Real Estate Appraisal

Module 1

Chapter 1

Introduction to Appraisal

Key Terms

- Appraisal
- Appraisal Foundation
- Appraisal Institute (AI)
- Appraisal Review
- Appraiser
- FIRREA (Financial Institutions Reform, Recovery, and Enforcement Act)
- USPAP (Uniform Standards of Professional Appraisal Practice)
Real Estate Appraisal

• **Appraisal**: The act or process of developing an opinion of value; an opinion of value
• Not a guarantee of value or a precise determination
• Must be supportable and based on evidence
• Valid as of a certain date—the **effective date**

Historical Background

• **1930s**: Origin of appraisal. It became necessary to create a more organized process of determining value so lenders could make consistent and informed decisions with regard to loans
• **1990**: The **Appraisal Institute** established standards of practice which would later be known as **USPAP**
• **1990s**: Appraisal licensing and certification began

USPAP

• Professional standards accepted and copyrighted in 1987 by the **Appraisal Foundation**
• Revisions occur every 2 years
• **Appraisal Qualifications Board** establishes minimum appraiser education/experience requirements and develops National Uniform Appraiser Examination
• FIRREA recognizes USPAP as current industry standard for appraisals and establishes the Appraisal Foundation as the authority for professional appraisal standards
USPAP Rules
USPAP contains special obligations for appraisers in the form of Rules:
• Ethics Rule
• Competency Rule
• Scope of Work Rule
• Jurisdictional Exception Rule

Ethics Rule
• Includes personal obligations and responsibilities of the individual appraiser, as well as practices that are unacceptable or could be considered misleading or fraudulent
• Details an appraiser’s obligation to perform assignments with impartiality, objectivity, independence, and without bias
• Deals with management issues, confidentiality obligations, and record keeping requirements

Competency Rule
• Requires appraisers have knowledge and experience necessary to complete assignments competently
• Contains specific requirements and procedures for appraisers who don’t have sufficient competence at the beginning of an assignment
Scope of Work Rule
- Contains an appraiser’s obligations in determining extent and level of research and analysis that must be performed in order to achieve credible results
- Scope of work can differ in each appraisal
- Primary reason why an appraisal:
  - Performed for one use cannot be used for other uses
  - Cannot be reassigned from one client to another

Jurisdictional Exception Rule
- Provides guidance and obligations for appraisers when law or public policy contradicts an obligation or prohibition of USPAP

USPAP Standards
- Checklist of personal responsibilities and obligations of the individual appraiser:
  - Standards 1 and 2: Deal with development and reporting (respectively) of a real property appraisal
  - Standard 3: Details proper procedure for appraisal prepared by another appraiser, and reporting the results of that review
USPAP Standards

- Standards 4 and 5: Concerned with development and reporting of a real estate consulting assignment
- Standard 6: Deals with mass appraisals (often for tax purposes)
- Standards 7 and 8: Deal with personal property
- Standards 9 and 10: Deal with business appraisals

Appraisal Work

- Civil lawsuits
- Eminent domain valuations
- Divorces
- Feasibility studies
- Bankruptcies
- Insurance claims
- Estates
- Dispute resolution
- Trusts
- Impact studies
- Zoning changes
- Consulting
- Tax matters
- Determining construction or remodeling costs

Eminent Domain

- Eminent domain is the “right” of the government to take private property for public use, as long as owner is paid just compensation
- Condemnation is the “action” of the government taking private property
- A dispute over eminent domain may end up in arbitration where two different appraisers can come up with differing yet well supported opinions of value for the same property
Appraisal Review

- Act or process of developing and communicating an opinion about the quality of another appraiser’s work that was performed as part of an appraiser, appraisal review, or appraisal consulting assignment
- Takes into account market data available as of an appraisal’s effective date
- An appraisal review can be both a review and an appraisal

Appraisal Qualifications

- Certification or licensing is voluntary in Ohio, but most appraiser work requires the appraiser be state licensed or certified
- All appraisals in excess of $250,000 in transaction value that will be used in connection with any federally-related transaction must be performed by a state licensed or certified appraiser

Appraiser Qualifications

- To become a licensed appraiser, one has to:
  - Be 18 years of age
  - Acquire some level of college education
  - Take necessary prelicensing courses
  - Obtain extensive training through apprenticeship
  - Pass licensing/certification exam
- Continuing education and credential renewal are required on an annual basis
Appraisal Certifications

• Licensed Residential Appraisers may appraise:
  – Residential land, single-family homes, and 2- to 4-unit residential properties valued up to $1 million that are non-complex in nature
  – Residential land or single-family or 2- to 4-unit residential properties with a transaction value of up to $250,000 that are complex in nature

Appraisal Certifications

• Certified Residential Appraisers
  – Have no limit on value or complexity of land, single-family homes, or 2- to 4-unit residential properties they may appraise
• Certified General Appraisers may appraise:
  – Any type of property (e.g., residential, investment, commercial) with no limits on value

Professional Organizations and Designations

• Member in professional organizations is not required
• They offer benefits such as continued educational offerings and the ability to obtain professional designations in recognition of their education, experience, and competence
Professional Organizations and Designations

• Appraisal Institute®
  – MAI ®
  – SRA ®
  – SRPA ®
• National Association of REALTORS ®
  – Residential Accredited Appraiser (RAA)
  – General Accredited Appraiser (GAA)

Chapter 1 Quiz

1.) An appraisal is a(n)
   a. determination of value.
   b. guarantee of value.
   c. opinion of value.
   d. projection of future value.
Chapter 1 Quiz

2.) Which is recognized throughout the U.S. as the accepted standards of appraisal practice?
   a. Appraisal Foundation
   b. Appraisal Institute
   c. FIRREA
   d. USPAP

Chapter 1 Quiz

3.) The primary purpose for the passage of FIRREA was to
   a. bailout the savings and loan industry and try to prevent future insolvency.
   b. develop, interpret, amend, and publish the Uniform Standards.
   c. establish the Appraisal Foundation.
   d. establish professional standards in real estate appraisal.

Chapter 1 Quiz

4.) An appraiser develops an opinion of value of a property
   a. based on an assessment of future events.
   b. based on calculated assumptions.
   c. based on the gathering and analysis of objective facts and data.
   d. consistent with the value needed by a client.
Chapter 1 Quiz

5.) Which USPAP Rule contains obligations of an appraiser in determining the extent and level of research and analysis that must be performed in a particular assignment in order to achieve credible results?
   a. Competency Rule
   b. Ethics Rule
   c. Jurisdictional Exception Rule
   d. Scope of Work Rule

Chapter 1 Quiz

6.) Which USPAP Rule requires appraisers to avoid actions that could be considered misleading or fraudulent?
   a. Competency Rule
   b. Ethics Rule
   c. Jurisdictional Exception Rule
   d. Scope of Work Rule

Chapter 1 Quiz

7.) Which USPAP Rule provides guidance and obligations for appraisers when law or public policy contradicts an obligation or prohibition of USPAP?
   a. Competency Rule
   b. Ethics Rule
   c. Jurisdictional Exception Rule
   d. Scope of Work Rule
Chapter 1 Quiz

8.) Which USPAP Rule requires appraisers to have the knowledge and experience necessary to complete an assignment?
   a. Competency Rule
   b. Ethics Rule
   c. Jurisdictional Exception Rule
   d. Scope of Work Rule

Chapter 1 Quiz

9.) Appraiser certification in Ohio
   a. is voluntary.
   b. requires passing written exams.
   c. requires a minimum of two years of appraisal experience.
   d. all of the above

Chapter 2

Real Estate and Appraisal
**Key Terms**
- Annexer
- Appurtenance
- Bundle of Rights
- Deed Restriction
- Fee Simple
- Fixture
- Personal Property
- Police Power
- Property
- Real Estate
- Real Property
- Site
- Trade Fixture
- Zoning Laws

**Real Property vs. Personal Property**
- **Property**: Right of ownership in an object (e.g., right to use, possess, transfer, or encumber)
  - Anything that is owned, either real or personal
- **Real Property**: Not only physical land and everything attached, but also bundle of rights in real estate
- **Personal Property**: Tangible items (usually) not permanently attached—any property that is not real property
  - Also called chattel or personalty

**Real Property vs. Personal Property**
- Unless otherwise agreed to in advance, all real property is included in the transfer
  - Personal property that happens to be on the land is not included
- Generally, if property is movable and not affixed to land, it’s usually considered personal property
Legal Considerations

• What was the intention of the annexer?
  – *Annexer* is the person who owned the item as personal property and brought it onto the real property

• What was the purpose of the annexation?
• The court will look for objective evidence of the annexer’s intention

Fixtures

• **Fixtures**: Original rule was if item was securely attached to the real property (e.g., nailed down), it was considered a fixture
• Now, physical attachment is still taken into account, but isn’t decisive
  – An oriental rug tacked down is still considered personal property if owner never meant for it to stay with the house
  – Keys to the house and remote control openers for garage doors are considered real property items even though they aren’t physically attached to the property

Trade Fixtures

• Equipment a tenant installs for use in his trade or business that can be removed by the tenant before the lease expires
  – Unless a document forbids it
• When disputes arise, courts take into account the relationship of involved parties
  – Buyers generally favored over sellers
  – Lenders generally favored over borrowers
  – Tenants generally favored over landlords
Bill of Sale

- If separate items of personal property are to be included in the sale of real property, it's best to get a separate bill of sale detailing those items.
- If an item is to be excluded, the fact should be clearly stated in the purchase contract.
- Items included or not included may be important considerations in an appraisal.

Real Estate vs. Real Property

- **Real Estate**: The actual physical land and everything, both natural and man-made, which is attached to it.
- **Real Property**: Not only the physical land and everything attached to it, but also the rights of ownership (bundle of rights) in the real estate.

Bundle of Rights

- All real property rights conferred with ownership including (but not limited to) the right of use, the right of enjoyment, and the right of disposal.
- If one secures the entire bundle of rights, that person has **fee simple** ownership – The greatest estate one can have in real property.
- Freely transferable and inheritable, and of indefinite duration, with no conditions on title.
Appurtenances

- Legal term for access rights, surface rights, mineral rights, some water rights, and limited air rights
- Usually transferred with the property, but may be sold separately
- May be limited by past transactions
- Important for appraiser to know if the entire bundle of rights is being transferred (fee simple) or if there are restrictions

Rights Accompanying Real Property

Deed Restrictions

- Limitations on real property use, imposed by a former owner through language included in the deed
  - Also called restrictive covenants or restrictive conditions
- Usually involve an owner’s promise not to use property in a particular way
- May also grant previous owner or other parties access across land being transferred
Government Restrictions

- Can have more serious impact on land value through **police power**:
  - Land use controls (zoning laws)
  - Environmental protection laws
  - Eminent domain
  - Escheat

Improvements

- Additions to real property
- Can be natural (trees, lot feature) or man-made
- Two types of man-made improvements:
  - To the land (site improvements that provide water, sewer, etc.)
  - On the land (major improvements—buildings/structures)

Improvements to the Land:
**Land vs. Site**

- **Land** refers to surface of the earth
  - Legally also refers to everything under the ground and the land into the air
- **Site** refers to a parcel of land with enhancements that make it ready for a building or structure
  - Site improvements can add value to appraisals of vacant land
  - Site improvements often do not add measurable value to appraisals of homes and other buildings
Improvements on the Land: Fixtures vs. Improvements

- **Fixtures**: Items of personal property attached to, or closely associated with, real property in such a way they legally become part of real property
- **Improvements**: Man-made attachments to real property—generally refer to major fixtures (e.g., a building)

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Improvements on the Land: Fixtures vs. Improvements

- Appraiser must be careful to include everything that is part of real property, and exclude everything that is personal property
- If there is an improvement on real property, this becomes the appraisal’s focal point
- Special fixtures (swimming pool) or site features (ravine) can also positively or negatively affect value
- Market desire may change over time—this is where the appraiser’s experience comes in

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Chapter 2 Quiz

1.) Which would most likely be considered personal property?
   a. barbecue grill
   b. deck at the back of a house
   c. patio
   d. porch
Chapter 2 Quiz

2.) Which would most likely be considered real property?
   a. lawn furniture
   b. roll-away bed
   c. sleeper sofa
   d. window seat

Chapter 2 Quiz

3.) Which issue is considered by the court when deciding if something is real property or personal property?
   a. Is the item securely attached to the property?
   b. What was the intention of the annexer?
   c. What was the purpose of the annexation?
   d. all of the above

Chapter 2 Quiz

4.) The bundle of rights that are transferred with real property ownership are
   a. right of disposal.
   b. right of enjoyment.
   c. right of use.
   d. all of the above
5.) Assuming that they are not limited by past transactions, all are legal appurtenances that go along with the transfer of real estate, EXCEPT unlimited _______ rights.
   a. air
   b. mineral
   c. subsurface
   d. surface

6.) Which government restriction/police power could have the most direct impact on the value of property?
   a. deed restrictions
   b. eminent domain
   c. restrictive covenants
   d. zoning

7.) Which is considered an improvement?
   a. garage
   b. septic system in place
   c. utility line
   d. all of the above
Chapter 3

Value and the Real Estate Market

Key Terms

- Arm's Length Transaction
- Buyer’s Market
- Cost
- Economic Base
- Law of Diminishing Returns
- Law of Increasing Returns
- Market Price
- Market Value
- Progression
- Regression
- Seller’s Market
- Supply and Demand
- Value

Value

- **Value**: The amount of goods or services offered in the marketplace in exchange for something else
  - Not always equal to price, it’s what a typical person would pay for something as determined by the marketplace
Value Characteristics (D-U-S-T) of Real Estate

- **Demand:** Need or desire for a specific good or service by others
- **Utility:** Ability of a good or service to satisfy human wants, needs, or desires
- **Scarcity:** Perceived supply of good or service relative to the demand for the item
- **Transferability:** The ability to freely buy, sell, encumber, or dispose of property in any way the owner sees fit—the fewer restrictions on real estate, the higher the perceived value

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Effective Demand

- **Also called effective purchasing power**
- **Associated with transferability**
- **Considers the ability of a particular market to afford a property**
- **For Example:** When a multi-million dollar home is offered for sale in a market where there is significant poverty or unemployment, there may not be a presence of effective demand

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Physical Characteristics of Real Estate

- **Immobility:** The fact it can’t be moved from one place to another
- **Indestructibility:** Land can’t be destroyed or consumed like other products
- **Uniqueness:** Each parcel of land, each building, and each house are said to be different
  - Also called non-homogeneity

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P-E-G-S

- Four broad forces that affect all aspects of life and the economy—have significant impact on value in the real estate market:
  - Physical
  - Economic
  - Governmental
  - Social

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Economic Forces

- Business cycles
- Economic base
- Supply and demand
- Inflation
- Cost of money (interest rates)

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Governmental Forces

- Revenue generating laws (taxes)
- Right to regulate laws (police power)
- Fiscal and monetary policy
- Secondary mortgage markets
- Government programs
Social Forces

• Demographic changes
• Migrations of the population
• Social trends
• Buyer tastes and standards

Physical Forces

• On a property
  – Topography
  – Water
• External to a property
  – Location
  – Popularity
• Both on and external to a property
  – Environment
  – Environmental issues

Specific Factors That Affect Value

• Change: Constantly occurring, such that none of the great forces or property specific factors remain constant
  – Thus, value is subject to constant change
• Specific factors that affect value can be subdivided into:
  – Economic (broad market) factors
  – Physical (property specific) factors
Economic (Broad Market) Factors

- The most important economic factors that can also have a specific effect on an individual piece of property:
  - Supply and demand
  - Uniqueness and scarcity

Supply and Demand

- Creates:
  - **Buyer’s Market**: Situation in the market in which buyers have a large selection of properties from which to choose
  - **Seller’s Market**: Situation in the market where property offerings are scarce and buyers have fewer properties being offered on the market from which to choose
- The market is said to be in balance when there are slightly more homes available than buyers

Uniqueness and Scarcity

- **Scarcity** is tied to the supply demand model
  - Specifically relates to the fact there is a limited amount of real estate within a geographical region
- **Uniqueness** can be good or bad
  - A “unique” feature of a house could make more or less desirable—in turn increasing or decreasing its value
Physical (Property Specific) Factors

• These principles of value go directly to the very nature of the land itself and its usage:
  – Highest and best use
  – Location
  – Substitution
  – Conformity
  – Contribution

Highest and Best Use

• Most profitable, legally permitted, feasible, and physically possible use of a property
• The most property-specific factor an appraiser considers
• A vital consideration when appraising vacant land or land that has undergone a zoning change

Location

• The exact position of real estate
• Can be talked about with respect to a given neighborhood, and even within the neighborhood itself
• Situs: Term used to describe the place where something exists, an area of preference, or preference by people for a certain location
• Most important aspects of a house or land are location, location, location
Best and Worst Homes

- Aspect of location
- Progression: Value of a home is positively affected by other homes in the area
  - Usually said about the “worst” home in the “best” area
- Regression: Value of a home is negatively affected by other homes in the area
  - Usually said about the “best” home in the “worst” area

Substitution

- Says an informed buyer will not pay more for a home than a comparable substitute
- Can also be applied to items within a home
  - If a fireplace costs $2,500 to add to a typical home in the area, an appraiser can’t justify adding much more than that to the value of a home

Conformity

- Says that a particular home achieves its maximum value when it is surrounded by homes similar in style and function
- Goes for neighborhoods as well
- Principles of progression and regression also come into play here
- Appraisers need to see how well a property conforms to the neighborhood and if the improvements are typical for the neighborhood
Contribution

- Says a particular item or feature is worth only what it actually contributes in value to the real estate
  - Mary owns a 4-bedroom home in a neighborhood of 3- to 4-bedroom homes. She plans on adding a 5th bedroom addition. Since 5-bedroom homes are not desirable in her neighborhood, she should not expect her home’s value to be increased by the same amount as the cost of the addition when or if she sells it.

Law of Diminishing Returns

- Says that beyond a certain point, the added value of an additional feature, addition, repair etc., is less than the actual cost of that item
  - Also called law of decreasing returns
- A homeowner can add too much to a property such that she cannot increase the price enough to recoup the money she has invested

Law of Increasing Returns

- Says the added value of an additional feature, repair, etc., is more than the actual cost of that item
- Of course, one can go too far, and beyond a certain point, the law of diminishing returns will again come into effect
- Remember: The value of an item/improvement is equal only to what the market determines a typical buyer is willing to pay for it, not what it actually cost
Types of Value

- There are many different kinds of value which produce very different value opinions
- A property can have many different values at the same time
- The type and definition of value in an appraisal should always be appropriate for its intended use
  - A seller wants market value, the bank is interested in loan value, and an insurance company is concerned with insurance value

Market Value

- The most probably price a property should bring in a competitive and open market
  - (e.g., an arm’s length transaction—the transaction occurred under typical conditions in the marketplace, with each of the parties acting in their own best interest)
- Value conclusion most frequently specified in an appraisal

Arm’s Length Transaction

- Buyer pays cash for property at closing or obtains mortgage through a lender so as to pay seller the agreed-upon price at closing
- Seller does not grant any unusual payment concessions (e.g., owner financing)
- Buyer and seller are not related in any way
- Buyer and seller are both acting in their own best interests
- Buyer and seller are not acting out of undue haste or duress
- Buyer and seller are both reasonably informed about all aspects of the property, its potential uses, market value, and market conditions
- Property has been available on market for reasonable time period
Market Value and the Secondary Market

- **Market value** is seen as the most probable selling price for real estate by secondary mortgage market participants (Fannie Mae, Freddie Mac) and USPAP guidelines.

Loan Value

- The amount of money a lender is willing to let someone borrow to finance a property.
- Usually a percentage of appraised value, known as a loan-to-value ratio (LTV).
  - A lender may agree to let a person borrow 90% (LTV) of the appraised value. So if a house appraises for $100,000, then the loan value would be $90,000.

Insurance Value

- The amount property can be insured for, usually representing only the replacement costs of the structure and disregarding any value for the land.
  - Because land can’t be “lost,” and only the building needs to be replaced if it is destroyed.
- Can cover:
  - Replacement cost—Building a functional equivalent
  - Reproduction cost—Building an exact replica.
Assessed Value

- The amount of value used to calculate taxes due
  - Usually represents a percentage of market value
- If the market value of a house is $100,000 with an assessment level of 35%, $100,000 x 35% would result in an assessed value of $35,000. This figure is then used along with the millage for a given area to determine tax due.

Other Types of Value

- **Asset Value**: Value of property based on specific investment criteria
- **Book Value**: Value of property as capital based on accounting methods
- **Liquidation Value**: Value a property could get if sold under duress of a must-sell situation with less than typical market exposure
- **Salvage Value**: Value of property in a distress situation

Value vs. Price vs. Cost

- **Value**: What a typical buyer would pay for something
- **Price**: What one buyer paid
- **Cost**: Dollars needed to develop, produce, or build something
- **Market Value**: Most probably price a property should bring in a competitive and open market
- **Market Price**: What the property actually sold for in a transaction
- **Asking Price**: Amount seller asked for property
- **Offering Price**: Amount buyer first proposed to buy property for
Chapter 3 Quiz

1.) The real estate market is said to be in balance when there are more
   a. buyers than houses for sale.
   b. buyers than sellers.
   c. houses for sale than buyers.
   d. houses than apartments.

Chapter 3 Quiz

2.) The influence of the cost of money on real estate is
   a. irrelevant because interest rates are not important to real estate.
   b. less than other big ticket items because mortgages have adjustable rates.
   c. more than other big ticket items because mortgages are long term.
   d. negligible because people are not always rational.

Chapter 3 Quiz

3.) How do the government programs administered by the FHA and VA affect the real estate market?
   a. They build additional low-income housing.
   b. They make fewer houses available for the general public.
   c. They provide insurance or make loan guarantees to lenders.
   d. They service only veterans.
Chapter 3 Quiz
4.) The physical forces affecting real estate contribute to its value because
   a. economies of scale will help those who buy more.
   b. people can just move to a new area anytime they want.
   c. a popular area will always remain popular and desired.
   d. there is a limited supply that cannot be moved, destroyed, or created.

Chapter 3 Quiz
5.) Uniqueness and scarcity help the value of real estate because
   a. it’s impossible to find exactly what you want in a house.
   b. no two properties are exactly the same.
   c. real estate is difficult to find.
   d. real estate is unlimited.

Chapter 3 Quiz
6.) ABC Company just opened in a new suburb of Pittsburg. Potential workers are hoping to move into the area but there are limited houses for sale and no new construction underway. What type of market has been created?
   a. a balanced market
   b. a buyer’s market
   c. a seller’s market
   d. a trader’s market
Chapter 3 Quiz

7.) A new company that moves to an area helps the local real estate market by helping maintain a healthy
a. balance.
b. economic base.
c. economy of scale.
d. environment.

Chapter 3 Quiz

8.) A nice, well-kept house located in the heart of an all-residential area, surrounded by other well-kept houses of similar style and value, is an example of
a. conformity.
b. highest and best use.
c. both conformity and highest and best use.
d. neither conformity nor highest and best use.

Chapter 3 Quiz

9.) A run-down house in a good neighborhood
a. benefits from the principle of progression.
b. benefits from the principle of regression.
c. is hurt by the principle of progression.
d. is hurt by the principle of regression.
Chapter 3 Quiz

10.) When the value of an additional feature is worth more than the actual cost of the item, this is an example of the law of
   a. decreasing returns.
   b. diminishing returns.
   c. increasing returns.
   d. none of the above

Chapter 3 Quiz

11.) Maximum value for a property can be achieved only when
   a. demand, utility, scarcity, transferability, and purchase ability are present.
   b. the market is in balance.
   c. supply outweighs demand.
   d. there is a buyer’s market.

Chapter 3 Quiz

12.) Market value is the
   a. dollars needed to rebuild the property.
   b. price determined by Freddie Mac, Fannie Mae, and/or USPAP.
   c. price a property actually sold for.
   d. theoretical price that real estate is most likely to bring in a typical transaction.
Chapter 3 Quiz
13.) Which is NOT part of an arm’s length transaction?
   a. buyer and seller are acting in their own best interest
   b. buyer and seller are not related
   c. buyer and seller are reasonably informed about the property and its uses
   d. buyer and seller have agreed upon payment terms for a land contract

Chapter 4
The Appraisal Process

Key Terms
- Change
- Cost Approach
- Income Approach
- Lease
- Life Estate
- Partial Interest
- Sales Comparison Approach
- Site
- Subject Property
The Appraisal Process

- Appraisal opinions are developed objectively
- An appraisal must follow a step-by-step procedure (ensures process is orderly)
  - Allows appraisals to be valuable tool lenders and others can rely on when making assessments and decisions with regard to a specific property

Defining the Problem

- Consists of identifying information the appraiser uses to determine the scope of work in an assignment.
- Here, the appraiser identifies these elements:
  - Client and intended users
  - Intended use
  - Purpose of the appraisal
  - Date of value opinion
  - Relevant property characteristics
  - Other assignment conditions
Identify the Client and Other Intended Users

- **Client** is the party who engages the appraiser in an appraisal assignment, and with whom the appraiser has an appraiser-client relationship.
- **Intended user** is a party identified by the client at the time of the assignment. The client is always an intended user in an assignment.
- Additional intended users may be specified by the client; and may or may not have the same need or use as the client.

Identify the Client and Other Intended Users

- In a mortgage transaction, the borrower, property owner, and/or the real estate agent are not intended users in an assignment unless specified by the client at the onset.
  - An appraiser cannot, without such specification or later consent, discuss the appraisal or the appraised value, or provide a copy of an appraisal report to any of these parties.
- Per USPAP, paying for an appraisal does not make that party the client or an intended user.

Identify the Intended Use and Purpose of the Appraisal

- The **use** of the appraisal is a key determinant of the research and analysis performed during the appraisal’s development.
  - Similar to intended users, different intended uses might require different research and/or analysis, or at different levels.
- The **purpose** of an appraisal is always to determine a value opinion for a defined type of value and is very different from the intended use of the appraisal.
Identify the Date of the Value Estimate

- Two dates are required for every appraisal:
  - Effective date establishes the context for the value opinion (can be current date, retrospective date, or prospective date)
  - Date of the report is an indication of the perspective from which the appraiser is examining the market
- Appraisals are usually performed with a current effective date
- A retrospective appraisal uses an effective date in the past
- A prospective appraisal uses an effective date in the future, valuing the property utilizing anticipated market conditions

Identify Property’s Relevant Characteristics

- Have significant influence on extent to which:
  - Property is identified and/or inspected
  - Data that will be researched and analyzed,
  - Valuation methods employed
  - Final reconciliation of value.
- Include both physical and legal specifics of real estate and the rights being considered in the assignment

Type of Property

- An appraiser will likely approach assignments quite differently:
  - Identification of proposed improvements requires extensive analysis of construction documents
  - An existing structure usually entails a completely different identification process
  - A drive-by inspection may not be sufficient if property being appraised is not visible from road
  - Appraising a fractional interest in real property is technically different, depending on type and definition of value and the property’s characteristics
Location

- Properties can be **specific** or **general** in use
- Another relevant property characteristic to location is **economic considerations**
- **Supply and demand** is related to economics and physical characteristics

---

Interest to be Appraised

- **Fee simple interest** (entire physical property including bundle of rights)
- **Partial interest** (any interest in real estate which one may have other than the full bundle of rights — Lease, life estate, fractional interest, a physical segment of the property)
- Any personal property being considered in the assignment
- Each type of appraisal requires different skills and experience to arrive at an accurate estimate of value

---

Identify Other Assignment Conditions

- Laws, regulations, and guidelines that apply in the assignment — For Example: Requirements of HUD, the FHA, VA, Fannie Mae, Freddie Mac, and Ginnie Mae
- Ethically, the appraiser cannot disregard these conditions
Examples of Other Assignment Conditions

• FHA requires appraiser to view crawl space and attic, and observe the operation of mechanical systems (as applicable).
• Fannie Mae does not allow for the appraisal of a physical segment (or part) of a property
• Fannie Mae (and others) requires the use of the standardized residential reporting forms
• Fannie Mae (and others) requires the interior and exterior of a manufactured dwelling be inspected
• Fannie Mae (and others) requires a minimum of three comparable sales when developing the sales comparison approach

Scope of Work

• Includes the appropriate development elements for the remainder of the assignment
• An “appraisal plan”—an outline identifying the work needed to complete the appraisal
  – Can be used as a guide for all who will participate in the appraisal, as well as a basis for the appraiser to establish an appropriate fee for the assignment
• Determines the steps going forward including:
  – Extent to which the property is identified
  – Extent to which the property is inspected
  – Type and extent of data researched
  – Type and extent of analysis applied

Collection and Analysis of Data

• Real estate appraiser must verify the data
• It's important for the appraiser to ensure that all data and facts relied upon in performing the appraisal are the most current and complete available
• Two types of appraisal data are:
  – General data
  – Specific data
General Data

- This general data will cover some of the broad forces that we talked about which affect value: P-E-G-S
- General data sources typically include:
  - Government records
  - Public records and filings
  - Magazines, newsletters, and trade publications
  - Other sources relied upon for their timeliness and accuracy
- Most appraisers keep up-to-date files with the latest information on economic trends in an area and changes in laws and other aspects affecting real estate markets

Specific Data

- Specific data that's collected, verified, and analyzed can be further divided into two categories:
  - Data about the subject property
  - Data for comparative purposes

Subject Property Data

- Includes information on a subject's site and improvements
  - Site's legal description often found in title work or public records, and verified by personal observation
  - Description of improvements acquired through personal observation of structure’s interior and exterior
- USPAP rules state an appraiser must also analyze any current sales contract, option, or property listing, if available, and analyze any prior sales of the property occurring within the past 3 years
Comparative Purpose Data

- Requires that data be obtained for each of the approaches to value being developed

<table>
<thead>
<tr>
<th>Approach</th>
<th>Obtained From</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales Comparison</td>
<td>• Buyers, sellers, real estate agents, multiple listing services, and public records</td>
</tr>
<tr>
<td>Cost</td>
<td>• Cost manuals detailing building and construction costs in a given area</td>
</tr>
<tr>
<td></td>
<td>• Good relationships with builders and developers</td>
</tr>
<tr>
<td>Income</td>
<td>• Sellers, investors, accountants, and others</td>
</tr>
<tr>
<td></td>
<td>• Internet-based sources, from public records to cost information</td>
</tr>
</tbody>
</table>

End Module 1

Real Estate Appraisal

Module 2
Determine Highest and Best Use

- Heart of the valuation process
- Appraiser must look at use of land which supports the highest value for property as of the effective date of the appraisal
- Is the property being used for its most profitable permitted use?
  - Considerations differ in residential vs. commercial situations, and for vacant vs. improved land

Determine Highest and Best Use

- The appraiser performs three steps:
  1. Estimates value as if the land were vacant
  2. Estimates value as the land is currently improved
  3. Compares the values derived from each of the first two steps to determine the highest and best use
Tests of Highest and Best Use

<table>
<thead>
<tr>
<th>Tests of Highest and Best Use</th>
<th>Evaluation Based Upon</th>
<th>Questions</th>
</tr>
</thead>
<tbody>
<tr>
<td>If the ideal improvement ...</td>
<td>Evaluation Based Upon</td>
<td>Questions</td>
</tr>
<tr>
<td>Legally permitted?</td>
<td>Government restrictions, as well as deed or other restrictions</td>
<td>In the ideal type of building permitted with the existing zoning on the property?</td>
</tr>
<tr>
<td>Physically possible?</td>
<td>Physical limitations of the land</td>
<td>What's the chance of zoning change?</td>
</tr>
<tr>
<td>Economically feasible?</td>
<td>Economic limitations of the improvement</td>
<td>What is the best use for the property?</td>
</tr>
<tr>
<td>The most profitable?</td>
<td>The economic advantage that would be produced</td>
<td>How much would it cost to change to the best use?</td>
</tr>
</tbody>
</table>

Other Points about Highest and Best Use

- If certain uses are not possible, the appraiser should note this in the appraisal report, along with the appropriate reasons.
- A valid analysis of highest and best use translates into the most profitable use of the land, which in turn determines the most probable (and highest) price property can command in open market.

Other Points about Highest and Best Use

- Assumptions made when discussing the determination of highest and best use:
  - Only one highest and best use for land at a given point in time
  - Implies the right mix of capital improvements and land
  - Land not devoted to highest and best use results in loss of income
  - Gives the owner maximum economic advantage
  - Allocates land resources efficiently; maximizing economic return
  - Gives economic benefits to surrounding land (conformity)
  - Gives economic benefits to community (conserve a scarce resource—land)
Determine Value of Land

• A separate site/land value is used for:
  – Cost approach method (added to cost of replacing building to arrive at a total value)
  – The building residual income technique
  – Insurance appraisal (value sought for building without regard for land)

• Five popular methods to derive a value for land apart from any structures on it:
  – Sales comparison
  – Allocation
  – Subdivision analysis
  – Land residual
  – Ground rent Capitalization

Application of the Approaches to Value

• Value opinion for subject property should be developed using applicable approaches to value
  – Sales comparison approach
  – Cost approach
  – Income approach

Application of the Approaches to Value

• Questions that come to mind when determining the applicability of the approaches to value:
  – How can the sales comparison approach be used if there aren’t enough (or any) recent comparable sales in the area for an uncommon building that’s being sold (e.g., school, church, library)?
  – How can the cost approach be used to arrive at an accurate cost for an old building, a unique building (e.g., museum), or a large structure subject to future inflationary pressure to rebuild and prone to cost overruns (e.g., arena)?
  – How useful is the income approach for residential properties in an area almost exclusively owner-occupied and there is little or no data on rent or income figures for homes in the area?
Reconciliation and Final Value Estimate

- Value indications are reconciled to arrive at a final value conclusion
  - Rarely, if ever, are the value indications from different approaches equal
- Appraiser gives each approach to value an appropriate weight, depending on property type and the amount and quality of data available
- The indications from each of the three approaches are never mathematically averaged
- The appraiser is able only to form an opinion of the value of a property. Only the marketplace can truly determine the value of a property

USPAP and Report Conclusions

- Three important requirements for all reports, written or oral, from which USPAP does not allow deviation:
  
  Each written or oral property appraisal report must:
  (a) clearly and accurately set forth the appraisal in a manner that will not be misleading;
  (b) contain sufficient information to enable the intended users of the appraisal to understand the report properly; and
  (c) clearly and accurately disclose all assumptions, extraordinary assumptions, hypothetical conditions, and limiting conditions used in the assignment

Report Conclusions

- The final step of the valuation process is to prepare and submit a report of the conclusions
- Report should include all data gathered and analyzed, including specific references where appropriate to support conclusions, and a final value estimate for the subject property
Report Types

• USPAP allows appraisal to be oral or written
  – Oral reports are rare for most appraisals, and have special USPAP requirements
• Appraisal report is primary means of communicating the appraisal results to the client
• The appraiser may choose, based upon the intended use and the intended user(s) of the appraisal, various levels of reporting as allowed by USPAP
• The appraiser may choose, or be directed by the client, to report the appraisal by using a narrative format, which is somewhat like a thesis, or a reporting form
• Most residential appraisals for use in financing utilize standardized mortgage industry forms

Uniform Residential Appraisal Report (URAR)

• A standard industry appraisal report form used by lenders and appraisers
• Developed and approved by secondary mortgage market participants Fannie Mae and Freddie Mac
• Used for residential appraisals and preferred by lenders because it is standardized
  – Allows residential properties to be compared in a consistent manner

Chapter 4 Quiz

1.) Which is NOT an approach to value?
   a. comparative market analysis
   b. cost approach
   c. income approach
   d. sales comparison approach
Chapter 4 Quiz

2.) Defining the appraisal consists of identifying the
   a. effective date of the appraisal.
   b. purpose of the appraisal (type of value).
   c. relevant characteristics of the property being appraised.
   d. all of the above

Chapter 4 Quiz

3.) A partial interest is
   a. also known as fee simple interest.
   b. an interest that is the entire bundle of rights, plus some additional rights.
   c. any interest in real estate that is less than the entire bundle of rights.
   d. none of the above

Chapter 4 Quiz

4.) The principle of change says
   a. all factors that influence real estate are constantly changing and, thus, the property value itself is subject to constant change.
   b. the property value itself should only increase.
   c. some factors that influence real estate are subject to change and, thus, the property value itself may change from time to time.
   d. the appraiser and the method used will affect the market value of real estate.
Chapter 4 Quiz

5.) Why is the effective date important in an appraisal?
   a. The appraisal is valid for one year from the date of the appraisal.
   b. The appraisal is valid for six months from the date of the appraisal.
   c. The appraisal is valid only as of the effective date on the appraisal.
   d. The date is not important because of the principle of change.

Chapter 4 Quiz

6.) Which type of data may be relevant to an appraisal?
   a. general data covering the great forces in the marketplace
   b. specific data for comparative purposes (such as other sales or cost information)
   c. specific data on the subject property (such as legal description)
   d. all of the above

Chapter 4 Quiz

7.) When looking at highest and best use, what is the primary question the appraiser must answer?
   a. Can the client afford to have existing improvements razed?
   b. What is the best way to ensure value without tearing down the existing structure(s), if at all possible?
   c. What is the ideal improvement for each possible zoning type?
   d. What is the ideal improvement for the land if it were vacant?
Chapter 4 Quiz

8.) Which is NOT an important assumption of highest and best use?
   a. Highest and best use gives maximum economic advantage to the owner.
   b. Highest and best use implies the right mix of capital improvements and land.
   c. Land devoted to highest and best use will always result in a loss of income.
   d. There is only one highest and best use for land at a given point in time.

Chapter 4 Quiz

9.) When reconciling indications of value, an appraiser ________ mathematically averages them.
   a. always
   b. never
   c. rarely
   d. sometimes

Chapter 4 Quiz

10.) According to USPAP, appraisal reports must
    a. be prepared on an industry form.
    b. be provided to the client in written form only.
    c. be provided to the property owner, even if he is not the client.
    d. clearly and accurately set forth the appraisal in a manner that will not be misleading.
Chapter 5

Appraisal Data

Key Terms

- Cost Manuals
- General Data
- Multiple Listing Services (MLS®)
- Specific Data
  - Subject Property Data
  - Comparative Purpose Data
- Uniform Residential Appraisal Report (URAR)

Types of Appraisal Data

- As a review, there are two categories appraisal data can fall into:
  - General Data
  - Specific Data
Types of Appraisal Data

• General Data covers forces that affect a property’s value, but are not directly related to a particular property
• Specific Data covers all information relevant to the subject property itself or specific comparable properties
  – Subject Property Data includes information on subject property site and improvements
  – Comparative Purpose Data includes information about comparable sale properties, as well as income and cost information

General Data Resources

<table>
<thead>
<tr>
<th>General Data Resources</th>
<th>Government Reputations</th>
<th>Professional Reputations</th>
<th>Other Resources</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government census data</td>
<td>Trade publications or newsletters</td>
<td>Magazines and newspapers</td>
<td></td>
</tr>
<tr>
<td>Government publications</td>
<td>Professional magazines, journals</td>
<td>Maps and reports</td>
<td></td>
</tr>
<tr>
<td>Government records</td>
<td>REALTOR® boards</td>
<td>Lenders and mortgage companies</td>
<td></td>
</tr>
<tr>
<td>Court house and registers</td>
<td>Multiple listing services (MLS)</td>
<td>Property managers and rental companies</td>
<td></td>
</tr>
<tr>
<td>Public records and filings</td>
<td>Internet resources</td>
<td>Moving and storage companies</td>
<td></td>
</tr>
<tr>
<td>U.S. Department of Commerce or local chamber of commerce</td>
<td>Home builder associations or other professional associations</td>
<td>Employment agencies or labor groups</td>
<td></td>
</tr>
<tr>
<td>Planning, highway, county commissioner’s offices</td>
<td>Accountants, lawyers, engineers, and other business people</td>
<td>Builders, contractors, and architects</td>
<td></td>
</tr>
<tr>
<td>FHA or other government agencies</td>
<td>Specialized research companies</td>
<td>Colleagues and other contacts</td>
<td></td>
</tr>
</tbody>
</table>

Specific Data Resources

<table>
<thead>
<tr>
<th>Specific Data Resources</th>
<th>Property Specific</th>
<th>Comparative</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal inspection</td>
<td>County records, deed, mortgage</td>
<td>Multiple listing services (MLS)</td>
</tr>
<tr>
<td>Buyer, seller, broker, and agent</td>
<td>Internet resources</td>
<td>Published, recorded information</td>
</tr>
<tr>
<td>Sales Comparative Data</td>
<td>Cost Approach Data</td>
<td>Income/Expense Data</td>
</tr>
<tr>
<td>Personal inspection (condition)</td>
<td>Personal Inspection (depreciation)</td>
<td>Personal Inspection (vacancy)</td>
</tr>
<tr>
<td>Buyer, seller, broker, and agent</td>
<td>Cost manuals (books, electronic, internet)</td>
<td>Seller, broker, and agent</td>
</tr>
<tr>
<td>County records, deed, mortgage, sales</td>
<td>Supply houses and labor pools</td>
<td>Property managers and rental companies</td>
</tr>
<tr>
<td>Multiple listing services (MLS)</td>
<td>Architects, contractors, and engineers</td>
<td>Accountants and other professionals</td>
</tr>
<tr>
<td>Computer databases and Internet</td>
<td>Internet resources</td>
<td>Financial statements</td>
</tr>
<tr>
<td>Published, recorded information</td>
<td>Professional magazines, journals, and organizations</td>
<td>Professional journals and organizations</td>
</tr>
</tbody>
</table>
Data Collection

- Collected data should first be verified for relevancy, accuracy, and reliability
- Ideal sales comparison data should reflect market conditions similar to those on the effective date of the appraisal
- Cost approach data should be from the most recent cost sources
- Income and expense data should be relevant and representative to the type of value in the assignment
  - For example, market level income and expenses are used when appraising for market value

Efficient Data Collection

- Technology has assisted to streamline the appraisal process.
  - From cross-checking and cross-referencing sources to gathering data and completing appraisal reports
- One of the best means for verifying much of the data about the subject property is still a personal inspection

General and Specific Data Sections—URAR Form

- The URAR is a standard appraisal report form used by lenders and appraisers
  - Developed and approved by Fannie Mae and Freddie Mac
- The first page of the URAR is where general and specific data are discussed
- Appraiser may complete additional addenda pages to further comment on any area of information/analysis used in the appraisal
Subject Data

• First section on the URAR deals with data on the subject property
• Data requested
  – Legal description
  – Assessor’s parcel number
  – Taxes
  – Current owner
  – Neighborhood
  – Map reference
  – Census tract
• The balance of the information is supplied by the lender or available from the purchase contract.

Census Tract Map

Neighborhood Data

• Involves both general and specific information
• Is the neighborhood considered:
  – Urban? (an area within a town/city that has full availability to all services common to that setting)
  – Suburban? (associated with an area adjacent to an urban area, but may enjoy some or all of the common services as do urban residents)
  – Rural? (an area disassociated with an urban or suburban setting, usually not having access to common services with the urban area)
• Many lenders/investors perceive more risk associated with lending for properties specified as rural
Neighborhood Boundary Map

Site Data
- Combination of research facts and personal observations
- Main information needed:
  - Legal description
  - Zoning information
  - A map
- Appraiser may make a simple sketch of shape and dimensions, encroachments, easements, or physical features

Zoning Map

The white areas are residential zones.
The black areas are commercial zones.
The gray areas are industrial zones.
Plat Map

Subdivision Plat Map

Site Sketch
Description of Improvements

- Almost all of this information can be obtained from personal observation
- Other sources: The seller, real estate agent, or other person who has knowledge of the property
- Appraiser must verify as much of this information as possible
- If information cannot personally be verified, the source of that information must be noted in the appraisal file and appraisal report
- Some of these items may affect the value of the subject property
Chapter 5 Quiz

1.) The types of data an appraiser may collect in preparing an appraisal are:
   a. general data on a national and local level.
   b. specific data about the subject property.
   c. specific data for comparative purposes.
   d. all of the above

Chapter 5 Quiz

2.) A primary purpose of gathering general data is to
   a. act as a means of verifying and cross-checking specific data.
   b. correlate general data with a specific subject property and its selling price.
   c. look at general trends that may affect value in the real estate market.
   d. make specific predictions about future interest rate levels.

Chapter 5 Quiz

3.) The most reliable resource for gathering specific data about the subject property is
   a. the FHA or other government agencies.
   b. personal inspection.
   c. professional journals.
   d. the property owner.
Chapter 5 Quiz

4.) Which is important to the data collection process?
   a. analysis of data only
   b. both analysis of data and verification of data
   c. neither analysis of data nor verification of data
   d. verification of data only

Chapter 5 Quiz

5.) Which data section appears in the Uniform Residential Appraisal Report?
   a. neighborhood data
   b. site data
   c. subject data
   d. all of the above

Chapter 6

External and Environmental Influences
Key Terms

- Decline
- Environmental Hazard
- Gentrification
- Growth
- Neighborhood
- Nuisance
- Radon Gas
- Revitalization
- Stability
- Stigmatized Property

Neighborhoods

- Any constant, contiguous area that may be identified by similar characteristics or physical boundaries
  - Also referred to as a market area
- Can be defined by:
  - Shared physical characteristics (similar style, age)
  - Shared physical boundaries (natural or artificial)
  - Similar uses or zoning
  - Price ranges or income levels
  - Shared shopping, social, civic, or recreational facilities

- Cannot be defined by race, ethnicity, or any other protected classes
- Appraiser must define the neighborhood for each appraisal but must be careful not to use superficial boundaries
Neighborhood Boundaries
• Natural boundaries: Rivers, lakes, parks, mountains, or valleys
• Artificial boundaries are man-made dividing lines: Streets, highways, railroads, school, zoning, or political districts
• During the personal inspection, the appraiser looks for:
  – Similarity of land usage and types of improvements
  – Consistency of building style and landscaping
  – Maintenance or upkeep

February 2015
Neighborhood Boundaries
• Appraiser should test conclusion of boundaries by comparing social and economic characteristics to make sure these are consistent within the defined neighborhood
• Census data or other data on age, occupation, income level, etc., should be gathered and compared to confirm neighborhood is appropriately defined

February 2015
Neighborhood Life Cycles
• A properly defined neighborhood will likely continue to age together
• A neighborhood’s life cycle includes four stages:
  1. Growth
  2. Stability/Equilibrium
  3. Decline
  4. Revitalization
Growth
• First stage, when property values rise as development activity begins and continues
• Buyers fuel this growth by continuing to purchase property in the area
• This demand equals acceptance of the area and prices being charged, and allows the area to grow to maturity

Stability/Equilibrium
• Second stage, when the area is built up to the point where there is little, if any, vacant property
• Characteristics:
  – Property values at their highest
  – Demand typically remains high
  – Stability and maturity
• Some neighborhoods may never go beyond this stage

Decline
• Third stage, when property values begin to fall as demand falls
• Characteristics:
  – Observable through decay/deterioration
  – Area becomes even less desirable
  – Lower prices
  – Lower-income residents with less money for repairs will be attracted to the homes
• May be accelerated by conversion of properties to rental units, or to commercial uses
Revitalization
• Final stage, when property values rise again as demand increases, resulting in increased renovation and rehabilitation
• Characteristics:
  – Neighborhood can return to stability/equilibrium state
  – Properties again seen as attractive; people fix up homes
  – Generally a slow process
• Gentrification: Process of rapid revitalization of properties where current residents are displaced
  – Benefits neighborhood but can create problems for tenants

How the Four Broad Forces Affect Neighborhoods
• P-E-G-S also influence neighborhoods
• These forces can affect the boundaries of neighborhoods as well as the neighborhood’s life cycle
• The effects can be positive or negative

Economic Effects
• Can play a role in determining the boundaries of a neighborhood through:
  – Housing prices
  – Income level of the residents
  – Level of business development in the area
  – Property usage
• May affect the construction industry
• A neighborhood’s life cycle may be affected by:
  – Income levels and general business activity
  – Economic base
  – High interest rates (affect low-income neighborhoods the hardest)
Governmental Effects

- Main determinants of a neighborhood's boundaries:
  - City streets and other man-made barriers
  - Zoning
  - School or taxing districts
  - Designation of a historical district
  - Boundaries of governmental services (e.g., fire and police departments)
- All of the above can also influence a neighborhood's life cycle

Social Effects

- Determinants of a neighborhood's boundaries:
  - Recreational and cultural activities
  - Accessibility to commercial, retail, and jobs
  - Level of education and social status of given area
  - Buyer perceptions of neighborhood's social factors
- Influences of a neighborhood's life cycle:
  - The perception of convenience
  - Demographic trends (e.g., population age, family size)

Physical Effects

- Determinant of a neighborhood's boundaries:
  - Roads and rivers
  - Parks and other areas of similar land usage
  - Properties with comparable maintenance and upkeep
- Influences of a neighborhood's life cycle:
  - Road or zoning changes
  - Maintenance and upkeep of homes
  - Conformity of architectural styles of buildings or homes
  - Nuisances or environmental hazards
Nuisances
• Nuisance: Anything outside property boundaries that interferes with the right of quiet enjoyment
  – Must originate from another person's property
  – One cannot be a nuisance to himself—only to neighbors
  – Permanent nuisance is an external obsolescence
  – Cannot contribute to neighborhood/property values in a positive way

Environmental Hazard
• A situation in which there is potential for harm to persons or property from conditions that exist in a property or the surrounding area
• Can be either separate from a property or contained within the boundaries of a property

External Environmental Concerns
• Cover more than just nuisances:
  – Toxic substances in nearby landfills
  – Waterways with high levels of pollution
  – Thick smog from nearby factories
• Other less-quantifiable hazards:
  – Proximity to nuclear power plants
  – Presence of high-tension power lines
• Property owners often feel helpless, since these hazards are often outside their control and may never be removed or cleaned up
Stigmatized Properties

- Properties made undesirable to most people by a past event; often a crime or environmental hazard:
  - Traumatic acts (murder suicide)
  - Toxic waste dumps
  - Nuclear power plants that have been shut down
- Most times, the agent must disclose this fact to prospective buyers
  - Check your broker's policies

Stigmatized Properties

- The fear may persist even after the hazard has been removed or neutralized
- A buyer's typical reaction is: “Why take a chance when there are ready substitutes elsewhere?”
- It can be difficult for a neighborhood to make the transition from decline to revitalization

Environmental Concerns within a Property

- Some of the primary environmental concerns include:
  - Lead-based paint
  - Asbestos
  - Underground storage tanks
  - Radon Gas
  - Mold
  - Meth labs
  - Urea-formaldehyde foam insulation

February 2015
Environmental Concerns within a Property

• If any of these concerns are present:
  – Sellers must disclose it on the Residential Property Disclosure Form
  – Appraiser must note it as they have an impact on property value

• If there is suspicion any of these hazards are present, an expert should be called

Lead-Based Paint

• Residential Lead-Based Paint Hazard Reduction Act: Sellers and landlords are required to disclose known lead paint hazards for homes built prior to 1978:
  – Must give buyers/tenants any reports available from prior lead tests
  – Must give buyers/renters a pamphlet on how to protect families from lead in homes

Lead-Based Paint

– Home buyers have a 10-day period (or other mutually agreed upon time) to conduct lead paint inspection or risk assessment at their own expense, if desired
– Sellers, landlords, and real estate agents must include certain language in sales contracts and/or leasing agreements to ensure that disclosure and notification actually take place. (This has been included in most board real estate contracts.)
Lead-Based Paint

- Sellers, landlords, and real estate agents all share responsibility for ensuring compliance
- Sellers aren’t required to remove lead paint, correct hazards, nor do any testing
- Certain properties are exempt
- Not always a major issue—seen as correctable
- Contingency language in purchase contracts should spell out what happens if lead paint hazards are found

Asbestos

- Fibrous material once very common in building materials due to insulating and heat-resistant value
  - Especially used around furnaces and ductwork
  - Commonly used as a roofing shingle, exterior siding, and floor covering material
- No longer used—loose asbestos particles believed to cause cancer if the enter lungs

Asbestos

- Can pose a value problem:
  - Removal is expensive process
  - Must be done by EPA-licensed contractors
- Remove or leave it alone?
  - Since it is only thought to be a problem once it becomes airborne, some people believe it best not to disturb it
  - If left alone, it could become airborne at a future point due to some unforeseen accident or fire
Urea-Formaldehyde Foam Insulation

- Type of insulation that was popular because it could be blown into an existing structure
  - Recently, safer types of blown insulation have been developed as alternatives
- Banned from residential use by EPA because of potential health risks from toxic fumes the substance can give off when first installed

Radon Gas

- Naturally occurring radioactive gas that emanates from the earth:
  - Odorless, colorless, and tasteless
  - Identified as a cancer-causing agent
  - Radioactive and, if indoors, can build up to dangerous levels
- Radon can vary from one house to the next—even on the same street

Radon Gas

- Effect on property values is hard to determine:
  - Cost of purging a house of radon gas is relatively inexpensive
  - Low levels of radon: Simply sealing cracks may be enough
  - Higher levels of radon: May need to install a remediation system that includes a fan or blower to bring in fresh air and keep air moving through the house
Radon Gas

- Liability issue:
  - Who pays for associated costs of fixing the problem?
  - What about health issues?
- Presently, sellers generally not held liable if they did not know of the existence of any adverse conditions
  - This could change as sellers can now be held liable for other environmental hazards—even if the sellers did not know they existed
- Sellers must disclose any known radon hazards

Underground Storage Tanks

- EPA has enacted tougher standards by imposing additional steps owners and property managers must take to protect underground storage tanks against corrosion, spills, leaks, and overfills
- Tanks that hold less than 100 gallons, fuel tanks used for heating, and certain waste water treatment tanks are exempt
- The Residential Property Disclosure form requires seller to disclose presence of any underground storage tanks or wells

Underground Storage Tanks

- The common practice for the storage of fuel or chemicals in rural areas may now be an expensive process
  - Ensuring tanks don’t leak
  - Digging them up/removing them altogether
- Can pose even bigger environmental dilemmas for commercial properties, where costs can be much higher
Mold

- A fungus that can grow anywhere on any organic material
- To grow, it requires moisture, oxygen, and a food source
- Some molds produce toxic substances known as mycotoxins. One of these types of mold is stachybotrys, or black mold:
  - Greenish-black in color and grows on materials with high cellulose content such as drywall, ceiling tiles, and wood that is chronically moist
- There are many different varieties and types
- Different types may or may not dangerous to humans
- Can produce allergens which can trigger reactions (e.g., wheezing, eye/skin irritation, stuffy nose, asthma attacks)
- Suspected health issues:
  - Chronic fatigue
  - Flu-like symptoms
  - Immune system, neurological, and digestive problems

Mold

- EPA has not specifically required mold disclosure or set standards to measure contamination
- Signs indicating presence of moisture, increasing the likelihood of mold, include:
  - Visible mold growth
  - Leaking roofs/windows
  - Warped wood
  - Peeling dry-wall tape
  - Plumbing leaks
  - Musty odors
  - Water stains on ceilings, walls, or floors
  - Cracked/peeling paint
  - Clogged gutters
Mold

- Licensees must be careful not to act as experts or make claims they cannot verify
- Sellers should be encouraged to disclose any actual or potential problems
- More states may implement new laws regarding mold and real estate, including disclosure statements and requirements for licensees
- Extra steps that may be taken include:
  - Homebuyers purchasing separate mold protection insurance
  - Property inspection by a mold specialist

Methamphetamine (Meth) Labs

- An illegal, man-made drug that is extremely addictive
- Since the ingredients are not necessarily hard to find, meth labs are found in homes, apartments, motels, wooded areas, and cars
- Meth’s cooking process creates:
  - Higher risk of fire and explosions
  - Dangerous residue, toxic byproducts, and fumes

Methamphetamine (Meth) Labs

- Meth residue cannot always be removed
  - Some houses have been demolished as a result of the proliferation of chemicals
- Toxic byproducts can create mini toxic waste sites
- Anyone living in a contaminated property can develop health problems:
  - Serious respiratory problems
  - Burning in the hands and feet
  - Nausea
  - Headaches
  - Liver damage
Other Environmental Concerns

- Amendments to CERCLA have increased the burden on sellers/owners of property
- By increasing scope of liability, burden of identifying hazardous sites has been placed on the marketplace
- All parties to a transaction must take steps to protect themselves:
  - Appraisers must make extra effort to ensure they are aware of any potential environmental hazards
  - When in doubt, call an expert!

Chapter 6 Quiz

1.) Which CANNOT define a neighborhood’s boundaries?
   a. ethnic origin of residents
   b. income level of residents
   c. natural and artificial boundaries
   d. upkeep and maintenance

Chapter 6 Quiz

2.) The four life cycle stages a neighborhood normally goes through, in order, are
   a. decline, revitalization, stability/equilibrium, and growth.
   b. growth, stability/equilibrium, decline, and revitalization.
   c. revitalization, growth, decline, and stability/equilibrium.
   d. stability/equilibrium, decline, growth, and revitalization.
Chapter 6 Quiz

3.) Gentrification is the
a. aging of a neighborhood.
b. aging of the population.
c. rapid deterioration of the neighborhood.
d. rapid revitalization of the neighborhood.

Chapter 6 Quiz

4.) Governmental factors can affect the life cycle of a neighborhood by
a. changing tax rates.
b. changing zoning.
c. widening a road.
d. all of the above

Chapter 6 Quiz

5.) A nuisance
a. affects some of the owner’s bundle of rights.
b. always emanates from within an individual’s property’s boundaries.
c. can always be removed.
d. none of the above
Chapter 6 Quiz

6.) A stigmatized property
   a. is irrationally shunned by an uneducated buyer.
   b. is one that may be undesirable to some people because of a past event.
   c. need not be disclosed to a potential buyer by the real estate agent.
   d. should be avoided at all costs.

Chapter 6 Quiz

7.) To comply with EPA lead-based paint regulations for houses built before 1978,
   a. buyers must be given a 10-day period to conduct lead tests.
   b. known lead paint hazards must be disclosed.
   c. a lead paint brochure must be given to buyers and prospective tenants.
   d. all of the above

Chapter 6 Quiz

8.) Radon gas
   a. can present a problem indoors if allowed to build up to dangerous levels.
   b. is expensive to remediate.
   c. is a man-made waste byproduct.
   d. makes a house worthless because it must be condemned by the EPA.
Chapter

Residential Construction and Home Inspection

Key Terms

- Building Codes
- Concrete Footers
- Foundation
- Framing
- Gross Living Area (GLA)
- Home Inspection
- Permits
- Pitch
- Rough-ins

Basics of Residential Construction

- Real estate agents will benefit from having general knowledge of a home, its construction, and its systems.
- Several necessary steps in the building process—steps may vary depending on:
  - Whether individual chooses a builder’s existing house plan or creates his own
  - Hires sub-contractors himself or hires a builder
  - Area a person lives
Site Work

• First step in home building process
• Improvements made to land to make it viable (e.g., public water/sewer lines, wells, septic system)
• Consider:
  – Deed restrictions
  – Easements
  – Set back requirements
  – Aesthetics/energy

Foundation

• Basic structure on which rest of building will sit
• Next step after site work is finished
• Usually has **concrete footers**: the base a foundation sits on
• Typical residential types:
  – Concrete slabs
  – Piers and beams
  – Crawl spaces
  – Basements

Concrete Slabs

• Foundation made from a layer of poured concrete reinforced with steel rods (called **rebar**)
• Sits directly on ground, with only a thin layer of sand or gravel
  – A mesh, waterproofing membrane and/or Styrofoam sheeting may act as insulation
• Concrete footers may or may not be used
  – When not used, additional holes are dug deep into ground so continuous pour of concrete produces piers connected as one piece with the concrete slab
Piers and Beams

- Columns of concrete, wood, or steel (piers) rest on footers or other type of reinforced base
- Supports of wood or steel (beams) span the columns to provide support for the floors, roof, etc.
- The lower beams that span the piers are called floor joists
- Building codes may limit height of the piers to discourage using this as a way to build a house onto the side of a hill

Crawl Spaces

- The unfinished space below the first floor of a house or other structure, but space that is less than a full story in height
- Technically not a foundation, but rather a part of another foundation type
- Can also be created where only a partial basement is dug below a house

Basement

- Part of a house or building which is partially or entirely below grade (ground level), and used to support the rest of the structure
- Typically at least one full story in height
- Formed as a result of space dug first before a house or building is erected
- Walls can be poured concrete, or built from concrete blocks or stone and sit on concrete footers and serve as the foundation for the house
Framing

- Basic load bearing skeleton to which interior walls, exterior walls, and roof are attached
- When complete, a person can walk around the floor plan of the home, from room to room, to see how the layout feels
- Wood is typically used
  - Concrete blocks usually reserved for commercial buildings
- Types of wood frame houses are platform, post and beam, and balloon frame

Platform Framing

- House/building constructed one story at a time, with each story serving as a platform upon which to build the next story
- Most common type of framing
- Wood studs are cut to the height of each story
  - With horizontal flooring and support across the top of the studs
  - Studs for the next story are then cut and attached to the flooring

Post and Beam Framing

- The floor for higher stories (and roof) is supported by beams that sit on top of posts and the outside wall perimeter
  - Similar to the way a post and beam foundation is constructed
- Not as many interior walls are needed, allowing for larger and more open rooms
- Heavier than other types of framing
- Wood often left exposed for decorative purposes
Balloon Framing

- Long vertical studs run from the foundation to the roof of the house
- Horizontal studs (ledger boards) are nailed to vertical studs to provide support for floor and roof joists
- Rarely used today due to poor fire-resistant design and cost issues
  - Common in older multi-story brick buildings

Roofing

- Last step in framing a house
- Several styles of exterior roof design can be used
- Style can influence choice of roof frame:
  - Truss roofing
  - Joist and rafters
  - Sloped joist

Truss Roofing

- Consists of several pieces attached together to a triangular structure that creates a beam of support to hold up the roof covering
- Held together by nails, bolts, or metal plates (called gusset plates)
Joist and Rafters

- Joists supported by outer load bearing walls and central load bearing wall
- Ceiling rafter begin on outer load bearing walls, rising as they come to the center peak of a roof

Pitch = roof's vertical rise in inches ÷ the roof's horizontal span in feet

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Sloped Joist

- Joists go from outer load bearing walls to a central load bearing wall which is slighter higher than the outer walls
- No rafters because joists are essentially taking that position
- Allows for vaulted ceilings

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Roof Styles and Materials
Rough-ins

- Any type of interior work to a house or building that is not part of the finish work
- Include things like electrical wiring, plumbing, heating and air-conditioning, and so on
- Permits are needed and inspections will follow to ensure work complies with building codes and safety rules
- After all work is done, a final inspection is made

Interior Finish Work

- Ceilings and walls of studs will be covered with drywall or other material, and then painted
- Floors will be covered with specified flooring materials
- Lights and light switches, plumbing fixtures, and kitchen cabinets will be installed, as well as trim and other special finishing touches

Exterior Finish Work

- May get wrapped up about the same time as the interior, before it, or after it
- Work on the exterior has been going on for quite some time:
  - After framing is completed, and usually before any rough-in work begins, some additional exterior work is done to help keep weather and elements out while the rest of the house is being completed
Completion

- Finish outside features like patios, driveways, and landscaping
- Clean-up the worksite
- Haul away debris
- Final inspections have been performed
- House has been approved for habitation

Styles of Houses

- Two ways to define the style:
  - Exterior appearance
  - Functional layout

Exterior Styles

- English Tudor
- American Colonial
- Spanish Villa
Exterior Styles

Functional Layouts of Houses

- One-story, referred to as a "Ranch"
- One-and-a-half story, referred to as a "Cape Cod"
- Split-level—multi-level, short stairs
- Bi-level—2 levels, one sunken, no basement
- Two-story

House Layout Examples

One-Story Residences have one level of living area. The roof structure has a medium slope. The attic space is limited and is not intended for living area.

One-and-One-Half Story Residences have two levels of living area. Characterized by a steep roof slope and dormers, the area of the upper level, whether finished or unfinished, usually equals 40% to 60% of the lower level.
House Layout Examples

Two-Story
Two-story residences have two levels of finished living area. The area of each floor is approximately the same. The roof structure has a medium slope. The attic space is limited and not designed for usable living area.

Two-and-One-Half Story
Two-and-one-half story residences have three levels of living area. Having a steep roof slope with dormers, the area of the third floor, whether finished or unfinished, usually equals 40% to 60% of the second floor.

Calculating Area

- Always calculated using outside dimensions of structure
  - Building costs always should include outside walls
- For residential property, non-living areas are subtracted from the outer dimension totals when figuring square footage
  - This is referred to as Gross Living Area (GLA)
Home Inspections

- Homes inspections cover many more areas than we have discussed in this chapter
- Real estate agents and appraisers must remember not to portray themselves as having expertise in these areas unless they receive additional specialized training or certification

Chapter 7 Quiz

1.) Which type of roof allows for vaulted ceilings?
   a. joists and rafters
   b. sloped joists
   c. truss roofing
   d. none of the above

Chapter 7 Quiz

2.) A roof’s pitch is the
   a. rise of the roof.
   b. rise of the roof in feet, divided by the span of the roof in inches.
   c. rise of the roof in inches, divided by the span of the roof in feet.
   d. run of the roof.
Chapter 7 Quiz

3.) The home's plumbing would be installed during the ______ stage.
   a. completion
   b. interior finish
   c. rough-in
   d. site work

Chapter 7 Quiz

4.) Floor coverings would be installed during the ______ stage.
   a. completion
   b. foundation
   c. interior finish
   d. rough-in

Chapter 7 Quiz

5.) Landscaping is typically completed during the ______ stage.
   a. completion
   b. exterior finish
   c. rough-in
   d. site work
Chapter 7 Quiz

6.) A Ranch-style home is typically
   a. one-story.
   b. one-and-a-half-stories.
   c. split-level.
   d. two-stories.

Chapter 7 Quiz

7.) A Cape Cod-style home is typically
   a. one-story.
   b. one-and-a-half-stories.
   c. split-level.
   d. two-stories.

Chapter 7 Quiz

8.) When platform framing is used in construction, each story of the structure
   a. is built one story at a time.
   b. is constructed simultaneously.
   c. has a crawl space.
   d. has its own footer.
Chapter 7 Quiz

9.) The component of a house on which the foundation rests is known as a
   a. footer.
   b. lateral.
   c. pier.
   d. sill plate.

Chapter 7 Quiz

10.) Electrical wiring, plumbing, and heating ductwork installed in a house as a step in the construction process, and later will be connected to their main service points and hidden from view, are known as
   a. basic essentials.
   b. framing.
   c. rough-ins.
   d. temporary utilities.

Chapter 7 Quiz

11.) The triangular structure that creates a beam of support to hold up the roof of a structure is known as a
   a. foundation.
   b. gusset plate.
   c. ledger.
   d. truss.
Chapter 7 Quiz

12.) The roofing material installed during the framing process which will serve as a base layer for the final roof covering is known as
   a. a ledger.
   b. a rafter.
   c. rebar.
   d. sheathing.

End Module 2

Real Estate Appraisal

Module 3
Chapter 8

Site Valuation

Key Terms

- Assemblage
- Government Survey System
- Location Survey
- Lot and Block
- Metes and Bounds
- Plat
- Plottage
- Range Lines
- Section
- Survey
- Townships

Theory of Site Valuation

- Sometimes the subject of an appraisal is vacant land or site
- Necessary for developing the cost approach
- Instrumental in highest and best use analysis (and others)
**Inherent Value of Land**

- **Scarcity**
  - land supply is limited—no more can be created in any location

- **Indestructibility**
  - land goes on forever—always has potential to make income

- **Immobility**
  - land can’t be moved—regardless of situation
  - Location is primary determinant of value

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**Land Value Theorem #1**

- Land value is the primary determinant of real property value
  - Land and its location are the real factors determining the value of property
  - You’re buying the location first and the house second

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**Land Value Theorem #2**

- Land derives its value from market demand
  - The reason why one location of land is more desirable than another is because of market demand
  - Example: There’s no market demand for nice, large houses located next to toxic waste dumps, so the value of land (and the house) is much less
Ways to Increase Value of Land

• One way to increase the value of land is to have more of it
  – Improvements to raw land to make it into a site can add value, but the inherent value of the land is still the same
  – If buildings are added, the value of the real estate is increased, but not the inherent value of the land

Assemblage

• The combining of two or more parcels of land into one larger parcel
  – Typically done to increase utility of land by allowing one larger building to be constructed on the parcel than could have been built on the smaller individual parcels
• Value of the land will increase
  From Plottage—combining two or more parcels into one, with an increase in value over the value of the two parcels individually
• Increase in value usually due to a change in use

Value of Frontage

• Adding more front footage makes land more valuable than adding more depth (even if total amount of land added is the same)
• More value for commercial properties due to its usefulness for business purposes
  – Generally, the marketplace does not make the same distinctions for residential property (with the exception of waterfront footage)
Highest and Best Use

• An important element in considering site value
• An appraiser will need to gather data and analyze the physical characteristics of the property—whether residential dwelling or commercial property
• Abbreviated (for residential properties) by private and public limitations that could single out only one or two potential property uses

Highest and Best Use in Commercial Properties

• Is the site currently improved or vacant?
  – If improved, is improvement bringing the greatest return to the land in terms of market value?
• Analysis often more complex and detailed than would be performed for a residential property
  – Multiple uses may be permitted by zoning
  – Includes whether property should be improved and with what specific type of structure
  – Appraiser’s recommendation may be to tear down the improvement(s)

 Identifying the Site

• Identifying the correct site involves obtaining and verifying the site’s legal description
  – Address may not be enough (particularly when dealing with vacant land) or may not exist
• The test of a valid description of property is the ability to identify and distinguish that property from any and all other parcels of land
• There are three basic types of legal descriptions used:
  – Government survey system
  – Lot and block system
  – Metes and bounds system
Government Survey System

• A legal description for land, referencing principal meridians and base lines designated throughout the country
  – Also called the government rectangular survey
• A particular piece of land is identified by directions and coordinates, which count from these lines as reference points
  – North-south lines (range lines) run parallel to principle meridians at six mile intervals
  – East-west lines (township lines) run parallel to base lines at six mile intervals
  – These lines break up land into six mile by six mile squares called townships

Township Identification Diagram

Township Diagram
Lot and Block System

- Legal description used for **platted property**
  - Any property subdivided from a large tract into smaller lots
- Lots are numbered, first with a block number for the area, then each individual lot receives its own number
- States property’s lot and block number in a particular subdivision
  - **Plat or plat map** can be consulted to find exact location of property boundaries

Plat/Plat Map

- A detailed survey map of a subdivision, or other grouped lots of land, recorded in the county where the land is located
- Generally kept in county recorder’s office in a plat book
  - General location of the land indicates which book must be consulted to look at the plat map
  - The specific map allows a person to look up exact location of lot using lot and block numbers
- Will usually also give details such as streets, public easements, and ownership information
  - May include zoning, elevations, and flood plains
Plat Map Example

Metes and Bounds System
• Legal description that starts at an easily identifiable point of beginning (POB), then describes property's boundaries in terms of courses (compass directions) and distances, ultimately returning to the POB
  – May also refer to monuments (fixed physical objects)
  – Care must be taken when selecting monuments to make sure they are more or less permanent
  – The safest market is a pin (rod driven into the ground)

Sample Metes and Bounds Survey
Other Points about Site Identification

- Maps may can be used to help locate property with government survey system or lot and block legal descriptions
- Locating property by its legal description and verifying that it is the correct lot and more or less in the correct position is not the same as a survey
- Appraiser may simply state as a limiting condition or assumption in final appraisal report that the legal description was provided by the owner, lender, etc., and was assumed to be correct

Collecting and Analyzing Site Data

- General data on:
  - Economic forces
  - Governmental forces
  - Social forces
  - Physical forces
- Specific data factors

Specific Data Factors

- These factors will fall into one of the categories identified previously:
  - Physical
  - Governmental
  - Economic
- Social factors were not included in the list as they are not as significant a consideration for vacant land or site
Physical Factors

- Appraiser must take into account the lot’s
  - Size (e.g., width, depth, shape, size of usable area)
  - Configuration
  - Topography (flat or hilly) and drainage
  - Soil type
  - View
  - Utilities and other site improvements
  - Position, location within neighborhood, and access

Governmental Factors

- Zoning
- Public easements for roads or sewer
- Building codes that restrict building size/placement
- Taxes and public services

Economic Factors

- Specific position or location of lot with regard to market demand for that type of property
- Are current utilities adequate for land’s ideal use?
  - What is the cost if upgrades are necessary?
- General conformity of lot size/use
- Positive/negative environmental factors
Using Data to Value the Site

- Appraiser must choose a method of evaluation that will yield the most accurate results
  - Different data are used depending on method chosen
- Five common methods:
  - Sales comparison method
  - Allocation method
  - Subdivision analysis method
  - Land residual method
  - Ground rent capitalization method

Sales Comparison Method

- The value of real estate is estimated by taking a market analysis of recent sales in the area where the subject property is located
- Appraiser obtains data on other similar properties recently sold in the same market area
  - Should be as similar to the subject property as possible
- Market evidence is used to adjust price of other properties to account for differences between them and the subject

Adjustments

- Any difference a typical buyer might pay more or less for can be considered an adjustment for the other sales
  - Adjustments are made for location of lot, physical characteristics of lot, restrictions on lot, financing concessions, and other atypical terms of sale
- The subject is never adjusted
- If the comparable sale:
  - Has something that is better than the subject property, value must be subtracted from the sale price
  - Has something that is inferior to the subject property, value must be added to the sale price
Sample Adjustment

<table>
<thead>
<tr>
<th>Sale Price</th>
<th>Comparable #1</th>
<th>Comparable #2</th>
<th>Comparable #3</th>
</tr>
</thead>
<tbody>
<tr>
<td>______</td>
<td>$14,000</td>
<td>$13,500</td>
<td>$14,250</td>
</tr>
<tr>
<td>Wooded</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Location</td>
<td>Middle</td>
<td>Corner</td>
<td>Corner</td>
</tr>
<tr>
<td>______</td>
<td>$14,250</td>
<td>$14,000</td>
<td>$14,000</td>
</tr>
</tbody>
</table>

Allocation Method

- The value of land is determined by establishing a typical ratio of site value to total property value in an area, then applying that same ratio to the subject property
- Can be used to derive value of building or improvement as well
- Drawback: Does not have mechanism to consider differences between the properties/sites

Subdivision Analysis Method

- Takes total projected sale value of all finished lots and subtracts out all costs of development—resulting figure is calculated value of raw land
  - Used for valuing raw land that will become residential land for subdivision development
- Calculations can become quite involved
Subdivision Analysis Method

- Developer needs to determine how many lots can be physically created from raw land
- Developer must calculate total costs (time, cash flow, time value of money)
- An analysis must be made of the developer's ongoing expenses as well as cash flow resulting from eventual sale of individual lots

Land Residual Method

- An income method of site valuation that attributes a certain part of the income produced by property to the building or other site improvement, and then attributes the remaining income to the land
  - Uses a capitalization rate (rate of return on investment that is typical for its type)
- Useful when value of building/improvement is known and value of land is unknown

Ground Rent Capitalization Method

- Income method of valuing land based on the annual income it could potentially generate, divided by an appropriate capitalization rate
- Primarily used for commercial properties
  - Can also be used where residential buildings are built on leased land
Chapter 8 Quiz

1.) Which does NOT contribute to land’s inherent value?
   a. immobility
   b. improvements
   c. indestructibility
   d. scarcity

Chapter 8 Quiz

2.) The combining of two or more parcels of land into one larger parcel is known as
   a. annexation.
   b. assemblage.
   c. platted.
   d. plottage.

Chapter 8 Quiz

3.) “S 1/2 of NW 1/4” represents which type of legal description?
   a. government survey system
   b. lot and block system
   c. metes and bounds system
   d. none of the above
Chapter 8 Quiz

4.) How many acres are in a section?
   a. 406
   b. 460
   c. 640
   d. 6,400

Chapter 8 Quiz

5.) A detailed survey map of a subdivision is called a
   a. county recorded map.
   b. plat map.
   c. plot map.
   d. all of the above

Chapter 8 Quiz

6.) Which may NOT be found in a metes and bounds legal description?
   a. compass directions
   b. monuments
   c. point of beginning
   d. township markers
Chapter 8 Quiz

7.) The process of verifying that an improvement properly sits within the boundaries of the property, and that there are no encroachments from neighboring land onto the subject property is called a
   a. encroachment survey.
   b. location analysis.
   c. location survey.
   d. survey.

February 2015

Chapter 8 Quiz

8.) The most important physical factor in determining site value is
   a. demographics.
   b. improvements.
   c. size.
   d. taxes.

February 2015

Chapter 8 Quiz

9.) The most important governmental factor in determining site value is
   a. census data.
   b. private deed restrictions.
   c. public utility easements.
   d. zoning.
Chapter 8 Quiz

10.) The most important economic factor in determining site value is
   a. land is more valuable with improvements than vacant.
   b. land is valuable no matter where it is.
   c. location of the lot with regard to market demand.
   d. the size of any existing improvements.

Chapter 8 Quiz

11.) Which site valuation method uses adjustments to make other properties closer to the subject property?
   a. allocation method
   b. ground rent capitalization method
   c. sales comparison method
   d. subdivision analysis method

Chapter 8 Quiz

12.) Which site valuation method uses a ratio of land value to total property value?
   a. allocation method
   b. land residual method
   c. sales comparison method
   d. subdivision analysis method
Chapter 8 Quiz

13.) Which site valuation method takes the total projected sales value of all lots and subtracts development costs to arrive at a land value?
   a. allocation method
   b. ground rent capitalization method
   c. sales comparison method
   d. subdivision analysis method

Chapter 9

Sales Comparison Approach

Key Terms

- Amenity
- Comparable Properties
- Competitive Market Analysis (CMA)
- Gross Adjustments

- Matched Pair Analysis
- Net Adjustments
- Sales Comparison Approach
- Subject Property
Defining the Sales Comparison Approach

• An appraisal method that develops an indication of the value of real property by comparing the property being appraised with other, recently sold properties
  – Data are collected and adjustments made for differences
• Also called the market approach
• Subject property is the property being appraised or for which a value opinion is sought
• Comparable properties are other similar properties ideally from the same market area

Market Value and the Sales Comparison Approach

• Market value is typical value sought in an appraisal for a real estate purchase or mortgage finance transaction
• Appraiser must evaluate value of home based on what he feels a typical buyer would pay
  – Lenders want to limit their risk in making the loan
Substitution and the Typical Buyer

- A **typical buyer** is one who:
  - Is acting in her own best interest
  - Acting without undue pressure, influence, or emotional attachment
  - Would rationally and readily accept a less expensive substitute if one were available in the marketplace (theory of substitution)

Comparable Data

- Comparable sales must be part of an arm’s length transaction
- A minimum of three comparables is required by most lenders
- Best if these comparables are:
  - As recent as possible (6-12 months from date of current appraisal being performed)
  - Similar as possible to subject property (e.g., physical characteristics and locational attributes)

Comparable Data

- If there aren’t enough sold properties in subject’s immediate neighborhood, appraiser may:
  - Look in another similar area
  - Use older sales, making adjustments up or down depending on market conditions at time of sale
- Sales comparison approach provides a method of adjusting properties so that meaningful comparisons can be performed between the comparables and subject property
Adjusting Properties

• The process of making chosen comparables come as close as possible in features to the subject so that meaningful price comparisons can be made:
  – The subject property is the starting point and never changes
  – If comparable is missing a feature the subject has, appraiser adds (+) to comparable
  – If comparable has a feature the subject does not, appraiser subtracts (-) from comparable

Adjustment Example

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<tr>
<th>Feature</th>
<th>Subject Property</th>
<th>Comparable 1</th>
<th>Comparable 2</th>
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Adjustments

• Three important things to know about adjusting properties:
  – Adjustments are applied only for features present or absent the day the comparables sold
  – Adjustments are made only for significant features
  – Adjustment totals are sometimes limited by lenders and others
Adjustments Only as of the Day the Comparables Sold

- Adjustments made to comparable properties for differences between them and subject property, as of the day comparables sold
  - Changes to comparables after they sold are not considered because this would not be reflected in their sale prices

Adjustments Only for Significant Features and Conditions

- Significant features generally refer to physical features of the properties
- “Conditions” imply conditions of the transaction or market conditions
- Significant features/conditions could vary from property to property and from market to market

Features of a Property

- Date the sale took place
- Property location
- Size of lot
- Condition
- Age
- Style and construction of home
- Size of home/square footage
- Total number of rooms
Features of a Property

- Number of bedrooms
- Number of full/half bathrooms
- Basement
- Garage
- Heating/cooling/water
- Other (e.g., unique features like patios, breezeways, built-in shelves, swimming pools)
- Terms of sale

Adjustment Totals are Sometimes Limited

- May be limited by Fannie Mae and other lenders
  - Benchmark as to how closely comparable sales compare to subject
- Most lenders observe two basic guidelines:
  - Total net value of all adjustments should not exceed 15% of comparable’s sale price
  - Total gross (absolute) value of all adjustments should not exceed 25% of comparable’s sale price
- The less a comparable must be adjusted, the more relevant and comparable the data is

Gross Adjustments vs. Net Adjustments

- **Gross Adjustments**: Overall total of all adjustments applied regardless of whether adjustment is applied as positive or negative
- **Net Adjustments**: Sum of adjustments, taking into account whether adjustment was a positive or negative
  - Reflect percent of absolute adjustments when compared to comparable sale price
Deriving and Applying Adjustments

- An adjustment can be applied for any amenity or condition which, in the marketplace, results in a difference in price between two properties
  - **Amenity:** Any tangible or intangible feature that enhances and adds value to real estate
- An adjustment value is likely determined by performing a **matched pair analysis**

---

Matched Pair Analysis

- Process of developing the contributory value of specific property characteristics or features by comparing pairs of similar properties
  - Also called **paired data analysis**
- Ideally, only one different characteristic between the pairs of properties
- The more sets of comparables used to derive contributory value, the more meaningful the results will be

---

Matched Pair Analysis

- Appraisers may not perform matched pair analysis for each appraisal
  - Appraiser will gather data/information on a regular basis and store it for use
- Appraiser must ensure adjustments being applied using stored data are relevant and represent market reaction to the feature or condition
These matched pair sets were deduced from the given information. By finding the difference in price, the feature’s contributory value can be determined.

Percentage Adjustments

- Sometimes, a dollar figure adjustment is not appropriate
- Adjustments applied as a percentage of the sale price may be more appropriate for:
  - Financing concessions
  - Terms of sale
  - Date of sale
Financing Concessions

• Includes seller-paid points, interest rate buy downs, assumptions, and owner/seller financing
• Appraiser must study transaction to determine whether they influenced the transaction and perhaps allowed seller to get a higher price

Terms of Sale

• Covers most other types of concessions a seller may have made in selling a home:
  – Seller paying for any fees or inspections, personal property included in sale, or any other special items (e.g., decorating allowance)
• Appraiser must analyze the marketplace to ascertain whether these concessions are typical, and if the payment of these items by the seller influenced the transaction

Date of Sale

• Usually, the older a comparable transaction is, the less likely it is to reflect current market conditions
  – Using comparable properties less than 6 months old is usually preferred
• Property values go up or down in percentages
• Favorable method for observing market condition change is the sale of the same home (in the same condition) twice over a given period of time
How to Apply Percentage Adjustments

• Appraiser must translate a dollar figure from the matched pair analysis into a percentage, then convert that percentage back to a dollar figure when applying the adjustment

Priority of Adjustments

• Appraisers use a systematic order in which they apply adjustments:
  – Financing concessions
  – Terms of sale
  – Date of sale (market conditions)
  – Location
  – Physical features or differences

Competitive Market Analysis (CMA)

• A method of determining the recommended listing price and/or anticipated sale price of a property by comparing the subject property to other properties that have sold, are presently for sale, or did not sell in a given area
  – Also called a comparative market analysis
• Not the equivalent of an appraisal
Competitive Market Analysis (CMA)

- Performed by a real estate agent to assist clients in determining a suggested price at which they could buy or sell a home
- Tends to be more subjective
- Gives weight to properties depending on how quickly they sold or days on market
- Does not derive and apply adjustments for property differences

Chapter 9 CMA Case Study

- Using the CMA sheet provided, analyze the subject by comparing it to the competing properties, sold properties, and not sold properties
- You need to be able to substantiate your recommendation for the subject property

Chapter 9 Quiz

1.) Which of the following are necessary to perform the sales comparison approach?
   a. comparable sales
   b. matched pair analysis data for significant features
   c. subject property
   d. all of the above
Chapter 9 Quiz

2.) Matched pair analysis
   a. is a means of determining the contributory value of specific property characteristics or features by comparing pairs of similar properties.
   b. is a means of using comparable sales to determine the value of a subject property.
   c. is unimportant as appraisers attempt to find comparables which are as similar to the base as possible.
   d. all of the above

Chapter 9 Quiz

3.) What is the priority of adjustments (beginning with the most important)?
   a. financing concessions, location, terms of sale, physical features, and date of sale
   b. financing concessions, terms of sale, date of sale, location, and physical features
   c. physical features, location, date of sale, terms of sale, financing concessions
   d. physical features, terms of sale, date of sale, financing concessions, and location

Chapter 9 Quiz

4.) An amenity is
   a. always adjusted for in an appraisal.
   b. always a physical, tangible feature.
   c. any feature for which there is a ready substitute in the marketplace.
   d. any tangible or intangible feature that enhances and adds value to real estate.
Chapter 9 Quiz

5.) A competitive market analysis is _______ equal to an appraisal.
   a. always
   b. more or less
   c. never
   d. sometimes

Chapter 9 Quiz

6.) Analyzing properties currently listed as part of the appraiser’s analysis assists with
   a. determining contributory value of a particular feature.
   b. establishing replacement cost.
   c. estimating land value.
   d. evidencing competition and the upper limit of value.

Chapter 9 Quiz

7.) When a dollar amount of difference attributable to a particular property feature cannot be observed by comparing the sale prices of a matched pair,
   a. an adjustment must be applied to address the difference.
   b. the appraiser is using an unacceptable technique.
   c. the need for an adjustment is not supported.
   d. the properties in the matched pair should be discarded.
Chapter 9 Quiz

8.) A comparable property which sold for $150,000 required $10,000 in upward adjustments and $5,000 in downward adjustments. What was the percent of total gross adjustments applied?
   a. 5%
   b. 10%
   c. 17%
   d. 20%

Chapter 9 Quiz

9.) If in a comparable sale which sold for $80,000, the seller contributed $4,000 to buy-down the buyer’s interest rate, what would be the percent of adjustment observed from this transaction?
   a. 2%
   b. 5%
   c. 7.5%
   d. 10%

Chapter 9 Quiz

10.) The date for which the appraiser’s value opinion is valid is known as the
   a. appraised date.
   b. date of the report.
   c. effective date.
   d. inspection date.
Chapter 10

Cost Approach

Key Terms

- Cost Approach
- Cost Manuals
- Depreciation
- Economic Life
- Effective Age
- External Obsolescence
- Functional Obsolescence
- Remaining Economic Life
- Replacement
- Reproduction

Defining the Cost Approach

- An appraisal method that develops an indication of the value of real property by figuring the cost of building the house or other improvement on the land, minus (-) depreciation, plus (+) the value of the vacant land
- More reliable for newer structures (less depreciation to consider)
- Used for replacement cost, unusual buildings, and as a secondary check or support of other approaches
- Remember: Cost does not always equal value
Cost Approach and USPAP

• USPAP states that when a cost approach is applicable, an appraiser must:
  – Develop an opinion of site value by an appropriate appraisal method
  – Analyze such comparable cost data as are available to estimate the cost new of the improvements
  – Analyze such comparable cost data as are available to estimate the difference between cost new and the present worth of the improvements (accrued depreciation)

Substitution and the Typical Buyer

• Remember, a typical buyer is one who is acting in his own best interest, and would rationally and readily accept a less expensive substitute
• Assuming no delay, the typical buyer would pick the less expensive substitute:
  – Structure more or less comparable in features and quality

Cost of Building an Improvement

• Replacement: Building functional equivalent (substitute) of original building using modern materials, methods, and design
• Reproduction: Building exact duplicate (replica) of original building
• Common cost approach methods:
  – Square foot method
  – Comparative unit method
  – Quantity survey method
  – Unit-in-place method
  – Index method
Square Foot Method

- Relies on cost manuals
  - Books, electronic media, and online sources that give estimated construction costs for various types of buildings in different areas of the country
- Example: An appraiser is figuring the cost of a 1,250 square foot, one-story home in the Midwest. The cost service indicates a total cost per square foot of $48.65 (assuming replacement cost is being used), so:
  1,250 x $48.65 = $60,812.50 cost estimate

Comparative Unit Method

- Uses the cost of recently built comparable structures, using recently constructed buildings as a basis for estimating the cost of replacing the subject property
- Favored by many appraisers as it more closely reflects costs observed in the subject market
- Appraisers gather data from:
  - Other new construction projects appraised
  - Interviews with local builders and contractors

Quantity Survey Method

- Most detailed of the cost approaches because it requires a thorough itemization of every building component used
  - Duplicates the process a contractor goes through when determining a bid for a contract
- Process is painstaking and not often practiced
- Because of the detail involved, often considered to be the most accurate
Unit-in-Place Method

- Estimates the cost of reproducing a building by looking at the unit cost of each of the structure’s component parts, and adding all of these unit costs together based on actual need and usage
  - Component parts include electrical, plumbing, framing, roofing, etc.

Index Method

- Estimates the cost of a building by taking its original cost and multiplying that number by an index factor, based on when the building was originally constructed
- Not very common
- Considered less accurate because it takes minimal factors into account
- May prove difficult to determine because the original building cost must be known

Calculating Depreciation

- **Depreciation**: A loss in value to property for any reason
- Loss in value could be attributable to:
  - Physical deterioration
  - Functional obsolescence
  - External (economic) obsolescence
- Depreciation is **never** applied to land—only improvements depreciate
Three Types of Depreciation

- Straight-line depreciation
- Age life method
- Breakdown method

Straight-Line Depreciation

- Takes the total amount of depreciation divided by the number of years, or age of the structure
  - Example: If a 10-year-old structure has depreciated $20,000 since it was built, the depreciation is $2,000 per year
- Not typically used by appraisers

Age Life Method

- Considers ratio of the effective age to the total economic life
  - Also called economic age-life method
- Economic life: The time during which a building can be used for its intended purpose, or generate more income than is paid out for operating expenses
- Remaining economic life: Period of usefulness a building has remaining as of the day of the appraisal
Age Life Method

- **Effective age**: What has been used up of the life of a structure
- The remaining economic life could be thought of as what life is left in the structure:
  
  Effective Age + Remaining Economic Life = Economic Life

Age Life Method

- **Effective age** addresses all forms of depreciation by considering the presence of physical deterioration, functional obsolescence, and external obsolescence
- A building’s effective age is not necessarily equal to it’s actual age

Age Life Depreciation Formula

\[
\frac{\text{Effective Age}}{\text{Economic Life}} = \text{Depreciation Percentage}
\]

\[
\text{Current Cost of Building} \times \text{Depreciation Percentage} = \text{Age Life Depreciation}
\]
Age Life Depreciation and Physical Deterioration

- Regarding physical deterioration, a building:
  - In good condition has more useful economic life
  - In well-kept condition could remain at the same effective age for many years
  - With significant deferred maintenance may have an effective age that's greater than its actual age
- When a building is renovated, remodeled, or updated, the effective age decreases, but the clock for effective age begins moving forward once the modifications have been completed

Breakdown Method

- Sometimes called the observed depreciation method
- Breaks total depreciation into three categories:
  - Physical deterioration
  - Functional obsolescence
  - External obsolescence

Physical Deterioration

- Actual wear and tear on something due to age, the elements, or other forces
- Often observable during appraiser’s personal inspection
- Calculation is easier for physical items than for less-tangible items

\[ \text{Price} \times \text{Depreciation Percentage} = \$ \text{Depreciation} \]
Incurable vs. Curable

• Return on investment for money spent on repairs may be taken into consideration; if cost to repair is:
  – Less than the value the repair would contribute to sale value, physical deterioration is curable
  – More than the value the repair would contribute to sale value, physical deterioration is incurable

Long-Lived Items

• Items in a property expected to last for the life of the structure:
  – Basements
  – Foundations
  – Load bearing walls/framing
  – Insulation
  – Roof trusses
  – Floor joists

Short-Lived Items

• Items in a property expected to be replaced during the lifetime of the structure:
  – Carpet
  – HVAC system
  – Paint
**Functional Obsolescence**

- When a building is less desirable because of something inherent in the design of the structure
- Observable during an inspection, but may need to be confirmed with a demographics study or market analysis
- Examples: Outdated home styles, out-of-date fixtures, homes with only one bathroom, unusual floor plans
- May be **curable** or **incurable**

**External Obsolescence**

- When something outside the boundaries of a property makes it less desirable
- Causes may be economic, environmental, or location
- May be observable, but often requires additional research
  - Will it continue? How does it affect market value?
- Examples: declining neighborhood, nearby landfill, new highway that creates noise or re-routes traffic
- Often **incurable**

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**Cost Approach URAR Sample**

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Chapter 10 Quiz

1.) Which is necessary to perform the cost approach?
   a. depreciation
   b. replacement or reproduction cost data
   c. site value
   d. all of the above

Chapter 10 Quiz

2.) Depreciation is
   a. always the result of external obsolescence.
   b. always the result of functional obsolescence.
   c. always the result of physical deterioration.
   d. a loss in value for any reason.

Chapter 10 Quiz

3.) The cost approach is NOT the most applicable method for
   a. determining an insurance replacement value.
   b. a recently constructed building.
   c. a residential condo in a complex with 50% occupancy and many recent sales.
   d. an unusual building for which there are no comparable sales available.
Chapter 10 Quiz

4.) ________ cost is more commonly used because _________.
   a. Replacement / most of the time, a similar building is an acceptable, less expensive alternative.
   b. Replacement / people are always interested in replacing a damaged home with one that is exactly like their old one.
   c. Reproduction / most of the time, a similar building is an acceptable, less expensive alternative.
   d. Reproduction / people are always interested in replacing a damaged home with one that is exactly like their old one.

Chapter 10 Quiz

5.) Which is the most important consideration in developing the cost approach?
   a. a building's actual age
   b. a building's effective age
   c. both a and b
   d. neither a nor b

Chapter 10 Quiz

6.) Age life depreciation
   a. is not concerned with a building’s economic life.
   b. is not concerned with a building’s effective age.
   c. takes the effective age of a building divided by the total economic life to arrive at a depreciation percentage.
   d. all of the above
Chapter 10 Quiz

7.) Severe structural damage to a basement and foundation would likely be considered
   a. curable functional obsolescence.
   b. curable physical deterioration.
   c. incurable external obsolescence.
   d. incurable physical deterioration.

Chapter 10 Quiz

8.) External obsolescence
   a. always has something to do with things outside the boundaries of the property.
   b. is always curable.
   c. is always the same as functional obsolescence.
   d. none of the above

Chapter 10 Quiz

9.) A house with a poor floor plan that would be very difficult and costly to change would likely suffer from
   a. curable external obsolescence.
   b. curable functional obsolescence.
   c. incurable external obsolescence.
   d. incurable functional obsolescence.
Chapter 10 Quiz

10.) How does the appraiser determine the appropriate weight to be given to the cost approach?
   a. The appraiser always uses the cost approach as supporting evidence for the other appraisal methods.
   b. The appraiser considers what the purpose of the appraisal is before deciding how much weight to give the cost approach.
   c. If the figure for the cost approach is very different from the other figures, the appraiser uses a weighted average to bring it in line.
   d. If the figures for the cost approach and the sales comparison approach come out very different, the appraiser knows not to give the cost approach much weight.

Chapter 11

Income Approach

Key Terms

- Anticipation
- Capitalization
- Contract Rent
- Direct Capitalization
- Direct Capitalization Rate
- Effective Gross Income
- Fixed Expenses
- Gross Income
- Gross Monthly Rent Multiplier (GMRM)
- Market Rent
- Net Operating Income (NOI)
- Potential Gross Income
- Reserves for Replacement
- Variable Expenses
Defining the Income Approach

• An appraisal method that develops an indication of value of real property by analyzing the amount of rent or income the property could generate using market data

• Two ways to derive value:
  – Employ a gross monthly rent multiplier (GMRM) to analyze market rent of property
  – Direct capitalization using a direct capitalization rate to analyze the net income stream produced by the property

Capitalization

• An income approach technique that converts the income of a property into a value opinion through either the application of a direct capitalization rate or factor, such as a multiplier

Income Approach and USPAP

• USPAP states that when an income approach is applicable, an appraiser must, as appropriate
  – Analyze such comparable rental data as are available to estimate the market rental of the property
  – Analyze such comparable operating expense data as are available to estimate the operating expenses of the property
  – Analyze such comparable data as are available to estimate rates of capitalization
  – Base projections of future rent on reasonably clear and appropriate evidence
Defining the Income Approach

- Useful for appraising income-producing properties
  - It analyzes the rent/income and produces a direct correlation with the value of property
- Parallels thought process typical investors go through when making a buying decision
  - Investors typically not emotional about buying decisions and like to have objective means to compare properties

Typical Investor

- One who is acting in his own best interest
- Typically more rational than other buyers
  - Even less likely to make decisions based on emotional attachment
- Overall, the indications produced through the analysis form a basis for direct comparison
  - This involves the theory of substitution, as well as the theory of anticipation

Theory of Substitution

- Says that an informed buyer—or, in this case, a prudent investor—will not pay more for a property than for a comparable substitute
- Even truer for an investor
  - Theoretically, for an investor, income from one property may be as good as another
Theory of Anticipation

- An economic theory that says value is created by expectation of future benefits
  - Such as profit on resale, pleasure, tax shelter, production, income, etc.
- The investor looks at future expected income stream, as well as expected future resale value
  - Projection of future anticipated benefits limits what a property is worth in the market place.

About the Gross Monthly Rent Multiplier (GMRM)

- **GMRM**: Rate of return, stated as a factor or multiplier, used to derive a value opinion from anticipated monthly rent a property could generate
  - Can be used to estimate value of other rental property
- **No consideration** is given to expenses, vacancies, collection losses, debt service, or depreciation
  - Comparable properties used must be similar in respect to lease terms and physical characteristics
- Can be used to support value indications derived from other appraisal methods

Deriving the GMRM

- The GMRM is derived with a very simple formula
  \[ \text{Rental Home Sale Price} + \text{Gross Monthly Rent} = \text{GMRM} \]
- GMRMs are calculated for a number of comparable properties similar to the subject property
  - GMRMs are analyzed and weighted, giving the most consideration to properties most like the subject
  - A GMRM figure is selected to apply to subject property to estimate a value
GMRM Example

<table>
<thead>
<tr>
<th>Sale Price</th>
<th>Monthly Rent</th>
<th>Formula</th>
<th>GMRM</th>
</tr>
</thead>
<tbody>
<tr>
<td>66,200</td>
<td>530</td>
<td>66,200 + 530</td>
<td>124.91</td>
</tr>
<tr>
<td>573,000</td>
<td>590</td>
<td>573,000 + 590</td>
<td>123.73</td>
</tr>
<tr>
<td>575,000</td>
<td>610</td>
<td>575,000 + 610</td>
<td>122.95</td>
</tr>
<tr>
<td>565,000</td>
<td>525</td>
<td>565,000 + 525</td>
<td>123.81</td>
</tr>
<tr>
<td>565,500</td>
<td>550</td>
<td>565,500 + 550</td>
<td>131.00</td>
</tr>
<tr>
<td>620,000</td>
<td>575</td>
<td>620,000 + 575</td>
<td>121.74</td>
</tr>
<tr>
<td>572,800</td>
<td>650</td>
<td>572,800 + 650</td>
<td>112.00</td>
</tr>
<tr>
<td>68,000</td>
<td>520</td>
<td>68,000 + 520</td>
<td>130.77</td>
</tr>
</tbody>
</table>

Using the GMRM

- The gross monthly market rent from the subject property is then multiplied by the GMRM derived in the first to arrive at an estimate of value:

\[
\text{Gross Monthly Market Rent} \times \text{GMRM} = \text{Estimate Value}
\]

Income Approach
Analysis on the URAR Form

- URAR form used for single-family properties
- Income approach not often developed/reported for single-family properties primarily due to:
  - Prominence of owner-occupied properties
  - Lack of sufficient data
Income Approach Analysis on the URAR Form

- URAR accommodates only one line for the reporting of the income approach
  - When not applicable, appraiser's reconciliation notes must contain an explanation
Chapter 11 Continued

Direct Capitalization Method

• An income capitalization method that takes a property's single-year net operating income (or NOI) divided by a direct capitalization rate

• Most generally used for:
  – Larger residential properties with more than four units
  – Non-residential commercial properties

Net Operating Income (NOI)

• The estimated amount the property owner/investor should realize after accounting for certain losses and operating expenses (including replacement reserves) for the property
Determining NOI

• Five steps:
  – Determine PGI (Potential Gross Income)
  – Estimate rates of vacancy and collection losses
  – Determine EGI (Effective Gross Income)
  – Estimate operating expenses
  – Determine NOI

• For direct capitalization, method considers these components on an annual basis

NOI Formula

\[
\text{PGI} - \text{Vacancy and Collection Losses} = \text{EGI} \\
\text{EGI} - \text{Operating Expenses} = \text{NOI}
\]

Potential Gross Income (PGI)

• Income that could be produced by a property in an ideal situation, with no vacancy or collection losses (e.g., rent that could not be collected due to a tenant who failed to pay)
  – The income a property could generate if fully rented and occupied during the particular period being analyzed
• In most cases, PGI is based on an annual amount
Effective Gross Income (EGI)

- The potential gross income, less vacancy and collection losses
- If PGI is what the property owner could have taken in, EGI can be thought of as what that property owner did take in:

\[ \text{PGI} - \text{Vacancy and Collection Losses} = \text{EGI} \]

---

NOI and Vacancy and Collection Losses

- Do not confuse NOI with cash flow
  - Cash flow considers other obligations (e.g., payments toward loan debt and income tax obligations not considered in the NOI)
- Formula for NOI:

\[ \text{PGI} - \text{Vacancy and Collection Losses} = \text{EGI} - \text{Operating Expenses} = \text{NOI} \]

---

Operating Expenses

- Day-to-day costs of running of a property, like repairs and maintenance, but not including debt service or depreciation
- Considered on an annual basis
  - Since income is also analyzed at an annual level
- Divided into three types:
  - Fixed expenses
  - Variable expenses
  - Reserves for replacement
Fixed Expenses

• Ongoing expenses that do not vary based on occupancy levels
• Examples:
  – Real estate taxes and insurance on the property
  – Services contracted at a level rate for, perhaps, a year at a time—like refuse collection
  – Cost of a security light for a parking area where the expense is a reoccurring flat fee

Variable Expenses

• Operating expenses necessary to the property, but dependent on the property’s occupancy level
• Examples:
  – Maintenance and repairs
  – Any utilities to the living units furnished by the lessor
  – Management fees (often expressed as a percent)
• Other examples of variable expenses might be legal or accounting fees charged on a non-consistent basis

Reserves for Replacement

• Refers to an amount of money set aside for future replacement of major items
  – Sometimes just called reserves
• Most often applied as an annual dollar (sometimes as a percentage) amount
• Common components for which a replacement reserve is typically considered:
  – Roof, heating and/or air-conditioning systems, carpeting, and lessor furnished appliances
Deriving a Direct Capitalization Rate

- **Direct Capitalization Rate**: Rate of return, stated as a percent, used to derive a value opinion from anticipated net operating income a property could generate
  - Used for direct capitalization in income approach
  - Also called a cap rate or rate
- Formula easily remembered as IVR:
  \[
  \frac{\text{Net Operating Income}}{\text{Value}} = \text{(Direct Capitalization) Rate}
  \]

Overall Capitalization Rate Example

<table>
<thead>
<tr>
<th>Sale</th>
<th>Sale Price</th>
<th>NOI</th>
<th>I - V - R</th>
<th>Rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$420,000</td>
<td>$30,600</td>
<td>30,600 - 420,000 = -0.0932</td>
<td>9.32%</td>
</tr>
<tr>
<td>2</td>
<td>$470,000</td>
<td>$42,300</td>
<td>42,300 - 470,000 = -0.0900</td>
<td>9.00%</td>
</tr>
<tr>
<td>3</td>
<td>$395,000</td>
<td>$39,100</td>
<td>39,100 - 395,000 = -0.0990</td>
<td>9.90%</td>
</tr>
<tr>
<td>4</td>
<td>$452,000</td>
<td>$40,900</td>
<td>40,900 - 452,000 = -0.0905</td>
<td>9.05%</td>
</tr>
<tr>
<td>5</td>
<td>$405,000</td>
<td>$36,500</td>
<td>36,500 - 405,000 = -0.0901</td>
<td>9.01%</td>
</tr>
</tbody>
</table>

Applying a Direct Capitalization Rate

- When applied to the subject’s net operating income, a value conclusion is revealed
- The formula used is as follows:
  \[
  \frac{\text{Net Operating Income}}{\text{(Direct Capitalization) Rate}} = \text{Value}
  \]
Chapter 11 Quiz

1.) Which is necessary to develop the direct capitalization technique?
   a. expenses
   b. income
   c. rate
   d. all of the above

Chapter 11 Quiz

2.) The theory of anticipation says
   a. a buyer won’t pay more for the subject than for a comparable property.
   b. a property is worth more if an investor is excited about acquiring the property.
   c. real estate will always appreciate in value.
   d. value is created by the expectation of future benefits.

Chapter 11 Quiz

3.) Which would NOT be considered an operating expense?
   a. debt service
   b. fixed expenses
   c. reserves
   d. variable expenses
Chapter 11 Quiz

4.) Vacancy and collection losses
   a. are always 10%.
   b. are considered when using a GMRM.
   c. are not considered when doing a direct capitalization method appraisal.
   d. determined by analysis of market data.

Chapter 11 Quiz

5.) The gross monthly rent multiplier does NOT take into account
   a. collection losses.
   b. expenses.
   c. vacancy losses.
   d. all of the above

Chapter 11 Quiz

6.) A main disadvantage of the gross monthly rent multiplier is
   a. the capitalization rate is not accurate enough.
   b. it can be used only to support the cost approach, not the sales comparison approach.
   c. the lack of very similar comparable data.
   d. using the GMRM is more complicated than the capitalization rate.
Chapter 11 Quiz

7.) Potential gross income, less vacancy and collection losses is the
   a. capitalization rate.
   b. effective gross income (EGI).
   c. gross rent multiplier (GRM).
   d. net operating income (NOI).

Chapter 11 Quiz

8.) Using IRV, what would be the indicated value (rounded to the nearest one hundred dollars) of a property that has NOI of $8,000 if the overall capitalization rate is indicated at 9.25%?
   a. $65,300
   b. $74,000
   c. $86,500
   d. $92,400

Chapter 11 Quiz

9.) If a subject property has a market rent of $625 per month and a GMRM of 183.75 is deemed applicable, what is the appraiser’s indicated value conclusion (rounded to the nearest one thousand dollars)?
   a. $103,000
   b. $115,000
   c. $132,000
   d. $184,000
Chapter 11 Quiz

10.) A six-unit apartment building with a net operating income of $24,000 recently sold for $390,000. What is the indicated overall capitalization rate (carried to two places) derived from this data?
   a. 6.15%
   b. 6.95%
   c. 7.10%
   d. 7.25%

Chapter 11 Quiz

11.) An unfurnished house rents for $8,100 per year, which is determined to represent market level. The property recently sold for $147,000 in an arm’s length transaction. What is the GMRM indicated (rounded to two places)?
   a. 5.51
   b. 18.15
   c. 181.48
   d. 217.78

Chapter 11 Quiz

12.) A GMRM is applied to __________ to produce a value indication.
   a. contract rent
   b. effective gross income
   c. market rent
   d. net operating income
Chapter 12
Reconciling Estimates of Value and Reporting Conclusions

Key Terms

- Addenda
- Reconciliation

Reconciliation

- The appraisal process of analyzing the values derived from the different appraisal approaches to arrive at a final opinion of value
- This is the appraiser's opportunity to bring together all data collected, verified, and analyzed during the appraisal process
Reconciling Estimates of Value

- The appraiser must determine the strengths and weaknesses of each appraisal approach used
  - Reflecting on quality and quantity of data analyzed and relevance of a particular approach
- Skill and experience are important as the appraiser goes through the appraisal reconciliation process

Steps in the Reconciliation Process

- The appraiser:
  - Looks at the strengths and weaknesses of each appraisal method and technique used
  - Considers the quality and quantity of the data that were gathered and used
  - Decides which of the approaches to value is the most applicable to solving the valuation problem at hand for the subject property
  - Reviews each step in the approaches developed and considers their relevance and reliability

Steps in the Reconciliation Process

- If the appraiser determines in the scope of work not to include one or more of the valuation approaches in his analysis, USPAP requires the appraiser to explain his reasoning for the exclusion in the appraisal report
- Each approach has different considerations when deciding the weight to give each approach
Weighting the Sales Comparison Approach

• The appraiser primarily considers what type of property the subject is
  – This is a reliable approach if there is sufficient data to perform the analysis
  – Most likely the best indicator of value for most residential assignments of owner-occupied residential properties

Weighting the Cost Approach

• The appraiser considers the type and age of the subject property
  – This is a relevant approach if property is special purpose or single-use—for which there is not sufficient comparable data
  – The newer the structure, the more applicable it would be

Weighting the Income Approach

• The appraiser considers:
  – Whether or not the property currently has, or has the potential to generate, an income stream which can be analyzed
  – If there are other similar properties with an income stream which could form a basis of comparison
  – The amount and sufficiency of income, expense, and other data available
Giving Each Appropriate Weight

- Weighting the approaches is an important step because it would be rare for the values to be equal.
- The appraiser decides which of the appraisal approaches is most relevant/reliable given available data, and which best reflects the market value of the subject.
  - This will then be used as the basis for the appraiser’s final opinion of value.

Reconciliation in Appraisal Report

- Report should provide details of appraiser’s reasoning and logic; it should be clear, understandable, and not misleading.
- Report states the final value opinion:
  - In most reports (including URAR), this will be a single number.
  - USPAP allows it to be stated as a range, or a relationship to a benchmark (e.g., more than, less than).
URAR Reconciliation Sample

Completed URAR Appraisal Report

- The complete URAR Appraisal Report can be found at the end of Chapter 12
- The complete appraisal also includes additional sections and addenda, which are typical parts of a standard appraisal report

Appraisal Addenda

- Additional parts of an appraisal report
  - Supporting evidence used by the appraiser in defense of estimate/opinion of value
- Typically includes:
  - Photographs of subject
  - Sketch of improvement's floor plan
  - Chart/table used to calculate area of house
  - Photographs and information on comparables
  - Location map pinpointing location of subject and comparables
Chapter 12 Quiz

1.) During the reconciliation process,
   a. the appraiser decides which approach to give
      the most weight, then throws out the other
      approaches.
   b. the appraiser decides which approach or
      approaches to give the most weight.
   c. the appraiser must always determine an
      exact dollar amount to present as his final
      opinion of value.
   d. value approaches are mathematically
      averaged.

Chapter 12 Quiz

2.) In the final appraisal report, the
    appraiser
   a. details the reasoning he used in arriving at the
      final opinion of value.
   b. explains why one or more of the appraisal
      methods may not have been used.
   c. notes any specific conditions, unusual
      circumstances, or assumptions.
   d. all of the above

Chapter 12 Quiz

3.) When using the URAR form, which
    income approach technique does the
    form accommodate?
   a. comparative unit
   b. direct capitalization
   c. gross income multiplier
   d. gross rent multiplier
Chapter 12 Quiz

4.) During reconciliation, the value indication produced by the sales comparison approach for a residential property
   a. is always used as the final opinion of value.
   b. is never used as the final opinion of value; it is used as support for either the income or cost approach.
   c. may be given the most weight if the data is reliable and the approach is applicable.
   d. none of the above

Chapter 12 Quiz

5.) When an appraiser decides to use one particular approach as a primary indicator of value in an appraisal,
   a. any other approaches developed are not reported in the appraisal report.
   b. he has violated USPAP as it prohibits correlating with only one approach.
   c. he must not discuss in the report the other approaches developed.
   d. other approaches may be used to support that opinion.

End Module 4