

Wisconsin Legislative Council

Subcommittee on Property Tax Assessment

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(contents come directly from the *Wisconsin Property Assessment Manual*, bold lettering highlights relevant concepts and principles)

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Bundle of Rights

Real property includes “all fixtures and rights and privileges appertaining thereto.” This means **the assessor must not consider only the physical attributes** of the land and improvements **but the intangible benefits that are associated with them** including:

- The right to sell an interest
- The **right to lease an interest** and to occupy the property
- The right to mortgage an interest
- The right to give an interest away
- The right to do none or all of these things

The assessor does not evaluate liens.

Standards of Value

Market value -- **market value is the most probable price which a property should bring in a competitive and open market** under all conditions requisite to a fair sale, where the:

1. Buyer and seller are typically motivated;
2. Both parties are well informed and acting in their own best interests;
3. A reasonable time is allowed for exposure in the open market;
4. Payment is made in terms of cash; and
5. 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.

Market Value

The goal of the assessor is to estimate the current market value of the bundle of rights for a particular property, considering only those rights and privileges that the owner, or beneficial owner, can transfer to a willing buyer in an arms-length transaction.

Uniformity

Uniformity in taxation ensures equity among taxpayers and . . . jurisdictions across the state.

The ultimate goal is equality between the tax burden of each of the property owners

Highest and best use

Highest and best use is defined as that use which over a period of time produces the greatest net return to the property owner.

Three Approaches to Value

- The **sales comparison approach** is predicated on the principle of substitution; that the typical buyer will pay no more for a property than it would cost to buy a reasonably comparable property.
- The **income approach** to value is based on the principle of anticipation. It is the calculation of present value based on anticipated future benefits. Typically these benefits are in terms of rents and other income that the property may produce either directly or indirectly. **These are compared to the typical rents and expenses of similar property types in developing an opinion of value.**
- The **cost approach** relies on determining either the reproduction or replacement cost of the improvements, subtracting all depreciation, then adding the value of the land.

Income Approach

If a property encumbered by leases is sold, only the owner's interest in the property (leased fee interest) is actually transferred to the buyer.

The market value of a leased fee interest depends on how the contract rent relates to the market rent. If the contract rent is at the same level as the market, the leased fee interest has the same value as a fee simple interest. In this case, the leasehold interest has no value.

A leasehold interest may acquire value if the lease rate is below market. In this case, the leasehold interest has value due to the below market lease. Whenever a leasehold interest has value, the leased fee interest is reduced below that of the fee simple interest.

Conversely, when the lease rate is above market rates, the leased fee interest may be more valuable than the fee simple interest.

Dark Store Theory Valuation Gray Areas

- Interest being valued – fee simple or leased fee
- Valuing above market lease contracts
- Contract rents versus market rents
- Leaseholder creditworthiness

Dark Store Theory Valuation Gray Areas – Interest being Valued

- Leased fee, includes leases in the bundle of rights valued; or
- Fee simple, ignores contractual leases

My Opinion

Income producing real estate is valued by investors based on its income-production ability, actual leases should be considered in the bundle of rights and per the “willing buyer and willing seller” discussion in the Wisconsin Property Assessment Manual.

Dark Store Theory Valuation Gray Areas – Valuing Above Market Lease Contracts

Should above market lease contracts be considered (i.e. only below market lease contracts should be considered)?

Are above market lease contracts paying for “value-in-use” improvements (i.e. why would a tenant pay above market rents)

My Opinion

The present value of the remaining contractual term and the market rents thereafter should be valued, regardless of whether contract rents are above or below market rents, investors purchase the expected (contract rents) and anticipated (market rents). Lease contracts are part of the bundle of rights that convey with the property.

The concept of uniformity suggests that both above market and below market lease contracts be considered in symmetrically.

Dark Store Theory Valuation Gray Areas – Contract versus Market Rent

The Wisconsin Property Assessment Manual is unclear as to whether contract or market rents should be used in the income approach to value

Valuing the “bundle of rights” presumes valuing the lease contracts that are in place, whether they are above or below market if they are conveyable to the next buyer.

However, on page 7-20 contract rents are to be compared to “typical rents and expenses” in the market.

My Opinion

Private valuation of income producing real estate relies on contract rents for the duration of the contract and then market rents. The Wisconsin Property Assessment Manual tempers the use of contract rents with the need to compare contract rents to market rents.

Dark Store Theory Valuation Gray Areas – Leaseholder Creditworthiness

Long-term absolute net leases, contracts where the tenant is responsible for all property expenses and capital expenditures, reduces the purchaser risk of owning that cash flow, thus reducing the cap rate or discount rate thus increasing the price.

At the same time, creditworthy tenants are able to negotiate better lease terms and lease rates with property owners, reducing net rental rates and thus reducing the property value. Alternatively, a nationally branded organization may be able to more productively use the space and have higher sales.

My Opinion

The “highest and best” use of the land and improvements will find the highest and best user of that real property and that leaseholder creditworthiness is offset by lower rents or higher productivity of a nationally branded retailer.

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