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A New Frontier: *Appraising in a World of Change*



Myths in the Sales Comparison Approach: *Examples from Multifamily Appraisals*

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I am a valuation consultant specializing in assisting appraisal firms, lenders, and attorneys with a 'second set of eyes' on complex real estate engagements and industry best practices

Formerly, I was the Chief Appraiser for Freddie Mac Multifamily (for 13 years), Director of the undergraduate real estate program at the University of Baltimore. I earned the MAI designation from the Appraisal Institute (1991), the SPRA from the Society of Real Estate Appraisers (1990), and am an Appraiser Member of the District of Columbia Board of Real Estate Appraisers.

I have been a contributing author to *Real Estate Issues* (Counselors of Real Estate), *The Appraisal Journal* (the Appraisal Institute) and to *The Assessment Journal* (International Association of Assessing Officers) and taught real estate appraisal and valuation methodology classes for The Johns Hopkins University, University of Baltimore, and Anne Arundel Community College (USA). My website has copies of those papers.



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Agenda - Myths in the Sales Comparison Approach: Examples from Multifamily Appraisals

Introduction

Who am I?
Why are we
talking about
this?

Myth #1

Economies of
Scale Exists

Myth #2

Adjusting for
Unit Size is a
Thing

Myth #3

Location
Adjustments
are Hard to
Prove

Wrap-up

Q&A



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First: Let's get this terminology correct

(This slide is more for the appraisers amongst us that started in this business in the 20th Century!)

It is called the Sales Comparison Approach, not Market Approach or Market Data Approach.

The terminology was changed in 1983 (8th edition of *The Appraisal of Real Estate*).

Sure, some clients still use the old label and if you Google “*Market Data Approach*” there are plenty of websites using that terminology but let us, as professional real estate appraisers, use the correct terminology!



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Responses to this material that should be left at the door:

- “That’s not the way I learned this.”
- “That’s not the way we did it at my old firm.”
- “That’s not the way I’ve always done it.”
- “Well, in my market...”
- “I’ve never had a client push back on my methodology.”
- “I’ve never had Freddie Mac or Fannie Mae push back on my methodology.”
- “If this is such a good idea, how come I never heard it before?”
 - Corollary: *If this is such a good idea, someone else would have come up with it before you!!*



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Myth #1: Economies of Scale Exists and it is a “Thing” in Multifamily Appraisals

< It doesn't, and it isn't >

Introduction

Myth #1

Myth #2

Myth #3

Wrap-up



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Economies of Scale: This is an issue that should go away

- Economies of scale (i.e., an adjustment for unit size or project size) is typically a relatively minor feature contributing to the value of a multifamily property and is not necessarily a conscious item of price negotiation or evaluation by a purchaser.
- Typically, economies of scale makes a difference if someone buys a large quantity of lumber or toilet paper or marbles or widgets, but it does not make a large difference in the purchase price negotiations of a real estate buyer, nor will a seller recognize it in their pricing.
- In the 16th edition of *The Appraisal of Real Estate* (p. 508), the reference to economies of scale is related to a building's construction cost, not to sales' pricing, sales adjustments, or property operation.



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Economies of Scale (cont.)

Has this conversation *ever* taken place??

Buyer: “Look, I know you are asking \$150,000 per unit for this 600-unit property but there is an identical property across the street with identical amenities and in identical condition that only has 125 units, so I will offer you 10% less per unit for your property (\$135,000 per unit) due to economies of scale.”

NO, it never happens!

The Existence of *Economies of Scale* is Magical Appraisal Thinking.

It is Appraisal Mythology.



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Economies of Scale (cont.)

What are the extra expenses or savings for a property with 600 units vs. 125 units?

- A need for another leasing person, or two
- A need for another maintenance person
- You get to buy your light bulbs in bulk
- You save some money when the roofers re-shingle the roof in 10 years

Please don't do this.



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Economies of Scale (cont.)

If you are in construction, then 84 Lumber, Home Depot, or your local supplier will give you a better price on 2 x 4's if you are building a couple of houses vs. a backyard shed, but that is not how it works in multifamily sales pricing.

If you are a remodeler and are re-doing an apartment building with 100 bathrooms, they will give you a better price on toilets and sinks than if you are doing your own condo, but not in multifamily sales pricing.

Please don't do this.



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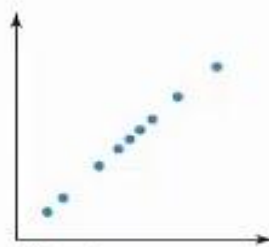
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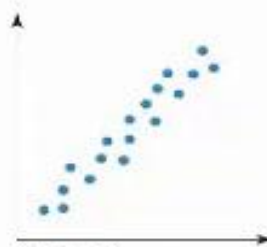


Economies of Scale (cont.): *A few visuals to help understand R-squared*

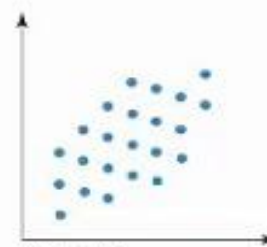
Scatter Plots and Correlation Coefficients



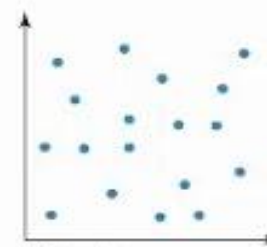
(a) $r = 1$
perfect positive
correlation



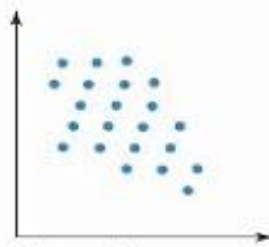
(b) $r \approx 0.8$
strong positive
correlation



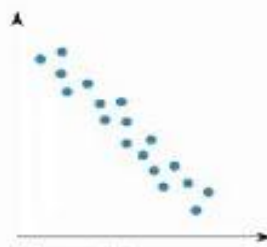
(c) $r \approx 0.3$
moderate to weak
positive correlation



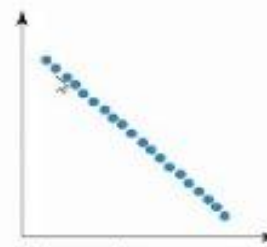
(d) $r = 0$
no correlation



(e) $r \approx -0.3$
moderate to weak
negative correlation



(f) $r \approx -0.8$
strong negative
correlation



(g) $r = -1$
perfect negative
correlation



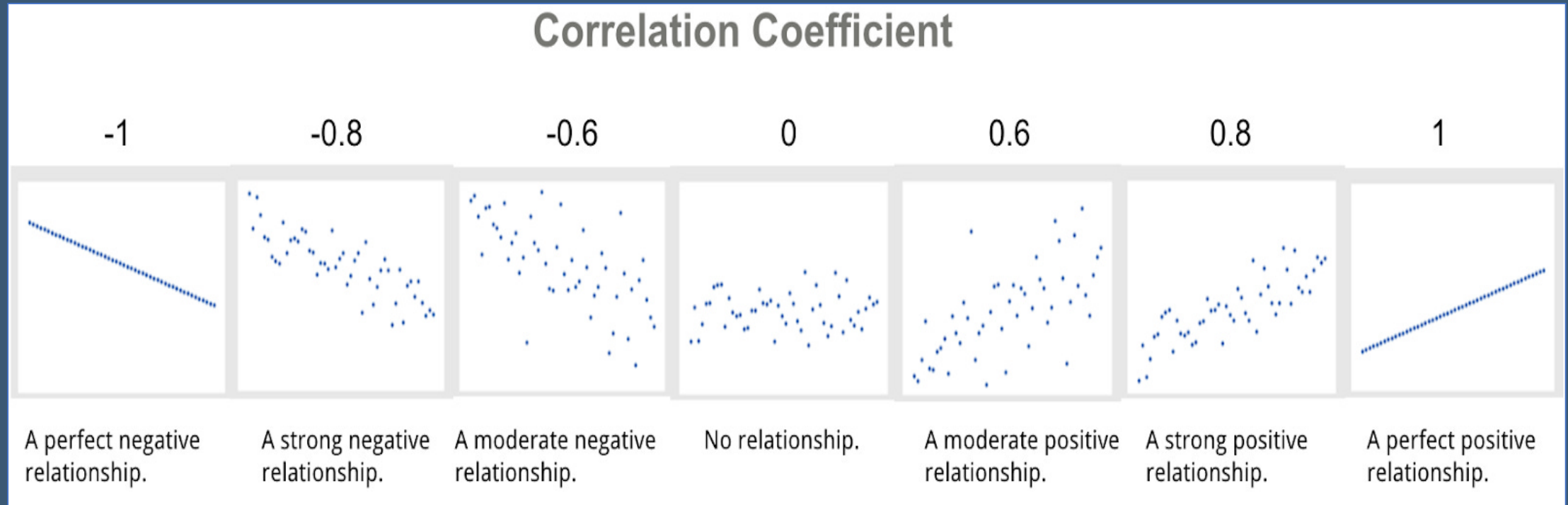
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Economies of Scale (cont.): *A few visuals to help understand R-squared*





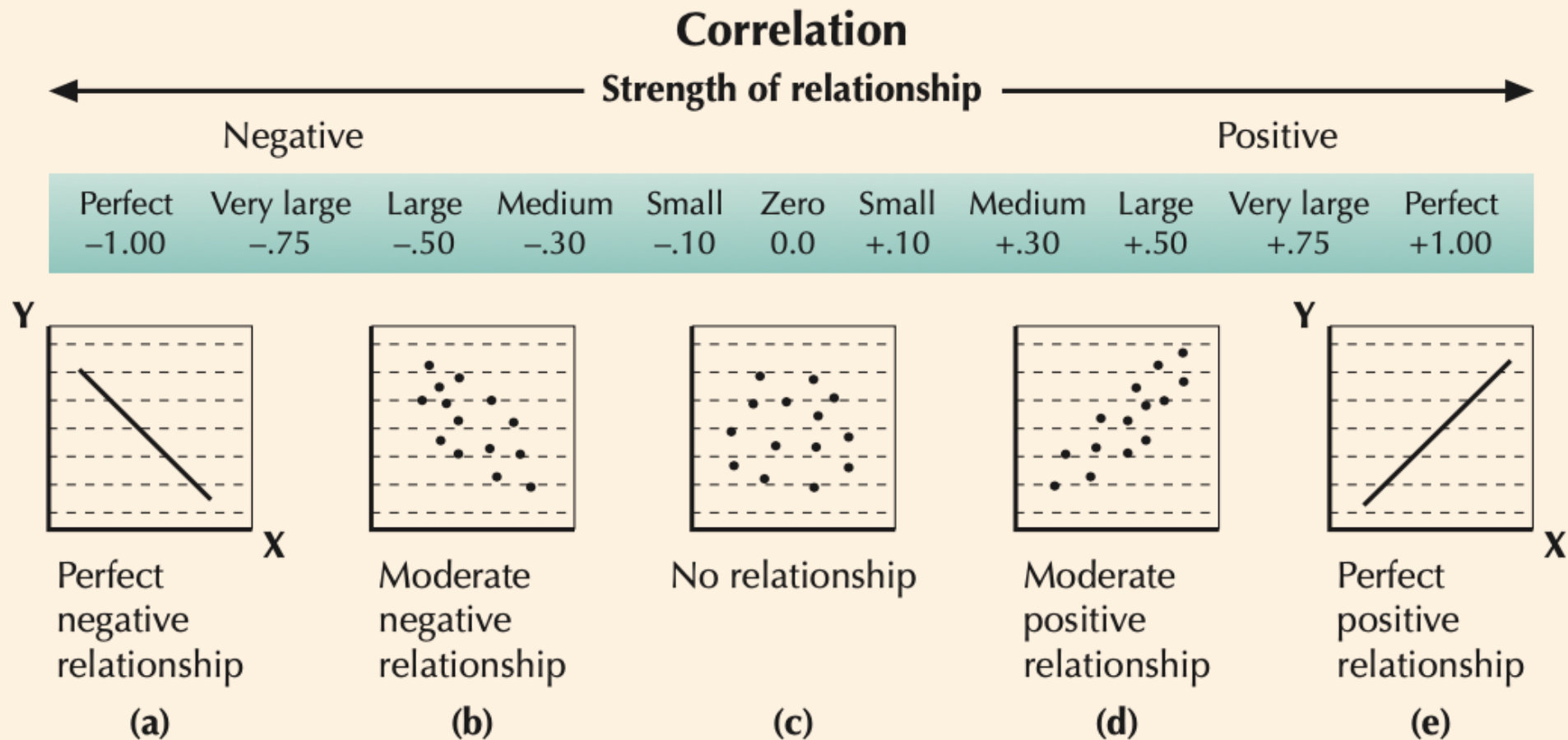
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Economies of Scale (cont.): *A few visuals to help understand R-squared*





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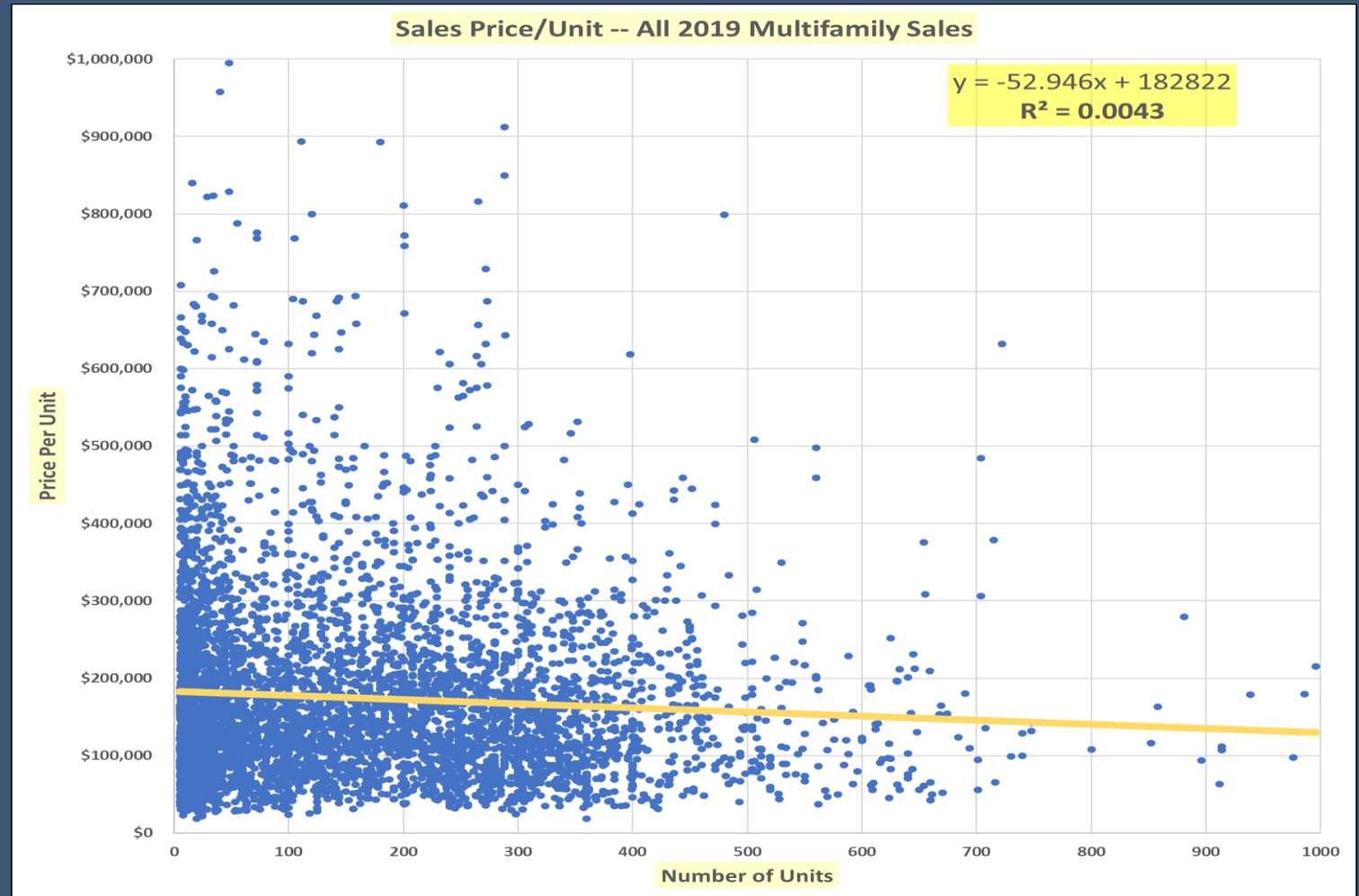
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Economies of Scale (cont.): “But in my market....”

Based on 5,500+ multifamily sales in 2019, there is no statistical correlation between number of units and price per unit.





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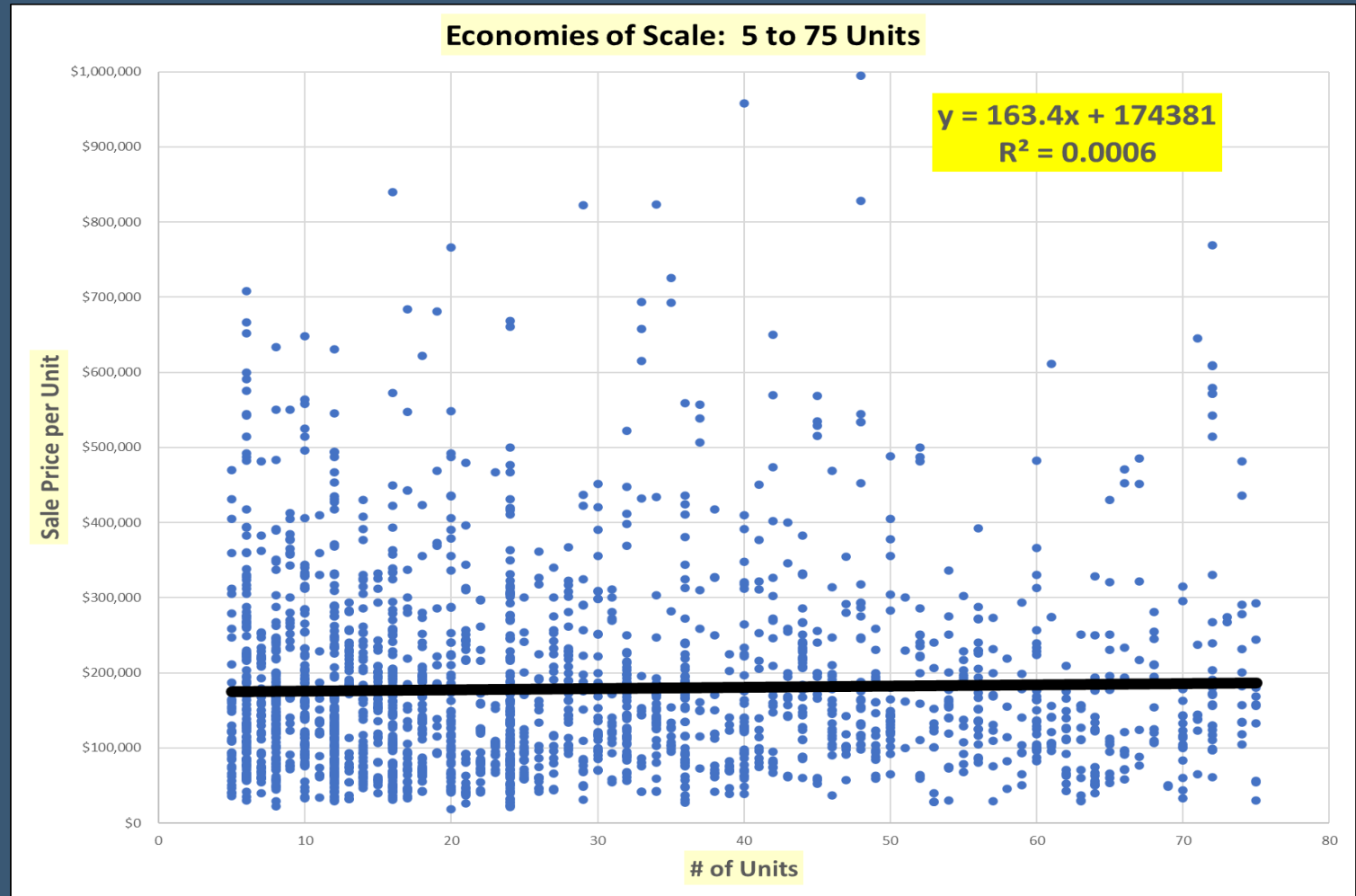
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Economies of Scale (cont.): *But what about properties less than 75 units?*

Based on 2,000+ multifamily sales in 2019 of fewer than 75 units, there is no statistical correlation between number of units and price per unit,





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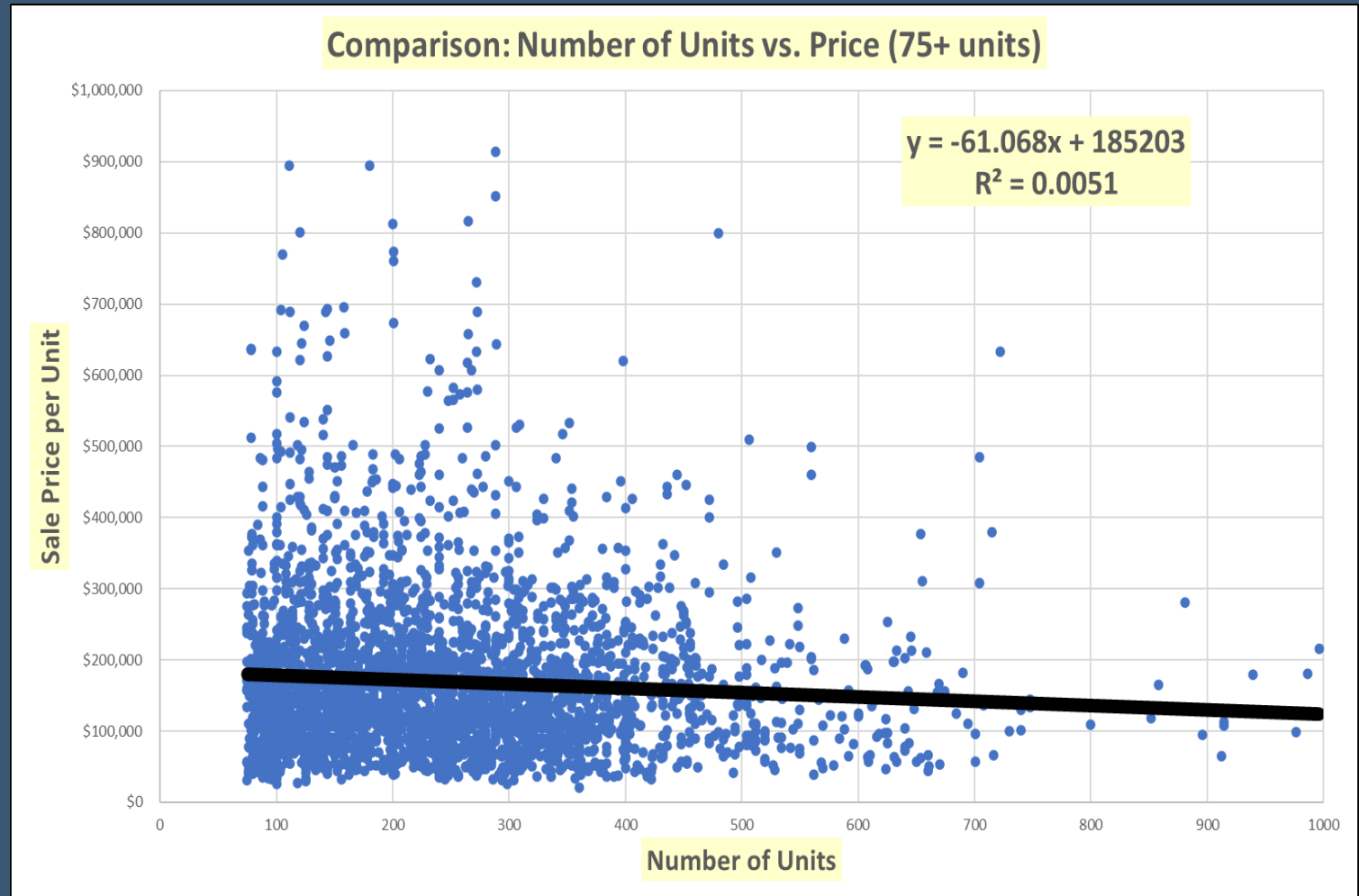
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Economies of Scale (cont.): *But what about properties larger than 75 units?*

Based on 3,200+ multifamily sales in 2019 larger than 75 units, there is no statistical correlation between number of units and price per unit





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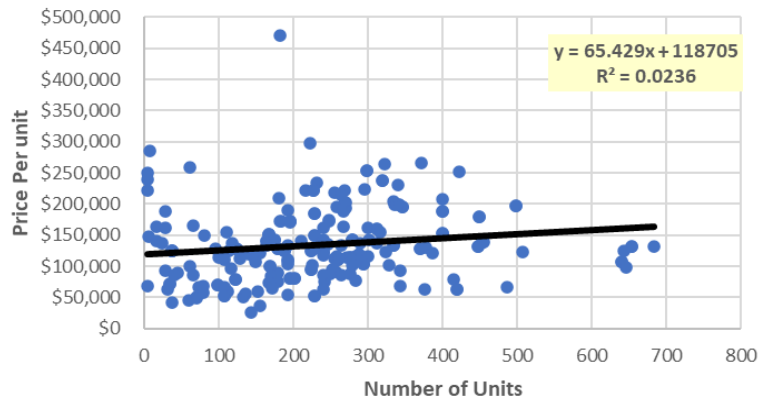
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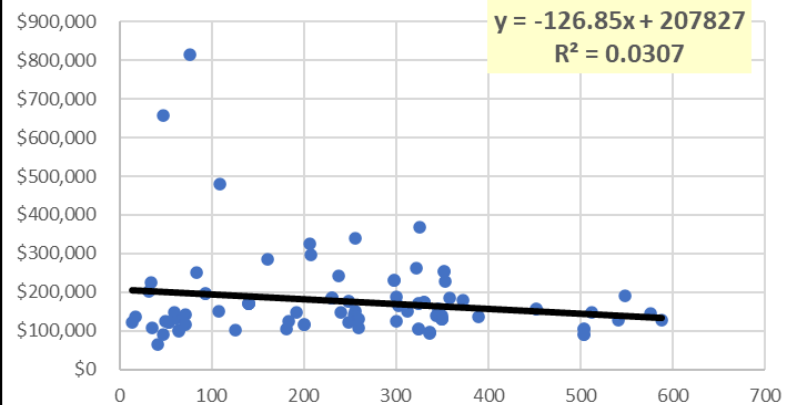


Economies of Scale (cont.): *But what about specific metropolitan areas?*

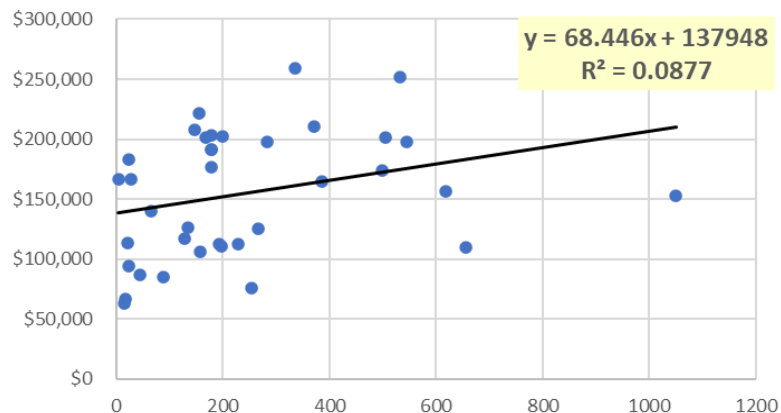
Atlanta: Units vs. Unit Price



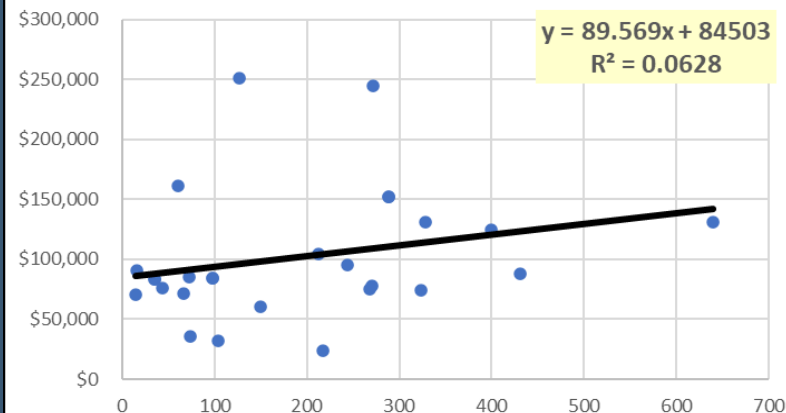
Austin: # of Units vs. Unit Price



Baltimore: Number of Units vs. Unit Price



Birmingham: # of Units vs Unit Price





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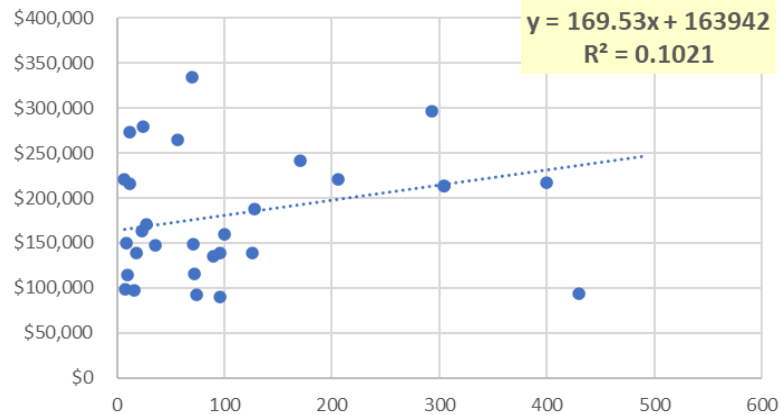
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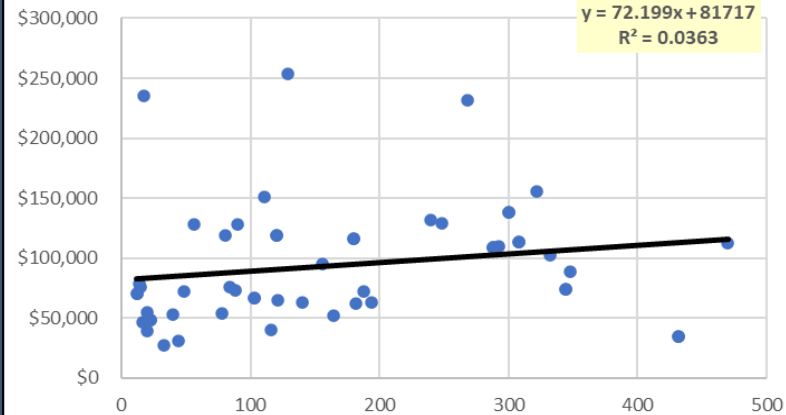


Economies of Scale (cont.): *But what about specific metropolitan areas?*

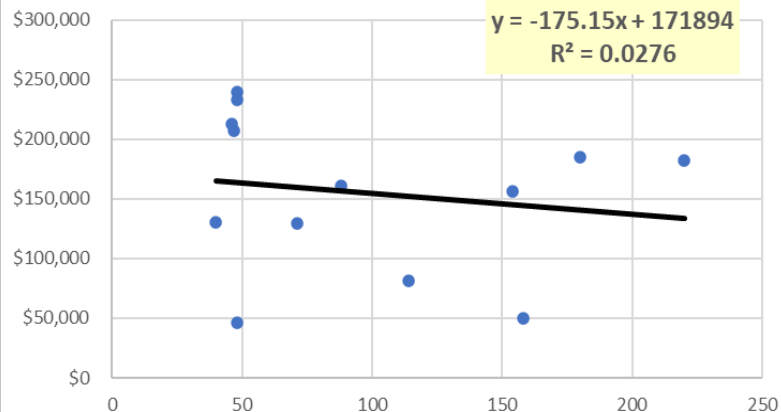
Salt Lake City: # of Units vs. Unit Price



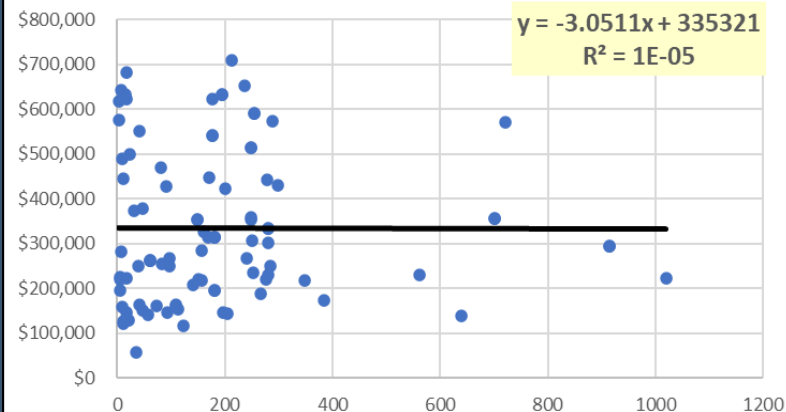
Columbus: # of Units vs. Unit Price



Boise City: # of Units vs. Unit Price



Boston MSA: # of Units vs. Unit Price





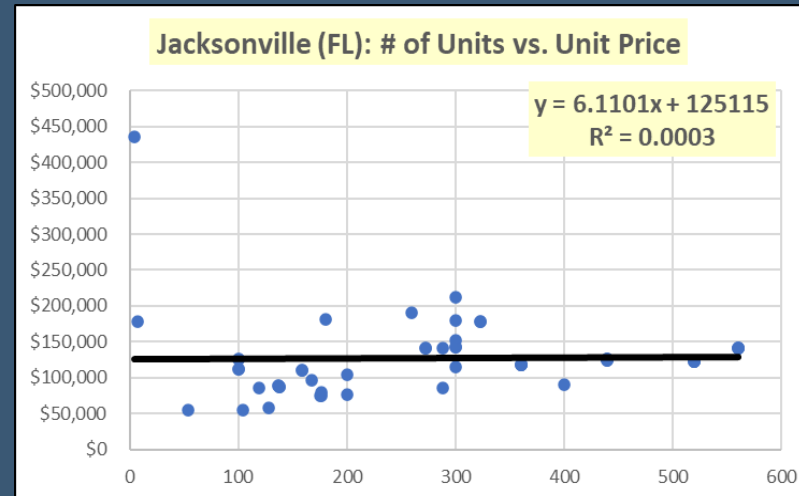
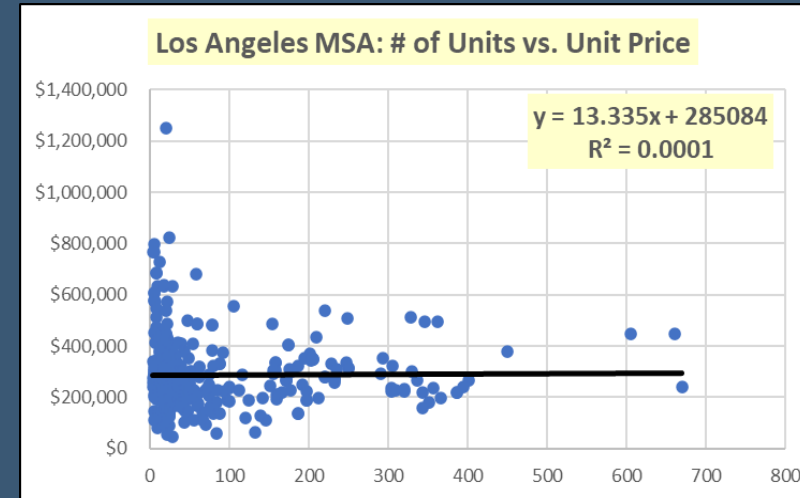
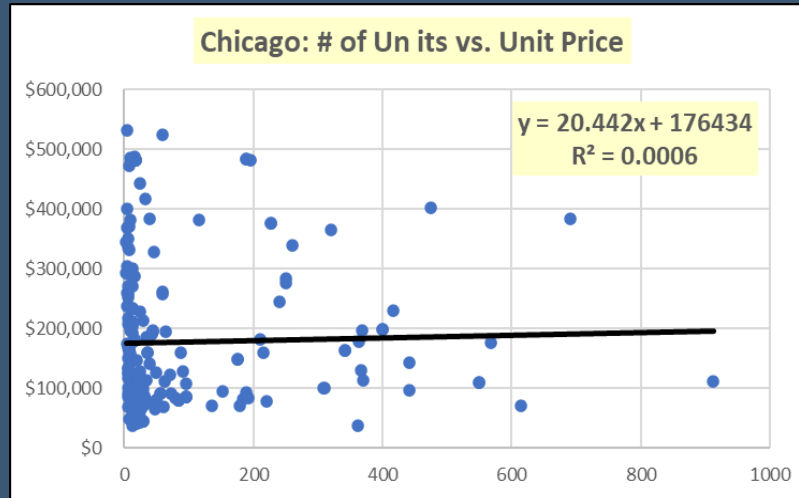
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Economies of Scale (cont.): *But what about properties larger than 75 units?*





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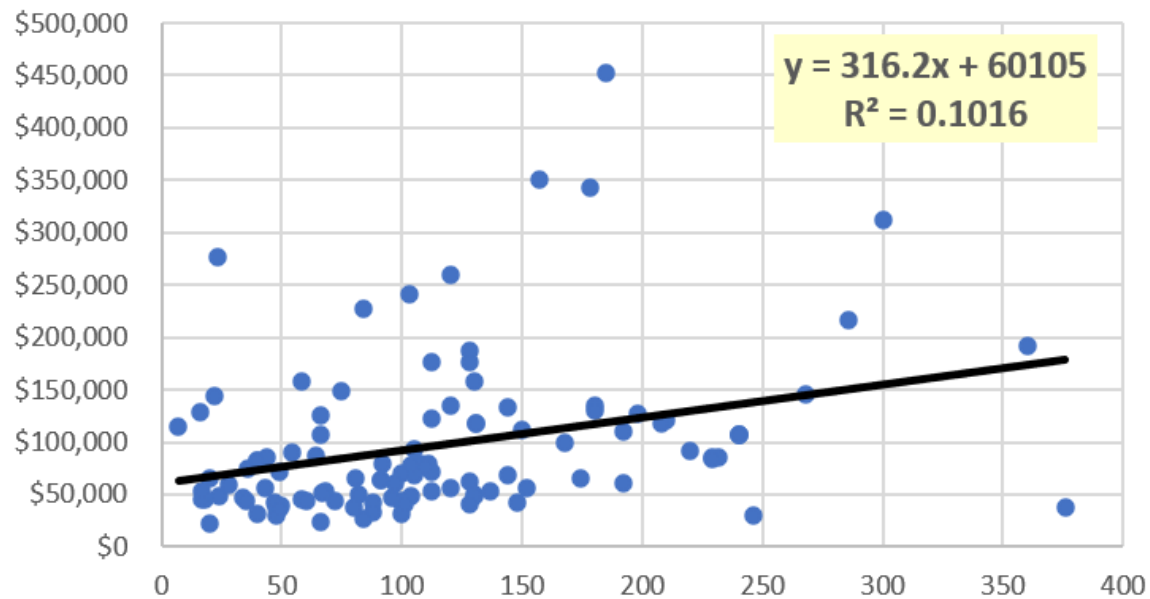
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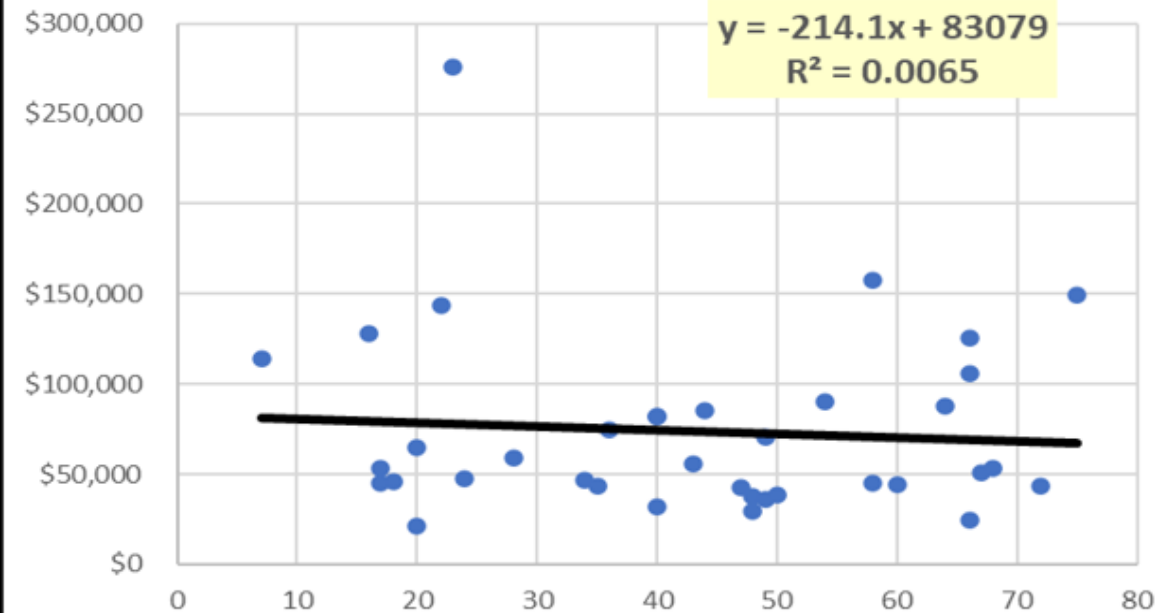


Economies of Scale (cont.): *But what about properties outside a MSA?*

No MSA: # of Units vs. Unit Price



MSA not stated <75 units





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Myth #2: Adjustments for Unit Size is a Thing

< It isn't >

Introduction

Myth #1

Myth #2

Myth #3

Wrap-up



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Myth #2: Unit Size is a thing (It really isn't.)

You are looking at a rent roll and it says that 1br apartments are 650 sq. feet, 2 bedrooms are 1,075 sq. feet, and studios are 460 sq. feet.

How do you know that these measurements are accurate?

How do you know what the unit sizes of the subject are? Of the rental comparables? Of the sales comparables?

We take the word of the property managers.

It is the rare appraiser that measures units and compares them to what they are told in the rent roll, found on CoStar or Apartments.com, or found in the marketing materials of the property online.

We take the owner's measurements as a given. Why?



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Unit Size (cont.)

Typically, tenants do not measure units before they sign the lease, investors do not independently measure the units, nor do landlords provide evidence of how they measured or what is included in their calculations.

That is, some managers include balconies and patios in their measurements, as well as basement storage or mechanical locations attached to patios/balconies, or hallways or pro-rata common areas. Some don't.

Do we know how the subject's management measured their units?

And, even if you know how your subject property's unit sizes were calculated/measured, *what about the comparable sales?* What about the comparable rentals?



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Unit Size (cont.) – USPAP compliance

The issue of accuracy of measurement is addressed in USPAP's *Frequently Asked Questions* #176. Even though this FAQ's question is about single-family residences and ANSI standards, *the answer is absolutely applicable* to multifamily and other commercial property types, as well:

176. MEASURING SINGLE FAMILY RESIDENCES USING THE ANSI STANDARD

Question: Are appraisers bound by USPAP required to comply with ANSI Z765-2021, the Standards Method for Measuring Square Footage in Detached and Attached Single Family Houses?

Response: No. Appraisers are not required by USPAP to comply with ANSI Z765-2021, which is a voluntary standard. However, use of the ANSI standards may be an assignment condition in some assignments.

Although appraisers are not required by USPAP to adhere to a specific standard of square footage measurement, appraisers are required by Standards Rule 1-1(b) to *not commit a substantial error of omission or commission that significantly affects an appraisal*. This rule requires the appraiser to gather factual information in a manner that is sufficiently diligent. Standards Rule 1-1(c) requires appraisers to *not render appraisal services in a careless or negligent manner*. Appraisers must use due diligence and due care in performing appraisal services, including gathering factual data such as square footage.



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Unit Size — Actual measurements by an appraiser vs. the property manager's

Example #1

Unit #	Unit Type	Owner's SF	Actual SF	Difference
Unit 1A	Studio	370	235	-36%
Unit 1B	Studio	370	235	-36%
Unit 1C	Studio	370	235	-36%
Unit 1D	Studio	370	235	-36%
Unit 1E	Studio	370	235	-36%
Unit 1F	Studio	370	235	-36%
Unit 1G	Studio	370	235	-36%
Unit 1H	Studio	370	235	-36%
Unit 2A	Studio	370	235	-36%
Unit 2B	Studio	370	235	-36%
Unit 2C	Studio	370	235	-36%
Unit 2D	Studio	370	235	-36%
Unit 2E	Studio	370	235	-36%
Unit 2F	Studio	370	235	-36%
Unit 2G	Studio	370	235	-36%
Unit 3A	Studio	370	235	-36%
Unit 3B	1 Bedroom	410	354	-14%
Unit 3C	1 Bedroom	410	354	-14%
Unit 3D	1 Bedroom	410	354	-14%
Unit 3E	1 Bedroom	410	354	-14%
Unit 3F	2 Bedroom	510	354	-31%
Total NRA (SF)		8,070	5,530	-31%
Avg Unit Size (SF)		384	263	-31%



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Unit Size – Actual measurements

Example #2

Unit #	Unit Type	Owner's SF	Actual SF	Difference
1	4/2	1,500	1,100	-27%
2	4/2	1,500	1,100	-27%
3	3/1	1,200	760	-37%
4	2/1	1,000	675	-33%
5	3/1	1,200	760	-37%
6	2/1	1,000	600	-40%
7	2/1	800	600	-25%
Total NRA (SF)		8,200	5,595	-32%
Avg Unit Size (SF)		1,171	799	-32%

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Unit Size – Actual measurements

Example #3 *(Owner's measurements are smaller unit sizes than appraiser measured)*

Unit #	Unit Type	Owner's SF	Actual SF	Difference	Unit #	Unit Type	Owner's SF	Actual SF	Difference	Unit #	Unit Type	Owner's SF	Actual SF	Difference
101	1 Bed / 1 Bath	450	770	71%	302	1 Bed / 1 Bath	450	770	71%	108	2 Bed / 1 Bath	1,100	1,025	-7%
102	1 Bed / 1 Bath	450	770	71%	303	1 Bed / 1 Bath	600	770	28%	114	2 Bed / 1 Bath	1,100	1,025	-7%
103	1 Bed / 1 Bath	600	770	28%	304	1 Bed / 1 Bath	600	770	28%	115	2 Bed / 1 Bath	650	1,025	58%
104	1 Bed / 1 Bath	600	770	28%	305	1 Bed / 1 Bath	600	770	28%	201	2 Bed / 1 Bath	1,100	1,025	-7%
105	1 Bed / 1 Bath	600	770	28%	306	1 Bed / 1 Bath	600	770	28%	209	2 Bed / 1 Bath	1,100	1,025	-7%
106	1 Bed / 1 Bath	600	770	28%	307	1 Bed / 1 Bath	550	770	40%	214	2 Bed / 1 Bath	1,100	1,025	-7%
110	1 Bed / 1 Bath	550	770	40%	308	1 Bed / 1 Bath	1,100	770	-30%	215	2 Bed / 1 Bath	1,100	1,025	-7%
111	1 Bed / 1 Bath	600	770	28%	310	1 Bed / 1 Bath	550	770	40%	309	2 Bed / 1 Bath	1,100	1,025	-7%
112	1 Bed / 1 Bath	550	770	40%	311	1 Bed / 1 Bath	600	770	28%	314	2 Bed / 1 Bath	1,100	1,025	-7%
202	1 Bed / 1 Bath	450	770	71%	312	1 Bed / 1 Bath	550	770	40%	315	2 Bed / 1 Bath	1,100	1,025	-7%
203	1 Bed / 1 Bath	600	770	28%	402	1 Bed / 1 Bath	450	770	71%	401	2 Bed / 1 Bath	1,100	1,025	-7%
204	1 Bed / 1 Bath	600	770	28%	403	1 Bed / 1 Bath	600	770	28%	409	2 Bed / 1 Bath	1,100	1,025	-7%
205	1 Bed / 1 Bath	600	770	28%	404	1 Bed / 1 Bath	600	770	28%	109	2 Bed / 1 Bath	1,100	1,025	-7%
206	1 Bed / 1 Bath	600	770	28%	405	1 Bed / 1 Bath	600	770	28%	301	2 Bed / 1 Bath	1,100	1,025	-7%
207	1 Bed / 1 Bath	550	770	40%	406	1 Bed / 1 Bath	600	770	28%					
208	1 Bed / 1 Bath	1,100	770	-30%	407	1 Bed / 1 Bath	550	770	40%	211	3 Bed / 1 Bath	1,400	1,280	-9%
210	1 Bed / 1 Bath	550	770	40%	408	1 Bed / 1 Bath	1,100	770	-30%					
212	1 Bed / 1 Bath	550	770	40%	410	1 Bed / 1 Bath	550	770	40%	311A	Studio / 1 Bath	400	510	28%
					411	1 Bed / 1 Bath	600	770	28%	107	Studio / 1 Bath	400	510	28%
										111A	Studio / 1 Bath	400	510	28%
										111A	Studio / 1 Bath	400	510	28%
											Total NRA (SF)	29,800	32,300	8%
											Avg Unit Size (SF)	784	850	8%



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Unit Size – Actual measurements

Example #4

Unit #	Unit Type	Owner's SF	Actual SF	Difference
1	3BR/1BA	1,000	890	-11%
2	2BR/1BA	800	715	-11%
3	2BR/1BA	800	715	-11%
4	3BR/1BA	1,000	890	-11%
5	2BR/1BA	800	715	-11%
6	3BR/1BA	1,000	890	-11%
7	2BR/1BA	800	715	-11%
8	3BR/1BA	1,000	890	-11%
9	2BR/1BA	800	715	-11%
10	3BR/1BA	1,000	890	-11%
11	2BR/1BA	800	715	-11%
12	3BR/1BA	1,000	890	-11%
Total NRA (SF)		10,800	9,630	-11%
Avg Unit Size (SF)		900	803	-11%



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Unit Size (cont.)

But Marty, why are you talking about unit size??

- “We don’t have that issue in my market.”
- “We’ve never had push-back from any of our clients”
- “I know these property managers – they wouldn’t report inaccurate unit sizes.”

My response is:

You don’t know.

- You don’t know if the numbers you are given are accurate.
- You don’t know *how* the square footages were derived.
- You don’t know if one manager’s method of measurement is similar to another managers in your market.

You don’t know!



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Unit Size (cont.)

Professional Appraisal Issue #1: How do you know that the information provided to you by property management or a 3rd-party source is accurate, correct, not misleading, or all of the above? (i.e., USPAP issue)

Professional Appraisal Issue #2: How can appraisers make credible adjustments for unit size in their Sales Comparison Approach or rental analysis if the information provided to them is inconsistent and/or inaccurate? (also USPAP)

Professional Appraisal Issue #3: Do you want to trust your license to these unknown property managers? (i.e., your professional livelihood is at stake)



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Unit Size

I am not saying that you must measure your subject's units or the sizes of the comparable sales or rentals.

I'm saying that you shouldn't ignore this issue.

I am recommending that we do not include an adjustment for "unit size" or "average unit size" in the Sales Comparison Approach or rental analysis since we do not know that the sizes given to us are accurate.



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Unit Mix: Recommended adjustment instead of unit size

Pricing for multifamily properties is related to the income generated by the units, and variation between sale pricing is typically based, in part, on the unit mix of each property.

- Generally, a property with all 2-bedroom units will generate a greater income per-unit than a property with all 1-bedroom units.

The focus of my recommended adjustment in the Sales Approach compares each sale's unit mix to the subject to reflect influences on pricing by investors in this market.



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Unit Mix (cont.):





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Myth #3: Location Adjustments are hard to quantify

<They really aren't that difficult >

Introduction

Myth #1

Myth #2

Myth #3

Wrap-up



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One of the primary issues from clients: Adjustments for the comparable sales are not adequately explained or tied together with data or narrative discussion.

An appraiser will typically write: *“This sale is better located than the subject, so I will adjust it downward by XX%.”*

Better, more transparent explanations would also contain the phrases:

- “...*because* the sale is located near a transportation hub” or
- “...*because* the sale was renovated two years ago” or
- “...*because* the sale is operating at 98% occupancy and the subject is only at 70%”, ***or whatever is the appropriate reason.***

The operative phrase starts with “...because...”.



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Ways to support location adjustments can include relative differences in:

- Comparative household income
- Average rents between properties in the area
- Average single-family sales prices as a proxy for locational attributes
- Unemployment %'s or news of change of employer base
- Transit Scores (relative access to public transportation) and Walk Scores

Some type of quantitative or qualitative support is better than:

“Based on my years of experience and knowledge of the area...”

- Or -

“I talked to an investor I know, and this is what they said...”

- Or -

“This is the way I’ve always done this – no one has ever pushed back...”



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Illustration for a Location Adjustment on Relative Median Household Income

- Compare household income between the subject's census tract (or other geographic identity), and the sales comparables' location
- Note: This example uses income from renter-only households

Premise: Household income does not drive price directly but it drives achievable rent, which drives NOI and value.

Sample Illustration of an Adjustment for Relative Household Income

	Subject	Comp 1	Comp 2	Comp 3
Tract renter median HH income	\$78,000	\$92,000	\$71,000	\$64,500
Income ratio (Subject / Comparable)	—	84.8%	109.9%	120.9%
Rent factor*	—	93.6%	103.8%	107.9%
Rent-only differential	—	-6.4%	3.8%	7.9%
Adjustment rounded to:		-5%	5%	10%

**Rent factor reflects that not all income goes to rent.*

Rent Factor = (Subject Income ÷ Comp Income)^{0.40} (illustrative purposes only;

Your subject property's calculation is dependent on many factors.



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Walk Scores and Transit Scores: <https://www.walkscore.com/>

My new neighborhood vs. old neighborhood

27 Woodholme Village Court

[Add scores to your site](#)

Pikesville, Maryland, 21208

Commute to **Downtown Garrison**

6 min 17 min 58 min [View Routes](#)

Favorite

Map

Nearby Pikesville Apartments on Redfin

[Looking for a home for sale in Pikesville?](#)

Walk Score
6

Car-Dependent

Almost all errands require a car.

Transit Score
54

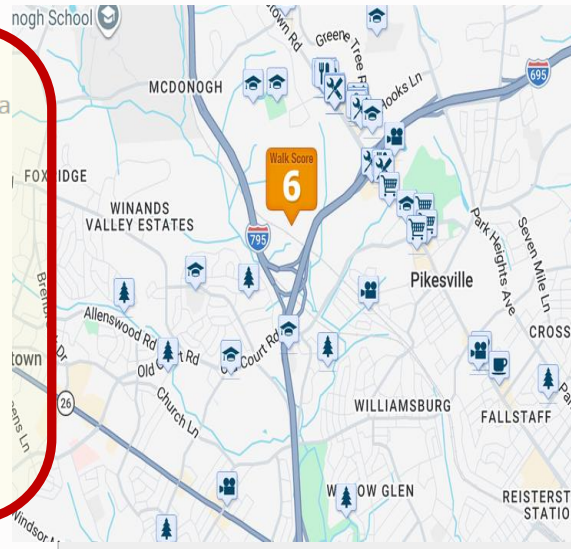
Good Transit

Many nearby public transportation options.

Bike Score
7

Somewhat Bikeable

Minimal bike infrastructure.



[About your score](#)

5304 Reno Road Northwest

[Add scores to your site](#)

Chevy Chase-DC, Washington, DC, 20015

Commute to **1st St. and E Capitol St. NE, Washington, DC 20004**

35 min 39 min 44 min 60+ min [View Routes](#)

Favorite

Map

Nearby Washington, DC Apartments on Redfin

[More about 5304 Reno Road Northwest](#)

Walk Score
64

Somewhat Walkable

Some errands can be accomplished on foot.

Transit Score
71

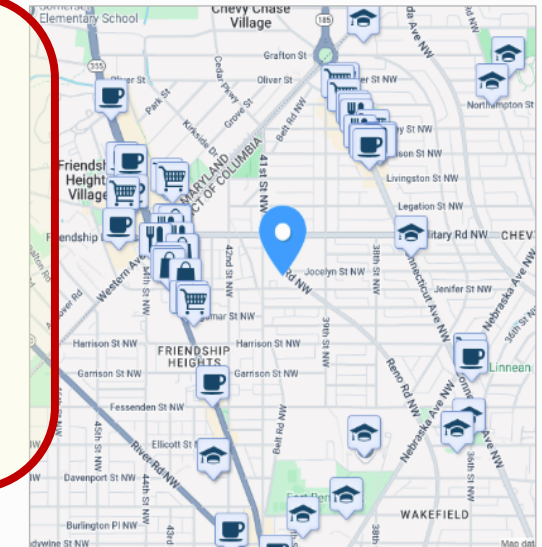
Excellent Transit

Transit is convenient for most trips.

Bike Score
65

Bikeable

Some bike infrastructure.



[About your score](#)



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Location Adjustments - One last thought:

Adjustments do not have to be quantitative... but they have to be *something*

The subject property is located adjacent to an office building adjacent that is only 30% occupied and the landscaping has not been kept-up by their property management, which seems to have caused a reduction in the subject property's rents and higher vacancy since the first of the year. Sale #1, 3, and 4 were not affected like this on their dates of sale so they have superior locational characteristic as compared to the subject. As such, their prices were adjusted downward by XX%

Shopping Mall Sale #3 has two empty anchor stores but the subject just signed-long term leases with national viable tenants, so an upward adjustment of XX% was made to this sale.

Warehouse Sale #1 is located ¼-mile from the intersection of I-95 and I-64 in Richmond (VA) which is a superior located compared the subject, which is located 5 miles from Interstate I-64 in Charlottesville (VA). This sale received an downward adjustment of XX%.

Wrap-up →



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Just a few final thoughts

Introduction

Myth #1

Myth #2

Myth #3

Wrap-up



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Things reviewers look for in particular in the Sales Comparison Approach:

- Are the sales in reasonably close proximity to the subject?
- Are they reasonably recent?
- Are the sales of a similar market appeal and investment class as the subject property?
- Are any of the individual adjustments in the sales grid unusually large?
- Is the totality of the adjustments unusually large?
- Do any one or two sales stand out?
- Does the financial information and property blurb in the outlines make sense?

Do the appraiser's explanations make sense?



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Questions & Discussion

Martin A. Skolnik, MAI | marty@skolnikconsulting.com

My mother: "If all your friends jump off the Chesapeake Bay Bridge, would you do it too?"

15-year old me: <snarky teenager mumble/grumble>

My mother: "Don't do stupid stuff."

CE Credit Verification: Please complete your sign-in sheet before leaving



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Questions?





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If I have time....



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Adjustments for Changing Market Conditions (a/k/a “Time Adjustment”)

There is usually very poor support for the “Changing Market Conditions” adjustment.

Tip: Freddie Mac publishes an *Apartment Investment Market Index* (AIMI):

- <https://mf.freddiemac.com/aimi> and
- <https://mf.freddiemac.com/aimi/about>

The Freddie Mac *Multifamily Apartment Investment Market Index* (AIMI) can be the tool for identifying changes in local (24 MSA's) or national multifamily markets.

To calculate the index, Freddie Mac uses:

- Growth rates in multifamily rental income
- Growth rates in multifamily property prices
- Multifamily mortgage rates



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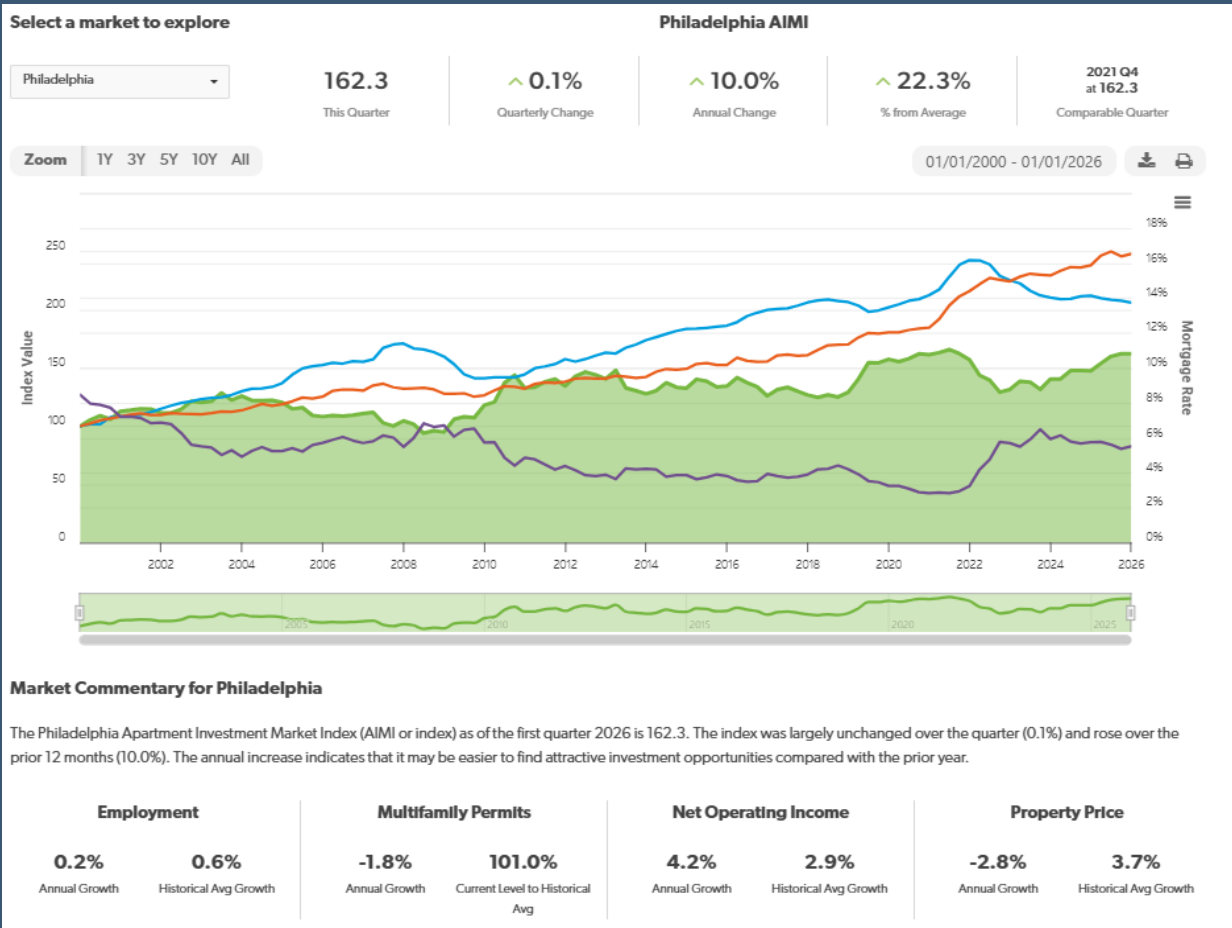
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Changing Market Conditions (cont.)

26-year look-back



Three-year look-back

