



CALIFORNIA SALESPERSON EXAM / FOCUSED REFERENCE

Appraisal approaches and income analysis

Review key distinctions and a worked scenario, then use the checklist to identify what needs another practice attempt.

Original exam-preparation material. DRE controls the examination. Review the linked full lesson for context; these sheets do not guarantee a passing result.

Cost / Price

Cost is the amount required to create or obtain something. Price is the amount asked, offered or paid. Neither is automatically market value.

Market value / Investment value

Market value uses typical market participants and stated open-market assumptions. Investment value belongs to a particular investor and that investor's objectives.

Value in use / Market value

Value in use reflects a particular use or user. Market value reflects the most probable price in the defined market under the stated assumptions.

Chronological age / Effective age

Chronological age is elapsed time. Effective age reflects condition and utility and is the age used in the simplified age-life depreciation formula.

Reproduction cost / Replacement cost

Reproduction creates a duplicate. Replacement provides equivalent utility with current design and materials. Land is separate in both cases.

Functional obsolescence / External obsolescence

Functional obsolescence comes from the property's design or utility. External obsolescence comes from an influence outside the property.



Subject / Comparable

In the sales comparison approach, adjust the comparable to make it reflect the subject. Do not adjust the subject.

Capitalization rate / Cash-on-cash return

Cap rate divides NOI by value and ignores financing. Cash-on-cash divides cash flow after debt service by the cash invested.

GRM / Capitalization rate

GRM uses a matching gross rent figure. Capitalization rate uses NOI after vacancy and operating expenses.

Reconciliation / Averaging

Reconciliation weighs the relevance and reliability of the indications. A simple arithmetic average does not do that.

Appraisal / CMA or BPO

An appraisal is an opinion developed within appraisal law and standards. A real estate licensee may give a pricing opinion in ordinary licensed business, but California law says it must not be referred to as an appraisal.

Work through the facts

A six-unit building has market rent of \$2,400 per unit per month. Vacancy and collection loss are estimated at 4%. Laundry income is \$3,600 a year. Stated operating expenses are \$52,000 a year. Annual debt service is \$84,000. Comparable sales support a 5.75% cap rate. The price is \$1,900,000 and the buyer would invest \$500,000 in cash.

- Build the income: Potential gross rent is 6 times \$2,400 times 12, or \$172,800. Vacancy and collection loss at 4% is \$6,912. Add \$3,600 of laundry income after the vacancy deduction to reach effective gross income of \$169,488.
- Find NOI and value: Effective gross income of \$169,488 minus \$52,000 of stated operating expenses gives NOI of \$117,488. Divide by the 5.75% market cap rate to get an indicated value of about \$2,043,270.
- Measure coverage and the buyer's cash return: Debt service coverage is \$117,488 divided by \$84,000, or about 1.40. Before-tax cash flow is \$33,488. Dividing that cash flow by the buyer's \$500,000 investment gives a cash-on-cash return of about 6.70%.



- Read the price: At the \$1,900,000 price, the going-in cap rate is about 6.18%. That is higher than the 5.75% rate derived from the stated comparables, so the price is below the value indicated by direct capitalization. The conclusion still depends on whether the income, expenses and comparable cap rate are credible.

Check the distinction

The common traps are skipping vacancy, forgetting other income, subtracting debt service before calculating NOI, and treating the cap rate as the buyer's cash-on-cash return. Keep the property calculation separate from the financing calculation.

Recall without notes

- Value: distinguish cost, price, market value, investment value, value in use, assessed value, insurable value and liquidation value; explain DUST, highest and best use, effective date and the major valuation principles.
- Methods of Estimating Value: choose among sales comparison, cost and income; adjust the comparable in the right direction; classify depreciation; apply the age-life and cost formulas; explain reconciliation and the appraisal versus CMA boundary.
- Financial Analysis: build EGI and NOI in the correct order; separate operating expenses from financing and capital items; solve IRV, GRM or GIM, expense ratio, debt coverage, cash-on-cash and percentage-change questions without mixing gross, net, monthly or annual figures.

Continue with the full lesson or practice

Read the complete lesson

Scan to keep studying, or open the address below.

<https://www.passcaliforniarealestate.com/content-areas/valuation>



Controlling sources and further reading

Bureau of Real Estate Appraisers, licensing

<https://www2.brea.ca.gov/>

DRE, Reference Book, investment analysis

<https://www.dre.ca.gov/files/pdf/refbook/ref15.pdf>

The Appraisal Foundation, USPAP

<https://appraisalfoundation.org/pages/uspap>



Business and Professions Code 11302, appraisal defined

https://leginfo.legislature.ca.gov/faces/codes_displaySection.xhtml?lawCode=BPC§ionNum=11302

AB 948, appraisal bias and the fair appraisal notice

https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=202120220AB948

IRC Section 1031, like-kind exchanges

<https://www.irs.gov/businesses/small-businesses-self-employed/like-kind-exchanges-real-estate-tax-tips>

IRC Section 121, sale of your home

<https://www.irs.gov/taxtopics/tc701>

IRS Publication 527, residential rental property

<https://www.irs.gov/publications/p527>

IRS Publication 946, depreciation

<https://www.irs.gov/publications/p946>

IRS Publication 544, exchanges and dispositions

<https://www.irs.gov/publications/p544>

IRS Publication 537, installment sales

<https://www.irs.gov/publications/p537>

BOE, Proposition 13 assessment system

<https://www.boe.ca.gov/proptaxes/pdf/pub29.pdf>