HOUSATONIC COMMUNITY COLLEGE
CAPITAL REAL ESTATE SCHOOL

Salesperson Real Estate Principles and Practices

60-hour Webinar Course Content Material

TOPIC 6:
RE Appraisal – Market Valuation

March 2020
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Housatonic Community College

Capital Real Estate School

Webinar Slides – March 25th 2020

TOPIC 6: Appraisal Market Valuation

An appraisal is a licensed appraiser's opinion of a home's market value based on comparable recent sales of homes in the neighborhood. Appraisals are usually ordered on behalf of a buyer's lender to protect the interests of the lender. The lender's underwriter will compare the appraisal price to the final purchase price of the home to ensure the buyer is not borrowing more than the house is worth.

6 RE Appraisal – Market Valuation

- **Learning objectives**
  - Explain appraisal concepts and the process employed by the appraiser.
  - Differentiate between value and price.
  - Describe the three approaches (methods) to value.
  - Estimating Value and effects of Value
  - CMA Comparable/Competitive Market Analysis

6 RE Appraisal – Market Valuation

- **Appraisals – Market Valuation Sub-Topics Covered in this Module**
- **A. Appraisals**
  1. Purpose and use of appraisals for valuation
  2. General steps in appraisal process (pages
  3. Situations requiring appraisal by certified appraiser
- **B. Estimating Value**
  1. Effect of economic principles and property characteristics
  2. Sales or market comparison approach
  3. Cost approach
  4. Income analysis approach
- **C. Competitive/Comparative Market Analysis**
  1. Selecting comparables
  2. Adjusting comparables

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Steps in the Appraisal Process

- ## Appraisal Industry

  A. The collapse of many savings and loan associations as a result of the surge into unsound investments was at least partly the consequence of questionable property appraisals.

  B. Congress introduced appraisal regulation by passing FIRREA in 1989.

  C. Appraisals performed as part of a federally related transaction must comply with state standards and must be performed by a state-certified or state-licensed appraiser.

  D. State appraiser licensing requirements and appraisal standards must meet minimum levels set by the Appraisal Standards Board and Appraisal Qualifications Board of the Appraisal Foundation, a national group of representatives of major appraisal and related organizations.

  E. Appraisal Foundation, a national group of representatives of major appraisal and related organizations.

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Appraisal Purpose and Use

- **Appraisal Purpose & Use of Appraisals for Valuation**

  A. The collapse of many savings and loan associations as a result of the surge into unsound investments was at least partly the consequence of questionable property appraisals.

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What Title Policy is Insured Against

- **Situations Requiring Appraisal via Certified Appraiser (Residential | General)**

    A. All transactions of $ 1,000,000 or more

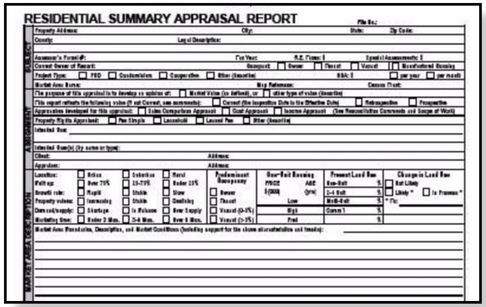
    B. Non-residential and residential (*other than one- to four-family*) trans- actions of $250,000 or more

    C. Complex residential transactions of $250,000 or more

    1. 1. A regulated institution may presume that appraisals of one- to four-family residential properties are not complex, unless the institution has readily available information that a given appraisal will be complex.

    2. 2. The regulated institution is responsible for making the final determination of whether the appraisal is complex.

EXAMPLE: An example of a complex appraisal would be an appraisal of a commercial property in the center of a residential neighborhood.



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Types of Appraisers

Three Types of Appraisers

Three types of Licensed Appraisers

PROVISIONAL APPRAISER

- Pass 75 hours of class training.

1. Pass 15 hour USPAP Course
2. Pass 30 hour Appraisal 1 Course
3. Pass 20 hour Appraisal 2 Course

- Licensed for 4 years only!
- Can execute Residential only appraisals under supervision – not accepted by most lender institutions.
- Renew every year; April 30th
- 28 hours CE every 2 years

RESIDENTIAL APPRAISER

- Pass 200 hours of class training.
- Complete 2,500 hours field time to take exam.

- 28 hours CE every 2 years
- Perform only Residential (Single Family, 22-3-4 unit homes) property market valuations
- Renew every year; April 30th
- Can directly manage only/up to three (3) Provision Appraisers.

GENERAL APPRAISER

- Pass 300 hours of class training.
- Complete 3,000 hours of field time to take exam.

- 28 hours CE training every 2 years.
- Perform ALL (residential, commercial, industrial, mixed-use, agricultural) market valuations.
- Renew every year; April 30th
- Can directly manage only/up to three (3) Provision Appraisers.

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Appraisal vs BPO and CMA

Appraisal Process

- A systematic procedure enables an appraiser to collect, organize and analyze the necessary data to produce an appraisal report.

DIFFERENCES BETWEEN CMA - BPO - APPRAISAL

	Created by	Created or Positioned For	Purpose & Reason	Fee or Chargable	FAIR SUBJECTIVE OR OBJECTIVE	NUMBER OF PAGES	SPECIFIC FORMS	ORGANIZATIONAL CONTROL	METHODS	TIME TO CREATE / COMPLETE
CMA Comparable Market Analysis	Broker or Salesperson	Buyer or Seller	Solicit a Listing	Free *(can Charge***)*	Subjective and Biased	2-4 or 5-40 typical	None	NONE user discretion	One	20-min
BPO Broker Price Opinion	Broker or Salesperson	Lender	Solicit a Listing	~$50-$185 each	Subjective and Biased	2-4 pages total	2-page Lender form	Lender and Gov't	oOne	1-2 hours
APPRAISAL Market Valuation	Appraiser Only	Lender Buyer or Seller	Property Market Valuation	~$400-$1.2K (Res) $800-$3K (Com)	Objective Fair & Honest	30-40 pages typical	8 page USPAP Form	USPAP	All Three	1-1.5 weeks
				*** if property is sold then Brokerage must refund fee						

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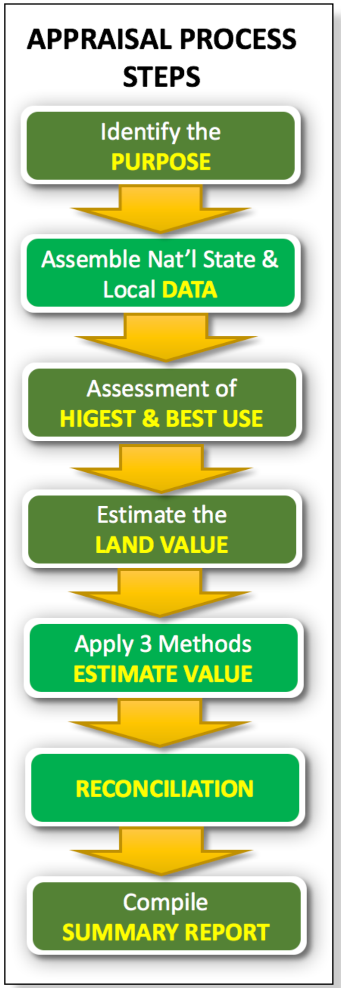
Steps in the Appraisal Process

The Appraisal Process Steps

A. **State the problem** what type of value is being sought?
B. **List the data needed and the sources.**
C. **Gather, record, verify, and analyze** the necessary data.
   1. **General data** national, regional, city, and neighborhood data; data about factors not located on the property
   2. **Specific data** data on the subject land and improvements
   3. **Both general data and specific data** would include information regarding each of the three approaches to value.

D. **Determine the highest and best use of the site.**
E. **Estimate the land value, usually by sales comparison analysis.**
F. **Estimate the value by each of the three approaches.**
G. **Reconcile the estimated values for the final value estimate.**
H. **Report the final value estimate.**



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Steps in the Appraisal Process

- **EFFECT OF ECONOMIC PRINCIPLES AND PROPERTY CHARACTERISTICSPHYSICAL CHARACTERISTICS AFFECTING VALUE**

1. **DURABILITY:** Although improvements depreciate physically over time, land does not.

   Example: Buy some land and let it sit for 30 years and then come back to check on it, it still looks the same. Even a brick building may still look the same. This feature increases the value of real estate.

2. **IMMOBILITY**: Real estate is not movable.

   Example: have you heard that the 3 most important aspect of real estate value is location, location, location. Immobility can be good or bad because if your property is in a good location, that will bring its value upwards. But if it‘s in a bad location, you cannot move it elsewhere.

3. **HETEROGENEITY** (non-homogeneity): Every property is UNIQUE; No two parcels are alike.

Even when you have two adjacent lots in the subdivision that would seem to be of the same size and value, they still have two different legal descriptions; one is lot #1 while the other is lot #2.

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Steps in the Appraisal Process

ECONOMIC CHARACTERISTICS AFFECTING VALUE (D.U.S.T.)

1. **DESIRABILITY (DEMAND):** Whether or not there are possible buyers interested in the property that are willing, able, and have the financial means to purchase.

2. **SCARCITY (SUPPLY):** Whether or not there are other similar properties of a comparable nature within the same general area that will compete with the subject

3. **UTILITY:** The type of use that the subject property is most suitable for, and whether or not it satisfies the needs of a certain buyer.

4. **TRANSFERABILITY:** The ability to sell, lease, will property to another person. The more the restrictions on the sale, lease or transfer of property, the less the value.

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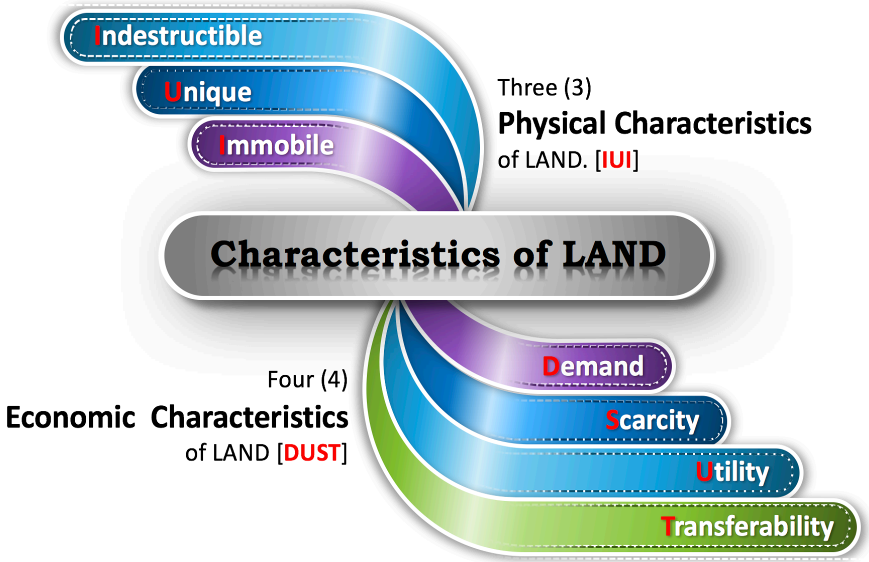
Property Economic Characteristics

ECONOMIC CHARACTERISTICS AFFECTING VALUE (D.U.S.T.)



1. **DURABILITY (INDESCRUCTABILITY):** Although improvements depreciate physically over time, land does not.
   - **Example:** Buy some land and let it sit for 30 years and then come back to check on it, it still looks the same. Even a brick building may still look the same. This feature increases the value of real estate.
2. **IMMOBILITY:** Real estate is not movable.
   - **Example:** have you heard that the 3 most important aspect of real estate value is location location, location. Immobility can be good or bad because if your property isin a good location, that will bring its value upwards. But if it's in a bad location, you cannot move it elsewhere.
3. **HETEROGENEITY (UNIQUE):** (non-homogeneity): Every property is UNIQUE; No two parcels are alike. Even when you have two adjacent lots in the subdivision that would seem to be of the same size and value, they still have two different legal descriptions; one is lot #2while the other is lot #2.

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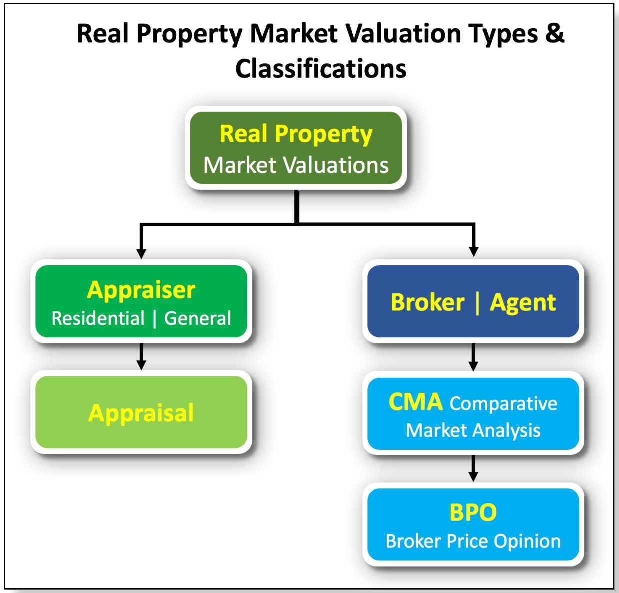
Three Types of Market Valuations: Appraisal | CMA | BPO

Types of Appraisals (Broker|Agents & Appraisers)

- **Appraisal** - an opinion of value; a detailed estimate of a property's value by a professional residential or general appraiser.
- **CMA** – **Comparable or Competitive Market Analysis** - A comparative market analysis is an examination of the prices at which similar properties in the same area recently sold.
- Since no two properties are identical, agents make adjustments for the differences between the sold properties and the one that is about to be purchased or listed to determine a fair offer or sale price. Essentially, a comparative market analysis is a less-sophisticated version of a formal, professional appraisal.



- **BPO** – **Broker Price Opinion** - When doing a BPO, the real estate pro researches the 'subject property,' they take pictures of it, they also scope out the neighborhood as well as pull 6 comparable properties *(3 Active Comps and 3 Sold Comps)* in their MLS (Multiple Listing Service). They then take all of this information, the pictures they took of the subject and their knowledge of the local real estate market and they input it into a BPO form.

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Three Methods of Appraising Market Valuation

The Sales Comparison Approach

1. An estimate of value is obtained by comparing the subject property (the property under appraisal) with recently sold comparable properties (properties similar to the subject).

2. **The factors** for which adjustments to the comparable properties are made:

   a. **Property rights** in cases where less than the full bundle of rights is involved

   b. **Financing concessions events** such as differences in mortgage loan terms or owner financing

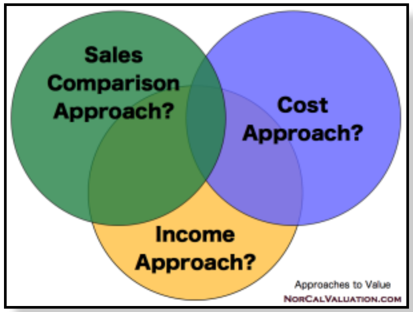
   c. **Market conditions** interest rates, supply and demand, and other economic indicators

   d. **Conditions of sale** motivational factors such as foreclosure or a sale between family members

   e. **Market conditions** since date of sale changes in economic conditions between the date of the sale of the comparable property and the date of the appraisal

   f. **Location compensate** for locational or neighborhood differences

   g. **Physical features** and amenities physical differences between the comparable properties and the subject



3. A dollar value is assigned to each difference between the subject property and the comparable properties.

4. **Adjustments** are made as follows:

   a. If the comparable property is better than the subject property, or has a feature that the subject property lacks, the value of the comparable is decreased accordingly.

   b. If the comparable property is not as good as the subject property or lacks a feature that the subject property has, the value of the comparable is increased accordingly.

6 RE Appraisal – Market Valuation

BREAK TIME!

CLASS BREAK

15 MINUTES ….. BACK AT 8:00PM

WE WILL RETURN AND COMPLETE 3.5 HR SESSION

INSTRUCTOR PHONE CONTACT DURING BREAK

STEVE FULLER

203.692.5533 (MOBILE)

6 RE Appraisal – Market Valuation

Three Methods of Appraising Market Valuation

The Sales Comparison Approach (cont'd)

3. **Determining reproduction or replacement cost new**
   - **a. Square-foot method** the average cost-per-square-foot
   - **b. Unit-in-place method** replacement cost based on the construction
   - **c. Quantity survey method** the cost of the raw materials plus the cost of the construction labor plus indirect costs
   - d. **Index method** the percentage increase or decrease in construction costs to the present time is applied to the original cost of the improvements

4. **Depreciation**—loss in value of an improvement due to all cause
   - a. **Physical deterioration** normal wear and tear
     - (1) **Curable-repairs** that are economically feasible
     - (2) **Incurable repairs** that are not economically feasible
   - b. **Functional obsolescence** outmoded items and poor design
     - (1) **Curable outdated** physical or design features
     - (2) **Incurable outdated** physical or design features
   - c. **External obsolescence** incurable, because it is caused by a problem external to the property and, therefore, beyond the property owner's control

5. **Depreciation** is usually calculated on a straight-line basis the assumption being that depreciation occurs at an even rate over the structure's economic life.

6. **Cost approach** used for appraising newer or special-use buildings, such as schools, churches, and public buildings.

6 RE Appraisal – Market Valuation

Three Methods of Appraising Market Valuation

The Cost Approach

1. Steps in the cost approach to value

a. Estimate the value of the land as if it were vacant and available to be put to its highest and best use.

b. Estimate the current cost of constructing the building(s).

c. Estimate the amount of accrued depreciation resulting from physical deterioration, functional obsolescence, and external obsolescence.

d. Deduct the accrued depreciation from the estimated construction cost of new building(s).

e. Add the estimated land value to the depreciated cost of the building(s) and site improvements to arrive at the total property value

2. Reproduction Cost versus Replacement Cost.

a. **Reproduction cost** the current cost of a duplicate of the subject property, including both the benefits and the negative features of the property

b. **Replacement cost** the current cost of improvements with utility or function similar to the subject property

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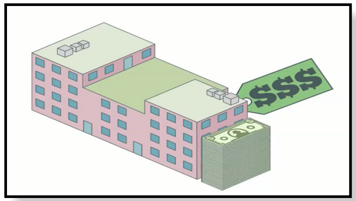
Three Methods of Appraising Market Valuation



The Income Approach

is based on the present value of the rights to future income

1.Income divided by rate equals value.

2.Steps in the income approach to value

a. Estimate the annual potential gross income from all sources, including rent, concessions, and vending

b. Deduct for vacancies and rent loss to obtain the effective gross income.

c. Deduct the annual operating expenses to obtain the annual net operating income; does not include:

(1) De**bt service** (principal and interest payments)

(2) **Capital expenditures/capital improvements**

d. Estimate the price an investor would pay for the income produced by this particular type and class of property.

(1)Compare the annual **net operating incomes** of recently sold similar properties to their sales price

(2)The annual net operating income divided by the sales price results in the capitalization ("cap") rate.

e. Apply the capitalization rate to the subject property's annual net operating income to obtain an estimated value.

3. **Gross rent multipliers and gross income multipliers** informal substitutes for income capitalization

a. **Gross rent multiplier (GRM)**

(1)Used for one-to-four residential units

(2)Based on the gross monthly rent of recently sold similar properties

(3)The sales price divided by the gross monthly rent results in the gross rent multiplier

b. **Gross income multiplier (GIM)**

(1)Used for five or more residential unit properties and commercial properties

(2)Based on the gross annual income (from all sources) of recently sold similar properties

(3)The sales price divided by the gross annual income results in the gross income multiplier.

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Capitalization Rate Calculations

Calculating the Capitalization (Cap Rate)

GROSS INCOME:

$270,000 per year (15 Apts @ $1,500/mo. * 12 mo.)
(this is 15-unit apartment building @ **$875K**)

How to calculate Net Income:

$270,000 (Gross Income annual)
-$15,000 (Taxes per year)
-$9,000 (Maintenance per year)
-$21,000 (Insurance)
= $225,000 (NET INCOME)

NET INCOME / PURCHASE PRICE = CAP RATE

$225,000 / $875,000 = 0.257 = 25.7%

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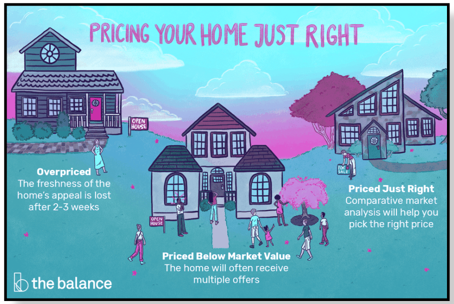
Steps in the Appraisal Process

Typical Terms and definitions:

Market Price is the last price the real property has sold for which could be several years. When a real property has recently sold, the Market Price and the Selling price are the same. When a property is for sale, the Market Price is the price the property last sold for. When the property sells, the **Selling Price** is the recent sales price and at that time matches the Market price.

Selling Price is the price that a real property as most recently sold for. This term refers more exclusively the recent sale price of the real property. The previous sale price (generally 2-40 years) is the Market Price.



Asking Price is the price that a seller wishes to sell the real property for. This often differs from the actual 'list price' that is found on the listing, MLS (Multiple Listing Service) or fair open market listed price. The seller in many cases has a more sentimental and higher value opinion and this sometimes is referred to as the 'dream price'.

List Price is the price of a real property for sale set by the seller and licensed real estate listing agent. The List Price is the agreed price between what the seller and CMA (comparative/comparable market analysis) price provides. Comparative Market Analysis is an examination of the prices at which similar properties in the same area recently sold. Real estate agents perform a comparative/comparable market analysis for their clients (signed to listing agreement) to help them determine a price to list when selling a home or a price to offer when buying a home.

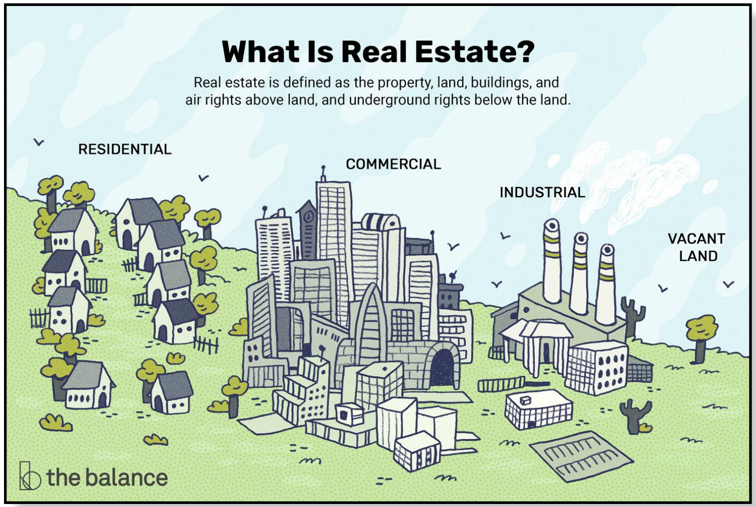
Selling Price is the price that a real property as most recently sold for. This term refers more exclusively the recent sale price of the real property. The previous sale price (generally 2-40 years) is the Market Price.

6 RE Appraisal – Market Valuation

Steps in the Appraisal Process

Types of Real Estate Value

- market
- reproduction
- replacement
- salvage
- plottage
- assessed
- condemned
- reversionary
- appraised
- rental
- leasehold
- insured
- reversionary
- appraised
- rental
- leasehold
- insured
- book value



Market value. Market value is an estimate of the price at which a property will sell at a particular time. This type of value is the one generally sought in appraisals and used in brokers' estimates of value.

Reproduction value. Reproduction value is the value based on the cost of constructing a precise duplicate of the subject property's improvements, assuming current construction costs.

Replacement value. Replacement value is the value based on the cost of constructing a functional equivalent of the subject property's improvements, assuming current construction costs.

Salvage value. Salvage value refers to the nominal value of a property that has reached the end of its economic life. Salvage value is also an estimate of the price at which a structure will sell if it is dismantled and moved.

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Types of Valuation

Types of Real Estate Value (cont'd)

Plottage value. Plottage value is an estimate of the value that the process of assemblage adds to the combined values of the assembled properties. This concept presupposes that two typical parcels of land is worth less than the two parcels combined into one.

Assessed value. Assessed value is the value of a property as estimated by a taxing authority as the basis for ad valorem taxation.

Condemned value. Condemned value is the value set by a county or municipal authority for a property which may be taken by eminent domain.

Depreciated value is a value established by subtracting accumulated depreciation from the purchase price of a property.

Reversionary value. Reversionary value is the estimated selling price of a property at some time in the future. This value is used most commonly in a pro-forma investment analysis where, at the end of a holding period, the property is sold and the investor's capital reverts to the investor.

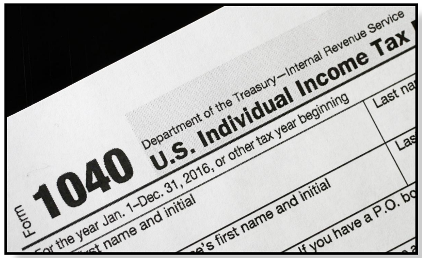
Appraised value. Appraised value is an appraiser's opinion of a property's value. Rental value. Rental value is an estimate of the rental rate a property can command for a specific period of time.

Leasehold value. Leasehold value is an estimate of the market value of a lessee's interest in a property.

Insured value. Insured value is the face amount a casualty or hazard insurance policy will pay in case a property is rendered unusable.

Book value. Book value is the value of the property as carried on the accounts of the owner. The value is generally equal to the acquisition price plus capital improvements minus accumulated depreciation.

Mortgage value. Mortgage value is the value of the property as collateral for a loan.



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Gross Rent Multiplier

Calculating Gross Rent Multiplier (G.R.M.)

Purchase Price	=>	$280,000
Monthly Rent (2 Tenants)	=>	$3,200
Annual Income (2 Tenants Monthly Rent * 12)	=>	$38,400

STEP 1: Formula

$$\text{Gross Rent Multiplier} = \frac{\textbf{Purchase Price}}{\textbf{Annual Income}}$$

STEP 2: Substitute Values

$$\text{Gross Rent Multiplier} = \frac{\$280{,}000}{\$38{,}400}$$

STEP 3: Resulting G.R.M.

Gross Rent Multiplier = **7.29 to recover Purchase price**

- **G.R.M.** of 7.29 indicates 7 yrs 4 mo. to recover purchase price.
- **G.R.M**. ranges typically from 4~10
- **G.R.M.** of 12 is considered poor investment and 4 would be good investment opportunity.

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Gross Rent and Gross Income Multiplier

Gross rent multiplier (GRM) 1-4 unit properties

- G.R.M. Tool calculation allows investors to a quickly (roughly) estimate value of real estate property investment before considering operating expenses and taxes.
- Used as a substitute for the income approach in appraising a single-family home. Rule of thumb calculation within Income Capitalization approach.
  - **Formula for GRM: Sales Price ÷ Monthly rental Income = GRM.**
  - **Total Monthly Rental Income × GRM = Estimated Market Value.**

$$\text{Gross Income Multiplier} = \frac{\text{Current Value of the Property}}{\text{Gross Annual Income of the Property}}$$

Gross income multiplier (GIM) 5 or more unit properties

- Used as a quick way to appraise commercial and industrial properties.
- Rule of thumb calculation within the Income Capitalization approach.
  - **Formula for GIM: Sales Price ÷ Annual Rental Income = GIM.**
- The method applies a multiplier to the estimated gross income of the subject property; the income is either based on the current rent roll of the property or a projection of what the property should earn in a competitive market.
- Although the gross rent/income multiplier provides a fast and brief method of estimating the value, it does not take into consideration any operating expenses, vacancies, etc. therefore it may not be as reliable as the capitalization approach described earlier.
  - **Value = GRM x Rent (Monthly or yearly)**
  - **Example:** Property #1 was sold for $100,000 and yielded gross ents in the amount of $10,000/yr. What would property #2 be evaluated at with $15,000/yr. in gross rents?
  - **Solution:** G.R.M. = $100,000 /□$10,000 = 10 G.R.M for property #1
    10 X $15,000 = $150,000 value for property #2

6 RE Appraisal – Market Valuation

Methods in CMA for adjusting and selection of Properties

COMPETITIVE/COMPARATIVE MARKET ANALYSIS – CMA

A.An estimate of property value (conducted usually by the real estate agent) used to assist the seller in determining a listing price for the property by relying on sale and leasing data of comparable properties.

B.A CMA will not be relied upon by the lender in determining the amount of mortgage loan to be provided to the buyer.

C.C. According to Connecticut state rules/regulations, an real estate licensed salesperson (agent) is authorized to provide the CMA only for the purpose of "soliciting a listing" and establishing a selling (or leasing) Listing Agreement agreed "List Price" for a property that the salesperson is preparing to place on the open market via MLS (Multiple Listing Service)

D.NOTE: In Connecticut, a salesperson or Broker may charge for a CMA but will be required to refund to charge/cost if the property is sold by that salesperson or Broker/Brokerage.

E.Methods used for selecting and adjusting comparables for many residential and some commercial properties are usually similar to those used by licensed appraisers, an agent who faces a complicated valuation task must seek an expert opinion from a licensed appraiser.