
CHAPTER 8. MARKET COMPARISON APPROACH TO VALUE

- 8-1. PRINCIPLE OF SUBSTITUTION. The comparison approach to value is based upon the principle of substitution which states that a prudent person will not pay more to buy or rent a property than it will cost him to buy or rent a comparable substitute property. The objective of this approach is to deduce from other sales the amount which the subject property would bring on the market. In theory, the best comparable sale would be an exact duplicate of the subject property and would indicate, by the known selling price of the duplicate, the price for which the subject property could be sold.
- 8-2. UNITS OF COMPARISON. In apartment house comparison, the entire project does not offer a convenient basis for comparison with other entire projects since possible differences in size, composition, areas, units and rooms are almost unlimited. For this reason, it is customary to express the market prices found in market comparables in some units of comparison. Some frequently used units of comparison are: sale price per living unit, sale price per room, sale price per square foot and gross income multiplier.
- a. Comparison Approach Using Sale Price Per Unit. When the unit of comparison is sale price per living unit, it is important that size and/or composition be considered. If the value of a subject property composed entirely of efficiencies and one-bedroom apartments is determined by comparison (without adequate adjustment) with other sold properties all of which are composed entirely of two-bedroom and three-bedroom apartments, gross error will result. For this reason, the living unit is an undesirable unit of comparison unless comparable sales can be found which predominately are composed of the same kinds of apartment units (in terms of number of bedrooms) as found in the subject property. If there is considerable overlap in the types of apartments (efficiencies, 1 BR, 2 BR, etc.) between subject property and comparable sale property, the sale can be used and differences in the percentage of total units allocated to the various types of units, or even the absence of one type of unit from a comparable property, could be considered by an appropriate adjustment for size or composition to that sale price per unit.

* (8-2) (1) After selection of comparable sales which are satisfactory in terms of composition, the projects sold which are most similar to the subject in terms of location, rental range, remaining economic life, size and intended tenant market are chosen from the larger group as being those most useful for comparison. In determining comparability, the sole basis for determining whether a comparable sale will be utilized is the determination of physical and locational similarities and dissimilarities. The race, color, religion, sex, or national origin of the residents of the area have no bearing upon the estimate of rental value and shall not be considered or mentioned on the appraisal report. The address of property, date of sale, sale price and number of units are recorded. In the next column, sale price per unit is shown. Those property characteristics which best explain the significant value difference between subject and comparable properties will be used as headings for adjustment columns. These might be: location, time, size, composition, livability, amenities offered, economic life, and any other significant difference. For example, if some projects have air-conditioning and others do not, adjustment is required either in a separate column, or under "equipment" or under "livability," or under "plan." But if subject and all comparables have air-conditioning, this would not represent a factor of adjustment. Adjustment is always made from the comparable to the subject.

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(2) An example of entries and remarks in the comparison approach using the living unit as the unit of comparison follows:

L. COMPARISON APPROACH TO VALUE.

Adjustments

7. Address of Comparable Sale	Sale Date	Sale Price	No. Units	S. P. per Unit	Eco LOC	Size Life	Time	Comb Adj.	Adj Price Subj	
									Time	Comb Adj.
a. 862 Avondale	6/68	1,080,000	100	10,800	.95	1.00	.98	1.00	.93	10044
b. 4436 Belvedere	5/67	1,187,500	125	9,500	1.02	1.05	.96	1.04	1.07	10165
c. 2937 Birchwood	3/68	712,800	72	9,900	1.10	1.00	.91	1.02	1.02	10098

Subject Price PU \$10,100 x 84 units

8. Indicated Value of Subject by Comparison \$ 848,400

0. REMARKS CONCLUSIONS AND SIGNATURES

Remarks. Section L (a) comparable in prestige neighborhood with prices approximately 5% higher than subject. (a) comparable units slightly larger than subject. (b) subject has park near, which makes location slightly better than comparable. (b) comparable has 10 years less remaining economic life than subject, for which local market gives 5% more for longer lived property. (b) comparable has 15% of units in large 3BR apartments, subject has none; average size of subject apartment 96% of comparable. (c) comparable is outlying. Due to less distance subject location has prices 10% higher.

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- (8-2) b. Comparison Approach Using Sale Price Per Room. If projects of greatly different composition must be compared because of scarcity of data, the sale price per room offers less hazardous pitfalls for the appraiser than the sale price per unit. Among other adjustments, if there is a significant difference in average room size between the subject and any comparable property, an adjustment for room size would be needed. It is usually the case that projects having a composition of unit types with a higher number of rooms per apartment (other factors being equal) will have less sale price per room than projects having a smaller number of rooms per apartment. If the disparity justifies it, an adjustment may be made for composition between average number of rooms per unit in the two projects. Other adjustments are also made for other characteristics causing significant differences in market prices.
- c. Comparison Approach Using Sale Price Per Square Foot. It is obvious that with the square foot as the unit of comparison, no further adjustment for differences in area will be required. However, adjustments for composition or

other factors significantly affecting the sale price per square foot of the projects being compared should be made as described in foregoing paragraphs. An example of the comparison approach, using sale price per square foot, follows:

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- (8-2) d. Comparison Approach Using Gross Income Multiplier. If an apartment property sale price is divided by the annual gross income, the result will be the gross rent multiplier indicated by that transaction. When a number of sales from equally good locations in the same community are analyzed in this manner, the gross rent multipliers of comparable properties with similar remaining economic lives, similar attractiveness and livability, and offering similar utilities and services included in the rent, will normally fall in a fairly consistent pattern.
- (1) If analysis of the sale of several comparable unfurnished apartment properties reveals that each sold at a price which was approximately 6 1/2 times its annual gross rent schedule, then it is reasonable to estimate that the subject property will bring a market price approximating 6 1/2 times its annual rent schedule.
 - (2) When such an estimate is made, the comparison involves economic comparability and the unit of comparison is the gross income multiplier.
 - (3) As in the comparison approach with any other unit of comparison sales of other properties are sought which are as much like the subject property as possible. Among adjustments for other characteristics which affect market prices, it is necessary to pay particular attention to those which are not automatically compensated

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- (8-2) for by the method used. These are location, time, remaining economic life, and utilities and services included in the rent. Adjustments for location should reflect the differences in the typical gross income multipliers as found in the two locations being compared, rather than differences in sale price. For example, assume there are two similar 8 unit apartment properties; one in a location better than the other. Apartment A, in the poorer location sold for \$60,000, has an annual gross income of \$10,000 with a GIM of 6.0. Apartment B, in the better location, sold for \$69,300, has an annual gross income of \$11,000, a GIM of 6.3. When the gross income multiplier is the unit

of comparison and with the subject property located next to Apartment B, then Comparable A would receive a location adjustment of 1.05 in comparison with subject property (which indicates the difference in income multipliers) rather than 1.155 (which indicates the difference in sale prices) or 1.10 (which indicates the difference in rents). The location adjustment should reflect differences in GIM, only, due to location.

- (4) Similarly, with time adjustments, a change in rent levels alone is not reflected in the time adjustment but a time adjustment is made for changes in the GIM with the passage of time. Adjustments in GIM for time and location should be minimal to avoid duplicating adjustments which will be reflected in rent levels.

8-3. ESTIMATE OF VALUE. Value is defined as the price which typical buyers would be warranted in paying for a property for long-term use or investment, if they were well informed, acted intelligently, voluntarily and without necessity.

8-4. CORRELATION. Values produced by the summation, market price and capitalization approaches should be correlated.

- a. A narrow range is usually indicative of a well conceived property, properly balanced in respect to its physical and economic characteristics and acceptable to the market. Capitalization is the principal approach, since properties of the type eligible for insurance under Section 207 are planned, designed and located with the principal objective of producing a monetary return to an investor owner for a term of years and at a rate of return consistent with market conditions at the time of the appraisal. The final estimate of value will usually be that found by capitalization, preferably rounded to the nearest \$100, except that it shall never exceed summation or comparison.

- b. A word of caution in making the value determination. A finding of economic feasibility in the feasibility stage is a finding which has verified a market for the project at supportable rents, with reasonable expenses and net income sufficient to support a maximum mortgage which will permit construction of the project contemplated. Such a project in a normal money market should be built, and the value determination, by definition being for long-term use or investment, should be in a reasonable relationship to project cost and debt service requirements. Where such is not the case the pertinent factors in the value determination must be carefully reanalyzed to make certain no improper judgment has been used.

8-5. INELIGIBLE FINDING. If it is found that the application does

not comply with eligibility tests, an appropriate memorandum is directed to the ADTSB/CU recommending rejection and stating the reasons therefore, or setting forth the conditions under which a finding of eligibility may be made.

This conceivably could happen in instances where there is only one stage (Firm) processing, or where the sponsor has changed plans and/or specifications.

- 8-6. TITLE II CONSIDERATIONS IN AREAS AFFECTED BY MILITARY, ATOMIC ENERGY, OR SPACE INSTALLATIONS. See Reference 6 of the Foreword.