

Corky Hyatt Seminars Missouri Real Estate Practice Course by Home Study

Textbook: Pricing Residential & Non-Residential Properties

The goal of this chapter is to provide tools and techniques that will assist you in positioning seller's properties to sell for the highest possible amount in the shortest possible time given the current market conditions! You will find an avalanche of information in your multiple listing or information service, but information does not translate immediately into knowledge of the market nor does it necessarily assist you in proper pricing. Sometimes the data simply confuses you, the owner, the selling agents, and the prospective buyers!



A top agent in Salt Lake City, Utah “coined” the following statement:

“80% of the marketing of your home, Mr. & Mrs. Seller, happens right here when we select the price!”

Her point is that no matter how enthusiastic you are about a listing, no matter how many dollars you spend on promoting that listing, it will not sell unless and until it is **properly priced for its current market conditions, location, and “staging!” or property condition!**

Each of the parties listed below provides a part of the **“pricing puzzle.”**

- The real estate agent or licensee provides the seller with comparable² pricing data so that the seller can make a sound decision pricing or price “positioning” decision.

Corky Hyatt		RESIDENTIAL		5/8/2007 11:08 P.M.
SUBJECT PROPERTY				
Address		1380184	1391599	Addresses have been removed to protect the privacy of the home sellers and buyers!
MLS #		A	A	
Status		345	345	
Area	101	Single	Single	
Type	Single	Mission Trails	Stilwell	
Subdivision		Ranch	Ranch	
Floor Plan	1.5 Sty			
Total Sq. Ft.				
Age Description	UC	21-30 yr	51-75 yr	
Bedrooms	1	4	2	
Total Baths	1.0	2	2	
Fireplace?	N	Y	N	
Basement	Block	Full, Ins Ent	Walkout, Concrete	
Garage #	1	2	3	
Garage Description	Attach	Attach, Front	Detach	
Utility Room	Basemnt		Hall	
Construction		Stone Fr	Frame	
Dining Description	Bkfs Rm	Formal	Eat In, Liv/Din	
Heating		Cent Ele	Cent Gas, F Air Gas	
Cooling	Attic Fan	Cent Ele	Cent Ele	
Water		Public	Public	
Sewer		Septic	Septic	
Interior Feature		Pantry, Pnt Carpet	KR Isle, Pnt Carpet	
Great Rm Sz/Level				
Kitchen Sz/Level				
Dining Rm Sz/Level		14x8/1		
Living Rm Sz/Level				
Family Rm Sz/Level				
Hearth Rm Sz/Level				
Master BR Sz/Level		20x13/1		
Exterior Feature		Deck, Stor Shed	Barn, Fixer Up	
Lot Description		Acreage, Treed	Acreage, Treed	
Assoc Dues \$	\$	\$0*	\$0*	
Contract Date				
Sale Date				
Sale Terms				
Days on Market				
CDOM		77	30	
Original List \$		\$249,950	\$280,000	
List \$	\$229,876	\$249,950	\$280,000	
Sale \$				
Sale \$/List \$				
Sale \$/Orig List \$				

- The seller sets the asking price or listing price, understanding that in most “normal” markets there may be some difference between the listing or asking price and the contract or sale price. In a very fast or “seller’s” market there may be no difference or the sale price may be higher than the list price. In a slow or buyer’s market, there may be a substantial difference!
- One buyer determines “value” of the subject property by making an offer to purchase it at a specific price. Because value, like beauty, in “in the eye of the beholder” value is in the “eye of the” Buyer!
- The Appraiser “checks” the value determined by one specific buyer against “market value” which is determined by all the buyers who purchase like properties in a six month time frame.

The CMA (Competitive or Comparative Market Analysis):

Known both as a comparative market analysis and a competitive market analysis, this LICENSEE-prepared document provides the seller with information about other properties by which he or she can compare their own property and arrive at a “pricing position.”

“Comps” used include active listings, expired listings, pending contract properties, and solds or closed sales.

¹ “Staging” is a term coined by national listing and pricing trainer Barb Schwarz which means preparing the property to attract buyers, both inside and exterior staging. For more information on “staging” go to www.barbschwarz.com.

² The term “comparable” or “competitive” means the other properties with which you will compare your subject property (the seller’s property which you are attempting to list for sale) to arrive at the most likely selling price or “market value.” As explained more fully in the CMA (Comparative Market Analysis) section, the comparables generally consist of actively listed, expired, pending sale, and sold properties in a proximate geographic area to the subject property, of the same floor plan, and sold in the past six months or less.

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Many sellers believe that they must “make a profit” when they sell their home. However, there is no relationship between what a seller paid for her home and what it is worth in the current market. Like stock, real estate values go up and down in reaction to a wide array of conditions including the political climate including elections and military actions; interest rates and the economy; social changes and crime, as well as environmental crises whether they be contaminated soil such as Times Beach, MO, or storms such as the havoc caused by Hurricane Katrina in 2005.

Nationally recognized real estate trainer David Knox³ offers an excellent dialog in response to seller’s comments such as “I paid more than that for my property” or “It was worth more than that last year.” **He suggests that you ask the seller if they’d received their home through an inheritance and paid nothing for it, what would they ask for it when it came time to sell.** The answer, of course, is that they would still want to sell it for market value! His very valid point is that no matter what a seller paid for a property, what it was worth last year, or what they think it’s worth today, it will still sell [barring unusual circumstances] for market value!



While value, like beauty, is in the “eye” of one beholder, one buyer; market value is that value determined by a group of buyers! To qualify as “market value,” the purchase must not be made under duress or pressure as in a sale motivated by death, divorce, or foreclosure. These catastrophic situations for a seller can result in prices significantly lower than market value due to the need to sell quickly, even if at a lower price.

Supply and demand determine real estate values just like they determine values in other areas of commerce. “Beanie Babies” by TY, Inc. demonstrate the power of supply and demand. When a Beanie is commonly available it sells for \$5 to \$6 dollars. During the height of “Beanie Baby” frenzy in the late 1990’s, their values shot up. In fact, due to the lack of availability, some Beanies sold for \$3,500 or more! When the manufacturer decided to end the line, did so, and then brought them out again, he ruined the market and their values fell to below the original purchase prices of these stuffed toys. In fact, like many collectibles, thousands of collectors were left with quantities of virtually worthless toys. Supply and demand works the same way in real estate property sales. When a type of property such as a particular floor plan home or a specifically located office condominium becomes rare or highly desirable, the price or lease rate goes up. When these same properties are readily available, the price goes down.

In real estate, the amount of supply versus the amount of demand is called a Seller’s Market or a Buyer’s Market. In a **seller’s market**, the defining characteristics include the following:

1. More buyers wanting to purchase than sellers wanting to sell, therefore seller’s negotiating positions are strengthened at the expense of the purchasers.
2. Few, if any, seller concessions such as paying buyers’ loan costs or redecorating.
3. Rising prices, often above list price or asking price.
4. Shorter days on market (DOM).
5. Multiple offers. In fact, buyers must make faster decisions to get the house they choose before another buyer does!
6. Appraisal challenges because prices may rise sharply above the comparative sales for the preceding months.

When there are more sellers than there are purchasers, the opposite occurs and we call it a **buyers’ market**. The characteristics of a buyer’s market include the following:

1. Buyers have the upper hand because there are most properties available then there are buyers ready, willing, and able to purchase them.
2. DOM or days on market lengthen.
3. Sellers make concessions to entice buyers such as paying their closing costs or re-carpeting.
4. Generally sale prices flatten or fall as a result of this buyer market.

³ For additional information about David’s live and dvd training, his consumer videos and dvd’s, and other resources, go to www.davidknox.com.

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A Comparative Market Analysis or CMA is a document which you the potential marketing or listing agent prepares to educate a seller about the best pricing position, specifically the asking price which will produce the fastest sale at the highest possible sale price with the fewest challenges in the CURRENT MARKET! To prepare an accurate CMA, you will use the same process that an appraiser uses to establish market value. You will compare the subject property to others that are actively listed for sale, are currently under contract pending closing, have expired or gone off the market unsold, or have sold. To qualify for inclusion in your CMA, these four types of properties must also meet the following additional criteria:

- Comparable properties must be located in the same geographic area,
- Must have been built in the same or similar style or floor plan with comparable amenities, and
- The Sold comparables must have closed in the last six months.

Both consumers and some, especially newer, real estate agents confuse and misuse the term “appraisal.” In fact, you may hear it utilized to describe a CMA. However, appraisals and CMA’s are significantly different and the terms must not be used interchangeably!



The **three approaches to value** used by an appraiser include:

- The comparable (market value) approach,
- The cost (replacement minus depreciation) approach,
- The income (rental income) approach.

Licensees use only the comparable or market value approach to setting the best list price for their seller.

Many factors regularly affect value. Some of the key factors include:

Physical influences: the condition of the property or the land underlying the property, such as soil, rock, shifting and settling.

Environmental influences include soil contamination in the lot as well as lead, water, radon, etc.

Economic influences include changes in interest rates as well as commercial changes such as plant closings or new military bases. Existing financing can also affect pricing. For example, in a high or higher interest rate market, a seller with a lower interest, non-escalating mortgage that is assumable by the buyer may receive a higher price or benefit from a faster sale than sellers with no such assumable loan!

Government influences include legal changes, school district changes, or tax increases.

An example of a **Social influence** would be an increase in major crime in an area.

Remember that by social influences, we do not reference the “protected classes” which must not be discussed during the pricing or any other phase of the listing and selling processes!

To prepare an accurate CMA, research the listing and sale statistics for the property area during the past year. It is helpful to compile statistics and keep track of the inventory of homes for sale versus the number of homes that sell each month and each year. For example, if five homes are listed each month and only one home sells each month, the market has a five-month inventory. Therefore the seller must position his house competitively to sell with so much competition and you experience more of a buyer’s market. Whereas, when five homes sell each month and five are listed, the market has only a one-month’s inventory and sale odds increase to “Seller’s Market” conditions!

In addition to multiple listing service data and statistics, there are a number of rich sources of information which is helpful when pricing properties. Your local chamber of commerce or a local research firm may publish significant trends in your local economy and real estate market. Your local home builders association may also offer statistics regarding housing starts and completions per month, quarter, and year as well as the absorption rate (home may new homes are sold per month as compared to the number of new homes being built per month). The National Association of REALTORS® provides regular research reports for listing and sale data by region of the county. Even national

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publications such as the Wall Street Journal and USA Today print housing statistics such as number of units sold, average sale price, average days on market for regions of the country. You local newspapers and news services as well as business journals print economic market information regarding business openings, closing, employment rates, interest rates, and economic trends. To better prepare a seller for the type of market in which their home will be sold, keep up with the conditions which affect value from all sources available in your area as well as nationally and internationally.

When researching properties through your MLS to prepare a CMA, you must consider each of the four necessary statuses: active, pending, expired, and sold. ACTIVE listings are those currently on the market for sale. They are your seller's competition. EXPIRED listings are those which have been rejected by qualified buyers. Their listings expired without accomplishing a sale. PENDING sales are properties that are under contract but not closed. Therefore the prices listed in the MLS are list prices not sale prices. SOLD listings are properties that have been active, then "pendings" (properties that are under contract and "pending" closing) and have now have closed. "Sold" prices are the actual sale prices not the listed prices, and sold properties are your best data. They represent the price and terms which qualified buyers were willing to pay for properties like your subject property within the last six months!

In addition to the four property statuses which must be represented in a complete CMA, the number of properties in each status must be enough to accurately represent the market in the subject property's area. The acceptable number ranges from at least three properties for each of the statuses to as many as five to seven in each category. For sold-



status properties, you will need to research the information that assists you in preparing accurate comparable pricing statistics for your seller. You will need the following information:

- The date of the sale,
- The original list price as well as the listing price at the time of sale,
- The number of days on the market, and
- Any seller concessions which "adjust" the sale price

The list price to sale price ratio averaged for all comparable sales indicates what percentage of list price your seller may expect to attain. The days on market (DOM) predicts your seller's DOM as long as the market has not changed. The terms of sale and financing predict the likely terms of sale and financing for your seller as well as what sale concessions your seller is

like to have to make in order to sell in the current market. To make sure that the comparable properties you select really are comparable to your subject property, make sure that they are the same in as many of these characteristics as possible! The most important characteristics to compare are style or floor plan, size (square footage) or number of bedrooms, baths, etc.; and age/condition.

After you've researched the data, complete your CMA form by including the following information about each property:

- **Address;**
- **Bedrooms (#);**
- **Baths (#);**
- **Style/floorplan (ranch, split level, two story, story and a half, or bilevel);**
- **Age (years);**
- **Garages (#);**
- **Basement (yes or no);**
- **Financing (assumption only);**
- **List price;**
- **Sale price (if applicable);**
- **List date;**
- **Sale date (if applicable);**
- **Expiration date (if applicable); and**
- **DOM or days on market!**

No readily available comparable properties, i.e. none in MLS? Research other sources, such as the following:

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- Ask experienced associates in your office, your company.
- Call area appraisers. Appraisers call us for information, so don't worry about returning the "favor!"

Adjustments to Your Comparables? As a new associate, you will not be adjusting your comparables for differences between them and your subject property, to property which you are pricing. Appraisers adjust comparables when they can't find three of the same floor plan, size, age, and other related characteristics as the subject property. As a new agent, you do not have the experience or expertise to adjust, so don't! When you are more experienced, you will begin to adjust comparables. The best source for the value of adjustments is your local appraiser. Appraisers are trained in adjusting for an extra half bath or more square footage. When you do begin to adjust, you may wish to call an appraiser to learn the value of an extra half bath in the subject property's market area.



Presenting Pricing Information & Strategies to the Seller:

There are two strategies for presenting pricing to the seller: the pricing first strategy and the pricing last strategy! Most experienced agents use the pricing first strategy. They understand that if the seller won't price the property properly, they probably aren't interested in taking that seller's listing. However, as a new associate you will generally prefer the pricing last strategy. By presenting marketing first, you win the seller's favor and then present pricing once they've decided to list with you! As nationally recognized trained David Knox points out, presenting pricing when they're in a positive mind set, i.e. following your marketing presentation, makes for a happier seller and one more likely to price correctly!

One of the best ways to secure proper pricing is to elicit the best price from the seller rather than impose it on him!

Using the **"10" approach**, you and the seller together set a 1 to 10 valuation, 10 being highest, for each characteristic of the property. Once you evaluated all the key points, i.e. location, condition, signage, lock box, day sleeper, etc., you can determine an overall value for the property.

For example, if the location is a 9, the condition a 10, but the seller won't allow a lock box that is a 2, then the overall rating might be a 7. Once the overall rating is decided, place the property in the pricing as follows: Look at the list of comparables by sale price from the lowest to the highest. Place a "10" at the high end and a "0" at the low end. Now place the property where it falls, i.e. at the "7" position. If the high or "10" is \$137,900 and the low or "0" is \$128,600, then the "7" would be about $\frac{3}{4}$ of the way up the scale or perhaps \$134,900! By using this technique, the seller feels empowered to price the property himself and feels that you and he are a pricing team not pricing adversaries!

Pricing the property correctly not only procures qualified buyers but it also insures that the property, once sold, will appraise! Because 94% of all home sales in the U.S. are financed rather than being cash sales, the appraisal is a key element of a successful closing. To secure an appraisal at or above the sale price, prepare an Appraisal Packet for the appraiser, including the information listed on this slide.

Present the packet to the appraiser when he or she comes to appraise the property. They will appreciate having your data, whether or not they use the comparables you've selected. At the very least, the **Appraisal packet** prevents the appraiser missing a critical comparable and therefore appraising the property below sale price! **Remember that the appraiser works for the lender not the buyer, even though the buyer pays for the appraisal!** Appraisers know that lenders are depending upon them to establish market value because the loan amount is a percentage of the sale price or the market value, whichever is LOWER! Therefore, by providing accurate data for the appraiser in the Appraisal Packet, you are protecting the interest of the buyer and the seller.

What's included in the Appraisal Packet?

1. A cover letter or Executive Summary.
2. The MLS data sheet for the subject property.

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3. The flyer for the subject property (include this because it generally includes more descriptive information than the MLS data sheet includes).
4. A MLS comparative market analysis with at least three solds that match the subject property (see the three requirements for an appraisal listed below).

Even though buyers pay for the mortgage appraisal, the appraiser works for the lender! The lender hires the appraiser to determine the value of the property to assure them that they are not loaning too much. Therefore, when a purchaser takes an 80% mortgage, they are borrowing 80% of the sale price or the appraisal, **whichever is lower!**

Pricing Scripts & Dialogs:

The following scripts are simply a selection of pricing objections which a seller might raise and suggested responses to each objection.

- ☒ Seller: "I paid \$175,000 for the house and have put more than \$25,000 in it in improvements while I've lived here!" (Remember that many sellers can't differentiate between "improvements" which add value to the property and "maintenance" which simply keeps it at market value by replacing items that wear out!). Agent: "Cost and value are two different items. If you had received the house as an inheritance with not cost, would you expect to receive nothing for it or market value?"
- ☒ Seller: "But we spent over \$3,000 on the drapes!" Agent: "The appraiser won't give you any value for the drapes because the purchaser will probably replace them anyway and they generally won't fit in your next home."
- ☒ Seller: "We're moving to a higher priced area so we need more for this property to enable us to buy there." Agent: "Would you pay more for a property to buy it because the seller needed more money to buy his next home or would you expect to pay market value?"

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Real Estate

APPRAISER'S
INFORMATION PACKET

Memo to: _____

From: _____

Date: _____

Reference: _____

We hope that the enclosed information will be of assistance to you in preparing the appraisal for the property referenced above.

Please find the following information enclosed:

- A copy of the Heartland MLS data sheet for the subject property
- A copy of the flyer we prepared giving additional information
- A CMA printout from the HMLS
- Copies of the data sheets for possible comparable sales

If you have any questions or if we can be of further assistance, please call. My card is attached for your convenience.

 Corky Hyatt, CRB, CRS, GRI
Hyatt Real Estate
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To learn objection-handling techniques, compile a list of seller pricing objections and then solicit good responses from experienced agents in your company and other firms in your area. Once you've secured good responses that make sense to you, learn them verbatim! We call these "scripts" and they are tools for properly priced listings! Another source of good pricing scripts is a DVD or video produced by David Knox which you will find at his website, www.davidknox.com.

HOW DO I PRICE INVESTMENT PROPERTIES?

Let's begin with Income-producing properties that are residential in nature, i.e. multi-family units, whether they are duplexes, tri-plexes, four-plexes, or small apartment complexes. Remember that value in investment property is determined principally by income! Let's consider such a property and see how to estimate its value.

Begin with the monthly rental income. If there is no current monthly income, you can estimate the monthly income for the subject property based on rent for comparable properties. To determine the value of the property from it's income, we use the GRM (Gross Rent Multiplier)

The gross rent multiplier is the ratio of the sales prices of comparable rentals to the monthly rent.

The three steps of the gross rent multiplier are:

1. Estimate monthly market rent
2. Determine the gross rent multiplier
3. Calculate the value

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Estimate the market rent, or the rental income a property would most likely command in a competitive market. Note: It is important to be able to distinguish between market rent and contract rent. Contract rent is the actual rental income specified in a lease. Market rent, like market value, is determined by comparing the property to other similar rental properties and then compare their rental income. Be sure to compare “apples to apples,” i.e. three-bedroom, one-bath split level duplex to a three-bedroom, one-bath split level duplex!



To calculate the GRM (gross rent multiplier), start with the sales prices and monthly rents of as large a sample as possible of comparable residences that have recently soled. Preferably, secure at least five comparable rents. Too few will skew the results and give a GRM that isn't dependable for the market area. For each comparable, divide the sales price by the monthly rent.

Example:

For a property that sells for \$65,000 and has a monthly rent of \$600, the GRM is 108.3, or

Property Price $\frac{\$65,000}{\$600}$
Monthly Price = 108.3 GRM

The gross rent multiplier approach assumes that there is a reasonably consistent ratio between price for which a residence sells and the price for which it will rent. The GRM is determined by combining data from as large a sample of comparable properties as possible into a single number. Appraisers may use the statistical measures of range, mean, median, and mode to select a single GRM to use.

To calculate the value of a property, multiply the estimated market rent for the subject property by the gross rent multiplier.

Example:

Consider a subject property for which the estimated rent is \$1,200 and the gross multiplier is 111.

The estimated value is:

Estimated Rent	\$1,200
GRM	<u>111</u>
Property Value	\$133,200

The cost approach involves estimating the value of the site and improvements independently, then combining them to obtain an estimate of property value.

The cost approach formula is:

Reproduction or Replacement Cost New
- Accrued Depreciation
+ <u>Site Value</u>
= Estimated Property Value

Step One: Reproduction cost is the cost to produce an exact duplicate of the building, down to the last brick, at current prices, using the same materials, standards, design, layout, and quality as the original building. **Step One: Replacement cost** is the cost of building a structure with the basic function and structure as the current building, but built with modern materials, according to current standards, design and layout.

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Step Two: Accrued depreciation is the difference between the current value and the new cost of the improvements. It includes all forms of depreciation and is also known as diminished utility. Appraisers are trained to figure accrued depreciation, but most real estate licensees are not.

Step Three -- Add Site Value: To estimate site values (the value of the site or the vacant land), research the comparable or market value of the land as if it has no structure on it. Remember that vacant means ready for building and able to be developed to its highest and best use.

use.

This is most commonly done using the sales comparison approach to answer the question, "For what price have similar sites recently sold?"

The **income approach** leads to an estimate of the current value of the property based on the future benefits of owning the property. The income approach is actually comprised of an entire family of techniques.

The **two main techniques** are:

- ***Gross rent multiplier (residential)***
- ***Direct capitalization (commercial)***

The gross rent multiplier, or GRM technique, is used for the valuation of simple rental properties, such as single-family residences, duplexes, and apartments of up to four units.

For review, the GRM formula is:

$$\frac{\text{Estimated monthly income}}{\text{X gross rent multiplier}} = \text{Value}$$

The **direct capitalization technique** is used for valuing commercial real estate and for residential properties with a large number of units. It involves calculating net operating income, then dividing the net operating income by a capitalization rate to estimate the property value. Direct capitalization is not typically used for single-family residential and smaller multi-family properties primarily because the typical buyers and investors are not knowledgeable of or interested in the level of detail involved in this approach. For more information about direct capitalization, take a commercial real estate valuation or appraisal course.

How Does an Appraiser Determine Value?

For each assignment, USPAP (the appraiser's code of ethics and practice) requires an appraiser to use all three approaches to value. If the appraiser fails to use any of them, she or he must justify the basis for the omission in her report.

Let's go to the experts to better define USPAP. Here is the description of USPAP quoted from

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“What is USPAP?”

The *Uniform Standards of Professional Appraisal Practice* (USPAP) are the generally accepted standards for professional appraisal practice in North America. USPAP contains standards for all types of appraisal services. Standards are included for real estate, personal property, business and mass appraisal.

- USPAP was originally written in 1986-1987 by an appraisal profession Ad Hoc Committee on Uniform Standards and was donated to The Appraisal Foundation in 1987.
- The Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) of 1989 cites USPAP as the standards to be enforced by state real estate appraiser licensing agencies.
- USPAP compliance is also required by professional appraisal associations, client groups and by dozens of federal, state and local agencies.
- USPAP is released on an annual basis. Regulators base enforcement decisions on the edition of USPAP in effect as of the date of an appraisal report.
- USPAP is growing in acceptance throughout the world. Many professional associations in Central and South America, Europe and Asia have accepted and adopted USPAP as the standard of practice for their membership.”⁴

Once an appraiser reaches an estimate of value for each of the three approaches, she reconciles them. In most cases, values resulting from the three methods vary. The basis of her decision is the strength of the data collected. The appraiser never averages the three values to arrive at a final estimate of value. Instead, she reports one of the values as the final estimate, and indicates whether the other two estimates support the final estimate.

⁴ This description of USPAP is copied from The Appraisal Foundation’s website. You can check it out further by clicking on this link:
http://www.appraisalfoundation.org/s_appraisal/doc.asp?SID=1&DID=155&CID=60&VID=2&RTID=0&CIDQS=&Taxonomy=False&specialSearch=False#q2