

Real Estate Appraisal

Fall 2008

Final Exam Review

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TTh 9:30-10:45

- 1) Be able to define market value in the context of an appraisal.
 - a) What key assumptions lie behind this definition of market value?
 - b) How do the other types of value differ from market value? Why?
- 2) Be prepared to solve a highest-and-best use problem.
- 3) Make sure you can separate out leased fee and leasehold interests and determine how changes in market value pass through to each interest. This is the question from the homework assignment.
 - a) Be able to explain how land and building value are affected by changes in market conditions.
 - b) What do we mean when we say that the land is the residual?
- 4) Sales Comparison Approach
 - a) Know the basic order of adjustments and the reason for this order.
 - b) Expect to estimate the value of a property using the sales comparison approach when given the appropriate adjustment factors.
 - c) Multiple regression analysis
 - If given regression output and information about a subject property, you should be able to estimate the property's value.
- 5) Cost Approach
 - a) What is the difference between reproduction cost and replacement cost? When would each be the more appropriate measure to use in an appraisal?
 - b) Be able to explain the different methods of estimating costs and how they differ:
 - Comparative-unit method
 - Segregated cost method
 - Unit-in-place method
 - Quantity survey method
 - c) Age/life method
 - Be able to do the age/life method to estimate accrued depreciation.
 - Make sure you are familiar with my "comments on the age/life method."
 - Know how to use market extraction to estimate the appropriate depreciation rate for the age/life method.
 - d) Know how to apply the breakdown method to estimate accrued depreciation. Make sure you have gone through the handout I've prepared on this.

6) Income Approach

- a) Know how to lay out a pro forma operating statement and calculate net operating income (NOI). The basic layout of the pro forma is given below. Note that the specific breakdown of income and the names each item on this statement can vary in practice.

$$\begin{array}{r} \text{Potential gross income (PGI)} \\ - \text{Vacancy and credit losses (V\&C)} \\ \hline \text{Effective gross income (EGI)} \\ - \text{Operating expenses (OE)} \\ \hline \text{Net operating income (NOI)} \end{array}$$

- Make sure you understand what is included and what is not included in each of these line items. You will likely be required to lay out a pro forma for a property on the exam.
 - Remember that operating expenses do not include interest paid on mortgage debt, nor do they include income taxes paid by the investor.
 - You should have some understanding of how you can estimate proper values for rental income, other income, vacancy and collection allowances, operating expenses, etc.
 - Current leases on the property in questions
 - Market comparable information
 - Published surveys such as the *IREM Income/Expense Analysis* reports, the ULI's *Dollars and Cents* series, or the *BOMA Experience Exchange Reports*.
 - How should you deal with reserves for replacements when forecasting cash flows?
- b) Make sure you understand the basic cap rate formula and its theoretical underpinnings.
- Know how cap rates are used. Make sure you also understand their limitations.
- c) Direct capitalization
- Understand the different multipliers we discussed and be able to use them to estimate the value of a property.
 - Potential gross income multiplier
 - Effective gross income multiplier
 - Net income multiplier
 - Capitalization rate
 - Make sure you can explain when each of these multipliers would be appropriate/useful and when they would not.