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| Income Capitalization Approach |

Methodology

The market valuation of the subject property is summarized in this section via the **Direct Capitalization Method** of the Income Approach. In applying the Direct Capitalization Method, two components are necessary in arriving at an estimate of net operating income: potential revenues and projected operating expenses; with the difference resulting in net operating income. Value is then derived by dividing stabilized year's income by a market derived capitalization rate. Therefore, it is important to analyze both income and expenses for the subject property in terms of reasonability and their relative relationship to similar properties in the marketplace.

Potential Gross Rental Income

A review of current subject market trends indicates that typical tenant leases in the subject market area for similar apartment properties are typically month-to-month. Generally, the landlord pays water / sewer / and garbage expenses and the tenants are responsible for all other utilities including their electric and gas (if applicable), phone, cable, and internet service. However, some landlords have been charging back utility expenses to the tenants with the use of RUBS (ratio utility billing services), and some newer properties, especially townhouse units, are separately metered allowing the landlord to have utilities directly billed to the tenants. Of the five rent comparables referenced in this section three charge extra for RUBS, water and sewer, while the other two included these expenses in their rental rate. It was noted that the subject is currently charging $40 per month for two bedroom units and $50 per month for utilities. We have anticipated the subject will continue to operate in the same manner.

Comparable Rent Analysis

Rental Adjustments

In order to estimate the current market rent for the subject apartment units we conducted a survey of reasonably comparable apartment units located in the immediate to expanded market area. The results of this survey are summarized in the following table, along with a location map and photographs of the apartment building comparables. Some historic income and expenses were provided for the subject and we have further relied on the expense comparables.



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| --- |
| **Rent Comparable Location Map** |
|  |
|  |

Merge & Insert Rent Comp Photos or Write-ups

Comparable Rent Analysis

The following analysis compares the subject property’s different unit types with similar apartments in the immediate area. It is noted that the qualitative adjustments presented on the prior page are expressed as numeric adjustments and are presented for informational purposes only and are intended to allow the reader to understand the though process of the appraiser, when arriving at a concluded market rent estimate. A matched-pairs analysis, while acceptable in theory, is highly limited due to the fact that no two properties are exactly alike.

2.0 Bed / 1.5 Bath Units



Analysis of Comparable Properties

Our analysis of the comparable properties in the subject property’s immediate area considers the following elements of comparison:

Location: All of the projects are in the same general area as the subject and no adjustments have been applied for location.

Quality/Age/Condition: Most of the comparables are considered similar to the subject and no adjustments have been applied. However, Comparable 1 was considered to be to be of superior age/condition.

Appeal:Each comparable property has various physical traits that determine its appeal. All were similar to the subject.

Unit Design / Layout: Each comparable property has various unit features, design and layout project amenities that determine its appeal. On the previous chart the comparable properties’ unit features and project amenities were subjectively adjusted compared to the subject property.

Recreation Amenities: Most of the comparables are considered similar to the subject and no adjustments have been applied. However, Comparable 4 was considered to have superior amenities compared to the subject.

The adjusted rental range for 2.0 bedroom / 1.5 bath units is $1,050 to $1,415 per month for the rent comparables with an average rent of $1,176. We noted that the subject units are currently renting between $900 and $1,099 or an average of $996. The subject units will potentially see some units turnover, but it is likely the tenants will stay as the new rental rate is in-line with competing project and the included rent comparables. Considering recent rental activity, location, unit size, the appraiser has concluded to an average rent of $1,050 per month per unit for the 2.0 bedroom / 1.5 bath units. Note the 2.0 bedroom / 1.0 bath units are slightly smaller at 936 SF and both rent for $950. A market rent of $975 is anticipated for the subject’s 2.0 bedroom / 1.5 bath units.

3.0 Bed / 2.0 Bath Units



Analysis of Comparable Properties

Our analysis of the comparable properties in the subject property’s immediate area considers the following elements of comparison:

Location: All of the projects are in the same general area as the subject and no adjustments have been applied for location.

Quality/Age/Condition: Most of the comparables are considered similar to the subject and no adjustments have been applied. However, Comparables 1 and 5 were considered to be to be of superior age/condition.

Appeal:Each comparable property has various physical traits that determine its appeal. All were similar to the subject.

Unit Design / Layout: Each comparable property has various unit features, design and layout project amenities that determine its appeal. On the previous chart the comparable properties’ unit features and project amenities were subjectively adjusted compared to the subject property.

Recreation Amenities: Most of the comparables are considered similar to the subject and no adjustments have been applied. However, Comparable 4 was considered to have superior amenities compared to the subject.

The adjusted rental range for 3.0 bedroom / 2.0 bath units is $1,100 to $1,550 per month for the rent comparables with an average rent of $1,338. We noted that the subject units are currently renting between $1,025 and $1,350 or an average of $1,179. The subject units will potentially see some units turnover, but it is likely the tenants will stay as the new rental rate is in-line with competing project and the included rent comparables. Considering recent rental activity, location, unit size, the appraiser has concluded to an average rent of $1,150 per month per unit for the 3.0 bedroom / 2.0 bath units. Note the 3.0 bedroom / 2.0 bath units are slightly larger at 1,295 SF and both rent between $950 and $1,125. A market rent of $1,125 is anticipated for the subject’s 3.0 bedroom / 2.0 bath units.

Potential Gross Rent

Applying the subject’s estimated market rent, to each of the subject units or $\_\_\_\_\_\_\_\_\_ per month. This equates to a total annual gross rent of $\_\_\_\_\_\_\_\_\_\_ for the subject property. Note “x” marked interior inspected units were inspected during the ${inspect\_date} inspection.



Other Income

This category accounts for all non-rental associated income for the subject property. Other income sources are late fees or non-sufficient fund fees. Most of the other items are offset by their actual costs, and are therefore not considered real estate income. However, some of the security deposits are typically forfeited upon turnover. The subject’s operation statement does not show complete expenses and limited income information. The appraiser has anticipated **$100 per unit** or a total of $\_\_\_\_\_\_\_\_ annually.

Utility Reimbursement Income (RUBS)

The subject is charging the tenants for utility usage on a monthly basis in addition to base rent. Based on the rent survey data, most competing properties are passing utility expenses onto the tenants in the form of RUBS, with a $30 to 75 per month indicated. The subject is currently obtained a monthly utility reimbursement of $40 to 60 per unit per month, which falls in the range of the market averages. The appraiser has anticipated an average of $50 per month per unit, or **$\_\_\_\_\_\_\_\_\_**, is used in this income analysis.

Potential Gross Rental Income

Applying the subject’s estimated market rent, to the each of the subject units and adding the additional income described above results in annual potential gross rental income for the subject of **$\_\_\_\_\_\_\_\_\_** ($\_\_\_\_\_\_\_ per unit). This amount is indicated in the following stabilized income and expense statement for the subject property.

Vacancy and Credit Loss

This expense category accounts for the time period between tenants, as well as possible prolonged vacancies under slow market conditions. The assignment will reflect the probable vacancy during the economic life of the property.

Copy this paragraph directly from Market Analysis

Out of 565 units surveyed by the appraiser (including the subject property) in the immediate market, there were only 10 vacant units (1.70%). The market is strong with decreased vacancy, moderately increasing rental rates, and no concessions. In the subject’s immediate to expanded market area, the reported Fall 2020 vacancy rate of 3.35% is estimated, up slightly from 2.63% estimated in Spring 2020.

A stabilized vacancy and credit loss of **5.0%** is estimated for the subject property based on that most apartment investors utilize a 5.0% vacancy factor over the long term. The concluded rate is equivalent to 6 months of rent loss every 10 years.

Effective Gross Income

Based on the preceding, effective gross rental income for the subject property is estimated at **$\_\_\_\_\_\_\_\_\_** ($\_\_\_\_\_\_\_ per unit).

Projected Operating Expenses

The next step in the Income Capitalization Approach is to estimate the subject's stabilized operating expenses. The market rent conclusion has been based upon a modified gross basis. The landlord is therefore responsible for expenses including real estate taxes, insurance, property management, common area utilities, garbage, maintenance, advertising, office expenses, turnover expenses, and reserves for replacement. To estimate expenses applicable to the subject, interviews with management firms and local utilities are utilized. We were not provided historical expense data for the subject property. Or We were provided historical expense data for the subject property based on the last three years of tax returns which are somewhat lacking in detail. We have relied upon our expense comparables that are similar to the subject property.

Real Estate Taxes: Please see the Tax Information Section for the discussion on the subject’s taxes. The current tax rate for fiscal tax year 2019-2020 has been reported at $\_\_\_\_\_\_\_\_\_\_ that was billed in October 2019. Since this still current we have applied this amount in our analysis.





Insurance: The surveyed apartment complexes (see prior table) indicated a range of building insurance expenses of between $180 and $224 per unit, but it appears insurance is on the rise. The subject’s historic expenses so no payments for insurance, which is suspect. Giving credence to the expense comparables, a charge of **$225 per unit** is reasonable based on the subject’s age and number of units.

Professional Management: This estimate is based upon a comparison with several similar contracts for other complexes, as well as discussions with professional management firms. Typically, professional management fees range between 5.0% and 10.0%, depending on the size, on-site manager and quality of the project. Smaller projects typically require a higher fee on a percentage basis. Contracts on large projects or multiple projects can run as low as 3.0%. The subject’s expenses do not show a maintenance charge. Given the subject’s project size, ant that there is an on-site manager, a management fee of **9.0%** of effective gross income, is reasonable.

Repairs and Maintenance: This category includes ongoing routine repairs and maintenance such as water heaters, garbage disposals, etc., as well as landscaping, parking lot cleaning and general maintenance. Note that in the expense comparable chart these items include Repairs & Maintenance, Landscaping, and turnover. The expense comparables ranged from $500 to $1,174 per unit annually with an average of $940 per unit. The subject’s 2016 expenses included a lot of capital repair items or $2,492 per unit, thus were given little consideration. Considering the age and construction of the improvements, with consideration to the expense comparables, a maintenance and repairs expense of **$1,000 per unit** is projected.

Utilities: This category includes common area electricity, water, sewer, and garbage expense. The comparables range from $967 to $2,048 per unit for the combined utility expenses annually with an average of $1,361 per unit. The subject’s 2020 expenses were $2,042 per unit, which seem to be on the high side of typical, although bracketed by the comparables. The appraiser has adjusted this expense to a market level based on the expense comparables, thus applying a reasonable utility expense of **$1,600 per unit** per unit.

Advertising: Given the subject’s size, an annual advertising budget is not considered typical. Given the prevalence of Craigslist (free), few small apartment complexes are utilizing the newspaper or rental guides any longer. A minimal advertising expense of **$20 per unit** annually is anticipated.

Reserves for Replacement: Reserves for replacement are not a typical annual cash expenditure, but rather the annualized costs of major expenses to be incurred in the future such as repair of roofing, replacement of carpeting, appliances, and repair or replacement of parking areas and window coverings. Typically, in the local market, reserve allocations are approximately 2.0% to 3.0% of the effective gross annual income for a multi-family project. A **2.5%** reserves factor is allocated based on the subject’s average quality construction.

Total Operating Expenses

Based on the preceding, total stabilized operating expenses for the subject property of **$\_\_\_\_\_\_\_\_\_** (\_\_\_\_.\_\_% of EGI) were considered reasonably supported in this analysis. As a comparison, the expense comparables ranged between \_\_\_\_\_% and \_\_\_\_\_% of effective gross income. The subject’s projected expenses are reasonably supported by the comparables.

Net Operating Income

Deducting projected annual operating expenses from effective annual gross income results in total projected net operating income for the subject property of **$\_\_\_\_\_\_\_\_\_** ($\_\_\_\_\_\_\_ per unit), as is summarized on a following page. It is at this time that net income can be capitalized into a value estimate.

Overall Capitalization Rate

Direct Comparison Analysis

The final step of the Income Capitalization Approach is to capitalize the estimated net operating income by an appropriate rate. The capitalization rate is estimated using the market sales method. The overall capitalization rate of each sale is market derived by dividing its net operating income by its cash equivalent sale price. This technique illustrates what purchasers are willing to pay for the net operating income available from competitive investment properties. This method best approximates the decision-making processes of the typical investor.

The primary factors influencing capitalization rates are: 1) The quality and certainty of the net operating income stream; 2) risk factors; 3) physical and locational characteristics of the property; 4) the competitive market position of the property and 5) the potential for future appreciation. The following chart summarizes the data used to estimate the market capitalization rate applicable to the subject property.

Merge cap rate comparables from CARDS and insert into here (example below)

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Comp. No.** | **Property Name Address Location** | **Sale Date** | **Year Built (Renovated)** | **Building Area (GBA)** | **Cash Equivalent Sales Price** | **Cap Rate** |
| 1 | Pacific Village Apartments 9655 SW McKenzie Street  Tigard, OR | 8/17 | 1968 | 26,512 | $4,225,000 | 6.67 % |
| 2 | Aloha West Apartments 18633-35 SW Blanton St. Beaverton, OR | 2/17 | 1970 | 11,500 | $1,575,000 | 6.85 % |
| 3 | Village Victorian Apts. 16290 SW Shaw Street  Beaverton, OR | 1/17 | 1960 | 40,500 | $5,725,000 | 6.32 % |
| 4 | Icon Beaverton Apts. 14620 SW Farmington Rd  Beaverton, OR | 10/16 | 1968 | 45,780 | $6,500,000 | 6.37 % |
| 5 | None 6770 SW King Boulevard  Beaverton, OR | 10/16 | 1959 | 17,119 | $2,675,000 | 6.34 % |
| A | Portland Collective 2073 SW Park Avenue Portland, OR | 3/17 | 1945 | 36,671 | $10,650,000 | 5.98 % |
| B | Village 185 18380 NW Heritage Pky. Beaverton, OR | 3/16 | 1979 | 80,575 | $13,100,000 | 6.10 % |

The surveyed capitalization rate sales data indicate a range of capitalization rates from 5.98% to 6.85% (average = 6.25%). The comparables show a relatively small range and are considered to be fair indicators of a market capitalization rate and all of them have been weighed on our conclusion. Since our rental rate conclusion takes into consideration some existing tenants are paying below market and less likely to move, the income stream is considered less risky. Based on the subject’s age / condition and unit mix, a capitalization rate toward the middle of the range is considered reasonable.

Cap Rate Conclusion

Based on the preceding, we have concluded a **direct capitalization rate** of **\_\_\_\_\_\_%** as reasonable for use in analyzing the subject property on a stabilized basis.

Concluded Market Value Via The Income Capitalization Approach

To value the subject by Direct Capitalization, the Net Operating Income was divided by the selected overall rate yielding a **stabilized market value** of the fee simple interest in the **subject property**, via the **Income Capitalization Approach** (rounded to the nearest $5,000):

|  |  |
| --- | --- |
|  |  |
| **Concluded Market Value Via the**  **Income Capitalization Approach:** | **$\_\_\_\_\_\_\_\_\_\_\_\_** |

Our analysis of the subject property via the Income Capitalization Approach is presented on the following page.

