Chapter 18 Summary
Appraisal and Valuation – Introduction

California Real Estate Principles

Competitive Market Analysis (CMA): Real estate salespeople are called upon to provide comparable sales to a seller who wants to list a property for sale.

Real Estate Appraisal is an estimate or opinion of value, based on time and effort of the appraiser, never on the established price of the property.

Appraiser’s Ground Rules: payment must be in cash or its equivalent; Buyer and seller must be unrelated and well-informed consumers.

The appraisal process:

- **State the problem.** The appraiser determines why he/she has been hired to make an appraisal on the property.
- **Gather, record, and verify** the necessary data using all of the tools available.
- **Analyze and Interpret** using the following information:
  - Neighborhood Analysis: A gathering of facts about a neighborhood to determine the appeal to the buyer.
  - Neighborhood Cycle: The process of neighborhood change, involving the four phases of change.
  - Site Analysis: A gathering of facts about a particular location.
- **Estimate Land Value** - For appraisal purposes, land never depreciates in value.
- **Estimate the value of the property** by each of the three approaches to value:
  - Market Data (sales comparison);
  - Cost (or Summation);
  - Income.
- **Reconcile estimated values** for the final value estimates - the appraiser reconciles the estimates of value received from the sales comparison, cost, and income approaches to arrive at a final estimate of market value for the subject property.
- **Report final value estimates** - Types of Appraisal Reports: Letter; Short or Form and Narrative.
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Principles of Real Estate Value:

- **Highest and Best Use**: The possible use of a property that would produce the greatest net income and thereby develop the highest value.
- **Substitution**: The maximum value of a property tends to be set by the cost of purchasing an equally desirable and valuable substitute property.
- **The Law of Supply and Demand**: The value of a property increases when the supply is short and decreases when there is too much.
- **Conformity**: An appraisal principle of value based on the concept that the more a property or its components are in harmony with the surrounding properties or components, the greater the contributory value.
- **Regression and Progression**: Regression and progression occur between dissimilar properties.
- **Anticipation**: Property can increase or decrease in value in expectation of something in the future, such as appreciation or rezoning.
- **Contribution**: Means the value of any component of a property is what it gives to the value of the whole or what its absence detracts from the whole.
- **Assemblage**: The combining of two or more adjoining lots into one larger tract to increase their total value.
- **Competition**: When one business attracts another business of similar type; together they may make more money than they would have singularly.
- **Change**: Real property is constantly changing—expanding, stabilizing, declining or being reborn.

**Sales Comparison Approach** (Market Data Approach) is used for appraising residential property or vacant land (compares property to similar properties and makes adjustments).

**Cost Approach** (Summation Approach) is used on buildings that do not have market data because they are unusual properties (building without income).

- **Reproduction cost**: To replace with the same materials as original construction.
- **Replacement cost**: To replace with current materials and methods with utility and function similar to original.

**Cost can be determined** by square foot cost; Unit in place and Quantity survey method.
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Depreciation: a loss in value due to any cause; any condition that adversely affects the value of an improvement. There are 3 types of depreciation:

1. **Physical deterioration** - A reduction in utility or value resulting from an impairment of physical condition; can be divided into either curable (painting/routine maintenance) or incurable types (installing siding on a building which also needs major interior repairs).
2. **Functional obsolescence** – A loss of value of an improvement due to functional inadequacies, often caused by age or poor design. May be attributable to such things as outmoded plumbing fixtures, inadequate closet space, poor floor plan, excessively high or low ceilings, or antiquated architecture.
3. **Economic, environmental, or external obsolescence** - A loss of value (typically incurable) resulting from extraneous factors that exist outside of the property itself; a type of depreciation caused by environmental, social, or economic forces over which an owner has little or no control.

**Effective Age**: Differs from the actual age (chronological age) by such variable factors as depreciation, quality of maintenance, and the like. Chronological Age: Actual age in years of the building, based on building date.

**Physical Life**: Actual age or life of a structure that is considered habitable as opposed to economic life.

**Economic Life**: Estimated period where an improved property will yield a return over and above economic rent. The Income Capitalization Approach is a value based on the present value of the rights to future income (for income generating properties).

**Appraisals in California**:
- The estimate of the cost of replacing a building is usually made by the square foot method.
- The appraisal of mobile homes attached to foundations on individual lots uses the same approaches as for other residential properties, and the market data approach works best in this appraisal effort.
- Any appraisal for a real estate transaction that involves federal insurance OR assistance MUST be undertaken by a licensed or certified appraiser.
- The appraiser must have a special license or certificate issued by the California Office of Real Estate Appraisers.

In California, there are four levels of licensing for real estate appraisers: **Residential License/Certified Residential/Certified General** and **Trainee License**

Real estate appraiser licenses are **valid for two years**.