What you need to know to make smart offers on small properties

How to Find the Value of Small Residential Real Estate

If You Can't Find the Value,
You Can't Make the Deal

There are only a handful of really key skills that every real estate investor just absolutely must learn to be successful.

Coming up with a reasonable value for any given property is one of those skills.

If you can't do this, you should literally never make an offer, because any offer you do make is sort of…random. Without some idea of what a particular house is worth, you have no idea whether you're paying a market price, under-market price, or waaaaaay to much for it.

And what you pay for a property, relative to its value, makes a significant difference in your overall success as a wholesaler, retailer, landlord, lease/optioner, whatever.

If you believe that a property is worth $150,000 fixed up and that it needs $30,000 in work to fix it, your offer, if you're a wholesaler, is likely to be in the $65,000 range ($150,000 after-repaired value x .7 - $30,000 in repairs - $10,000 profit = $65,000), because you believe that you can sell it to a retailer or landlord for around $75,000 ($150,000 after-repaired value x .7 - $30,000 in repairs).

But if you're wrong about the fixed-up value, and it's only $125,000, you've made a major error in your offer: no smart buyer will pay $75,000 for a property that's going to cost $30,000 to repair and be worth only $125,000 afterward.[1]

If you yourself are the potential landlord in this scenario, your problem might be a bit different: your incorrect belief that the house is worth $150,000 (fixed up) will lead you to offer $75,000 for it.

Let's assume that you plan to take a very common path: buy it and fix it with your own money or private money, then refinance it with a conventional lender after it's repaired and performing.

Your PLAN is that the property will appraise for the refinance at $150,000, and you'll be able to borrow 75% of that, or $112,500, which means you'll be able to get back all of your (or your private lenders') money. Since you only have $105,000 in it (the $75,000 you paid plus the $30,000 you added in repairs), you'll be able to cover all the appraisal and closing costs on the loan from the loan proceeds, as well,

Unfortunately, you guessed wrong, and the property will only appraise for $125,000. The bank will lend you 75% of the correct appraisal, or $93,750, leaving you $8,250 short of getting back you or your lenders' money. Not a fatal error, but certainly not what you planned.

If your estimate of value is incorrect, everything that follow it—your offer, your planned profit or

1 If you don't understand why smart investors don't think that being "all in" for $105,000 in a $125,000 house is a good deal, this is an excellent learning and networking opportunity for you: go ask one. And until you DO understand why, please don't make any offers.

return on investment, all of it—is also incorrect.

That's why finding the right value is such a key skill to develop.

Why Finding Value Seems So…Darn…Hard…

Until you get your feet under you in regard to this important skill, the whole "What's it Worth??" question can seem super-confusing.

I know this, because I get questions like this from coaching students nearly every week:

"There's this property I'm thinking of buying. My comps say it's worth $105,000. Zillow says it's worth $135,000. An experienced local agent me it would probably sell for at least $115,0000, but then I just had a wholesale buyer tell me it's only worth $95,000. I'm confused beyond belief."

How is it possible that 4 sources looking at, one assumes, the same data, and come up with such drastically different values? It's not just confusing—it's absolutely disheartening then you're the one trying to lock down a value so that you can make an offer.

There are several reasons for this, the first of which involves that fact that, unlike something like gold or a share of a company, a piece of property doesn't necessarily have a single value that the entire world agrees upon on literally a continuous basis.

Think about how we "know" what a share of, say, Procter and Gamble stock is worth.

We "know", because we check the little crawler on our phone, and it tells us. But how does the crawler know?

It knows because thousands of shares of P&G stock are BEING SOLD every minute of most days. That means that thousands of different people are looking at the stock and deciding what they'll buy for or what they'll sell for; at the price point at which someone who owns the stock will sell it at this moment and someone who wants it will buy at this minute, the price is set at this minute.

A piece of small residential real estate is different; there's only one seller for any given piece of real estate, and he might be "valuing" it—in other words, deciding what he'll take to part with it—on any number of factors that have nothing to do with the bricks, the mortar, the square footage, the amenities, or the price at which other people have sold similar properties. He might be very emotionally attached to the property, which might lead him to not sell it unless he gets MORE for it than others have.

Or, and this is the case where we as investors usually come in, the seller may be so sick of dealing with his property that he sells it for $40,000, even though other sellers of similar properties in his neighborhood have sold for $100,000, and it would only take $10,000 to repair his property.

In theory, that house is "worth" more than he sold it for, but to the seller, it's clearly only worth $40,000, because no one put a gun to his head to make him give it up for that price.

Or, in the reverse, you'll deal with lots and lots of sellers for whom their property is worth more than that it's worth to you. If he has a property worth $100,000 that needs $60,000 in work, but won't let it go for less than $60,000, that's what it's worth TO HIM. You can talk until you're blue in the face to this seller about how his property isn't "worth" $60,000, but it won't do any good because it's not "worth" it to the seller to trade his property for less than $60,000 in cash.

Another example is one you've run across if you're a wholesaler: when you've carefully done your evaluation, KNOW you're offering a particular property at a great price, and yet, some buyer tells you that he wouldn't pay more than ½ of what you're asking.

That buyer might state his objection as, "It isn't worth what you're asking", but what he really means is, "I don't like this area, or the kind of work this house needs, so I wouldn't PAY what you're asking." In other words, it's not "worth" that to ME.

Despite all the appraisal and BPO professionals out there, the truth is that real estate has different uses, and therefore different "values", to different people. It doesn't matter that the house next door to yours sold for $300,000—yours isn't worth $300,000 unless you find a buyer who thinks it's worth $300,000 TO HIM. And by the way, even that doesn't matter unless that buyer is ready, willing, and able to buy.

It's important that you understand that it's the very fact that different people value a given piece of real estate differently, usually due more to emotional than mathematical factors, that makes it possible for us to buy properties at one price and sell them at another, or to buy properties at under-market prices.

If real estate had the same "efficient market" that other investments like bonds, stocks, and commodities does—one where the price is constantly set by thousands of buyers and sellers—you'd never be able to 'arbitrage' real estate, and all the wholesalers, retailers, and lease/optioners who depend on buying under market to make all or part of their profits would be out of business.

Yet, despite the fact that we can chat philosophically about the meaning of value in real estate, there has to be some objective measure of what a property is "worth", or we'll always be at sea and thousands of appraisers will be out of a job. So, we do have an agreed-upon measure: it's called after-repaired value.

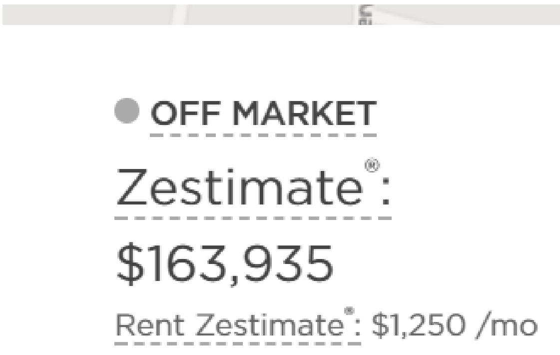
Sadly, the Easy Way is Almost Always the WRONG Way…

In this age of on-demand data at your fingertips, it's natural to want a quick answer to the question, "What's this house worth, anyway?".

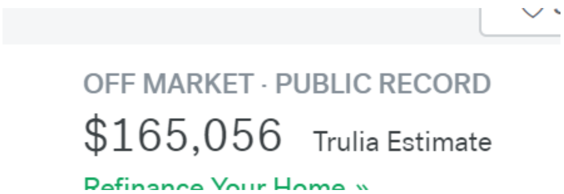
After all, there are dozens of websites, from Zillow to Trulia to HouseValues to Redfin to Realtor.com, that allow you to type in an address and get an instant estimate of a property's value.

Unfortunately, those estimators are just not accurate. In fact, the values that Zillow et al. assign to properties are notoriously…generous…by which I mean completely wrong and almost always to the high side.

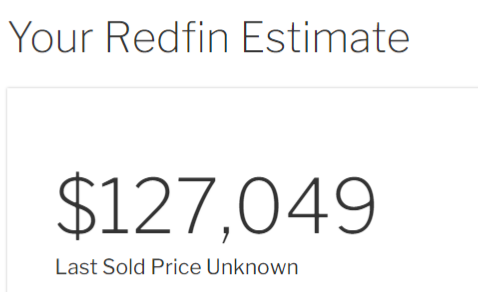
Here are 4 estimates from 4 websites on the SAME property that I pulled on the SAME day:



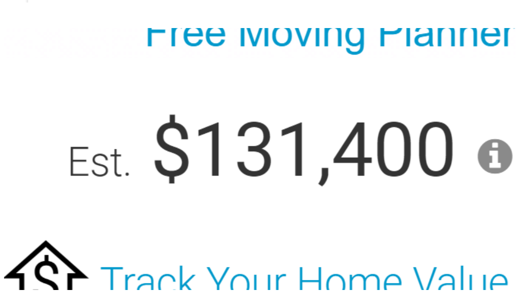
Zillow says it's worth almost $164,000



Trulia—which is owned by Zillow—says $165,000



Redfin says $127,000…



And Realtor.com says $131,000

This house simply cannot be worth both the high estimate of $165,000 and the low of $127,000, and it makes a big difference to your offer which, if any, is correct.

The bottom line is, none of these sites is consistently correct in their estimates of value and the REASON is that they all use something called an Automated Valuation Model, or AVM, to calculate the estimates they give you.[2]

The way in which the AVMs are calculated are super-double-top secret, but Zillow's seems to be to average the TAX VALUATIONS (not sale prices) of pretty much all of the adjacent properties, whether they're really comparable or not, and without regard to their condition today.

And that information in itself is inaccurate, because tax valuations—those numbers that your city or county sticks on a property as a value from which to calculate the pound of flesh they take every year in the form of property taxes—is ALSO kind of a random number.

Basically, in most areas, the tax valuation of a property is EITHER the last sale price of that property (if it occurred in the prior 1-3 years and was "arm's length", OR it's the highest price the local treasurer thought they could reasonably set without the owner objecting, OR it's the price set when the owner DID appeal the valuation. In other words, not a good way for you to estimate price.

In fact, the tax valuation of that property that the free websites set between $121,000 and $165,000? $115,740:

Market Improvement Value	[illegible]
Market Total Value	115,740
TIF Value	0
Abated Value	0

So, as much as we like the 10 second answer, the real way to find out what a particular property is worth is to look at individual sales of individual houses, use the sales of houses that were in "After Repaired Condition" at the time of sale as a start, and then find the individual sales that are closest to ours in style, age, size, and so on.

Why After-Repaired Value is ALWAYS Your "Number"

The "After-Repaired Value", or ARV, of a property can be defined as:

2 Well, that, and the fact that their business model—which is to collect information on properties that are potentially for sale and sell that information to agents—doesn't require them to be accurate. You go to the sites, type in an address of a house you're thinking about selling or buying, and as far as Zillow et al. are concerned, their job is done. You've just given them a lead to sell. Whether you get the accurate value for that lead isn't important.

The most likely sale price of a property <u>when it is in good condition</u> for the neighborhood in an arm's length transaction.

Note the 3 important modifying phrases in that definition:

- **Most likely sale price**: the ARV isn't meant to guess at a conservative sales price or an optimistic, best-case one, but rather to the most likely one
- **Arm's length transaction:** This is a sale between a buyer and seller where neither has any special pressure or motivation to act
- **Property in good condition (for the neighborhood)**: in other words, having no major deficiencies or extraordinary improvements or upgrades.

This doesn't sound much like the deals we typically look for, does it?

As real estate investors, our ideal targets are sellers who have lots of motivation to sell quickly rather than at top price.

Often, those deals come with a certain amount of 'distress' in their condition; they're rarely in perfect (or even good) condition for the neighborhood.

So, given that we're almost never looking at properties that meet either of the last 2 requirements, why do we care about after-repaired value?

The reason that we begin every calculation of offer price with ARV is simple: **there's no other logical and reasonable way set a value on a property.**

Yes, what we're doing is buying a property that's NOT in after-repaired condition, but our goal is never to find the as-is value—it's to find the after-repaired value and CALCULATE the as-is value.

To understand the logic of this, think about it this way: If you were trying to figure out the as-is value of a distressed property by using comps, how would you go about doing that?

If your first instinct was to say, "by finding out what other distressed properties have sold for", think about it some more.

Because if you REALLY wanted to find out what a buyer would pay for your property (which needs a furnace, a roof, a kitchen, paint and carpet), you'd have to find other properties in the area that had sold that needed a furnace, a roof, a kitchen, paint, and carpet—and needed the same number of cabinets in the kitchen, the same square footage of carpet, and so on.

If the other junker sales in the area needed plumbing, wiring, siding, and windows, they're not really "comparable" to yours. Different repairs carry different repair costs, right? So, a house that sold for $100,000 and needed $100,000 worth of repairs wouldn't sell for $100,000 if it needed $50,000 in repairs.

That's why all calculations of what to pay for a property start with what the property will be worth FIXED UP, and then back out the cost of repairs specific to that property.

How to Determine the After-Repaired Value of a Property

There are 3 primary ways that appraisers use to circle in on the value of a property. The only one you'll need to know about to find the value of single family homes, condos, and 2-3 unit properties is the one called the Comparable Method.

The comparable method involves researching recent sales of similar properties to discover the market value for your "subject" property.

The first step in this process is to find a quick way to get comparable sales—in other words, to find out what properties have sold recently, and for how much, and what basic features those properties have

> Remember, even if you make a mistake in calculating the ARV, it won't hurt you in the long run. A small error of 5% or so may cut into your profits some, but your buyers will let you know if you've made a major error, and simply won't buy at the price you're offering. If you find out you've made a major mistake, you should have "outs" in your contract in the form of contingencies that will allow you to get out of it or renegotiate your price with the seller!
>
> **Never, Never Let Your Uncertainty about the Exact Value of a Property Keep You from Making an Offer!!**

Ultimately, all data about comparable sales comes from one of 2 sources:

- **Public records data**, which is typically available in some form to anyone who wants it. With the exception of a handful of states and individual counties, information about when and for how much a house sold is recorded in the public record and available online. In some areas you have to pay for this access; in some the data is sparse (for instance, you may be able to see what the house sold for but not how many bedrooms it has), but in most reasonably populated cities, there's a treasure trove of sales information online. Unfortunately, that data is not always easily searchable, and there's one other deficiency in public record data: the treasurer/auditor/recorder does NOT have information about the condition of the property at the time at which it sold.

- **MLS data,** which is information entered by agents in the course of listing and selling properties. This information is privately owned by the local board of Realtors, and information about properties that have SOLD is generally accessible only with a password to the database, and only by licensed agents.[3] The downside of this information is that the only sales you'll find in MLS are properties that sold THROUGH MLS—no for sale by owner properties, no sheriff's or trustee's sales, no off-market sales of any kind. On the bright side, though, there is very often information about the general condition of the property at the time of sale.

3 I don't think it's any big secret that many non-agents have direct access to MLS through various work-arounds, the most honest and legal of which is to become an "Unlicensed assistant" to an agent, and pay for your own access.

- **Aggregators of Public and MLS data**. In addition to providing "estimates", several of the free online systems like Zillow, Realtor.com, and so on DO offer the ability to search for recent sales in the area. Generally, this sale data comes from a combination of MLS data (many agents have a feed between their MLS subscription and Zillow, so when a property sells, Zillow does, in fact, know how much it sold for) and public record information. If you bother to learn how to access the individual sales, you can use these sites to determine a value; however, be aware that the information here is somewhat spotty and not as complete as true public record info.

While depending on a real estate agent or working your way through courthouse data or one of the free online sites may be fine for the investor who's going to deal with only a handful of offers—and therefore a handful of evaluations—per year, there's a much better alternative for folks who plan to evaluate several properties a month, and that's a comparable properties service.

Comparable properties services are companies that gather information from public records about properties in a given area, and then provide the information to subscribers in an easy-to-use, searchable online format.

I can't say enough good things about how easy a comparable properties service makes it for you to find and filter comparable sales. With most systems, you can enter an address of your subject property (that's the one you're trying to find the value of), and then characteristics that you want to see in the comparable sales (like "only sales within ¼ mile in the last 12 months" or "Only sales of brick houses"), and get JUST the data you need.

The systems then line up the sales for you so that you can see exactly how your subject property is or isn't like the comps.[4] I've inserted an example of how this data typically looks on the next page.

Although these services can be fairly pricey ($800-$2,000 per county per year (your local real estate association may have a special deal with a service—ask before you subscribe), the ease of access to comparable property sales, plus details about the property including square footage, last sale date, etc. will prove to be so valuable to you that you'll probably want to subscribe sooner rather than later.

Companies that provide comparable property services in your area might include:
✓ Haines Criss+Cross Plus Real Estate (www.haines.com) which covers parts of 7 states, primarily in the Midwest.
✓ RealQuest (www.realquest.com), an internet-based service that has a very wide national coverage.
✓ CRS data, which covers several states in the Mid-South
The best way to find the best system in your area is to ask other investors and appraisers which system they use.

Your other options—visiting the courthouse to look up sales, or using the MLS via an agent—are inferior both in terms of convenience and in the amount and organization of data available.

Once you've found a reliable source of comparable sales, the next step is to learn how to "comp" properties using those sales. What this basically comes down to is the ability to recognize <u>which</u> of the

4 The term "comp" is used in 2 different ways in our lingo: as a verb ("I comped that house at $125k") meaning the act of finding and evaluating comparable sales, and as a noun ("There was one comp at $125k"), meaning a comparable sale.

properties that sold are largely similar to your "subject" property, and which are very dissimilar and must therefore be discarded. Since many of the properties you look at will be in older neighborhoods where the properties range widely in age, construction, style, and size, this will be the most time consuming step you'll take in determining the ARV.

Field	Subject	Comp Property	Comp Property	Comp Property
Tags				
Address	10882 Maplehill Dr	1902 Bluehill Dr	1870 Roosevelt Ave	1934 Lotushill Dr
City	Cincinnati	Cincinnati	Cincinnati	Cincinnati
Zip	45240-3365	45240-3310	45240-3322	45240-3316
Parcel Number	5900391024200	5900391008500	5900391010300	5900391012600
Sale Date		May-31-2017	Jun-20-2017	Sep-12-2017
Sale Price		$59,900	$447,000	$70,000
Deed Type	Warranty Deed	Warranty Deed	Grant Deed	Warranty Deed
Owner Name	Bonham Donald R	Bird Randi J	At Cedar Llc	Rahman Abdur
Distance (miles)		0.2703	0.2083	0.1802
Location	Springfield Township	Springfield Township	Springfield Township	Springfield Township
School District	Mount Healthy CSD	Mount Healthy CSD	Mount Healthy CSD	Mount Healthy CSD
Census Tract	0215725010	0215091015	0215092009	0215092008
Usage	510 Residential - Single Family	510 Residential - Single Family	510 Residential - Single Family	510 Residential - Single Family
Legal Desc	MAPLEHILL DR 62 X 151.66 IRR LOT 173 SEVEN HILLS VILL BLK G	BLUE HILL DR 63.03 X 139.52 IR LOT 79 SEVEN HILLS VILLAGE SUB BLK B	ROOSEVELT AVE 60 X 153.60IRR LOT 506 SEVEN HILLS VILLAGE SUB BLK B	LOTUSHILL DR 65 X 130 LOT 455 SEVEN HILLS VILL BLK C
Total Square Feet	1,025	1,000	1,000	1,000
Square Feet 1st Floor	1,025	1,000	1,000	1,000
Bedrooms	3	3	3	3
Baths	1 full	1 full	1 full	1 full
Rooms	5	5	5	5
Style	Conventional	Conventional	Conventional	Conventional
Stories	1	1	1	1
Year Built	1962	1961	1961	1962
Construction	Brick	Frame/Masonry	Frame/Masonry	Frame/Masonry
Basement Type	Finished	Finished	Finished	Unknown
Heat	Yes	Yes	Forced Air	Forced Air

Figure 1 A typical results page from a comparable properties service. Note that it shows the subject property and 3 sales, all of which were within 1/3rd of a mile of the subject, sold in the 12 months prior to the day I ran the comp, and within 20% of the ft2

ANY comparable property that you use will have to have these characteristics in order to be valid:

1. It must be geographically ***close*** to your subject property - within ¼ to 1/2 mile in a typical urban or suburban neighborhood. You'll have to expand your search radius in rural areas.

2. It must have sold ***recently***—and recently means different things in different market cycles. In a market that's quickly rising or falling, the sales should have been in the last 6 months. In a market that's more stable, sales within the last year will are fair game. Under NO circumstances are sales more than a year old useful, other than to show price trends in the area.

3. It must have been in ***good condition*** at the time of the sale, whatever that means in the particular neighborhood you're examining.

4. It must be in the ***same school system***, although it is not necessary that the children go to the same school within the system.

5. It must be, in the minds of people who live there, ***in the same "neighborhood"*** as your subject property. We all know of adjoining neighborhoods where one is more prestigious and therefore more expensive than the other. For that matter, we also know of neighborhoods where the "north" is more prestigious than the "south" part of the same neighborhood.

6. It must be an ***arms-length transaction***, meaning that neither the buyer nor the seller was under undue pressure or had unusual motivation to act. This pretty much eliminates all sheriff's sales, sales from banks to owners, estate cases, sales where owner financing or a seller carryback of any sort was involved, and transfers between spouses in a divorce.

Other than these "musts", your selection of comparable properties will be on a "most similar" basis. If you can find 4 or more properties that fit the above criteria and are like yours in all the ways that matter (see table for "the ways that matter"), you should have a very good basis on which to draw a conclusion about the ARV on your property.

Features that can affect the value of a property by more than 10%
(try not to compare properties that are different in these important ways)

Construction (brick or stone vs. frame)	Number of rooms
Square footage (if more than 200 feet or 20% different)	Number of bedrooms
Basement vs. crawlspace or slab	Number of full baths
Availability of public utilities (gas, sewer, etc.)	Off-street parking vs on-street
Style, if the style is unusual for the neighborhood	Number of full levels
Era of construction (1920's vs. 1970's)	Condition of the property at time of sale
Owner financing of any kind	Forced sales (like sheriff's sales)
Use/zoning (1 vs.2 family, residential vs. commercial zoning)	
Defects in the surrounding area (houses on busy streets vs. houses on quiet streets, houses next to factories vs. houses in all-residential neighborhoods, etc.)	

Features that affect the value of the property by less than 5%
(compare properties with or without these features freely)

Porches	Fireplaces	Above ground pools
Patios	Finished basements	Laundry rooms
Attic storage	Entry halls	Balconies

Features that affect the value, but which you can account for simply by calculating the cost to make the change (These are all features which can be changed relatively easily; for instance, a home without central air can become a home with central air for less than $3,000, excluding new ductwork)

Central air	Siding	Landscaping
Decks	Ceiling fans	Fences

When you've located—on paper—a number of comparable properties that are similar as to size, construction, and important features, and that are close by and have sold in "arm's length" transactions in the past 12 months or so, there are two more important steps to take before deciding on an after-repaired value.

First, **it's crucial that, at some point before putting an offer on paper, you actually drive around and look at the comps** just to make sure that the data you have is accurate.

It's not unusual to find that the public records have transposed a digit (recording that a 1,200 square foot property is a 2,100 square foot property, for instance) or added a placeholder (a property that sold for $20,000 is recorded as having sold for $200,000) or has outdated records on a property (stating that it has 4 rooms, when in fact a recent owner has added a 5th room). And no, looking at the properties on Google maps isn't good enough.

Second, **you must research the condition of the property <u>at the time of the sale</u>**. Knowing what it looks like now isn't enough: the only "good" comps for finding after-repaired value are those that sold in after-repaired condition. A property that clearly has new siding and landscaping may have sold that way – or the buyers might have done the improvements after the sale. The two best resources for finding this information are the MLS (this will only work for properties that sold through agents, of course) and the various sites that aggregate MLS data, like Realtor.com.

Once you've selected your 3-5 closest comparables, the final step is to use the data to determine an after-repaired value for your subject property. Most of the time, even the most similar properties in a given neighborhood will sell in a range of 10%-15% (from top price to bottom price). These differences are due to the fact that the value of any given piece of property is in the eye of the beholder. A seller that doesn't care to have buyers tramping through his property for months on end might sell for a little less than "market"; a For Sale by Owner might be willing to sell for less because he has no commission to pay; an out-of-town buyer might pay a little more than average, simply because property values seem so cheap in the Midwest compared to California; or a couple buying their first home might pay top price because they're "in love" with the architectural details of the property. **Nonetheless, the entire range of prices, since they represent what real buyers are willing to pay for real properties with real money, are ALL correct "fair market values."**

In fact—and this is important—if you see comps that are just way out of line with the bulk of the sale prices of truly comparable sale, just eliminate them. Don't worry about why one house in a group of 10 sold for $40,000 when the rest sold for between $160,000 and $180,000. It's irrelevant. It's clearly not reflective of the typical sale price in the area.

<u>In a hot or rising market</u>, most realistic way to take these disparate figures and turn them into an ARV that you can work with is to assume that, since your subject property will be in good condition for the neighborhood when your buyer finishes renovating it, it will be worth the top end of the price range. For instance, with good comps selling at:

$156,700 $157,500 $159,000 $159,300 $160,500

A good estimate of ARV would be $160,000. To think that your subject property, when fixed up, would sell for $160,000 is both realistic and defensible. Taking an average would result in an ARV of $158,600, which is clearly too low, and a great example of why averaging is always a bad idea. The median price of $159,000 would be a more conservative approach, but as you will see in the next section, the difference in your ultimate offer will be negligible anyway.

In a cool or slowing market, it's much more reasonable to use the middle or low end comps as the ARV—in our example above, you'd probably assume that your ARV is around $157,500. But what's even more important in such a market is the AGE of the comparable—in other words, the newer the sale, the better the comp.

Whatever you do, DON'T AVERAGE!!! It's so tempting to look at the list of comparable sales above and conclude that the safest value for the property is the AVERAGE, which is $158,600. However, that's too low in a hot market, and too high in a dropping market—and this is an example that uses a fairly tight range of comparable prices. In real life, those sales would probably be between $138,000 and $160,000, and averaging would give you a price that was far too low or too high, depending on the market.

What About Areas Where Even the Comparable Sales are Dissimilar?

If you work primarily in neighborhoods where there are a lot of very similar houses—in other words, areas where properties were largely built after 1945 or so—it should be easy for you to find sales of properties that are more or less identical to your subject property. Same builder, same floorplan, same age, same construction, same everything

However, if you work in urban areas in older cities, you'll often find that no 2 houses in a neighborhood are exactly alike. It's pretty common in these areas to find 3 3-bedroom 1960s ranches infilled between an 1890's Victorian with 11 rooms but only one bath and a 1910 Foursquare with 4 bedrooms and a bath and a half.

These sorts of areas are a challenge, but one that's not too difficult to overcome. The thing to remember is that, in an area with a lot of dissimilar properties, EVERY buyer is mentally weighing to pros and cons of the extra 300 square feet, or the extra bath, and guessing at an end value.

It works like this: you still begin by narrowing the comps down to the BEST. You really don't want to compare that 3 bedroom 1960s ranch with the 11 room frame Victorian from 1890, but the Victorian and the Foursquare might be the closest you can come to same age/size/etc.

You then look at the DIFFERENCES between the properties—again, the ones that are basically impossible to resolve, like square footage, construction, and layout—and decide about whether you think the difference helps the value, hurts the value, or is neutral.

For instance, if the Victorian has 1 bath (and no good way to add 2nd), and the foursquare has 2 baths, the question becomes, how much more will someone pay for the convenience of that 2nd bath? And a good way to determine that is to try to find other examples of similar one and 2 bath houses that have sold recently. We know for certain that a 2nd bath is worth more; what we have to do is guess how much more.

Usually, a combination of guessing and your instincts about these differences will get you to about the right place. But a great way to resolve any questions you still have is to ask an experienced agent, appraiser, rehabber, or landlord in the area.

What to Do When There are "No Good Comps"

When the real estate market is hot, finding good comparable is usually no problem. There are plenty of sales happening, and enough of them are similar to your subject property to give you a good grip on value.

When that the market slows, though, finding a real, current value for a properties, especially in slower-moving rental neighborhoods, can be more of an art than a science due to simple lack of data.

So, once we've exhausted the "usual means" of finding value, what then? The answer is, we use whatever circumstantial evidence we can find to sort of circle in on the value, make our best guess, make our offer (with appropriate "out clauses", of course). Here are some of the ways that, though not perfect, we unfortunately have to resort to when the appropriate comparable sales just aren't there.

1. **Take a look at some of the non-arm's length transactions**. Although sales from banks to investors are not "market price" sales or fixed up properties, they at least tell us what other real estate entrepreneurs think investors are paying for junkers in the area.

2. **Take a look at the active, fixed-up listings on the market.** Obviously, what someone is "asking" for a property and what they're going to get can be two very, very different things. But you can get a feeling for what values AREN'T by looking at current and pending listings and days on market through the MLS. A property that is listed at $325,000 and has been on the market for 300 days is clearly overpriced. A property that went pending in 28 days at $300,000 was priced approximately correctly, though the final sale price might turn out to be somewhat lower than the list price.

3. **In rental neighborhoods ONLY, we often use a "trashflow analysis" to circle in on value.** This simple analysis is a sort of scaled-down version of the formula commercial investors use to determine the value of apartment buildings and other commercial properties.

The idea of the trashflow analysis is that landlords—and those are folks who really buy in type 2 areas—want to make a certain minimum monthly profit when they buy a property. The formula takes this and other expenses into account, then takes what's left over and assumes that amount is what's available for a mortgage payment. The question then is, "How much mortgage will that monthly payment support?".

The basic trashflow analysis formula is this:

Gross expected monthly rent (get from craigslist for similar rental properties in the area)
- 20% of gross rent (this accounts for vacancies, maintenance etc.)
- Monthly taxes (get from your tax collector's website)
- Monthly insurance (an insurance agent can help you understand what this cost is)
- Any other expenses that would be paid by the owner of the property—utilities, trash etc.
- The typical landlord's expected monthly cash flow in your area

= the amount of monthly rent left for mortgage payment

In my area, the numbers on a real type 2 property might look like this:

Gross rent $900
-20% of gross $180
-monthly taxes $80
-monthly insurance $20
- other expenses $0 (in my area, tenants in single families pay all utilities etc.)
- desired cash flow $200
=$420 left over for mortgage payment

What about the weird-o properties?

Sometimes, the problem with finding comps isn't that there haven't been enough sales, but that the property you're contemplating buying isn't like the other house in the area, at all. Examples would include:

- Round or octagonal houses
- The original 1893 farmhouse in the middle of the 1950's subdivision that was built with the family sold the farm
- Houses built entirely of metal or poured concrete
- The house that has a 2,000 square foot addition in a neighborhood where everything else is a 900 square foot ranch

In general, when it comes to houses, weird is BAD and detracts from the value of the property. You may have to bring in a professional to determine how much value should be deducted for weirdness, but the first question you should ask is, "Should I be considering this house, which is less desirable than the ones around it, at all?

The question is, what do we do with that $420?
Answer: we back it into a mortgage balance. In other words, we answer the question: how much mortgage would a $420 payment support?

Before that question can be answered, we would need to know at what rate the buyer would be borrowing, and how long the amortization period would be. Unfortunately, we can't know what any particular buyer's access to money is like, so we make the assumption that any buyer would be getting a private loan at 8% fixed interest amortized over 30 years.

From here, we can either use a financial calculator to work out the balance of the mortgage OR use Microsoft Excel, which has a “present value” function that will calculate this. The formula in Excel is @PV(yearly interest rate expressed as a decimal/12,months over which the loan will be amortized, monthly payment as a negative number, 0,1)

In the case of the example above, what you’d enter into Excel is @pv(.08/12, 360,-420,0,1) and the result would be $57,620.66. If you care what that number actually represents, it’s how much your buyer could borrow against the property at 8% interest for 30 years, and still pay all his other expenses and get $200 a month in cash flow.

So, in a sense, this represents the loose ARV of the property. To get to the sale price, you’d need to do one more step:

Mortgage balance
-repair costs
=value to the landlord

Why? Because the properties we sell are NOT in after repaired condition! The money that the buyer borrows has to both buy AND FIX the property.

4. **Call in professional help**. So, if you’re so worried that you’re going to make a mistake that it absolutely keeps you from making offers, there are these people called appraisers who do this for a living.

Now, I’m not suggesting that you pay hundreds of dollars for an appraisal every time you even think about maybe making an offer on a property; what I’m suggesting is that there are these things called “contingencies” that you can put into purchase contracts, and they can say whatever you want them to say. Like, “Buyer’s obligation to purchase this property is contingent upon buyer obtaining, at buyer’s cost, an appraisal to determine the after-repaired value of the property. If buyer is not satisfied with the results of this appraisal, buyer will not be obligated to purchase property, and earnest money will be returned to buyer”. Or something like that.

Two notes about this strategy: first, you won’t be able to get an after repaired appraisal without a complete “statement of work” telling the appraiser exactly what “improvements” he’s appraising around. No appraiser can reasonably be asked to give an opinion as to the value of the finished product without knowing what is to be included in the finished product. In fact, not every appraiser can do a competent after-repaired appraisal even with a statement of work, so get referrals before you hire one.

Second, please note that, due to the expense of the appraisal, it should only be dome when the rest of the terms are negotiated—meaning that all the paperwork is signed, including any addenda necessary to complete a deal on a bank owned property[5]

5 Although you should be warned that an appraisal contingency in a bank-owned property contract will almost certainly get that offer rejected.

Please, Just Settle on a Number and Get on With It!

Again, you'll never know to the penny what a property is "worth". And again, if you're off by even a few thousand dollars, you'll probably still be fine, given that you reduce the ARV by 20-40% before you make your offer anyway. I see investors lose deals every day because they can't stop analyzing and re-analyzing deals and get down to making an offer. Don't be one of those investors. Be educated and careful, but don't be OCD about it.

Bringing this All Together:
Understanding the Steps and Where the Appraisal Fits Into a Real Estate Deal

There's an order in which real estate deals tend to occur, and a place where each activity, like evaluating comps, fits in.

In the case of the appraisal, it's generally something like this:

1. **You identify a potential deal**. If it's listed, go to step 2, because you already know that it's for sale. If it's NOT listed, you won't go to step 2 until you've determined that the seller actually does want to sell the property. Doing a bunch of valuations on properties that you like the look of and are curious about is a great way to waste hundreds of hours on something that will never turn into anything.

2. **You find the comparable sales, and work through them to find the ones that seem most similar to determine a PROBABLE ARV**. Since this is sort of a 'pre-screening' stage to help you decide whether the property is even sort of worth looking at (If the seller's asking twice what any property in the area has sold for and has indicated he won't take less, it's a waste of time to move on to step 3), consider this a preliminary appraisal, done all online.

3. **IF the seller's asking price seems reasonable given the comps and probable condition, THEN go look at the property**. This is the stage at which you 'drive by' the comps, since you're near the property anyway

4. **Based on what you see when you view the property and drive by the comparable properties**, make your final estimation of the after-repaired value you may find that your subject property is different from some of the comparables in key ways (like yours is on a busy street and most of the comps aren't) that could change which comps you focus on

5. **Using your new ARV, run the formula you'd normally use to calculate your offer**, come up with a number, and make the offer. If you're not certain that you're pretty close to the value, include an appraisal contingency in your offer.

6. **IF you're getting institutional or hard money financing, there will be another appraisal step**—a formal appraisal by a professional. This will be an as-is, not after-repaired appraisal, and should 'come in' at or above your offer price.

Action steps for this chapter

❑ Work the problem that follows. Refer back to the written material here to make your way through it, and see how you do

❑ Ask a few appraisers, agents, and investors in your area which comparable service they use, why they like it, and how much it costs to subscribe to it.

❑ If you can afford it, subscribe to a comparable service. If not, find a real estate agent who is willing to provide comparable sales to you or experiment with Zillow.com or HouseValues.com

❑ Using the comparable properties service you've chosen, comp 3 properties that you already know the value of—your own home, properties in the area that have sold recently, etc. Familiarize yourself with the service and the data it provides, and see if you come up with values that explain why these properties sold for the prices they did

Sample Appraisal Problem

Let's try using your new knowledge to come up with a value for a property in Cincinnati.

Let's assume that we're doing this appraisal on January 20th, 2018, so that the comps don't look completely dated.

I've provided you with ample date, downloaded from our county's website, a comparable properties service called Haines Criss Cross Plus Real Estate, and MLS.

The criteria under which I searched for comparables in the Haines system were:
- Sold within 1 year
- Sold within .3 miles
- Properties that are +/- 20% of the square footage of the subject

The criteria under which I searched for comparables in MLS were:
- Sold within 1 year
- Sold within ¼ mile
- Properties within +/- 20% of the subject's square footage.

Based on the information given here, you should be able to take these steps:

- First, determine which comparable sales should just be deleted because they're too dissimilar to the subject property, or were not arm's length transactions, or were not in after repaired condition at the time of sale.
- Answer this question: Why are the comparable properties not exactly the same across the two systems? In other words, why do we not have exactly the same properties, despite having nearly the same search criteria?
- Based on the remaining sales, come up with an approximate after-repaired value for this property and explain why

This is the public record data available on the subject property from the Hamilton County Auditor's website:

Parcel ID	Address	Index Order	Tax Year
590-0391-0242-00	10882 MAPLEHILL DR	Parcel Number	2017 Payable 2018

Property Information

Tax District 122 - SPRINGFIELD-MT.HEALTHY
School District MOUNT HEALTHY CSD

Appraisal Area
59018 - SPRINGFIELD 18
Sales

Land Use
510 - SINGLE FAMILY DWLG

Images/Sketches

Owner Name and Address
BONHAM DONALD R
10882 MAPLEHILL DR
CINCINNATI OH 45240
(call 946-4015 if incorrect)

Mailing Name and Address
CORELOGIC
2500 WESTFIELD DR STE 102
HOFFMAN ESTATES IL 60124
(call 946-4800 if incorrect)

Assessed Value
17,200

Effective Tax Rate
89.353574

Total Tax
$1,334.57

Property Description
MAPLEHILL DR 62 X 151.66 IRR LOT 173 SEVEN HILLS VILL BLK G

Appraisal/Sales Summary	
Year Built	1962
Total Rooms	5
# Bedrooms	3
# Full Bathrooms	1
# Half Bathrooms	0
Last Sale Date	9/12/2007
Last Sale Amount	$78,000
Conveyance Number	87372
Deed Type	WD - Warranty Deed (Conv)
Deed Number	136550
# of Parcels Sold	1
Acreage	0.216
Front Footage	0.00

Tax/Credit/Value Summary	
Board of Revision	No
Rental Registration	No
Homestead	No
Owner Occupancy Credit	Yes
Foreclosure	No
Special Assessments	Yes
Market Land Value	12,930
CAUV Value	0
Market Improvement Value	36,210
Market Total Value	49,140
TIF Value	0
Abated Value	0
Exempt Value	0
Taxes Paid	$674.85
Tax as % of Total Value	2.670%

REMOVE THIS PAGE AND INSERT THE PAGES CALLED MAPLEHILL HAINES COMPS—SEVERAL PAGES

REMOVE THIS PAGE AND INSERT THE PAGES CALLED MAPLEHILL MLS COMPS—SEVERAL PAGES

Don’t read this page until you’ve tried the problem yourself:

Here are some hints about working this problem.

On the list of comparables from Haines (those are the ones lined up side by side with no pictures), we know we can eliminate the following:’’

- Comparable 2, because the price is so out of line with the other properties. This was either a multi-parcel sale or a typo by the person entering it at the courthouse
- Comparable 6, because the transfer was TO FNMA—not an arm’s length transaction. The MLS sale was FROM the bank to a consumer or investor, and is also not a comparable
- Comparable 9 because it’s so out of line, and because it was transferred via a quit-claim deed which usually indicates a distressed sale
- Comparable 10 because it’s a transfer TO a bank. Note that, per MLS, the house later sold for LESS than the price at which the bank “acquired” it

Comparing the rest with the MLS comps, we can also eliminate these Haines comps:

- Comparable 7, because the listing indicates that it was lender-owned, which typically means the condition is fair, not good
- Comparable 11, because the MLS listing indicates that it’s an as-is (so the condition isn’t good) cash (so it won’t pass a bank’s condition requirements) sale
- Comparable 11

1936 Roosevelt appears in the MLS comps but not the Haines comps; we can eliminate it because it’s a short sale, which is not an arms-length transaction

1934 Lotushill appears in the MLS list as a $27,000 “as is” sale and in Haines as a $70,000 sale 5 months later. The later sale is a good comp because it’s clear that the property was renovated and resold in the interim

1935 Windmill appears only in MLS. The comp can’t be eliminated, but it is suspect because there’s no indication of recent upgrades or other comments that would make us believe it was in after-repaired condition

1931 Lotushill appears in MLS only but was lender owned

10739 Maplehill appears in MLS only; comp can’t be eliminated but is suspect because it was a “pocket listing” (sold before sent)

10900 Maplehill at $55,000
10934 Lotushill at $70,000 (second sale)
10739 Maplehill at $55,000
1935 Windmill (possible not updated) at $46,500

Since the only one of these comps that indicates that it's newly renovated in the one at 10934 Lotushill, I would tend to give it some weight.

Thus, I'd probably spit the difference between the 2 highest comps, and guess the value at about $62,000

What did you guess?