ACE Valuation

A Real Estate Pro's Guide to Valuation Methods of a Property

CMA's, BPO's, & What to except when you are expecting…A good appraisal

A.C.E.
ELITE DEAL CLOSERS

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Learning Objectives

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

1. List the 3 methods most commonly used to value a property.
2. Choose the correct valuation method when providing a customer with a market estimate of a property.
3. Provide an overview of the Replacement Cost method.
4. Provide an overview of the Income Valuation method and formula.
5. Provide a seller/customer with an overview of the Comparable method and why it utilized most often.
6. Provider a seller/customer with a suggested listing price by calculating a property's value using given variables (class exercise).
7. Calculate price per square foot.
8. Explain to the customer why some items are 'adjusted' and what that means for their listing price.
9. List the ways in which a BPO differs from a CMA.
10. List ways that you can serve your customer best during the appraisal process and in communicating with the appraiser.
11. Describe actions you can take when a property you are working with appraises lower than expected or needed for financing.
12. Describe what a "CAP rate" is and why it's important.

Timeline

Introduction	10 min.
Chapter 1: Where do values come from?	30 min.
Chapter 2: Using the comparable method	30 min.
Chapter 3: Comparative market analysis	30 min.
Chapter 4: Brokers price opinion	15 min.
Chapter 5: Appraisal	15 min.
Chapter 6: Using the Income approach	20 min.
Total	150 min. (3hrs CE)

Introduction

Forward

VISION

In our extensive interaction in the real estate market both as consumers and practitioners we have had the experience of seeing both the highs and lows of service and professionalism in the real estate industry.

One common thread we have realized is that professionals close deals and closers are professionals.

We developed our courses as a means of setting a definitive road map guiding Realtors to recognize and develop the practices that are common to professional “deal closers”.

Our mission is to bring a level of professionalism into a profession that at times sorely needs it. We are the caretakers of our clients’ most valuable assets and as closers, as an ACE (Accredited Closing Expert) we hold this trust sacrosanct.

That being said, we have attempted to use a little humor throughout this book to make it a little easier to read. Some may say this is unprofessional as professionals never laugh, wear a permanent scowl, and eat nothing but a diet of rusty nails. The subject matter we go into here is often dense and we wanted to take some pity on you having to read all of this. We hope a little levity will not only make it a bit of fun but also help you to remember it.

Expectations from attendees of this program:

- To endeavor to conduct every transaction in the most professional and effective manner for, most importantly, the consumer (customer) but also extending to the other professionals with whom the transaction requires you to interact.

- To continue to educate yourselves at all times on the ever-changing aspects, both legal and market related in their industry.

- To clearly keep in mind the goal of the transaction and not get bogged down in the minutia and personalities that tend to distract from that.

- To find solutions and solve problems not to doubt and aggravate issues.

- To not be afraid to say “I don’t know” once but never twice.

- To work within the realm of your expertise.

Purpose of this Course

To give you the tools to build a strong real estate business, with exceptional customer service, and advertising that is both compelling to the customer and compliant with the ethical standards we have. We will give you the tools necessary to avoid all the distractions and superfluous activities that can get in the way of closing customers for life.

Overall goals for the Real Estate Professional

Confirm that you are comfortable with losing the time required if you are going to commit the crime.

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Chapter 1:

Where do values come from?

There are **three** main methods of valuation for real estate that are employed. There is more than one method as no single method alone that can give a value for all types of property. The methods of valuation that are commonly used are:

1. Replacement cost
2. Income
3. Comparable

What will determine the method to use will be the type of property, if there are enough comparables, and if the property generates income. The most effective way to tell what something is worth is to see what someone will pay for it when exposed to the open market. Theoretically this gives you the true value of the thing you are trying to sell. The problem comes in for the person doing the valuation if they are not worried so much about who is buying the property now but instead who will buy the property the next time. The issue is maybe the person that agreed to the current price is overpaying. If that is the case the bank, insurer, or whoever the valuation is for may have an incorrect opinion of value if they rely simply on what one person is currently willing to pay for the property today. For this reason, they use the next best method of determining value. They will compare and average other similar sales in the area. This ensures that the buyer willing to offer you the best price for your house is not alone in their opinion of value of similar properties. The method we are discussing is called the is called the comparable method and will discuss it more shortly.

The comparable method is the best way to ensure the properties' value matches what the market is willing to pay, but there is an issue; what if the buyer is buying in a place that does not have enough comparable sales to compare to? If the buyer is an investor and is buying an income producing property, like an apartment complex, typically there are not enough of those in the immediate area that have sold in the past few months to give a good picture of current market value. When this occurs we have to look at a different method of valuation, and that is called the income approach. This method looks at the rate of return investors in the general area are willing to exchange their money to purchase properties . This method of valuation is called the income approach to value (or income approach), and we will look at this more in depth later.

The income approach is also very accurate in determining what investors will spend to buy a given property. What if you were looking to get a value on a building that didn't have comparable sales and did not generate income (or an income that is less than what an alternative use might be). Let's say you were asked to give an opinion of value on a building that is used as a public library. How the heck would we figure out what that is worth?

This brings us to the last of the three valuation methods, replacement cost. Below are the main tenants of using the replacement cost method to determine a property's value.

The first thing to know about the replacement cost method of valuation is that it is the least commonly used method. So why are we talking about it? This is a class on valuation of real estate. If there is a method of finding a value on real estate, **you as a real estate professional should know it regardless of how frequently you get to use it.** You are supposed to be the expert, so here is a chance to make sure you are one. The next thing to know about this method is when to employ it. You will use this in the case of a property that does not have enough recent comparable sales to provide us with a value, and also does not generate income comparable to the property's potential. The way to do this valuation requires a construction estimate to rebuild the property from scratch. We then add the value of the land. Finally, we subtract any depreciation. So, if the building is not brand new, we are going to say that over time the building has worn down, and therefore is less valuable.

So, let's work through this from the top.

- Let's say construction costs for this type of building are $175.00 per sq. ft.
- The building is 100,000 sq. ft.
- The land the improvements are sitting on is worth about $2Million.
- We would multiply our construction cost by the number of square feet we would need to build $175 x 100,000 = to get our building cost of $17,500,000.00.
- We then add our land cost of 2 million to get a total value of $19,500,000.00 (total new construction plus land value).

Now we need to decide how to depreciate this property.

- The first thing we know is if the property is residential or non-residential.
  - If it is residential, we can depreciate the improvements over 27.5 years and non-residential over 39 years. (This applies only to the improvement portion of the property. We cannot depreciate the land.)
- In this case, let's say this is a library (so that is non-residential) that is 20 years old.
- We will take our 17,500,000.00 and divide it by 39 years to get the annual depreciation: $448,717.95.
- We now need to multiply that by the age of the building 20 (years old) x $448,717.95 (annual depreciation) = $8,974,359.00 (total property depreciation.)
- We now subtract our total property depreciation ($8,974,359.00) from the total new construction plus land value ($19,500,000.00). This gives us a replacement cost value of $10,526,641.00.

This method is very theoretical and much less precise than the other methods used as construction cost are not always aligned with what people are willing to spend for things right now. Also, the depreciation of the building is also theoretical. While things do wear down that does not mean this property actually went down in value. For these reasons and others the replacement cost approach is the least effective method of valuation. It is however the best method we have when the reasons we initially cited are present and preclude our ability to use the other two methods we mentioned. Let's practice this one though before we move on.

CLASS EXERCISE

- Building is 50,000 sq.ft.
- Construction costs are $200 per sq. ft.
- Land value is $2,000,000.00.
- Building is commercial/non-residential for depreciation.
- Building is 10 years old.

What is the property's value ?

The Income Approach

When we enter the world of investment property, we always need a very accurate way to determine what a property is worth. The issue is, if you are looking to buy a car wash for instance, it is very difficult to find a lot of carwashes of the same size, that have closed in the immediate area, in the recent past. For this reason, we need to be able to compare properties of different sizes and in different areas easily. We do this by comparing the ratio of how much the investors spent to buy properties in the area versus the net income those properties provided. Here are the things to know about this method of valuation:

This is a very common method of valuation.

It is used on investment properties

It compares the property's income to the typical market rate of return for a similar property.

The formula for this is Net income/Market rate of return = Value

This is used to eliminate the issue that there are far fewer commercial sales.

Also income properties are vastly different.

Risk is different based on different business types and the market rate of return already has that risk figured in

Higher risk = higher rate of return = Lower purchase price

One of the very nice things about this method is it looks at the thing most investors are most interested in (the return on investment) and it uses that to determine what the property is worth. It also is using the net rate of return which means losses to collections, vandalism, or property damage are already addressed in the properties expenses. This means this method not only takes into account the return but also the risk associated with achieving that return.

The income approach formula is: Net Operating Income/Market rate of return = Property Value

CLASS EXERCISE

Income approach valuation

Market for this type of property is an 8% rate of return.
Property has Net operating income of $22,000.00 per year.
What is the value of this property?

The Comparable Method

This is the method of valuation most often used in residential real estate. For this reason, we are going to spend a lot of time in the next several chapters discussing the various permutations of the comparable method we will run into in the real estate business. CMA's, BPO's, and appraisals are typically done using the comparable method. It compares prices paid for similar properties and determines what the price for the subject property will be based upon. The comparable method is pretty needy though. It needs several things in order to be most effective. Below is a list of the things needed in order for the comparable approach to work.

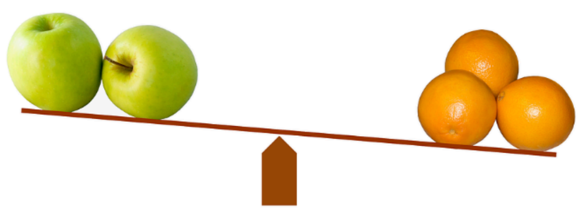
- Requires a lot of market activity.
- Requires similar properties.
- Requires similar usually close location to the subject.
- This method requires adjustments to the comps to allow for differences between the subject and the comparables.
- Should be very accurate as it compares what people have actually paid for a similar property in the area.
- Requires the use of the most similar comparables.

As you can see there is work to be done to make the comparable approach produce an accurate value for us. This work we have to do is what makes for differences in the opinions of value that we see. So, let's get to it in the next couple of chapters and see how we use this method most effectively.

Chapter 2:

Using the comparable method

To use the comparable method there is a specific set of rules "the book" says we should follow. This is to ensure that valuations are as similar as possible when using this method. Nothing is more annoying than doing a valuation for a property only to forget and do it again and come out with a different value. This standardized set of rules is supposed to fix that. (Notice I said supposed to.)



- We will compare the most similar available and sold properties to the subject.
- We will make adjustments for things that are better or worse than the subject.
- We will always adjust the comp.
- We will make sure not to double adjust (sq.ft./bedroom/bathroom count)
- We will give our greatest weight to closed comps.
- We will make sure the comps are similar types of sales (arm's length, related party, distressed, etc)

The first thing on the list and probably the most important thing we need to have to use the comparable method is we need to have comparable properties to compare our property to. That was kind of obvious guys. It's right there in the name. So how do we make sure to have the most similar properties to compare our subject to.

Here are a the most important factors to property value and thus the things we want to be most similar:

Most recently sold

- Closed sales within the last 90 days.
- Go longer if there are not enough.
- Going longer can give you a picture of the markets trend over time.

Closest proximity

- Within a ¼ mile (if not enough ½ mile is fine)
- Same neighborhood if possible
- Same subdivision
- Same development
- Same building

Similar bedroom and bathroom count

Closest sq.ft.

Making adjustments for size/ beds& baths

- Look for how much a certain amenity affects the closed sale prices of home.
- Bigger homes typically sell for more than smaller ones.
- Divide the sale price by the sq.ft. to get the price per sq. ft.
- Average this for your most applicable closed comps and then apply to the subject.

*If doing a sq. ft. adjustment do not adjust for bedroom/bathroom as well or reduce adjustment amount. Theoretically a 3/2 at 2200 sq. ft. will sell for less than a similar 4/3 of the same size.

Class exercise: Price per sq. ft.

- Comp A 2200 sq. ft. 3/2 home sold for $300,000.
- Comp B 2600 sq.ft. 4/3 closed for $365,000.
- Comp C 2285 sq. ft 3/2 home closed for $320,000.
- The subject is 2400 sq ft 3/2
- What is the price per sq ft of each one?
- What is the average price per sq. ft.?
- What is the average price per sq. ft of the 3/2’s only?

Most similar style

- A two-story house may be desirable.
- Tile roof vs shingle roof
- Mediterranean vs colonial
- Garden apartment vs high rise
- To determine this we want to look for instances where there are most similar sales and adjust.

If I find an 1800 sq. ft. colonial that closed for $25,000.00 less than the Spanish villa style home of the exact same size in similar condition I have a basis for an adjustment

Most similar year built:

Does this matter? You bet your back side it does!

- Newer homes usually sell at a premium.
- Are normally less expensive to heat/cool.
- Are less expensive to insure.
- Are normally built to suit the more recent trend in taste.
- Are normally preferred by buyers.

Most similar location

- An example of a location issue would be A home on a main street.
- It is better comped against the difference in price a home a little further away also on a main street sold for compared to the other homes in its neighborhood.
- This will give us an idea of how much of a negative adjustment to make for our home being on a main street.

Class Exercise: Location adjustment

- The subject is in a cul-de-sac and none of the ones in the neighborhood that sold are.
- The average home in the neighborhood is selling for $345,000.
- There is a cul-de-sac home in the neighborhood next door that is a bit older that sold for $275,000.
- The average closed home in that area is $260,000.
- What should the adjustment be?
- There is more than one way to do it.

Most similar lot size

- Not always adjusted for
- If lots are of similar size i.e. 9,500 sq. ft. vs 11,000 sq. ft. no or minimal adjustment will be made
- If the lots sizes get larger then adjustments become necessary 12,000 sq. ft. vs ½ acre
- Check to see if there are major differences in the sold comps that have to be attributed to the lot size

Most similar view/waterfront

- Huge adjustment items especially in condos
- Can be a 30% or greater adjustment made just based on the unit view.
- Waterfront properties are more desirable than those without it.
- Make sure to note which properties have a water view and which don't.
- Try to only use properties with a similar view or develop an adjustment amount for the view.

Most similar extras (pool, deck, dock, valet, etc.)

- My building has a gym.
- Well my building has a door man.
- Well my building has a spa with free massages.
- Well my building has a guy that follows you around all day to tell you what a wonderful human being you are and rub your shoulders when you get stressed.
- Buildings have different amenities.
- Whenever possible always comp within the same building or development.
- This removes the need to make arbitrary adjustments for the value of amenities.
- It also allows your valuation to be more accurate.

- If we are comping a home with a pool vs one without we will use the methods discussed before to get our adjustment amount.
- Many times with homes there will not be another recently sold home with this amenity.
- You may need to go back to older sales to try to determine a valuation for these extras.

This last point highlights something that makes the comparable approach more like art than science at times, despite its best efforts not to be. Adjustments can be messy. Not everyone uses the same data to value their adjustments. When making multiple adjustments on comps this makes for the potential for a wide variation in value. Here are some things to keep in mind:

- Amounts for adjustments are not always cut and dry.
- In theory a pool or 4th bedroom should have a market value but determining it isn't easy
- Maybe our adjustment was too big or small.
- Maybe there was info about the sale we didn't know (sold to their cousin)
- Maybe someone just got a good deal (why did the 4/2 sell for less than the 3/2 of the same size in the same condition a week apart)
- Different values on adjustments often lead to discrepancies between appraisals.

Another idea we just alluded to was that different types of sales matter. If I am selling a distressed property, it would be best to comp it (compare it) against other distressed sales. If I am looking for a good valuation on the arm's length transaction, I am doing for my customer I don't want the appraiser including the sale of a home between family members or a distressed sale either. Both of those sales have different motivations than my seller which will affect how much the seller will take for the property. For this reason, you always want to make sure that non-distressed and arm's length sales are what is being used when you are trying to value a traditional sale property.

In the next chapters we will look at the specific things we typically do in real estate that bring us into contact with the comparable approach and discuss how to specifically handle them:

Chapter 3:

Comparative market analysis

The CMA (comparative market analysis) is one of the most commonly used tools in a real estate agents arsenal. It is supposed to be a valuation done by a real estate market professional to give an owner or potential buyer a high-level opinion of value. These CMAs are usually done at no cost. On the listing side they are used as a basis for pricing the property, and on the buyer's side as guidance for how much to offer. The ultimate goal with a CMA is to figure out how much the home will appraise for and have our value match that of a future appraisal. We know what things make properties most comparable from the previous chapter. Now we need to know what things to include in our CMA.

Included for sure:

- Active comps
  - Show what the competition is doing.
  - Shows what people have to this point been unwilling to pay for properties they have access to.
- Closed comps
  - Shows what successful sellers had priced their property at.
  - What someone has chosen to pay for a similar type of property recently in the area.
  - Is the only true metric of value we have for this method.

Optional Items to include:

- Pending
  - What price people listed at to get a successful offer?
  - How much recently active inventory has gone pending recently.

- Too many pending can let us know if there might be closing issues.

- Expireds
  - What people listed for and did not sell for?
  - How long they listed for
  - Can let us know if a market has a lack of activity.

The issue with CMA's often boils down to a sense from agents that the bigger it is, the better they look to the customer. **The fact that several sources will generate these gigantic CMAs for them with the bare minimum of work on their part and this is an easy trap for agents to fall into**. Agents know they need credibility, and they don't necessarily feel like they have the market knowledge to earn it. They think the giant CMA makes them seem more qualified to handle the customer's business and covers them for not having as much market knowledge as they feel like they should. The issue is that is not how the customer typically perceives it. The customers just see an overwhelming amount of data and basically find themselves needing to trust the agent as to what all this noise really says. The things to keep in mind are:

Customers are not agents

Less is more

More data doesn't actually help

Pending and expired data advises me but overwhelms them

I can refer to it but want to keep the process streamlined

For all of these reasons I have spent most of my career trying to minimize my CMA's. I want something easy to handle, understand, and explain. I used to include pending and expired listings. First I got rid of the pending listings as they didn't really help me to make much of a case with my customer. Pendings don't have any relevant data as to the actual sale price of the property which means the seller will look at the data as viable (the listing price) and think that is what the home sold for. This does not help me to make my case for a reasonable list price for the home. The next thing that had to go was the expired listings. Yes, they do show what overpriced homes there were and what they were listed for when they sat there for months and didn't sell. The thing is that is more data my customer needs explained to them, and I feel that can be done just as well with the active properties. **You see the active properties and the expired properties both have one thing in common: No one has agreed to pay the price they are asking for them.**

With these two items gone and seeing no need to add pictures or superfluous data the CMA I currently use which has been most successful for me looks something like this:

Josh's Property Grid

Distance		ML #	St	Address	Subdivision/Complex	LP$	SP$	#Beds	#FB	#HB	SqFt LA	TYPE	YR	#GAR	Pool	WTRFR	Lot SF	CD	CDOM
0.9 mi	1	A11032410	A	2517 Centergate Dr Unit#203	AVENTINE AT MIRAMAR CONDO AVENTINE AT MIRAMAR CONDO	$260,000		2	2	0	1,330	Condo	2003	1		No			18
0.9 mi	2	A10904655	A	220 SW 116 Ave Unit#15308	Marquesa Condo The Marquesa Condo	$245,000		2	2		1,130	Condo	1999	1		No			280
1.0 mi	3	A11026093	A	2071 Renaissance Blvd Unit#303	EL-AD ENCLAVE AT MIRAMAR Renaissance	$225,000		2	2	0	966	Condo	2000	0		No			33
0.9 mi	4	A10995137	CS	12011 SW 26th St Unit#109-1	MARTINIQUE #3 CONDO MARTINIQUE	$279,000	$274,000	2	2	1	1,241	Condo	2007	0		No		04/06/2021	39
0.9 mi	5	A10984033	CS	2669 SW 121st Ter Unit#705	MARTINIQUE NO 2 BLDG 5 MARTINIQUE	$254,900	$254,900	2	2	1	1,000	Condo	2007	0		No		02/26/2021	4
0.9 mi	6	A10975263	CS	2403 Centergate Dr Unit#206	AVENTINE AT MIRAMAR CONDO Aventine	$245,000	$241,000	2	2	0	1,205	Condo	2003	1		No		04/01/2021	66
1.0 mi	7	A10943409	CS	11177 SW 8th St Unit#107	DEVONAIRE CONDO AT PEMBRO DEVONAIRE CONDOMINIUM	$239,000	$230,000	2	2	0	1,065	Condo	2002	0		No		12/10/2020	13
0.9 mi	8	A11013671	CS	2445 Centergate Dr Unit#206	Aventine At Miramar Aventine at Miramar	$235,000	$241,000	2	2	0	1,205	Condo	2003	1		No		05/10/2021	46
1.0 mi	9	A10829093	CS	726 SW 107th Ave Unit#502	HAMPTON ISLES CONDO HAMPTON ISLES CONDO	$233,000	$224,000	2	2	1	1,170	Condo	2003	0		No		11/16/2020	157
1.0 mi	10	A10952090	CS	772 SW 106th Ave Unit#1910	HAMPTON ISLES CONDO HAMPTON ISLES	$230,000	$215,000	2	2	1	1,100	Condo	2003	0		No		02/16/2021	70
1.0 mi	11	F10278178	CS	2487 Centergate Dr Unit#205	AVENTINE AVENTINE	$225,000	$230,000	2	2	0	1,205	Condo	2003	1		Yes		05/04/2021	3
1.0 mi	12	A11025883	CS	2458 Centergate Dr Unit#101	AVENTINE AT MIRAMAR BLDG 8 AVENTINE	$220,000	$220,000	2	2	0	1,080	Condo	2003	1		Yes		05/07/2021	0
1.0 mi	13	A11015615	CS	2451 Centergate Dr Unit#304	AVENTINE AT MIRAMAR BLDG Aventine at Miramar	$214,900	$211,000	2	2	0	1,072	Condo	2003	0		No		04/30/2021	10
1.0 mi	14	A10954181	CS	2427 Centergate Dr Unit#204	AVENTINE AT MIRAMAR BLDG AVENTINE AT MIRAMAR BLDG	$214,900	$200,000	2	2	0	1,072	Condo	2003	0		No		12/16/2020	13
0.1 mi	15	A10943952	CS	2280 E Preserve Way Unit#203	EL-AD RESIDENCES AT MIRAM Residence at Miramar	$214,000	$203,000	2	2	0	977	Condo	2006	0		No		03/09/2021	89
1.0 mi	16	A10964334	CS	2427 Centergate Dr Unit#103	AVENTINE AT MIRAMAR Aventine at Miramar	$210,000	$205,000	2	2	0	1,072	Condo	2003	0		No		02/02/2021	48
0.7 mi	17	A10904335	CS	1200 SW SW 113th Terrace Unit#203	CLUB QUARTERS AT RAINTREE Club Quarters at Raintree	$205,000	$200,000	2	2	0	1,037	Condo	1989	0		No		11/20/2020	26
0.1 mi	18	A10941476	CS	2201 W Preserve Way Unit#205	EL-AD RESIDENCES AT MIRAM El-Ad Residences at Miram	$204,900	$202,500	2	2	0	977	Condo	2005	0		No		04/01/2021	149
1.0 mi	19	A10940007	CS	2103 Renaissance Blvd Unit#203	EL-AD ENCLAVE AT MIRAMAR ENCLAVE AT MIRAMAR	$197,900	$195,000	2	2	0	966	Condo	2000	0		No		11/25/2020	19
1.0 mi	20	A10924907	CS	2021 Renaissance Blvd Unit#206	EL-AD ENCLAVE AT MIRAMAR ENCLAVE AT MIRAMAR	$194,500	$187,500	2	2	0	966	Condo	2000	0		Yes		11/20/2020	35
1.0 mi	21	A10955044	CS	2163 Renaissance Blvd Unit#106	EL-AD ENCLAVE AT MIRAMAR EL-AD ENCLAVE AT MIRAMAR	$189,000	$189,000	2	2	0	826	Condo	2000	0		Yes		12/23/2020	7
0.7 mi	22	A10974044	CS	11251 SW 13th St Unit#102	CLUB QUARTERS AT RAINTREE Raintree	$185,500	$179,000	2	2	0	1,112	Condo	1989	0		No		02/22/2021	14
0.7 mi	23	A10901230	CS	1276 SW 113th Ter Unit#204	CLUB QUARTERS AT RAINTREE CLUB QUARTERS AT RAINTREE	$182,900	$175,000	2	2	0	1,037	Condo	1990	0		No		12/08/2020	107
1.0 mi	24	F10256767	CS	12601 SW 13 Unit#G304	CENTURY VILLAGE CENTURY VILLAGE	$150,000	$148,000	2	2	0	1,207	Condo	1990	0		No		04/12/2021	113

Chapter 4:

Brokers price opinion

During the post 2008 housing bubble crash one of the things that became a major topic in real estate was the B.P.O. (which stands for brokers price opinion). Real estate sales came to a near complete stop and one of the only ways to make any money was to do valuations for banks. The reason for this is that lenders had a huge number of non-performing properties. They did not necessarily know what those assets were worth. The normal method to determine the value of things for a lender would be to get an appraisal. The thing is, appraisals cost quite a bit of money (usually several hundred dollars), and with the huge volume of properties needed those appraisal costs would add up to a huge investment. So, lenders with lots of properties decided to go a less expensive route and pay real estate agents to do BPO's instead. **A BPO differs from a CMA in several ways:**

- BPO uses a standardized form.
- Much more time consuming than a CMA.
- Requires line-item adjustments.
- Requires price per sq. ft.
- Can be exterior (drive by) or interior.
- Requires pictures.
- Require a narrative of the market.
- Require a description of why adjustment was made.
- Requires reasons why the comps you used were the comps you used.

*Can't be generated by picking some comps in the MLS or RPR and then telling it which pages you want.

*Requires you to know the valuation process.

There is more than just one form as most lenders have their own that they like to use. The thing that is important to note is the presence of the form at all. If they asked three agents for CMA's the odds are that they would get three completely different formats. That would make comparison very time consuming for the folks ordering the BPO. They don't like to have their time consumed so they send a form which is very time consuming for us to fill out.

The reason why the BPO form is so much more time-consuming is the need to make line-item adjustments on every single comp for every single field where it differs from the subject and then to assign a dollar amount to that adjustment and then add all of those adjustments up to come up with an adjusted sale price. If that sounds less than fun, I am overselling how exciting it is. **Here are the things you will be required to do with a BPO:**

- Each comp has a column with room for adjustments
- You write down the details of the subject in its column
- Where the subject differs from the comp you make an adjustment for the difference
- When the column is complete you add up all adjustments and add or remove that amount from the sale price
- You will be asked for the sales price per sq. ft.
- You will be asked for the adjusted price per ft. too

Amongst the BPO family there are two main varieties: The **interior** (or full) BPO and the **exterior** (or drive by) BPO. These vary in how much time they take to complete and the amount of information that you will need to submit not to have the BPO rejected. A rejected BPO is a pain in the back side. We don't like pain there, so we want to get the BPO right the first time. Here are the major differences between the two BPO types:

- Exterior: Only outside pictures (normally each side of the house)
- Exterior: Limited knowledge so limited depth. (just a ballpark for the bank)
- Exterior: They use to value the assets they have, decide whether accept S.S., whether to sell the mortgage, etc.

- Interior: Requires pictures of each room plus exterior pics
- Interior: Want a much more detailed analysis
- Interior: Leaves less room for ambiguity
- Interior: Usually is the last step before listing the property for sale

The other major thing that a BPO requires us to do that is a pain in the neck and time consuming is a narrative describing the property, the market, and anything else we think is relevant. That may seem kind of fun to do….when you have only one to do. When they give you eight of them to do and you are getting paid $20-35 each you are not looking to write an epic novel. You just want to give them your opinion of value and move on. The things you will need to do in your BPO Narrative are:

- You will need to describe the market.
- You will need to describe the property.
- You will need to tie that description in with the comps you used.
- You will need to tie that description in with the adjustments you made.

*If your BPO came in significantly lower than someone else's be prepared to defend your opinion of price.

CLASS EXERCISE: DO A DRIVE BY BPO

- Review your provided exercise packet.
- Select the active and closed comps you will use.
- No pictures will be required.
- Property is a foreclosure.
- Has been vacant for 8 months.
- We do not know the interior condition.

*Remember it is about doing the best you can with the information you have and being able to justify what you put in the report.

Chapter 5:

Appraisal

The person that really decides what a buyer can pay for a property is not the seller and most often it is not the buyer either. It is the appraiser that decides on the market value of the property, and from that the bank determines what they will lend on the home. Why do appraisers get so much power? It is because they are the property valuation experts. Their job is to follow a standardized format called USPAP (Unified Standards of Professional Appraisal Practice) and determine a valuation for a property based upon a few different methods of valuation. So, it is probably a really good idea to understand how they do what they do to better enable us to keep them from messing up our deals. Here are the things to know about how an appraiser does their thing:

- They follow a standardized set of rules called **USPAP** (Uniform Standards of Professional Appraisal Practice)
- They are going to go through a process very similar but even more arduous than the BPO.
- They typically use all three methods of valuation.
    1. Replacement cost
    2. Income
    3. Comparables

Once the appraiser has done their valuation using all three methods they will determine which one yields the highest value and use that. This normally means they will be using the comparable method as it:

- Normally yields the higher sale price.
- Normally the appraisal is being done for an end user.
- Is the one that tends to lead to the truest valuation of the property.

Our appraiser has to basically do a more complicated BPO to give a valuation for our property. Now that we have done our own BPO we can get an idea of what that looks like. We now need to use our knowledge of valuation to help getting the appraiser to bring the value in where we need it be. Here are some thoughts to help get your appraiser to make you more happy and less sad:

- Meet the appraiser.
- Coffee and donuts don't hurt.
- Bring three active and three closed comps.
- Think of the BPO narrative process.
- They have to justify everything to the bank.
- Also bring the comps you don't want them to use and tell them why to disqualify them.

When it comes to working with anyone we need to consider what their motivation is. So, what is the motivation of the appraiser? To make your life miserable. Probably not. They have pressures from forces working on them that if we properly understand them, we can help turn the tide to our good. Here is a look at the motivations of an appraiser:

- They want to get paid.
- They don't want the bank busting their chops.
- If they are high they can get in trouble with the bank
- This would seem to make it so they would always come in low to be safe.
- Contested valuations and complaints from agents counteract the tendency to be too conservative.
- We need to understand them and help them make the case.
- It makes their job easier and shows them you know valuation and will probably contest a low appraisal.

Remember sometimes appraisers flat out make mistakes…as do we real estate agents. We want to be able to get them to correct those mistakes if we can without making then look bad as that is really counterproductive. When appraisers make mistakes, this is typically how they do it and what you need to do about it:

- They use bad comps.
- Don't adjust for something that makes a huge valuation difference.
- This is when you contest the appraisal.
- You need to have your data tight and never make it personal.
- Make sure to show why your comps are a better fit.
- Or why your adjustments are more accurate.

When it comes to working with appraisers our best goal is to try to get them on our side and we do this not by being annoying whiney agents but by making their jobs easier if we possibly can. Everyone likes to be understood and thought of. **When you show up with not just the comps you want them to use but the ones that you think are not as good and the reasons why, you show them that you understand and appreciate what they have to go through and have done your best to make their lives a little bit easier.**

Chapter 6:

Using the Income approach

The income approach to valuation is a very important means of determining property value. It centers around what the property earns in income and how much other investors have been willing to pay recently for similar amounts of income. The thing that makes this method so interesting is it takes into account the two things that most interest investors.

- Risk
- Return

This takes into account investment risk because it is basing its valuation on similar types of properties in a similar asset class. One thing this method of valuation requires us to do is to determine an asset class for the subject property and then:

- Risk is assumed to be the same.
- Appreciation is assumed to be the same.
- Rent appreciation is assumed to be the same.

In other words, if we determine our rental property is a "C" property an income valuation will be based upon what other investors were willing to pay for the income of similar income property in a similar neighborhood. You may think this sounds just like the comparable method and to this point you'd be correct. The major difference is the income approach does not compare sale prices but instead the rate of return the property generates. In other words, this method is comparing the ratio of dollars of net income the property generates by the number of dollars invested to generate those dollars and comparing that ratio to other investments. This allows us to compare a $150,000.00 single family home sale to a $255,000.00 duplex to see if the price makes sense. To do this we would just need to know the net income for the closed sale and compare that to the purchase price to develop our ratio and then compare that to the income the duplex generates to see if our $255,000.00 price is too high or too low.

This covers the risk side as other investors have already priced that risk into their purchases and our valuation is based upon their post risk assessment purchase price. It also addresses returns by basically ignoring them as it is conceding the appreciation and rental increases will be similar across similar asset types in similar areas. **This leaves us with two very simple formulas to determine what our properties value is.**

- **Cap rate = Income/purchase price= Rate of return**
- **Income valuation= Income/market rate of return= Market value**

We use the cap rate to determine what the market ratio for income versus purchase prices of sold investments are. We then use the second formula to apply a value to our subject property based upon what the market values our income is at. Unfortunately, this sometimes requires us to tidy the numbers up. What if the property is vacant? Then there is no income. How would we value that. We would start with finding out what the market rent would be based upon rental comps in the MLS or other data source. Then we would proceed to the chart below:

Definition	Term
Purchase price: How much the investor paid for the property with all closing costs added	PP
Gross Potential Income: What the property earns if rented 100% of the time with no vacancy.	GPI
Vacancy Factor: An amount we remove based on the market that accounts for the property being vacant part of the time	-Vacancy Factor
Gross Operating Income: The total gross income the property can expect to make in a year	= GOI
Real Estate Taxes: What you pay the state government for the privilege of owning real estate	-Taxes
Insurance: What you pay to insure against hazards and risks to the property such as fire or vandalism	-Insurance
Repairs and Maintenance: What it costs to keep the property up and running	-Repairs
Miscellaneous: Expenses that were paid for the property that did not fall into any of the above categories	-Miscellaneous
Net Operating Income: The amount of money left in our bank after all rents are collected and all bills paid.	= NOI

Let's look at how we determine market cap rate. There are a couple of ways of doing this:

Sold method: (Accepted Cap Rate)

- See what several recently sold properties income properties have sold for.
- See what those properties are renting for.
- Estimate and subtract expenses to get the NOI.
- Divide the NOI by the sale price to get the cap rate.
- Average all cap rates to get the market cap rate.

Available method: (Offered Cap Rate)

- Look at several available investment properties.
- Look at the current GOI.
- Look at the projected GOI.
- Estimate and subtract expenses to get NOI.
- Divide NOI by purchase price to get cap rate.
- Average cap rates to get market cap.
- Decrease cap rate slightly to allow for negotiated price.

The sold method is by far the superior one, but sometimes in a hot sellers' market a more aggressive cap rate could be used, and the available method is a way of arriving at that cap rate.

Class Exercise: What is the market cap rate?
Market vacancy is 5%

Closed sale A	Closed sale B	Closed sale C
$240,000.00	$280,000.00	$268,000.00
Market rent $2,300.00	Market rent $2,650.00	Market rent $2,500.00
Expenses $7,800.00	Expenses $9,400.00	Expenses $8,350.00

Closed A _____________

Closed B _____________

Closed C _____________ Average _____________

Class Exercise: What is the market cap rate?
Market vacancy is 5%

Available A	Available B	Available C

• Asking $295,000
• Current rent $2,300.00
• Projected rent $2,500.00
• Taxes 2% of PP
  • rounded down
• Insurance 1.25% of PP
• Repairs .75% PP
	• Asking $195,000
	• Current rent $1,700.00
	• Projected rent $1,750.00
	• Taxes 2% of PP
	  • rounded down
	• Insurance 1.25% of PP
	• Repairs .75% PP
		• Asking $245,000
		• Current rent $1,950.00
		• Projected rent $2,200.00
		• Taxes 2% of PP
		  • rounded down
		• Insurance 1.25% of PP
		• Repairs .75% PP

Closed A Current _____________ Projected _____________
Closed B Current _____________ Projected _____________
Closed C Current _____________ Projected _____________
Average Current _____________ Projected _____________

Conclusion

- Valuation is central to the successful purchase & sale of real estate.
- Customers want to hire a real estate market expert.
- Any real estate expert should know what things are worth.
- All agents want to be paid like experts.
- They market themselves as an expert.
- In doing so many misrepresent themselves and thus defraud the customer.
- Don't be them.
- Be the agent that knows your market and knows what things are worth.

Your goal should be just that, so each day **strive to have the best information available to help your customers make the best possible decisions** when it comes to their purchases and sales of property. To be their true 'go-to' person for real estate.