

# **Appraisal Review: Back to Basics II**

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# Appraisal Review: Back to Basics II

## When there is no smoking gun...

- The detection of a faulty or fraudulent appraisal involves more than one glaring error or omission—there is seldom an obvious “smoking gun”
- Therefore, the reviewer must collect the evidence—a series of errors, omissions, oversights that, collectively, will alert the reviewer to a conclusion (value) that is not supported.

## USPAP excerpts

*CREDIBLE: worthy of belief.*

Comment: Credible assignment results require support, by relevant evidence and logic, to the degree necessary for the intended use.

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## STANDARD 2: REAL PROPERTY APPRAISAL, REPORTING

In reporting the results of a real property appraisal, an appraiser must communicate each analysis, opinion, and conclusion in a manner that is not misleading.

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## Standards Rule 2-1

Each written or oral real property appraisal report must:

- (a) clearly and accurately set forth the appraisal in a manner that will not be misleading;
  - (b) contain sufficient information to enable the intended users of the appraisal to understand the report properly; and
- USPAP must be followed in all appraisal assignments
    - It is a violation of USPAP to intentionally “**overvalue**” a property
    - It is a violation to intentionally “**undervalue**” a property

## **USPAP.... unwound**

Appraisal reports:

- Must be “credible”
- Must include all “relevant” information
- Must have “support”
- Must contain “sufficient information”
- Cannot be “misleading”

## **The Issues**

- Inconsistencies
- Effective Age Unsupported
- Comp Selection
- Seller Concessions—Subject AND Comparables
- Adjustments Unsupported
- History

## Inconsistencies

*Consistency is Crucial!*

- The appraisal report must be *consistent* throughout-- information, explanations, analyses and conclusions found in *all* sections.

Inconsistencies: Start at the beginning

- Photos
- Maps

### Photographs

Look at the photographs *first*

- Are comparables similar to subject?
  - Design
  - Condition
  - Age
  - Quality
  - Surroundings

Photographs: *Consistency Check!*

- Neighborhood:
  - Comments/descriptions
- Improvements section:
  - Information in the comments sections
  - Does subject appear to be in conformity with the neighborhood (as evidenced by similarity to comparables)
- Sales Comparison Approach:
  - Description of comparables
  - Adjustments (or lack of) for obvious elements of comparison

## Photographs—Appraiser’s Responsibility

Photographs should be an “accurate” picture of what the appraiser has seen—subject, comparables and surrounding area.

*Required: Comparables must be viewed by the appraiser “at least from the street”.*

## Maps

- The location of the subject, the comparables, and the neighborhood
- Populated area vs. non-populated area
- Note the location of the comparables within the neighborhood layout—boundaries, etc.
- Notable division of land such as major thoroughfares, freeways, railroad tracks, etc., may indicate neighborhood boundaries
- The location of ocean, lakes, mountains, golf courses, etc. in relation to subject and comparables
- The existence of external obsolescence (both subject and comparables)
- The use of regional maps that do not adequately reflect distances
- Compare neighborhood layout with satellite maps, such as Google Earth, etc.

## Maps: *Consistency Check!*

- Neighborhood Characteristics:
  - Location: Urban-Suburban-Rural
  - Growth Rate
- One-Unit Housing Trends:
  - Property Values
  - Demand/Supply
  - Present Land use
- Neighborhood comments

- Site data (i.e. external obsolescence)
  - Highways, Freeways, busy streets
  - Commercial establishments
- Sales Comparison Approach
  - Comparable listings/Comparable sales data (top of page 2 of URAR)
  - Selection of Comparables
    - Distance
      - In relation to neighborhood boundaries
    - Adjustments (or lack of):
      - Location
      - Site
      - View

## Effective Age Unsupported

Large *unsupported* differences between the subject's *Actual Age (Year Built)* and *Effective Age*, will likely result in an inflated market value.

- Note: This also applies to the actual age/effective age variances of comparables (if reported).

## Effective Age

### Definition:

- The age indicated by the *condition* and *utility* of the structure

## Effective Age

- Better maintained building = lower **effective age**
- Poorly maintained building = **older** effective age
- Typical/average maintenance = effective age and actual age are **same/similar**

## Supporting Effective Age

- The wider the variance, the more details needed for support
- Specifics should be provided for updates, remodeling, etc., that would increase the subject's value based on local market acceptance
- Be cautious of the difference between *upgrades* and *maintenance*

## Effective Age...significance

The results of all Approaches to Value must be similar—therefore:

- The value indicated by the Cost Approach must be similar to the value by the Sales Comparison Approach

## Unsupported Effective Age = Inflated Value

*Age/Effective Age: Inconsistencies*

- Age/effective age variance not supported; therefore, lack of support for:
  - Adjustments in Sales Comparison Approach
  - Value by Sales Comparison Approach
  - Depreciation & Cost Approach
  - Opinion of Value

## Comp Selection

**“Comps” vs. “Sales”**

***The selection of Comparables is NOT just an “opinion”***

**Is it a Comp or a Sale?**

*Be cautious of statements such as:*

- *“Due to the lack of sales similar to the subject in size, quality, and amenities, it was necessary to extend the neighborhood boundaries.”*
- *“Due to the lack of sales similar to the subject in size, quality, and amenities, it was necessary to utilize comparables from other neighborhoods.”*

## Comp Selection

- Compare stats provided at the top section of Page 2 of URAR (Sales Comparison section) with the comparables provided

### Uniform Residential Appraisal Report

File#

There are	comparable properties currently offered for sale in the subject neighborhood ranging in price from \$	to \$	.
There are	comparable sales in the subject neighborhood within the past twelve months ranging in sale price from \$	to \$	.

- This data should reflect listings and sales that are *directly competitive* with the subject property

## Comp Selection —The Market Decides!

The **order of influences/features** that have the most impact on the value of a residential property:

- **Location**
- **Site influence (if applicable)**
- **Room Count (# of Bedrooms; # of Baths)**
- **Style/Design**
- **Gross Living Area (GLA or square footage)**
- **Quality, Age, Condition, Amenities, Other**

**Location** is the primary consideration in the selection of comparables.

- Except for **Location**, the other influences listed may change in the order of importance and impact, depending on the various markets

## Comp Selection—The Market Decides...Recap

The **influences/features** may change in order of importance, except **Location**—which will always be #1.

## “Bracketing”

*Underwriting* guideline meant to demonstrate relationship of subject’s price/value and GLA as compared with the neighborhood

- The goal is to prove that the subject’s value is not the highest; or size is not the largest

- Typically applies to gross living area, sale price, adjusted sale price, and value
- If not used properly, bracketing may force the inclusion of inappropriate sales and/or sales located outside of the subject’s neighborhood.
- Be cautious if appraiser included comparables from other neighborhoods in order to provide the upward end of bracketing
  - Note: This is acceptable if underwriter required; but upper end of price range should not be emphasized in final value.

***Bracketing will only be meaningful when limited to the subject’s neighborhood***

## Comp Selection: The Appraiser’s Responsibility

The Appraiser’s Certification:  
(Excerpt from URAR Form)

7. *I selected and used comparable sales that are locationally, physically, and functionally the most similar to the subject property.*

## Seller Concessions

The Affect of Financing Concessions begins with Subject's Terms...

### Subject: Prior "Offerings"

The purpose of this summary appraisal report is to provide the lender/client with an accurate, and adequately supported, opinion of the market value of the subject property.			
Property Address	City	State	Zip Code
Borrower	Owner of Public Record	County	
Legal Description			
Assessor's Parcel #	Tax Year	R.E. Taxes \$	
Neighborhood Name	Map Reference	Census Tract	
Occupant <input type="checkbox"/> Owner <input type="checkbox"/> Tenant <input type="checkbox"/> Vacant	Special Assessments \$	<input type="checkbox"/> PUD	HOA \$ <input type="checkbox"/> per year <input type="checkbox"/> per month
Property Rights Appraised <input type="checkbox"/> Fee Simple <input type="checkbox"/> Leasehold <input type="checkbox"/> Other (describe)			
Assignment Type <input type="checkbox"/> Purchase Transaction <input type="checkbox"/> Refinance Transaction <input type="checkbox"/> Other (describe)			
Lender/Client	Address		
Is the subject property currently offered for sale or has it been offered for sale in the twelve months prior to the effective date of this appraisal? <input type="checkbox"/> Yes <input type="checkbox"/> No			
Report data source(s) used, offering price(s), and date(s).			

**Clue:** The contract price is the same or higher than the list price

### Contract: Terms of sale

C O N T R A C T	I <input type="checkbox"/> did <input type="checkbox"/> did not analyze the contract for sale for the subject purchase transaction. Explain the results of the analysis of the contract for sale or why the analysis was not performed.		
	Contract Price \$	Date of Contract	Is the property seller the owner of public record? <input type="checkbox"/> Yes <input type="checkbox"/> No Data Source(s)
	Is there any financial assistance (loan charges, sale concessions, gift or downpayment assistance, etc.) to be paid by any party on behalf of the borrower? <input type="checkbox"/> Yes <input type="checkbox"/> No		
	If Yes, report the total dollar amount and describe the items to be paid.		

- This is not a new Item in the appraisal process

### USPAP: SR 1-5(a)

- Appraiser must, if such information is available to the appraiser in the normal course of business, "*analyze all* agreements of sale, options, or listings of the subject property current as of the effective date of the appraisal..."
- It is critical that an appraiser have access to the sale price and the terms.

- Appraisers often will give support to the proposed sale price but will not know the terms.
- Without the details of all terms, the sale price data is useless and should not be given any consideration.

## Source of Seller Concessions

- Lenders must cooperate in providing sales contract to appraisers
- Full disclosure should be *mandatory* for Realtors, Brokers, Builders, Developers—any party associated with the sale who has knowledge of the financing terms

## Financing Concessions

(from Fannie Mae selling guide)

“Our definition of market value is intended to assure that appraisals reflect an opinion of market value after adjustments for any special or creative financing or sales concessions—such as seller contributions, interest rate buy-downs, etc.—have been made.”

- The asterisked section of the definition provides consistent interpretation for the appraiser. Specifically, we want to emphasize that the phrases *"those costs which are normally paid by sellers as a result of tradition or law in a market area; these costs are readily identifiable since the seller pays these costs in virtually all sales transactions" refer to all of the sellers in a specific market area...*

## Financing Concessions

- The determination to make adjustments is *not* based on how typical the concession might be for a segment of the market
  - Ex: New developments
- Seller concessions directly influence the price paid for real estate, but typically do not contribute to the subject's value

## Financing Concessions: The appraiser's responsibility

(Excerpts from HUD, Fannie Mae & Freddie Mac):

- Appraisers are required to verify and analyze all sales on a cash equivalent basis (interest rate buy-downs, below market financing, owner financing, etc.)

- The appraiser must verify all sales transactions for seller concessions and report those findings.
- Comparables should be adjusted if their sale prices were influenced by the following:
  - Special/non-market financing terms
  - Loan discount points; loan origination fees
  - Buyers closing costs paid by seller
  - Interest rate buy-downs
  - Gift down payments or settlement assistance
  - Builder incentives and giveaways
  - Swaps/exchanges
  - Personal items (non-realty) included in sale

## **Adjustments Unsupported**

- All significant adjustments should be explained by the appraiser.
- Avoid unsupported “escape” adjustments and vague explanations.
- Watch for obvious lack of proper verification procedures when:
  - Lack of details on comparables
  - Financing details not disclosed

## **Explanation of Adjustments**

The statement:

“Comp #1 is inferior to the subject in condition and was adjusted upward \$20,000”

...is *not* an acceptable explanation.

### Adjustment explained:

- The subject was recently updated with new carpet, ceramic tile and hardwood floors, designer wallpaper and complete remodeling of kitchen.
- Comparable #1 was recently painted, but has not been updated. Therefore, comparable #1 was adjusted upward \$20,000 condition.

### Explanation of Adjustments: The Appraiser's Responsibility The Appraiser's Certification: (Excerpt from URAR Form)

10. *I verified, from a disinterested source, all information in this report that was provided by parties who have a financial interest in the sale or financing of the subject property.*
12. *I am aware of and have access to, the necessary and appropriate public and private data sources, such as multiple listing sources, tax assessment records, public land records and other such data sources for the area in which the property is located.*

## History

Appraisers are required to REPORT and ANALYZE prior history:

Subject: appraiser must report and analyze prior sale within 3 years

Comparables: appraiser should report & analyze the difference between the sales price reported in the appraisal and any prior sales within the previous one year.

*Merely "reporting" is not acceptable; appraiser must analyze.*

### History: Analyze

- Did the subject sell higher than *list price*? Is this supported?
- Is the Opinion of Value **higher** than a prior sale reported? What does this mean?
- Is the Opinion of Value **lower** than a prior sale reported? What does this mean?

## History

***The proper reporting and analyzing of the History is NOT an option for the appraiser or the lender—it is mandatory***

## Underwriter Watch

- Comparables selected from outside the subject neighborhood when more similar ones located within the neighborhood.
- Unusually high or low prices of comparables that do not fall in line with the other sales data
- A wide variance in sale prices of the comparables
- All comparables being “inferior” or “superior” to the subject in Quality of Construction or Design
- The Dates of Sale of the Comparables are not consistent with information found in the Neighborhood section.
  - Page 1 of URAR reflects an active or increasing market; comparables are old
- Large variances in **site** sizes of the comparables as compared to subject’s site
- Comparables located on superior sites with views such as **golf courses, waterfront/water view**, etc.; yet, subject does *not* have the same type of site or view
- Inconsistency in the subject’s **effective age** (page 1; URAR) and the **adjustments** to the comparables for quality/age/condition
- Assigning an **effective age** to the comparable sales without providing details of the condition, quality, upgrades, etc.
- Emphasis of square footage as the primary selection criteria; then choosing comparables outside the neighborhood for similarity to, or bracketing of, the square footage
  - Remember that GLA (square footage) is just one element of comparison; it is not the most important influence on value
- Excessive variances in square footage of the comparables
- The comparables are significantly different from the subject in key elements of comparison—this may be a hint that they were located in a different markets

- Ignoring significant functional differences
  - Example: Using comparables of 3-bedroom **comparables** for a 1-bedroom **subject** and/or adjusting only a minimal amount for such differences
  - Adjusting only for square footage and ignoring differences in # of Bedrooms
    - BR count is part of the functional layout; it is separate from the square footage of the dwelling for comparison purposes.
- Failure to emphasize the *best* comparables to support the final opinion of value
  - Example:
    - Comparables 4, 5, or 6 (found on page 2; URAR) are truly the *best* comps
      - However, the adjusted prices of comparables 4, 5, or 6 do not support the final
    - Yet, appraiser emphasizes comparables 1-3 and provides a value based on the first 3 comps.

### **Increasing Markets—Positive Time adjustments**

- Positive Time Adjustments are acceptable to the lender, but should be thoroughly supported
- If comparables are very recent, it may be questionable as to whether time adjustments are necessary
- It is quite common to have a gradually increasing market, yet time adjustments are not necessary
- Careful consideration of supply/demand is critical
- Ample market data should be available in an increasing market
- Comparables should be located within the subject's neighborhood. These comps will be more representative of the current market conditions
- Recent comparables should be available in an increasing market
- Provide listings and/or pending sales for additional support

- Comparables that support the subject's value should be available *within the subject's market area*; no need to go outside the neighborhood when there is activity within
- If new developments, consider comparables from competing builders, as well as local resales to substantiate increases in prices
  - Just because a price is established by the builder does *not* mean that it is market supported
- Be cautious of fraud—some comparables are the result of fraudulent transactions. The appearance of increasing prices may snag an unsuspecting appraiser—know your market!
- Support positive time adjustments with ample data—more than just one sale and resale--of properties located in the subject's neighborhood and comparable with the subject
- Do not use average % price increases reported in various publications—these are typically just averages for the city, region, etc. The data used to support increasing markets should come directly from the subject neighborhood and should be a result of the appraiser's analysis.
- Builder price increases *are not* support for positive time adjustments—appraisers should rely on their independent analysis of the subject's market
- “History” information reported for both subject and comparables should correlate and be consistent with an *increasing market* (sales prices of prior sales lower than current values/prices reported)
- *Consistency Check!* Are the ratings for increasing prices and/or positive time adjustments consistent with the information provided in all sections of the appraisal report?

### **Decreasing Markets & Negative Time Adjustments:**

- Appraisers' responsibility is to report declining markets—regardless of the concern that it will “kill the deal”.
- Awareness of what is going on in the area—employment stability, development, any negative issues that would affect real estate
- Careful consideration of supply/demand is critical
- Consider “days-on-market”—are the houses taking longer to sell?

- Are foreclosures starting to frequent the neighborhood and the MLS sales?
- Carefully view the entire neighborhood for signs of distress—lots of listings, poor upkeep, boarded up homes
- Comparables should be located within the subject’s neighborhood. Even if older, these comps will be more representative of the current market conditions
- Thorough explanations within the appraisal regarding the decline—what is the cause: closing of a major employer, catastrophe (hurricane), hazardous site determined in the area
  - Communicating the reason allows the underwriter to make decisions on the loan based on the possibility that stable market conditions will return
- Provide listings and/or pending sales which will reflect current conditions
- To determine the amount of a negative time adjustment—use the same process used for determining a positive time adjustment: The analysis of the sale and resale of several truly comparable properties, located within the neighborhood.
- Sales activity within new developments will reflect a slowing housing market—the better deals that are being offered by the builders (concessions, discounts, bonuses, give-aways), the more likely the market is slowing
  - Appraisers are responsible for adjusting for these concessions included in the sales price of the comparable sales
- “History” information reported for both subject and comparables should correlate and be consistent with a *decreasing market* (sales prices of prior sales higher than current values/prices reported may indicate a declining market)
- *Consistency Check!* Does the appraiser fail to rate or mention property values as declining; yet, information in other sections of the appraisal report is not consistent with a stable or increasing market??

## The Risk of Refis

- Appraisers are “instructed” that a certain value is needed
- This “value” often includes:
  - Loan balance
  - Credit card or other debts
  - Closing costs
  - Enough variance to avoid PMI

**NONE OF THESE ITEMS HAVE ANY RELATIONSHIP TO MARKET VALUE!**

## **Relationship with Appraisers**

- Update requirements for appraisers—be specific.
- Maintain strict internal policies against pressure/influence toward appraisers
- If the comparables are questionable, ask for additional ones
- Require (written) explanations if inconsistencies noted in the appraisal
- Request thorough explanations as needed for support of effective age, large adjustments, etc.
- Be more selective—choosing appraisers based on “fee” will get you what you paid for
- Develop “A” List of Appraisers—this effort will save time/money in the long run and reduce losses.
- Understand the Appraiser’s role and responsibility and hold accountable

***It is the appraiser’s responsibility to produce a credible appraisal; it is the underwriter’s responsibility to determine if the appraisal is acceptable***

## Websites/Resources

- [www.fncinc.com](http://www.fncinc.com) (FNC Inc)
  - GAAR®—Generally Accepted Appraisal Rules™ (automated appraisal review)
  - Appraisal Score
  - CMS—Collateral Management System
  - [education@lists.fncinc.com](mailto:education@lists.fncinc.com) Attendees: Appraisal Institute's seminar: "Quality Assurance in Residential Appraising: *Risky Appraisals=Risky Loans*"  
(List of Appraisers who have attended seminar emphasizing quality control)
- [www.appraisalinstitute.org](http://www.appraisalinstitute.org)
  - Appraising Residential Properties, 4<sup>th</sup> Edition (Book)
  - Appraiser Directory
- [www.appraisalfoundation.org](http://www.appraisalfoundation.org)
  - USPAP document

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