Montana Chapter Newsletter

Spring/Summer 16

UPCOMING MONTANA CLASSES!

Application & Interpretation of Simple Linear Regression
June 1-2 at the Best Western GranTree Inn in Bozeman

FHA Appraising for Valuation Professionals: FHA Single Family Housing Appraisal Requirements
June 3 at the Best Western GranTree Inn in Bozeman

Click here for full info & to register for these classes

We are always looking interesting courses and encourage our chapter members to e-mail their suggestions to sunny@mercuryvaluation.com

AI Education Trust Scholarships - July 1 Application Deadline

The next Appraisal Institute Education Trust Scholarship deadline is July 1. Three scholarships are available:

- AIET Candidate for Designation Scholarship
- AIET Minorities & Women AI Course Scholarship
- AIET 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 educationtrust@appraisalinstitute.org.

Congratulations on a Recent Designation!

Congratulations to Courtenay Graham, SRA, and Scott A. Spear, MAI, SRA, who were both designated in April! Courtenay is the third SRA, along with Jeff Buszmann, SRA and Travis Kehl, SRA who worked with Doug Smith, SRA, AI-RRS.

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Leadership Resource Registry Submission Deadline Sept. 2

The 2017 National Leadership Resource Registry is now open for submissions. In order to be considered for national Appraisal Institute committees, interested parties must submit their interests into the Registry by Sept. 2. To access the Registry, click here then log on to the AI website.

2017 AI VP Candidates Under Consideration

The Appraisal Institute's National Nominating Committee will interview four candidates for 2017 AI vice president during its May 4 meeting in Chicago. The committee is expected to nominate one or more individuals for 2017 vice president at the Board's May 5-6 meeting in Chicago.

The candidates are Joseph J. Calvanico, MAI; Steven G. Elliott, SRA; Kern G. Slucter, MAI, SRA; and Stephen S. Wagner, MAI, SRA, AI-GRS.

AI professionals may view the candidate questionnaires (log-in required) and provide input by April 29, 2016. Correspondence should be addressed to M. Lance Coyle, MAI, SRA, CCIM, chair, 2016 National Nominating Committee, and emailed to Joan Barngrover, Board Secretary and Special Assistant to the CEO, jbarngrover@appraisalinstitute.org.

Call for Nominations: Lifetime Achievement & Outstanding Service Awards

The Appraisal Institute would like to recognize some of its brightest, most committed and deserving members. If you know someone who fits the award criteria, please nominate them for either the Lifetime Achievement Award or the Outstanding Service Award. Submissions for both awards must be completed by **May 27**. Announcements of the awards will take place at the Appraisal Institute's Annual Conference this July in Charlotte, North Carolina.

Lifetime Achievement: The Lifetime Achievement Award is presented to the individual who has best demonstrated high ethical standards; contributed to the Appraisal Institute at the chapter, regional, national and/or international level(s); provided service to his or her community; and contributed to the appraisal profession. A minimum of 20 years of service is recommended to be eligible for this award.

Outstanding Service: The Outstanding Service Award is presented to the individual who has contributed ideas, service hours and dedication to ensure a specific program or effort is implemented at either the chapter, region, national and/or international level(s). This Designated member must be instrumental to the success of the program or effort, which also must be far enough along to measure and provide proof of success. Additionally, the program or effort must be beneficial to chapters, regions, national, international, designated members, candidates, affiliates, practicing affiliates and/or the profession.

Click here for more information or to nominate a Designated Member.

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, AI-RRS, at hotelman@montana.com.

BOOK REVIEW: Using Residential Appraisal Report Forms: URAR, Form 2055, and the Market Conditions Form-Second Edition

Mark Ratterman, MAI, SRA Presents an Excellent Book for Completing an Appraisal Report Tune-Up

By Douglas G. Smith, SRA, AI-RRS

In this tumultuous year of 2016, two books are essential additions to the appraiser's library. The first being, of course USPAP-2016-17 introduced as of January 2016 and effective until December 31, 2017. The second book, not so well known, is the second edition of a book first published in 2005 by Mark R. Rattermann, MAI, SRA, Using Residential Report Forms: This book, updated at the end of 2009, includes a new section on the Market Conditions Form, the 1004MC. Appraisers will find this book useful for performing an appraisal tune-up of their reports. Appraisers who review appraisal work will find accurate reference citations from Fannie Mae and USPAP and well thought out summaries of commonly accepted appraisal practices and methodology. The unique feature of the book is that it allows for variation, particularly in the methods of deriving adjustments. Lastly, this book reminds in detail that almost every line in these commonly used reports requires analysis over and above simply listing and writing in the information. This book is made available on the Appraisal Institute web site. For the budget minded, the first edition is still available at a substantial discount.

Background

Mark Rattermann, MAI, SRA authored many texts for the Appraisal Institute and is a faculty member for the Appraisal Institute. Currently, Mr. Rattermann is a senior partner with Resource, LLC, a real estate appraisal firm located in Indianapolis and owner and manager of Education Resource, LLC, a real estate education company. The Appraisal Institute adapted Rattermann's book Valuation Analysis and Logic to a full course that is one of the more popular courses given by the Appraisal Institute. The first chapter, "The Psychology of the Valuation Process," is said to be one of the most influential sections of recently published appraisal texts. The chapter, "Supporting Quantitative Adjustments," presents the logic behind extracting and supporting adjustments for common elements of comparison, including line items found in the sales comparison section of the URAR form. Although this book is the text for an Appraisal Institute course, this book is also available as a stand-alone text available at the Appraisal Institute online book store.

Reports Under the Microscope

Perhaps the biggest change in the current appraisal marketplace is that clients or their representatives, mostly appraisal management companies are actually reading appraisal reports. It is obvious they don't like what they are seeing. Appraisers are receiving an unprecedented number of policies and procedure bulletins and memos regarding all manner of report requirements. Engagement letters have expanded to sometimes six pages with detailed instructions and in some cases detailed suggestions for text to be inserted into appraisal reports. States are moving to regulate appraisal management companies and among some of the requirements included in the regulations are that review staff must have USPAP training. Expect to see, then, more emphasis on purely USPAP issues that in the past were largely ignored. Many appraisers are asked by loan underwriters to support their adjustments. Rattermann's book is timely as clients and their representatives give reports increased scrutiny. Rattermann begins with two essential sources of poor reports. He points out the most obvious, "Probably the single most significant factor that contributes to poor appraisal report writing is the common practice of cloning an old report, a practice so widespread that some appraisers have been known to go so far as not replacing the comparable sales with new ones because it meant taking more photographs of the comparables." Another problem, Rattermann cites that appraiser do not read the report after it is written. Rattermann suggests that good appraisal practice is to let the appraisal report sit for a short while, read it, make the necessary corrections, and then send it on.

The Lost Sections

Appraisers accept that the one constant in appraisal reporting is change and the last two years prove that certain expectation. Several changes came in stealth and for many appraisers are ignored. Perhaps the most helpful aspect of Rattermann's book is that the author considers and describes the appraiser's role in determining not only what is put into each line of the report but what is expected in terms of analysis. The most obvious example of a section that may not be receiving the attention it deserves is Tax Year/Real Estate Taxes. Appraisers do report taxes but Rattermann makes the case that this section allows the appraiser to analyze and report the tax encumbrances on the property. Consider that property values have fallen and tax assessments may be based on higher values with the result that the property may be overtaxed. Appraisers must take into account taxes that apply to comparables. Consider that appraisers may have to use comparables from greater than normal distances that may lie in another tax authority district and these comparables may differ significantly in assessed taxes. If the taxes are excessively high, an appraiser can choose to adjust for the difference in the cost of owning one property with high taxes versus the cost of owning other properties in the same market with lower taxes that might have been purchased instead. The point is that merely listing reported taxes is not the end all and be the appraiser's entire entire obligation; the taxes must be analyzed. Rattermann gives specific methods of calculating adjustments. In the example of excessive taxes, a logical and common method of calculating an adjustment is to capitalize the extra cost of ownership by applying an appropriate capitalization rate and dividing the difference in the tax amounts by it.

Another section that does not receive sufficient attention is the section on Special Assessments. This section requires the appraiser to research any special assessments due and payable, announced, or even rumored to be forthcoming. They will have a dollar-for-dollar impact on value unless they are paid off at closing. Here, the appraiser must, under current economic conditions, pay particular attention to open ended assessments for unforeseen expenses of homeowner associations. The sale price if affected if the seller must pay for the costs or the buyer inherits them. The bottom line is that the appraiser must know when the sale price is affected by a special assessment. Rattermann follows up by revisiting the analysis of homeowner association dues and addresses the background on what constitutes a PUD. In all sections of the book, there are references to Fannie Mae and how to find complete information as to Fannie Mae's expectations for determining just what is a PUD, for instance.

One-Unit Housing Trends

Of all the sections of the Fannie Mae form reports, no section has received more attention than that of "One-Unit Housing Trends" culminating in the requirement that the Market Conditions Report, the 1004MC must be included with every report. Rattermann takes the appraiser through this section and outlines in detail the analysis required to fulfill the completion of this section. The exhibits in this section include: Extraction of Value Changes in the Market; Supply and Demand Analysis and Varying Market Condition and Price Ranges. The Market Conditions Report is fully covered in the concluding chapters. Rattermann rounds out this section of the URAR with a discussion of other neighborhood issues that could be considered and discussed such as neighborhood features, the size and width of streets, streets privately held by a homeowner's association, building set back lines and other issues such as location of airports and the existence of vacant land nearby. In short, this text demands a fresh look at the job of appraising as it relates to addressing appraisal issues within a form report.

Improvement Section of the URAR

Since this is a section that differs greatly between the 1004 and the 2005, Rattermann addresses each separately. Throughout this section, Rattermann sets out Fannie Mae's expectation for each of the lines and demonstrates the later consequence of each piece of information. For instance, the issue of openings to the upper floors is discussed in detail. For most lenders, openings to the upper floor that expose the floor below cannot be included in the GLA for the second and third floors, with the exception of the stair cases. This allows the appraiser to include the area around a center hall staircase but not include the unfinished second or third-floor areas for properties with cathedral or vaulted ceilings. Ratterman is quick to point out that although such a feature cannot be figured into the GLA, it does not preclude the appraiser from adding value to it.

Appraisers debate "Property Condition." This issue in question is whether an appraiser should rate the quality and condition of the subject improvements in accordance with all housing in a geographical area (usually a city or a town) or with the properties it competes with only. In the past, appraisers were asked to label all properties for condition and quality based on a comparison to the properties with which they competed. Rattermann carefully leads the appraiser in a discussion of this issue citing for Fannie Mae and USPAP as well as ERC guidelines. Rattermann discusses fully the implication of the following statement by Fannie Mae, "Based on the factual data of the improvements, the appraiser must express an opinion about the condition of improvements." He follows up with this interesting take: "If an appraiser accepts the notion that the condition rating means comparing a property to those with which it competes, the question arises as to what the appraiser is to do when appraising a just-completed "new" home. Many appraisers will rate the home as being in good condition, an erroneous rating, considering that if a new home is compared to other newer homes, it cannot be rated above average. In such a situation, the appraiser's logic must prevail. The new home must also be rated in average condition compared to homes with which it competes, which are probably new also." There cannot be a better illustration than this example that appraisers must be open-minded when considering the process of completing form reports.

Units of Comparison

The real substance of the book is when the author turns the page to Page 2, The URAR and Form 2005-Sales Comparison Approach. Rattermann discusses fully in this section and in the section on the 1004MC, the entries required for the Supply and Demand Study. Then he goes on to discuss the sales comparison logic and purpose. This section of the book presents the logic behind extracting and supporting adjustments. There are twenty common elements of comparison ranging from real property rights conveyed to porches/patios/decks. There are twenty-one or more if an additional item is added in the space provided. In each case, Rattermann offers the generalized format of discussing the main avenues to extract adjustments, the income approach, the sales comparison approach and the cost approach. For some adjustments, Rattermann points out the helpfulness of surveys or interviews. This part of the book is essentially a confidence builder for appraisers because of the openness of the process in that it clearly avoids settling on one way of deriving adjustments. This portion of the book is genuinely helpful to those appraisers completing review work. Good review appraisers review work by others with the general premise that, "My idea does not make your idea, a bad idea." This section of the text reinforces that premise. Rattermann's approach to methods for extracting and supporting adjustments for the gross living area considers alternatives such as the cost approach and income approach. These approaches, according to Rattermann are possible but the cost approach is very labor intensive as it is based differences in costs less depreciation between the subject and comparables. There may not be good data readily available for the income approach calculating differences in GRM. The paired data analysis method will work well for the GLA and Rattermann's emphasis in this section is the sensitivity analysis in which the appraiser enters the attributes of the subject and the comparables on an adjustment grid and then tries various rates of adjustment until the range in indicated values narrows. Examples of this type of analyses are set out in the text.

The book rounds out the discussion of completing the forms with information about how to best complete the cost approach section, Income approach section and PUD section. Methods such as using the market extraction technique to determine depreciation are included in this section. A worthwhile chapter for consideration is the chapter on Page 5, the URAR and form 2055-Appraiser's Certification. The text takes the appraiser through each of the items and interprets the meaning and outlines areas where the appraiser may supplement the information.

To some, it may appear that Mark Rattermann's Book Using Residential Appraisal Forms is more appropriate for beginning appraisers but experienced appraisers will find this book useful as both a reminder and report card on their work of completing form appraisal reports. The changes in the market dictate closer attention to several sections of these forms such as concessions and sales contract analysis that are receiving close attention from clients. Appraisers will also find the specific summaries of Fannie Mae and USPAP issues that are helpful in the review process. Make this book a part of your appraisal library in 2016

The Disparity Between Market Rent and Contract Rent

By George Page, SRPA, SRA

In this article I decided to prepare a hypothetical leasehold problem for your consideration. The problem deals with the disparity between market rent and contract rent, and in this case, the advantage goes to the lessee who is renting below market with 3 years remaining on the lease. These are all my own figures, thoughts and analysis for your consideration.

Here's my example, the lease fee estate represents the owner's position. Say market value is $2,857,000. Assume the overall cap rate in the CBD is 7.0%. The market rent for this improved 20,000 sq. ft. space is $10 per sq. ft., generating $200,000 in rental income annually. The monthly market rent is $16,667 monthly ($200,0000 / 12), but the contract rent is $3 less or $7 per sq. ft. annually. The lessee has a rent advantage when compared to your market rent study. Assume the lessor is selling the property out from under the lessee, and the lessee will be looking for new rental space. The owner is breaking the current 5 year legally binding lease agreement.

The contract rent is $7 per sq. ft. or $140,000 annually. Therefore, the lessee pays $11,667 monthly, with payments at the beginning of each month. Let's say the lessee has 3 years or 36 months remaining on a 5 year lease.

The lessee has a $5,000 monthly advantage in rents, which is the difference between market rent at $16,667 and contract rent at $11,667. Your assignment is to analyze the lessee's financial position in this broken lease agreement.

The question, what is present discount value of a series of $5,000 monthly payment today?
Switch your HP12C to Beginning of Year (BOY), for calculating the present worth of the series of discounted payments. N's 36 months, Interest 7% or .583 monthly and monthly payments at $5,000 in advance. The present value (PV) answer is $162,877. The dollar function used is simply the present worth of a series of 36 monthly payments discounted back to present day value. The End of Year (EOY) calculation is slightly less at $161,932, but rents are paid in advance, so that explains using the BOY function.

If the property sells at market for $2,857,000, the lessee has a .057 or 5.7% interest in the sale price. The lessee's share of the pie is say $163,000 (R). The owner's share is $2,694,000 or .943 or 94.3%. The owner will be reluctant to share a piece of the pie, but the lessee has a valid financial position in the property unless the lease language suggests otherwise. The lesson is, keep rents at market levels. The problem is that rents tend to lag the market, and therefore, it's critical that rents target current market activity.

One another subject, we talked about multiple regression, but no mention was made of simple regression. The difference being is that simple regression (a regression with one independent variable), a graph can provide an accurate regression solution. For a multiple regression (two or more independent variables), a two-dimensional graph is not adequate. Instead, a model or an equation is needed. In simple terms, regression means that observations of values tend to regress toward their mean, or average value. In a linear model, the plot is a straight line relationship between independent and dependent variables.

The Relationship Between the Basic Six Dollar Functions

By George Page, SRPA, SRA

This quarter I decided to write about the relationship between dollar functions. This may be elementary stuff for some appraisers, but not so for others struggling to better understand dollar functions. These are my own figures and thoughts to show how the tables are interrelated.

The question is, how well do appraisers understand the relationship between the basic six dollar functions? Instead of dollars, we could be using rubles, pesos or some other monetary unit-of- one for compounding and discounting. Basically, we're dealing with either a single lump sum to be compounded or discounted verses a series of funds to be compounded or discounted.

Do appraisers recognize there's a reciprocal relationship between these functions? Let's use 10 years at 6 % interest rate annually to illustrate the reciprocal relationship between these functions. This relationship is very easy to examine with a set of financial tables for quick factor reference, but you can simply develop all factors using your HP-12C. I recognize that a 6 % interest rate is not very realistic in today's economic climate, but is used for illustration purposes only.

One: The PW of One is the reciprocal of the FW of One, and vise-a-verse. When we discuss the PW or FW of One, the "One" could be a dollar or any other currency unit of one. The proof is, take a factor from either function at say, 10 years at 6 percent interest. Next, one divided by that factor will give you the reciprocal factor for the other function. This shows the relationship between the PW of One and FW of One. These two functions deal with a one-time lump sum event as opposed to a series of payments. The PW of One function deals with the shrinkage or the discounting of one unit, while the FW of One deals with the growth or compounding of a single unit.

PW of One: (Discounting) N's 10, Rate 6%, FW of One = PW .5584 1 / .5584 = 1.7908
This function answers the question, what $1 due in the future is worth $0.56 cents today.

FW of One: (Compounding) N's 10, Rate 6%, PW of One = FW 1.7908 1 / 1.7908 = .5584.
This function answers the question, how $1 grows with compounding to $1.79 over time.

Two: The Sinking Fund is the reciprocal of the FW of One Per Period. First take any factor from either of these two functions at a given term and interest rate. Next, one divided by that factor will give you the reciprocal factor. This shows the relationship between the Sinking Fund and the FW of One Per Period. These two functions deal with a series of payments as opposed to a single one time transaction.

Sinking Fund: N's 10, Rate 6%, FW of One = PMT .075868 1 / .075868 = 13.1807

The sinking fund targets a series of level payments to achieve a desired future fund for replacement. The question is, you need to replace a $13.18 item in 10 years, so what periodic payment should be set aside in an interest bearing account to achieve the $13.18? The answer is a periodic payment .076 cents.

FW of One Per Period: N's 10, Rate 6%, PMT of One = 13.1808 1 / 13.1808 = 0.75868
This function deals with the compounding growth of a series of level period payments. This is how a $1 deposit every year for ten years will grow with compounding to $13.18 and end of 10 years. The deposits are at the BOY and the accumulation is at EOY.

<u>**Three:**</u> Lastly, the Installment to Amortize is the reciprocal of the PW of One Per Period. First, take any factor from either one of these functions at a given term and interest rate. Next, one divided by that factor will give you the reciprocal factor. This shows the relationship between the Installment to Amortize and the PW of One Per Period. These two functions deal with a series of payments as opposed to a single event.

Installment to Amortize: N's 10, Rate 6%, PW of One = PMT .135868 1 / .135868 = 7.3600
This function is akin to a level mortgage installment payment of principal and interest.

PW of One Per Period: N's 10, Rate 6%, PMT of One = PW 7.3600 1 / 7.3600 = .135868
This function deals with the discounting of a series of level period payments to present day value. The question is, what you pay today for the right to receive $1 per year for the next 10 years with payments spread over time? The discounted value is worth $7.36 today.

<u>*Q&A*</u>

By Douglas G. Smith, SRA, AI-RRS

Question 1:
After submitting my report for a REO property with 5 comparable sales, the 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 1:
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 the instant 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 which in this case consists of a search for 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.

With an eye towards a professional level of business communication, response should be both timely and carefully expressed.

Question 2:
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. Not sure what has changed, that 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 2:
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 multi-family 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.

Question 3:
The room layout for an attached townhouse included a second floor bedroom and bath and on the first floor a second bedroom, kitchen, living room and bath. One room on the first level was being used as a bedroom.

The door to this room was a two panel French door. There was a skylight but no window to the exterior and there was a small closet. What is the current definition of a bedroom?

Answer 3:
Interestingly, Fannie Mae does not offer a specific definition of a bedroom. The following guidance is offered in the most recent Selling Guide:

Layout and Floor Plans

> “Dwellings with unusual layouts and floor plans generally have limited market appeal. A review of the room list and floor plan for the dwelling unit may indicate an unusual layout, such as bedrooms on a level with no bath, or a kitchen on a different level from the dining room. If the appraiser indicates that such inadequacies will result in market resistance to the subject property, he or she must make appropriate adjustments to reflect this in the overall analysis. However, if market acceptance can be demonstrated through the use of comparable sales with the same inadequacies, no adjustments are required.”

It is clear, then, that at least Fannie Mae depends on the appraiser to determine the definition of a bedroom and whether a room used as a bedroom meets local market acceptance, suggesting that adjustments for unusual layouts, for instance, be derived from the local market.

Then we move on to consider what FHA has to say about bedrooms. Here we receive more detailed information.

In Section II (B) 3. (v.)L “The Appraiser must not identify a room as a bedroom that cannot accommodate ingress or egress in the event of an emergency, regardless of location above or below grade.”

FHA Handbook 4001.1 no longer contains the guidance concerning the size of windows below-grade.

In summary, the classification of a room as a bedroom largely rests upon market acceptance and safety issues relative to egress. Other physical short comings can often be accounted for by either market based or cost to cure based adjustments to value.

> The International Building Code (IBC)
>
> "The International Building Code (IBC) is a model building code developed by the International Code Council (ICC). It has been adopted throughout most of the United States. Since the early 1900s, the system of building regulations in the United States was based on model building codes developed by three regional model code groups. The codes developed by the Building Officials Code Administrators International (BOCA) were used on the East Coast and throughout the Midwest Since the early 1900s, the system of building regulations in the United States was based on model building codes developed by three regional model code groups. The codes developed by the Building Officials Code Administrators International (BOCA) were used on the East Coast and throughout the Midwest of the United States, while the codes from the Southern Building Code Congress International (SBCCI) were used in the Southeast and the codes published by the International Conference of Building Officials (ICBO) covered the West Coast and across to most of the Midwest. Although regional code development has been effective and responsive to the regulatory needs of the local jurisdictions, by early 1990s it became obvious that the country needed a single coordinated set of national model building codes. The nation's three model code groups decided to combine their efforts and in 1994 formed the International Code Council (ICC) to develop codes that would have no regional limitations.

"After three years of extensive research and development, the first edition of the International Building Code was published in 2000. The code was patterned on three legacy codes previously developed by the organizations that constitute ICC. By the year 2000, ICC had completed the International Codes series and ceased development of the legacy codes in favor of their national successor."

Excerpts from the 2015 edition of The International Residential Code.

The basic change in the code was that, the code no longer singled out rooms as bedroom but described all rooms as "Habitable rooms." When mentioning egress, the Code does include the nomenclature "sleeping rooms."

The following are excerpts from the latest edition:

Habitable rooms shall have a floor area of not less than 70 square feet (R304.2)

Habitable rooms shall not be less than 7 feet in any horizontal direction. (R304.3)

Habitable space, hallways and portions of basements containing these spaces shall have a ceiling height of not less than 7 feet. For rooms with sloped ceilings, the required floor area of the room shall have a ceiling height of not less than 5 feet and not less than 50 percent of the required floor area shall have a ceiling height of not less than 7 feet. (R305.1)

Basements, habitable attics and every sleeping room shall have not less than one operable emergency escape and rescue opening. Where basements contain one or more sleeping rooms, an emergency escape and rescue opening shall be required in each sleeping room. Emergency escape and rescue openings shall open directly into a public way, or to a yard or court that opens to a public way. (R310.1)

Emergency and escape rescue openings shall have a net clear opening of not less than 5.7 square feet. The net clear opening dimensions required by this section shall be obtained by the normal operation of the emergency escape and rescue opening from the inside. The net clear height opening shall be not less than 24 inches and the net clear width shall be not less than 20 inches. (R310.2.1)

Where a window is provided as the emergency escape and rescue opening, it shall have a sill height of not more than 44 inches above the floor; where the sill height is below grade, it shall be provided with a window well in accordance with Section R310.2.3. (R310.2.2)

The horizontal area of the window well shall be not less than 9 square feet, with a horizontal projection and width of not less than 36 inches. The area of the window well shall allow the emergency escape and rescue opening to be fully opened. (R310.2.3)

The essence of the 2015 International Residential Code is that the code does not specifically call out bedrooms but refers to all habitable areas of a home. However, in Code # R310.1, at least one opening must open to the outside. Therefore, it can be said that for each sleeping room, there must be two emergency escape and rescue opening.

A bedroom ceiling needs to be at least 7 Ft. tall. It's okay if some portions of ceiling are below this level the, but at least 50% of the ceiling needs to be a minimum of 7 ft in height. Most ceilings tend to be at least 8 ft tall, so ceiling height is not usually an issue (R305.1).

Lastly, The room should be at least 70 sq Ft., and more specifically the room cannot be smaller than 7 feet in any horizontal direction. (R304.2 / R304.4).

The Closet Myth

Many believe that a closet defines a bedroom. In short, the market defines a bedroom as well as other considerations listed above. As a practical matter a bedroom should probably have a closet since most buyers expect one, but technically the International Residential Code does NOT mandate a bedroom to have a closet. So the lack of a closet does not necessarily mean a room cannot be a bedroom. However, as Fannie Mae makes clear, the appraiser must consider what is expected in the local market , and what is required by the local city/county? Would buyers consider a room as a bedroom if there is no closet? In newer tract subdivisions it's probably a matter of functional obsolescence not to have no closet, but in older classic homes where bedrooms were sometimes not built with closets, it's very likely not an issue at all. For instance, consider a Victorian or Prairie style Bungalow home without closets in any bedrooms. While some real estate professionals believe closets are always required, that rule doesn't really apply here for two reasons: 1) The IRC definition of a bedroom does not actually mandate a closet; and 2) If the market considers the rooms as bedrooms, that's what they are. It would be highly improbable for buyers to walk through an old Victorian home without closets and say, "The house was stunning and utterly perfect… but there are no bedrooms". Ultimately closets are not technically mandated by the international definition, but they may be expected and/or required by local code.

We can conclude that the room in the townhouse does fails in the definition of a bedroom based on the absence of two exits, one to the outside. The following is link to the 2015 International Residential Code.
http://codes.iccsafe.org/app/book/toc/2015/I-Codes/2015%20IRC%20HTML/index.html

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