Valuation Process

What are the Steps?

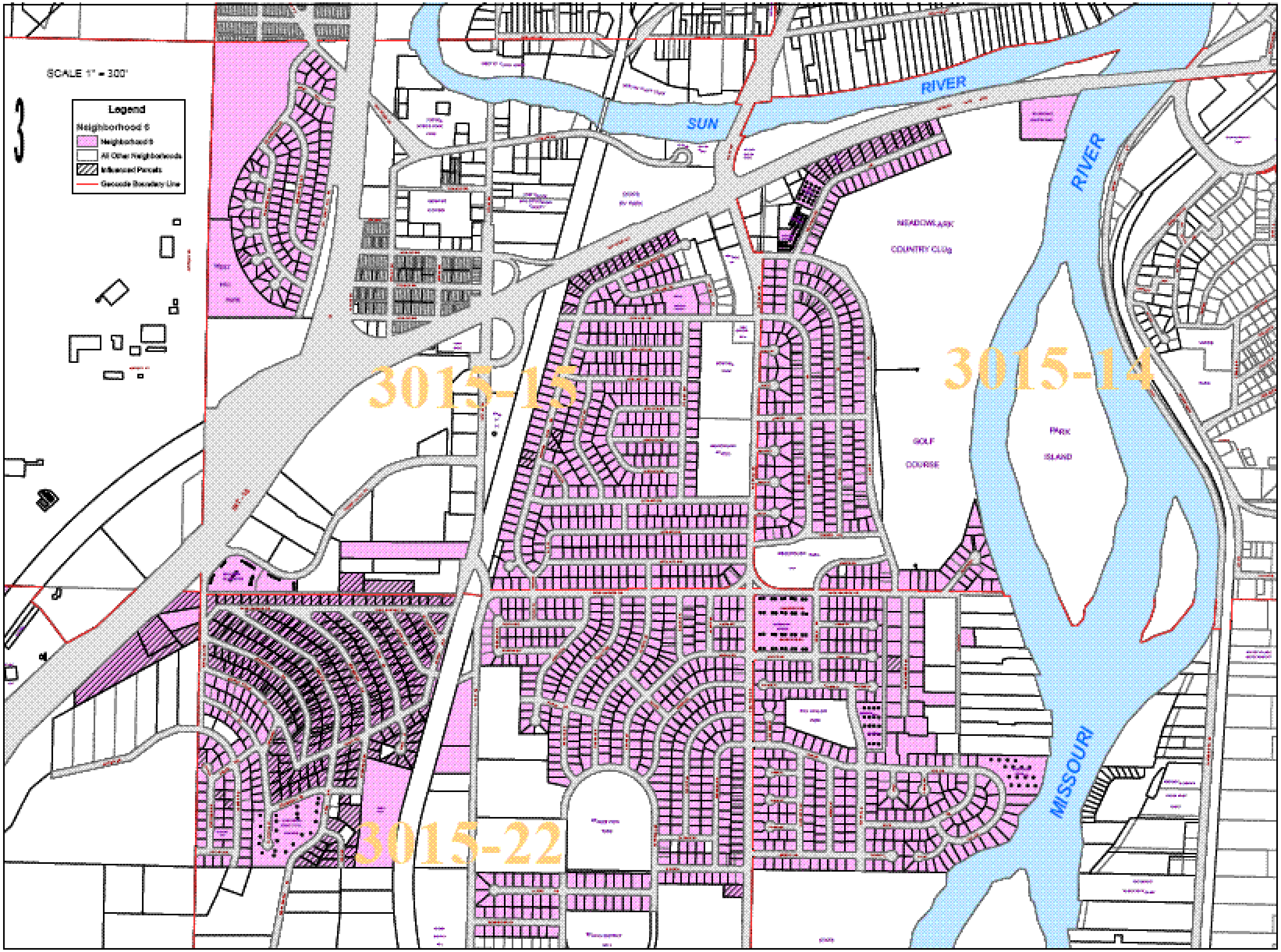
- Neighborhood Delineation
- Land Valuation
- Cost Development
- Residential & Commercial Property Valuation
- Final Value Review

NEIGHBORHOOD DELINEATION

Neighborhood Delineation

- Neighborhood: the environment of a subject property that has a direct and immediate influence/impact on its value. The term is primarily an urban concept; however, it may be extended for appraisal purposes to rural areas covering many counties – that’s the case in Montana.

CITY OF GREAT FALLS, CASCADE COUNTY, MONTANA NEIGHBORHOOD 6 INFLUENCE CODED PARCELS



LAND MODELING

Computer Assisted Land Pricing (CALP)

Land Valuation Methods

- Sales Comparison Approach
- Allocation Method
- Extraction Method
- Capitalization of Ground Rent

COST TABLE DEVELOPMENT

Cost Collection

- New construction costs are gathered statewide for all property types.
- Costs must include all direct and indirect costs.
- Costs are collected from the following sources:
  - labor costs from the Department of Labor & Industry;
  - localized costs from companies (i.e. lumber yards, retail outlets, etc.) that provide materials, such as lumber, plumbing fixtures, electrical components, to contractors;
  - on-site during new construction review;
  - sales of new construction (building residual); and
  - substantiated advertised costs

Local Cost Index

- A local cost index is used to adjust the calculated statewide average costs to a local cost.
- A local cost index represents the difference between the local market and the statewide market.
- Separate local cost indices are calculated in each county for residential, commercial and agricultural structures.
- Collected local costs are compared against the statewide average costs to determine the local cost index.

VALUATION

Valuation Methods

- Cost Approach
- Market or Sales Comparison Approach
- Income Approach

COST APPROACH

Cost Approach

- Cost Approach – The cost approach is accomplished by determining the replacement cost new of a structure and deducting any loss in value due to physical deterioration, and functional or economic obsolescence, plus the addition of the land value. It is the approach that can be used on all types of construction on each type of property. Its widest application is in the appraisal of properties where the lack of adequate market and income data preclude a reasonable application of the other approaches to value.

Cost Approach Example

- An estimate of value based upon the cost incurred to build the improvements, less depreciation, plus land value

Replacement Cost New	$125,000
Less: Depreciation	<$35,000>
Plus: Land Value	$ 25,000
Appraised Value	**$115,000**

MARKET OR SALES COMPARISON APPROACH

Market or Sales Comparison Approach

- Using sold properties with similar characteristics, a review of the market is performed where individual properties are valued using 3 to 5 comparable sales. The sales are adjusted to the subject for differences such as square foot of living area, location, year built, time, quality grade, etc. The adjustments for each comparable are then applied to their sale price. The result is an estimate of value for the subject property, based on the adjusted sales of the comparable properties.
- Similar approach used by fee appraisers

Market or Sales Comparison Approach Example

Subject

Comparable 1

Comparable 2

Comparable 3

Market or Sales Comparison Approach

- Preferred method for residential valuation is the market or sales comparison approach
- The Cost Approach is the secondary method of valuation if inadequate sales information is available

COMMERCIAL PROPERTY

Income Approach

- Income Approach – The income approach requires the development of basic data sets of income and expense information dependant on the type of income producing property under appraisal. Through use of a capitalization rate, income is capitalized into an estimate of value.

Commercial Property

- Preferred method for commercial valuation is the income approach
- The Cost Approach is the secondary method of valuation if there is inadequate income and expense information

Structures With The Highest Application Of Income Value

- Duplex
- 4-plex
- Apartment
- Office – low rise
- Retail
- Warehouse
- Triplex
- Retail Multi
- Mini-warehouse
- Downtown Row

Steps in Income Modeling

- Define income model area
- Stratify sales file
- Analysis of improved sales
  - Develop capitalization rates
  - Determine market rents and typical expenses by different uses
- Create preliminary income models
- Field validate income models
- Finalize models
- Apply values to subject properties

Income Approach

Potential Gross Income
Less: Vacancy and Collection Loss
Less: Typical Operating Expenses
Equals: Net Operating Income

The Net Operating Income is divided by an appropriate cap rate to arrive at a market value.

$$I / R = V$$

I = Income, R = rate, V = Value

Income Approach

- Income = $24,000
- V/C Loss = 5%
- Expenses = $6,840
- Cap Rate = 10.5%
- Net Income = $15,960
- Value = $\frac{\text{Income}}{\text{Rate}}$
- Value = $\frac{\$15{,}960}{10.5\%}$
- Value = $152,000

RECONCILIATION OF VALUES

Reconciliation Of Approaches To Value

- The final step in the appraisal process is reconciliation of the 3 approaches to value, or, in order words, resolving the differences that result from the application of the 3 approaches to value, which is required by law.
- The appraiser looks carefully at each approach and considers *why* the value difference exists.
- The differences are reconciled and a decision made as to which values and indicators should be given the most weight.