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PROPERTY VALUATION

(BG3 ALT S6)

Section 14 –

Methods of Valuation –
Comparisons Method Pt 2

Real Estate Business Management Program

Year 3 – Work study program

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8 November 2023

Property Valuation (BG3 ALT S6)

Agenda

7. When is the Comparison method used?
8. Applying the comparison method of valuation.
9. Comparison metrics.
10. Information needed for a comparable.
11. Key factors affecting comparability.
12. Selecting comparable evidence.
13. Applying the comparison method of valuation.
14. Sources of comparable evidence.
15. Hierarchy of Evidence.

Property Valuation (BG3 ALT S6)

7. When is the Comparison method used?

Rent Reviews

I frequently use comparable information when representing Landlord's interest in negotiating rent reviews.

New Industrial Unit Comps

For a new industrial unit that we are the agents for in an area we aren't 100% familiar with. We have created a comps table with similar industrial units in the area that have been leased recently and collated the information of when they were leased, who by, and for how much. This will then allow us to come up with an accurate rent to charge potential tenants.

Comparisons Method

I am currently calculating end of year valuations for my companies property portfolio. The comparisons method underpins all our valuations as they are calculated on an investment basis. All our properties are let and these leases will expire by effluxion of time or via a break clause at some point in the future. The comparisons method is then used to determine a yield and ERV for the subject premises, on which to valuation the reversion.

Comparison Method

In my current role, we manage the local shopping centre where we often use the Comparison Method for pricing our units when we market them or re-negotiate leases. This is due to most of the internal units being a very similar size with a similar footfall however some of the other units can be more difficult with adjustments for the units, for example units at the entrances or near the high street, due to the value of this location varying depending on the use of the unit.

I recently completed the build on a development in Cheshire which comprised x6 new build 4 bed homes at c. 1800sqft each.

Ahead of the build, I used the comparison method of valuation to determine the anticipated GDV of the development and in turn calculated the expected profit.

Comparison Method



I recently completed a red book valuation using the comparison method, on a pair of occupied semi-detached 3 bed houses. This method was most appropriate to use as the instructing client sought to clarify the value in order to determine whether the property offered a reasonable level of security against a loan (mortgage) upon it. The same method was used to determine whether the current rental levels were comparable to Market Rent level. I found reasonable comps for sales on the same road, of both newer and similar aged properties.

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8. Applying the comparison method of valuation

The Comparison method works best in the following circumstances:

- ✓ The properties have the same use (i.e. residential).
- ✓ The properties are of similar construction and similar size.
- ✓ The properties are in the same area.
- ✓ Recent transaction data is available.

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8. Applying the comparison method of valuation

- The comparison method of valuation is the most common method of valuing property (especially residential).
- It involves carrying out a valuation by directly comparing the property with similar properties which have sold in the past and using evidence of those transactions to assess the value of the property.
- Analysis should encompass every attribute of a transaction that was different from every other attribute in selected comparable transactions.
- The more comparables that are available to the valuer, the easier it is to derive an estimate of value with substantive evidence.
- Units of comparison can include per sqm, per hectare, per unit, per room. Several metrics should be used as a cross check.
- A competent valuer will be able to quantify the differences between properties and those at more distant locations.

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9. Comparison Metrics

Attributes that might make one property different from another and explain differences in value could be put into three main groups (other groupings are possible):

1. Physical Structure, construction, size condition etc.
2. Locational factors, amenities, accessibility, transport.
3. Legal constraints, lease terms, planning.

The two key metrics for commercial real estate are rents and yields:

- **Rents** – data more readily available. Analysis and adjustment is a key skill (covered next week).
- **Yields** - sales are limited and often difficult to analyse especially if the current rent property is let at less than market rental levels for the property.

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10. Information needed for a comparable


In the light of the above, the valuer needs to know for each comparable:

- **Locational characteristics**
- **Physical Characteristics**
- **Lease terms (confirmation of terms ...)**
 - Type of transaction (new letting, rent review, lease renewal).
 - Rent and any lease incentives (e.g. premiums, rent-free periods).
 - User clauses.
 - Tenant fit-outs.
 - Service charges.
 - Security of tenure.
 - Repair obligations.
 - Insurance responsibility.

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11. Key factors affecting comparability

RICS PROFESSIONAL STANDARD



Comparable evidence
in real estate valuation

Global
1st edition, October 2019
Effective from 9 October 2019

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Appendix B: Factors affecting value and comparability by sector

Sector	Key factors affecting comparability (other factors may be relevant in specific cases)
Rural	<p>Agricultural land: land use mix, soil type, capability, aspect, layout, accessibility, drainage, irrigation, proximity to markets, size, suitability and layout of buildings, eligibility for support payments, environmental or other statutory designations/schemes, tenure, planning opportunities, use of machinery, size, water distribution and availability, sporting rights, riparian ownerships, minerals, public development/compulsory purchase proposals. For information on the categorisation of rural real estate see RICS' <i>Valuation of rural property</i>.</p> <p>Farm buildings: age, construction type, layout, adaptability, access, compliance with farm quality assurance requirements, pollution hazards, electricity supply and other mains/private services, redevelopment/conversion opportunities.</p> <p>Farmhouse: ability to sell separately, access, size, demand for specialist housing type, other factors as for residential real estate generally.</p>
Residential	<p>Houses and apartments (sale): age, construction type, layout, adaptability, access, compliance with quality assurance requirements, pollution hazards, electricity supply and other mains/private services, redevelopment/conversion opportunities.</p> <p>Houses and apartments (rent): as above, plus lease terms.</p>

Comparable evidence in real estate valuation

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Sector	Key factors affecting comparability (other factors may be relevant in specific cases)
Commercial (offices)	<p>Owner-occupied: layout, flexibility, floor area (quantum), building services, specification (including air conditioning), service charge level, transport facilities, car parking, energy efficiency and environmental sustainability.</p> <p>Rental: as above, plus key lease terms, unexpired term, provision for rent increase, responsibility for repairs, maintenance and insurance, any restrictive covenants.</p> <p>Investment: yield (rent factors as above, plus tenant covenant strength).</p>
Commercial (town centre retail)	<p>Rental: site and precise location, shop frontage and display windows, shop layout, number of floors, adjacent complimentary uses, rental zoning method, floor level (if in multi-storey shopping centre/mall), loading facilities, pedestrian flow, parking, access to public transport, lease terms.</p> <p>Investment: location and layout, tenant covenant strength, lease terms and length. In shopping centres/malls the quality of centre management may also be relevant.</p>
Commercial (out of town retail)	<p>Rental: building layout, size, height, loading, access, car parking and access to public transport, other retail units adjacent, visibility and key lease terms: unexpired term, provision for rent increase, responsibility for repairs, maintenance and insurance, restrictive covenants, planning restrictions (especially regarding use).</p> <p>Investment: yield (rent factors as above, plus tenant covenant strength and lease terms).</p>
Industrial/warehousing and distribution	<p>Rental: accessibility to major transport links, site access and loading facilities, building layout and eaves height, floor loading, layout offering clear space, power supply, office content, site coverage, environmental issues, potential for alternative use.</p> <p>Investment: yield (rent factors as above plus tenant covenant strength and lease terms).</p>

Comparable evidence in real estate valuation

Property Valuation (BG3 ALT S6)

11. Key factors affecting comparability

When using the method for the valuation of property, the following elements are some that can be compared:

- Price.
- Age of building.
- Location.
- Type of construction.
- Use of building.
- Structural condition.
- Decorative condition.
- Position of property.
- Size.
- Floor area.
- Layout.
- Condition of fixtures and fittings.
- Date of sale.

You can set out the information in a table and show the adjustments made for each element to reflect the differences in the comparable from the property being valued.

12. Selecting comparable evidence

The RICS (2019) Comparable evidence in real estate valuation (1st edition) states:

“ When identifying, analysing and applying the comparable evidence, the potential purchaser and/or valuer should seek to ensure that it is:

- **comprehensive** – ideally a number of comparables rather than a single transaction or event.
- **very similar** – ideally identical to the item being valued.
- **recent** – i.e. representative of the current market the result of an arm's length transaction in the open market verifiable, so far as practicable consistent with local market practice.

.....**Challenges arise**, however, when considering assets that are less widely traded or that are rarely identical, which is often the case for real estate. In such circumstances the skills of the valuer assume a much greater importance.”

Property Valuation (BG3 ALT S6)

13. Applying the comparison method of valuation

Approach

- Select suitable comparables (comparable set).
- Extract relevant information.
- Analyse information including comparable sale prices, rental values, yields etc.
- Adjust sale prices, rentals, and yields for noted differences.
- Formulate an opinion of market value for subject property.

Figure 1: Simplified comparable analysis matrix (office rental)

	Comparable evidence			Subject
	2 Market Street	84 Bridge Street	14 Market Street	60 Bridge Street
Agreed rent (in local currency unit)	48,000	38,500	57,200	To be assessed
Net internal area (NIA) (m ²)	190	155	254	205
Rent per m ²	253	248	225	
Date	3 months ago	1 month ago	7 months ago	Now
Transaction type	Letting	Letting	Rent review	Rent review
Specification*	AC, L, RF	AC, L, RF	CH, L	CH, L, RF
Specification comparison	Better	Better	Slightly inferior	
Date adjustment (Rising market)	Lower than subject	No adjustment	Lower than subject	
Condition	Better	Better	Worse	
Location	Better	Better	Better	
Layout	Similar	Worse	Better	
Net qualitative adjustment (compared with subject)	Better	Similar	Slightly worse	

*Specification abbreviations: AC: air-conditioned; CH: central heating; L: lift; RF: raised access floors. Considerable expansion of these terms may be needed for individual cases, and valuers may also need to consider such matters as energy efficiency that are directed to use as well as to specification.

Property Valuation (BG3 ALT S6)

13. Applying the comparison method of valuation

When using the method for the valuation of commercial property, the following elements are some that can be compared and analysed:

- Rental income.
- Yield.
- Capital value.
- Quality of covenant.
- User restrictions.
- Lease terms.
- Condition of building.
- Car parking provision.

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13. Applying the comparison method of valuation

- The property must be a similar property with similar qualities.
- The comparables must be in close proximity.
- Transactions must be recent – the period of time applicable will be dependent on market conditions at the time of the transaction and current market conditions. This can dramatically change in a short period of time.
- Macro-economic conditions at the time of each comparable transaction must be considered.
- Any special considerations of the transaction should be taken into account.
- It should be ascertained if there was a special purchaser involved.
- The more evidence available the better the valuation.
- A thorough inspection of all underlying factors in the market must be made.
- Trends in market values should be observed.
- Consider who are likely purchasers in the marketplace, their requirements and purchasing power.
- A valuer must be extremely familiar with the market within which the valuation is being carried out and also with the local area within which the property is located.

Property Valuation (BG3 ALT S6)

14. Sources of comparable evidence

- Market Transactions.
- Direct transactional evidence.
- Publicly available information.
- Databases.
- The newspapers.
- Asking prices.
- Historic evidence.

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15. Hierarchy of Evidence

- It is important to understand how robust the evidence is that you have collated.
- The ability to weigh (or rank) evidence collected according to its relevance to the particular property being valued is an essential part of the valuation process.
- There are some additional factors to be considered for the hierarchy of rental evidence relating to the currency and nature of the agreement: open market letting, rent review and so on.
- Section 4.4. and Section 4.6 of the RICS Comparable evidence in real estate valuation (1st edn) for the Hierarchy of evidence.

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evidence
valuation



Next Lecture

Section 15 – Methods of Valuation – Investment Method Pt1