

The Advanced Teachings of Mrs. Langerhorn: 18 by Klarise Yahya Commercial Loan Broker

Note to the Reader ... These are not the notes of our conversations that were published earlier under the title “Mitochondria Learns to Invest”. These are the papers Mrs. Langerhorn left me after she passed away. They are her advanced teachings, and as such they overlap and reinforce her earlier principles. I hope you gain from them as much as I did. The earlier lessons are incorporated in the book “Stairway to Wealth” available at LuLu.com

Appraisals: The Market Approach

The termite guy got there early, but just sat in his truck and waited. He'd parked beneath a shade tree half a block behind us. When he saw my husband and Ben and I gathered on the sidewalk in front of the property he started his truck up and drove to us, backed into the driveway, and offloaded a stepladder. He wore really thick glasses with filmy lens and a dirty braided cord running behind his neck and hooking onto both sides of the glasses just in front of his ears. It looked like the cord was originally turquoise. The inspector (we'd hired a private building inspector to look at the building and tell us what was wrong) showed up a few moments later in a beat up old truck. I saw his hands through the windshield and noticed he had really thick fingers. Then he got out of his truck and I saw that he was very strong looking. The vision that came to my mind was that when the mule is sick he could probably pull the plow himself. Then he said “Hi” and smiled. He had a mouth full of dentures, perfectly formed and unnaturally white. He was wearing a hairpiece much too youthful for his age, and I caught myself starting to laugh. The vision of this elderly, Russian-peasant looking man being so vain was at the same time both funny and terribly touching. I suddenly knew he was married to a young wife and was trying to stay attractive to her. I liked him immediately.

It was still early, and while we waited for the appraiser Ben explained that all the units were vacant and that he had the keys to each, but that he'd never been inside. That experience would be novel for us all.

The termite guy announced that he would start outside and he'd let Ben know when it was time to go inside the units. He left us and began his work. The inspector smiled and softly said that he “guessed” he'd get started outside as well. Ben and my husband left to explore the units.

The appraiser showed up just on time. I was grateful that he was timely, but I really hoped that he would have come a little early so I could ask him some questions. Well, I decided, I would just have to follow him around and try to engage him in conversation while he worked.

He walked over to me and explained that he'd be taking photos of the front of the property and, although I'd "surely improve the photograph", he said that humans weren't permitted in the pictures and wondered if I could possibly stand a little to the side? Naturally, I appreciated the grace with which he addressed the issue and I moved out of camera range.

The appraiser stood in the middle of the street and took a photograph of the front of the property before turning to his right – away from the sun – and taking a street scene. He approached and explained that he would be measuring the outside of the property before going into each unit and that he'd be taking lots of photographs. I took this moment to ask him how he would be appraising the property because, I said, it was in poor condition and there was no income.

He explained that he would be doing a rental survey and assigning market rents to each of the units. As far as the condition was concerned, he would try to find recent sales in approximately the same shape. Thus, it was important that the subject be inspected before the comps were selected. If he couldn't find cosmetically similar comps, he would use the available sales even though they might be in better cosmetic condition and then take adjustments to offset the subject's inferior condition.

I repeated to the appraiser that the property was in really poor condition – I emphasized *really, really, poor* – and was probably not even fit to live in. He looked at me but didn't say a word. The silence became uncomfortable, and I broke it by just coming flat out and telling him that we wanted a low value. He continued the silence for another moment before saying that "The value is what it is" and that he would try to do the best job he could to determine the market value, but he could not say in advance what that value might be. He asked if I wanted him to continue the appraisal. I found myself a little flustered and finally muttered something affirmative. I'd always heard how appraisers could be coaxed to come up with whatever number you needed, but we had to be stuck with an appraiser hadn't got the memo.

So I smiled and said, "That's exactly what we want". Then I asked if I could follow him around and maybe he could tell me how the appraisal process worked. He consented, saying, "Shall I just give you the twenty-five cent tour, then? I won't be teaching you to appraise, and there will be plenty of things left out. But if you have any questions afterwards, I'll be happy to answer anything I can." He didn't even wait for my agreement, he just started talking.

"An appraisal is an opinion of value. To arrive at a reasonable opinion, an appraiser generally reconciles the three approaches to value. These are (a) the market approach, (b) the income approach, and (c) the cost approach. Sometimes not all approaches are needed. For a number of reasons, the Cost Approach is the one most often left out because no sales of reasonably similar vacant land have occurred recently and because it's very difficult to measure accrued depreciation. And, sometimes, both the Cost and the Income Approaches are inappropriate, so only the Market Approach is employed. It all

depends on the assignment, but most people, in most cases, would probably agree that the Market Approach is the more important metric.

“The market approach compares the prices of several similar elements of measurement. For example, one can compare building area and bedrooms and number of units. Normally, a dozen or more elements are considered. The only requirement is that to be a “comp” it has to be (d) a recent sale (e) within the subject’s neighborhood which (f) a typically motivated purchaser would likely find equally desirable in (g) an arms length transaction.

“Time guidelines vary with the property type. Single family homes and condos require comparable sales within six months, and preferably much less. The window for apartment buildings is longer. Comps for heavy industrial properties can be years old and still very acceptable, simply because these properties sell very seldom.

“Similarly, a property’s neighborhood will vary with property type. A SFR or condo may have a neighborhood largely restricted to the subdivision or project. An apartment building’s neighborhood may be delineated by City limits. Copper mines may be compared to the sale of other copper mines even in different continents”. He smiled, “Not that I’ve ever appraised a copper mine, of course”.

“Equal desirability is the mouse in the butter. I know we’re appraising an apartment building here, but simply for illustrative purposes consider three different SFR’s.

“The first house is perfect. The only way you could improve it is to dust it with a Kleenex. After work and on weekends, he paints and landscapes and fixes. She waxes the driveway. Their home is perfect because they hate each other. They will do anything to avoid being together. This property will probably sell at the top of whatever market its size, bedrooms, and location fit it. We’ll skip the second property for a moment.

“The third property is owned by Billy Bob, who likes to stand in his packed dirt front yard, next to the pickup truck on blocks, hook his thumbs in the chest of his overalls and look around majestically before proudly announcing, “Me and Suzie Jean have been here 35 years and we ain’t done nothin’ to it”. All you can do is look around, pause, and confidently reply, “Billy Bob, I think you’re right!”

“Ok, so we have an example of a top-of-the-market property and a bottom-of-the-market property. The middle home, the one we skipped, is just an average home. It’s like the one’s most of us live in. Generally pretty good, but if you look hard enough you can find things that need changing.

“Given a reasonably active market, once we’ve found recent sales of about the same size, with about the same amenities, in the same neighborhood, the comps will often break down into three value tiers. There will be a few immaculate houses and they are the uppermost value tier. There will be a few owned by Billy Bob’s cousins, which along with REO’s and (most) rentals, constitute the bottom tier. The vast majority of homes, as you would expect, will be just average.

“Now, which value tier does the subject property best fit? That’s where you’ll look to find the comps that probably should be used.

“After inspecting the subject property and selecting the comps, the important (for valuation purposes) characteristics of the comps are adjusted to hypothetical equivalency with the subject. Does one comp have greater living area? Make a negative adjustment. Does another comp have fewer bedrooms? Perhaps a positive adjustment is indicated. If recent sales smile upon you and the comps are very similar to the subject, maybe only a few adjustments will be required. After all the appropriate adjustments are made the comps should have “adjusted” values pretty close, say within 10% of each other.

“It is then appropriate to give greater weight to just one of the sale comps. Maybe one sold much more recently, so you would overweight it. Or another might have fewest net adjustments, so in your judgment that one would take precedence. Usually there will be reasons why one sales comp is more reflective of the subject’s current value than the other comps, so your reconciliation will weight towards that comp. Occasionally the comps, after adjustments, are so alike the subject that there is no reason to favor one comp over another, so you weight them all equally.

”I guess that’s the short introduction to the Market Approach, he concluded.”

He’d finished photographing the back of the building and measuring all around, making a sketch diagram of the improvements as he did so, and we were back at the front. The door to the first unit was open. The appraiser rewound his measuring tape and walked inside. I followed him. I wanted to know about the Income Approach.

Klarise Yahya is a Commercial Loan Broker. If you are thinking of refinancing or purchasing five units or more anywhere in the U.S.A., **Klarise Yahya** can help. **Find out how much you can borrow!** For a complimentary mortgage analysis, please call her at **(818) 500-9966**