Property Appraisal Methods and Valuation Approaches

Posted on September 19, 2018

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Sales Comparison Approach of Appraisal:

The sales comparison approach to appraisal/valuation is a method that is based on comparing the property appraised (the subject property) with properties that possess similarities with the subject. These similarities could be location, nature of construction, and accommodation details, among others. Different types of comparisons include straight comparison, which in itself is the simplest, or more complex analysis, such as analysing the rate per unit area. Sales that have taken place recently in the neighbourhood are deemed sufficient comparisons and are analysed against the subject property. Some of the factors that are analysed include the sale price, the physical aspects of the properties, and the functional and locational features of each property. After the analysis, relevant adjustments are made so as to arrive at the market value of the property. In the appraisal of 2380 Appletree Court, the different sales comparisons that have been used include 2043 Appletree Court, 4207 E Park Trail Orlando and 4470 E Park Trail Orlando.

The sales comparables that have been used in the appraisal of 2380 Appletree Court are not more than three months old and are within a reasonable radius of the subject property (2380 Appletree Court). This supports the Sales Comparison Approach as one of the approaches used in the appraisal.

Contractor’s Approach/Cost Approach:

This approach involves the assessment of the value of the land (based on a direct comparison of sales of vacant land/development sites) and the addition of the ‘added value’ of the improvements (buildings, etc.) on the land. The added value of the improvements is assessed based on analysis with regard to market evidence, often on a rate-per-area basis. It is also known as the summation approach of appraisal/valuation.

While these two methods were used in the appraisal of 2380 Appletree Court, one method was not used. It is the Income Approach of Appraisal. The income approach is expressed in a formula.

Market Value = Annual Income/Rate of Return or the Capitalisation rate (MV=A/R)

The Income approach is predicated on the principle of anticipation, which holds that the present value

is indicated by the expectations of future benefits.

This method is used for the valuation of income-producing properties.

Given a known or estimated stream of net rental income, the end value is thus driven by the expected return rate. The choice of return is made by comparison with other investments that bear the nearest relationship in matters such as physical characteristics, use, degree of risk, and life of the investment.

The price being offered to the Seller by the Buyer at the time of appraisal is $165,000. The appraiser settled upon a market value of $167,900. This is not favourable to the buyer since s/he is willing to offer a lower price for the same property ($165,000). However, it is within the range of value that the appraiser has come up with; hence, the appraised value supports the offered value.

The part where all the maintenance issues are addressed is important in the appraisal report since it can be a basis for negotiation of the offer. If there are many defects and repair work to be carried out, it means that the buyer will have to part with extra cash to facilitate the repairs. This would make the buyer willing to buy the property at a lower value than that offered by the seller. On the other hand, if there are minor repair works or maintenance issues, the seller has the upper hand during negotiations over the terms of the offer. This is because the buyer would not incur extra repair costs, as he is already buying property in good condition.

Functional obsolescence refers to the diminished usefulness or desirability of an object, especially due to the design being old or its failure to adapt to current and prevailing conditions. In real estate, functional obsolescence usually has a negative effect on the appraisal value returned. In a case where there is a one-bedroom house in a part of town where the number of bedrooms in typical houses has increased in recent years, the single-bedroom house would be rendered functionally obsolete because it lacks the capacity most buyers want. Despite being in good condition, it does not suit the current market as it lacks newer modifications.

There are different conditions that would lead to adjustments in the value of the comparable properties that have been used in the appraisal. They include but are not limited to the following:

Economic factors such as an increased flow of money in the economy make the demand for properties go up due to the many potential buyers.

Despite the comparables in use being relatively smaller than the subject property, they return a positive adjustment due to the location of the subject property, which is relatively more desirable than the comparables used.

In this neighbourhood, the presence of a pool decreases the value of the property. This is because properties with a pool are going for a lower price than those that do not have a pool (Comparable No. 3).

Comparable sale No. 1 is the most similar to the subject property since it also does not have a

swimming pool, just like the subject property, and also sits on a similar land size.

A review of the brochure for properties for sale on Lincoln Street shows that the subject property for sale has been compared with other similar properties in the neighbourhood. The purpose of this comparison is to give the buyer the chance to make a reasonable judgment while buying the property. The different properties in the neighbourhood include 1159 Corona Street and 638 East 12th Ave Street. The subject property itself has been described in detail, including its location, size, accommodation and also the potential rent that it can generate. This information is very useful to the buyer since, for instance, the buyer would like to familiarize themselves with the property they are buying. The information provided also helps in making decisions, such as the particular method of valuation/appraisal that should be used. Since it is an income-generating property, it is no surprise that the Income Method of Valuation (Capitalization) has been used.

The sale price of the unit has been given as $495,000. This has been realized after capitalizing on the income generated from the property. Described below is the Income Approach of Appraisal, also expressed as a formula.

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This method is used for the valuation of income-producing properties.

Given a known or estimated stream of net rental income, the end value is thus driven by the expected return rate. The choice of return is made by comparison with other investments that bear the nearest relationship in matters such as physical characteristics, use, degree of risk, and life of the investment.

From the information given, I would buy the property at the quoted price since it is within the market range.

The factors that I would consider while buying the property include but are not limited to the following:

(i) Presence of environmental pollutants within the immediate neighbourhood

(ii) Zoning regulations that affect the immediate neighbourhood and the probability that the status quo could change in the near future

(iii) Is the tenure of the title to the property freehold or leasehold tenure?

Flat rent refers to a situation where the monthly instalments paid by the tenant are constant for a leasing period. In graduated rent, the landlord may increase the monthly instalment rate without the consent of the tenant, as agreed upon earlier during the contractual agreement. In indexed leasing,

instalments increase proportionally to a reported index.

Returns in real estate are a result of rent. In indexed rent, the landlord increases rent in proportion to a change in the consumer price index. This means that landlords will always have maximum returns, even in inflationary periods, as inflation is passed down to tenants indirectly.

Usable Square Feet refers to the total space within the perimeters of a leased space that a tenant would occupy, that is, inside the perimeters of the leased space. For a property leased by multiple tenants, every tenant pays a certain proportion of the amount required for the property's common area. Rentable square footage is the total area within the perimeters of the leased property. Every space is accounted for except common areas such as staircases and elevators (O'Grady, 2013).

The leasing amount varies with space. A firm has to substantiate which mechanism to use in order to lease a space. The less rentable square footage there is, the less a company would spend on monthly instalments.

In a Triple Net Lease, a single tenant leases a property and pays for operating expenses together with monthly rent. The tenant will account for all utilities. In gross leasing, the tenant is responsible for paying the landlord the monthly instalments. The landlord pays for the operating expenses. The rent paid by the tenant is constant.

In Triple Net Leasing, the landlord has positive cash flows. He is receiving money from the tenants. The net cash flow is very different from gross leasing. Operating expenses are incurred by the tenant.

As a tenant, I would prefer Gross Leasing over a Triple Net Lease. The payable rent is calculated based on estimates of costs incurred by the landlord; a tenant can presume the flow of costs and hence can plan for a probable flow of monthly leasing payments.

According to Section 4.1 of the lease agreement, minimum rent is the rent payable, which is the rate per square foot of the floor area of the premises and the amount per month and per year applicable during each lease year.

Percentage Rent is the rent payable to the landlord as a percentage of the income that the tenant generates from the continued occupancy of the premises.

Additional rent refers to the extra amount that the tenants will be paying to the landlord to cover expenses such as taxes, among others.

The concept of assignments and subletting

In this section, different terms have been described, such as the Landlord's right to recapture, which describes the circumstances under which the landlord may take possession of the property that he has let out; and Consent not to unreasonably withhold, which describes what ought to happen in the event one party is withholding consent from the other one.

The section also has a sub-section that deals with permitted transfers and deemed assignments, which describes in detail the prevailing circumstances and the methods that can be used to resolve different disputes that could arise, for instance:

the tenant can issue a notice to the landlord, and if the landlord doesn't consent, assign the lease or even sublet the whole premises to any individual(s) or entities: (i) that owns a majority of the equity interests in the Tenant; (ii) a majority of the equity interests in which are owned by Tenant; or (iii) a majority of the equity interests in which are owned by the same individual(s) or entity that owns a majority of the equity interests in Tenant.

For deemed assignments, there is the provision that if there is any substantive change in the partners or the members of the tenant, it is in the form of a partnership or LLC (limited liability company) and also in the event the tenant is a state corporation. With deemed assignments, there is the statement to the effect that if there is a transfer in the shares of the stocks of a tenant which leads to a substantive change in the identity of the ownership, then it effectively becomes an assignment in its own right in accordance with Section 13. An exemption is in the case of the transfer of the stock to the tenant who occupies a publicly held entity.

References

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