

Writing the A.A.O.M. Demonstration Appraisal Report

Introduction

As part of the AAOM Accreditation Program candidates are required to prepare and submit a “Demonstration Appraisal Report” valuing an income-producing property. This document is intended to be an overview or outline of the demonstration appraisal report.

The Demo Report’s intention is to provide the opportunity for the candidate to demonstrate their knowledge of, and ability in, the application of appraisal theory and practice. It is the most complete presentation of a property appraisal that an individual can produce given the limits of the individual’s abilities and the market evidence available at the time of the appraisal.

The Demonstration Appraisal Report is intended to test the candidate’s ability to apply appraisal theory relevant to the appraisal of an income producing property, and to assemble a comprehensive appraisal report with each section completed thoroughly and accurately. When the report is completed, each section is linked with other sections to provide a continuous narrative leading to the final conclusion. It is intended to be a concise but thorough examination of the candidate’s level of knowledge and expertise.

The purpose of preparing a Demonstration Appraisal Report is to test the candidate’s ability to gather the necessary data, analyze the data properly, and write an appraisal report setting forth the analysis and conclusions which will lead the marker to the same conclusion with the opinion of value.

This guide has been developed to assist the candidate in preparing a Demonstration Appraisal Report on an income-producing property using a structured format report.

Selection of the Subject Property

The most important step in preparing a demonstration appraisal report is the selection of a subject property. If a poor selection is made, it may be difficult to write a demonstration appraisal report that will receive a passing grade. For many income producing properties in the market, sufficient comparable market data does not exist to enable the candidate to demonstrate all that is required for this report. Onus for selecting a suitable property lies solely with the candidate.

The success of the report largely depends on the availability of ample market data to support the requirements required to properly appraise the subject property. If the community in which the property was originally chosen by the candidate has limited market data, it may be necessary to investigate other properties in another community in which the candidate finds a more active market. Necessary market data includes, but is not limited to, sales of vacant land and improved properties, as well as paired and resale data in support of necessary adjustments in the land value section of the cost approach and direct comparison approach. It is important to ensure that you have sufficient market data before choosing a property.

The candidate should first gather data that will be needed for the preparation of the report, especially bare land sales and improved property sales. Once this information is available, a subject property can then be chosen for which there is ample data and that best fits the data, not only of comparables to be analyzed in comparison to the subject, but also to be used to justify and support adjustments made to the comparables.

Adequate market data must be available for proper demonstration of site valuation and the sales comparison approach. Sufficient income data must also exist to justify, support, and document rental data, sales of rental properties, and gross rent multipliers.

Candidates will often select a property first, only to find later that although the property in itself is suitable, there is insufficient market data relating to the property or its immediate area to complete the report. It is suggested that the candidate select a property use, for example – apartment, strip mall, etc, where ample market data is available. Once the use is selected, all market data to support that use should be accumulated and given a cursory analysis. From the data available, the candidate should select a subject property that best fits the data.

It is recommended that the subject property for the demonstration appraisal report be an income producing property which conforms to the zoning and represents the highest and best use of the site as if vacant.

The highest and best use of the site as if vacant must be for development with an income producing property and the existing development must be an income producing property. Also, make sure that the highest and best use of the site as if vacant is the same as or very similar to the highest and best use of the property as improved. As an example, it would be very difficult to undertake a demonstration appraisal report on a property where the highest and best use of the site as if vacant was for a single family dwelling project and the highest and best use of property as improved is as an income producing property.

The subject property must be such that the site as if vacant could be sold on its own, independent of any other property.

See **Submission Requirements** for how to register a Demo property selection.

The Physical Report

The demonstration appraisal report should demonstrate the candidate's thorough knowledge of the process to value an income producing property. Therefore, photographs, exhibits, grammar, spelling, overall presentation and binding of the physical report should be as professional as the candidate can possibly produce. It is recommended the report be prepared on 8½ by 11 inch paper and bound securely to ensure that the report remains intact through shipping and grading.

The analytical sections of the report, which includes everything after the introduction, for example, property description, and market analysis through the reconciliation and final value option, should provide adequate justification, support, and documentation.

Justification demands evidence that a statement is well founded. Justification is best provided by reference to market extracted data. It is an explanation of how the supporting data and documentation have been interpreted to reach the conclusion.

Support means to verify or substantiate statements and conclusions with as much factual data as possible. For example; the estimate of remaining economic life should be supported with the statement of how it was extracted and confirmed in the market and what sources were referenced.

Documentation is the process of providing evidence for a statement or fact. Reliable or authoritative sources should always be used and referenced. Examples of some areas of the report requiring extensive documentation are comparable sales, market rentals, gross rent multiplier selection, cost new estimates, and depreciation.

Market Extraction

One of the major objectives of the demonstration appraisal report is to demonstrate the process of extracting data from the market to support, document and justify the conclusions presented throughout the report. Some examples of extracted support data follow.

In the sales comparison approach, all adjustments to comparable sales should be market supported. The method for extracting market support can vary significantly depending on the kind of data available. Examples of market extraction may include extracting accrued depreciation from comparable sales. A location adjustment can be supported by demonstrating the difference in value from one property location to another. Other means of extracting market support could include paired sales analysis and examining differences in rent caused by varying conditions.

In the cost approach, the cost new estimate could include estimates from published cost services and a detailed cost breakdown prepared by a qualified building contractor. These costs can be further supported using cost comparables found in the market.

Depreciation must be supported by the breakdown method. Short and long lived items to be considered under the depreciation section of the cost approach should be detailed. These same items (like other items of depreciation) should be adequately covered in the sales comparison and income approaches as well. The condition of the improvements,

actual age, estimate of effective age, and remaining economic life must be explained and justified. Depreciation consistency should be demonstrated in all approaches to value.

In the income approach, market rent estimates and gross rent multipliers can be supported with an appropriate analysis of comparable rentals.

It is not required that all facts be documented through the market extraction process. However, sufficient exhibition of the method should be included to demonstrate its proper use, application and comprehension.

Items or Schedules

Items or schedules should contribute to the clear understanding of your written description and discussion. Place illustrations within the report where they will be most helpful to the reader. Items or schedules should include, but are not limited to, the following;

Photographs

Photographs of the subject property, comparable sales, land sales, and rentals should be included along with any other scene that might be considered important to understanding the value conclusion. This would include cost new comparables, rental comparables and gross rent comparables. Photographs should be identified and dated.

Maps

Maps indicating the neighborhood boundaries, the location of the subject property, and the location of all comparable sale properties must be included in the report. Be sure to include a directional arrow on each map. An area map locating the subject and the subject neighborhood in relation to the central business district, work centers, competing neighborhoods, and other important locational considerations which relate to the property being appraised may also be helpful. Maps should show street names in legible print.

Plot Plan

A plot plan that shows lot and exterior building dimensions, easements, the placement of the improvements on the site, and abutting street rights of way is required. The plan could also indicate the location of any major site improvements, for example, walks, driveways, etc. and any other characteristics which would help the reader better visualize the site.

Building sketch and floor plan

Provide a scale drawing of each level of the floor plan including all floors, basement area, and attached structures. The plan should indicate all windows, door swings, and plumbing fixtures, stairways, etc. Include all exterior dimensions, room sizes and area calculations.

The outline shown on the following pages is suggested for the "AAOM Demonstration Appraisal Report". It is recommended that the candidate follow the outline closely but it is not mandatory that the candidate follow the exact order of the outline. The outline consists of nine (9) sections that make up the report. Each individual segment of each section of the outline should be addressed.

Section # 1

Property Identification / Table of Contents

The first thing in the property identification section is to identify the subject property. The cover page or title page should include the identification as a “Demonstration Appraisal Report”.

Next, include the building or business name and the address of the property and include a good, recent photograph. A frontal photograph of the subject property at the beginning of the report is recommended to give the reader a mental picture of the property. All photographs must be in color.

Finally give the effective date of valuation of the report and the date the report is submitted.

The second item to include is the Table of Contents which includes the addenda. The Table of Contents lists the major components of the report in sequence.

Once the entire report is completed, number each page consecutively throughout the report except the addenda, in numerical order. The numbering of pages normally begins after the Table of Contents. Use headings and subheadings to identify the major sections of the report in sequence.

Do not use a number and letter to identify a page such as 1A; otherwise the marker would not know if a page is missing. Include appropriate page references in the Table of Contents. The required schedules must be titled and be listed either by alphabetical letter (A, B, C, etc.) if included in Addenda or by page number if inserted in the body of the report.

Section # 2

Summary of Salient Facts and Conclusions

Once the balance of the report is completed, an outline of the major points and important conclusions is recommended. Provide all summary data in point form, as required by the headings listed below.

This summary of salient facts and conclusions provides the marker with a convenient summary and gives the candidate an opportunity to stress points that were considered in reaching the final opinion.

Items to be included in the Summary of Salient Facts and Conclusions include:

1. Registered owner of the property
2. Building or business name
3. Location or address of the property
4. Assessment roll number
5. Present zoning applicable to the subject property
6. Legal description of the property

7. Site size of the property in acres and square feet
8. Building size
9. Highest and best use of the property
10. Type of Property – Apartment, Strip Mall, Warehouse, etc
11. Reference the year of the demonstration appraisal report
12. Breakdown of assessment for the effective date of the appraisal
13. Estimates of value by:
 - i. The Cost Approach
 - ii. The Direct Comparison Approach
 - iii. The Income Approach
14. Final Estimate of Value
15. Date of Final Estimate of Value

The candidate should make sure that this summary page corresponds exactly with the data and conclusions in the body of the report.

Section # 3

Subject Property Analysis

Area Analysis

This section of the report should describe community area background information pertinent to the valuation of the subject property. Only information relevant to the subject property should be discussed, analyzed, and included in this section.

Information relevant to the subject includes:

1. General locale – location of community within the province
2. Location of subject property to the general area
3. Economic growth of the area
4. Comment on the availability of land for commercial development
5. Comment on any governmental or economic factors or trends that would adversely affect the future of the subject area
6. Comment on traffic flow with reference to the subject area

Items used in this section should include;

- i. City area map or municipal map showing the location of the subject property

Neighborhood Analysis

This section will focus on the subject property's neighborhood area. The candidate will provide a brief overview of this area defining the boundaries of the subject neighborhood. In discussion the candidate will provide the following information:

1. History of the neighborhood
2. Predominant type and extent of improvements in the area
3. Land use and zoning in the area

4. Vacancy and/or occupancy rates in the area
5. Services provided to the area
6. Location and accessibility of the neighborhood compared to other competing neighborhoods
7. Location of the neighborhood in regard to employment centers, the central business district, transportation routes, and other characteristics relevant to values a market acceptance of the neighborhood.

The neighborhood analysis must end with a conclusion. The conclusion should consist of a summary of pertinent factors affecting property values and a projection of economic trends for the neighborhood.

Items used in this section should include:

- i. Neighborhood map showing location of the subject property. Where possible, use a zoning map for this purpose

Site Data Analysis

The site must be accurately described. Provide a brief description of the subject property indicating site dimensions, road frontages and zoning. Describe the streets that access the property and the utilities and services supplied to the property.

Items used in this section should include:

- i. Plot plan indicating site dimensions, road frontages, adjacent streets, and the approximate location of the subject buildings

Description of Improvements

A general analysis of the improvements should contain a detailed description of all buildings and improvements on the site. The candidate should describe the subject property as if walking the marker through the improvements.

The description of improvements should include the current use, building type, building dimensions, area, interior layout, structural and construction details, as well as any accessory buildings.

The analysis portion should include a discussion of the age and condition of the improvements. This analysis should also include a discussion on the age and condition evaluation of the short and long life building components, i.e., windows, heating systems, suite decorations (apartment), etc.

Items used in this section should include:

- i. Floor plan showing the building layout with dimensions

Assessment Analysis

This section should include assessment information that may affect the valuation of the subject property. The subject's current assessed value should be presented. The

candidate should describe how the assessed value is determined. This would include a discussion on the reference year used to determine the level of value. The candidates' position including any recommended changes to the assessment should be discussed at this point. Assessment trends in the area of the subject property should be discussed and analyzed. Assessment history of the subject property should be provided in support of that analysis. In addition, a comparison of the subject property's assessment with other competing properties' assessments should be provided to assess and support future assessments for the subject. This section should end with a comment on the likelihood of a reassessment and the impact on the subject property.

Items used in this section should include:

- i. Copy of the assessment roll for the applicable reference year

Section # 4

Legislative Requirements

In this section, briefly describe the Act that governs the assessment of property in Manitoba and quote pertinent legislation as it relates to assessable property. Explain the "equity" provision of the Act in your discussion

Items to reference include:

1. assessor
2. Improvement
3. land
4. property
5. real property
6. value
7. reference year
8. assessment at value
9. Presumption of validity of assessment
10. When general assessment to be made

Summarize your position concerning compliance with the legislative requirements in regard to the subject property.

Section # 5

Highest and Best Use Analysis

This section should begin with the proper definition of highest and best use and include the source of the definition.

Two separate studies are mandatory for this section:

- A highest and best use analysis of the site as vacant
- A highest and best use analysis of the property as improved.

Highest and Best Use as if Vacant

Highest and best use analysis establishes the specific usage that supports market value. Most properties are purchased with the intention of continuing the current way it is used. Some properties, however, are valued primarily for conversion to or redevelopment for an alternative use. Market value, then, is based on the property's highest and best use. In most cases, the analysis will merely state that the current use is the most appropriate one for the property. If the neighborhood is changing, this should be pointed out with a discussion of what types of uses are most appropriate.

Provide a discussion and concluding statement as to the highest and best use of the site as if vacant. Consideration must be given to all uses permissible under the current zoning and to the likelihood of zoning change. Factors such as supply and demand and other principles that might affect the value of the subject must be taken into account.

This analysis should include a discussion that addresses the four criteria. The highest and best use must be:

1. Physically possible
2. Legally permissible
3. Financially feasible
4. Maximally productive

This analysis should end with the conclusion as to the ideal improvement, which would represent the highest and best use if it were vacant.

Highest and Best Use of the Property as Improved

Through an analysis of the four criteria for highest and best use, this discussion should establish which use is maximally productive. This analysis should reach a highest and best use conclusion that includes curing any curable deficiencies, making repairs, or renovating the structures. A comparison of the existing improvements with the ideal improvements should identify functional obsolescence which is shown in the cost approach. Any deficiencies must also be considered in the sales comparison and income approaches.

Summarize your opinion on the highest and best use as it relates to the subject property.

Sales Investigation Process

Describe the extent of the process of collecting, confirming and reporting data. The extent of the appraisal investigation could include details of the property inspection. In some cases, such as the appraisal of an apartment building, it may not be possible to inspect each suite. This section of the report could describe the extent of the inspection. The candidate should also describe the extent of the investigation such as the parameters for comparable sales and rentals searches and the extent of the confirmation process.

The Valuation Process

The three approaches to value are used for single property valuation purposes. The three (3) approaches to value include:

1. The Cost Approach
2. The Direct Sales Comparison Approach
3. The Income Approach

Each approach is to some extent related to the other two approaches and must be market based to have any relationship to market value. The candidate must consider the three approaches to value in estimating the value of a property.

Section # 6

The Cost Approach

The cost approach is a useful tool in determining market value when a property is new. It is also useful in valuing special use properties or properties which do not trade in the market with any degree of frequency. The cost method of appraisal is based upon the principle of substitution. According to this appraisal method, no purchaser would be willing to pay more for a property than the cost of a new replica property. This approach considers the cost to replace the improvements, less any depreciation inherent in the property, added to the market value of the land.

The value of the property consists of three elements, which when combined, formulates the value of the property;

$$\text{Value} = \text{Cost of Improvements} - \text{Depreciation} + \text{Land}$$

This proposition leads to a second conclusion which declares that the replacement cost of a new property sets the upper limit of market value. No one will pay more for a new property than the cost to create a property which provides equal utility. A purchaser may also estimate the cost to bring an existing structure up to desired levels of physical and functional utility. In the report, provide a definition of the cost approach and quote the reference source. There are four (4) steps involved in this approach that are to be outlined and explained in detail.

The steps are:

1. Estimate the land value as if vacant
2. Estimate the building replacement cost
3. Estimate the accrued depreciation from all causes and deduct from the estimated reproduction cost of the building
4. Addition of the estimated vacant land value to the building depreciated worth estimated by the Cost Approach plus the total value of any site improvements to arrive at an estimated market value

The Cost Approach is also known as the summation approach because at the end the three steps are brought together to derive an indication of value.

Step 1 - Estimate the land value as if vacant

- the land value can be determined by a review of properties that have sold prior to and in the reference year. This land value can be determined using the Direct Sales Comparison Approach and making certain adjustments to relate to the subject property. These adjustments are made to the bare land sales so that they are reflective of the subject property. Adjustments are made for financing, time difference (expressed in months), zoning, location, size, motivation, or physical characteristics. Since commercial property is purchased on the basis of size or square foot area sales of a similar type to the subject should be chosen. Adjustments made for time and location are expressed as a percentage between the comparable property and the subject while dollar adjustments are used for services and size adjustments. Explain the adjustments that relate to the sales.
- The next step is to provide a brief written summary of subject property land information such as zoning, land area, services, land to building ratio, and land assessment. Explain and document how the land assessment was calculated commenting on such items as size adjustment and depth tables, if applicable.
- Provide a brief description of at least 3 bare land sales and develop a sales comparison table showing support for the rate chosen.

Items used in this section should include:

- i. Map showing the location of the comparable bare land sales

Comparable Land Sales Table - Example

	Comparison # 1	Comparison # 2	Comparison # 3	Subject Property
Roll #				
Address				
Legal Desc.				
Sale Date				
Consideration				
Zoning				
Frontage (FF)				
Area – Sq.Ft. (SF)				

Equiv Frntge (EF)				
Sale Price per SF				
Sale Price per FF				
Sale Price per EF				
Adjustments				
Time				
Zoning				
Location				
Physical				
Adjusted Sale Price				
Adjusted Sale Price per SF				
Adjusted Sale Price per FF				
Adjusted Sale Price per EF				

Time Adjustment Support

Sales within a six month time frame should be used, however, the availability of adequate comparable sales require that the candidate go beyond that time frame. A comment should be made regarding the lack of recent sales in the area and that time adjustments were used to provide the best comparison to the subject property.

Adjustment for time is the first adjustment to be considered. The valuation of the subject property must be made with reference to a specific date, often referred to as the effective date. Comparable sales will usually have taken place prior to the effective date. Each comparable sale must be adjusted for time to bring it forward to the effective date. The adjustment period must commence on the date upon which the comparative sale took place and end on the effective date.

A number of methods are used to assist in determining the rate or rates to be applied. The most common methods are the consideration of sales and re-sales of specific property within the immediate area of the subject property. Comparable properties that have sold more than once are used to develop a trend for determining time adjustments.

Re-sale Method

Address	22 Main Street	27 First Avenue	18 Second Street
Sale Date (dd/mm/yy)	03 -01-03	18-11-02	29-03-03
Sale Price	\$50,000	\$52,700	\$49,200
Resale Date	02-12-03	15-11-03	31-10-03
Resale Price	\$55,000	\$60,000	\$52,600
% Price Difference	10%	14%	7%
No. of Months	11	12	7
% Change / Month	0.9%	1.2%	1.0%

Another time adjustment method is the paired sales. Paired sales are properties that are similar except for the location and date of sale. At least two sets of paired sales must be used.

Paired Sales Method

Pairings	Sale Date	Sale Price	% Price Difference	No. of Months	% Change per Month
13 White Avenue	20-11-03	\$61,900	14%	14	1.0%
292 Gold Crescent	19-08-02	\$54,300			
27 White Avenue	03-12-03	\$60,500	8%	11	0.7%
92 Yellow Drive	01-01-02	\$56,000			

The third source of time adjustment is from statistical sources such as CMHC or Multiple Listing Services. These sources are weak and should only be used as back up for the other methods.

Statistical Sources - MLS

Month		Average Sale Price	% Change
May 2003		\$153,400	+ 5.9%
July 2003		\$154,000	change
September 2003		\$159,300	over 6
November 2003		\$162,500	months

Items used in this section should include:

- i. Time adjustment charts indicating % change

Before the adjustment analysis is indicated, it is expected that the appropriate unit or units of comparison would be supported from the market. Ideally, the report should clearly indicate how the market values the subject property (example - sale price per acre, sale price per square foot etc.) The adjustments must be derived in a manner consistent with how the final adjusted prices will be reconciled in the market value estimate.

The adjustment process should narrow the range of final adjusted sale prices, not broaden it. Typically, the value of the subject property should fall within the indicated range. The reconciliation of the adjusted sale prices should not rely on the median or mean average. Instead it should provide a rationalized evaluation of the comparables and of the degree of objectivity and subjectivity in the adjustment analysis, as well as a weighting of the comparables as indicators of value for the subject property. The candidate must explain, justify and support all adjustments for significant differences between the comparable sales and the subject property. This section should end with a reconciliation of the comparables into a final value indication. The candidate must provide a written summation outlining and justifying their position respecting the land value.

Step 2 - Estimate the building replacement cost

Replacement cost is the cost as of a particular date. The candidate must provide a written summary of the building information such as building size, age, type of construction, number of stories, condition, land to building ratio and other relevant data. A brief written explanation with respect to the estimate of cost for the building must be provided.

The building replacement cost new should be developed from at least two sources. Cost manuals are the basis of a cost model in a form that is familiar and easy to use. There are commercially available cost manuals that have a national scope, use local modifiers, and are updated frequently. One such manual is the Marshall & Swift / Boeckh Costing Service. When third party manuals are not adequate, local cost manuals such as the Province of Manitoba Assessment Cost Manuals were developed and maintained to be

used for mass appraisal purposes. After costing the building using two cost manual sources the candidate should comment on the suitability of the method chosen to value the subject property

Items used in this section should include:

- i. Two different cost summary sheets showing detailed calculations must be included in the addenda

Step 3 - Estimate the accrued depreciation from all causes and deduct from the estimated reproduction cost of the building

Depreciation is a loss in value from replacement cost new due to all causes except depletion, as of the date of the appraisal or simply, a loss of value from any cause. It is the difference between replacement cost new and market value.

Depreciation is the reduced value of a property compared to the hypothetical new and similar property that has had no loss in value. Accrued depreciation is measured as of the appraisal date and applies only to the improvements.

Accrued depreciation reflects the demand side of the market in conjunction with the principle of contribution. The cost of construction represents the supply side of the market. Cost and value are similar when improvements are new and represent highest and best use. As improvements age, they suffer physical deterioration and obsolescence and, as a result, lose value relative to newer structures. This loss in value is caused by a perceived diminished utility for the property on the part of potential buyers. The true measure of depreciation is the effect on the marketability and sales price.

There are 3 general causes of accrued depreciation to be included in the report:

1. **Physical Deterioration** – caused by deterioration in the physical components of the structure. All structures deteriorate with age
2. **Functional Obsolescence (curable/incurable)** – caused by an inability of an improvement to perform its function efficiently. Functional obsolescence may be attributable to deficiencies, defects, inefficiencies, or super-adequacies of a property. An example of this would be low hanging pipes in commercial buildings
3. **Economic Obsolescence** – adverse factors outside of the property that decrease the desirability and are usually beyond the owner's control. Economic obsolescence often arises from changes in the highest and best use of the property due to market shifts or governmental actions. An example of this would be when a one industry community employer moves or closes down causing values to property values to decrease.

The candidate should be prepared to explain how physical depreciation, functional and economic obsolescence, and other market related factors were arrived in relation to the subject property.

Items used in this section should include:

- i. Depreciation tables relating to the subject property.

Step 4 - Addition of the estimated vacant land value to the building depreciated worth estimated by the Cost Approach plus the total value of any site improvements to arrive at an estimated market value (Summary of Valuation by the Cost Approach)

In the final step in the Cost Approach the candidate must show the breakdown of the value by the cost approach. This will include an estimate of the total cost new of the improvements, an itemized breakdown of depreciation, and deduction of the total depreciation from the total cost new to indicate the depreciated value. To this figure the contributory value of the site improvements and the site value are added.

This section must end with an indication of value derived by the Cost Approach.

Section # 7

The Direct Sales Comparison Approach

The purpose of the market comparison approach is to derive a value based on recent sales prices of similar properties. The method assumes that the typical buyer pays no more for one property than the cost of purchasing an identical property. The Direct Sales Comparison Approach is therefore based on the economic principle of substitution.

Information is collected on recent sales of properties similar to the subject property. How recent and how similar the comparables are depends on the availability of the data. Because comparables will not be identical to the subject some price adjustment is necessary. The idea is to simulate the price that would have been paid if the comparables were actually identical to the subject. Differences that do not affect value are not adjusted. If the comparables are superior to the subject, an amount is subtracted from the sale price. Inferior features require that an amount to be added to the sale price. From the group of adjusted sale prices, the candidate selects an indicator of value that is representative of the subject.

The candidate should provide a definition of the Direct Sales Comparison Approach and outline the steps involved in this approach.

The procedure to follow involves:

1. Verification of all comparable sales – sales must represent market value
2. Data Collection – gather all relevant information pertaining to the comparables
3. Analysis of market data to develop units of comparison and select attributes for adjustment (model specification) –

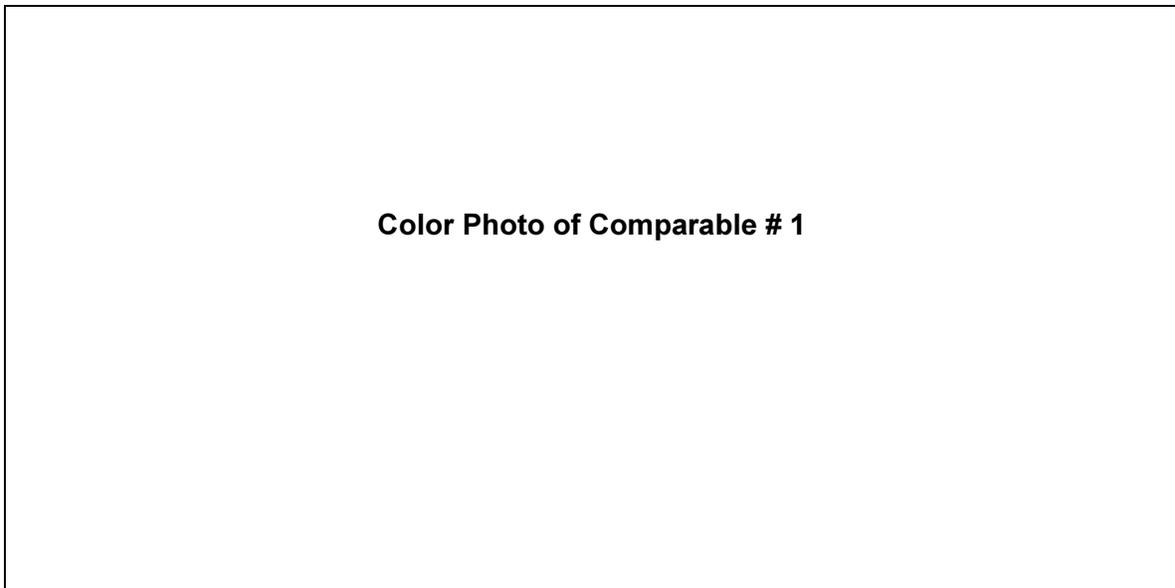
adjustments to consider are for differences in location, time, age, and construction

4. Development of reasonable adjustments (model calibration) – applied to the comparables to arrive at an adjusted sale price that reflect the characteristics of the subject property
5. Analysis of the adjusted sale prices to provide an estimate of market value for the subject property.

A minimum of three independent comparable sales that precede the effective date of the appraisal should be used. It is advisable to add the comparable properties in the body of the report instead of in the addenda. Each comparable property should adequately and sufficiently detail a description of each sale.

It is advisable to compile the information in the suggested chart format on the following page.

Comparable # 1 - Example



Roll Number:
Address:
Date of Sale:
Consideration:
Zoning:
Use:
Lot Size:

Plan Area – Building:

Gross Area – Building:

Land/Building Ratio:

No. of Suites: (Apt)

Vendor:

Purchaser:

Remarks: Describe the comparable in terms of its' relation to the subject

Items used in this section should include:

- i. Map showing the location of the three comparables and the subject

Sales Adjustments

After selecting the appropriate comparables to the subject property adjustments may have to be made. These adjustments are made to make the comparable property similar to the subject property. All adjustments are made from the comparables to the subject. Downward adjustments are made if the comparable is superior and upward adjustments are made for an inferior comparison to the subject. Adjustments are always made to the sale price of the comparable property for any differences between the comparable and the subject property.

Adjustments can either be made in a dollar amount or as a percentage amount. A discussion on each adjustment relating the comparable to the subject must be made. Corroborating data must be included in the report to justify the adjustment. Some adjustments to consider include:

1. Time
2. Location
3. Age / Condition
4. Physical – building Size
5. Motivation

Include other applicable adjustments, as necessary, pertaining to the subject property.

Sales should be presented on an adjustment grid that demonstrates all supportable adjustments. All adjustments should be market supported and calculations leading to the concluded adjustment must be provided in the report.

Comparable Building Sales Table - Example

	Comparison # 1	Comparison # 2	Comparison # 3	Subject Property
Roll #				
Address				
Legal Desc.				
Sale Date				
Consideration				
Date Built				
No. of Suites (Apt)				
Plan Area – Sq.Ft. (SF)				
Gross Area – Sq.Ft. (SF)				
Avg. Suite Size (Apt)				
Avg. Room Size (Apt)				
Sale Price per SF				
Sale Price per Suite (Apt)				
Sale Price per Room (Apt)				
Adjustments				
Time				
Zoning				
Age / Condition				
Location				
Physical				
Adjusted Sale Price				
Adjusted Sale Price per SF				
Adjusted Sale Price per Suite (Apt)				
Adjusted Sale Price per Room (Apt)				

Summary of the Direct Sales Comparison Approach

This approach should end with reconciliation of the value derived from the comparable sales. The reconciliation should end with a final indicated value by the Direct Sales Comparison Approach. The candidate should outline the choice of the best comparable and the resulting rate which was applied. A detailed explanation should be included to indicate the reasoning for the chosen comparable and the final estimate of value.

Section # 8

Income Approach to Value

The income approach is an analysis of the present value of future benefits from the real estate such as rental income. The approach is based on the fact that income properties are bought and sold on the basis of the expected income to be produced through anticipated rents or the future sale of the property. The income approach is most commonly applied to income producing properties such as apartment blocks, strip and major malls, hotels, and motels.

The formula is commonly expressed as:

$$\text{Value} = \text{Income} / \text{Capitalization Rate}$$

Capitalization

Capitalization is the process whereby this annual net income is converted into a lump-sum value for a property. The most common method for determining a capitalization rate is through the analysis of income producing properties that have sold and compare the sale price to the income the property generates. This comparison produces a capitalization rate known as the overall rate, which can be applied to income properties that are similar and produce similar income streams to arrive at an estimated market value. A value indication is derived through direct capitalization of net operating income. Income value can be calculated by capitalizing the net income produced by the real estate. The income received and the capitalization rates employed are established through a comparison with other market opportunities and transactions. The capitalization rate is nothing more than the mathematical relationship between the income and the capital value. This value indication is calculated as the net operating income divided by the market capitalization rate.

The direct capitalization formula is:

$$\text{Capitalization Rate} = \frac{\text{Net Operating Income}}{\text{Sale Price}}$$

Capitalization Rate Determination - Example

Comparable #	Sale Price	Net Operating Income	Capitalization Rate
1	\$500,000	\$75,000	75,000/\$500,000 = .15 or 15%
2	\$450,000	\$63,000	63,000/\$450,000 = .14 or 14%
3	\$480,000	\$72,000	72,000/\$480,000 = .15 or 15%
Subject Property	?	\$69,000	?

Investor's required return = 15% (Capitalization Rate)

NOI of Subject Property = \$69,000 (example)

Market Value = $\frac{\text{Net Operating Income}}{\text{Capitalization Rate}}$

Market Value = $\frac{\$69,000}{.15} = \$460,000$

The application of the income approach is generally restricted to those properties that are typically rented. The approach values all portions of the property that contribute to the generation of the income. Therefore, it does not readily distinguish between the value of the different parts such as land and buildings. With the appropriate financial information the income approach makes it possible to estimate market values quickly and easily for large and reasonably complex income producing properties. The approach readily adjusts to changing market conditions.

The following steps are used to estimate value using the Income Approach:

1. Estimate potential gross annual income of the property, as if fully occupied
2. deduct an allowance for typical vacancy and collection loss
3. add other or miscellaneous income such as parking, and laundry
4. calculate effective gross income

5. estimate annual operating expenses, which include all the normal expenditures that are associated with the operation of the property
6. determine net operating income (NOI)
7. select the appropriate capitalization rate
8. capitalize the net income to derive indicated value

1. Estimate potential gross annual income of the property, as if fully occupied

The first step in the income approach to value is to estimate the subject's potential gross income. This is the rent justified by an analysis of the income of comparable properties and is known as market rent for the property. Market rent may be equal to, greater than, or less than the contract rent, which is the rent stated in the lease and currently being paid by the tenant. When the contract rent equals the market rent, it is an indication that the lease is representative of the market and may be used as the potential gross income in the capitalization process. This gross annual income is therefore the amount of annual rent the property is capable of producing at 100% occupancy at current market rent levels.

2. Deduct an allowance for typical vacancy and collection loss

This is a loss of income due to unrented or vacant space or by tenant delinquencies. Review annual rental market report sources such as CMHC and MLS for overall market vacancy for the subject area

3. Add other or miscellaneous income

This may include parking and laundry and is not normally subject to vacancy and collection loss.

4. Calculate effective gross income

Potential gross income less vacancy and collection losses plus other or miscellaneous income.

5. Estimate annual operating expenses

These expenses are necessary to operate the property in order for it to continue to generate income. Expenses should be stabilized over a two to three year period. This ensures that the highs, lows, and non-applicable expenses are not being analyzed as a typical expense for a given year. Stabilizing expenses also maintain equity between similar properties. A chart detailing the actual expenses, stabilized expenses, and reserves for replacement, (if applicable) should be included in the report.

6. Determine net operating income (NOI)

The effective gross income less expenses determines the net operating income.

7. Select the appropriate capitalization rate

This is determined through a detailed capitalization analysis. Direct capitalization rates must be developed from sale data. Explain and show documentation on the determination of the applicable capitalization rate.

8. Capitalize the net income to derive indicated value

This is the last step in the income approach to value. It is the conversion of the net operating income into a final estimate of value based on the following formula:

$$\text{Value} = \frac{\text{Net Operating Income}}{\text{Overall Capitalization Rate}}$$

Items to include:

- Reconstruct an Income and Expense statement to include the eight (8) steps involved in the Income Approach to Value

Section # 9

Reconciliation and Final Estimate of Value

The purpose of reconciliation is to complete the process of correlation, which has taken place throughout the report, and to develop the value indications derived in the approaches into a final opinion of value. Reconciliation is a discussion that analyzes the quantity and quality of the data examined in each approach. This analysis includes examination of the strengths and weaknesses of the three approaches and the relevance they have to the property being appraised and the appraisal problem. It is not a restatement of methodology presented or analysis within the report.

Explain any wide discrepancies. It is not necessary for the results of the three approaches to be close. Apply sound reasoning to the facts and interpretations that lead to the final opinion, keeping in mind the definition of value and the intended use of the report.

1. Summarize, review, and explain the relative importance of the estimates developed by each of the applicable approaches. Discuss the strengths and weaknesses of the three approaches, both in general and in the specific circumstances. Weigh the importance of each approach against the other and lead the market to a specific conclusion
2. Any wide discrepancies must be explained
3. If applicable, consider any impact of the highest and best use (if the subject improvements represent an over or under improvement of the highest and best

- use of the site as if vacant) Discuss its sale price in light of the value indications (explain any significant discrepancy.)
4. Demonstrate the facts and steps leading to the final conclusion of value, concentrating on the strengths and weaknesses of each approach and the general validity thereof in light of the value estimates from the appraisal approaches
 5. State final estimates of value and effective date thereof

Section # 10

Addenda

The report must include the schedules specified below, either in the Addenda or in the body of the report. Some suggestions for the Addenda are as follows:

- call them items or schedules, not exhibits
 - use 8.5 x 11 paper throughout
 - All maps and plot plans must show north direction, ideally oriented to the top of the page or towards the spine of the report. Make sure the road names can be read. If the scale is such that the detail cannot be read by the marker, supplement the larger maps with "blow ups" of the specific areas needed.
1. City or regional map showing north, subject neighborhood, subject property,
 2. Neighborhood map showing north, subject property, boundaries, and other pertinent points of interest
 3. Plot plan showing all sides of lot, as well as location of improvements on lot, lot dimensions, street/ lanes, etc
 4. Floor plans showing exterior dimensions of building and interior layout.
 5. Map showing the location of the comparable land sales in relation to the subject property
 6. A cost summary sheet showing details of the cost manual calculations
 7. map showing the location of the comparable improved property sales in relation to the subject property
 8. Photographs of the comparable improved property sales
 9. Any additional supporting data referred to in the body of the report

To be acceptable, all addenda material must be presented in a professional manner, in the same sequence as the narrative sections of the report.