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Valuation of income property - by Steven Spangle

February 12, 2021 - Appraisal & Consulting

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COVID-19 has impacted the entire country in numerous different ways in the past year and it has had a direct effect on the real estate industry.

According to the U.S. Bureau of Labor Statistics the country has the highest unemployment rate (6.7% in December 2020) since 2009 with an average seasonally adjusted rate for New England of 6.9%. Connecticut, Massachusetts and Rhode Island were above the National and New England averages. These states are the major employment centers for New England and thus would reasonably have the highest unemployment.

The number of tenants, both residential and commercial, who are behind in their rent and the number of property owners who are more than 90 days delinquent in their mortgage payments represents a major problem that is also negatively impacting lenders and landlords.

The level of concern over these deficiencies is indicated by the federal government imposing moratoriums of evictions and foreclosures and renewing them as they expired. The city of Boston now plans to allocate $2.5 million toward a rental voucher program which will be in addition to Section 8 federal housing vouchers. These are very positive steps; however, many New England communities do not have the financial ability to follow suit.

More than ever before we need to be aware of external influences and focus on how these issues relate to the markets that we work in and the specific properties we are dealing with. Any national or local issue that impacts the cashflow of a property, has to be recognized, analyzed and, as appropriate, included in a final value conclusion when valuing income producing properties.

The challenge presented by the COVID-19 virus is that much of the general data developed prior to February, 2020 is no longer applicable.

The virus has not changed how properties are valued but it has changed the type and amount of information gathered. With income producing properties the value is all about the money. Appraisers and brokers need to know more than what rents were originally agreed to. They also need to know how much rent is actually being collected and are there units paying less than originally agreed upon rent? Has any type of arrangement been made for a lower rent and is there an agreement to recover unpaid rents in the future? If such an agreement exists what are the specific terms?

Conditions in various market areas, even within a single community can be very different and can change quickly. There is a need for both appraisers and brokers to co-operate in sharing as much information as possible about what is happening with income properties within a market. The COVID-19 pandemic has resulted in a verification process that requires more detailed and in depth questioning than might have been required in the past.

As part of the process of establishing support for subject market rents, vacancy and expenses, the confirmation process needs to include questions about original rents, actual payments or non-payments and any agreements with tenants about repaying any rent deficiency. Both parties should be aware of typical eviction costs. Issues related to any increased operating expenses caused by the present market should also be discussed.

If the subject property has occupied units that are not paying part or all of the agreed upon rent, would perspective buyers assume, they could immediately achieve market rent for the units? It is likely there would be a rent up period that is different from a year ago. Brokers and appraisers must have a market supported basis for any assumptions they make. These would include what similar properties are being rented for, vacancy levels and lease up times, and expenses related to evicting non-paying tenants and potential increase in future uncollected rents.

The selection of comparables to support rents, vacancy, expenses, gross rent multipliers or cap rates will require more time and research since all conclusions need support from transaction proximate to the effective date of value.

The work and time involved in valuing income property is likely to be longer and take more effort to provide a support and credible appraisal. A real estate community that recognizes the challenges faced by both appraisers and brokers and works co-operatively toward gathering the information needed in valuing income producing properties will benefit the industry.

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