



UNDERSTANDING HOW THE VALUATION OF YOUR RESIDENTIAL PROPERTY WORKS*

There are 3 traditional approaches to the valuation of Real Property:

- The Income approach, in which investment real estate is valued for its income and expenses.
- The Cost approach, which finds the value as a result of adding the cost of the land plus construction costs. This is mainly used in new construction or unique properties (a museum or a church, for example).
- The Sales comparison approach which is the method most commonly used to value residential property. Recent sales records of other similar properties (comparables or "comps") are selected and their values adjusted when comparing them to a subject property.

In the first place it must be said that valuating Real Property is not an exact science. Selecting comparables and adjusting for differences is somehow subjective and it explains why 3 licensed appraisers would come up with 3 slightly different values for the same property but within a close range.

In the second place homeowners must be aware of the fact that appraisals are only performed by *licensed appraisers*. A Real Estate Broker performs market analysis or property evaluations that, depending on the expertise of the Broker may be as accurate as a bank appraisal or not. Furthermore, an experienced and active Broker may have updated market information unavailable to most appraisers.

You should also beware of offers to value your property over the phone, "just driving by and looking at the outside" or thru the Internet. These are highly inaccurate methods because the value of a property is affected by condition, layout, modifications and major renovations. Valuating it by looking at the outside is like selecting your spouse by looking at a picture. Valuating a house through the Internet is like getting married through the Internet.

Finally, you should resist the temptation to regard the value of your property to be higher just because it's your property. For us homeowners, our house is obviously the best one because it's where we live, where we have put a lot of effort, love and attention, but this doesn't necessarily mean that our house is objectively better than a comparable property. For us, no house is comparable to ours, but for banks and potential buyers, this is what valuating is all about: comparing similar properties.

The comparable method: factors that determine value.

Location, location, location.

It is common knowledge that the single factor that exerts the most influence in property values is location. That is pretty easy to understand, but what are the rules and features of location that must be taken into account?

- When selecting comparable properties one of the main considerations is proximity of these comparables to the subject. Ideally, these comparables should not be more than 0.5 miles away from the subject property and they should absolutely be located within the same zip code.
- But there are aspects of location that are subtler. One of them is zoning. While some banks will not make residential loans in manufacturing districts, changes in zoning may dramatically affect best and highest use of a certain property, for better or for worse.
- The proximity to transportation and other amenities is an aspect of location important to both homeowners and potential tenants. This is key in our area since 75% of the properties have more than one residential unit.
- Negative features of location could be determinant: noise, pollution, unsightly views, a bad traffic pattern, etc. We must remember that a well-informed buyer will definitely ponder all of these. The successful sale of a property more determined by the realistic pricing of the property rather than affected by these negative features. In other words, we can change the price of real estate but we can't change its location.

Time of sale.

Fannie Mae appraisers are generally required to find comparable sales that are not older than six months. When looking at records of sales in your area, make sure that they correspond to the most recent sales (look at our public record pages inside this issue for last December and January sales). The market changes monthly and you must be sensitive to its changes. If supply is higher now than when the comparable sales happened, allow for an adjustment when pricing your property.

Type of property.

Evidently, you want to compare your property with similar properties. You should be looking at a minimum of 3 "comps" that have the same number of families, construction, lot size, etc. than yours. You know the saying, "you can't compare apples with oranges". In an attempt to justify exorbitant asking prices you could hear things like "oh well, if a one family sells for \$500,000, my two family home is a good deal at \$875,000". As you may agree, it doesn't work like that...

The comparable properties should be of the same construction, number of stories and approximate square footage than yours. Some times this proves to be a difficult task and the selection of comparable sales requires a reasonable and reasoning mind. For example, you may describe the number of rooms in a property, which is important information but not as revealing as square footage.

A good exercise is to calculate the price per square foot of the subject and compare it to the market's average. If there is a big discrepancy, chances are that the subject may not sell at the inflated price.

Supply and demand also determine what types of property are most desirable; these varies according to the times and to trends. In a hot market, buyers may be willing to appreciate 2 bedroom units because 3 bedroom units are not affordable; by contrast, in a cooling market, choosier buyers will demand the 3 bedroom units that can be easily found because of the surplus inventory and the 2 bedroom units will have to adjust their values beyond per square foot expectations.

Other factors: age and condition, amenities.

As a rule of thumb, homeowners should compare houses that are in the same age group (one could imagine the following groups: properties in their teens, in their twenties and thirties and, mature properties). Age is very related to condition and appraisers have a term for age related defects called "functional obsolescence". This applies to features that are now considered a

defect (lead piping or a railroad layout, for example) even though they are not illegal. However, age per se is not a defect; many a times the condition of a property has to do with the way it has been maintained and treated. In other cases, like the major systems, bathrooms and kitchens, new is obviously more efficient, durable and eye pleasing than old.

On the other hand condition has its limits at increasing property values. Fannie Mae appraisers have rules regarding how much can a property be favored over other comparables because of condition. In other words and to put it very graphically, not because you refurbish a bathroom with gold fixtures is the value of your home going to be dramatically different to the market average. Think of the condition of your home as the model year of a car: a potential buyer will mostly consider the age, the miles and the functionality of the vehicle and pleasingly regard the custom stereo as a "freebie". Good average condition is a common expectation of buyers, in other words they take it for granted! Luxury conditions are a nice lure but they often do not bring the same amount of dollars they cost. Finally, poor conditions are penalized by buyers who must add to the cost of renovations, the headache of dealing with them.

The value of certain amenities varies from market to market. In some areas a full finished basement is a must. In others it is parking. Pool or no pool, corner or middle of the block, the best way to judge these features is to walk in the shoes of a potential buyer. Just make sure that you are objectively comparing your home to others. We often downgrade the value of things we don't have and emphasize the value of things we have; it's human nature. A good tip: keep it real. Pricing your home more accurately and marketing it exhaustively will lead to a higher price, in less time and without headaches.

A word on the veracity of information and the reputation of the sources.

Even though it is understandable that some homeowners will refuse to reveal the final sales price of their homes, we can't excuse so called professionals that pull prices out of thin air. Very simply, do not take either opinion. The only certainty of a sales price is to see the public records of sales (as published right here in *On the Market*) or like the appraisers are required to do by law, to get a copy of the HUD statement from a property closing. Don't go by what "Paul or John said Mary sold her house for", verify it. Even Multiple Listing Service records have flaws and hype. Sometimes, closing costs have been included in the sale of the property making the final price higher. Sometimes a property sold for less because the homeowner was not advised professionally. Sometimes the price has been inflated in a speculative sale. Get a good sample of the market, deal with reputable sources or simply call me if you want to verify a sales price. My information is accurate, I will only ask for a cup of coffee. Thanks for your patronage!



****Call me if you need to value commercial property. In our next issue of On the market we will talk about the affordability test of multifamily property.***

Manuel Vargas
917-559-2002