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Accessory Dwelling Units May Have Higher Values when Using Income Approach: The Appraisal Journal

CHICAGO (Nov. 20, 2012) – Residential properties with accessory dwelling units — such as in-law apartments or coach houses — may have higher value potential if the properties are valued for investment income using the income capitalization approach, according to an article published this week in The Appraisal Journal.

The Appraisal Journal is the quarterly technical and academic publication of the Appraisal Institute, the nation's largest professional association of real estate appraisers. The materials presented in the publication represent the opinions and views of the authors and not necessarily those of the Appraisal Institute.

"Understanding and Appraising Properties with Accessory Dwelling Units," by Martin John Brown and Taylor Watkins, examines how to value properties with permitted ADUs — a concept that has been widely misunderstood by real estate professionals despite being promoted by some cities. In the article, the authors acknowledge that, in addition to providing social and environmental benefits, ADUs have legitimate income potential, and, when income is the basis for valuation, perceptions of the value of these properties can vary.

In the study, the authors test an income-based approach to valuing properties with ADUs. For 14 properties with ADUs in Portland, Ore., an income capitalization approach produced valuations that were significantly higher than actual sale prices, by 7.2 percent or 9.8 percent on average, depending on the formula used. ADUs also contributed on average 25 percent or 34 percent of each property's appraised value, depending on the formula used.

The study shows that appraisers requiring an alternative or counterpoint to the sales comparison approach for properties featuring ADUs can gain insight through the income approach, which may help them develop more credible and consistent valuations for this emerging form of development.

However, the authors emphasize that when an institution such as Freddie Mac forbids the income approach as the primary method of valuation, the income method can still play a role in the reconciliation phase, lending weight to any final opinion of value developed via the sales comparison or cost approaches.

Read Understanding and Appraising Properties with Accessory Dwelling Units in the Fall 2012 issue of The Appraisal Journal.

Also in The Appraisal Journal's Fall 2012 issue:

"An Alternative Sales Analysis Approach for Vacant Land Valuation," by D. Richard Wincott, MAI, shows a new appraisal approach that adjusts comparable sales by mirroring the price-quality decisions of buyers.

"The Effects of Mineral Interests on Land Appraisals in Shale Gas Regions," by Joseph B. Lipscomb, Ph.D., MAI, and J.R. Kimball, MAI, discusses mineral interests and the issues that appraisers must consider in regions affected by shale gas formations, including the dominance of the mineral estate.

"Haunted Flats: Quantifying the Value of Stigmatization in an Apartment Market," by K.F. Man and Vincent Wong, looks at the ways superstition may affect how people conduct economic activities. The authors find that sale prices for residences where an unnatural death has occurred are 7.5 percent lower than other apartments' prices.

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