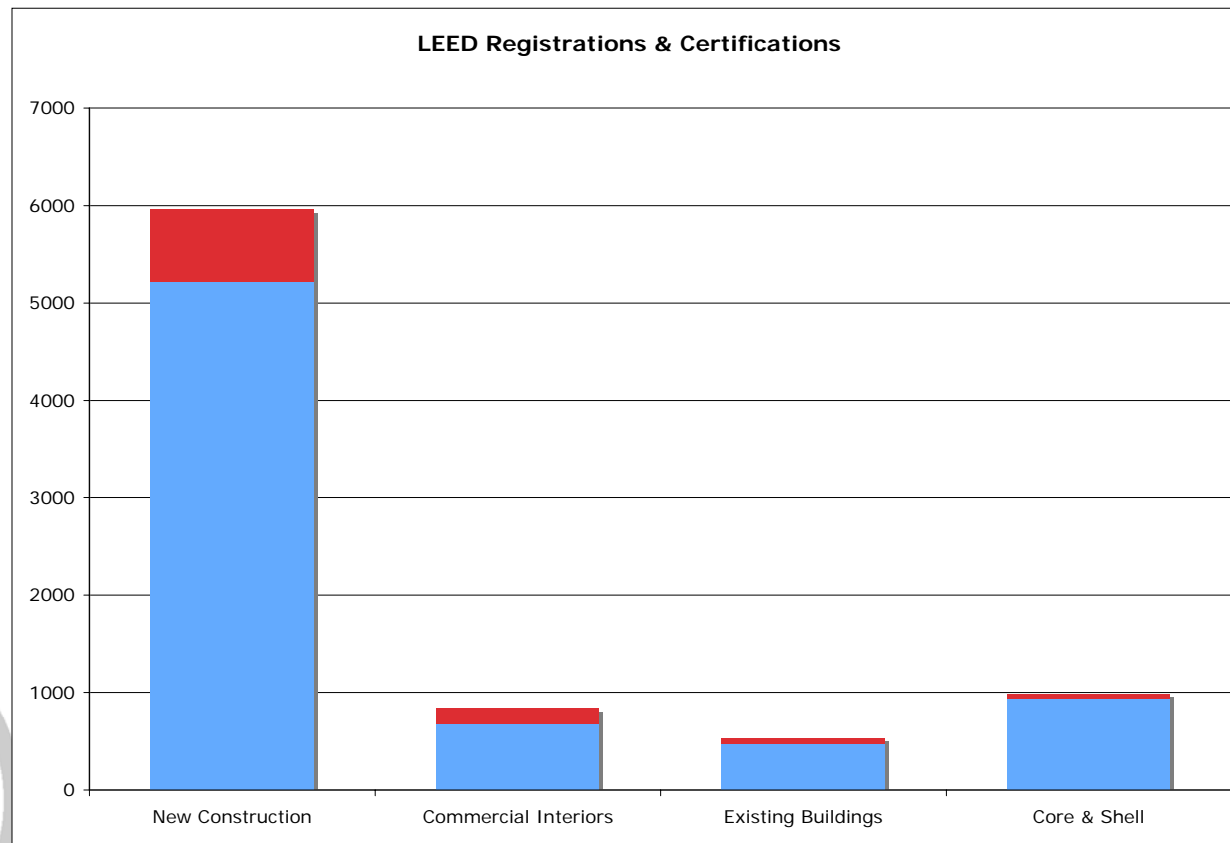
Overview

- ❖ Why Now?
- ❖ The Green Building Investment Hypothesis
- ❖ Underwriting & Valuation
- ❖ The Valuation Problem
- ❖ Appraisal Qualifications & Content

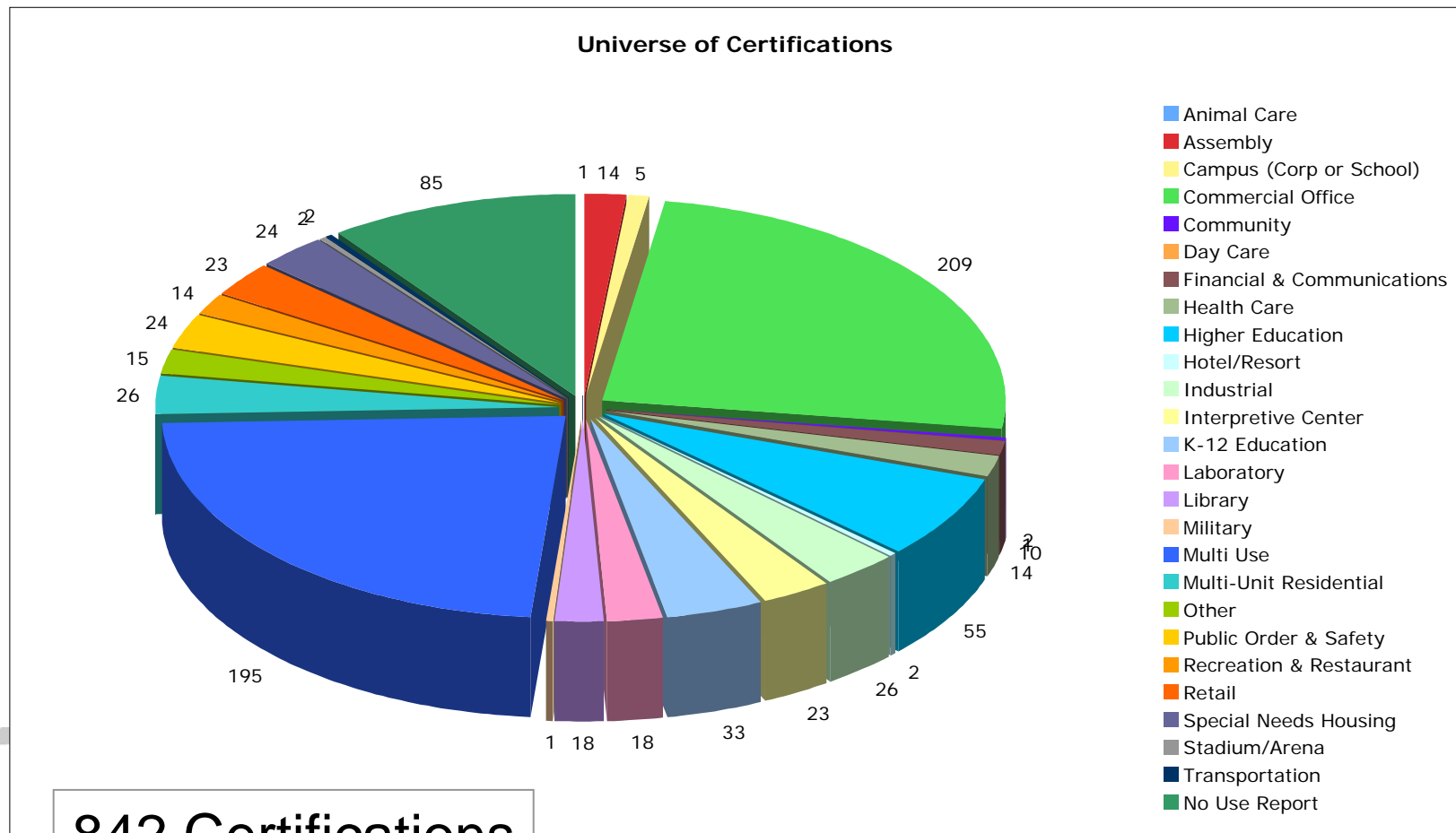


Why now?

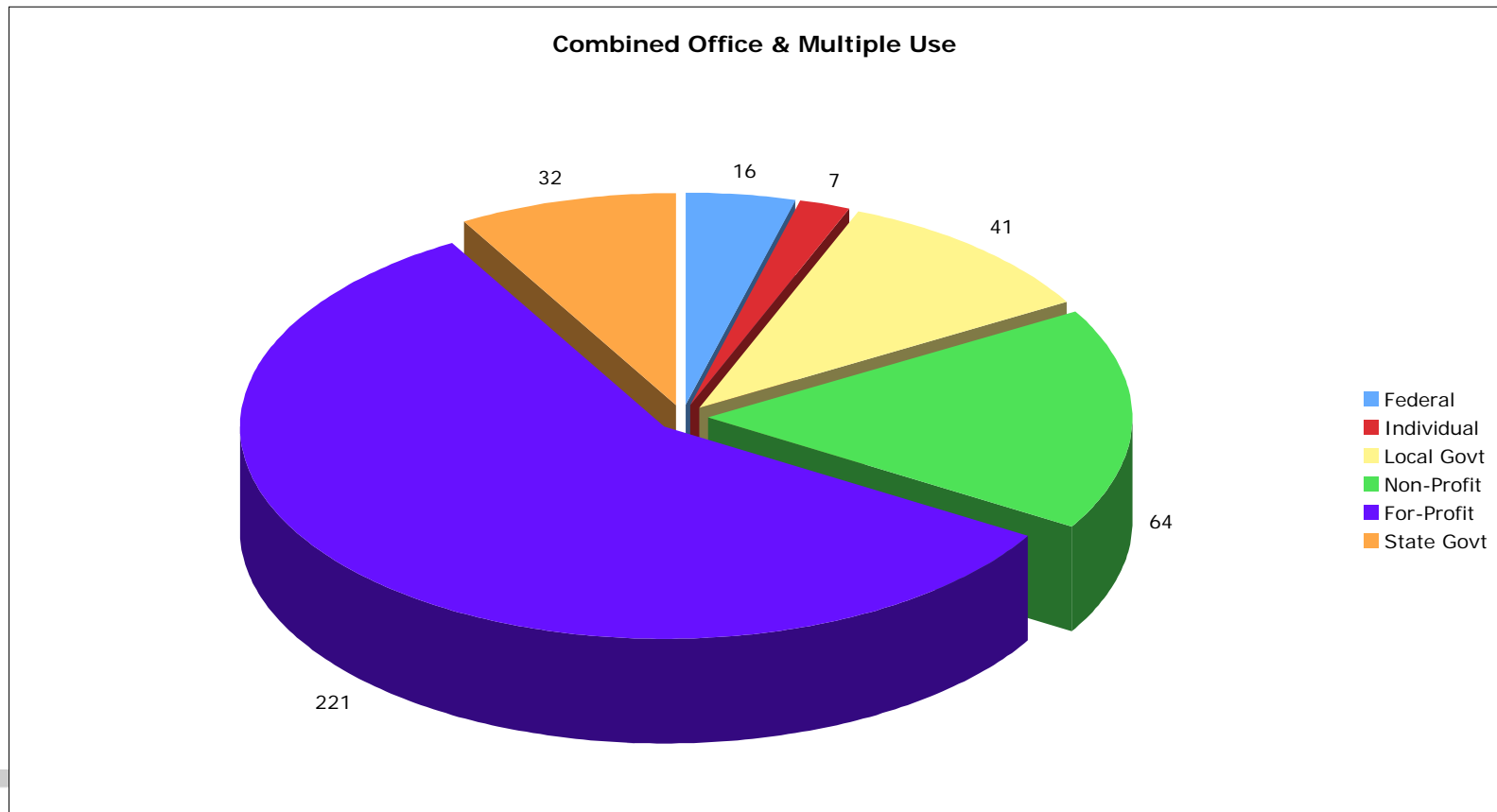
- ❖ Approximately 1,000 certified projects; some 7,300 registrations (applications)



Why now?



Why now?



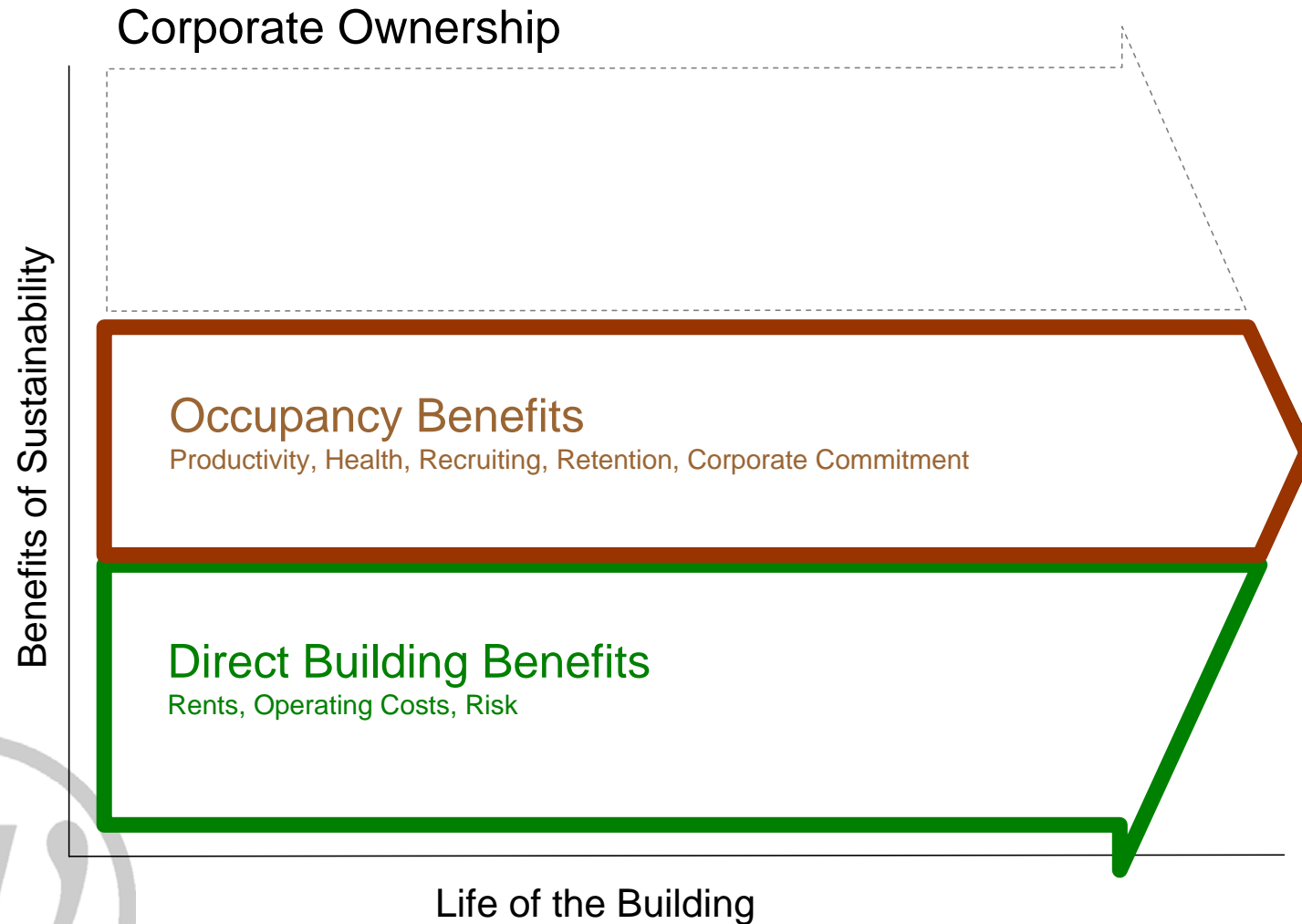
GBFC Estimates About 70 IRE Certifications



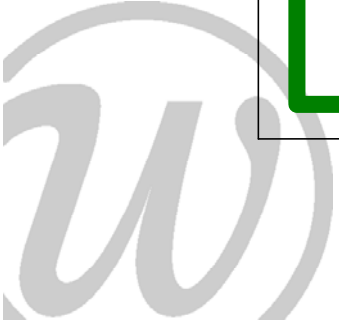
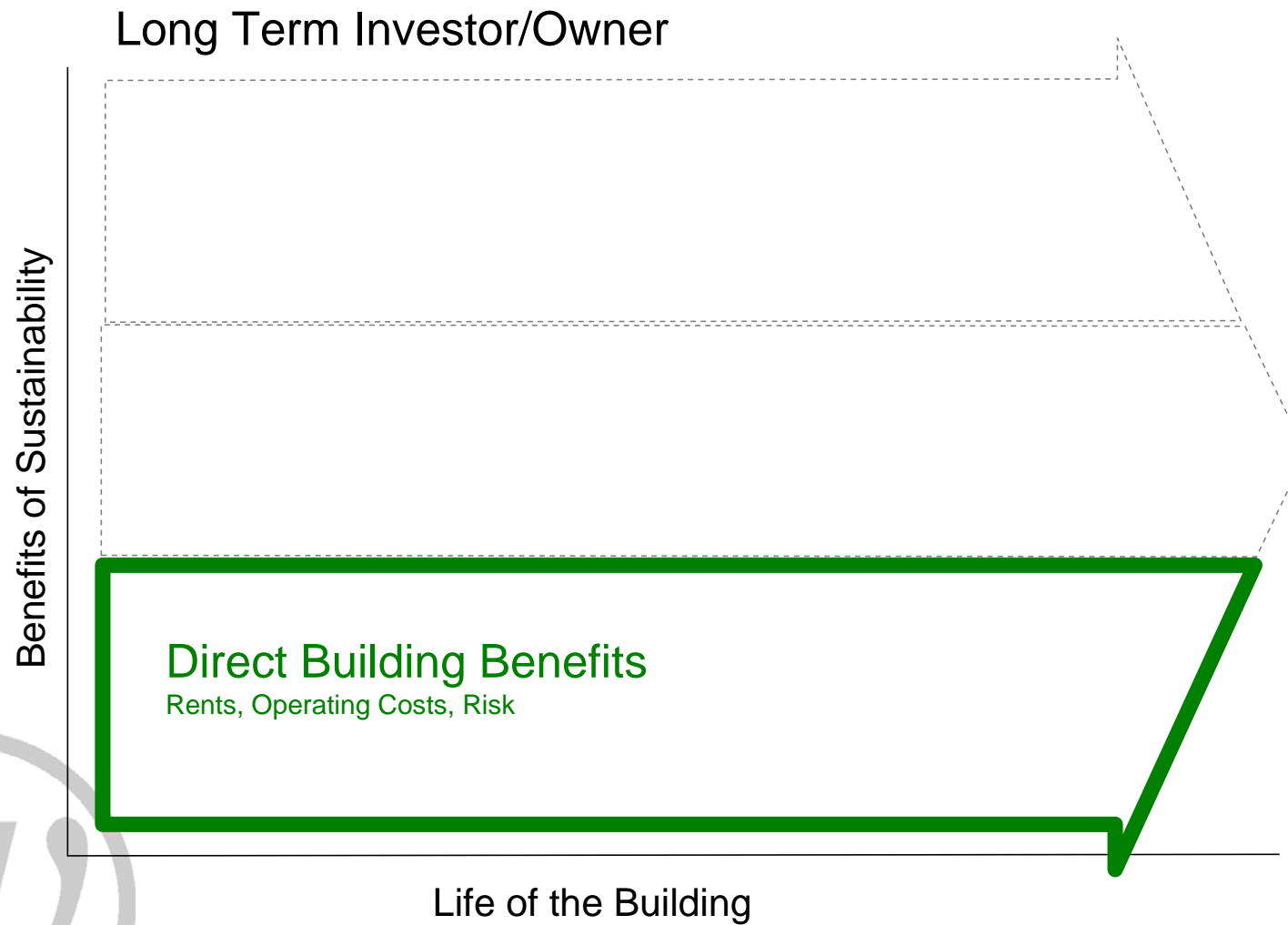
Why now?



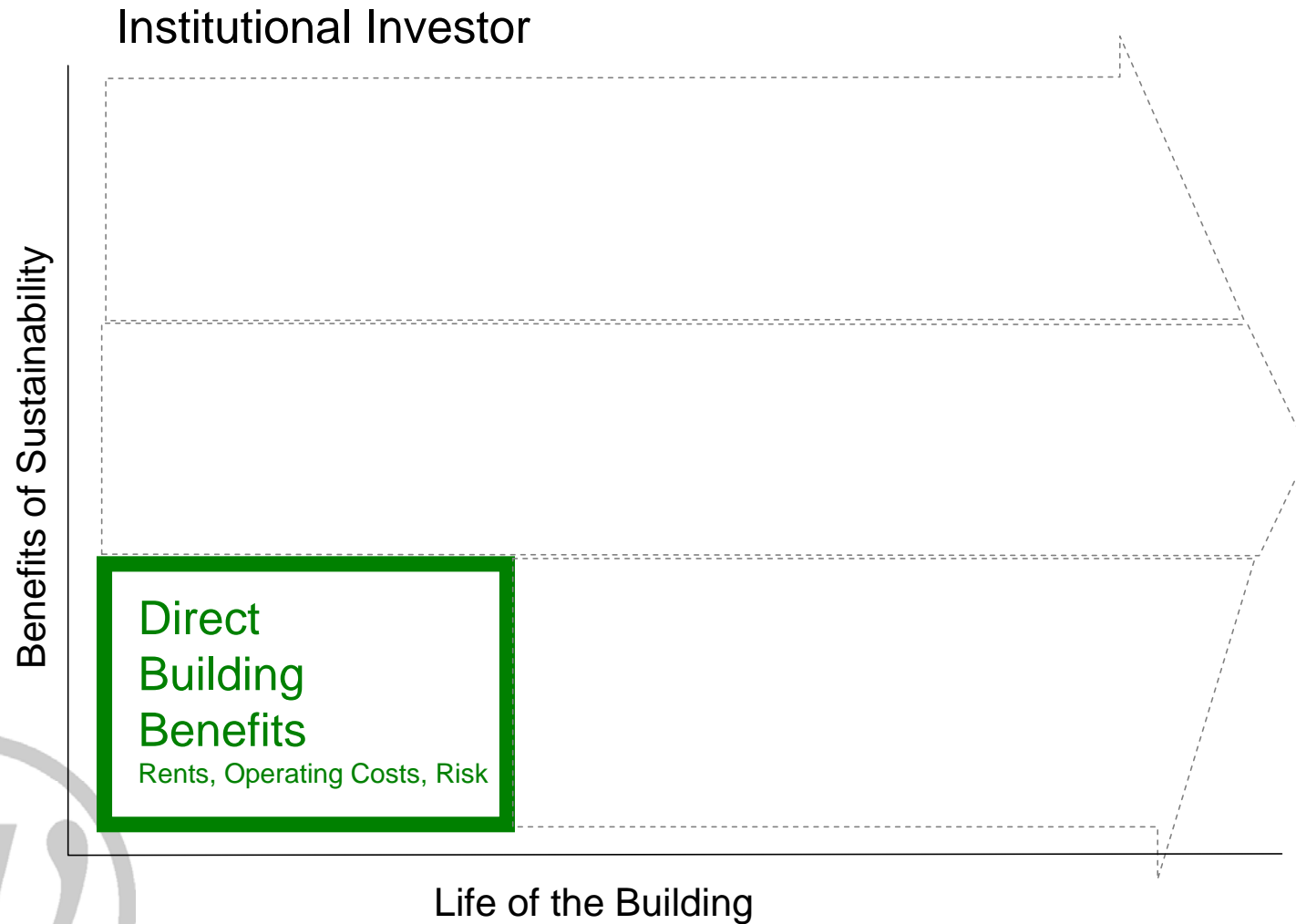
Why now?



Why now?



Why now?



Why now?

- ❖ **Corporate Interest - The Tenant**
- ❖ **Investor Interest - The Money**
- ❖ **Developer Interest - The Supplier**
- ❖ **Public Sector Support - The Regulator**
- ❖ **Public Interest - Climate Change**



Green building hypothesis...

- ❖ **Rents** will be higher...
 - ❖ **Operating expenses** will be lower...
 - ❖ **Absorption** will be faster...
 - ❖ Tenant **turnover** will be lower...
 - ❖ **Risks** will be lower...
 - ❖ **Value** will be higher!
 - ❖ Any **added costs** can be recovered!!
- ✓ For Investment Real Estate, the hypothesis remains only that today.....



Validation?

- ❖ Institutional Fund Formation
 - ◆ Hines/CalPRS - \$150 mm
 - ◆ Hines/Metropolitan Life - \$600mm
 - ◆ Thomas Properties Fund
 - ◆ Revival Funds - \$150 mm
 - ◆ Various “Smart Growth” Funds
 - ◆ Piggyback on SRI Objectives?



Business case, underwriting & valuation

- ❖ **A full presentation of costs and risks...**
 - ◆ **Transparency is as important as empiricism**
 - Potential for product/system to fail or to underperform
 - Uncertainty of energy/building modeling
 - Contractor cost, availability and quality
 - Leases and market conditions may limit rent benefits



Business case, underwriting & valuation

❖ A full and accurate presentation of benefits...

◆ Reduced Risk

- Energy price volatility
- Sick buildings/mold lawsuits
- Regulatory change

◆ Monetization of Public Benefits

- Accelerated permitting of project
- Density bonuses
- Financial incentives

◆ Reduced Cap Ex and Tenant Improvement Costs

- Favorable tax treatment
- Reduced tenant turnover

◆ Understanding the Potential Value Impact



The valuation problem

- ❖ Valuation of green buildings (today) **lacks a body of market experience and data** about how sustainable properties perform in comparison to traditional properties.
- ❖ Property valuations in North America, Europe and Japan **depend** substantially **on published data** (transactions, market metrics); **such data are not yet available** for sustainable buildings; it will take years to accumulate.
- ❖ The challenge for valuers and users of valuation reports for sustainable buildings is to have an appraisal analysis that
 - ◆ **addresses the sustainability features** of the building
 - ◆ **clearly** and “transparently” **describes the process leading to the selection** of the features,
 - ◆ addresses **who benefits** from the features, and
 - ◆ **clearly describes the valuer’s opinions about these benefits** and their contribution to property value.



The valuation problem

- ❖ The goal of the valuation report is **clarity, transparency** and **credibility**; the reader should have a very complete understanding of the valuer's investigation, analysis and opinions with respect to the impact on value of sustainable features. This is **in addition to** the existing responsibilities of the valuer and valuation report.
- ❖ For the next few years, until the widespread availability of property performance data for sustainable buildings and the accumulation of a body of knowledge about sustainable properties, **valuation reports must contain additional information** about the sustainable property valued and its marketplace, in order to be clear, transparent and credible about the valuer's investigation, analyses and opinions.



What gets valued...?

- ❖ Valuation methodologies for sustainable buildings are, in essence, the same.
- ❖ The valuer needs to recognize that some of the benefits of sustainable features **do not accrue directly to the benefit of the private parties** that are presumed in the market value definition. While these types of benefits may be real and of indirect or societal benefit, they should not be included in the typical valuation that estimates market value, in exchange, among private parties.

Benefits from Property

Private
(exclusive)

**Non-
monetary**

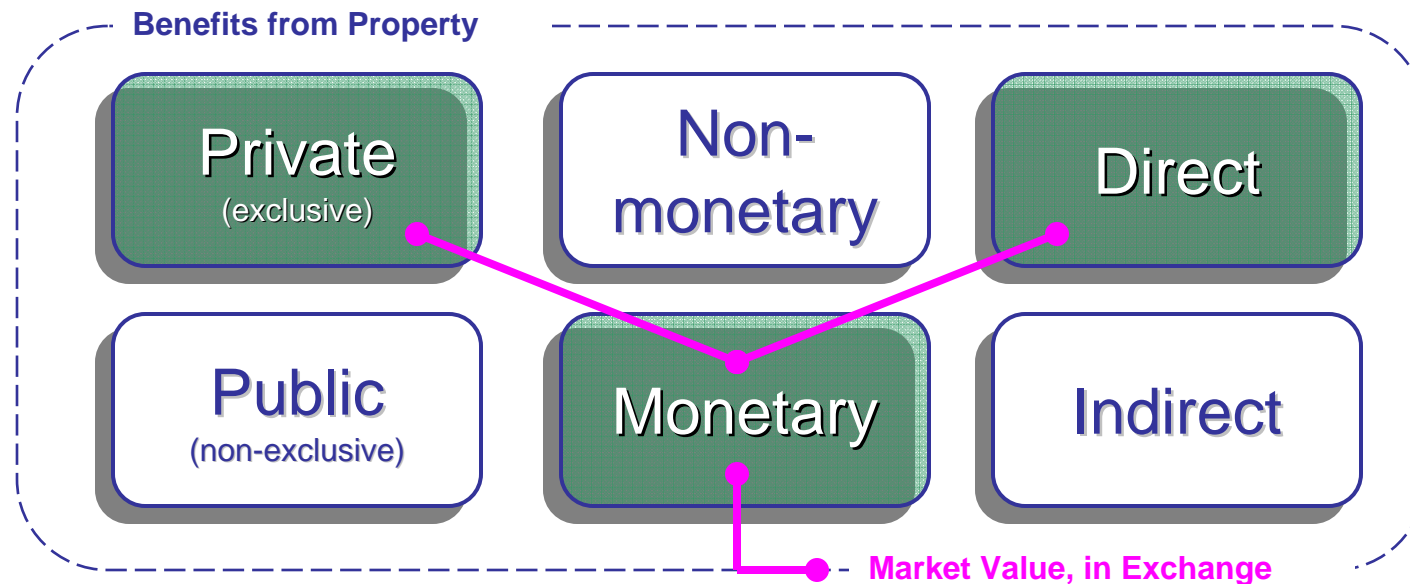
Direct

Public
(non-exclusive)

Monetary

Indirect

What gets valued...?



- ❖ The valuer needs to exercise care to consider **all of the costs** (capital or first costs, operating costs and risk) and **all of the [private/monetary/direct] benefits** (revenue, absorption, capital appreciation, etc.) in **all approaches to value**.
- ❖ We find that an emphasis on “**most probable buyer**” as part of the highest and best use analysis is a very effective means by which the valuer can assess the probable buyer’s willingness to assume cost and risk, as well as seek the benefits of sustainable buildings or projects.

Appraiser qualifications

- ❖ The qualified valuer should have a sound understanding of the goals and objectives of sustainable buildings; **LEED accreditation** is good evidence of such competency.
- ❖ The valuer should have a sound understanding of how the sustainability features of the building being valued benefit the user, owner or tenant in the specific marketplace in which the property is located.
- ❖ **The valuer should have training in and a sound understanding of the “trade-off” analysis or “value engineering” process** for the specific building being valued; this will allow a competent assessment of the type and amount of benefit to be realized from sustainability features that are “includable” in the analysis of market value, in exchange, among private parties.



Appraisal content

- ❖ The valuation report needs to include specific topical areas such as:
 - ◆ In the **property description** - a detailed discussion of the **trade-off analysis or value engineering process** that resulted in the specific sustainability features of the property valued.
 - ◆ In the **property description** - a discussion of how each sustainability feature will **add cost or add improved performance** to the property and **who bears the costs and who benefits** from sustainability features. This discussion also should address **when or over what period of time** the benefits are received.
 - ◆ In the **market analysis** - a discussion of how sustainability features are perceived by buyers, sellers, brokers, investors, lenders and regulators, and how that may affect supply and demand factors.

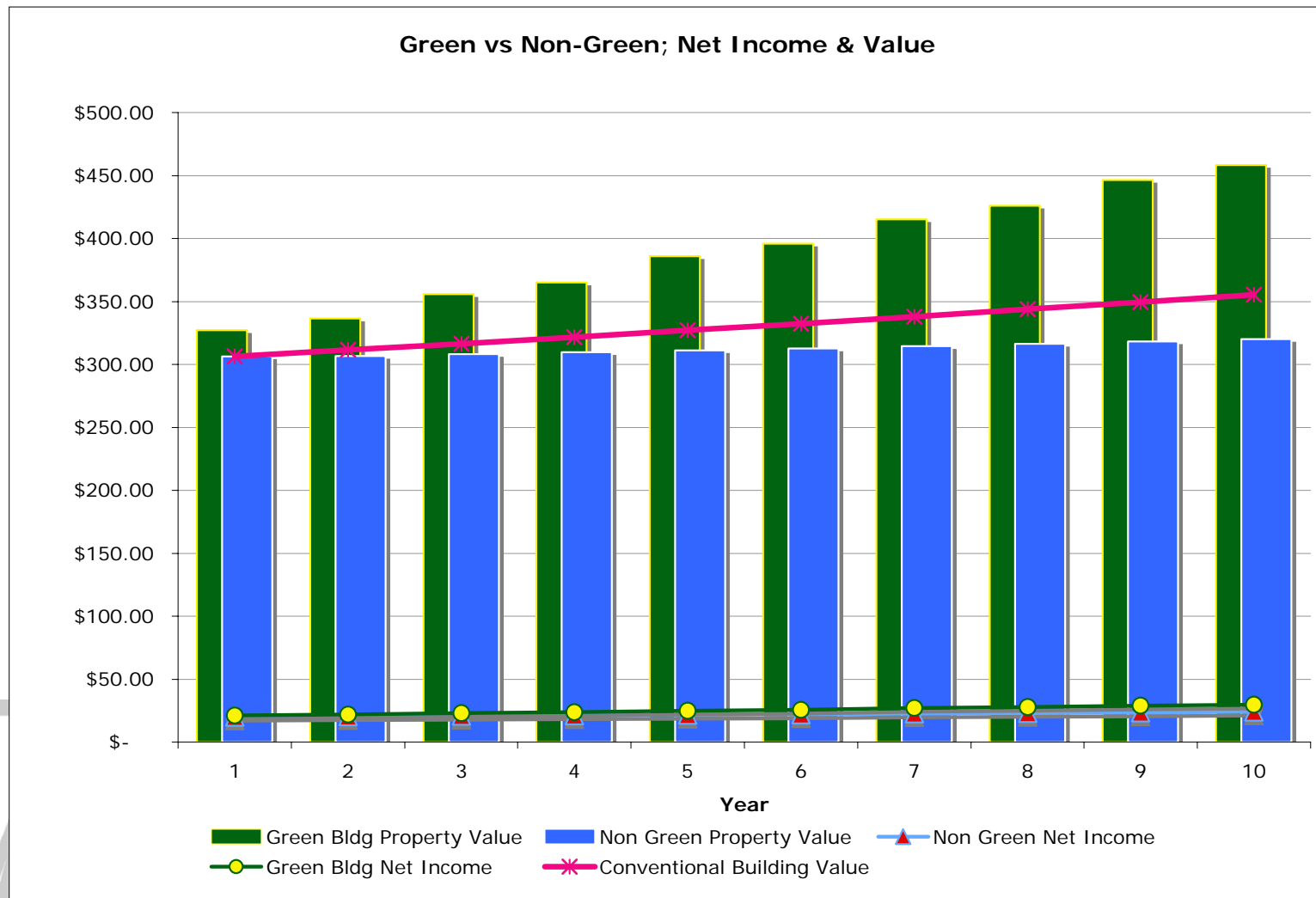


Appraisal content

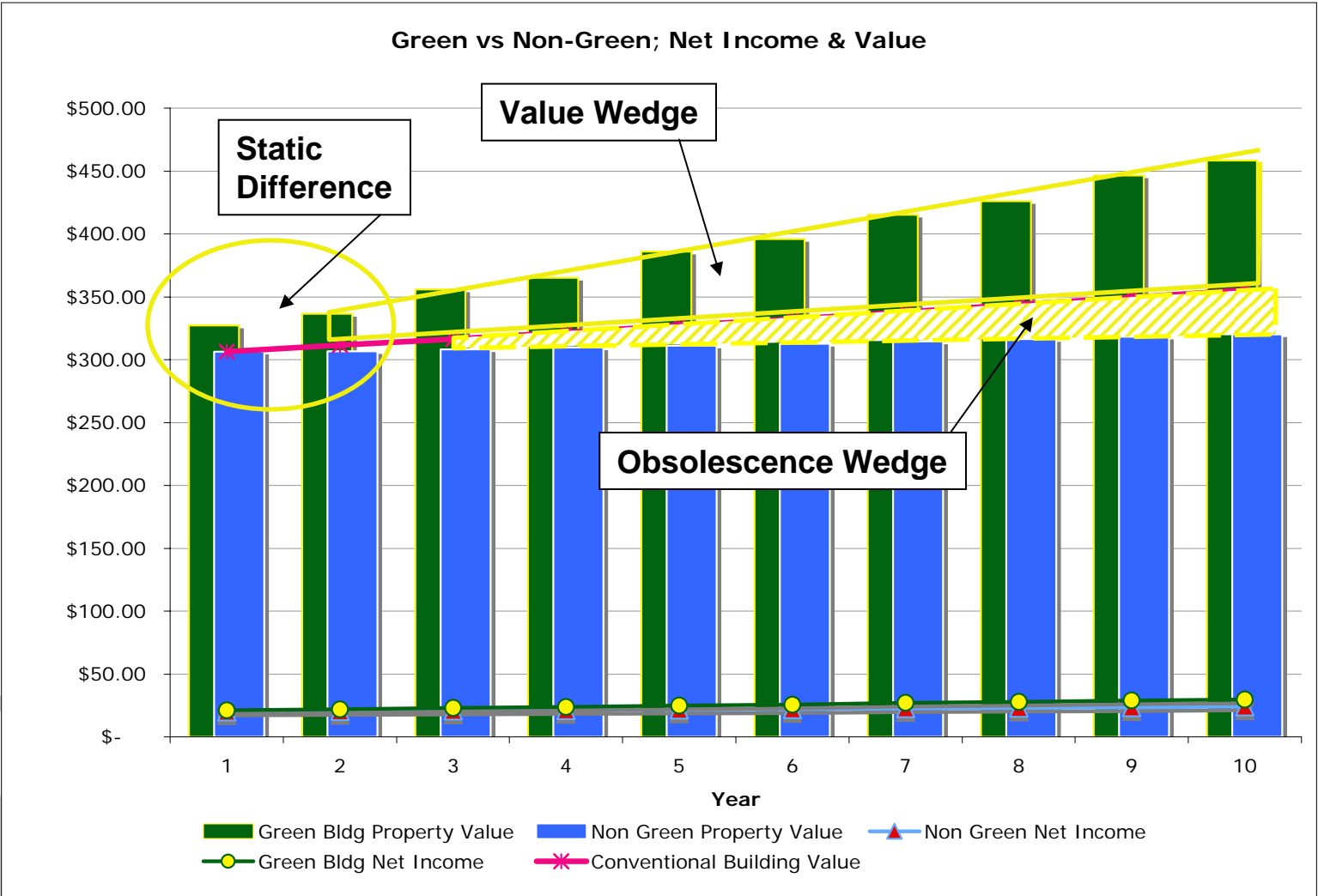
- ◆ In the highest and best use analysis, a discussion of how the probable buyer will regard the costs and benefits of sustainable features. This may also include a discussion of the user or tenant's perception of benefit.
- ◆ In the Cost Approach analysis, careful recognition of first costs and the associated benefit, as well as who the benefit inures to. This may include considerations of incentives.
- ◆ In the Sales Comparison Approach analysis, recognition of sustainability features in the subject property, as well as in any comparable sales. The valuer must have detailed information on comparable sales (more than typical), with respect to their own sustainability features, in order to have a well-supported analysis. Adjustments to compensate for differences between comparable and subject may have to be income-based.



Green vs non-green - the future?



Green vs non-green - the future?



Summary

- ❖ Our shared goal is to think comprehensively about Green Buildings - **making the business case, testing it through underwriting, and valuing sustainable buildings.**
- ❖ For the foreseeable future, the investment, underwriting and valuation process will be defined by its need for **thoroughness, transparency and credibility.**
- ❖ You must invest in education, resource materials and development of a comprehensive approach to your green building appraisal problem.
- ❖ In time, investment, underwriting and valuation of green buildings will become much more common, and the development community will have a body of knowledge, relevant data and shared experience to rely upon.



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Firm Information

Waronzof Associates, Inc. is a Los Angeles-based land economics and real estate consulting firm founded in 2000 by Timothy Lowe. The firm provides land economics and real estate consulting services to private, public institutional and fiduciary clients in four service areas – **Consulting, Complex Valuation, Litigation Support** and **Asset Management**. Land economics is the study of land and its improvements in terms of its productivity, profitability and utility for a specific use. We consider the properties and problems we encounter in the context of their surroundings and economic relationships – private or public, direct or indirect and monetary or non-monetary.

Since formation, the firm has served a variety of clients, among them Latham & Watkins, Kilroy Realty Corporation, Rus, Miliband & Smith, Morrison & Foerster, California State Teacher's Retirement System, Segerstrom Companies, Allen, Matkins, Leck, Gamble & Mallory LLP, Trammell Crow Company, PerkinElmer, Edward's Theatres, Deloitte & Touche, Cygnion Corporation, the City of Tukwilla, Billet, Kaplan, Sokol & Dawley, Pulte Homes, City of Chula Vista Redevelopment Agency, the Worldwide Church of God, Sisters of Social Service, Blue Cross & Blue Shield of Louisiana, Hellmuth, Obata & Kassabaum (HOK) and others. More recently, Waronzof has become heavily involved with the issues and opportunities created by sustainable properties and portfolios. We are among the leaders in the industry in understanding how sustainable and high performance buildings are different from conventional properties, and how investment outcomes may be affected.

Consulting covers the broad array of real estate problem solving for individual properties, portfolios and for real estate enterprises. "How do we best use it?" "What kind of tenants should we seek?" "What do we do with it now?" are consulting kinds of questions. We tailor our approach based on the specific needs and goals of the property or portfolio owner. Our consulting assignments help define strategy, position properties in the market, refine concept plans, assist in transactions, and help real estate owners and developers make decisions about their properties. **Complex Valuation** includes property and portfolio valuation services, including appraisals and specialized forms of value reporting such as financial reporting or fair compensation. Our practice concentrates in valuation problems involving very large, unique or complex assets – such as the valuation of a major office building or regional shopping complex – as well as the valuation of real estate partnerships, holding companies or other partial interests. **Litigation Support** includes analysis of properties, projects and real estate entities in the context of litigation, dispute or in avoidance of litigation. Our services include economic analysis leading to conclusions of lost profits, economic damages, property value, loss of economic viability and estimates of fair compensation. **Asset Management** describes the services that we provide related to the acquisition, disposition and operation of commercial and investment property. These services include assisting buyers acquiring property and investors evaluating the proposed plans and acquisitions of project promoters, completing detailed due diligence for property acquisition, assisting owners in the preparation and search for debt and equity investment, analyzing the financial impacts of differing development or deal structure alternatives, assisting in negotiations for lease or purchase, preparation for disposition or redevelopment and the search for prospective buyers or bidders for specialized properties.

Learn more about Waronzof at www.waronzof.com