Appraising 2-4 Unit Residential Properties

- Dan Jones, AACI, P.App. - BC – provided perspective from over 68 appraisers in 4 firms
- Patrick Clay, AACI, P.App. - BC
- Sanjit Singh, AACI, P.App. - Alberta
- Deana Halladay, CRA – Winnipeg
- Jeffrey Barss, B. Comm, AIC Candidate Member – Nova Scotia
- Lisa Glennie, BA, CRA – Nova Scotia
- Mike Kirkland, - Newfoundland
- Claudio Polito, AACI P.App. – Ontario
- Murray Visser, AACI, P.App. – Ontario
- Steven Rocca, CRA – Ontario
- Lora Wylie, CRA – Ontario
- Dennis Murphy, CRA – Ontario
- Ed Saxe, CRA – Ontario
Do you typically use a Form or do a Narrative for this type of property?

- The vast majority of respondents use the Form Report. Narrative addendums are provided when needed.
- In some cases a full Narrative is required but usually when the function is for some form of dispute or litigation where a full explanation leads the reader to the same conclusion.
- We will do it either way – fees go up for Narratives but it’s not necessarily more accurate.
If you use a Form, do find the AIC Residential Full Form 0912 – Income Approach Addendum to be comprehensive? Do you have any comments about this form?

- Never use it
- Not completed as income approach but only to report rent (actual and market) and expenses
- Accurate expenses are rarely available so we don’t use this form
- Income approach on 4 unit properties not relative in my market
- Needs additional narrative in order to provide the required analysis and provide support for other aspects of income producing properties
- Net floor area column rarely used
- Not trading on income unless close to University/College where they can be rented on a room by room basis.
- AMC’s require the use of their forms which more or less are similar to this form.
- Don’t use it for 2 – unit since its not applicable but use it for 3-4 unit and find it acceptable.
- It’s limited but flexible.
- Useful but in most cases requires an addendum to further address issues.
- Lenders are looking to this form as a rental schedule only. Use interviews with owners or MLS for expense information.
- This form is all the lenders ask for.
Are stakeholders (lenders and AMC’s) asking for a different form? Is it more or less comprehensive?

- AMC’s generally have their own form. Some are similar and others are less comprehensive.
- Use existing CRAL report
- Existing form is acceptable for most stakeholders.
- We fill out the AIC form or the AMC form as best we can based on an interview with the owner and MLS information if available.
Appraising 2-4 Unit Residential Properties

Do you use capitalization rate analysis for these type of properties? Explain if needed.

- Yes, where data is available. I will extract cap rates from comparable sales and provide additional comparable sales with cap rates if required. There is limited data in the marketplace.
- It's been offered to lenders but some just don't want to see it.
- Maybe on 4 unit buildings, but not 2 and 3 unit.
- No, investors do not use for such property under 5 units.
- Yes, we maintain in-house data and complete an income approach for all properties since they are income producing. The approach may not be overly detailed and may not be the final approach relied upon.
- Not a sophisticated investment – trade on the basis of price per suite.
- Lenders are looking for the income addendum but not expecting a cap rate analysis and in reality these properties are not selling based on this variable.
- Don't use it when using a form but may develop an analysis in a narrative.
- It's too confusing for most clients.
Do you use GRM (Gross Rent Multiplier) for analysis of these properties?

- Yes, when data is available
- Rarely
- Only for 3 and 4 unit buildings – but mostly only on 4 unit buildings
- I use GRM for 3-4 units but in our market most of the duplex’s are owner occupied so I adjust based on size, condition, etc.
- Don’t like to use it – not typically accurate and could yield results off by 25%. Archaic.
- We find the GIM most reliable.
- Most properties in the area do not trade based on the GRM but we may considered it as guideline when the comparables have similar expenses (ie. Rent includes utilities are compared with others where rent includes utilities and visa versa)
- As the strength often quoted for the Direct Comparison Approach is that it “best mimics the actions of buyers and sellers” we find that a Gross Rent Multiplier to be more easily understood, and implemented. As I state in my GRM form, ”Often income statements, both for the subject and for comparables sales, have been influenced by distorted values. The expense amounts are often not verifiable and sometimes are inflated for Income Tax purposes. Gross rents can be verified during interviews with the tenants at the time of our inspection …”

\[
\text{GRM} = \frac{\text{Purchase Price}}{\text{Scheduled Gross Income}} = \frac{\$1,175,000}{\$164,245} = 7.15
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&= 7.15
\end{align*}
\]

Is this really a Direct Comparison Approach?
Appraising 2-4 Unit Residential Properties

What other units of comparison are applicable? Price per sq. ft., Price per unit, Price per bedroom, or any other suggestion you may have?

• *Price per unit is most applicable (Manitoba)*
• *Price per bedroom*
• *Rooming houses can be price per room and with students could be compared to 5 or 6 unit apartments but this is an AACI assignment.*
• *In high rent area we may adjust using floor area and number of bedrooms, but only for adjustments, not the unit of comparison itself.*
• *Price per unit and price per bedroom is less dependable since if the are not purpose built there is a lack of continuity of building design and this leads to inaccuracy.*
• *We will often include a price per sq. ft. as one of the units of comparison.*
Can you indicated who you find may typically be buying these types of units?:

2 Unit: Owner ___ %  Investor _____%  
50/50*, 75/25***, 80/20, 90/10***, 100/0

3 Unit: Owner ___ %  Investor _____%  
0/100, 10/90*, 20/80*, 40/60*, 50/50*, 75/25**

4 Unit: Owner ___ %  Investor _____%  
0/100**, 5/95*, 10/90***, 25/75, 50/50**
Are you asked to estimate market rental rates for vacant units?

- **Not asked, but provide when doing income approach and there is a vacant unit.**
- **Always asked by lender. Look for historical rents – know the market (check ads, MLS etc.)**
- **Rely on historical rents supported by market**
- **Even if not asked, we do this for each appraisal.**
- **All the time**
Are you required to provide a table of comparable rental rates?

- No
- No
- Almost always include one since we have one on file.
- No
- No
- No
- No
- No
- No
- No
- No
- No
- No
Are you asked to estimate market rental rates as a separate assignment without appraising the property as a whole? If so, do you receive pressure from the client when you request to inspect the units prior to providing such estimates?

- Only for single family
- We’ve been asked but tell the client we can’t do it without an inspection or a full appraisal.
- Yes, when asked. We only request access where there is no recent MLS or prior appraisal data available.
- I’ve been increasingly asked to conduct a stand alone market rent report. This type of point estimate of value is considered an appraisal (as per CUSPAP) and therefore the report must meet all the minimum requirements for an appraisal.
- I generally don’t do it unless I’ve appraised the property in the past.
- Becoming a more common assignment – at times asked to inspect and others to provide a generic range. Inspections cost money.
- We conduct this assignment but don’t need to see the units.
- No inspection… we treat an assignment like this as a desk or drive-by consulting assignment and give a range of values based on previous MLS or internal data we have about the subject property.
Do you make inquiries, other than asking the owner, as to if the present number of units are legal? If so, what is/are the typical option(s) available to you in your market?

This question was the most commented on by the participants.

- If suspected ask City with discretion not to flag an illegal suite. I get conflicting information from different City departments. “Business license” is required in my jurisdiction
- Extraordinary Assumption and limiting condition or advise the lender to obtain a certificate indicating that the suite conformed are possible options.
- City Hall, Realtor, MLS, Zoning maps
- Always put statement that the lender is advised to obtain formal confirmation
- Consider licensing of suites and zoning conformity.
- Check with ExploreHRM GIS database as well as with PVSC (assessment) both of which indicate number of units. If the building has more units ask the owner for an occupancy permit and then put in assumption placing legal verification up to the lender. Sometimes request times for verification are preclusive to the process.
- Hard to find accurate report of legal unit count as sources have different #’s and owners are coached as to what to say to us.

- City indicates if the units are legal and each unit is charged a water tax rate.
- We will usually verify for larger units, but do not want to raise red flags with municipalities in the case of basement apartments etc. We make an assumption and limiting condition and suggest that the client verify themselves. I do not want to cause a landlord to have their basement apartment shut down because we started poking around. At the same time we want to make it very clear to the client/lender that we did not look into it. If a landlord claims it is all legal etc, we will look into it though, but far too often it takes a month to hear back on a 2 day appraisal turn around. In the case of a single family home with a basement apartment where zoning does not allow it, the secondary exits clearly do not exist etc, that is more than likely not legal, we simply state that although it is rented, we are appraising it as if it is just a finished basement, giving no consideration to income and also make it clear the unit may be not legal.
- Full investigation of legality of suites: call City Hall, how many are legal? Do they have all permits at point of conversion? Do they comply with building cost and are they City approved?
Do you find design build 2-4 Unit buildings sell at a premium compared to converted dwellings? Would you typically compare design builds with dwelling conversions?

- Try to compare similar styles with similar styles but with the absence of data may use both.
- Generally sell at a premium in GTA in conforming neighbourhoods but there doesn’t seem to be much of a difference in areas where there is a strong sample of both types.
- Income drives value – not design.
- Not an issue in our market.
- Built for purpose always trade different than conversions. Converted units are often purchased to be converted back into single family (Toronto). 2-4 units rarely trade on their income. Entry level investments for retirement/ pensions.
- We always try to compared similar design styles. Purpose built often sell for more due to efficiencies within the design and definitive separate metering.
- Always try to compare similar types but some lenders prefer closer comparables and cross type analysis may be necessary. Even when this is the case we will back up with a dated sale of a similar type.
- They generally have more appeal and there does seem to be a difference in some areas. However, in high demand areas, there is little to no difference.
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Your Are
Worth more
that you
think!!

Appraising 2-4 Unit Residential Properties
Do you have a set fee for 2-4 Unit buildings?

2 Units
350, 400, 450, 500, 600

3 Units
400, 600, 750

4 Units
450-500, 800, 800-900, 1000, 1200
Do you have any other advice for members looking to take on this type of work?

- Seek out colleagues that can mentor you through the first few assignments.
- Build a database of rental information and GRM rates. Often Realtors will not state the proper GRM so discussions with property managers and other leasing agents is key.
- Try to inspect as many units as possible, always emphasize to the landlord that full access is necessary and explain to tenants why you are taking pictures and get their approval. (PIPEDA Form)
Questions to Participants

• Do you, CRA’s feel you receive adequate education through your courses to have the competency to prepare these assignments

• Is the Income Approach really being done in these appraisals?
  • Does it need to be done?
  • Maybe just state that it’s not the driving force to value in this marketplace and thus has not been developed.

• Where is the tipping point between value as finished space and value as an additional unit in an income producing property.
Commercial Zoned Properties

- If the property is zoned commercial the highest and best use analysis must be vetted and signed by an AACI designated member. If the highest and best use is determined to be the continued residential use, than the CRA can complete the report. If not, it must be co-signed by an AACI and a commercial valuation analysis is required.

No extraordinary assumption can be used that ASSUMES that the present use is the highest and best use.
## The FORM

### Services and Amenities Included in the Rent:
- [ ] Electricity
- [ ] Garbage Collection
- [ ] Parking
- [ ] Water Heaters
- [ ] Refrigerator
- [ ] Stove
- [ ] Hot Water
- [ ] Cable TV/Satellite

### Income:

<table>
<thead>
<tr>
<th>Floor</th>
<th>No. of Units</th>
<th>No. of Forms</th>
<th>Net Floor Area</th>
<th>Monthly Rent—Per Unit</th>
<th>Annual Sq. M. or Ft.</th>
<th>Total Monthly</th>
<th>Total Annually</th>
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<td>Laundry</td>
<td>Units X $</td>
<td>X 12 Months = $</td>
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<td>Other</td>
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### Gross Income

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<thead>
<tr>
<th>Less: Vacancy and Collection Loss</th>
<th>$</th>
<th>%</th>
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<thead>
<tr>
<th>Parking</th>
<th>Monthly</th>
<th>Total</th>
<th>Occupancy</th>
<th>SUP Total</th>
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<tbody>
<tr>
<td>Interior</td>
<td>Spaces at $</td>
<td>Per Space $</td>
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<tr>
<td>Exterior</td>
<td>Spaces at $</td>
<td>Per Space $</td>
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</table>

**Effective Gross Income**
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<thead>
<tr>
<th>EXPENSES</th>
<th>TOTAL</th>
<th>PER UNIT</th>
<th>SQ. M. OR SQ. FT.</th>
<th>% OF GROSS INCOME</th>
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<tbody>
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<td>TAXES: MUNICIPAL</td>
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<td>SCHOOL</td>
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<td>OTHER</td>
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<td>INSURANCE</td>
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<td>ELECTRICITY</td>
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<td>GAS OR FUEL OIL</td>
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<td>JANITORIAL</td>
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<td>REPAIRS AND MAINTENANCE</td>
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<td>PAINTING AND DECORATING</td>
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<td>RESERVE</td>
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<td>ELEVATOR MAINTENANCE</td>
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<td>PROPERTY MANAGEMENT</td>
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<td>GARBAGE COLLECTION</td>
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<td><strong>TOTAL EXPENSES</strong></td>
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<td><strong>NET INCOME</strong></td>
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<td><strong>CAPITALIZATION</strong></td>
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<td>NET INCOME $</td>
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<td><strong>ESTIMATED VALUE BY THE INCOME APPROACH (rounded)</strong></td>
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The FORM
Appraising 2-4 Unit Residential Properties

- Fee’s are being driven down for these type of properties and appraisers commonly underestimate the amount of work required for a million dollar 4-unit property. Once they see the effort required and the non-proportional fee they back away from this market.
- Don’t be talked into doing work outside of scope ie: 5 units or commercial zoned property.
- Don’t sell yourself short! – At least base your fee on time – use the time to do a single family as the benchmark for your hourly rate.
- No rooming houses no matter how packaged. Have the appraisal co-signed by an AACI or refer it to an AACI if it something different than you were told – you will never regret this decision.
- Maybe check to see if permits were issued
- Remember to consider a Highest and Best Use of the land as if vacant and improved as sometimes these differ and can have an impact on valuation (ie. Non-conforming uses in areas where zoning density has decreased).

- Be careful comparing purpose built to conversions.
- Appraisers need to adopt the investor mindset when looking at these properties and realize that the time adjustments they may see in the single family sector are not applicable in the investor market when variables have not changed so dramatically over the same period.
- Ask for help if you don’t know.
- Determine if the appraisal is suited for a form or a narrative before you quote.
- Authorized vs. unauthorized accommodation.
- Fees should not be set but rather evaluated on the basis of a preliminary search to find out the difficulty of completing the assignment – often comes down to availability of data and the difficulty of the highest and best use analysis.
- A very clear conversation with the client needs to be upfront especially when dealing with legal vs. non-legal units and what you will not be including in the analysis.
Understanding your risk.

Is this work litigious? Professional Practice discussion with Nathalie Roy-Patenaude

- Observations and assumptions need to align. Assume it’s up to code. If it’s illegal, don’t have the assumption that you have assumed it to be illegal – need align with back “it’s assumed that it meets all legal requirements – unless otherwise stated in the report”
- Don’t typically apply cap rates to 2-4 units,
- Have discussion on cap rates - Say it’s not applicable and why – no data? Not a market driving force?
- Perhaps a truly defined “Income Approach” is not applicable to 2-4 Units – if its not an Income Approach – don’t conclude one as such or call it one. You can fill out the addendum if required but you may conclude the approach is not applicable.
- Need clarification as to what client needs?
- Request for just a market rent? This is an appraisal assignment – opinion of market rent (stand alone request) it is value – must conform with 24 standard rules. Still requires the work – they should specify what the rent includes, utilities, storage, parking, etc. Lender is looking at gross or net. Not necessarily inspected – full, drive-by, desk top, etc. up to appraiser – may not give a fixed value most likely give a range. Up to appraiser to assess the risk. More limited the scope the higher the risk. Need to do more inquiry when no inspection. Some appraisers say – if I can’t inspect, I’m not doing it – well within his/her rights.
Understanding your risk.

Is this work litigious? Professional Practice discussion with Nathalie Roy-Patenaude

• **GRM – GIM is Direct Comparison Approach and seems to be most used.**

• **Lenders request for “what if” the basement was rented in a single family home? This is a market analysis and should be separated from the report in an addendum and clearly stated that it should not be relied upon. They may be using it to qualify the buyer, but that’s a lender problem.**

• **There is no extraordinary assumption that can allow a CRA to do a 5 plex. However, if there is a 5 unit building and the 5th unit is illegal a CRA could do the report stating that it is a legal 4 plex and not include the income for the illegal 5th unit in the income approach. It should be compared to other 4 plex’s.**

• **If it’s a triplex with a fourth space (don’t call it a unit!) – it could have contributory value as “owner’s space”.

Not much in the way of complaints from the public for this type of work.
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Final note – the path to better revenues

• Become a specialist – maintain a simple database of sales including whatever information you can draw from MLS. It will speed up the process and if you let your colleagues know you can do them more efficiently you may find referrals come your way.

• Be consistent and charge a fee that reflects the time. If you can do three single family reports in the same time, then the fee should be 3 times the single family rate. Investors are often less fee sensitive.

• This can be the path to your AACI that you may have been looking for.

• Take a challenge, move outside your comfort range, challenge yourself to grow, ask for help.
Thank You