

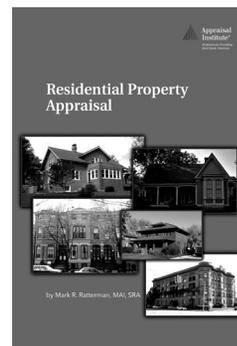
Exploring Residential Property Dynamics: Commentary on *Residential Property Appraisal*

About This Column

Appraisers who value residential properties complete assignments in dynamic markets. This edition of Resource Center looks at *Residential Property Appraisal*, a resource that offers appraisers information and guidance on application of real property concepts in both typical and atypical residential assignments.

The newly published *Residential Property Appraisal* is an essential text for the residential appraiser, whether seasoned or novice. This is the most recent in the Appraisal Institute's books of particular interest to residential appraisers.¹ Its sixteen chapters cover the basics—addressing timeless topics with current applications. In addition, it covers subtopics such as specialty residential property types, green and high-performance houses, and specialty residential markets. The reader will find helpful supplementary information in a section on financial calculator basics and a bibliography for those interested in digging deeper.

The author, Mark R. Ratterman, MAI, SRA, is an outstanding communicator. He offers clear explanations of basics that even experienced appraisers can use for a refresher and that novices need for in-depth understanding and clarity. The writing is clear and to the point, with ample examples, illustrations, and resource citations. In addition, Sandra K. Adomatis, SRA, LEED Green Associate, and Maureen Sweeney, SRA,



Residential Property Appraisal by Mark R. Ratterman, MAI, SRA

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AI-RRS, contribute chapters on residential specialty segments as described below.

Residential Property Appraisal is intended for both instruction and reference. Its complete, functional index is an essential aid for looking up topics or terms of interest. Of course, the PDF version of the book inherently carries the ability for the user to search for any word or group of words. The appendix at the end of this column lists key concepts that are defined in *Residential Property Appraisal*.

1. Other books include, but are not limited to, *The Valuation of Condominiums, Cooperatives, and PUDs*; *Residential Green Valuation Tools*; *Appraising the Tough Ones: Creative Ways to Value Complex Residential Properties*; *Valuation by Comparison: Residential Analysis and Logic*, 2nd ed.; *Identifying Residential Architectural Styles*; *Using Residential Appraisal Report Forms: URAR, Form 2055, and the Market Conditions Form*, 2nd ed.; and *An Introduction to Green Homes*. Of course, residential appraisers also rely on the Appraisal Institute's texts *The Appraisal of Real Estate* and *The Dictionary of Real Estate Appraisal*.

Chapter 1, “Real Property Ownership and Appraisals,” introduces foundational concepts in real estate including the following:

- Forms of ownership
- Distinction between real property and real estate
- Personal property
- Tangible and intangible property
- Fixtures and trade fixtures
- Types of estates
- Eminent domain
- Powers of government
- Leasehold and leased fee interests
- Identification of property rights
- Condominiums and cooperatives
- Planned unit developments (PUDs)

The chapter also has excellent to-the-point discussions about contracts, leases, types of deeds, and options.

The second part of the chapter provides an overview of appraisal and appraisers. It explains what an appraisal is, why appraisals are needed, the valuation process and related services, and residential appraiser qualifications, including licensing, certification, designations, credentials, and competency.

Chapter 2, “Principles of Value, Real Estate Economics, and Finance,” takes a look at the concept of value and types of value; gross and net pricing; insurable value; and assessed value. Principles of real estate economics are clearly explained. Real estate markets are examined by property type, including their key characteristics, and the differences between neighborhoods, districts, and market areas are explained. The classic “four forces that influence value” are presented along with the significance of changes, trends, and cycles in real estate markets.

The second portion of the chapter gets into the financing side of residential real estate, with a

look at the sources of mortgage money, the secondary mortgage market, and influences on the mortgage market. This discussion covers the federal reserve system, credit regulation, and the US Department of the Treasury. The chapter is rounded out with a discussion of the particulars of loan risk, points, financial trends, financing fraud, and financing plans and trends.

Chapter 3, “The Valuation Process, Beginning the Appraisal, and Data Collection,”

offers a good in-depth overview of the approaches to value, which are more specifically addressed in later chapters. The text here starts with an effective discussion of the valuation process and a diagram of the steps involved. The author presents a thorough treatment of the important topics of scope of work, data collection, property description, site value, and data analysis. The text provides a practical look at elements of data analysis in the appraisal process—including market and neighborhood analysis and highest and best use analysis—with illustrative examples.

Chapter 3 concludes with a brief discussion of reconciliation and reporting the defined value, with more thorough examples left for later in the book. The real-world topics of scheduling and planning, collection of data on the subject property, property inspection, and collection of data on comparable properties also are discussed.

Chapter 4, “Neighborhood and Market Area Analysis and Highest and Best Use,”

provides information about analysis of location. The distinction is made between a *market study* and a *marketability study*, and an explanation is given as to the questions each answers, the items included, and the use of each. The distinctions between *neighborhood* and *market area* are explained, and critical market area influences and trends are presented. The discussion addresses the following topics related to these concepts:

- **Social influences**, including population trends and characteristics, community and neighborhood organizations, and the need for understanding the quality of services, establishments, and neighborhood associations.
- **Economic influences**, including demographics about income and purchasing power, financing availability, real estate prices, rent levels, new construction, government services and tax influences, public and private restrictions, schools, and owner-occupancy rates.
- **Environmental influences (physical and geographic)**, including siting factors, flood zones, location as it relates to the overall community, transportation systems and linkages, recreation, amenities, soils, views, characteristics and conditions of residences, and adequacy of utilities. There is also discussion of the importance of consistency in markets and reporting neighborhood conclusions.
- public and private limitations on ownership rights of the site (zoning, covenants and use restrictions, party-wall agreements);
- understanding physical characteristics of the site (immediate location characteristics, physical and economic linkages, environmental influences);
- tax and assessment information;
- real estate tax status (especially compared to similar properties);
- special assessments;
- government and private services and costs;
- explanations of the types of legal descriptions; and
- data sources for site information.

The chapter has a thorough discussion of each item, with illustrations, exhibits, and examples.

Highest and best use is the next main section of the chapter. Several commonly used highest and best use definitions are presented and discussed. This chapter offers a well-explained section on highest and best use of a site as though vacant and highest and best use of a property as improved. The concept of *consistent use* is addressed and analyzed. There is also a useful discussion of special situations in highest and best use analysis; it tackles the concepts of interim uses, legally non-conforming uses, excess and surplus land, and neighborhoods in transition. Examples are included throughout the discussion to augment definitions and concepts.

Chapter 5, “Site Description,” addresses what is needed for understanding of a site before its valuation. Topics covered here include

- legal and other descriptions;
- property rights involved;

Chapter 6, “Improvements Description,” addresses the description of building improvements, from site placement and utility to construction materials and building systems features. The chapter discussion covers Fannie Mae quality of construction ratings and property condition ratings. Residential architecture and trends, types of houses, house living zones and condition are all in this chapter.

Chapter 7, “Land and Site Valuation,” delves into the difference between land and site. The text explores the notion of valuation of *property rights* to or in the physically described real estate; the principles of progression and regression; and the market forces that influence land value. The chapter allocates significant discussion to the valuation of land and site in the residential context. The major land and site valuation techniques are thoroughly discussed with clear explanations and examples of each. Emphasis is on the sales comparison method, with seventeen pages describing the technique and thor-

ough examples of research, comparison, and adjustments (both qualitative and quantitative), and applied conclusion.

Other land or site valuation techniques discussed include the allocation technique, extraction technique, income capitalization techniques (land residual and ground rent capitalization), and subdivision development analysis. When to use each of these land or site valuation methods is covered and examples are provided.

In Chapter 8, “The Cost Approach,” the application of this approach and its pros and cons are examined. The author breaks the cost approach into the following useful steps:

1. Develop an opinion of the market value of the site as though vacant.
2. Estimate direct and indirect construction costs of the improvements.
3. Estimate the entrepreneurial incentive required to bring the improvements into production.
4. Add direct costs, indirect costs, and entrepreneurial incentives.
5. Estimate improvements’ applicable depreciation from any cause.
6. Deduct the depreciation from all causes from the improvement cost estimate.
7. Estimate the contributory (net) value of the site improvements.
8. Add the site value to the depreciated cost of all improvements.

Other sections of interest examine the relationship of the cost approach to appraisal principles, the challenges of overimprovement and underimprovement, and the applicability of the cost approach. Cost-estimating methods are introduced with examples. The comparative unit method, unit-in-place method, and quantity survey method are also covered. Finally, this chapter offers a good introduction to depreciation, with details left to the next chapter.

Chapter 9, “Estimating Depreciation,” introduces the three types of depreciation—the market extraction method, age-life method, and breakdown method. There is a thorough explanation of each depreciation type, with helpful diagrams illustrating the relationship and major items in each method. The examples help improve the reader’s understanding and are valuable for both the student and experienced appraiser as a reference.

Chapter 10, “The Sales Comparison Approach,” gets into the basic steps of this approach and includes an example of a sales comparison adjustment grid. The discussion addresses real-world topics such as errors in data searches, strengths and limitations of the approach, and the research and selection of comparable sales. The latter section discusses how to identify comparable properties, the importance of field inspection (particularly when database information is insufficient), the importance of highest and best use, and verification of data—with key items to cover in the verification process. A brief section on “thinking of comparables as competitive properties” contains some particularly valuable practical points.

The process of making comparison adjustments is a significant part of this chapter. It addresses units of comparison, dollar versus percentage adjustments, sequence of adjustments, and paired-data analysis and its limitations. Qualitative analysis is also covered, including ranking. The chapter concludes with considerations in the final reconciliation of data, findings, and analysis in the sales comparison approach.

Chapter 11, “Adjusting Comparable Sales,” continues the discussion of the sales comparison approach and process. There is an overview of the concept of comparison adjustments and elements of comparison followed by a discussion of each of the following examples of elements of comparison:

- Real property rights conveyed
- Financing terms, concessions
- Conditions of sale
- Expenditures immediately after purchase
- Market conditions, date of sale
- Location
- Property interests
- Site size
- View amenity
- Improvement age
- Improvement condition
- Above-grade room count
- Above-grade gross living area
- Basement, finished area below grade
- Heating, cooling, energy-efficient items
- Garage, car storage
- Porches, patios, decks
- Intangible property, economic characteristics
- Zoning
- Personal property, nonrealty components

Of course, there may be subitems and other points for consideration depending on the comparable and appraised property characteristics. For example, in the section on rights conveyed, long-term leased land is addressed as well as differences in rights such as mineral rights, life estates, and negative easements. Under the section on financing terms and concessions, non-standard or creative financing is discussed along with the possible impact on price of the comparable and need for comparison adjustments. Other financing arrangements, such as seller financing, non-cash considerations in a comparable transaction, and below-market rate financing, are covered with valuable examples.

The condition of sale element of comparison has good coverage in the chapter along with an example. The consideration of expenditures made immediately after purchase and market conditions/date of sale elements of comparison are discussed effectively. The location adjustment is well covered and addresses key practical points. For example, the discussion looks at

whether location is in the site value or a separate adjustment for the total property sales comparison process. Ample examples are provided in this section and throughout the chapter.

Comparisons of improvement condition brings up some practical points useful to the practitioner, as does the discussion of above-grade and below-grade footage. As with other topics, the examples make the discussion practical and useful for understanding and reference.

Chapter 12, "The Income Capitalization Approach," provides a good overview of the income capitalization approach for the residential appraiser, its research and data requirements, and applicability. This section includes the use of multipliers and the direct capitalization process as relates to the single-family residential property. This chapter has excellent discussions, and many examples, involving:

- the data collection and rent survey process,
- analysis of lease provisions,
- derivation of multipliers from the market (including the adjusting of comparable sales),
- reconciliation of the multiplier indications,
- estimating monthly rent (including adjusting market data),
- reconstructed operating statements,
- estimating operating expenses, and
- direct capitalization of a single year's net income.

This chapter is a significant aid to understanding the income approach for single-unit residential property because of its clear writing, practicality, and helpful examples.

Chapter 13, "Final Reconciliation and the Appraisal Report," covers a topic of importance for appraisal reports. The discussion in this chapter will help appraisers—even experienced practitioners—understand reconciliation and improve the appraisal process and their writing of the reconciliation part of their appraisal reports. Part

of reconciliation includes a self-review of the work done in the appraisal process through the approaches; to enhance this step the text includes a good self-review checklist. (Page 407)

The importance of addressing the appraisal question and any special situations is part of the self-review and reconciliation process. For example, the client may need a defined value for the property “as is” or “as if repaired,” or may want a list of needed repairs and estimated cost to complete, or may have stipulated specific requirements for the report’s content.

The chapter has a good discussion about the importance of reviewing for adequacy of data and analysis, consistency, math, and other such items. The author notes that discussion in the reconciliation section of the appraisal report should address the applicable approaches, quality and quantity of data available and used, the value indications, and the supported final value indication. As the author says, “Reconciliation is a process that is required in all appraisals. Reconciliation is necessary because value opinions are often based on imperfect data” and multiple value indications as well as special conditions or assumptions. (Page 422)

Examples of various commonly used form reports are included in the text, but the reader must remember that these change from time to time, so it is important to check current requirements of the client, regulators, and the secondary mortgage market.

Chapter 14, “Specialty Residential Property Types,” drills down into concerns regarding certain types of residential properties. This section, contributed by Maureen Sweeney, SRA, AI-RRS, addresses the specific situations and considerations for specialty property types, including condominiums, site condominiums, condo-hotels, cooperatives, planned unit developments (PUDs), and small income-producing residential properties.

The author points out several important details to keep in mind in valuing these special types of

residential property. Awareness of the following basics will help keep the appraiser’s thinking and analysis process on track in these assignments:

- Buyers and sellers buy and sell real property (i.e., rights), not real estate.
- The address of a property is merely directions to the mail carrier—it does not describe the bundle of rights involved.
- *Condominium* is a generic term used to describe a property that is or is not attached to another unit and normally has a level of maintenance performed by a homeowners association (HOA).
- *Condominium* is also a legal term, specifically defined by the state jurisdiction in which it is located.
- PUDs are properties with ownership normally like most other types of real estate, with interests spatially defined by the legal description. PUDs normally have HOAs (community associations), and individual ownership carries both individual and joint property rights. (Pages 423–424)

The chapter has a thorough five-page overview of condominiums, condominium ownership, common elements, limited common elements (LCEs), site condominiums, and condo-hotels.

Cooperatives, their characteristics, valuation considerations, and a comparison of condominiums and cooperatives make up the next section. It addresses cooperative ownership and proprietary leases. The balance of the first part of the chapter is a discussion of PUDs, leasehold estates and ground (land) leases. Examples are included to increase the reader’s understanding.

The last ten pages of the chapter address the valuation of “small income-producing properties.” These include duplexes, triplexes, quads, two-flats, and three-flats. The author notes the importance of understanding the bundle of rights, and characteristics of the lease(s) in place for such properties. Also important is an understanding of the market norm for occupancy period; rent

amount; payment of utilities, insurance, and taxes; parking; concessions; termination terms; and tenant restrictions. The landlord and tenant obligations are among the points for appraisers to investigate—for the subject and comparable rentals alike.² The distinction between market rent and contract rent is explained as well.

As the text explains, the capitalization technique most often used in the appraisal of small income-producing properties is *direct capitalization*. This topic is well covered and explained with good examples.³

Chapter 15, “Green and High-Performance Homes,” was contributed by Sandra K. Adomatis, SRA, LEED Green Associate. The meaning of “green” and “high-performance” are discussed so the reader has an immediate basic understanding of the terms. The six elements of green building are listed and discussed individually:

- Site
- Water efficiency
- Energy efficiency
- Indoor air quality
- Materials
- Operations and maintenance

The energy efficiency section of this chapter explains energy ratings and rating systems and solar photovoltaics. The indoor air quality section addresses indoor pollutants. The materials section discusses quality and quantity of materials and the effect on the construction budget and building performance. Finally, the operations and

maintenance section examines the importance of the truly green building ideally costing less to operate than a non-green building.

The chapter goes on to explain the “Residential Green and Energy Efficient Addendum” report form, and green verification programs, including

- Energy Star,
- LEED,
- Living Building Challenge,
- National Green Building Standard,
- Pearl Certification, and
- Passive House.

Several green residential studies are shown for additional resources of information for appraisers. (Pages 459–460)

Chapter 16, “Specialty Residential Markets,” also contributed by Maureen Sweeney, SRA, AI-RRS, covers a number of useful topics:

- Senior housing
- Investor markets
- Bulk sales, which may involve a few residences or a portfolio of residences
- Multiple sales of similar units, such as developed residential lots, houses, and condominiums
- Foreclosure properties, including a financial institution’s real estate owned properties
- Homes in poor condition
- Relocation appraisals⁴
- Rural markets

2. It is important for the appraiser to understand state landlord-tenant laws for residential property, especially for reported month-to-month rentals.

3. Gross rent multiplier analysis is also explained, with examples.

4. The Employee Relocation Real Estate Advisory Council uses the term *anticipated sales price*; its definition and components are explained in the text. The client for relocation appraisals has particular needs, one of which is a *prospective opinion of value* considering the client’s *specified marketing period*. Forecasting is in the definition of *anticipated sales price*, and thus involved in the appraisal process and appraisal report.

The discussion on specialty markets is significant. In these assignments, the appraiser needs to consider items, and even valuation techniques, that may differ considerably from the typical residential property appraisal. The author alerts appraisers to the special items calling for particular attention in each specialty category. Examples further enhance readers' understanding.

The book's regular chapters are supplemented by a five-page special section on **Financial Calculator Basics**, with emphasis on the classic workhorse, HP-12C calculator. This part of the book addresses the calculator's mortgage and other financial functions and offers helpful hands-on examples. Also included are citations for additional resources.

Another helpful supplement follows: the **Bibliography**, which includes citations for a number of books on residential appraisal, including many with advice on completing residential forms and on valuing specialty residential property types and markets. The section "Publications about

Appraisal Forms" points the residential appraiser to good online resources, including some resources for appraising green properties. The text concludes with a twelve-page **Index** to help the reader find specific topics and terms.

Recommendation. Valuers will find the Appraisal Institute's new *Residential Property Appraisal* a helpful reference and guide. The text covers the basics and more. Written by residential experts, it provides a thorough overview of all aspects of residential appraisal as well as the issues that may be encountered. The general discussion leads the reader through the various steps in a valuation of residential property. This is supplemented by chapters on the specific considerations in valuation of green residential properties and specialty residential property types, such as condominiums. The clear writing and exhibits throughout aid in the reader's understanding. *Residential Property Appraisal* is an essential text for residential appraisers, no matter what the level of experience.

About the Author

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If you know of additional resources of interest to real estate analysts and valuers—or would like to suggest topics for this column—please contact the author.

SEE NEXT PAGE FOR APPENDIX >

Appendix Terms and Concepts Defined in *Residential Property Appraisal*

Actual age	Earnest money	Highest and best use
Ad valorem tax	Easement	Homeowners association
Anticipated sales price	Economic base	
Anticipation	Economic base analysis	Improvements
Appraisal	Economic life	Income capitalization approach
Approaches to value	Effective age	Indirect costs
Assessed value	Effective date	Inspection
Assignment condition	Effective gross income multiplier	Installment contract
Assumption of mortgage	Effective purchasing power	Insurable value
Automated valuation model	Elements of comparison	Intended use
	Eminent domain	Intended user
Balloon payment	Entrepreneurial incentive	Interim use
Bargain and sale deed	Entrepreneurial profit	
Basic industries	Equity	Jurisdictional exception
Bundle of rights theory	Escheat	
Buydown	Estate	Land
	Excess land	Lease
Capitalize, capitalization	External obsolescence	Leased fee interest
Cash equivalency analysis		Leasehold interest
Common elements	Fair housing laws	Legal permissibility
Community associations	Fannie Mae	Legally nonconforming use
Competition	Federal discount rate	Limited common elements
Conditional sales contract	Fee simple estate	Linkage
Condo hotel	Final reconciliation	Littoral rights
Condominium	Financial feasibility	Location
Condominium ownership	First mortgage	
Consistent use	Fixture	Market area
Contract	Forecasting	Market rent
Contract for deed	Form report	Market study
Cooperative ownership	Fraud	Market value
Cost approach	Freddie Mac	Marketability
Creative financing	Fully amortizing mortgage	Master plan
	Functional obsolescence	Maximum productivity
Date of opinion of value		Mortgage
Decline	General data	Mortgage-backed securities
Deed	General warranty deed	Mortgagee
Deed of trust	Gentrification	Multiple listing
Deed restriction	Ginnie Mae	
Direct capitalization	Green, high performance	Neighborhood
Direct costs	Gross rent multiplier	Neighborhood life cycle
Disintermediation	Growth	
District		

CONTINUED >

Appendix *(continued)*

Operating expense ratio	Sales comparison approach
Option	Scope of work
Overimprovement	Second mortgage
	Secondary mortgage market
Paired sales analysis	Seller financing
Partial interest	Sequence of adjustments
Personal property	Service industry
Physical deterioration	Site
Physical possibility	Siting factor
Planned unit development	Special assessment
Points	Specific data
Police power	Stability
Potential gross income	Subordinate lien
Potential gross income multiplier	Substitution
Principal, interest, taxes, and insurance	Superadequacy
Pro rata share	Surplus land
Progression	Tangible property
Proprietary lease	Taxation
Prospective opinion of value	Title
Purchase-money mortgage	Trade fixtures
Purchasing power	Transition
Quitclaim deed	Underimprovement
	Unit
Real estate	Useful life
Real property	Utility
Recession	
Reconciliation	Valuation process
Regression	Value
Relocation	Value in use
Relocation company	Verification
Remaining economic life	
Remaining useful life	Zoning
Replacement cost	
Report	
Reproduction cost	
Reserve requirement	
Restrictive covenant	
Revitalization	
Riparian rights	
Risk	