

BUSI 330

Suggested Answers to Review and Discussion Questions: Lesson 2

1. Ownership of real property consists of a number of specified rights. The function of appraisal is to estimate the value of real property encompassed by these rights. The rights associated with ownership can include three elements: physical, legal, and financial considerations. In finding a value estimate, all three of these elements must be considered, or the value will not fully reflect the real property interests actually held. Perhaps the most common mistake would be to focus too much attention on the physical elements, forgetting that legal and financial considerations have an impact on value as well.

Below is a brief description of each of these three elements:

Physical Elements: the quantity and quality of the property. Quantity consists of the dimensions of the land and improvements, while quality consists of the condition of the improvements. Less quantity and lower quality will have an adverse effect on value estimates.

Legal Elements: the highest form of ownership is unencumbered fee simple property. Any restrictions on fee simple ownership can lower value. Therefore, the appraiser must search for any private or public limitations on the use of the property. It is also important that the appraiser know all the possible uses for the property as favourable development choices can raise value estimates.

Financial Elements: An appraiser must look to see if the sale of the property was at arms-length or if it had special financing terms, i.e., vendor financing. If it was not arms-length or did contain special terms, then the sale price could be misleading. The appraiser must also investigate how possible leases and tenancy agreements could affect the value estimate.

NOTE: This question is quite open-ended, and therefore any reasonable discussion of ownership rights and their impact on value would be considered acceptable. However, a comprehensive answer should discuss rights from all three categories above and must explicitly recognize the distinction between physical components and less tangible ownership rights.

2. The term "real estate" implies a focus only on the physical components of real property (i.e., land, buildings, etc.), while "real property" expands this definition to include intangible rights attached to properties (i.e., lease terms, financing, easements, air rights, etc.). An appraiser does more than estimate the value of the real estate. He/she also examines the underlying property rights. Therefore, real property appraiser is the preferred term.
3. (a) The "bundle of rights" refers to the package of legal privileges that are attached to the ownership of real property. These include the right to:
 - Use the property
 - Sell the property
 - Lease the property
 - Enter the property
 - Give the property away
 - Refuse to do any of these actions

An owner in fee simple has the right to do any of these with their real property. However, these rights may be limited through a number of voluntary or involuntary restrictions. For example,

- Taxation: the government has the right to charge the owner property taxes
- Expropriation: the government has the right to take private property for public benefit
- Policing: the government's right to regulate the health, safety and welfare of the individual and community through building codes, zoning, sanitary regulations, etc.
- Escheat: the government has the right to take ownership of property if the owner dies and there is no known heir

Voluntary restrictions on ownership rights could include a lease in which the owner allows others to use the property for a fee, an easement in which the owner allows a neighbour the right to enter a portion of the property, or a restrictive covenant where an owner agrees to not undertake some form of activity.

In appraising the value of a property, the appraiser must consider all ownership rights, including all restrictions on fee simple ownership. A property that has the full bundle of rights, unencumbered by restrictions, will typically have a higher value than another similar property that has less than the full bundle of rights.

(b) Students should provide two examples of limitations that affect value, one positive and one negative, and explain how they affected the value of the property in question.

4. *Joint Tenancy*: ownership is unseparated in that one owner cannot sell without the other's permission. This type of tenancy carries with it a right of survivorship. If either the friend or his wife died, the surviving party would receive the deceased's full interest in the property.

Tenancy-in-Common: a situation where two or more parties can own a property in different percentages. Each person can sell his or her interest without the other's permission. Owners can be individuals, companies, or partnerships. This type of tenancy has no right of survivorship, and therefore an owner of an interest in a tenancy in common can leave his/her interest to whomever they wish.

Students should briefly describe the advantages and disadvantages of each in this specific situation.

5. In a co-operatively owned property, the buyer does not own title to the unit, but instead owns shares in the company and receives a long-term lease on the unit they occupy. Because the buyer is not on title as owner of their unit, the buyer will have difficulty obtaining an individual mortgage on their unit. The only financing possible would be one mortgage on the whole building, which might make it difficult to arrange financing for one individual buyer (such as for your widowed mother). A benefit of living in a co-operative is that the owners can control many aspects of their living arrangements, such as who is allowed to buy units and rules for owners' use of the premises (e.g., restrictions on pets, children, etc.). The downside of this restriction is that owners may be restricted in their own use, such as needing to seek permission to sell their unit or not being allowed some desired use.

In condominium or strata ownership, the buyer of a unit obtains fee simple ownership, rather than a long-term lease. As a result, it is simple for a buyer to arrange a separate mortgage based on title of his or her own unit. The operation of the strata complex, as determined by its bylaws and strata council, can be similarly restrictive to co-operatives, but in general, owners of condominium units experience fewer restrictions than co-op owners. For example, condominium owners usually have the right to sell to anyone or at any time without requiring permission of the strata corporation. However, there can be

restrictions on use, such as limitations on exterior finishes allowable, or rules against renting out the premises.

6. (a) *Economic life* is the period over which the property remains economically useful and viable, while *physical life* is the period that the structure is in existence until it becomes physically unstable.

Economic life and physical life can differ greatly. The economic life is the period of time over which property may be reasonably expected to perform the function for which it was designed. Many structures are built with the intent of having a specific life, regardless of the actual period the building may stand. This can be because of increasing technology demands, change of city planning, superior higher and better uses of the land parcel. A property's economic life cannot exceed its physical life; typically, it is shorter.

- (b) Income-producing properties are valued based on the future cash flows the property is expected to generate. Therefore, appraisers are concerned with the economic life of a structure as this comprises the future income, while the physical life could potentially include periods where the building sits vacant or other situations where the property is not generating income.

7. (a) Contribution
 (b) Progression
 (c) Conformity
 (d) Externalities

- (a) An answer to the question should include the following points:

- Appraisal is a professional service, not a commodity. Valuation work is not “once size fits all” – every assignment is unique.
- The client may want something less than a full/comprehensive appraisal i.e., professional advice rather than an appraisal.
- Give the client the services they want, there is no need to give a gourmet meal if they want fast food.
- You work harder than you need to, in terms of answering the client’s question.
- You charge more than the client wants to pay, by giving them services they don’t want or need.
- OR you get underpaid, in providing service beyond what the client will pay for.
- Charge according to the services rendered:
- You don’t provide the same product to all clients.
- If they want gourmet treatment, they have to pay for it.
- If they are happy with cheap fast food, then your time will be limited and you **MUST** make your restricted scope fully clear at the outset.
- If they want gourmet treatment at fast food prices, then you have to decline.
- If someone else will provide this, you have to stand strong and assume they won’t, or won’t do it in an appropriate manner, and can’t remain in business long.
- You have an ethical obligation to do the amount of work reasonable to produce a credible/duly-founded product under the scope of work agreed upon - no more and no less.
- If the assignment is higher risk, then your due diligence is increased, and the fee must address that.
- If the client will settle for a lesser service, then the fee can also address that, but the work must at minimum be sufficient to cover off the minimum work that is necessary to be credible.

- The reasonable appraiser test rules: if you've passed this test, then you have satisfied your professional obligations and limited your liability.
 - Your answer may differ depending on the scope of work and that in itself is not a problem with Standards or professionalism.
 - The amount of research and analysis you are being paid to do may change the conclusion.
 - Your answer is not wrong if you have been paid to do a restricted scope of work exercise and as a result, key facts are unknown to you.
 - This is like getting a quick medical opinion from your GP versus an intensive and intrusive testing battery at the hospital. Same professional, two different scopes of work, two different levels of professional services, two different expectations for due diligence in giving credible opinions, two different conclusions, neither is wrong in the circumstances.
 - The most important consideration is to accurately describe the scope of what services are provided for the fee, and include this in both the letter of engagement and appraisal report.
- (b) Any constraints placed on the assignment by the scope required by the client should also be reflected in the limiting conditions and critical assumptions. For example, assume the scope of work as per the assignment is to appraise the house without the benefit of an interior inspection. As a consequence, not only should the letter of engagement and statement of scope in the appraisal report clearly state this, but a limiting condition should indicate this as well; and, a critical assumption should be stated that articulates assumptions made by the appraiser in the absence of an interior inspection.