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October 21, 1974

MEMORANDUM

TO: Mr. James R. Leonard

FROM: Maury Seldin
Metro Metrics, Inc. Maury Seldin HH

SUBJECT: SUPPLEMENTAL COMMENT

As a supplement to the report which we have developed to provide a basis for my formulating an opinion of value of the various parcels which are the subject of the Marianas Political Status Commission negotiation with the government of the United States, I herewith submit comments on three aspects relevant thereto. These areas are (1) Prices for leasehold interests instead of fee simple interests; (2) Adjustments in prices for conveyance of lesser interests, and (3) comment on the presentation of the U.S. representative Mr. Roy Markon.

Price of Leasehold Instead of Fee Simple Interest

The value indicated by analyses submitted in the study is summarized in Table I. That value, as noted in the study, is of a fee simple interest.

I surmise that the people of the Marianas desire to retain title to the land even though they are willing to make certain land available to the United States for certain purposes. The holding of title has a strong emotional benefit which would be difficult to value. Under the circumstances the people would value title more than a user would value the same title. Thus, it is in all likelihood most economically advantageous to both parties to deal with a lease rather than a sale.

Lease values are generally predicated on market values. The usual process is for the owner and the prospective user to agree on an annual rent which reflects either a competitive price for use of like property and/or a price which provides a fair return to the owner based upon the value of the property. The rent for such a fair return is calculated by multiplying the value of the property by the competitive rate of return.

The competitive rate of return is what similar owners are able to get in the market considering the risk associated with the tenant's ability to pay and other factors such as adjustment for changing productivity of the land and changing price levels. Leases are made in a variety of patterns including step up leases (prearranged increasing rentals), index leases (rentals varying with some price or cost index), percentage leases (rentals varying with sales volume) and reappraisal leases, among others. The simplest, of course, is a level payment lease, i.e. same rental for the entire term.

Computations for such leases if based upon value start with a basic rent for rate of return to which an amount is added to cover taxes and other costs. Sometimes renewal options are included in the agreement with varying provisions for new rental schedules upon renewal.

The rate of return used for the present circumstances might well be on the order of 10 percent. Such a rate is lower than the local prevailing rates but of course the credit worthiness of the subject tenant is the finest in the world. Given today's inflationary expectations the prevailing rate for long term United States government loans is about 8.3 to 8.4 percent. Current quotations on selected U.S. Bonds are as follows:

7-1/2%	1988-1993	91.92 - 91.28	8.36% yield
7 %	1993-1994	85.22- 86.22	8.29% yield
8-1/2%	1994-1999	100.02- 100.18	8.44% yield.

These rates are obviously lower than 10 percent, but the owners are, I surmise, considering a 50 year lease without periodic adjustment for inflation. They could well consider a lower rate and opt for a periodic adjustment for inflation in excess of inflationary expectations imputed in the long term United States government rate. Such an approach is complicated and would probably make little, if any, significant difference since a single lump sum payment is being considered.

If a single lump sum payment is considered then the series of future payments (say for 50 years) would be discounted back to the present. Presumably the discount rate would be the same as the interest rate. Thus, almost all of the difference in rent attributed to different rates are removed by the use of a single payment. For example, an asset worth $1,000,000 would at the varying interest rates provide for an annual rental as follows:

Interest Rate	Annual Rental
7%	$ 70,000
8%	80,000
9%	90,000
10%	100,000
11%	110,000
12%	120,000

The present value of $1.00 per year for 50 years would be as follows:

Capitalization Rate	Present Value for $1.00 Per Year
7%	13.801
8%	12.233
9%	10.962
10%	9.915
11%	9.042
12%	8.305

When the annual rent is multiplied by the present values the capitalization values are as follows:

Capitalization Rate	Annual Rental	Present Value of $1.00 Per Year for 50 Years	Indicated Value
7%	$ 70,000	13.801	$966,070
8%	80,000	12.233	978,640
9%	90,000	10.962	986,580
10%	100,000	9.915	991,500
11%	110,000	9.042	994,620
12%	120,000	8.305	996,600

Thus for every million dollars in value a single lump sum payment of $990,000 will be the equivalent with relatively minor variations due to the capitalization rate. The 8.3 percent rate gives a present value differing about 1 percent from the recommended rate of 10 percent.

The net result is that if leasehold is used rather than fee simple and a single payment is made the price is about 99 percent of the fee simple price using the 10 percent capitalization rate or 98 percent of the fee simple price using the current long term government bond rate of about 8.3 percent.

Conveyance of Lesser Interest

The negotiations may result in the conveyance of an interest less than a leased fee for exclusive use as assumed in the previous discussion. These are arrangements under consideration, I surmise, for joint use of some of the facilities.

An appropriate position for the landowner is that he should be paid a fair market value that assumes the land will be used at its highest and best use. If the tenant wishes to make a lesser use of the land and forego certain more profitable opportunities that may well be his option, but at his expense. Landowners ordinarily are not prepared to underwrite the underutilization of land by the tenant if that choice is the tenant's choice.

If the landowner negotiates to restrict the use to a desired use then it is reasonable to command a rent only equal to the thus restricted use. The reduction of rent because of a lesser use is then dependent upon who causes the less profitable use.

Irrespective of the use to which the land is put and whether it is a highest and best use or a less profitable use, there may arise a case in which the landowner is a co-user. In that case, the reasonable reduction in the rental would relate to what the landowner would be willing to pay for the use to which the land is being put. Using the Tanapag Harbor parcel as a specific case we have the following:

1. The starting rental is a rental based upon a fair price based upon highest and best use.

2. The tenant's desire not to develop to the most economic use is the tenant's choice and should not reduce the rental payment.

3. The choice of land use as made by the tenant then may make available a use to the landowner. The reduction in rent for that use is related to the price the land owner is willing to pay for these benefits. That could be quite nominal in the case of very valuable land.

If we use the Tinian Harbor case the reduction in rent could be substantial because the land would be at highest and best use and the extent of use might be substantial.

In either or both cases the tenant may make substantial improvements at considerable costs. The costs do not necessarily represent value to the landowner. The costs may increase the productivity of the land and the rental might thereby be adjusted. But, the extent of the adjustment is related to benefits rather than costs.

The value of such benefits is really the value of a lesser interest conveyed. The retention of some rights to use is thus an item of negotiation in the rental price. If these rights are not valuable then the landowner may convey the full leasehold interest and negotiate to buy or not buy use on a competitive basis. A competitive price and the option to use or not to use is a reasonable basis upon which to negotiate a rental rate reduction.

Comments on the U.S. Presentation

Mr. Markon identified his presentation as one in which he attempted to relay a judgment without having really made an evaluation. He stated that he had "no handle" with which to make an evaluation. What he in fact did is to rework our format with some fragments of his own analysis.

We have considered his comments and submit the comments which follow noting adjustments which we see as appropriate.

As to the restriction on land use adjacent to the airport at Isley Field, we note that he made a valid point in noting the adverse influence of the airport. Additionally, he has a point on access for industrial use. Considering these comments and our review of the situation we have adjusted downward the value of the Isley Field parcel from our preliminary estimate which was indeed preliminary. Thus, our judgment is that a price of $3,535,000 is more reflective of the value based upon 125 acres at $10,000 per acre, 200 acres at $7,500 per acre and 157 acres at $5,000 per acre.

As indicated by Mr. Markon's comments, he did not conduct any analysis of the economic and residential development of Saipan with particular attention to the subject area. He has no economic base analysis of the island and indeed his experts as he identified them do not ordinarily deal with making such forecasts. Our analysis indicates that there is a market and that the acreage estimated is reasonable for present purposes. We would agree that additional analysis of the parcel is warranted but would specify that it is essential to include an economic base analysis and to consider a demand analysis for industrial users and not simply a cursory judgment by an appraiser as to the amount of land which could be absorbed and hence a value.

The glaring inadequacy of Mr. Markon's failure to utilize an economic base analysis is even more apparent when he discussed the island of Tinian. He did not indicate any line of reasoning that inferred an analysis of economic base of Tinian beyond a statement of some acreage for various land uses. Our analysis shows a projected economic development. If he wants to debate acreage he should conduct an analysis of the economic potential or better yet engage a disinterested land economist to conduct such an analysis.

A possible explanation for Mr. Markon's under allocation of land in Tinian is that he may be dealing with land to be absorbed (over an unspecified time) rather than land for which there is a market. Ordinarily the land required to make a market will be at least several fold greater than will actually be developed to allow for competition. We have considered this in our estimates. I think Mr. Markon has made some judgments on feel without having conducted the analysis or reasoned through the behavior of land markets.

We have reviewed the allocation he made for the Tanapag Harbor parcel and are at a loss to explain how anyone would reasonably allocate 100 acres or 1/2 of the parcel to a public use if they were looking to make the most economic use of the land. It is a presumption on his part to assume that the local government would require a use of land which would make the best case for a low sales or lease price. Our analysis shows that the parcel is suitable for a variety of more valuable uses than he submits. His allocations might carry some questionable weight if they were made by a disinterested party. He cannot really negotiate as an advocate and simultaneously present himself as an objective analyst.

TABLE 1-1

SUMMARY OF INDICATED VALUES

	Acreage	Value Per Acre		Subtotal By Parcel
Tanapag Harbor				
Residential				
Low Density	67	$ 12,000	$ 800,000	
Medium Density	60	15,000	900,000	
Hotel	20	100,000	2,000,000	
Marina	20	40,000	800,000	
Commercial	10	30,000	300,000	
Industrial	20	25,000	500,000	
TOTAL - TANAPAG HARBOR	197			$ 5,300,000
Isley Field				
Primary	125	$ 10,000	$1,250,000	
Secondary	200	7,500	1,500,000	
Tertiary	157	5,000	785,000	
TOTAL - ISLEY FIELD	482			$ 3,535,000
Tinian				
Industrial				
Harbor	50	$100,000	$5,000,000	
Airfield	250	10,000	2,500,000	
Primary	100	10,000	1,000,000	
Secondary	100	5,000	500,000	
Total Industrial	500		$9,000,000	
Commercial				
Primary	200	$ 10,000	$2,000,000	
Secondary	200	5,000	1,000,000	
Total Commercial	400		$3,000,000	
Resort	300	$ 10,000	$3,000,000	
Residential	1,500	$ 2,000	$3,000,000	
Agricultural				
Primary	2,500	$ 800	$2,000,000	
Secondary	7,275	600	4,365,000	
Tertiary	1,000	400	400,000	
Total Agricultural	10,775		$6,765,000	
Other				
Construction Land	2,900	$ 100	$ 290,000	
Undeveloped Land	1,100	100	110,000	
Total Other	4,000		$ 400,000	
TOTAL TINIAN	17,475			$25,165,000
Farallon de Medinilla	229	$ 100	$ 22,900	$ 22,900
				$34,022,900
			Say	$34,000,000