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Seeing the forest through the trees. Look at your adjusted comp sales price range.

By Rachel Massey, SRA, AI-RRS

Growing up, my parents used to refer to my inability to see the forest through the trees. As a parent, I have noticed the same issue with my son. As a reviewer, I see it play out in some of the reports I review. This simply means not being able to see the bigger picture because focus is so narrow that we only see what was right in front of our eyes.

Fortunately, I am older now, and (usually) better at seeing the bigger picture. My son is better, but still struggles. I suspect this is a common phenomenon in all occupations, and particularly in our line of work. It appears to be human nature to a large degree, but something we can be aware of and work to improve.

This phenomenon can happen in many aspects of the appraisal puzzle. One of the most common is places is within the Sales Comparison Approach. When the unadjusted sales price range is widened through the adjustment process, something is likely wrong and we have failed to see the forest through the trees, or have focused on individual adjustments (trees) to the detriment of the bigger picture (forest).

Simply put, the sum of the parts may not equal the whole. Individual adjustments could skew data to widen the range and if we do not step back and examine the bigger picture, we could end up with illogical results. A simple way to double check that we look at the bigger picture is to ask if each sale used is overall superior, inferior or equal to the subject.

If we believe that the sale is inferior to the subject, then logically it should have sold for less than the appraised value. If we believe the sale is superior to the subject, then logically it should have sold for more than the appraised value. That is the basis of bracketing that we hear so often.

I kid you not, as a reviewer I am looking at something right now, which prompted me to write more. The unadjusted sales price range of the three comparable properties used in the report was $195,000 to $199,500. This is great and an ideal range, in particular for a smaller renovated older home.

The problem is, the appraisal report took this nice tight range, and through the rote adjustment process, widened it from $173,500 to $218,000. Does this make any sense to any of you? This scenario is the perfect opening for the appraiser to describe what their thought process is to help their client understand the logic of the adjustments, as well as the final opinion of value. While it is possible that the adjustments were all solid and made complete sense, something larger did not.

For instance, in this report, the appraisal stated that most weight was placed on sale 2 because it was most similar, but it was actually the largest of the sales, with an extra bath, an extra car stall, a different style and age, and the oldest of the three sales used. The adjusted value of that comparable was also the $173,500, yet the appraised value was $200,000.

The appraised value was higher than all the unadjusted sales prices, which is acceptable when explained,

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but the direction of adjustment on this sale, downward over $20,000 (over 10%) indicated the appraiser him/herself thought this sale was superior. If this is the case, why would the appraised value be greater than the unadjusted price of a sale that was superior? Not saying that it could not be, just that explanation to help the client understand why would be in order.

Perhaps in this scenario the gross living area adjustment was too high, or one of the other adjustments was larger than what the market would bear. Maybe the style was inferior to the subject and the other sales? Maybe there was some unexplained issue that was not considered, such as an odd floor plan, or even maybe the other sales were incorrectly adjusted.

How did the appraisal take a 2.5% range in unadjusted prices and turn it into a 25% range? The adjustment process should narrow the range not widen it, but sometimes it just is what it is, and the range really does widen slightly. When that happens, what the appraiser should do is step back and discuss the issue and why it widened, and reconcile the quality of the data within the sales comparison approach. If one sale is more meaningful than the others are, then the unadjusted sales price of that property might be even more telling than the adjusted price, and it could have been in this situation - it just was not explained as such.

The direction of the individual adjustments at the bottom of the grid can also help show whether each comparable sale is superior, inferior or equal, to the subject or at least that it was presented as such. Small adjustments on the net side, may show something relatively similar, while larger net adjustments will indicate that a sale is inferior or equal and can help determine if the adjustments were logical. For instance, if the comparable sold for $200,000 and adjusts to $210,000, but in our opinion, it was a superior sale, something is off and not adequately analyzed. In case this is an unbelievable scenario to many of you, unfortunately it is not.

Remember the purpose of adjustments is to render the comparable properties equal to the subject. If the comparable has greater square footage, it is usually thought of as superior, however this is not always so. Think about larger houses with awkward additions. Sometimes the awkward addition can detract from the property, not add to it. What about a six car garage in a market that expects a two car? Would it be possible that the third car stall adds value, but after that, most buyers do not care, and some buyers find it is a negative?

Maybe the market recognizes an increase in value per square foot to a certain level, but then, after a certain size, it becomes a negative. It could make sense that 8,000 square feet is overkill in a market when most buyers are happy with 4,000 square feet. Maybe the additional 4,000 square feet is not universally desired, in particular in climates with excessive heating and/or cooling costs.

In the end, the appraised value should ideally not be higher than the sales that are adjusting downward as that shows overall superiority (unless it is a nominal amount). The converse is also true. If for some reason, in the opinion the value is greater than something that would otherwise show as superior, explain, explain, explain.

Do not look at the adjustments mechanically, but look at them in this larger holistic manner and see the forest through the trees.

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About the author

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Residential Highest and Best Use Analysis: More than Just a "Check Box" - Reviewers and state boards want to see more explanation

By Denis Desaix, MAI, SRA

Editor's comments: I was trained at an assessor's office where the first question always was: "What is the highest and best use?" It is a critical first question when I do commercial appraisals, where H&BU is often an issue, so I get lots of practice now .

Unfortunately, H&BU is not encountered very often with residential appraisals, especially for lender work, where unusual properties are often screened out before taking the loan application.

When I started using forms for lender work, there was just a check box. Plus, if I ever checked that the current use was not the highest and best use, many lenders didn't like it. Some lenders wanted me to continue with the appraisal at the highest and best use (such as an interim use for a house with many new apartments constructed nearby that had multi-family zoning or the H&BU was to subdivide the lot). However, these situations were relatively rare.

"Fannie Mae will only purchase or securitize a mortgage that represents the highest and best use of the site as improved." And, the USPAP says: "An appraiser must analyze the relevant legal, physical and economic factors to the extent necessary to support the appraiser's highest and best use conclusion(s)".

Today, with increasing Scope Creep, residential appraisers are expected to include more explanation of H&BU. This article includes suggested "boilerplate".

To me, the primary issue is: "Why risk your license for doing a misleading appraisal when H&BU is not the current use?" You need to think about H&BU for all residential properties. Also, clients are expecting to see more H&BU analysis in your reports, especially when the subject is unusual for the neighborhood.

Additionally, H&BU analysis keeps you out of trouble. For example, the home is in commercial zoning. A H&BU analysis is needed, but you need to know about commercial properties. You turn down the assignment.

End of editor’s comments

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I was recently referred an assignment that involved three adjacent parcels needing valuations for estate purposes in a suburban neighborhood of $1,000,000+ homes.

One was a level flag lot with an old barn. The other two were hillside sites and had recorded easements for a shared driveway from the main street, but no driveway or usable dirt road yet existed. The two hillside lots were large enough where in theory they could be subdivided into two more lots (2 subdivided into 4).

To add to the situation, one of the hillside lots had a home with multiple additions done without permits, and the additions created an encroachment across the boundary line to the other hillside lot. The home had been abandoned for a number of years, was not habitable, and in very poor condition.

Per the planning authority, since these three lots had always transferred together under single ownership, the authority did not care about the encroachment. However, if the two hillside sites were sold separately, the encroachment needed to be demolished or remedied by a lot-line adjustment.

I was the 6th appraiser the attorney had contacted; she said the prior 5 were unsure of how to approach the situation. I told her the "how" to approach the problem was simple: I need to figure out:

(a) what are the likely uses for the parcels,

(b) if there is more than one use, which use (or competing uses) will result in the highest value, and then

(c) based on the use, who will be the likely buyer.

Knowing the answers to those questions would tell me what kind of sales (vacant sites, improved sites, sites that sold with the intent to subdivide, etc.) to use as comparables.

She said that made sense to her.

In two minutes, the client understood why highest and best use analysis is critical to correctly solving the valuation problem.

The opening example may seem extreme, but it demonstrates why highest and best use analysis is a fundamental element of the appraisal process.

Commercial appraisers will spend a fair amount of time analyzing H&BU for their assignments as competing uses are more common within a commercial zone or general plan area that allows commercial use versus residentially zoned areas.

Residential lender appraisals and H&BU

For residential appraisers specializing in mortgage finance assignments, the question of H&BU is rarely challenging.

The Fannie Mae/Freddie Mac forms are limited to a check box regarding the "as improved" H&BU. Usually, (a) if the home exists, (b) the zoning allows for residential use, and (c) the improvement contributes value to the site, then (d) the highest and best use as-is is "as improved".

In such cases, an appraiser may be inclined to answer "yes" and move on. In fact, it is so common (as would be expected) that an existing residence's H&BU as improved is "as is" it is easy for us not to give the analysis any thought (or worse, not complete the analysis).

This article focuses on residential H&BU, regardless if the results are being conveyed in a narrative or form report.

Highest and best use analysis is a critical step in correctly identifying what kind of property the subject is, and what comparables to use when valuing the subject.

Highest and Best Use Analysis

H&BU analysis determines
(a) what should be done with the property if it were vacant, and if the property is improved,
(b) what should be done as-it-is.

Answering these questions helps the appraiser determine who the likely buyer will be and what is the best analysis and comparables to use for the assignment. H&BU analysis can also assist in identifying obsolescence (if something should be replaced because it is outdated, that likely translates into functional obsolescence).

The Four Factors

There are four criteria used to analyze H&BU:
(1) legally permissible,
(2) physically possible,
(3) financially feasible, and
(4) maximally productive.

Briefly, the process works as follows:

1. Legally Permissible. What uses are legally permitted at the site? What does the zoning or general plan regulation allow on the site? In many residential districts, zoning restricts the permissible use to residential only. Sometimes, the zoning will allow certain neighborhood support uses (such as houses of worship) in a residential zone. Alternatively, one- or two-unit residential use may be permissible.

Legally permissible considers what restrictions exist now, but also must consider if any changes are likely in the near future.

2. Physically Possible. Size, shape, and topography are some of the elements analyzed in this category. Once the appraiser determines what uses are legal, the next step is to determine if the site can physically support the use. A site's shape or slope may eliminate it from reasonably being developed.

I emphasize the term "reasonably" because advances in construction technology make it possible to construct an improvement in almost every scenario, but the cost would be prohibitive with no expectation of recapturing it. This is different from the next step of "financial feasibility" which tests the cost of development, but does so in the context of "should the site be developed now or later?"

3. Financially Feasible. Once the uses are narrowed to what is legally permissible and physically possible, the next step is to determine if development (for vacant properties) or a change (for improved properties) is financially feasible.

In other words, if I improve this vacant site or make a change to the existing improvements, can I expect to earn more money than I spend? If the answer is "yes", then I should consider taking the action. If the answer is "no", then I should consider waiting.

It may not be financially feasible to initiate a project now, but it might be in the future. If a property is improved and that improvement contributes value to the site, but it is likely the use will change in the near future, then the current use is "interim use".

4. Maximally Productive. When more than one use is financially feasible, then an evaluation of which one is maximally productive is necessary. If the only use of a property is a one-unit residence and it is feasible to build one, then there is no alternative use to consider.

If, however, I can build a one- or two-unit improvement and both are financially feasible, then I have to consider which one creates the greatest return on my investment. The evaluation here is not which use has a higher sale price. I also have to consider my costs.

Example: Calculation of maximally productive use

Technically, maximally productive is the use that returns the highest value to the land. Using the one- vs. two-unit property scenario, the illustration is as follows:

Assume that I need a 20% return (my Entrepreneurial Incentive, or "EI") on my direct and indirect costs regardless if I build a one- or two-unit property. Assume that my costs for the one and two-unit improvements are $150k and $250k respectively. Assume that the sale prices for the one and two-unit improvements are $500k and $600k respectively. What should I do?

Since I need to earn 20% return on my direct and indirect costs, I calculate the two options as follows:

(Sale Price) - (Cost + Entrepreneurial Incentive) = Land Value

One-Unit: ($500k) - ($150k + $30k) = $320k

Two-Unit: ($600k) - ($250k + $50k) = $300k

The one-unit option is the maximally productive choice. In theory, a potential buyer who intends to develop a two-unit improvement would not offer more than $300k for the specific site, but the one-unit developer will pay up to $320k.

As Vacant & As Improved

H&BU as vacant considers the subject's site as if it were vacant. If it were vacant, what (if anything) should be built and how soon should the construction start? It should be evident how the four steps of the H&BU analysis apply to vacant land. In the residential world, the answer is usually "build a house, and build it now." However, the answer could be "build a house, but not now… wait until it is financially feasible to do so."

It might not be as evident how the four steps of H&BU as improved are applied. The first two are quick and straightforward: If the current use conforms to the zoning, it is legally permissible, and since the improvement exist, it is obviously physically possible.

However, financially feasible and maximally productive are answered when evaluating the following possibilities. There are four things that I can do to an improved property:

A. Remodel (change the use)

B. Renovate (update/modernize; improve the existing use's functionality)

C. Demolish (tear it down; perhaps build a replacement, perhaps build an improvement with a different use, perhaps hold as-vacant for future development)

D. Leave as-is

Highest and Best Use & the USPAP

Standard Rule 1 contains the appraisal development standards. In the USPAP, Standard Rule 1-3 states: "When necessary for credible assignment results in developing a market value opinion, an appraiser must:

(b) develop an opinion of the highest and best use of the real estate."

"Comment: An appraiser must analyze the relevant legal, physical, and economic factors to the extent necessary to support the appraiser's highest and best use conclusion(s)."

Note that the requirement is for "market value" opinions. If an appraiser has an assignment for insurable value, highest and best use analysis may not be relevant. For market value appraisals its consideration is required when it is necessary for credible results.

Market value appraisals used for residential lending require a H&BU analysis. Therefore, for the remainder of this article, the assumption is that in all cases where market value is being opined, an H&BU analysis must be complete.

Standard Rule 2 contains the appraisal-reporting standard.

- Standard Rule 2-2 (a) (x) states: "When an opinion of highest and best use was developed by the appraiser, summarize the support and rationale for that opinion;"

The above standard is for "appraisal report" formats and includes the Fannie/Freddie form reports. Since development of H&BU is required for opinions of market value, summarizing that analysis is a requirement.

Summarize vs. State? Appraisal Report vs. Restricted Appraisal Report

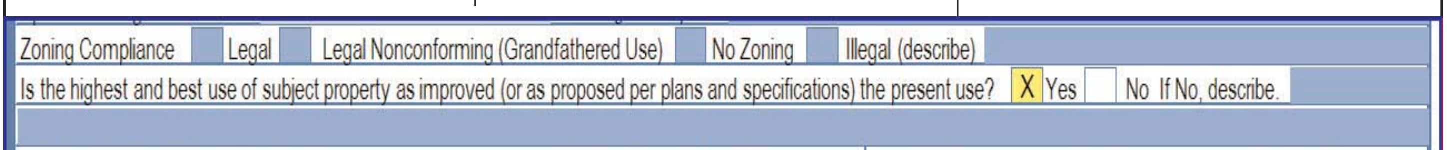
In the USPAP, one of the biggest changes was the creation of two reporting formats: the Appraisal Report and Restricted Appraisal Report. The significant difference between the two is how results are communicated to the client and intended users. In a restricted appraisal report, the requirement is to "state" certain things. In an appraisal report, the requirement is to "summarize" certain things.

Many appraisers confuse the type of report with the level of analysis necessary to conclude credible results. In theory, the level of analysis is the same regardless of the reporting option used.

Advisory Opinion 11 (AO-11) is updated to address the two new reporting formats and to provide some guidance on the difference between "summarizing" and "stating". One of the items noted in the AO requiring summarization is H&BU analysis.

Below is the section from the 1004 one-unit residential appraisal report that addresses H&BU:

It should be apparent after reading AO-11, a report that includes only a "yes" check box to this question is insufficient in terms of summarizing the analysis. Therefore, residential appraisers completing reports on the Fannie/Freddie report forms must supplement the check box section in order to ensure compliance with the USPAP.


Zoning Compliance ☐ Legal ☐ Legal Nonconforming (Grandfathered Use) ☐ No Zoning ☐ Illegal (describe)

Is the highest and best use of subject property as improved (or as proposed per plans and specifications) the present use? X Yes ☐ No If No, describe.

H&BU and Fannie Mae
From Fannie Mae's current Selling Guide (April 2014):

"Highest and Best Use"

"Fannie Mae will only purchase or securitize a mortgage that represents the highest and best use of the site as improved. If the current improvements clearly do not represent the highest and best use of the site as an improved site, it must be indicated on the appraisal report. The appraiser determines highest and best use of a site as the reasonable and probable use that supports the highest present value on the effective date of the appraisal. For improvements to represent the highest and best use of a site, they must be legally permitted, financially feasible, and physically possible, and must provide more profit than any other use of the site would generate. All of those criteria must be met if the improvements are to be considered as the highest and best use of a site."

"The appraiser's highest and best use analysis of the subject property should consider the property as it is improved. This treatment recognizes that the existing improvements should continue in use until it is financially feasible to remove the dwelling and build a new one, or to renovate the existing dwelling. If the use of comparable sales demonstrates that the improvements are reasonably typical and compatible with market demand for the neighborhood, and the present improvements contribute to the value of the subject property so that its value is greater than the estimated vacant site value, the appraiser should consider the existing use as reasonable and report it as the highest and best use."

Freddie Mac's requirements are similar. The above is consistent with the USPAP and accepted appraisal methodology.

H&BU analysis for improved properties: the four choices

To return to the H&BU analysis for improved properties, the four choices are:

A. Remodel (change the use)

B. Renovate (update/modernize; improve the existing use's functionality)

C. Demolish (tear it down; perhaps build a replacement, perhaps build an improvement with a different use, perhaps hold as-vacant for future development)

D. Leave as-is

If the choice is "A" or "C", the H&BU as improved is not as-is. The property's use must change (residential to commercial, or maybe one-unit to two-unit) or the improvement should be demolished. Choice "D" means as-is, nothing needs to be done (H&BU as improved is certainly as-is).

It is choice "B" that sometimes confuses appraisers. Again, as long as the existing improvements are a legal use and they continue to contribute value to the site, H&BU as improved is "as is".

Identifying if updates or renovation is likely to occur, and to what degree it will occur, is going to identify who competes to purchase the property (owner-user, investor, or both) and what the buyer will do (renovate now, renovate later, etc.).

This analysis helps ensure that the appraiser will select and analyze the most similar comparables.

Analyzing H&BU and Reporting the analysis for a mortgage appraisal assignment

If a house is in such bad condition that it no longer contributes value to the site the H&BU as improved is not "as is".

It should be demolished or significantly renovated. This situation is not that common and is the easiest to deal with. Keep in mind, however, that even a newly constructed home may not contribute value to the site.

A new home built on a site where a multi-story office building should be might be fully depreciated when the final inspection is signed-off.

The examples I have selected are the more common scenarios: A recently renovated/updated home, a home with no updates ready for renovation, and a home that is in poor condition and requires repair and renovation. Each scenario has a unique market condition dynamic.

Example: Renovated home - market strong with nearby new construction

The subject is a 40-year old home in a neighborhood of similar age homes. The subject has been renovated (kitchen, baths, interior have all been renovated and updated, and exterior has been updated as well). The market is strong (demand exceeds current supply) and renovated homes sell quicker and at the upper-end of the value range.

A review of the sales for the last 12-18 months shows that most of the homes that have sold have some level of upgrades, and many are upgraded to a similar level as the subject.

There are also newly constructed homes on sites where the older improvements were demolished. All the renovated and newly constructed homes are purchased by owner-users as a primary residence.

The H&BU analysis for this scenario may read like this:

The legal use of the site allows for one-unit residential and that is what the subject is. There is demand for such properties in this market; new home construction is occurring and older homes are being renovated. A residential improvement can be built on the site and it is financially feasible to do so. There is no other competing use for the site. HBU as vacant is to build a one-unit residential improvement.

Improved one-unit residential properties within this market are typically purchased for owner-occupancy (owner-user), although some homes are non-owner occupied/rentals. The typical buyer is purchasing for utility (residence). This is especially true of renovated homes or newly constructed homes. The improvements contribute value to the site: the property, as improved, is more valuable than if vacant, ready for development.

The HBU "as improved" is "as is". The improvement should be retained as is, with a regular maintenance schedule and routine replacement of short-lived items as needed.

The above summary communicates the following to the client/intended user:

1. The subject is a one-unit residence and that use is legally permissible. In fact, that is the only permissible use.
2. It is physically possible to build a residence on the site as evidenced by the existing improvement.
3. If the site were vacant and put up for sale, someone would buy it and build a house on it.
4. In general, one-unit homes in this market are purchased by owner-users. Therefore, my best comparables would be similar owner-user purchased properties.
5. Specifically, given the subject's renovations, the most likely buyer is an owner-user. Therefore, I am very much going to concentrate on finding owner-user purchases of renovated properties as comparables.
6. No one would tear down a recently renovated home in this neighborhood.
7. Since it is renovated, the best choice is to keep it as-is, and just make sure it has a regular maintenance and replacement schedule as needed.

Example: older home needing updates- stable market

The subject is a 55-year old home in a neighborhood of similar age homes. The subject, while adequately maintained, has no significant renovations or recent upgrades (the last upgrade was 30-years ago, and that was the kitchen and baths, which now appear dated to current tastes/expectations). The market is stable.

In this neighborhood, renovated homes sell quicker and at the upper-end of the value range, and homes with few or no renovations sell at the lower-to-middle price range.

A review of the sales for the last 12-18 months shows that there has been a mix of homes sold: some renovated (commanding a premium) and some without modernizations or renovations.

Calls to brokers reveal that homes without upgrades compete with owner-users and investors. Sometimes, the owner-user will purchase the home and update/renovated while occupying the residence and sometimes, the owner-user will purchase and renovate prior to move-in. Investors also compete for these homes, but prefer homes that need repairs as well as modernizations as they are priced lower.

There are newly constructed homes on sites where older improvements were demolished.

The H&BU analysis for this scenario may read like this:

"The legal use of the site allows for one-unit residential and that is what the subject is. There is demand for such properties in this market; new homes are being built and older homes are being renovated. A residential improvement can be built on the site and it is financially feasible to do so.

There is no other competing use for the site. The HBU as vacant is to build a one-unit residential improvement.

Owner-users and investors purchase improved one-unit residential properties in this market, although investors prefer homes needing upgrades and repairs. The subject is an older home with no significant modernizations or recent upgrades: it would appeal to both an owner-user (who would purchase and occupy the home while updating) and an investor (who would purchase the home and either upgrade and sell, or upgrade and retain as a rental).

While the likely buyer of the subject will upgrade the property, the improvements in their as is condition contribute value to the site: the property, as improved, is more valuable than if vacant, ready for development. The HBU "as improved" is "as is", with a new owner likely to upgrade after purchase."

Again, a lot of information is communicated in the above.

1. Like the first example, the as vacant H&BU is to construct a one-unit residential improvement; there are no other uses for this site.
2. In this case, there is competition between owner-users and investors in the subject's segment of the market (homes not upgraded). Therefore, when I search for comparables, I am going to consider owner-user and investor purchases.
3. Whoever buys this home (owner-user or investor) is probably going to upgrade/renovate it to some degree after purchase.
4. Since the improvements contribute value to the site, the H&BU is "as improved" and I am going to value it “as-is”. My best comparables are those where the buyer's intent is to purchase and renovate/upgrade. For owner-users, the upgrade work might occur prior to occupancy or during occupancy. In this case, I can consider investor or owner-user purchases as long as the condition is similar to the subject.

Example: Fixer needing repair-market weak

The subject is a 40-year old home in a neighborhood of similar age homes. The owner has passed away and the estate is selling the property. It was a rental and the renter moved out 9-months ago. The property is not well maintained and has been vandalized since the renter moved out. It needs kitchen and bath repairs, window replacement, new flooring and paint.

This market has a number of foreclosures, and many were rental units abandoned during the default process with excessive deferred maintenance and needed repairs. There are more homes available for sale in this market than there are buyers willing to purchase. Owner-users are finding significant price discounting from 2-years ago, and even upgraded and renovated homes are selling at historically low prices.

There are also some vacant parcels in the neighborhood and a subdivision project started 2-years ago has stalled: the newly constructed homes in that project are listed at a Price per sq.ft. below their replacement cost.

The H&BU analysis for this scenario may read like this:
"The legal use of the site allows for one-unit residential and that is what the subject is. There are no other competing uses for the site. At this time, there is an oversupply of available inventory and a weakness in demand. No new homes are being built in this market and vacant lots remain vacant. A residential improvement can be built on the site, but it is not financially feasible to do so. The HBU as vacant is to hold for future development. When market conditions change, this site will be developed as a one-unit residence.

While owner-users and investors purchase improved one-unit residential properties within this market, because of the subject's poor condition, the likely buyer is an investor. Investors typically purchase poor condition homes (many times all cash transactions), upgrade them, and sell (flip) or hold them as rentals. In this market, the competitive properties are homes in similar, distressed condition. This includes REO sales in similar condition. Although the subject is in need of significant work, the improvements in their "as-is" condition contribute value to the site. It is financially feasible to renovate the home and then sell it at a profit after cost or hold for rental income and then sell. The HBU "as improved" is "as is", with the buyer being an investor who will renovate and sell to an owner-user or retain as a rental."

Here are the significant points communicated in this summary:
1. The current use is legal and there are no other permitted uses. It is obviously physically possible to construct an improvement on the site. However, it is not financially feasible to do so at this time. No one would build a new home now, but probably will once the market conditions improve. The H&BU of this site as vacant is to hold for future development.
2. The market is weak and supply exceeds demand.
3. The subject is in poor condition, is a fixer, and may not qualify for conventional or regular FHA financing. Homes like the subject sell in an "all cash" transactions. The likely buyer is an investor who is going to renovate and sell or rent out.
4. Properties that are competitive to the subject are fixers; this includes REOs. Therefore, an REO (which some lenders and appraisers consider as being inappropriate comparables) in similar condition competing for the same type of buyer should be considered as a potential comparable (and may be the best comparable).
5. Even though the property is in poor condition, the improvement still contributes value to the site. It is not so bad that one should tear it down or that renovation is not financially feasible; therefore, the H&BU as improved is "as is". The value of this property, "as is", is based on its investor pre-renovation value.

Summary

Highest and best use analysis is a fundamental component of the appraisal process for market value appraisal assignments.

The USPAP requires H&BU analysis for market value assignments (when necessary for credible results) and when communicated in an appraisal report format, requires the analysis be adequately summarized.

For residential mortgage assignments, the Fannie/Freddie report forms must meet the reporting requirements of SR2-2 (appraisal report). These forms provide a check-box answer "yes" or "no" to one aspect of the H&BU analysis: "Is the highest and best use of the subject property as-improved (or as proposed per plans and specifications) the present use?" Simply checking the box does not meet the USPAP's summary requirements. The form must be supplemented with appropriate summary of the analysis.

Although the form asks for H&BU as improved, I recommend an appraiser also include the H&BU as vacant. In theory, one cannot complete the as improved analysis without completing the as vacant analysis. In practice, when completing the cost approach, one must always complete an H&BU analysis as vacant. Full compliance is always attained if the complete H&BU (as vacant & as improved) analysis is summarized in the report.

H&BU helps the appraiser determine:
(a) what the best use of the site as vacant and as improved would be,
(b) who would buy the subject, and
(c) what types of sales are the best comparables.

What about original 3-parcel assignment?

Recall that there were 3-parcels: a flag lot with an old barn and two other lots that could be subdivided. Additionally, there was a significantly damaged house with illegal additions on one of the lots; additions encroached onto the other lot.

What was the outcome of that assignment?

1. The flag lot's H&BU was to build a custom SFR. This was the easiest analysis. The likely buyer would be a developer, although there was a small section of the potential buyer pool that would be an owner-user who would develop the property for his/her own use. H&BU: tear down the barn and build a house.
2. The two other parcels could theoretically be subdivided (four parcels total). However, the shape of the area limited that feasibility to a realistic split of three parcels. Assemblage and then subdivision was a potential use.
3. Further analysis of the two parcels concluded that due to the topography, a 3-lot split would not be financially feasible; developing an additional easement/driveway to access all lots would require a new road to go up the steepest grade and terminate at the top of the hill (arguably the most valuable site for a house). Therefore, dividing the 2-lots was not an option.
4. One consideration was to apply for a lot-line adjustment to eliminate the encroachment and renovate the existing improvement. However, due to the location of the encroachment (at the top of the hill), adjusting the lot-line would significantly reduce the value of the non-improved parcel and reduce its building area to all hillside slope. The result would have been to eliminate the feasibility of developing it by itself. A lot line adjustment was not an option.
5. Another consideration was to merge the two lots; this would eliminate the encroachment and allow the existing improvement to be renovated. Unfortunately, due to the condition of the improvement, it was fully depreciated. It no longer contributed any value to the site, and it was not financially feasible to renovate. It should be demolished so that the site could be developed with a new improvement.
6. It was possible to merge the two lots and sell it as a single parcel for development. This would only be maximally productive if the value of the new, combined parcel exceeded the sum of the two individual parcels (after all costs). Based on the analysis, combining the two lots would have created a large lot with surplus land. Merging for a single lot sale was not maximally productive.
7. The H&BU of the improved lot was to demolish the existing structure and build a custom SFR. The H&BU of the second hillside lot was to sell as-is and build a custom SFR. Because of the topography (which still presented some development challenges), the likely buyer for these parcels would be a developer who had the wherewithal and competence to develop the sites.

About the Author
Denis A. DeSaix, MAI, SRA, is a principal of Metrocal Appraisal, an appraisal and consulting firm located in Northern California. Denis has over 20-years appraisal experience, ranging from mortgage finance, review, litigation support, portfolio valuation, and estate and tax appeal assignments. Denis is an active member (and current Secretary) of the Appraisal Institute (Northern California Chapter), and of the East Bay Chapter of the Real Estate Appraisers Association. Denis is proud to have served as a United States Marine.

Author Disclaimer: The advice, opinions, and examples in this article represent the views and opinions of the author only, and are not intended to represent the views of any associations the author is affiliated with, or any other entity. Examples provided in the article are for illustrative purposes only, and are not intended to be used as substitutes for language or comments in any appraisal report or assignment.

Fee and turn time surveys - appraisers vs. lenders

I have combined two appraiser surveys from Valuation Review (Voice of the Appraiser) and Alterra Group (National Appraiser Survey. The surveys do not have exactly the same questions, but it is good to have more than one survey. All the 2016 survey reports were done in October 2016.

Valuation Review included a survey from lenders. Stratmor Group had a lender survey (Appraisal Process and Turn-Times Survey. You can see what your clients say, such as how many use AMCs and appraiser panels.

For more information on the surveys see the end of this article.

Compare your appraisal business with these surveys. Are your fees high or low? How does your gross income compare?

When available, I have included data from 2015, 2014 and some previous years for comparison purposes.

Next month I will have more survey results, such as background checks, blacklists, and mobile appraising.

Fees - what appraisers say

As you can see below, fees have been going up, but there are still appraisers working for lower fees. There are few appraisers working for under $300. Where do you fit in?

What is your typical appraisal fee? Source: Valuation Review

2011

Less than $100	0.2%
$100 to $200	3.4%
$200 to $300	27.4%
$300 to $400	45.8%
$400 to $500	17.1%
More than $500	6.1%

2015

Less than $100	0.1%
$100 to $200	0.8%
$200 to $300	8.5%
$300 to $400	45.8%
$400 to $500	29.9%
More than $500	14.9%

2016

Less than $100	0.4%
$100 to $200	1.5%
$200 to $300	5.8%
$300 to $400	39.5%
$400 to $500	32.3%
More than $500	20.5%

Source: Alterra
What is your typical fee today for a 1004 with MC?
2016: Least $100, Most $2,000, Avg. $391.22, Mode $350

Source: Alterra
How has your appraisal fee changed over the past 12 months?
2016: Decreased 12%, Increased 33.7%, Stayed the same 54.3%

Have you seen an increase in your appraisal fees since "customary and reasonable"? Source: Valuation Review

2012 Yes 29.9% No 70.1%
2015 Yes 28.3% No 71.7%
2016 Yes 39.7% No 60.3%

As an appraiser, how would you rate the typical appraisal fee you are paid? Source: Valuation Review

2014

Low	5.5%
Average	10.6%
Above Avg.	41.5%
Cust/reas.	42.4%

2015

Low	9.4%
Average	13.9%
Above Avg.	37.1%
Cust/reas.	39.6%

2016

Low	28.6%
Average	43.6%
Above Avg.	18.9%
Cust/reas.	8.9%

Comment: Fees have gone up, but more appraisers say their fees are too low.

In an ideal world, how much would you charge for an average 1004 appraisal (with MC) based on amount of work required and amount of time consumed to perform an appraisal? Source: Alterra

2014 - (Avg. fee)

Under $200	1.2%
$201-$300	14.4%
$301-$400	23.9%
>$400	3.2%

2015

Least	$200
Highest	$2,000
Avg.	$448
Mode	$400

2016

Least	$275
Highest	$2,000
Avg.	$498
Mode	$500

Have you increased your FHA fees since the new handbook was published? Source: Alterra
2016: Yes 41%, No 27.8%, Same 8.1%, Other 23.1%

Comment: good to see that many increased their fees with the emphasis on inspection requirements.

If your fee has decreased, is it due to fee erosion or volume or both? Source: Alterra

2016: AMC fee pressure 55.5%, Volume Discounts 0%, Both 30.5%, N/A 13.3%

I establish my appraisal fees based on:

2016: A flat rate per appraisal 78.1%, Per hour to complete 21.9%
Source: Alterra
Comment: I need to use per hour more. Much better to vary by difficulty of property or difficult client.

Have you seen an increase in your appraisal fees since "customary and reasonable"? Source: Valuation Review

2011 Yes 29.9% No 70.1%
2015 Yes 28.3% No 71.7
2016 Yes 39.7% No 60.3%

As an appraiser, how would you rate the typical appraisal fee you are paid? Source: Valuation Review

2011

Low	5.5%
Average	10.6%
Above average	41.5%
Customary and Reasonable	42.4%

2015

Low	9.4%
Average	13.9%
Above average	37.1%
Customary and Reasonable	39.6%

2016

Low	28.6%
Average	43.6%
Above average	18.9%
Customary and Reasonable	8.9%

Income (all the results are from Alterra) Note: mode is most frequently occurring number)

What is your approximate gross annual income?

2016: Least $10,000; Most $500,000; Avg. $90,213; Mode $100,000
2015: Least $15,000; Most $500,000; Avg. $83,806; Mode $100,000

How has your appraisal revenue changed over the past 12 months?

2016: Decreased 12.0%, Increased 33.7%, Stayed the same 54.3%
2015: Decreased 51.5%, Increased 13.3%, Stayed the same 35.7%
2014: Decreased 65.7%, Increased 12.0%, Stayed the same 22.3%
Comment: Definitely increased income since 2014 for many appraisers.

If your income has decreased, is it due to fee erosion or volume or both?

2016: Question not asked
2015: Fee erosion 26%, Volume decrease 20%, Both 55%, n/a 3%
2014: Fee erosion 8.4%, Volume decrease 24.1%, Both 51,7%, 15.8 3%

Appraisals completed per month
How many appraisals have you completed in the past 12 months? Source: Alterra

2016: Least 1, Most 1000, Avg. 236, Mode 200
2015: Least 40, Most 659, Avg. 231, Mode 200

Turn around time

What is the average turnaround time for a full appraisal report of a residential appraisal assignment? Source: Valuation Review

2011

Same day	0.5%
1 day	4.1%
2 to 3 days	44.1%
4 or more days	51.3%

2015

Same day	0.8%
1 day	3.1%
2 to 3 days	37.2%
4 or more days	37.2%

2016

Same day	0.5%
1 day	4.0%
2 to 3 days	31.5%
4 or more days	64.0%

Has the turnaround time quickened in the last few years?

2016: Yes, 35.2%, No 64.8%
Source: Valuation review

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Working with AMCs/lenders - what appraisers say

Source: Valuation Review
What percentage of work do you receive from AMCs?

2016: Less than 25%	41.0%,
Between 25-50%	13.3%,
Between 50-75	19.7%,
More than 75%	26.0%

Source: Alterra
How much of your business was from AMCs?
2016:

0-10%	18.9%
,11-25%	8.3%,
25-50%	11.6%,
51-75%	14.5%,
76% or more	41.1%,
n/a	13.3%

Comment: Different results from Valuation Review and Alterra, especially for more than 75%. May have been more commercial appraisers, or commercial/residentialresponding to Valuation Review's survey.

Have you felt any increased scrutiny from lender clients in the past year? Rank from 1 to 5. Est. from graph. Source: Alterra 2016

Appraisal fee	1.6
Portal fee	4.2
Timely payment	3.3
Recommendations from other appraisers	5.0
Client requirements	2.8
Friendly people to work with and they treat me well	4.0

Have you felt any increased scrutiny from lender clients in the past year? Source: Valuation Review
2016: Yes 65.0%, No 35.0%

From the AMC/lender side - what lenders say
Source: Valuation Review

Have you pared down or increased the number of appraisers you work with in the past year? Source: Valuation Review
2016: Pared down 20.4%, Increased 61.1%, Stayed the same 18.5%
2015: Pared down 31%, Increased 35%, Stayed the same 33%
Comment: They have really increased their fee appraiser recruitment attempts.

What is the expected turnaround time for a full appraisal report of a residential appraisal assignment? Source: Valuation Review
2016: 4 or more days 89.5%, 2 to 3 days 10.5%, 1 day 0.0%, Same day% 0.0
2015: 4 or more days 85.1%, 2 to 3 days 14.5%, 1 day 0.0%, Same day% 0.0
2014: 4 or more days 70%, 2 to 3 days 20%, 1 day 10%, Same day n/a
Comment: Their turn times are definitely increasing since 2014.

Time to get appraisal completed
2016: 2-3 weeks
2015: 2-3 weeks
Comment: Guess they have accepted the wait. Should have used much longer time periods for the survey immediately above.

What is your typical appraisal fee that you pay?

2014

Less than $100	0.0%
$100 to $200	n/a
$200 to $300	n/a
$300 to $400 About	25%
$400 to $500 Over	50%
More than $500 About	25%

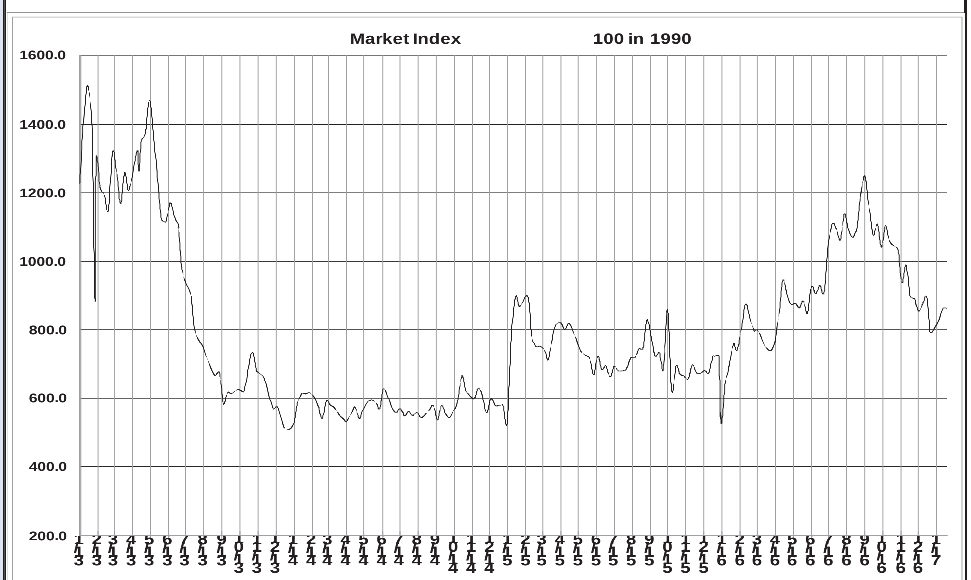
2015

Less than $100	0.0%
$100 to $200	5.4%
$200 to $300	1.8%
$300 to $400	23.2%
$400 to $500	57.1%
More than $500	14.3%

2016

Less than $100	0.0%
$100 to $200	1.8%
$200 to $300	1.8%
$300 to $400	9.3%
$400 to $500	51.9%
More than $500	35.2%

MBA Loan Volume Application Index – 1/13 to 1/17



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Comment: I have no idea why appraisers work for under $300. In the appraiser survey above, 7.3% were working for under $300.

Increased scrutiny or vetting on appraisal vendors

2016: Increased 80%
2015: Increased 76%

Comments from the report: "We review the instances where the AMC's QC process failed," one respondent said. "When we identify a required revision that should have been caught by the AMC, we hold the AMC accountable."

"Other examples of increased scrutiny by lenders is the fact that many are asking for more appraisal samples of various price points, proposed versus existing; suburban versus rural providing more minimum requirements of items (tax map, property card, flood map, location maps, etc.) that must be included in the appraisal."

From the AMC/Lender side - Stratmor

Source: Stratmor Insights Appraisal Process and Turn-times Survey October 2016

How do lenders obtain appraisals?

About 2/3 use AMCs. The remainder use in-house appraisal panels or a combination of AMCs and appraisal panels.

Property location and service, i.e., turn-times, are the primary factors driving the use of AMCs.

Which lenders use AMCs vs. appraisal panels

Under $2 billion:

- AMC	65%
- Appraisal panel	20%
- Both	15%

Over $2 billion:

- AMC	63%
- Appraisal panel	6%
- Both	31%

Comment: Definitely better to work for smaller lenders, who use more appraiser panels.

Post TRID changes in turn-times - purchase (est. from graph)
Note: most of the increase was due to increases in volume of appraisals in 2016 Q2 and Q3 and lack of qualified appraisers
Purchases

Average purchase increase
5.74 days (79%)

Increased by more than 10 days	18%
Increased by 5-10 days	29%
Increased by 0-5 days	51%
Stayed the same	22%
Decreased by 0-5 days	2%

Comment: Purchase turn times shorter than refis, as it should be.

Post TRID changes in turn-times - refi (est. from graph)

Average refi increase
6.28 days (81%)

Increased by more than 10 days	27%
Increased by 5-10 days	21%
Increased by 0-5 days	50%
Stayed the same	26%
Decreased by 0-5 days	3%

How much did appraisal fees increase post-TRID?

No lenders reported a decrease in their appraisal fees.

Increased by more than 50%	2%
Increased by 25-50%	18%
Increased by 10-25%	27%
Increased by 5-10%	40%
Increased by 0-5%	4%
Stayed the same	3%

Looks like almost all AMCs/lenders increased their fees.

About the surveys

Voice of the Appraiser is done by Valuation Review and sponsored by Landy E&O insurance. The report has many comments from appraisers and analyses by the authors. All the reports can be downloaded at www.valuationreview.com. The October 2016 report is worth downloading and reading. More than 1,100 appraisers from all 50 states completed the 2016 (sixth annual) Voice of the Appraiser

National Appraisal Survey is done by Alterra Group, LLC, which includes Appraisal Buzz. All the reports can be downloaded at www.appraisalbuzz.com. It does not have any appraiser comments but has different questions, to be covered in the next issue of Appraisal Today.

Stratmor Group results do not have all the results, only those that were free. Not included: QC practices and who does reviews, time of appraisal fee collection and other data. $500 for a copy of the full survey.

1,118 individuals invited. 580 companies invited. 56 respondent companies. Independent mortgage companies 27 (48%), Bank owned/affiliated 24 (43%), Credit union owned/affiliated 4 (7%), Builder/Realtor affiliated 1 (2%)

The survey time period was Aug. 16 to Sept. 16, 2016. Google the survey name to download a copy.