Further analysis of the purchase price for 400 Aviation Blvd compared to the Ward Levy Appraisal Group's appraisal

While the MAI appraiser's conclusion places the property's value at $37 million based on a reconciliation of the three valuation approaches, the County's decision to proceed with the $46.1 million acquisition is well-justified. This valuation reflects several compelling considerations that align with the County's strategic objectives and long-term benefits:

1. Context of the Appraisal and Its Limitations

- **Sales and Income Approach Limitations**: The appraiser heavily weighted the Sales Comparison and Income Approaches, which are influenced by market averages and investor perspectives. These approaches rely on historical data and comparisons to inferior properties, as explicitly stated in the appraisal. The appraiser noted that the comparable properties were smaller, older, and of lower quality, making them an imperfect benchmark for a unique, high-quality, Class-A property like this one.

- **Cost Approach Considerations**: While the Cost Approach indicated a value of $88.5 million, the appraiser discounted this method due to its theoretical nature and the acknowledgment that new construction in Sonoma County is largely infeasible due to market conditions. However, the appraiser also admitted that a buyer would consider the extent of the discount versus replacement cost as part of their purchase decision, which aligns with the County's rationale for purchasing the building.

2. Unique Owner-User Value

- **Owner-User Perspective**: The appraiser acknowledged that the most likely buyer is an owner-user, not an investor. For an owner-user like the County, the value of the property extends beyond market metrics and includes strategic considerations such as immediate availability, operational suitability, energy efficiency, and long-term cost savings. These factors are not fully captured in an appraisal focused on market transactions and investor-oriented returns.

3. Replacement Cost and Market Realities

- **Infeasibility of New Construction**: The appraiser explicitly stated that constructing a similar building is economically infeasible in Sonoma County under current market conditions, highlighting that new office construction would be limited to owner-user buyers like the County. The $46.1 million purchase price is substantially lower than the $88.5 million replacement cost, representing a significant discount and demonstrating the soundness of the County's investment.

- **Strategic Value of Securing the Building Now**: The appraiser noted that buyers would consider the replacement cost when making a purchase decision. For the County, purchasing this high-quality building at a price far below replacement cost ensures it avoids the risks, delays, and higher costs associated with attempting to build a similar facility in the future.

4. Market Behavior Defines Value

- **Market Value as the Agreed Price**: Market value is what a willing buyer agrees to pay a willing seller under fair conditions. If the County purchases the building at $46.1 million, this transaction itself establishes market value, particularly for a unique, high-quality property with no direct comparables.

5. Strategic and Long-Term Considerations for the County

- **Cost Efficiency Over Time**: The County gains a building that meets its needs immediately, avoiding the costs of leasing, future construction, or operational inefficiencies from using outdated facilities. The energy-efficient design will provide ongoing savings that further justify the purchase price.

- **Avoiding Market Volatility**: By purchasing now, the County locks in a price for a scarce, high-quality asset, avoiding potential cost increases, rising interest rates, or future market shortages.

Conclusion: Why the County's investment is justified

The County's decision to purchase the building at $46.1 million is sound and reflects a strategic investment based on replacement cost savings, long-term operational benefits, and the unique value of the property as an owner-user asset. While the appraiser reconciled a $37 million value based on market-based methodologies, this appraisal does not fully account for the County's specific needs, the infeasibility of replacement, and the strategic advantages of acquiring this building at a price significantly below its replacement cost. This purchase is both reasonable and financially prudent in the context of the County's goals and operational priorities.

Replacement Cost Approach is Most Appropriate

The **replacement cost approach** is the most appropriate valuation method for the County's potential purchase of the subject property. Here's an explanation of why this approach is suitable, given the unique characteristics of the property and the context of its use:

1. **Lack of Reasonable Sale Comparables in the Market** The replacement cost approach is particularly relevant when there are no comparable sales available. In this case, the property is a recently completed, Class-A, steel-framed, energy-efficient office building – a unique asset in the Sonoma County market. As the letter points out, there are no "apples-to-apples" sales comparables for this type of high-quality office building in the area. The other office buildings in the market, which are mostly lower-quality Class B or

C, do not provide a fair basis for comparison due to their different conditions, amenities, and levels of construction.

2. **Owner-User Property, Not an Investment Property** The subject property is being acquired for use by the County itself, rather than for income generation or resale. In such cases, the income approach (which is typically used to value properties based on their potential rental income and is suited for investment properties) is less relevant. The County's goal is not to generate income from the property but to use it as a functional, strategic asset to house its operations. Therefore, valuing the property based on its income-generating potential does not accurately reflect its value to the County as an owner-user.

3. **Accurate Reflection of Cost to Recreate the Asset** The replacement cost approach estimates the value of the property by determining what it would cost to replace or reproduce the building with a similar one of equivalent utility, quality, and functionality, accounting for current construction costs, materials, labor, and land value. Given that the building is recently constructed and includes modern, energy-efficient systems, the replacement cost approach captures the true cost the County would face if it were to build a similar facility today.

   The estimated replacement cost for a similar building, including land, is over $100 million, which is substantially higher than the $46.1 million purchase price. This demonstrates that purchasing the existing building provides significant cost savings compared to constructing a new one from scratch. The replacement cost approach thereby affirms that the County is obtaining a substantial discount, reflecting a value that considers both current construction costs and the value of modern amenities and sustainability features.

4. **Value Derived from Utility and Functionality for the County** The replacement cost approach is ideal for properties whose value is derived from their utility to the owner rather than their marketability to third parties. As an owner-user, the County values the building based on its ability to serve its operational needs efficiently and effectively. The replacement cost approach considers the cost to acquire a similar asset that provides equivalent utility – in this case, a high-quality, energy-efficient office building that meets the County's specific requirements.

5. **Long-Term Perspective and Strategic Investment Considerations** The County's investment in this building is a strategic decision focused on long-term use and benefits. The replacement cost approach aligns with this perspective by valuing the building based on its long-term utility, quality of construction, and ability to meet the County's needs. It accounts for future costs avoided, such as potential increases in construction prices, delays, or disruptions in new construction projects, and ensures the County is not paying more than what it would cost to recreate a similar building in today's market.

6. **Market Value Uncertainty and Volatility** In periods of market volatility or when market conditions are uncertain (as indicated by fluctuating vacancy rates and declining

office values in some areas), the replacement cost approach offers a more stable and reliable basis for valuation. It is less influenced by short-term market fluctuations and focuses on the intrinsic value of the property as a necessary asset for the County. This method helps ensure that the County's investment is based on the true cost of acquiring a functional asset rather than speculative market trends.

Conclusion: Use of the Replacement Cost Approach

The replacement cost approach is the most appropriate method for valuing the subject property because it accurately reflects the cost the County would incur to replace or reproduce the asset it needs – a high-quality, Class-A office building – in the current market. It accounts for the lack of comparable sales, the property's use as an owner-user asset, the unique benefits of modern construction and energy efficiency, and the strategic importance of the building for the County’s long-term operational needs. This approach demonstrates that the $46.1 million price represents a significant cost saving compared to constructing a similar building and confirms that the County’s investment is justified.