

Confronting the Neighborhood Impacts of Foreclosure

Pricing and Valuation of Vacant Properties: Developing a Neighborhood Stabilization Approach

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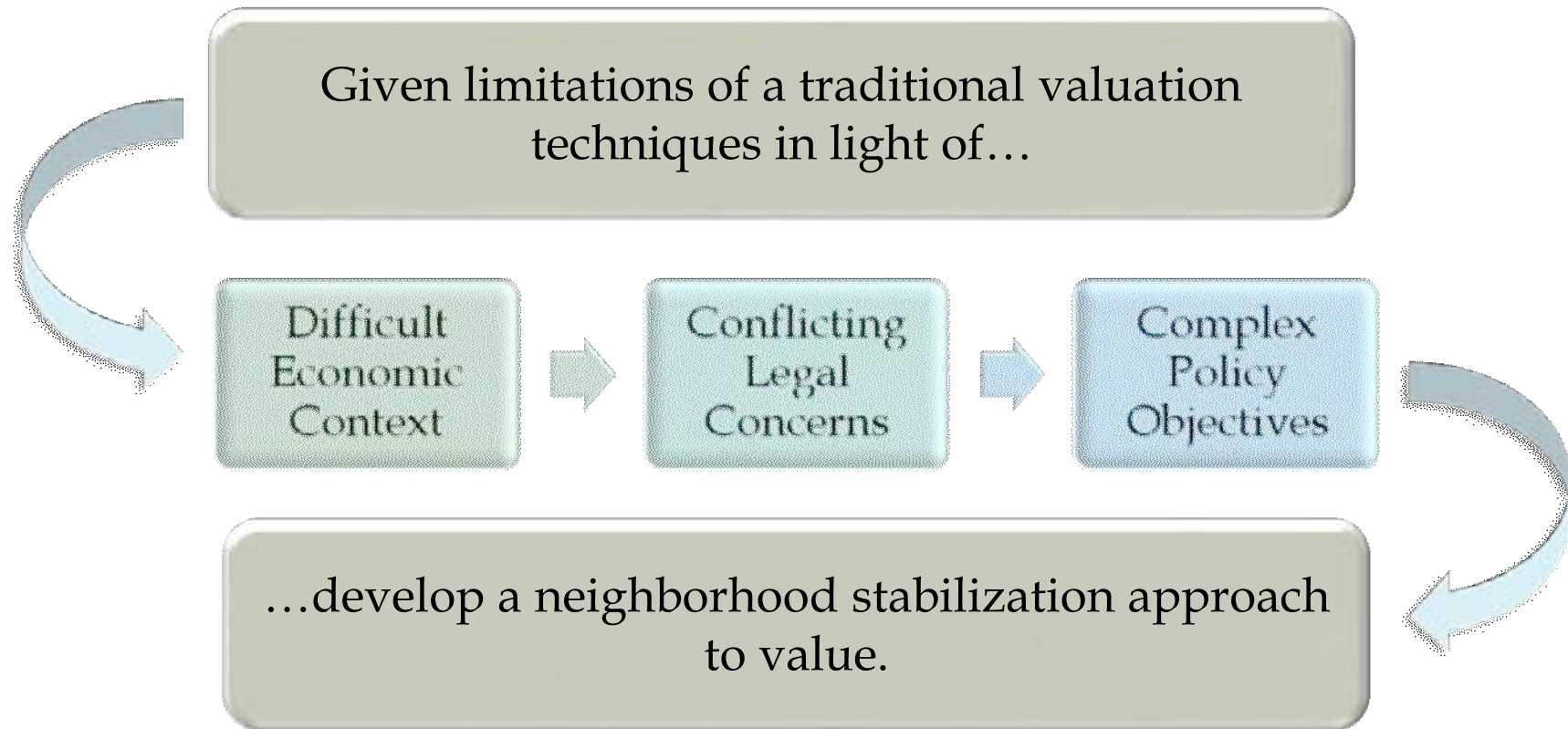
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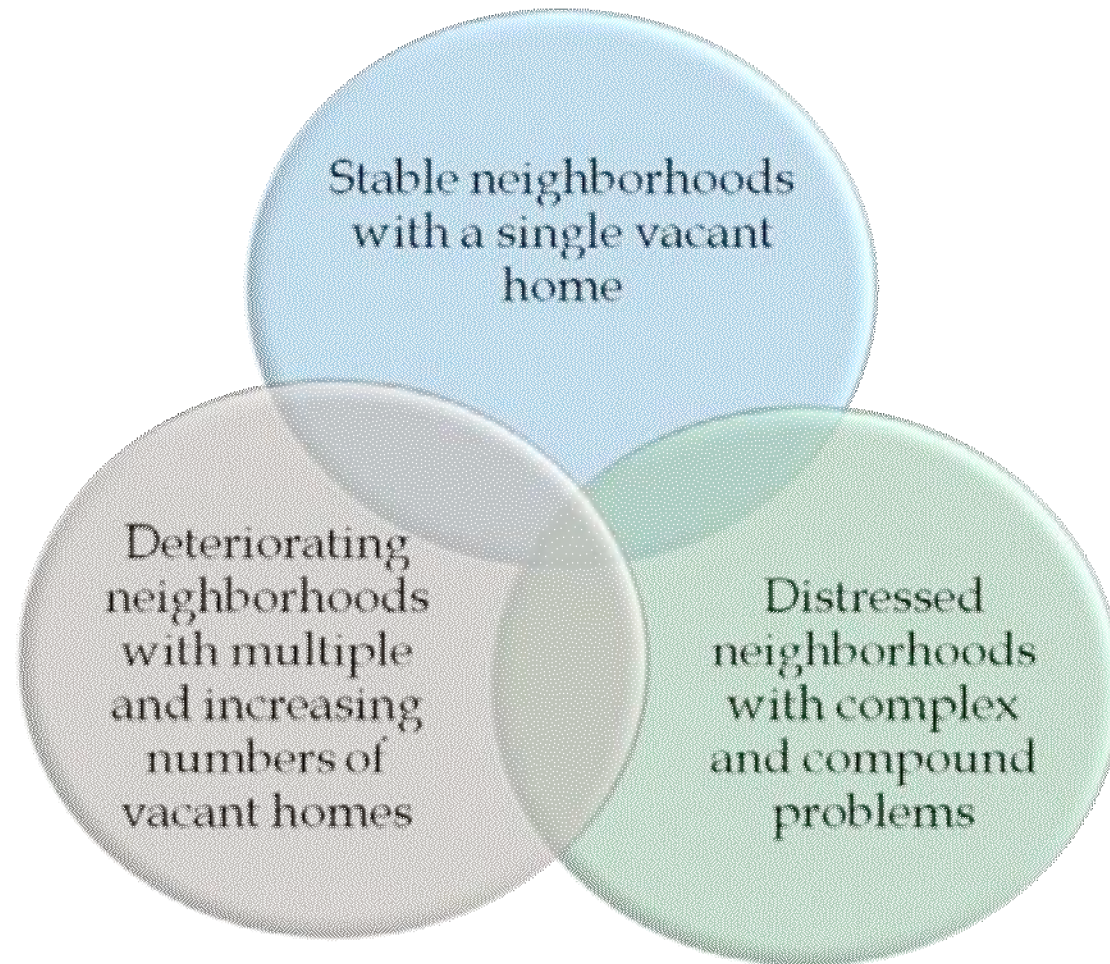
The National Community Stabilization Trust

John H. Vogel, Jr., Adjunct Professor, Tuck School of Business, Dartmouth University

Purpose of Presentation



Neighborhood Market Context



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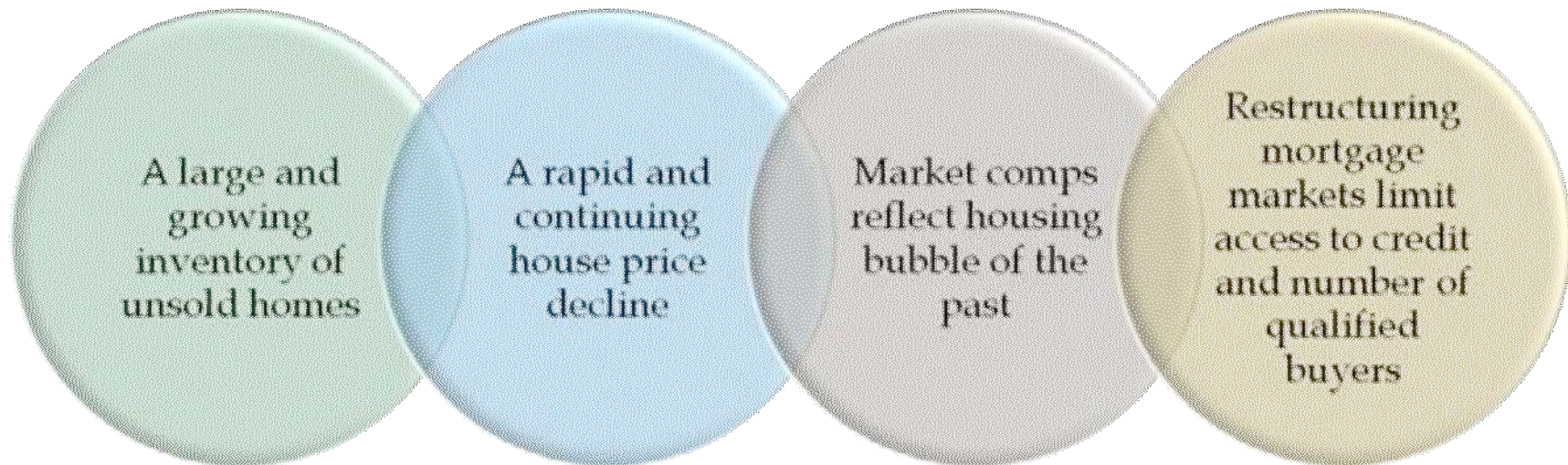
Valuation methods are distorted by unique economic circumstances affecting different regions

Areas of massive over-building

Areas with declining populations and limited effective demand

Areas where values are distorted by over-leverage and fraud

Macro economic conditions for vacant houses present significant problems in valuation



The market has evolved to include many different types of sellers with different constraints

Public and Quasi-Public Sellers

- FHA
- GSE's
- Secretary of Treasury under TARP

Private Sellers

- Bank-held portfolios
- Servicers on behalf of investors in non-securitized whole loans
- Servicers of securitized portfolios

Different Market Participants Have Different Perspectives on Valuation

Sellers

Disposition prices must be consistent with FIRREA requirements, appraisal standard and fiduciary obligations to investor
Key objective is maximizing value / minimizing losses in a declining market.

Buyers

Key objective is securing a fair price in a declining market where the buyer is purchasing the uncertain risk of market performance.

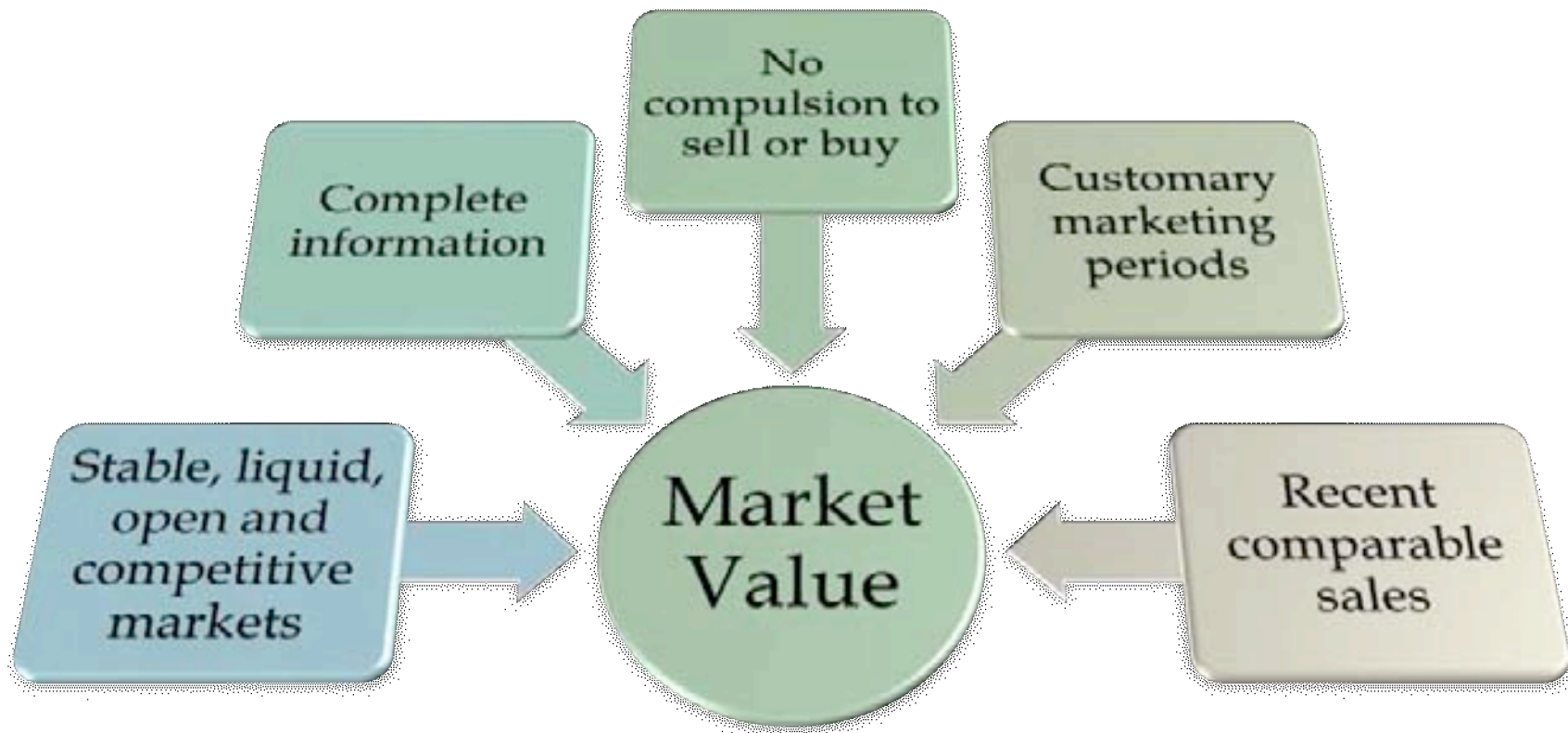
Private Philanthropies

Key objective to avoiding the moral hazard of using public and philanthropic resources to bail out private institutions.

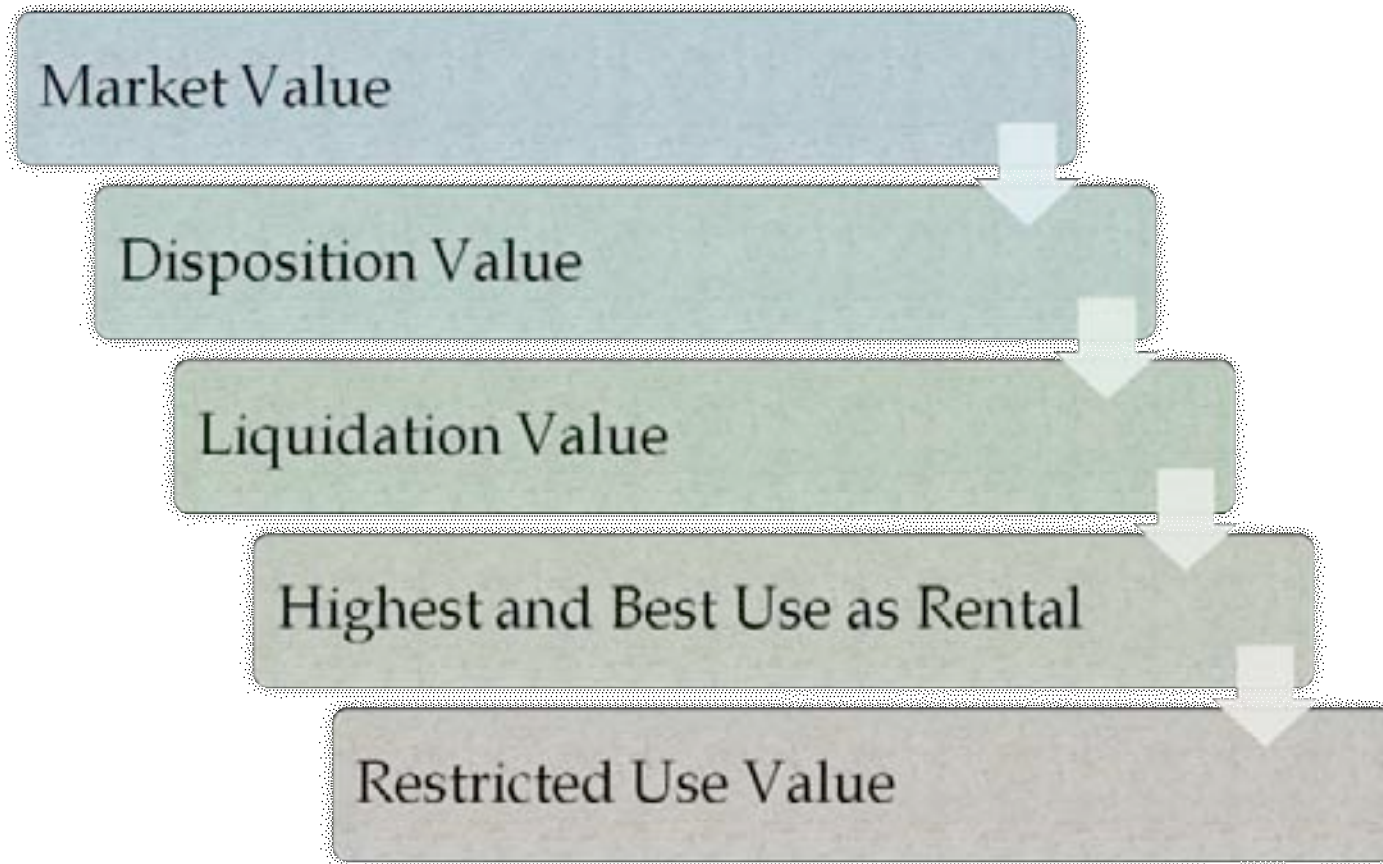
Government

Acquisition pricing must comply with the requirements of Housing and Economic Recovery Act of 2008.

Traditional single family valuation techniques are difficult to apply and are based on retrospective look at recent sales comparables



Alternative valuation approaches must be considered



Net Realizable Value (NRV)

- ▶ Market value minus the cost of disposition.
- ▶ The estimated selling price in the ordinary course of business less estimated costs of completion (to the stage of completion assumed in the determining the selling price), holding, and disposal. (FASB)

Source: *The Dictionary of Real Estate Appraisal*, 3rd Edition, The Appraisal Institute

Applying the Net Realizable Value Approach to Vacant Property

Estimated market value assuming normal market conditions and procedures through a BPO, an AVM or a full appraisal

Less Saved holding costs of insurance, real estate taxes and maintenance

Less Avoided transaction costs of brokerage and sellers internal supervision and administration

Less Savings in capital costs due to early receipt of proceeds

Less Possible decline in value over the holding period

Less Rehabilitation required for code compliance and marketing

Equals Net Realizable Value

Valuation Worksheet Example

Valuation Worksheet

Market Assumptions

Total Extended Time on Market	120 days	Extended time on market in excess of Seller/Service 30 day hold
Estimated House Price Appreciation/Depreciation	-1.00% per month	
Discount Rate / Interest Rate	10.00%	For the purposes of the NPV calculations.
Current Market Value	\$ 100,000	Either Seller/Service or Buyer commissioned appraisal.

Holding Cost Assumptions

Interest	10.00%	\$ (3,333)	Carrying Costs in excess of Seller/Service 30 day hold
House Price Appreciation/Depreciation (per month)		\$ (4,000)	Market fluctuations per local conditions
Real Estate Taxes	3.00%	\$ (1,000)	Payments necessary to keep property current
Insurance		\$ (1,000)	Payments necessary for appropriate insurance coverage
Maintenance		\$ (3,000)	Payments necessary to keep property sales ready
Interim Repairs		\$ (3,000)	Payments necessary for repairs prior to sale
Total Holding Costs Assumptions		\$ (15,333)	

Seller/Service Savings

Third Party Costs		\$ (1,000)	Miscellaneous additional third party costs
Administrative Costs		\$ (1,000)	Miscellaneous additional administrative Seller/Service costs
Brokerage Fee/Cost of Sale	6.00%	\$ (6,000)	
Seller/Service Savings of Interest on Protective Advances	0.00%	\$ -	
Total Seller/Service Savings		\$ (8,000)	

Total Adjustments	23%	\$ (23,333)
Net Realizable Value		\$ 76,667

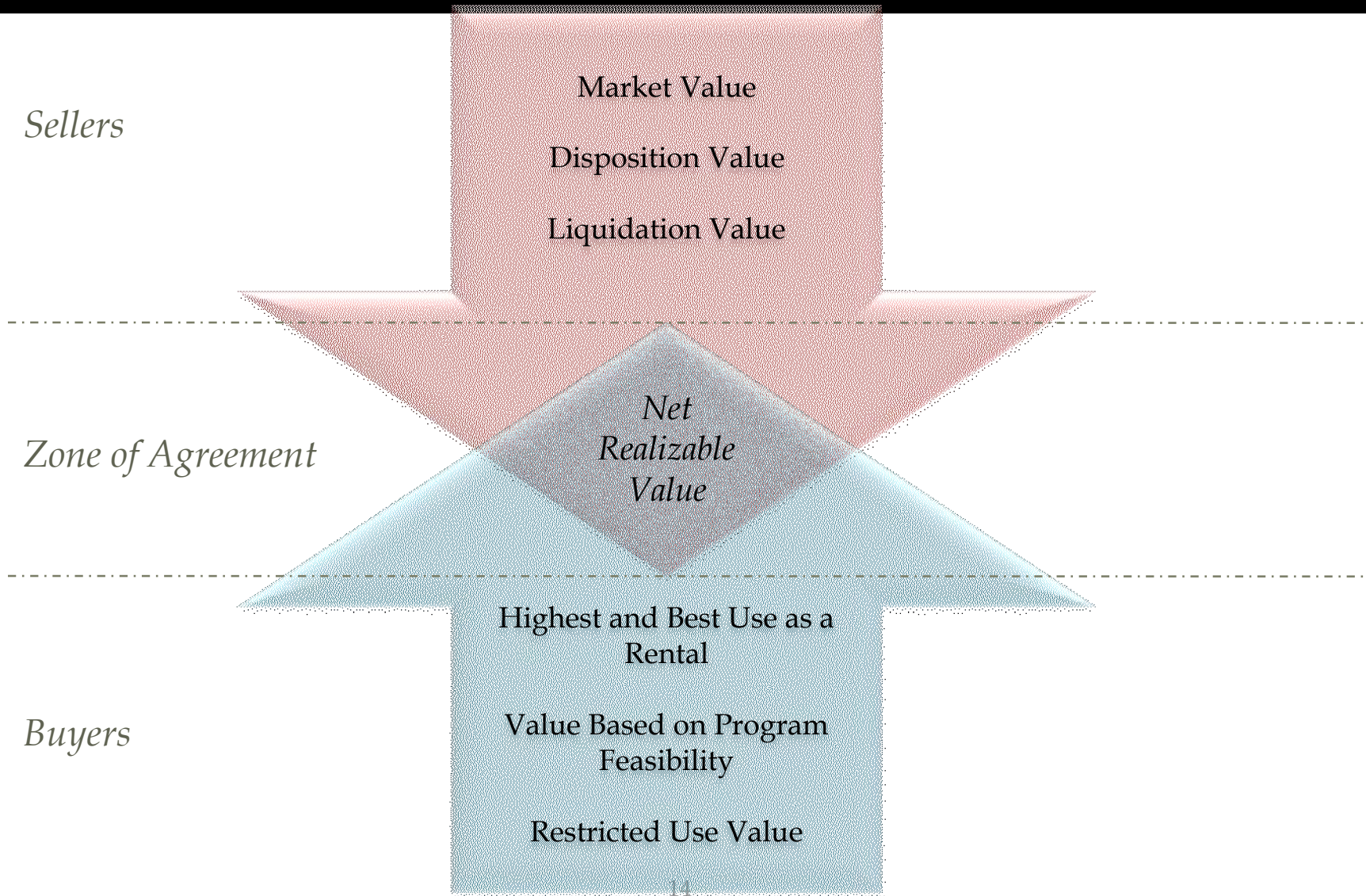
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Sensitivity Analysis Example

Sensitivity Analysis of Time on Market and Housing Price Appreciation/Depreciation on a Nominal Basis

		<i>Estimated House Price Appreciation/Depreciation</i>				
		-2.50%	-1.50%	-1.00%	0.00%	1.00%
<i>Estimated Time on Market to Closing</i>	60 days	22%	20%	19%	17%	15%
	90 days	26%	23%	21%	18%	15%
	120 days	29%	25%	23%	19%	15%
	150 days	33%	28%	25%	20%	15%
	180 days	37%	31%	28%	22%	16%

NRV Is a Roadmap to Price Agreement



Key Issues In Implementing the NRV Approach

- ▶ AVM's and BPO's have high error rates in declining and volatile markets
- ▶ Low and negative home values raise special issues
- ▶ There is an unintended consequence of resetting neighborhood comps to a lower level:
 - Trade off between having a vacant house on the block that depresses prices, versus
 - a new and current comp that establishes declining prices, versus
 - a renovated house re-occupied at an affordable price and subject to a regulatory restriction
- ▶ Using NRV results as “Seller's Adjustment to Price” may help mitigate downward market pressure resulting from lower sale prices

Benefits of NRV Approach

To Sellers

Avoids risk of market volatility

Avoids uncertainty of length of holding period

Saves out-of-pocket costs

To Buyers

Quicker price discovery and reduction of bid-ask spread between buyers and sellers

Reflects market risks and program feasibility concerns

Complies with requirements of the HERA of 2008

Conclusion

- ▶ NRV is an approach appropriate to neighborhood stabilization goals
- ▶ It balances the fiduciary responsibilities of Sellers with the programmatic needs of Buyers with a process that is speedy, open, transparent and
- ▶ Will result in vacant property coming to the market more quickly in a manner in which all parties benefit