

Tidbits, Liability Issues

Extraordinary assumption: *An assumption, directly related to a specific assignment, which, if found to be false, could alter the appraiser's opinions or conclusions. Extraordinary assumptions presume as fact otherwise uncertain information about physical, legal, or economic characteristics of the subject property; or about conditions external to the property such as market conditions or trends; or about the integrity of data used in an analysis. An extraordinary assumption may be used in an assignment only if: It is required to properly develop credible opinions and conclusions; the appraiser has a reasonable basis for the extraordinary assumption; use of the extraordinary assumption results in a credible analysis; and the appraiser complies with the disclosure requirements set forth in USPAP for extraordinary assumptions. (The Dictionary of Real Estate Appraisal, 4th ed)*

Hypothetical condition: *That which is contrary to what exists but is supposed for the purpose of analysis. Hypothetical conditions assume conditions contrary to known facts about physical, legal, or economic characteristics of the subject property; or about conditions external to the property, such as market conditions or trends; or about the integrity of data used in an analysis. A hypothetical condition may be used in an assignment only if: Use of the hypothetical condition is clearly required for legal purposes, for purposes of reasonable analysis, or for purposes of comparison; use of the hypothetical condition results in a credible analysis; and the appraiser complies with the disclosure requirements set forth in USPAP for hypothetical conditions. (The Dictionary of Real Estate Appraisal, 4th ed)*

- If the property is a **UMB** (Unreinforced Masonry Building), what is the lender's tolerance level? Do they want to move forward with the appraisal?
 - The San Francisco Department of Building Inspection (DBI) maintains a master list of over 2,000 UMBs citywide. To determine if a property is on the UMB list, call DBI's Seismic Safety Division at 415-558-6083.
 - Sample extraordinary assumption: *The subject is observed to have a brick foundation. After consultation with the City of San Francisco Building Department, we have determined that this property is not on the UMB (unreinforced masonry building) list. We presume that it will be able to continue current operations without further seismic retrofitting of the foundation.*
- Barred windows without **quick-release safety latches** for fire egress:
For more information: www.fire.ca.gov
- **ADA compliance**
 - Appraiser does not have to be an expert in ADA requirements, but Competency Rule requires disclosure.
 - Example disclosure statement, from the Appraisal Institute: *The Americans with Disabilities Act (ADA) became effective on January 26, 1992. I have not made a specific compliance survey and analysis of the subject property to determine whether or not the improvements are in conformity with the various detailed requirements of the ADA. It is possible that a compliance survey of the property together with a detailed analysis of the requirements of the ADA could reveal that the property is not in compliance with one or more of the requirements of the Act. If so, this fact could have an effect upon the value of the property. Since I have no direct evidence relating to this issue, possible noncompliance with the requirements of ADA was not considered in developing an opinion of the value of the property. This appraisal is made under the presumption that the subject does not require substantial modifications/costs to comply with the ADA.*

- **The Fair Housing Act**
 - <http://www.usdoj.gov/crt/housing/title8.php>
 - Prohibits discrimination in sale or rental of housing to persons with disabilities. Does not apply to single family homes or rooms/units in properties of up to four units, as long as the owner actually maintains and occupies one of the units as his/her residence.
 - Owners must allow persons with disabilities to make accessibility modifications to units at their own (the tenant's) expense.

- **Unwarranted/unpermitted units**
 - Confirm legality of all units by checking public records, permitting records at planning/building departments
 - If unwarranted, discuss if common in the market, how valued by market participants; should the unpermitted space be included with the legal GLA, or adjusted for separately in the grid?
 - This may require an extraordinary assumption. An example is as follows: *On inspection, the subject was observed to have three residential units, though public records indicate two units. The observed total GBA and room counts are in accordance with legal records. We assume that the subject will be permitted to continue present operations as a three-unit building. (include details specific to the property and unit(s) in question)*
 - Ability to rebuild if destroyed –
 - California Senate Bill No. 2112, enacted in 1994 with the goal of preserving multifamily housing units across the state, precludes local agencies from prohibiting the reconstruction, restoration, or rebuilding of multi-family dwellings that are destroyed as a result of a catastrophic event (i.e., fire, earthquake, flood), or the public enemy.
 - http://info.sen.ca.gov/pub/93-94/bill/sen/sb_2101-2150/sb_2112_bill_940922_chaptered
 - The law allows reconstruction of legal non-conforming units, provided that any reconstruction conforms to the following:
 - The building code at the time of reconstruction;
 - Local zoning ordinances, so long as the pre-damage size (number of bedrooms) and number of dwelling units are maintained;
 - Architectural regulations including design guidelines and standards, so long as the pre-damage size and number of dwelling units are maintained, and;
 - A building permit is obtained within two years after the date of the damage or destruction.
 - Local legislation should be included in your analysis as well.
 - San Francisco – Section 188 of the Planning Code shortens the time required to obtain a building permit to within one year of the date of damage or destruction
 - <http://www.municode.com/Resources/gateway.asp?pid=14139&sid=5>

[San Francisco Apartment Association newsletter](#) – excellent resource for market analyses and recent significant trades. <http://www.sfaa.org/>

Rent Control

Adjusting for Below Market Rents in a Rent-Controlled Market

Questions to keep in mind:

- An occupied rental property in a rent-controlled market generally requires a leased fee valuation. This needs to be confirmed with the client, as often with small properties you will get a standard engagement for a fee simple valuation.
- How far below market are the contract rents at the subject and at the comparables (upside rent potential)? Are all comparables subject to the same rent control restrictions as the subject? Has ownership banked any allowable rent increases?
- Are there any protected tenants at the subject or the comparables? Section 8 or HUD units? (Rents are subject to different restrictions, and may require an extraordinary assumption in your income forecast i.e. *There is currently one tenant at the subject property receiving Section 8 voucher, occupying Unit 2. We assume that the Section 8 contract will be renewed in the coming year.*)
- Are there any very long term tenants, at significantly below market rents, at the subject or the comparables? Does this impact expectations of upside rents/tenant turnover rates?
- How do these factors influence sales price, price per unit, GRM, and cap rate? Can you determine trending? Typically we look at the connection between operating expense ratios and the GRM, and between upside rent potential and the leased fee cap rate.

Ideally, of course, all of your sales comparables will be purchased for the same intended use, and have similar occupancies, upside rent potential, and operating expense ratios.

When this is NOT the case, it may be helpful to determine the relationship between value and upside rent potential by placing the comparables in a grid, or to weight the most similar sales in your GRM analysis.

What income do I forecast?

- Market, contract, contract with any pending annual increases - should confirm with client...
- The forecast reflects the next year's income, so typically contract rent forecasts incorporate any rent increases allowed under rent control legislation during the year.
- If rents are increasing, we typically forecast contract rents in place for leased units (with applicable rent increases), and market rents for vacant or owner-occupied units.
- If rents are decreasing, you *may* opt to assume that any tenants in place would re-negotiate leases to market terms, and forecast either market rents, or a blending of market and contract rents.
- Local political climate may play a roll in your analysis.

Pertinent Legislation

In 1995, the California legislature enacted the Costa-Hawkins Rental Housing Act, which suspends rent control following a qualifying vacancy and reinstates it for a new tenancy. In essence, this means that when a tenant vacates a rental unit, it can be leased to a new tenant at market rent terms. <http://www.ci.berkeley.ca.us/rent/OrdRegs/civilcode.html>

San Francisco Bay Area Cities with Rent Control Ordinances:

Berkeley

http://www.ci.berkeley.ca.us/rent/OrdRegs/gcause/Ordinance.html#13_76_100

Campbell

http://municipalcodes.lexisnexis.com/codes/campbell/_DATA/TITLE06/Chapter_6_09_RENTAL_INCREASE_DISPU/index.html

East Palo Alto

<http://www.ci.east-palo-alto.ca.us/housingdiv/Rent%20Stabilization%20Ordinance.pdf>

Fremont (pertains to mobile homes only)

Hayward

<http://www.ci.hayward.ca.us/municipal/uncodified/Ordinance%2090-04.pdf>

Los Gatos

<http://www.town.los-gatos.ca.us/faq.asp?TID=31>

Oakland

<http://www.oaklandnet.com./government/hcd/rentboard/docs/RentOrdinance2003.pdf>

San Francisco

<http://www.nmhc.org/Content/ServeFile.cfm?FileID=5251>

San Jose

http://www2.sjhousing.org/report/Misc/Chapter_17.23.pdf

Intended Use Issues, and Impact on Value

2-4 unit properties are purchased in the Bay Area by a variety of different users:

- Investor looking for rental income stream and return of investment at resale
- Owner-occupant looking for some rental income to offset high mortgage payments
- Investor looking to convert to condominiums and reap future rewards
- Investor looking to convert to TIC ownership and reap future rewards
- Multiple owners looking to occupy as TIC or eventual condo ownership

What if the intended use is not the HBU or the current use?

What you need to know:

For the subject and the comparables, determine the motivations of the buyer. Ask the buyer or agent if the property was purchased for owner occupancy, continued tenant occupancy, condo conversion or TIC conversion. If a conversion was planned, was any work completed at time of sale (filings, survey maps, permitting, renovations, etc.)? Ideally all of your comparables should be similar to the subject in terms of intended property use. When this is not possible, then estimate an appropriate adjustment based on how the intended use impacted the contracted sales price. Determine if there were any protected tenants in place at time of sale, and if the property had a history of prior evictions, either under Just Cause or the Ellis Act, and ask how this impacted the sales price.

Tenant Evictions for Owner-Occupancy

From Andy Sirkin's webpage, a prominent San Francisco Real Estate Attorney specializing in TIC and other fractional ownership agreements:

<http://www.andysirkin.com/HTMLArticle.cfm?Hit=2&Article=7>

Specific legislation varies by municipality. In San Francisco, tenants may be evicted for owner-occupancy under a limited set of Just Cause conditions. Even if these conditions are met, however, a tenant can challenge the eviction in the courts. A tenant-owned property being marketed for potential owner-occupancy has associated risk that should be addressed in an appraisal.

If a landlord cannot meet the owner-occupancy Just Cause eviction requirements, they may instead utilize the Ellis Act. The Ellis Act is a state law in California that allows owners to essentially go out of the rental business, and remove dwellings from rental use subject to certain restrictions. Tenants can be evicted under the Ellis Act anywhere in California, but local law can impact the procedures and requirements.

How does this affect value?

In the case of Just Cause evictions:

The presence of protected tenants will impact ability to owner-occupy a unit and may impact value: Cannot evict a tenant with an unexpired lease, or a protected tenant (over 60 or disabled who have lived there for at least 10 years, or catastrophically ill and have occupied the unit for at least 5 years). If a tenant is in place during a condo conversion, they have the right to remain for a year after the conversion is complete, or for life if over 62 or disabled.

The history of an owner-occupancy eviction will limit a new eviction and may impact value: Only one owner-occupancy eviction is allowed per building, unless units are occupied by family members. If there has been an owner-occupancy eviction in the building since November 1998, this is the only unit that can *EVER* be targeted for an owner-occupancy eviction.

Relocation expenses must be paid, by San Francisco law, to tenants subject to owner-occupancy evictions: \$4,500/person who has lived in the unit for at least a year, up to a maximum of 3 persons/unit, or \$13,500, plus \$3,000 more for each person over 60 or disabled under California law, plus another \$3,000 if at least one child under 18 resides in the unit. These fees increase annually based on the Consumer Price Index (CPI).

In the case of Ellis Act evictions (in San Francisco, varies by municipality):

County Records filings describe the ongoing rent restrictions due to the Ellis evictions; this shows up on all future title reports and may affect the value of the property and the owner's ability to obtain financing.

Once a building has an Ellis eviction, the ability to return the units to the rental market is severely limited: None are permitted to be re-rented during the first two years after the eviction, and during the first ten years, re-rental must first be offered to the evicted tenant. For the first five years, the maximum rent allowed is that paid by the evicted tenant plus any annual rent increases that would have been allowed under rent control legislation.

Moving expenses: Low income tenants are entitled to moving expenses of \$4,500, whereas elderly (age 62+) and disabled tenants are entitled to \$3,000.

Condominium conversion is virtually banned after a building has been subject to an Ellis eviction: Local laws may change condominium conversion requirements based on past evictions. For example, San Francisco law now makes it more difficult to convert a building to condominiums if elderly or disabled tenants were evicted after November 16, 2004. The San Francisco Subdivision Code also seems to give the Planning Commission discretion to disapprove condominium conversion where there is evidence that tenants have been evicted to "prepare" a building for conversion, and a five-year rental history is required as part of the conversion application packet.

Resale value: Some Realtors believe that Ellis evictions lower resale value, though this may not be evident across the board, given varying motivations of the different buyer types. **To determine effect on value for a specific property, you must speak with parties involved in the transaction.** There are certain lenders who refuse to finance Ellis buildings, but this has proven problematic only for larger buildings where relatively few lenders are willing to provide financing.

The TIC (Tenancy in Common) market

Popular in San Francisco, still an active market. Generally will apply to smaller income properties, often with parking amenity. Look at listing, talk with broker, see if marketed for conversion, what is occupancy at time of sale. Local developers report typical buyout costs of \$12-15K per unit in some markets, up to \$15-30K in others, not including additional \$5-10K per unit in attorney fees. Upside resale potential will be reflected in the GRM and list/sale pricing.

There are some concerns now over the possibility of eliminating the Ellis Act in California – primarily initiated by Southern California democratic legislators, unknown if Governor Schwarzenegger would veto or not. Developers express concern over this possibility following November elections.