How Commercial Properties Are Valued

Valuation Method: Income Approach

Our office looks at the commercial property the way a buyer would approach a market transaction: by examining its highest and best use through the three approaches to value.

- Income
- Sales comparison
- Cost

For income-producing properties, “the income approach is the preferred valuation approach” (International Association of Assessing Officers, Standard on Mass Appraisal of Real Property, Section 4.4). Our office primarily relies on the **income approach**, with secondary support and consideration from other approaches.

The **income approach** begins with analyzing income and expense data to determine typical gross incomes, vacancy rates, net incomes, and expense ratios for comparable types of properties. Income estimates can be transformed (capitalized) into estimates of building value in various ways. The CCAO uses **unloaded cap rates,** which,consistent with general real estate market analysis, account for expenses and real estate taxes in transforming income into estimated value.

Appendix 1: Market Research

We are a team of appraisers and analysts with combined decades of assessment and appraisal experience and leadership. We don’t have real-time income, expense, or vacancy information for every property, so we develop market estimates using reliable sources of market data that impacts value.

In our revaluation of Rogers Park Township in 2024, we incorporated data from the following sources:

- Past Appeal Information
- Bloomberg, a computer software system that enables access to a broad range of financial data
- CoStar, a leading source of commercial property rents and sales
- Moody’s REIS
- Trepp, which reports on appraisals and operations of properties receiving CMBS loans
- PWC, RERC, Realty Rates, and other national surveys
- CBRE, JLL, Cushman & Wakefield, IREM, and other leading reporting firms
- Local brokers, appraisers, and other market participants
- Properties’ websites to determine rents and property characteristics
- Public documents including construction permits
- RPIE, the Cook County Assessor’s platform for owners of commercial properties to submit property-associated income, expense, occupancy rates, and similar data.

Appendix 2: How the CCAO Determines Assessed Values for Commercial Properties Based on the Income Approach

Reassessment starts with revaluation. The majority of commercial properties are valued with the most weight given to the income approach. To produce a fair estimate of market value and a fair assessment of most commercial income-producingproperties during a reassessment year, the CCAO undertakes the following steps:

1. **Determine a property's use** by reviewing the property's history, including property class, tenants, business, and external photography of the parcel. It is important to understand the property's characteristics to accurately group it with similar properties.

2. **Estimate the Potential Gross Income (PGI)** generated by the property. Most often, rent is the primary source of income for commercial property.Other incidental income streams may include fees from parking or advertising signage. Expenses include property taxes, insurance, repairand maintenance costs, property management fees, and service expenditures for professional services. The CCAO derives market rent for properties from market data sources (shown on the prior page) and past appeal information.

3. **Derive market-level vacancy** based on location and property type. Some level of commercial property vacancy is normal and expected. The CCAO does consider reductions as a result of vacancy when a building is not serving its intended use due to conditions outside the control of the property owner, such as a casualty event or other localized factors, or new construction that has not yet been leased. The CCAO derives market rent for properties from market data sources (shown on the prior page). The Effective Gross Income (EGI) is the result after deducting a market vacancy from the PGI.

4. **Derive market-level operating ratio,** which is a combination of non-real estate tax expenses and real estate taxes. Applicable real estate operating expenses include property taxes, insurance, repair and maintenance costs, property management fees, and service expenditures for professional services. A market operating ratio is deducted from the EGI to arrive at the Net Operating Income (NOI).

5. **Produce capitalization rates.** Once we've been able to recreate a snapshot of a property's income statement based on market data, we use a standard valuation metric called a "capitalization rate" to convert income to value. This capitalization rate (or cap rate) quantifies the relationship between a single year's NOI (income minus expenses) and the total property value.

   <u>Cap rates have an inverse relationship to value.</u> Properties with lower cap rates tend to have higher values. Properties with higher cap rates tend to have lower values.

   The Cook County Assessor only uses unloaded capitalization rates when deriving market values for properties. The cost of real estate taxes is included in the operating expense ratio, which eliminates the need to load the capitalization rate. The South and West suburbs have varying tax rates, which is reflected in the varying operating expense ratios of different townships and municipalities.

6. **To estimate building value, divide its estimated income by cap rate.** A property with $100,000 of net income, divided by a 9.5% cap rate, has an estimated market value of $1,052,631. A 6.5% cap rate generates an estimated market value of $1,538,461.

7. **Apply Level of Assessment, per County ordinance.** A property's assessed value depends on its market value and its level of assessment (LOA). Since 1973, the Cook County Board has passed ordinances to set different levels of assessment depending on the property's use. Multifamily properties have a 10% LOA. A multifamily building valued at $1,000,000 has an assessed value of $100,000. Commercial properties like office and retail buildings have a 25% LOA. A commercial building valued at $1,000,000 has an assessed value of $250,000.

   Note that the CCAO administers incentives that permit a reduced assessment for some multifamily, commercial, and industrial properties. The goal of these programs is to promote economic development and neighborhood vitality.

8. **Send notice of reassessment.** Many buildings are divided into multiple Property Index Numbers (PINs). Owners of multiple PINs will receive multiple reassessment notices containing the assessed value of each PIN.