Rural Appraisal Challenges

Relating Policy to Practice

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Disclaimer

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Agenda

- Overview of Rural Appraisal Challenges
- Comparable Selection
- Comparable Adjustments
- Cost Approach
- Reconciliation of Value
- Audience Questions

Overview of Rural Appraisal Challenges

Rural markets are often characterized by stable or slow population growth rates and a limited availability of comparable sales data. These two attributes of rural markets highlight two unique appraisal challenges.

Limited Sales Data

- High degree of dissimilarity
- Large adjustments
- Complicated analysis

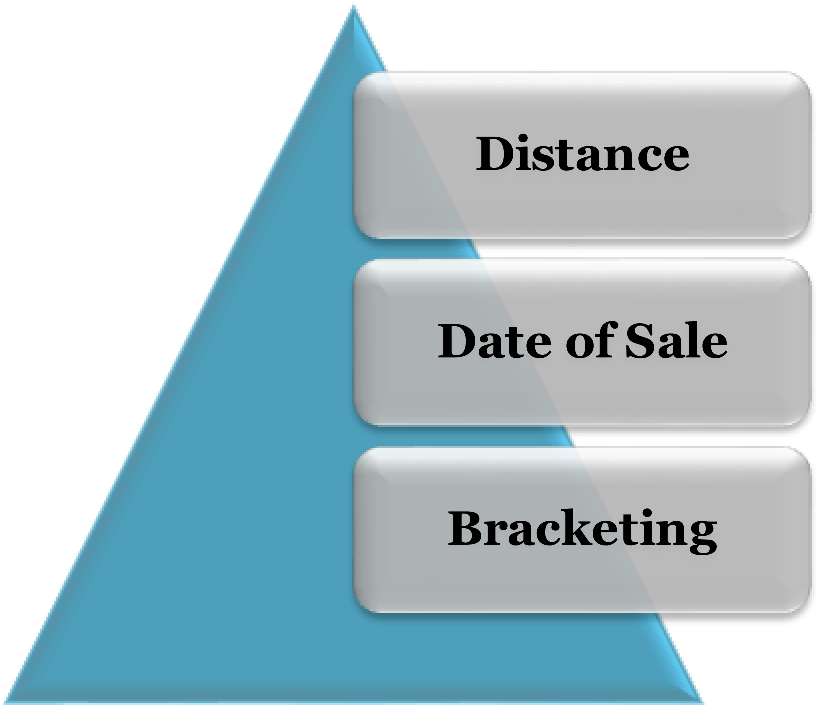
New Construction

- Limited new development
- No sales of new construction
- Age and condition adjustments

The objective of this webinar is to highlight specific Fannie Mae policies that offer the appraiser flexibility in solving these challenges.

Comparable Selection

Appraisers restrict their comparable sales search to conform to arbitrary guidelines that result in diminished accuracy and unclear assignment results.



- **Comparable sales that are more distant can be acceptable, but the market reaction to location differences cannot be overlooked.**
- **When recent sales are limited, consider whether market conditions are conducive to expanding the date of sale criteria.**
- **Bracketing the value can offer the reader some assurance about acceptability of that value in the market, but acceptability is not the same as accuracy.**

Key Principle: *Arbitrary guidelines restrict comparable research and exclude relevant comparables which can diminish credibility. Fannie Mae's comp selection policy may be more flexible than you think.*

Comparable Selection - Distance

Comparable distance requirements are often misinterpreted. It is important to note that Fannie Mae has no specific threshold for comparable distance, only that there is adequate justification and explanation.

- **When to Expand** – There is not a blanket approval of distant comps. Moreover, distance is not a more important attribute than other property attributes. The appraiser must identify the most significant attributes and make comparable selections based on this assessment.
- **Issue to Consider –** Accepting assignments in locations where the appraiser does not have access to appropriate data sources (i.e. MLS) is a USPAP violation and Fannie Mae policy violation that CU™ can identify. Lack of access to data sources is not an acceptable justification for expanding the comparable search parameters. This puts you and your intended users at risk.

B4-1.3-08: Comparable Sales (01/31/2017): Selection of Comparable Sales

*"Comparables that are significantly different from the subject property **may be acceptable**; however, the appraiser must describe the differences, consider these factors in the market value, and provide an explanation justifying the use of the comparable(s)."*

B4-1.3-08: Comparable Sales (01/31/2017): Rural Properties

*"Comparable sales **located a considerable distance** from the subject property **can be used if they represent the best indicator of value for the subject property**. In such cases, the appraiser must use his or her knowledge of the area and apply good judgment in selecting comparable sales that are the best indicators of value. The appraisal must include an explanation of why the particular comparables were selected."*

Comparable Selection – Date of Sale

A common misconception is that Fannie Mae will not accept appraisals with comparable sales that are greater than 12 months old. On the contrary, Fannie Mae expects appraisers to make time adjustments when they are warranted.

- **Market Trends** – Consider the current market conditions when deciding whether it is appropriate to expand the date of sale parameters of your comparable research.
- **Adjustment Support** – If adjustments for date of sale are required, it will be necessary to conduct an adequate level of analysis to support those adjustments and summarize the results of your analysis in the appraisal report. Our analysis suggests appraisers routinely under adjust or neglect time differences, which can have an adverse impact on your CU score.
- **Evaluate** – It is important to consider the size of the adjustments and support for the adjustments before making the final decision about expanding parameters.

B4-1.3-08: Comparable Sales (01/31/2017): Age of the Comparable Sales

"Additionally, older comparable sales that are the best indicator of value for the subject property can be used if appropriate. For example, if the subject property is located in a rural area that has minimal sales activity, the appraiser may not be able to locate 3 truly comparable sales that sold in the last 12 months. In this case, the appraiser may use older comparable sales as long as he or she explains why they are being used."

Comparable Selection – Bracketing

Historically, lenders have required that the appraiser conclude at a value that is within the adjusted and unadjusted sale price range. However, in rural markets or with unique properties, this practice may be contrary to credibility.

- **Conformity** – Rural markets have a wide range of age, quality, condition and other features. There is very little conformity because the development trends are extremely inconsistent.
- **Unique Styles** – There is often a greater variety in housing styles in rural markets, which results in a higher degree of non-conformity in the comparable selection (think log homes, berm homes, “shouses”, etc.).
- **Requirements** – Fannie Mae only requires that “the indicated value in the Sales Comparison Approach must be within the range of the adjusted sales price of the comparables that are reported in the appraisal report form”

B4-1.3-11: Valuation Analysis and Reconciliation (04/15/2014): Reconciliation
"The final reconciled indicated value must be within the range of the values indicated by the Approaches used in the appraisal report form."

B4-1.3-09: Adjustments to Comparable Sales (01/31/2017): Appraiser’s Comments and Indicated Value in the Sales Comparison Approach
“the indicated value in the Sales Comparison Approach must be within the range of the adjusted sales price of the comparables that are reported in the appraisal report form.”

Comparable Adjustments – Net/Gross Adjustments

When comparable sales are limited there is often an inherent increase in the degree of dissimilarity. This causes the accuracy of adjustments to be even more important to credible assignment results.

- **Adjustments Thresholds** – Net and gross adjustment thresholds have long been used as a determinant of acceptable comparable sales and potential value inflation. However, such guidelines have proven to be counterproductive to appraisal credibility.

- **Under-adjustment** – To avoid high adjustment percentages some appraisers choose to either avoid making certain adjustments or will adjust at a rate that keeps the net/gross percentage under the threshold.

- **Comp Selection** – Appraisers are more inclined to select comparable sales that require fewer adjustments for primary characteristics (GLA, Age, & Lot Size) and overlook important value drivers like condition, quality, and other site attributes.

B4-1.3-09: Adjustments to Comparable Sales (01/31/2017): Analysis of Adjustments
"Fannie Mae does not have specific limitations or guidelines associated with net or gross adjustments. The number and/or amount of the dollar adjustments must not be the sole determinant in the acceptability of a comparable."

"The expectation is for the appraiser to analyze the market for competitive properties and provide appropriate market based adjustments without regard to arbitrary limits on the size of the adjustment."

Comparable Adjustments – Support for Adjustment

Limited sales in a given market increases the complexity of analyzing property differences and supporting adjustments with market data and analysis. There are many options for supporting adjustments that are acceptable to Fannie Mae.

- **Paired Sales Analysis** – Paired sales analysis can be completed using sales located in different markets. Adjustments for a variety of different property features may be more easily determined in other markets.

- **Regression Analysis** – Gathering a large population of sales data (could be accomplished through an expansion of geographic and time parameters) and conducting a regression analysis for specific property features could be another method of supporting adjustments for comparable sales.

- **Prior Sale Analysis** –Analysis of the subject property prior sale and comparison to other sales at that time may produce suitable adjustment support for certain property attributes.

- **Depreciated Cost** – Estimating the cost of a property feature as though it were new, and then applying appropriate depreciation adjustments to the cost will result in an indication of market value.

Comparable Adjustments – New Construction

A common theme among appraisals of new construction properties in rural markets is the absence of age and condition adjustments even when the comparable sales are more than five years old.

- **Why is this happening** – The common explanation is that because there are no sales of new construction in the subject's market area, the appraiser is unable to demonstrate the market reaction to age and condition.

- **Why does it matter** – At the most basic level, failure to make adjustments for known factors that the market is reacting to results in an inaccurate opinion of market value. More broadly speaking, this often results in failure to obtain financing for these homes because the appraised value does not support the contract price (not that it always should).

- **Recommendation** – Include the derivation of your adjustment rates for critical adjustments in your appraisal report.

★ ***Key Principle:*** *Some support for adjustments, particularly for significant property attributes, is better than no support. Not making adjustments for key differences is rarely an acceptable approach.*

Cost Approach

The cost approach can provide much needed support in rural property appraisals. The inherent weaknesses of the sales comparison approach often experienced in rural markets place greater emphasis on a well-supported cost approach.

When is a Cost Approach warranted:

1. Any time the appraiser deems it necessary
2. Manufactured Housing (Fannie Mae Requirement)
3. New construction
4. Limited comparable sales
5. Comparable adjustments are large and/or numerous
6. Subject property is a unique style
7. Significant site improvements are present

Cost Approach – Site Value

The opinion of site value is a critical component of a credible cost approach. It is important for the appraiser to include an appropriate level of detail about how that site value conclusion was developed.

Methods for supporting the opinion of site value:

- **Direct Sales Comparison** – Analyzing historical sales of vacant land within the subject's market area is a preferred method because it is easy to employ and easy for the reader to understand.

- **Extraction Method** – This method can offer an alternative to direct sales comparison. However, estimating depreciation can sometimes be difficult. Often, the appraiser can apply the extraction to the same sales used in the Sales Comparison Approach, although the improvements do not need to be similar to the subject.

- **Allocation Method** – Often considered the least reliable method of site valuation, it still may offer much needed support when limited site valuation data exists.

***Key Principle:** It is critical that the appraisal includes adequate support for the opinion of site value.*

Cost Approach – Depreciation

Depreciation is often overlooked in the cost approach. It is important that the appraiser address all forms of depreciation, not just physical. Accurately adjusting for depreciation accounts for market factors in the cost approach.

- **Accuracy** – Failure to analyze and adjust for all forms of depreciation can inflate the opinion of value and create a significant divergence in value indications between the various approaches.

- **Support** – Supporting the depreciation estimate with reliable market data can be difficult, but it is critical to producing a credible cost approach.

- **Consistency** – Sometimes we see an appraisal where the appraiser has reported an adverse location influence in the sales comparison approach (e.g., Busy Road, Commercial Influence), but in the cost approach there is no accounting for external depreciation.

★ ***Key Principles:*** *1) The information provided in the cost approach must be consistent with comments and adjustments mentioned elsewhere in the appraisal report. 2) Depreciation rates must be derived from market data, just like other adjustments.*

Reconciliation of Value – Evaluation

The appraiser must evaluate the reliability of each approach, the validity of the indicated values, the reliability of the available data, and explain which approaches were given the most weight based on these evaluative measures (B4-1.3-11).

- **Appraiser Certification #4** – This certification states that the appraisal is based on the sales comparison approach. However, this does not preclude the use of, and reliance on the cost approach, or income approach with proper reconciliation support.

- **Evaluating the Approaches** – In cases where the sales comparison approach is diminished in credibility, an alternative approach can offer greater confidence in the final value conclusion and may be less subjective depending on market factors and data availability.

B4-1.3-11: Valuation Analysis and Reconciliation (04/15/2014)

"The appraiser considers the reliability and applicability of each of the approaches to value that was utilized in the appraisal report. After consideration of each of the approaches to value, the appraiser will provide his or her final value opinion."

"The reconciliation is based on the appraiser's judgment of the results developed as part of the valuation process and must never be an averaging technique with the exception of the use of a weighted average technique that includes proper explanation."

Reconciliation of Value – Weighting

While the sales comparison approach is often considered the most reliable for residential appraisals, there are circumstances in which the final reconciled value does not match the indicated value via the sales comparison approach.

- **Sales Comparison Approach** – While the sales comparison approach must offer reliable results, it is not required to be the MOST reliable value indicator. There are circumstances under which the sales comparison approach is less reliable. Consider unique housing styles, properties atypical for the market, etc.

- **Alternative Approaches** – It is acceptable from a Fannie Mae policy perspective for the appraiser to conclude at a final reconciled value that does not equal the value indicated by the sales comparison approach.

B4-1.3-11: Valuation Analysis and Reconciliation (04/15/2014)
"The final reconciled indicated value must be within the range of the values indicated by the Approaches used in the appraisal report form."

★ ***Key Principles:*** *While the final value is often more consistent with the sales comparison approach, it is not a violation of Fannie Mae policy if it is not.*

QUESTIONS