

Suggested Answers to Review and Discussion Questions: Lesson 5

1.
 - (a) The direct comparison approach is based on the *principle of substitution*, which says that "an informed purchaser would pay no more for a property than the cost to him/her of acquiring an existing property with the same utility". In other words, the value of a given property should be equal to the prices recently paid for other similar properties.
 - (b) The direct comparison approach is a method of valuing property by comparing the subject property with a number of similar properties that have recently sold in the same or similar areas. The sale prices of the comparables are adjusted to compensate for attributes that are different from the subject property. These adjusted sale prices are then used to arrive at an indication of the subject property's value.
2. Students should list three sources of data available in their area that can be used in the direct comparison approach. Possible sources include: MLS, TEELA, Land Titles/Registry Office, Tax Assessment Office, Real Estate Board, CMHC, parties to the sale, and appraiser's own files.
3. Ten elements of comparison: real property rights conveyed, financing terms, conditions of sale (motivation), expenditures made immediately after purchase, market conditions (time), location, physical characteristics, economic characteristics, use, and non-realty items.

Items 1 to 3 are not common in most sales situations, but if they are present they can have a strong effect on sale price.

Rights conveyed must be adjusted first, so that both the comparable and the subject are being compared on the basis of the same "bundle of rights". If the ownership rights are different, then the comparable cannot be considered similar enough to be used.

Below-market or non-market financing arrangements can affect the sale price, so it must be confirmed that the stated price has not been affected by any undue stimulus. If it has, the price must be adjusted to its "cash equivalent" status to reflect a normal sale.

If the vendor was motivated to sell quickly or a non-arms-length transaction was involved, then the price must be adjusted to reflect these special conditions.

If the comparable sale is not adjusted for these elements, then it cannot be considered a normal sale and should not be used as a comparable. Once these adjustments have been made, then the comparable can be treated similar to other comparables, and adjustments can be made for Items 6-10.

4. A unit of comparison is used to compare dissimilar properties. It reduces the complex traits and characteristics of different properties into a common basis that facilitates comparison. For example, two lots with very different dimensions could be compared on the basis of value per square foot or square metre of area, or perhaps on the value per foot/metre of waterfront. These units of comparison can then be applied to other properties to formulate estimates of value, income, cost, etc. Ideally, units of comparison should reflect those that buyers and sellers are using to describe properties.

The two main units of comparison for residential properties are total property (bulk analysis) and physical units.

Single-family residential properties most often use one-to-one comparison (bulk), while strata or condominiums sometimes also use the price per square metre (or square foot). Single-family

residential properties are typically not standardized enough in terms of size and attributes to compare on a per room basis.

Multi-family residential properties are difficult to compare on a bulk basis, because they are typically too dissimilar to directly compare. Instead, they can be compared on the basis of price per suite, price per room, or price per square metre (or square foot).

Students should illustrate their discussion with examples of two different units of comparison that they found in a real estate publication.

5.
 - (a) *Reconciliation* is the process by which the appraiser evaluates and selects, from among two or more alternative conclusions or indications of value, a single value estimate that is most applicable to the property being appraised.
 - (b) In reconciling different values, the appraiser must exercise judgment as to which comparables are the most similar to the subject and thus the best estimates of the subject's value. Typically, the best comparables are those sales that require the least absolute adjustments, since this indicates a high degree of similarity to the subject. These comparables should be given the greatest weight in reconciling values.
6. Supply and demand of real estate affects prices at which properties are bought and sold. Properties offered for sale constitute supply, while buyers represent demand. When the demand for a particular product or type of property is high, prices tend to increase; vice versa, when demand is low, prices tend to decrease. Due to the time needed for construction, there is often a lag before any shift occurs in the supply side of improved properties. Shifts in demand are not subject to this lag and can occur more rapidly. A change in any of the elements that affect supply and demand may cause prices of the subject property and comparable properties to vary.
7. The direct comparison approach to value is most useful when there is an adequate amount of data available on recent sales comparables; i.e., with properties that are bought and sold regularly. Thus, it is particularly applicable and reliable for properties such as single-family homes. It is also useful in appraising small owner-occupied commercial and industrial properties, if there are sufficient comparable sales.

The direct comparison approach is the least applicable when there only a limited number of sale transactions that can be used for comparison. Also, in times of rapid economic change, the past sales of properties may not be good indicators of current market value.

8. The main difference between quantitative and qualitative adjustment techniques is that the quantitative technique compares a comparable sale with the subject property by applying percentage or dollar adjustments to up to 10 different elements of comparison. The qualitative technique does not apply percentage or dollar adjustments, but rather subjectively estimates whether the comparable sale is inferior, similar, or superior to the subject property.