2.3 APPROACHES TO VALUE

2.3.1 Sales Comparison Approach

This approach to value is based on a comparison of the subject property to other similar properties that have recently sold. Based on this comparison and analysis, it should be possible to arrive at a logical, reasonably supported, defensible opinion of value for the subject property. This approach has been defined as an interpretation of the reactions of typical participants in the market. The sales comparison approach is also based on the principle of substitution that implies that a prudent person will not pay more to buy a property than it will cost to buy a comparable substitute property. In this approach the appraiser searches the subject's market area for sales of comparable properties and then compares them directly to the subject property. A specific investigation must be done of each sale to ensure that it is an "arms length transaction." Differences between the comparable sale properties and the subject are identified and logical market supported adjustments are made adjusting the sales to the condition of the subject property. The adjustments should be done in a grid. Sample formats illustrating typical grids for various types of property are included in attachments in this manual. In order to simplify the adjustment process the appraiser can allocate the sales prices into the basic components for that type of property. A proper sequence of adjustments has date of sale and market and/or financing conditions adjusted first with the rest of the adjustments made to an adjusted sale price. When adequate data exists, adjustments can be derived by paired sales analysis between the sales. All adjustments should be logically explained, supported and justified. After all adjustments are made, a range of value for the subject is indicated. The sales should then be correlated and a value for the subject should be based on the data that is best supported and most reliable. This approach to value is the approach that should be used and relied upon in all cases where adequate market data exists. In most cases, there is no need to develop the cost or income approaches.

2.3.2 Cost Approach

The cost approach to value is based on the principle of substitution, which implies that no rational person will pay more than the cost of buying a comparable site and constructing a building of equal desirability and utility. The process involves finding the market value of the land through the market analysis. The cost new of the improvements (either reproduction or replacement cost) minus depreciation from all causes is then added to the land value to arrive at a final value estimate. One of the more obvious problems with the cost approach involves the fact that many older buildings would not be built in the same manner (number of stories, spatial layout, etc.) or of the same materials today. Therefore, a decision must be made whether you should reproduce the exact building or go to a functionally equivalent replacement structure. The other major problem with the cost approach is estimating depreciation. Depreciation has traditionally been broken down into physical, functional and economic. The physical and functional can be further broken down into curable and incurable. Although the curable portions of depreciation can be measured by the cost of the necessary work or repair, the only meaningful measure of total depreciation is from the market. In order to make meaningful adjustments in the market approach and documented depreciation rates, it is necessary to allocate your sales. The cost approach is generally considered to be the most significant in the valuation of public buildings or certain types of special use properties for which market data is limited. The cost approach is also used to value minor buildings and site improvements that are acquired when there is no market evidence available to logically support their values. The cost new of improvements is obtained from cost data reference books and services. When using cost manuals a reference should be made regarding the name of the source and page numbers from which the costs are obtained. Cost new can also be based on contractor estimates.

2.3.3 Income Approach

The income approach to market value involves various techniques of capitalizing or converting net income into value. The process includes a gross income or economic rent estimate based on market rental data with deductions for vacancy and rental losses and all operating expenses. The net income can then be capitalized by various techniques (each based on a particular set of assumptions) into a market value estimate. Since the capitalization rate should also be obtained from the market, there ought to be enough market data for the appraiser to prepare a sales comparison approach that would have greater reliability than would the income approach. Typically there will be few, if any, properties involved with our acquisition program that will require use of an income approach. Discounted cash flow analysis is a recent variation of the income approach which has some application for valuing income producing portions of property such as sign sites or as a method of estimating damages due to projected rent loss.