



**FINANCE
NEW • YORK**
THE CITY OF NEW YORK
DEPARTMENT OF FINANCE

PROPERTY DIVISION

**INSTRUCTIONS TO ASSESSORS RESPONSIBLE FOR VALUING
COMMERCIAL, INDUSTRIAL, SPECIALTY/UTILITY, APARTMENT
BUILDINGS WITH MORE THAN 10 UNITS, AND BUILDINGS UNDER
CONSTRUCTION
FOR JANUARY 5, 2004 TENTATIVE ASSESSMENT ROLL**

GENERAL INFORMATION

REORGANIZATION

The Property Division personnel have been assigned to one of six teams. Five teams are responsible for valuing real property in the City of New York and the other team, Valuation Policy, sets policy with the Team Leaders. The Valuation Policy Group and Team Leaders will be responsible for ensuring that the policy is implemented. In addition, the Internal Audit Division, which reports to the Commissioner's Executive office, will randomly audit the Property Division's estimated values.

Each valuation team is responsible for specific types of property as described below:

- Commercial – office, stores and lofts;
- Residential – apartment buildings with more than ten units, including cooperatives and condominiums;
- Industrial – garages, hotels, theatres, factories and warehouses;
- Specialty / Utility – utility property such as switching equipment and generators and institutional properties such as nursing homes and places of public assembly;
- New Construction – buildings under construction, recently completed, or undergoing major renovation.

An Administrative Assessor/Team Leader manages each valuation team. Team Leaders oversee personnel in all five boroughs. Team Leaders will also have an office in Manhattan to facilitate communication with the Valuation Policy group. A Supervising Assessor is assigned to each borough to assist the Team Leader. In addition to providing day-to-day support for assessors, the Supervising Assessor is responsible for valuing property.

An Administrative Liaison will provide support for all personnel and oversee borough based Assistant Administrative Liaisons. These Assistant Administrative Liaisons will serve as Office Managers.

NEW COMPUTERS/ACCESS TO STATE-OF-THE-ART SOFTWARE

Each assessor has been provided with state of the art Dell computers with access to the Internet. This will enable you to run a newly created Geographical Information System (GIS) that is laden with critical data essential to the valuation process. Income, vacancy, and gross square footage are among the many variables loaded onto this GIS system. As a result, you will be able to view trends geographically, thus facilitating property valuation.

Internet access will also allow you to make use of soon to be purchased subscriptions to certain real estate reports and databases. These real estate database and analysis programs will allow you to study variables considered in the valuation of real property.

For example, CoStar has a complete building profile on over 10,000 office, retail and industrial properties. These profiles include rentable building area, average asking rents, building vacancies, listings of current leases, amount of space covered by each lease, lease expiration date, and office building class. Images and floor plans are included for almost all buildings. CoStar has an agreement with MapQuest, which enables the user to map all of their reports and searches, and view trends geographically. They also track buildings under construction, and provide percentage of pre-leased space. CoStar also tracks sales of a large variety of property types (commercial, industrial, and residential), providing gross income, expenses, sales price, down payment, building square footage, sales price per square foot, cap rate, # of tenants, and land square footage.

Reis Reports provides information for office, retail, and residential property both nationally and locally. Assessors can access information on rents, vacancies, new construction, sales prices, and capitalization rates. You can also compare local information with national information.

ASSESSOR RESPONSIBILITIES

The Property Division is responsible for producing a fair, accurate and legal assessment roll each year. Now, more than ever, it is extremely important that we are able to explain how we derive our values to the public. The Property Division staff must work cooperatively to produce a roll in which we can all take pride.

As you know, “market value” is the most probable sale price of a property in terms of money in a competitive and open market assuming that the buyer and seller are acting prudently and knowledgeably, allowing sufficient time for the sale, and assuming that the transaction is not affected by undue pressures. So, we’re trying to estimate the value that a reasonable buyer would pay a reasonable seller.

Assessors are responsible for valuing the properties in their assigned areas. This means you are responsible for assuring that:

- Properties are assigned to the correct building class and tax class;
- The physical characteristics of the building, including the square footage, are accurate; and
- Properties are valued in accordance with these guidelines and general appraisal rules.

It is extremely important that you document and use all of the information that is provided about each property. You must use these guidelines to value the properties assigned to you. Our value estimates must be consistent among different types of property and sections of the City and you must be able to explain them to your supervisors.

INFORMATION TO THE PUBLIC

This year, we are planning to include details about how each income producing property was valued in the Flack Notice that we send to the public in January. We will provide our income, expense and capitalization rate estimate. Thus, this critical information must be correctly entered into the CAMA system. Toward that end, we are working hard to develop a computerized version of the Property Valuation Document for your use. However, until it is produced, it is extremely important that you record information about your values in a clear and consistent manner so that we can extract the information into the real property assessment database.

Next year, we will provide all property owners with our valuation method. Homeowners will be told which model was used and utility owners will receive details about cost.

SQUARE FOOTAGE

It is important to understand what square footage information is being reported. As you know, properties are measured in several different ways. (See NY Times, Real Estate Section "Office Data: Many Players, Fuzzy Numbers" Sunday, April 20, 2003.) The measurement for commercial properties for example can be based on gross square footage, rentable square footage, or usable square footage. When arriving at vacancy rates, some estimates include sublease space while others do not. In the residential arena, while our database for residential properties is based primarily on square footage, most tenants and owners also look at whether the units are studios, one, two, or three bedrooms.

The "per square foot" income and expenses reported could vary greatly depending on which measurement system is being used. For example, an owner reporting income of \$40,000, would show income of \$40 per square foot for a 1,000 gross square foot building; \$44.44 for a building based on 900 rentable square feet; and \$53.33 per square foot for a building with 750 usable square feet. This is a variation of more than 33%. Therefore, you should make sure that you are using the same unit of comparison when valuing properties.

These guidelines are developed using gross square footage. The Department of Finance uses gross square footage in its measurements of all buildings because it is the most easily verifiable. However, this means that our income figures are generally lower per square foot than the real estate industry, which typically uses rentable or usable square footage. Please note that the market asking rents for office space have been converted to gross square footage this year, and as such appear lower. We converted the market asking rents by using an efficiency ratio (rental area divided by the gross area) of 85%. For example, if you estimate the efficiency ratio to be 85% and the rent published is \$50 per rentable square foot, our guidelines would show a gross rent per square foot of

\$42.50. ($\$50 \times .85 = \42.50). There are some buildings in the City with lower efficiency ratios (70 to 75%) and the variation for those buildings could be much greater. This year's guideline adjustments for market rent are based on an 85% efficiency ratio for Class A office space, and an 80% efficiency ratio for Class B office space.

Next year, we will be working to improve our square footage estimates.

CHANGE IN VALUES

Our goal for this season is to reflect market value as we see it and based on these guidelines. In December, the Valuation Policy team will review reports to determine if market value changes will unfairly impact any major property type. If necessary, the senior Property Division team will recommend that the Commissioner adjust the capitalization rates.

FIELD INSPECTION INSTRUCTIONS

We expect that Commercial, Residential, Industrial, and Specialty team assessors have already conducted field inspections of their assigned properties. Assessors assigned to the New Construction team will be expected to conduct field inspections throughout the valuation season as needed. All assessors should use the following guide when conducting field inspections.

- Document the inspection date of the property and the names of the person or persons who provided information and their relationship to the property.
- Observe and inquire about occupancy.
- Inquire about leases, lease terms, and rents if that information is not already provided in an addendum.
- Observe overall condition. We will provide you with information about Building Department work permits. In addition, we are working with Hunter College to identify physical changes that may not have been reported to the Building Department.
- Verify square footage if our information seems grossly inaccurate. We are also working with Hunter College to identify buildings where the structure varies from our gross square footage information.
- Verify building class and use.

Overall state of the Market

As you know, two major forces impact property values. Sales, which are a measure of the properties potential income stream, and leases/rents and vacancies, which are a measure of a properties ability to sustain its current income stream. Both forces must be studied in a market analysis in order to determine the proper capitalization rates that will be used to calculate full market value.

Several publications have noted that 2003 has thus far been a period characterized by high investment demand for all types of real estate. The national and local commercial and residential real estate markets have been a magnet for investors that are dissatisfied with stock market losses and low rates of return, and seeking to capitalize on low mortgage rates and the promise of slow but steadily improving real property generated income streams. This demand has resulted in sales prices that are increasing.

Interestingly, the vacancy rates have been rising and the combined glut of direct lease and sublease space has done little to stem the tide of investors. It's clear that investors are willing to settle for lower equity returns especially given the returns in the stock and bond markets. Real estate has proven again to be a safe and almost guaranteed investment vehicle.

Some recent acquisitions seem to support this theory. The \$1.4 billion dollar GM building sale serves as a case in point. The \$700 per square foot sales price seemed attractive because it is considered a trophy or flagship building and this would bring considerable prestige to the investor. The sale of 52 Hanover Square, and its owners plans for renovations, shows investors confidence in the long term recovery of the real estate market and the belief that they will be able ride out the initial instability and see the increased returns in the more distant future.

State of the Office Market

While the national office market is the weakest of real estate investment markets due to high vacancy rates and an overabundance of sub-lease space that combine to keep direct lease rates favorable to the tenant, thus diminishing returns, the Manhattan office market remains relatively strong and is still enjoying its status as a magnet for investments. This is not to say that the New York City office market has fully recovered from the effects following September 11, but the negative net absorption rates have decreased overall, and it is largely felt that the economic downturn will not get any worse. Until recently, vacancy rates, which are a measure of supply and demand, have been steadily increasing in New York City since September 11 as a result of the number of companies who have talked about relocating. Increasing unemployment levels due to diminished corporate returns during this past period of recession has also had a negative impact on vacancy rates, as companies need less space because of a smaller workforce. The resulting increase in both direct lease and sublease space as tenants either opted not to renew or moved abruptly before the end of the lease term turned the leasing advantage away from property owners towards the lessees and sub-lessees. Free rent, work letters and other tenant accommodations are now the norm—it's a tenant's market.

Earlier this year, sublease space accounted for 35% of the total available space in Midtown but today it accounts for 30%. Many predict that a good indicator of recovery in the office market will be when the percentage of available sublease space to overall available space approaches the 2000 figure of 18% when the office market was at its strongest. Another marker of the beginning of the office market recovery is that actual rents as a percentage of asking rent actually increased from 2002 to 2003 in various business districts. In Midtown, the ratio of actual rents to asking rents went from 85 to 88% and in Midtown South; actual rents to asking rents went from 77 to almost 86% for the aforementioned time periods.

We believe the second quarter of 2003 marks the beginning of what we hope will be a turnaround in the Manhattan Office market with the first reduction in overall office vacancy rates. The recent mega sales of Class A Office buildings also support the view that the New York City Office market is about to embark on a period of positive economic growth.

Developing Capitalization Rates for the Office Market

Sales: Valuation Policy has analyzed 81 office sales that occurred during the period January 2000 to July 2003. The selling price range for Manhattan Class A office buildings is \$219 to \$695 per gross square foot not including the \$774 per gross square foot for the GM Building. The highest price per gross square foot, \$695, was for 399 Park Avenue. The Class B sales range from \$77 to \$409 per gross square foot. We will continue to monitor sales until the roll is released and will provide you with updated information on a regular basis.

We reviewed these sales to better understand sales price capitalization rates. These sales show capitalization rates ranging from as low as -1.21 to as high as 10.80%.

While these fall out capitalization rates were instructive, we nonetheless developed our capitalization rates as we do every year. We used a modified Ellwood method. As you know, Ellwood requires that we estimate several factors including:

- Mortgage/Equity Ratios
- Interest Rate
- Mortgage Term
- Equity Return
- Holding Period

We determine the equity return for investors by building up a return rate from a safe investment such as a treasury note. We add additional basis points on to the safe investment vehicle rate note to adjust for what a property investor might expect. We add basis points for management costs, illiquidity, and risk. Our Manhattan base capitalization rates for Class A and B office buildings range from 7.75 to 12.75%.

Valuation Policy used market reports including Korpacz Real Estate Investor Survey published by Price Water House Coopers; Commercial Mortgage Commitments published by American Council of Life Insurers; RealtyRates Investor Surveys published by RealtyRates.com; and Real Estate Outlook published by Cushman & Wakefield and the Appraisal Institute to develop these capitalization rates.

As you know the Ellwood capitalization rate method, which we use, requires that we estimate mortgage ratios, holding periods, interest rates, and equity return. We did not estimate appreciation or depreciation this year because it is largely thought that these are subjective variables. Our assumptions for each office building class are included in the addendum.

Vacancy Rates

In addition, we wanted to have the most up-to-date information about vacancy rates. We relied on Colliers ABR reports. Tax Policy provides information about the real estate market monthly as does OMB and the Comptroller's office. Vacancy rates as of August 2003 are included in the guidelines and we will send you a monthly update through December.

VALUING OFFICE BUILDINGS

Given the limited number of sales of commercial properties and the complex and unique details underlying the financing of some of the properties that did sell, you are required to estimate commercial property values using the income approach. As you know, the income approach requires that we estimate the income and expenses of a property and capitalize the net income to arrive at an estimated market value as of January 5, 2004.

The primary source for our income and expense estimates is Real Property Income and Expense (RPIE) and Tax Commission Income and Expense (TCIE) statements. These statements typically reflect income and expenses for calendar or fiscal year 2002. Therefore, in order to estimate a value as of January 5, 2004, this information must be updated. It is extremely important that you follow these guidelines when updating information.

Income

Unless you believe the owner has underreported income, you should use the income information that the owner provided to value the property. When analyzing the income of a property, there are several things that you should consider.

- First, how does the income reported compare to the average income for buildings of its type and age and the market asking rent as adjusted based on the efficiency ratio.
- Second, did the owner report any income that should not be included such as interest income and real estate tax refunds.
- Third, if the income is above average, does it reflect leases written when the market was higher or an above average occupancy rate. If the income is below market, does it reflect an above average vacancy rate or very old leases.
- Fourth, what if any concessions are being offered. Owners are offering free rent for various periods along with work letters. Assessors must factor in this free rent in their income computation and prorate the cost of tenant improvements (work letters), over the lease term, as part of the operating expense. Along this line, assessors must adjust existing tenant improvement and leasing expense to 6.67% of the effective gross income for the property. This will recapture 100% of the leasing and tenant improvement costs over a period of 15 years.

Expenses

Unless you believe the owner has overstated expenses, you should use the expense information that the owner provided to value the property. You must analyze the expenses that are reported.

- First you should only include allowable expenses. Because we are valuing property free and clear of all encumbrances, mortgage interest is not an appropriate expense for valuation purposes. In addition, other expenses such as depreciation, ground rent and corporate or partnership taxes should not be included.
- Second, owners often report some expenses that they incur in one year when those expenses should be amortized over the life of the lease. If the owner has reported expenses that should be amortized, you should assume a 15 -year lease term.
- Third, assessors should remove non-real estate expense items from the miscellaneous expense category and reallocate legitimate real estate expense to

other appropriate categories. In any case, the miscellaneous expenses you use should not exceed 2% of the estimated gross income.

- Fourth, you should provide an allowance for expenses that are not reported. Management and Administration for example should be adjusted to or included as 1.5% to 3% of gross income.

Selecting a Capitalization Rate

After you have analyzed income and expenses to arrive at a net income, the next task is to select a capitalization rate. The capitalization rate should be selected based on your analysis of the building compared to other similar buildings, based on your analysis of the income and expenses, and based on your review of the guideline ranges. You should not account for below market leases by changing the reported income. Instead, you should adjust the capitalization rate within the guidelines to account for these differences.

For your convenience, we are providing specific instructions for how we want you to select a capitalization rate for different valuation scenarios. It is very important that you follow these instructions.

The examples below focus on income and expense statements that submitted for the year 2002. These statements are reviewed and updated to project an income and expense for 2003. During the course of the year, the rental of large segments of vacant space will have a profound positive effect on the income stream for 2003. Consequently, space becoming vacant during the course of the year may have a negative effect on the income. Assessors must monitor the rental market of their assigned areas so that they will be aware of major changes in the occupancy levels of properties within their portfolio. Addenda filed with some of the RPIEs provide pertinent information concerning expiration of lease terms.

Conditions I—Choosing a Capitalization Rate for Buildings with Typical Occupancy

The following buildings are located in an area with an income range from \$38.00 - \$73.00 per gross square foot, and the market rent at \$56.00 per gross square foot. The capitalization rate range is 7.75% - 10.05%, with the market rate at 9.00%. The buildings do not have significant vacancies.

- a) The first office building is receiving a market gross income of \$56.15 per square foot.
 - Update the income by the percentage listed on the guidelines.
 - Update expense according to the guidelines after reviewing for non-related real estate expense.
 - Select the market capitalization rate because the income is at market. (9.00%).
- b) The second office building is receiving above market gross income of \$68.50 per square foot.
 - In this case, update the income by the percentage listed on the guidelines.
 - Update expense according to the guidelines after reviewing for non-related real estate expense.
 - Since the income is at the high end of the income range, and might not be able to be sustained at this level over time, use the cap rate at the high end of the

cap rate range to compensate for the inherent risk in having above market leases. In this case, a rate of 9.82%.

- c) The third office building is only commanding a below market income of \$38 per gross square foot.
- Although the income is below market rent, update the income by the amount on the guidelines.
 - Update expense according to the guidelines after reviewing for non-related real estate expense.
 - Since the income is at the low end of the income range, and will most probably increase towards the market standards as leases are renewed, use the cap rate at the low end of the cap rate range to account for the possibility of positive economic growth. In this case, a rate of 7.75%.

Condition II—Choosing A Capitalization Rate for Buildings with Extraordinary Vacancy

The procedure for determining value in buildings with extraordinary vacancy rates is a multi-step process. Unless the reported or observed vacancy rate exceeds 1.5 times the neighborhood vacancy rate in the guidelines category, you are required to use the reported income in valuing the property. For example, if the guidelines indicate that the vacancy rate is 12% then you should use the reported income unless the vacancy rate is more than 18%. Once vacancy rates exceed 1.5 times the neighborhood vacancy rate, you will be required to build up the excess vacant space at market rent levels. First, update actual income by the instructions on the guidelines. In the case of vacancy rates in excess of 1.5 times the neighborhood rate, determine the space to be added back using the market rent. Add this dollar figure to the updated actual income and divide it by the gross square footage. Use this income per square foot to aid you in selecting a capitalization rate.

The examples below illustrate the Departments policies that should be followed when valuing parcels with vacancy rates in excess of 1.5 times the neighborhood rate.

- a) This 100,000 square foot class A office building is located in Midtown South. The income range is \$21.15 - \$42.50 per gross square foot, with a market income of \$33.15. The capitalization rate range is 8.45% - 10.75% with a market rate of 9.75%. The market vacancy rate is 7.5%. This building is receiving income of \$36.00 per gross square foot on 79% of its space. This building has an above average vacancy rate of 21%.
- Occupancy is at 79% (calculation: $.79 * 100,000 = 79,000$)
 - Neighborhood vacancy level is 7.5%.
 - Allowable vacancy for the neighborhood is 11.25% (calculation: $7.5 \% * 1.5 = 11.25\%$).
 - Building vacancy is 21%.
 - The percentage of space for which income must be added is 9.75% (calculation: $21\% - 11.25\% = 9.75\%$).
 - Determine total square footage to be added back at market income (calculation: $100,000 * 9.75\% = 9,750$ sq ft.).

- The rent for this space should be calculated and added back (calculation: $9,750 * \$33.15 = \$323,212.50$).
 - The reported income is \$2,844,000 (calculation: $79,000 * \$36.00 = \$2,844,000$).
 - This income should be updated according to the guidelines (calculation: $2,844,000 * 1.02 = \$2,900,880.00$).
 - The total adjusted effective gross income is the updated reported income plus the rent for the space to be added back (calculation: $\$323,212.50 + \$2,900,880.00 = \$3,224,093.00$).
 - The rent per square foot to be used to select a capitalization rate is \$32.24 (calculation: $\$3,224,093/100,000$). Select a capitalization rate of 9.53%, which is slightly lower than the market capitalization rate (see sliding scales).
 - Update the expenses according to the guidelines after reviewing for non-related real estate expense. The expenses must be consistent with the expense guidelines.
- b) The 100,000 square foot class B office building is located in the Downtown Finance/World Trade Center. The income range is \$19.35 - \$35.25 per gross square foot with a market income of \$30.10. The capitalization rate range is 9.35% - 12.00% with a market rate of 11.00%. The market vacancy rate is 12%. This building is receiving income of \$25.00 for 68% of its space. This building has an above average vacancy rate of 32%.
- Occupancy is 68% (calculation: $.68 * 100,000 = 68,000$).
 - Neighborhood vacancy level is 12%.
 - Allowable vacancy for the neighborhood is 18% (calculation: $12% * 1.5 = 18%$).
 - The building vacancy is 32%.
 - The percentage of space for which income must be added back is 14% (calculation: $32% - 18% = 14%$).
 - Determine the total square footage to be added back at market income (calculation: $100,000 * 14% = 14,000$).
 - The rent for the space should be calculated and added back (calculation: $14,000 * \$30.10 = \$421,400$).
 - The reported income is \$1,700,000 (calculation: $68,000 * \$25.00$).
 - **Do not update the current income** of \$1,700,000 because this is a Class B property.
 - The total adjusted effective gross income is the updated reported income plus the rent for the space to be added back (calculation: $\$1,700,000 + \$421,400 = \$2,121,400$).
 - The rent per square foot to be used to select the capitalization rate is \$21.21 ($\$2,121,400/100,000 = \21.21). Select a capitalization rate of 9.68%, which is slightly above the lowest capitalization rate for this neighborhood (see sliding scales).
 - Update the expenses according to the guidelines after reviewing for non-related real estate expense. The expenses must be consistent with the expense guidelines.

This formula for building back vacancy in excess of 1.5 times the neighborhood vacancy rate should be used in all cases in which a percentage of the building is occupied, and any partial income is reported. In cases of vacancy greater than 1.5 times the neighborhood vacancy rate, but less than 50% of the gross space, use market income to build back the excess vacancy. However, in cases of vacancy greater than or equal to 50% of the gross space, you are directed to build back the excess vacancy using the low end of the income guidelines. In situations in which a building is 100% vacant (i.e. Bankers Trust in the World Trade Center Zone), you are instructed to use the replacement cost new approach to develop an improvement value. Then depreciation should be subtracted from this figure leaving only 20% salvage value. This depreciated improvement value should be added to the land value to generate a full market value for the entire property. See the following example:

- a) A 500,000 square foot building has been deemed economically obsolete. Use our internal cost guidelines, which are based on Marshall and Swift, to determine the replacement cost new for the improvement (calculation: $500,000 \times \$300.00 = \$150,000,000$). This new figure should be multiplied by 20% (salvage value) resulting in an improvement value of \$30,000,000. The land value should be added to this figure to generate a total value.

Special Valuation Scenarios

- a) A 350,000 square foot office building leased 50,000 square feet at \$40.00 per square foot for a period of 10 years. After leasing this 50,000 sq. ft. as of January 1, 2003, the building is currently 10% vacant. The new tenant will receive 6 months free rent. The 2002 income is \$29.10, based on 265,000 sq. ft.
- Calculate the effective yearly income for this new space (calculation: $6/120 = 5\%$; use $1.00 - .05 = .95$ or 95.0%; rent for year = $50,000 \times \$40.00 = \$2,000,000 \times 95.0\% = \$1,900,000$).
 - Update the existing rent and add rent for this new space. The income of \$7,711,500 is updated by 2%. The new rent with the effective income for 2003 is \$1,900,000. Total new rent is \$9,765,730 or \$27.90 psf ($\$9,765,730 / 350,000$).
 - Adjust your expense to factor in the new space rented on January 1, 2003. Use your guidelines for assistance.
 - Since the rented space is at \$27.90 psf. (see sliding scales), use an above market capitalization rate of 9.10%.

A building has a new lease that includes a work letter (tenant improvements). This year the Property Division is allowing 6.67% of the effective gross income for leasing and tenant improvements. These expenditures are spread over the life of a lease; therefore the Division has adopted the following procedure to account for this adjustment. Even if this expenditure and leasing cost add up to only 5% of the effective gross income, the assessor should use 6.67%, the standardized amount. Similarly, if these expenditures exceed 6.67%, they will be reduced to the standardized amount. See the example below which illustrates the way in which to prorate tenant improvement over the course of the lease.

- b) A 150,000 sq. ft. building has a new lease that includes a work letter (tenant improvement). The assumptions that follow are that 150,000 sq. ft. leased for 15 years; the work letter is for \$40.00 psf.; the space leased for \$55.00 psf.
- Calculation: prorate \$40.00 over 15 years = \$2.67 psf. Use this knowledge **solely** as a justification for allowing a 6.67% adjustment to gross income to cover leasing expense and tenant improvements regardless of the expense amount submitted by the owner.
 - Update expense according to the guidelines after reviewing for non-related real estate expense.
 - Select capitalization rate.

Special Valuation Circumstances

Owner-occupied properties

Use estimated income from comparable buildings, actual leases or the guidelines. Typical leased commercial buildings will have a mix of tenants over time and will usually not collect market rent throughout the building except for short periods. Your rental estimates for owner-occupied buildings should reflect the same pattern. Ascribe a vacancy rate similar to comparable buildings in the area to arrive at an estimated effective gross income.

Generally, income estimates for owner-occupied properties should keep pace, but not exceed growth in market effective rents for similar properties. If the prior year's estimate was significantly below or above your current estimate, review the case with your supervisor. There is no artificial restriction on how much your value may increase or decrease provided your estimates are well founded.

Where a building is owner-occupied, use comparable expense from similar type properties. In other cases, there will be properties that are partially owner-occupied, again look to comparable properties for your estimate of expense. After selecting the comparable expense, compare with the appropriate guidelines to confirm the accuracy of your estimate.

Loft Type Building

A loft type building is, by definition, a building built prior to 1930 for commercial and/or manufacturing use with ceilings 14 feet or higher. It is, or at one time was, occupied by manufacturing tenants. Typical tenants are clothing designers/manufacturers, jewelers, storage/filing, recording/TV studios and any combination of mixed uses including office and residential.

A loft-office is loft space that has been converted to office use due to the decline in manufacturing within the city. Although they may function well as back office space, they tend to lack the amenities found in a typical office building. For example, some deficiencies include:

- Small, slow elevators.
- Small lobbies.
- Dated electrical and/or communication service (except for dotcom buildings).
- Inefficient HVAC due to equipment age, building design and ceiling height.

- Dated building fixtures (plumbing, windows, etc.).

During the 1990's, many loft buildings were converted to residential or office/dotcom use. Loft-offices typically will have a higher rent than a normal loft building due to additional amenities. However, care should be taken in reviewing the supplied rent since these buildings are most vulnerable to the decline in asking rents and vacancies. Lofts that have been converted to residential use should have their building class changed to D5 (Converted Elevator Apartments) or C5 (Converted Walk-up Apartments) and valued using residential guidelines.

Some smaller buildings may have a loft building class (due to use), assessors must closely examine the use to determine if these properties are better classified as a K9 – miscellaneous store or K4 – stores with apartments above.

The loft guidelines provided by the Department of Finance are designed for buildings with mixed-uses. Loft space continues to undergo major changes in the borough of Manhattan. Assessors must pay attention to the information on the Tax Commission Application for Correction and the Real Property Income and Expense form. Generally, the owners provide information on the occupancy of the space and coupled with rents per square foot that is similar to a class B building should lead assessors to investigate the actual use. Where there is adequate reason to indicate that the building class should change, request an inspection and afterwards make the appropriate change if required.

Finally, the price per square foot of loft buildings sold in the last 3 years range as follows:

- Midtown West: \$96 - \$213/Sq. Ft.
- Fashion/Javits Center: \$58 - \$184/ Sq. Ft.
- Chelsea/Flatiron/Gramercy/Murray Hill: \$69 - \$267/Sq. Ft.
- Below 14th Street: \$53 - \$230/Sq. Ft.
- Boroughs: \$32 - \$103/Sq. Ft.

Trophy Buildings

As you know certain Manhattan buildings are considered trophy properties. Among the trophy properties are: The GM building, 399 Park Ave, Rockefeller Center etc. A full list of the buildings that we consider trophies can be found in the addendum.

The characteristics of trophy properties are:

- Unique–limited supply (one-of-a-kind);
- Quality–investment grade;
- Price–investment grade and limited supply within upper end of price range;
- Size–500,000 square feet and over;
- Location – prime location in the central business district;
- Height–30 stories or higher;
- Rent–exceeds market rents of class A office buildings.

Assessors cannot allow vacancy to exceed the neighborhood vacancy rate. These properties command higher rents than the rents of most class A properties. In addition, sales of trophy properties far exceed market average sale price for class A office

buildings. Valuation Policy has provided a new section of the guidelines to assist you in the rate selection process for these properties.

World Trade Center Zone

The World Trade Center Zone was originally created following the terrorist attacks of September 11, 2001 to recognize the unique problems that arose that made it difficult for property owners to maintain a steady income stream. Unfortunately, the area closely surrounding Ground Zero is still experiencing higher vacancy rates, and is actually undergoing a volatile transition from a commercial to a burgeoning residential neighborhood. This situation has continued the need for special consideration. As a result, the World Trade Center Zone will be added to the guidelines this year as its own business district. The boundaries of the World Trade Center Zone (WTCZ) for the 2004/05 assessment roll are: South by Rector Street, East by Broadway, North by Chambers Street, West by West Street and including all properties facing on Chamber Street, Rector Street and Broadway. A map of this area has been included in the addendum. The World Financial Center has been removed from this special zone because it has shown evidence of economic stability and growth during the past year.

State of the Retail Market

The retail market remains strong both nationally and locally. Within the city, retail strips continue to show low vacancies and high asking rent per square foot as demand for space remains high. Average asking rent for all retail space increased 3.5% in Manhattan. Furthermore, average asking rent increased by 4.9% for all major retail strips located in Manhattan. The flagship retail strips of Madison Avenue from 57th – 67th St. and Fifth Avenue from 48th – 59th St. showed dramatic increases in average asking rents from \$491.00 and \$530.00 in 2002 to \$676.00 and \$646.00 respectively. The high pedestrian traffic within the city remains the draw. Also, the increase in residential properties surrounding these areas will further increase these traffic levels leading to long term increases in asking rents. Consequently, these well-located properties continue to draw attention from the real estate investment sector. (REBNY Retail Report Spring 2003: Crains NY 9/03)

While the premier strips are relatively thriving, not every strip is as actively vibrant. Midtown South (Canal St. to 30th St.) and Downtown (South of Canal St.) saw average asking rent for all space decline by 1.5%. Hudson Street in Tribeca had a 1.6% decline and Broadway in Lower Manhattan had a 7.4% decline. These declines suggest the continuing struggle in these areas to recover from September 11. A recent survey of the area by Planning and Review indicated a vacancy rate of about 25% for ground floor retail.

Sales Price per square foot ranges for ground floor retail space

Lower Manhattan (South of Canal Street):	\$475 to \$884
North of Canal Street to 110 th Street:	\$330 to \$1475
North of 110 th Street:	\$147 to \$396

The Boroughs

In general, retail activity in the boroughs is just as negatively affected as it is in Manhattan by continued fall out from September 11 and an uncertain economy. While

statistics are not readily available for the boroughs, it is reasonable to expect that the primary retail corridors will hold their own and stores will do reasonably well. Conversely, it is expected that in the secondary and tertiary retail strips rents will be negatively affected and activity will not be as robust as consumers exercise caution in their spending habits.

Major retail activity appears to revolve around the development of new upscale malls and the expansion of existing shopping centers. The main activity is in Brooklyn and Queens and joins with the established malls in Staten Island and the Bronx to signal an energetic trend in retail activity for the future. Encouraged by reports of high sales per sq.ft., retailers such as Target, Gap, Walmart, JC Penney and Sears are opening more branches in Brooklyn and Queens.

In Brooklyn, the recently built Gateway mall is thriving. The downtown Fulton Street Mall – formerly Albee Square – is in the process of being transformed into a gleaming shopping destination, undergoing a \$400 million renovation. Another new shopping emporium is Atlantic Terminal Center at Flatbush Ave with 373,000 sq.ft. being developed. It is projected to be opened in March 2004 and will be anchored by Target. It will be an extension of Atlantic Center, which has tenants like Old Navy and Marshalls.

In Queens, Jamaica Center, a year old 200,000 sq.ft. project with a Gap and Walgreens, is one of several new outlets already serving the inner city market. Another development is the Queens Center, a bigger, bustling mall with a JC Penney, Victoria's Secret and Macys. It currently sees so much traffic that it will expand to approximately one million sq.ft., with as many as 100 new stores by next year. In addition, a new 100,000 sq.ft. mall is being proposed for Main Street and 39th Avenue in Flushing.

Rents appear to be stable with no evidence of any major increases as the retail industry responds to the realities of an overall soft rental market.

The preferred method of valuing retail properties is by the income approach. In today's market a typical retail income and expense statement is usually a variation of or a simulation of a net lease arrangement, with a very low expense ratio or a net lease arrangement outright.

In cases where the income and expense statement is not a strict net lease the expense ratio is typically in the low teens to low twenties. It is unusual to find any expense ratio that is greater than 30% no matter what the lease structure is.

In selecting a base capitalization rate to convert net income into full market value, the assessor must use gross income as the factor that drives which capitalization rate is applied.

Triple Net Lease

Where there is a straight net lease, the assessor must “build up” the net lease amount to a gross income by adding the appropriate or additional expense and 2003 real estate tax. The guidelines provide a typical expense ratio factor at the low, median and high end of the income ranges. This should be used as a guide to select an appropriate expense factor

to add back to the net lease. After selecting the capitalization rate based on the “build-up” gross income, apply it to the net lease income exclusive of the effective tax rate.

Valuing Retail Properties

- (1) Analyze reported income
 - Remove unrelated real estate income
 - Add for owner occupied space
 - Add back for excess vacancy (up to market vacancy)
 - Effective Gross Income remains
- (2) Review Expense
 - Remove unrelated real estate items such as interest payments
 - Review management claim; allow up to 5%
 - Review repairs and maintenance; allow up to 6%
 - Review miscellaneous claim; allow up to 2.5%
 - Adjusted Expenses remains
- (3) Deduct Adjusted Expense from Effective Gross Income
- (4) Net Operating Income results
- (5) Select a Base Capitalization Rate from the appropriate guideline category using effective gross income per square foot as the factor that determines the rate
- (6) Enter the Effective Gross Income, Adjusted Expense, and Base Cap Rate on CAMA screen MASM 44

State of the Residential Real Estate Market

While there has been a significant amount of residential construction, most construction outside of Manhattan and north of 96th Street in Manhattan is built with government subsidy. The Housing Development Corporation and the Department of Housing Preservation and Development provide low interest loans and other financing to enable developers to construct low- and moderate-income housing. Under some HPD and HDC programs, more apartments are reserved for low and moderate-income families. There are also a number of instances where buildings constructed within Manhattan may be constructed as part of a special program as well.

80/20 Housing

In return for these government benefits, developers are required to assign at least 20% of the housing units to low and moderate-income families. These families do not pay market rents for their units. Assessors will compute the total rent of these buildings using the below market rents for the apartments used by these families as well as the market rents for the other units.

Within the last year, major residential groups have purchased portfolios of apartment buildings throughout the five boroughs, spending approximately \$300 million on 68 buildings. The capitalization rates computed, from these sales, range from 2% to 6% in Manhattan and 3.5% and 12% in the borough of Brooklyn.

The lower interest rates and the investment quality of apartments in New York City are generating these sales. This year our capitalization rates for residential buildings have declined somewhat to reflect the favorable market conditions.

State of the Residential Coop/Condo Market

The sales of coops and condominiums remain strong due to favorable interest rates on mortgages. This is enticing more residents to purchase apartments rather than rent. Sales prices increased for all sizes of units with less than three bedrooms while prices for larger coops and condominiums declined 7% and 5% respectively. Consequently, the flow of people into the coop/condo market from the rental market has led to a decrease in rents for similarly sized rental apartments. Average monthly rents dropped from \$3,268.00 in 2001 to \$3,108.00 in 2002. The smallest sized units showed the steepest declines with studio rents decreasing by 10% and one bedroom rents decreasing by 9% from 2001 to 2002. Another reason for the decline in residential rents is the constriction of the job market, which in turn reduces the demand for apartment rentals by newcomers seeking economic opportunity (Crains NY, 9/03).

Capitalization Rate Calculations

The residential rates are calculated using the Ellwood method. The mortgage ratio, selected for residential properties, ranges from 75/25 for the best areas of Manhattan to 20/80 for the lowest valued areas in the boroughs.

Our mortgage interest rates range from 5.75% to 8.00% (using a 5 year treasury note as a base) with the equity rates ranging from 5.50% to 12.35%.

We estimate a holding period of 5 - 10 years and mortgage term of 15 years, which is consistent with our data from the American Council of Life Insurers.

These factors conclude in a capitalization rate range of 7.58%, in the best neighborhoods in Manhattan, to 14.20% in walk-up apartments in the boroughs.

Apartment sales in Manhattan run from \$185 to \$418 per square foot for elevator apartments. The boroughs have walk-up apartments with sales of \$50 to \$132 per square foot. The elevator apartment sales in the boroughs come in at \$42 to \$84 per square foot. Market capitalization rates from these Manhattan sales indicate a range of 2% to 6%; and in the boroughs, the range is 3.50% to 12%.

RealtyRates.com Investor Survey reports in its third quarter that capitalization rates for all apartment types range from 6.03% to 13.34% for its Band of Investment Technique and 6.36% to 14.08% for its Survey Rates. National Investor Survey 2003, published by CB Richard Ellis, Inc. Valuation and Advisory Services supports a rate of 6.00% to 10.25% for their class A, B, and C buildings. These sources were used to derive our residential capitalization rate guidelines.

This year, in an effort to more properly categorize residential properties, and as a result more accurately value them, we have developed two complete sets of residential guidelines for the five boroughs: regulated and unregulated. We direct you to determine whether or not properties are subject to rent regulation, and then choose the appropriate set of guidelines to help you determine full market value.

Valuing Residential Properties

- 1) Analyze reported income
 - Remove unrelated real estate income
 - Effective Gross Income remains
- 2) Review Expense
 - Remove unrelated real estate items such as interest payments
Review management claim; allow up to 5% in Manhattan and up 7% in economic depressed area in the city.
 - Review repairs and maintenance; allow up to 15%
Review miscellaneous expenses; reassign appropriate real estate expenses.
 - Allow 1% of the effective income for Reserve for Replacement
These are not the only expenses that we allow you to adjust. If other expenses are overstated, you should make all necessary adjustments.
 - Adjusted Expenses remains
- 3) Deduct Adjusted Expense from Effective Gross Income.
- 4) Net Operating Income results.
- 5) Divide effective gross income by the number of units in order to determine which set of guidelines to use: regulated or unregulated. If monthly income per unit exceeds \$2,000, it might be appropriate to use the unregulated guidelines. In all other cases, use regulated guidelines. We can only use unregulated guidelines if the tenant's income exceeds \$175,000. Therefore, in certain neighborhoods only regulated guidelines would be appropriate.
- 6) Select a Base Capitalization Rate from the appropriate guideline category using effective gross income per square foot as the factor that indicates the rate to select.
- 7) Enter the Effective Gross Income, Adjusted Expense, and Base Cap Rate on CAMA screen MASM 44.

Valuing Residential Properties with 11 – 20 units

This year we are directing you to value smaller residential rentals, cooperatives, and condominiums using Gross Income Multipliers. The Valuation Policy team did a study on gross income as it relates to full market value for unregulated properties. The resulting Gross Income Multipliers have been developed for use in valuing all types of small residential properties. The underlying philosophy is that the full market value of unregulated and regulated properties should be determined by the gross income that is received. Unregulated rentals, cooperatives, and condominiums will receive more rent per unit, and as a result, should have higher market values than regulated rentals, and cooperatives. The procedure to be followed is to take Gross Income as it is reported on the TCIE or RPIE form. Update it by the percentage listed in the guidelines. Then multiply the income by the appropriate Gross Income Multiplier to generate a market value.

Neighborhood Ratings

This year, in order to avoid arbitrary designation of area ratings, a project is underway to more concretely define the factors that determine them. This process used to be largely subjective and reliant on management's personal opinion about the quality of life within each neighborhood. There are a number of factors that exert an influence over residential

market values, and efforts are underway to identify them. The factors that we are considering this year are: crime rate, public elementary school performance, per capita income, and median sales price. Neighborhoods with the lowest crime rates, highest test scores, per capita income, and median sales prices will be deemed most desirable, and given the highest area rating. Conversely, neighborhoods with the highest crime rates, lowest test scores, per capita income, and median sales prices will be given the lowest area rating.

As you are undoubtedly aware, assessors cannot change the neighborhood rating, but you do have some flexibility when choosing capitalization rates to account for differences by block or property within a neighborhood.

Rent Regulation

As you know, there have been significant changes to the City's rent regulation rules since 1993. Rent regulation rules that govern most New York City apartment buildings guarantee three things. First, the rules limit the rent that an owner may charge. Second, tenants are guaranteed a lease and cannot be evicted without justification. Finally, the rules require that owners provided tenants with essential services and equipment. These rules generally apply to buildings that were constructed before 1974 and that were built with a government subsidy of any kind (exemption or funding such as a low-interest loan). The current rent regulation rules are as follows:

- Owners may charge market rents to households with income of more than \$175,000 if the rent of the apartment exceeds \$2,000.
- Apartments that rent for \$2,000 or more per month and become vacant are no longer subject to rent regulation--deregulated.
- Regardless of rent, landlords may charge 20% more for apartments that become vacant.

Other income sources in apartment buildings must not be overlooked when estimating rents or reviewing income statements. Other income sources in rentals, cooperatives and condominiums include retail, commercial, and garage spaces. There is also ancillary income in some apartment buildings such as laundry services and billboard advertising.

Valuing Cooperatives and Condominiums

It is with the information above in mind that we give guidance on the way in which to value cooperatives and condominiums. Previously, you were asked to select comparable rental properties when valuing cooperative and condominium buildings. The difficulty with this approach was that suitable comparables that accurately reflected the type of rent that cooperative and condominium owners would collect could not be found in some areas. This resulted in building and unit values that were not representative of the value that would be assigned if the property was a rental. Since we have more information about cooperative and condominium rental values, it is important that you widen your analysis of the market to include the following:

Cooperatives and condominiums file information with the Tax Commission and it includes maintenance information. If the per unit maintenance is more than \$2,000 and the owner's income is more than \$175,000, then it's fair to say the building would likely be deregulated and so market rents are appropriate.

If we analyze the sales in a cooperative or condominium building, we can also arrive at better rent estimates. For example, a person renting their cooperative and condominium would probably want to cover the mortgage and maintenance costs. Rents of \$2,000 per month can pay for a loan where the selling price is about \$350,000, if you assume a 90% loan, 6.5% interest rate and 30-year term. Therefore, apartments selling for more than \$350,000 would probably rent for at least \$2,000 per month taking them out of rent stabilization which means you can use market rent comparables.

The sales information also tells us something about the income of the household. A family with income of less than \$175,000 probably could not afford an apartment that sells for more than \$400,000. This is because the combined mortgage and maintenance payments would exceed half of a family's monthly income after taxes. As a result, cooperative and condominiums in most area rating 1 neighborhoods would be deregulated because the rents would be above the threshold and the income of the owners would be above the threshold. Therefore, you are authorized to use market rents for these properties.

The Technology team will provide rental comparables for coops and condominiums.

If there are comparable rental properties, you should use them regardless of whether you determine that the property would be deregulated. If the best comparables are inferior in location or amenities, adjust them upward to estimate income. In these cases, use at least income from the 75th percentile for the type of residential property you are valuing. The Technology Group will provide the percentile report.

There are other sources that you can rely on to obtain income for rental apartments, condominiums and to a lesser extent for cooperatives. Comparable rental data appears in local newspapers, websites and various New York magazines.

Cooperatives also file expense information on RPIE and TCIE forms. Otherwise, estimate expenses consistent with the character of the neighborhood and in line with rental buildings that provide similar services and amenities. Where there is no comparable rental, use the upper range of the appropriate guidelines to estimate expense.

You must consider the following in your capitalization rate selection:

- Select a capitalization rate consistent with the quality of the neighborhood and building and certainty of the income stream;
- Use the capitalization rate range for the proper building class and area rating;
- Adjust your capitalization rate accordingly if the area rating is inaccurate by going to the end of the range closest to the correct area rating;
- Use the middle of the range for most properties;

- Select a cap rate at the lower end of the range for exceptional buildings and superior location;
- Use a lower cap rate for properties potentially affected by luxury and vacancy decontrol.

Assessors must use the adjustment sheet #2 for cooperatives and residential condominiums.

State of the Industrial Market

The industrial or manufacturing sector is currently undergoing a period of turmoil. It can be characterized by low vacancies and increasing asking rents. As New York City's strong manufacturing base begins to weaken in relation to its retail sector, many industrial property owners are being faced with a chance to convert their buildings to retail use to capitalize on the higher retail asking rents. This is leading owners of industrial property to refuse to re-lease space to existing industrial tenants at current prices. Often, these owners are seeking to astronomically raise rents in the hope that the industrial tenants will be forced to find new locations. Other owners are only entering into short-term leases amidst speculation of a possible conversion to retail space. Still others, are simply warehousing space in anticipation of the transition to retail use. The result is a shortage of affordable industrial space. Vacancy rates are practically nonexistent. Rising rents and the shortage of suitable space are having a positive impact on sales of industrial buildings. Owners of industrial businesses, who formerly leased space, are now seeking to capitalize on the favorable investment climate characterized by low mortgage interest rates. They are attempting to purchase these industrial properties instead of facing the possibility of being forced out of business because they cannot afford the rent increases. In fact, average sales price per square foot in 2003 showed an increase over 2002 in all major industrial areas (Bush Terminal, Green Point, Hunts Point, Long Island City, and Maspeth). The most dramatic of these increases occurred in Hunts Point where average sales price per square foot went from \$46.25 in 2002 to \$88.85 in 2003. (Crains NY, 9/03).

Valuing Gas Stations

The various approaches to valuation of real estate are comparative sales, income and cost approach. We find it practical to utilize the cost approach in valuing gas stations. An analysis of the pitfalls involved in using the other valuation methods will be presented as an argument in favor of the cost approach.

It is impractical to value gas stations by the sales approach because of the nature of the business. Most gas stations are operated under the umbrella of a franchise arrangement. Among other things, these are characterized by the existence of a special relationship between the franchiser and the franchisee. Typically there are long term contracts for gasoline purchase, equipment leasing, and other business related servicing. Also, experience has shown that most sales are between related parties. Furthermore, it is difficult to separate the business component of a sale from its real estate aspects. All of these factors impact the sales price thus proving that the sale is usually not significant.

The income approach is to be rejected as well, but for a different set of reasons. The income reported in Tax Commission filings is on the application for an owner occupied or operated facility. Often, the income reported is a net lease with a low per square foot rate over a long term, generally below market. Typically, in a franchise operation, such a lease is normally between related parties and the rate quoted is not arms length. Furthermore, it is usual in this business for overall rent to include a percentage of gross sales in addition to a base rent amount, but this percentage is invariably not reported. In cases where income is declared, it may include a conglomeration of gross sales, concession sales, repair shop, car wash and car storage receipts. It is difficult at best to quantify what portion can be attributed to the real estate itself. Moreover, gas stations are often on large lot tracts, with a footprint of the improvements covering only a small portion of the lot. Generally, income attributable to improvements is not in proportion to the area of the whole lot, and the factors are skewed.

As a result, we conclude that the cost approach is the best way to value gas stations because this method controls for all of the factors listed above. The procedure that should be followed for the valuation of gas stations is listed below.

- (1) List all the components of the gas station with pertinent sq.ft. and number of units
- (2) Determine cost new per component using the supplied cost guidelines
- (3) Determine age of each component from observed condition, factoring in actual age.
 In other words, determine effective age versus life expectancy.
- (4) Determine depreciation of component based on effective age
- (5) Deduct percent depreciation from cost new of component
- (6) Add depreciated cost of components = building cost
- (7) Add land value to building value = Full Market Value

Factories and Warehouses

Assessors must use the available rental information to assist them in projecting the income and expense for the owner-occupied space. These industrial uses are categorized in primary and secondary locations. Determine the location of the subject to assist you in selecting the comparables from the correct group.

Underutilized Factories and Warehouses

Assessors must be aware of factory and warehouse buildings that have space available but the owner chooses not to offer the space for rent or is holding out for above market rents thus creating a vacancy level far in excess of the vacancy in the area. Where this under-utilization is occurring, add rent up to the level of the vacancy norm.

Assessors must select the capitalization rates from the appropriate category of the guidelines.

Garages

Valuation Policy prepared guidelines for parking lots and parking garages. Assessors must identify the location of the property in relation to the various zones in Manhattan before selecting the appropriate guideline category. Valuation Policy will provide assistance to assessors in valuing these facilities.

State of the Hotel Market

The hotel market is thought by analysts from HVS International and Hotel and Motel Management to be undergoing a period of re-growth following the devastation wrought on the industry caused by the economic recession and 9/11. Prior to 2001, the Manhattan hotel industry was experiencing high levels of growth for over a decade. Statistics for the year 2000 show 59,159 rooms in operation, an 83.8% occupancy rate, and an average rack rate of \$222.14. This net increase of 1,573 rooms along with a 3.2% increase in occupancy rate, and a 1.08% increase in average rack rate over 1999, combined to make 2000 a banner year for the hotel industry.

Unfortunately, 2001 statistics show that following 9/11, the hotel industry was set back in time to the mid 1990's in terms of occupancy rate and average rack rate. Number of rooms rose to 60,870, but occupancy rates declined to 73.5% and average rack rate decreased to \$196.71 for 2001. The concurrent losses within the New York City tourist market along with the inability to increase returns due to business travel left the Manhattan hotel industry struggling to stay afloat. Occupancy rates and average rack rates were further impacted by the increased room rates as new hotels completed construction and entered the already tight market. Massive public relations campaigns were launched in late 2001 and throughout 2002 in order to lure travelers back to New York City. Statistics for 2002 saw number of rooms increase again to 62,607, with occupancy rates declining to 72.9%, and average rack rate decreasing to \$192.78.

It is not until 2003, that it is evident that the hotel market is once again on the upswing. Year to date figures for 2003 show an increase of rooms to 63,903, along with an increase in occupancy rate to 74.2% and an increase in average rack rate to \$198.56. This has had a positive impact on sales transactions and market value. Sales prices for hotels are closely tied to vacancy rate and average rack rate. As a result, 2001 and 2002 saw decreases in hotels sales prices, as the rate of return was not high enough to justify decreasing capitalization rates into higher value. Also, the volume of hotel sales decreased during that time period as owners did not want to settle on lower prices. Prices and sales volume will recover as occupancy rates increase enabling owners to raise rack rates and increase income stream or return.

In fact, national statistics for the first half of 2003 have shown an increase in major and mid-market hotel transactions, as well as an increase in dollars spent on major and mid market hotel transactions. Locally, the \$115 million sale of the Metropolitan Hotel in July 2003 marks the first time that a Manhattan hotel transaction passed the \$100 million mark in recent history. (Hotel & Motel Mgmt, 8/03: HVSInternational.com)

Interestingly Price Waterhouse Coopers has a different more pessimistic analysis of the hotel market. They quote slightly different occupancy and rack rate statistics to prove their point. In 2002, vacancy rates were 73.5% and average rack rate was \$182.54. However, Price Waterhouse Coopers state that average vacancy rate declined to 70.7% and average rack rate declined to \$171.34 in 2003. The fact that different analysts have opposing views of the hotel market can be interpreted to mean that growth if any has not been significant enough to impress all sources.

Valuing Hotels

Valuation Policy formerly known as Planning and Review valued all hotels except classes 3 and 4 for the 2003/04 assessment roll. The analyses are in CAMA but Valuation Policy will provide the original analyses to the Team Leader.

Department of Finance classifies hotels in six classes for valuation purposes. The hotel classifications are super luxury, luxury, class I, class II, class III and class IV.

Here is a description of the classes.

- **SUPER LUXURY** – An exclusive and expensive luxury hotel, often palatial, offering the highest standard of service, accommodations and facilities – Elegant and luxurious public rooms – A prestige address – Establishments in this category are among the world’s top hotels.
- **LUXURY** – An outstanding property offering many of the same features as “Super Luxury” – May be less grand and offer more reasonable rates than the “Super Luxury” properties, yet in many instances may be just as satisfactory – Safe to recommend to most discriminating clients. These include many Boutique hotels in Manhattan.
- **CLASS I** – Basically a “Luxury” hotel with less pronounced degree of luxury than found in “Luxury” hotels. In most cases, these are well-established famous name, depending heavily on past reputation. The more contemporary hotels may be heavily marketed to business clients, with fine accommodations and public rooms offering luxury standards in comfort, but with less emphasis on atmosphere and personal service.
- **CLASS II** – An above average hotel with standardized rooms, amenities and public areas. May have superior executive level or wing. Suitable for average clients not expecting deluxe facilities or special services.
- **CLASS III** – Essentially a “Class II” hotel with comfortable but somewhat simpler accommodations and public areas. May be lacking some features like restaurants. Some of the rooms or public areas, while adequate, may tend to be basic and functional – Usually suitable for cost-conscious clients.
- **CLASS IV** – Strictly a budget operation with limited or no amenities. Some may be quite old and may not be well maintained.

Hotels are to be valued using the Income Approach. When income is known through TCIE, RPIE or other income and expense statements the assessor is to use the room income against the expenses supplied on the guidelines. When income is not known, the assessors are to use rack rates supplied by Valuation Policy Quality Control and follow the instructions provided on Reconstructed Rack Rate Method forms.

In the valuation process, assessors are expected to consider the quality of the income stream, nuances of hotel operation, as well as, the location and overall physical condition of the property when selecting appropriate operating ratios and cap rates. Furthermore, owing to the cyclical nature of the hotel industry, it is critical that Industrial team personnel be fully informed about their hotels. To that end, they are to physically inspect all hotels in their districts. Assessors should be aware of any hotel alterations, refurbishing and/or rehabilitation. In addition, they should look for telltale signs of

possible hotel class change like drastic room rate increases, name changes, new management or new franchise agreements.

Examples of our hotel valuation method are presented on form A and B located in the addendum. Valuation Policy will continue to provide support for assessors valuing hotels during the field season.

Valuing Theatres

The unit of comparison for theater properties is Market Value per seat. Historically, the method of valuation has been the Cost Approach.

Assessors should compile a thorough inventory of all theaters in their assigned areas. This inventory should include theater type (stadium, multi-plex, legitimate, off-Broadway, etc.) number of seats, screens, year built, year altered, present market value per seat, concessions, arcade, parking and any leased areas.

Assessors are to use this information to aid in the valuation of theaters in their assigned areas. By arraying theaters by type from most desirable to least desirable they can determine not only valuation trends, but also values for individual properties.

Valuation Policy will provide additional resources and assistance. The source of theatre cost factors is Marshall and Swift: see addendum

SPECIALTY/UTILITY TEAM

The Specialty/Utility Team is valuing properties that are presently in the Real Estate of Utilities Corporation. The facilities of major utility companies such as Con Edison and Verizon as well as those of smaller companies that have equipment (generators, UPS systems and cellular sites) will be valued using the cost approach – cost new less depreciation plus the land value.

The Specialty/Utility Team also has a mixture of properties that were either built with a specialty purpose or where the use of the property is atypical for valuation. The team will utilize the income and cost approach in their valuation of these properties. There is a myriad of parcels found in Specialty. They range from churches, schools, museums and places of public assembly to vacant land that has a unique purpose.

Cost guidelines, taken from Marshall and Swift are being provided for many types of properties that the specialty unit will value. Please see the addendum for an overview of this information. There will also be a review of land values to ascertain the current market.

Some specialty properties will be valued using the income approach. The Specialty Team will value schools, medical facilities, and miscellaneous (Z category) leased properties that file income and expenses using this method. Where applicable, comparable properties will also be valued using the income approach to value. Additionally, this approach will be the valuation method to value some properties (IDA, not-for-profit) with partial exemptions.

Specialty assessors who have already determined the use of Z9 (miscellaneous other) parcels must now ensure that they have been assigned to the appropriate building class. Some Z9 properties (for example: junk yards, land with partial buildings, land used for flea markets or storage of equipment, etc) cluster to categories that do not presently exist. Inform your Team Leader of these property groups, as there is a procedure in place to create new building classes, and reassign those parcels.

NEW CONSTRUCTION TEAM

The New Construction Team will determine the value of tax class 1 new construction on vacant land, 2003/04 class 1 progress assessments and alterations. The New Construction Team will value new classes 2 and 4 construction on vacant land and pick up the appropriate descriptive data.

The appropriate team (Commercial, Residential, Industrial, Specialty) will value 2003/04 progress assessments and alterations of classes 2 and 4 properties. Although new construction and physical change will be permit-driven, we want assessors on all teams to look out for new construction in their areas and report it to the New Construction Team. Please take special note that the Times Square Development Zone remains the location for new office building construction. Our estimate of reproduction cost new for average office buildings ranges from \$250 to \$390.

If actual or projected rents are not available, use the guidelines to develop a projected income value for new buildings and gut renovations and reconcile this value with your cost-based value. You should use the same approach for the affected portions of partially renovated buildings.

Your value should reflect hard and soft construction costs. Also, value the finished building using a reasonably optimistic income projection. Determine an appropriate percentage of completion and apply it to the income projection value. If the actual costs drive your total value above the income projection value, reduce your estimated values for the site – land and pre-existing improvements. Since building cost and land value (cost approach) set the upper limit of value for the entire parcel, any income driven value that exceeds the estimated cost value in the first year will default to the cost approach value.

Valuing New Construction

The building value should be set at its correct value even if the land value is reduced to accomplish this goal. At no time should the building value exceed the replacement cost new.

When assessing a new or renovated building, value the total finished building using a reasonably optimistic income projection. Determine an appropriate percentage completion and apply it to the income projection value. If the actual costs would drive your total value above the income projection value, use the income value as your estimated market values for the site – land and improvements. For class 1 properties, the same rules apply but substitute comparable sales for projected income.

CAMA field 521, percent complete, represents the percentage of construction completed at the Taxable Status Date. This field is set to zero if the structure is 100% complete. This field must be entered if the Building Status (CAMA field 504) is 1; New Building in Progress.

Assessors must determine the percentage of completion for unfinished alteration and new construction as of the taxable status date. This information provides the correct basis for completing the additional improvement value the following year.

In addition, commercial properties may now be eligible for up to three-year progress assessments. It is vital that assessors enter the percent complete on record to enable the granting of these progress assessments.

RECORDING VALUES

Income Approach

All teams valuing properties by the income approach must enter the income and expense on screen MASM 44 and denote the sources of this data by entering the adjustment reasons in fields 641 and 717. Also enter your selection of capitalization rate on this screen. The Technology Team will enter the effective tax rates globally.

There are two critical entries, V in field 235 to post the value and field 970 to state the approach taken in valuing the property. If there is a change to the land value, field 311 must also be updated with the land value per square foot.

The adjustment reasons (reasons for override changes) for income and expense are:

1. Update prior/partial income and expense
2. Outside of market range
3. Net lease*
4. Field inspection
5. Change in building status e.g. fire, demo
6. Change in vacancy/lease status
7. Unaccounted owner occupied space
8. Clerical error
9. Other

* An override code is needed for total expenses if the **Net Flag** is set to “y” and expense is zero.

Adjustment sheet #2

Assessor must use the adjustment sheet #2 for owner-occupied properties, buildings with owner-occupied space over 20%, buildings under construction or renovation and any other properties for which actual income is unavailable. Assessors will also use this form in their valuation of cooperatives and condominiums.

This year, show your adjustments to income and expense on the back of the Property Valuation Documents (PVD). If the income and expense are not preprinted on the PVD, make the adjustment, if any, on the adjustment sheet #2 and attach it to your PVD. **You do not have to fill out the PVD in this instance.**

Cost Approach

Where a property is valued using the cost approach, the assessor must clearly enter the calculations on screen PACS 9. The Department of Finance retains this data.

In valuing new buildings, it is appropriate to show your calculations of the cost approach even if an income approach is entered on MASM 44. This holds true for partially complete buildings.

Adjustment sheet #2

You are instructed to complete the adjustment sheet #2 for any property undergoing construction or renovation. You may complete sheets for additional properties as needed. If an adjustment sheet is prepared for a property, attach the PVD and any additional notes that may be needed to explain the valuation.

PVDs/CAMA

For properties where you complete an adjustment sheet, use that sheet for all of your calculations and notes; do not write on the PVD. For all properties, write brief comments on the CAMA screens in the comment fields as needed. Date the comments so that anyone can reference the period to which they apply.

ADDENDUM
List of Trophy Buildings

Block	Lot	Address	Building Name
1273	22	9 West 57 Street	Solow Building
995	5	1472 Broadway	Conde Nast Building
1049	29	10 Columbus Circle	Time Warner
1005	29	1301 Ave of Americas	Credit Lyonnaise
1013	29	582 Seven Avenue	5 Times Square
1002	1	745 Seven Avenue	Morgan Stanley
1282	21	379 Madison Avenue	Bear Stearns
1268	34	666 Fifth Avenue	666 Fifth Avenue
1294	1	761 Fifth Avenue	General Motors Building
1283	21	277 Park Avenue	Chase World Headquarters
1297	23	405 Lexington Avenue	Chrysler Building
1280	9010	200 Park Avenue	Metropolitan Life Building
1308	1101, 1102	399 Park Avenue	Citibank Bldg
40	3	60 Wall Street	J.P Morgan Chase Building
35	10	111 Wall Street	Citibank Building
1009	5	152 West 57 Street	Carnegie Hall Tower
1271	38	712 Fifth Avenue	Rizzoli Building
1291	28	75 East 55 Street	Park Avenue Tower
1292	15	580 Madison Avenue	IBM Tower
1282	65	575 Fifth Avenue	The Center of Fifth
1307	23	599 Lexington Avenue	595 Lexington Avenue
1312	15	123 East 57 Street	-----
1014	33	3 Times Square	Reuters
1289	14	512 Madison Avenue	Continental Illinois
1006	13	141 West 53 Street	1325 Avenue of Americas
1007	29	120 West 55 St.	Alliance Capital
1267	22	15 West 51 St.	Warner Communication
1337	14	23 East 44 St.	3 Regal UN Plaza II
1286	35	1330 Avenue of Americas	ITT Building
1288	27	57 East 52 Street	Park Avenue Plaza
1309	32	161 East 54 Street	900 Third Avenue
1295	1	101 Park Avenue	Kalikow Building
1287	33	350 Park Avenue	Republic National
1284	7	7 East 48 Street	Tower 49
1313	40	731 Lexington Avenue	One Beacon Court
1004	29	1285 Avenue of Americas	Paine Webber
1280	9090	450 Lexington Avenue	450 Lexington Avenue
1298	23	425 Lexington Avenue	425 Lexington Avenue
16	120,125,140, 150	WFC Complex- Battery Park City	World Financial Center (WFC)
1264	5,30	610 Fifth Ave., 600 Fifth Ave.	Rockefeller Center

1265	50,1001 - 1109	1250 Sixth Avenue	Rockefeller Center
1266	1	1260 Sixth Avenue	Rockefeller Center

Cost Guidelines Overview for Various Types of Specialty Properties

DEFINITIONS (as it pertains to Marshall & Swift):

Base Cost: Represents a completely finished building in the physical or hard construction sense, but not necessarily a completely finished project.

What **is** included:

- ✓ Average architect and engineer fees (plans, permits, survey and plan check).
- ✓ Normal interest on only the actual buildings funds during period of construction and processing or service fees.
- ✓ All material and labor costs, including tax.
- ✓ Normal site preparation (excavation, backfill and grading) for structure only.
- ✓ Cost of delivering utilities.
- ✓ Contractors' profit and overhead (job supervision, workman's compensation, insurance, equipment, temporary facilities, security, etc).

What **is not** included:

- ✗ Cost to buy land and associated costs (property taxes, legal fees, escrow fees, demolition, storm drains, right of way and rough grading).
- ✗ Pilings or hillside foundations (considered as improvements to land). Compacting and terracing.
- ✗ Costs of land planning (land interest & taxes, feasibility studies, environmental impact reports, appraisal, land & material testing, consulting fees, etc.).
- ✗ Costs of doing business (discounts or bonuses paid for financing, funds for operating startup, project bond issues, developmental overhead, permanent financing, etc.).
- ✗ Yard improvements (septic systems, signs, landscaping, paving, fences, pools, etc.).
- ✗ Off-site costs (roads, utilities, park fees, impact or entitlement fees, special assessments, etc.).
- ✗ Furnishings and fixtures not normally found in a contract and are peculiar to a definite tenant (desks, seats, kitchen equipment, etc.).
- ✗ Marketing costs (advertising, leasing, commissions, association dues, etc.).

Furthermore, Marshal & Swift requires the Assessor to assign a quality rating and to be familiar with the various construction classes.

To judge quality, the Assessor needs to consider the following four items:

- Cost of the materials and components (thickness, intricacy, materials used, application, color, etc.).
- Workmanship (normally workmanship is equivalent to the grade of materials).
- The amount of various components. For instance, although the quality of workmanship and components may not be above normal, there may be an above

average number of components (windows and doors) thus raising the overall structure quality.

- Overall size and complexity (a smaller building will have a larger per square foot cost than a larger structure of similar use).

Although there are various distinctions, the class of construction can be quickly determined as follows:

Class A: Buildings have fireproofed structural steel frames with reinforced concrete or masonry floors and roofs.

Class B: Fire-resistant construction of reinforced concrete frame and concrete or masonry floors and roofs.

Class C: Buildings have masonry or concrete exterior walls. The roof and floor are made up wood or steel, except for concrete slab on grade.

Class D: Buildings generally have a wood frame, floor and roof structure. May have a concrete slab on grade. Are of combustible construction. It also includes all structures that do not fall into the other categories (tubular steel, hoop shape, tarp roof buildings, etc.).

Class S: Buildings made of incombustible metal frames, roofs and walls, such as, pre-engineered metal buildings.

Story Height Multipliers: A multiplier is applied to the base cost for any variation from the average story (ceiling) height. Average story heights vary upon the building type (office, residential, theater, etc.).

Multistory Building Factor: The general rule is 0.5% is added to the base cost for each story, over three, to all base costs, excluding mezzanines, up to 30 stories; over 30 stories, add 0.4% for each additional story.

Current Cost Multipliers: Since sections are updated, at best, annually, these multipliers, which are dependent upon the construction class, bring the base costs published in Marshall & Swift up-to-date.

Local Multipliers: This final multiplier is applied once all other factors have been added. It reflects local cost conditions and designed to adjust the basic costs to each locality (borough). They are based on weighted labor and material costs, including local taxes. They are published quarterly and are dependent on the construction class.

EXAMPLES OF VARIOUS PARCELS THAT MAY BE DONE VIA THE COST APPROACH:

Government Buildings (City Hall, Town Centers, Court Houses):

Start with: Base cost: (section 15 page 30 - based on construction class & type).
Multiply by: Multistory building factor (section 15 page 30).
Add: Sprinkler cost (section 15 page 36).
Multiply result: Current cost multiplier (section 99 page 3).
Multiply result: Local multiplier (section 99 page 9).

Schools (Elementary, Middle, High School):

Start with: Base cost: (section 18 pages 9 thru 11 - based on construction class & type).
Multiply by: Multistory building factor (section 18 page 9 or 10).
Add: Sprinkler cost (section 18 page 35).
Multiply result: Current cost multiplier (section 99 page 3).
Multiply result: Local multiplier (section 99 page 9).

Colleges:

Start with: Base cost: (section 18 page 26 - based on construction class & type).
Multiply by: Multistory building factor (section 18 page 26).
Add: Sprinkler cost (section 18 page 35).
Multiply result: Current cost multiplier (section 99 page 3).
Multiply result: Local multiplier (section 99 page 9).

General Hospitals:

Start with: Base cost: (section 15 page 24 - based on construction class & type).
Multiply by: Multistory building factor (section 15 page 25).
Add: Sprinkler cost (section 15 page 36).
Add: Extreme climate minus moderate climate HVAC factor (section 15 page 25).
Multiply result: Current cost multiplier (section 99 page 3).
Multiply result: Local multiplier (section 99 page 9).

Medical Office Building (public & private - examination & outpatient):

Start with: Base cost: (section 15 page 22 - based on construction class & type).
Multiply by: Multistory building factor (section 15 page 22).
Add: Sprinkler cost (section 15 page 36).
Multiply result: Current cost multiplier (section 99 page 3).
Multiply result: Local multiplier (section 99 page 9).

Outpatient (Surgical) Center:

Start with: Base cost: (section 15 page 25 - based on construction class & type).
Multiply by: Multistory building factor (section 15 page 25).
Add: Sprinkler cost (section 15 page 36).
Add: Extreme climate minus moderate climate HVAC factor (section 15 page 25).
Multiply result: Current cost multiplier (section 99 page 3).
Multiply result: Local multiplier (section 99 page 9).

Convalescent Hospital (hospital like rest & nursing homes):

Start with: Base cost: (section 15 page 26 - based on construction class & type).
Multiply by: Multistory building factor (section 15 page 26).
Add: Sprinkler cost (section 15 page 36).
Multiply result: Current cost multiplier (section 99 page 3).
Multiply result: Local multiplier (section 99 page 9).

Group Care Home (residential small care or special needs):

Start with: Base cost: (section 11 page 23 - based on construction class & type).
Multiply by: Multistory building factor (section 11 page 20).
Add: Sprinkler cost (section 11 page 28).
Multiply result: Current cost multiplier (section 99 page 3).
Multiply result: Local multiplier (section 99 page 9).

Homes For the Elderly:

Start with: Base cost: (section 11 page 13 - based on construction class & type).
Multiply by: Multistory building factor (section 11 page 13).
Add: Sprinkler cost (section 11 page 28).
Multiply result: Current cost multiplier (section 99 page 3).
Multiply result: Local multiplier (section 99 page 9).

Mortuary (Funeral) Homes:

Start with: Base cost: (section 11 page 26 - based on construction class & type).
Multiply by: Multistory building factor (section 11 page 27).
Add: Sprinkler cost (section 11 page 28).
Multiply result: Current cost multiplier (section 99 page 3).
Multiply result: Local multiplier (section 99 page 9).

Theatres (Live stage & cinema):

Start with: Base cost: (section 16 pages 12 & 13 - based on construction class & type).
Multiply by: Story Height Multiplier (section 16 page 23).
Multiply result: Multistory building factor (section 16 page 11).
Add: Sprinkler cost (section 16 page 22).
Multiply result: Current cost multiplier (section 99 page 3).
Multiply result: Local multiplier (section 99 page 9).

Gas Stations & Equipment (all equipment & buildings):

Start with: Base cost: (section 64 pages 1 thru 6 - based on cost range).
Add: HVAC upgrade (section 64 page 2 – if necessary)
Multiply result: Current cost multiplier (section 99 page 3).
Multiply result: Local multiplier (section 99 page 9).