Intergovernmental Affairs
Assessment Services
Manitoba

ASSESSMENT*Facts*

Answering your questions about assessment

The Three Approaches to Value

There are three internationally accepted methods of measuring the value of property: the cost approach, the sales comparison approach and the income approach. Depending on the nature of the property being valued, one or more of the approaches may be used by the assessor.

Cost Approach

- The cost approach begins by establishing the value of the land on which the building sits, using sales of similar lands. To the land value is added the replacement cost of the buildings, less depreciation. In determining the replacement cost of a building the assessor considers such factors as age, size, condition, quality of construction and other features that influence value.

- The cost approach is best suited to value special purpose buildings that rarely, if ever, sell in the marketplace and which do not generate rental income to its owners. Examples of properties valued by the cost approach would include large industrial plants, communication towers, and institutional buildings such as schools and hospitals. The approach is also used in the case of new properties that have not been affected by the various forms of depreciation.

Sales Comparison Approach

- The sales comparison approach utilizes property sales information to estimate the value of unsold properties. Assessment Services receives the records of all sales of property from the Land Titles Office. Properties where sales have occurred are checked by staff to ensure that: (a) the amount of the sale value is correct; (b) there are no unusual circumstances surrounding the sale; and (c) the information on file accurately reflects the land/building characteristics which existed at the time of purchase. Information concerning sold properties is confirmed mostly through property inspections and phone calls. Sales that are “non-valid” are excluded from the sales analysis. Examples of sales which may be non-valid are family sales, mortgage sales, and estate sales.

- Land rates and building assessments can both be determined using the sales comparison approach. Location is one of the primary factors affecting market value. For this reason, municipalities within the Province are divided into "neighbourhoods". Sales within these neighbourhoods are analyzed using specially designed computer programs in combination with statistical analysis. Neighbourhoods can be analyzed independently or in "groupings". The purpose of grouping sales for sales analysis is to expand the sales base where sales patterns are similar. This helps to ensure equitable land and building assessments.

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- The majority of assessments are determined using the sales comparison approach. It is important to recognize that assessment is "mass appraisal" and as such it is different than the individual appraisal of properties. Assessment reflects the most probable market value of the property in the reference year. If your property sold in 2003 (reference year for the 2006 reassessment), your assessment will likely be close to the actual sale price but it need not be exactly that amount. The primary purpose of assessment is to ensure that similar properties receive similar assessments so that taxes are distributed fairly. Assessment is therefore more general than individual.

Income Approach

- For some properties, the income that they generate is the best indicator of their value. Properties like hotels, apartments and commercial buildings that are leased out generate income for their owners. It is this rental income that attracts a buyer and determines the selling price.

- To ensure accuracy by the income approach, it is essential that income and expense information, requested from the building owners, is submitted to the assessor. Information gathered is treated with the strictest of confidence.

- The income approach converts the net operating income of a property into an estimated market value through capitalization. The net operating income is the gross revenue generated by the property minus typical operating expenses. In most cases the actual income is not used in determining value but the typical revenue generated by similar properties is used. This ensures equitable tax distribution among similar properties. Typical expenses are those necessary to operate and maintain the property as well as provide for replacement. The capitalization rate is derived by dividing the net income of comparable properties that have sold into their sale prices. This rate is applied to a property's net income and the resulting figure is the estimated market value. Simply stated, the income approach equations are:

$$\frac{\text{Net Operating Income (sale property)}}{\text{Sale Price}} = \text{Capitalization Rate}$$

$$\frac{\text{Gross Income - Expenses}}{\text{Capitalization Rate}} = \text{Market Value}$$

- For purposes of the income approach, certain expenses are not allowable as deductions from the gross revenue. For example, this may include depreciation charges and debt service charges.

- It is important to note that the income approach is only one of the approaches to value used by the assessor to estimate market value. Replacement cost and sales comparison values are also considered and the most appropriate value for the circumstances is chosen.