



Appraising places of worship:

UNIQUE PROPERTY VALUATION

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A-typical real property is often thought to be the most difficult or complex to appraise. One example, which I will examine in this article, is a place of worship asset valuation. In reality, however, the same methodologies used to value more commonly traded assets are also employed in the appraisal of unique properties. It is a matter of applying known valuation principles within the specific context of the asset being appraised. For the purpose of this article, the case study is that of a 5-year-old Sikh temple located in the western region of Toronto, Ontario.

Following routine valuation procedure, the initial question is, of course, "What is



the highest and best use of the land as though vacant and improved?" But, before we can answer that question, it is important to frame the highest and best use analysis around understanding how the word *market* is defined for the unique property at hand and whether the circumstances within which the subject property trades reflects a definition of value other than *Market Value*.

Buyers of this asset type operate within a somewhat closed market. The notion of a restricted or closed market gives rise to the possibility of an alternate value definition known as *Value to Owner*. This is a concept whereby value, due to

its unique specificity, may be higher to a particular prospective buyer. For example, the relative scarcity of Sikh temples in an area that has the requisite demographic, will create demand and thereby *Value to Owner* that may be higher than open *Market Value* based upon more common land uses. Ultimately, places of worship carry great importance to members of a given faith, which further gives rise to the notion of *Value to Owner*. Whether the concept of *Value to Owner* or open *Market Value* is greater will be confirmed or rejected through application of the feasibility portion of the highest and best use analysis.

With a preliminary understanding of the subject's market and its underlying motivations, the highest and best use analysis will become more readily understood around the four pillars of consideration:

- legally permissible;
- physically possible;
- financially feasible; and
- maximally productive.

Let's examine each pillar in the context of the property at hand.

Legally permissible

- Zoning permits light industrial use, which was the main development in the immediate area and within the subject complex.
- Other uses allowed under land use controls include commercial office and retail.
- Based upon legality alone, there are a number of alternate options available.

Physically possible

- Subject place of worship is situated on remaining area of a site that resulted from an industrial condominium (strata) project completion. Therefore, minimal options were left due to the relatively small land area and the fact that the subject parcel is land locked, i.e., ingress and egress must be through the industrial mall.

Financially feasible – market research:

- What use(s) are in demand as per the demographic base? Highest proportion of demographic is within the Sikh community.
- What use(s) do the Sikh community need or value the most? Members of the Sikh community travel well beyond the region to attend religious services.
- If demand exists for a place of worship, what is the cost vs. return? How is this quantified in the context of a development that is not purchased for an investment? In other words, how is feasibility measured? As will be discussed later in this article, feasibility is measured through understanding that the non-profit corporation that owns the subject must be financially sustainable on par with for profit corporations.

Maximally productive

- Of the options that are feasible, which one or combinations thereof maximize value and accurately define highest and best use? In the case of the subject, given the site limitations and other factors, use of a Sikh temple was ultimately determined to represent highest and best use as if vacant and improved.

Highest and best use

As if vacant

As noted earlier, the subject land parcel was deliberately left vacant following the construction of a light industrial condominium (strata) within the complex. This was due to a number of factors. First, the scale (relative to demand) of light industrial use within the condominium (strata) complex was maximized. Second, demand for alternate uses as permitted under land use control, such as retail and commercial office space, dwindled post-pandemic. Therefore, the feasibility threshold was not met through industrial, retail, or office use. The last consideration was the fact that the subject site lacked independent access, i.e., it is land-locked with no on-site parking facility.

However, through market research it was determined that there was a prevalent Sikh demographic and that Sikh parishioners in the area currently travel a significant distance to worship. In this vein, the condominium (strata) board expressed willingness to provide an easement granting access to the Sikh temple through the industrial complex on the condition that the development was strictly for a Sikh temple. Consequently, given the unique limitations and demographic considerations, the most desired and valued use is that of a Sikh temple if the subject site was hypothetically vacant as at the valuation date.

As improved

In this particular case study, the subject Sikh temple was recently constructed. To a degree, there is a benefit of hindsight.

Attendance records confirm that the temple operates near or at full capacity on a daily basis. During the feasibility phase of the analysis, it was noted that the value and greatest return on construction costs were highest with the largest possible building size/capacity. Essentially, the larger the building, the greater the number of parishioners that could financially contribute to the non-profit entity that owns the subject property. In other words, economies of scale for the property could only be achieved through donations spread over a large parishioner base. This was confirmed through an examination of the financial statements of the non-profit corporation. Clearly, strong financial solvency of the non-profit is essential for the continuance of the subject property in its operation as a Sikh Temple. Therefore, highest and best use as improved is as a Sikh temple in its current form as to the building size/capacity and quality of capital improvements in place, which maximize desirability and value.

Valuation methodology

With highest and best use established as a regional Sikh temple, the analysis then turns to how the value of the property is determined. In this regard, the central consideration lies in understanding the thought process of potential buyers in the market of the subject property. That is because the true appraisers are buyers who we, as real estate valuers, must understand so as to communicate their motivations within an appraisal report. Buyer behaviour is captured within one or more of our traditional valuation methodologies; the direct comparison approach, cost approach, and income approach.

Direct comparison approach

If buyers within the subject market segment must quantify its value, what valuation elements do they consider relevant? Clearly, as indicated earlier, a larger building will command a higher value since it achieves economies of scale

through a higher number of individuals that may offer charitable donations to the non-profit. Location is also a central consideration since the temple must be proximate to the demographic that it serves. Building condition and quality of improvements also weigh in. Religion and worship of a person's faith is revered. This would infer that quality construction materials and appropriate finishing (i.e., religious embellishments) are an important consideration. They form part of the capital improvements in keeping with the tradition of Sikh temples and thereby contribute to the property's value.

With these main drivers of value identified, the next logical step is to decide the basis upon which appropriate comparables will be selected. What asset types would be a suitable proxy for a Sikh temple? The subject property is clearly not a generic asset that lends itself to comparison. However, in lieu of reliance upon other Sikh temple transactions, which conceivably may not exist, the question then is: What would a prospective buyer of the subject property consider as an alternative asset that could be converted into a Sikh temple? If we look at the key value drivers – building size, location, and quality/condition of the capital improvements – it becomes apparent that other assets may act as surrogate comparables. Examples may include a banquet hall and sports complex.

Typically, these types of buildings are larger in size and offer ample parking due to the building size/capacity. Under normal circumstances, adjustments for differences between each comparable and the subject are addressed through a pairing analysis. However, if insufficient market data exists in order to perform a pairing study, then an alternate approach is to survey prospective buyers of religious properties and ask how they determined value at the time of purchase and on what basis and to what degree would the purchase price vary due to the differences between a comparable and a subject property.

Cost approach

On the surface, the cost approach's application is very different than the direct comparison approach. However, a closer examination of the relationship between these two methodologies reveals the fact that they are both comparison based.

The more unique a property is, the less likely that generic comparisons exist. If a property is so unique that no true comparison exists, then the logical 'comparison' becomes the cost to re-create the property as a proxy of its value. The cost to re-create becomes its own comparison to a potential buyer. Examples include a 3.5M square foot industrial building – there are only a handful of buildings of this size in Canada. In this case, a buyer would determine the value of the underlying land through comparison and then estimate cost to build, which collectively would give a summation of value through the cost approach. More importantly, a *comparison* was made between the subject property and cost.

Income approach

Through the course of analysis and market research, it became clear that the Sikh temples are not typically leased through a management company or otherwise purchased for income. Rather, temples are most often purchased and owned by a non-profit on behalf of the Sikh community for a use that is typically not directly associated with an income stream. Consequently, the value of the subject does not correspond to an income-based valuation methodology.

Conditional considerations

While the standard limiting conditions may appropriately address most of the subject value drivers, given their impact on value it is noteworthy to highlight them here.

- In the case of the subject project, the fact that it is land-locked was addressed through an easement agreement with the condominium (strata) corporation of the industrial units within the complex. Accordingly, the subject's value is conditional upon the continued existence and legal enforceability of

the easement agreement that provides access and parking.

- As indicated earlier, the feasibility of the subject and its sustained value is tied to the level of donations. Therefore, Market Value is contingent upon an existing demographic that will support and maintain a financially solvent non-profit corporation.
- Market Value is also predicated upon economic conditions yielding a discretionary income level that enables parishioners to make financial donations to the non-profit.
 - The value of the subject through the notion of *Value in Use* was \$16,000,000. If the Sikh temple was no longer in demand or financially insolvent for whatever reason, the value would revert to open *Market Value*, which was determined to be \$4,500,000 (land value) less

demolition costs of the existing Sikh temple building. Accordingly, if the authorized user of the report is a lender, the disparity in value from a *Value in Use* to open *Market Value* is a critical notation to include in the report in order to inform the client of potential future risk related to the length of the loan amortization period.

Summary

At the onset of this article, I stated that routine valuation procedures adequately address valuation issues of even the most unique or difficult valuations, and this holds true. It is simply a matter of understanding the market in which the subject property operates and the corresponding motivations and interests of the prospective buyers within that particular market segment. ▣