

BUSI 499 Income Property Guided Case Study

PURPOSE AND SCOPE

The *Income Property Guided Case Study* course BUSI 499 is intended to give the real estate appraisal student a working knowledge of the practical application of all basic appraisal theory relevant to the appraisal of an income-producing property. The course will provide you with the opportunity to identify your own subject property, and to apply all basic appraisal theory required for the completion of a narrative appraisal report on the subject property that you select. Note that this course focuses on the appraisal of non-agricultural, income-producing properties such as apartment buildings, warehouses, retail outlets, and office buildings.

As a student, you may ask yourself: "why do I have to complete a narrative report on an income-producing property as a university course"? As a practising appraiser, if you are carrying out any type of appraisal other than on single family dwellings (houses), you will be required to complete narrative appraisal reports to varying degrees of detailed analysis. This course offers you the opportunity to apply the theory that you have learned in your course work in a real life situation, with the guidance of an experienced tutor. The lessons for this course, your tutor, and the interaction with fellow students through the course discussion forum, will help to ensure that you have every opportunity for a positive learning experience in the practical application of appraisal theory. This exercise will be time-consuming and challenging – this course is recognized as degree credit calibre work. **Successful completion of BUSI 499 will count for six credits towards the Bachelor of Business in Real Estate Degree offered from UBC.**

In today's market, appraisal clients are increasingly demanding analytical and narrative report writing skills. Regardless of market pressures to do more for less, traditional requirements for narrative appraisal reports are still valid today. Narrative reports are required:

- in response to specific client requirements;
- for court or arbitration purposes when property values are in dispute;
- in support of expropriation;
- in case of property distribution resulting from divorce;
- in case of estate distribution as part of a will;
- for financing purposes on investment or income-producing properties;
- for income tax purposes such as capital gains tax; and
- for regulatory and audit purposes.

With the globalization of the real estate investment market, an increasing number of reports are being read, analyzed, and critically reviewed by investors and clients unfamiliar with not only the subject property, but also the subject's locale and neighbourhood. This class of client is interested in not only the appraiser's opinion of market value, but also the derivation of that value, the solidity of the data and analysis in support of the value conclusions, the subject property's investment viability in its local context, and how well it can compete with other properties for investment dollars.

In recent conferences and publications in the appraisal industry, a common theme is the need for more detailed analysis in support of opinions of values from appraisers. In today's income-producing real property market, it is no longer sufficient to simply provide information and statistics, but **the requirement is to add knowledge and insight**. Data is becoming cheaper and more readily available. What is in demand are

individuals with the skills, knowledge, and experience to be able to professionally, objectively, and correctly conduct research to obtain the most relevant data, as well as the ability to analyze that data, explain step by step how the analytical process has been applied, and through a convincing narrative argument, convince the reader (i.e., investor, purchaser, financial decision maker) that the opinions and conclusions have been properly justified and explained. This is the purpose of this course – to provide you with an opportunity, in a learning environment, to apply the appraisal theory that you have been taught in order to weave a well-substantiated convincing analysis, in narrative form, to a client who is assumed to be unfamiliar with the subject's city and area, justifying each of the numerous decisions you have to make in applying the appraisal process.

In the *Canadian Appraiser* magazine, Volume 45, Book 1, Spring 2001, a court case that focused on the direct comparison approach was summarized on page 43. To quote from that article:

In those circumstances [where directly comparable properties are unavailable], the Court instructed that a reasonable appraiser should do the following:

1. The appraiser should obtain as much information as possible to adequately inform him or her about the comparables that are available;
2. The appraiser should view comparable properties, including the inside of the property, to be able to make whatever adjustments are necessary to use them in the appraisal in a meaningful way;
3. Although the appraiser's experience is an important factor in real estate appraisal, the appraiser should be able to express how particular aspects of his or her experience are used in researching conclusions in the appraisal; and
4. Finally, the appraiser should expressly alert the reader of the appraisal to the possibility that the appraisal is less reliable because of the absence of appropriate comparables by making a statement to that effect in the appraisal.

In the case being reviewed (*Kokanee Mortgage MIC Ltd. V. Concord Appraisals Ltd.*, [2000], B.C.J. No. 1629 and 1745), it was found by the court that the appraiser did not perform as a "reasonable appraiser" as defined above, and the appraiser was required to pay significant damages to the bank. Again, the point here is that there is an expectation of a *reasonable* degree of disclosure and rigour in the completion of an appraisal analysis, as reflected in the appraisal report. Satisfying the concerns expressed in this decision are fundamental to the objectives of this course.

The application of appraisal theory in this course will provide you with the tools necessary to apply all of the steps in the appraisal process in a planned, professional manner that will satisfy the "reasonable appraiser" test. Within certain constraints and having to meet specified requirements, you will have significant flexibility in the selection of your own income-producing subject property and effective date of appraisal. You will be expected to apply basic appraisal theory, most notably the three traditional approaches to value, for the most standard subject property you can locate for which there are, hopefully, more than adequate market comparable sales and lease transactions. In order to keep the subject of the course as straightforward as possible, your task will be to estimate the fee simple interest of your subject property, assuming that there are no lease or financing encumbrances. This means that you are to ignore any impact on value that may be caused by existing leases or mortgages for the subject property.

The first few lessons of the course will address the appraisal process in general, emphasizing critical thinking and report writing skills. Market research and data analysis will also be reviewed before commencing the work of crafting the narrative appraisal report. Lessons 8 to 17 inclusive will cover all of the required sections of the narrative appraisal report. Lesson No. 18 will provide a summary of the process, and will emphasize the importance of linkages and the need for consistency of data, analysis, and conclusions throughout the report. Lesson No. 19 represents the take-home final examination for this course, requiring the consolidation of the individual lessons into a coherent, logical, narrative appraisal report.

COURSE OBJECTIVES

The overall objective of this course is for students to learn, through practical experience, how to apply valuation principles and standards, and to gain skills relative to economic, legal, and physical research, written communication, and critical thought.

Listed below are specific objectives for what a student should learn from this course:

- How to apply the appraisal process to produce a narrative appraisal report for an income-producing (non-agricultural) property.
- How to apply critical thinking, research, and analysis principles and skills in the planning, preparation, and analysis of data relevant to the application of a highest and best use analysis and the application of the three traditional approaches to value (cost, income, and direct comparison).
- How to write more effectively in the context of a narrative appraisal report.
- How to reconcile various indications of market value into a single, logically supported estimate of market value.
- How to accurately disclose assumptions, limiting conditions, and significant value-impacting factors relevant to the analysis undertaken, and upon which the value conclusion is contingent.
- How to identify the impact of relevant real property characteristics on market value.
- How to justify, with appropriate market-derived support, adjustments necessary in components of each of the three traditional approaches to value.
- How to convey a technical appraisal analysis of an income-producing property to an assumed uninformed, non-appraiser reader/client, through a narrative appraisal report.

LESSON 1 – Appraisal Process and Course Expectations

General Objective

The general objective of this introductory lesson is to provide a refresher on the valuation process and to review the Canadian Uniform Standards of Professional Appraisal Practice in order to understand its requirements for a full narrative appraisal report.

Specific Objectives

1. Define the steps in the valuation process.
2. Explain the AIC's CUSPAP requirements for a full narrative appraisal report.

LESSON 2 – Critical Thought

General Objectives

The overall purpose of this lesson is to emphasize how clear thinking and simple logic can be used to integrate relevant data and personal knowledge into the formation of valid conclusions relative to principles of value in real estate appraisal.

Specific Objectives

1. Incorporate relevant data and subjective judgments based on personal experience into the appraisal process in a systematic way. In doing so, students should learn from past experience and interpret the evidence from that experience for what it really says.
2. Identify the relevant uncertainties in the appraisal process and understand why people have difficulty dealing with this uncertainty.
3. Know and apply the methods for estimating and forecasting.
4. Identify the biases and traps that people fall into while estimating and forecasting, and apply methods for avoiding or overcoming them.

LESSON 3 – Principles of Research

General Objectives

To provide a review of the principles of research to be applied in this course, and of the basic primary and secondary sources of data required for the completion of a narrative appraisal report on an income-producing property.

Specific Objectives

1. Understand the basic principles of research.
2. Identify primary and secondary sources of information relevant to the appraisal of an income-producing property.

LESSON 4 – Market Research and Subject Property Identification

General Objectives

There are two general objectives for this lesson. First, the lesson will review the market research and sources of information which are directly related to real estate appraisal. Second, the lesson will discuss how to select the subject property for this course.

Specific Objectives

1. Identify the types of information required for an appraisal analysis.
2. Identify sources of the required information.
3. Evaluate options and select the subject property for this course.

4. Support the choice of the subject property by completing a checklist of required and recommended criteria.
5. Apply appropriate space measurement techniques to record dimension and area data for the subject and comparable properties.
6. Create a reference file for the collection and recording of essential information on comparable land sales, improved property sales, and rental transactions.

LESSON 5 – Data Analysis and Tools

General Objective

To review the techniques of analyzing data in support of the application of the valuation process.

Specific Objectives

1. List and evaluate the nine elements of analysis and support for adjustment.
2. Apply the techniques of data analysis to information gathered in support of the subject property valuation.

LESSON 6 – Report Writing – General

General Objectives

To emphasize the importance of effective business report writing skills in preparing a narrative appraisal report.

Specific Objectives

1. List and define the main principles of effective report writing.
2. Incorporate the main principles to ensure a clear, logical, concise, non-ambiguous narrative writing style.

LESSON 7 – Title Searching – Land Titles Office and Registry Office Information

General Objectives

To understand how to search titles in either the Torrens (Land Titles) or Registry System, and to analyze registered documents to obtain key data required for appraisal report applications.

Specific Objectives

1. Complete a title search of a property at a land titles or registry office.
2. Identify on the Certificate of Title or Deed and the transfer document, or the electronic equivalent records, the most pertinent information required for appraisal report applications.

LESSON 8 – Area and City Analysis, and Neighbourhood Analysis

General Objectives

To review the theory on area, city, and neighbourhood data and analysis, and to apply this theory in writing a narrative report on the subject property selected by the student.

Specific Objectives

1. Research and analyze data relevant to the Area and City Analysis context of the valuation of an income-producing property.
2. Research and analyze data relevant to the Neighbourhood Analysis context of the valuation of an income-producing property.
3. Complete, for the subject property, the "Area and City Analysis" section of the narrative appraisal report.
4. Complete, for the subject property, the "Neighbourhood Analysis" section of the narrative appraisal report.

LESSON 9 – Site and Improvements Description, and Assessment & Taxes

General Objectives

To review the theory on the inspection and description of the subject property, both land and improvements, and assessment and property taxes; and to apply this theory to the subject property selected by the student, reporting the results in a narrative report format.

Specific Objectives

1. Complete a property inspection for an income-producing property, systematically examining both exterior and interior, inventorying the property's characteristics, and noting any observed defects.
2. Apply the procedures and techniques required in a commercial property inspection.
3. Measure and calculate site and improvement areas for income-producing property.
4. Complete, for the subject property, the "Land Description and Analysis" section of a narrative appraisal report.
5. Complete, for the subject property, the "Description of Improvements" section of a narrative appraisal report.
6. Investigate appropriate sources, and obtain and analyze data related to assessment and property taxes for the subject property.
7. Complete, for the subject property, the "Assessment and Taxes" section of a narrative appraisal report.

LESSON 10 – Zoning/Land Use Controls and Highest and Best Use

General Objectives

To review the theory on zoning or land use classification and highest and best use, and to apply this theory to the subject property selected by the student, reporting the results in narrative report format.

Specific Objectives

1. Research through appropriate sources, any zoning or other land use control requirements for the subject property.
2. Analyze subject property data in comparison to the minima and maxima requirements of the zoning bylaw or other land use controls.
3. Justify and state a conclusion as to whether or not the subject property is in full conformity with all of the zoning and land use control requirements.
4. Complete the "Zoning or Land Use Classification" section of the narrative appraisal report.
5. Analyze the subject's highest and best use, taking into account the highest and best use criteria and all other related land economic principles.
6. Justify and state a conclusion of the highest and best use of the subject site as if vacant and as improved.
7. Complete the "Highest and Best Use" section of the narrative appraisal report.

LESSON 11 – Cost Approach – Land Value

General Objectives

To review the theory on land valuation, and to apply this theory to the subject property selected by the student, reporting the results in a narrative report format.

Specific Objectives

1. Identify appropriate vacant land sales for the subject.
2. Compare and contrast the vacant land sale comparables to the subject, identifying similarities and significant differences.
3. Applying techniques from Lesson 4, justify adjustments and apply them to the comparable sales to equate them to the subject property for any differences that may have an impact on market value.
4. Reconcile for the subject site as if vacant, an estimate of its market value from the adjusted sale prices of the comparable vacant land sales.
5. Complete, for the subject property, the "Land Value" section of the appraisal report.

LESSON 12 – Cost Approach – Cost Analysis

General Objectives

To review the theory on cost estimating, and to apply this theory to the subject property selected by the student, reporting the results in a narrative report format.

Specific Objectives

1. Explain the difference between "replacement cost" and "reproduction cost".
2. Explain the different implications of using replacement cost or reproduction cost in the depreciation analysis.
3. Apply the Marshall & Swift/Boeckh cost manual or computerized costing service to estimate the cost new of the subject building. (It is assumed that the students already know how to apply this cost manual or computerized costing service.)
4. Estimate the cost new of the subject building by applying the comparative method or by obtaining two builder's quotes.
5. Reconcile the cost estimates into a single estimate of the subject's cost new.
6. Estimate, with the cost sources stated, the cost new of the site improvements.
7. Complete, for the subject property, the "Cost Analysis" section of the appraisal report.

LESSON 13 – Cost Approach – Depreciation Analysis and Cost Approach Summary

General Objectives

This lesson has two general objectives: first, to review the theory on depreciation, and to apply this theory to the subject property selected by the student, reporting the results in a narrative report format; and, second, to complete a summary of the application of the cost approach to value.

Specific Objectives

1. Apply all steps of the breakdown (observed condition) method to analyze and estimate the amount of depreciation that has accrued to the subject building.
2. Apply the age/life method to analyze and estimate the amount of depreciation that has accrued to the subject's site improvements.
3. Complete, for the subject property, the "Depreciation Analysis" section of the appraisal report.
4. Complete, for the subject property, a summary table of the cost approach to value, with value conclusions.

LESSON 14 – Direct Comparison Approach

General Objective

To review the theory on the direct comparison approach and to apply this theory to the subject property selected by the student, reporting the results in a narrative report format.

Specific Objectives

1. Identify appropriate improved property sales for the subject.
2. Compare and contrast the improved property sale comparables to the subject, identifying similarities and significant differences.
3. Identify any differences with comparable sales that may have had an impact on market value and, applying techniques from Lesson 4, justify adjustments, and apply them to the comparable sales to equate them to the subject property.
4. Reconcile an estimate of the subject property's market value from the adjusted sale prices of the comparable improved property sales.
5. Complete, for the subject property, the "Direct Comparison Approach" section of the appraisal report.

LESSON 15 – Income Approach – Income and Expense Analysis**General Objectives**

To review the theory on the analysis and stabilization of income and expense statements, and to apply this theory to the subject property selected by the student, reporting the results in a narrative report format.

Specific Objectives

1. Analyze and stabilize, with justification, the income statement for an income-producing property.
2. Analyze and stabilize, with justification, the expense statement for an income-producing property.
3. Analyze and justify a vacancy and collection loss for an income-producing property.
4. Analyze, justify, and calculate the potential gross income, effective gross income, and net operating income for an income-producing property.
5. Complete, for the subject property, the "Income and Expense Analysis" subsection of the income approach.

LESSON 16 – Income Approach – Capitalization Process and Summary of the Income Approach**General Objectives**

This lesson has two general objectives: first, to review the theory on capitalization and to apply this theory to the subject property selected by the student, reporting the results in a narrative report format; and, second, to summarize the results of the application of the income approach to value.

Specific Objectives

1. Analyze comparable property sales in order to justify an overall rate applicable to the subject's net operating income.
2. Apply the overall rate to the subject's net operating income to provide an indication of the subject's market value.

3. Analyze comparable property sales in order to justify a gross income multiplier applicable to the subject's gross income.
4. Apply the gross income multiplier to the subject's gross income to provide an indication of the subject's market value.
5. Complete, for the subject property, the "Capitalization" subsection of the income approach to value.
6. Complete, for the subject property, the "Summary of the Income Approach".

LESSON 17 – Reconciliation, Certification, and Introduction

General Objectives

To review the theory on reconciliation, and to apply this theory to the subject property selected by the student, reporting the results in a narrative report format. The CUSPAP requirements for a certification page and the standard components of the introduction section for a narrative appraisal report will be reviewed.

Specific Objectives

1. Evaluate the relative merits of each traditional approach to value in reconciling their value indications into a single estimate of value for the subject property.
2. Justify and conclude the "exposure period" associated with the subject's effective date of appraisal and estimate of market value.
3. Complete, for the subject property, the "Reconciliation and Final Estimate of Value" section of the appraisal report.
4. Complete, for the subject property, the "Certification" section of the appraisal report.
5. Define the interest appraised for the subject property.
6. Identify and list all limiting and contingent conditions and critical assumptions associated with the appraisal analysis and market value estimate for the subject property.
7. Detail the "scope" associated with the analysis undertaken for this appraisal.
8. Create an executive summary for the subject report.
9. Complete, for the subject property, the "Introduction" section of the appraisal report.

LESSON 18 – Summary and Linkages

General Objectives

To review the requirements of a narrative appraisal report, including the requirements of CUSPAP.

Specific Objectives

1. Plan the consolidation of course assignments in order to produce one consolidated, narrative appraisal report.
2. Identify where narrative linkages are required in order to consolidate the assignments in a logical and coherent manner.
3. Review past assignments to ensure that their content will comply with CUSPAP.

LESSON 19 – Submission of the Narrative Appraisal Report

General Objectives

To permit the student to apply all relevant appraisal theory in the completion of a full, narrative appraisal report on an income-producing property.

Specific Objectives

1. Complete, for the subject property, a narrative appraisal report which provides a thoroughly documented and supported estimate of the market value of the subject property.