

THE FORSYTHE APPRAISALS FLASH

Appraisal Insights for Real Estate Professionals



Making Sense of "Substitute Properties"

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What should the primary, motivating factor be for an appraiser when selecting comparable properties? While typical answers may include: quality, condition, style, size, location and/or amenities, the fact is that appraisers don't start by *selecting* the comparables; rather, they first identify the properties that the *buyers* would consider as equally desirable alternatives.

A "**comparable property**" is defined as a *similar property to be used for comparison in the valuation process*. Whereas a "**substitute property**" is defined as an *equally desirable property that competes with the subject in its market area*.

When reviewing appraisals, most people generally think in terms of the definition of "comparable property" in that they equate "similar" to "identical" properties (or as near to identical as possible), and they expect similar physical property characteristics to be compared. For example, two-story homes would be compared to other two-story homes, and the comparison of a one-story home to a two-story home might be regarded as "incorrect methodology."

It is imperative that appraisers research the buyer's needs and seek out "substitute" properties, which may or may not be "similar" in the sense that many users/readers typically equate. The appraiser should be analyzing the motivations of a particular market segment. Are purchasers interested in location first? And if so, are they willing to consider any style property as long as it is located in the desired area? Are participants more interested in the size/utility of the site, the number of stories, or the bedroom count?

Once the appraiser understands what the particular buyer desires, they are more likely to compare apples to apples. *But it doesn't mean that all of the apples need to be red!* If their needs are driven primarily by location, for instance, in a historical district; water-frontage, or rural setting, then potential buyers may consider any style, or possibly even size, (within reason) simply for the opportunity to own a home in that particular area.

So it may be reasonable for the appraiser to compare a one-story ranch to a 100-year old two-story farmhouse, as they strive to reflect the buyer's main motivation in purchasing the property, which, in this scenario, is location. When it is necessary to use substitute properties, which may not seem comparable to the lay-person, it should be expected that the appraiser adequately explains the need to use seemingly dissimilar properties.

The next time you review an appraisal report and see what appears to be a "non-comparable" property, ask yourself if you would consider the property as a reasonable substitute. A good appraiser will narratively lead the reader through the comparable selection process and clearly explain what motivating factors of analysis were considered.

*Do you have any suggestions for future articles you'd like to see?
Please e-mail Deb deLambert at debd@forsytheappraisals.com.*

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