VALUATION OF INCOME PROPERTIES / APPRAISAL

Market Value: The **Price** at which a willing **Buyer** and a willing **Seller**, each without undue pressure, would **Buy** and **Sell** a particular **Property**, as of a particular **Date**.

Appraised Value: An estimate or **Opinion** of **Property Value**, for a particular **Purpose** as of a particular **Date**, by a particular **Appraiser**. The three primary **Appraisal Methods** are: **Sales Comparison**, **Capitalization of Income**, and **Replacement Cost**. Each of the three **Appraisal Methods** should, in theory, produce a similar **Valuation**.

Sales Comparison (or Comparable Sales): Compares recent **Sales** of highly **Comparable Properties** that are similar in **Location**, **Size**, **Age**, **Construction Quality**, and other factors. This is generally the only method used for **Residential Properties**, and one of the three methods used to appraise **Commercial Properties.**

Capitalization of Income: **Gross Rent Multiplier**, **Capitalization** of **Net Operating Income**, and **Discounted Present Value (DCF)** of projected future annual **NOI**.

Gross Rent Multiplier: **Annual Rental Income** × **Gross Rent Multiplier** = **Price** (or **Value**). The **Gross Rent Multiplier** must be derived from the **GRMs** on **Sales** of **Comparable Properties**. This simple method is often used for valuing **Apartments**.

Capitalization of NOI: **Cap Rate** = **NOI** ÷ **Price**, so **NOI** ÷ **Cap Rate** = **Price** (or **Value**), and **Cap Rate** x **Price** = **NOI**. The **Capitalization Rate** (aka **Cap Rate**) is derived from recent **Sales** of **Comparable Properties** and is affected by **Market** conditions. Falling **Interest Rates** will tend to lower **Cap Rates**, while rising **Interest Rates** will increase **Cap Rates**. An increase in **Demand** relative to **Supply** in the local **Market** will lower **Cap Rates**, while an increase in **Supply** relative to **Demand** will raise **Cap Rates**.

Discounted Present Value (DCF): A 10-year cash flow model is typically created. The **Discount Rate** used (or required **Internal Rate of Return**) is based on the Buyer's assessment of the **Risk** of achieving the projected future **NOI** and projected future **Sale Price** relative to current alternative **Investments** and **Capital Market** benchmarks.

Replacement Cost: The sum of **Land Value** + **Depreciated Replacement Cost** of the **Improvements**. **Depreciation** of the **Building** can come from **Physical Depreciation, Functional Obsolescence,** and **External Obsolescence**. The **Land Value** is derived from a **Comparable Sales** analysis of similar **Land** parcels. The **Replacement Cost** approach is more reliable when the **Improvements** are relatively new.

Land Value: A "**Highest and Best Use"** analysis to determine the **Value** of a particular **Land** site, whether the **Land** is **Vacant** or **Improved**. A particular **Land** parcel might actually be worth more if the existing **Improvements** are demolished and removed.