

APPRAISAL CLASS NOTES

(from: www.DonRDenton.com/appraisal/)

Chapter 1

THE APPRAISAL PROFESSION

The professional real estate appraiser estimates the value of real property (land and/or buildings). Value may be sought for any number of reasons, such as setting a sales price or determining insurance coverage.

The appraiser needs some of the expertise of the surveyor, the builder, the broker, the accountant, the economist, and the mortgage lender.

An appraiser's acceptance of compensation that is contingent on the reporting of a predetermined value is unethical and unlawful.

One of the most important actions taken by Congress through FIRREA was the requirement that, as of July 1, 1991 (later extended to January 1, 1993), all "federally related real estate appraisals" must be performed only by appraisers licensed or certified (as required) by the state in which the real estate is located.

A certified appraiser is required for transactions involving property valued at more than \$1-million or complex one-unit to four-unit residential property with a transaction value greater than \$250,000.

Federal agency directives have indicated that appraisals of nonresidential property and complex residential property valued at less than \$250,000 also may be handled by licensed rather than certified appraisers.

In October 1992, Congress passed legislation that requires any agency seeking to establish a de minimus value – a minimum valuation threshold below which appraiser licensing or certification is not required – to determine in writing that the threshold set would not threaten the safety and soundness of lending institutions.

Chapter 2

REAL ESTATE AND ITS APPRAISAL

Appraisal refers to both the process by which the appraiser reaches certain conclusions (USPAP Standard 1) and the written report in which those conclusions are communicated (USPAP Standard 2).

Rights, benefits, and improvements that go with the land are called appurtenances.

Real estate is the land itself and all the things permanently attached to it. The definition of real estate typically includes land; fixtures (attachments) to the land; anything incidental or appurtenant to land that benefits the landowner, such as an easement right to use your neighbor's driveway for access to your property; and anything else that is considered immovable (part of the real estate) by law, except for annually cultivated crops (called emblements) and other severable (removable) things that are sold by a contract of sale that complies with the laws regulating the sale of goods.

Question: Unless specifically excluded, every transfer of land includes the:

(a) fixtures, (b) mineral rights, (c) air rights, (d) all of the above.

Question: Which of the following normally would not be considered a fixture:

(a) trees, (b) fences, (c) foundation walls, (d) area rugs.

A tenant usually may remove a fixture before the end of the lease term if the fixture was installed for the purposes of trade, manufacture, ornament, or domestic use and if it can be removed without damage to the premises.

Question: Fee simple ownership could include ownership interest in all of the following EXCEPT: Lease hold rights of a tenant

The lot and block system, also called the lot, block, and tract system and the subdivision system, is the method used to describe most residential and commercial building lots.

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Individual parcels are referred to by the tract, block, and lot numbers by which are identified in the subdivision map filed in the county recorder's office.

A metes and bounds description defines the perimeter of a parcel of land by using measured distances from specific boundary markers.

The US government survey system, also called the section and township system and the rectangular survey system, is most useful in identifying large tracts of rural property. Land area is divided into townships measured and numbered starting at the intersection of a base line running east and west and a meridian running north and south.

Question: How many acres are in S-1/2 of the SW ¼ of the NW ¼ of Section 4?

Answer: 20 acres (640 acres per section divided by 4, divided by 4, divided by 2)

Question: What is the land area covered by the parcel described as the W-1/2 of the E-1/2 of the SW-1/4 of Section 24?

Answer: 40 acres (640 acres per section divided by 4, divided by 2, divided by 2)

The highest or most complete form of ownership in medieval times was the freehold estate. The holder of a freehold estate was not subject to the overlord but could do with the property whatever he or she chose. Freehold estates are estates of ownership.

A license is a temporary permission to come onto the land of another.

An encroachment exists when part of an improvement to land extends over the boundary line onto an adjoining parcel.

A joint tenancy is a form of co-ownership that must meet certain legal requirements to be effective.

Question: Which statement is NOT true with respect to property held in joint tenancy?

Answer: (a) the owners must be husband and wife (is NOT true)

Community property is all property acquired by either spouse during marriage, except property acquired (1) by gift or inheritance, (2) with the proceeds of separate property, or (3) as income from separate property.

Under the condominium form of ownership, an owner's interest in an individual unit would normally be fee simple ownership.

Fee simple ownership of a parcel of real estate generally includes the land as well as all fixtures, such as buildings, attached to it.

To be legally valid, the deed must be delivered to and accepted by the grantee. Title passes to the grantee when the deed is delivered. A deed is of no effect if it is NOT delivered.

The trust deed (a deed held by trustee while a loan is outstanding), or deed of trust, is a form of instrument used to hypothecate real estate as security for a debt.

A reconveyance deed is issued when the trustor under a deed of trust has repaid the underlying debt in full.

A trustee's deed is issued when a foreclosure is completed outside of court.

A deed can be legally valid even though it is not witnessed.

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Chapter 3

THE REAL ESTATE MARKETPLACE

Balance is the principle concerning the four factors of production: land, labor, capital, and management.

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Retail properties or income-producing properties are always susceptible to competition.

Question: A subdivision of look-alike homes will benefit from what principle?

Answer: The principle of conformity

Single-family homes and other buildings in residential areas should follow the principle of conformity. That is, they should be similar in design, construction, age, condition, and market appeal to other buildings in the neighborhood.

A house that has NOT been well maintained but is in a neighborhood of well-kept homes will benefit from the overall good impression created by the neighborhood and its probable desirability. This is an example of the principle of progression.

An example of the principle of regression: A house that has been meticulously maintained in a neighborhood of homes that have NOT been kept up will suffer from the unfavorable impression created.

In an appraisal for market value, any improvement to a property, whether to vacant land or a building, is worth only what it adds to the property's market value, regardless of the improvement's construction cost. In other words, an improvement's contribution to the value of the entire property is counted, not its intrinsic cost.

Property demand may be expected to expand during a period of growth.

The four stages a neighborhood goes through are:

- (1) Growth, (2) equilibrium (or stability), (3) decline, and (4) revitalization

Highest and Best Use (page 52)

As long as the money spent on improvements to the land and structures produces a proportionate or greater increase in income or value, the law of increasing returns is in effect. At the point when additional improvements bring no corresponding increase in income or value, the law of decreasing returns is operating.

The underlying principle behind appraising is substitution. That is, the price someone is willing to pay for a property is influenced by the cost of acquiring a substitute or comparable property.

The effect of supply and demand is most obvious on the value of older buildings in very desirable areas.

Income attributable to land rent that remains after the expenses of ownership are deducted is referred to as surplus productivity.

Chapter 4

THE APPRAISAL PROCESS

Sales comparison approach (or market data approach) to appraising makes the most direct use of the principle of substitution. It is the primary approach used in residential and vacant land appraisals.

The Cost Approach is used when no comparables are available.

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Chapter 5

BUILDING CONSTRUCTION AND THE ENVIRONMENT

The space between the ground and the foundation is called the crawlspace.

In balloon frame construction, the studs extend continuously to the ceiling of the second floor.

Small outlets evenly spaced around the base of the masonry perimeter of a brick house are called weep holes.

The effectiveness of insulation depends on its resistance to heat flow – it R-value – rather than just its thickness. The larger the R-value, the more resistance to heat flow.

The overhang of a pitched roof that extends beyond the exterior walls of the house is called an eave.

Roof designs include: Gable (common), Hip (all four sides slope to a peak), Gambrel (barn-like look), Mansard (barn-like look with all four sides sloping to a point)

Skylights can bring both natural illumination and the heat of the sun into rooms. A skylight lets about five times as much daylight into an area as a window of the same size.

Solid core doors are generally preferred for exterior doors because they provide better heat and sound insulation and are more resistant to warping. Hollow-core doors are commonly used for interior locations, where heat and sound insulation are not critical.

Panel doors consist of stiles (solid vertical members of wood or metal) and rails (solid horizontal members of wood or metal) enclosing flat plywood or raised wood panel fillers or, in some types, a combination of wood and glass panels.

Air-conditioning: Twelve-thousand BTUs are the equivalent of a one-ton capacity.

Construction of a house:

Backfill –

Sill Plate –

Wall stud –

Ridge Beam –

Chimney Flashing –

Riser –

Chapter 6

DATA COLLECTION

Economic base refers to the level of business activity in a community – particularly activity that brings income into the community from surrounding areas – defines its economic base.

Assemblage is the process of combining adjacent lots and the increase in value that may result from ownership of the larger parcel is called plottage. (A state exam question)

Question: In real estate, the term improvement refers to all of the following except:

- (a) Utilities
- (b) Sewer and Drainage Systems
- (c) Structures on a site
- (d) Land in urban areas

If the appraiser has no choice but to use properties with varying financing terms, the selling prices could be adjusted to reflect those variances by using a cash equivalency technique.

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Chapter 7 SITE VALUATION

Highest and Best Use

In a highest and best use analysis, the appraiser must determine the use that fulfills the following four tests. The site must be (PLEM):

- (1) Physically possible
- (2) Legally permitted
- (3) Economically feasible, and
- (4) Maximally productive

Question: A property use as opposed to a building specification contrary to local zoning regulations would require which of the following: (a) Conditional use permit (CUP)

A conditional use permit (CUP) is always listed on the deed.

Some properties are appraised at a time when they are not yet at their expected highest and best use. The present use in such a case is considered an interim use.

Six methods are commonly used in appraising sites:

- (1) Sales comparison method
- (2) Allocation method
- (3) Abstraction method
- (4) Subdivision development method
- (5) Ground rent capitalization method
- (6) Land residual method

Question: A separate land valuation is required in the:
(a) Building residual technique (page 253-256 of text)

Question: The formula, property net income less building net income, is used in estimating site value by the method known as:

- (a) Land residual method

In the allocation method, the ratio of land value to building value is used when estimating site value.

In the abstraction method, when the sales price of a property is known, the value of all improvements can be subtracted from it to find the site value.

Question: The formula, land net income divided by the capitalization rate equals land value, is used in estimating value by the method known as:

- (a) Land residual

Problem: The ratio of land value to building value is approximately 1:4. What is the land value of a property valued at \$200,000?

Answer: \$40,000 for the land (\$160,000 for the building)

Question: The value of 100 acres of land best suited for high density residential use may be found by using what method of appraisal? Answer: Sub-division method

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Chapter 8

THE COST APPROACH, Part 1: Reproduction/Replacement Cost

Question: The appreciation is most important to an appraiser using what method of appraisal? Answer: Cost approach

Question: In the cost approach to value, what do we depreciate? Answer: Improvements

Question: What would be the best appraisal approach to use in estimating the market value of an athletic stadium?
Answer: Cost approach

Question: What would be the best appraisal approach to use in estimating the market value of a library? Answer: Cost approach

There are four methods of estimating the reproduction cost of a structure:

- (1) Index method
- (2) Square-foot method
- (3) Unit-in-place method
- (4) Quantity survey method

In the quantity survey method, a building permit and land survey are indirect costs of construction.

Question: When trying to determine replacement costs, which method uses direct and indirect costs? Answer: Quantity survey method

Chapter 9

THE COST APPROACH, Part 2: Depreciation

Depreciation is most important to an appraiser when using the cost approach.

An outmoded room layout in a home is an example of functional obsolescence.

ADA: The Americans with Disabilities Act of 1991

APN: Assessor Parcel Number

The age-life method of computing depreciation (also called the straight-line method or economic age-life method) is the simplest to understand and use.

In the age-life method, the annual percentage of cost lost through accrued depreciation is found by dividing 1 (one) by the years of the building's economic life.

Long-lived items are those that should last as long as a structure's remaining economic life. Foundation, framework, walls, ceilings, and masonry would fall within this category.

Deterioration of a building foundation is considered long-lived incurable.

Capitalized value method of determining depreciation is also referred to as the rent loss method.

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Chapter 10

THE SALES COMPARISON APPROACH

Question: Using the sales comparison method, adjustments are always applied to what? Answer: Sales price of the comparable

Question: As a general rule, the sales comparison approach is the most reliable approach with which type of property?

Answer: Single family residency

The highest and best use is generally limited to the property's present legally permitted uses (based on the zoning).

In the Sales Comparison Approach, the adjustments that will be made to the sales prices of the selected comparable properties may be expressed in several ways. Most often, a dollar adjustment is used to indicate the value of a desirable feature present in the subject property but not the comparable, resulting in a plus (+) adjustment to the sales price of the comparable.

Question: Matched pairs analysis is used to determine which of the following: (a) Value of adjustments

When making adjustments to the sales prices of the comparables, they should be made in the following order:

- (1) Financing
- (2) Time
- (3) Seller motivation

Question: A house comparable to the subject property sold recently for \$134,000 and is very similar except that the comparable has an extra ½-bath valued at \$3,600. What is the adjusted sale price? Answer: \$130,400

Chapter 11

THE INCOME CAPITALIZATION APPROACH

Because single-family residences usually produce only rental income, the gross rent multiplier is the method used in their appraisal.

Question: What ratio results when the sales price of a property is divided by its gross monthly unfurnished rental?

Answer: Gross rent multiplier

Question: Net operating income excludes which of the following:

- (a) Rents
- (b) Rents plus any other income
- (c) Gross income
- (d) None of the above (the correct answer)

The gross rent multiplier is a number that expresses the relationship between the sales price of a residential property and its gross monthly unfurnished rental: $\text{Sales Price divided by the Gross Rent equals GRM}$

The gross rent multiplier method should be used for appraising single-family residences.

The operating expense ratio is the ratio of total operating expenses to effective gross income.

Problem: A building that has an effective gross income of \$75,000 and total operating expenses of \$12,000, has a net income ratio of? Answer: 0.84

The break-even ratio is the ratio of the operating expenses plus the property's annual debt service to potential gross income.

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Chapter 12

DIRECT AND YIELD CAPITALIZATION

In the income capitalization approach, property value is treated as a function of the NOI.

The formula for the income capitalization approach is: $\text{NOI} \div \text{Capitalization Rate} = \text{Value}$.

To find the required NOI a property must produce to provide a specific rate of return on investment, you can use: $\text{Property Value} \times \text{Capitalization Rate} = \text{NOI}$.

Question: Which approach would normally carry the most weight in valuing a strip mall? Answer: Income Capitalization

Question: If a buyer wants a 10% return on investment and is interested in a retail complex that produces an NOI of \$63,000 per year, what would the buyer be willing to pay for the complex? Answer: \$630,000

Question: To receive a 14% return on an investment of \$500,000, what would the NOI be? Answer: \$70,000.

To use the building residual technique, the appraiser must know the value of the land.

Chapter 13

RECONCILIATION AND THE APPRAISAL REPORT

In the cost approach, the cost of reproducing or replacing the structure less depreciation plus the site value was calculated.

In the income capitalization approach, value was based on the income the property should be capable of earning.

In the sales comparison approach, the utility of recently sold similar properties was compared with the appraised property and the sales prices were adjusted to derive an estimate of value.

Using all three approaches to value and assigning different weights to each approach is known as reconciliation.

The narrative style report is the longest and most inclusive. It includes the facts plus the appraiser's reasoning used to estimate the value of the property.

Chapter 14

APPRAISING PARTIAL INTERESTS

Leased fee includes the rights of a person who owns a piece of property but leases it to someone else.

In a triple net lease, the lessee most likely would pay for fire insurance.

In a gross lease, the tenant usually pays a fixed rental over the period of the lease, and the landlord pays all expenses of ownership, such as taxes, assessments, and insurance.

Under a net lease, in addition to the rent, the tenant pays part or all of the property charges, such as taxes, assessments, insurance, and maintenance.

A triple net lease, also known as a net, net, net lease, or absolute net lease, calls for a fixed rental payment by the tenant plus all operating and other expenses, such as taxes, assessments, insurance, and maintenance.

CAM – contribution to area maintenance

TI – tenant improvements

Valuations are appraisals

If there is a sub lessee who also has an interest (which may occur when scheduled rent is less than market rent), the middleman (the prime lessee) is referred to as a sandwich lessee.

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Chapter 15

APPRAISAL MATH AND STATISTICS

Problem: There were 400 foreclosures this year and 500 last year. What is the percent change?

Answer: Minus 25%. (Although minus 25% is wrong, it is apparently the answer they want on the test.)

Problem: A rectangular shaped building that is 35' wide and 55' long has a perimeter of?

Answer: 180'

Problem: The cost to pave a driveway that is 18' wide and 330' long at \$8.25 per square yard would cost how much?

Answer: \$5,445

The deviation is the measure of how widely the individual variates in a population vary. (See the top of page 349)