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不動産鑑定評価基準 英訳

Japan Real Estate Appraisal Standards

English Translation

公益社団法人 日本不動産鑑定士協会連合会  
国際委員会

○ **実務指針**

「実務指針」とは、指針の制定改廃に関する規程第 3 条第 2 号の規定に基づき、不動産鑑定士が不動産鑑定評価等業務に係る実務を行うにあたり指針とすべきものとして、かつ当該業務の適正さを確認するための指針として公益社団法人日本不動産鑑定士協会連合会（以下、「本会」という。）が公表するもので、不動産鑑定士が当該業務を行う際には準拠するものとし、準拠できない場合又は他の方法に拠る場合は、その合理的な根拠を明示しなければならないものをいう。

○ **業務指針**

「業務指針」とは、上記規程第 3 条第 3 号の規定に基づき、不動産鑑定業者が不動産鑑定業を営むにあたり指針とすべきものとして、かつ不動産鑑定評価等業務に係る実務の適正さを確認するための指針として本会が公表するもので、不動産鑑定業者が、不動産鑑定業を営む際には、原則として準拠しなければならないものをいう。

○ **研究報告**

「研究報告」とは、上記規程第 3 条第 4 号の規定に基づき、本会が調査研究して作成した成果物のことをいい、不動産鑑定士にあつては不動産鑑定評価等業務を行うに際して、不動産鑑定業者にあつては不動産鑑定業を営むに際して、それぞれ参考になるものとして本会が公表するものをいう。

本書は、上記の内、「**研究報告**」に該当します。

## 本研究報告策定の背景

我が国の不動産鑑定評価制度の根幹をなす「不動産鑑定評価基準」については、未だ英訳が整っていない。過去においては、英訳されたものが書籍等として販売されている（巻末の参考資料ご参照）が、現時点において、不動産鑑定評価基準の最新の内容が反映された英訳は存在しない。

グローバルに企業・投資家が活動する現在の社会において、日本の不動産鑑定評価基準の理解を促進し、日本の不動産鑑定評価・制度に対する信頼を確固たるものとするためには、不動産鑑定評価基準の英訳は必須であると考えます。

加えて、東南アジアを中心とした諸外国の不動産鑑定評価制度・基準の高度化を支援していく上でも、英訳をもってコミュニケーションを促進していく必要があると考えます。

また不動産鑑定士にとっては、不動産鑑定評価基準の英訳が無償で誰にでも入手可能となることにより、海外顧客とのビジネス拡大に資することになると考える。さらに、不統一な英訳により発信された英文の不動産鑑定評価書等に関わる信用リスク・金銭的（損害賠償）リスク管理の観点からも、不動産鑑定評価基準の英訳が整うことは、不動産鑑定業界全般の利益になるものと考えます。

上の状況を踏まえ、不動産鑑定士協会連合会として、不動産鑑定評価基準の統一の英訳として発信することを念頭に、国際委員会・国際評価実務小委員会にて英訳を作成したものである。

以上

- 不動産鑑定評価基準の制定者
  - Enactor of Japan Real Estate Appraisal Standards
  - 国土交通省
  - The Ministry of Land, Infrastructure, Transport and Tourism
  
- 不動産鑑定評価基準の沿革
  - History of Japan Real Estate Appraisal Standards
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  - Completely revised on 3 July 2002
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# JAPAN REAL ESTATE APPRAISAL STANDARDS ENGLISH TRANSLATION

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## **GENERAL STANDARDS (GS)**

### **CHAPTER1. FOUNDATIONS OF REAL ESTATE APPRAISAL**

It is essential for a Licensed Real Estate Appraiser (LREA; hereinafter "Appraiser") to fully understand what is involved in the appraisal of real estate, why appraisals are necessary, the role that appraisals play in society, and what is required of Appraisers and Appraiser candidates.

#### **Section 1. Real Estate and Its Value**

Real estate ordinarily refers to land and improvements upon the land. Because of its utility, land is indispensable for all human activity. Real estate reflects the relationship between the various uses people make of land as well as people's lives and activities. This relationship between people and land becomes tangible when it is based on what makes up real estate and the ways it contributes to human needs.

The interaction of natural, social, economic, and governmental factors helps to determine the configuration of real estate, which accounts for its economic value. The economic value of real estate in turn represents the main criterion in the selection of its optimal configuration.

The value of real estate is typically indicated by economic value or a monetary amount that results from the interaction of three elements:

- (1) recognized utility
- (2) relative scarcity
- (3) and effective demand.

The economic value of real estate is basically determined by natural, social, economic and governmental factors that influence the three elements listed above. The relationship between real estate value and these four factors is two-sided: the value of real estate is formed under the influence of these factors while at the same time the value itself influences these factors, since the value also becomes a criterion for the selection of real estate.

#### **Section 2. Characteristics of Real Estate and Its Value**

Although the degree to which real estate contributes to the lives and activities of people is expressed as its price, land has characteristics different from other ordinary assets:

- (1) physical aspect: fixed geographical location, immovability, durability, finite supply, and nonfungibility; land parcels cannot be substituted for or interchanged with one another.
- (2) socioeconomic aspect: changeable social and economic utility and status (potential uses

could be competitive or complementary; uses could also be changed), and physical adaptability (land parcels can be divided or consolidated).

The social and economic utility of real estate depends on whether the characteristics of the land meet the specific physical and socioeconomic requirements for the intended use. The type of use and the social and economic utility of real estate can vary based on changes in these requirements.

In addition, because real estate shares common physical and socioeconomic attributes, all real estate represents a component of a regional or local market, depending on or complementing other real estate in that market, competing with or supporting similar real estate in that market, and demonstrating its social and economic utility through these relationships (called the regionality of real estate).

Although regional and local real estate markets differ by size, composition, and function, all of these markets are identified by their land use and are based on the relationship to specific physical and socioeconomic requirements in the same way as individual real estate. While regional and local markets have characteristics that distinguish them from other regional and local markets, they also maintain a mutual relationship with markets in other regions, and occupy a social and economic position through a mutual relationship (called the characteristics of the region).

Because of these characteristics of real estate, real estate price can be distinguished from the price of other ordinary assets:

- (1) The value of real estate represents price in exchange, but real estate value is also indicated by rent paid as compensation for the right to occupy and use a property. This correlation between price in exchange and rent can be seen in the relationship between capital and benefits.
- (2) The price of real estate reflects the compensation paid for the ownership interest. The right to use or occupy a leased fee estate is compensated in the form of rent, which represents economic profit to the lessor. In situations where two or more property rights are involved, or lessor profits derive from, the same real estate, the price (or rent) can be formed for each property right as well as the lessor's profit.
- (3) Regional or local real estate markets are not static, but rather they are continually changing, expanding or contracting, concentrating or dispersing, growing or declining. Judging whether or not the use of real estate is optimal requires continual review to see whether or not the real estate is able to maintain optimal utility over time, even if it is currently under optimal use. So, the price (or rent) of real estate normally depends on long-term considerations, extending from the past into the future. The current price (or rent) is an extension of yesterday, a reflection of tomorrow, and in the process of

continual change.

- (4) The sale price of real estate is normally based on the specific circumstances of the transaction. Moreover, the sale price is also influenced by the individual attributes of the real estate. It could be extremely difficult for ordinary people to determine the appropriate value of real estate from looking at the sales price. For this reason, an appraisal by an Appraiser, as an expert, is essential for determining the appropriate value of real estate.

### **Section 3. Real Estate Appraisals**

Because the characteristics of real estate differ from those of other ordinary assets, it is necessary to rely on Appraisers to determine the appropriate value.

Real estate appraisals are estimates of the economic value of real estate as a monetary amount. This process consists of determining an indication of the level of value and/or rent that the real estate is able to sustain within certain value parameters. Appraisals have these steps:

- (1) gaining an accurate perception of the real estate
- (2) effectively gathering and organizing all the required data
- (3) fully understanding the factors that form the value of real estate, along with the principles related to real estate value
- (4) applying appraisal methods
- (5) while analyzing all related data that has been gathered and organized, and considering the effects of natural, social, economic, and governmental factors on the real estate
- (6) and then reaching a final judgement of the economic value of the real estate in a monetary amount.

How well an appraisal is performed depends on the abilities of the Appraiser carrying out the successive stages of the appraisal as well as how completely those abilities have been applied. How well an appraisal is done also depends on the quality of the collection and the organization of the required data plus the skill in analyzing and interpreting that data. So, appraisals can only be rationally and objectively performed when they are done by skilled specialists, having sophisticated knowledge, extensive experience, and proven judgement skills, and who are also able to apply these abilities systematically and thoroughly.

The objective of real estate appraisal is to estimate the appropriate value or an indication of the probable market value of real estate in a market operating rationally under a set of economic circumstances. When performed by skillful experts, as demonstrated by the professional work of Appraisers, a real estate appraisal can be seen as the judgment or opinion of an expert on the value of real estate.

Since a real estate appraisal also reflects the value of a property within value parameters, an

appraisal's social and public significance must be considered to be extremely wide ranging.

#### **Section 4. Responsibilities of Appraisers**

Land use and transactions must follow the requirements that are set out in the Basic Act for Land. In particular, land should not become the target of speculative transactions. Appraisers must conduct real estate appraisals that follow this requirement.

Appraisers are recognized by the Real Estate Appraisal Act as being people charged with appraising real estate, who have the status of being capable and knowledgeable specialists, and who have been granted that status by attaining certain qualifications. For these reasons, Appraisers are required to earn the trust and to meet the expectations of society. They must understand the social and public significance of real estate appraisal, be aware of their own responsibilities, and perform appraisals accurately and with integrity.

To accomplish these tasks, Appraisers have to make real estate appraisals impartially and follow a strict ethical code and all legal requirements; they must not act in any way that could damage the trust society has placed in them as specialized professionals. In addition, Appraisers must not disclose to anyone, without proper cause, any confidential information that is learned while carrying out their duties, and they must strive to maintain their reputation by strictly observing these five guidelines:

- (1) Since accurate appraisals can only be developed through the systematic integration of sophisticated knowledge, extensive experience and proven judgmental skills, appraisal skills must be improved through continuing study and training.
- (2) Appraisers must not only be able to provide clients with easily understandable and impartial explanations of appraisal results, but they must make every effort to raise the level of trust in real estate appraisals by educating the public on real estate appraisals and practices.
- (3) During a real estate appraisal, the Appraiser must maintain a fair and reasonable attitude regardless of his or her own interests or for any other reasons.
- (4) During a real estate appraisal, the Appraiser must take special care as a professional.
- (5) When appraisal assignments that are thought to exceed the limits of an Appraiser's abilities or that involve associations or special interests that might prevent reaching a fair or impartial appraisal, the Appraiser should, as a matter of principle, not accept these types of assignments.

## **CHAPTER 2. USE CATEGORY AND INTEREST CATEGORY OF REAL ESTATE**

When appraising real estate, it is necessary to analyze the real estate based on its area characteristics, physical utilization and state of interests. It is important to consider on above based on the type of real estate, which is characterized by its area.

The type of real estate represents composite concepts or real estate, comprising from, the use and interest categories. Since these two categories essentially determine the economic value of real estate, it is only possible to conduct highly accurate appraisals of real estate after first analyzing from these two categories.

The use category of real estate refers to real estate classified with respect to its use, and the interest category of real estate refers to real estate classified by its physical utilization and the status of interests.

### **Section 1. Use Category of Real Estate**

#### **I. Use Category of Area**

The use category of area can be classified into building site area, agricultural area, forestland area, and similar.

A building site area refer to an area where it is considered reasonable from the natural, social, economic, and administrative perspectives to be used as a site for buildings and structures for living, commerce, and industrial production, and can be categorized into residential area, commercial area and industrial area. Residential area, commercial area and industrial area can be further subcategorized according to their size, specific characteristics, and function.

An agricultural area refers to an area where it is considered reasonable from the natural, social, economic, and administrative perspectives to be used for cultivation for agricultural production.

A forestland area refers to an area where it is considered reasonable from natural, social, economic, and administrative perspectives to be used for planting and growing trees, bamboo, or special forest products for forestry production.

Note that among building site area, agricultural area and forestland area, there are some areas that are undergoing conversion from one use category to another use category, and that within building site area and agricultural area, there are areas that are undergoing transition from one use subcategory to another use subcategory.

#### **II. Use Category of Land**

The use category of land is classified according to the use category of area. It is classified into building site, agricultural land, forestland, land with prospective use, and land with transitional use, and are further classified into subcategories based on the use category of the area.

The building site refers to land located in the building site area, which can further be subcategorized into residential, commercial, industrial, and other sub-categories. Residential land refers to land in a residential area; commercial land refers to land in a commercial area; and industrial land refers to land in an industrial area.

Agricultural land refers to land in an agricultural area.

Forestland refers to land (excluding standing trees and bamboo) in a forestland area.

Land with prospective use refers to land in an area undergoing conversion from one use category to a different use category between building site area, agricultural area and forestland area. It can be subcategorized into land with prospective use for a building site, land with prospective use for agricultural, and others.

Land with transitional use refers to land located within building site area or agricultural area that is undergoing transition from one use subcategory to a different use subcategory.

## **Section 2. Interest Category of Real Estate**

The following provide examples of the interest category of building site and building and its site:

### **I. Building Site**

The interest category of a building site can be classified into vacant land, the land portion of a building and its site, leasehold interest in land, leased fee interest in land, and sectional superficies (air/underground rights) based on the physical utilization and status of interest.

Vacant land refers to a building site on which no building or other improvements stands and where there is no legal or deed restriction on use and earning a profit.

The land portion of a building and its site refers to a building site on which buildings stand and where the buildings and the land are owned by the same owner.

Leasehold interest in land (shakuchiken) refers to leasehold interest in land (superficies (chijoken) for the purpose of owning building or leasehold interest in land (chinshakuken) as defined in the Act on Land and Building Leases (Shakuchishakka-ho; including the Land Lease Law (Shakuchi-ho), before it was revoked).

Leased fee interest in land refers to ownership of a building site where leasehold interest in land exists.

Sectional superficies (air/underground rights) refer to superficies established

underground or in the air to own improvements.

## II. Building and Its Site

The interest category for a building and its site can be classified into an owner-occupied building and its site, a tenant-occupied building and its site, a building and its leasehold land, and a condominium unit and its site, based on physical utilization and status of interest.

An owner-occupied building and its site refers to a building and its site where the building and the landowner are the same, and where there is no legal or deed restriction for the owner to use and earn profit.

A tenant-occupied building and its site refers to a building and its site where the building and the landowner are the same, but the building is leased.

A building and its leasehold land refers to a building and its site where a building exists with the leasehold rights on the land.

A condominium unit and its site refers to an exclusively owned area as defined in Article 2, Paragraph 3 of the Law for Unit Ownership of Building (Tatemono no Kubunshoyu ni kansuru Horitsu), co-ownership of the common area for the exclusively owned area as defined in Article 2, Paragraph 4 of the same act; and the use right of the land (*shikichiryoken*) as defined in Article 2, Paragraph 6 of the same act.

## CHAPTER 3. INFLUENCES ON THE FORMATION OF REAL ESTATE VALUE

Factors influencing the value of real estate (or value influence factors) refer to (1) those factors that affect the utility of the real estate, (2) its relative scarcity, and (3) the effective demand for real estate. Although real estate value is formed as a result of the interaction of numerous factors that influence value, those value influence factors themselves tend to continually change. So, when appraising real estate, it is necessary to clearly understand how market participants view value influence factors, as well as to sufficiently analyze the changes, trends, and the interrelationships among the value influence factors and to evaluate the effect of the influences on the three factors listed above.

Value influence factors are classified into general factors, area specific factors, and property specific factors.

### Section 1. General Factors

General factors refer to factors that have an effect on the features of real estate within general

economic society and on the price level. These are broadly classified into natural, social, economic, and administrative factors.

Following list shows examples of major general factors:

I. Natural Factors

1. geological and ground condition
2. soil and soil layer
3. topography
4. geographical location
5. climate.

II. Social Factors

1. population
2. family configuration and household formation
3. urbanization and public infrastructure development
4. education and social welfare
5. transactions, use, and earning practices of real estate
6. architectural styles
7. development of informatization
8. lifestyles.

III. Economic Factors

1. savings, consumption, investment, and foreign trade balance
2. fiscal and monetary conditions
3. commodity prices, wages, employment, and corporate activity
4. taxation
5. corporate accounting system
6. technological innovations and industrial base
7. transportation system
8. globalization.

IV. Administrative Factors

1. land use planning and regulations
2. building codes and mandatory disaster prevention safeguards
3. policies related to building sites and housing developments
4. real estate taxation
5. regulations that apply to real estate transactions.

## Section 2. Area-Specific Factors

Area-specific factors refer to factors that form area-specific characteristics for size, composition, and function based on relationships with general factors and that have an overall effect on the formation of the value of real estate in a specific area.

### I. Building Site Area

#### 1. Residential area

Following list shows examples of major area-specific factors in residential area:

- (1) climate, including sunlight, temperature, humidity, and wind direction
- (2) street width and structure
- (3) distance from the city center and availability of transportation
- (4) nearness to commercial facilities
- (5) waterworks, city gas service, garbage disposal, and sewers
- (6) development of telecommunications infrastructure
- (7) location of public institutions and utilities
- (8) presence of nuisances, such as sewage treatment plants
- (9) risk of flooding, landslides and other natural disasters
- (10) noise, air pollution, and soil contamination
- (11) lot size, layout, and use
- (12) residences, hedges, landscaping, and street appearance
- (13) quality of the natural environment, including scenic views
- (14) land use planning and regulations.

#### 2. Commercial Area

Following list shows examples of major area-specific factors of commercial area in addition to the area-specific factors listed above (section 1):

- (1) types, sizes, and concentration of commercial or service facilities
- (2) quality and size of trade and customer profile
- (3) availability of transportation for customers and employees
- (4) convenience for loading and unloading merchandise
- (5) street accessibility and additional features, such as covered arcades
- (6) business types and their competition
- (7) entrepreneurship and financial resources for business owners in the area
- (8) volume of automotive and/or pedestrian traffic
- (9) available parking
- (10) degree of governmental assistance and regulation.

### 3. Industrial Area

Following list shows examples of major area-specific factors of industrial area in addition to the area-specific factors listed above (section 1):

- (1) arterial roads, railroads, harbors, airports, and other transport networks
- (2) availability of a workforce
- (3) location of consumer market(s) and industrial suppliers
- (4) power, water, and drainage costs
- (5) location of related industries
- (6) risk of water and/or air pollution
- (7) degree of government assistance and regulations.

## II. Agricultural Area

Following list shows examples of major area-specific factors of agricultural area:

1. climate, including sunlight, temperature, humidity, wind, and rainfall
2. topography, including rolling hills, elevated highlands, and lowland areas
3. soil
4. water utilization and water quality
5. risk of flooding, landslides, and other natural disasters
6. condition of roads
7. location to rural communities
8. location to distribution center(s) and farms
9. distance from consumer market(s) and availability of transportation
10. degree of governmental assistance and regulations.

## III. Forestland Area

Following list shows examples of major area-specific factors of forestland area:

1. climate including sunlight, temperature, humidity, wind and rain
2. altitude and topography
3. soil and soil layers
4. condition of forest roads
5. availability of a workforce
6. degree of governmental assistance and regulation

For an area undergoing conversion or transition from one use category to another, more emphasis should be placed on area-specific factors after the conversion or transition. However, if the conversion or transition is still in the early stages, more emphasis should

be placed on area-specific factors before the conversion or transition.

### Section 3. Property-Specific Factors

Property-specific factors refer to factors that provide real estate with individuality and form the value of individual properties. Property-specific factors are classified according to land and building category.

#### I. Property-Specific Factors for Land

##### 1. Building Site

###### (1) Residential Land

Following list shows examples of major property-specific factors of residential land:

- ① topography, geology, and ground soil
- ② sunlight, wind, dryness, and wetness
- ③ lot width, depth, size, and shape
- ④ difference in level, corner lot, or any other positioning to facing street
- ⑤ width and condition of the facing street
- ⑥ layout and network of the facing street
- ⑦ distance from transportation
- ⑧ proximity to commercial facilities
- ⑨ proximity to public institution and utilities
- ⑩ proximity to nuisances , such as sewage treatment plants
- ⑪ condition of adjacent real estate and surroundings
- ⑫ availability and usability of water supply, sewage system, and gas services
- ⑬ usability of telecommunications infrastructure
- ⑭ presence of buried archeological artifacts and the condition of underground structures
- ⑮ presence and extent of soil contamination
- ⑯ regulations or restrictions specified in public laws and private deeds.

###### (2) Commercial Land

Following list shows examples of major property-specific factors of commercial land:

- ① topography, geology and ground soil
- ② lot width, depth, size and shape
- ③ difference in level, corner lot, or any other positioning to facing street

- ④ width and condition of the facing street
- ⑤ layout and network of the facing street
- ⑥ proximity to center of commercial area
- ⑦ proximity to main transportation systems
- ⑧ location in conformity with customer flow
- ⑨ condition of adjacent real estate and surroundings
- ⑩ availability and usability of water supply, sewage system, and gas services
- ⑪ usability of telecommunications infrastructure
- ⑫ presence of buried archeological artifacts and condition of underground structures
- ⑬ presence and extent of soil contamination
- ⑭ regulations or restrictions specified in public laws and private deeds.

### (3) Industrial Land

Following list shows examples of major property-specific factors of industrial land:

- ① topography, geology, and ground soil
- ② lot width, depth, size and shape
- ③ difference in level, corner lot, or any other positioning to facing street
- ④ width and condition of the facing street
- ⑤ layout and network of the facing street
- ⑥ proximity to main transportation systems used by employees for commute
- ⑦ location of arterial roads, railroads, harbors, airports and other transport networks
- ⑧ condition of electric other power resources as well as the difficulty in leading in
- ⑨ availability and condition of drainage
- ⑩ availability and usability of water supply, sewage system, and gas services
- ⑪ usability of telecommunications infrastructure
- ⑫ presence of buried archeological artifacts and condition of underground structures
- ⑬ presence and extent of soil contamination
- ⑭ regulations or restrictions specified in public laws and private deeds.

## 2. Agricultural Land

Following list show examples of major property-specific factors of agricultural land:

- (1) sunlight, dryness, wetness, and rainfall
- (2) soil condition
- (3) presence and condition of farm roads
- (4) irrigation and drainage
- (5) ease of cultivation
- (6) proximity to rural communities
- (7) proximity to shipping area
- (8) risk of disaster
- (9) regulations or restrictions specified in public laws and private deeds.

## 3. Forestland

Following list shows examples of major property-specific factors of forestland:

- (1) sunlight, dryness, wetness, and rainfall
- (2) altitude above sea level and topography
- (3) soil condition
- (4) ease of carrying out and transporting lumber
- (5) ease of management
- (6) regulations or restrictions specified in public laws and private deeds.

## 4. Land with Prospective Use and Land with Transitional Use

For land that is undergoing conversion or transition from one use category to another, more emphasis should be placed on property-specific factors after the conversion or transition. However, if the conversion or transition is still in the early stages, more emphasis should be placed on property-specific factors *before* the conversion or transition.

## II. Property-Specific Factors on Building

Following list shows examples of major property-specific factors of building that are common to all uses:

1. age of the structure (new structure, extension, reconstruction, etc., or relocation)
2. size, height, type of construction, and materials
3. functionality of design and equipment

4. construction quality and dimensions
5. building quality for earthquake resistance, fire resistance, etc.
6. maintenance and management
7. presence of harmful substances and extent of contamination
8. conformity of building with its environment
9. regulations or restrictions specified in public laws and private deeds.

Note that property-specific factors that market participants focus on for transactions vary by the building use.

### III. Property-Specific Factors on Building and Its Site

In addition to the examples in I and II above, other major examples of property-specific factors on building and building site include the layout of the building, parking lots, pathways, and gardens within the site, overall compatibility between building and site especially for the size of the building relative to the site, the quality of planned repairs and the management program as well as the extent of their implementation.

In addition, property-specific factors on property for lease include how well the property is operated. Major examples are indicated below:

1. status of the lessee and provisions in the lease contract
2. occupancy level of a leased property
3. type of ownership for structures, facilities, interiors, etc., and responsibility for repair expenses, etc.

## **CHAPTER 4. PRINCIPLES OF REAL ESTATE VALUE**

The value of real estate is made up of the interaction of several factors that affect the utility, relative scarcity, and the effective demand for that real estate. When the process of value formation is studied, basic economic laws or principles are in play. At the heart of real estate appraisal is the investigation and analysis of the process of value formation. Therefore, to reach an appropriate final judgment on the economic value of the real estate, it is necessary to recognize these rules as guidelines that are required for an appraisal and to use the principles below that concretely express them.

Although these principles are based on general economic rules, they are recognized and expressed from the standpoint of an appraisal.

Note that these principles are not independent of one another, but rather are directly or indirectly related.

### I. Principle of Supply and Demand

While the value of a commodity is determined by the relationship between the supply of and demand for that commodity, the value of that commodity could also have an effect on the supply and demand.

The value of real estate is determined by the relationship between supply and demand, but real estate also has physical characteristics and socioeconomic characteristics that differ from the attributes of other commodities. The effect of these additional characteristics is reflected in the dynamics of real estate supply and demand and the formation of real estate value.

## II. Principle of Change

In general, the value of a commodity changes as the value influence factors change.

The value of real estate is also formed within a continual process of change that reflects an array of various cause and effect relationships among the value influence factors. The value influence factors themselves undergo constant change. So, when appraising real estate, the dynamic cause and effect relationships among the factors should be understood. In particular, the process of change must be analyzed in order to determine the highest and best use of the property (see paragraph IV below).

## III. Principle of Substitution

In cases where two or more commodities are interchangeable, the value of these commodities is determined by the mutual effect they have on one another.

The value of real estate is also formed in relation to the value of other substitute real estate or commodities.

## IV. Principle of Highest and Best Use

The value of real estate is analyzed on the premise of the potential best use of the real estate, i.e., the use under which the real estate will achieve its maximum utility (highest and best use). The highest and best use is an objective indicator of that use, which under real socioeconomic circumstances is both rational and legally permissible and that is also practicable for someone having common sense and an ordinary ability to operate the property under that use.

Note that the actual use of a property is not necessarily the highest and best use for that real estate. A use based on irrational or personal circumstances could result in underutilization of the real estate.

## V. Principle of Balance

It is necessary for the elements of real estate to be in balance in order to achieve that real estate's maximum profitability or highest amenity. So, in order to estimate the highest and best use of real estate, it is necessary to analyze whether or not a balance of the elements has been achieved.

#### VI. Principle of Increasing or Decreasing Returns

When an investment is continually increased by a definite amount, the gross income from the investment increases with each increment. However, although the income corresponding to each increment increases up to a certain point, it eventually reaches the point of diminishing returns where it begins to *decrease*.

This principle applies to additional capital investment in real estate as well.

#### VII. Principle of Income Allocation

Gross income generated from the combination of land, capital, labor, and management (organization) should be allocated to each of these elements. Therefore, that portion of gross income remaining after the other portions have been allocated to capital, labor, and management (organization) can be attributed to the land, provided the allocation has been made correctly.

#### VIII. Principle of Contribution

The degree that each component of real estate contributes to income generated by the overall real estate has an effect on the total real estate value.

This principle is especially useful when considering the viability of additional investment in the property when determining the highest and best use.

#### IX. Principle of Conformity

It is necessary for real estate to conform to the environment in order to achieve maximum profitability or highest amenity. So, it is necessary to analyze whether or not that real estate conforms with its environment when determining the highest and best use.

#### X. Principle of Competition

In general, excess profit stimulates competition, while competition reduces excess profit and could ultimately eliminate any excess. For real estate in particular, a competitive relationship is also seen both among properties and between properties and other commodities striving to gain excess profit through use. Therefore, the value of real estate is shaped by this competition.

#### XI. Principle of Anticipation

The value of a commodity is determined in anticipation of future profitability.

The value of real estate is also influenced by the anticipation of market participants to the changes in value influence factors.

## CHAPTER 5. BASIC APPRAISAL PREMISES

The identification of 1) the subject property, 2) the date of value, and 3) the type of value or rent are at the foundation of real estate appraisal.

### Section 1. Identification of the Subject Property

When appraising real estate, it is necessary to identify the physical characteristics of the land and/or building to be appraised as well as the property rights, i.e., fee simple and the other interests.

The identification of the subject property is required to clearly recognize and distinguish the property from other real estate, which should ultimately be verified by an Appraiser when confirming that the actual use of the property conforms with the purposes and conditions of the appraisal.

#### I. Requirements for the Subject Identification

1. The items required for an identification of the subject real estate are defined as the requirements for the subject identification.

The requirements for the subject identification are what is needed to identify physical characteristics, such as the location and dimensions of the property as well as the status of interests in the property, e.g., fee simple and leasehold interest.

The following list shows the requirements that correspond to the purpose of an appraisal:

- (1) When an appraisal is based on the "as is" condition, where the real estate could be the land alone or a combination of the land and buildings.
- (2) When real estate is a combination of land and buildings, only the land is to be appraised, assuming the buildings did not exist. (The appraisal in this case is referred to as the appraisal as if it were vacant land.)
- (3) When the real estate is a combination of land and building(s), either the land or the building is to be appraised as a component, based on the condition that the other component exists. (The appraisal in this case is referred to as a component appraisal.)

- (4) When the appraisal is based on an assemblage or subdivision, the real estate to be appraised is real estate after the assemblage or subdivision. (The appraisal in this case is referred to as assemblage or subdivision appraisal.)
- (5) For land where site construction has not been completed or for building where construction (including new construction, extensions, or renovations) has not been completed, an appraisal is conducted on the assumption that the construction is complete. (The appraisal in this case is referred to as an appraisal for a property to be completed, etc.)

In addition to those listed above ((1) through (5)), a property can be valued with different conditions from the date of the value that are related to ownership or interests in the property.

2. When setting the requirements for identification, the validity of the requirements must be confirmed in light of the purpose of the appraisal. Confirming the validity must be done so that any of the benefits to any intended user of the appraisal report is not in jeopardy after the investigation and approval of any matters related to the property.

Also, when conducting an appraisal for a property to be completed in addition to considering the requirements described above, it is necessary to collect architecture plans for identifying any physical characteristics after completion based on the date of value and construction agreements to confirm the identification of ownership and interests associated with the completed property.

Finally, it is necessary to obtain any permits and approvals required by law and to determine that completing construction is realistic in light of the ability of the builders to secure financing.

## II. Assumptions for Area-Specific or Property-Specific Factors

Although there are cases where a client requests the Appraiser to make certain assumptions or limiting conditions on the effect of area-specific or property-specific factors for the property, these assumptions and limiting conditions imposed by the client must be reasonable, realistic, and legitimate. The Appraiser must be objective, so the benefits for any intended user of the appraisal report are not jeopardized.

In general, when the assumptions and limiting conditions for area-specific factors are reasonable, these are usually limited to matters provided by the official agencies with the authority to alter, revise, or end planning projects as well as any regulations.

## III. Conditions to the scope of investigation

For the scope of a standard investigation by an Appraiser, when there are specific value influence factors that make it difficult to confirm their impact on the value of the real estate, conditions on the scope of the investigation can be set based on any of the value influence factors. However, the conditions on the scope of investigation should be adopted only when it is determined that these conditions do not jeopardize the benefits for any intended user of the appraisal report.

IV. Limitations on conditions when an appraisal has a significant impact on the benefits of any intended user of the appraisal report

When an appraisal has a significant impact on the benefits of any intended user of the appraisal report, such as an appraisal of a property for securitization (outlined in Section 1 of Chapter 3 of the specific standards) and an appraisal of real estate for investment under the Companies Act, in principle, any of assumptions, limiting conditions, or any condition to the scope of the investigation, related to any of the requirements for the subject identification, area-specific or property-specific factors, which are different from the actual usage or situation of the subject property, must not be adopted.

However, if the appraisal of a property for securitization meets the requirements outlined in Section 2 of Chapter 3 of the specific standards, an appraisal for a property to be completed can be completed.

V. Consent from client on additional conditions

1. The adoption of additional conditions must be in the appraisal contract and agreed upon with the client.
2. When it is recognized that adopting additional conditions is not appropriate, it is necessary to revise the conditions, after explaining this to the client.

## **Section 2. Identification of the Date of Value**

Since value influence factors change over time, the value of real estate is only valid on the day of the value. So, for a real estate appraisal, it is necessary to identify the reference date of the valuation; this date is defined as the date of value. An additional benchmark, the date of rent is the first day of each period of rental income.

The date of value can be current (a current date), in the past (a past date) or in the future (a future date), based on the date when the appraisal has been completed.

## **Section 3. Identification of the Type of Value or Rent in Appraisal**

Appraisals by Appraisers must contribute to establishing an appropriate price in the market

by estimating the appropriate value of real estate.

## I. Value

The value determined by a real estate appraisal is essentially the market value. However, there are other defined values that might also be determined, depending on the conditions corresponding to the purpose of appraisal such as an assemblage or component market value, a market value based on special considerations, and a nonmarket value. Therefore, the type of value to be estimated must always be judged and clarified following the conditions that correspond to the purpose of the appraisal. Note that there are cases where the purpose of an appraisal requires an estimate of the market value of real estate based on special considerations.

### 1. Market Value

Market value refers to the probable value for real estate that satisfies the conditions associated with a rational market under actual socioeconomic circumstances. A market that satisfies the conditions considered rational under actual socioeconomic circumstances means a market that satisfies these conditions:

- (1) The market participants must be acting on their own free will and be able to enter or leave the market and are motivated to maximize their returns with prudent and wise expectations and behavior. Market participants will satisfy certain requirements, including:
  - ① no special motivation causing either a quick sale or purchase
  - ② having the ordinary knowledge and information required to conduct transactions regarding the subject property and the market to which the subject property belongs
  - ③ has paid the labor and other costs normally considered necessary to conduct transactions
  - ④ perceived the value of the highest and best use of the subject property
  - ⑤ ordinary access for purchasers to financing.
- (2) The transaction does not have any special form that restricts market participants or induces either a quick sale or quick purchase.
- (3) The subject property must have been on the market for a suitable period of time.

### 2. Limited Market Value

Limited market value (LMV) refers to the value of marketable real estate in a

limited market of buyers and sellers, which deviates from the market value as a result of an assemblage or subdivision.

Examples of situations where limited market value is determined include:

- (1) transactions by a land lessee for consolidating land leasehold interests with the land leased fee interest of the landlord
- (2) transactions for the purpose of making an assemblage with adjacent real estate
- (3) transactions for real estate where the subdivision of real estate is considered against economic rationality.

### 3. Market Value Based on Special Considerations

Market value based on special considerations refers to the appropriate economic value of the marketable real estate under the purpose of appraisal with the background of social demands by laws and ordinances that deviates from the market value as a result of not satisfying all conditions on which the market value is premised.

Examples of cases where the market value is based on special considerations include:

- (1) where the value of the investment profitability is based on valuation for a typical investor based on the purpose of appraisal regarding any property for securitization outlined in Specific Standards Section 1, Chapter 3
- (2) where the value determined is premised for an appraisal for a quick sale as defined in the Civil Rehabilitation Law
- (3) where the value determined is premised on having an appraisal for the continuation of a business under the Corporate Reorganization Law or the Civil Rehabilitation Law.

### 4. Nonmarket Value

Nonmarket value refers to the appropriate economic value of generally nonmarketable real estate, such as a cultural asset, based on the existing use of the real estate.

Examples of situations where nonmarket value is determined include an appraisal that emphasizes preservation of the structure designated as a cultural asset, as well as a religious building or public facility, whose operation is expected to continue in its present state.

## II. Rent

The rent determined by real estate appraisal is generally either market rent or renewed

rent. However, since there are also situations in which limited market rent must be determined (depending on the conditions that match the purpose of the appraisal specified by the client), the limited market rent should be fully estimated and clarified.

#### 1. Market Rent

Market rent is an appropriate rent (market rent under a new lease) reflecting the economic value of the real estate, which would probably be established in any new lease contract (to use or benefit from real estate based on leasehold, superficies, or easement) under the same market concept as market value.

#### 2. Limited Market Rent

Limited market rent is a rent (under a new lease) reflecting appropriately the economic value of the real estate, which would probably be established in any new lease agreement under the same market concept as limited market value.

Examples of situations where limited market rent are determined include leases based on:

- (1) use in conjunction with adjacent real estate
- (2) the divided use of real estate against economic rationality.

#### 3. Renewed Rent

Renewed rent is a rent that indicates appropriately the economic value of the real estate, which would probably be established between the parties to extend the lease term of the real estate.

## **CHAPTER 6. AREA ANALYSIS AND PROPERTY ANALYSIS**

In performing area and property analyses of subject property, it is necessary to accurately understand the specific effects of the general factors that are the basis for these analyses.

### **Section 1. Area Analysis**

#### I. Purpose of Area Analysis

Area analysis refers to analyzing and determining the type of area where subject property is located, characteristics of the area, the characteristics of the market for the subject property, and the influence these characteristics have on overall use and formation of value of properties within the area.

#### II. Application of Area Analysis

##### 1. Area and Its Characteristics

Areas of particular importance in an area analysis are those from the use perspective (or area of use), for example subject neighborhood area and similar area and the wider area that includes subject neighborhood area and similar area, which is the same supply and demand area.

The characteristics of subject neighborhood area are usually embodied in the general standard use of properties in the area. The standard use provides information on the relative position of areas to each other based on their use patterns and the formation of value. Standard use is a strong indicator for determining the highest and best use of each property in the area.

The area where the real estate is located is not fixed; area-specific factors that characterize the area is constantly changing. Therefore, when performing an area analysis and to determine the standard use, current and future trends of the area-specific factors as well as standard use need to be analyzed together with the results of understanding the characteristics of the market for the subject property.

#### (1) Area of Use

##### ① Subject Neighborhood Area

The subject neighborhood area refers to the area of use where subject property belongs, which is located within urban or rural area that are of larger size and contents. This is an area that is regionally clustered around a particular use for living and activities, such as a residential, commercial, or industrial, and has characteristics that directly affect the formation of the value of the subject property. Subject neighborhood area will change depending on how the area-specific factors that form the characteristics of the area change and evolve.

##### ② Similar Area

A similar area refers to an area having features that are similar to subject neighborhood area, and the real estate in that area is regionally cohesive, centered on being used for a specific purpose. This area cohesiveness is determined by similarities to the characteristics of the subject neighborhood area.

#### (2) Same Supply and Demand Area

The same supply and demand area generally refers to an area where there are other real estates that can be substituted with the subject property, which mutually influence the formation of each value. It is more extensive, including subject neighborhood area, and defines the boundary of similar areas that are

related to the subject neighborhood area.

In general, regardless of whether the subject neighborhood area and a similar area within the same supply and demand area are adjacent, real estate as the integral elements of an area are in a relationship of substitution, competition, etc. based on the similarity of area-specific factors. As a result, both areas have an impact on each other.

Even for real estate outside the subject neighborhood area and a similar area in the same supply and demand area, but inside the same supply and demand area, a relationship of substitution, competition, etc., might be established with subject property based on similar use, size, grade, etc.

Since the geographical scope of the same supply and demand area differs depending on the preferences of users—according to the type, character, and scale of the property—it is necessary to make an appropriate judgement based on an accurate understanding of the preference of users according to the type, character, and scale of the property.

Basic items that should particularly be noted when determining the same supply and demand area are as follows:

① Building Site

a. Residential Land

The same supply and demand area generally tends to correspond to the geographical scope of a commute to the city center. However, local preferences tend to narrow the geographical scope.

Note that the strength of preferences, based on regional prestige, quality, etc. can have a particular impact on the geographical scope of the same supply and demand area.

b. Commercial Land

The same supply and demand area for highly commercial land generally tends to correspond to the scope of the area where a substitution can be made for commercial revenues which is based on extensive commercial backlot. Therefore, the scope of the area tends to be broadly formed according to the characteristics of highly commercial land.

For ordinary commercial land, it generally tends to coincide with the scope of the area where a substitution can be made for commercial revenues, which is based on a narrow commercial backlot. However,

local preferences tend to narrow the geographical scope.

c. Industrial Land

The same supply and demand area for large factory land, such as industrial land oriented towards industrial infrastructure with preference for convenience for ports and high-speed transportation networks, generally tends to correspond to the scope of the area where a substitution can be made for advanced transportation facilities that enable large-scale movement of raw materials, products, etc. Therefore, the geographical scope tends to be nationwide.

For small and medium-sized factory land, such as industrial land oriented towards consumption area with preference for proximity for distance to the consumption area and the scale of consumption, generally tends to correspond to the scope of the area where a substitution can be made for cost economics related to production and the sale of products.

d. Land with Transitional Use

The same supply and demand area generally tends to correspond to the supply and demand area of the use category of the land to which the subject land is expected to be transitioned. However, in cases of low maturity, it tends to be the same as to the same supply and demand area for the use category of the land before the transition.

② Agricultural Land

The same supply and demand area generally tends to correspond to the area of possible agricultural production activities for each of the agricultural management entities located within the area for possible and normal agricultural production activities surrounding subject agricultural land.

③ Forestland

The same supply and demand area generally tends to correspond to the area of possible forestry production activities for each of the forestry management entities located within the area for possible and normal forestry production activities surrounding subject forest land.

④ Site with Interim Use

The same supply and demand area generally tends to correspond to the same supply and demand area for the use category of the land where the land is expected to be converted. However, in cases of low maturity, it tends to be the same as to the same supply and demand area for the use category of land before the conversion.

⑤ Building and Its Site

The same supply and demand area tends to correspond to the same supply and demand area according to the use of the subject land. However, there are cases that it may not correspond to the same supply and demand area of the land because the geographical scope of real estate that can be substituted for the building and its site as a whole could differ, depending on the use, size, quality, etc.

2. Market Characteristics of Subject Property

To understand the characteristics of the market for the subject property in an area analysis, it is important to accurately understand the attributes that market participants in the same supply and demand area have, from what perspective they select the use structure of the real estate, and make decisions regarding the value influence factors. It is also necessary to accurately understand supply and demand trends in the same supply and demand market area.

In addition, the characteristics of the market that have been identified should be reflected in the determination of the standard use in the subject neighborhood area, as well as in various judgement for applying appraisal approaches and reconciling the indicative value or indicative rent.

## Section 2. Property Analysis

### I. Purpose of Property Analysis

The value of real estate is estimated based on its highest and best use. Therefore, when appraising real estate, it is necessary to determine the highest and best use of the subject property. Property analysis refers to analyzing the effect of property-specific factors on the use and the formation of value of the subject property to determine its highest and best use.

### II. Application of Property Analysis

#### 1. Guidelines for Analyzing Property-Specific Factors

Property-specific factors individually contribute to the formation of the market value of the subject property. Therefore, when analyzing property-specific factors, it is important to accurately understand which property-specific factors that typical users of the subject property would focus on for taking actions and how they would evaluate the superiority and competitiveness of the subject property compared with properties that could substitute for, or would be in competition with, the subject property.

The result of the analysis of property-specific factors should also be reflected in various judgements when applying appraisal approaches, reconciling the indicative value or indicative rent, and such.

## 2. Guidelines for Determining the Highest and Best Use

When determining the highest and best use of real estate, special consideration should be given to the following points:

- (1) The use of the real estate should be done in a way that would be adopted by someone having common sense and an ordinary ability to operate the real estate under that use.
- (2) The use of the real estate should allow for the sustainable generation of revenues over a reasonable period into the future.
- (3) The point in time when utility can be fully demonstrated is not in the unforeseeable future.
- (4) Since the highest and best use of individual real estate is typically subject to restrictions imposed by the characteristics of the subject neighborhood area, it is especially necessary, when performing a property analysis, to estimate and determine the interrelationship with the standard use of properties within the subject neighborhood area. However, there is a possibility that the use of the subject property could differ from the standard use depending on the location, size, environment, etc. In these cases, the highest and best use should be determined after analyzing property-specific factors for each use.
- (5) Value influence factors are constantly changing. So, it is necessary to determine the highest and best use taking into consideration the possibility that the use of the subject property could change, especially when changes in area-specific factors affecting value formation can be predicted objectively.

When determining the highest and best use of a building and its site, special consideration should be given to the following points:

- (6) when the actual use of the building, etc. does not correspond to the highest and best use of the land as if vacant, it is necessary to consider the cost and other factors required to realize the highest and best use of the land as if vacant. In these cases, the highest and best use of building and its site might not be the same as the highest and best use of the land as if vacant.
- (7) It is necessary to fully compare and consider the economic value of continuing the actual use of the building, etc. and the economic value of demolishing or changing the use of the building, etc., with appropriate consideration of the cost of demolition or changing the use of the building, etc.

## **CHAPTER 7. APPRAISAL APPROACHES**

There are three approaches to real estate appraisal: the cost approach, the sales comparison approach, and the income approach.

The cost approach focuses on the cost required to reproduce the real estate (called reproduction cost new). The sales comparison approach focuses on sales data or lease data from the sale or leasing of comparable real estate. The income approach focuses on the income generated from the real estate. All of these approaches attempt to estimate the value of, or rent for, the real estate.

The approaches to real estate appraisal can be classified depending on the methods used to estimate real estate value or methods used to estimate real estate rent. The value or rent estimated through the application of an appraisal method is referred to as the indicated value or the indicated rent.

### **Section 1. Appraisal Approaches for Determining Real Estate Value**

The basic appraisal approaches for estimating the value of real estate are divided into cost, sales comparison, and income capitalization approaches. There is also a fourth approach, development approach, which uses concepts from these three approaches.

#### **I. General Guidelines for Estimating Value Indications**

##### **1. Correlation between General Factors and the Application of the Appraisal Approaches**

General factors are value influence factors that affect the formation of the overall value of the real estate. Not only must general factors be considered at each step in the application of the appraisal approaches, but they must also be kept in mind when reviewing the soundness of the value estimate.

## 2. Gathering and Selecting Data

The data required for applying the appraisal approaches consists of construction data in the cost approach, comparable sales data in the sales comparison approach, and income data in the income capitalization approach. (This type of data is called comparable data). Comparable data should be gathered in an orderly way in a large volume based on a rational plan appropriate for the application of each appraisal approach. Note that it is not right to use comparable data for speculative transactions.

Comparable data should satisfy all of these requirements.

### (1) Comparable real estate data that concerns:

- ① Real estate located in the neighborhood or a similar area within the same supply and demand area, or when otherwise unavoidable, a vicinity near the neighborhood. (These are generally known as a similar area within the same supply and demand area).
- ② Where the highest and best use of the subject property differs from the standard use in the neighborhood, real estate located in the same supply and demand area can be substituted for or is in a competitive relationship with the subject property. (This is called substitutive or competitive real estate in the same supply and demand area.)

(2) Comparable data should reflect transactions closed under normal circumstances or else should be able to be adjusted to reflect transactions closed under normal circumstances.

(3) Comparable data should allow adjustments for changes in price levels and market conditions over time.

(4) Comparable data should allow for comparisons with area-specific and property-specific factors.

## 3. Adjustment for Conditions of Sale

Comparable data must be adjusted when the transactions, from which the comparable data were gathered, were closed under special circumstances that affected the comparable property's value.

- (1) For example, comparable sales data could reflect special circumstances for a quick sale or purchase. These special circumstances are attributable to the characteristics of the real estate market as well as the capabilities of the parties to the transaction and any special motivation those parties are acting on. Nevertheless, the conditions under which the comparable real estates were transacted must be thoroughly investigated.

- (2) Special circumstances refer to circumstances that do not satisfy conditions characterizing a rational market operating under an actual socioeconomic environment. Market value is necessarily based on the existence of a rational market.

#### 4. Time Adjustment

In situations where there is a possible change in the price level between the date of a transaction from which comparable data was compiled and the date of value, the price of the comparable data must be adjusted to the price level on the date of value.

#### 5. Comparison of Area-Specific Factors and Property-Specific Factors

The prices of comparable data reflect both area-specific and property-specific factors. Therefore, it is necessary to compare area-specific and property-specific factors on the subject property and comparable real estate when either the comparable real estate is located in a similar area within the same supply and demand area or the comparable real estate is a substitutive or competitive property in the same supply and demand area. On the other hand, if the comparable real estate is located in the same neighborhood, it is necessary to compare only property-specific factors on the subject property with the comparable real estate.

## II. Cost Approach

### 1. Concept

The cost approach is used to first estimate the reproduction cost of the subject property on the date of value and then deduct any accrued depreciation from the reproduction cost. (The value derived by this approach is called the value indicated by the cost approach.)

The cost approach is applied in situations where the subject property is a building or a building and its site and it is possible to estimate the reproduction cost and appropriately estimate the accrued depreciation. Where the subject property is only land, the cost approach can be applied if the reproduction cost of the land can be estimated appropriately.

### 2. Application Method

#### (1) Concept of Reproduction Cost

Reproduction cost refers to the total cost required to reproduce a duplicate of

the subject property on the date of value.

In situations where it is difficult to estimate the reproduction cost because of changes in building materials, construction methods, and other reasons, the replacement cost with the equivalent utility to the subject property can be considered the reproduction cost.

## (2) Methodology for Estimating Reproduction Cost

The reproduction cost is estimated by adding the ordinary incidental expenses that are borne by the client to the standard construction costs paid by the client to the contractor, assuming the contractor will deliver the completed building to the client in a state that allows immediate use, based on the construction contract.

Note that this is different from the replacement cost. The replacement cost is the total cost of constructing *another* property having equivalent utility to the subject property. The replacement cost is estimated by adding the ordinary incidental expenses, borne directly by the client, to the standard construction costs paid by the client to the contractor.

Note that the incidental expenses in these cases might include ordinary financing costs and the standard development risk equivalents borne by the client until taking ownership of the completed building from the contractor.

- ① The reproduction cost of land is estimated by adding the standard site preparation costs of the real estate plus the ordinary incidental expenses borne by the client to the standard acquisition cost of the raw land.

When applying the cost approach to land, if a comparison is made to the area-specific factors on the land between immediately after the building site is prepared and on the date of value and if it is objectively recognized that changes in the social and economic environment affect the value of the land through the development of public or convenience facilities or the construction of housing, it is possible to add the increment in land value that corresponds to the changes in the area-specific factors.

- ② The reproduction cost of a building and its site is estimated by adding the reproduction cost of the land (if the site is located in a built-up area where the reproduction cost cannot be estimated, the value of the vacant land including the ordinary incidental cost borne by the client can be determined by the sales comparison and income capitalization approaches) or the value of a land leasehold interest including the

ordinary incidental costs borne by the client for the reproduction cost of the building.

③ Direct and indirect methods are used to estimate the reproduction cost. Either method can be applied, depending on the degree of reliability of the construction data gathered, or both methods can be used together.

a. The direct method is a method for directly estimating the reproduction cost of the subject property. The direct method estimates the reproduction cost of the subject property by 1) investigating the category, grade, and volume of materials used and the kinds and duration of the required labor; 2) estimating the direct construction costs based on the unit price on the date of value in the area where the subject property is located; 3) adding to this estimate all indirect construction costs and a general management fee that includes a reasonable profit for the contractor; and 4) finally adding the ordinary incidental expenses borne by the client.

There are cases where the circumstances are clear, including the price of the raw land, direct and indirect construction costs required to prepare the site for construction, general management expenses (including a reasonable profit for the contractor), incidental expenses paid directly by the client, and their specifications (including category, grade, volume, time and unit price). In these cases, it is possible to estimate the reproduction cost by analyzing, adjusting, and updating these specifications for changes over time, if necessary.

b. The indirect method is a method for indirectly estimating the reproduction cost of the subject property either from similar real estate located in the neighborhood or similar area within the same supply and demand area or from other substitutive or competitive real estate in the same supply and demand area.

There are cases for using the indirect method where the circumstances are clear, including the value of the raw land, the direct and indirect construction costs of the real estate, general management expenses (including a reasonable profit for the contractor), incidental expenses borne by the client, and the specifications (including category, grade, volume, time and unit price) for comparable real estate. In these cases, it is possible to use the indirect method to determine the reproduction cost of the subject property by analyzing,

adjusting, and updating these specifications for changes over time, if it is necessary, and then comparing both area-specific factors and property-specific factors.

### 3. Depreciation Adjustment

The purpose of adjusting the depreciation is to deduct the amount of depreciation incurred—based on several factors for depreciation from the reproduction cost of the subject property—in order to arrive at the appropriate value indicated by the cost approach on the date of value.

When making depreciation adjustments, the amount of depreciation must be estimated by analyzing and examining the subject property both partially and comprehensively, focusing on the depreciation factors.

#### (1) Depreciation Factors

Depreciation factors can be categorized as physical deterioration as well as functional and economic obsolescence.

Note that these factors are not independent of one another, but rather are mutually related and interactive.

##### ① Physical Deterioration

Examples of physical deterioration include normal wear and tear from using the real estate, deterioration occurring over time or resulting from natural causes, and incidental damage.

##### ② Functional Obsolescence

Examples of functional obsolescence affecting real estate include incompatibility between a building and its site, poor design, outdated form, and inadequate or inefficient facilities.

##### ③ Economic Obsolescence

Examples of economic obsolescence include neighborhood decay, nonconformity between the real estate and its surroundings, or a decline in the marketability of the real estate compared with either real estate in a substitutive or competitive relationship or other nearby real estate.

#### (2) Methods for Estimating Depreciation

There are two methods, used in conjunction with each other, to estimate the amount of depreciation for a property.

##### ① Method Based on Useful Life

The depreciation estimation method based on useful life is founded on

the useful life period indicated as the sum of the actual age and the remaining economic life of the real estate on the date of value.

Several elements are especially important when applying the remaining economic life method: the period during which the utility is considered sustainable on the date of value depending on deterioration looking at physical and functional factors as well as competitiveness measured by economic factors; the use category and actual condition of the subject property; and the remaining economic life.

The method based on useful life consists of two standard ways for estimating depreciation: straight line and declining balance. The application of either of the two ways for estimating depreciation should be decided by the use category and actual condition of the subject property.

In situations where the subject property consists of two or more separable components, each with a different age or remaining economic life, how the depreciation for each component is estimated and how the salvage value is estimated at the end of the period should be decided based on the use category and actual condition of the subject property.

#### ② Methods Based on Observation

The depreciation method based on observation directly estimates the amount of depreciation by examining the actual condition of each depreciation factor, such as design, functionality of facilities, state of maintenance and management, as well as the state of repairs and conformity with the surrounding environment.

### III. Sales Comparison Approach

#### 1. Concept

The sales comparison approach first gathers a large amount of sales information from comparable real estate, then the most appropriate data is selected. The market prices negotiated for the sale of comparable real estate is then adjusted for differences in sales conditions or changes occurring over time, if necessary. Area-specific and property-specific factors are then compared to indicate value in the sales comparison approach.

The sales comparison approach is applicable when real estate transactions are made involving comparable properties in the neighborhood or a similar area within the same supply and demand area or real estate transactions involving substitutive or competitive real estate in the same supply and demand area.

## 2. Application Method

### (1) Collecting and Selecting Data

Since the sales comparison approach uses the sales of comparable real estate in the market as the basis for estimating value, it is necessary to first collect a large amount of sales information on comparable properties.

Comparable sales information is collected from transaction data on properties in the neighborhood or similar areas within the same supply and demand area or located near the neighborhood, when necessary and unavoidable. In situations where the highest and best use of the subject property differs from the standard use in the neighborhood, information on comparable sales is collected from transaction data on real estate in a substitutive or competitive relationship within the same supply and demand area. In any case, the sales information on comparable real estate must satisfy all three of these requirements:

- ① the data should reflect normal circumstances under which transactions are closed or the data should be able to be adjusted to reflect normal circumstances.
- ② the data should allow for adjustments for changes in price levels and market conditions over time.
- ③ the data should allow for comparisons with area-specific and property-specific factors.

### (2) Sales Condition and Time Adjustments

An adjustment must be made when the sale of comparable real estate has any special circumstances that affect the sale price. When some time has passed since the sale of comparable real estate closed and a change in the price level has occurred during that period, the sale price of comparable real estate must be adjusted to the price level on the date of value.

When making a time adjustment, it is necessary to adjust the sale price after estimating the rate of change in the value of land or buildings under the same land use classification as the comparable real estate in the neighborhood or when a comparable area has a change in value similar to the neighborhood.

### (3) Comparison of Market-Specific Factors and Comparison of Property-Specific Factors

A sale price reflects both area-specific and property-specific factors where the

real estate related to the sale is located. Therefore, it is necessary to compare both area-specific and property-specific factors for the subject property with comparable real estate when the comparable real estate is in a similar area within the same supply and demand area or when it is in a substitutive or competitive relationship with the subject property and is located in the same supply and demand area. On the other hand, if the comparable real estate is in the same neighborhood, it is only necessary to compare property-specific factors with the comparable property.

To simplify the comparison of area-specific factors and property-specific factors, it is necessary to identify a benchmark site that has typical property-specific factors in each area.

#### (4) Allocation Method

Situations will arise where comparable sales data is selected from real estate with two components, while the subject property has only one. The value of the extra component of the comparable property must be estimated at first, and then must be deducted from the overall sale price to generate a comparable price for the subject property.

Alternatively, the allocation method may be used. Ratios between the values of property components, reflected by comparable sales, can be developed based on sales prices or development costs. The sale price derived from the comparable data is then multiplied by the percentage for the common component of the subject and comparable properties. (This is called as the allocation method.)

### IV. Income Capitalization Approach

#### 1. Concept

The income capitalization approach estimates the total present value (PV) of the adjusted net operating income or net cash flow (NCF) that the subject property is expected to generate in a future period, (The value indication derived from this approach is called the value indicated by the income approach.)

The income capitalization approach is used for determining the value of leased properties and for business properties other than those being leased.

Real estate value generally reflects its profitability, where income is the core of the economic value of real estate. So, the income capitalization approach should be applied to all the real estate other than those that do not have general marketability, such as structures designated as cultural assets. This approach can be applied to

owner-occupied real properties based on the assumption that these properties were leased.

Further, when there is a sharp increase in the sale price of real estate, a significant difference between the sale price and the value indicated by the income approach can be the result. In these situations, the income capitalization approach should be used to verify sale prices, which tend to be speculative.

## 2. Methods for Determining Value Indicated by the Income Approach

There are two basic methods for determining value indicated by the income approach. One method, called direct capitalization, applies a capitalization rate directly to net cash flow (NCF); the other method, discounted cash flow (DCF), discounts the net cash flow (NCF) generated over the typical holding period together with the reversionary value at the end of the holding period. Each income stream is discounted to the present value (PV) at the time the income is generated. All the discounted income streams are then added up.

These methods are calculated using the following formulas:

### (1) Direct Capitalization Method

$$P = \frac{a}{R}$$

where:

P = subject property value indicated by the income approach

a = net cash flow (NCF) for one period

R = capitalization rate

### (2) DCF Method

$$P = \sum_{k=1}^n \frac{a_k}{(1 + Y)^k} + \frac{P_R}{(1 + Y)^n}$$

where:

P = property value indicated by the income approach

$a_k$  = net cash flow (NCF) for each period

Y = discount rate

n = holding period (or analysis period in cases where resale is not assumed, as is understood hereafter)

$P_R$  = reversionary value

The reversionary value refers to the value of the subject property at the end of the holding period and is represented by the formula:

$$P_R = \frac{a_{n+1}}{R_n}$$

where:

$a_{n+1}$  = net cash flow (NCF) for period  $n + 1$

$R_n$  = capitalization rate at the end of the holding period (terminal capitalization rate)

### 3. Application Methodology

#### (1) Net cash flow (NCF)

##### ① Concept of Net Cash Flow

Net cash flow (NCF) is the income from the real estate, or the remaining value after deducting the distribution to capital (excluding the capital for the real estate) as well as labor and management (organization) in proportion to their contribution to total income *from* the total income generated from the combination of real estate used for income-generating purposes, the capital involved (excluding the capital for the real estate), and labor and management (organization).

##### ② Calculation of Net Cash Flow

The net cash flow (NCF) of a real estate is calculated by subtracting the total expenses from the total income generated in one year. In addition, net cash flow (NCF) varies depending on the way that gross income and total costs are viewed: either as perpetual (level) NCF or non-perpetual (variable) NCF, or as NCF before depreciation or NCF after depreciation. Note that the variability in NCF is closely related to the selection of the method (direct capitalization or DCF) for determining value indications by the income approach as well as the method for determining capitalization rates or discount rates.

Further, in the direct capitalization method, the net cash flow (NCF) used might, in some cases, be the subject property's first-year NCF or, in other cases, a stabilized NCF.

The net cash flow (NCF) should be estimated by carefully analyzing every

line item looking at past transitions and future trends. The Appraiser's analysis must be based on a direct understanding of the subject property's gross income and total related costs. Particularly in this case, the expected limits on earnings growth must be carefully examined.

The discounted cash flow (DCF) method clearly indicates periodic or annual net cash flows (NCF), the reversionary value, and the timing for when these income streams are generated. So, it is necessary to thoroughly investigate the outlook for net cash flow (NCF).

In the application of the direct capitalization method, the net cash flow (NCF) of the subject property might be *indirectly* determined based on the net cash flow (NCF) of any property similar to the subject property, located in the same neighborhood or similar areas within the same supply and demand area, or the NCF of real estate in a substitutive or competitive relationship in the same supply and demand area. In these cases, it is necessary to compare area-specific factors and property-specific factors then adjust the net cash flow (NCF) of the comparable real estate.

a. Calculation of Gross Income and Commentary

(a) When real estate is to be leased or for business other than a lease

The gross income for leased real estate is the total of the nominal rent, interest earned on refundable deposits, interest earned and amortization of nonrefundable deposits, and other income, such as revenue from parking (nominal rent and others). When applying the DCF method to a property for lease, it is necessary to pay attention to the provisions of the lease agreement(s) as well as changes in the rents and the occupancy rates of the leasable space for each period.

The gross income for a property for business other than a lease is generally the sales amount. However, the gross income can be either the amount based on the nominal rent and others for the real estate among the sales amount or the nominal rent and others when assuming the lease of the property.

When calculating the gross income from real estate leased by a tenant who runs a business other than a lease and the gross income from real estate for a business other than a lease, it is necessary to be careful of the current state and future movements of the business provided by the real estate.

- (b) When the highest and best use of vacant land is for the development of a building for lease

The gross income that is likely to be generated by the building and its site is estimated by assuming that a building for lease is the highest and best use.

b. Calculation of Total Expenses and Commentary

The total expenses of the real estate for lease (see paragraph a-(b) above) include depreciation (excluded where net cash flow (NCF) is determined before depreciation), maintenance and management fees (including maintenance costs, management fees and repair expenses), real estate taxes (property tax, city planning tax), insurance premiums, and other miscellaneous expenses.

Where the real estate being appraised is a property for business other than a lease, the total expenses of the property include the cost of purchases and sales as well as general and administrative costs. However, even if the real estate is used for business other than for a lease, when the gross income is either the amount based on the nominal rent and others related to the real estate among the sales amount or the nominal rent and others in the case of assuming to lease the property, the total expenses depend on the above example for calculating the value of the real estate for lease.

When applying the DCF method, an Appraiser must pay special attention to the timing that expenses, such as large-scale repairs, will occur during the holding period.

(2) Capitalization and Discount Rates

① Concept of Capitalization and Discount Rates

The capitalization rate and discount rate both reflect the profitability of real estate. Although they are both used in the income approach to determine the indicated value, they are basically different, as is explained below.

The capitalization rate is used in the direct capitalization method where the property value is determined from the net cash flow (NCF) for a single period. In the DCF method, the terminal capitalization rate is applied to estimate the reversion or anticipated property value at the end of the holding

period. Capitalization rates incorporate a component for the uncertainty accompanying anticipated changes in future income.

The discount rate in the DCF method is used for estimating the present value (PV) of income to be generated in the future. The discount rate excludes any component for uncertainty, as well as any accompanying anticipated change in the net cash flow (NCF) and reversions that are forecast over consecutive periods based on the income outlook.

## ② Estimation of Capitalization Rate and Discount Rate

### a. Considerations when Estimating Capitalization Rate and Discount Rate

It is necessary to investigate trends in the returns on real estate and other investments since both the capitalization rate and discount rate are closely related to the profitability of comparable assets and investment yields in the financial market.

Moreover, since the capitalization rate and discount rate tend to differ by region, property type, and grade, both rates must be estimated by an analysis of area-specific and property-specific factors that affect the subject property.

### b. Methods for Estimating Capitalization Rates

Examples of the methods used to estimate capitalization rates include:

#### (a) Estimation by Comparison with Comparable Sales for Similar Real Estate

This method estimates the capitalization rate by making adjustments to market-derived capitalization rates for differences occurring over the time since the transaction involving a comparable property was closed, for any special circumstances of the transaction, and for changes in area-specific and property-specific factors.

#### (b) Estimation by the Weighted Average of Loan and Equity

The capitalization rate can be estimated by the weighted average of the respective capitalization rates for components of a capital investment (loan and equity) required for acquiring the subject property.

#### (c) Estimation from Capitalization Rates for Land and Building Components

Where the subject property includes a building and its site, the capitalization rate can be estimated using the weighted average of the respective capitalization rates for physical components (land and building) based on the respective ratios between the components.

(d) Estimation from the Relationship with the Discount Rate

The capitalization rate can be estimated by considering the growth rate in the net cash flow (NCF) of the subject property based on the applied discount rate.

c. Methods for Estimating Discount Rates

Examples of methods used to estimate discount rates include:

(a) Estimation by Comparison with Comparable Sales of Similar Real Estate

This method estimates the discount rate by making adjustments to market-derived discount rates for differences occurring since the time the transaction was concluded as well as for the special circumstances of the transaction and for changes in area-specific and property-specific factors. Adjustments are based on the discount rate estimated from comparable sales on the subject property and similar real estate.

(b) Estimation by the Weighted Average of Loan and Equity

The discount rate can be estimated by the weighted average of the respective discount rates for components of a capital investment (loan and equity) required for acquiring the subject property.

(c) Estimation Based on the Uniqueness of the Real Estate Investment Relative to Yields on Financial Assets

This method estimates the discount rate by considering the uniqueness of the subject property as an investment looking in particular at risk, non-liquidity, management difficulty, and asset security relative to yields on bonds and other financial assets.

(3) Application of Direct Capitalization or Discounted Cash Flow (DCF)

It is necessary to decide whether or not to apply the direct capitalization method based on the availability of data, the title category of the subject property, and the purpose of the appraisal or the discounted cash flow (DCF).

## Section 2. Appraisal Approaches for Determining Real Estate Rent

There are several appraisal approaches for determining the rent paid for real estate. Where the rent is to be set for a new lease, acceptable ways include summation, rental data comparison, and income analysis approaches. Where the rent is to be set for a *renewed* lease, acceptable ways include rents disparity analysis, yield, trend, and rental data comparison approaches.

### I. General Considerations for Determining Rent

In a rent appraisal, the Appraiser estimates the effective rent to be paid to the lessor of the real estate over the period of the payments. However, it is possible to estimate the nominal rent in addition to the effective rent, if it is requested and the Appraiser is provided with: 1) the specifics of the payment period and timing; and 2) information on paid deposits, such as *kenrikin*, *shikikin* or *hoshokin* (either a nonrefundable or refundable deposit for the subject space).

#### 1. Effective Rent and Nominal Rent

Effective rent refers to all reasonable economic compensation payable to the lessor over the period of payments regardless of the type of rent. Effective rent represents gross rent, or net rent plus miscellaneous expenses normally required to operate the real estate (called operating expenses).

Nominal rent refers to rent paid at the time of each scheduled payment. In other words, nominal rent is the effective rent minus the interest on the deposits and the amortization of nonrefundable deposits, provided the lessor has received deposits, such as *kenrikin*, *shikikin*, and *hoshokin*, specified in the lease contract.

Further, although it is a common practice for utility expenses, cleaning, and sanitation costs as well as heating and cooling costs to be paid each month in the form of “added” rent or as common area charges for leased space, portions of these payments can be equivalent to part of the rent.

#### 2. Estimation of Nominal Rent

When the lessee paid the deposits specified in the lease, the nominal rent is determined by deducting the interest earned on the deposits and the amortization of nonrefundable deposits from the effective rent.

The interest earned and the amortization of nonrefundable deposits should be determined based on the circumstances, including changes in the value of the subject property during the lease period.

It is possible to estimate the investment yield by comparing various investment returns, such as the expected yield on real estate, the market-derived capitalization

rate, the interest on long-term deposits, the yield on government and corporate bonds, and the interest paid on loans from financial institutions, while keeping in mind differences in the kinds of deposits specified in the lease contract, the specific term and rental payments negotiated, and the type and condition of the subject property.

### 3. Calculation Periods for Rent

For leased building sites and leased properties that include buildings and building lots, a one-month unit is generally used to calculate the rent determined by an appraisal. A one-year unit is used for calculating rent for other types of land.

### 4. Estimation of Renewed Rent

It is possible to estimate the renewed rent, based on the current rent, by carefully comparing the background of lease contracts, the background of the rent revision, and the content of lease contracts in addition to property taxes, land and building prices, rents in the neighborhood area or a similar area in the same supply and demand area, or a change in rent for a substitutive and competitive property in the same supply and demand area, after the time the current rent was agreed on and applied between the contracting parties, in consideration of the fairness between the contracting parties.

## II. Appraisal Approaches for Determining Market Rent under a New Lease

### 1. Summation Approach

#### (1) Concept

The summation approach at first estimates the base value of the subject property on the date of value. The base value is then multiplied by the anticipated yield and operating expenses are added to the resulting amount to arrive at the gross rent. (The rent estimated by this method is called rent indicated by the summation approach.)

The summation approach is applicable where the base value of the subject property, the anticipated yield, and the operating expenses can be accurately estimated.

#### (2) Application

##### ① Base Value

The base value is the real estate's value that is used for estimating the indicated rent by the summation approach. The base value is estimated by the cost and the sales comparison approaches.

## ② Anticipated Yield

Anticipated yield is the ratio between the anticipated net cash flow (NCF) to the capital invested in the leased real estate.

The method for estimating anticipated yield is the same as the method for estimating the capitalization rate in the income capitalization approach. In this particular application, special attention should be paid to the characteristics of the rent.

## ③ Operating Expenses

Examples of expenses included in the total estimate of operating expenses for leased real estate include:

- a. depreciation (not applicable in the use of any anticipated yield for the net cash flow before depreciation)
- b. maintenance and management fees (including maintenance costs, management fees, and repair expenses)
- c. real estate taxes (including property taxes and city planning tax)
- d. insurance premiums (including premiums for fire, machinery, boilers, and other insurance)
- e. allowance for collection loss
- f. vacancy allowance

## 2. Rental Data Comparison Approach

### (1) Concept

The rental data comparison approach at first collects a large amount of rental data on new leases in order to select actual effective rents (which refers to the total economic compensation to the real estate as reflected in the rent). Then, if necessary, adjustments are made to the comparable rents for lease condition and the time factor. Finally, for the subject property being compared with the rent comparable real estate, area-specific and property-specific factors must be considered to arrive at the indicated rent. (This approach is called rent indicated by the rental data comparison).

The rental data comparison approach is used when real estate leases are compared with similar properties in the neighborhood or a similar area within the same supply and demand area, or real estate leases involving substitutive or competitive real estate in the same supply and demand area.

## (2) Application

### ① Collection and Selection of Data

The process of collecting and selecting rental data is the same as in the sales comparison approach. In this particular application, the rental data should be selected from lease contracts with similar terms and rent payments.

### ② Comparing Lease Conditions, Changes in Rent Levels, and Market-Specific and Property-Specific Factors

The comparative procedures are the same as in the sales comparison approach: comparisons are made between the subject property and comparable properties for different conditions for lease and rent levels over the time since the comparable transactions took place as well as comparisons of area-specific and property-specific factors.

## 3. Income Analysis Approach

### (1) Concept

The income analysis method is used to estimate, at first, the net income that the subject property is expected to generate over a certain period of time (after depreciation, which is called the income net rent) by analyzing the gross income based on general corporate management, and then the indicated rent of the real estate by adding any necessary expenses. (The rent arrived at using this method is called income rent.)

The income analysis method is effective when it is possible to appropriately estimate the net income attributable to the real estate for business operations.

### (2) Application

#### ① Estimation of Income Net Rent

The estimation of the income net rent is the same as that of the net cash flow (NCF) in the income capitalization approach. In this case, it is necessary to pay close attention to the characteristics of the rent.

#### ② Methodology for Indicating Income Rent

The income rent is calculated by adding the income net rent to the operating expenses expected to be included for the rent in the lease.

In some cases, it is necessary to directly estimate the income rent

equivalent to the rent including the income net rent and operating expenses by analyzing the gross income based on general corporate management.

### III. Appraisal Approaches for Estimating Renewed Rent

#### 1. Rents Disparity Analysis Approach

##### (1) Concept

The rents disparity analysis approach arrives at a reasonable rent for the subject property by adding an estimated increase to or deducting an estimated decrease from the actual effective or nominal rent. The increased or decreased amount is obtained by first estimating the difference between the reasonable effective or nominal rent, based on the economic value of the subject property, and the actual effective or nominal rent, and then estimating the portion of the difference assignable to the lessor by a careful analysis of lease terms, contract negotiations, and other items. Finally, the assignable amount is either added to, or deducted from, the actual effective or nominal rent.

##### (2) Application

- ① The reasonable effective rent based on the economic value of the subject property is the market rent assumed on the date of value, which is estimated by the summation and rental data comparison approaches.

Where any deposit has been paid to the lessor as a condition of the lease contract, the reasonable nominal rent based on the economic value of the subject property is estimated by deducting the interest earned and/or the amortization of deposits, such as *kenrikin*, *shikikin*, and *hoshokin*, from the effective rent.

- ② The portion of the difference assignable to the lessor is appropriately estimated after considering the value influence factors specific to the renewed rent by analyzing a wide range of factors that generated any difference, and further analyzing lease terms, contract negotiations, and other items, then making an appropriate judgement.

#### 2. Yield Approach

##### (1) Concept

The yield approach arrives at an estimate of gross rent by adding operating expenses to the base value multiplied by the rental yield rate under a renewed lease.

## (2) Application

- ① The methods for estimating base value and operating expenses in the yield approach are the same as in the summation approach.
- ② The rental yield rate under a renewed lease is based on the ratio of net rent to the base value at the time the current rent was agreed upon. The rental yield can be determined after considering the value influence factors specific to the rent under a renewed lease by thoroughly comparing 1) the anticipated yield, 2) yield rates reflected in the data, including the yield at the time the contract was signed and each time the rent was revised, 3) the growth rate in the base value, and 4) yield rates reflected in comparable data for similar real estate in the neighborhood or similar neighborhoods in the primary market area, or comparable rental data for real estate in a substitutive or competitive relationship with the subject property and located in the primary market area.

## 3. Trend Approach

### (1) Concept

The trend approach arrives at an estimate of gross rent by adding operating expenses on the date of value to the net rent at the time the current rent was agreed upon, which is then multiplied by a trend factor for the growth rate in the rent.

Where it is possible to determine a trend factor for the actual effective rent or the actual nominal rent since the time the current rent was agreed upon, the Appraiser can arrive at the indicated rent by directly multiplying the current rent by the trend factor.

### (2) Application

- ① A trend factor represents the amount of change in rent corresponding to changes in economic conditions between the time the current rent was agreed upon and the date of value. The trend factor can be determined by a thorough analysis of economic indicators or real estate indexes, including changes in land and building values, changes in commodity prices, and changes in income level, taking into account the value influence factors specific to the rent under a renewed lease.
- ② The method for estimating operating expenses is the same as in the

summation approach.

#### 4. Rental Data Comparison Approach

The rental data comparison approach is applied in the same way as the rental data comparison approach for estimating rent under a new lease. In the application of this approach, note that it is necessary to appropriately compare the value influence factors specific to the rent under a renewed lease.

## **CHAPTER8. APPRAISAL PROCEDURE**

Real estate appraisals require a planned, orderly procedure based on a realistic understanding and reasonable judgment. This procedure typically includes 1) identification of basic appraisal premise, 2) identification of client, parties for submission, and conflicts of interest, 3) planning of appraisal procedures, 4) confirmation of subject property, 5) collecting and organizing documents, 6) review of documents and analysis of value influence factors, 7) application of appraisal approaches, 8) reconciliation of indicative value or indicative rent, 9) determination of appraisal value, and 10) preparation of appraisal report. These steps should be carried out in an orderly manner When conducting real estate appraisal.

### **Section 1. Identification of Basic Appraisal Premise**

When conducting appraisals, the basic appraisal premise needs to be first identified. So, the purpose and conditions of the appraisal, together with purpose of the appraisal need to be clearly confirmed with the client.

### **Section 2. Identification of Client, Parties for Submission, and Conflicts of Interest**

The items listed below should be confirmed with the client together with confirming the items in the previous section:

- I. The client, parties for submission other than the client, and parties for disclosure other than the client
- II. Conflicts of interest associated with Appraisers and appraisal companies
  1. Conflicts of interest of Appraisers and appraisal companies involving the appraisal of the subject property

Any conflicts of interest must be disclosed for the subject property or any affinity or special interest with a person who has an interest in the subject property and its details with the Appraiser(s) involved (all Appraisers involved in the appraisal; the

same applies hereafter) and appraisal companies involved (including the appraisal company that the Appraiser(s) belong to; the same applies hereafter) must be disclosed).

2. Relationship between the client, and Appraiser(s), and the appraisal company involved

Any special financial, personal, or business relationship and its details between the client, and Appraiser(s), and appraisal company involved must be disclosed.

3. Relationship between the parties for submission, etc. and the Appraiser(s) and appraisal companies involved

Any special financial, personal, or business relationship between the parties for submission of the appraisal report or parties for disclosure of the appraisal value other than the client (parties for submission, etc.) as well as Appraisers and appraisal companies involved and its details must be disclosed. If the parties for submission, etc. are not determined or unknown, it would be sufficient to indicate as such.

### III. Whether or Not the Appraisal Value Will Be Publicly Disclosed

#### **Section 3. Planning of Appraisal Procedures**

Appraisal procedure must be orderly planned, based on the basic appraisal premise (see Section 1, above), that reflect the nature and volume of the work to be performed and the processing capacity. The appraisal procedure should include identifying the subject property, collecting and organizing the documents, reviewing the documents and analyzing the value influence factors, applying appraisal approaches, reconciling the indicative value or indicative rent, and finally determining the appraised value.

#### **Section 4. Confirmation of Subject Property**

For confirmation of subject property, details of the subject property determined in accordance with Section 1 must be clarified. Confirmation of the subject property is classified into the confirmation of the physical state and the state of interest of the subject property, and must be accurately conducted through site inspections, interviews, confirmation of public documents, and others.

##### I. Confirmation of the Physical State of Subject Property

For confirmation of the physical state of the subject property, the existence or nonexistence of the subject property and its contents identified in accordance with Section 1 shall be verified by physically confirming the location, lot number, size, etc. of the land, and the house number, structure, use, etc. of the building, using the identification

documents (see Section 5 I).

In addition, when confirming physical state, it is necessary to understand whether there is any difference between what is registered on the certificate of registered information (*toukijiko shomeisho*) and the actual condition of the subject property.

## II. Confirmation of the State of Interests

For confirmation of the state of interests, the existence or non-existence of the interests subject to the appraisal determined in accordance with Section 1 shall be verified by clearly confirming all interests pertaining to the subject property physically confirmed by above I, using confirmation documents.

## Section 5. Collecting and Organizing Documents

Since the result of an appraisal depends on the documents used, collecting and organizing the documents must be based on an appropriate and reasonable plan so that the documents can be used in the appraisal process. Collecting and organizing should be accurately conducted through site inspections, interviews, confirmation of official documents, etc., and should be both fair and valid.

Documents required for appraisals can largely be categorized as below.

### I. Confirmation Documents

Confirmation documents refer to the documents required to confirm the physical state and the state of interests of the real estate. Examples of confirmation documents include the certificate of registered information, drawings of the land or building, photographs, and maps showing the location.

### II. Documents on Value Influence Factors

Documents on value influence factors refer to the documents that reflects the value influence factors and can be classified into general documents for general factors, area-specific documents for area-specific factors, and property-specific documents for property-specific factors.

General documents and area-specific documents should be routinely collected in an organized way. Property-specific documents should be collected appropriately according to the differences in the type of subject property and the conditions for the appraisal, such as requirements for subject identification.

### III. Comparable Documents

Comparable documents refer to documents relating to the actual transaction prices or

rents required to apply the appraisal approaches. Examples of comparable documents include construction comparables, sales comparables, income comparables and lease comparables.

There are also cases where previous appraisal values as well as the asking price of the subject property can be used for reference.

### **Section 6. Review of Documents and Analysis of Value Influence Factors**

When reviewing documents, it is necessary to consider whether or not the collected documents are reliable as well as necessary and sufficient for performing the appraisal. To analyze the value influence factors, it is necessary to consider whether the documents are suitable for the type of subject property as well as the purpose and conditions of the appraisal.

When analyzing value influence factors, the highest and best use of the subject property needs to be determined by analyzing general factors and conducting area and property analyses based on the documents collected.

Further, for value influence factors, in cases where factors that have a significant impact on the formation of value of subject property cannot be fully identified (even with all the care taken as a professional), it is necessary, in principle, to use the results of surveys, etc. conducted by other professionals. However, sometimes there are restrictions due to the purpose of the request or the client's circumstances. For instance, with the client's consent, an appraisal may be conducted by setting certain assumptions or limiting conditions or by setting conditions within the scope of the investigation or by estimating the degree of influence that the factors have on the formation of value within the scope of the Appraiser's investigation and analysis skills. In those particular cases, when setting certain assumptions or limiting conditions or conditions to the scope of the investigation, it is necessary to satisfy certain requirements for setting the conditions, and when estimating, it is necessary to determine that an objective estimation can be made.

### **Section 7. Application of Appraisal Approaches**

Appraisal methods should be appropriately applied to the assignment subject for the appraisal. In this case, multiple appraisal approaches reflecting market characteristics of subject property should be applied based on area and property analyses. Where the type of subject property or circumstances involving the location or reliability of the documents make it difficult to apply multiple appraisal approaches, every possible effort should be made to incorporate the concepts of each approach.

### **Section 8. Reconciliation of Indicative Value or Indicative Rent**

The reconciliation of indicative value or indicative rent refers to the work of reconsidering

the value or rent indicated by multiple appraisal approaches, making judgements on the reliability of each indicative value or indicative rent, in turn leading to a final decision of the appraisal value.

When reconciling indicative value or indicative rent, it is important to be able to explain the value influences on the subject property in a logical and practical way. For this reason, each step of the appraisal procedure should be reconsidered objectively and critically, and this should be done by appropriately reflecting the differences in the reliability of each indicative value or each indicative rent based on the review. In this case, particular attention must be given to these matters.:

I. Reconciliation of Each Indicative Value or Indicative Rent

1. appropriateness of the documents selected, reviewed, and applied
2. appropriateness of applying every principle of value for the assignment
3. appropriateness of the analysis of general factors as well as area and property analyses
4. appropriateness of judgments of adjustments and revisions made in applying each approach
5. consistency of judgment regarding value influence factors commonly applied in each approach
6. appropriateness of the balance between unit value and total value.

II. Judgement for Reliability of Each Indicative Value or Indicative Rent

1. consistency between the results obtained through area analysis and property analysis, and each approach applied
2. relative reliability, based on the characteristics and/or limitations of the documents used in applying each approach

### **Section 9. Determination of Appraisal Value**

After thoroughly performing the procedures described in Sections 1 through 8, the appraisal value should be determined appropriately using the highest professional ethics.

The published land price must be used as a standard when estimating the market value of land within the publicized area defined under Paragraph 1, Article 1 of the Ordinance for Enforcement of the Land Price Publication Act (*Chikakojiho Shikokisoku*) determined by the Minister of Land, Infrastructure, Transport and Tourism.

### **Section 10. Preparation of Appraisal Report**

The appraisal report is prepared when the appraisal value is determined.

## CHAPTER 9. APPRAISAL REPORT

An appraisal report is a document containing the results of a real estate appraisal. Its purpose is to clearly present the judgment and opinion of the Appraiser based on his or her professional knowledge and experience as well as to clarify the scope of the Appraiser's liability.

### Section 1. Guidelines for Preparing an Appraisal Report

The primary objectives of the appraisal report are to communicate the basic appraisal premise and the appraisal value, to explain the rationale for arriving at the appraisal value, and to indicate the extent of the liability of the Appraiser involved in the appraisal. So, when preparing an appraisal report, all documents used in the appraisal process should first be organized, then items related to the judgment of value influence factors and the application of appraisal approaches should be clarified and prepared based on the judgement.

The content of the appraisal report is the substance of the appraisal report presented to the client by the Appraiser's company. The appraisal report has an effect not only on the client but also on third parties. It also is the basis for forming a logical real estate value. For those reasons, when preparing an appraisal report care must be taken not to leave any room for misunderstanding, and an Appraiser must provide as full an explanation as possible to the client as well as third parties, especially for the rationale used to determine the appraisal value.

### Section 2. Report Contents

An appraisal report must contain, at the least, the items listed in I through XII with full attention for every item:

#### I. Appraisal Value and Type of Value or Rent

If limited market value, market value based on special consideration or limited market rent is estimated for real estate where the market value or market rent can be estimated, market value or market rent must be stated in parentheses with a clear statement that this figure is the market value or market rent. For the appraisal of a nominal rent, as defined in CHAPTER 7, Section 2-1-1, the nominal rent and a note stating that it is nominal rent must be reported together with the effective rent and a note in parentheses stating that it is the effective rent, if the nominal rent differs from the effective rent.

#### II. Assumptions and Limiting Conditions of Appraisal

An appraisal report should clearly state details of the requirements for the subject identification, any assumptions or limiting conditions or conditions on the scope of the

investigation regarding area-specific or property-specific factors that are in place to reflect the purpose of the valuation, and should also clearly state the rationale for determining that it is appropriate to impose such assumptions for the valuation. If necessary, an appraisal report should also provide the value of the subject property without such assumptions as a reference.

III. Location of the subject property, lot number, type of land use, house number, structure, use, area, and interests for the subject property

IV. Matters related to Confirmation of Subject Property

The results of the comparison between the confirmation of the physical state and the state of interests of the subject property with confirmation documents must be clearly stated.

In addition, considering the fact that doubts could arise at a later date on the current state of the subject property, the following items must also be included:

1. date of site inspection
2. name of Appraiser who conducted the site inspection
3. name and occupation of the guide at the site inspection
4. inspection coverage (including whether or not an internal inspection was conducted)
5. the reason that it was not possible to conduct a full site inspection, if relevant

V. Relationship between Purpose of Valuation and the Conditions and Type of Value or Rent

An appraisal report must state the rationale for determining the type of value according to the purpose and conditions of the appraisal. In particular, where the type of value estimated is market value based on special consideration, an appraisal report must clearly indicate the rationale for social demands by laws and regulations. Where the type of value estimated is nonmarket value, the report must indicate the supporting facts, such as a designation as a cultural asset.

VI. Date of Value and Date of Appraisal Report

VII. Principal Reasons for Determining Appraisal Value

An appraisal report shall state the principal reasons for determining the appraisal value based on the items listed below.

1. Area Analysis and Property Analysis

Based on the type and category of the subject property and the type of rent, an appraisal report must include discussions of the scope and state of the same supply and demand area and subject neighborhood area; value influence factors affecting the subject property; market trends in the same supply and demand area and the behavior of typical market participants in the same supply and demand area ; the superiority or inferiority of the subject property in relation to substitutive or competitive real estate; and the relative competitiveness of the subject property.

2. Highest and Best Use

The highest and best use of the subject property and how it was determined must be clearly described. For the highest and best use of a building and its site, the report must also describe the highest and best use of the land as though vacant.

3. Application of the Appraisal Approaches

For the appraisal approaches that were applied, the relationship to provisions of Specific Standards Chapters 1 through 3, use category, and state of the interests for the subject property, and the type of rent should be described, as well as the relationship to the market characteristics of the subject property identified through area and property analyses.

4. Indicative Value or Indicative Rent

An appraisal report must explain the results of judgement regarding a reconciliation and the reliability of the indicative value or the indicative rent.

5. Compliance in Relation to the Published Land Price

6. When the parties have different views of the facts

If there are any differences in relation to the subject property that the parties have that result in a claim, such as disputes, how these were handled must be described.

7. Other Items

When the purpose of the appraisal is to estimate nominal rent (as discussed in CHAPTER 7, Section 2-1-1 of General Standards), an appraisal report must describe the relationship between that nominal rent and the effective rent. If renewal rent is estimated, the most recent agreed upon point in time must be stated.

### VIII. Handling Unknown Appraisal Items and the Scope of the Investigation

When there are items that cannot be clarified at each stage of the appraisal procedure, such as confirmation of the subject property, review of documents, and analysis of value influence factors, due to limitations in the collection of documents for the appraisal or inadequacy of documents, the handling of these items in the appraisal must be described.

In these cases, the scope and content of the investigation conducted by the Appraiser must be clearly stated. In cases where the results of an investigation, etc. conducted by other professionals are used, the scope and content of the investigation conducted by those professionals must be clearly stated.

### IX. Conflict of interest associated with Appraisers and appraisal companies involved

#### 1. Conflict of interest associated with Appraisers and appraisal companies involved regarding the subject property

Any conflict of interest for the Appraisers or appraisal companies involved and the subject property or parties who have connections or interests in the subject property and any details of these interests must be specified in the appraisal report.

#### 2. Relationship between the client and Appraisers or appraisal companies involved

Any special financial, personal, or business relationship between the client and the Appraisers or the appraisal companies involved and details of the relationship must be specified in the appraisal report.

#### 3. Relationship between the parties for submission/disclosure and Appraisers or appraisal companies involved

Any special financial, personal, or business relationships between the parties for submission/disclosure and the Appraisers or appraisal companies and the details of the relationship must be specified in the appraisal report. (If the parties for submission/disclosure are not determined or unknown, that must also be indicated.)

### X. Names of Appraiser(s) involved

### XI. Names of client and parties for submission, etc.

### XII. Details on whether or not the appraisal value will be publicly disclosed

**Section 3. Appendix to Appraisal Report**

Maps clearly showing the location of the subject property, drawings of the land and/or buildings, photographs and other identification documents as well as comparable data should be attached to the appraisal report where necessary.

Documents obtained from the reports of investigations conducted by other professionals should also be attached to the appraisal report. However, these types of documents should only be attached to the appraisal report when the consent of the professional who compiled them has been obtained.

## **SPECIFIC STANDARDS (SS)**

Appraisers should perform appraisals of real estate based on the specifics of each assignment using their own specialized knowledge, professional capabilities, and in accordance with the General Standards. To ensure appropriate appraisals of specific property types, Appraisers should employ techniques that match the use and interest categories of real estate as well as the type of rent (discussed below).

### **CHAPTER1. APPRAISAL OF REAL ESTATE VALUE**

#### **Section 1. Land**

##### **I. Building Site**

##### **1. Vacant Land**

The appraisal value of vacant land is determined by reconciling the value indicated by the sales comparison approach, based on comparable sales data for vacant land as well as the building and its site (if an allocation method can be applied) and the value indicated by the income approach applying a land residual method.

If the reproduction cost can be estimated, the appraisal value should be determined by reconciling the values indicated by the cost approach as well. In cases where the subject land is larger than the standard land size of the subject neighborhood area, the value estimated (see below) will also be taken into account when determining the appraisal value. (This method is called the development approach):

- (1) If it is considered reasonable to use the land as a whole, the value will be estimated by deducting from the total sales price the amount equivalent to standard building construction costs and ordinary incidental costs to be borne directly by the ordering party, assuming the construction of the building represents the highest and best use of the land as of the date of value.
- (2) If it is considered reasonable to use the land by division, the value will be estimated by deducting from the total sales price the amount equivalent to the standard development costs of the land and ordinary incidental costs to be borne directly by the ordering party, assuming the subdivision of the vacant land into standard building sites as of the date of value.

Sales and income comparables used when applying an allocation method and a land residual method should be those applied for the highest and best use of the land.

## 2. Land Portion of Building and its Site

The land portion of building and its site is closely related to buildings and improvements, and has organic utility in conjunction with the buildings and improvements. For this reason, an appraisal of the land portion of building and its site is performed as a partial appraisal of the land (in addition to the right to use the land for the building and other constructions, other rights that will limit use and income gaining, such as easements, will be taken into account as is) if continuing use with the current building and improvements is considered reasonable.

The appraisal value of the land portion of building and its site is determined based on the value of the vacant land considering 1) whether or not there is any difference between the highest and best use of the land portion of the building and its site and the vacant land, 2) the degree of land assemblage with buildings and improvements as well as the difficulty in converting to vacant land, taking into account the value indicated by the sales comparison approach applying the allocation method and the value indicated by the income approach applying land residual method.

However, the value of the land portion of building and its site can also be determined based on the value allocating the amount attributable to the land by analyzing the value of building and its site ("composite property value").

## 3. Leasehold Interest in Land and Leased Fee Interest in Land

Since the value of the leasehold interest in land and the value of the leased fee interest in land are closely related, the following points should be considered thoroughly and the two interests should be compared:

- ① The common practice of leasing a building site and the transaction of leasehold interest in land and its level of maturity could differ depending on each city; even within the same city, it could differ depending on the area.
- ② The existence of a leasehold interest in land does not necessarily mean that the leasehold interest in the land has value. In the common practice of leasehold interest in land, there are cities or areas where leasehold interest in land is independently seen as subject for transaction, while in other cities or areas, it is not independently seen as subject for transaction but is considered together with building as subject for transaction.
- ③ The state of the transaction of leasehold interest in land:
  - a. whether or not it is an area where leasehold interest in land was originally contracted with value and was inherited

- b. whether or not it is an area where the transaction of leasehold interest in land involves parties other than the lessor
  - c. whether or not it is an area where many leasehold interest in land are for the purpose of owning a solid building
  - d. whether or not it is an area where the lessees have a strong awareness of the right of leasehold interest in land
  - e. whether or not it is an area where giving and receiving a lump-sum payment is a common practice
  - f. whether or not it is an area where either the seller or buyer of a leasehold interest in land usually pays a transfer fee.
- ④ State of leasehold interest in land:
- a. originally contracted or inherited
  - b. superficies or leasehold
  - c. sublease or not
  - d. whether the purpose is to own a solid building or a nonsolid building
  - e. whether it is primarily a building for residence or for commercial use
  - f. presence or absence of a specified lease term
  - g. presence or absence of special provisions
  - h. contract is written or oral
  - i. presence or absence of title registration
  - j. fixed-term leasehold interest in land (fixed-term leasehold interest in land as specified in Section 2, Paragraph 4 of *Shakuchi Shakka Ho*).

(1) Leasehold Interest in Land

① Value of Leasehold Interest in Land

The value of a leasehold interest in land reflects the economic benefits (including those based on a lump-sum payment) expressed in monetary terms that accrues to the lessee from the use and profit of the land in conforming with Land Lease and Building Lease Law (*Shakuchi Shakka Ho*; including *Shakuchi Ho* before abrogation).

Economic benefits attributable to the land lessee includes a wide range of benefits generated by the use of the land, mainly consists of below.:

- a. stable benefit for the land lessee being able to exclusively use and generate revenue by occupying the land for a long period of time
- b. a portion of the value consisting of the difference between appropriate rent reflecting the economic value of the building site to

which the leasehold interest is attached and the actual nominal rent (“rent difference”) as well as the present value of the economic benefits during the term of the difference, which is customarily the subject for the transaction.

② Appraisal of Leasehold Interest in Land

Approaches applied for appraisal of leasehold interest in land differ according to the existence of the transaction practice for leasehold interest in land and its maturity.

a. Areas where transaction practice is highly matured

The appraisal value of leasehold interest in land is determined by reconciling 1) the value indicated by the sales comparison approach based on comparable data for leasehold interest in land and the composite property with leasehold interest in land, 2) the value indicated by the income approach applying land residual method, 3) the value estimated by capitalizing the rent difference based on the agreement of the leasehold interest in land that is subject for transaction, and 4) the value estimated by calculating the ratio of leasehold interest in land of the area, if the area is matured, for the transaction of leasehold interest. In this case, the following items should be comprehensively considered: (a) through (g) ((a) through (i) in the case of the appraisal of fixed-term leasehold interest in land):

- (a) possibility for future revision of the rent and the amount of the revision
- (b) state of the leasehold interest in land and the remaining life of the building
- (c) background of the agreement, the lease period that has already elapsed, and the remaining period of the lease
- (d) amount of the lump-sum payment paid/received under the agreement and related conditions in the agreement
- (e) amount expected in the future of the lump-sum payment and related conditions in the agreement
- (f) transaction practice of leasehold interest in land and transaction yield of leased fee interest in the land
- (g) value as vacant land and value as the land portion of building and its site for the land subject for the leasehold interest
- (h) conditions of agreement in relation to the building at the maturity

of the lease term

- (i) period during which use and revenue of the building cannot be expected due to construction or demolition of the building during the lease term.

b. Areas where transaction practice is not mature

The appraisal value of leasehold interest in land is determined by reconciling 1) the value indicated by the income approach applying land residual method, 2) the value estimated by capitalizing the rent difference based on the agreement of the leasehold interest in land, which is the subject for transaction, and 3) the value estimated by deducting the value of leased fee interest from the value of the land as the vacant or land portion of building and its site subject for the leasehold interest. In this case, the items above should be comprehensively considered: (a) through (g) ((a) through (i) in the case of the appraisal of fixed-term leasehold interest in land).

(2) Leased Fee Interest in Land

The value of leased fee interest in land reflects the economic benefits expressed in monetary terms that accrue to the land lessor in relation to the value of the leasehold interest of that land. The economic benefits attributable to the land lessor refers to the economic benefits during the lease term for the actual nominal rent after deducting related costs and the present value of the economic value reverted at the maturity of the term.

Note that if giving/receiving a lump-sum payment is expected in the future, the economic benefit of this lump-sum payment could also constitute an economic benefit attributable to the land lessor.

The appraisal value of leased fee interest in land is determined by reconciling the value indicated by the income approach estimating the total present value of the net cash flow based on the actual nominal rent and the value indicated by the sales comparison approach. In this case, the items above should be comprehensively considered: (1)-②-a-(a) through (g) ((a) through (i) in the case of appraisal of fixed-term leasehold interest in land).

For appraising leased fee interest in land where the land lessee is purchasing the leased fee interest, note that there could be incremental economic value attributable to the recovery of marketability by having the building site or

building and its site to be owned by the same owner.

#### 4. Sectional Superficies

The appraisal value of sectional superficies reflects the economic benefits expressed in monetary terms, typically based on the value of the land where the sectional superficies are established, determined by details of the right and benefit of the scope of the right, reflecting the economic benefit of both the right set with subdivided space in planar and three dimensions and the use restriction of the space in order to maintain the utility of the space where the right is set, within the whole economic benefit of the land with sectional superficies. The appraisal value of sectional superficies is determined by reconciling 1) the value indicated by the sales comparison approach based on an analysis of the contract data, 2) the value indicated by the income approach applying land residual method, and 3) the value developed by applying a vertical allotment ratio for sectional superficies, also with consideration of the value estimated by a sectional superficies ratio of contract comparable data of sectional superficies.

## II. Agricultural Land

Appraisal of agricultural land may be requested for transactions where the objective is to convert the agricultural land to another land use, for example, the acquisition of land for public works.

In this case, the appraisal value of agricultural land is determined based on the value indicated by the sales comparison approach, taking into account the value indicated by the income approach as a reference. Where a reproduction cost can be estimated, the appraisal value should be formed by reconciling the value indicated by the cost approach as well.

Note that when acquiring agricultural land for public works, there are cases where agricultural compensation is sometimes provided separately as compensation for the losses normally incurred in the land acquisition.

## III. Forestland

Appraisal of forestland may be requested for transactions where the objective is to convert the forestland to another land use, for example, the acquisition of land for public works.

In this case, the appraisal value of forestland is determined based on the value indicated by the sales comparison approach, taking into account the value indicated by the income approach as a reference. Where the reproduction cost can be estimated, the appraisal value

should be formed by reconciling the value indicated by the cost approach as well.

Note that when acquiring forestland for public works, there are cases where forestation compensation is sometimes provided separately as compensation for the losses normally incurred in the land acquisition.

#### IV. Land in Prospective Use to Building Site

The appraisal value of land in prospective use for a building site is determined by reconciling the value indicated by the sales comparison approach and the value estimated using the following steps: (a) assume vacant land after conversion and improvement, (b) deduct the amount equivalent to the typical cost for site improvement and typical expenses to be borne directly by the ordering party from the estimated land value in (a); and (c) appropriately adjust the value derived in (b) based on the maturity of the land in prospective use to the building site. In particular, the effect over the neighborhood area of the factors accelerating development of city expansion should be comprehensively considered, as well as the following:

1. government ordinances and/or regulations that enable or hinder conversion of the land in the prospective uses for the building site
2. current and anticipated construction of public facilities in the surrounding area
3. current and anticipated construction of residential housing, commercial facilities, and factories in the surrounding area
4. difficulty of making site improvements and level of requirements
5. efficient use of the building site after improvements.

When appraising land in prospective use to building site with low maturity, the appraisal value is determined based on the value indicated by the sales comparison approach, taking into account the value of the land category before the conversion while adding an expectation of the conversion to a building site.

### **Section 2. Building and Its Site**

#### I. Owner-Occupied Building and Its Site

The appraisal value of an owner-occupied building and its site is determined by reconciling the values indicated by the cost, sales comparison, and income approaches.

The appraisal value of an owner-occupied building and its site, where converting the use of the building or remodeling the building structure for another use is the highest and best use, is determined by taking into account the increase in economic value after the change in use as well as the cost for renovation and related expenses.

The appraisal value of an owner-occupied building and its site, where demolition of the

building is the highest and best use, is determined by adjusting the value based on the highest and best use of the site with deducting an estimate for the required expenses including demolition, removal, and transporting debris from the salvage value of the materials remaining after the building is demolished.

## II. Tenant-Occupied Building and Its Site

The appraisal value of a tenant-occupied building and its site is determined based on the value indicated by the income approach, derived by a summation of the present value of the net cash flow based on actual effective rent, and taking into account the values indicated by the cost and sales comparison approaches. (In a transaction where the seller did not pass on to the buyer a part of the lump-sum payment that the seller previously received, the interest on and amortization of that portion of the payment are not to be included in estimating the net cash flow.) In this case, the following items should be comprehensively considered:

1. possibility of a future revision of rent and the amount of the revision
2. amount of lump-sum payment given/received under the agreement and related conditions in the agreement
3. amount expected in future for the lump-sum payment and related conditions in the agreement
4. background to the agreement, the lease period of the building that has already elapsed, the remaining period of the lease, and the remaining life of the building
5. transaction practice of tenant-occupied building and transaction yield
6. purpose of building lease, form of the agreement, whether or not it is registered, whether or not it is a sublease, and whether or not it is a fixed-term building lease (as specified in Article 38 of the Land Lease and Building Lease Law or Shakuchi Shakka Ho)
7. value of leasehold interest in the building.

In the case of an appraisal of a tenant-occupied building and its site where a building tenant is purchasing the tenant-occupied building and its site, note that there could be incremental economic value attributable to the recovery of marketability by having the tenant-occupied building and its site becoming an owner-occupied building and its site.

## III. Building and Its Leasehold Land

### 1. Owner occupying the building

The appraisal value of a building and its leasehold land is determined by reconciling the values indicated by the cost, sales comparison, and income approaches.

In this case, items indicated above in the section for leasehold interest in land ②-a-(a) through (g) ((a) through (i) in the case that the leasehold interest is fixed-term leasehold interest in land) should be comprehensively considered.

## 2. Tenant occupying the building

The appraisal value of a building and leasehold land where the building is leased is determined based on the value indicated by the income approach, derived by the summation of the present value of net cash flow based on actual effective rent, and taking into account the values indicated by the cost and sales comparison approaches. (In a transaction where the seller did not pass on to the buyer a part of the lump-sum payment that the seller previously received, the interest on and amortization of the portion of the payments are not to be included in estimating net cash flow.)

In this case, items indicated above in the section of Leasehold Interest in Land ②-a-(a) through (g) ((a) through (i) in the case that the leasehold interest is fixed-term leasehold interest in land), and section II 1 through 7 should be comprehensively considered.

## IV. Condominium Unit and Its Site

### 1. Value Influence Factors on Condominium Unit and Its Site

The following are examples of value influence factors unique to a condominium unit and its site.

#### (1) Property-Specific Value Influence Factors of Building and Its site of a Whole Building of a Condominium Unit

##### ① Factors of Building

- a. year of construction (newly built, expansion or reconstruction. or relocation)
- b. building area, height, structure and materials
- c. functionality of design and facilities
- d. construction quality and volume
- e. condition of facilities, such as entrance and conference rooms
- f. number of floors
- g. intended use of the building and condition of the use
- h. condition of maintenance and management
- i. mix of residences and commercial shops
- j. quality of earthquake resistance, fire resistance, and related items
- k. whether any harmful substances were used in the construction and their

condition.

② Factors of Site

- a. shape of the site and extent of any open space area
- b. facilities on the site
- c. size of the site
- d. state of interest in the site.

③ Factors of Building and Its Site

- a. layout of the building and additional facilities within the site
- b. balance between the size of building and site
- c. any long-term repair plan and its adequacy and the amount of the reserve fund for the repair plan.

(2) Property-Specific Value Influence Factors of Exclusive Area

- ① floor level and location
- ② sunlight, view, and scenery
- ③ interior finish and quality of maintenance and management
- ④ size of the condominium unit and room layout
- ⑤ use of the adjacent real estate
- ⑥ accessibility to elevators and other common facilities
- ⑦ state of interest and ownership ratio of the right in the site
- ⑧ amount of unpaid management and other fees by the condominium unit owner.

2. Appraisal of Condominium Unit and Its Site

(1) Owner-Occupied Condominium Unit

The appraisal value of a condominium unit and its site, where the owner of the condominium unit is using the exclusive area, is determined by reconciling the values indicated by the cost, sales comparison, and income approaches.

The value indicated by the cost approach is developed by first estimating the whole building value of the subject condominium unit by the cost approach, then applying an allocation rate based on the utility by floor and location on the same floor.

## (2) Tenant-Occupied Unit

The appraisal value of a condominium unit and its site where the exclusive area is leased is determined based on the value indicated by the income approach, derived by a summation of the present value of the net cash flow based on the actual effective rent, and taking into account the values indicated by the cost and sales comparison approaches. (In a transaction where the seller did not pass on to the buyer a part of the lump-sum payment that the seller previously received, the interest on and amortization of the portions of the payments are not to be included in estimating the net cash flow.)

In this case, items 1 through 7 in the previous section (II) should be comprehensively considered.

### **Section 3. Building**

A building and its site are closely related: the building has organic utility in conjunction with its site. For this reason, generally the building and its site as a whole are subjects for the appraisal. However, there are cases of only appraising the building where the building and its site as a whole has marketability or only appraising the building where the building and its site as a whole does not have marketability.

#### **I. Appraisal only of a building where the building and its site as a whole has marketability**

In this case, the appraisal of a building will be conducted as a partial appraisal of the building as a breakdown of the overall appraisal value, under the condition that the building is combined with its site.

The appraisal value of the building in this case is determined based on the value indicated by the cost approach, taking into account the values indicated by the sales comparison approach based on the allocation method, and the value indicated by the income approach applying a building residual method.

However, it can also be determined based on the composite property value by allocating the amount attributable to the building.

#### **II. Appraisal only of a building where the building and its site as a whole does not have marketability**

In this case, the appraisal of a building is generally the case of estimating the nonmarket value of such buildings as cultural heritage buildings, religious buildings, and public facilities maintaining the current status with the focus of conservation. The appraisal value of a building in this case is determined based on the value indicated by the cost approach.

### III. Leasehold Interest in a Building

Leasehold interest in a building is a leasehold interest over a building as specified by the Land Lease and Building Lease Law (Shakuchi Shakka Ho, including Shakka Ho before abrogation).

The appraisal value for the leasehold interest in a building, where there is transaction practice for the leasehold, is determined based on the value indicated by the sales comparison approach taking into account the individual circumstances between the parties concerned as well as the amount developed by deducting the value of a tenant-occupied building and its site from the value of the owner-occupied building and its site, with any necessary adjustments. If the ratio of leasehold interest in the building can be estimated, the value developed by a ratio of leasehold interest in the building should also be taken into account. In this case, items indicated above in 1 through 6 in the section for Tenant-Occupied Building and Its Site should be comprehensively considered.

Further, the value of leasehold interest in a building may be realized individually in relation with the lessor, reflecting the economic benefit practically lost by the lessee with an involuntary eviction request from the lessor. The appraisal value of leasehold interest of the building in this case is determined by reconciling the values developed by 1) an amount equivalent to the difference between the actual nominal rent of a new contract necessary to lease an alternative building similar to the current building and the current actual nominal rent for a period of time, adding a lump-sum payment which has prepaid nature as rent, and 2) deducting the value of a tenant-occupied building and its site from the value of an owner-occupied building and its site, with any necessary adjustments. In this case, the individual circumstances between the parties concerned should be taken into account, and items indicated above in 1 through 6 in section for Tenant-Occupied Building and Its Site should be comprehensively considered.

## **Section 4. Appraisal Methods to Be Applied for Estimating Market Value Based on Special Consideration**

- I. Where the value of investment profitability for investors is to be estimated based on a valuation for a purpose of appraisal as specified under the Specific Standards, Chapter 3, Section 1: Appraisal of a property for securitization.

In this case, the appraisal value is determined based on the value indicated by the DCF method of the income approach, verifying the value derived from the DCF method against the value indicated by the direct capitalization method and reconciling this amount with values indicated by the sales comparison and the cost approaches.

- II. Where the value based on a quick sale is to be estimated based on a valuation for a purpose as specified under the Civil Rehabilitation Law (*Minji Saisei Ho*).

In this case, the appraisal value is determined by reconciling the values indicated by the sales comparison and the income approaches, based upon the assumption of a quick sale, then verifying this amount against the value indicated by the cost approach. In situations where there is little comparable data, the appraisal value can be determined by adjusting the market value estimated by the ordinary procedure, then adjusting the value downward to reflect the circumstances of the quick sale.

- III. Where the value based on the continuation of a business is to be estimated based on a valuation for a purpose as specified under the Corporate Reorganization Law or Civil Rehabilitation Law (*Kaisha Kosei Ho or Minji Saisei Ho*).

In this case, the appraisal value is generally determined based on the value indicated by the income approach (based on the net cash flow attributable to the real estate from the whole business operation), taking into account the value indicated by the sales comparison approach and after verifying the value indicated by the cost approach.

## CHAPTER2. RENT APPRAISAL

### Section 1. Building Site

- I. Estimating Market Rent under a New Lease

1. Value influence factors of market rent under a new lease

Specific value influence factors of market rent under a new lease are:

- (1) contractual practices of leases in the area
- (2) contractual details on which the new rent is based, such as the type and purpose of the lease, whether or not a lump-sum payment is given/received and the details, and whether or not any special covenants exist (and the details).

2. Estimating the market rent of a building site

To appraise the market rent of a building site, an appropriate rent figure is estimated reflecting the economic value of the building site based on its use and the conditions of the lease contract.

The appraisal of market rent of a building site is determined by reconciling the rent indicated by the summation approach, the rent indicated by the rental data comparison approach, and the rent indicated by the rental data comparison approach using the allocation method. When the net cash flow can be properly estimated, the rent

indicated by the income analysis approach should also be taken into account. In addition, when the net cash flow, which is generated from the rental business of the building and its site, can be properly estimated, the rent indicated by the rental business analysis method (a method to determine the indicative rent of building site by estimating the net cash flow attributable to the land based on the whole net cash flow generated from the whole building and its site) should also be considered.

### 3. Estimating special rent for the building site

The appraisal of special rent is determined by reconciling 1) the rent indicated by the summation approach by applying the special value of the building site (combined use with adjacent building site(s) or partial use of the whole building site) as the base value, and 2) the rent indicated by the rental data comparison approach by applying rent comparables of combined use with adjacent building or partial use of the whole building site. In this case, following items should be comprehensively considered:

- (1) state of interest of adjacent building site(s)
- (2) conditions of lease contract of the comparables.

## II. Estimating Renewal Rent

### 1. Value influence factors for renewal rent

Specific value influence factors for renewal rent are mainly those related to the factors that arose between the time of the most recent agreement and the date of the rent. The main examples are:

- (1) change and revisions of rent of a) building sites in the neighborhood area or similar areas within same the supply-demand area, or b) alternative competitive properties in the same supply-demand area
- (2) changes in land value
- (3) changes in real estate taxes
- (4) contract conditions and their background
- (5) contribution of the lessor or lessee to the development of the neighborhood area.

### 2. Revising Actual Nominal Rent of an Ongoing Lease Contract of Building Site

The appraisal for the revision of actual rent based on an ongoing lease contract of a building site is determined by reconciling the rent indicated by the rents disparity analysis, the yield, the trend, and the rental data comparison approaches. In this particular case, the following items should be comprehensively considered, mainly

during the time of the most recent agreement to the time of the date of rent:

- (1) change and revisions of rent for a) building site(s) in the neighborhood area or similar areas within the same supply-demand area, or b) alternative competitive properties in the same supply-demand area
- (2) change in land value
- (3) change in net rent as a proportion of rent
- (4) (change in yield of leased fee interest in land
- (5) change in real estate taxes
- (6) degree of difference between market rent under the new lease and the current rent at the time of the most recent agreement and at the date of rent
- (7) contract conditions and their background
- (8) the period elapsed from the lease start date, and the period elapsed between the time of the most recent agreement and the time of the date of the rent
- (9) background of rent revisions in the past.

In cases where the revision of rent is triggered by the renewal of the lease upon expiration of the contract term or the transfer of the leasehold right to a third party, if a renewal fee or title transfer fee is paid, the amount of the fee or title transfer fee is determined based on a comprehensive consideration of these amounts.

### 3. Revising Rent Following a Change in Contract Terms or Purpose of Use

The appraisal for the revision of rent following a change in contract terms or the purpose of use is determined by adding an appropriate allocation of increased economic value of the building site and the building on top of the site with changes in contract terms or the purpose of use to the rent estimated in paragraph 2 (above). In this case, the following items, in addition to the items in paragraph 2 (above), need to be comprehensively considered:

- (1) state of the lease
- (2) details of changes in the contract terms or purpose of use
- (3) amount of fee for the consent to change the contract terms or extension or reconstruction of building, if it is paid.

## Section 2. Building and Its Site

### I. Estimating Market Rent under a New Lease

#### 1. Value influence factors of market rent under a new lease

Specific value influence factors for market rent under a new lease for a building and its site shall correspond to the appraisal for estimating market rent under a new

lease for a building site.

## 2. Estimating market rent of a building and its site

To appraise the market rent of a building and its site, an appropriate rent figure is estimated reflecting the economic value of the building and its site based on its use and the conditions of the lease contract.

The appraisal of market rent of building and its site is determined by reconciling the rent indicated by the summation approach and the rental data comparison approach. When the net cash flow from the property can be properly estimated, the rent indicated by the income analysis approach should also be considered.

In cases where the market rent is only for a part of the building and its site, the relationship of the whole and the subject part is comprehensively considered when determining the market rent.

## II. Estimating Renewal Rent

The appraisal for renewal rent of a building and its site shall correspond with the appraisal to estimate the renewal rent of a building site. In this case, the terms "change in land value" and "change in yield of leased fee interest on land" in Chapter 2, Section 1, II should be replaced with "change in land and building value" and "change in yield of building and its site," respectively.

# CHAPTER 3. APPRAISAL OF REAL ESTATE VALUE FOR SECURITIZATION

## Section 1. Basic Appraisal Premise for Properties for Securitization

### I. Definition of Subject Properties for Securitization

In this chapter, the phrase "subject properties for securitization" refers to properties (including those held under trust beneficiary rights) that are subject to or likely to become subject to a real estate transaction for any the following reasons:

- (1) assets undergoing liquidation as defined in the Act on Securitization of Assets, real estate transactions related to investment trusts as defined in the Act on Investment Trust and Investment Corporation, and real estate transactions undertaken by investment corporations as defined in the same act.
- (2) real estate transactions related to real estate specified joint enterprise agreements as defined in the Act on Real Estate Specified Joint Enterprise.

- (3) securities defined in Article 2, Paragraph 1, Items 5, 9 (limited to those related to a limited company (including a limited liability company that continues to exist as a company limited as specified in the provisions of Article 2, Paragraph 1 of the Act on the Establishment of Relevant Acts in connection with the Enforcement of the Companies Act) established for the purpose of exclusively conducting real estate transactions), 14 and 16 of the Act on Financial Instruments and Exchange, as well as real estate transactions that generates income or profit mainly for the purpose of fulfilling obligations of rights considered to be securities under the provisions in Items 1, 3 and 5 of Paragraph 2 of this article.

The appraisal of subject properties for securitization must be conducted as prescribed in this chapter. In this case, a statement on securitization must be included in the appraisal report.

Even when appraising properties other than properties for securitization, it is important that the Appraiser conducts the appraisal as prescribed in this chapter for appraisals of a largescale rental property held for investment purposes, and whenever it is considered necessary to protect the other investors, purchasers, or any other interested party.

## II. Responsibility of Appraisers

- (1) Appraisers must always conduct appraisals in a way that gives full consideration to the appropriate procedures for the appraisal of subject properties for securitization, while recognizing that they (the Appraisers) have a significant influence on the decision making, not only on the people requesting the appraisal of subject properties for securitization (referred to here as "clients") but also of a wide range of investors and others, keeping in mind that Appraisers bear the important responsibility of upholding the public reputation of the real estate appraisal profession.
- (2) When appraising a property for securitization, the Appraiser should look to enable the securitization of the subject property by providing clients with explanations of the data, procedures, and other matters related to the appraisal, in this way improving the understanding of the clients and obtaining their cooperation. The Appraiser must also take care in the way that information is presented in the appraisal report in order to make the content of the appraisal report on the subject property for securitization easier for the clients, people with conflicts of interest in the subject property, and others to understand and use for comparisons. The Appraiser must be

fully accountable, ensuring that the data and other informational materials used in the appraisal are available for disclosure.

- (3) Whenever several Appraisers are working together on the appraisal of a property for securitization, the roles of each Appraiser must be clearly defined, and all of the Appraisers must work as a team to complete the appraisal assignment, sharing information on the overall appraisal while maintaining close and thorough teamwork.

## **Section 2. Requirements on the Appraisal of a Building and its Site Yet to Be Completed for Securitization**

In addition to the requirements set out in the postscript of General Comments Chapter 5, Section 1, I 2, the appraisal of a building and its site yet to be completed for securitization should be conducted only when there is full disclosure of any damage that could occur if construction was suspended, the construction period was postponed, or the content of construction is changed by the covenants in the purchase agreement or various types of insurance for the subject property.

## **Section 3. Planning of Appraisal Procedures**

### **I. Items to be confirmed during planning of appraisal procedures**

When planning an appraisal procedure, the Appraiser should confirm with the client in advance any items related to the appraisal of a property for securitization in order to develop an appropriate and reasonable work plan that allows for the competent and reliable implementation of the appraisal. The confirmed information should be reflected in the appraisal procedures and the procedures should be changed whenever any change occurs in the specified information. Items that should be confirmed include:

- (1) purpose of the appraisal and background on why the appraisal was requested
- (2) classification of the subject property under (1), (2), or (3) of Section 1, I (above)
- (3) the major subjects covered in the engineering report (an investigative report on the condition of the subject property for securitization, conducted by an expert having specialized knowledge of buildings, mechanical and electrical (M&E) systems, environmental issues, etc.) The same applies in Section 3 below, as well as data needed to apply the DCF method, other related documents, and when these documents will be available.
- (4) whether there are explanatory comments from the preparer of the engineering report

- (5) the scope of the site inspection, including the interior inspection of the subject property
- (6) any other items needed to plan the appraisal procedure.

## II. Records of items to be confirmed

After confirming the items listed above in (1) through (6) of Section 3, I (1), records must be prepared for each of these items, and these records must be attached to the appraisal report as appendices. Included among these records are:

- (1) date confirmed
- (2) name of the Appraiser who made the confirmation
- (3) name and occupation of the person who provided the confirmation
- (4) content of the confirmation, and the status of reflection on the content in the appraisal procedure
- (5) details of any changes in the appraisal procedures or changes in the content of the report that were made as a result of any change in the content of the confirmation.

## III. Purpose of the appraisal, and the relationship between the client and the parties involved in the property securitization

In many cases, a wide range of parties are involved and hold intricate conflicts of interests in the subject property for securitization. The appraisal report must state the purpose of the appraisal of the property for securitization, the background on reasons why the appraisal was requested as well as the following items concerning the conflicts of interests of the client with regard to the property for securitization:

- (1) Whether the client holds conflicts of interest in the securitization of the property. All parties should be identified, such as an originator, arranger, asset manager, lender, equity investor, special purpose company (SPC), corporate investor, or funding agency (referred to here as "parties involved in the securitization").
- (2) Whether the client has capital ties or business connections to any of the parties involved in the securitization and if so, the details of those relationships.
- (3) The details of any other special interests between the client and any of the parties involved in the securitization.

## **Section 4. Investigation of Property-Specific Factors on the Subject Property for Securitization**

### **I. Investigation of property-specific factors on the subject property**

During the investigation of property-specific factors on a property for securitization and to ensure and to detail the physical and legal confirmation of the property, it is necessary to confirm the data needed for the appraisal. The required data includes the identification of associated rights and interests, any restrictions under public statutes, the presence of toxic substances such as asbestos, determination of earthquake resistance, and the history of remodeling, expansion, etc. of the subject property. This data is gathered through interviews with the manager of the property as well as onsite inspections and interior inspections of the property in the presence of the client (including anyone designated by the client).

### **II. Property inspection**

The Appraiser must include the following items related to the site inspection in the appraisal report:

- (1) date of the site inspection
- (2) name of the Appraiser who performed the site inspection
- (3) names and occupations of the guide for the site inspection and the manager of the subject property
- (4) scope of the site inspection (including whether or not the interior inspection was conducted) and the items verified during the site inspection
- (5) if it was not possible to perform any part of the site inspection, the reasons must be stated.

### **III. Handling an engineering report and property investigation by the Appraiser**

- (1) For an appraisal of a property for securitization, the Appraiser must ask the client to submit an engineering report required for the appraisal. After analyzing and evaluating the report's content, the Appraiser must incorporate its conclusions into the appraisal. However, if no engineering report is submitted, or if its content is considered inadequate for use in the appraisal, the Appraiser must then take action. This action should include conducting an independent investigation to substitute for the engineering report, in that way fulfilling the requirements of the assignment. As well, the appraisal report must describe the results of that investigation as well as the reasons why the original engineering report was considered to be inadequate.

- (2) For example, the engineering report could be lacking some points or be inadequate for use in reappraising a property for securitization that had already been appraised or the subject property for securitization may be vacant land (or land where the buildings are to be demolished).
- (3) The appraisal report must include a statement of the decision made on whether or not to use the content of the engineering report in the appraisal, along with the reasons for that decision. For all the items listed in the following table, the specified information must be included in the appraisal report. Appendix 1 provides a sample format for an appraisal report. The same applies in the case of the second statement at III (1) above (beginning with "However").

Item	Content
Basic information about the engineering report	<ul style="list-style-type: none"> <li>• Name, etc., of the preparer of the engineering report</li> <li>• Date of the investigation undertaken for the engineering report and the date when the engineering report was prepared</li> </ul>
How the engineering report was obtained and handled in the appraisal	<ul style="list-style-type: none"> <li>• From whom the Appraiser obtained the engineering report (name, occupation, etc.)</li> <li>• Date obtained</li> <li>• Whether explanatory comments were obtained from the preparer of the engineering report</li> <li>• How the engineering report was handled in the appraisal</li> </ul>
Method of investigation of property-specific factors, which is required for the appraisal	<p>Statement concerning whether the engineering report was used for the investigation of property-specific factors or whether the Appraiser investigated these influences. (The investigation might also have been done by another expert, at the request of the Appraiser). Property-specific factors to be investigated include:</p> <ul style="list-style-type: none"> <li>• Regulations and restrictions under public and private statutes (including the state of compliance with the law)</li> <li>• Renovation plan</li> <li>• Reproduction costs</li> <li>• Building environment related to toxic substances, including asbestos</li> <li>• Soil pollution</li> <li>• Earthquake risk</li> </ul>

	<ul style="list-style-type: none"> <li>• Earthquake resistance</li> <li>• Underground structures or objects</li> </ul>
Appraiser's conclusions about the method of investigation of property-specific factors, which are required for the appraisal	Decisions on whether or not to use the content of the engineering report or an investigation by the Appraiser of property-specific factors, along with the reasons for that decision, etc.

- (4) Because the engineering report might need to be revised or supplemented owing to changes in the market environment for real estate securitization, the Appraiser must maintain close contact with the preparer of the engineering report and must also make every effort to improve his or her knowledge and understanding of engineering reports.

### Section 5. Application of the DCF method

When appraising the value of a property for securitization using the income approach, the DCF method must be applied. In this case, it is necessary to apply the direct capitalization method for verification.

#### I. Clarifying the procedure for applying the DCF method

- (1) The appraisal report must include statements regarding the suitability of the data used to determine the property's value by the income approach. Along with the reasons for the conclusion, these statements must indicate:
- ① whether or not the data obtained from the client on the subject property, such as the income and expense amounts, has been used without any modification
  - ② whether or not the data obtained from the client on the subject property, such as the income and expense amounts, has been used without any modification
  - ③ whether or not the data collected by the Appraiser on the subject property, such as the income and expense amounts, has been used.
- (2) When the DCF method is used to determine the value by the income approach, in addition to explaining the selection of the terminal capitalization rate, discount rate, forecasts of future income and expenses, and other individual items that have been assessed, the appraisal report must

lay out the procedure showing how that data was used to determine the value by the income approach and the reasons for using that procedure. The appraisal report must clearly indicate such factors as the possibility of change in the economic situation, the specific comparables that were examined, and it must have a logical consistency. When multiple Appraisers work jointly to appraise multiple properties for securitization, they must ensure a logical consistency among all of the reporting on the subject properties for the selection of terminal capitalization rates, discount rates, forecasts of future income and expenses, and other data used when applying the DCF method.

- (3) The appraisal report must contain a clear statement of the relationship between the value indicated by the income approach, using the DCF method (including verification by direct capitalization), and the indicated value using the cost approach as well as the sales comparison approach. The appraisal report must also state the reasons for arriving at the appraisal value.
- (4) The Appraiser must strive for full accountability, working to improve his or her own knowledge and understanding in order to become proficient in the application of the DCF method.

## II. Uniformity in income and expense items in the DCF method

- (1) When applying the DCF method to determine the value by the income approach, the income and expense amounts for a property for securitization (referred to here as "income and expense items") must be described in the appraisal report for each of several continuous time periods. These time periods should be classified according to the items shown in the following table. Each of the income and expense items should be accompanied by a breakdown of how the figures were calculated. When describing this data in the appraisal report, each item in the "Item" column in the following table should be defined as specified in the table.

	Item	Definition
Effective gross	Room rental income	When all or a portion of the subject property is rented or operated by a contractor, the recurring income (assuming full occupancy)
	Income from common area management charges	Income collected under contracts with tenants for that portion of the recurring expenses for the maintenance, management, and operation of the subject property (including expenses for

		electricity, water, gas, regional heating and air conditioning, etc.) that apply to the common areas management (CAM)
	Utility fee income	Income collected under contracts with tenants for the portion of the recurring expenses for electricity, water, gas, regional heating and air conditioning, etc., in the operation of the subject property that apply to leased areas (assuming full occupancy)
	Parking fee income	Income from leasing the subject property's parking spaces to tenants or from renting parking spaces by the hour
	Other income	Other income from facility installation fees for signs, antennas, vending machines, etc., and income from lump-sum payments that are not refundable, such as key money and renewal fees
	Vacancy loss allowance	Decrease in each income item based on predicted vacancies, for the time it will take to replace tenants, etc.
	Collection loss allowance	Decrease in each income item based on predicted debt collection losses
Operating expenses	Maintenance and management expenses	Recurring expenses for the maintenance and management of the subject property, including building as well as mechanical and electrical (M&E) system management, security, and cleaning
	Utility expenses	Expenses for electricity, water, gas, regional heating and air conditioning, etc. incurred during the operation of the subject property
	Repair expenses	That portion of the expenditures for building and M&E system repair, renovation, etc., of the subject property that are recurring expenses for ordinary building and M&E system maintenance and management, etc. or are incurred to restore the building and M&E systems to their original condition
	Property management fees	Expenses for management services for the subject property
	Tenant recruitment expenses, etc.	Expenses for rental agency services, advertising, etc. to recruit new tenants as well as expenses for lease renewals or repeat leasing contracts with existing tenants
	Tax and public dues	Property taxes (on land, buildings, and depreciable assets) and city planning taxes (on land and buildings)
	Casualty insurance premiums	Premiums for fire insurance on the subject property and accessory equipment as well as liability insurance for losses by third parties, etc. due to subject property defects or management

		failures, etc.
	Other expenses	Other expenses for ground rent, road occupancy and utilization, etc.
Net operating income		Effective gross income minus operating expenses
Operating profit on lump-sum payments		Operating profit on security deposits and other lump-sum payments, which are refundable deposits
Capital expenditures		Portion of expenditures for building and M&E system repair, renovation, etc., which is recognized as increasing the value of the building, M&E system, etc., or strengthening its durability
Net cash flow		Net operating income plus operating profit on lump-sum payments minus capital expenditures.

- (2) When using the DCF method to determine the value by the income approach, it is necessary to identify and explain the income and expense items and their definitions to the client before obtaining the requisite data and to confirm that each income and expense item corresponds to the specified definition.
- (3) Appendix 2 is a sample format for an appraisal report when the DCF method is applied. This format can be revised as necessary to conform with the specific appraisal situation based on factors such as the purpose and the category of the subject property for securitization.

### Supplementary Provisions

#### Supplementary Provisions (completely revised on 3 July 2002)

The real estate appraisal standards will be enforced from 1 January 2003.

#### Supplementary Provisions (partially revised on 2 April 2007)

1. These standards will be enforced from 1 July 2007.
2. Assistant real estate Appraisers are considered to be real estate Appraisers with respect to the application of the revised standards.
3. Approximately once a year, the Ministry of Land, Infrastructure, Transport and Tourism will take all necessary measures, such as any more revision of the standards, when it is recognized that further consideration is necessary of the status of the appraisal businesses based on the revised real estate appraisal standards as stated in this notification.

#### Supplementary Provisions (partially revised on 28 August 2009)

This revision will come into effect on 1 January 2010 and the revised real estate appraisal standards will apply to appraisals that conclude contracts on or after this same date.

#### Supplementary Provisions (partially revised on 1 May 2014)

This revision will come into effect on 1 November 2014 and the revised real estate appraisal standards will apply from the date of appraisal when the contract is concluded.

Appendix 1

Appraiser	Affiliation	Date	Name of property	Location of property			
Basic information about the engineering report and its acquisition							
Basic information about the engineering report and its acquisition	Preparer		Client	Date investigated	Date prepared	Obtained from	Date obtained
	A						
	B						
	C						
D							

How the submitted engineering report was handled in the appraisal, whether an additional investigation by the Appraiser was needed, results of the investigation by the Appraiser, etc.

Results of the investigation and preparer comments (Enter A, B, C, or D in the "Preparer" column)	Explanatory comments from the preparer	Item	Was the engineering report used or did the Appraiser(s) conduct an investigation?	Items used in appraisal and reasons for so including them	
					Location overview
					Building overview
					M&E system overview
					Structural overview
					Regulations and restrictions under public and private statutes (state of compliance with the law)
					Renovation/renewal history and plans
					Emergency repair/renewal expenses
					Short-term repair/renewal expenses
					Long-term repair/renewal expenses
					Replacement cost
					Asbestos (Phase 1)
					PCBs
					Other

  

2. Building environment survey	Asbestos (Phase 2)
3. Soil pollution risk assessment	Soil survey (Phase 1)
4. Earthquake risk assessment	Simple analysis
	Detailed analysis

Barricaded structures or objects	
Building environment survey	Asbestos (Phase 2)
Soil pollution risk assessment	Soil survey (Phase 2)
	Environmental assessment, etc.
Earthquake resistance survey	Earthquake resistance determination by architects, etc.

Note: "Phase 1" indicates investigating the possible presence of toxic substances or pollutants by performing field surveys, collecting and analyzing data, and conducting interviews. "Phase 2" indicates confirming the presence or absence of toxic substances or pollutants by taking samples and conducting chemical analyses. "Simple analysis" indicates analysis using statistical methods. "Detailed analysis" indicates the use of analytical techniques.

**Appendix 2**

Identification of the subject property

Land	Location and parcel number	Land category	Lot area							
Building	Location	House number	Structure	Purpose	Floor area	Date completed				

	Effective gross income										Year after expiration of the preservation period (n+1)	Grounds for assessment			
												Assessment method	Anticipated change	Additional comments	
(a)	Room rental income														
(b)	Income from common area charges														
(c)	Rental income, including income from common area charges [(a)+(b)]														
(d)	Utility fee income														
(e)	Parking fee income														
(f)	Other income														
①	(g)+(d)+(e)+(f)														
	Vacancy loss allowance for (c) and (d)														
	Vacancy loss allowance for (e) and (f)														
	Total vacancy loss allowance														
(g)	Collection loss allowance														
②	Effective gross income [(1)-(g)-(h)]														
(h)	Collection loss allowance														
(i)	Maintenance and management expenses														
(j)	Utility expenses														
(k)	Repair expenses														
(l)	Property management fees														
(m)	Tenant recruitment expenses, etc.														
(n)	Tax and public dues														
(o)	Casualty insurance premiums														
(p)	Other expenses														
③	Operating expenses[(i) + (j)+(k)+(l)+(m)+(n)+(o)+(p)]														
④	Net operating income [②-③]														
(q)	Operating profit on lump-sum payments														
(r)	Capital expenditures														
⑤	Net cash flow[(④)+(q)-(r)]														
(s)	(Reference)														
(t)	Operating efficiency ratio (OER)														
(u)	Balance of lump-sum payments (refundable deposits)														
(v)	Compound present value rate														
(w)	Present value														
(x)	Total for (s) column														

Value indicated by the income approach [(1)+(s)]*	
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(u)	Sale value @ hor:n+1 years / z	
(v)	Sale expenses	
(w)	Reversionary value (u) - (v)	
(x)	Current reversionary value	
(y)	Discount rate	%
(z)	Terminal capitalization rate	%

Reasons for conclusion	Additional comments

## Reference Materials

1. “Japan Real Estate Appraisal in a Global Context” (September 9, 2008; revised 1<sup>st</sup> edition)

(“Real Estate Appraisal Standards in English” (July 31, 2003; 1<sup>st</sup> edition)

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Part 1: Evolution and Characteristics of Japan Real Estate Appraisal

Part 2: Real Estate Appraisal Act

Part 3: Real Estate Appraisal Standards (Partially revised on April 2, 2007)

General Standards (GS)

Specific Standards (SS)

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Part 5: Guidelines for the Appraisal Overseas Investment Properties (GL) (Notified and enforced on January 25, 2008)

(Japan Real Estate Institute, the owner of this book, has granted a license to the Japan Association of Real Estate Appraisers, which has been used in this English translation.)

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第1編：日本の不動産鑑定評価の展開と特質

第2編：不動産の鑑定評価に関する法律

第3編：不動産鑑定評価基準（平成19年4月2日一部改正）

総論

各論

第4編：不動産鑑定評価基準運用上の留意事項（平成19年4月2日一部改正）

第5編：海外投資不動産鑑定評価ガイドライン（平成20年1月25日通知）

（なお、本書籍は、著作物所有者である一般社団法人日本不動産研究所より公益社団法人不動産鑑定士協会連合会宛に「使用許諾」を得ており、今般の英訳においても活用させて頂いた。）

2. 「英語で読む証券化対象不動産の鑑定評価の実務」(2011年7月6日初版)

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I. 日本の不動産鑑定評価制度の概要

II. 不動産鑑定評価基準（各論第3章）

III. 証券化対象不動産の継続評価の実施に関する基本的考え方

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V. 参考資料

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6. 海外投資不動産鑑定評価ガイドライン
7. 不動産鑑定業者の業務実施態勢に関する業務指針  
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8. 日英用語対照表
9. 関連税制等

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