

Special Purpose, Special Problems

A Case Study in Hospitality Valuation
and Functional Obsolescence

Shawn Wilson, MAI

IAAO ANNUAL

LEGAL 
SEMINAR

PROPERTY TAXATION AND THE LAW:
CHALLENGES AND SOLUTIONS



IAAO



The Location: Norfolk, Virginia



- 4.09 acres of land
- 600 feet of frontage on the Elizabeth River
- Adjoins marina and promenade
- Ferry and sightseeing boats dock at the marina

Subject Lawsuit



Taxpayer vs. local assessor challenge



Four tax year in dispute 2020-2023



Inconsistent / incomplete income and expense information provided by taxpayer



Dispute included value attributable to tax abatement grant(s)
[that is a different presentation]



Case study includes only 2023 appraised values

The Spread (chart includes value of grants)

Tax Year	Assessor Total MV	Shawn Wilson Total MV	Taxpayer Total MV
2023	\$ 18,021,600	\$ 19,130,000	\$ 6,840,000
2022	\$ 20,469,700	\$ 18,063,000	\$ 6,050,000
2021	\$ 25,464,800	\$ 16,975,000	\$ 5,130,000
2020	\$ 34,996,600	\$ 15,877,000	\$ 4,300,000

Property History

- Originally developed as a Rouse-style festival marketplace in the 1980s
- Leased to new owner, 40-year lease with option to renew
- Major renovation completed in 2017
- Closed during COVID, attendance has been recovering over time



110,000 square feet, right on the river

- Pedestrian bridge to municipal parking garage
- Two story building with elevators
- Indoor and outdoor areas streetside and waterfront



The Market



Blue Moon Taphouse



Event Space, 2nd Floor Waterfront



Stripers Restaurant



PBR Country Bar



Riverfront Promenade Area



Special Purpose Property

An improved property with a unique physical design, special construction materials, or a layout that particularly adapts its utility to the use for which it was built and may be costly to modify to another use.

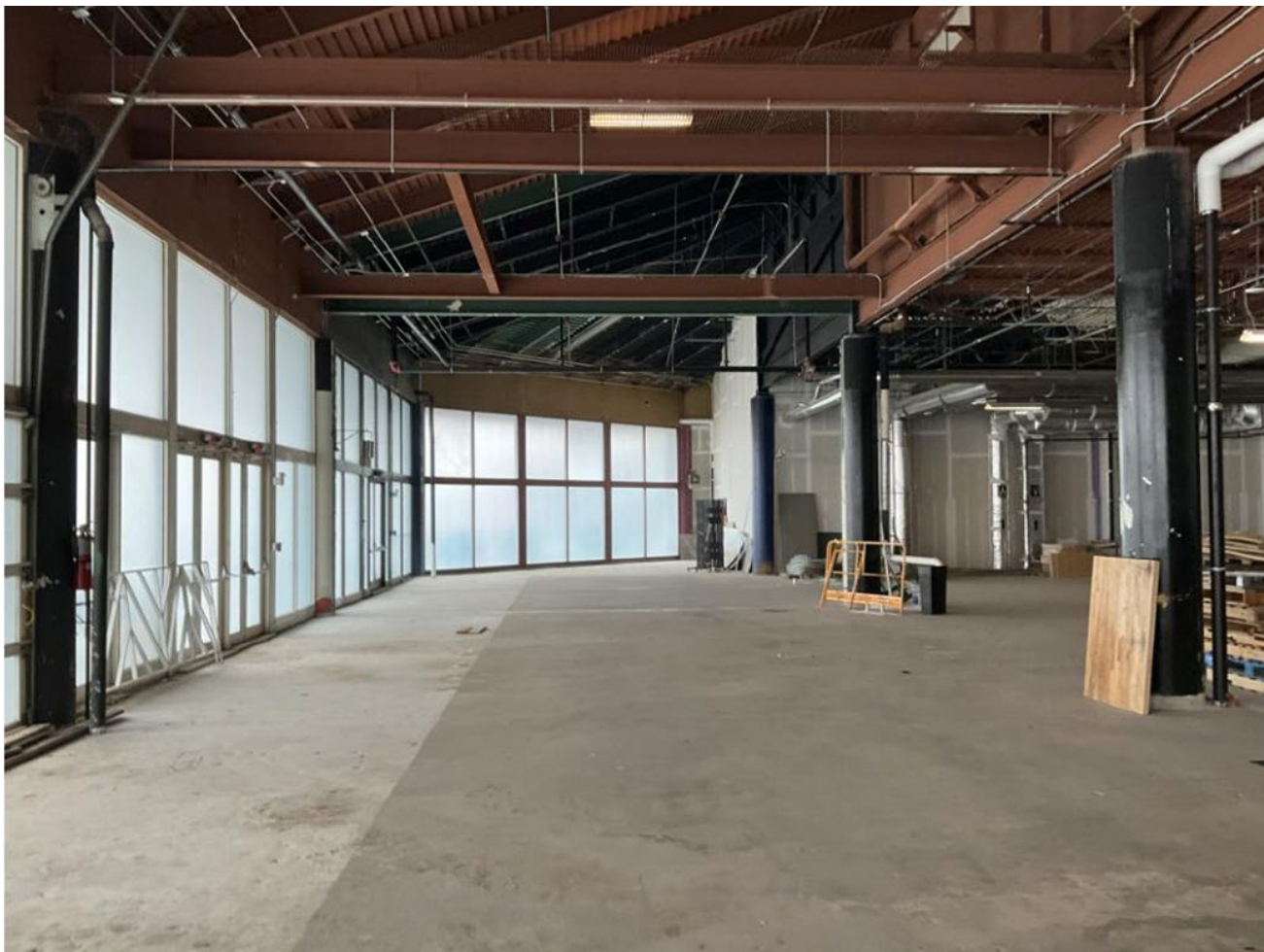
*Source: Appraisal Institute, **The Dictionary of Real Estate Appraisal**, 7th ed. (2022)*

Special Purpose Characteristics



- Lease limits uses to restaurant, retail and entertainment
- Majority of finished space designed for a single operator / single tenant
- Limited alternative uses for finished space without substantial modification
- Most of the space is owner-occupied

Unfinished Building Area



Unfinished area: 40,000 square feet



Valuation Overview

Both appraisers
applied all three
approaches to
value

Unfinished
building areas
were analyzed
differently

Depreciation
handled
differently

Owner-
occupancy makes
things more
complicated

What is it worth in 2023?

2023 Tax Year	Wilson	\$/sf for 110,000sf	Taxpayer	\$/sf for 110,000sf
Income	\$ 15,640,000	\$142.18	\$ 6,150,000	\$55.91
Cost	\$ 17,310,000	\$157.36	\$ 6,180,000	\$56.18
Sales Comp	\$ 14,700,000	\$133.64	\$ 6,150,000	\$55.91
Reconciled	\$ 15,000,000	\$136.36	\$ 6,150,000	\$55.91

Sales Comparison Approach

- How to appraise a former festival marketplace?
- Are there any market value comps?
- Right on the water, and ground zero for events and tourism
- Use local, regional or national sales?
- How to handle unfinished square footage?



Sales Comparison... Comparison

Sales Comparison	Wilson	\$/sf for 110,000sf	Taxpayer	\$/sf for 110,000sf
SF bldg	70,000		77,167	
SF is	finished only		leasable	
\$/sf	\$210.00		\$79.70	
Value	\$ 14,700,000	\$133.64	\$ 6,150,000	\$55.91
Comparable	<i>Minimum</i>	<i>Maximum</i>	<i>Minimum</i>	<i>Maximum</i>
Sales	\$112.71	\$358.06	\$45.60	\$105.31

Majority of the building
is owner-occupied

- Rent roll at market?
- Corporate branding choices

Inconsistent /
incomplete income and
expense information
provided by taxpayer

- Use “actual” numbers?
- IRS tax numbers?



Income Approach – Rent Comps



Are there any market value comps nearby?



How would a potential buyer evaluate it?



How to handle unfinished square footage?



Market issues or management choices?

Warning: Busy Slide Coming Up

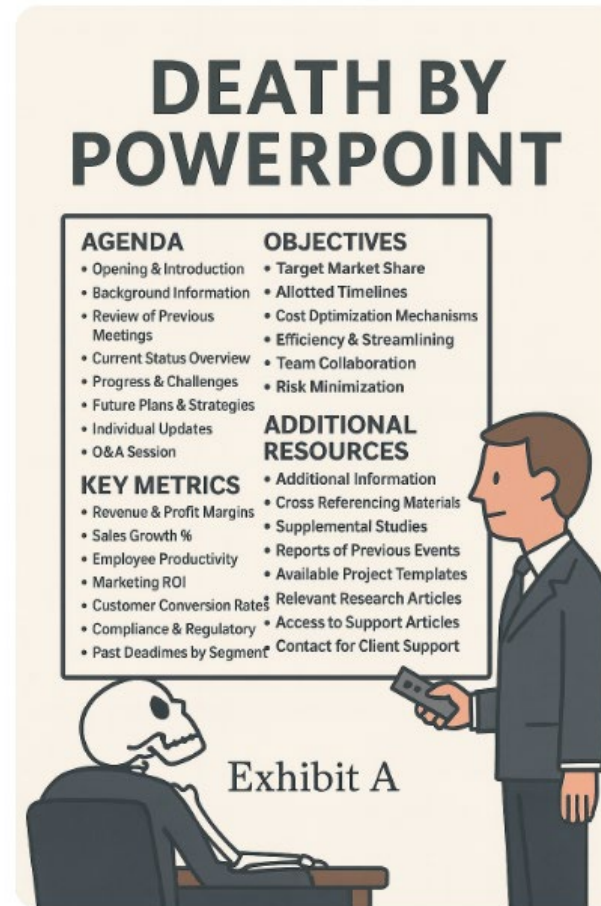
DEATH BY POWERPOINT



Attorney

Exhibit A

*Source: ChatGPT
("create graphic of pain
caused by too much
data on one slide,
audience is attorneys")



*Source: ChatGPT
("That looks good! but what I need is one slide with tooooooo much stuff on it")

Income Approach Comparison

Income Approach	Wilson	\$/sf	Taxpayer (reconstructed from DCF)	\$/sf
Rent - finished	NNN rent	\$24.00	Gross rent	\$31.59
Rent - unfinish	50% of market	\$12.00	0% of market	\$0.00
PGI	\$ 2,090,000	\$19.00	\$ 2,437,345	\$22.16
V&C	\$ 731,500	35%	\$ 297,345	12%
EGI	\$ 1,358,500	\$12.35	\$ 2,140,000	\$19.45
Expenses	\$ 67,925	5%	\$ 1,664,108	78%
NOI	\$ 1,290,000	\$11.73	\$ 475,892	\$4.33
Cap	8.25%		7.7%	
Reconciled	\$ 17,310,000	\$157.36	\$ 6,150,000	\$55.91

Cost Approach Issues

- Depreciation buffet
- Majority of the building is owner-occupied
 - Dysfunctional?
 - Obsolete?
- Market issues or management choices?
- How to handle unfinished square footage?



The Depreciation Buffet

Physical Deterioration

Functional Obsolescence

External or Economic
Obsolescence



- Loss in value due to age or condition
- May be curable or incurable
- Examples
 - Nice house with a leaky roof
 - Office building with deferred maintenance
 - Well-maintained big box store that is 15 years old



- ❖ Loss in value due to design or utility issues
- ❖ Factors within the property boundary
- ❖ May be curable or incurable
- ❖ Examples
 - ❖ Nice house with pink tile bathrooms
 - ❖ Warehouse without dock-height floors
 - ❖ Retail building with inadequate parking



- Factors beyond the property boundary
- Almost always incurable
- Can be temporary or permanent
- Owner cannot control or mitigate
- Often influences more than one property in a location or market
- Usually **locational** or **economic**

External Obsolescence - LOCATIONAL

- Property location creates disadvantage
- Almost always incurable
- Can be temporary or permanent
- Examples
 - Wildfires occur in market area
 - Downwind of nearby chemical plant
 - Airport flight paths change, flights now overhead

External Obsolescence - ECONOMIC

- Detrimental condition in market area
- Almost always incurable
- Can be temporary or permanent
- Examples
 - New business competitors open nearby
 - Large employer closes nearby plant
 - Insurance premiums spike due to regional risk

One-Sentence Contrast*

Physical Deterioration

- “The building is worn out”

Functional Obsolescence

- “The building design no longer works”

External or Economic Obsolescence

- “The world around the building changed”

*Source: ChatGPT (without citation, claims to be paraphrased from multiple sources, caveat emptor)

One-Phrase Contrast*

Physical
Deterioration

• *Condition Problem*

Functional
Obsolescence

• *Design Problem*

External or
Economic
Obsolescence

• *Market Problem*

*Source: ChatGPT
(without citation,
claims to be
paraphrased from
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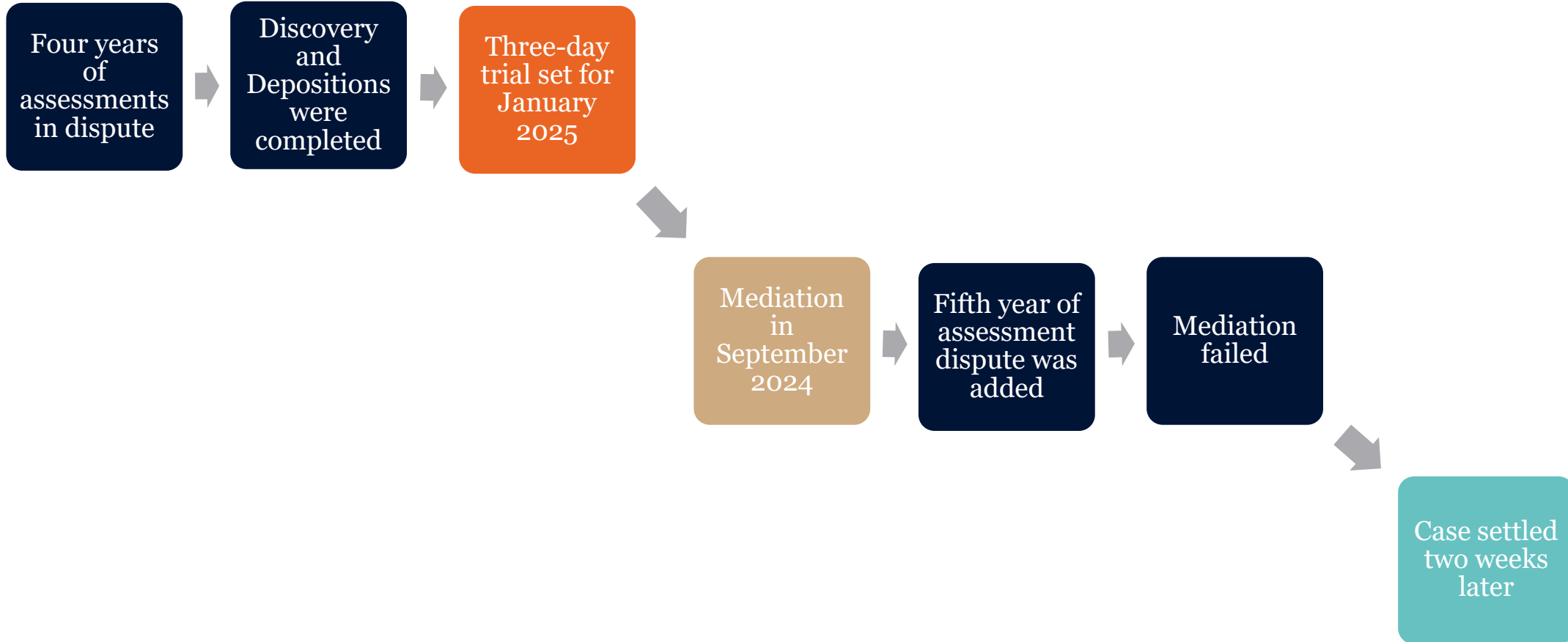
The Depreciation Buffet

Depreciation Details	Wilson	Comments	Taxpayer	Comments
Physical	10%	full bldg	26.9%	full bldg
Functional Obs	55%	full bldg**	100.0%	2nd floor
External Obs	0%		35.0%	full bldg*
Overall	65%		85.0%	
	** Functional sf vs Value add		*Feasibility Rent / Actual Inc	

Cost Approach Comparison

Cost Approach	Wilson	\$/sf	Taxpayer	\$/sq ft
RCN	\$ 24,000,000	\$200.00	\$ 23,669,893	\$215.18
Deprec	\$ (15,600,000)	-65%	\$ (20,010,222)	-85%
Depr. Impvts.	\$ 8,400,000	\$76.36	\$ 3,659,671	\$33.27
Land	\$ 8,910,000	\$50.00	\$ 2,520,000	\$14.15
Total	\$ 17,310,000	\$157.36	\$ 6,179,671	\$56.18
Reconciled	\$ 17,310,000	\$157.36	\$ 6,180,000	\$56.18

So What Happened?



Final Scorecard

YEAR	TAX ASSESSMENT	SHAWN WILSON TOTAL MV	CORRECTION	TAXPAYER'S TOTAL MV
2024	\$ 14,334,200		\$ 12,741,500	\$ 9,000,000
2023	\$ 18,021,600	\$ 19,130,000	\$ 17,500,000	\$ 6,840,000
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Any questions?

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