



Appraisal Institute of Canada

Institut canadien des évaluateurs

Designation Examination ~ Canadian Residential Appraiser (CRA)

Sample Case Study Question

The Appraisal Institute of Canada's written designation examination tests your ability to apply the First Principles of Value (www.aicanada.ca/images/content/file/first_principles_of_value.pdf) by answering a series of questions that reflect "real life" work experience. Specifically, the examination consists of one case study worth 40 marks and three short questions each worth 20 marks, for a total of 100 marks. The complete exam is to be answered in a three hour period. Below is a sample case study question and answer to help you prepare for what to expect from the examination.

CASE STUDY QUESTION: TENURE ISSUE

You have been asked to establish the market value of a single family dwelling in a mature suburban area. It has come to your attention that the corner of the main building on the subject property encroaches on the neighbouring property by 17 inches.

1. Bearing in mind the First Principles of Value, how would you establish the value impact of this issue?
2. What specific issues would you pursue to assist in finding your conclusions?
3. In relation to function and purpose, how much would you research these issues?

This is an interesting question as this exact situation arose in a conversation I had with a former construction worker two weeks ago. He had been working with his brother-in-law, a contractor, who had inadvertently built a house 7 inches over a lot line. The outcome was the brother-in-law's bankruptcy.

Answers

The response to Questions 1 and 2 are addressed in the following section where information is given under each of the sub-headings of "First Principles." A separate answer to Question 3 is given at the end.

Question 1: *Bearing in mind the First Principles of Value, how would you establish the value impact of this issue?*

Question 2: *What specific issues would you pursue to assist in finding your conclusions?*

Problem Identification

Key to providing a response to this question is “Identifying the Problem”. The assignment is to establish the value impact of this issue. To begin with, the assumption is being made that value in this assignment relates only to market value. Next to be resolved is what is being impacted. There are two properties affected by the situation, the subject property with the house, and the neighbouring property where the house encroaches 17 inches over the lot line. It is not stated what type the neighbouring property is, i.e. whether it is an adjoining residential lot, a non-residential lot, or the public road. An assumption is made at this point that the neighbouring property is also a residential lot and that it is improved with a single-family dwelling.

The problem then would be to determine the value impact on both properties.

Property Content/Property Rights

First Principles divides this concept into four sub-sets:

1. *Physical understanding:* To understand the problem, both properties have to be understood. In the best case, current surveys of both properties would be available showing the shape and dimensions of both lots, and the position of the houses on both lots. This will allow the appraiser to understand the characteristics of the two sites, and the set backs that exist between the houses and their respective lot lines.
2. *Legal understanding:* The question does not state it, but it will be assumed that both properties are owned in “fee simple” title.
3. *Financial understanding:* In valuing a residence, the nature of the financing marketplace needs to be understood. In the current market, I am going to conclude that mortgage financing is available at interest rates and other terms similar to those that existed during the time period of the market data selected for analysis. There is no evidence that the market has fundamentally changed.
4. *Location understanding:* Nature of the neighbourhood and particularly its residents needs to be understood. Some neighbourhoods are characterized by fundamentally accommodating residents, while generally litigious people dominate others. Characteristics of the area residents will have to be understood in this assignment.

Property Rights

What property rights are to be valued, or in this case, what impact on value is caused by this situation to a property that has specified property rights. In this case, the rights of both properties are taken to be “fee simple”, and the impact to be addressed is to what extent this 17-inch encroachment affects the value of the fee simple interest in both lots.

Function/Purpose

To answer a question with respect to ‘Purpose’, the appraiser must first understand the objective of an assignment. In this case, the objective is to provide advice on the impact of this

encroachment, and as it is not clear in the question in relation to which property the answer relates, the response that will be given will be the value impact on both parcels of land.

As stated above, it is not clear in the question to whom this advice would be given, so the response that will be given will be the value impact on the owners of both parcels of land. The function of the assignment will be to provide advice to the client with respect to the impact of the problem on both properties.

Highest and Best Use

Highest and Best Use often is taken as a given, with the conclusion that the current use is the highest and best use. In this example, a situation exists that has to be addressed. The 17-inch encroachment can't be ignored and a solution has to be found. Options that exist to correct the problem would include moving the lot line or moving the house. In the condition of the property with the encroachment in place, neither property may be easily marketable, nor may their highest and best use be certain. It may not be possible to move the lot line; and it may be uneconomic to move the house.

Determining highest and best use in this scenario requires an understanding of what is legally possible with respect to moving the lot line, as well as the economics of moving the house, and what would happen if neither is possible, or if neither of the property owners is prepared to agree to a potential solution.

Land Use Regulations

One of the options that would be available to correct this situation is moving the lot line, i.e. selling some of the land from the lot where the house encroaches on, to be merged with the lot where the house was built. The appraiser must know the requirements of the zoning bylaw that governs the properties with specific reference to lot size and dimension minimums, yard set backs, and any other relevant regulations.

In the event the lot line were to be moved and if the now smaller lot size of the site onto which the house encroached did not meet the minimum requirements of the zoning bylaw, the appraiser would have to consider the likelihood of achieving a variance from the bylaw.

Economic Variables

To design a solution for this problem and answer the question as to the value impact of the encroachment, the appraiser will have to have an understanding of the economics of the community, typical residents and the potential costs of achieving a solution to the problem.

Value of improved residential properties in the neighbourhood will have to be well understood. Data will be needed to consider the value impact of varying lot sizes. Both properties in this scenario are affected. If the solution is to move the lot line, then one property will have a larger lot, and the other smaller. Is there a value impact resulting from the smaller size?

A remedy to the problem may be moving the house, and if so the cost of moving it back onto its proper lot needs to be estimated. This cost will have to be considered in relation to the value of the property after a move was completed. It is possible that the move may be economically unfeasible and could cost more than the value of the property after the move was completed.

Legal Issues

Issues that need to be determined include whether the encroachment could be legalized by an agreement between the parties. Further, it must be known if the owner of the property that is encroached upon has the legal right to a remedy, and what range of remedy options may exist. This goes beyond the scope of work of an appraiser, so the appraiser likely will have to get advice from legal counsel to the client.

Other legal aspects that must be addressed relate to zoning, lot severance and variance applications. Advice from legal counsel would have to be obtained in order to complete the assignment. The appraiser should not attempt to arrive at legal conclusions of his/her own.

Research

Completing any assignment requires information, and the degree to which research is necessary is a function of the problem to which an answer is sought. Some assignments may be answered with fairly basic research. In this instance it is concluded that the scope of research to be undertaken will have to be fairly extensive as the economic well being of two property owners is at stake.

Legal and land use planning advice will be essential for the appraiser to complete this assignment, and at a minimum competent legal counsel must be sought. Land use information can be researched by the appraiser, but it may equally be necessary to engage a land use planner to answer questions with respect to the likelihood of success in a variance application to move the lot line.

Research will be necessary on the estimated cost of relocating the house back onto its lot. Also, comparable market data will be needed to determine the value of both properties after the remedy to the encroachment is completed. This information will be considered in relation to the economic viability of completing the remedy.

Socio-economic characteristics of the neighbourhood in general and those of the owners of the two houses in question need to be addressed. A potential remedy that includes moving the lot line may not be achievable if the neighbour is intransigent. In the event a move of the lot line is agreed to by the neighbour, and is legally permitted, the cost of achieving a moved lot line, and the value impact of the now different lot sizes of both properties will have to be understood.

Question 3: In relation to function and purpose, how much would you research these issues?

The amount of research to be completed in this part of the assignment will vary depending on responses to initial questions between the appraiser and the client.

In advance of any detailed research the appraiser needs to know:

1. Who is the appraiser's client?
2. To what question does the client need/want an answer; i.e. is the value impact market value, and if so is the impact to be measured to both properties or one or the other?

Research on function then has to include an estimate of the level of real estate knowledge possessed by the client. An uninformed client will need more information and have it presented in an easily understood manner. The client will have to be interviewed to arrive at such a conclusion.

Some additional and low-level research will be needed on zoning regulations, neighbourhood characteristics and the availability of market data. Some communities will be easily researched, others not so, and in advance of understanding the scope of the function of a report, the appraiser will need to have an understanding on the availability of data and the difficulty in its collection, verification and analysis. At this point in the assignment, the data would not be researched, but its availability needs to be estimated.