BUSI 330

Suggested Answers to Review and Discussion Questions: Lesson 1

1. The three characteristics necessary to gain professional recognition are: Integrity, Competence, and Provide Quality Work. Students must expand on the importance of these characteristics.

2. *Fee appraisers* are generally self-employed and provide service to the general public. They are involved in diverse work which includes mortgage financing, expropriation, divorce settlements, and foreclosures. They charge a fee for their work based on the time involved, and they usually work under contract as a consultant or counsellor.

   Institutional Appraisers generally work for a large private company (i.e., insurance companies, pension advisors, banks, mortgage companies, utilities, real estate companies). Their work includes the determining of value for security purposes, the purchasing of property for investment, and the review of appraisals.

   Government appraisers are found in all three levels of government. They work in areas which include expropriation, taxation, assessment, rights-of-way, easements, etc.

3. Conflicts between stakeholder groups can arise, and impact the appraiser's obligations to the groups, when the goals of the stakeholders are in conflict, for example:
   - a seller wants the appraiser to estimate a high market value to sell the property, and the buyer wants the lowest market value possible;
   - a seller wants the lowest value for property assessment and taxation purposes while the government assessor wants to establish a fair market value;
   - a developer wants a very high value to obtain maximum financing, while the lender wants a conservative estimate of value to minimize risk;
   - an appraiser desperate for business may cut corners in the delivery of services, and may compromise professional standards while the professional association and peers of the appraiser are trying to reinforce the objectivity and professional standards of appraisers;
   - etc.

   The appraiser can manage these conflicts by conducting business in an objective and professional manner, that adheres to the standards of the profession. The appraiser needs to be transparent in business dealings, and not compromise the integrity and objectivity of the "market value" definition in delivering services. The appraiser can refuse to undertake an assignment that compromises professional standards, or would jeopardize a positive relationship with the stakeholder groups. Conducting oneself ethically is the best approach.

4. Students should choose <u>three</u> of the following categories and explain how they are similar and how they are different. Students should also explain which category of value they believe is the most important in real estate.

   Value in exchange is the amount of goods and services or purchasing power that an informed purchaser would offer in exchange for economic goods under given market conditions.

   Value in use is the value of an economic commodity to its owner/user based on the productivity (income potential, utility, or amenities) of the economic commodity to a specific individual. Value in use is recognized only in cases of expropriation or forced taking.

Objective value is based on the "cost to create", or the cost to build or manufacture the commodity. It might or might not relate to market value and plays a significant part in the cost approach, i.e. estimating the reproduction or replacement cost of a building.

Subjective value describes the reasons or rationales in the minds of purchasers and vendors which underlies the values they set. It is the emotional reasoning that determines why a property sells for the price it does. Subjective value is the basis for the comparative process of arriving at a value estimate (i.e., determining the value of one property by comparing it to others which have recently sold) and it dominates real estate appraising.

Investment value represents the value of a specific investment to a particular investor. As used in appraisal assignments, investment value is the value of an investment to a particular investor, based on his or her investment requirements. In contrast to market value, investment value is value to an individual, and does not necessarily represent value in the marketplace.

Going-concern value is the value created by a proven property operation. The established business is considered a separate entity, providing a value which is distinct from the value of the real estate alone. Going-concern value includes an intangible enhancement of the value of an operating business enterprise, which is associated with the process of assembling the land, building, labour, equipment, and marketing operation. This process leads to an economically viable business that is expected to continue into the future.

Insurable value may be "actual cash value" or may be based on the replacement and/or reproduction cost of physical items that are subject to loss from hazards. Insurable value is that portion of the value of an asset or asset group that is acknowledged or recognized under provisions of an applicable loss insurance policy.

Assessed value applies in real property taxation and refers to the value of the property for the purpose of calculating real property taxes. The nature and definition of assessed value can change from jurisdiction to jurisdiction, and therefore the appraiser must be familiar with the applicable legislation.

Market value is the most probable price which a property should bring in a competitive market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Market value is the basis of the majority of real estate appraisal assignments.

Market value is the most important in real estate as, according to its definition, it best reflects the independent, unbiased actions of buyers and sellers in the market to establish a market-based price.

5. In order to obtain value, a commodity must have the characteristics of an economic good: utility, scarcity, effective demand, and transferability. Students should discuss how each of the four characteristics contributes to creating value and provide <u>their own</u> example for each of the four characteristics.

Utility: A commodity such as real property cannot have value unless it has utility. This is "the capacity of an economic good to satisfy human desires or needs". This emphasizes that value is not inherent in a thing, but exists in the minds of those desiring that thing. For example, in remote areas of Canada, land has little value if there is no road access, because there is little "use" for the land.

Scarcity: A desired or needed commodity must be scarce to have value. If the commodity is available in virtually unlimited quantities and obtainable without any effort or cost to the user, then it cannot have economic value, no matter how desirable or necessary it is. For example, there is not a market for selling breathing air in Canada.

Demand: For a commodity to have value, it must be desired or "needed" and those who desire it must have the ability and means to afford it. If the income is not present to support the need for the commodity, then there is no market and no economic value. For example, there may be no demand for houses in a small town with a depressed economy, which means these houses have no value.

Transferability: The commodity must be transferable, with the capability of being exchanged for money or other goods measured in money. If it is not transferable, it may have value in use, but it cannot have value in the market. For example, a parcel of polluted industrial land may be prohibited from sale and therefore has no value.

6. Market value is by far the most important concept in real estate appraising. It is defined as:

"The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus." (USPAP 1994 Edition)

Basic criteria:
- Buyer and seller are typically motivated;
- Both parties are well informed or well advised, and are acting in what they consider their best interests;
- A reasonable time is allowed for exposure in the open market;
- Payment is made in terms of cash in Canadian dollars or in terms of financial arrangements consistent with the standards of behaviour in the market; and,
- The price represents the normal consideration for the property sold unaffected by special considerations such as creative financing or sale concessions.

7. In real property appraisal, value, price, and cost have very different meanings.

Cost is the price paid to create the market commodity. It is the outlay of capital for supervision, land, materials, and labour sufficient to bring an improvement into existence. Under some conditions, cost can be an appropriate measure of value, but in many cases the cost to produce something will be different than its value or "worth" in the market.

Price is the amount actually paid for a property in a particular transaction. It is an historic fact, representing the amount that the buyers and sellers determined that the particular property was worth to them based on their personal needs and desires. Price in a given transaction may not represent "market value"; e.g., if the parties were not acting rationally, experienced undue influence, were not at arm's length, there was unique financing, etc.

Value is an estimate of the price a property should sell for in a typical transaction in a given market. It is a subjective amount, based upon what the appraiser estimates the property is "worth" given the expectations of how the market as a whole might act. It is less objective than estimating cost, but is also less subjective than trying to estimate the exact price that a property will sell for (rather it is the price it would most likely sell for, given typical market conditions).

8. (a) Value to the owner is the personal value placed on a property by a specific individual investor. It is a very subjective measure of value and reflects the particular characteristics of a person. For example, one individual may be willing to pay more for a home that is located next to a school,

whereas another individual may be willing to pay less for the same house because it is located next to a school.

(b) The estimated value of a property for lending purposes is known as lending value. It is a long-term conservative estimate of the value of the security as determined by the lender and, therefore, does not necessarily equal market value or sales price. For example, the market value of a property could be $200,000, however, the lending value of the property for lending purposes may only be $175,000.

9. While market value is the expected or most probable selling price of a property, investment value is the value to an investor of a property's benefit flows given the investor's tax status and financing preferences.

10. For each of the four forces which affect real property values (social, economic, government, physical), students should provide TWO examples of how each has affected real property values in their own area (8 examples in total). Listed below are possible examples for each of the forces.

Social Forces:
(a) Population growth and decline.
(b) Population density shifts.
(c) Changes in sizes of families.
(d) Geographical distribution of compatible groups.
(e) Attitudes toward education and social activity such as marriage, birth, divorce, and death rates.
(f) Racial and religious distribution.
(g) Attitudes toward architectural design and utility.
(h) Other factors emerging from social instincts, ideals, and yearnings.

SAMPLE ANSWER: The town I live in is becoming a retirement destination and there have been several developments aimed at attracting seniors (e.g., golf courses with adjacent townhouses). As a result, land values in some developable areas have increased.

Economic Forces:
(a) Natural resources — their quality, quantity, location, rate of depletion.
(b) Industrial and commercial trends.
(c) Employment trends.
(d) Wage levels and unionization.
(e) Availability of money and credit (tight money).
(f) Interest rates.
(g) Rates of production.
(h) Tax loads (burdens).
(i) Price levels.
(j) All other factors that have a direct or an indirect effect upon purchasing power.

SAMPLE ANSWER: The gradual decline in basic industries (i.e., logging and fishing) in the region I live in has had a negative effect on the value of basic or standard housing and lower middle class neighbourhoods in my town.

Governmental Forces:
(a) Building codes.
(b) Public health measures.
(c) Zoning bylaws.

(d) Social security measures.
(e) Police and fire regulations.
(f) Government-sponsored housing.
(g) Government guaranteed mortgage loans.
(h) National defence measures.
(i) Credit controls.
(j) Monetary and fiscal policies, including all forms of taxation.
(k) Rent controls.
(l) Special use-permits.
(m) Civic reaction to industry and development.

SAMPLE ANSWER: Zoning in my community has had a mixed effect on value. Several blocks away, the lots are zoned for duplexes, which has increased the value of the land for development purposes. However, the increased density has made the housing worth less. On the other hand, my street is zoned single-family only and in my opinion the larger lots and nice streetscape has resulted in an overall higher value.

Physical forces:
(a) Soil fertility.
(b) Climate.
(c) Topography.
(d) Mineral resources.
(e) Floods.
(f) Forest fires.
(g) Access to transportation corridors.
(h) Access to utility corridors.
(i) Street layouts and patterns.
(j) Direction of prevailing winds.
(k) Undesirable features, such as excessive noise, smoke, or fire hazards.
(l) Location of the municipality and neighbourhood relative to regional markets and regional geographic features.

SAMPLE ANSWER: I live in one of the more attractive neighbourhoods in my town, with most properties having either ocean frontage or a water view. As a result, the values of homes in my neighbourhood have tended to be higher than those in other less attractive parts of town.

11. The principle of substitution states that when similar commodities, goods, or services are available, the one with the lowest price attracts the greatest demand and widest distribution.

This principle helps establish property values because these tend to be set by the cost of acquiring an equally desirable substitute property. The principle of substitution recognizes that buyers and sellers of real property usually have options because various properties are available for similar uses.