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| Lish Properties, llc & 1-2-3 Flip Presents |
| Estimating ARVThe Investor's Guide to Comp Analysis |
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Determining how much a property will resell for after renovations is as much an art as it is a science. Appraisers can spend years honing their skills at property valuation, and even many seasoned real estate agents can have a difficult time assessing the resale value of a property before it is rehabbed. But, as a successful real estate investor, you will need to be able to determine what your properties will sell for, and you'll need to be able to do it reliably and consistently. And I'm going to tell you how to do it, using a three step process:

## Step #1: Pulling "Comps"

This first step is on that you're likely going to need some help with. You will need information about other properties that have sold in your area, and that information isn't always readily available. While websites like Zillow.com and Trulia.com are useful, the best and most up-to-date information is generally found on the MLS, which you'll need a licensed real estate agent to access for you. If you already have an agent you're working with to help you find properties, she should be happy to help you get this data; if you don't currently have an agent, this is your incentive to start building those relationships now.

Once you have an agent -- or someone else with access to the MLS -- who is willing to pull some data for you, you want to ask them to provide you a list of comparable properties (generally known as "comps"). Comps are other properties that are very similar to what your property will be after the rehab; the real estate market is relatively efficient, so if you can get a good idea of what similar properties have sold for, you should get a good idea of what your property will sell for. It's a simple concept, even if it's not always simple to do.

Before I go any further, let me explain what I mean by "similar" property. This is actually the biggest point of confusion for many new investors learning this process -- they assume that because both properties have a roof, a front door and a kitchen that they are "similar." For the purpose of determining resale value, nothing could be further from the truth. When looking for comparable properties, here are the top 5 things you want to see:

* **Time of Sale:** Most importantly, you are looking for properties that have sold within the previous 6 months (3 months is even better). Notice I say "SOLD" properties, and not properties that are currently listed for sale. Many investors assume that if there are 10 other properties listed for sale at about $150,000 in the same neighborhood that this must be an accurate representation of what the properties are worth. Wrong! If the properties were actually worth $150,000, they wouldn't all be for sale, would they? Most likely, the properties will sell for less than the asking price, and maybe for a LOT less. In fact, in a down market, many of these properties will not sell at all. Perhaps all the neighbors bought at the height of the market, they all owe $150,000 or more on their properties, and they can't afford to sell for any less; does that mean they'll get $150,000? Or course not. Some of these houses may soon be foreclosed on, and instead of being your comps, they could end up being your competition. So, when looking for comps, remember to ONLY use sold properties and stick to the previous 6 months.

* **Location/Proximity:** You want to find properties that are close to your yours. How close? It depends. If you're in a large city where real estate values can literally double from one street to the next, you're going to want to find other properties on the same street. If you're in a sprawling suburban area with large homogenous neighborhoods (planned developments or communities), then you're going to want to find properties in or around the same subdivision. And if you're in a rural area where there are many acres -- or even miles -- between houses, you'll probably be looking within several miles. In general, for most properties in typical suburban areas or small cities, you'll be looking for properties that are within a half-mile of the subject property.
* **Age and Style:** You want to find properties that are similar in age and style. A 1967 brick ranch is unlikely to sell for the same price as a brand new two-story McMansion with a finished basement (in my area, the ranch would likely sell for more!). The best case scenario when looking for comps is that your property is in a planned community, where most or all of the houses were built by the same builder within a year or two of each other. But, even if you're not this lucky, you should still be able to find other properties that were built in the same time period and of similar style.
* **Size:** When it comes to comps, size very much matters. If your property is more appropriately sized for a single couple than for a family of 6, that's going to affect how much it's worth. And when I say size, I'm not just talking about square footage. I'm also talking about the number of bedrooms and bathrooms, as well as finished basement areas. Best case, you should be looking for comps that have within 10% of the same finished square footage, the same number of bedrooms and the same number of bathrooms. Of course, the more bedrooms and bathrooms your property has, the more room you have for variance. In other words, while the difference between a 2 bedroom/1 bath house and a 3 bedroom/2 bath house is huge, the difference between a 6 bedroom/5 bath house and a 7 bedroom/4 bath house is relatively minor. Though even these small differences will ultimately play into your sales estimate.
* **Condition:** The last very important criteria for assessing a comp is the condition. A fully renovated property in move-in-ready condition will most certainly sell for more than a run-down, ready-to-be-foreclosed on house that hasn't been updated since the 1970s. While you may be hard-pressed to find comparable properties that have been fully remodeled (unless you're looking in an area that has lots of other investors), you at least want to find properties that are in good shape, move-in-ready and have the same level of finishes that yours does. Along with the condition of the property, you also want to ensure that the comparable was not a distressed sale; in other words, if a house sold as a short-sale or a foreclosure -- even if it was in good condition -- it's not a comparable for your property. This last point is very important...don't forget it.

Now, your job is to find at least three other properties that meet all the requirements above. In many areas -- and especially in a down housing market where there aren't many houses selling -- it may be difficult to find three other properties that are good comps for your property.

If you absolutely can't find three properties that meet the criteria, it's okay to expand your search a bit -- we'll account for that in the next step. Start by going back 9 months instead of 6; if necessary, go out a mile from the subject property instead of a half-mile. Perhaps find a house that's a few years older, has a few hundred more square feet or isn't in quite as good of condition.

## Step #2: Adjusting Your Comps

At this point, you should have at least three good comps to use for your analysis. For this next step, there is a little bit of math involved, but it's pretty straightforward, and if you can add, subtract, multiple and divide, you should have all the tools you need.

The purpose of this step is to adjust the value of the comps to ensure that they resemble the subject property as closely as possible. Remember, the goal of a valuation or appraisal is to have an apples-to-apples comparison of your subject property with the comp properties -- if the properties are different, you'll need to adjust their values to make them apples-to-apples.

For example, let's say your subject property and one of the comp properties are nearly identical, except that the subject property has 3 bedrooms and the comp property has 4 bedrooms. Clearly, if this is the only difference, then the comp property is going to be considered *MORE VALUABLE* than the subject property, as it has an extra bedroom. So, if the comp property had recently sold for $150,000, then it's likely that your subject property is worth a little bit less than $150,000. In other words, the 3-bedroom property is worth less than the 4-bedroom property.

In order to do your adjustments, you must compare each of the comp properties -- one at a time -- to the subject property, and perform an adjustment on each of the comps to determine an apples-to-apples value. Note that I said to "adjust the comps" -- what this means is that we need to determine what the comp property likely would have sold for had it been equivalent to the subject property. In the example above, where the comp sold for $150,000, but had an additional bedroom than the subject property, we'd have to adjust the $150,000 sale price *DOWNWARDS* to achieve an apples-to-apples comparison.

In my area, an extra bedroom may be worth about 3% more in sales price, so for this adjustment, we'd subtract about 3% from the comp sale price to get an apples-to-apples comparison. Subtracting 3% from the $150,000 sales price would put the comp value at about $145,500. There are no hard-and-fast rules about how much various property features are worth -- this is going to be highly dependent on the level of house, the area, what is typical for local properties, etc.

It's sometimes confusing to figure out which direction to adjust the comp values, but remember, the goal is always to try to figure out what the comp *WOULD HAVE* sold for had it been equivalent in features to the subject property. Here is a list of features you should consider when doing your adjustments, and also how the differences should be adjusted for:

* **Date of Sale:** If the comparable sale was more than 6 months old, the value may need to be adjusted depending on how the market has changed since the sale. If the market has improved, the comp value may be adjusted upwards; if the market has declined, the comp value should be adjusted downwards.
* **Age:** If the comp is older than the subject property, the comp value may be adjusted upwards; if the comp property is newer than the subject property, the comp value may be adjusted downwards.
* **Condition:**  If the comp is in worse condition than the subject property, the comp value should be adjusted upwards; if the comp is in better condition than the subject property, the comp value should be adjusted downwards.
* **Living Area Square Footage:** If the comp is has less square footage of living area than the subject property, the comp value should be adjusted upwards; if the comp less square footage than the subject property, the comp value should be adjusted downwards. Also note that living area above grade (above ground level) is generally worth more than living area below grade. So, an extra room on the second floor of the house would generally be worth more than a similar sized extra room in the basement. Lastly, note that unfinished area may be worth a little extra, but not nearly as much as finished living area.
* **Bedrooms/Bathrooms:** If the comp fewer bedrooms/bathrooms than the subject property, the comp value should be adjusted upwards; if the comp more bedrooms/bathrooms than the subject property, the comp value should be adjusted downwards. Note that extra bedrooms and bathrooms are not worth as much as extra square footage, but certainly add value. Also note that the fewer bedrooms and bathrooms the subject property has, the more the comp adjustment should be (in other words, going from 2 to 3 bathrooms is going to be much more valuable than going from 5 to 6 bathrooms).
* **Garage/Carport/Driveway:** If the comp has less garage space, carport space or general parking area than the subject property, the comp value should be adjusted upwards; if the comp less garage space, carport space or general parking area than the subject property, the comp value should be adjusted downwards. Again, the value difference is going to depend on the relative differences, not just the absolute difference; for example, going from a carport to a 2-car garage is going to be more valuable than going from a 3-car garage to a 5-car garage.
* **Porches/Patios/Decks:** If the comp has less desirable outdoor spaces than the subject property, the comp value should be adjusted upwards; if the comp has more desirable outdoor spaces than the subject property, the comp value should be adjusted downwards.
* **Fireplaces:**  If the comp has fewer fireplaces than the subject property, the comp value should be adjusted upwards; if the comp has more fireplaces than the subject property, the comp value should be adjusted downwards.

Let's look at an example of an actual property that I recently did a valuation on...

We are trying to determine the value of our subject property that has the following features:

|  |  |
| --- | --- |
| Age | 12 Years |
| Condition | Excellent |
| Square Footage | 1940 SF |
| Beds | 3 |
| Baths | 2.5 |
| Parking | 2 Car Attached Garage |
| Porches/Decks | Front Porch/Back Patio |
| Fireplaces | 1  |

We have found three properties in within 1 mile of the subject property that we believe are good comparables and should give us a decent idea of what our property should resell for. The three comparables have the following features:

|  |  |  |  |
| --- | --- | --- | --- |
|  | Comp 1 | Comp 2 | Comp 3 |
| Age | 12 Years | 12 Years | 5 Years |
| Condition | Excellent | Excellent | Good |
| Square Footage | 1854 SF | 1875 SF | 2650 SF |
| Beds | 3 | 3 | 4 |
| Baths | 2.5 | 2.5 | 3 |
| Parking | 2 Car Attached Garage | 2 Car Attached | 2 Car Attached |
| Porches/Decks | Front Porch/Patio | Front Stoop/Patio | Front Stoop/Patio |
| Fireplaces | 1  | 1 | 1 |

Now it's time to do our adjustments of the comps to give an apples-to-apples comparison of each of them to the subject property (remember, this was the actual analysis I recently did for one of my properties, and the values below are the values I assigned based on my experience):

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Subject Property | Comp 1 | Comp 2 | Comp 3 |
| Age | 12 Years | SAME | SAME | **- $3000** |
| Condition | Excellent | SAME | SAME | **+ $5000** |
| Square Footage | 1854 SF | **+ $1000** | **+ $1000** | **- $8000** |
| Beds | 3 | SAME | SAME | **- $1500** |
| Baths | 2.5 | SAME | SAME | **- $1500** |
| Parking | 2 Car Attached Garage | SAME | SAME | SAME |
| Porches/Decks | Porch/Patio | SAME | **+ $1000** | **+ $1000** |
| Fireplaces | 1  | SAME | SAME | SAME |
| **TOTAL ADJUSTMENTS:** | **+ $1000** | **+ $2000** | **- $8000** |

What this chart is telling us is that our Comp #1 is very close to our subject property in terms of features, and if we added $1000 to the price it sold for, that should give us a good idea of the value of our subject property. Likewise, with Comp #2, if we added $2000 to its sales price, we'd get a good idea of the value of our subject property. And lastly, with Comp #3, if we subtracted $8000 from its sales price, we should get a good idea of the subject property value.

## Step #3: Determining The Value of the Subject Property

Now that we have our comps, and we've adjusted them against our subject property, it's time to use this information to determine a reasonable valuation for our subject property. Remember, we determined above that if we take the actual sales prices of the comparables and adjusted them using our adjustment values, we should get a good idea of the valuation of our subject property.

Here are the actual sales prices of the comparables, along with the adjustments and the final adjusted value:

|  |  |  |  |
| --- | --- | --- | --- |
|  | Comp 1 | Comp 2 | Comp 3 |
| SALE PRICE | $105,000 | $105,000 | $120,000 |
| ADJUSTMENTS | + $1000 | + $2000 | - $8000 |
| **ADJUSTED VALUE:** | **$106,000** | **$107,000** | **$112,000** |

So, based on this analysis, it's likely that our subject property is worth somewhere between $106,000 and $112,000. From here, depending on how conservative you want to be, I would suggest that you either assume your subject property is worth the lower of the three values ($106,000 in this case) or the average of the values (about $108,500 in this case).

Like I said, this was an exercise I did recently on an actual property with these characteristics and the actual comps I used for my analysis. In the end, the property sold for $110,000, and when the buyer's appraiser did his appraisal, he used the same three comps I did as his main comps.

Below is a copy of the adjustments page from the actual appraisal (with personal information blacked out). As you can see, the appraiser uses several additional property features to do his adjustments (and is a lot more scientific about how he determines the adjustment values), but in the end, the appraiser came up with values that weren't too different than the quick and dirty analysis I provided above.

