Introduction

Probably the most asked question in real estate is, “How much do you think it is worth?” Every day a client or customer will ask about the fair price or fair rental for a property and an agent must be prepared to answer knowledgeably. Some of the most important services a listing agent can provide are to be familiar with how the worth of property is determined and to be able to explain it to the client.

Most homeowners know, within a range, the value of their homes. They probably are not aware they have used some of the same techniques the listing agent and the professional appraiser will use in determining the value of their home. For example, they may know the selling price of their neighbors’ house, and the selling price of the house down the street. They have added to—or subtracted from—the value of their own house, depending on amenities, location and condition to come up with a pretty accurate value, if they are being honest with themselves. This unit will examine the appraisal process and the methods used to determine property values so that you as an agent can answer when a client or customer asks the question, “How much do you think it is worth?”
This unit discusses the appraisal process, the forces that influence value, principles of valuation, and approaches of appraising property. In addition, you will become familiar with appraisal licensing standards and professional appraisal organizations.

**Learning Objectives**

After reading this unit, you should be able to:

- discuss the appraisal process.
- name the elements and forces that influence real estate value.
- explain how depreciation influences real estate value and how to calculate depreciation.
- describe the methods used in determining real estate value and the steps used in each method.

**Definition of Appraisal**

An **appraisal** is an unbiased estimate or opinion of the property value on a given date. **Value** is the present worth of rights to future benefits that come from property ownership. An appraiser gives his or her opinion of value in a written statement called an **appraisal report**. It is the conclusion of the appraiser’s research and analysis of all relevant data regarding the subject property.

Most of the time an objective and third-party opinion are needed to determine the value of real property. The professional appraiser because of training, experience, and ethics, is responsible for giving clients an objective opinion of value, reached without bias. An appraiser has a serious responsibility to be correct in evaluating data and not allow other factors to influence evaluation of a property. The appraiser must remember to be a neutral party, responding only to the forces affecting value and not to any other special interests who might want to influence his or her judgment.

An appraisal can be made for many different purposes. There are several reasons for determining the value of a particular property. The estimate of value may be different depending on the reason for ordering the appraisal. The condemnation value is going to be different from the taxation value, the insurance value, or the market value. An appraiser must know what

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**Purpose of an Appraisal**

- Taxation
- Insurance
- Condemnation
- Financing and credit
- Transfer of property ownership
those differences are and how to estimate the value of a property based on the purpose for which it is being used.

The purpose of the appraisal is distinct from the intended use of the appraisal report. The purpose of the appraisal helps define how the appraisal process will be laid out. The intended use helps decide which report type is most appropriate for communicating the results of the process.

**Definition of Value**

**Value** or worth is the present and future anticipated enjoyment or profit from the ownership of property. It is the relationship between the thing desired and the purchaser. It is also the power of one commodity to attract other commodities in exchange.

Sometimes market price, cost, and market value are the same, but this is misleading. **Cost** represents expenses in money, labor, material, or sacrifices in acquiring or producing something. **Market price** is the actual sales price of the property, while the price for which the property should sell is its market value. Market value has very little to do with the original cost. Neither cost nor appreciation is considered an essential element of value.

The conditions of the sale affect the price, such as good financing or a forced sale. The circumstances of one buyer and one seller may affect the sale of a specific property, giving it its own value, apart from some other similar parcel. The job of an appraiser is to determine the special factors of a sale and assign a value based on each individual transaction.

Example: Pamela and John wanted to buy their first house. They looked at several with their real estate agent and finally decided on one that was beyond their means. They made a hopeful, low offer. Unknown to them, the seller lost his job and was desperate to sell. He accepted their offer, which was well below market value.

In the above case, the sellers did not sell freely for market value, and the sales price only reflected their desperate situation, not the real value of the house.

**Types of Value**

The value of a parcel usually can be categorized by two basic types of value—market value and value in use.

**Market Value**

Real estate includes both land and anything belonging to the land, as well as rights or interests in that land. The price a property would bring if freely
offered on the open market, with both a willing buyer and a willing seller, is known as market value, or fair market value. Market value is sometimes called the objective value, since it may be determined by actual data.

A property that is offered for sale as a result of default, foreclosure, bankruptcy, divorce, death or any other unusual circumstances cannot be said to be freely and willingly offered on the open market, and the sale price of such properties would not represent fair market value. An appraiser would take into account that there were special circumstances in those sales and would not use the price paid as a comparable measure of value.

Review - Fair Market Value

- Buyer and seller are operating in their own interest.
- Buyer and seller are knowledgeable about the transaction and make careful decisions.
- The property is available for a reasonable time on the open market.
- The sale is for cash or trade or is specifically financed.
- Normal financing, available to qualified borrowers, is used.

Value in Use

Value in use (also known as utility value) is the usefulness of the property to a specific user. For example, a six bedroom home may not be useful to a couple with no children. Features that add value to a property are called amenities. However, due to the subjective nature of the user’s preference regarding amenities, value could actually decrease. This is called subjective value. For example, before listing a home, the owner remodeled the bathroom using her favorite color, lime green. If the prospective buyer also likes lime green, they may be willing to pay more for the home with the remodeled bathroom. However, a person who prefers neutral colors may overlook the value of the remodel and offer considerably less for the home or look for a lower priced, comparable property.

Elements to Create Value

There are four elements of value, all of which must be present for a property to have market value. They are demand, utility, scarcity, and transferability. Demand is the desire to buy or obtain a commodity. Effective demand is desire coupled with purchasing power. Demand and purchasing power available will affect the value of a property. Utility is the ability of a property to satisfy a need or desire, such as shelter, income, or amenities. Functional utility is the combined factors of usefulness with desirability. Scarcity refers to the availability
of a commodity in the marketplace. An oversupply diminishes value whereas an undersupply (or increased demand) increases value. **Transferability** means that title to the property is unclouded and marketable.

Each element by itself cannot create value. For example, something may be scarce, but if it has no utility there is no demand for it. Air has utility and may be in great demand, but is so abundant that it has no commercial value.

The appraiser must decide if there is a demand for a property, such as a high-rise residential building, or a low-cost housing project. Can it be used for the purpose it was intended, such as a family home or residential complex? How many projects like this one are there in the area? The fewer there are, the more value the subject property has. Is the title clear, and can the seller easily give ownership to a buyer? As you can see, all of these factors are important in assigning a value to a property. An appraiser must hold each one up to the property in question to arrive at a correct estimate of value.

**Forces Influencing Value**

The essence of life is change, and real estate is not excluded from that force. Value is created, maintained, modified, and destroyed by the relationship of the following four forces: physical characteristics, economic influences, political or governmental regulations, and social ideals.

**Physical Characteristics including Environmental Forces**

**Physical characteristics** are also called external characteristics. This includes quality of conveniences; availability of schools, shopping, public transportation, churches; and similarity of land use. **Environmental forces** may be climate, soil, topography, oceans, and mountains.

**Location:** This may be the most important factor influencing value, as far as highest and best use. Another term used to describe where the physical location of property is **situs**.

**Size:** The use of a property may be determined by the width and depth of the land. A **depth table** is used to estimate the value of commercial properties.

**Corner influence:** Commercial properties benefit from more exposure, while residential parcels may lose privacy and incur higher maintenance costs from increased frontage.
Thoroughfare condition: Width of streets, traffic congestion, and condition of pavement affect the value of properties fronting on those streets. The term front foot defines the width of a property along a street.

Exposure: The south and west sides of business streets are usually preferred by shopkeepers because customers will seek the shady side of the street and window displays will not be damaged by the sun. The north and east sides are less desirable.

Orientation: Orientation is the placement of a building on its lot in relation to exposure to sun, prevailing wind, traffic, and privacy from the street.

Plottage increment: By putting several smaller, less-valuable parcels together, under one ownership through the process of assemblage, the value of the parcels will be increased.

Shape: Irregular-shaped lots are more difficult and expensive to develop.

Topography and soil: Construction costs will be affected by the terrain and soil condition. Limited irregularity in the contour is best for residential property.

Economic Influences

Economic forces influence value. Some of these forces are natural resources, industrial and commercial trends, employment trends, wage levels, availability of money and credit, interest rates, price levels, tax loads, regional and community economic base, new development, and rental and price patterns.

Blighted area: This refers to a section of a city, generally the inner city, where most of the buildings are run-down and the property values are extremely low.

Inflation: This is an unearned increment that affects property values. An unearned increment is an increase in real estate value that comes about from forces outside the control of the owner, such as a favorable shift in population.

Business climate: The presence of shopping areas, offices and medical suites as well as financial, wholesale, industrial, and other consumer-friendly businesses is important to establishing value.
Obsolescence: This may be caused by external or economic changes and decreases the usefulness of property or causes deterioration.

Political or Government Regulations

Some political forces that can affect value are: building codes, zoning laws, public health measures, fire regulations, rent controls, environmental legislation, and the community economic base.

Directional growth: This is determined by how the area or city expands. Property in a growth area tends to increase in value.

Utility: The property’s ability to be used for the purpose it was intended fulfills its utility. Building restrictions and zoning ordinances affect utility.

Building restrictions and zones: These may increase or depress values.

Social Ideals and Standards

Social ideals and standards can affect value. Population growth and decline, age, marriage, birth, divorce, and death rates, all combine to cause changes in social patterns. The study of population is called demography.

Review - Four Main Forces Influencing Value
Mnemonic = PEPS
  Physical forces
  Economic forces
  Political forces
  Social forces

Principles of Valuation

Valuation is the process of estimating market value for real property as of a specific time. There are many valuation principles that interact to determine the final value of a piece of real estate. Not every property exhibits each principle; however, a real estate agent or professional appraiser must know the following basic principles of valuation before assigning value to any property.
**Principle of Change**

Cities and neighborhoods are always changing, and individual homes within those neighborhoods reflect that change. An appraiser must be aware of trends that affect the value of real estate. Economic, social, environmental, and governmental forces are always dynamic, causing changing values in real property.

**Neighborhood Life Cycle**

All neighborhoods change. They start out as young dynamic areas, and eventually disintegrate in the process of passing years. All property goes through four distinct changes called a neighborhood life cycle: (1) growth (development), (2) maturity (stability), (3) old age (decline), and (4) revitalization (renaissance).

Growth, maturity, and decline are normal in all areas, and frequently the process can be reversed just as it reaches the last stages. For example, when a lovely neighborhood grows to be old and worn-out, young families may choose to move in and completely revitalize the neighborhood all over again with development.

**Principle of Supply and Demand**

Like all other marketable commodities, real estate is affected by supply and demand. The principle of supply and demand is almost universally recognized as being the first step in how market prices are determined. Supply refers to the total amount of a given type of property for sale or lease, at various prices, at any given point in time. Demand refers to the desire and ability to acquire goods and services through purchase or lease.

Increasing supply or decreasing demand will reduce the price in the market. A buyer’s market is created because there is more supply than demand. Reducing supply or increasing demand will raise the price in the market. This creates a seller’s market because there is more demand than supply. The less there is of something, the higher the cost; the more there is, the lower the cost.

If home prices decrease, the result will be an increase in the value of money because a given amount of money has more purchasing power. Basically, the home buyer gets more for his or her money.

**Principle of Competition**

Competition is another of the economic principles effecting valuation. Buyers compete with each other to purchase properties. Sellers compete with each other to attract buyers to their properties. When two or more prospective
buyers are competing to obtain a particular property, the one giving the most attractive offer to a seller is the one most likely to prevail. In this case, buyers are in competition with one another to obtain a property. In order to attract prospective buyers, a seller must price his or her property competitively with other comparable offerings.

**Principle of Substitution**

The principle of substitution is the basis of the appraisal process. Explained simply, value is set by the cost of getting an equally desirable substitute. An owner cannot expect to sell for more than someone would ordinarily pay for a similar property, under similar conditions.

**Principle of Conformity**

The principle of conformity states that the more that structures are in harmony with one another, the more valuable each of those structures. A home's maximum value is realized when surrounding land uses are compatible and nearby homes are similar in design and size. This similarity is called conformity, and it upholds neighborhood values. Where there are mixed types of homes, unstable real estate values may occur.

**Principle of Highest and Best Use**

The principle of highest and best use is based on the reasonable use of real property at the time of the appraisal, which is most likely to produce the greatest net return to the land and/or the building over a given period of time. Evaluating the highest and best use includes assessing the buyers' reasons for buying, the existing use of the property, benefits of ownership, the market's behavior, and community or environmental factors.

Interim use is a short-term and temporary use of a property until it is ready for a more productive highest and best use.

**Principle of Progression**

The principle of progression states that the value of an inferior property will be worth more because of the presence of greater-valued properties nearby.
**Principle of Regression**

The opposite of progression, the principle of regression states that the value of a superior property will be worth less because of the presence of lower-valued properties nearby.

**Principle of Balance**

The principle of balance states that real estate value is created and sustained when contrasting, opposing, or interacting elements are in a state of equilibrium. A careful mix of varying land use creates value. Over-improvement or under-improvement will cause imbalance.

**Principle of Anticipation**

The principle of anticipation expresses that value is created by the expectation of future benefits. An appraiser estimates the present worth of future benefits when he or she assigns a value based on anticipated returns.

**Principle of Contribution**

The principle of contribution is the worth of an improvement as well as what it adds to the entire property’s market value, regardless of the actual cost of the improvement. An improvement is a valuable addition made to property to enhance value or extend useful remaining life.

A remodeled attic may not contribute its entire cost to the value of the property; but a new family room will increase the value of the house by more than the cost to build. This principle must be kept in mind by homeowners who want to change the character of their house in such a way that it no longer fits in the neighborhood. The cost of the improvement may not add to the value if the house is overbuilt for the area.

**The Appraisal Process**

At the end of an appraisal, an appraiser must be prepared to answer the following two questions:

“What is the highest and best use of the property?”

“What is this use worth?”

Professional appraisers have developed an orderly systematic method—known as the appraisal process—to arrive at an estimate of value.

The appraisal process is made up of four main steps: (1) state the problem, (2) gather data (general and specific), (3) decide on the appraisal method to be used, and (4) reconcile or correlate the data for final value estimate.
State the Problem

The appraiser must know why the appraisal is necessary. He or she must identify and describe the property to be evaluated and indicate the purpose of the appraisal. Then the extent of ownership to be appraised must be identified. Rights affect value because they set the limits within which the property may be used, and the appraiser must know how the property is owned in order to determine the value of those rights. Is it a fee simple? Are there restrictions on use or possibly a life estate or co-ownership? The purpose of the appraisal will determine the types of information that will be gathered.

Purposes of an Appraisal

- Market value for a sale
- Value for mortgage loan purposes
- Value for insurance purposes
- Value for condemnation proceedings
- Value for inheritance purposes
- Value for Internal Revenue Service purposes
- Value for property tax purposes
- Value for liquidation purposes

Once the appraiser knows the purpose for the property evaluation, it is possible to move on to the next step.

Gather the Data

To determine the property's value, data can be obtained from government publications, newspapers, magazines, the Internet, and personal observation. There are two types of data: general and site specific.

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<thead>
<tr>
<th>General Data</th>
<th>Specific Data</th>
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<tbody>
<tr>
<td>Region</td>
<td>Location</td>
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<td>Community</td>
<td>Lot type</td>
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<td>Neighborhood</td>
<td>Legal</td>
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<tr>
<td>Market</td>
<td>Improvements (buildings)</td>
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Data should be gathered on population trends, income levels, and employment opportunities.
General Data

*General data* is information about the area where the property is located that affects the value of the property.

Regional Data

A region is a metropolitan area, such as San Francisco Bay, Southern California, or the Central Coast. *Regional data* is information about the region’s economic health and amenities. Regional data can be gathered from monthly bank summaries, regional planning commissions, and government agencies. Governmental agencies, such as the Association of Bay Area Governments (ABAG) in the San Francisco Bay area, the San Diego Association of Governments (SANDAG), or the Southern California Association of Governments (SCAG) are also excellent sources for regional information.

Community Data

A community is the town or city where the property is located. *Community data* can be obtained from the Chamber of Commerce, City Planning Commission, city government agencies, banks, and real estate boards. As with the regional data, community data should be searched for information about the community’s economic health and amenities.

Neighborhood Data

*Neighborhood data* concerning the neighborhood’s condition and amenities can be obtained from personal inspections, real estate agents, or area builders. The appraiser notices the age and appearance of the neighborhood; any negative influences, such as physical or social hazards (rundown buildings, evidence of criminal activity); evidence of future development; and proximity to schools, businesses, recreation, and transportation.

The sales and listing prices of property in the neighborhood is the neighborhood’s *market data*. It must be collected and analyzed. Sources for sales information are assessor’s records and county recorder’s office, title insurance companies, other property owners in the area, and the appraiser’s own database.

Another factor that can affect value is the age of the buildings in the neighborhood. Information on structure age and other information regarding improvements can be gathered from the tax assessor’s office, city building department, or personal inspection of the improvements.
Site Specific Data

Site specific data is information that has to do with the specific location being appraised. Appraisers rely on available market information, such as listings, offers, leases, and sales reports as the foundation of their appraisal methods.

Location

Even though the location of the neighborhood and city must be considered in any analysis of a specific site or plot of ground, the exact spot of the site itself is the most important factor in determining value. Since most sites are different sizes and in different locations, some are more desirable than others and should be evaluated separately from improvements for the highest and best use.

Types of Lots

The type of lot on which a property is located can affect its value.

A cul-de-sac lot is found at the end of a dead-end street. It is a street that has only one way in and out. This may be desirable because of the privacy and quietness, but the lot may be undesirable if oddly pie-shaped on the turn-around section of the street.

A corner lot is found at the intersection of two streets. It may be desirable because of its accessibility, but may also be noisy and expensive to maintain because of the increased frontage.

A T-intersection lot is one that is fronted head-on by a street. The noise and glare from headlights may detract from this type of lot.

An interior lot is one that is surrounded by other lots, with frontage on the street. It is the most common type lot and may be desirable or not, depending on other factors.

A flag lot looks like a flag on a pole. The pole represents the access to the site, which is usually located to the rear of another lot fronting a main street.

A key lot, so named because it resembles a key fitting into a lock, is surrounded by the backyards of other lots. It is the least desirable because of the lack of privacy.
Legal Data

An appraiser must evaluate all legal data connected with the site, including the legal description, any taxes, the zoning, general plan, and any restrictions or easements. Additionally, the appraiser needs to determine if there are any other interests in the property.

Improvements

When an appraiser considers improvements, it means looking at any buildings or other permanent structures, such as a fence, a swimming pool, a sauna, or a built-in whirlpool. Real property is divided into land and improvements, and each adds its own value to a site. Improvements can be either on-site or off-site:

- **On-site improvements** are structures permanently attached to the land, such as buildings, swimming pools, and fences.
- **Off-site improvements** are items in areas that border the site and add to its value, such as street lights, sidewalks, greenbelts, and curbs.

Decide on Method of Appraising Property

There are three main approaches to appraising property to arrive at a market value estimate: (1) sales comparison approach, (2) cost approach, and (3) income approach. The sales comparison approach depends on recent sales and listings of similar properties in the area and are evaluated to form an opinion of value. The cost approach estimates the value of the land as if vacant and adds that to the depreciated cost of new improvements to determine an estimate of value for the entire property. The income or capitalization approach calculates the potential net income of the property considered and then capitalized into value.
Sales Comparison Approach

The sales comparison approach is the one most easily and commonly used by real estate agents. It is best for single-family homes or condominiums and vacant lots because sales information is readily available and easily compared. The market comparison approach uses the principle of substitution to compare similar properties.

As you recall, the principle of substitution states that a buyer will not pay more for a property than the cost of a similar one. The market comparison approach takes the current selling price of a similar property and adjusts it for any differences to arrive at the market value for the subject property.

The appraiser will collect data on comparable (called comps) properties that are as like-kind to the property in question as possible, in certain categories. Typical categories include: neighborhood location, size (comparable number of bedrooms/bathrooms as well as square footage), age, architectural style, financing terms, and the general price range.

The sales comparison approach is based on the idea that property is worth what it will sell for when there is no extra stress, if reasonable time is given to find a buyer. Because of this, the appraiser will research comparable sales to discover any special circumstances influencing those sales. Only those similar properties—sold on the open market, with approval of the seller, offered for a reasonable length of time—will be used for comparables. Also, if possible, only those properties that have sold within the past six months are selected. If the comparables are older than that, they are considered less reliable.

Features in either the property or the transaction itself are elements that can cause appraisals to vary. Estimates of value vary due to differences in the financing terms, time of the sale, sale conditions (arm’s length transaction), location, physical features, and in any income that is derived from the property.

Thus, a price is found for each comparable property that should reflect its present value in the current market where the subject property is being sold. Those properties not as comparable are excluded, and greater weight is given to the comparable sales most like the property being appraised. By using judgment
to reconcile the comparables, the appraiser arrives at the final estimate of value for the subject property, using the compatible comparables to show the value and price to be asked for the subject property.

**Advantages of Sales Comparison Approach**

- Most easily understood method of valuation and most commonly used by real estate agents.
- Easily applied for the sale of single-family homes.
- The sales comparison approach is best for single-family homes or condominiums and vacant lots.

**Disadvantages of Sales Comparison Approach**

- Finding enough recently sold similar properties to get comparable values.
- Correctly adjusting amenities to make them comparable to the subject property.
- Older sales unreliable with changing economic conditions.
- Difficulty in confirming transaction details.

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**Review - The Sales Comparison Approach Procedure**

1. Find similar properties, select and verify data.
2. Select appropriate elements of comparison, adjust sales price of each comparable. (Adjustment is always made to the comparable, not the subject property.)
3. Adjust sales prices of comparables by subtracting the adjustment if the subject property is inferior to the comparable and by adding the adjustment if the subject property is superior.

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**Cost Approach**

The **cost approach** looks at the value of the appraised parcel as the combination of two elements: the value of the land as if vacant and the cost to rebuild the appraised building as new on the date of valuation, less the accrued depreciation.

To determine value of a property using the cost approach, first obtain the value of the land, add the cost to build structure new, and then subtract any accrued depreciation.
The cost approach tends to set the upper limit of value for a property. In other words, the most something would cost if it were built new. Using the principle of substitution, a person will not pay more for a substitute if he or she can get the subject property for less. In the cost approach, the substitute is the cost of reconstructing the present building new on vacant land.

**Review - The Cost Approach Procedure**

1. Estimate the value of the land as if it were vacant, using comparable land sales. (Principle of Substitution)
2. Estimate the replacement or reproduction cost of the existing building as of the appraisal date. **Replacement cost** is the cost of restoring a property to its previous condition or replacing it with something of like kind and quality. **Reproduction cost** is the cost of replacing the improvement with one that is the exact replica, having the same quality of workmanship, design, and layout.
3. Estimate the amount of accrued depreciation to the improvements.
4. Deduct the amount of the accrued depreciation from the replacement cost (new) to find the estimate of the depreciated value of the improvements.
5. Add the estimated present-depreciated value for the improvements to the value of the land. The result is an estimate of value for the subject property.

The cost approach is used most often for appraising new buildings and special-purpose or unique structures. Depreciation on a new building is relatively easy to determine, whereas the cost approach is impractical with older buildings because of the difficulty in estimating depreciation. The cost approach is also used with buildings where it is difficult to find comparables because they are unique or one-of-a-kind, such as a church, fire station, or hospital.

Occasionally, the cost approach is the only one an appraiser can use. If there have been no recent sales (such as during recession or when interest rates are too high), there will be no comparables for the market comparison approach. If the subject is not an income-producing property, the income method (to be discussed next) cannot be used. So the cost method is a reliable way for an appraiser or real estate agent to determine the value of a property when all else fails.
Methods to Estimate the Cost of a New Building

To estimate the cost of building the structure new, an appraiser can use one of several methods.

Square-Foot Method

The square-foot method is the most common, used by appraisers and real estate agents to estimate the cost of construction. The size of the building in question is compared, by square foot, to other buildings with the same area. The building being appraised is compared with the most comparable standard building, and its cost per square foot is used for the subject property. This is the fastest way to estimate value using the cost method.

Cubic-Foot Method

This is a lot like the square-foot method, except that it takes height as well as area into consideration. The cubic contents of buildings are compared instead of just the square footage.

Quantity-Survey Method

This method is a detailed estimate of all labor and materials used in the components of a building. Items, such as overhead, insurance, and contractor’s profit are added to direct costs of building. This method is time-consuming but very accurate.

Unit-in-Place Cost Method

Cost of units in the building as installed is computed and applied to the structure cost. The total costs of walls in place, heating units, and roof are figured on a square-foot basis, including labor, overhead, and profit. This is the most detailed method of estimating value.

Depreciation

Depreciation means loss in value from any cause. It is usually measured by estimating the difference between the current cost to replace new and the estimated value of the property as of the date of appraisal.

The opposite of depreciation is appreciation, or an increase in value, usually as a result of inflation or some special supply and demand force relating to that specific property. Appreciation may balance the normal decrease of value due to depreciation.
All of the influences that reduce the value of a property below its cost new are included in the definition of depreciation.

**Physical Deterioration**
This type of depreciation can come from wear and tear, negligent care (sometimes called deferred maintenance), damage by dry rot or termites, or severe changes in temperature. This may or may not be curable.

**Functional Obsolescence**
Functional obsolescence is depreciation that is attributable to an item or feature within the subject property that is no longer useful or functional. Poor architectural design and style can contribute to functional obsolescence, as can lack of modern facilities, out-of-date equipment, changes in styles of construction, or changes in utility demand. For instance, a four-bedroom house with only one bathroom might be considered functionally obsolete because most homes today have at least two bathrooms with many having one bath for each bedroom. It may or may not be curable. Over-improvements are features that are too large or of a higher quality than needed for a property. For example, building a 10,000 square foot home in the middle of a tract of homes ranging in size from 1,200 to 1,800 square feet in size is an example of an over-improvement.

Physical deterioration and functional obsolescence are further divided into two-sub categories of depreciation called curable and incurable.

**Curable depreciation** refers to a loss in value that is economically feasible to correct. In other words, the cost to fix the problem is less than the loss in value, so fixing the problem makes economic sense.

**Incurable depreciation** refers to items of depreciation that either are physically impossible to cure or are too expensive to be worth curing. If the cost to fix the problem exceeds the loss in value caused by the problem, then it does not make economic sense to repair it.

**Economic Obsolescence**
This type of depreciation occurs because of forces outside the property. Changes in the social or economic make up of the neighborhood, zoning changes, over-supply of homes, under-supply of buyers, recession, or legislative restrictions can cause economic obsolescence. It is almost always incurable.

**Depreciation for Appraisal Purposes**
The book depreciation calculated by an accountant is not the depreciation considered by the appraiser, as we have seen. The appraiser does not look at
the owner’s original cost to purchase but uses the cost to build new on the date of the appraisal as the basis for evaluation, using the cost method. An appraiser subtracts the estimate of accrued actual (not book) depreciation on the building from the cost to build new.

As you recall, in using the cost method, the value of the land and the value of the building (improvements) are determined separately, then added together to calculate the value of the entire property. So, the appraiser figures the actual depreciation on the building and subtracts it from the cost to construct the building new. The next step is to add that amount to the value given the land (using the principle of substitution from other land sales) to estimate the value of the whole parcel.

There are several ways to calculate accrued depreciation; however, for our purposes we will only discuss the straight-line (or age-life) method. It is the one most commonly used by real estate agents and appraisers because it is easy to calculate, is used by the Internal Revenue Service, and is easily understood by the consumer.

Using the **straight-line method** to determine accrued depreciation, the appraiser assumes a building will decline in value the same amount each year, until nothing is left. For example, a property with an estimated effective age of 50 years would be said to depreciate at an equal rate of 2% per year (2% x 50 years equals 100% depreciation). In using this method of calculating accrued depreciation, the appraiser probably will not use the actual age of the building, rather the effective age, which is determined by its condition, not the number of years since it was built.

**Actual age** is the real age of a building. **Effective age** is not determined by the actual age of a building but by its condition and usefulness. **Economic life** is the estimated period over which a building may be profitably used. Economic life is usually shorter than physical (actual) life. For example, if the subject property was really 25 years old, but was as well-maintained and would sell for as much as nearby 20-year-old properties, it would be said to have an effective age of 20 years.

**Depreciation for Tax Purposes**

Depreciation for income tax purposes is book depreciation, or a mathematical calculation of steady depreciation or loss, from the owner’s original purchase price (**cost basis**). This allows the owner to recover the cost of investment over the **useful life** of the building. It is mathematically accrued annually and taken as an income tax deduction from the owner’s gross income.
Many times, this deduction makes gross income a negative amount on paper. The building seems to be losing value, giving the owner a paper loss that can be offset against other income. This paper loss, or tax shelter, is why many people invest in income property.

**Book value** is the current value (for accounting purposes) of a property, calculated as the original cost plus capital improvements and minus accumulated or accrued depreciation. Remember, this is used as an accounting method, not to be confused with actual depreciation of a building. Depreciation is allowed on buildings only, not on land. The depreciation, for accounting—or tax—purposes, is only a mathematical wasting away of the improvements. Property buyers have the least interest in an owner's book value.

The book value of a property may be calculated by adding the depreciated value of the improvement (the building) to the assigned value of the land. It is important to remember that book value and book depreciation are used only to figure income tax and are not particularly relevant to an appraiser.

**Book value equals the original cost of the property plus the cost of any improvements minus accrued depreciation.**

**Income Approach**

The **income approach** estimates the present worth of future benefits from ownership of a property. The value of the property is based on its capacity to continue producing an income. This method is used to estimate the value of income-producing property (rentals), usually in combination with one or both of the other methods. This approach is based mainly on the appraisal principles of comparison, substitution, and anticipation.

**The value of the property is based on its capacity to continue producing an income.**

**Contract rent**, or the amount actually paid by a renter for use of the premises, may or may not be the same as **economic rent**, or the amount the rental could bring in an open market. An appraiser valuating a property looks at the economic rent, rather than the contract rent, in order to discover the fair income of the property. Properties are valued using both the income capitalization approach and gross rent multiplier approach.
**Using Capitalization of Income**

The process of calculating a property’s present worth on the basis of its capacity to continue producing an income stream is called **capitalization**. Capitalization converts the future income stream into an indication of the property’s present worth. Risk determines the capitalization rate to be used. The higher the perceived risk, the higher the capitalization rate. The appraiser evaluates the expected future income and expenses of a property using the income approach to determine its present value.

<table>
<thead>
<tr>
<th>Formulas Used to Estimate the Value of an Income Property</th>
</tr>
</thead>
<tbody>
<tr>
<td>NOI divided by the Cap Rate equals the Value of the Property.</td>
</tr>
<tr>
<td>NOI divided by Value of Property equals Cap Rate.</td>
</tr>
</tbody>
</table>

The appraiser must determine the amount, reliability, and durability of the income stream. There are five basic steps to do this.

**Step 1. Calculate the Effective Gross Income**

The **effective gross income** is the total annual income from the property minus any vacancy or rental losses. That includes rental income plus any other income generated by the property, such as laundry room income or parking fees. Loss of income because of a vacant unit is known as the **vacancy factor**. Current market rents are used to determine the loss from the vacancy factor. **Market rent** is the rent the property should bring in the open market, while contract rent is the actual, or contracted, rent paid by the tenants. The appraiser uses the market rent in his or her calculations.

**Calculation:**

\[
\begin{align*}
\text{Gross scheduled annual income} & = 36,000 \\
\text{Subtract vacancy factor / rental loss} & = -3,600 \\
\text{Effective gross income} & = 32,400
\end{align*}
\]

**Step 2. Determine Operating Expenses**

Expenses are generally classified as being either fixed or variable. **Fixed expenses** include property taxes, insurance, and utilities. **Variable expenses** include management and maintenance.
Step 3. Calculate Net Operating Income

The net operating income (NOI) is the income after paying all expenses including a maintenance reserve. It does not include the principal and interest paid on a loan.

**Calculation:**

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxes</td>
<td>$1,920</td>
</tr>
<tr>
<td>Insurance</td>
<td>480</td>
</tr>
<tr>
<td>Management</td>
<td>2,400</td>
</tr>
<tr>
<td>Maintenance</td>
<td>1,000</td>
</tr>
<tr>
<td>Utilities</td>
<td>800</td>
</tr>
<tr>
<td>Reserves (roof, water heaters, etc.)</td>
<td>800</td>
</tr>
<tr>
<td><strong>Total expenses</strong></td>
<td><strong>$7,400</strong></td>
</tr>
<tr>
<td>Effective gross income</td>
<td>$32,400</td>
</tr>
<tr>
<td>Subtract expenses</td>
<td>-7,400</td>
</tr>
<tr>
<td><strong>Net operating income</strong></td>
<td><strong>$25,000</strong></td>
</tr>
</tbody>
</table>

Step 4. Select a Capitalization Rate

The capitalization rate, more accurately called the **internal rate of return (IRR)** in the financial community, provides for the return of invested capital plus a return on the investment. The rate is dependent upon the return a buyer will demand before investing money in the property. The greater the risk of recapturing the investment price (making a profit), the higher the cap rate and the lower the price. The lower the risk, the lower the cap rate, and the higher the price of the property.

- The greater the risk, the higher the cap rate and the lower the price.
- The lower the risk, the lower the cap rate, and the higher the price.
Choosing a capitalization rate is the hardest part for appraisers using the income approach. Generally, a real estate agent will need further study and practice to use this approach to valuation. One way a capitalization rate can be determined is by a market analysis of similar income properties and using the same capitalization rate as those recent sales have. The net operating income is divided by the sales price to determine the cap rate used in each sale. There are other methods of calculating a capitalization rate, which may be learned through more study of appraisal.

**Step 5. Calculate the Market Value**

Calculate the market value by dividing the net operating income by the chosen cap rate.

**Calculation:**

Net Operating Income is $25,000 and the Cap Rate is 8%

$25,000 divided by .08 equals $312,500

Market value = $312,500

**Using the Gross Rent Multiplier**

Real estate agents and appraisers use the gross rent multiplier to quickly convert gross rent into market value. It is used for income-producing properties and is an easy way to get a rough estimate of the value of rental units.

**Gross rent** is income (calculated annually or monthly) received before any expenses are deducted. A gross rent multiplier, when multiplied by the total annual rents, will give a rough estimate of a property value that can then be compared with other like properties. Generally, gross multipliers will be somewhere between x5 and x10, depending on the market, the condition, and the location of the property.

In other words, a property with a gross annual income of $36,000, when multiplied by the current gross multiplier of 10, will be valued roughly at $360,000. So when you hear property values described as ten times gross, five times gross, or seven times gross, it means the value is shown by whatever multiplier is used, times the gross income. This is only a quick estimate of value, and does not take the place of a professional appraisal.

The reverse process can be used to calculate the gross multiplier, rather than the market value. The reason you might want to do that is to compare properties to see if they are priced right or are above or below market value. If you know that most rental properties are selling for around eight times the gross
annual multiplier (eight times gross), simply divide the listed price by the gross income to arrive at the multiplier.

**Calculation to find Gross Rent Multiplier:**

Listed price is $360,000 and the gross annual income is $36,000

Divide the list price by the gross annual income

$360,000 divided by $36,000 equals 10

Gross Rent Multiplier is 10

The gross rent multipliers of several income properties may be compared using the market comparison method to estimate their value. A gross rent multiplier can be stated on either an annual or a monthly basis.

**Reconcile or Correlate**

The final step in an appraisal is to examine the values derived by the various approaches. **Reconciliation**, or correlation, of value occurs when the appraiser decides which of the values is the most appropriate for the subject property, and uses that figure to determine the final estimate for the property in question.

Many times an appraiser will use all three methods to arrive at the market value of a property. In most appraisals, all three approaches will have something to add. Each method is used independently to reach an estimated value. Finally, by giving to each separate value a weight that is most compatible to the subject property, the appraiser will arrive at a value for the property. This process is called reconciliation or correlation.

**The Appraisal Report**

Each written appraisal report must be prepared according to the following Uniform Standards of Professional Appraisal Practice (USPAP) standards: Self-Contained Appraisal Report, Summary Appraisal Report, or Restricted Use Appraisal Report.

When the intended users of the report include parties other than the client, the report must be either a Self-Contained Appraisal Report or a Summary Appraisal Report. When the intended users do not include parties other than the client, the report can be a Restricted Use Appraisal Report. The difference among the options is in the content and level of information provided.
An appraiser must be careful in deciding which type of report to use. Appraisal standards set minimum requirements for the content and level of information in each type of report. The final report is presented in either a short-form or narrative style. Appraisals are valid on the date that the appraiser signs and dates the report.

**Self-Contained Appraisal Report**

The **Self-Contained Appraisal Report** includes the identity of the client and any intended users (by name or type), the intended use of the appraisal, the real estate involved, the real property interest appraised, the purpose of the appraisal, and dates of the appraisal and of the report. It also describes work used to develop the appraisal, the assumptions and limiting conditions, the information that was analyzed, the procedures followed, and the reasoning that supports the conclusions. The report states the current use of the real estate and the use reflected in the appraisal, the support for the appraiser's opinion of the highest and best use, and any departures from the standards. It includes a signed certification.

**Summary Appraisal Report**

The **Summary Appraisal Report** covers the same categories as the Self-Contained Appraisal Report, but where the Self-Contained Appraisal Report includes descriptions, the Summary Appraisal Report contains summaries.

**Restricted Use Appraisal Report**

The **Restricted Use Appraisal Report** covers the same categories as the other two reports with several differences: only the client is named because there are no other users; the use of the report is limited to the client; and the report refers to the appraiser’s work file as the source of necessary additional information about the appraisal.
Steps in the Appraisal Process

1. State the problem.
2. Gather the data needed and the sources.
3. Gather, record, and verify the necessary data.
4. Determine the highest and best use.
5. Estimate the land value.
6. Estimate value by one of several methods.
7. Reconcile or correlate the estimated values for the final value estimate.
8. Write the Appraisal Report.

<table>
<thead>
<tr>
<th>General Data</th>
<th>Specific Data</th>
<th>Data for Each Approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>Region</td>
<td>Location</td>
<td>Sales data</td>
</tr>
<tr>
<td>City</td>
<td>Lot</td>
<td>Cost data</td>
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<tr>
<td>Neighborhood</td>
<td>Improvements</td>
<td>Income and expense data</td>
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<td></td>
<td></td>
<td>Population trends</td>
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<td></td>
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<td>Income level</td>
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<tr>
<td></td>
<td></td>
<td>Employment opportunities</td>
</tr>
</tbody>
</table>

Appraisal Licensing Standards

The Appraisal Foundation, a non-profit educational organization, was established in 1987 in response to the crisis in the savings and loan industry in the early 1980s. This crisis confirmed the importance of basing appraisals on established recognized standards, free from outside pressures.

The Appraiser Qualifications Board (AQB) was included in the foundation structure to develop these standards. It created the Uniform Standards of
Professional Appraisal Practice (USPAP) and established educational and experience requirements for the licensing of appraisers in all states. USPAP is recognized nationwide as the standard of professional appraisal practice, and all appraisers are required to abide by these standards. In California, the Office of Real Estate Appraisers (OREA) was established in 1990 to license appraisers. OREA has licensed over 18,000 real estate appraisers.

Types of Appraisal Licenses

There are four levels of real estate appraiser licensing in California:

1. Trainee License
2. Residential License
3. Certified Residential License
4. Certified General License

Each level requires a specific amount of education and experience, and each licensee must pass a state exam. Trainees must work under the supervision of a licensed appraiser. The types of structures that can be appraised are specified for each level. An appraisal on commercial property is conducted by a Certified General Appraiser. Continuing education is required to maintain the license.

Registered Appraisal Management Company

In 2009, the California Appraisal Management Company law was enacted requiring the registration of appraisal management companies with the Office of Real Estate Appraisers (OREA). The law also sets forth standards with which an appraisal management company must comply and provides enforcement authority to OREA.

CA B&P Code section 11302(d) defines an appraisal management company as any entity that satisfies all of the following conditions:

1. maintains an approved list containing 11 or more licensed or certified appraisers who are independent contractor or employs 11 or more licensed or certified appraisers who are employees;
2. receives requests for appraisals from one or more clients; and
3. for a fee, delegates appraisal assignments for completion by its independent contractor or employee appraisers.

Professional Appraisal Organizations

The major objective of these organizations is to make sure the members of the appraisal profession are knowledgeable and conform to a code of ethics and standards of professional appraisal practice. The main professional organization is the Appraisal Institute (AI). Members may hold the title of Member Appraisal Institute (MAI) or Senior Residential Appraiser (SRA).
# Uniform Residential Appraisal Report

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

**Property Address:**

**City:**

**State:**

**Zip Code:**

**Borrower:**

**Owner of Public Record:**

**County:**

**Legal Description:**

**Assessor's Parcel #:**

**Tax Year:**

**R.E. Taxes:**

**Neighborhood Name:**

**Map Reference:**

**Current Tax:**

**Occupant:**

**Owner:**

**Tenant:**

**Vacant:**

**Special Assessment:**

**Pub. NO.:**

**HCM #:**

**per year:**

**per month:**

**Property Rights Assumed:**

**Free and Clear:**

**Leasehold:**

**Other (describe):**

**Assignment Type:**

**Purposes Transaction:**

**Reference Transaction:**

**Other (describe):**

**Listing/Client:**

**Address:**

**Is the subject property currently offered for sale or has it been offered for sale in the twelve months prior to the effective date of this appraisal?**

**Yes**

**No**

**Report data source(s) used, offering price(s), and details:**

**Contract Price:**

**Sale of Contract:**

**Is the property seller the owner of public record?**

**Yes**

**No**

**Data Source(s):**

**Is there any financial assistance down payments, sale concessions, gift or assumption assistance, etc.) to be paid by any party on behalf of the borrower?**

**Yes**

**No**

**If Yes, report the total dollar amount and describe the terms to be paid:**

### Note: Race and the racial composition of the neighborhood are not appraisal factors.

<table>
<thead>
<tr>
<th>Neighborhood Characteristics</th>
<th>One-Unit Housing Trends</th>
<th>One-Unit Housing</th>
<th>Present Land Use %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Location</td>
<td>Urban</td>
<td>Stability</td>
<td>One Unit %</td>
</tr>
<tr>
<td>Suburban</td>
<td>Rural</td>
<td>Increasing</td>
<td>PRICE</td>
</tr>
<tr>
<td>Rural</td>
<td>Stable</td>
<td>Declining</td>
<td>AGE</td>
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<tr>
<td>Property Value</td>
<td>Increasing</td>
<td>PRICE</td>
<td>One Unit</td>
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<tr>
<td>Increasing</td>
<td>Stable</td>
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<td>%</td>
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<tr>
<td>Declining</td>
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<td>%</td>
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<tr>
<td>Stock</td>
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<tr>
<td>Growth</td>
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<td>Slow</td>
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<td>%</td>
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<tr>
<td>Marketing Time</td>
<td>Under 6 months</td>
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<td>%</td>
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<tr>
<td>6-12 months</td>
<td>Over 6 months</td>
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<td>%</td>
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<td>Neighborhood Boundaries</td>
<td>High</td>
<td>Commercial</td>
<td>%</td>
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<tr>
<td>High</td>
<td>Commercial</td>
<td>%</td>
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<tr>
<td>Low</td>
<td>Multi-Family</td>
<td>%</td>
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<tr>
<td>Neighborhood Description</td>
<td>High</td>
<td>Commercial</td>
<td>%</td>
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<tr>
<td>Market Conditions (including support for the above conclusions)</td>
<td></td>
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</tr>
</tbody>
</table>

### Dimensions

**Square Footage View:**

**Specific Zoning Classification:**

**Zoning Description:**

**Zone:**

**Zoning Code:**

**Utilities**

<table>
<thead>
<tr>
<th>Public</th>
<th>Other (describe)</th>
<th>Public</th>
<th>Other (describe)</th>
<th>Offsite Improvements-Type</th>
<th>Public</th>
<th>Private</th>
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<tbody>
<tr>
<td>Water</td>
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<td>Sewer</td>
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</table>

### General Description

<table>
<thead>
<tr>
<th>Link</th>
<th>One</th>
<th>One with Accessory Unit</th>
<th>Foundation</th>
<th>Exterior Description</th>
<th>Interior Material Condition</th>
</tr>
</thead>
<tbody>
<tr>
<td># of Stories</td>
<td>1</td>
<td>1 with Accessory Unit</td>
<td>Concrete Slab</td>
<td>Crawl Space</td>
<td>Foundation Walls</td>
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<tr>
<td>Full Basement</td>
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<td>1 with Accessory Unit</td>
<td>Concrete Slab</td>
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<td>Foundation Walls</td>
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<tr>
<td>Partial Basement</td>
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<td>Cellar</td>
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<td>Concrete Slab</td>
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<td>Foundation Walls</td>
</tr>
<tr>
<td>Slab</td>
<td>1</td>
<td>1 with Accessory Unit</td>
<td>Concrete Slab</td>
<td>Crawl Space</td>
<td>Foundation Walls</td>
</tr>
<tr>
<td>Type</td>
<td>Detached</td>
<td>Detached or Attached</td>
<td>Foundation</td>
<td>Exterior</td>
<td>Foundation</td>
</tr>
<tr>
<td>Foundation</td>
<td>1</td>
<td>1 with Accessory Unit</td>
<td>Concrete Slab</td>
<td>Crawl Space</td>
<td>Foundation Walls</td>
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<tr>
<td>Exterior</td>
<td>1</td>
<td>1 with Accessory Unit</td>
<td>Concrete Slab</td>
<td>Crawl Space</td>
<td>Foundation Walls</td>
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<tr>
<td>Interior</td>
<td>1</td>
<td>1 with Accessory Unit</td>
<td>Concrete Slab</td>
<td>Crawl Space</td>
<td>Foundation Walls</td>
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<tr>
<td>Material Condition</td>
<td>1</td>
<td>1 with Accessory Unit</td>
<td>Concrete Slab</td>
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<td>Foundation Walls</td>
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<td>Exterior Material Condition</td>
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<td>1 with Accessory Unit</td>
<td>Concrete Slab</td>
<td>Crawl Space</td>
<td>Foundation Walls</td>
</tr>
<tr>
<td>Interior Material Condition</td>
<td>1</td>
<td>1 with Accessory Unit</td>
<td>Concrete Slab</td>
<td>Crawl Space</td>
<td>Foundation Walls</td>
</tr>
</tbody>
</table>

### Facilities

- **Roofs:**
- **Exterior Walls:**
- **Interior Walls:**
- **Floors:**
- **Sub-Basement:**

### Additional Features

- **Special Energy Efficient Features:**
- **Other:**

### Additional Features

- **Special Energy Efficient Features:**
- **Other:**

### Other

- **Condition of the Property (including needed repairs, deterioration, renovations, razing, etc.):**
- **Physical Disabilities:**
- **Fireplace:**

### Does the property generally conform to the neighborhood functional use, style, condition, use, or construction, etc.?**

**Yes**

**No**

**If Yes, describe:**

**Does the property generally conform to the neighborhood functional use, style, condition, use, or construction, etc.?**

**Yes**

**No**

**If Yes, describe:**
### Uniform Residential Appraisal Report

**Subject:**

- **Address:**
  - **Proximity to Subject:**
  - **Sale Price:** $  
  - **Sale Price/Lease:** $  
  - **Sale Date:**

**Comparable Sales:**

<table>
<thead>
<tr>
<th></th>
<th>Subject</th>
<th>Comparable Sale #1</th>
<th>Comparable Sale #2</th>
<th>Comparable Sale #3</th>
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<tr>
<td><strong>Features</strong></td>
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<td><strong>Value Adjustments</strong></td>
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<tr>
<td><strong>Adjustment</strong></td>
<td></td>
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<td></td>
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<tr>
<td><strong>Description</strong></td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

**Condition:**

- **Above Grade:**
- **Below Grade:**
- **Gross Living Area:** sq. ft.
- **Total Living Area:** sq. ft.
- **Total Bedroom:**

**Subject Information:**

- **Determined by:**
- **Adjusted Sales:**
- **Gross Adj.:**
- **Net Adj.:**

**Analysis of Comparable Sales:**

**Summary of Sales Comparison Approach:**

- **Indicated Value by Sales Comparison Approach:** $  
- **Cost Approach:**
- **Income Approach:**

### Footnotes:

- This appraisal is made "as is," subject to completion per plans and specifications on the basis of a hypothetical condition that the improvements have been completed. Subject to the following reports or statements on the basis of a hypothetical condition that the reports or statements have been completed, or subject to the following required inspections based on the assumptions that the condition or structure does not require attention or repair.

- Based on a complete visual inspection of the interior and exterior areas of the subject property, defined scope of work, statement of assumptions and limiting conditions, and appraiser's certification, my (our) opinion of the market value, as defined, of the real property that is the subject of this report is $  

- As of  

- Effective date of the appraisal:

---

*Freddie Mac Form 70 March 2005*
### Uniform Residential Appraisal Report

**Unit 11 Valuation & Appraisal**

#### COST APPROACH TO VALUE (not required by Fannie Mae)

Provide adequate information for the lender to replicate the below cost figures and calculations.

Support for the opinion of site value (Summary of comparable land sales or other methods for estimating site values)

**Estimated:**

- **Replacement Cost New (RCN):**
  - Dwelling: Sq. Ft. $x
  - Garage: Sq. Ft. $x

**Effective Cost Data:**

- **Effective Date of Cost Data:**
  - Dwelling: $x
  - Garage: $x

**COST APPROACH TO VALUE**

<table>
<thead>
<tr>
<th>Item</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Opinion of Site Value</strong></td>
<td>$</td>
</tr>
<tr>
<td><strong>Total Estimate of Cost New</strong></td>
<td>$</td>
</tr>
<tr>
<td><strong>Less:</strong></td>
<td></td>
</tr>
<tr>
<td>Physical</td>
<td></td>
</tr>
<tr>
<td>Functional</td>
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<tr>
<td>External</td>
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</tr>
<tr>
<td><strong>Depreciation</strong></td>
<td>$</td>
</tr>
<tr>
<td><strong>Depreciated Cost of Improvements</strong></td>
<td>$</td>
</tr>
<tr>
<td><strong>Ask-Price Value of Site Improvements</strong></td>
<td>$</td>
</tr>
</tbody>
</table>

**Estimated Remaining Economic Life (HUD and VA only):**

- **Values Indicated Value by Cost Approach:**
  - $ |

**INCOME APPROACH TO VALUE (not required by Fannie Mae):**

- **Estimated Monthly Market Rent:**
  - $x 
  - Cross Rent Multiplier: $x

**Summary of Income Approach (Including support for market rent and G/M):**

- **Value:**
  - $x

### PROJECT INFORMATION FOR PUDs (if applicable)

- **Is the developer/builder in control of the Homeowners Association (HOA)?**
  - Yes [ ] No [ ]
  - Unit type(s): [ ] Detached [ ] Attached

- **Provide the following information for PUDs ONLY if the developer/builder is in control of the HOA and the subject property is an attached dwelling unit:**

  - **Legal name of project:**
    - 
  - **Total number of phases:**
    - 
  - **Total number of units:**
    - 
  - **Total number of units sold:**
    - 

  - **Data source(s):**
    - 
  - **Was the project signed by the conversion of an existing building(s) into a PUD?**
    - Yes [ ] No [ ]
    - If Yes, date of conversion:

  - **Does the project contain any multifamily units?**
    - Yes [ ] No [ ]
    - If Yes, Cite source(s):

  - **Are the units, common elements, and recreation facilities complete?**
    - Yes [ ] No [ ]
    - If No, describe the status of completion:

  - **Are the common elements leased to or by the Homeowners Association?**
    - Yes [ ] No [ ]
    - If Yes, describe the rental terms and options:

- **Describe common elements and recreational facilities:**

---

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Uniform Residential Appraisal Report

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

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

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

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

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

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

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

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

1. The appraiser will not be responsible for matters of a legal nature that affect either the property being appraised or the title to it, except for information that he or she became aware of during the research involved in performing this appraisal. The appraiser assumes that the title is good and marketable and will not render any opinions about the title.

2. The appraiser has provided a sketch in this appraisal report to show the approximate dimensions of the improvements. The sketch is included only to assist the reader in visualizing the property and understanding the appraiser's determination of its size.

3. The appraiser has examined the available flood maps that are provided by the Federal Emergency Management Agency (or other data sources) and has noted in this appraisal report whether any portion of the subject site is located in an identified Special Flood Hazard Area. Because the appraiser is not a surveyor, he or she makes no guarantees, express or implied, regarding this determination.

4. The appraiser will not give testimony or appear in court because he or she made an appraisal of the property in question, unless specific arrangements to do so have been made beforehand, or as otherwise required by law.

5. The appraiser has noted in this appraisal report any adverse conditions (such as needed repairs, deterioration, the presence of hazardous wastes, toxic substances, etc.), observed during the inspection of the subject property or that he or she became aware of during the research involved in performing this appraisal. Unless otherwise stated in this appraisal report, the appraiser has no knowledge of any hidden or unapparent physical deficiencies or adverse conditions of the property (such as, but not limited to, needed repairs, deterioration, the presence of hazardous wastes, toxic substances, adverse environmental conditions), that would make the property less valuable, and has assumed that there are no such conditions and makes no guarantees or warranties, express or implied. The appraiser will not be responsible for any such conditions that do exist or for any engineering or testing that might be required to discover whether such conditions exist. Because the appraiser is not an expert in the field of environmental hazards, this appraisal report must not be considered as an environmental assessment of the property.

6. The appraiser has based his or her appraisal report and valuation conclusion for an appraisal that is subject to satisfactory completion, repairs, or alterations on the assumption that the completion, repairs, or alterations of the subject property will be performed in a professional manner.
APPRAISER'S CERTIFICATION: The Appraiser certifies and agrees that:

1. I have, at a minimum, developed and reported this appraisal in accordance with the scope of work requirements stated in this appraisal report.

2. I performed a complete visual inspection of the interior and exterior areas of the subject property. I reported the condition of the improvements in factual, specific terms. I identified and reported the physical deficiencies that could affect the livability, soundness, or structural integrity of the property.

3. I performed this appraisal in accordance with the requirements of the Uniform Standards of Professional Appraisal Practice that were adopted and promulgated by the Appraisal Standards Board of The Appraisal Foundation and that were in place at the time this appraisal report was prepared.

4. I developed my opinion of the market value of the real property that is the subject of this report based on the sales comparison approach to value. I have adequate comparable market data to develop a reliable sales comparison approach for this appraisal assignment. I further certify that I considered the cost and income approaches to value but did not develop them, unless otherwise indicated in this report.

5. I researched, verified, analyzed, and reported on any current agreement for sale for the subject property, any offering for sale of the subject property in the twelve months prior to the effective date of this appraisal, and the prior sales of the subject property for a minimum of three years prior to the effective date of this appraisal, unless otherwise indicated in this report.

6. I researched, verified, analyzed, and reported on the prior sales of the comparable sales for a minimum of one year prior to the date of sale of the comparable sale, unless otherwise indicated in this report.

7. I selected and used comparable sales that are locationally, physically, and functionally the most similar to the subject property.

8. I have not used comparable sales that were the result of combining a land sale with the contract purchase price of a home that has been built or will be built on the land.

9. I have reported adjustments to the comparable sales that reflect the market's reaction to the differences between the subject property and the comparable sales.

10. I verified, from a disinterested source, all information in this report that was provided by parties who have a financial interest in the sale or financing of the subject property.

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

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

13. I obtained the information, estimates, and opinions furnished by other parties and expressed in this appraisal report from reliable sources that I believe to be true and correct.

14. I have taken into consideration the factors that have an impact on value with respect to the subject neighborhood, subject property, and the proximity of the subject property to adverse influences in the development of my opinion of market value. I have noted in this appraisal report any adverse conditions (such as, but not limited to, needed repairs, deterioration, the presence of hazardous wastes, toxic substances, adverse environmental conditions, etc.) observed during the inspection of the subject property or that I became aware of during the research involved in performing this appraisal. I have considered these adverse conditions in my analysis of the property value, and have reported on the effect of the conditions on the value and marketability of the subject property.

15. I have not knowingly withheld any significant information from this appraisal report and, to the best of my knowledge, all statements and information in this appraisal report are true and correct.

16. I stated in this appraisal report my own personal, unbiased, and professional analysis, opinions, and conclusions, which are subject only to the assumptions and limiting conditions in this appraisal report.

17. I have no present or prospective personal interest in the property that is the subject of this report, and I have no present or prospective personal interest or bias with respect to the parties in the transaction. I did not base, either partially or completely, my analysis and/or opinion of market value in this appraisal report on the race, color, religion, sex, age, marital status, handicap, familial status, or national origin of either the prospective owners or occupants of the subject property or of the present owners or occupants of the properties in the vicinity of the subject property or on any other basis prohibited by law.

18. My employment and/or compensation for performing this appraisal or any future or anticipated appraisals was not conditioned on any agreement or understanding, written or otherwise, that I would report (or present analysis supporting) a predetermined specific value, a predetermined minimum value, a range or direction in value, a value that favors the cause of any party or the attainment of a specific result or occurrence of a specific subsequent event (such as approval of a pending mortgage loan application).

19. I personally prepared all conclusions and opinions about the real estate that were set forth in this appraisal report. I relied on significant real property appraisal assistance from any individual or individuals in the performance of this appraisal or the preparation of this appraisal report. I have named such individual(s) and disclosed the specific tasks performed in this appraisal report. I certify that any individual so named is qualified to perform the tasks. I have not authorized anyone to make a change to any item in this appraisal report; therefore, any change made to this appraisal is unauthorized and I will take no responsibility for it.

20. I identified the lender/client in this appraisal report who is the individual, organization, or agent for the organization that ordered and will receive this appraisal report.
Uniform Residential Appraisal Report

21. The lender/recipient may disclose or distribute this appraisal report to: the borrower; another lender at the request of the borrower; the mortgagee or its successors and assigns; mortgage insurers; government sponsored enterprises; other secondary market participants; data collection or recording services; professional appraisal organizations; any department, agency, or instrumentality of the United States; and any state, the District of Columbia, or other jurisdictions; without having to obtain the appraiser’s or supervisory appraiser’s (if applicable) consent. Such consent must be obtained before this appraisal report may be disclosed or distributed to any other party (including, but not limited to, the public through advertising, public relations, news, sales, or other media).

22. I am aware that any disclosure or distribution of this appraisal report by me or the lender/recipient may be subject to certain laws and regulations. Further, I am also subject to the provisions of the Uniform Standards of Professional Appraisal Practice that pertain to disclosure or distribution by me.

23. The borrower, another lender at the request of the borrower, the mortgagee or its successors and assigns, mortgage insurers, government sponsored enterprises, and other secondary market participants may rely on this appraisal report as part of any mortgage finance transaction that involves any one or more of these parties.

24. If this appraisal report was transmitted as an “electronic record” containing my “electronic signature,” as those terms are defined in applicable federal and/or state laws (excluding audio and video recordings), or by facsimile transmission of this appraisal report containing a copy or representation of my signature, the appraisal report shall be as effective, enforceable and valid as if a paper version of this appraisal report were delivered containing my original hand written signature.

25. Any intentional or negligent misrepresentation(s) contained in this appraisal report may result in civil liability and/or criminal penalties including, but not limited to, fine or imprisonment or both under the provisions of Title 18, United States Code, Section 1001, at sec., or similar state laws.

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

1. I directly supervised the appraiser for this appraisal assignment, have read the appraisal report, and agree with the appraiser’s analysis, opinions, statements, conclusions, and the appraiser’s certification.

2. I accept full responsibility for the contents of this appraisal report including, but not limited to, the appraiser’s analysis, opinions, statements, conclusions, and the appraiser’s certification.

3. The appraiser identified in this appraisal report is either a sub-contractor or an employee of the supervisory appraiser (or the appraisal firm), is qualified to perform this appraisal, and is acceptable to perform this appraisal under the applicable state law.

4. This appraisal report complies with the Uniform Standards of Professional Appraisal Practice that were adopted and promulgated by the Appraisal Standards Board of The Appraisal Foundation and that were in place at the time this appraisal report was prepared.

5. If this appraisal report was transmitted as an “electronic record” containing my “electronic signature,” as those terms are defined in applicable federal and/or state laws (excluding audio and video recordings), or by facsimile transmission of this appraisal report containing a copy or representation of my signature, the appraisal report shall be as effective, enforceable and valid as if a paper version of this appraisal report were delivered containing my original hand written signature.
Summary

There are several types of real estate appraisal licenses in California. The appraisal license or certificate is specific and independent from a real estate license.

An **appraisal** is an unbiased estimate or opinion of the property value on a given date. Most appraisals are based on market value. **Market value** is the price a property would bring if freely offered on the open market, with both a willing buyer and a willing seller. Properties excluded from market value result from default, foreclosure, bankruptcy, divorce, and death.

The appraisal process is a series of four steps leading to a final value estimate: (1) stating the problem, (2) gathering data (general and specific), (3) deciding on the appraisal method, and (4) reconciling the data for final value estimate. Appraisal techniques include the cost approach, income approach, and sales comparison approach. The gross multiplier technique also determines estimated value.

Appraisal theory focuses on principles of value, which include change, substitution, supply and demand, highest and best use, progression, and competition.

Included in the appraisal process are the four elements for estimating value: demand, utility, scarcity, and transferability. After the value of the property is established, the appraiser reviews other forces, such as physical, economic, political, and social changes.

Another factor in the appraisal process is depreciation. **Depreciation** is a loss of value, and results from physical deterioration, functional obsolescence, and economic obsolescence. Classifications of depreciation are curable or incurable or as accrued or accrual for depreciation.

The final step in the appraisal process is the examination of the different values (reconciling). The appraiser decides which of the values is the most appropriate for the property. The final value conclusions are documented in a restricted summary or self-contained appraisal report.
Matching Exercise

Instructions: Write the letter of the matching term on the blank line before its definition. Answers are in Appendix B.

Terms

A. actual age  P. effective age  EE. property
B. amenities  Q. effective demand  FF. reconciliation
C. appraisal process  R. fair market value  GG. replacement cost
D. appraisal report  S. flag lot  HH. scarcity
E. appraisal  T. front foot  II. T-lot
F. assemblage  U. functional utility  JJ. transferability
G. capitalization  V. improvements  KK. utility value
H. conformity  W. interim use  LL. utility
I. contract rent  X. key lot  MM. vacancy factor
J. corner influence  Y. location  NN. value
K. cost  Z. market price
L. cul-de-sac lot  AA. market rent
M. depreciation  BB. market value
N. economic life  CC. orientation
O. economic rent  DD. plottage increment

Definitions

1. ________ An unbiased estimate or opinion of the property.

2. ________ A lot that looks like a flag on a pole, which represents the access to the site; usually located to the rear of another lot fronting a main street.

3. ________ The increase in the value when several smaller parcels are combined together into one larger parcel.

4. ________ The power of goods or services to command other goods in exchange for the present worth of future benefits arising from property ownership.

5. ________ Desire coupled with purchasing power.
6. _______ When land uses are compatible and homes are similar in design and size, the maximum value is realized.

7. _______ Real age of a building.

8. _______ Features that add value to a property.

9. _______ The price the property would bring if freely offered on the open market with both a willing buyer and a willing seller.

10. _______ The rent a property should bring in the open market.

11. _______ The cost of replacing improvements with modern materials and techniques.

12. _______ Commercial properties benefit from more exposure on a corner lot.

13. _______ The ability of a property to satisfy a need or desire, such as shelter, income, or amenities.

14. _______ The placement of a building on its lot in relation to exposure to sun, prevailing wind, traffic, and privacy from the street.

15. _______ Age of a building determined by its condition and usefulness.

16. _______ The expenses in money, labor, material, or sacrifices in acquiring or producing something.

17. _______ An orderly systematic method to arrive at an estimate of value.

18. _______ Sometimes called the objective value.

19. _______ The process that can be employed to convert income to value.

20. _______ The availability or lack of availability of a commodity in the marketplace.

21. _______ The usefulness of the property to its owner. This is subjective value or the value given for personal reasons.

22. _______ Title to property must be marketable with an unclouded title.

23. _______ The estimated period over which a building may be profitably used.

24. _______ What a property actually sold for.
25. _______ Lot that is the least desirable due to the lack of privacy because it is surrounded by the back yards of other lots.

26. _______ A lot that is fronted head-on by a street; noise and glare from headlights may be detractors from this type of lot.

27. _______ This may be the most important factor influencing value.

28. _______ The combined factors of usefulness with desirability.

29. _______ A lot found on a dead-end street with same way for ingress and egress.

30. _______ The final step in an appraisal is to examine the values derived by the various approaches.

31. _______ The process of putting several smaller less valuable lots together under one ownership.

32. _______ Any buildings or structures on a lot.

33. _______ Loss in value from any cause.

34. _______ Short-term and temporary use of a property until it is ready for a more productive highest and best use.

35. _______ The width of a property along a street.

**Multiple Choice Questions**

Instructions: Circle your response and go to Appendix B to read the complete explanation for each question.

1. “The relationship between a thing desired and a potential purchaser” is one definition of:
   a. economic function.
   b. economic necessity.
   c. effective public demand.
   d. value.

2. The market value of real property is most nearly its _______ price.
   a. asking
   b. listing
   c. market
   d. offered
3. Market value of improved real property is least affected by:
   a. an open market.
   b. its exchange value.
   c. its objective value.
   d. the original cost of materials.

4. The value of real property is best measured by:
   a. demand, depreciation, scarcity, and utility.
   b. cost, demand, transferability, and utility.
   c. cost, feasibility, scarcity, and utility.
   d. demand, scarcity, transferability, and utility.

5. The ultimate test of functional utility is:
   a. design.
   b. marketability.
   c. utility.
   d. maintenance costs.

6. In the appraisal of real property, the term unearned increment most nearly means:
   a. an increase in value due to population increase.
   b. a decrease in value due to social forces rather than personal effort.
   c. a decrease of property taxes.
   d. depreciation.

7. Which of the following appraisal approaches is based primarily on the principle of substitution?
   a. Cost approach
   b. Summation approach
   c. Sales comparison approach
   d. income capitalization approach

8. In determining the value on an unimproved parcel of land, the first thing to establish is its:
   a. listing price.
   b. purchase price.
   c. highest and best use.
   d. closest comparable properties.
9. In a well-planned residential community, which of the following contributes most to the maintenance of value?
   a. Conformity to proper land-use objectives
   b. Deed restrictions
   c. Variances to permit the highest and best use of every parcel of land
   d. Prevention of major thoroughfare construction through the community

10. Land is generally valued at its highest and best use. If someone buys land with a building on it that must be torn down, the appraiser should:
    a. add the salvage value.
    b. add nothing to the value of the land.
    c. deduct the cost of demolition.
    d. appraise the building using the income approach.

11. In the sales comparison approach to appraisal, what is the most important as well as the most difficult step?
    a. Collection of data on comparable properties
    b. Analysis of data on comparable properties
    c. Adjustment of data to reflect differences between subject and comparable properties
    d. Establishing the correct unit of comparison

12. The sales comparison approach to appraisal would be least reliable:
    a. in an inactive market.
    b. in a neighborhood where the land uses are rapidly changing.
    c. when the comparables are in the same price range.
    d. when the comparables are located in another neighborhood.

13. An appraiser is using the sales comparison approach. A comparable property has an amenity that is not present in the subject property. The appraiser would therefore:
    a. add the value of the amenity to the subject property's value.
    b. subtract the value of the amenity from the comparable property's value.
    c. realize it doesn't matter because no two properties are exactly alike.
    d. list the value of the amenity separately.

14. In appraising the value of a building using the replacement-cost method, an appraiser would consider all of the following, except:
    a. the cost of improvements to the land.
    b. a separate estimate for the value of the land.
    c. allowances for depreciation.
    d. the appropriate capitalization rate.
15. The cost approach is more difficult to apply to older properties than to newer properties because:
   a. historic costs are difficult to obtain.
   b. land prices are difficult to estimate on older properties.
   c. depreciation schedules are difficult to determine on older properties.
   d. zoning and building codes are subject to change.

16. Functional obsolescence would not include:
   a. eccentric design.
   b. items of surplus utility.
   c. lack of air conditioning.
   d. proximity to nuisances.

17. The major cause of loss of value of real property is usually due to:
   a. deterioration.
   b. passage of physical life.
   c. obsolescence.
   d. lack of maintenance.

18. A building that constitutes an improper improvement to its site is an example of:
   a. curable physical obsolescence.
   b. incurable physical obsolescence.
   c. curable functional obsolescence.
   d. incurable functional obsolescence.

19. Economic rent is best defined as the rent:
   a. required to produce a suitable return for the owner.
   b. generated by the property in a theoretically perfectly informed market.
   c. agreed to by a lessor and lessee under the terms of a written lease.
   d. received for comparable space in the competitive open market.

20. To calculate accurately a gross rent multiplier, the appraiser needs __________ from comparable properties.
   a. net income and selling price
   b. original cost and the annual income
   c. annual rent and the selling price
   d. net income and the capitalization rate
21. The capitalization approach is based primarily on the appraisal concepts of:
   a. change.
   b. competition.
   c. anticipation.
   d. retribution.

22. The effective annual gross income of a property is the difference between the annual gross income and:
   a. vacancy factor and rent collection losses.
   b. allowable expenses and depreciation.
   c. capitalization rate.
   d. administrative expenses and capital improvements.

23. The estimated period of time over which a property will yield a return on investment over and above the economic rent attributable to the land itself is known as its:
   a. earning period.
   b. economic life.
   c. investment period.
   d. productive life.

24. Which of the following would be used by an appraiser who has chosen the income approach to establish the value of an apartment building?
   a. Excess rent
   b. Percentage rent
   c. Economic rent
   d. Contract rent

25. A 12-year-old building that has been maintained in excellent condition is given an age of 6 years by an appraiser. This would be known as its:
   a. actual age.
   b. economic life.
   c. effective age.
   d. physical life.

26. When comparing the economic and physical life of a building, the economic life is usually:
   a. equal.
   b. longer.
   c. shorter.
   d. shorter or longer depending on the maintenance.
27. When calculating the net income, which of the following is not deducted?
   a. Maintenance expenses
   b. Management fees
   c. Mortgage interest
   d. Vacancy losses

28. In the capitalization approach to appraisal, the most difficult step is to determine:
   a. gross income.
   b. effective net income.
   c. net income.
   d. the capitalization rate.

29. The gross rent multiplier is defined as:
   a. sales value/gross rent.
   b. gross rent/sales value.
   c. assessed value/gross rent.
   d. gross rent/market value.

30. Usually, an appraiser estimates the value of a property by using all three major approaches. To obtain a final estimate of value, the appraiser ___________ the three indications of value.
   a. amortizes
   b. averages
   c. finalizes
   d. reconciles