Confronting the Neighborhood Impacts of Foreclosure

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

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Forsyth Street Advisors
The National Community Stabilization Trust
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Purpose of Presentation

Given limitations of a traditional valuation techniques in light of...

- Difficult Economic Context
- Conflicting Legal Concerns
- Complex Policy Objectives

...develop a neighborhood stabilization approach to value.
Neighborhood Market Context

Stable neighborhoods with a single vacant home

Deteriorating neighborhoods with multiple and increasing numbers of vacant homes

Distressed neighborhoods with complex and compound problems
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.

- A large and growing inventory of unsold homes
- A rapid and continuing house price decline
- Market comps reflect housing bubble of the past
- Restructuring mortgage markets limit access to credit and number of qualified buyers
The market has evolved to include many different types of sellers with different constraints.
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

- Market Value
- Disposition Value
- Liquidation Value
- Highest and Best Use as Rental
- Restricted Use Value
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)

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

### Nominal Basis

<table>
<thead>
<tr>
<th>Nominal Basis</th>
<th>Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Extended Time on Market</strong></td>
<td><strong>120 days</strong></td>
</tr>
<tr>
<td><strong>Estimated House Price Appreciation/Depreciation</strong></td>
<td><strong>-1.00% per month</strong></td>
</tr>
<tr>
<td><strong>Discount Rate / Interest Rate</strong></td>
<td><strong>10.00%</strong></td>
</tr>
<tr>
<td><strong>Current Market Value</strong></td>
<td><strong>$100,000</strong></td>
</tr>
<tr>
<td><strong>Extended time on market in excess of Seller/Servicer 30 day hold for the purposes of the NPV calculations.</strong></td>
<td></td>
</tr>
</tbody>
</table>

### Holding Cost Assumptions

<table>
<thead>
<tr>
<th>Holding Cost Assumptions</th>
<th>Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Interest</strong></td>
<td><strong>10.00% $3,333</strong></td>
</tr>
<tr>
<td><strong>House Price Appreciation/Depreciation (per month)</strong></td>
<td><strong>-1.00% $1,000</strong></td>
</tr>
<tr>
<td><strong>Real Estate Taxes</strong></td>
<td><strong>3.00% $1,000</strong></td>
</tr>
<tr>
<td><strong>Insurance</strong></td>
<td><strong>3.00% $1,000</strong></td>
</tr>
<tr>
<td><strong>Maintenance</strong></td>
<td><strong>3.00% $3,000</strong></td>
</tr>
<tr>
<td><strong>Interim Repairs</strong></td>
<td><strong>3.00% $3,000</strong></td>
</tr>
<tr>
<td><strong>Total Holding Costs Assumptions</strong></td>
<td><strong>$15,333</strong></td>
</tr>
</tbody>
</table>

### Seller/Servicer Savings

<table>
<thead>
<tr>
<th>Seller/Servicer Savings</th>
<th>Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Third Party Costs</strong></td>
<td><strong>$4,000</strong></td>
</tr>
<tr>
<td><strong>Administrative Costs</strong></td>
<td><strong>$1,000</strong></td>
</tr>
<tr>
<td><strong>Brokerage Fee/Cost of Sale</strong></td>
<td><strong>$6,000</strong></td>
</tr>
<tr>
<td><strong>Seller/Servicer Savings of Interest on Protective Advances</strong></td>
<td><strong>-0.00% $0</strong></td>
</tr>
<tr>
<td><strong>Total Seller/Servicer Savings</strong></td>
<td><strong>$8,000</strong></td>
</tr>
</tbody>
</table>

### Total Adjustments

<table>
<thead>
<tr>
<th>Total Adjustments</th>
<th>Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>23%</strong></td>
<td><strong>$23,333</strong></td>
</tr>
</tbody>
</table>

### Net Realizable Value

<table>
<thead>
<tr>
<th>Net Realizable Value</th>
<th>Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>$76,667</strong></td>
<td></td>
</tr>
</tbody>
</table>
### Sensitivity Analysis Example

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

<table>
<thead>
<tr>
<th>Estimated Time on Market to Closing</th>
<th>Estimated House Price Appreciation/Depreciation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>-2.50%</td>
</tr>
<tr>
<td>60 days</td>
<td>22%</td>
</tr>
<tr>
<td>90 days</td>
<td>26%</td>
</tr>
<tr>
<td>120 days</td>
<td>29%</td>
</tr>
<tr>
<td>150 days</td>
<td>33%</td>
</tr>
<tr>
<td>180 days</td>
<td>37%</td>
</tr>
</tbody>
</table>
NRV is a Roadmap to Price Agreement

Sellers

Market Value
Disposition Value
Liquidation Value

Zone of Agreement

Net Realizable Value

Buyers

Highest and Best Use as a Rental
Value Based on Program Feasibility
Restricted Use Value
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