

Montana Chapter Newsletter

UPCOMING MONTANA CLASSES!

It is that time of the continuing education cycle again. USPAP is updated every other year and as a chapter we attempt to offer the 7 hour update course at the first possible opportunity so Montana appraisers are abreast of any USPAP changes. In January of 2016 we are offering the course back to back in three locations, Missoula, Bozeman, Billings. Please keep in mind that if you are planning to attend a USPAP course it is mandatory that you have a copy of USPAP with you either in a digital format or in a traditional hard copy. We have made accommodations with the venues in all three course locations to have outlets for laptops if you choose to employ a digital copy of USPAP.

At this time we have not confirmed any additional educational offerings for 2016 but we are planning on offering both spring and fall courses. We are always looking interesting courses and encourage our chapter members to e-mail their suggestions to sunny@mercuryvaluation.com

2016-17 7hr USPAP Update Offerings Across Montana

January 25, 2016 - MISSOULA

Wingate by Wyndham, 5252 Airway Blvd, Missoula, MT

January 27, 2016 - BOZEMAN

GranTree Inn, 1325 N 7th Avenue, Bozeman, MT 59715

January 29, 2016 – BILLINGS (TBD)

Registration opening soon

[CLICK HERE TO REGISTER AND VIEW FULL INFORMATION](#)

Log Your AI Service Hours for CE!

Designated members and Practicing Affiliates, be sure to sign into your [AI CE log](#) and submit your service hours so you receive CE credit for...

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- Serving on an Appraisal Institute Board, committee, panel, or project team;
- Serving as a Candidate Advisor;
- Authoring publications, courses, seminars, or articles for the Appraisal Institute;
- and more!

For full information about applicable service hours, please see [Regulation No. 10: Continuing Education](#).

Candidate Annual Minimum Progress Deadline

Candidates for Designation have less than three months to complete their 2015 Annual Minimum Progress. National staff is asking all chapters to reach out to their Candidates to see how they can complete AMP by year's end. The two easiest ways to do so are by completing the Experience and/or College Degree requirements.

Candidates who have a Timeline to Designation set to expire in 2015 or a Candidate who is behind on Annual Minimum Progress should complete a [Candidate Extension Request](#) prior to the end of 2015 in order to avoid termination of his/her Candidacy.

Note: Candidate Attendance and Candidate AI CE requirements are no longer required (per Board of Directors action in the first quarter of 2015).

Designated Members AI CE Deadline/Extension

Designated members, if your cycle ends this year and you need more time to complete your AI CE, be sure to [complete an online extension form](#) by logging into your account.



Become a Candidate Advisor

The Admissions Department is actively recruiting Designated members to serve as Advisors to Candidates. The Advisor serves as a resource to the Candidate, providing them with knowledge on the Appraisal Institute and the appraisal profession. An Advisor may receive up to 125 points of continuing education credit in the category of "Service As a Candidate Advisor" (this is no longer part of Service to the AI) during each Appraisal Institute five-year continuing education cycle. [View the free online Advisor orientation](#).

AI Education Trust Scholarships - January 1 Application Deadline

The next Appraisal Institute Education Trust Scholarship deadline is Jan. 1. Two scholarships are available to eligible Candidates for Designation:

- Appraisal Institute Education Trust AI Course Scholarship
- Appraisal Institute Education Trust Minorities and Women AI Course Scholarship

Please note: It is recommended that, prior to submitting a scholarship application, applicants attend a minimum of two Appraisal Institute chapter meetings annually.

Learn more about AIET Scholarships [here](#) or email <mailto:educationtrust@appraisalinstitute.org>.

AI Seeks Proposals for 2016 Annual Conference Educational Sessions

The Appraisal Institute is seeking proposals by December 31 for panel sessions and presentations for its 2016 Annual Conference.

AI is seeking highly skilled speakers who can address issues and topics of interest to the valuation profession. All panels/presentations will be assigned to one or more of the following tracks:

- Commercial
- Residential
- General
- Institutional Client
- Attorney Client

[Learn more about submitting a presentation.](#)

Have Something to Contribute?

Do you have an idea for an article you'd like to contribute to the next newsletter? A news item to cover, topic to suggest, pictures from a Montana event? Send them our way! E-mail content and ideas to Douglas G. Smith, SRA at hotelman@montana.com.

2016-17 USPAP Changes Have Low Impact

By Douglas G. Smith, SRA

Soon, it will be time for state regulated appraisers to fulfill their two-year obligation to acquire their 7-hour USPAP update class. This time around, the changes are modest and require little in the way of report protocol modifications.

The actual AQB rules are as follows:

1. Appraisers must successfully complete the 7-Hour National USPAP Update Course, or its AQB-approved equivalent, every two calendar years. Equivalency shall be determined through the AQB Course Approval Program or by an alternate method established by the AQB.
2. Individuals who are credentialed in more than one jurisdiction shall not have to take more than one 7-Hour National USPAP Update Course within a two calendar year period for the purposes of meeting AQB Criteria.
3. USPAP continuing education credit shall only be awarded when the course is instructed by at least one AQB Certified USPAP Instructor who is also a state certified appraiser in good standing.

Although the ASB writes, amends, and interprets USPAP, the Board does not enforce USPAP. Through FIRREA, the Federal government has mandated that the states enforce real property appraiser compliance to USPAP. Professional appraisal associations also have the legal authority to enforce USPAP compliance by their members. In addition, many users of appraisal services (such as lenders, mortgage companies, etc.) have adopted USPAP and require employee or contract appraiser compliance to USPAP.

One important issue to keep in mind when planning for fulfilling the 7-Hour Course requirement is that when taking the course, an attendee must sign that they have access to the actual copy of USPAP. Copies may be obtained from the Appraisal Foundation from the Store or may be ordered over the phone by calling (800) 348-2831. There are three options. A print copy is \$75.00, A PDF copy is \$65.00 and the combination of both is \$99.00.

State Approval

Essential to fulfilling the obligation to take the course is to verify that the course selected is approved by the State in which the appraiser is licensed and that it is taught by at least one AQB Certified USPAP instructor. More states are approving the on-line course which in most cases is the most convenient and least expensive option.

Retirement of all Statements on Appraisal Standards

The major change in the revised 2016-17 USPAP is the final retirement of the remaining five Statements, SMT-2, 3, 4, 6 and 9. Guidance within each of these Statements has now been incorporated into the following:

- ADVISORY OPINION 33: Discounted Cash Flow Analysis
- ADVISORY OPINION 34: Retrospective and Prospective Value Opinions
- ADVISORY OPINION 35: Reasonable Exposure Time in Real and Personal Property

Opinions of Value

- ADVISORY OPINION 36: Identification and Disclosure of Client, Intended Use, and Intended Users

Advisory Opinions

The statements on Discounted Cash Flow Analysis and Retrospective Value opinions were modified in the

Advisory Opinions to apply only to real property. The remaining changes consist only of administrative edits and revisions to language and guidance that better reflect current practices and terminology. For a more details review of the revised Advisory Opinions, Go to The Appraisal Foundation website at www.appraisalfoundation.org to view the adopted Advisory Opinions in the Fourth Exposure Draft of proposed changes for the 2016-17 edition of the Uniform Standards of Professional Appraisal Practice, or click on the following link:

<https://netforum.avectra.com/eWeb/DynamicPage.aspx?Site=TAF&WebCode=ASBDrafts>

Significant Changes to Standard 3.Reviews

Standard 3-2 (e) was removed from the Standard. This section called for the appraiser to identify the effective date of the reviewer's opinion and conclusions. Standard 3-3 (c) was revised to simply state "When the assignment includes the reviewer developing his or her own opinion of value or review opinion, the following apply: This section was revised to include Standard 1, 6, 7 or 9. The subsequent wording eliminated references to the Scope of Work and instead merely stated "the assignment includes the reviewer developing his or her opinion of value and addressed the date of review in the following way: "The effective date of the reviewer's opinion of value may be the same or different from the effective date of the work under review."

Formerly, Standard 3 called for the appraiser to state the identity of the intended users. Standard 3-5 now reads: "state the identity of the client, unless the client has specifically requested otherwise; state the identity of any intended users by name or type.

There were no changes to the Standard 3 Certification.

The following is the rationale for changes to Standard 3:

In the 2014-15 edition of USPAP, STANDARD 3 required that the reviewer identify and report: the date of the work under review; the effective date of the opinions or conclusions in the work under review; the effective date of the appraisal review; and disclose the date of the appraisal review report. The ASB received numerous questions about the various dates in STANDARD 3 and took a closer look at the rationale for requiring these dates.

The effective date of the appraisal review added confusion and did not appear necessary in an appraisal review assignment. This is because the information necessary to understand the perspectives of both the original appraiser and the reviewer are covered with the disclosure of: the date of the report under review; the effective date of the appraisal under review; and the date of the appraisal review.

The majority of the comments received were in favor of eliminating the effective date of the appraisal review, although several contended the effective date of review should not be eliminated. The ASB adopted the deletion of the requirement to identify and report the effective date of an appraisal review.

Other Changes:

Record Keeping Rule

The Board changed the wording in this section that clarified that an appraiser must retain true copies of all written reports. USPAP also modernized the record keeping section to make it clear that data and information may be included in the workfile by referring to its location elsewhere.

Assignment Results

The Board outlined what are assignment results and specifically indicated that “Physical characteristics are not Assignment results.

Confidential Information

The Board made a revision that takes into account the Gramm-Leach-Bliley Act by stating information “Classified as confidential or private by applicable law or regulation.”*

“*NOTICE: For example, pursuant to the passage of the Gramm-Leach-Bliley Act in November 1999, some public agencies have adopted privacy regulations that affect appraisers. The Federal Trade Commission (FTC) issued two rules. The first rule (16 CFR 313) focuses on the protection of “non-public personal information” provided by consumers to those involved in financial activities “found to be closely related to banking or usual in connection with the transaction of banking.” These activities include “appraising real or personal property.” See GLB-Privacy. The second rule (16 CFR 314) requires appraisers to safeguard customer non-public personal information. See GLB-Safeguards-Rule. Significant liability exists for appraisers should they fail to comply with these FTC rules.”

The ASB adopted two paragraphs that were exposed in the Third Exposure Draft, which deal with protecting confidential information within the appraiser’s office. The intent was to acknowledge that employees or contractors have access to confidential information as part of a normal working environment and to require the appraiser to ensure that anyone who may have access to that information is made aware of its confidential nature.

These paragraphs were added:

An appraiser must take reasonable steps to safeguard access to confidential information and assignment results by unauthorized individuals, whether such information or results are in physical or electronic form.

An appraiser must ensure that employees, co-workers, sub-contractors, or others who may have access to confidential information or assignment results, are aware of the prohibition on disclosure of such information or results.

Changes in Reporting Standards

Language was added allowing the client to request non-disclosure of their identity. This change is far-reaching and extends into all reporting Standards. 2-2(b); 6-8(d); 8-2(b); and 10-2(b).

Exposure Time

The Board tweaked the section on Exposure time, yet again by emphasizing the word “Reasonable” The rationale is as follows:

USPAP currently requires that the appraiser develop an opinion of reasonable exposure time whenever exposure time is a component of the definition of value being applied. There may be cases when exposure time, but not reasonable exposure time is a component of that value definition and thus, an opinion of reasonable exposure time would not be necessary. In fact, stating such an opinion might even cause confusion. Therefore, the ASB has adopted the revision to the Comment at the end of Standards Rules 1-2(c) and 7-2(c).

This revision is particularly helpful to eliminate confusion in appraisals done for REO properties and relocation appraisals.

Conclusion:

There are no major changes in the 2106-17 edition of USPAP that call for significant altering of typical reporting protocols. This edition presents a challenge to USPAP Instructors as to how to make this up-date class interesting. Appraisers who do review work would do well to carefully read Standard 3 in its entirety. The above mentioned revisions of Advisory Opinions are best reviewed in their entirety by those appraisers doing commercial work. Workfile procedures are modified requiring a review of these procedures. In view of the demands of the passage of the Gramm-Leach-Bliley Act, and the vigilance necessary to protect confidentiality within an appraisal office and with outside contractors, the Confidentiality Section deserves careful consideration. Lastly, clients are more in the driver's seat as to whether their identity is disclosed.

Use of A La Mode Software Automated Valuation (AVM) Model Puts Montana Appraisers at Risk

By Douglas G. Smith, SRA

Having completed 150 desk reviews of appraisal assignments around Montana for USPAP compliance, I have gained some insight into the general competency of at least one segment of the population of appraisers who accept work from Appraisal Management Companies. Unfortunately, I cannot confirm good news on that front for fully 25% of the reviews were found to have serious USPAP compliance issues. There were some areas of the state where failure rates were 85%. I was very concerned to find that in almost every area of Montana, a fair number of appraisers are completely relying on the A La Mode Appraisal Software AVM that purports to prepare a weighted average of the comparable sales found in the report. Appraisers are adopting without any form of reconciliation the results of this AVM and in some cases including both sales and listings within the sample. The A La Mode Company never intended that this tool be adopted by appraisers for the final determination of value. It claims that the result is a "suggested" value.

I encourage any appraiser now using this AVM or is contemplating using this AVM to read Advisory Opinion 18(AO-18) " Use of an Automated Valuation Model (AVM and understand this section completely.

The most relevant portion of AO-18 is: "The output of an AV is not, by itself, an appraisal. An AVM's output may become a basis for appraisal or appraisal review if the appraiser believes the output to be credible for use in a specific assignment." "An appraiser can use an AVM as a tool in the development of an appraisal or appraisal review. However, the appropriate use of an AVM is like any tool, dependent on the skill of the user and the tool's suitability to the task at hand,"

In order to review reports using the A La Mode AVM, I had to conduct an investigation as to how it worked. I was stunned to find that the formula used was both bad math and worst statistics. I am guessing that no one using this model has taken the time to fully investigate the way the "weighted average" is calculated.

The reports in question use a weighting system that is part of the A La Mode Software system. The following is the means to calculate a given comparable weight (Comp Y). To calculate a given comparable weight,

the program uses the following formula where Y represents a unique comparable (ie Comp 1, Comp 2, Comp 3, etc.)

$$\frac{\text{CompY Gross Adj \%}}{\text{Total Gross Adj\%}} \times 100 = A$$

$$100 - A = B$$

$$\{\text{Total number of Comps}\} - 1 = C$$

$$\frac{B}{C} = \text{Weight of Comp Y}$$

This weighting system is offered by the appraisal software company as a means of “suggesting” a value. As can be seen in the formula, the algorithm uses percentages to arrive at yet another percentage which is weighted by allocating the distribution by one less than the comparable sales used. The allocation system, in effect, then evens out the distribution and therefore the results do not truly represent a weighted average. In this instance, USPAP weighs in with the following:

Standards Rule 1-1(a): An appraiser must be aware of, understand and correctly employ those recognized methods and techniques that are necessary to produce a credible appraisal. Standard Rule 1-6(b): An appraiser must reconcile the applicability and relevance of the approaches, methods and techniques used to arrive at the value Conclusion(s).

The typical report using the AVM explains the weighting system as follows:

“Estimated indicated value is determined by using the Gross Adjustment of sale price for each comparable as a measure of the relative quality of the comp. A lower adjustment indicates a better comp, and vice versa. The ratio of gross dollar adjustment to sale price for each of the comps is used to calculate the weight each comp should have in a weighted average calculation. This weighted average is used as the indicated value of the subject.

As with any method, this technique is not perfect. However, it does do a very good job of giving more weight to the most similar comps while at the same time minimizing values near the extremes of the indicated value range.”

In every case, I found the opinion of value in the report was the value determined by the AVM. Despite the fact that the explanation cited that the sample included only the sales, in some cases, the sample included both the sales and the listings and these listings were included without comment or explanation. In Montana, where there is likely a wide variance of the elements of comparison among the comparable sales and where appropriate comparable sales require larger than typical adjustments, putting the emphasis on an AVM that emphasizes the least amount of adjustments is singularly illogical. The use of this AVM as the sole means to determine an opinion of value is not appraising.

In most cases, the appraisal report never reconciles the approaches to value and the appraiser never exercises judgment in the reconciliation process giving weight to individual Comparable Sales. The reports would have, in most cases, benefited by a clearer statement within the reconciliation as to why the results of the weighted average analysis were emphasized and a clearer explanation as to how the weighted average was derived and the reason for the emphasis on the level of the gross adjustments rather than other qualitative and quantitative elements of the appraisal analysis.

I recommend that appraisers using the A La Mode AVM, suspend its use until all the elements of AO-18 are met, and that appraisers relying on this AVM, introduce accepted reconciliation techniques, halt including

listings within the sample or explain why listings are appropriate. Because this tool is based on faulty math and worst statistics, its use should be confined to its original use, merely to determine a “suggested” value not a value on which an appraiser is ready to stake his or her license and credentials.

A Closer Look at Listings

By Douglas G. Smith, SRA

By any measure, most residential markets around the country are experiencing a surge in the number of properties listed for sale. Properties are also remaining on the market longer. The analysis of these listings is taking center stage in the scenario of determining the health or frailty of the local market. One after another, lenders are asking for market value trends and supply and demand trends. One major lender recently issued these instructions, *“By comparing the total number of closed sales over the last 12 months to the number of current listings in the same market area, the potential supply can be determined.”* The instructions go on to comment, *“If the supply of properties for sale reflects an over-supply for the subject market, the appraiser should provide comments that explain how that over supply impacts market value.”* The National Association of Realtors® publishes information on listings. As of the end of April listings were up 7.9% over last year and the number of months’ supply was up 31.8% over last year. While the focus may be on the number of listings and lenders are requesting a quantitative analysis of listings, appraisers must be careful not to overlook the qualitative analysis of listings. To the appraiser, listings may not be what they seem and understanding the inner workings of real estate being offered for sale allows insight into the true condition of the current market and in some cases may suggest where the market is going.

Coming to Terms with Supply and Demand

Lenders refer to the quantitative analysis of listings as a supply and demand analysis. In traditional economic terminology these terms are a mischaracterization when applied to housing. The required analysis is more appropriately described as an inventory analysis. The terms supply and demand refer to a relationship of price and quantity of an offered product or service. Demand refers to how much (quantity) of a product or service is desired by buyers. The quantity demanded is the amount of a product people are willing to buy at a certain price; the relationship between price and quantity demanded is known as the demand relationship. Supply represents how much the market can offer. The quantity supplied refers to the amount of a certain good producers are willing to supply when receiving a certain price. The correlation between price and how much of a good or service is supplied to the market is known as the supply relationship. Price, therefore, is a reflection of supply and demand. The relationship is typically shown with supply on an upward slope. This means that the higher the price, the higher the quantity supplied. Producers supply more at a higher price because selling a higher quantity at a higher price increases revenue. In housing, the only portion of the so-called supply of housing is that which is new housing supplied by developers producing homes to meet demand at an acceptable price. Appraisers, with an economics bent, however are fighting a losing battle as lenders have the upper hand when labeling their own requirements.

Two issues split the analysis of the number of homes offered for sale in any market. The first is the makeup of the listings in terms of the intent of the sellers and the second is the part of the analysis that defines the market area from where the listings are drawn. Appraisers best define the market in traditional terms by identifying the market forces that are existing in a specific neighborhood. This is commonly referred to as granularity.

Granularity

The business dictionary defines granularity as, “Level of detail (fineness) considered in a model or decision making process. The greater the granularity, deeper the level of detail (fineness of data). In the Missoula, Montana market, the Office of Federal Housing Enterprise Oversight (OFHEO) produces the House Price Index (HPI) for the Missoula MSA. The HPI is a weighted, repeat-sales index, meaning that it measures average price changes in repeat sales and refinancings on the same properties. Citing this index satisfies some of the guidelines issued by lenders in response asking for statistical support for whether prices are stable, increasing or declining. Since the Standard & Poor’s/Case-Schiller monthly home price indices are only published for 20 metropolitan areas, this index is not relevant in Montana. The challenge facing appraisers is that these published indices in most cases don’t reflect what is happening on the ground in specific neighborhoods. All appraising is local and the chief benefit to any client for using an appraiser is that the appraiser enjoys geographic competency. The market as a whole may be acting in one way, but for very individual reasons, a specific neighborhood may be acting in the opposite direction. In the same way that price indices may vary for individual neighborhoods, so does the number of properties offered for sale vary. By studying the market area and those directly competitive a more accurate picture emerges. Hence, the level of granularity becomes the key to a more accurate analysis of the properties listed for sale.

Vapor Listings

Lenders and the press treat listings or the inventory of homes offered for sale as a reasonable statistic for gauging the health of the market. There is a sense that market onlookers regard listings as “surplus” properties. The more listings there are and the longer properties are on the market points, the more unhealthy the market. Listings are assumed to have the same characteristics and the sellers are assumed to have the same intentions or motivations. No accounting is made for the changes in motivations or intentions over time. In the Missoula market, developers are allowed to list in the local multiple listing service (MLS) land parcels on which the developer will build a certain model. All that exists is a platted parcel and a blueprint. In one local community within Missoula County, these “vapor listings” make up 40% of the listings. In the Missoula MLS, these properties are listed as to be developed (TBD) and rightfully in any inventory analysis should be subtracted from the total.

Competitive Set

Most MLS services allow for segmenting properties into broad categories such as single family units on lots or acreage or manufactured homes on lots or on acreage. Condominiums and townhouses might be another type of property lumped into a MLS neighborhood. While the total market within a neighborhood may provide an overall picture of the condition of the market, analyzing the market segment in which the property is found is more relevant. This extends to property attributes such as number of bedrooms and baths etc. One Company, Rels, the appraisal management company arm of Wells Fargo, requires appraisers to adopt a “Reasonable Substitute” analysis based on the asking price alone. In this analysis, the appraiser estimates the price point of the subject and analyzes the properties that are considered reasonable substitutes for the property being appraised. A property that is considered a reasonable substitute is considered to be an offered property that is priced within a range 20% below and 20% above the estimated value of the subject.

To correctly determine how the property being appraised fits into the market, listings must be analyzed in the context of both the neighborhood and the specific competitive set that applies to the property. The appraiser must initially identify and evaluate the property’s characteristics. This in turn allows the appraiser to identify the makeup of the pool of buyers for the property. Only then can the appraiser create a search mechanism for properties that are competitive to the subject.

True Listings

It takes some close reading of listings one-by-one but understanding the makeup of listings is an important exercise to understand the market. Most MLS listings do not readily identify properties that are vacant. Some identify properties if they have tenants in order to alert real estate agents that extra steps may have to be undertaken to show the property. By carefully reading the listings, looking to see if the occupant is listed with whom to make an appointment to show are indications of the property status. In the Missoula market, about 25% of the properties are vacant and less than 2% are tenant occupied. Keeping track of this ratio provides a measure of the seriousness of sellers. If sellers have vacated the property and have moved on, rising ratios may signal increasing weakness in the market. Most MLS listings are not helpful for determining how many properties are in foreclosure. These statistics are mostly drawn from courthouse records. Records are kept for notices of foreclosures and actual foreclosures. One helpful website is forcllosures.com. This website lists the foreclosure laws for each state and link to applicable state laws. Another site, foreclosure.com lists in detail foreclosure statistics, sheriff sales and bankruptcies. By placing the cursor, the statistics for the county are shown. Both of these sites to view the actual properties require a subscription.

The Collapse of the Greater Fool Theory

The makeup of the properties that are offered for sale changes over time. Presently there are a higher number of properties that are Real Estate Owned (REO) properties. One emerging category of listings is properties that are being offered by non-serious sellers. These sellers are different from the so called "upside down" sellers who have too much owing on their property to offer a realistic price. These are sellers who have been coaxed by real estate agents with too much time on their hands to list their property in hopes someone will come along and pay more than the going price for the property. In Montana, many benefited from this strategy because compared to markets outside Montana, Montana real estate seemed to be priced at bargain levels. Some listings are a result of the greater fool theory playing out. Many erstwhile investors purchased properties expecting another buyer, (the greater fool) to come along and pay an even higher price for the property. There is clear evidence in the present market, that rising prices on which the greater fool theory was based were ultimately unsustainable and someone had to be left holding the bag. The current property owner is turning out to be the greater fool. Again, a careful reading of listings is required to come to some sort of determination as to how many properties are listed that are virtually "unsellable" by current market standards. One other avenue of assistance is to track listings over time. "Unsellable" listings tend to become evident once the average marketing time is exceeded. Prior to this, appraisers may use as their best indicator a simple square foot measure, the offered selling price divided by the GLA. With some parameters set, this simple measure can provide not the most reliable indicator of properties that are priced unrealistically but at least some measure of properties that are not competitive properties.

Capture Rate

The estimated percentage of the total potential market for a specific type of property that is currently absorbed by existing like properties or is forecast to be absorbed by proposed properties is referred to as the capture rate. By tracking listings of properties over time, and performing a detailed inventory analysis in both good years and bad years, appraiser can more accurately define both the present condition of the market and isolate trends in the market's direction. The capture rate provides a base line for determining whether the market is normalizing or is continuing in a downward trend. This analysis, however, cannot be confined to the number of properties offered for sale but must be expanded to a closer look at the qualitative factors that make up the properties listed for sale.

Review of the Real Estate Finance, Statistics, and Valuation Modeling Course

By George Page, SRPA, SRA

I would like to reflect on how much I enjoyed the *Real Estate Finance, Statistics, and Valuation Modeling* course taught in January at Great Falls, Montana. I learned a great deal of information and even managed to pass the exam. I'm pretty much retired and in my late seventies, with a history of not performing well when it comes to exams. I bet half the class was under the age of 50. I studied hard for a couple of weeks leading up to the exam. I wanted to challenge my mind and body of knowledge by taking the course. My appraisal career dates back to 1965, and I've worked on everything from soup to nuts, six superfund sites, three high profile federal eminent domain court cases, and valuation service assignments in thirteen States and the Virgin Islands. Most of my state and federal appraisal activity involved partial takings, both as an appraiser and later as a reviewer, using Before and After Value Methodology.

I have a few comments about the statistic course material. My intent is not to be lecturing or bestowing knowledge, and I'm certainly not the arbiter of correctness. I just have a few thoughts for further consideration. I like working with numbers and some of the behind the scenes calculations when it comes to financial problem solving. I entered the appraisal profession before the introduction of the hand-held calculators; we did everything with paper and pen. I've used the HP-70, HP-38C and now use the HP-12C, a great tool, but I hope appraisers really understand dollar functions rather than just how to push buttons.

Statistics is an increasingly practical and necessary part of a valuation practice. It is a body of principles and methods concerned with extracting useful information from numerical data. The course covered a wide range of subject matter such as standard deviation, central tendency, normal distribution, standard error, confidence intervals, simple versus multiple regression. We also addressed some financial problem solving concerning loan balances, points paid, adjustable rates, risk issues, capital markets, along with discussion about the housing bubble and the Federal Reserve Bank.

I believe the statistics course covered too much material in a short period of time. It's easy to overload a person's capacity to truly understand multiple regression with all its coefficients in the Excel printouts. Personally, I've never used multiple regression or Excel, but just a brief introduction to that part of the course was a real eye-opener to me.

Too many terms for the same meaning: Loan Constant (LC), Mortgage Constant formerly called f and $f/12$, and the Capitalization Rate on the Mortgage known as R_m (R sub m), it's just all about computing debt service. Assume a \$1,000 loan at 10% interest, annual end-of-year payments, and a three-year term. The quick easy way with the HP12C is simply Enter N 's 3, i 10%, PV 1 = Annual Constant of $.402 \times \$1,000 = \402 annually. But here's another long way to solve for the mortgage constant. Start by backing up a year, use a two year holding period with loan balance $b.36556$, & therefore p . equals $.63441$., so now we can solve for R_m . There's really no need to proceed doing it the long way, but it can be done as follows: Sp represents the FW of One at the mortgage interest rate annually for a two year holding period. $Sp - 1 = N$'s 2, i 10%, PV 1 = FV 1.2100 minus 1. = $.2100$.

$$R_m = 1 + \frac{P}{Sp - 1} (i) \quad .402 = 1 + \frac{.63441}{.2100} (.10) \text{ Use the annual rate.}$$

$$PV \$1,000 \times .402 = \$402 \text{ Annual P \& I.}$$

Problem

Develop the interest-only and fully amortizing payment schedules for \$100,000, three-year, annual payment loan at 6% interest. Using the math in problem to prove that cost of debt (interest rate) is the same for both an interest-only loan and a fully amortized loan.

For an interest-only loan, you pay a level 6% per year or \$6,000 on same \$100,000, with a final payment of \$106,000 at the end of year three. The principal amount remains unchanged.

Step One:

Always figure the P & I, if you have the data to start with. In this case, the debt service is \$37,411 annually. $N's\ 3, i\ 6\%, PV\ \$100,000 = Annual\ Pmt.\ \$37,411$

The amortized principal would be \$31,411 the first year, \$33,296 the second year, and \$35,293 the third year for a total sum of \$100,000 at the 6% rate.

Step Two:

You can prove the cost-of-debt (interest rate) is 6% in each case by calculating the IRR, while considering the timing of level periodic cash flows during the three year term.

View the interest-only problem in terms of an investment and solve for IRR. Using a HP 12C, the initial investment is a minus (-) \$100,000 of equity money, followed by two years of positive level cash flows at \$6,000 each, and a final third year cash flow on resale at say \$106,000. The IRR is 6%, thus the cost of debt is same in both instances. Timing is everything.

Problem

What will be the monthly payments and the balance at the end of the 10th year on a monthly payment \$130,000 loan with a 30 year amortization period at an interest rate of 5.75% per year?

Step One:

Again start by computing the debt service with the known information. $N's\ 360, i\ .479\%, PV\ \$130,000 = Monthly\ Pmt.\ \$758.64.$

Step Two:

Question, what is the loan balance at the end of the 10th year or after 120 payments? A quick answer is, Enter 120 N's and hit FV, the answer is \$108,056. Simple.

With the HP12C, you can keep going up the scale in years for quick loan balances, but not down the scale in years. Nice HP-12C feature.

The balance (b) of the loan at the end of the 10th year is \$108,056, and therefore, the amount paid-off (p) would be the difference between \$130,000 and \$108,056 or \$21,944. The letter b is the balance yet to be amortized; it represents the present value of remaining payments. Letter b is the mortgage balance, the principal amount of loan at a point in time.

The mortgage balance (b) may be solved by finding its compliment known as p. which is the percentage of the mortgage repaid during a balloon or some specific holding period.

Calculating the percentage paid-off (p) using the FW of One with monthly compounding and the following formula:

$$(120 \text{ months}) \quad \underline{N's 120, i .479, PV 1 = FV 1.77462 \text{ minus } 1. = .77462}$$

$$P = \frac{Sp - 1}{.77462} = \frac{.77462}{.77462} = .168783$$

$$Sm - 1 \quad 4.589447$$

$$(360 \text{ months}) \quad \underline{N's 360, i .479, PV 1 = FV 5.589447 \text{ minus } 1. = 4.589447}$$

Therefore

$$1.00 \text{ minus } p.168783 = b .831217 \times \$130,000 = \$108,058$$

For calculation of "p", other equations may produce slightly different results, depending, in part, on rounding. The above equation was selected because both the holding period (120 months) and full amortization (360 months) term of the mortgage are known in the problem.

Sp and Sm represent the FW of One at the mortgage interest rate monthly for the holding period and full term, respectively.

$$Rm = 1 + \frac{P}{Sp - 1} (i) \quad .07003 = 1 + \frac{.168783}{.77462} (.0575)$$

$$.07003 / 12 = .005836 \text{ Monthly Constant}$$

$$PV \$130,000 \times .005836 = \$758.66 \text{ Monthly P \& I.}$$

N's 360, i .479, PV 1 = Pmt. .005836 X 12 = .07003 Annual Constant based on Monthly Payments. The Annual Constant based on Annual Payments is .070716.

The old saying that "statistics never lie, but liars always use statistics", is simply an acknowledgment of how easily statistics can be manipulated to create a desired impression.

For example, the rate of inflation grows in one year is from 2 percent to 4.5 percent, and then again from 4.5 to 6 percent in the second year, it would be technically correct to say that the rate of growth in inflation was down by about 92 percent in the second year, even though the inflation rate grew by 2.5 percent in both years. But the effect of making such a statement, even though it would be technically correct, could be very misleading to most readers. Unless the reader understands thoroughly that the 92 percent figure refers to the rate of growth in inflation, and not the rate of inflation itself, the figures would be quite deceptive.

First Year: 2.0% to 4.5% = A Percentage Increase of 125%.

Second Year: 4.5% to 6.0% = A Percentage Increase of 33%.

Difference: 92%

The Rate of Growth in the second year is "minus" 92%, while the Percentage of Increase in the second year is a "plus" 33%. You could also say that the Percentage of Decrease from year one to year two is a "minus" 73.6%.

Just for fun, I decided to put my new found statistics knowledge to use by looking back at my university transcript and viewing grade point averages per quarter for my junior and senior year.

I wanted to test measures of central tendency . . . mean, median, and mode. The array of numbers high to low is as follows: 3.00, 2.83, 2.60, 2.60, 2.43 and 1.94. The mean is 2.56, the median and mode are both 2.60. I'm looking for the mean of the population. The standard deviation is .36626. The square root of 6 observations is 2.4494 and the standard error is .1495 (.36626 divided by 2.4494). I used a 95% confidence interval with 6 observations minus 1 or 5 degrees of freedom. The 95% factor shown in the "t tables" is 2.571 times the standard error of .1495 equals .38 plus or minus from the mean of 2.56. Therefore, the values are 2.18 on the low side of the mean, and 2.94 on the high side of mean.

I'm much more aware of statistics in print and on the air after taking the course. Lots of dependent and independent grids are showing up all over the place.

Market Value vs. Investment Value Again

By George Page, SRPA, SRA

Market value is a group dynamic, meaning the amount of money a property is worth as viewed in the marketplace by more than one person. By contrast, investment value is singular in scope and the buyer chooses the worth independently of others. Market value is akin to objective value, while investment value falls into a subjective value category.

Objective value is how a group tends to observe the worth of an object having intrinsic value. Subjective value means you alone choose its value. Under the subjective premise, the choice is yours and you make the decision on what has value to you. What has value to you, may not have value to a group of observers.

Market value implies a cash value to the seller. The source the buyer's funds are secondary and can come from a variety of different sources. The source of the buyer's funds has nothing to do with the seller. The buyer could purchase with cash (all equity), leverage funds from lenders, inherit the money, stock and bond trades, chattels or use a variety of other capital held assets. Therefore, the way in which individual property is financed does not impact its market value. The loan-to-value ratio does not affect value, while favorable financing terms may impact the transaction price, but price is not value. Thus market value remains unchanged even with different lending ratios of equity and debt, but mortgage terms give rise to a whole range of financial issues, and buyers give consideration to these issues.

As appraisers, we've been taught that investment value targets the objectives of an individual investor as opposed of the masses. The personal objectives of a particular investor may be quite different from other investors viewing the same opportunity, but they all tend to gather around the mean. I tend to view investors of income property as informed buyers with similar expectations, so in that regard market value and investment value seem to be synonymous terms. But the whole argument of how investment value differs from market value is subject to interpretation by those on both sides of the issue.

The mortgage equity approach to value was a hot topic of discussion in the early eighties with the introduction of "Elwood's" red book philosophy and coefficient tables for different mortgages, interest rates and time. The main theme was that income property was seldom free and clear, and that investors leveraged their purchases with the best possible funding available. Elwood's teaching gave weight to a whole array of issues such as yield expectations, the equity position, mortgage terms, holding period, appreciation / depreciation, reversion and other buyer issues. The American Institute of Real Estate Appraisers embraced Elwood's teachings, but some appraisers seem to shy away from fully accepting his works as being too complicated. With the passage of time, Elwood's philosophy has fallen out of favor with

the appraisal community. Today, the Appraisal Institute's position is that financial terms do not impact market value and that loan-to-value ratios do not affect value which is contrary to the mortgage / equity philosophy.

It is my belief that market value and investment value can at times mirror each other. Knowledgeable income property investors will tend to leverage purchasing power by seeking the best possible mortgage terms. The question is: do the value objectives of a particular investor differ significantly from other prospective market investors looking at same or similar opportunities? They are all potential buyers making rational observations about a particular property and giving like consideration to the present worth of the future benefits of ownership. The present benefits deal with cash flow, while the future benefits deal with the reversion of the property or sale.

Direct Sales Comparison Approach:

The overall capitalization rates (OAR's), aka, big R or Ro and typically developed through the relationship of net incomes divided by sale prices as analyzed by comparable sales data. For instance, say the OAR as analyzed from sales data in the CBD falls within a range of 6.4 to 7.2 percent, and 6.5 percent is the better fit for our hypothetical subject property. The subject has a fairly stable net operating income (NOI) of \$32,500, and therefore, the market value could be estimated at say \$500,000. The figures below suggest an ideal market which is never the case.

<u>Sales</u>	<u>Sale Price</u>	<u>NOI</u>	<u>OAR</u>
1	\$500,000	\$37,500	.072%
2	\$475,000	\$32,300	.068%
3	\$455,600	\$27,336	.060%
4	\$525,000	\$34,125	.065%
5	\$540,000	\$34,560	.064%

Alternative Income Approach:

There's another way of introducing different reasoning and philosophy in viewing income property today known as the mortgage / equity approach. It is universally recognized that real property is seldom free and clear. Investors will seek funds to their advantage whenever possible. Knowledgeable buyers will give weight to a whole array of factors such as yield expectations, equity invested, leveraging the best mortgage terms giving consideration to appreciation / depreciation during a holding (projection) period . All of these different factors play into the development of the basic capitalization rate (r), and ultimately the overall capitalization rate (OAR), if there's any movement upward or downward in value during the holding period. Our hypothetical income property falls in a market value range of say \$455,600 to \$540,000. The property's net income is fairly stable at around \$32,500, but has been slightly increasing yearly. Investors are looking at a 60 percent first mortgage (60 to 40) ratio, with a 15 year term at 5 percent annual interest rate, fully amortized in equal monthly payments of principal and interest. As a whole, investors are considering a before-tax equity yield rate at say 12 percent return on their investment, coupled with a 5 year holding period. During the holding period the property is expected to appreciate between 5 to 15 percent, say 10 in value.

Step One:

Calculate the debt service on our hypothetical problem. N's = 15 yrs. or 180, Interest 5 percent or .416667 monthly, PV = \$1.00, and the answer is .007908 monthly times 12 equals .094895. The debt service factor is **.094895** referred to as Rm or the loan constant.

The .094895 is the annual rate on the mortgage with monthly conversion periods, not to be confused with the annual payment factor .096342.

Step Two:

Calculate the percentage paid-off (P) during the holding period. The mortgage is for 15 years, but the holding period is 5 years. Question: What is the loan balance at the end of the 5th year or after 60 monthly payments? Enter 180 N's, Interest .416667 monthly, PV \$1.00, and the debt service answer is -.007908. Now stop, enter 60 N's and hit FV, the answer is (b) - 0.74557 (change signs) the mortgage balance. The difference between 1. and .74557 is the percentage paid off (P) or **.254429**.

Step Three:

Calculate the annual sink fund factor at the equity yield rate for the holding period. The holding period is 5 years, and yield rate is 12 percent, and FV is \$1.00, and therefore, the sinking fund factor is **.157410**. We use an annual sinking fund factor based on the 5 year hold.

Let's now consider another way of developing the OAR without sales, but instead by analyzing yield expectations coupled with how income property is financed. The NOI is known in our hypothetical problem. All of this can be done without the use of algebraic formulas, but with just simple equations. The basic starting point is $Y - MC$, equals yield (Y) minus the mortgage (M) times the (C) mortgage coefficient equals the basic cap. rate (r). Basically, we need to find the right mortgage coefficient (multiplier) using the following equation: $C = Y + (P \times 1/Sn) - Rm$.

Again, the mortgage coefficient is (C), the yield is (Y), the percentage paid off during the holding period is (P), and the sinking fund factor is at the equity yield rate annually for the projection period (1/Sn), and finally minus the rate on the mortgage (Rm). If the property remains stable during the holding period without any depreciation / appreciation, then the basic rate (r) is the OAR. But if the property depreciates or appreciates during the holding period, we use the percentage of movement times the annual sinking fund factor at the yield rate for the projection period to develop the OAR. Depreciation would be a plus adjustment to the basic cap. rate (r), increasing the OAR, while appreciation is a minus adjustment to the basic rate (r) lowering the OAR. As shown below in our hypothetical case, we are used appreciation which subtracts from to the basic rate.

$$\begin{aligned}
 r &= Y - MC \\
 C &= Y + (P \times 1/Sn) - Rm \\
 &= .12 + (.254429 \times .157410) - .094895 \\
 C &= \mathbf{.065155 \text{ Mortgage Coefficient}} \\
 Y &= .120000 \quad M \times C \\
 &= \underline{-.039093} \quad (.60 \times .065155) \\
 r &= .080901 \quad \mathbf{Basic Capitalization Rate} \\
 &= \underline{-.015741} \quad (\text{App.} \times 1/Sn) \\
 &= \underline{-.015741} \quad (.10 \times .157410) \\
 Ro &= \mathbf{.065160 \text{ Overall Capitalization Rate}}
 \end{aligned}$$

Caution: the mortgage coefficient is nearly the same as the overall cap. rate in this example. Using an non-traditional income approach with a NOI of \$32,500 and a OAR of say 6.5 percent, the estimated market value is \$500,000.

Recap:

<u>Component</u>	<u>Ratio</u>		<u>Capitalization Rate</u>		<u>Weighted Rate</u>
Vo	= 1.00	x	.065160 Ro	=	.065160
Vm	= .60	x	.094895 Rm	=	-.056937
Ve	= .25		Difference		.008223

$$Re = .008223 / .40 = .020558$$

<u>Component</u>	<u>Ratio</u>		<u>Capitalization Rate</u>		<u>Weighted Rate</u>
Vm	= \$300,000	x	.094895 Rm	=	\$28,468 Rm
Ve	= \$200,000	x	.020558 Re	=	\$ 4,112 Re
Vo	\$500,000				\$32,580 NOI

$$Vo = NOI / OAR = \$32,580 / .065160 = \$500,000$$

<u>Component</u>	<u>Ratio</u>		<u>Capitalization Rate</u>		<u>Weighted Rate</u>
Vm	= .60	x	.094895 Rm	=	.056937
Ve	= .40	x	.020558 Re	=	+.008223
Vo	1.00		Ro	=	.065160

The equity dividend rate (Re) is the NOI (\$32,500), less the Debt Service (\$28,468) equals a positive cash flow of \$4,112 divided by the equity invested (\$200,000) indicating a positive equity dividend rate of .020558, say 2 percent.

Analysis of Projected Equity Yield:

Appraised Value	\$500,000	Net Income	\$32,500
Less Mortgage	<u>-\$300,000</u>	Annual Mtg. Pmts. -	<u>\$28,468</u>
Equity Money	\$200,000	Equity Cash Flow	\$4,112
		Equity Cash Dividend	.020558 or 2%

Projected Property Reversion:

Estimated Value	\$500,000
Plus Appreciation 10%	<u>\$ 50,000</u>
Estimated Value of the Reversion	\$550,000
(b) Less Mortgage Balance at the End of Period	<u>-\$223,671</u>
Vm \$300,000 x (b) .74557	

Estimated Equity Reversion a End of Period \$326,329
(Proceeds from Sale)

Recap of Equity Income & Reversion Values:

Equity Cash Flow \$4,112 x 3.604776	=	\$ 14,823	PW of 1PP @ 12%, 5yrs.
Equity Reversion \$326,329 x .56727	=	<u>\$185,168</u>	PW of ! @ 12%, 5, yrs.
Total Required Equity Investment Today	=	\$199,991	say \$200,000

Tips on Dealing with Engagement Letter Fine Print Report Clutter

By Douglas G. Smith, SRA

A recent retrospective review assignment went to Fannie Mae via an appraisal management company with 86 pages. The demand for copies of tax cards and MLS sheets pushed the limits of usual exhibits typically found in a summary report. With less emphasis on summarizing information, lenders want copies of material normally found in work files. Some information requests, like copies of MLS sheets, are pushing the envelope of local MLS policies on fair use of MLS data and copyright infringement. Engagement letters are expanding exponentially and include items that must be carefully considered that have serious business consequences such as a blanket request to include a copy of the typical E & O binder. More appraisal management companies are making the development of the cost approach mandatory with no regard whether the cost approach contributes to credible results. The development of the cost approach in the current market has serious implications; not the least of which is following Standard Rule 1-4 in which “an appraiser must collect, verify, and analyze, all information necessary for credible assignment results.” With the onset of many new appraisal management companies, appraisers are required to sign onerous indemnification clauses that are extraordinary on their face and have real future consequences. Finally, the speed with which a report must be returned is becoming central to the relationship of the appraiser and the AMC. The first step is to read and understand any contract for services with companies accepting an application to the appraiser’s panel. Reading and understanding the engagement letter is the second essential step to deal with the relentless expansion of an appraiser’s scope of work. Appraisers are facing a new environment with challenges not only to their business survival but also to their integrity. Thus, appraisers may have to face the hard choice of turning away business rather than accept unacceptable assignment conditions or contracts that defy the typical level of business risk.

Read Before You Sign

The typical relationship with an appraisal management company or lender client begins with the submissions of information such as verification of licensing, verification of E & O insurance, and signed copies of a W-9. The acceptance of this information results in receiving a basic contract for services. Most appraisers cannot afford competent legal advice and rely on their own judgment when reviewing this document. Time will tell but these contracts for service are not always adapted to individual state laws and some contain onerous acceptances of liability that make no business sense. Here is a typical clause in a standard contract for services from an appraisal management company:

“In addition to any and all other obligations of Appraiser hereunder, and any and all other remedies available to Company under this Agreement, Appraiser agrees that if a mortgage lender is required to repurchase a mortgage loan for any reason in any way related to or resulting from (i) any act, or failure to act, or any breach of any warranty, obligation, representation or covenant contained in or made pursuant to this Agreement by any Appraiser, its employees, agents or representatives; (ii) as a result of the action, negligence or omission by Appraiser or its employees, agents or representatives or anyone contracting with Appraiser; or (iii) any appraisal report submitted by Appraiser pursuant to this Agreement, Appraiser shall pay Company an amount equal to the repurchase price paid by such mortgage lender to repurchase such mortgage loan. Appraiser agrees that it shall pay the reasonable attorneys fees of Company incurred in enforcing Appraisers obligations hereunder, including, without limitation, the obligation of Appraiser to pay Company an amount equal to the repurchase price of a mortgage loan asset for the above. The obligations of Appraiser here under shall survive the termination of this Agreement.”

While agreeing to such terms may seem nonsensical, more appraisers are signing on to these companies under such terms, perhaps believing that no one would ever ask an appraiser to make good a defaulting mortgage plus attorney fees. There are two alternatives short of having every contract reviewed by an attorney. The first is to take one or two of these contracts to an attorney and seek advice as to how these contracts fit into applicable state law. The appraiser may get enough insight to fully evaluate the consequences of future contracts. The second is to purchase pre-paid legal services. Priced typically under \$50-\$65 per month, a typical pre-paid legal service will read proffered contracts as part of the service. As more and more appraisers take on appraisal management companies, more appraisers must fully evaluate their business needs when it comes to legal advice support.

Rat-a-Tat-Tat

TAT or turnaround time is the main preoccupation of most appraisal management companies. Appraiser may hope that the recent foreclosure debacle involving “robo-signing” may give the lending industry pause and consider, “what’s the rush?” but there is no indication that appraisal management companies are placing any less emphasis on speedy return of assignments. There is even some evidence that appraisal management companies use turnaround time as their answer to the “value-added” component of their services. Consider this information contained in a standard engagement letter:

Acceptance of this order also is also an agreement to the following terms of service: - Order contact to be contacted same day as order accepted to schedule appointment - Property is to be seen 24-48 hours for acceptance of order - Written report is due to XXXXXX within 24 hours of inspection - Appraisal review requests are due within 12 hours of revision request receipt - PLEASE BE ADVISED THE FINAL REPORT NEED TO BE IN OUR OFFICE WITHIN 24 HOURS FROM THE INSPECTION DATE. SHOULD NOT BE ABLE TO COMPLY WITH THIS REGULATION PLEASE LET US KNOW AND WE WILL RE-ASSIGN THE ORDER.

Can the typical residential appraisal report be completed in twenty-four hours from inspection and be fully credible? The carrying out of the scope of work is the province of the appraiser. The appraiser must consider in light of the increase in scope of work and verification demands whether tight turn times allow for the preparation of a credible report or more importantly in the context of preparation under USPAP whether the twenty-four or for that matter the forty-eight hour turnaround is an acceptable assignment condition. The tone of the above excerpt is troubling given the alternative that if failing to agree to the twenty-four hour turn times, “we will re-assign the order.” Nonetheless, in AO-19 lines 84 and 85, USPAP is clear: “*Appraisers, like other professionals, must ensure that those who use their services recognize the amount of work required—and expertise needed—to develop a credible value conclusion about a property.*” Another more stark reality is that in two years or so, who is going to place much weight on the twenty-four hour deadline when the report is reviewed by state officials at the State Appraisal Board for careless reporting or USPAP violations?

Cost Approach

Most appraisal management companies are making the development of the cost approach mandatory. This is puzzling in view of clear indications from Fannie Mae and FHA diminishing the necessity of the cost approach:

Unless the cost approach is deemed reliable on the above table (Proposed Construction, New construction or Properties less than one year old), or considered applicable in the appraiser's judgment, developing this approach is not required for a HUD/FHA appraisal.

Fannie Mae does not require the cost approach to value except for the valuation of manufactured homes.

The cost approach in most cases is simply not required by either Fannie Mae or FHA. The emphasis in USPAP is that the cost approach is developed when “necessary for credible results.” Fannie Mae adds that whether the cost approach is applicable depends entirely on the appraiser’s judgment yet engagement letters are coming through with words such as “must” or “mandatory” no matter that the cost approach is not necessary for credible results. Consider one phase of the cost approach in light of current market conditions. Standard 1-4 (iii) states: “*analyze such comparable data as are available to estimate the difference between the cost new and the present worth of the improvements (accrued depreciation).*” It is very clear, that in the current market, appraisers must calculate depreciation rather than rely on the simple expedient of using the age/life method. The summary of support for site value is compromised by the market conditions affecting recent site value sales. Therefore, appraisers have a greater responsibility to extract site values from sales of improved sites. Market conditions, then, have complicated the preparation of the cost approach. If the cost approach is prepared, it must be credible and not treated as an after-thought. Here, the appraiser may want to seize the initiative and simply apply reason particularly where the cost approach contributes little to credible results such as in the case of an older property where depreciation issues make it more difficult to conduct a coherent analysis. Failing a direct approach to eliminate the development of the cost approach at the onset of accepting the engagement letter, the appraiser has little choice but to fully comply. Appraisers may want to consider adopting the computerized version of the cost approach offered by Marshall & Swift or another cost service. Appraisers may want to fully integrate the Marshall & Swift form 1007 available within most appraisal software suites and fully comply with the issues of developing the cost approach. The complication of using this method is reconciling the computerized approach or the form 1007 approach with the cost approach found within the 1004 form.

E & O Binder

More appraisal management companies are demanding appraisers include a copy of their E & O insurance binder. Peter Christiansen of Liability Administrators offers the advice not to include the E & O binder. It is often misinterpreted by the homeowner as almost a “manufacturer’s warranty” and invites these parties to submit claims. Further he reminds that inclusion of the policy binder is illogical since E & O insurance is “claims made.” If a claim is made, coverage is only accepted if there is a policy in effect on the date the complaint is made. Christiansen offers the suggestion to reason with the client and even point out that the appraisal management company also runs the risk of being dragged into the claim. Again, appraisers must be prepared given the tone of the instructions. In a recent exchange with an appraisal management company, the company representative answered curtly, “Ok, I will inform vendor management to not send you any orders from this client.”

Aerial Maps, MLS Sheets and Other Copyright Material

Several clients are requesting copies of aerial maps. Appraisers are obtaining these maps from such services as Bing and Google Maps. Formerly Google encouraged signing up for a license to use Google Earth. As with any copyright material, appraisers must review the attached terms of use. Google now encourages the use of their maps but these must include attribution. Google commenting on use within reports states the following on their website:

“Basis for contractors' or environmental consultants' reports: Conforming with the general guidelines above, if the analysis of the scene in question has been created using Google Maps or Earth, you may use the Content in printed materials. You may not extract Content for derivative uses that do not relate to the products, such as for further editing within another drafting, desktop publishing, or GIS application.”

The use of MLS sheets within reports is more problematic and must be addressed with the specific MLS. Most retrospective appraisals ordered by Fannie Mae include a request to include the MLS sheets. Not only do some MLS listings often bear a copyright, some pictures within these listings also bear a copyright. If requested, the appraiser must determine whether the use of individual listings in a report is allowed. Some MLS groups allow the use of specific categories of print outs. Since requests for inclusion of MLS sheets is a growing trend, and if an appraiser finds there is no clear answer, a formal letter to their local Board requesting a determination may be appropriate.

Assuming that inclusion of MLS sheets is permissible, there are other major considerations. MLS sheets represent raw data and within a report, this data is reconciled in the verification process by cross-checking public records and interviewing market participants. MLS records are often incomplete and inaccurate. Should these sheets be included in the report, the appraiser must consider addressing those discrepancies within the report. At the very least, the summary of the scope of work should address that the appraiser has taken steps to reconcile and summarize the data viewed in the MLS document. The appraiser must expect that the intended user will compare the information in the report with the information found in the MLS property records.

Preparation

Once the appraiser has accepted the engagement letter, it is almost too late to ask for revisions in the scope of work. Appraisers must review the engagement letter and its implications before accepting the assignment. The first step when receiving a call for an AMC order is always log in order inquiries noting any requirements in the initial order form. When the engagement letter or appraisal order is received, the order needs careful attention to be certain no further clarification is needed by phone or e-mail. In this market, appraising REO properties often requires some specific information that is related to marketing time and days on the market. It is difficult to proceed without full instructions that involve the standard REO addendum. Lenders ordering REO properties also differ in their guidelines for using REO comparables in the analysis.

Lenders are issuing bulletins and guidelines separate than those found in the engagement letters. Lenders are expecting appraisers to incorporate their requirements into reports. The next step in following lender requirements is to systematically file these requirements so they may be reviewed when receiving a new assignment. This process can be as simple as incorporating the information in a file folder or maintaining a database on a program such as Microsoft Access with a means of copying the information into a narrative field. With the volume of information coming down from AMC Chief Appraisers, appraisers may have to resort to segregating the information into three-ring binders, a habit shared by appraisers before the days when Fannie Mae and FHA standardized lender requirements.

Argue From Strength

Clients are piling on more and more demands and requirements. Appraisers have to weigh these requirements against not only USPAP but against recognized guidelines set out by Fannie Mae and HUD. Appraisers need to keep their appraisal library current and know the actual requirements of an assignment. In this way, appraiser may be prepared to counter requirements that amount to unacceptable assignment conditions.

When Withdrawing Is the Only Option

Finally, the negotiation process may reach a point where no amount of research or clarification will meet the demands of the engagement letter. The objective of most appraisal assignments is to provide support for a

decision involving financing of the subject property. In simple terms, the subject may not meet the guidelines set by the lender. The appraiser then must rely on the framework set out in the Scope of Work and if the process has been competently followed, the appraiser has no choice but to conclude the process. Depending on the lender, concluding the assignment may consist of a simple statement contained in the “with conditions section” noting that after a thorough search, etc. the request may not be fulfilled. It may be a better alternative to simply not accept the assignment emphasizing the long term consequences. Given the strident “take or leave it” tone of some engagement letters; appraisers must simply be prepared not to take the tone personally. Meet these demands in a business-like manner. Superciliousness, that is showing haughty disdain, is never a sustainable business model and therefore these companies are not likely to endure.

Appraisers soon learn in their appraisal career, the real estate profession is largely driven by the state of the economy. Appraisers are now operating in a climate of uncertainty that is testing the ability of appraisers to not only understand local markets but to communicate their findings to clients. All this takes time that affects an appraiser’s productivity and therefore demands an appraiser’s careful attention.

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Montana Chapter, Appraisal Institute
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(206) 622-8425 - ai-montana@qwestoffice.net