Appraising the Individual Condominium Housing Unit

While the valuation of a condominium - or strata title (the terms are synonymous) - unit may at first glance seem simple and straightforward, there are a number of pitfalls that can snag the unwary.

**Measurements**

Confusion can arise when identifying the floor area of a condominium apartment, due to the different ways that may be used for expressing floor area. Strata lot size may well not equal livable area. Also, creative marketing can swell the size of an apartment unit by including a balcony, patio, or even parking stalls, for example.

The applicable Condominium or Strata Title Act specifies how the boundaries of individual condominium units are to be identified. In British Columbia, for example, the boundary is the centre of the floors, walls or ceilings, as the case may be, however, discretion is left to the Registrar-Land Titles for defining the limits of balconies, patios, private yard areas, garages, parking spaces, storage areas and areas and spaces not enclosed by floors, walls or ceilings.

In general, it is preferable to define the condominium by reference to the walls of the building. Any outside areas which are for the private use of the owner of a condominium may be regulated and defined under Exclusive Use agreements. These agreements can provide for the exclusive use of a part of the Common Property by one condominium owner and are the most appropriate way of dealing with such areas as balconies, gardens, basement storage space, and parking stalls.

Most real estate boards have adopted policies for how condominium sizes are to be set out. In most cases, an appraiser will find it appropriate to utilize these local policies. Typically, these policies might stipulate the condominium unit itself be defined by the square area resulting from measurements taken for the centre line of the demising (separating or party) walls. In multiple level condominiums, the area of each floor would be added. This area should coincide with the square area of the condominium as represented in the Condominium or Strata Plan. If confusion exists, the figures may be obtained from the plans registered at the registry or Land Titles Office.
For clarity, be specific, setting out the square area of the condominium unit together with any exclusive use areas:

“Condominium of 112.59 square metres together with exclusive use of balcony, large patio, and two parking spaces.”

Such a statement clearly defines for the reader what is being offered and eliminates much of the confusion in measurement of condominiums.

**Structural Condition**

While you may consider it obvious, not everyone realizes that an appraiser valuing a single unit does not inspect the roof, heating plant, basement, parking garage and so on. This can be a particular problem if standard appraisal forms being used are generic. Forms that contain tick boxes related to age or condition of roof, age of hot water tank, or call for simple overall conclusions of condition can be misleading, at best. The basis for any statement related to these areas should be included in the report, e.g. the building superintendent advises the roof cover was replaced two years ago.

**Phased Projects**

Units in a phased project may require special attention. Before a premium is accorded to a unit for its view or quiet setting, check to ensure such will remain after the project is completed. Caution is needed when giving any weight to the value of amenities - such as a special landscaping or recreational amenity - not yet built, but scheduled for future phases.

Distressed projects also require special attention. Consider a mixed use development that was to include retail or day care facilities. The appeal of units in this project may change if such are not provided. Also, an incomplete project may not comply with the zoning designation under which it was built. This is particularly true for contract zoned or mixed use projects.

**Rental Versus Ownership**

In some marketplaces, many strata units are purchased by investors looking for capital gain and inflation protection. These purchasers are more likely to be motivated by price than by cosmetics, whereas owner occupiers take “home” issues, like noise, smell of the hail ways, etc., much more seriously. Noting the prevalence of rental occupancies in the building, if known, may be useful. Is an adjustment for rental versus ownership necessary? Use of sales that involve similar condition and tenure will tell you for certain.

Since individual home ownership units typically are not bought as an income-producing property, the income approach is seldom applicable. If this approach is considered applicable, gross income multiplier techniques will be much less prone to error.
Parking
In some projects, parking is open, that is, no particular stalls in the parking lot are assigned to any specific unit. In other cases, an exclusive use agreement assigns a specific parking stall or stalls for each condominium unit. In townhouse units, it is common for the parking space in the attached garage to be part of the strata lot. It is also possible for the parking stall to be a separate strata lot. One could also find a case where no parking is available within a project for a specific strata unit.

Differences in appeal and value may be found for enclosed, covered or open parking, and security can be a great issue, or none at all. In older projects, parking garages constructed of reinforced concrete can require expensive repairs due to the corrosion of metal fasteners from winter road salt.

Appliances
Usually, but not always, appliances are included with a unit. In some cases, only some of the appliances go with the suite. Variances ought to be noted.

Direct Comparison
In the appraisal of an individual condominium dwelling unit, the Direct Comparison Approach is the only reliable approach to value.

Some experienced appraisers point out that the likelihood of making a material error in valuation because of unknown circumstances in a particular project can be diminished if comparables selected are from the project. This argument has substantial merit, provided one is satisfied the sales are, in fact, arms-length market transactions. This ensures that common misconceptions about the project don’t become compounded. Indeed, some appraisers hold that appraisals of individual units in a new or converted project ought to consider at least two sales outside the subject project, because the sales price of individual units within the project might be affected by the developers marketing technique.

Sales from outside the subject project ought to be similar in size and price to the unit being appraised, and from projects with a similar number and mix of units and common elements, including parking and recreational facilities. Obviously, a 20-unit project will not have the same recreational or common element facilities as a 200-unit project, and economic characteristics of the buyers also may be different.

The Cost Approach
Properly valuing a condominium unit by the Cost Approach requires appraisal of the site as if vacant and available, costing of all structures, landscaping and site improvements, estimation of soft costs, developer’s fees and entrepreneurial profit, and the determination of depreciation from all sources. Once the depreciated value of the entire project is known, it can be allocated to the
individual unit. The fee required for the time involved to properly complete this valuation far exceeds that which clients are prepared to pay. Moreover, the results are invalid, at the least, and can be downright misleading. Yet many lenders still persist in requiring a cost approach be completed for a condominium unit.

The solution to this problem lies in educating the client on the strengths and weaknesses of the Cost Approach, and the research and analysis necessary to complete a meaningful valuation. Appraisals in which the cost approach is completed ought to make clear the limited weight that can be placed on the results.

For any type of single family residential appraisal, unless an appraiser has skills in construction cost estimating, sufficient data for land valuation, and direct market evidence is available to measure depreciation, the cost approach ought to never be used for market value appraisals, i.e., for mortgage or value-in-exchange purposes.

**Replacement Reserves**

Periodically, strata corporations need to spend large sums of money for roof replacement and similar capital items. While provincial legislation may require the funding of replacement reserves, the level of contribution is commonly far less than what a specific project could require. It is possible for one strata project to have a substantial replacement reserve fund because the council has been diligent in building one up, and a similar project next door to have virtually no replacement reserve.

When you consider that roof replacement could necessitate a special assessment of $2,500 or more for the latter project, the significance of the presence or absence of reserve funding becomes apparent. As an appraiser, you aren’t expected to investigate reserve funds, but those reading your reports will find it useful if you state in your report that the level of reserves ought to be investigated if the project appears to need major work.

**Strata Fees/Assessments**

Common area maintenance and utility expenses are covered in the strata fees assessed to each owner.

The quantum of fees is determined by the developer or owners’ association, and will vary according to reserve levels, maintenance standards, amenities - like pools and tennis courts, upgrading requirements, and so forth.

It is doubtful if many purchasers read the strata corporation bylaws or analyze its financial status. While such are beyond the responsibility of an appraiser, where evident; unusually high or low fees should be noted. Included are cases where these costs are still tentative because the project is new or only partly sold.
Use caution in making adjustments for the level of strata fees. High fees may simply reflect more amenities, or a special assessment that will be complete in six months.

**Strata Corporation Bylaws**

Appraisers seldom, if ever, read the bylaws of the corporation governing a unit they are appraising, and such is neither necessary or practical to minimize liability. However, unusual situations can arise from time to time. Consider, for example, a strata title project on leased land. When the lease comes up for renewal and land rent jumps, unit owners could be in for a shock and will look to blame someone. Many strata corporations pass bylaws governing pets, children and so on. In some cases, it is not permissible to rent out units.

Explaining in the Assumptions and Limiting Conditions that these matters are not evaluated helps to alert readers of the need for diligence. However, if this type of information is available and pertinent, note it and quote the source, i.e., MLS, listing agent, tenant, and so forth. With the increasing availability of real estate board databases via modem, locating current or recent data on a property may take little time, and can provide useful information on matters such as these.

**Property Disclosure Statements**

In some areas of the country, these are likely to become more common. Their purpose is to protect the realtors involved, however it can be useful to attach these to your report, if available, as well as any other pertinent documents, like an MLS listing of the property.

**Developer Financing and Amenities**

As a marketing aid, developers sometimes include low interest rate financing. This type of incentive can lead to higher sale prices than would otherwise be expected. Although the present value of the financial gain can be calculated mathematically, such may be a poor reflection of the actual contribution to value.

Paired sales analysis is a superior technique, where possible.

**Non-Realty Incentives**

Although the major tax incentives such as MURBS have not been offered for some time, the valuation difficulties created by these projects were such that it warrants repeating: where tax incentives, developer guarantees of rentability or return on investment and other non-realty incentives are involved, the technique least likely to mislead those reading your report is to separately value the realty and non-realty.

To illustrate, when MURBS were offered as new units, purchasers were able to take write-offs of substantial soft costs in the first year, and then depreciate the remaining capital cost at rates of 5 to 10% per year. Because these tax deductions could be applied against other income, and since
some project marketing was quite aggressive, prices resulted that were significantly above the value of the realty. After the deductions had been taken, market value dropped quite significantly. In some cases, the owners were required to pay significant taxes on eventual sale of the MURB unit, due to the recapture of depreciation.

**In Closing, Don’t Forget the Basics . . .**

Remember a few simple rules:

- Use reasonable care to investigate and report relevant facts.
- Write your report with the intent that no one could possibly be misled by it.
- State what you did, what you know, and give the basis for everything else.
- Strive for quality.
- Avoid assumptions.
- Make clear the nature of your investigation.
- Report obvious problems.
- Report the unusual.
- Undertake only what your skill and the fee permits.
- Write professional reports.
- Communicate with your client and those depending on your services.

As with all claim prevention bulletins, the publication is not intended to set out all professional/ethical responsibilities or regulatory requirements, nor to identify all valuation or theoretical aspects of the subject matter. The purpose is simply to raise areas of potential liability exposure in ordinary day-to-day practice to the attention of members, and to suggest professional practices that can help avoid liability insurance claims. Members are encouraged to suggest topics and/or writers for future bulletins by contacting the Insurance Department at National Office.

**CUSPAP References**

**Legal Attributes**

**Practice Notes**

12.28.1 Members must be aware of the duty to investigate the legal attributes of certain property types. Condominium values, for example, can be affected by specific condominium bylaws that apply in some projects. The status of the reserve fund, special assessments for units in the complex and restrictions on common property can also influence values. While selecting sales from within
the same complex can mitigate some of these concerns, particular care should be taken when it becomes necessary to rely on sales from outside of the complex.

**Reserve Fund Study**

**Practice Notes**

12.47.1 Since Reserve Fund Studies are completed to provide financial planning advice, the consulting service should consider the stated policies in the condominium corporation defining those components to be covered by the study and incorporate a comprehensive benchmark analysis including life cycle analysis, current and future replacement costs and future reserve fund accumulations. The Study should provide comments on any apparent deficiency in the reserve fund account or in future reserve fund accumulation, along with a cash flow model covering an appropriate time frame.

**Information Sources for This Bulletin**


Lomax, D. A; Bruckner, Clarence A., “Condominiums The Future” Austin Chapter #80, Society of Real Estate Appraisers, Chicago, 1973


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