Principles of Real Estate
Chapter 13-Valuation and Economics

This chapter explores the principles of value, the forces that impact the value of property, and the appraisal process.

Overview

Objectives

At the end of this chapter, the student will be able to:

- List the steps in the cost approach
- Name the three methods for computing replacement or reproduction cost
- Describe the three types of depreciation
- Compute the depreciation on a building, with given information
- List the steps in the income approach
- Write the formulas that are essential to the income approach
- Compute the value, cap rate, or net income, with given information
• Provide the formulas necessary for GRM/GIM
• Calculate the value of a rental property, with given information
• Explain "weighted averaging" in terms of reconciliation

**Appraisal**

An appraisal is an analysis, opinion, or conclusion relating to the nature, quality, value, or utility of specified interest in, or aspects of, a specific piece of real estate or real property.

An appraisal may be performed for a variety of reasons. An appraiser may be doing one for insurance reasons, for a condemnation proceeding, or for a lender making a loan.

Whatever the reason for the appraisal, an appraisal is an opinion of value. Federal requirement for licensing and certification of appraisers became effective Jan 1, 1993.

Value has many definitions, but the goal of an appraiser in a real estate appraisal is to estimate fair market value or market value. Fair market value is defined as the most probable price a property will bring if:

- The buyer and seller are aware of market conditions.
- Neither is under abnormal pressure.
- The property is exposed on the market for a reasonable period of time.
- Payment is made in cash or its equivalent.
The seller is capable of delivering marketable title.

*Cost to the current owner is never a consideration of an appraiser in estimating the present value of a property.*

**Appraisal-Prerequisites of Value**

For a property to have value in the real estate market, it must have four characteristics:

- **Demand:** The need or desire for possession or ownership backed up by the financial means to satisfy that need.
- **Utility:** The capacity to satisfy human needs and desires.
- **Scarcity:** A finite supply.
- **Transferability:** The transfer of ownership rights from one person to another with relative ease.

**Appraisal-Principles of Value**

There are a number of economic principles at work that affect the value of real estate. They include:

- Highest and best use
- Substitution
- Supply and demand
- Conformity
- Anticipation
- Progression and regression
- Plottage
- Contribution
- Competition
- Change
Highest and Best Use

Highest and best use: The most profitable use to which the property is adapted and needed or the use that is likely to be in demand in the reasonably near future is the highest and best use.

For example, a highest-and-best-use study may show that a parking lot in a busy downtown area should, in fact, be replaced by an office building. It is that use which will provide the owner with the highest net return.

Substitution

Substitution: The principle of substitution states that the maximum value of a property tends to be set by the cost of purchasing an equally desirable and valuable substitute property, assuming that no costly delay is encountered in making the substitution.

The principle of substitution is the underlying principle for the direct sales comparison and cost approaches.

For example, if there are two similar houses for sale in an area, the one with the lower asking price would normally be purchased first.
Supply and Demand

Supply and demand: This principle states that the value of a property will increase if the supply decreases and the demand either increases or remains constant -- and vice versa.

For example, the last lot to be sold in a residential area where the demand for homes is high would probably be worth more than the first lot sold in that area.

Conformity

Conformity: This means that maximum value is realized if the use of the land conforms to existing neighborhood standards.

In residential areas of single-family houses, for example, buildings should be similar in design, construction, size, and age to other buildings in the neighborhood.

Principles of Value-Anticipation

Anticipation: This principle holds that value can increase or decrease in anticipation of some future benefit or detriment affecting the property.

For example, the value of a house may be affected if there are rumors that the block on which the house is located may be converted to commercial use in the near future.
Returns
Increasing and decreasing returns: Improvements to land and structures will eventually reach a point at which they will no longer have an effect on property values.

As long as money spent on improvements produces an increase in income or value, the law of increasing returns is applicable.

But at the point where additional improvements will not produce a proportionate increase in income or value, the law of diminishing returns applies.

Progression and Regression

Progression and regression: The principle that, between dissimilar properties, the worth of the better property is adversely affected by the presence of the lesser-quality property is known as regression.

Thus, in a neighborhood where the homes average in the $75,000 range, a structure that would be worth at least $90,000 in another neighborhood would tend to be valued closer to $75,000.

Conversely, the principal of progression states that the worth of a lesser property tends to increase if it is located among better properties.
Principles of Value-Plottage

Plottage: The principle of plottage holds that the merging or consolidation of adjacent lots held by separate land owners into one larger lot under a single land use tends to produce a higher total land value than the sum of the two sites valued separately.

For example, if two adjacent lots are valued at $35,000 each, their total value, if consolidated into one larger lot under a single use, might be $90,000.

The process of merging the two lots under one owner is known as assemblage. The increase in value is called a plottage increment and is a form of unearned increment.

Contribution

Contribution: The value of any component of a property consists of what its addition contributes to the value of the whole or what its absence detracts from that value.

For example, the cost of installing an air-conditioning system and remodeling an older office building may be greater than is justified by the rental increase that may result from the improvement to the property.
Principles of Value-Competition

Competition: This principle states that excess profits tend to attract competition.

For example, the success of a retail store may attract investors to open similar stores in the area. This tends to mean less profit for all stores concerned unless the purchasing power in the area increases substantially.

Principles of Value-Change

Change: No physical or economic condition remains constant. Real estate is subject to natural phenomena, such as tornadoes, fires, and routine wear and tear of the elements. The real estate business is also subject to the demands of its market, just as is any business.

Economic life is the period of time during which improvements to a property will yield a return in excess of rents attributed to the land itself. Usually economic life will be shorter in duration than physical life.

It is an appraiser's job to be knowledgeable about the past, and perhaps, predictable effects of natural phenomena and the behavior of the marketplace.
Forces Affecting Value

Four major forces are constantly at work influencing the value of real property. They work externally and within each property itself to create, sustain, and change its value. These forces are:

- Physical Forces
- Governmental/Political Forces
- Economic Forces
- Social Forces

The next few screens show the four major forces that influence value and give some examples of what the appraiser must consider in collecting, organizing, and interpreting the necessary data to arrive at his estimate of value.
Forces Affecting Value - Physical Forces

Physical forces would include:

- **Location** - convenience to schools, shopping, churches, recreation, jobs, and transportation.
- **Climate** - extreme weather condition, influences value either up or down
- **Topography** - steep hill may require excessive grading (leveling), or provide a great view
- **Utilities** - availability
- **Improvements** - exterior, interior, age, size, condition, depreciation
- **Orientation** - placement of the improvements on the lot in relation to other features of the lot
- **Size and shape** - irregular shapes, proportion of depth to width
- **Soil** - adequate to drainage and percolation (ability to absorb water), subsoil
- **Assemblage** - combining two or more lots into one large tract
- **Corner Influence** - for commercial use, corner lots tend to increase in value due to double access and exposure
- **Environment** - air and water pollution, flood and earthquake areas
- **Exposure** - merchants usually prefer south and west sides of a street to receive the most shade
- **Pedestrian Traffic Count or Traffic Count** - especially important in planning, developing, and leasing shopping centers and retail stores
Forces Affecting Value - Government/Political Forces

Forces falling within the realm of the political include:

- **Taxes** - may increase values if used to upgrade the community or if especially low
- **Zoning** - regulates size, height, and placement of buildings; regulates use and construction standards
- **Rent Controls** - tends to increase demand but discourages investors
- **Credit Controls** - lowers demand
- **Government Spending** - loan guarantees, subsidies
- **Community Services** - fire and police protection, street lights

Forces Affecting Value - Economic Forces

Economic factors appraisers must consider include:

- **Existing Supply of Property** - current vacancy rates and unsold properties on the market (price range)
- **Wages, Salaries, and Savings** - property values increase in proportion to purchasing power
- **Mortgage Money and Rates** - availability of funds and interest rate influence effective demand
- **Employment** - growth patterns, sources, availability of labor
Forces Affecting Value - Social Forces

Social forces involve:

- **Population Growth** - marriage, birth, divorce, and death rates
- **Demographic Trends** - education, income, age, occupation, household density
- **Amenities** - quality of schools and churches, convenience of public transportation
- **Directional Growth** - property in a path of growth tends to increase in value

Forces Affecting Value - Unearned Increment

When the impact of physical, governmental, economic, and social forces increases a property's value, that increase is called an unearned increment.

An appraiser must consider that land has certain **physical** and **economic** characteristics as well. The physical characteristics greatly influence the way in which land is bought and sold.

They are:

- **Immobility** - Its location cannot be changed.
- **Indestructibility** - it remains basically the same through natural and man-made changes.
- **Nonhomogeneity** - no parcel has an exact replica.
Forces Affecting Value-Economic Characteristics

Certain economic characteristics play a large part in making land the unique commodity that it is. They are:

- **Location or Situs** - Because land is immobile, it occupies a specific location. One parcel may be valued at substantially more than a similar parcel due to the difference in desirability of its locations. People prefer a particular location because of such things as weather, scenery, employment opportunities, or proximity to schools, shopping, jobs, and transportation -- things that fulfill human needs or meet human demands. The sum of all economic factors which influence the value of land is called situs.

- **Improvements** - Another economic characteristic of land is the impact that improvements have upon its value. Improvements like buildings, driveways, or landscaping attach to the land and become a part of it.

- **Fixed Investment (fixity)** - Improvements are made with the intent of lasting a long time. In fact, more buildings are torn down than fall down. Because improvements become a permanent part of real estate, they are influenced by the economic changes in the neighborhood. Most investments in buildings, for instance, are made initially for twenty to thirty years.

- **Scarcity** - The value of every commodity is influenced by its scarcity. An acre of land in a rural area, for example, cannot fulfill as many needs as an acre of land in an urban area, generally speaking. The land in an urban area is scarcer because of the demand for it, resulting in an increase in value.
The Appraisal Process

The key to an accurate appraisal lies in the methodical collection of data. The appraisal process is an orderly set of procedures used to collect and analyze data in order to arrive at an ultimate value conclusion.

The data are divided into two basic classes:

- **Specific data**, covering details of the subject property as well as comparative data relating to costs, sales, and income and expenses of properties similar to and competitive with the subject property.
- **General data**, covering the nation, region, city, and neighborhood. Of particular importance is the neighborhood where an appraiser finds the physical, economic, social, and political influences that directly affect the value and potential of the subject property.

The Appraisal Process - Neighborhood Cycles

In the neighborhood analysis, an appraiser must consider the neighborhood cycles.

They are:

- **Growth** - While a neighborhood is in the process of being developed, values tend to increase at a more rapid rate. Usually lasts 10-15 years.
- **Stability** - When the neighborhood is completely developed, values tend to stabilize or increase at a slower rate. Usually lasts 20-25 years.
- **Decline** - A neighborhood may have declining values if properties are not maintained. Usually lasts 5-10 years.
- **Renewal** - Property values will increase when a neighborhood in decline experiences renewal.
The Appraisal Process-Steps

There are a total of eight steps in the appraisal process. They are:

- Define the problem
- List the data needed and the sources
- Gather and analyze the data
- Determine the highest and best use, according to the appraiser's opinion
- Estimate the land value
- Estimate the value by each of the three approaches
- Reconciliation
- Report the final opinion of value

Of the eight, the four main steps in the appraisal process are:

- **Define the problem** -- the kind of value to be estimated must be specified, and the valuation approach(es) used must be the most valid and reliable for the kind of property under appraisal. In this step, the appraiser determines the time and cost involved and sets the fee.
- **Gather and analyze the data** -- depending upon the approach(es) used, comparative information relating to sales, income and expenses, and construction costs of comparable properties must be collected. All data should be verified, usually by checking the same information against two different sources.

In the case of sales data, one source should be a person directly involved in the transaction. The information collected must be reviewed to ensure that all relevant facts have been considered and handled properly and that no errors have been made in calculations.

- **Reconciliation** -- the appraiser finally makes a definite statement of conclusions reached. This is usually in the form of a value estimate of the property derived by reconciling the data analyzed.
- **Prepare the report** -- After the three approaches have been reconciled and an opinion of value reached, the appraiser prepares a formal written report for his or her client. The statement may be a completed form, a short summary, or a lengthy written narrative.
In order to arrive at an accurate estimate of value, three basic approaches, or techniques, are traditionally used by appraisers:

- The direct sales comparison approach
- The cost approach
- The income approach.

Each approach serves as a check against the others and narrows the range within which the final estimate of value will fall. Each approach is generally considered most reliable for specific types of property.

**The Sales Comparison Approach**

In the direct sales comparison approach, sometimes just called direct approach, an opinion of value is obtained by comparing the subject property (the property under appraisal) with recently sold comparable properties (properties similar to the subject). It is based on the principle of substitution, and is used on new and older homes, alike.

This approach is most often used by brokers and salespeople when helping a seller set a price for his or her residential real estate in an active market. It is the most reliable approach in appraising residential property. Since no two parcels of real estate are exactly alike, each comparable property must be compared to the subject property, and the sales prices must be adjusted for any dissimilar features.
Adjustments

The principal factors for which adjustments must be made fall into four basic categories:

- **Date of sale:** An adjustment must be made if economic changes occur between the date of sale of the comparable property and the date of the appraisal.

  The differences in original cost of two properties being compared by this approach is not important as long as the proper adjustments are made.

- **Location:** An adjustment may be necessary to compensate for locational differences.

  *For example, similar properties might differ in price from neighborhood to neighborhood, or even in more desirable locations within the same neighborhood.*

- **Physical features:** Physical features that may cause adjustments include age of building, size of lot, landscaping, construction, number of rooms, square feet of living space, interior and exterior condition, presence or absence of a garage, fireplace, or air conditioner, and so forth.

- **Terms and conditions of sale:** This consideration becomes important if a sale is not financed by a standard mortgage procedure.

After a careful analysis of the difference between comparable properties and the subject property, **the appraiser assigns a dollar value to each of these differences.** On the basis of their knowledge and experience, appraisers estimate dollar adjustments that reflect actual values assigned in the marketplace.

- **The value of a feature present in the subject property but not in the comparable property is added to the total sales price of the comparable.** This presumes that, all other comparables being equal, a property having a feature (such as a fireplace or wet bar) not present in the comparable property would tend to have a higher market value.
solely because of this feature. Likewise, the value of a feature present in the comparable but not the subject property is subtracted from the value of the comparable. The adjusted sales price represents the probable value range of the subject property. From this range, a single market value estimate can be selected.

The sales comparison approach is essential in almost every appraisal of real estate. It is considered the most reliable of the three approaches in appraising residential property.

Below is a sample market data worksheet.

<table>
<thead>
<tr>
<th>MARKET DATA WORKSHEET</th>
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</thead>
<tbody>
<tr>
<td>ITEM</td>
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<tr>
<td>Address</td>
</tr>
<tr>
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</tr>
<tr>
<td>Date of Sale &amp; Time Adjustment</td>
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<tr>
<td>Terms and Conditions of Sale</td>
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<td>Location</td>
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<tr>
<td>Size of Living Area</td>
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<td>Design &amp; Aesthetic</td>
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<td>Condition</td>
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<td>No. of Bathrooms</td>
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<td>Garage/Carport</td>
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<td>Porches, Patios, Pool</td>
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<tr>
<td>Basement</td>
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<td>Fireplace</td>
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<tr>
<td>Special Energy Efficiency Items</td>
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<tr>
<td>Total Adjustments</td>
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<td>Adjusted Value of Subject Property</td>
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<table>
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<tr>
<td>Comparable-B</td>
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<td>x20</td>
</tr>
<tr>
<td>Comparable-C</td>
<td>579,000</td>
<td>x20</td>
</tr>
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</table>

ESTIMATED VALUE BY MARKET DATA APPROACH: $70,300
Direct Approach To Vacant Land Valuation

When looking at vacant land, an appraiser will first need to determine the use for the property.

Subdivided lots zoned for commercial, industrial or apartment buildings are usually appraised and sold on a square foot basis. Thus, if land is currently selling for $3.00 per square foot, a 100,000-square-foot parcel of comparable zoning and usefulness would be appraised at $300,000. Another method is to value on a front-foot basis.

For example, if a lot has 70 feet of street frontage and if similar lots are selling for $300 per front foot, that lot would be appraised at $21,000. Storefront land is often sold this way. House lots can be valued either by the square foot, front foot, or lot method. The lot method is useful when one is comparing lots of similar size and zoning in the same neighborhood.

Rural land and large parcels that have not been subdivided are usually valued and sold by the acre.

For example, how would you value 21 acres of vacant land when the only comparables available are 16-acre and 25-acre sales? The method is to establish a per acre value from comparables and apply it to the subject land. Thus, if 16- and 25-acre parcels sold for $32,000 and $50,000, respectively, and are similar in all other respects to the 21-acre subject property, it would be reasonable to conclude that land is selling for $2,000 per acre. Therefore, the subject property is worth $42,000.

- The 4-3-2-1 rule is a depth adjustment that appraisers sometimes use when valuing vacant lots. It states that the land in the front one-fourth of the lot is worth four times as much as the back one-fourth. The direct sales comparison approach is used for single-family resales and raw/vacant land.
The Cost Approach

The cost approach or summation approach to value is also based on the principle of substitution.

The cost approach consists of five steps:

- Estimate the value of the land as if it were vacant and available to be put to its highest and best use.
- Estimate the current cost of constructing the building(s) and site improvements.
- Estimate the amount of accrued depreciation resulting from physical deterioration; or economic, external, environmental, functional and/or locational obsolescence.
- Deduct accrued depreciation from the estimated construction cost of new building(s) and site improvements.
- Add the estimated land value to the depreciated cost of the building(s) and site improvements to arrive at the total property value.

Estimating Land

Land value is estimated by using the market comparison approach; that is, the location and improvements of the subject site are compared to those of similar nearby sites, and adjustments are made for significant differences.
Cost of Construction

There are two ways to look at the construction cost of a building for appraisal purposes reproduction cost and replacement cost.

- **Reproduction cost** is the dollar amount required to construct an exact duplicate of the subject building at the current prices.
- **Replacement cost** of the subject property would be the construction cost at current price of a property that is not necessarily a duplicate, but serves the same purpose or function as the original. Replacement cost is most often used in appraising, since it eliminates obsolete features and takes advantage of current construction materials and techniques.

An appraiser using the cost approach computes the reproduction or replacement cost of a building using one of the following methods:

- **Square foot or cubic-foot method**: The cost per square foot or cubic-foot of a recently built comparable structure is multiplied by the number of square feet or cubic feet in the subject building; this is the most common method of cost estimation. The appraiser uses outside measurement for computing square footage.
- **Unit-in-place method**: The replacement cost of a structure is estimated based on the cost of individual building components, as installed, per individual unit of use, such as square feet of dry wall, insulation or paint. Such computations include the costs of labor, and also include indirect costs such as overhead, building permits, and builder's profits.
- **Quantity-survey method**: An estimate is made of the quantities of raw materials needed to replace the subject structure (lumber, plaster, brick, and so on), as well as the current price of such materials and their installation costs.

For example, reproduction might be stated as: 10,000 concrete slabs at $3.50 per slab, 1,500 doorknobs at $7.00 each, and so forth. These factors are added together to arrive at the total replacement cost of the structure.

**Quantity-survey method is considered to be the most accurate method.**
Depreciation

In a real estate appraisal, **depreciation refers to any condition that adversely affects the value of an improvement to real property**. Land, however, does not depreciate -- it retains its value indefinitely, except in such rare cases as misused farmland.

For appraisal purposes, depreciation is divided into three classes according to its use:

- **Physical deterioration - curable**: Repairs that are economically feasible, considering the remaining years of life of the building.

  *A new roof would be a warranted expense on a 40-year old brick building in otherwise good condition.*

- **Physical deterioration - incurable**: Repairs that would not contribute a comparable value to the building. Near the end of a building's useful life, major repair work, such as replacement of weather worn siding, may not warrant the financial investment.

- **Functional obsolescence - curable**: Physical or design features that are no longer considered desirable by property buyers, but could be replaced or redesigned at low cost.

  *Outmoded fixtures, such as plumbing, are usually easily replaced. Room function may be redefined at no cost if the basic room layout allows for it. A bedroom adjacent to a kitchen, for instance, may be*
converted to a family room.

- **Functional obsolescence - incurable:** Currently undesirable physical or design features that could not be easily remedied.

  *Many older multi-story industrial buildings are considered less desirable than one-story buildings. An office building that cannot be air-conditioned suffers from functional obsolescence.*

- **Economic (locational) obsolescence - incurable only:** Caused by factors not on the subject property, such as environmental, social, or economic forces, this type of obsolescence cannot usually be curable.

  *Proximity to a nuisance, such as a polluting factory or a deteriorating neighborhood, would be an unchangeable factor that could not be cured by the owner of the subject property.*

In determining a property’s depreciation, most appraisers use the breakdown method, in which depreciation is broken down into all three classes, with separate estimates for curable and incurable factors in each class. Depreciation, however, is difficult to measure, and the older the building, the more difficult it is to estimate.

*The cost approach is most helpful in the appraisal of special-purpose buildings such as schools, churches and post offices.* Such properties are difficult to appraise using other methods because there are seldom many local sales to use as comparables, and the properties do not usually generate rental income.

**The Income Approach**

The **income approach** to value is based on the present worth of the future rights to income -- the principle of anticipation. It assumes that the income derived from a property will, to a large extent, control the value of that property.

The income approach is most reliable when used for valuation of income-producing properties - apartment buildings, central business districts, shopping centers, and the like.

In estimating value using the income approach, an appraiser must go
through the following steps:

- **Estimate annual potential gross income.**
  - Based on market experience, deduct an appropriate allowance for vacancy and rent loss in order to arrive at the effective gross income.

- **Based on appropriate operating standards, deduct annual operating expenses of the real estate from the effective gross income in order to arrive at the annual net income.** Management costs are always included as operating expenses, even if the current owner manages the property him- or herself. Mortgage payments, however, (including principal and interest), are not considered operating expenses.

- **Estimate the price a typical investor would pay for the income produced by this particular type and class of property.** This is done by estimating the rate of return (or yield) that an investor will demand for the investment of his or her capital in this type of building. **This rate of return is called the capitalization (or "cap") rate and is determined by comparing the relationship of net income to the sales price of similar properties that have sold in the current market.**

  For example, a comparable property that is producing annual net income of $15,000 is sold for $100,000. The capitalization rate is $15,000/$100,000, or 15%. If comparable properties sold at prices that yield substantially the same rate, it may be assumed that 15% is the rate that the appraiser should apply to the subject property.

- Finally, the capitalization rate is applied to the property's annual net income, resulting in the appraiser's estimate of the property's value.

**Capitalization Rate**

With the appropriate capitalization rate and the projected annual net income, the appraiser can obtain an indication of value by the income approach in the following manner:

**Net Income/Capitalization Rate = Value**
Example: $15,000 income/10% cap rate = $150,000 value

The most difficult step in the income approach to value is determining the appropriate capitalization rate for the property.

This rate must be selected to accurately reflect the recapture of the original investment over the building’s economic life, give the owner an acceptable rate of return on his or her investment, and provide for the repayment of borrowed capital.

Note that an income property that carries with it a great deal of risk as an investment generally requires a higher rate of return than would a property considered a safe investment.

Gross Rent Multiplier

Certain properties, such as single-family homes or two-flat buildings, are not purchased primarily for income. As a substitute for the income approach, the gross rent multiplier (GRM) method is often used in appraising such properties.

- The GRM relates the sales price of a property to its rental income. (Gross monthly income is used for residential property; gross annual income is used for commercial and industrial property.)

The formula is:

Sale Price/Gross Monthly Rental Income = Gross Rent Multiplier

Example: If a home recently sold for $82,000 and its monthly rental income was $650, the GRM for the property would be computed thus:

$82,000/$650 = 126.2 GRM

- To establish an accurate GRM, an appraiser must have recent sales and rental data from at least four properties that are similar to the subject property. The resulting GRM can then be applied to the estimated fair market value of the subject property in order to arrive at its market value.

The formula then would be:
Rental Income x GRM = Estimated Market Value

The following is an example of GRM comparisons:

<table>
<thead>
<tr>
<th>Comparable No.</th>
<th>Sale Price</th>
<th>Monthly Rent</th>
<th>GRM</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$70,000</td>
<td>$500</td>
<td>140.0</td>
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<tr>
<td>2</td>
<td>$68,500</td>
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<tr>
<td>Subject</td>
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<td>$495</td>
<td>?</td>
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</table>

Note: Based on an analysis of these comparisons, a GRM of 140 seems reasonable for homes in this area. In the opinion of an appraiser, then, the estimated value of the subject property would be $495x140, or $69,300.

Reconciliation

After the data is analyzed using as many of the appraisal approaches possible, the appraiser uses a technique known as reconciliation (also called correlation) to arrive at his final estimate of value.

- **Reconciliation** does not mean averaging the preliminary estimates. It considers each approach on the basis of the validity and reliability of the data upon which it is based. Normally, the approach that is the most reliable and given the most weight will be determined by the type of property being appraised and the purpose of the appraisal.

  For instance, the direct sales comparison approach should be emphasized when appraising a home (unless it is relatively new) because of the availability of comparable sales in the market place. The cost approach should be given the most weight on a special purpose property, such as a church, museum, or school, because of the lack of comparable sales or income data. In the appraisal of income or investment property, the income approach should be given the most weight.
The Appraisal Report

The final step in the appraisal process is the appraisal report.

Here are the types:

- An **oral report** is an appraisal delivered to a client orally. It saves time but lacks written evidence as to what was said.

- A **form appraisal** report is an appraisal made on a preprinted form. The objective is to reduce the amount of time the appraiser must spend on reporting findings and conclusions and to standardize the information the lender is seeking.

- A **narrative appraisal** is a written report by the appraiser in a narrative format. It is typically 10 to 100 pages and sometimes longer. In it, the appraiser reports on everything pertinent to the property and the market for the property and gives his or her value opinion. This thoroughness allows the reader to follow in detail the appraiser's reasoning.

There are three types of reports:

- **Self-contained**, which is provided in a narrative format
- **Summary**, which is usually in a form report format
- **Restricted use**, which may be very brief, but contains the notation that it is restricted to the use by the client. It also warns that the appraiser’s opinions and conclusions may not be understood without access to the appraiser’s work file.

*On the next page is a sample form report:*
## Uniform Residential Appraisal Report

There are 3 comparable properties currently being offered for sale in the subject neighborhood, ranging in price from $254,000.00 to $269,000.00. There are 15 comparable sales in the subject neighborhood within the past 12 months, ranging in sales price from $220,000.00 to $329,000.00.

### Comparable Sales

<table>
<thead>
<tr>
<th>Feature</th>
<th>Subject</th>
<th>Comparable Sale 1</th>
<th>Comparable Sale 2</th>
<th>Comparable Sale 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Address</td>
<td>VIRGINIA BEACH, VA</td>
<td>VIRGINIA BEACH, VA</td>
<td>VIRGINIA BEACH, VA</td>
<td>VIRGINIA BEACH, VA</td>
</tr>
<tr>
<td>Property to Subject</td>
<td>0.00 miles</td>
<td>0.02 miles</td>
<td>0.57 miles</td>
<td>0.97 miles</td>
</tr>
<tr>
<td>Sale Price</td>
<td>$290,000</td>
<td>$300,000</td>
<td>$300,000</td>
<td>$300,000</td>
</tr>
<tr>
<td>Sale Price/Sq Ft.</td>
<td>$59.20</td>
<td>$59.20</td>
<td>$55.67</td>
<td>$55.67</td>
</tr>
</tbody>
</table>

### Data Source(s)

- MULTIPLE LIST SERVICE/PUBLIC RECORDS
- MULTIPLE LIST SERVICE/PUBLIC RECORDS
- MULTIPLE LIST SERVICE/PUBLIC RECORDS

### Value Adjustments

<table>
<thead>
<tr>
<th>Description</th>
<th>Subject</th>
<th>Comparable Sale 1</th>
<th>Comparable Sale 2</th>
<th>Comparable Sale 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales or Pricing Concessions</td>
<td>VA</td>
<td>VA</td>
<td>CONV</td>
<td>TYPICAL</td>
</tr>
<tr>
<td>Date of Sale Time</td>
<td>11-14-07</td>
<td>02-28-07</td>
<td>02-28-07</td>
<td>02-28-07</td>
</tr>
</tbody>
</table>

### Qualities of the Subject Property

- **Type**: Single Family
- **Bedrooms**: 3
- **Bathrooms**: 2.5
- **Square Footage**: 2,119 sq ft
- **Garage**: 2 Car ATT
- **Porch/Deck**: Porch/Deck
- **Appliances**: Refrigerator, Stove, Dishwasher
- **Finishes**: Fenced

### Analysis

- **Adjusted Sale Price**: $289,000
- **Comparables**
  - Sold At: 1,030,000
  - Sold At: 900,000

### Summary of Sales Comparison Approach

Comparables are the most similar and most recent comparables that could be located. Adjustments for feature differences, comparables are all similarly affected by mouse, equal weight given all comps after adjustments for feature differences. Some data by MLS as public records slow to record, subject and comparables conform to market area.
Narrative Report

After identifying the property and the rights being appraised, a narrative report will include:

- Detailed information on the objective of the appraisal assignment
- The definition of value as used in the report
- Regional, city and neighborhood influences on value
- Economic trends
- The physical characteristics of the land and its improvements
- The condition of title
- The zoning
- A survey or map
- Photographs of the property
- A statement as to the property’s highest and best use.

Each comparable sale is reported with its sale details and all facts used are identified as to their sources.

The appraiser concludes by showing how the information was analyzed in order to value the property.

In Review

- A real estate appraisal is the opinion of the value of a particular piece of property.
- For a property to have value in the real estate market, it must satisfy the requirements of demand, utility, scarcity, and transferability.
- The principles of value are guided by the affects of highest and best use, substitution, supply and demand, conformity, anticipation, progression and regression,
plottage, contribution, competition, and change.
- Physical, economic, governmental and social forces all impact the value assigned to real estate.
- The appraisal process is an orderly set of procedures used to collect and analyze data in order to arrive at an ultimate value.
- There are a total of eight steps in the appraisal process: define the problem, list the data needed and the sources, gather and analyze the data, determine the highest and best use, estimate the land value, estimate the value by each of the three approaches, reconciliation, and report the final opinion of value.
- Traditionally, there are three techniques used by appraisers
- The direct sales comparison approach compares the subject property with recently sold comparable properties.
- The cost approach consists of five steps, including determining the highest and best use of a piece of property.
- The income approach to value is based on the present worth of the future rights to income from a property.
- After using as many of the appraisal approaches as possible, the appraiser uses a technique known as reconciliation to arrive at his final estimate of value.