



Real Estate Pricing

4 Hours Continuing Education

Real Estate Pricing

Orientation

Course Description: Pricing and valuation is the core of the real estate business. Everyone interested in buying or selling a property wants to know:

- What is this property worth?
- What could I sell this property for?
- What should I pay for this property?
- If I seek a return of X%, what price should I pay?

Agents and appraisers should be prepared to answer these questions. This course will prepare you to do just that.

The eight learning objectives of this course are as follows:

1. Identify basic valuation principles, including supply and demand, absorption rate, etc.
2. Identify three approaches to value
3. Evaluate all three approaches to value to determine which approach (or approaches) should be used
4. Explore market analysis for residential real estate pricing
5. Identify how to select comparables for residential real estate pricing
6. Contrast an appraiser's job with an agent's job
7. Identify components of automated valuation models (AVMs)
8. Discuss how to prepare and present pricing data.

To enhance comprehension, review questions will be asked throughout the course.

A final exam will be administered after the course is completed to check for mastery of the material.

If you do not pass the final exam, you can review the course material and retake the exam at no additional cost.

If assistance is needed with this course you can contact PDH Academy at 888-564-9098 or at pdhacademy@gmail.com.

After completing the course and final exam, we ask that you take our course survey to help us continue to provide high-quality continuing education.

Real Estate Pricing

Introduction

Welcome to PDH Academy's course on pricing residential real estate for agents.

In this course, we will cover the following objectives:

1. Identify basic valuation principles, including supply and demand, absorption rate, etc.
2. Identify three approaches to value
3. Evaluate all three approaches to value to determine which approach (or approaches) should be used
4. Explore market analysis for residential real estate pricing
5. Identify how to select comparables for residential real estate pricing
6. Contrast an appraiser's job with an agent's job
7. Identify components of automated valuation models (AVMs)
8. Discuss how to prepare and present pricing data.

Module 1 Pricing and Valuation

Pricing and Valuation: Pricing and valuation is the core of the real estate business. Everyone interested in buying or selling a property wants to know:

- What is this property worth?
- What could I sell this property for?
- What should I pay for this property?
- If I seek a return of X%, what price should I pay?

Agents and appraisers should be prepared to answer these questions. Let's first distinguish between various types of pricing or valuation. Most of the time, agents prepare Comparative Market Analyses, known as CMAs, or Broker Price Opinions (BPOs). We should note that BPOs are not legal for agents to prepare in a handful of states. CMAs are almost always used as a step in either listing a house, or in advising a buyer what to pay for a property. BPOs can be used for the same reasons, but are often requested by lenders for any of the following reasons:

- Pre-foreclosure, to determine an estimate of current market value
- Short sale decisions, when the lender has received an offer below list price and wants an opinion as to whether or not the price offered is fair
- Relocation companies, before listing a house for sale (Relocation companies often obtain two appraisals, a CMA from the agent who will list the house, and a BPO from another agent)
- Remove of PMI (Private Mortgage Insurance)
- Portfolio analysis, which is when a block of mortgages are sold or transferred from one lender to another
- Some types of refinancing or home equity lines of credit (for non-federally related mortgages)

Although the word "broker" appears in "Broker Price Opinion", in many states, salespeople can perform these. In some states, agents can perform valuations for non-federally related purposes, such as for an estate, or valuing a property when the owner goes into a nursing home. Before performing these, agents should think seriously about their competency, and what would happen if their valuation was challenged, particularly if the person challenging it would obtain an appraisal. That would potentially put a salesperson into a situation where she might be testifying about value, and the other side would have a certified appraiser doing the same—this could end badly for an agent. Before performing *any* valuation other than a CMA in anticipation of getting a listing, or in helping a buyer decide what to offer, you should investigate the regulations in your state regarding agents giving opinions of value.

Before we go on, let's talk about risk, which was just referenced above. In every state, the day an agent gets a salesperson's license (or broker's license, in states which have all –broker status), he or she is able to immediately go out and price property—whether they know what they are doing or not. One of the top ten complaints that Errors and Omissions Insurance Companies who defend real estate agents report that they defend is inaccurate pricing. If an agent prices a house incorrectly, whether it is too high or too low, it is still a problem. A house which is underpriced will sell quickly, but the owners may

figure out they undersold it, and possibly sue. A house which is overpriced will sit and languish on the market, causing buyers to repeat the refrain: “What’s wrong with that house?” Ideally, an agent will be trained by a broker, manager, or mentor about how to price property in their market.

Almost all of the time, an agent is preparing an estimate of current fair market value. The definition of fair market value used by Fannie Mae is the most widely used definition, and it reads as follows:

“Market value is the most probable price that a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller, each acting prudently, knowledgeably and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

- *Buyer and seller are typically motivated;*
- *Both parties are well informed or well advised, and each acting in what he or she considers his/her own best interest;*
- *A reasonable time is allowed for exposure in the open market;*
- *Payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and*
- *The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.”*

—Source, Fannie Mae

We’ll return to the definition of fair market value later in the course; every part of it is very important. For now, note these particular elements in it and what they mean:

- Competitive and open market...each acting prudently, knowledgeably...well informed and well advised: buyers and sellers both have to have good market knowledge, and not be under duress. Consider how a sale from a knowledgeable, local seller to an unknowledgeable buyer from another state might not qualify as ‘market value’, particularly if the buyer did not obtain counselling from a real estate professional.
- A reasonable time is allowed for exposure in the open market: consider the practice, in some areas, of ‘pocket listings’, which are listings only one agent knows about; they are not shared via MLS or other sources, and ask if this meet the criteria for market value? It may not.

Appraisers

Appraisers, on the other hand, have a different set of tasks and duties, and a different level of education and experience. Since January 1, 2015, a 4 year college degree has been required to become an appraiser. Additionally, there are these requirements:

Type of Certification	College Degree	Appraisal specific education	Hours of Experience	Examination
Residential	Yes—4 year	200 hours	2500	Yes/National
General	Yes—4 year	300 hours	3000	Yes/National

Dodd-Frank requires that only licensed or certified appraisers be used for a federally related loan. You can see that the requirements are arduous, and much more education and training is required to be an appraiser as opposed to a real estate agent. In addition to estimating fair market value for mortgage loan purposes, appraisers also estimate other types of value for other purposes. For example, appraisers may estimate:

- Retrospective value: what a property was worth at a particular point in time
- Prospective value: what a property will be worth at a certain point in time, or after a certain event, e.g. a new house to be built
- Value in use: what a property is worth to the current owner, because of its use
- Liquidation value: the (low) value of a property when the asset must be liquidated as soon as possible
- Investment value: what the property is worth to a particular buyer, given the parameters of that buyer's investment goals
- Insurable value: this is usually replacement cost new, without any depreciation taken

You can see that although agents and appraisers often perform the same task (estimating market value), they do have different roles in the process. However, both appraisers and agents must understand and adhere to basic valuation principles.

Basic Valuation principles: To properly price property, you have to understand basic valuation principles, which we will cover now.

Absorption rate: A measurement of how many properties are absorbed, or sold in a given market during a specific time frame. An absorption rate, to be meaningful, should focus in on a particular type of property, with definitive parameters. For example, if the agent or appraiser is pricing or appraising a property which is a 2 story, 4 bedrooms, 2 and a half bath home, between 2000 and 2500 square feet, between 10 to 30 years old, then those are the sales that are considered. If, in the past 12 months, 48 homes matching those criteria have sold, the absorption rate is 4 per month. If in the current market, there are currently 24 homes which meet the criteria are on the market, then there is currently a six month supply. When you are pricing a property, supply and demand, which work out to absorption rate are critically important. The National Association of REALTORS® says a six month supply is normal; many agents in some market feel that any supply over 4 months is excessive. In some price ranges, you might see as much as a 3 year supply of listings; this is very bad news for those sellers, who are facing lots of competition when selling their house. An absorption rate indicating a very low supply is a seller's market; they are likely to be able to ask and get more for their house; an absorption rate indicating a very high supply is a buyer's market, because there are plenty of choices for the buyer.

Anticipation: Property value influenced by expectation of future events--Think 'boom' years with investment and speculation. People buy real estate anticipating an increase in value. During the period

of time from 2000 to roughly 2006, people anticipated continuing huge increases in value, as the real estate bubble built up. This anticipation was unrealistic, as the housing bubble burst.

Appreciation: Increase in value, due to changes in market conditions, inflation, or other causes. In most markets, the overall appreciation rate will not reflect individual segments of the market. In other words, residential real estate can be appreciating, but commercial real estate can be stagnant.

Balance: The principle of balance relates both to a particular property as well as the market in which the property is located. Balance says things should be in proportion. Buyers expect, for example, larger homes to contain more bedrooms and bathrooms. It also relates to land use and balance in a neighborhood. Ideally, in any community, there is a proper blend of single family homes, in a variety of price ranges; townhomes; condominiums; apartments, commercial and industrial uses.

Cash flow: Cash that “flows” to the owner of an investment property; it refers to the money left after all expenses have been paid.

Change: Everything changes, including neighborhoods and markets. Real estate change is segmented into these categories: growth (or development); stability; decline; revitalization or gentrification. You should always identify what stage a neighborhood is in when you are pricing a property in that neighborhood. Gentrification sometimes occurs block by block, or even house by house, making pricing a home in a neighborhood where this is occurring very tricky.

Competition: The principle that says success invites competition; “excess profits attract excess completion. At some point, competition will reduce every “slice of the pie”. The last mortgage bubble revealed how excess profits attracted excess competition, and led to massive losses.

Conformity: Appraisal principle that says homogenous neighborhoods tend to stabilize and enhance value. Conformity refers to size, style, age and condition. Homogenous neighborhoods, where the houses conform in terms of size, style, and amenities, tend to enhance value, while non-conforming neighborhoods, such as a rural area where a mansion is a quarter mile from a single wide mobile home, are more difficult to price in.

Contribution: The principle of contribution states that the value of a component is relative to its contribution to the whole rather than its value individually. In other words, cost does not equal value. An owner installs an in-ground swimming pool at a cost of \$30,000, but the contributory value to the property as a whole is estimated at only \$10,000. Real estate agents and appraisers both end up fighting the “cost does not equal value” battle with unhappy buyers and sellers.

Externalities: Influences outside a property which affect value. These can be physical, governmental, economic, or social.

Increasing and decreasing returns: An improvement to the property which increases the rate of return on the property. Decreasing returns occur when the improvements result in diminishing returns, because the cost of the improvement does not yield an equal increase in value.

Opportunity cost: The cost that is given up or forgone by taking one alternative over another. Imagine you have inherited a million dollars; after much analysis, you put the money into investment “A”, which yields 4%. As it turns out, investment “B”, which you also considered, ends up yielding 5%. You have had an opportunity cost. In real estate, some investors often regret not investing in real estate in periods before lots of appreciation in a market.

Progression: The theory that a property of lower value will have its value enhanced by its proximity to a higher value property. Simply put, the most modest home in the neighborhood will be enhanced in value by being close to the higher priced properties.

Regression: The theory of regression is the mirror image of progression; the fanciest house in a modest neighborhood will be pulled down the surrounding homes, and will not realize the value it would get in a neighborhood where the houses were more like that house.

Substitution: The principle of substitution states that the price a buyer is willing to pay will be set by the cost of obtaining a substitute or comparable property. Buyers shop competitively; in that homogeneous neighborhood where there are ten homes for sale, all of which are very similar to each other, the cheapest one will almost always sell first.

Supply and demand: Supply and demand govern economic activity across the scale. In housing, an oversupply of houses, and low demand, equals lower prices and a “buyer’s market”, because buyers have many properties to choose from. In a market with an undersupply of houses, and high demand, we have a “seller’s market”, because there are few properties to choose from. In most real estate markets, supply and demand varies across types and price ranges of properties. For example, there could be a low supply of homes priced from \$150,000 to \$200,000; but an oversupply of homes listed from \$500,000 to \$600,000.

Using Valuation Principles:

Let’s imagine we are going to price a home in our area. As we go through the steps, we’ll identify what principles we are applying.

We start with a good understanding of our market as a whole. How is the economy? Are there positives or negatives which affect value? These are **externalities**. We then move into the neighborhood, and we decide if the neighborhood has **balance**, meaning is it close to schools, shopping, and other amenities? What stage is the neighborhood in? This reflects **change**. Is the neighborhood homogeneous, meaning the homes are similar? This is **conformity**. Is the house the most modest home in the neighborhood, which is **progression**, or is it the fanciest house in a very modest neighborhood, which is **regression**? Have values been increasing in the neighborhood? This is **appreciation**, which can lead to **anticipation** on the part of buyers. What is the current **supply and demand** in the neighborhood? This represents **competition**. And, what homes like this have sold in the past twelve months? We need that number to calculate an **absorption rate**. Of the homes that are for sale, are they similar to our subject, and will this cause buyers to employ the principle of **substitution** and decide to buy another house which has a lower asking price? Have the owners made improvements to the house which they think will **contribute**

(principle of contribution) to its value, or have some of those improvements resulted in **decreasing returns?** On the other hand, have the owners recently made upgrades which will result in a higher price **(increasing returns)?** As you can see, we have not even gotten to the stage of evaluating the house by choosing comparable data, yet the market has already given us an enormous amount of information necessary to value this house. One of the things you will learn in this course is that these economic factors can influence market value much more than the physical characteristics of the house. Physical characteristics are very important; but a multi-million dollar mansion located in an economically depressed area, with a high supply of houses available is judged on the market, not on the characteristics of the house.

Module 1 Pricing and Valuation

Review Questions

1. One of the major differences between a certified appraiser and a real estate salesperson is:
 - a. Why they value properties, e.g. for sale purposes
 - b. The level of education and training needed to become an appraiser
 - c. Attitude; appraisers have bad ones
 - d. Expertise; appraisers always have more expertise in any market

2. Mr. Jones has added an elaborate, in ground swimming pool, complete with hot tub and outdoor kitchen, to his modest three bedroom ranch home. This is an example of:
 - a. Change
 - b. Conformity
 - c. Decreasing returns
 - d. Balance

3. Agent Ann has analyzed the market for one story, 3 bedroom, 2 bath ranch houses for the past year. She has determined that 24 such homes have sold in the past year. This is:
 - a. Absorption rate
 - b. Supply and demand
 - c. Increasing returns
 - d. Anticipation

4. Ms. Smith purchased her home five years ago for \$125,000. Today, it is worth \$140,000. This illustrates:
 - a. Anticipation
 - b. Appreciation
 - c. Balance
 - d. Cash flow

5. Mr. and Mrs. Hunter live in a homogeneous subdivision, where the houses are very similar. They list their house at a time when ten other houses like theirs are also for sale. The three houses listed below their asking price sell first. This illustrates the principle of:
 - a. Supply and demand
 - b. Increasing returns
 - c. Conformity
 - d. Substitution

6. CMA stands for:
 - a. Comprehensive Market Analysis
 - b. Calculated Market Appraisal
 - c. Competitive Market Analysis
 - d. Complete Market Assurance

7. A BPO, under Dodd-Frank, can be used for all **but which** of the following reasons?
 - a. To make a decision regarding accepting a short sale offer
 - b. For portfolio analysis
 - c. To originate a federally related loan
 - d. To price a property for a relocation company

8. Before agreeing to perform a CMA or BPO for a reason other than listing a house or advising a buyer what to offer, an agent should consider:
 - a. Why the valuation is needed
 - b. If the agent has the competency to perform the valuation
 - c. Whether or not the situation could lead to a situation where an agent is testifying to value against a certified appraiser
 - d. All of the above

9. True or false? All states allow real estate agents to perform BPOs.
 - a. True
 - b. False

10. True or false? A CMA is the same as an appraisal.
 - a. True
 - b. False

11. True or false? Anyone who wants to be a Certified Appraiser, going forward from January 1, 2015, needs to have a four year college degree.
 - a. True
 - b. False

12. True or false? A 'pocket listing' may not meet the requirement for fair market value, because of the lack of exposure of the property on the open market.
 - a. True
 - b. False

13. True or false? If an appraiser is estimating retrospective value, they are estimating the value of a property at some point in the future.
 - a. True
 - b. False

14. True or false? An analysis of the absorption rate in the market indicates that 36 homes similar to the subject have sold within the past year. This is a rate of 3 per month.
- a. True
 - b. False
15. True or false? An analysis of the absorption rate in the market indicates that 36 homes similar to the subject have sold within the past year. This is a rate of 3 per month. If the current number of listings is 6, that is a seller's market.
- a. True
 - b. False
16. True or false? A BPO is the same as an appraisal.
- a. True
 - b. False
17. True or false? Agents can price a house the first day they are licensed.
- a. True
 - b. False
18. True or false? All states have certified appraiser license classes
- a. True
 - b. False
19. True or false? Appraisers must complete both an education and an experience component before becoming certified.
- a. True
 - b. False
20. True or false? All states allow agents to perform BPOs.
- a. True
 - b. False

Module 2 Data & Information Gathering

Data and Information Gathering: In this module, we will discuss data and information gathering that must be done in order to price the property. Before we can price any property, we have to know what we are pricing. We need to know general information about the market, which is the context for valuation, and the house itself.

General and Specific Data:

- General Data: This is information about trends in the market. The appraiser needs to be aware of trends, such as population changes, economic changes, such as a change in the workforce; national influences, such as interest rates, incentives to buyers (like any first time buyer tax rebate), unemployment and other features.
- Specific Data: This is everything which relates to the subject property. It will include data on the subject property, the neighborhood, the comparables, trends in the market for that kind of property, public information, including published information which might affect value (tax increase, mandatory sewer hook-up, zoning changes).

Sources of data:

- Local, regional and national news, especially financial news
- Census data
- Interest rates and mortgage applications (usually found in a financial newspaper, such as The Wall Street Journal)
- Local interest rates from rate sheets
- Rental data, if needed, from property managers and owners
- Information about climate and soils, available from the county agricultural office
- Weather patterns—available from the National Weather Service (NOAA)
- Topography—topo maps are generally available at the county level
- Cost manuals
- Local costs from local builders
- Public utility companies
- Neighbors
- Financial statements for income producing properties
- County, city or local planning or engineering commissions

Sources of data:

- Zoning officer and zoning maps
- Local Chamber of Commerce
- Local REALTOR® Board
- Other appraisers
- Multiple Listing Services
- REALTORS® Property Resource (RPR©)
- County Courthouse Records—deed, assessment

- Brokerage offices (especially important for listings not placed in the MLS)
- Interviews with buyers and sellers (especially important for non-brokered sales)
- The appraiser's files
- Physical inspection of the subject
- Exterior inspection of the comparables
- Neighborhood analysis by visiting the neighborhood

Much of this information you have already observed, and absorbed, by virtue of being a real estate professional in your market. Some of it will not apply, for example, if it is not an income producing property, then the information specific to that is not necessary. But you know as a real estate agent that the mantra "location, location, location" will always apply; all properties are priced in context of their location.

Before you get to the House: First of all, get the assessment card, deed, map, and any related documents from either an online service or by visiting the courthouse. Most counties now have the bulk of this information online; as soon as you bring up the picture and card on the property, you will know more about the house and the neighborhood.

Look at FEMA (Federal Emergency Management Agency) maps online to get preliminary information about flood plain, although be advised that there is a lot of remapping going on in the United States post the Biggert-Waters Act, so always check with the local municipality to see if they have recently redrawn their flood plain maps, or if they are in the process of doing so.

Define the neighborhood: Appraisers define a neighborhood in geographical terms; you don't have to be so precise, but it is crucial that you define the neighborhood in terms of what buyers consider to be the neighborhood. Take a page out of the appraiser's book by further defining the neighborhood in terms of typical age range and price range. Outliers should generally be eliminated. You should be able to describe the neighborhood in terms of its location within a larger area, the type of uses in the neighborhood, and the age and price range. Here's an example:

"The subject property is located in a neighborhood of homes approximately 50 to 80 years old, single family, two story homes, of approximately 1800 to 2000 square feet, with a price range of \$125,000 to \$150,000. The neighborhood is south of the University, and the eastern boundary is Brandon Park; the western boundary is the commercial area along Central Ave., and the southern boundary is the commercial district along Main St."

You will understand, by identifying the neighborhood, that you should find comparable sales in this neighborhood, or a competing one. A competing neighborhood is one in which buyers for this neighborhood would also look for houses, so it will probably share the same school district, proximity to employment, and other features. On the other hand, when pricing a house in this neighborhood it would be inappropriate to use a comparable from *this* neighborhood:

"The subject property is located in Sunny Side Development, just north of the city limits. Sunny Side is bordered by the city on the south, and farmland on the east, west and north. Sunny Side is comprised of

single family homes, two story, which are between 10 and 30 years old; 2500 to 3000 square feet in size, and in a price range from \$250,000 to \$275,000.”

By the way, this is one of the most common errors agents make when pricing properties—using the wrong comparables. If you compare an apple to an orange, you get fruit salad, not a reliable CMA.

Note that you describe the neighborhood in terms of the houses and the uses, *never* by reference to the *people*, in terms of protected classes. You can say: “Most of the apartments in the neighborhood are student housing”, or “The high rise apartment building is housing for the elderly”, but you would *not* say: “This section of town is home to the city’s growing Hispanic population.”

Preliminary comparable gathering: Begin to look for possible comparables based on size, age, location, amenities, etc. This is particularly important if the property is in a rural or remote location. Check the MLS for not just sold listings, but current “For Sale” as well as “Pending, Expired and Withdrawn” listings.

Zoning, Deed Restrictions, Current Issues: Any deed restrictions or restrictive covenants should be reviewed. These are usually on public record, with a deed. You have to know about any current issues which could affect value. Let’s use an example of a community which is requiring all residents to connect to public sewer by a certain date. The tap on fee is \$6000, plus each property owner must pay to install a lateral line from the main sewer line in the street to the structure. You will want to know if this has been completed; if it is scheduled to be completed; or in the case of a potential listing, if the sellers expect the buyer to pay for this connection. If that is the case, the buyer will expect to pay less for the property.

Highest and Best Use Analysis: This is a fundamental part of valuing property. If you incorrectly estimate the highest and best use (HBU), or fail to recognize the relevant characteristics of the property, your valuation will be flawed. The highest and best use analysis begins when you learn the location of the property. From there, you use PLEM as a mnemonic to remember the tests of highest and best use:

P is physically possible

L is legally permissible

E is economically feasible

M is maximally productive

The last category—“maximally productive” is what makes HBU analysis very complex for commercial property. For example, a parcel may physically be able to have a hotel, strip mall, big box store, or large chain restaurant on it; all are legally permissible; all appear to be economically feasible. However, to determine which use is maximally productive requires an appraiser to do a market study on the possible uses and decide which one would result in the greatest return to the owner of the land.

For the vast majority of residential pricing, the highest and best use is the current use. If you are appraising a single family home in a neighborhood of other single family homes, or even a neighborhood with 2-4 family homes, it is most unlikely that the highest and best use will be anything other than the current use. However, a mistake here can be very costly for all concerned.

Here's an example of an agent missing highest and best use:

The agent was contacted by the executor of an estate to price and sell a single family home. Because the property had been lived in and used as a single family home up until the time of the former owner's death, the agent simply pulled comps of other single family homes, priced the property at \$195,000 and put it on the market. It sold promptly, and the new buyer paved part of the back yard to provide parking, and turned this large, two-story home into two professional office suites. The buyer knew what the agent didn't know: this part of town had recently been rezoned "Village Commercial" and the homes in this zoning were in high demand for use by all kinds of professional offices. The buyer who reconfigured it sold it for over \$400,000—and that's when the agent got sued by the estate. If you are ever in doubt about highest and best use, consult with a certified appraiser in your area.

Gathering Data at the Subject Property: Measure! We are going to discuss how appraisers measure houses, because we say today that you sell a house twice, once to the buyer and once again to the appraiser. If you count all of the finished area below grade, for example, and price that 1200 square foot ranch as if it is a 2400 square foot ranch, you and the appraiser will be far apart. Appraisers measure according to Fannie Mae Guidelines.

Fannie Mae Guidelines: Exterior measurements of all levels at grade or above grade. If a level is partially at grade, and partially below grade, it is treated as being below grade. If the second story is not the same footprint as the first story, e.g. a Cape Cod, take interior measurements. When measuring a bi-level home, take into account cantilevers. . A cantilever is a section of a house which hangs over the foundation or first floor. Many bi-level homes have a cantilever on the upper level. Electronic tools are available; for occasional use, nothing beats a 200' tape. Be prepared to walk around the exterior of the home, fighting shrubbery, uneven terrain, mud, snow, rain and whatever else you find. Every agent should have footwear in their vehicle that allows them to troop around in mud and snow.

Let's review how an appraiser measures houses, in accordance with Fannie Mae guidelines:

Two Story Houses

For a two story home with equal floor space on both floors, it's simple: measure the exterior of the first floor and double it. A two story with equal sized space on both floors looks like this:



But not all two story homes have equal floor space on both levels. Sometimes the upper level is smaller, as in these houses:



And, the Classic Cape Cod always has less square footage on the second level than it does on the first, as in this house:



The solution for all of these examples is to measure the finished area above grade by measuring the perimeter of the first floor, exterior measurements, and the interior of the finished area on the second floor. Often, homes of this style have eave storage, or closets which extend into eaves. The general rule of thumb is that anything under 5' is not useable for living space and is not counted. It is houses like this that you need a good measuring tape, clipboard, pencil and sketch paper. In the Cape Cod above, for example, the middle dormer visible in the photo was in an unfinished attic portion of the house; the other two dormers you can see were each in a bedroom. For this reason, **do not rely on courthouse information, or any "formula" for computing this area— some agents use 75% or 60%, for example. *This is unreliable—measure!***

One Story Houses

The basic ranch house is easy to measure; again it is a perimeter measurement of the exterior.



All that you have to watch in this house is noting whether or not there is finished area to the left of the garage door; the garage is not living area, so you need to measure the area of the garage and deduct it from the total.

There are quirks with one story homes. Look at this one:



If you look closely, you see that the main level cantilevers stick out over the lower level. When measuring this house, you would do the perimeter which is exposed, add the cantilever, and get your square footage. This house has a garage on one side of the lower level. The garage door is at grade, but the rest of this level is not completely above grade, so it is not counted in the same manner as the upper level. First of all, measure the garage; this isn't living area, and is not included in your total. There is a family room on the right hand side of the basement as you face the home. This is also not *above grade living space*. Many agents and consumers erroneously think appraisers do not "count" this space, because they look at the square footage number the appraiser uses. That is the square footage *above grade*. It *is counted*; it is just counted in the below grade living area section of the forms used. The two sections appear in the grid on the second page of the Uniform Residential Appraisal Report form; first is the finished area above grade, and then, the basement square footage and any finished area below grade.

Uniform Residential Appraisal Report

File No. PDH Sample

There are 6 comparable properties currently offered for sale in the subject neighborhood ranging in price from \$ 200,000 to \$ 225,000		There are 24 comparable sales in the subject neighborhood within the past twelve months ranging in sale price from \$ 190,000 to \$ 230,000		
FEATURE	SUBJECT	COMPARABLE SALE NO. 1	COMPARABLE SALE NO. 2	COMPARABLE SALE NO. 3
123 Beech St Address Anytown, XX XXXXX Proximity to Subject		156 Beech St Anytown XX XXXXX 4 blocks W	301 Jasmine Lane Anytown XX XXXXX .5 mile NE	224 Rose Lane Anytown XX XXXXX .5 mile NE
Sale Price	\$ 220,000	\$ 227,500	\$ 219,500	\$ 225,000
Sale Price/Gross Liv. Area	\$ 122.22 sq. ft.	\$ 113.75 sq. ft.	\$ 118.65 sq. ft.	\$ 118.42 sq. ft.
Data Source(s)		ATMLS #123456;DOM 45	ATMLS #234567;DOM 50	ATMLS #34256;DOM 60
Verification Source(s)		Courthouse	Courthouse	Courthouse
VALUE ADJUSTMENTS	DESCRIPTION	DESCRIPTION	DESCRIPTION	DESCRIPTION
Sale or Financing		Armlth	Armlth	Armlth
Concessions		Conv;0	FHA;0	Conv;0
Date of Sale/Time		s04/XX; c04/XX	s05/XX; c05/XX	s03/XX; c02/XX
Location	N;Res;	N;Res;	N;Res;	N;Res;
Leasehold/Fee Simple	Fee simple	Fee simple	Fee simple	Fee simple
Site	15000 sf	15000 sf	15000 sf	15000 sf
View	N;Res;	N;Res;	N;Res;	N;Res;
Design (Style)	DT1;Ranch	DT1;Ranch	DT1;Ranch	DT1;Ranch
Quality of Construction	Q3	Q3	Q3	Q3
Actual Age	10	10	9	11
Condition	C4	C4	C4	C4
Above Grade	Total Bdrms: 6 Baths: 3 2.1	Total Bdrms: 6 Baths: 3 2.1	Total Bdrms: 6 Baths: 3 2.0	Total Bdrms: 6 Baths: 3 2.1
Room Count				
Gross Living Area	35 1,800 sq. ft.	2,000 sq. ft.	1,850 sq. ft.	1,900 sq. ft.
Basement & Finished Rooms Below Grade	0sf	0sf	0sf	0sf
Functional Utility	avg	avg	avg	avg
Heating/Cooling	gas/cac	gas/cac	gas/cac	gas/cac
Energy Efficient Items	avg	avg	avg	avg
Garage/Carport	2ga2dw	2ga2dw	2ga2dw	2ga2dw
Porch/Patio/Deck	rear deck	rear deck	rear deck	rear deck
Net Adjustment (Total)	<input type="checkbox"/> + <input checked="" type="checkbox"/> - \$ 7,000	<input checked="" type="checkbox"/> + <input type="checkbox"/> - \$ 200	<input type="checkbox"/> + <input checked="" type="checkbox"/> - \$ 3,500	
Adjusted Sale Price	Net Adj. -3.1%	Net Adj. 0.1%	Net Adj. -1.6%	
Gross Adj. of Comparables	Gross Adj. 3.1% \$ 220,500	Gross Adj. 1.7% \$ 219,700	Gross Adj. 1.6% \$ 221,500	

SALES COMPARISON APPROACH

did did not research the sale or transfer history of the subject property and comparable sales. If not, explain _____

My research did did not reveal any prior sales or transfers of the subject property for the three years prior to the effective date of this appraisal.
 Data source(s) County Courthouse records

My research did did not reveal any prior sales or transfers of the comparable sales for the year prior to the date of sale of the comparable sale.
 Data source(s) County Courthouse records

Report the results of the research and analysis of the prior sale or transfer history of the subject property and comparable sales (report additional prior sales on page 3).

ITEM	SUBJECT	COMPARABLE SALE NO. 1	COMPARABLE SALE NO. 2	COMPARABLE SALE NO. 3
Date of Prior Sale/Transfer				
Price of Prior Sale/Transfer				
Data Source(s)				
Effective Date of Data Source(s)				

Analysis of prior sale or transfer history of the subject property and comparable sales All of the comparables used were sold by the original owners; there were no sales between when these houses were built and the sales used. The subject has also had only one owner.

Summary of Sales Comparison Approach. The comparables indicate a tight range of value, which supports the sales price of \$220,000 for the subject. Although the comparable which required the least net and gross adjustments is comparable #2, which has a reconciled value of \$219,700; we have rounded this to \$220,000 in view of the the other two comparables, which also had very low adjustments, comparable #3 actually had a lower gross adjustment at 1.6% than did comparable #2 at 1.7%

Indicated Value by Sales Comparison Approach \$ 220,000

The form above is page 2 of a Fannie Mae form that is called the 'grid'. Here you see the subject property, and all of the comparables used in the appraisal. This one, prepared for classroom purposes, is very simple, and the comparables required few adjustments. In real life, an appraiser might not get this lucky. Let's work through it, interpreting some of the things you see. This report is prepared in accordance with the Uniform Appraisal Dataset (UAD) requirements from Fannie Mae. All appraisals prepared for lending must use the UAD dataset.

Line by line:

Data Source(s): this shows the MLS, the MLS# and the Days on market.

Verification Source: The verification source is the courthouse, meaning public records. The data source is MLS; confirming it is public records.

Sales or financing concessions: all three of these sales are "arm's length", which is what we want. Arm's Length will be discussed in further detail later in the course.

All three sales were listed as "conventional", with zero for seller concessions. Seller concessions are financial costs the seller incurs to make the sale happen; they usually are the seller paying some of the buyer's closing costs.

Date of sale and time: In an actual appraisal, there would be no "x" used, but you can see that comparable #1 settled in April; comparable #2 settled in May, and comparable #3 settled in March. The 'c02/XX' for comparable #3 indicates that it went under contract in February, and settled in March.

Location: Under UAD, locations are either 'neutral', 'beneficial', or 'adverse'. Most locations are neutral. The choices are 'beneficial', 'neutral' or 'adverse'. All three are listed as being 'residential'. In your appendix for this course, you can review all of the UAD ratings available.

Leasehold/Fee Simple: All of the properties are owned in fee simple ownership, which is typical for residential real estate. However, there are sections of the United States where all the land is leased; Middletown, Pennsylvania is one such place; all of those who own houses have 100 year leases on the land.

Site: Site is next, and it is indicated by square footage. Fannie Mae guidelines are to use square footage up to one acre; then acreage for anything 1 acre and above.

View: View is classified the same way as location. However, the house with a view of a lake would probably be classified as 'beneficial'; the house overlooking the six lane freeway would probably get a rating of 'adverse'.

Design and style: DT indicates detached; 1 indicates one story; ranch indicates style.

Quality of construction: the subject and all three are Q3; see the appendix for a description of this. There are six quality ratings; 1 is the highest quality; 6 is the lowest. Quality refers to original quality when built.

Actual age: Actual age is just what it sounds like, the actual age of the subject. If the house is so old that its actual age is unknown, the appraiser uses a tilde sign--~ to indicate 'about'. So, ~100 would indicate that the house was about 100 years old.

Condition: Condition also comes in six categories, with 1 being brand new, never occupied and 6 being basically uninhabitable. See the appendix; note that the subject and all three comparables are all C4.

Above Grade Room Count: Room count is next. Under Fannie Mae guidelines, there are no ¾ baths; any room in which a person can bathe, either by shower or tub, is a full bath. Half baths are indicated by .1 per half bath, so if a house had 2 full and 2 half baths, it would be 2.2.

Under that is the gross living area above grade. See the number "35"? This is the amount the appraiser adjusted the square footage by. Note that the price per square foot of the comparables is, respectively, \$113.75 for comp. #1; \$118.65 for comp. #2, and \$118.42 for comp. #3. This reflects the total price per square foot, including the lot, garage, site improvements, etc. Square footage adjustments are not typically the cost per square foot; rather they are a reflection of how much the typical buyer pays per square foot for additional square footage.

Basement & finished Rooms Below Grade: The subject and all three comps are on slabs, with no basements. Be certain to review the UAD information in the addendum so you can interpret this area of the form if there is a basement.

Functional Utility: Next is functional utility, and all three comparables are listed as 'average'. An appraiser would use this area to make adjustments for functional problems. An example would be a house with bedrooms on a level without bathrooms.

Heating and Cooling: Heating and cooling is next; the subject and all three comps have gas heat and central air conditioning.

Energy Efficient Items: Energy efficient items are indicated as average; this means within the context of buyer expectations for this age and type of house. Homes that are 8 to 11 years old, as the subject and the comparables are, would be expected to have good insulation packages, and thermal windows.

Garage/Carport: Fannie Mae has appraisers indicate how many garage or carport spaces there are, and then how many cars can be parked, side by side (NOT tandem) in the driveway. In this case, all four houses have a 2 car garage and room for two cars in the driveway.

Porch/Patio/Deck: All four properties have decks

The remaining lines are blank for things the appraiser has noted that he believes add value, and require an adjustment. An example would be a fireplace, or possibly an in-ground swimming pool.

Keep this form in mind for the upcoming modules.

Split level homes

Measuring gets complicated with split level homes. Some have as many as four or five levels. This can be: basement, garage, lower level rec room, main living area, bedroom area. Here's an example:



This house has four levels. The lower level, which is to the right of the garage (the garage was added later, is close to at grade at the garage; it is at grade at the rear; but as the house continues moving from

left to right, you can see that more of this level is below grade. Consequently it is counted as being below grade. This level contained a family room, half bath and laundry room. The lowest level (a storage level in this house), is under the brick area at the far right. The brick area at the far right is at or above grade completely; this has the living room, dining room and kitchen. Moving back from right to left, the portion with the shutters over the family room level is the bedroom level, which contains three bedrooms and one bath. This is all above grade. It is hard to see in this picture, but that level also has a cantilever, which must be measured and accounted for.

Another real challenge is a contemporary style home where only part of the second level is finished into living space; the balance is open to the first floor, as in this house:



The glass portion at the front of the house is open from first floor to second floor. There is a master bedroom and bath at the rear of the second level. The garage has finished area over it, which was a later add-on. In this case, measure only the finished, livable area. The cathedral space only gets measured once; no one can live in thin air, so there is not a second level to count.

Another example of a difficult house to measure is this:



You would begin measuring this house by measuring the footprint, meaning the base of the house, at grade level, all the way around. Although you would measure the garage (visible at the left hand side of the photo), that is not finished area, it is garage. However, there may be finished space over the garage. You will count all finished, heated space. For a room to be classified as a bedroom, it needs to have egress by both a door and a window, so windowless rooms may be called a 'den' or something else, but not a bedroom. It is a common misconception that it is a requirement that in order to be considered a bedroom, a room must have a closet. That is incorrect; this is NOT a requirement in Fannie Mae, VA, FHA, or any other source. Early American homes often did *not* have closets in the bedrooms; the furniture included wardrobes in the rooms.

Now look at the right hand side of the picture. You will see a skylight in the roof. In the case of this house, that room had a cathedral ceiling, and the skylight provided light from this angle. There are windows on the side you can't see. The center of this house has a one story entrance area, then a second floor, where the clerestory windows are visible (they are the high, not tall, but wide windows, under the roof line). You would measure the living space on the second floor, and none of the cathedral space should be counted twice (there is no living space in the second story of a cathedral ceiling room). When you have a house that has angles like this, with eaves, you don't measure to the eave; you measure to what is living space, or about anything which is 5' tall or greater. In some houses like this, the eave space in the angles is storage; there are doors from the living area (small doors, because the space is only about 4 to 5 feet in this part). The storage area should not be counted as living space.

Finally, this house was very difficult to measure:



Not only did it have multiple angles, part of the first floor had a cathedral ceiling to the second floor. Again, do not measure cathedral ceiling spaces as if they have two floors if they only have one. This house had a 'cat-walk'—a walkway which extended over the cathedral ceiling area to connect two living spaces on the second floor. When the floor plan was drawn, it included the catwalk, which was wide enough to hold some furniture.

Other things to note:

- Style of home—Colonial, Traditional, Cape Cod, ranch, bungalow, bi-level, Contemporary, Victorian, log, etc. Another great source is online from the National Association of REALTORS®: http://www.realtor.org/rmoarchitecture_guide/residentialstyles
- Exterior overall condition
- Roofing material and condition
- Type of exterior materials and condition—wood frame, cedar shake, aluminum, brick, vinyl, stone, composition asphalt, permastone, asbestos
- Type of windows and condition—single hung, double hung, jalousie, fixed—wood, vinyl, aluminum, single pane, double pane, thermal
- Are there storm windows and/or screens?
- Are there spouting and downspouts—and are they galvanized, aluminum, copper?
- Quality of home—a great resource for quality of construction is the Marshall and Swift handbook. Their service is available online. Find them at: <http://www.marshallswift.com/ecatalog.aspx?categoryid=1&sename=residential-products&>

Other things to note:

- Is there a driveway? How wide is it? How many cars can be parked in it? What is the surface—macadam, concrete, gravel, brick?
- Are there sidewalks? Are they public (in front of the house, for the public to use) or private (from the driveway to the house) or both? Are they concrete, brick, slate, gravel paths?
- Is there a garage? Is it detached, attached, built-in? Is it one car, two car, or more?
- Are there outbuildings? What are they?
- Are there porches? Are they enclosed, open, screened? Are there decks? Are there other similar outside living spaces—breezeways, patios, pergolas, gazebos?
- Is there a swimming pool? In ground or above ground?
- What is the topography of the site?
- Is the site size typical for the neighborhood?
- Is it landscaped? Well landscaped, indifferently landscaped, or overgrown?
- How does the home fit into the neighborhood? Is it homogeneous, or is your subject property the only A frame on a block of two story, vinyl sided Colonials?

Other things to note:

- What is the neighborhood comprised of? Single family homes—2-4 family homes, a mixture? Are there commercial, industrial or special use (schools, hospitals, nursing homes) in the neighborhood? Are there any positive externalities: public parks, bike trails, golf course, easy access to highways, shopping, public transportation, schools? (Note that many buyers will respond more favorably to an elementary school in the neighborhood than they will to a high school Are there negative externalities: busy highway, dump, landfill, sewage treatment plant, rendering plant, noisy manufacturing plant, chicken farm, veal farm, etc.? This is where you begin to notice any **external or economic obsolescence**
- What stage is the neighborhood in?
- What are the amenities in the community and how close are they: schools, shopping, hospitals, libraries, medical offices, public transportation, parks, recreation, etc.?

Interior Inspection: After you have done all the outside work for the appraisal inspection, it is time to go inside the house. Most of the time, you need interior room measurements for the MLS system. You will usually start at the front and work your way back; then either go up or down (if it is two story).

Whichever room you start in, you begin by making notes of materials and condition:

- What are the walls? Plaster, drywall, paneling? Painted or wallpapered? What is the condition?
- What is the ceiling? Plaster, drywall, or tiles would be the normal choices.
- What is the height? Higher ceilings appear in some upscale homes; you will find older homes with very low ceilings, especially on the second floor-sometimes as low as 6' to 6.5'.
- What is the floor covering? Wood—is it hardwood or soft wood? Carpeting? Ceramic tile? Laminate? Vinyl?
- What about the doors? Are they hollow core, solid, stained, painted or what? You will see everything from a plain masonite door, hollow core, to finished solid wood doors with six panels. You will have already seen at least one exterior door, and noted if it is insulated, wood, metal, glass, combination.

As you are checking the rooms, look at light fixtures and outlets; see if there appear to be adequate outlets and fixtures:

- Are the outlets grounded (three prong?)
- In an older house, are any outlets in the floor? This is a code issue.

When you get to the kitchen, you want to take particular notice of the following:

- Kitchen cabinets—materials, condition, adequacy
- Countertop—type of finish, adequacy, condition
- Built-in appliances—estimated age, condition, functionality—is the dishwasher near the sink, or has it been installed in an awkward location?
- Lighting—is it adequate for the preparation of food?
- Eating area—is it adequate? If it is a separate area, is it easily accessible to the kitchen? What is the flow in the house like? Can you access the dining room or dining area easily from the kitchen? How would the house function for entertainment?
- Is there an exhaust fan, and does it really exhaust to the outside, or is it just a charcoal filter?
- Is the house dated in terms of décor?
- Is there readily observable **physical deterioration** (worn out parts or systems, parts of the property which have deteriorated) or **functional obsolescence** (old kitchens, old baths, bedrooms on a level without a bathroom, walk through bedrooms, etc.)

As your general inspection continues, note where doors and windows are, if they are adequate, and if any placement has created traffic problems. Believe it or not, builders still make stupid errors—I have been in a brand new house where the front door would not open the entire way, because it hit the bottom step. Ideally, homes should have public zones and private zones. The reason most homeowners prefer a half bath or powder room near the public rooms of the house (kitchen, dining room, living room, and family room) is to keep the private areas of the house (bedrooms and family bathrooms) private.

Functional Utility: As you look through the house, you are looking at functional utility. Think of this as how easy it is to function in a house—flow, floor plan, storage, convenience etc. You will see glaring examples of functional obsolescence—older homes with virtually no closets, captive bedrooms, captive bathrooms, bathrooms on a different level than a bedroom, garages which open into formal rooms, or worse yet, private rooms; basements which are only accessible from the outside; outmoded kitchens with limited cupboard and counter space; outmoded bathrooms, without showers, small, cramped, etc. You take note of this because if you prepare a cost approach, you must estimate the amount of functional depreciation and deduct it from the replacement cost new. It will also affect value in terms of the market approach.

As you continue your inspection of the house, you will want to inspect the attic and basement.

Attic: Appraisers doing an FHA appraisal must put their “head and shoulders” up into the crawl space. You don’t have to do that, but you want to find out as much as you can about the attic.

If it is a walk-up attic, your inspection is easier. You are looking for:

- Insulation
- Wiring—is there any old knob and tube wiring in the attic?
- Stains, leaks, water spots—any evidence of leaks, now or in the past?
- Roof rafters or trusses—do they appear to be in good condition? Is there any evidence of charring (which could indicate a fire at one time). Can you see daylight anywhere, which would indicate a hole?
- Flue—does a flue come through the floor of the attic and continue up to the roof? What is the material? What is the condition?

Basement: If the house has a basement, there is much to be seen and noted there.

- What are the foundation walls? Many older homes have stone foundations. Sometimes the interior has stucco like finish over the stone. You will also see: concrete block, poured concrete, and pre-engineered reinforced modular foundation systems.
- What is the floor? Usually it will be concrete or dirt, although sometimes you will see brick or slate. Look up at the floor joists. Are they sagging? Are there any signs of infestation? Have they been reinforced in any way?
- What is the distance between floor joists? Have any support posts been added? Where? What is above that support? Are there windows for ventilation?
- The other things you typically see in basements are the **mechanical systems** of the house, most commonly, furnace and hot water heater. Note what kind of heating system the house has, and how water is heated.

Electrical System: The basement is the place to look at wiring. Usually, the fuse or circuit breaker box is located in the basement. Caution! Just because the house has a 200 amp circuit breaker box in it **does not mean it has 200 amps!** Homeowners are known for DIY projects, which may include buying a circuit breaker panel box and moving the wiring from a fuse box into the panel box. The amperage is determined by the meter, usually found on the outside of the house. Simply put, if the power company is not supplying 200 amps of electricity to the house, it doesn’t have 200 amps of electricity.

Other basement inspection issues:

- Is there water, dampness, mold, musty smell, etc?
- Is there a sump pump?
- Is there an outside entrance?
- Pipes—look at supply lines as well as waste lines. What material(s) are they made of? In some houses, you will see copper, even in waste lines. Most of the time, you will see a mixture of materials from galvanized to copper to plastic. Hopefully, you will not see lead.
- Speaking of pipes, if the house is heated with hot water or steam, what are those pipes made of? Copper, galvanized or, in newer construction, flexible plastic are the usual choices
- Are the hot water heat supply lines insulated? With what material? Asbestos? Foam? Nothing?
- Is the washer and dryer hook up in the basement? Is there a utility sink?
- Is any portion of the basement finished? If so, this is a whole other aspect of your inspection.

Finished basements: The quality of basement finishes varies as greatly as the finish of the main living levels. For example, both of the following are “finished basements”:

- Basement “A” has ceramic tile flooring; wood wainscoting with a chair rail; painted drywall above the wainscoting; drywall ceiling with indirect lighting; gas log fireplace; built-in shelves for a media center, games, and books.
- Basement “B” has masonite paneling, which because it is not designed for below grade use, has warped and is now waving off the wall; indoor/outdoor carpeting for a floor covering; suspended ceiling with fluorescent lighting, similar to what is found in offices; and a woodstove in the corner.

Both basements are “finished”. But only one will add more value to the property as a whole—basement “A”.

Utilities: The basement is also a place to verify the utilities. A well tank or water softener will be seen, if present; a meter will indicate that either the water or the sewer is being metered. Caution: in some locales, public sewer is in place but the houses are still on private wells. Meters have been installed to meter the *sewage*, not the water. Always ask and confirm details with the owner.

Back outside: If the property is on a well and septic, locate the well (you can usually see the well head above the ground, although some homeowners will cover it with something decorative—a “wishing well”, lighthouse, etc. If the owner knows where the septic is, head in that direction. If they don’t know, when in the basement, note which direction the waste pipe exits the house. If the house is on an on-site system, walk around the property. You are looking for any visible signs of failure of the system—spongy ground when it is not otherwise wet; odors; or at the extreme, evidence of waste materials surfacing on the ground. If the property has a mound system, not only will the mound be visible from the outside (it is a mound, and therefore hard to miss) but inside there should be an alarm system. This is because sand mound systems pump the contents of the septic tank up (contrary to gravity), and if the power goes out, it serves to warn the homeowners to stop flushing toilets and otherwise putting water down the drains until the power comes back on.

Module 2 Data & Information Gathering

Review Questions

1. Which of the following types of data is *specific* data, as opposed to *general data*?
 - a. The unemployment rate in the county where the house is located
 - b. The overall climate of the region of the country where the house is located
 - c. The square footage of the house
 - d. The main employment opportunities in the area
2. Which of the following types of data is *general* data, as opposed to *specific* data?
 - a. The annual taxes on the property
 - b. The zoning of the parcel
 - c. The size of the lot
 - d. The demographics of the community (age, education, gender, etc.)
3. Which of the following is correct about flood plain determination?
 - a. If the property does not appear on a FEMA map online, it is not in the flood plain
 - b. If the property does appear on a FEMA map online, it is in the flood plain
 - c. The local municipality is the best source for *current* flood plain information
 - d. Local municipalities do not keep flood plain maps.
4. You would define a neighborhood by all **but which** of the following characteristics?
 - a. Age of homes
 - b. Size of homes
 - c. Style of homes
 - d. Ethnic makeup of the neighborhood
5. In the example used in the text about an agent who priced a property incorrectly because of her failure to analyze highest and best use, what salient fact did she miss?
 - a. The lot was big enough to have some of it paved
 - b. The house was big enough to be turned into two office
 - c. The property had recently been rezoned "Village Commercial"
 - d. The rents were high for office space in that area
6. Which is correct regarding Fannie Mae guidelines for measuring a house?
 - a. Only finished area above grade is considered as finished space
 - b. Finished area above grade is measured and reported in one place on an appraisal report; finished area below grade is measured and reported just below that in the grid
 - c. Finished area below grade is not counted
 - d. Both above and below grade levels are added together and counted as one

7. When looking at a house to price it, which answer best describes what you should do?
 - a. Walk through the house and listen to what the owners say about their house
 - b. Go through the main living areas, and think about how the house should be staged
 - c. Go through the entire house, noting things like age, condition, type of heating, plumbing materials, wiring, kitchen, baths, updates, etc.
 - d. Get the information you need for MLS and ask the sellers what they want to ask for the house

8. If there is a 200 amp circuit breaker box in the basement, this indicates:
 - a. There is definitely 200 amp electrical service to the house
 - b. There *might* be 200 amp electrical service to the house, but the outside service entrance (the meter) will determine how much amperage is being supplied to the house
 - c. There is at least 150 amp electrical service to the house
 - d. None of the above

9. While going through a house to price it, you notice that it is a Cape Cod style home, with one bedroom and a full bath on the main level, and two more bedrooms (but no bath) on the second level. This is an example of:
 - a. Physical deterioration
 - b. External obsolescence
 - c. The influence of style on the home
 - d. Functional obsolescence

10. While looking at a house to list it, you notice that the roof is very old, and appears to be on its last legs. This is an example of:
 - a. Physical deterioration
 - b. External obsolescence
 - c. Functional obsolescence
 - d. All of the above

11. Ideally, the family bathrooms and bedrooms should be:
 - a. Easily accessible to guests
 - b. Located in various parts of the house
 - c. In a private area of the house
 - d. In the public area of the house

12. True or false? Much of the work involving the pricing of a house can be done in your office, by analyzing the public records, MLS data, and your knowledge of the local neighborhood.
 - a. True
 - b. False

13. True or false? A neighborhood will typically be described in terms of the age, size, style, and price range of the houses in it.
- True
 - False
14. True or false? "The neighborhood is comprised of single family homes, mostly owned by African Americans." This is an acceptable way to define a neighborhood.
- True
 - False
15. True or false? "The neighborhood is near the University, and many of the multi-family homes in this neighborhood are student housing." This is an acceptable way to describe a neighborhood.
- True
 - False
16. True or false? Under Fannie Mae guidelines, appraisers do *not* consider finished area below grade at all.
- True
 - False
17. True or false? None of the work involving the pricing of a house can be done in your office.
- True
 - False
18. True or false? Under Fannie Mae Guidelines, appraisers must classify houses with quality and condition ratings.
- True
 - False
19. True or false? Under Fannie Mae Guidelines, appraisers must characterize locations as one of the following: neutral, beneficial, or adverse.
- True
 - False
20. True or false? "The neighborhood is comprised of single family homes, approximately 10 to 20 years old; and the neighborhood is restricted to single family homes by both zoning and deed restrictions." This is an acceptable way to describe a neighborhood.
- True
 - False

Module 3 Approaches to Value

In this module we will discuss pricing and valuation by defining, and understanding, how to develop the three approaches used in the real estate industry to value real estate. Agents are familiar with the market approach, which is what is used when preparing a comparative market analysis (CMA) or a broker's price opinion (BPO); however, there are circumstances where a cost or income approach is valid.

Learning objectives:

- ✓ Understand the three approaches to value
- ✓ Cite examples of the strengths and weaknesses of each approach
- ✓ Identify when to use each approach or approaches when valuing or pricing a property

The Three Approaches to Value:

Cost: The cost approach is simply what it sounds like: estimating the cost of the improvements to the property, and adding in the land value. It is not as simple to do as it sounds; the appraiser must determine the quality and condition of the improvement, and then estimate depreciation.

Market: This approach is the one most agents are familiar with, as CMAs and BPOs are based on the market approach to value, which compares the subject property to other similar properties which have sold. Adjustments have to be made for differences between the subject and the comparables.

Income: This approach to value is based on the premise that investors purchase income producing real estate for the stream of income it provides. This approach can range from rather simple—developing a GRM (Gross Rent Multiplier) to extremely complex—estimating the internal rate of return.

Cost Approach Methods:

There are at least four methods of cost approach; we will concentrate today on the square foot method, but here are the definitions all the four methods:

- Index method: The appraiser takes a factor which represents the percentage increase of the cost of construction from the date of the original construction to present time. This factor is multiplied by multiplied by that original cost.
- Square-foot method: This is the most commonly used method. The cost per square foot is taken times the square footage. Appraisers generally use published cost estimates, which can be tweaked for different features, such as hardwood floors, higher ceilings, etc.

- Unit-in-place method: This is a more detailed construction cost which looks at each component part. It is often used in multi-family housing because the cost will be multiplied by the number of units. The component cost includes material, labor, overhead, and builder's profit. For most items, the component parts are estimated in square feet; certain items, like furnaces, plumbing fixtures and appliances, are estimated as complete units.

- Quantity survey method: This is very detailed, with itemized costs of building by the component parts. It includes indirect costs such as permits, land surveys, insurance, payroll taxes, overhead, profit, and direct costs for all phases of construction, from site preparation to finish.

*Note that both the unit-in-place method and the quantity survey method may be referred to as a segregated cost method. This is because each individual cost is taken out, or segregated, from the whole.

The most commonly used method is the cost per square foot method. Here are the steps:

1. Estimate the cost of the improvements to the property, and
2. Add in the land value.

It is not as simple to do as it sounds; you must determine the quality and condition of the improvement, and then estimate depreciation. A website from Marshall and Swift, <https://www.swiftestimator.com/> is available, on a fee basis, to determine cost. This site guides you through determining the quality of the building, as well as determining age-life depreciation.

When we do the cost approach, the steps are:

1. Estimate the replacement or reproduction cost new
2. Determine physical depreciation, and determine a depreciation amount or rate for it
3. Determine functional obsolescence, and determine a depreciation amount, or rate for it
4. Determine economic or external obsolescence, and develop a depreciation rate for it
5. Add in the land value plus the value of any site improvements (depreciated, if necessary)

*Note: land does not depreciate—either in appraising, or in the income analysis of a property.

To do the cost approach we need to understand all three types of depreciation and how they are estimated. It should be noted that physical depreciation can be curable or incurable; functional depreciation can be curable or incurable; but economic, or external depreciation is only ever incurable.

Physical is curable because repairs can be made, unless the cost to do so is not warranted by the value as improved; functional is curable for the same reason, but external is always incurable because it is from the location of the subject, and you can't move where the property is situated.

Physical depreciation: Improvements wear out over time. Some wear and tear is normal; some wear and tear is more than would typically be expected for a property of the actual age of the subject.

As we discussed in Module 2, effective age is the estimate the appraiser makes of the subject's age in terms of its current condition and utility. When doing an appraisal report using appraisal software, once an appraiser enters an effective age and an estimate of remaining economic life, the software makes the calculation based on an age-life computation. Age-life method of calculating depreciation is the simplest of the methods used by appraisers, and the most commonly used for residential real estate. It does use the assumption that depreciation occurs at an even rate during the projected life of the structure. The computation is made by dividing effective age by the total economic life.

The formula is:

Effective age ÷ Total Economic Life = Accrued Depreciation.

Example: A building has an effective age of 5 years, and an economic life of 50 years. The depreciation is 10% ($5 \div 50$).

Today's software for appraisers does this calculation automatically; indeed, online services such as Marshall and Swift's Estimator also can and will make this computation automatically.

Market Extracted Depreciation: This is another method, not as commonly used, to extract depreciation. To do this you locate a sale, and then estimate the cost new of the building. Then you first subtract the value of the site, then subtract that figure from the replacement cost new, and you will come up with the amount of depreciation the building had.

For example:

A property sold for \$250,000. The replacement cost of the building is \$325,000. The site value is \$50,000.

$\$250,000 - \$50,000 = \$200,000$.

$\$325,000 - \$200,000 = \$125,000$ of depreciation.

$\$125,000 \div \$325,000 = .38$, or 38%; the building had 38% depreciation.

If the building is 10 years old, the depreciation, on a straight line basis, is 3.8% per year.

Practical Application: The practical application of the cost approach is generally for special purpose buildings, such as churches, schools, and other institutional buildings, and unusual houses, or situations where it is apparent the highest and best use of the land is as if vacant and unimproved. There are circumstances where the value of a parcel is the land value minus the demolition costs. This is rare, but consider a situation where either the property has been polluted, and the cleanup costs are high, or the property contains things like asbestos and lead, which will require special demolition and land fill fees. If

the cost to clean up the parcel, and/or remove the existing improvements is more than the value of the site, as if vacant, then it has a negative value.

Special purpose buildings: The reason the cost approach works best for these is that it is what is practical to use. There are usually very few, if any, comparable sales for these types of properties; because they don't provide an income stream there is not data to do an income approach. Even if you can find some comparables, a cost approach is a good check on the value.

Another thing to keep in mind is that if you are pricing one of these buildings, the chances are great that it will be repurposed, which is put to another use. When investors buy buildings to repurpose, they approach the problem from the end and work back to the beginning.

For example: an investor purchased a former elementary school, and turned it into apartments for the elderly. The building was old; the original part dated from 1909, and the 'newer' part from the 1920's. There were known environmental issues, mostly lead and asbestos. Additionally, the building was not ADA compliant, and although each classroom was large enough to make a good sized one bedroom apartment out of it, each unit had to have plumbing, a kitchen and bath, and a separate heat source. The investor started at the end, and worked backward. He knew he could make 30 apartments, and he researched market rents for those apartments. From there, he estimated the costs of rehabbing the structure, adding a very healthy margin for 'surprises' that might be encountered when working on a building over 100 years old. He also took into account his time, because during the time he was working on the building, he would have no income, but ongoing expenses. His costs included both the direct costs of rehabbing, and the indirect costs, such as surveying, legal fees, permits, advertising, etc. He also put in profit, because as much as many people enjoy challenges, they need to make a living. That brought the investor back to his acquisition price on the building, which was less than \$5.00 a square foot. At the time, the *replacement cost new* of this building was running around \$150 a square foot. The difference is the depreciation found in an older building.

Residential applications: The cost approach is useful in residential in certain circumstances. First, an easy one: new houses. If a seller has a brand new house to sell, it is very important to know the cost of building another new home similar to it, because the typical purchaser will compare either buying the existing (although new) house, or building to suit themselves. The more complicated one is when you are faced with an unusual house for which there are no comparables. This could be a home which is so unusual that there are simply not any reliable comparables for it. It could include specific features which are not common in the marketplace. In some cases, the improvement no longer contributes to the overall value of the site; in other words, the market sees no value in the improvement, and it is a tear down. Then, you need to calculate land value.

The Market Approach to Value:

Market: This approach is the one most agents are familiar with, as CMAs and BPOs are based on the market approach to value, which compares the subject property to other similar properties which have sold. Adjustments have to be made for differences between the subject and the comparables. The market approach to value works best when the following conditions exist:

- The subject is fairly homogeneous in terms of other housing which has sold, which generally means it is not an exotic style or type
- There is a good sized pool of comparable data for you to draw comparables from
- The market is active, with sales occurring frequently

The market approach to value will not work well when:

- The property is unusual—in style, size, site size, etc.
- There is a very limited pool of comparable data
- The market is static, with sales occurring infrequently

Most of the time for residential real estate, the market approach will work well. The biggest errors made by agents in developing CMAs, and by some appraisers are:

- Using comparable sales which are really dissimilar—you can't compare "Middle Class Estates" to "Pricey Developments".
- Using comparable sales which are dated, especially when the market is changing or has changed
- Making inappropriate adjustments for differences between the subject and the comparables

Some general guidelines: The closer the comparables are to the subject, the better. FHA, and other lenders, for example, prefer, if possible, that appraisers "bracket" the subject property by both size (square footage) and price. In other words, if the subject property is an 1800 square foot house which sold for \$80,000, these lenders prefer an appraisal with a comparable exactly 1800 square feet; one which is 1600 square feet; one which is 2000 square feet; one which sold for \$78,000; one which sold for \$80,000; and one which sold for \$82,000. However, we don't always get the comparables we would like; we simply get the ones we have. But, keep in mind, as you price a property which will eventually have to be appraised, that these are things the appraiser is looking for.

To make certain we select the comparables we ought to have, let's return to the definition of market value most commonly used:

The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently, knowledgeably and assuming the price is not affected by undue stimulus.

Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

1. Buyer and seller are typically motivated;
2. Both parties are well informed or well advised, and each acting in what he or she considers his or her own best interest;
3. A reasonable time is allowed for exposure in the open market;
4. Payment is made in terms of cash in U. S. dollars or in terms of financial arrangements comparable thereto; and
5. The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

--Source: Fannie Mae

Exercise:

In this exercise, we need to determine if the sales are “arms-length”. An arm’s length sale is one where the parties do not have a personal relationships which would influence the price; both are typically motivated, well-informed and well advised, and acting in what they consider to be their own best interest; a reasonable time is allowed for exposure in the open market, and the price represents the normal consideration for the property sold unaffected by special or creative financial, or sales concessions granted by anyone associated with the sale.

With this in mind, consider the following potential comparable sales and indicate whether or not you would use them. Use the following:

- T (True), meaning it is an arm’s length sale or
- F (False), meaning it is not an arm’s length sale, or
- “Depends”, meaning you would need more information.

Exercise:

Consider the following potential comparable sales and indicate whether or not you would use them. Use the following:

- T (True), meaning it is an arm’s length sale or
 - F (False), meaning it is not an arm’s length sale, or
 - “Depends”, meaning you would need more information.
1. Sale is between John Smith, a single person, and Mary Smith, a single person, to Mary Jones, formerly Smith.

FALSE. Would not use; this is fairly evident that this is a sale between two people who were formerly married to each other. Not arm’s length.

2. Sale did not go through a real estate broker. Price paid seems excessively high; courthouse documents list buyer's address as a distant state.

FALSE A buyer with an apparent lack of local knowledge makes this not a good comp.

3. Property was put in the MLS and went under contract in about 30 days, selling for 98% of list price. Sales price seems reasonable in light of market. Buyer and seller have different last names.

TRUE Appears to be arm's length and can be used.

4. Property came through MLS as "Sold" and was purchased by the broker of the company which listed it.

DEPENDS. You want to investigate this. Did the broker set the asking price? Did the broker know when he set the price that he had an interest in the property? May not be useable as a comp.

5. Property was sold through MLS; under comments, the listing agent has: \$50,000 1% SBA loan is assumable. The total price paid was \$100,000 and MLS indicates the buyer assumed the 1% loan as part of the consideration.

FALSE Don't use. See item #5 above.

6. Sale was made between a straw party (a person acting on behalf of another person) who represented a large corporation, as a buyer, and a seller, who did not have a broker and was known to be elderly. The property consisted of several acres of farmland. Shortly after the purchase, the Department of Transportation announced an extension of Route 99 right next to the property, with an exit at the property.

FALSE Not arm's length; one party was more knowledgeable than the other.

7. The seller was a builder. The property was not in the MLS. From the exterior, the property looks similar to other properties in the subdivision. However, when you contact the buyer to confirm details of the sale, he smugly says: "I got such a great deal on this place. You know, for the same price as my neighbors paid last year, I got the upgraded kitchen and a finished basement."

FALSE Uh-oh! If the builder is adding that much 'stuff' and selling the property for the same price as homes went for last year, without the added stuff, the market is soft; builder is trying to prop up prices in his subdivision by adding 'extras'. This is why an appraiser looks at the agreement of sale and sees if there are concessions.

8. The property is an income producing property, which is originally listed for \$250,000. Several months later, it sells to a local investor for \$195,000.

TRUE *Could be a perfectly reliable comp, and probably was. The original price was probably aspirational.*

Even in a pool of comparables which are all arms-length sales and therefore acceptable to use, there will be comparables which will be superior to the others. Again, you will want to find the most similar physical characteristics, location, terms of sale, and the most recent sales.

Exercise:

The following exercise is practice in selecting comparables.

You are pricing a 3 bedroom, 2 ½ bath one story home, 1800 square feet, with an attached two car garage. It is on a lot which measures 100 x 150, and is built on a slab. It has gas heat and central air conditioning. The house is 10 years old, and is in average condition (it has been maintained, but not upgraded). It is located in a desirable residential subdivision.

Here is a list of potential comparables to use to price this house. All of these sales are arm's length, and the buyers used typical financing, so no adjustments are needed for those items. Using what you know about selecting comparables, which of these would you use?

- Comp. #1: 3 bedroom, 2 ½ bath, 1900 square feet, on a slab, attached two car garage. Lot is 100 x 150, gas heat and central air. House is 8 years old, and the sale occurred 15 months ago. House is located two blocks away from the subject.
- Comp. #2: 3 bedroom, 2 ½ bath, 2400 square feet, partial basement, attached two car garage. Lot is 200 x 200; gas heat and central air. House is 15 years old; sale occurred two months ago. House is located four blocks away from the subject.
- Comp. #3: 3 bedroom, 2 ½ bath, 2000 square feet, on a slab, two car garage, lot is 100 x 150, gas heat, central air, 10 years old, sale occurred 60 days ago; house is located across the street from the subject.
- Comp. #4: 4 bedroom, 3 full bath, 2200 square feet, on a slab, two car garage, gas heat, central air, 8 years old, lot is 100 x 150, sale occurred 30 days ago; same subdivision.
- Comp. #5: 3 bedroom, 2 bath house, 1850 square feet, on a slab, lot is 100 x 150, gas heat, central air, 2 car garage, house is 9 years old, sale occurred 45 days ago, house is located in a competitive subdivision.

- Comp. #6: 3 bedroom, 2 ½ bath house, 1900 square feet, lot is 100 x 150, on a slab, 2 car garage, gas heat and central air; house is 11 years old; sale is 70 days old. Located in a competitive subdivision.

How do you decide which comparables to use? The easiest thing is to grid the sales and identify where you would have to make adjustments. The fewer adjustments you have to make, the more reliable the comparable will be.

Features	Subject	Comp 1	Comp 2	Comp 3	Comp 4	Comp 5	Comp 6	Adjustments?
Bedrooms	3	3	3	3	4	3	3	Comp. 4
Baths	2 1/2	2 ½	2 ½	2 ½	3	2	2 ½	Comps. 4 and 5
Square footage	1800	1900	2400	2000	2200	1850	1900	All would need to be adjusted; comps. 2 and 4 would need the most adjustment
Age	10	8	15	10	8	9	11	
2 car garage	2 car	2 car	2 car	2 car	2 car	2 car	2 car	All the same
Lot size	100 x 150	100 x 150	200 x 200	100 x 150	100 x 150	100 x 150	100 x 150	Comp. #2 would need to be adjusted
Slab Basement	Slab	Slab	Partial Bsmt	Slab	Slab	Slab	Slab	Comp. #2 would need to be adjusted
Heat a/c	Gas/cac	Same	Same	Same	Same	Same	Same	
Date of sale	--	15 months	2 mos	60 days	30 days	45 days	70 days	Comp. #2 would need to be adjusted
Location	--	2 blocks	4 blocks	Across the street	Same subdivision	Comp. sub	Com sub	May have to adjust for competitive subdivision; may not.
Total:		2 adj (time & size)	4 adj. size, lot size, square ft, age, basement	1 adj size	3 adj Size, BR, bath	2 adj size, bath	1 adj size	

From this chart you can see the comparables which will require the least number of adjustments are 1, 3, 5 and 6. Because Comp. #1 would require a time adjustment, it is better to use 3, 5, and 6, and not

make a time adjustment. Also, when an appraisal is done for the loan, the appraiser will not be able to use a comp which is this dated.

So Your Comps Aren't Perfect—Adjust! Of all the things which are hard to teach, and harder to learn, making adjustments is at the top of the list. This is true for many reasons. First of all, there is generally no “one size fits all” adjustments across the board. Before making any adjustment, you must ask yourself if the difference observed in the comparable is meaningful in the marketplace. Then, you need to remember that you can only adjust the comparables, never the subject. The subject “is what it is”. In the case of the comparables above, you will have to determine the appropriate adjustment for square footage and baths, and possibly bedrooms.

However, be careful when adjusting for *both* bedrooms and square footage. Most of the time, you should only adjust for one, not both. Whenever possible, find comparables which have similar square footage and the same bedroom count. Most appraisers, if they used comparable #4, would adjust for the bath and the square footage, but wouldn't adjust for the bedroom, because the square footage adjustment has already covered it.

For the square footage, the bathroom count, the partial basement, and the lot size, you should make market based adjustments. *Market based adjustments* are exactly what they sound like: adjustments based on market behavior. There is no ‘one size fits all’.

Adjustments will be different in different price ranges, based on the expectations of typical purchasers in that market. Let's take the partial basement comparable #2 has, for example. Based on the subject data, and the data for the other 5 potential comps, it would appear that basements are an anomaly in this market. So, the next question is whether or not they are a desirable feature, which they might be, because even a partial basement offers storage and a potential workshop area; or if they are not desired, and in fact, the market places no value on them. How do you find out? You research the market to find out what impact basements have had on other sales. Talk to agents and appraisers, and ask if they think having a basement (even a partial basement) had an impact on the selling price.

If you are a REALTOR®, another source of possible adjustments is found at the REALTORS® Property Resource site (RPR®). RPR® is an automated valuation model (AVM) designed by and for REALTORS®. Like other AVMS, it uses algorithms and statistical analysis to value property, and features of a property. On this site, you can adjust the basic features of a house, and the algorithms will indicate an adjustment. Often, your experience in the market will guide you.

Turning to the square footage adjustment, keep in mind that this is *not* a cost based adjustment; it is an adjustment based on how much more a typical purchaser will pay for additional square footage. When it comes to adjusting for square footage, keep in mind that there are diminishing returns with square footage. In *most* markets, there is a noticeable increase in the amount a buyer will pay for a 2500 square foot house versus a 2000 square foot house, for example.

However, as the houses get larger, the amount diminishes. At the 6000 square foot level, buyers are typically not paying as much per extra square foot as they did at the 2000 square foot level. To make this adjustment, again, ask other agents, or appraisers, or use RPR®. The same technique will work for bathrooms and lot size. Always confirm that the feature made a difference. Appraisers are required to view all the comparables they use, at least from the exterior. This is a good thing to do; for example, in comparable #2, which had the larger lot size, suppose you drove by and discovered that half the lot was a steep bank. You might logically conclude that the additional space was unusable, and therefore did not impact value. You could also do what an appraiser would, and call one of the agents familiar with the sale, and ask about whether or not it impacted the sales price.

Appraisers reconcile in the market approach to the comparable they think is either most similar to the subject, or most compelling. Usually, it is the comparable which required the least net and gross adjustments. The fewer the adjustments, the more reliable the value is. You are not doing an appraisal, and we recommend you give the sellers a range of price to list in, and an expected range for the selling price. For example, you might say: “Based on the comparable sales, I would recommend listing between \$140,000 and \$150,000, and to expect a sales price between \$135,000 and \$145,000.

You noticed in the initial exercise that no sales prices were given for the comparables; this was intentional, to make you focus on the similarities and differences. But, sometimes the price a property sold for makes it an outlier, statistically, and you need to examine why, and possibly discard the sale as a comparable. In the grid below, we have added prices. Analyze these for a moment.

Features	Subject	Comp. 1	Comp 2	Comp 3	Comp 4	Comp 5	Comp 6	Adjustments ?
Bedrooms	3	3	3	3	4	3	3	Comp. 4
Baths	2 1/2	2 ½	2 ½	2 ½	3	2	2 ½	Comps. 4 and 5
Square footage	1800	1900	2400	2000	2200	1850	1900	All would need to be adjusted; comps. 2 and 4 would need the most adjustment
Age	8	8	15	10	8	9	11	

2 car garage	2 car	2 car	2 car	2 car	2 car	2 car	2 car	All the same
Lot size	100 x 150	100 x 150	200 x 200	100 x 150	100 x 150	100 x 150	100 x 150	Comp. #2 would need to be adjusted
Slab Basement	Slab	Slab	Partial Bsmt	Slab	Slab	Slab	Slab	Comp. #2 would need to be adjusted
Heat a/c	Gas/cac	Same	Same	Same	Same	Same	Same	
Date of sale	--	15 months	2 mos	60 days	30 days	45 days	70 days	Comp. #2 would need to be adjusted
Location	--	2 blocks	4 blocks	Across the street	Same subdivision	Comp. sub	Com sub	May have to adjust for competitive subdivision; may not.
Sales Price	--	\$285,000	\$264,000	\$210,000	\$187,000	\$199,900	\$209,000	
Price per sq. ft		\$150	\$110	\$105	\$85	\$108	\$110	
Total:		2 adj (time & size)	4 adj.	1 adj size	3 adj Size, BR, bath	2 adj size, bath	1 adj size	

What should jump out at you is that comp. #1 and comp. #4 are *outliers*, meaning that they are numbers that are statistically outside the norm. This becomes even more apparent if you compute this by price per square foot, which is the column below the price. In a homogenous neighborhood, where lot sizes are similar; houses are similar in style, age, square footage, and room count, a price per square foot is a

good benchmark to refer to. In the real world of selling real estate, every seller will want to talk about comparable #1. Don't use it! It is an outlier; and it is 15 months old. Explain to the seller that a lender will not allow an appraiser to use a comparable that dated. None of the sellers will want to be compared to sale #4, and you should find out why it sold that low (relative to the rest of the neighborhood). It will usually come down to one of two things: condition or motivation (or both). Speaking of condition, you want to investigate the condition of comparable #2—at 15 years old, it is almost twice the age of the subject. But, it could be in good enough condition that this effectively does not matter. But, we have a good range of value for our 1800 square foot subject; even without tweaking for square footage per se, or bathrooms, we can predict that a sale will probably occur between \$105 and \$110 per square foot, or \$189,000 to \$198,000. We would tweak this based on an analysis of absorption rate, because this could pull us in either direction.

Absorption Rate

Developing an absorption rate when pricing a property is crucial to getting the correct answer. Absorption rates measure supply and demand, by looking at how many properties like the subject the market is absorbing (how many are selling). To develop an absorption rate, first delineate the type of property you are pricing, and segregate it from the other sales. In other words, if you are pricing the subject property used as an example above, you will only be looking at ranch houses, probably 1700 to 2500 square feet, at least 3 bedrooms and 2 baths, 3 to 20 years old, in this neighborhood, or competitive neighborhoods. When we say 'competitive neighborhoods', we mean those which a buyer would consider as well as the neighborhood where the subject is located. In fact, the exercise of narrowing the market is buyer driven. You want to focus on the properties that the typical purchaser for this house would consider. So, a buyer for a 3 bedroom 2 bath ranch is not interested in 2 story, 4 bedroom homes; they are not looking at condos; they are not looking at two story townhouses. Once you have focused in on the type of property, go back in time twelve months and see how many houses like this sold. Let's look at two potential scenarios for pricing our subject:

Scenario #1: 48 homes like this sold in the past 12 months, or 4 a month. Currently, there are six for sale. That's a one and a half month supply. In that case, the seller can be aggressive on pricing, and you would probably suggest an asking price over \$200,000.

Scenario #2: 48 homes like this sold in the past 12 months, or 4 a month. Currently, there are 40 homes on the market, or a 10 month supply. In this scenario, the seller needs to price below \$200,000, probably much closer to the lower end of the range, possibly at \$190,000.

Module 3 Three Approaches to Value

Review Questions

1. The effective age of the home is 10 years, and the economic life is 60 years. What is the depreciation?
 - a. 16.67%
 - b. 6%
 - c. 50%
 - d. 50 years
2. The effective age of the home is 15 years, and the economic life is 45 years. What is the depreciation?
 - a. 3%
 - b. 33.33%
 - c. 30%
 - d. 30 years
3. The effective age of the home is 30 years, and the economic life is 50 years. What is the depreciation?
 - a. 15.67%
 - b. 20%
 - c. 60%
 - d. 20 years
4. A property sells for \$275,000 and the land value is \$45,000. The replacement cost new of the building is \$290,000. How much depreciation is there in **dollars**?

$$\$275,000 - \$45,000 = \$230,000$$

$$\$290,000 - \$230,000 = \$60,000$$

- a. \$15,000
- b. \$45,000
- c. \$30,000
- d. \$60,000

5. A property sells for \$275,000 and the land value is \$45,000. The replacement cost new of the building is \$290,000. How much depreciation is there in **percentage**?

$$\$60,000 \div \$290,000 = 0.206; \text{ approximately } 21\%$$

- a. 50%
 - b. 20.6%
 - c. 95%
 - d. 15.67%
6. A property sells for \$750,000, and the land value is \$250,000. The replacement cost new of the structure is \$950,000. How much depreciation is there in **dollars**?

$$\$750,000 - \$250,000 = \$500,000$$

$$\$950,000 - \$500,000 = \$450,000$$

- a. \$500,000
 - b. \$200,000
 - c. \$450,000
 - d. \$250,000
7. A property sells for \$750,000, and the land value is \$250,000. The replacement cost new of the structure is \$950,000. How much depreciation is there in **percentage**?

$$\$450,000 \div \$950,000 = 0.473; \text{ approximately } 47\%$$

- a. 47.3%
 - b. 60%
 - c. 79.3%
 - d. 26.67%
8. Which of the following is the most commonly used method to develop a cost approach?
- a. Unit in place method
 - b. Reproduction cost
 - c. Replacement cost
 - d. Quantity survey method

9. Which is correct about the cost approach?
- The cost approach is developed; depreciation is added in; land value is subtracted
 - The cost approach is developed on the building and site improvements; depreciation is taken; land value is added back in
 - The replacement cost is estimated, the depreciation is deducted, the land value is added back in, as are site improvements
 - The value as a whole is developed; depreciation is taken, but the land value is subtracted at the end
10. The formula for age/life depreciation is:
- $\text{Effective age} \div \text{Total Economic Life} = \text{Accrued Depreciation}$
 - $\text{Effective age} \div \text{depreciation} = \text{total economic life}$
 - $\text{Actual age} \div \text{economic life} = \text{depreciation}$
 - $\text{Depreciation} \div \text{economic life} = \text{effective age}$
11. The cost approach is often what is the only approach that can be developed for:
- A two unit duplex
 - A single family home
 - Unimproved land
 - A special-purpose building
12. The cost approach, when applied to single family homes, makes the most sense to use when:
- The house is very similar to other homes, 30 years old, and there are many comparable sales
 - The house is brand new
 - The house is 40 years old, and there are some comparables
 - The cost approach should always be used
13. Which of the following is an example of curable physical depreciation?
- A worn out roof on an otherwise sound house
 - An outmoded kitchen in a house
 - A house located near a sewage treatment plant
 - A house with major structural damage
14. Which of the following is an example of curable functional depreciation?
- A very narrow house (12' wide) with no hallways; all rooms connect to each other, so all bedrooms and the bathroom are captive; to cure you would need to install a hallway, which would make all the rooms about 9 x 9.
 - A house with an outdated bathroom
 - A frame house which needs to be painted
 - A house near a six lane highway

15. Which of the following is an example of economical, or external, depreciation?
- A house with a very old furnace, and old wiring
 - A house with very dated décor
 - A house with unpleasant neighbors
 - A house right next to active railroad tracks
16. Which of the following situations would suggest that a cost-based adjustment should be developed?
- One comparable has two bathrooms, and the subject has one
 - One comparable has a newer kitchen than the subject property
 - The former owners removed the plumbing fixtures from the bathroom
 - The house needs a new roof
17. The current market for houses like the subject looks like this: in the past 12 months, 36 homes like the subject have sold. Today, there are 12 homes like the subject listed for sale. Which of the following is correct?
- The absorption rate is 4 per month, and there is a 3 month supply
 - The absorption rate is 3 per month, and there is a 4 month supply
 - The absorption rate is 36 per month, and there is a third of a year supply
 - The absorption rate is 6 per month, and there is a 2 month supply.
18. Automated valuation models use which of the following to value properties:
- Guesswork
 - Algebra
 - Linear regression
 - Geometry
19. One of the elements of the definition of market value includes:
- Buyer and seller are both represented by real estate agents
 - Buyer and seller are typically motivated and well informed
 - Buyer and seller are under duress
 - Buyer and seller are strangers
20. Which of the following sales appears to **not** be an arms-length transaction?
- Sale was between John Smith, Seller, and Mary Jones, Buyer; Mary Jones was moving to the area from another state
 - Sale was from the Estate of Miriam Hoyt to Fred and Tina Keller; the Kellers purchased the property through an agent, and did not know the late Mrs. Hoyt
 - Sale was from Investors Real Estate, LLC to Ira Investor; Ira Investor is one of the owners of Investors Real Estate, LLC
 - Sale was from Dennis Reardon to Karen McCandless; seller and buyer knew each other slightly

21. Which of the following is the best guidance after selecting a pool of comparables which are as similar to the subject as possible?
- Use the comps located as close as possible to the subject, so for example, across the street is better than a block away
 - Use the comps which show the highest possible price or value
 - Use the comparables which will require the most adjustments
 - Use the comparables which will require the least adjustments
22. Which is most correct?
- All differences between the subject and the comparable are meaningful, and must be adjusted for
 - All adjustments will be cost based
 - Some differences between the subject and the comparables will require adjustments, and these adjustments are usually market based
 - Adjustments are the same across the board, regardless of the type of property, price range, or particular market it is in
23. Which of these would represent adjusting a property twice for the same thing?
- You adjust for condition and location
 - You adjust for number of baths and square footage
 - You adjust for garage space and square footage in the house
 - You adjust for condition and modernization within the house
24. Which of the following pieces of information used by an AVM might be incorrect, or missing?
- The square footage of the house, as per courthouse records
 - The fact that the seller paid 6% of the buyer's closing costs
 - The fact that the buyer was the seller's granddaughter
 - All of the above
25. Automated Valuation Models (AVMs) are used by which of the following?
- County assessment offices, to establish a value for taxation
 - Lenders, for removal of PMI
 - Portfolio management for lenders
 - All of the above
26. Expired listings are included in a CMA to:
- Show which other offices can't sell houses
 - Remind the sellers that they shouldn't give up, but should keep relisting with you
 - Show what price point the market finds unacceptable
 - Indicate a good asking price

27. The goal of preparing a CMA and presenting it to the seller is to:
- a. Have them see the property from 'your side of the desk', e.g. objectively
 - b. Have them list the property with you at any price
 - c. Be able to refer back to when they ask too much
 - d. Show you know how to do this, just like the other agents.

Module 4 Income Approach to Value

In this module, we will wrap up our three approaches to value by discussing the income approach to value. We will then discuss how and when this approach is useful for pricing property. We will consider all three approaches for pricing; and we also discuss the reconciliation process. Reconciliation is a process in appraisal methodology where the appraiser considers all the approaches developed, and decides which one is most indicative of value.

Our specific learning objectives for this module include:

- Understanding Gross Rent Multipliers (GRMs)
- Understanding Capitalization Rates (“cap rates”)
- Demonstrate the ability to develop a GRM, and apply it to a property
- Demonstrate the ability to develop a cap rate, and apply it to a property

The Income Approach to Value: The income approach to value Income-producing property recognizes that income producing real estate is typically purchased as an investment, and will search for *market* indications of how the typical investor values the stream of income the property is producing. There are two methods that can be used. They are the Gross Rent Multiplier (GRM) and the Capitalization Rate (‘cap rate’). Both of these formulae recognize the relationship between value, or price, and income generated.

GRM: Of the two, the GRM is the one that you should always be able to compute. It is also less reliable than a cap rate. The reason GRMs are easy to compute is that you only need two pieces of information: gross rent and sales price. For *commercial* real estate, income is expressed in an *annual figure*; for *residential* real estate, income is expressed in a *monthly figure*. Because this course is focused on *residential real estate*, we will always use *monthly figures for rent* for GRMs. Here’s an example of how a GRM is calculated:

The property sold for \$100,000, and gross monthly income was \$1000. To calculate the GRM, you simply divide the sales price by the rent. So, $\$100,000 \div 1000 = 100$ as the GRM.

Why are GRMs not as accurate as cap rates? Well, because you are only looking at *gross income*, not *net income*, and a difference in expenses can severely affect the return on the investment. Often, you will be stuck using a GRM because the only information available to you via the data other agents provide will be the gross income and the sales price. If you have to use a GRM because you do not have enough data to develop a cap rate, try to compare properties which have the same number of units, and the same allocation of expenses to tenants and landlords.

For example, if you are valuing a 3 unit building, where the owner pays the water, sewer, garbage and heat, and can choose between two other 3 units to use to develop a GRM, try to find one where the landlord is also paying those same expenses. You will understand logically that the more expenses the landlord shifts to the tenant, the less rent the landlord will receive. Also, if you are forced to use a GRM

from a property not identical to the subject in terms of who pays what, generally speaking, the market value (price) will reflect the differences.

Practice your skills with GRMs by answering these questions:

1. The property has four units, each rented for \$800 a month, and it sold for \$250,000. What is the GRM?

Solution: Take $\$800 \times 4$ to get \$3200 a month gross rent. Divide $\$250,000$ by $\$3200$ to get 78.125.

2. The property has an annual gross income of \$18,000, and sold for \$112,500. What is the GRM?

Solution: Convert the annual gross income to monthly by dividing $\$18,000$ by 12, which equals $\$1500$. Divide $\$112,500$ by $\$1500$ to get 75.

3. The property has two 2-bedroom units, both of which rent for \$600 a month, and two 1 bedroom unit, which rent for \$500 a month. The property sold for \$157,300. What is the GRM?

Solution: Rent is $\$2200$ a month ($\$600 + \$600 + \$500 + \500) $\$157,300 \div 2200 = 71.5$

These three sales are the only data you have to develop a GRM. Let's analyze the data:

The three GRMs are fairly tight, and range from a low of 71.5 to a high of 78.125. The median GRM (the number in the middle) is 75; the mean (average) is 74.875, both of which would indicate that a GRM of 75 is very reliable.

Cap Rates: Cap rates are much more reliable than GRMs, because they look at *net* income, not *gross income*. And, what is left over is what matters! This is referred to as NOI (Net Operating Income) Cap rate math is simply the "IRV" formulae. In the IRV formulae, I = income; R = rate (cap rate) and V = value (price). The income is always *net annual income*, regardless of whether the property is residential or commercial. Let's look at a quick example:

The property has net operating income of \$15,000, and sold for \$250,000. What is the cap rate? The cap rate is 6%. Here's the math: $\$15,000 \div \$250,000 = .06$, which is 6%. Computing cap rates brings us into the discussion of *investment value*. Investment value is simply defined as the value of an income producing property to a particular buyer, based on his goals for a return. As the desired rate of return goes *up*, the price the buyer will pay goes *down*. Conversely, the investor willing to accept a *lower* rate of return will be willing to pay *more* for the property.

If we know the rate of return our investor wants to get, we simply divide the net operating income by the desired rate of return. So if our investor in the example above desires an 8% return, instead of 6%, that buyer will only pay \$187,500 for this property. [$\$15,000 \div .08$]. On the other hand, if a buyer would be satisfied with a return of 4% on this same property, that buyer would pay \$375,000 for the property. [$\$15,000 \div .04$].

Practice Problems: Using the IRV formulae (Income divided by Value = Rate; Income divided by Rate = Value; Rate times Value = Income, solve the following problems:

1. The NOI is \$12,000; the property sold for \$110,000; what is the rate?

Answer: 11%; $\$12,000 \div \$110,000 = .11$, or 11%

2. The property sold for \$120,000, and the buyer told the cap rate is 7%. What is the net operating income?

Answer: \$8400. Take \$120,000 times 7%.

3. The NOI is \$18,000, and the buyer wants a cap rate of 7.5%. What should he pay?

Answer: \$240,000. Divide \$18,000 by 7.5%

Why is the cap rate approach complicated? Because, we need accurate figures for all of the expenses; and we may even calculate reserves for replacements. Reserves for replacements are money the owner puts aside to replace things which will need to be replaced over time, specifically over their period of ownership. These include: roofs, furnaces, air conditioning units, appliances that the owner provides, etc. For example, an investor is purchasing a property he plans to hold for 15 years. In 5 years, the property will need a new roof, and the estimated cost will be \$25,000. The reserves for replacement is calculated by taking the amount needed, divided by how many years you have to save for it. In this case, the reserves for replacement should be \$5000 a year, so that at the end of 5 years, the investor has \$25,000 to replace the roof.

Let's define some of the other terms used when developing an income statement:

Potential Gross Income (PGI): The amount of income that the property can potentially produce, from all sources. The income is usually rent, but if the owner of the building has, for example, a coin operated laundromat in the building for the tenants to use, this will generate income. This should be calculated based on market rents, which may or may not be contract rent.

Contract rent: What the tenant is paying, per the lease. This may not be market rent. However, the leases have to be analyzed. If the building is rented at below-market rents, and the tenants have lengthy leases, it will affect value.

Vacancy and credit allowance: This is an amount, calculated by using a percentage derived from the market, or by the current owner's actual figures, which takes into account money not received when the units are vacant, or if the tenant pays, but the check bounces. By the way, a red flag when listing an apartment building is an owner who has 100% occupancy, and has had this for a long time. This is usually an indication that the rents are below market rate.

Effective Gross Income: This is the income remaining after the vacancy and credit allowance is taken.

Fixed expenses: These are expenses the owner has regardless of occupancy. They include things like taxes and insurance.

Variable expenses: These are expenses which vary depending upon occupancy or other factors. For example, if the owner pays the water and sewer, and the building is fully occupied by tenants using a lot of water, this expense will go up. Another example is snow removal; if the owner pays snow removal and it is a winter with a lot of snow, this expense will go up. *Any* expense relative to how many tenants are in the property is variable, so it includes management fees.

Management fee: This is a fee to manage the property: find tenants, collect rents, etc. This should be calculated and deducted, even if the owner is doing it on his own, because everyone's time is money.

Below is a sample of an income property worksheet:

Income Property Worksheet

Potential Gross income from all sources: _____(1)

Vacancy and credit allowance: (subtract) _____(2)

Effective gross income: [Line 1 minus line 2] _____(3)

Expenses:

Insurance: _____

Taxes: _____

Utilities: _____

Garbage removal: _____

Maintenance: _____

Legal &

Professional: _____

Repairs: _____

Supplies: _____

Total of all expenses: _____(4)

Net operating income *before* reserve for replacements:[Line 3 minus line 4]: _____

Reserve for replacements (see discussion): _____(5)

Net operating income *with* reserve for replacements: [Line 3 minus lines 4 & 5]: _____

Reserve for Replacements Discussion: This is a calculation that many purchasers miss; but appraisers will calculate it. Most owners don't put this money aside, which means that when the building needs repairs, they are often at a disadvantage. There are some instances where it is not necessary to calculate them. Example: Investors were purchasing a 5 year old, single family home for their college age son to live in while he attended a nearby university. Since their expected ownership period was 4 to 5 years, they did not calculate a reserve for replacements.

The reproduced form below is from a form used by appraisers to calculate reserves for replacements.

1025 sample

Replacement Reserve Schedule

Adequate replacement reserves must be calculate regardless of whether actual reserves are provided for on the owner's operating statements or are customary in the local market. This represents the total average yearly reserves. Generally, all equipment and components that have a remaining life of more than one year-such as refrigerators, stoves, clothes washers/dryers, trash compactors, furnaces, roofs, and carpeting, etc.-should be expensed on a replacement cost basis.

Equipment	Replacement Cost	Remaining Life	By Applicant/ Appraiser	Lender Adjustments
Stoves/Ranges	@ \$ _____	ea. + _____	Yrs. x _____	Units = \$ _____
Refrigerators	@ \$ _____	ea. + _____	Yrs. x _____	Units = \$ _____
Dishwashers	@ \$ _____	ea. + _____	Yrs. x _____	Units = \$ _____
A/C Units	@ \$ _____	ea. + _____	Yrs. x _____	Units = \$ _____
C. Washer/Dryers	@ \$ _____	ea. + _____	Yrs. x _____	Units = \$ _____
HW Heaters	@ \$ _____	ea. + _____	Yrs. x _____	Units = \$ _____
Furnace(s)	@ \$ _____	ea. + _____	Yrs. x _____	Units = \$ _____
(Other)	@ \$ _____	ea. + _____	Yrs. x _____	Units = \$ _____
Roof	@ \$ _____	+ _____	Yrs. x One Bldg. = _____	\$ _____
Carpeting (Wall to Wall)		Remaining Life		
(Units) _____	Total Sq. Yds. @ \$ _____	Per Sq. Yd. + _____	Yrs. = _____	\$ _____
(Public Areas) _____	Total Sq. Yds. @ \$ _____	Per Sq. Yd. + _____	Yrs. = _____	\$ _____
Total Replacement Reserves. (Enter on Pg. 1)				\$ _____

Operating Income Reconciliation

Cash Flow & Debt Service: The money left after all the expenses have been paid, and, if calculated, the reserve for repairs subtracted, is the cash flow. "Happiness is positive cash flow" is the mantra for most investors. Appraisers do not go on to calculate debt service; classic appraisal theory states that having debt on the property is a choice of the owner. However, in the real world where you are selling to investors, they will consider cash flow. At a fundamental level, most investors want the cash flow to cover the debt service, and give them some money left over. You can always use these calculations to estimate a price on an income property.

Example: The property has a net operating income of \$15,000. The cap rate answer, using a 6% return, has a value, or price of \$250,000. Let's look at this from a cash flow perspective. \$15,000 a year is \$1250 a year. Suppose the potential buyer says: "I don't want to make a lot of cash; I'm building equity by having the tenants buy the property for me. As long as I can cover my payments, I'm fine." That means you can use \$1250 a month left to cover debt service. From here, using either a financial

calculator, or a financial calculator app on your phone, you enter \$1250 as the payment, then enter the terms of the loan available to investors in your market. Typically, lenders will want a shorter term, generally about 15 years, and typically they will charge a higher interest rate. For this example, let's use a 15 year term and a 6% interest rate. The math is:

\$1250 gets entered as payment; 15 years gets entered as the term; 6% gets entered as the interest rate. This will cover a mortgage amount of \$148,000 (rounded). What should the purchase price? We'll assume that the lender requires a 20% down payment (which is typical for investment real estate). The math is: enter \$148,000, and divide by .80 (80%). That yields \$185,000, which is the purchase price for this investor, who wants the debt service payments totally covered by the rent. You can see that this is much lower than the amount indicated by the 6% cap rate. In this case, the cap rate would be .08 (8%)

What is the income property worth? This question is best answered: "It depends!" What does it depend upon?

- What kind of return, expressed as a cap rate or GRM, is the buyer looking for?
- What terms are available in the market for financing of investment properties?
- What returns are other investors accepted, based on your analysis of closed sales?

The last point is important, because it brings us back to the market approach. Analysis of closed sales, of any kind of property, shows us what other buyers are willing to pay for a property. If we have an investor who wants a 9% return, for example, and other investors in the market are willing to accept a 7% return, he will probably not succeed in purchasing a property for his price, which will be lower than the other buyers are willing to pay.

Red Flags with Income Properties: There are several things that will affect the value of income producing properties, or be red flags for you when you go to price them for sale.

- Below market rents: what you usually hear from the owner is: "These tenants are terrific, they've been with me for 10 years, and they never complain about anything." Of course they don't! They have checked around and realize that they are paying way below market rent. So, they won't call the landlord for every little thing—they'd rather pay to fix the toilet themselves, or paint a room, and continue to pay \$300 below market rent.
- Expenses that are 40% or more of the gross income: this is a rule of thumb in investment real estate, and it usually holds true. If expenses creep up to this high a percentage of gross income, then the rents need to be adjusted.
- Owner can't produce any records: You should review the leases and the Schedule E when you price and list an income property. The Schedule E is considered the most reliable. An Excel spreadsheet can be a work of fiction, but most people do not lie on their federal tax return. Without reviewing leases, you don't know what the rents really are, or what the terms are.
- Deferred maintenance and worse: Some owners only want to sell an income producing property after they have milked every dime out of it. By this we mean that they have continually taken

the money the property produced, and used it personally, as opposed to maintaining the property. One thing to check in your area is whether or not there is a mandatory codes inspection for rental property, either on an annual basis, or at the point of sale. If the property has seriously deferred maintenance, the cost of bringing it up to code could cost thousands of dollars.

Risk and Reward: Depending upon your market, you will observe different rates of return on different types of rental properties. This is particularly noticeable if part of your market includes student housing. Because student housing is considered to be riskier (as a whole, students are not noted for taking good care of their rental units), investors often demand higher returns on these properties.

Reconciliation: Appraisers sometimes prepare all three approaches to value: cost, market and income. It would be rare for an agent to do that when pricing a property, and probably unnecessary. When an appraiser does a reconciliation, it means considering all the approaches developed, and determining which one is most indicative of value. Often, one approach supports another approach. With income producing properties, the market approach generally reflects the income approach. What this means is that when we look at the market for sold income properties, the prices paid reflect the returns investors are willing to accept in that market at that time. When we think about the cost approach, which is typically only used, in residential appraisal, for new homes, we can also see that the market approach will reflect the cost approach, or that they will support each other. For example, a buyer who wants a new house will shop around and see what builders would charge to build a new house, and compare that to new homes which are listed for sale. A buyer would be very unlikely to pay more for a new house than what it would cost them to have a builder build one for them. You will generally find that even if you perform another approach as part of your pricing, you will rely on the market approach. When you are pricing new homes, do the research to find out what it would cost to build a new house like the one for sale; this will be part of the discussion with the sellers. When you are listing an income property, develop an income approach, but base your cap rates and GRM on sales in the marketplace.

Pricing Discussions: Most of the time in the real estate business, we are having pricing discussions with sellers, although we will also assist buyers in setting a price they would be willing to pay, based on market data. One of the things to emphasize to both sellers and buyers is that typically a property has to go through the appraisal process. If the seller insists on trying to compare their house, which is 20 years old, and in an average, middle class neighborhood, and has around 2200 square feet, to houses which are 5 years old, in upscale neighborhoods, and have 3200 square feet, he will be very upset when the appraiser compares his house to homes which are truly similar—and does not come in at his price. It's important to convey to your clients that real estate professionals do not *create* markets; we simply observe and report what markets are doing.

Agents and Appraisers: Agents and appraisers *should* respect each other professionally, and assist each other. That does not always happen, and there are (unfortunately) rude and incompetent people in all aspects of the real estate industry. They are a minority, but it is the trouble makers who get the attention. In this section, we will talk about what agents should do, what appraisers should do, and some of the common problems observed.

Requirements	Appraisers	Agents
Education and experience	College degree, 200-300 hours of additional appraisal-specific education; 2500 to 3000 hours of practical experience; take and pass a national exam with state specific questions. Some states have an “apprentice” license category, but appraisers are not fully certified, and able to do appraisals on their own, until they have met all of the requirements above.	No college degree; HS or GED in most states; pre-licensing courses (length varies), take and pass a state exam; no experience requirement at salesperson level
Advocacy	Appraisers cannot advocate for their client, a cause, or a value	Agents advocate for their clients; it is a fiduciary duty
Bias	Appraisers are expected to be unbiased, and if they have a bias, to turn down the assignment	Agents may have a bias for their client or for the property; the only thing in license law which is close is the requirement for agents to disclose their ‘true position’ when selling a property they have an interest in, or in acquiring a property
Report	Appraisers generally produce a lengthy, written report. Specific clients, such as Fannie Mae, HUD, VA, etc, have specific requirements	There is no uniform requirement for an agent’s CMA; it can be very detailed or have little detail
Rationale for value/price	Appraisers can be asked by a number of people to defend their report, including their adjustments and their final value conclusion	Agents may have a rationale for a price, but seldom have to defend it. Worth noting: on the list of the “Top Ten” things Errors and Omissions companies reported that they defended real estate agents against were charges that the property was improperly priced or valued
License/Certification	To do FIRREA-related appraisals (for federally related loan transactions) an appraiser must	Real estate salespeople must be licensed; some states allow agents to perform both CMAs

	be certified. Some states have licensed appraisers, who can perform appraisals which are not federally related (like estates and divorces)	and BPOs; some states do not allow agents to do BPOs, or make any valuation other than for a seller or buyer
Scope of Work; Level of Reporting	Strictly detailed in both USPAP (Uniform Standards of Professional Appraisal Practice) as well as by additional, lender-specific requirements	No standard in the industry at all, except for Article 11-1 in the REALTOR® Code of Ethics, which is much looser than USPAP.
Competency Requirements	USPAP specific; also clients such as Fannie Mae have requirements	In all states, the day an agent receives a license they can price a house
Certifications	Appraisers have 25; final one says they understand lying is breaking a federal law, and they can be fined, or imprisoned, or both	Some states require a disclosure that a CMA or BPO is not an appraisal

You can see from this list that what appraisers do and what agents do is very different. Yet, both are interested in getting the price or value correct. Agents want to price a house to both sell, and get through the appraisal process; appraisers are charged with developing a 'credible' appraisal, which is defined in USPAP as 'worthy of belief'. Appraisers must also develop an appraisal which will survive the scrutiny of underwriters, clients, and others.

Agents and Pricing: If you are a REALTOR®, there is specific guidance in the REALTOR® Code of Ethics regarding price opinions. It is found in Article 11:

Article 11

The services which Realtors® provide to their clients and customers shall conform to the standards of practice and competence which are reasonably expected in the specific real estate disciplines in which they engage; specifically, residential real estate brokerage, real property management, commercial and industrial real estate brokerage, land brokerage, real estate appraisal, real estate counseling, real estate syndication, real estate auction, and international real estate. Realtors® shall not undertake to provide specialized professional services concerning a type of property or service that is outside their field of competence unless they engage the assistance of one who is competent on such types of property or service, or unless the facts are fully disclosed to the client. Any persons engaged to provide such assistance shall be so identified to the client and their contribution to the assignment should be set forth. (Amended 1/10)

- *Standard of Practice 11-1 When Realtors® prepare opinions of real property value or price they must: 1) be knowledgeable about the type of property being valued, 2) have access to the information and resources necessary to formulate an accurate opinion, and 3) be familiar with the area where the subject property is located unless lack of any of these is disclosed to the party requesting the opinion in*

advance. When an opinion of value or price is prepared other than in pursuit of a listing or to assist a potential purchaser in formulating a purchase offer, the opinion shall include the following unless the party requesting the opinion requires a specific type of report or different data set: 1) identification of the subject property 2) date prepared 3) defined value or price 4) limiting conditions, including statements of purpose(s) and intended user(s) 5) any present or contemplated interest, including the possibility of representing the seller/landlord or buyers/tenants 6) basis for the opinion, including applicable market data 7) if the opinion is not an appraisal, a statement to that effect 8) disclosure of whether and when a physical inspection of the property's exterior was conducted 9) disclosure of whether and when a physical inspection of the property's interior was conducted 10) disclosure of whether the Realtor® has any conflicts of interest (Amended 1/14)

Source: National Association of REALTORS® Code of Ethics, 2016.

This article of the Code was amended in 2014 to address some of the issues with Broker Price Opinions (BPOs) being performed by agents who did not have the competency, geographic or otherwise, to perform them, and did not always disclose any potential conflicts of interest. We'll discuss competency for appraisers in this module, but *any real estate professional* offering to price, value, or appraise a property should have the appropriate competence. Competence can be geographic, as in familiarity with the local market and its nuances; it can also be related to the type of property: commercial, residential, recreational, condo, etc.

Whether you are a REALTOR® or not, you should not engage in activities outside your area of expertise without getting help. To price a property when you have no knowledge of the local market, or the type of property, is a disservice to the client.

Appraisers and Competence: There are two main things to discuss when it comes to appraisers and competence. The first is the Competency Rule in USPAP, which reads as follows:

"Competency Rule

An appraiser must: (1) be competent to perform the assignment; (2) acquire the necessary competency to perform the assignment; or (3) decline or withdraw from the assignment. In all cases, the appraiser must perform competently when completing the assignment."

Fannie Mae is even more stringent when it comes to geographic competency. In the Appraiser's Certification, which is in your appendix, let's look at certifications #11 and #12:

"11. I have knowledge and experience in appraising this type of property in this market area.

12. I am aware of, and have access to, the necessary and appropriate public and private data sources, such as multiple listing services, tax assessment records, public land records and other such data sources for the area in which the property is located."

This is very clear: if an appraiser should call you and 1) not know exactly where your small town is; 2) ask you to bring comparable sales data and meet them there because 3) they don't belong to your MLS, and

therefore do not have a lock-box key, that person would be violating these certifications. Don't let them in! Instead, contact the lender and question how the geographic competency of the appraiser was established, and tell the lender 1, 2 and 3 as cited.

Working together: Appraisers and agents can and should work together, with professional respect and competence on both sides. Every agent should have a 'go-to' appraiser who they can call when they have a tough property to value, or a question about highest and best use. Appraisers should be able to ask agents about pending sales, why a property sold for the price it sold for, which can be either because it showed beautifully (a 'cream-puff', in real estate lingo) or had issues ("the people were absolute slob....and they had eight cats."). Agents should be proactive. Do not assume that because you don't bring up the low sale on the street that the appraiser won't find it (she will). Instead, if there is a reason that house shouldn't be used as a comparable, share it. Things you might know that the appraiser doesn't know: 1) The sellers were more than typically motivated, for any one of a number of reasons 2) The inside was in poor condition 3) There were issues discovered during a home inspection. There can be other reasons as well. Agents should also understand the phrase "One sale doesn't make a market". What does this mean? Well, appraisers are looking at a typical purchasers, not a one in a million long shot. A mentor once described some sales as "Two fools met, one for asking it, and one for paying it." What this means is that one sale, at a higher price than is typical for the neighborhood, size, type of house, is an anomaly, and most appraisers are reluctant to use this comp; or if they use it, to reconcile to it, because there is no other data to support this number.

Module 4 Income Approach to Value

Review Questions

1. Cap rates and GRMs are:
 - a. Complicated ways to value income property
 - b. Formulae which reflect the relationship between the rent (income) the property generates and its value (price)
 - c. Formulae which reflect the risk associated with the property
 - d. Formulae which calculate the internal rate of return on the property

2. Which of the following is correct?
 - a. For residential real estate, when calculating a GRM, use the annual rent divided by the price the property sold for
 - b. For residential real estate, when calculating a GRM, use the monthly rent divided by the price the property sold for
 - c. For residential real estate, when calculating a GRM, use the annual rent, and divide the price by the rent
 - d. For residential real estate, when calculating a GRM, divide the sales price by the monthly rent

3. Why might an agent develop a GRM, instead of a cap rate?
 - a. A GRM is more reliable than a cap rate
 - b. A GRM is more complicated than a cap rate
 - c. The information required to develop a GRM is usually readily available
 - d. Agents can't do the math for a cap rate

4. Which of the following is correct?
 - a. The higher the cap rate the buyer wants, the more he will pay for the property
 - b. The lower the cap rate the buyer wants, the less he will pay for the property
 - c. The price is not affected by the cap rate
 - d. The cap rate and the price move in unison

5. A property sells for \$250,000, and the monthly rent is \$3000. What is the GRM?
 - a. 83.33
 - b. 12
 - c. 69.44
 - d. None of the above

6. A property has NOI of \$33,000 and sells for \$425,800. What is the cap rate?
 - a. 9.25%
 - b. 7.75%
 - c. 5%
 - d. 11%

7. An investor buyer wants a cap rate of 6.25%. The property he is looking at has NOI of \$27,500. What should he pay for the property?
 - a. \$220,000
 - b. \$171,875
 - c. \$148,958
 - d. \$440,000

8. Fixed expenses are:
 - a. Expenses which change with the occupancy of the property
 - b. Expenses which do not change with the occupancy, such as taxes and insurance
 - c. Expenses such as water, sewer, and gas
 - d. Expenses such as management fees

9. Potential gross income is:
 - a. The income left after all of the expenses have been paid
 - b. The income left after the vacancy and credit allowance has been deducted
 - c. The income left after the reserve for replacements has been deducted
 - d. The income that the property could produce with all units rented, and 100% of income from other sources, such as an on-site laundromat

10. Effective gross income is:
 - a. The income left after all of the expenses have been paid
 - b. The income left after the vacancy and credit allowance has been deducted
 - c. The income left after the reserve for replacements has been deducted
 - d. The income that the property could produce with all units rented, and 100% of income from other sources, such as an on-site laundromat

11. Reserve for replacements is:
 - a. Money set aside to cover expenses when tenants are in the process of being replaced
 - b. Money set aside to cover management fees
 - c. Money set aside to cover the replacement of items which will need to be replaced, such as roofs, furnaces, water heaters, appliances, etc.
 - d. Money set aside to pay a back-up, or replacement manager

12. Which of the following is correct?
- Contract rent is based on current market rents
 - Contract rent is market rent
 - Contract rent is never market rent
 - Contract rent is what the tenant has agreed to pay, per the lease
13. If you are going to calculate the cost of debt service as a way to price a property, which of the following is correct?
- You calculate effective gross income, divide by 12, and this is the amount available to cover a mortgage payment. You then put that figure into a financial calculator as “payment”, enter the interest rate and term of the loan to solve for the amount of mortgage that payment will cover.
 - You calculate NOI, divide by 12, and this is the amount available to cover a mortgage payment. You then put that figure into a financial calculator as “payment”, enter the interest rate and term of the loan to solve for the amount of mortgage that payment will cover.
 - You calculate NOI, divide by 12, and this is the amount available to cover a mortgage payment. You then put that figure into a financial calculator as “mortgage amount”, enter the interest rate and term of the loan to solve for the payment
 - You calculate potential gross income, divide by 12, and this is the amount available to cover a mortgage payment. You then put that figure into a financial calculator as “payment”, enter the interest rate and term of the loan to solve for the amount of mortgage that payment will cover.
14. A red flag for pricing an investment property would be:
- Lower than market rents
 - Market rents
 - Well maintained property
 - Expenses are 20% of gross rent
15. Expenses should generally be no more than what percent of gross income?
- 70%
 - 20%
 - 65%
 - 40%
16. Which of the following would be an item that should be calculated into a reserve for replacements on an income producing property?
- Light bulbs for the halls and stairs
 - Painting apartments
 - Management fees
 - Cost of replacing a roof in 5 years

17. If an appraiser develops more than one approach to value, the process of considering all the approaches developed, and deciding which one is most indicative of value is called:
- Reconciliation
 - Averaging
 - Weighting
 - Analysis
18. Which of the following is correct about appraisers, versus agents?
- Appraisers can begin valuing property their first day on the job, just like agents
 - Appraisers have limited educational requirements
 - Appraisers must have a master's degree
 - Appraisers must obtain practical experience before becoming fully certified
19. Which of the following is correct about agents, versus appraisers?
- Agents must take certain post-licensing courses before pricing real estate
 - Agents must have a college degree
 - Agents cannot advocate for their clients
 - Agents can price a home the first day they are in the real estate business
20. Requirements for competency in an appraiser are found in:
- Both USPAP and Fannie Mae's Appraiser Certifications
 - USPAP only
 - Fannie Mae only
 - State law only
21. Agents who are REALTORS® will find specifics of competency for pricing real estate in:
- Article 1 of the REALTOR® Code of Ethics
 - Article 11 of the REALTOR® Code of Ethics
 - In the Preamble to the Code of Ethics
 - Article 3 of the REALTOR® Code of Ethics

Real Estate Pricing

Course Summary

All real estate professionals involved in appraisal, pricing, or any other valuation need to do the best job they can. To do so, they must thoroughly investigate the property they are trying to price; look at all the market data available to them; consider how the differences between the subject and the comparables affect the value or price of the property, and report their findings to the client. An agent does not want to overprice listings, because they will languish on the market, and damage your professional reputation. Appraisers want a reputation of being honest and fair. Both professions can work together, and supply each other with very useful information.

Real Estate Pricing

Appendix

Uniform Residential Appraisal Report Sample

Uniform Residential Appraisal Report

File No. PDH Sample

The purpose of this summary appraisal report is to provide the lender/client with an accurate, and adequately supported, opinion of the market value of the subject property.

Property Address 123 Beech St, City Anytown, State XX, Zip Code XXXXX. Borrower B. Buyer, Owner of Public Record S. Seller, County County. Legal Description Volume XXX Page XXX. Assessor's Parcel # 12-345-87B, Tax Year 20XX, R.E. Taxes \$ XXXX.XX. Neighborhood Name Forest Estates, Map Reference, Census Tract. Occupant Owner Tenant Vacant, Special Assessments \$, PUD HOA \$, per year, per month. Property Rights Appraised Fee Simple Leasehold Other (describe). Assignment Type Purchase Transaction Refinance Transaction Other (describe). Lender/Client, Address. Is the subject property currently offered for sale or has it been offered for sale in the twelve months prior to the effective date of this appraisal? Yes No. Report data source(s) used, offering price(s), and date(s).

1 I did did not analyze the contract for sale for the subject purchase transaction. Explain the results of the analysis of the contract for sale or why the analysis was not performed. Contract Price \$ 220,000, Date of Contract, Is the property seller the owner of public record? Yes No, Data Source(s). Is there any financial assistance (loan charges, sale concessions, gift or downpayment assistance, etc.) to be paid by any party on behalf of the borrower? Yes No. If Yes, report the total dollar amount and describe the items to be paid.

Table with columns: Neighborhood Characteristics, One-Unit Housing Trends, One-Unit Housing, Present Land Use %. Rows include Location (Urban, Suburban, Rural), Built-Up (Over 75%, 25-75%, Under 25%), Growth (Rapid, Stable, Slow), Marketing Time (Under 3 mths, 3-6 mths, Over 6 mths), Neighborhood Boundaries, Neighborhood Description, Market Conditions (including support for the above conclusions).

Dimensions, Area 15000 sf, Shape, View N,Res;. Specific Zoning Classification, Zoning Description. Zoning Compliance Legal Legal Nonconforming (Grandfathered Use) No Zoning Illegal (describe). Is the highest and best use of the subject property as improved (or as proposed per plans and specifications) the present use? Yes No. If No, describe. Utilities Public Other (describe), Water, Sanitary Sewer, Off-site Improvements—Type Public Private. Electricity, Gas, FEMA Special Flood Hazard Area Yes No, FEMA Flood Zone, FEMA Map #, FEMA Map Date. Are the utilities and off-site improvements typical for the market area? Yes No. If No, describe. Are there any adverse site conditions or external factors (easements, encroachments, environmental conditions, land uses, etc.)? Yes No. If Yes, describe.

Table with columns: GENERAL DESCRIPTION, FOUNDATION, EXTERIOR DESCRIPTION materials/condition, INTERIOR materials/condition. Rows include Units One One with Accessory Unit, # of Stories, Type Det. Att. S-Det/End Unit, Basement Area sq. ft., Design (Style), Year Built, Effective Age (Yrs), Heating FWA HWBB Radiant, Amenities, WoodStove(s) #, Drop Stair, Stairs, Fuel, Fireplace(s) #, Fence, Garage # of Cars 2, Floor, Scuttle, Cooling Central Air Conditioning, Patio/Deck, Porch, Carport # of Cars, Finished Heated, Individual Other, Pool, Other, Att. Det. Built-in.

Appliances Refrigerator Range/Oven Dishwasher Disposal Microwave Washer/Dryer Other (describe). Finished area above grade contains: 6 Rooms, 3 Bedrooms, 2.1 Bath(s), 1,800 Square Feet of Gross Living Area Above Grade. Additional features (special energy efficient items, etc.). Describe the condition of the property (including needed repairs, deterioration, renovations, remodeling, etc.). C4. Are there any physical deficiencies or adverse conditions that affect the livability, soundness, or structural integrity of the property? Yes No. If Yes, describe. Does the property generally conform to the neighborhood (functional utility, style, condition, use, construction, etc.)? Yes No. If No, describe.

Uniform Residential Appraisal Report

File No. PDH Sample

There are 6 comparable properties currently offered for sale in the subject neighborhood ranging in price from \$ 200,000 to \$ 225,000	
There are 24 comparable sales in the subject neighborhood within the past twelve months ranging in sale price from \$ 190,000 to \$ 230,000	
FEATURE	SUBJECT
123 Beech St Address Anytown, XX XXXXX Proximity to Subject	156 Beech St Anytown XX XXXXX 4 blocks W
Sale Price	\$ 220,000
Sale Price/Gross Liv. Area	\$ 122.22 sq. ft.
Data Source(s)	ATMLS #123456;DOM 45
Verification Source(s)	Courthouse
VALUE ADJUSTMENTS	DESCRIPTION
Sale or Financing	Armlth
Concessions	Conv;0
Date of Sale/Time	s04/XX; c04/XX
Location	N;Res;
Leasehold/Fee Simple	Fee simple
Site	15000 sf
View	N;Res;
Design (Style)	DT1;Ranch
Quality of Construction	Q3
Actual Age	10
Condition	C4
Above Grade	Total Bdrms: 6, Baths: 3, 2.1
Room Count	6 3 2.1
Gross Living Area 35	1,800 sq. ft.
Basement & Finished Rooms Below Grade	0sf
Functional Utility	avg
Heating/Cooling	gas/cac
Energy Efficient Items	avg
Garage/Carport	2ga2dw
Porch/Patio/Deck	rear deck
Net Adjustment (Total)	\$ 7,000
Adjusted Sale Price of Comparables	Net Adj. -3.1% Gross Adj. 3.1%
	\$ 220,500
	Net Adj. 0.1% Gross Adj. 1.7%
	\$ 219,700
	Net Adj. -1.6% Gross Adj. 1.6%
	\$ 221,500

I did not research the sale or transfer history of the subject property and comparable sales. If not, explain _____

My research did did not reveal any prior sales or transfers of the subject property for the three years prior to the effective date of this appraisal.

Data source(s) County Courthouse records

My research did did not reveal any prior sales or transfers of the comparable sales for the year prior to the date of sale of the comparable sale.

Data source(s) County Courthouse records

Report the results of the research and analysis of the prior sale or transfer history of the subject property and comparable sales (report additional prior sales on page 3).

ITEM	SUBJECT	COMPARABLE SALE NO. 1	COMPARABLE SALE NO. 2	COMPARABLE SALE NO. 3
Date of Prior Sale/Transfer				
Price of Prior Sale/Transfer				
Data Source(s)				
Effective Date of Data Source(s)				

Analysis of prior sale or transfer history of the subject property and comparable sales **All of the comparables used were sold by the original owners; there were no sales between when these houses were built and the sales used. The subject has also had only one owner.**

Summary of Sales Comparison Approach. **The comparables indicate a tight range of value, which supports the sales price of \$220,000 for the subject. Although the comparable which required the least net and gross adjustments is comparable #2, which has a reconciled value of \$219,700, we have rounded this to \$220,000 in view of the other two comparables, which also had very low adjustments, comparable #3 actually had a lower gross adjustment at 1.6% than did comparable #2 at 1.7%**

Indicated Value by Sales Comparison Approach \$ **220,000**

Indicated Value by: Sales Comparison Approach \$ **220,000** Cost Approach (if developed) \$ _____ Income Approach (if developed) \$ _____

The cost approach is not reliable with homes of this age; there is insufficient data to produce an income approach to value. The market approach was the only approach developed and is considered to be most reliable.

This appraisal is made "as is," subject to completion per plans and specifications on the basis of a hypothetical condition that the improvements have been completed, subject to the following repairs or alterations on the basis of a hypothetical condition that the repairs or alterations have been completed, or subject to the following required inspection based on the extraordinary assumption that the condition or deficiency does not require alteration or repair: _____

Based on a complete visual inspection of the interior and exterior areas of the subject property, defined scope of work, statement of assumptions and limiting conditions, and appraiser's certification, my (our) opinion of the market value, as defined, of the real property that is the subject of this report is \$ **220,000** as of **xx/xx/xxxx**, which is the date of inspection and the effective date of this appraisal.

Uniform Residential Appraisal Report

File No. PDH Sample

This report form is designed to report an appraisal of a one-unit property or a one-unit property with an accessory unit, including a unit in a planned unit development (PUD). This report form is not designed to report an appraisal of a manufactured home or a unit in a condominium or cooperative project.

This appraisal report is subject to the following scope of work, intended use, intended user, definition of market value, statement of assumptions and limiting conditions, and certifications. Modifications, additions, or deletions to the intended use, intended user, definition of market value, or assumptions and limiting conditions are not permitted. The appraiser may expand the scope of work to include any additional research or analysis necessary based on the complexity of this appraisal assignment. Modifications or deletions to the certifications are also not permitted. However, additional certifications that do not constitute material alterations to this appraisal report, such as those required by law or those related to the appraiser's continuing education or membership in an appraisal organization, are permitted.

SCOPE OF WORK: The scope of work for this appraisal is defined by the complexity of this appraisal assignment and the reporting requirements of this appraisal report form, including the following definition of market value, statement of assumptions and limiting conditions, and certifications. The appraiser must, at a minimum: (1) perform a complete visual inspection of the interior and exterior areas of the subject property, (2) inspect the neighborhood, (3) inspect each of the comparable sales from at least the street, (4) research, verify, and analyze data from reliable public and/or private sources, and (5) report his or her analysis, opinions, and conclusions in this appraisal report.

INTENDED USE: The intended use of this appraisal report is for the lender/client to evaluate the property that is the subject of this appraisal for a mortgage finance transaction.

INTENDED USER: The intended user of this appraisal report is the lender/client.

DEFINITION OF MARKET VALUE: The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller, each acting prudently, knowledgeably and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby: (1) buyer and seller are typically motivated; (2) both parties are well informed or well advised, and each acting in what he or she considers his or her own best interest; (3) a reasonable time is allowed for exposure in the open market; (4) payment is made in terms of cash in U. S. dollars or in terms of financial arrangements comparable thereto; and (5) the price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

*Adjustments to the comparables must be made for special or creative financing or sales concessions. No adjustments are necessary for those costs which are normally paid by sellers as a result of tradition or law in a market area; these costs are readily identifiable since the seller pays these costs in virtually all sales transactions. Special or creative financing adjustments can be made to the comparable property by comparisons to financing terms offered by a third party institutional lender that is not already involved in the property or transaction. Any adjustment should not be calculated on a mechanical dollar for dollar cost of the financing or concession but the dollar amount of any adjustment should approximate the market's reaction to the financing or concessions based on the appraiser's judgment.

STATEMENT OF ASSUMPTIONS AND LIMITING CONDITIONS: The appraiser's certification in this report is subject to the following assumptions and limiting conditions:

1. The appraiser will not be responsible for matters of a legal nature that affect either the property being appraised or the title to it, except for information that he or she became aware of during the research involved in performing this appraisal. The appraiser assumes that the title is good and marketable and will not render any opinions about the title.
2. The appraiser has provided a sketch in this appraisal report to show the approximate dimensions of the improvements. The sketch is included only to assist the reader in visualizing the property and understanding the appraiser's determination of its size.
3. The appraiser has examined the available flood maps that are provided by the Federal Emergency Management Agency (or other data sources) and has noted in this appraisal report whether any portion of the subject site is located in an identified Special Flood Hazard Area. Because the appraiser is not a surveyor, he or she makes no guarantees, express or implied, regarding this determination.
4. The appraiser will not give testimony or appear in court because he or she made an appraisal of the property in question, unless specific arrangements to do so have been made beforehand, or as otherwise required by law.
5. The appraiser has noted in this appraisal report any adverse conditions (such as needed repairs, deterioration, the presence of hazardous wastes, toxic substances, etc.) observed during the inspection of the subject property or that he or she became aware of during the research involved in performing this appraisal. Unless otherwise stated in this appraisal report, the appraiser has no knowledge of any hidden or unapparent physical deficiencies or adverse conditions of the property (such as, but not limited to, needed repairs, deterioration, the presence of hazardous wastes, toxic substances, adverse environmental conditions, etc.) that would make the property less valuable, and has assumed that there are no such conditions and makes no guarantees or warranties, express or implied. The appraiser will not be responsible for any such conditions that do exist or for any engineering or testing that might be required to discover whether such conditions exist. Because the appraiser is not an expert in the field of environmental hazards, this appraisal report must not be considered as an environmental assessment of the property.
6. The appraiser has based his or her appraisal report and valuation conclusion for an appraisal that is subject to satisfactory completion, repairs, or alterations on the assumption that the completion, repairs, or alterations of the subject property will be performed in a professional manner.

Uniform Residential Appraisal Report

File No. PDH Sample

APPRAISER'S CERTIFICATION: The Appraiser certifies and agrees that:

1. I have, at a minimum, developed and reported this appraisal in accordance with the scope of work requirements stated in this appraisal report.
2. I performed a complete visual inspection of the interior and exterior areas of the subject property. I reported the condition of the improvements in factual, specific terms. I identified and reported the physical deficiencies that could affect the livability, soundness, or structural integrity of the property.
3. I performed this appraisal in accordance with the requirements of the Uniform Standards of Professional Appraisal Practice that were adopted and promulgated by the Appraisal Standards Board of The Appraisal Foundation and that were in place at the time this appraisal report was prepared.
4. I developed my opinion of the market value of the real property that is the subject of this report based on the sales comparison approach to value. I have adequate comparable market data to develop a reliable sales comparison approach for this appraisal assignment. I further certify that I considered the cost and income approaches to value but did not develop them, unless otherwise indicated in this report.
5. I researched, verified, analyzed, and reported on any current agreement for sale for the subject property, any offering for sale of the subject property in the twelve months prior to the effective date of this appraisal, and the prior sales of the subject property for a minimum of three years prior to the effective date of this appraisal, unless otherwise indicated in this report.
6. I researched, verified, analyzed, and reported on the prior sales of the comparable sales for a minimum of one year prior to the date of sale of the comparable sale, unless otherwise indicated in this report.
7. I selected and used comparable sales that are locationally, physically, and functionally the most similar to the subject property.
8. I have not used comparable sales that were the result of combining a land sale with the contract purchase price of a home that has been built or will be built on the land.
9. I have reported adjustments to the comparable sales that reflect the market's reaction to the differences between the subject property and the comparable sales.
10. I verified, from a disinterested source, all information in this report that was provided by parties who have a financial interest in the sale or financing of the subject property.
11. I have knowledge and experience in appraising this type of property in this market area.
12. I am aware of, and have access to, the necessary and appropriate public and private data sources, such as multiple listing services, tax assessment records, public land records and other such data sources for the area in which the property is located.
13. I obtained the information, estimates, and opinions furnished by other parties and expressed in this appraisal report from reliable sources that I believe to be true and correct.
14. I have taken into consideration the factors that have an impact on value with respect to the subject neighborhood, subject property, and the proximity of the subject property to adverse influences in the development of my opinion of market value. I have noted in this appraisal report any adverse conditions (such as, but not limited to, needed repairs, deterioration, the presence of hazardous wastes, toxic substances, adverse environmental conditions, etc.) observed during the inspection of the subject property or that I became aware of during the research involved in performing this appraisal. I have considered these adverse conditions in my analysis of the property value, and have reported on the effect of the conditions on the value and marketability of the subject property.
15. I have not knowingly withheld any significant information from this appraisal report and, to the best of my knowledge, all statements and information in this appraisal report are true and correct.
16. I stated in this appraisal report my own personal, unbiased, and professional analysis, opinions, and conclusions, which are subject only to the assumptions and limiting conditions in this appraisal report.
17. I have no present or prospective interest in the property that is the subject of this report, and I have no present or prospective personal interest or bias with respect to the participants in the transaction. I did not base, either partially or completely, my analysis and/or opinion of market value in this appraisal report on the race, color, religion, sex, age, marital status, handicap, familial status, or national origin of either the prospective owners or occupants of the subject property or of the present owners or occupants of the properties in the vicinity of the subject property or on any other basis prohibited by law.
18. My employment and/or compensation for performing this appraisal or any future or anticipated appraisals was not conditioned on any agreement or understanding, written or otherwise, that I would report (or present analysis supporting) a predetermined specific value, a predetermined minimum value, a range or direction in value, a value that favors the cause of any party, or the attainment of a specific result or occurrence of a specific subsequent event (such as approval of a pending mortgage loan application).
19. I personally prepared all conclusions and opinions about the real estate that were set forth in this appraisal report. If I relied on significant real property appraisal assistance from any individual or individuals in the performance of this appraisal or the preparation of this appraisal report, I have named such individual(s) and disclosed the specific tasks performed in this appraisal report. I certify that any individual so named is qualified to perform the tasks. I have not authorized anyone to make a change to any item in this appraisal report; therefore, any change made to this appraisal is unauthorized and I will take no responsibility for it.
20. I identified the lender/client in this appraisal report who is the individual, organization, or agent for the organization that ordered and will receive this appraisal report.
21. The lender/client may disclose or distribute this appraisal report to: the borrower; another lender at the request of the borrower; the mortgagee or its successors and assigns; mortgage insurers; government sponsored enterprises; other secondary market participants; data collection or reporting services; professional appraisal organizations; any department, agency, or instrumentality of the United States; and any state, the District of Columbia, or other jurisdictions; without having to obtain the appraiser's or supervisory appraiser's (if applicable) consent. Such consent must be obtained before this appraisal report may be disclosed or distributed to any other party (including, but not limited to, the public through advertising, public relations, news, sales, or other media).

Uniform Residential Appraisal Report

File No. PDH Sample

22. I am aware that any disclosure or distribution of this appraisal report by me or the lender/client may be subject to certain laws and regulations. Further, I am also subject to the provisions of the Uniform Standards of Professional Appraisal Practice that pertain to disclosure or distribution by me.
23. The borrower, another lender at the request of the borrower, the mortgagee or its successors and assigns, mortgage insurers, government sponsored enterprises, and other secondary market participants may rely on this appraisal report as part of any mortgage finance transaction that involves any one or more of these parties.
24. If this appraisal report was transmitted as an "electronic record" containing my "electronic signature," as those terms are defined in applicable federal and/or state laws (excluding audio and video recordings), or a facsimile transmission of this appraisal report containing a copy or representation of my signature, the appraisal report shall be as effective, enforceable and valid as if a paper version of this appraisal report were delivered containing my original hand written signature.
25. Any intentional or negligent misrepresentation(s) contained in this appraisal report may result in civil liability and/or criminal penalties including, but not limited to, fine or imprisonment or both under the provisions of Title 18, United States Code, Section 1001, et seq., or similar state laws.

SUPERVISORY APPRAISER'S CERTIFICATION: The Supervisory Appraiser certifies and agrees that:

1. I directly supervised the appraiser for this appraisal assignment, have read the appraisal report, and agree with the appraiser's analysis, opinions, statements, conclusions, and the appraiser's certification.
2. I accept full responsibility for the contents of this appraisal report including, but not limited to, the appraiser's analysis, opinions, statements, conclusions, and the appraiser's certification.
3. The appraiser identified in this appraisal report is either a sub-contractor or an employee of the supervisory appraiser (or the appraisal firm), is qualified to perform this appraisal, and is acceptable to perform this appraisal under the applicable state law.
4. This appraisal report complies with the Uniform Standards of Professional Appraisal Practice that were adopted and promulgated by the Appraisal Standards Board of The Appraisal Foundation and that were in place at the time this appraisal report was prepared.
5. If this appraisal report was transmitted as an "electronic record" containing my "electronic signature," as those terms are defined in applicable federal and/or state laws (excluding audio and video recordings), or a facsimile transmission of this appraisal report containing a copy or representation of my signature, the appraisal report shall be as effective, enforceable and valid as if a paper version of this appraisal report were delivered containing my original hand written signature.

APPRAISER

SUPERVISORY APPRAISER (ONLY IF REQUIRED)

Signature _____
 Name _____
 Company Name _____
 Company Address _____
 Telephone Number _____
 Email Address _____
 Date of Signature and Report _____
 Effective Date of Appraisal xx/xx/xxxx _____
 State Certification # _____
 or State License # _____
 or Other (describe) _____ State # _____
 State _____
 Expiration Date of Certification or License _____

Signature _____
 Name _____
 Company Name _____
 Company Address _____
 Telephone Number _____
 Email Address _____
 Date of Signature _____
 State Certification # _____
 or State License # _____
 State _____
 Expiration Date of Certification or License _____

ADDRESS OF PROPERTY APPRAISED
 123 Beech St _____
 Anytown, XX XXXXX _____

SUBJECT PROPERTY
 Did not inspect subject property
 Did inspect exterior of subject property from street
 Date of Inspection _____
 Did inspect interior and exterior of subject property
 Date of Inspection _____

APPRAISED VALUE OF SUBJECT PROPERTY \$ 220,000 _____

LENDER/CLIENT
 Name _____
 Company Name _____
 Company Address _____
 Email Address _____

COMPARABLE SALES
 Did not inspect exterior of comparable sales from street
 Did inspect exterior of comparable sales from street
 Date of Inspection _____

Uniform Residential Appraisal Report

File No. PDH Sample

22. I am aware that any disclosure or distribution of this appraisal report by me or the lender/client may be subject to certain laws and regulations. Further, I am also subject to the provisions of the Uniform Standards of Professional Appraisal Practice that pertain to disclosure or distribution by me.
23. The borrower, another lender at the request of the borrower, the mortgagee or its successors and assigns, mortgage insurers, government sponsored enterprises, and other secondary market participants may rely on this appraisal report as part of any mortgage finance transaction that involves any one or more of these parties.
24. If this appraisal report was transmitted as an "electronic record" containing my "electronic signature," as those terms are defined in applicable federal and/or state laws (excluding audio and video recordings), or a facsimile transmission of this appraisal report containing a copy or representation of my signature, the appraisal report shall be as effective, enforceable and valid as if a paper version of this appraisal report were delivered containing my original hand written signature.
25. Any intentional or negligent misrepresentation(s) contained in this appraisal report may result in civil liability and/or criminal penalties including, but not limited to, fine or imprisonment or both under the provisions of Title 18, United States Code, Section 1001, et seq., or similar state laws.

SUPERVISORY APPRAISER'S CERTIFICATION: The Supervisory Appraiser certifies and agrees that:

1. I directly supervised the appraiser for this appraisal assignment, have read the appraisal report, and agree with the appraiser's analysis, opinions, statements, conclusions, and the appraiser's certification.
2. I accept full responsibility for the contents of this appraisal report including, but not limited to, the appraiser's analysis, opinions, statements, conclusions, and the appraiser's certification.
3. The appraiser identified in this appraisal report is either a sub-contractor or an employee of the supervisory appraiser (or the appraisal firm), is qualified to perform this appraisal, and is acceptable to perform this appraisal under the applicable state law.
4. This appraisal report complies with the Uniform Standards of Professional Appraisal Practice that were adopted and promulgated by the Appraisal Standards Board of The Appraisal Foundation and that were in place at the time this appraisal report was prepared.
5. If this appraisal report was transmitted as an "electronic record" containing my "electronic signature," as those terms are defined in applicable federal and/or state laws (excluding audio and video recordings), or a facsimile transmission of this appraisal report containing a copy or representation of my signature, the appraisal report shall be as effective, enforceable and valid as if a paper version of this appraisal report were delivered containing my original hand written signature.

APPRAISER

SUPERVISORY APPRAISER (ONLY IF REQUIRED)

Signature _____
 Name _____
 Company Name _____
 Company Address _____
 Telephone Number _____
 Email Address _____
 Date of Signature and Report _____
 Effective Date of Appraisal xx/xx/xxxx _____
 State Certification # _____
 or State License # _____
 or Other (describe) _____ State # _____
 State _____
 Expiration Date of Certification or License _____

Signature _____
 Name _____
 Company Name _____
 Company Address _____
 Telephone Number _____
 Email Address _____
 Date of Signature _____
 State Certification # _____
 or State License # _____
 State _____
 Expiration Date of Certification or License _____

ADDRESS OF PROPERTY APPRAISED
 123 Beech St _____
 Anytown, XX XXXXX _____

SUBJECT PROPERTY
 Did not inspect subject property
 Did inspect exterior of subject property from street
 Date of Inspection _____
 Did inspect interior and exterior of subject property
 Date of Inspection _____

APPRAISED VALUE OF SUBJECT PROPERTY \$ 220,000 _____

LENDER/CLIENT
 Name _____
 Company Name _____
 Company Address _____
 Email Address _____

COMPARABLE SALES
 Did not inspect exterior of comparable sales from street
 Did inspect exterior of comparable sales from street
 Date of Inspection _____

Uniform Appraisal Dataset Definitions

File No. PDH Sample

Condition Ratings and Definitions

C1 The improvements have been very recently constructed and have not previously been occupied. The entire structure and all components are new and the dwelling features no physical depreciation.

**Note: Newly constructed improvements that feature recycled materials and/or components can be considered new dwellings provided that the dwelling is placed on a 100% new foundation and the recycled materials and the recycled components have been rehabilitated/re-manufactured into like-new condition. Recently constructed improvements that have not been previously occupied are not considered "new" if they have any significant physical depreciation (i.e., newly constructed dwellings that have been vacant for an extended period of time without adequate maintenance or upkeep).*

C2 The improvements feature no deferred maintenance, little or no physical depreciation, and require no repairs. Virtually all building components are new or have been recently repaired, refinished, or rehabilitated. All outdated components and finishes have been updated and/or replaced with components that meet current standards. Dwellings in this category either are almost new or have been recently completely renovated and are similar in condition to new construction.

**Note: The improvements represent a relatively new property that is well maintained with no deferred maintenance and little or no physical depreciation, or an older property that has been recently completely renovated.*

C3 The improvements are well maintained and feature limited physical depreciation due to normal wear and tear. Some components, but not every major building component, may be updated or recently rehabilitated. The structure has been well maintained.

**Note: The improvement is in its first-cycle of replacing short-lived building components (appliances, floor coverings, HVAC, etc.) and is being well maintained. Its estimated effective age is less than its actual age. It also may reflect a property in which the majority of short-lived building components have been replaced but not to the level of a complete renovation.*

C4 The improvements feature some minor deferred maintenance and physical deterioration due to normal wear and tear. The dwelling has been adequately maintained and requires only minimal repairs to building components/mechanical systems and cosmetic repairs. All major building components have been adequately maintained and are functionally adequate.

**Note: The estimated effective age may be close to or equal to its actual age. It reflects a property in which some of the short-lived building components have been replaced, and some short-lived building components are at or near the end of their physical life expectancy; however, they still function adequately. Most minor repairs have been addressed on an ongoing basis resulting in an adequately maintained property.*

C5 The improvements feature obvious deferred maintenance and are in need of some significant repairs. Some building components need repairs, rehabilitation, or updating. The functional utility and overall livability is somewhat diminished due to condition, but the dwelling remains useable and functional as a residence.

**Note: Some significant repairs are needed to the improvements due to the lack of adequate maintenance. It reflects a property in which many of its short-lived building components are at the end of or have exceeded their physical life expectancy but remain functional.*

C6 The improvements have substantial damage or deferred maintenance with deficiencies or defects that are severe enough to affect the safety, soundness, or structural integrity of the improvements. The improvements are in need of substantial repairs and rehabilitation, including many or most major components.

**Note: Substantial repairs are needed to the improvements due to the lack of adequate maintenance or property damage. It reflects a property with conditions severe enough to affect the safety, soundness, or structural integrity of the improvements.*

Quality Ratings and Definitions

Q1 Dwellings with this quality rating are usually unique structures that are individually designed by an architect for a specified user. Such residences typically are constructed from detailed architectural plans and specifications and feature an exceptionally high level of workmanship and exceptionally high-grade materials throughout the interior and exterior of the structure. The design features exceptionally high-quality exterior refinements and ornamentation, and exceptionally high-quality interior refinements. The workmanship, materials, and finishes throughout the dwelling are of exceptionally high quality.

Q2 Dwellings with this quality rating are often custom designed for construction on an individual property owner's site. However, dwellings in this quality grade are also found in high-quality tract developments featuring residences constructed from individual plans or from highly modified or upgraded plans. The design features detailed, high-quality exterior ornamentation, high-quality interior refinements, and detail. The workmanship, materials, and finishes throughout the dwelling are generally of high or very high quality.

Q3 Dwellings with this quality rating are residences of higher quality built from individual or readily available designer plans in above-standard residential tract developments or on an individual property owner's site. The design includes significant exterior ornamentation and interiors that are well finished. The workmanship exceeds acceptable standards and many materials and finishes throughout the dwelling have been upgraded from "stock" standards.

Q4 Dwellings with this quality rating meet or exceed the requirements of applicable building codes. Standard or modified standard building plans are utilized and the design includes adequate fenestration and some exterior ornamentation and interior refinements. Materials, workmanship, finish, and equipment are of stock or builder grade and may feature some upgrades.

Q5 Dwellings with this quality rating feature economy of construction and basic functionality as main considerations. Such dwellings feature a plain design using readily available or basic floor plans featuring minimal fenestration and basic finishes with minimal exterior ornamentation and limited interior detail. These dwellings meet minimum building codes and are constructed with inexpensive, stock materials with limited refinements and upgrades.

Q6 Dwellings with this quality rating are of basic quality and lower cost; some may not be suitable for year-round occupancy. Such dwellings are often built with simple plans or without plans, often utilizing the lowest quality building materials. Such dwellings are often built or expanded by persons who are professionally unskilled or possess only minimal construction skills. Electrical, plumbing, and other mechanical systems and equipment may be minimal or non-existent. Older dwellings may feature one or more substandard or non-conforming additions to the original structure.

Definitions of Not Updated, Updated, and Remodeled

Not Updated

Little or no updating or modernization. This description includes, but is not limited to, new homes.

Residential properties of fifteen years of age or less often reflect an original condition with no updating, if no major components have been replaced or updated. Those over fifteen years of age are also considered not updated if the appliances, fixtures, and finishes are predominantly dated. An area that is 'Not Updated' may still be well maintained and fully functional, and this rating does not necessarily imply deferred maintenance or physical/functional deterioration.

Updated

The area of the home has been modified to meet current market expectations. These modifications are limited in terms of both scope and cost.

An updated area of the home should have an improved look and feel, or functional utility. Changes that constitute updates include refurbishment and/or replacing components to meet existing market expectations. Updates do not include significant alterations to the existing structure.

Remodeled

Significant finish and/or structural changes have been made that increase utility and appeal through complete replacement and/or expansion.

A remodeled area reflects fundamental changes that include multiple alterations. These alterations may include some or all of the following: replacement of a major component (cabinet(s), bathtub, or bathroom tile), relocation of plumbing/gas fixtures/appliances, significant structural alterations (relocating walls, and/or the addition of square footage). This would include a complete gutting and rebuild.

Explanation of Bathroom Count

The number of full and half baths is reported by separating the two values by a period. The full bath is represented to the left of the period. The half bath count is represented to the right of the period. Three-quarter baths are to be counted as a full bath in all cases. Quarter baths (baths that feature only toilet) are not to be included in the bathroom count.

Real Estate Pricing

Final Exam

The following 40 questions are the final exam for Real Estate Pricing.

These questions will be graded, and you will need at least a 75% to pass.

If needed, there is no additional charge for retakes.

1. Ms. Smith has added a bathroom to her house, which means that her house now has the same number of bathrooms most houses in her neighborhood have. This is an example of:
 - a. Change
 - b. Decreasing returns
 - c. Increasing returns
 - d. Balance

2. Agent Barry has analyzed the market for one story, 3 bedroom, 2 bath ranch houses for the past year. He has determined that 24 such homes have sold in the past year, and there are currently 4 houses for sale. This market would be characterized as:
 - a. A seller's market (high demand, low supply)
 - b. A buyer's market (low demand, high supply)
 - c. A flat market
 - d. A stable market

3. Real estate agents and appraisers should strive for which of the following?
 - a. Outdoing each other
 - b. A professional relationship with mutual respect
 - c. Agents are not allowed to communicate with appraisers
 - d. A divisive relationship; they are natural competitors

4. BPO stands for:
 - a. Comprehensive Market Analysis
 - b. Broker's Professional Origin
 - c. Broker's Price Opinion
 - d. Broker's Paid Opinion

5. Geographic competency is:
 - a. for appraisers only
 - b. for agents only
 - c. for both appraisers and agents
 - d. None of the above

6. Which of the following types of data is specific data, as opposed to general data?
- The current interest rates available for mortgages
 - The major industries in the region
 - The parcel number for the property
 - The climate of the region
7. Highest and best use analysis includes:
- Physically possible, legally permissible, extra feasible, maximally profitable
 - Phonologically possible, lawfully permissible, economically feasible, maximally productive
 - Physically possible, legally permissible, economically feasible, maximally productive
 - Psychically possible, locational optional, economically productive, maximally feasible.
8. A part of a house which extends out over the foundation, or footprint, is known as:
- Clerestory
 - Cantilever
 - Garrison
 - Eave
9. Reproduction cost is:
- The same as the Unit in place method
 - The same as reproduction cost
 - The most commonly used to develop a cost approach
 - The least likely method used to develop a cost approach
10. Which of the following would be site improvements?
- The detached garage
 - Sidewalks and connections to public water and sewer
 - The foundation of the house
 - The land itself
11. $\text{Effective age} \div \text{Total Economic Life} = \text{Accrued Depreciation}$ is:
- The formula to determine age/life depreciation
 - The formula to determine economic life
 - The formula to determine the actual cost
 - The formula to determine functional depreciation

12. To value a special-purpose building, such as a church, which approach would most likely be developed?
- The income approach
 - The quantity survey method
 - The cost approach
 - The market approach
13. Which of the following properties is one where you would probably develop a cost approach?
- A thirty year old single family home
 - A three unit property, which is about 30 years old
 - A brand new, single family home
 - All of the above
14. Which of the following circumstances would suggest that a cost-based adjustment should be developed?
- One comparable has two bathrooms, and the subject has three
 - One comparable has a 2 car garage, and the subject has no garage
 - The former owners removed the furnace from the house
 - The house needs a new roof
15. The current market for houses like the subject looks like this: in the past 12 months, 48 homes like the subject have sold. Today, there are 24 homes like the subject listed for sale. Which of the following is correct?
- The absorption rate is 4 per month, and there is a 6month supply
 - The absorption rate is 3 per month, and there is a 4 month supply
 - The absorption rate is 36 per month, and there is a third of a year supply
 - The absorption rate is 6 per month, and there is a 2 month supply
16. Automated valuation models are used by:
- Lenders
 - Agents
 - Consumers
 - All of the above
17. Which of the following would probably disqualify a sale from being used as a comparable?
- Buyer and seller are both represented by real estate agents
 - Buyer and seller are typically motivated and well informed
 - Buyer or seller was under duress
 - Buyer and seller are strangers

18. Which of the following pieces of information about a sale would have been verified by an AVM?
- The square footage of the house
 - The fact that the seller paid 6% of the buyer's closing costs
 - The fact that the buyer was the seller's granddaughter
 - None of the above
19. Which is correct?
- Cap rates and GRMs both use gross income to estimate value
 - Cap rates and GRMs both use a capitalization rate
 - Cap rates and GRMs are equally reliable for valuing income property
 - Formulae which reflect the relationship between the rent (income) the property generates and its value (price)
20. A property sold for \$150,000, and the monthly rent was \$1600. The GRM is:
- 1600
 - 160
 - 93.75
 - 106
21. A property has a NOI of \$45,000 and sells for \$620,700. What is the cap rate?
- 9.25%
 - 7.25%
 - 5%
 - 11%
22. An investor buyer wants a cap rate of 5%. The property he is looking at has NOI of \$27,500. What should he pay for the property?
- \$220,000
 - \$171,875
 - \$148,958
 - \$550,000
23. Expenses such as taxes and insurance are:
- Expenses which change with the occupancy of the property
 - Fixed expenses
 - Variable expenses
 - Optional expenses

24. The income that the property could produce with all units rented, and 100% of income from other sources, such as an on-site laundromat is known as:

- a. Effective gross income
- b. Net operating income
- c. Theoretical income
- d. Potential gross income

25. Potential gross income less which of the following gives you effective gross income?

- a. Vacancy and credit allowance
- b. Fixed expenses
- c. Variable expenses
- d. All of the above

26. An item appraisers use, which investors do not always calculate is:

- a. Fixed expenses
- b. Debt service
- c. Reserves for replacements
- d. Sinking fund

27. Something appraisers do not put into their calculation, but most investor buyers do consider is:

- a. Reserve for replacements
- b. Debt service
- c. Fixed expenses
- d. Variable expenses

28. A value of what a property would be worth at a particular time in the future is:

- a. Speculative value
- b. Appreciated value
- c. Retrospective value
- d. Prospective value

29. A value sought by a bankruptcy court would most likely be:

- a. Fair market value
- b. Retrospective value
- c. Liquidation value
- d. Value in use

30. The theory that the value of the most modest home in a neighborhood of higher priced properties will be enhanced is:
- Progression
 - Regression
 - Substitution
 - Opportunity cost
31. An investor chooses from two possible investments, and selects one. The potential for the investment he did not take is known as:
- Regression
 - Opportunity cost
 - Progression
 - Externalities
32. Which of the following is correct about using foreclosures and short sales as comparable sales to determine value?
- They should *never* be used
 - They should *always* be used
 - They should be considered, and if they are numerous enough in the market, they should probably be used
 - None of the above
33. When doing a CMA, expired listings are:
- Not used, because they did not sell
 - Included, as an indication of what buyers are unwilling to pay
 - They have no bearing on the situation
 - Required by law to be used
34. Investment value is:
- The value to an investor, based on his or her goals for return
 - The same as fair market value
 - The same as value-in-use
 - Replacement cost less depreciation
35. An absorption rate is developed to analyze:
- Change in the market
 - Supply and demand
 - Conformity
 - Fair Market Value

36. Multiple linear regression is the math used in:
- The cost approach
 - In CMAs and BPOs
 - In automated valuation models
 - In the income approach
37. Which of the following approaches would typically be developed for a 30 year old, four unit apartment building?
- Cost approach
 - Income approach
 - Quantity survey method
 - Regression analysis
38. When analyzing income property, which is correct?
- Use market rents, unless the current leases have a long time before they expire
 - Use lease rents, regardless of the length of the lease, or whether or not it is at market rent
 - Use current rents, regardless of whether or not they are market or not
 - Use whatever rent rates are necessary to make your numbers work
39. A house with one bathroom and five bedrooms has:
- External obsolescence
 - Internal obsolescence
 - Functional obsolescence
 - Physical depreciation
40. Whether your role is appraiser or agent, you have a responsibility to:
- Come in at the highest number possible
 - Please the client with your results
 - Get the listing
 - Be honest and fair, and use the right data