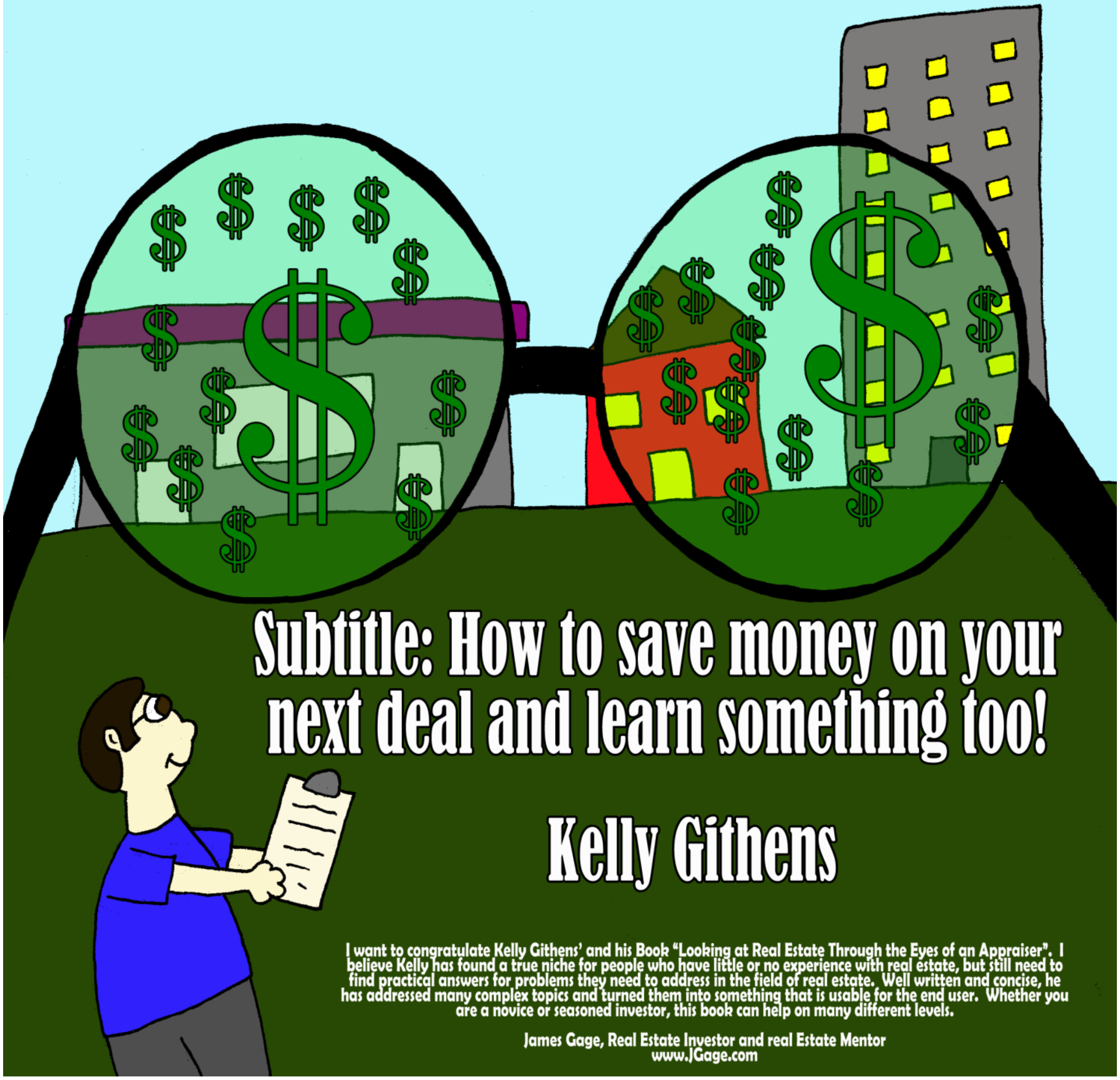
# Looking at Real Estate Through the Eyes of an Appraiser



## Subtitle: How to save money on your next deal and learn something too!

**Kelly Githens**

I want to congratulate Kelly Githens' and his Book "Looking at Real Estate Through the Eyes of an Appraiser". I believe Kelly has found a true niche for people who have little or no experience with real estate, but still need to find practical answers for problems they need to address in the field of real estate. Well written and concise, he has addressed many complex topics and turned them into something that is usable for the end user. Whether you are a novice or seasoned investor, this book can help on many different levels.

James Gage, Real Estate Investor and real Estate Mentor
www.JGage.com

# Introduction

The purpose of the eBook is to help the person with no or little real estate experience learn some of the basics of real estate, some useful tools and most importantly, how to save some money. Topics I'll be covering include:

**Introduction**

1. Looking at land
2. Looking at improvements
3. Highest and Best Use Analysis
4. Basic financial analysis
5. Looking at markets
6. How to quickly value a residential property
7. Commercial property types and quick valuation techniques
8. How to quickly look at and understand a residential appraisal
9. Appealing property taxes
10. Investing in Real Estate

**Summary**

I don't look at this as a one off piece of work and fully expect this work to live and grow, to serve people who are not experts in the field of real estate but need a functional working knowledge of the field or where to find answers.

Let me introduce myself. My name is Kelly Githens and I'm from Portland, Oregon. Summarizing my pedigree, I have an MBA, I was a Captain in the Army, and I'm a Certified General Appraiser in Oregon and had my Mortgage Loan Originator License. I got into real estate out of curiosity and a sense of destiny.

Beginning, I resigned my commission from the Army as a Captain in 1985 and immediately took my first contract in Saudi Arabia, teaching Saudi Arabian National Guard soldiers American techniques and systems. Between my first and second contracts, I had some down time at home in Portland where I took and passed training to be a Realtor. I had no idea why I took the course; a combination of boredom and the knowledge that I wanted to be a real estate investor to make my fortune.

After completing my second contract, I got back in-country in 1990. From there, I returned to Killeen, Texas and Central Texas College, to finish the last term I needed to complete my MBA. During the course of studies, I read an article in the Wall Street Journal about the Resolution Trust Corporation and how there was a great need for competent Real Estate Appraisers. So with that factoid ingrained in my head, I returned to Portland, Oregon to pick up my life.

I asked some of my old acquaintances about appraisers, specifically who had the best reputation and who I should work for. I talked with three appraisers and set up and appointment with one who was an MAI (Member of the Appraisal Institute). At the same time I interviewed three times with Nike for a position in overseas logistics. I sometimes wonder what would have happened had I taken that position-coulda, woulda, shoulda.

Back to the MAI. He wooed and won me with the prestige associated with the MAI designation and I became a commercial real estate appraiser. I entered a four year period of existing in a no man's land. What I mean by that is that I was fundamentally unhappy and couldn't understand why. It finally dawned on me why I was unhappy; I had wanted to be an appraiser so I could be the best investor possible. Now that made sense. However, in the mean time I was learning a trade that was making me unhappy. My job as an MAI Candidate entailed verifying sales, leases, photographing various properties and sitting for endless hours in front of a dictaphone, dictating notes for transcription. During this time I took numerous courses from the Appraisal Institute, most all of which were demanding. Now that I liked-I always liked being challenged. I remember spending back to back weeks on Capitalization Theory and getting a kick out of being tested and meeting the challenge.

About this time I had a crisis of faith and realized how fundamentally unhappy I was appraising commercial real estate. Also about this time, one of my buddies said he wanted to buy, fix and flip houses. So it wasn't a big leap for me to tell-off my MAI and quit.
We did about seven properties in 1995. When I say about seven properties, two of the properties had various attributes I discovered which provided additional money-making profit centers. We were making a decent wage, at about $70k apiece, but nothing to write home about. I realized we needed to use the concept of leverage, using hard money. My buddy was content with doing one property at a time and so we got an amicable divorce and we're still friends.

During this period, I was spending some time with a residential appraiser and his soon-to-be wife. He agreed to show me how to complete the residential appraisal form, the URAR (Uniform Residential Appraisal Report Form 1004), for a portion of the fee and introduce me to Washington Mutual Savings Bank or WAMU. In turn, he was having some problems with some commercial properties he was appraising, specifically on how to build capitalization rates. It was a short, but profitable relationship. My relationship with WAMU lasted for almost 10 years. I average about 300 appraisals per year over that time period and got to appraise most all types of residential real estate.

The cash flow was great, but things came crashing down in 2006. At that time I was making a conscious decision to migrate from appraising into developing "Shoe Box Condominiums", which is basically taking a residential property with a big back or side yard and developing the entire site to the maximum allowable density allowed by the existing zoning code. Well 2007 happened and I wound up sitting on four development properties which couldn't begin to cash flow.

Back to the drawing board. I listened to a RE guru from back east who specialized in buying and selling apartments. Well, the difference between what he was selling and reality was really an eye opener. I never did reconcile his pitch and what he was selling with what goes on in the real world. So after a long while and plenty of pit stops in the last couple of years, it's dawned on me that I have a story to tell folks who don't know much about real estate, but need a crash course; kind of like Real Estate for Dummies, but more condensed, concise and from someone with my background as both an appraiser and as an investor. I know you can always turn to a Realtor or maybe a Real Estate Attorney, but I think everybody should have at least a basic or cursory knowledge of this field. And it is a field with its own secular body of knowledge.

But enough of me, this is about you and your needs. Talking with beginning investors at my REIA (Real estate Investors Association), a constant question I hear is, "Where do I get the background or fundamental knowledge in the field in real estate?" My first response is to suggest taking a class at your local community college relating to the basic, principals or fundamentals of real estate. I suggest attending a class instead of taking an online course, cause you can interact with the instructor and ask your questions and get a human response.

My goal is to pass on the general framework to look at, perform due diligence and get an idea of how to value real estate. The field of real estate is so broad and all-encompassing. it's been difficult to choose what to address and explain and what to pass over. If I do get it wrong and go into too much detail or not enough, I apologize in advance and reserve the right to change my approach. I've vetted this document enough times to be pretty sure there is something in here from newbies to the field up to the beginning investor, to either save you money on your next deal or provide you with some good usable knowledge. Enough said, now let's get down to it...

# Chapter 1.
# Looking at Land

Let's get started with the basics. The underlying component to all real estate is the land. Here's the way I look and how you can look at it. First thing is to do, is to get what in my part of the country is called a "Trio". Other parts of the country may have other names for the three items which make up a "Trio". I've included them so you can easily follow along with me. The first part of the "Trio" is the tax statement. The statement has a many factual items that can tell you a lot about the property. Here, we're just focusing on the land component. You can follow along with me and check out what this statement tells you about the land, as well as other items relevant to the entire property. This tax statement tells you the following and I've numbered the items so you can follow along:

**1.** Tax ID or what's called the assessor number
**2.** Property address also referred to as situs address
**3.** City, State and Zip Code
**4.** County
**5.** Lot Square Feet (SF)
**6.** Lot Dimensions
**7.** Acreage: A quick lesson on acreage. There are 43,560 SF in an acre. If the lot we were looking at had 5,000 SF, then the acreage would be .11 acres: 5,000 SF/43,560 SF = .11 acres. If you have a large lot, say 341,567 SF, that would be 7.84 acres: 341,567 SF/43560 = 7.84 acres.
**8.** Market Land: This is what the assessor thinks the land component of the property is worth.
**9.** Thomas Guide Page, Column and Row.
**10.** Property Class
**11.** Land Use
**12.** Subdivision
**13.** Legal Description
**14.** Information of Map and Tax Lot Information, to include the Township, Range, Section and Quarter Section.
**15.** Census Tract and Block
**16.** Lot Number
**17.** Zoning
**18.** Tax Area Code and Rate

| | | | |
|---|---|---|---|
| Presented by: | [redacted] | | 1/14/2013 11:49:36 AM |

## MULTNOMAH COUNTY, OR

| | | | |
|---|---|---|---|
| **Tax ID:** | [redacted] | **Latest Listing ID:** | [redacted] |
| **Prop Addr:** | [redacted] | **County:** | [redacted] |
| **City/State/Zip:** | [redacted] | **Carrier Rt:** | [redacted] |

## OWNER INFORMATION

| | | | |
|---|---|---|---|
| **Owner Name:** | [redacted] | | |
| **Owner Addr:** | [redacted] | **Phone:** | |
| **City/State/Zip:** | [redacted] | **Carrier Rt:** | [redacted] |

## LAND INFORMATION

| | | | | | |
|---|---|---|---|---|---|
| **Lot SqFt:** | 8250 | **Lot Dim:** | 0x0 | **Acreage:** | 0.19 |

## BUILDING INFORMATION

| | | | | | |
|---|---|---|---|---|---|
| **Year Built:** | 1947 | **Bedrooms:** | 2 | **Parking SF:** | 280 |
| **Eff Yr Built:** | 1947 | **Bathrooms:** | 1 | **Garage:** | DETACHED |
| **Style:** | BUNGALOW | **Living SF:** | 810 | **Fuel:** | ELECTRIC |
| **Stories:** | 1 | **Bldg SF:** | 810 | **Heat Method:** | BASEBOARD |
| **# of Bldgs:** | 1 | **Bldg SF Ind:** | LIVING | **Sewer:** | |
| **Bldg Code:** | SINGLE FAMILY | **Bsmnt SF:** | | **Roof Cover:** | COMPOSITION |
| **Fireplace:** | 2 | | | **Roof Type:** | GABLE |
| **Fireplace Type:** | TYPE UNKNOWN | | | **Air Cond:** | |
| **Foundation:** | CONCRETE | | | | |
| **Exterior Finish:** | WOOD | | | | |

## SALES INFORMATION

| | Deed Type | Sale Date | Sale Price | Document No |
|---|---|---|---|---|
| **Current:** | | 6/6/2012 | $93,000 | 000000080705 |
| **Prior:** | | 2/10/2012 | $183,150 | 000000040748 |

| | | | |
|---|---|---|---|
| **Title Co:** | [redacted] | **Vest Type:** | |
| **Lender:** | | **Loan Amt:** | $0 |
| **Loan Type:** | | | |

## TAX INFORMATION

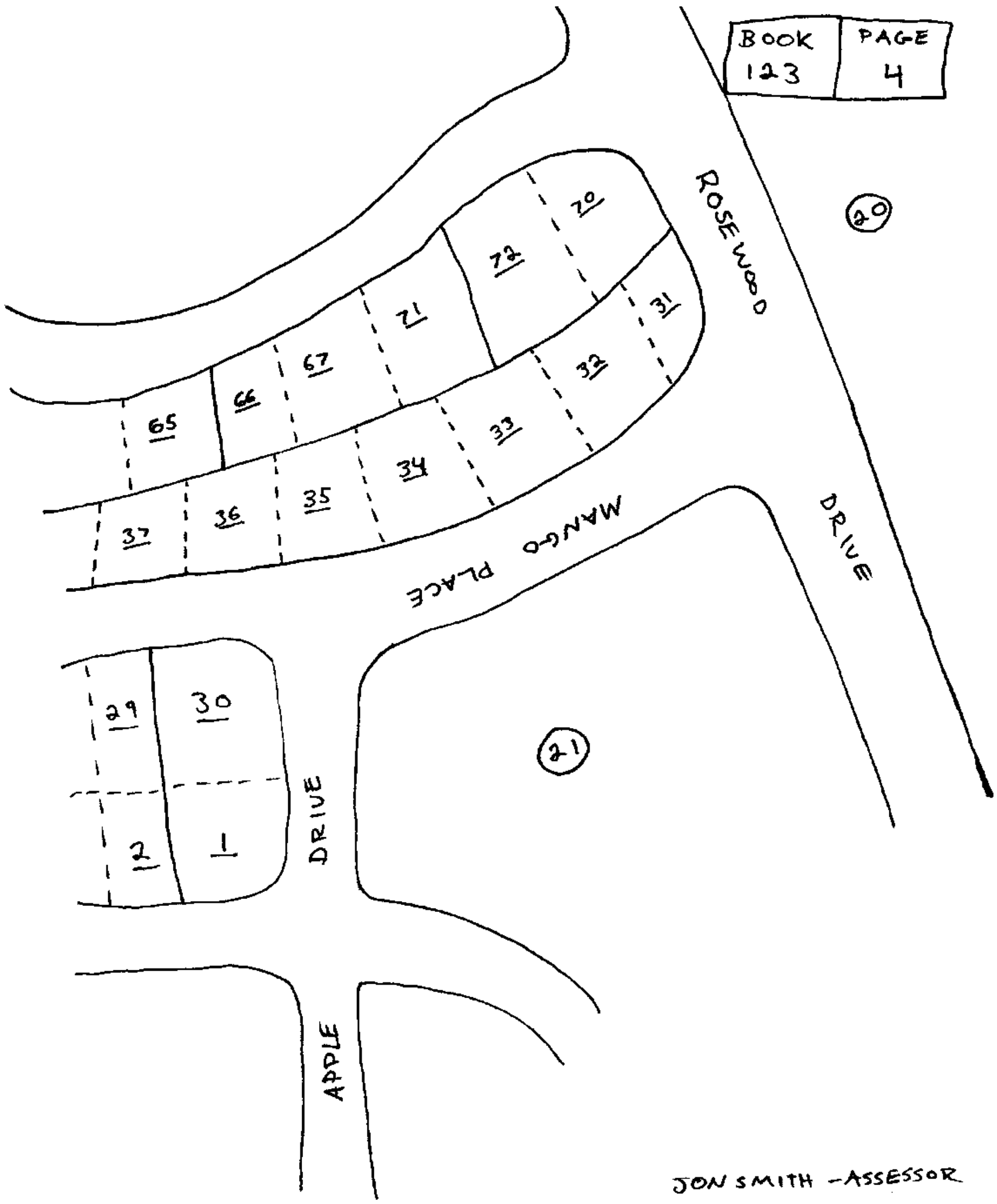
| | | | | | |
|---|---|---|---|---|---|
| **Tax Period:** | 11-12 | **Market Land:** | $80,300 | | |
| **Tax Year:** | 2011 | **Market Impv:** | $58,010 | | |
| **Tax Amt:** | $1,952.28 | **Market Total:** | $138,310 | **Assessed Total:** | $93,830 |

## LEGAL INFORMATION

| | | | | | |
|---|---|---|---|---|---|
| **Map Page:** | 597 | **Map Code:** | [redacted] | **Census Tract:** | [redacted] |
| **Map Column:** | J | **Township:** | [redacted] | **Census Block:** | 1 |
| **Map Row:** | 1 | **Range:** | [redacted] | **Lot:** | 3 |
| | | **Section:** | [redacted] | **Zoning:** | R7 |
| **Nbrhd Code:** | [redacted] | **Qtr Section:** | [redacted] | **Tax Area Code:** | 006 |
| **School Dist:** | | **16th Section:** | [redacted] | **Tax Rate:** | 0.000 |

| | |
|---|---|
| **Prop Class:** | SINGLE FAMILY RESIDENCE / TOWNHOUSE |
| **Land Use:** | SFR |
| **Subdivision:** | [redacted] |
| **Legal Desc:** | [redacted] |

The second of three items you should get with the "Trio", is called the Plat Map. What this map does is to represent what the boundaries and dimensions look like for the subject site as well as other surrounding sites. Most of the time these maps will be marked with a star or an arrow to show you where the subject site is located. Our title companies usually provide a smaller scale plat map where you see where the subject is in relation to known streets or landmarks, then a larger scale map so you can focus on the dimensions and things on or around the subject site.



The third item you should receive is the last vesting document. Normally, this will include the buyer, seller, date, document number, consideration paid for the property and also make mention of any other thing which may have relevance to the property you're looking at.

5 / 3

FIRST AMERICAN

BOOK 2236 PAGE 2088

## STATUTORY WARRANTY DEED

[redacted] AS TENANTS BY THE ENTIRETY, Grantor,

conveys and warrants to [redacted], Grantee,

the following described real property free of liens and encumbrances, except as specifically set forth herein:

A part of the Lewis Hale Donation Land Claim in the Southeast one-quarter of Section 11, Township 1 South, Range 3 East of the Willamette Meridian, in the City of Gresham, County of Multnomah and State of Oregon, described as follows:

Beginning at the West line of said Hale Donation Land Claim, 519.2 feet North of intersection of the center line of the Powell Valley Road with the West line of said Hale Donation Land Claim; thence continuing North 100 feet; thence East 337.5 feet; thence South parallel with the West line of said Hall Claim 100 feet; thence South 88°41' West 337.6 feet to the point of beginning.

*EXCEPT that portion thereof lying in Kline Road.*

Recorded by First American Title Insurance Company of Oregon

543863

This property is free of liens and encumbrances, EXCEPT: 1989-90 TAXES A LIEN, NOT YET PAYABLE; THE RIGHTS OF THE PUBLIC IN AND TO THAT PORTION OF THE PREMISES HEREIN DESCRIBED LYING WITHIN THE LIMITS OF ROADS, STREETS AND HIGHWAYS.

THIS INSTRUMENT WILL NOT ALLOW USE OF THE PROPERTY DESCRIBED IN THIS INSTRUMENT IN VIOLATION OF APPLICABLE LAND USE LAWS AND REGULATIONS. BEFORE SIGNING OR ACCEPTING THIS INSTRUMENT, THE PERSON ACQUIRING FEE TITLE TO THE PROPERTY SHOULD CHECK WITH THE APPROPRIATE CITY OR COUNTY PLANNING DEPARTMENT TO VERIFY APPROVED USES.

The true consideration for this conveyance is $ 70,000.00 (Here comply with the requirements of ORS 93.030)

DATED this 11TH day of SEPTEMBER 19 89.

X [redacted] X [redacted]

STATE OF OREGON, County of [redacted] )ss.

The foregoing instrument was acknowledged before me this 11TH day of SEPTEMBER 19 89 by [redacted]

[redacted]

Notary Public for Oregon

My commission expires: ~~6/22/92~~ 3/20/95

SEAL

CORPORATE ACKNOWLEDGMENT

STATE OF OREGON, County of ________ )ss.

The foregoing instrument was acknowledged before me this ______ day of ________ 19 ____ by ________ and by ________ of ________, a corporation, on behalf of the corporation.

Notary Public for Oregon

My commission expires:

SEAL

Title Order No. [redacted]

Escrow No. [redacted]

THIS SPACE RESERVED FOR RECORDER'S USE

STATE OF OREGON, Multnomah County } ss

I, a Deputy for the Recorder of Conveyances, in and for said County, do hereby certify that the within instrument of writing was received for record and recorded in the record of said County [redacted]

In Book BOOK 2236 PAGE 2088 On Page

Witness my hand and seal of office affixed

Recorder of Conveyances

[redacted] Deputy

After recording return to:

[redacted]

NAME, ADDRESS, ZIP

Until a change is requested all tax statements shall be sent to the following

SAME AS ABOVE

NAME, ADDRESS, ZIP

TI 96 — 9/85

9-14-89

You can order this Trio, or something like it from your local title company. If they want money, then find a Realtor. Realtors have established relationships with title companies in the course of business, so it's no problem for them to get you a Trio. The tax statement may be available within public municipal records. But combined, these three things can tell you a tremendous amount about your subject site.

Now, in addition to the Trio, let's build a list of things to look for and then we'll discuss the various types of land and how to value them.

These are the various attributes I look at when I look at land:

**Zoning:** What is the zoning of any particular site and what can be done with it? What is the highest and best use? Get this from the local municipality in charge of land use. They will be able to direct you to the correct zoning designation and an explanation of what can and can't be done under the zoning designation. We are going to discuss highest and best use more in detail later.

**Utilities:** What utilities serve the site and where are they located? Water, sewer, gas and electricity are normal utilities. Where are they located both to the site and on the site?

**Topography:** How does the land slope and in which direction.

**Improvements:** What is on the site right now? Improvements consist of things like curbs, sidewalks, driveways, fencing, the structures built on the land, outbuildings, etc.

**Vegetation or landscaping:**

**Size:** How big is the site?

**Streets:** What type of street serves the site? For example, it's good to have a four lane boulevard run right by a warehouse or commercial building, but what if it runs by a house? Is that good or bad?

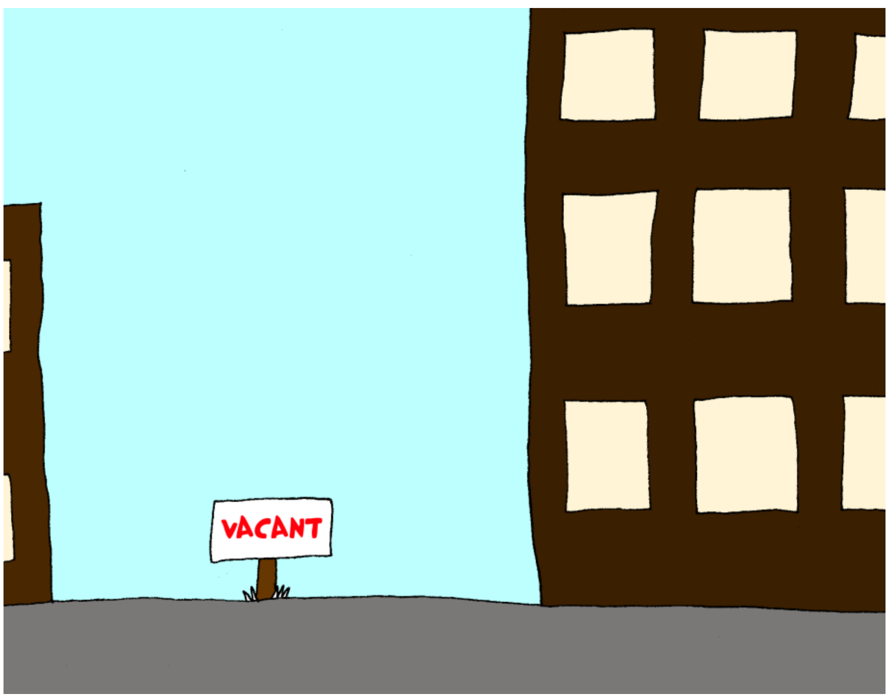
**Flood Map Location:** Is the site located where there has been or might be flooding?

**Easements or encroachments:** An easement is a legal access to or even through a property. If you find an easement on a property you are researching, then you probably need help understanding the particular easement and how it burdens the site you're looking at. Encroachments are when improvements or items of record extend into your site; like when the positioning of a house straddles a property line, crossing over the property line.

Another great source for verifying the existence and current use of any given parcel is the use of Google Maps and Google Earth.

**Valuation.** How do you value any parcel of land? That will depend mainly on the zoning. The zoning tells you what you can and can't do with the particular parcel. That's pretty simplistic, but that's the way it is. For example, if you wanted to value a residential building lot, you would look for other similar building lots which have sold or are for sale. Once you have identified a typical building lot, you can add or subtract value based upon location in the subdivision, larger or smaller size, view, etc.

If you wanted to look at a parcel which was zoned for multifamily, you would simply start by dividing square footage by the allowable density. If you had a 12,500 SF parcel with a zoning of R2 (2,000 SF minimum per unit), your first calculation would be to divide 12,500 SF / 2,000 = 6.25. Round down to 6 units and you have the density calculation. Next, you look for closed sales or active listings to determine how much someone paid for land with that type of the zoning. Let's say you found three sales with the same R-2 zoning: 4,000 SF for $40,000; 10,000 SF for $90,000; 6,000 SF for $60,000. Using the same calculation above, they are all around $20,000 per unit. Looking back at the parcel we were interested in with 6 units, multiply the price per unit we found in the marketplace at $20,000 and the resultant value is $120,000 (6 units x $20,000 per unit)




Commercial or industrial land is usually valued based upon the price per SF or acre. If you have a 5,000 SF lot zoned General Commercial, look for closed sales or active listings of properties with the same zoning. If you have to use a zoning which is less or more intense, just make sure you make notes to account for why that sale or listings sold for higher or lower. In our example, let's say I found two closed sales close by: One was zoned General Commercial and one was zoned Mixed-Use Commercial. The General Commercial parcel sold at $10/SF (Let's say a 10,000 SF parcel which cost $100,000, or $100,000 / 10,000 = $10/SF). The Mixed Use Commercial had 15,000 SF and sold for $105,000. Based upon the sales price, the Mixed Use Commercial parcel sold at $7/SF ($105,000 / 15,000 SF = $7). The third sale you located was an active listing. It is about the same size as the subject, with 7,000 SF and the same General Commercial Zoning. When you contact the broker who is listing the property, he or she says the asking price is $85,000, or $12.14/SF ($85,000 / 7,000 SF = $12.14. All things being equal, the list price is going to be higher than the final sales price. Same for most any big ticket item where you can negotiate. You have three sales, one of which has a use of lesser intensity and one of which is an active listing where the seller is willing to negotiate. So adjust the parcel with lesser intensity up and the active listing down and you wind up with an adjusted value of $10/SF. When you apply this to the 5,000 SF parcel you are interested in, the value is $50,000. A very simple, but effective way of looking at land.

An appraiser is paid to look for things which cause values to change and then account for them in a report. Things like size regression where larger parcels with the same zoning and location will sell for a lower price per SF than smaller parcels. Front feet on busy streets are another way to look and value land. Busy corners are also looked at with special techniques to gauge values.

I've created a checklist so you can effectively analyze a property by answering the questions or filling in the blanks (See Land Checklist). Together with the Trio and the Land Checklist, you now have the beginnings of a very comprehensive set of data from which you can make decisions.

**Land Checklist**

**Zoning:**

**Utilities**

**Topography:**

**Site Improvements:**

**Size:**

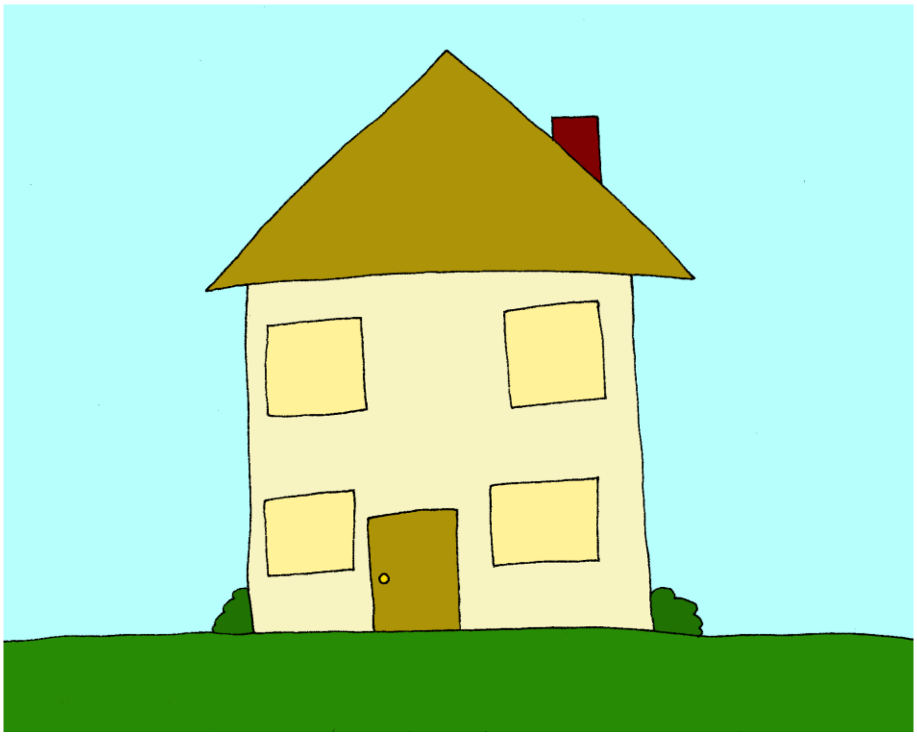
**Landscaping:**

**Streets/Access:**

**Flood Map:**

**Easements/Encroachments:**

# Chapter 2.
# Looking at Improvements



Now that you've analyzed the land, let's look at improvements. We're going to focus on residential improvements. We won't be discussing other types of commercial improvements; those will be addressed in Chapter #4. This isn't a lesson in development, architecture, engineering, building or rehabbing, but on how I look at the basic structure. I've included an improvement checklist to keep your thoughts all in one place.

Any time you're dealing with or purchasing residential real estate, it's in your best interest to have a professional inspection done. This does a couple of things for you. It gives you a baseline of where the property is right now with respect to condition and maintenance. It provides the seller notification that you know about the properties' deficiencies and gives you negotiation room. Look for a building inspector who is licensed, bonded and has references within the state or municipality where you live. When you find one, negotiate with him to give you the costs associated with fixing the items listing in the report. That way you can back out the cost to fix the items and come up with a purchase price that reflects what needs to be fixed. If you can't find an inspector to itemize the costs to fix up or what we call in the business as the "cost to cure", you might be leaving money on the table when you go to make a purchase.

When it comes to costing items out, I suggest using Costhelper.com. Play around with it. It's a very useful tool for getting a general cost for just about anything.

After I've taken a look at the site, I want to see how the improvements, in this case a house, are situated on the land. Most of the time, this will tell you where the utilities are located. If you have any question, then go to the local municipality which has jurisdiction regarding building and building codes and ask to look at their records and get copies of the records for the file you've opened on this property. While you're doing your research at the building department, look up the permit history. This will tell you when and what type of permit was pulled. This can be very useful. For example, if you're interested in a property that has an addition to the basic structure, you want to find out if the addition was permitted and when. Most lenders won't lend on a properties which additions or improvements made which were not permitted; a very valuable tool in your research.

Next, see which streets go by or serve the property. Then look at parking; total number of parking spaces and the type of parking: Covered, uncovered, driveway, garage, off site, etc.

Now you're ready to look at the structure, in this case a house. These are the things I note and you should too. I've included a checklist to help keep your thoughts together. Also, note the condition of each item on the checklist.

**Foundation:** Most all newer properties have poured in place concrete foundation. If you find there's no perimeter foundation, then most probably the foundation is post and pier. That simply means the house sets on foundation posts and concrete pier pads

**Exterior:** What is the subject siding?

**Roof, gutters and downspouts:** What is the roof covering, how old is it and how many layers. If you can answer these three questions, you'll have a good idea of the roof condition and life span. For example in Oregon, a 30 year roof normally lasts 15 years-cause it rains a lot here! You can put a new roof over the old one two to three times, depending on the county.

**Windows:** Newer properties all have vinyl windows while older ones can be wood frame or maybe aluminum.

**Parking:** Garage, carport, covered or uncovered?

OK, so you've got a good picture of the outside, now let's go over the inside. First of all, let's talk about above grade and below grade. A lot of folks, even professionals get confused about how to count living area. To an appraiser, a residence has above grade and below grade area. If you don't have a basement, then move on and don't worry about it.

If you do have a basement, then it's either finished or unfinished. Many municipalities have confused the issue by requiring ingress and egress (coming or going) openings per so many square feet of finished basement area. To me it's either finished or unfinished-I'm not a building code inspector. Finished basement area usually has a heat source, demising walls which partition the area and floor, wall and ceiling coverings. Unfinished basement area is usually concrete floors, walls and open beam or exposed ceilings.

Above grade living areas will be just that, it will be above grade and may have one, two or even three stories. First of all, see how the floor plan lays out. Are there enough bedrooms and bathrooms to properly serve the property? For example if you had a 6,000 SF house with only two bedrooms then you've got a functional problem. The same house with six bedrooms, but only one bathroom, you've got a functional problem. I suppose there are rules of thumb about how many bedrooms, bathrooms, etc./per total square feet, but use your own common sense and don't be afraid to ask a RE professional.

What are the stud walls or wood framing covered with? Used to be lathe and plaster for older homes, now almost everything is covered with drywall. How much and what type of insulation does the subject have? What are the floor coverings in the different rooms?

Let's talk about kitchens. Is the kitchen updated? What type of appliance package does it have? A basic appliance package usually includes a refrigerator, range/oven, dishwasher, disposal, hood fan and built-in microwave. Are these items newer or older? This makes a difference in your budget as older appliances require more upkeep and need to be replaced sooner. What types of counter tops are there and in what condition? What materials and condition are the cabinets?

Bathrooms. A full bathroom has a toilet, sink and at least a shower. The first question to be asked is how many are there and how do they serve the living area? As the building industry and consumers have evolved, most dwellings have two stories with two or more bathrooms as the norm. To serve these two story properties, normally there will be a ½ bathroom on the main floor. As opposed to a full bathroom, a ½ bathroom has only a toilet and sink. On the second floor of the stereotypical two story dwelling, there will be a bathroom to serve the master suite and at least one more to serve the rest of the bedrooms. Looking at any given bathroom, the questions I ask are these: What are the floor coverings? What are the counter tops? Are there any other appointments worth mentioning?

While I'm performing an inspection, folks often ask me, "What improvements can we make where we get the most bang for our buck?" To answer that question, we must first ask which price tier we are addressing. Smaller and less expensive properties have needs and opportunities not found in larger more expensive homes and vice versa. All things being equal, most of the time the answer lies in the kitchen or bathroom(s). An excellent reference source is Money Magazine. Once a year they have a section on how much thing cost to improve, replace or add and the associated yield they should expect to return. As far as pinning costs down, once again refer to Costhelper.com.

We’ve discussed the improvements, how they lay out, the condition and various appointments.  Lastly we want to address amenities.  Amenities are nice to have things, which don’t necessarily come with the property.  Things like fireplaces, patios, decks, pools, hot tubs, outbuildings, water features, etc.  I group these things together and try to value them separately from the real estate.  Nowadays, sometimes the only way to tell one property from another is the amenities.

Realize that based upon the price and location of any given house, there will be a price tier in which it belongs.  Based upon the price tier, this is what dictates the quality of the different appointments.  In other words, when you go into a $500,000 house, you expect to find higher quality appliances and appointments.  If you go into a house $75,000 house you expect economy grade appliances and utilities.  This part is pretty much just common sense.

**Improvements Checklist**

**Address**

**Exterior**

- **Parking**
- **Foundation**
- **Siding**
- **Roof, gutters and downspouts**
- **Windows**

**Interior**

- **Size**
  - **-Above Grade Gross Living Area (GLA)**
  - **-Below Grade SF**
    - **--Finished SF**
    - **--Unfinished SF**
  - **-Floor Plan**
- **Walls/Trim**
- **Floor Coverings and Condition**
- **Kitchen**
  - **-Appliance Package**
  - **-Cabinets**
  - **-Counters**
  - **-Flooring**
  - **-Other**

- **Bathroom**
  - **-Counters**
  - **-Sinks**
  - **-Tub/Shower**
- **Amenities**

# Chapter 3.

# Highest and Best Use

This is a definition of Highest and Best Use (HBU) found from Wikipedia. The subsequent definition and descriptions serve the purpose of educating you and providing a back ground for analyzing and making decisions with regards to all type of real estate. Once you understand the concept and run any given piece of property through the four step algorithm, you will have yourself a head start towards thorough real estate analysis. Every time I look a piece of property which is complex in any way, I automatically do a HBU analysis. This analysis automatically invokes alternate uses which could make the property more profitable. However, realize there are whole courses taught on the concept of HBU and this is only intended as an introduction. All of the smartest real estate moguls look at real estate through the HBU decision-making process or they have someone do it for them.

HBU is a concept in real estate appraisal that shows how the highest value for a property is arrived. In any case where the market value of real property is sought, that value must be based on its highest and best use. Highest and best use is always that use that would produce the highest value for a property, regardless of its actual current use. The Appraisal Institute defines highest and best use as this:

Highest and Best Use: The reasonably probable and legal use of property, that is physically possible, appropriately supported, and financially feasible, and that results in the highest value.

The prior quotation shows that there are a series of tests which any proposed or theoretical use of a property must pass, before it can be the highest and best use of the property.

In some cases, a proposed use might be the highest and best use. An example might be an industrial-used site that is now legal for high rise residential buildings. However, the cost to clean up (remediate) the site is so expensive that the value as currently used is higher. In that case, if it can be continued, the existing industrial use would likely be the highest and best use.

In some cases, appraisers are given specific instructions as to an assumed highest and best use. This use might not pass the tests discussed below as a legitimate highest and best use and may very well produce a different value. One example of this might be a parkland valuation, where the appraiser has been instructed to ignore all other possible uses.

Test of highest and best use. In order to be considered as the highest and best use of a property, any potential use must pass a series of tests. The exact definition of highest and best use varies, but generally the use must be the following:

1. **Legally allowable**

2. **Physically possible**

3. **Financially feasible**

**4. Maximally productive**

**1. Legally allowable.** Only those uses that are, or may be, legally allowed are potential highest and best uses. This may exclude uses that are not, and unlikely to become, allowed by zoning, uses forbidden by government regulations, and uses prohibited by deed restrictions or covenants.

Properties with a use that predates existing zoning or other property regulations may be legally nonconforming. Such grandfathered uses are generally legal even though they do not meet current zoning or other regulations. Since their use predates these regulations, they are "grandfathered in". However, some such uses may not be reproduced if the legally nonconforming improvement is destroyed or damaged beyond a certain point. This is often referred to as the “burn down clause” and can be verified with the municipal planning department.

"Legally allowable" can be a tricky conceptual test, because even uses that are currently not permitted may be considered. This happens when there is a reasonable prospect (at least 50%) that the regulation, zoning, deed restriction, etc. can be changed to permit the proposed use.

**2. Physically possible.** Any potential use must be physically possible given the size, shape, topography, and other characteristics of the site. For example a 40,000 SF single story warehouse would not fit on a 10,000 SF site; therefore, that use would fail the physical possibility test.

**3. Financial feasibility.** The highest and best use of a property must be financially feasible: The proposed use of a property must generate adequate revenue to justify the costs of construction plus a profit for the developer. In the case of an improved property, with obvious remaining economic life, the question of financial feasibility is somewhat irrelevant. In the case of an improved property with limited remaining economic life, the question of financial feasibility becomes a question of the maximally productive use of the site. If the value of the land as vacant exceeds the value of the property as improved less reversion/demolition costs, then redevelopment of the site becomes the maximally productive use of the property, and continued use of the existing improvements that do not represent the highest net value of the site is considered to be financially unfeasible.

**4. Maximally productive use.** Finally, the use must generate the highest net return (profit) to the developer. A property that could hypothetically be developed with residential, commercial or industrial development might only have one of those uses as its highest and best use. These three hypothetical development scenarios follow to illustrate the test of maximally productive use.

Price of Site: $100,000 (remains unchanged in all three examples)
Cost to construct 10,000 SF industrial warehouse: $750,000
Market Value of 10,000 SF industrial warehouse: $910,000
Profit for industrial development: 7%

Cost to construct 10,000 SF retail strip center: $1,500,000
Market Value of 10,000 SF retail strip center: $1,840,000
Profit for retail development: 15%

Cost to construct 10,000 SF of residential condominiums: $1,200,000
Market Value of 10,000 SF of residential condominiums: $1,534,000
Profit for residential development: 18%

As the examples illustrate, even though the retail development results in the overall highest market value for the development, the residential development scenario results in the highest net return to the developer and this makes it the maximally productive use.

**Vacant and Improved**

The Test of Highest and Best Use is applied to an improved property both as improved and as if vacant. Vacant properties are generally only given the as vacant test. The Highest and Best Use as vacant may be the same or different as the Highest and Best use as improved.

For example, “House A” in a residentially zoned area may have a highest and best use as vacant and a highest and best use as improved that are both residential.  A similar “House B” in a commercially zoned area may have a highest and best use as vacant as a commercial lot and highest and best use as improved as a single family residence.

If the value of the commercial lot as vacant in "House B" exceeds the value of house as a residence as improved plus demolition costs, the overall highest and best use of this property would be the as vacant value of the commercial lot. For example, assume that "House B" has a value as a house of $200,000, and a site value as a commercial lot of $250,000 with a cost to demolish the house and prepare the site at $25,000. The highest and best use of the site is to demolish the house and sell the site as a commercial lot. The market value would be $225,000 ($250,000 site value minus $25,000 demolition cost). However, if the demolition costs rose to $55,000, the highest and best use would be the existing residential use, because the value as a commercial lot (now $195,000) would not exceed the existing value as a residence.

This would be the highest and best use of the property, even though it is contrary to what actually exists. Even if the house is not razed and the site sold as a commercial lot, the highest and best use is the commercial lot use. The market value of the property is driven by this hypothetical conversion, even if it never takes place due to the utility that this potential conversion would bring to a purchaser.

**Economic Theory**

The economic concepts of utility and substitution drive the highest and best use analysis. The highest and best use of a property determines its utility to a potential purchaser. The purchaser of such a property would pay no more than a competing property with the same utility while a seller would accept no less than the seller of a comparable property.  This is called the “principal of substitution”.

**Other HBU Considerations**

HBU is a designation to identify an entity that could have a higher value if used for a different purpose.

In appraisals, an entity is assessed at its highest or best use to maximize value and increase revenue. However, the value of an entity at its highest or best use may not be greater than the value of an entity in its present use if remediation is required to convert the entity to a different use.

Every time I look at a property, I put on my Highest and Best Use glasses. This lets me examine any given property to see if it is currently at its Highest and Best use, or can it be further developed for additional profit. Being able to perform this analysis quickly is what separates the experienced investor from the novice.

I'd like to pass on a couple of more concepts that often relate to HBU. There are so many formulas which relate to commercial properties. However, I want to pass on just two which might be of help later: Floor Area Ratio and Land to Building Ratio.

**Floor Area Ratio (FAR).** The total square feet of a building divided by the total square feet of the lot the building is located on. FAR is used by local governments in zoning codes. Higher FARs tend to indicate more urban (dense) construction. An quick example would four story building with 10,000 SF per floor equals 40,000 SF. If your site were also 40,000 SF, the FAR would be 1 (10,000 SF x 4 = 40,000 SF / 40,000 = 1).

**Land to Building Ratio (LBR).** Ratio of land with improvements to the total acreage available. To calculate the land to building ratio, just divide the square footage of the land parcel by the square footage of the building: 40,000 SF Land / 5,000 SF Building = 8:1

Both of these calculations can have great impact on determining if any given parcel is being under-utilized and the associated HBU.

Reference: The Appraisal of Real Estate, 13th Edition, by the Appraisal Institute

# Chapter 4.
# Basic Financial Analysis

**Basic financial statements:**
Basic accounting says we have three types of financial statements to get both a snapshot and long term picture of a businesses' worth. These all figure into the computation for the Schedule E of your Income taxes. They Are:

**Income and Expense**
**Profit and Loss**
**Balance Sheet**

While that's interesting, the most important financial tool I want to talk about is an APOD. No, it's not a fruit. It's an acronym for Annual Property Operating Data. The purpose of an APOD is to tell the user what happened financially to the property over the year, part of the year or multiple years as referenced in the document.

So we've taken gross revenues, we've added in all other income associated with the real estate, deducted vacancy and credit loss, then further deducted both fixed and variable expenses to arrive at net operating income (NOI). That's the bottom line, the NOI. Everything you've done is to arrive at this one figure. I've provided an APOD so you can see the various line items and how they are sequenced.

## APOD

| | |
|---|---|
| Purpose | |
| Name | |
| Location | |
| Type of Property | |
| Date | |
| Price | |
| Loans | |
| Equity | |

| Assessed/Appraised Values | | |
|---|---|---|
| Land | _ | _% |
| Improvement | _ | _% |
| Personal Property | _ | _% |
| Total | | 100% |
| Adjusted Basis as of | _ | |

| Scheduled Rents | | | |
|---|---|---|---|
| | of | = | |
| | of | = | |
| | of | = | |
| | of | = | |
| | of | = | |
| | of | = | |
| | of | = | |
| | of | = | |
| | TOTALS | | |

| Mortgages: | Balance | Payment | #Pmt/Yr | Interest | Term |
|---|---|---|---|---|---|
| 1st | | | | | |
| 2nd | | | | | |
| 3rd | | | | | |
| Potential | | | | | |
| 1st | | | | | |
| 2nd | | | | | |
| 3rd | | | | | |

| | Monthly | Annual | % | Comments |
|---|---|---|---|---|
| 1\| SCHEDULED RENTAL INCOME | | | | |
| 2\| Less: Vacancy and Credit Losses | | | | |
| 3\| EFFECTIVE RENTAL INCOME | | | | |
| 4\| Plus: Other Income | | | | |
| 5\| GROSS OPERATING INCOME | | | | |
| 6\| Less: Operating Expenses | | | | |
| 7\| Accounting and Legal | | | | |
| 8\| Advertising, Lincenses, Permit | | | | |
| 9\| Property Insurance | | | | |
| 10\| Property Management | | | | |
| 11\| Payroll-Resident Management | | | | |
| 12\| | | | | |
| 13\| Taxes-Worker's Compensation | | | | |
| 14\| Personal Property Taxes | | | | |
| 15\| Real Estate Taxes | | | | |
| 16\| Repairs and Maintenance | | | | |
| 17\| Services-Elevator | | | | |
| 18\| Janitorial | | | | |
| 19\| Lawn | | | | |
| 20\| Pool | | | | |
| 21\| Rubbish | | | | |
| 22\| Other | | | | |
| 23\| Supplies | | | | |
| 24\| Utilities-Electricity | | | | |
| 25\| Gas and Oil | | | | |
| 26\| Sewer and Water | | | | |
| 27\| Telephone | | | | |
| 28\| Other | | | | |
| 29\| Miscellaneous | | | | |
| 30\| | | | | |
| 31\| TOTAL OPERATING EXPENSES | | | | |
| 32\| NET OPERATING INCOME | | | | |
| 33\| Less: Annual Debt Service | | | | |
| 34\| CASH FLOW BEFORE TAXES | | | | |

**Capitalization Rate Computation**

A Capitalization rate or Cap Rate, simply put, is an expression of the income stream changed into a value. Capitalization rates can be as simple and as complex as you want to make them or they need to be. The basic computations are:

**NOI / Property Value = Cap Rate**

**NOI / Cap Rate = Property Value**

**Property Value x Cap Rate = NOI**

Those are the three different variations of the same equations. Like I said, you can have it simple or complex. There have been whole books addressing the topic of income capitalization. The primary books on Capitalization Theory that comes to mind are books by Leon Ellwood and Charles Akerson.

There are two basic types of capitalization, Direct Capitalization and Yield Capitalization. Direct capitalization utilizes the formulas above. Yield capitalization is used for irregular income streams and/or irregular time periods. Yield Capitalization is often referred to as a Discounted Cash Flow Analysis (DCF). The purpose of Yield Capitalization is to discount a cash flow stream into a present value. This technique is good for properties which are vacant and have no steady revenues. It is also good for properties which have been rehabbed and are going through a prolonged lease up period.

Most all of the teachers/gurus force all computations through the direct capitalization method, no matter what the condition of property or income streams. Say you're involved with a project that has just been completed or rehabbed. There is no NOI, so what do you do? Most gurus would tell you to create an APOD using market medians or averages for all of the line items within an APOD. In theory if your research is spot on, you'll get gross revenues, vacancies, and expenses directly from the marketplace, so in theory you will be mirroring the marketplace. Or when there is little market data, you can build a cap rate based upon known market variables and investment return expectations, often called the" Band of Investment". Or you can do a DCF analysis. Each technique has its own merits and pitfalls. One way to tell if someone is a true professional is to see if they understand different capitalization techniques and when to use the appropriate one(s).

## DCF model

| (in million) | 2006 | 2007 | 2008 | 2009 | CAGR (06 - 09) | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|---|---|---|---|
| | Actual | | | | | Forecast period | | | | |
| Sales | 2,955 | 3,568 | 4,102 | 4,663 | 16% | 5,036 | 5,438 | 5,874 | 6,343 | 6,851 |
| % growth | | 20.7% | 15.0% | 13.7% | | 8.0% | 8.0% | 8.0% | 8.0% | 8.0% |
| Total costs | -2,511 | -3,047 | -3,524 | -4,031 | 17% | -4,316 | -4,661 | -5,034 | -5,436 | -5,871 |
| % sales | 85.0% | 85.4% | 85.9% | 86.5% | | 85.7% | 85.7% | 85.7% | 85.7% | 85.7% |
| **EBITDA** | **444** | **521** | **578** | **631** | 12% | **720** | **778** | **840** | **907** | **980** |
| % margin | 15.0% | 14.6% | 14.1% | 13.5% | | #### | #### | #### | #### | #### |
| Depreciation & Amortization: | -49 | -63 | -75 | -84 | | -91 | -98 | -106 | -114 | -123 |
| % sales | 1.6% | 1.8% | 1.8% | 1.8% | | 1.8% | 1.8% | 1.8% | 1.8% | 1.8% |
| **EBIT** | **396** | **459** | **503** | **548** | 11% | **629** | **680** | **734** | **793** | **856** |
| Taxes (30%) | -119 | -138 | -151 | -164 | | -189 | -204 | -220 | -238 | -257 |
| Capex | | -79 | -41 | -169 | | -116 | -125 | -135 | -146 | -158 |
| % sales | | 2.2% | 1.0% | 3.6% | | 2.3% | 2.3% | 2.3% | 2.3% | 2.3% |
| Increase/Decrease in NWC | | **-145** | **-77** | **-18** | | **2** | **-31** | **-34** | **-37** | **-40** |
| **Unlevered Free Cash Flow** | | **159** | **309** | **281** | | **417** | **417** | **451** | **487** | **526** |
| WACC | **11.4%** | | | | | | | | | |
| Discount Period | | | | | | 0.5 | 1.5 | 2.5 | 3.5 | 4.5 |
| Discount Factor | | | | | | 0.95 | 0.85 | 0.76 | 0.69 | 0.62 |
| **Present value of free cash flow** | | | | | | **395** | **355** | **344** | **334** | **324** |

| **Terminal Value** | |
|---|---|
| Terminal Year Free Cash Flow | 526 |
| Perpetuity Growth Rate | 3.0% |
| Terminal Year EBITDA | 980 |
| Terminal Value | 6,483 |
| **Implied Exit Multiple** | **7.0x** |
| Discount Period | 5.0 |
| Discount Factor | 0.6 |
| **Present Value of Terminal Val** | **3,787** |
| % of Enterprise Value | 68% |

| (in million) **Net Working Capital** | 2006 | 2007 | 2008 | 2009 | | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|---|---|---|---|
| | Actual | | | | | Forecast period | | | | |
| Account receivables | 10 | 14 | 17 | 13 | | | | | | |
| Inventory | 543 | 749 | 827 | 953 | | | | | | |
| Prepaid expenses and other | 110 | 42 | 63 | 94 | | | | | | |
| **Total Current Assets** | **663** | **804** | **906** | **1,060** | | **1,128** | **1,218** | **1,316** | **1,421** | **1,535** |
| % sales | 22.4% | 22.5% | 22.1% | 22.7% | | 22.4% | 22.4% | 22.4% | 22.4% | 22.4% |
| Account payable | | | | | | | | | | |
| Accrued Liabilities | | | | | | | | | | |
| Other Current Liabilities | | | | | | | | | | |
| **Total Current Liabilities** | **-509** | **-505** | **-530** | **-666** | | **-735** | **-794** | **-858** | **-926** | **-1,000** |
| % sales | 17.2% | 14.1% | 12.9% | 14.3% | | 14.6% | 14.6% | 14.6% | 14.6% | 14.6% |
| **Net Working Capital** | **155** | **300** | **377** | **394** | | **393** | **424** | **458** | **495** | **534** |
| % sales | 5% | 8% | 9% | 8% | | 8% | 8% | 8% | 8% | 8% |

### DCF model

| Input | |
|---|---|
| **Wacc Calculation** | |
| **Target Capital Structure** (1) | |
| Debt to Total Capitalization | 29.1% |
| Equity to Total Capitalization | 70.9% |
| Debt to Equity Ratio | 41.8% |
| **Cost of Equity** | |
| Risk-free rate (2) | 4.0% |
| Market risk Premium (3) | 7.1% |
| Levered Beta (4) | 1.22 |
| Size Premium (5) | 1.7% |
| **Cost of Equity** | **14.3%** |
| **Cost of Debt** | |
| Cost of Debt | 6.0% |
| Taxes | 30.0% |
| **After Tax Cost of Debt** | **4.2%** |
| **WACC** | **11.4%** |

(1) Obtained from Beta and Capital Structure tab
(2) Interpolated Yield on 10-year Treasury bond
(3) Obtained from Ibbotson SBBI Valuation Yearbook
(4) Obtained from Beta and Capital Structure tab
(5) Low-Cap Decile size premium based on market capitalization, per Ibbotson

| Output | |
|---|---|
| **Enterprise value** | |
| Present value of Free Cash Flow | 1,753 |
| **Terminal Value** | 6,483 |
| Discount Factor | 0.58 |
| **Present Value of Terminal** | **3,787** |
| % of Enterprise Value | 68% |
| **Enterprise value** | **5,540** |
| Less: Total debt | 100 |
| Plus: Cash and Cash Equi. | 300 |
| Net Debt | -200 |
| **Implied Equity Value** | **5,740** |
| Outstanding shares | 10,000 |
| **Implied share price** | **0.57** |
| **Implied multiples** | |
| Enterprise Value | 5,540 |
| SALES 2010 | 5,036 |
| EBITDA 2010 | 720 |
| **Implied EV/SALES** | **1.1x** |
| **Implied EV/EBITDA** | **7.7x** |

### DCF model - www.business-valuation.net

Sensitivity Analysis

| WACC \ Perpetuity growth % | 2.0% | 2.5% | 3.0% | 3.5% | 4.0% |
|---|---|---|---|---|---|
| 9.4% | 6,496 | 6,861 | 7,284 | 7,778 | 8,365 |
| 10.4% | 5,715 | 5,985 | 6,292 | 6,644 | 7,052 |
| 11.4% | 5,102 | 5,309 | 5,540 | 5,801 | 6,097 |
| 12.4% | 4,609 | 4,771 | 4,950 | 5,149 | 5,372 |
| 13.4% | 4,204 | 4,333 | 4,475 | 4,631 | 4,804 |

| EBITDA % \ Annual sales growth % | 7.0% | 7.5% | 8.0% | 8.5% | 9.0% |
|---|---|---|---|---|---|
| 12.3% | 4,402 | 4,468 | 4,534 | 4,602 | 4,670 |
| 13.3% | 4,885 | 4,961 | 5,037 | 5,115 | 5,193 |
| 14.3% | 5,368 | 5,453 | 5,540 | 5,628 | 5,716 |
| 15.3% | 5,851 | 5,946 | 6,043 | 6,141 | 6,240 |
| 16.3% | 6,334 | 6,439 | 6,546 | 6,654 | 6,763 |

Another relatively simple tool is the Gross Rent Multiplier (GRM).   It is fairly simple to use and can be applied to all income producing properties.  To find the GRM for any property, you need to find a market-derived GRM.  Find 3-5 recent sales which also produced rental income.  For each sale/rental, take the sales price, and then divide by the annualized gross revenues.  Take a look at the properties on which you have calculated the GRM and determine if they are inferior, the same or superior.  Figure where in the arrayed GRMs, your properties resides.  Then take that GRM and multiply it by your subject's gross revenues and the result will be an estimate of value using the GRM technique.

A quick example would have the gross revenues for a property and either the sales or listing price.  Let's say you are looking at a 100 unit apartment with revenues of $1,200,000.  They are asking $4,000,000 for the project.  $4,000,000 / $1,200,000 = 3.33.  This calculation provides another data point to reconcile to get the most accurate valuation.  It provides another way to compare different properties.  The major problem with the GRM is it doesn't take into account differences in management and operating expenses.  How these operating expenses are managed is a crucial piece of information relating to valuation.

Through experience, you can read an APOD and with a minimum amount of research into the subject's marketplace, can tell if a broker or prospective seller is blowing smoke and looking for the next biggest fool or really telling the truth.  Sometimes it's a combination of fairy tales and solid market data.  For example, let's look at C class apartments in Houston, TX.  Through research and interview, you can quickly figure out if it's in a decent location, as well as the market occupancy and rents for any given property.  I know from experience, normally the operating expenses for a class C multifamily property run from 40%-50% of effective gross income.  I also know many of these properties are do not have individual water meters and how this can be remedied using what is called the Residential Utilities Bill

Back System or RUBBS. If you don't believe any portion of the data, you can go into the marketplace and verify the item in question by research.

Proforma Data. Dictionary.com defines proforma as indicating hypothetical financial figures based on previous business operations for estimate purposes. What this means in essence is made up numbers which, in theory, were extracted from the subject marketplace.

For example, if you were interested in valuing any given piece of real estate and it were vacant, you could tell what it would be worth given access to data from similar properties in the subject marketplace.

A good example would be a vacant single tenant warehouse.

-First you would look at what the cost would be to fix it up and make it ready to rent for the new tenant.

-The next thing to do is figure out the absorption rate, how long it should normally take to lease up and the carrying costs to maintain the property while it is vacant.

-Next, you would figure out what it would rent for, the type and normal length of lease to expect in that particular marketplace. If your research is accurate, you should be able to tell if it's a deal or not.

Let's take a quick example and put music to the words. You've found a deal on the warehouse in a decent part of town in an industrial zoned district. The warehouse has 20,000 shell and 2,000 SF of office space. Parking, land to building ratio and everything looks OK, just one problem: It's vacant and damaged. First thing to do is get the costs associated with fixing it up. Say they are $100,000 to fix the walls, roof and office space. They want $1,000,000 for the property. You research the marketplace and find rents, on a blended rate, combining shell and office space, are $.25 per month on an absolute net basis, where the tenant pays for all fixed and variable expenses. So let's do some math. 20,000 SF for the shell + 2,000 SF for the office is 22,000. A lease rate of $.25 x 22,000 = $5,500 per month x 12 months = $66,000 per year on an absolute net basis, or pretty much your NOI. You research the marketplace, interviewing owners, tenants and brokers who have properties such as the one you are thinking about buying. You find that most leases are five years in length and there is usually three month period to get the property leased. So a three month lease up period and a 60 (5 year) month lease period produces a vacancy rate of 5% (3 months / 60 months). Based upon your simple market research, you've now got enough to make a proforma APOD:

**Revenue: $66,000 on an absolute net basis**
**Vacancy at 5%: $3,300**
**Effective Gross Income: $62,700**
**Operating Expenses: Included in lease basis**
**NOI: $62,700**

In your marketplace, you discover that the median capitalization rate for a property of this type is 8%. Capitalizing the Income produces a value of $783,750 ($62,700 / 8%). Plus you've got to account for the downtime and cost to make repairs. Let's say you want a 10% return on your money. Instead of the market capitalization rate, insert the desired 10% and you have a value of $627,000. But you haven't included the cost to repair. So subtracting the $100,000 to fix up the building and calculating a carrying cost for the time it takes to fix the structure, you have $100,000 + $50,000 which includes the trouble and time for managing the fix up and the down time where it's not leased. So you take the desired purchase price of $627,000 after you take the NOI and capitalize it at the rate you want, then take away the fix up and carrying costs and you come up with purchase price of $477,000. A far cry from the $1,000,000 asking price.

Brokers can take any of the above components and twist them to their advantage; the moral of the story is don't be the next biggest fool and learn to do your due diligence or find a professional you can trust to do it for you.

Let's talk about a couple more formulas investors and everyone else uses to gauge if a prospective deal is a good one.

Cash on Cash. This formula calculates the return on actual cash invested. The basic formula is:

**Annual Cash Flow / Cash Invested = Cash on Cash Return**

Example. Suppose you are interested in purchasing a property with six units that each pays $1,000 per month rent. You estimate the first year's operating expenses to be $28,800. You are planning on a new mortgage with $126,000 down payment, loan points of $2,940, and a monthly payment of $1,956. You estimate that your closing costs (escrow, title, inspections, and appraisal fees) will be $2,100.

In this case, you would need to make five calculations (to determine Annual Cash Flow and Cash Investment) before you can compute for cash on cash.

**Annual Rental Income: (6 units x $1,000) x 12 = $72,000**
**Net Operating Income (NOI; income less expenses): $72,000 - 28,800 = $43,200**
**Annual Debt Service (mortgage payment): $1,956 x 12 = $23,472**
**Annual Cash Flow (net operating income less payment): $43,200 - 23,472 = $19,728**
**Cash Investment (down payment + points+ closing costs): $126,000 + 2,940 + 2,100 = $131,040**

**Annual Cash Flow / Cash Invested = Cash on Cash Return**
**$19,728 / $131,040 = 15.06%**

The only concept that we haven't addressed previously is the annual mortgage payment. But whoa, I don't want to get so far ahead of myself that I lose you. Now that you know this specific investment opportunity yields a 15.06% cash on cash return, you can compare it to similar properties, or alternative investments such as a T-Bill rate, and decide whether or not to proceed with a purchase.

I couldn't leave without providing one more basic, but important calculation: Payback Period.
The payback period is calculated by counting the number of years it will take to recover the cash invested in a project.

Let's assume that a company invests $400,000 in more efficient equipment. The cash savings from the new equipment is expected to be $100,000 per year for 10 years. The payback period is 4 years ($400,000 divided by $100,000 per year).

**Leases**
Leases are the way revenues are generated for any given property and are field of study unto themselves. Most people think leases are in some form of far out esoteric language. Once you get the hang of them and understand the boilerplate language, they can be easily understood. In lieu of a learning curve, look for advice from a broker who specializes in the specific type of real estate you are interested in.

For the owner, the simplest form of lease is an absolute net lease. This lease is where the tenant pays for all of the expenses related to the property and may even have a clause where reserves are set up for the various portions of the real estate which will eventually have to be replaced. Not much of a problem calculating NOI with an absolute net lease.

Next is the triple net (3N). This is where the tenant pays for taxes, maintenance and insurance. Any other expenses are borne by the landlord.

**Modified net lease.** Simply put, this is where one or more of the three main components are negotiated where the tenant isn't responsible for all or part of the three components.

**Modified gross lease.** This type of lease may have one or more of the 3N components, but has other items which the tenant pays for.

**Fully gross lease.** This type of lease is where the tenant pays for everything up front and takes into account various prorated common charges. Many retail or office type uses where there are multiple tenants tend to use this type of lease.

**Escalators**
For leases which are long in length, most of the time there are escalators built into the lease. This is where both parties agree to an increase in rents at a points in time based on some type of index.

**Tenant Improvements (Tis)**

In many new leases, the tenant needs to configure the rented space into something that supports the business activity.  This usually happens where the landlord will pay for or build-out these new improvements.  The cost of this build-out can be cheap all the way up to the way expensive, depending on the needs of the business.  Most of the time the landlord will cover the costs up front, then amortize the cost of the Tis over the course of the lease.

Summarizing, there are many financial tools an investor can learn and use.  Some are some are simple and easily learned and others are relatively sophisticated where you might need help.  Regardless, use the tool which is the most appropriate and gather your data points in order to get the best valuation possible.

# Chapter 5.
# Looking at Markets

Alright, let's talk about markets. There are markets for everything; chickens, horses, diamonds, etc, but we're going to limit ourselves primarily to residential real estate. In your area you have many markets. In real estate, the two markets we're concerned with the geographic markets and price tiers. We can break down these two segmentations further by the different asset classes or types of residential properties: Single family, multifamily (>5 units), multifamily (<5 units), residential land, condominiums, manufactured homes, etc.

Think about it. Where are the most and least expensively priced homes? Can you draw a line around the different neighborhood boundaries? Your multiple listing service may have geographic boundaries. The assessor's office may have segmented your town or city into distinctly different areas. Another way appraisers often quantify the population and land use in specific areas is the use of census tracts. If you find a census tract breakdown, you'll see the population is broken down into racial, ethnic groups, renters, owners, income, etc. From these groupings, analysis can illustrate the needs which need to be filled in a particular area. This is called a Market Study.

Let's first look at things from a macro perspective. The list below is a pretty comprehensive list of things which, when combined cause both macro and micro trends which influence the real estate markets globally, regionally and locally.

Period I Growth Phase
♦ Accelerated development activity
♦ Increasing leasing activity
♦ Access to inexpensive credit
♦ Rising rents and asset values
♦ Expanding risk profile
♦ Growth in "start ups"
♦ Geographic expansion
♦ Rising GDP
♦ Rapid job growth
♦ New competitors entering the market

Period II Plateau Phase
♦ Overly optimistic underwriting
♦ Increase in capital raising
♦ Aggressive compensation for talent
♦ Blind entrepreneurism
♦ Low cap rates
♦ Supply/demand out of balance

♦ Protracted closing period
♦ Increase in "guarantees"
♦ High investment sales activity
♦ Generous TIs and lease terms
Period III Crisis Phase

♦ Declining asset values
♦ Entity downsizing
♦ Declining rents and occupancy
♦ Discounted asset/loan sales
♦ Cash is king
♦ Workouts/restructurings
♦ Little to no development activity
♦ Leasing concessions
♦ Limited access to credit
♦ Government intervention

Period IV Transition Phase
♦ Focus on fundamentals
♦ Recapitalization
♦ Industry consolidation
♦ New business models emerge
♦ Reduced/restructured compensation
♦ Government incentives
♦ Commitment to CRM
♦ Realistic underwriting
♦ Diversification of risk
♦ Next-generation leaders emerge

More pragmatically, let's say you're interested in your own neighborhood or a neighborhood where you're considering moving. The next thing to understand about areas or neighborhoods is that they all have cycles. There are four different segments to a full cycle:

The cycle starts with formation or growth. The area is newly developed. Support and service facilities such as police and fire departments, shopping, schools, medical and religious facilities are developed to serve the population.

The cycle then moves on to maturity. Infill development occurs and the neighborhood finds its' own identity. Housing prices rise or remain steady.

Then onto decay. As with most everything with a naturally occurring life cycle, improvements grow older and the area becomes less popular. Prices go down and generally the population decreases.

The last portion of the cycle is regrowth or what is commonly called gentrification. This portion of the cycle is often helped by local government stimulus or use of a Master Plan. A Master Plan can be found at most all local planning departments and identifies areas which are targeted for growth and stimulus. Astute developers often target these areas due to the tax incentives they often provide. These areas which are the target for growth are commonly referred to as being in the "Path of Progress".

A good rule of thumb is that the closer to the city core, the higher the density. The corollary is also true; the further away from the any given city nucleus, the less dense and usually less expensive the properties are.

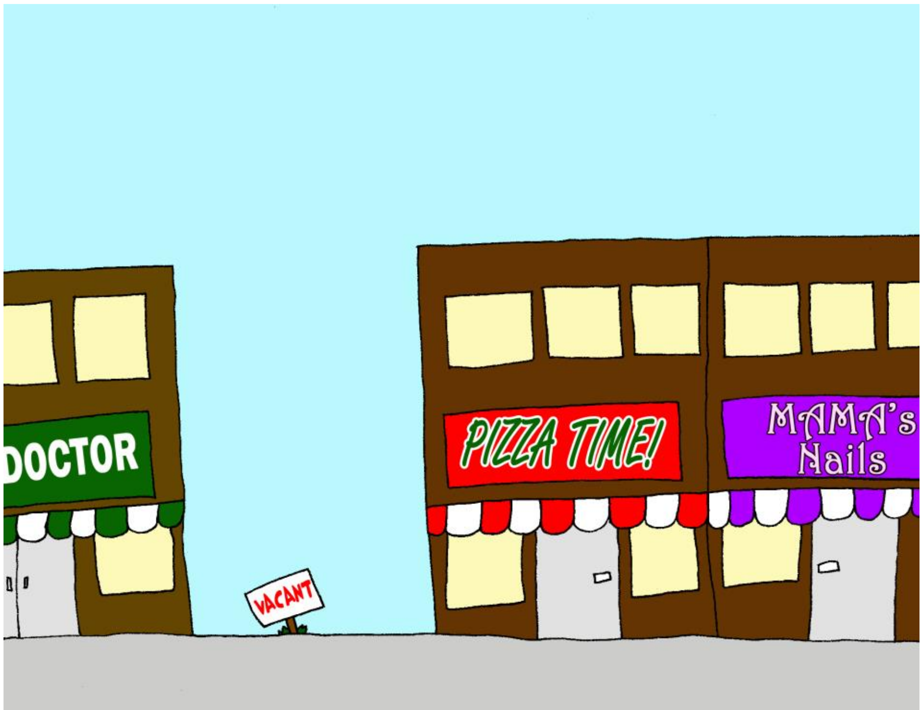
Another quick or acid test for determining the viability of any market is job growth. When I asked a multifamily guru about which benchmark or indicator he used in determining whether to be in a market, he replied with no hesitation, +2% annualized job growth rate. Makes sense. Where the jobs go the people will follow.

An idea or concept that has come to me from time to time is in the form of a question. The question is, "When an area gentrifies or regrows, where do the people or families go to live when they can no longer afford the gentrified neighborhood?" In my home town, I found the answer when a newspaper article came out and declared the area where I grew up as a kid was now the area where people or families who had little financial resources went to live. Whenever I drive the area any more, I realize it's true; my old stomping ground is now the "hood".

There are now plenty of statistical tools to determine the viability of any market in the country. And there are plenty of cost effective ways of figuring out which are currently the best markets and which are to be considered emerging markets. Understanding the concepts of market cycles as they apply to momentum and profitability can produce staggering results.

# Chapter 6.

## How to Quickly Value a Property



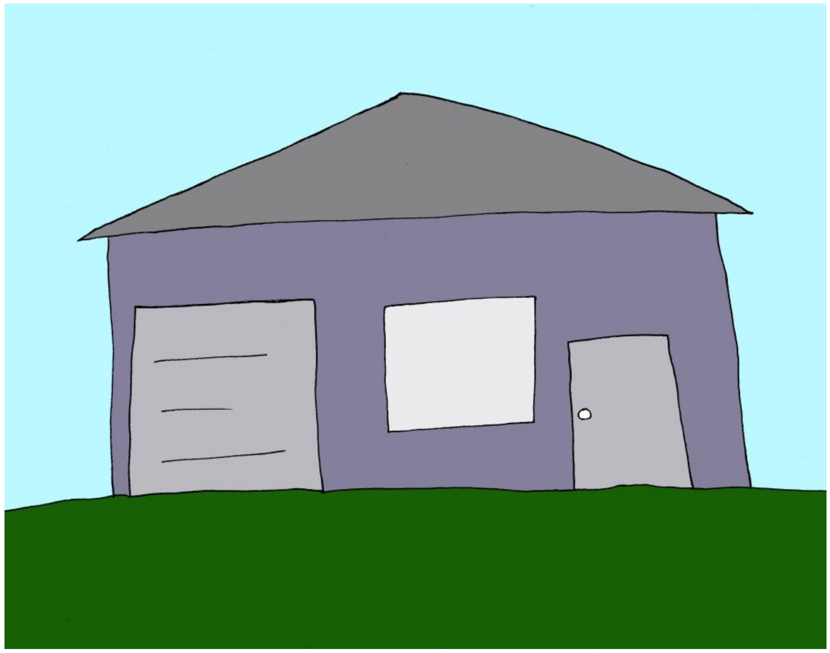

Even the title of this chapter chokes me up. Whole books have been written and courses been taught on this subject and there is no way to really give it the justice it deserves. But I have to remember this is an introduction, or primer, and not beat myself up too much. One of my primary goals is to give you a basic algorithm, or method, to come up with a usable value for most any type of real estate. This doesn't preclude doing your research or due diligence on the property you're researching. As an appraiser, I'm always looking for data points, the more the merrier, which I can reconcile to come up with a value that means something.

Let's look at land. Say you've found a commercial parcel along a heavily traveled roadway you're thinking of buying. The first thing you want to do is order the trio as we previously discussed. This will give you all kinds of information on the characteristics of the property, the plat map and last vesting document. Once you have the property fixed in your mind and matched up the assessor's information with what is physically there, you need to put on your HBU hat and run the property through the four criteria, with special focus on the zoning, or what you can legally do with the property. Once you've done that, you're ready to move on to the valuation. In the case of commercial land, it is usually bought and sold on the basis of price per square foot or some other unit of measure. That's what it's all about; identifying the unit of measure the marketplace looks for and then locating recent comparable sales or listings to compare to your subject property.

As I said, you're looking for data points to reconcile.  First thing to do is look at the vesting document and see when it was purchased and for how much.  If it's a fairly recent sale, you have your first data point.  Then immediately move on to the assessor's valuation of the site.  There will be an estimation of the market value of the land component and estimation of the market value for the improvement component.  In this case we're looking just at the land.  It might be worth a call to the duty appraiser (assessor) at the assessor's office which has jurisdiction.   When you make the call, ask for someone who specializes in the type of property you're interested in; in this case, commercial land.  Ask the specialist how they arrived at their estimate of value for the subject site and if their current estimate of value is tied to real market value.  You've now got another data point.  Whether it's usable or not, you need to determine that.  While you're on the phone with the specialist, ask if they know of any other recent sales and/or listings.

Next, call on a local Realtor who has access to MLS and has at least a working knowledge of commercial real estate.  Prepare your questions ahead of time and realize that they are busy people.  Ask for some comparables and insight into the local market.  Next would be to call a broker who specializes in the type of property on which you're focusing.  Ask the same prepared questions and gather more data points.

Finally, a great source of information for finding answers to all sorts of questions is your local title company.  Explain to them what you're trying to do and ask for help locating comparable properties in the local marketplace.  Now you've got a lot of raw data.  Usable data are recent sales of commercial land near your subject.  Unusable include properties with access issues, steep topography or a site which doesn't have access to utilities.  This is where appraising becomes more of an art than science; filtering out good comparables from bad and figuring why some properties sold for more than others.  Sort the data into the usable and unusable, then drive and maybe even photo the different comparables so they make sense.  Extract the best comparables, making notes as to which properties are most like the subject.  Your range should be fairly tight.



Valuing a residential lot is slightly different. You're looking for the value of the land, with or without improvements. If you go through land sales in the neighborhood you're researching, you'll probably come up with a recurring value, which is what the average lot sold for. Now some lots are superior because of various factors such as views, size location, etc. Some lots are inferior for exactly the same reasons, because they have problems. In any case, the unit of measure you're looking for is the price per lot.

Now let's look at valuing a house on land. First get a trio on the property you're interested in. Identify which are the most important characteristics of the property you're interested in: Bedrooms, bathrooms, condition, square footage, site size, etc.

Once again, take a look at the assessor's estimate of value and the last sale of the property. If you have any questions, call the assessor's office. Remember, they are public servants and should be responsive to your queries.

With the advancement of new technology on the web, new sources of residential real estate valuation are in place and popping up all over the place. These are called Automated Valuation Models or AVMs. Some of them are Redfin.com, eappraisal.com, etc. In fact, there are some sources that use a combination of multiple sources, such as [http://homes.yahoo.com/home-worth](http://homes.yahoo.com/home-worth). This site uses a combination of eappraisal.com and Zillow to provide a range. All of these sources provide data points which can then be reconciled into a usable estimate of value. However, the flaw with all AVMs is that they don't incorporate current condition and other unique features into their estimate of value. They can be really good for stereotypical tract homes, but become less accurate for custom dwellings or homes with unique features. But let's use them for what they provide us-another data point.

Next, find a Realtor who specializes in the area in which you're interested.   What you want is a Broker's Price Opinion (BPO).  There should be no or little cost associated with their assistance; they are looking for the business and you represent business.  If one broker is too busy, then move on to the next.  The BPO you're asking for isn't rocket science and anybody can do one with even a little bit of training.

Ask your local title company for help too.  Make sure to emphasize what you think the important characteristics of the property you're researching and explain this to the customer service representative.   You're looking for recent sales of properties which have the same characteristics as the property you're interested in.

For example, if you're considering buying, fixing and selling a fixer ranch style home on a standard city lot in a particular neighborhood, until you can quickly estimate what needs to be fixed or updated, you want comparables which are also fixers.   Remember whenever possible compare apples to apples and oranges to oranges.  If the property you're interested in has basement area, you need to decide if you are going to break down above grade area from below grade area or just lump it all together.  Regardless, just be consistent or it gets confusing.

Now you've got an estimate of what the fixer ranch style dwelling is worth.  Next, let's find out what the same fixer is worth all fixed up.  Go through the same procedures, using AVMs, BPO, title company, etc, looking for ranch style dwellings which are fixed up or remodeled.  Whenever possible, get comparables which have pictures so you're not just relying on someone's opinion of condition.  Most of the time, pictures don't lie.  Now, take the price per SF of your best fixer comparables and divide the sales price by the Gross Living Area square footage.  If they are fairly close, just average them out.  Do the same thing for the remodeled comparables.  Apply the fixer price per SF to the property you're interested in and then do the same thing for the remodeled price per SF.  Subtract the fixer estimate of value from the remodeled estimate of value and you have a difference which can be attributed to profit, cost to fix up, holding costs and cost of capital.  Here's the example of what we just discussed.

**Subject dwelling is 1,425 SF.**

**Fixer comparables are as follows:**
**1,110 SF with a purchase price of $90,000.    Price per SF is $81/SF**
**1,200 SF with a purchase price of $100,000.  Price per SF is $83/SF**
**1,400 SF with a purchase price of $125,000.  Price per SF is $89/SF**
**1,565 SF with a purchase price of $130,000.  Price per SF is $83/SF**
**1,650 SF with a purchase price of $141,000.  Price per SF is $85/SF**

Let's say you got to look at photos and they were all in the same general poor condition.  So your range is $81-$89/SF.  If there is one house which appears to be most like the house you're thinking about, then use that one.  Or you can just take an average:  $81 + $83 + $89 + $83 + $85 / 5-the number of properties you're considering.  $421 /5 = $84/SF.

Now do the same thing with four comparables you found which were fixed up:
**995 SF sold for $160,000.  Price per SF is $160/SF**
**1,246 SF sold for $187,500.  Price per SF is $150/SF**
**1,465 SF sold for $218,000.  Price per SF is $149/SF**
**1,590 SF sold for $234,000.  Price per SF is $147/SF**

Our demonstrated range is from $147-$160 per SF. You can average, but properties which are fixed up generally fall into more predictable patterns than properties which are sold as fixers. So the average would be: $160 + $150 + $149 + $147 / 4 = $151/SF. However, the property you are looking at is 1,425 SF. The closest comparable to this has 1,465 SF and this correlates almost directly to $149/SF. Both pretty close. I'd average them together and come up with a fixed up price per SF of $150.

Notice that in a perfect market, the price per SF goes down, the larger the square footage of the structure. At this time, let me introduce you to an important concept: The concept of regression. Simply put, it means that generally speaking, the larger the structure, the less it will sell per SF. Or, vice versa, where a smaller structure sells for more on a square foot basis. It's the same with our example, where the fixed up properties sold for less per SF when the structure was larger.

Another one of the key ways appraisers justify making adjustments is the use of "Matched Pairs". What that means is finding a closed sale which is truly comparable to your subject property, but having only one difference. A simple example would go like this. The property you are interested in is a ranch style dwelling with 1,200 SF of GLA, three bedrooms, two bathrooms and a double garage. It recently sold for $160,000. You find a similar property two blocks away. It too has 1,200 SF of GLA, three bedrooms, two bathrooms, but has no garage. I sold for $150,000. You check them both out: Both are the same size, same condition, bedrooms, bathrooms, etc. The only difference is the first property has a double garage and the second doesn't. You take the difference in sales prices and, everything else being equal, and you can attribute the price difference to the double garage. This is a simple, but powerful tool for finding and making adjustments.

Back to our project house. When the square footage of the subject property is applied to the fixer price per SF, the value becomes $119,700 (1,425 SF x $84/SF). So if you can negotiate a cheaper price, you're doing well with respect to the market average. When the square footage is applied to the fixed up price per SF, the estimate of value for the subject becomes $213,750. The difference between the fixer price and fixed up price is $94,050. You say wow, that's a lot of profit! But you forgot to back out all of your costs that got you to the fixed up value. As I said before, you have all kinds of costs which go into the transaction:

**-Purchase cost**
**-Carrying costs**
- **--Utilities**
- **--Insurance**
- **--Interest payments if you financed**

**-Fix up costs**
**-Transaction fees such as Realtors commission, title insurance, escrow, etc.**

Finally, when you get to closing and look at your HUD-1 Closing Statement, you get a final payoff to you. Most all textbooks and conversations with prudent investors reflect a return of 15% of the sales price for entrepreneurial profit; just another good rule of thumb.

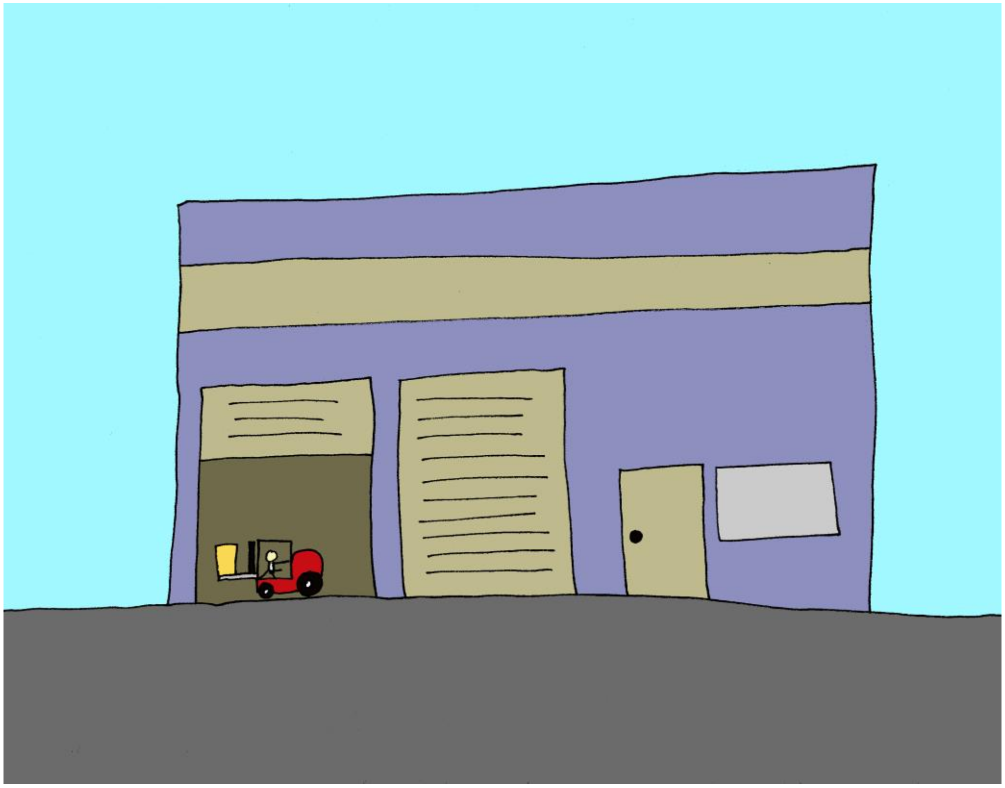
There are one heck of a lot more property types than just commercial land and houses. But the point that I'm trying to make is that they all have units of measure by which they are calculated and valued. For example, both houses and office buildings can be valued on a price per SF basis, but their intended uses are much different.

# Chapter 7.
# Commercial Properties

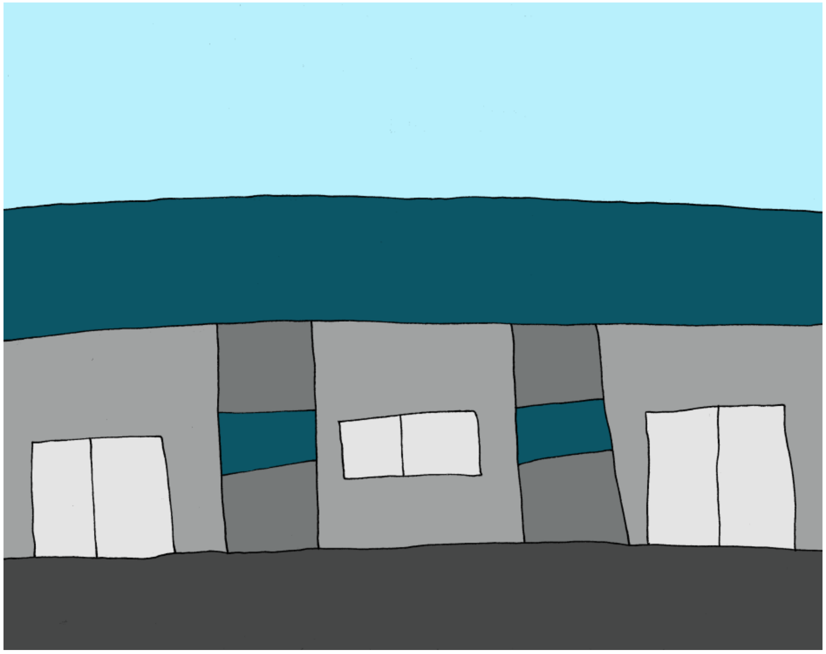
As we continue with our journey through the real estate world at the 30,000 foot level, I would be remiss if I didn't address commercial real estate. The primary purpose of commercial real estate is to produce revenue for the owner and serve the renter in a business endeavor. For the first four years working for the MAI, all we did was commercial real estate. He only appraised properties which had a lower value threshold as they normally don't take as long to appraise and they would normally be covered under his Errors and Omission Insurance coverage. The types of properties we are going to discuss all have one thing in common: They were created to produce income. However, the differences in the asset categories we're are going to discuss make for a comprehensive list of investing pros and cons.

I have had what I thought was a truly profound thought on which commercial asset categories make the best investment in this overall economic climate, irrespective of our current President's philosophy on investment real estate. My thought is simply this: After picking the correct geographical market, pick an asset category which has the strongest ties to the end consumer. Time and again, I've gotten into discussions about this topic and no one has come up with a better argument-yet. What I mean is that the best asset categories have a direct relationship with the end user. For example, let's talk about the office or retail category. For the most part, they are leased by a business and not leased directly by an individual. Yeah, the leases may have personal guarantees, but that's not the main point. The point is that if a business which leases retail or office space becomes insolvent, they simply go bankrupt, close up shop and the owner has to go after the business for breaking the lease. After that there may be a prolonged lease-up period where the owner is without revenue. However, if your asset category has a direct tie to the end user, the scenario changes a lot.

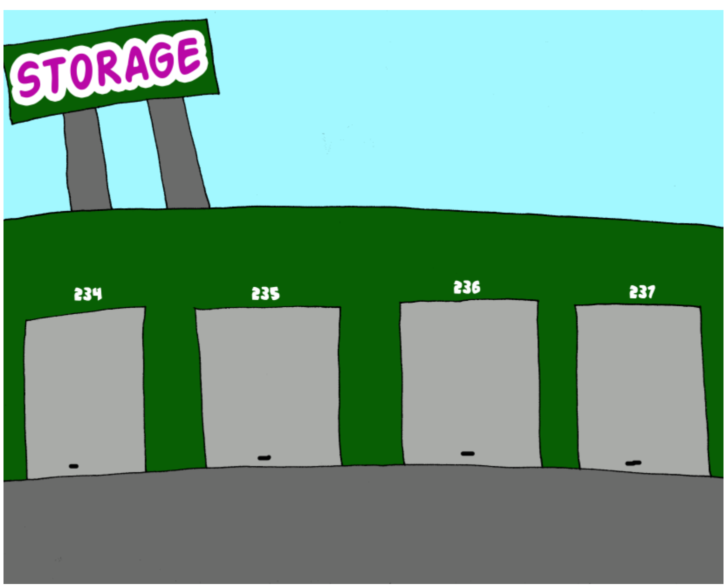
A great example of the asset having a direct tie to the end user is an apartment. If the end user decides he/she aren't going to pay rent, the owner or representative can make life miserable for the tenant and, depending on the state, evict the tardy tenant quickly. See the difference. Based on this logic and in this economic climate the best asset categories are self-storage, manufactured home parks and apartments. A compelling argument could be made for adding other asset categories like assisted living, but let's stay focused.



**Industrial:**
Industrial properties can be broken down into several categories:  Warehouses, flex space, self-storage and various other types of uses.  There are many types of warehouses:  Distribution warehouses, storage warehouses, truck terminal warehouses, etc.  Warehouses can be built from all types of materials.  With the advance of building technologies, the most prevalent type of warehouse today is the concrete tilt-up warehouse.  This is where the builder pours the wall in place on the ground using forms, then raises the walls up to fit together with the other walls.  They can be built to configure to the land and the needs of the user.  Warehouses can be identified by their different configurations and uses.  Warehouse development ties directly to land to building ratios.  In other words, you need enough land to support the intended activities.   Most all of the time there will be a section, either inside or attached, where the offices are situated.  Other factors include how much clear height (or how high is the roof) and how many service doors are there, and are they at dock height or at grade level.   As income producers, they are usually leased on a triple or absolute net lease, with a shell rate for the warehouse and a surcharge for the office space.  TI's are generally included and amortized over the course of the lease or a pre-agreed  upon time frame.

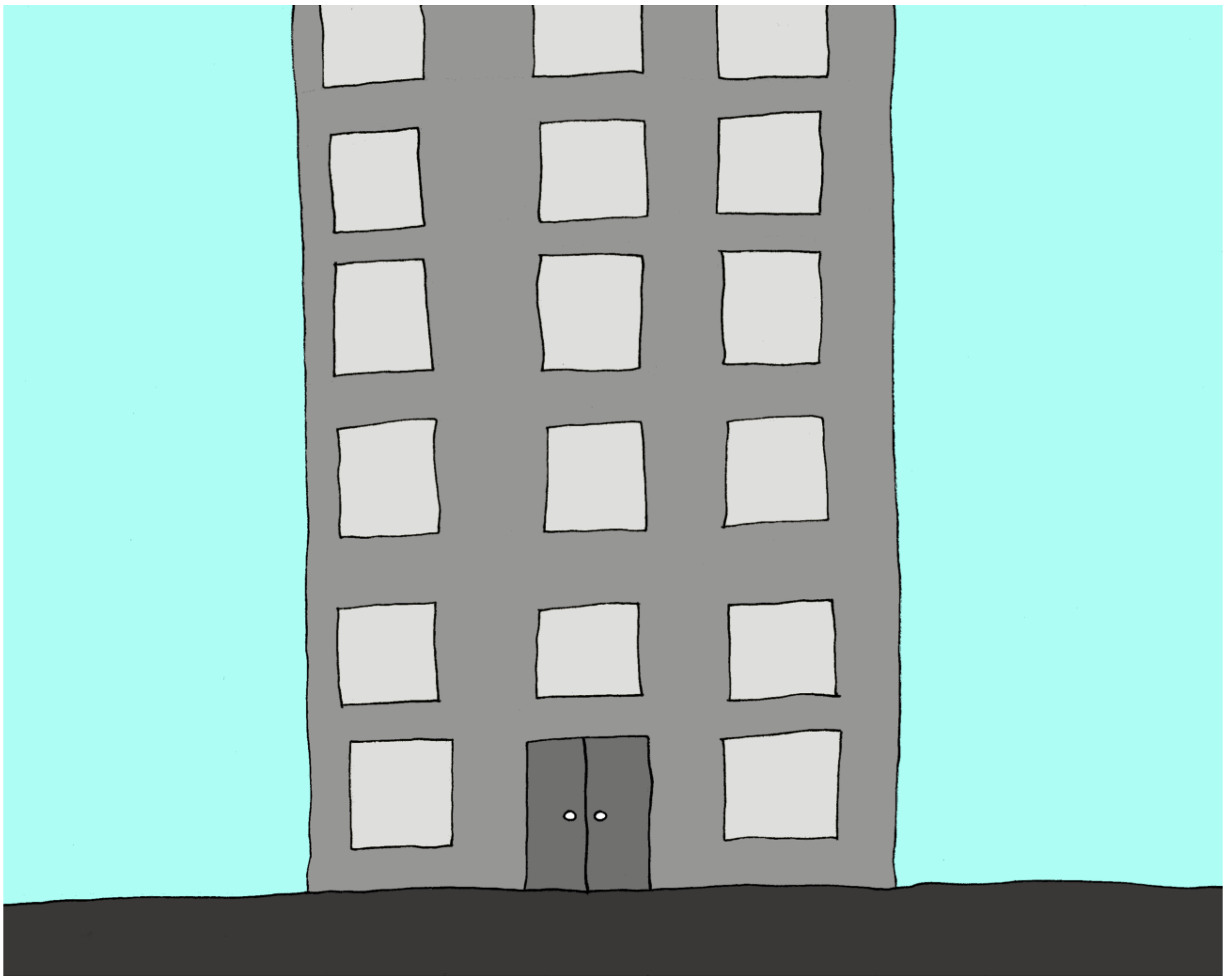


**Flex Space:**
This is a cross between office and warehouse. Usually, flex buildings are situated in industrial areas, but look more like office space. They usually have lower clear height and more office space than a normal warehouse. As an income producer, they will generally lease for more than warehouse, but less than straight office space. Leases are usually negotiable and anywhere from a fully gross lease to an absolute net are common.




**Self Storage:**
Self storage is another industrial use which has come of age. Developers, owners and speculators are beginning to realize that with the age of mobility, comes the need to store all types of things. These

facilities are generally located on industrial land and are generally comprised of metal structures of various size and configuration on paved and fenced land. Technology has enabled these properties to be used with minimal interaction between the end user and property management. New kiosks can create contracts, dispense items such as locks and other key items-all without the aid of a human. If run correctly, one can eliminate a lot of the tenant headaches as well as wear and tear on a property.

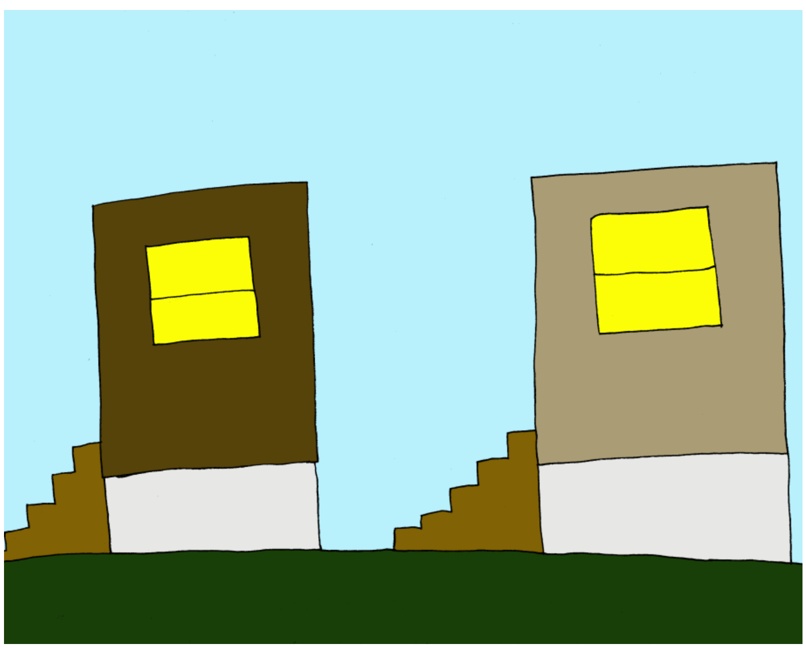


**Office:**
Offices serve as places to run a business from. They can be constructed from low to high priced building materials. They can range from single to multi levels. They generally fall into one of the following categories: A, B, C, D. Class A Office space is the best. It is usually expensively built, appointed and commands the highest rents. Class B, C and D are other grades based upon both location and build-out. Besides the structure and internal build-out, the land to building ratio should always meet the needs of tenant parking and other transportation needs of the businesses. Offices are generally rented on some type of a gross basis, where common area maintenance, taxes, insurance and other expenses can be pro-rated and passed on to the tenants. Office area is broken down into three fundamental categories: Gross building area, where all of the building area is lumped together; Net Rentable Area, this is the

specific area rented to a specific tenant; Common area, is the area shared by all tenants.  As I stated, the expenses for these areas are usually calculated, then pro-rated among the tenants.  Leases tend to be multi-year in length, with increases occurring periodically based on a given set of circumstances or indexes, like the Consumer Price Index (CPI).

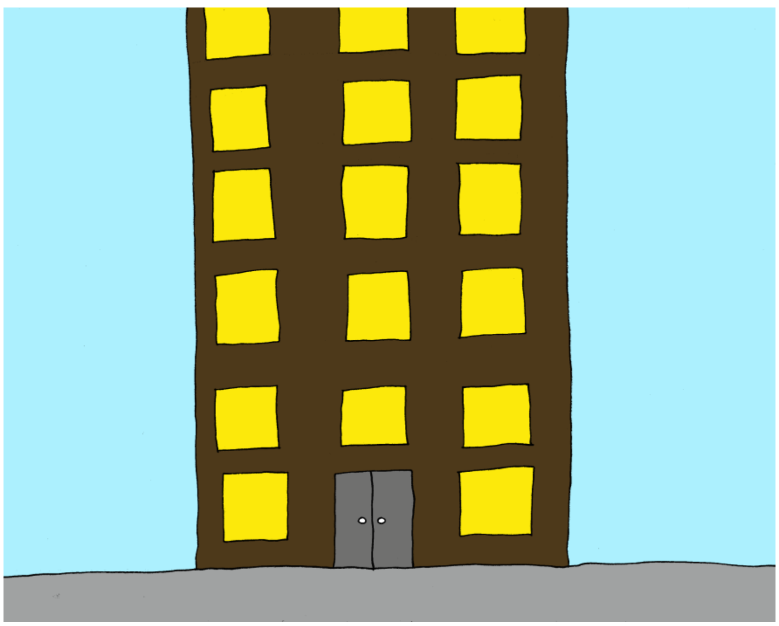

**Retail:**

Retail properties come in all types and sizes, from a free standing building to a regional retail mall. Other types of retail uses include strip malls, neighborhood shopping centers and specialty retail centers.  Like I said, they come in all types of flavors.  Like office, most all leases have provisions where the landlord passes on the expenses to the consumer and leases can be fully gross to absolute net and everything in between.  TI's are crucial to most retail properties and retail leases.



**Manufactured Home Parks:**

I had never considered manufactured home parks until a good friend of mine explained why he consciously changed from brokering apartments to brokering manufactured home parks. He explained that with most manufactured home parks, the tenants own their own manufactured home and simply lease the pad underneath the manufactured homes. They have to pay for their own utilities and upkeep on their home. Made and makes good sense to me. For those parks which have manufactured homes owned by the park, he and his investors, quickly refurbish and sell the park-owned homes on contract to new buyers. His active participation in the long range management causes vacancy to go down, lower expenses wherever possible and make capital improvements which make sense. This combination lowers vacancies, lowers expenses and increases revenues and value.



**Apartments:**

Apartments are one of the most popular investments to all types of investors, from individuals to REITs. For lending and ad valorem taxes, apartments start where residential leaves off: 5 units and larger. As with other types of commercial real estate, apartments are broken down into various grades: A, B, C and D. In addition, apartments have a location component which is also graded.

The best units are A units. These units are newer, have little or no deferred maintenance and command the highest rents. B units are generally a bit older and have a bit more expenses. C units are generally older units with some issues relating to maintenance and problems with passing through various expenses.

The location component cannot be overstated. The best locations are close to all support facilities; schools, shopping, police, fire departments, medical facilities and shopping. They are located close to popular areas and generally have low crime rates. The average income is higher than the norm.

On the other end of the spectrum is a D location. This location is close to, if not in, a ghetto. It is not close to most support facilities, has high crime rates and a lower average income.

The ideal property for an investor who wishes to maximize return on investment and effort would be a C apartment complex in an A or B location. What this means is you have an underperforming project in an area which supports higher rents. In other words, there is room to turn the property around, making changes in the physical structure as needed, changing the tenant base and increasing rents.

A quick story about a C property in an F location. A buddy of mine who is a commercial broker found a 25 unit apartment complex in Toppenish, Washington on an Indian Reservation. He made a low-ball offer without seeing the units. This is often-times the best way to buy commercial real estate, using the Ready-Fire-Aim offer technique versus the standard Ready-Aim-Fire. This is true because there is usually a long due diligence period when purchasing commercial real estate. He brought six of us investors together quickly so we could fund the deal. My broker buddy let it be known he would not be a hands-on day to day manager. Nobody else wanted the job either, so by default it was going to fall onto my plate.

The project had a bunch of deferred maintenance which needed to be fixed and the tenant base to be cleaned up before we could sell and profit. We found a general contractor from our local REIA who was willing to relocate and take on the project. Collectively, we created a punch list of items we wanted done and contributed capital for the fix-up. Some of the deferred maintenance items included painting, some roofs and replacement of the old wood frame windows. Since I was second in command, the general contractor and I talked nearly every day.

One evening, I got a call from our contractor and he was pretty shaken up. Turns out two of the local residents got drunk and into a fight. One shot the other dead in a vacant lot next to our project. A week or so later, he called and told me about a fellow who got into an argument with his girlfriend and somehow fell out one of our apartment windows and broke his neck. Turns out we didn't do our due diligence, which should have included checking with the local police department and checking crime statistics. Live and learn. We turned the property around and sold it about a year later, making a tidy profit and proving that "next biggest fool" principal is alive and well. What this means is that if you make a mistake investing in real estate, generally speaking, there is always someone dumber than you to buy the property and bail you out. I've seen it work all too often. By following a systematic plan of due diligence, however, you'll be able to avoid many of the mistakes so common to commercial real estate investors.

# Chapter 8.
# How to Quickly Look at and Understand a Residential Appraisal

You can quickly go through and understand a residential appraisal. Going through a commercial narrative appraisal takes a lot longer. The Residential Appraisal Form goes by a couple of different names, but is best known as FMNA Form 1004 has about four pages you need to focus on, while a narrative appraisal can easily be in excess of a 100 pages.

Both appraisals focus on the valuation of a specific property. The complexity and depth of analysis are what differs between the two.

The residential appraisal is broken down into segments. So I've included a copy of the 1004, broken down by section, so you can follow along. If you look at the 1004, the different portions are broken down on the left hand side.

The first section is all about identifying the subject, the client and the purpose of the appraisal. In most instances, the purpose is for a purchase or refinance transaction and the property rights will be appraised in fee simple, with the entire bundle of rights in ownership. More complex appraisals may examine different portions of the bundle of rights. Here is where the appraiser states which type of value is sought. Is it a distressed (REO or Short Sale) value or a non-distressed market value? We can even look back in time to look at what a property would have been worth at a specific point in the past with a retrospective value.

**Uniform Residential Appraisal Report** File #

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

| SUBJECT | | | |
|---|---|---|---|
| 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 | Census Tract | |
| Occupant ☐ Owner ☐ Tenant ☐ Vacant | Special Assessments $ | ☐ PUD HOA $ | ☐ per year ☐ per month |
| Property Rights Appraised ☐ Fee Simple ☐ Leasehold ☐ Other (describe) | | | |
| Assignment Type ☐ Purchase Transaction ☐ Refinance Transaction ☐ Other (describe) | | | |
| Lender/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 date(s). | | | |

The second section has to do with the purchase contract, if there is one. Understanding a Contract; Purchase Money Agreement; Earnest Money Agreement, is a topic unto itself.

| | |
|---|---|
| CONTRACT | I ☐ did ☐ did not analyze the contract for sale for the subject purchase transaction. Explain the results of the analysis of the contract for sale or why the analysis was not performed. |
| | |
| | Contract Price $ Date of Contract Is the property seller the owner of public record? ☐ Yes ☐ No Data Source(s) |
| | Is there any financial assistance (loan charges, sale concessions, gift or downpayment assistance, etc.) to be paid by any party on behalf of the borrower? ☐ Yes ☐ No<br>If Yes, report the total dollar amount and describe the items to be paid. |
| | |
| | |

The third section is about the subject neighborhood and general trends such as land use, price trends and general neighborhood boundaries.

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

| Neighborhood Characteristics | One-Unit Housing Trends | One-Unit Housing | Present Land Use % |
|---|---|---|---|
| Location ☐ Urban ☐ Suburban ☐ Rural | Property Values ☐ Increasing ☐ Stable ☐ Declining | PRICE AGE | One-Unit % |
| Built-Up ☐ Over 75% ☐ 25–75% ☐ Under 25% | Demand/Supply ☐ Shortage ☐ In Balance ☐ Over Supply | $ (000) (yrs) | 2-4 Unit % |
| Growth ☐ Rapid ☐ Stable ☐ Slow | Marketing Time ☐ Under 3 mths ☐ 3–6 mths ☐ Over 6 mths | Low | Multi-Family % |
| Neighborhood Boundaries | | High | Commercial % |
| | | Pred. | Other % |

NEIGHBORHOOD

Neighborhood Description

Market Conditions (including support for the above conclusions)

The fourth section is about the subject lot. This section addresses zoning, highest and best use, dimensions, size and the utilities and roads which serve the site.

SITE

Dimensions Area Shape View

Specific Zoning Classification Zoning Description

Zoning Compliance ☐ Legal ☐ Legal Nonconforming (Grandfathered Use) ☐ No Zoning ☐ Illegal (describe)

Is the highest and best use of the subject property as improved (or as proposed per plans and specifications) the present use? ☐ Yes ☐ No If No, describe

| Utilities | Public | Other (describe) | | Public | Other (describe) | Off-site Improvements—Type | Public | Private |
|---|---|---|---|---|---|---|---|---|
| Electricity | ☐ | ☐ | Water | ☐ | ☐ | Street | ☐ | ☐ |
| Gas | ☐ | ☐ | SanitarySewer | ☐ | ☐ | Alley | ☐ | ☐ |

FEMA Special Flood Hazard Area ☐ Yes ☐ No FEMA Flood Zone FEMA Map # FEMA Map Date

Are the utilities and off-site improvements typical for the market area? ☐ Yes ☐ No If No, describe

Are there any adverse site conditions or external factors (easements, encroachments, environmental conditions, land uses, etc.)? ☐ Yes ☐ No If Yes, describe

The fifth section has to do with improvement description. By the time I reach this section, I've already inspected the property and sketched out the exterior and made notes about the improvements. Always remember, appraisers are forced to look at improvements from the standpoint of above grade and below grade. This section defines the quality, construction and condition of the subject. It also should make note of any condition which might impair the livability. Anything which can't be expressed by a check in the box or an abbreviated comment should find its way into the text addenda.

IMPROVEMENTS

| General Description | Foundation | Exterior Description materials/condition | Interior materials/condition |
|---|---|---|---|
| Units ☐One ☐One with Accessory Unit | ☐ Concrete Slab ☐ Crawl Space | Foundation Walls | Floors |
| # of Stories | ☐ Full Basement ☐ Partial Basement | Exterior Walls | Walls |
| Type ☐Det. ☐Att. ☐ Sedate.-Det./End Unit | Basement Area sq. ft. | Roof Surface | Trim/Finish |
| ☐Existing ☐Proposed ☐Under Const | Basement Finish % | Gutters & Downspouts | Bath Floor |
| Design (Style) | ☐ Outside Entry/Exit ☐Sump Pump | Window Type | Bath Wainscot |
| Year Built | Evidence of ☐ Infestation | Storm Sash/Insulated | Car Storage ☐ None |
| Effective Age (Yrs) | ☐ Dampness ☐ Settlement | Screens | ☐ Driveway # of Cars |
| Attic ☐ None | Heating ☐FWA ☐ HWBB ☐ Radiant | Amenities ☐ Woodstove(s) # | Driveway Surface |
| ☐ Drop Stair ☐ Stairs | ☐ Other Fuel | ☐ Fireplace(s) # ☐ Fence | ☐ Garage # of Cars |
| ☐ Floor ☐ Scuttle | Cooling ☐ Central Air Conditioning | ☐ Patio/Deck ☐ Porch | ☐ Carport # of Cars |
| ☐ Finished ☐ Heated | ☐ Individual ☐ Other | ☐ Pool ☐ Other | ☐ Att. ☐ Det. ☐ Built-in |

| |
|---|
| Appliances ☐Refrigerator ☐Range/Oven ☐ Dishwasher ☐Disposal ☐ Microwave ☐Washer/Dryer ☐ Other (describe) |
| Finished area **above** grade contains: Rooms Bedrooms Bath(s) Square Feet of Gross Living Area Above Grade |
| Additional features (special energy efficient items, etc.) |
| |
| Describe the condition of the property (including needed repairs, deterioration, renovations, remodeling, etc.). |
| |
| |
| |
| |
| Are there any physical deficiencies or adverse conditions that affect the livability, soundness, or structural integrity of the property? ☐ Yes ☐ No If Yes, describe |
| |
| |
| |
| Does the property generally conform to the neighborhood (functional utility, style, condition, use, construction, etc.)? ☐ Yes ☐ No If No, describe |
| |
| |

The sixth section is the sales comparison grid. This is where the subject is compared to similar properties which recently sold or are currently listed. At the bottom of each of the comparables is the adjusted value of the property. Then, as an appraiser, it's my job to take these adjusted values and reconcile them into my estimate of value by the Sales Comparison Approach. Below that is a smaller grid which states whether the subject was transferred in the last three years and the comparables transferred in the last one year.

SALES COMPARISON APPROACH

There are comparable properties currently offered for sale in the subject neighborhood ranging in price from $ to $ .

There are comparable sales in the subject neighborhood within the past twelve months ranging in sale price from $ to $ .

| FEATURE | SUBJECT | COMPARABLE SALE # 1 | | COMPARABLE SALE # 2 | | COMPARABLE SALE # 3 | |
|---|---|---|---|---|---|---|---|
| Address | | | | | | | |
| Proximity to Subject | | | | | | | |
| Sale Price | $ | | $ | | $ | | $ |
| Sale Price/Gross Liv. Area | $ sq. ft. | $ sq. ft. | | $ sq. ft. | | $ sq. ft. | |
| Data Source(s) | | | | | | | |
| Verification Source(s) | | | | | | | |
| VALUE ADJUSTMENTS | DESCRIPTION | DESCRIPTION | +(-) $ Adjustment | DESCRIPTION | +(-) $ Adjustment | DESCRIPTION | +(-) $ Adjustment |
| Sale or Financing Concessions | | | | | | | |
| Date of Sale/Time | | | | | | | |
| Location | | | | | | | |
| Leasehold/Fee Simple | | | | | | | |
| Site | | | | | | | |
| View | | | | | | | |
| Design (Style) | | | | | | | |
| Quality of Construction | | | | | | | |
| Actual Age | | | | | | | |
| Condition | | | | | | | |
| Above Grade Room Count | Total Bdrms Baths | Total Bdrms. Baths | | Total Bdrms. Baths | | Total Bdrms. Baths | |
| Gross Living Area | sq. ft. | sq. ft. | | sq. ft. | | sq. ft. | |
| Basement & Finished Rooms Below Grade | | | | | | | |
| Functional Utility | | | | | | | |
| Heating/Cooling | | | | | | | |
| Energy Efficient Items | | | | | | | |
| Garage/Carport | | | | | | | |
| Porch/Patio/Deck | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| Net Adjustment (Total) | | ☐ + ☐ - | $ | ☐ + ☐ - | $ | ☐ + ☐ - | $ |
| Adjusted Sale Price of Comparables | | Net Adj. %<br>Gross Adj. % | $ | Net Adj. %<br>Gross Adj. % | $ | Net Adj. %<br>Gross Adj. % | $ |

I ☐ did ☐ did not research the sale or transfer history of the subject property and comparable sales. If not, explain

My research ☐ did ☐ did not reveal any prior sales or transfers of the subject property for the three years prior to the effective date of this appraisal.

Data source(s)

My research ☐ did ☐ did not reveal any prior sales or transfers of the comparable sales for the year prior to the date of sale of the comparable sale.

Data source(s)

Report the results of the research and analysis of the prior sale or transfer history of the subject property and comparable sales (report additional prior sales on page 3).

| ITEM | SUBJECT | COMPARABLE SALE # 1 | COMPARABLE SALE # 2 | COMPARABLE SALE # 3 |
|---|---|---|---|---|
| Date of Prior Sale/Transfer | | | | |
| Price of Prior Sale/Transfer | | | | |
| Data Source(s) | | | | |
| Effective Date of Data Source(s) | | | | |

Analysis of prior sale or transfer history of the subject property and comparable sales

Summary of Sales Comparison Approach

Indicated Value by Sales Comparison Approach $

The seventh section is the Reconciliation Section.  Down below the Sales Comparison Section is the Reconciliation section.  There are three" Approaches to Value" which appraisers use to come up with an estimate of value for any given property.  There is the Cost Approach, which combines land value with replacement or reproduction costs for any given structure to come up with a total value.  There is the Income Approach, where the Income of a given property is translated into a value by the use of a rate or multiplier.  Finally, there is the Sales Comparison Approach.  In theory, the Sales Comparison Approach is the closest to copying the mind of an astute purchaser when buying residential real estate.  When reconciling the various data points, the Sales Comparison Approach is usually the best Approach and it's the one which is most heavily weighted.

| RECONCILIATION |
|---|
| **Indicated Value by: Sales Comparison Approach $ Cost Approach (if developed) $ Income Approach (if developed) $** |
| |
| |
| |
| 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 repairs or alterations on the basis of a hypothetical condition that the repairs or alterations have been completed, or ☐ subject to the following required inspection based on the extraordinary assumption that the condition or deficiency does not require alteration 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 , which is the date of inspection and the effective date of this appraisal.** |

The eighth or final section to pay attention to is the Text Addendum.  This is the area where everything which can't be explained by a checked box or a one or two word answer in the main form.

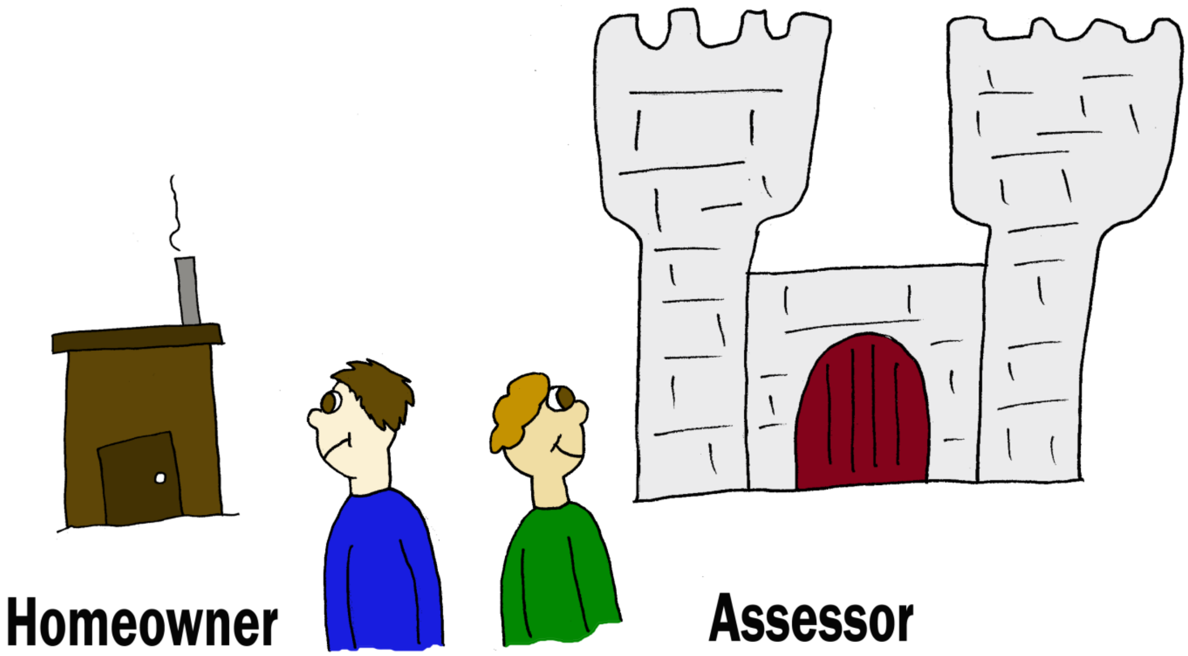
ADDITIONAL COMMENTS

Most everything else in the form is boilerplate and used as disclaimers to protect the appraiser and satisfy regulatory requirement. Some pretty boring stuff and can easily be used in place of a sleeping pill-even without the advice of a doctor!

A couple of other things a lot of folks don't know. When you take out loan from a conventional lender, the appraisal is part of the entire process. The point is that you paid for the appraisal at some point in the process, so ask for a copy.

Another point is about protesting an appraisal. If you see something in the report which is wrong and may affect value, then report it to your loan officer and ask for a "Reconsideration of Value". If the appraiser measured the improvements incorrectly or missed some close-by comparables, don't hesitate to ask for reconsideration. It's your property, or going to be your property and nobody performs better as an advocate for you than you.

# Chapter 9.
# Appealing Property Taxes




In 2007 the mortgage meltdown caused property values to plummet. Your area may have been hit harder or less hard than other areas. Regardless, it's unlikely that your county assessor kept up with the downward trends and as a result you may be being charged for an overstated value that has no foundation in the real market.

Assessors have many more properties that they can conceivably get to in the course of a year. So they do a couple of things to distribute the workload evenly. First of all, they have what is called a cycle. For most counties, this means that only once in a six or seven year period will they get to a specific property. Even then they may not even get out to take a photo or interview the owner with respect to any sales data, improvements or upgrades that have taken place over the last cycle.

Secondly, they use what is called AVM trending software. AVM means Automated Valuation Model. It is software created especially for assessors, and is used to generate a value for your property, comparing relevant property characteristics between your property and others in the same pre-determined geographic area. There are several benefits and drawbacks to using a mass appraisal system. Among the benefits, once installed, it takes much less time to produce estimates of value. The major drawback is that there are no human eyes to evaluate whether the AVM has used good data or weighted the data correctly. AVMs are good for houses in tract houses which have little differences between them. The more custom features a house may have, the less effective the software and the more susceptible to error. What that means to you as a property owner is two things. Your property is undervalued or your property is overvalued.  If it's undervalued, then you're paying less property tax than you should.  Oh, me!  However, if you're paying more than you should, then you might have a problem that's very fixable.

Below is an extract from the website of a city close to me.  Their property tax appeal system is sound and pretty well laid out.  If you're considering a tax appeal, look on the website of your local county and see how their appeal process is laid out.

**Information:  Board of Property Tax Appeals**

If you have decided to appeal your property value to the Board of Property Tax Appeals, this information will explain the appeal process.  It tells you how to prepare for your hearing, what to expect at the hearing and what follows the hearing. Please take time to read this carefully and keep it until your case has been concluded.

**Timelines:  Timelines will vary by county.**

-You must file an appeal between the date the tax statement is mailed and December 31.

-The Board of Property Tax Appeals can only consider petitions for the current tax year value.

Hearings may be scheduled between the first Monday in February through April 15. XXXX County has two panels which hear appeals.   A typical residential hearing is limited to a total of 10 minutes.

Decisions are typically deferred to between 2 p.m. and 4 p.m., at the end of the hearing day. The time needed to make a decision varies considerably from case to case, making it impossible for the Board to schedule the decision on your appeal. If you are present, the Board will try to minimize your wait to hear your decision. At the decision time, you will be unable to comment or offer any further testimony. The Board's decisions are available by telephone in three to five business days.

Duplicated copies of petitions are acceptable, but you must submit a separate completed petition for each account number.

**Submit your appeal:**

**By Mail:**
Board of Property Tax Appeals
PO Box XXXX
City, State and  Zip Code

**In Person:**
Board of Property Tax Appeals

XXXX
City, State and Zip Code

**Or By Email:**
BOPTA@XXXX.XX

*Please only submit once*

**Appeal rights**

You can appeal the real market value, specially assessed value or assessed value of your property. The Board of Property Tax Appeals can only hear appeals of the current tax year values. The Board does not have authority to consider appeals for any other tax years.

If you are appealing principal or secondary industrial property (including personal property) that is appraised by the Department of Revenue, you must file your appeal directly with the Tax Court.

**Personal Property**

It is taxable in XXXX, if it is currently being used or being held for use in a business. Learn more about personal property at the XXXX Department of Revenue.

Floating property (houseboats, boathouses or combos) is also taxable as personal property.

Learn more about manufactured structures at the XXXX Department of Revenue site.

Personal property exceptions include the addition of leased property, increased non-inventory supplies, and the acquisition of any other taxable personal property less the value of items disposed of during the same year. The exception amount is calculated by subtracting last year's real market value from the current year's real market value.

**Value definitions**

The following information is provided to help you understand how your property was assessed. Please read this information carefully.

Real Market Value (RMV) is the value the assessor has estimated your property would sell for on the open market as of the assessment date. The assessment date for all Real and Personal Property is January 1st.

Exception means a change to property, not including general on-going maintenance and repair, that increases your property's value by more than $10,000 in one year or by more than $25,000 over five assessment years. Changes that could affect maximum assessed value include new construction or additions, major remodeling or reconstruction, rezoning along with a change of use, a subdivision, or a disqualification from special assessment or exemption.

Personal property exceptions include the addition of leased property, increased non-inventory supplies, and the acquisition of any other taxable personal property less the value of items disposed of during the same year. The exception amount is calculated by subtracting last year's real market value from the current year's real market value.

Assessed Value (AV) is the value used to calculate your tax. It is the lower of real market value or maximum assessed value.

Specially Assessed Value (SAV) is a value established by statute. The legislature has established several programs that create value levels below market value for certain types of property. Each program has specific applications and use requirements. Examples of types of property that may qualify for special assessment are farm land, forest land, historic property, and property which qualify as "open space".

If Real Market Value exceeds Market Value: You may wish to appeal the real market value of your property if you believe the value exceeds the amount the property would have sold for on the open market as of the assessment date. Note: A reduction in the real market value will usually not change your tax bill unless the real market value is less than the maximum assessed value.
If Exception Value exceeds Market Value: If you believe the real market value of an exception is higher than its actual market value, you may appeal the portion of the real market value which applies to the exception. Exception values are not shown separately on your tax statement. You will need to obtain the exception value from your county assessor and use it to complete the appeal form.

Assessed Value: You may appeal the assessed value of your property if you believe the assessor made an error in the calculation. The total assessed value is shown on your property tax statement.

You are encouraged to contact your county assessor, who can help you understand how your property value was determined.

**Preparing Evidence**

A strong case requires careful preparation. Whatever you provide as evidence becomes a permanent part of your file. It cannot be returned to you. This means that before coming to your scheduled hearing, you must photocopy all documents, including photographs that you wish to leave with the Board.

The only evidence the Board can consider is what you provide with this appeal. Evidence submitted in prior appeals is not usable by the current Board. You may send your evidence with your petition, or bring it at the time of the hearing. All evidence, including any display, should fit in an 8-1/2 x 14 inch size file folder.

It is the petitioner's responsibility to prove their value is too high.

**The Board**

The function of the Board of Property Tax Appeals is to hear petitions for reductions in real market value, specially assessed and assessed value. Board members are not part of the Assessor's Office. They play no role in setting the assessed value. They are private citizens who are appointed by the Board of County Commissioners. They are not professional appraisers, but have training, experience and knowledge in property valuation. The Board may be thought of as a panel which decides the value of your property based on the evidence you present.

**By State law, the Board will:**

Consider evidence relating to the reduction of real market value, specially assessed and assessed value.

**By State law, the Board cannot:**

Consider hardship as a factor in establishing value
Set the amount of tax you owe
Consider a sharp increase in value in a single year to be a valid reason for appeal;
Regard lack of normal property maintenance as a reason for appeal (however, severely deferred maintenance and structural problems are considered);
Consider testimony on tax rates or the fairness of the tax system.

**Types of evidence**

You must provide evidence that the real market value is less than the real market value shown on your tax statement. There are a number of ways to offer this evidence to the Board.

Purchase documents - If the property was recently purchased, the purchase price is one proof of value, provided the sale meets the criteria discussed previously. Useful pieces of evidence are copies of:

**1. Signed sales agreement**
**2. Closing statement**
**3. Recorded deed or contract**

Appraisal/Real Estate Broker Opinions of Value - If the property has been appraised recently, a copy of the appraisal is useful evidence. All appraisers and brokers must be licensed in Oregon. The Board may ask you about the purpose of the appraisal.

**Sale listings -** You may have recently listed your property for sale, or it may be currently on the market. If this is the case, provide copies of the listing(s) with a real estate agent giving dates, terms and listing price.

**Comparable sales -** Perhaps you have owned your property for many years and do not plan to sell it. To prove its real market value, you will need to use proof of sales of comparable properties near yours.

You may obtain this information at the Division of Assessment, Recording and Taxation's Customer Service Office at XXXX City, State and Zip Code any weekday between 9 am and 4:30 pm.

Look for sales of houses similar to yours in size, quality, construction class, and age that are located near you. Construction classes range from 1 (lowest) to 8 (highest) and reflect the quality of materials and methods used.

If you find houses comparable to yours that sold (close to the assessment date of January 1st) for less than the real market value of your house, this may be evidence your house is over- valued.

Pictures are very useful in your comparison. All photographs of houses should be clear views of the entire front of the houses. A suggested format for presenting evidence is shown in the format for single family houses section toward the end of this page.

**Characteristics cards -** While at the Assessor's Office you may also want to look up the characteristics cards of your property and of comparable properties. This is a sheet listing details of the property and giving the assessed value of the land and building(s) for the last three years. Characteristics included in addition to the size, age and class of construction are a listing of the various rooms, type of heat, garage, fireplace, patio, etc.

This information can be printed for $X.XX .  If you notice errors on the characteristics card for your property, you should speak to the Appraiser on duty via in office visit or call XXX-XXX-XXXX.

**Repair estimates -** Routine maintenance such as painting and re-roofing are a continuing responsibility of the homeowner. Failure to keep the property in good condition is not in itself grounds for requesting a value reduction from the Board.

**The Hearing**

State law requires that notices be mailed at least five days prior to the hearing. Nearby parking is available. Citizens with disabilities should call the office at XXX-XXX-XXXX to obtain special assistance.

If you know in advance that you will be unable to attend on given day(s) and have listed those times on your petition, every attempt will be made to accommodate your schedule. Hearings cannot be rescheduled.

If, after your hearing is scheduled, you find you cannot attend, you may send a qualified representative. You can fill out the Authorization to Represent form if you want to someone else to appear at that hearing on your behalf.

State law requires that hearings must be held between the first Monday in February and April 15. XXXX County has two panels which hear appeals. A typical residential hearing is limited to a total of 10 minutes.

Within those 10 minutes, you will introduce yourself and identify your property. The Board Chair will announce the current value and your requested value, and will confirm the size, location and type of property under appeal.

The Chair may ask for clarification of anything on your petition which may be unclear. You will then be asked to make a statement supporting your requested value.
The Board will not have had time to review your petition or evidence prior to the hearing. If you have included a written statement, it is not necessary to read it to the Board, but you should briefly summarize its content.

Describe each piece of evidence you present. There may be questions by Board members either at the end of your statement, or perhaps for clarification as you make your presentation.
You must make your statement, present your evidence, and allow for questions within the 10 minute period. The process is informal. You should expect to be treated with courtesy. The Chair must, however, adhere to the time schedule and you will be asked to cooperate in this regard.

**The Decision Process**

To insure that all appellants are heard at the scheduled time, the Board hears all the day's testimony before making any decisions. The decision-making process is typically deferred to between 2 p.m. and 4 p.m.

You do not have to be present but are welcome to observe the process. The time needed to make a decision varies considerably from case to case, making it impossible for the Board to schedule the decision on your appeal. If you are present, the Board will try to minimize the wait to hear your decision. At the decision time, you will be unable to comment or offer any further testimony. The Board's decisions are not available by telephone.

**After The Decision**

The decision will be a formal order, mailed to you about four weeks after the hearing.

Inquiries on refunds should be made to Customer Service at XXX-XXX-XXXX. Refunds are issued approximately six to eight weeks from the time you receive your decision.

**Format for single family homes and plexes of comparable sales**

| Subject Property (Yours) | Comparison #1 | Comparison #2 | Comparison #3 |
|---|---|---|---|
| **Street Address** | | | |
| **Area of lot (SF)** | | | |
| **Construction class (1-8)** | | | |
| **Year built** | | | |
| **Basement (full/partial)** | | | |
| **Number of baths** | | | |
| **Number of bedrooms** | | | |
| **Type of heat/AC** | | | |
| **Number of fireplaces** | | | |
| **Garage size (single/double)** | | | |
| **Area of house (SF)** | | | |
| **Distance from subject** | | | |
| **Sales price** | | | |
| **Sale date** | | | |
| **Other** | | | |

**Instructions:** Use this work sheet to compare your property to nearby properties which have recently sold. If you plan to present these comparisons to the Board of Property Tax Appeals as evidence to support your request for a valuation reduction, please include a photograph of the front of each house. Mark the photograph of your house "Subject" and mark the other photographs, "Comp #1," "Comp #2," "Comp #3" on the reverse side of each photograph.

So let's look at your properties' tax statement. The first thing to do is find the correct millage rate for your property. This is the rate applied to the assessor's valuation of your home. Don't assume you know this rate; verifying the correct millage rate is one of the key point you need to know. In theory, if you take the tax assessed value and multiply it by the millage rate, you should have calculated your taxes. But assessors and legislators tend to confuse the issue, so check with the assessor's office for the correct computations.

Now, go and find out what your home is really worth. You can use AVMs, BPO and other tools and argue your own case. But when it comes right down to it, you really want to be represented by someone who can argue your case and talk the same language as those who imposed their valuation on you. I think it just makes sense to use an appraiser to argue with an appraiser. Once you've found out what your properties current market value is, then subtract the tax assessed valuation from your current estimate of market value. Take the difference, multiply it by the millage rate and you have your estimated tax savings.

**Let's take a look at a quick example:**

Your tax bill is $6,500. Tax assessed value is $650,000. In our simplified world, the millage rate would be: .01 ($6,500 / $650,000)

You do your research. First you explore the AVMs and come up with a range of values from $325,000-$425,000. Hmmm… that's quite a bit lower than the tax assessed value. You ask for and get a BPO from a Realtor saying the value is between $350,000-$400,000. Looking pretty good. Finally, you engage an appraiser who has experience with disputing property taxes. Careful here, in some jurisdictions, the professional who prepared the report cannot also represent you at your hearing. Make sure you check this little tidbit out. OK, so you get the appraisal back and the estimate of market value is $375,000. So take the difference of the tax assessed value and subtract the current estimate of market value and you have the difference: $650,000 - $375,000 = $275,000. Take this figure and multiply it by the millage rate and you have your potential savings, net of your cost to appeal. In this case: $275,000 x .01 = $2,750. That's not chump change. If you prevail, you might get your refund pretty quickly, plus have the lower value on file in your properties' record jacket. This savings will stay in effect until something happens where the assessor has to recalculate your property taxes; something like a sale, the property comes up in an appraisal cycle or you take out a permit for improvements.

You have to be the judge as to whether it's worth it or not. But if know your property has taken a real hit in value in the last few year, it's at least worth checking it out to see if you can potentially save money now and into the foreseeable future.

# Chapter 10.
# Investing in Real Estate

It's a well-known fact that most fortunes are made from real estate and stocks. This chapter isn't so much a "how to" as much as it is a "stay away from" chapter. I realized a few years back that to be successful in real estate, I needed five things:

1. **Correct mindset**
2. **A mentor who had my welfare first and foremost**
3. **A system which could be used consistently to make profits**
4. **The use of private money in order to use leverage**
5. **A team**

Let's address these five components individually.

**1.** First, let's address the mindset. If your mind is not right, you can purchase all the coaching and products you and your bank account can handle, but it's very unlikely you're going to have the type of success you're looking for. I know, I had to get this right before I was ready forward in my real estate investing life. This is called the "next shiny object" syndrome, where you can buy a product, try and implement it without much success, then put in on the shelf when the next shiny product or technique is introduced. Often times, this occurs when you have negative or limiting beliefs. These are patterns or habits which stop you from doing what you need or want to do. Some are deeply ingrained from childhood and some of which we are unaware. If this description fits you, there are decisive actions you can take. First of all, take some time and do some research on self-help. Tony Robbins, Joe Vitale and other mainstream coaches have put out a voluminous amount of material on the subject. When "The Secret" came out it was unique. Now everybody's got their twist on how to identify limiting beliefs, how to get rid of them and re-program yourself for success. If that's what it takes, then you've only got two options: 1. Get into something where you don't need to be self-reliant, ie a job; or 2. Identify your problems and re-program yourself. If you don't, you're logically bound to do the same thing over and over again-the very definition of insanity.

**2.** Secondly, let's talk about a guru or mentor or coach. I think it's important to have a mentor so as to forego most of the mistakes and to have a template for success. Most all of the time, the mentor you choose will have a system they are trying to sell you on. Most of the gurus are dynamic, charismatic people. They sell you on their product or service, but once they're gone and you try and implement their program, you find out there is no real communication and you're really alone. I've read plenty of articles on how to select the correct mentor. Here are some criteria for selecting a mentor:

**-**He or she (they) should have experience and a track record. In other words, they should have experienced success in the area of real estate in which they consider themselves to be an expert. If they can't prove to you that they've successfully closed deals, then move on.

**-**Ask yourself if their product or technique is usable in the current real estate environment. The field of real estate investing is always changing and you don't want to try and implement a product or program that was good a decade ago, but doesn't work in today's marketplace.

-They should be available to you for one on one consultation; they shouldn't pawn you off on a junior associate.

**-**They should have testimonials or references you can check out

**-**Their plans for you should be clear, concise and measurable.

**-**Their cost should be proportionate with what you stand to profit from using their services.

I could go on ad nauseum about mentor selection, but these are the basics. There are a lot of hucksters out there who want to sell you the glamor and glitz and will promise everything under the sun to make a sale. They will lure you in with a "free" presentation in order to pique your interest and then immediately try and upsell you into a program or programs. Many times these circuses travel with multiple speakers, each with their own unique pitch trying to sell their programs. I suggest doing three things prior to committing to a mentor:

**(1)** Google or research them as best you can. Follow up on testimonials or references.

**(2)** Go to Rip Off Report (http://www.ripoffreport.com/) and put the mentors name or the name of the course they are selling and see what pops up.

**(3)** Go to John T. Reed's website (http://www.johntreed.com/Reedgururating.html). John has made a vocation of evaluating most all of the popular gurus and their products. Well worth the time to check him out.

**3.** Third, you need to select a system that you feel comfortable with and which fits the time and financial resources you have available. This is easier said than done. Just Google "Real Estate Investing" and automatically you're overwhelmed with the options. Most of these work or did work at some time in the past. It's really up to you to determine if the system you purchase is still relevant and current in the tumultuous field of real estate investing. Do you want to do fix and flips, short sales, REO properties, auctions, wholesaling, etc? My suggestion is to focus on a niche which resonates positively with you, your skillset and your resources. Then research the mentor/guru/coach and determine exactly what you get with the course and how much access you have with the guru. If you determine the niche you chose is relevant and you get to have interaction with the guru, you might have a winner. However, caveat emptor-let the buyer beware and pay attention to the return policy.

**4.** Fourth is the relatively new concept of private money. I'm a firm believer this can be a fantastic win-win for both the lender and the borrower. With institutional savings returns at near an all-time low, there are many folks out there with savings accounts and IRAs which are producing next to nothing. If you know what you're doing, you can provide the answers to these people who want better returns, but are nervous about investing in real estate. Fears can be negated when the lender realizes that part of your program entails putting the money they lent into purchasing undervalued real estate and putting title to the property in the lenders name. There are many courses out there that provide step by step guidance and training necessary to get private money. Once again, look for someone with a proven record and has some credibility.

**5.** Fifth is a having a team you can trust in place. While the concept pretty much speaks for itself, it's important to have professionals with whom you are compatible to look over your shoulder and review your documents, situation or anything else related to real estate. Players on your team should include:

**-Bookkeeper.** If you have any type of repetitive transactions, like receiving rents or managing properties, it's important to have a bookkeeper so you don't wind up paying an accountant for doing a bookkeepers work.

**-Accountants.** If you have real estate, you need one. Whether it's preparing your taxes or providing advice, it's a good thing to have one that is knowledgeable in the field.

**-Attorney.** Make sure that you have one that specializes in real estate.

**-Broker.** Never hurts to have a broker or two who specialize in the area or type of property you're interested in.

**-Appraiser.** Like a broker, it sure can't hurt having access to an appraiser for a non-biased pay-for-play information gatherer.

**-Contractor.** Make sure they are licensed and bonded in case you need legal recourse.

**-Property Manager.** Landlord-Tenant laws have become so complicated and specific, if you have rental properties, you want somebody to put between you and your tenants. Unless you want to deal with tenants and toilets, find a good property manager.

Those are pretty much the professionals you need in your corner at all times. Make sure you're compatible with all of the above mentioned professionals above and make sure you know their hourly rates so you're not surprised when you get a bill in the mail for services rendered.

I believe these are the keys to successfully investing in real estate. First, get your mind right. Then pick and mentor and a system; sometimes the mentor will have the system and if they go together-so much the better. Lastly, if you want to use leverage, consider how to raise private money, staying away from issues relating to the IRS or SEC.

Once again, try and be careful and do your due diligence and don't just throw money at a guru or product and expect success. Lastly, you want a team which will support you and your efforts in real estate. Success takes time and effort.

Here are some of the basic types of investing program. I've purposely left the identification of originators and their programs generic. Some of them are more relevant than others in this ever-changing real estate market.

**-Wholesaling residential properties.** This type of entry level investing is where you find the good/great deal and pass it on to an investor, while making a fee off of the transaction.

**-Buying, fixing and flipping residential properties.** There are so many of these programs it's easy to get confused. The basic premise of these courses is simply buy low, fix up the property and sell high.

**-Buying and selling REO properties.** These programs focus on finding distressed bank assets and then purchasing them for resale.

**-How to short sale properties.** These programs entail working with a bank, often-times through a Realtor, where one buys a property for less than the mortgage amount.

**-Buying HUD Homes.** These programs teach you how to identify profitable deals in the desired market, then how to make offers that get accepted.

**-Wholesaling commercial properties.** Many loans are coming due on commercial properties and the income on these properties cannot support the debt and therefore the property becomes a non-performing asset the banks want off of their books.

**-Buying, fixing and flipping commercial properties.** The programs out there tend to be over simplified, but the concept of buying low and selling high still apply.

There are many other types of RE investing programs out there in the marketplace and on the web. They tend to be pretty much all the same with respect to the concept. The big difference to you, the wannabe investor, is how much coaching or hand-holding you get. The more face time you can get with the originator (not assistant or associate), the better. Often times, the idea is to get you going so you can partner with the originator of the program. Sometimes their motivation is clear, other times not so clear. But be aware, they don't create these programs for their health, they want to profit and if you happen to be a profit center, well so much the better for them. Once up and running, these programs can produce great, consistent income and help you achieve your financial dreams.

# Summary

I hope you got something out of this eBook.  For me, it was a labor of love and the self-satisfaction of knowing I tried to give something back which was meaningful. The purpose of this whole exercise was to try and simplify a wide-ranging body of knowledge, breaking it down into usable parts. When I Googled to see if there was anything on the net about my topic relating to looking at real estate from an appraiser's standpoint, I found very little.  I see the need and a huge market for an inexpensive advocate for the property owner, but nothing can take the place of knowledge.  You don't need to be an expert in the field of real estate, but as a homeowner, prospective homeowner or even an investor, you need answers to questions or know where to find them or who to ask.

After writing this, I've come to the conclusion this is a document which can be improved and expanded to meet the needs of the reader.   There are so many more topics to address which relate to real estate and how it affects you, your family and your pocketbook.  Just thinking about it, some of the topics I think need to be addressed include:

**-Real Estate Negotiation**
**-Real estate taxation**
**-How to calculate a mortgage**
**-How to get a loan**
**-Property Management**
**-More info on how to estimate costs**
**-More on Real Estate Investing Techniques**
**-More on Cost vs Value**
**-More on the Landlord and Tenant Act**

Also, there is no reason you cannot contact me and address a specific question(s) or subject. My website is under construction, but you can contact me at kellygith@gmail.com.