



Pandemic Perspective: Expropriation Valuation in a Time of Crisis

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Introduction

- ▶ The Covid-19 Pandemic (Pandemic) will have a profound impact on the marketplace, as well as the way we do business.
- ▶ What are the Appraisal Institute of Canada's recommendations on Pandemic issues?
- ▶ What is the real estate market telling us about the impact of the Pandemic?
- ▶ How will appraisal practices have to change in the Pandemic?
- ▶ What impact will the market disruption have in an expropriation context?

Appraisal Institute of Canada's Recommendations on Pandemic Issues

- ▶ Major Issue #1: Changes in Market Conditions. Because of the market uncertainty related to the Pandemic, the AIC proposes that appraisers insert the following language in Letters of Transmittal, in Extraordinary Items, and wherever a value statement is made:

Significant Value Uncertainty

The outbreak of the Novel Coronavirus (COVID-19), declared by the World Health Organization as a "Global Pandemic" on 11 March 2020, has impacted global financial markets. Travel restrictions have been implemented by many countries.

Market activity is being impacted in many sectors. As at the valuation date (effective date), we consider that we can attach less weight to previous market evidence for comparison purposes, to inform opinions of value. Indeed, the current response to COVID-19 means that we are faced with an unprecedented set of circumstances on which to base a judgement.

Consequently, less certainty – and a higher degree of caution – should be attached to our valuation than would normally be the case. Given the unknown future impact that COVID-19 might have on the real estate market, we recommend that you keep the valuation of this property under frequent review.

Appraisal Institute of Canada's Recommendations on Pandemic Issues

- ▶ Major Issue #2: Property Inspections. Currently, appraisers are being told not to perform interior inspections if local health regulations cannot be adhered to. When a property inspection is not possible, the AIC proposes that appraisers insert the following language in Letters of Transmittal, in Extraordinary Items, and whenever a value statement is made:
- ▶ **Extraordinary Limiting Condition:** Due to the Coronavirus pandemic, local health authorities are strongly advising (or mandating) limited exposure to or contact with other people. Entering properties for inspection purposes is contrary to local health authority advice and is not possible at this time. This assignment was completed without physical access to the interior/exterior of this property. Property details have been identified and collected through other means as noted in this report.
- ▶ **Extraordinary Assumption:** Because of the inability to access and view the interior/exterior of this property, information and details concerning the interior/exterior finishing, quality and condition are taken from sources deemed reliable. If any of these details are subsequently determined to be inaccurate, the appraiser reserves the right to amend the report and the value herein.

What is the Real Estate Market Telling Us About the Impact of the Pandemic?

- ▶ The short answer – we don't know yet.
- ▶ We are now three months into the Pandemic-era. Most commercial property transactions have a closing period of 60 to 120 days. The vast majority of sales that have closed in the last three months are of transactions that were agreed to pre-Pandemic.
- ▶ What happens in times of major market disruption? Three market phases take place.
- ▶ Phase 1: Transactions that are signed prior to the market disruption either close, or the buyer refuses to close even under the threat of litigation. New Pandemic-era buyers and sellers “hold”, to determine if the change in market conditions is temporary or longer-term.
- ▶ Phase 2: Sellers that must sell, either because they cannot make mortgage payments or to cut their losses, while buyers with financial means swoop in to acquire properties at a discount.
- ▶ Phase 3: The “new normal”. The real estate markets stabilize, and could return to a pre-Pandemic level, or there may be new value standards. The “new normal” will likely vary based on property type.
- ▶ Today, we appear to be in a transition between Phases 1 and 2, and we may not reach Phase 3 until the fall or 2021.

How Will Appraisal Practices Have to Change in the Pandemic-Era?

- ▶ For expropriations occurring after March 11, 2020, it is possible that, depending on property type, determinations of market value post-Pandemic will not be supportable for some time.
- ▶ Transactions that occur during Phases 1 and 2 in the post-Pandemic market, may not represent market value based on the definition that must be employed by all appraisers.
- ▶ Market Value is defined by the Appraisal Institute of Canada as follows: The most probable price, as of a specified date, in cash, or in terms equivalent to cash, or in precisely revealed terms, for which the specified property rights should sell after reasonable exposure in a competitive market under all conditions requisite to a fair sale, with the buyer and the seller each acting prudently, knowledgeably, and for self-interest, assuming that **neither is under duress** (emphasis added by gsi).
- ▶ If the definition of market value assumes that a vendor is not “under duress”, then there is an argument that many comparable market transactions that are the result of a “forced” sale as a result of the Pandemic, are not by definition a market transaction.

How Will Appraisal Practices Have to Change in the Pandemic-Era?

- ▶ What this will mean is, for most commercial real estate transactions that occur during Phases 1 and 2 of the market evolution post-Pandemic, they may not represent a transaction that is supportable by market evidence that can be relied upon for an estimate of compensation in an expropriation context.
- ▶ There will be different timelines for different real estate property types. A clearer picture will likely emerge for residential properties earlier, followed by improved commercial properties, with development land potentially the last property type to have sufficient market data for a supportable estimate of market value.
- ▶ Post-Pandemic certain real estate markets may flourish, well others could see an enduring decline due to a paradigm shift as a result of the market's new needs and wants. For example, we could see a decrease in demand for urban condominium apartment living, with increased demand for low-rise residential options in outlying suburban areas. The retail market could experience major changes due to never-before-seen levels of online sales. Office demand could soften because of the impact of newly acceptable levels of working from home.

How Will Appraisal Practices Have to Change in the Pandemic-Era?

- ▶ There is a necessity to invoke an Extraordinary Assumption regarding market conditions. Although the valuation of some property will allow for an appraisal of Pandemic-era market conditions, most will not until there is a sufficient amount of market data for analysis. For expropriations that have occurred after March 11, 2020, gsi is currently invoking an Extraordinary Assumption that the valuation is based on market conditions prior to March 11, 2020, as follows:

As at the effective date of April XX, 2020, the Covid-19 virus pandemic was causing a significant degree of uncertainty in capital markets, that could have influenced real estate values. Canada and the entire Global Community were experiencing unprecedented measures undertaken by various levels of government to curtail health-related and economic-related impacts of the Covid-19 virus pandemic. The duration of the event was not known and could not be reasonably predicted at that time. There was potential for negative impact with respect to micro- and macro-economic sectors, as well as upon various real estate markets; however, it was not possible to predict the impact, or the influence of then or future government countermeasures. Accordingly, this point-in-time valuation extraordinarily assumes the continuation of market conditions prior to March 11, 2020 (the date that the World Health Organization declared a "Global Pandemic"), and assumes that longer-term market conditions remained unchanged from trends apparent as at March 11, 2020.

Market Disruption in an Expropriation Context

- ▶ The Great Recession spurred on by the financial crisis in 2007 provides a lesson for the current pandemic.
- ▶ The real estate market in Ontario went through a period of rapid decline with a relatively quick rebound.
- ▶ In many cases, expropriations that occurred during the market trough resulted in challenging compensation claims.
- ▶ Many owners that were expropriated during the market trough put forward arguments that compensation offers based on sales of properties during the market decline were not a valid basis for compensation, as a prudent vendor would have held out until the market recovered, which with the benefit of hindsight at the time of settlement hearings had occurred.
- ▶ If the real estate market is able to rebound in late 2020 or early 2021, we could see a similar scenario.

Conclusions

- ▶ Changes in Market Conditions – Extraordinary Assumptions may need to be invoked in appraisal reports that necessitate valuations based on pre-Pandemic market conditions, until such time that market transactions that meet the definition of market value exist.
- ▶ Property Inspections – Until local regulations are relaxed to the point of allowing for internal property inspections, special accommodations will need to be made to allow appraisers to assess improved properties based on photographs provided by the landowner.
- ▶ Property Values – Currently, the impact of the Pandemic on commercial property values is not known. It will only be once market transactions that meet the definition of market value occur, with a sufficient number of transactions, that supportable market value estimates in the Pandemic-era can be opined in appraisal reports.

Conclusions

- ▶ A Short-Lived Market Trough – The expropriation industry will be challenged with regard to compensation claims as a result of expropriations that occur during the Pandemic-era. This issue will be compounded if there is a market rebound that occurs in the fall of 2020 or early 2021. Hearings for those expropriations could occur in a rebounded marketplace, and landowners will claim that Pandemic-era sales were not representative of market value.