APPRAISAL TODAY

May 2016

Index

Practical tips on qualifying the 1004MC and preparing a Market Conditions Summary

By Doug Smith, SRA, AI-RRS

Editor's note: In some markets there is rapid price appreciation. Lenders are complaining that appraisals are too low. The 1004MC is not set up to address this. You need to explain how you are using pending sales, agent interviews, etc. Two articles in this newsletter discuss this problem and how to handle it.

The introduction of the 1004MC Addendum focuses the appraiser's attention on the entire issue of market conditions. In response, appraisers have expanded and supplemented market information in their approach to summarizing the state of the local real estate market. Charts and graphs are showing up in reports as well as detailed statistics.

With the mechanics of preparing the 1004MC report figured out, appraisers are now introducing qualifying addendums to the 1004MC in an effort to explain calculations, data sources and data availability.

Appraisers are also addressing liability management. Whatever information is provided in a report, the main aim is always report coherence and consistency throughout the report.

The focus must always be on the reader and the essential information necessary on which to base decisions. Issues of competency, guidance from Fannie Mae and Freddie Mac, plus liability management must be addressed in a straight forward way that is easily understood by the reader.

But, too much is sometimes not a good thing and some attention must be paid to summarizing the information.

Two Basic Fundamentals

In the crunch of pressure to adapt to the requirements of the 1004MC, it is evident that appraisers may have lost sight of two fundamental issues.

The first issue became apparent last year when I completed over 200 desk reviews of mostly single unit residential properties. Appraisers simply are not aware of USPAP requirements for developing and reporting market conditions and the economic environment. In this regard, appraisers are not following the clearly set out directions stated within the basic residential forms and the 1004MC itself.

Secondly, appraisers simply don't address the real and pressing concerns of the lender who must understand the economic environment in which they must make decisions for accepting collateral in exchange for loans on that collateral.

USPAP and Form Directions

In almost every appraisal I reviewed last year, the reports did not identify the economic and physical characteristics of the subject neighborhood as they related to the subject property according to Standards Rule 1-2(e) (I) ; 1-3(a) or 2-2(a)(iii)

Standards Rule 1-2(e) (i):

(e) identify the characteristics of the property that are relevant to the type and definition of value and intended use of the appraisal,

(i) its location and physical, legal, and economic attributes;

Standards Rule 1-3 (a) Standards Rule 1-3

When necessary for credible assignment results in developing a market value opinion, an appraiser must:

(a) identify and analyze the effect on use and value of existing land use regulations, reasonably probable modifications of such land use regulations, economic supply and demand, the physical adaptability of the real estate, and market area trends;

Standards 2-2(a)(iii)

Standards Rule 2-2

(a) The content of an Appraisal Report must be consistent with the intended use of the appraisal and, at a minimum:

(iii) summarize information sufficient to identify the real estate involved in the appraisal, including the physical, legal, and economic property characteristics relevant to the assignment;

USPAP clearly requires information regarding economic supply and demand, market area trends and economic attributes. The implication is that these are mostly quantitative measures and require a quantitative summarization rather than vague generic qualitative statements.

1004 and 1004MC Instructions

Appraisers generally ignore the instructions found on page 1 with the Neighborhood section on Market Conditions that in the parenthesis states: (including support for the above conclusions). The question appraisers face is whether the introduction of the 1004MC fulfills this written requirement to support the conclusions of the One-Unit Housing Trends.

While the One-Unit Housing Trends section must be consistent with the findings in the 1004MC, there is grave concern that the 1004MC does not fully reflect accurate trends in the Neighborhood.

The 1004MC includes a concise set of instructions which indicate much is required of the appraiser that is not adequately covered by the form and narrative portion of the form.

"The appraiser must use the information required on this form as the basis for his/her conclusions, and must provide support for those conclusions, regarding housing trends and overall market conditions as reported in the Neighborhood section of the appraisal report form. The appraiser must fill in all the information to the extent it is available and reliable and must provide analysis as indicated below. If any required data is unavailable or is considered unreliable, the appraiser must provide an explanation. It is recognized that not all data sources will be able to provide data for the shaded areas below; if it is available, however, the appraiser must include the data in the analysis. If data sources provide the required information as an average instead of the median, the appraiser should report the available figure and identify it as an average. Sales and listings must be properties that compete with the subject property, determined by applying the criterial that be used by a prospective buyer of the subject property. The appraiser must explain any anomalies in the data such as seasonal markets, new construction, foreclosures , etc."

What do Lenders Want?

Lender clients depend on the appraiser to identify the market environment in which the subject is located and render sufficient information about the market environment allowing the lender client to confidently make a decision about the worthiness of the subject for loan collateral.

What are the basics on which a decision is made? Lenders want to know the trends in the market. Is the market moving in a direction and at what rate? They want to know activity in the market, whether there is new construction and whether foreclosures are a factor in the market place.

The major failing of the 1004MC is that it only requires data from one year and that data is distributed unevenly in one six month segment and two 3 months segments.

It is readily obvious that one year does not have enough data to establish a trend. The many failings and challenges of the 1004MC have been discussed at length with a major article in the April edition of Appraisal Today and authored by George Dell.

A concrete suggestion to meet the level of inquiry from lenders is to determine with some certainty what is actually happening in the marketplace by assembling data over a 24 month period or longer. Data may include those properties that are reasonably similar to the subject using the parameters set out by the 1004MC.

Appraisers are discouraged from using price as a parameter. But, with a non-homogeneous market, listings are cluttered at each end of the price spectrum. In statistics, eliminating outliers is generally an accepted practice. The appraiser should feel confident that results of a search for those properties considered reasonably similar can include an analysis of properties that are not suitable to the analysis with these eliminated as outliers.

Next determine the level of sales activity in each twelve month period, calculate the absorption rate and using the absorption rate from the last twelve month determine the inventory level (Supply).

By using the overall 24 month period, the days on the market and the list/sell rate can be determined. With a little investigation, most multiple listings services can be found to generate pivot tables or scatter diagrams that can accurately demonstrate seasonal activity. These can easily be transferred into the report narrative.

This level of analysis can easily be converted into a narrative form with the 1004MC being the end product. By expanding the basic market analysis, the appraiser will have gained a better understanding of the market and, in turn, the lender will have a greater understanding of the overall trends in the market.

A separate analysis of new construction is appropriate with information gained by an analysis of properties offered as new construction and again compared from one year to the next.

The McGregor and Underwriters

When I started in appraising and heard from underwriters, I quickly learned that identifying the problem to be solved included heading off potential comments and requests for revisions and corrections by the underwriter about details within a completed report.

Underwriters have their hot buttons. They are leery of properties where there is one bedroom above grade and want to see similar comparable sales. The appraiser who attempts to appraise a triple-wide manufactured home with no similar structures is in trouble. Beyond the basic valuation, there are always one or two items that need additional comment or handling.

When confronted with these details that attract the attention of reviewers and underwriters, I thought about the scary childhood bedtime story, "Peter Cottontail in Mr. McGregor's Garden."

In this story, Peter Cottontail is admonished by his mother not to go into Mr. McGregor's garden lest he wind up like his father; baked into a pie by Mrs. McGregor. Peter, in search of fresh vegetables, ignores his mother's advice and soon encounters Mr. McGregor who runs after him with a rake and tries to net him in a sieve.

Taking a cue from this childhood story, I began to look for the "McGregor" in each assignment, something that would send the underwriter after me with a rake and net. The whole issue of market conditions is the ultimate "McGregor."

In the current market environment, critical decisions hinge on the health of the local market. In a declining market, borrowers generally borrow at stricter loan-to-value ratios and at higher interest rates. There is, then, a lot riding on getting it right, making the market condition summary a true test of competency. There are also looming issues of liability and appraisers must shield themselves from the consequences of matters beyond their control.

In the boom years, lenders paid little attention to the market summary. Underwriters relied on the check marks found on page one, and appraisers obliged by relying on concise statements that varied little from one report to another.

Now, with the emphasis on the steps to prepare the 1004MC, appraisers are reacting with an abundance of information that, in some cases, goes far afield of what is required or relevant to the subject at hand.

Advisory Opinion 16 - Fair Housing Laws and Appraisal Report Content

Reviewing Advisory Opinion 16 - Fair Housing Laws and Appraisal Report Content is an absolute must for every appraiser intent on accurately summarizing market conditions. This advisory opinion directly addresses compliance with Fair Housing Laws, but also offers some direct advice on language found in the market condition summary and in the 1004MC:

“Appraisers should exercise care that comments made in a report will not be perceived as illegally biased or discriminatory. Factual descriptions rather than subjective phrases allow the user of a report to draw his or her own conclusions. The use of terms that reflect a scale such as "high," "low,""good," "fair," "poor," "strong" "weak," "rapid" "slow," "average," or the like should also provide contextual information that properly explains the frame of reference and the relative position of the subject property on the scale. For example, if absorption is stated as "rapid," the context of the rating should be cited as well ("rapid" relative to what?) “

Appraisers would do well to carefully read comments in their summary and avoid unsupported characterizations of the market or market segments. In a changing market, comparisons must be made in context.

Addendum Creep

Appraisers are creating "addendum sprawl" now that most appraisers are able to fill out the form. Appraisers are going in ten different directions qualifying what is presented. To read the hieroglyphics derived in the 1004MC, appraisers need to present their own Rosetta Stone - some way for readers to understand what they are trying to say.

Appraisers need to head off concerns by underwriters and cover some liability issues. The emphasis should be on outcome rather than process, but the reader may need some guidance on the process. As the underwriters gain experience, appraisers may be able to cut back on addendum comments later.

Liability management issues.

The primary issue with 104MC is the source and quality of the MLS data.

On April 3, 2011 Peter Christensen and Robert Wiley writing for the Appraisal Legal Defense and Insurance Blog issued a short article on liability management issues with the 1004MC.

In summary, they offered the following suggested language to be inserted into the 1004MC report. "Appraiser's 'Inventory Analysis', 'Median Sale & List Price, DOM' and other observations in this addendum are based on the data source identified above, which appraiser generally believes to be an acceptable source of market data. However, the appraiser cannot verify all of the information in that data source and cannot guarantee the accuracy of such data or conclusions based thereon. The appraiser also cannot guarantee future market conditions affecting the subject property."

Scope of work issues

Several scope of work issues affect the approach to the 1004MC. Appraisers must cite the data source and what level analysis was used as well as describe software used if any in addition to MLS supplied data.

Using software programs for 1004MC

For appraisers considering incorporating a software program to assist with the completion of the MC addendum, there are two major issues.

The first deals with the data used by the appraiser. Credibility of the output depends on the quality of the database.

Secondly, appraisers must consider the basic USPAP issue of competency. Appraisers will benefit from a review of Advisory Opinion 18 that addresses the USPAP issues of using a computer modeling program. Although directed to valuation models, the guidance found in AO-18 applies to the use of any software modeling program. The appraiser may not fully understand the intricacies of the program, but must be able to describe the overall process and verify that the program's output is consistent in producing results that accurately reflect prevailing trends in the marketplace.

Scarce data

In some cases, the appraiser is confronted with scarce data and the statistical reliability/unreliability of small samples. Fannie Mae FAQ #4 is applicable because it discusses what actions the appraiser must take if there is not enough data to present a meaningful analysis.

In those situations, the appraiser must complete the form with the information he or she has for the defined neighborhood/area - the lack of data may speak to what is occurring in that area. Additional analysis can be addressed in the summary/conclusion section of the form on data in nearby areas for competitive properties. The appraiser must provide support for his or her conclusions regarding housing trends as noted in the Neighborhood section of the appraisal report.

Not all questions about the data handling in the 1004MC have been answered. There is some evidence that appraisers are not consistent in reporting some of the data in the report. Some of these discrepancies are related to software programs that have been a curious factor in the introduction of the 1004MC. A summary of calculations addressing issues such as the average/mean issues as well as giving the underwriter some guidance can be helpful to the reader. Most of the calculations need some explanation.

Market change is taking place that requires the appraiser summarize the level of change in which one level is changed from another. How much does it take to move from stable to declining?

Market Conditions - How much is too much?

Appraisers may be tempted to include too much information in the market conditions section of the report. Appraisers must discipline themselves to summarize market conditions and remember that the objective to inform the reader. The 1004 remains a summary report. Appraisers must show some mercy to reviewers and underwriters.

As a kid, I did magic at family parties. I asked my grandmother to make a cape for me. She said, "Just do your magic, Douglas, don't be a show off." Appraisers would do well to follow that advice; just stay with the magic and skip the cape and top hat. Large wordy documents take on the appearance of being burdened with boiler plate which is considered report dandruff-dead, dry and flaky.

Appraisers analyze, reconcile and report. The emphasis on reporting is credibility. Exhaustive addendums lose credibility in the clutter.

What does the lender need to know? The emphasis is outcome over process. The result of the exercise is a valuation report with a 1004MC addendum not vice versa.

Report writing tips

The general approach to writing the market condition summary is to bring the reader along to a conclusion. The most effective way to do this is to think in terms of the classic outline: Introduction, Body and Conclusion.

Start with a summary of the important issue in the introductory sentences. If the neighborhood is bucking the trend in an overall declining market, this is an important introduction to the analysis to follow. Then follow up with a tightly written analysis.

This does not have to be totally in narrative form. In some cases, tracking the last two or three years on a spread sheet will quickly show which way the market is headed. A picture is worth a thousand words remains true when conveying ideas.

Total sales, list/sell ratios, median home values and other relevant data can demonstrate what the market is doing. Bulleted information is very effective for conveying information in the body of the summary. Lastly, sub-titles help to organize sections of the report.

Finally, summarize conclusions and tie these conclusions to the check marked section of the report found at the beginning of the report.

Writing Style

Write in active voice. An appraiser sent me a market condition summary example that ran four pages, legal size in 10 point type. A typical sentence follows: "Much of the market expansion and speculation was funded with sub-prime and alt-A loans." This is passive voice. Write in active voice to help the reader. Instead write: "Sub-prime and Alt-A loans funded market expansion and speculation." Push verbs to the front of sentences to invoke more interest.

Conclusion

The Preamble to USPAP states, "It is essential that appraisers develop and communicate their analyses, opinions, and conclusions to intended users of their services in a manner that is meaningful and not misleading."

One contributor to Appraisers Forum put it best about the 1004MC by saying, "The form is the form. If the appraiser explains the limitation of the form, the appraiser is not misleading, merely reporting. The contributor went on to say, "Concise and relevant information is far better than pages of generic and irrelevant statistics."

About the author

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

Data Science. What is it? What does it mean for appraisers?

By George Dell, MAI, SRA, ASA

Editor's note: George Dell wrote two recent articles for Appraisal Today: April - Issues with the 1004mc - a closer look and in March - Statistical errors in the 1004MC George's articles focused on statistical problems. Doug Smith's article above focuses on how to handle 1004MC issues.

Data Science is the answer to "Big Data." So -- what is "Big Data?" Big Data is a big and encompassing concept. Basically it includes everything around the reality that we now have electronic data about everything, instantly available. It includes data gathered for no particular reason, as well as for a reason. The puzzle is making it useful.

Data science is a set of tools, concepts, and attitudes. Yet it is more. It is a powerful new approach to making discoveries, understandings, and predictions.

Data science includes the computation, management, and analysis of that data. It includes the old statistics, but is much, much, more. It is about connecting data with the human brain. And using the brain's strengths, as augmented by computation, visualization, collaboration, communication, and mutual help. It is especially about how to increase the understanding of what data can tell us.

It is about:

- Creating useful questions about that data.
- Exploring, classifying, and predicting from that data.
- Converting that data into information (by sorting and associating).
- Explaining that information toward usable knowledge and good decisions.

It requires basic analytical skills, and always requires subject-matter knowledge. Does this sound like what appraisers do? Yes.

What is small data? Within the "big data" concept, certain problems use only small amounts of data for individual solutions. In fact, an important part of data science is the sorting, classifying, and grouping data for further analysis. In this sense, valuation can be considered a "small data" subset of today's big data world. Why is this? It is because our most relevant data set is the competitive market segment. Usually this is limited to a defined small (not huge) data set.

So what is the big change for us?

In the past, appraisers worked diligently to 'gather' sales comparables. Gathering, improving, and storing data was the main task of an appraiser. In the office where I trained, the library was as large as the office area. That library of old appraisals, MLS books, zoning regulations, maps, and public records 'leads' was the most important asset of the appraisal office. And who you knew was as important as what you knew. We went to chapter meetings of the old SREA to connect, and to trade comps. It was about getting comps. Once you had 5 or 6 good comps, your job was almost done. Just write a few paragraphs of qualitative comparison on each sale, reconcile, give it to the typist, sign it, and out the door!

Today, we no longer own the data, we buy it. Basically we have data much cheaper, more complete, and easier to sort and pull inside our computer or the on the cloud. So what is the big difference. Analytically, it means we can work with complete data sets. So the next question is: What is the ideal complete data set? Is it the neighborhood, the city, or what?

If we look at appraisal theory, and basic economic theory, the answer is clear. In The Appraisal of Real Estate" (Appraisal Institute, 14th ed.) only a foot note states: "Market value is based on conventional economic theory, which predicts a unique market-driven price at the point where supply equals demand in a competitive market."

This raises the next question: what is a market? Here is where we may have some confusion. A "market" can mean "all the houses in a neighborhood, which are for sale" and "all the possible buyers for houses in that neighborhood." What is important here is that not every buyer is looking at every size house in that neighborhood. A house buyer will typically look at certain sizes of house in a given neighborhood, and possibly compare with similar houses in another nearby neighborhood.

The point here is that the relevant market segment that competes for this buyer's attention is defined by more than just size or location (or other features). It is also defined by the property type (optimal use), the transaction elements (financing, motivation, concessions, etc.), the competitive time (what actually was on the market on the date of value), and the other 'similar' characteristics of the property.

Data science is as a catalyst integrating interdisciplinary fields like business analysis that incorporate computer science, modeling, statistics, analytics, and mathematics.

Data science applies computation. Computation means handling large, instantly available databases, reducing that data to the question being asked. It means classifying that data into relevant and irrelevant and marginally relevant groups.

It means identifying the relevant predictor variables (elements of comparison?)

It means predicting to the next case. It provides a pathway to use computation to analyze massively available amounts of data, sort the relevant, and to extract knowledge from them.

With such automated methods turning up everywhere from genomics to high-energy physics, data science is helping to create new branches of science, and influencing areas of social science, business, economics and even the humanities. The trend is expected to accelerate in the coming years as data from mobile sensors, sophisticated instruments, the web, and more, grows.

In academic research, we will see more traditional disciplines spawning new sub-disciplines with the words "computational" or "quantitative" in front. Data science is the maturation of economics from the historic land, labor, capital - then entrepreneurship - and now information. It is the encapsulation of the age of information.

About the author

George Dell, MAI, SRA, ASA
www.Valuemetrics.info
Appraiser education, tools, and community-building

George Dell MAI, SRA, ASA, is a recognized authority on applications of predictive methods to asset valuation and risk/reliability issues. He has broad graduate-level education in mathematics, statistics, econometrics, finance, and insurance.

He has authored numerous articles, seminars, and is a co-author of the AI book "Appraisal Valuation Modeling".

In developing the "new valuation modeling paradigm," he provides the answer to "big data." The "data science" tools are the answer to the current troublesome issues for the appraiser, the lending industry, and the health of the economy.

His academic paper, "Auditable Appraisal Best Practices"© was presented at the joint AI and Union of Pan American Valuers in 2010, winning the "best manuscript" award out of over 100 papers submitted.

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

For more information, go to www.valuemetrics.info .

No man's land & the aggressive real estate market

By Ryan Lundquist.

Editor's comments: Ryan's blog is written primarily to help real estate agents and consumers as it is advertising for his appraisal business. I have included it as it is recent and addresses recent changes in his market.

It's easy to explain what the market did, but what is it doing now? Everyone and their Mom can sound like an expert with the benefit of hindsight, but how do we see the current market? Do we give more weight to recent sales or listings? Do we have to wait for sales to close to know how the market is unfolding? Let's consider a few thoughts below.

Four points to consider:
1. Sales show us the past: A sale might close escrow today, but does it really tell us about the market today? Not necessarily. A closed sale on April 12, 2016 probably got into contract in early March, so it likely tells us more about the market 30-45 days ago rather than today. The current market in April could actually be higher or lower, so it's important to ask how value has changed if at all.

2. Pendings help us see the current market: The current market is often better seen in the pendings and listings rather than the sales. This assumes we have enough solid data of course. One of the most practical questions we can ask is whether properties are getting into contract at higher levels or not.

Simply put, if pendings are higher than the most recent sales (and they're not padded with

concessions), they help us see the current market has probably increased in value.
Other questions to consider: Are properties getting into contract more quickly? Is inventory going up or down? Is the sales-to-list price ratio increasing or declining in the neighborhood? Are sellers offering incentives to buyers or not? It's easy to be so fixated on sales that we don't ask these questions, but the answers help us gauge current trends.

Remember though, sales might tell us about the past, but we still give them strong weight because they actually closed at that level. After all, pendings might not end up selling. In that sense we have to "appraise" the pendings too. Are they reasonable? Do they reflect the market? Or are they outliers?

3. Getting bid up to "no man's land": Sometimes in a frenzied market, properties can easily get into contract for more than they are worth. Yes, the market has been aggressive and values have been increasing (see trends in Ryan's blog posting), but sometimes properties are simply getting bid up to "no man's land" so to speak.

In other words, there just isn't any support for a value that high based on all market data. Remember, even when housing inventory is incredibly sparse like it is right now, there still has to be support for the value. We can't just list at an astronomical level or let offers get bid up way beyond what is reasonable and expect a magical appraisal to meet the contract price.

4. Making or not making market adjustments: If the market has changed since the sales went into contract, appraisers may need to account for that with a market conditions adjustment. If you didn't know, appraisers can give an up or down adjustment to the comps if the market has changed since the comps went into contract. In fact, if an adjustment is not given when it should be given, the appraised value could easily reflect the market in the past rather than today.

Appraisers need to consider what a real market adjustment for time might look like. For instance, last week I used a comp that was nearly one year old since recent sales were sparse, and I gave an 8% adjustment up since the neighborhood market has increased in value by that much. I could have given a small token adjustment that I just made up, but 8% was very reasonable based on more recent sales and current pendings.

About the author

Ryan Lundquist is a certified appraiser and focuses on residential appraisals in the Sacramento area. His clients include home owners, real estate agents, governmental agencies, attorneys, and lenders.

Ryan runs the Sacramento Appraisal Blog, which is a top-ranking appraisal blog in the United States.

Ryan has been seen multiple times on CBS 13, quoted in the Sacramento Business Journal, Sacramento Bee, and various other publications. Ryan is the Chair of the Housing Opportunity Committee with the Sacramento Association of Realtors, and is also a board member of the Real Estate Appraisers Association of Sacramento. Ryan won the Affiliate of the Year award in 2014 from the Sacramento Association of Realtors.

On the next page is a Most Excellent Graphic from Ryan on what to look for.

House of Corrections
Copyright on internet articles and blog posts.

In last month's newsletter article, "What is a bedroom?" by Doug Smith, SRA, AI-RRS, we forgot to include a credit for Ryan Lunquist. Doug included some of the closet section of Ryan's blog post "The 4 requirements for a room to be considered a bedroom". Subscribe to his blog. It is written to promote his appraisal business to home owners, real estate agents, etc., but lots of the writing is useful for appraisers. Here is a link to Ryan's article: http://sacramentoappraisalblog.com/2014/09/09/the-4-requirements-for-a-room-to-be-considered-a-bedroom/

FYI, when you write something on a cocktail napkin, it is copyrighted. That is what our national copyright laws say. You do not need to have a copyright notice or file for a copyright with the federal government. I always have a copyright notice on anything that I write. But, I did not have one on my blog. I am putting up a notice today.

Most of what is written on the internet is free, such as my blog and postings on chat boards, etc. But, all of it is copyrighted.

I often use small portions of an article. This is called "free use", so people can say something without getting permission. I use this a lot in my free email newsletters. I put the material in quotes and reference the original source.

I have been a publisher since 1992, before the internet, when copyright was much clearer, as everything was on paper.

What should you do? Ask the author for permission to reprint and give the author a credit. Email is good, as then you have a record.

How to handle rapidly increasing prices in your market

Appraisers are always causing problems for lenders. In declining markets, we are "too high" causing loans to go bad. In increasing markets, we are "deal killers", particularly on sales, where there is a "target value", the sales price. On refis there is less pressure, as real estate commissions are not involved.

There are significantly increasing prices in many areas now. Appraisers need to figure out how to determine and support higher values.

Fortunately, the 1004MC makes appraisers show lenders that prices are changing. I don't hear about getting kicked off an approved list for negative market conditions adjustments in declining markets. But, when prices are changing rapidly, up or down, the 1004MC often does not work well.

For many decades, appraisers were taught to not "come in" under the sales price. Historical data shows that few appraisals are under the sales price. In the early 1990s, in my area we had major price declines. At an appraisal conference I chatted with the chief appraiser at one of the lenders. He said there were no price declines.

Much of this article is about lender appraisals. If you are doing non-lender work, you can use whatever methods you want to get the most accurate and reliable value with no hassles.

Only using closed sales and nothing else

Many appraisers were trained to only look at sales. But, sales are the past. If you only look at sales, you will be high in declining markets and low in increasing markets.

I think appraisers should be as accurate as possible in their valuations and use whatever is available.

What if all appraisers only looked at the past - closed sales?

Somehow, appraisers are able to value properties at higher (or lower) values than the closed sales. Otherwise, appraisers would control the market as buyers could not get loans.

Of course, you can always use inappropriate sales - from another market, etc.

Another reason why market condition adjustments are critical.

Once again, similar to lender denial of price declines, they are just noticing. We have had dramatic price increases in the San Francisco Bay area for the past 3-4 years and are way over the peak year, prior to 2008.

What about underwriters and AMCs?

I am sure lenders are telling them that appraisers are being too "low" and that using pending sales are okay. Also, that they are not requiring that one sale be higher than the appraised value of the subject.

How should you explain what is happening in your market?

Explain in "layman's" terms so anyone can understand. Remember, underwriters and almost all AMC employees are not experienced appraisers. See Doug Smith's article on the 1004MC in this newsletter for suggestions on how and what to write.

For example, the 1004MC does not work for rapidly changing markets. You need to explain what is happening.

Or, you have a stable market, but a home sells for over list.

Prices are not going up everywhere

There are some areas, such as the "Rust Belt" where prices are not increasing and sales are slow. There are many people who owe more than their homes are worth.

One of my brothers lives a 2.5 hour drive north of where I live. The market is slow and many people owe more than their homes are worth. Another friend has a rental home a 2 hour drive east of where I live. The same situation in both areas as they are distant from employment.

Be sure to explain in your appraisal report why the market is slow with no price increases.

Pressure from lenders/AMCs

Once again, similar to lender denial of price declines in the past, they are just noticing. We have had dramatic price increases in the San Francisco Bay area for the past 3-4 years and are way over the peak around 2007. In my city, they are going up 5%, or more, each month.

Some lenders (and AMCs) are pressuring appraisers to be higher. I heard about one large lender that had a meeting for its fee appraisers. They said the appraisers were too low and that appraisers had too many negative comments.

Definitely possible for the appraisers who only look at sales in a rapidly increasing market.

Sometimes lenders are more ‘polite’ such as this from Rels:

"… When time adjustments are warranted and utilized within an appraisal, we recommend that you provide commentary within the appraisal as necessary to thoroughly describe the changes that are occurring within the subject's market and the data that was used to calculate them. This will help the reader of the report to better understand the changes in value that are occurring within the subject's market and the rational for making these adjustments."

"So while the closed sales may lag the market, care must be taken to ensure that your opinions of market value do not. By studying the market as a whole, you can document trends and ensure that your appraisals are accurate and reflective of current market conditions."

What to watch for, from the Big Lender letter above

• Decreasing Inventory
• Decreasing Days on Market
• Increasing Asking Prices
• Increasing List to Sales Price Ratios
• Increasing Frequency of Offers Exceeding Asking Prices
• Increasing Frequency of Multiple Offer Scenarios
• Reduction in REO & Short Sales
• Active New Construction Market
• Increasing Positive Media Coverage

What about price declines?

Just think the opposite of the suggestions in this article and Ryan Lindquist's article. For example, long days on market, no pendings and lots of listings and expireds. Newspaper articles about price drops and few sales. No new construction. Etc. Etc.

I have always used MLS

I got my brokers license in 1985 because they were going to require 3 more classes. It was a big advantage in 1986, when I started my appraisal business. I had full online MLS access, including listings, pendings, expireds, etc. and the most recent sales. Many other appraisers could not get the information as they did not have real estate licenses. They used the quarterly printed sales books or CMDC books, a California data co-op.

I had never appraised residential properties in the San Francisco Bay area when I started my business. I started in a wide geographic area, but it was not hard to figure out the current local markets using MLS. For example, features that were important were mentioned in the MLS. I had selling and listing agent contact info.

My recent experience with rapidly increasing prices, etc.

In the San Francisco Bay area our market can change overnight. For example, from September to December 2015, the market was slow. Sometime in January, it started taking off like a rocket with at least 5% per month increase. This has happened before in the past several years in our very strong spring market.

How long did it take for me to figure this out? I started appraising long before there was any data available. I learned to "feel" what was happening. In the past it took me about 3 weeks to figure it out. This time it took me longer because there were so few listings and sales.

How do I know about the changes with very few sales? There is not enough data for any statistical analysis. I speak with agents every week at open houses. They tell what is happening today. Last fall they were complaining about few offers. Very few homes were selling for over list price.

Almost all my work is for estates which are always retrospective appraisals. My last estate assignment was for 12/31/15 when the market was stable.

But, in early 2016 I was hired to do appraisals for three possible sales to a tenant. I had to be sure my value was as reliable as I could determine. The sales were useless as they were too old. The listing prices did not mean much as homes were selling for way over list and there was were very few pending sales. When they closed there was no consistency in list/sales ratios.

I begged the listing agents to tell me the sales prices on the sales I needed. I told them I would not did not disclose the sales prices in the appraisals, but I knew what they were. It really helped me determine a reasonably accurate value. I would have been way too low using sales from late 2015.

This is why appraisers will always be needed.

Search for listings and pendings then sort - an easy, quick way to see what is happening

The best indicator of the current market is to see the number of listings vs. pendings. I search in the neighborhood or market area, then sort the listings.

Few pendings and lots of listings = slow market with possible declining prices.

Few available listings and lots of pendings = strong market with possible increasing prices.

Of course, listings vs. expireds are very good indicators in declining markets.

Days on market

This is another excellent indicator of current market conditions. Sort sales, listings, etc. by days on market. Longer DOM = slow to declining. Short DOM = very active to increasing.

You Must Call Real Estate Agents

You must call real estate agents on pendings and closed sales. I prefer to call listing agents. Ask questions about multiple offers, sales price on pending, etc. Otherwise you will not know the current market.

Whether to disclose the sales price on a pending sale in your appraisal report

I am a licensed real estate broker and am subject to confidentiality requirements, so I never disclose the sales price. I always tell the agents that it will not be disclosed until the loan closes.

But, appraisers who are not licensed real estate agents can be more flexible. When an agent discloses the accepted offer, some appraisers ask permission to disclose it, and some don't. I recommend asking permission. If the buyer receives a copy of your appraisal before close of escrow, with the comp's sales price, there could be problems.

1004MC conflicts

Obviously the 1004MC cannot handle rapid price changes. Lenders now want you to use pending sales, etc.

Just explain how you used the very limited data that you had.

Appraisals for sales and the sales price

Now that appraisers seldom know what the borrower "needs" to get a refi, there is much less pressure. However, that does not mean you can be low because you don't take the time to determine the current market in a rapidly appreciating market.

Since appraisers are required to review the sales contract, if available, there is almost always a "target" value - the sales price. Even if you don't get a copy of the contract, the agent will almost always tell you. Maybe the lender has a copy of the contract and will send it to you.

It is important to lenders (and to the buyer and agent) that you do not come in lower than the sales price because you use old sales and do not take the time to check out pending sales to find out what is happening today. You can use the data discussed in this article and in Ryan Lindquist's article to support your value.

Even more important is that you take the time to act as a professional appraiser and not just a "form filler".

What if the sales price is really too high?

That's why lender regulators require it and use appraisers to identify these sales.

This can occur in any market - stable, declining, increasing. You need to call the listing and selling agents and find out why it is such a high sales price.

I sometimes am uncomfortable with very high sales prices for a very popular property with many offers going way over list. I sometimes call them "auction prices". I don't use them for comps. If I was appraising this type of property, you will have to make a lot of calls and explanations.

There are many reasons. For example:

• Is there a house that you have wanted for a long time? What if you got a big inheritance and could afford to buy it?

• It is next door to a close relative's property. Their mother is getting older and needs someone close by, but not living in your house. Or, an adult child is looking for a home. Or, a close friend is looking for a house.

- A builder (or speculator) wants a few high sales, so appraisers will use them. He uses "creative methods" to get the sale to close with the high price.
• The sale price is high for fraud purposes. Many appraisers have been unknown "accomplices" and got into a lot of trouble.

Why do all this work and just let the appraisal come in low on a sale?

You are a professional appraiser. Don't let "old ways" of appraising, such as only considering closed sales, limit your ability to provide a more accurate value.

Of course, now it is easier, as lenders are screaming about low values, especially when appraising for a sale.

"One sale does not make a value"

When prices are shooting up, one similar recent pending sale can make a big difference.

For example, I appraised a home for an estate "as of" 12/31/15 for $875,000. The market was stable from September to December and I had recent sales. No market condition adjustment was indicated.
I appraised a very similar home for a tenant buyout as of March 31 for $1,050,000. Both properties were original with no updating.

There was a very similar home, but with many upgrades, that was a pending sale. I saw the sale on a broker's tour. It was listed for $895,000 and was set to close at $1,140,000. I did not disclose the sales price, but it was my best indicator of value for the subject. It also indicated a significant price increase in a short period of time and was a good indicator of market conditions.

I advised my client, the landlord, that my value was less reliable because I did not know how much the staging and upgrades affected the price. But, it would help her negotiate a sales price with her tenant.

Low listing inventories and few sales

This is why the 1004MC and other statistical methods don't work well.

Fortunately, lenders have relaxed their requirements due to complaints from buyers, sellers and real estate agents.

What if you don't have a sale higher than the value of the subject?

Just explain about increasing prices. Discuss how many are selling over list price. Lenders don't want low appraisals.

Where to get more information

There is lots of info on appraising in declining markets, but I could find nothing on increasing markets.
==

YIPES

By Doug Smith, SRA, AI_RRS

Editor's note: this was written in 2000, during the last dot.com boom. Another one is occurring now!!

Contributor Doug Smith from Southwest Montana took a class in Northern California (Petaluma) and asked a few Northern California appraisers about YIPES when he saw a bulletin entitled "Housing Crisis in Silicon Valley." and suggested YIPES as a name for the trend. Below is his info on YIPES.

YIPES is the next new appraisal acronym. YIPES labels the trend where list/sell ratios exceed 100%. I understand this is reaching crisis proportions in Silicon Valley as houses are bid up over listing prices.

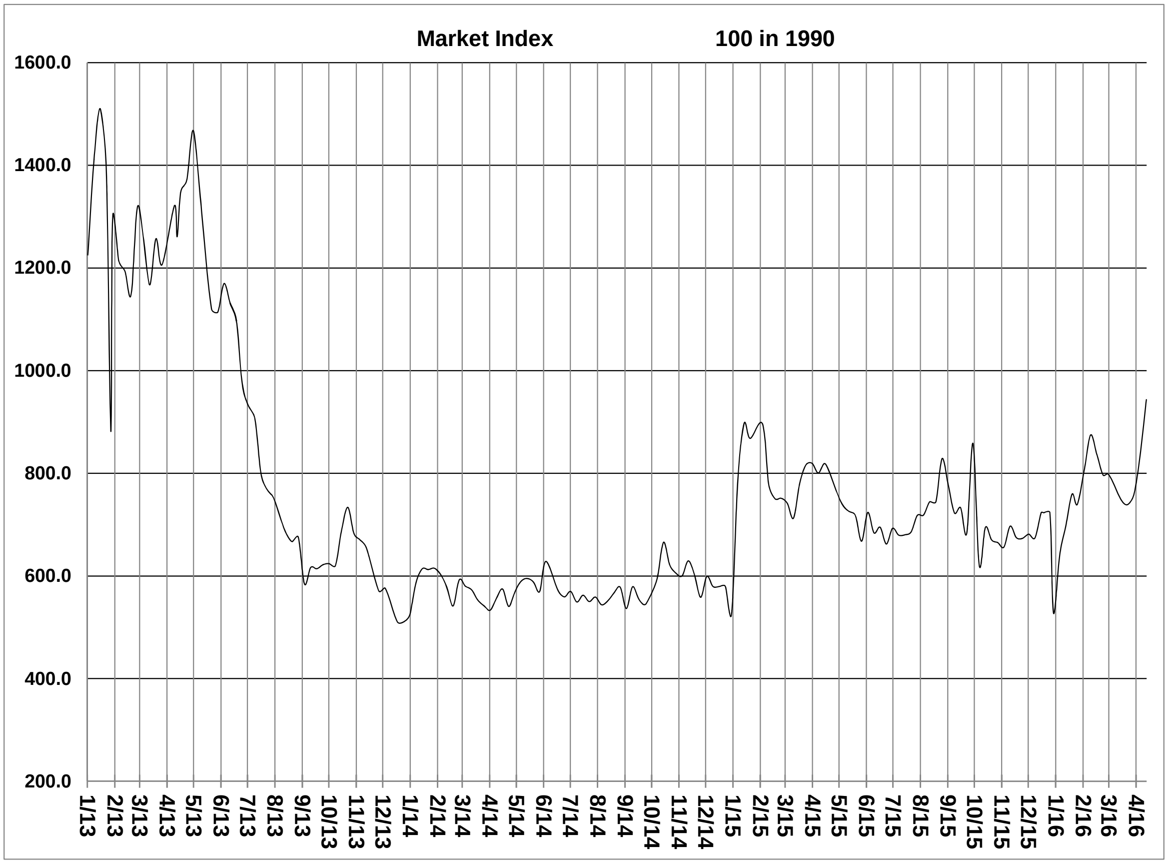
The trend and second level acronym (yuppie is already an acronym) is "YIPES" or "Yuppies in Pursuit of Expensive Shelter." Yipes is listed on the URAR sale grid as "List/Sell Ratio " and is an adjustment that is calculated after separating the site cost by matched pairs of non yipes sales and yipes sales. Yipes is expressed as a percentage increase by square foot of GLA.

In a fast moving market, this will enable the appraiser to adjust sales upward for YIPES instead of applying a time adjustment. A matched pair analysis must be done to determine if a list/sell ratio adjustment is required for site costs.

In some cases, particularly in Silicon Valley, site location may require a percentage adjustment that might exceed the adjustment required of the improvements. In the case of a site adjustment, the buyer's employers' NASDAQ company symbol of each of the comparables must be shown on a location map.

MBA Loan Volume Application Index 1/13 to 4/16

As you can see below, volume has declined since early 2013. 2015 volume picked up from 2014 and went up and down. 2016 has been overall going up. But, there is definitely a shortage of appraisers willing to work for low AMC fees. Loan apps have been going up and down since then. Overall volume is predicted to increase slightly in 2016.



The survey covers approximately 75 percent of all U.S. retail residential mortgage applications, and has been conducted weekly since 1990. Respondents include mortgage bankers, commercial banks and thrifts. Base period and value for all indexes is March 16, 1990=100.

Appraisal Today
ISSN 1066–3900
Appraisal Today is published 12 times per year by
Real Estate Communication Resources.
Subscription rate: $99 per year, $169 - 2 years

Publisher

Ann O'Rourke, MAI, SRA
ann@appraisaltoday.com

Subscriber Services
Theresa Lua
M,T,W 7AM to noon
Friday 7AM to 9 AM (Pacific time)
info@appraisaltoday.com (24 x 7)

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