Market Value Assessment in Saskatchewan Handbook

Strip Commercial

Valuation Guide

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Strip Commercial Properties Valuation Guide

Market Value Based Assessment Legislation in Saskatchewan

Saskatchewan has different assessment legislation[1] than other jurisdictions in Canada that must be taken into account when valuing properties for assessment and taxation purposes. There are specific definitions in Saskatchewan for "base date", "market value", "Market Valuation Standard" and "mass appraisal". It is important to understand how these definitions relate to one another and the requirement for market value based assessments to be determined in accordance with the Market Valuation Standard.

Base Date is defined as "...the date established by the agency for determining the value of land and improvements for the purpose of establishing assessment rolls for the year in which the valuation is to be effective and for each subsequent year in which the next revaluation is to be effective;"

Market Value is defined as the "...amount that a property should be expected to realize if the estate in fee simple in the property is sold in a competitive and open market by a willing seller to a willing buyer, each acting prudently and knowledgeably, and assuming that the amount is not affected by undue stimuli;".

Market Valuation Standard means the "standard achieved when the assessed value of property:

(i)   is prepared using mass appraisal;

(ii) is an estimate of the market value of the estate in fee simple in the property;

(iii) reflects typical market conditions for similar properties; and

(iv) meets quality assurance standards established by order of the agency;"

Mass appraisal is defined as "…the process of preparing assessments for a group of properties as of the base date using standard appraisal methods, employing common data and allowing for statistical testing;".

Assessment legislation in Saskatchewan requires that non-regulated property assessments be determined pursuant to the Market Valuation Standard. Throughout this Handbook the term "market value based assessments" is used to refer to non-regulated property assessments. Unlike single property appraisals, market value based assessments must be prepared using mass appraisal and "...shall not be varied on appeal using single property appraisal techniques". All Handbook references to market value are subject to the requirements of the Market Valuation Standard.

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[1] The following Acts provide the statutory basis for property assessment in Saskatchewan:

- *The Assessment Management Agency Act*
- *The Interpretation Act, 1995*
- *The Cities Act*
- *The Municipalities Act*
- *The Northern Municipalities Act, 2010*

For more details on how to access this information refer to Appendix 2: Resources - Section 2a (Queen's Printer).

1.0 Introduction

Strip commercial properties can be found lining most major thoroughfares in any town or city. The strip commercial property type includes many of the retail and commercial facilities that are not dealt with elsewhere in this Handbook.

1.1 Nature of Strip Commercial Properties

Strip commercial properties include a wide variety of retail, office, commercial, and residential uses. Typically a commercial strip is comprised of a number of individually owned properties standing adjacent to one another, but it can also constitute a number of stores owned by one individual or company. This makes for a diverse group of properties. However, the common characteristics are:

- Orientation to the street;
- Exposure to pedestrian or road traffic;
- Commercial retail activities on the ground floor; and
- In some instances residential, office, and/or other commercial activities on upper floors.

Strip commercial properties may be purchased as a real estate investment, or to provide a location for the owner to conduct business. From an assessment point of view, the critical element affecting the value of a strip commercial property is the income generating potential of the real estate. This potential is related to a number of factors, primarily location. The desirability of any location may be measured by the amount of exposure to potential customers, accessibility, and availability of parking.

1.2 Strip Commercial Properties Covered in this Valuation Guide

The term strip commercial properties refers to properties that:

- Are oriented to street or road traffic;
- Contain ground floor commercial activities;
- Are generally located adjacent to other commercial or retail properties, but may stand alone;
- Receive real estate income predominantly from commercial pursuits; and
- Have three storeys or less.

Strip commercial properties not included in this valuation guide:

- Auto dealerships;
- Hotel and motel properties;
- Multi-residential properties with four or more rental units;
- Larger stand alone properties (for example - in excess of 30,000 square feet); and

- Larger multi-tenanted commercial properties with sufficient on-site parking and not strictly oriented to the street. This type of property may be more appropriately categorized as a neighbourhood shopping centre. (Refer to the Shopping Centre Valuation Guide).

1.3 Scope of Valuation Guide

- This valuation guide is designed as an aid in the valuation of commercial strip properties for assessment purposes.
- The valuation guide provides a practical tool to evaluate and determine market value based assessments.
- It sets out a procedure to follow to derive market value based assessments for strip commercial properties using the income approach.
- Valuation parameters provide the guidelines that establish statistically sound market value based assessments for strip commercial properties as of the base date.
- The valuation guide is designed as a tool to aid the assessor in deriving market value based assessments; it is not intended to replace the assessor's judgement in the valuation process.
- The methods presented in this valuation guide are aimed at deriving assessment values for a number of different groups of strip commercial properties.

Hypothetical data and analysis are provided throughout this Valuation Guide in the narrative and in various examples, tables and forms. These examples are provided for illustrative purposes only. The exact form of the market value assessment analysis is up to the discretion of the assessor subject to the Market Valuation Standard and other relevant legislation.

2.0 Analysis of Strip Commercial Properties

2.1 Property Types

Retail

Many strip commercial properties, especially those located away from the urban core, are located on major streets or arterial roads and are single-level. This type of strip commercial property, which can be either single or multi-tenanted, is designed to appeal to vehicle and/or pedestrian traffic.

Retail with Office or Multi-Residential Space Above

The other major type of strip commercial property has one or more retail uses on the ground floor and office or multi-residential space on one or more upper floors. Upper floor office space typically consists of self-contained offices with little or no common area. The multi-residential space may be rented to the ground floor tenant to provide a place to live and work in one setting, or may be rented to other individuals to provide an additional source of rental income for the owner of the property.

Strip commercial properties, with retail space on the ground floor and office/residential space on the upper floors, are typically located on main arterial roads and busy thoroughfares. There may be a number of smaller tenants on the ground floor, or a larger tenant such as a drugstore, grocery store, or bank that may occupy a substantial portion of the space. Other typical tenants might include a wide range of businesses including video stores, restaurants, convenience stores, and clothing stores.

2.2 Approaches to Value

Sales Comparison Approach

In certain municipalities, there may be a sufficient number of strip commercial properties sales to enable valuation on the basis of the sales comparison approach. Where the sale information is present and applicable, the sales comparison approach may be considered. If the sales information is not sufficient then other approaches to value may be considered.

Income Approach

Strip commercial properties generate income - except for the owner-occupied sites. The types of lease arrangements vary from net to gross rents. There is usually sufficient information available to establish typical income levels from strip commercial properties. In most municipalities, there are sufficient numbers of strip commercial properties to establish typical rental rates and to find income and expense information. In addition, there are generally sales available to indicate capitalization rates required in determining market value based assessments.

Cost Approach

The cost approach is the only approach that can be applied when neither reliable sales nor income data are available.

In most municipalities, however, there is likely to be a sufficient number of sales and/or income information available to complete the other approaches to value, either of which is preferable to the cost approach.

2.3   Recommendation

Because strip commercial properties are frequently bought, sold and developed on the basis of expected income, the income approach to value reflects the way the market views these properties. The income approach applies well in a mass appraisal environment. The combination of market orientation and significant leasing activity renders the income approach the most appropriate method for the valuation of strip commercial properties. Therefore, the following recommendation is made:

> The income approach is recommended for the valuation of strip commercial property for assessment purposes.

The theory behind the income approach to value is that a property's value reflects the present worth of anticipated or forecasted future benefits from the real estate. As such, the income approach analyses the rents and income from a strip commercial property and converts this typical net revenue into an estimate of value.

2.4   Application of the Income Approach to Value

Income Approach Methods

In general, there are two methods available to convert future income into a present value:

- Direct capitalization, and
- Yield capitalization (discounted cash flow analysis).

The direct capitalization method is most applicable to the valuation of income-producing properties in a mass appraisal environment. It requires the least amount of data to apply, reflects typical rents and market conditions, and is best suited to the use of statistical analysis. The yield capitalization method is not suitable for use in mass appraisal valuations in Saskatchewan due to its consideration of individual investor preferences (reflects personal versus typical market conditions), its need for more market data and numerous estimates of rents, holding periods and projected reversions, and its lack of suitability for statistical analysis. For these reasons the yield capitalization method will not be further detailed in this Guide.

The valuation approaches presented in this valuation guide employ two variations of the direct capitalization method. Both methods rely on the same principles:

- Capitalization of the Net Operating Income; and
- Gross Income Multiplier.

Overview of the Direct Capitalization Method

The analysis in this section presents a direct capitalization method that is suited for mass appraisal applications.

Direct capitalization converts or "capitalizes" the expected level of potential net income into a market value based assessment using an overall capitalization rate. The conversion factor or capitalization rate is a reflection of all of the investor's relative and comparative feelings and aspirations about the property in light of the investment characteristics offered by the asset and in comparison to other investment opportunities on the market.

In its most basic form, the direct capitalization method is an elementary mathematical ratio involving the estimation of typical net operating income (NOI) as of a valuation date, which is then capitalized into value to produce a market value based assessment.

The Direct Capitalization Method

$$\text{Market Value} = \frac{\text{Net Annual Operating Income}}{\text{Capitalization Rate}} \qquad V = \frac{\text{NOI}}{\text{R}}$$

For example:

$$\text{NOI} = \$100,000$$

$$\text{Capitalization Rate (R)} = 10\%$$

$$\text{Market Value} = \$100,000 \div 0.10 = \$1,000,000$$

Although there are other methods of converting expected future income into an estimate of value (e.g. discounted cash flow), the direct capitalization method lends itself to mass appraisal applications. It is possible to develop market value based assessments under this formula through proper evaluation of the potential net income and through the selection of an appropriate capitalization rate.

In establishing market value based assessments using the income approach, the objective is to evaluate the typical income generated by the real estate.

Overview of the Gross Income Multiplier Method (GIM)

Where the direct capitalization method capitalizes net operating income, the gross income multiplier derives values on the basis of a gross income (gross rent). Accordingly, these multipliers may be used when data on operating expenses are unavailable, inconsistent or otherwise unreliable.

By convention, a gross rent multiplier (GRM) is the factor applied to the gross monthly rent, and a gross income multiplier (GIM) is the factor applied to the gross annual income.

Market Value = Gross Annual Income x Gross Income Multiplier

A GIM is developed through analysis of sales of similar properties as it relates market value evidence to the gross income of those properties, as indicated by the following formula:

Sale Price ÷ Gross Annual Income = Gross Income Multiplier

2.5 Practical Valuation Process

In this valuation guide the income approach has been developed into a practical valuation tool with guidelines on:

- Collecting data;
- Analysing information;
- Developing valuation parameters;
- Determining market value based assessments; and
- Testing the quality of assessment values. (Refer to the Valuation Parameters Guide for a general discussion on statistical testing.)

3.0 Strip Commercial Properties Valuation Process

Overview of the Procedure

1) Collect appropriate information.

2) Classify strip commercial properties into homogeneous groups.

3) Establish the typical market rents for each group and sub-group of strip commercial property.

4) Select valuation process:

   • Direct capitalization method; or

   • Gross income multiplier method.

5) Apply method(s) to derive market value based assessments.

6) Add/deduct for other appropriate value, if required.

7) Determine a market value based assessment of the property.

8) Test results.

3.1 Collect Appropriate Data

More than any other factor, the type and quality of information available dictates the methods that can be used to value properties. The effort made during the information collection stage will determine the quality of the final analysis.

Supporting Information

Sources of supporting information include: strip commercial property owners/managers, real estate consultants and brokers, real estate publications, industry associations, and government sources.

Property Information

To compare, classify and develop useful GIMs and other valuation parameters for strip commercial properties, it is necessary to obtain pertinent physical and descriptive information. Typical information that could be collected for a property and entered into an assessor's valuation system is shown on the Strip Commercial Properties Data Entry Example. *(Refer to Figure 5.)*

Information from Assessment Records

Where possible, the assessor will verify the existing assessment record information when inspecting the property. When the information is not available or obtainable from the inspection, the property owner (or the designated contact person) is typically contacted to provide the information.

Property Inspection

To keep records up to date, all assessed properties are generally inspected from time to time. Along with the physical measurements, the following types of items may be noted when inspecting strip commercial properties.

Land:

- Lot size and area including effective frontage and depth;
- General comments on availability of on-site or off-site parking; and
- General comments on location of property.

Where there appears to be surplus or excess land, the assessor can note this on the record and review the zoning and land use by-laws governing the property.

Buildings:

- Year built;
- Details of all retail uses on ground floor;
- Details of all upper floor uses (if any):
    - Dimensions and area of all office space
    - Multi-residential space
        - o Number and type of suites
        - o Personal property included in the rent (fridge, stove, etc.)
- Quality of buildings;
- Condition of buildings;
- General comments on office/residential space; Level of occupancy;
- Recent renovations; and
- Photograph of property.

Rents and Financial Information

It is recommended that the assessor attempt to obtain income and expense and other financial information including:

- Typical rent and tenant type;
- Total gross rent per annum;
- Income from other sources (e.g., parking);
- Income collected to cover operating expenses: power, cable, etc. (could be included in gross rent);
- Total operating expenses; and
- Property taxes.

Typical Vacancy Rates

Allowances (or percentage rates) for vacancy and bad debts can be established by analysing information from the assessor's requests for information to strip commercial property owners (or the designated contact person). It is also possible to obtain such information from the managers of strip commercial properties. For supporting information there are also a number of real estate firms that keep statistics on such matters.

Sales Data

Sales data is necessary for determining gross income multipliers and capitalization rates. The assessor can request the following information:

- Property address and legal description;
- Sale price;
- Date of transfer;
- Instrument number;
- Name and address of vendor and purchaser;
- Interests transferred (fee simple or other);
- Financing conditions; and
- Value of chattels.

There will be instances when, in addition to the sale of the real property, the purchaser is also purchasing the retail business that operates out of the property. In the latter case, the sales data may have to be adjusted or discarded to ensure reliable market value based assessments.

Data Analysis

For the assessor to gain full value from the data collected, the data should be organized in such a way that meaningful comparisons can be made and valuation conclusions drawn. By collecting and organizing the data on a number of strip commercial properties it becomes possible to establish the typical performance, characteristics, and valuation parameters to apply in the valuation of other strip commercial properties.

Collecting and tabulating such data also enables the assessor to distinguish between the typical value of real estate components and the actual performance of a specific property. A market value based assessment determined through mass appraisal methods demands the application of a property's typical performance in the marketplace, not its actual performance. As noted in the Valuation Parameters Guide, this requirement is established in the Market Valuation Standard mandated in legislation in Saskatchewan's municipal Acts.

3.2 Classify Properties into Homogeneous Groups

The key to a successful market value based assessment analysis in a mass appraisal environment is to classify all strip commercial properties into groups containing common elements. This process is commonly referred to as stratification.

Strip commercial properties can be stratified based on the types of properties prevalent in the jurisdiction and/or market area. There is no one correct or appropriate classification system.

The objectives of this stratification are to:

- Stratify strip commercial properties into specific groups so that comparisons are meaningful; and conversely
- Have broad enough definition of these classes so that there are sufficient numbers within the group to establish values.

The functionality, viability, and value of a strip commercial property largely depends on its attributes: the quality of the physical improvement, the nature of the use of the property, and perhaps most importantly, its location. The valuation of a strip commercial property therefore rests on the analysis of these features. The ability to make comparisons with other strip commercial properties is crucial. The elements that can be used to categorize strip commercial properties are:

- Physical characteristics;
- Use;
- Location.

Physical Characteristics

Although there may be other types of improvements, the primary structure is usually the most important improvement. The value-generating characteristics of a building may be divided into three categories: functional efficiency, durability, and attractiveness/aesthetics.

Functional Efficiency

Functional efficiency refers to the degree to which a building is suited for its intended use. Although the relationship of a structure to its site is a factor in functional utility (for example, retail stores often require on-site parking), the internal layout of the building is often the primary factor. Attributes such as the size and shape of rooms, ceiling height, circulation patterns, number of storeys, privacy, and storage capacity are primary in determining a property's functional efficiency.

The dynamic aspect of functional efficiency should also be emphasized. With social, economic, and technological changes, functional requirements for a given use are also subject to change. For example, changes in the tastes and preferences of consumers may have a major effect on the functional criteria for retail store design.

Durability

Durability essentially refers to construction quality and the ability of a structure to remain productive exclusive of functional considerations. A high quality structure resists deterioration, has lower maintenance costs, and, assuming it remains functional, has a longer economic life. The quality and condition of a building's structural components and subsidiary systems are the primary determinants of construction quality.

Attractiveness/Aesthetics

Although attractiveness is somewhat subjective, the aesthetics of a property may affect its value. Extreme designs not in keeping with the surrounding area in a commercial district, for example, generally have a shorter period of market acceptance. What is considered attractive is also subject to the changing tastes and preferences of market participants.

Use

Combined with a ground-floor commercial use, the property may also incorporate office or residential uses on one or more upper floors. Infrequently, some strip commercial properties may also have a secondary commercial use on a second floor of the property, or one-half floor above, or below grade.

The strip commercial property may comprise a single storefront with or without floors above, or it may consist of a row of storefronts under common ownership.

Locational Characteristics

The most important single attribute of land is its location. The essence of location involves space and the need to transport people, goods, and services from one geographic location to another. The locational requirements of a given parcel of land depend on its use.

Observations

For the most part, the groups of strip commercial properties in a jurisdiction and/or market area can be established by observation.

Observations can be made to determine the homogeneity of the properties within a group of strip commercial properties. Typically, depending on the availability of sufficient and reliable market evidence, the following trends may be noted:

- Similar properties may have similar rent levels;
- Similar properties may be of a similar range in size, and
- Similar properties may have comparable locations

In addition some statistical measures such as coefficients of dispersion (CODs) can be generated on these and other physical identifying factors to determine the homogeneity of the properties within a strip commercial properties group.

3.3 Establish Market Rents and Valuation Parameters

From the data collected it should be possible to determine appropriate statistical measures (median, mean, range, etc.) for each group of strip commercial properties.

From the data collected, it should be possible to determine various valuation factors by group of strip commercial properties.

From records, property inspections, and other sources, a number of statistics can be compiled for each group of strip commercial property. An example of the mean is presented in *Figure 1*:

Figure 1: Strip Commercial Properties Data Example

Unit of Comparison	Mean
Number of Units	2
Unit Size (sq. ft.)	1,588
Year Built	1986
Land/Building Ratio	3.03

In addition to the data presented in *Figure 1*, collecting detailed income and expense data permits the assessor to generate a number of statistics such as those presented in *Figure 2*.

In the analysis of rents, storefronts may be categorized according to the different qualities of retail space within the given group of strip commercial properties. For example, corner locations have higher exposure and may command higher rents than interior sites. Not all categories of storefront will be present in each group of strip commercial properties.

3.4 Select Valuation Process

Depending on the income information available, one or both of the following approaches to value can be used:

- Direct capitalization:
    - Sales data
    - Income and expense data
- Gross income multiplier (GIM)
    - Sales data
    - Income data

If the leases for strip commercial properties in the jurisdiction and/or market area are predominantly gross and if there are sufficient sales to generate the appropriate valuation parameters, consider a GIM approach.

When there are net leases, or in cases where the gross income multipliers cannot be determined, consider using the direct capitalization method.

Figure 2: Strip Commercial Properties Valuation Parameters Example

NET RENTS

Profile Summary	Class 1 Poor location		Class 2 Downtown >1 storey comm/ res.		Class 3 Downtown 1 storey commercial		Class 4 Older highway commercial		Class 5 Newer highway commercial	
Parameter	Mean	Range	Mean	Range	Mean	Range	Mean	Range	Mean	Range
Ground Floor Uses										
Corner Location	$7.45	$0.32	$8.10	$0.45	$9.62	$0.74	$11.47	$0.68	$14.80	$1.40
Inferior Storefront	$6.03	$0.26	$6.56	$0.36	$7.79	$0.60	$9.29	$0.55	$11.99	$1.13
Standard Storefront	$6.71	$0.29	$7.29	$0.41	$8.66	$0.67	$10.32	$0.61	$13.32	$1.26
Superior Storefront	$7.38	$0.32	$8.02	$0.45	$9.52	$0.73	$11.36	$0.67	$14.65	$1.39
Other (e.g. Basement)	$3.50	$0.25	$4.00	$0.31	$4.60	$0.40	$5.10	$0.42	$5.50	$0.61
Upper Floor Commercial										
Retail	$4.21	$0.21	$4.80	$0.42	$5.42	$0.61	$5.77	$0.69	$6.50	$0.75
Office	$4.50	$0.54	$5.10	$0.72	$5.83	$0.63	$6.10	$0.59	$6.47	$0.52
Upper Floor Apartments (Monthly)										
Bachelor	$460	$21	$525	$21	$655	$39	$505	$25	$575	$32
One Bedroom	$552	$29	$720	$28	$738	$32	$685	$27	$722	$34
Two Bedroom	$691	$35	$780	$22	$804	$27	$772	$22	$830	$26
Operating Expense Recoveries Residential Units	$1,600	$330	$2,000	$294	$2,120	$178	$1,872	$561		
Expense Recoveries per SF Commercial	$1.34	$0.21	$1.87	$0.78	$2.08	$0.61	$1.99	$0.69	$2.24	$0.75
Taxes Recovered per SF Commercial	$1.77	$0.33	$2.01	$0.52	$2.11	$0.70	$1.88	$0.46	$2.20	$0.39
Parking Space Revenue (Per space per year)	$357	$123	$712	$231						
Vacancy and Collection Allowance	7.0%		7.0%		6.0%		5.0%		5.0%	
Expenses as a % of Gross Income	42.0%	5.3%	40.3%	4.8%	39.6%	3.2%	41.1%	2.9%	39.5%	3.3%
Gross Income Multiplier	4.40	0.90	4.75	0.75	4.85	0.38	4.70	0.36	4.60	0.40
Capitalization Rates (Base)	12.8%	2.2%	11.6%	2.0%	11.2%	1.3%	11.8%	2.0%	12.0%	2.0%

3.5 Apply Method to Derive Value

The assessor may apply either the gross income multiplier or direct capitalization method to produce a market value based assessment.

Review of Gross Income Multiplier (GIM) Method

1) Establish typical gross income, based on typical rents and income.

2) Deduct typical vacancy rate from typical gross income to produce the typical effective gross income (EGI);

3) Multiply the typical EGI by the GIM to produce an estimated market value based assessment.

Estimate Typical Gross Income

The potential gross income is calculated by establishing the typical rent for all space in the building as of the base date.

The assessor will need to determine the typical gross income for that group of strip commercial property. Typical market rents are established through the analysis of all the information collected on the properties contained within a particular group. The typical income figures for a particular group of strip commercial property are entered into the assessor's valuation system. The Strip Commercial Properties Data Entry Example shows typical data that is collected. *(Refer to Figure 5.)* The part of Strip Commercial Income Analysis and GIM Example dealing with gross income is presented in *Figure 3*.

Figure 3: Calculation of Typical Gross Income Example

Address	Assessment Roll #:		SC Class:	2	Base Date:	
					Typical rents are:	Net

	Area in sq. ft	TYPICAL RENTS	
Ground Floor Area		**Rent per**	**Annual Rent**
Corner location	1,200	$8.10	$9,720
Inferior storefront	0	$6.56	$0
Standard storefront	4,000	$7.29	$29,160
Superior storefront	0	$8.02	$0
Other (e.g. Basement)	800	$4.00	$3,200
Upper Floor Area			
Retail	0	$4.80	$0
Office	0	$5.10	$0
Total Area in sq. ft.	**6,000**		
Upper Floor Apts.	**# of Units**	**Rent per Unit**	
Bachelors	0	$525	$0
1 Bedrooms	4	$720	$34,560
2 Bedrooms	0	$780	$0
Total Rental Income	**4**		**$76,640**
Other Income			
Parking Spaces	0	$700	$0
Operating Expense Recoveries per sq. ft.		$1.87	$11,220
Taxes Recovered		$2.01	$12,060
Expense Recoveries per Res. Unit per year		$2,000	$8,000
Other :			$0
Other Income			**$31,280**
Total Gross Income		**Typical**	**$107,920**

Income used in valuation		$107,920
Less vacancy and collection allowance:	7.0%	-$7,554
Total Effective Income		**$100,366**

Estimate Effective Gross Income

Applying the typical vacancy and collection loss allowance to the expected gross income produces the normalized effective gross income for the property. The primary source of information on vacancy rates is the information supplied on the request for information forms returned by the property owners. It is also possible to obtain such information from the managers of strip commercial properties. For supporting information there are also a number of real estate firms that keep statistics on such matters.

Multiply the EGI by the GIM to Produce a Value Estimate

Once the effective gross income has been established, the market value based assessment of the property can be determined by applying the GIM. The GIM is determined through analysis of sales of properties displaying similar income, expense and risk characteristics.

GIM = Sales Price ÷ Typical Gross Annual Income

Note: A GIM developed in the analysis of one group of strip commercial properties may not be applicable to other groups of strip commercial properties.

Gross Income Multiplier Calculation Example

Effective Gross Income	$100,366
GIM	4.75
Value	**$476,739**

Review of Direct Capitalization Process

The direct capitalization process builds on the effective gross income established in the gross income multiplier analysis.

1) Determine the typical effective gross income.

2) Deduct typical expenses to determine typical net operating income (NOI) attributable to the real estate.

3) Establish the typical capitalization rate from market sales data.

4) Divide the NOI by the capitalization rate to determine the estimated market value based assessment.

Expenses and Net Operating Income

After analysing rents and the effective gross income (in the assessor's valuation system), the assessor determines the typical expenses to be applied to derive the net operating income (NOI). *(Refer to Figure 4.)*

Deducting the appropriate typical expenses from the effective gross income produces the net operating income for the property.

Figure 4: Determination of Expenses and Net Operating Income Example

Address		Class Statistics	
Assessment Roll #		Class	**2**
Base Date		No. in class	42
Effective Gross Income	**$100,366**		
Expenses		***Typical % of EGI***	
Utilities		7.5%	
Administration/ Management		10.0%	
Operating		6.5%	
Other		2.5%	
Sub-Total	**$26,597**	**26.5%**	
Property Taxes		13.9%	
Expense Rate used in calculation	26.5%		
Net Operating Income	**$73,769**		

Capitalize the Net Operating Income into Value

The value of the income stream is determined by capitalizing net operating income.

$$\text{Value} = \text{Net Operating Income} \div \text{Capitalization Rate}$$

Establishing Capitalization Rates

Sales of Strip Commercial Properties – Recommended Approach

Turning the equation in the capitalization method around produces the appropriate formula for establishing capitalization rates:

$$\text{Capitalization Rate} = \text{Net Operating Income} \div \text{Value (Sale Price)}$$

In the same manner that income and rents are analysed for property valuation purposes, the income and other data should be analysed for strip commercial properties that have sold as of the base date in order to establish the capitalization rates to be applied to strip commercial properties.

Other Approaches

If there is insufficient market sales evidence to establish capitalization rates, there are other possible ways such as mortgage-equity or band of investments to derive rates. These other approaches are not suitable for use in mass appraisal valuations in Saskatchewan.

Capitalization Rate Guidelines

Since the income approach is based on the present worth of future benefits, when applying capitalization rates it is important to consider the expected future income at the time of the valuation.

A number of influences can affect the capitalization rate to be applied to a strip commercial property. In general, favourable conditions may lower the capitalization rate and raise the value, and negative conditions may raise the capitalization rate and lower the value. Some of the issues to consider when establishing a capitalization rate are:

- Economic conditions;
- Competition and expected changes in competition;
- Location - roads, parking, access, visibility;
- Property age and condition; and
- Property design.

Selection of an appropriate capitalization rate is essential for the determination of an equitable market value based assessment for a property. The selection task starts with an analysis of the capitalization rates demonstrated in the sales of similar strip commercial properties.

After a review of the available information, appropriate statistical measures (median, mean, and range, etc.) can be determined for capitalization rates for each class of strip commercial properties. From this the typical capitalization rates can be determined for the group of properties being valued.

Effective Tax Rate

There are two ways to deal with the impact of property taxes when valuing a strip commercial property:

1. The first is to deduct the actual property taxes charged as part of fixed expenses (before determining net income). Under this approach, the net income produced is entirely attributable to the rental income stream of the property, and the capitalization rate employed in the valuation process is the base rate. The base rate is established as outlined above.

2. The second method to account for property taxes is to determine the effective tax rate and add this amount to the base capitalization rate. Under this method property taxes are not included in fixed expenses.

The best way to determine effective tax rates is to apply the taxes against properties that have recently sold.

Effective Tax Rate Calculation Example

Property taxes	$62,000
Market value based assessment of property	$2,000,000
Effective tax rate:	$62,000 ÷ $2,000,000 = 3.1%

Using this method the effective tax rate of 3.1 percent is added to the base capitalization rate to determine the market value based assessment as per the example below:

Net income	$73,769
Base capitalization rate	11.6%
Effective tax rate	3.1%
Total capitalization rate	<u>14.7%</u>
Value	**$501,830**

3.6 Add / Deduct Other Values

There may be certain properties where the entire value of the property is not completely captured by the foregoing application of a given valuation approach. In these situations a lump sum adjustment may be required. For example, a property may have surplus or excess land which is not developed due to current market conditions. This land may be valued separately and added to the market value based assessment for the entire property. A similar lump sum adjustment may also be applied for improvements if warranted.

3.7 Market Value Based Assessment of Property

An example of this procedure is set out in *Section 5.0*.

4.0 Validation of Results

The strength of an assessment system rests on two tenets: (1) its ability to produce appropriate market value based assessments; and (2) its treatment of similar properties in a fair and consistent manner.

To accomplish these ends, the valuation process reflects the views and methods used in the marketplace. The process is applicable to all properties.

There are two areas where the quality of the results can be ensured quickly and efficiently:

1. Valuation parameters; and
2. Check against sales values.

Valuation Parameters

The assessor's valuation system has valuation parameters that have been researched, collected and analysed by local assessors. Appropriate statistical measures (median, mean, range, etc.) can be determined for each valuation parameter.

When the assessor applies these valuation parameters to all similar properties, then the market value based assessments will be fair and consistent.

Check Against Sales Values

To ensure that the market value based assessments developed are in line with the local market, the assessment values will typically be checked against any sales of similar properties that took place. Such sales also have inferences for values of similar properties.

5.0 Strip Commercial Properties Valuation Example

The following three pages present hypothetical examples of market value based assessment analysis of strip commercial properties.

Figure 5: Strip Commercial Properties Data Entry Example

Example of typical pertinent physical and descriptive data about the property.

Figure 6: Strip Commercial Properties Income Analysis and Gross Income Multiplier (GIM) Example

Example of summary data on typical rents and income for a strip commercial property that would enable the assessor to calculate the appropriate market value based assessment for the property using a Gross Income Multiplier.

Figure 7: Strip Commercial Properties Expense Analysis and Valuation Summary Example

Example of summary data on typical expenses for that class of strip commercial property and the valuation parameters that would enable the assessor to calculate the appropriate market value based assessment for the property.

Figure 5: Strip Commercial Properties Data Entry Example

Address	
Municipality	
Assessment Roll #	

Base Date	
Property Class	**2**
Measurements in:	Square feet

Building Data	
Year built	1983
Renovations	No
Number of storefronts	4
Number of floors	2
On-site parking spaces	0
Municipal parking (y/n)	Yes

Property Details - Rentable Areas		
Ground Floor Uses	**No. of units**	**Total Area:**
Corner Location	1	1,200.0
Inferior Storefront		
Standard Storefront	3	4,000.0
Superior Storefront		
Upper Floor Uses		
Retail		
Office		
Bachelor Apartment		
1 Bedroom Apartment	4	3,200.0
2 Bedroom Apartment		
Other		
Basement	1	800.0
Other:	0	-
Total Rentable Area		**9,200.0**

Inspection Notes	
Inspection date	12-May-96
Condition (Fair, Avg, Good)	Avg
Location (Fair, Avg, Good)	Avg
Quality (Fair, Avg, Good)	Avg
Rental appeal	Avg
Tenant type	General retail
Food, pharmacy and 2 clothing stores	

Location comment	Near centre of town, numerous hotels nearby
Site comment	Level & landscaped
Other comment	

Sale Data			
Sales price	$396,000	Real estate price @ 100% interest	$396,000
Sales date		Financing	
Instrument number		Effect of financing (+/- %)	0.0%
Interests transferred	100.0%	Final price @ market financing	**$396,000**
Value of chattels & bus.	$0	Market Sale ? (yes/no):	yes
Vendor name			
Vendor address			
Purchaser name			
Purchaser address			

Figure 6: Strip Commercial Properties Income Analysis and GIM Example

Address	Assessment Roll #:		SC Class:	2	Base Date:	
			Typical rents are:		**Net**	

Ground Floor Area	Area in sq. ft.		TYPICAL RENTS	
			Rent Per	Annual Rent
Corner location	1,200		$8.10	$9,720
Inferior storefront	0		$6.56	$0
Standard storefront	4,000		$7.29	$29,160
Superior storefront	0		$8.02	$0
Other (e.g. Basement)	800		$4.00	$3,200
Upper Floor Area				
Retail	0		$4.80	$0
Office	0		$5.10	$0
Total Area in sq. ft.	**6,000**			
Upper Floor Apts.	# of Units		Rent per Unit	
Bachelors	0		$525	$0
1 Bedrooms	4		$720	$34,560
2 Bedrooms	0		$780	$0
Total Rental Income	**4**			**$76,640**

Other Income				
Parking Spaces	0		$700	$0
Operating Expense Recoveries per sq. ft.			$1.87	$11,220
Taxes Recovered			$2.01	$12,060
Expense Recoveries per Res. Unit per yr			$2,000	$8,000
Other :				$0
Other Income				**$31,280**
Total Gross Income			Typical	**$107,920**

Income used in valuation		$107,920
Less vacancy and collection allowance:	7.0%	-$7,554
Total Effective Income		**$100,366**

Value by Gross Income Multiplier

Effective Gross Income	$100,366
GIM	4.75
Value sub-total	$476,739
Other Value	$0
Market Value Based Assessment	**$476,000**

Figure 7: Strip Commercial Properties Expense Analysis and Valuation Summary Example

Address		Class Statistics	
Assessment Roll #		Class	**2**
Base Date		No. in class	42
Effective Gross Income	**$100,366**		
Expenses		*Typical % of EGI*	
Utilities		7.5%	
Administration/ Management		10.0%	
Operating		6.5%	
Other		2.5%	
Sub-Total	**$26,597**	**26.5%**	
Property Taxes		13.9%	
Expense Rate used in calculation	26.5%		
Net Operating Income	**$73,769**		

Value by Direct Capitalization of NOI

Net Income	$73,769
Capitalization Rate	14.70%
Value Estimate	**$501,830**
Other Value	$0
Market Value Based Assessment	**$501,000**

Capitalization Rate Class 2	
Base Capitalization Rate	11.60%
Effective Tax Rate	3.10%
Overall Capitalization (OAC)	**14.70%**

6.0 Strip Commercial Properties Valuation Guide

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