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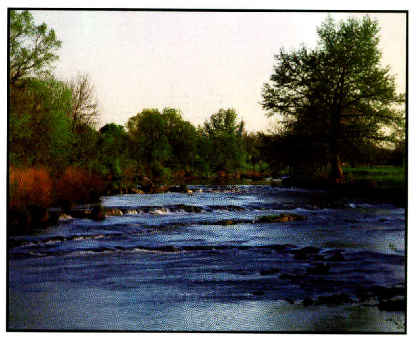
On the Cover



The Pedernales River in the Texas Hill Country invites campers, hikers and swimmers. Less than 100 miles long, the river flows here through the Lyndon B. Johnson National Historic Park. Photographer Laurence Parent.

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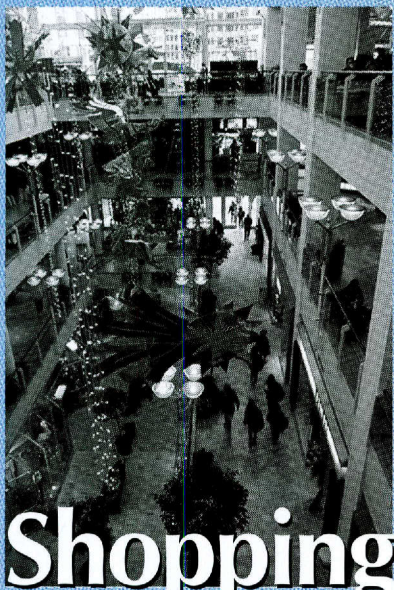
BENCHMARKS



Shopping Center Trends

What do jazz, blue jeans and shopping centers have in common? They are all U.S. exports. The International Council of Shopping Centers (ICSC) celebrates its fortieth anniversary this year and notes with pride that more than 60 countries are represented among its 34,000 members.

At the ICSC's annual meeting in Las Vegas recently, trends were a prime topic of discussion.

Look for new services offered in shopping centers—oil changing, dry cleaning, libraries, automobile license renewal, housing information—anything that does not compete with a center retailer, says Rebecca L. Maccardini of Forbes/Cohen Properties in Southfield, Michigan.

The impact of shopping centers is often overlooked, says William H. McCabe, Jr., of New England Development in Newton, Massachusetts. Frequently shopping centers are the largest local taxpayer and largest employer. He says shopping centers must renew their look periodically.

"If you're not doing something major after ten years, you're in trouble," says McCabe.

"In 1946, the nation had perhaps 100 shopping centers," says F. Kemper Freeman, Jr., of Kemper Development Company in Bellevue, Washington. "Today the evolution of shopping centers has entered a new stage—redevelopment. It's the biggest trend in the industry."

Other trends the experts see include:

- Bankruptcy abuse. As bankruptcy stigma fades, retailers use it as excuse for closing poorly located stores.
- Retail innovations. Local retailers find niche in boutique shops.
- Larger stores. Expanding amenities and product lines.
- Entertainment focus. Retailers point to studies showing 60 percent of movie patrons also shopped in the mall.
- Merchandise diversification. Retailers look to other revenue sources. Example: 40 percent of Rain Forest Café revenue is from nonfood items.
- Slow growth. Fewer shopping centers built and existing centers emphasize capturing greater market share. Renovation outpaces new construction.
- Super centers. Still big news.
- Consumer buying habits. Drastic changes expected as technology enables shopping via the world-wide web. Catalog stores hurt most by Internet.
- Urban redevelopment. Key components include trendy retailers, live stage performances, restaurant potpourri and virtual reality games.
- Suburban reimaging. Brighter colors, new tenants.

Office Market Outlook

Just three or four years ago, the office market outlook was so bleak many wondered if it would ever recover.

"Today it's hard to find an office market anywhere that is declining," says Stephen Duffy of Ernst & Young in Newport Beach, California. But two notable exceptions are Dallas and Los Angeles.

In Dallas, office vacancy is 25 to 30 percent. In Los Angeles, it is 18 to 24 percent.

"Dallas is a difficult office market," he says. "Nearby Los Colinas marketplace is on fire. Speculative offices are being built, and rents are rising."

Duffy believes the latter trend will revive the downtown. Today, the most expensive office space is in the suburbs. The relatively low cost of downtown offices will eventually lure tenants back.

Sugarland is prime for retail office development, says Duffy. The burgeoning bedroom community lacks the offices that normally follow residential development.

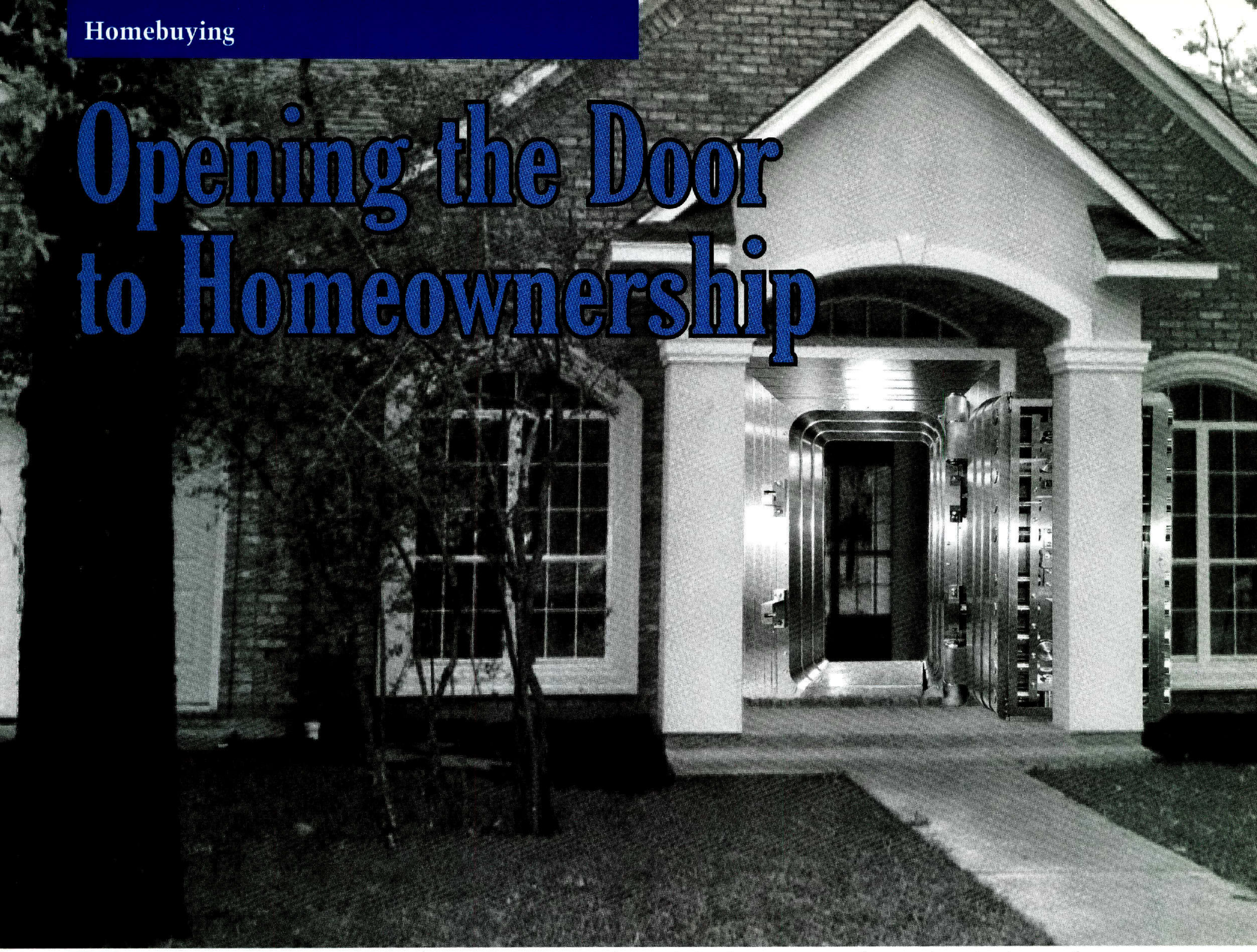
"Economics, demographics and amenities will combine to create a boom office market there," he says.

The reason office markets nationwide have turned around is simple, says Duffy. "Construction stopped."

No question—higher rents lie ahead, says Duffy. John Knott of Sullivan & Knott in Las Vegas, Nevada, agrees. "Markets are improving, vacancy rates are falling and space is getting tight."

(Benchmarks continued on page 22)

Opening the Door to Homeownership



By Jack C. Harris

Great times for housing markets mark the end of this decade. Moderate economic prosperity—no booms, no busts—and low interest rates have created robust markets around the country. Texas 1996 home sales through Multiple Listing Services were up by 8 percent from the previous year. The state's overall affordability has never been better. By year's end, more than 70 percent of Texas households could afford to buy a median-priced home.

Many would-be first-time buyers, however, apparently are hitting financial barriers to homeownership. The percentage of Texas households owning their home has been falling behind the nation for more than two decades. In 1996, only five other states had a lower ownership rate than Texas. Unlike the nation, Texas has never fully recovered from the declining ownership rates of the 1980s. In 1996, 61.8 percent of Texas households owned their homes (65.4 percent nationwide) compared to 62.5 percent in 1982. This pattern means that not enough new homeowners are being created to replace those who die, move or become renters.

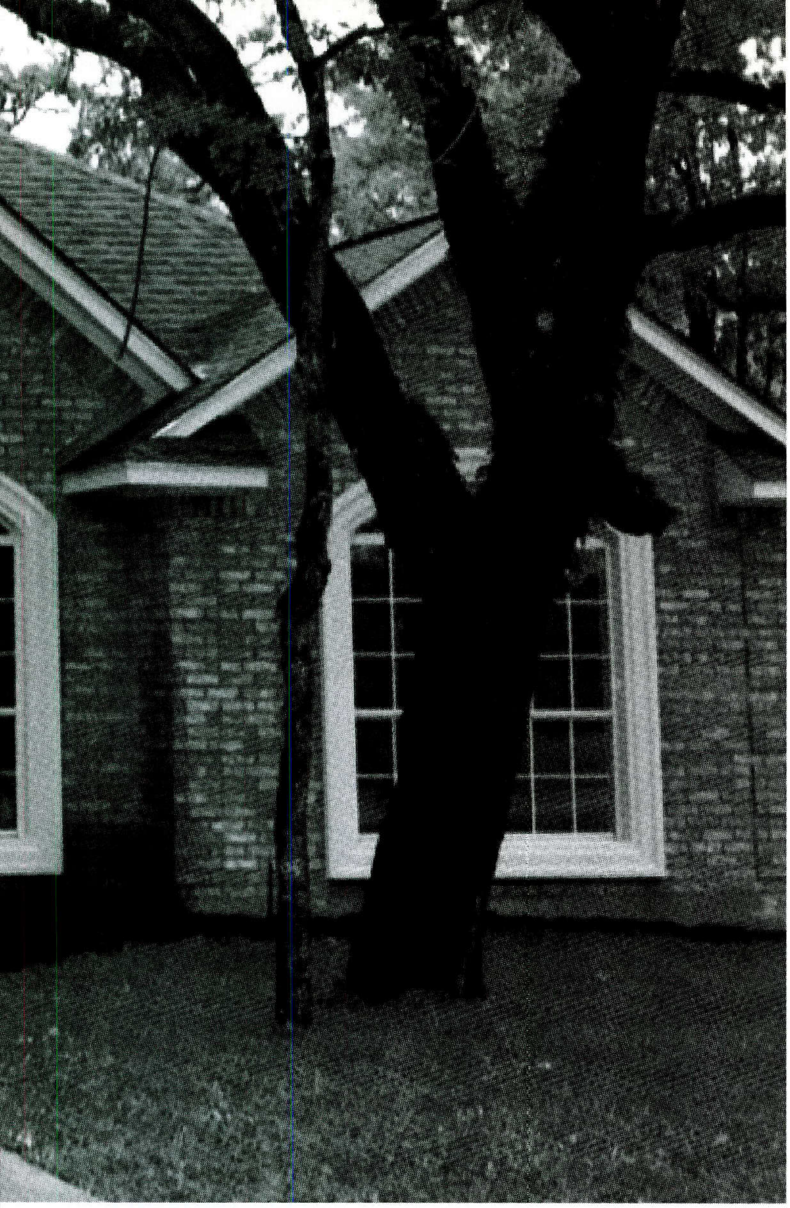
Nationally, homeownership rates among the young have not recovered. The rate for household heads aged 35-39 was 61.1 in 1996, down from 67.6 percent in 1982. For those aged 30-34, the rate fell from 57.1 to 52.6 percent. Although current age-composition data are not available for Texas, it might be reasonable to suspect an even more adverse trend in light of the state's lower overall rate.

This downward trend is important because first-time buyers are vital to housing markets. Normally, most sales represent existing homeowners who are changing houses for one reason or another. The percentage of repeat buyers ran about 60 percent in the 1980s but dipped to less than 55 percent in the mid-1990s, according to Chicago Title Company's most recent homebuyers' survey. Some of these relocatees are newcomers to the area, counterbalanced somewhat by those leaving the area. The rest are households moving up to better accommodations. Generally, "move-up" buyers need someone to purchase their old home. Frequently, this is the role of the first-time buyer. Without sufficient first-timers, owners of modest homes can not move as easily, slowing the entire housing chain.

Housing Markets Tough on First-Time Buyers

People who buy a home usually remain homeowners through subsequent moves. Unless they encounter unusually bad markets, homeowners build equity through mortgage repayment and home appreciation. This equity provides the down payment for future houses. Also, tax laws allow homeowners to defer capital gains on home sales when they purchase a replacement home of equal value. It is the first purchase that is tough.

Why are people finding it so difficult to buy that first home? First-time buyers are highly sensitive to the cash requirements of the purchase. They do not have proceeds from a previous sale to supply a down payment. The low interest rates that make mortgages more affordable also mean that savings deposited in liquid accounts grow slowly. At the same time, mortgage lenders have been making fewer high loan-to-value, insured mortgages until the last few years pressured by a demand for more affordable loans (see figure).



Many potential homebuyers may believe they are not affluent enough to obtain a loan. A recent survey by the Mortgage Guaranty Insurance Corporation found that two-thirds of borrowers who had taken advantage of special mortgage programs could have qualified under standard criteria. They became homeowners primarily because program administrators showed them how to qualify.

The mortgage industry has made a concerted effort to make homeownership more accessible. They now offer special loans and programs that reduce down payment requirements, offer alternative ways for a borrower to acquire a down payment, ease qualifying criteria and help prospective buyers better understand the financing decision and responsibility of homebuying. This article describes resources available to Texas homebuyers. Details on obtaining more information about these programs are provided.

Easing Market Entry

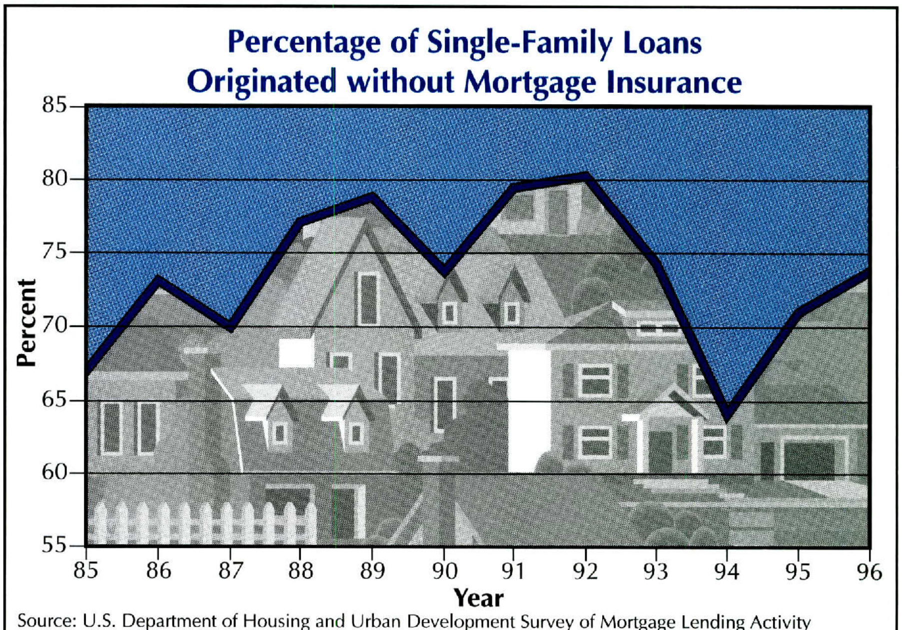
Virtually all segments of the mortgage industry recognize the problem of entry-level buyers and are trying to present solutions. An alliance of federal agencies, industry groups and nonprofit organizations has been formed at the national level. The goal of National Partners in Homeownership is to raise the nation's homeownership rate to 67.5 percent. A parallel 2 percentage point increase in Texas homeownership would produce 136,000 new homeowners. The trick is to reduce the often-formidable financial commitment required to get a mortgage, yet not undermine the borrower's sense of responsibility and ability to repay the loan. All this must be done while remaining profitable (for private entities) or conserving public resources.

From the lender's standpoint, a mortgage loan is highly leveraged even when the borrower makes a 20 percent down payment. When the down payment is reduced to 5 percent, the lender takes on most of the risk that the property will hold its value. From the viewpoint of a prospective homebuyer, however, even a 5 percent down payment, on top of other transaction costs, may be a major obstacle. Yet 5 percent is about the lowest rate available with conventional financing.

Those needing more help traditionally have sought Federal Housing Administration (FHA) insurance, which can provide more leverage (especially with transaction costs and the mortgage insurance premium wrapped into the loan). The FHA 203(b) program, which insures single-family mortgages, was changed in 1991, making it somewhat less attractive to the cash-strapped homebuyer. The volume of loans insured by FHA in 1991 was the lowest in six years.

Now the pendulum is swinging the other way, and the 203(b) loan is, once again, a good starting place for the first-time buyer. The 1991 restrictions on the percent of closing costs that can be financed into the loan have been repealed. The one-time insurance premium (MIP) due at closing has been reduced to 2.25 points from the original 3.8 points (the premium is 2 points for loans with 15-year or shorter terms). Additionally, homebuyers who complete a special education course need only pay a 2 percent up-front premium.

The maximum mortgage amount has been raised and now is pegged to the maximum size loans that the Federal Home Loan Mortgage Corporation (Freddie Mac) can purchase (the FHA limit for single-unit Texas homes ranges from $78,660 in most counties to a high of $145,000 in Galveston). The annual one-half percent premium is still in effect, however. One new thing that FHA does for young buyers is to allow friends and family to help with the down payment (including a pilot program that lets young couples set up a bridal registry for those who want to contribute to a home purchase fund). The FHA now allows borrowers to use parental loans as part of the down payment.

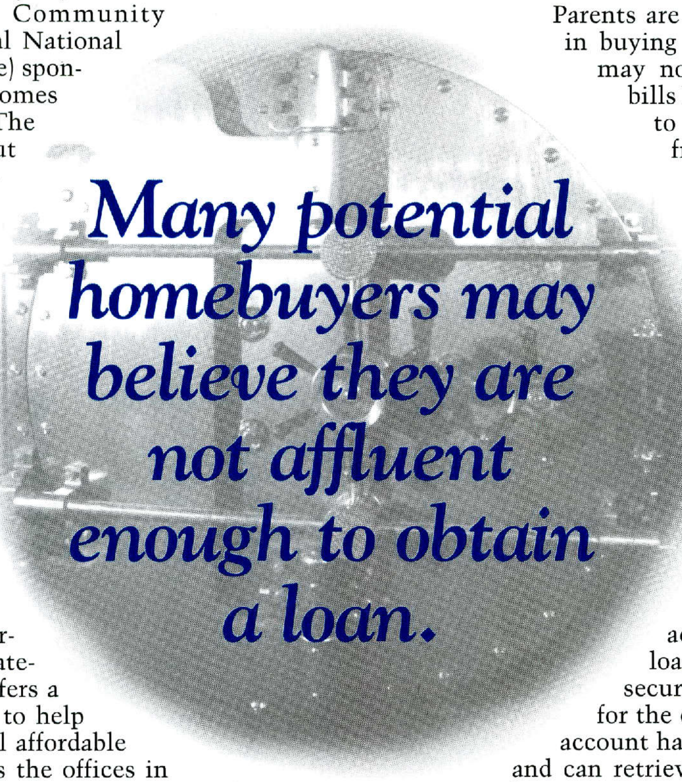


Source: U.S. Department of Housing and Urban Development Survey of Mortgage Lending Activity

Another FHA program has attracted considerable interest from those seeking loans with low down payments. The 203(k) program is designed for homes that require substantial rehabilitation. In other words, this program is ideal for those who want to invest "sweat equity." The unique feature is basing the loan on the lesser of total acquisition and renovation costs or 110 percent of estimated value after renovations. For owner-occupants, the loan amount is calculated like the 203(b) program.

A number of special loans in the conventional arena, while not restricted to first-time homebuyers, are well suited to their needs. Under the Community Homebuyers Program, the Federal National Mortgage Association (Fannie Mae) sponsors loans for borrowers with incomes lower than the local median. The program was launched in 1989 but expanded in 1994 with Fannie Mae's commitment to provide $1 trillion for ten million home loans by 2000, of which $311 billion has been committed.

Four types of loans are available under the program: Fannie 97 (requiring a 3 percent cash down payment), a 3/2 option loan (3 percent cash plus 2 percent loan or grant), Start-Up Mortgage (interest-only payments in the first year) and Fannie Neighbors (waives the income limit in designated central cities). Currently, 106 Texas lending institutions participate, and all but ten operate statewide. In addition, Fannie Mae offers a network of "partnership offices" to help coordinate the program with local affordable housing efforts. The table shows the offices in Texas and Fannie Mae's five-year commitment to each city.



Many potential homebuyers may believe they are not affluent enough to obtain a loan.

Fannie Mae Partnership Offices in Texas

City	Five-Year Commitment
Houston	$2 billion
San Antonio	$1 billion
Border Region	
El Paso	$500 million
Laredo	$105 million

Source: Federal National Mortgage Association

Freddie Mac takes a similar approach in its Affordable Gold program, launched in October 1996. Included in the program are 3 percent, 5 percent and 3/2 option down payment loans. Both Fannie Mae and Freddie Mac recognize that lender risks are increased under such loan terms. To try to head off delinquency problems, the agencies require special educational courses and counseling for borrowers.

One product of the Financial Institutions Reform, Regulation and Enforcement Act of 1989 is a mandate to the regional Federal Home Loan Banks (FHLB) creating a fund for special affordable housing programs. As a consequence, the FHLB of Dallas conducts an Affordable Housing Program that finances the purchase, construction and rehabilitation of homes for families with limited income.

Owner-occupant programs cater to families with no more than 80 percent of the local median income, while rental housing programs target families with no more than 50 percent of median income. The Dallas bank operates the program by awarding advances and grants to stockholder institutions and nonprofit organizations that submit proposals along the bank's guidelines. The bank moneys may be used to pay closing costs, lower down payments, buy down principal amounts, buy down interest rates or a combination of these elements. This program is relatively small (the bank awarded more than $1 million to Texas institutions in the second half of 1996) but might be worth an inquiry when other options are not suitable.

Parents are a common source for assistance in buying a first home. However, parents may not have the ready cash. Several bills have been introduced in Congress to allow penalty-free withdrawals from Individual Retirement Accounts (IRA) for this purpose. Despite widespread verbal support, little has been accomplished to make this a reality. A bill was passed in 1996 that allows IRA withdrawals for medical purposes. So, a precedent has been set for opening these accounts for selected purposes.

Parents may find other opportunities to help without committing cash. Some banks and security brokerage houses make mortgage loans up to 100 percent of value when the borrower or sponsor opens an account pledged to back up the loan. Basically, the value of money or securities in the account substitutes for the down payment. The owner of the account has access to any income generated and can retrieve the account when the loan is retired.

Working the Qualifying Side

One consequence of a reduced down payment is an increased loan debt. This puts additional pressure on the borrower's ability to qualify for the loan. Therefore, while the down payment often is recognized as the biggest problem facing the novice buyer, easing underwriting criteria may be necessary as well. Many programs described previously have income and debt ratios that are more generous than those for standard conventional loans. In addition, the government provides first-timer mortgage loans at below-market interest rates through the tax-exempt mortgage bond program.

Loans within Fannie Mae's Community Homebuyers program feature qualifying ratios usually found on loans with higher down payments. For example, their 3/2 option loan requires monthly payments to be no more than 33 percent of monthly income and total monthly debt payments to be no more than 38 percent of income. Even these relaxed standards are considered "guidelines" that could be exceeded if evidence suggests that the borrower can handle higher levels of debt (for example, a good record of paying rental payments as large as the projected debt payment).

Freddie Mac takes a similar approach. No maximum housing expense-to-income ratio is set, but a guideline of total debt payments-to-income ratio of 40 percent maximum is used unless there are compensating factors (such as a track record of handling higher debt). In addition, loans originated as part of the FHLB program may offer easier qualifying guidelines or lower interest rates.

Below-market interest rates, and thereby easier qualifying, is the primary attraction of the mortgage revenue bond (MRB) program, one of the oldest assistance programs specifically targeted to first-time buyers. The program originated in the 1970s when a group of municipalities began floating bond issues to provide mortgage loans to their residents. Such bonds are exempt from federal income tax. Consequently, mortgage loans with below-market interest rates could be made from bond proceeds at no net cost to the city government. The Mortgage Subsidy Bond Tax Act of 1980 restricted the loans to first-time buyers and capped each state's volume to the greater of $200 million or 9 percent of the average volume of mortgage loans originated within the state during the last three years.

Part of the Texas allocation is used by the Department of Housing and Community Affairs to fund mortgages offered by lenders statewide. The remainder can be used by individual localities that want to issue their own bonds. Since 1985, the department has issued more than $1.7 billion in single-family mortgage revenue bonds. The most recent state-wide program provides more than $98 million in mortgages with an interest rate of 6.65 percent with one origination and one discount point. These are 30-year, fixed-rate loans with 3 to 5 percent down payments and can be used to buy new or existing homes. The department has a companion program of down payment assistance that can reduce the initial outlay to 3 percent cash combined with a special noninterest-bearing loan that is repayable at sale, refinancing or loan retirement.

To be eligible for these loans, a borrower must not have owned a home during the past three years. They must have an income no higher than the local median and qualify for the loan. The limit on the value of the home purchased with one of these loans is 90 percent of the median area purchase price (call the department's hot line at 1-800-792-1119 for details). If the borrower's income is less than 80 percent of the median, he or she is eligible for the down payment assistance program. If income is lower than 50 percent of the median, the borrower does not have to be a first-time buyer.

Future Housing Market

Everyone benefits from easier entry into the housing market. A steady supply of new buyers makes trade-up buying more feasible. An active market is beneficial to the brokerage industry. And the key to market activity is affordable financing.

Fortunately, many of the major players in the mortgage field are making special efforts to extend affordability to first-time and moderate-income buyers. Agents knowledgeable about these sources of affordable loans may be able to open up new markets for entry-level homes. Program providers offer brochures and other descriptive information on these loans. A canvas of local lenders may indicate who is participating in affordable programs and the specifics of those loans. Having the right financing source could expand the horizon for both the buyer and the agent.

Dr. Harris is a research economist with the Real Estate Center at Texas A&M University.

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For More Information on Loan Programs

The best way to find out what is available in local areas is to contact mortgage lenders in the community to see if they participate in the described programs or offer similar ones. In addition, the Texas Department of Housing and Community Affairs can send a list of lenders participating in their mortgage bond program (local governments may have bond programs in addition to the state program). For more information on the loan programs described in the article, contact the following agencies:

Federal Housing Administration (FHA). The FHA is a component of the U.S. Department of Housing and Urban Development (HUD). The state office can be reached at 817-978-9000. Regional offices are located in Dallas (214-767-8359), Houston (713-313-2274), Lubbock (806-743-7265) and San Antonio (210-472-6806). To find out more about the pilot program that allows funds from a special bridal registry to be applied to the down payment, call 1-800-CALLFHA. The web home page for HUD is at www.hud.gov; it offers information about FHA and other housing programs, as well as links to state and regional offices. A complete description of the 203(k) program can be found at www.hud.gov/fha/sfh/sfhrehab.html.

Federal National Mortgage Association (Fannie Mae). Information on Community Homebuyers can be found at 1-800-7FANNIE. Their web site is www.fanniemae.com.

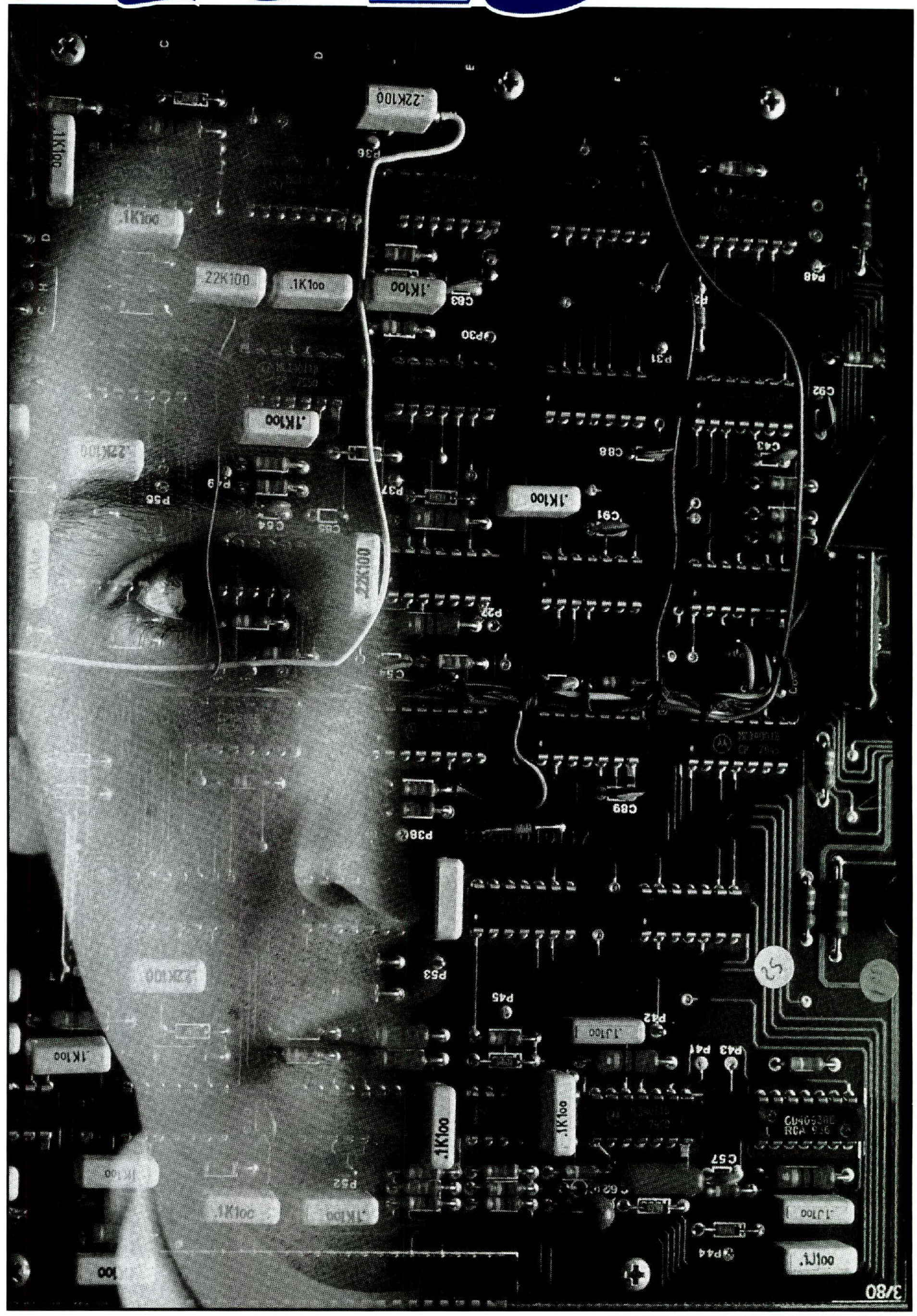
Federal Home Loan Mortgage Corporation (Freddie Mac). This agency has three contact methods. The telephone number is 703-903-3933. The web site is www.freddiemac.com. The e-mail address is corprel@freddiemac.com.

Federal Home Loan Bank of Dallas. The number for the Community Investment Division, which administers the Affordable Housing program, is 214-714-8712. Their extensive web site is at www.fhlb.com (add "/ahp.html" to the address for details on the program).

Texas Department of Housing and Community Affairs. The department maintains a toll-free hot line at 1-800-792-1119 to handle questions on its programs. Consumers may request a brief description of the current state bond program complete with names of participating local lenders.

CHOICES

By Allen Tappe



In many ways, opportunity has never been greater in the real estate industry. However, for the first time, consumers have a real choice to make. Will they pay for real estate services, or will they provide for themselves? Technology empowers buyers, sellers and investors to choose nontraditional participation in the real estate market.

The real estate community must answer some real questions to seize today's opportunities. How can professionals offer quality service to consumers? Will consumers buy what the industry is selling?

Industry outsourcing answers part of the question. Many organizations buy services from outside sources that they could provide for themselves. Individuals do the same thing—contract landscape services, hire mechanics to work on automobiles, call for computer support and seek legal services and healthcare. Why do consumers choose to pay for certain services rather than rely on their own abilities?

Marketing Motivators

Several reasons motivate consumer and investor decisions to purchase outside services.

Convenience is one issue. Helping a homebuyer, for example, anticipate the weight of the burden they are choosing to bear is important to the selling process.

Time and timing are both significant issues. Personal time involved and invested must be considered and valued. Will they have the time to get it done, and will they get it done in time? Real estate consumers face this question when they choose not to engage a professional.

Security is another major issue in every real estate transaction, yet it is rarely discussed in the selling process. Many real estate professionals have been threatened and attacked while selling homes. Do people really want to put their families at risk just to save money? They need to weigh all the facts.

Beyond the physical risks come the legal and investment risks. Do consumers understand the personal exposure involved in title and disclosure issues? Helping them think through the whole story is the role of the selling professional.

Complexity may hamper any but the most astute do-it-yourselfer. Beyond the convenience issue lies the reality that buying and selling property is not automatic. Finding the right buyer or seller is not always easily accomplished. What is the market doing? Do self-help consumers understand the size of the mountain they are choosing to climb?

Financial implications also are significant. Using professional negotiators is a practical money issue. Professional representation can provide a tremendous financial advantage. Consumers need to consider the prospect of leaving money on the table as a consequence of trying to negotiate for themselves.

Every consumer should deal with these issues creatively. However, real estate professionals also must analyze their own role in the new marketplace.

Rethinking the Standards

Past services need to be redefined. Some skills may need to be retooled or replaced. Industry standards may need to be raised. An opportunity to change lies ahead.

Professional self-image is the basis for ultimate value in the marketplace. If real estate professionals do not believe in themselves and their services, then why should clients hire them?

Industry reputation is vital to consumer confidence. Why are not the brightest and the best being recruited into this industry? How many colleges and universities have real estate recruiters on their campuses? Young people are looking for opportunity, not jobs. Does real estate represent a valid career? Brokers and managers need to proactively target recruits rather than passively receiving anyone who can breathe and pass the licensing test.

Retention needs to become the rule rather than the exception. Too many new agents come into this business and are tossed into the deep water with little or no support. As a result, the industry accepts an 80 percent fall-out ratio for new agents. The profession's message and reputation suffer as a result.

Performance expectations are too low. Unfortunately, too many agents are being encouraged to settle for less than a minimum wage existence. When people are dealing with major financial pressures, they are often tempted to sacrifice professional performance for survival.

Customer service standards need to be higher. Trust in a professional relationship is born out of honesty and integrity. How long do consumers have to complain about not hearing from their agent before the industry decides to make it an issue? Legal and ethical matters have long since received industry attention; however, customer service has been left to individual and company discretion. What if local boards made it more of an issue? What if warnings and fines were given to proven offenders? What if habitual offenders were ultimately removed from their board of choice? How attractive would that board of choice become to real professionals? What would consumers think?

Practicing real estate is about choices. Helping consumers to recognize and fully understand the choices they are making about *convenience, time, timing, security* and market *complexity* is a professional responsibility. Awakening to the significance of choices that influence *self-image, reputation, retention, success* and consumer *trust* is equally vital. An even greater need, however, is to understand the high-tech world.

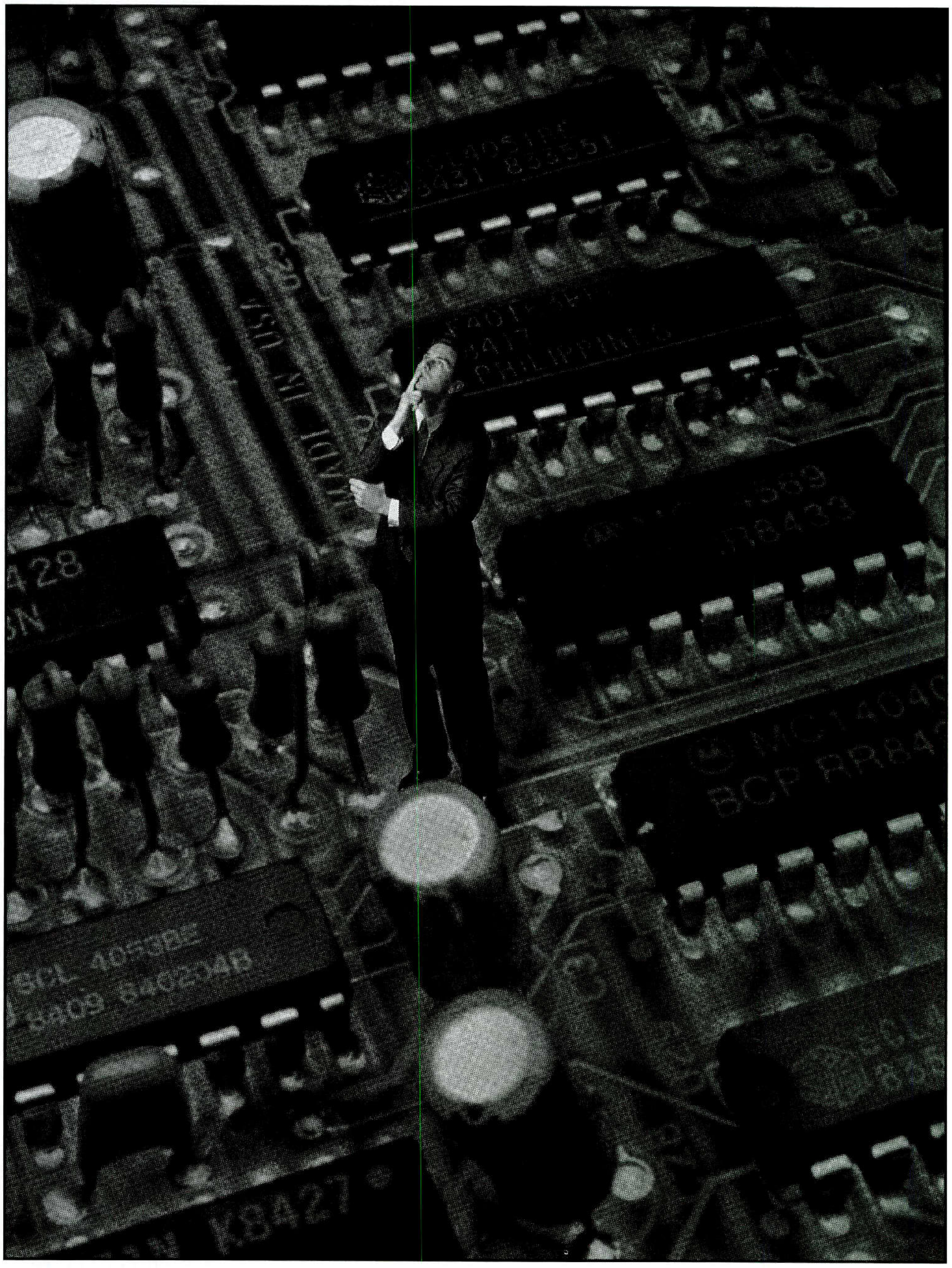
Twenty years ago, John Naisbitt saw the need for "high touch response" in a high-tech world. The most significant question facing every professional is "What value do I bring to the table that will not soon, if ever, be replaced by the computer?" The computer has definitely increased the capacity to perform, and it has provided incredible convenience. At the same time, it has become a foe of sorts.

Jeremy Rifken, in his book *The End of Work*, chronicles the impact of automation and then focuses upon what he calls "the third revolution." For the first time, "white collar" America faces the same challenge "blue collar" America dealt with earlier—displacement by a machine. The question is: Are real estate professionals ready to respond to the challenge? Unless the high-touch people issues are addressed, this industry inevitably will decline.

Responding to Reality

More effective interpersonal connection is one challenge. This requires mastering key concepts, skills and disciplines such as communication. In the past, the industry has taken communication for granted. It seemed to come with the adult package. Unfortunately, adults often come together in the marketplace with no real ability to communicate. Instead of connecting, they collide.

Communication is a "cross cultural" experience. People from different backgrounds do not always communicate, even when speaking the same language. Anticipation and preparation are vital to communication. Never assume anything in interpersonal transactions. Effective discovery about the other person is essential. Ask questions and listen actively for the insights that will foster connection.



Brokers must make wise professional choices. They must accept the challenge the computer offers and respond with the human connection. . . .

Effective communication alleviates fear. Insecurity characterizes this period in history more than ever before. The breakdown of foundational institutions, coupled with rapid change, has taken a toll. Licensees should never underestimate the potential insecurity of their clients.

Facing Conflict

Human conflict also challenges the professional. Conflict is not much appreciated, and it is most often avoided or denied. A professional's role, however, is to facilitate resolution. The following keys are essential to handling conflict.

Appreciate it. Nothing of value comes without some conflict. Real estate opportunities arise out of consumer conflict. Conflict may generate better customer service. Recognize it and accept it as opportunity.

Anticipate it. Anticipation is the best form of preparation. Expect conflict.

Prepare for it. Be prepared to provide leadership. A professional must be prepared to respond with reason as opposed to reacting out of emotion. Rather than personalizing, perform.

Real estate practitioners have the opportunity to help consumers and investors make informed choices.

Create with it. Conflict is energy and can be used as a creative force. A professional will seize the opportunity and respond with the kind of service that makes a company legendary in the customer's mind.

Customer service is often talked about but sadly neglected. The best professional connection with customers requires a responsive style and approach. A profitable connection embraces the following concepts:

Customer service is a lifestyle, not a program. Those who do not enjoy serving people should find another career. Real estate clients pay for service. They deserve it. The professional's job is to serve the client.

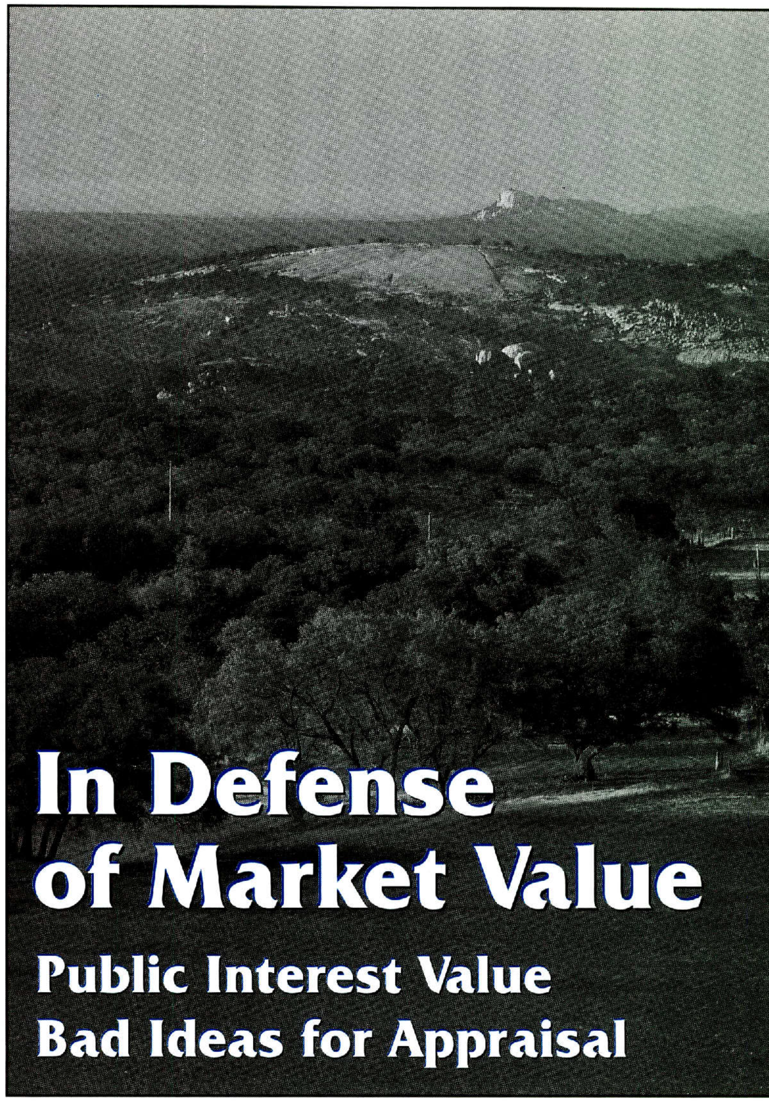
Customers are employers. While officially independent contractors, in reality real estate licensees are employees of the customers. If customers go away, the profession goes away. What clients need and want counts.

Customers are the future. The opportunity to serve others will be produced through the distinctiveness of the service. Customer appreciation is an opportunity to produce. Referrals must be created. Ask for them.

After weighing the facts, it is easy to see that the real estate industry is not dead. It may be in decline if real estate professionals are not committed to excellence. Today's choices will write tomorrow's history. Real estate practitioners have the opportunity to help consumers and investors make informed choices.

At the same time, brokers must make wise professional choices. They must accept the challenge the computer offers and respond with the human connection no computer will ever know. Will people pay for services they are now empowered to perform for themselves? Absolutely. Real estate professionals can choose today to be the chosen alternative.

Tappe is president of The Tappe Group in Arlington, Texas. This article is based on comments made at a point-counterpoint debate sponsored by the Texas Association of Realtors in April 1997.



In Defense of Market Value

Public Interest Value Bad Ideas for Appraisal

By Charles E. Gilliland

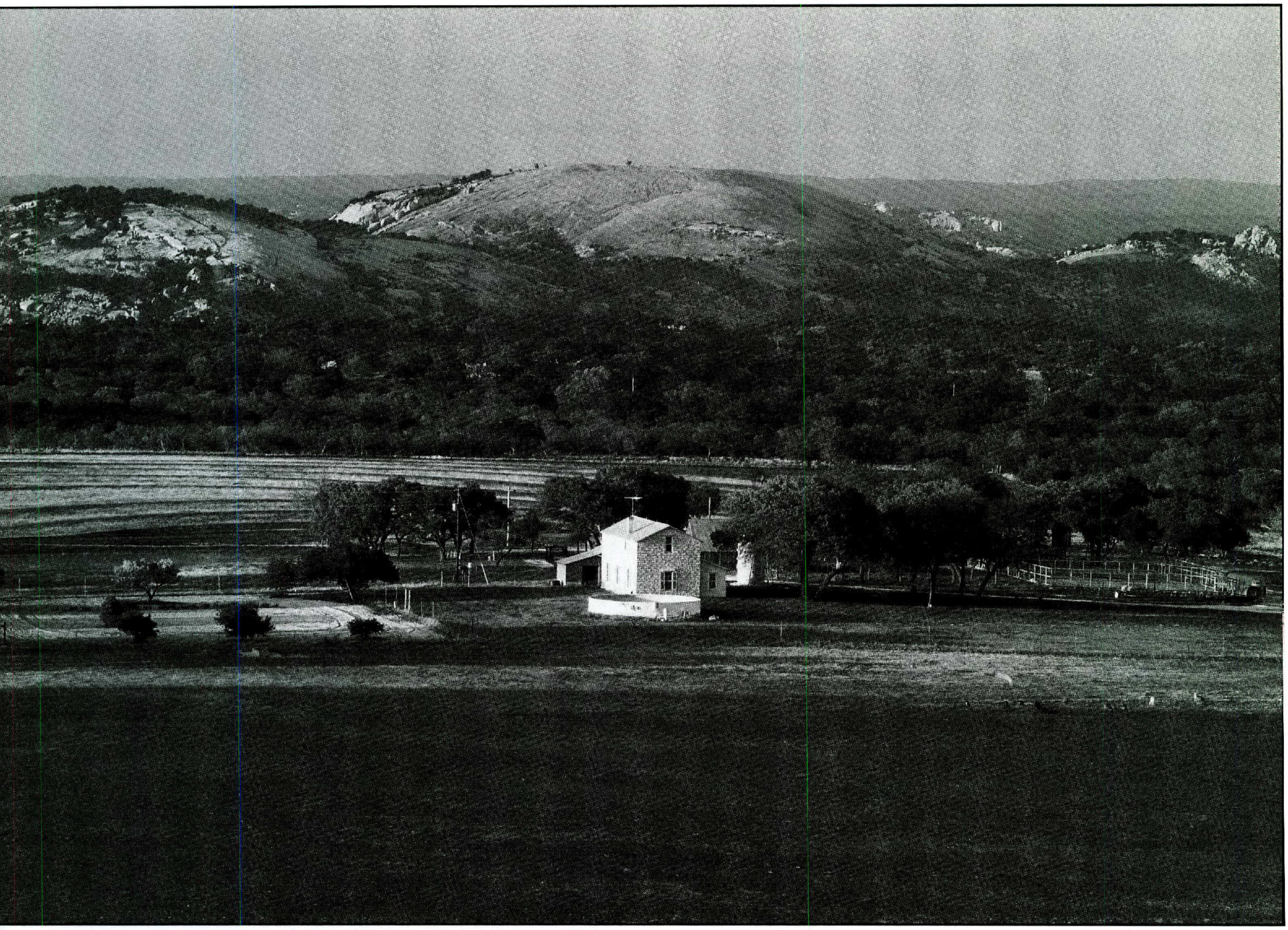
The drive to create government-owned environmental preserves has precipitated a controversy in the appraisal industry. Government agencies have acquired properties for which the cost exceeded market values. After such purchases were found to be illegal, some individuals suggested altering the concepts of market value and highest and best use to allow higher prices for environmentally significant real estate.

As defined in the *Appraisal Journal*, "Environmentally significant real estate is . . . a bundle of private real property rights that controls use of a parcel with attributes of geographical, biological, ecological, archaeological, paleontological, cultural, and/or historical significance to society" ("Highest and Best Use: Preservation of Environmentally Significant Real Estate" by Donald C. Wilson, January 1996, p. 76).

This idea has ignited controversy among appraisers because it threatens to alter current appraisal standards and inflate the cost of setting aside environmental preserves. This solution could pave the way to altering appraisal practice in other areas when market value estimates inconveniently obstruct planned projects.

Eminent Domain

The government generally acquires property for public uses through condemnation or a purchase under the threat of condemnation. For example, private land transactions seldom occur to accommodate highway construction. The



eminent domain process assumes that the public purpose constitutes greater value than the exchange value between typical participants in the private market. Furthermore, the process deems market value (value-in-exchange) in a private, competitive market between unrelated buyers and sellers to constitute fair compensation for private assets required to accomplish government objectives for the public good.

The government, however, rarely needs properties chosen at random from a market. Rather, it targets specific tracts because of their unique features. For example, properties located in the path of a planned highway are indispensable and, therefore, targeted for acquisition.

When a private user wants a property for a particular use, the buyer acquires it by offering a sum representing greater value for the current owner than continued ownership. These prices often exceed market value for three reasons.

First, no market for land in the envisioned use currently exists. Second, the buyer believes that profits from the envisioned use will exceed returns to current uses. Third, the owner clearly values continued ownership more than the value-in-exchange. Both the owner and the buyer harbor private property valuations that exceed market value. Clearly, offers at market value will not be accepted.

When current owners have no motivation to sell, government offers on land needed for a public project often meet determined resistance. However, allowing government to increase offers to more than market value would open the door to potential corruption. Condemning authorities could fashion special terms for favored constituents and vastly increase the cost of a public project in the process. Therefore, the courts in eminent domain proceedings have established market value as a fair basis for compensating owners when a public project requires private property. This solution ensures that government pays the opportunity cost of diverting the needed asset from its current use. Meanwhile, the previous owner receives compensation that could replace the property with an equivalent.

Typically, the government extends offers to property owners based on an appraised value at current highest and best use. Frequently, property owners object to initial offers, and the condemnation process focuses on estimates of the market value of the property. Appraisers rely on a commonly accepted set of definitions and principles to estimate these values. Because appraisers apply these principles, most controversies converge to a limited range of possible market values. A fact-finding entity then hears evidence and determines compensation.

Acquisitions without Eminent Domain

When government undertakes a public project without the power of condemnation, the current owner can safely refuse to accept market value offers. If the agencies pursue these projects while constrained to market value, appraisals based on market values of currently competing private uses can obstruct the project. Agencies may find these appraised values to be a barrier when they fall short of an owner's reserve price. Because appraisers adhere to prescribed concepts when estimating market value, deals fail. An appraisal that could provide a different, higher value could remove those difficulties.

When proponents of both private and public projects that depend on real estate values encounter binding restrictions linked to market value, they often pressure appraisers for a "more appropriate valuation." This kind of pressure produced openly scandalous abuses and contributed to the savings and loan debacle in the 1980s. As a result, the appraisal profession came under public scrutiny. In some cases, appraisers even received prison sentences. The situation precipitated reform that culminated with the adoption of a set of Uniform Standards of Professional Appraisal Practice (USPAP) designed to assure the public that every appraisal meets specific requirements.

This 1980s housecleaning should ensure that proposed changes in the appraisal process face healthy skepticism. However, a new controversy centered on appraisals of environmentally significant real estate renews pressures on some appraisers to develop accommodating market-value estimates. Proponents of environmental preservation and politically influential owners of ecologically sensitive land have urged replacing accepted market value procedures, rooted in traditional highest-and-best-use analysis, with a new concept called *public interest value.*

Redefining appraisal to evade market value standard... invites abuse....

Public Interest Value

The Appraisal Institute defines public interest value as follows:

> Public interest value is the value of a specific property to a public agency or other entity that purchases property based upon the purchaser's determination that the acquisition is in the public interest. Public interest value presumes a negotiated purchase, as opposed to a condemnation action. (See *Report of the Appraisal Standards Council Subcommittee on Public Interest Value,* p. 2).

Proponents see public interest value as a means to circumvent the perceived constraints current standards impose on government acquisitions. They contend that current standards undervalue environmentally significant real estate. Specifically, proponents argue that the concept of market value and the principle of highest and best use can not adequately account for public interest value. Therefore, they believe appraisers reach flawed conclusions when appraisals are based entirely on the private marketplace.

Difficulty arises as government entities attempt to acquire environmentally significant property without condemnation. Most agencies are constrained to pay no more than market value. Appraisers estimate a project's market value based on a projected highest and best use that identifies the comparable sales to consider. Appraisers ascertain the "reasonably probable" use of the property as that use which a dispassionate participant in the private market would envision at the time of purchase.

Governments are expected to pay only the amount required to divert land from the privately defined highest and best use. In other words, government must match the most likely bid in a private party transaction but not exceed that amount. To bid higher would allow government agencies to set prices in excess of private evaluations. Such a process could lead to government manipulation of markets to benefit specific constituents at the expense of others. This would substantially distort the market's efficiency.

Ascertaining highest and best use sets the stage for the entire appraisal process. Because environmental preservation has not been a prevalent use among competing arms-length private party buyers, appraisers must turn to another use when setting market value. Public interest value proponents argue that appraisers should consider a "noneconomic" highest and best use to estimate market value. Especially on environmentally significant real estate, they argue, the value may substantially exceed the next best use. Appraisers should consider that fact in determining value.

The disagreement over these fine points of appraisal practice actually suggests abandoning market disciplines to achieve the ends of public interest value proponents.

In some transactions, government agencies frequently purchase environmentally significant real estate from land trusts shortly after those trusts acquire the property from a private individual. The trusts negotiate a price with the owner based on market value appraisals and sell to the government at that price plus a markup.

The problem arises when the government must obtain properties at market value. Market value can not differ for the land trust and the government agency on or near the same date. Thus, government transactions that appear to return a markup to the land trust run counter to price restrictions imposed by law.

For example, a May 1992 audit conducted by the inspector general for the Department of the Interior concluded that the department had paid in excess of market value in numerous transactions. Clearly, the market value criterion blocks the government's purchase of environmentally significant properties. Using public interest value presumably would overcome this barrier.

Appraisers could be instructed to estimate a value based on environmental preservation as the proposed use. This kind of appraisal concentrates on purchases by public entities creating environmental preserves for comparable sales. Furthermore, public interest value appraisals typically exclude adjustments for remote locations, assuming that the public interest is not sensitive to location. Proponents of public interest value contend that these appraisals reflect highest and best use and produce a market value estimate for the properties in question. Opponents vigorously deny this claim.

Highest and Best Use and Market Value

The interrelated concepts of market value and highest and best use establish the validity of the appraisal process. These operational concepts, derived from economic theories about the problem of value, seek to derive an objective appraised value that reflects the cost of dedicating real estate to a given use. An estimated value derived via the traditional appraisal process represents the cost to society for diverting real estate from a physically possible, financially feasible, legal and optimum use to another use.

Highest and best use analysis simulates bids from various sources for a particular property at a specified time. The analyst considers each possible land use in turn, examining it in light of market operations. The procedure uses market data to test the four-fold highest and best use criteria designed to establish the likelihood that a particular use could prevail in a contest to gain control of the property. Potential uses include agricultural production as well as consumer-related activities, such as recreational use. The result summarizes the current prevailing use subject to social values as they are expressed through the legal and moral context of the marketplace.

Properly conducted, a highest and best use analysis indicates the most probable outcome of this hypothetical competition for ownership. The prevailing use should represent value to the most effective user of the property because he or she can and will pay more for the property than anyone else.

Critics argue that highest and best use analysis does not consider the value of other so-called stakeholders in property use decisions. Subjecting appraisal to this limitation biases the process in favor of existing uses and excludes nonmarket values such as the value of environmental preservation, they contend. This line of argument essentially rejects the market as an efficient means of allocating land to various uses.

Including highest and best use analysis in appraisal assumes that the market effectively organizes human activities to promote social improvement. The assumption rests on the powerful motivation of profit in return for promoting socially beneficial land development.

A framework of laws and customs governs acceptable enterprise practices. Within this social framework, however, owners can manage property as they see fit and realize the consequences. Generally, individual owners are viewed as being productive members of society who manage their affairs responsibly for their own profit.

In the case of environmentally significant property, highest and best use analysis will fail to provide a satisfactory result when the legal, economic and social context of the market inadequately represents the true value of environmental preservation. That failure transforms the matter from an appraisal problem to a political and legal problem. Once a political solution has defined a social consensus through a legal or moral solution, the market can incorporate the value of environmental preservation into its price-setting mechanism.

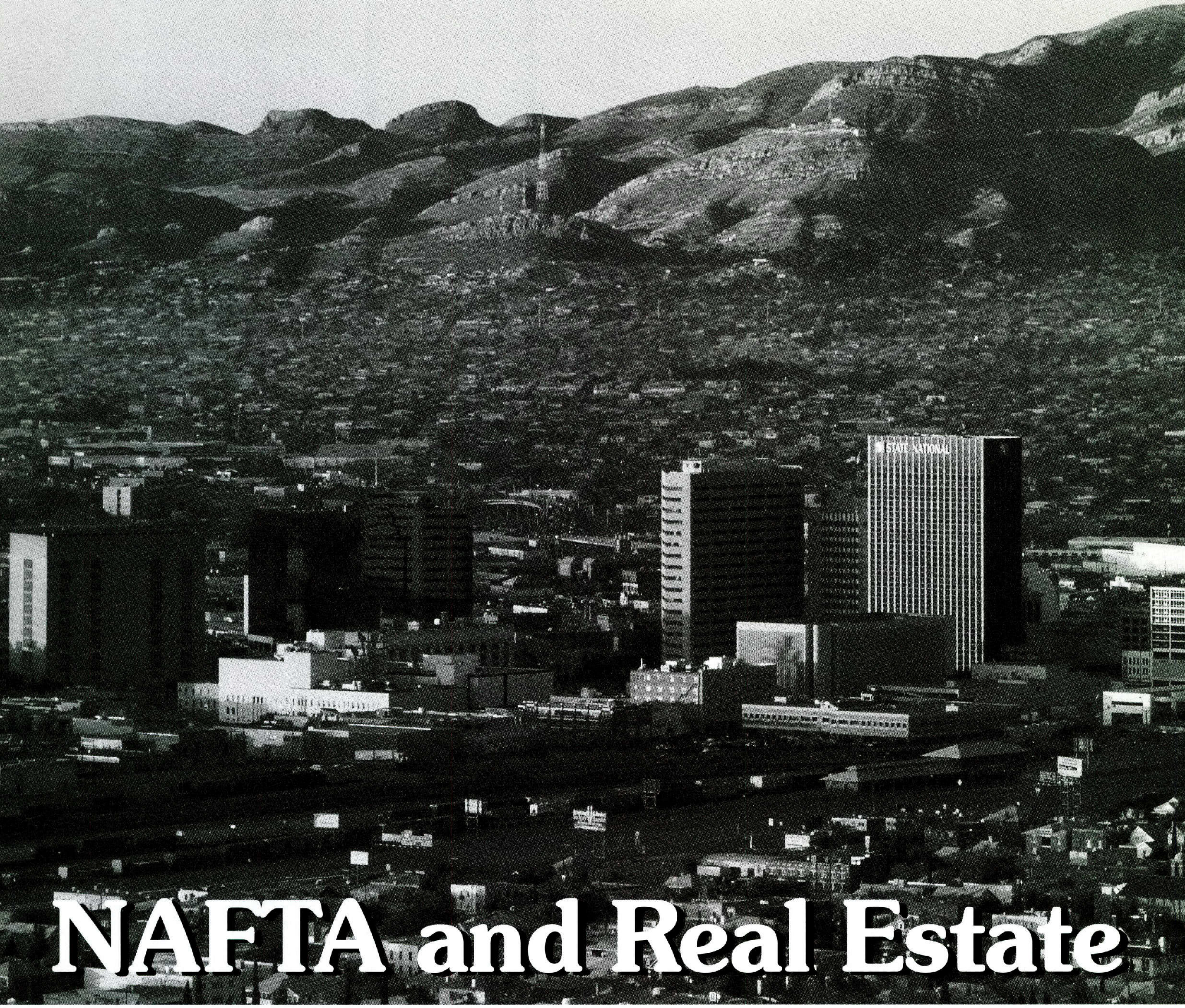
The government's size and power ensure that it can never become just another buyer in the market. Using sales negotiated by the government for their conservation holdings to establish comparable sales creates the incentive to manage today's purchase with tomorrow's valuations in mind.

Rather than create a perverse incentive system when the process involves difficulties in acquiring real estate and necessitates the use of intermediaries, the most efficient solution should require a change in government acquisition rules, not a recasting of appraisal terminology. Either the government should authorize finder fees and pay costs incurred by interim purchasers or such acquisitions should occur under the auspices of condemnation. Either step would solve the problem of paying in excess of market value for properties acquired for environmental preservation. Those solutions would also open the process up to public scrutiny.

Any solution that seeks to change an established, functioning analytical process resembles a redrawing of the 100-year flood plain to accommodate development. Later, when the floodwaters invade a hospital, the recast boundaries drawn on a map provide scant comfort. Similarly, redefining appraisal practice to evade the market value standard leaves little practical constraint and invites abuse with special interests using government to control the market.

A May 1992 audit conducted by the inspector general for the Department of the Interior concluded that the department had paid in excess of market value in numerous transactions. Clearly, the market value criterion blocks the government's purchase of environmentally significant properties. Using public interest value presumably would overcome this barrier.

Dr. Gilliland is a research economist with the Real Estate Center at Texas A&M University.



NAFTA and Real Estate

By Judon Fambrough

The 1994 North American Free Trade Agreement (NAFTA) was enacted to increase the free flow and exchange of commerce by eliminating trade barriers between the United States and its neighbors, Canada and Mexico. Many viewed the treaty as a mechanism to foster a freer flow of goods, but the treaty also addresses cross-border services provided by licensed professionals.

Some Texas real estate licensees believe that they may practice real estate in Mexico and Canada by virtue of NAFTA and vice versa. In part, they argue that the treaty is the supreme law of the land. Any barriers placed on the practice of real estate by the respective countries or states violate the treaty.

Treaties are agreements or contracts between two or more nations or sovereigns. They are created by agents appointed for this purpose and are sanctioned by each nation's supreme powers.

The U.S Constitution specifically empowers the President, by and with the advice and consent of the Senate, to make treaties, provided that two-thirds of the senators present concur. States are prohibited from entering treaties, alliances or confederations with foreign nations. Without the consent of Congress, states are prohibited from entering pacts with other states to prevent breaking up or weakening the union as a whole.

Treaties may encompass any concern within the international domain. However, a treaty may not be inconsistent with the U.S. form of government, may not interfere with the relations between the states and the United States nor contradict the federal Constitution.

Acts of Congress are the supreme law of the land. Treaties maintain the same status when made under the authority of the United States.

When the terms of treaties contradict state law, the treaties prevail. As supreme law of the land, treaties supersede conflicting provisions in state constitutions and statutes. This is true regardless of whether the state provisions were passed before or after the enactment of the treaty.

Courts are directed, though, to avoid overriding state laws or impairing rights arising under them when possible. Only

when the language of the treaty clearly intends to accomplish a national policy are state laws subordinated.

Treaties are classified as either executory or self-executing. An executory treaty requires the enactment of legislation before becoming law. Self-executing treaties become operative without the aid of legislation. They are the equivalent of an act of Congress.

When interpreting treaties, the courts give words their natural and ordinary meaning. When treaties are executed in two languages, both versions are viewed as originals. Both are intended by the contracting powers to have identical meaning. Thus, a construction must harmonize the two languages.

As noted, NAFTA specifically addresses reciprocal recognition of licensed professionals. "Cross-Border Trade in Services" addresses measures adopted or maintained by the three countries regarding services (Chapter 12). In particular, "Licensing and Certification" attempts to eliminate any unnecessary barriers to the licensing or certification of another country's nationals (Article 1210). To do this, each country is directed to ensure that the licensing and certification requirements:

- are based on objective criteria such as competency and ability to provide the service,
- are not more burdensome than necessary to ensure the quality of service and
- do not constitute a disguised restriction on cross-border service providers.

Within two years of the effective date of the treaty, each party must eliminate any citizenship or permanent residency requirements for the licensing or certification of another's professional service providers.

The term *professional services,* as defined by the treaty, means services requiring specialized post-secondary education or equivalent trading or experience; it also embodies where the right to practice (render the service) is granted or restricted by a country. Texas real estate licensees qualify as professional service providers under the definition.

NAFTA focuses on the standards for reciprocal recognition of cross-border professional service providers (Annex 1210.5). The treaty provides that each country shall encourage the relevant bodies of its respective territories to develop mutually acceptable standards and criteria for licensing and certification of professional service providers. The recommendations are submitted to the Free Trade Commission, which is composed of cabinet-level representatives.

The standards and criteria should be based on the following factors:

- education—accreditation of schools or academic programs;
- examinations—qualifying examinations for licensing, including alternative methods of assessment, such as oral examinations and interviews;
- experience—length and nature of experience required for licensing;
- conduct and ethics—standards of professional conduct and the nature of disciplinary action for nonconformity with those standards;
- professional development and re-certification—continuing education and ongoing requirements to maintain professional certification;
- scope of practice—extent of, or limitations on, permissible activities;
- local knowledge—requirements for knowledge of such matters as local laws, regulations, language, geography or climate; and
- consumer protection—alternatives to residency requirements, including bonding, professional liability insurance and client restitution funds, to provide for the protection of consumers.

Each country is to develop procedures for the temporary licensing of another country's professional service

The trade commission reviews the recommendations and determines their consistency with the treaty. Based on the review, each party encourages its respective competent authorities, (states, provinces and territories), where appropriate, to implement the recommendations within a mutually agreed upon time.

In the meantime, each country is to encourage its relevant territorial agencies to develop procedures for the *temporary licensing* of another country's professional service providers. For example, the treaty mandates procedures and guidelines for the temporary licensing of engineers within one year.

Establishing mutual reciprocal standards for recognizing real estate professionals will not be easy. The practice of real estate in the United States and Canada is governed on the state or provincial-territorial level, respectively. In Texas, for example, the Texas Real Estate Commission oversees the licensing of real estate practitioners. No national real estate license exists in Canada or the United States.

In Mexico, the practice of real estate is administered on the federal level. To practice real estate, one must become a member of the Asociación Mexicana de Profesionales Inmobiliarios, A.C. (better known as AMPI). To join, the candidate must demonstrate both an understanding of the Spanish language and knowledge of the real estate laws of Mexico. Also, the person must be known among the membership and have an ethical, trustworthy reputation. Membership in AMPI entitles one to practice real estate in the 31 states of Mexico and its federal district.

Another problem in the United States, and possibly Canada, is that the practice of real estate may be administered on two tiers. For example, in Texas, a licensee must first became a salesperson and then a broker. Colorado recognizes no real estate salespersons, only brokers.

John M. Stone, CCIM, CPM, CIPS, of Dallas and Texarkana, has extensive knowledge of the practice of real estate in the United States, Canada and Mexico. He is a member of AMPI and served three years on the Commercial Investment Committee of the Canadian Real Estate Association (counterpart to the National Association of Realtors [NAR]). He has been asked by NAR to serve on its NAFTA task force to implement reciprocal standards for recognition and licensing of cross-border real estate professionals.

Stone envisions using certain national real estate designations as the threshold for reciprocal recognition. Using national advanced real estate designations has several advantages. It avoids creating unfamiliar guidelines that may be confusing, expensive and time-consuming to draft and implement. It is also expedient, following the precedents established for lawyers, CPAs and insurance brokers under those professional models for licensing and standards.

Likewise, the program takes advantage of the two sets of standards—those required for national designations and those listed earlier by NAFTA for the reciprocal recognition of licensed professionals. The credibility of the designations would be enhanced by the accord.

"Best of all," says Stone, "the standards force all practitioners in North America to speak the same language in real estate matters regardless of nationality or native tongue. Currently, Spanish, French and English are the three most common languages in the three countries. Real estate has its own language regardless of one's native tongue."

Currently, the most widely recognized and accepted national designations for commercial-investment real estate include:

- Accredited Land Consultant (ALC) by the Realtors Land Institute,
- Member Appraisal Institute (MAI) by the Appraisal Institute,
- Society of Industrial and Office Realtors (SIOR) by the Society of the same name,
- Counselors in Real Estate (CRE) by the American Society of Real Estate Counselors,
- Certified Property Managers (CPM) by the Institute of Real Estate Management and
- Certified Commercial Investment Member (CCIM) by the Commercial Investment Real Estate Institute.

The most widely recognized and accepted designations for residential real estate include:

- Certified Residential Specialist (CRS) by the Residential Council of NAR,
- Certified Real Estate Brokerage Manager (CRB) by the Brokers Council of NAR and

Many view the North American Free Trade Agreement (NAFTA) as a mechanism to foster a freer flow of goods, but the treaty also addresses cross-border services provided by licensed professionals.

- Leadership Training Institute Graduate (LTG) by the Women's Council of Realtors.

The most widely recognized national designation for **both** residential **and** commercial-investment real estate is the Certified International Property Specialist (CIPS) by the International Section of NAR.

Other national designations exist. Stone says only these, however, merit cross-border recognition under NAFTA. If others are recognized, he feels that the issuing organization, institute, society or council should be a part of NAR. Currently, the MAI designation is the only one on the list not affiliated with NAR.

Stone believes the Graduate Realtors Institute (GRI) designation would not qualify. Its purpose is to help graduates acquire skills necessary for more advanced real estate designations.

Stone proposes that anyone with one of these national designations be qualified for licensing in the desired jurisdiction of NAFTA. This means that a Texas licensee having one or more of these designations would be eligible to meet the ordinary licensing requirements of the provinces in Canada or to become a member of AMPI in Mexico.

Other reasonable qualifying criteria may be imposed. The designations would not **make** the designee a member or licensee in the jurisdiction. They would merely qualify the designee for membership or licensure.

Under his proposal, designees receiving cross-border recognition to practice real estate would carry two photograph identification cards. One would be issued by the organization, institute, society or council granting the national designation; the other by the NAFTA jurisdiction approving their right to practice real estate.

"The procedure accomplishes two goals," says Stone. "It encourages real estate professionals to obtain an advanced real estate designation to practice internationally. Also, it elevates the competency of real estate professionals."

This is but one alternative. Regardless of what is proposed, one thing is clear. Standards for the cross-border practice of both commercial-investment and residential real estate need to be enacted according to NAFTA's guidelines.

Stone says real estate practitioners need to formulate practical standards that are fair and respond to all constituencies. Likewise, the Association of Real Estate Licensing Law Officials (ARELLO) should cooperate with practitioners in the development. The interaction ensures the use of common-sense procedures that are fair to real estate consumers and practitioners.

"If real estate practitioners do not take the initiative to provide input, they may be entrusting their fate to standards imposed by a court decree," he says.

The treaty directs the Free Trade Commission to periodically review the implementation of the standards (the reciprocal recognition of licensed professionals) at least once every three years. NAFTA has been in effect three years as of January 1, 1997. It is unclear if the Free Trade Commission has reviewed the standard during this time.

Presently, the greatest real estate opportunities in Mexico rest in commercial real estate, not residential. In particular, the demands for high-quality office, retail and industrial space as well as coastal resorts are at an all-time high, according to Stone.

However, the demand for real estate in all sectors should rise with the implementation of NAFTA's provisions, giving U.S. lenders an opportunity to acquire or cooperate with Canadian and Mexican lenders and begin new operations. NAFTA ends a 50-year prohibition of foreign bank ownership in Mexico. Nonbank U.S. real estate lenders are already expanding real estate financing in Mexico.

Developing mutually acceptable standards consistent with NAFTA's guidelines allowing real estate professionals to practice in each country will require years of hard work. After the development of standards, the governments within each country must review, ratify and incorporate the standards into their laws.

Fambrough is an attorney, member of the State Bar of Texas and senior lecturer with the Real Estate Center at Texas A&M University.

Low Inflation: Good News for Commercial Real Estate?

By Wayne E. Etter and Harold D. Hunt

The Federal Reserve Board of Governors (Fed) has made one thing abundantly clear during the past several months—inflation will not be tolerated. Recently, the Fed attacked the possibility of future inflation even though many outsiders argue that little present evidence indicates that strong inflationary pressures are developing. Even the possibility of strong inflationary pressures developing at a future date, however, has caused the Fed to raise interest rates with the objective of slowing economic growth and maintaining price stability.

A traditional benefit of owning real estate is its role as a hedge against inflation. During inflationary periods, increasing real estate values are expected to keep pace with inflation. Investors who own real estate presumably do not need to fear inflation as would bond and mortgage investors; the value of outstanding bonds and mortgages declines when market interest rates rise in response to expected inflation.

Long-run commercial real estate values are determined by supply-and-demand conditions within their particular market area. In a market where increased demand for space relative to supply exists (or is expected), market rental rates will increase; however, during inflationary periods, rental rates also may increase because of specific commercial lease clauses that link rental rates to the inflation rate. Over time, increased rental rates from either source will be capitalized into increased real estate values. Thus, during recent years, commercial property values have increased from both the greater demand for space and the effects of inflation.

If the effects of supply and demand on property values were set aside, how might real estate values be affected during a period of little or no expected inflation? In particular, how might a sustained noninflationary period affect the value of commercial real estate?

Effects on Net Operating Income

Because *pro forma* projections of net operating income (NOI) have a fundamental role in estimating a property's value, the impact of little or no inflation on NOI is considered first. In the simplest terms, a property's net operating income is calculated as follows:

Potential gross income	$100,000
Less: Vacancy and collection loss	-5,000
Effective gross income	$ 95,000
Less: Operating expenses	-35,000
Net operating income	$ 60,000

Commercial property leases can be designed to protect the owner (and the tenant in some cases) from the adverse effects of inflation. In particular, these leases can address the effect of expected inflation on potential gross income and operating expenses.

For example, some leases contain escalation clauses that specify periodic increases in a tenant's rent, while others base the amount of the periodic increase on the CPI or some other price index. Many retail property leases contain percentage lease clauses that define the tenant's rent as the greater of a fixed minimum rent or a specified percentage of sales.

As the retailer's sales increase beyond the break-even point (*i.e.*, fixed minimum rent equals the specified percentage of sales), their rent increases. In some leases, the retailer's sales increases caused only by inflation (*i.e.*, the same quantity of goods sold but at higher prices) are offset by periodic raises in the fixed minimum rent, but the effect is the same. Escalations in the fixed minimum rent may take place according to an agreed schedule, or they may be linked to the CPI.

Without terms such as these, commercial property owners would be reluctant to enter into long-term leases with tenants. Tenants are willing to accept these terms because a long-term lease allows them to capture the benefit of maintaining their business presence at a preferred location; presumably, they believe that a rental rate increasing approximately at the inflation rate is a fair price to pay for this benefit.

Owners insulate themselves from operating expense increases through the use of leases with expense stops or triple-net leases. These arrangements vary, but for the owner, the objective is either to limit the amount of operating expenses they pay (any excess of actual operating expenses more than the expected amount will be paid by the tenant) or to pass all operating expenses except management and leasing expenses through to the tenant. For their part, tenants often demand lease clauses that limit the annual percentage increase in operating expenses for which they will be responsible.

Accordingly, during periods of inflation many commercial property owners receive increasing rental income over time with either limited or no exposure to increasing operating expenses. Because management and leasing expenses are a percentage of collected rent and expected rental income, respectively, they normally increase only as income increases. Thus, during periods of inflation these lease terms produce increasing NOI for the property owner.

During the inflationary environment of the last few years, commercial property leases have protected property owners

from inflation and, therefore, have been the incentive for tenants to enter into long-term leases. But during a period with little or no expected inflation, will tenants agree to higher rental rates when current leases expire and/or the fixed minimum rent periodically increases? Tenants may agree to these terms for those locations having a high demand, but when property owners compete for tenants, their agreement is less likely. Thus, in the absence of inflation, the supply and demand for space will become the predominant factor in properties' ability to generate increasing NOI. (Of course, according to the terms of their percentage leases, retail tenants that experience an increase in the quantity of goods sold will pay higher rent.)

Effects on the Property's Value

Real estate's role as an inflation hedge is more dependent on its potential for increased value than for its current income. A property's value is a function of its expected income. When investors estimate a property's value (to compare to its cost or offering price), they take the property's projected income into account whether they use the income capitalization approach or a discounted cash flow (DCF) model. With either model, a reduced income expectation will reduce the investor's estimate of the property's value, if all other things are equal. The DCF model is the most useful for understanding how this takes place.

When a DCF model is used to estimate a property's value (without consideration of debt or income taxes), the property's estimated current value is equal to the present value of expected NOI during the holding period plus the present value of its future resale price.

To estimate a property's resale price five or ten years into the future, the property's NOI is estimated for the year following the expected resale; this estimated NOI is capitalized using the terminal capitalization rate that future investors are expected to be using at the time of the resale. Most NOI estimates are not perfect, but if, at the time of the estimate, the estimate is believed to be reasonable it will be used to establish the property's current value.

Usually when this calculation is reviewed, most of a property's estimated current value may be attributed to the property's projected resale proceeds. In the following illustration, for example, the property's resale proceeds contribute approximately 64 percent of the property's total value

Year	NOI if growth rate is 3%	Resale	Present value at 10%
1	$60,000		$54,545
2	61,800		51,074
3	63,654		47,824
4	65,564		44,781
5	67,531		41,931
5		$695,564	431,891
	Estimated value of property		$672,046

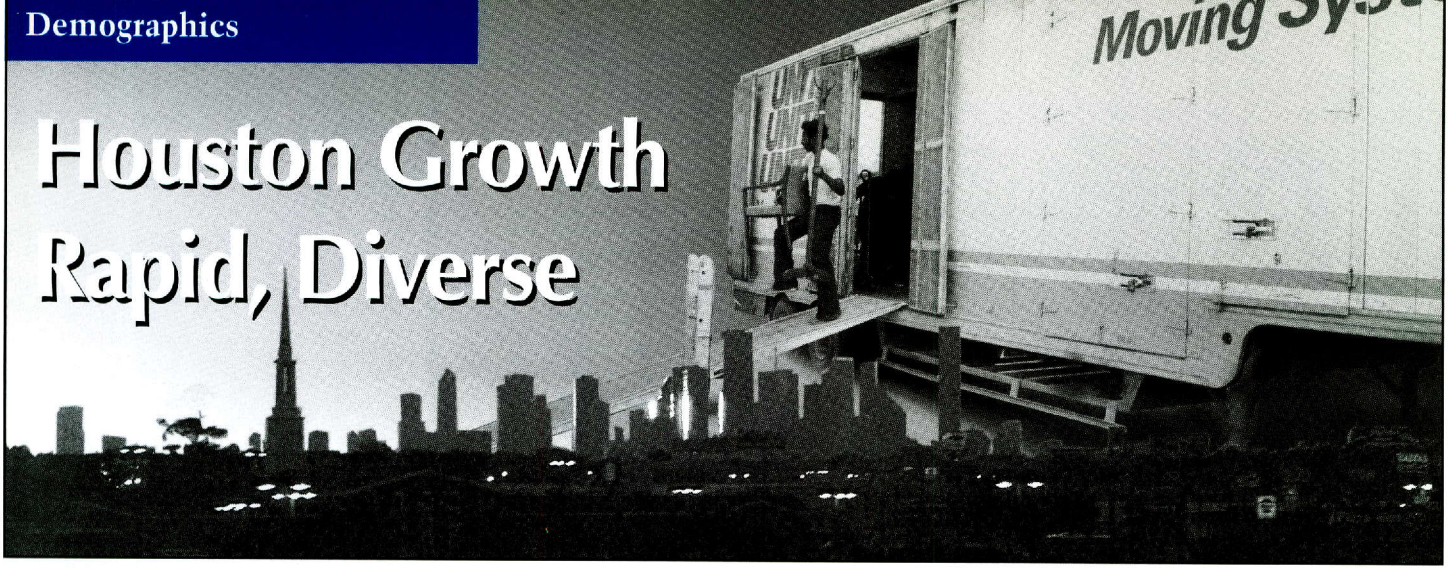
The critical point is that if the estimator currently believes that NOI will increase little or none over the holding period, then little or no property appreciation will be forecast unless current investors lower their required rate of return or future investors lower their capitalization rate. There is little reason to believe that current investors will pay a higher price for a property when its appreciation potential is reduced. In fact, it seems likely that current investors would pay less for NOI given its slight potential for appreciation. In the following example, the present value of the property's resale value contributes 63 percent of the property's current estimated value, but because NOI increases only 1 percent per year, the property's value declines to $623,160, a reduction of $48,887 or 7.3 percent.

Year	NOI if growth rate is 1%	Resale	Present value at 10%
1	$60,000		$54,545
2	60,600		50,083
3	61,206		45,985
4	61,818		42,223
5	62,436		38,768
5		$630,606	391,557
	Estimated value of property		$623,161

Many commercial leases provide the owners with rising NOI during inflationary periods; these same lease terms will produce a much smaller increase in NOI during a period of little or no inflation. Thus, if the Fed's efforts to control inflation are successful for a sustained period, the value of commercial real estate is unlikely to increase over time without an increased demand for space relative to supply.

Dr. Etter is a professor with the Real Estate Center and of finance at Texas A&M University. Hunt is a graduate research assistant with the Center and a doctoral candidate in Urban and Regional Science.

Houston Growth Rapid, Diverse



By Steve H. Murdock

Houston's rapidly growing population means real estate opportunities abound. At the same time, the diversity suggests the need for careful sub-area market analyses.

The U.S. Bureau of the Census estimates the Houston metropolitan area (Chambers, Fort Bend, Harris, Liberty, Montgomery and Waller counties) had nearly 3.8 million persons as of July 1, 1996. It was the state's largest metropolitan area (Dallas was second with roughly 2.7 million).

Houston's 3.8 million is an increase of nearly 470,000 persons or 14.1 percent since the 1990 census. This growth exceeded the total population of 22 of the state's other 26 metropolitan areas and was faster than Texas' overall 1990-96 growth rate of 12.6 percent.

The Houston metropolitan area contained 19.8 percent of the state's population in 1996 but accounted for 21.9 percent of the state's growth of 2.1 million in the previous six years. Houston's share of Texas' population has thus increased in the 1990s.

Total metropolitan area growth, however, masks both differences in the magnitude and sources of population growth. For example, the central city county, Harris County, increased its 1990-96 population by 11 percent while the suburban counties of Fort Bend and Montgomery increased by 36.1 percent and 34.9 percent respectively.

Although only 1990 to 1995 data are available for towns and cities (from the Texas State Data Center at Texas A&M University), these data show the city of Houston increased by 6.3 percent compared to 11.4 percent for the metropolitan area and 8.9 percent for Harris County. On the other hand, Conroe increased by 36.4 percent and Katy by 30.8 percent. As in previous periods, the suburbs grew faster than the central city, but in the 1990s both have been growing relatively rapidly.

The sources of the Houston area's population growth also reveal diverse patterns. Of the net population increase, nearly 285,000 or 60.6 percent was the result of natural increase (number of births minus number of deaths). Roughly 38,000 or 8.1 percent was attributable to inmigration from other states, and 147,000 or 31.3 percent came from immigration from other nations. For the state, 55.2 percent of the 1990-96 growth was from natural increase, 21.8 percent was net inmigration from other states and 23 percent was net immigration from other nations.

The effects of natural increase and international immigration were particularly apparent in Harris County. Of the county's 1990-96 net increase of nearly 309,000, natural increase was responsible for nearly 250,000 or 80.8 percent. International immigration of more than 135,000 offset net domestic outmigration by nearly 76,000.

Dividing Harris County's growth into the two components—natural increase and migration—80.8 percent of the total county's net growth was the result of natural increase. Only 19.2 percent was from migration.

Harris County was clearly the center for international immigration, gaining nearly 92 percent of net immigration into the metropolitan area (135,000 out of 147,000). Without immigration, Harris County would have increased its population by only 6.2 percent—44 percent less than its actual 11 percent growth rate.

For suburban counties such as Fort Bend and Montgomery, the patterns are very different from those in Harris County. For example, Fort Bend increased by more than 81,000 persons to 306,800. Of this total, 23.7 percent resulted from natural increase, 66.2 percent from inmigration and 10.1 from international immigration. Similarly, Montgomery County increased its 1990-96 population by 63,600 to 245,800. Of this, 18.7 percent was attributable to natural increase, 77.1 percent to net inmigration from other states and only 4.2 percent to net immigration from other nations.

Of the total 1990-96 suburban growth of more than 161,000 in the Houston metropolitan area, 21.8 percent was from natural increase, 70.7 percent from net inmigration from other states and only 7.5 percent was the result of immigration from other countries.

If current trends continue, the Houston metropolitan area will have more than four million persons by 2000. Harris County will increase by more than 17 percent between 1990 and 2000, but suburban areas will show more than a 37 percent increase.

Although generalized growth patterns characterize the Houston area, quite different real estate markets will emerge within Houston's population. International immigration historically has involved ethnic minorities with lower incomes and fewer resources for real estate expenditures than native-born residents.

Domestic inmigration has generally involved larger proportions of Anglos with higher incomes and greater real estate purchasing power than native-born residents. The patterns of the 1980s suggest that Anglo populations left the central-city county. Central-city growth in the 1990s continues to come from the large number of immigrants.

Houston area real estate will find different markets in the central city and suburban areas. Although all areas have some higher valued and some lower valued real estate, the opportunities probably will be for more modestly priced housing units for the central city and more traditional middle-income units for suburban areas.

Products will have to target specific populations. The industry will have to offer a diverse range of real estate products. Successful marketing strategies must reflect variations in demographic trends within the Houston market area.

Murdock is a research fellow with the Real Estate Center and chief demographer of the Texas State Data Center, Department of Rural Sociology, at Texas A&M University.

In a Word: Define With Care

By Judon Fambrough

On Sunday, May 18, 1997, a second-floor balcony at the University of Virginia collapsed. The people standing on the balcony were seeking a better view of the graduation ceremony. A rusted support rod appears to have snapped on the building designed by Thomas Jefferson in 1822. Eighteen people were injured, and one was killed.

If a similar incident occurs in Texas, should the agent who listed and sold the structure worry about a lawsuit? Should heirs worry about liability?

The answers can be found in the difference between the statute of limitations and the statute of repose. The distinction affects real estate practitioners.

The *statute of limitations* defines the prescribed time allowed for an aggrieved party to file a suit after the right arises. (This is sometimes stated as "after the cause of action accrues.") Generally speaking, the right accrues when an injury occurs, a contract is breached or a misrepresentation is discovered.

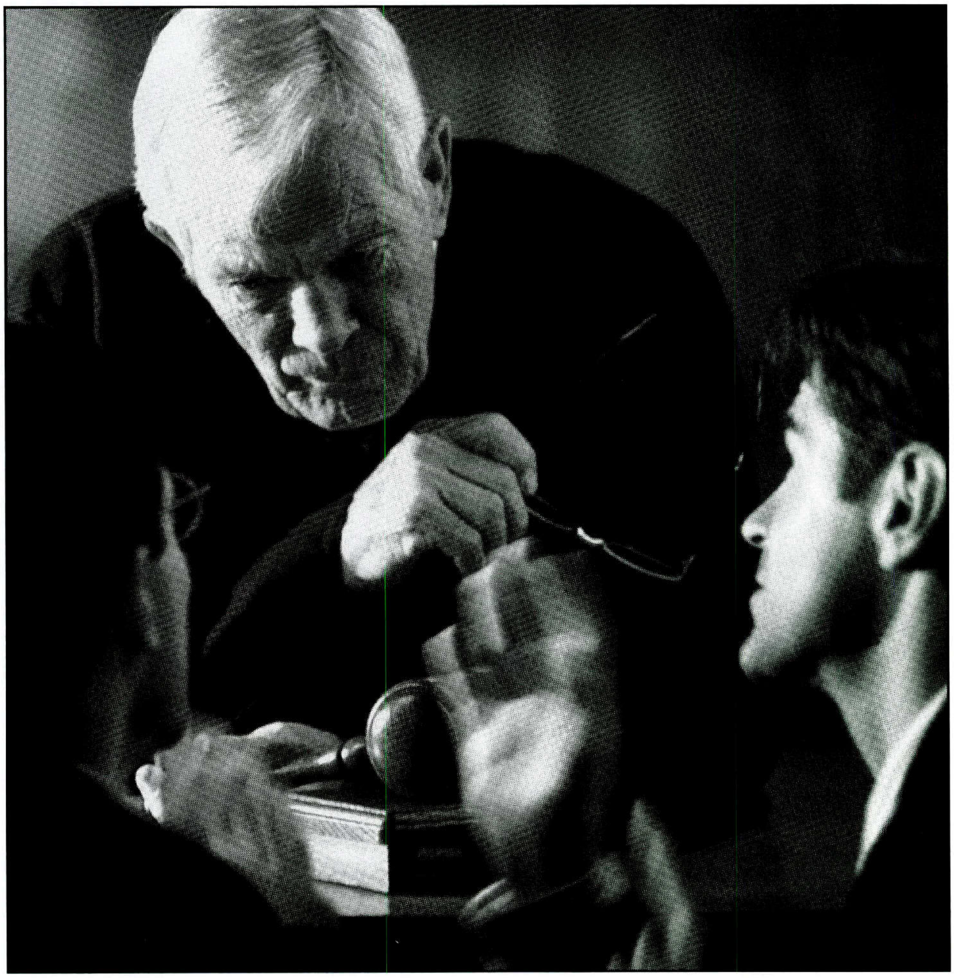
In Texas, the variations in the length of the statute of limitations are broad. For example, the statute of limitations for filing a taking action against the government under the Texas Private Real Property Rights Preservation Act of 1995 is 180 days while under one of the adverse possession statutes it is 25 years.

The statute of limitations is not an automatic bar against filing a lawsuit. Instead, the statute of limitations is an affirmative defense that the defendant must plead and prove. Many times it takes the form of a motion for summary judgment. If it is not raised, the defense is waived. The plaintiff may proceed to a valid enforceable judgment against the defendant.

Frequently, the courts mistakenly interchange the statute of repose with the statute of limitations. The terms are similar but distinctly different.

The statute of limitations specifies the time in which the suit must be filed **after the right to sue arises**. The statute of repose also limits the time in which an action may be brought, but it is **unrelated to when the right to sue accrues**. The Texas statute of repose absolutely bars a lawsuit after a specified time.

Legal treatises word the distinction another way. The statute of limitations bars a cause of action if not brought within a certain period. The statute of repose prevents a cause of action from ever arising after a given time.



Courts mistakenly interchange the statute of repose *with the* statute of limitations. *The terms are similar but distinctly different.*

Texas has four statutes of repose found in the Texas Civil Practices and Remedies Code. The statutes are designed to relieve certain professionals and manufacturers from the burden of indefinite potential liability.

Architects and engineers are protected from latent defects in designing, planning or inspecting construction after ten years from the time the project is substantially completed. Persons who furnish construction or repair improvements are protected from latent defects after the same period. A 1989 statute protects surveyors after ten years following a completed survey. Finally, a 1993 statute protects manufacturers and sellers of manufacturing equipment after 15 years from the date of sale. The 75th Legislature considered adding interior designers and landscape architects to the list.

Under the first three statutes, if a person presents a written claim for damages during the ten-year period, a two-year extension from the time of presentation may be added.

The statute of limitations is an affirmative defense. If not timely raised, it is waived. The statute of repose is an absolute bar to a lawsuit. It can and should be raised as an affirmative defense. If not timely raised, it could be used conceivably to set aside a judgment after a trial concludes. No Texas case law addresses this issue, however.

The statute of limitations generally, but not always, has a discovery rule attached. This means the statute of limitations begins when a misdeed occurs or when the misdeed is discovered, whichever is later. For example, one section of the Texas Business and Commerce Code, better known as the Texas Deceptive Trade Practices Act (DTPA), states that any DTPA action must be brought (filed) "within two years after the date on which the false, misleading or deceptive act or practice occurred or within two years after the consumer discovered or in the exercise of reasonable diligence should have discovered the occurrence of the false, misleading, or deceptive act or practice."

The statute of repose has no discovery rule associated with it. The statute may cut off the right of action before the injured party discovers or reasonably should have discovered the defect or injury.

The statute of repose can never extend but can shorten the applicable statutes of limitations. For example, suppose someone is injured in a faulty building designed and completed nine years earlier. The statute of limitation for filing a personal injury against the architects and engineers is two years. In this situation, however, the injured party must file within one year because of the ten-year statute of repose.

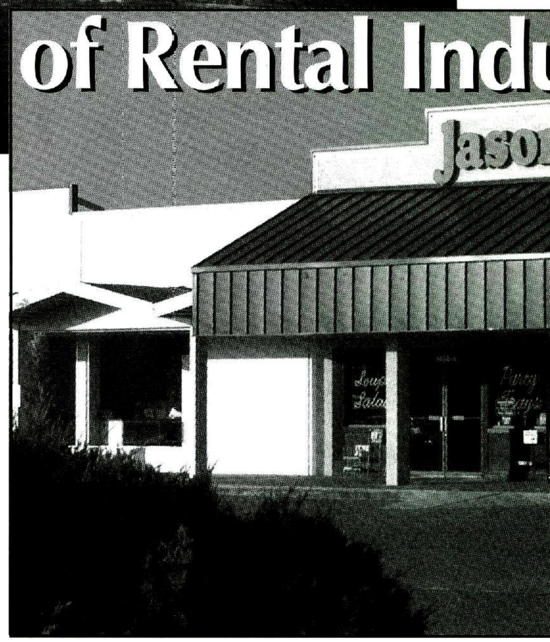
The statute of repose has successfully withstood judicial challenges. One court ruled that the statute did not violate due process. Another court held that it did not violate the plaintiffs' right of access to court.

In Texas, the statute of repose would protect Jefferson and his heirs starting ten years after the structure was substantially completed. Real estate practitioners are not protected. Consequently, if the licensee knew the balcony was defective when the property was listed and sold and did not disclose this fact to the buyer, he or she faces potential DTPA liability for the next two years or two years after the nondisclosure is discovered, whichever is later.

However, the statute of repose that protects contractors is worded slightly differently from the one protecting architects and engineers. Contractors (persons furnishing construction or repair of improvements) are not protected against willful misconduct or fraudulent concealment. Architects and engineers are protected. Evidently, the legislature was more concerned about fraudulent concealment in the **performance** of the construction or repairs than in the **design.**

Fambrough is an attorney, member of the State Bar of Texas and senior lecturer with the Real Estate Center at Texas A&M University.

Tax Aspects of Rental Indu



By Jerrold J. Stern

The building boom of the 1980s created a highly competitive market for selling commercial space in the 1990s. Property owners are motivated to offer inducements to prospective tenants in an effort to fill vacancies. The tax treatment varies greatly, however, among alternative rental inducements. This column explains the tax rules for three types of rental plans—rent abatement, cash inducement and build-out allowance.

Rent abatement. A common inducement in leases is to grant the tenant a period of rent-free occupancy at the beginning of the lease. For example, a five-year lease might include a six-month, rent-free period. **No tax effect** evolves from the rent-free occupancy periods as long as the time is reasonable in light of common business practice in the community. Thus, no income is recognized by the tenant, and no deduction is granted to the lessor. Of course, the lessor also does not recognize income for uncollected rent. However, a rent abatement would have **taxable consequences** if total rents over the entire lease term exceed $250,000.

Unrestricted cash inducement. Generally, amounts received from the landlord as lease inducements and expended by the tenant without restriction are recognized as **income by the tenant.** If the tenant spends the inducement funds to remodel the property being leased, the tenant can write off (deduct) the amount over 39 years, regardless of the lease term.

For example, assume a lessor gives the lessee $390,000 without restriction when the lessee signs a ten-year lease. The lessee uses the funds to remodel the building being leased. The tax result is that the lessee has $390,000 taxable income but can deduct it at the rate of $10,000 per year for 39 years, regardless of the lease term. Any portion of the $390,000 not deducted prior to the time the lessee vacates can be deducted in full when the lessee vacates. In similar fashion, the lessor capitalizes the $390,000 payment and deducts it over a 39-year period, regardless of the lease term.

Build-out allowance resulting in lessor-owned property. A more common arrangement is for the lessor to offer cash in the form of a build-out allowance. The tenant then has the opportunity to remodel or complete construction to suit the tenant's business. The build-out allowance is **not** income to the lessee because the funds are required to be used to improve property owned by the lessor. The only tax effect is that the **lessor can write off the cost over 39 years.** Thus, if the $390,000 amount in the earlier example were provided to the lessee in the form of a build-out allowance, the lessee would have no income or deduction as a result of the $390,000. The lessor would capitalize it, and deduct it over 39 years.

Build-out allowance resulting in lessee-owned property. Another type of build-out allowance results in lessee-owned property, such as furniture, fixtures or equipment. The tax result is that the lessee recognizes income and then depreciates the amount based on the type of property. The lessor writes the amount off over the lease term.

For example, assume a $390,000 allowance is given to a lessee for furniture, fixtures and equipment that would be owned by the lessee at the end of the lease. The lessee has $390,000 of taxable income but can depreciate the allowance over a five- to seven-year period (the recovery period available for most furniture, fixtures and equipment). The lessor deducts the allowance over the lease term.

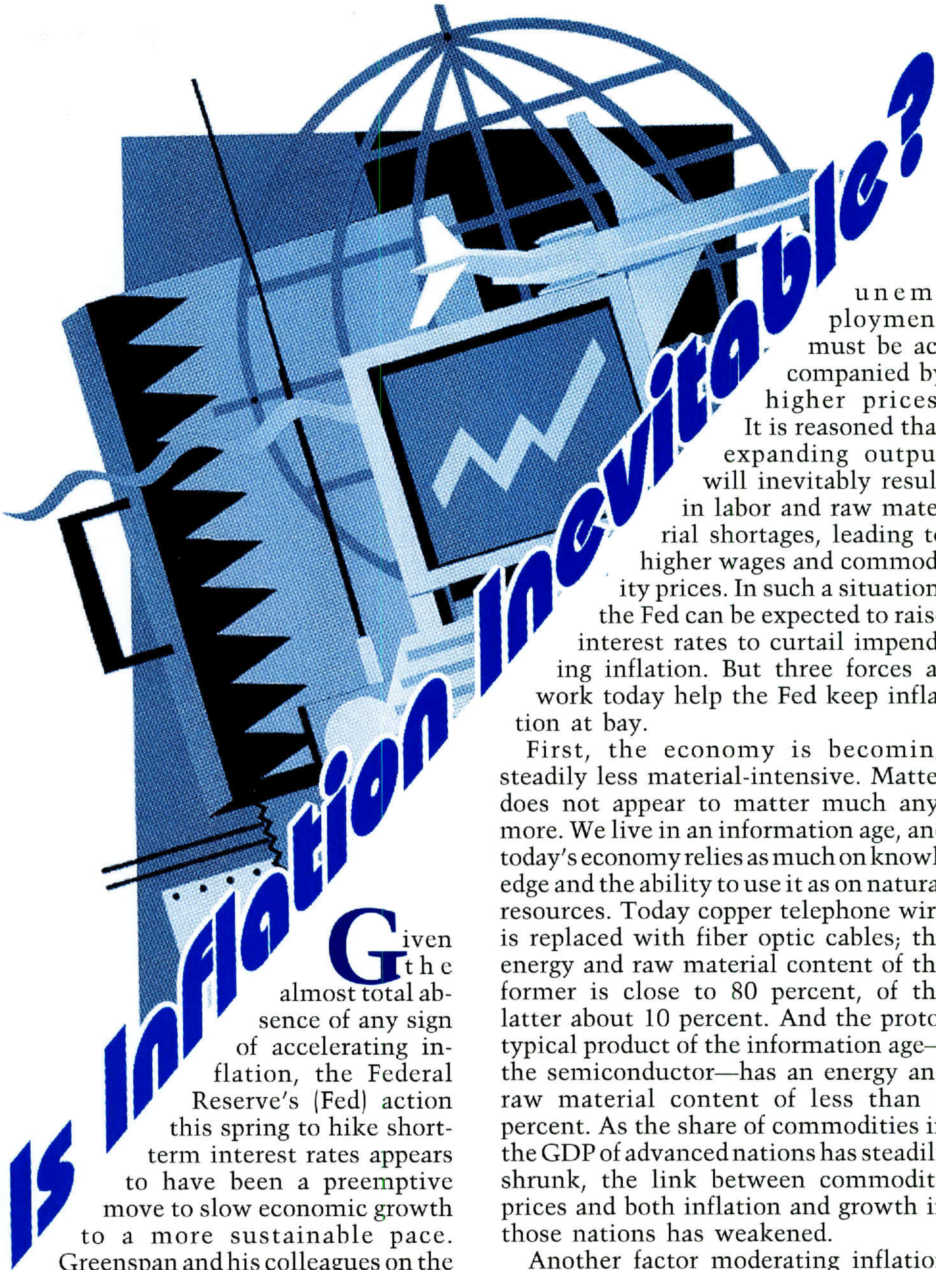
Who owns the leasehold? As indicated, the ownership of the leasehold (the property purchased with the build-out allowance) dramatically affects the tax consequences. If the owner of the leasehold is not clear, the IRS looks at a number of factors, including transfer of legal title; which party pays property taxes; which party bears the risk of loss for damage or theft; which party receives profits from use and sale of the property; and how the parties treat the transaction in their accounting records.

Rental inducements provide a valuable tool in the current commercial real estate market. Property owners who are considering the use of rental inducements should discuss the tax consequences with their tax advisors.

Dr. Stern is a research fellow with the Real Estate Center at Texas A&M University and a professor of accounting in the Graduate School of Business at Indiana University.

By Jared E. Hazleton

Is Inflation Inevitable?



Given the almost total absence of any sign of accelerating inflation, the Federal Reserve's (Fed) action this spring to hike short-term interest rates appears to have been a preemptive move to slow economic growth to a more sustainable pace. Greenspan and his colleagues on the Fed's Open Market Committee were concerned that if output continued to expand at the 3.5 percent clip recorded during the last half of 1996 and the first few months of this year, inflationary pressures would develop down the road.

The $64 question is: Can the economy continue to grow at a pace slow enough to pacify the bond market and Fed fears of higher inflation in the future but fast enough to maintain sufficient momentum to prevent a recession? The answer to that question has important implications for the real estate industry because it will determine both the potential for expanding sales and the likely course of mortgage interest rates during the next year or so.

Conventional wisdom has it that strong economic growth and falling unemployment must be accompanied by higher prices. It is reasoned that expanding output will inevitably result in labor and raw material shortages, leading to higher wages and commodity prices. In such a situation, the Fed can be expected to raise interest rates to curtail impending inflation. But three forces at work today help the Fed keep inflation at bay.

First, the economy is becoming steadily less material-intensive. Matter does not appear to matter much anymore. We live in an information age, and today's economy relies as much on knowledge and the ability to use it as on natural resources. Today copper telephone wire is replaced with fiber optic cables; the energy and raw material content of the former is close to 80 percent, of the latter about 10 percent. And the prototypical product of the information age—the semiconductor—has an energy and raw material content of less than 2 percent. As the share of commodities in the GDP of advanced nations has steadily shrunk, the link between commodity prices and both inflation and growth in those nations has weakened.

Another factor moderating inflation is that manufacturing increasingly is becoming decoupled from labor, as output expands even while fewer workers are being employed. The closest analogy to what is happening in manufacturing today is what occurred in agriculture 60 years ago. Very few Americans now live on the farm, not because farmers are uncompetitive but because they are so productive not many of them are required. By investing in information processing equipment and knowledge systems, businesses today lessen their labor requirements while raising productivity and reducing the threat of wage-induced inflation.

Global competition is the third factor holding back inflation. In the past, when labor pressed for higher wages, businesses often took the easy way out, agreeing to raise wages in the firm expectation they could pass on the higher costs to their customers by raising prices. In today's global economy, labor leaders understand that higher wages may lead to job losses if higher costs motivate employers to invest elsewhere. And even when workers press for higher wages, management understands that it will not be able to forward the added costs to consumers without risking a loss of market share.

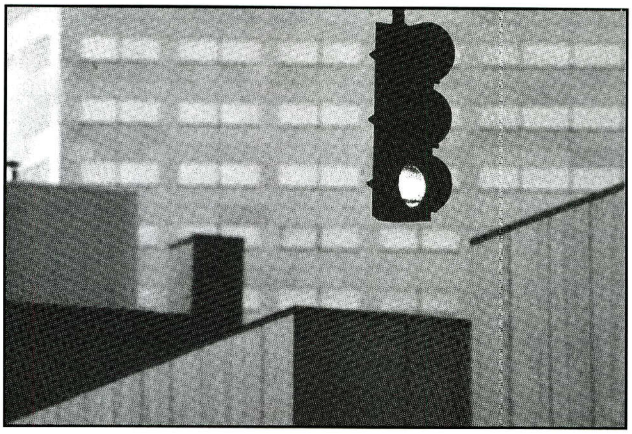
A stronger-valued dollar also dampens inflation by making it easier for imports to compete against domestic products. Two years ago, for example, a Japanese auto company selling its cars in the United States received just 80 yen for every dollar of sales. Today, because the dollar has appreciated, the firm receives more than 120 yen. Japanese and other importers can choose either to keep their U.S. prices constant, taking home more of their own currency, or to reduce their prices to increase market share. In the face of this type of competitive pressure, American firms are reluctant to raise their prices.

To say that new forces in the world help keep inflation in check is not to say that prices will forever behave themselves. Monetary or fiscal mismanagement could lead to accelerated inflation. But combined, the dwindling importance of commodities, the rise in productivity associated with the information revolution and the globalization of competitive pressure constitute a new economic environment in which rising inflation does not necessarily go hand-in-hand with economic growth.

Old thought patterns die hard, however, and most of today's money managers cut their teeth in a world constantly threatened with inflation. Their preoccupation with this threat, while understandable, should not shut out the possibilities for sustained economic growth with stable, or at most, modestly increasing prices.

While the Fed did hike short-term interest rates this spring, the overall effect on long-term rates was modest. Given the central bank's demonstrated vigilance in protecting against the possibility of accelerating inflation and an economic environment in which it is difficult for firms to raise prices, long-term interest rates—including mortgage rates—are likely to remain at or near their current levels for some time. At the same time, the Fed's modest tightening of credit should retard growth enough to ensure the continuation of a "Goldilocks" economy—not too hot and not too cold.

Dr. Hazleton is a research fellow with the Real Estate Center and director of the Center for Business and Economic Analysis at Texas A&M University.



Register Early for Legal Seminar on Ad Valorem Taxes

Only the first 450 registrants will be able to attend the Eleventh Annual Legal Seminar on Ad Valorem Taxation, so prompt registration is recommended.

"We began receiving registrations even before the seminar was announced," says Real Estate Center Registrar Margaret Benedict. "The seminar has been sold out for several years, and it appears 1997 will be no different."

This year's seminar is set for Aug. 27-29 at the Renaissance Hotel in Austin. It is co-sponsored by the State Bar of Texas Committee on Ad Valorem Taxation and the Real Estate Center.

Among the topics to be discussed are structural changes and alternative school funding, legislation, the unauthorized practice of law, nation-wide perspectives, case law, bankruptcy, abatements,

Texas Homes Slightly Less Affordable

Texas housing was a little less affordable in the first quarter of 1997, although it is still favorable.

The state-wide affordability index, compiled by the Real Estate Center, measured 1.76 for the first three months of the year. This is a drop from 1.78 for the same period last year.

"The decline means that approximately 71 percent of Texas families could afford a median-priced home at the beginning of 1997 compared to 72 percent who could afford a home in early 1996," says Research Economist Jack C. Harris who tracks the Texas Housing Affordability Index. Each 1 percent represents approximately 70,000 households.

Harris says higher mortgage interest rates are to blame for the decline. The composite rate on mortgages closed in Texas, which includes fixed-rate and adjustable-rate loans, climbed in mid-1996 and has eased little during the past nine months.

"The average interest rate in the first quarter was 7.58 percent compared to 7.21 percent one year earlier," says Harris. "Modifying the effect of the higher rate is the fact that the median household income rose by 4 percent during the year while median house sales prices rose by only 2 percent."

Harris adds that some individual Texas cities actually have higher affordability indexes this year than last. In each case, the improvement was caused by lower sales prices.

Texas Housing Affordability Index
First Quarter 1997 and 1996

Metropolitan Area	First Quarter 1997	First Quarter 1996
Abilene	2.16	2.12
Amarillo	1.96	1.95
Arlington	2.32	2.3
Austin	1.27	1.3
Beaumont	1.86	1.83
Brazoria County	2.29	2.45
Brownsville	1.52	1.78
Bryan-College Station	1.51	1.45
Corpus Christi	1.97	2.02
Dallas	1.53	1.6
Denton	1.79	1.95
El Paso	1.52	1.59
Fort Bend	2.22	2.42
Forth Worth	2.14	2.17
Galveston	1.7	1.62
Garland	2.89	2.96
Harlingen	1.81	1.98
Houston	1.76	1.88
Irving	1.68	1.75
Killeen-Fort Hood	1.75	1.81
Longview	1.89	Unavailable
Lubbock	1.99	1.92
Lufkin	1.82	2.01
McAllen	1.23	1.23
Montgomery County	1.59	1.87
Nacogdoches	2.07	Unavailable
North NASA	1.85	2.03
Northeast Tarrant Co.	1.88	1.82
Odessa-Midland	2.26	1.88
Palestine	2.4	2.74
Paris	1.8	2.14
Plano	1.59	1.89
Port Arthur	1.77	1.87
San Angelo	2.52	2.14
San Antonio	1.71	1.76
San Marcos	1.69	1.14
Sherman-Denison	2.18	2.39
Temple-Belton	1.63	1.72
Texarkana	Unavailable	1.86
Tyler	1.96	1.92
Victoria	2.73	2.49
Wichita Falls	2.19	2.38
Texas	1.76	1.78
United States	1.31	1.38

No data available for Texas City and Waco
Source: Real Estate Center at Texas A&M University

intangibles and delinquent taxes. Speakers will be attorneys from major Texas law firms and other professionals in the ad valorem tax field.

Cost for the 1°-day seminar is $240 for those pre-registered. If the seminar is not sold out in advance, registrations will be available at the door for $265 per person.

Ten hours of continuing education credits are possible at the seminar. Mandatory Continuing Education credit in law is available to Texas real estate licensees through a reciprocal agreement between the Texas Real Estate Commission and the State Bar of Texas.

Credit for this year's seminar has been requested from:

State Bar of Texas, Texas Board of Legal Specialization (bankruptcy law, real estate law and tax law), Texas Department of Licensing and Regulation, Institute of Property Taxation, Board of Tax Professional Examiners, State Board of Public Accountancy, American Society of Appraisers, American Society of Farm Managers and Rural Appraisers and Texas Appraiser Licensing and Certification Board.

For more information or to register, call Benedict at 409-845-9691.

Chief Economist, Video Specialist Join Staff

Mark G. Dotzour is the new chief economist for the Real Estate Center. He replaces Ted C. Jones who is now with Stewart Title.

Since 1987, Dotzour has been in the Department of Finance and Real Estate at Wichita State University. His academic background also includes work at Comenius University in Bratislava, Slovakia; Lincoln University in Christchurch, New Zealand; and at the University of Texas.

Dotzour was president of Dotzour Realtors in Wichita, Kansas, from 1978 to 1981. He managed a residential brokerage office with eight salespersons. Prior to that position, he sold residential housing for three years.

The Center's new chief economist also has experience as a developer. From 1978 to 1981, he was president and co-owner of Gleneagles Development, Inc., in Wichita. He developed Gleneagles subdivision, a development of 120 luxury home sites.

Dotzour received his bachelor of business administration cum laude from Wichita State University in 1976. He received a Ph.D. from the University of Texas in 1987.

Wendell E. Fuqua rejoins the Center to again take charge of videotape production. In 1978, Fuqua was responsible for setting up the Center's first videotape studio. He wrote scripts and produced, directed and edited numerous videotape programs.

In 1985, Fuqua opened his own script writing and videotape production firm in Harrisonburg, Virginia. Among his clients were the U.S. Postal Service, the Virginia Department of Education, the U.S. Army, the Office of Government Ethics and USF&G Insurance Company.

Fuqua's background includes work at the *Austin American-Statesman.* He is a former U.S. Air Force captain. He received two degrees from the University of Texas—in journalism and art.

His first Center assignment is to configure a modern videotape studio for production of programs to benefit licensees and the public.

Where There's a Will

Test Your Knowledge of Texas Wills and Other Testamentary Documents

By Judon Fambrough

Although you probably have already made out a will, you may not be aware of the types of wills recognized in Texas, the requirements for execution of each and how your property would be divided if you died intestate (without a will).

Take this quiz to test your knowledge of the subject. After reviewing the correct answers on page 24, you may wish to order the Real Estate Center report, *Texas Wills* (publication 449).

The report contains, as inserts, forms for the Statutory Durable Power of Attorney and the Directive to Physicians as promulgated in the statutes.

	True	False	
1.	❑	❑	A valid nuncupative (oral) will requires the testator to be on his or her death bed and to make the bequest in the presence of two credible witnesses.
2.	❑	❑	If you die intestate, your children always receive your half of the community property.
3.	❑	❑	A holographic will requires no witnesses for validation; hence, this type of will can not be made self-proving.
4.	❑	❑	If you die intestate, your surviving spouse will receive one-half of your separate real property if you have children.
5.	❑	❑	A self-proving will requires no witness testimony to be entered into probate.
6.	❑	❑	If you die intestate, your surviving spouse will receive one-half of your separate personal property if you have no children.
7.	❑	❑	A formally executed will (better known as a type-written will) **that is not self-proving** requires two witnesses to sign in the testator's presence. The testator need not sign in the presence of the witnesses, nor the witnesses in each other's presence.
8.	❑	❑	In Texas, if you have not executed a Directive to Physicians to Withhold Life-support Devices (better known as a Living Will), your spouse and/or next of kin can not legally make that decision on your behalf.
9.	❑	❑	The primary reason for executing a Statutory Durable Power of Attorney is to avoid having a guardian judically appointed if you become mentally incompetent.
10.	❑	❑	If a couple executes a Right-of-Survivorship Agreement to avoid probate of the community property when the first spouse dies, **all** the community property must be subject to the agreement. The couple can not pick and choose among the assets.

Fambrough is an attorney, member of the State Bar of Texas, senior lecturer with the Real Estate Center at Texas A&M University and author of Texas Wills.

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______	☐	*Texas Rural Land Prices, 1996*	TG-1174	$3/$7	______
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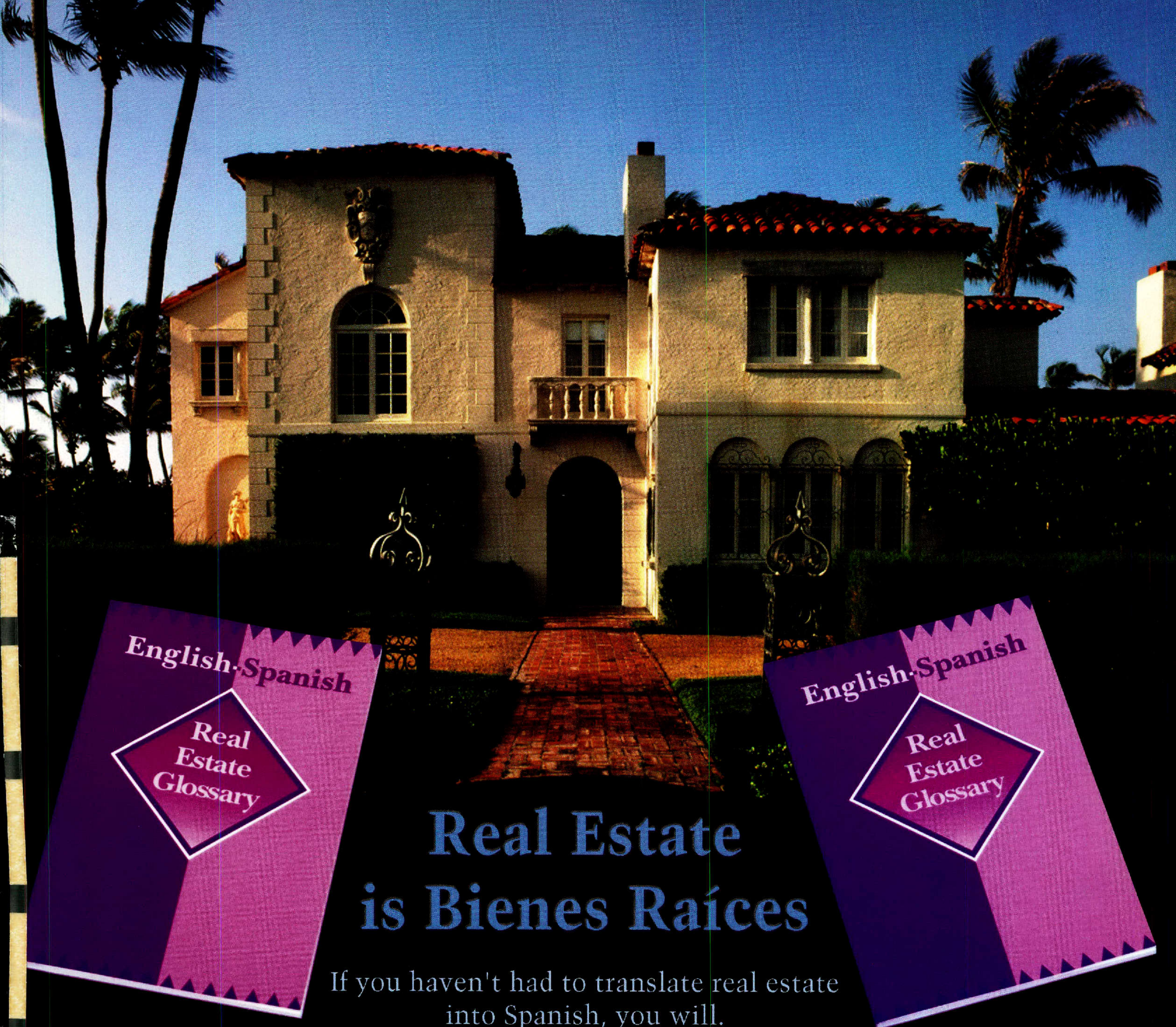
Answers to Texas Wills Test

1. False 2. False 3. False 4. False 5. True 6. False 7. True 8. False 9. True 10. False

For a detailed discussion of the answers, call the Center's Fax-on-Demand system at 409-862-7461 or 409-862-7460 and request number 1179. The information is free. Telephone charges, if any, apply.



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