

The Appraisal of Real Estate – *Third Canadian Edition* –

EXAM REVIEW NOTES

Chapter One – Real Property and Its Appraisal

Introduction

- Land provides the foundation for social and economic activities for the people who inhabit and share it.
- Land is investigated and analyzed in a variety of disciplines – the government, law, geography, economics, and environmental studies
- The concepts of real property differs among the various disciplines:

Legal; consideration of ownership and use

Economic; as an agent of production

Sociology; as a resource and commodity

Finance; as value in exchange

Geography; physical elements and related activities

- All disciplines have common understanding of land attributes: uniqueness, physical immobility, durability, utility and finite supply
- Value is an economic concept based on these aspects of land
- Values is determined by the actions and attitudes of people in response to social and economic factors, the constraints of law, and legal encumbrances

Concepts of Land

Geographic and Environmental

- Each parcel is unique in physical attributes and location which impacts its utility and highest and best use. Adjacent properties are still considered unique
- Various processes including physical, biological, chemical, and socioeconomic affect human habitation and activities on land. This will in turn affect the value of land
- Land has many uses including agricultural, commerce, residential and recreational
- Land use is affected by climate, topography and distribution of natural resources, population, industry and current trends in these areas
- Land's geography provides the background that appraisal requires regarding natural resources, location of industry, actual and potential markets
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Government and Legal

- Laws reflect the rights and obligations associated with various interests in land
- Land includes the ground, what is under and over it, as well as what is attached. Mineral rights are not included in Canada
- Canadian law has defined the government's land use controls at federal, provincial, municipal and First Nations levels
- Ownership rights are subject to law and value of these rights are a focus of appraisal

- Appraisers must consider easements, access and use restrictions, and the recording and conveying of titles. The information is recorded by a government agency and available at the
- Appraisers must be familiar with local and provincial laws, which constitutionally have primary jurisdiction over land

Economic

- Land ownership has rights that can be legally limited by government statutes
- Land ownership is a form of wealth and therefore an object of value

Social

- Modern society is concerned with land use and how rights are distributed because land is fixed in quantity... but land can be modified, destroyed and sometimes created
- Increased demand puts pressure to use land more intensively
- Laws are intended to serve the public good
- Currently the principle restrictions on land use in Canada arise from planning and zoning provisions
- Changing land use controls affect the nature and extent of private ownership, hence values
- Land use controls determine what and where development can occur and those activities allowed subsequent to development. Recent efforts include increased air and water regulation
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Real Estate, Real Property and Personal Property

REAL ESTATE – Land, buildings, and other affixed improvements, as a tangible entity

- Real estate is immobile and tangible; it includes land and all things attached, whether natural or created by humans

REAL PROPERTY – The interests, benefits, and rights inherent in the ownership of real estate

- A right or interest is also referred to as an estate in land, is determined by duration and may be either freehold or leasehold
- The total range of ownerships interests is called the *bundle of rights*
- Ownership bundle consists of the right to: use, sell, lease, enter, give it away or do nothing. Each may be separated and traded in the marketplace
- Restrictions on the bundle are placed by common law and all levels of government.

REAL ESTATE – Land, buildings, and other affixed improvements, as a tangible entity. Also includes items that have been installed or attached to the land or building in a rather permanent manner. All real estate improvements were once personal property; when attached to the land, they become real estate

PERSONAL PROPERTY- Movable items of property that are not permanently affixed to, or part of, the real estate. Personal property is not endowed with the rights of real property ownership

TRADE FIXTURES – Unlike fixtures, which are regarded in law as part of the real estate, trade fixtures are not real estate endowed with the rights of real property ownership. They are personal property regardless of how they are affixed. A trade fixture is to be removed by the tenant when the lease expires unless this right has been surrendered in the lease – Also known as a chattel fixture

- Appraisers must distinguish between real estate, real property, personal property and trade fixtures

Appraisal Practice

- In Canada, the *Appraisal Institute of Canada (AIC)* is the major appraisal organization that sets standards for education appraisal practices
- The *Canadian Uniform Standards Professional Appraisal Practice (CUSPAP)* is a set of appraisal standards that must be followed by all members of the AIC
- Members will complete appraisal reports, carry out consulting or appraisal review for clients, all of which are governed by the CUSPAP guidelines
- The AIC also requires members to re-certify by taking various courses which are appraisal specific or related to real estate in some manner
- Appraisal practice includes Appraisal, Appraisal Review and Appraisal Consulting

Appraisal Reporting Options

- CUSPAP details three types of appraisal reports:
- Narrative Report; comprehensive and detailed
- Short narrative; consists of concise and brief descriptions
- Form; a standardized format, combining check-off boxes and narrative comments

Purpose and Intended Use of an Appraisal

- The purpose is the stated reason and establishes the scope of the assignment
- The purpose is established by the client, explaining what they want answered about the property
- Values sought can be: market value, fair value, assessed value, use value, investment value, business value or other types of value as defined by the client and the appraiser
- The purpose establishes the foundation of the final value conclusion
- The intended use is how the client will use the appraisal information for their needs, such as: market value for sale or purchase purposes, investment value, assessed value, to assist in setting lease rates, government expropriation, etc
- The date of the appraisal must also be shown as forces on any given day can affect a property's value

- **Appraisals are commonly used in situations involving the transfer of ownership, financing and credit, litigation, taxation, investment counselling and in other business decision making**

Appraiser Liability

- **Members are required to carry liability insurance through the AIC**
- **Area of possible liability are negligence, misrepresentation, fraud, breach of contract, or lack of compliance with the CUSPAP**
- **Appraisers are providing opinions of value and to avoid liability, a thorough and professional job is necessary. This requires good market data support for all opinions and adjustments to validate a reliable estimate of value for the subject**

Chapter Two: The Nature of Value -

- Objective Value – cost to build only
 - Subjective Value – what market will pay for item. Value is in minds of buyers/sellers. It's what they perceive.
 - Value is what you buy
 - *Current Market Value most probably price, as of specific date, cash or equiv. in local currency, comparables to the market, buyer/seller knowledgeable, and there is no stress between transaction (arm's length)
- Four Economics create value:
- 1) Utility: Ability to satisfy want, need and desire. Amenities = design features that relate to desirability and utility to owner/tenant. Size utility, design and location utility, etc.
 - 2) Scarcity: supply and demand. If demand is consistent, scarcity of commodity makes it more valuable. When Demand is high, then value is high.
 - 3) Desire: Wish for an item to satisfy human need or wants beyond essentials of life
 - 4) Effective purchasing power: Paying for property or goods within the market. How much power do you have to do this?

All four above affect supply and demand.

- Classical Theory Influenced Cost Approach in 1776.
- David Ricardo developed rent theory based on concept of marginal land and law of diminishing returns. Land residual returns = rent. His theory contributed to highest and best use and land residual in income approach.
- John Stuart Mill brought forth interest and value in use = capital value. The role of risk determining interest and inequities of "unearned increments" accruing to land.
- Challenges with this.....
 - o Karl Marx said all value is direct result of labour and high wages = low capitalist profits
 - o Marginal utility = links value to the utility of and demand for the marginal, or additional, unit of an item therefore one item in demand in the market = market becomes diluted and cost of production becomes irrelevant (CONCEPT OF CONTRIBUTION)
 - o Neoclassical merges supply cost consideration with demand price = basis for contemporary value theory.
- Alfred Marshall
 - o Supply fixed, value is function of demand
 - o Price, cost, value all equal

- distinction between value theory and valuation theory i.e method of estimating, measuring or forecasting a defined value
 - developed concepts such as site value via capitalization of income, depreciation of buildings and land which influence of difference building types and land uses on site value
- Marshall identified three traditional approaches to value:
 - market (direct) approach
 - Reproduction/replacement costs
 - capitalization of income
- Irvin Fisher fully developed the income theory of value = income capitalization approach
- Market: set of arrangements which buyers and sellers brought together through price mechanism.
- Real estate market: exchange real property rights for other assets such as money
 - Various attributes: type, location, income potential, investor/tenant characteristics
- Cost = relates to production, not exchange
- Value = monetary worth of property, goods or services to buyers and sellers
- Market value reflects collective perceptions and actions of a market
- Fair value: Asset exchanged in orderly transaction
 - orderly transaction: exposure to market before sale allowing marketing
 - market participants are not related, knowledgeable on product, able to sell/buy, motivated (not forced)
 - consider highest and best use and if it is physically possible, legal and affordable. Specifically in use with others and exchange alone.
- Use Value: Value a specific property has for a specific use
 - i.e. old factory with original owner – lots of use value to him/her, but not necessarily for a large market (or a market if any)
 - i.e. farmland – value based on productivity vs. highest and best use not regarded
 - for particular buyers at a particular time
 - worship, schools, museums all specialized and restricted with their functional utility to the use for
 - these specialized properties normally do not receive current market value (CMV), but can for legal purposes
- Investment Value: Value of a specific property to a specific investor. Based on a person/entity's investment requirements
 - investment value = value to an individual, not necessarily a market place
 - subjective relationship between particular investor and given investment
 - specific investment criteria needs to be known
- Business Value: (or business enterprise value)
 - Market Value of the going concern including real property, personal property, and intangible assets of the business

- Going concern value = value of a proven property operation. This assumes business will continue to operate in the future.
- Going concern: all tangible and intangible assets of an established and operating business with an indefinite life
- Tangible: personal and real property
- Intangible: contracts, workforce, patents, etc.
- Public Interest Value: (or natural value, intrinsic value, scenic values, etc.)
 - highest and best use not related to economics
 - driven by social, political and public policy goals
 - highway buys parcel (100% market value department, 25% over market value paid to owner for public interest to avoid transaction/litigation costs that require expropriation)
- Assessed Value: MPAC normally does this. Value based on tax rolls
- Insurable Value: Based on replacing physical item
- Actual cash value: replacement cost – depreciation = value

INTENDED USE/PURPOSE OF APPRAISAL DETERMINES WHAT VALUE TO USE*