VOLUME 24 • ISSUE 3 • March 2016
www.appraisaltoday.com

APPRAISAL TODAY

Adjustment, Part 2 - what are the best adjustment methods for your market?

The Primary Rules of Adjustments

1. No adjustment support method will work for all adjustments.
2. Do not make adjustments for every line item on the sales comparison grid.
3. You are determining an adjustment, not a value. There are no restrictions on date of sale, similarity to subject, etc. For example, I went back 10 years on two appraisals. That was the most recent information for an adjustment. I explained it in my appraisal. Underwriters, reviewers and my state board would have understood it. More important, my clients who were the buyers and/or sellers, could understand it as the appraisal was for a possible sale.

You need to be able to use more than one method. In this article I provide information on some of what is available. In speaking with appraisers, most had one or a few methods that they use. That is okay, but what about when they don't work? In this article I give you some ideas for other methods.

Savvy appraisers are now making few adjustments below GLA on the grid, unless they are a significant factor. Do buyers really say "I will pay $1,500 more for a fireplace in this $250,000 house? No. $1,500 is only .06 percent of value. There is rarely an appraiser who is that accurate in valuation.

How many adjustment methods are there?

There are over 25 methods, per Richard Hagar. I don't have a list of them, but one way to look at them is by the three basic approaches to value, plus statistical.

CU and adjustments

CU uses a multiple regression software for adjustments. As you will see in this article, there are many other methods which CU cannot use.

That is why appraisers cannot be replaced for all appraisals. Maybe the easy tract homes will not need to be appraised. How many appraisals do you do on easy tract homes? I do very few as there are very few tract homes in my area. Even in "easy" tract home neighborhoods, there are always oddball properties that require an appraiser to determine an accurate value.

My primary sources for adjustment information in this article

Unfortunately, residential adjustments are covered in very few classes, except how to use Excel for adjustment classes. Only matched paired sales and a few cost methods were covered in my appraisal classes in the 1970s and 1980s.

My primary sources for this article were:

1. Richard Hagar's adjustment webinars - good explanations of 13 methods in the first 2-part webinar, How to Support and Prove Your Appraisal Adjustments. In the second 2-part webinar, Solving Appraisal Adjustments: Solving Common Problems, has detailed hands-on using Excel for adjustments in Part 1 and detailed examples in the second 2-part webinar.

IN THIS ISSUE

2. Mark Ratterman's book Valuation by Comparison - 30+ pages on adjustments with mathematical illustrations. He discusses the plusses and minuses for each possible methodology. Also includes other topics, such as comp selection, which are very useful.

3. Henry Harrison's book Appraising the Tough Ones does not go into mathematical detail on the methods, but has the best explanations of how to approach appraising homes that are unusual for that market. It will give you many ideas on how to approach appraising them. It is well written and very practical, even including a section on dealing with underwriters and client communication. He also has information on many other topics. For example, an appraiser asked me about how to do partial interest on a home for an estate. I told him to read what Harrison says. He completed the assignment. He got a hefty fee as other appraisers refused to bid on it. Harrison actually has a chapter on life estates. I see questions about these types of appraisals posted online regularly with sometimes incorrect responses. Every appraiser should have a copy of this book.

The three sources are very different. All three use examples to show what adjustment works best. Harrison focuses on the "big picture" of how to approach valuation, but does not show complex mathematical computations. He gives you ideas on how to approach complex residential properties, including adjustments.

Ratterman uses grids and mathematical computations plus explanations. He has many examples using sales grids with 3 comps.

Hagar's webinars use single (single line) regression, tables and graphs, but is in a webinar format with less text than Ratterman. He uses many more statistical methods.

I liked all of them myself. I have used Harrison's book for many years as a source of ideas. I preferred Hagar as I learn best by using all methods of communication - seeing, reading(slides) and hearing. Ratterman has lots of detail if there is a method I want more information on. Harrison has the "big picture", focusing on value.

What about appraisal textbooks?

The Appraisal of Real Estate, 14th Edition, Appraisal Institute (2013), with 847 pages, has 50 pages on depreciation, but very little on adjustments. There are a few pages on single trend lines and cost. Most of the adjustment methods use commercial property examples.

Appraising Residential Properties, 4th Edition, Appraisal Institute (2008), with 500 pages has short sections on cost, buyer preferences, rent, paired sales and qualitative analysis. There are 10 pages on regression.

Now I know why adjustment methods were not covered in my appraisal classes back in the 1970s and 80s, except paired sales and cost. There is not much in the textbooks now. When I ask “old timers” what they use, most say cost or paired sales.

I know now that there are many methods not covered in any classes or seminars, except for regression.

Before CU, it was one of those “dirty little secrets” of form appraising - little or no support for adjustments in residential lender appraisals.

Which book is best for you?

If you want to learn about many different adjustment methods and prefer to learn in a webinar format, Hagar would work for you. Also, his webinars are available for download within a day so you can see it over and over. The first part of his second adjustment webinar spends time on hands-on Excel so you can learn to do scatter graphs and simple regression (two variables).

If you like to read rather than listen, Ratterman's is good. His book is like a textbook. The analysis of the pluses and minuses of adjustment methods is more comprehensive than Hagar's webinars. He uses gridded sales and tables of sales frequently. Most of the book is about many other good topics, such as buyer motivation, comp selection, etc.

If you're not sure, just buy both books and the webinars.

How I got started doing fewer adjustments

I don't do lender work, so don't have anyone asking me why I don't make many adjustments. But, I worry about our state regulator who wants to see adjustment support.

I always make market conditions adjustments when needed. That is the easiest adjustment to make with lots of data, both online and using scatter graphs on MLS data. Seller concessions are unusual in my very strong market, so I do not use any adjustments. In a slow market, with large concessions, I would adjust for them. Here's how I got started:

- For the first 6 months I did the "old way" by putting in all the dollar adjustments I used to make.
- Next I changed them to qualitative adjustments using plus and minus signs, with a net total of the plus and minus signs for each comp. I kept a printed copy of the original appraisal with dollar adjustments, plus notes on the plus and minus signs.
- Finally I quit making plus and minus signs

What happened, over time, is that the adjustments did not matter that much in determining the value. The Corelogic analysis of adjustments in relocation appraisals, discussed in last month's newsletter, had this conclusion as well.

If I have good support for a valuable adjustment, such as a very good view, I include the dollar amount of the adjustment on my grid. Over time, I have accumulated support for

various adjustments and use a percent of value to calculate the adjustment. In my small market, percent adjustments are fairly stable over time. For example, location in a very popular school district is 10% of value, based on sales over the past 10-15 years.

I reconcile the comps in my comments, explaining how I determined the final value. I discuss each comp. For example, if I don't have support for a dollar view adjustment: Sale 1 at $700,000 is superior to the subject as it has a much better view (can see two bridges). Sale 3 at $600,000 has no view. The subject has a one bridge view and is superior to Sale 3, but inferior to Sale 1's view. A value of $660,000 is selected.

This is not exact, but is far better than guessing with no analysis. I am expanding my methods in determining adjustments, so I may have been able to use a quantitative method, such as simple regression, to get a more reliable dollar adjustment.

Should you use the same adjustment methods in all appraisals?

No, unless you are appraising a similar home, in the same neighborhood, in the same price range, at about the same time. Every market area, neighborhood and price segment values components differently at different times in a market cycle. A new home in a neighborhood likely has a SF value different than a 50 year old home. The sixth bedroom in one neighborhood may have high market value, but no value in another.

Source: Hagar

What adjustment methods should you use/learn?

When I decided to write this article I wanted to make lists of adjustment methods by type, such as by sales, cost, etc. But, the materials I used were not written this way. Instead they use practical examples as illustrations of methods. This is probably much better, but requires more time to listen or read the material.

What are the most common adjustments needed in your market? Quality, condition, GLA, view, market conditions, etc.? The Hagar and Ratterman both discuss these examples.

You will not find much discussion of adjustments for minor features such as fences, fireplaces, etc. They are very seldom of significance in value and are difficult to support. Ratterman gives advice on methods to use for some of these adjustments.

What about commercial appraisal adjustments?

To me, commercial appraisal adjustments are much easier than residential as most are based on income. For example, a warehouse that has a dock high loading dock rents for more than one that lacks this important feature. Just capitalize the difference in rent. Homes are much more difficult because of the wide varies of factors and motivations in purchasing a home.

Even if the subject is an owner user commercial property, there are many fewer factors that affect value, such as location on a busy street for a retail property. In contrast, there are many, many factors that affect homes. Buyer psychology is very important.

Statistical methods can also be used. For example, export warehouse sales from Costar, or whatever database you have available, and do a scatter graph of price vs. sq.ft.

The methodologies for residential and commercial adjustments are the same.

In Part 1 of Hagar's second adjustment webinar (just after the one hour mark) there is an excellent example of using a scatter graph for mixed use properties in Mercer Island WA, using the six available sales from 2005 to 2014. It showed that land was being purchased, even if there was an old building and showed the price per sq.ft. of the land. It also indicated no time adjustments. Hagar refers to another appraiser who went to other cities for sales, which did not work well.

Interviews

The two books and the webinars discuss market participant interviews as important methods to help determine adjustments.

Ratterman discusses buyer interviews. But, other market participant interviews can also be used. You may not be able to get a reliable dollar amount, but you will be able to find out what is important.

What adjustment methods should be used so others can understand it?

- Name recognizable by others
- Understandable by a competent appraiser
- Published article or book that explains it
- Review appraiser looking at your work file can understand it.

Source: Hagar

You need to be more flexible

Adapt to the amount of information you have.

- Your methods and thinking must not be rigid.
- How you think about the adjustment/support problem must be dynamic.
- Adapt to the quality of information (data, support).
- Think of how to look at the information from a different point of view.

No single way to obtain and analyze data is perfect.

Source: Hagar

Keep good notes on adjustments you make

Our memories are not always good. Plus, you may want to use the methodology in another appraisal

report. Maybe state regulator wants to see it. Keep records for every adjustment you make in your work file. Also, keep a master adjustment file you can use.

Qualitative vs. Quantitative adjustments

Qualitative: descriptive, subjective, or difficult to measure (Hagar) such as: more than, Inferior, Average, Good. They are opinions.

Just because you cannot support a dollar or percent adjustment does not mean a qualitative adjustment cannot be made.

I use qualitative adjustments in the overall reconciliation for factors that are important to the value, but not quantifiable. Example: After applying supportable market based adjustments, the adjusted sales price is $200,000 to $250,000. Due to the subject's superior location I believe that the subject's market value is at the upper end of the range. Facts set the upper and lower limit of value.

Quantitative: Factual, such as 2,500 sq.ft., price per sq.ft.

What if there are "no comps" See Primary Rule #3 (on Page 1)

You are trying to determine an adjustment, not the value.

Get out of the box. Erase lender requirements from your mind, such as one year, close proximity, etc. You are not always looking for sales similar to your subject.

You can use whatever comps/data that you can find - go in the past, go to another area, etc. Different city, listings/pendings/expireds, go back in time, different sales prices, quality, condition.

Use regression with "big data" (see below) and include many sales, not just those similar to the subject.

Both simple and multiple regression is not limited to sales similar to the subject.

Use multiple adjustment methods for the same adjustment in an appraisal

Per Hagar, there are 25+ adjustment methods - regression, big data, matched pairs, cost, etc. (Sorry, I don't have a list of them.)

Your goal is to have more accurate adjustments.

Tips for difficult appraisals, including rural areas - Harrison's book

Every appraiser has difficult appraisals without good comps. This book will give you lots of ideas on how to approach the appraisals. Plus, the book has lots of examples.

The book focuses on determining value, but definitely applies to estimating adjustments.

The book has a 20-page chapter: "Complexity in the Valuation of Rural Properties" with examples - farmettes and Ranchettes, properties with growing stock, and horse farm. Harrison's book has the best explanation of ways to approach unusual properties. You can use Ratterman or Hagar for the adjustment methodology (tables, histograms, scatter graph, etc.

My favorite method is going back in time. I recently went back 10 years for bedroom adjustments (2 vs 3) in very small market segments where this adjustment is critical. I found two paired sales examples for each appraisal and calculated a percent of value. Remember, you are not using 10 year old sales on your adjustment grid. You are using them to determine an adjustment.

Other methods in the book include:

- Going out geographically
- Considering alternative uses
- Discount or bonus factor from another market
- Cost and profit
- Income

He discusses Traditional vs. Nontraditional Valuation Theory. In his opinion "Traditional valuation theory may be useless in appraising complex residential properties. If the traditionalist assumes that the sales comparison approach is the only approach applicable to residential property, what will happen when there is no market data or no comparable properties in the market, and the appraisal must rely on the cost or income capitalization approach? When traditional valuaton theory is applied to complex residential assignments it usually does not work.

Scatter graphs/single regression can work well with limited data such as 3-4 sales. Hagar has lots of examples

To get started - practice one or two methods

- Practice an easy property with numerous sales
- Practice until you understand and become comfortable with a method.
- Increase your skills by adding several more methods to your "tool kit"

Source: Hagar

Which method is best for a specific adjustment?

There is one rule: There are many ways to make an adjustment.

Ratterman discusses this in his examples. For example, extracting and supporting adjustments for quality adjustments. He discusses paired data, income, cost, buyer interviews, and statistical, plusses and minuses. Paired sales were not available. He recommended developing a cost new of a home for good quality and the cost new of average quality. As he says, this method is somewhat subjective, but is an accepted method. Hagar used statistical methods, such as median prices and scatter graphs.

What about methods not covered in these books or webinars?

There are many methods, such as using histograms. I learned about several of them in George Dell's 2-day class - Stats, Graphs and Data Science. He is offering it through the

Appraisal Institute and other appraisal associations. For more info go to www.valuemetrics.info. It is a fast paced class covering lots of material and includes some adjustment methods I had not seen before. Unfortunately, I was unable to find any courses or webinars covering more of the methods.

Sales comparison methods

Matched paired sales. This is familiar to most appraisers, but good sales are not often available. Also, as Harrison says, you can use this method to prove almost anything. But, it is an accepted method.

Using tables of MLS data can help in finding paired sales.

Listing and sales history of the subject can be very useful. Always look at the sales history, such as change in listing price, expirations, increase from previous sale. This data can be used for adjustments for market conditions, age, land value, etc. Ratterman has a good analysis of how to use this data in the 20-page Chapter 4. This is also a good method to get land value on new construction if there was a previous land sale.

Extracting adjustments for age from comps is another use. For example, the same model home with different ages. Ratterman shows how to extract GLA adjustment from 3 gridded sales after the age adjustment is made.

Starting on page 68, Ratterman discusses using bracketing for age, using 3 comps.

Cost methods

This approach has been in use for decades. In other countries, with limited sales data, it is the only method and is typically done by licensed engineers.

Many appraisers use it today. But, it is not always market based. For example, using sales price divided by sq.ft. of the comps to get a GLA adjustment. This is useful for determining a value, but not for an element of comparison (GLA).

Cost does work for comparing the cost new from a builder with the Sales price less land for the same model, but older, then calculating a ratio. Hagar discusses this method.

Simple regression is much better. If I calculate Dollars per sq.ft. in my market, I get $450 per sq.ft. for GLA, which is not reasonable.

Regression gives me about $200 per sq.ft. which is more reasonable. Regression determines how the change in sq.ft. affects the total value. A mathematical equation is provided for the price per sq.ft. adjustment. If there are big differences in land values, you may have to remove the sales with large lots.

But, cost is better than nothing and is recognized as a method for determining adjustments. Both Hagar and Ratterman discuss Cost methods, using examples.

Using cost to cure can be a good method, if it is used in your market segment. It can be used for investor purchases, as they are very sensitive to fix-up costs and are knowledgeable.

Cost new is always available. The difficulty, of course, is determining depreciation. Hagar and Ratterman have methods for this adjustment.

On page 65, Ratterman has an example of determining a adjustment for lack of a basement. He has an example on quality adjustment, using Cost, on Page 95.

Hagar also has good cost examples.

Income

These methods are much simpler than sales and cost. Although appraisers complain there are no house rentals available, rentals occur in almost every market.

Ratterman uses GRM and explains it in detail on Page 64, Income Capitalization Approach. Start by finding comps very similar to the subject that are, or will be, rented in the future. Include a comp that has the adjustment you are looking for, such as a 2 car vs. 3 car garage. Next adjust for concessions, time, etc. Then determine the monthly rent by using rental comps and calcuate a GRM for the comps. Extract the GRM difference for a 3 car garage.

Hagar has a few examples of using income (GRM).

Statistical - tables and graphs

Ratterman and Hagar use statistics, including medians, means, graphs and tables.

For example, Ratterman has a table of MLS sales for two different subdivisions. He calculates the average sales price for each and calculates an 18.92% adjustment. Hagar uses similar methods.

Both Ratterman and Hagar use scatter graphs for many adjustments. This is also a good method if there are few sales.

They both use tables and graphs for lot size, views, design, condition and other elements of comparison. But, Hagar uses statistical methods more extensively in his webinars.

Single regression - scatter graphs work very well, especially useful if data is limited

Single (single line) regression looks at only one adjustment. For example, GLA and sales price to determine a GLA adjustment.

Scatter graphs with linear and polynomial trend lines are very popular and easy to use.

Ratterman does not use regression methods as often as Hagar does, but does have some examples.

Hagar uses scatter graphs, which are very popular now. The first part of his second webinar series spends hands-on time on explaining how to use Excel for single (single line) regression.

He uses R-squared to determine the reliability of adjustments and what to

do if it is low.

Excel is a very complicated program to learn. But, if you are only using it for tables and single regression it is not that difficult. Hagar's second webinar explains how to do it, assuming you know how to use tabs, cut and paste, etc.

If you take the time to learn Excel, be sure you use it regularly so you won't forget it.

Once you start using single regression, you will probably use it on most of your appraisals. It is fast and easy, but does require practice.

Where to learn how to use Excel

Residential appraisers don't use many features of Excel. You can take a basic Excel class or use one of the many youtube tutorials. You will need to learn how to use tabs, copy and paste, etc.

There are also tutorials for appraisers on youtube.

Your next step, after learning the basics of Excel, is to learn how to do a scatter graph. There are tutorials on youtube, or you can follow Hagar's second webinar, part 1.

Fortunately, we all use tables, so it is not very difficult. The URAR sales comparison grid is a table.

You will also need to learn to download data from your MLS into Excel. It is not difficult to do. Your MLS should have classes or help available.

What about multiple regression?

This is popular in appraiser Excel classes. However, multiple regression is very tricky and difficult to use. I recommend single regression unless you are very at good using Excel and have excellent statistical training. There are too many mistakes that can be made. More important, there are many other adjustment methods available.

My first statistics class was in 1962. I used multiple regression for my MBA "mini thesis" in 1980. I looked at the variability of REIT stocks. I did not use property data, even though I had worked at an assessor's office. Property data is variable and there are no standards. REIT stock prices are known and standardized.

What about "off the shelf" multiple regression software?

I reviewed Redstone and Statwing in early 2015 for this newsletter. Both showed that the GLA adjustments were reliable. Lot size adjustments were also often reliable. To get any other adjustments I had to manipulate the data. In single regression you can remove outliers (way above or below the trend line), but you know which sales were removed. In Redstone and Statwing there was lots of data and it was hard to keep track of what I was doing. They also take time to learn.

As we all know, AVMs (multiple regression software) work best in conforming tract neighborhoods with homes no more than 10 years old. If you work in these areas, multiple regression may work for you.

Don't count on getting many reliable adjustments from any multiple regression software.

On the plus side, I learned my GLA adjustments were way too low in my local market.

Big data vs. smaller data sets

Hagar uses the term "big data" to refer to larger data sets, typically MLS downloads.

In using this data, for example, you download all the sales in a neighborhood or wider market area.

With smaller data sets, such as used in scatter graphs, you typically download much fewer sales or type them in, focusing on sales similar to the subject.

Using Excel and big data can be very useful. Hagar gives good examples of using big data and explains when you would use big data. In the first section of the second webinar, go to 1 hour, 4-5 minutes for the start - condo view adjustments.

He also goes over how to figure out what big data to use. It took him three tries to get a GLA adjustment. This starts at about 1 hour and 12 minutes in the first part of the second webinar series.

Doesn't adjustment support take a lot of time?

The more you use specific methods, the faster it goes.

It avoids questions from reviewers, state board regulators, CU, etc. about how you did your adjustments.

To get started, select a few methods, learn them and use them in your appraisals. Many appraisers find simple regression easy and fast to use.

Classes and webinars

Live-hands on classes are good for Excel and other statistical methods such as pivot tables and histograms.

Unfortunately, most of the classes and all day seminars for appraisers are about using Excel. Excel can be challenging to use and there are many versions of the software. Residential appraisers don't use it except for graphs. Commercial appraisers use Excel regularly in their appraisals.

For example, I recently took a 7-hour Excel residential adjustment class, advertised as advanced, from the Appraisal Institute. Many of the students had never used Excel and had different versions of Excel. There were 50+ students and no "helpers" to assist students having problems. Most of the class was on pivot tables, which I never learned how to use.

But, if you prefer hands-on live classes see what is available. Live, online classes are available from appraisal education providers and other sources.

Richard Hagar's webinars - the best for most appraisers

Richard Hagar's webinars cover the techniques discussed in the two books above. A significant plus is that you receive a link to the webinar so you can go over it again. Hagar moves through material quickly, so this is very valuable. But, it is valuable for any webinar that covers a lot of material that is new to you. You can scroll through the recording to find what you want. The recordings are bit tricky to scroll, so be sure to write down the times for sections you like, so you can go back to them.

His first two part webinar, *How to Support and Prove Your Adjustments*, is recorded and available for $79. It was recorded in June 2015. It covers cost, income, grouped data, histograms, allocation between land and improvements, time adjustments, and an introduction to statistical methods. A lot of time is spent explaining to appraisers that adjustment support is required. At that time, CU had started in January and appraisers were now required to support adjustments. There were a lot of angry and confused appraisers. You can skim this part if you want.

His second two part webinar: *Appraisal Adjustments: Solving Common Problems*, is available recorded for $79. It was recorded in February 2016. This webinar is the best discussion I have seen on regression and a very understandable hands-on discussion on using single (single line) regression, which is a very useful adjustment method. (You will need the Excel sample files and a PDF of the Powerpoint slides).

Hagar is a practicing appraiser who goes way beyond just explaining the math. He comments on it in "appraiser-ese", for someone who has never seen regression done. In the hands-on regression in Part 1, you can follow along using another computer with Excel, or stop the tutorial and do the steps in the hands-on regression exercise on your computer. This time, there were no angry appraisers and much less time was spent on what Fannie and regulators want.

I recommend buying both webinar series.To purchase the webinars, go to www.workingre.com and click on Webinars, near the middle of the a page, just under the large blue WorkingRE and OREP logos. Other webinars are listed also.

Other Hagar adjustment-related seminars: Live: Two Part Webinar: Complex/Unusual Properties (this month). Recorded: Land Value and the Cost Approach.

Where to buy the books

Appraising the Tough Ones ($45, $35 for AI Members) and Valuation by Comparison ($40, $30 for AI members) are available from the Appraisal Institute at www.appraisalinstitute.org.

The best way to order them is to Google the names of the books. Finding them on the AI web site can be tricky.

I have written many articles on adjustments, starting in early 2015. Go to the paid subscriber page to download and read the newsletters.

I am working on a Special Report on Adjustments, available free to paid subscribers. It combines all the articles I have written, plus articles by other authors that I compiled in 2015.

Reviewer as mind reader

By Rachel Massey, SRA, AI-RSS

In some of the appraisals we have all read, there can be so much left unsaid that it is clear that either the appraiser doesn't feel comfortable communicating, or thinks the intended users are mind-readers. You see this a lot when reviewing, as there are often leaps of faith that are made in the appraisers head that simply never translate to paper (or screen nowadays). The appraisal could be perfect, a thing of absolute beauty, but if it is not translated in some clear manner to the client, it seems to assume a level of clairvoyance that most users lack.

Example: Kitchen Updating

Take for example the following sentence:

"C3; kitchen updated one to five years ago. Bathrooms updated one to five years ago." This is the sum-total of the discussion and the materials noted simply as Cpt,Ceramic/Avg. That is it, nothing else. There is no commentary related to what was updated other than the kitchens and the baths. But what precisely were the updates? The appraisal leaves it up to the imagination of the client other than a few blurry photographs that do not show much.

How about providing something a bit more meaningful in addition to the required language related to updates, remodeling, or no updates. For example, saying what was done such as: "Replaced 16" square ceramic tile flooring, replaced quartz countertops, newer porcelain farm-sink, and plumbing fixtures. Kitchen cabinets are original, but in good condition. Appliances were replaced between 10-15 years ago. Bathroom updating includes new vanity, sink and plumbing fixtures and new 12" ceramic tile flooring. The tile wainscoting is older but has been well maintained."

Which one provides information that is more meaningful? This could be the exact same house, but one description is brief and not particularly useful. The longer description above gives the client a much better understanding of the subject property. If the appraisal sets the stage by providing meaningful information about the condition of the property, it is much easier to take this to the next logical step, which is to describe the comparable sales and how they compete with the subject.

It helps the client understand why two properties might have a C3 rating, but different levels of updating or maintenance, which results in an adjustment even within the same rating on the UAD form.

Even if the house is completely standard without any upgrades or updates, it is simple enough to write that and let your client know that the 10-year old house still has the original paint, floor coverings, cabinets, counters, appliances, etc. Perhaps the original improvements are well maintained and clean, showing little, if any wear. Perhaps they include cabinets off their hinges, chipped counter tops, broken tiles, carpet that is badly worn, stained and with seams showing, or perhaps it is somewhere in between with some wear patterns and staining and a few marks on the cabinets, with dated, but maintained counters. While photographs tell a story, so too can the wording in the report.

Example: Using Bullet Points

If you do not like to write, how about a few bullet points about the house followed by a paragraph about condition and other features, for example:

Features:

" Hardwood floors in the kitchen, dining nook and hearth area
" Kitchen has center island and good work flow
" Kitchen upgrades include updated tile backsplash and raised panel cabinetry
" Corner fireplace between living room and hearth area
" 2nd floor has large bonus room area above garage
" Master bedroom with large walk-in closet and private bathroom
" Full, unfinished basement
" Property backs up to a retention pond and then to XXX Rd
" Fenced yard, 12x26 rear deck

Example: Site Comments

The subject is one of the few properties in the neighborhood with a favorable view as it does not back up to other houses. It backs up to a retention pond (pond for water run-off when developing the subdivision) and beyond that a neighborhood road. While the view of the retention pond and road is not as favorable in the market as those with a private wooded view, it is superior to the vast majority of properties in the subdivision that back up to other houses.

Summary

A few sentences, or even short comments in bullet point format is far more than many reviewers see in their daily work. This type of communication really helps to paint a picture of what the house is like and what, if anything, makes it different from others. What is different or special about the house sets the stage for the comparable sales that are chosen, as well as how they compete. Remember, your client is counting on you to provide enough information for them to make an informed decision about lending on the property.

About the author

Rachel Massey, SRA, AI-RRS has been in the real estate field in the Ann Arbor area since 1984, first in sales, and then as a full time appraiser since 1989. She has a Bachelor's degree from Siena Heights University with a real estate concentration, and is an AQB Certified USPAP instructor. Rachel was one of the original members of the Michigan Council of Real Estate Appraisers and has a passion for helping other appraisers through writing, teaching and with peer review. She has expertise in lake appraisal, Relocation appraisal work and other residential work in Washtenaw County and surrounding communities. When not appraising or thinking about appraisal, she can be found enjoying sunsets, walking, and the occasional toss about the mat in aikido. Rachel can be reached at rachmass@comcast.net or through her website, www.annarborappraisal.com

Curable Queries - Bracketing and SFR vs. Duplex

By Doug Smith, SRA, AI-RRS

Editor's note: This is the return of column that I did in the first few years of this newsletter. Send your questions to Doug at hotelman@montana.com

Question 1 - Bracketing

Underwriter sent a request to add one comparable sale that bracketed the lower end of the comparable sales within the analysis. A search of the market failed to identify any comparable sales that were reasonably similar to the subject that might have provided an additional comparable sale. How should I handle this request?

Answer

Requests from underwriters must be considered on three levels.

- The first level is that each request must be considered in the context of the business relationship with the client.
- The second level is that the request must be analyzed in terms of basic appraisal methodology.
- The third level, and perhaps the most important criteria for handling underwriter requests, is how the final revised report will meet USPAP standards.

Timeliness is an important factor in responding to underwriter requests. Manners count and whether the request is reasonable or unreasonable, maintaining a professional attitude throughout the process is essential to maintaining an ongoing relationship with clients. In this case, the underwriter's concern was likely that the appraisal reconciliation concluded a value at the lower end of the range with the underwriter asking for additional support of the reconciled value.

The essential point of responding to any requests is that the appraiser is in the driver's seat. While bracketing is a useful tool, the application of bracketing is entirely up to the appraiser. The adequacy of the assignment results hinge on the appraiser's decisions in regard to the Scope of Work.

Scope of Work Rule:

"The scope of work must include the research and analyses that are necessary to develop credible results."

USPAP further states:

"An appraiser must not allow the assignment conditions to limit the scope of work to such a degree that the assignment results are not credible in the context of the intended use."

Therefore, the most expedient way to respond to the request is to apply proper appraisal methodology. In this case it consists of a search for an additional comparable and finding none that are reasonably similar based on similar highest and best use. Report the results. The appraisal analysis requires that comparable sales be reasonably similar with similar highest and best use. Sales that do not meet this criteria are merely examples of sales and as such are not appropriate to the analysis.

Using a professional level of business communication, the response should be both timely and carefully expressed.

Question 2 - Single family home vs. duplex

The client ordered an appraisal on a property that is a duplex according to tax records.

In response to the identifying the property as a duplex, I received the following response: "Per the Lender-Spoke to borrower, this is a single family home, it does have an attached apartment with separate entrance who's address is 235 1/2 XXX Ave, for mailing purposes, but home is insured as SFD, tax assessed as SFD and currently financed with XYZBank as SFD.

I was not sure what has changed, but the property is now being considered a multifamily home. Please respond so that the appropriate service name can be updated. Thanks."

How should I respond to the lender?

Answer:

This is clearly a case where the borrower has been successful in determining the Scope of Work.

The first step in this assignment is to check the tax records. In fact, the property was identified by the taxing authorities as a multi-family dwelling.

The second step is to check zoning. Zoning for this area was single-unit. However, the property was built in 1940 which may have created a situation where the property was legal use under a grandfather status. There is an ADU (Accessory Dwelling Unit) overlay for this district and the property may in fact have a permit for an ADU. The key to this question is that it is simply a matter of Problem Identification.

Scope of Work Rule:

"An appraiser must gather and analyze information about those assignment elements that are necessary to properly identify the appraisal or appraisal review problem to be solved."

The expedient response is to let the lender know that their information is in error and that the property is identified by the tax authorities as a multifamily unit.

The second step is that due to conflicting information, the assignment requires an initial highest and best use analysis. The appraiser is cautioned not to make an assertion about the property without a full analysis that involves determining the possibility that the property was a legal conforming use.

In addition, the physical layout must be considered to determine if the second unit could be considered an accessory unit. In this case the tax records indicated that both units were equal in size. Therefore, while it is likely that the property should have been appraised and considered an income property, that distinction can only be determined by backing up and fully considering all the elements of a highest and best use analysis.

Editor's comment: This is sometimes attempted by borrowers (and some lenders) to get a single family loan, which has better terms than multifamily loans. Also, some municipalities, including where I live, will make a determination of the number of legal units. Many of the multifamily properties in my city were homes converted to apartments during World War II and have non-legal units. Also, post World War II, non-permitted units are common. County tax records are often not correct as to number of units.

About the author

Doug Smith has an appraisal practice in Missoula, Montana, and is a certified general appraiser doing both residential and commercial appraising with a specialty in hotel appraising and feasibility studies. He has an MBA from the University of Montana and the SRA designation from the Appraisal Institute. He can be contacted at hotelman@montana.com.

1004MC - the good, the bad, and what Fannie says

The 1004mc form was required April 1, 2009. Soon after, appraisers started complaining about the form.

In this month's newsletter, I have an article by George Dell, MAI, SRA, written in 2010. George tried to get the major statistical flaw corrected with no success.

There are many other issues. I have attached the most recent Fannie FAQs issued Feb. 12, 2015, which is mostly a repeat of what they have said in the past, but does provide some guidance. You may be able to use some of it to set up a boilerplate response to the issues.

Next month I will have more information and advice on how to handle the issues in your appraisal reports, including sample boilerplate.

Is Fannie going to eliminate or change the form?

No on eliminating the form. Very low probability it will be changed.

What is "good" about the MC form?

By requiring that appraisers use the MC form, lenders knew that Fannie wanted market conditions adjustments. Appraisers would not "get into trouble" if they made them.

When I started my appraisal business in 1986 I had never done a residential lender appraisal. I worked for an assessor's office. When I asked experienced appraisers most told me that lenders "did not like" time adjustments. If you made them, you could "get into trouble". In the 1990s to the 2000s there were periods of price declines. Some appraisers who put time adjustments in their appraisals lost many, or all, of their lender clients.

In periods of increasing prices, appraisers did not accurately value properties without time adjustments.

What is "bad" about the MC form?

There are many issues with the form. But, you can not produce a misleading report even if Fannie seems to want to make you do it. Fannie, lenders, state regulators, etc. do not want misleading reports.

Per Doug Smith:

A common mistake is that the market trends on page one don't match up with the 1004mc.

The second common mistake is to say the 1004MC shows no trends and not back that up with supplementary info.

When was it effective?

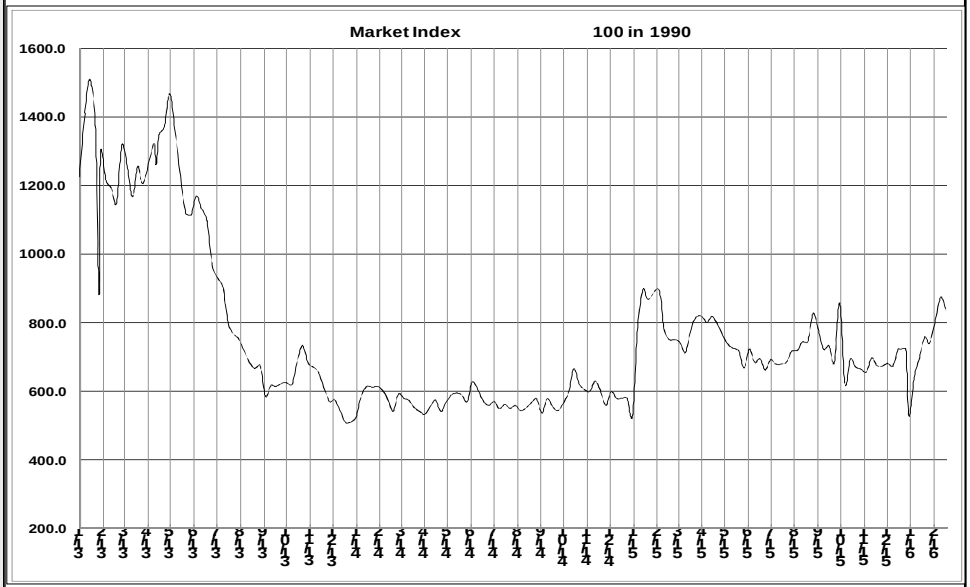
Date required: April 1, 2009.
Date on form: March 2009.

Who designed the form?

Robert Murphy, former Director - Property Valuation and Eligibility for Fannie Mae and another appraiser (name not available) designed the form.

Reportedly, the form was designed and implemented very quickly due to pressure about declining property values. Also, reportedly, no other appraisers were consulted and it was not exposed

MBA Loan Volume Application Index – 1/13 to 2/16



Appraisal Today
ISSN 1066–3900
Appraisal Today is published 12 times per year by Real Estate Communication Resources.
Subscription rate: $99 per year, $169 - 2 years
Publisher
Ann O'Rourke, MAI, SRA, MBA
ann@appraisaltoday.com
Subscriber Services
Theresa Lua
M,T,W 7AM to noon
Friday 7AM to 9 AM (Pacific time)
info@appraisaltoday.com (24 x 7)

Editorial and Subscription Offices
2033 Clement Ave., Suite 105
Alameda, CA 94501
Phone: 1-800-839-0227
Fax: 1–800–839–0014
Email: info@appraisaltoday.com
www.appraisaltoday.com

for comments before being issued.

Unfortunately Robert Murphy retired from Fannie last fall and was not available for comments.

What Fannie says about the purpose of the form

From the form: The purpose of this addendum is to provide the lender/client with a clear and accurate understanding of the market trends and conditions prevalent in the subject neighborhood. This is a required addendum for all appraisal reports with an effective date on or after April 1, 2009.

From the 2-12-16 FAQS Q39. What is the purpose of the Market Conditions Addendum?

Due to the complexity of the real estate market, the Market Conditions Addendum is intended to capture additional information to enhance the transparency of the market trends and conditions analyzed by the appraiser.

What the form says about how to fill it out

Instructions: The appraiser must use the information required on this form as the basis for his/her conclusions, and must provide support for those conclusions, regarding housing trends and overall market conditions as reported in the Neighborhood section of the appraisal report form. The appraiser must fill in all the information to the extent it is available and reliable and must provide analysis as indicated below. If any required data is unavailable or is considered unreliable, the appraiser must provide an explanation.

It is recognized that not all data sources will be able to provide data for the shaded areas below; if it is available, however, the appraiser must include the data in the analysis. If data sources provide the required information as an average instead of the median, the appraiser should report the available figure and identify it as an average.

Sales and listings must be properties that compete with the subject property, determined by applying the criteria that would be used by a prospective buyer of the subject property. The appraiser must explain any anomalies in the data, such as seasonal markets, new construction, foreclosures, etc.

New 1004MC FAQs and MC instructions dated 2-12-16 (4 pages) attached at the end of this newsletter

Appraisal and Property Related Frequently Asked Questions (FAQs) February 12, 2016 Following the FAQs, the Attachment on page 10 provides Guidelines for Using Market Conditions Addendum to the Appraisal Report (Form 1004MC).

There are 6 FAQs and a 2 pages of Guidelines - attached at the end of this newsletter.

There does not appear to be anything new, but it is always best to reference the most complete Fannie advice.

What should you do now?

Include George Dell's scatter graph in your appraisals, using your own data, if there is a discrepancy between the 1004mc and the actual market conditions trends. See his article in this newsletter.

The attached recent Fannie Mae document, at the end of this newsletter, tells what they expect. You can cut and paste and reference this in your appraisal.

Next month I will have suggested boilerplate and other information.

Statistical errors in the 1004MC

By George Dell, MAI, SRA

Excerpt from manuscript: Common Statistical Errors and Mistakes: Valuation and Reliability Estimation Information Loss Error: Fannie Mae Form 1004MC - Trend Analysis ARES 2010 Annual Meeting George Dell, MAI, SRA, ASA April 15, 2010 www.valuemetrics.info

Editor's notes: Will Fannie change or eliminate the MC form? Not likely. Fannie recently sent out more instructions on how to fill out the MC form. The relevant pages are attached at the end of this newsletter. This article is a relatively easily understandable explanation of the statistical defects of the 1004MC.

Next month I will have information on how to explain the 1004MC issues in your appraisals.

Footnotes are at the end of the article.

Abstract:

This excerpt summarizes how the 1004mc form always provides a false indication of market trend and size. The cause is the grouping of data when the exact information is known. The mathematics/statistics may be correct, but the model is bad. Additional information is available on the www.valuemetrics.info website.

Some Specific Gross Errors

We have considered some 'large' errors. These are errors which may pervade in or impact the entire professional culture. We now turn to smaller errors and mistakes. In spite of these mistakes being 'small', they can have great impact because of influence or regulatory power or simply social inertia.

Again we do well to remember, our goal is *usefulness* not theoretical perfectionism. It is understandability, not obfuscation. We will first examine a case, in common practice, which defeats its own purpose due to significant and unnecessary *information loss*.

This case demonstrates the application of a valid statistical tool - *matched pair comparison*. (This is termed "grouped" pair comparison in most appraisal literature). This example presents an improper model because it does not meet the stated needs of the user nor the public good. It is perhaps a first attempt at enforcing the use of market analysis for residential appraisers. It is the Fannie Mae (and Freddie Mac) form 1004MC. This is a form which is now required for all form appraisals performed for loans eligible for resale to these organizations.

The **stated purpose** of this form *"is to provide the lender/client with a clear and accurate understanding of the market trends and conditions prevalent in the subject neighborhood."* **We now consider whether this model accomplishes its purpose.**

It is reasonable to assume that the information desired will be **timely**, not historical. It would also be reasonable to assume that it would reflect the **correct direction** of the market relevant to the subject property. As an added bonus, it might help support the magnitude of the market trend, to coincide with the 'time' adjustments used in the analysis.

There are several issues.

The first "statistical" issue with this analysis is the definition of the problem. Does the lender/client really want to know about "market trends and conditions in the *neighborhood*?"

What goes on in a neighborhood may be quite different from what goes on in a competitive market segment. For example, an area may have both high rise view condominiums and affordable apartment conversions. A neighborhood has both. The median price aggregated for all condominiums combined may indicate a stable market with price trend near zero.

But, is this this information useful? Is it even relevant? It may be that the expensive high-rise units are falling in value, while the cheaper units are rising in value - or vice versa. The author has found occurrences of each case at one time or another. Thus the indication of a market which includes these several sub-markets is not useful for either type of subject property. This error of colloquiality further ignores that the market area sometimes matches the neighborhood, and sometimes does not.

The appropriate model would include only the competitive market segment (or district), not the neighborhood.[1] Let's say the appraiser does not wish to be forced into an

Sales trend analysis portion of the Fannie Mae 1004mc form

MARKET	Median Sale & List Price, DOM, Sale/List %	Prior 7–12 Months	Prior 4–6 Months	Current – 3 Months	Overall Trend		
	Median Comparable Sale Price				☐ Increasing	☐ Stable	☐ Declining
	Median Comparable Sales Days on Market				☐ Declining	☐ Stable	☐ Increasing
	Median Comparable List Price				☐ Increasing	☐ Stable	☐ Declining
	Median Comparable Listings Days on Market				☐ Declining	☐ Stable	☐ Increasing
	Median Sale Price as % of List Price				☐ Increasing	☐ Stable	☐ Declining
	Seller-(developer, builder, etc.) paid financial assistance prevalent? ☐ Yes ☐ No				☐ Declining	☐ Stable	☐ Increasing

irrelevant analysis. He or she, confronted with this conflict between the user's (Fannie Mae) colloquial definition and the professional definition required and being tested for appraiser licensing (and for professional designations) -- chooses expediency and pretends that the neighborhood is actually the competitive market segment.

This uncomfortable conflict between a client requirement and basic appraisal education typifies the relationship to real-world competence and ethical behavior. This forms the appraiser context for dealing with this form-versus-content issue.

Having dealt with (or avoided) this problem of client's instructions versus competency requirements, the appraiser then proceeds to fill in the form. Most residential loan appraisers now use a spreadsheet application to generate the results to fit the form. The following data set is an example, typical of market conditions trends in many areas in the U.S.A. during 2009-2010.

See top graph below.

Based on the analysis dictated by the form, it is clear the trend is downward. Lacking other understanding of statistical analysis, presumably this provides an *"accurate understanding of the market trends and conditions prevalent in the subject neighborhood."*[2]

We could go the next step and provide a bar-chart column graph with these values to better illustrate the declining market.

See bottom graph below

The appraiser concludes to a declining market. The data and the graph both show a decline of about $12,000 per 3-month period, or about $4,000 per month over the entire year.

He now also has clear support for a downward time adjustment for his three comparables, all compliant to some 'guidelines' that sale dates be within six months of the date of value.

So what's the problem?

While this solution to the market trend problem seems intuitively beneficial - it is a striking graphic example of the cost of information loss. In this case, the model error defeats the purpose of the exercise. How is this so?

How would a 'best practices" econometric model for time-series analysis eliminate such failures of intent and process?

First the analyst would look at the data. Typically a scatter graph. In this case we have the exact date of each sale. If possible, it is wise to first look at the data without rounding the date of sale to the 6 month, 3 month, 3 month groupings. Rounding or a summary statistic is a form of information loss. When we took the medians of each time period, we discarded data about the exact date, and proceeded to analyze only the summarized 'rounded' values, the medians. We compared medians of large groups.

What should we have done? For two variables, we have exact dates and exact prices. A scatter graph is generally the indicated form of chart. It is the right visual model for this type of time-series analysis. The graph now enhances the ability of the human brain to see the market. To "let the data speak".

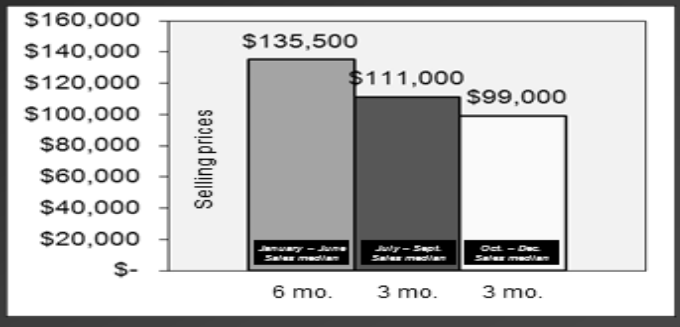
For this market, it is clear, using the right tool, that the market has clearly reversed its trend, hitting bottom some near three months prior, and requiring an *upward* adjustment since September 1. (A *linear* trend simple regression would provide a good time adjustment for sales occurring in the last three months, the otherwise most

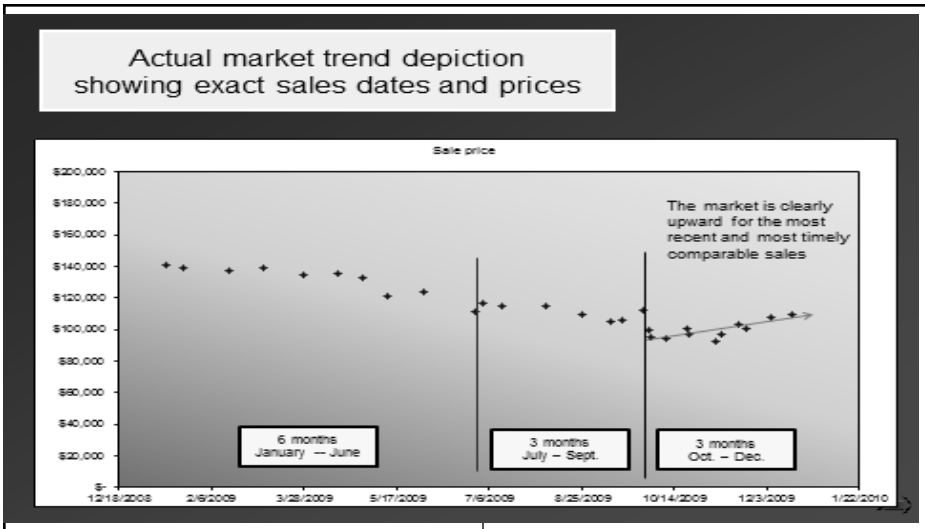
Information Loss Example:
Neighborhood Sales as required by the 1004mc form

Closed date	Sale price	Closed date	Sale price	Closed date	Sale price
1/12/2009	$ 141,000			10/1/2009	$ 95,000
1/22/2009	$ 139,000			10/10/2009	$ 94,000
2/15/2009	$ 137,000	7/3/2009	$ 117,000	10/21/2009	$ 101,000
3/6/2009	$ 139,000	7/13/2009	$ 115,000	10/22/2009	$ 97,000
3/28/2009	$ 135,000	8/6/2009	$ 115,000	11/5/2009	$ 93,000
4/15/2009	$ 136,000	8/25/2009	$ 110,000	11/8/2009	$ 97,000
4/29/2009	$ 133,000	9/10/2009	$ 105,000	11/18/2009	$ 103,000
5/12/2009	$ 121,000	9/16/2009	$ 106,000	11/22/2009	$ 101,000
6/1/2009	$ 124,000	9/27/2009	$ 112,000	12/5/2009	$ 108,000
6/28/2009	$ 111,000	9/30/2009	$ 100,000	12/17/2009	$ 110,000
January – June	Median $135,500	July – Sept.	Median $111,000	Oct. – Dec.	Median $ 99,000

Form 1004mc indicates a market *decline*

Information Loss Example:
Column graph depicting 1004mc form representation of the neighborhood market decline





reliable comparable sales.

Is this a circumstantial event? Does this tool indicate the wrong direction only in some circumstances? No. For each and every market bottom, it will show the wrong trend 100% of the time![3] And it will be wrong at the relevant decision window - when it matters.

So what is the cause? It is the information loss problem which results when the measurement is taken on a parameter (the median), rather than utilizing correctly the exact date of closing for each market data point.[4]

How can this be avoided? The solution is already evident. The analyst/appraiser must be steeped in the use of the right graph for the right situation. The scatter graph visually explains the market trend to the analyst (and to the lender/client). From there the analyst can fit a curve, whether a linear, a spline model, or a polynomial.[5] The change in trend is indicated immediately. The resulting time adjustment reflects *all* the known market information as of the date of value.[6]

The use of the right procedure and the right model is actually easier for appraisers to implement, as well as accomplishing the result desired. Other statistical and economic tools can be used to improve and even predict this result.

While this may seem like a small issue. It has great economic and political impact. A half million appraisals reporting declining markets three months after the market has turned -- extends the depth and length of the recession, increases the size of government subsidies, puts greater pressure on our public servants, and further damages the reputations of our public and semi-public organizations.

FOOTNOTES

1 The Appraisal of Real Estate. Thirteenth ed. Chicago: Appraisal Institute, 2008. 54-55. Print. This discussion distinguishes clearly between a market area, a neighborhood, and a district. The definition of 'neighborhood' is defined as a group of *complementary* land uses. Thus it leaves undefined whether even gas stations or detached homes should be included in the analysis. In the understood professional sense, there would be little purpose in analyzing say neighborhood values, without first restricting to a specific (competitive) land use. But this then is not a neighborhood, it is a property type in a given area.

2 FannieMae form 1004mc (Market Conditions Addendum)

3 It will however be correct by coincidence for any market which does not *change* its trend for at least a six month period. E.g., if a market stays level for the six months prior to the date of value, the median will stay the same between the two periods. The level market will be confirmed some six months after it begins!

4 Dell, George, MAI, SRA. *Introduction to Real Estate Econometrics*. San Diego: Real Estate Econometrics, 2002. 40-42. Print

5 The choice of curve fitting, whether order of polynomial, linear spline, or other functional form - is a modeling decision. There are modeling guidelines for these offered in valuemetrics.info workshops, but they are beyond the scope of this paper.

6 Dell, George, MAI, SRA. *Stats and Graphs 1*. San Diego: Valuemetrics, Inc., 2006. 32. Print

About the author

George Dell MAI, SRA, ASA, is a recognized authority on applications of predictive methods to asset valuation and risk/reliability issues. He has broad graduate-level education in mathematics, statistics, econometrics, finance, and insurance. He has authored numerous articles, seminars, and is a co-author of the AI book "*Appraisal Valuation Modeling*".

In developing the "new valuation modeling paradigm," he provides the answer to "big data." The "data science" tools are the answer to the current troublesome issues for the appraiser, the lending industry, and the health of the economy. His academic paper, "Auditable Appraisal Best Practices"© was presented at the joint AI and Union of Pan American Valuers in 2010, winning the "best manuscript" award out of over 100 papers submitted.

George is CEO and chief instructor for Valuemetrics, Inc., which provides a curriculum of hands-on workshops for appraisers and lenders. The entertaining workshops present simple, clear, and practical tools to define market comparables. Also, two tools: contrasting and simple regression, are shown for their ease of use - when properly modeled.

Q36. How should the appraiser determine appropriate adjustments for sales concessions on the comparables?

The appraiser must consider the impact a sales concession had on the transaction. The adjustments must reflect the difference between what the comparables actually sold for with the sales concessions and what they would have sold for without the concessions, so that the dollar amount of the adjustments approximates the reaction of the market to the concessions.

Q37. What types of comments must the appraiser make when explaining the adjustments that were made in the Sales Comparison Approach?

The appraiser must provide appropriate comments that reflect the logic and the reasoning for the adjustments provided, especially for the characteristics reported on the appraisal report form between the Sales or Financing Concessions and the Condition line items. A statement only recognizing that an adjustment has been made is not acceptable.

Market Conditions Addendum to the Appraisal Report (Form 1004MC)

Q38. Is the *Market Conditions Addendum to the Appraisal Report* (Form 1004MC) required for both manually underwritten mortgage loans and those underwritten with Desktop Underwriter® (DU®)?

Yes, the Market Conditions Addendum (Form 1004MC) must be included with the appraisal report for all appraisals on one- to four-unit properties. The addendum must be provided with Fannie Mae Forms 1004, 1004C, 1025, 1073, 1075, 2055, 2090, and 2095.

Note: Appraisal Forms 1075, 2055, and 2095 are not currently fieldwork options offered by DU.

Q39. What is the purpose of the *Market Conditions Addendum*?

Due to the complexity of the real estate market, the *Market Conditions Addendum* is intended to capture additional information to enhance the transparency of the market trends and conditions analyzed by the appraiser.

Q40. What if requested data are not available to the appraiser? For example, what if comparable active listings from a previous time period are not available?

If the appraiser is unable to complete a portion of the addendum because data, such as historical listing data, are unavailable or unreliable, the appraiser must provide an explanation of his or her efforts to obtain such data and why the information is not available. Simply stating “not applicable” or “N/A” without an explanation is not an acceptable response.

Some local MLSs may be a source of appropriate data. Appraisers should be aware that software programs currently being marketed may pull data from the MLS but still require additional technical steps to make the data usable for purposes of the market analysis required by the addendum. While these types of programs may be helpful in gathering the data, they are not a substitute for the appraiser’s analysis.

The requirements of the addendum are not intended to be so onerous that they hinder the appraiser in completing the appraisal. Fannie Mae does not expect appraisers to have advanced technical skills to obtain data in support of these requirements; however, appraisers must make a reasonable and conscientious effort to obtain data that support an accurate and complete analysis.

Q41. What should the appraiser do if there are not enough data to provide a meaningful analysis?

If there are not sufficient data to provide a meaningful analysis for the defined neighborhood, the appraiser must complete the form based on the information that is available and provide an explanation. The lack of data may be an indication of the market conditions. If additional analysis of nearby areas that include competitive properties is performed, it must be discussed in the summary/conclusions section of the form. In any scenario, the Neighborhood section of the appraisal report must include the appraiser's conclusions regarding the housing trends.

Q42. What if information requested is only available as an "average" instead of the median?

In that situation, the appraiser must indicate in his/her findings that the data are available on an average basis and not as a median.

Q43. What is the absorption rate and how is it helpful in identifying market trends?

The absorption rate is the rate at which properties for sale have been or can be sold (marketed) within a specific area. It is helpful in determining supply and demand trends for a market area.

Q44. How is the absorption rate determined?

The absorption rate is determined by dividing the total number of sales for a given market by the time period being analyzed.

Example:

If there were 60 sales during the 6-month time period being analyzed, the absorption rate would be 10 sales per month (60 sales divided by 6 months).

If there are 240 active listings, there would be a 24 month supply of homes on the market (240 active listings divided by 10 sales per month).

This calculation may support an appraiser's conclusion that there is an oversupply of homes on the market. Anomalies in the data such as seasonal markets, new construction, or other factors must be addressed in the form.

Q45. Is the Median Sale Price as % of List Price determined by dividing the Median Comparable Sale Price by the Median Comparable List Price from the preceding data on the form, or is it based only on comparables for sold properties?

The Median Sale Price as % of List Price is to be determined by analyzing the comparables that have sold and settled during the specific time frame, not by using the data from the lines above this section on the form.

Q46. When the Inventory Analysis is completed, should the data entered show a trend?

The data may show a trend/direction or no trend at all. However, it is important to remember that the time periods for the analysis include one six-month period and two three-month periods. The appraiser must properly analyze the first column before determining any trend.

Attachment

Guidelines for Using *Market Conditions Addendum to the Appraisal Report* (Form 1004MC)

Form 1004MC is intended to provide the lender with a clear and accurate understanding of the market trends and conditions in the subject neighborhood. The form provides the appraiser with a structured format to report the data and to more easily identify current market trends and conditions. The appraiser's conclusions are to be reported in the "Neighborhood" section of the appraisal report.

Fannie Mae recognizes that all of the requested data elements for analysis are not equally available in all markets. In some markets, for example, it may not be possible to retrieve the total number of comparable active listings from earlier periods. If this is the case, the appraiser must explain the attempt to obtain such information.

Also, there may be markets in which the data are available in terms of an "average" as opposed to a "median." In this case, the appraiser needs to note that his or her analysis has been based on an "average" representation of the data. Regardless of whether all requested information is available, the appraiser must provide support for his or her conclusions regarding market trends and conditions.

Inventory Analysis Section

The "Inventory Analysis" section assists the appraiser in analyzing important supply and demand factors in order to reach a conclusion regarding housing trends and market conditions. When completing this section, the appraiser must include the total pool of comparable properties from which a buyer may select a property in order to analyze the sales activity and the local housing supply. One of the tools used to monitor these trends is the absorption rate.

The absorption rate is the rate at which properties for sale have been or can be sold (marketed) within a given area. To determine the absorption rate, the appraiser divides the total number of settled sales by the time frame being analyzed. The months of housing supply is based on the total listings for the applicable period divided by the absorption rate.

EXAMPLE

Step 1: Calculate the absorption rate.

> If there were 60 sales during a 6 month period (e.g., "Prior 7–12 Months" column), the absorption rate is 10 sales per month (60 sales/6 months).

Step 2: Calculate the months of housing supply.

> If there are 240 active listings, there is a 24-month supply of homes on the market (240 active sales/10 sales per month).

This may support the appraiser's conclusion that there is an over-supply of homes on the market. Anomalies in the data, such as seasonal markets, new construction, or other factors must be addressed in the form.

Median Sale and List Price, DOM, List/Sale Ratio Section

The appraiser must analyze additional trends, including the changes in median prices and days on the market (DOM) for both sales and listings, as well as a change in list-to-sales price ratios.

EXAMPLE

If the median comparable sale prices are $300,000, $295,000, and $305,000 for their respective time periods, the overall trend for the prior 12 months is relatively "stable."

Overall Trend Section

The “Overall Trend” section is designed to reflect potential positive trends, neutral trends, or negative trends in inventory, median sale and list price, days on market, list-to-sale price ratio, and seller concessions.

EXAMPLE

An increase in the absorption rate is generally viewed as a positive trend, whereas a decrease in the absorption rate may be viewed as a negative trend. A decrease in the number of days on the market, either sales or listings, more than likely represents an overall positive trend.

Seller Concessions

Form 1004MC also provides a section for comments on the prevalence of seller concessions and the trend in seller concessions for the past 12 months. The change in seller concessions within the market provides the lender with additional insight into current market conditions. The appraiser should consider and report on seller-paid (or third-party) costs. Examples of these items include, but are not limited to, mortgage payments, points and fees, and in condo or co-op projects, items such as homeowners’ association fees. Seller concessions must be carefully analyzed by the appraiser since excessive concessions often lead to inflated property values.

Foreclosure Sales and Summary/Analysis of Data

The presence and extent of foreclosure/REO sales is worthy of comment when analyzing market data and must be reported on the form. The form also allows for the appraiser to summarize the data and provide other data analysis or additional information, such as analysis of pending sales, which over time can show a market trend.