Sage Group
A National Appraisal Network

TEXAS REAL ESTATE UPDATE

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“ Special permit … by providing for specific uses which are deemed necessary or desirable but which are not allowed as of right because of their potential for incompatibility with the characteristics of the district…”

Source: UMASS.edu

Special Use Buildings

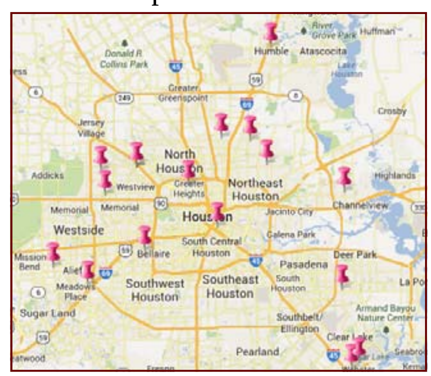
Special use building has long been viewed as a necessary requirement by those users who cannot meet occupancy requirements from existing, built inventory. However, renovation activity, with business enhancements, is becoming a very active market.

The aging Baby Boomer generation is driving demand for nursing homes, hospitals and age-restricted facilities. Retrofitting older buildings can, many times, remain a cost effective alternative, rather than building new inventory. Further, there are few remaining vacant sites in many urban cores of the larger Texas metros. Those vacant sites and tear-downs to get an urban location are typically very expensive and cost prohibitive.

In the last 12 months, 17 special use buildings (includes schools, hospital or religious uses) have sold in metro Houston.

Of the 5 that sold in Dallas, buyers included large institutional owners like W.P. Carey and Spirit Realty Capital.

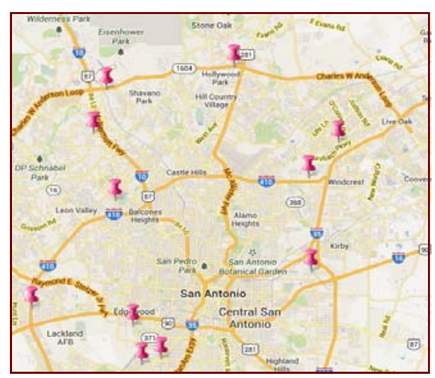
Airstream was one of 11 buyers in San Antonio buying special use properties in the last year. A large transaction included the Manor Healthcare senior housing facility.



Source: www.oconnordata.com

While hospitals and senior housing command the ‘big bucks’, a number of churches have and are being acquired across the state. In July 2013, Northrock Church acquired a 49,376 square foot building in San Antonio.

One of the most notable historical acquisitions of a special use building is the Lakewood Church purchase/retrofit of the Houston Summit (former home to the Houston Rockets)!



Next Month

Why premium locations can be expensive, but can drive enhanced revenue to building occupants.

Dr. Kenneth Eugene Lehrer will also provide a snapshot view of the economy.

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Till – Until Matters Become Normal

The business environment in an integrated computer economy affects all facets of our national enterprise system. In this regard, The United States Supreme Court in a plurality decision of Till vs. SCS Credit Corporation entered into the field of finance and economics in seeking to determine and apply a rate of interest that best comports with the purposes of the Bankruptcy Code. While it is not the goal of this presentation to fully explain a decision of the Supreme Court, the economic output of that decision is extremely interesting and presents a perplexing dilemma in our current financial environment.

In a cram down bankruptcy reorganization plan (a bankruptcy plan that is confirmed by the Court over the objections of some creditor parties) one of the more interesting and complex questions that has to be dealt with as part of the plan is - What is the interest rate the debtor is going to pay to the creditors over the life of the plan? Cram downs often provide for installment payments over a period of years. Clearly, the debtor wants the lowest possible interest rate so remaining principle debt balances can be paid and rebuild the business as fast as possible. The creditors want high rates of interest to compensate for costs and risks of having to involuntarily participate in a plan wherein they objected.

The Supreme Court in seeking to determine an appropriate method of interest rate calculation to be applied, was on their own as the Bankruptcy Code provided little guidance as to the rate of interest Congress had in mind when it adopted the cram down provision [11 U.S.C. Sect. 1325 (a)(5)(B)]. The choices advocated by the four (4) underlying case opinions were – the formula rate, the coerced loan rate, the presumptive contract rate or the cost of funds rate. The Court decided upon the formula rate. Here, the rate takes its fundamentals from ordinary lending practices as the approach begins by looking to the national prime rate and mass media. That rate reflects the financial market's estimate of the amount a commercial bank should charge a creditworthy commercial borrower to compensate the lender for the opportunity costs of the loan, the risks of inflation and the relatively slight risk of default. Bankrupt debtors typically pose a greater risk of nonpayment than solvent commercial borrowers and the approach then requires an upwards adjustment. The size of the risk adjustment depends on such factors as – circumstances of the business, the nature of the security and the duration and feasibility of the reorganization plan (quoted in parts from the Courts decision). The Court concluded – that the formula approach, namely the one the Court selected, begins with a concededly low estimate of the appropriate interest rate (the prime rate) and requires the creditor to present evidence to support a higher rate and places the evidentiary burden on the more knowledgeable party, thereby facilitating a more accurate calculation of the appropriate interest rate. In other cases and decisions this output of the Supreme Court in 2004 has become known as the Till Plurality Formula Method.

With the Till Formula Method, the courts have generally decided the proper scale for the upwards risk adjustment over the prime rate, as generally observed and approved is an upwards adjustment between 1.0% to 3.0%. Hence, a cram down reorganization plan can be approved with a Till Adjusted Rate Plan of 5.25% (3.25% for the prime rate + 2.0% for an upwards Till Adjustment).

The main underlying reason for discussing the Till Decision is the far reaching consequences of the Federal Reserve in fostering an extremely low set of interest rates to try and stimulate our lackluster economy. At the time of the Till decision in May, 2004 our national prime rate of interest was 4.0% and subsequently rose to 8.25% in 2007 before being lowered again.

Based upon this simple analysis, it reveals the many loans and other financial agreements that have come into being with longer term and far reaching effects based upon a politically structured set of interest rates that should not be overlooked. As the nation hopefully regains its economic independence, a set of interest rates that created misaligned low interest rate contracts, especially if our nation should find itself in a situation of higher inflation (say 4.5%) should not be overlooked. The potential for prior agreements and low fixed rate contracts to distort the incomes and balance sheets of financial institutions has the underpinnings of continued negative economic influence. This distorted income is in addition to the potential losses that bond holders and home owners face if interest rates rise to accommodate potentially higher rates of inflation as the created set of low interest rates fade from the scene. Most analysts focus on the more widely visable forms of disruption to our economic future. However, other factors (Till Agreed Cases) can also add to our future difficulty in sustaining growth and development.

While the Till Decision of the Supreme Court was viewed as a sound decision to "clear the air" in regards to certain Bankruptcy issues and offer support to those in need of financial assistance, it is also clear how 9 on the Court and 7 at the Federal Reserve can potentially create a mismatch of 16.

— About Sage Group —

We are a group of appraisal professionals working together to provide a single source of information and analysis for commercial real estate professionals across the country. Our team is managed by John Fisher, CCRA, LEED AP, W. F. "Buddy" Trotter, Jr., MAI, Michael L. Miller, MAI, Andre Suissa, MAI, Greg Zachary, Senior Appraiser, Derrick Johnson, MAI and H. E. "Skip" Preble MAI, CRE, CCIM. Dr. Kenneth Eugene Lehrer manages financial services practices. For more information about us or to sign up to receive our newsletter, contact Michael L. Miller, MAI at 713.358.8450 or mmiller@sageappraisalnetwork.com.

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