



## December 2016 Index

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*Editor's Note: I write this article every December. There are not many changes since December 2015, but it is good as a reminder of what you can do now to save taxes next year. Be sure to check the details in this article and/or discuss the issues with your tax advisor.*

The goal is to reduce taxes by deferring (or occasionally, accelerating) income to a year in which you are (or may be) in a lower tax bracket, take advantage of tax credits and deductible expenses, and when legally allowable, earn income tax-free (such as retirement accounts).

There is lots of complicated advice available on reducing taxes, but most does not apply to appraisal the businesses. Travel and entertainment for marketing purposes is one example.

Your greatest savings in taxes is usually by using a SEP-IRA or Solo 401-k retirement account. You can deduct up to \$53,000 in income or 25% of income whichever is less (generally - check with your tax advisor). Taxes will be paid when you withdraw the money. No penalties are due for withdrawals after age 59 ½. I saved \$5,000 on my taxes last year.

Expense deductions are good, but you have to spend money to get them.

There are other options, such as Roth IRA. You can also save taxes by setting up an S-Corp (pay yourself a salary). They are more complicated to set up and I don't include them in this "last minute" tax tips article.

I also assume you are using a tax professional who will be sure you take deductions such as up to 50% of your self employment (combined Social Security and Medicare) contributions.

### **Ways to defer income**

If you are self-employed and on the cash basis of accounting, bill your clients near year end if you can. They will probably pay you next year.

If you work for AMCs that require a fast turnaround and send your invoice with the appraisal and pay quickly, this may not be an option.

Of course, although you have deferred taxable income, you have also deferred receiving taxable cash until 2017, so your income will be higher in 2017.

### **Ways to increase deductible expenses by timing payments**

Pay as many bills as you can by the end of the year, such as property taxes, software maintenance agreements, etc.

Purchase equipment and vehicles by the end of the year. For 2016 the limit is permanent at the \$500,000 level deduction for new and used equipment, as well as off-the-shelf software. The equipment must be financed/purchased and put into service by the end of the day, 12/31/2016. ("Section 179")

Consider making charitable donations before the end of the year. Credit card payments for business or charitable donations made by December 31 are deductible.

Don't forget that your Appraisal Today renewal and other subscriptions are tax deductible.

Take advantage of all business deductions

Review your records and cancelled checks carefully to take advantage of all business deductions. Be sure your deductions are adequately supported by written records that indicate time, amount and business purpose.

Be sure to check business expenses using a personal checkbook or credit cards. For example, sometimes a vendor will not accept my business Amex credit card, so I have to use my personal card. Also, I sometimes use a personal credit card for paying expenses on my rental property.

Every year I go through my personal checking account and credit cards to be sure I don't miss a deduction.

I hate cash purchases as I don't keep track of them very well and sometimes forget to throw the receipt into a special "petty cash" box.

### **More ideas for reducing 2016 personal taxes**

If your personal itemized deductions are close to the standard deduction, consider "bunching" your expenses every other year.

Pay your fourth quarter state estimated tax payment in December instead of January every other year. Pay your January mortgage payment on December 31 every other year. Just be sure the bank reflects this extra payment in the annual mortgage interest paid form so that your deduction matches the information the bank sends the IRS.

Pay your property taxes early.

### **Charitable contributions**

Clean out your closets every other year and contribute your unwanted items to a charity for a deduction. Be sure to get a receipt for all donations and contributions, regardless of the amount. Photos can also work well for verifying your donations.

You can contribute by using a credit card by 12/31/15. Then pay it off when you receive your credit card statement.

### **Medical expenses**

Medical expenses are deductible only to the extent they exceed 10% of Adjusted Gross Income(AGI). If you are 65 or older, the threshold remains at 7.5%.For the self-employed, 100% of health insurance premiums are deductible to reduce AGI rather than as an itemized deduction.

## **Mileage deduction**

Beginning on Jan. 1, 2016, the standard mileage rates for the use of a car (also vans, pickups or panel trucks) is:

- 54 cents per mile for business miles driven, down from 56.5 cents in 2015.
- 19 cents per mile driven for medical or moving purposes, down from 23 cents in 2015
- 14 cents per mile driven in service of charitable organizations - no change from 2015

Be sure to keep a log of your mileage. If necessary, you can estimate it by using your calendar for days of appraisals, medical appointments, and charitable activities.

I doubt if appraiser business mileage gets questioned by the IRS as much as we work in the field.

## **Education expenses**

For appraisers, CE costs are another deduction, including travel expenses. Be sure to keep complete records, especially if going to a conference or other CE where you are staying overnight.

Don't forget meals. If you don't keep good record of your meals you can use a standard deduction. If you are driving, be sure to record it in your mileage log.

## **SEP-IRA and Solo 401k contributions are not taxable until withdrawn and can save big money on taxes**

For 2016, if you are making money, consider contributing to a SEP-IRA or Solo 401k. I have put the maximum I am allowed into my SEP-IRA for the past 4 years. Since I am over the age of 59½ I can withdraw money at any time without paying a penalty.

This year I saved \$9,000 in taxes by putting money in my SEP-IRA.

If you are younger, at least you are putting something into your retirement account that saves your taxes.

Like most appraisers, my income can vary quite a bit from year to year. This is a way for me to put aside money in the high years and withdraw it in the low years without penalty, if you are 59½ years or older.

For the 2016 tax year, the IRS has not changed the contribution limit to \$53,000, or twenty-five percent of the employee's salary or self employed net income, whichever is the smaller.

These limits are subject to future cost-of-living adjustments as the years go by.

For 2016 taxes, IRA contributions must be made by April 15, 2017. SEP contributions can be made as late as October 15, 2017, if you request an extension of time to file your income tax return. You can pay your taxes on April 15 and wait until October 15 to file your return, so you don't accrue much, if any, in penalties and interest. Or, wait until then to pay a few thousand dollars in remaining tax due.

## **How to set up a SEP-IRA by December 31, 2016**

It is very easy to set up by using a company such as Vanguard. Just call on the phone. I use Vanguard because their cost is low and they are very easy to work with, but you can use any investment service you want.

## **Set up a Solo 401k plan by year end**

These plans must be established by December 31st in order to be effective for a given tax year. The one-participant 401(k) plan isn't a new type of 401(k) plan. It's a traditional 401(k) plan covering a business owner with no employees, or that person and his or her spouse. These plans have the same rules and requirements as any other 401(k) plan.

Contribution limits in a one-participant 401(k) plan:

The business owner wears two hats in a 401(k) plan: employee and employer. Contributions can be made to the plan in both capacities. The owner can contribute both:

Elective deferrals up to 100% of compensation ("earned income" in the case of a self-employed individual) up to the annual contribution limit: \$18,000 in 2016, or \$24,000 in 2016 if age 50 or over; plus:

Employer non elective contributions up to: 25% of compensation as defined by the plan, or for self-employed individuals.

Total contributions to a participant's account, not counting catch-up contributions for those age 50 and over, cannot exceed \$53,000 for 2016.

FYI, these plans are more complicated to set up than a SEP IRA.

### **SEP IRA vs. Solo 401k**

For a good discussion on the pluses and minuses for self employed persons with no employees to go [www.sepira.com/sep-ira-vs-individual-401k.html](http://www.sepira.com/sep-ira-vs-individual-401k.html).

### **What if you have employees?**

You will need to look at other types of plans. I had one in the past. They require employee contributions.

### **Who should do your taxes?**

I strongly recommend using an enrolled agent or a CPA. Why? They are tax experts and, also very important, they can represent you if you have an IRS audit. They can calculate such items as Alternative Minimum Tax, depreciation, and advise you on deductions.

I always fill out a form that I am sent by my tax provider. Don't show up with a box of receipts unless you want to pay a very big fee. If you don't use Quicken or Quickbooks, make a commitment to do it ASAP. Don't wait until just before April 15 to start using the software.

Once, I represented myself at an IRS tax hearing about my husband's commercial fishing business. It did not go well as I had no experience or training in what to do at the hearing.

### **Keep business and personal expenses separate**

Of course, you should have separate business checking and credit cards. If you don't, do it now and try to get your 2016 personal vs. business expenses straightened out ASAP.

Most of us occasionally pay business expenses in cash or with personal credit cards or checks. Be sure to check your records or box of receipts. I try to do as few cash payments as possible as they are a hassle to keep track of.

The IRS scrutinizes personal expenses that may have been claimed as a business expense, such as the use of a business vehicle for personal use. Be diligent about keeping good records.

### **Home office deduction**

If you rent your home, take the deduction. If you own your home, there are some issues, primarily recapture of depreciation when you sell your home.

An appraiser can deduct home office expenses as long as the office is used regularly and exclusively to perform substantial administrative or management functions and there is no fixed space available at work locations. Be aware that if you have a computer in your home office, it also must be used exclusively for business in order for the home office to be deducted.

If you work out of your home and don't have a separate office location, you should be able to claim

a home office deduction.

In the past, some people did not claim it because they thought it was a "red flag". But if the only location you run your business is a home office, there should not be any problems.

I have had both a home office and another office in an office building for over 20 years. I do not claim my home office. I sometimes work at home, but my business is run out of my separate office.

When I first started my business, I ran it out of a detached rear building behind the home I rented. If I had owned the property there would be tax consequences if I sold the property and I may not have claimed the deduction.

Some of the expenses you can deduct include a portion of your real estate taxes, deductible mortgage interest, rent, utilities, insurance, depreciation, painting and repairs. The total amount you can deduct depends on the percentage of your home used for business.

Important: The minus of the home office deduction is recapture of depreciation if you sell your home. In other words, you have to pay back the deductions you received during the years.

But, if it's in the guest house in your backyard, the portion of your sale proceeds attributable to that separate structure would be taxable, even though the building was part of your overall home sale. And you still must pay tax on the gain equal to the depreciation on the home office.

I store a lot of business and appraisal files in my home garage. For the past two years, I have been deducting this expense as depreciation, which I will have to pay back when the property is sold. I doubt if the IRS will say anything as self employed appraisers have a lot of files to store.

If you're a tenant, it's easy, with no worries. Just be sure you keep good records. There are some somewhat controversial topics such as using part of a room for business file storage.

For more information, read "Should you take a home office deduction?" in the March, 2013 issue of Appraisal Today. Send me an email and I will send it to you.

### **What am I doing?**

I expect my taxable income to go down next year and want to spend as much as I can this year. Trying to cut back. Gotta turn down more appraisals...

Going through my personal checks and credit cards. Sometimes I have to use a personal credit card if they do not accept my American Express card.

Making charitable donations.

Getting some repairs done on my rental property.

Buying whatever business supplies and equipment. Paying early my business insurance, property taxes, and Quarter 1 2017 tax payments estimated. Plus buying Holiday cards and gifts.

Figuring how much to put into my retirement account, tax free.

I should have started earlier!!

### **Trump and Income Taxes**

If you are trying to decide whether to reduce your taxes this year or next year by spending more and deferring income, possible income tax changes may be a factor.

Will your taxes go up or down next year with possible changes in income tax rates and other changes?

Trump proposes to reduce the number of tax brackets from seven to three, with rates of 12 percent, 25 percent and 33 percent. That would slash the top rate from the current 39.6 percent.

There are some other factors, such as elimination of personal exemptions and head-of-household status. Google for more info.

My tax rate is very high because my Social Security of \$3,200 per month is added to my business

income. It puts me into a very high tax bracket. I am hoping tax rates will go down. To be honest, it is a disincentive to work harder.

Of course, no one knows when, or what, will happen if income taxes are changed. But, changes seem very likely with the Republicans in the House, Senate, and presidency. For decades they have been trying to get tax reductions.

### **Where to get more information**

Google "year end tax tips self employed". Most of the tips for appraisers are in this article. But, sometimes it is a good idea to read how someone else explains it. And, there may be tips not covered in this article applicable to your personal tax situation.

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## **Marketing with holiday gifts and cards - An Easy and Most Excellent marketing tool!!**

*Editor's Note: I write about this every December, and it makes me remember to get some cards at the office supply store!!*

There are not many changes since December 2015, but it is good as a reminder of easy ways to say "thank you" for appraisal business, being very helpful on an appraisal, etc. In the past I used to get many holiday cards from vendors, other appraisers, etc. Sometimes I would get a gift such as a Starbucks gift card. But, this has slowed way down in recent years as a residue of the recession I guess. If you send something, it will be remembered.

Why would you want to send holiday gifts and cards? It is one of the few times in the year that sending something is not unusual. A few appraisal assignments or referrals, or even one, will more than pay for the cost. Send them to current clients, previous clients, new clients, prospective clients, etc.

Don't forget the real estate agents that were willing to spend time to explain their sale and appraisers that helped you on an appraisal.

Appraisers tend to be very weak on all types of marketing, even the easiest, such as sending holiday cards and gifts!

### **This is one of the easiest types of marketing you can ever do!!**

No web site, no email solicitations, no phone calls!! Just compile names and addresses from people you already know. Does not take much time, except for writing addresses on envelopes.

### **What if you don't have any clients except AMCs?**

Say thank you with a card to helpful real estate agents, property managers, appraisers, employees at vendors who have been helpful such as forms software companies, etc.

### **What about AMCs?**

If there is someone who has been helpful, send them a gift card. If you don't have their postal address, send a personal thank you email. I doubt if they will get many from appraisers!! Don't forget the chief appraiser or appraisal managers. They probably have postal addresses so you can send holiday cards.

### **When should cards be mailed?**

By December 10. Get started now!!

### **When to send gifts and cards?**

What if you don't have time to do this now, or want to send at another time, so you will be remembered?

There are many times to send gifts. For the traditional holiday gifts, you can send them before Christmas, between Christmas and New Years, and after New Years.

Some like to send at the traditional week before Christmas, others near Thanksgiving, and others early the next year. Your gift stands out more if not sent at the traditional time, but you may prefer the Christmas season.

Be sure to send thank you cards throughout the year, sent out soon after receiving a good referral or data you really needed. This is a "must."

### **Who to send gifts or cards to**

1. Best clients.
2. Second tier clients.
3. The rest of your clients.
4. Referral sources - as many as you can. Other appraisers, real estate agents, accountants, attorneys, your neighbor, etc.
5. Vendors who have been especially helpful.
6. AMC employees who have been helpful.
7. Appraisers and real estate agents who have been helpful with data and/or advice.
8. Good prospects.
9. Instructors and speakers that you liked.
10. Authors of articles that you liked.

What am I doing this year? My best attorney client - flowers for the office. I did it last year and I'm sure they will really appreciate it this year. I'm sending holiday cards with personal notes to many clients, referral sources, appraisers, real estate agents, etc.

Starbucks gifts go to many of the appraisers and real estate agents who have helped me this year. Plus, attorney clients who I get work from once or twice a year.

Holiday cards are a good reason to contact clients I have been trying to get for many years. Plus a few vendors who have been very helpful.

### **Why send holiday cards**

"Unlike the cards we mail to loved ones, greetings we send for business are generally used for two purposes: as a thank-you to individuals at other companies with whom we have an ongoing relationship, or as a means of staying on the radar of an existing, former or prospective client," says manners expert Thomas P. Farley.

### **What type of holiday printed cards are best?**

A "season's greetings" card is usually a better choice than a Christmas card, so you don't offend anyone. I am located in the very diverse San Francisco Bay Area, so I always send neutral holiday cards.

A handwritten address on the envelope is a very good idea.

Always, always include a personal signature and a short handwritten note, if possible.

Be sure to be "generic" in your cards and your message. Don't mention a specific holiday.

Humor is risky and not recommended. But, sending a humorous card to someone you know well may work.

### **Government and institutional employees - be careful**

When I was first employed by a county Assessor's office in the mid-1970's, I was told not to accept anything from a taxpayer. If I went to lunch with someone, I was to pay for my own lunch.

Many government agencies have similar policies. Before sending anything other than a holiday card, be sure to check.

Some banks and other institutional clients have strict policies, although few are as strict as government agencies. Check to be sure. Some of my lender clients requested that any gifts be for the entire appraisal department, such as flowers or candy.

### **Email "cards"**

Postal mail is best, but it is sometimes hard to get postal addresses.

Email addresses can sometimes be difficult to obtain. Send them to people that you have current email addresses for.

When I checked online, many of the e-cards had music, which can be very annoying. Search for Business Seasons Greeting cards.

To get a quick idea of what they look like and how they work, go to [www.123greetings.com](http://www.123greetings.com).

You can send yourself a greeting card and see what it looks like. Unfortunately, there are ads in the emails because it is free so I don't recommend actually using this particular service.

Another option, which may be better, is to just send a personal holiday email with maybe a photo of yourself or another photo embedded in the email. And a personal message. We don't get many emails that say Thank You!!

### **"Special" one time gifts**

Remember the mortgage broker days? Many businesses send one time gifts, such as home made cookies or candy. Gift certificates are also popular, with an almost endless list of choices, including restaurants, book stores (don't forget the online stores such as [amazon.com](http://amazon.com)), car wash services, movie theaters, etc.

A gift basket is another good choice. Go to your local Yellow Pages and look under "gift baskets." To get an idea of the endless varieties of gift baskets, go to your favorite search engine and look for "gift baskets."

"Perennial" flowers such as poinsettias are good. You can also have cut flowers delivered.

### **Gifts that last**

One gift I see almost every morning is a coffee cup from a local appraisal firm that I received many years ago.

I used to send out a small desk calendar with my company info to about 100 people. They loved it and called me when they didn't get one.

One year I set up monthly flower deliveries to a lender client that gave me lots of work. It went to the appraisal department, not the chief appraiser.

### **Ideas on what to send**

Sending gift cards, such as Starbucks, is a very easy choice.

Most of us select gifts appropriate to the volume of work, how easy the client is to work with, and the likelihood of continued work. For example, a gift basket for your best clients, and a calendar or card for others.

A gift that would appeal specifically to the person is always good. For example, a gift certificate to



a popular restaurant for two for someone who likes to eat out, or a gift certificate for a "meal delivery" company for those with children who are too busy to go out for dinner. Or, a box of chocolates for a "choc-o-holic."

A gift that is seen every day, such as a desk calendar, mouse pad, or paper clip dispenser, personalized with your company name works well.

Some other possibilities:

- Home baked cookies, pastries, or candied pecans.
- Gift baskets - food, wine, chocolate, many choices.
- Dom Perignon champagne - for the top clients
- Modest gift at Christmas and a card at Thanksgiving or New Year's
- Baskets from local fruit wholesalers
- "Happy New Year" cards and wine
- Desk nameplates
- Rum soaked holiday cakes
- Starbucks certificates
- Sticky Note Pads (540 Sheet Ones) with your name printed on all 4 sides
- Souvenir Stick Pen (\$.75 Each)
- Massage therapist for an hour to do chair massages one afternoon between Thanksgiving and Christmas (Editor's note: this one is my favorite!)
- Chocolate cheesecakes on Halloween and boxes of chocolates on Valentine's Day.
- House shaped paperclip holders with your company name & info printed on the roof

### **Your employees (including family)**

Don't forget your employees - a special holiday lunch and gifts really make a difference. What if your family members are your employees? It makes an even bigger difference!

### **Where to get gifts**

For gifts personalized with your name, do them ASAP. Advertising companies are used to last minute requests, but they are all busy before Christmas.

For gifts with your name on them, use an advertising specialties company. Look in your phone book for names, or use the Internet.

### **How to send gifts**

Personal delivery by the principal or owner is always best, even for cards. If at all possible, do this for your best clients.

For non-local gifts you can use the U.S. mail or UPS.

### **What personal message should you include in your cards?**

Remember, this is for business, which is different than sending cards to personal friends and family. Look in the mirror. What type of message do you like to receive?

This depends on how well you know the person. For example, you can mention about a spouse or a hobby.

Don't make it too much of a "sales pitch".

Go to a store and see what is on the cards there. Check out messages online for business card companies. Don't include a business card.

### **Business law and gifts**

Bribery is the primary issue from a legal viewpoint. Appraisers seldom give such large gifts, but it has happened. For example, you're bidding on a big appraisal contract and pay for a Hawaii vacation for the person making the decision before you are awarded the contract.

### **USPAP and gifts**

Some appraisers mistakenly believe that USPAP doesn't allow giving gifts to clients.

USPAP doesn't include much about marketing and gifts.

"The payment of undisclosed fees, commissions, or things of value in connection with the procurement of appraisal, review, or consulting assignments is unethical." "Disclosure of fees, commissions, or things of value connected to the procurement of an assignment should appear in the certification of a written report and in any transmittal letter in which conclusions are stated." (Emphasis added.) appraisal reports. Thus, appraisers try to avoid situations where USPAP would require such disclosure.

Understand that payment of fees, etc. in order to get an assignment is not prohibited by USPAP. It just has to be disclosed.

### **USPAP and gifts after getting assignments**

Although USPAP doesn't forbid giving current clients "things of value" as a "thank you," it does not address how far you can go (i.e. trip around the world for two). Business law does.

Remember all the stories in the newspapers about business owners being accused of bribery? U.S. law is pretty strict on giving bribes to get work from a current customer or a prospect.

The basic rule is that the gift must be appropriate to the work performed. For example, a client has given you \$2,000 in work over the past 12 months. A box of candy, flowers, etc. is certainly appropriate. If a client has given you \$150,000 in work, a more expensive gift would be appropriate, say a set of golf clubs.

### **Gifts prior to getting an assignment**

USPAP (and business law) problems typically involve giving "things of value" in anticipation of getting an assignment.

For example, an appraisal firm conducts a random drawing with prizes. Clients are allowed a certain number of entries based on the number of appraisals ordered within a certain period of time. This "thing of value" must be disclosed as the number of tickets is tied to the amount of work given. In contrast, if every appraisal ordered contained an entry form for the drawing, it would not have to be disclosed as the entries are given to everyone and not based on how many appraisals were ordered. This is similar to a discount on your fee, say 10% for the next three months. In both cases, it is available to everyone.

### **Planning for next year**

It may be too late to order personalized gifts, so plan now for next year.

If you want your gifts to have your company name on them (a very good idea), order them now. Traditionally you can order up to 3 weeks before you need them, but suppliers can get back logged at holiday time.

### **Where to get more information on gifts**

For gifts with your name on them, use an advertising specialties company. Google for local companies.

Baskets can be ordered from local stores or national companies over the Internet. In the phone

book, look under Gift Baskets & Parcels. Sometimes they are available at grocery stores. Check with local real estate agents and see who they use.

### **Where to get more information on cards**

Google Holiday Business Cards for vendors, if you want them custom printed or emailed.

For ideas on what type of a message, go to web sites that sell business cards or Office Depot or other local store that sells cards.

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## **Tips for Dealing with Complex Residential Appraisals**

### **By Joseph Lynch**

*Editor's note: The author recently taught a class on the topic. I have reprinted the article in its original format, thus it is different than my articles above.*

The residential lending appraisal landscape is poised to change with the implementation of appraisal waivers from Fannie Mae and Freddie Mac. Thanks to the Uniform Appraisal Dataset, Fannie and Freddie now have a massive database of residential sales across the United States and are starting to use automated valuation models (AVMs) to replace residential appraisals. We don't know full details about these programs at the time of writing but the future is clear: there will be fewer simple appraisals going forward. The lending appraisals left will be complex assignments not easily handled by AVMs. Now is the time to move into complex residential assignments.

This article is not intended to be an in-depth examination of the many ways a residential appraisal can be complex nor how to solve every complex appraisal problem you encounter. Instead, the purpose of this article is to get you thinking about the issues involved with complex residential assignments. I will offer two definitions of complex assignments, discuss categories of complexity, provide examples I've encountered in my business recently, mention business considerations, offer some problem-solving techniques, and will break down in detail an assignment with a lot of issues. Finally, I offer advice for increasing your skills with complex residential assignments.

### **What is a Complex Residential Appraisal?**

The FDIC uses the following definition for complex residential appraisals.

**"Complex 1-to-4 family residential property appraisal means one in which the *property to be appraised*, the *form of ownership*, or *market conditions* are *atypical*."** <sup>1</sup>

**Atypical** is the key word. But what is an "atypical" assignment?

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<sup>1</sup> FDIC Law, Regulations, Related Acts 2000-Rules and Regulations, Part 323-Appraisals (<https://www.fdic.gov/regulations/laws/rules/2000-4300.htm>)

The California Bureau of Real Estate Appraisers (BREA) uses a slightly different definition. From the Fall 2015 edition of The California Appraiser:

“Q: What constitutes a “complex” assignment?

A: This is a report in which the *scope of work had to be expanded* to address some *unusual property* or *ownership attribute*.

Examples of “complex” are:

- A unit in a community land trust might provide an example involving ownership type.
- A house abutting an auto body shop might be an example of an external complication that might have a negative impact on value.
- A property in which you have to pass through the kitchen to get to the only bathroom would reflect a complication in functional utility.

These are the kinds of properties that help the Bureau of Real Estate Appraisers (BREA) decide whether a residential (AL) upgrading to a certified residential (AR) can handle the more demanding assignments.”<sup>2</sup>

The BREA definition has the very practical idea that expanding an assignment’s scope of work from the typical assignment implies complexity. However, like the FDIC definition, there is a relative aspect. If most properties in an area are custom homes on large acreage lots, the typical assignment in that area is what most of us would consider at least somewhat complex.

### What Makes a Residential Appraisal Complex?

Residential appraisals can be complex for many reasons. Some broad categories with examples include:

#### Highest and Best Use

- Is the subject’s highest and best use as a single family residence, as vacant land, or as a commercial property?
- **The most dangerous issue to get wrong is highest and best use. If you get the highest and best use wrong, you can be significantly wrong on your value and leave yourself open to sanction and lawsuits.**

#### Ownership

- What is the value of a life tenancy?

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<sup>2</sup> [http://www.orea.ca.gov/pdf/15-350\\_Fall\\_Newsletter.pdf](http://www.orea.ca.gov/pdf/15-350_Fall_Newsletter.pdf) , Page 10

- The subject is part of a co-housing project. What effect, if any, on the subject's market value given that it is part of a co-housing project?

#### Rapidly Changing Market

- The largest employer in the county announced yesterday that it was closing. What effect does this have on the subject's market value?
- An earthquake hit the area. What is the value of the subject on the day before the earthquake and the day the earthquake hit?

#### Data

- No Central Data Repository
  - What if 30% of the sales in the market are pocket listings (listings not included in the MLS but instead handled by one office)? How do you get that data? Are pocket listings truly representative of the subject's market value?
  - How do you find SFR rental data when there is no central database of rentals?
- Overlapping MLS Systems
  - Need to check both MLS systems for data
  - Need to purge duplicate entries during data analysis
- Scarcity of Sales
  - What is the current market value of the subject when the last competitive sale was 12 months ago?
  - How do you determine market direction when the overall market is non-conforming with few sales?
- Unreliable Data
  - Some areas or property types are notorious for unreliable property characteristics, complicating analysis.

#### Property Characteristics

- Location
- Lot Size
- Over-improvement
- Under-improvement
- Unusual Design
- Unusual Amenities
- Accessory Dwellings
- Condition
- High Quality Design
- Income Production
- Lot shape/configuration

## Stigma

- Death in a home
  - What is the value impact of a notorious murder in a home? Will anyone live there or is highest and best use to tear the home down?
- Toxic waste nearby
  - What is the value impact of living near a Superfund site?

## Time

- Private party work sometimes calls for dates of value much older than the typical residential lending assignment. How do you know the condition of the subject when your date of value is 10 years ago? How do you verify your data when the agents involved retired five years ago? How do you find your data when your date of value is prior to the start of MLS in your area?

## Some Methods for Dealing with Complexity

### **Expand Your Scope of Work**

Complex residential appraisals require more work by nature. Expect to spend more time on the assignment and to take the necessary steps to address any complexity.

### **Define your Subject's Market**

When you first realize that you might have a complex assignment on your hands, spend some time considering the subject's market. Where would potential buyers of the subject look for homes? This is the starting point for your data collection.

### **Unpeel the Onion-Expand Outward**

For complex assignments, you often need to expand outside of the typical box for your search for comparables. Should you limit your comparable data search to only the subject's neighborhood? Or does it make sense to look throughout the subject's city? Or is it one of the best homes in the county? Does it have regional appeal?

### **Research, Research, Research!**

Be exhaustive in your search for data. Dig through your data sources for comparables. Call agents active in the subject's sub-market and pick their brains for sales data and ask for opinions regarding the subject's complex issue. Build a network of local appraisers you can rely on for both data and advice. When you have a really complex assignment, knowing who to call for advice is crucial. It's just as important to maintain your relationships with other real estate professionals by sharing your knowledge with others.

## **Time**

Time is your friend when dealing with a complex residential assignment. In general, time adjustments are the easiest and most reliable adjustments to make. Don't limit your comparable search to the lender box of 3 months/6 months/12 months back. Go back as far as necessary to deal with your subject's complexity.

## **Prior Sale of the Subject**

A special case of going back in time for comparables is to consider the prior sale of the subject. Using the prior sale of the subject is a great way to deal with issues unique to the subject such as location or a physical characteristic. If you're lucky, the subject has sold within a reasonable time frame and can be time adjusted forward to be used as a comparable. **The prior sale of the subject can be your best comparable.**

Even if you can't use the prior sale of the subject as a direct comparable, you can use the prior sale of the subject to examine what your subject's market is and what a possible adjustment for the factor might be. The last time the subject sold, what did other homes nearby sell for? Which ones appear to have been reasonably similar in characteristics and price? What was the subject's competitive market?

**What did the listing agent for the subject say about the prior sale of the subject?**

## **Bracket the Factor of Complexity**

This is somewhat obvious but if at all possible, bracket the factor of complexity. This creates a box around the impact of the complex feature and lends credibility to how you dealt with the issue. One significant benefit of bracketing is that lending clients understand bracketing well. For example, if your subject is facing a busy street, you can use a sale on a much busier street to establish a bottom on the subject's external obsolescence from its negative location.

## **Qualitative Analysis**

From the Dictionary of Real Estate, 5<sup>th</sup> Edition, Qualitative Analysis is the process of accounting for differences that are not quantified. Qualitative analysis is very useful for answering subjective questions and as a starting point for understanding the subject's place in the market. You can use qualitative analysis to place the subject overall in a group of competitive sales or you can use it to analyze specific property characteristics.

- Where does the subject fit in the neighborhood? Is the subject the best home, the worst home, or relatively typical? What does this mean for comparable selection?
- How does the quality of the subject's kitchen remodel compare to other homes in the neighborhood?
- The subject is halfway up a mountain with panoramic views looking west. How does the subject's view compare to homes near the bottom of the mountain? How does the subject's view compare to homes at the top with views in all directions?

- The subject is a spec home built from relatively common plans. It is a step up from nearby tract homes but is a step down from truly custom homes.

The subject's position in the market can help you zero in on value. Along with bracketing, qualitative analysis can help you understand a needed adjustment for a characteristic.

### **Consider Proxies if No Better Data Exists**

Sometimes data research finds a sale not directly competitive with the subject but is affected by the same issue of complexity. This supplemental sale can help you understand the impact on the subject. For example, the subject is a small home on a busy street with no recent competitive sales on a similar busy street. However, there are sales of much larger homes on the same street plus similar large models on quiet streets. The larger home sales can be a guide for a reasonable location adjustment.

Caution: Sometimes proxies can be misleading. What is true for one market segment may not be true for another so be sure to be exhaustive in your data search before moving to proxies.

### **Survey Market Participants**

Conduct a formal survey of market participants to measure the group's opinion of the impact of the complex factor. When you have no data, a formal survey can provide guidance for how to deal with a complex issue. However, it's very easy to introduce bias in a survey so spend time constructing it. This article offers advice. <http://www.wikihow.com/Conduct-a-Survey>

### **Partner with an Expert**

Find someone with expertise in dealing with your subject's complex issue. During the assignment, you have the opportunity to develop competency as required by USPAP. Having help can speed up the learning curve and produce results faster.

### **Use Common Sense!**

Whatever you do, before sending the report on, put on your appraiser cap (thanks George!), and ask yourself, does it make sense?

### **Explain Yourself**

Complex appraisal assignments require a higher level of analysis and a higher level of communication. The subject is unusual, you had to take unusual steps to determine the impact of the complexity, and the reader of the report deserves an explanation. Be as clear as possible in explaining the complex issue(s), your methods for dealing with the complexity, and your logic and reasoning.

## **Business Considerations**

Complex assignments take more time and require specialized expertise. Charge for your time! If a complex assignment will take twice as long as a typical assignment, charge at least twice as much as you would normally. **Charge more than you think you should for something you haven't deal with before because your time estimate is likely low.**



Complex assignments can clog your production queue when you're busy so budget extra time to give you time to think through the assignment.

Consider your client. Does the client really want an expert on this assignment or are the client expectations unrealistic? Does the client need an expert and maybe you're not?

**It's OK to pass on any assignment.**

**USPAP requires competency or that you develop competency during the course of the assignment.**

**Don't get in trouble!**

## Examples

These are recent examples of complex assignments I've completed to highlight some of these techniques.

1. Backs  
Arterial



I recently appraised a home that backed a four lane, 45 mph major arterial. This assignment was somewhat complex because of the subject's location backing the major roadway and the lack of recent competitive sales in a similar location. I went back four years to find the most recent competing sale backing the arterial and time adjusted it forward. I discussed the comparable

sale with both the listing agent and buyer's agent and found that this sale was on the corner of the busy street and the less busy street entering the subdivision. The comparable sale had an inferior location compared to the subject because it was directly exposed to noise from the busy street along the side of the home directly open to the intersection. I adjusted this sale up slightly for inferior location and adjusted the rest of my comparables more for superior location. I used time to find a good comparable and qualitative analysis to compare the subject's location to the dated sale and other comparables to place it in its market.

2. Halfplex with Accessory Dwelling



I recently received an order to appraise a semi-attached home (a “halfplex,” from “half of a duplex”). It was in a neighborhood with other recent competing halfplex sales in a university town with very low vacancies. What made it complex was the detached one bedroom/one bath permitted accessory dwelling in the back yard, unique in my experience. Entry to the accessory dwelling was through the back yard with no separate public entrance. The accessory dwelling did not have separate utilities and was really the prototypical “granny unit.” However, it could be legally rented. It was zoned single family residential. Despite an extensive search of MLS and discussion with local market participants, no similar sales found of an entry tier property with an accessory dwelling.

This is a halfplex with an accessory dwelling. It is clearly superior to a halfplex without the accessory dwelling but somewhat inferior to a duplex with separate utilities and entrances. I placed the subject above the halfplex sales and below the duplex sales.

I considered what the subject's market is and placed it in that market. I used qualitative analysis to get a sense for where the subject's market value should be.

3. Abandoned Home in the Forest

I recently assisted on an appraisal of an abandoned house in a forest that had not been maintained for at least 30 years. This was a highest and best use problem: what should the owners do with the property? The subject's condition was essentially unsalvageable; the existing improvements were a safety hazard. Additionally, environmental regulations placed severe restrictions on building on the site today.

Going back three years I found several examples in the county of unbuildable lots. These sales were my comparables. Recommendation to the client was to hold for a time when the subject's market had improved enough to make a sale feasible.

I expanded my market to include the entire county because of the rarity of unbuildable lots, expanded my time horizon for the search, and spent most of my effort on highest and best use. I was fortunate to partner with a very experienced appraiser to guide me with the highest and best use analysis and report write-up.

4. Private Party Cohousing Assignment

Cohousing is a specialized form of planned development living designed specifically to encourage community. Management is participation based by the community and often based on consensus. Projects in my area have a large kitchen and dining area for the entire community to gather weekly for communal meals. Demand for cohousing is high with waiting lists and very few sales transacting formally through the local MLS. I was asked to determine current market value for someone in a nearby cohousing community when the last sale in the community had occurred eight years prior. No one in the community wanted to sell during the collapse of the real estate market during the great recession. This appraisal was complex because of the lack of recent sales.

To determine competitive sales, I examined sales in the cohousing community from prior to the housing market crash and compared those sales to others in nearby planned developments at that time. I then looked at recent sales in those projects that competed with the subject's project prior to the housing crash. I used the recent sales from the competing projects plus I time adjusted forward the most recent sale in the subject's project (from 8 years ago) and used these as comparables. Indicated range of value was relatively narrow. I had competency in cohousing because a mentor had introduced me to it in the past. This assignment has turned into three more at relatively high fees but with less time required because of my initial research.

5. College City Eight Year Old Home Never Lived In





The subject was an average quality home built in 2006 that was never lived in on a one acre lot. It backed a cemetery and was located in College City, a small unincorporated community in Colusa County, northwest of Sacramento. There were sales in the closest town on normal density residential lots and on 10+ acre lots, with nothing in between. Also, Colusa is covered by two MLS systems. Complex issues to deal with included the subject's near new condition, the subject's in between lot size, the subject's location backing a cemetery, and combining data from both MLS systems for market analysis.

This assignment required me to focus on placing the subject. It sits between the in town residential market and the residential acreage market. The marginal difference for lot size in town is much higher than the difference for acreage properties. So I adjusted the in town residential homes \$1 per square foot up for lot variance and the acreage properties down \$7,500 per acre to meet the subject in the middle. I used new construction to bracket the subject's not quite new (C2) condition.

To determine the impact of the subject's location next to the cemetery, I searched but found no sales at all in Colusa County adjacent to a cemetery going back 10 years. I found sales adjacent to cemeteries in nearby Yolo County and used these as proxies for the subject. I interviewed market participants and conducted a survey of local real estate agents. The survey, interviews, and data from Yolo County all agreed-no impact from backing the cemetery.

Because of my experience in this market, combining data from the two MLS systems was just another step in the analysis.

## Suggestions for Moving into Complex Assignments

Here are some steps to take to build competency in complex residential assignments.

- Build connections with other appraisers. I have a large pool of friends and colleagues I can approach for help. I trade emails with my friends daily and am a participant in two appraiser forums.
- Join an appraiser organization. I am president of our local appraiser group. We meet monthly for classes and networking. Through the organization, I know more than 100 local appraisers and know who the experts are in my region.
- Take classes to build your knowledge. I take classes to build my skills and increase the type of work I can complete. Don't just take the cheapest online courses to fill out your continuing education. I highly recommend taking good quantitative analysis classes like those put on by George Dell. You might see me there. <https://www.valuemetrics.info/> for more information.
- Find experienced appraisers willing to mentor you. When you get that next complex assignment, see if one of these folks are willing to partner with you. I am very fortunate to have had great mentors over the years.
- Build a library of good appraisal books. Real Estate Damages by Randall Bell, The Valuation Analyst by David Braun, and Valuation by Comparison by Mark Ratterman are all worth your time.
- Join your local real estate board. Go to the meetings and tours to build your knowledge. Network with the real estate agents to build trust so when you call, someone answers.
- **When you find an unusual property, make a note of it. That unusual property may be a comparable in your complex assignment in six months.**

### About the author

Joe is a certified residential appraiser in Northern California and is president of the Sacramento Chapter of the Real Estate Appraisers Association.

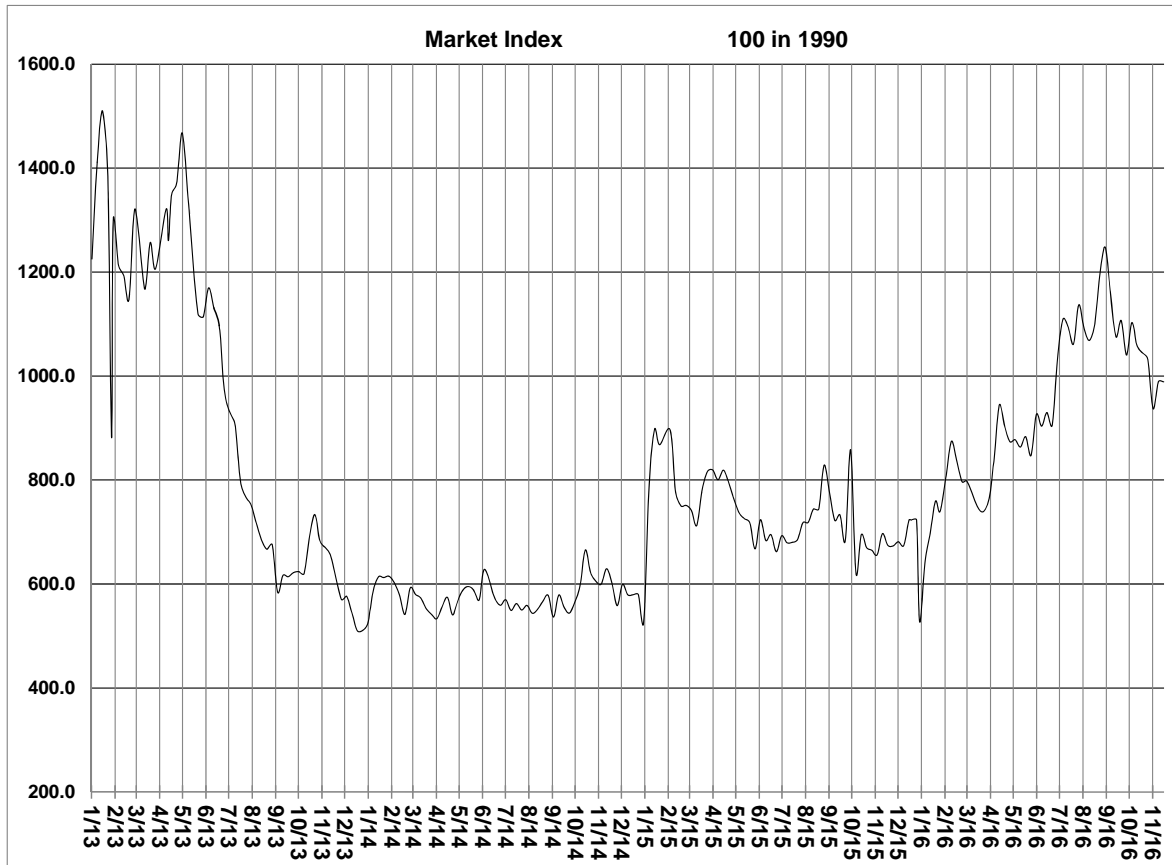
He teaches appraisers how to use Excel and is lucky enough to occasionally assist George Dell in classes.

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